MAGAZINE OF THE ASSOCIATION OF ASIA PACIFIC AIRLINES

Orient aviation

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China Takes Shape

Airline mergers approved, now the real work starts to make the industry pay dividends

EXCLUSIVE:
We will come through Bali tragedy, says new Garuda chief

SPECIAL REPORT:
Leasing in the Asia-Pacific

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TAKING SHAPE

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GARUDA AN IRONIC VICTIM

The events in Bali were a tragic reminder to all that terrorism can strike anywhere, anytime. Whatever the political or religious reasons behind such atroci ties, there can be no excuses for the perpetrators.

We all know that Indonesia has its problems, but the selection by the bombers of Bali, 'Island of the Gods' and core of the nation's tourism industry, as a target delivers a clear message: at work or play, no one is safe from terrorism.

The big question for Asia-Pacific airlines is whether Bali will be followed with similar heinous acts at holiday resorts elsewhere in the region, particularly in a place like Thailand, which is hugely popular with western tourists.

If Bali is a blip on the tourism radar screen, as some analysts have suggested, then that is good news for the airlines. But if there is a repeat of terrorists targeting foreigners in the region then it could mean big trouble for the airline business.

But whatever the future holds, it is now fact that the costs of terrorism will increasingly become a fixed item on airline balance sheets.

When terrorism strikes airlines suffer through lost passengers who shy away from travel, higher insurance costs and additional security expenses. They are hit by the loss of consumer confidence in uncertain times and by slowing economies, dipping share prices and weakened local currencies.

If indeed Islamic extremists are responsible for the Bali tragedy, it is particularly poignant that the major victim of the bombings will be Garuda Indonesia, the national flag carrier of the world's most populous Muslim nation. With 70% of its international traffic moving through Bali, the affect on Garuda will be serious and the coming months will be a challenge for the carrier's new president, Indra Setiawan, interviewed by *Orient Aviation* in Jakarta shortly after the attack.

After four years of restructuring Garuda has been making an operating profit in the last couple of years. It was looking forward to further growth. The events in Bali are a serious setback for these ambitions.

Bali also is a major market for Qantas Airways, Singapore Airlines, Japan Air Lines, Korean Air and Malaysia Airlines. All will have to adjust their business plans.

As I said, the danger now is of wider ramifications. It would be cruel for the airlines, after they have rebuilt business so intelligently since the Asian economic crisis and 9/11, if terrorism once again, in the short term at least, won the day. It is hoped this will not happen and that travellers will thumb their noses at those whose business is terror.

However, Bali underscores the new reality: that no one is immune from terror.

TOM BALLANTYNE
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PERSPECTIVE

Edited by
Christine McGee

SCANDALOUS

With the demise of his airline and telecommunications empire almost complete, the full extent of **Tan Sri Tajudin's** looting of shareholder funds is being revealed by Malaysian investigators. Most recently, the former chairman of **Malaysia Airlines (MAS)** and, until he was voted out, the chairman of TRI, the country's second largest cellular phone operator, was accused of plundering TRI of US$6.2 million in the days before he was forced out of the company. It also is alleged by Malaysian investigators that Tajudin and his brother, also a TRI director, sold themselves the company's Daimler and Mercedes cars for US25 cents each as their days looked numbered at the Kuala Lumpur- based company. Tan Sri Tajudin had to relinquish control of TRI earlier this year after he forfeited payments on a raft of multi-million dollar loans. The company is now restructured and owned by cellphone company, **Celcom**. The elusive Malaysian sold out at MAS last year, in controversial circumstances and at a price far above the market value of MAS shares at the time. This October, lawyers for TRI filed a suit in the Malaysia High Court that sought a US$14.5 million refund of remuneration paid to the former TRI chairman, his brother and co-director at TRI, **Bistaman Ramli** and a third former director, **Lim Kheng Yew**.

Separately, they have filed a report that alleges payments made by TRI to third parties in 1998 and 1999, for amounts of US$68.2 million, were for fictitious invoices. Investigations continue.

BUSINESS BEDFELLOWS?

At press time, it was strongly rumoured that **Qantas** and **Air New Zealand** were about to sign a deal that would finally see Air New Zealand opening the door to Qantas's purchase of 25% equity in the Auckland-based carrier. Sources said a deal had been struck that would put two Qantas directors on the 82% government-owned Air NZ board and also give Air NZ chairman, **John Palmer**, a chair around the Qantas director's table – if industry regulators decide the partnership will not create an Australasian airline monopoly. The parties are reported to expect to surrender some slots at **Sydney Airport** to smaller Australian domestic carrier, **Virgin Blue**, in order to have the new ownership package approved by regulators in both countries.

BATTLE WON BUT NOT THE WAR

Following fever pitch airline opposition to a Japanese Government plan to collectively privatise profitable **Narita Airport** in a package with debt-laden **Kansai Osaka** and planned new airport, Chubu, outside Nagoya, the **Ministry of Land, Infrastructure and Transport (MLIT)**, dumped the plan in mid- October and opted for individual privatisation of the three airports. The MLIT decision did not placate either the **International Air Transport Association (IATA)** or the members of the **Scheduled Airlines Association of Japan**. The airlines believe the millions in profits that the sale of Narita will eventually bring to government coffers will be diverted to **Kansai** in a debt reduction campaign. Instead, they want the funds to be used to reduce **Narita Airport** airline user charges – at present the highest in the world. Summing up the airline view, a **Japan Airlines Group** spokesman said privatisation of Narita could take up to five years. In the meantime, "the fact remains it is well within Narita's ability to reduce its charges right now, for which the airlines continue to lobby". Narita stands to make very substantial profits from increased revenue after the opening of the facility's second runway last April so there is no need nor justification for the Narita authorities to wait for privatisation to take place before cutting fees, the spokesman said.

BALI BOMB AFTERMATH

Asia-Pacific carriers remain cautious about the effects of the murderous bombings in Bali on October 12 which killed and maimed hundreds of tourists and local residents. However, the consensus view is that another such attack in popular tourist resorts like Thailand or Malaysia would deal a serious blow to Asia-Pacific airlines' accelerating economic recovery.

Six days after the bombing, **Qantas** chief executive, **Geoff Dixon**, said Bali was an important market for the carrier, but it only accounted for 1% of Qantas revenue. **Singapore Airlines (SIA)** said its Bali services contributed annual revenues of 3% to SIA. **Dr Mohamad Abdullah**, senior general manager corporate services at **Malaysia Airlines**, said the airline has maintained its normal twice-daily service to Bali, but was monitoring the situation carefully. Japanese carriers expect a decline in travellers to the Buddhist island as do **Cathay Pacific** and the Korean carriers – in the short-term. These views suggest some optimism within the airline industry that the after-shock of Bali's bombs will not be as enduring as originally thought – as long as there are no more attacks.■

MAYBE YES BUT, THEN AGAIN, JUST MAYBE

With eight months to go before his current contract with **Singapore Airlines (SIA)** expires, the airline's deputy chairman and chief executive, **Dr Cheong Choong Kong** (pictured), enjoys keeping his audiences guessing, writes chief correspondent, **Tom Ballantyne**. Speaking in Canberra, Australia, where he was recently awarded an honorary degree of Doctor of Science by his alma mater, the **Australian National University (ANU)**, the 59-year-old SIA boss said that setting up an SIA operation was a viable option but "there were degrees of viability". "What I meant by options," he said, "were options that are not just confined to Australia, but options in other places. We have to evaluate these other options and await developments." He added: "Our resources being limited, we cannot do too many things at once." Australia's Prime Minister, **John Howard**, already has said he is supportive of a third domestic airline operating in Australia, particularly a foreign-owned one.

Dr Cheong was a graduate of the Colombo Plan, a programme operated from the 1950s that offered gifted students from around the region sponsored places at Australian universities. As a student mathematician in Adelaide and Canberra more than 35 years ago, Dr Cheong completed his undergraduate studies at Adelaide University and then moved to Canberra's ANU to earn his MA and PhD.

REGIONAL ROUND-UP

JAL, CAL AND THAI TO UPGRADE FLEETS

Industry giant, Japan's **JAL Group**, Taiwan's **China Airlines** and **Thai Airways International** have announced plans to alter and upgrade their fleets. A JAL Group statement said the airline, now made up of **Japan Airlines** and **Japan Air System**, will accelerate replacement on its domestic network of the 563-seat B747-100SR aircraft with B777-300s. At the same time, the flag carrier has converted its Boeing order from five B777-200s to three B777-300s and two B777-200s. The group will also replace its freighter fleet of 10 B747-200Fs with B747-400F aircraft. Boeing has firm orders from the JAL Group for two of the new freighters, scheduled for delivery in 2004.

In Taiwan, several weeks of intense, see-sawing negotiations between **Boeing** and **Airbus Industrie** and **China Airlines (CAL)**, resulted in the flag carrier's fleet renewal plan consisting of a US$4 billion order for 10 Boeing B747-400 jets and 12 Airbus A330 airplanes. Media reports in Taiwan claimed Boeing had knocked off US$20 million from the price of each of its planes and also reported Airbus had signed for discounts of US$72 million for its airplanes – a discount of US$6 million per Airbus airliner.

At the same time, Taiwan's economic ministry announced it had approved CAL's plan to invest US$47 million for a 25% share of Shanghai-based **China Cargo Airlines**.

Thai Airways International shareholders – largely government parties – were told at an extraordinary general meeting in October that THAI will develop a shortfall in its fleet and suffer a drop in projected growth unless it orders new aircraft in the next 18 months. THAI's board said the airline was running at 80% capacity on many of its long-haul routes and needed to address its shrinking capacity, especially on Thailand to Europe services. The meeting voted in favour of the acquisition of two long-range and one medium-range airplane.

AirAsia: proved its critics wrong

LOW-COST AIRASIA TO DOUBLE FLEET

Malaysia's domestic low-cost carrier, **AirAsia**, intends to double its fleet, increase flights and expand onto international routes. Chief executive of the 11-month old carrier, **Tony Fernandes**, said critics who said AirAsia would only last three months were wrong. "We have flown 800,000 passengers and are now making a profit of M$1 million (US$264,000) a month," he said. The airline operates five leased B737-300s and plans to expand its fleet to 13 airplanes, either Airbus or Boeing airliners, by the end of 2003. "But we would rather have one aircraft type. We will likely go for Boeing," he said in a recent interview in Kuala Lumpur. Fernandes, a 25% investor in AirAsia, said the venture had five partners and they wanted to increase funds with a capital raising. It has spent US$2.5 million on computer systems for its Internet booking service and now needed to invest in engineering and aircraft maintenance staff and facilities.■

CHINA TO BUILD COMMUTER JET

Chinese aviation authorities have granted partial funding for the establishment of a jet aircraft manufacturing company in Xian, with plans for the **AVIC 1 Commercial Aircraft Company** to have a home-grown advanced regional jet flying by 2006. The official *China Daily* said the company's proposed ARJ21 was intended to fill domestic demand for 300 60-90 seat commuter jets in the next two decades. AVIC 1 in Xian said it would welcome foreign investment in the project and has invited tenders for engine and electronic systems development from interested parties. **General Electric** aircraft engines is said to be discussing installation of its CF34 engines on the proposed aircraft. Eighty percent of mainland domestic flights carry less than 100 passengers.

Meanwhile, negotiations are continuing between China's **AVIC II** and Brazilian regional jet manufacturer, **Embraer**, to assemble regional jets in the northern city of Harbin.

DHL BUYS INTO AIR HONG KONG

DHL Worldwide Express Inc., which began its life as an Asian company founded by an American, has bought a 30% share of Air Hong Kong, an all-freight subsidiary of **Cathay Pacific Airways**. At a joint October press conference, the two new partners said they would invest US$300 million in the company by 2004 – including ordering new airplanes and creating 700 jobs. They intended Air Hong Kong to operate a fleet of eight air freighters by 2010, with services to 11 cities in the region.

A week before the Cathay Pacific-DHL deal was announced, DHL said it had won approval from the Hong Kong Government and associated parties for a US$100 million, 15-year contract to build and operate a dedicated express freight terminal at **Hong Kong International Airport**. The new terminal, scheduled for construction from 2004, will be built in three stages over an eventual area of 18,200 sq metres. The new development means that **Hong Kong Air Cargo Terminals (HACTL)**, operators of the airport's Superterminal 1, will lose DHL's custom – the facility's largest tenant.

CHINA AIRLINES RE-JOINS IATA

Taiwan's flag carrier, **China Airlines**, announced in late September that it had returned to the **International Air Transport Association (IATA)** fold after an absence of 28 years. The airline was obliged to end its membership of IATA in 1974 after Taiwan's withdrawal from the **United Nations** three years earlier.

THAI AIRPORTS' IPO DELAYED

Airports Authority of Thailand has postponed its planned Initial Public Offering (IPO), which had been slated for November, "due to weak market conditions".

Its adviser on the float, **Merrill Lynch Phatra Se-**

curities, said the airport company's revenue projections also might be revised, based on reports of increased user charges and landing fees being imposed at Thai airports. In early October, the operator of Bangkok's **Don Muang International Airport** and five other Thai airports, said it hoped to raise US$350 million via the IPO, money needed to fund the construction of the new **Suvarnabhumi International Airport**. Foreign investors were to be offered 30% equity in the IPO, a figure that will not change when the airport listing goes ahead, said Merrill Lynch Phatra Securities.

Thailand's prime minister, **Thaksin Shinawatra**, told the builders of the new airport, the **New Bangkok International Airport Co. (NBIA)**, that he would personally intervene in the disputes between parties involved in the construction unless they were speedily resolved.

He said the airport must be completed on time – by December 2004 – as the new facility would be a major driver of the Thai economy. Most industry observers do not expect the NBIA to meet the Prime Minister's deadline – or for that matter for it to take serious notice of his demands for conflict resolution. The new Thai minister for transport, **Suriya Jungrung-reangkit**, said he will set up a task force to fast-track the airport's construction so it can meet its declared deadline for completion.

SHANGHAI'S PUDONG TO EXPAND

Shanghai's US$1.7 billion **Pudong International Airport** is now the sole airport allowed to receive international flights and services from southern China, Macau, Hong Kong, north-eastern China and some cities in Shandong province.

Rules for Shanghai's airports, the newer Pudong facility and bulging **Hongqiao Airport**, came into effect on October 27 and are intended to transform the under-used complex into a regional hub airport that will attract its planned potential passengers of 20 million a year. In 2001, 6.9 million passengers passed through Pudong, but despite these low numbers, Shanghai's city fathers announced plans in October to build a second runway and another terminal at Pudong.

Both Shanghai planners and Dutch airport designers, **NACO**, said work on the second runway and the additional terminal will begin in 2003, with the runway completed in 2004 and the terminal ready by 2006-07. Vice secretary general of the Shanghai city government, **Wu Nianzu**, told the media in October: "The competition among international aviation hubs is very fierce. There are some which already have outpaced Shanghai. We must concentrate our efforts to make Pudong an international hub."

CHINA SOUTHERN BIRD STRIKE STUDY

China Southern, China's largest airline, concerned about the threat of migratory birds across the Pearl River Delta, has commissioned a study into possible bird strikes at the newly finished **Baiyun International Airport**, outside Guangzhou. An airline public relations spokesman, Jeff Ruffolo, said the study would examine the migration, feeding habits and ecological environment for bird life in the areas surrounding the new airport. The results would be presented at an **International Bird Strike Committee** seminar in May 2003.

CHINESE AIRPORTS RESTRUCTURE FEES

The **Civil Aviation Administration of China (CAAC)** has revised the criteria for passenger and landing charges for Chinese domestic carriers, a restructuring estimated to earn an additional 4% to 5% in revenue for major airports.

CAAC cut passenger fees by five yuan to 45 yuan per person carried, an average reduction of 26.9%.

Offsetting the reduced passenger levies are increases in aircraft landing fees of up to 290%.

The new scale of domestic fees for Chinese carriers now matches those charged to foreign airlines flying into mainland airports.

Air Pacific: 13 years of profit

AIR PACIFIC TO LEASE TWO B747S

Fiji flag carrier, **Air Pacific**, 46% owned by **Qantas Airways** and 51% by the Fijian Government, will boost its capacity 60% next year by leasing two Boeing B747-400s. The news comes hard on the heels of a record US$13.9 million profit in the carrier's latest year, its 13th consecutive year in the black.

The two new jets, which will replace one older B747-200, will be used on Nadi-Sydney and Nadi-Los Angeles routes. According to managing director and chief executive officer, **John Campbell**, Air Pacific's growth also requires additional mid-range aircraft of 250-300 seat capacity. It is considering the B767-330, B777 and the Airbus A330. Delivery is envisaged between 2004 and 2007.

Air Pacific's current all-Boeing fleet includes one B747-200, one B767-300, two B737-800s and one B737-700. ■

DANES BUY INTO HAINAN AIRPORT

Operators of Denmark's glossy **Copenhagen Airport** have signed up for 20% of the Initial Public Offering (IPO) of China's island airport, **Melian Haikou Airport**, in Hainan. The European airport group said it would pay US$66.3 million for its share of the IPO, which has been approved by Beijing, but has yet to be launched. As part of the package, the parties to the deal have signed a 10-year services agreement that requires the European investors to assist Melian Airport in upgrading its operations and services. Two directors from **Copenhagen Airport** will join the board of the airport company. Hainan Airlines, the largest independent airline in China, currently operates the airport and controls 58% of the facility. It is based on an island that its local city fathers like to call "the Hawaii of the East".

ASIA 'HAS FASTEST GROWING AIRPORTS'

Airports Council International (ACI) said in its newest statistics, for June 2002, that Tokyo's Narita and Shanghai's Pudong were the world's fastest growing airports. ACI added that among the 30 busiest airports in the world only Tokyo Narita (+6.3%), Bangkok's Don Muang (+0.7%) and Singapore (+0.4%) – all Asia Pacific airports – recorded an increase in passengers in June, compared to the same month in 2001.

BRIEFLY. . .

FLEETS . . . Air New Zealand (AirNZ) has signed off purchase of five A320 aircraft, confirmed options for 20 more of the airplanes and has written contracts for the lease of 10 A320s. **China Postal Airlines**, now 49% owned by **China Southern Airlines**, has ordered four Boeing B737 freighters to service its planned air freight expansion, with the first airplane to be delivered in December and the remaining three to follow at monthly intervals from the beginning of 2003. **SilkAir**, the leisure airline subsidiary of **Singapore Airlines** and the operator of an all-Airbus fleet, has converted six of its eight Airbus options to firm orders. The carrier, which serves 25 regional destinations, said it will pay US$328 million for four Airbus A320s and two Airbus A319s, with delivery planned over five years. **A-Net**, an 18-month-old domestic subsidiary of Japan's All Nippon Airways, has ordered four Bombardier DHC8-400 turboprops to operate on its Itami Osaka- Kochi (on Shikoku Island) route. Bombardier delivered its first 74-seat Q400 turboprop to **Japan Air Commuter (JAC)**, based out of Kago-shima, southern Japan, in September. JAC ordered five of the airplanes, with one option, in 2001.

SilkAir converted six of eight Airbus options to firm orders

MANUFACTURING . . . Korean Air's (KAL) manufacturing arm has won its second contract to supply parts to be incorporated into the construction of Boeing flap support fairings. At the **Farnborough Air Show** in England in September, the Boeing Group chairman, **Phil Condit**, said his company would increase its orders to third parties for manufactured parts. KAL has completed a Boeing contract to produce 6,000 parts for flap support fairings. The new order, valued at US$89.8 million, requires the production of another 6,000 of the same units.

ROUTES . . . Lufthansa German Airlines added another non-stop Munich-Shanghai service to its China network in September, bringing the number of services between Germany and the Chinese city to 11 a week. Recent air service negotiations between Germany and China look set to increase Germany's quota of flights to the mainland in the next two years. Lufthansa operates 10 services a week between Frankfurt and Beijing and 10 on Germany-Hong Kong routes. **Singapore Airlines (SIA)** has added another daily Singapore-Shanghai service to its network, bringing the number of daily flights on the route to three. The carrier will also restructure its services to offer daily flights from Singapore to Johannesburg from December, as well as introducing two weekly services to Mauritius. The network changes will eliminate Durban as an SIA destination on Singapore/Johannesburg/Durban services from January 12. Elsewhere, SIA has increased its Singapore-Brisbane flights to 14 a week and will add flights to Sydney and Melbourne – one flight each to the Australian cities – from October to January next year. Two additional services from Singapore to Christchurch New Zealand will operate during the Antipodean holiday season – from November 20 to January 12, 2003.

LETTER TO THE EDITOR

No wonder the Golin Harris/Forrest report in October's *Orient Aviation* ("Hong Kong hub faces Mainland threat, says study") was dubbed in the vernacular media a miniature "China threat theory". For now that China finally begins to develop her aviation industry to a scale that is necessary for her huge market, she is immediately branded a threat to the aviation industry of her own Hong Kong Special Administrative Region, which has long been monopolised by the British controlled carrier Cathay Pacific Airways. As if the Mainland's gain has to be Hong Kong's loss. As if there cannot be a win-win scenario.

The Mainland carriers are merely taking up their entitlement under Article 132 of the Basic Law of Hong Kong in trying to route their international services through Hong Kong.

The Mainland airports of Beijing, Shanghai and Guangzhou are being developed into the potent international hubs that China needs. They are not meant to pose a threat to Hong Kong's international hub airport, which draws heavily on the Pearl River Delta for its passenger and cargo traffic.

The previous British administration, instead of transferring Hong Kong from the dozens of UK-other country Air Service Agreements (ASAs) to the China-other country ASAs allowed Hong Kong to conclude its own ASAs with these other countries as long as the routes did not intrude into the Mainland.

Now Cathay wants to re-enter the Mainland market to butter the other side of their bread, starting with the Hong Kong-Beijing, – Shanghai and -Xiamen routes. But these are domestic routes. Cathay must change its 'substantial ownership and effective control', to become a genuine Chinese carrier, to enter these routes. Being 'registered in and having its principal place of business in Hong Kong' helps but is not enough.

Peter Lok, Independent Director
China Eastern Airlines, China Southern Airlines, Hong Kong CNAC and former Director of Civil Aviation, Hong Kong

BUSINESS ROUND-UP

MERGED CARRIERS LIST IN TOKYO

On October 2, **Japan Airlines Systems Corp.**, the management entity that will guide **Japan Airlines** and **Japan Air System** to union in 2004, listed on the **Tokyo Stock Exchange** and was officially established as the holding company for the amalgamated carriers. The new airline group, the sixth largest carrier in the world, said it would operate as three separate companies: for international, domestic and cargo operations. The carrier forecasts it will record a group profit of 22 billion yen (US$202 million) for the fiscal year to March 2003. The airline group's president, Isao Kaneko, speaking at the Tokyo Stock Exchange, said fare discounts and the return of profitable slots at Tokyo's **Haneda Airport** had shaved US$205.4 million off annual income this year, but gains in cargo earnings had shown a 10% increase over the 2001-2002 year. (See page 30).

CAL RAISES PROFIT FORECAST

Taiwan's **China Airlines (CAL)** has increased its forecasted 2002 profit by 56% to NT$2.2 billion (US$62.7 million) as booming cargo business and lower interest payments beefed up its predicted bottom line. A CAL statement in mid-October said its earlier April forecast of a fiscal year 2002 profit of NT$1.41 billion had been revised upwards because cargo revenue has been so strong.

In the first nine months of this year, the carrier's air cargo business grew by 24% over the same period last year. The airline said it expected its September results to show a 28% improvement over the same period in 2001.

However, passenger operations have not matched the carrier's freight business, with traffic effected by the post 9/11 decline, a recovering economy and a fatal China Airlines crash in May this year. Passenger revenue declined 4% in September compared to the same month in 2001, with the company predicting an overall decline of 7% for the current fiscal year.

At the same time, **EVA Air**, Taiwan's second international airline, raised its pre-tax 2002 profit forecast to NT$1.41 billion, an increase of 37%. The airline also attributed surging cargo growth for its improving results for the latest fiscal year.

SHANGHAI'S IPO DISAPPOINTS

Shanghai Airlines, Shanghai city's second regional carrier and mainland China's sixth largest carrier until the October airline mergers were unveiled, experienced disappointing trading when its shares were listed on domestic exchanges in September.

Analysts blamed weak market conditions for the poor response to the IPO from domestic investors, which valued the shares at US82 cents (6.81 yuan).

It was hoped the 200 million shares offered on the market in late September would reach a post-launch price of up to 8.50 yuan.

The carrier needs cash to pay for the five new aircraft it has on order.

QANTAS LOSES ITS SPARKLE

After institutional investors staged a near stampede in their enthusiasm for **Qantas Airways'** recent A$$800 million (US$444 million) capital raising, retail investors were less than interested in taking up their A$$200 million share of the offer when it became available in September.

Qantas hoped to have its offer fully subscribed to accumulate cash to pay for its planned fleet upgrade and, possibly, purchase of a 25% equity stake in cross Tasman rival, **Air New Zealand**.

Instead, Qantas had to content itself with A$120 million from a sale that offered shares at $4.20, but saw the market value them at $3.70 in floor trading.

Analysts blamed the less than 100% result on everything from the threat of war in the Middle East and the subsequent rise in fuel prices to rumours that Singapore Airlines might set up a third domestic airline in Australia.

THAI IPO DELAYED AGAIN

Blaming unattractive market conditions, **Thai Airways International (THAI)** president, Kanok Abhiradee, said the never-ending prologue to the flag carrier's listing of 23% of its equity would not take place in the first quarter of 2003 - at the earliest.

At a press conference in Bangkok in October, Kanok said the U.S.-led threat of attack in Iraq and the subsequent impact of rising fuel prices had dampened investor enthusiasm in airlines. ■

It's ambitious, it's revolutionary and it's necessary. The restructuring of China's airline industry has officially begun. The goal, particularly after China's entry into the World Trade Organisation, is to make one of the world's great aviation juggernauts profitable and internationally competitive. There were no surprises in October's announcement in Beijing's Great Hall of the People of the merging of the nine CAAC carriers into three groups. It will not happen overnight, but the future for China's airlines is ...

TAKING SHAPE

It could take up to three years to complete the restructuring

By Barry Grindrod, in Hong Kong and Melody Su, in Beijing

It's official. In October, after 18 months of intense negotiations between Beijing and Mainland airlines, the Civil Aviation Adminis tration of China (CAAC) announced its long-heralded reform of the airline industry.

That was the easy part. Now, with nine former CAAC carriers consolidated into three groupings, the hard part is to make them work; and for them to become efficient and profitable.

It's not going to be straight forward. And it's going to take longer than most people think, say industry observers.

Indeed, Wang Kaiyuan, president of Air China and the new China National Aviation Holding, said in October he believed it would take his group three years to complete the transition.

The October announcement produced no surprises. Air China heads the China National Aviation Holding, which includes the China National Aviation Corp (CNAC) and China Southwest. China Eastern Airlines (CEA) leads the China Eastern Air Holding and has China Northwest Airlines and Yunnan Airlines under its wing. The Mainland's largest carrier, China Southern Airlines (CSA), pilots the China Southern Air Holding with China Northern Airlines and Xinjiang Airlines completing this grouping.

The lead airlines will see their collective market share rise from 63% to about 85% of China's airline capacity in revenue tonne kilometres. The three groups will hold about 80% of the mainland industry's assets.

The Chinese media dubbed them "arranged marriages", and for sure the restructuring of China's major airlines are not exactly "marriages" made in heaven. Observers expect the honeymoons to be challenging as corporate cultures clash and executives vie for the best posts in the early months of the new order.

One of the biggest unanswered questions for lead carriers like CSA and CEA is who is going to pay the debts of the loss-makers in their groups? Both China Northern and China Northwest are said to be many millions of yuan in the red.

The CNAC must be particularly worried about its group. Leader Air China has been badly managed and losing money for years. China Southwest, too, is in debt. The latter, said insiders, serves Lhasa, in Tibet, with four flights a day, many of them re-supplying the Chinese military based in the city with personnel and equipment for which there is no reimbursement.

It is hoped, however, that the State Council, which has been driving the reform plan, will provide some financial assistance, or debt forgiveness, to the new holdings.

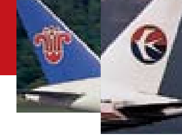
Said aviation consultant, Jim Eckes, who has worked in the region for more than 30 years: "This is a major distraction for China Eastern and China Southern. They should be concentrating on expansion, but find themselves in a position where they may have to focus on earning revenue to pay the debts of the other carriers they have inherited."

Both of the above carriers are listed on the New York and Hong Kong stock exchanges. "This is not very good news for foreign investors because the airlines are being forced to do things which are against their interests," said Eckes.

And an analyst, who asked not to be identified, said any potential foreign strategic investor would have to be worried about the complexity and lack of visibility of the restructuring process. "Nobody is going to put US$200 million into an air-

China Southern Airlines: to share revenue and code-share with its partners during restructuring

China Eastern Airlines: to request its partners do not launch rival routes before reorganisation completed



line if they do not know where the money is going or for what," he said.

Also, there has been no direction on how surplus staff will be managed. Again, this will not be easy. CSA, for example, has been having difficulty in recent times trying to consolidate its several maintenance operations in China, but has met with opposition from staff. This could be a sign of conflicts to come.

There are concerns, too, about early moves by the CAAC to cash in on its former airlines.

Shortly before transferring ownership of the airline shareholdings to the Ministry of Finance, the CAAC increased airport landing charges. In response, the airlines said they will ask the Ministry of Finance to remove the 5% airport infrastructure tax that carriers are required to pay as part of the landing fees.

"The genie will soon be out of the bottle," said the analyst. "The restructuring will suffer from volatility in the initial stages. There will be higher costs to meet before the extra revenue comes in."

But the plan is moving forward and, importantly, it has been mandated by the State Council. The timetable for the mergers has slipped. It has been compromised by two accidents involving Chinese airlines earlier this year. Negotiations also have been extended by concerns about financial issues and matters relating to corporate culture.

However, the legal aspects of the consolidation are scheduled to be completed by the end of December. The operational reorganisation; aircraft, routes, marketing and human resources, are expected to take between 18 months and three years to put in place.

CEA has said China Northwest and Yunnan Airlines should become part of its publicly listed company by the end of 2003. Details of the principal terms and asset injection had "yet to be considered and finalised", said a CEA statement.

The three carriers will continue to operate independently until the consolidation is complete. The CEA statement said they compete directly on 10 passenger routes including Shanghai, Tokyo and Nagoya. In the coming months CEA will seek to reduce competition on the 10 routes and request that China Northwest and Yunnan do not launch new rival routes.

China Southern said in a statement that prior to the assets and liabilities of the airlines being transferred to the new holding company, revenue will be shared by China Northern, Xinjiang and itself on competing routes. Code-sharing will be adopted on the routes and tickets sold jointly by the carriers.

The whole restructuring is a bold move by China. Its aviation industry has made rapid strides forward in the last 15

Wang Kaiyuan, president of China National Aviation Holding: consolidation will lead to improved products and services

years. Now, with China a member of the World Trade Organisation (WTO), it is a priority for the country to become more competitive, efficient and transparent in the international marketplace.

In recent years, the CAAC has been encouraging consolidation and streamlining in the industry. During this time the number of China's carriers has almost halved from a peak of 40 airlines. Most recently CEA purchased Wuhan Airlines.

"The restructuring is a good thing for the aviation industry in the long run," said Peter Negline, regional transport analyst for JPMorgan in Hong Kong. "It has been too fragmented. The WTO requires more modern, efficient and productive entities. If you have got 30 airlines trying to be all things to all people, you are going to run into problems sooner or later."

China National Aviation Holding president Wang said once the restructuring was complete products and services would have high standards with air fares, directed by the state, sensitive to market forces.

In recent years, over-capacity in the market has led to serious price wars. Fare discounting still continued even after the practice was declared illegal.

Mainland analysts have said the restructuring of the CAAC carriers meant the smaller provincial carriers would have to become more competitive to survive. They said the stronger of the second tier carriers could improve by "self-development" as Shanghai Airlines demonstrated when it listed on the Shanghai Stock Exchange. The second Shanghai carrier also has taken a 10% stake in Sichuan Airlines. Hainan Airlines, which also is listed in Shanghai, has strengthened its competitive hand in the last two years by acquiring three small carriers, Xinhua Airlines, Changan Airlines and Shaanxi Airlines.

Other airlines could benefit by 'hitching their wagons' to the major groupings, said the China experts. China Southern recently purchased 39% of Sichuan Airlines, with second tier carriers Shandong Airlines and Shanghai Airlines each taking 10% in the same carrier.

Some believe the smaller operators could form a loose alliance of their own, but this has been tried with Sino-sky and failed to be effective.

One of the major pluses for the mainland airlines is that the CAAC will no longer have the dual role of regulator and airline operator. CAAC vice-minister, Gao Hongfeng, said his organisation was focusing on China's air traffic control system, which is undergoing a major upgrade, and the safety and security of the airlines. In time, the CAAC would be responsible for regulating the entire aviation industry.

CAAC minister, Yang Yuanyuan, stressed that while flight safety and on-time performance should be guaranteed, the new groups must demonstrate modern management and enterprise throughout their organisations.

Three major air service and support holdings were also unveiled in October. They were China TravelSky Holding, China Aviation Oil Supply Holding and China Air Supplies Holding.■

THE NEW HOLDINGS

CHINA NATIONAL AVIATION HOLDING

- Air China
- China National Aviation Corp
- China Southwest Airlines

Total assets worth 57.3 billion yuan (US$6.9 billion). It has 118 airplanes serving 307 air routes and employs 23,000 staff.

CHINA EASTERN AIR HOLDING

- China Eastern Airlines
- China Northwest Airlines
- Yunnan Airlines

Total assets worth 47.3 billion yuan (US$5.7 billion). It has 142 airplanes serving 386 air routes and employs 25,000 staff.

CHINA SOUTHERN AIR GROUP

- China Southern Airlines
- China Northern Airlines
- Xinjiang Airlines

Total assets worth 50.1 billion yuan (US$6 billion). It has 180 airplanes serving 666 air routes and employs 34,000 staff.

Airport reforms need time

By Melody Su
in Beijing

China has made giant steps towards civil aviation reform this year, starting with the announcement by CAAC at its annual meeting of its blueprint for the future, through airline mergers and the handing over of airport administration to local government. The establishment of three major air groups was announced in October, but the complexities of reform at the country's many loss-making airports means there is still much to be done if the co-ordinated development of the industry is not to suffer.

By the end of 2000, the top five airports in terms of passengers, Beijing Capital International, Shanghai Hongqiao, Guangzhou Baiyun, Shenzhen Bao'an and Xiamen Gaoqi, had completed, or were implementing, stock system reforms, a process which started in 1995.

In 1996, Xiamen Gaoqi, for instance, was listed on the Shanghai Stock Exchange with financing of 230 million yuan (US$27 million), followed in 1998 by Shanghai Hongqiao (Shanghai Stock Exchange, 1.923 billion yuan) and Shenzhen Bao'an (Shenzhen Stock Exchange, 2.74 billion yuan) and in 1999 by Beijing Capital International (Hong Kong Stock Exchange, 2.74 billion yuan). CAAC has also tested the waters over airport management by handing Xiamen Gaoqi and Shanghai Hongqiao to the Xiamen and Shanghai municipal governments respectively.

But this has come at a cost. Most of China's civil airports have incurred heavy losses, thanks to the single investment, inflexible marketing system. Statistics also show that 65% of mid to small airports are operating at a loss, with an average debt ratio of 70%.

CAAC vice minister Yang Guoqing has listed five reasons for handing airport management to local government:

- Airports, as important gateways to a city or an area, are an integral part of the local economy.
- Handing them over should increase local government's interest in investing in airports, managing them and adopting policies that will boost development.
- Local governments can do a better job of management and construction.
- Airports will benefit from the increased independence such as system brings.
- CAAC and regional administrative bureaus will be free to spend more time increasing safety in the air and on the ground.

The experience of overseas airports is often cited as the best way forward; with ownership and operating rights separated, investment widened and operating management systems regularised to improve administration.

Nanjing Lukou Airport is one successful example of the way forward. In 1997 and 1998, when it was already being run by the local government, it reformed the systems of its six subsidiaries – terminal, passenger transportation, cargo transportation, food, advertisement and bus transportation – and established five branches and one joint venture. The Airport Corporation took an 80% share of the branches, with operators also increasing their shares.

The branches now run themselves, with the Airport Corporation only carrying out project management through regulation. Through this, profit growth at each branch has shown at annual 50% increase, with the branches reporting a 30 million yuan profit in 2001.

The Airport Stock Company, founded in 1998 to develop market resources, concentrates on airport operations and management, but with different responsibilities from the corporation. In 2001, the airport handled 2.79 million passengers and 62,500 tonnes of cargo and mail, an increase of 14 and 17% respectively over a year earlier.

Unfortunately, not all China's airports are in the same situation. There have been suggestions that loss-making airports hand management to major private enterprises, either domestic or foreign, and that the CAAC set up a specialised division to supervise airport operations.

Reforms are bringing other problems too, such as difficulties in co-ordinating air traffic control departments with a local government operation.

Before reforms began, both air traffic control and the airports themselves belonged to the CAAC and were seen as two co-operating departments within the same organisation. That no longer holds true and problems are expected, particularly when it comes to airport extensions and air traffic control upgrades.

Regulations to smooth relationships between local government and civil aviation departments are being drafted by the CAAC, said Qin Zhanggao, director of the CAAC Airport Division. The new rules will help with the CAAC's supervision of airport management. After nine series of amendments, they are expected to be issued by the end of next year.

Airport reform is a complex business in a country like China, thanks to complicated relationships between the CAAC and local governments and the fact that almost half the industry's employees will be involved. Most experts believe that it will take time to get it all right.

The Civil Aviation Administration of China wants to hand airport management to local government at airports such as Xiamen Gaoqi (above)

By Oscar Seow

Airline plan: is confidence being confused with bluff?

After a year and a half of tough negotiations with its airlines, China's State Council has finally approved what may be the most ambitious programme of reform for its aviation sector in the history of, well, economic reforms. If Beijing can carry its plan to fruition, it will have achieved a wonder not far short of the Great Wall itself.

The country hopes to accomplish, at a single stroke, what in the West has taken nearly three decades of natural market evolution and regulatory reform in the airline industry.

Within 18 months, the Civil Aviation Administration of China (CAAC) hopes to have completed the merger of the airlines under its control into three groups – under the leadership of Air China, China Eastern and China Southern Airlines.

In its plan, China will reduce the destructive competition now prevalent, begin the move to deregulating airfares, help its airlines gain access to international pools of capital and place them in a strengthened position to partner with global airlines and alliance partners.

More importantly, Beijing hopes its reforms will force airlines to focus on managing for yields, rather than expansion, for growth.

Even in the U.S., the world's most sophisticated airline market, this process of reform did not really start until the late1970s and is arguably very much ongoing.

China does not plan to stop there. It is expected to continue to unveil further liberalisation within the industry as mandated by its membership in the World Trade Organisation – fuel prices will eventually be deregulated, for one – and to ensure that its airlines develop their competitiveness against the rest of the world.

Given Beijing's apparent will, the good money is on China staying the course and completing its reform programme. So far, all the airlines involved seem happy with the marriages arranged for them – at least outwardly – and, on the whole, they are optimistic for the industry's future in China.

There is a newfound hope among the mainland airlines that the CAAC's reform plan will allow them to overcome, once and for all, the lingering financial troubles that have plagued them since the Asian economic crisis sent their industry into a tailspin in 1998.

Yet sceptics might argue that confidence is merely being confused with bluff. After all, can decades of management, or mismanagement, and ideology really be changed overnight and on a single directive from Beijing? It's hard to say, given China's usual opacity. Foreign media were not even invited to the reform plan's unveiling. But by any measure, the mainland airline industry is far from healthy and the CAAC's reform plan is, indeed, light on concrete measures to deal with its two biggest ills – unsustainably high levels of gearing and rampant over-capacity in the system.

China Eastern Airlines: key financial arrangements for mergers still under negotiation

To be fair, most reforms are a work in progress. It took the CAAC and the big three airlines nearly 18 months of intense negotiations to put together a platform upon which they could all agree to begin restructuring the industry. That delay was said to be largely due to their refusal to assume the debt burdens of the smaller regional carriers, most of which are extremely unprofitable as well.

Presumably, Beijing will have agreed to provide the three new carrier groups with some form of debt relief to ensure they can hit the ground running. Still, China Eastern said in an ominous statement to the Hong Kong Stock Exchange, just a few days after the official unveiling, that key financial conditions for its mergers remained under negotiation.

Another question mark concerns the industry's need to shrink capacity and to raise operations to profitable levels. Much of China's airline debt was accumulated in the misguided belief that carriers could grow themselves out of trouble. Regional carriers rapidly expanded their fleets and moved to capture more market share at any cost.

Inevitably, costs skyrocketed and airfares plummeted to money losing, and illegal, levels. The combination of these missteps culminated in the industry suffering heavy losses, beginning in 1998. If the reform plan is to have any hope of success, Beijing will have to deal with these problems – and quickly.

To its credit, it has already begun to address the questions of illegal discounting and over-competition on the triangle network between Beijing, Shanghai and Guangzhou. But doubts remain about the CAAC's ability to enforce reduced capacity on thin, unprofitable routes to second and third-tier cities. No doubt, the provincial governments will be lobbying against contraction at every turn.

While Beijing works to solve these dilemmas, the process will be hampered by slowing growth in China's much vaunted air travel market. The International Air Transport Association (IATA) forecasts that average annual traffic growth in the mainland could top 9.5 per cent between now and 2006. Yet figures suggest that actual growth in the past year has been nowhere near that mark, based partly on fears that the mainland economy could be headed towards a cyclical downturn.

For China to choose this moment to raise airfares and shrink capacity cannot possibly help spur demand. Indeed, with greater economic forces at play, Beijing's reforms could actually undermine growth in demand for air travel, creating yet another set of problems.

At worse, traffic could even contract, putting the entire reform plan into jeopardy. In short, there may be no foolproof solution to the economic woes of China's airline industry – but when has anything truly ambitious ever been easy? ■

*Oscar Seow's **INSIDE GREATER CHINA** column will appear monthly in* Orient Aviation *from December 2002.*

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A war with Iraq could lead to another suspension of war risk cover at a time when the future of vital insurance guarantees for airlines is uncertain. TOM BALLANTYNE reports.

Insurance plan on the brink

The future of GLOBALTIME, the International Civil Aviation Organisation's (ICAO) planned worldwide airline insurance scheme, designed to cover carrier's needs for stable war risk cover, was in the balance in late October, as it awaited a decision from several major nations on participation.

An official deadline for notification of agreement from ICAO member states passed on October 15 with confirmation of acceptance from members representing only 6.25% of annual contribution rates to ICAO. For the insurance scheme to proceed 51% is required. There has been no word from major nations in Europe, the United States or Japan.

As *Orient Aviation* went to press sources at IATA said they had been told unofficially that European Union countries had met, with 13 of the 15 nations involved deciding in favour of the scheme. That would place the acceptance level at between 30% and 40%.

With IATA and ICAO officials expecting the U.S. to decide not to take part, the launch of the scheme could depend on whether several other nations, including Japan, belatedly opt to enlist. But insiders were almost certain the percentage target would not be achieved.

GLOBALTIME, inspired by the airlines themselves through the International Air Transport Association (IATA), was approved in principal by the ICAO Council in June. It is aimed at establishing a global aviation war risk insurance scheme to cover the risks left open by the withdrawal of commercial insurance coverage following 9/11.

Assad Kotaite, president of the ICAO Council, said the objectives were to allow air transport operations to continue "under reasonable financial conditions, spread the aviation war risk and related risks amongst all parties, including participating states, and provide adequate insurance coverage in the short and medium-term while allowing the private insurance markets to come back gradually into the market".

Once implemented, it would provide third-party coverage for airlines and others involved in civil aviation, through a non-profit insurance entity backed by state guarantees. A pool to meet claims would be built up primarily through premiums and investment income earned on premiums. State guarantees would be called upon only as means of last resort.

Coverage would be capped at US$1.5 billion per insured and per occurrence, for claims in excess of the US$50 million limit currently available from the private insurance market.

If all 187 ICAO contracting states adopted the scheme, coverage up to an amount of US$15 billion would have been available, but now this figure will be far lower, if the scheme goes ahead at all.

> 'THERE IS NO INDICATION THE INSURANCE MARKETS CAN RETURN WITH AFFORDABLE COVERAGE FOR A LONG TIME'
>
> – IATA director general Giovanni Bisignani

The U.S. is unlikely to take part because the Federal Aviation Administration is providing cover that protects passengers, making it pointless for airlines to sign up for another scheme.

"The airlines and their air transport partners urgently need affordable, global, non-cancellable, non-discriminatory and universally available third-party war risk insurance," said IATA director general, Giovanni Bisignani, in October. "There is no indication the insurance markets can return with affordable coverage for a long time. The airlines and their air transport partners have been shouldering exorbitant insurance premiums for the past 13 months, only alleviated by the existence of national state guarantees."

"IATA strongly believes governments must continue to play a role in ensuring that people and property on the ground are protected should civilian aircraft be used again as weapons of war," Bisignani added.

In September, the European Commission urged governments to stop providing state-backed insurance from the end of October, which would force carriers to go back to the commercial market and pay high premiums. The U.S. Senate Commerce Committee has recently approved legislation to extend support to the airlines for war risk insurance until mid-2003.

Commercial war risk insurance is available again, although it is limited and extremely expensive.

In late October, it was reported several insurers, including AIG, Berkshire Hathaway and Axis, were forming a consortium to offer third party war risk coverage to airlines similar to the ICAO plan and at a price lower than previously available.

Howard Goldberg, director taxation and insurance at IATA in Montreal, told *Orient Aviation* he believed the insurance market would find it difficult to stay away from offering cover to airlines "because there is so much money in it".

Even if there is a wider range of commercial cover in the market it may not solve the problem, he said. "It depends on its availability. This new consortium offering will apparently be selective in the airlines it will cover. We have 280 members around the world. All of them should have access.

"Our guidance from our board of governors is clear: it must be affordable, accessible, non-cancellable and recognise the inherent role of government in this. We should not be sharing this burden even if there are commercial arrangements available, because it is not reasonable for us to carry the burden. However, who knows how all this will play out."■

Garuda Indonesia has weathered corruption, near bankruptcy, Asia's economic downturn and the industry tremors of 9/11. And, until one fatal day in October, it was on track to recovery. Now the carrier's new president, Indra Setiawan, must deal with the damaging fall-out of October's horrific bomb attack in Bali. Less than 48 hours after the explosion, TOM BALLANTYNE flew into Jakarta for this exclusive interview.

Bombing puts Setiawan to the test

'Garuda will come through this crisis'

Indra Setiawan is under no illusions that when bloody terror struck at the heart of Indonesia's tourism infra structure on Saturday October 12, by blowing apart a nightclub in Bali's Kuta township and killing nearly 200 foreign visitors and local Balinese, it also ripped deep into the life systems of Garuda Indonesia.

For the famed holiday island it was a case of Paradise Lost. For Garuda, it marked a watershed that will see well-laid plans redrawn yet again possibly coupled with a lengthy search for ways to win back frightened customers.

Some 70% of the international passengers it carries, mainly from Australia, Japan, Korea and Europe, fly to and from Bali on package holidays. Garuda doesn't even operate direct flights from Australia to Indonesia's capital, Jakarta. All 27 weekly services from Sydney, Melbourne, Brisbane, Adelaide, Perth and Darwin go to the airline's hub at Denpasar, Bali's airport. Anyone heading for Jakarta has to complete the journey on a domestic connection.

Hardly surprising then that within 24 hours of the disaster, Setiawan, Garuda's president, was at the bombing scene with Indonesian President Megawati Sukarnoputri, surveying damage he described as "shocking" and holding crisis meetings with local and national tourist officials.

By Tuesday, Setiawan was back in his Jakarta office, talking to *Orient Aviation*. "I am confident that, while it might take time, Garuda will come through the crisis, with the help of a hard line from Indonesia's government," he said.

"Our government has made a statement that we will fight all terrorism and it is working with the U.S. Federal Bureau of Investigation (FBI) and other agencies from countries such as Australia, Japan and Germany."

The initial reaction from intended Bali holidaymakers was not unexpected. Immediate cancellations in the wake of the attack saw load factors plummet. However, Setiawan was buoyed and surprised by early reports that the drop in load factors from Australia, Europe and Japan was not as large as initially expected. Some flights were still leaving Australia "one-third to half full" and only about 20% of bookings had been cancelled for the remainder of October. He did expect a serious decline in Japanese visitors, who traditionally shy away en masse from trouble spots.

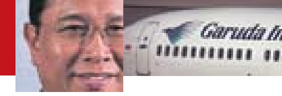
He recalled that in the 1980s when a cholera outbreak struck Indonesia, Japanese tourists all but disappeared. It took up to two years to win them back.

"We are the airline that has the most traffic to Bali and obviously the impact will be significant. It is too early to say precisely what that impact will be or how long it will last," he said.

Garuda Indonesia president, Indra Setiawan: before the Bali bombing Garuda's passenger traffic, revenue and yields were improving

The Bali bombings could hardly have come at a worse time for Garuda. After more than four years of radical rationalisation and restructuring, first under the stewardship of banker Robby Djohan and then fellow banker Abdulgani, who were heavily backed by expertise from Germany's Lufthansa Consulting, the clouds were clearing.

Last November, Garuda finalised the rescheduling of a massive US$1.8 billion debt burden and since 1999 has been making modest profits. Setiawan disclosed that in the first six months of this financial year, ending June 30, operating profit was about US$22.4 million, a 90% improvement on the previous



year's period. He believed the full year result would lie somewhere between $46.5 million and $60 million, although this is now subject to review because of the bombing.

Internal documents for August on operating revenue and key indicators, the latest month available and provided exclusively to *Orient Aviation*, show the upward swing was continuing in the second half. Passenger revenue lifted 7.7% over the same month in 2001 to US$86 million. Significantly, passenger load factors rose 6.8% to 73% and, even more importantly, passenger yield, at 5.6 US cents in August last year, was up 17% to 6.6 US cents, clearly showing Garuda had succeeded in improving the fundamentals of its cost structure.

Still full of enthusiasm for the industry he has dedicated a quarter of a century to, 51-year-old Setiawan may be the right man at the right time for Garuda.

A native of Jakarta, he represents a return to leadership at Garuda of a career airline executive, following the reigns of bankers Djohan and Abdul-gani. Since joining Garuda in 1977 he has worked in every critical area, from marketing, planning and development to finance and accounting, from organisation and quality control to research and development and flight schedule planning. His knowledge across the complex divisions of the carrier will be tested in the months ahead.

Yet Setiawan's appointment in May this year was surrounded by controversy. In 1997, the government appointed Setiawan as executive vice-president, commercial, of the second state-owned carrier, domestic Merpati Nusantara. In July 1999, he returned to Garuda as a commercial advisor to Abdulgani. But Setiawan was not the man Abdulgani recommended as his replacement and he faced tough competition for the post from Samudra Sukardi, managing director of Abacus Distribution Systems Indonesia, which is 95% owned by Garuda.

Sukardi was tipped to succeed Abdulgani because his younger brother Laksamana was Minister of State Enterprises. In the event, Laksamana eschewed such nepotism.

Some critics, Sukardi among them, have complained little seems to have happened in the way of progress since Setiawan took over. The new boss said this could be because much of his work is taking place behind the scenes, lifting staff morale to improve performance and introducing a new culture within the ranks of the carrier's 9,000 employees.

Garuda is focusing on three key areas, he said. "Firstly, we are improving production, having aircraft in good condition and lifting on-time performance, which is our golden egg. Secondly, we are putting a great deal of effort into marketing to convince people that our product, our pricing and all aspects of what we do are the best. Last but not least there is the human side. This is a people business and how you manage people is very important."

Internally, the corporate cultural shift is tagged "Smile and Care".

But a priority for Setiawan now is, following the Bali bombing, completely reviewing a business plan that had already been reworked after the New York World Trade Centre bombings.

Planned fleet expansion may also have to be put on hold, or pared down. Garuda has a fleet of 44 aircraft: three B747-400s, four B747-200s (two are parked), six A330-300s, five DC-10s and 26 B737s (300/400/500).

also will remain one of the few Asian airlines not operating scheduled flights to North America, with Setiawan making it clear the U.S. "is not in our business plan".

Marketing in the U.S. is very difficult, he explained. "Many airlines launching new flights to the U.S. have to operate them at a loss for as much as two years. We need quick yielding operations and could not afford to carry a route for that length of time. We are very careful to fly to places that are profitable."

That may be tough to achieve in the foreseeable future, but it is not all bad news for Garuda. Setiawan (and others) do not believe Bali will impact on Indonesia's domestic traffic, which has been climbing steadily over recent years, after dipping during the Asian economic

Garuda Indonesia: 70% of its international passengers fly to Bali

Setiawan plans to phase out the older DC-10s and B747-200s, leasing in up to four new B747-400s. Longer term, the airline has 18 New Generation B737s on order as well as six B777s and options on three more A330s.

Increasing the B747-400 fleet is critical because the three currently in service are fully utilised. The problem with that is if one is out of service for any reason it has to be replaced with a 200 series jet. "You cannot fly directly from Singapore to London, or from Bangkok to Frankfurt, with that plane. We have to use the Middle East as a stopover."

He said the search was already underway for extra 400 series aircraft, but after Bali the actual number to be acquired is under review.

Given the circumstances, Garuda will not be launching a spate of new routes either, although it was scheduled to begin flights to Shanghai in late November. It previously flew to Beijing and Guangzhou, but dropped the Chinese capital because of poor traffic. Garuda crisis. Domestic passenger numbers this year are expected to be 11 to 12 million, up from around 9.7 million in 2001.

Continuing growth on the home front excites Setiawan, even though Garuda faces a plethora of competitors: there are now more than 17 recognised domestic operators and countless other small, single aircraft operations nibbling away at available traffic in various parts of Indonesia. At least Garuda no longer flies everywhere. It concentrates on 24 trunk sectors.

He said that only 1.5% of Indonesia's 230 million people fly. "It means there are possibilities, room for development of air transportation here in Indonesia without even talking about international.

"I am conscious about service. We won't become absorbed in damaging price wars. You can still have creative pricing without doing that. The point is that if everyone offered exactly the same product only crazy people would choose the higher price. But if one airline is offering something different or better, the

price is not the only factor. We do not care about what other people are charging," said Setiawan.

Six more B737s are expected to be added this year to the domestic fleet and additional aircraft are planned for the carrier's low-cost operation, City Link. Currently using Fokker F28s, it may get B737s or Fokker F100s.

Another area of improvement is in relations with Merpati Nusantara. The two have been working on synergising their operations, working together in such areas as maintenance and schedule co-ordination, pooling resources and operating single transfer desks at airports where previously there were two.

They double up on some routes, such as Jakarta-Denpasar, but tend to attract a different market sector. The route is a major one for Garuda, connecting Jakarta with its international services in Bali, while Merpati operates on from there to smaller domestic centres.

Setiawan does not believe Merpati can ever become a long-haul international operator, but he said it has a regional role to fill with short-haul services to nearby ports such as Darwin in Australia, Kupang in Malaysia and Mindanao in the Philippines, as well as operating from secondary Indonesian destinations such as Sumatra to Singapore.

"Garuda has a better product and a better image, but Merpati has a big domestic network. If you can combine that there will be a giant alliance of airlines in Indonesia. It is all about increasing the leverage of the two carriers."

Privatisation is the other ongoing issue for Garuda but, according to Setiawan, the government has set no timetable. "Our task is to bring Garuda into a better condition and to be attractive to potential investors. Next year there may be some preparation for privatisation, but it will depend on the state of the market," he said.

Now, it also will depend on the depth of damage caused by October's tragedy and how rapidly Indonesia, tourism officials and Garuda are able to convince business and leisure travellers that security levels are adequate and that the country is serious about stamping out terrorism. Their task, in short, is to put the Paradise back into Bali.■

Start-ups prompt safety fears

By Tom Ballantyne

There is growing concern that the start-up boom in Indonesia's domestic airline market, mainly using elderly aircraft, coupled with intense ticket discounting, poses a threat to air safety.

The president of national flag carrier Garuda Indonesia, Indra Setiawan, has urged the country's air regulators to strictly enforce maintenance rules, clearly indicating he is worried that with the low profit margins these airlines earn some operators may be tempted to cut corners in critical operational areas.

"Don't give the airlines any concessions from the maintenance side because safety is number one," he said. "Don't give room for the operator to play fast and loose, cut corners or bend rules to save money. By being strict, the operator will have to think twice about the cost they charge for tickets. I am not talking about competition. I am talking about the good of the nation."

Setiawan is not alone in drawing attention to the risks. Wahyu Hidayat, former president of government-owned Merpati Nusantara and now chairman of the Indonesian National Air Carriers Association (INACA), supported calls for a tough stance by regulators, and said that the increasing number of airline operators should force the government to establish strong passenger safety regulations.

"Passenger safety has to be taken into consideration in running this business," he said.

Many foreign companies operating in Indonesia are also tussling with the issue of which airlines their staff should be allowed to fly on when they travel domestically. It is a sensitive problem, but while they will not comment publicly, several western executives told *Orient Aviation* they try to insist on flying with major carriers such as Garuda and Merpati. However, many minor routes are not served by the main operators and across the scattered islands that make up the Indonesian Archipelago, land or sea transport is not an alternative.

Wahyu Hidayat, chairman of the Indonesian National Air Carriers Association: government must introduce strong passenger safety regulations.

With a mostly deregulated market, the domestic airline industry in Indonesia has exploded. Established carriers such as Garuda, Merpati, Bouraq, Dirgantara Air Service and Pelita were joined in recent years by Awair, Lion, Indonesia Airlines, Star Air, Airmark and Bayu Indonesia Airlines, bringing the total of regular scheduled carriers to 15.

In February, seven more were granted licences: Alatief Alair International, Asia Avia Megatama, Bali International Air Services, Nusantara International Services, Rusmindo Internusa, Indonesia Airlines Avi Patria and Satrio Mataram Airlines. All, except one, are based in Jakarta.

Also, there are countless, mostly single aircraft charter operators operating in the country carrying passengers aboard a hotch-potch of mostly veteran aircraft, including old Boeing B727s, Douglas DC-9s, early model B737s and Russian turboprops and jets. These include several aircraft formerly operated in Nigeria, not known for its maintenance standards.

It is understood that while Indonesia's five largest airlines operate about 65 routes, the country's entire fleet flies more than 200 routes to over 90 destinations. Statistics are difficult to obtain in Indonesia, but available information shows in 1999 the total number of aircraft used was 125, decreasing to 110 in 2000, but rising to around 179 last year.

"It is unbelievable," said one longtime airline official. "There are small airlines out there that would have to get 135% load factors just to break even."

What concerns industry professionals in Indonesia is that operating under an economic formula such as this makes it inevitable some will have to break the rules to survive.■

By Tom Ballantyne in Hong Kong

U.S. belly freight ban 'could put carriers out of business'

Air cargo and airline industry executives have intensified a lobbying campaign aimed at forestalling any possibility that new U.S. security regulations could include a total ban on belly freight. They argue such a move would be an over-reaction to post 9/11 terrorism fears and that it could drive some major carriers out of business.

A ban is one of the options under consideration by Washington's new Transportation Security Administration, tasked with safeguarding the transit of cargo by land, sea and air. Officials involved in air cargo are horrified legislation along these lines can even be considered.

If imposed, it could spark an income crisis for a number of major Asian airlines. Already fighting to recover from the lengthy air traffic downturn, operators such as Korean Air, Japan Airlines and China Airlines would see critical revenue from bellyhold cargo on trans-Pacific services to North America wiped out overnight. Many big passenger airlines rely on cargo for 20% to 40% of their revenue.

The debate reached a peak during the recent Air Cargo Forum held in Hong Kong by The International Air Cargo Association (TIACA). Michael Wisbrun, executive vice-president of Dutch operator KLM Cargo, warned the introduction of such rules by the U.S. or other governments would have major consequences.

Wisbrun said half of all air cargo flown around the world travels in the belly of commercial passenger aircraft. It is worth some US$10 billion in revenue annually to airlines.

"That cargo is important on passenger flights to 80% of all destinations and over 90% of all frequencies. Around 50% of the US$10 billion is contributory to airline fixed costs. If it is banned, a lot of destinations will just stop being served because without the income from the bellyhold cargo the routes will simply become uneconomic to operate," he said.

Olivier Bijaoui, head of WFS/SFS, a cargo handling group operating at 42 ports in Europe and the U.S. and moving 1.7 million tonnes annually for international airlines, argued banning bellyhold cargo on passenger flights is not the way forward. "With new types of aircraft like the B777, where the cargo capacity on sectors like the trans-Atlantic can represent enormous revenue-earning prospects to the carriers, the loss would leave some in an even more desperate situation than they are now."

He believes the cargo industry must have a more representative voice before any hurried legislation is introduced. "Cargo, from a security viewpoint, is a very different issue than passenger security and we must be sure that the right people are aware of the fact. The people in the U.S. who are looking at cargo security should involve cargo people in their discussions".

Korean Air: Asian's largest cargo carrier. Any belly hold cargo ban would slash revenue overnight

The bellyhold cargo debate spotlights the serious problems security authorities are facing coming to grips with the complex global trade in air cargo. Security standards for freight around the world vary widely and experts say the imposition of new standards and tightened rules has serious ramifications for the industry. Measures will cost billions of dollars to implement world-wide and could seriously slow the flow of air cargo traffic.

Who pays for new technology and an upgraded security system for cargo shipments – the industry, governments or third parties – is also a major issue.

Stephen Tisdale, director of aviation and transportation practice at PwC Consulting, agreed a ban on bellyhold cargo would make many routes in airline networks unviable, but pointed out that, despite this, something has to be done.

"In many cases we still do not know what the true identity is of the shipper or the contents of the shipment, nor the identity of employees who have access to cargo areas," he said.

The key is a system that verifies the identity of shippers, the contents of shipments and employees involved. "There is a solution, but there is also a trade-off in terms of what it will cost, the time it takes and the impact it has on airline operations ... but it must be an industry-led solution and it must be a phased approach. The big bang solution will only result in chaos," he warned.■

Early pressure for new JAL

Labour relations may prove greatest challenge

By Daniel Baron in Tokyo

Japan's airline industry marked the beginning of a new era on October 1, when Japan Airline System Corporation (JAL), the new hold ing company of the combined Japan Airlines and Japan Air System, commenced trading on Japan's stock exchanges.

The new JAL ranks third in the world in terms of market capitalisation, after U.S.-based Southwest Airlines and Singapore Airlines, and sixth in terms of traffic (IATA statistics for 2001). It has 287 aircraft serving 172 cities in 30 countries and more than 52,000 employees.

The JAL Group's new logo has begun appearing at ticket counters in Tokyo. The first aircraft sporting a new livery will fly in November. The airline's brand identity adopts the theme "Arc of the Sun".

The JAL Group also launched subsidiaries to handle its sales and travel agency/tour operator functions.

JAL president and CEO, Isao Kaneko, said the new entity aimed "to be known as an industry leader in safety, reliability and customer service, as well as a company that will maximise return to stakeholders."

He also referred to the bigger, long-term picture. "An airline is not just about carrying people. It is also an expression of technology, culture and peace itself. We want to continue our long history of contributions to all of these."

Japan Airline System's first contribution to itself will be cost reductions. The carrier is hoping to save 73 billion yen (US$610 million) by fiscal year 2005 through consolidation of facilities, job cuts via attrition and fleet reductions.

JAL is counting on the reductions to offset an across-the-board 10% cut on standard domestic fares and the return of 20 slots at Haneda and Osaka-Itami airports. A domestic environment now characterised by severe price competition with rival All Nippon Airways (ANA) also will eat into yields.

However, JAL's ability to compete with Japan's new airlines may be hindered by a Fair Trade Commission (FTC) ruling in September that forced both JAL and ANA to rescind deep discounts on routes served by the new entrants.

The FTC is likely to scrutinise any

JAL president Isao Kaneko: airline will continue to match low cost fares of start-ups

fare reduction on routes flown by upstart competitors, a reality that has Kaneko cautious, but confident. "We will abide by the FTC's rulings, but do not regret matching fares and will continue to match them when necessary," he said.

As for preventing a gradual, long-term loss of business to the small carriers, Kaneko is unfazed. "JAL provides added value, but since most domestic flights are very short, it is natural that some travellers will initially jump on price alone."

In summing up the domestic situation, with its capacity limitations and high user charges, Kaneko highlighted the market's reliance on Haneda Airport. "Sixty percent of all domestic flyers use Haneda. Unlike other countries we cannot just create a new low-cost hub somewhere." He added what the country really needed was "a system that allows price to reflect actual demand".

That statement could apply to jet fuel as well. Steadily rising kerosene prices, due to apprehension about another Gulf War, threaten to cut into savings gained through hedging, although JAL is hopeful the rises will be offset by a strong yen.

As with any airline merger, smooth integration of labour groups, including eight unions in this case, may prove to be the greatest challenge. Kaneko expressed confidence that, unlike the more restrictive Japanese corporate structure of the past, there was "room for a variety of employment styles to meet the needs of both labour and management".

JAL has set up a committee of employees from JAL and JAS to discuss the respective corporate cultures and operation practices and develop new ideas for the combined carrier.

As for marketing, JAL remains one of the few major international players not already in a global alliance. Kaneko reiterated that JAL was not considering membership. "Not going the alliance route has been the right decision," said the JAL president. "We have bilateral agreements with 20 airlines. These have worked very well for us."

The stance perhaps reflects the possibility that if locked into an alliance, JAL would have less to gain from the other members than they would from it. This is due to the strong preference of Japanese travellers for their own national carriers. Overall, 70% of JAL's passengers are Japanese, with the figure naturally much higher on domestic services.

"At the moment, all of the alliances are in a state of flux," added Kaneko. We follow their development and are open to considering membership if and when the time is right."■

The Arc of the Sun logo for the new JAL Group, made up of Japan Airlines and Japan Air System

IATA chief gets tough

By Daniel Baron
in Tokyo

It is early days but Giovanni Bisignani, the new director general of the International Air Transportation Association (IATA), is making his presence felt.

At the annual world assembly of the Airports Council International (ACI), held in Tokyo in October, Bisignani roared in with a strong message to airport operators regarding the growing disparity between returns of airlines and airports. "If one of the partners in a partnership is losing his shirt while the other is counting his money," said Bisignani, "it is no longer a partnership."

IATA is forecasting that its member airlines will lose a total of US$12 billion in 2002.

Bisignani urged airport operators to lower user charges and improve services. "I don't accept the pricing policies of our suppliers who basically operate as monopolies. Airlines and their customers cannot pay for airport inefficiencies," he said.

The IATA chief also went to Tokyo with some carefully chosen words for the Japanese Government and the Narita Airport Authority (NAA) over plans for the country's three main airports and the stalling of negotiations for reduced user charges at Narita.

In a letter to Japanese Prime Minister, Junichiro Koizumi, Bisignani urged Japan to "make Narita a symbol of Japan's reform agenda". Koizumi was brought into power on a wave of populist support for his far-reaching plans for reform.

"It is now time for Narita and the Japanese Government, Narita's main shareholder, to wake up to the competitive realities of business," said Bisignani.

On the subject of Narita's role in subsidising loss-making Kansai, he said that IATA had "no patience for privatisations that breed inefficiency, uncontrolled monopolistic behaviour or cross-subsidisation of troubled developments".

It was a call that mostly went unheeded. Only a few days after Bisignani's departure from Tokyo, Japan's Ministry of Land, Infrastructure and Transport (MLIT) officially abandoned its plan to privatise three airports – Narita, Kansai and Chubu – at the same time. Instead, the MLIT will privatise only Narita, a move that could mean a massive subsidy for Kansai and little change in user charges.

Meanwhile, with the theme "Managing Airports in Turbulent Times: Looking Beyond the Crisis", the ACI world assembly opened with recognition of the Asia-Pacific region's ability to do just that.

ACI director general, Robert Aaronson, applauded the region's continuing growth and cited "more airport development here than any other part of the world".

Former Japanese prime minister, Ryutaro Hashimoto, echoed the sentiment with a historical reference and pointed out "a high rate of personal savings, government-lead industrial policy and education lead to peace and stability that enabled the explosive growth in aviation in Asia".

Giovanni Bisignani, director general of IATA: time for Narita and the Japanese Government to wake up to the competitive realities of business

Delegates had much to share on the lessons learned during the past year. "Think the impossible," said Josef Felder, president and CEO of Unique, which operates Zurich Airport. In addition to the crisis of 9/11 itself, Felder faced the sudden collapse of primary customer, Swissair, shortly thereafter, followed by one aircraft crash in November and another in December. He urged airport operators not to be complacent in planning for the nightmare that might, and in his case did, come true.

Sydney Airports Corporation CEO, Tony Stuart, reminded his colleagues of the role perception plays in rebuilding confidence among passengers in the airport and air travel itself. "No matter how good the covert security, what mattered most to passenger perception was the overt security," said Stuart. He also urged airport owners and operators to "engage all of the travel partners" involved in passengers' interaction with the airport.

The issue of aircraft noise also took centre stage at the assembly. The ACI formally launched a long-debated "noise rating index" to rate airports on a scale of A to F. The index is split into two categories: cumulative and individual reduction in noise, based on levels stipulated in Chapter 3 of ICAO's environmental guidelines. More stringent Chapter 4 standards will become effective in January 2006.

Implementation of the rating system will be voluntary, however, leading one to suspect that high-grade airports will embrace the benchmarking tool, while others will quietly ignore it.

For its part, Narita Airport remains uncommitted to the new index. NAA managing director, Masahiko Kurono, said his airport would consider adopting it, but gave no further detail. The original *raison d'etre* behind the construction of Narita Airport was, in fact, noise at Tokyo's close-in Haneda.

Other airport operators advocated persuading the airlines to speed up retirement of aircraft not meeting Chapter 3 requirements. Joop Krul, director of airport development at Amsterdam's Schiphol Airport, said ICAO "should phase out Chapter 3 altogether because it is not strict enough". Krul advocated enforcement of the stricter Chapter 4 guidelines.

On the other side of the coin, Shinobu Kobayashi, vice-president of flight operations engineering at Japan Airlines (JAL), illuminated the challenge many carriers face in balancing the noise equation. JAL, explained Kobayashi, purchases aircraft assuming 20-30 years of usage, meaning that some of its B747 Classics will be in service for another 10 years.

The inability of the Classics to meet ICAO's Chapter 3 guidelines has forced JAL to reduce the maximum landing weight on its freighter Classics, a move which, according to Kobayashi, will result in US$12.5 million in lost revenue per year. The carrier has moved to mitigate the potential losses with its recently announced purchase of two new B747-400 freighters, to be delivered from 2004.

Upali Wickrama, chief of forecasting and economic planning at ICAO, summed up the situation succinctly. "Global measures are not always effective," said Wickrama, "because it is always a local matter."

THE DELTA CONNECTION

By Kitty McKinsey

There are five airports in the Pearl River Delta and Hong Kong International Airport chief, David Pang, believes cooperation and competition between them can only be good for the economic wealth of the region

Spend an hour with David Pang, the chief executive of Airport Authority Hong Kong and the word you will hear most often is "flow."

"An airport is the centre of flow – a flow of people, a flow of goods," he said in an interview with *Orient Aviation*. "Today's airport is not just 'air' (and) 'port,' it's really a multi-modal flow. You link the air flow with the surface flow, land flow and in Hong Kong, water flow."

And in Hong Kong, where making money is paramount, Pang added: "History shows us when flow happens, the people flow, the goods flow, money and information will flow, so you create wealth for the society.

"The airport should be a centre of economic growth, the engine of economic growth."

Pang sees Hong Kong International Airport promoting economic growth not just for Hong Kong, but also for the Pearl River Delta and even southern China.

The population of Hong Kong is 6.8 million, but the airport handled 33 million passengers last year.

Reaching into southern China opens up a market of 25 million or 30 million people. (The airport has the capability to deal eventually with some 87 million passengers a year.) With China now in the World Trade Organisation, business with southern China can only increase.

Distance should be no obstacle, as long as the airport is accessible, Pang argued.

"My definition of accessibility is time plus money plus reliability," he said. "If we can come up with a solution with the least time, the minimum money and the maximum reliability to help people wherever they are, to help them make money (or more money), then we are their airport and they will use us."

That's why Airport Authority Hong Kong concentrates on improving connections from the airport to the entire Pearl Delta Region. There are now 165 buses from the airport to cities and towns throughout the Pearl Delta Region, a huge improvement over just two years ago.

Hong Kong International Airport: major developments in the pipeline

Next year ferry services will connect the airport with many cities in the region as well.

As a long-time businessman who spent lots of time on the road, Pang understands well that the traveller heading home to Dongguan (in southern China) from Paris does not want to spend any more time in Hong Kong than necessary. The airport's aim is to provide a hassle-free, one-stop service. "One stop – your first stop is home," Pang said with a smile. "After a long trip, that means a lot for our customers."

Pang sees Hong Kong both competing with and co-operating with the other four airports in the Pearl Delta Region. "Healthy competition helps us to improve ourselves and makes all of us become better and our customers will be happier," Pang said. At the same time, the airport can work together to improve and increase flows through the region to create more wealth for Hong Kong and China. The co-operation comes in creating a bigger pie, Pang said; the competition will be in dividing up that bigger pie.

Hong Kong International Airport gets 18% of its business (six million passengers a year) from Taiwan-related

travel, including compulsory stopovers for people flying from Taiwan to mainland China.

The Airport Authority predicts that direct flights, if instituted between Taiwan and mainland China, could cut 10% of the airport's total traffic, so Pang is concentrating on growing other business to replace the possible loss.

Despite a slight drop in passenger traffic in Hong Kong since the September 11 terrorist attacks in the U.S, cargo traffic continues to grow, up 9.3% in August 2002 over a year earlier.

The airport's current annual cargo capacity is three million tonnes, and can increase eventually to nine million tonnes per year.

The airport itself, built on 1,255 hectares of reclaimed land in the South China Sea, and opened in 1998, was acclaimed as one of the top 10 construction achievements of the 20th Century. The passenger terminal is light, open space where efficiency reigns in everything from check-in to immigration control and baggage delivery on arrival.

It's been voted World's Best Airport two years in a row in an independent survey by Skytrax Research in London. This achievement is no accident. For what he calls the "hard" features of the airport – safety, security, facilities, signposting and the like – Pang said: "you have to set very stringent targets and you measure it and you improve it. There is no short-cut for that."

Just as challenging is what he calls the "soft" part: "We want to create the HKIA experience, to make it very enjoyable and very memorable."

Hong Kong airport's giant shopping mall (called Hong Kong Sky Mart) covers 31,000 sq metres and includes more than 150 outlets. Hong Kong Sky Mart features a huge range: small stores selling local specialties, international designer fashions, snack bars and fine dining. But Pang has even more in mind when Sky Mart adds another 8,300 square metres over the next three years: a cinema, shower and napping rooms, a large business centre and even off-beat services like film processing for passengers who would drop off film before check-in and pick up prints after passport control.

"At the end of the day, you want to make this a destination in its own right, where people have fun, they come here and enjoy themselves, in addition to taking a flight out," Pang said.

Of course it's not just fun. There's serious money to be made in serving the huge numbers of people as they move through the airport.

"The concept of Sky Mart goes back to looking at the flow," Pang said. "The flow is not just the volume of the flow, but also the quality of the flow. How can you inject more value in the flow and extract more value out of the flow?" There's that word again.

PANG ON USER CHARGES

"Our partnership with airlines is very important to us, and one practical way we've been able to demonstrate this is through the 15% reduction/discount in landing and parking charges we've had in place since January 2000. During that time we've also offered a generous rebate to airlines introducing new routes to HKIA.

"We've decided to extend the reduction until the end of the year, but it's too early to say what will happen after that, as any decision will involve consultation with the airlines. While no one can make any guarantees about the level of airport user charges next year, I can say that we've always had an excellent consultation process in place and that will continue.

"Our airport user charges are fair, transparent, based on the user-pays principle and offer value for money. We operate the airport in a commercially prudent manner and are investing in services and facilities that generate economic activity for the airport and wider community."

Major developments at HKIA

- *In October, the Hong Kong Airport Authority announced that it had awarded the concession for its new express cargo terminal to DHL International. A franchise proposal was presented to the Airport Authority board in August.*

- *A major logistics centre is under construction at the airport. The facility, being built and operated by a consortium of Asian and European partners, Tradeport Hong Kong Ltd, is scheduled to open next year and create 1,000 new jobs and generate HK$10 billion (US1.3 billion) in economic benefits over 25 years.*
  The three-storey centre will have a total floor area of 28,200 sq metres. It will supply a wide range of logistics and chain management services including inventory/stock management, supply, distribution, support services, shipment/transportation, strategic storage for Just-In-Time deliveries and specialist cargo handling. Potential commodities include high value products like aircraft parts, perishables and animals.

- *The Airport Authority and the Hong Kong Special Administrative Region (SAR) Government have invited expressions of interest for the development of an international exhibition centre at the airport. It is to be built on a 17-hectare waterfront site on the northeast corner of the airport island. It is scheduled to open in 2005.*
  The centre will be a key development in the first phase of SkyCity, a 57-hectare commercial complex being developed by the Airport Authority. It is expected to have about 100,000 sq. metres of floor space and host major international boat and car shows and other trade fairs. It also will host sports events and concerts.
  The SAR Government has said it is prepared to invest up to HK$2 billion (US$260 million) in the project.

Macau carving out a niche role

Airport chief sets a goal to attract North American airlines to the 'Las Vegas of the East'

Five centuries after Portuguese mariner-merchants made Macau a gateway to China from the West, the small territory's airport similarly sees itself as a link between mainland China and Europe, as well as the world's other Portuguese-speaking countries.

As important as that "bridge" role is for Joao Manuel de Sousa Moreira, chairman of CAM Macau International Airport Company, the airport also has a greater symbolism. "For me the most important role of Macau's airport is as a guarantee of the autonomy and identity of Macau for the future in the system, one country, two systems (like Hong Kong, Macau has reverted to Chinese sovereignty, but retains its own administration)," he told *Orient Aviation*. "The airport creates the condition for us to be independent in the aviation sense."

Although transplanted from Portugal (he has also worked in Africa), Sousa Moreira is a big Macau-booster, clearly proud of his adopted home. "Macau is small, but we have all the conditions to be a link between Europe and Asia. We have service, logistics, banks, Internet, telecommunications and we have the skills to make the connections especially with the Pearl River Delta, the world's fastest-growing economic region."

Since he presided over the opening of Macau's 24-hour airport in 1995, Sousa Moreira has seen a steady increase in passenger traffic and cargo. The airport, which can handle six million passengers a year, processed 3.8 million last year, with numbers climbing about 15% annually.

In July, passenger traffic hit a monthly high of nearly 390,000, with the daily average up 20% since 2001 (from 10,000 a day to 12,000).

There are five airports in the booming Pearl River Delta, dominated by Hong Kong International Airport, just 60 km to the east. Sousa Moreira takes a realistic view of his own airport's role. "I am not in competition with Hong Kong, that's clear," he said. "I want to have a niche market, to be complementary to Hong Kong."

Joao Manuel de Sousa Moreira, chairman of CAM Macau International Airport Company: the airport is marketing itself as an alternative to the region's congested airports

He said Macau could carve out enough of a niche market to act as a smaller Asian hub, with good distribution provided by Air Macau, a road network into southern China and a railroad link to Guangzhou planned for the future. Indeed, the airport is marketing itself as "an alternative to the region's increasingly congested airports." Or, as Sousa Moreira puts it, "small is beautiful".

The airports in the Pearl River Delta are increasing co-operation with one another, with a high-level A5 Forum and lower-level task forces. The idea of the A5 Forum is "to create synergy among the five airports," Sousa Moreira said. "Of course each must continue to defend and protect their own market, but we can co-operate in the promotion of the Pearl River Delta around the world, in human resources, in IT systems for the five airports. We can co-operate in air control systems, in the training of the personnel and most importantly we can co-operate in an emergency."

Just in case this picture of co-operation sounds too rosy, Sousa Moreira laughed and added: "This doesn't mean I am going to give them my market or they are going to give me their market."

One of the brightest spots in Macau International Airport's growth is cargo traffic (see separate story), which has tripled since 1996 and was up more than 40% in July this year over July 2001. Sousa Moreira recognises growth will slow because, as he puts it, "trees don't grow to the sky". A steady growth rate

Air Macau: intent on securing 10% of the air cargo market in the Pearl River Delta

of five or six percent a year is realistic, he said. A planned logistics park connected to the airport is also intended to foster growth of cargo traffic.

On the passenger side, a big shadow over the airport's future is the possibility that direct flights will be permitted between Taiwan and mainland China. Now travellers to and from Taiwan have to transit through Hong Kong or Macau. While Hong Kong gets a larger absolute number of these travellers, this traffic makes up a whopping 30% to 40% of passengers passing through Macau International Airport.

Although there are no clear plans for direct flights that would end the Taiwan traffic, Sousa Moreira is taking steps to try to cultivate replacement traffic. The answer is more destinations for airlines that already fly into Macau and attracting new airlines. One success is that Singapore's SilkAir began serving Macau in July.

Next year Sousa Moreira will begin discussions with U.S. and Canadian airlines aimed at attracting one or two new carriers by 2005. Now that Macau is part of China, negotiations should be easier, he said. Discussions with American and Canadian airlines in 1997 foundered over the airlines' desire to have any flights to Macau include a stopover in mainland China – an issue that is no longer a deal-breaker.

To sell American and Canadian airlines on Macau flights, Sousa Moreira said he would have to do a lot of promotion of Macau itself and not just the airport's facilities. "What I am going to tell them is we have the skills, we have a safe and secure airport and we have the opportunity to facilitate travels within Asia, we have gambling, we will have Disneyland near Macau in Hong Kong.

"In Macau we have weeks of East-West culture, we have facilities for families, we have golf. Macau in total is a resort. If people want to stay in Asia in Europe they come to Macau, if they want to stay in Europe in Asia they come to Macau."

The airport's current facilities can handle six million passengers, with plans to handle 10 million by 2008 or 2010. Future expansion – which will call for the same kind of land reclamation that has already doubled the size of Macau itself – calls for loading air bridges to increase from four to 10 and aircraft stands to rise from 19 to 24. There are also plans to double the size of the cargo centre.

Sousa Moreira admitted that in the beginning he had reservations about how much growth could be achieved with an airport in a territory with fewer than one million residents. Seven years after he took over, though, he is gratified: "It has exceeded my expectations. Macau's airport is a successful operation and is going to continue to be a success for the future." ■

MACAU ACCEPTS CARGO CHALLENGE

The threat of opening direct air links between Taiwan and China has hung over Macau Airport ever since it opened in 1995. Take away the Taiwan and mainland China passenger traffic and there is not a lot left.

But now a new China - Taiwan air services agreement allows for the introduction of cargo flights, cargo is seen as one of the keys to future success and Macau Airport and its airline Air Macau, are starting to tap that potential.

The airport operator, CAM Macau International Airport Company, has said its goal is to claim 10% of the air cargo market in the Pearl River Delta, which is put at three million tonnes a year. In 2000, Macau Airport handled 68,084 tonnes. To snare 10% of the market, with the likes of Hong Kong, Guangzhou and Shenzhen breathing down their necks in the region, is quite a challenge.

For starters, Air Macau has chartered Malaysia's Transmile Air Services to fly a B727 freighter between China, Macau and Taipei. A second aircraft was introduced in October.

Twice-weekly charter flights between Huangshan, in China, and Macau were launched by China Eastern Airlines in August, using a B737-400. ■

Vienna bids to woo back Asian carriers

The 19th-century Austrian statesman, Prince Metternich, once said the Balkans began on Landstrasse-Hauptstrasse, a main Viennese shopping street. It's that proximity to Eastern Europe that Vienna International Airport hopes to capitalise on to carve out a special role as Asia's gateway in the 21st century to Europe – both East and West.

By coincidence, just as Communism was collapsing in Eastern Europe in 1989, the airport embarked on a major expansion that made it an ideal transfer hub in the centre of Europe.

"We feel we were just in time for a new step into the future," says Otto Wiederhold, marketing communication director for Vienna International Airport.

The airport's major tenant, Austrian Airlines, has made it into a major hub for flights from other European points to East European capitals like Warsaw, Prague, Minsk and Sofia. Now the airport wants to ease access to the continent from Asia as well.

The airport plans to restart marketing efforts in Asia that were curtailed after the 1997 financial crisis. Early marketing will be directed primarily at Asian travel agents and tour operators. It will emphasise Vienna's role as a crossroad between East and West, as well as its central position for land travel.

"Tourists from Southeast Asia and Hong Kong travel not just to see one country," Wiederhold said. "There are few airports from which you can reach as many countries as from Vienna. If you put a group of tourists in a coach at Vienna airport, then you can show them Prague, Bruno, Venice, Salzburg, Innsbruck, Verona, Munich, and much more."

As part of any Asian marketing effort, the airport will also try to increase flights to or through Vienna from Asia. (Some important airlines, like Singapore Airlines, have been lost as airlines increasingly rely on alliances rather than offering all routes themselves.)

The airport would also like to woo back Korean Airlines, which dropped Vienna as a destination. "The airport needs long distance flights, and needs Asia," he added, because such flights are more profitable than flights to the United States, for example, where there is more competition. – **Kitty McKinsey** ■

By Tom Ballantyne
in Hong Kong

U.S. airports target Asian cargo traffic

Airport executives across North America are enviously eyeing the speed of air traffic and cargo recovery in Asia and lobbying operators throughout the region to expand their trans-Pacific passenger and freight networks into new destinations in the U.S. and Canada.

Encouraged by strong signs the aviation recovery in the Asia-Pacific is outpacing the return of business elsewhere, dozens of airport marketeers, representing nearly 20 North American airports, descended on the recent air cargo exhibition and forum organised in Hong Kong by The International Air Cargo Association (TIACA).

Held every two years and staged in Asia for the first time in a decade – 3,000 delegates and 250 exhibitors were at the event – the North American airport community took full advantage of the opportunity to launch campaigns targeting Asian airline customers.

China Airlines: a weekly cargo flight to Miami International Airport. The airport is looking to attract other Asian carriers

They are focussing their early attention on cargo traffic, but plan to follow up with marketing efforts directed at attracting passenger flights. Most Asian carriers currently operate into major West Coast gateways such as Los Angeles, San Francisco and Vancouver, or to New York using the polar air routes.

But other airports are pushing hard to lure business away from the traditional hubs, offering lower landing fees and the promise of uncongested skies, with no arrival and departure delays. Leading the charge are major facilities such as Oakland, Miami and Washington Dulles. But other centres are not far behind. They include Dallas Fort Worth, Calgary, Houston, Memphis, St. Louis, Pittsburgh, Nashville, Kansas City and Denver.

At least two airports – Oakland and Miami – are confident of capturing Asian business in the near future. Oakland, in particular, believes it has a strong argument to convince Asian airlines they should eschew heavily-congested San Francisco and land across the way at what is already a substantial facility.

Ray Keiser, air cargo consultant for the Port of Oakland, said the airport has "location, location, location" and is "the low cost, delay-free airport" for access to the important U.S. West Coast and Intermountain marketplace.

"It is an ideal gateway and Oakland International is open 24 hours, seven days a week. It has on-site U.S. Customs, refrigerated storage, bonded warehouses, U.S. Customs-certified container freight stations and foreign trade zone status. Best of all for airlines, operating into Oakland means lower costs and greater savings."

Keiser cites landing fees at Oakland of US$1.14 per 1,000 lbs MGLW, compared to $3.986 at nearby San Francisco. "What that translates into for an MD-11F over a year is significant. If you operate one flight a week it will cost you around $25,000 at Oakland, but not far off $80,000 at San Francisco. If you operate three weekly flights it is around $75,000 a year compared to more than $240,000. These are significant savings, a third of the cost of operating into San Francisco – and you can add the money you save because there are no congestion delays on landing or take-off."

Chris Mangos, manager, marketing and trade development at Miami International, believes there is "great potential" to win Asian business, not only as a freight gateway to the U.S. Southeast, but also as a major link in the cargo chain to Latin America, which is heavily served from Miami.

"We realise it is not easy to convince airlines to launch to a new destination, but Miami is an international business centre for the Western hemisphere and a vital hub of trade, commerce and finance for North America, South America, Central America and the Caribbean," he said.

With only one Asian flight currently – a weekly China Airlines freighter from Taipei – Mangos has spoken to a number of other Asian airlines and has been able to "make a strong case for them to at least consider the opportunities at Miami".

Memphis, headquarters of freight giant FedEx – it handles 95% of all cargo at the airport – is also keen to expand its customer base. Presently there is a Northwest Airlines freighter service operated jointly with Japan Air System and Korean Air (KAL) from Asia and airport president and chief executive, Larry Cox, believes there is a good chance KAL might be convinced to operate in its own right.

"Asia is where the growth is going to be and it makes good sense for them to fly to a hub like Memphis, which has everything a cargo operator would want in the way of facilities and distribution. We think our cost structure is very friendly to large airlines," said Cox.

Airports are using every argument they can to convince potential Asian customers to come their way. Kansas City touts itself as having the largest on-airport foreign trade zone site in the U.S. and boasts one of the lowest flight delay records of any airport in the country.

St Louis is building new cargo facilities and, like Kansas City, pushes the point it is centrally located for distribution of freight throughout the U.S.

How many will be successful in talking Asian airlines into launching services – cargo or passenger – remains to be seen. While dramatically lower operating costs through reduced landing, parking and handling fees will be tempting, their biggest hurdle will likely be persuading conservative-minded carriers to abandon traditional ports of entry.

Leading by example

In a fast changing industry ABACUS boss Don Birch throws down the challenges

By Barry Grindrod in Bangkok

ABACUS president and chief executive officer, Don Birch, did not mince his words. He looked the 102 airline delegates from 50 countries attending his company's bi-annual international conference in the eye and asked: "Do you have contingency plans if things go wrong in Iraq, if there is instability in the Middle East? If not, then you should have."

The chief of Asia's own computer reservation system (CRS) company said experience showed organisations that had best survived crises were those which had been prepared and had responded most rapidly to changing circumstances.

And, throwing down the gauntlet, he said following September 11 it was the low-cost airlines which were the first to "step up to adversity". They acted faster than the traditional airlines in winning back passengers.

ABACUS is 65% owned by airlines!

The next day Birch made the same rallying cry to travel agents from 20 countries who were attending the ABACUS "World of Opportunities" themed conference in Bangkok, in September. "Be prepared," he urged and added this included preparing beyond the immediate concerns of the troubled Middle East.

The travel distribution paradigm is changing, said Birch.

Travel agents must transform themselves from being simple cogs in the travel supply chain to creators of both demand and value.

And to the airlines that complain about high CRS fees he said: "It's not just a fee for selling a seat. They must understand why they are using us. It's about adding value.

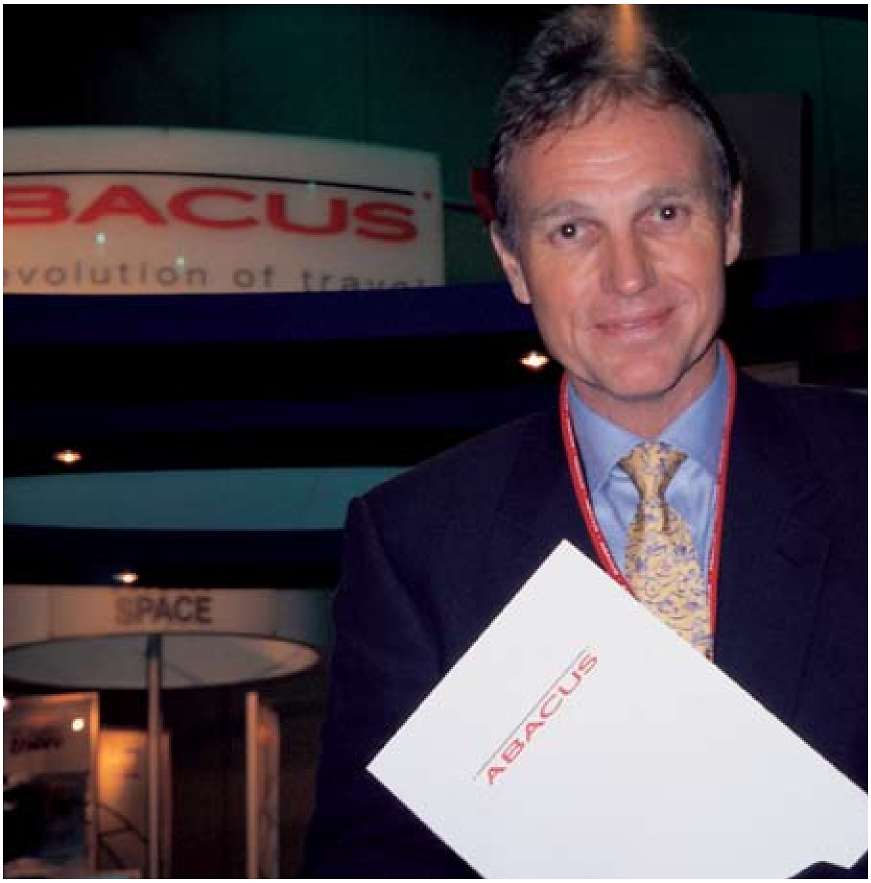
"If an airline is not satisfied, then it should go to the CRS and see what more can be done."

With such straight talking it is easy to see why Birch has made his mark in the short 16 months since he joined ABACUS.

However, when his appointment was announced there were a few raised eyebrows in the industry. Many had expected a Sabre appointee to fill the post as the U.S. controlled company had been exerting increasing influence over ABACUS since it took a 35% stake in the Asian-controlled CRS in 1998, replacing Worldspan as the CRS's partner.

Birch, who cut his teeth on computer reservation systems at Cathay Pacific Airways in the late 1970s, was seen by some as a compromise between Sabre and ABACUS's airline owners.

The new ABACUS boss was just settling his feet under the table when the events of September 11 threw the travel and airline industry into a tailspin.



ABACUS president and CEO Don Birch: change in technology hard to understate

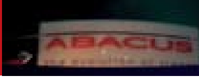
Birch and ABACUS decided to lead by example. With confusion reigning supreme among travellers and with many becoming the non-travelling public overnight, it was decided, through the launch of the ABACUS TravelSmart Asia campaign, to keep people abreast of changes in the travel market and to allow them to make informed choices.

TravelSmart Asia also joined forces with the Association of Asia Pacific Airlines' campaign designed to restore the confidence of airline passengers in flying.

"We have had a whole series of events in the last 30 years which have impacted on travel, but the impact has lessened with each incident as consumers adapt," said Birch.

After the Gulf War it took nine to 10 months for ABACUS's numbers to recover. After September 11 it took only seven weeks, said Birch. At the end of this year ABACUS will show single digit growth, he predicted and added: "This is impressive."

Birch appears to thrive on challenges. He needs to. Technology, the Internet, emerging markets, none more so than China, are posing considerable chal-



lenges for computer reservation system (CRS) and global distribution system (GDS) companies like ABACUS.

After taking on the job, he immediately started introducing new skill sets to the company while warning agents – and his own staff – that times were changing and the travel industry had to adapt or suffer the consequences.

When he arrived at ABACUS Birch found his staff, though confident, to be lacking in marketing skills. So he went out and hired 70 people with new skills "and a raft of experience".

He talks of the need for education, the need for ABACUS to understand its agency community and the need for the agents to understand the changes they face.

To this end Birch has set himself a target of visiting 10 agencies a month – it has 9,000 in 20 countries – and has called on more than 100 of them since he joined the company.

"ABACUS is in the business of distributing seats for its owners and customers and that has not changed," said Birch.

"What has changed is the nature of the equation. It is now not a physical transaction, but a value transaction. It sounds puerile, but when the airlines are saying 'cut your fees' I do not accept that. I say 'you get more value from us and you need to accept that. If you do not we need to have a conversation'.

"In the Asia-Pacific 95% of tickets are sold through travel agents. The Internet has been slow to take off for a number of reasons and given the more complex nature of travel in Asia, we are completely convinced that the travel agent is not going to go away.

"This means that airlines must engage GDSs in order to get their product to market. So just like any business they need to select their suppliers to maximise the service effectiveness they receive from preferred suppliers.

"For example, most companies only deal with two or three banks, because to use more is not efficient and it is unlikely that they will be able to maximise both the service offering and the volume pricing offered by each bank. The same is true for CRS, so from our viewpoint the airline will get more value from their distribution costs if they focus their business with ABACUS and we can better meet their individual needs in each market.

"It is not just segment fees, but a whole menu of different marketing and distribution options. Our pricing schemes already reflect this and will continue to do so next year. We were the only GDS to reduce the segment fee in recognition of the post 9/11 economic problems."

Birch wants to see the airlines step up the pace of e-ticketing and more readily adopt the electronic distribution of so-called net fares.

"The existing paper based system is

(Cont. on next page)

ABACUS AT A GLANCE

ABACUS was established in 1988 by four Asian airlines, Cathay Pacific Airways, Singapore Airlines, Malaysian Airlines and China Airlines. Headquartered in Singapore, and now with offices throughout the Asia-Pacific, the company provides travel information and global distribution systems (GDS) specially tailored for customers in the region.

Today, 11 airlines hold equity in ABACUS International Holdings, which in turn holds a 65% stake in ABACUS International. All Nippon Airways (ANA), EVA Air, Garuda Indonesia, Dragonair, Philippine Airlines, Royal Brunei Airlines and SilkAir have joined the original foursome over the years as partners.

In 1998, Sabre, the largest GDS in the U.S. and a leader in electronic distribution of travel and travel-related services, bought a 35% share in ABACUS.

In 1990, ABACUS and ANA established INFINI, Japan's first full-scale CRS. ANA holds 60% equity and ABACUS 40%. It switched to the ABACUS/Sabre reservations system in 2000.

The CRS has 9,000 agency clients in 20 countries.

BIRCH: the airline man

What ABACUS chief, Don Birch, does not know about airlines is not worth knowing. He spent 25 years with Cathay Pacific Airways' parent company, the Swire Group, of which 21 years were with the airline. He has had extensive experience with computerised reservation systems (CRS) and immediately before joining ABACUS had his own Internet start-up company for hotel reservations in Europe.

All of which makes him ably suited to run one of the world's leading CRS business companies and one that is majority-owned by airlines.

Cambridge educated, in 1972 Birch took the traditional Cathay trainee's route; three month assignments in various departments. His assignments included working on the tarmac loading baggage into aircraft in the summer heat and stints in the catering department and in what was known then as "the complaints department", now part of customer services.

Cathay had just acquired its second B707 when Birch arrived, having previously flown Convairs. It was very much a regional airline in those days and it was not until 1979, when Cathay bought its first widebody aircraft, that the airline started to take off as an international carrier.

After his induction period, Birch moved to Indonesia in 1974 and then on to Japan for almost three years, at a time when Japan's travel boom was just beginning.

He was then called back to Hong Kong on a mission that was to be a pointer to his future. Cathay had written and developed a simple computer reservations system called CPARS (Cathay Pacific Airways Reservations System). The airline then proceeded to sell it to a number of other carriers.

Birch became project manager for converting Cathay's simple, but effective, CPARS system into CUPID (Cathay Univac Passenger Information Distribution).

He then ran the reservations department before becoming chief information officer from 1982-86.

After a time running the airline's subsidiary businesses, Birch joined the marketing department.

He was Cathay's representative in talks with Singapore Airlines, Malaysia Airlines and China Airlines, the first four ABACUS partners, about the new start-up CRS company.

"There was a threat coming from the U.S. in the form of Sabre. The cry was why pay Sabre, let's pay ourselves," he said.

Birch became a Cathay board member in 1990 as director Hong Kong. He later was appointed director customer services before he left the airline to join the parent, Swire Group, in Taiwan.

both inefficient and prone to mistakes at all stages. Travel agents love electronic net fares, because they are guaranteed and airlines should love them because administrative support and follow-up is much reduced. Mostly however, airlines no longer need to pay wholesalers to distribute their fares. The savings can be significant," said the ABACUS president.

"I also would like to see airlines using their selected travel agents more effectively in the distribution process.

"To-day many of the processes are still based upon the manual/telephone/fax environment which can be re-engineered to use the CRS distribution networks and the manpower of travel agents.

"Group handling is a good example. Airline labour is always more expensive than travel agents, so it makes sense to 'out source' these functions to the travel professionals."

"The Internet was seen as the beginning of the end for traditional travel agents, but that has not proved the case. Dotcoms have come and gone, but the agent lives on.

"The first, and possibly the second, wave [of Internet development] has already passed through and a lot of lessons have been learnt – and money lost. Most people now realise the Internet is just another channel and needs to be managed as such.

"The reason why the U.S. has been relatively successful is because there was already a strong culture of dealing directly with the airline or hotel on the telephone with credit cards and the Internet makes this better. In Asia, this is not the case plus all the markets are so different.

"While use of the Internet will slowly build in our part of the world [Asia-Pacific], it will focus mainly upon simple journeys (domestic travel) and special short-term pricing.

"ABACUS is working with travel agents to adapt this new channel as a means of enhancing their traditional role. The best-in-class examples use the Internet very much as a virtual extension of their physical office and we see this as a major part of what happens next. Don't expect the Internet to be more than 3-4% of Asian travel in the medium-term."

Birch said the airline distribution model was changing today. Airlines were hurting financially and were putting the squeeze on travel agent commissions and the fees of CRS companies.

There was a need for agents and CRSs to change their business models, too, he said. They were no longer just suppliers of tickets. They must add value to the customers needs.

Looking to the future, like the rest of the airline and travel industry, ABACUS sees the emergence of China as key to the future growth of the region. In 20 years, outbound traffic from China will be equal in size to whole of the rest of Asia, said Birch. "It will double our business," he said.

Although the door is closed to GDSs, Birch believes this will change in time. Meanwhile, ABACUS sells software to Mainland China and Sabre has its products there, too. Birch makes forays to Beijing and ABACUS invests heavily in *guanxi* [networking] in China.

"China's systems today will not meet the CRS community [needs]. It will have to accommodate new technologies in one form or another at some stage," said Birch.

The recent consolidation of airlines and airports in China will lead to a more commercial view being taken, he said.

India, Vietnam and Indonesia were other markets with great potential, said Birch. He will be on the case. Guaranteed.

Bangkok's 'model' carrier

By Daniel Renford in Bangkok

Bangkok Airways is going from strength to strength, according to Peter Wiesner, the regional carrier's vice-president of marketing.

"We have no frequent flyer programme, we have no alliance and yet we are able to remain profitable," Wiesner told delegates at the ABACUS international conference in Bangkok in October.

Despite 9/11, which sent the global airline industry into a tailspin, Bangkok Airways has proved that expansion in the terrorist aftermath is still possible for the region's independent airlines.

"Bangkok Airways is a real inspiration for us," said Nikos Gitsis, director of the Philippine's recently established independent carrier, South East Asian Airlines. "It's a model for other independent carriers like us in this region."

The carrier became Thailand's first privately owned airline in 1986. Today, Bangkok Airways serves all Thailand's major resort destinations and flies to Cambodia, Laos, China and Singapore with a fleet of two Boeing 717-200 twin-jets, seven ATR72-200s and one ATR72-500.

Among a number of factors to which Wiesner attributes the airline's success is its ability to fill niche markets such as Siem Reap, in Cambodia and Koh Samui, in Thailand, "a good balance of interline and own sales" and its comprehensive distribution network with major GDS

Bangkok Airways: 95% of the airline's passengers are foreigners

(global distribution system) providers.

"Since 95% of our customers are foreigners, cementing good relationships with GDS providers has been very important to our position in the region," he said, and added the airline was not in the business of competing "head on" with the major carriers. "That's not to say we have not suffered the affects of 9/11. We had to postpone additional aircraft deliveries and are prepared to do whatever is needed [to survive]."

However, two additional ATR72-500s will join the fleet by March.

While the region kicks its heels about the implementation of e-ticketing, Bangkok Airways is forging ahead with a strategy to implement full-scale e-ticketing on all its routes.

The carrier has launched e-ticketing on its Bangkok-Samui route and plans to establish e-ticketing for all Thai tickets by the end of 2003. As e-ticketing becomes the norm, the airline will start charging for any physical tickets issued, said Wiesman.

"Today, we are selling to 1% of our passengers via the Internet. Even though we are a small airline, we have been very successful on the electronic side."

Wiesner said e-ticketing increased savings, particularly on high volume routes. He added he expected the airline to save in the region of US$10 to $12 per ticket by going electronic.

Despite a volatile start to the year, Wiesman said the airline had achieved a "very good increase in revenue" for the first five months. By year-end, the airline was projecting 1.3 million passengers, up from around 1 million in 2001, and 4.2 billion baht (US$100 million) in revenue.

Owner of Sukhothai and Koh Samui airports, Bangkok Airways also has invested US$12 million in building an airport at Trad, only kilometres from the boat pier to Koh Chang, Thailand's "Phuket of the East".

With the new airport scheduled to open in November, it is not yet known what pricing strategy Bangkok Airways will use to recoup its investment, but sources hinted it would be similar to Koh Samui airport, where high landing fees have discouraged other carriers.

Earlier this year, Bangkok Airways announced plans for regional investment at secondary airports in Cambodia, Laos and Myanmar. Siem Reap, Luang Prabang and Bagan are expected to be the first to be developed, with other facilities planned to follow them as the carrier expands its route network in Southeast Asia.

Air Andaman set to expand

Air Andaman, which bills itself as Thailand's low-cost carrier, entered a code-sharing arrangement with Cambodia's Mekong Airlines in September on the Bangkok-Siem Reap route, writes Daniel Redford.

Under the agreement, Air Andaman is to lease one of its Fokker F50 aircraft to Mekong Airlines, which will then make half the seats available to Air Andaman.

Air Andaman began its operations in February this year with two BAe Jetstream 31 aircraft.

It added three 50-seater Fokker 50 aircraft to its fleet after forming an alliance with Thai Airways International (THAI), when it took over some of the national carrier's least profitable domestic routes.

Since it's launch, Air Andaman has expanded its network to serve 12 destinations in Thailand and operates 20 daily flights.

The domestic carrier also provides charter services to destinations in Thailand and Southeast Asia using its Jetstream 31 or Fokker 50 aircraft.

According to Shane Chumintarachak, the airline's marketing director, plans are afoot to add two Fokker aircraft to its fleet before year's end to fly new domestic services to Surin and Loei.

He said the carrier was considering links with Langkawi in Malaysia, Laos, and Kunming in southern China, but said no definite plans for these routes had been drawn up yet.

LEASING

Vulnerable

Lessors with portfolios dominated by less popular aircraft risk falling by the wayside, say industry leaders

By Tom Ballantyne

The leasing market, according to Robert J. Genise, president and chief executive officer of lessor Boullioun Aviation Services, has been "challenging, to say the least". His comment comes as an understatement in a year when the aviation industry was shaken to its core by the events of September 11 in the U.S.

Genise suggested some lessors may face more than challenging times. "At Boullioun we have always believed it takes three things to succeed in the leasing business: people, planes and funding. Lessors with the requisite combination of these three qualities are managing successfully through the worst industry downturn in history and are likely to emerge with their relative competitive positions enhanced.

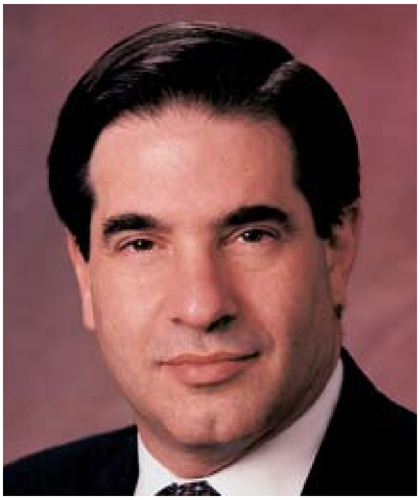
"Lessors with older portfolios or portfolios dominated by significant concentrations of less popular aircraft are continuing to experience difficulties. Lessors without all three of the requisite success qualities are increasingly vulnerable to falling by the wayside."

These sentiments are endorsed by major players in the leasing market like Ansett Worldwide, International Lease Finance Corporation (ILFC) and GECAS.

Harry Forsyth, Ansett Worldwide's vice-president marketing said success is not only about providing outstanding asset management skills supported by strong technical and operation experience. Success, he said, is to go a step further, to think long-term and to concentrate on building customer loyalty.

Everyone agreed the industry has had a difficult 12 months, but there is unanimity that recovery is on the way. Forsyth said Ansett Worldwide's September industry overview showed there had been 40 commercial aircraft leases announced in July, a 29% increase over the same month a year ago.

"Year-to-date, there have been 341 commercial aircraft leases compared to 273 in the same period last year. We expect the number of lease transactions to closely follow the seasonal pattern for the remainder of the year, which is a traditional summer lull followed by a ramp-up in preparation for Northern Summer 2003," said Forsyth.



Robert J. Genise, president and chief executive officer Boullioun Aviation Services: remained profitable during the downturn

Both Genise and Forsyth said lease rates have declined during the current downturn although the impact has been blunted by lower interest rates for the U.S. dollar. "We've certainly worked harder to keep our aircraft busy," said the Boullioun chief. "Despite this we have remained solidly profitable amid the airline industry's worst ever downturn."

Leasing companies with solid corporate parents – in the case of Boullioun, German banker WestLB and with Ansett, owner Morgan Stanley – are weathering the turbulence well. Along with the big two, ILFC and GECAS, they are doing surprising business.

Ansett Worldwide, with a US$5 billion portfolio of 176 aircraft with 73 airlines in 44 countries, has written business this year with airlines in Hawaii, Slovakia, Egypt, Tunisia and Majorca as well as several in Asia. It provided a B767-300 to Air Niugini, a B767-300ER to Vietnam Airlines (the second of the type provided by Ansett Worldwide for the carrier's six strong B767 fleet) and extended a lease on a B737-300 with China's Shenzhen Airlines.

ILFC, which owns a portfolio of 600 plus jet aircraft valued at more than $26 billion, has completed lease transactions for more than 130 jets this year, includ-

SPECIAL REPORT

ing a number in the Asia-Pacific. These involved an A340-300 for Air Tahiti Nui, an A310-300 for Air India, two B737-300s for Malaysian low-cost operator AirAsia, two B777-200ERs for Vietnam Airlines and four B737-700s for China's Xiamen Airlines.

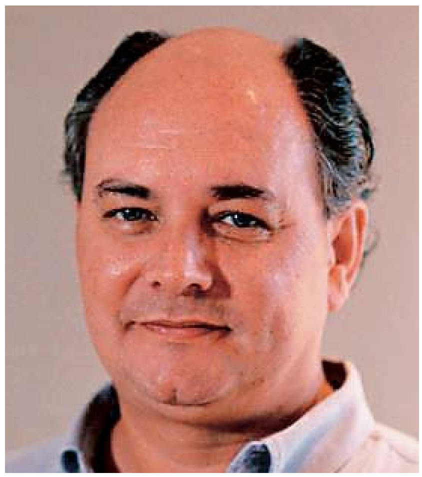
GECAS, which owns about 1,000 aircraft and manages 300 others, has signed a deal to handle the lease for five of 15 A320s ordered by Air New Zealand and may capture some of the others when arrangements are finalised. It has also completed a leasing arrangement for three engines for Asiana Airlines.

Among aircraft placed in Asia by Boullioun are a B737-800 to China's Hainan Airlines, a B737-700 on a long-term lease to Shanghai-based China Eastern Airlines and four new B737-700s to Australia's Virgin Blue. It also announced a medium-term lease of four B737-300 aircraft to prominent, UK-based low-cost carrier GO, including one aircraft placed on behalf of a Japanese investor.

Together, Boullioun and its partner, Singapore Aircraft Lease Enterprise (S.A.L.E.), have a portfolio of 124 jets worth $3 billion with 50 customers.

Despite this good flow of business, all lessors and their customers are nervous about the global political front. Forsyth said the world economy remained "on a nervous footing with mounting fears of a war with Iraq and continued weakness in American consumer spending and manufacturing output".

"World stock markets are already beginning to 'price-in' a war with Iraq, with major losses being registered amongst all the major bourses in Asia, Europe and North America," he said. "The money markets also are factoring in a slowdown in economic growth, with interest rate swap curves tightening significantly from May this year. In fact, some commentators are now advocating a softening of U.S. monetary policy given current stagnant consumer spending.



Harry Forsyth, vice-president marketing Ansett Worldwide: lessors and airlines nervous about potential war in Iraq and state of U.S. economy

"A U.S.-led invasion of Iraq would potentially be very damaging to both a struggling global economy and the global aviation industry," said Forsyth.

Genise agreed military and political turbulence in the Middle East is likely to dampen market demand for aircraft. "We also believe there will be continuing demand for sale-and-leaseback transactions that assist airlines in generating liquidity and managing their fleets optimally. We expect the market for the A320 family, B737 Next Generation and recent vintage B737 Classic models to continue to improve," he said.

"We anticipate continuing problems in the U.S. market are likely to mean lease rates for older aircraft — meaning 1990 vintage or older — will remain weak into 2003. In addition, the market for less popular types such as the MD-80, the Fokker 100, the Boeing 757 and Airbus A300 models will remain depressed.

"Traditionally, leasing has been more attractive to smaller airlines that have fewer financial resources, corresponding lower credit ratings and less access to capital. But today, even the majors are recognising that leasing is a valuable tool for airlines seeking to manage their fleets in an increasingly liberalised, competitive and cyclical environment."■

Nervous times for investors

By Tom Ballantyne

While aircraft leasing companies have moved quickly in adjusting their strategies to meet new market conditions post 9/11, often benefiting from airline moves to rationalise and economise by leasing instead of purchasing, the changed environment has made investors in aircraft nervous.

How nervous? International Aircraft Investors (IAI) is a stock exchange listed, U.S.-based investor group, which is an owner/lessor of used, single-aisle jet aircraft on lease to U.S. domestic and foreign airlines.

It currently leases planes to carriers in North America, Central America, Europe, Asia and the South Pacific. IAI's lease portfolio consists of 15 aircraft with a book value of US$238.3 million and one aircraft under a financing lease with a net investment of US$15.7 million.

Its latest financial analysis shows that in the six months to June 30 this year, total revenue decreased to US$14.8 million, from US$19.7 million in the same period in 2001. IAI suffered a net loss in the period of US$1.5 million, compared to a profit of US$174,000 for the same trading months last year.

"The downturn in the economy continues to severely affect the aviation market," said chairman William Lindsey. "Five of IAI's lessees filed for bankruptcy during 2001 and 2002. Two of the aircraft were repossessed and lease terms on the remaining aircraft had to be renegotiated at substantially lower lease rates. We look for a continuation of the difficult operating market through 2003."

What happened to IAI is typical. It had a B757-200ER repossessed and sitting on the ground, earning no rent for two months until it was leased to Las Vegas operator, National Airlines.

Also, the company had to settle for less income on airplanes already in service which had lease contracts scheduled for renewal. These included a three-year lease extension on one of IAI's B737-300 aircraft to Southwest Airlines until December 2005 and a one year lease extension on an IAI owned B737-400 aircraft to South Korea's Asiana Airlines until January 2004.

In April, a B737-200 was returned by Air New Zealand when the lease expired. In June, another B737-200 was sent back by Panama's COPA airline.

Revenue from plane rental decreased by 23%, or $2.1 million, to $7.1 million in the three months ended June 30 alone.

During that quarter, said Lindsey, depreciation decreased to $4.2 million, from $4.4 million in the same period in 2001. The write-downs were based on the values of the aircraft in both a slowing global economy and airline traffic in the last 12 months.■

Low interest rates make leasing an attractive proposition for airlines, meanwhile ...

S.A.L.E eyeing freighter market

By Tom Ballantyne

Having a successful year in the midst of the worst downturn in aviation history was no accident, according to Robert Martin, managing director of Asia's home-grown aircraft leasing firm, Singapore Aircraft Leasing Enterprise (S.A.L.E.).

"There were a few things we put in place which, in hindsight, were exactly the right things to do," he said.

Foremost among those was a strategy aimed at pinning down lease deals that, on average, are far longer term than those pursued by most competitors. "These long-term leases provided us with good revenue throughout the downturn and we had only two situations where we needed to transition aircraft on an unscheduled basis. One was Sabena and the other Ansett," said Martin.

"During such a downturn you have to accept that. With the rest of the portfolio, the longer term means you are not transitioning a large portion of your portfolio and for that reason we have been holding up reasonably well."

Speaking from Dublin in the midst of a month-long business foray through Europe, the Middle East and North America, Martin has plenty of reason for satisfaction.

In 2001-2002, S.A.L.E. recorded its eighth year of consecutive growth, with revenue up 13%, to US$155.6 million, and profit before tax improved by 14.8%, to US$47.5 million.

During the current financial year there is bound to be "some impact" from lower lease rates now prevailing in the market and the overall trading environment for airlines, said Martin. However, he remains bullish about prospects and despite ongoing concerns, business has been far from slow.

In August, S.A.L.E. entered agreements with Brazilian carrier, TAM Linhas Aereas, covering the lease of two new A320 aircraft and in October the lessor took delivery of the last of six B777s ordered from Boeing. The aircraft

Robert Martin, managing director of Singapore Aircraft Leasing Enterprise: many more airlines want purchase lease-back deals on aircraft

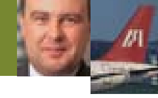
is being leased to Dubai-based Emirates Airline on a 10-year term.

Martin said the company had financed two B777-300s, one B747-400 freighter and one A320 since the start of its current fiscal year [in April]. "S.A.L.E. has raised US$355 million in the first half of the year, reflecting our strong relationship with leading banks worldwide and our ongoing ability to attract new lenders," he said.

He is convinced it is not only a great time to be in the leasing business, but an ideal period for airlines to lease jets. Interest rates are at their lowest levels since the 1950s, a bonus for both supplier and customer, he argued. "This is important for customers because, frankly, now is a great time to fix in their long-term interest rates. But on the cost side of our business interest rates are much lower and to a certain extent that has cushioned the impact of the reduction in interest rates on the revenue side," said Martin.

"You have to look at both sides of the equation, the cost side as well as the revenue side. We are a growing company and we are spreading our fixed costs across a greater number of assets, so the fixed cost per aircraft is reducing."

Along with other leasing companies, S.A.L.E. is tapping into new business that would normally go elsewhere. Many airlines are opting for lease ar-



rangements instead of outright purchase because of the attractive rates available in the current market.

"A lot more airlines want purchase lease-back on delivery of aircraft. This is because while the leasing market has had its issues, at the same time the banking market has much greater issues. I've been meeting a number of banks in Europe and they had aircraft returned from the likes of Ansett, Sabena and Swissair. They have still got aircraft on the ground from a year ago," said Martin.

Faced with grounded assets and the prospect of zero return from unsecured debt in collapsed airlines, banks are being cautious, reluctant to provide further unsecured debt to the industry. "The flip side of that is you are seeing ourselves and some of our larger competitors stepping into this area where the banks would have been," said the S.A.L.E. chief.

Earlier this year S.A.L.E. signed a 12-year purchase lease-back deal with Korea's Asiana Airlines for a B747 freighter and Martin is currently in talks with a number of European operators for similar agreements. One is oneworld alliance partner Finnair. "Usually, Finnair would not do this sort of business. However, because of the market situation post 9/11 they are looking to find different funding sources."

With the last of its B777 firm order delivered and 31 of the A320 family to be delivered through to 2008, Martin said S.A.L.E will be looking at replenishing its order book. "We will start off looking at narrowbodies. We will probably review the wide-bodies at a later date.

"In the meantime, I intend to focus much more on the purchase and lease-back market for wide-bodies. We perceive there are not many players in that market and there is a lot of opportunity to help airlines at this point."

The freighter market also is in Martin's sights. He described it as "going gangbusters". "We are absolutely in the freighter market. It is a leading indicator of where the market is going. We see opportunities and we will take advantage of that."

As for the future, Martin believed the fundamentals are in place for recovery. "Interest rates are at cyclical lows. The freight market is coming back, particularly here in Asia. U.S. domestic growth is beginning to show some signs of picking up. Some people think stock markets are near the bottom," he said.

The industry has three fears, according to Martin. "The first is what happens if Bush moves into Iraq. People say it is 70% likely to happen, probably around January. Next, what happens if United Airlines falls into Chapter 11. United is one airline in the world that nearly every bank, the capital market and manufacturers are exposed to. That would cause negative vibes. Thirdly, oil prices. But unlike the Gulf War, Saudi Arabia is no longer the world's largest producer of oil. Russia is. So we are not so reliant on Saudi Arabia as we were previously.

"I believe short-term there is going to be some uncertainty until we get the Iraq situation out of the way. There are some lingering fears in the U.S. about terrorism, but then again those of us who have lived in Asia and Europe for the last 20 years have had that already.

"So I think the pick-up will happen quite quickly once we have got Iraq out of the way. There is quite a lot of pent-up demand waiting for this situation to clear itself, perhaps in the second half of next year and into 2004.

"That's the way we have positioned ourselves in terms of deliveries. Our deliveries will begin to pick up again in 2004 and if we place a new order we would look at deliveries in 2005-2006."

SALE is jointly owned by Singapore Airlines (35.5%), U.S. based Boullioun Aviation Services (35.5%), Temasek Holdings (14.5%) and the Government of Singapore Investment Corporation (GIC) (14.5%).

The company has offices in Singapore, London, and Washington D.C., San Diego and California in the U.S. It has a portfolio of 44 aircraft.

Indian Airlines leases ATRs

There is plenty of anecdotal evidence that airlines are reaping cash benefits from a drop in leasing prices over the past year after they rationalised routes and fleets to cope with dwindling traffic, pushing surplus capacity into the market, **writes Tom Ballantyne**. And this is not only in the big jet end of the business.

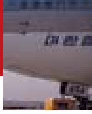
One carrier that has moved to take advantage of the new market conditions and save several million dollars in the process is Indian Airlines (IA). Locked in tough competition on Indian domestic regional routes with private rivals, Jet Airways and Air Sahara, IA is snapping up four 50-seater ATR-320s from Franco-Italian planemaker, Avions de Transport Regional (ATR). The monthly lease price is around US$70,000, a sharp reduction on the $100,000 asking price a year ago.

Insiders said that will save the carrier some $7.5 million over the next five years. Two of the airplanes are expected to arrive in December and the others early next year. They will operate under the banner of IA's low-cost subsidiary, Alliance Air, and be based in northeast India at Kolkata. It is understood IA has been studying leasing ATRs for some time, but held back until the economic climate improved.

While the cheaper leasing arrangement will help government-owned IA better compete with Jet and Sahara it will still need to look seriously at further modernisation and expansion of its domestic fleet.

Indian Airlines: leased ATRs as competition with private operators intensifies

Jet leases the larger 62-seater ATR-72 and has foreshadowed plans to switch to the bigger and faster Brazilian manufactured Embraer regional jet in 2004. Before the end of this year, Air Sahara will introduce leased 50-seater Canadian Bombardier CRJ-200 jets and hopes to have 10 in operation, in a comprehensive short-haul network, before the middle of 2003.



KAL cashing in from Skyteam

By Daniel Baron in Atlanta

At a recent SkyTeam seminar for media and analysts, the underlying theme was synergy with stability. Repre sentatives from the alliance argued the case of superiority through anti-trust immunity agreements (ATI) and reliance on hubs in times of crisis.

Said Paul Matsen, senior vice-president international and alliances at Delta Air: "As the only alliance with ATI in both the Atlantic and Pacific markets we can deliver on price and schedule and realise greater benefits than competing groups."

SkyTeam members Air France, Alitalia, Delta Air and Czech Airlines were granted ATI in January 2002. Korean Air (KAL) was added in June last year.

Revenue gains through ATI, said Delta, would be realised via joint bidding for large tour groups, joint corporate contracts, inventory and fare synchronisation and improved network connectivity.

Delta's massive operation in Atlanta has been key to the growth of SkyTeam. The carrier offers over 900 daily departures from the megahub.

On the other side of the Atlantic, Paris Charles de Gaulle airport provides similar benefits to Air France.

SkyTeam partners benefiting from anti-trust immunity agreements

Important to SkyTeam members has been the ability to leverage the hubs in times of crisis. Pierre-Henri Gourgeon, Air France president and chief executive officer, told how the alliance served as a cushion after the U.S. terrorist attacks. "With the code-shares between our hubs we were able to reduce capacity while keeping a market presence. There was no change in the number of destinations sold by Air France," said Gourgeon.

KAL, SkyTeam's only member in Asia, is reaping the rewards of ATI as well as from reinstated code-shares with Air France and Delta this year. Following a series of KAL accidents, Delta and Air France cancelled code-shares with the carrier in 1999.

KAL has earned an additional US$1.5 million per month since Delta resumed code-sharing in May, with approximately 30,000 passengers coming from the U.S. carrier. Approximately 8,000 Air France passengers have flown with KAL since their code-share was restored in April. "We expect to earn about US$2.6 million per year from this arrangement," said KAL public relations manager Crimson Lee.

One weak link in SkyTeam's network is lack of service between the United States and Tokyo. In 2001, Delta withdrew almost completely from the Japanese market, leaving a single daily service between Narita and Atlanta. For its part, KAL serves Los Angeles from Narita. SkyTeam is no doubt hoping to fill the gap with Northwest Airlines and Continental Airlines, which are hoping to forge a marketing agreement with Delta and possibly alliance membership.

Southeast Asia also remains underserved by SkyTeam. Delta has alluded to its interest in Thai Airways International (THAI), although THAI has gone on record as being committed to maintaining membership in Star Alliance.

CHINA IN BRIEF

NEW SYSTEM SPEEDS BEIJING CLEARANCE

An advanced, automated express parcel examination system, officially launched at Beijing Capital International Airport in September, has cut customs checking and passing down to two hours, half the previous time taken. An increase in international traffic has led to rapid growth in express cargo import and export figures, which are up 10% annually.

The new system, introduced to meet increasing demand, checks 1,080 parcels an hour.

FIRST BULLETPROOF DOOR FITTED

The first bullet proof cockpit door in China was installed by Guangzhou Aircraft Maintenance Engineering Company (GAMECO) on a Zhejiang Airlines A320 in September, in response to the CAAC's new regulation that requires them on all fixed-wing airplanes weighing at least 5,700kg.

The doors, now part of FAA and JAA regulations, can be modified temporarily, with an inside lock fitted, before a permanent change is made. The CAAC's Airworthiness Department has set a deadline for all final modifications to be completed by the end of next year.

SHANGHAI AIRLINES JOINS THE TOP 500

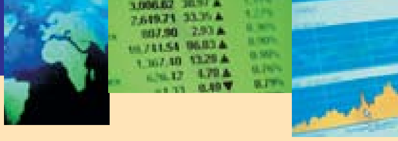
Shanghai Airlines, which had a turnover of 3.04 billion yuan in 2001, became the first local Chinese airline to join the China's 500 top enterprises, when it was rated 352nd in the 2002 list. The airline carried 3.32 million passengers and one million tonnes of cargo and mail in 2001. Its total transportation turnover reached 505.9 million tonne-kilometres, another first for a local airline.

THE BIGGEST HANGAR IN THE WEST

China Southwest Airlines has invested 30 million yuan (US$3.66 million) in building the biggest and the best-equipped hangar in the west of China. With a total area of 21,990 sq metres, the hangar, built at Southwest's Chengdu base, is able to take three narrow-body aircraft. It started operation in October.

FIRST NEW YORK NON-STOP FOR AIR CHINA

Air China's Flight CA981, which landed at New York's Kennedy International airport on September 27, marked the first non-stop flight by a Chinese mainland airline to the city. The journey, via the Polar route, took 13 hours.



JULY 2002 STATISTICS

JAPAN CLOUDS ROSY PIC-

Compiled and presented by Kris Lim of the Research and Statistics Department of the Association of Asia Pacific Airlines Secretariat

In July, the Association of Asia Pacific Airlines (AAPA) members' international passenger traffic, measured in revenue passenger kilometres (RPKs), grew by 2.3% compared to the same month in 2001. The number of passengers carried (PAX) increased by 3.5%.

Capacity (2.3%) rose for the first time since August last year. Load factor was unchanged at 76.6%. The numbers were partly influenced by Cathay Pacific Airways' (CX) traffic figures, which were distorted by the combined effect of Typhoon Utor and Hong Kong Aircrew Officers Association's industrial action that impacted on the airline's operations in July 2001.

If the Cathay Pacific Airways figures are removed, RPKs contracted 0.5% and PAX rose 0.5%. Capacity was up 1.6%, leading to a decline in load factor of 1.6 percentage points, to 76.9%.

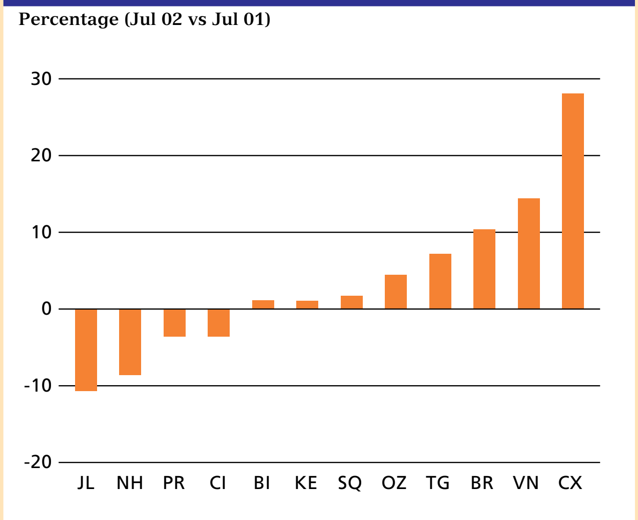
However, the overall result was masked by the persistent traffic declines of the two Japanese carriers, Japan Airlines (JL) and All Nippon Airways (NH). The majority of the carriers reported a very encouraging increase in traffic – Vietnam Airlines (VN: 14.6%) reported its fifth consecutive month of double-digit growth while EVA Air (BR: 10.4%) posted its first double-digit rise this year after averaging 4.8% growth in the first six months.

EVA Air: averaged 4.8% passenger growth in the first six months of 2002

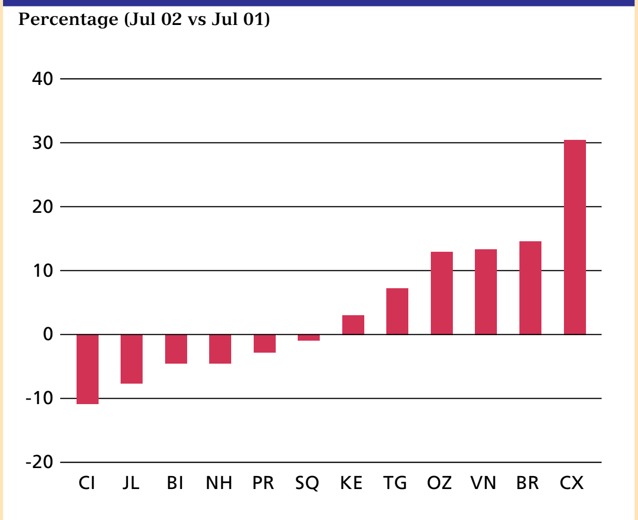
In addition, Thai Airways International (TG) recorded its sixth straight month of positive RPK growth, with a 7.2% increase in July. Asiana Airlines (OZ: 4.5%) experienced its seventh straight month of expansion, but rival Korean Air's (KE) RPK growth slowed somewhat.

Among the carriers to boost capacity in July, only Cathay Pacific Airways (12.6 percentage points) and EVA Air (4.1 per-

RPK GROWTH BY CARRIER



PAX GROWTH BY CARRIER




Thai Airways International: six straight months of RPK growth

centage points) reported an improvement in load factor (PLF). As a result, the two carriers had the highest PLFs for July – EVA Air (83.3%) and Cathay Pacific Airways (82.0%). The remaining airlines managed to fill 70% or more of their seats despite experiencing moderate declines in load factor.

CARGO

AAPA member airlines continued to experience strong growth in freight traffic in July. Freight tonne kilometres (FTKs) grew 19.5% year-on-year. Capacity rose 8.8%, which resulted in a 6.3 percentage point improvement in load factor, to 68.2%. The figures were also partly distorted by Cathay Pacific Airways' 46.1% year-on-year increase in FTKs. Removing Cathay Pacific from the equation, overall FTK growth was still an equally impressive 16.4%.

Four other carriers reported more than a 20% increase in FTKs over July 2001 – Royal Brunei Airlines (BI: 38.4%), EVA Air (28.7%), Vietnam Airlines (27.9%) and Asiana Airlines (20.2%). Philippine Airlines (PR), however, had only a marginal increase in FTKs.

With the exception of Korean Air, all carriers posted an improvement in load factor. Royal Brunei Airlines emerged with the biggest improvement (14.6 percentage points). Asiana Airlines (79.4%) had the best load factor among all the AAPA carriers, followed by China Airlines (CI: 78.5%), EVA Air (76.9%), Korean Air (73.9%) and Cathay Pacific Airways (71.8%). The remaining carriers registered a load factor below the 70% mark.

RESULTS OF THE 12 MONTHS TO JULY 31, 2002

PASSENGER

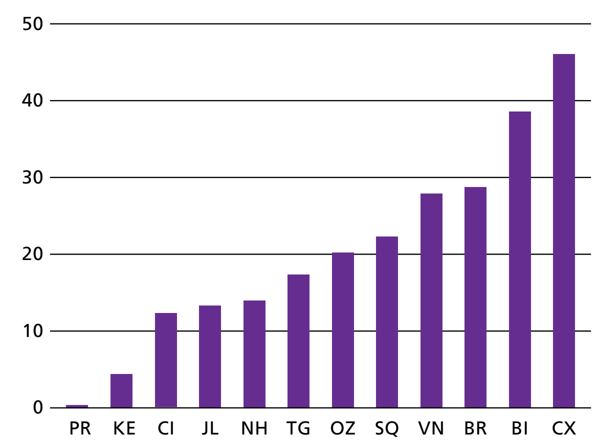
AAPA consolidated international RPKs and PAX for the 12-month period under review contracted by 5.9% and 2.4% respectively. Capacity declined by 3.5%, which resulted in a load factor of 72.4%, down 1.8 percentage points.

CARGO

Consolidated AAPA international FTKs for the 12-month period grew by 2.2%. Capacity was down 0.3%, which produced a load factor of 67.4%, up by 1.6 percentage points.

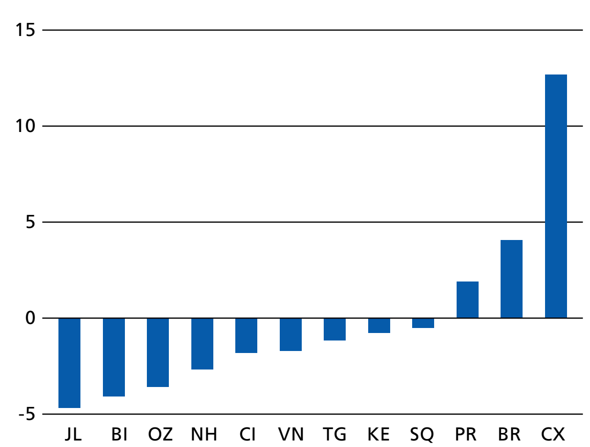
FTK GROWTH BY CARRIER

Percentage (Jul 02 vs Jul 01)



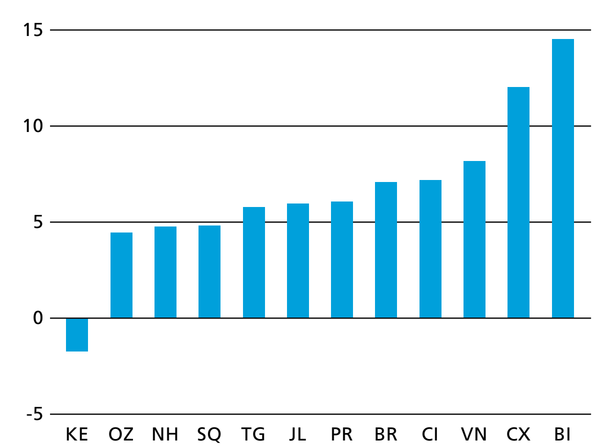
PASSENGER LOAD FACTOR GROWTH BY CARRIER

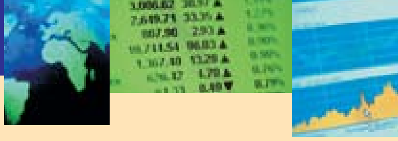
Percentage Points Change (Jul 02 vs Jul 01)



FREIGHT LOAD FACTOR GROWTH BY CARRIER

Percentage Points Change (Jul 02 vs Jul 01)





SUMMARY

The fact the AAPA consolidated international passenger traffic results drifted between moderate positive and negative growth for the past few months was mainly due to the results of the two Japanese carriers. Closer examination reveals individual carriers – other than Japan Airlines and All Nippon Airways – have shown marked improvement since January this year.

The majority of the carriers have surpassed the traffic levels achieved during the first seven months of 2001. The economic situation in the country and the reluctance of the public to travel – especially on long-haul routes – is a concern, which would be further complicated by the breakout of war in the Gulf region.

Freight traffic looks set for a sustained recovery as intra-regional trade is expected to drive growth due to the emergence of Mainland China as a key trading partner for many countries in the region, even if exports to the U.S. falter, at some stage, because of continuing uncertainty about the economy. ■

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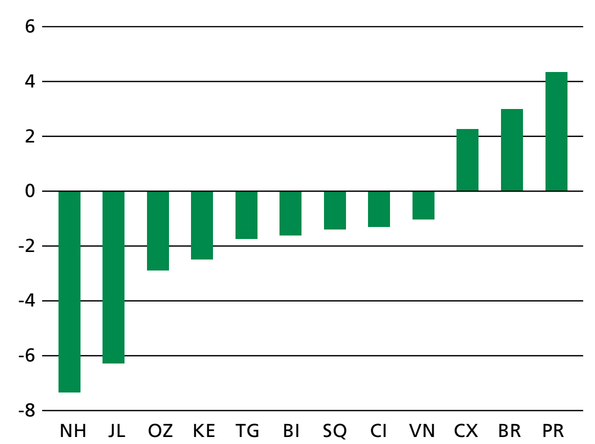
PASSENGER LOAD FACTOR GROWTH BY CARRIER

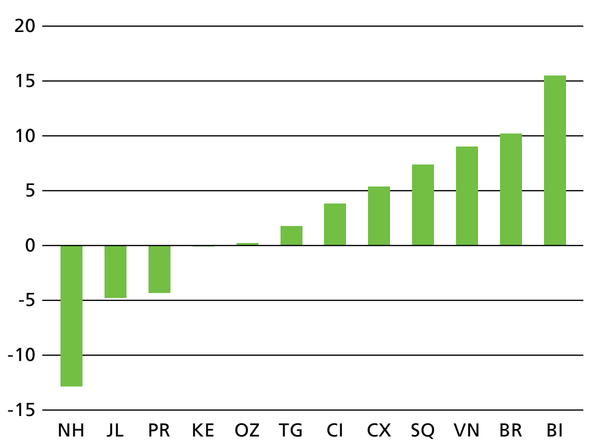
Percentage Points Change (Aug 01 - Jul 02 vs Aug 00 - Jul 01)



Cathay Pacific Airways: 82% passenger load factor in July

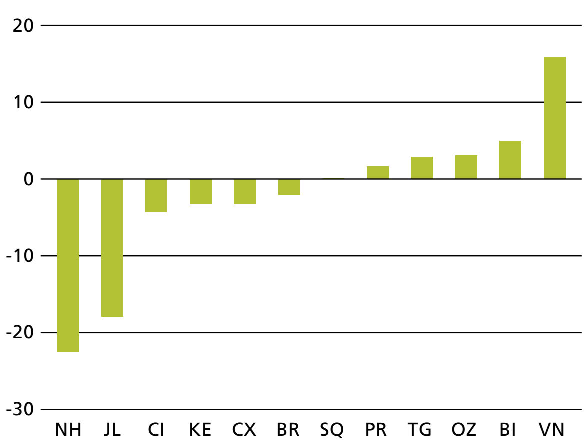
FTK GROWTH BY CARRIER

Percentage (Aug 01 - Jul 02 vs Aug 00 - Jul 01)



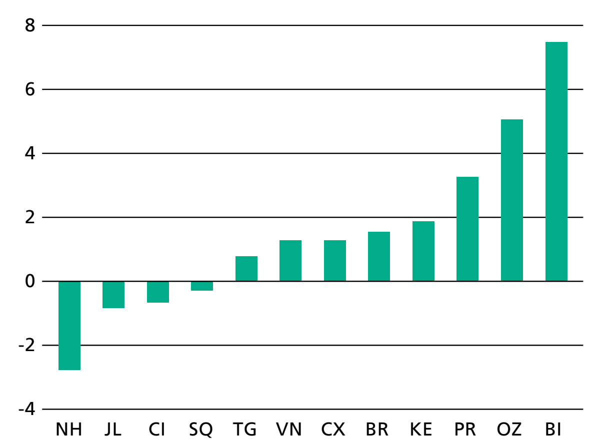
RPK GROWTH BY CARRIER

Percentage (Aug 01 - Jul 02 vs Aug 00 - Jul 01)

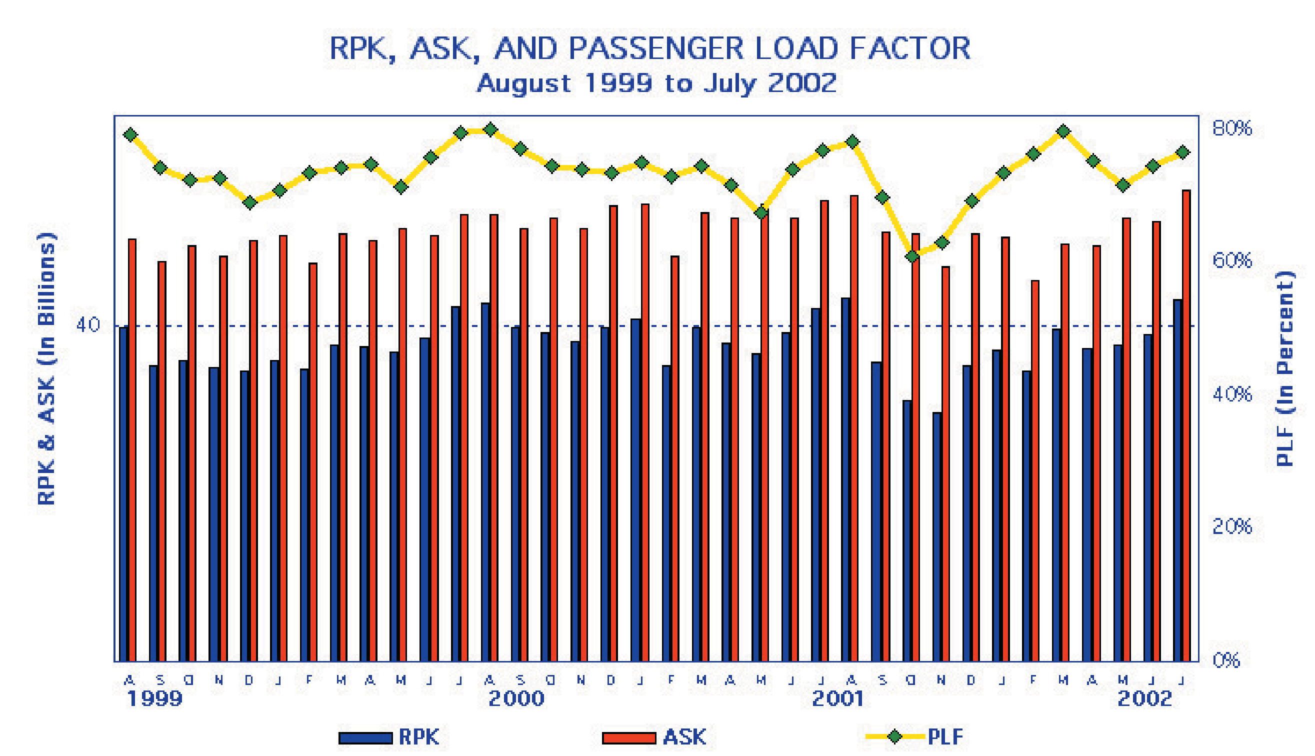


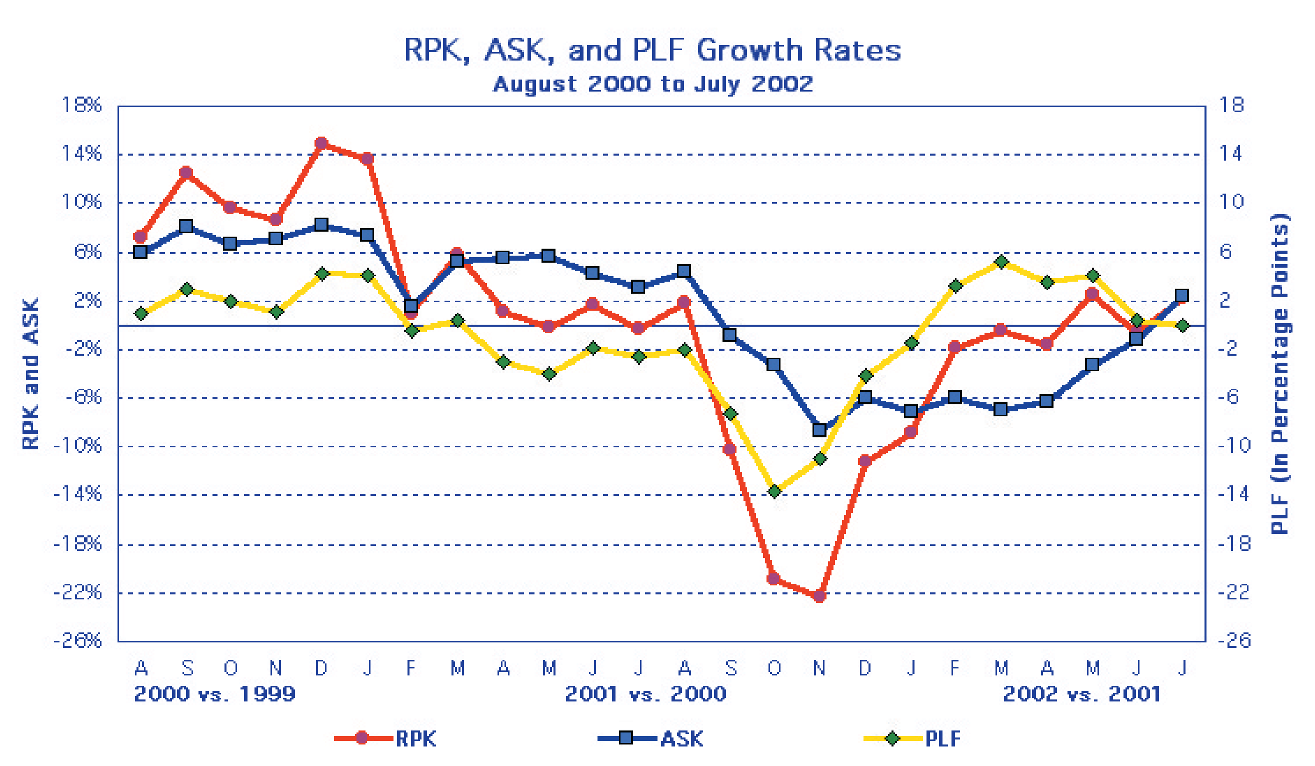
FREIGHT LOAD FACTOR GROWTH BY CARRIER

Percentage Points Change (Aug 01 - Jul 02 vs Aug 00 - Jul 01)

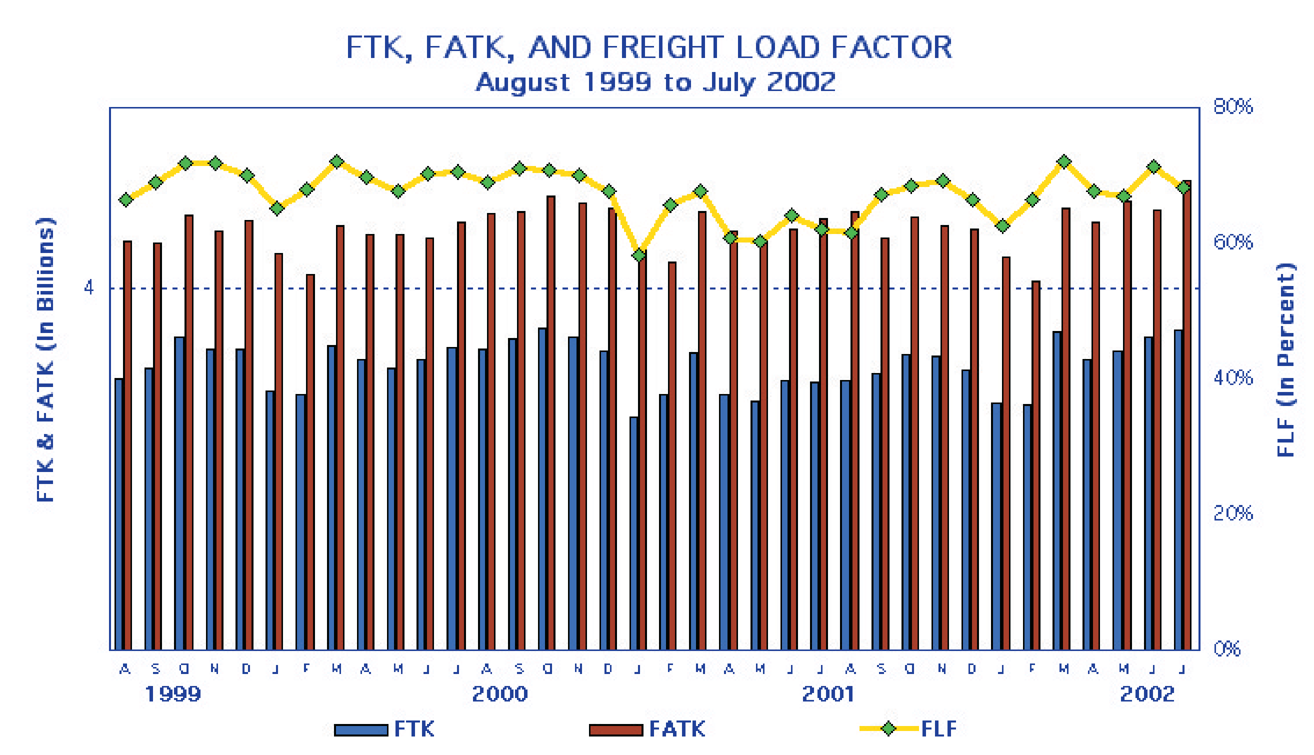


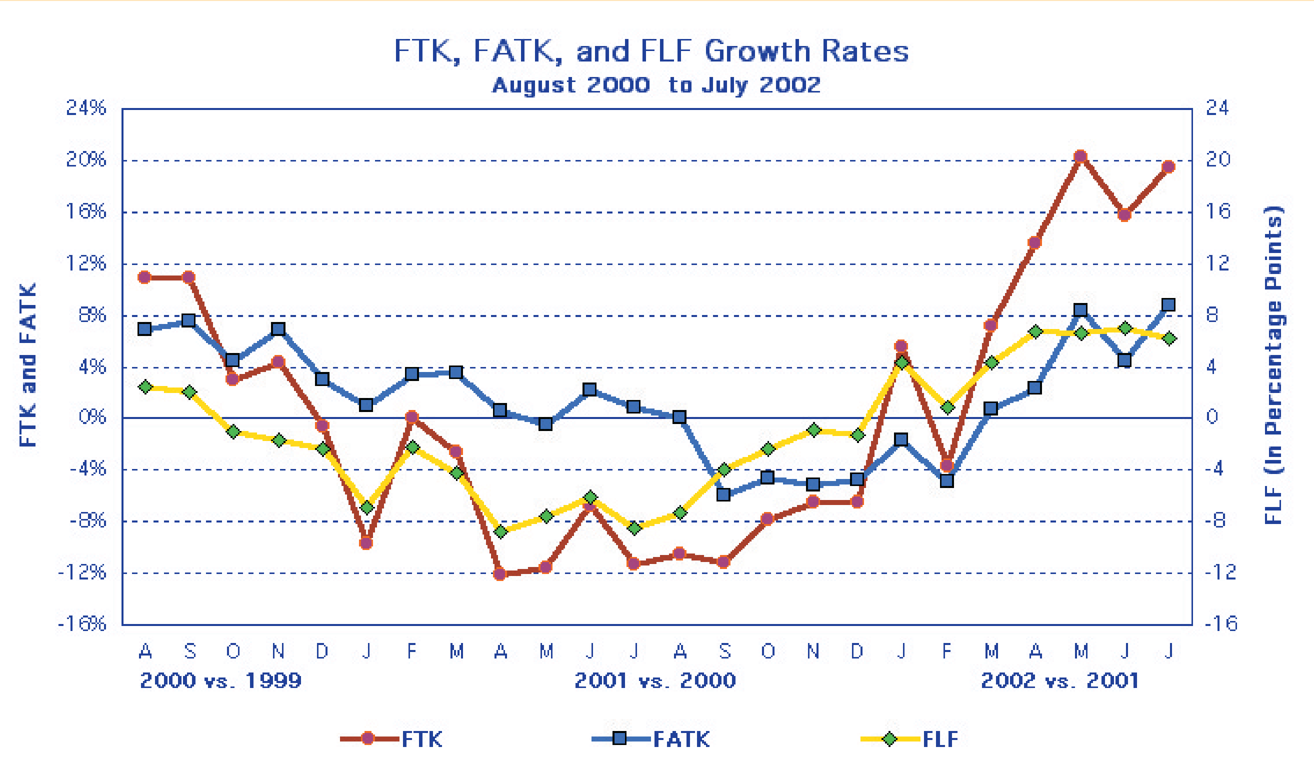
MONTHLY INTERNATIONAL PAX STATISTICS OF AAPA MEMBERS

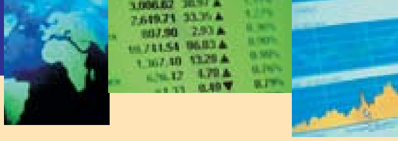




MONTHLY INTERNATIONAL CARGO STATISTICS OF AAPA MEMBERS







AAPA MONTHLY INTERNATIONAL STATISTICS SUMMARY OF CONSOLIDATED RESULTS IN THOUSANDS

2001 TO 2002

	RPK (000)	ASK (000)	PLF %	FTK (000)	FATK (000)	FLF %	RTK (000)	ATK (000)	PAX (000)
AUG-01	43,315,945	55,559,023	77.96	2,978,443	4,838,280	61.56	7,031,073	9,907,159	9,825
SEP-01	35,601,847	51,038,190	69.76	3,061,243	4,555,532	67.20	6,406,828	9,210,564	8,229
OCT-01	31,006,991	50,974,094	60.83	3,277,370	4,793,876	68.37	6,151,064	9,438,030	7,475
NOV-01	29,565,610	47,049,593	62.84	3,243,992	4,685,510	69.23	5,978,041	8,974,938	7,211
DEC-01	35,267,317	51,023,617	69.12	3,090,062	4,655,223	66.38	6,346,707	9,307,797	8,384
JAN-02	37,126,908	50,541,963	73.46	2,723,224	4,352,161	62.57	6,215,154	8,960,696	8,481
FEB-02	34,506,659	45,314,221	76.15	2,714,321	4,081,188	66.51	6,343,335	7,842,815	8,298
MAR-02	39,611,128	49,729,631	79.65	3,512,735	4,881,714	71.96	7,247,896	9,438,779	9,350
APR-02	37,255,496	49,573,917	75.15	3,203,656	4,738,718	67.61	6,688,035	9,267,518	8,872
MAY-02	37,650,015	52,692,923	71.45	3,315,590	4,960,585	66.84	6,856,231	9,740,280	8,824
JUN-02	38,886,391	52,282,994	74.38	3,459,836	4,859,617	71.20	7,121,377	9,635,831	8,761
JUL-02	43,053,295	56,186,324	76.63	3,540,061	5,191,938	68.18	7,579,883	10,324,348	9,807
TOTAL	442,847,602	611,966,490	72.36	38,120,533	56,594,342	67.36	79,965,623	112,048,755	103,517

2001 TO 2002

	RPK %	ASK %	PLF	FTK %	FATK %	FLF	RTK %	ATK %	PAX %
AUG-01	1.77	4.40	-2.01	-10.53	0.06	-7.29	-4.07	1.80	4.40
SEP-01	-10.31	-0.89	-7.33	-11.22	-6.00	-3.95	-10.86	-3.83	-5.63
OCT-01	-20.93	-3.26	-13.59	-7.84	-4.61	-2.40	-15.20	-4.28	-14.88
NOV-01	-22.28	-8.73	-10.95	-6.44	-5.21	-0.91	-15.13	-7.22	-16.44
DEC-01	-11.27	-5.92	-4.16	-6.55	-4.75	-1.28	-9.93	-5.61	-5.22
JAN-02	-8.89	-7.12	-1.42	5.50	-1.72	4.28	-2.94	-4.93	-6.32
FEB-02	-1.81	-5.98	3.23	-3.70	-4.95	0.86	3.59	-9.86	3.58
MAR-02	-0.52	-6.98	5.18	7.09	0.68	4.31	3.19	-2.95	3.00
APR-02	-1.65	-6.26	3.53	13.62	2.27	6.76	4.85	-1.99	1.82
MAY-02	2.58	-3.31	4.10	20.27	8.30	6.65	10.24	2.04	4.03
JUN-02	-0.56	-1.11	0.41	15.75	4.41	6.97	6.83	1.64	-0.93
JUL-02	2.25	2.33	-0.06	19.51	8.75	6.26	9.70	5.46	3.51
GROWTH	-5.93	-3.54	-1.84	2.16	-0.28	1.61	-1.99	-2.42	-2.38

CALENDAR YEAR[4]

	RPK (000)	ASK (000)	PLF %	FTK (000)	FATK (000)	FLF %	RTK (000)	ATK (000)	PAX (000)
1997	387,763,016	561,392,742	69.07	31,741,381	45,688,853	69.47	67,739,088	96,736,079	88,696
1998	382,106,292	557,130,177	68.58	30,958,021	46,204,321	67.00	66,141,448	97,199,731	86,198
1999	416,820,106	576,253,703	72.33	35,277,459	51,519,550	68.47	74,179,615	104,437,440	94,242
2000	462,466,095	617,787,854	74.86	39,020,611	56,255,588	69.36	82,533,153	112,874,721	103,527
2001	446,262,043	626,881,408	71.19	35,858,596	55,742,084	64.33	77,638,545	112,962,219	102,778
2002	268,089,892	356,321,973	75.24	22,469,423	33,065,921	67.95	48,051,911	65,210,267	62,393

CALENDAR YEAR[5]

	RPK %	ASK %	PLF	FTK %	FATK %	FLF	RTK %	ATK %	PAX %
1998	-1.46	-0.76	-0.49	-2.47	1.13	-2.47	-2.36	0.48	-2.82
1999	9.08	3.43	3.75	13.95	11.50	1.47	12.15	7.45	9.33
2000	10.95	7.21	2.53	10.61	9.19	0.89	11.26	8.08	9.85
2001	-3.50	1.47	-3.67	-8.10	-0.91	-5.03	-5.93	0.08	-0.73
2002[5]	-1.26	-4.02	2.10	11.19	2.65	5.22	5.09	-1.38	1.20

Note:

1. The consolidation includes 15 participating airlines. Consolidated results for JAN - JUL 2002 are subject to revision.
2. KA and NZ do not participate in this report.
3. AN data from JUL 1998 to JUN 2001 only. VN data from JAN 1998 onwards.
4. CY denotes Calender Year (January - December): JAN - JUL 2002.
5. YTD comparison: JAN - JUL 2002 v JAN - JUL 2001.