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CHINESE PUZZLE

Mergers in place, but still questions to answer

Boom or bust? Indonesia's wide open skies

SPECIAL REPORT: European investment in Asia-Pacific Part 1

PARIS AIRSHOW **ISSUE**

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COVER STORY

Chinese Puzzle

Page 30

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NEWS

FEATURES

SPECIAL REPORT: *European investment in Asia Part 1*

COMMENT

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CHINA MERGERS – ALMOST THERE

Mergers and acquisitions are always painful – and not always necessary. But in the case of the Chinese airline industry, there will be more pain – including job losses – if the master plan to slim down and consolidate the nation's airlines is to succeed.

Reading our cover story this month on the progress of the mergers, first formally announced by the Civil Aviation Administration of China (CAAC) almost a year ago, the optimists prevail.

They believe there will be some brutal battles for control of the three major airline groups of Air China, China Eastern and China Southern respectively, and that it will take time for the power struggles to be resolved. Some of the present chief executives of the government controlled airlines might not be around in 18 months, analysts believe.

However they add that senior management of China's airlines know they must reduce capacity, match purchases or leasing of aircraft to their network needs and attempt to set orderly guidelines for ticket-pricing if they are to survive in a China that will eventually join the World Trade Organisation.

The smart operators among these elites also recognise they must take the hard decisions now. The CAAC has done its work by providing the blueprint for airline reform. Now it is up to the individual airlines to put that theory into practice.

BARRY GRINDROD
Publisher/Managing Editor

COMEBACK KIDS: He is never one to miss an opportunity to burnish his company's image abroad, but BAE SYSTEMS' executive vice-president Asia, Martin Craigs, outdid himself when he cornered Bill Clinton – post-prandially of course – at the fancy China Club in Hong Kong in May. After spotting Clinton at a nearby table, Craigs quickly acquired a bottle of Bushmill's Irish whiskey and presented it to Clinton "in appreciation of his peace work in Ireland". Flushed with presidential afterglow, Craigs now hopes to persuade Clinton to return to the region as a guest of the local Aerospace Forum, an aviation networking and lobby group that has raised more than US$200,000 for the flying eye hospital charity Orbis. Craigs, honorary chairman of the regional forum, said Clinton is a well-known supporter of Orbis. If Clinton says yes, he will join a galaxy of aviation heavyweights who have addressed the forum since it began in the mid-eighties – including Airbus' Jean Pierson, Boeing's Phil Condit, British Airways' Lord Marshall, Virgin Atlantic founder Sir Richard Branson, Cathay Pacific Airways chairman Peter Sutch, Continental Airlines' Gordon Bethune, Embraer's Maurice Bothello, Moritz Suter of Crossair and Astronaut Pete Conrad. It could happen, said Craigs. " All we need are a few generous sponsors."

BAE SYSTEMS' executive vice-president Asia Martin Craigs with former U.S. president Bill Clinton in Hong Kong.

PERSPECTIVE

PEOPLE PERSON: Only two weeks into his chairmanship of Thai Airways International (THAI), former academic and an architect of Thailand's democratic constitution, Chaianan Samudavanij, invited labour representatives to the airline's board meeting, reported Thai's excited media. Why? "Because we have nothing to hide," he said. But he could have added because he needs their support to revive an airline that has had 16% shaved of its share price this year and suffered from the drop in value of the Thai baht. Chaianan is only the third chairman of THAI not to be an air force general, a politician or a government official and he already has removed life-time first class travel privileges and corporate credit cards for THAI directors. Reviving THAI is critical to the new Thaksin government as tourism is the country's number one foreign currency earner. Sceptics said the well-intentioned chairman has an uphill battle ahead of him and claimed earlier attempts to revamp the airline – it was 41 in May – have failed "because of vested interests, politics and fraud".

GOODBYE: Following the sudden May 14 suspension of Somchet Thinaphong as president of the New Bangkok International Airport Company, (NBIA), a political adviser to an influential minority party, the New Aspiration Party, Mati Tang-Painich, is tipped to replace him. Somchet has been moved to an "empty drawer" desk job in the national transport department and is not expected to return to the NBIA when a fact-finding committee report on his performance is completed. Mati, an architect and property developer, had earlier lost the job to Somchet – who was favoured by the former government of Chuan Leekpai. Mongol Ampornpisit's chairmanship of the NBIA is also under threat since the new Thaksin government was elected.

PIONEER: Bryan Grey (71), the Australian who launched low-cost, no-frills flying in Australia, died in Melbourne in May after a long illness. Grey launched Compass Airlines in 1990 with a fleet of A300s, when he took on the Australian duopoly of Qantas Airways and the then Ansett Airlines on the major trunk routes of the nation. Compass ran out of money a year later, but Grey won the nation's respect as an "Aussie Battler" who made flying affordable for Mr and Mrs Average and their families. Grey, a descendant of 19th century Australian prime minister, Charles Earl Grey, was a protégée of Sir Reginald Ansett, the founder of private carrier, Ansett Australia. He also had been managing director of Air Niugini.

CHANGING PACE: James E. Hall, chairman of the National Transportation Safety Board (NTSB) during most of the Clinton White House years, has returned to private law practice and is now heading up Dillon, Hall and Lungershausen's office in Washington DC, a firm that also has offices in Hong Kong and Stuttgart. Hall, a decorated Vietnam veteran from Tennessee, worked on former vice president Al Gore's staff when Gore was a Senator. He chaired NTSB airplane accident investigations in Indonesia, Japan, mainland China and Brazil among many others that involved the NTSB. In 1996, President Clinton and the U.S. Congress gave Hall's NTSB responsibility for co-ordinating assistance to families of accident victims, following revelations worldwide of poor treatment of the families of victims of airplane accidents by some airlines.

APPROVED: Three airport bosses were elected for second two-year terms at the annual Airports Council International Pacific (ACI-Pacific) conference in San Francisco in April. Toru Nakamura, who runs Narita Airport Authority in Japan was re-elected president and Tony Stuart and Larry Berg, bosses of Sydney International Airport and Vancouver International Airport respectively, were endorsed as directors for a second term. Hong Kong International Airport's (HKIA) David Pang, in charge at HKIA since January, has joined the 12-member board.

BOOSTED: As the competition intensifies between the world's two leading airline alliances, Star and oneworld, oneworld's Central Management Team, based in Vancouver, has appointed Maunu von Lueders as vice president sales for oneworld. Also now at oneworld in Vancouver are marketing planning and product development manager Petra Mayer (ex British Airways), manager frequent flyer programme development, Malcolm Pryor (ex Qantas Airways) and Robert Antoniuk, oneworld's manager brand performance and development. In April, oneworld established an office in London, which is run by ex-British Airways staffer and new oneworld vice president public relations, Michael Blunt.

REGIONAL ROUND-UP

Air China Prepares to list

Air China has revived its plan to list off shore now that the proposed re-struc ture of China's airline industry has been formally laid out by the Civil Aviation Administration of China (CAAC). In mid-May, the Beijing-based carrier was reported to be positioning itself for an Initial Public Offering in Hong Kong, and probably New York, in 2002, with the expectation of raising US$500 million from the dual listings. Air China is one of the three lead airlines that will form China's restructured aviation industry. In April the CAAC announced that the ten airlines under its control would be reformed into three groups led by Air China, China Eastern Airlines and China Southern Airlines.

Separately, Germany's transport minister, Kurt Bodewig, said Air China could join the Star Alliance – made up of Lufthansa German Airlines and 14 other global carriers – by 2004. Bodewig said he discussed the possible relationship between Air China and the German flag carrier with his Chinese counterparts in Beijing in May.

SIA opts out of bigger Air NZ share

Singapore Airlines' (SIA) push to increase its stake in Air New Zealand and Ansett is on hold with SIA looking north and west for easier and more lucrative investment opportunities. Air New Zealand-Ansett Group (AirNZ-Ansett) chief executive, Gary Toomey, confirmed there are no ongoing talks with the New Zealand government about raising SIA's stake in the Australasian carrier. Meanwhile, AirNZ-Ansett has engaged Salomon Smith Barney to assist in arranging funding for the group's long-overdue US$1.18 billion fleet renewal programme. Toomey also confirmed an early April report that the group would have substantial cash on its books by June 30. He expected to have NZ$600 million to NZ$1 billion on the group's balance sheet by then, but he said that gearing is a problem.

Thai Airways International: partial sale of carrier will proceed this year

THAI rules out foreign investors?

Thailand's new national government said it favours selling 13% of national carrier, Thai Airways International (THAI), to domestic investors rather than a strategic foreign buyer. THAI president, Bhisit Kuslasayanon said: "If we have a partner, we would prefer it to be a Thai partner. We might not need a partner at all, it could just be a [initial] public offering."

More delays for New Bangkok Airport

One of the most likely outcomes of the latest power struggle at Bangkok's Suvannabhumi Airport (New Bangkok International Airport) is that the Thai capital's planned terminal complex will not open in 2004 as scheduled. This fact was underlined by Somchet Thinaphong, the president of the NBIA, who was suspended abruptly from his post on May 14. A review of the NBIA terminal design by the U.S.-based Murphy Jahn/TAMS/ ACT consortium (MJTA) brought the project within the Thai Government's budget of US$1.09 billion – out of a total project cost of US$2.8 billion. The reduced estimates were achieved by designing a narrower concourse, use of more local materials and thinner glass and steel structures.

IATA condemns Sydney Airport fees

In May, International Air Transport Association (IATA) director general, Pierre Jeanniot, wrote to the Australian prime minister, John Howard, to protest against fee increases of 97% for user airlines at Sydney International Airport. He said the international airline community "is deeply concerned at the recent decision and added the Australian body that authorized the increase had not taken into account the revenue generated, or costs incurred, in the provision of services other than aeronautical services at the airport". "This runs contrary to international practice in the setting of airport charges, and represents a serious deviation from the policies of ICAO, of which Australia is an influential member," he said.

Meanwhile, the Australian Government has chosen three bidders for the purchase of Sydney International Airport. Formal expressions of interest in Australia's busiest gateway closed with analysts estimating the airport's sale could provide the nation's coffers with

By Tom Ballantyne in Seattle

The ink has hardly dried on developers' sketches of Boeing's proposed Sonic Cruiser, but already some airlines are tussling for the honour of becoming the launch customer for the plane that promises to fly faster without making a supersonic bang. Speaking in Seattle, the planemaker's commercial aircraft chief Alan Mullaly confirmed the reaction of American Airlines (AA) boss Don Carty to the project was to ask if AA could sign up for the first three years of production.

Boeing's vice president marketing for the Sonic Cruiser, John Roundhill, now working with potential customers like Virgin Atlantic's Richard Branson, on the airplane's configurations.

Boeing is hardly likely to upset other customers by agreeing to that sort of deal and there are other enthusiasts sniffing around to jump in early with an order. Among them is Virgin Atlantic, which has confirmed it began talks with Boeing in May about the Sonic Cruiser. Owner Sir Richard Branson said Virgin is considering becoming a launch buyer. "We would love to become a launch customer. We are very interested and will be pursuing it with vigor. We will work with them (Boeing) to make sure it becomes a reality," he declared. Branson added the proposed airplane offered a tremendous advantage over the supersonic Concorde because it was "very quiet" and "environmentally friendly because it will fly under the ozone layer".

US$2.08 million to US$2.6 billion. They are believed to be: ABN AMBRO with the National Australia Bank and Copenhagen Airport, Denmark; Hochtief, a German construction company, and two Australian banks, the Commonwealth and Macquarie Banks; insurer AMP Ltd, Hastings Fund Management and Hong Kong's Cheung Kong Infrastructure Holdings.

Hong Kong Heats up

Competition on the Hong Kong-London route will intensify with the news that the Special Administrative Region of Hong Kong (SARHK) has granted Air New Zealand-Ansett fifth freedom rights out of Hong Kong to London, with immediate effect according to local media reports. Cathay Pacific Airways, Virgin Atlantic Airways and British Airways already operate five flights between them on the route. Earlier in the year, the HKSAR granted Star Alliance carrier, bmi british midland, rights to add London-Hong Kong to its network. bmi said it is assessing the viability of launching on the route.

However, Virgin Atlantic Airways managing director, Steve Ridgway, said in Hong Kong the carrier would increase its London-Hong Kong flights from seven to nine per week, with the aim of making the route a twice-daily service. In addition, Virgin aims to increase its Shanghai-London service to daily flights from the current four per week. Ridgway noted the number of visas issued by the British consulate in Shanghai to Chinese travelers had increased 40% year-on-year. He added: "With the opening of the second runway at Narita, there is potential to increase our frequencies to Narita as well, ultimately to double daily." Virgin also wants to increase its recently started service to Delhi to daily flights. Bombay and Bangalore are possible future destinations.

No fee flights at Kuala Lumpur airport

From May 1 all new services into Kuala Lumpur International Airport (KLIA) have been eligible for free parking and landing fees. Malaysia's transport minister, Datuk Seri Dr Ling Liong Sik, said the incentive would apply to existing airlines flying into the airport and carriers using the airport in future. Under the proposed fee waiver, an airline with four flights into the country would enjoy free parking and landing charges for its fifth and subsequent flights. Flights must have at least 25% capacity and only passenger aircraft qualify. Dr Ling said the offer was made by the KLIA hubbing committee, which was established to develop incentives for the airport's potential user carriers.

SAir rules out MAS investment

Eric Honegger, chairman of SAir, told *Orient Aviation* in May his company – which is undergoing a massive restructure to abort continuing losses at its subsidiary Swissair – would be unable to pursue a strategic partnership with Malaysia Airline Systems (MAS). "We have informed the [Malaysian] Ministry of Finance and the MAS management that under the present circumstances for our group, this is the situation," he said. However, he added the Swissair/MAS code-share on the Kuala Lumpur-Zurich route is considered "a full success". MAS will add a fifth service each week on the route from September 8.

FLEETS

The Vietnamese Government has given the go-ahead for a major modernisation of the Vietnam Airlines (VNA) fleet that will see it spend 15 trillion dong (US$1.03 billion) in the next five years to build its fleet from 23 to 34. Trade union newspaper, Lao Dong, said VNA has 10 A320s, five B767s, six ATR 72s and two Fokker jets. All are leased except the short-haul ATRs and Fokkers. No details were given of aircraft types involved in the expansion, but the six-strong short-haul jet fleet will be increased to 18 by 2005. VNA spokesman Nguyen Chan said the carrier had revenues of 8.254 trillion dong last year, 15% higher than targeted. It carried 2.9 million passengers, including 1.2 million international passengers, in 2000, up 11% from the previous year. Money for the fleet expansion will come from airline earnings, preferential government loans, bonds and income tax credits.

Fleet renewal plans for Air India and Indian Airlines were scrapped by the civil aviation ministry, pending privatization. The decision prompted concerns it would damage efforts to sell the airlines, a policy that has attracted lackluster interest in either carrier.

Vietnam Airlines to spend US$1.03 billion on new airplanes

China Airlines' (CAL) new A340 airplane joined flight operations in May, bringing the fleet to 53 airplanes and marking another step in CAL's fleet simplification plans. CAL will add four A340s to its fleet later this year to replace its MD-11s.

Jet Airways, India (PVT), Ltd., India's most prestigious and successful privately owned airline is leasing three new ATR72-500s from SA-FAIR. The aircraft will supplement Jet Airways' existing fleet of 5 ATR72-500s. Jet Airways now operates a fleet of 37 airplanes. The carrier plans to add two more B737 Next Generation aircraft to its fleet by March 31, 2002.

Malaysia Airlines (MAS) now has an even dozen B777 aircraft in its fleet after taking delivery of its twelfth Triple Seven. MAS managing director, Datuk Md Nor Yusof, said the national carrier would own and operate the aircraft. The previous MAS management sold a number of its relatively new aircraft and leased them back to MAS.

Briefly . . .

Airports . . .Macau International Airport (MFM) recorded passenger traffic of 351,793 in April and set an airport record as the highest single traffic month, a gain of 18.63% over the same month last year. Cargo handled also climbed significantly, reaching a total of 6,030 tonnes, again setting a monthly record compared to April 2000.

Leasing. . . South Korean carrier, Asiana Airlines is leasing two Airbus A321-200s with IAE V2533-45 engines from CIT Leasing of the U.S., bringing the total number of airplanes leased by CIT to Asiana to five.

JAL HITS HIGH WITH RECORD PROFITS

Both the JAL Group and the group's airline, Japan Airlines (JAL), set new records for consolidated JAL Group revenues and non-consolidated JAL-only sales revenues in the fiscal year ended March 31.

A May 17 company statement said JAL Group net income increased by 40.02 billion yen (US$323.8 million), with revenue rising by 6.6% over the previous twelve months to 1,704 trillion yen. Pre-tax profit registered an impressive 137.6% leap to 53,300 million yen.

JAL's operating profit soared 75% to 78.64 billion yen, despite brutal operating conditions of high fuel prices, a slowing global economy and a domestic market that is teetering on the brink of recession.

JAL international cargo volume declined by 1% last year, but total revenue for the airfreight division rose 3.5% to 148.40 billion yen. JAL president and chief executive, Isao Kaneko, said air cargo traffic had dropped off in line with the declining U.S. economy.

International traffic was up 8.8% for the year, and business class traffic was "particularly good" with growth of 8% to Europe and other destinations, the JAL statement said. Domestic travel expansion rose by only 0.6%.

The airline said it expected a fall-off in business this year with sales forecast to be about 1.8 trillion yen, but net profit to decline by 25 billion yen.

The record results for JAL are a tribute to the tough measures Kaneko and his management team took in the airline's long-term

Japan Airlines: doing well in tough times

strategic re-structure that began more than three years ago.

The re-making of the airline's corporate culture has involved setting up a discount carrier, implementing management modernization, reducing overall staff numbers and introducing a revised pay and conditions structure for the carrier's cabin crew.

BUSINESS ROUND-UP

*Singapore Airlines Profits up 33.1%**

The SIA Group announced profits of S$1.55 billion (US$855 million) for the year to March 31, 2001, but warned the outlook for this year was uncertain. The result, fueled by strong passenger and cargo demand, was boosted by one-off gains of $575 million earned from the partial listings of SIA Engineering Company (SIAEC) and Singapore Airport Terminal Services (SATS). The group sold a 13% equity in each of the two companies when they were listed in 2000.

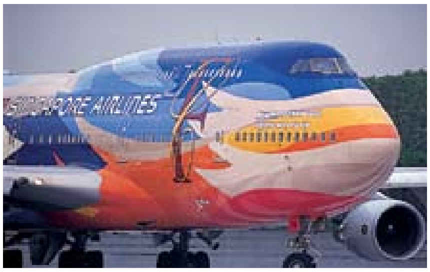
Profits before tax for the airline were $1,607 million – a decline of 2.1% – after the inclusion of interest of $44 million earned on borrowings, a surplus of $166 million from the sale, and sale and leaseback of several aircraft, the sale and leaseback of six A340-300 spare engines and sales of aircraft spares and other spare engines, lower gross dividends of $60 million from SIAEC and SATS – they did not pay dividends for 1999-2000, but SIA received a special dividend of $371 million in March last year – and a $132 million provision for employee bonus payments for the year 2000-2001.

Post-tax profits rose 5.7% ($73 million) and the operating profit of subsidiaries climbed 12.4% ($38 million). SIA said capacity rose 6.6% over 1999-2000 to 18,034 million tonne kilometers and traffic increased 7.9% to 12,985 million tonne kilometers. Fifteen million passengers flew with SIA in the last fiscal year – up 8.9% – and its aircraft uplifted 975 million kilograms of cargo, a rise of 7.8%. SIA Cargo will be corporatised in July this year. The carrier said it planned capacity growth rates for the next twelve months of about 5% for both passenger and cargo business.

**** The Company refers to the parent airline and the Group is the Company and its subsidiary and associated companies.***

THAI still for sale, But reports losses

The new Thai national government confirmed the proposed sale of 13% of Thai Airways International (THAI) – valued at 8.7 billion bath (US$193.3 million) – will proceed after this July. At the same time, THAI announced a net loss for the first six months of its fiscal year of 935 million baht (US$2.13 million), a decline of 109% or 10,625 million baht, on the same period last year. THAI's executive vice president finance and information technology, Amnuay Chanya, said the figures resulted from increased fuel costs of 4,187 million baht for the six month period and foreign exchange losses of 12,157 million baht for the same period.



Singapore Airlines: outlook for 2001 uncertain

Bad news for Korean carriers

South Korea's two international airlines posted first-quarter net losses, with Korean Air recording a widened loss to 230.8 billion won (US$176.7 million) compared to a 41.7 billion won loss a year earlier. The nation's second international carrier, Asiana Airlines, swung to a net loss of 103.4 billion won in the same period after it had recorded net profits of 53.7 billion won for the same three months in 2000. Korean analysts said both airlines had been affected by the weakening national currency, the global slowdown and snow in January. Korean Air is sticking to its forecast for the year of a profit of 70 billion-100 billion won on sales of six trillion won.

Ansett predicted To lose $170 million

Ansett Australia is set to lose $170 million in the year to June, according to analysts, a profit deterioration of $314 million over the previous year. Chairman of Air New Zealand, which owns Ansett, Sir Selwyn Cushing, said the group expected to post a loss for the year due to worsening economic conditions and intense competition in Australia.

WAR ZONE

...Australasian rivals' new battle for market share

The sudden May demise of Australian no-frills carrier, Impulse Airlines, and its immediate absorption into national carrier, Qantas Airways, highlighted the frailty of discount start-ups in an airline environment of high fuel prices, extra capacity and intense pricing competition. **Tom Ballantyne** *reports.*

Australian aviation is still coming to terms with the recent loss of one of its no-frills hopefuls, Impulse Airlines, which buckled under the burden of low fares. At press time it was gobbled up by national flag carrier, Qantas Airways, in a virtual co-operative takeover.

After the country's corporate watchdog, the Australian Competition and Consumer Commission (ACCC) (AirNZAnsett), approved the deal Air New Zealand Ansett (AirNZAnsett) continued talks with Sir Richard Branson's Australian airline, Virgin Blue, about a potential commercial tie-up to counter the approval for the Qantas buyout of Impulse.

Critics are concerned the May developments will result in Australia's air market returning to a duopoly, a situation which industry deregulation, introduced in the late 1980s, was designed to end.

Both Ansett and Virgin have strongly protested about the Qantas/Impulse deal and have argued it gives the big flag supreme dominance in the market. But Impulse has been losing millions and would not have lasted the year with being rescued. Most analysts had expected the ACCC to give the go-ahead to the deal, but with certain conditions.

The news of the compact came as another severe body blow to the struggling AirNZ Ansett group. Ansett has been losing serious money in the last 18 months, a situation that has not been helped by ongoing maintenance problems with its fleet of mature B767s, which were grounded by aviation regulatory authorities during the mid-April peak Easter holiday break. The last of the eight jets temporarily incapacitated by the no-flights ban returned to service on May 8.

Some reports suggested Ansett could have lost as many as 20% of its passengers to Qantas during the maintenance crisis, a claim vehemently denied by AirNZ Ansett chief executive Gary Toomey. He insisted customers have remained loyal to the award-winning carriers and that forward bookings are as strong as they were at the same time last year.

Nevertheless, Ansett is taking no chances on the matter and has launched a major advertising and customer loyalty campaign to re-launch the brand and convince passengers the airline is improving. The ad campaign features famous Australians declaring: "Am I with Ansett? Absolutely."

The commercial pact between Qantas chief executive, Geoff Dixon, and Impulse founder and CEO, Gerry McGowan, will allow the start-up carrier to continue to exist as a company owned by McGowan. But the Impulse livery would disappear and the carrier's fleet of eight B717s and 13 Beechcraft 1900Ds would be contracted to Qantas, complete with its pilots and cabin crew, and fly under Qantas colours.

It is expected the ACCC will demand that a share of Impulse's landing and take-off slots at Sydney Airport be handed over to other operators. In addition, it is likely the commission will encourage Brisbane-based Virgin Blue to start services on the primary Sydney-Melbourne trunk route, where it does not yet fly.

Whatever the pricing watchdog decides, Impulse will disappear, becoming the third discount operator to fold since airline market deregulation in Australia began. Two versions of the pioneering no-frills carrier, Compass Airways, failed in the early 1990s. Ironically, Compass founder, Bryan Grey, aged 71, passed away in Melbourne in May.

Dixon and McGowan made no apologies for their deal, which was thrashed out during several weeks of secret talks between the two of them. So far, it looks like a win-win outcome for the two chief executives. McGowan can keep his company and Dixon eliminates an annoying discount competitor that had been forcing Qantas to sell thousands of seats at unsustainably low prices.

They said the commercial relationship between Qantas and Impulse was a direct result of the increasingly competitive conditions in the Australian and world aviation markets. McGowan said Impulse and a number of its institutional shareholders, particularly from Singapore, had decided the major trunk route market was too difficult for the young Australian airline to continue operating on its own.

Dixon is jubilant. After taking over the Qantas reins last March, he knew that later in the year he would report the airline's first fall in annual net profit in six years. The decline is a result of domestic competition, global market conditions and high fuel prices. After the carrier reported a 22% slide in earnings in the first half to December 31, Dixon reacted with job cuts of up to 1500 staff and a major restructure to reduce expenses.

The recent airline turbulence has not been confined to Australia. Across the Tasman Sea, thousands of New Zealand domestic passengers were left stranded in April when local operator, Tasman Pacific Airlines, (TPA) went into liquidation. Formerly Ansett New Zealand, in recent times TPA had been operating as Qantas New Zealand under a Qantas franchise arrangement.

Qantas had no equity in the carrier, but the collapse left it without a domestic network in New Zealand. The rush is on to fill the gap.

In mid-May, the New Zealand Government said it would put Virgin Blue's application to operate in New Zealand on the fast track. The company, majority owned by Sir Richard Branson, also applied to operate Australia-New Zealand services.

Dixon said the Impulse deal and the additional capacity it brings into the fleet would allow his airline to send four B737s across the Tasman to operate as a Qantas-New Zealand trunk route network.

Meanwhile, Virgin Blue boss, Brett Godfrey, then in Seattle collecting the first of the airline's new B737-700s, diverted the delivery flight to Auckland to talk with New Zealand Prime Minister, Helen Clarke, about operating his carrier in the country.

AirNZ Ansett is considering expanding the operations of its low-cost subsidiary, Freedom Air – it operates leisure flights between New Zealand and Australia – to New Zealand domestic routes.

The success of all these plans could bring a new era of vicious discounting to New Zealand's skies and lead to more casualties at Australian airlines.

INDONESIA'S BOOM OR

... how many new carriers will survive?

Indonesia was one of the countries worst affected by the late 1990s regional economic recession, when its airlines suffered a miserable 18 months as their passengers deserted them. Business has gradually improved in the last two years to the point where an estimated 100 airlines , mostly tiny operators, will be plying Indonesia's skies by the end of next year. Analysts do not expect them all to survive, especially as the country continues to labour under poor political and economic leadership, but there are plenty of experienced hands guiding the helms of these airlines and they believe in their future. TOM BALLANTYNE *looks at Indonesia's aviation transport explosion.*

The Indonesian National Government is coming under increasing pressure to forge open skies air treaties with the U.S. and European nations, a move the local airline industry believes will spark desperately needed growth in tourism and fuel an unprecedented boom in new airline operators.

As many as 65 new operators have emerged nationwide in Indonesia in the last two years and the number is predicted to reach more than a hundred by the end of next year.

The vast majority of the start-ups are tiny airlines – domestic commuter carriers or charter companies with a single plane. But at least 14 of them appear to have the investment backing to survive, at least for long enough to make a significant impact in the market.

With domestic routes deregulated and virtual open skies operating among Southeast Asian countries such as Indonesia, Thailand, Singapore, Malaysia and Brunei, liberal air treaties with North America and Europe would bring welcome opportunities for both existing and new Indonesian carriers to improve their businesses.

Everyone agrees this nation of 200 million people (though much of the population is poor and cannot afford air travel) is primed for spectacular growth in air traffic numbers, given the right conditions.

Industry insiders made the point to *Orient Aviation*, however, that until the country can stabilise politically, foreign investors will be reluctant to enter, or in many cases re-enter, its aviation market.

At the beginning of 2000, five long-established airlines were operating in Indonesia; state-owned international carrier Garuda Indonesia, domestic Merpati Nusantara and private carriers Bouraq Indonesia, Mandala Airlines and Dirgantara Air Services.

By the end of the year, that number had doubled, with the addition of Pelita Air Service, Lion Airlines, Bayu Indonesia, Air Wagon International (Awair) and Airmark Indonesia. They are set to be joined by seven new ventures in coming months; Satrio Mataram Airlines, Jatayu Gelang Sejahtera, Star Air, Alatief Alair International, Asia Avia Megatama, Republic Express, and Kartika Airlines.

Announcements of inaugural domestic flights are made by the bunch and on a weekly basis. Up to 50 prospective operators were lined up for licences at press time, although some start-up applicants are cargo and helicopter services. With the country still in the midst of recovery from the economic woes of 1997-98 and a new wave of economic and social unrest unleashing itself on the archipeliago, it will be a battle to fill all the new seats and establish longevity for the newcomers.

Some analysts had expected Jakarta to tighten requirements for air operator certificates in order to slow the rush of new airlines, but it has not happened.

Indonesia's Air Communication director general, Soenaryo Yosopratomo, said his office would not restrict the number of new licences for scheduled airlines because "having more scheduled airlines in operation will benefit passengers through competitive ticket pricing and more choices".

The splurge on airline investment received another boost from political pressure

National flag carrier Garuda Indonesia forced to discount fares on some routes groups among Indonesia's far-flung island provinces who are fighting for increased autonomy.

Plans have been announced by Sumatra, Sulawesi and Riau to launch their carriers. Sumatra Airlines is attempting to own attract US$70 million from foreign investors to get off the ground.

The governor of Riau, Saleh Djasit, has set up a team to prepare for the establishment of Riau Airlines. Sulawesi officials said three B737s are being leased from Singapore Air Charter to launch Sulawesi Airlines, which would serve the major cities of Makassar, Palu, Menado and Kendari in Sulawesi and fly to Jakarta, Surabaya and Bali.

While the number of newcomers appears staggering, leading industry officials pointed out Indonesia's air travel market is yet to fully recover from the economic crisis of almost four years ago.

Wahyu Hidayat, president director of Merpati and chairman of the Indonesian National Air Carriers Association (INACA), said that in 1997 airlines carried 13.5 million passengers. In 1998, the figure plunged to 6.5 million. But in 1999 the number climbed to 7.3 million passengers and rose to 8 million travellers annually in 2000.

While forecasts vary, some in the industry predicted numbers could soar by 20% this year. Others are more cautious and said current volatility and uncertainty in global markets will hold back the increase to around 10%.

INACA predicted growth, but does not expect numbers to rise to 10 million until 2004, a figure still below 1997 levels.

Much of the domestic growth will be driven by pricing, with new airlines challenging incumbents with promotional pricing and discount airfares.

Garuda has had to cope with discounting on several of its routes. Awair offered US$108 fares on Jakarta-Surabaya, compared to the national carrier's $150. Pelita charged $223 on Jakarta-Makassar against Garuda's $274. Lion offered $115 fares on Jakarta-Pontianak, 30% lower than Merpati.

Garuda International boss Abdulgani: still finalising a restructure of the airline's US$1.6 billion debt

Garuda, Merpati and other established airlines have not been slow to react on the pricing front, but Hidayat believed fares have to be stabilised to enable airlines to operate profitably, particularly in the tough times expected through the remainder of 2001.

"From my point of view the potential market is there. Why? Because there are 200 million people in Indonesia and there is not sufficient air transport to provide the services required from island to island," said Hidayat.

He is uncertain how many of the new airlines will ultimately survive, but he said there was room for several more carriers. "Sometimes people get euphoric about setting up airlines. Many of these new airlines are being launched by ex-bureaucrats, ex-travel agents or ex-air force officers, All of them think they can make a lot of money easily.

"What they have to realise is this is a high profile, low profit business that involves a lot of hard work and risks," he warned.

Hidayat also predicts a significant shift in the demographics of Indonesian industry and said new growth centres will emerge in outlying centres like Medan and Balikpapan and away from the traditional hubs of Jakarta and Surabaya.

Benny Rungkat, a long time airline official who is president and chief executive of Kartika Airlines, supports this view. Rungkat's carrier will focus much of its new network on the scattered island provinces of eastern Indonesia.

"We will concentrate on air tourism, combined with marine tourism. Indonesia has a tremendous asset in these islands, with their beautiful sandy beaches and reefs ideal for diving that are just waiting for thousands of tourists to visit," explained Rungkat.

Both Rungkat and Hidayat see opportunities to link these locations directly with overseas hubs, bringing tourists from Singapore, Bangkok, Japan, Australia and other centres directly into marine resorts without having to fly through Jakarta.

Open international skies, they added, will add to these opportunities as long as treaties are equitable and give Indonesian airlines the same opportunities as their foreign counterparts.

Another newcomer, Lion Mentari, is moving quickly to make its presence felt in the market. An airline spokesman, Yun Ka, said it will open new routes to Timor, India, Taiwan and South Korea. It planned a new service to East Timor before the end of June linking Surabaya in East Java to the East Timor capital, Dili, via Denpasar, on Bali.

Yun said the carrier had obtained the necessary permit from the United Nations Transitional Administration in East Timor (UNTAET) for the three times a week flights aboard a Russian made YAK42D.

From July 1, Lion Mentari intends to add a service from Denpasar to Taiwan and on to Seoul using an A310-300. In October, flights linking Medan, northern Sumatra with Madras in India are planned, with links to services into Singapore and Kuala Lumpur. The airline has a fleet of five YAK42Ds and a B737-200 and will soon take delivery of two Airbus A310s and two MD-82s.

New competitors have brought new pressures to bear on Garuda. The airline's president, Abdulgani, has done an excellent job guiding the carrier back on to the financial rails, but he is still finalising the restructuring of the massive US$1.6 billion in debt the airline was carrying when he took charge in 1998. With the assistance of Lufthansa Con-

Bouraq: a private airline that survived the 1998 economic collapse

Merpati: on its way back to health under a new boss

Sempati Air: a government backed carrier that went bankrupt in 1998 sulting, Garuda has steadily been rebuilding its strength.

Prior to the economic crisis, Garuda flew to 27 provinces in Indonesia and 38 international destinations. Now, it operates to a little over 20 domestic and 21 international routes. Among some of the international services it dropped were Seoul, Taipei, Paris, Zurich, Saigon and Rome.

Overall, according to the Ministry of Transport in Jakarta, only 20% of the international routes available under Indonesia's bilateral air agreements are being served by local carriers. That leaves plenty of room for newcomers to grab a slice of the pie, particularly on regional sectors.

As fledgling operators like Awair, now flying Airbus A300-600ER jets to Singapore and Taiwan, claim international customers, Garuda is renewing its efforts to re-open foreign routes dumped after the crisis and to retain market share.

With plans to privatise in 2003, it is doing relatively well. Passenger load factors have risen from 56.3% in June 1998 to more than 70% early this year and yields have lifted from 3.4 cents per seat/km in 1999 to 5.1 cents last year.

Awair, which was launched in June last year with two Airbus A310s leased from Swissair, is a perfect example of the challenge Garuda faces. It is now licensed to fly on 27 domestic and 28 international routes and has a business plan which involves a 27-strong fleet by the end of next year or early 2003. It also has an eye on Taiwan, Australia and other regional cities as destinations and is not ruling out long-haul flying with leased Boeing B777s.

Awair is one airline that appears to have the expertise to survive. Its management includes several former directors of Garuda. Commercial director Kussuyono held the same position at the national flag carrier and the director of operations, Yassir Ismail, also held that position at Garuda. Asep Chandra, who was director of quality control at Garuda, is Awair's technical director.

Lion Mentari is another upstart, already operating on several routes from Indonesia to Malaysia, including Kuala Lumpur. President-director Rusdi also has Singapore in his sights, although he has said the airline wants to be "a big fish in a small pond", an indication he intends proceeding with caution.

In their stampede to grow, small carriers are not only looking to the West for aircraft. Lion and Bayu Air are both reportedly considering purchase of a large number of Russian-made Yak42D, 120-seat jets, which would presumably be cheaper than their Boeing or Airbus counterparts.

This all adds up to clear evidence some of the newcomers don't plan to stay small for long.

There is another problem which impacts on all airlines. During the airlines' down-sizing in 1998 many of Garuda's pilots were farmed out to overseas airlines, including EVA Air, Swissair, Tunis Air and Korean Air.

Cockpit crew from other operators such as Merpati and Sempati (which went bankrupt and folded) also went abroad. Airlines old and new are working hard to persuade many of these to return to fill the flight decks of the nation's rapidly expanding fleet.

And the issue is not only pilots. Said one Jakarta airline analyst who did not want to be named; "A lot of airline professionals, from managers to ground staff and engineers, were left without work during the economic downturn. Many left the country to work for overseas airlines.

"The crisis also resulted in a drop of candidates for training in aerospace and airline-related jobs because they saw no future in it. Now there is a demand again but it takes time to pick up the slack.

"It means some of these new airlines will be trying to operate with executives and staff who may not be sufficiently qualified. It will be a big problem in the next few years as these airlines attempt to expand," the source said.

While the Indonesian government tussles with domestic problems such as social unrest and violence, as well as economic factors like the plunging rupiah/US dollar exchange rate, it will also have to make critical decisions that will decide the course of the air transport industry.

One will be whether changes are made to foreign ownership limits applying to airlines. A Presidential Decree, No. 96, issued last July, limits offshore ownership to 49% of an airline, but there is some sentiment in the industry that favours a review of the decree to attract investment in the air transport sector.

But there are others who believe it does not matter. Lion Airlines president, Rusdi Kirana, said recently foreign investors were not interested in the local airline business. And they will not be as long as Indonesia is in economic crisis and facing political instability. "The airline business is a long-term activity. It would not be possible to operate under unstable conditions. The earliest investors are likely to come in is five years, and then only if the situation is considered safe and stable," he declared.

That contention has not proven entirely correct with at least one operator, Kartika, successfully attracting investment from the U.S. and Taiwan.

Indonesia's airlines, established and newcomers alike, are certainly living in interesting times. Unfortunately, much of what the future holds will depend on issues outside their control; the course of local and regional economies, the value of the rupiah and, last but not least, whether or not Jakarta manages to resolve political and social problems and bring stability to their home market.

Indonesia's skies are awash with hopeful newcomers in the wake of government deregulation of the airline industry. Some estimates suggest there are now 65 air transport companies in existence, though many are tiny, non-scheduled charter operators flying with a single aircraft. Here is a list of the five long-established carriers and 14 fledgling operators considered to have the best chance of success. Where available, fleet numbers are given.

Established Airlines;

- Garuda Indonesia, 42 planes, started operations in 1950.
- Merpati Nusantara, 34, 1962.
- Dirgantara Air Services, 17, 1971.
- Mandala Airlines, 7, 1969.
- Bouraq Indonesia Airlines, 5, 1967.

Newcomers;

- Air Wagon International, 2, June 2000.
- Lion Mentari Airlines, 1, June 2000.
- Bayu Indonesia Air, 1, June 2000.
- Jatayu Gelang Sejahtera, not available, July 2000.
- Pelita Air Services, not available, July 2000.
- Internusa Air, 2, End of 2000.
- Camar Nuansa Air Services, 1, Plans to begin flights end of 2001.
- Indonesia Airlines Avi Patria, 2, Plans end of 2002.
- Satrio Mataram Airlines, not available, Plans end of 2001.
- Star Air, not available, Plans end of 2001.
- Kartika Airlines, 3, June 2001.
- Alatief Alair International, not available, not known.
- Asia Avia Megatama, not available, not known.
- Republic Express, not available, not known.

WEAVING SOME MERPATI MAGIC

When Wahyu Hidayat took charge at Merpati 18 months after the first devastating effects of the Asian economic recession hit Indonesian airlines, the carrier was almost extinct. Ever since that day in 1999, he has been working to restore the carrier to its former glory, with the aim of eventually listing the nation's largest domestic carrier. In the meantime, he has to wage economic war to keep the airline's progress on track during a year of continued social and political unrest in Indonesia. TOM BALLANTYNE *reports.*

Wahyu Hidayat, president of Indonesia's biggest domestic carrier, government-owned Merpati Nusantara, is working to a punishing timetable aimed at privatising the airline by 2004.

But he is not hanging about wondering who might nibble at the opportunity of an equity stake. Brought in by the nation's government in March 1999 to rescue a state asset mired in debt and facing collapse, Hidayat has not let such an operating history dent his enthusiasm for achieving his 2003 goal.

He wants potential suitors to begin lining up now and told *Orient Aviation* interested parties should "feel free to contact me immediately".

"I've already talked to many airlines that are potential strategic investors, but if you are interested in buying into Merpati, get in touch and we will sit down and discuss it," he said.

The invitation not only involves attracting potential investors.

Hidayat, who is chairman of the country's industry body, the Indonesian National Air Carriers Association (INACA) is looking for partners for co-operative commercial deals.

For instance, he believed Merpati could operate leased jets for other airlines, providing crews but flying routes on a revenue-sharing basis – under the partner carrier's livery.

His fighting talk is all about returning Merpati to the status it enjoyed before it was ripped apart in the 1997-98 regional economic crisis. And while Merpati achieved significant gains in 1999 and 2000, the latest wave of local, regional and global market uncertainty, along with persistent unrest in parts of the Indonesian archipelago, have braked the recovery, he said.

Nevertheless, since he took over at Merpati, he has pumped new life back into the carrier and laid building blocks designed to ensure its survival and eventual expansion.

President and director of Merpati Nusantara Wahyu Hiyadat: "We must have political stability. That is what we need most of all."

When Hidayat arrived at Merpati in 1999, the airline was crippled. Two years earlier, before the Asian economic crisis, the second national carrier operated a fleet of 68 B737s, Fokker F-100s and F28 jets and carried up to 4.6 million passengers annually.

By 1998, 200 routes had shrunk to 144 and some 60% of the fleet was grounded because the airline could not pay for ongoing maintenance. Passenger numbers had plunged by almost half, to 2.4 million a year. Hidayat immediately implemented a drastic recovery plan and despite difficulties, within a year encouraging signs of recovery emerged.

"During the 10 years leading up to 1998, Merpati never reported a profit before tax," said Hidayat. "I became chief executive in March, 1999, and by the end of the year we were in profit. Our operating income was 82 billion rupiah (US$11.7 million). Profit before tax was 72 billion rupiah (US$10.3 million)."

At the same time, the struggle to put planes back in the air continued, with the number of operating aircraft rising from 23 to 29 in 1999. Last year, the fleet increased again to 34 and hit 36 aircraft this June.

Fiscal year 2000 showed even more promise, according to Hidayat, when Merpati operating profits more than doubled to 167 billion rupiah (US$23.9 million).

Unfortunately, that was not the entire story.

"Until the middle of 2000 it was OK. We were making a profit and everything was going well. Then in August and September the foreign exchange rate – the rupiah against the U.S. dollar – took a turn for the worse, from 7,800 rupiah to 9,500 rupiah.

"We had a problem. So while we doubled our operating income we suffered more than US$11 million in foreign exchange losses," explained Hidayat.

The situation has not improved, with the exchange rate continuing its decline this year. In May this year, the national currency was 11,000 to the U.S. dollar.

"Some 70% of our expenses are written in the American currency and the present exchange rate is making it very difficult for us," said Hidayat.

Since times have become tough again, he has refocused on cutting costs and extracting more efficiency and productivity at the airline. The task is made harder because Merpati has also attempted to retain jobs during its rebirth and has not cut staff to save money.

Such strategies may create short-term difficulties for Merpati in its search for investors, but it is not the only issue concerning the airline chief.

Hidayat is confident Indonesia's air transport industry has a big future but before it is assured he believes one other element is vital. "The next five to ten years may be a difficult period. We must have political stability. That is what is needed most of all," he said.

Indeed, with regional airlines facing the toughest competitive climate in their histories, Merpati could do without ongoing social strife in its own marketplace.

BENNY'S RISKY BUSINESS?

His airline might be new and it might be small, but ex-Bouraq executive boss, Benny Rungkat, believes it will survive in a market bursting with new carriers. He also hopes to form a partnership one day with national carrier, Garuda Indonesia. TOM BALLANTYNE reports.

As fledgling Indonesian domestic Kartika Airlines launches into the country's increasingly crowded skies in June with its first two Boeing B737-200 jets, president and chief executive, Benny Rungkat, will be reminding himself that big ambitions have to be tempered with early caution.

The veteran airline executive he was formerly with established Bouraq Airlines – knows full well that air transport is a risky business.

"We have to be careful not to invest too much. This has to be a high revenue, low-cost operation and if we keep the costs low then the risk is far less," he declared to *Orient Aviation*.

Even with predictions that some 100 airlines, many of them single aircraft min-nows and charter operators, will be plying Indonesia's air routes by next year, Rungkat is confident Kartika will survive.

The keys to success, he believed, are judicious leasing of second-hand jets and concentration on niche markets where future growth will be generated.

"This country is no good for brand new aircraft which can cost up to US$40 million each. You can purchase a reliable, used B737 for $9 million or a Fokker F28 for $4 million. Or you can lease these aircraft economically.

"They may be older aircraft which can't operate in the U.S. or Europe because of noise restrictions, but they can be flown safely and reliably here and they are ideal for the market," he explained.

Kartika is taking the wet-leasing route. Its first two 120-seat B737s were scheduled to arrive in late May from Malaysian's Transmile aviation group, complete with cockpit crew, some of whom were Indonesian pilots who left the country when the economy collapsed four years ago.

A third will fly in to join the fleet this month and two others will come from Taiwan's Air Asia in the near future. Rungkat said this is only the beginning. Backed by investors in Indonesia, the U.S. and Taiwan, Kartika has been talking to American carrier Horizon Air about the possible lease of 11 Fokker F28-4000s. The fleet plan sees nine B737s in the air before the end of this year and growth to 19 Boeings and 21 F28s by the end of 2003.

Kartika's initial route will be from Jakarta to Surabaya and Manado in eastern Indonesia. The launch service will be followed by a route north from the capital to Bintan island, a popular tourist resort for Singaporeans and Malaysians, then on to Medan in Sumatra province and Penang, Malaysia.

The third route will add Jakarta-Surabaya frequencies to Kartika's network, but the flights will continue to Balikpapan and Makassar in Kalimantan.

The expansion focus will be on eastern Indonesia. Rungkat sees tremendous growth, fuelled by tourism, to centres such as Bali, Lombok, Flores, Timor, Sulawesi and Irian Jaya, the traditional spice islands of the East Indies.

He plans a hub and spoke system, with bases in Jakarta and Surabaya serving west and east Indonesia.

He does not see Kartika as an airline going solely on its own and taking on the bigger, more established players. "I would like to have co-operation with other airlines such as Garuda, feeding passengers from our niche routes to them and taking their customers on to places they don't fly. And I would eventually like to see us as a member or associated with an alliance such as Star, able to exchange passengers and feed from each other.

"Garuda is not a member of Star, although it has very close links with Lufthansa. I would hope Garuda will join the alliance and we can be allies. I would like to work with them because I am a small airline and we can both benefit from the partnership," said Rungkat.

Whether Garuda, itself still in recovery, agrees remains to be seen. But Benny Rungkat has absolutely no doubt that if and when a shake-out of the country's plague of newcomers takes place, Kartika will not be one of those to disappear.

CHINA CHILL?

By Tom Ballantyne

Senior executives from U.S. planemaker Boeing may not be voicing it publicly but they remain privately concerned that short to medium-term business with Beijing, potentially worth billions of dollars, may suffer in the wake of the U.S. spy plane collision incident and ongoing diplomatic tension between the two powers.

This is despite speedy moves in mid-May by both Boeing and Chinese air regulators to quash strong reports that a US$1 billion order for at least 30 new generation B737 jets is on hold.

But at the same time, Boeing insiders say the company's chairman Phil Condit is being strongly advised by his staff to put off any trips to China, at least for the time being. Advisers fear that as head of one of the biggest firms in the U.S., especially one which is deeply involved in military and space production as well as commercial aircraft, he would be in serious danger of becoming the meat in a tricky political sandwich.

First reports of the claimed action on aircraft orders appeared in the *Asian Wall Street Journal (AWSJ)*, apparently based on reports by Chinese airlines who met with executives of Western jet leasing firms.

Analysts were hardly surprised, given that Beijing has a history of using trade muscle to show its displeasure. In the past it has announced big orders for Airbus when unhappy with Washington... and major orders for Boeing when upset with Europe.

Because of this, senior Boeing managers are maintaining an extremely close watch on Chinese developments, fearing aircraft orders could yet be used as a diplomatic weapon.

The *AWSJ* report appeared to be based on strong evidence. While it said Chinese officials did not explicitly link the status of the Boeing order to strained relations between the countries, it quoted officials of leasing companies as saying the orders were effectively in limbo. "Those are all on hold now," one was quoted as commenting.

Another leasing executive, Peter D. Chang, managing director of U.S.-based China Aviation Marketing Inc., indicated he has been asked by Chinese officials to help supply aircraft to fill the anticipated shortfall created by a hold on the Boeing jets, although he expected the U.S. order to be signed eventually.

China has ordered 30 Next Generation B737 jets from Boeing Aerospace

China Aviation's clients include Boullioun Aviation Services of the U.S. and Singapore Aircraft Leasing Enterprises (S.A.L.E.), both of which compete with Boeing for Chinese orders.

The newspaper report also quoted a senior official from China Aviation Supplies Import & Export Corporation, the government agency handling most aircraft deals, as saying the issues surrounding the Boeing purchase "are something very sensitive and I don't know if it's going to be affected or not."

There have been other indications of a potential trade chill on the aviation front. On the day the U.S. Navy surveillance aircraft made an emergency landing in Hainan after colliding with the Chinese fighter (the Chinese Air Force pilot died), Hainan Airlines cancelled a previously scheduled meeting with a U.S. leasing company executive to discuss the purchase of a B737.

Another carrier, China Xinjiang Airlines, also abruptly broke off negotiations for a B737 sale, saying it could not get approval from government authorities.

Nevertheless, Boeing officials are denying any unusual activity. After the *Wall Street Journal* report appeared, Tom McLean, the planemaker's spokesman in China, said; "For us, it's been business as usual ."

In Seattle, Boeing spokeswoman Ivy Takahashi insisted the orders appeared to be on track for the normal approval process. "We were given no indication this pending order or future pending orders should be directly impacted by the current political situation. We don't believe this 30 aeroplanes order is being put on hold. It's very much within the time-frame which we originally anticipated," she said.

"We anticipated May and June as the time-frame when we would get a confirmation on the yet to be finalised orders. This being May 14, we don't have any indication or reason to make an assumption that this is being put on hold."

Another Boeing executive, Bob Saling, added; "The relationship we have with the Chinese government is very good and over time, everything always works out."

On the Chinese side, there also appears to be uncertainty about the precise situation. Officials at all three of the country's major carriers, Air China, China Eastern and China Southern, said they had heard of no decision to suspend Boeing orders. Ma Songwei, a spokesman for the Chinese regulator, the Civil Aviation Administration of China (CAAC), said he had asked other officials about the *Asian Wall Street Journal* report and none had heard of such a postponement.

In China, where the right hand often appears not to know what the left hand is doing, this does not mean the reports are untrue.

It is highly plausible that political decisions have been taken and pressure is being put on behind the scenes, without any official announcement, to hold up the Boeing orders, at least for a while.

It is for that reason that Boeing's upper echelon may be nervous. They have projected China will be the world's second largest market for commercial jets through 2019 and orders from Beijing are critical to maintain stability on production lines into 2002 at a time U.S. demand for new jets is flattening.

Boeing delivered 19 jets to China last year and is scheduled to ship 26 previously ordered aircraft through this year. But it wants to pin down more.

On the plus side there appears to be no indication a recently confirmed order for two B747 freighters for China Southern is affected. The first freighters owned by the airline, they are due for delivery in mid-2002 and will be used to open cargo routes to Japan and Europe.

As Boeing heads into the Paris Air Show and another confrontation with rival Airbus on its home turf, like everyone else, Phil Condit and his team will simply have to wait and see.

CHINA:

Shape of things to come

With a brace of important announcements in the space of days, China's turbulent aviation industry appears to have quickened its pace of reform and change. But in the words of one analyst, there is still "a hell of a lot of work to do" before the overhaul is complete and the sector's notorious growing pains have eased. **Jonathan Sharp** *reports.*

Confirming a widely reported consoli dation blueprint, the Civil Aviation Ad ministration of China (CAAC) said at the end of April that nine airlines under its wing would merge into three groups led by the nation's biggest carriers, Air China, China Eastern Airlines and China Southern Airlines. Another CAAC-run carrier, Great Wall Airlines, is already in the process of teaming up with China Eastern.

The mergers are key to Beijing's goal of forging a strong and internationally competitive airline sector out of a fragmented industry that presently features more than 30 airlines and has long been dogged by over-capacity, reckless price wars, heavy indebtedness and poor records of safety and service.

According to the *Xinhua* news agency, upon completion of the consolidation the China Southern group would emerge as the largest, with a fleet of 180 aircraft and 606 flight routes. The Air China group would have 118 aircraft and 339 flight routes and the China Eastern group would have 118 aircraft and 437 routes.

Hard on the heels of the long-expected CAAC announcement came the less heralded news that six regional airlines left out of the CAAC merger plans and thus risking being marginalised would form an alliance called China Sky Group.

But many questions remain to be answered before the final shape of the revamp is settled. Referring to the CAAC-mandated restructuring, Peter Negline, regional transportation analyst with JPMorgan , said that while the outlook for the Chinese aviation sector was positive and exciting, the big issue was one of timing.

"There is a long way for them to go, and there are problems you cannot solve overnight. There will be complex legal issues to work through in terms of actually putting the businesses together." He cited regulatory hurdles that still had to be cleared and problems such as airlines saddled with expensive equipment.

He said that one of the biggest debilitating aspects of the industry in China was that a lot of capacity was acquired or ordered in the early to mid-1990s at exorbitant, top-of-the-market rates.

"The asset rehabilitation process is key to seeing, perhaps by the middle of this decade, a very different and much more competitive, profitable, sustainable and self-supporting industry emerging," he said.

It was a positive sign that the merger line-up had been confirmed. "The fact

China's air travellers: biggest future world market

Peter Hilton of Hong Kong Research at Credit Suisse First Boston: China Sky Alliance must be tested in the market place

that this policy has taken a year or so to get all of the ducks lined up suggests that everybody's heading in the same direction," said Negline.

He said that while the international, cargo and – in particular – the domestic markets were all important for Chinese aviation, the first issue it had to focus on was safety.

"I think the industry has made some very important steps in that direction, but they cannot afford to take their attention off that issue."

He said that of the three pillar airlines in the CAAC consolidation plan, China Eastern had the advantage of having fast-developing Shanghai as its base. "Shanghai has to be one of the most valuable hubs in the country."

However, the emergence of the six-airline China Sky alliance might "rattle the cage" of China Eastern, particularly as it included Shanghai Airlines, which has been a fairly fierce competitor of China Eastern for some time.

"I think China Eastern is going to have more to deal with than the other two majors (because) it will have a major competitor on its doorstep," said Negline.

According to the blueprint, China Eastern is teaming up with China Northwest Airlines, which is reported to be in difficulties, and Yunnan Airlines, which is in much better shape.

Under an earlier plan, Yunnan Airlines was to link with its nearer neighbour, Guangzhou-based China Southern Airlines, which is linked with China Xinjiang Airlines and China Northern Airlines.

Negline said that Xinjiang Airlines, based in the far western city of Urumqi, was making money on both passenger and cargo traffic, including quite a high level of government traffic ferrying bureaucrats and military personnel.

While Xinjiang Airlines' fleet included some outmoded Soviet-built aircraft it also had Boeing models that would fit well with China Southern's fleet. China Northern Airlines, on the other hand, has little commonality with China Southern and is losing money.

Negline said the teaming up of China Southern, in the southern city of Guangzhou, and China Northern in faraway Shenyang raised the question of whether the airlines heading each of the three merged groups could exercise proper control over their partners.

"Airline businesses run best when there is fairly centralized fleet planning, network development and aircraft scheduling. You can decentralize things like maintenance and pilot training to a certain extent, but there are a lot of issues that are key to the business that you can't decentralize.

"Will the guys at China Southern in Guangzhou have genuine control over pricing in Shenyang? Will they able to control airport operations?"

Negline said he was not surprised by the emergence of the China Sky alliance as a response to the announcement of the CAAC mergers, whose airlines control an estimated 82% of the Chinese market. "It's an issue of survival."

The group comprises Shanghai Airlines, Shandong Airlines, Shenzhen Airlines, Sichuan Airlines, Wuhan Airlines and China Postal Airlines and together accounts for about 12% of China's traffic volume.

"I don't think a lot of those guys would have done very well just with 10-20 aircraft in a secondary city," said Negline, who pointed out the dynamic opportunities posed by China's rapid growth, its impending accession to the World Trade Organisation and the possible opening of direct air links between Taiwan and the mainland.

He said it was an interesting twist for the group to include China Postal, which operates mail routes for the Chinese government.

"Even for some of these smaller airlines, if they are in cities where there is fast-rising industrial development, there definitely will be decent opportunities for a good nation-wide postal or express parcel network. This group will probably have enough belly space to support that."

Like Negline, Peter Hilton of Hong Kong Research at Credit Suisse First Boston said it remained to be seen how viable the China Sky alliance was. While its structure was unclear,

Peter Negline, regional transportation analyst with JPMorgan: too much capacity in China market

alliance members have spoken of code-sharing arrangements and route coordination, followed by equity swaps.

Similarly he said the course ahead for the aviation sector's restructuring was still clouded. "At least they have laid out the broad brush strokes."

He said a lot of the airlines involved had complicated structures with parent organisations. "So the initial mergers will probably be between parents such as China Southern Airlines (Group), and then the underlying airlines will get merged as well."

Issues such as which assets are to be involved in the mergers, when the links will be finalized and how profitable the sector eventually will be all remain to be settled.

Hilton likened China's problems of over-capacity and fragmentation to those of the American aviation industry in the early 1980s prior to deregulation.

But instead of allowing a painful shakeout involving bankruptcies, China was seeking to restructure its way out of over-capacity, excessive competition and low profitability.

"The government would like to get to a point of profitability which puts the industry on a footing where it can consider investments that it will require to resist competitive forces quicker."

Hilton noted that of the big three Chinese airlines, national flag carrier Air China is due to merge with China National Aviation Corp, a holding company for Zhejiang Airlines, Air Macau and a Hong Kong-listed firm that has a 43.3% stake in Hong Kong's Dragonair.

He said that the Air China group's interest in Dragonair might lead to suggestions of entering into competition with Hong Kong's Cathay Pacific Airways. However he thought that since the whole merger process was aimed at reducing excessive competition and improving the cash flow of major airlines, the powers-that-be in China would be inclined not to take steps to exacerbate competition.

"Once Dragonair gets inside the Air China group, there are more than enough management challenges to go around," Hilton said.

He believes that Cathay Pacific was strategically interested in increasing its access into China, and a partnership with China Eastern made sense "in that it is based in Shanghai which is the northern doppelganger of Hong Kong."

But he said Cathay and other regional airlines that may be keeping a weather eye on the China scene would probably wait until they see the mainland industry's final form. In particular, they might want to see if proposals to lift the limit on foreign investment in Chinese airlines from 35% to 49% come to fruition.

Hilton sees a post-merger Air China, while not as large as the China Southern group, as a strong player in view of its role as flag carrier and therefore an airline that authorities would strive to make a success. It also has the advantage of a hub in the Chinese capital and, arguably, a hub in the south through Dragonair.

Also, Air China is due to link up with China Southwest, a profitable airline that Hilton described as "a very positive acquisition – Air China have done very nicely in terms of what they have picked up".

•Jonathan Sharp was Reuters correspondent in Beijing in the early 1970s and witnessed the arrival of China's first large-scale imports of Western airliners: Boeing 707s and Hawker-Siddelev Tridents (the latter were paid for in gold).

Shandong Airlines' boss Sun Dehan: leader of second tier China Sky Alliance

SURVIVAL OF THE SLICKEST

In a swift defensive action, six second-tier mainland carriers left out of the planned mergers of ten government-owned airlines have formed the China Sky Enterprises Group Alliance. By staff reporters.

Gritty Sun Dehan is not the sort of airline boss to allow his gutsy little carrier to disappear in the wake of the merger of ten of China's government-owned airlines into three groups.

So it was no surprise to learn, only days after the Civil Aviation Administration of China (CAAC) had announced its proposed merger plan, that Sun, president and chief executive of the listed coastal province carrier Shandong Airlines, had formed an alliance of six of the carriers left out of the CAAC's big three future aviation strategy.

Called the China Sky Enterprises Group, its other members are Shanghai Airlines, Shenzhen Airlines, Sichuan Airlines, Wuhan Airlines and China's only postal air carrier, China Postal Airline.

The six airlines, which grouped together have a fleet of close to 100 aircraft serving about 500 routes in China, are estimated to account for 12% of all airline travel in the nation and contribute about 35% of total, national airline profits to the industry. Estimated annual revenue of the alliance is eight billion yuan (US$966.4 million).

Spokesmen for the individual airlines in China Sky said that some of their management were unnerved by the massive re-structure of mainland carriers announced on April 30. Many of the overlooked carriers faced a choice: seek to join one of the groups and be swallowed up by a bigger carrier further up the industry chain or form a united front or alliance to protect market share.

A Shandong Airlines' spokesman, Zheng Baoan, said at the alliance's unveiling in May that it would take shape in two stages. Firstly, the members would agree on code-shares and the integration of their route networks. Once these are established, the carriers intend to make equity swaps and sales between themselves.

This is not the first time Shandong Airlines, believed to be China's most profitable airline, has been in an alliance. In 1997, it was the leading force behind the New Star alliance of Shanghai, Shenzhen, Wuhan, Zhongyuan and Hainan Airlines, which did not last. Zhongyuan Airlines is being acquired by China Eastern Airlines and listed Hainan Airlines has chosen to go its independent way.

Sun has always been a strong supporter of CAAC's market reforms and believes that small, short-haul carriers have a very promising future in China. However, Sun's airline is not perceived as very influential in Beijing and he had to rely on provincial government support to get his airline up and running in the 1990s.

It is expected he, and the presidents of the other provincial airlines in alliance – with the exception of Shanghai Airlines – will be following Sun's example by building their support at home political bases if they are to be viable in the post-merger era of Chinese mainland aviation.

EXPLOSION

Despite the twin setbacks of the 1998 Asian recession and the U.S. and Japanese economic slowdowns of this year, China remains on statistical track as the nation forecast to record one of the fastest and largest growth in airline passengers in the next 15 years. **Tom Ballantyne** *reports.*

Trade normalisation and market liberalisation will help China achieve the second highest rate of air traffic growth in the Asia Pacific – a staggering 208% increase over the years to 2014, according to the latest edition of the Air Transport Action Group's (ATAG) Asia/Pacific Air Traffic Growth & Constraints.

Using projections based on International Air Transport Association (IATA) traffic forecasts, ATAG said China's expansion will be outstripped only by Vietnam, which will see even more phenomenal growth of 10.5% annually, or a 347% increase in the period.

However, from 1999 to 2014, China will become the largest Asia/Pacific country for domestic and international scheduled passengers combined, with air travel numbers predicied to increase from 69.6 million to 214.7 million.

Vietnam's growth will be more spectacular, but actual passenger numbers involved will be far smaller, with traffic rising from 4.3 million in 1999 to 19.2 million in 2014.

ATAG clearly sees China as the primary driving force behind overall Asia/Pacific airline growth in the first two decades of the century, a position underpinned by strong projections for the Special Administrative Region (SAR) of Hong Kong.

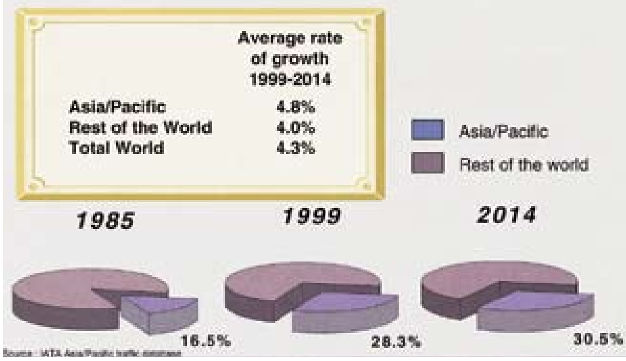
The former British colony, which was handed back to China in 1997, grabs third place on the projected growth table, with forecast yearly rises in traffic of 6.2% behind China's 7.8%. China's total share of the region's air traffic in 1985 was 9.9%. This increased to 16.1% in 1999 and will reach 24.6% in 2014.

ATAG said it should be noted China has revised its air traffic statistics and percentages cited in the latest edition of Air Traffic Growth & Constraints. The third update of the 1992 publication does not match the figures for corresponding years published in the 1997 edition of the report.

While ATAG paints a bright picture for China's airline industry, despite ongoing questions over volatile economic conditions, it does point to potential problems, They are predicted to arise from insufficient airport capacity at the nation's air terminals, particularly in the busy Pearl River Delta region in southern China.

The delta – at present an economic powerhouse for the country – is served by five airports; Hong Kong, Shenzhen, Guangzhou, Zhuhai and Macau. They have a combined annual passenger capacity of 105 million and in 1999 handled some 52 million passengers between them.

However, ATAG said assuming an average annual growth rate of 7%, it would take only 10 years for traffic to reach saturation airport capacity.



Asia-Pacific share of world traffic

In the past, Japan has been the region's dominant travel market (domestic & international travel combined). In the future, it will be China. In 2014, over 214 million passengers will travel to, from and within China.

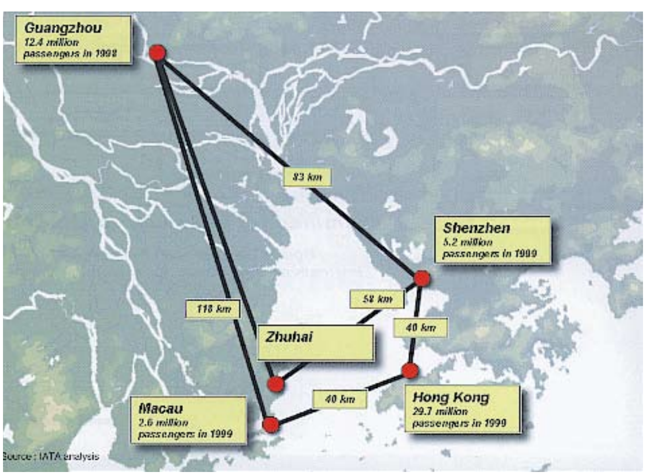
Figures are annual passengers in millions.

	1985			1999			2014		
	Domestic	Int'l	Total	Domestic	Int'l	Total	Domestic	Int'l	Total
China	13.5	1.9	15.4	52.9	16.7	69.6	157.3	57.4	214.7
Japan	43.8	16.3	60.1	91.5	48.0	139.5	108.8	87.0	195.8
Chinese Taipei	5.9	4.8	10.7	32.5	19.9	52.4	51.6	49.5	101.1
Korea (Rep. of)	3.3	4.2	7.5	21.1	17.3	38.4	37.8	45.2	83.0
Australia	13.1	5.5	18.6	25.4	14.0	39.4	41.1	34.1	75.2
Hong Kong SAR, China	0.0	9.3	9.3	0.0	29.1	29.1	0.0	71.4	71.4
Thailand	1.4	5.4	6.8	6.3	19.4	25.7	15.0	44.3	59.3
India	8.8	4.6	13.4	13.0	11.4	24.4	31.0	26.5	57.5
Singapore	0.0	8.6	8.6	0.0	21.7	21.7	0.0	51.4	51.4
Malaysia	3.3	3.4	6.7	8.2	10.2	18.4	15.5	23.8	39.3
Indonesia	2.6	2.4	5.0	4.4	6.8	11.2	8.9	18.3	27.2
New Zealand	2.7	2.2	4.9	5.9	5.9	11.8	10.8	12.4	23.2
Philippines	3.3	3.1	6.4	2.0	7.0	9.0	4.6	16.3	20.9
Vietnam	0.0	0.1	0.1	1.7	2.6	4.3	8.4	10.8	19.2
Pakistan	2.3	2.7	5.0	3.3	4.3	7.6	4.9	8.4	13.3
Hawaii	0.0	3.2	3.2	0.0	5.2	5.2	0.0	7.1	7.1

Note : For the sake of consistency in trend analyses, traffic to and from Hong Kong has been considered separately from traffic to and from China, even though Hong Kong is part of China.

Source : IATA Asia/Pacific traffic database

Saturation capacity at five Pearl River Delta Airports by 2010 (ATAG forecast 2001)



China will become the leading Asia-Pacific country for total domestic and international travel by 2014 (ATAG forecast 2001)

OUT OF THE SHADOWS

The China National Aviation Corp. (CNAC) is assuming a higher industry profile as its influence grows in greater China aviation. By staff reporters.

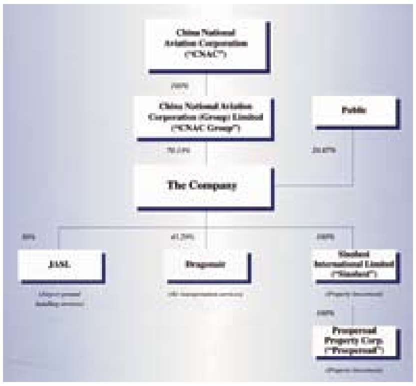
One insider said the question most often raised in China about the proposed merger of Air China and the China National Aviation Co. (CNAC) is: will the CNAC tail wag the Air China dog?

No-one knows the answer to that question yet, but there is no doubt the CNAC leadership has quickly matured into a group with a polished public face to its management and an expanding list of subsidiaries within its operating ambit.

Its new chairman Kong Dong, who was quickly promoted from president and executive director in Hong Kong to overall chairman earlier this year, is confident and seen as a winner. He ran Shenzhen International Airport in the early 1990s and was promoted to oversee the extensions at Beijing Capital International Airport. He also has been effectively in charge of the China Ocean Helicopter Company.

The CNAC also brings to its new grouping, which has profitable carrier China Southwest as another member, income from its holdings in Zhejiang Airlines, Air Macau and most importantly, appealing and expansionary good earner, Dragonair in Hong Kong. These advantages suggest to some analysts that the CNAC will seek control in the new grouping disproportionate to its size and the number of airplanes it flies.

The circumstances in which the CNAC now finds itself are light years away from its start in life in the 1930s as China's flag carrier. When the Communist Party won power in 1949, the Civil Aviation Administration of China (CAAC) was established. Under the new regime, the CNAC became the equivalent of a modern day logistics supplier and operator of distribution services for the CAAC's airlines. It languished in that role for decades in the shadowy world of mainland aviation bureaucracy and vainglorious politics. In those 40 plus years, several of China's ambitious provinces started their own airlines, which further reduced the CNAC's profile. It was not until the early 1990s that the CAAC revived the fortunes of the CNAC by granting it approval to operate as an airline in Hong Kong.



CNAC: doing well with its investments

The unexpected arrival in the then British colony of a mainland carrier intent on setting up rival airline operations stunned most members of the industry in Hong Kong. The plan provoked several vibrant dialogues between the management of Cathay Pacific Airways, Cathay Pacific – controlled Dragonair, Chinese aviation authorities and the CNAC about the intrusion onto the very lucrative turf of Hong Kong and neighbouring China.

An artful and intelligent compromise and some subtle corporate diplomacy produced a very positive result for the CNAC. Cathay Pacific agreed to sell it a large cache of its shares in Dragonair (43.29%), thereby prematurely terminating its 15-year management contract at the regional carrier.

Stanley Hui, a rising star at Cathay Pacific, jumped ship to head a re-aligned Dragonair now controlled by mainland investment and aviation interests. Able and sophisticated Thomas Tsang, from Air Hong Kong, also joined the CNAC and is now general manager of its Hong Kong operations. After the deal with Cathay Pacific was struck, the CNAC application to set up an airline in Hong Kong was quietly dropped.

Until its recent move to Lantau, the CNAC's administration has kept a low profile at its Hong Kong base, in downtown offices. *Orient Aviation* interviewed Kong's predecessor, Wang Guixiang, before the return of Hong Kong to China in mid-1997, who said, enigmatically as always, that his airline group had "interesting plans".

Since then Dragonair has expanded its network in China and extended its charter and scheduled services to several regional, mainly leisure, destinations. It also is developing cargo services that extend beyond its regional passenger routes, to Europe. The CNAC has spread its wings, too, and controls Air Macau and CNAC Zhejiang Airlines. It also has significant equity in ground, ramp, cargo and catering services based at Hong Kong International Airport (HKIA).

The company's burgeoning interests in Hong Kong are housed grandly at CNAC House, a new complex situated on a rise almost directly opposite the vast Cathay Pacific Airways complex, Cathay City.

At this stage, Kong spends most of his time in Beijing,where he is very busy, according to insiders. Doing what? we asked. Nobody was prepared to elaborate on that.

THE CNAC DECISION-MAKERS

THE BOSS...

A trained economist, Kong Dong (53) succeeded Wang Guixiang as chairman of China National Aviation Company Limited last March a few months after he was appointed executive director and president of China National Aviation Corp. and its parent, China National Aviation Corporation (Group) Ltd in January. A graduate of the Jiangxi Institute of Technology, he has headed up several demanding projects in mainland aviation including developing Shenzhen International Airport and was director-general of the recent multi-million dollar expansion of Beijing's international airport. He told *Orient Aviation* in 1993: "Only by training middle management and investing in building the skills of workers will Chinese airports and airlines reach international standards. When this happens outside expertise will be attracted to China and we will make another step towards reaching satisfactory world status". He joined China National Aviation Corporation and China National Corporation (Group) Ltd. as Executive Director and President in January 2001.

THE EXECUTIVE DIRECTORS...

There are four executive directors, Chuang Shih Ping, (90), Zhang Xianlin (47), Tsang Hing Kwong Thomas (46) and Xin Wei (48).

Chuang, the founder and honorary chairman of Nanyang Commercial Bank, has been a CNAC director for more than 40 years and advises the company on overall strategy and development. He is honorary president of the Chinese Bankers Club in Hong Kong and the Hong Kong Chiu Chow Chamber of Commerce Ltd.

Zhang joined the CNAC Group in April 1997 and is its executive vice-president in charge of finance, investment, sales and marketing. He also is a director and a member of the executive committee of Dragonair and was a CAAC deputy director-general for finance before he joined the CNAC. An accountant, he graduated from Huazhong University of Science and Technology and holds a Master of Business Administration degree.

CNAC chairman Kong Dong: record of success

A London University-educated science graduate, [Thomas] Tsang Hing Kwong (46), is a director of Dragonair and a member of the carrier's executive committee. Before he joined the CNAC Group as vice president in April 1995, he was a manager at certified public accountants Peak Marwick Mitchell & Co. and was a founder of freight only carrier, Air Hong Kong Ltd.

Xin Wei (48) is a vice-president of the CNAC Group, and is in change of new airport development projects for it. Xin graduated from Beijing Economics University and is an economist who joined the CNAC Group in September, 1996. He has had many years of experience in the aviation transportation industry.

THE NON EXECUTIVE DIRECTORS...

[Peter] Lok Kung Nam (65), who was head of the Civil Aviation Department when he retired in 1996. At present he is a consultant to the Flight Standards Department of the CAAC and Helicopters Hong Kong Ltd, and a non-executive director of China Eastern Airlines and China Southern Airlines.

Dr. [Henry] Hu Hung Lick (81), a Paris trained academic, is president of Shue Yan College, a member of the Standing Committee of the Chinese People's Political Consultative Conference, and a member of the Preparatory and Selection Committee for the First Government of the Hong Kong Special Administrative Region.

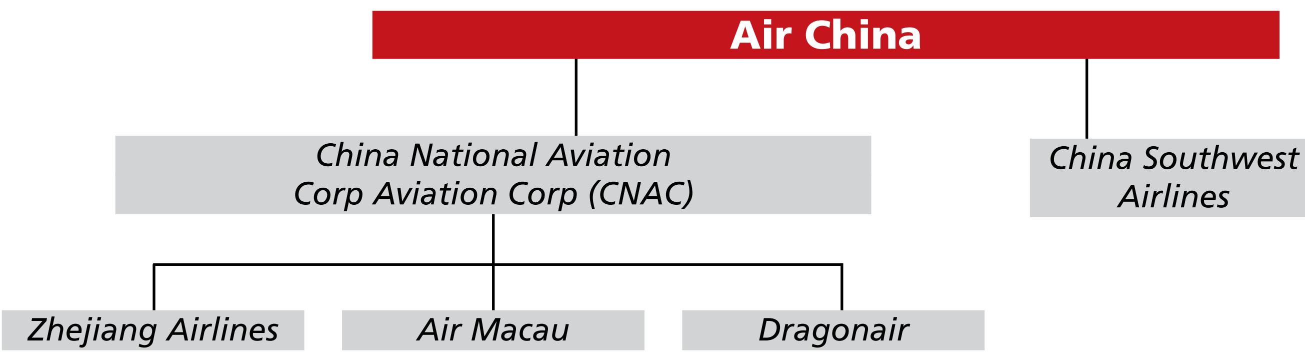
[Charles] Ho Tsu Kwok (51) who has been a non-executive CNAC director since 1997, is the chairman of Hong Kong Tobacco Co., Ltd and the founder of the Global China Technology Group. Ho is a member of the Ninth National Committee of the Chinese People's Political Consultative Conference, chairman and director of the Sing Tao group, director of China Petroleum and Chemical Corporation and an economic consultant to the Shandong Provincial Government.

[John] Li Kwok Heem (46) is the chief executive officer of the Hong Kong Business Aviation Centre Ltd and financial adviser with Herbert Tsoi & Partners, Solicitors and Notaries. Previously, he was a partner with certified accountants, Pricewaterhouse-Coopers. He graduated from the Imperial College of the University of London in science and is a Fellow of the Institute of Chartered Accountants in England and Wales and the Hong Kong Society of Accountants.

CHINA'S SUPER CARRIERS

Eighteen months ago there were more than 30 airlines operating in the People's Republic of China. In June 2001, that number had been halved in a grand plan conceived by the Civil Aviation Administration of China (CAAC). The re-structure of the ten government-owned airlines into three major groups headed by one of the big three China carriers – Air China, China Eastern Airlines and China Southern Airlines – is the most significant development in mainland aviation in the last three decades.

I. Air China, CNAC and China Southwest Airlines



AIR CHINA

The smallest of the big three carriers, Beijing-based international carrier, Air China, is 100% owned by the Chinese government and is the country's flag carrier. The carrier was restructured as a semi-independent company in July, 1988 following CAAC's first round of reforms. It is the last of the big three to announce plans for domestic and foreign listings, planned for either 2002 or early 2003.

Air China operates 72 aircraft, including 18 B747s, seven B777s, 10 B767s and 26 B737s. Due to overcapacity however, the three A340s were subsequently leased out, while four older B747s were sold and one converted to a freighter.It has eight A318s on order, with options for two more, and will become the launch carrier in Asia for the A318.

Alliances and mergers

Air China avoided codeshare agreements in the early 1990s, but since 1995 it has established them with Asiana Airlines, Korean Air, Northwest Airlines, SAS, Swissair and Tarom and most importantly, Star Alliance leader, Lufthansa German Airlines.

Co-operation between Lufthansa and Air China was established in 1989 when they founded their joint venture maintenance company, AMECO. In 1991, the carriers signed a freight codeshare agreement covering eight weekly China-Germany frieght frequencies. They now operate passenger codeshares between Beijing and Frankfurt and have established a study programme where Lufthansa is training more than 20 Air China managers a year in Germany. Air China is also being wooed by the European carrier in a developing relationship that could lead to the China airline joining the global Star Alliance.

Air China	
Identity code	*CA*
Founded	*1988*
Ownership	*100% state*
Headquarters	*Beijing*
Destinations	*Domestic 47*
	International 34
Passengers carried 1999 (000s)	*Domestic 4,200*
	International 2,444
Aircraft fleet (units)	*74*

CHINA SOUTHWEST AIRLINES

CAAC set up the Chengdu carrier in 1987 and wholly owns the carrier. It has developed an extensive route network and is one of the nation's truly viable airlines, with annual passengers rising to more than six million.

China Southwest could benefit from the merger as its management is keen to establish a commuter jet fleet to serve outlying Sichuan province airports. It has a fleet of 37 airplanes.

China Southwest Airlines	
Identity code	*SZ*
Founded	*1987*
Ownership	*100% state*
Headquarters	*Chengdu*
Destinations	*Domestic 42*
	International 6
Passengers carried 1999 (000s)	*Domestic 4,349*
	International 159
Aircraft fleet (units)	*42*

CNAC ZHEJIANG AIRLINES

Zhejiang Airlines was established in July 1986 by a joint-venture agreement between the Zhejiang Provincial Government and China Eastern Airlines. It started services with two Tu-154 aircraft. It has never made a profit and was acquired in late 1996 by China National Aviation Corp. (CNAC). CNAC introduced four A320s into the fleet four years ago but the carrier is still struggling.

CNAC Zhejiang Airlines	
Identity code	F6
Founded	1987
Ownership	100% state
Headquarters	Hangzhou
Destinations	Domestic 15
	International 0
Passengers carried 1999 (000s)	Domestic 850
	International 0
Aircraft fleet (units)	8

DRAGONAIR

Dragonair has been expanding rapidly since it commenced operations in July 1985 with a B737-200 service to Kota Kinabalu (Malaysia). In January 1990, Cathay Pacific and its parent company, Swire Pacific acquired a 35% holding in Dragonair, while CITIC Hong Kong acquired a 38% share. In the second half of 1990, Swire and Cathay Pacific increased their holding in Dragonair to 43%, while CITIC Pacific's holding rose to 46%.

In 1996, CNAC acquired 3.7% of the carrier, subsequently increased its equity in September 1997 to 43.2%. Its major strategic advantage is its position as the only Hong Kong carrier with access to mainland China.

The CNAC owns 43.3% of Dragonair. Other shareholders include CITIC Pacific Ltd. (28.5%), Swire Pacific Ltd. (7.7%) and Cathay Pacific (17.8%).

Dragonair	
Identity code	KA
Founded	1985
Ownership	43.29% CNAC
	56.71% corporate
Headquarters	Hong Kong
Destinations	Domestic 0
	International 27
Passengers carried 1999 (000s)	Domestic 0
	International 2,218
Aircraft fleet (units)	18

AIR MACAU

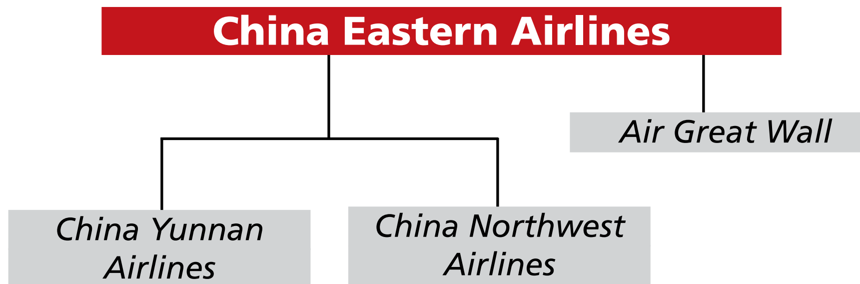
Air Macau is the national carrier of Macau and was set up in 1994 by the governments of China and Portugal. The Macau Air Transport Company, wholly-owned by China, originally held 51% of the carrier, Portugal State Airlines 25% and the Macau Government 5%.

It launched services to Taiwan – thereby developing Macau into a centre for Taiwanese travellers to visit China.

The flag carrier's shareholders have changed to 51% for the CNAC, with other shareholders taking a reduced equity to accommodate the change.

Air Macau	
Identity code	NX
Founded	1994
Ownership	51% CNAC, 39% corporate,
	5% Macau Territory, 5% investors
Headquarters	Macau
Destinations	Domestic 0
	International 13
Passengers carried 1999 (000s)	Domestic 0
	International 1,300
Aircraft fleet (units)	8

II. China Eastern Airlines, China Yunnan Airlines, China Northwest Airlines and Air Great Wall



CHINA EASTERN AIRLINES

Eastern Air Group, the holding company of Shanghai-based China Eastern Airlines controls more than 30 joint ventures and foreign-funded enterprises involved in passenger and cargo transport, tourism, hotels, catering, property, import-export, advertising and futures exchange. China Eastern listed both domestically (Shanghai) and internationally (Hong Kong and New York) in 1997.

The group operates more than 75 aircraft, including three freighters. China Eastern's fleet has undergone extensive renewal since 1998 involving Airbus aircraft.

Under the re-equipment programme, the airline's fleet is expected to increase to 100 aircraft by 2005. It bought China General Aviation Corp (CGAC) three years ago, a medium-sized airline with 2,000 employees. Eastern General Aviation Company (a subsidiary of China Eastern) was established to hold CGAC's civil aviation operations and assets, including three Boeing 737s. In September 2000, China Eastern announced plans to acquire 55% of Air Great Wall. China Eastern has expressed some interest in the oneworld alliance, of which Cathay Pacific is a member. It operates code-shares with All Nippon Airways and Air France. It has joined the Cathay Pacific Airways' FFP, Asia Miles.

China Eastern Airlines	
Identity code	MU
Founded	1987
Ownership	67.8% state, 32.2% traded shares
Headquarters	Beijing
Destinations	Domestic 26
	International 18
Passengers carried 1999 (000s)	Domestic 6,750
	International 1,717
Aircraft fleet (units)	80
Net profit/(loss) 1999 US$m	18.2 (group)

CHINA NORTHWEST AIRLINES

China Northwest Airlines was established in December 1989 during a CAAC restructuring. Set up in Xian in Shaanxi, it launched its first international service, to Nagoya, in 1992.

China Northwest Airlines	
Identity code	WH
Founded	1989
Ownership	100% state
Headquarters	Xian
Destinations	Domestic 36
	International 8
Passengers carried 1999 (000s)	Domestic 2,409 (1998)
	International 304 (1998)
Aircraft fleet (units)	36

YUNNAN AIRLINES

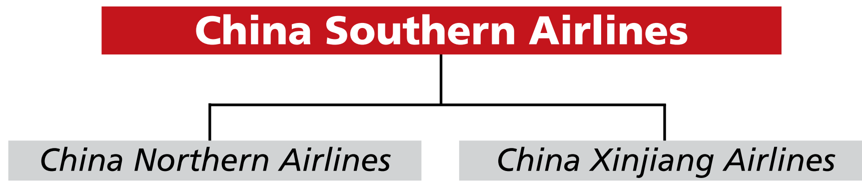
Yunnan Airlines started 1992. Its one of ten airlines under CAAC control and is based in Kunming in Yunnan. Tourism helped make it China's most profitable airline in 1998. It operates more than 22 routes and has reported strong growth in passenger and cargo traffic.

Yunnan Airlines	
Identity code	3Q
Founded	1992
Ownership	100% state
Headquarters	Kunming
Destinations	Domestic 44
	International 3
Passengers carried 1999 (000s)	Domestic 2,301
	International 107
Aircraft fleet (units)	20

AIR GREAT WALL

Air Great Wall is expected to take two to three years to completely integrate into the China Eastern airline group. China Eastern plans to expand the Ningbo operation by increasing its fleet to eight medium and six regional jet aircraft by 2002 and to launch services to Hong Kong, Thailand and Japan within the next three years.

III. China Southern Airlines, China Northern Airlines and China Xinjiang Airlines



CHINA SOUTHERN AIRLINES

China Southern Airlines is one of the forces in Chinese aviation. The Guangzhou-based carrier is listed on the New York and Hong Kong stock exchanges and operates an integrated international, domestic and regional passenger and freight business.

There are five branch companies in the group: Henan, Hubei, Shenzhen, Hainan and Hunan. There also are five 60%-owned subsidiary airlines (Xiamen Airlines, Guangxi Airlines, Zhuhai Airlines, Guizhou Airlines and Shantou Airlines). Xiamen Airlines china owns 60% of Fujian Airlines – the Fujian branch of China Southern.

The Guangzhou carrier accounts for 25% of domestic passengers and 23% of cargo traffic. It also operates a growing international network and is building freight capacity with its new international services. It is the largest airline in China for numbers of passengers, routes flown, weekly scheduled flights, flying hours, and fleet size.

China Southern is 65.2% owned by the Southern Airlines Group, which was established by the Chinese Government in 1991 to assume control of the airline operations of CAAC's Guangzhou Administration. The remaining 34.8% is mostly held by Hong Kong fund managers and other investors outside mainland China. Under government regulations, the airline cannot be more than 35% owned by non-Chinese interests, although China Southern management recently indicated it would like to raise the foreign ownership ceiling.

Fleet

China Southern operates a mixed fleet of 79 aircraft, mostly Boeing aircraft.

China Southern has taken operational and managerial control of Zhongyuan Airlines and will run its assets by way of a trust or leased operation. Zhongyuan, which has 560 employees, will eventually use the China Southern name. The combination of the two airlines has strengthened its position in central China, doubling the market share previously held by its Henan Branch at Zhengzhou's Xinzheng Airprt to 60%.

Through the merger, China Southern has eliminated duplicate routes, improved aircraft utillisation and reduced costs by closing three unprofitable cargo stations belonging to Zhongyuan in Zhenghou, Mengzhou and Qinyang. Two additional cargo offices have been opened in Luoyang, west of Zhengzhou.

In 1997, China Southern and Delta Air Lines entered into a codeshare arrangement for the Guangzhou-Los Angeles route. It has also established code-sharing partnerships with Asiana Airlines for the Seoul-Shenzen and Guilin-Seoul routes, with Vietnam Airlines on the Guangzhou-Ho Chi Minh City route and with Japan Air Systems for the high growth Guangzhou-Osaka operation.

China Southern Airlines	
Identity code	*CZ*
Founded	*1980*
Ownership	*65.2% SA Group (state owned)* *34.8% traded shares*
Headquarters	*Guangzhou*
Destinations	*Domestic 56* *International 18*
Passengers carried 1999 (000s)	*Domestic 13,521* *International 838*
Aircraft fleet (units)	*42*

CHINA NORTHERN AIRLINES

China Northern Airlines was established by the CAAC in 1990 and is based at Shenyang's Taoxian Airport. It has more than 8,700 staff and diverse business activities, including passenger and freight operations, maintenance and general aviation.

It operates an extensive network in the northern border regions of China and has three regional branch airlines, including the Sanya Branch, based on the southern island of Haikou.

Fleet

China Northern's current fleet includes 35 MD80 and MD90 aircraft, three A300-600 wide-bodies and 10 smaller Y-7 regional aircraft. It took delivery of ten of the MD90s (manufactured in China, in cooperation with Boeing) between August 1996 and March 1999.

It ordered ten A321s in March 2000 for delivery between 2001-2005. The aircraft were originally part of an order for 30 Airbus aircraft placed by China Aviation Supplies Import and Export Corp. in May 1997.

Alliances and partnerships

China Northern signed a revenue pooling agreement with Korean Air in 1994 on the Shenyang route, which is the carrier's sole foreign alliance.

China Northern Airlines	
Identity code	*CJ*
Founded	*1990*
Ownership	*100% state*
Headquarters	*Liaoning*
Destinations	*Domestic 35* *International 7*
Passengers carried 1999 (000s)	*Domestic 3,662 (1998)* *International 227 (1998)*
Aircraft fleet (units)	*51*

XINJIANG AIRLINES

Xinjiang Airlines has been operating for more than 50 years and is based at Urumqi International Airport. It was re-launched as an semi-independent by CAAC in January 1985. Before then it ran regional services in the Xinjiang Autonomous Region in the remote northwest region of China.

Xinjiang Airlines	
Identity code	*XO*
Founded	*1985*
Ownership	*100% state*
Headquarters	*Urumqi*
Destinations	*Domestic 35* *International 0*
Passengers carried 1999 (000s)	*Domestic 1359* *International 68*
Aircraft fleet (units)	*22*

IV.China Sky Aviation Enterprise Group

SHANDONG AIRLINES

Shandong Airlines is one of China's youngest airlines, which was established by the Shandong Provincial Government in March 1994. It commenced operations the following year with three B737-300s, four SAAB340s and one Y-7. It has since diversified into airport management, training and maintenance.

Shandong Airlines was jointly established by 11 State enterprises, who hold 65% of equity. On 12 September 2000, it listed 140 million B shares, or 35% of total equity, on the Shenzhen Stock Exchange. The shares soared 50% on debut, attributed to strong buying by institutional investors and underwriters. Shandong Airlines was only the fourth Chinese airline to be approved to list B shares (for foreign or local ownership), after Hainan Airlines, China Eastern Airlines and China Southern Airlines.

Shandong Airlines operates seven B737-300 aircraft and eight SAAB340s. It was one of the earliest mainland carriers to place an order for regional jet aircraft. In December 1999, the carrier outlined a plan to introduce five 50-seat CRJ200s by 2001. The airline plans to purchase three more B737s and ten CRJ700s over the next five years.

Shandong Airlies	
Identity code	SC
Headquarters	Jinan
Based/Offices	Jinan Yaoqiang; Qindao Liuting; Wuzhou
Staff 1999	1100 (after merger with Shanxi Airline sin 2000)
Structure	Limited liability company
Ownership	65% held by 11 companies, 35% listed on Shenzhen Stock Exchange
Major copetitor	China Eastern Airlines, Shandong Branch

China Sky Aviation Enterprise Group Alliance

Shandong Airlines	Sichuan Airlines
Shanghai Airlines	Wuhan Airlines
Shenzhen Airlines	China Postal Airlines

SHANGHAI AIRLINES

The city-based carrier was set up in 1985 and was the first independent airline in China. It is now a diverse group that followed the example of Shandong Airlines and expects to launch a domestic share issue in the near future.

It has 15 aircraft, mainly medium size Boeing airplanes but it has ordered regional jets for some of its services and intends to add 19 aircraft to its operations in the next five years.

SHENZHEN AIRLINES

Shenzhen Airlines was founded in 1993 and is based at Shenzhen Airport. It has been profitable since it commenced operations, deriving efficiencies from its all-B737 fleet.

Shenzhen Airlines is owned by the Shenzhen Municipal Government.

Its current fleet consists of six B737-300s and four B737-700 series.

Shenzhen Airlines	
Identity code	4G
Founded	1993
Ownership	100% state
Headquarters	Shenzhen
Destinations	Domestic 25 International 0
Passengers carried 1999 (000s)	Domestic 930,000 International 0
Aircraft fleet (units)	8

SICHUAN AIRLINES

Sichuan Airlines is 16 years old, and operates out of Chengdu. The airline carried 21,500 passengers in its first full year of operations and exceeded 1.2 million passengers in 1998. It has diversified into catering, advertising, real estate and tourism activities. Sichuan Airlines is owned and operated by the Sichuan Provincial Government.

Sichuan announced it was considering establishing a separate regional airline company and selling shares in the carrier. The first MA-60 was delivered in July 2000 and commenced service on the Chengdu-Xiangfan and Chongqing-Nanchong routes. And the carrier also ordered five ERJ-145s valued at $100 million in May 2000, Embraer's first order from China.The airline expects to expand its regional traffic with four airports under construction in Sichuan Province and strong growth has been evident on routes to Qinghai province.

WUHAN AIRLINES

Wuhan Airlines was established in 1986. The airline operates from the new Wuhan Tianhe Airport also has bases at Yichang and Enshi airports. Wuhan Airlines mainly operates to military facilities across the country.

It is 100% owned by the Hubei Provincial Government and has assets of $240 million.

Wuhan Airlines operates 12 aircraft including 6 B737s and 6 Y7s. The airline plans to expand its fleet to around 40 aircraft over the next five years. It is one of several carriers expanding regional operations.

CHINA POSTAL AIRLINES

China Postal Airlines commenced services in November 1996. The airline operates eight postal routes for the Ministry of Posts and Telecommunications from its base at Beijing with three Y-8-100Fs.

In February 2000, the airline announced plans to purchase 10 longer range Y-8-400Fs from Shanxi Aircraft Manufacturing Corporation, the first of which were due for delivery in late 2000.

CHINA'S LEASING POWERHOUSE

By Tom Ballantyne

San Francisco aircraft leaser, Pegasus Aviation, has its targets aimed squarely west – in the direction of the world's biggest potential aircraft leasing market – as it builds its business in the Asia-Pacific and China.

Pegasus, the winged horse of legend, has its eyes set on China. But it is no mythical beast; more a fast-growing aviation company aiming to cash in on the nation's airline expansion and lift its already significant presence in the market.

Pegasus Aviation, the world's largest privately held aircraft leasing company, plans to increase its Asian business to more than US$1 billion before year end. And its expansion plans for Asia, and China in particular, don't end there.

In the longer term, Pegasus wants the Asia-Pacific to increase its share of the company leasing portfolio from the present 20% to more than a third, according to Pegasus' vice-president marketing Asia-Pacific, Troy Tollen.

While he identifies several target markets across the region, he said China holds enormous potential that Pegasus intends to tap.

The company already has a head start. It has leased 10 aircraft to three of China's large airlines: China Southern Airlines, China Eastern Airlines and Shanghai Airlines. The deals are a major portion of Pegasus' Asia business, with 14 aircraft leased.

Apart from its China business, Pegasus has placed a B777-200 with Malaysia Airlines, two MD-11 freighters with Korean Air and a DC10-30 is leased to Biman Bangladesh Airlines.

Its two latest Chinese deals were confirmed in April, when it increased the number of airplanes leased to China Southern Airlines and added Shanghai Airlines as a customer. Pegasus leased a Boeing B737-700 to the Shanghai carrier and acquired one of the airline's Boeing B757-200ERs in a purchase/leaseback transaction.

Said Richard Wiley, Pegasus president and CEO: "With the addition of Shanghai to our business and the leasing of our 10th aircraft in China, we have become one of the top leasers in this important market."

"Shanghai Airlines is growing rapidly and the transaction with Pegasus will contribute to our development," says James Xia, the airline's chief financial officer and senior vice president. The carrier, headquartered in the same city as one of the big three China carriers, China Eastern Airlines, intends to increase its fleet from 17 to 30 airplanes during the next five years. Expected fleet additions include the Next Generation B737, the Boeing B757 and B767.

Also, the airline has ordered the Bombardier CRJ Regional Jet and Raytheon Business Jet and plans a listing on the Shanghai Stock Exchange.

Within days of signing up Shanghai Airlines, Pegasus leased two jets, adding to the three already with China Southern, to the Guangzhou-based carrier. China Southern sold one Airbus A320 and one Boeing B757-200 to Pegasus and leased them back.

Shanghai Airlines: newest customer for U.S. aircraft leasing company Pegasus.

While China may be the powerhouse behind future growth, Pegasus is not ignoring other markets. Tollen said the company's strategy involved focusing on other high growth markets such as Korea, Taiwan and Oceania as well as developing second-tier markets in India, Indonesia and the Philippines.

It also sees a big opportunity in freighter leasing and will boost its freighter business with the acquisition of MD-11 and B747 cargo aircraft.

Intensifying its marketing and sales efforts in China and the Asia- Pacific is hardly a surprising strategy for Pegasus. The company is no minnow, with a current lease portfolio of 223 aircraft and assets of some US$3.6 billion. In the year to March 31 it had total revenues of $462 million.

But Asian business has trailed far behind other regions. Compared with the 14 aircraft it has in Asia, Pegasus has 58 aircraft leased in North America and a similar number in Latin America and the Caribbean, plus 22 airplanes out to European airlines.

Pegasus began life as a small aircraft lessor in 1988, but in the last few years its expansion has been phenomenal. In the last three years, its assets have grown 418.6%, its leasing revenues increased 261.1% and its aircraft portfolio expanded by 134.7%. Its interests extend beyond aircraft leasing to affiliates: spare parts company International Aero Components and a maintenance facility.

Tollen said despite the present downturn in Asian air cargo business, the long-term prospects for the region's freight traffic indicated continued strong growth.

Pegasus management also believes the increasing number of air services agreements being negotiated by countries within the region and with the U.S. will increase competition and bring more diversity in aircraft type into the market.

The growing trend for Asia-Pacific carriers to use operating leases as a fleet transition tool matches Pegasus' strategy. The market demand for Boeing narrow-bodies such as the B737 and B757 is compatible with the company's fleet strength.

Hong Kong International Airport is now multi-modal

Freight expectations at Chek Lap Kok

By Jonathan Sharp

Less than three years after it opened, Hong Kong International Airport has become a seaport as well as it aims to become a fully multi-modal hub and fend off competition from cheaper transport facilities in mainland China.

Existing routes for the enormous volumes of mainland Chinese cargo flowing to and from the airport at Chek Lap Kok have been supplemented with the opening of a Marine Cargo Terminal (MCT) perched on the island airport's waterfront. This will provide direct sea links via ferries shuttling freight to 16 ports in the huge manufacturing district of China's Pearl River Delta.

The MCT will be operated under a five-year licence by Chu Kong Air-Sea Union Transportation Co Ltd, a joint venture between the mainland's Chu Kong Shipping Development Co Ltd and Hong Kong Air Cargo Industry Services Ltd (HACIS), a subsidiary of Hong Kong Air Cargo Terminals Ltd (HACTL), which processes 80% of freight at the airport.

The MCT, occupying a 1.4-hectare site close to the airport's air cargo facilities, is forecast to handle 60,000-70,000 tonnes of freight by the end of the year and the capacity of the terminal's workshop is 150,000 tonnes annually. This will still be a tiny fraction of the cargo handled at the airport, whose annual throughput now totals 2.24 million tonnes.

The terminal's operators claim cost and time savings for shippers using the new facility, although they are vague about details.

Mark Ashall, managing director of joint venture partner HACIS and also marketing director of HACTL, said reductions in transport times to and from the eastern side of the delta closest to Hong Kong may not be significant. Indeed for some time-sensitive goods such as electronics, traditional truck transport may be faster.

But he stressed the terminal's potential for cargo shipments to and from the western side of the delta, on the opposite side of the Pearl River from Hong Kong. The western delta region will grow steadily as a manufacturing base because much more land is available than on eastern areas of the delta that were already developed.

"We see a movement of manufacturing over time towards the western Pearl River Delta and this service will be particularly applicable for that given the longer trucking distances from there," said Ashall.

HACIS managing director Mark Ashall: manufacturing moving to western side of China's Pearl River Delta

He forecast the volume handled by the marine terminal would grow steadily. "But it will take a little time for individual agents to re-allocate a large part of their business to this mode of transportation."

Certainly there was no lack of interest when the Marine Cargo Terminal was formally opened on March 28, with several hundred representatives of airlines and agents present.

Ashall said HACTL had seen increasing business for its bonded trucking service, launched last year, in which formalities are streamlined for shipments arriving at Chek Lap Kok and sent by sealed truck to Guangzhou's Baiyun airport.

He said the service had recently carried shipments from Swissair and Emirates. A total of 18 airlines had signed up for the service, with 10 as regular users.

Speaking of HACTL's overall business, Ashall said the company was seeing exports to the United States slipping as a result of the U.S. economic slowdown.

"We started to see that towards the end of last year, and for the first couple of months this year it has slowed down significantly," he said.

Imports from the United States were less affected, although they were somewhat weaker. On the other hand, imports from Europe were up on a year-on-year basis.

Much is made of Hong Kong's proximity to the economically vibrant Pearl River Delta as key to Hong Kong's future as a trading centre. Hong Kong Airport Authority chairman, Victor Fung, speaks glowingly of the opportunities presented by China's accession to the World Trade Organisation, with China's trade with the world estimated to double in the first five years after entry.

"I hope in the not too distant future we can proudly claim that Hong Kong International Airport is the premier airport for the Pearl River Delta," Fung said earlier this year.

However, consultant Philip Bowring believes Hong Kong should set its sights beyond the Pearl River Delta to encompass China as a whole.

He said New York's hinterland, for example, is the whole United States, not just the adjoining northeast American states. London's position is due at least as much to its global English-speaking hinterland as to England itself.

"China joining the WTO increases the nation's integration with the world, but it reduces, not enhances, the role of the Pearl River Delta which will now operate on the more level playing field compared with the rest of China – which is where Hong Kong business opportunities lie."

In any case, Bowring adds, the focus of China's industrial growth has shifted north. "In the past Hong Kong may have had a narrower role serving southern China. But having enlarged that role to an all-China, Asian and regional role, why make such a fuss about the Pearl River Delta in isolation?"

It was a blow to Seattle but a godsend to Chicago when massive Boeing Aerospace announced in May it will move its corporate headquarters to the windy city, in the U.S. Midwest. The exit east for the global company is a timely symbol of its recent moves – rapid and radical. Tom Ballantyne reports from the U.S.

Boeing Aerospace Company chairman Phil Condit and his new vice-chairman, Harry Stonecipher: moving cities and riding high

OUR KIND OF TOWN

By TOM BALLANTYNE in Seattle

With widespread approval from airline customers for its proposed Sonic Cruiser, the smiles are back on the faces of top executives at the Boeing Aerospace Company.

When you add the corporate headquarters move to Chicago to the potent mix of products announced by the company and recent decisions that could cement Boeing's future leadership, it is no surprise Chairman Phil Condit (59) appears a satisfied man.

In May, six weeks after the unveiling of the Sonic Cruiser fast passenger jet to an excited market, the Boeing board announced it had voted in the present company president and chief operating officer (COO), Harry Stonecipher, (65) as vice-chairman of the group.

The decision to extend Stonecipher's contract – he was due to retire next year – and make him Condit's deputy was not only an acknowledgement of Stonecipher's importance at Boeing but was also a pointer to the future.

The president and COO of McDonnell Douglas until it was bought by Boeing in 1997, Stonecipher is focusing less on the day-to-day operations of the company and more on business opportunities that are likely to provide long-term growth, said Phil Condit.

Insiders said this does not mean he will wind down at Boeing. Many believe he may "officially" retire in 2002 – he was due to step down last May but was asked to stay another year – but that he will continue to be an integral part of the corporate structure, perhaps as a long-term adviser, especially as his tenure on the board runs to 2003.

In the meantime, the subtle change in top management opens the way for grooming a successor to eventually take over from Condit himself.

Under Condit's astute leadership Boeing has undergone the most dramatic corporate restructure in its history in the last two years. Globalisation is now the name of the game and it is no longer "that Seattle planemaker".

Military products and space technology have joined commercial aircraft on equal terms, with their contributions to revenue and profits increasingly representing a larger slice of the Boeing pie.

Indeed, the reason why Chicago was chosen over Denver and Dallas as the new corporate headquarters for the company was to create some distance between top management and the individual business units of the group.

Condit told *Orient Aviation* he does not want divisions based in its centres at St Louis and Long Beach to think the commercial aircraft people were receiving more attention than they were. Thus Seattle – where Boeing began more than 80 years ago – is history for the 500-strong HQ contingent, to be relocated to its central neutral venue by this August, with operations to be in full swing a month later.

Chicago apparently was the clear favourite for Boeing, despite concerns that the city's O'Hare International Airport is the most congested airport in the U.S. Talk of U.S. tax breaks of up to US$22 million helped, although all three cities where throwing money at Boeing to attract the company to their respective metropolises.

Said Condit; "We're continuing to transform our company with a focus on long-term growth and value creation. Our new corporate architecture – with a leaner headquarters located separately from our major business units – is a fundamental element of our business strategy.

"We looked at three very exciting metropolitan areas in which to base our company. Each community had many positive attributes and would be a suitable location for a corporate headquarters. It was a very difficult decision and no single factor made the difference. In the end, we looked at all the data and made what we believe is the right choice for Boeing."

When the chairman, Stonecipher and their team settle into Chicago, they will be dealing with an empire fast becoming a truly global business.

It has seven core business units; commercial aircraft, military aircraft and missile systems, space and communications, Boeing

Capital Corporation, Commercial Aviation Services, Connexions By Boeing and Air Traffic Management. Condit said there will be more and that some of them may well be based outside the U.S.

Underscoring this growing power and responsibility, the heads of Boeing's three main divisions – commercial aircraft at Seattle, military at St Louis and space at Long Beach, California – have been promoted to president and chief executives of their respective units.

These men, Alan Mulally in Seattle, Jerry Daniels in St Louis and Jim Albaugh at Long Beach, must be regarded as potential future presidents or chairmen.

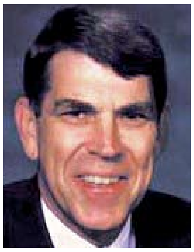
But they don't have the succession battle to themselves. Boeing, which spends a staggering US$130 million annually on education and leadership training, could be described as the Lucky Company.

It also has Mike Sears, another former McDonnell Douglas executive who headed Boeing's military operations in St. Louis until he was named Boeing's chief financial officer last year. He is understood to want the job of president.

Mulally is always mentioned by analysts, along with Sears, as favourites to replace Stonecipher and eventually Condit.

However, there is currently no single contender nor is there a guarantee that when Stonecipher, and eventually Condit, step down, any of the names now in the speculation ring will end up with the top job.

What is clear is that Boeing has plenty of choice and lots of time to see how its businesses develop and its top line chief executives perform before the succession game is played out and the top job is decided.

Three presidents and a CFO...
From left: president and chief executive of Boeing Commercial Airplanes, Alan Mullaly; president and chief executive of military aircraft, Jerry Daniels, president and chief executive of Boeing Space, Jim Albaugh and Boeing Aerospace's chief financial officer and ex-St Louis boss, Mike Sears.

BOEING'S FUTURE FREIGHTER

Move over, Antonov, Boeing says there is room for just one more aircraft type in the super-size aircraft market. Tom Ballantyne reports from Long Beach, California, on plans for the launch of Boeing's Globestar, a commercial version of the mighty C-17 military transport. Boeing may have ditched efforts to build a high capacity passenger jet to compete with the Airbus A380, but it has firm plans to outdo its European rival on the big freighter front... though the competition will not be coming from any where near Toulouse.

The US planemaker wants to turn its massive four-engine C-17 military transport into a commercial freighter to compete with Russia's giant Antonov 124, a cargo carrier that has a monopoly in the over-sized freight market.

"We think it would look good in the Boeing freighter catalogue," said Stuart Thomson, Vice President Business Development at Boeing's Aircraft and Missile Systems Division.

The C-17 is built at Long Beach, California and has been flying operationally with the U.S. Air Force (USAF) since 1995. The military version can carry 77,519 kilograms of cargo in 18 pallet positions and has a range of around 2,400 nautical miles.

The mighty Antonov 124 will soon have a rival – the Globestar – an adaptation of Boeing's military transport, the C-17.

For the USAF, the price is US$236.7 million per aircraft, but a commercial version would be cheaper, probably around $140 million.

Thomson said Boeing would need to pin down at least 10 orders to launch the Globestar in the commercial market and added some freight operators have expressed interest in the concept. The proposed aircraft is designated the BC-17X and major infrastructure changes will be necessary on the Long Beach production line to cater for construction of the airplane to conform with civil aviation regulations.

Thomson said Boeing is convinced there is a significant niche market for Globestar. The latest available studies show the 20 Russian Antonov freighters in service worldwide completed at least 432 commercial missions in 1999; 53 in the UK, 77 in France, 35 in Canada and 267 in the U.S. In addition, they operated an undisclosed number of flights from Australia and for the United Nations.

"There is continued commercial niche market growth and such an aircraft would allow us to derive value from an existing product line. The timing is right," said Thomson.

"We have studied the size of the market. If you believe more and more people around the world are demanding just-on-time service and more rapid shipment of material then one would say there is increasing demand for shipping outsized products.

"We are not going to ship grain or coal, but there are many items that could be shipped by air that go by sea. This includes large industrial equipment such as printing presses. We think there is a market for a significant number of very large freighters."

However, a number of modifications will have to be required to turn the military transporter into a civil heavyweight. These include installation of a commercial cargo floor, a manoeuvre load control system and 9G cargo barrier, bird strike protection, a new airflow circulation system and commercial cockpit avionics.

Flying only to win: Spirit of Kai Tak team. Father and son John and James Darcy with Mike Miller and Mark Graham

Baron Pierre de Coubertin, founder of the modern Olympics, said the glory is in taking part, not winning. That idealistic spirit may have rubbed off on some of the 35 teams taking part in the London to Sydney Air Race 2001, staged in March and April, but not on the Hong Kong entry that won it with apparent ease.

With an exemplary eye for detail and a single-mindedness that would have done a military planner proud, the four-man team flying the Aerostar Super 700 christened "The Spirit of Kai Tak" was never content just to take part. They flew to win, left nothing to chance – and left their opponents, many of them fuming, in their slipstream.

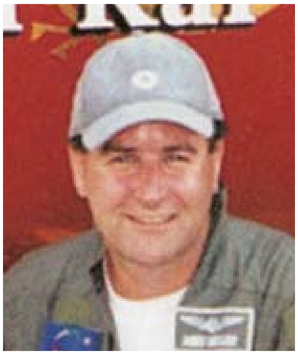
"We had the best preparation right from the word go," said team captain Mike Miller, whose job when he is not racing small aircraft or fast cars is as a Cathay Pacific Airways Boeing 747-400 training captain. We operated that aeroplane to its absolute 'nth' degree; we were there to win the race."

This was apparently not the case for many others in the event, which was staged to mark Australia's centenary of federation and followed the "Kangaroo Route" trail-blazed by a Vickers Vimy bomber in 1919.

"The majority of the other pilots in the race were wealthy amateurs and they had not prepared their aeroplane they way we had. For a number of them it was a fun ride, a good adventure and their competitive instincts were somewhat suppressed."

But those instincts were not dormant for long. Soon after the race started in marginal weather conditions on March 11 from London's Biggin Hill Airport, it became clear that "The Spirit of Kai Tak" was in a league of its own and, barring disaster, would romp to victory at Bankstown Airport in Sydney after scheduled stops in 28 cities and 17 countries.

"There were huge questions asked about how we were getting such fast speeds," said James D'Arcy, the team's second pilot, whose father, 71-year-old retired pilot John D'Arcy, was technical advisor to the team. The third pilot and remaining crewmember was investment banker and private pilot Mark Graham.



Mike Miller: "We had the best preparation right from the word go."

However, there was no question of the Hong Kong team bending any of the rules laid down by the Federation Aeronautique Internationale (FAI). Even when the organizers changed the rules during the race – as they were entitled to do – the result played into the hands of Miller and his teammates.

In the early stages of planning for the race and after exhaustive study of the FAI rules, Miller and his team decided that a twin-engined, turbo-charged and pressurized aircraft would give them the right edge to enable victory.

Contestants' performances were rated under a formula based on a so-called reference speed that was determined by the aircraft's flight manual and a variety of other factors.

"All roads led to the Aerostar," said Miller, despite the fact the aircraft had a reputation for being quirky and complex. "A lot of people have been killed because Aerostars have some unusual systems. They are demanding for the average pilot to fly. So they have a bit of a bum rap."

With funds supplied by the two D'Arcys and Graham, an Aerostar 601 was bought. Although budgets were exceeded, help eventually came from sponsors, the first and most important being Miller's employers, Cathay Pacific.

Although the team's Aerostar was built

HIGH SPIRITS

Flying to win was the only game in the air for the victorious quartet aboard the Spirit of Kai Tak who steered their aircraft to victory in the recent 2001 London to Sydney Air Race. **Jonathan Sharp** *reports.*

in 1980, it had the attraction of having been flown a mere 1,450 hours. It was extensively upgraded and rebuilt in the United States to Super 700 specification, with new or overhauled engines, turbochargers and exhausts – anything to maximize the performance.

"We removed anything to do with comfort like the leather seats, the teakwood furniture, the air-conditioning unit. We saved over 200 kilograms in weight, " Miller told *Orient Aviation* in Hong Kong.

Much thought went into the livery: a brilliant Ferrari red was chosen to give a sense of speed – and because red is a lucky colour for Chinese. The livery sported a traditionally styled dragon stretching from tail to nose.

Considerations of good fortune went into the choice of registration number, which is 888 KT, with "8" deemed lucky in Chinese while KT recalled Hong Kong's cramped, but much-loved, old airport at Kai Tak.

"We ensured we had all the good luck on our side. It certainly spooked the opposition when we turned up for the race," said Miller.

Competitors were not timed from lift-off to touchdown on each leg but from 10 miles from the start to a designated point close to the end of the day's destination. "The organizers didn't want a race that was from take-off to landing because this would lead to people cutting corners – safety was the supreme consideration."

This arrangement was key to the success of "The Spirit."

Miller described how when leaving from Dubai, for example, while most aircraft headed straight towards the starting point, his aircraft did an immediate 180-degree turn and flew in the opposition direction before turning back again. The idea was to zigzag skywards to reach the Aerostar's optimum altitude of 25,000 feet before heading for the next way station.

"We crossed the start line doing 280 knots whereas everybody else crossed the start line doing 150 knots. By thinking laterally we were always picking up an advantage."

The organizers "cottoned on" to this ploy and reduced the permitted flying radius from the start point to five miles from10 miles, and barred circling climbs.

To no avail. Miller and his team adopted a "snaking" manoeuvre following takeoff, which allowed them to reach a reasonable altitude before reaching the start point, and still stay within the law.

Overcoming technical problems the local way

"Every time they changed the rules it worked to our advantage, because it precluded anybody else from doing the same thing that we had been doing. Every decision that the organizers made seemed to fall in our favour."

Although the race authorities' best efforts failed to curb "The Spirit," a number of mechanical problems inevitably cropped up, including the failure of automator belts providing power to the aircraft's electric systems.

Then in extreme heat at a refueling stop in the Australian outback the aircraft suffered from fuel vaporization, a potentially major problem that was eventually solved but, in the words of James D'Arcy, made for "an interesting takeoff".

Other problems included a shortage of the right fuel supplies at Calcutta that necessitated lowering engine power settings and a shortened route in order to reach the next destination, Rangoon. They made it – but with fuel warning lights showing.

It was a team decision to fly that leg. "It scared the hell out of me," said D'Arcy.

Last time for a race of this magnitude said the winning team members

"But I work on the basis that if Miller says he wants to go, I assume he does not want to kill himself."

Logistical problems such as those encountered at Calcutta are among reasons cited by Miller for believing that a similar long-distance air race will never be repeated.

"I think it's the last time there will be an air race of that magnitude. A lot of countries we went through have stopped stocking piston-engine fuel. In some places organizers had to ship fuel in just for the race."

He added: "In terms of bureaucracy it's very difficult to organize little aeroplanes to fly around the world across countries like India and Pakistan. The borders are very tightly controlled and they are very careful about who they let cross the border. It took two years to get permission for us to fly across them."

D'Arcy said another reality was the requirement to fly in certain lanes. Flight plans are nominated for participants, which eliminates some of the racing element because everybody has to fly the same route.

"If you fly from Pakistan to India and you veer off the particular route, somebody's likely to think you are an invading party."

And with the ease of air travel today, people do not appreciate the challenges of flying small aircraft over long distances. "It's maybe not as glamorous as it once was," said Miller. "But to me flying little aeroplanes is a lot more fun than flying jumbos."

With this in mind Miller hopes that Cathay will buy "The Spirit of Kai Tak" and keep it in Hong Kong so he can fly both the Aerostar and jumbos – less fun though the latter may be.

The first Connexion By Boeing customer is expected to be named at the Paris Air Show in mid-June, following six months of trials aboard a specially equipped B737.

WORTH THE WAIT

It is more than two years since Boeing announced it would develop Connexion By Boeing – an inflight communications system that would bring the Internet into airline cabins across the globe. *Tom Ballantyne* learnt in Seattle that the company's Internet-in-the-air system is about to sign on its first customer – a U.S. airline – for the real time e-mail, communications and entertainment system.

The long-awaited commercial birth of Connexion By Boeing, the planemaker's broadband inflight internet/email service, is imminent. Boeing officials expect to make an announcement on a launch customer within weeks, possibly during June's Paris Air Show.

They are maintaining strict secrecy on the potential buyer. Scott Carson, president of Connexion, confirmed Boeing is involved in "ongoing active discussions with less than a dozen, but approaching that number, of airlines around the world".

Roll out of the system will occur, in North America, with the first aircraft likely to be operational by the middle of next year followed by Europe. Asian carriers are among those involved, including Singapore Airlines (SIA). This is despite the April introduction of a Tenzing Communications Inc. inflight email/internet system by the carrier. The move made SIA the first operator in the world to offer inflight e-mail using a satellite-based communications network – although the system is not yet installed fleet-wide. The Tenzing system, in conjunction with e-mail, has a dedicated server onboard that downloads and stores hundreds of thousands of web pages for passenger browsing.

Carson made no apologies for the delay in finding a customer and described the early systems as "pathfinders" – all based on relatively low bandwidths and not representing a real time experience.

"You have a message leaving your machine and go to a server on the aircraft and then being dribbled off at a data rate these systems can accommodate. The Internet is largely based on what the carrier has decided to host on the airline," he said.

Broadband allows users real time access to the entire Internet as well as e-mail, which is transmitted instantly without having to be stored on a server and fired to the ground through satellites at intervals.

"Airlines like Singapore [Airlines] have told us they are quite satisfied with the initial low bandwidths, but they want to be in broadband. What you are seeing are early pathfinders, but the movement will come in our direction.

"We are thrilled the airlines are starting to pick them up (the early systems). We launched into discussions with airlines over a year ago and one of the first questions we asked was should we launch at more narrow band.

"Consistently, both in the US, in Europe and in Asia, the message we got back from airlines was broadband is the right place to be. So we have stayed on our path to deliver the first true broadband capability to the aeroplane and we believe increasingly the airlines are coming to us."

In January, Boeing began flight tests of its system, using a specially outfitted Boeing B737 painted in Connexion By Boeing livery.

AcrossFrontiers on IFE "Net"

Tenzing Communications Inc. has invited inflight software supplier, AcrossFrontiers International, to provide its country and culture profiles to passengers with laptop computers onboard airlines that have installed the Seattle company's inflight e-mail and Internet system.

The country guides, a specially adapted version of CountryFocus, AcrossFrontiers' on-line country and culture reference tool, is hosted by Tenzing's onboard server. Passengers can use their personal computer's web browser to log in and access essential information about popular countries.

CountryFocus is flying on Air Canada and Singapore Airlines – the two carriers now operating Tenzing Communications' system on some of their aircraft. Other Tenzing customers, including Cathay Pacific Airways and Virgin Atlantic Airways, are expected to include the AcrossFrontiers' content when they fully install the e-mail and Internet system.

European Aviation Investment in the Asia-Pacific

Part 1

European aviation companies continue to look east as they strengthen their businesses in the world's fastest growing region for the industry and its related services. Part 1 of our special report looks at selected MROs and support companies that have recently set up, or plan to establish new facilities in the region.

TWO DOWN, TWO TO GO

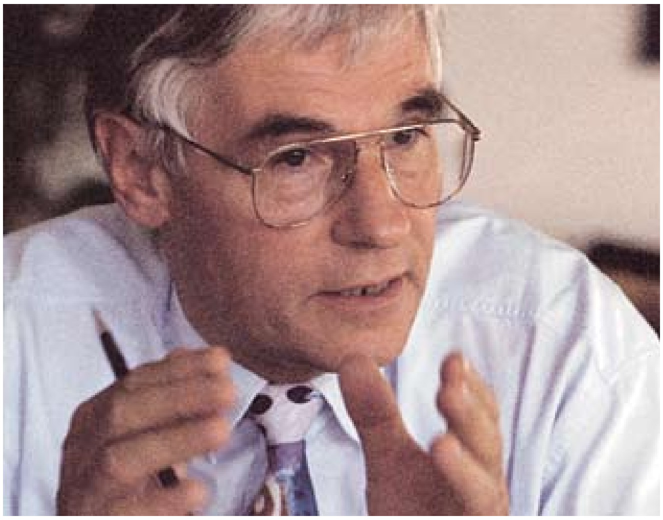
Despite the financial gloom of its Swiss-based parent, SAir, MRO specialist SR Technics intends to establish centres of excellence – in China and in one other Asia Pacific country. Tom Ballantyne *reports from Palmdale in the U.S.*

Swiss maintenance, repair and overhaul (MRO) giant SR Technics, after opening its second global centre of excellence in Palmdale, California, is focussing its attention on the Asia-Pacific where it intends to set up maintenance hubs in China and one other Asia-Pacific site.

Despite the recent troubles of parent SAir, mired in financial woes and embarked on a total re-think of its overall business strategy, the MRO arm has been cleared to continue its business as usual, including expansion plans.

"SR Technics achieved good results in 1999-2000, increasing its total revenue. This fact leads us, for the time being, to remain with our current strategy. Of course, we periodically review and refine our strategy.

"Anything else would be pure speculation," the president and chief executive officer of SR Technics, Dr. Hans Beyeler, told *Orient Aviation* at the opening of the Palmdale facility in March.



SR Technics president and chief executive Dr Hans Beyeler: his Asia-Pacific MRO centres will combine his company's experience with fine local aviation artisanship.

While no-one is speculating on the record about where the MRO company's two regional centres could be, insiders said there is strong interest in Shanghai as the base for a China operation, with Thailand and Hong Kong neck and neck for the other facility.

Orient Aviation has confirmed some attention has also been given to Australia, but the general view was that Sydney, Melbourne or Brisbane would have been too far from the centre of Asia proper for a Centre of Excellence.

Despite earlier reports it had been ruled out, Thai Airways International's (THAI) engineering facility at U-Tapao remains a preferred site as far as SR Technics is concerned, although political developments in Bangkok are causing SR Technics some frustration in its negotiations when it comes to U-Tapao.

The country's new government, strongly nationalistic and apparently opposed to foreigners taking a major equity stake in THAI or any of its divisions, is still reviewing policy on this front. Until the government finalises its new policy on foreign investment, SR Technics is hamstrung. But there is little doubt U-Tapao would be an ideal opportunity for the Swiss company. Known as THAI's Second Aircraft Maintenance Facility, it was officially opened in May 1999 and is winning a reputation for high quality work. As recently as April,THAI's Bangkok Technical Department and the U-Tapao operation received the ISO 14001 Certificate, a recognition of high standards, from the Bureau Veritas Quality International (BVQI). The search for Asian centres of excellence has taken on new urgency since SR Technics' major rival, Lufthansa Technics, purchased Philippine Airlines' maintenance division in Manila last year.

The MRO's management told *Orient Aviation* these decisions were taking shape in the lead-up to the SAir Group's April announcement of losses of US$1.7 billion for the last fiscal year – attributed to the company's investment in three regional European airlines. A year earlier it made profits of US$158 million.

Before the announcement, no-one in any of the group's divisions, including SR Technics, knew what the future would hold or what would happen to the existing business plans of the group.

However, the MRO subsidiary largely escaped the knife, although it must concentrate on winning further cost efficiencies and greater productivity.

SAir has decided to sell SAir Logistics, the group's freight transportation subsidiary, which posted a profit of $57.6 million year in 2000, up from $3.5 million in 1999. Revenue jumped 27% to a record $989 million from $785 million. Swisscargo, the air freight unit, made the biggest contribution to the bottom line with a net profit of $40 million.

Also to be sold is a 10% stake in Swiss-based freight forwarder, Panalpina, and its 45% share of SwissGlobalCargo, a joint venture with Panalpina. The group will retain its 33.7% stake in Cargolux Airlines International, the Luxembourg-based all-cargo carrier.

SAir lost money on Swissair and its two other Swiss airline units, Crossair and Balair, as well as Sabena Belgian Airlines, France's AOM and Germany's LTU Group. The only profitable airline investments were LOT Polish Airlines and South African Airways.

Mario Corti, SAir's new chief executive, said the strategy of taking stakes in regional airlines instead of joining a global alliance had failed and would be changed. This shift means previous plans for any equity interest in Asian airlines like THAI and Malaysia Airlines have been cancelled.

With restructuring plans under way across the group, SR Technics has had its future assured. The official inauguration last March of the Palmdale, California, facility, was a giant stride forward for the MRO operation as it has given it entry into the world's biggest aircraft engineering market.

Already SR Technics America has its hands full, converting 57 DC-10 aircraft into modern MD-10 dedicated freighters for global freight giant Federal Express. This contract requires replacement of the three-man cockpits of the DC-10s with the modern two- man Boeing Advanced Common Flightdeck (ACF) in Palmdale. The first MD-10 was delivered to FedEx in March.

In addition to these modifications, there are plans to broaden the facility's range of services to include maintenance work for Airbus aircraft in 2002. The MRO has invested US$50 million in Palmdale and created 350 jobs in less than a year.

Dr. Beyeler said the rapid development of U.S. strategy "gives us a jump on the market and will help us to establish additional product lines and to further pursue our global expansion strategy".

The company's U.S. strategy gives a strong indication of its approach to the Asia-Pacific.

Beyeler does not care about competitors' reputations. He is determined to enter new markets and fight for business on the back of the impressive reputations for quality of Swissair and SR Technics.

At Palmdale, he told *Orient Aviation*: "We at SR Technics believe that in an open U.S. market of aircraft services there is not enough drive for quality and performance. Operators that rely on sub-contractors for technical services may therefore not make the best possible use of their expensive investments in aircraft, nor do their fleets maintain optimum re-sale value.

"From our experience, gained by being permanently pressed for top performance by customers like Swissair, we felt there was room for improvement."

He added: SR Technics aims to blend Swiss experience and tradition for high quality work and top performance with well-proven fine American workmanship and aviation expertise.

As SR Technics homes in on its plans for its Asia-Pacific Centres of Excellence, it is just the sort of fighting talk Dr Beyeler plans to bring to the region.

March 1999: Opening ceremony at Thai Airways International's MRO facility at U-Tapao, south of Bangkok.

In for the long haul: LTP president and CEO, Thomas Gockel (right), and head of marketing and sales, business development, Rainer Janke outside the Manila engineering and maintenance facility.

PAL boost for LTP

Now the search is on for third party contracts

By Barry Grindrod in Manila

When Lufthansa Technik (LHT) was in negotiation with Philippine Airlines (PAL) for the purchase of its engineering and maintenance division last year, the rumour mill was rife.

Sell, said the dissenters, and the German Maintenance, Repair and Overhaul (MRO) giant would slash the workforce of almost 1,300.

After all, said the mainly hardline unionists, the airline, which went into receivership on June 1998 with US$2.2 billion of debt, had cut its staff numbers from 13,000 to 8,000 and its fleet from 54 aircraft to 22.

But LHT, with ambitions to make the project a major MRO hub in Southeast Asia, had said expansion, not contraction, would be the name of the game. It was good to its word.

The sale of the engineering arm, which was a provision of PAL's "rehabilitation" (survival) plan under the stewardship of the receiver, was completed in July 2000 with LHT taking a 51% stake in a joint venture, Lufthansa Technik Philippines (LTP). Philippines Airlines services company, MacroAsia Corporation, took up the remaining 49%. In September last year LTP started operations at the 226,000 sq metre facility at Manila's Ninoy Aquino International Airport and its two smaller centres in Cebu and Davao.

The workforce has now topped 1,600 and the figure is expected to surpass 2,000 sometime next year.

Furthermore, LTP is attracting skilled labour back to the Philippines from airlines overseas, particularly the Middle East and the U.S. Many maintenance personnel had left when job prospects dried up at PAL.

As LTP president and chief executive officer, Thomas Gockel, told *Orient Aviation*: "We are progressing better than we had expected. We are receiving very positive feedback from the staff. Morale is high."

For the first time in years there is stability in the former PAL division – and major investment.

Including start-up costs more than US$200 million will be invested in LPT in the first 10 years of its operations.

According to Gockel, the reasons LHT opted to invest in the Philippines were threefold.

They were:

- a skilled workforce with a good working knowledge of English.
- excellent facilities in three maintenance bases. At the Manila headquarters it has an 18,000 sq metre, four-bay hangar, a 11,000 sq metre engine overhaul building, a 2,000 sq metre engine test cell and 15,000 sq metres of workshops and warehouses.
- the Philippines tourism and aviation market has huge potential with all the region's major air transport hubs within three hours flying time of Manila.

On completion of the sale last year the then chairman of LHT, Wolfgang Mayhruber, who now heads the German national airline, said: "Our medium-term goal is to turn this Manila facility, with its strategic location in Southeast Asia, into a 'one-stop shop' offering the full line of aircraft MRO services, at first locally, then regionally and ultimately, internationally."

The resurgence of PAL in the marketplace is providing LTP with an unexpected business boom. It is contracted to maintain the PAL fleet that has grown from a low of 22 aircraft immediately after entering receivership to 34 jets. LTP also maintains Air Philippines fleet, in which PAL chairman, Lucio Tan, has a majority shareholding.

But in the future LTP is staking much hope and expectation on developing third party contract work and co-ordinating its services with other Lufthansa MRO centres in the Asian region (see box).

LTP's line maintenance customers in Manila include Singapore Airlines, Korean Air, EVA Air, China Airlines, Air Nuigini, Egypt Air, KLM Royal Dutch Airlines and Nippon Cargo Airlines. In Cebu and Davao its clients include Malaysia Airlines and SilkAir.

LTP has aircraft C-check capability for B747-400s and -200s and is hoping to have D-check approval by mid-2002. By then, said Gockel, the company will be marketing its services enthusiastically in Europe. It has capabilities up to C-check for B737s, A340s, A330s, A320s and A300s.

Its engine capability at the moment is modest, confined to CF6-50s. No decisions have been made as yet about which engines LTP will add to its portfolio, but airlines in Europe and the U.S. will be major sales targets.

LTP holds maintenance approvals and licences from the Federal Aviation Administration in the U.S., the Japan Civil Aeronautics Board, the Civil Aviation Administration of Singapore, the Civil Aviation Administration of China and the Air Transport Organisation. LTP is currently preparing for JAR approval.

As Rainer Janke, head of LTP marketing and sales, business development, said: "We are in this [LTP] for the long haul." Gockel and Janke are two of only 14 Germans among the workforce. Both agree the transition has been smooth. "The [former PAL] employees knew there was a need for change and they have responded accordingly," said Gockel.

The signs are good and once all the necessary certification is in place, it will be up to the marketing men to secure that all important third party work.

Asia's key role in LHT's profitable year

PAL resurgence unexpected boom for LTP

Lufthansa Technik (LHT) doubled its pre-tax profit and increased sales 24% in the year 2000, chief financial officer Peter Jansen reported at the annual press conference in May, writes *Barry Grindrod* from Hamburg.

In its sixth year as a stand-alone company within the Lufthansa Group, LHT recorded a pre-tax profit of 37.1 million euros (US$32.65 million), twice the amount of 1999. Sales reached 2.25 billion euros, up 433 million euros on the previous year. Aggregate sales, including subsidiaries and affiliates, reached 3.6 billion euros.

The chairman of the executive board of LHT, August Wilhelm Henningsen, told *Orient Aviation* that "no less" than 10% of its sales were from clients in Asia. In recent years LHT has been expanding in the region.

The ground has been broken for the building of a components servicing centre in Shenzhen, southern China. "Work there is progressing well," said Henningsen.

For three years between 1997 and 2000, the LHT chief was head of the Aircraft Maintenance and Engineering Company (AMECO) joint venture with Air China in Beijing. AMECO is the largest of LHT's 20 subsidiaries worldwide, with a workforce of 3,600 people. LHT also operates the China Aviation School, for engineering and maintenance trainees, in Taipei. It has regional offices in Beijing, Tokyo and Singapore.

"The growth figures in Asia are a big factor in our success," said Henningsen. "[The region] is very important indeed." While there were no plans to expand further in Asia at this stage, additional investments would be made in the existing facilities.

A US$20 million investment was under review for a project at Lufthansa Technik Philippines in Manila, but said he could not comment further at this stage pending further negotiations with Henningsen parties. He spoke of growing competition in the MRO sector that was characterised by two trends: the growing number of aircraft and engine manufacturers now offering MRO services and the growing number of airline shops being spun off as independent MRO providers.

"But since the air transport continues to boom ... the high demand for aircraft and engine maintenance and overhauls, as well as for the steady flow of components, is expected to persist," said Henningsen.

THE PAPERLESS COCKPIT

...coming soon to an aircraft you fly

Three years ago, the management team at Lido AeroNet Pte Ltd parent, Lido GmbH in Germany, sat down and worked out a business plan for new products for the 21st century. They decided it would be new cockpit navigation software and that they would launch the company in Asia. *Christine McGee* reports.

Lido AeroNet's team believed pilots and flights departments would love their systems to catch up with the modern IT world.

So one business they believed had a future was the production of all products a pilot needs to fly and the products ground staff require to support crews in the air.

But they would have to be in 21st century form that did away with the reams of printouts, maps and charts that are part of everyday life in the aircraft cockpit.

Lido AeroNet also decided the new products had to be launched in markets where a lot of new business soon would be. And as Lido's business was aerospace,, it did not take too long for the corporate strategists to headquarter the company in mid-Asia, in the region earmarked as the largest future aviation market in the world.

Thus it was that six months ago, Ralf Cabos, managing director of Lido AeroNet Pte Ltd and co-managing director of Lido GmbH in Germany, found himself in Singapore setting up a company to sell radical new software to airlines for their cockpit crews and airline despatch departments.

Said Cabos: "Lido AeroNet was created in June 2000 and is 100% owned by Lido GmbH, which is now part of the Lufthansa Systems Group. When we did our business plan, we knew we had to be in Asia. We considered Hong Kong, but it was very expensive and the government there provided no incentives to establish ourselves.

"Often the inflight entertainment system server is more up to date than the computer equipment available to cockpit crew," said Lido AeroNet managing director, Ralf Cabos

"Singapore was much more accommodating. We hired our first staff member in August and had the official opening of the office in November last year."

Lido AeroNet is part of a three-company group. The two others are Lido Technology in Poland and Lido Flightnav in Switzerland. Each of them is concerned with a sector of the cockpit information market for pilots and their ground support staff.

"We will invest about US$12.5 million in the company in Singapore during the next two years because we hope we are coming into the market at the right time. We have 52 staff here and have set up an office in New Delhi with 60 people. By July we will have 80 people in head office. We also have a sales and marketing support office in Auckland," said Cabos.

Lido AeroNet is selling systems that provide integrated real-time inflight navigation information systems that are augmented by on-screen graphics during flights. The systems, the company believes, will save cockpit crews valuable time in gathering information on flying conditions and changed flight paths, especially in poor weather. Essentially, various Lido AeroNet systems will do the sorting, searching and calculating of flights for flying crews.

"We envisage the day when the captain can download his flight plan from a computer at his departing airport, or on a laptop at the hotel before leaving for the airport," said Cabos.

" Our intention is to arrive at the point where our systems can show pilots, on their screens, exactly the piece of data they need. We can turn a mass of information into one single sheet of data," he said.

Of course, it will probably never be that simple, and the Lido AeroNet boss said as a result of being on the ground in Asia, and not back in Europe, he changed his approach to customers. "We are beside them, working with them. We changed our product definition because the operating environment was different. We are looking for launch customers and many of the people that we are dealing with are regional carriers. They don't have big sophisticated IT departments. They have basic PCs, so we altered our emphasis to match our systems with their equipment capabilities.

"It has not been a drawback. We will apply these experiences with customers when we introduce our products to smaller carriers in the U.S. and Europe," said Cabos.

LIDO AeroNet Pte Ltd's products and services include:

- *Flight planning and operations control – software tools that deliver flight planning and flight operations applications from the company's 24/7 Singapore centre*
- *Delivery of AIP content by the Internet, both as a browsing service and as electronic documents*
- *Data delivery to pilots – Internet based delivery of weather, NOTAM and geographical modules that are augmented by high resolution graphics*
- *FlightWatch – a system that considers all flight specific restrictions and flight diversions that enables crews and ground operations to do live inflight monitoring*
- *Web-based briefing solutions and blue-tooth based mobile device synchronisation and update services for pilots – anywhere in the world*
- *Flight Ops Documentation Services – based on XML technology and using content management systems. The systems will cover airline manuals and other flights operations documents*
- *Mobile Platform applications – the development and support of notebook mobile devices and onboard server based solutions, which will ultimately result in a paperless cockpit*

European planemaker wants more Japan orders

AIRBUS MOVES INTO JAPAN

On his five day swing through North Asia in May, Airbus Industrie boss, Noel Forgeard, made it clear at his stopover in Japan that his visit was not the usual political courtesy call.

Forgeard said at a press conference in Tokyo that the European airplane manufacturer had set up a marketing and liaison subsidiary in Japan with the intention of wresting aircraft orders from rival Boeing. Patrick Carroll, the president of the British Chamber of Commerce in Tokyo will run Airbus Japan KK, he said.

"Japan indeed stands as a weakness in our overall success, I am committed to do what it takes to change that," Forgeard said in Tokyo. Airbus Industrie has won almost 50% of the worldwide orders for new aircraft, but it has only 18% -20% of new airplane business in Japan.

Airbus Industrie chief executive Noel Forgeard: committed to selling more Airbus airplanes to Japanese airlines

At the press conference, Forgeard said his company has asked Japanese aerospace companies to decide, by mid-June, if they want to contribute to the development and construction of Airbus's 555-passenger aircraft, the A380.

"At the end of last year we made some proposals to Japanese manufacturers – including Boeing partners Mitsubishi and Kawasaki – for eight per cent of the A380," he said. "These discussions have not come to fruition, but we have to make a final decision in June. It would be unrealistic for Europe and Japan not to work together. It is the right time for it."

Airbus Industrie estimated Japanese airlines would buy 600 new airplanes in the next two decades and 180 of them would be Very Large [passenger] Aircraft.

Forgeard said the orders Airbus hoped to pick up in Japan would be the first from any Japanese airline since the regional economic recession set in three years ago.

"It will not be enormous news, but we have a significant number, a few aircraft orders, this year. We have had no new contracts for two years," he told reporters at the opening of Airbus Japan on May 22.

Foundation stone laid At Zhuhai aero engine shop

Executives of China's first joint venture engine repair and overhaul facility – a 50/50 partnership – laid the foundation stone at their southern China MTU Maintenance Zhuhai Co. Ltd, in mid-May.

MTU Aero Engines, a DaimlerChrysler company, and China's largest carrier, China Southern Airlines (CSA), agreed a year ago to set up the facility. They chose the Zhuhai site because it was close to both Hong Kong and Macau – centers of good communications and transport links for airlines using the facility, said the partners.

The engineering shop will start off repairing International Aero Engine V2500s, which power Airbus's A320 airplanes and Boeing and Airbus airplanes equipped with CFM56 engines. The facility intends to have a workforce of 730 by 2009 and bring in annual sales of $220 million by that date.

The facility will have the capacity to repair 300 engines a year and it is planned to gear up for a 150 engines annually by 2006.

From the date of its proposed opening in November 2002 the repair shop will have immediate work to hand – the overhaul and repair of the engines that power the 81 Boeing and 20 Airbus airplanes operated by CSA.

When the absorption of China Northern Airlines and Xinjiang Airlines into CSA is completed, work from the combined fleets will increase to 180 aircraft.

Southern Airlines Group president, Yan Zhi Qing said: "When this engine overhaul center opens, it will have the same level of technological capability as MTU facilities in Germany." The Southern Airlines Group is the parent company of CSA. He continued: "We will provide comprehensive, aircraft engine quality services to our airline and other airlines throughout China, Southeast Asia and around the world. The establishment of this joint venture will assist CSA in meeting its long-term goals of improving airframe maintenance capability, ensuring continued aircraft airworthiness, thereby lowering aircraft maintenance costs."

Executive vice president of MTU Engines, Paul Egon Grall, said the joint venture will give MTU entrée to the Chinese market and improve MTU's service offerings in the entire region. He added the German parent company expects to boost its regional presence by being closer to its customers, especially in markets such as Asia and The Americas.

Yan Zhi Qing, president of the Southern Airlines Group, parent of China Southern Airlines: engine repair unit will reduce airline maintenance costs in long-term

"We have found a reliable partner who will help us get our foot in the Asian door. China Southern, in turn, benefits form the advanced repair technologies it learns form MTU," Grall said at the celebrations that followed the laying of the foundation stone.

ECONOMIC SLOWDOWN STARTS TO BITE

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

The Association of Asia Pacific Airlines (AAPA) member carriers reported flat growth of 0.3% in consolidated revenue passenger kilometres (RPK) in February. But passengers carried (PAX) recorded negative growth of -1.2%. Capacity grew a moderate 0.9% which dragged passenger load factor (PLF) down by 0.5 percentage point to 72.9%.

With the economic slowdown starting to bite, only three airlines reported double-digit growth in RPKs – Royal Brunei Airlines (BI – 48.0%), Vietnam Airlines (VN – 35.1%) and Garuda Indonesia (GA – 14.5%). Four airlines registered growth ranging from 2.9% (JL – Japan Airlines) to 9.1% (PR – Philippine Airlines). The remaining six airlines – five of them from Northeast Asia – reported negative growth. EVA Air (BR) experienced the biggest decline of 12.7%.

Six airlines reported an improvement in PLF with Royal Brunei Airlines heading the list with a gain of 19.7 percentage points. The other notable improvements were recorded by the Japanese airlines – All Nippon Airways (NH – 4.1 percentage points) and Japan Airlines (3.0 percentage points). Of the eight airlines posting a decline in load factor, EVA Air (-5.6 percentage points) and Cathay Pacific Airways (CX – 5.9 percentage points) suffered worst.

Nine airlines filled 70% or more of their capacity with Vietnam Airlines (82.8%), Thai Airways International (TG – 78.6%) and Japan Airlines (75.1%) coming top of the list. There were, however, four airlines reporting load factors between 60% and 70%.

Cargo Results

After two consecutive months of decline, the AAPA consolidated freight tonne kilometres (FTK) managed a marginal growth of 0.1% in February. Capacity, however, rose by 3.1%, reducing the freight load factor (FLF) by 2.0 percentage points to 65.9%.

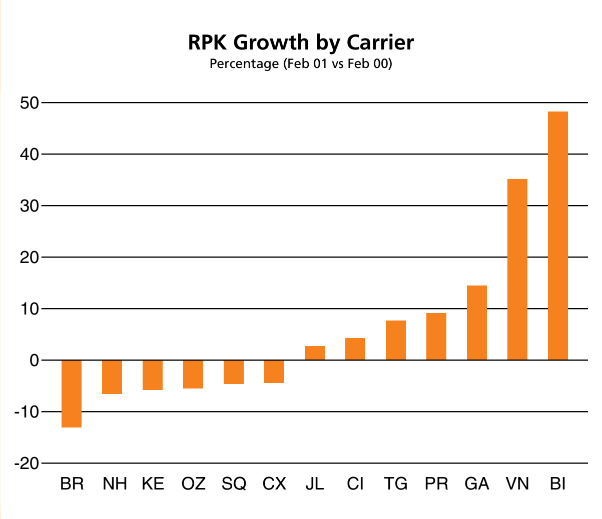
Eight carriers managed to report growth amid lacklustre trade. Vietnam Airlines (46.0%) reported huge growth, followed by China Airlines (CI – 26.4%) and Thai Airways International (10.7%) – the only carriers with double-digit growth. Five carriers experienced a contraction in freight traffic this month. Royal Brunei Airlines (-25.3%) suffered the biggest drop, followed by All Nippon Airways (- 16.5%) and Korean Air (KE – 14.6%).

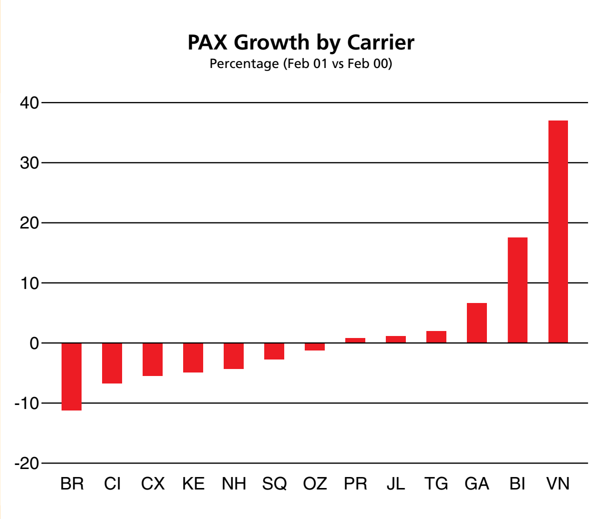
Only Vietnam Airlines (7.2 percentage points) recorded significant improvement in FLF. Four other carriers registered more modest growth. The remaining eight airlines suffered a decline ranging from 0.5 percentage point (Cathay Pacific Airways) to 15.0 percentage points (Royal Brunei Airlines).

Eight carriers had a load factor of more than 60%. The top four were Korean Air (75.9%), China Airlines (75.6%), Asiana Airlines (OZ – 74.7%) and EVA Air (70.9%). Three carriers – all from Southeast Asia – posted load factors of below 50%.

Results of the 12 months to February 28, 2001

The AAPA consolidated RPKs and passengers carried for the 12-month period under review grew by 11.0% and 9.6%, respectively.





Capacity increased 6.8%, enabling PLF to increase 2.9 percentage points to 75.1%.

All carriers benefited from a robust 2000 with nine carriers reporting growth above 10%. Philippine Airlines' strong recovery continued with year-on-year growth of 33.2% for the twelve-month period. Vietnam Airlines was next with 26.8% growth. The other carriers with significant growth were China Airlines (17.8%), Garuda Indonesia (16.4%), Asiana Airlines (13.8%), Royal Brunei Airlines (13.0%), Cathay Pacific Airways (13.0%), Thai Airways International (11.1%) and Japan Airlines (10.2%).

Twelve carriers reported an improvement in load factor, ranging from a modest 0.2 percentage point (Asiana Airlines) to 7.9 percentage points (All Nippon Airways). The only carrier to experience a decline was Korean Air (-1.2 percentage points).

The PLFs were high with Vietnam Airlines (77.5%) leading the pack. Next in line were Asiana Airlines (77.1%), Singapore Airlines (76.8%), Thai Airways International (76.1%), Japan Airlines (75.8%), China Airlines (75.7%), Cathay Pacific Airways (75.6) and EVA Air (75.4%).

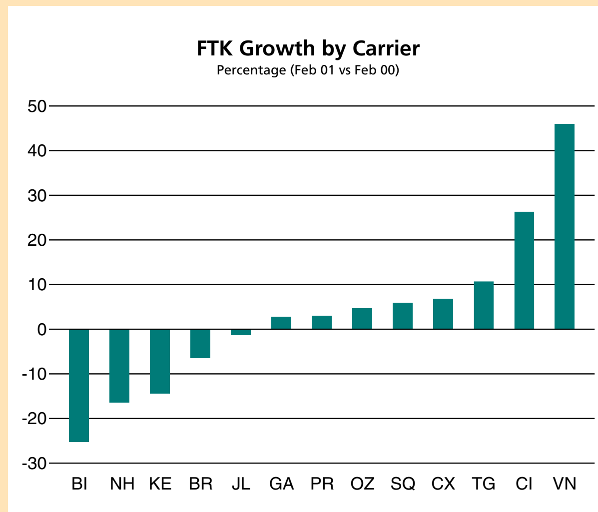
Cargo Results

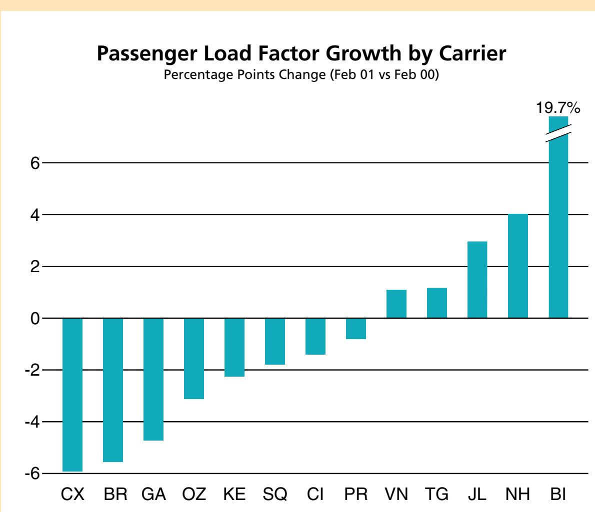
The consolidated FTKs for the 12 months ending February 28 grew by 8.1%. The capacity rose by 7.8% that resulted in a load factor of 69.6%, up 0.2 percentage point.

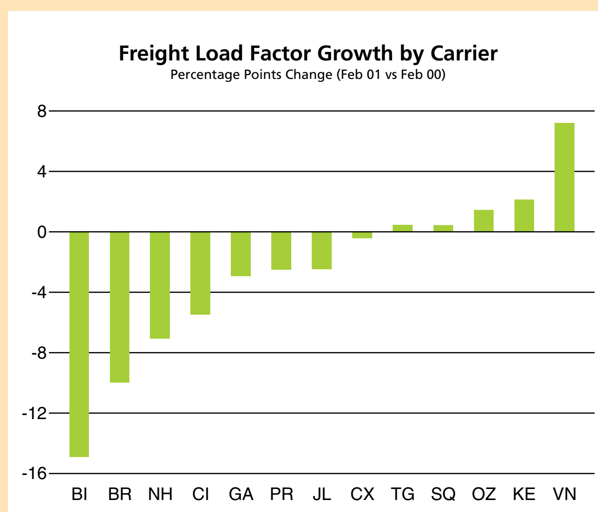
With the exception of All Nippon Airways (- 4.5%) and Royal Brunei Airlines (- 9.1%), all carriers reported growth in FTKs. Philippine Airlines (22.1%) performed best of the member carriers. Three more airlines managed double-digit growth – China Airlines (20.8%), Vietnam Airlines (19.7%) and Garuda Indonesia (12.6%).

All Nippon Airways (10.3 percentage points) and Garuda Indonesia (6.1 percentage points) continued to register notable improve-

Japan Airlines: passengers up 3% in February 2001







China Airlines: freight load factor of 82.2% in February

ment in FLF. Three other carriers managed marginal improvement. The remaining nine airlines suffered a decline in load factor.

Five Northeast Asian carriers reported FLFs exceeding 75% – China Airlines (82.2%), EVA Air (78.6%), Asiana Airlines (76.7%), Korean Air (76.7%) and Cathay Pacific Airways (71.6%). On the other hand, three carriers – Royal Brunei Airlines, Vietnam Airlines and Philippine Airlines – had load factors below the 50% mark.

Summary

February was one day shorter than the corresponding month in 2000, therefore both traffic and capacity could be expected to be marginally impacted by 2% – 3%. Nevertheless, it is obvious that on top of this there was a sharp curtailment of capacity and traffic expansion in comparison to rates of growth experienced during most of 2000.

The steady trend of decreasing growth since last October is likely to continue for at least the next six months and could extend beyond that period if weak exports translate into a general softening of the Asian economies. China and Europe traffic could become more significant. As Asian countries remain attractive tourist destinations, with the bonus of relatively weak currencies in most places, passenger traffic is expected to be more resilient than freight. Freight traffic may only see growth in the second half of the year, which will especially benefit the Northeast Asian carriers with the anticipated admission of China to the World Trade Organisation and a better trade environment.

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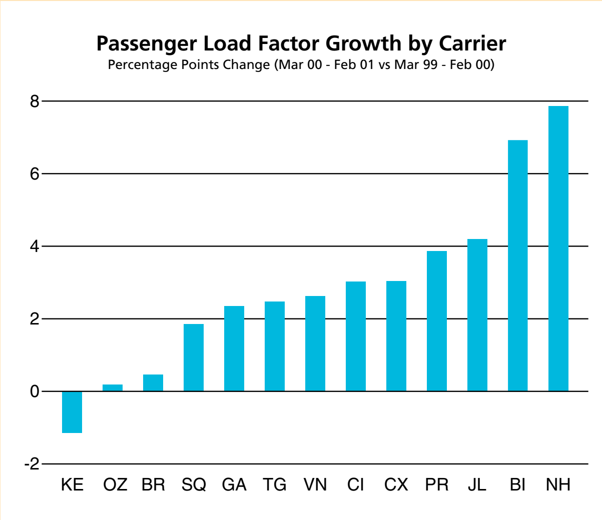
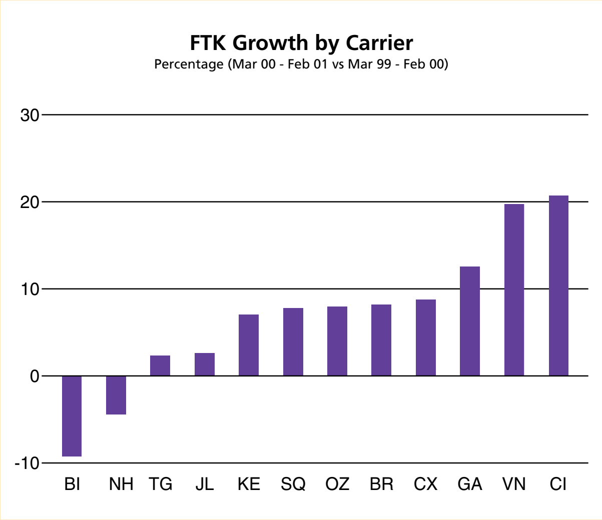
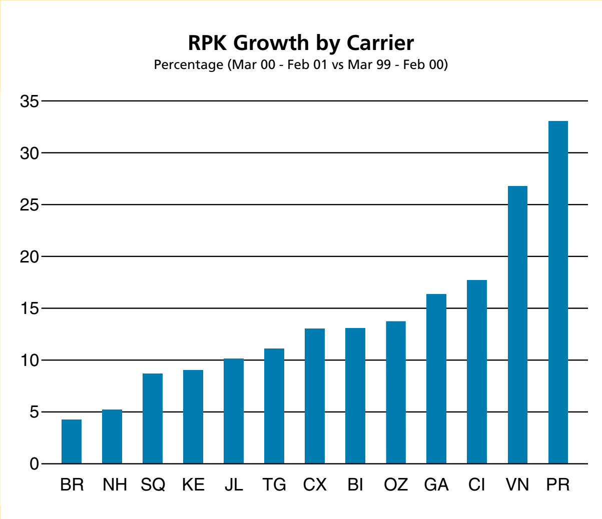
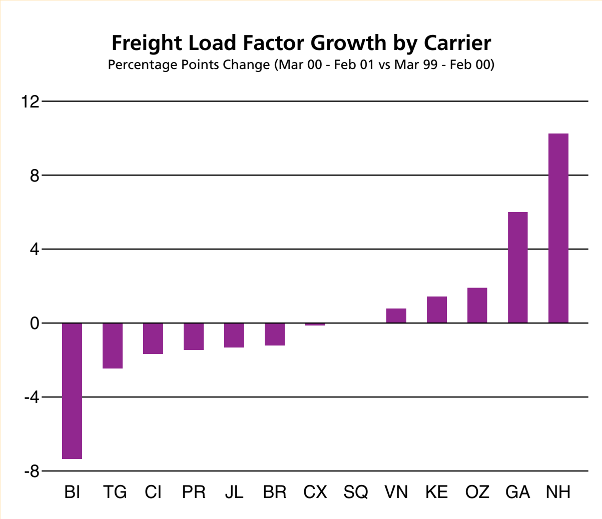
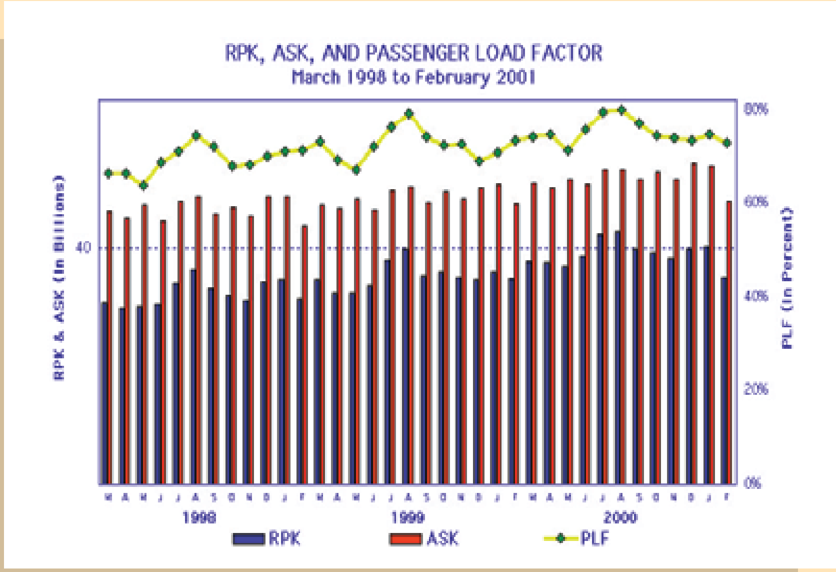


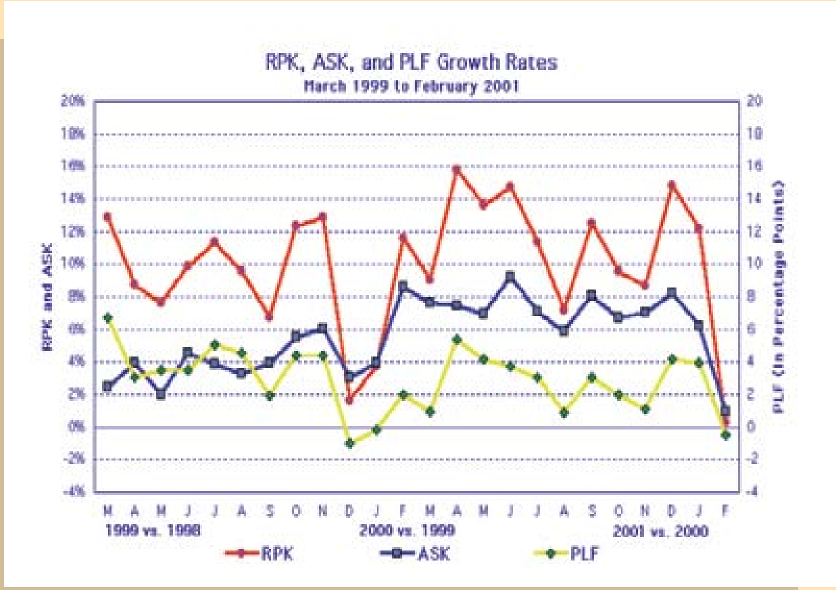




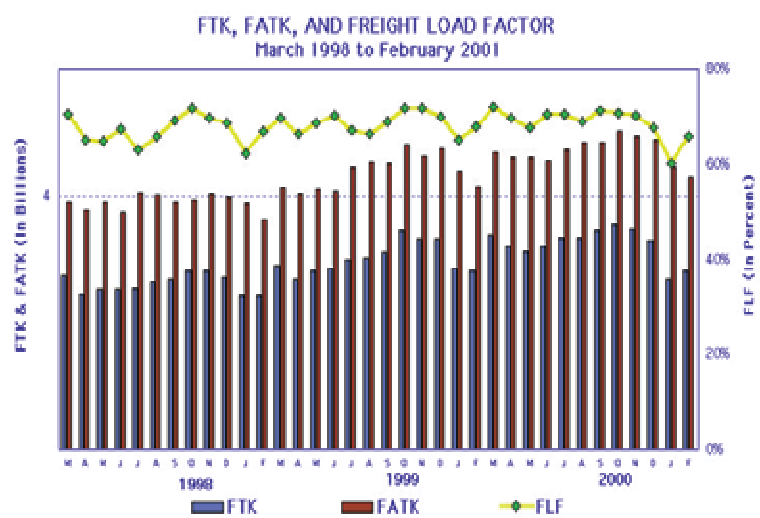


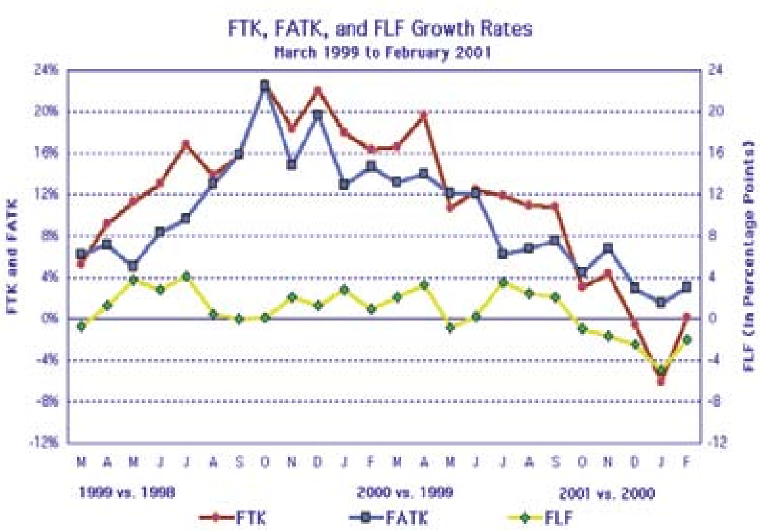
Monthly international PAX statistics of AAPA members





Monthly international cargo statistics of AAPA members





AAPA monthly international statistics (MIS)

*IN THOUSANDS

2000 to 2001

MAR-00	37,637,467	50,831,746	74.04	3,368,597	4,683,125	71.93	6,909,610	9,348,746	8,487
APR-00	37,456,270	50,155,854	74.68	3,206,711	4,605,727	69.62	6,729,187	9,211,994	8,532
MAY-00	36,785,555	51,663,143	71.20	3,117,148	4,602,811	67.72	6,587,965	9,339,170	8,283
JUN-00	38,462,047	50,721,560	75.83	3,205,060	4,554,317	70.37	6,825,239	9,220,322	8,539
JUL-00	42,210,457	53,221,980	79.31	3,339,584	4,731,881	70.58	7,306,299	9,503,672	9,358
AUG-00	42,563,884	53,219,304	79.98	3,328,928	4,835,287	68.85	7,329,682	9,731,918	9,411
SEP-00	39,695,907	51,498,288	77.08	3,448,015	4,846,064	71.15	7,187,257	9,577,705	8,720
OCT-00	39,213,125	52,689,409	74.42	3,556,216	5,025,502	70.76	7,253,911	9,859,762	8,782
NOV-00	38,040,505	51,552,700	73.79	3,467,407	4,944,456	70.13	7,044,098	9,673,473	8,630
DEC-00	39,744,563	54,234,897	73.28	3,306,664	4,887,447	67.66	7,046,451	9,860,647	8,846
JAN-01	40,241,361	53,812,799	74.78	2,682,952	4,453,377	60.25	6,418,139	9,388,152	8,971
FEB-01	34,891,538	47,877,174	72.88	2,821,637	4,283,067	65.88	6,096,764	8,662,026	7,962
TOTAL	466,942,679	621,478,854	75.13	38,848,919	56,453,061	68.82	82,734,602	113,377,587	104,521

2000 to 2001

	RPK %	ASK %	PLF	FTK %	FATK %	FLF	RTK %	ATK %	PAX %
MAR-00	9.04	7.59	0.99	16.64	13.20	2.12	13.51	10.24	8.69
APR-00	15.79	7.49	5.35	19.67	13.97	3.31	18.24	10.76	14.37
MAY-00	13.61	7.15	4.05	10.72	12.10	-0.84	12.91	9.48	11.17
JUN-00	14.75	9.16	3.69	12.44	12.12	0.20	14.38	10.62	11.61
JUL-00	11.40	7.07	3.08	11.87	6.29	3.52	12.01	5.30	9.48
AUG-00	7.15	5.93	0.91	10.89	6.88	2.49	9.06	6.40	5.81
SEP-00	12.50	8.09	3.02	10.84	7.56	2.11	11.72	7.84	12.21
OCT-00	9.61	6.70	1.98	3.01	4.44	-0.98	6.33	5.53	9.68
NOV-00	8.68	7.03	1.12	4.36	6.83	-1.66	6.49	6.90	8.70
DEC-00	14.83	8.23	4.21	-0.57	2.97	-2.41	7.20	5.59	11.31
JAN-01	12.18	6.22	3.93	-6.13	1.53	-4.99	3.09	3.88	13.80
FEB-01	0.31	0.93	-0.45	0.12	3.10	-1.96	0.15	1.79	-1.20

Calendar Year

	RPK (000)	ASK (000)	PLF %	FTK (000)	FATK (000)	FLF %	RTK (000)	ATK (000)	PAX (000)
1995	326,071,184	471,535,677	69.15	23,838,488	36,487,508	65.33	54,250,542	79,121,583	76,378
1996	374,365,998	529,442,583	70.71	27,783,667	43,091,640	64.48	62,557,622	90,816,037	86,703
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[5]	75,132,899	101,689,973	72.88	5,504,589	8,736,444	65.88	12,514,903	18,050,178	16,933

Calendar Year

	RPK %	ASK %	PLF	FTK %	FATK %	FLF	RTK %	ATK %	PAX %
1996	14.81	12.28	2.53	16.55	18.10	-1.55	15.31	14.78	13.52
1997	3.58	6.03	-2.46	14.24	6.03	8.22	8.28	6.52	2.30
1998	-1.46	-0.76	-0.70	-2.47	1.13	-3.60	-2.36	0.48	-2.82
1999	9.08	3.43	5.65	13.95	11.50	2.45	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[6]	6.34	3.66	0.85	-3.02	2.30	-0.58	1.64	2.87	6.22

Note:

1. The consolidation in the above table includes 16 participating airlines.

2. Data for Feb 2001 are subject to revision as actual data for AN Feb 2001 and QF Feb 2001 are not available.

3. KA and NZ do not participate in this report.

4. AN data from Jul 1998 onwards. VN data from Jan 1998 onwards.

5. CY denotes Calender Year (January - December). Year 2001 to-date: Jan 2001 - Feb 2001.

6. Year-on-year comparison: Feb 2001 v Feb 2000.

POLITICS MUST NOT HINDER REFORMS

TURBULENCE

By Tom Ballantyne

Is China's airline industry about to deliver on years of promise? The signs have never been so encouraging, with urgently needed regulatory change finally emerging in more than ethereal form.

Beyond the country's borders, both in Asia and the rest of the world, the enormous potential of this sleeping aviation giant has long been recognised. Indeed, it remains difficult to comprehend the impact of an unfettered Chinese airline market on the global airline industry and its traffic trends.

Until now, this potential has never been realised because Beijing remained extremely nervous about ripping away protective layers of bureaucracy and baring its carriers to the open, competitive pressures of western world aviation. Nor have China's carriers had "the western benefits" of decades of hard-bitten commercial experience to hone their survival skills.

Beijing decision-makers may have been right to apply the brakes on the aviation industry, but their critics would argue that the decades-long control exercised over Chinese airlines by an all-powerful Civil Aviation Administration of China (CAAC) has held up airline development, possibly by a decade.

In practice, CAAC control meant carriers could not select suitable aircraft for their airlines, individually choose their routes or gather sufficient information to understand the strategies of fellow mainland operators. As a result, they have not, until recent years, had to make the commercial decisions that are bread and butter management choices for foreign rivals.

But the CAAC recently officially announced the 10 airlines under its control would be organised into three groups: Beijing-based Air China, Shanghai-based China Eastern and the Guangzhou-based China Southern. Each will have assets of around US$6 billion and will operate some hundreds of aircraft between them.

Just as importantly, a fourth aviation group has emerged – China Sky Aviation Enterprises – made up of carriers Shandong, Shanghai, Shenzhen, Sichuan, Wuhan and China Postal airlines.

Given that the CAAC does allow the new groups to operate like real businesses, their futures appear astounding. According to the latest Air Transport Action Group (ATAG) report, based on International Air Transport Association (IATA) statistics, air traffic in China will grow 208% by 2014, the second highest expansion rate in the world after Vietnam. In real terms, China will become the largest Asia-Pacific country for domestic and international scheduled passengers combined, with air travel numbers climbing from 69.6 million to 214.7 million.

If China allows Chinese citizens more and easier access to foreign travel then the potential impact for all airlines on their numbers hardly has to be explained. Also, there is a feeling, still to be publicly acknowledged by any of the parties concerned, that foreign airlines may be allowed to take significant stakes in Chinese carriers with whom they already have partnerships. Another possible development could see Hong Kong's Cathay Pacific Airways, long isolated from Chinese air routes, forging a partnership with one of the new groups. Does it make sense in this global environment that a major international airline has a network spanning the world – except for China?

Then there is the question of alliances. Talk to Star, oneworld and the smaller alliance groupings and they will always tell you: yes, we would like a Chinese member, but no, they're not quite ready yet.

In the midst of all this change, issues that could thwart the ambitions of China's airlines to gain full freedom have emerged. One of these is the ongoing tension over U.S. spy flights along China's borders that has developed since the dramatic mid-air collision of a Chinese fighter and a U.S. reconnaissance aircraft off the Chinese coast on April 1 this year. A *China Daily* report quoted Chinese analysts who believe the new tension in China-U.S. relations may increase Airbus Industrie's chances of securing aircraft orders from Chinese carriers ahead of Boeing. It cited as significant that CAAC boss, Liu Jianfeng, personally approved test flights of an Airbus A319 for China Southwest Airlines in Tibet in April, a decision normally handled by a more junior official. This sort of political manoeuvring is hardly new and Beijing is not the only one to engage in it. France has attempted to apply political pressure on airlines operating in South Pacific French territories to buy Airbus instead of Boeing airplanes. But there is a big difference between a tiny South Pacific island state that might buy a few aircraft and China, where the country's fleet is forecast to increase from 600 to 1,600 aircraft by 2019.

If China wants its airlines to be equal players on the world aviation stage it has to leave Boeing and Airbus out of the diplomatic equation. All it succeeds in doing is forcing a carrier to operate aircraft that might well be entirely the wrong piece of equipment for the task required. And it does not matter whether it is a Boeing or Airbus jet. It can work both ways to the detriment of the airline. Add Taiwan to this mixture and the situation becomes more volatile. Talk of cross strait flights ebbs and flows, as does the rhetoric from Beijing, Taipei and Washington DC. But the threat to future airline market stability cannot be underestimated.

Some common sense, an improvement in relations and opening of direct air routes would represent a huge boost to the entire Asia-Pacific market place and would bring massive gains to China's own airline industry. The alternative hardly bears thinking about. Economic conditions, fuel prices and political posturing aside, it is high time the airlines of China are given free reign to express themselves in a global world. For far too long the talk has centred on "potential". Turning that potential into reality should now be the top priority.