AIRLINE weekly®
INDEPENDENT WORLDWIDE COVERAGE

April 16, 2012
Issue No. 378

Something Even More Special?

What to expect if US Airways does merge with American

It's not inevitable. But a US Airways-American combination has become likely enough, and possibly imminent enough, that it's time to start wondering not just whether something will happen but—more interestingly—what a hypothetical "American Airways" would look like. How well positioned would it be to compete against United and Delta—and to compete against and cooperate with other global giants?

First and least importantly, the merged airline would likely be called American Airlines—the far more famous global brand—even if it essentially results from a hostile takeover by US Airways. Don't forget: the current US Airways management team is quite familiar with taking over a larger airline and adopting its brand. Yes, some people view US Airways as an airline that's been frustratingly left out of recent transactions. But in fact, not only is it the airline that caused those transactions—Delta merged with Northwest after US Airways tried to buy Delta, and United merged with Continental after US Airways tried to merge with United. It's also the airline that started the current round of consolidation with a merger that it *did* successfully execute: the one between America West (which current US Airways executives ran) and the old US Airways.

See also:
• "American Airways" hubs, p. 7

A major difference between that merger and this would-be merger is that the 2005 deal saved two airlines that probably wouldn't otherwise exist today: the old US Airways was in "Chapter 22" (a slur for a company that's gone bankrupt not once but twice) and close to liquidation, while America West would have later succumbed to the fuel spike, recession and brutal pricing environment in the western U.S.—the America West part of the combined airline's network has by all appearances been unprofitable for several years now. (An important lesson: no, bigger isn't *always* better. But it often is—not just being bigger per se, with the related economies of scale, negotiating leverage, pricing power and so forth, but also the diversified geographical exposure.)

A US Airways-American merger, on the other hand, would unite one airline (US Airways) that is already solidly albeit not spectacularly profitable with

CONTINUED ON p. 9

Pushing Back: Inside This Issue

Turkish Airlines was one of the airline industry's great success stories in the latter half of the 2000s. But the glow is now fading amid higher fuel prices, adverse forex trends, an increasing overlap with Gulf carriers and overambitious growth. Last quarter, it was one of the worst performers among major global airlines—even bankrupt American and restructuring Air France/KLM did better.

Qatar Airways, which competes with Turkish for many of the same global traffic flows, doesn't say anything about its financial performance. But it's deafeningly loud when it comes to network expansion. Last week it shouted its intention to serve four more U.S. cities using the new B787s that will start arriving this summer.

But otherwise, last week was a slow one for news, as carriers prepared for the busy earnings season that starts with Southwest reporting Thursday. The giant low-fare airline, whose fares aren't all that low anymore, already said it would post a Q1 loss. But other U.S. carriers will do better thanks to strong revenue trends.

Elsewhere, two Chinese carriers warned of weak Q1 results, Air India received another bailout, Air Canada scuffled again with pilots and Iberia endured more pilot strikes as BA announced layoffs at British Midland. In the meantime, Delta made its case against the U.S. Export-Import Bank, and Bill Clinton made his case for it.

But whatever other news is making headlines, this fact rings loudest: WTI oil averaged $103 a barrel last quarter, the highest average since Q3 of 2008.❍

Earnings

Net result; operating margin
*ex special items (operating margins all ex SI)

October-December 2011 (3 months)
Turkish Airlines: $294m/-$121m*; -4%

“ Verbulence

Let's not be a victim of fuel. If it's 40% of your cost structure, you can't just say it's not in your control.

—Delta CEO Richard Anderson, speaking at a U.S. Chamber of Commerce aviation summit in Washington ”

The 2000s will be a decade to forever remember for **Turkish Airlines**, whose home nation flourished both economically and geopolitically. Energized by China-like wealth creation and deepening intercontinental trade links, the airline managed double-digit or near-double-digit operating margins in 2007, 2008 and even 2009, when many of its peers were reeling from the global recession. The new decade, however, is off to a shakier start. Though Turkey's economy grew a bullish 9% in 2010, Turkish Airlines saw its operating margin drop to just 6%. Then, despite another year of 9% GDP growth in 2011, the airline's operating margin was down to just 1%. In fact, Turkish posted a $30m net loss excluding special items for all of last year (official net profit was $12m). The year ended, moreover, with a $121m fourth quarter net loss ex items (official net profit was $264m) and a negative 4% operating margin. Even struggling **Air France/ KLM** did better than that. So what's the problem? For one, Turkish is growing too fast. Its ASM capacity grew another 25% last year and 26% in Q4 alone—this after upping its ASM production 15% in 2010 and 22% in 2009. Undoubtedly, some of this growth was sensible given the economy's remarkable expansion and network synergies underpinned by Istanbul's privileged geography. But it was probably excessive in light of new challenges like pricier fuel and a weakening local currency, which caused fuel outlays to rise a shocking 96% y/y last quarter. The airline also had to contend with the aftermath of unrest in key Middle Eastern and North African markets as well as the Japanese tsunami. Plus, economically struggling Europe is Turkey's largest export market and its airline's largest revenue generator. There's also talk that Turkey's high inflation and large current account deficit could cause future macroeconomic worries. And don't forget that Arabian Gulf carriers, with similarly bullish capacity growth, compete in many overlapping markets. Nevertheless, the fact that Turkish managed to increase Q4 revenues 56% y/y was impressive, even if overshadowed by a 59% rise in operating expenses. And despite the earnings slowdown, it remains a growing force in global aviation, empowered by Istanbul's geography, lowish labor costs, Star Alliance membership and a growing world economy. At the close of 2011, Turkish had a fleet of 180 planes, all but 35 of them narrowbodies. In terms of network expansion, after adding 19 international routes in 2011, it's already added London Gatwick, Moscow Vnukovo, Novosibirsk, Accra, Mogadishu and Dhaka in early 2012, with more to come this summer. Istanbul's airport congestion is a growing concern, however, although the government is working on plans for an all-new airport that could open later this decade.

Herky-Jerky Turkey

Turkish Airlines is growing everywhere, especially in the Americas and Far East. But Europe remains its most important market.

Region	Q4 revenue	y/y change
Europe	$575m	48%
Far East	$385m	76%
Mideast	$236m	52%
Americas	$152m	116%
Africa	$118m	55%
Domestic	$244m	27%

It's not quite the big gain that **Delta** reported a week earlier, but **United** said its passenger unit revenue for March rose a healthy 4% to 5% y/y, helped by the fact that during last March, the Japanese tsunami depressed performance on Pacific routes (United and Delta are the two largest U.S. airlines in Japan). Like Delta, United reported markedly higher Atlantic load factors this March than last, the fruit of industry capacity cuts. Two U.S. airlines without long-haul operations, meanwhile—**Southwest** and **JetBlue**—saw their March PRASM rise 5% and 8% y/y, respectively. A third, **Allegiant**, reported a 1% to 2% drop, but on a 24% increase in ASM capacity.

Airlines in Scandinavia reported mixed first quarter demand trends. **SAS** said yields were down 3% and unit revenues flat y/y in February, adjusted for forex changes, adding that the figures were "somewhat weaker" in March. **Norwegian**'s March unit revenue, by contrast, increased 5% on higher yields and higher load factors. **Finnair**, too, said unit revenue is improving, and that it's pleased with recent traffic trends. In economically battered Spain, meanwhile—where the airline market is shrinking overall—**Vueling** reported impressive traffic gains in the wake of **Spanair**'s collapse.

Elsewhere in Europe, **Flybe** told investors that it "performed in line with management's expectations" from January to March, its fiscal fourth quarter. Demand conditions, moreover, are good for its maintenance and training units, and the company overall feels confident despite conditions that "remain challenging." Flybe is the leading player in U.K. domestic markets, operates a regional unit for **Finnair**, aims to boost connecting traffic at secondary hubs like Manchester and recently agreed to fly two Q400s for **Brussels Airlines**, part of the **Lufthansa** empire. It also codeshares with **British Airways**, **Air France** and **Etihad**.

Airlines around the world are offering 1% more flights this April than last, and 3% more seats, according to data released by OAG. It's the 11th straight month of y/y capacity growth. OAG also notes that seven out of the busiest 15 airports in the world are now outside of North America and Europe, with Beijing on track to surpass Atlanta as the world's busiest within the next 12 months.

And speaking of Atlanta: **Delta** CEO Richard Anderson, who's also the current chairman of Airlines for America, used a speech in Washington to muster support for government policies that help rather than hinder the nation's airlines. Speaking at an aviation event hosted by the U.S. Chamber of Commerce, Anderson cited outdated antitrust guidelines for evaluating airline deals (it took two years to get a slot swap approved with **US Airways**) and what he called a need for "fair skies" as opposed to mere "open skies": it's not free trade if a carrier like **Japan Airlines** gets $8b in government money. (In fairness, non-U.S. carriers point to Chapter 11 bankruptcy protection as a big subsidy to U.S. carriers—Delta wouldn't be around today without it.) Anderson also repeated A4A's persistent demands for a national airline policy that includes a commitment to NextGen air traffic control, lower taxes, visa reform and regulatory relaxation—if carriers like **Spirit** and **Allegiant** want to charge for carry-on bags, for example, that should be their choice. Though he refrained from discussing rumors about Delta buying an oil refinery, Anderson did make his case against the Export-Import bank, whose support for rival airlines "really hurts us." It's not that he has a problem with America supporting its exporters in general. But Delta—a big generator of foreign money in its own right—is severely disadvantaged when a competitor can pay just $1m in annual interest over the 20 year life of a widebody plane, while Delta (according to an example he gave) is forced to pay $4m. One instance where harm was done: after **Air India** purchased B777s with U.S. subsidized loans, it deployed them to the U.S. and priced below Delta, driving Delta out of the market.

At another conference, this one hosted by the Ex-Im bank itself, former president Bill Clinton spoke in favor of the bank, which he called critical to ensuring a level playing field for U.S. exporters. Boeing, of course, now sells the vast majority of the commercial aircraft it manufactures not in the U.S. but abroad. Congress faces a May 31 deadline for reauthorizing Ex-Im's charter.

Correction: In our April 2 issue, we incorrectly reported operating margins for Shandong Airlines. The correct figures should be positive 7% for Q4 and positive 13% for all of 2011. Apologies for the error.

AirWaves

Noteworthy Airline Coverage From Other Media

Southwest CEO Gary Kelly, talking with *The Dallas Morning News*, gives his explanation as to why it's taking so long—and will take a lot longer—before the company's two airline brands **Southwest** and **AirTran** can codeshare with each other. Simply put, he says there's too much other work to do. The company just introduced a new maintenance system while integrating AirTran operationally and incorporating new B737-800s. Kelly also assigns higher priority to being able to sell international flights on the Southwest side, although that too isn't expected to happen for another 18 months. Also on the back burner is selecting and implementing a new reservation system, which would improve the airline's ability to rebook passengers during disruptions, optimize pricing, expand merchandising and so on. That won't happen until 2015 at the earliest. As things stand now, customers can't even book an AirTran flight on southwest.com, and vice versa, leaving lots of uncaptured would-be synergies—which, in turn, is leading to a growing sense among some investors that buying AirTran might have been a mistake, given Southwest's inability to properly integrate it in a timely fashion. Others wonder if Southwest is being too conservative in its plan to revamp its technology, urging more investment and manpower.

The *Financial Times* reports a campaign by **Emirates** to expand London Heathrow flying by landing with steeper descents and avoiding use of the runway space closest to nearby homes affected by noise—in other words, to use just 3km of a 4km runway. If it can prove that it can do this safely, the airline argues, then curfews should be relaxed. At the moment, flights are not permitted to take off or land between midnight and 6am. Emirates operates five flights a day from Dubai to London Heathrow, not to mention another three to London Gatwick. It also serves Manchester, Birmingham, Newcastle and Glasgow.

Speaking of airlines at London Heathrow, it's no wonder **Virgin Atlantic** is upset about **BA**'s purchase of **British Midland**. According to *Dow Jones*, Richard Branson's airline gets no less than a quarter of its transatlantic traffic fed to it by British Midland via a codeshare pact. Antitrust regulators are requiring BA to continue facilitating interline traffic between its new subsidiary and other airlines, but the financial terms for Virgin might become worse than under its current codeshare pact with bmi.

Who We Are and How to Reach Us

Airline Weekly is a product of Airline Weekly Corp., an independent company of journalists and former industry professionals with a shared interest in commercial passenger aviation worldwide. Airline Weekly is a subscriber-based publication and does not accept advertising from airlines. Editorial policy forbids staff members from owning stock or any other stake in airlines.

Pricing

Individual annual subscriptions (48 issues) are $695; multiple-reader discounts and enterprise licenses are available.

Editorial inquiries
Jay Shabat, Publisher
jayshabat@airlineweekly.com
Media inquiries
Seth Kaplan, Managing Partner
skaplan@airlineweekly.com
Subscriptions and advertising
Jason Cottrell, Marketing Manager
jcottrell@airlineweekly.com

AIRLINE weekly

746 NE 7th Avenue, Fort Lauderdale, FL 33304, USA
+1 954 524 8855 • airlineweekly.com

Fleet Sheet

Aircraft Developments

- With its resource- and population-rich home economy still booming, Indonesia's **Garuda** placed orders for another 11 A330-300s. The transaction, announced while U.K. prime minister David Cameron was visiting Jakarta, will add to Garuda's existing fleet of 14 A330s, six of them -300s. Boeing wasn't left out of the fun, however, with Garuda also taking delivery of a milestone B737 last week: the 300th delivered with Sky interiors.
- **Transaero** finalized orders for four B787-8s, aircraft it will use both internationally (no surprise) and also domestically (Russia's vast territory makes longhaul planes essential). This same airline, which specializes in longhaul leisure flying, is also buying B747-8s and A380s.
- **Virgin Atlantic**, which started flying A330-300s last spring, will this spring start receiving them with three-class business-market configurations. For Virgin, that means economy, premium economy and Upper Class, the latter a high-end business cabin. Unsurprisingly, the first market to receive the new planes will be London Heathrow-New York JFK, which Virgin flies three times a day each way. The twin-class A330-300s it already has are used to serve Orlando from London Gatwick, Manchester and Glasgow. Separately, Virgin founder Richard Branson told *Diario Financiero* that he's considering London flights to Santiago, Chile. But then again, Richard Branson says a lot of things.

SkyMoney

Airline Finance

- Here we go again: The Indian government will flush another gargantuan sum of money—this time nearly $6b—down the **Air India** toilet. This time, the equity infusion will be stretched out from now until 2020 and linked to a plan that envisions independent maintenance and ground handling units, still owned by Air India but focused on third party insourcing as well. Despite being handed a cup of life-saving medicine, some unions still complained about the cup. In the meantime, the airline will stick with plans to acquire 27 B787-8s, the first of which will arrive in June. And in a related matter, government officials continue to debate the merits of allowing foreign airlines to buy non-controlling stakes in Indian airlines. Repeatedly propping up Air India, of course, seriously retards the development of well run airlines like **Jet Airways** and **IndiGo**—and by extension retards the development of India's entire air transport sector. Air India performs no economically useful functions for its country in the way that a loss-making government carrier in a small nation dependent on tourism might (i.e., perennially money-losing Caribbean state airlines are more forgivable). The one exception is that its existence does create market oversupply, which in the short run benefits consumers through lower fares, a phenomenon highlighted by the fact that India is one of the world's fastest growing airline markets. But then again so is Brazil, which let its national airline **Varig** go bankrupt, opening the door to **TAM** and **Gol**, two healthy airlines making great contributions to their economy.
- **China Southern** and **China Eastern** both issued profit warnings for the first quarter, advising investors that results would be significantly down versus Q1 last year. The companies, based in Guangzhou and Shanghai, respectively, blamed a slowdown in passenger demand, weak cargo demand, higher oil prices and smaller forex gains.
- As disclosed in its earnings report last month, fuel hedging saved **Lufthansa** a massive $991m last year, with 26% of that savings achieved in the first quarter, 37% in the second, 26% in the third and only 11% in the fourth. It also saved another $407m on fuel from favorable forex trends, bringing its total fuel hedge and forex gains to almost $1.4b. Its entire operating profit last year, keep in mind, was less than $1.2b.

AirBuzz

Marketing, Price, Promotion & Alliances

- Is **United** becoming the airline America loves to hate? The carrier again ranked dead last in March among the big four U.S. legacy airlines in three key operational metrics: on-time performance, lost bags and (unsurprisingly, considering the other two) customer complaints. True, a messy reservation system migration caused a lot of that, but January and February—before the migration—were scarcely better. Supporting the statistics are anecdotes, such as one told to *Airline Weekly* last week by a customer who had gotten a message to contact the airline about a schedule change. She finally learned, after a long hold and then discussions with perplexed agents, that—of zero consequence to her—only the flight number had changed.
- **Delta** and **Southwest** are fighting an ad war in the Atlanta market, as noted by the *Atlanta Journal-Constitution*. One of Delta's lines: "Improving first class begins by offering one." And Southwest: "Say bye-bye to bag fees, Atlanta."
- **Virgin Australia**, following the lead of **Qantas** and a growing number of airlines in Latin America, will create a separate division to mange its frequent flier plan. Virgin sees lots of earnings potential in its Velocity plan but thinks the best way to tap that potential is by creating a stand-alone business unit with a dedicated chief executive. It did not, however, say anything about wanting to eventually divest the plan, as **Air Canada** did with Aeroplan. Separately, Virgin Australia said it would update the interiors of the B777-300ERs it flies mostly to California.
- **KLM** said it's updating its World Business Class product, starting with the 22 B747-400s in its fleet. The airline will provide more detail, including the unveiling of new seats, during the second half of this year.

The Backend

Sales, Distribution, Tourism & Corporate Travel

- ARC, which facilitates transactions between airlines and travel agencies, said U.S.-based agencies sold more than $23b worth of airline tickets during the first quarter of 2012, up 7% y/y and up 18% versus Q1 2010. Rumors of their death, in other words, are greatly exaggerated. In fact, agencies remain a vital link in the airline distribution chain, particularly with respect to corporate travel.
- Travelport's 2011 annual report provides some useful facts about the company, which distributes tickets for roughly 360 airlines worldwide. Of these airlines, **American**, **Air France** and **Emirates** are its largest revenue producers in North America, Europe and Mideast/Africa/Asia, respectively (note that it counts **United** and **Continental** separately). Travelport now has about 65 full-content agreements, mostly with major global airlines, that ensure access to all public fares offered by a carrier. In fact, about three quarters of its GDS bookings come from carriers with these full-content deals. But some important ones will expire this year, including those with **American** and **US Airways**, the two airlines that are most critical (and litigious) with regard to GDS companies. Note also that more than 40% of Travelport's GDS revenue comes from just 15 airlines, with LCCs now accounting for about 5% of segments and growing fast—its largest LCC suppliers are **Frontier**, **Southwest**'s **AirTran** unit and **Air Berlin**.
- Package tour operators traditionally earned money from airlines by obtaining bulk-rate discounts on seats in exchange for selling large volumes of tickets. But as *Travel Weekly* reports, the model isn't working well these days on transatlantic markets. Capacity cuts leave little excess capacity for airlines to provide to tour operators, and hefty fuel surcharges make whatever discounts they receive less significant. At least one big operator called selling airline tickets a loss-making activity. It's hard to offer travelers a packaged tour, however, if you don't provide the airfare.

A Mixed Bag in East Asia

Financial results from October to December 2011 feature some of the world's most profitable airlines and biggest loss-makers

Japan Airlines stuns the world with an incredible bounce-back from bankruptcy; cost cuts, capacity cuts and the strong yen all helped
All Nippon rides many of the same trends that benefited JAL; becoming a more international airline, one now armed with B787s
Skymark not left out of the party: also posts phenomenal profits by expanding domestically with its B737-800s; but does it really want A380s?
Singapore Airlines not the dominant airline it used to be; faces strong and growing competition on many different fronts
Cathay Pacific, helped by $109m in fuel hedge gains and its stake in Air China, has a pretty good second half of 2012; weak cargo markets a worry
Korean Air manages operating profits in the off-peak fourth quarter but loses money at the net level; Japanese carriers becoming tougher rivals
Asiana posts similar results to those of its archrival Korean Air; both carriers highly exposed to a potential economic slowdown in China
Thai Airways suffers big loss in peak quarter; troubles include fallout from floods, weak outbound tourism from Europe and rising competition
Malaysia Airlines a complete mess, overwhelmed by competitive forces and strategic errors (i.e., growing too fast); will AirAsia alliance help?
AirAsia highly profitable again; expanding with new units in the Philippines and Japan, online travel JV with Expedia, alliance with Malaysia Airlines
Garuda, growing extremely fast, did better in 2011 than in 2010, both for Q4 and the full year; Indonesia a market to watch
Air China still the strongest among the mainland's Big Three but not immune to cargo slowdown and high fuel prices, exacerbated by forex trends
China Eastern hardly the basket case it once was before merging with Shanghai Airlines; nevertheless losing money again
China Southern also loses money in the off-peak quarter; trying to be a player in the competitive Europe & northeast Asia to Australasia market
Hainan Airlines continues to post strong margins thanks to domestic profits underpinned by well-reputed service and low costs
Shandong Airlines, controlled by Air China, continues to contribute solid operating margins; Jinan and Qingdao both solid home markets
China Airlines slips back to sizeable losses after a brief moment in the sun during 2010; heavily dependent on Taiwan's weakening cargo markets
EVA Air in the same boat as China Airlines; hopes things will improve by joining the Star Alliance
TransAsia an up-and-coming challenger to CAL and EVA in Taiwan; now getting a substantial portion of revenues from cross-Strait routes
Tiger Airways hit hard by grounding in Australia but Singapore unit losing money too; now expanding in Indonesia via Mandala Airlines
Cebu Pacific has an excellent peak Q4 albeit not as stunningly good as the one it had a year earlier; next move is launching longhaul A330 flights
Philippines Airlines still a mess but just received more capital to perhaps use for fleet renewal; AirAsia Philippines only its latest headache

Q4: Oct.-Dec. 2011	Revenues	Expenses	Op. Profit	Op. profit ex si	Net profit	Net profit ex si	Op margin ex si	Net margin ex si	Revenue y/y	Expenses y/y	Difference	ASMs y/y
Japan Airlines	$4,001	$3,283	$718	$718	$629	$684	**18%**	17%	Did not report last year			-4%
All Nippon	$4,722	$4,191	$530	$530	$141	$437	**11%**	9%	10%	-10%	20 pts	4%
Skymark	$245	$207	$38	$38	$14	$14	**16%**	6%	30%	36%	-6 pts	37%
Singapore Airlines	$3,004	$2,882	$122	$122	$116	$116	**4%**	4%	1%	12%	-11 pts	4%
Cathay Pacific (6 mo.: July-Dec.)	$6,617	$6,271	$346	$346	$345	$345	**5%**	5%	7%	15%	-8 pts	9%
Korean Air	$2,785	$2,718	$67	$67	$128	($70)	**2%**	-3%	9%	10%	-1 pt	10%
Asiana	$1,183	$1,135	$48	$48	($14)	($14)	**4%**	-1%	8%	7%	1 pt	10%
Thai Airways	$1,566	$1,697	($131)	($131)	($180)	($150)	**-8%**	-10%	-5%	7%	-12 pts	1%
Malaysia Airlines	$1,150	$1,562	($413)	($71)	($399)	($73)	**-6%**	-6%	0%	11%	-11 pts	1%
AirAsia	$644	$463	$181	$141	$64	$110	**22%**	17%	15%	17%	-2 pts	11%
AirAsia Malay	*$398*	*$244*	*$153*	*$113*	*$43*	*$88*	***29%***	*22%*	*9%*	*7%*	*2 pts*	*5%*
AirAsia Thai	*$139*	*$120*	*$19*	*$19*	*$20*	*$20*	***14%***	*14%*	*23%*	*42%*	*-19 pts*	*19%*
AirAsia Indonesia	*$107*	*$99*	*$9*	*$9*	*$2*	*$2*	***8%***	*2%*	*28%*	*21%*	*7 pts*	*20%*
Garuda	$1,007	$936	$71	$71	$63	$63	**7%**	6%	32%	27%	5 pts	27%
Air China	$3,758	$3,785	($27)	($27)	($100)	($100)	**-1%**	-3%	8%	36%	-28 pts	6%
China Eastern	$3,266	$3,436	($169)	($169)	($159)	($159)	**-5%**	-5%	6%	17%	-11 pts	7%
China Southern	$3,626	$3,815	($190)	($190)	($110)	($110)	**-5%**	-3%	16%	17%	-1 pt	13%
Hainan Airlines	$1,088	$1,046	$42	$42	$83	$83	**4%**	8%	16%	38%	-22 pts	17%
Shandong Airlines	$373	$345	$28	$28	($4)	($4)	**7%**	-1%	21%	21%	flat	22%
China Airlines	$1,104	$1,180	($76)	($76)	($72)	($72)	**-7%**	-7%	-3%	11%	-14 pts	8%
EVA Air	$824	$867	($43)	($43)	($46)	($46)	**-5%**	-6%	-3%	9%	-12 pts	11%
TransAsia	$73	$74	($1)	($1)	$1	$1	**-1%**	2%	5%	16%	-11 pts	38%
Tiger Airways	$131	$141	($10)	($13)	($13)	($15)	**-10%**	-12%	-1%	26%	-27 pts	13%
Tiger Singapore	$100	$103	($4)	($4)	x	x	**-4%**	x	50%	100%	-50 pts	71%
Tiger Australia	$31	$38	($7)	($7)	x	x	**-21%**	x	-51%	-36%	-15 pts	-59%
Cebu Pacific	$218	$190	$29	$29	$32	$32	**13%**	15%	25%	42%	-17 pts	19%
Philippine Airlines	$386	$429	($43)	($43)	($34)	($34)	**-11%**	-9%	-4%	9%	-13 pts	1%

Source: company reports and *Airline Weekly* analysis; all figures converted to U.S. dollars using exchange rates from October to December

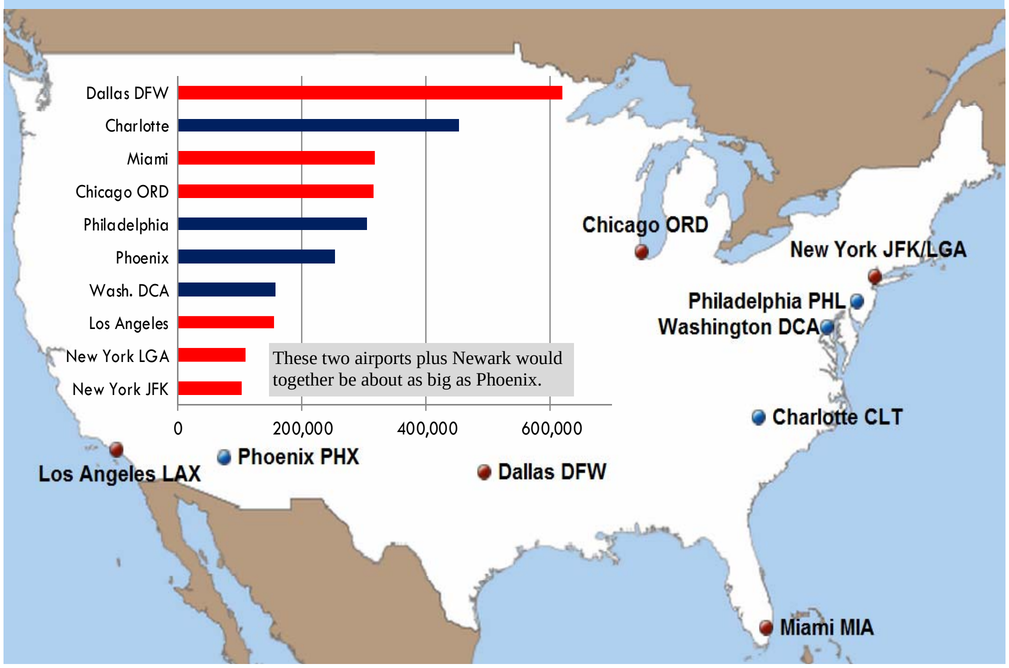
State of the Unions

Workforce Developments

- April is delivering more labor headaches for **Air Canada**, this time in the form of pilot sickouts that caused cancellations (of about 75 flights within North America) and delays. Last month, Canada's government told pilots (like they told ground staff) they weren't allowed to strike, and last week officials called the sickouts "illegal," the word also used by Air Canada's management. Union leaders too said they neither ordered nor condoned the action. But in an unrelated scuffle, management scolded the leader of its pilot union for publicly questioning maintenance safety practices.
- **British Midland**, which **BA/Iberia** says is losing close to $5m a week, plans to slash about 1,200 positions, mostly at its Castle Donington headquarters and at regional airports throughout the U.K. BA hopes to close on the acquisition of its longtime rival this week and is currently discussing layoff plans with the unions involved. BA management is spinning the news as a way to save 1,500 jobs that otherwise would have been lost—**Lufthansa**, after all, might have closed British Midland altogether had BA not bought it. Recall, though, that it's only buying the mainline operation, not **bmibaby** or **bmi Regional**. Those entities are still up for sale.
- While BA is excited about getting Heathrow slots for another 20 or so daily flights, the excitement is muted by the flights that **Iberia** is losing in Spain—losing to strikes, that is. Pilots stopped working Monday and Friday last week as they said they would, with more strikes scheduled this week. This has been going on since December, leading to losses that by some accounts total $4m per day. With the busy summer season coming up, the damage could worsen, all the more so if flight attendants join the pilots in their work stoppage. Both unions are livid about the creation of **Iberia Express**, which is essentially Iberia with lower paid and more productive workers—all of this, meanwhile, as Spain trends toward becoming the new Greece, or if not quite that bad, at least the new Ireland or Portugal. The government's borrowing costs are soaring as lenders worry about the nation's budget deficits, economic stagnation and frighteningly high unemployment.
- **Allegiant**'s new Hawaii flights (see page eight) complicate its **Ryanair**-like crew scheduling practices. The carrier does not currently overnight its crews—they fly out and back in the same day. But doing so on Hawaii flights—which are about six hours long from the U.S. west coast—entails an extra pilot to comply with federal air regulations (FARs). Put another way, a pilot flying to Hawaii and back in the same day would require too many consecutive hours of flying, more than the FARs permit. Hence the third pilot, which allows for everyone to have sufficient rest. This does of course come with a cost—three pilots for a flight that would otherwise require two—but Allegiant calculates that's less costly than paying for meals and hotel rooms and parking its B757s overnight in Honolulu.

American and US Airways: Top Combined Hubs

By weekly seats scheduled for July. Current AA in red, US in blue. (Source: OAG MAX Online)



The Landing Strip

Airport Developments

- The extra day in February this leap year explains why many airports are showing y/y traffic increases for the month. But it's certainly not the only explanation for 16% y/y growth at Istanbul's main airport or 23% growth at Moscow Sheremetyevo. These were the fastest growing airports among those tracked by Airports Council Europe, for facilities that handle more than 10m annual passengers anyway. Last year, Istanbul handled 37m passengers, making it busier than all but seven European airports—London LHR, Paris CDG, Frankfurt, Amsterdam, Madrid, Munich and Rome FCO. Moscow SVO ranked 17th last year among airports in greater Europe, which by ACI's definition includes Turkey and the Soviet Union. Its busier (and slightly slower-growing) counterpart Domodedovo ranked 12th. At Istanbul and Moscow, growth is driven by home airlines like **Turkish Airlines** and **Aeroflot** taking advantage of brisk economic expansion. All things being equal, by the way, leap day should mathematically add just less than 4% to an average airport's February figures this year.
- What about just Western Europe? The main airports Oslo and Helsinki, both in Scandinavia, each grew 12% y/y in February, while Lisbon grew 11% and Vienna 10%. Of the continent's 10 busiest airports, meanwhile, Amsterdam was No. 1 for February growth, with volumes up 8%. For the record, Oslo has new flights by **Qatar Airways**, Helsinki a big buildup by **Norwegian**, Lisbon healthy growth by **TAP**, Vienna new flights by **TAP** and **Aegean** and Amsterdam a buildup by SkyTeam's **Air France**, **KLM**, **Alitalia** and **Air Europa**.
- **Delta** broke ground on a $160m renovation and expansion project at New York LaGuardia. The carrier, now much bigger at LaGuardia following its slot swap with **US Airways**, is fighting hard to be the carrier of choice in New York City. It's spending even more money to upgrade its decrepit JFK facilities.
- Paris Charles de Gaulle Airport opened a new building that connects concourses 2A and 2C, which house mostly oneworld airlines. The new facility will expand handling capacity by about 5m (including some work yet to be done) and—to be sure—includes lots of new shopping.

Who's Flying Where

- It's hard to find an airline quite as busy as **Qatar Airways**, which will start receiving B787-8s this summer, will open a new airport in Doha this upcoming winter and plans to open new flights to Zanzibar, Helsinki, Gassim, Yangon, Zagreb, Perth, Mombasa, Kilimanjaro, Erbil, Baghdad and Belgrade (whew). But wait, there's more. After initially deploying its first B787 to London Heathrow, Qatar will use subsequent deliveries to launch a U.S. market offensive, targeting Atlanta, Chicago, Boston and Detroit. CEO Akbar Al Baker informally unveiled the plan during a visit to Canada, without specifying start dates. The airline, which already has more than 100 planes, is due to receive five B787s this year.
- **Air France** began flying from Paris to Wuhan, its ninth destination in greater China. If you picture China's eastern seacoast as a semicircle with Beijing at the top, Shanghai at the center (and to the right) and Guangzhou at the bottom, Wuhan would be roughly halfway down the straight line connecting the top (Beijing) and bottom (Guangzhou). Wuhan is one of many inland Chinese mega-cities with rapidly industrializing economies.
- Hawaii goes a long way toward explaining the remarkable success of **Alaska Airlines**, which in turn explains why Alaska keeps growing there—last week it started flying to Honolulu from Oakland and San Jose. But **Allegiant** wants a piece of that pie too and finally unveiled launch routes for its long-planned Hawaii service. It will fly B757s to Honolulu three times a week from Las Vegas and once a week from Fresno. Service will begin in June. Separately, Allegiant also launched a new base in Punta Gorda, about a 45-minute drive up Interstate 75 from Fort Myers and roughly an hour south of Sarasota. **Southwest**, remember, is ending **AirTran**'s Sarasota flights. Punta Gorda had been rather quiet ever since short-lived **Skybus**, which had a sizeable operation there and even bigger plans, succumbed to the 2008 fuel spike (not to mention its own ineptitude).
- **AirAsia** is like **Ryanair** in many ways. But one big difference is that it now sells some connecting itineraries. Since last year, it has offered a service called "Fly Thru" whereby travelers connecting through Kuala Lumpur won't need to re-check their bags, won't need to re-pass through security, won't need to check in twice for the two separate flights and won't need to obtain a transit visa. Many full-service airlines, of course, already offer such services through their hubs. But AirAsia was traditionally a point-to-point airline. It only recently began promoting connecting itineraries as its network has expanded. The new Fly Thru service is available on a limited number of itineraries, the latest being those linking Indonesia to southern China. Chennai to Singapore is another, with more coming soon.
- **Cyprus Airways**, under attack by **Aegean** in its home market, is hitting back with new two-class A320 flights to London Heathrow from Aegean's hub Athens. The service won't start until October, however, missing the peak summer and hitting right up against the off-peak winter. But Cyprus will have a rough time winning even season-agnostic business travelers: it will be up against both Aegean, a Star Alliance member, and **British Airways**, part of oneworld. Cyprus Airways is not an alliance member. The new service won't likely help the airline's double-digit loss margins.
- **Bahamasair**, a state-owned airline that almost surely loses money—but which pipes in visitors for its country's critical tourist sector—announced new flights to Richmond, Louisville, Raleigh-Durham and Baltimore BWI. But not from Nassau, the biggest market in the Bahamas. Instead, the new flights will operate from Freeport on Grand Bahama Island, just 55 miles east of Florida.
- Elsewhere in the Bahamas, **Silver Airways** (formerly known as **Gulfstream International**) upgauged its Fort Lauderdale-Marsh Harbour (Abaco) flights to Saab 340B Plus aircraft from Beechcraft 1900D. The airline, which was recapitalized under new management as it exited bankruptcy, is replacing its Beech fleet with Saabs (which are more comfortable, more economical and have 34 seats rather than 19). Silver, which codeshares with **United**, schedules and prices its own markets "at risk" within Florida and to the Bahamas and also has two "essential air service" (i.e., government subsidized) networks: one from Cleveland (feeding United's hub there) and another within Montana.

1 + 1 = ? Would American plus US Airways be a winning combination?

CONTINUED FROM p. 1

another that, after whacking its costs in bankruptcy, would almost certainly be a profitable standalone airline. US Airways' case for a merger would thus be not that it's necessary for survival—it's clearly not—but that the two airlines would be stronger together than apart.

For perspective, a combined American-US Airways would (by ASM capacity this week) be the No. 2 airline in the U.S. and in the world, just behind United and ahead of Delta. That assumes no major post-merger capacity cuts, which is a reasonable assumption based on United and Delta—both cut almost nothing post merger. By revenue, the combined company would be No. 3 in the world behind Lufthansa (with its ample non-airline revenue) and United, based on 2011 figures.

A merger would combine one carrier (US Airways) that has grown through consolidation over the decades and another (American) that has grown mostly organically. If they do merge, they would be doing so not because decision-makers think there wouldn't be any challenges—but because they recognize there would be enormous challenges but think the benefits are worth the risks and headaches. Those challenges fall into four broad categories: technology, fleet, labor and network.

No merger is complete without some technological snafus. Just ask United, whose customers are still frustrated by lingering issues from when it integrated its reservations systems more than a month ago. A post-merger American would likewise have big decisions to make about which systems to adopt followed by big challenges associated with migrating systems and retraining people. But technological challenges are at least usually limited in duration: they rarely have a long-term broad strategic impact on an airline (with Southwest's inability to execute technologically perhaps being an exception in terms of the harm it has caused). The good news for the airline is that suppliers would fall all over themselves to be the surviving post-merger provider in every key area, which—as in other operational areas—would mean nice negotiating leverage for American.

The fleet negotiations have already happened, and American already committed—months before it filed for Chapter 11 protection—to a massive 460-narrowbody order (260 from Airbus, 200 from Boeing). In this regard, the merger would be quite different from those at Delta and United, which brought together airlines with relatively light order books and thus a clean decision-making slate for a post-merger management team. But those also created merged carriers that weren't exactly a paragon of fleet harmony. In each case, as would be the case here, a primarily "Boeing airline" merged with a primarily "Airbus airline." But while fleet simplicity matters, it matters less at huge legacy airlines where each of several fleet types has enough scale to efficiently support an infrastructure of mechanics, parts, pilots, flight simulators and so on. Having five A320s and B737s would be tremendously inefficient; having 250 of each isn't such a big problem. Some people think American over-ordered, even if it got great per-unit prices—Delta, which has an old fleet too and whose management team gets some benefit of the doubt for having turned it into the most profitable U.S. legacy airline, much more cautiously ordered not just from one manufacturer but also just one variant: 100 B737-900ERs. But even if American did get too ambitious—a question whose answer depends partly on unknowns like future fuel-price trends—the order would proportionally be a lighter load for a larger merged airline. American and US Airways also have incompatible widebody fleets and incompatible outstanding widebody orders (a mix of A330s, A350s, B777s and B787s). But again, Delta manages its consistent profitability despite being a flying museum (you can even still fly on an old Northwest DC-9) of every aircraft type imaginable. United too succeeds despite a rather messy combined United/Continental fleet.

Remember that statement about how if this happens, it won't be because anyone thinks it'll be easy? In no area is that more true than labor integration. US Airways still hasn't integrated the pilots and flights attendants from its last

CONTINUED ON p. 12

JetGreen

Environment, Conservation & Fuel

- Who would've thought 10 years ago that an airline would invest in an energy company? And if that's not weird enough, how about an airline from fossil-fuel-rich Qatar investing in a California-based alternative fuels company? In the latest reminder that we're living in interesting times, **Qatar Airways** plans to invest in Byogy Renewables Inc., a San Jose biofuel company with an intriguing business plan. Instead of making, say, jatropha into jet fuel, Byogy simply adds one more step to existing ethanol operations, converting, for example, sugar-based ethanol into jet fuel. Simply put, Byogy turns ethanol into jet fuel. The point is to enable aviation to leap ahead in renewable fuels, taking advantage of the scale that can be brought by an ethanol industry producing tens of billions of gallons each year. Questions remain, however, as to whether it can be done at competitive prices and whether this will help aviation's carbon footprint. One reason the industry is chasing "second-generation" feedstocks such as camelina and jatropha is that "first generation" biofuels such as sugar- and corn-based ethanol provide negligible carbon reduction. Furthermore, the ethanol-to-jet (the industry refers to it as "alcohol-to-jet") process hasn't been certified for use yet, although certification is expected in the next couple of years. One positive that using corn and sugar would certainly bring is to diversify the industry's fuel sources. Qatar Airways is also pioneering gas-to-liquid synthetic jet fuel, which also does little for aviation's carbon footprint but should at least decrease dependence on crude oil. And Qatar isn't the only airline interested. Brazil's **Azul**, Byogy says, is close to signing on too. Also, as we reported last fall, **Virgin Atlantic** is working with New Zealand's LanzaTech on a "clean" fuel project that also uses an ethanol-to-jet process.
- Meanwhile, the airline industry hasn't given up on second-generation biofuels—far from it. **Qantas** continues to lead on this front, conducting Australia's first revenue biofuel flight last week with a round trip from Sydney to Adelaide using a 50/50 blend of biofuel and fossil fuel in both engines of an A330. The biofuel component came from recycled cooking oil delivered by the Dutch company SkyNRG. Probably more important than the flight itself, Qantas also announced that it would conduct—using government funds—a feasibility study for a sustainable jet fuel industry in Australia. This is just one of a handful of low-carbon jet fuel projects Qantas has going. One reason for the airline's motivation could be that Qantas will soon be exposed to three carbon tax plans—in New Zealand, in Australia and the E.U. Emissions Trading System (ETS).
- One opponent of the E.U. ETS played a new card last week. After threatening retaliation against European airlines and European manufacturers, another third-party casualty is being threatened: the climate itself. India's environmental minister, citing the E.U.'s unilateralism, called the ETS a "deal breaker" when it comes to global climate talks. India also, as promised, formally forbade its airlines from participating in the ETS.

Around the World

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

Airline	Share Price	Change from last week	Change from last year	Comment
United	21.47	0%	2%	Southwest stepping up campaign for permission to add int'l flights from Houston Hobby
Delta	10.12	-2%	9%	Best preforming U.S. airline stock y/y, save for Allegiant
American	0.50	0%	-91%	Eagle, its regional unit, wins ground handling contract for United Express at nine airports
US Airways	7.84	1%	-3%	Should find out in early June if American will win the right to cancel labor contracts
Southwest	7.95	-4%	-32%	Operates its first B737-800; inaugural route: Chicago Midway-Fort Lauderdale
Alaska	34.74	-4%	-42%	United, with a hub in nearby San Francisco, is pulling out of Oakland, an LCC haven
JetBlue	4.78	-1%	-14%	Now operating from its new headquarters just across Manhattan's East River in Queens
Spirit	21.52	3%	x	Largest metro area that it doesn't serve (directly or via nearby airports) is Houston
Allegiant	58.65	-1%	44%	Four new routes from Punta Gorda: Fort Wayne, Niagara Falls, Peoria and South Bend
SkyWest	10.26	-4%	-35%	Flew 3% more block hours this Q1 than last
Republic/Frontier	4.87	-3%	-11%	Frontier ending service to Aspen, a popular ski resort city in the Colorado Rockies
Pinnacle	0.40	-26%	-93%	Executive pay becoming an issue in its turnaround efforts
Air Canada	0.88	1%	-63%	Qatar Airways CEO says Canada's prime minister should "tell Air Canada to go to hell"
WestJet	13.90	1%	-2%	Struggling Thomas Cook terminates Canadian flying agreement with Chorus
Aeromexico	22.75	-1%	x	Signed updated full-content worldwide distribution pact with Amadeus
LAN	21.84	-1%	21%	Passenger revenues increased 42% from 2008 through 2011; cargo revenues rose just 19%
TAM	44.83	0%	49%	Will build a new cargo terminal at Sao Paulo GRU; expects cargo increase post LAN merger
Gol	5.78	-7%	-57%	Announces another management reorganization; eliminating some executive positions
Copa	80.91	-1%	48%	Domestic ASM capacity (i.e., intra-Colombia) down to less than 5% of company total
AviancaTaca	3880	-4%	x	Actually serves more international destinations from San Salvador (25) than Bogota (23)
Emirates	(not publicly traded)			Serves London LHR, Mumbai and Doha 5x daily; nothing else more than 4x daily
Air Arabia	0.73	2%	-4%	Bahrain Air to operate 5th freedom from Dammam in Saudia Arabia to Beirut and Khartoum
Turkish Airlines	2.85	10%	-36%	Steep fall in stock price y/y reflects its recent earnings slowdown
Kenya Airways	14.05	1%	-62%	Owners of Fly540 want to bring LCC revolution to Africa with Stelios; can they pull it off?
South African Air.	(not publicly traded)			LCC unit Mango still flying just five B737-8s from five airports; not much room for growth
Jet Airways	354	4%	-24%	Between April and January, traffic at Indian airports rose 14% y/y (17% domestic, 7% int'l)
Aeroflot	124.55	2%	-28%	Its busiest airports by seats this month: Moscow SVO, St. Petersburg and Sochi (Diio Mi)
Crude oil futures (WTI, for delivery next month; source New York Mercantile exchange)	$103	0%	-6%	U.S. natural gas prices suffering a major collapse as new extraction technologies lead to greater supply; if only that were true for oil.

Some stocks traded on multiple exchanges; not intended for trading purposes

Around the World

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

Airline	Share Price	Change from last week	Change from last year	Comment
Lufthansa	9.98	-2%	-33%	Lowered shorthaul unit costs 4% last year; Air France hoping to achieve something similar
Air France/KLM	3.62	-8%	-69%	Remains interested in a partnership with both Etihad and its ally Air Berlin (*Les Echos*)
BA/Iberia	175	-3%	-22%	Airbus begins building BA's first A380, which will arrive next year; has 12 firm orders
SAS	8.15	-1%	-62%	Says premium bookings are "weaker on certain routes;" growing ASKs 5% to 6% this year
Alitalia	(not publicly traded)			Now in control of rival WindJet; Blue Panorama takeover uncertain
Finnair	2.23	-1%	-39%	Outsourcing its engine maintenance to SR technics; will result in almost 300 job cuts
Aer Lingus	0.99	4%	22%	Oddly doesn't fly to either Norway or Denmark, not even Oslo and Copenhagen
Virgin Atlantic	(not publicly traded)			Upcoming route launches: Vancouver in May and Mumbai in October
easyJet	481	-1%	41%	Investors impressed with its recent performance; note its y/y stock price gain
Ryanair	4.34	-2%	27%	Announces eight more route closures from Edinburgh next winter; blames high airport costs
Air Berlin	2.23	-1%	-27%	Will serve the Russian enclave of Kaliningrad, between Poland and Lithuania, from Berlin
Norwegian	102.50	-9%	-1%	Norwegian, Icelandair only Scandinavian airlines with B787 orders (Finnair bought A350s)
Vueling	5.06	7%	-45%	Now has three bases outside Spain: Toulouse, Amsterdam and (most recently) Rome FCO
Aegean	1.40	4%	-30%	Q1 tourist arrivals to Greek airports down 9% y/y; air arrivals to Athens itself down 16%
Japan Airlines	(not publicly traded)			Jetstar Japan gets operating certificate sooner than planned; will launch in early July
All Nippon	231	-2%	-2%	Preparing to fly to Myanmar, an up-and-coming tourist market
Korean Air	50500	1%	-23%	Owns Topas, a leading GDS in Korea; Japan Airlines owns Axess and ANA owns Infini
Cathay Pacific	13.62	-1%	-31%	Rival Hong Kong Airlines says all of its flight attendants now trained in martial arts
Air China	5.31	1%	-34%	New mega-airport being built in Beijing will have nine runways and capacity for 200m pax
China Eastern	2.44	-5%	-28%	Trying to build its presence in Wuhan, a city west of Shanghai along the Yangtze River
China Southern	3.58	-1%	-10%	Chinese economy grew 8% y/y in Q1, slightly less than the consensus forecast
Singapore Airlines	6.31	-2%	-20%	Vietnam Airlines wants to accelerate fleet growth, according to local media
Malaysia Airlines	1.30	-2%	-29%	Firefly unit celebrating its fifth anniversary
AirAsia	3.47	2%	33%	Thai AirAsia moving toward an IPO; could happen as early as next month
Thai Airways	25.50	2%	-31%	ASK capacity up 3% y/y during first two months of 2012; RPK traffic up 4%
Cebu Pacific	69.00	3%	-13%	Ossified rival Philippine Airlines likely to use some of its new investor capital to re-fleet
Qantas	1.67	0%	-22%	Jetstar now operating in 16 countries; don't tell the Qantas pilots
Virgin Australia	0.41	-2%	37%	Investing in regional partner Skywest; buying convertible shares worth up to 10% of equity
Air New Zealand	0.68	-1%	-19%	The ex-Pacific Blue launches first N.Z. flight with planes bearing Virgin Australia name

Some stocks traded on multiple exchanges; not intended for trading purposes

Courtin' Horton: Is US Airways correct that a merger would have many merits despite real challenges?

CONTINUED FROM p. 9

merger nearly seven years ago. Combine its famously intransigent unions with American's, and it's easy to imagine the mother of all labor nightmares. On the other hand, though, precisely the fact that American's rank and file don't love its executives might make them open to outside overtures—and with three seats on the nine-member creditor committee (essentially the airline's board for now), unions will have a lot to say about what happens. Within a few months, if a judge imposes what management says is necessary, American's workers might find themselves working for far lower compensation. US Airways workers are likewise still working at bankruptcy-era wages, having turned down better offers from management that union leaders think aren't good enough. US Airways management makes it clear that the airline can't afford to pay what its competitors pay because its mostly second-tier network doesn't provide the revenue they get: US Airways' unit revenue is roughly 15% less on a stage length-adjusted basis, by its estimates, and it sustains itself by in turn paying roughly 15% less. A combination with American would vastly change the revenue picture for the better (more on that in a moment). While labor shouldn't expect a blank check, it's easy to imagine US Airways being able to offer employees from both airlines more than they would get without a merger. US Airways management is keenly aware that lack of labor buy-in was a major reason why its 2006 bid for Delta failed.

Mergers in other industries often generate a mix of cost and revenue synergies. But when airline mergers succeed, in most cases they do so far more because of revenue synergies than because of cost synergies. In fact a highly successful merger might have no net cost synergies: imagine the "cost creep" if a combined US Airways-American ends up having to give raises to more than 100,000 employees to get them to get their buy-in for a deal. And what drives those all-important revenue synergies? The combined network, along with related pricing power that results from less competition.

First, start by conceding what a combined US Airways-American network would *not* be: a dream route map. It would not be "checkmate," as former Continental CEO Gordon Bethune described a combined United-Continental network. Maybe not even "check." American likes to talk about its "cornerstone" cities, but almost nowhere in the world does an airline profit in a hub city where it's not the top carrier—and it's not No. 1 in New York, Chicago or Los Angeles. (It *is* No. 1 in Dallas and Miami, which are almost certainly its most profitable hubs.) US Airways, on the other hand, is No. 1 at all four of its hubs (in order of apparent profitability, they are Washington Reagan, Charlotte, Philadelphia and Phoenix). But it can't do much more than it's doing at any of them, either for regulatory (Reagan) or market-demand reasons. Its smallish hubs do outpunch their weight in many ways, but they're still smallish hubs. Finite local demand means more of a dependence on lower-yield connecting traffic than in bigger cities, which helps explain the unit-revenue disparity.

A merged network wouldn't solve all those problems, but it would at least make some of them less important. Take Chicago O'Hare, the hub that—perhaps more than any other—American can't live with and can't live without. A quick look at any map makes its importance to American's system obvious: American is lucky enough to have a hub in the premier Midwestern city, perfect for east-west traffic flows across the northern U.S. while generating far more local demand than, say, Detroit. The difference is that Delta dominates Detroit, whereas American is a distant second in Chicago—by ASM capacity, United is now nearly 40% bigger. American is thus left to pick up the corporate contracting scraps there. Ditto to varying degrees in New York and Los Angeles. Now, it's true enough that American's profitability everywhere will improve once new labor contracts are in place—pay rates will drop, and more flexible work rules will provide new revenue opportunities too (remember when American had to abandon plans to fly from Dallas to Beijing because its pilots said no?) But the fact won't change that it's hard to profit in a hub where you're not No. 1. What *would* change after a merger with US Airways is that those hubs where American is not the top airline will simply comprise a smaller percentage of its overall flying—dropping from 43% of its seats today touching those hubs, according to an *Airline Weekly* analysis using OAG MAX Online, to 28%. Every legacy airline flies some routes that don't profit in a narrow sense but are important for other reasons, such as securing lucrative corporate contracts that are overall moneymakers. But currently, American subsidizes too much of that unprofitable flying.

One lesson from recent mergers—Air France/KLM was the first to prove this on a large scale—is that redundant post-merger hubs are not a bad thing. They are at worst slightly positive (because the combined airline at least controls capacity and pricing at both hubs) and at best highly positive, because capacity can be optimized among hubs. Sure, Newark and Washington Dulles handle a lot of the same international traffic flows for United, but that's fine: now the two hubs cooperate rather than compete, plus United can tactically shift some capacity, as it did when it recently moved its Buenos Aires flights from Dulles to Newark. Similarly, the proximity of Philadelphia to Washington and New York can only be either a somewhat good thing or a very good thing. American and US Airways together with American's joint venture partners would control the largest share of transatlantic capacity from northeastern seaboard airports (starting at Washington Dulles and going north), a title currently held by United and its partners. Given American's key position in oneworld compared to US Airways' place on Star's periphery, a merged airline would almost certainly remain in oneworld and within American's existing joint ventures across the Atlantic and Pacific and to Australia. Those too could enable some interesting flying: Philadelphia—or maybe even Charlotte—might be able to support flights to Tokyo, for example, but US Airways doesn't have aircraft with the range for that. A350s would change that a few years from now, but American's B777s—or Japan Airlines' B787s, for that matter—could change it a lot sooner.

Again, American's network *still* wouldn't match United's for revenue generation. But that's okay: Delta's doesn't either, but it matches United's profitability by having lower costs.

Of course, all this would still need to pass regulatory muster. There's no guarantee antitrust officials would look kindly upon the creation of yet another giant airline. But not much logic would support saying no, considering this airline wouldn't even be as big as the merged United that they allowed not long ago. And it wouldn't monopolize any sphere in the way that a merged Delta/US Airways could have used Atlanta and Charlotte to dominate many southeastern U.S. traffic flows. Regulators might require certain divestitures: considering they weren't thrilled about letting US Airways' seat share at capacity-constrained Washington Reagan rise to (soon) 44% after its slot swap with Delta, it's hard to imagine they would let the combined airline control 57% of the airport after adding American's slots.

But that's an exception. Generally, the merged airline would be incrementally more powerful, and the industry as a whole would again—as after other recent mergers—likely become incrementally less competitive and incrementally more profitable. No, regulators aren't likely to say no. But of all the other stakeholders who do hold the cards, just one group—US Airways management—is clearly in favor of a deal for now. They would have to convince not just their shareholders (probably not a tough sell) but also, more ominously, labor groups at both airlines. American's creditors and perhaps management. The pitch: that while a standalone American might be okay, a bulked-up airline could really be—as American used to say—something special in the air.❍