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Airlines, Already Suffering, Brace for More Woes

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The airline industry is in the midst of one of its most wrenching summers ever. And the fall and winter may be even worse — unless people start to fly again.

While the airlines have been struggling for more than a year as leisure travelers pulled back on spending, the industry has been battered from all directions since the financial system nearly collapsed last September.

Business and international travel, which had been a relative bright spot until then, dropped precipitously. Fuel costs have also been difficult to manage, as carriers first struggled to pay record high prices last summer and now have to contend with extraordinarily volatile prices. And the credit markets, which the airlines have turned to in previous tough times, are particularly reluctant to lend now, giving some carriers little choice but to pay high interest rates.

For the time being, analysts agree that the airlines, by cutting routes and employees, grounding planes and imposing fees, can weather the downturn. In fact, when the latest round of capacity cuts takes effect in September, the seats on domestic flights will drop to 66.5 million — down from a peak of about 84 million in 2001 and the lowest September figure since 1984, according to OAG Aviation, which tracks flight schedules.

But if conditions continue to deteriorate, analysts say, some airlines may not survive.

"There are too many airlines and too much capacity and really no pricing power," said Hunter Key, an airline analyst at Stifel Nicolaus in Baltimore. "This is as bad a crisis as the industry's ever seen."

Giovanni Bisignani, the chief executive of the International Air Transport Association, told airline chiefs much the same thing in June. "Today's situation is unprecedented, the most difficult ever," Mr. Bisignani said. "I am a realist. I don't see facts to support optimism."

For travelers, this means that airlines will continue to cut flights in the fall — not by eliminating service outright as they did last year but by reducing the frequency and using smaller planes on certain routes. Passengers may also see new fees.

A bit of good news for travelers is that airlines, worried about keeping the passengers they still have, are continuing to offer low fares, which are often further discounted. [Southwest Airlines](#) ran a 48-hour sale last week that slashed one-way fares below \$100 on many shorter routes for travel this fall, and other carriers quickly matched the cuts.

But a fare sale is not enough to counter the overall trend of passenger demand falling faster than the airlines can cut capacity.

The industry has also been cutting jobs. In April, the total number of employees at American carriers was 583,030, down from 624,372 in 2007 and more than 24 percent below the peak in May 2001.

Globally, airline employment is also down significantly. The world's carriers employed 1.48 million people in 2008, the latest figure available from the air transport association, down from 1.71 million in 2000.

Willie Walsh, the chief executive of British Airways, recently lamented that his airline was in a "fight for survival," asking staff members last month to consider working up to 30 days without pay. Air France said last week that the airline was considering temporary layoffs later this year, on top of a planned 3,000 job cuts it announced in May.

John Heimlich, chief economist of the Air Transport Association, a trade group of American airlines, said the carriers had been struggling for most of this decade. "One year's profit or loss is not adequate to determine a company's financial health," he said. "It's the cumulative deficit and consecutive years of weakness that has mattered."

The decline in demand for premium seats on international flights has taken a significant toll. When the economy was rolling, airlines could charge thousands for seats in the front of their planes, and business customers, in particular, paid for both the comfort and convenience. Those high fares subsidized the discounted seats in the back.

But when the economy deteriorated last fall, premium travel dropped off with it. The number of passengers traveling on business and first-class tickets between North America and Europe was down 18.4 percent in April compared with the same month last year, the International Air Transport Association said. And traffic between North America and Asia was down even more in that period, nearly 26 percent.

"With the front end of the plane emptying out, you really can't afford to keep filling up the back of the bus with ever-cheaper fares," said Peter Morris, chief economist at Ascend, an airline industry consultancy in London.

Competition on trans-Atlantic routes is already fierce, with roughly 50 airlines offering connections between major European and United States cities. The liberalization of air travel between the two continents through the 2007 "open skies" agreement has kept steady downward pressure on fares on the most heavily traveled routes.

For inter-European travel, the switch by many business- and first-class travelers to economy seats has hit mainline carriers like Lufthansa and Air France-KLM hard, analysts said. But what is bad news for some has proven to be a boon to others.

"The big players that depend heavily on corporate traffic are being hit worse than average," said Mr. Morris of Ascend. "But at the other end of the spectrum, there are low-cost carriers like Easyjet, [Ryanair](#) and Air Berlin that can potentially mop up bits and pieces from the people who are willing to step down a bit and accept lower frequency and fewer amenities."

While all the American carriers are suffering, some analysts have said they are looking most closely at the financial condition of [United Airlines](#) and [US Airways](#).

United relied heavily on corporate and trans-Pacific fliers before the downturn. [Fitch Ratings](#) cited the declines in both early last month in explaining why it had lowered United's credit rating further into junk status. It also said the airline faced "steady and heavy debt maturities" later this year and next.

In late June, the carrier was able to raise \$175 million by issuing new debt but only at a high interest rate of 17 percent.

United officials said they remained optimistic about the carrier's prospects. "I think we have shown our

ability to raise liquidity in clearly what is a tough market environment,” said Kathryn Mikells, the chief financial officer. “United is a resilient company.”

The problems at US Airways are somewhat different. It has struggled since a \$1.5 billion merger in 2005 with America West, a low-fare carrier, analysts say. The combined company now finds itself with the thinnest cash position of any major airline, said Basili Alukos, an analyst at [Morningstar](#) Research, meaning it may have to resort to further borrowing to meet debt payments.

But, Mr. Alukos said: “All their assets are already mortgaged. They don’t have much borrowing capability left.”

Dan Cravens, director of investor relations for US Airways, would not comment specifically on what analysts have said, but pointed out that the carrier had found cash in tough times before.

Traffic and revenue have also fallen at carriers like Southwest, [JetBlue](#) and [AirTran](#). But the drop has not been as steep, partly because they rely less on corporate travelers.

One of the few ways the airlines have generated new revenue is through fees for things like exit row seats to bringing pets on board. Baggage fees, for example, added \$566.3 million to airlines’ pockets in the first quarter of this year, according to the Bureau of Transportation Statistics.

Michael Boyd, an aviation consultant in Denver, estimates that fees now constitute nearly 5 percent of revenue at some large airlines. Still, the fees alone cannot offset falling income.

The best outlook for the industry is if passenger demand picks up soon. Combined with the shrinking number of seats, that would allow airlines to bolster air fares — a necessary step, analysts say, toward a turnaround. “If there’s going to be a recovery, it will most likely take the form of fewer discounts,” said Gary Chase, an airline analyst at [Barclays](#) Capital in New York.

Passengers already feel the impact of the capacity cuts. After squeezing her way off a cramped US Airways flight to New York over the July 4 holiday weekend, Michelle Zeccola, a frequent flier from Columbia, S.C., recalled when planes were less crowded. “I could literally sit across three seats by myself if I wanted. Now it’s totally booked.”

Nicola Clark contributed reporting.

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