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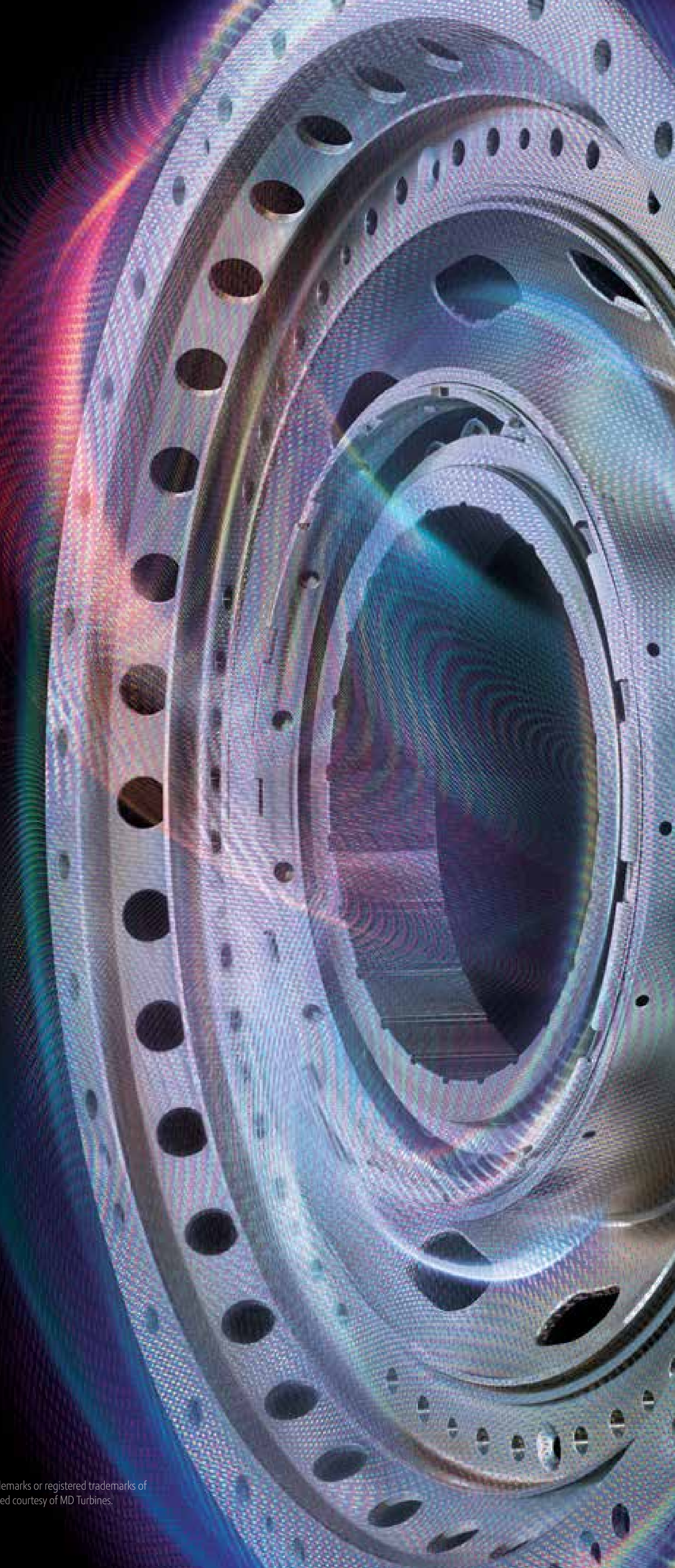

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So quiet you might wonder
is this thing on?
The PurePower® Geared Turbofan™ engine is by design the quietest in its class. We reduced the noise footprint by 75%, or as much as 20 decibels below today's strictest standards. Where jets are concerned, that's practically a whisper. But the message? Loud and clear: lower noise fees, access to more airports, happier airport neighbors, shorter flight tracks and extended curfew operation. Simply a better, quieter engine at its core. (But you didn't hear that from us.) Learn more about the PurePower® PW1000G engine at PurePowerEngines.com.
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Old world carriers' bias laid bare

Airlines advocate liberalized skies, open markets and the abolition of outdated rules and regulations – except when it does not suit them.

The latest example of this blinkered thinking is a heavy hitting campaign, orchestrated by North America's American Airlines, Delta Airlines and United Airlines, to contain Gulf carrier expansion in the U.S.

The anti-Gulf onslaught centres around a U.S. government White Paper, which was published in April and largely researched by the Big Three American carriers over a two-year period. The paper argues that Emirates Airline, Etihad Airways and Qatar Airlines have been assisted in their rapid global expansion by Gulf government subsidies of at least US$40 billion and hence have an unfair operating advantage in the U.S. market.

But as our main story this month reveals, this may be only the beginning of the Northern American carriers' competitive woes. They could soon be fighting a market war with not one, but two formidable foes: the big three airlines from the UAE and China's Air China, China Eastern Airlines, China Southern Airlines and Hainan Airlines. All four Mainland airlines have made it clear building market share to the U.S. and beyond is a priority.

It appears, however, that North American airlines have one rule for the Gulf carriers and quite another for Mainland airlines. The question is why?

A decade ago, the same U.S. airlines that are protesting against a Gulf invasion were all for Open Skies with the People's Republic of China. But China's civil aviation authority resisted the U.S. government's overtures when its representatives came courting in Beijing. China believed their young airline industry was not yet ready to compete against the then mighty U.S. in an Open Skies environment.

Fast forward to 2015 and Chinese airlines are in a very different place. Industry forecasts universally agree China will overtake the U.S. as the largest domestic airline market in the world in the near future – and that their global growth will be exponential.

In our main story, "Assault from the East" new statistics from consultancy, CAPA, reveal that for the first time in trans-Pacific airline history, China will have more seats into the U.S. in the peak season than U.S. airlines will have to China.

So why are North American airlines crying poor about Gulf competition and saying very little about a much larger threat, numerically, from across the Pacific?

Chinese airlines are subsidized. They make no secret of it. Collectively, they received a minimum of US$1 billion in subsidies from central and provincial governments and airports in 2014. Yet this "assistance" does not seem to bother American carriers in the same way it does when they attack Gulf competitors.

Could it be that Mainland China is critical to North American carrier's expansion and therefore relationships must be nurtured rather fractured? Delta Airlines' CEO, Richard Anderson, the most public face of the anti-Gulf campaign in the U.S., has made it clear he wants Shanghai to become a hub for his Atlanta-headquartered carrier. He has no such ambition in the Gulf.

Unfortunately, whatever the merits of the opposing arguments, this battle is not going to go away soon. In May, after a long period of lobbying by major European airlines against Gulf carrier growth into Europe, the Europeans reportedly have had a victory. The Netherlands media has said its government will freeze Gulf carrier route expansion into Amsterdam's Schiphol Airport.

It is argued that the bankruptcy protection many U.S. carriers have enjoyed is a form of subsidy and saved them from extinction. So they should accept that if the industry, as a whole, wants to operate freely then their protectionist stance has no industry validity. ■

TOM BALLANTYNE
Chief Correspondent
Orient Aviation Media Group

ASSAULT FROM THE EAST

Military commanders fear fighting on two fronts, yet that is the spectre U.S. carriers face. As aggressive Gulf rivals attack their markets across the Atlantic an even more serious threat is emerging as Chinese airlines expand into North America, writes **TOM BALLANTYNE**.

The news has not grabbed the headlines yet, but when it does, it will mark out 2015 as a landmark year in trans-Pacific airline operations. Just two years ago, American airlines flew close to double the number of flights to China as Chinese airlines did to the U.S.

This year, in the peak northern summer travel season, Air China, China Eastern Airlines, China Southern Airlines and Hainan Airlines will overtake their U.S. rivals for the first time on the trans-Pacific route.

According to OAG data and the CAPA consultancy, Mainland China's four biggest airlines will operate 2,028 U.S.-China flights a week from July to September 2015 compared with 1,853 flights by U.S. carriers. Each week, for three months, Chinese airlines will operate 9.4% more flights and 14.5% more seats across the Pacific than their North America counterparts.

And the threat from Asia is increasing. Hainan Airlines has announced a twice a week Changsha-Los Angeles service that is not yet bookable and therefore not included in the data. It is another significant shift in aviation's balance of power and adds statistical weight to the argument that the axis of airline influence is moving east.

Carriers in the U.S. might be having their most profitable period in years, but the twin threats from the Gulf and China mean they must fight on two fronts to retain their global industry influence.

For the last two months, America's big three airlines, United Airlines, Delta Air Lines and American Airlines, have attempted to discredit the Gulf's Emirates Airline, Etihad Airways and Qatar Airways by alleging their success is fed by US$40 billion in Gulf government subsidies. They are hoping to convince Washington to contain the Middle East carriers' North American expansion and revise the terms of an Open Skies agreement.

Several analysts believe that American airlines have become so focused on the Gulf that they will be taken by surprise when they are hit by the even bigger threat to their market share from across the Pacific.

According to the Civil Aviation Administration of China (CAAC), 6.13 million airline passenger trips were made between China and the U.S. last year; a number expected to grow by around 15% annually. Whoever captures the biggest piece of that expanding pie will dominate the market.

The CAPA consultancy said the U.S. airlines fear competing with the Gulf carriers, which operate under Open Skies regimes into the North America. Of more lasting importance, it said is how critical the North American market, and especially the U.S., will be to Chinese airlines' international growth.

For years, the U.S. has wanted Open Skies with the Mainland, but China resisted because its airlines were smaller.

They wanted gradual expansion. "Now the tables are turning. The rapid change of pace, with more growth clearly to come, is giving U.S. airlines cause to reflect on their experience with Gulf carriers," said analysts.

A new round of bilateral negotiations between China and the U.S. is approaching. It is thought U.S. airlines may no longer favour Open Skies with China and will want to prevent another onslaught of foreign carrier capacity into their territory. "Consumers, tourism bodies and the U.S. government may have another fight looming," CAPA said.

Like their Gulf counterparts, Chinese airlines are making no secret of their intentions to expand. Air China vice president and North America general manager, Dr. Zihan Chi, said at a recent U.S. conference that China-U.S. services were "low-hanging fruit". Hainan Airlines vice president, Hou Wei, said North America was the biggest opportunity for his airline.

Hainan has announced it will buy 30 B787-9s and that most of them will be used for North American services. China Eastern Airlines' order for 20 B777-300ERs will be primarily utilized on North American flights.

Air China, China Eastern and China Southern are building their trans-Pacific networks by adding flights to New York from thriving inland cities such as Wuhan and Chengdu. Fujian-headquartered Xiamen Airlines has ordered six B787s and raised the possibility of flights to the U.S. later this year.

But it would be misleading to suggest the big U.S. carriers are totally ignoring the threat from the East. Delta's chief executive, Richard Anderson, recently told his employees in a recorded message that the airline wants to create an international hub in Shanghai to build on a growing relationship with China Eastern. Both airlines are SkyTeam alliance members.

Delta will launch a daily Los Angeles - Shanghai service later this year. "As we plan for our long-term future, it becomes clearer every day that China will be a major part of our business," he said.

American Airlines chief executive, William Parker, visited China on his first trip abroad after taking charge at the carrier. He admitted that although the group is the largest airline in the world, it has been late in targeting the China market.

"I visited China because we think it is a crucial market and is very important for our growth," he said in an interview. "China is relatively small for us now, but it has huge potential. China will become a very important emerging market for us. We think the Asia-Pacific will grow the fastest because economic growth here is the fastest in the world," he said. "Secondly, we are smaller than our competitors in this region, so our growth rate can be higher."

American flies to Shanghai from Chicago, Los Angeles and Dallas/Fort Worth, and from Chicago to Beijing. In May, it launched a service from Dallas/Fort Worth to Beijing. Parker said the airline is concentrating on tier one cities, but depending on how air rights negotiations proceed, tier two and three cities could be the future focus for the Dallas/Fort Worth headquartered airline.

The largest U.S. carrier in the China market is United Airlines. Its president and chief executive, Jeff Smisek, said China is very profitable and important for the airline and that United intends to expand to more Chinese cities.

Stiffer competition and Chinese airlines' improved service quality are pushing United to remain competitive, he said. "It is healthy for everyone, no matter whether it's the passengers or carriers," he said. Smisek is concerned over-capacity could develop on China routes and warned if capacity grew faster than demand, fares would fall and damage the market.

In the meantime, while China's U.S. onslaught is gathering pace, there are no signs that the angry war of words between the big three North American carriers and the major Gulf airlines is abating. United, Delta and American are maintaining the rage and standing by their accusations that Emirates, Etihad and Qatar have benefitted from more than $40 billion in subsidies from their government owners in the last ten years.

In mid May, Etihad Airways published a report written by an independent consultancy, The Risk Advisory Group, which said the three largest U.S. airlines have received US$71.48 billion in government assistance, of which most of it has been provided since 2000. The report said the funding support was largely associated with Chapter 11 restructuring and bailouts from the Pension Benefit Guaranty Corporation. The accused American carriers said the report was wrong.

Etihad alleged the benefits have helped American, Delta and United "to transition from the verge of bankruptcy to today's industry leaders, each achieving multi-billion dollar profits".

The Risk Advisory Group said the biggest beneficiary was Chicago-headquartered United Airlines, which received funding of US$44.4 billion, and added the three airlines were beneficiaries of billions of dollars in fuel tax savings and tax incentives.

Also in May, Emirates president, Sir Tim Clark, pointed out it had taken the U.S. carriers two years to compile their

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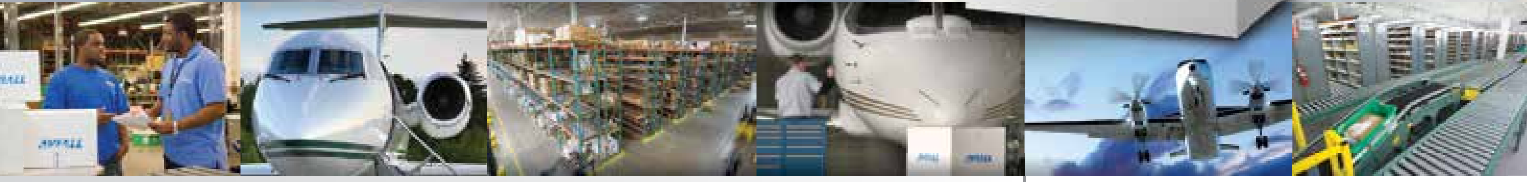

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Subsidised Indian carriers drove us from India says Delta boss

Delta Airlines chief executive, Richard Anderson, claimed North American carriers had to abandon India because of the subsidies Indian carriers receive from their national and provincial governments.

Anderson, in a speech at the U.S. National Press Club in Washington DC last month, said: "India is a very big country. It has a huge relationship with the U.S., particularly for Information Technology, and there is huge agricultural trade between the two countries.

"But in essence, we don't really have an aviation trade. We have exited the market completely because subsidized [Indian] carriers have come into the market place to shift the traffic from us and take us out of the market place."

Anderson said Delta and American Airlines should be in India "but that it was not sustainable when there are US$41 billion in subsidies (allegedly for Indian airlines). It is very difficult, if not impossible for us to compete. And that harm is immediate."

He added the recent U.S. White Paper on American aviation "had proved beyond doubt" there are subsidies provided by several governments as they are in India. "Those countries all required these airlines to file their financial statements," he said.

"Oddly enough, in the U.S. we don't require that. But other countries do. And these are certified financial statements that show these subsidies. They are full disclosed. You can't refute the evidence. It is overwhelming."

report on alleged subsidies. "If it took them two years and we have a response to make - which has to be robust - we will require more time to do that. So we will do that. We will deal a sledge hammer blow to that report. So watch this space. It's coming."

Emirates chairman and chief executive, Sheikh Ahmed bin Saeed Al Maktoum, told reporters in Dubai the airline is pressing ahead with global expansion that could include more U.S. routes.

He wouldn't name potential destinations and cited competitive reasons and confidentiality agreements for his reticence.

"We cannot stop. This is really the direction of the UAE government and the Dubai government. The minute you stop, somebody will pass you. In terms of expansion, we will continue," he said. Emirates recently announced plans for daily flights to Orlando, its 10th U.S. destination, to begin in September.

Qatar Airways will expand its services in the U.S and has announced its first direct flights to Los Angeles, Boston and Atlanta from its Doha hub and its second daily flight to New York.

It will operate B777s to Los Angeles and Atlanta and the new A350 to Boston and for its second New York flight. The Los Angeles service begins next January, followed by Boston in March and Atlanta in July.

The U.S. airlines, in a joint statement, said these additional flights and capacity increases "will exacerbate the existing harm to U.S. airlines by diverting even more passengers away from U.S. airlines' to the Gulf carriers' subsidized services".

In Washington last month Qatar's outspoken chief executive, Akbar Al Baker, refuted the "baseless" claims of the "Big Three" U.S. airlines and called them "a transparent attempt to block new competition and limit consumer choice".

He told a press conference U.S. Open Skies agreements are about offering choice and the ability to fly with the airline you prefer, to regions which are under-served by U.S. carriers.

"The Big Three want to restrict choice. World travelers would suffer if they succeed. Qatar Airways offers important services to the U.S. and many American interests recognize our value. We serve markets in the Gulf and Indian subcontinent that U.S. carriers do not serve," he said.

To emphasise their value, the three chiefs of the Gulf operators, Clark, al Baker and Etihad's James Hogan, pointed to the billions of dollars they have spent buying aircraft produced in the U.S.

It is ironic, and an example of the convoluted nature of airline operations, that in the midst of this fierce debate, the European Commission (EC) has granted anti-trust approval for a profit-sharing pact between Delta, Air France-KLM and Alitalia. Etihad has major equity in Alitalia. All three are members of the SkyTeam alliance.

Fedex boss opposes limiting Gulf access to U.S.

FedExExpress chief executive, David Bronczek, has warned that breaking agreements and cutting Gulf carriers' access to the U.S. would damage the North American economy because it is dependent on world trade.

The global air freight carrier boss wrote, in an open letter to the U.S. secretaries of State, Transport and Commerce that "retrenchment in any way from Open Skies by the U.S. would jeopardise the economic growth benefits that air cargo provides".

"Retrenchment would result in higher fares and fewer options for flying passengers," he said. "Retrenchment benefits only a very few. The U.S. should not return to the restrictive, inefficient and expensive agreements of the past where customers, communities, air cargo and the greater U.S. economy suffered."

FedEx believed if gulf airlines had their access to North America cut back it would lead to retaliation in the form of reduced access to the U.A.E for U.S. airlines. Such an outcome would have a huge negative impact on FedEx's very busy Dubai hub, Bronczek said.

Europe jumps aboard the anti-Gulf bandwagon

The Gulf subsidies row appeared to take a serious turn for the worst last month when Dutch newspaper, Financieele Dagblad, reported the Netherlands' minister for infrastructure and the environment, Wilma Mansveld, confirmed her government had frozen landing rights expansion for Emirates Airline, Etihad Airways and Qatar Airlines at Amsterdam's Schiphol Airport.

"I want, together with my European colleagues, to take a tougher approach to the rise of airlines in the Middle East if there is talk of unfair competition," Mansveld told the newspaper.

The decision is a response to European airlines' complaints, including struggling Air France-KLM, that the Gulf carriers benefit from government subsidies to the detriment of the complainant European airlines.

At press time, the effected Middle East carriers said they had not been notified of the Dutch decision. An Emirates Airline spokesperson said that "under the UAE-Netherlands air services agreement, there are no restrictions on the number of frequencies and the size of the aircraft used".

Emirates flies double daily between Dubai and Amsterdam. Etihad operates a daily Abu Dhabi-Schiphol service and code shares with Air France-KLM. Qatar Airways will commence flying from Doha to the Netherlands capital this month.

The agreement was reached after a three-year investigation by the EC. The airlines offered to give up slots at Amsterdam, Rome and New York that will allow rivals to offer tickets on their flights on these routes.

Back in the U.S.-China market, Chinese airlines are acknowledged as having a larger home market and a much bigger catchment area than the U.S. "Chinese airlines have many potential advantages, including one of size. They come from a market of 1.3 billion people compared with 300 million in the U.S," said CAPA.

"Although travel propensity may be larger in the U.S. it is rapidly increasing in China. Some 80% of Air China's U.S.-China flights once came from a U.S. point of sale, but this has shifted to 50:50."

In addition to their home market, Chinese airlines have been growing sixth freedom traffic from China to other parts of Asia, a far more populous catchment area than the U.S. carriers can target beyond the U.S. Air China even looks at U.S.-China-India traffic flows. With time, Chinese airlines will be much stronger sixth freedom players.

One measure U.S. airlines take to protect their long-haul markets is to charge partners high interline and codeshare rates for behind gateway flights, which gives them an advantage, CAPA said.

"Foreign airlines have partially worked around this by partnering with non-alliance U.S. carriers, mostly JetBlue, but also Virgin America. These airlines have no long-haul networks of their own so they have nothing to protect. Passengers fed to them are incremental and generally profitable," the consultancy said.

Given the huge effort U.S. carriers have put into attacking the Gulf carriers, it is an issue that should receive another airing based on the American airlines' with the Gulf. The four big Chinese airlines who serve the U.S. received $162 million (at Air China), $589 million (at China Eastern), $276 million (at China Southern) and $82 million (at Hainan) last year.

As well, some long-haul growth is under-written by local Chinese governments. "This amounts to more than route launch incentives, which are globally common," said analysts. "Without the subsidies some Chinese carriers' trans-Pacific routes would simply not be offered."

It appears U.S. airlines are turning a blind eye to this issue, althought it is a weapon they could use to restrict Chinese expansion. "Herein is an emerging dilemma. Mainland airline expansion and Open Skies are in the interest of the U.S. Although there is no public rumbling about derailing U.S.-China Open Skies, it is not difficult to envisage the American carriers taking a similar view towards Chinese carriers as they now do to Gulf airlines," said analysts.

China has geographical, network and cost advantages. They will be bigger than U.S. carriers.

But while there is potential for a major battle between Chinese and U.S. airlines it should not be forgotten that there are other big players in the trans-Pacific market. Global airlines based in Hong Kong, Japan, Korea and elsewhere in the region will be considering using sixth freedom rights to syphon off some of the growing China – U.S. traffic.

In the end, the U.S. carriers could ride their wave of anti-Gulf campaigning and also seek to restrict Chinese airline expansion. "Alternatively, a defeat in their anti-Gulf lobbying could bring them back to earth and [force them to] explore ways to be better partners with Chinese airlines," CAPA said.

"As China and the U.S. run out of frequencies for growth and need a new round of air talks, the U.S. government will undoubtedly remember that whatever the rhetoric from its airlines, increased numbers of visitors to the U.S. will make an economic contribution far larger than the airline on which they fly. America has supported Open Skies. Logic suggests it will inevitably continue to do so." ■

Starting over at MAS

Malaysia Airlines new chief executive, Christoph Mueller, has told the carrier's 20,000 staff a job cull has commenced - and at the highest levels - as the company faces a new start.

Tom Ballantyne reports

Wasting no time, Malaysia Airlines (MAS) chief executive and former pilot, Christoph Mueller, wrote to staff in his first week at his new desk that 6,000 of them had no future at MAS and also negotiated an agreement to reduce the airline's catering costs by up to 25%.

In his first interview since he took charge on May 1, Mueller said the new company that will emerge from troubled MAS will be like "a start-up".

He told Reuters news agency in Kuala Lumpur "he was hired to run the new company entirely on a commercial terms" and that there was very little margin for error. "It is not a continuation of the old company in a new disguise. Everything is new," he said.

Malaysian government investor, Khazanah, took MAS private last year in a restructuring estimated to cost US$1.65 billion. Auditing firm, PricewaterhouseCoopers Malaysia, will oversee the transfer of the airline's liabilities and assets to a new airline, Malaysia Airlines, which will operate from September this year.

Mueller said it would take three years to bring the new airline's costs into line with the industry norms in the region.

Mueller's alacrity points to tumultuous times at MAS. His three-page memo to all staff - details were released by the National Union of Flight Attendants Malaysia – warned there would have to be massive cost cutting and as well as the 30% reduction in staff. He said MAS's financial situation is more challenging than previously thought.

It will shrink in size as it tries to overcome a tarnished image within the travel industry and the public, he said. MAS has been badly hit in the last year by the double disasters of MH370 and MH17. Mueller has been set the task of overseeing a $1.7 billion turnaround.

In his memo, Mueller said parts of the organization seemed "depressed" and that "the airline is suffering from a heavily damaged brand reputation" in key markets, with many people avoiding the carrier because "they are frightened".

He pointed out this year will be more challenging than anticipated because a strong U.S. dollar was hurting operations. As a result, MAS has not fully benefited from lower jet fuel prices. "We cannot turn the airline around by fixing the revenue side alone," Mueller said.

"The contrary is the case. The reason for our precarious situation is mainly our uncompetitive cost levels. We share this problem with almost all legacy carriers around the world and new low-cost carriers are attacking us.''

In order to grow, Mueller said "sometimes we have to retreat and regroup before growing again. That is the ultimate target. We want to grow again in the last phase of the restructuring".

Mueller took the helm from Ahmad Jauhari Yahya. He will engineer the migration of MAS to a new company, MAS Bhd, which will take over the airline's operations on September 1. Other points his memo made were that corporate procurement has to be on better terms and conditions in all areas of operations.

MAS has to be smaller in size and will outsource certain functions. Broken relationships between staff and management, unions and management, and even between departments are to be fixed, and there is a need to pay attention to details in service delivery, he said.

Mueller wrote that "since the new airline will be smaller, we simply do not have enough work for all of you". Employees are to receive their termination and appointment letters at their home address early this month. Those who are asked to stay will receive new contract conditions benchmarked against competitors.

Mueller will certainly be facing a showdown with workers over the recovery plan. The flight attendants union has protested termination by mail is "obnoxious and arrogant" and complained its 3,500 members are stressed and worried. The union has written to the Malaysian prime minister, Najib Razak, and asked him to urge the airline to offer short and medium-term layoffs and salary cuts before a final termination exercise is carried out.

A new deal with Brahim's Airline Catering (BAC) is the first of a number of anticipated renegotiations with suppliers and a critical element of the 12-point MAS Recovery Plan. In a joint statement, MAS and BAC said the new pricing methodology, coupled with new product offerings and menu structure will provide a 20%-25% reduction in catering costs compared with the previous catering contract. The deal is made up of two separate agreements covering "wide body aircraft" flights and "narrow body aircraft" flights, which is in line with international norms.

BAC is the exclusive in-flight caterer to MAS under a 25-year catering agreement that was due to expire in 2028 at Kuala Lumpur International Airport (KLIA) and Penang International Airport.

In a statement to the country's stock exchange, BAC said it had no option but to sign the service level agreement (SLA) if it was to remain as MAS's caterer and continue to be relevant as a global halal flight kitchen servicing 36 other international airlines at KLIA.

BAC can be compelled under the new MAS Act to continue supplies to MAS despite MAS withholding payments. BAC is prevented from filing legal action for unpaid receivables. This had caused severe cash flow problems at BAC and affected its ability to upstream dividends to to parent company, Brahim's. ■

Christoph Mueller, MAS's new CEO: everything will be new at MAS

Analysts put "hold" on Mainland airport investment

China's major listed airports are amongst the worlds' busiest, but their value as short term investments is being questioned as e-commerce syphons off duty free spending and limited air space curtails expansion.

TOM BALLANTYNE reports

Low spare runway capacity, regulated airport charges and the negative impact of e-commerce on airport retail revenue is forecast to dampen revenue growth at China's four biggest airports in the short to medium term, report global investment bankers, Jefferies.

Produced by the investment bank's Hong Kong office, the report cautioned investors about Mainland airport stocks after it looked at prospects for return on investment at Beijing Capital International Airport, Guangzhou Baiyun International Airport, Shanghai International Airport and Shenzhen Airport.

Jefferies rated Shanghai as a "Buy" because it has the highest earnings growth of the four airports in the study, is supported by "relatively large" spare capacity and expanding commercial space and will benefit from the opening of a Disney Park in the first quarter of 2016.

Shenzhen is a "Hold" while Beijing and Guangzhou at set at "Underperform" because of a dearth of spare capacity until 2019 that coincides with the beginning of a development investment cycle.

Jefferies said there is insufficient spare capacity to drive volume growth, with the four airports operating at 85%-98% of their runway capacity for peak hour take-off and landing slots.

The high utilization will limit the passenger throughput, which is an overwhelming earnings driver, Jefferies said.

Equity analysts, Boyong Liu, Johnson Leung and Violet Gu, predicted average earnings growth at the airports will drop to 8% for the next four years compared with 12% in the last three years (excluding Shenzhen, which is in ramp-up stage).

Adding to the pressure will be the next phase of airport expansion, planned to 2019, when surging construction costs are unlikely to be compensated by higher airport charges. The expansion will lead to up to six years of depressed earnings and deteriorating returns on investment before returning to previous profit highs.

It is estimated the cost of adding handling capacity for a single passenger will rise to above 100 yuan (US$16.12) by 2019, from 60 yuan in 2004-2008.

Shanghai Pudong airport: offers best investment prospects

Additional runways or passenger terminals won't solve the airport congestion if no airspace is added, said Jefferies. In China, 70%-80% of airspace is used for military purposes, particularly around major cities. It takes tough negotiations between the CAAC (Civil Aviation Administration of China), airports and airline managements and military air traffic controllers to add airspace to a newly opened airport, which means that expanding an airport may not lead to more capacity and better slot times.

Shenzhen has long been under-utilized because of insufficient airspace, the report said, and "we also do not expect Guangzhou to increase its peak hour air flights despite the opening of its third runway in earlier this year".

Another impediment to profitable airport investment is the impact of e-commerce on the airports' earnings model. China's airports, like their counterparts worldwide, rely on retail and duty free non-aeronautical revenue for a significant portion of their income. The Jefferies report said non-aeronautical revenue has been declining sharply since 2012 as online shopping flourishes in China.

"With booming emerging cross-border e-commerce, we expect this negative impact to quickly spread to duty-free shopping," the report said. "This negative impact is not only irreversible, but likely to escalate, as online retailers benefit from continuing improvements in smartphone penetration, online payment systems and modern logistics services.

"Ineffective brand portfolios and a lack of consumer experience also make Chinese airports more vulnerable to e-commerce cannibalization than their regional peers, such as Hong Kong International Airport and Changi Airport in Singapore," said Jefferies.

Until now, investors have viewed retail concession income at Beijing and Shanghai, with a smaller percentage in Guangzhou and Shenzhen, as less vulnerable to online competition because of the pricing of duty free products and the ever expanding foot traffic at Chinese airports.

However, the airports' monopoly on duty-free products is being challenged by cross-border e-commerce companies such as Haitao, Amazon and eBay. Mainland consumers also are buying direct from overseas as well as shopping at the proliferation of new duty-free shops in China's Free Trade Zones and offshore islands.

"We believe airport duty-free sales growth could face more downside risk, as cross-border e-commerce, as well as duty-free shops outside airports, are as yet low in penetration," Jefferies said.

Airport valuations, are based on "bullish expectations" that China's outbound tourist traffic will drive expanding non-aeronautical revenue growth and that a lack of near-term expansion will produce high dividends.

The sector presents fewer upside opportunities than toll roads and Hong Kong-listed seaports, which can raise tariffs and tolls and do not require the same level of capital investment as airports, the report said.

The analysts also argue there is little room to increase aeronautical charges in China. "Despite the recent deregulation of port tariffs and potential price reform for toll roads, we do not expect something similar to happen at airports in the near future."

Jefferies forecast aeronautical charges will increase by two per cent a year if the aircraft and passenger mix is improved and fees for smaller ancillary services, such as security inspection fees, are increased.

"We do not see a significant rate hike for core aeronautical services such as take-off and landing fees and passenger service charges, said the analysts. "The government will continue to balance airports' social value and profitability and expect airport operators to use non-aeronautical revenue to supplement earnings.

"The best mid-term scenario would be for the CAAC to set a narrow price range around a current guided price and let airports and airlines negotiate the charges. Airlines' strong bargaining power should make it difficult to push aeronautical increases through. We expect strong resistance from carriers to any increase in airport charges, especially as airlines contribute to the CAAC's Civil Aviation Development Fund for airport construction," Jefferies said.

"Last but not least, airport aeronautical charges are regulated around the world, given an airport's monopoly position in providing the service, which makes it difficult for airports to significantly raise prices." ■

Non-aeronautical revenue has been declining sharply since 2012 as online shopping flourishes in China

Jefferies Investment Bank Hong Kong

Qantas rebounds on fuel price fall

By Tom Ballantyne

Qantas Group CEO, Alan Joyce, told investors last month that the company is set to deliver one of the biggest turnarounds in the carrier's history.

Long lambasted for delivering a litany of losses at the group, Joyce told an investor briefing he would announce an underlying profit, for the year to June 30, of US$700 million, $170 million more than the consensus profit forecast by analysts.

Considering that the group's red ink stretched to the horizon less than a year ago, it was good news for investors to hear Joyce say returns to shareholders were "top of mind" at the carrier.

Since reporting a loss for the 2013-2014 year of US$2.6 million, a combination of factors had turned the tide for Qantas with the dramatic decrease in the price of fuel since last June the most important factor. Joyce said the Qantas fuel bill will be $426.1 million lower in the current year, down from $3.5 billion 12 months ago.

Joyce's massive transformation program, that is eliminating 5,000 jobs, trimming routes and cancelling or delaying aircraft deliveries to achieve savings of $1.55 billion by 2017, is paying dividends. The program will reduce costs by $678 million this year and keep Qantas on track to cut debt by $775 million.

According to Joyce, the carrier is positioned to outperform in the international market through its budget network, strong international alliances and a favourable competitive environment because of a lower Australian dollar.

He argued the airline has long-term advantages in the domestic market, where it has a 63% market share, as it narrows the cost difference with rival, Virgin Australia.

"We are looking at our own game and we believe, even if Virgin Australia achieves 100% of their program, that we will get our cost base within 5% [of them]. "If they don't achieve that, the cost difference will narrow even further,'' Joyce said.

Qantas is making "rapid progress" towards delivering its business transformation and its credit profile was expected to "reach its target two years ahead of the initial time frame". Maintaining an optimal capital structure would provide the opportunity to return capital to shareholders or reinvest in the business, Qantas said.

The airline group is protecting itself against unfavourable movements the fuel and foreign exchange markets with a hedging program. Official results for the year ended June 30 will be announced in August. ■

WINNING OVER THE COSMOPOLITAN YOUNG

ANA Holdings boss, Shinya Katanozaka, a key architect of the two-year-old Japanese airline group, knows the company must break free from its domestic dependence to achieve its ambitious growth targets.

Geoffrey Tudor reports from Tokyo

Shinya Katanozaka relishes a challenge. And that is just as well because he has plenty ahead of him in his new role as CEO and president of ANA Holdings Ltd.

Top of his list, he said when spoke to Orient Aviation last month, is to persuade big numbers of younger, affluent and more internationally sophisticated Japanese to replace its loyal but ageing domestic passenger base.

"Japan's demographic changes compel us to radically shift the company's direction from the domestic to the international market. ANA has traditionally been heavily dependent on the domestic market," said Katanozaka. "This dependence must change, especially as the company faces intensifying competition from both foreign carriers and a rehabilitated local rival, Japan Airlines (JAL)."

Katanozaka, a former senior executive vice president and director of ANA Holdings, whose expertise includes marketing and corporate planning, took charge of the airline group, with its 64 subsidiaries, on April 1. He is responsible for the bottom line, the mid to long-term strategy and strategic investment, including the group's fleet. He is supported by All Nippon Airways (ANA) CEO, Osamu Shinobe, who runs day-to-day operations at the airline, the group's key subsidiary.

In the decade to 2025, ANA Holdings plans to increase sales revenue from 1.7 trillion yen (US$14.24 billion) to 2.5 trillion yen and to achieve a 200 billion yen operating income target. That target is almost double the results planned for this fiscal year.

In ball park figures, ANA's domestic passenger revenue for the 2015 fiscal year will be about 700 billion yen and international passenger revenue around 500 billion yen.

"In 2025, we are planning for the majority of our growth to come from our international business. Again, in ball-park figures this means domestic revenue will drop to around 600 billion yen, while international passenger revenue will be up to 800 billion yen. So we need to maintain our domestic market share while increasing international business," said Katanozaka.

Achieving these international growth targets will come from expansion of the route network with ANA hoping to win international business from increasing inbound traffic, especially from events such as the International Rugby Championships and the 2020 Olympics and Paralympics Games. More international slots at Narita and Haneda airports, as yet unallocated, also may contribute to international passenger growth.

In the short to medium term, Katanozaka wants to expand the network as quickly as possible, to take advantage of the limitations on JAL. A condition of JAL's rehabilitation is that the carrier cannot commit to new investments or open routes until 2017. JAL and ANA compete on many international routes.

"We want to change that by serving destinations where neither carrier has service," he said. New international routes this year include Tokyo-Houston from this month with Tokyo-Kuala Lumpur to be launched in September.

"For the time being, or at least until the mid-term, we'll be extending flights or opening flights to destinations that we have been considering and or were committed to be launched by my predecessors including Istanbul, Mexico and Sydney. These routes will be the first new routes that we're going to add to our network.

But Katanozaka has his sights set further into the future by broadening the airline's service network. By 2025, he is considering servicing cities in Latin America, Africa and Eastern Europe where no Japanese airline has flown.

"Probably by 2025, the world business environment will be very different from now," said Katanozaka, although he acknowledged Asia will remain at the core of ANA business.

"The potential demand for such destinations from Japan could be very limited, but actually we need to study about that. I would like to encourage the younger people in our company to think about the growth of the business, analyze our needs and identify routes ANA should serve.

In the current long term plan to 2025, Katanozaka has drawn a world atlas, showing the regions where Japanese carriers have not yet set wing. "This is to help stimulate our younger people," he said.

In addition to the core group company, Katanozaka is responsible for ANAH's budget airlines, Peach Aviation, based in Kansai, and Narita-headquartered Vanilla Air.

"Peach, in which we have a 38% stake, has performed much better than expected and is generating profits. It could be out of deficit at the end of this fiscal year," he said.

"Vanilla Air, which is a wholly-owned ANAH subsidiary, is running a deficit. The company started life as a partnership between us and Tony Fernandes' AirAsia. However, we went through a 'divorce'. Whether or not we can generate profits for this year (ending March 2016) is critical."

Vanilla's performance in the full 2014 year was better than anticipated. Katanozaka said the budget carrier's original projected passenger numbers were 1.1 million, but the latest traffic data indicated they would reach 1.14 million for the 12 months.

"Sales revenue should be 12.2 billion yen. We will still

face an operating loss, but it will be smaller than predicted. Operating losses declined from 5.9 billion yen in 2013 to 3.6 billion yen last year," Katanozaka said.

"Vanilla's load factor in the closing months of the fiscal 2014 year showed steady improvement at 85% in January 2015 and 90% in February."

Other positive factors that should help Vanilla Air are the installation of a new revenue management system managed by an expanded revenue management team and the April opening of a dedicated low-cost carrier terminal at Narita.

Ten years from now Katanozaka wants the two budget subsidiaries to operate to regional resort markets, predominantly in Asia.

"Both LCCs fly A320s, which can fly around 2,000 km. To service medium range routes up to 4,000 km, we may have to think about a shift in aircraft type. If you look at the globe to the east of Japan you see only Hawaii as a resort destination, so we need to go in the other direction, to Southeast Asia and China for resort destinations that can be flown by LCCs," he said.

"The competition in this market is very fierce. In Asia, among others, we have Scoot, Nok, Tiger and Jetstar Thailand. There are many LCCs competing with each other.

"However, in Japan I have confidence we can succeed in this business by using our brand power. We want to capture a bigger share of the inbound travel market."

ANA has developed ties with three domestic carriers, Air Do (13.6%), Solarseed (8.56%) and Star Flyer (17.96%) that include code sharing as well as held equity. When domestic carrier, Skymark, sought bankruptcy protection earlier this year, ANA offered to buy up to 19.9% of the carrier.

Details of the fate of stricken Skymark will be announced at press time, when Skymark must submit its rehabilitation plan to the Tokyo District Court. Katanozaka declined to speculate on the outcome.

He also oversees a wide range of associated ANA Group businesses. In the fiscal 2005 year, non-air income was 17% of operating revenue, or 232.9 billion yen, including its hotel business, which was sold in 2007.

In the current year, non-air income will be 11% of operating revenue, or 195.8 billion yen. By 2025, non-air business revenue is planned at 15% of total sales or about 375 billion yen, almost double the target for the current year.

That's a formidable sum, but the group CEO is keen to develop non-air business where it can enhance group financial performance, particularly as the scope is diverse. A recent example of the strategy is the group's 2012 purchase in Miami of the Panam Flight Training company and the launch of a training academy in Thailand in September 2014.

A little known fact about the ANA Group is that subsidiary, ANA Trading, is a major player in the Japanese banana business. It imports bananas from Ecuador and wholesales the fruit to supermarkets nation-wide, said Katanozaka.

Japanese foodstuffs such as high quality beef and fruit are becoming very popular in overseas markets, particularly

ANA Group builds Okinawa MRO facility

ANA Holdings is coordinating with Mitsubishi Heavy Industries and other investors to establish an MRO facility that will target narrow-body aircraft such as the A320 family and the B737 in Okinawa's Naha. The yet-to-fly Mitsubishi Regional Jet could be handled at the facility.

Scheduled to open in 2016, the initial customers are expected to be predominately Japanese carriers, but it is planned to sell the service to non-Japanese carriers.

"This is an opportunity for the ANA Group to contribute to the Okinawa economy by operating a high quality MRO service in the city. It's a good investment for all involved. A win-win situation where there is great potential for growth," said Katanozaka.


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A cultivated man

Shinya Katanozaka, 59, was born in Kagoshima, Kyushu, the most southerly of the four main islands of Japan. A graduate in law from Tokyo University, he joined ANA in 1979 and has remained with the carrier for the 36 years of his working life.

One of the key architects of two-year-old ANA Holdings, Katanozaka was a senior vice president and a board member of the group when Shinichiro Ito nominated him as his successor. Ito, who is now chairman of ANA Holdings, said Katanozaka "was passionate about his work and could see things from a wider perspspective".

He is a specialist in marketing, personnel and corporate planning and has had years of experience in product and services strategy and customer relations at the airline.

Married, with two daughters, Katanozaka has broad tastes in music with a special fondness for Mozart. He enjoys traditional Japanese story-telling, but his greatest love is gardening.

At weekends at his home in Tokyo's western suburbs he tends what he calls his 'tiny' garden. He has two Japanese tangerine trees which bear about 100 of the sweet fruit every year. "To get a good harvest, you need to prepare the ground and trim off excess buds – to concentrate the plant's energy," he says.

Business commitments make it hard to find the time to care for the garden as much as he would like, but he tries to maintain some colorful flower beds.

Gardening, Katanozaka told *Orient Aviation*, reminded him of the human condition. He quotes an ancient Chinese poem, "every year the flowers bloom the same as usual, it is the people who admire the blooms that change".

in Asia. Katanozaka wants to leverage the ANA cargo hub in Naha, Okinawa, by exporting high-class Japanese food products to Hong Kong and Singapore, where affluent consumers have created demand for the quality produce.

ANA operates cargo flights between its Naha, Okinawa hub and four key airports in Japan: Narita, Kansai, Chubu and Haneda. It also flies to nine cities in Asia out of Naha and is planning routes to Amoy and Manila from October.

In August 2013, ANA Holdings announced a major investment of US$25 million in Myanmar's Asian Wings Airways, the first investment in a Myanmar-based carrier by a foreign airline, ANA said at the time. A year later it cancelled the planned partnership. It said changes in the competitive environment in Myanmar and an inability to reach agreement on the proposed capital participation were the reasons behind the decision.

Despite this setback, Katanozaka is seeking opportunities to invest in Asian airlines to expand ANA's network. The group is 'studying various projects' involving cooperation with Asian airlines "whether we take a stake or not". For example, ANA has made code share deals with Philippine Airlines and Garuda, without any financial investment.

"We believe Asian aviation will be deregulated. We would like to be ready for that eventuality. But many Asian airlines are national flag carriers so we are limited in what we can do. I don't think we will invest on a massive scale," he said, although ANA Holdings has ample funds available if opportunities emerge.

By 2020, the group expects to be operating 265 airplanes at ANA and 40 aircraft at its budget carriers. At present ANA has a fleet of 250; 230 ANA aircraft and 20 among their LCCs. New types joining the fleet include the MRJ and the A320/321neo.

Developing ANA as a global brand is another priority for Katanozaka, especially as he was responsible for the airline's award winning 2009 "Inspiration of Japan" product and services rebranding.

The ANA brand is not as well known as its competitor JAL, said Katanozaka, mentioning ruefully that when he makes an internet search for ANA in the U.S. up pops "ANA – The American Nurses Association".

"We have a board of advisors and they've been saying to us that we should change the name of ANA – maybe we should rename the airline ANA – Japan," he said. "I'm still considering such advice," he said.

"We are raising our brand awareness. In April, we sponsored a U.S. Ladies Professional Golf Association tournament at Mission Hills Golf Club in California and supported it with advertising on CNN. This was a very successful, profile raising event. ANA is now the Official Airline of the LPGA and the tournament. The newly-named ANA INSPIRATION drew a good response.

"A few weeks ago, we unveiled a B787-9 Dreamliner with a fuselage design based on the Star Wars character R2-D2. This received massive coverage world-wide and the aircraft will carry the design for five years from this autumn.

"Until recently, foreign passengers accounted for about 30% of the total passengers on our international flights, but it has gone up to almost 40%. "Coming back from Los Angeles recently I noted that about 60% of the passengers were non-Japanese and they were all enjoying our Japanese food.

"We want foreign passengers to enjoy flying with us. We want them to share their experiences on social networks with their families and friends, enjoying 'The ANA Experience' as a global brand." ■

Outside the airline box

ANA Holdings is developing plans to operate food courts dedicated to Japanese cuisine - "Washoku" - throughout Southeast Asia. In June, the company will open a 1,300 sq. meter 600-seat Japanese food court with a sushi shop, tempura restaurant and a Japanese pub, or izakaya, in Singapore. It will be operated by Global Retail Partners, a joint venture with food and beverage companies and other investors. ANA Trading, with 40% of the enterprise, is the biggest investor.

A similar food court is planned for Singapore's Changi Airport and at other locations throughout Southeast Asia.

Airlines wary of lithium battery bulk business

Following a U.S. Federal Aviation Administration's (FAA) series of controlled tests on lithium-ion batteries, which resulted in a powerful explosion that could have caused "a catastrophic failure of the airframe" during flight, many airlines are turning away bulk shipments of the batteries.

TOM BALLANTYNE reports

A growing number of airlines, including Asia-Pacific carriers, are banning the carriage of bulk shipments of lithium-ion batteries in the holds of their passenger and freighter as concerns because of concern they pose a serious risk to the safety of flight. The airlines' decisions are being made as the International Civil Aviation Organization (ICAO) moves swiftly to develop a safer way of packaging the batteries.

Last month, the organization's hazardous cargo committee established a special working group to study packaging that could contain any fire or explosive gases ignited by the batteries. If a safe solution is not developed, it is understood a formal proposal to ban bulk battery shipments from all passenger planes could be put to ICAO's meeting on dangerous cargo in October.

Airlines are becoming nervous about the risks to air safety posed by the increasing numbers of the lithium-ion batteries that are being shipped from Asian markets and especially China, by air freight.

International Air Transport Association (IATA) director general and CEO, Tony Tyler, warned at the World Cargo Symposium in Shanghai in March that the rise of e-commerce and the ability of small businesses to export to a global audience has created a significant new market of shippers who are not necessarily familiar with the rules on shipping dangerous goods.

Several airlines are restricting bulk shipments of lithium ion batteries on their passenger and cargo aircraft.

"In particular, it is lithium batteries that give us cause for concern," he said. "The safe transportation of lithium batteries by air is a global challenge, but it is important to note that China is a major source of lithium battery production. We need to work hard with all stakeholders in China to tackle this crucial issue."

The calls for a ban are aimed only at actual shipments, not batteries that passengers take on board aircraft in their personal electronic devices or carry-on bags. In a presentation last year Airbus engineer, Paul Rohrbach, said an aircraft might be able to withstand a fire generated by a small number of lithium-ion batteries, but a fire involving lots of them could destroy the plane.

More than five billion lithium-ion batteries were produced last year and the number is forecast to reach more than eight billion annually by 2025. Cathay Pacific Airways, Qantas and Air China are among airlines that have banned or placed restrictions on bulk battery shipments aboard their passenger and freighter aircraft.

The lithium-ion battery industry has been growing at an enormous rate. The rechargeable batteries are used in hundreds of devices from mobile phones and tablets to power tools and electric cars. It's not unusual for as many as 80,000 to be shipped in a single consignment.

But bulk shipments are not the only concern. Tyler pointed out that, disappointingly, airlines are seeing some "willful non-compliance". "For example, there is a supplier on Alibaba (a Mainland Chinese online sales platform) that said it would re-label 300 Watt hour batteries as 100 Watt hour, and even ship them via the standard postal service. We are pressing regulators and the e-commerce sites to be more diligent in making sellers aware of regulations and, as importantly, taking action to address non-compliance", he said.

Lithium batteries have been involved in several incidents in the past year when they have burst into flames in air cargo warehouses. There is no definitive proof, but speculation persists that a shipment of the battery type aboard Malaysia Airlines flight MH370 could have been a factor in its disappearance.

A report on MH370, released earlier this year, claimed a shipment of lithium-ion batteries had not been properly screened before it was loaded on to the fatal B777. MAS said in a statement that the Motorola Penang battery cargo had been inspected in line with procedures "defined by the International Civil Aviation Organization". The batteries were not considered

dangerous goods because they were packed in accordance with ICAO regulations.

But airline concerns about the possible risks to shipping lithium batteries have been heightened by the FAA's test program of the last 18 months. The tests repeatedly showed a single short-circuiting battery in a large shipment can cause overheating that spreads to other batteries. Fire suppression systems have been able to put out the initial flames, but they could not contain the spread of continually increasing temperatures known as thermal runaway.

The overheated batteries emit a mixture of explosive gases, of which hydrogen is the most abundant. As the gases build up, they eventually explode and ignite an intense fire. The February FAA test resulted in a powerful explosion, despite being conducted in a pressurized chamber with an atmosphere of 5% Halon (the main gas used to suppress fires in the cargo compartments of passenger planes).

Triggered by smoke, fire suppression systems unleash Halon until the gas reaches 5% of the air in the cargo compartment. It has long been accepted by aviation authorities that this level is enough to put out most fires, including a lithium-ion battery fire.

"We now no longer believe that would be the case," said Captain Mark Rogers, who represents the Air Line Pilots Association in the U.S. and Canada and other international pilot unions on cargo issues in ICAO proceedings.

In March, the International Coordination Council of Aerospace Industry Associations, which represents firms such as Boeing and Airbus, and pilot unions, submitted a joint working paper to ICAO that recommended a ban on bulk battery shipments on passenger planes until safer packaging is developed.

The goal of the ICAO working group is to design fire-resistant packaging which would guarantee that any overheating, fumes or fire occurring in a lithium battery shipment would be contained within the packaging.

New standards also would apply to lithium metal batteries, which are not re-chargeable and are used in items such as watches and toys. They are already banned on passenger planes globally.

Last December, IATA released a free online guide to lithium battery risk mitigation for air transport. Also published in Chinese, the "Lithium Battery Risk Mitigation Guidance for Operators" provides operators involved in transporting lithium batteries with best safety practices and clear guidelines for the bulk battery shipments. It advises airlines how to educate passengers about the risks associated with packing lithium batteries in checked baggage.

Tyler said: "Safety isn't something that only happens at the airport or on board the aircraft. It is a shared responsibility. Above all, regulators need to step up and not assume that airlines will do the job for them. Regulators are the key to having regulations followed. The industry is doing what it can, but without oversight, surveillance and, where necessary, enforcement, compliance at the source of the shipment will be limited." ■

Asia-Pacific global airline influence accelerates

Asia-Pacific airlines are bounding towards global airline dominance. In this months special report, Orient Aviation outlines the socio-economic factors operating across the Asia-Pacific that are dictating the future size and shape of this regional aviation power house.

Tom Ballantyne reports

When the International Air Transport Association (IATA) recently released its first 20-year passenger growth forecast it confirmed the trend airline analysts have long identified. The Asia-Pacific, despite some performance stumbles along the way, is on a growth trajectory that will see the region become the world's airline market sooner rather than later.

In the next two decades, global passenger numbers are predicted to climb to 7.3 billion a year, a 4.1% average annual growth rate, doubling the 3.3 billion passengers who flew in 2014. By 2030, with 5.5% annual air passenger expansion, China will overtake the U.S. as the world's largest passenger market (defined by traffic to, from and within) and will account for 1.3 billion passengers a year, 856 million air travelers more than in 2014.

China is not the only expansion story in the Asia-Pacific. The ninth largest market, India, will have 367 million passengers annually by 2034, an extra 266 million compared with today. It will overtake the U.K. (148 million extra passengers in a total market 337 million) and become the third largest market in the world around 2031.

Indonesia will enter the top ten around 2020 and achieve sixth place by 2029. In 2034, it will have a passenger market of 270 million passengers.

But there will also be some losers. Reflecting a declining and ageing population, Japanese air passenger numbers will grow 1.3% per year and decline from the world's fourth largest market in 2014 to ninth in 2033.

The IATA forecast, produced in association with Tourism Economics, analyzed passenger flows across 4,000 country pairs. It said routes to, from and within the Asia-Pacific will see an extra 1.8 billion annual passengers by 2034, for an overall market of 2.9 billion passengers.

In relative terms, the region will increase its size, compared with other regions, to 42% of global passenger traffic by 2032. With an annual average growth rate of 4.9%, the region will be joint highest with the Middle East, which will remain a far smaller market than Asia. The figures are in stark contrast to North America, which will expand by 3.3% annually. Europe will have a growth rate of 2.7% a year.

In 2050, if current growth continues, Asia's per capita income could rise 600% in purchasing power parity (PPP), matching Europe and other Western economies. In the next two decades, around three billion Asians will enter the global middle-class, the vast pool of consumers who are airline passengers.

But there are several serious hurdles to overcome if the region's airlines are to take full advantage of the opportunities ahead.

There are concerns about the region's safety reputation and not only because of several recent incidents and accidents. The persistent failure of some regulatory authorities – Thailand, Indonesia, India and the Philippines among them – to keep pace with ever increasing oversight requirements has resulted in several downgrades by the Federal Aviation Administration and the European Union that have contained growth at the airlines operating in these countries.

Infrastructure, or lack of it, remains an operating and safety issue. Despite multi-billion dollar investments in new and existing airports, both airports and the region's air traffic management systems cannot keep up with demand for extra flights.

Personnel shortages, from the cockpit to air traffic control operators to technicians and engineers at both airlines and MRO facilities are a continuing problem. Airbus' latest global market forecast projected Asia-Pacific airlines would need 2,253 new jets to 2033. There are 1,600 aircraft operating in Southeast Asia. It is the only region in the world with as many aircraft on order as already are in service.

Each new plane needs as many as a dozen pilots. Training facilities have been investing in expansion, but right now the figures don't add up to providing sufficient crew for all the aircraft ordered by carriers in the region.

Boeing forecast the Asia-Pacific would require 216,000 new pilots in the next 20 years. It is the largest number of collective flight crew in the world and is estimated to be make up 40% of the global demand.

Traditional airline models are also being re-defined. Full service airlines are constantly adjusting their strategies to meet fast developing challenges, especially from budget airlines. In some countries such as the Philippines, Thailand and South Korea LCCs have captured almost 50% of the local market. Some of that business is lost business from full service carriers.

While Asia-Pacific airlines undoubtedly are amongst the best in the world for their service standards they have not been able to entirely thwart LCCs' penetration into traditional markets. More recently, long-haul budget carriers are making inroads on routes formerly flown only by full service airlines.

As a result, full service airlines will continue to launch or set up joint ventures with budget carriers to be part of the expanding LCC sector.

Some Asia-Pacific carriers have been forced to change. Malaysia Airlines (MAS) and Thai Airways International (THAI) are undergoing major downsizing and restructuring exercises to survive.

MAS's remaking has followed two previously inconceivable accidents in last year while THAI is undergoing a financial revamp after management lost its way during a period of political unrest in the country. The proliferating budget carrier competition in its THAI's market did not help.

There are likely to be similar challenges in other countries across the region. China's LCCs are in an early stage of development and Korean budget airlines are gaining a large share of a market once the domains of Korean Air and Asiana Airlines.

When the region's airline leaders met in November last year for the annual Assembly of Presidents of the Association of Asia Pacific Airlines (AAPA), the body's director general, Andrew Herdman, said most economies across the Asia-Pacific were growing relatively strongly, with the region's airlines reporting passenger and freight traffic increases.

"Although Asia-Pacific airlines continue to invest heavily in the latest generation of fuel efficient aircraft to meet traffic growth demands, there is an increasing concern about the need for corresponding long term investments in related aviation infrastructure, including airport terminals, runways and air navigation services," he said. "Governments have key roles to play in coordinating such investments and ensuring that the necessary regulatory oversight of the industry keeps pace with growth."

At the same time, Asian carriers have sought to contain a yield decline as competition intensifies because of a long running, regional capacity surplus. The dramatic decline in the price of fuel since June last year is helping to arrest that decline.

> **In 2050, if current growth continues, Asia's per capita income could rise 600% in purchasing power parity (PPP), matching Europe and other Western economies. In the next two decades, around three billion Asians will enter the global middle-class, the vast pool of consumers who are airline passengers**

AAPA figures for the 2014 calendar year showed healthy growth in international air passenger demand. Air cargo reported a revival in demand after three consecutive years of decline.

A total of 256.1 million international passengers flew on the region's carriers during the year, representing an annual increase of 4.8% over the previous year. Sustained growth in Asian regional economies, and robust trade activities supported by stronger U.S. markets, helped underpin business and leisure travel demand.

However, the combined 4.7% increase in international passenger traffic, in revenue passenger kilometer (RPK) terms, was slightly outpaced by a 6.0% expansion in available seat capacity, which led to a 1.0 percentage point decline in the average international passenger load factor to 77.0% for the year.

Overall, Herdman said, the outlook for the coming year remains broadly positive, with sustained growth in the global economy continuing to drive air travel demand, whilst lower oil prices will also help to keep air travel affordable, said Herdman.

"Looking ahead, no-one can forecast where the price of oil will settle, but airlines have put fleet and network planning as one of their priorities. Over the next two decades, the arrival of more and more fuel-efficient aircraft such as B787s and B777s as well as A350s will play a major role in cost reduction."

The latest figures from the AAPA, for March, reveal growth is being sustained although the 11.3% increase in international passenger carried benefitted from the region-wide Lunar New Year holiday.

"Overall, for the first quarter of 2015, we saw an encouraging 9.4% increase in international passengers carried by Asia-Pacific airlines reaching an aggregate total of 67.7 million, substantially higher than the 4.9% growth of the previous year," said the AAPA. "During the same period, Asian airlines saw international air cargo demand grow by 8.4%, partly boosted by the dispute affecting maritime shipments at U.S. West Coast ports."

In the next two decades Asia-Pacific airlines will face many familiar challenges and probably a few no-one has considered yet. But they have shown great resilience in handling crises and change, which is likely to continue. ■

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