

The fall and fall of JAL

By Geoff Tudor in Tokyo

High in the sky on January 1, three special **Japan Airlines (JAL)** plane loads of sightseers viewed the first dawn of 2010 as they circled Mount Fuji, a symbol of good fortune on the first day of a Japanese New Year.

Down on the ground, a cast of politicians, bureaucrats, bankers and airline executives continued their deliberations about the ailing airline's fortunes, holding exceptional New Year holiday negotiations to seek a solution for securing the former flag carrier's future by saving it from collapse.

By January 15, it became clear that the government

had agreed a way forward in finalizing JAL's rehabilitation, a task that in over the past six months had evolved into a massively complex transaction involving three different restructuring teams, foreign suitors wooing JAL with fistfuls of dollars and the prospect of a completely new top management team led by charismatic 78-year-old **Kazuo Inamori**, founder of **Kyocera Corporation**.

On January 19, as its shares dropped to as low as three yen apiece, JAL filed with the Tokyo District Court for bankruptcy protection under the Corporate Rehabilitation Law of Japan. The



Japan Airlines: the biggest failure of a non-financial firm in post-war Japan

airline's failure was the biggest in post-war Japan of a non-financial firm, according to the *Nihon Keizai* newspaper. JAL was burdened by debts of 2.32 trillion yen (US\$25.7 billion). Creditor banks have agreed to waive around 358.5 billion yen.

On the same day, the government-backed **Enterprise Turnaround Initiative**

Corporation (ETIC), formally stepped in to oversee the JAL reconstruction plan and assist the airline's return to profitability. In the interim, the airline would maintain flight operations and for customers at home and abroad it would be "business as usual".

Major steps to be taken in the rehabilitation plan included



Answers, made by

the following.

- Over the next three years, 15,700 of 47,000 JAL Group jobs will go, which is one third of the work force and nearly double the target of an earlier plan.
- The number of Group subsidiaries, including travel companies and hotel operations, will be cut from 110 to 57 through selling off, liquidation and integration.
- Major fleet economies involve acceleration of the retirement of all the 37 remaining 747-400 aircraft by March 2015. Sixteen MD-90s will go, replaced by 50 small and regional jets.
- In addition to existing route cuts, a further 31 routes – 14 domestic and 17 international – face the axe.
- More than 20 overseas offices will be closed.
- While JAL goes through this

process, fuel purchases, aircraft leases and other commercial activities necessary to maintain flight operations, such as spare parts purchase and inflight catering will be backed by the ETIC, including airport user fees overseas and insurance premiums.

- Mileage awards will be honoured during the turnaround.
- Scaled down business size and an aim for Group revenues of 1.36 trillion yen in the year ending March 31, 2013, a reduction of 30% on the 2009 financial year.
- De-list JAL stock 100% from the **Tokyo Stock Exchange**, effective February 20, wiping out all share value.

ETIC's strategy for JAL's revival enables the airline to operate as usual through further financial support of up to 600

billion yen in bridge loans from both the turnaround corporation and the **Development Bank of Japan**. Additionally, ETIC will invest another 300 billion yen in JAL.

Other ETIC plan details include asking commercial lenders for 730 billion yen in debt waivers. Another one trillion yen in roll-over financing and aircraft purchase loans is an extra part of the package in future.

JAL's liabilities will reportedly exceed assets by more than 800 billion yen at March 31 2010. ETIC will cover this.

One of JAL's most sensitive measures to save future costs was the reduction of pension payments. Current employees have agreed to accept a 50% future pension cut and for retirees, a 30% cut in payments.

Adding to the complexities

were approaches by **American Airlines** and **Delta Airlines**, both offering cash investments of US\$1 billion or more, with the obvious string that in the case of American JAL should remain in the **oneworld** alliance or, in the case of Delta, JAL should join rival alliance **Sky Team**.

But the ETIC team felt that accepting foreign investment was inappropriate until the domestic rescue had been settled. A decision on the choice of partner may be decided this month. Delta is regarded as the favourite.

Rival **All Nippon Airways** said of the bail out: "We are highly concerned that the fair and competitive environment would not be secured under the financial support and injection of public funding". ■

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The step beyond

Wallop resigns over excess baggage

Wallop Bhukkanast resigned as executive chairman of the **Thai Airways International (THAI)** board in mid-January, a week before publication of an investigation into a complaint that four passengers, including Wallop, his wife and THAI executive vice-president commercial, **Pruet Boophajam**, transported unauthorised excess baggage on a flight from Tokyo to Bangkok last November.

Wallop, his wife and their female travelling companion exceeded their combined baggage allowance of 170 kgs by 228 kgs while Pruet checked in 113 kgs of baggage, which exceeded his allowance by 73 kgs.

THAI said it would seek compensation for the excess weight checked in by the four travellers. (I'm in charge, says new THAI president. See page 26)

AVIC building engine facility

The **Commercial Aircraft Engine Co. (CAEC)**, a subsidiary of Mainland aviation manufacturing conglomerate, **Aviation Industry Corp. of China (AVIC)**, has started construction on its US\$472.5 million engine research and development complex in Shanghai, with completion planned for 2013.

The company has signed an agreement with **MTU Aero Engines** for development and production of an engine

for its planned C919 150-seat passenger airliner, which will be launched in 2016.

CAEC has chosen **CFMI's** LEAP – X1C as the launch engine for the C919, but said Mainland manufactured engines ultimately will power the mid-sized aircraft. Partners in year-old CAEC are **AVIC (40%)**, **Shanghai Electric Group (15%)** and **Shanghai Guosheng Group (15%)**. The company said several Chinese and western investors have expressed interest in acquiring the remaining 30% of CAEC.

Late last year, **General**

Electric Co. signed a joint venture agreement (50/50) with **AVIC** to supply avionics systems - from China - to the world's airline manufacturers. The venture is awaiting regulatory approval from the Chinese government.

Macau feels the economic pain

A fall-off in both regional and long-haul tourists, increased cross strait flights and a decline in business activity across southern China have forced the Macau government, a Special Administrative Region of China, to inject 200 million patacas (US\$24.33 million) to keep budget carrier, **Viva Macau**,

afloat.

Launched five years ago, **Viva Macau** flies to Tokyo, Sapporo, Hanoi, Ho Chi Minh City, Jakarta and Melbourne and operates a fleet of three B767s. Separately, China's flag carrier, **Air China**, has paid US\$19.3 million to increase its equity in struggling **Air Macau** from its current 51%.

Suffering from the same economic and cross strait problems as **Viva Macau**, **Air Macau** lost US\$13.03 million in 2008 and is reported to have increased its deficit significantly for the 12 months to December 31, 2009.

An **Air China** spokesperson said **Air Macau** had good long-term prospects because of the region's fast economic growth.



Viva Macau: has received a US\$24.33 million cash injection to stay afloat

SHORTTAKES

AIRPORTS: The **Airport Authority of Hong Kong** will acquire 49% of **Shanghai Hongqiao Airport**, Shanghai's second airport, following its investments in airports in Zhuhai and Hangzhou, also in China. Singapore's **Changi Airport Group** has signed a Memorandum of Understanding with the **Chongqing Airport Group**, China to co-operate on joint projects and staff exchanges.

ENGINES: **Engine**

Alliance's G5200, designed specifically to power the A380, achieved 100,000 revenue flight hours last month. GP7200 customers include **Emirates Airline**, **Air France**, **Korean Air**, **Etihad Airlines**, **Air Austral** and the **International Lease Finance Corporation**.

FLEET: **All Nippon Airways**, the launch customer for the B787, has ordered five 767-300ERs and five

B777-200ERs for delivery between 2010-2013.

China Eastern plans to buy 16 A330s for delivery between 2011 and 2014.

Malaysia Airlines has announced plans to purchase 15 A330-300s with options for 10 of the aircraft type, adding it intended to undertake a rights issue to finance the acquisition of the Airbus airplanes.

LEASING: China's **HNA Group** has bought **Allco Finance Group** for a reported US\$150 million.

The leasing company has a portfolio of 68 aircraft.

ROUTES: **Cathay Pacific Airways** will launch four times a week flights from Hong Kong to Milan in March as well as boost its services to Toronto and Los Angeles in March and May respectively.

Continental Airlines will resume twice a week flights between Hong Kong - Guam, in April, conditional on government approval.

Singapore Airlines will change its Singapore

- Zurich services from 12 flights a week to a daily A380 service next month. It will also begin a five times a week service from its home base to Manchester via Munich in the same month.

TRAINING: **Shanghai Eastern Flight Training Company**, a subsidiary of **China Eastern Airlines**, has bought two simulators: A320 and A330 7000 series full flight simulators from CAE. ■

China's carriers back in the black

News that China was leading the worldwide recovery from recession was supported by profit figures from its airlines. Last month, the **Civil Aviation Administration of China (CAAC)** revealed a collective profit of 7.4 billion yuan (US\$1.08 billion) in 2009, a significant recovery following a 31.8 billion loss in the previous year.

Helping the turnaround were government subsidies, hedging gains and the reintroduction of the civil aviation construction fund. Passenger volume rose 19.7% to 230 million and cargo volume rose 9.3% to 4.5 million tonnes.

The CAAC expressed optimism for 2010 as China's economic environment continued to improve. It expected passenger numbers

to climb 13% to 260 million this year with cargo increasing 12% to five million tonnes.

But challenges that will continue to confront China's aviation industry will be high fuel prices, the US dollar-yuan exchange rate and, in the domestic market, the impact of the Mainland's new high-speed rail network.

China is still struggling in the international marketplace where figures have yet to recover to pre-crisis levels from 2007. However, the CAAC will continue to encourage the launch of more international routes with the help of subsidies.

The regulator said it would continue to control capacity increases. Last year, Chinese carriers added 158 aircraft to their fleets, 40 fewer than planned. This year, 208 planes are scheduled to be added to China's fleet of 1,417 aircraft (as of December 31) with 17 retired.



Spring Airlines: costs 35% below the industry average

LCC Spring bounces to 8-fold profit rise

Exploding the once held myth that low-cost carriers could never succeed in China, Shanghai-based **Spring Airlines** increased its profit in 2009 almost eight-fold over 2008. Its income last year was 158 million yuan (US\$23.1 million) compared to 20 million yuan a year earlier.

Passenger numbers rose 46% to 4.3 million in 2009 with an average load factor of 95%.

The airline's costs are about 35% below the industry average, according to an airline

spokesperson. Last year, Spring saved 103 million yuan in operating expenses.

But no pain no gain. Last year, senior management had their salaries slashed by 30%. Spring also saved fuel by optimising routes, altitude and air speed and reducing aircraft weight.

The LCC is now looking to spread its wings overseas to Japan, Korea, Taiwan, Hong Kong and Macau by the end of the year.

Spring has a fleet of 15 A320s. It will add seven more this year and another 10 in 2011. ■

Guarded optimism for 2010

Members of the **Association of Asia Pacific Airlines (AAPA)** may be showing signs of recovery, but "the outlook for 2010 very much depends on the sustainability of what still appears to be a rather fragile global economic recovery", said its director general, **Andrew Herdman**.

Preliminary traffic figures for 2009, released last month, showed member airlines carried 132.9 million international passengers, 5.7% fewer than in the previous year. Passenger traffic measured in revenue passenger kilometres (RPKs) fell 6.5%, indicating particular weakness in demand on long-haul routes. Available seat capacity was reduced by 6.1%,

which resulted in a marginal drop in the average passenger load factor (PLF) by 0.4 percentage points to 74.6%.

AAPA international air cargo traffic, expressed in freight tonne kilometres (FTKs), suffered an even more significant decline in the year, down 11%. Airlines made corresponding reductions in cargo capacity, which resulted in an average freight load factor (FLF) of 66.1%, almost unchanged from the previous year.

"We have been through downturns before, but none as severe as we've experienced in the past two years," said Herdman. "Demand for passenger travel and air cargo shipments both recorded sharp

falls. The business impact on airlines was even more dramatic as the collapse in corporate travel and intense price competition in a shrinking market saw airline revenues falling by 20-25%.

"Airlines responded by cutting capacity and redoubling efforts to reduce costs throughout the business, but were unable to fully offset the effects of sharply lower revenues. Meanwhile oil prices, representing our single biggest cost, fell back from their 2008 peak, but remained extremely volatile. Overall, Asia-Pacific airlines are expected to report significant losses for 2009, following similar heavy losses suffered in 2008."

"On a more optimistic note, traffic trends in recent months have shown signs of recovery, in line with the improving

global economic outlook led by developing economies in the Asia-Pacific region. The cargo business is regaining some of its dynamism and passenger demand on short haul leisure routes within the region has already picked up, although business travel demand is recovering more slowly.

"Asia-Pacific airlines remain focused on conserving cash, rebuilding damaged balance sheets and carefully managing capacity to match demand as they work towards restoring profitability. Whilst we remain hopeful about future prospects, the outlook for 2010 very much depends on the sustainability of what still appears to be a rather fragile global economic recovery." ■

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