"Low-Cost Airlines Become Big Spenders"

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Low-Cost Airlines Become Big Spenders
By EDWARD WONG
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Like lottery winners unleashed on Fifth Avenue, low-cost airlines in the United States and Europe are snapping up planes at a frenzied pace. They want to grow, and they want to grow fast.

Among the shoppers are AirTran Airways of Orlando, Fla., which ordered 50 Boeing 737's on June 30, and Britain's easyJet, which in October said it was buying 120 Airbus A320's.

By volume, such deals by this new generation of carriers involve some of the biggest aircraft sales in years. Low-cost airlines accounted for 61 percent of narrow-body jet orders so far this year and 75 percent last year, for a total of 385 planes. In 2001, the rate was just 15.5 percent, or only 39 jets, according to Back Aviation Solutions, an industry consulting firm.

Executives say the planes are needed to fuel double-digit capacity expansion over the next several years. That in turn is crucial to capturing market share and meeting increasing demand, they say. But given the generally eviscerated state of air travel, are the low-cost airlines trying to grow too quickly?

At Ryanair, the Irish discount carrier that is adding seats at a faster rate than any other European airline, the percentage of filled seats has dipped this year. Chris Avery, a J. P. Morgan Chase analyst, downgraded its stock rating July 14, citing a "weaker earnings growth year" because of "excessive capacity expansion."

In the United States, the economic downturn is so serious that Southwest Airlines, the world's most profitable carrier ever, is tempering its growth even as younger low-cost peers push ahead with ambitious expansion plans.

Though industry experts and former executives say the growth rates could be manageable, given both the current trends in passenger spending and the track record of executives at the low-cost airlines, they also warn of possible pitfalls.

"The **People Express** issue is still relevant in the sense that some of these guys could be lured into a higher-than-rational growth environment," said Robert W. Mann, an industry consultant in Port Washington, N.Y., referring to the no-frills upstart of the 1980's that foundered after expanding too quickly.

But Mr. Mann added: "I have always felt there was an insatiable desire for travel at the right price. In that sense, as long as they can continue to produce travel in popular markets at the right price, the sky's the limit."

Donald Burr, the founder of **People Express**, said that the three interrelated problems that hampered his airline - too-rapid expansion, hubris from the company's initial success and lack of proper information technology - could spell the downfall of companies in the current start-up crop if they are not cautious.

"One has to be very careful about managing success," said Mr. Burr, who still follows the industry. "When you're very successful, you've really got to get your paranoia up."

There is little doubt anymore that low-cost airlines not only are here to stay, but have also become the trendsetters of the industry, pushing air travel in directions that the traditional carriers are struggling to follow.

Industry experts say this is only the beginning of a huge change in air travel that was set off a quarter-century ago by American deregulation. But the very success of the low-cost business model - and consequently its popularity among entrepreneurs - makes the environment more cutthroat than when Southwest started in the 1970's.

With so many low-cost airlines popping up and expanding quickly, the number of **routes** where they compete is increasing. In the Los Angeles market, for example, Southwest, AirTran and JetBlue Airways already overlap on several **routes**.

In Europe, low-cost airlines are growing even faster and struggling to maintain success.

Ryanair shook up investors this month when it reported that its planes were only 79 percent full in June, versus 88 percent a year earlier. Michael O'Leary, the chief executive, warned that for the full year the airline's load factor - or percentage of seats filled - would drop to about 80 percent, from 85 percent in 2002.

Nevertheless, the airline is moving ahead with its sweeping growth plans. The company has ordered 125 737's from Boeing since the start of 2002, with an option for 125 more. It will take delivery of 18 jets this fiscal year and intends to increase capacity by 60 percent over the period, as well as by 20 to 25 percent a year for the next several years, said Sean Coyle, a company spokesman. Part of that, Mr. Coyle said, will come from entering more **airports** in Europe - it currently operates out of four on the Continent - and adding 20 to 30 **routes** a year.

"It's part of the long-term plan; nothing has really changed from a growth perspective for Ryanair," Mr. Coyle said. "I don't think there's any question that this year's growth rate in terms of capacity is large. >From a safety perspective, we have it well under control. From a financial management perspective, we have it well under control."

But some industry experts are asking about the capital outlay that will be required for Ryanair's expansion. And they are watching the growing competition across Europe - most obviously from easyJet, which is also in a rapid expansion mode, having ordered 120 A320's last year and aiming for capacity growth of 25 percent a year until 2007. Newer low-cost airlines are also emerging in markets that Ryanair wants to enter, including cities in Central and Eastern Europe.

"When I look at guys who are growing very fast and may have trouble, I look across the water to a guy like Ryanair," said Mr. Mann, the industry consultant. "He's growing very rapidly, he's got an apparent appetite for new airplanes. He's going to a lot of different markets, adding complexity."

But Mr. Mann added that the opportunities for expansion are larger in Europe than in the United States because deregulation is at an early stage in most countries there.

Daniel Solon, an industry analyst for Avmark International in Barcelona, Spain, said that capacity growth rates for Ryanair and easyJet looked reasonable, given the steady delivery schedule of their aircraft orders. Ryanair has spread delivery of its 125 Boeing jets from this year to 2009, while easyJet will take delivery of its 120 Airbus planes until 2007. Mr. Solon added that it made sense for the airlines to take advantage of the current slump in airplane sales to major carriers to negotiate favorable deals with Boeing and Airbus.

Low-cost airlines on this side of the Atlantic have also placed major orders recently, though not as large as those in Europe. In mid-June, Jet- Blue signed up for 100 regional jets from Embraer of Brazil. Two months earlier, it ordered 65 Airbus A320's. It said its capacity would grow 55 to 60 percent this year.

AirTran plans to increase capacity by 25 percent a year for the next few years with the 50 737's and six 717's it just ordered from Boeing. Its current fleet - 64 717's and 8 DC-9's - has limited flying range. The 737's will allow it to add transcontinental **routes** and possibly service to Mexico, Canada and the Caribbean.

"We still think it's very controlled growth," said Joseph Leonard, AirTran's chief executive. "If we find we're growing too fast, we'll slow it down. We will not outgrow our profitability."

Southwest has chosen not to increase its capacity as quickly as either AirTran or JetBlue. For one thing, Southwest is already much larger than either of the upstarts. Besides, Herbert D. Kelleher, Southwest's legendary founder, has always preached measured growth.

>From 1991 through 2000, Southwest increased its capacity by an average of 14 percent a year. That slowed to 9 percent in 2001, 5 percent in 2002 and will most likely be 4 percent this year. The company said yesterday that it would speed up plane deliveries next year and increase capacity by 6 to 7 percent.

"We need to grow at a pace that we feel we can manage and that the current economic environment can support, regardless of what our competition is doing," said Gary C. Kelly, Southwest's chief financial officer. "If we can grow faster comfortably, then we'll do that."

Southwest, though, will inevitably end up competing more and more with other low-cost airlines on some **routes** as those carriers expand. It now overlaps directly with three other low-cost airlines on 14 **routes**, and that is not counting metropolitan areas where Southwest and low-cost rivals fly into separate but nearby **airports**.

Mr. Burr, the **People Express** founder, said there were lessons to be learned from the implosion of his company. Capacity grew at an average rate of 137 percent a year from **People Express's** start in 1981 to 1985. But its load factor fell from 74.6 percent in 1983 to 69.8 percent the next year. In 1986, when **People Express** was sold to Continental Airlines, the load factor was 58.6 percent.

Contributing to his airline's decline, Mr. Burr said, was the reluctance of executives, guided by early success, to change anything about their product, even as rivals were thinking up new ways to steal market share.

"The public wants an improved product all the time," he said. "**People Express** didn't refresh its product. The minute you think you're going to produce a commodity product at the lowest possible price, someone else will come along and produce that, but give people a better product. They'll have better on-time performance, ticket you better, give you TV or whatever."

Mr. Burr also said **People Express's** computers were not sophisticated enough to deal with frequent-flier programs or a complex ticket pricing strategy called yield management that American Airlines popularized in the mid-80's. American quickly moved in for the kill, taking out ads that said it was matching **People Express's** fares in all markets where the two competed. Almost overnight, Mr. Burr said, his airline's percentage of filled seats plummeted.

These days, though, the traditional carriers are in no shape to knock anyone out. United is trying to restructure in bankruptcy court, American is struggling to avoid a trip there, and their biggest competitors are desperately flailing away. And in the short term, at least, the growth of low-cost airlines will more likely than not leave the old guard with another round of bruises and black eyes.

Attached Photo:

The success of the low-cost model, pioneered by airlines like Southwest, has led to a competitive environment. Southwest is tempering its growth plans while upstarts like JetBlue are expanding more rapidly.

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