CHICAGOBUSINESS
POWERED BY CRAIN'S

Asian blues hit United

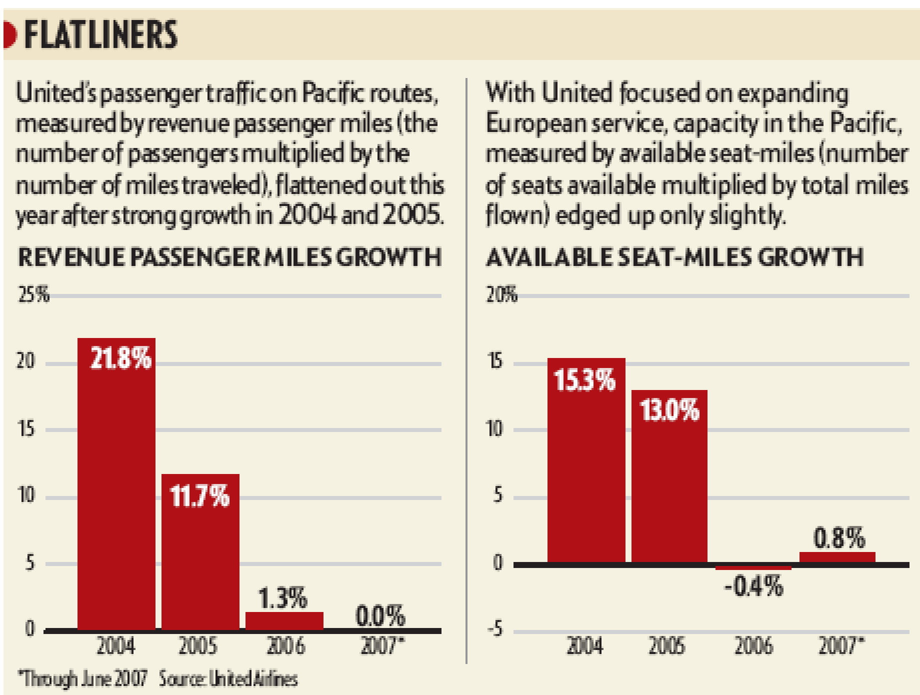
By Paul Merrion
July 07, 2007

United Airlines is leveling off in Asia, a lucrative market essential to the carrier's recovery plan.

After two years of double-digit gains, United's passenger traffic on Pacific routes rose just 1.3% in 2006, and flattened in the first half of 2007. Revenue growth in the region skidded to 4.9% in the first quarter, down from 9% in 2006 and 16% the year before.

Any slowdown in trans-Pacific business spells trouble for United, which counts on Asian flights for 18% of its $19.34 billion in revenue last year. As United's largest overseas market, Asia can make or break the airline's post-bankruptcy strategy of emphasizing high-fare international flights over domestic routes dominated by discounters.

"There's no question Asia has been central to their recovery from bankruptcy and it will continue to be important," says Henry Harteveldt, a travel research analyst in the San Francisco office of Forrester Research Inc. "But there is a legitimate need to re-examine their Pacific strategy in order to avoid it becoming a drag on their profitability."



No single factor explains United's stall over the Pacific, where demand for air travel continues to grow. Leading causes include resurgent competition from rivals with newer planes and snappier service, as well as a decision by United brass to chase an increase in demand in Europe. Loaded down with debt that financed its exit from bankruptcy last year, United lacks the resources to pursue growth in both markets.

United is treating Asia as a cash cow, hiking fares without adding capacity. A typical business class fare on United's Chicago-Hong Kong route was about $5,622 each way in April, a 29% jump from last year, according to Harrell Associates in New York, which tracks business fares.

"We've optimized and allocated our resources to where we are achieving excellent performance from our Asia service, and most importantly are still providing customers with the most convenient service," a spokeswoman for United's Chicago-based parent, UAL Corp., said in a statement.

EUROPE IN DEMAND

Boosting capacity 8.5% on trans-Atlantic routes this year enabled United to cash in on rising demand for business travel to Europe and an uptick in European tourists drawn to the United States by the weak dollar.

"Everybody is heading to the Atlantic now," says Darryl Jenkins, an airline consultant in Virginia. "They're able to get such good fares and they're making money there." Mr. Jenkins estimates that United had slightly higher profit margins last year on Atlantic flights than on Pacific ones.

But the shift is costing United Pacific passengers. Pacific-bound planes ran 82.4% full in the first half, down from 83.1% last year, making it the only market where load factors declined.

The spokeswoman says United will add Asian capacity later this year on new routes from Washington, D.C., to Beijing and San Francisco to Taipei, Taiwan. A database of airline schedules compiled by Seabury Airline Planning Group LLC in Virginia indicates United will be offering 8% more seat-miles (a capacity measurement) to the region by the end of the year.

Filling those seats will be tougher in a market United once dominated. Barriers to competition are falling in Asia, with China opening up more routes to U.S. carriers and new rivals such as Australia's Virgin Blue eyeing U.S. destinations.

"United historically operated in a somewhat protected position in the Pacific," says George Hamlin, managing director of Airline Capital Associates Inc., a consulting firm in New York. "Now they're facing additional competition from U.S. carriers and more and more foreign competition."

United's chief U.S. rival for trans-Pacific routes, Northwest Airlines Corp., is making a strong move in the region, where overall passenger traffic is growing at 5% to 6% annually, according to Brian Pearce, chief economist of the International Air Transport Assn. After cutting flights during its own bankruptcy sojourn, Eagan, Minn.-based Northwest boosted Asian capacity 5.8% this year, and traffic was up 2.4% through May.

RIVALS WITH NEW 787s

Northwest will be the U.S. launch customer next year for Boeing's new 787 Dreamliner, a long-range, wide-bodied plane that's cheaper for airlines to operate and more comfortable for passengers. Asian airlines angling for a bigger slice of U.S.-bound traffic also are stocking up on 787s.

Newer planes and a reputation for better service are helping Asian carriers claim a share of trans-Pacific traffic. Hong Kong-based Cathay Pacific Airways saw capacity and traffic grow more than 10% last year on routes to North America.

United, hobbled by heavy debt and weak profit, has announced no plans to buy new planes. Service, meanwhile, has suffered in the wake of staff reductions and other cost cuts.

Both factors will make it harder for United to restore the glitter to an Asian route system Forrester's Mr. Harteveldt calls "the brightest, shiniest jewel in their crown," albeit one that's "lost a little bit of that luster."