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Air Pressure

Discount Carrier Lands Partners In Ill-Served Cities

Shrugging Off Industry Woe AirTran Thrives on Deals That Guarantee Revenue
Flying High Rollers to Biloxi

By MARTHA BRANNIGAN

WICHITA, Kan.-David Wells, president of Key Construction Inc. here, keeps a lid on expenses. But last December he readily committed the building contractor to spending \$20,000 over 12 months to fly on low-fare carrier AirTran Airways.

Like many Wichita executives, Mr. Wells sees it as money well spent. For years, the city's airfares have been among the nation's highest. Lacking competition from low-fare carriers, Wichita was a seller's market for giants such as AMR Corp.'s American Airlines and Delta Air Lines.

AirTran, whose arrival in such a market typically drives down fares 50% or more, offered a cheaper alternative, even with the strings it attached to starting service: big financial commitments from area businesses and local government. Last year, nearly 400 businesses agreed to shell out a total of \$4.7 million for AirTran tickets to woo the Orlando, Fla., carrier. City officials agreed to add as much as \$4.5 million in revenue guarantees over two years. They also chipped in \$600,000 to help promote the new service.

Much of the airline industry is still reeling from the effects of Sept. 11 and the economic downturn. Many carriers, such as UAL Corp.'s United Airlines and US Airways, have had to slash costs and routes and seek federal loan guarantees to combat a surge in losses.

By contrast, AirTran has quietly stayed a course of steady growth. Chairman Joe Leonard, a 58-year-old industry veteran, made his first Wichita-style deal several days after taking over three years ago. While the industry has struggled, he has pushed harder for such "public-private partnerships," as he calls them. The "public" part taps municipal coffers mainly for revenue guarantees that protect AirTran against losses during the initial phase of operations; the private builds "travel banks," in which businesses pledge to spend a specified amount on tickets. Both elements help to build a loyal following and a cushion against the early losses of expanding into a new city and the invariable backlash from bigger competitors who respond by slashing their own fares and expanding service.

For any city, affordable air links are crucial to attracting new business and encouraging existing businesses to expand. Other carriers, such as America West Airlines and Horizon Air, have used travel banks in recent years, and revenue guarantees have been around even longer. But no carrier has been as aggressive and deliberate in lining up support as AirTran. The airline, which flies to 37 cities in the East and Midwest, has signed eight "partnerships" so far, five of them since Sept. 11.

"They are very much in the driver's seat," says Bailis Bell, Wichita's airports director, who helped lead the campaign to attract AirTran in competition with other cities courting the carrier. "A lot of cities are interested in their service-and their prices." Since AirTran's arrival in May, a full fare on the Wichita-Washington flight has dropped to about \$460 recently from \$1,667 last November.

AirTran has struggled in the past year, posting a net loss of \$2.8 million for 2001, on revenue of \$665.1 million. But revenue was up last year over 2000, and is projected to rise again this year. The carrier also expects to return to profitability in the second quarter and for the full year. It ranks No.3 among discounters behind fast growing JetBlue Airways and low-fare leader Southwest Airlines.

Unlikely Turnaround

AirTran's ability to grow in the worst environment for airlines in years highlights one of the most unlikely turnarounds in the airline business. Six years ago, when the carrier was known as ValuJet, it grounded all flights for three months after the crash of a DC-9 into the Everglades killed all 110 people on board. Safety concerns led many to bet the carrier wouldn't fly again.

It was a long journey from industry pariah to coveted carrier. In one of its few lucky breaks: the carrier had just floated a package of \$150 million in junk bonds in 1996 before the Everglades crash. That gave it some financial resources as it addressed the safety concerns during the shutdown and endured 11 consecutive quarterly losses.

In 1997, ValuJet merged with AirWays Corp., a holding company for low-fare AirTran Airways. By the time Mr. Leonard, a former Eastern Airlines president, took the helm in January 1999, the airline was on its last leg. It had been through the merger, had changed its management and name, and had moved its headquarters from Atlanta to a one story building in an office park near the Orlando airport.

One of Mr. Leonard's first steps was to demand daily cash reports, which provide a snapshot of the company's finances, including its cash position and expenses. Even as profits rose, he kept chanting the mantra of cost control. When he did spend money, it went to shoring up infrastructure, such as spending on technology in every area from reservations to maintenance, to improve efficiency. A Web site that makes it easy to book online has helped AirTran steer 46% of its sales to the site-one of the highest percentages in the industry. That adds up to big savings since it costs the airline just 25 cents to process a ticket online, compared with \$8.50 through a travel agent.

A key move was to forge closer ties with Boeing Co., which already was supplying AirTran with a fleet of new Boeing 717 jets to replace its aging DC-9s. Mr. Leonard turned Boeing into AirTran's biggest shareholder and top lender. Boeing Capital Services Corp. refinanced \$201 million of AirTran's junk bonds last year, receiving an 8% stake in the airline. Boeing also agreed to finance the acquisition of 20 of the Boeing jets during 2002, enabling AirTran to continue its rapid fleet modernization. The new jets burn 24% less fuel, are cheaper to maintain and have leather seats in business class.

Like Southwest, AirTran adopted a simple fare structure and a generous frequent-flier program. Upgrades to business class from coach are just \$25, and every six round-trip tickets yields a free ticket for any route. This year, as most major carriers fly far fewer seats than a year ago, AirTran is expanding by 20%. It operates 388 daily flights to 37 cities with a fleet of 64 planes.

Mr. Leonard's experiment with revenue guarantees began just days after he arrived. The Beau Rivage Resort and Casino in Biloxi, Miss., eager to ferry gamblers to the town, cut a deal in which it pays a fixed hourly rate for the airline to fly passengers to the casino from three other southern cities. The rate virtually ensures a profit for AirTran as long as the carrier keeps costs down.

"It was a guaranteed revenue stream, and at that time we didn't have many guaranteed revenue streams," Mr. Leonard says. Nearly a year later, AirTran signed a similar deal with the Grand Bahama Tourism Board and the Our Lucaya Beach and Golf Resort for service between the island and Atlanta.

As its fortunes improved, the airline that once had to struggle to lure passengers was besieged by calls from communities looking for low-fare service. Last year, it says about 100 cities made pitches for its attention. It added three destinations-two of which offered major backing.

One of those was Tallahassee, Fla. The state capital won AirTran service in November after Gov. Jeb Bush promised to steer state employees to its planes, and the city agreed to reimburse the airline up to \$1.5 million for the first year of operation if revenue fell below plan.

Also in November, AirTran began testing its first travel-bank project when 327 local businesses in Pensacola, Fla., fed up with Delta's \$800 fares to Atlanta, amassed \$2.1 million in ticket pledges. In a bid to lure AirTran away from nearby Fort Walton Beach, Fla., local government officials in the Pensacola area and the Chamber of Commerce pitched in about \$889,000 in incentives, including a guarantee for two years that operating costs wouldn't exceed the levels they had been in Fort Walton Beach. AirTran packed up its ticket counters and computers and left for Pensacola. A last-minute scramble by Fort Walton Beach residents to hang on to the carrier failed.

As those deals came together in the tumultuous period following Sept. 11, Mr. Leonard decided that shifting more of the risk of expansion to communities made sense. "We're basically saying for small and midsize cities, if you want us to come-and we've got a lot to offer-you need to bring money," Mr. Leonard says. "We're not going to experiment on our nickel."

In Wichita, AirTran raised the stakes, making its richest deal yet: It asked for both a revenue guarantee and a travel bank, and on top of that extra cash to promote the new service. It had an edge in being the only one of three low-fare carriers targeted by Wichita to show interest in expanding there.

Wichita, a major center for aerospace manufacturing, had battled sky-high fares for years. Sheryl Wohlford, co-owner of Automation-Plus Inc., a Wichita manufacturer, says she was embarrassed to submit travel bills to clients, who sometimes wondered if she added a mark-up. At Key Construction, Mr. Wells urged employees to drive three or more hours to alternative airports, where fares were lower than those in Wichita. Other Wichita businesses left town in search of better air service.

"You couldn't go anywhere without hearing talk of high airfares," says Wichita Mayor Bob Knight, who led the effort to court low-fare carriers.

Winning Package

Wichita, which was competing with other cities on AirTran's short list, estimated that the entry of a low-fare carrier could lead to annual airfare savings of \$43 million. It worked to come up with a winning package for AirTran. Sullivan Higdon & Sink, a local ad agency, designed for free a "Fair Fares" campaign aimed at galvanizing business support. Air-sickness bags doled out by canvassers to local businesses asked, "Is Your Company Sick of Overpriced Airfares?" TV and radio stations pitched in free air time. As many as 200 local volunteers worked on the effort, many going door-to-door.

Volunteers working from a local call center telephoned 16,000 local businesses, and a direct-mail campaign hit 40,000 companies in 44 Kansas counties to drum up support for the drive. Automation-Plus pledged \$3,000 to the travel bank. Hesston College put up \$12,000, about a quarter of its air-travel budget for the year. Sullivan Higdon & Sink pledged \$15,000.

In late January, Mr. Bell, the airports director, pressed AirTran for a firm commitment. Kevin Healy, AirTran's vice president of planning, who scouts out new markets, said he was impressed, but needed more: A revenue guarantee, preferably from the city.

City officials and AirTran negotiated a \$4.5 million package that ensures the airline about \$3,000 per flight hour for two years. The city sweetened the pot with \$600,000 in advertising support. The original plan was for AirTran to start daily service to Atlanta, where passengers can connect to flights to AirTran's three dozen other cities. But AirTran also added a route to Chicago, which is a major destination for Wichita travelers, grabbing an option the city had planned to pitch to other carriers.

Despite the guarantees, the deals carry risk for both AirTran and the communities offering subsidies. Since AirTran began offering service to Tallahassee in November, Delta has slashed fares, at times undercutting AirTran. Delta, which quit the Tallahassee Chamber of Commerce to protest the AirTran deal, has boosted its capacity between Tallahassee and Atlanta by 35% to 808 seats a day from 598.

Delta spokesman Tom Donahue says Delta's changes in Tallahassee reflect a broader strategy to add flights to Atlanta as it rebuilds after Sept. 11. "Delta competes aggressively, but fairly, against all rival carriers, including AirTran," he says. As for deals cut by AirTran, Delta says it opposes "subsidies and revenue guarantees" because they distort competition.

Two and a half months after AirTran started service in the Florida capital, its revenue lagged behind projections by \$2.4 million, triggering the city's revenue guarantee. In late February, Mr. Healy asked the city to pay its \$1.5 million guarantee, and offered to accept monthly installments of \$300,000 to ease the blow.

City officials remain upbeat. "We're focusing on the positive," says Phil Inglese, Tallahassee's assistant airport director. "Airfares are wonderful."

AirTran's flight into Pensacola has been smoother. The airline in February added a fourth daily flight to Atlanta. Travel-bank supporters are prodding friends and neighbors to fly AirTran to combat Delta's fare-matching. "We have to remind them, 'You like these fares today? They may not be there tomorrow,' " says Belinda Zephir, Pensacola Airport's marketing manager.

In Wichita, the newcomer is already shaking things up. Delta's full fare to Atlanta, which according to airport data was \$1,298 in November 2001, was \$376 on June 5. Fares to Chicago, New York and Washington have taken a similar plunge. The number of passengers at the airport surged 16% in June from a year earlier.

AirTran recently billed Wichita \$732,358 for its losses during May, its first month of operations in the city. The loss was wider than city officials had expected, says Mr. Bell, the Wichita airports director, noting that "the economy is still a little slow." But he adds: "An awful lot of people are very pleased to have AirTran service here."