

## **Reno Air Admits It Needs Partner To Fight Revival of Bigger Rivals**

**By Scott McCartney Staff Reporter of The Wall Street Journal**

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RENO, Nev. -- By most measures, Joe O'Gorman has turned long-struggling Reno Air around in just eight months. Yet by his own admission, that isn't enough to ensure the airline's survival -- and he is out looking for a deal.

After a disastrous first quarter on top of an unprofitable 1997, Reno staged a full house cleaning in February, when all 11 officers were replaced with six executives. Mr. O'Gorman, a retired United Airlines executive, navigated a swift turn toward business travel instead of leisure, and close-to-home Western destinations instead of secondary routes spread coast-to-coast. Reno Air's earnings nearly tripled in the third quarter, after posting a small second-quarter profit, to the best the six-year-old carrier has ever mustered. Costs were down 5.6%, while fares were up 3.6%. Earnings soared over Wall Street estimates, and Reno's shares jumped 31% in one day.

Why then, is Mr. O'Gorman so worried? "Our long-term viability is risky," he says bluntly. "We've never found a niche that works."

### Competition From the Majors

Like many small airlines, Reno faces a difficult future competing against resurgent major airlines, which are forging domestic alliances, taking delivery of new airplanes and squeezing smaller carriers out of their niches.

Thus Mr. O'Gorman would like to sell Reno into a bigger airline. But airline mergers have proved to be difficult to execute and rarely are embraced by labor. That leaves code-sharing, when airlines combine networks by listing each other's flights as their own in reservation systems. "I'm convinced we have to do something with a partner," he said, "simply because we lack some of the things customers want: a network, airport clubs, perks and mileage."

Mr. O'Gorman says he is pounding the partnership trail. He would love to strike a deal with AMR Corp.'s American Airlines, with whom Reno already has some limited marketing ties. American is hungry for the West Coast traffic feed it lost when it closed its San Jose, Calif., hub in 1993. Chairman and Chief Executive Donald J. Carty has said he would love to have a low-cost airline-within-an-airline subsidiary, similar to UAL Corp.'s Shuttle by United, Delta Air Lines' Delta Express or USAirway Group Inc.'s MetroJet.

### Opposition From Pilots

Reno could fill that bill, but not without the blessing of American's pilots. The Allied Pilots Association would veto codesharing with Reno, as allowed under its contract, APA President Capt. Richard T. LaVoy said. "Even though acquisition is expensive and combining labor groups is difficult, for my money, that's preferable to these looser relationships," he said.

Executives from American and Reno say a deal remains possible. One option might be to gradually integrate Reno into American, preserving the cost advantages of Reno's lower-paid workers for a number of years while giving APA protections that its flying won't be turned over to Reno.

"APA is not an obstacle, apparently," one American executive said. "It all depends on how you structure it."

A spokesman for the carrier declined to comment except to say American talks to "lots of people about lots of things all the time." Last week, Reno signed a joint marketing agreement with Canadian Airlines, which is 33% owned by AMR.

Earlier this year, Reno hardly looked attractive to anyone. The airline's operation was experiencing frequent delays and numerous flight cancellations. The reservations system grew so slow that in February, 65% of all callers hung up in frustration before reaching a reservationist.

Costs shot higher, and managers continued to scramble to find new routes that worked. The carrier tried charters to riverboat-gambling towns, and to Jamaica and Cancun, Mexico. Even though its strength was in the West, Reno tried to carve a niche in Gulfport, Miss., flying from there to Atlanta and St. Petersburg, Fla. In all, Reno opened and closed in 19 different cities over six years.

"We were too opportunistic," says Joanne Smith, senior vice president for marketing and planning. "We changed schedules and markets all the time, and never gave markets time to develop."

With losses mounting, Reno lost its bank credit line, and Boeing Co. began demanding the airline begin making cash reserves for maintenance on some leased airplanes.

#### Shift in Strategy

By spring, the new management team had decided the airline's strategy was too scattered and too focused on low-yielding leisure travel. Quickly, Reno pulled out of five cities and grounded three of its 30 airplanes. The company cut its work force by 330 employees, or 15%. It even switched to cheaper peanuts, dropping the cost to 12 cents per passenger from 46 cents.

"We just thought we were a big airline and could spend money," said Bev Grear, senior vice president of operations.

At the same time, Reno beefed up flights from its San Jose hub in an effort to draw more higher-yielding business travelers, and fixed the reservation system by hiring new agents and retraining all workers. The call-abandonment percentage is now in the single digits.

The result was earnings of \$13.3 million, or 78 cents a diluted share, in the third quarter, compared with \$4.8 million, or 39 cents a diluted share, in 1997. This year's earnings included a \$3.1 million gain, or 17 cents a share, on the sale of aircraft.

"They clearly have turned the corner," says Brian Harris, airline analyst at Salomon Smith Barney.

Unlike other small carriers such as Airtran, Midwest Express and Frontier Airlines, Reno flies almost exclusively in low-fare markets, competing wingtip-to-wingtip in the West against Southwest Airlines, Shuttle by United and Alaska Airlines. Competition keeps coming; United's Shuttle announced an expansion in San Jose just as Reno announced its San Jose buildup. If the economy weakens, Reno will face even more pricing pressure, Mr. Harris pointed out.

Mr. O'Gorman predicts the airline will end the year in the black, but won't forecast much beyond that. "We had a big hole to dig out of," he said. "As long as the economy doesn't tank, we'll be OK."

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