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***MIDYEAR INDUSTRY REVIEW  
AND OUTLOOK***

Text of Remarks by  
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I'm pleased to be invited back again. Forecasters like myself unfortunately tend to have one-time appearances, since we're so frequently off the mark, and either are not invited back, or fearful of facing what could be a skeptical audience. Looking back at my notes from last year, I can say I did get it half right. My presentation was entitled, "Recession and Travel: What Lies Ahead." Well, a recession did materialize, and along with it a slowing of travel growth. As for the "what lies ahead" part, less than 60 days after we met the events of 9/11 made all my projections pretty much worthless. But that's all behind us now, and today I want to talk about 2002, and give you a midyear assessment of where we are ... and where we appear to be going, as our industry recovers from those lows of late last year.

## **Our Industry Pre 9/11**

It's best to begin, I think, with a few brief comments about the state of our industry, pre 9/11. As some of you may recall, I indicated last year that a slowdown in industry growth was already underway. The decade of the 90s had come to an end, with records having been set in virtually every travel sector. Domestic and international air travel by Americans had mushroomed by 40 percent. Cruise passenger volume doubled. U.S. hotel sector profits quadrupled, hitting a record \$24 billion in the year 2000. Much of this growth of course was fueled by a boom-boom economy, rising stock market wealth, and the carefree spending of both consumers and businesses. But, like all overly-inflated growth phenomena, there is an end to it, and this came as the new decade began.

Against this backdrop there was then 9/11, and as all of us know, the bottom fell out of travel, and this has been followed by a whole host of negative news -- geopolitical as well as on Wall Street, and in the business community. A friend of mine recently asked ... "why can't we just start this new century over again?"

## **Travel Recovery Progress**

In looking at a wide variety of data, it is clear that with each new month recovery is inching forward, not dramatically, but slowly and consistently. Most all statistical indices are still below year ago, but the deficit is narrowing. Domestic air, on a revenue passenger mile basis, is running 8 percent below year ago. Nationally, hotel room nite demand, which gets an important boost from drive business, is off less, 2 to 3 percent below year ago.

In assessing industry recovery progress, beyond these broad-based indicators, it's important to look at some significant differences in performance by travel sector -- business versus leisure travel, domestic versus international, etc, etc.

What's troublesome is that some of the weakest sectors are tremendously important in terms of industry revenues. Business travel represents an estimated 35 percent of our domestic travel revenues. It remains in the doldrums. Then, there's domestic revenue that comes from inbound international visitors. It too is also down dramatically. These foreign dollars represent 15 percent or more of all travel revenue generated in the U.S. For destinations such as New York City, they're even more important.

So what we have, if one does the math, are two travel sectors representing half of our industry's domestic revenues, and both are a drag on full industry recovery. Will the weaknesses in these two sectors continue? Over the shortterm, unfortunately, I think yes. Let me talk about business travel now, and international a bit later.

### **Business Travel Weaknesses**

A business travel upturn is only going to occur when companies see their earnings outlook improve. Companies will then loosen the tight T&E spending constraints that have been in effect since the Spring of last year. An improved economy by itself is not going to bring a business travel upturn. The economy has already improved, but business travel hasn't. Corporate profits are not keeping pace with the economic rebound. A weak stock market also doesn't help, as it dries up a key source of corporate growth and expansion capital. Business travel does best when companies are expanding, not contracting.

An upturn in business travel is also being hurt by other factors. The airlines have, I believe, done little to stimulate business travel by dealing with the wide disparity that still exists in between business and leisure airfares. Airfares represent 40 percent on the corporate T&E dollar, and high fares are a negative.

Another disappointment is that the carriers seem to be standing on the sidelines as business travelers are subjected to airport hassle and inconveniences associated with new security procedures. In a way, business travelers are saying to themselves: "is this trip worth the time (time involved in travel getting to the airport, check-in time, security and search time); and is it worth the money (high airfares). Time and money. It's pretty basic.

### **Leisure Sector Strengths**

The leisure sector indeed looks a lot better, both in terms of year-to-date recovery and its prospects in the months ahead. Up to now the consumer has demonstrated amazing resiliency in the face of domestic terrorism warnings, unrest in the Middle East, recession and job layoffs, church scandals, corporate accounting abuses, and the sharp declines on Wall Street.

Through these events, consumers on Main Street continue to be optimistic about the future, and have continued to spend. What has changed, however, was how and where they are spending their time and money. Both have become home-centered. It can clearly be seen in data reported for residential home sales, home furnishings, and in home improvement sales that ring the cash registers of Home Depot and Lowes. Two-third of Americans are homeowners. In the three quarters since 9/11, real spending for consumer durables is running a strong 8 percent above year ago, 4 times the rate of increase in spending for all other consumer goods and services.

Shifts in travel are following the same pattern. Though the term has now been grossly overused, "close-to-home" drive travel is the overriding theme for the leisure market in 2002. Travel marketers have been astute in seeing this and taking advantage of it wherever possible.

Carnival, with six cruise brands, now has 19 different domestic drive to ports of embarkation along the East Coast, Gulf and West Coast. New business from drive to ports will help boost cruise passenger counts above year ago. Hyatt, this winter, promotes "Hometown Getaways"; Mexico, now "closer than ever." Here in New York, NYC & Company successfully shifted its focus to its own "close to home" regional market. California, in realizing that 85 percent of its tourism income comes from state residents, pulled its out-of-state advertising and launched an in-state campaign.

Walt Disney World tourism interests recognized that it was in the center of the nation's fourth largest state, with a 16 million population, and has offset declines in out-of-state air arrivals with in- state drive visitors. Las Vegas, whose air visitor counts are down 8 percent, has offset these with a 12 percent increase in auto visitors. As a result, total visitor counts year-to-date are down only a modest 2 1/2 percent.

The Caribbean and Hawaii don't have the benefit of drive market business, and their arrivals are therefore down more sharply. The lessons here, I think, are that sometimes we take our local and regional markets for granted when they can be the primary source of visitor volume. Companies such as Six Flags, with 28 regional theme parks, understand this. So do the new gaming operators: the midwest and Gulf riverboat and dockside sites, the Indian casino sites, such as Foxwoods and the Mohegan Sun complex, smack in the middle of the populous Northeast corridor. These new and glitz-filled regional tourism products all represent more competition for the traditional more laid-back lake, beach and mountain vacations.

I believe that this "close-to-home" phenomenon is not a shortterm one, tied to economic factors and consumer travel budgets. The consumer is doing just fine. They haven't cut their spending, but rather changed their spending patterns.

## **The Travel Anxiety Syndrome**

In the troubled and uncertain world that we now live in, I think we're going to see a continuance of what has triggered the "close-to-home" travel phenomenon. I call it a "travel anxiety syndrome" ... apprehension, worry, and, to many, fear of being away from the security of one's home and family. It's a complex set of attitudes, perhaps different for each of us: ... fear for our own safety, worries of being stranded and away from loved ones, or apprehension that makes it difficult to enjoy a vacation when burdened by these kinds of worries and concerns.

I'm not a psychologist, but I do know that human emotions and attitudes are a far more powerful influence on consumer behavior than economic factors. I do hope that our national leaders in Washington start to recognize this and not focus just on how to fight terrorism, but how to live with it. Travel cannot prosper in an environment of apprehension and fear. In such an environment, there's the risk that "close-to-home" patterns will revert to "stay-at-home" patterns.

## **International Travel**

International travel is obviously most impacted by geopolitical factors. As I mentioned earlier, inbound arrivals continue to be weak. Though the major foreign currencies have strengthened against the dollar, this has occurred only in the last few months, too late to give a boost to the inbound markets. Over the longer term, the situation will probably be different. Most analysts believe that the dollar is now beginning a longer term downward movement against the Euro, Japanese yen, and other currencies. For travel, historically, this has meant a stimulus to inbound travel, and a weakening in the outbound market. Over the 1985-95 period, when foreign currencies were increasing in value, inbound arrivals tripled. But by 1995, when the dollar began its rise, outbound travel mushroomed while inbound growth slowed.

In spite of historical dollar economics, I think over the long term the outbound market will be less affected this time by a weaker dollar ... for a couple of reasons. First, the number of higher income prospects are growing. The top 20 percent of U.S. households now control half of all income. A high proportion of these are in the 45+ age group, the prime prospects for international leisure travel. In terms of numbers, this age group will grow by a quarter over the 2000-2010 period, while the 25-44 group shrinks in size by 5 percent. Outbound European travel accounts for about half of overseas travel by Americans and, unfortunately, it appears that this year is a write-off, except for VFR and special interest destinations. I'm told that bookings from the sizable number of "wait-and-see" prospects just didn't materialize, as many had hoped they would in May and June.

The softness in outbound air sales is taking its toll on travel agents, with their year-to-date international dollar volume down 12 percent. With commission losses and the strong gains reported by on-line agencies such as Expedia, Travelocity, and now, Orbitz, the number of brick and mortar travel agency locations continue to decline. Since January of 2000, 5,500 agency

locations have been closed, a dramatic 20 percent decline. The challenge for travel suppliers clearly is how to get more volume from fewer agencies.

## **Net Conclusions**

As we look ahead to the second half of the year, all the numbers will look better, as they'll be compared against a weak prior-year basis. For 2002 as a whole, when the final aggregates are in, we'll still be below the highs reached in that very good year ... the year 2000. I estimate that we will have recovered almost all — 95-97 percent — of domestic trip volume, but still only 90 percent or so of international business.

Well, we've covered a lot of ground with some good news, bad news, but more uncertainties. I've talked perhaps too long about external factors that are impacting our business. That's because never in my time in this industry have I seen so many external variables have so much of an impact on us. In dealing with these external uncertainties, I think our industry has done an admirable job this year, though recovery is still not yet complete.

The industry has weathered a financial storm. With the exception of the airlines this year, most will still earn reasonable profits as a result of cost-cutting and finding close-to-home replacement markets to offset declines in far-from-home source markets. The consumer is in good shape. Though there are some recent signs of consumer spending cutbacks, consumers will still travel. An upturn in business travel may have to wait a bit longer.

In terms of strategies, close travel supplier scrutiny of costs has to continue, until the recovery is on firmer ground and pricing has improved. Weaknesses in travel pricing have done as much or more damage to suppliers' profitability as has the fall-off in travel demand. And, strategies that focus on one's core markets should continue to be given priority-- whether they be core geographic markets or customer segments such as your frequent travelers. It's not yet the time to be searching for new prospects, or opening new markets, or venturing into the unknown.

Hopefully, by year end, industry recovery will be further along, and we can then look at 2003 as a year when growth will resume again. But this will be in a very different environment, where our skills in dealing with external variables will be a key determinant of success.