



# **Some similarities but also real differences**

## **Opportunities and Challenges**

Chris Tarry

51<sup>st</sup> AACO AGM

Cairo

6<sup>th</sup> November 2018

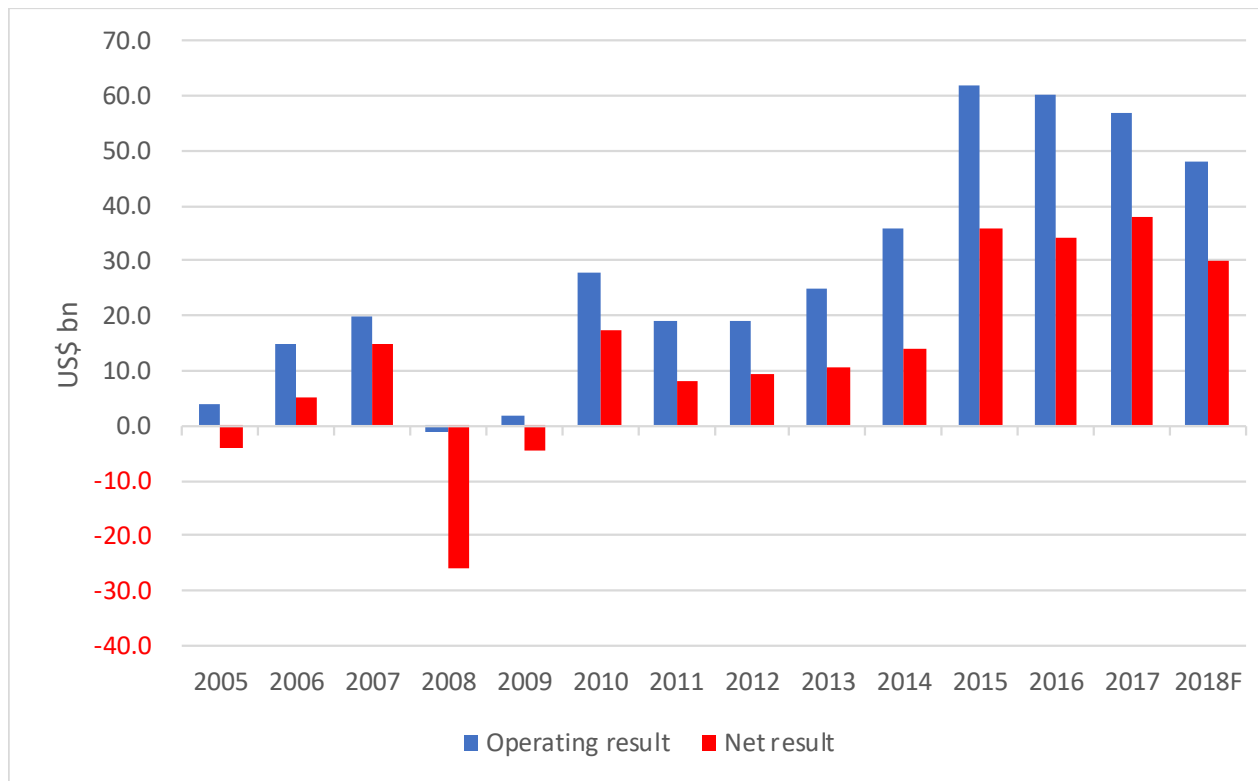


## Issues for consideration

- The operating environment and outlook where, amongst other things, there are:
  - Near term declines in prospect for advanced economies
  - Apparent disconnects between stock markets and the real economy
  - Intensifying trade wars with their direct and indirect impacts
- Strategic and structural issues and consequences which include:
  - Maturing markets and responses
  - Model convergence and
  - New operating models
  - Consolidation
- What do these, and some other factors, represent in terms of opportunities and challenges for AACO's members?



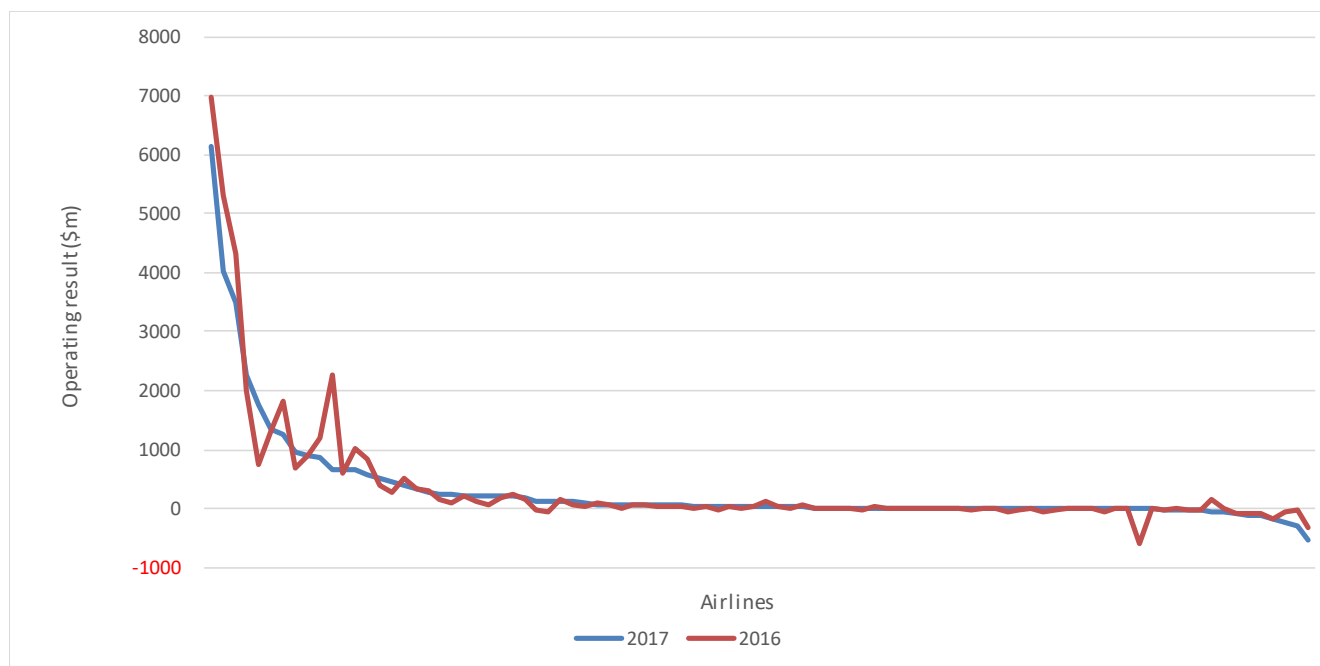
# Industry financial performance



Source CTAIRA estimates (FY 2018) and IATA data (2005-2017)

- Outlook is increasingly challenging and significant “downside risk” with an inevitability of a materially lower result for 2019
- An excess of ROIC over WACC is company specific and not transferable across the industry

## A wide range of outcomes



Source CTAIRA and Company data

- For most managements a positive outcome is something slightly better or less worse than the previous year
- Not always about the financial performance given the importance of connectivity and the economic value generated
- However there may come a point for public owners when sustaining the financially unsustainable is no longer possible and a new approach is required which may also need regulatory change

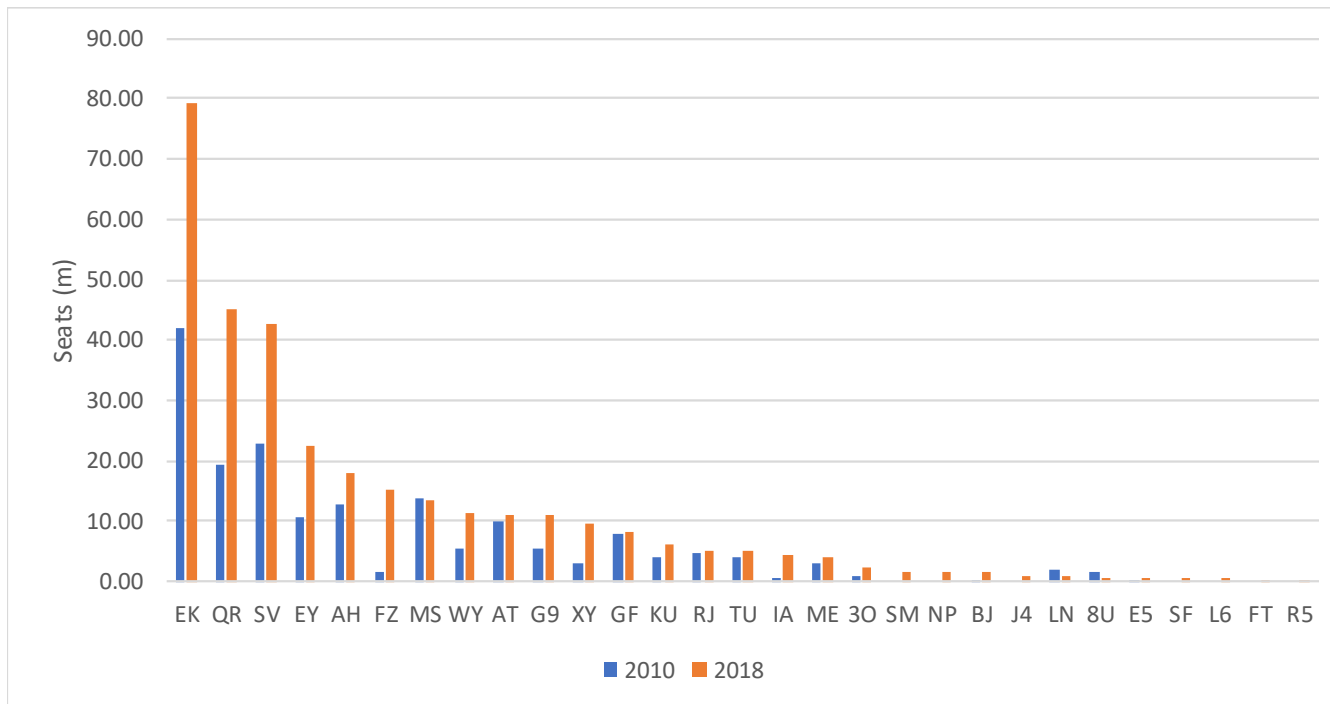


## Generalisations are always dangerous

- There is a need to focus at the level of the individual companies where there are:
  - Industry wide/macro factors
    - Fuel – Up by 32.3% over the last 12 months
    - Non-fuel costs – up 5% per year since 2009
    - US \$ - expected to strengthen further in both absolute and relative terms
    - Capacity – Industry seats up by 5.6% (ASKs 7%) in 2018 ; AACO seats up by 1.2%
    - Economic - Global economic growth likely to slow more quickly than expected
    - Structural change and in particular the competitive consequences
    - Regulatory change – trend continues towards more open markets
    - Event related disturbance/dislocation - regional issues including Brexit
  - Company specific factors
    - Market focus and exposure determine impact of industry wide and macro factors
    - Internal
    - Event related
- What then might it mean?



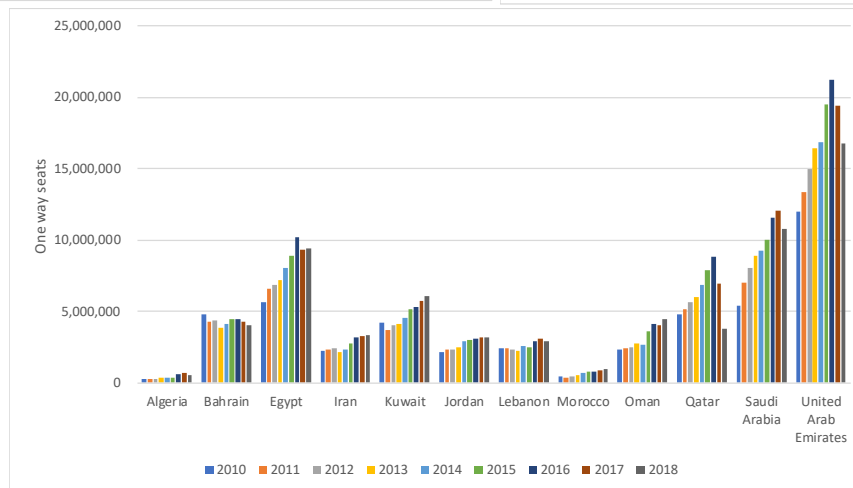
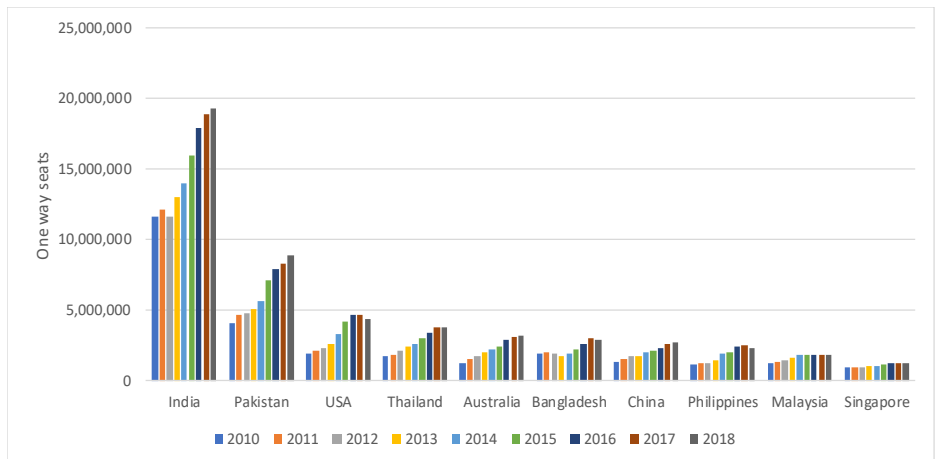
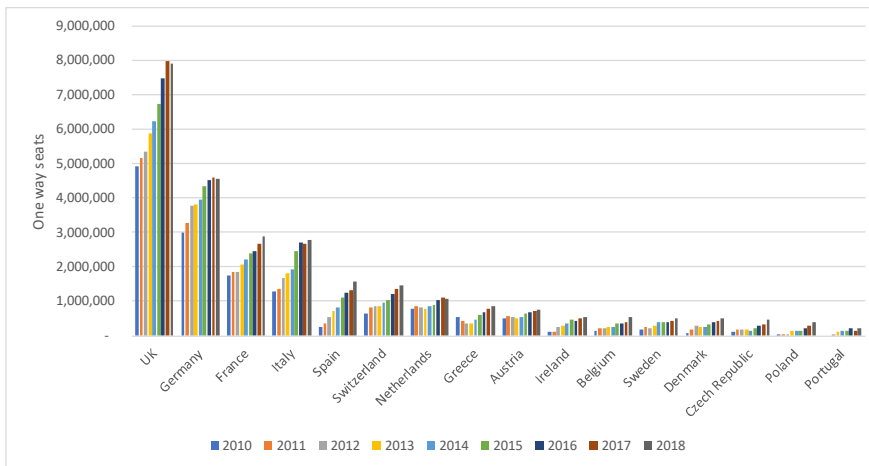
# The need to recognise differences



Source: CTAIRA from Capstats data

- Not just in terms of size but also focus (domestic/international, point to point and flow traffic) – whilst there may be some common challenges, others will be airline specific – as in fact are the opportunities.

# Market dependence – “Middle East group”

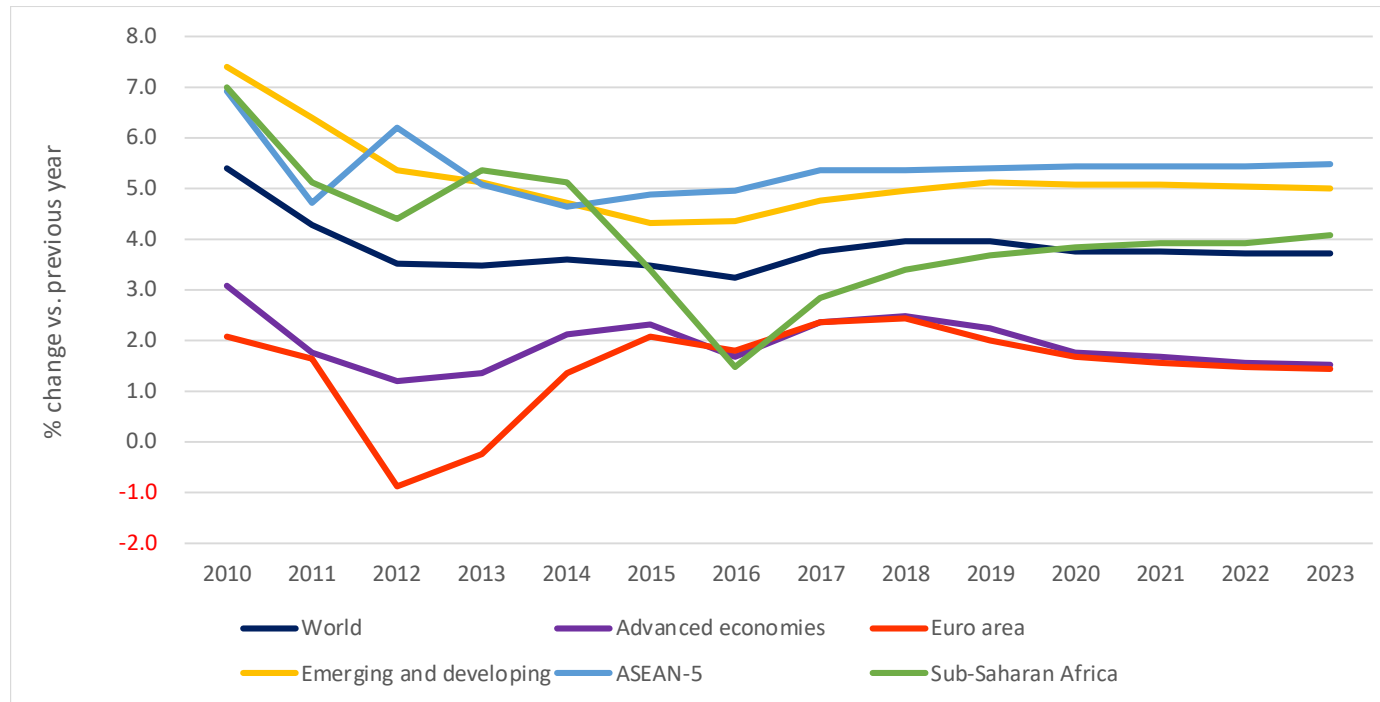


Source: CTAIRA from Capstats data

- Materially different market determinants and traffic types, by purpose ultimate destination and source and origin



# GDP outlook – challenge rather than opportunity



Source: CTAIRA from IMF data

- Perhaps understating the reality of a sharper downward adjustment
- Recent stockmarket falls should be seen as a “leading indicator” for the “real economy”
- Average for AACO member countries 2018-2023 3.3% a year - but a wide range





# The US dollar – challenge rather than opportunity



Source Federal Reserve of St Louis

- Relative economic strength and further rises in US interest rates will cause it to strengthen further in both absolute and relative terms



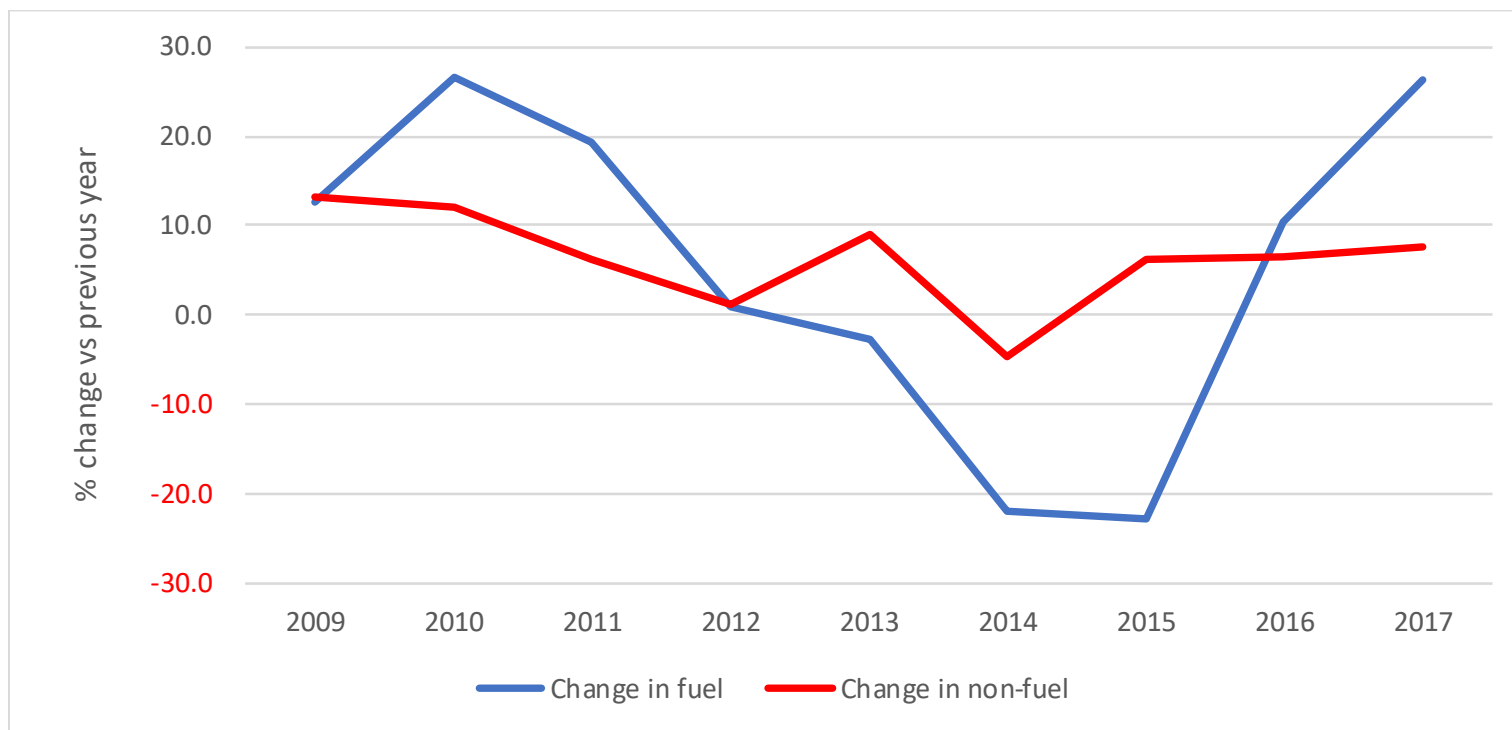
## Fuel – a real challenge



Source: CTAIRA from EIA data for Gulf Coast

- General expectation higher still into 2019
- Whilst negative for airline costs and on the purchasing power for most, clearly GDP positive for the economies of some AACO members – the outcome depends on exposure.

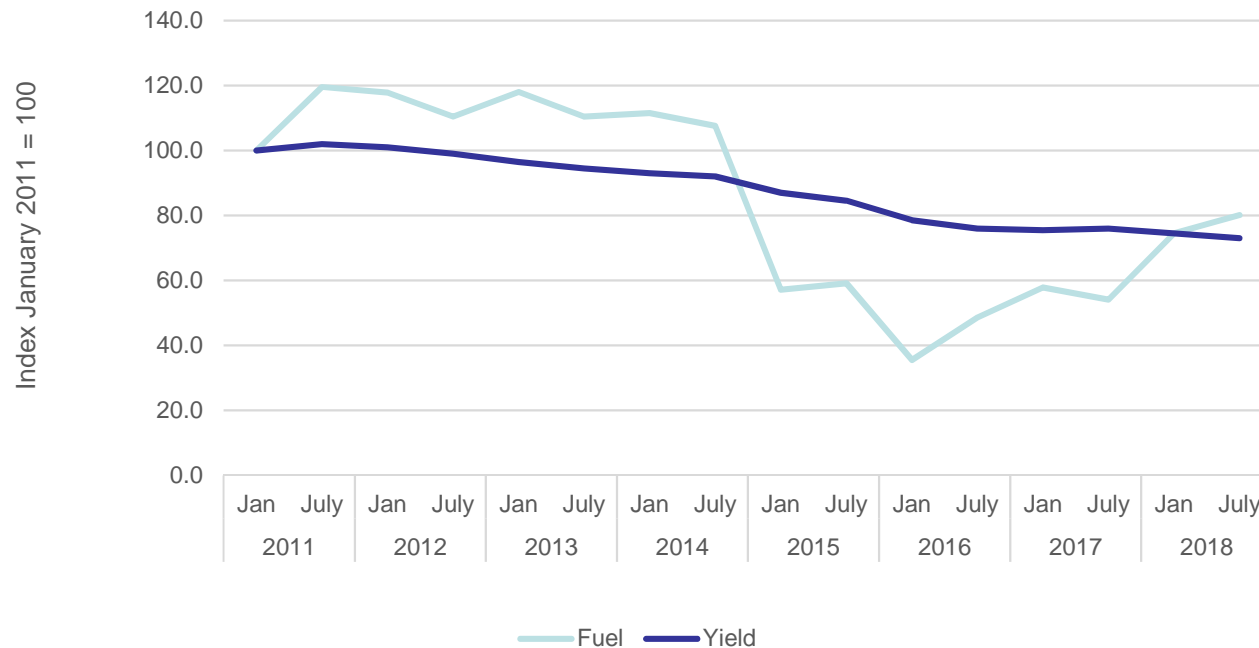
## Costs – not only about fuel now



Source CTAIRA and IATA data

- Average rate of increase in non-fuel costs 5% p.a. since 2009
- Fuel up 33% over last twelve months

## Yields and fuel



Source CTAIRA from IATA data

- Inexorable decline in yield - initially fuel price fall ameliorated yield decline
- Since January 2016 fuel prices have risen but yields continue to fall
- Ability to pass on fuel price rises is market and indeed route specific

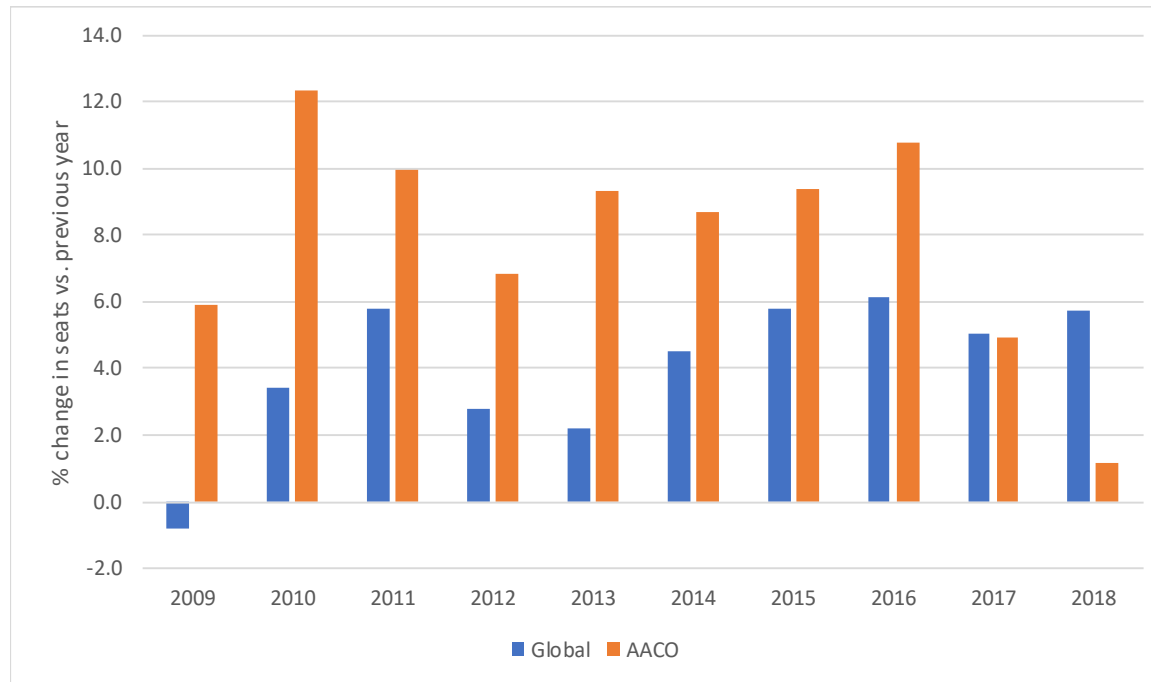


## The issue of event related disturbance

- Generally an external event which has a demand impact
  - Most recently in evidence through
    - Regional disputes
      - No fly zones and a need to redeploy capacity
    - Brexit
      - Economic and perhaps access issues – but impact a function of dependence on the UK as a source market given impacts on GDP (perhaps 0.5%-1.0% off the growth rate) and the value of the £.
      - Gulf capacity and resulting “value prices” has resulted in some moves away from traditional sun and sand destinations for UK leisure travellers but can only be at “the margin” – a clear demonstration of how economics works.



# Industry and AACO member capacity changes

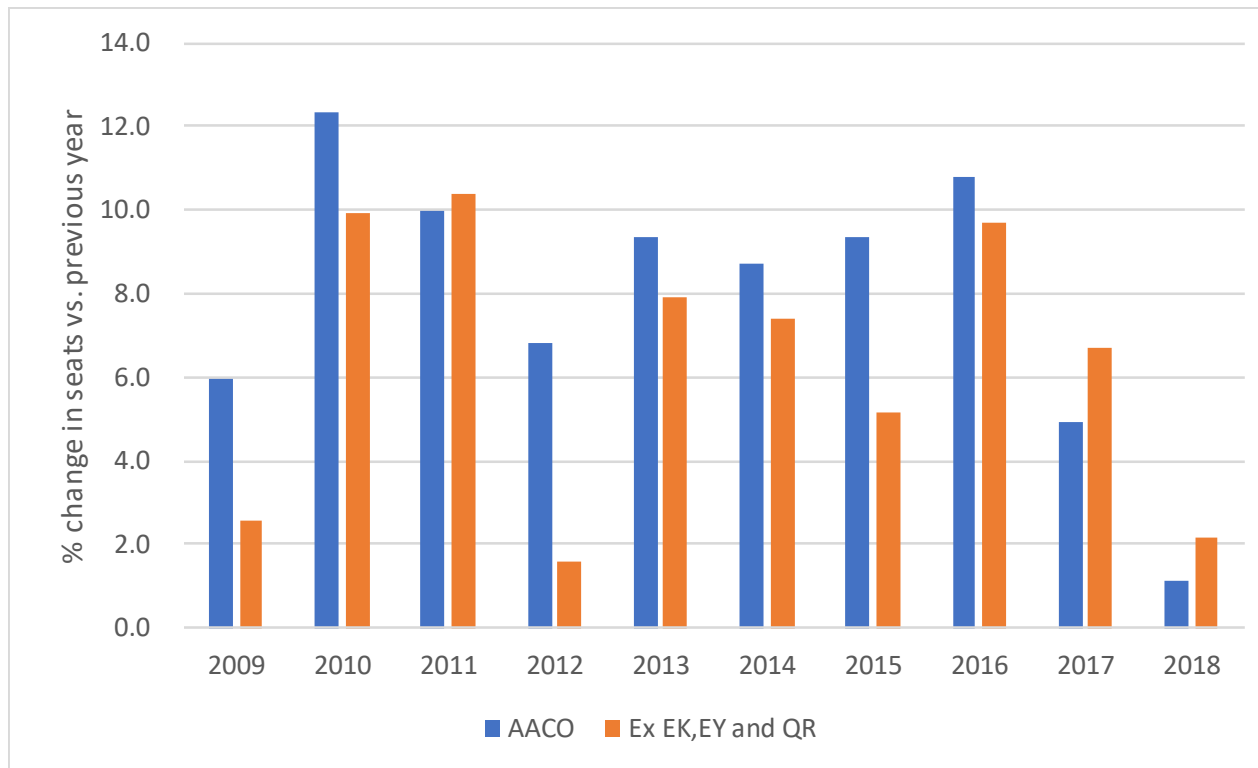


Source CTAIRA from Capstats data

- Significantly greater than the industry until 2017 but a reversal since
- The rules of economics apply to the airline industry just as any other.
- Across the industry clear signs of “over delivery” into a downturn



## Behind the headlines



Source CTAIRA from Capstats data

- Size distribution of AACO airlines highlights the need to move away from generalisations
- Below this a wide range of variation and also need to consider absolute changes
- A sign of a switch from volume to value or for 2018 an impact of capacity redeployment?



## **Structural change – challenge or opportunity?**

- Market disruptors including LCC long haul
  - “In market” opportunities as well as traffic diversion
- Maturing “demand aggregation” models
- Consolidation
  - Merger opportunities
    - In country?
  - Portfolio approaches?
    - Examples include: IAG, Singapore Airlines, Emirates/flydubai
    - Opportunities involve: “Product” and geographic diversification or both?
- Pan Regional models
  - Already present but considerable scope to grow
- Virtual models
  - Providing connectivity and realising the necessary economies of scale





## Concluding observations

- Key ongoing challenges result from
  - Economic outlook in source markets
  - Fuel price direction
  - Strength of US\$
  - Capacity overall but chiefly deployment decisions of competitors
- Principal areas of opportunity
  - Consolidation
  - Increased reach and access – but “regulation dependent”
- Near term outlook appears to be more challenge than opportunity, although for some both challenge and opportunity, where responses and outcomes will of course depend upon the starting point and the ability to respond.



**CTAIRA**  
THE SPECIALIST AVIATION CONSULTANCY

CTAIRA Limited

[Christarry@ctaira.com](mailto:Christarry@ctaira.com)

[www.ctaira.com](http://www.ctaira.com)

+44 1892 520207

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