



The economics of airline financial performance and wider economic benefits

6th April 2018, Paris

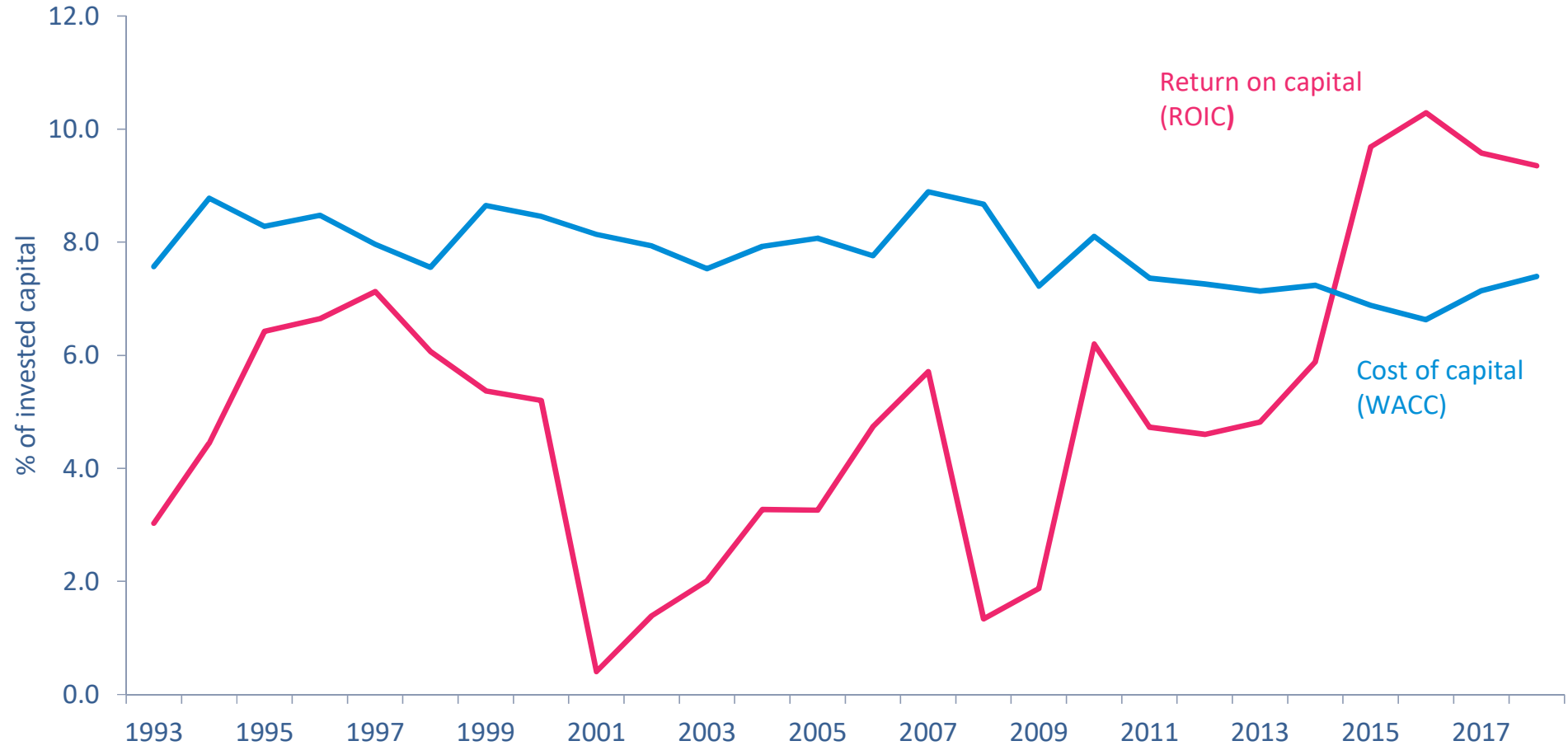
Brian Pearce,
Chief Economist, IATA
www.iata.org/economics

Outline

- Why is the airline industry suddenly profitable?
 - After decades of investor capital destruction
 - Is the change widespread?
 - Have the underlying economics of the industry changed?
 - Why is the emergence of protectionism such a threat?
- How does air transport bring economic benefit?
 - Users
 - Wider economic benefits
 - Come from the people, goods, capital and ideas we carry between cities
 - Rather than the jobs required to run the service (with some exceptions)

Airlines have suddenly become profitable (for their equity investors)

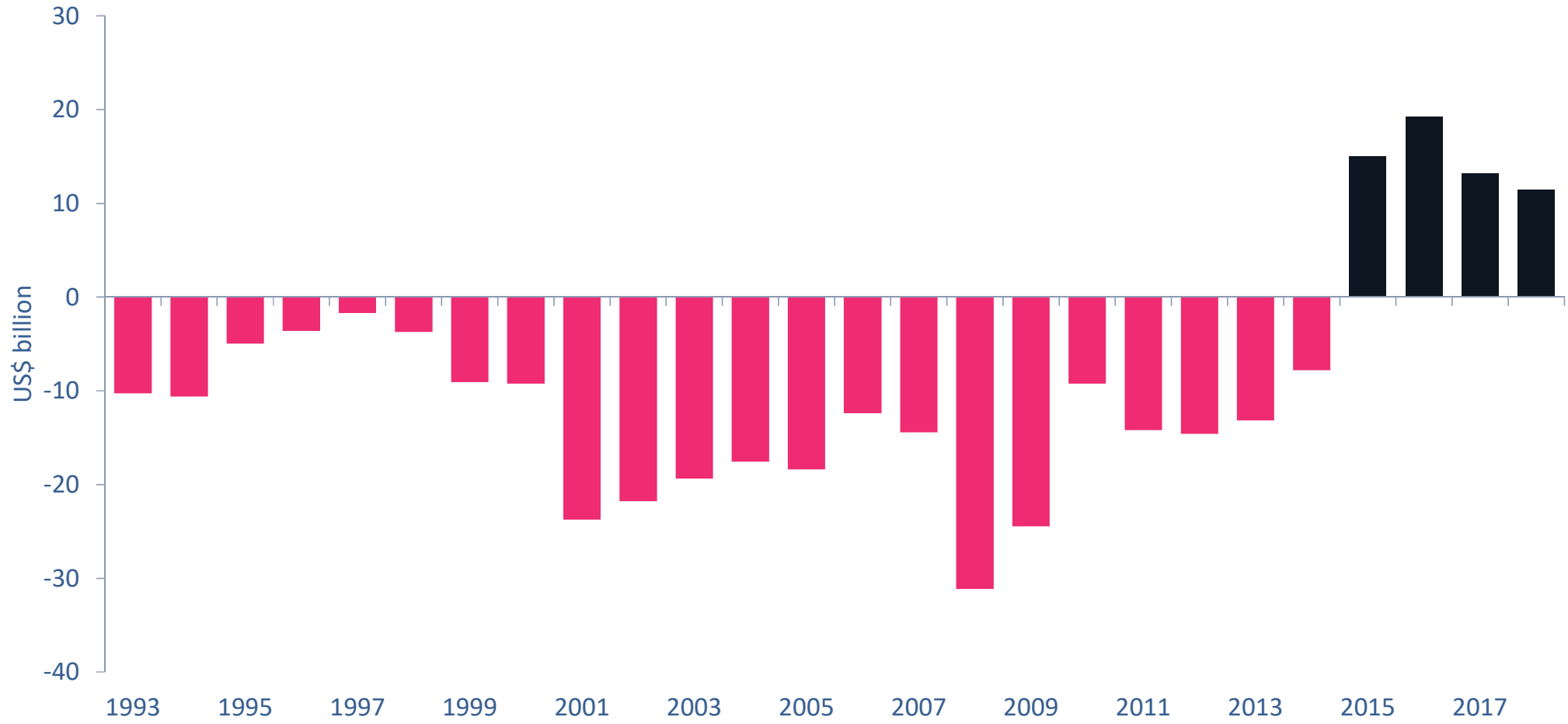
Return on capital invested in airlines and their cost of capital



Source: IATA Economics using data from McKinsey, The Airlines Analyst, IATA forecasts

After decades of investor value destruction

Difference between investing in airlines and investing in similar assets elsewhere



Source: IATA Economics using data from McKinsey, The Airlines Analyst, IATA forecasts

And widespread airline failures

European LCCs



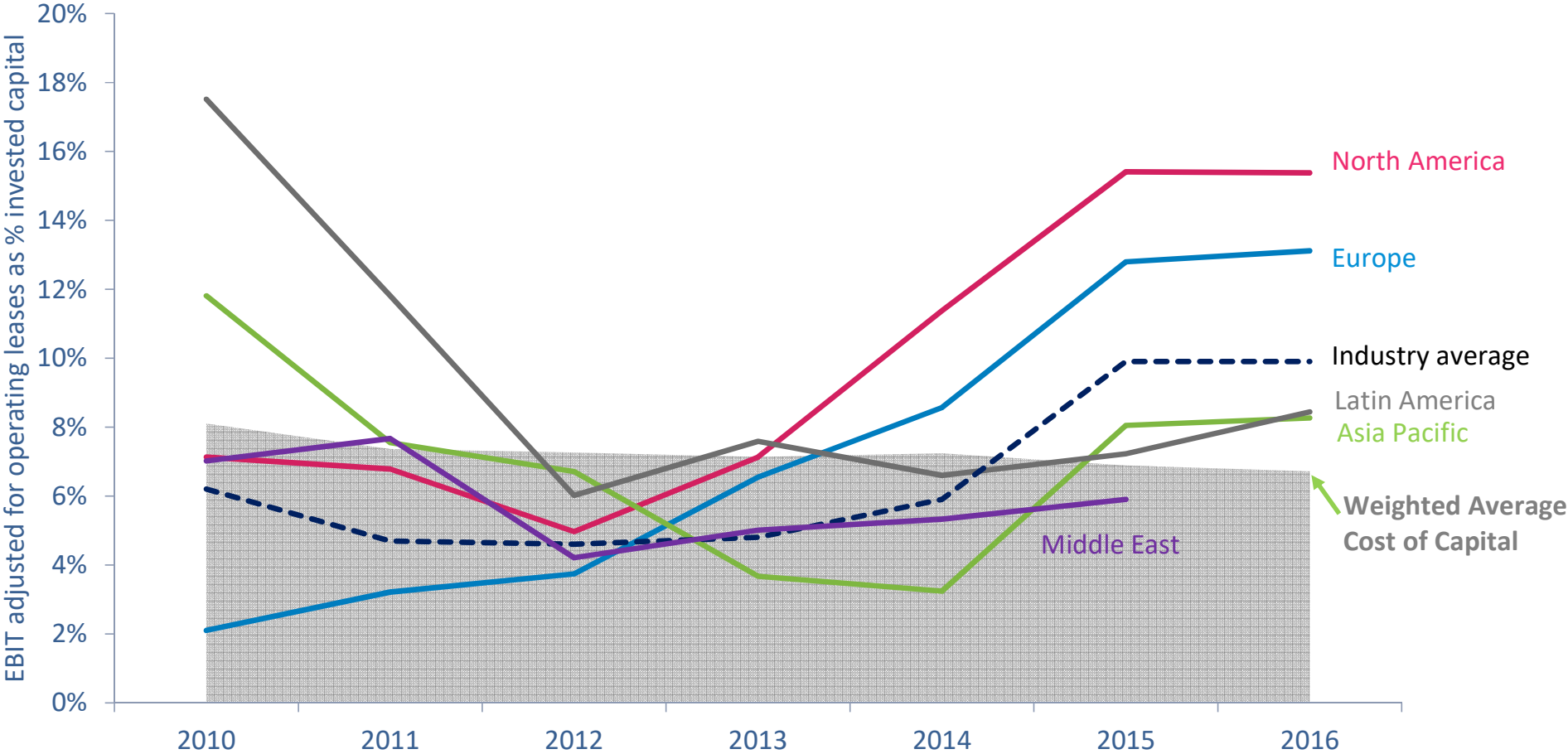
Failed

Survived

Source: HSBC report – early 2014 situation. Since then Monarch and airberlin have failed

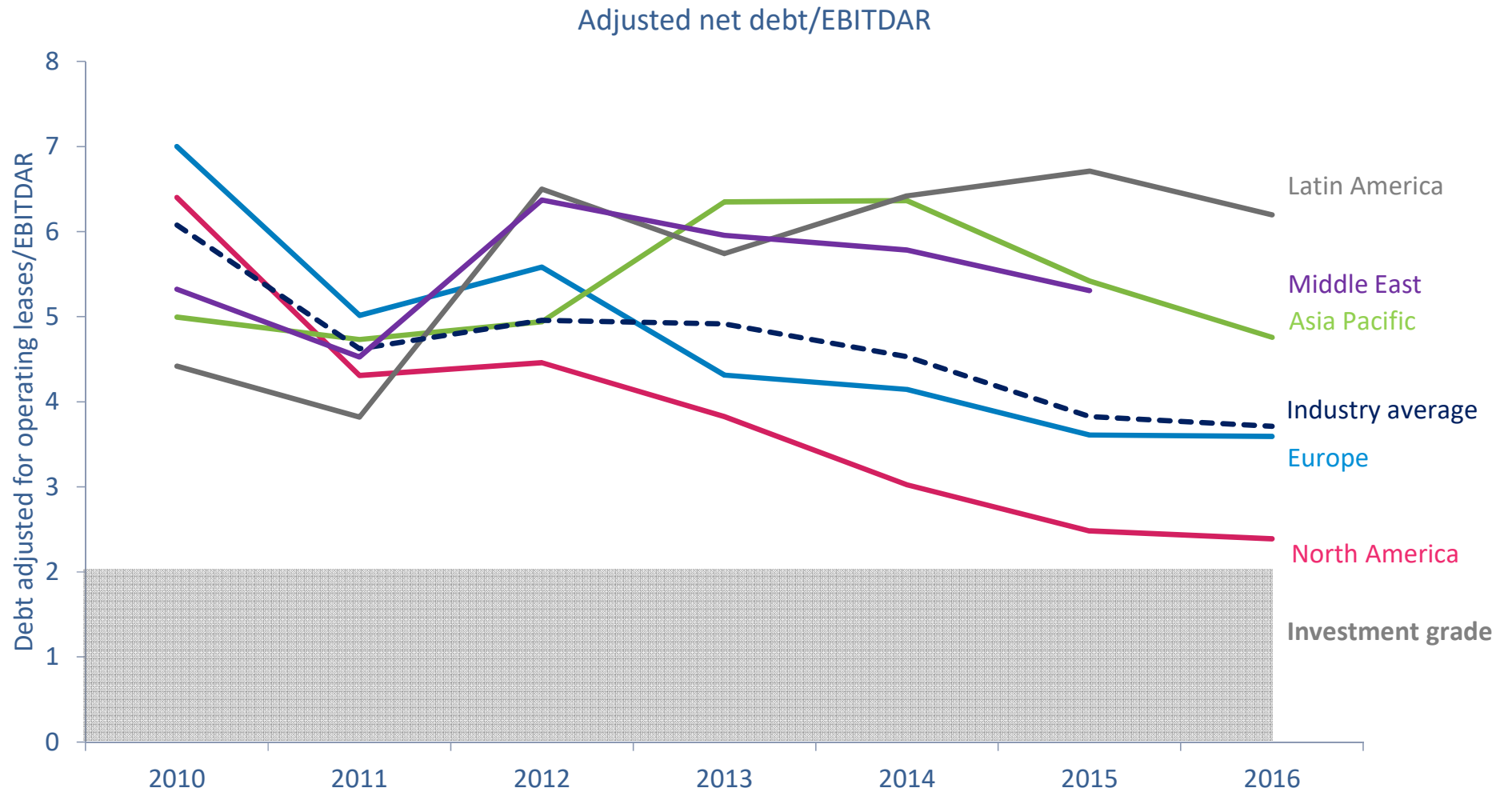
But improvement has been very uneven across the industry

Return on invested capital



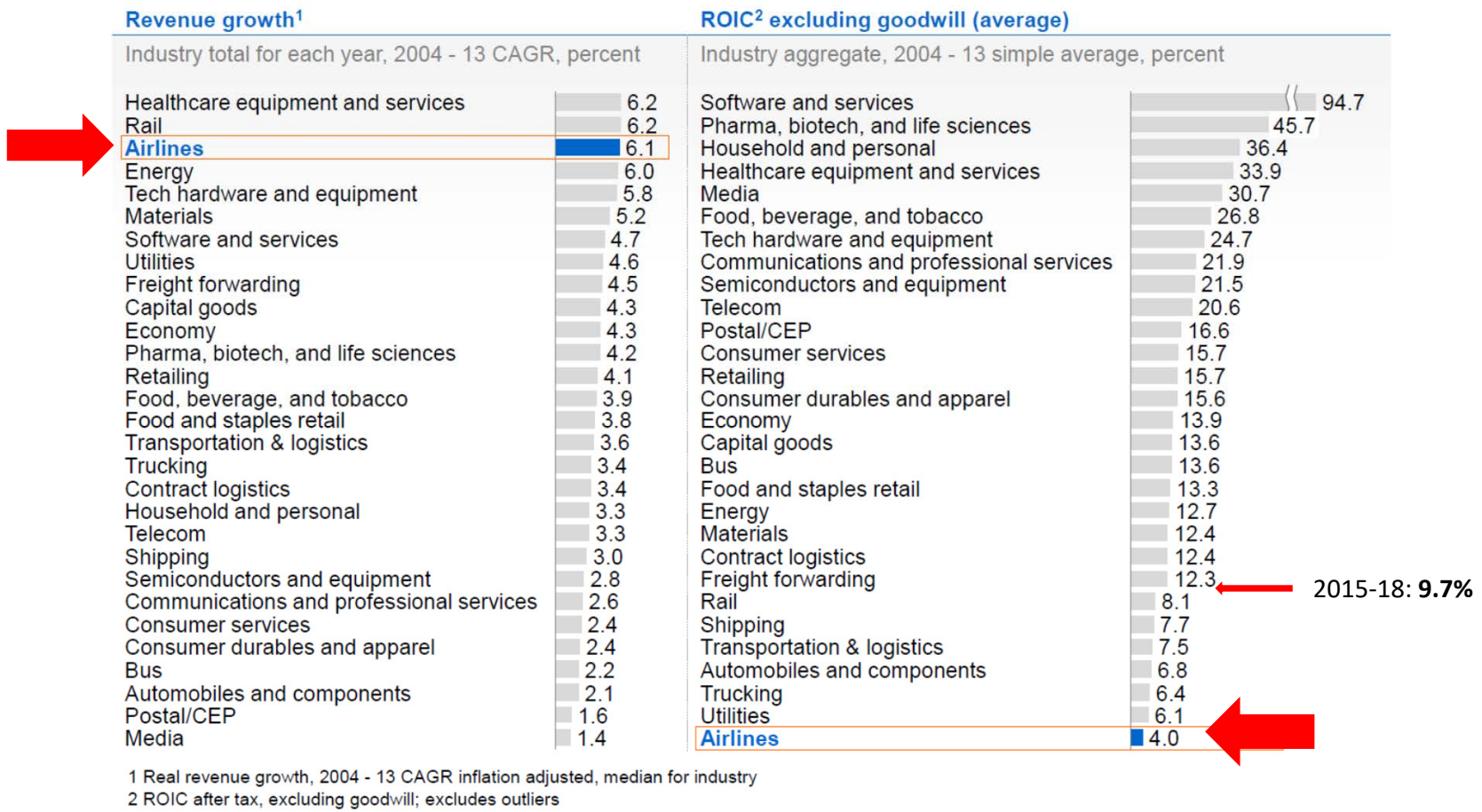
Source: IATA Economics using data from IATA and The Airline Analyst

Balance sheets remain highly leveraged in some regions



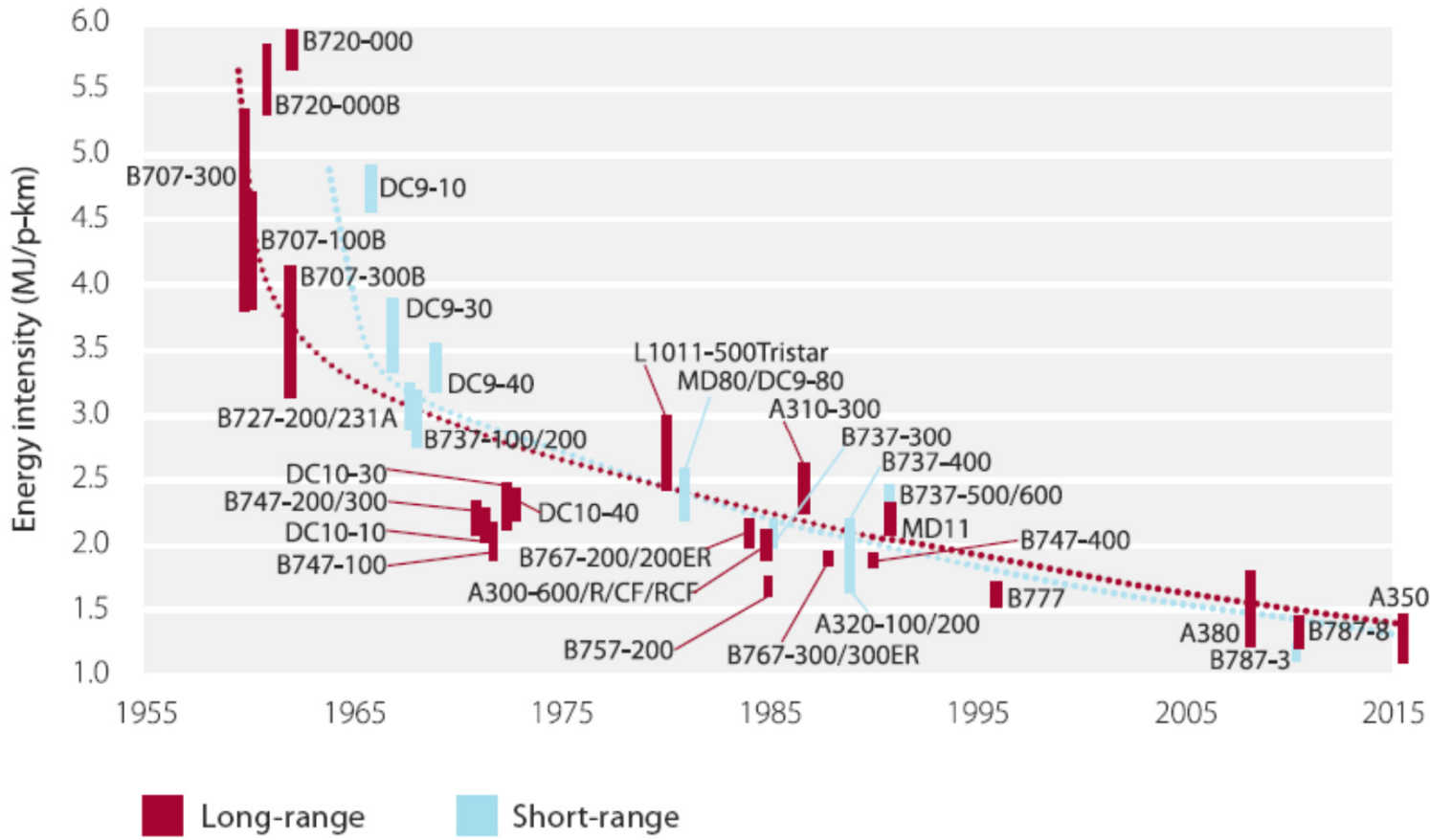
Source: IATA Economics using data from The Airline Analyst

There has always been a paradox at the heart of air transport



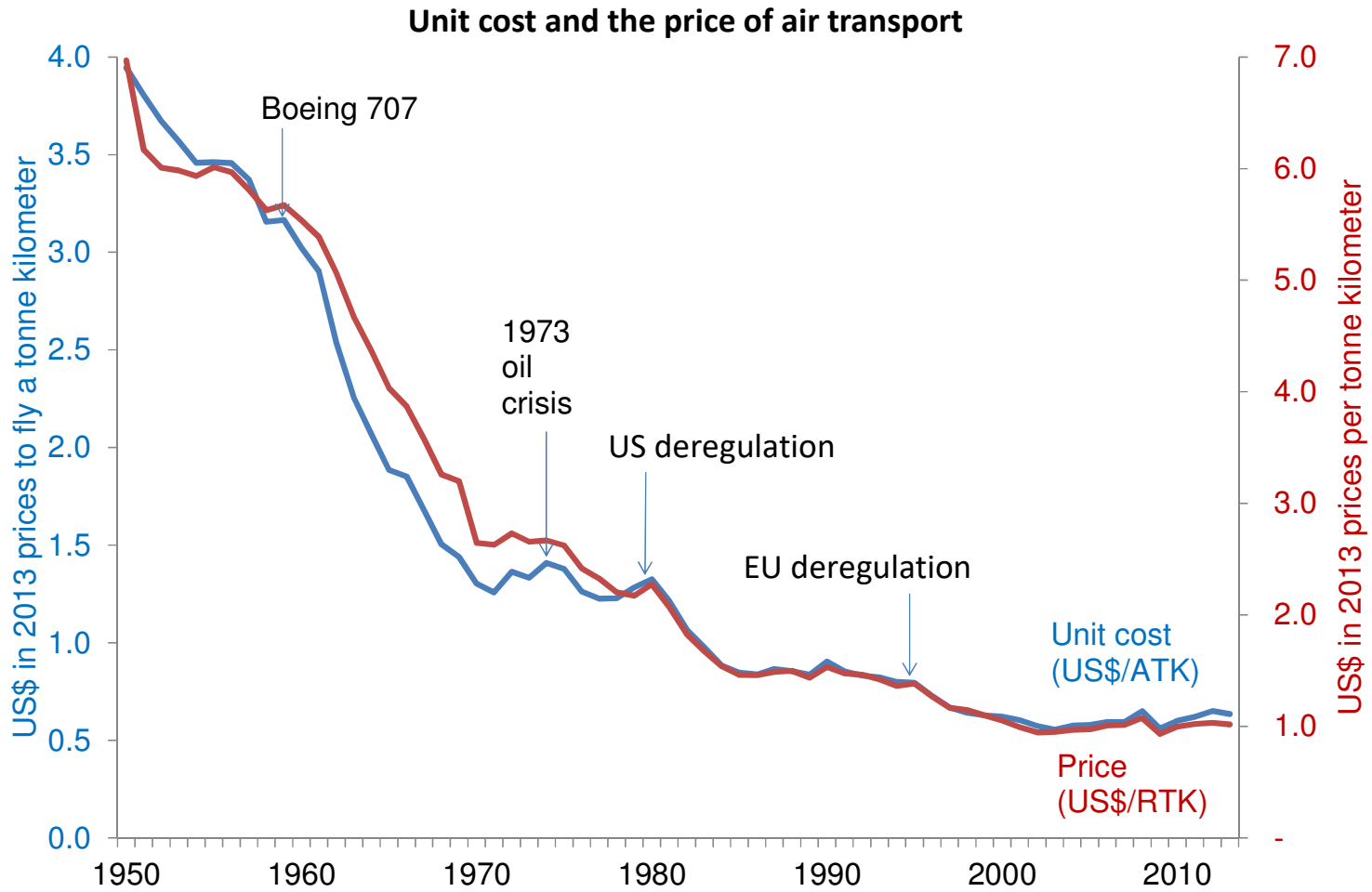
Source: McKinsey presentation to IATA

Technology continues to cut costs dramatically



Source: Lee

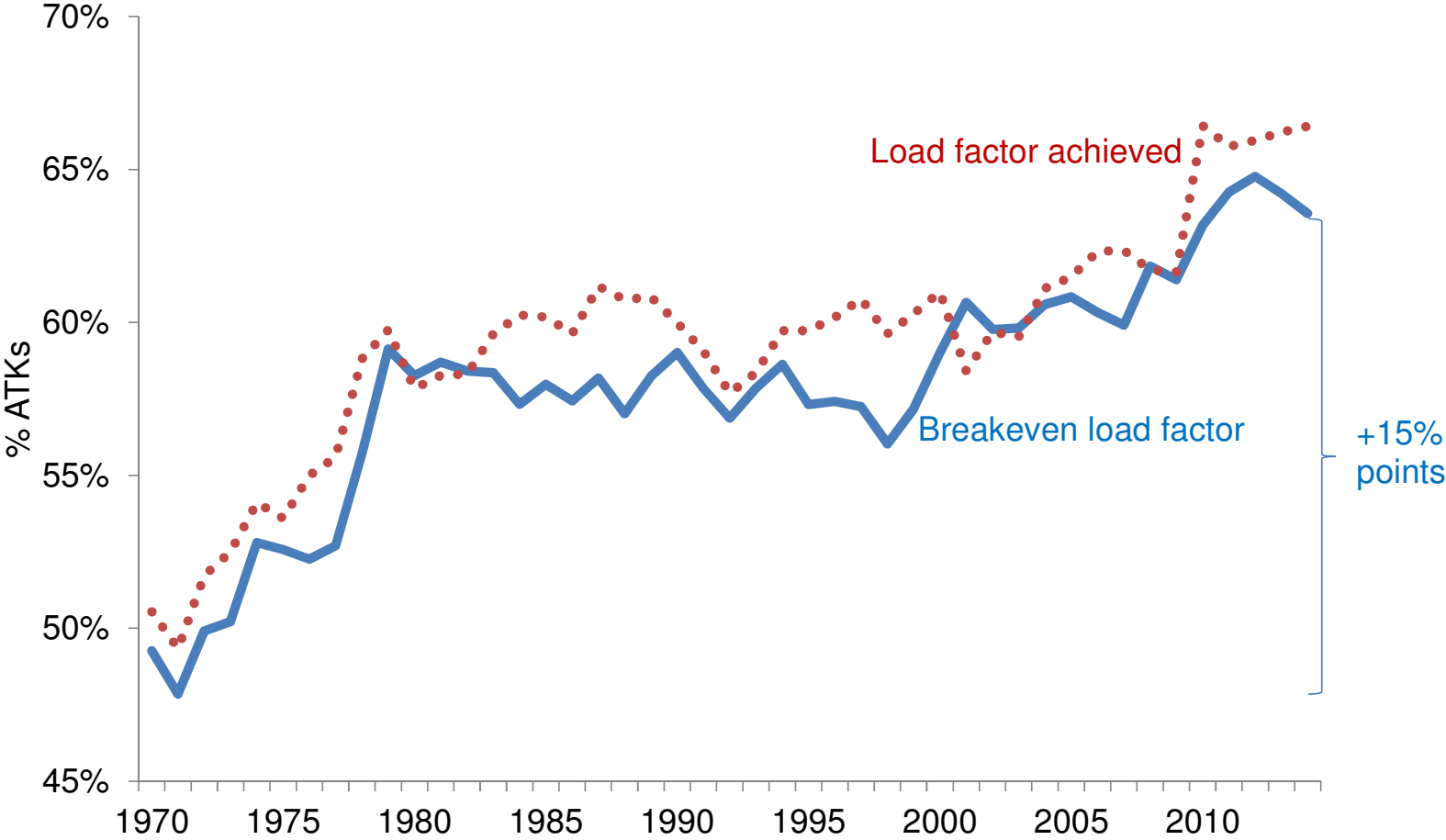
Typically airlines pass all gains through to consumers



Source: IATA Economics using data from ICAO and IATA Statistics

In fact prices have fallen further than costs forcing up breakeven loads

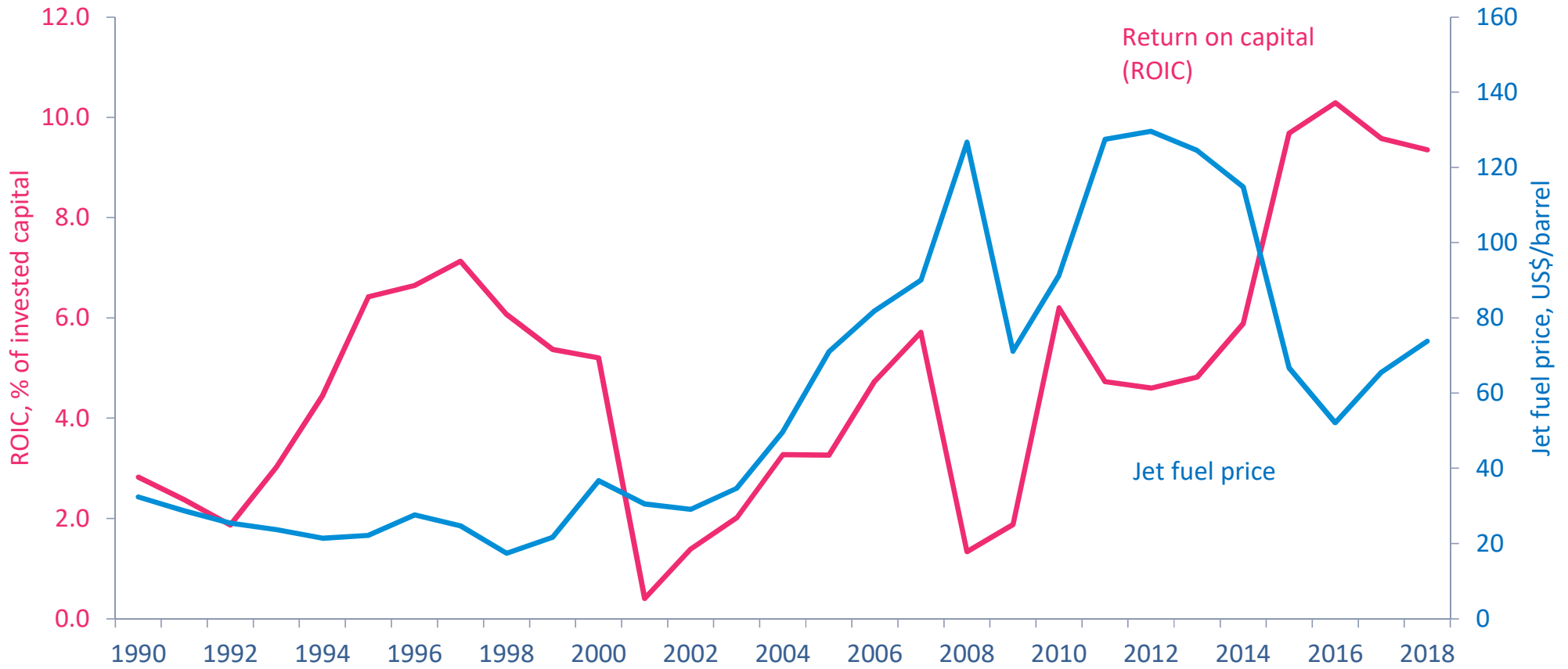
Breakeven and actual load factors



Source: IATA Economics using data from ICAO and IATA Statistics

Have industry economics changed or is it just low fuel costs?

Airline industry ROIC and jet fuel prices



Source: IATA Economics using data from McKinsey, Platts and own forecasts

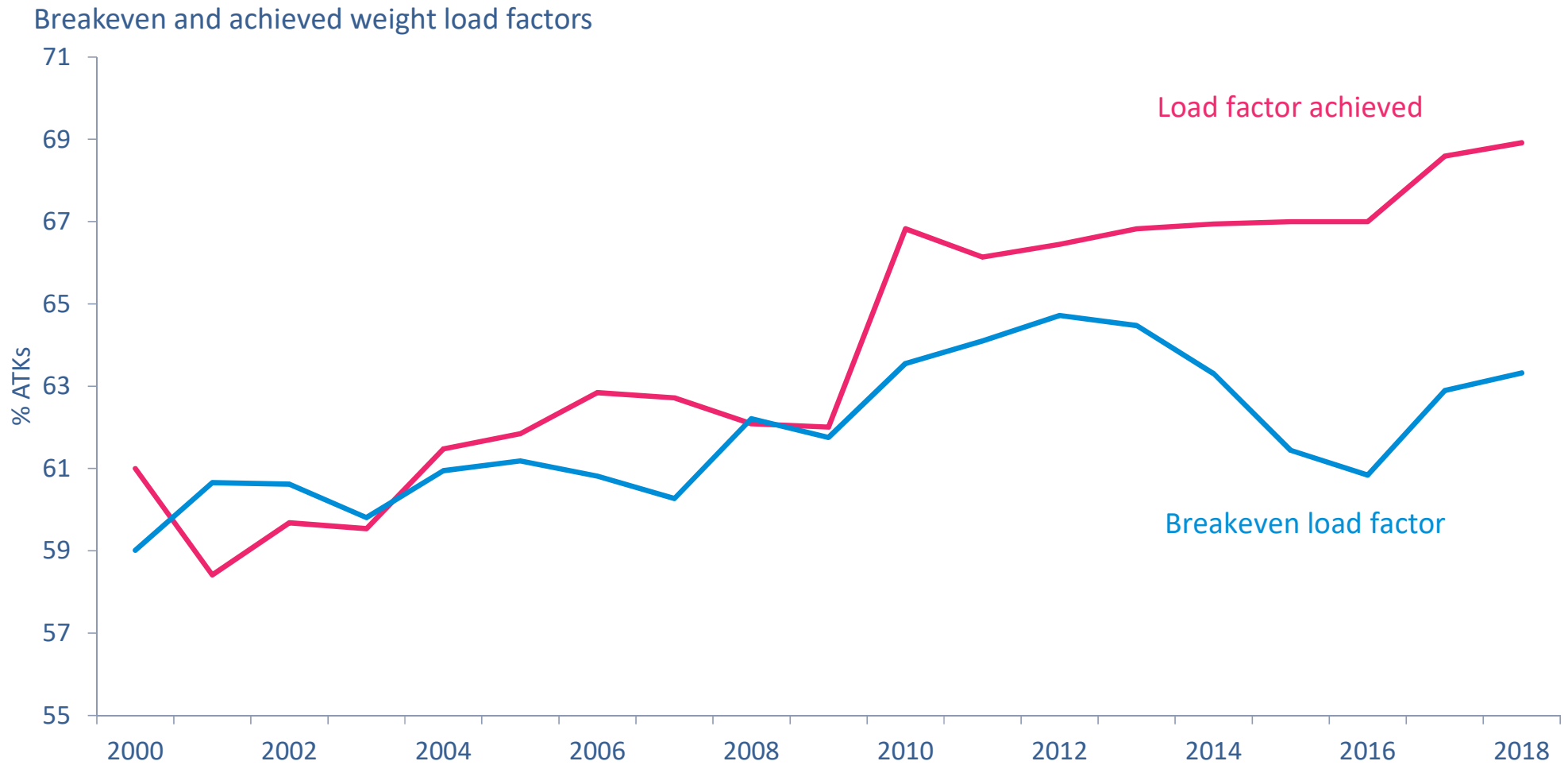
The underlying economics of air transport

- Perishable
- Fixed costs high
- Barriers to entry low
- Competitive advantages hard to defend
- Aircraft are a platform to serve many markets
- Economies of scale in aircraft size but business travelers want frequency and flexibility
- Few scale economies in fleet size but economies of density in networks

OUTCOME:

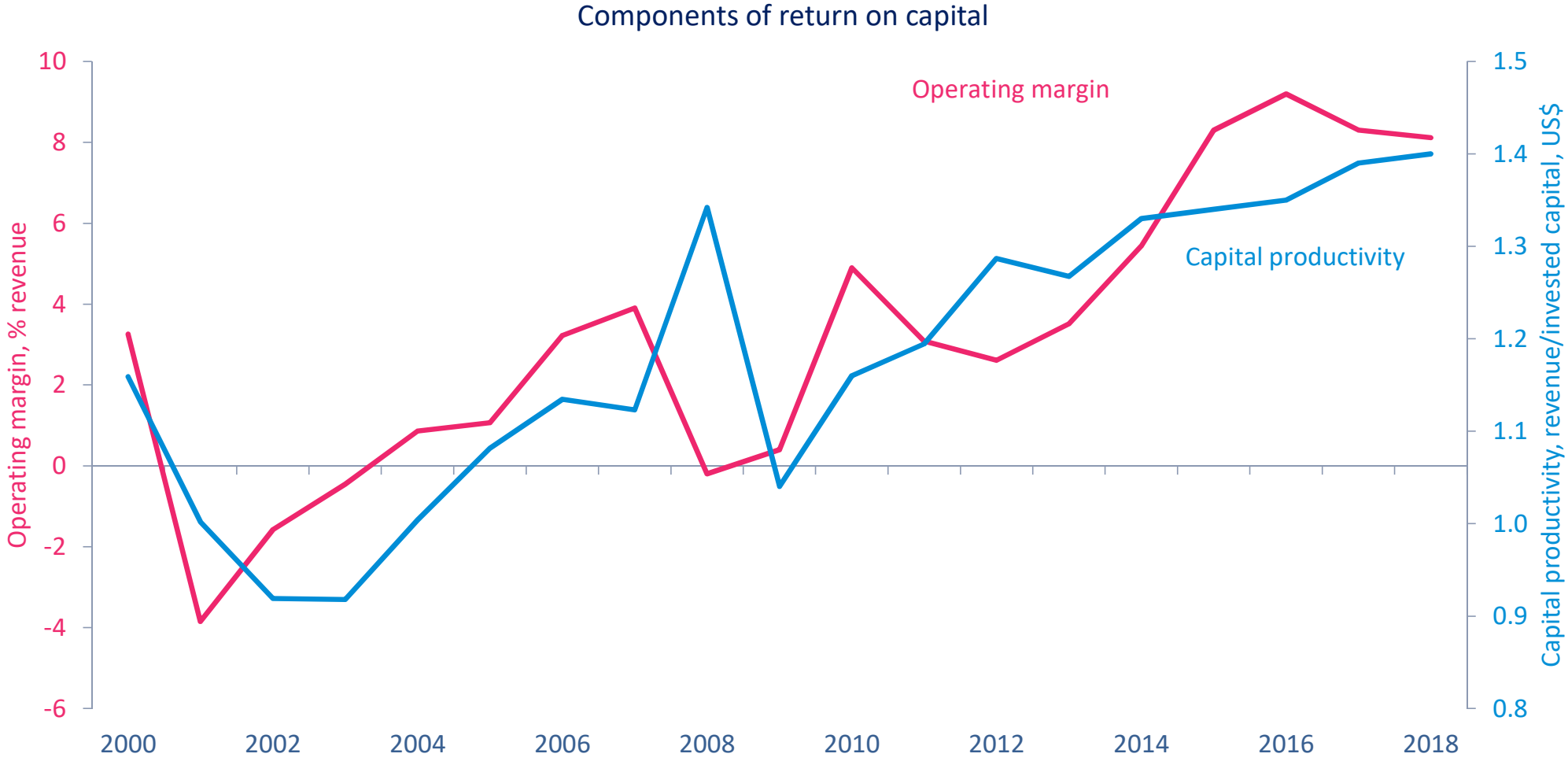
- Prices pushed down towards variable costs,
- But ways need to be found to cover fixed costs:
 - Differential pricing, sequential use of coupons, non-refundable tickets....and now **ancillaries**
- Network density economies through merger prevented by bilateral and O&C regulation barriers:
 - Leading to code shares, alliances and now **ATI JVs** and **equity partnerships** on international markets

Improvement in performance pre-dates fall in fuel costs



Source: IATA Economics using data from ICAO, IATA Statistics, IATA forecasts

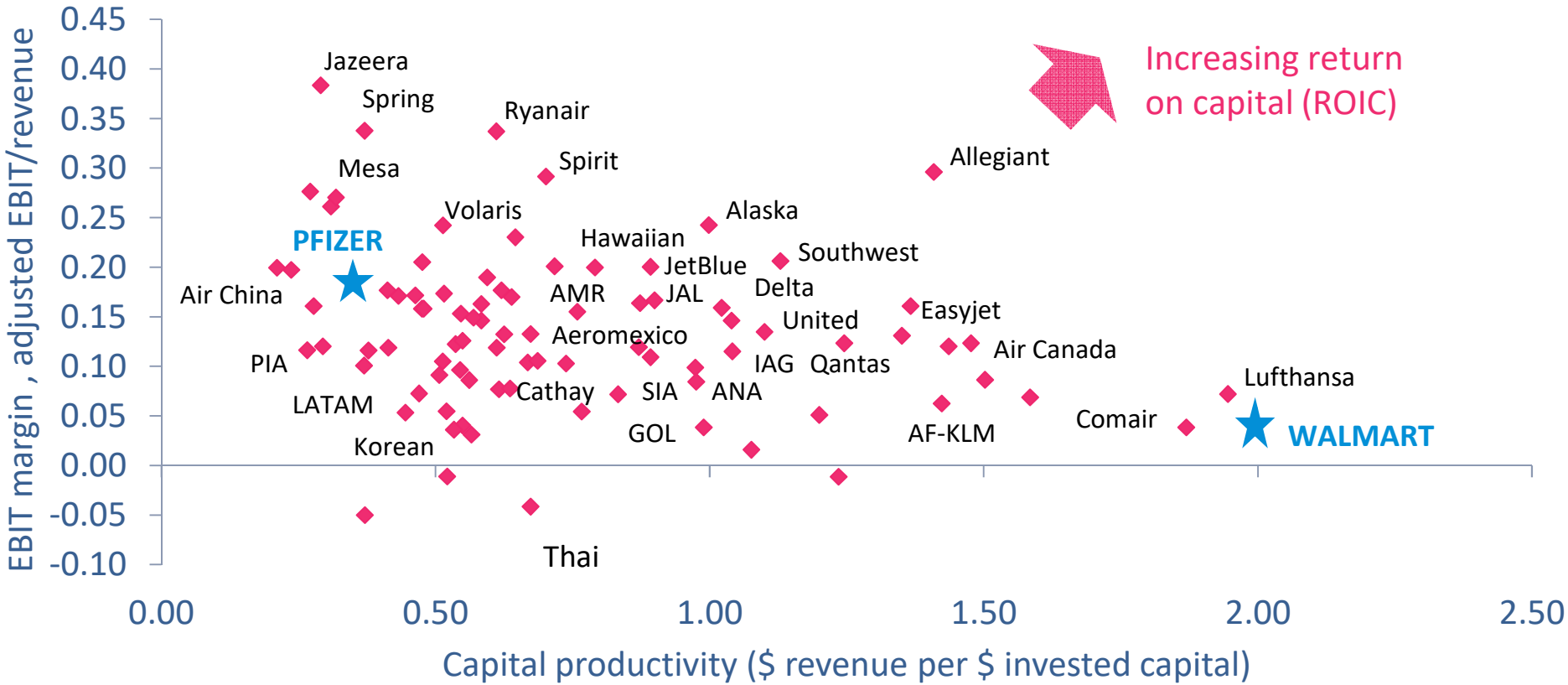
Airlines are sweating assets as well as improving margins



Source: IATA Economics using data from ICAO, McKinsey, The Airline Analyst, IATA forecasts

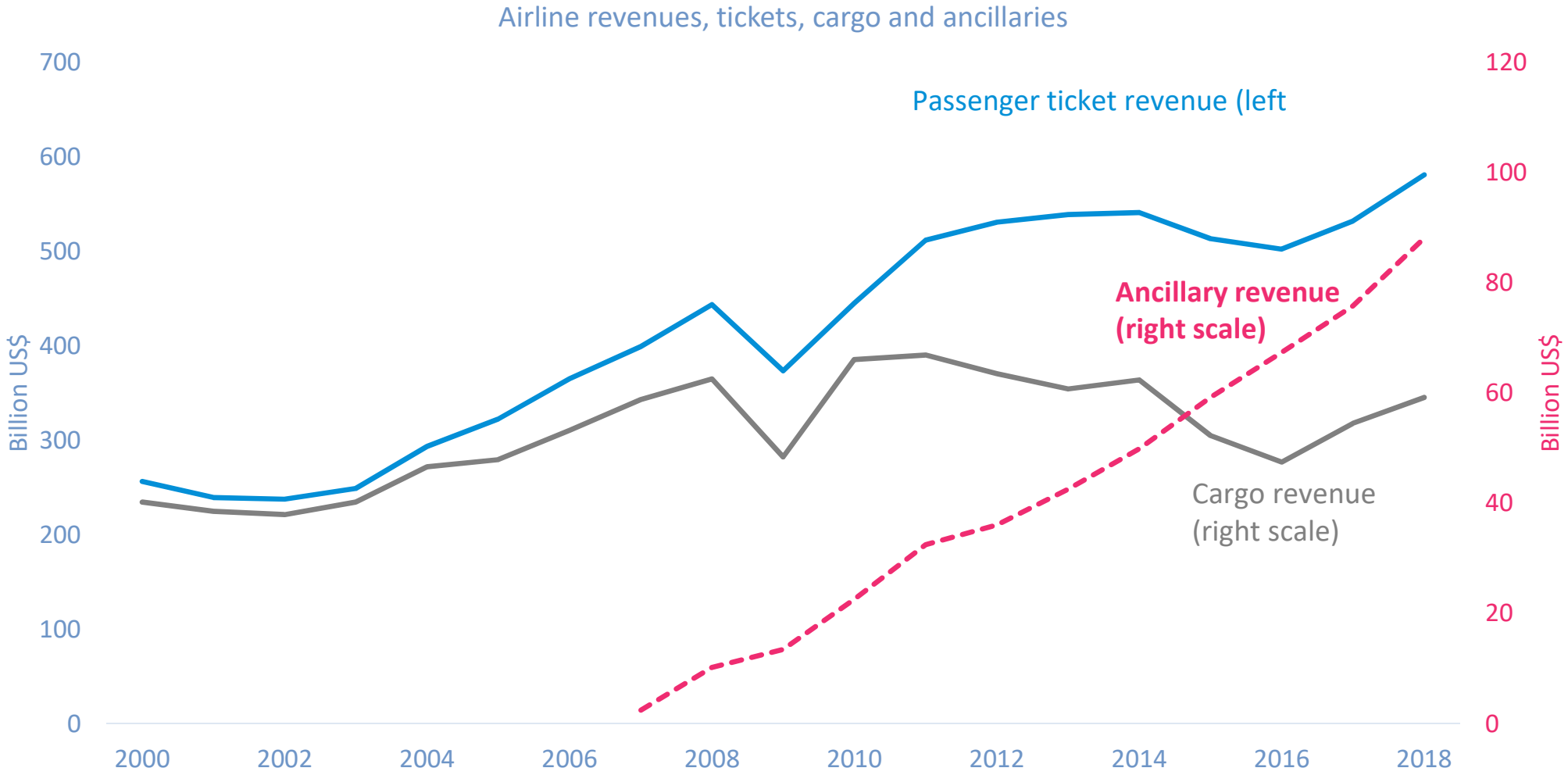
Wide variety of successful business models

2015 ROIC = adjusted EBIT/revenue * revenue/invested capital



Source: IATA using data from The Airline Analyst

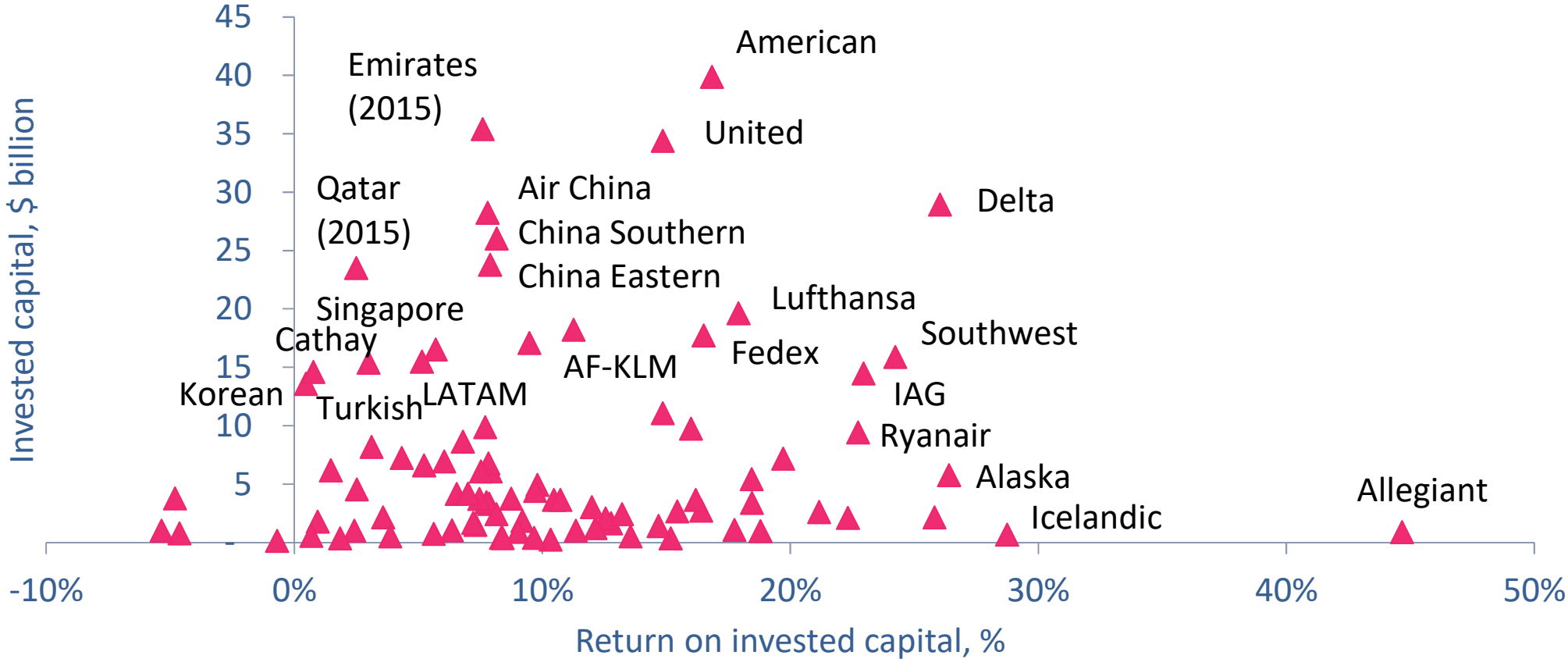
Ancillaries are changing the nature of the airline product



Source: IATA Economics using data from ICAO, The Airline Analyst, PaxIS, IdeaWorks

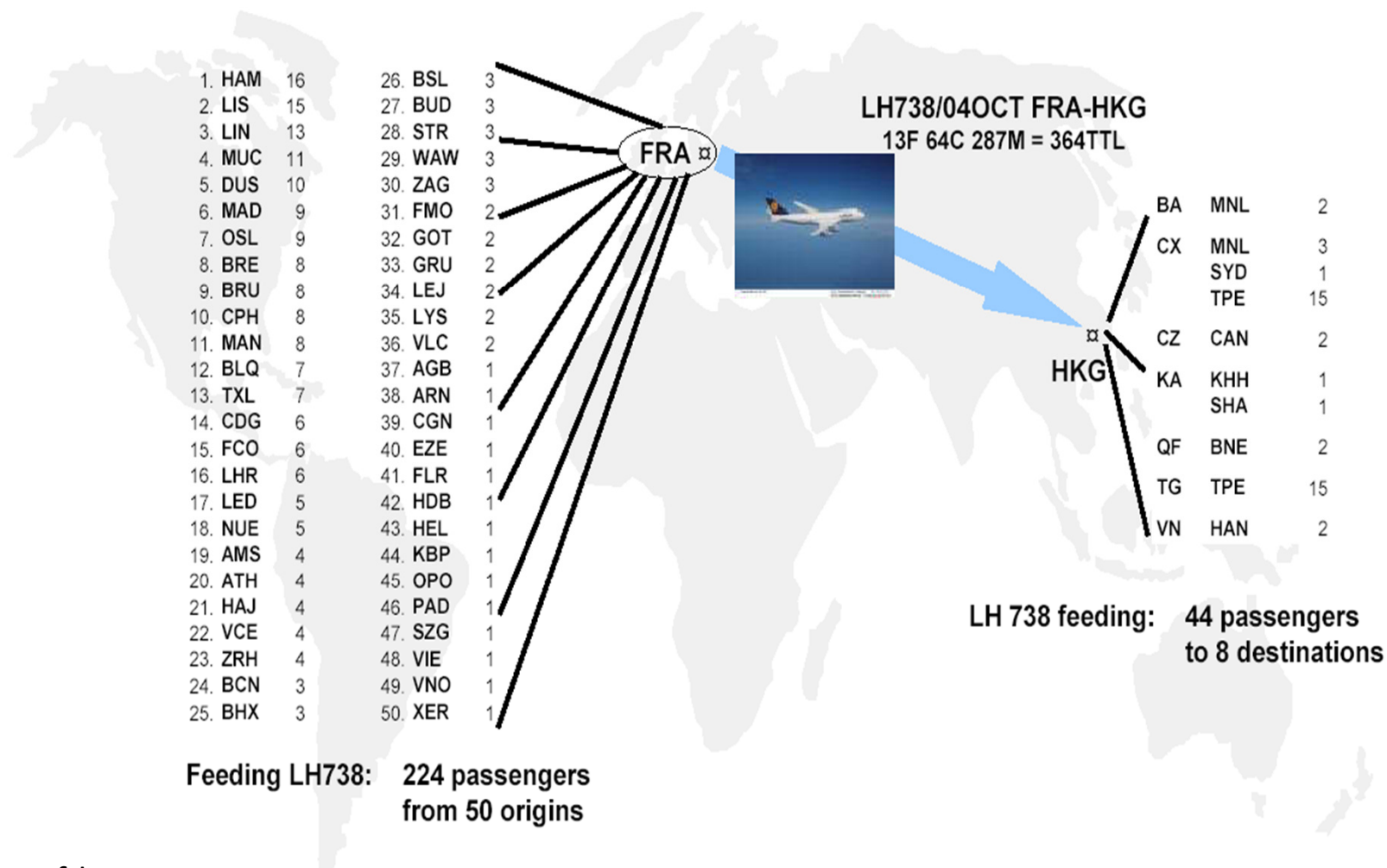
Consolidation important but not simply because of size

Return on invested capital versus invested capital, 2016



Source: IATA Economics using data from IATA and The Airline Analyst

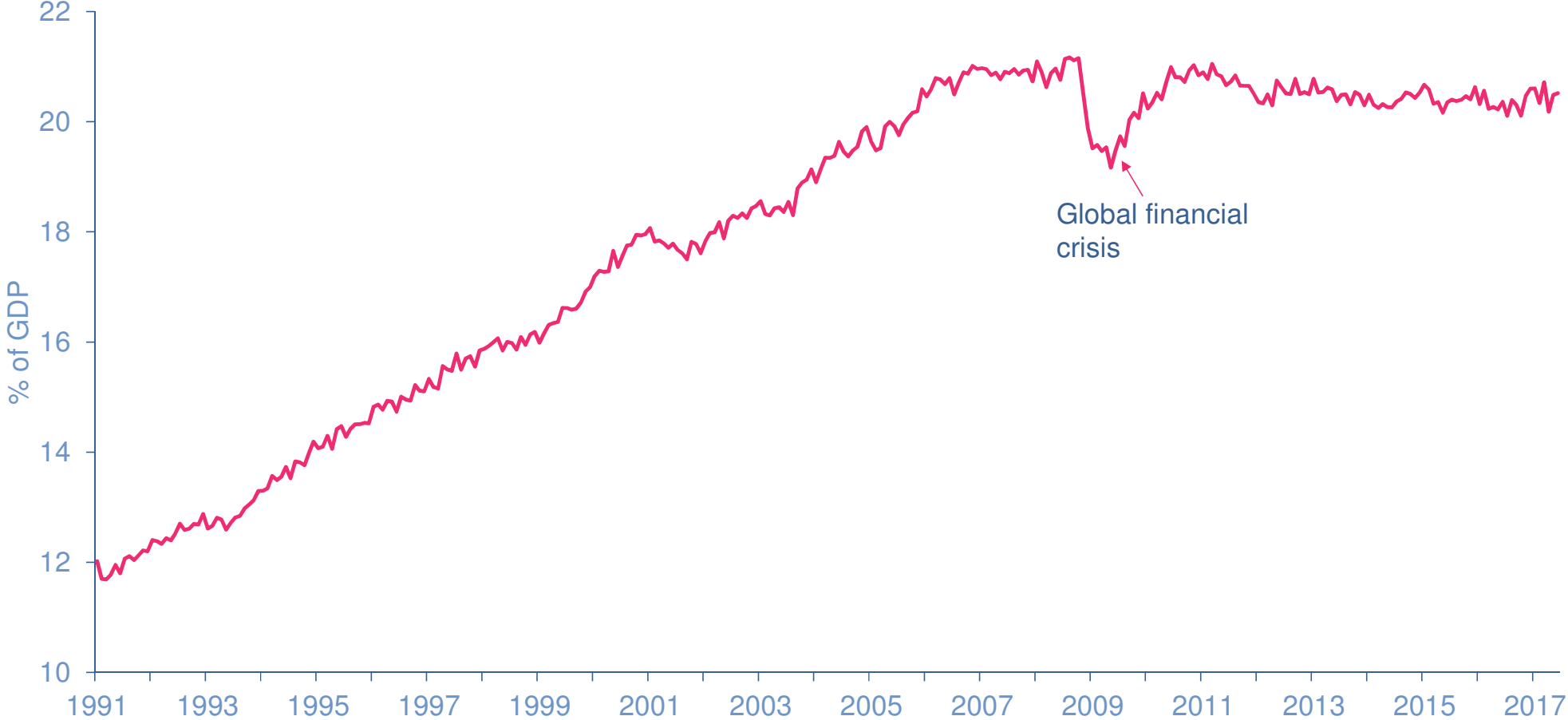
JVs doing better job than code shares/alliances to get density economies



Source: Lufthansa

Protectionism (or the new 'localism') is a major threat

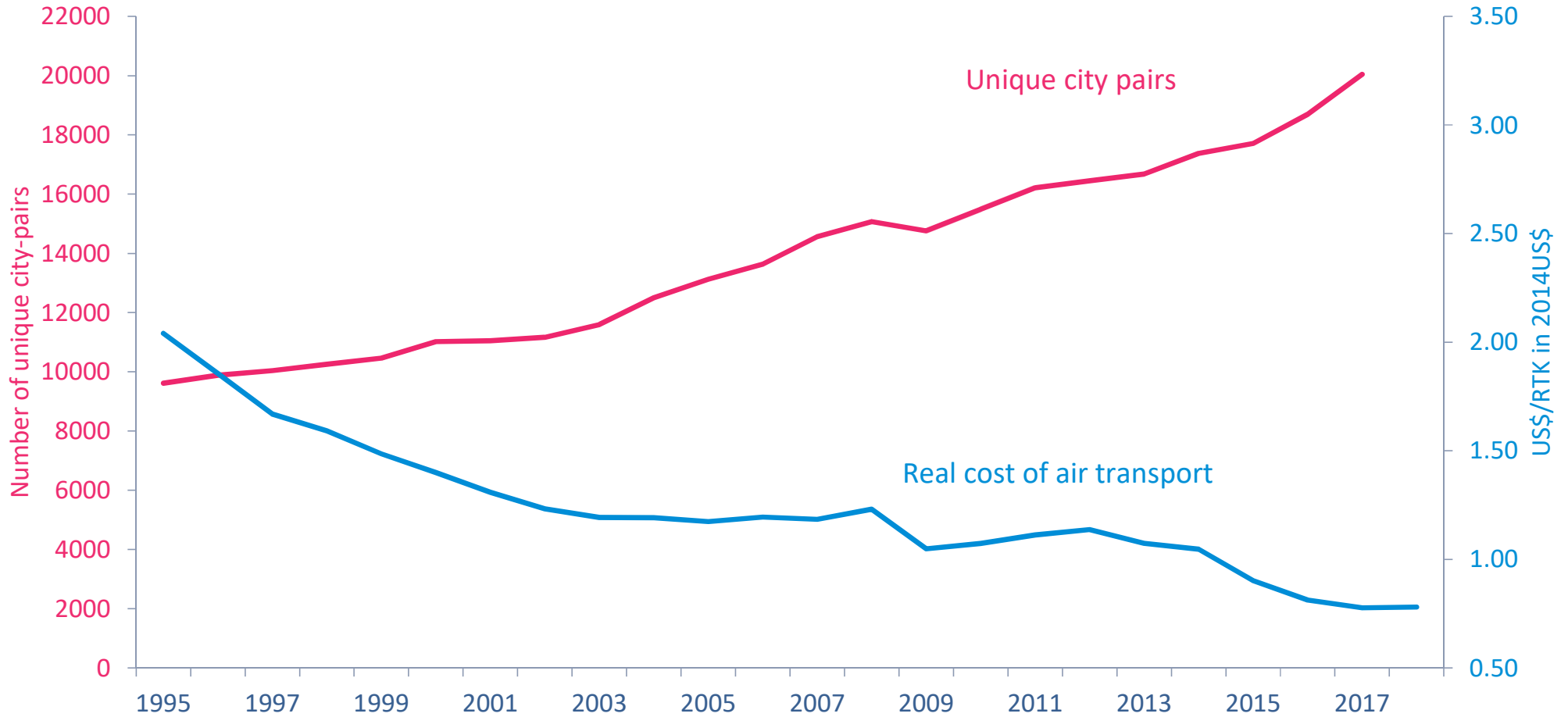
Share of goods trade (exports+imports) in global GDP



Source: IATA Economics using data from Netherlands CPB

Benefits to consumers (and economy) arise from cheap city connections

Unique city-pairs and real transport costs



Source: IATA Economics using data from ICAO, Boeing, OAG, SRS Analyser

Wider economic benefits

- Often measured by the jobs and GVA in the supply chain, through I-O models
 - Economic footprint is a useful description
 - But it measures cost not benefit
 - Do labor productivity gains really mean lower wider economic benefits?
- Economic benefits generated by connecting cities at lower cost
 - Air transport network is an infrastructure asset, a bridge between cities
 - Boosting the productive capacity of an economy
 - Generating flows of people, goods, capital, ideas, competitive pressure
 - Raising productivity through agglomeration, gains from trade
 - Higher GDP from the supply-side, in economies close to full capacity
 - Demand-side/spending flows do matter where economies/regions under-developed
 - More research and evidence required!

LOOKING FOR INSIGHTS INTO AIR TRANSPORT MARKETS AND ISSUES?

Download the new IATA Economics Research App

Available for  iOS and  Android





NEW IATA ECONOMICS RESEARCH APP

Keep up to date with IATA Economics' latest analysis on key aviation issues and market trends.

Receive personalised notifications when new research is available, share content through social media and email, and read your favourite content off-line, perfect for people on the go!



Access industry-leading economic analysis on key aviation issues and market trends through:

-  Reports
-  Charts
-  Presentations
-  Videos and more.

To find out more visit:
www.iata.org/econapp

