JUNE 2012

FLIGHTPATHS

www.flightpaths.com.au

SOME LIGHT?

The International Air Transport Association (IATA) released its revised industry outlook for 2012 at June's AGM in Beijing.

It says that global industry profits are expected to be US$3.0 billion, unchanged from the last update in March.

A fall in oil prices, stronger than expected growth in passenger traffic and a bottoming out of the freight market are driving some improvements in the profitability according to IATA. "However, this is offset by the continued and deepening European sovereign debt crisis, which has led markets to expect a further deterioration and damage to economic growth, the adverse impact of which has been built into this forecast," said IATA CEO and DG Tony Tyler.

This will be the second year of declining returns since airline profits peaked in 2010 at US$15.8 billion with a net profit margin of 2.9%.

Tony Tyler

FREE SUBSCRIPTION
Just send an email to info@silverskypublishing.com with the word subscribe in the subject box

CONTACT US
Geoffrey Thomas, PO Box 8205, Perth Business Centre, Stirling St, Perth WA 6849
Phone +61 41 793 6610 • geoffreythomas@silverskypublishing.com

In 2011, industry profits fell to US$7.9 billion for a 1.3% net profit margin. This year's projected $3.0 billion industry profit would yield a net profit margin of just a meager 0.5%.

IATA noted that compared with the previous forecast in March, North American and Latin American carriers are expected to see improved prospects.

While the outlook for African carriers is unchanged the outlook for European, Asia-Pacific and Middle Eastern carriers has been downgraded, with European losses now expected to be US$1.1 billion (nearly double the previously forecast US$600 million loss).

"The $3.0 billion industry profit forecast has not changed. But almost everything in the equation has. Demand has been better than expected, so far this year. And fuel prices are now lower than previously anticipated, but that's on the expectation of economic weakness ahead. The Eurozone crisis is standing in the way of improved profitability and we continue to face the prospect of a net profit margin of just 0.5%," said Mr Tyler.

"Although airlines face the common challenges of high fuel prices and economic uncertainty, the regional picture is diverse.

"THE EUROZONE CRISIS IS STANDING IN THE WAY OF IMPROVED PROFITABILITY."
Tony Tyler

Carriers in the Americas are seeing improved prospects for 2012. The rest of the world is seeing reduced profitability. For European carriers, the business environment is deteriorating rapidly resulting in sizable losses," added Mr Tyler.

IATA said that world GDP growth, a key driver of airline profitability, is expected to be 2.1% in 2012.

That is slightly better than the anticipated 2.0% growth forecast in March. But this is still a slower growth environment than last year, and one in which airlines will struggle to recover cost increases.

Historically, the airline industry has fallen into losses (at a global level) when world GDP growth drops below 2.0%.

Oil prices have slipped below US$100/barrel (Brent), as the Eurozone crisis generated fears of recession, having been above US$120/barrel earlier this year.

The forecast uses the latest consensus estimate for Brent, which has been revised down to US$110/barrel (from the US$115/ barrel used in the March outlook).

Even with this price softening, fuel is still expected to account for 33% of airline operating costs, the same as in 2008 when oil prices spiked.

Interestingly given the actual slower economic growth environment it has been notable said IATA that up to April passenger demand, measured in revenue passenger kilometers, continued to expand at an above-trend rate of 6.0%.

The strongest markets have been those linked with Asia, Latin America, and the Middle East, where economies have been more robust.

However, a weaker second half of the year is expected as deepening problems in Europe damage confidence, although that situation seems to change on a weekly basis, making planning just that much more difficult.

As a result the strength of travel demand in the first part of this year has caused IATA into an upward revision to the forecast for air travel growth to 4.8% from 4.2% in the previous forecast.

Passenger numbers are expected to reach 2.966 billion this year, up from 2.835 billion in 2011.

IATA said that cargo demand has bottomed out, following a sharp fall in 2011, in line with the moderate improvement of business confidence in a number of economies outside Europe. However the upturn is weak and narrowly based, with only Middle Eastern airlines seeing significant volume gains.

Overall 47.8 million tonnes of freight are expected to be shipped by air in 2012, basically unchanged from the 47.7 million tonnes carried in 2011.

As airlines have limited capacity growth, resulting higher asset utilization and lower oil prices will help to contain cost increases in 2012 to 7.3%, down from a rise of 10.6% in 2011 said IATA.

However, revenue growth is expected to slow more significantly—from 9.3% last year to 5.7% this year.

PASSENGER DEMAND ... CONTINUED TO EXPAND AT AN ABOVE-TREND RATE OF 6.0%

Keeping revenues ahead of costs is the constant challenge in the airline industry IATA said. In 2012, operating revenues are expected to reach US$631 billion, while operating costs will grow to US$623 billion.

The resulting operating profit

IATA warned that the EBIT of US$8.6 billion reflects the narrowness of the gap between revenues and costs.

“It doesn’t take much to eliminate the 1.4% operating profit margin,” said Mr Tyler.

“Moreover, these earnings are just sufficient to pay for debt interest, taxes, and other financial transactions.”

IATA forecasts this will leave airline shareholders with a net profit of just US$3 billion in 2012.

IATA says that Asia-Pacific carriers are expected to make the largest contribution to industry profits (US$2.0 billion), even with a US$0.3 billion downgrade from the previous outlook, due to the weak first quarter performance.

This is less than half the US$4.9 billion profit that the region delivered in 2011 and a quarter of the US$8.0 billion achieved in 2010.

IATA notes that Asian carriers make up about 40% of the global air cargo business and the weakness of this market in 2011 was the reason why there was a large decline in the region’s profits.

Looking ahead IATA warns that the risks to the forecast are primarily on the downside.

While the forecast is built on the market’s expectation that the sovereign debt crisis in the Eurozone will intensify, the risk of more severe economic weakness in the event of a broader Eurozone banking crisis could easily wipe out industry profits IATA said.

Similarly, the recent softening in oil prices could easily reverse should the ongoing dispute with Iran deteriorate, causing fears of a disruption in oil supply to resurface IATA warned.

“There has been no let-up in the volatility of the economic environment. A few months ago, an oil price crisis was the biggest risk. Now all eyes are back on Europe. Markets are expecting the Eurozone sovereign debt crisis to intensify and economic damage to follow. But with little clarity on how European governments will manage the situation beyond providing further liquidity, the risk of a major downward shift in economic prospects is very real. The next months are critical and the implications are big,” said Mr Tyler.

GOVERNMENT MUST STEP UP

The International Air Transport Association has called on governments to be stronger partners in maximizing aviation's economic and social benefits.

Addressing June's AGM in Beijing IATA CEO and DG Tony Tyler said that the industry's license to grow is earned through working with governments to constantly make flying even safer, more secure, and more sustainable.

"Now we need an agenda to achieve tax regimes that do not kill growth, regulation that facilitates growth, and infrastructure that can efficiently accommodate growth," said Mr Tyler.

"Doing so will enable the substantial economic benefits—jobs and growth—that global connectivity provides."

Mr Tyler's remarks came in his State of the Industry address at the 68th IATA Annual General Meeting and World Air Transport Summit.

Mr Tyler highlighted that aviation is a key driver of economic growth, jobs, and prosperity:

- In 2011, aviation safely transported some 2.8 billion passengers and 48 million tons of cargo. The value of goods transported by air is estimated at $5.3 trillion, which equals to 35% of the value of all goods traded internationally. A recent study by Oxford Economics confirmed that aviation's contribution to the global economy supports 57 million jobs and some US$2.2 trillion in economic activity

- Oxford Economics projected that aviation will grow about 5% annually to 2030. That would see passenger numbers rise to 5.9 billion and cargo shipments could triple to nearly 150 million tonnes. This connectivity would support 82 million jobs and US$6.9 trillion of global GDP.

"Aviation's benefits are not guaranteed. Aviation is expected to grow about 5% annually to 2030. If that growth is held back by even one percentage point, the global economy will forfeit over a trillion dollars and 14 million jobs. Modern economies cannot prosper and create jobs if they are not connected to global opportunities through aviation.

"Governments need to unleash the power of aviation to drive jobs and growth. And airlines need to be successful businesses—keeping revenues ahead of costs and generating returns for their shareholders—to deliver economic benefits," said Mr Tyler.

And Mr Tyler elaborated the agenda for profitable growth with respect to taxes, regulation, and infrastructure as follows:

Taxes: "Excessively taxing aviation makes no sense. Taxes dampen growth—with a knock-on effect on jobs and the broader economy. Bluntly put, making connectivity more expensive destroys jobs and slows economic growth. The United

Kingdom had to admit this when the recent increase in its GBP 2.6 billion Air Passenger Duty (APD) threatened direct connectivity to Northern Ireland. With inward investment and jobs at stake, the government reduced international APD for Northern Ireland. Regrettably, the government increased this job-destroying tax across the rest of the United Kingdom instead of abolishing it altogether," said Mr Tyler.

In contrast said Mr Tyler low tax regimes of "Hong Kong, Singapore, and the United Arab Emirates are building their economies around air connectivity."

tarmac delays. To avoid potential fines, flight cancellations increased."

"Making airlines pay for the mistakes of governments or incentivizing airlines to cancel flights are the unintended consequences of poorly thought-out punitive passenger rights legislation on both sides of the Atlantic. Airlines don't want delays. And fines don't address their root causes. The market forces of choice and competition empower passengers and are the best way to drive up service levels so long as governments also do their part," said Mr Tyler.

AUSTRALIA NEEDS A LONG-TERM PLAN TO MEET SYDNEY'S CAPACITY NEEDS.

"The result is a virtuous circle. They are great markets for airlines. Businesses prosper from connectivity. And governments reap the benefits of increased employment and a stronger tax base. Aviation should be seen by governments as a source of revenue—but not as a cash cow. Aviation is a powerful workhorse. Using it wisely will deliver benefits throughout the economy," said Mr Tyler.

Regulation: "Sensible regulation that increases safety or enhances competitiveness is good. But too often even the best-intended new regulation can have unintended and damaging consequences," said Mr Tyler.

He noted punitive passenger rights legislation in the United States and Europe as examples of misguided regulation.

"For example EU Regulation 261 forced airlines to compensate passengers for the hasty and unnecessary decision by governments to close European airspace in 2010 when a volcano erupted in Iceland and the US introduced heavy fines for long

"When regulating, governments should consult with industry, evaluate the costs and benefits, and keep focused on unleashing aviation's power to generate jobs and growth," said Mr Tyler.

But one area that Mr Tyler wants regulation is infrastructure suppliers.

"Recently, the South African regulator allowed a 161% increase in airport charges and a 70% increase in air navigation fees. Similarly, the Indian regulator allowed a 346% increase in charges at Delhi."

"Both regulators followed prescribed guidelines, but failed to protect the public interest. We must work with governments to build regulation that supports jobs and economic growth by keeping the cost of connectivity reasonable," said Mr Tyler.

Infrastructure: "Where governments are focused on jobs and growth, the urgency of accommodating the increasing demand for connectivity is crystal clear. You cannot unleash the power of an industry to drive economic benefits unless it has the capacity to grow," said Mr Tyler.

He took aim at European governments for failing to deliver the Single European Sky (SES). "By 2020, the Single European Sky (SES) is meant to cut air navigation costs in half and increase capacity by 70%--important goals for the European economy. But states are falling at the first hurdle."

"The latest Performance Review Board assessment is depressing reading. Most states won't meet even the un-ambitious targets that they agreed to. And as a result, airlines face EUR189 million more cost in 2014."

"SES has the strong support of the European Commission, the European Parliament, and Vice President Siim Kallas. They have the full support of the industry to drive a top down approach. This should include severe consequences for states and air navigation service providers that don't meet their targets," said Mr Tyler.

Also on Mr Tyler's radar is the need for governments to meet demands for connectivity with airport capacity.

"A few kilometers of runway and an efficient terminal infrastructure can put global markets at the doorstep of every local economy. Some governments understand this and are realizing the benefits of prioritizing airport investments."

"But there is also a long list of countries that are not taking full advantage of aviation's economic potential. The United Kingdom is not expanding Heathrow's runway capacity. Germany is banning night flights at Frankfurt. Australia needs a long-term plan to meet Sydney's capacity needs. And India has not mustered the political will to build a new airport to serve the needs of its financial capital—Mumbai. And this is just the start of a long list," said Mr Tyler.

LUXON THE NEW CAPTAIN

Air New Zealand has appointed Christopher Luxon as its next Chief Executive Officer to replace Rob Fyfe who steps down at the end of December.

Mr Luxon is Group General Manager International Airline and has held that role since joining Air New Zealand in May, 2011, following a successful career at Unilever in North America, Asia and Australia.

His most recent role there was President and Chief Executive Officer of Unilever's Canadian business.

Air New Zealand Chairman John Palmer said that Mr Luxon brings a wealth of international business experience to Air New Zealand and an exceptionally strong commercial and customer focus.

"Christopher has world class strategic, commercial, leadership and stakeholder management capabilities proven across multiple markets. These have been highly evident to the Air New Zealand Board in the year that he has been with the company and we have seen him affect positive commercial outcomes in our toughest operating division," said Mr Palmer.

Mr Luxon says he feels exceptionally privileged to be given the opportunity to lead the world's best airline and further build on its commercial success of the past decade.

"Rob Fyfe has done an incredible job transforming Air New Zealand and steering it through some of the most difficult trading conditions in modern history. I will take over an airline that has significant financial strength, some incredibly exciting commercial opportunities and 11,000 Air New Zealanders who are committed to being world class in everything they do," said Mr Luxon.

Chief Executive Officer Rob Fyfe congratulated Mr Luxon on his appointment.

"Christopher thoroughly deserves to lead Air New Zealand into the next chapter of its history. He is a world class executive on every level and will challenge Air New Zealanders to lift the airline's commercial and customer focus to an even higher level," said Mr Fyfe.

Mr Palmer said that the Board is delighted that it has been able to appoint an internal candidate to the role of Chief Executive Officer.

"We conducted an exhaustive international search for a new Chief Executive Officer and it gives the Board great heart that the succession process it had in place furnished strong internal candidates leading to this appointment."

Mr Palmer added that the Board and Mr Fyfe have in place a well planned transition period over the next six months to ensure a seamless transition.

Mr Luxon will be able to use this time to get close to the parts of the business outside his current responsibilities and to access the key domestic and international aviation, investor and stakeholder relationships that are crucial to running a world class airline.

Christopher was born in Christchurch in 1970 and is the eldest of three boys.

Mr Luxon attended Canterbury University to complete a Master in Commerce majoring in Business Administration.

In his last year at Canterbury University, Mr Luxon was recruited into the Unilever Management Trainee Program where recruits would rotate in 6-12 month cycles around all parts of the business.

Mr Luxon spent time in Sydney, London, Chicago and Toronto.

Mr Luxon is married to his wife Amanda and they have two children – William aged 12 and Olivia aged 10."

CELEBRITIES RULE!

Love them or hate them they hit the mark and hold viewers riveted which is vital when you're talking about safety videos.

And these are not just ordinary safety videos we're talking about. Air New Zealand's safety videos have been smash hits with the latest one being watched by more than one million people on YouTube in its first week.

Tens of millions more have seen, read or heard about it through global media coverage including the United States based Entertainment Weekly, OK! magazine, and HuffingtonPost, Australia's Sydney Morning Herald, and Mashable — the world's largest independent digital and social media news source. It's even been covered by one of the kings of celebrity gossip, Perez Hilton.

The hand-sketched safety video currently features on the YouTube 'Popular Videos around the Web' list ranking #2 in the global comedy category and #6 overall and amazing feat by any measure.

The new video features Emmy-nominated American actor Ed O'Neill of hit TV show Modern Family and New Zealand born actress Melanie Lynskey of Two and a Half Men, as well as cameo appearances from a range of well known international political, sporting and entertainment personalities.

It's featured on the Modern Family fan site, while the President Obama cameo appearance has earned coverage on a number of US political blogs.

Air New Zealand General Manager Marketing and Communications, Mike Tod, said that the celebrity spotting nature of the new video has been a key to its' popularity. "Inviting viewers to name five of the celebrities who appear in the video to be in to win an around-the-world-trip for two has captured the imagination of a global audience and encouraged them to share it – creating an amazing viral effect in just seven days."

"Air New Zealand has a great track record of being able to convey important safety messages in an engaging way that communicates the message while making passengers smile – the bonus to paying attention this time around is the chance to win a trip to see the world."

Air New Zealand's previous safety videos have been watched online more than 20 million times.

But the real strength of the videos is to see the effect on passengers on Air New Zealand planes with every passenger riveted to the screens.