A watershed moment in Australian aviation and corporate travel

Peter Harbison, CAPA – Centre for Aviation
In a nutshell

• Australian aviation growth, international and domestic, has ground to a halt – in fact it is even trending downwards.
• This will have significant ramifications for tourism – domestic and international – as well as for airports and the wider economy
What the airlines are saying
All positive at Qantas: but outlook slowing

“We’re seeing increased softness in parts of the domestic corporate market for May and June, particularly financial services, telecommunications and some areas of construction. Growth is also slowing in the small business market. We’ll have a better sense of how temporary this is after the Federal Election, which always has a dampening impact on travel demand."
Qantas’ overall market share of corporate travel revenue increased by 2.5 percentage points in the quarter to its highest level in three years, despite a net reduction in capacity.

Market share of small-to-medium business travel continued to grow, assisted by initiatives from Qantas Loyalty.
Total revenue between 1 January and 31 March 2019 grew by 2.3 per cent to $4.4 billion and Group Unit Revenue2 was up by 4 per cent.

This performance was despite a shift in the timing of Easter, which commenced in the third quarter of FY18 but moved wholly into the fourth quarter of FY19. This meant a significant amount of revenue also moved into the fourth quarter, with a favourable alignment between public holidays and school holidays driving very strong leisure travel demand.

Normalising for this shift, Group RASK for the four months from 1 January 2019 grew by approximately 5.5 per cent.
Virgin pulling in its horns – 737MAX deferrals

“The revised timing also results in a number of positive commercial benefits for the Group. This includes a significant deferral of capital expenditure by extending the use of existing aircraft given the relatively young age of our fleet along with providing the Group earlier access to the superior operational economics of the MAX 10 aircraft.”
Virgin: Profit downgrade; seeing weak demand

“The Group expects FY19 underlying earnings to be at least $100 million down on the FY18 comparative result of $64.4 million, reflecting the uncertainty of revenue trading conditions in the domestic market and inclusive of annual fuel and foreign exchange headwinds in excess of $160 million.

“Demand has weakened in both the corporate and leisure sectors, driven by lower levels of consumer and business confidence, consumer spending and the impact of the Federal Election. The corporate sector has been affected by the timing of the Easter holiday period and has been slow to recover due to the impact of the Election.”
The market grinds to a halt
Qantas: “capacity discipline”

“Continued capacity discipline in Group Domestic (down 1 per cent) and Group International (down 1.9 per cent) assisted with yield management and recovery of fuel costs.”
Qantas domestic passenger numbers fall

Pax numbers have been trending down over the past year

Negative 2.0% y-o-y in 2Q2019

Source: CAPA – Centre for Aviation, Qantas
Virgin Australia domestic seats

Virgin grew last year. Negative to flat in 2019

The values for this year are at least partly predictive up to 6 months from 20-May-2019 and may be subject to change.

Source: CAPA – Centre for Aviation, Virgin Australia
Fewer passengers flew domestically in Mar-2019 y-o-y

“There were 5.28 million passengers carried on Australian domestic commercial aviation (including charter operations) in March 2019, a decrease of 2.8 per cent on March 2018.” - BITRE

(but Australia overall was down 4.8%)

Source: BITRE
Domestic seat growth: flatlining

- Total only 4% seat growth between 2012 and 2018
- GDP growth meanwhile has averaged 2-3% annually
- Pax numbers: 5,714,000 in Q4 2012 vs 5,694,000 in Q4 2018
- Aviation growth is typically 1.5-2x GDP
- At, eg 5% growth p/a, traffic would be up ~30%

The values for 2019 are at least partly predictive up to 6 months from 20-May-2019 and may be subject to change.
Australia lags the world in domestic growth

In 2018 Australia showed the slowest growth of any significant domestic market in the world – instead of growing with GDP (red bar) + City pair numbers have declined (negative blue bar)

Source: IATA

Sources: IATA Economics, IMF, SRS Analyst
And fares stagnate – for now
Domestic economy fares (to May-2019)

Flexible economy (business traveller) fares are starting to flatten, following last year’s upward trend.

Source: BITRE
Domestic business fares (to May-2019)

And actual business class fares slide further......

Source: BITRE
As confidence slides
"The forward looking indicators of the survey continue to suggest that the weakening in conditions over the second part of 2018 is unlikely to be reversed any time soon.... Conditions are still positive but below average, suggesting a loss in momentum but that for now the private sector continues to grow moderately."

NAB chief economist Alan Oster

Source: NAB
Domestic services - Bottom line

- Domestic capacity is declining
- Fares static or slipping
- Qantas is focussed on profits
- Virgin is focussed on recovery
- Business confidence was slipping (post-election may have improved)

So no capacity increases likely
International capacity growth ceases too
International capacity growth *negative* in 2019?

May-2019 is lower y-o-y. Predictive capacity filings suggest a small increase over the year.
A$ is at a decade low

Why is that important?

• Reduces foreign airline revenues for Australian outbound travel. Today ~65% of seats are outbound travellers

• Lowers Australian propensity to travel

Source: XE.vcom
International travel is today predominantly outbound

- Inbound exceeds outbound for the first time - 1987
- Outbound overtakes inbound - 2007

- Directional flows likely to reverse over time, as we once again become an inbound tourism destination.
- This will tend to be more strongly foreign airlines
The Gulf carriers
Etihad cuts back

Etihad is still recalibrating, as it seeks a new strategy

Source: CAPA – Centre for Aviation, OAG
Emirates’ growth stalls

The lower AUD and market competitiveness is providing challenges for the biggest of the Gulf carriers.

Source: CAPA – Centre for Aviation, OAG
But Qatar still grows – steady in MEL

Qatar is most likely to continue growth in Australia – although Ministerial intervention has prevented QR adding to BNE services

Source: CAPA – Centre for Aviation, OAG
US-Australia
No growth in the US market

Despite its solid profitability, US-Australia capacity is holding steady

- Qantas operates 45% of seats + JQ 5%
- Virgin – 16% + DL 7%
Singapore-Australia
Qantas’ “offshore hub” is also down

Even Australia-Singapore is down 3% y-o-y, despite Qantas moving its Dubai operation to Singapore.

Source: CAPA – Centre for Aviation, OAG
China-Australia
Even China is now declining as intense competition hurts airlines

Australia’s largest tourism source market is regathering its breath as intense competition makes life difficult for China’s airlines

Source: CAPA – Centre for Aviation, OAG
MEL has a good spread of foreign tails

- Qantas-Jetstar’s 26% is the largest international operation
- Virgin Australia has only a 6% capacity share
- Emirates (8%) and SIA (8%) are the largest foreign airlines

Source: CAPA – Centre for Aviation, OAG
Avalon relies entirely on Jetstar for domestic

Tiger did serve Avalon at one time but Jetstar has dominated

Source: CAPA – Centre for Aviation, OAG
And on AirAsia X for international

- Competition enters the Melbourne airport market for international services
- AAX is largely a 6th freedom operator, opening markets beyond KL – notably Thailand, China
London-Perth: a “gamechanger”?
“Almost every flight is full and it turned a profit almost immediately, which is rare for new services because they have start up costs and it normally takes time to build demand.

“Key among the data was an independent analysis by Deloitte Access Economics, which found the non-stop 787 Dreamliner service had in its first year:

“Facilitated a $101 million increase in spending by visitors (92% of which is from international stopover passengers), with $2.3 million spent at Perth Airport alone by people passing through.

Directly and indirectly supported creation of 601 full time equivalent jobs, particularly in the tourism and hospitality sector.

“With 71 per cent of international visitors on the route choosing to stopover in Perth, helped to drive more than 1 million visitor nights spent in WA.

“Generated over $100 million in free publicity due to global interest in the service, including significant exposure for WA as a destination.

“Just under 60 per cent of passengers on the London-Perth leg are from Australia while UK residents make up the majority of overseas passengers at 31 per cent. Qantas has seen a 30 per cent increase in the total number of passengers travelling between Australia and London via Perth – including a 7 per cent increase in visitors from the UK travelling to Perth.

“The new service is also attracting people from other parts of Australia to Perth to join the service, with average outbound passengers made up of 25 per cent from Melbourne, 7 per cent from Sydney, 6 per cent from Brisbane and 4 per cent from Adelaide.
Melbourne-Perth-London

- Offers an alternative to routes via the Gulf, Singapore, Sydney etc
- 25% of the outbound pax board in Melbourne

Source: Deloitte: Qantas
Despite the new option for Melbourne-London travellers, MEL-PER capacity is down app 8% y-o-y
“Loyalty” is increasingly central to airline strategy – and revenues

Source: CAPA – Centre for Aviation, OAG
Loyalty

“Qantas Loyalty continued to see strong revenue growth from the Frequent Flyer program as well as its other businesses, including Qantas Money and Qantas Insurance. There are several initiatives to be announced in the fourth quarter that will continue to support Loyalty’s performance, with earnings growth of 7-10 per cent expected for the second half of FY19.”

Virgin Australia reviews whether to sell its 70% holding in Velocity – to burn the furniture or not
"Loyalty" is increasingly sticky

Diversification and Growth at Qantas Loyalty
One of the world’s most diverse airline loyalty programs

- 4%¹ growth in Qantas Frequent Flyer membership; 9%² growth in Qantas Business Rewards membership (>220,000 SME members³)
- Record⁴ number of Qantas Points earning credit cards acquired; average earn per card increasing
- Expanding member earn options – >500 Coalition earn partners including 59 B2B⁵
- Growth in total points redeemed supported by 8%¹ growth in air redemptions; new POS options launched including Kogan
- >$150m premiums⁶ sold since launch; >20%¹ growth in health customer joins
- >426k app downloads and >453b steps taken since launch, also rewarding customers for healthy sleeping, cycling, swimming and health checks
- New Premier Titanium⁷ – first metal card offering Status Credits and First Class lounge passes
- >4.2b points earned on Premier credit card products since launch; 4 industry awards from Canstar and Mozo
- >$4.5bn loaded on Qantas Travel Money⁸; 5 star Canstar rating for the 4th time since launch⁹
- Relaunch of Qantas Shopping with enhanced website and more than 250 partners³
- Qantas Wine¹⁰ revenue growth of 33%¹ in 1H19
- Scaling Qantas Hotels with significant investments in product & digital enhancements
- 35%¹ growth in revenue; >271k guest bookings across >300K properties available³

Source: Qantas

• The full service airlines have become very adept at targeting travellers directly in order to capture their travel preferences
• Qantas has one of the most effective loyalty programmes in the airline world
• These measures also generate good ancillary revenues (and can help keep fares down)
Premium Economy
Premium economy and pricing for corporates and SMEs

• Many airlines have adjusted their aircraft configuration to respond to changing corporate and SME spending patterns
• LCCs are *gradually* adapting to corporate needs

Source: Qantas
Premium Economy is spreading fast

- 25% of the world’s 4,900 commercial passenger widebody aircraft now feature premium economy products.
- 55 airlines worldwide offer premium economy class product.
- Most of the aircraft with PY are Boeing 777; 39% have PY.
- A330s are next in overall numbers and have 11% with PY.
- 53% of all A350s in service have PY.

Source: CAPA Inflight database
# Airlines with Premium Economy

<table>
<thead>
<tr>
<th>Airline</th>
<th>Priority / Dedicated Check In</th>
<th>Priority Baggage</th>
<th>Priority Boarding</th>
<th>Separate Cabin</th>
<th>Dedicated Food &amp; Beverage</th>
<th>Amenity Kit</th>
<th>Lounge Access</th>
<th>Extra Baggage</th>
<th>Aircraft Types *</th>
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<td>×</td>
<td>✓</td>
<td>787</td>
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*Note: Covers aircraft types fitted with purpose built premium economy seating. Aircraft with regular economy seats but extra legroom are not included.

Main issues for corporates:
- Defining the product
- Not all aircraft/routes are covered
- Lounge access rarely included

Some LH LCCs have business products which are as good as, or better than FSCs’ PY
To fly LCC or not? - choices are reducing

• Most of the aircraft orders in this region are from LCCs, long (into Asia) and short haul
• LCCs are gradually adapting to corporate needs

<table>
<thead>
<tr>
<th>BUSINESS</th>
<th>OWNERSHIP²</th>
<th>LAUNCH</th>
<th>AIRCRAFT³</th>
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<tr>
<td>Jetstar Australia</td>
<td>100%</td>
<td>2004</td>
<td>52 x A320s/A321s</td>
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<tr>
<td>Jetstar International</td>
<td>100%</td>
<td>2006</td>
<td>11 x 787-8s</td>
</tr>
<tr>
<td>Jetstar New Zealand²</td>
<td>100%</td>
<td>2009</td>
<td>8 x A320s 5 x Q300s</td>
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<tr>
<td>Jetstar Asia (Singapore)</td>
<td>49%</td>
<td>2004</td>
<td>18 x A320s</td>
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<tr>
<td>Jetstar Japan</td>
<td>33%</td>
<td>2012</td>
<td>24 x A320s</td>
</tr>
<tr>
<td>Jetstar Pacific (Vietnam)⁵</td>
<td>30%</td>
<td>2008</td>
<td>17 x A320s</td>
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</table>
The rise and rise of LCCs

<table>
<thead>
<tr>
<th>Airline Group</th>
<th>Order book</th>
<th>Fleet size</th>
<th>Ratio</th>
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<tbody>
<tr>
<td>VietJet</td>
<td>328</td>
<td>59</td>
<td>5.6:1</td>
</tr>
<tr>
<td>IndiGo</td>
<td>427</td>
<td>174</td>
<td>2.5:1</td>
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<tr>
<td>AirAsia/AirAsia X</td>
<td>494</td>
<td>243</td>
<td>2.0:1</td>
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<tr>
<td>Lion (incl, Batik Air, Malindo, Thai Lion, Wings)</td>
<td>446</td>
<td>304</td>
<td>1.5:1</td>
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<td>Singapore Airlines (incl Scoot, Silkair)</td>
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<tr>
<td>Garuda Indonesia (incl Citilink)</td>
<td>99</td>
<td>193</td>
<td>0.5:1</td>
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<tr>
<td>Qantas (incl Jetstar)</td>
<td>115</td>
<td>277</td>
<td>0.4:1</td>
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</table>

4 LCC groups account for 85% of all orders in S Asia and SE Asia.
The Outlook
Oil prices are becoming uncomfortably high

- Risk is on the upside
- Demand remains strong, as economies remain good
- But potential for lower prices if economies slow

Source: Oil-price.net
The challenge to global trade in 2019

World Economic Forum Survey:

- 91% believed economic confrontation among major powers will multiply in 2019.
- 88% believe there will be an erosion of multilateral trade agreements.

There is a need for collaboration to address problems – “but collaboration is not necessarily taking place.”

WEF President Borge Brende
“'Clouds on the horizon': CEOs warn of consumer sentiment on knife edge” – AFR, 3-Mar-2019

“Stretched household budgets have left consumer sentiment on a knife edge, warn chief executives who worry the drawn-out election campaign and poorly considered policy promises could damage the economic outlook further.

“Overall, business leaders remain optimistic about the resilience of the Australian economy, but beneath the management bravado there is a simmering undercurrent of concern.”
Thankyou and enjoy the day!