November 2013

JCR-VIS

SECTOR UPDATE

Airline Industry

The main drivers of future air traffic and fleet growth would be the emerging economies like Pakistan with a growing level of first time flyers...

Today's airline industry exists in an intensely competitive market. As per data available from the information centre of The World Bank, during 2012 approximately 2.8billion people traveled using air transportation. The global airlines industry is expected to reach an estimated $832.8 billion in 2020 with a CAGR of 3.7% over the next seven years (2013-2020).

The global airline industry comprises air transport service providers of passenger and cargo. Industry services are used by individuals and business for international, domestic, and regional travel purposes across the world. North America led this industry, followed by Europe and Asia in 2012. Growth of the North American market is driven by growing demand in long-haul international services while increasing demand from emerging economies, continuous demand for new low-cost carriers, deregulation, and rising middle class are factors driving growth in markets such as Asia and the Middle East.

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...however, the company is in financial distress due to continued financial and operational mismanagement.

Studies indicate that the European market growth is primarily driven by development of air transport in Eastern Europe and intra-continental travel within the European Union. Asian growth on the contrary is driven by rising per capita GDP in emerging economies such as China, India, and countries in the Middle East such as UAE and Saudi Arabia.

International Scenario

Revenues of global commercial airlines amounted to $680b (2011: $636b) during 2012, with a growth of 6.9% for the year; this was slightly lower than that of the preceding year on account of recession in the Eurozone. As per IATA's outlook for financial performance of global airline industry, revenues are projected to increase at a modest rate of 5%, going forward. Airlines in emerging economies continue to record stronger growth as compared to developed economies; international air travel on GCC, African and Latin American airlines is expanding at rates well above the global pace, with growth of 12.1%, 11.2% and 8.7%, respectively[1].

The aviation sector is characterized by high competition arising from soft barriers to entry (given the availability of lease financing and outsourcing support services), cyclicality, and vulnerability to economic shocks. Moreover, significant costs including fixed cost such as aircraft lease charges, capital and labor, (with limited ability to adjust the same during downturns and high cash outlay towards pension schemes), and variable cost such as fuel along with regulation focused on safety, maintenance, hours of operation for personnel and restrictions on routes, landing rights and slots add to the inherent risk of the airline industry. While profit margins tend to be low, cash flows tend

[1] *IATA Air passenger market analysis*

to be relatively stronger with high levels of depreciation and amortization. Although adjusted leverage (off balance sheet leverage) tends to be high for airlines that use operating leases.

Internationally the airline industry is segmented into premium travel, general travel and budget travel. Airlines operating at the high-end have a focus on the affluent traveler, they are the prime customers of new aircrafts and thus their average fleet age is the youngest. Their aircraft configuration is dominated by luxury travel in terms of facilities & services available, seat pitch and on and off-plane services. Airlines targeting general traveler generally opt for refurbished planes available as outright sale or on dry lease (aircraft without crew and maintenance staff), the latter being the preferred choice. They usually offer limited seats in other than budget class. The scope of in flight service is narrow and accordingly fare differential is notable. Budget airlines predominantly operate with older aircrafts on dry leases involving low capital expenditure. Their target market is migrant workers, leisure travelers and low end general travelers offering competitive fares with basic in-flight services.

Over the last decade the airline industry has experienced significant change in the operating environment, including high and volatile fuel prices, increased competition and an economic recession that reduced demand for travel. While airlines spent about 10% of their total cost on fuel in 2001; by 2012 this proportion increased to 32% and an all time high of 35% in 2008. Consequently, a number of airlines globally have filed for bankruptcy during this period. The aviation industry, particularly in Europe and North America, is considered highly competitive with low profit margins.

Local Scenario

Pakistani air travel market is a hybrid of general and budget travel. On international routes the resident airlines compete with other international players on the general market segment of the business by offering competitive fares in view of their low fixed costs with some compromises on in-flight services. Domestically and regionally the market is budget oriented with some corporate travel. Air traffic in Pakistan is projected to grow at over 12% on the back of population and economic growth with total revenue as of 2012 amounting to $1.9b. For airlines operating in Pakistan, fuel cost is significantly higher given that there is a material difference in fleet age of domestic and international airline operators.

While currently there are four players in the Pakistan Airline Industry, Pakistan International Airline (PIA), Shaheen Air International Limited (SAIL) Air Blue Limited (AL) and Indus Air (which only recently commenced operations), historically PIA has had a monopoly over the domestic aviation sector. Subsequent to the open skies policy adopted by the country in 1990s, 20 new licenses were issued to prospective airliners. However, the growth in air travel was impacted after UN sanctions were imposed on the country during the same time period, resulting in a number of airlines rolling back plans to commence operations.

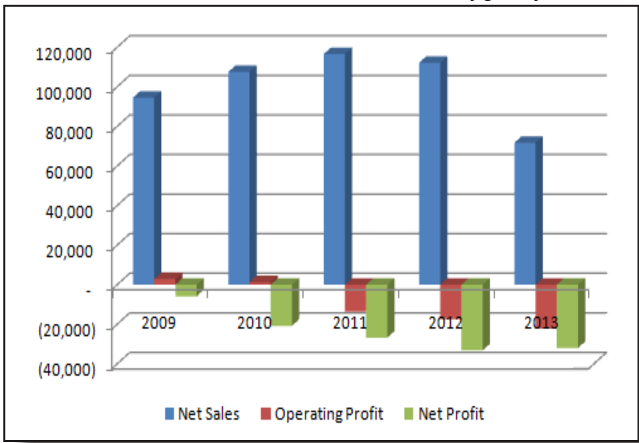
Fuel Cost % of total revenues	FY13	FY12	FY11
Pakistan International Airlines*	54% (2012)	55% (2011)	48% (2010)
Global Commercial Airlines	31%	32%	28%
**Year-end is December*			

Besides being the national carrier, PIA is also the market leader in terms of market share, fleet size and routes covered. The company has a fleet of 39 aircrafts, of which, 24 are operational while the management plans to induct 10 additional A320s on dry lease. The current fleet includes 6 ATR 42-500, 12 Airbus 310-300, 3 Boeing 737-300, 4 Boeing 747-367, 6 Boeing 777-240 and 3 Boeing-340s.

PIA operates to 24 domestic and 34 international destinations and overall market share of PIA in terms of passengers is around 50%. Moreover, with the arrival of 10 new A-320s for domestic routes, PIA plans to refurbish their Boeing 777 fleet and use them only on long haul flights, particularly for the UK, US, Europe and Canada, resulting in improved efficiency. However, the company is in financial distress due to continued financial and operational mismanagement. It is also overstaffed, resulting in low revenue per employee (Rs. 6.4m) and high employee to aircraft ratio. At end-Mar'13, PIA had a negative equity of Rs. 125b and total debt of Rs. 163b. The company incurred a net loss of Rs. 33.2b in 2012 and registered negative funds from operations.

The weak performance of PIA along with the expanding demand constitutes an opportunity for SAIL and AL, who have an operational fleet of 14 and 6 (4-A320s and 2 A-340s) aircrafts, respectively. SAI operates to 8 domestic and 12 international destinations while AL operates on 5 domestic and 6 international destinations. In contrast to the other two competitors, market share of SAIL has grown steadily over the last six years with the growth being particularly noteworthy in FY13. This trend is expected to continue with the airline poised to operate on new routes with a larger fleet.

Pakistan International Airlines *9 months figures for 2013*



Domestically, travel agents comprise the main avenue for ticket sales for airlines with online bookings limited to less than 5% of ticket sales. SAIL is perceived to have a strong foothold in booking tickets through travel agents while AL is considered the leader in online bookings. The latter is also considered to be technologically more sophisticated with a dynamic pricing model in place allowing for effective ticket pricing for customers. SAIL's target market to date has remained blue collar customers with quality service and meals, ensuring customer loyalty.

New competitors that may enter the market include Rayyan Air, Vision Air and Fly Pakistan Air. Air Indus, majority owned by Karakoram Motors, has commenced operations in Aug'13 with a fleet of 3 Boeing 737-300 and operating on 8 domestic destinations. Any new airline is subject to the restriction of operating domestic flights for one year and fulfilling other conditions of domestic operations as per Civil Aviation Authority (CAA) Pakistan regulations before becoming eligible for international operations. Resultantly, competition from new entrants may emerge over the medium to long term.

Conclusion

Industry experts are of the view the main drivers of future air traffic and fleet growth would be the emerging economies. Emerging markets like Pakistan have a growing middle class which generates a significant level of first time flyers. The economic growth also promotes domestic and international tourism. Another peculiarity of the domestic market is the sizeable level of migrant regional workers who are regular travelers. Also the overseas Pakistani communities in North America and European region are regular travelers to Pakistan.

The demand side of the local air traffic market appears to be comfortably placed in the medium to long term. However, the focus of the local airline industry would continue to be on the budget travel with some openings in the general and premium market appearing along with the consolidation of economic growth.

Jahangir Kothari Parade (Lady LLoyd Pier)
Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose genrosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.

Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs). Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.


Jahangir Kothari Parade

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