Airline Capacity Discipline: Where and to What Extent?

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Background

- U.S. industry largely unprofitable in the 2000s
- Focus on market share
- Excess/uneconomic levels of capacity
- Growth, but not profitable
Recent Developments

- Significant consolidation
  - Delta-Northwest
  - United-Continental
  - Southwest-AirTran
- Yet another one? (American-US Airways)
- Capacity reduced; hubs downgraded
- Profits improving; Wall Street approving
Is this the Recipe for Continuing Financial Success?

- No
- U.S./North America may be the biggest airline market today, but the world is changing
- There will be other markets that will grow significantly, and profits can be realized
A Related Problem

- Focus on short-term profitability may lead to lost long-term opportunities
- Markets outside N. America forecast to grow rapidly
- U.S. carriers need to plan how to benefit
- Once current economic difficulties resolved, U.S. carriers need to be ready to execute
Source: Boeing Current Market Outlook 2012-2031
Emerging Economies Growing Faster than Mature Economies

Source: Airbus Global Market Forecast 2012-2031
A Growing Middle Class Will Spark Demand

Source: Airbus Global Market Forecast 2012-2031
The Top Dozen Economies are Changing

The world of 2031 will be very different from today

Country ranking by GDP

1 - US
2 - Japan
3 - Germany
4 - France
5 - UK
6 - Italy
7 - Russia
8 - Spain
9 - Canada
10 - Brazil
11 - Mexico
12 - China

Source: BIS Global Insight, Airbus

Source: Airbus Global Market Forecast 2012-2031
Asia is Expected to have the Most Large Cities in 20 Years

Source: Airbus Global Market Forecast 2012-2031
GDP Growth Rates will be Greatest in “Non-Traditional” Markets

Source: Airbus Global Market Forecast 2012-2031
High Growth is Outside the U.S., Europe and Japan

Source: Boeing Current Market Outlook 2012-2031
Trade Will Grow Faster than GDP

Globalisation expected to generate growing world trade

World real GDP
CAGR 2012-2031: +3.2%

World real Trade*
CAGR 2012-2031: +5.3%

Source: Airbus Global Market Forecast 2012-2031

* Exports + Imports
Airline Traffic Growth Outstrips GDP Growth

Source: Boeing Current Market Outlook 2012-2031
Long-Haul Has Grown More Rapidly Than Short-Haul

Source: Airbus Global Market Forecast 2012-2031
The “Action” is Shifting

Source: Boeing Current Market Outlook 2012-2031
Asia-Pacific: A key Factor in the Airline Industry Future

<table>
<thead>
<tr>
<th>Growth measures</th>
<th>New airplanes</th>
<th>Share by size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy (GDP)</td>
<td>320</td>
<td>3%</td>
</tr>
<tr>
<td>Traffic (RPK)</td>
<td>3,230</td>
<td>27%</td>
</tr>
<tr>
<td>Cargo (RTK)</td>
<td>7,990</td>
<td>66%</td>
</tr>
<tr>
<td>Airplane fleet</td>
<td>490</td>
<td>4%</td>
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<tr>
<td>Total</td>
<td>12,030</td>
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</table>

<table>
<thead>
<tr>
<th>Market size</th>
<th>2011</th>
<th>2031</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deliveries</td>
<td>340</td>
<td>460</td>
</tr>
<tr>
<td>Market value $1,700B</td>
<td>1,080</td>
<td>3,490</td>
</tr>
<tr>
<td>Average value $140M</td>
<td>3,170</td>
<td>9,230</td>
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<tr>
<td>Regional jets</td>
<td>120</td>
<td>490</td>
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<tr>
<td>Total</td>
<td>4,710</td>
<td>13,670</td>
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</tbody>
</table>

Source: Boeing Current Market Outlook 2012-2031
China: The Gold Red Star of Asia-Pacific

### China
**Key indicators and new airplane markets**

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<th>Growth measures</th>
<th>New airplanes</th>
<th>Share by size</th>
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</thead>
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<tr>
<td>Economy (GDP)</td>
<td>110</td>
<td>2%</td>
</tr>
<tr>
<td>Traffic (RPK)</td>
<td>1,190</td>
<td>23%</td>
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<tr>
<td>Cargo (RTK)</td>
<td>3,650</td>
<td>69%</td>
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<tr>
<td>Airplane fleet</td>
<td>310</td>
<td>6%</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>5,260</strong></td>
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</table>

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<th>Market size</th>
<th>2011</th>
<th>2031</th>
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<tbody>
<tr>
<td>Deliveries</td>
<td>80</td>
<td>140</td>
</tr>
<tr>
<td>Market value</td>
<td>280</td>
<td>1,310</td>
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<tr>
<td>Average value</td>
<td>1,490</td>
<td>4,220</td>
</tr>
<tr>
<td></td>
<td>60</td>
<td>310</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,910</strong></td>
<td><strong>5,980</strong></td>
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</table>

Source: Boeing Current Market Outlook 2012-2031
Dramatic Growth Within China: Past is Prologue

Source: Boeing Current Market Outlook 2012-2031
The PRC Domestic Market Will Become the Largest in the World

Source: Airbus Global Market Forecast 2012-2031
Why Consider the PRC Domestic Market?

- Emphasizes the dramatic changes coming in the global market
- Domestic PRC feed will provide a significant competitive lever for Chinese carriers
- U.S. carriers need to have a competitive strategy, including service between hubs and interior points, using 787/A350
### Regional Forecast Growth Rates

<table>
<thead>
<tr>
<th>Region</th>
<th>Africa</th>
<th>Latin America</th>
<th>Middle East</th>
<th>Europe</th>
<th>North America</th>
<th>Asia Pacific</th>
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</thead>
<tbody>
<tr>
<td>Asia Pacific</td>
<td>7.4%</td>
<td>5.4%</td>
<td>7.2%</td>
<td>5.7%</td>
<td>4.8%</td>
<td>6.7%</td>
</tr>
<tr>
<td>North America</td>
<td>6.0%</td>
<td>5.1%</td>
<td>6.4%</td>
<td>3.8%</td>
<td>2.2%</td>
<td></td>
</tr>
<tr>
<td>Europe</td>
<td>4.8%</td>
<td>4.6%</td>
<td>5.1%</td>
<td>3.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Middle East</td>
<td>6.9%</td>
<td>-</td>
<td>5.1%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Latin America</td>
<td>8.3%</td>
<td>6.5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Africa</td>
<td>6.2%</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Source: Boeing Current Market Outlook 2012-2031
N. American Airline Growth Depends on Other Regions

Source: Airbus Global Market Forecast 2012-2031
Focus on Latin America

- American the dominant U.S. carrier
- Recent/announced service expansions:
  - Miami-Manaus; also separate Salvador/Recife
  - Miami-Asuncion, Paraguay
  - Miami-Rotan (Honduras)
  - DFW-Lima
  - Second JFK-Sao Paulo
  - Second MIA-Rio de Janeiro
COPA—Unexpected Innovation in the Latin American Market

- Successful use of Panama as a North-South hub
- Strategy: single-aisle aircraft & frequency
- Single-stop connections between North & South America
- Economic efficiency
- A “Black Swan”
Connecting Asia & Latin America via the U.S.: not a New Idea!

Photo © Mel Lawrence; collection of George Hamlin
Connecting Asia & Latin America via the U.S

- Many Asia-Latin markets too long for nonstops
- New aircraft (787, A350) can address these opportunities
  - Appropriate size
  - Adequate range
- Example: Japan-Brazil via Miami
Alliances: The Whole is Greater than the Sum of the Parts

Photo © George Hamlin
What About Africa?

- Pan Am pioneered service between the U.S. and west and southern Africa
- However, a decade ago, no U.S. carrier served sub-Saharan Africa
- Extensive Chinese presence in Africa: drawn by natural resource abundance
- Delta now serving West/South Africa
- United flying Houston-Lagos
And African Carriers Serve U.S. Markets

Photos © George Hamlin
Capacity Discipline: Where & How Much?

- Quarterly earnings vs. investment for long-term
- Capacity discipline and ‘right-sizing’ still important in mature N. American markets
- International markets: a different story
- *Not* unbridled expansion but focus on positioning to benefit from global growth
Summary & Conclusions

- Capacity growth restraint continues to be important in the short run in mature markets.
- Future airline growth will be largely outside the U.S., Europe and Japan.
- Many potentially profitable opportunities, even in the near term.
- The Challenge: assure growth reflects market opportunity.