What future for Airports ?

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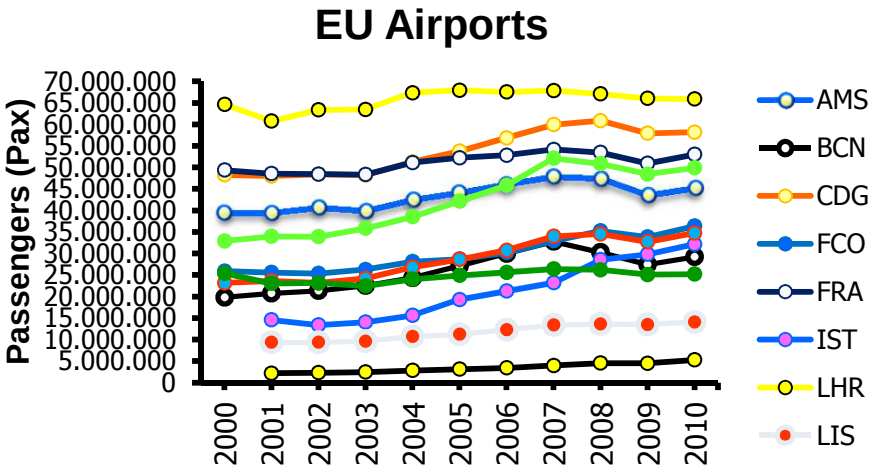
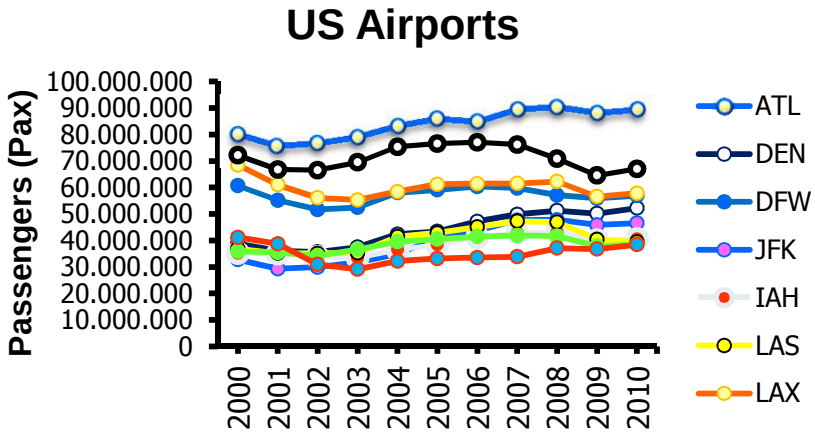
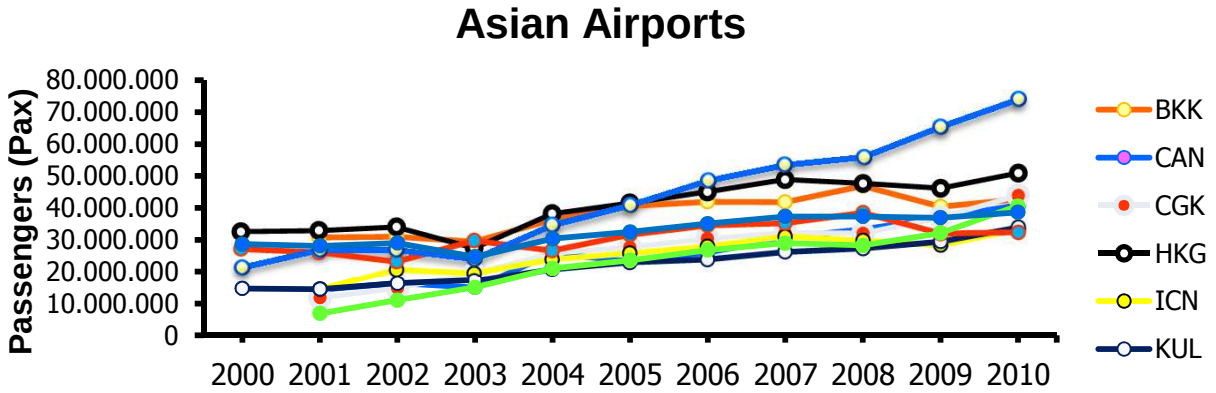
* We thank Rui Couchinho, Franziska Kupfer, Hilde Meersman, and Evy Onghena, Vasco Reis for data and discussions.

SOME FACTS……

- General about airports (pax, cargo and movs)







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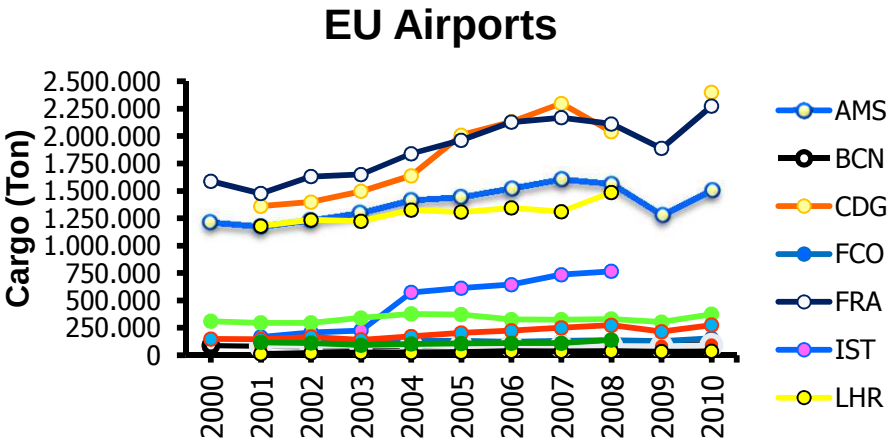

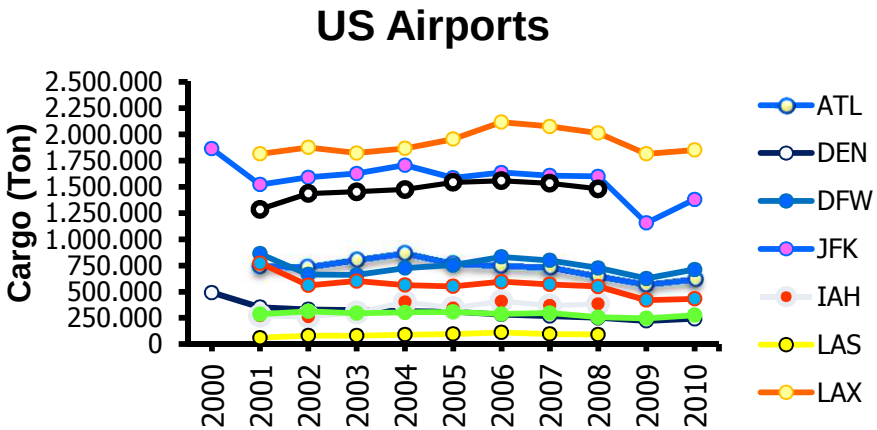

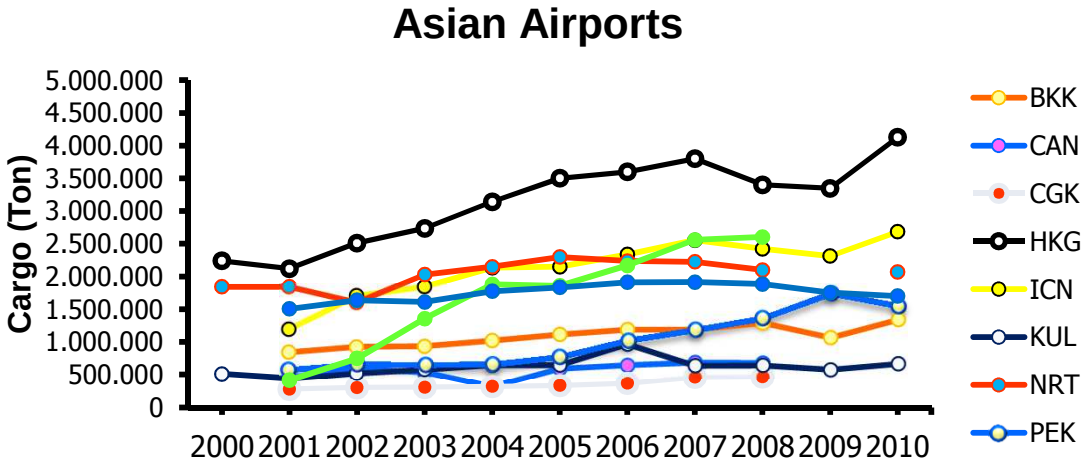

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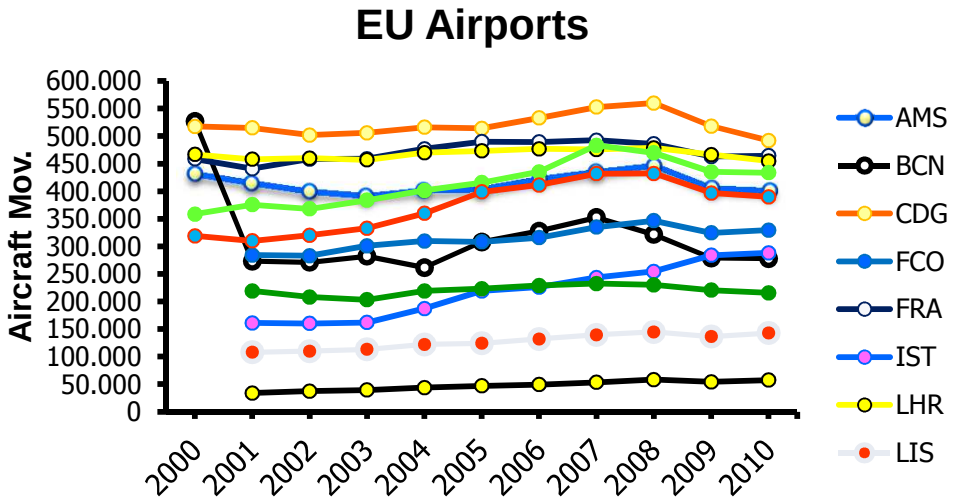

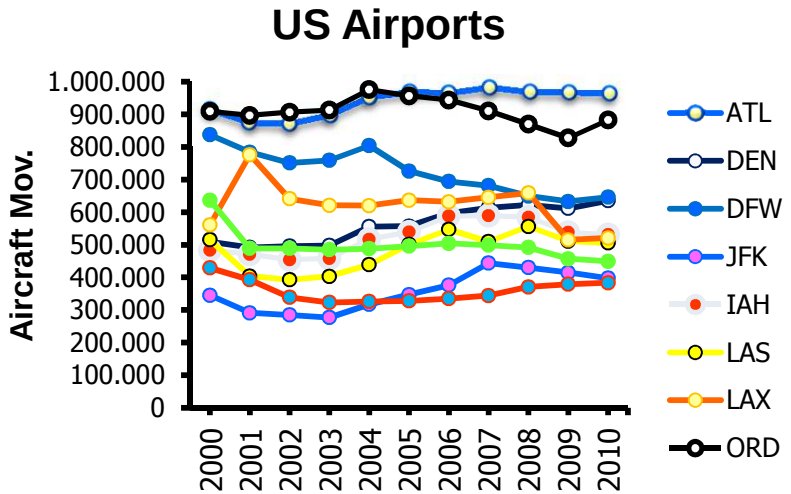

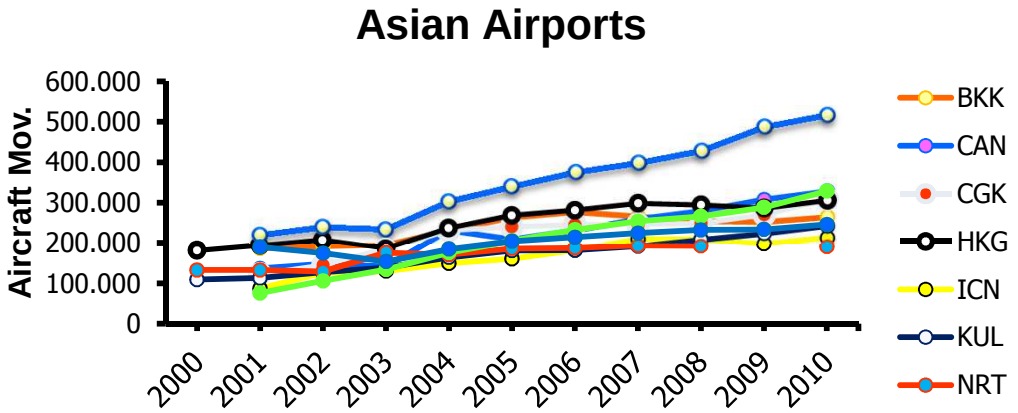

ANNOUNCEMENTS AT THE SAME MOMENT…

- Brussels Airport:
  - cash flow increase of 28% (April-June 2011)
  - due to tariff increases
  - due to growth of Brussels Airlines
- Brussels Airlines: expected loss of about 80 mln €
- Ryanair increases profit expectations for 2011 to 440 mln €
- Some actors also gain from other non-aeronautical sources, and this can be very significant

Some facts…. (ctd)

- The big three European airlines do have problems
- Some small to medium-sized airlines are in big trouble (Olympic, Austrian,…)
- Some low cost airlines (e.g. Ryanair) are still successful, but after important measures (e.g. re-scheduling and/or decreasing supply)
- If some low cost airlines can find a good match between demand and structure of supply, why can’t the others?

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1. Introduction
2. **Brief recap of evolution in last 20 yrs**
3. Facts and figures
4. Causal evidences: driving factors
5. Possible ways to go: airlines and airports
6. Conclusions

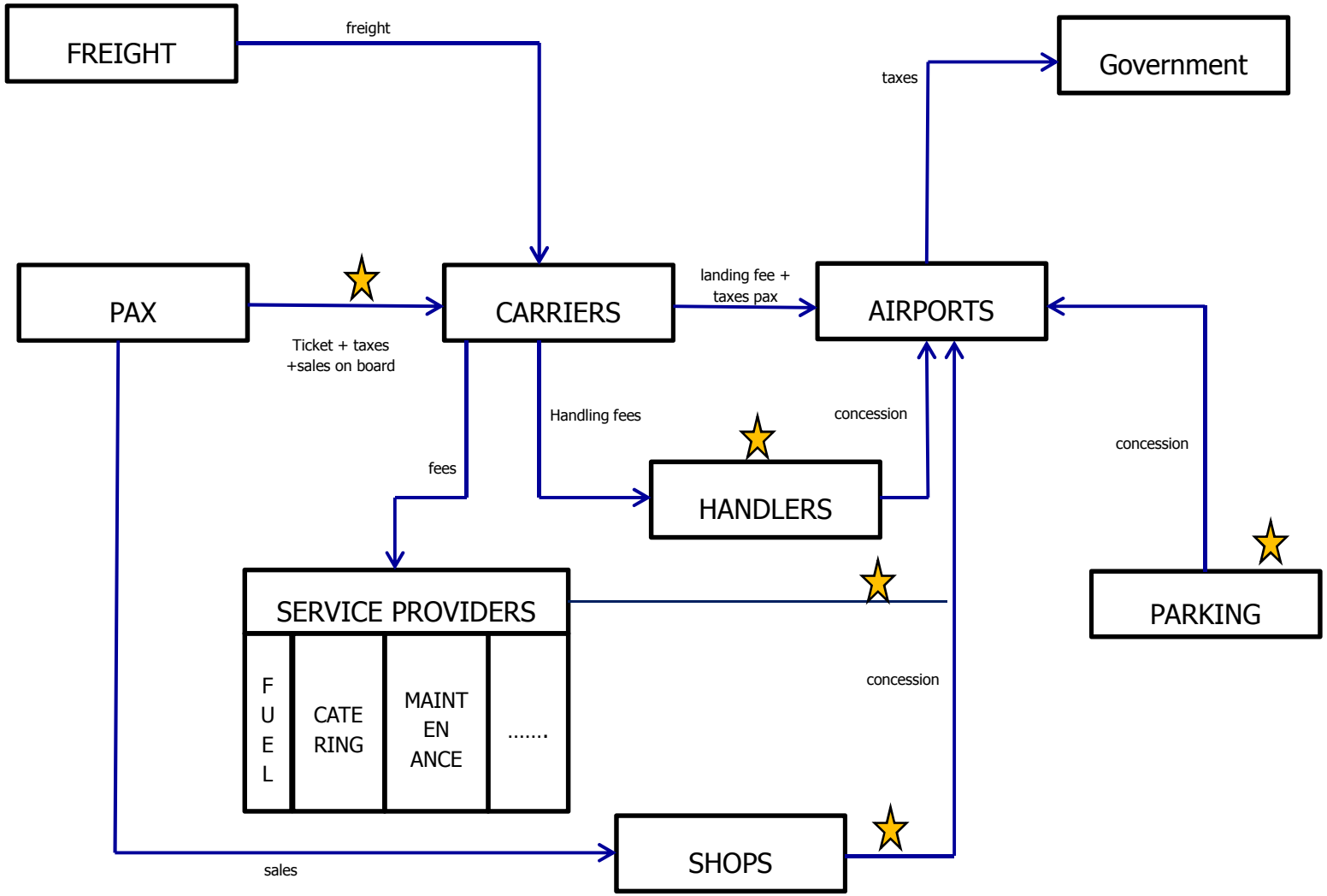
WHERE IS THAT BRIGHT FUTURE?

- US domestic airline industry: deregulated in 1978
- The European Union followed with its own deregulation (three packages)
- Elimination of most economic restrictions on new entry and pricing
- Expectations after deregulation: a healthy air transport industry
- Reality is less bright: who looses money in the air transport chain, who gains?

THE PLAYING FIELD

- The air transport chain: many actors, with mutual relationships
- Hypothesis
  - most airlines do have problems, due to lower yields and higher costs
  - airports are successful, due to several income flows
  - service providers: mixed picture

PHYSICAL AND FINANCIAL FLOWS



MODELLING

- ***Revenue carriers***

  Ticket revenue = f(number of passengers, yield, …)

  Auxiliary income = f(number of passengers, income level passengers, ….)

- ***Revenue airports***

  Landing fees = f(number of planes) = indirectly f(number of passengers, size of planes)

  Concessions = f(expected number of passengers, competition, space, ….)

MODELLING (ctd)

- ***Revenue service providers***

  Revenues = f(number of planes, number of passengers, price level, ….)

Crucial common variable: number of passengers
(being generator of cash flow)

Incentive: increase that number of passengers

- A similar reasoning applies to ***Air Cargo***

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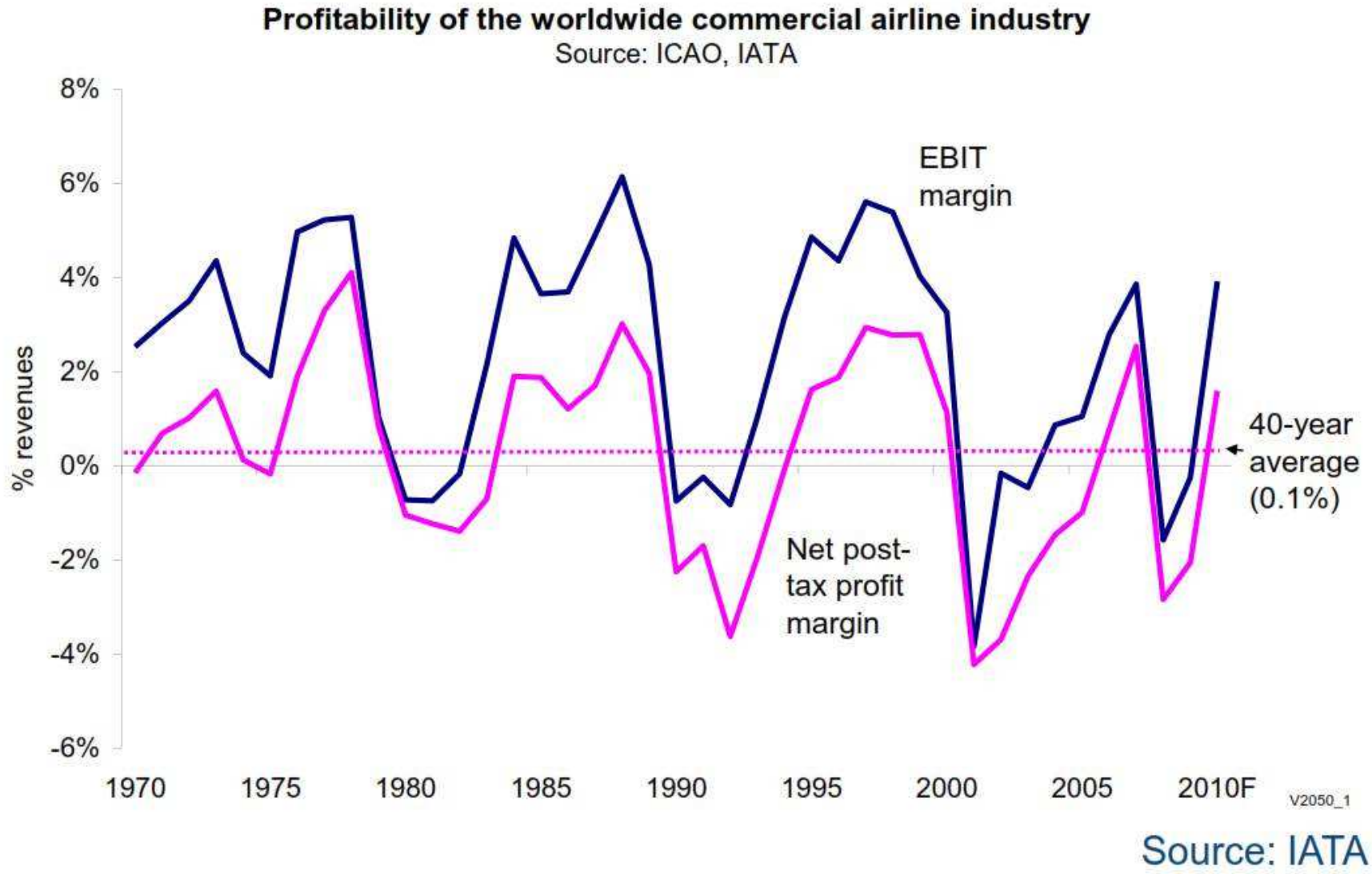
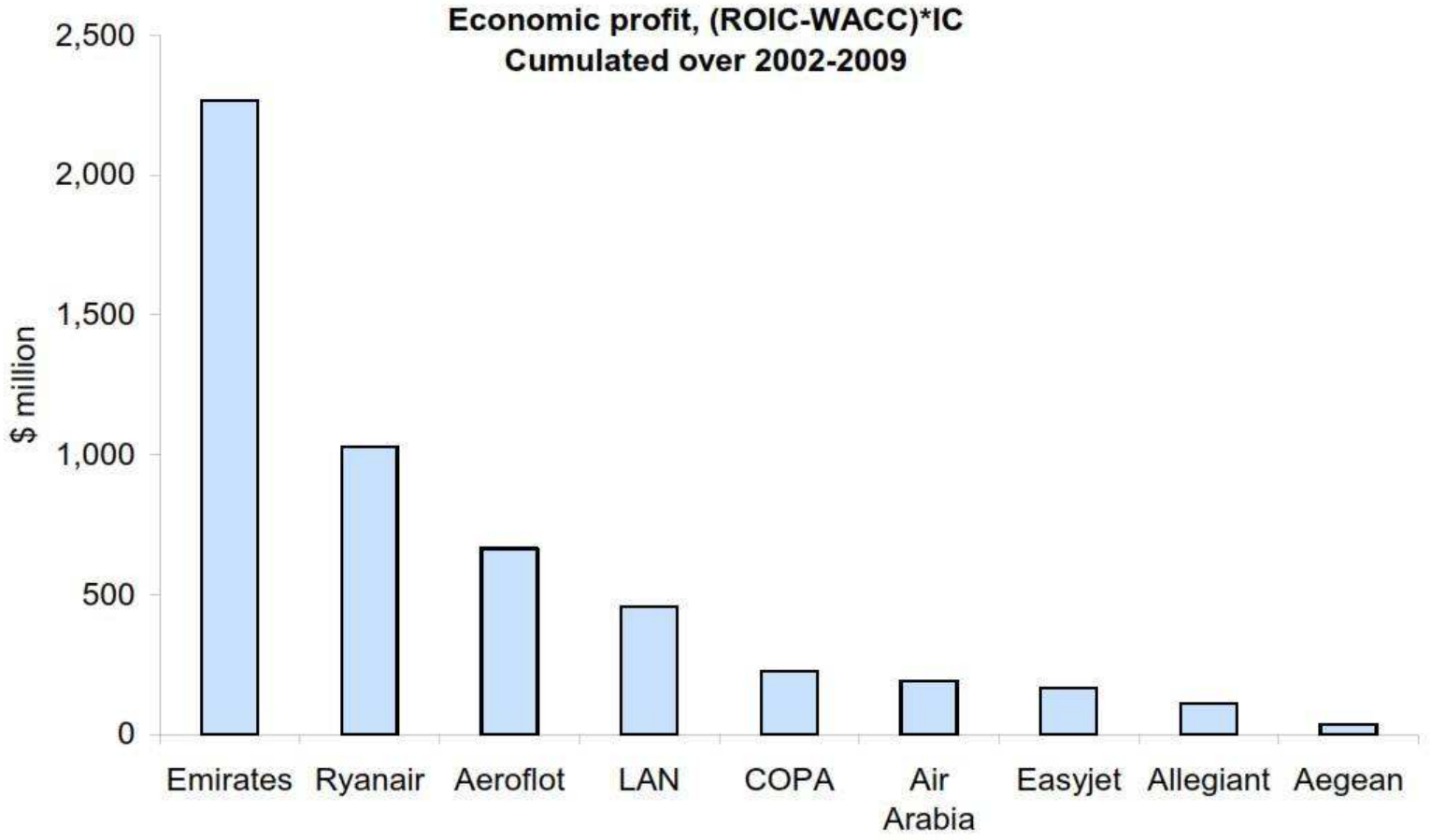

Profitability of the worldwide commercial airline industry
Source: ICAO, IATA
8%
6%
4%
2%
0%
-2%
-4%
-6%
% revenues
EBIT margin
40-year average (0.1%)
Net post-tax profit margin
1970
1975
1980
1985
1990
1995
2000
2005
2010F
V2050_1
Source: IATA

COMPANY REPORT BRUSSELS AIRLINES

Profile	12/31/2010 1,000 €)	12/31/2009 (1,000 €)	12/31/2008 (1,000 €)	12/31/2007 (1,000 €)	12/31/2006 (1,000 €)
Turnover	693,752	629,540	783,429	755,464	620,768
Net added value	149,505	99,133	171,211	145,419	147,037
P/L for the periode after taxes (+/-)	5,249	-39,812	-6,800	25,624	4,839
Cash flow	15,802	-28,925	7,250	40,711	27,655
Total assets	371,661	325,580	419,489	448,963	448,865

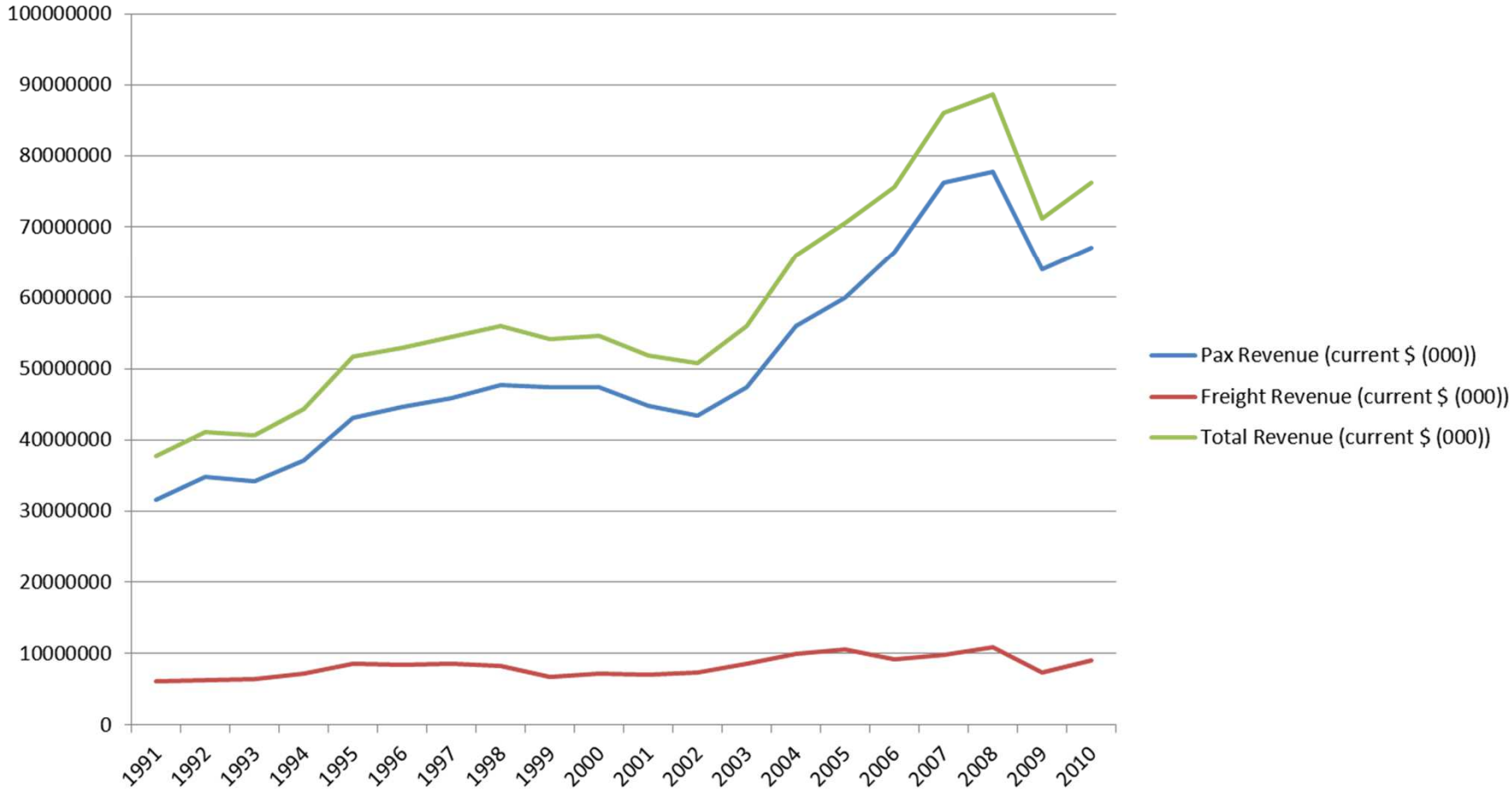
Source: bel-first (update 159 – June 2011)

A handful of airlines created value



Source: McKinsey & Company for IATA

TOTAL REVENUE (AEA, total int.)



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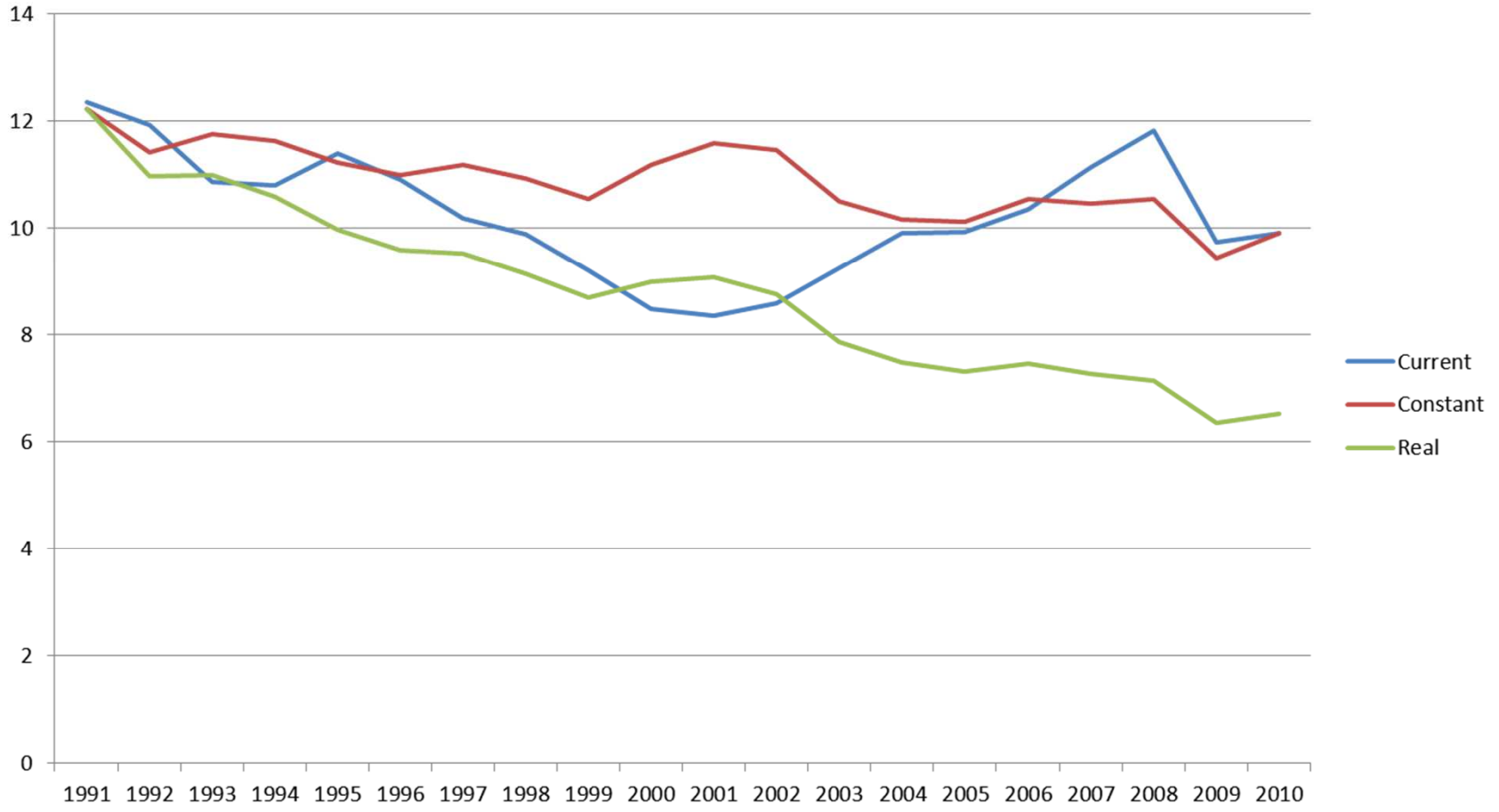
DEFINITIONS

- Passenger yield: the average amount of passenger revenue received per Revenue Passenger Kilometre (RPK)
- Cargo yield: The average amount of cargo (freight and mail) revenue received per Cargo Tonne Kilometre (CTK)

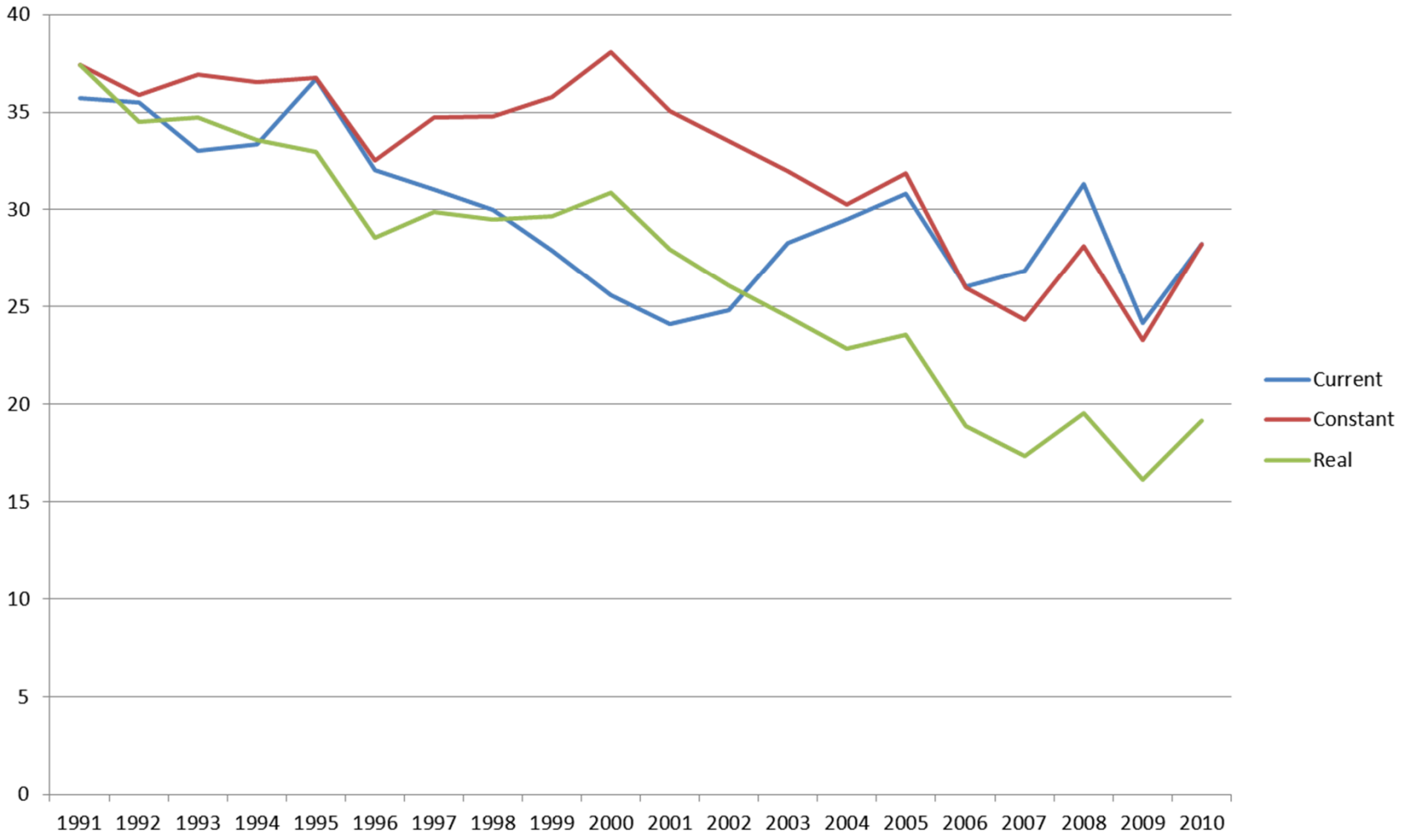
DEFINITIONS

- Current yield: yield without any exchange rate or inflation adjustments
- Constant yield: yield adjusted for exchange rate fluctuations versus the US dollar
- Real yield: yield adjusted for exchange rate fluctuations and inflation (deflator: OECD Consumer Price Indices)

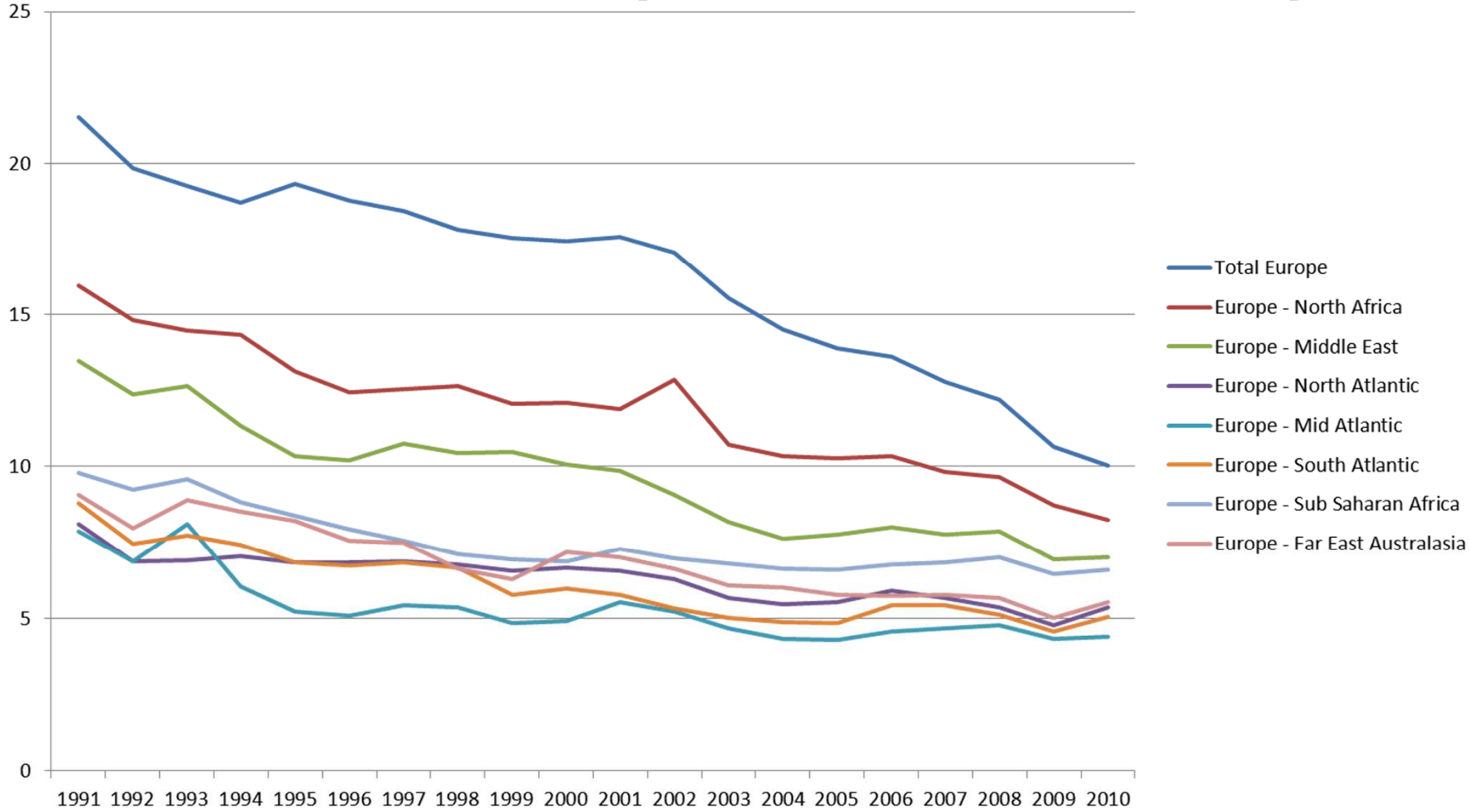
PASSENGER YIELDS (Usc/RPK) (total int.)



CARGO YIELDS (Usc/CTK) (total Int.)

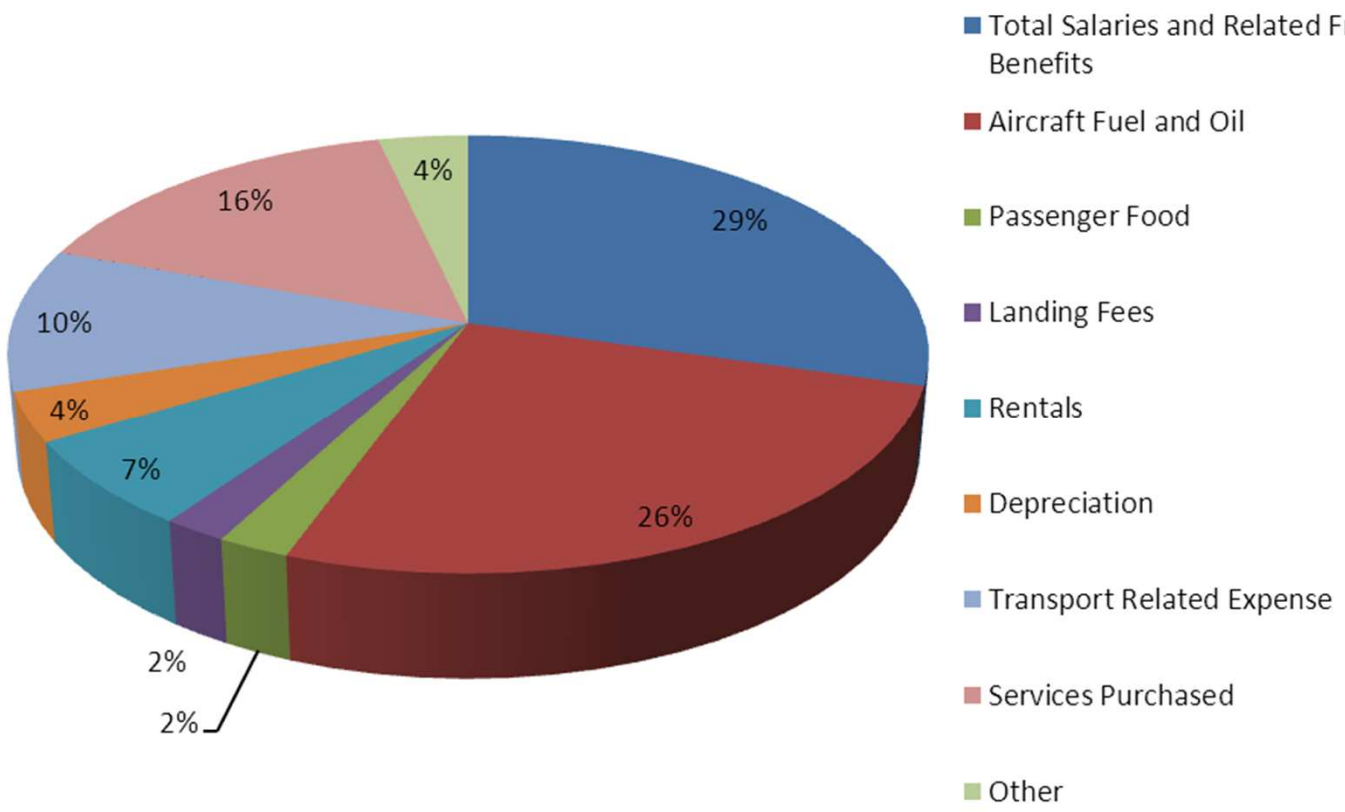


PASSENGER YIELDS FOR VARIOUS ROUTES (Usc/RPK, real, AEA)



CARGO YIELDS FOR VARIOUS ROUTES (Usc/CTK, real, AEA)

AIRLINE COSTS
(total operational cost AA, 2010)

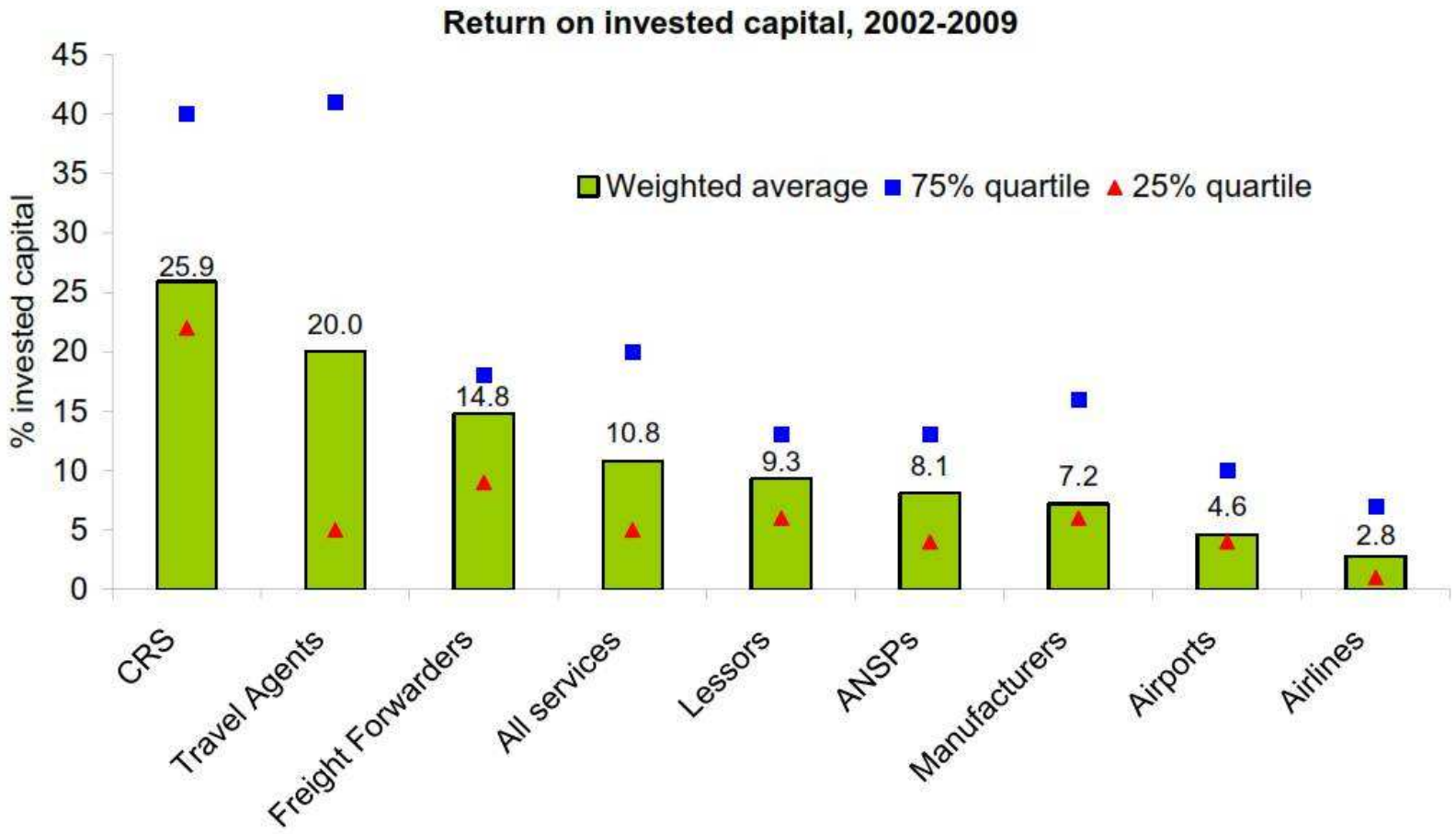


POTENTIAL CAUSES

- "*No conventional long-run equilibrium explanation for an industry that perpetually loses money*" (Borinstein, 2011)
- Four potential theories:

1. Exogeneous cost drivers: taxes and fuel
2. Exogeneous demand shocks
3. Entry and expansion of low-cost carriers
4. A series of unfortunate events

Most of the value chain is profitable



Source: McKinsey & Company for IATA

AIRPORTS

- Analysis of income flows of airports
- Analysis of financial control of airports (eg Brussels airport has been sold by Macquarie to an Canadian pension fund)

- Questions that need urgent answer ?

  - What is the best airport pricing strategy, single till or dual till?
  - Is capital ownership relevant ?
  - Is ownership-structure-performance the new paradigm ?

COMPANY REPORT BRUSSELS AIRPORT HOLDING

Profile	**12/31/2009 (1,000 €)**	**12/31/2008 (1,000 €)**
Turnover	n.a	n.a.
Net added value	-161	-48
P/L for the periode after taxes (+/-)	16,261	11,467
Cash flow	n.a.	n.a.
Total assets	2,551,310	2,568,139
Return on capital employed (%)	4.44	4.15

Source: bel-first (update 159 – June 2011)

SERVICE PROVIDERS: GROUND HANDLING

- Increasing share for independents, less for airports and airlines self-handling
- Independents: relatively small club (Swissport, BBA Aviation, Aviapartner, Menzies, Servisair…)
- Eclectic ownership mix (e.g. 3i in Aviapartner)
- Independent sector has a very wide range of scales, models and profitability

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POTENTIAL STRATEGIES

- What do we learn out of the analysis?

  - some actors are making profits, other actors are losing money
- If we have a zero-sum game: no incentive to co-operate
- The air transport business is NO zero-sum game

  - Incentive to make the pie a bigger one

  - Can we find a partnership-performance relation ?

POTENTIAL STRATEGIES (ctd)

The case of the airports

- Aim is profit maximization
- Realized by maximizing revenues and/or minimizing costs
- Revenue side:
  - increase the number of passengers?
  - increase landing tariffs? (cf. elasticity)
  - increase the other sources of revenue
- Message: don't kill your best client (cf. the system character of the business)

POTENTIAL STRATEGIES (ctd)

The case of the airlines

- Aim is profit maximization
- Cost side:

  - minimize input factor costs, including landing charges
- Revenue side:

  - increase the number of passengers?

  - increase yield? (cf. elasticity)
- Message: strengthen your negotiation position in your home or hub airport
  - ❖ Is "cabotage competition" paying ? (restructuring and creaming off others markets, e.g. legacy going for low cost)

POTENTIAL STRATEGIES (ctd)

The case of the service providers (e.g. shops)

Aim is profit maximization

- Cost side:

  - minimize concession payments (besides other input factor payments)
- Revenue side:

  - increase the number of passengers?

  - optimize product price level? (cf. tax free shops, and elasticity)
- Message: hope for more and richer passengers, your clients

POTENTIAL STRATEGIES (ctd)

The solution could be CO-OPERATION

- Airports: taking share in capital of home carriers (e.g. re-capitalization program)
- As part of Single till – Dual till discussion
- No mergers; no discrimination of non-participating actors, e.g. other airlines
- Are alliances airline-airports effective, or just a fancy trend ?
- Partnerships can work: e.g. Vancouver

The message: the chain approach increases the pie, and the pieces of cake of each actor!

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CONCLUSION

- The air transport sector is like an economic laboratory where new evolution and trends tend to come to light
- Think in terms of policy packages, allowing to offset the negative impacts of one instrument with the positive impact of other instruments
- Allow 'out of the box' movements in the relation between actors
- Design policies considering the whole chain, not only the main actors, 3rd and 4th parties do play a role creaming-off profits

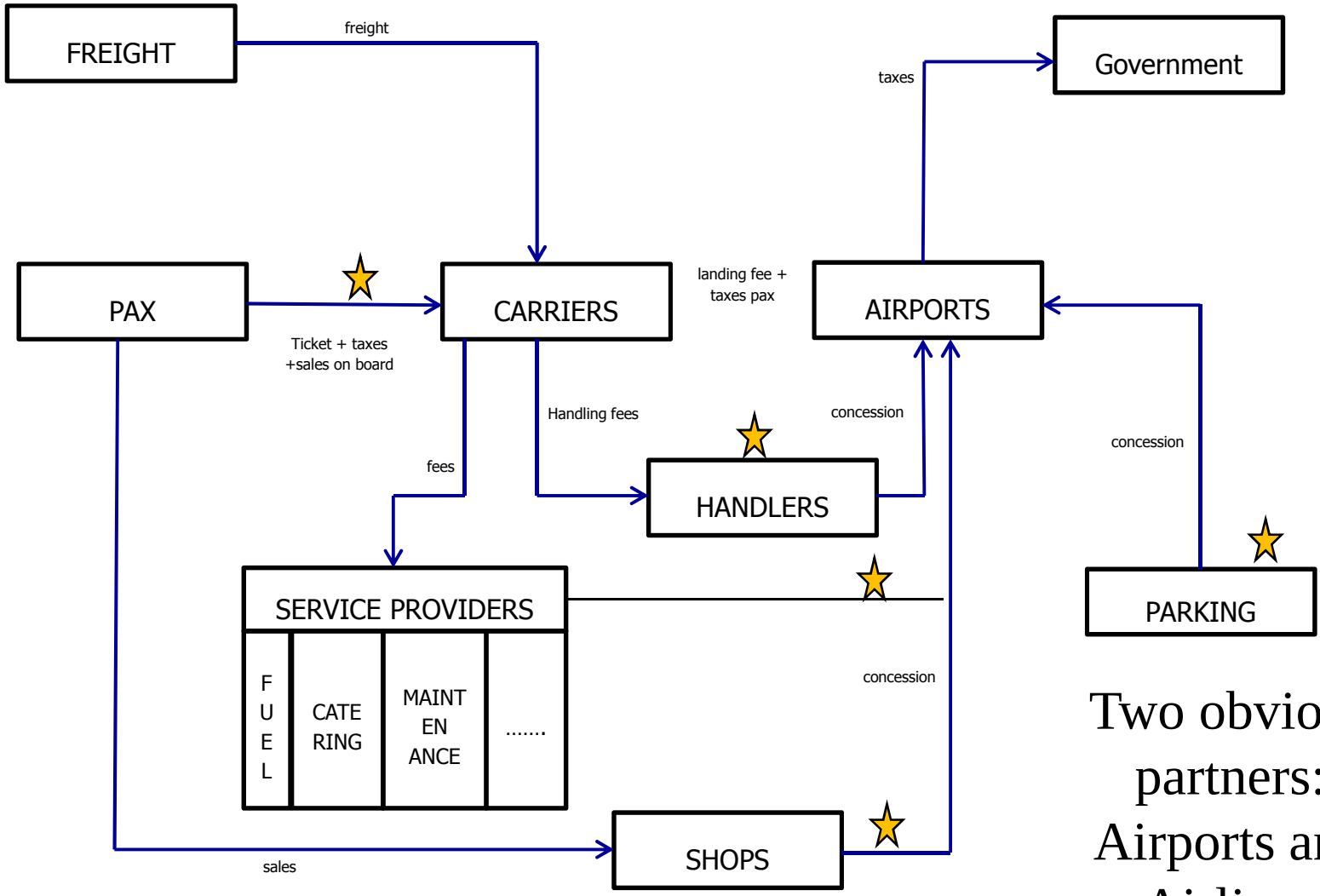
CONCLUSION (ctd)

What will be the effect of the new (announced) policy of the European Commission?

- Liberalisation of ground handling services: at least three instead of two!
- More flexible use of landing and take-off slots (i.e. European framework to sell/buy slots, and airlines should use higher percentage of slots)
- More transparency concerning airport noise limits

Do not forget: a system will be influenced!

CONCLUSION (ctd)



Two obvious partners: Airports and Airlines

THANK YOU