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A Conversation With...

Giovanni Bisignani
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International Air Transport Association

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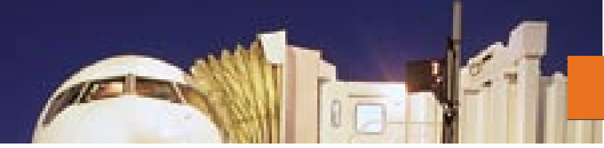


Shaping up

Last year, world scheduled airline passenger revenues surpassed US$400 billion for the first time, continuing an increase that began three years ago and looks to continue.

By Vijay Bathija | *Ascend* Contributor

Since the air transportation industry's decline of 2001 and 2002, world airline revenues have been increasing again for the past three years. In 2004, total airline revenues increased above the 2000 peak for the first time, and that growth continued last year at a very healthy 10 percent.

Although the airline industry has always been cyclical, the past few years have been even more challenging than the usual down cycles. Airline traffic and revenues are susceptible to world events, both economic and political, and since peaking in 2000, the industry has endured two main events that led to the decline in revenues:

- The events of Sept. 11 caused a decline in overall airline traffic and revenues.
- Severe acute respiratory syndrome had significant downward impact on international traffic and revenues, especially in Asia. Some Asian carriers saw almost a 50 percent drop in their traffic.

The impact of these events led to an economic slowdown around the world. Because business traffic is closely tied to the level of economic activity, airline travel also slowed.

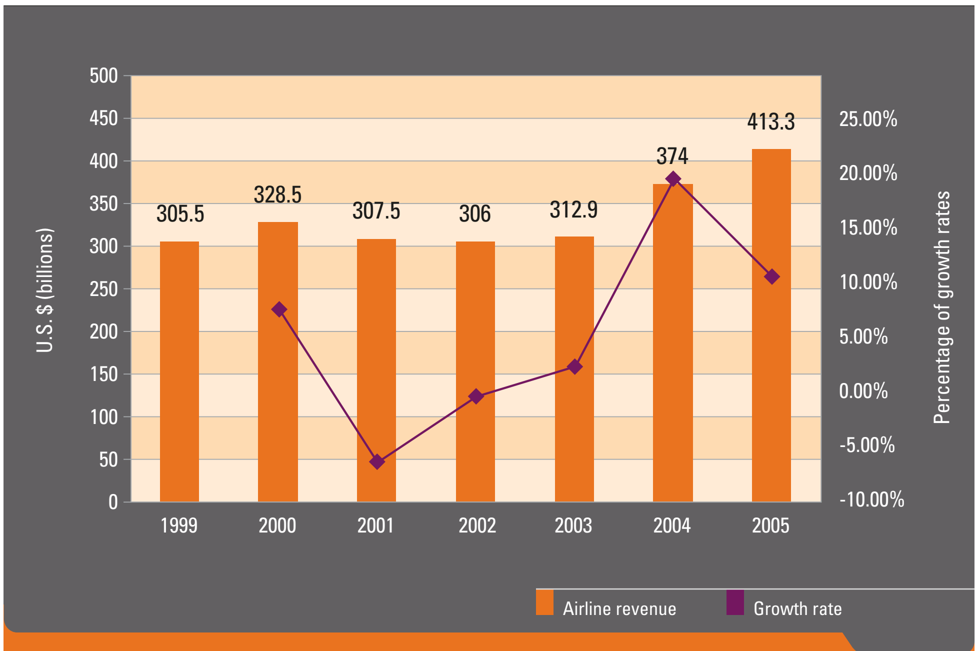
However, since 2003, an economic recovery started to take shape, and airline revenues have increased correspondingly.

"The airline industry has gone through many challenging times," said Nejib Ben-Khedher, president and managing partner of the consulting practice for the *Sabre Airline Solutions*® business. "However, we think the recovery will continue as people's need for travel continues to grow with globalization and economic progress."

Factors contributing to the continuing growth of airline revenues include:

- Worldwide economic recovery,
- Liberalization and growth of emerging markets such as India, China and Brazil,
- Continued strong growth in the Middle East,
- Growth of low-cost carriers around the world.

Worldwide Airline Revenues



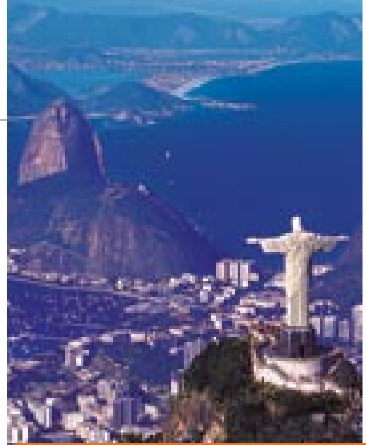
Scheduled airline passenger revenues have increased steadily since 2002. In 2004, revenues crossed the previous peak of 2000 and continued the upward momentum in 2005.

Worldwide economic recovery after the weakness seen in 2001 and 2002 has included a return of leisure as well as business travel. Airline industry revenues spiked sharply in 2004 following the strong volatility of demand from 2001 to 2003. This trend has returned to more stable levels in 2005, and the International Air Transport Association forecasts more stable growth during the next five years. International traffic is expected to grow between 5 percent to 6 percent during that period.

Another factor contributing to the growth of airline revenues worldwide is the rapid expansion of the airline industry in strong growth markets such as India, China and Brazil.

India is emerging as a growing economic force and is expanding rapidly in the service sector. A growing middle class and its increasing integration with the world economy are resulting in rapid expansion of domestic and international traffic. India's domestic traffic grew by almost 50 percent in 2005 and expects to continue growing. With liberalization, international traffic is also growing and capacity is being added rapidly by Indian and foreign carriers to meet the growing demand.

Airline traffic in China has shown strong growth that is expected to continue in the coming years. Since 1990, domestic China traffic has grown from less than 20 million to almost



Emerging regions, including Latin America, China and India, are showing strong growth in airline traffic that is contributing to the improved performance of airlines serving those areas and helping airline passenger revenues pass US$400 billion for the first time.

Latin America photo from Sabre Airline Solutions archive; Shanghai-Pudong Airport photo by Andrew Hunt/AirTeamImages.com; Delhi skyline photo by Christine Dedman/Dreamstime.com

120 million passengers in 2005. According to IATA, international traffic to and from China is also expected to grow 9.6 percent annually during the next five years — one of the highest growth rates in the world.

Latin American countries are experiencing a similar growth trend. Traffic within Latin American countries is being boosted by economic revival within the region, especially in countries such as Brazil and Mexico.

Developing countries show stronger responsiveness in demand to growth in economic activity. Business expansion leads to increased employment and higher disposable income, resulting in new demand, therefore the growth in demand and capacity as well as airline revenues from these regions is expected to continue growing rapidly.

While high oil prices have been a drag on the industry and economies as a whole, the Middle East is showing strong traffic growth due to the investment of petro dollars. With the expansion of its population base and already high levels of income, the Middle East is one of the fastest-growing regions in the world. Due to strong trade surplus and desire to divest from dependence on oil alone, a significant investment is taking place in the region's tourism and aviation sectors.

"Air traffic in the Middle East is poised to continue to grow during the next few years due to strong intra-regional travel as well as emphasis on tourism and high interest in the region from outside," Ben-Khedher said. "The airlines in the region are growing and adapting best practices as well to meet this surge in demand."

The low-cost carrier segment has also featured strong growth during the last few years leading to new market demand. Last year was a particularly strong growth year for LCCs in Asia and Latin America. Asia, in fact, had the highest number low-cost carrier start ups in 2005 owing to the rapid liberalization of air traffic in the region. The emergence of LCCs in countries such as India, Malaysia and Brazil has boosted traffic in these regions. At the same time, the largest LCCs in Europe have continued their growth path, albeit with some profitability challenges, resulting in higher share of revenues for the LCC segment as a whole.

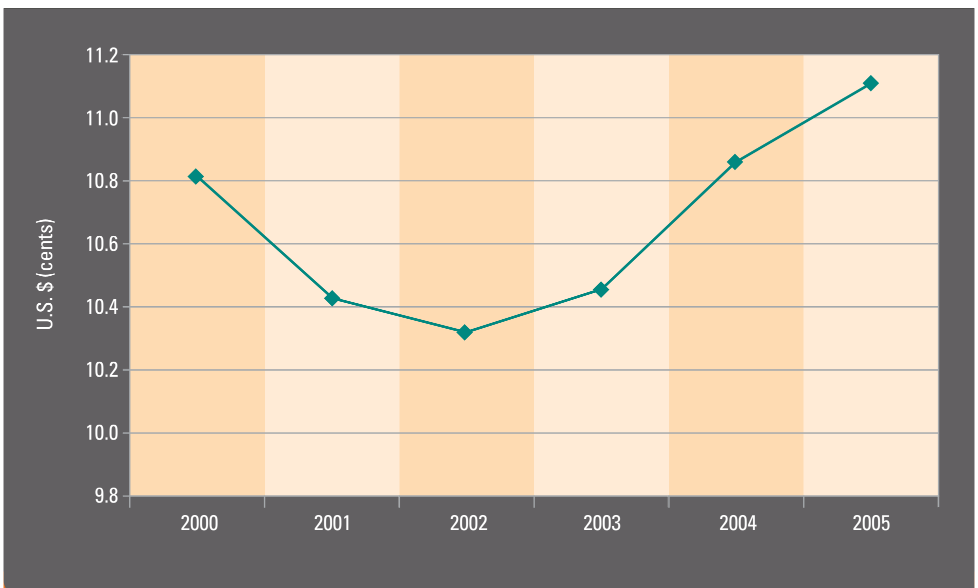
The airline industry has high levels of fixed costs. As revenues vary year to year and month to month, airlines do not have the ability to reduce capacity in the same ratio, leading to a decline in traffic, as seen between 2001 and 2002, which often leads to lower revenue per unit or yield. Worldwide yields significantly reduced in the slow period from the peak of 2000. Recovery started slightly in 2003 and picked up pace in 2004. For the first time in 2004, the yield of 10.9 cents per revenue passenger kilometer was higher than the yield in the peak days of 2000. The momentum continued last year and the yield reached 11.1 cents per unit.

"Airlines are finally seeing improved yield, which will enable them to meet cost pressures and improve profitability," Ben-Khedher said. "We hope this will continue in the next few years as the industry comes out of one of the most challenging times in history."

While the return of yields and revenues is a good story, the industry's profitability is not as large as it could have been. High fuel costs have taken away the benefit of higher yields, causing airlines in many parts of the world to still struggle to maintain profitability. In 2005 alone, the industry, according to IATA, lost almost US$6 billion. The U.S. airline industry has been most affected, losing US$10 billion in 2005. Europe and Asia did better with profits of about US$1.3 billion and US$1.5 billion, respectively. However, these numbers are only marginal in relation to total revenues. Fuel prices touched a record high in mid 2006, putting a strain on airline budgets. High fuel has forced airlines around the world to raise fares and limit capacity increases.

The industry has been going through a fundamental restructuring and recovery forced by lower revenues. In the new landscape, airlines are battling increased competition and higher fuel costs. Deregulation around the world has brought new players and forced older ones to adapt. But, despite the changes, demand for air travel will continue to grow as will industry revenues as air transport becomes a basic need to meet demand from globalization.

Worldwide Airline Passenger Yield/RPK



After reaching lows in 2002, the past few years have seen a steady improvement in airline passenger yields, reaching 11.1 cents per revenue passenger kilometer last year.

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