BUSINESS AVIATION IN 2017: ADAPTING TO SURVIVE

In the first few years following the 2008 recession, annual business aviation conventions tended to herald an imminent recovery in demand, as much in hope as expectation. That misplaced optimism has petered out, and even the 'new normal' of slow growth has been disappointed by recent trends in new aircraft deliveries, which are forecast to fall to their lowest level in more than a decade in 2017. But beyond the doom and gloom for manufacturers, business aviation utilisation has been picking up. Flight activity in Europe is up 5% this year, after almost eight years' stagnation.

By Richard Koe

It might seem incongruous that the demand for business jet flights is recovering, given the wider environment's many prevailing macroeconomic risks and uncertainties. Trump appears to be re-writing the US out of its role as a global policeman and champion of free trade; the European Union is fighting to survive a populist contagion; economic growth in developing economies has substantially slowed with the slump in oil and commodities. Traditionally, business jet buyers take their cue from a stable macro-economy, and in particular, robust equity and currency markets. Right now, that stability is conspicuously missing.

It was the twin surprise of 2016, Brexit and Trump, which appeared, against all expectation, to mark a turnaround in sentiment in the business aviation industry. Since the second half of last year, the UBS monthly market confidence tracker has seen steady improvement. JetNet's quarterly surveys bounced back from historically low scores in early 2016 to an optimistic outlook by 2017, and especially in Europe. A turnaround in North America, at least temporarily, is no great surprise given Trump's reflationary economics and personal advocacy for business aviation. A pick-up in Europe would seem to be more of a revelation.

EUROZONE'S GROWTH

In fact, quietly, the Eurozone has enjoyed over 14 quarters of consecutive growth in GDP. The ECB's relentless quantitative easing appear to have warded off deflation, and as austerity gives way to some fiscal expansion, economic growth will probably accelerate this year. Corporate profits should improve, and with it, corporate investment in capital assets, like aircraft. Consumer confidence has improved more quickly, and Europe is still a magnet for high net worth individuals. The latest Knight Frank Wealth Report shows the population of Ultra HNWI has grown 42% in the last 10 years and is set to a grow a further 43% in the next decade.

The overhang in Europe is the political risk, with a whole variety of potential outcomes, which could undo pretty solid economic fundamentals. Primarily the concern is that radical populist parties gain power and start to mimic the nationalist and protectionist rhetoric across the Atlantic. But coming into the second quarter of 2017, that risk has modified. Greek debt has been kicked down the road, the populist tide was halted in Holland, and a Le Pen victory in France now looks unlikely. So far, the UK economy has also held firm despite the fog of Brexit. In March, European PMI accelerated, and

Chart 1: Q1 2017 business aviation activity trends by country

European stocks surpassed their 2015 highs.

This broad-brush of the streaky geopolitical climate in Europe is largely reflected in recent business aviation flight activity. Departures in the first Quarter were up by 7,600 flights compared to Q1-2016. As shown in Chart 1, the busiest two markets, France and Germany, have seen an average monthly gain of well over 1200 flights compared to last year. Underlying business jet growth is stronger; almost 40% of business aviation flights in Europe are turboprop and piston operated and this activity has steadily declined in the last 18 months. Considering just business jet activity, flights are up by more than 6% in 2017.

BRIGHT SPARKS

Recent growth in business jet activity is less impressive when compared to the halcyon pre-recession days; there were 33,000 business jet sectors flown in February 2017 compared to over 40,000 operated in February 2008. But again, the aggregate trend masks a very mixed picture when flight activity is shown by business jet segment. As shown by Chart 2, all but two jet segments have increased activity in Q1 2017. The Ultra-Long range and Super-Midsize segments have seen strong growth, as demand for Heavy and Midsize has wilted. All Light Jet segments are up, but the VLJ segment is what really stands out, with more than 20% YTD growth.

Digging deeper, we can see which aircraft types are generating most growth in activity. Owner activity continues to increase on the perennially most popular aircraft for Private Missions, the PC-12. Falcon platforms such as the 7X and Falcon 2000, as well as the substantial fleet of mostly ageing Challenger 600 jets, all contribute a large share of Owner flights, all growing YTD. Notably, the Citation Mustang has more than 20% YTD growth in Private activity. These are the bright sparks for otherwise declining Owner activity, which reflects the considerable number of ageing privately owned aircraft parked for sale.

CHARTER DEMAND

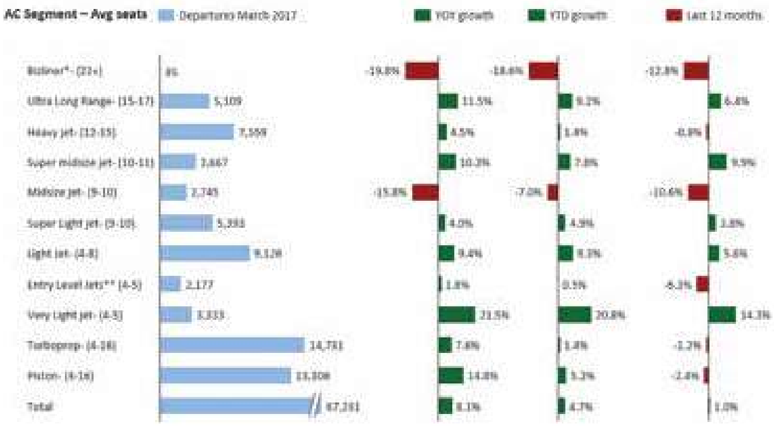
For AOC activity, the Citation Excel/XLS and King Air 200 remain the most popular charter aircraft, although demand has softened for these two veteran platforms in the last twelve months. The growth generators in terms of AOC activity are the best-selling Phenom 300 and Challenger 350 jets, and the Global Express platform. Both have been integral in reinvigorating the leading fractional fleets, and are also starting to permeate some of the major European fleet operators.

The Citation Mustang also has a solid growth in Charter demand. This is not surprising, reflecting the growth in the fleet size of leading operator GlobeAir as well as the recent merger of Blink and WiJet. The VLJ operators are still far from 'darkening the skies' as some claimed they would a decade ago, but they have generated non- stop growth over the last 5 years, and as their floating fleets start to expand towards 20 aircraft, they should start to harvest economies of scale. And whilst the Mustang is the backbone of the VLJ fleet in Europe, the Phenom 100 now has a third of the activity, with Charter sectors this year growing more than 30%.

Other aircraft with strong Charter appeal include older jet types such as CJ1 and CJ2, Embraer Legacy, and Falcon 900. The recession saw a big drop in Charter demand for these aircraft, but their activity is recently resurgent. In part that reflects creeping economic growth, encouraging users to respond to rock-bottom prices in an over-supplied market. But it also appears to be driven by the emergence of a number of new charter brokerage models. Broadly categorised as 'online brokers' these include membership platforms such as JetSmarter, bidding platforms such as Victor and PrivateFly, and price-generators such as Stratajet.

All have achieved prodigious growth in the last few years. Victor is ranked as one of the fastest growing digital firms in the UK, claiming a four-year average sales growth of 139 per cent. Last year Victor asserted that more than 30% of their bookings are from first time buyers. PrivateFly, which has traded for almost a decade now, continues to

Chart 2: Q1 2017 trends in aircraft activity, by segment



see its searches increase by 50% a year. Both have expanded aggressively into the US market. Relative newcomer Stratajet has expanded from 5 to more than 60 staff in two continents claims to be growing sales at 40% a month. JetSmarter became the first business aviation unicorn when its $105M raise in December valued it at $1.5BN.

In a long stagnant market where aircraft sales and per-aircraft utilisation are both still 40% shy of 2008, these are striking success stories. So far, the growth of these online disruptors appears to have come at the expense of traditional charter broker competitors, rather than from newcomers to business aviation. That shouldn't bother them, as they've so far taken less than 10% share of the market. And they may be pushing on an open door, as their customers, driven by the need for 'retail-immediacy' in their purchase of any other travel service, will increasingly demand the same digital experience when booking a private jet.

The growth of the online booking platforms is also working in harness with smarter fleet utilisation. Fleet management software is getting more sophisticated, facilitating much improved yield management. Leveraging the social networks which they´re using in order to build member-only access, the likes of JetSmarter have identified niches for deploying city shuttles allocated by seat-demand. It's no coincidence that the European shuttle routes JetSmarter are promoting on their website highlight many of the region's most popular and fastest growing connections.

EUROPE'S GREEN LIGHT FOR SET CHARTERS

If the US is trailing Europe the launch of online charter platforms – Stellar Labs is making up ground – it's well ahead in deploying new operating models. Just as NetJets innovated the fractional and then card products back in the 90s, the US has seen a wide range of shuttle and membership models establish themselves in the last 5 years. Besides JetSmarter, Wheels Up and Surf Air are looking to import these formulas to Europe this year. The price- point for charter in the US has long been lower due to the authorisation of single engine commercial operations. Europe's green light for SET charters from March 2017 is another well-timed stimulus to the charter market over here.

EBACE 2017

No one expects much fanfare at EBACE 2017. The OEMs are still in the doldrums. With the notable exception of the PC-24, their response has been pretty conservative; tinkering rather than redesigning the production line. The conference headline themes are likewise conservative: risk-mitigation; environmental issues, Brexit concerns, Security measures. But the recent trends in aircraft charter activity is telling another story, of a sector which is starting to get significant growth by adopting innovative business models. In the next 12 months' we will see whether the disruptive innovators in this niche can do more than just steal market share, and actually expand the industry to the benefit of its entire supply chain. ■

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