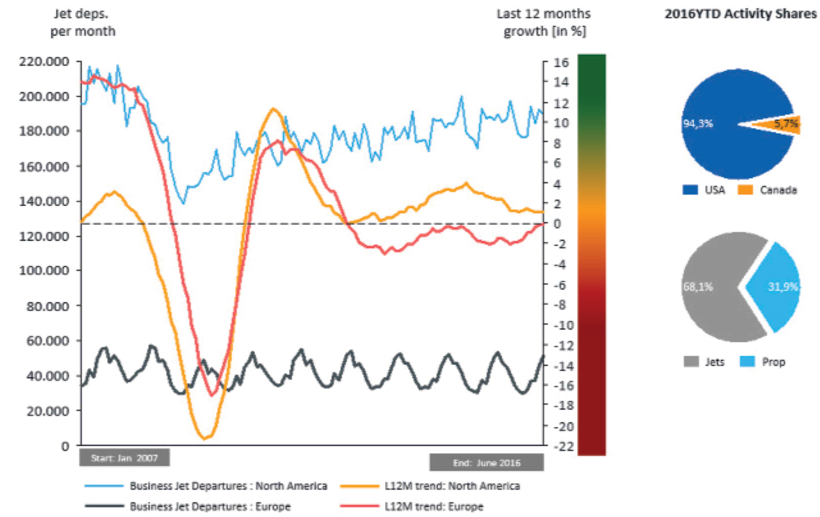
NORTH AMERICAN MARKET WEATHERING STORMY WATERS

As NBAA once again comes into view, the Business Aviation industry hopes that aircraft deliveries pick up the declining trend so far this year. **Richard Koe** reports



The conventional view over the last few years has been that flat is the new normal when it comes to business aviation. As forecasts for recovery have more recently been downgraded, even flat is coming to be seen as positive. This year's total new aircraft deliveries are now expected to be in the same range as the first half's disappointing 5% decline. Following guidance from leading OEMs, next year's deliveries are also expected to fall, probably to their lowest point since 2009. In this context, flight activity in North America, where at least two thirds of all business aviation activity happens, is doing well to hold its own.

That was the status after the first half of the year; compared to the same period 2015, business aviation activity was up 3% across North America in July. As shown in Chart 1, the 12-month rolling average trend for business jet departures is down a little in 2016, but has maintained forward momentum since it last flat-lined in 2012, and activity is up at least 40% from its trough in 2009. Having suffered a similar fall in 2009, the comparable European trend has been much weaker in that period, with business jet flights from across the region only regaining some flat-line stability in the last few months.

Within North America, the United States is the dominant market, with almost 95% of business jet activity in 2016. Flight activity levels are also relatively depressed in Canada due to the downturn in the oil and gas market. Within the US, a similar slowdown is evident in the state oil capital Texas, as shown in Chart 2. In contrast, the state with most and fastest growth in business aviation flight activity this year is California. With its economy – which would register as the 6th largest of any country worldwide – growing 4% compared to 2% for the US as a whole, California's robust appetite for business aviation is not a surprise.

The growth in business aviation activity in North America this year has come primarily in large aircraft, as shown in Chart 3. This reflects the relatively strong delivery trend for new aircraft in these segments since the recession, including the Global 6000 and Gulfstream 650 in the ultra-long range class, and the Challenger 350 and Gulfstream 280 in super-midsize. With the likes of NetJets and Flexjet upgrading their fractional fleets with the industry's largest ever orders, the active fleet in these segments has grown substantially in the last 5 years. Textron and Embraer have also benefiting from the replacement and upgrade cycle through the market entry of the Citation Latitude and Legacy series.

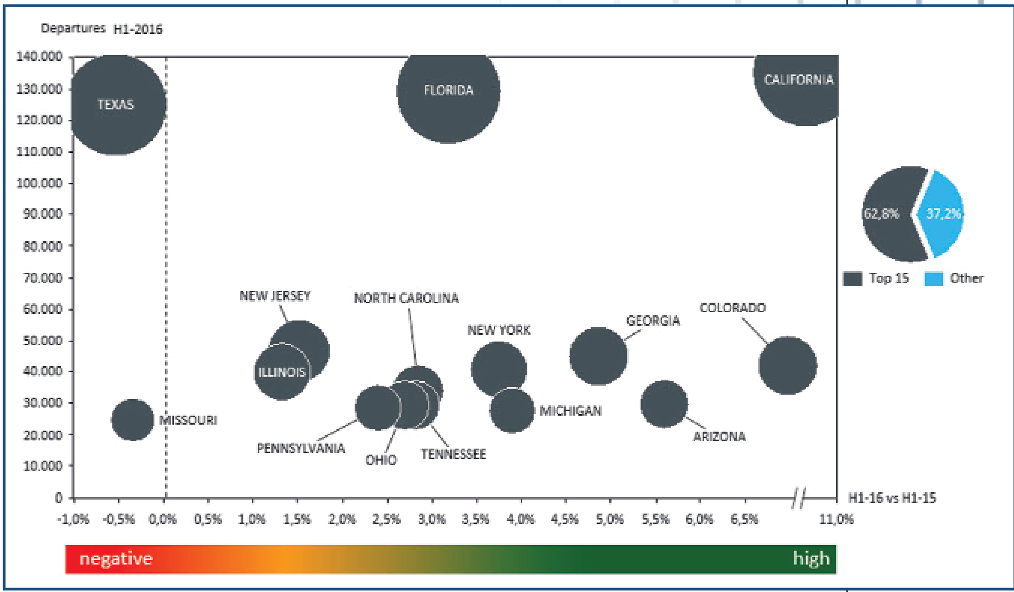
Conversely, the traditional staple of the business jet fleet, heavy and midsize jets such as the Challenger 600, Hawker 700-900 and Lear 60 series, have seen a consistent slowdown in activity. This is reflected in the stubbornly-high number of pre-owned aircraft for sale in the North American market. Belying the overall ratio of around 11% inventory for sale, at least a third of the ten-year-plus fleet is idly sitting for sale, despite precipitous falls in prices.

Overall, the lighter aircraft segment in North America is doing relatively well in terms of activity. This may reflect the relatively constant if tepid economic growth since 2010, with aircraft-owning firms and individuals benefitting from low interest rates, low energy costs, high corporate profits and strong stock market. The oil price slump is less kind to the larger aircraft segments, whose owners' economic fortunes tend to be more closely tied to the energy market. This is one reason, amid wider and increasingly serious economic and political distractions, for the downward drift in delivery guidance from the OEMs since 2015. So whereas 2016 activity levels are benefitting from some fleet growth in the last 2-3 years, the impact of falling large jet deliveries may see a standstill in activity trends next year.

The flipside of the buyer's market in terms of discounted prices is that business jets are now depreciating more like cars than vintage wine. With the economic horizon increasingly murky – the US GDP's growth cycle is already ageing, and the global economy more turbulent than ever – American businesses aren't brimming with confidence. Convincing their shareholders and employees that a corporate jet is justified is no synch. Even in the relatively good times of record corporate profits up 'til this year, businesses have been taking money from the table rather than investing it. By cutting back on production, OEMs have finally realized that the capacity they've pumped into the market is not all going to find a home.

As aircraft deliveries become ever more reliant on the dwindling proportion of existing owners who think it's time to upgrade, flight activity is reflecting the more risk-averse majority who increasingly prefer to use business aviation on an ad hoc basis. Hence the chartered fleet has been consistently busier than either fully-owned or fractional aircraft active in the North American market. In the first half of 2016 for example, Part-135 departures were up by 3%, whilst Part 91 flying is dawdling at scarcely 1%. Part 91-K activity is also stagnant this year. At the aggregate level the fractional model, with a fleet still 30% lower than it was pre-crisis, is yet to recapture the confidence of its erstwhile customers.

At the operator level, there is considerable divergence from these aggregate trends, as shown in Chart 4. In the fractional space, dominant supplier NetJets has a relatively strong activity trend over the last 12 months, whereas sister-company and leading aircraft management operator EJM demonstrates the lower end of owner activity trends. Meanwhile turboprop fractional operator PlaneSense, among the top 10 busiest operators in North America, has flights growing more than 30% over the last 12 months. PlaneSense benefits from having the most popular single business aviation aircraft in the US, the Pilatus PC-12, flight activity up 20% this year, ranking it alongside the Challenger 300 and Phenom 300.



Another operator with success built around the PC-12 is Surf Air, a Californian start-up providing a charter hybrid based on 'all you can fly' membership. With a fleet of a dozen aircraft and options to take another 50, Surf Air has rapidly expanded its operations in the last 12 months. As reflected in its average sector duration of 1.2 hours, Surf Air operates as a short-haul shuttle operator, specializing in sectors of around 400 miles. XO Jet, another California-based operator has found a way to grow its business throughout the recession, employing a much more expansive continental footprint of point to point connections. XO Jet's flat trend in the last 12 months suggests this model may have reached its limits for now.

As NBAA once again comes into view, the industry will be hoping that the 3rd Quarter's deliveries pick up the declining trend so far this year. Flight activity levels, which have held up during the summer, at least in the charter market, should be an encouraging sign, at least for some operators and their OEM suppliers. As with the economy at large, the industry will be guessing at the outcome of the looming US presidential election, and its potential impact on their customers. Given the downside risks already blotting the 2017 horizon, no one wants another surprise; another year of flat deliveries and sluggish activity growth will be a welcome alternative.

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