NORTH AMERICA HOLDING STEADY IN TURBULENT WATERS

The business aviation industry hasn't had it easy this year. Erstwhile reliable drivers of the demand for new business jets - from the oil price and the global equity markets, to corporate profits and global trade – all are veering in the wrong direction. Geopolitical tensions and terrorist threats have upset the normal course of business, and not just in the world's usual trouble spots. In fact, the level of political distraction has been highest in the industry's key markets, first in post-Brexit Europe, now in potentially pre-Trump America. In short, the business jet's best customers, whether the ultra-wealthy or big corporation, are rattled. This is not a good time to be pitching them a new aircraft.

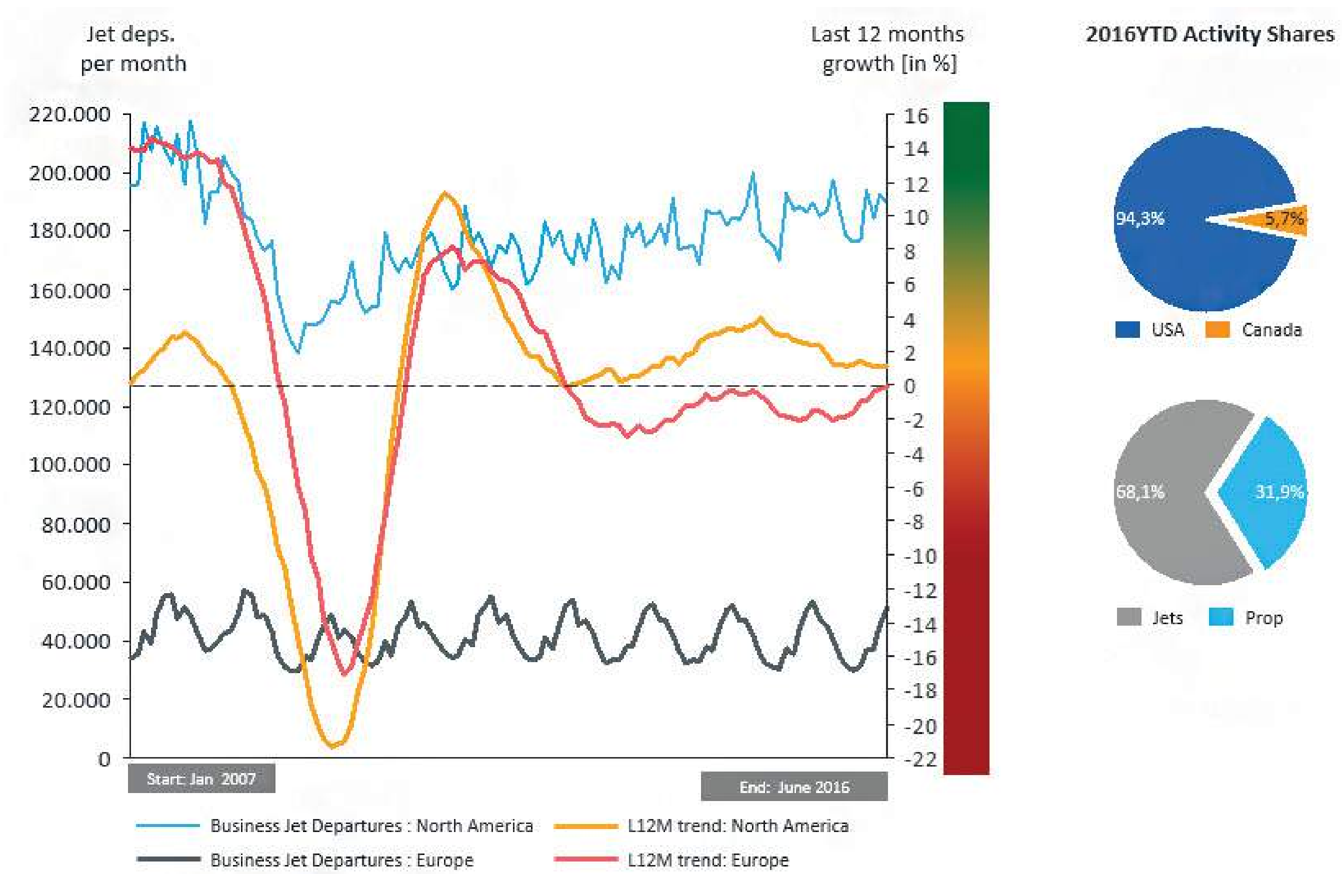
By Richard Koe

STUTTERING TREND

The state of the market is aptly reflected in the stuttering trend line of aircraft deliveries; last year a handful of units up, this year so far 5% down, accompanied by some fairly pessimistic OEM outlook, suggesting sales for next year deliveries are likely to be down too. Other guidelines to the industry's health are also patchy: pre-owned inventory for sale is creeping up; prices are soft for almost all aircraft types; residual values are falling. As forecasts for recovery are progressively downgraded, even flat is coming to be seen as positive. So it should be relatively good news that at least business aviation activity trends are fairly resilient in the industry's dominant North American market.

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 overall 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

Chart 1: Long term trends in business jet activity in North America and Europe



that period, with business jet flights from across the region only regaining some flat-line stability in the last few months.

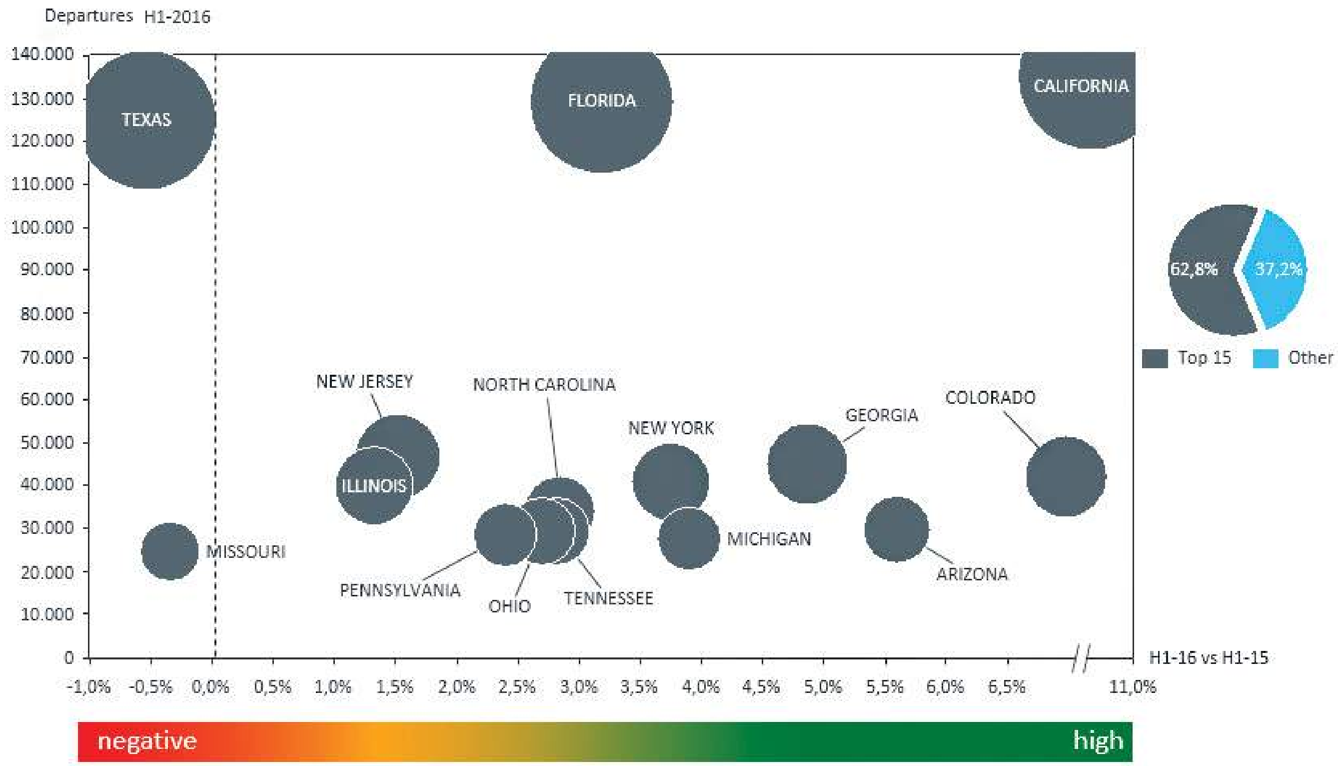
Within North America, the United States is the dominant market, with almost 95% of business jet activity in 2016. Flight activity levels are also relatively depressed in Canada due to the downturn in the oil and gas market. Within the US, a similar slowdown is evident in the state oil capital Texas, 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.

NEW LARGE AIRCRAFT DELIVERIES

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 are 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 these categories in the North American market. Belying the overall ratio of around 11% inventory for sale, up to a third of

Chart 2: States in the US with most business aviation flight activity in 2016



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 solid, if tepid, economic growth, 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 health of 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.

BUSY CHARTERED FLEET

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 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. In the fractional space, dominant supplier NetJets has a relatively strong activity trend over the last 12 months, whereas sister-company and leading owner-aircraft management operator Executive Jet Management is seeing no activity growth. 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 avi-

Chart 3: Activity levels by aircraft segment in North America in 2016

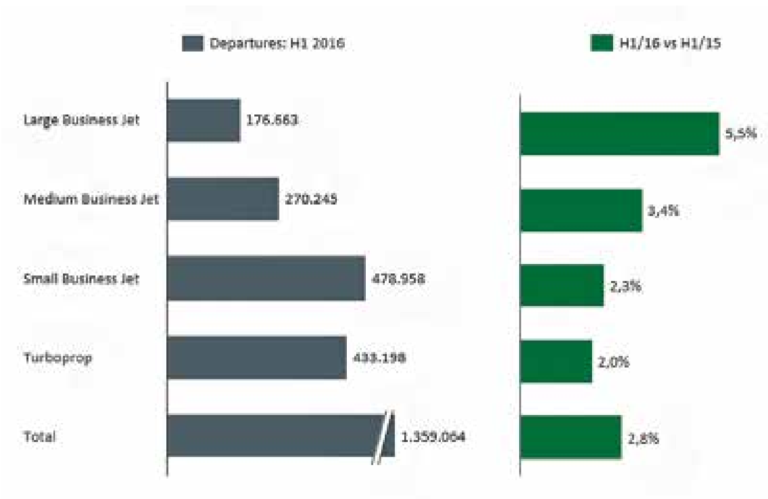
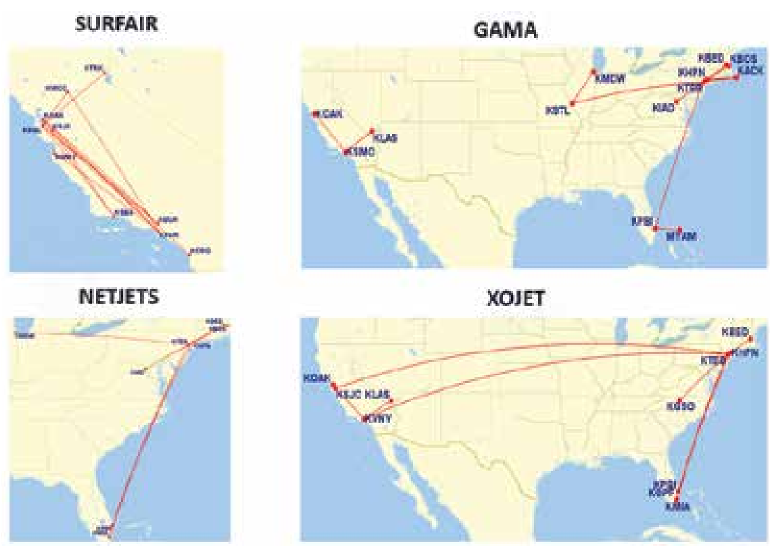


Chart 4: Contrasting operational footprints of leading US operators in 2016



ation 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. Surf Air operates as a regional 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. Gama Aviation is a more typical Part-135 player, with primary city pairs serving the commercial hubs up and down the US East Coast.

THE ELEPHANT IN THE ROOM

The NBAA is now coming onto the horizon at a delicate point in the year. The industry will be hoping that the relatively becalmed summer and early autumn financial markets have encouraged some traction in business jet sales, to make up for a rough first half year. But the elephant in the room is the imminent US Presidential election. Donald Trump is a well-known champion of flying business jets, and the industry probably prefers him to Mrs. Clinton in terms of its specific interests. But the wider potential ramifications of a Trump win, in terms of turbulence in currency and equity markets, not to mention the shockwaves to international relations, are much bigger concerns. Given the downside risks already blotting the 2017 horizon, another year of flat deliveries and sluggish activity growth will be a welcome alternative to any more surprises just now. ■

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