THE STORY IN BUSINESS JET CHARTER

There is nothing new in hearing more optimism around our industry in the run-up to the annual EBACE convention. It springs from a common need to promote a bullish outlook, even if this has regularly dissipated as the year goes on, ever since the industry went into recession back in 2009. So, we might expect this year to be no different. We've seen positive industry sentiment since last year but we're also beginning to get some wake-up calls, with the end of the Trump-Bump surge in equity markets, and some Q1 business jet delivery numbers which confirm that unit sales in 2017 are likely to be at their lowest for a decade.

By Richard Koe

No one is seriously trying to make out that the business jet manufacturers are going to pull out of the rut this year. The OEMs are still focused on damage-limitation, streamlining production lines in response to weak demand and a severely over-supplied market. The real glut has emerged in the large cabin space, with new deliveries falling more than 30% in North America and Western Europe over the last 12 months. With pricing still soft in the pre-owned market, it's one of the best buyer's market in years. The front-seats in this industry are with the leading aircraft brokers; many well-educated business jet owners will now consider a young but depreciated pre-owned jet to a new one off the production line.

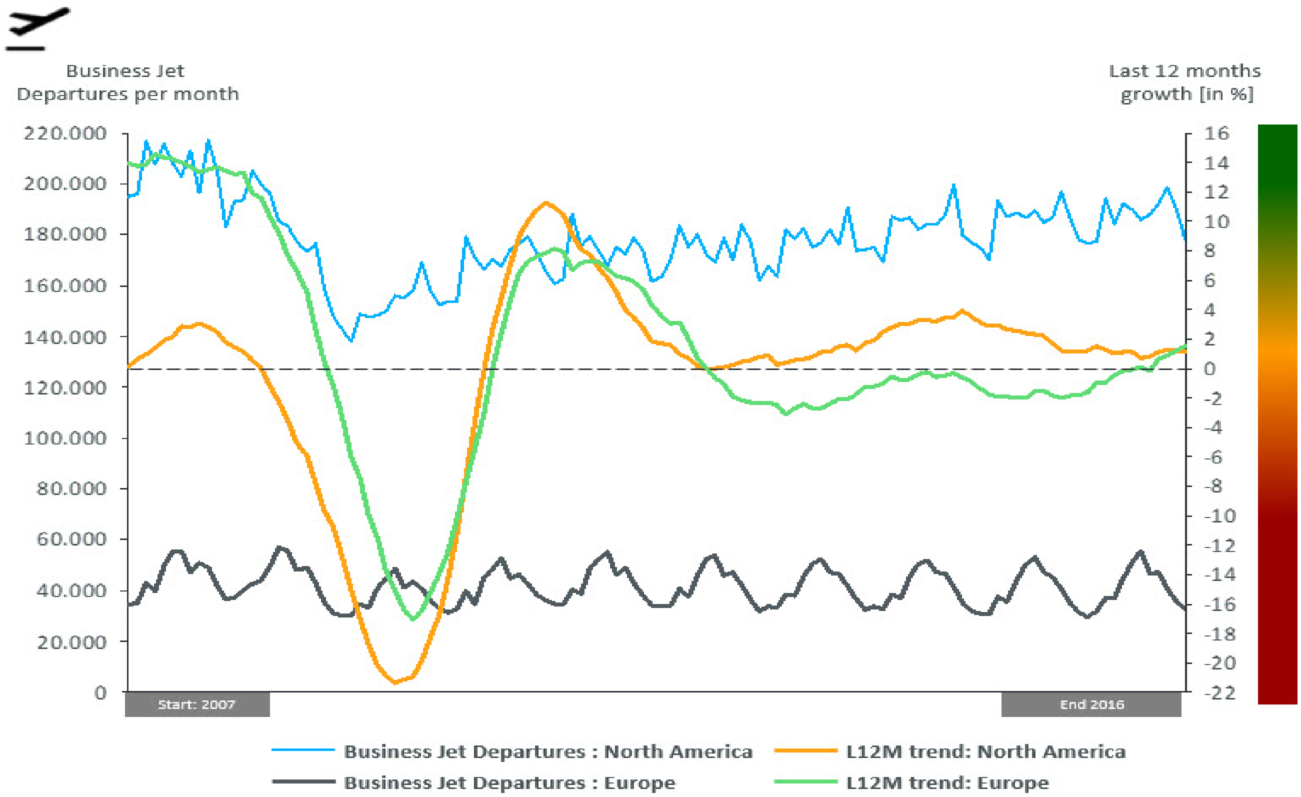
Amid the gloom for new aircraft sales, there is a contrary upswing in business aviation activity. Brandon Mitchener, EBAA's new CEO, fastened on this at EBACE, seeing green shoots in the strong growth in flights operated in Europe in the first Quarter of 2017. Q1 did indeed see a bump in business jet activity in Europe, although over the long run, with activity considered on a rolling 12-month basis, the growth trend is still quite weak. At the very least, as shown in Chart 1, the business cycle in terms of flight activity in Europe appears to be belatedly catching up and even overtaking the positive cycle in the US the last few years.

THE FULL STORY

But the aggregate trend in activity doesn't relate the full story. The main reason the aggregate trend is still torpid is that aircraft owners are flying considerably less. Consistently in the last 18 months, private flight activity has been dropping around 5% year on year. Given that these flights comprise at least half of all sectors operated, the decline has coloured the whole market. It's also overshadowed the real growth story, which is evident in AOC flight patterns. Some of this activity belongs to fractional operations, some to medical, government and military activity. Once these are stripped out, it's clear that the strongest growth is coming from on-demand charter. As shown in Chart 2, that year-to-date trend is more than 10%.

Zooming in on the business jet charter trend, it's clear that most of the growth is coming from Small Jets, which have operated 54% of the sectors in this period. The Light Jet segment, which has operated over 18,000 Charter flights in the first 4 months of the year, is up by 10% compared to last year. Very Light jets flew 7,000 Charter sectors in the same period, growing 13% YOY. The Super Light seg-

Chart 1: Rolling 12-month business jet activity trends, North America and Europe



ment added a further 10,000 charter sectors, 5% more than last year. Chart 3 highlights the aircraft behind this growth in charter: since 2013, Citation Excel, the most active Small Jet, has a CAGR of 3%, the Citation Mustang's activity is growing at 8% and the venerable CJ2, which flew more than 18,000 Charter sectors in 2016, has a 3 year CAGR of 11%.

EUROPEAN REGION

The charter growth story is unevenly distributed across the European region, as shown in Chart 4. The UK and France are the core markets, each seeing more than 10,000 Charter departures so far this year, and in both countries, these flights have grown almost 15%, in contrast to declining Private flight activity. The difference is more exaggerated in Italy and Switzerland, where Owner activity is in reverse, but Charter flights surging. Not all countries are seeing such strong Charter trends – there are heavy declines in Turkey – and in some countries, Private flights are well up, such as Spain and Sweden.

Almost all Europe's busiest Charter pairs are well up this year. The busiest is Le Bourget-Geneva, with more than 500 business jet charter flights through April 2017, 40 more than last year. Geneva-Luton had only half that number of flights but was up by 80 sectors compared to last year. The largest gains have come on some winter ski shuttles: there were an additional 65 flights between Le Bourget and Sion, and the 199 jet charter flights between Vienna and Innsbruck were up by almost 100% compared to the 2016 ski season. Coming out of the Winter season, AOC flights in April were up by 20% from Nice, and by 55% from Palma de Mallorca.

So where is this growth coming from? There have been various recoveries in activity since 2009, with an initial bounce in 2010-2011, before the Eurozone crisis, and again in 2012-2014, when the oil price introduced new large cabin aircraft owners to the market. But charter activity was stagnant until mid-2016, and since then has seen sustained recovery. Clearly the improving economy is a rising tide for all boats. But whilst the 1.8% GDP growth forecast for the Eurozone in 2017 might be an improvement, it's still very modest encouragement, and offset by the many downside risks in the global macro-economy. All the same, business sentiment in Europe has clearly and significantly improved with the dis-

Chart 2: Growth in Charter activity in Europe, 2017 YTD

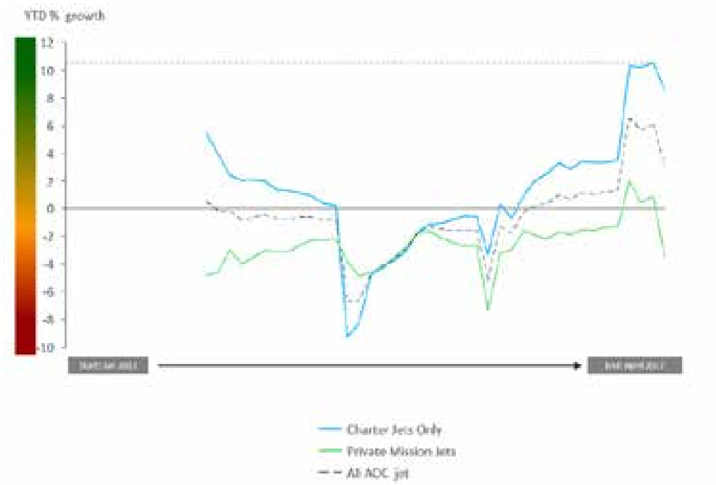
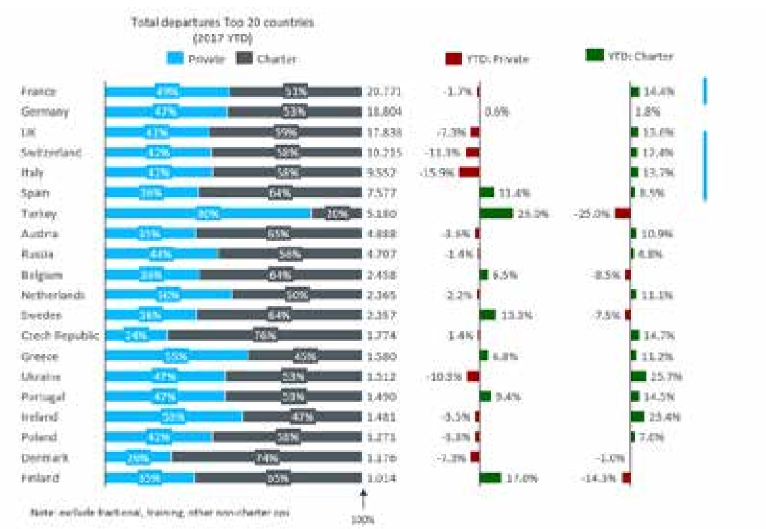


Chart 3: Charter trends, select aircraft types in Europe since 2013



sipation of populist political risks so far this year.

Charter demand may also have been stimulated by lower charter prices, as operators feel the pressure of an over-supplied market. Certainly, some aircraft owners have been willing to see their aircraft chartered to 3rd parties at price points at which owned and operated fleets can't compete. But it may also be that operators are getting better organised, reducing costs, and more effectively promoting their brands. In short, the supply side is addressing its biggest weakness, chronic fragmentation and lack of scale efficiency. Our review of Q1 activity by size of operator seems to confirm this; operators with 5 or fewer tails, almost 80% of the active fleet, saw declining utilisation. The minority of larger fleets, in contrast, saw growth of around 20% YOY.

But it may not be as simple as that. The headline consolidation has come from just two operators, Gama Aviation and Luxaviation, and their combined acquisitions, petering out over the last year, have scarcely consolidated 5% of the market inventory. Besides, neither of these groups is focused on the charter business. More convincing is the charter activity being generated by dedicated charter operators. As shown in Chart 6, these owned and operated fleets have seen growth rates of more than 20% in the last year. The aggregate trend of all other operators is very modest by comparison. Through owning and operating, the charter operators have the operational flexibility to build brands, which are bringing more users into the market.

WHERE DO CUSTOMERS COME FROM?

The next question is where the customers are coming from. Is it the same charter customers as before, just flying more? Or does the growth reflect an influx of newcomers to the industry? There is anecdotal feedback that both apply, although it may be more credible that charter activity is benefiting from customers exiting various ownership programs, whether through time-share, fractional or full ownership. Volatility and uncertainty in the macro-environment generally encourage risk-aversion, so it would be no surprise to see would-be aircraft owners choosing, at least temporarily, to buy lift off a highly competitive charter market.

Those with a stake in the traditional business of big-ticket aircraft sales should take heed. A shift in customers towards the charter market could turn out to be longer lasting. After all, the sharing economy has disrupted usage behaviour across dozens of industries in the last few years, with the market leadership – for town taxis, music, entertainment, hotels – passing to digital platforms capable of mediating shared usage. Our industry has been quite dismissive of this threat. Yes, customers may charter an aircraft to themselves, but they're unlikely to share seats with complete strangers, which would also necessarily mean scheduled departures, and from that point, so the argument goes, the convenience of flying privately is spoilt.

DISRUPTIVE MODELS

Despite the doubts, the seat-sharing charter operators and associated platforms have clearly gained

Chart 4: Private and Charter Missions, by Country, 2017 YTD

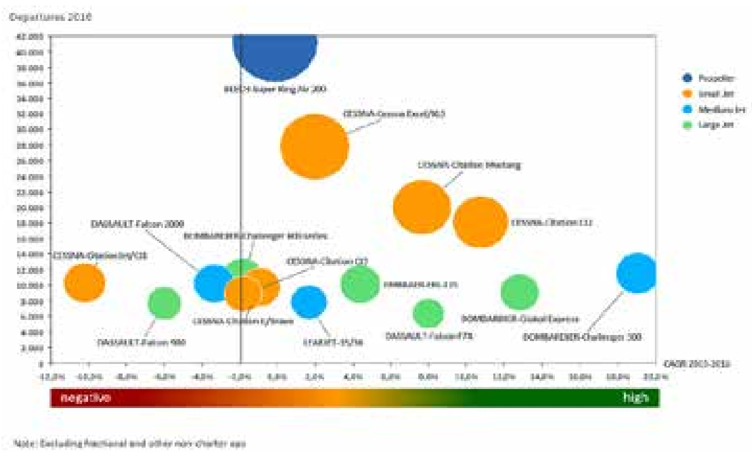
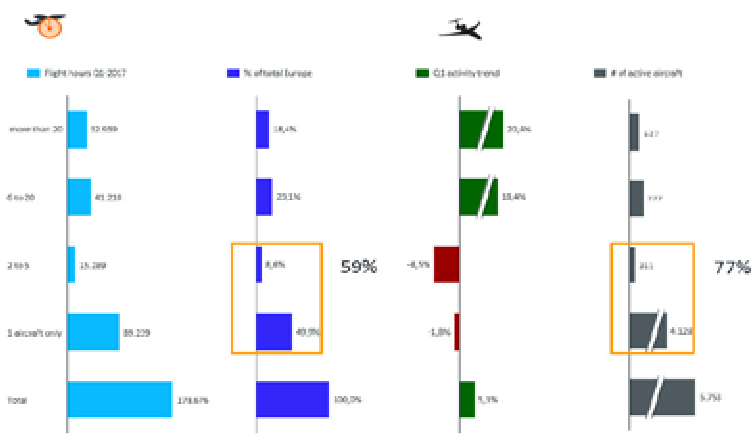


Chart 5: Q1 2017 flight activity in Europe, by size of operator



momentum in the last couple of years. Most of the growth has come in the US, with the likes of Surf Air, Wheels Up and JetSmarter deploying various seat-charter products. All have built services around membership models, funding operations with prepaid subscriptions and then using the affiliated members to source preferred schedules. For Wheels Up, the shuttles are an add-on to their aircraft-charter program, but for Surf Air, using its own fleet of PC-12s, and JetSmarter, aggregating lift from other operators, the shuttles are the backbone of the business. JetSmarter shuttles have multiplied in Europe this year, undoubtedly contributing to the growth in charter. Both Wheels Up and Surf Air intend to enter the European market in the next 12 months.

It's not just the operators who are innovating the traditional charter model. Digital charter brokerage platforms are also now gaining traction. They've been around several years, but arguably without going much beyond automating the reverse-auction process, which many brokers insist is done better manually. It hasn't been comparable to browsing Expedia to compare available hotel options and book on the spot. But that contrast has narrowed in the last year, with the 'online brokers' more capable in matching dynamic demand to real-time supply, and giving users price options to book. The digital platforms are also a lot more adept at reaching out to the wider travel market and bringing clarity to a product that's still poorly understood.

The combined market share of the online brokers still appears to be no more than 10% of all charter flights. But that's at least double where they were a couple of years ago, and even if their growth claims are only half right, they're clearly taking market share from the rest of the market. More importantly, they've won the digital argument; it's now commonly agreed that access to the charter market will migrate to online channels, even if it retains a high-touch customer service. The key question is whether that will bring a whole new market of users to the industry. The growth in on-demand charter this year may indicate that is already happening. A year from now we will surely know a lot more. ■

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