

Business Aviation in CEE and Russia

Has Putin spoiled the party?

Business aviation activity in Central and Eastern Europe tumbled 15% in August and year to date the number of flights is 10% fewer than last year. It's almost certain this trend will worsen as the year continues. The conflict in Ukraine is obviously the core of the problem, but the repercussions, in terms of sanctions, exodus of foreign capital and barriers to trade, are only just being felt by the wider economy. Business aviation activity is bound to suffer from these knock-on effects.

This rather bleak outlook would put an end to the rapid recovery of business aviation in Russia and CEE following the financial crisis of 2008. As Western European economies shrank and all aviation travel, especially business aviation, fell back, interest turned to these developing markets to the east. Over four years, business aviation in Russia grew 30%, in Ukraine, 70%, in Poland, 40%. Aircraft sales and flight activity soared to address the lifestyle demands of a newly minted generation of high net worth individuals.

The growth period for Russia and Eastern Europe was a boon for aircraft manufacturers faced with slim pickings in their larger and more mature US and EU regions. Russia's new rich, in particular, have sought only the very latest technology and performance capabilities, in terms of large cabin jets with ultra-long range. Gulfstream and Bombardier have flourished, with up to 25% of their global deliveries going to the region. New regional operators sprang up, and established market leaders like NetJets and VistaJet established their sweet spot out of Moscow.

DARKENING ECONOMY

Of course, there were well-recognized problems and challenges in developing this market, particularly on the supply side. Regulatory standards were poorly supervised, illegal charter was rife, infrastructure such as FBOs and maintenance

facilities were thin on the ground. Perceived weakness and selectivity in legal enforcement also deterred financing for locally registered jets. Add to that extremely high import taxes and it is not hard to see why only a few dozen of the several hundred jets based in Russia are locally registered.

There appeared to be some improvement to the supply side in 2013, with the Russian business aviation association (RUBAA) lobbying a reduction in permit costs and operational complexities for local registers, and there has been considerable investment in FBO facilities at a few of the 'flagship' airport hubs. But the broader economic climate deteriorated in the meantime and by the end of 2013 business aviation activity in Russia had fallen 8%. Caught between a darkening economy to the east and a still-stagnant Western Europe, the CEE region had also slipped 5% by year end.

THE UKRAINE CRISIS

Meanwhile the Ukraine crisis was already simmering, but few analysts built its subsequent escalation into their initial forecasts for 2014, which were generally rosy for Europe as a whole. The speed and scale with which the Ukraine crisis developed caught the industry on the hop. The Ukrainian market has taken the largest knock, with activity falling off by as much as 55% by August, with year to date declines equivalent to 1,000 fewer flights per month so far this year.

Given that Ukraine's falling activity represents almost 20% of all activity in CEE, its downward spiral is coloring the whole region's prospects. Furthermore, Russian incursions in Ukraine have sapped confidence across CEE economies, undermining business jet connections to other parts of Europe. In terms of departure volumes, Poland, Slovakia, Hungary, Bulgaria are all in rapid decline. Overall, East-West European connections have been falling all year and in August they slumped 15%.

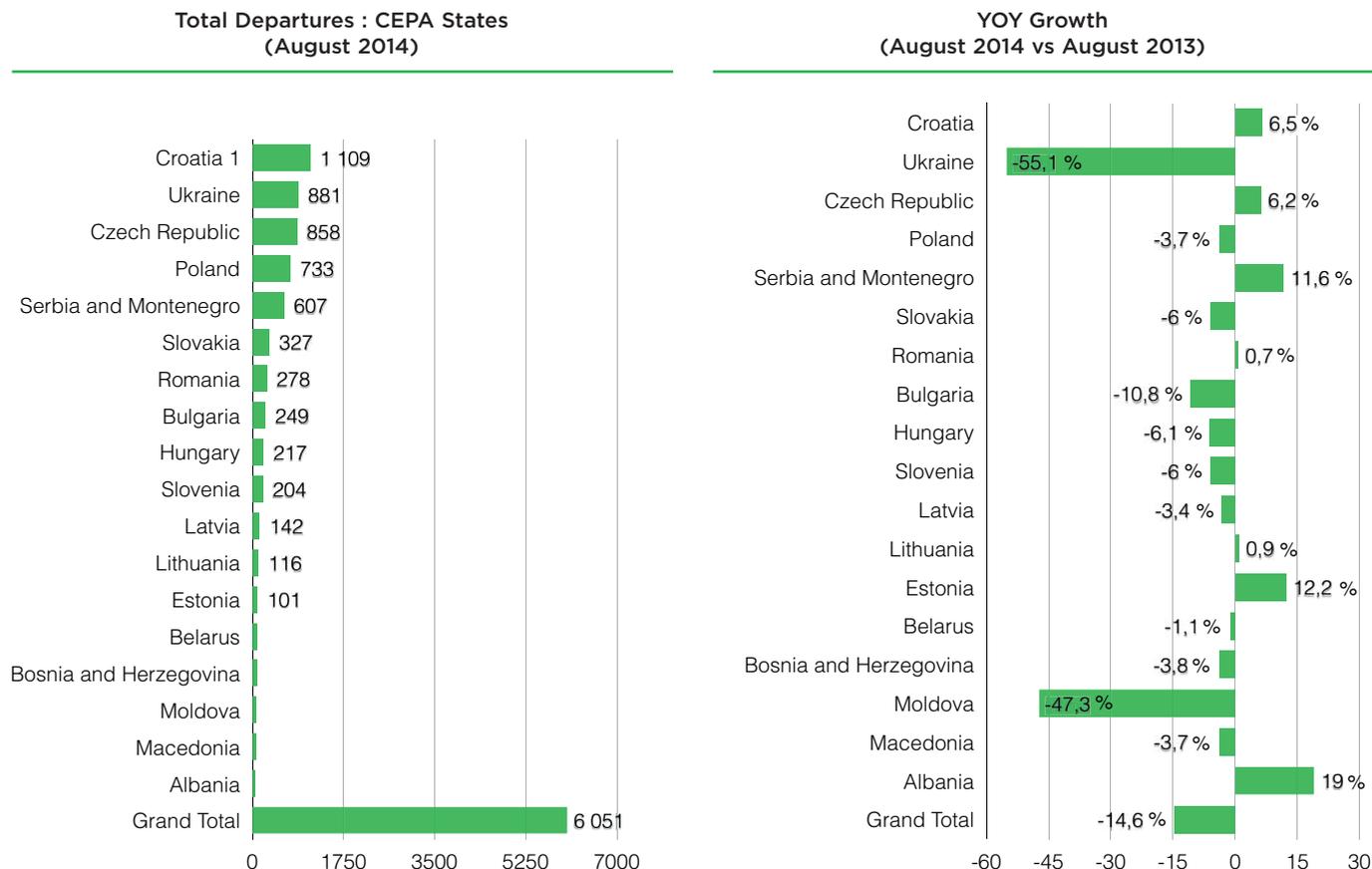
As for Russia, here too the repercussions of the Ukraine crisis are accelerating the decline in business aviation activity. Down 9% year to date, August saw Russian activity fall a further 15%, with charter flights down as much as 20%. Indeed connections between Europe and the CIS region as a whole fell more than 30% in August. Some of this activity may represent just a temporary suspension of activity. But given the significant role played by business aviation in developing trade and investment, this level of fall-off is a damaging indicator.

SUMMER SLOWDOWN

Business aviation operators, brokers and suppliers will certainly have felt this slowdown over the summer. Flights from Moscow to the Mediterranean, especially Vnukovo-Nice, represent some of the busiest city pairs in Europe. This year they are down at least 10%. Inbound VIP tourists from Ukraine are far worse affected.

BUSINESS AVIATION ACTIVITY IN CENTRAL AND EASTERN EUROPE IN AUGUST 2014

YOY FALL >1,000 FLIGHTS IN UKRAINE IS MAIN REASON FOR CEPA DECLINE. OTHERWISE, THERE WERE NET GAINS, SUPPORTED BY GROWTH IN CROATIA, CZ-REP, SM, IN PARTICULAR.



ted. In August 2013, there were more than 70 business jet flights to Nice from Zhuliany Kiev, but only 20 such departures last August.

Upstream, manufacturers and the various facilitators of business jet acquisitions – whether financiers, insurers or legal counselors – are facing a new and much more complex environment. Sanctions targeted at specific members of Putin's coterie have effectively grounded a few jets and will certainly have aborted a number of transactions in progress. The difficulty of identifying the real owners of assets within often-opaque organizations will further deter the much-needed intermediation of Western financiers and advisers.

UPBEAT JET EXPO

Having said that, the annual Jet Expo forum for business aviation in Moscow in September was relatively upbeat. The host airport, Vnukovo, remains Europe's 5th largest departure point for business aviation flights. And in terms of heavy jet departures, even after declines of 10% this year, Vnukovo is still Europe's number one airport. In fact overall this airport's charter departures to Europe is slightly up this year, which suggests that whilst some owners are a little more wary, Moscow still has plenty of wealthy people looking to rent a jet during the summer.

Moreover, it appears that so far at least, the plunge in flights heading west from

Russia is largely concerned with East not West European destinations. As of August, flights to Western Europe as a whole were actually up 6%. Notably, flights to Germany are up 7% YTD.

Leisure markets such as Greece are attracting more than 30% growth in flights from Russia. Looking at specific destinations, the patterns is quite random; flights from Russia to Geneva, Zurich, or Lonon Luton have fallen about 20%, but they are up by 25% to Milan, +35% to Frankfurt, +45% to Farnborough.

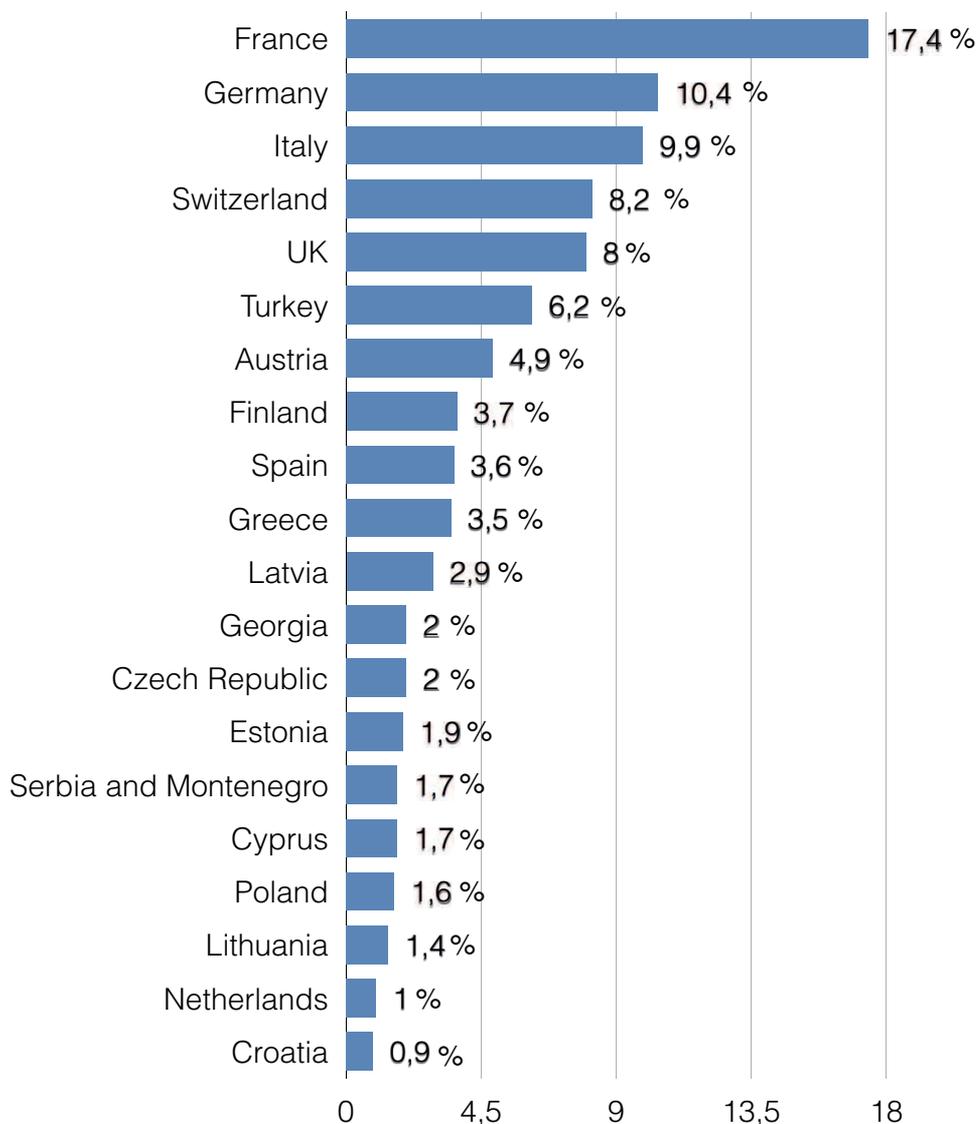
DIVERSIFIED MARKET

Meanwhile there have been signs that Russia's business aviation market is diversifying. In Moscow, Domodedovo's in-

BUSINESS AVIATION CONNECTIONS FROM RUSSIA TO WESTERN EUROPE

SO FAR IN 2014, BUSINESS AVIATION FLIGHTS FROM RUSSIA INTO EUROPE HAVE ACTUALLY INCREASED TO GERMANY. THE TWO COUNTRIES WITH LARGEST INBOUND DECLINES ARE SWITZERLAND & TURKEY

Market Share



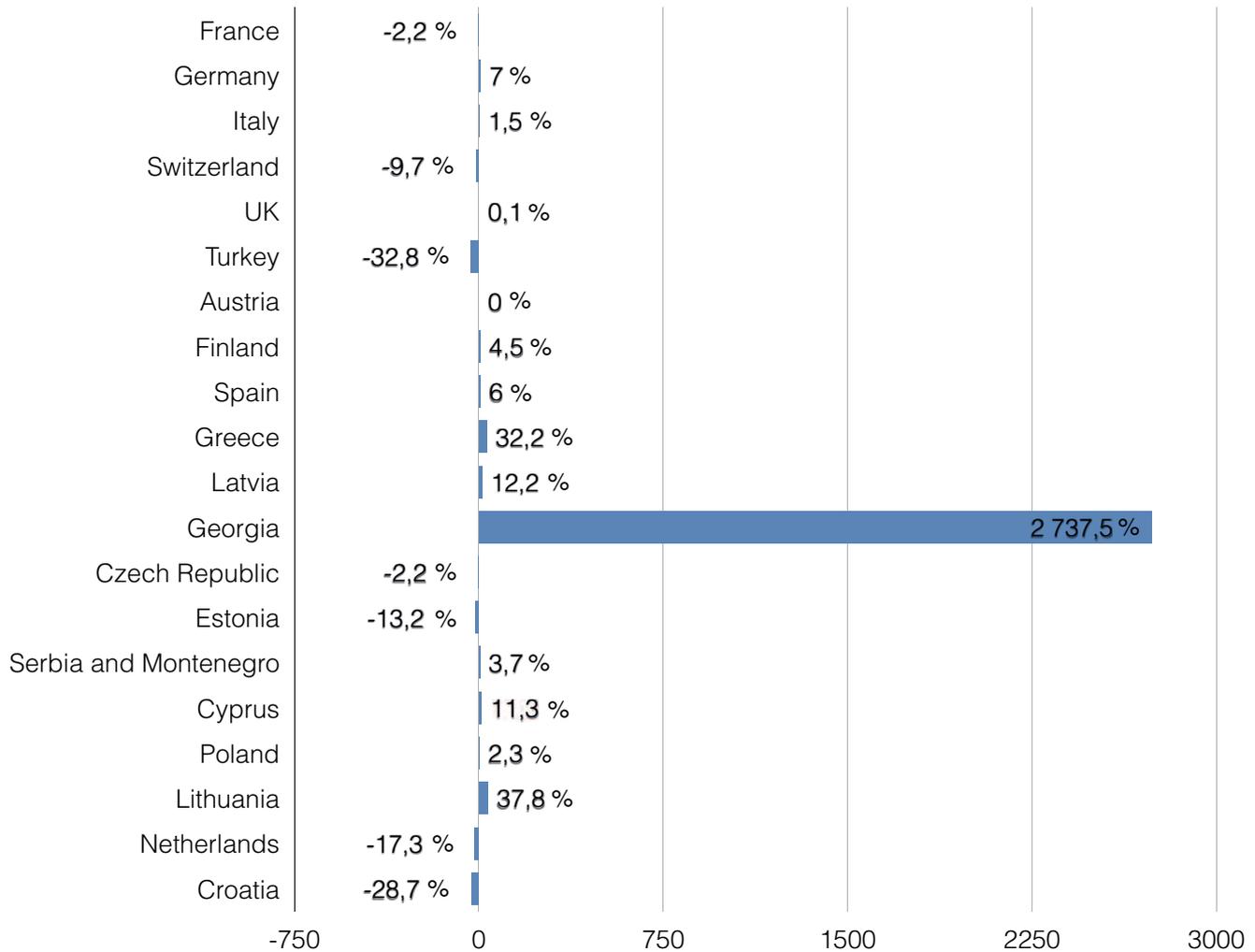
Infrastructure investments have positioned it to start competing with Vnukovo's dominant role. St Petersburg's Pulkovo airport activity is actually well up this year. Regional business aviation airports such as Dnipropetrovsk and Sochi are emerging. Undoubtedly Odessa will now also become an important hub. Ekaterinburg is an important connector for flights heading east to Asia.

Turboprop aircraft have a role to play in accessing remote destinations in Russia's interior. But distance and lifestyle aspirations continue to ensure that more than 99% of business jet departures from Russia are by jet, and of these, far more by heavy than light aircraft. In fact in the longest range heavy jet segment there is not yet any sign of activity slowdown. For example, the busiest ULR jet out of Russia is the G550 and its charter missions are up 30% YTD. Equally, Falcon 7X owner flights are up 20% YTD.

WEATHERING THE STORM

Parts of CEE may also be weathering the storm. Flight activity is up this year in Croatia (CEE's largest market this summer), Czech Republic, and the Baltic states. In fact the 2nd most popular CEE city pair in August was Riga-Vnukovo. CEE's busiest city pair is Bratislava-Prague, with some 45 flights a month representing 10% increase on last year. Vienna is the 9th most active airport in all of Europe, with activity up 1.5% this year. Then there are a number of smaller but fast growing airports in CEE such as Ostrava, for which flights are up 45% this summer. CEE's busiest aircraft segment is the light jet, down near 30% due to collapse in Ukraine. But some jet types are still prospering - the Legacy and Falcon 2000 are two aircraft with increasing popularity in this region YTD. The second most popular aircraft segment in the region is the turboprop, and that activity is growing in 2014 - the PC12 by more than 30% in August. There is also a populous business piston fleet in CEE, with activity more than 10% up this year, with outliers such as the Cirrus SR-22

YTD (Jan-Jul)



flying more than 50% more this year than last.

LOOKING FORWARD

Over the next year, we would expect continuing fragility for the business aviation sector in the CEE region. There may be further negative shocks, should the Ukrainian conflict resume and perhaps spread to other countries. Likewise, CEE could suffer from the EU's potential triple dip into recession, and certainly won't benefit from the region's stubborn economic stagnation. And surely there is no short term recovery for Ukraine. Overall, the most optimistic outcome is some

sort of accommodation between the EU and Russia over Ukraine, and, finally some sort of economic recovery in the Euro zone.

As for Russia, even if the EU accepts its incursion into Ukraine, sanctions will take a while to lift. Even then, the negative impact of the crisis on international capital markets will undermine east-west trade and investment for some time. But Russia remains energy-rich, and the vast majority of energy oligarchs will still fly privately. There is likely to be a migration in aircraft registrations towards neutral and off-shore locations, which will further erode the domestic register. But in

the long term, Bombardier is probably right to expect 5% growth rate in aircraft deliveries to Russian clients over the next 20 years. For Gulfstream and Bombardier at least, Putin hasn't yet spoiled the party. ■



Richard Koe is MD of WINGX Advance, which provides actionable market intelligence and consulting to the business aviation industry. Customers include operators, airports, OEMs, FBOs, banks and insurance companies.