Business Aviation in Europe

A painful recuperation

This was supposed to be the year that the economy gained 'escape velocity' and the business aviation industry followed suit. Buoyed by sustained GDP growth, falling unemployment, and pent-up demand for corporate investment, renewed faith in private jet travel has been anticipated for some time. Last year, these correlations appeared to decouple, but in 2014 the consensus was that business as normal would resume, even in recession-battered Europe. Unfortunately the data is proving to be stubbornly resilient to this optimism. However, while there is no doubt we've reached a disappointing half way mark to a year that was finally expected to lift the industry out of recession, the recovery may yet be in sight.

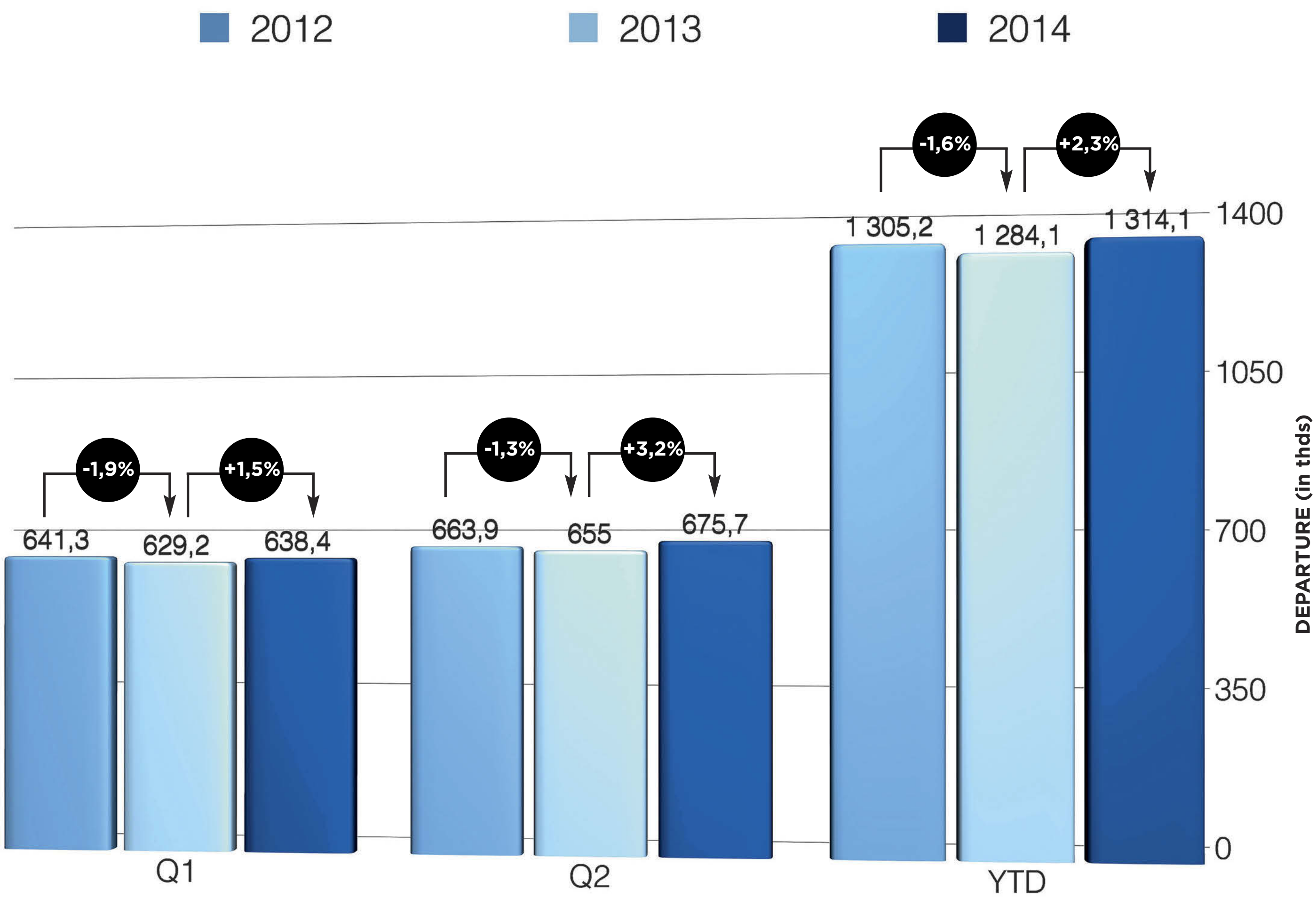
True, in the US, where the economic recovery is well established and the market for business aviation much deeper, there has been some pick up. Flight operations in North America are some 2% up YOY. Interestingly, after a slump in 2013, fractional flights are up most, around 5%. US customers also purchased more aircraft, with Q1 deliveries up 10% on a rolling 12month basis.

UNCERTAIN EUROPEAN MARKET

The European picture is altogether less promising. New jet deliveries inched up in Q1, but the 12month trend is down. Preliminary 2nd Quarter results show further decline, and the most recent UBS poll of industry professionals shows a slight deterioration in outlook. As in the US, inventory for sale is winding down, but prices aren't yet hardening. It's a buyer's market, aircraft anywhere from 50% off previous peak pricing. But access to financing is limited, and although customer interest is up, there is little willingness to transact. Arguably, at least in Europe, the correlation between the economy and business aviation is not decoupled; it's simply that the economic recovery is insufficiently established to get customers back into the market. GDP growth in the Euro area is extremely tepid, and in all probability France, Europe's largest business aviation market, has tipped back into recession in the last 3 months. At best, avoiding further sovereign crises, the EU's growth this year will do well to exceed 1%.

LOOKING UP TO THE CORPORATIONS

Business aviation stands or falls as a business tool, so it's to the corporations that the industry looks for its recuperation this year. In the US, corporate profits are at a 10 year high, growing 8%. So far this hasn't translated into much higher business aviation activity, but cash hoarding from several years of



Q2 BUSINESS AVIATION ACTIVITY IN NORTH AMERICA

cost cutting is reaching its limits. As investors look for further growth, US companies are renewing their investment in productive capital assets, including corporate aircraft. This is less likely to happen in Europe, where business confidence is more fragile. Even in Germany, Europe's resilient powerhouse the last 12 months, the latest Purchasing Managers Index is barely scratching positive territory. Unemployment levels in Europe are creeping down but still at generational highs. Whatever the productivity gains on paper, it's a very difficult pitch right now for a European corporate CEO to convince his board to invest in business aviation.

UKRAINIAN CRISIS

Then there's the unexpected geopolitical twist in Ukraine. Europe is particularly dependent on trade with Eastern Europe and Russia, especially with respect to energy imports. Economically, the EU can ill-afford to impose sanctions on Russia, but there are even greater security stakes in ignoring further escalation. The Ukraine crisis is closest to home but only one of a number of unanticipated regional conflicts to darken horizons for growth in global trade and cross-border investment this year.

The impact of the Ukraine crisis on business jet orders is as yet difficult to gauge. Certainly a number of deals have unraveled, and should sanctions be expanded, new buyers in these regions will find financing and legal support all but disappear. The effect on business aviation activity is easier to discern. Flights from Ukraine are down 24% year to date, 15% off in Russia. More broadly, business aviation connections between East and West Europe is downward trending, most recently falling 12% in June. The CIS region's operations are disproportionately weighted towards large aircraft and charter activity, so the effect of the slump on the European industry's fuel suppliers and charter brokers is much greater. Nota-

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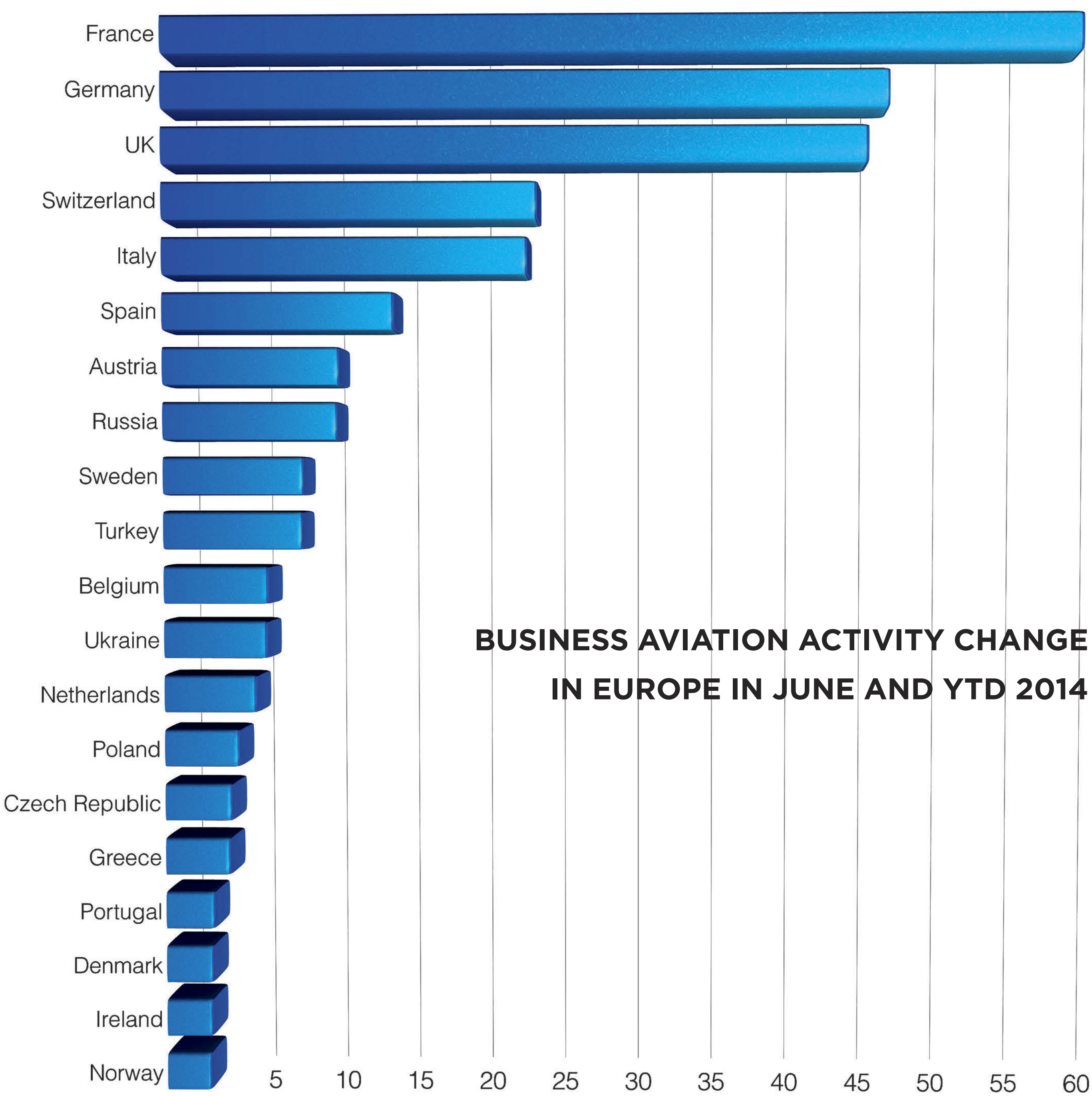
bly Turkey, with a similar profile of heavy jet charter operations, is also receding as a business aviation market this year. Its decline reflects a broader concern that emerging markets are destabilizing. As foreign investors head for the exit, business aviation activity is bound to follow.

THE BRIGHT SPOT

Yet it would be wrong to paint a uniformly bleak picture to the European market. Business aviation activity increased in the first few months of the year, and the EBAA reports there continues to be a small net growth of activity within the EU area. Several country markets in Europe are recently gaining activity. Business aviation in Benelux, Iberia, even Greece – a Mecca for high-end tourism even if the economy is moribund – is relatively flourishing. Activity in France is also slightly up – and that can only be because leisure trips are outweighing



TOTAL DEPARTURE TOP 20 COUNTRIES (2014 : YTD) declines in business travel.

Then there is the bright spot of the UK, where several years of austerity, leavened with a judicious monetary expansion, has apparently brought back the animal spirits of economic regeneration in 2014. The most recent data indicates that the financial-services based recovery has expanded into a broader industrial expansion. Projected growth rates for the next 12 to 18 months will exceed those of any other OECD member, let alone the EU. The relatively strong economic recovery in the UK is already a locomotive for business aviation. At the half waypoint of 2014, flight activity picked up 6% up year on year. In June, domestic private jet flights picked up by 9%. With its revitalized economic prospects, the UK also appears to be pulling more international flights – up 10% from the US, 16% from Turkey, 18% from Nigeria, 34% from India, 65% from Hong Kong. It may not be a coincidence that the UK government reduced Air Passenger Tax (APD) on long haul flights in March this year.

The UK's renewed growth as a business aviation market is, as you would expect, strongly reflected in the London area. Flight movements at Farnborough, Northolt and Luton are more than 10% up for the year. These airports are finding particular success in handling large, long-range business jets. For example, operational flight hours on links to Almaty from Luton are up 34% this year, and from Luton to Dubai, over 70%.

ENDURING SUCCESS STORY

Long range, large cabin aircraft have been the enduring success story of the industry's long recession. This is certainly true of the UK. Whilst the historic compound annual growth rate of business aviation flights is barely 1%, ultra long-range jets have picked up more than 5% activity each year, even through the recession. Across Europe, and through 2014, the same is true; whilst the midsize and light aircraft market continues to struggle, ultra long-range jets continue to find more customers. Underlying this pattern is a fundamental customer demand for latest technology, range and cabin size. Activity analysis, customer surveys and jet deliveries indicate that this is a global phenomenon not just European. The customer behind the data is the ultra high net worth individual. This 'global citizen', with at least $30m in net assets, is prepared to pay for a ubiquitous residence and non-stop connections.

According to global wealth-monitor Wealth-X, the 'UHWNI' population is growing at an annual 5% clip, even in economically stagnant Europe. So for the top end of the business aviation market, growth prospects actually look pretty solid. In contrast, the lower end of the market is shaky. Customers, typically smaller businesses and entrepreneurs, are cost-conscious. They can afford to be picky, given a fleet that is at least thirty percent (30%) over capacity. With five years of constantly declining activity in the midsize and light jet segments, it's only a surprise that so many operators are still in business.

VERY LIGHT JETS' SUSTAINED GROWTH

Apart from the demand for 'ULR' jets, what stands out is the sustained growth of flights on Very Light Jets in Europe. Contrary to their launch slogans five years ago, this success does not indicate the 'taxi jet' operators' success in attracting a new generation of business jet users away from scheduled airlines. Temporarily perhaps this business case has failed. But where they have been highly successful is in migrating pre-existing business jet users from older and more expensive light jets (and fractional programs) to the smaller but brand new cabins of the VLJs.

That the VLJs are winning the battle of the cost-conscious customer is evident in the comparative year on year activity change for specific aircraft types. The leading VLJ in Europe, the Citation Mustang, operated fifteen percent (15%) more flights in June, YOY. By contrast, the larger, older, more expensive Citation Bravo lost twenty percent (20%) comparable activity. The Phenom 100 is proving to be another successful value proposition. For 2014 YTD its flight operating hours are up thirteen percent (13%).

Amid the still stagnant activity across most of the rest of the European fleet, the success of the VLJs hints that the near-term recuperation for business aviation needs to come through improvements on the supply side. Simply put, there is no evidence the market is quickly recovering; so to induce it, the industry needs to innovate, with better products, more efficiency, and lower prices. At least the products – in terms of new aircraft –are just around the corner: the Lear 85 and Challenger 350 this year, the long-awaited Honda jet next year, the super-versatile PC 24 a year or so after.

QUIETER INNOVATIONS

There are also other quieter innovations ongoing, and when the market properly recovers we may look back on them as milestones. These include operator consolidation, with Luxembourg Lux Aviation's acquisition of three large management fleets in the last 12 months; the launch of Wheels Up and Route One, two well-financed charter operators looking to bring large turboprop fleets to the entry level market; the emergence of instant- pricing charter search platforms online such as PrivateFly and Stratajet. So while there is no doubt we have reached a disappointing half way mark to a year that was finally expected to lift the industry out of recession, the recovery may yet be in sight.

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