Special Report

Aviation Industry: A Long Road to Recovery

January 2022

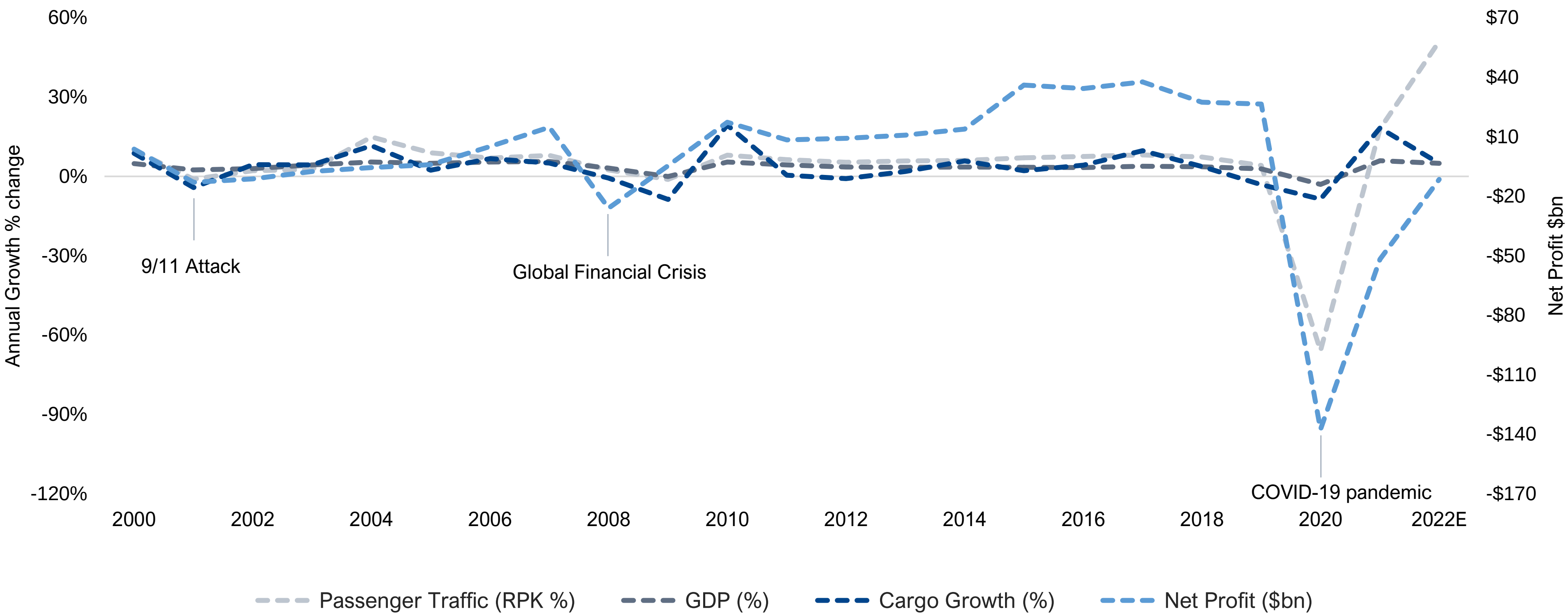
Executive summary

- The last decade brought a sustained run of profitability to the global aviation industry. However, the COVID-19 outbreak negatively impacted the industry, making it the worst hit.
- Many airlines were forced to suspend operations in 2020 as airports and borders were shut down. As a result, passenger traffic significantly dropped. Contrary to this, air cargo recorded robust growth by the end of 2020 due to increased demand for critical goods during COVID-19.
- As the pandemic struck airline revenue, the strong support from government and financial packages prevented mass bankruptcies during the first six months of the crisis in 2020. Airlines with strong balance sheet and low-cost structure were able to survive the crisis.
- With travel bans eased in 2021, passenger demand (RPKs) is expected to rebound in 2022. Domestic carriers will continue to do well compared with international full-service carriers. Additionally, the outlook for business/corporate travel looks weaker than leisure travel.
- Short-haul, low-cost airlines model (Southwest airlines, Spirit airlines, etc.) would enjoy more flexibility, as they can open and close routes between cities and capture long-term growth opportunities, whereas legacy carriers are restricted in growth and flexibility by their respective hubs.
- Low crude oil prices provided some cushion from margin headwinds in 2020. However, the rally in oil prices increased the cost of jet fuel, which would pressurize the airlines to remain profitable.
- Revenue and profitability are expected to recover but will still be below the pre-pandemic level of 2019 for most carriers until 2024. Moreover, industry now faces a major challenge to recover as it has taken on more cumulative debt in a year than over the last 40 years.

Airline losses expected to recede with rebound in passenger traffic

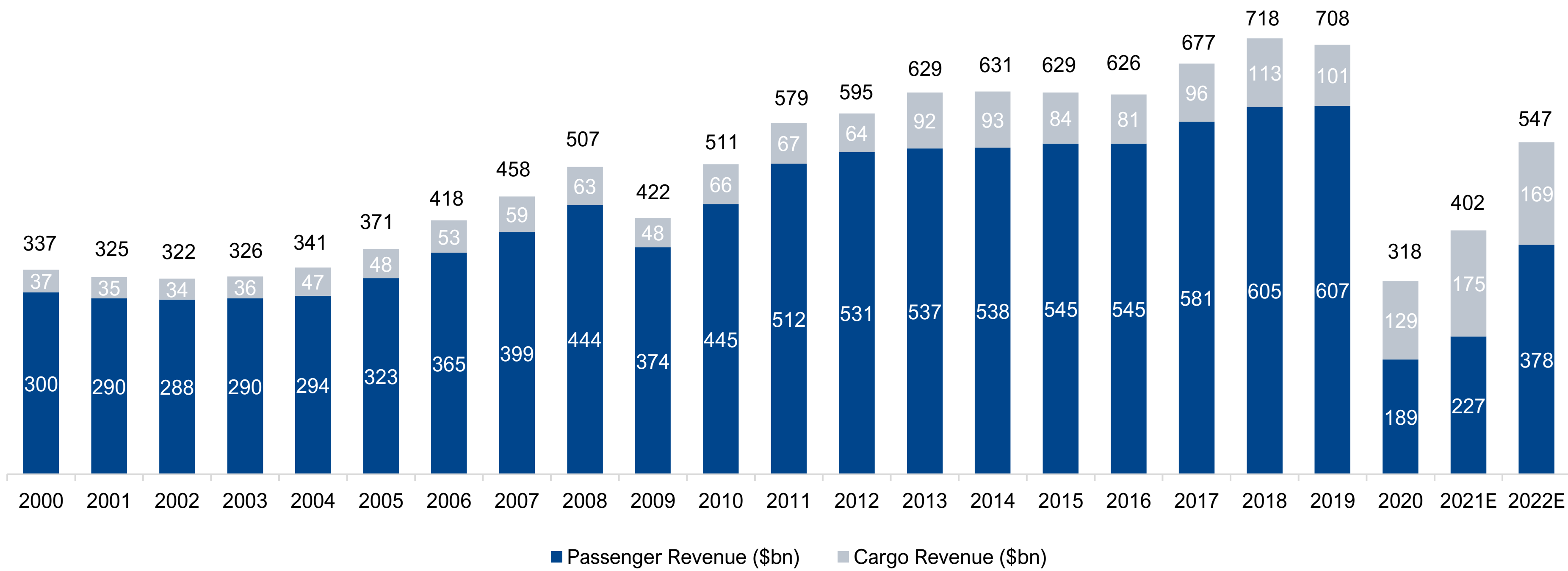
- Prior to 2010, the airline industry rarely made profit. However, in the last decade, it recorded consistent net profit until 2017. However, net profit decreased to $26 bn in 2019 from the peak of $38 bn in 2017 due to grounding of Boeing 737 max and geopolitical uncertainty.
- In the wake of COVID-19, airlines were hit harder than the catastrophic events of 2008 financial crisis and 9/11 combined. Air passenger traffic (RPK) declined 66% with a net loss of $138 bn in 2020 due to grounded fleet, travel restrictions, and scheduled uncertainties.
- Following the unprecedented decline in 2020, RPK is expected to rebound 51% in 2022 from 18% in 2021. However, the industry is unlikely to fully recover to the pre-COVID-19 level until 2024.

Air Travel Demand, World Economic Growth, and Net Profit



Source: IATA, KPMG, IMF

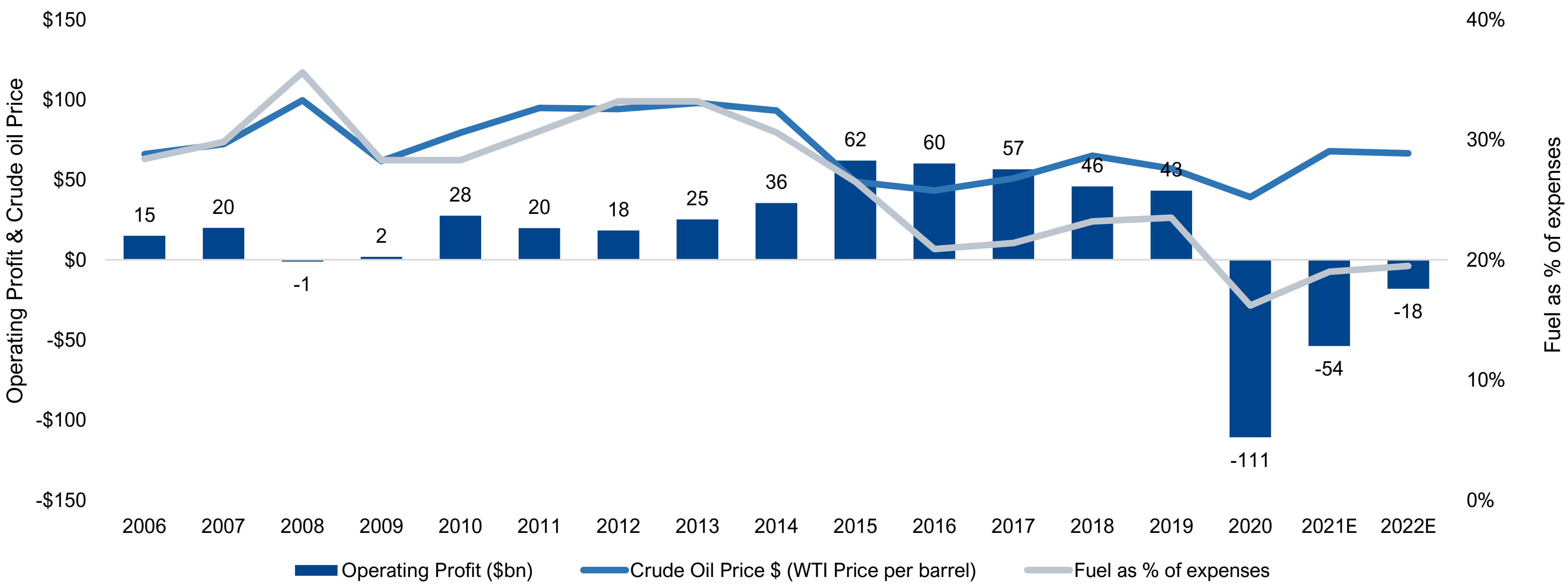
Contrary to decline in RPK, surge in cargo flights amid increase in operations using passenger aircraft during pandemic



- Since the global financial crisis, the industry registered a sustained increase in revenue at a CAGR of 3.7% between 2010 to 2019 to $708 bn in 2019, driven by increase in passenger volumes and air-cargo operations.
- With massive decline in RPK in 2020, passenger revenue dropped 69% from $607 bn in 2019 to $189 bn in 2020. However, revenue is expected to rebound due to increased demand in domestic markets.
- On the contrary, cargo operations were stronger in 2020 primarily due to an increase in cargo-only charter flights on increased demand for critical goods during COVID-19.
- Cargo will continue to remain an important source of revenue for the industry in the wake of declining passenger revenue.

Source: IATA

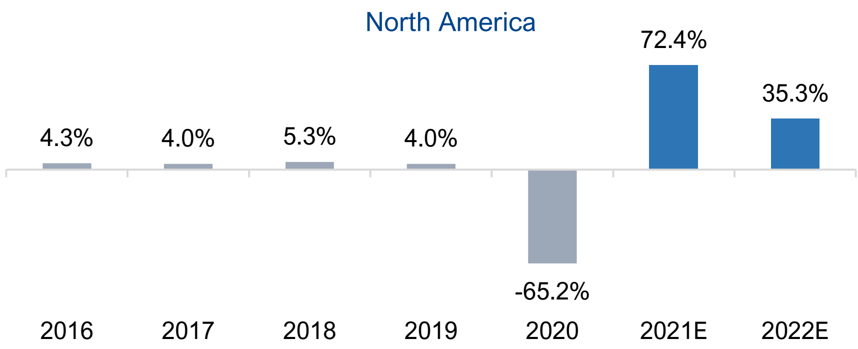
Despite recovery in passenger traffic, profitability to be impacted by increase in crude oil prices

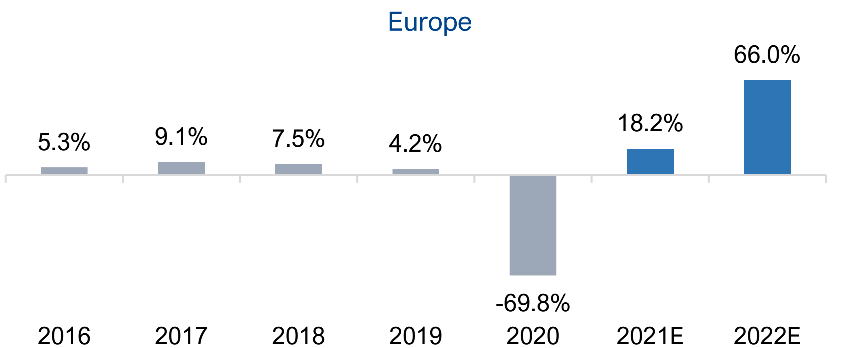


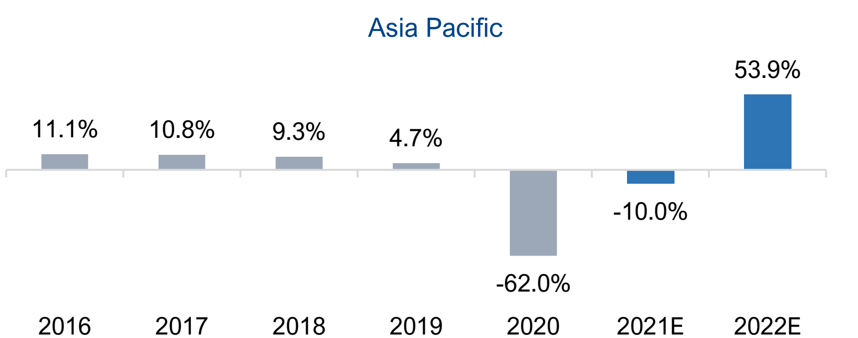
- Crude oil prices increased sharply from a negative $37.6/bbl in April 2020, driven by boost in global oil demand and supply cuts by OPEC and partner countries.
- International crude oil prices will continue to move higher on growing demand. As a result, prices is expected to be around $66 per barrel in 2022.
- In a high-cost environment, carriers will have little headroom to increase fares and improve profitability.
- It will further stress the balance sheet of airlines already struggling to return to business.

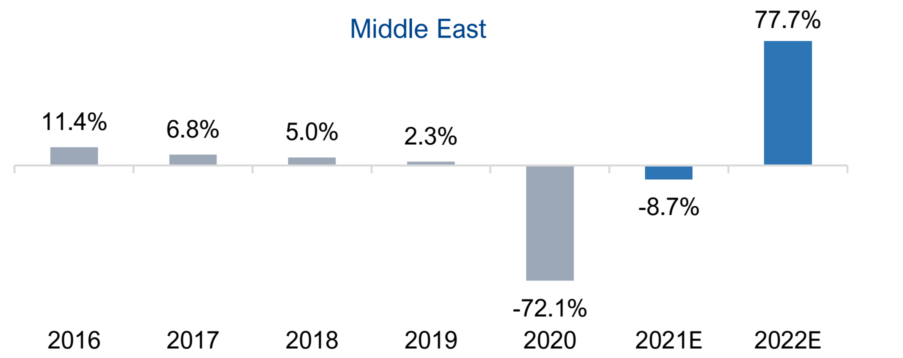
Source: EIA, IATA

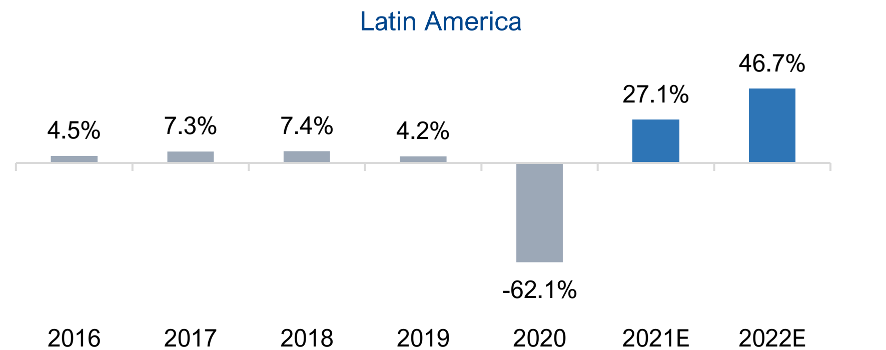
Region-wise airline passenger traffic (RPK) recovery to be uneven; travel demand from North America and Europe to outpace that from Asia-Pacific

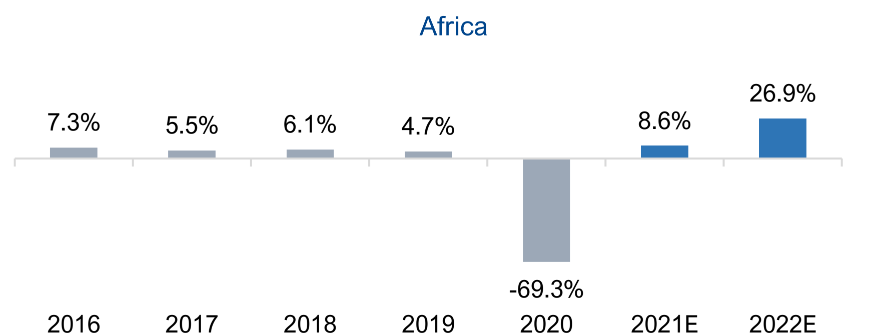








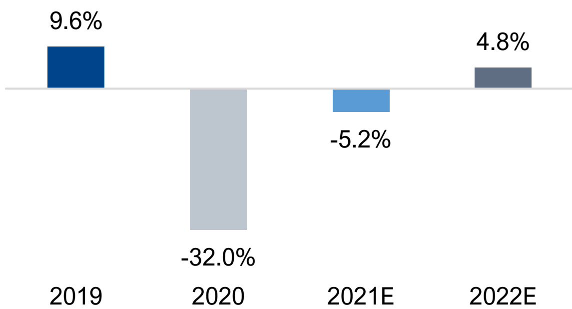




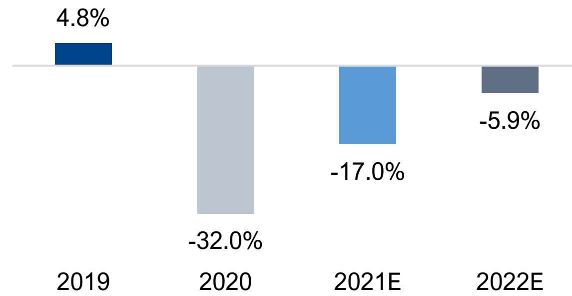
Source: IATA

North American airlines expected to return to profitability earlier than others; losses in other regions expected to narrow in 2022

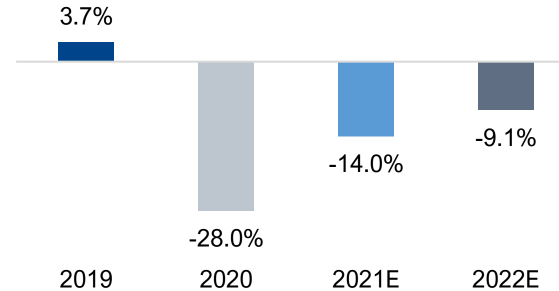
North America Operating Margin



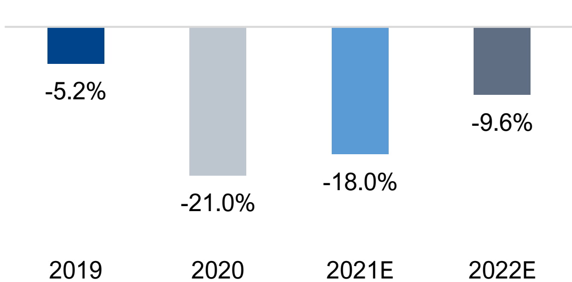
Europe Operating Margin



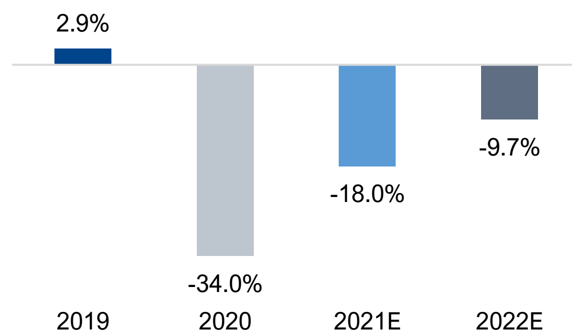
Asia-Pacific Operating Margin



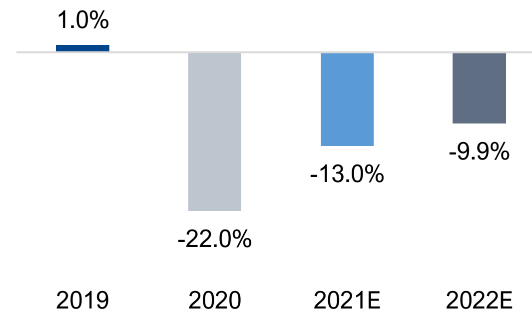
Middle East Operating Margin



Latin America Operating Margin



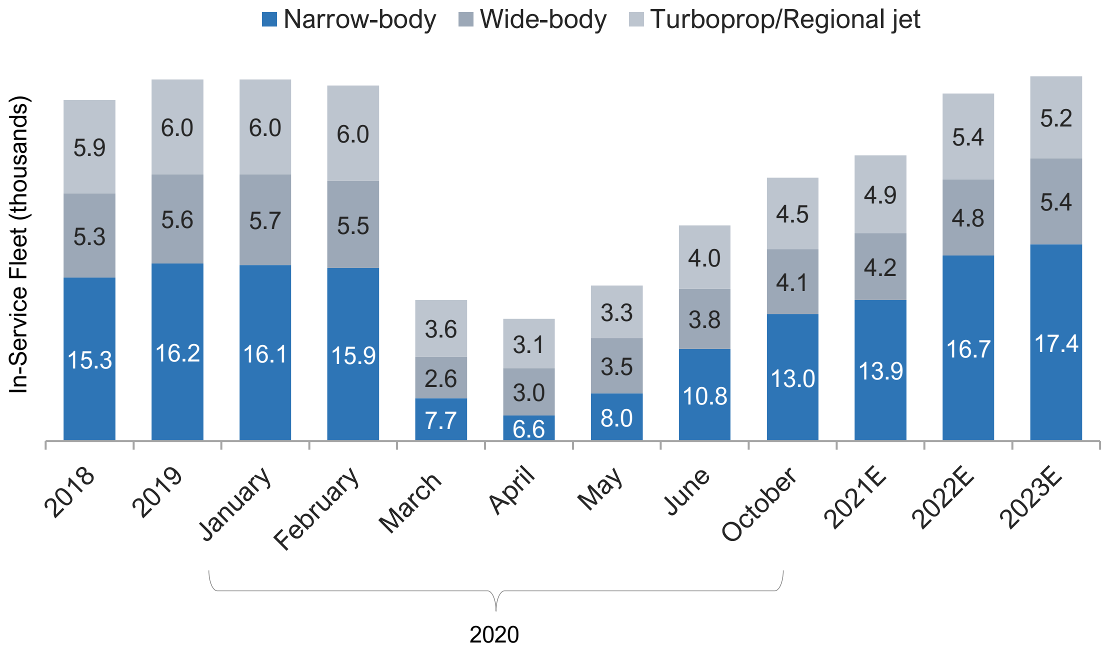
Africa Operating Margin



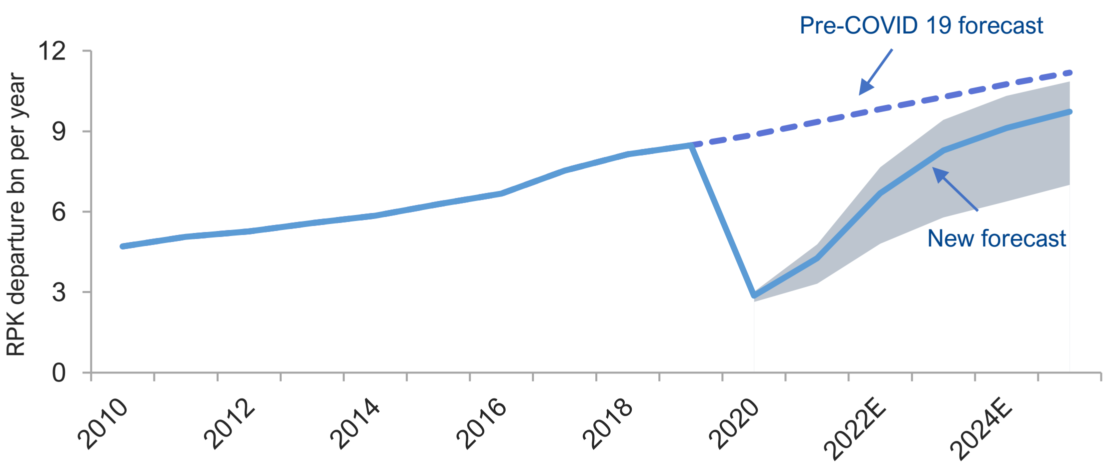
- All regions would continue to record losses, as international passenger markets recover slowly. North America will return to profitability in 2022, driven by large domestic markets.
- Asia-Pacific was impacted by government restrictions and slower vaccination rates than Europe and North America. That said, airlines in the region are likely to suffer losses in 2021 and 2022.
- European airlines are dependent on medium- and long-haul international traffic and operating margin will be impacted .
- Recovery in Middle Eastern airlines will be delayed due to dependence on long-haul international markets.
- Even before the pandemic, Latin American airlines faced operating issues, which were further exacerbated by COVID-19. As a result, weak performance is expected to continue.

Source: IATA

Fleet size and passenger traffic to slowly climb back to pre-COVID-19 level



- Before the onset of COVID-19, Boeing and Airbus had strong order books as aircraft demand exceeded the production capacity.
- Fleet size shrank significantly in March 2020 with sharp decline in long-haul international traffic.
- Narrow-body fleet would recover faster than wide-body fleet following COVID-19, as the industry aligns to the realities of a small travel market.

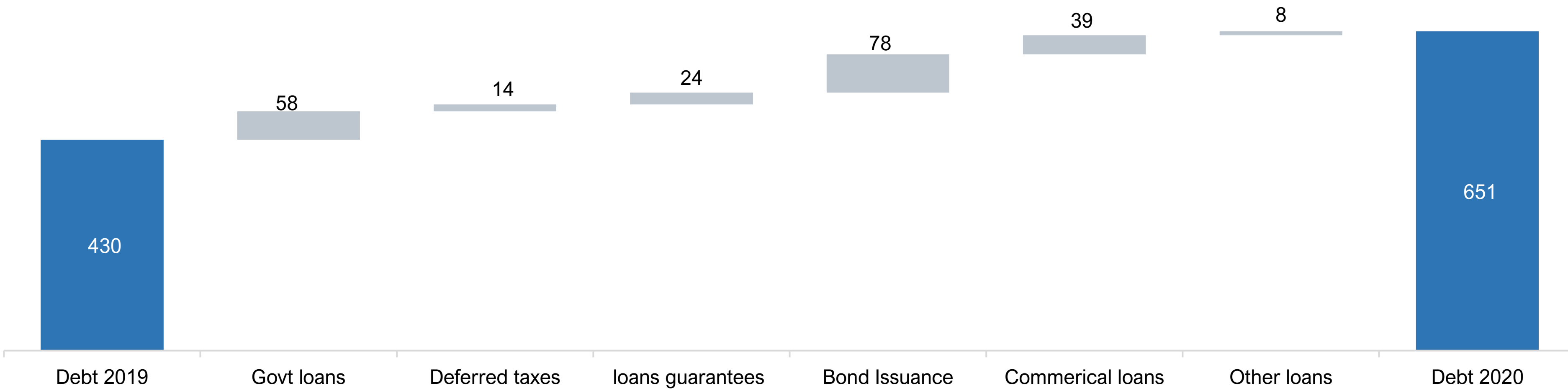


- Although COVID-19 vaccines are being rolled out, production challenges exist. As a result, air travel would bounce back substantially only in 2022.
- Currently, passenger demand remains low because of the lag in business travel and weak consumer confidence and travel restrictions.
- Passenger traffic is expected to return to the pre-COVID-19 level by 2024.

Source: IATA, Oliver Wyman

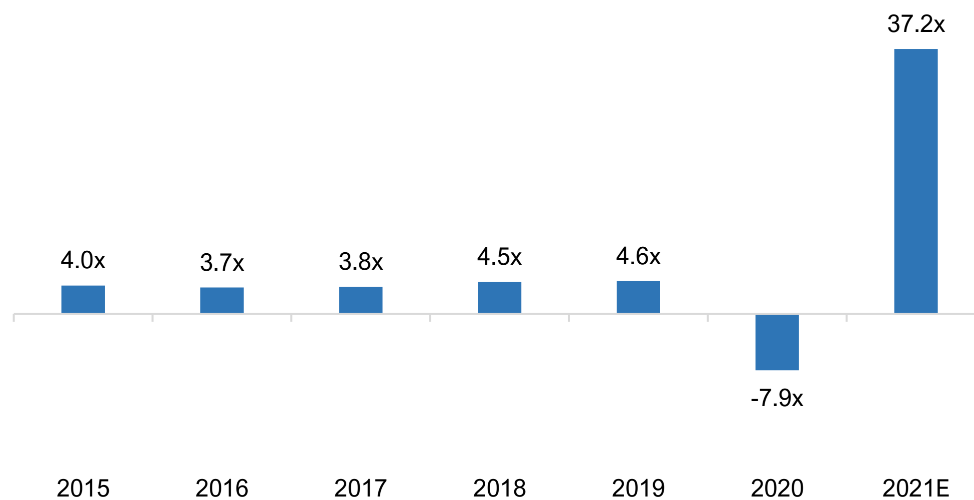
Airlines avoid bankruptcy during COVID-19 with financial support from government and capital markets

Government support totaled $243 bn as of September 2021



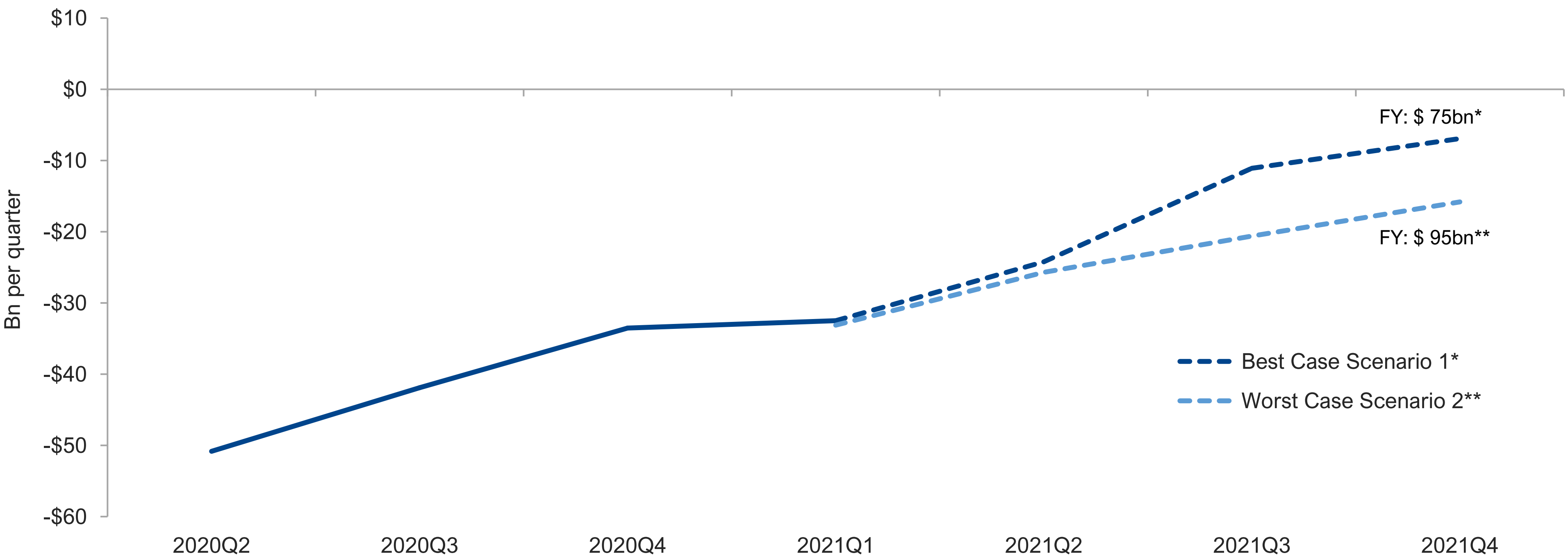
- Government aid to airlines in the aftermath of COVID-19 prevented bankruptcies. As of September 2021, financial support from government totaled $243 bn.
- Carriers also tapped the bond and loan market and raised over $100 bn to improve liquidity.
- While airlines in the US, Europe, and Asia received significant government support, the Middle East and Africa received limited aid.
- Capital support is likely to be needed and must come in different forms, as recovery in international and domestic markets is still a long way.

Adjusted Net Debt* / EBITDAR



*Source: IATA, *Debt adjusted for operating leases*

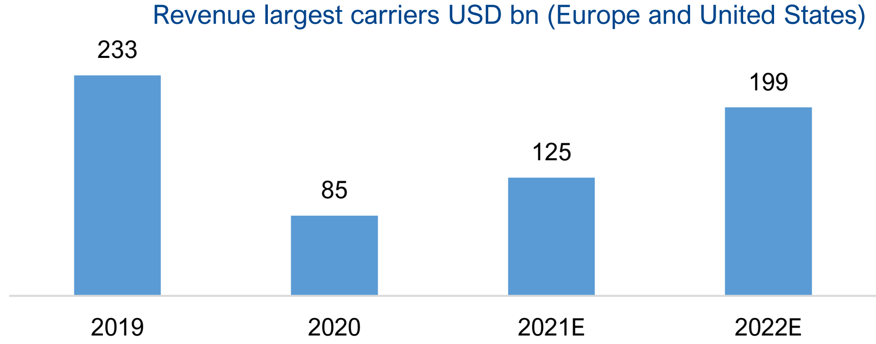
Cash burn to continue as profits insufficient to cover high fixed cost



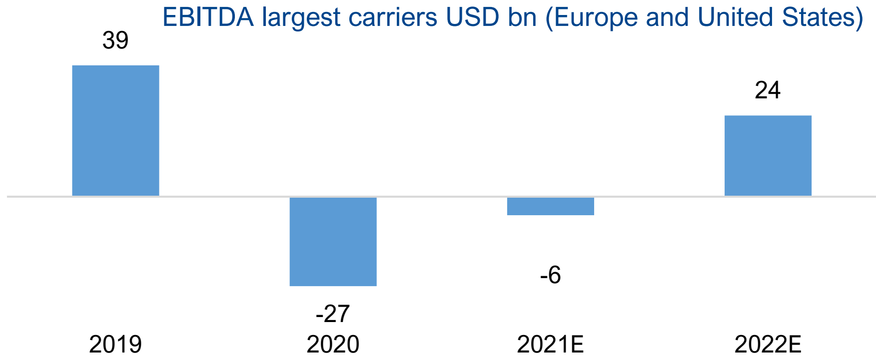
- In response to COVID-19, airlines implemented measures by reducing available seat miles (ASM), capex, negotiating payment terms with lenders, and lower working capital requirements to conserve liquidity.
- Despite the initiatives, the free cash flow deteriorated significantly in Q2'20 with cash burn of $50 bn.
- Recovery in H2'20 remained slow as the second wave of COVID-19 in many regions led to renewed restrictive measures.
- The best-case scenario would be airlines burning cash of $75 bn in 2021 due to weak travel demand. However, it could fall to $95 bn if government tightens border restrictions.
- While cash burn will diminish from the peak of the crisis, the slow recovery in demand would result in airlines continuing to burning cash.

Source: IATA, *2021 passenger demand would be 38% of 2019 levels, **2021 passenger demand would be 33% of 2019 levels

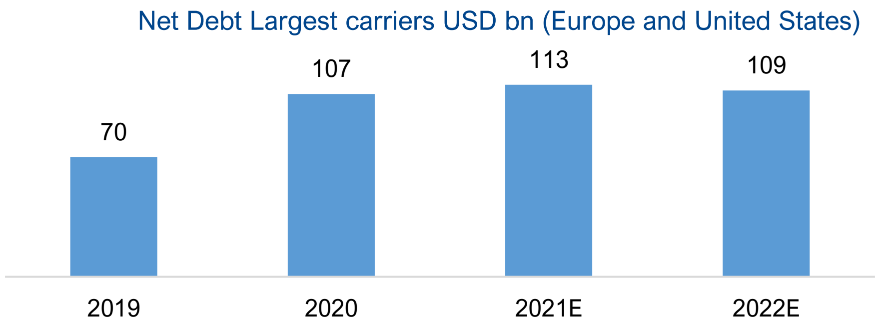
Combined financial performance of largest carriers in the US and Europe



- The revenue of the largest carriers in the US (Delta, American, United Airlines Holdings) and their counterparts in Europe (Lufthansa, International Airlines, and Air France KLM) is expected to rebound in 2022 but remain below the COVID-19 level.
- That said, the resurgence in COVID-19 cases could set those plans back.



- With recovery in revenue, EBITDA would turn marginally positive on cost-saving initiatives undertaken by carriers.
- To support profitability, airlines reduced capacity by downsizing its fleet size and workforce.



- While airlines have sufficient liquidity to fund operations over the short term, they will emerge with high levels of debt, which will take years to deleverage.
- Since 2019, the net debt of the six network carriers in the US and Europe increased 60.5% to USD 113mm in 2021.
- Capital structure restructuring is likely to be needed in case cash flows do not recover to a suitable level to enable airlines to organically deleverage.

Source: CAP IQ

500+
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2500+
Global clients

120+
Sectors and sub-sectors researched by our analysts

80+
Countries where we have delivered projects

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Connect with our Team

Ashwinikumar Dole
Senior Manager, Investment Research

+91.124.668 9999 (Extn: 327)
ashwinikumar.dole@aranca.com

Tarun Vanjani
Senior Analyst, Investment Research

+91.124.668 9999
tarun.vanjani@aranca.com

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