Changing Traffic & Financials, Intensified Competition

(September 2015)

AIR TRAFFIC PERFORMANCE

- January-July: **+5%** for **passenger traffic**, **+0.4%** for **freight traffic**.

  Passenger traffic remains dynamic this year, despite the negative impact of geopolitical tensions between Russia and Ukraine, as well as occasional labour unrest within airlines and Air Navigation Service Providers.

  Passenger traffic at EU airports is now consistently outpacing traffic at non-EU airports for the first time since 2006 – with airports in Romania, Ireland, Portugal, Greece, Lithuania, Hungary and Belgium leading the surge. The situation in Russia and Ukraine is affecting not only airports in these countries, but also other European airports for which traffic to these countries is significant.
  Air freight remains flat – partly due to the deceleration of growth in emerging countries and more structural factors.

  At present, more than 70% of European airports are seeing passenger traffic growing.

- **Aircraft movement** at European airports have increased by **+2.1%** since January.

  This summer has seen airlines adjusting their capacity upward in response to strong seasonal passenger demand. Seat capacity is up by +4% on intra-European routes (almost exclusively because of Low Cost Carriers), while it is increasing by +8% on routes between Europe and other World regions (with the Middle East and North America seeing the strongest increases).

2015/2016 OUTLOOK

- As economic conditions are set to keep improving in the EU on the back of the ECB's stimulus programme and cheaper oil prices, this **positive momentum for air traffic** should persist **in the medium-term**.

  However, **downsize risks remain significant** – from Greek debt negotiations fallouts to the risk of an emerging market crisis as well as renewed terrorism threats and continued geopolitical tensions.

ECONOMIC & FINANCIAL PERFORMANCE

- The financial performance of Europe's airports is **gradually improving**, reflecting more positive trading conditions. The industry's **average return on capital invested (ROIC)** stands at **+6.8%** - broadly in line with the cost of capital.

  However, airports in the EU and in the Eurozone are still not delivering an acceptable return for their shareholders, with their ROIC significantly lower at **+5.7%** and

+5% respectively. This also remains in sharp contrast to the performance of airports in emerging markets (+16.1%).

- This improvement is entirely attributable to **costs reductions** and **lower capital costs**.

  Sustained efforts to cut costs over the past years are paying off – with staff costs in particular down by **-17.4%** from their 2008 levels, as well as maintenance costs and energy & waste costs decreasing by **-51.2%** and **-9.1%** respectively (per passenger, in real terms).

- Conversely, the **revenue environment** is becoming **ever more challenging** for airports.

  Aeronautical revenues coming from user charges paid by airlines and passengers keeps decreasing – reflecting **rising competitive pressures**. This year, these charges are down by **-0.8%** in real terms, without even accounting for substantial discounts offered to airlines. These discounts are made available as part of traffic growth or traffic retention incentive schemes as well as bilateral commercial agreements.

  Diversified **commercial revenues** (retail, food & beverage, car parking & rental, real estate, advertising, etc) have always compensated for lower aeronautical revenues. But a combination of factors including market maturity, shifting consumer behavior, competition from online retail and off-site parking as well as more restrictive airline cabin bag rules are all converging to **erode these revenue streams**.
  For the first time in 2013, commercial revenues were not only decreasing on a per passenger basis (**-4.1%**) but this decrease was actually much steeper than the contraction in aeronautical revenues.

TRAFFIC CONCENTRATION & AIRPORT COMPETITION

- Air traffic continues to be shaped by **airline structural realignment** and **airline hybridisation**. Most of the growth in traffic since the global financial crisis has been driven by Low Cost Carriers (LCCs) and, to a lesser extent, by ambitious non-European airlines expanding their European presence. The **move upmarket of LCCs into primary airports** combined with the **magnitude of their aircraft orders** (918 aircraft) and the difficulties of Full Service Carriers to restructure suggest that this trend will continue – with LCCs further growing their market share.

- These market developments are resulting in an **increasing concentration of air traffic**, with less new routes and smaller regional airports at risk of losing out in terms of connectivity.

  These market developments are also pointing to **airport competition** increasing in scope and intensity. **Larger airports and hubs are the new battlefields**, with each of them working to diversify their traffic mix and build resilience in their network. This includes attempts by airports to generate self-connecting traffic outside of airlines' own interline products, through dedicated passenger service and assistance.