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# A Look Back: A Look Forward

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*October 2014*

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1978:4 – 1982:4

**I really don't know one plane from the other. To me they are just marginal costs with wings.**

— Alfred Kahn, 1977

**No one expects Braniff to go broke. No major U.S. carrier ever has.**

— *The Wall Street Journal*, 30 July 1980

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1983:1 – 1991:1

“  
If we went into the funeral business, people would stop dying.

— *Martin R. Shugrue, Vice-chairman Pan Am*

I can't imagine a set of circumstances that would produce Chapter 11 for Eastern.

— *Frank Lorenzo*

”

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1991:2 – 2001:4

I think historically, the airline business has not been run as a real business. That is, a business designed to achieve a return on capital that is then passed on to shareholders. **It has historically been run as an extremely elaborate version of a model railroad, that is, one in which you try to make enough money to buy more equipment.**

— Michael Levine, Executive VP Northwest Airlines, 1996

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2002:1 – 2009:3

The worst sort of business is one that grows rapidly, requires significant capital to engender the growth, and then earns little or no money. Think airlines. Here a durable competitive advantage has proven elusive ever since the days of the Wright Brothers. **Indeed, if a farsighted capitalist had been present at Kitty Hawk, he would have done his successors a huge favor by shooting Orville down.**

— Warren Buffett, annual letter to Berkshire Hathaway shareholders, February 2008

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2009:4 – Present

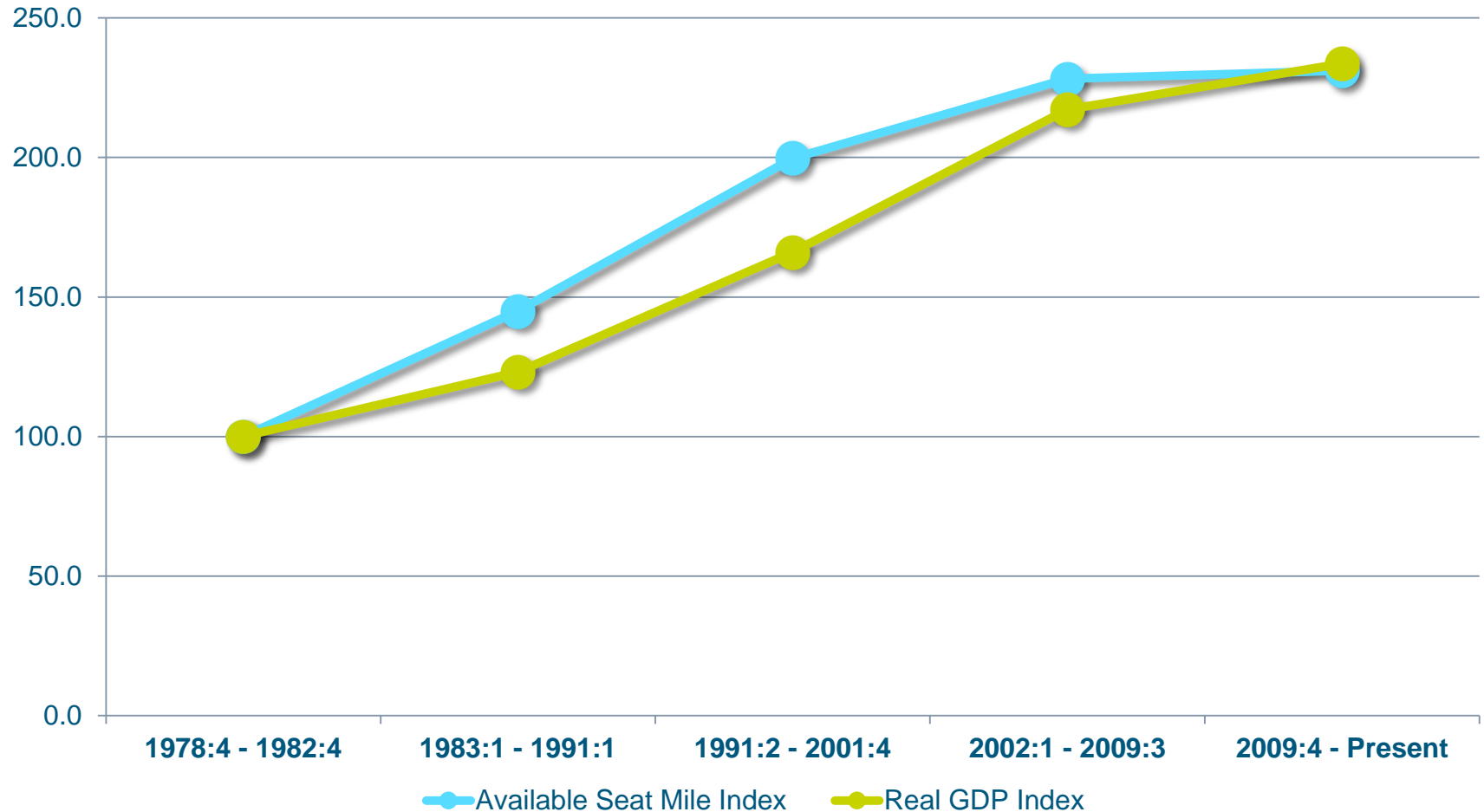
Should we see demand decrease, however, we will respond nimbly and appropriately by decreasing capacity and taking costs out to help ensure we remain profitable throughout the business cycle.

— Jeffrey Smisek, United Airlines CEO

**This [the airline industry] Is No Longer a Hobby”**

— Richard Anderson, Delta Air Lines CEO speaking to analysts on 1Q 2012 earnings call

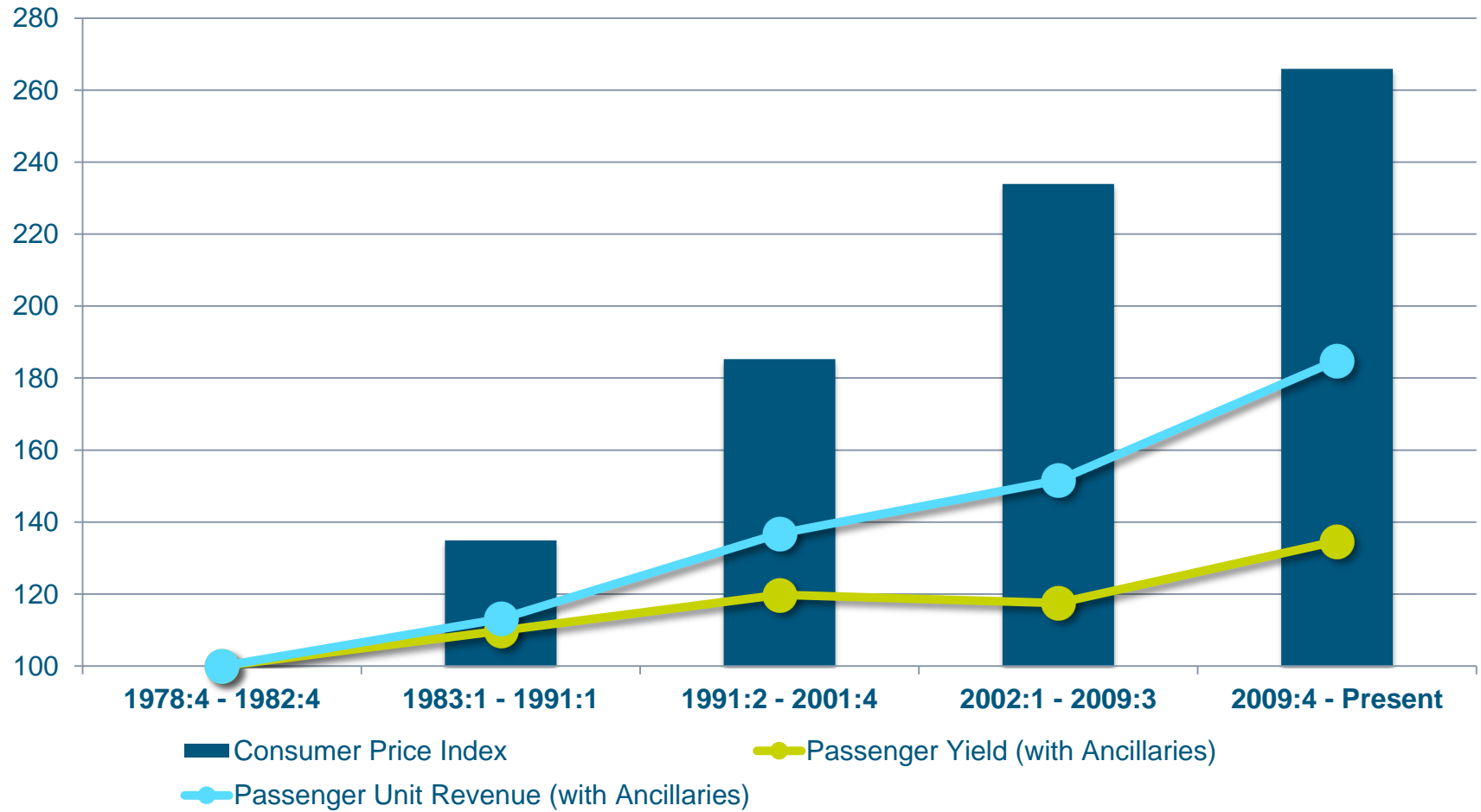
# Capacity Grows Faster Than Real GDP: An Industry That Grew Too Big



Note: SAAR, 2009 Chained Dollars  
Note: Business cycle 1 = 100



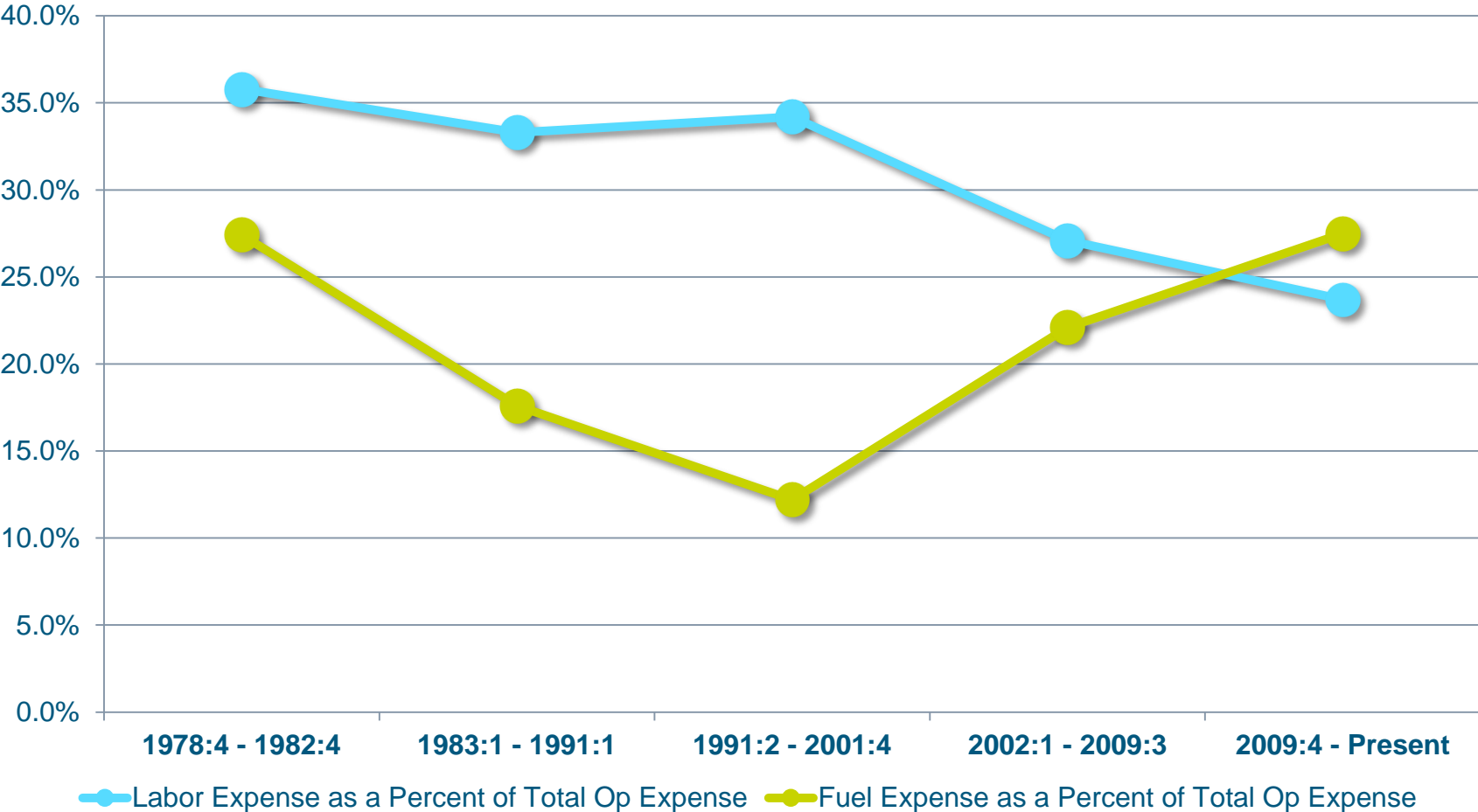
# Unit Revenue Does Not Keep Pace With Inflation: The Consumer Benefits In A Significant Way



Note: Consumer Price Index SAAR  
 Note: Business cycle 1 = 100

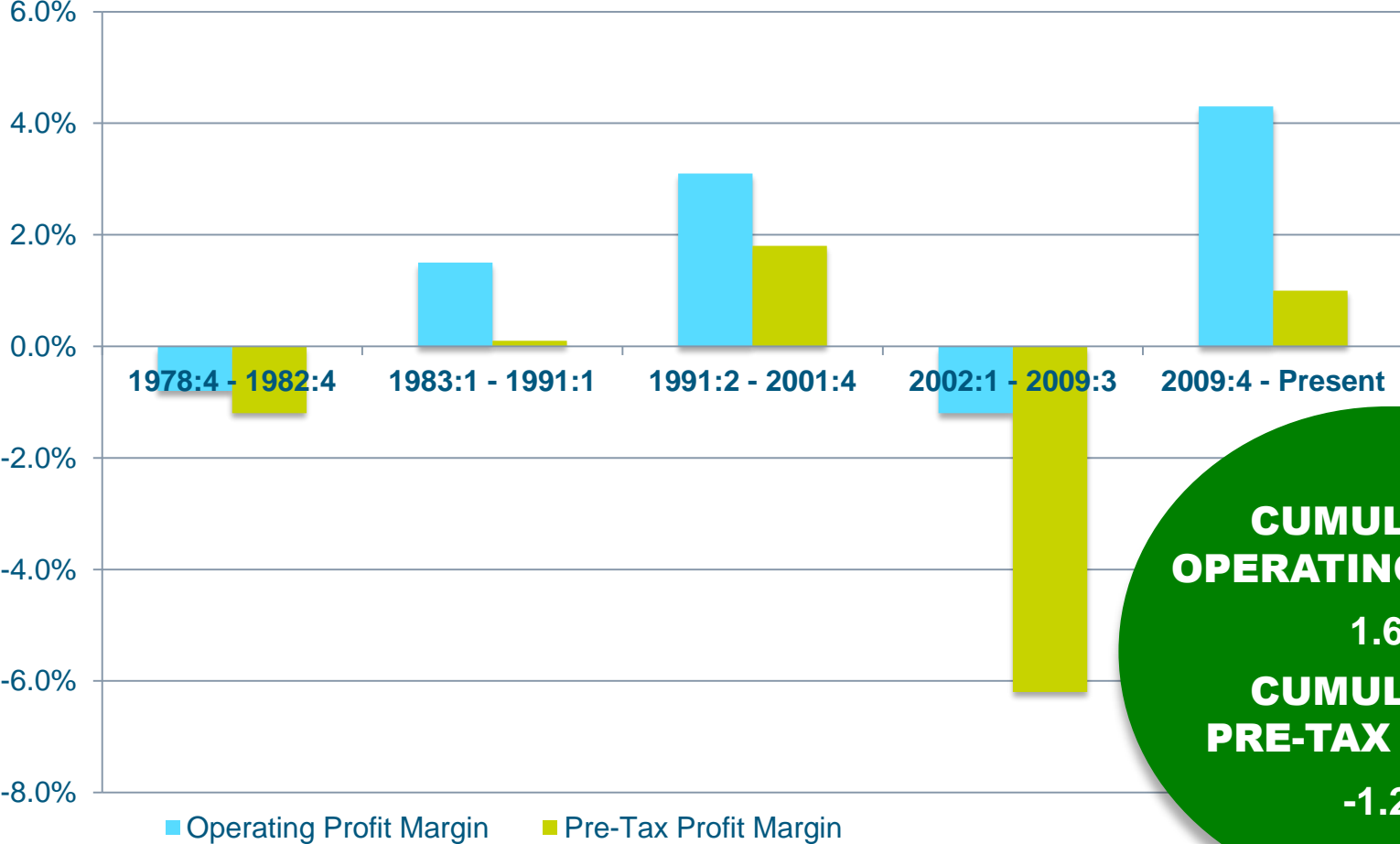


# An Uncontrollable Cost: Fuel Was the Catalyst the Industry Needed to Change Its Game



Data Source: A4A Airline Cost Index Tables

# However: The Current Cycle Appears to be Something Different



**CUMULATIVE OPERATING MARGIN**  
1.6%

**CUMULATIVE PRE-TAX MARGIN**  
-1.2%

Data Source: A4A Airline Cost Index Tables

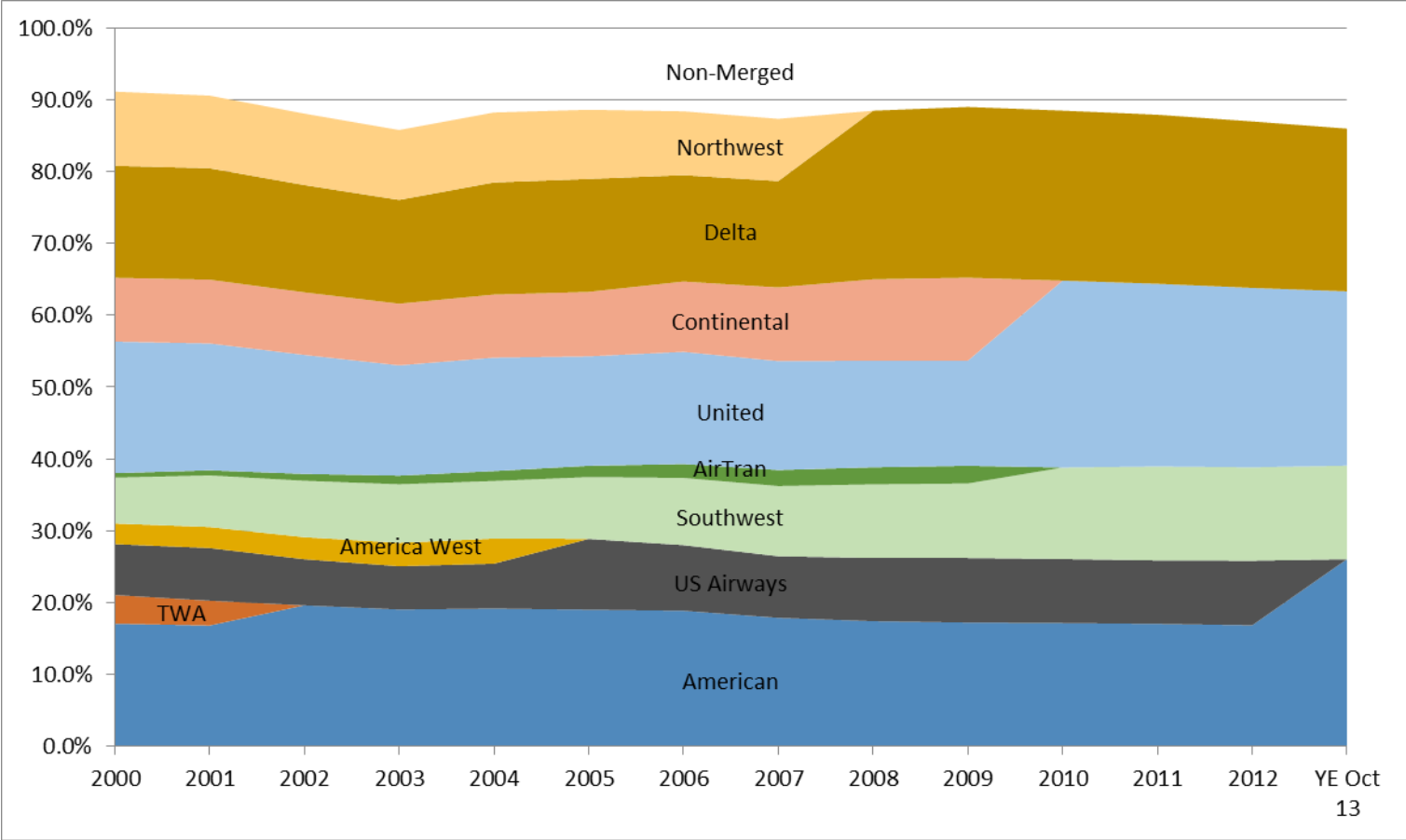
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## Commercial Air Service:

*Challenges and Opportunities*

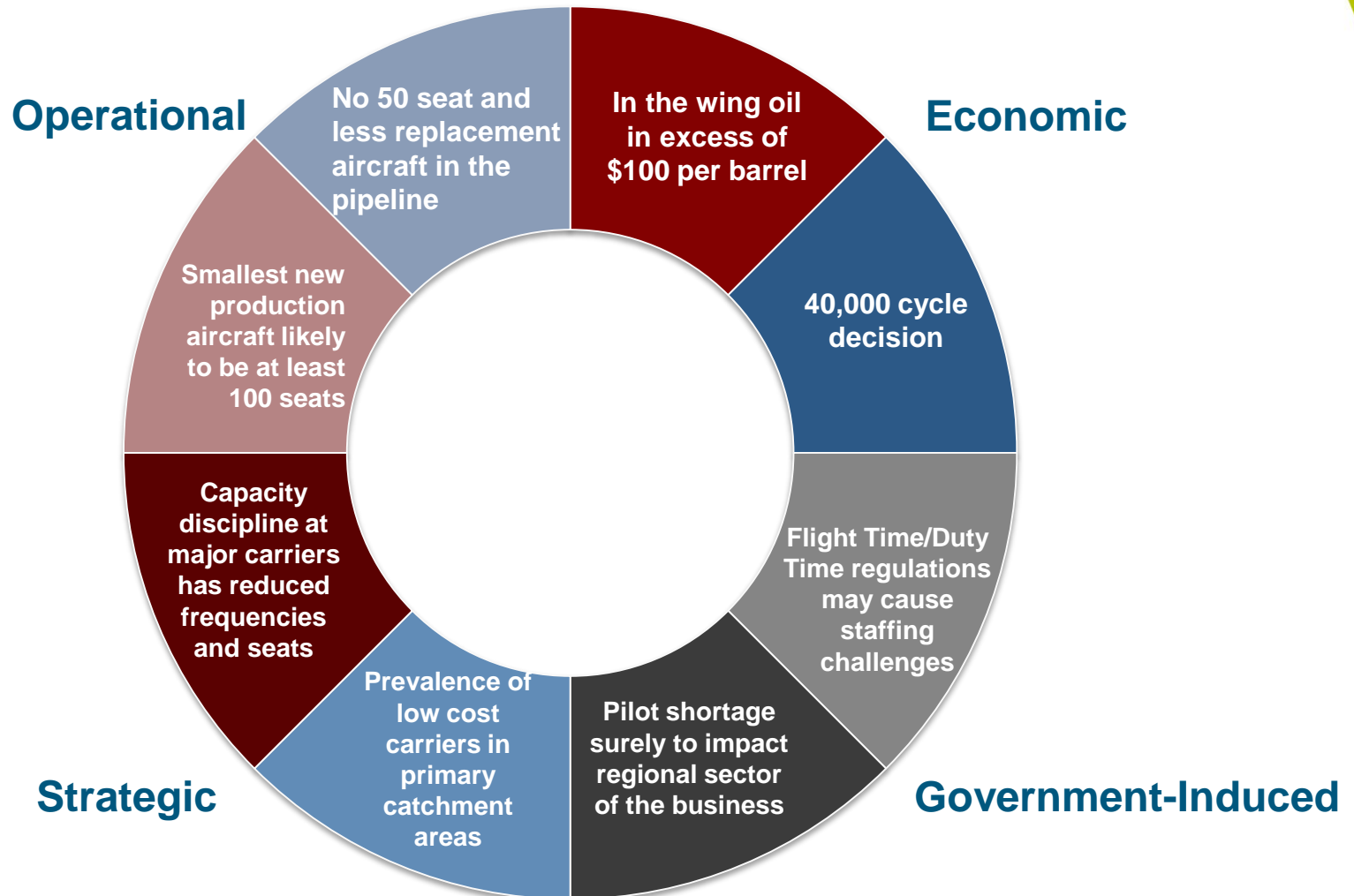
# Consolidation in the U.S. Makes Air Service Expansion Much More Difficult



# The historic relationship of airline industry growth and GDP is broken. Is the break in the pattern the future?

- What will cause the legacy carriers to grow?
- Where will that growth be?
- What is the future of LCCs? What happens as their costs increase—does WN return to growth?
- What is the future of ULCCs?
- WILL THERE BE A REGIONAL INDUSTRY?
- What does all this mean for airports? Or for passengers?

# Challenges Facing Air Service in the United States



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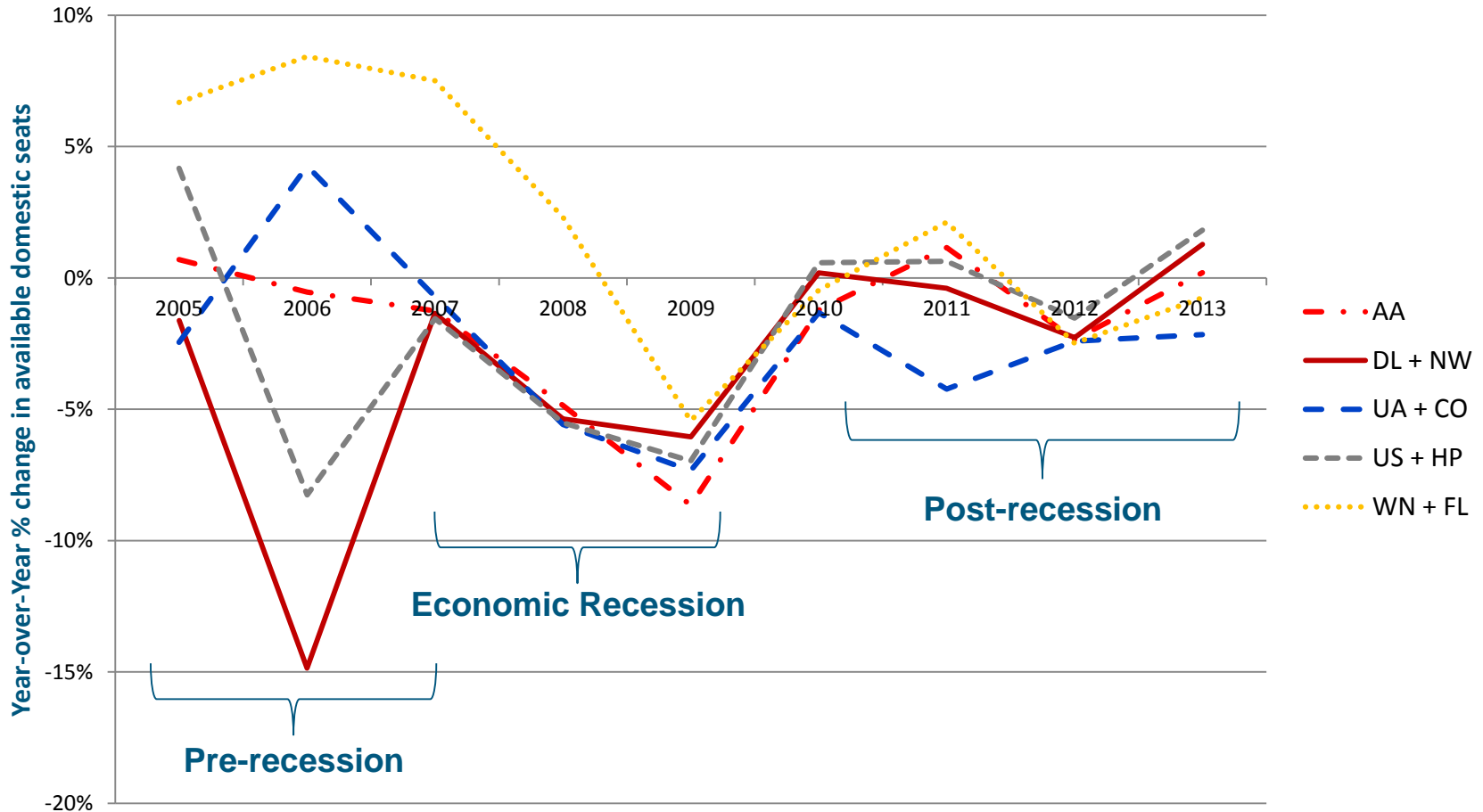
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## The National Picture:

*How Has Capacity Discipline Affected Air Service?*



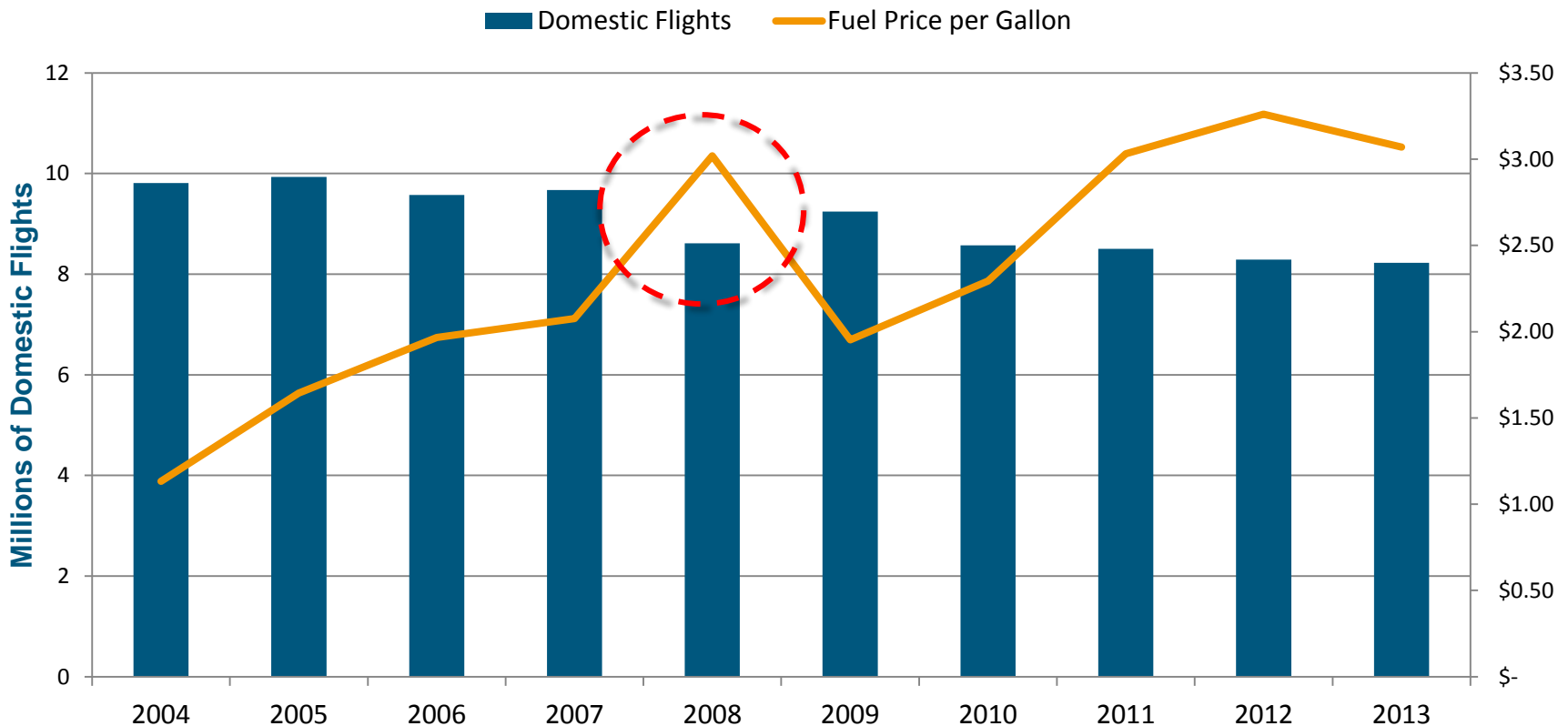
# The Last Nine Years of Domestic Aviation can be Divided Into Three Time Periods



Source: InterVISTAS analysis of Innovata schedule data via Diio Mi

# An upward shock to the price of fuel in 2008 caused airlines to quickly pull back capacity

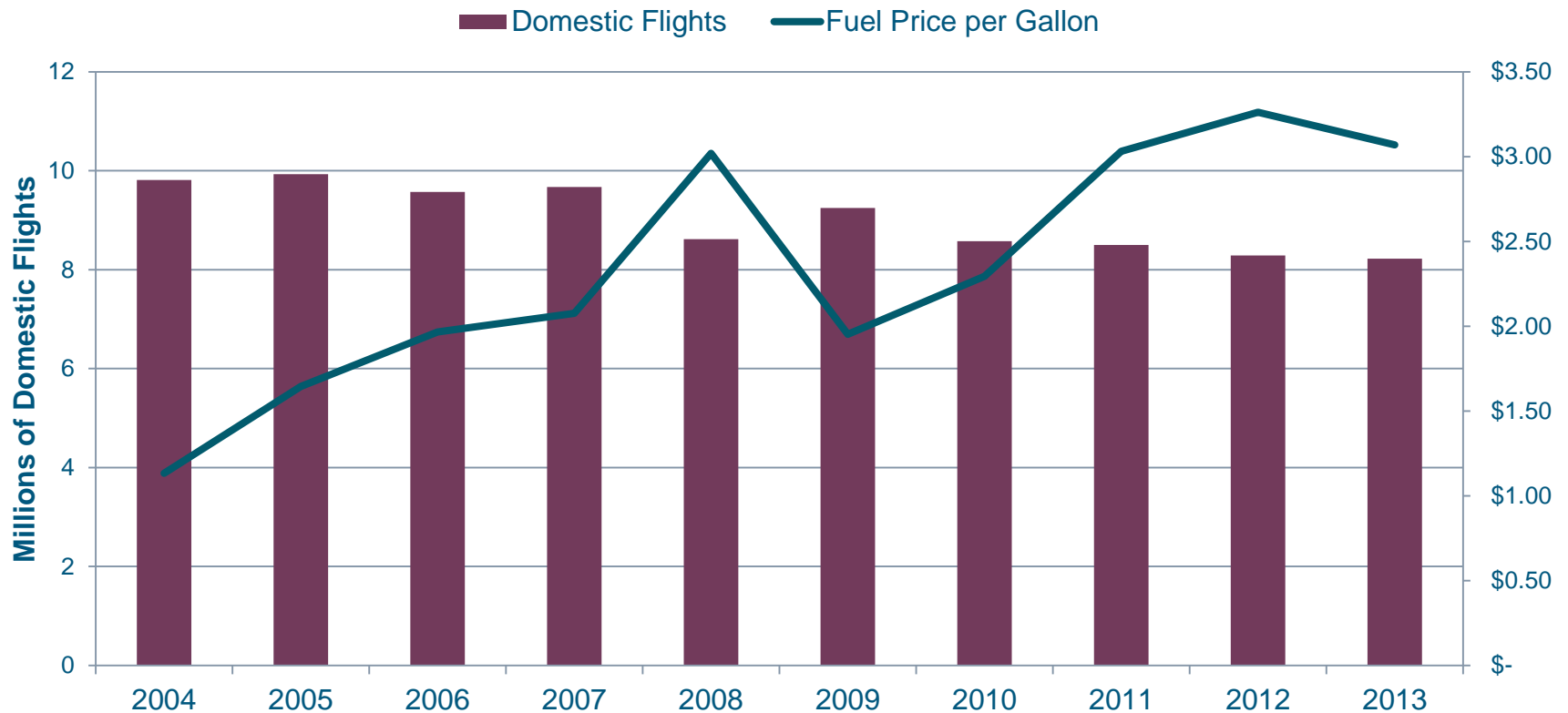
Scheduled Domestic Flights and Fuel Price per Gallon



Sources: BTS Form 41 cost data (via MIT Airline Data Project) and Diio Mi schedule data

# Fuel Prices and Capacity Rationalization

- According to the MIT Airline Data Project, airline fuel prices have stabilized, yet scheduled domestic flights have not rebounded.

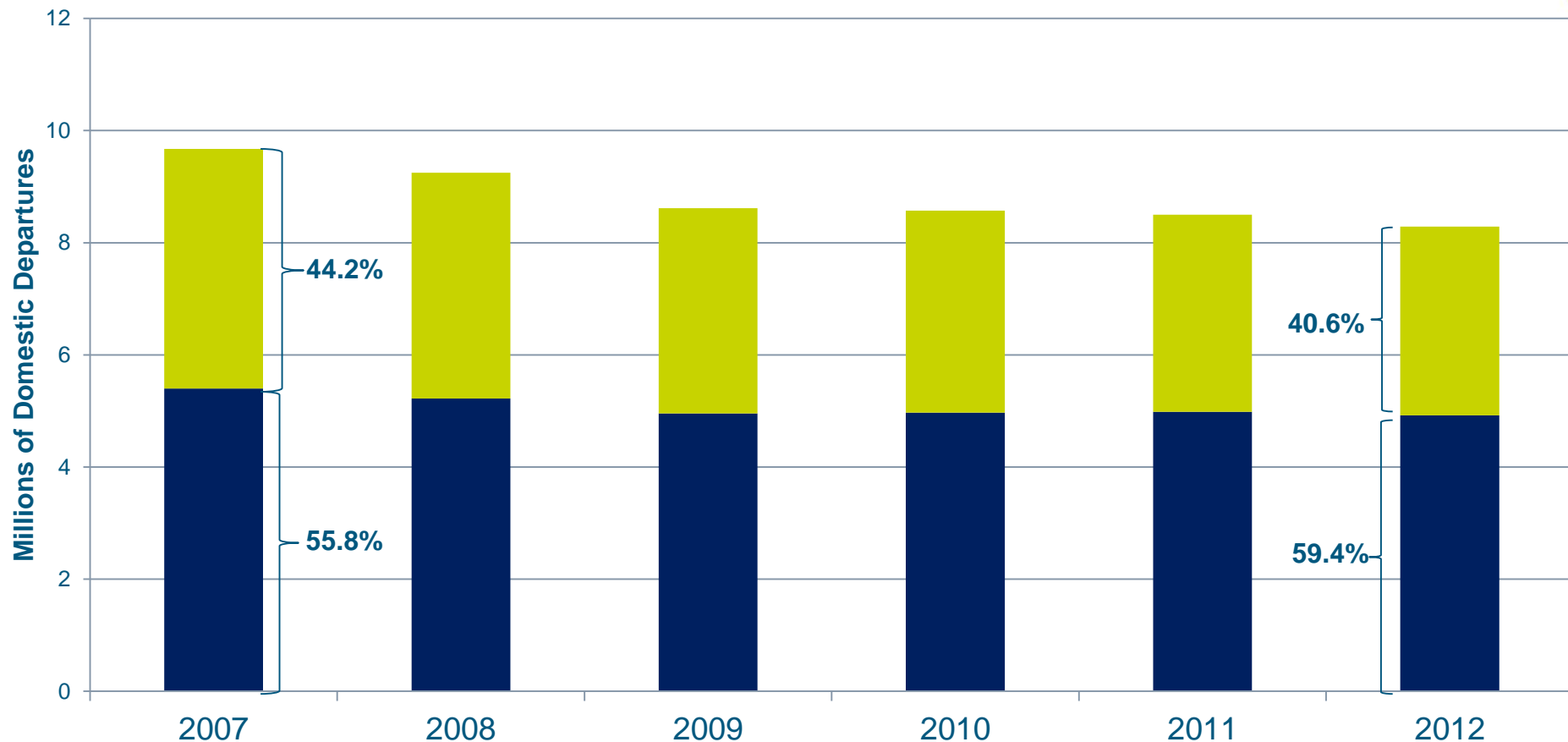


Source: Diio Mi and MIT Airline Data Project

# From 2007-2012, U.S. Airlines Cut 1.4 million Domestic Flights from the National Airspace System

## Scheduled Domestic Departures from U.S. Airports

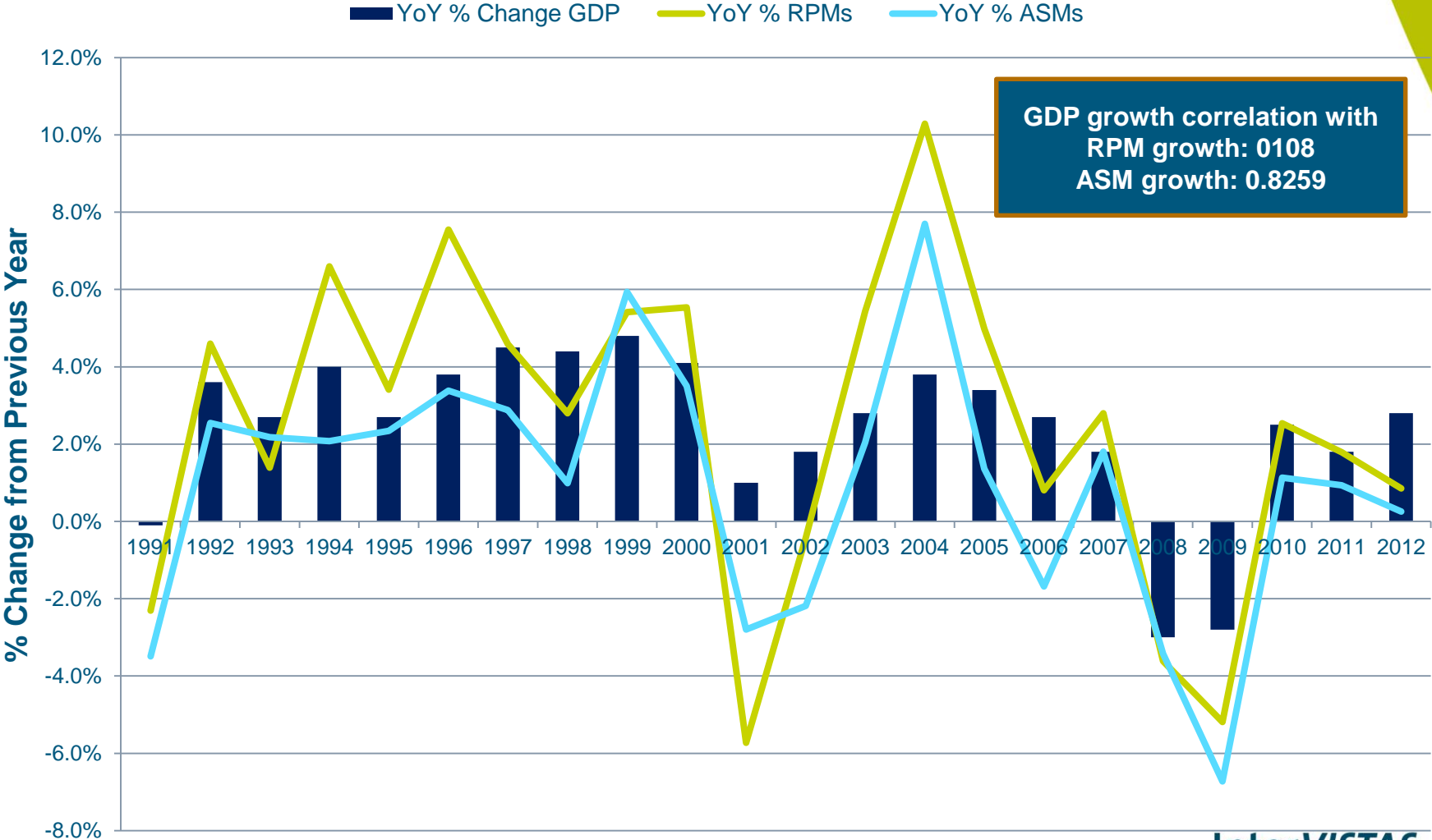
■ Large Hub ■ Non-Large Hub



Source: InterVISTAS analysis of Innovata schedule data via Diio Mi

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# Growth in Domestic ASMs and RPMs has been Historically Tied Closely to GDP



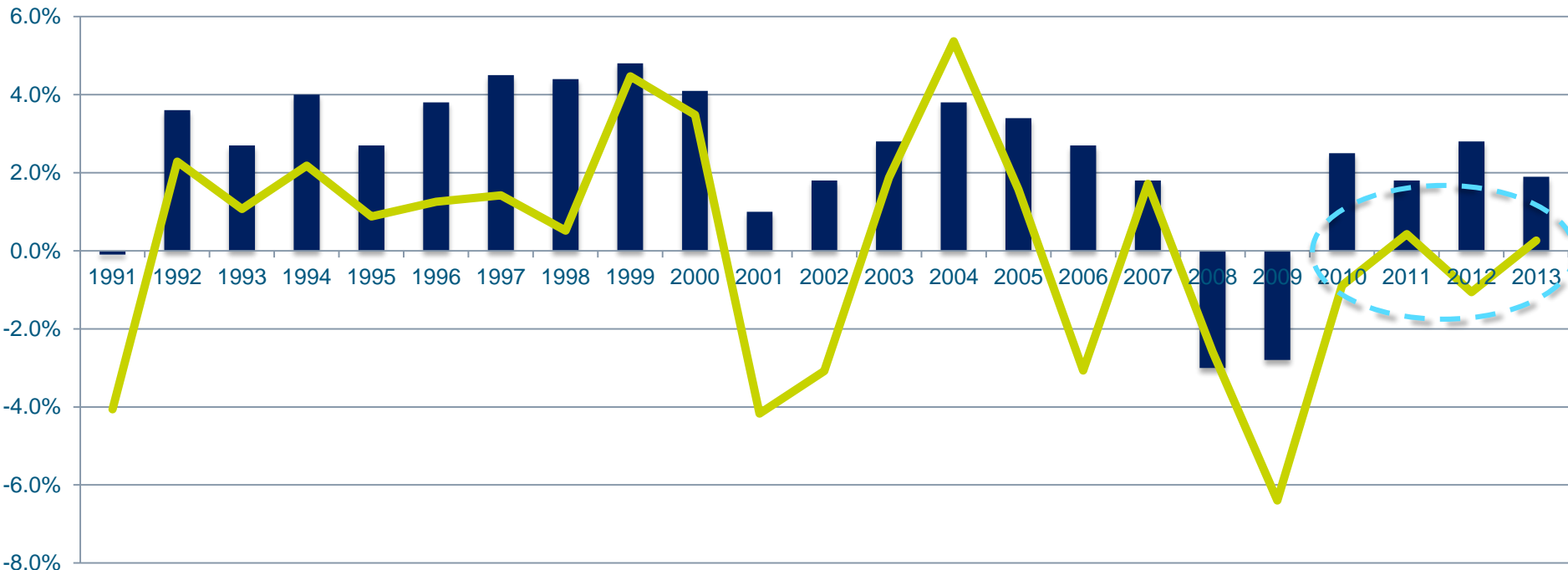
Source: BTS T-100 via Diio Mi, BEA

# Domestic Seat Capacity has Remained Stagnant Despite Economic Growth

- Represents a recent shift in airline strategy; typically, airlines grow capacity in times of domestic economic growth.

Year-over-year % Changes in U.S. GDP and Domestic Seat Departures

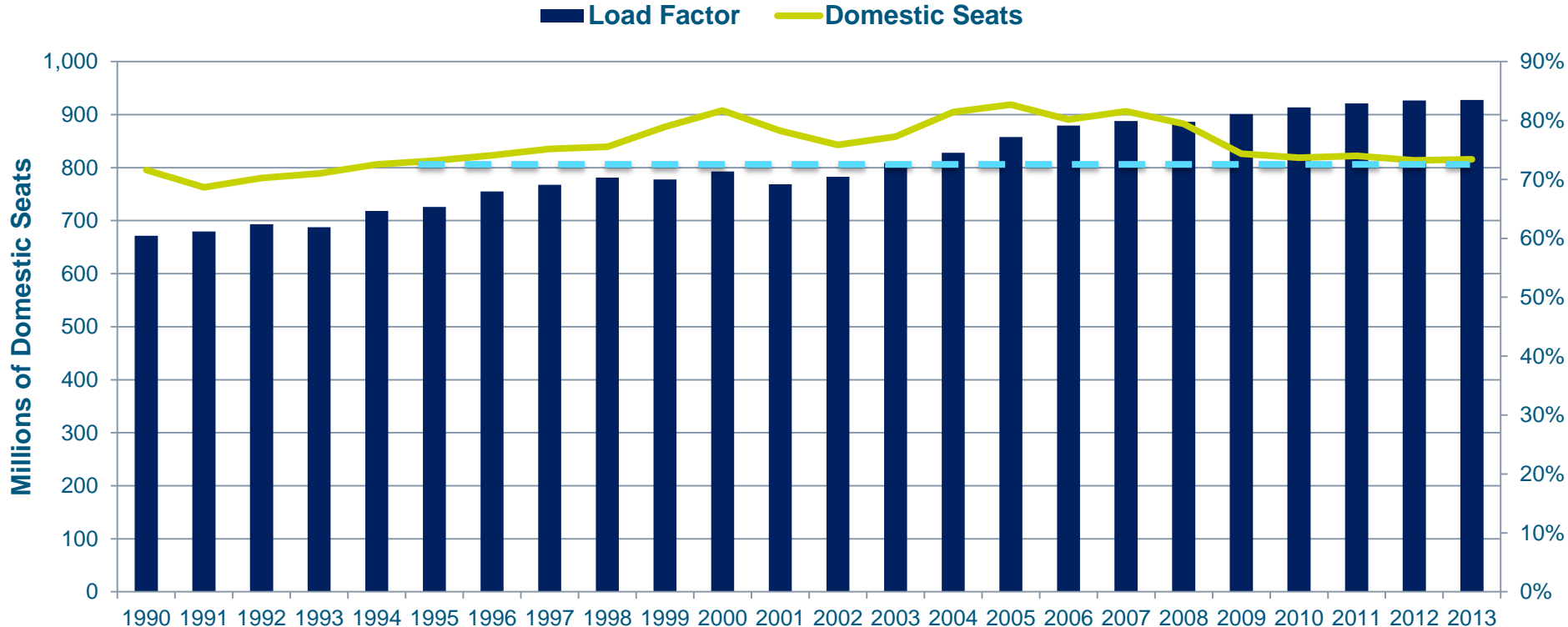
■ YoY % Change GDP    — YoY % Change Domestic Seats



# Capacity Discipline and Schedule Rationalization Wiped Out Nearly 100 million Domestic Seats

- Available domestic seats are at their lowest level since 1995

U.S. Average Load Factor and Available Domestic Seat Departures

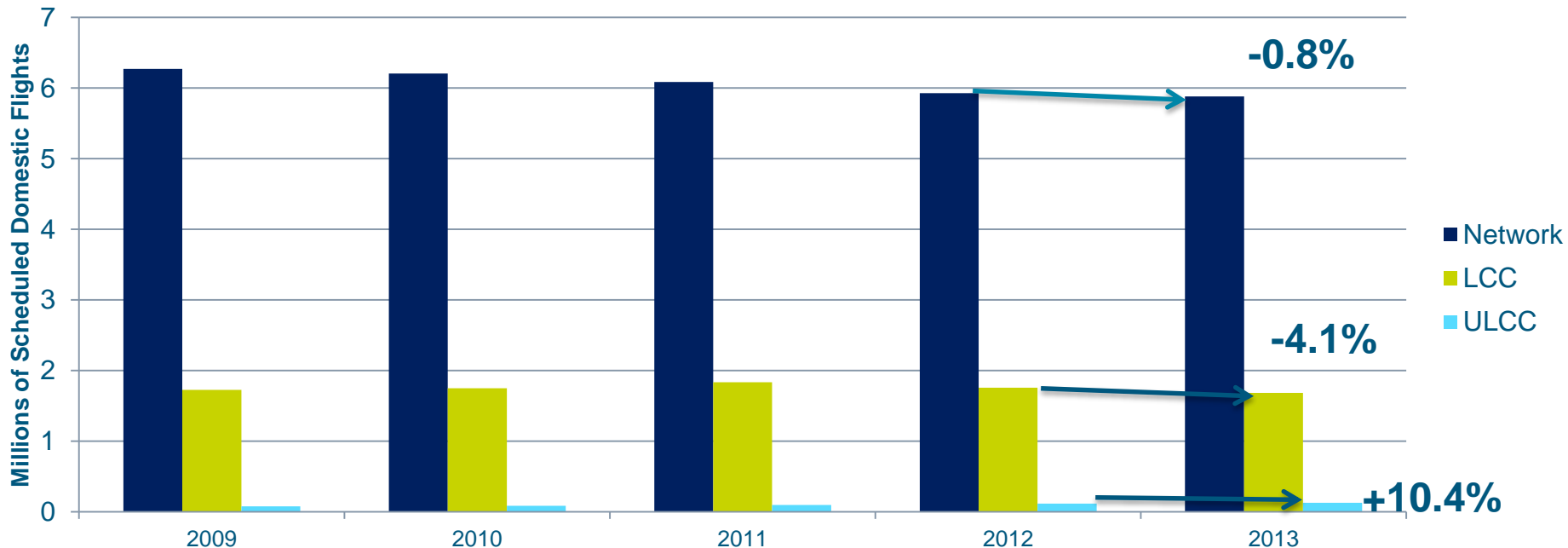


Source: BTS T-100 via Diio Mi, BEA



# LCCs Now Lead Network Carriers in Cutting Capacity

- Ultra-Low Cost Carriers departures continue to grow (+10.4% from 2012-2013), but they only represent 1.4% of the total domestic capacity in the United States.
- Network carriers (-0.8%) and Low Cost Carriers (-4.1%) continued to cut scheduled flights from 2012-2013.



Source: InterVISTAS analysis of Innovata schedule data via Diio Mi

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# Capacity Discipline is the “New Normal” for Airports of All Sizes

- **Rationalization (2007-2009):** *an active reduction of available seat capacity as a result of macroeconomic shocks to the airline industry and a “new normal” of higher fuel prices.*
- **Capacity Discipline (2010 – present):** *a restriction of seat capacity growth by network carriers (and Southwest) even as passenger enplanements have continued to increase.*
  - Capacity discipline started as early as 2010 as carriers held seat capacity at lower, “rationalized” levels despite an economic recovery.
  - Capacity discipline has “locked-in” lower levels of available seats and departures at smaller airports.

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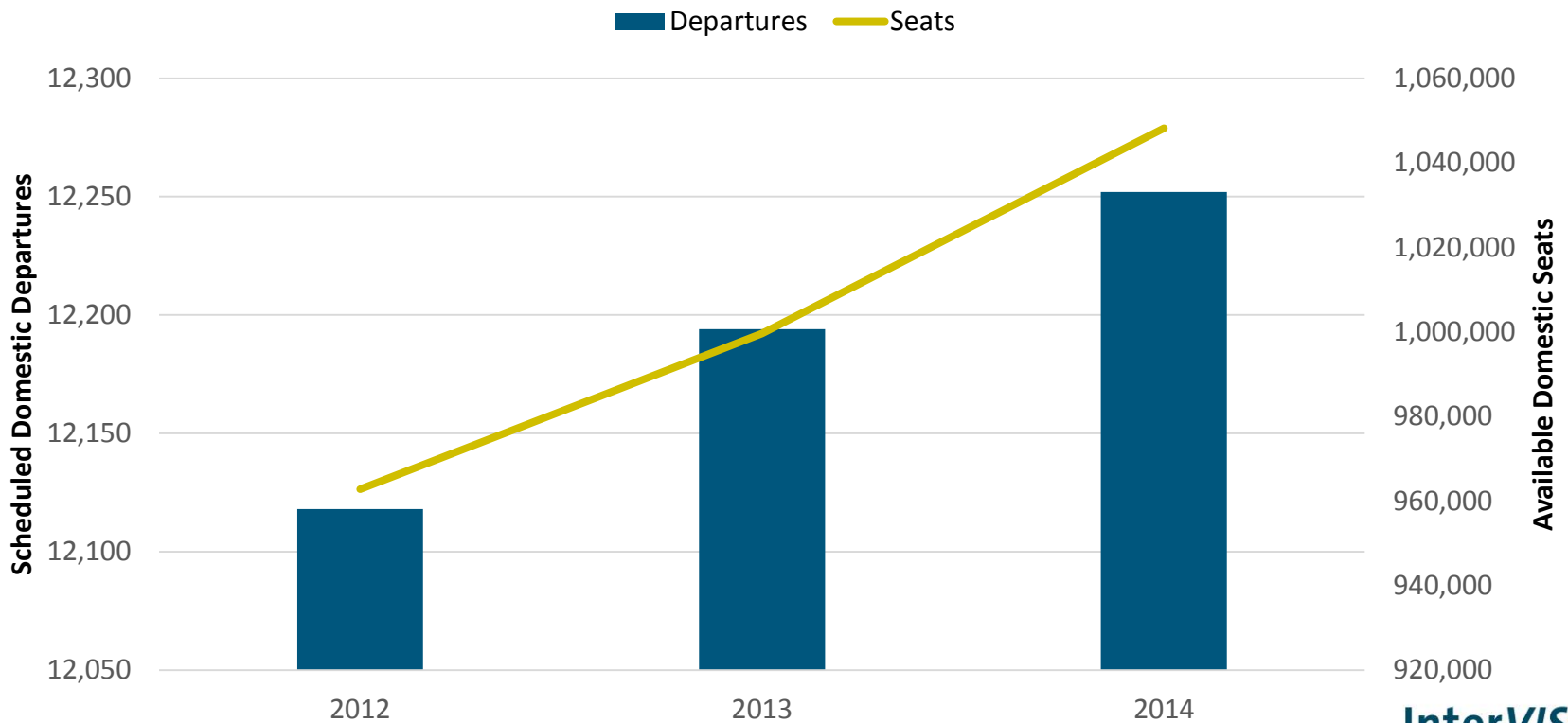
## The Kansas Picture:

*How Has Capacity Discipline Affected Air Service?*

# ICT Has Seen Steady Performance in the Midst of Industry-Wide Cuts

- Despite limited national growth, ICT has seen growth in both seats and departures over the last three years.

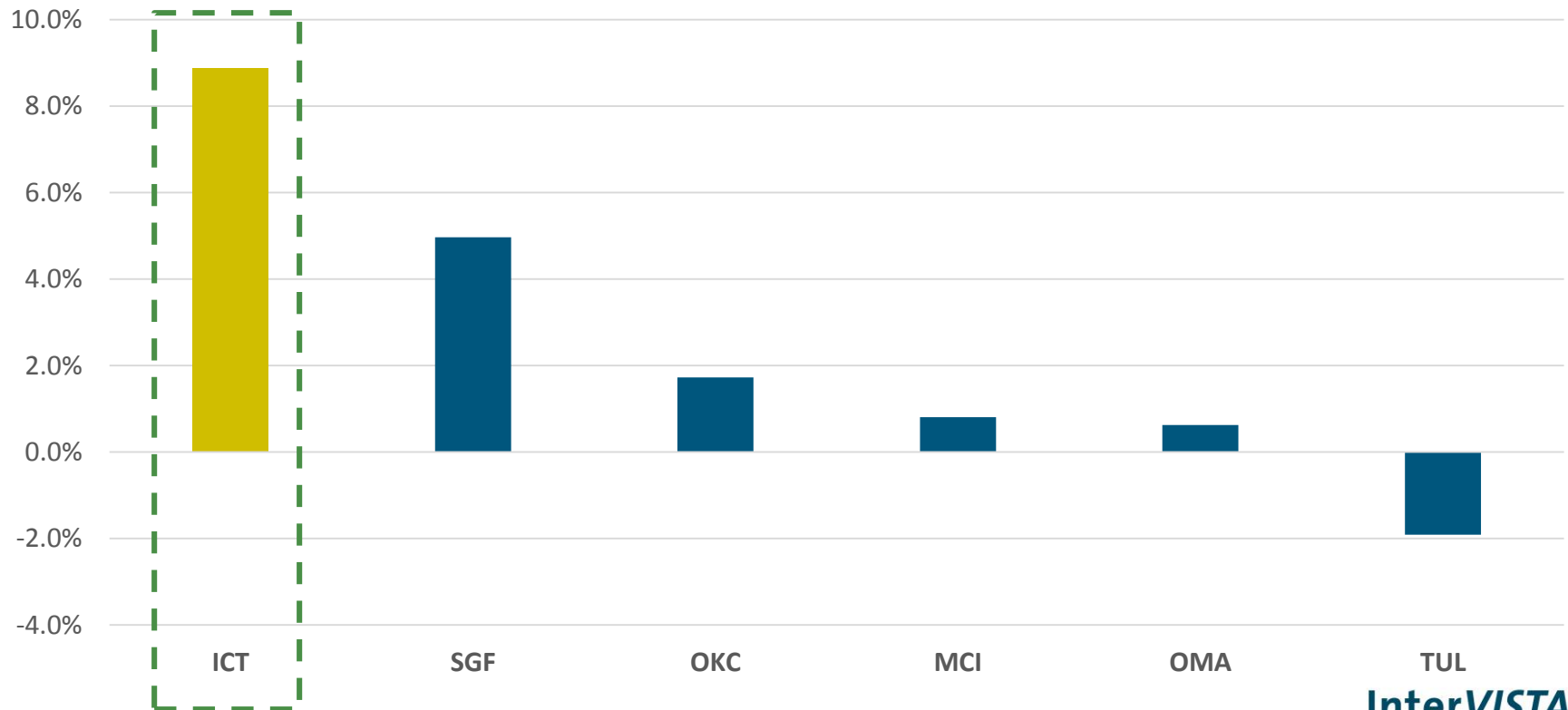
Scheduled Departures and Available Seats from ICT, 2012-2014



# Among Mid-Sized Midwestern Airports, ICT is on Top In Terms of Recent Growth

- Southwest Airlines growth to new destinations has increased ICT's available seats by 8.9% from 2012 to 2014.

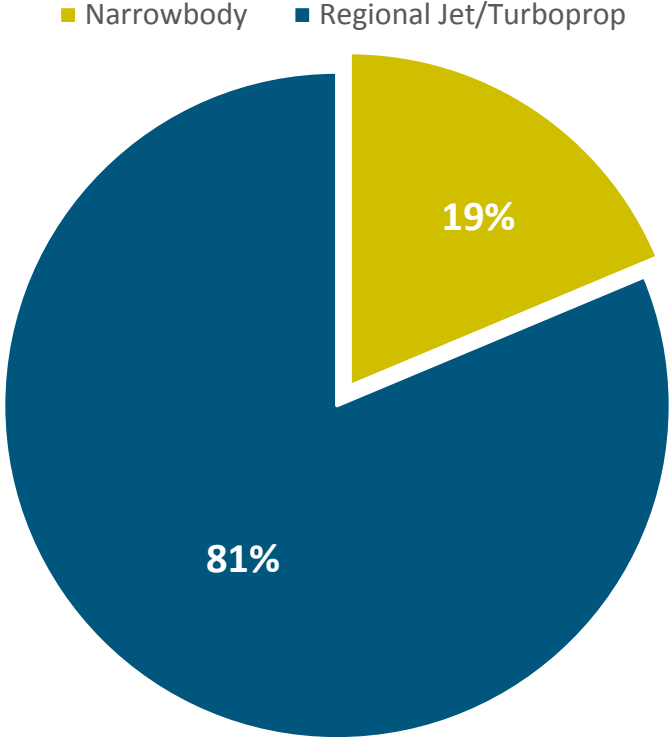
**% Change in Available Domestic Seats, 2012-2014**



# Commercial Aviation in the State of Kansas is Heavily Reliant on Smaller Regional Jets

- In 2013, over 80% of departures from Kansas airports were operated by regional jet or turboprop aircraft.

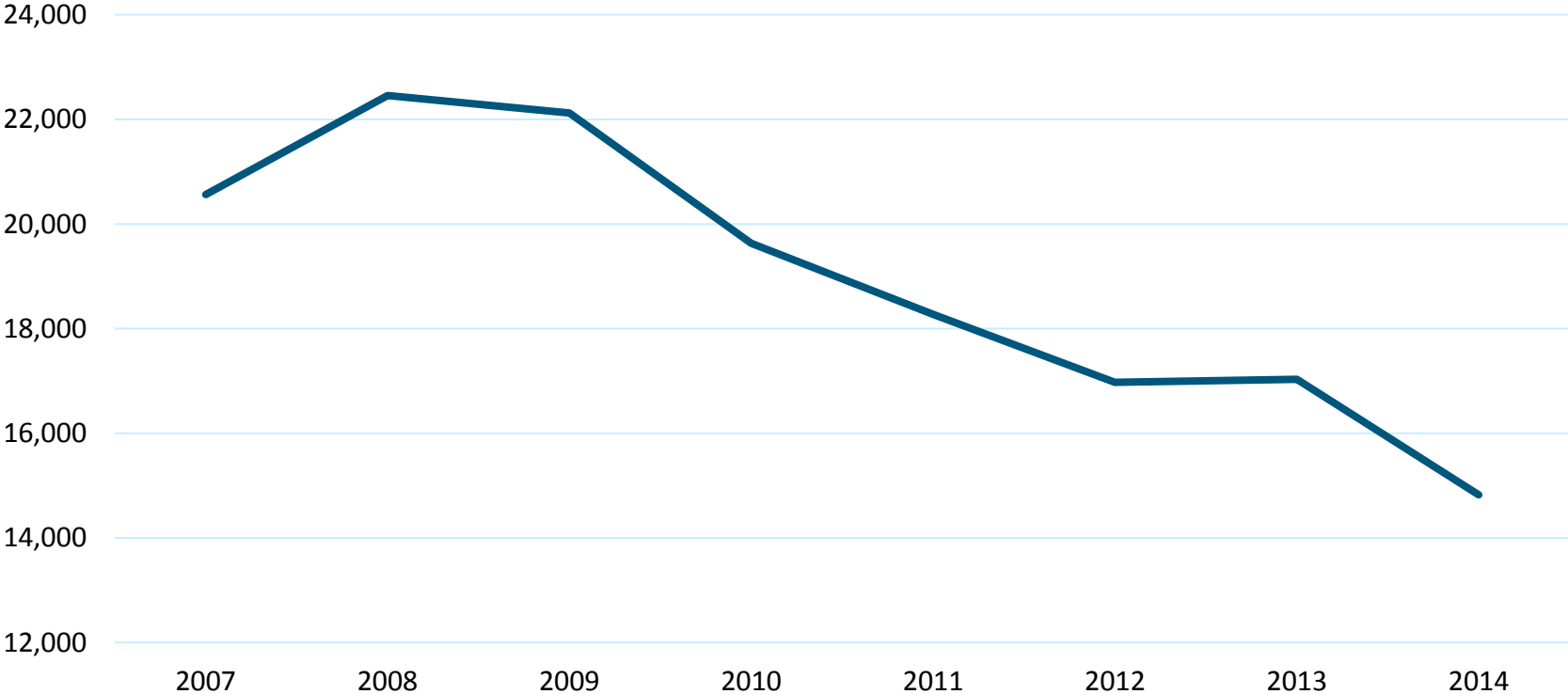
**Scheduled Domestic Departures from Kansas Airports by Aircraft Type (2013)**



# Kansas' Reliance on Regional Jets Leaves the State Vulnerable to Industry Trends

- As airlines cut regional jet frequencies nationwide, Kansas has seen a 33% reduction in RJ departures since the 2008 peak.

Scheduled Regional Jet/Turboprop Departures from Kansas Airports, 2007-2014





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## Final Thoughts

# For How Long Will Capacity Discipline Remain the Status Quo?

- The short-term future will depend on how long airlines continue to practice capacity discipline.
- Is capacity discipline a stable equilibrium?
- **Prisoner's dilemma:** there appears to be an incentive for airlines to break with capacity discipline and gain more market share, but if all airlines do so, there will be too much capacity in the market.
- Which airline will be the first to break with capacity discipline, and when will that break occur?
- Expansion opportunities are limited so long as capacity discipline is in effect.

# In Every Prior Business Cycle.....

- Passenger load factors increased;
- Hub and Spoke systems came and went; and
- The LCCs/ULCCs became increasingly prevalent
  - Another market share grab will present itself
- Fares trended downward (current business cycle being an exception);
- Small community access improved (current business cycle being a mixed exception);

# 3 Guiding Principles in the “New Normal” of Air Service Development

- **Retain It:**
  - It is a mixed picture for Kansas airports
- **Enhance It:**
  - Upgrading of aircraft brings better passenger comfort
- **Expand It:**
  - Capacity Discipline continues
    - It's a Zero Sum Game

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***THANK YOU!***

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