

**Global Aviation Industry**

Global Airline Business Confidence Index (January'2018) reveal a positive outlook for air travel supported by healthy demand growth on both freight and passenger traffic. The International Air Transport Association (IATA) forecasts global air passengers to register a 20-yr CAGR of 3.8% per annum, and intra Pakistan air traffic to grow at a CAGR of 9.9% over the next 20 years on the back of economic and demographic progression. Total passenger traffic (domestic and international) in Pakistan has grown at a CAGR of 7.5% over the past five years with number of passengers reported at 18m during FY17 (FY12: 12.6m). Growth in international passenger traffic with a CAGR of 9.2% over the last five years has outpaced domestic passenger traffic with a CAGR of 2%.

**Local Industry Structure**

The local aviation sector comprises a total of four players: Pakistan International Airlines (PIA), Shaheen Air International Limited (SAI), Air Blue Limited, and Serene Air. Passenger traffic has been consistently growing with the share of international passengers surging more than domestic passengers. During FY17, total number of passengers in Pakistan were reported at 18.2m (FY16: 17.2m), an increase of 5% as compared to the preceding year. Share of international passengers in overall passenger traffic increased to 80% (FY14: 75%) while the remaining 20% comprised domestic passengers. Focus of Pakistani airlines is inclined towards international traffic considering higher margins on those routes. Given the healthy demand outlook for passenger traffic, five new private airline operators have applied for Regular Public Transport (RPT) License to Civil Aviation Authority (CAA); one player (Air Sial) has already been granted license by CAA. The list of upcoming airline operators is as follows:

1. Liberty Air
2. Go Green Airways
3. United Airways
4. Afeef Zara Airways
5. Air Sial (License granted by CAA)

Domestic Passengers	FY12	FY13	FY14	FY15	FY16	FY17
Air Blue	438,548	639,722	424,892	409,882	486,930	398,814
Air Indus	-	-	393,737	280,754	-	-
PIA	2,493,218	2,380,523	1,925,409	1,594,653	2,138,701	2,396,401
Shaheen Airline	316,596	336,278	846,175	868,678	836,308	584,044
Others	-	-	-	-	-	193,485
<b>Total</b>	<b>3,248,362</b>	<b>3,356,523</b>	<b>3,590,213</b>	<b>3,153,967</b>	<b>3,461,939</b>	<b>3,572,744</b>

International Passengers	FY12	FY13	FY14	FY15	FY16	FY17
Air Blue	608,099	698,119	685,004	1,047,662	1,352,454	1,404,106
Air Indus	-	-	-	-	-	-
PIA	3,682,244	3,330,613	3,061,523	2,744,766	3,003,856	3,221,698
Shaheen Airline	737,994	1,061,397	1,347,587	1,421,987	1,478,750	1,568,479
Foreign Carriers	4,383,935	4,697,489	5,786,659	6,727,522	7,930,728	8,408,133
<b>Total</b>	<b>9,412,272</b>	<b>9,787,618</b>	<b>10,880,773</b>	<b>11,941,937</b>	<b>13,765,788</b>	<b>14,602,416</b>

Source: CAA

### Market Share - Domestic Passenger Traffic

Domestic Passenger Traffic (DPT) increased to 3.57m (FY16: 3.46m) passengers during FY17 witnessing a CAGR of 1.9% over the last five years. As per IATA, intra-Pakistan routes are going to be amongst the fastest going routes on account of which DPT is expected to grow at a healthy pace over the medium to long-term. Over the last two years, PIA's market share in terms of DPT has increased on a timeline basis and was reported at 67% (FY16: 62%, FY15: 51%) during FY17. Market share of Air Blue and SAI have witnessed noticeable decline to 11% (FY16: 14%, FY15: 13%) and 16% (FY16: 24%, FY15: 28%) respectively during FY17. Decline in market share is partly attributable to continued focus of private sector airlines on international routes given the higher margins vis-à-vis local routes. Given the expected entry of new players who are only eligible to commence operations on international routes after one year of continued satisfactory operations on domestic routes, market share in DPT of existing players is expected to decline over the short-term.

Domestic Passengers (Market Share)	FY12	FY13	FY14	FY15	FY16	FY17
Air Blue	14%	19%	12%	13%	14%	11%
Air Indus	0%	0%	11%	9%	0%	0%
PIA	77%	71%	54%	51%	62%	67%
Shaheen Airline	10%	10%	24%	28%	24%	16%
Others	0%	0%	0%	0%	0%	5%

Source: CAA

### Market Share - International Passenger Traffic

Total international passenger traffic (IPT) increased by 6% during FY17 and amounted to 14.6m (FY16: 13.8m) passengers. Foreign carriers dominate in terms of IPT market share with the same recorded at 58% (FY16: 58%, FY15: 56%) during FY17. Following foreign carriers, PIA holds the second highest market share in IPT at 22% (FY16: 22%, FY15: 23%) followed by SAI at 11% (FY16: 11%, FY15: 12%) and Air Blue at 10% (FY16: 11%, FY15: 9%). Currently, local carriers are generating a significant chunk of their revenues and profitability from GCC routes. However, in the backdrop of slowdown in GCC growth and regulatory changes in these jurisdictions, diversification to newer routes is considered important. For instance given the reliance on Kingdom of Saudi Arabia (KSA) routes, local airliners lost passenger traffic in FY17 due to imposition of additional fee of 2,000 SAR on Umrah pilgrims (who perform Umrah more than once in three years) by the Government of KSA. However, traffic has normalized on the route post revision in this policy (now additional fee is collected only from passengers who do Umrah twice in one Islamic year).

International Passengers (Market Share)	FY12	FY13	FY14	FY15	FY16	FY17
Air Blue	6%	7%	6%	9%	10%	10%
Air Indus	0%	0%	0%	0%	0%	0%
PIA	39%	34%	28%	23%	22%	22%
Shaheen Airline	8%	11%	12%	12%	11%	11%
Foreign Carriers	47%	48%	53%	56%	58%	58%

## Fleet Composition and Age

Aircraft Type	Number of planes	Average Age (Years)
<b>Pakistan International Airlines</b>		
ATR 42	5	11.2
ATR 72	5	5.8
Airbus A310	3	24.7
Airbus A320	11	12.1
Boeing 777-200	8	13.1
Boeing 777-300	4	10.3
<b>Total</b>	<b>36</b>	<b>12.2</b>
<b>Shaheen Air International</b>		
Airbus A319	6	12.6
Airbus A320	8	14.9
Airbus A330	4	10.9
<b>Total</b>	<b>18</b>	<b>13.3</b>
<b>Air Blue</b>		
Airbus A320	3	5.7
Airbus A321	5	3.6
<b>Total</b>	<b>8</b>	<b>4.4</b>
<b>Serene Air</b>		
Boeing 737	3	6.9

Amongst local players, PIA possesses the highest number of aircrafts with a total fleet size of 36 airplanes comprising average fleet age of 12.2 years. SAI stands as the second largest airline operator with a fleet size of 18 aircrafts with fleet age showing significant reduction to 13.3 years. SAI and Air Blue are operating aircrafts from the same manufacturer (Airbus) which results in maintenance and operational cost efficiencies.

### Business Risk

- The aviation sector is characterized by high competition arising from soft barriers to entry (given the availability of lease financing and outsourcing support services), cyclical, and vulnerability to economic shocks.
- Significant costs add to the inherent risk of the airline industry. These include fixed costs such as aircraft lease charges, capital and labor, (with limited ability to adjust the same during downturns and high cash outlay towards pension schemes) and variable costs such as fuel along with regulations focus on safety, maintenance, hours of operation for personnel and restrictions on routes, landing rights and slots.
- While profit margins tend to be low, cash flows tend to be relatively stronger with high levels of depreciation and amortization for airlines that purchase aircrafts. Adjusted leverage (off balance sheet leverage) tends to be high for airlines that use operating lease to finance the acquisition of aircrafts.
- Efficient operations of airline operators are contingent on availability and price of aircraft fuel. Inability to pass on significant increase in fuel prices to passengers can materially affect their operating results. In the backdrop of increasing competition, ability to fully pass on significantly higher fuel prices will be one of the major challenges for airline operators.
- Growing competition from foreign airliners, expected entry of new players' along with increased focus of the government to revitalize Pakistan International Airlines is expected to increase the competitive landscape.
- Reliance on limited routes of existing operators for a major chunk of revenues and profitability is a key business risk factor.
- Proper research of estimated traffic and anticipated competition is important for route selection while

diversifying into newer routes. In case the estimated traffic does not materialize or competition is higher than projected than an airline has to continue to operate in losses as cancellation charges on pre-booked tickets is sizeable.

- The airline industry is subject to extensive government regulation, and new regulations may increase their operating costs. Regulatory non-compliances may also result in penalties for operators.
- Given these inherent characteristics, the airline industry is generally considered to pose high business risk.

#### **Financial Risk**

- Two of the three major airline operators incurred sizeable losses during FY17 on the back of higher fuel prices, increasing completion, inefficiencies (particularly for PIA) and other regulatory and external factors.
- In the backdrop of increasing fuel prices, financial profile of airline operators is expected to remain under pressure.
- Adjusted gearing levels (accounting for off-balance sheet operating lease payments) continue to be on the higher side. Interest based bank borrowings are considered manageable for private airliners but are sizeable in case of PIA.
- Route selection strategy and diversification in the same is considered important for stable revenue growth of airline operators.

#### **National Aviation Policy (NAP) (Salient Features)**

The NAP has introduced a number of financial and operational requirements (fleet age, flight punctuality & regularity) which may pose a challenge for existing operators. These include:

- Formation of an independent body, Safety Investigation Board reporting to the Minister of Aviation. The body shall investigate accidents and any serious incidents, as deemed fit.
- A Pilot Deviating Reporting system has been developed. A web-based portal will allow pilots to anonymously report incidents including regulatory violations.
- Maximum chronological age of aircraft operating in Pakistan has been set at 20 years for commercial operations.
- Calendar age of all types of commercial aircraft, operated by Pakistani operators shall not be more than 12 years at the time of induction with minimum of 35% remaining operational life. Aircraft older than 20 years, being operated by Pakistani operators, shall not be allowed to continue operations in Pakistan. The existing operators have to fulfill this requirement within 2 years.
- Minimum fleet size for domestic and international operations shall be 3 airworthy aircrafts and 5 airworthy aircrafts, respectively.
- Paid up capital for Regular Public Transport (RPT) license shall be enhanced to Rs. 500m while current RPT and other operators will enhance their paid-up capital to the revised requirement within a period of two years.
- Pakistani designated airlines shall be eligible to commence operations on international routes after one year of continued satisfactory operations on domestic routes.
- Import or lease (wet/damp/dry) of any General Aviation aircraft shall be tax and duty free.
- Duties shall also be abolished on the import of maintenance kits and associated parts of aircraft.

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