

# Are We There Yet?

By Steve A. Steckler

At the start of 2002, this column predicted that airport finances would not fully recover from 9/11 and the economic hangover until 2005. With another 18 months to go, even that dire prediction may have been optimistic.

## The Perfect Storm

In the first half of 2003, unprecedented bankruptcies, cancelled leases, and big facility closures by faltering airlines continued to wreak havoc on some major airports around the country. SARS and the war in Iraq piled on to make matters even worse. Like the weather on the East Coast this summer, industry executives are wondering if it will ever stop raining bad news for U.S. airports.

It is clear now that, as grim as 9/11's independent effects were on U.S. aviation, the attacks coincided with a number of other airport income-depressing factors to create The Perfect Aviation Storm: a post-bubble economy, an acceleration of the inevitable day of reckoning for high-cost airlines, and most recently another war.

The travelers that are flying are traveling cheap. Angela Gittens, aviation director for Miami International Airport, notes that "even the business traveler has found the low-fare market," and adds that the resulting pressure on airline income was affecting the airport's pricing power with the airlines. Not only that, most airports are still contending with twice the security line-item costs they carried before 9/11.

The final budgetary straw is twisted with irony: greatly improved passenger and baggage screening have reduced the terminal dwell times that had for a time inflated per-passenger revenue from food, beverage, retail and parking. Anecdotal and statistical evidence now suggests that unit non-airline revenues have stagnated or are falling back toward pre-9/11 levels.

## Airlines in Debt, Paying The Rent

US Airways' announcement that it would not adhere to all of the terms of its Pittsburgh leases and United's decision to close its maintenance facility in Indianapolis are just two of the more frightening examples of how airline corporate financial problems can suddenly create disastrous situations for airports. Both airports can now expect long-term pressure on their income statements as major portions of their rental income disappears and newly stranded assets begin to gather dust near the taxiways. Is this a harbinger for other U.S. airports?

Salomon Smith Barney estimates that by the end of corporate fiscal year 2003, airline debt will have reached 93 percent of total airline capital, a huge increase in leverage from the already-high 71 percent level in 2000. And while it is true that their debt service burdens have been made easier by falling interest rates, the leverage ratios are still eye-popping to financial analysts.

The higher leverage and stubborn passenger revenues have sent investors fleeing as well. In February the stock market value of the entire passenger airline industry had fallen to just \$3.2 billion.

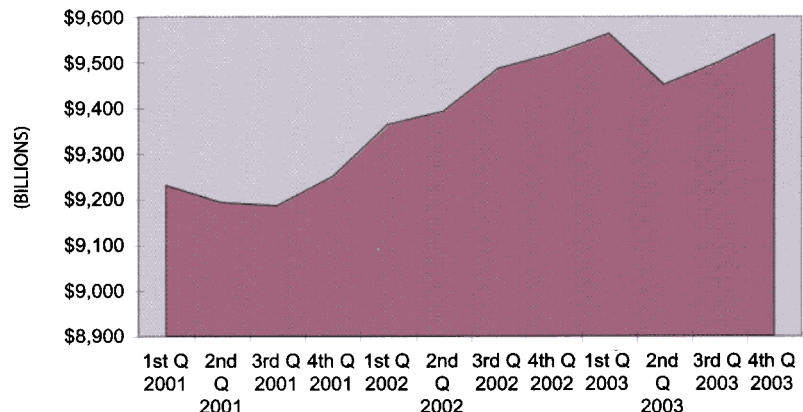
And why not? The industry lost \$7.7 billion in 2001, \$10 billion in 2002, and will lose another \$6.7 billion in 2003. While there has been some rebound in values due to the shorter-than-anticipated Iraq war, airport executives may be the only ones left willing to give an airline more than 30-day net terms.

## GDP and the Aviation Industry

The financial fortunes of the aviation industry have been closely linked to changes in U.S. Gross Domestic Product (GDP), with passenger and cargo volumes growing somewhat faster than GDP; that is, until recently (see below). This also goes for airport revenues, but unfortunately the relationship cuts both ways.

Figure 1 (Fig. 1), real (inflation-adjusted) GDP, shows the stumbling economic recovery as it has progressed since the end of the year 2000 when real GDP actually fell after the corporate investment bubble burst and was quickly reflected in the stock market. The chart also incorporates a consensus economic forecast for the remainder of 2003, showing even more stumbling, albeit slightly upward. Remember, however, that even if GDP recovers more smartly, airport operating costs are still high due to added

Fig. 1 REAL (INFLATION-ADJUSTED) GDP



SOURCE: U.S. DEPARTMENT OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS

security costs. Thus, their ability to pass higher costs onto the airlines and passengers is sharply limited by both the airlines' financial state and the increasing dominance in the recovery of price-sensitive leisure travelers.

Even the business traveler has learned to use discount carriers, as their market share and network reach has increased. Web-based reservations become more widespread and corporations continue to beat down travel budgets. In fact, nominal air fares (excluding taxes) are now at their lowest levels since 1987, while total traffic volume and total industry seat capacity is still below pre-9/11 levels.

### Another Warning: Air Cargo and Passenger Volumes Part Ways

Cargo volume was already falling faster than passenger volumes before 9/11 as the economy slowed, and stayed low into spring 2002. However, it never declined as much as passenger volume after 9/11 and since early 2002 it has rebounded gradually to levels about 7 percent above 2000's level. The fact that air cargo is now recovering more consistently with GDP than passenger volumes (just as it was falling more consistently before) is a cause for concern: until 9/11, cargo and passenger growth moved together with GDP, although not at identical rates. For the past two years, however, passenger growth has been lagging well behind GDP growth, modest as it has been.

Of course, regardless of the threat level, cargo is never afraid to fly, nor can it substitute a conference call for a planned face-to-face meeting. While dandy for cargo carriers, this has made the overall industry recovery notably more confounding than

passenger carriers and airport executives had planned. According to the Air Transport Association, passenger ticket sales have historically accounted for 0.90 to 0.95 percent of GDP, but since 9/11 they have accounted for less than 0.75 percent. Something disconcerting is going on here, and it's not just fierce airline price competition.

### GDP and Airport Finances

Airport net operating income is the closest measure airport executives have to GAAP-type profitability for a private corporation. It is essentially the money left over after paying operations and maintenance expenses, but before paying debt service. The November/December 2001 installment of this column included the forecast shown in Fig. 2 for the post-9/11 recovery of airport operating income, based on revenues minus operating expenses per enplaned passenger (OPINPAX).

A slowing of GDP growth, combined with reluctant passenger demand (reflected in the declining share of GDP spent on air travel) and rising airport security costs, have put a serious squeeze on the net operating income of U.S. airports. In fact, changes in passenger and cargo volumes have tended to lag slightly any shifts in the overall economy, so any recovery of operating income is likely to lag the anticipated economic recovery by a year or so.


Although airport operating income has begun to improve for many airports recently, as anticipated in this column in October 2001, the sluggish economy and slower-than-expected return of business travelers suggests that the recovery will fall short of the forecast over the next 18 months. Some directors of airports with large international passenger volumes, like Miami's Gittens,

which have also been vulnerable to SARS-related fears and the struggling regional economies of Latin America and the Pacific Rim, are now saying that their net operating income may not recover to pre-9/11 levels until 2006 or 2007.

### Walking Toward the Light?

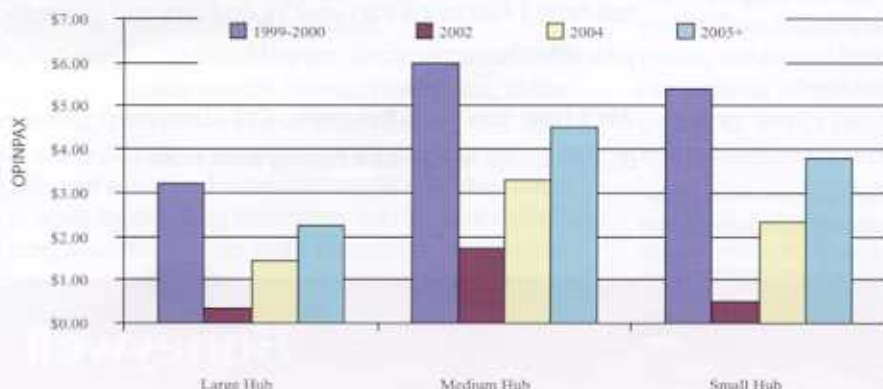
Airport executives are an ardently optimistic group, buoyed until now by the knowledge that, since airline deregulation began 25 years ago, passenger volumes and aviation industry revenues have always tracked well with GDP. Accordingly, any brief war or economic crisis had been justifiably viewed as just another temporary interruption of an otherwise endlessly expanding universe of enplanements. However, this column warned after 9/11 that terrorist threats were only one of several relatively new ones (and a short-term one at that) on the GDP-to-aviation relationship that happened to emerge at about the same time (the others included, but were not limited to, the rapid growth of leisure travel's market share and suddenly improving electronic alternatives to business travel).

As pessimistic as this article may seem, it shares with America's airport executives a faith that the fear factor that has persisted for the past 18 months will eventually diminish if there are no more terrorist assaults on the U.S. aviation system. That factor probably accounts for much of the recent deviation of aviation revenue and passenger volumes from GDP. But probably not all of it.

Twenty-five years from now, the growth of the U.S. aviation industry may indeed have tracked with GDP, but that might be just a coincidence. In fact, the industry will probably look as different from today as today's looks from pre-deregulation: the respective balances of cargo and passenger revenue, business and leisure travelers, and airline and non-airline revenue will all be different, and certainly too the market share of today's major carriers, at least among the survivors. And who knows what new factors might come to drive airport operating income? Hopefully, it won't be security costs. 

*How are these views reflected at your airport? If you would like to share your ideas and information, please e-mail [SSteckler@IMGgroup.com](mailto:SSteckler@IMGgroup.com)*

Fig. 2 AIRPORT OPERATING INCOME OVER TIME



[SOURCE: HISTORICAL COMPILATION OF AAAE RATES AND CHARGES SURVEY]

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