WAVESTONE

THE RISE OF THE LONG-HAUL, LOW-COST CARRIERS:

WHAT DOES IT MEAN FOR AIRPORTS?

Long-haul, low-cost (LHLC) traffic appears to have really taken off in 2018, with the arrival of new players on the scene and a proliferation of routes. How are airports gearing up for this? Will they need to adapt to remain competitive and take advantage of this new golden goose?

Here we set out the issues and opportunities in this new market for airports.

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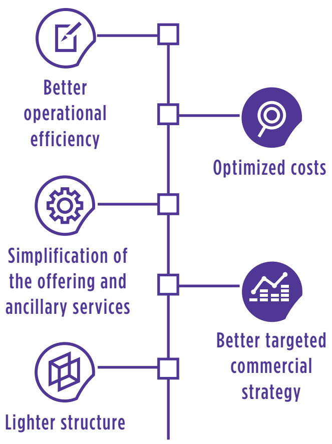
LHLC CARRIERS FINALLY TAKE OFF

The low-cost success story continues

After their appearance in the US, following the sector's liberalization at the beginning of the 1980s, low-cost operators have significantly developed worldwide; today, they represent the main driver of growth in air transport.

Based on five pillars, which center around maximizing efficiency, the model has enabled ultra-competitive ticket prices to be offered on a sustainable basis, attracting new customers and contributing to the economic growth of tourist areas served by low-cost flights.

The five pillars of the low-cost model

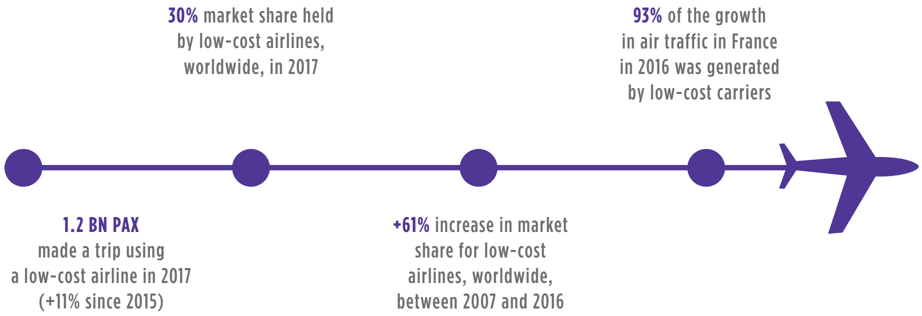


Players like easyJet and Ryanair have become heavyweights in the short and medium-haul sectors, increasing their passenger numbers tenfold since the start of the 2000s and posting double-digit annual growth rates. Ryanair, whose particularly profitable business model is now being questioned, carried 129 MPAX in 2017. It has risen to 5th place among global carriers in terms of passenger numbers—only slightly behind the traditional market leaders.

2 1 3 RYANAIR

The most profitable European airline in 2016 and 2017, with a rate of return of **23.5%**, compared with the **6.3%** European company average

Source: CAPA



Source: ICAO, Union des Aéroports Français (UAF – the French airports trade association), and DGAC (the French civil aviation authority)

The rise of the LHLC carriers

Although questions remain about the adaptability of the low-cost model to the long-haul market (see our publication **"Can the low-cost model be adapted to long-haul carriers?"**), it's clear that several pioneers have taken the plunge and a number of major European players are following in their wake; to do this, they are taking advantage of various favorable factors:

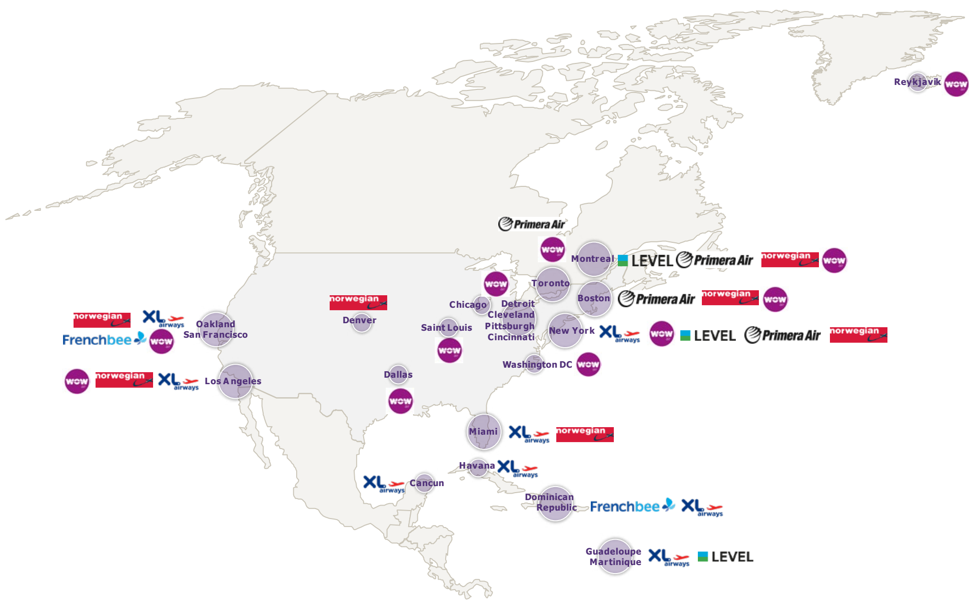
/ The fact that the low-cost model is now mature for the short and medium-haul markets, with market shares increasing steadily

/ The emergence of new, better performing, and fuel-efficient aircrafts such as the Boeing 787 or Airbus A350 (Norwegian is increasing the number of its flights that use 787s)

/ Favorable socio-economic factors for new entrants: low kerosene prices, increased demand for leisure travel, and the growth of middle classes in emerging countries.

Today, some twenty companies offer LHLC flights worldwide—with a significant increase over the past two years. As a result, the number of summer-season LHLC routes from Europe increased by a factor of 2.5 between 2015 and 2017, especially in the transatlantic segment—the best indicator of the current trend.

Today, LHLC carriers are operating flights to North America from Paris



Less than seven hours flying time from Europe, North America's East Coast allows for rapid aircraft rotations and the use of planes to be maximized over the course of a day. It also has the advantage of being within reach of the new long-range, single-aisle designs, such as the Airbus A321 Neo LR, and the Boeing 737 Max, which are cheaper, less kerosene-heavy, and easier to fill, than large-capacity aircraft. It is not surprising, in these conditions, that low-cost operators are snapping up these types of models.

Although the sustainability of the long-haul business model remains to be proven, a point underlined by Norwegian's negative results in 2017, the offering is well and truly present on the market today. And, in a market of one billion consumers where 80% of the customer base comprises leisure or VFR* passengers, ticket prices remain the number-one driver and LHLC carriers will find their niche, something that the CEOs of French Bee and XL Airways confidently emphasized at the most recent Paris Air Forum. And, provided the price of a barrel remains stable, the gamble looks like it will pay off; IAG's desire to buy Norwegian, as well as having already established its own LHLC subsidiary, Level, is testament to this. Willie Walsh, IAG's CEO, believes that low-cost will eventually represent 40% of the long-haul offering.

* *Visiting Friends and Relatives*

> "We believe that long-haul, low cost is a segment of the market that is under-served, and we believe that we can do so profitably."
>
> Willie Walsh, CEO, IAG

AIRPORTS' RESPONSES REMAIN HESITANT

Strengths are present

While less sensitive at this stage of their development than legacy carriers on issues related to hubbing and transfers (saturation peaks, routes taken by passengers to get to connecting flights, baggage transfers, business lounges, etc.), LHLC carriers are, however, particularly attentive to the development potential and operational efficiency offered by airports. And this is an area in which the major airports have good reasons to satisfy them:

	The expectations of LHLC operators	*What the major airports can offer them*
DEVELOPMENT	Sufficient capacity to support them in their development: runway, infrastructure, terminals, contact stands for better operational efficiency, time slots, attractive catchment areas, etc.	• Runways and stands suitable for long-haul traffic (length> 3500m, stands for Code E and F aircraft) • Terminals with several piers and large departure lounges (or pre-boarding areas) that can be used flexibly when needed • Attractive locations centered on key economic areas
DEVELOPMENT	Well-managed tariff policies, or even incentives (transparency and stability of usage fees, incentive mechanisms to optimize the use of airport resources, etc.)	A system of charges regulated and supervised by an independent regulatory authority, in a way that ensures full transparency for airlines (for example: ADP Group's 2016-2020 Contrat de Régulation Economique [Economic Regulation Contract] under the French Civil Aviation Code; the UK's Civil Aviation Act for the major London airports covering the 2014-2019 period)
OPERATIONS	Optimized operations (landside and airside) to minimize costs and turnaround times	• The roll out of self-service facilities: check-in, baggage drop-off, and automated border-control gates, enabling processes to be simple and effective • Geolocation of passengers • Pre-boarding procedures and WiWo passenger flows if needed • The implementation of Airport-Collaborative Decision Making processes (there were 28 A-CDM airports in May 2018) recommended by Eurocontrol, and the use of an Airport Operations Center (APOC)
OPERATIONS	A range of tailored airport services and transport, especially for the airlines based at the airport (crew rooms, parking for crew, lounges, shops, etc.)	• Operating premises (crew room), parking for crew, shuttle buses, lounges, shops • Multimodal surface access

Local initiatives

But beyond this, the tailoring of airport offerings to low-cost carriers' operational needs, for both infrastructure and passenger services, has been quite patchy and doesn't come near matching their contribution in terms of overall traffic. Is this because low-cost still doesn't represent the majority of traffic for most major airports?

The initiatives pursued by some major airports have led us to distinguish three types of approach:

- To host low-cost traffic using existing structures without providing a specific offering,
- To develop dedicated low-cost solutions to ensure its growth,
- To offer services adapted to low-cost to complement their hub offering.

Developments to anticipate

A market that's changing rapidly, in terms of technology and services, should encourage the major airports to remain focused:

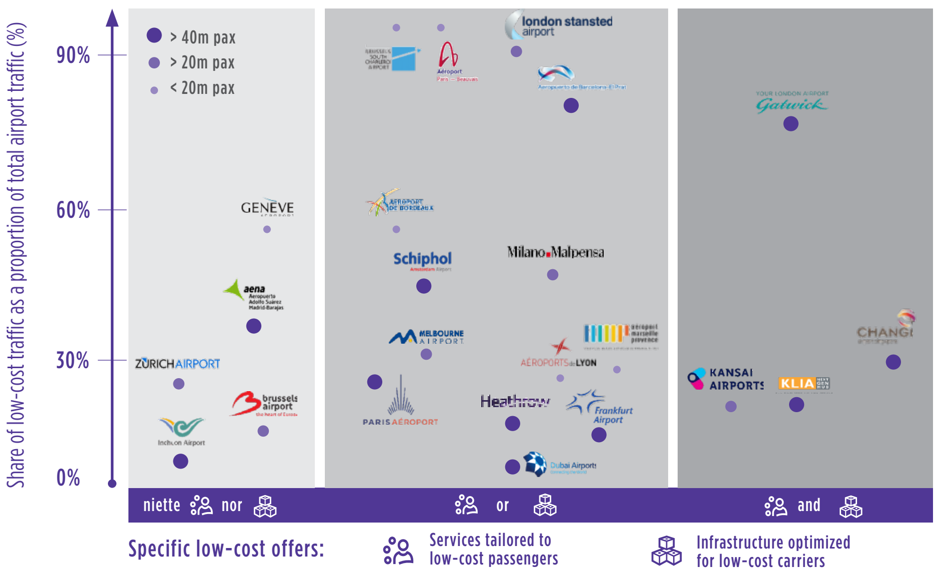
/ The arrival of new single-aisle, long-range aircraft, which are smaller and more economical, will soon enable low-cost carriers to offer point-to-point, long-haul destinations from secondary airports that have more competitive charges (Norwegian has already ordered 30 Airbus A321 Neo LRs, and easyJet has just opened a new base in Bordeaux)

/ The development of alliances between medium and long-haul low-cost airlines (for example, easyJet and Corsair) will inevitably have consequences for the way in which transfers are managed (routes passengers take to get to connecting flights, baggage handling, management of slots, etc.). Some airports like London Gatwick, Milan Malpensa, and Dublin are already offering self-connection solutions (see the "Focus" on p.7)

/ The move upmarket by LHLC carriers will eventually require a broader offering of low-cost and "à la carte" airport services, something that will increase competition between hubs.

The way major airports are positioning themselves in response to low cost traffic

Source: Wavestone



Three types of airports and how they respond to the demand for low-cost

"UNIVERSAL"

Airports that do not provide a specific offering and host low-cost carriers using their existing structures

An offering exists, but it's not fully tailored to the needs of low-cost carriers

- Turnaround times not optimized
- No, or very small, financial discounts
- Passenger services, such as self check-in, self bag drop, or access to certain lounges are reserved for legacy airlines

"RELIANT"

Secondary airports for which low-cost is a key growth driver and which offer dedicated solutions

Passengers use a terminal dedicated to low-cost companies

- Optimized turnaround times and operating processes
- Fees are on average 1/3 lower than fees for legacy carriers, as a result of discounts on aircraft parking and passenger charges
- Low-cost ground services

"EARLY ADOPTER"

Major airports that complement their hub offering by developing dedicated low-cost solutions

Creation of structures dedicated to low-cost that are integrated into the hub's overall offering

- Easier connections between different terminals
- Provision of self-service equipment for all passengers (check-in, baggage, etc.)
- Self-connection on offer (Gatwick)
- A variable retail offering: no retail in the low-cost terminal (Schiphol) or low-density retail (Kuala Lumpur)

LHLC: A NEW FRONTIER FOR AIRPORTS?

So far, low-cost has generally benefited major airports

Low-cost traffic initially developed at secondary airports, enabling new point-to-point connections, which, until then, had seen little or no interest from the main airports. At that time, favorable charges, the fastest turnaround times, and, in some cases, subsidies to operate flights, were the sought-after factors.

Low-cost carriers then began a progressive shift toward the main airports in the 2000s, in particular with a view to attracting business customers (who represented about 20% of the passengers carried by easyJet in 2017) and benefiting from larger catchment areas and the potential for connecting routes. The majority of low-cost airlines now operate from major hubs and offer a full range of services at the airport.

LHLC is a continuation of these developments and is not, in any way retrograde, especially since secondary airports don't always have the infrastructure required to service long-haul traffic (in terms of runway length, terminal capacity, stands that will take large aircrafts, border control facilities, ground-handling services, etc.).

LHLC offers larger revenue potential

The creation of new operators, and moves to open new routes, offer major airports a raft of opportunities to increase their aeronautical revenues, and they're clearly competing to attract new entrants and encourage them to choose their airport as a base.

But beyond this, it's the new consumption habit of "à la carte" travel that offers new possibilities for airports and their service offerings. By the choices they make, LHLC passengers indirectly encourage airports to create competitive service offerings that can complement, or even compete with, the optional services offered by airlines, before, during, and after a flight. And it's worth remembering that non-aeronautical activities are ultimately more profitable for airports.

Toward dedicated infrastructure?

Overall, airports are working hard to attract new LHLC carriers, building on existing infrastructure that is compatible but not necessarily optimal. Airports periodically consider relatively inexpensive efforts to tailor facilities, but the fundamental question remains as to whether to invest tens, or even hundreds, of millions of Euros in specific infrastructure at a time when the model is continuing to evolve and its sustainability can't be guaranteed.

Some operators have already anticipated such future developments:

- Kuala Lumpur's airport opened a new terminal in 2014, facilitating connections and services between Air Asia and its low-cost subsidiary, Air Asia X, through the Gateway@ KLIA2 facility (providing baggage handling, transfers, and retail space designed for all types of passengers)
- Since 2013, London Gatwick Airport, the main European LHLC airport in terms of number of routes, has been offering its Gatwick Connects transfer system for connecting passengers using independent airlines (assisting passengers when they arrive, transferring luggage, reservation systems, etc.)
- The future Terminal 3 at Frankfurt Airport will include a pier designed specifically for the needs of low-cost carriers and connected to the existing terminals to enable full integration into the hub system (an extension of the baggage-handling system, self-service equipment, contact stands enabling rapid turnaround, an open/closed gates strategy, etc.).

And new, innovative services

LHLC, then, could result in more far-reaching consequences than anticipated, for airports that want to take full advantage of it. While traditional infrastructure will undoubtedly be able to provide a minimum level of service, airlines and their passengers will almost certainly turn to the most innovative airports in this area: those capable of offering them services that are tailored to their needs:

> "Customers today expect low cost flight offers. Hence, a major aviation gateway like Frankfurt cannot continue to ignore this market trend over the long run."
>
> Dr. Stefan Schulte, CEO, Fraport

Offerings aimed at LHLC airlines

- Partnership offers that support LHLC companies in their development by acting as a business partner
- Innovative solutions to optimize ground operations and reduce costs
- Tariff incentive packages (airport charges represent 16% of a low-cost airline's costs)

Offerings aimed at LHLC passengers

- Innovative and inexpensive offerings that facilitate access to airports
- Free services in terms of basic comfort and facilitation
- Paid, à la carte services (food, shopping, entertainment, etc.)
- Packaged multi-service offerings available online

In the end, the low-cost model, and its constant focus on optimizing the use of resources, could prove to be beneficial to airports, by enabling:

- the optimization of existing capacity and therefore investment
- increases in aeronautical and non-aeronautical revenues
- improved customer satisfaction and branding
- increased customer loyalty and data capture
- operations to be optimized (streamlining of processes, reductions in support costs, better punctuality, improvements in security, etc.).

LHLC will then have served as a catalyst for the transformation of airports involving a definitive change from the role of operator to that of a provider of services and solutions, optimized ground operations, and a richer customer experience.

SELF-CONNECTING, A STRATEGIC ISSUE FOR HUB AIRPORTS

The practice of self-connecting, which consists of making your own arrangements to connect between two or more flights operated by different companies, is something increasingly present at major airports. In 2016, 55 million passengers planned a journey that involved two or more flights offered by different airlines (with at least one low-cost flight). This figure is expected to double within five years.

It can be explained, in particular, by:

/ The desire of passengers to control their costs and no longer systematically opt for end-to-end offers (instead securing the best price for each leg of the journey)

/ The contribution that new technologies have made to facilitating reservations by offering more visible information on possible routes

Self connect

- Passengers and their baggage **are not checked through end-to-end** at the start of the trip (i.e. there is no interline agreement between the airlines)
- Passengers must **pick up their baggage** when the flight arrives
- The route to the boarding area for the second flight is **in the publicly accessible area** (often at another terminal)
- The passenger **checks in** and goes through all checks again

Easy connect

- Passengers and their baggage are **checked through end-to-end** at the start of the journey
- **Baggage transfer** for the connection is **handled** directly by the transit airport
- The route to the second flight is **in the publicly accessible area** (often at another terminal) and requires the passenger to go through all checks again

Perfect Connect

- Passengers and their baggage are **checked through end-to-end** at the start of the journey
- **Baggage transfer** for the connection is **handled** directly by the transit airport
- The **route** to the boarding area for the second flight is **facilitated** as a result of a **dedicated layout** which makes it possible to avoid going through all checks again (depending on the incoming flight's origin and the second flight's destination)

Evolutions in the low-cost model

The evolution of the low-cost model, and the emergence of alliances between low-cost airlines, have encouraged some airports to offer connection facilitation solutions, although these are less sophisticated and cheaper than the major international hubs' automated baggage-handling systems. Our analysis of the possible modes of connection reveals three categories, with the currently observable trend being what we refer to as Easy Connect:

Gatwick Airport is a European pioneer in assisted transfer, and could easily serve as an example, especially as LHLC airlines now see this type of service as a major lever for their development.

Gatwick CONNECTS Your flight connection service

- **Free services:** management of connections between some airlines* (check-in, baggage transfer, etc.) using a reception desk located in the arrivals hall
- **Paid services:** connection packages included with online booking that includes fast-track security checks, complimentary drinks, vouchers, assistance if the connecting flight is missed, etc.

- Booking of long-haul flights using Gatwick's alliance network
- Gatwick Connects service included
- One end-to-end reservation
- «Missed flight» insurance
- Fast track security checks
- Will next be deployed at Madrid, Berlin-Tegel, Schiphol, Venice, and Edinburgh

There are many benefits for airports:

/ The potential to capture this new market for passengers who plan "à la carte" trips

/ Rapid improvements to the customer experience and airport image, without major financial investment

/ Diversifying the service offering and the generation of new, non-aeronautical revenues (fast-track services that avoid queues, missed connection insurance, etc.)

/ Airports to position themselves as a fully involved player in the journey.

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