European Low-Cost Carriers White Paper

A detailed report reflecting on the impact low-cost carriers have had on the European aviation market

OAG report on European Low-cost carriers

Dedicated to the late Adrian Hunt, former CEO of Deutsche BA
- a good colleague, friend of OAG and contributor to this paper

1. INTRODUCTION

In a single decade, low-cost carriers (LCCs) have transformed the European aviation scene beyond recognition. They have changed people's leisure and travel habits, opened up direct services between EU city pairs that were not available through the legacy airlines, forced established airlines and tour operators to change their business models, popularised regional airports by breathing life into otherwise under utilised airports and changed forever the image of air travel. Perhaps though, the most significant achievement for the LCCs, especially in the EU, is that they have bought air travel within easy reach of everyone across Europe. Who could have predicted, 10 years ago, that Ryanair would carry more passengers in Europe per month than British Airways?

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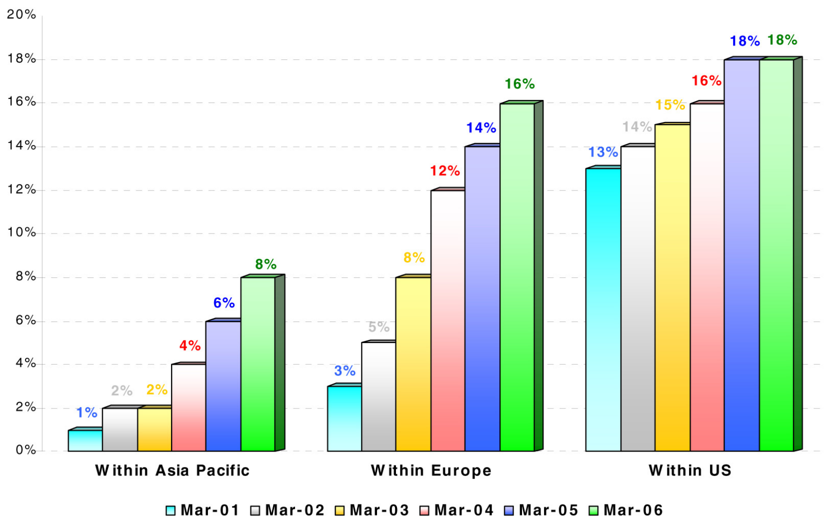
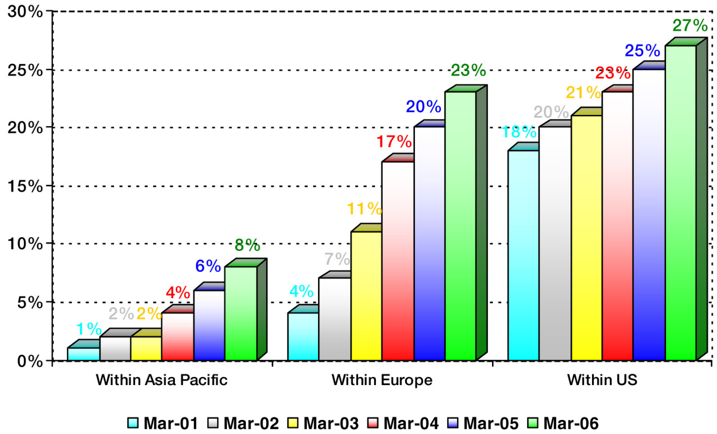
2. FREQUENCY OF FLIGHTS ON LCC vs TOTAL ON ALL CARRIERS



3. SEAT CAPACITY ON LCC FLIGHTS vs TOTAL ON ALL CARRIERS



But the story is not one of unqualified success. Several LCCs have collapsed leaving passengers with no financial protection, although the same happens with the failure of a full-service scheduled airline. LCCs are often accused of misleading advertising and poor levels of customer service, although they often out perform the legacy airlines in operating performance.

The EC has forced Ryanair to repay 4 million in subsidies from Charleroi airport in Belgium, pending an appeal to the European Court of Justice. It ruled that publicly owned airports cannot subsidise airlines, but the case had features peculiar to Charleroi and Ryanair argues that the costs of setting up its base far outweighed the financial support received. With the bravado that has come to typify the low-cost sector, Ryanair accuses the EC of double standards, allowing ailing carriers such as Alitalia to remain afloat with public money.

But nothing seems to retard the spectacular progress of low-cost carriers throughout Europe. OAG identifies 40 LCCs throughout Europe, with several now expanding from their home countries. Air Berlin has a growing network in Spain and Ryanair and easyJet have both established dominant positions by opening bases throughout Europe.

The enlargement of the EU in May 2004 to include 10 more nations has given LCCs renewed impetus, with many new services starting in Central and Eastern Europe as a result of the deregulation that EU membership brings. Despite a largely regulated environment, LCCs have also begun to appear in the Middle East and Africa.

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Although Ryanair had started operations a decade earlier from its Irish base, the LCC revolution really got underway with the creation of the single European Aviation Market which enabled Ryanair and easyJet to expand their services of low fares and high frequencies. Further expansion occurred with the growth of the Internet and developments in technology such as yield and capacity management systems which bought huge cost savings for airlines to pass on to passengers, triggering a boom in flight capacity.

The low-cost model adopted by Ryanair and easyJet - based on Southwest Airlines' successful formula in the US - has been copied by most other LCCs. Elements of it - especially web booking based on variable one-way fares - are now the norm for full-service carriers, too. The key components are ticketless travel, Internet booking rather than through the more costly Global Distribution Systems, no commission for travel agents, no seat allocation or connecting flights, and "no frills" such as in-flight catering (customers pay extra for what they require), business class and lounges.

That model remains essentially the same 10 years on, although Ryanair is now indicating that it could cut costs further by banning hold baggage, thus reducing loading and turnaround times even further, and introducing totally automated check-in. easyJet has also evolved from this model, building hubs at London Gatwick and introducing automated check-in and lounges etc.

The airline has also pioneered services to secondary airports such as Frankfurt Hahn and Stockholm Skavsta, which may be distant from the city advertised - 120km and 88km respectively. It has attracted criticism by describing Charleroi in Belgium as "Brussels", and Gerona in Spain as "Barcelona".

The most profitable routes for LCCs are of no more than two hours' duration, allowing maximum utilisation of aircraft. They started by flying city-to-city routes but are now increasingly targeting resorts, although many tend to ignore routes of three hours or longer. This means that major markets such as the Canary Islands are little served by LCCs, except those owned by tour operators.

The UK is the largest and most mature market for LCCs in Europe, followed by Germany and Spain, which is now seeing the fastest growth. France has no major LCC of its own, for reasons which include the dominance of Ryanair, its high-speed TGV rail network and a relatively small market for Mediterranean flights compared to the more northerly sun-seeking markets of Germany, Scandinavia and the UK.

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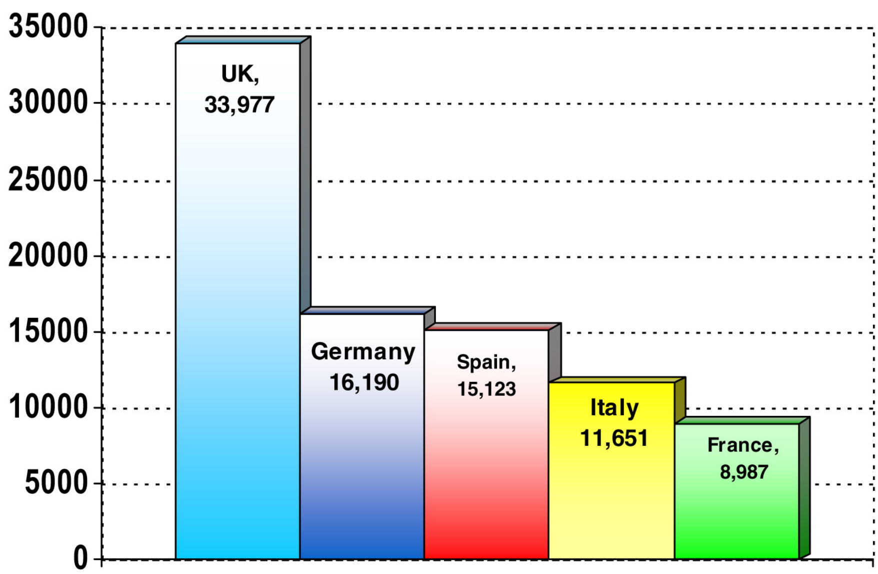
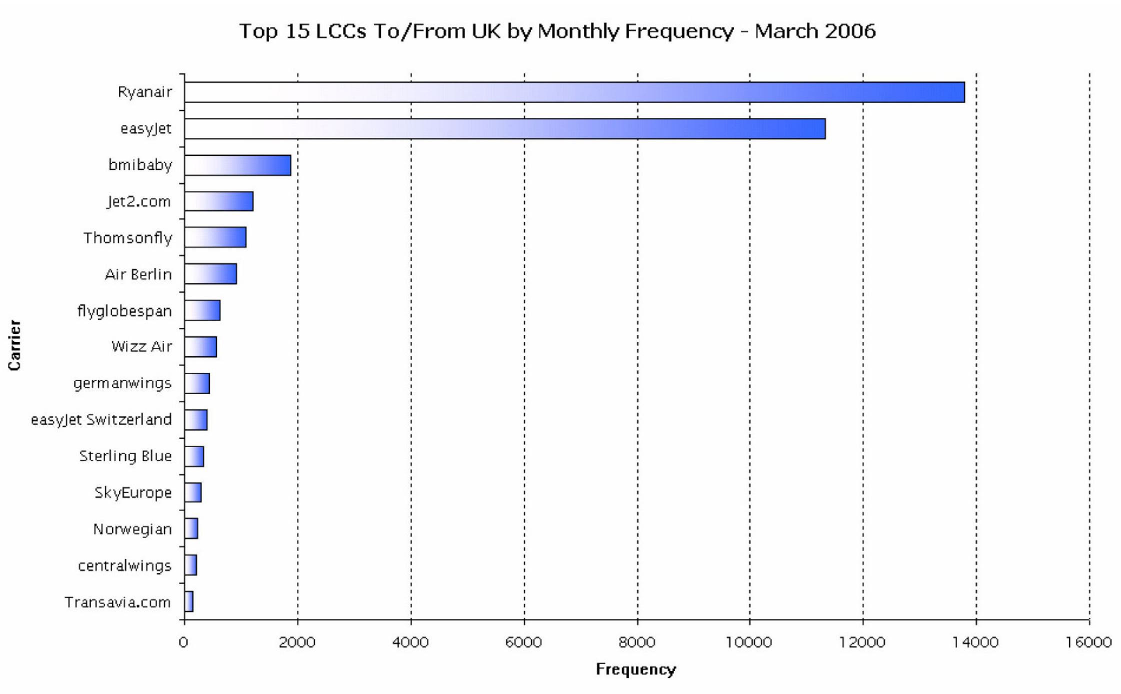
4. LOW COST CARRIERS OPERATING TO/FROM MAJOR EUROPEAN COUNTRIES BY FREQUENCY IN NOVEMBER 2005



Source: OAG MAX Online. February 2006

In addition to Ryanair (based in Ireland but with its biggest operations in the UK), and easyJet, LCCs based in the UK include bmibaby (part of BMI, formerly British Midland); Flybe (formerly British European and Jersey European); and start-up carriers Jet2 and Flyglobespan. Monarch Scheduled and Thompsonfly are also developing rapidly, having grown out of charter airlines.

5. LOW COST CARRIERS TO/FROM THE UK



Source: OAG MAX Online. March 2006

Apart from Manchester, UK regional airports had few direct scheduled services to Europe before the LCC revolution

Initially, full service airlines operating from the UK did not regard LCCs as much of a threat as the LCCs were based at secondary airports - Ryanair at London Stansted, and easyJet at London Luton. Failure to examine and understand the LCC business model meant full-service airlines soon found LCCs eating into their markets and creating new business. Apart from Manchester, UK regional airports had few direct scheduled services to Europe before the LCC revolution. easyJet is now the second largest carrier at London Gatwick after British Airways.

The reaction of legacy carriers on short-haul routes started with indifference until the gradual realisation that the threat was here to stay. In 1998, BA set up its own low-cost subsidiary, Go, to compete with Ryanair. But in 2001 BA sold its fledgling to a management buy-out, only for easyJet to purchase Go a year later for a much higher price. KLM's Buzz was also relatively short-lived, launched in 2000 and sold three years later to Ryanair.

BMI set up its bmibaby offshoot in 2002, but it operates from regional bases rather than London - a development plan also followed by Flybe. In 2005, however, BMI introduced "Tiny" fares and bmibaby branded promotions for its own flights from Heathrow, while introducing paid-for in-flight service and withdrawing business class on all but a few short-haul routes.

It is now possible to fly from Heathrow on BMI, BA and many foreign carriers - such as Aer Lingus and Iberia - for the same or lower fares than LCCs offer from Gatwick, Stansted or Luton. Full-service benefits are still offered by most Heathrow airlines, including business class, seat selection and (possibly) free in-flight food, as still offered by BA. But capacity controls on Heathrow mean that LCCs often still offer a better deal from other UK airports, and the introduction of low fares from Heathrow has not impeded the LCCs' growth.

As legacy carriers have had to adopt new business models to cope with LCCs, the same is happening to tour operators in markets such as Germany and the UK, where they play a dominant role. Having saturated most city-to-city routes, LCCs are now targeting resorts and eating into tour operators' market share.

Of the four dominant tour operators in the UK, MyTravel (formerly Airtours) was the first to react to this trend by setting up its own LCC, MyTravelLite. That brand - which operated only from Birmingham - has now been scrapped due to retrenchment at cash-strapped MyTravel, but the biggest operator, Thomson (part of TUI UK) is now taking major steps.

Its LCC subsidiary, Thomsonfly, started operations in 2004 from only one airport - Coventry, near Birmingham, which at that time had no other scheduled operations. For summer 2005 it added flights from Bournemouth and a new airport developed from a former military airfield, Robin Hood Doncaster Sheffield. Thomson's charter airline Britannia has now adopted Thomsonfly branding, and for summer 2006 TUI UK will operate LCC model services from 11 UK airports including Gatwick and Luton.

The distinction between LCC and charter services has now become blurred, with predictions that UK tour operators First Choice and Thomas Cook will do something similar. Thomsonfly has followed other LCCs by making accommodation, car hire and other ground services bookable through its website, competing with carriers such as easyJet but effectively unpackaging its own product.

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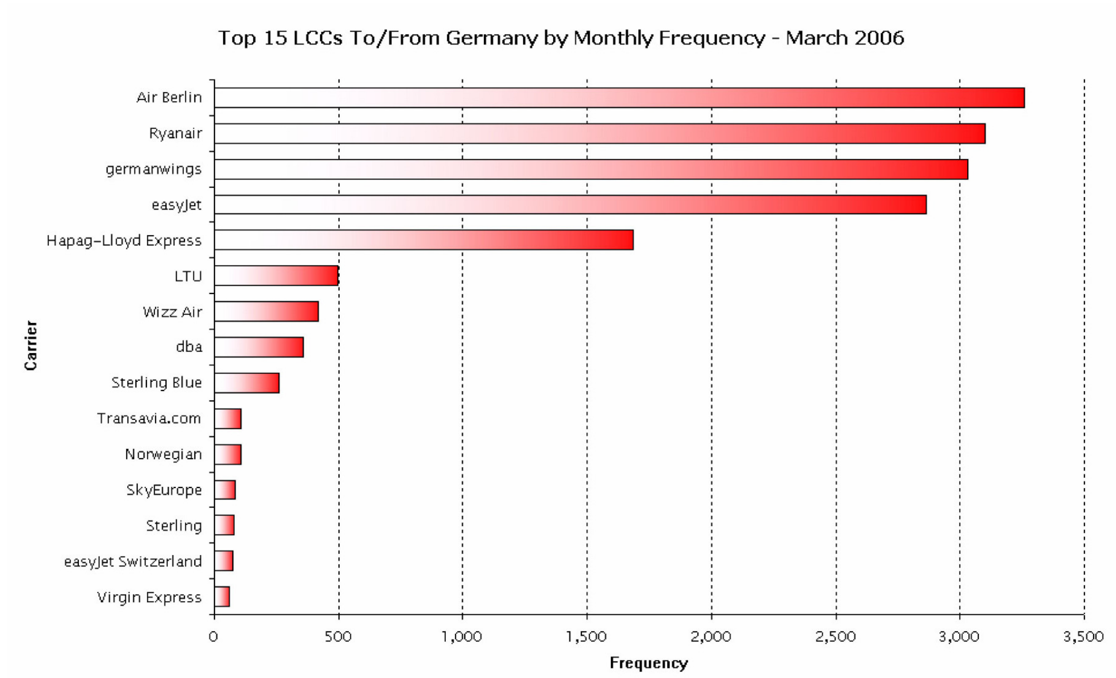
A major question raised by this is the loss of financial protection. Although the EC package travel regulations require tour operators throughout the EU to protect their customers' money in the event of their failure, the same does not apply to flights, accommodation and other elements booked separately.

With most LCCs being formed by entrepreneurs rather than multi-nationals such as TUI, inevitably there have been several failures - including Air Polonia of Poland and EUJet of the UK. A survey by the UK Civil Aviation Authority found that families had to pay an average of £400 to get home after EUJet's failure in July 2005, while those yet to travel lost their money unless they had paid at least £100 by credit card, this being protected under UK law. Such protection does not exist in most European countries although it may be possible to insure against an airline's collapse.

In Germany, also, tour operators have entered the LCC arena with Thomas Cook-owned Condor competing with Air Berlin on some routes. TUI also owns German LCC Hapag-Lloyd Express although this is mainly a business carrier.

6. LOW COST CARRIERS TO/FROM GERMANY



Source: OAG MAX Online March 2006

Central and Eastern Europe has been a key growth area since many of its states joined the EU in 2004

Full service airlines throughout Europe are being forced to react to the growing power of LCCs by adapting their business models. Iberia, for example, makes in-flight food an optional extra but plans a 17% reduction in domestic capacity for 2006-08. SAS Scandinavian Airlines operates its own LCC, Snowflake, as does LOT Polish Airlines with Centralwings.

Central and Eastern Europe has been a key growth area since many of its states joined the EU in 2004 and the Czech Republic declared open skies in the 1990s, creating a huge leisure market for Prague. Ryanair and easyJet are making inroads but the dominant LCCs are Wizz Air, with bases in Hungary and Poland; and SkyEurope, operating out of Hungary, Poland and Slovakia. Bulgaria and Romania, which are due to join the EU in 2007, are also starting to see some LCC activity.

The Middle East remains a largely regulated market, but LCCs are appearing as established carriers protect their markets and start-up airlines look for new opportunities. The huge movement of expatriate workers between the Indian sub-continent and the Gulf region is being targeted by Gulf Traveller, an all-economy carrier set up by Gulf Air; while Air Arabia, based in the competitive emirate of Sharjah, claims to be the region's first LCC established in 2003.

MenaJet started operations from Lebanon in 2004, targeting outbound leisure passengers; while Kuwait-based low-cost carrier Jazeera Airways started flights in November 2005 with about 30 flights per week to Amman, Bahrain, Beirut, Damascus and Dubai.

In North Africa, Royal Air Maroc set up LCC subsidiary Atlas Blue in 2004 to serve the French, Italian, Belgian, Dutch, German and British markets, concentrating on the leisure destinations of Marrakesh and Agadir.

South Africa has witnessed the arrival of LCCs Kulula and 1time, but a constraining factor here is the low ownership of credit cards compared to Europe.

Will the LCC boom continue in Europe? It seems inevitable that the growth rates of recent years will slow down, except in Central and Eastern Europe where there is still untapped potential. The larger LCCs have proved they can attract a totally new market while eating into the market share of legacy airlines and tour operators, but some consolidation is likely at the expense of smaller operators.

The larger LCCs have proved they can attract a totally new market while eating into the market share of legacy airlines

The load factors and profitability of Ryanair and easyJet are the envy of the industry.
In February 2005, Ryanair announced firm orders for a further 70 Boeing aircraft, which will increase its fleet to 225 aircraft, with 200 options pending. When it can be cheaper for someone living in northern England to fly to Europe for the weekend rather than take a train to London, LCCs will continue to flourish.

Business travellers are also flying LCCs in a big way, although the lack of flexibility in most fares means a high no-show factor. The Barclaycard Business Travel Survey 2004-05 shows that 71% of UK business travellers had flown on a LCC and that 96% were very satisfied and would use one again.

Will the full-service model survive on routes within short-haul Europe in the long-term? The answer is probably not.

- E N D S -

Contributors

- The late Adrian Hunt, Deutsche BA
- Dave Richardson - one of the UK's leading travel and tourism journalists and regular contributor to Travel Trade Gazette, Buying Business Travel, ABTA Magazine and Selling Long-Haul.

7. Market Analysis

OAG is the only industry data supplier that provides past, present and future flight schedules for virtually every scheduled airline in the world. We have a suite of products and services that enable flight schedules and route data analysis up to 1 year in advance and 10 years historical. This information shows passenger movements and emerging trends and is vital for accurate strategic planning and forecasts.

OAG Market analysis products and services include; **OAG MAX Online, Bureau and CD and OAG Global Route & Hub Connectivity Reports**

OAG is the only industry data supplier that provides past, present and future flight schedules for every airline worldwide

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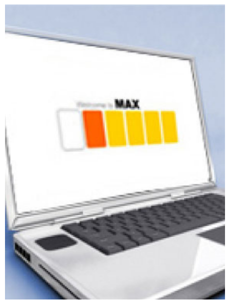

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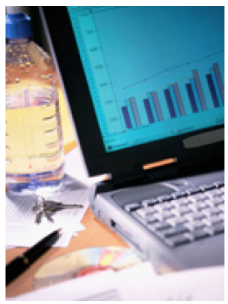

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