



BETTER information  
for better DECISIONS



# The Long Climb to Recovery - T2RL's Outlook

12<sup>th</sup> May 2020

Trusted. Impartial. Expert



## INTRODUCTION

This is the first edition of T2RL's analysis on the market recovery for the airline industry during and after the COVID-19 pandemic. T2RL will update this document on a quarterly basis as new information and developments become apparent.

## EXECUTIVE SUMMARY

The Global Pandemic caused by SARS-CoV-2 since the latter part of 2019 is causing greater economic and societal disruption than any event since the end of the Second World War. At the time of writing many countries are in "lock-down" with non-essential economic activity severely curtailed. A few regions appear to have passed the peak of the outbreak and are slowly reopening their economies. Others such as the UK and the USA are at the height of the outbreak while Africa in particular is bracing itself for the arrival of large numbers of cases.

One of the industries most affected is air transport. It is almost certain that the rapid spread of the virus around the world was facilitated by passenger journeys between regions. It appears that this virus has a long incubation period compared with influenza and other viral infections and that people who are asymptomatic are also able to spread it. This means that measures such as excluding air passengers with fevers, as was done with SARS in 2003, would not be as effective in preventing the spread of COVID-19. The only measure available to prevent the spread of the epidemic by air was to shut down large parts of the air transport network. There is some regional variation but in general T2RL research shows air passenger traffic is down by 90-95% compared with a year ago.

The airline business is one with very high fixed costs. Even with the most drastic retrenchment measures no airline will be able to survive a 90% drop in revenue for more than a few months and many are much closer to the edge than that. In the short-term national governments are supporting some airlines in their jurisdiction but those without government support will find it hard to survive.

The problems of the airlines read through into challenges for the industries that support them including aircraft manufacturers, airport operators and ground handlers. [Boeing](#) announced it is to lay off 10% of its workforce through voluntary measures and [Airbus](#) has furloughed 6,000 production workers in Europe with further announcements expected in June. They also have huge impact for companies in the distribution chain and those that supply them and the airlines with technology. These are the entities with which T2RL works from day to day and these are the entities whose outlook we will follow. We intend to publish this report on a quarterly basis to record the moves towards recovery in our areas of expertise. We will identify the most likely paths that the recovery will take and highlight the actions that companies may take to improve their prospects as the market comes back. Given the nature of this crisis there is limited historical perspective to apply. Any projection we make is based on the best information that we have at that time and is subject to change as new data come to light and the situation evolves. This is why



we intend to revisit our analysis at regular intervals and we fully expect that it will change dramatically over time.

We base our projections on five time-bands. We define the immediate future as being roughly between now and the end of the Northern Hemisphere summer. This period is characterised by the most uncertainty and chaos. Following that we expect the situation to stabilise somewhat although slowly. We consider 6-12 months, 1-2 years and 2-3 years. The final band is beyond 3 years, a time when the “new normal” should be established and the shape of our industries should be more settled.

At the start of this process we are guided by the insight of Charles Darwin 150 years ago. In “On the Origin of Species” Darwin identified that those species that were most successful were not necessarily the biggest, fastest or strongest. Rather they were the ones that best adapted to their environment. We believe that to be true of the current situation. The environment for airlines and their supporting industries has changed dramatically. Those that survive and prosper will be those that best adapt to this changing environment. The most valuable attribute will be flexibility and the ability to learn and change at a faster pace than they have ever needed to before.

## THE MARKET FOR AIRLINE SERVICES

Just as the events of 11 September 2001 drove major changes in the approach to security in airlines and airports we expect that the current pandemic will lead to new requirements being placed on the industry. These may include changes in physical arrangements such as screening of arriving and departing passengers and enforced social distancing in both aircraft and airports. It is also very likely that governments will require airlines to collect more data on passengers. This in turn will place a burden on travel agents and GDSs to enable such data collection at the time of booking.

### The Immediate Future

Most of the immediate impact is already apparent and we have high confidence in our view of the shape of the next six months or so.

It is clear that domestic markets will be the first to begin recovery and we already see this happening in China. International routes are constrained by government action to close borders which will slow down their reopening. Where flights are operated we will see restrictions in capacity with many airlines closing middle seats or even complete rows of seats. In the very short term this will make little difference as demand is so low that load factors will be depressed to the point where there is no real chance of filling many seats. Several airlines have announced that they will require passengers to wear masks and at least one large carrier (United Airlines) has said that it will supply them to all passengers. These measures will all add costs and in a few cases will further reduce revenue opportunities.

[The Long Climb to Recovery: 12<sup>th</sup> May 2020](#)



The financial impact of the crisis on airlines is already large and will continue to grow. We expect to see airlines forced into administration, bankruptcy protection and even liquidation. Even airlines that are financially strong will face pressure to reduce costs dramatically. The biggest opportunities for cost reduction lie in reducing headcount and retiring aircraft. [British Airways](#) and [Ryanair](#) have both announced large job cuts in the last week of April and Lufthansa has suggested that it will retire all of its four engine aircraft. In the short term this may not be very significant as fuel prices are liable to remain depressed for some time. However, airlines that have hedged their fuel purchases may find that brings additional pressures as they are obliged to pay well above spot prices. We also expect to see a number of airline mergers leading to substantial reductions in capacity in specific regions.

There will be very little business travel in the next few months. Most corporate travel insurance will not provide cover while the outbreak is still categorised as a pandemic. Companies have a duty of care to their employees and would have significant legal exposure if they were to require them to travel. Government restrictions will also limit corporate travel in the short term. Many SMEs and some corporates are likely to move into administration and bankruptcy as the economic shut-down drives failure of their business models. Some will restructure but many will not survive, putting further pressure on the travel industry

Similar restrictions will apply to personal travel but there may be a small uptick in demand for visits to vulnerable family members once it becomes physically possible to make such journeys. Demand for vacation travel will be extremely low because of restrictions on destinations, nervousness of potential travellers and the financial squeeze suffered across the economy.

## 6 – 12 Months

The seeds for change in this time scale are already in place and we have a high degree of confidence in our expectations. The most recent updates may be found at [www.t2rl.net/airline/covid19](http://www.t2rl.net/airline/covid19) where we track developments including the availability or otherwise of government support for airlines.

The number of active airlines will diminish both through bankruptcy and liquidation and through mergers. It is likely that an end to the pandemic will be formally declared during this period which will lead to a small resurgence in demand for international travel. This will be limited by specific restrictions applied by individual governments. Airlines with a higher proportion of domestic business will fare better but this only helps in geographically large and/or diverse markets such as the USA, Canada, China and those where airline service is the only practical mode of transport including island nations. Airlines whose domestic operations are primarily about feed to international routes will benefit far less.

The uptick in personal travel will wear off as the recession starts to hit hard. Corporate travel will remain depressed as businesses continue to use travel-avoiding technology such as video conferencing. As we move into 2021 businesses will be starting to push through changes to their operating structures such as switching some manufacturing from global to local centres.

[The Long Climb to Recovery: 12<sup>th</sup> May 2020](#)



We also expect the move to social distancing within aircraft to stabilise in this period. It is possible that some airlines will introduce screens or other forms of physical separation between seats but it is not yet clear that there is a strong evidence base for such initiatives. They might also be difficult to achieve within regulatory constraints since physical changes to seats usually require recertification. The achievement of separation standards applicable on the ground is simply impossible within the confined space of an aircraft without reducing load factors by an order of magnitude.

## 1-2 Years

As we look to longer time scales confidence in our forecasts reduces somewhat. Once we look more than a year out it is essential that we remain alert to changes in base cases that will have impact in late 2021 and into 2022.

We expect to see fewer airlines in the market and therefore less competition. Schedules will continue to be restricted compared to pre-pandemic levels. Flight prices may start to increase as a consequence of reduced competition and increased operational costs.

Fuel prices will increase from the current very depressed levels although they will probably be volatile as markets start reopening.

Bio-security standards that are created during the initial reopening will be standardised and enforced across the industry. This could take the form of virus checks at all ports, and vaccine certificates added to PNR for inclusion in transmission of passenger details to destination immigration and government agencies. Based on experience after 9/11 we expect that some new processes will be put in place due to political pressures regardless of any evidence base for their effectiveness. Once implemented it will be almost impossible to remove them so airlines and airports are likely to have costs imposed for a very extended period.

Leisure demand will recover only very slowly as prices increase. Corporate travel starts to pick up slightly as businesses resume international trade and services, although we do not expect corporate travel to reach last year's level of demand for several years at least. Recession, downsizing, new habits and ways of working will all suppress demand for business travel.

## 2-3 Years

Starting in mid 2022 we expect the wave of airline failures and mergers to have largely passed. The surviving carriers will be looking hard at their business processes as they move towards the new normal. These are our expectations but there is a great deal of room for further shocks to push the industry in directions that are not yet apparent.

Given that domestic travel is likely to recover ahead of international, and that the only airlines able to make money from predominantly domestic business are those that follow Low Cost

[The Long Climb to Recovery: 12<sup>th</sup> May 2020](#)



Carrier (LCC) and Hybrid business models, we see all airlines adopting more practices from the LCC world. Point to Point routes will be the focus at the expense of large hub and spoke networks as airlines are forced to reduce their network and global presence.

Business travel is likely to ramp up as confidence grows in the post-COVID-19 world. We expect that there will be an effective vaccine in this time frame as well as improved screening and treatments.

Demand for leisure travel should also improve. Historical experience shows that demand for vacation travel recovers relatively quickly in those affluent European markets where the annual trip to the sun is seen almost as a human right. Other leisure travel such as for sporting and cultural events or short city breaks will probably be slower to come back. Patterns of leisure travel may also change with more demand for shorter trips to less crowded destinations.

## Beyond 3 Years

Beyond three years we should be seeing a new normal state of affairs. Certainly the changes prompted by the immediate crisis should be well established. However three years is plenty of time for new crises to emerge and any prediction beyond mid 2023 should be seen as a no more than a possibility.

There will be fewer airlines and those that remain are unlikely to have recovered to pre-crisis status, [BA](#) believes that it will be “several years” before there is a return to 2019 passenger levels. Networks will be much reduced compared to today and those passengers with true global requirements are likely to need to do business with multiple carriers. Interline itineraries, whether traditional or virtual will be unavoidable.

One option that has been floated in some circles is that in markets with strong domestic airlines international travel may be handed over to a single dedicated carrier owned by a consortium of the domestic airlines. This idea was first proposed in the USA after the second world war and would have entailed the domestic airlines at the time taking equity in Pan Am and feeding its services at international gateways. On the whole we think this is an unlikely path for the industry to follow. It could only apply to a handful of markets and governance issues would be very challenging. On the other hand we are entering uncharted waters and this is a radical idea that could solve some problems, albeit at the cost of introducing substantial new ones.

The big question in this time scale is the extent to which demand will return. Assuming that an effective vaccine is made available world-wide and that general economic recovery continues with no more major shocks we expect demand to be in the range of 80-100% of 2019 levels by the end of 2023. If we are correct in our expectations of fewer airlines serving that demand the surviving carriers should have returned to a reasonably strong economic situation.



## DEVELOPMENTS IN AIRLINE DISTRIBUTION

### The Immediate Future

With the return of domestic business before international we expect to see a further shift to direct bookings for simple itineraries. The ability of travel agencies to hold on to their share of business will depend in part on their business practices in the next few months. While some customers will seek reassurance from dealing with a familiar name as airlines struggle for survival we are also seeing unwelcome practices such as high cancellation and change fees imposed by some agencies during the crisis. There are forces pulling in both directions and it is quite likely that we will see different behaviours in different markets.

### 6-12 Months

As markets start to open up again we expect to see retrenchment in the travel agency business. In this time scale there is unlikely to be sufficient demand to sustain the current number of travel agency outlets. Small and medium sized agencies are likely to consolidate by mergers and failures while large multi-branch businesses will probably close a significant number of locations. In line with that we expect to see a “clicks and bricks” model gain traction in which customers are able to transact much of their business online while retaining the possibility of a face to face encounter, albeit less conveniently local, for complex interactions.

### 1-2 Years

We expect a continued increase in direct bookings due to simple point to point routes and as this is the most flexible channel for airlines to stimulate demand. Indirect traffic may see a slight increase in demand as corporate travel starts again with new processes needed for duty of care.

There will be demand for significant new technology to accommodate regulations and processes for travellers to have tests or certificates added to bookings or at check in. Travel agents may be deeply involved in processing these. Some operators will adapt quickly but others may be overrun by the technology requirements. We may see travel agencies switching to GDS providers that are more effective in automating and simplifying these requirements. This would ensure a simpler model for agents to operate than a direct connect. Some direct channels will not keep up with the requirement to support a continuous scalable change regime.

### 2-3 Years

We expect to see fewer travel agencies in the market due to bankruptcies and low demand. OTA traffic will be under pressure due to the fall in leisure demand and will be competing more than ever with the airline direct channels. Those airlines with a strong domestic market and technological capability may have the ability to encroach on OTA territory. In effect a small number of airlines have an opportunity to become the 'OTA' in their home markets.



## Beyond 3 Years

If airlines are successful in selling their domestic and even simpler international routes in direct channels they will have the ability to demand lower domestic GDS fees or even to take out domestic content in the GDS altogether as [Air India](#) did last year with Amadeus. Indirect bookings will look a lot more expensive than direct due to increased GDS fees being passed onto the traveller, putting further pressure on the remaining travel agencies.

## THE GDS MARKET

The GDS business follows a two-way distribution model and its health depends on that of both airlines and travel agencies. In the short term GDSs are under great pressure. This may lead to significant structural changes in the medium and longer terms.

### The Immediate Future

All three of the western GDSs are under huge pressure with revenue having practically dried up. To some extent this is offset by not having to pay any travel agency incentives but they also have largely inelastic fixed costs in staff, data centres and networks. Even before the COVID-19 crisis Travelport was the most vulnerable of the three as it was mainly dependent on the traditional booking fee revenue stream while its main competitors both have other substantial lines of business. Those other revenue streams have also diminished significantly so for the time being all three GDSs are in essentially the same boat. As always TravelSky in China stands apart.

Amadeus has very substantial reserves of cash and liquid assets. It is well-placed to survive for an extended period from its own resources.

#### *Amadeus' Cash Position*

- EUR 660 M Cash

#### *Cash preservation measures*

- EUR 300 M Reduction in fixed cost and capex
- EUR 320 M Dividend payment cancellation (June 20)

#### *Increased cash liquidity*

- EUR 750 M New Capital Bonds
- EUR 1000 M Undrawn revolving credit facilities
- EUR 1000 M Incremental loan facilities



Sabre's balance sheet is not as strong but it is likely to be supported in the last resort by the US Government. Without its services American Airlines could not continue and several other US carriers would be severely affected.

The Lufthansa Group position to terminate Sabre and Abacus GDS participation after 30 June 2020 sets a precedent that other carriers may follow. Fragmentation of content reduces the value of the GDS as an aggregator and forces agents to invest in technology if they wish to remain competitive. Time will tell if this strategy is valid.

#### *Sabre's Cash Position*

- 685 million USD Cash and cash equivalents (USD 375M credit facility)
- 1.075 billion USD Secured and exchangeable notes

TravelSky is supported by the Chinese state and in any case the recovery has started in China, albeit slowly.

Only Travelport appears to be very exposed. It does not have cash reserves at the same level as Amadeus and it does not have strategic importance to a national government. The sale of [eNett](#) at the start of 2020 looks very challenging following Wex's announcement it would back out of the deal and Travelport and Optal's position that they would seek legal remedy to enforce the sale. This would have given Travelport's [private equity owners](#) an immediate return and would have been a driver for the \$4.4 billion buyout that was finalised in May 2019.

## 6-12 Months

We do not see the GDS business coming back strongly in this time scale. Any growth in airline traffic is likely to be based on direct sales. All three western GDSs will be in survival mode and we expect to see layoffs and the sale of non-core assets where feasible.

It is hard to see Travelport being able to continue as an independent business but equally it is hard to see an obvious buyer. It is unlikely that Amadeus or Sabre would be allowed to acquire it by the regulators especially given the UK Competition and Markets Authority (CMA) position with respect to Sabre and Farelogix. Other potential suitors such as the big technology companies Google, Apple or Amazon would surely have other priorities at this time. The only slightly sensible buyer would be TravelSky but this would be a difficult proposition given tensions between the USA and China over trade and the blame game for the COVID-19 pandemic.

## 1-2 Years

We expect to see larger travel agencies due to consolidation, with increased purchasing power. This will create pressure for increased GDS incentives which will in turn lead to GDSs attempting to increase airline booking fees. If this happens it will provide further motivation for airlines to drive business to their direct channels and create a feedback loop that further pressurises the



GDSs. Amadeus and Sabre can compensate for this by enhancing their airline IT offerings but Travelport will once again be exposed.

One possibility is that if Travelport is able to survive into 2021 there may be a change in the US administration that would allow a more constructive dialogue with China over a possible tie-up with TravelSky. We would rate this a fairly low probability as TravelSky itself may not be ready for this relationship but nevertheless it is one of very few logical possibilities that would see some value being retained in Travelport.

## 2-3 Years

Whether by acquisition or its liquidation we expect Travelport to no longer be in the GDS market. The removal of Travelport from the market might reduce some of the upward pressure on agency incentives and perhaps enable the traditional GDS market to stabilise around two strong players with a focus on technology rather than distribution services.

## Beyond 3 Years

We expect that by this time GDS full content agreements will have largely disappeared. If the remaining GDSs all have airline IT businesses we should see more contracts that package PSS and distribution under a single agreement. Airlines should become less sensitive to the channel in which they sell their product and able to take a more holistic view of marketing and distribution.

# TECHNOLOGY CHANGES INCLUDING NDC AND ONE ORDER

## The Immediate Future

Airlines are retrenching wherever they can. They have no money to spend on technology developments with a return on investment longer than perhaps a couple of months. Maybe not even those. This means that further roll-out of NDC and ONE Order is going to take a very low priority. The 2020 Leaderboard target of 20% of indirect distribution via NDC will be missed although perhaps not by very much since 20% of a very small number is an even smaller number.

Information from airlines around the world is that technology staff are being laid off or furloughed. As a result, the majority of projects and therefore IT projects are on hold or cancelled completely.

## 6-12 Months

Much will depend on the GDSs being in a position to offer NDC pass-through at scale. If they are able to do so then airlines that have already invested in an NDC capability may be able to implement at low cost. This will depend on a realistic commercial approach being taken by all parties. In the most favourable case airlines with this capability will be able to react in a more agile manner to the indirect market upheavals of the coming years. Airlines that have not already



invested in NDC are unlikely to do so in the short to medium term. This opens the door for PSSs to take over the NDC flavoured APIs.

## 1-2 Years

There is potential for those airlines that had invested in NDC pre-COVID-19 to resume using those networks, if those agencies still exist and are able to support them. There will be great pressure on the NDC aggregators in the market and we are likely to see consolidation amongst them.

## 2-3 Years

We still foresee very few bookings via NDC. Traffic will still be focused around direct channels of which the airline.com will be by far the most significant due to the need for flexibility and control. OTAs do not need to invest to consume NDC content and there is no value for them to do so. The larger OTAs are more than capable of setting up and most already have set up direct connects with airlines without using NDC.

## Beyond 3 Years

Direct channels will be strong but due to increased GDS fees and fewer TMCs in the market airlines could start to take advantage of direct connects. These may use NDC but other APIs are available and may be easier to implement.

The growth of direct sales and a more “LCC-like” approach to business may generate interest in the same issues that prompted the development of ONE Order. However, it is likely that the disruption over the next few years will shift the requirements for ONE Order and require a complete rethink of its implementation.



*Travel Technology Research Ltd, trading as T2RL is an independent research and consulting company that specialises in the market place for airline IT systems. Based on data gathered and analysed since the year 2000 it has defined and tracked classifications of airlines and their IT providers. Its research is used by airlines to enable them to make informed choices of systems and vendors and by the vendors to help them develop products that best meet the current and future needs of the airline industry. For further information, visit our website at [www.t2rl.com](http://www.t2rl.com).*