

Fight or Flight – Insolvency In The Aviation Industry

Article By:

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Air Berlin, one of Europe's largest airlines, filed for insolvency on 15 August 2017. The airline, which is Germany's second-largest carrier after Lufthansa, filed following the decision by Etihad Airways to pull financial support. Etihad owns 29% of Air Berlin and had been pumping money into the struggling airline for the past 6 years.

The German government has stepped in to provide €150m in temporary credit lines backed by state guarantees to keep the airline flying. This funding is estimated to last for approximately 3 months. Air Berlin is now in the process of meeting with potential bidders however its CEO has confirmed this will be structured as an asset sale as the sale of the airline as a whole is not possible.

A recent trend?

Unfortunately for the aviation industry, Air Berlin's insolvency struggles are not isolated. In May, Italy's flagship airline Alitalia filed for administration after employees rejected a restructuring plan. Similar to Air Berlin, its largest shareholder is Etihad who stated at the time it would provide no further funding. Alitalia has received a six-month lifeline from the Italian government, with a tendering process ongoing and its ultimate fate still hangs in the balance.

An explanation for the problems airlines are facing is an over capacity in the market and that they simply have too many seats to fill. Global ratings agency Moody's published a report in March stating it expects European airlines' operating profitability to decline in 2017 as a widening supply/demand gap pushes yields lower.

The future: Better for budget?

However, the situation for the European aviation industry may not be as bleak as it seems, with low cost airlines seeming to come out on top. The Moody's report noted that in 2017 low cost airlines such as EasyJet and Ryanair would gain market share from incumbent airlines such as Air France, British Airways and Lufthansa as they begin to offer lower fares on the same routes.

Further, analysts at Liberum have called the failure of uncompetitive, inefficient airline operators a positive for the industry as their existence has only fueled the problems of overcapacity. When news of Air Berlin's insolvency broke shares in EasyJet and Ryanair rose by 4 per cent and 3 per cent

respectively, suggesting that the market believes this presents an opportunity for the budget airlines to expand their presence in Germany. Assuming, of course, there are enough pilots to go around and the industry can cope with changing regulation – a la Ryanair!

Consolidation of airlines, which has happened in recent years with the US airlines industry, effectively deals with the overcapacity problem. Alex Paterson, a transport analyst at Investec, suggests further consolidation is “inevitable” and is most likely to happen through more airlines being restructured or failing and rivals snapping up the newly available capacity. This seems to be the case in relation to Air Berlin. EasyJet and Lufthansa are amongst those who have made bids already; Air Berlin has stated it will decide on the bids on September 25.

Alex Kelly contributed to this post.

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