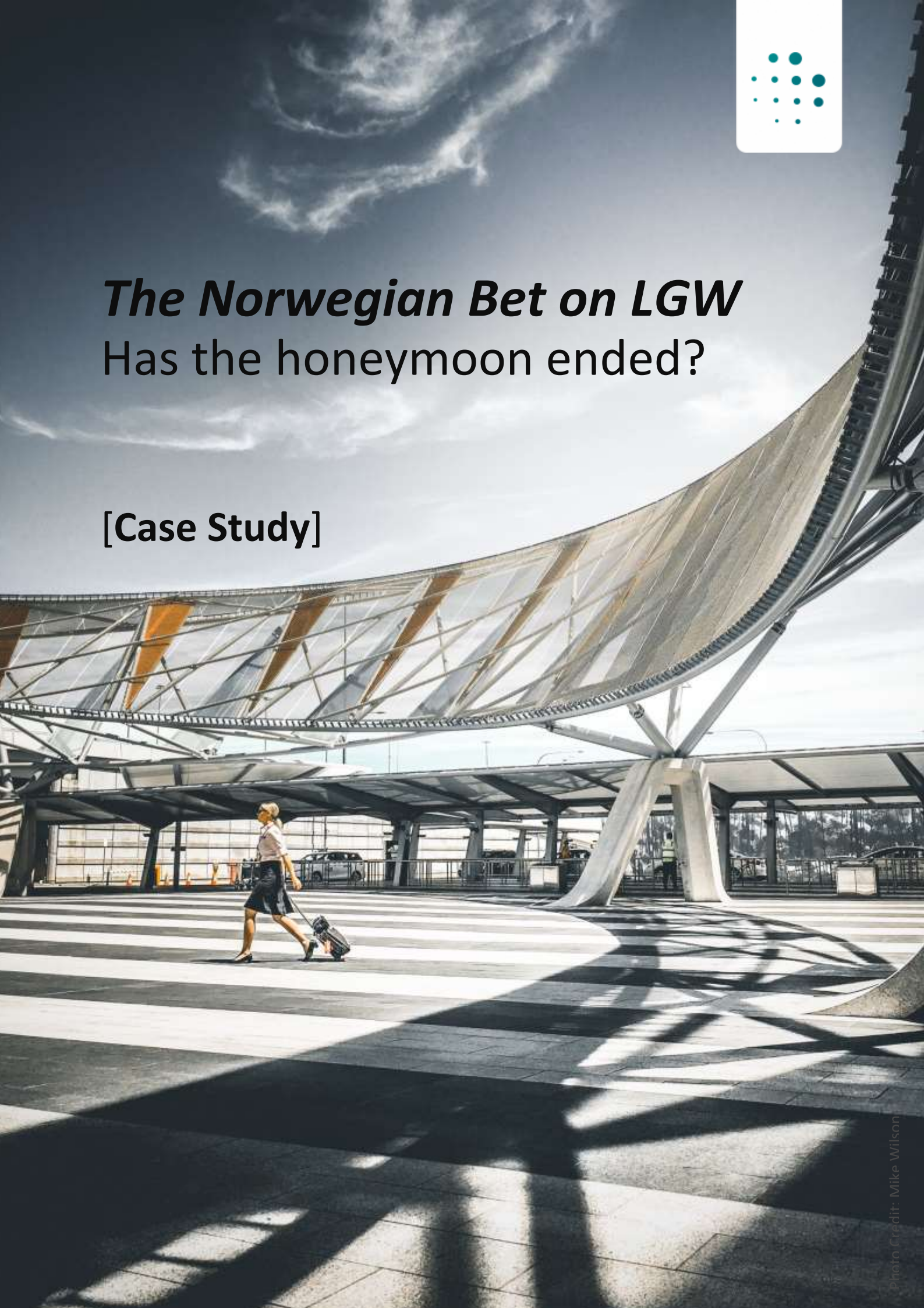




The Norwegian Bet on LGW Has the honeymoon ended?

[Case Study]



CASE OVERVIEW

Norwegian partnership with London Gatwick can be used as **a benchmark of successful collaboration between airlines and airports.**

While showing multi-million operating earnings during 2016, Norwegian has exhibited a **drop in revenue on the route London Gatwick-New York J.F.K during 2017.** However, the reasons appear to be industry, rather than carrier-based.

Norwegian is faced with high demand and is proceeding with its expansion over Europe and the Americas. Still the carrier is experiencing obstacles such as lack of available slots in London Gatwick, congested airports and currently restricted further development towards the Asia Pacific.

From an airport perspective, considering the impact that Norwegian's low cost long-haul strategy had on Gatwick and London Heathrow, it is reasonable to say that both airports are presented with opportunities, as well as threats.

In this case study we will be looking at **how the situation has evolved during 2017 and the first months of 2018** for the route LGW – JFK. While doing it, we will not simply analyze the performance of Norwegian for the route, but also keep a close eye on the **competition between Gatwick and Heathrow for the traffic to New York.**

THE CASE

Norwegian & London Gatwick - a 4-years-long collaboration

Norwegian Air Shuttle and London Gatwick Airport (LGW) started their partnership back in **July 2014**, when the airline introduced **the first low-cost long-haul flights to the U.S from London Gatwick**.

Already in 2016 the low-cost airline recorded the news-worthy amount of 500,000 UK¹ passengers on its ground-breaking long-haul flights. The two partners shared a successful collaboration which proved beneficial for both of them. New routes have been opened and additional flights added to those routes continuously since 2014.

Fast forward, **today Norwegian flies to 13 U.S. destinations and is the 3rd² airline by passenger numbers at Gatwick Airport**.

Apart from being unquestionably daring, Norwegian’s strategy has also paid off from a revenue perspective, as we proved with our analysis “The Norwegian Bet”.³ British passengers are clearly enjoying flying overseas with the budget airline. It is also fair to assume that given the increase in traffic, LGW must be rather fond of the partnership.

With our previous case study, we estimated that Norwegian achieved multi-million-dollar operating earnings on this route in 2016. However, our estimate excluded Norwegian’s ancillary revenues, which were likely to further increase the carrier’s earnings on the route. The estimate was based on our data for Norwegian’s daily fares in the period, also factoring in CASK (per-airline), seat capacity and load factors.

We also investigated how this new strategy impacted the market considering that Heathrow (LHR) and Gatwick (LGW) partially share the same catchment area.

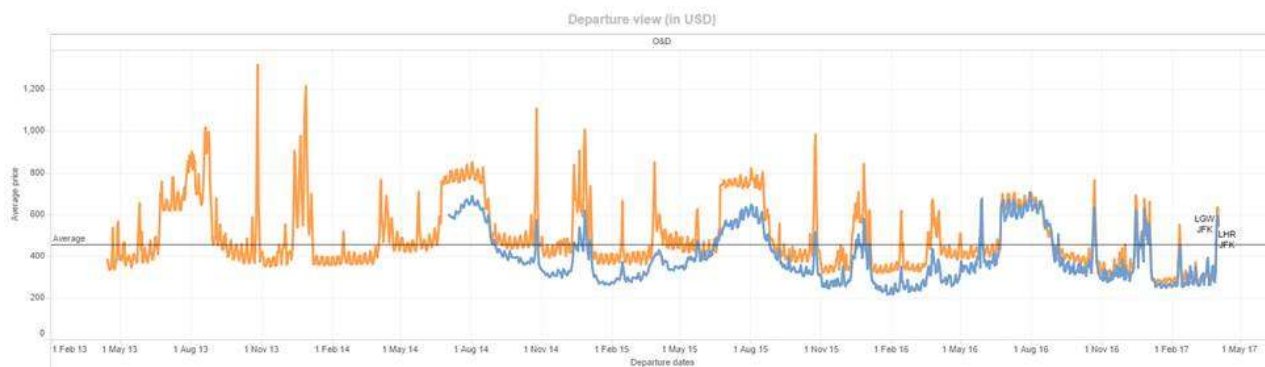


Fig 1. Average fares on the routes LHR-JFK (orange) and LGW-JFK (blue) for 2014, 2015, 2016 and 2017

Source: Infare Altus

¹ According to official Norwegian press release: <https://media.norwegian.com/uk/#/pressreleases/norwegian-soars-to-500-000-uk-passengers-on-low-cost-long-haul-flights-1365826>

² The London Gatwick Airport - Financial Results (30 September, 2017)

³ The full case study is available for download at: <https://www.infare.com/learn/>

Norwegian's impact on the London market

Six airports are located in London or in its close proximity. These airports largely share the same catchment area. It is then no surprise that the new entrant with a low-cost game on Gatwick impacted the traffic on the route LHR-JFK.

The competition for the route London-New York is fierce between Gatwick and Heathrow. Previously we compared the two routes from 2014 to April 2017 (Fig 1). Now we will be analyzing how the situation has evolved during 2017 and the first Quarter of 2018. (Fig 2).



Fig 2. Average fares on the routes LHR-JFK (orange) and LGW-JFK (blue) for 2016, 2017 and Q1 of 2018
 Source: Infare Altus

As shown by our first analysis, during 2016, LHR price level adjusted to LGW's ones on the LHR-JFK. This development continued throughout 2017, and from January onwards **LHR has shown an overall lower price level.**

Looking at the amount of price fluctuation (Fig 3), a drop can be observed from the start of June 2016. This variation gets remarkable in September. As a matter of fact, demand does not look too healthy throughout 2017. This indicates that both airports present surplus capacity in comparison to 2016.

Looking at airfares volatility measured per departure date, it appears that **demand has been softer on the route LHR-JFK during 2017, which indicates potential losses in passengers.**

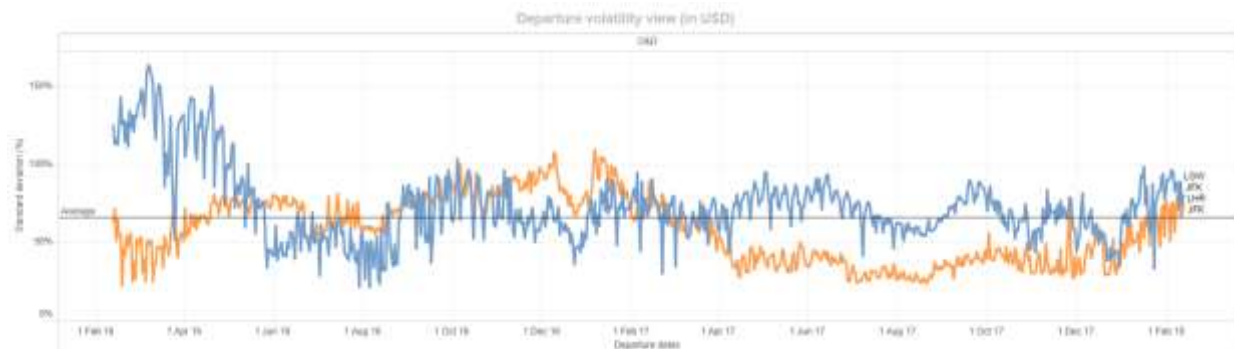


Fig 3. Departure volatility for the route LHR-JFK (Yellow) and LGW-JFK (Blue) during 2016 and 2017
 Source: Infare Altus

Market Response during 2017

Looking at Norwegian's endeavor from a financial perspective, according to our estimates, the situation was promising during 2016. However, things seem to have changed when comparing 2016 and 2017. 2017 looks a lot harder because of **higher fuel prices and a fierce drop in the average price level.**

2016 full year

Plane Seat Capacity	Load Factor	Passenger N.	Average Price (USD)	Total Revenue (USD)	CASK	Distance (in km)	Cost per Available Seat (USD)	Total Cost (USD)	Earning per Leg Flight (USD)
291	90%	262	331	86.689	0.0311	5560	173	50.391	36.298

2017 full year

Plane Seat Capacity	Load Factor	Passenger N.	Average Price (USD)	Total Revenue (USD)	CASK	Distance (in km)	Cost per Available Seat (USD)	Total Cost (USD)	Earning per Leg Flight (USD)
291	90%	262	270	73.360	0.036	5560	200	58.200	12.540

Fig 4. Earning estimate per leg flight in USD 2016 vs. 2017

Even though Norwegian holds a 45%⁴ advantage when it comes to fuel efficiency in comparison with the top 20 airlines on transatlantic routes, it is evident that the increase in fuel prices significantly impacted the airline's earnings. This being one of the causes behind Norwegian's drop-in profitability. As a matter of fact, **the profitability of the low-cost has decreased by 2/3 for the route LGW-JFK in 2017.**

In spite of this losses on the airline side, Gatwick celebrated the record-breaking passenger numbers delivered by Norwegian: during the past 12 months the airport welcomed 4,6 million ⁵passengers. **Norwegian also accounted for the 9,5 % of the overall airport growth thanks to the new or enhanced long-haul services.** The new long-haul services included the opening of brand new routes from Gatwick to Denver, Seattle and Singapore, and a 2nd daily service for the LGW-JFK route.

In the meantime, **Heathrow experienced only a 1,1% ⁶ growth in passengers** on its transatlantic routes to North America. Again, airfares volatility measured per departure shows that demand has been soft on the route LHR-JFK during 2017, which signals potential losses in passengers for Heathrow on the LHR-JFK route.

On the other hand, it is worth highlighting that although Heathrow is losing market share to Gatwick for its routes to North Americas, the airport is showing robust performance on its routes serving both the Middle East and the Asia Pacific. As a matter of fact, traffic to the Middle East showed a remarkable growth of 10,2%.

⁴ According to Norwegian Investor Q4 2017 presentation
⁵ The London Gatwick Airport - Financial Results (30 September, 2017)
⁶ London Heathrow Investor Report (December, 2017)

Breakeven Considerations

Norwegian quarterly estimation points in the direction of an overall price decrease. This quarterly profitability analysis also reveals that an **average price of USD 220 is Norwegian breakeven price** on the route LGW-JFK.

Q1 2017*

Plane Seat Capacity	Load Factor	Passenger N.	Average Price (USD)	Total Revenue (USD)	CASK	Distance (in km)	Cost per Available Seat (USD)	Total Cost (USD)	Earning per Leg Flight (USD)
291	90%	262	220	57.640	0.036	5560	200	58.200	-560

Q2 2017*

Plane Seat Capacity	Load Factor	Passenger N.	Average Price (USD)	Total Revenue (USD)	CASK	Distance (in km)	Cost per Available Seat (USD)	Total Cost (USD)	Earning per Leg Flight (USD)
291	90%	262	274	71.788	0.036	5560	200	58.200	13.588

Q3 2017*

Plane Seat Capacity	Load Factor	Passenger N.	Average Price (USD)	Total Revenue (USD)	CASK	Distance (in km)	Cost per Available Seat (USD)	Total Cost (USD)	Earning per Leg Flight (USD)
291	90%	262	325	85.150	0.036	5560	200	58.200	26.950

Q4 2017*

Plane Seat Capacity	Load Factor	Passenger N.	Average Price (USD)	Total Revenue (USD)	CASK	Distance (in km)	Cost per Available Seat (USD)	Total Cost (USD)	Earning per Leg Flight (USD)
291	90%	262	282	73.884	0.036	5560	200	58.200	15.684

Fig 5. Quarterly estimates of earning per leg flight in USD

Once we collected daily airfares for the carrier, we factored in Norwegian's load factor, which equals 90%⁷ and the plane seat capacity, which amounts to 291 passengers⁸. When it comes to the carrier's CASK, including fuel, we estimated it by looking at a peer-airline, Air Asia, which also presents low-cost long-haul flights.

⁷ As stated by Norwegian's CEO in April 2017 talking about the Airline's US flights, available at: <http://www.mediacentre.gatwickairport.com/press-releases/2017/norwegian-to-launch-new-low-cost-flights-to-seattle-and-denver.aspx>

⁸ Information available at: <https://www.seatguru.com>

* the average of quarterly results does not exactly match the 2017 full year price because of seasonality volume differences and roundups.

The extended honeymoon is still on!

We estimate that **Norwegian achieved multi-million-dollar operating earnings on this route in 2016, amount which has dropped by 2/3 in 2017.** Among the potential causes of this negative development, we identified surplus capacity. As a result, **the drop in operating earnings cannot be considered as carrier specific, but rather as a response to market conditions and thus aimed at keeping the load factor high.** However, our estimate excludes Norwegian's ancillary revenues, which are likely to increase the carrier's earnings on the route.

It is safe to conclude that **the airline is not faced by decrease in demand. On the contrary, according to our findings it has the potential to attract additional passengers to the airport where it resides.** Moreover, it seems that Norwegian could be able to sell 4x times more daily⁹ (doubling the current frequency) on the same route.

Handicaps such as increases in fuel price or an overall drop in the average price level are hard to avoid for any airline. In meantime, Norwegian will have to execute on the unmet potential of the LGW-JFK route. Another set of barriers have to be taken into considerations, such as: congested airports and unavailable slots. A further well-known factor limiting the carrier's long-haul growth is its shortfall in acquiring Siberian overflight rights. Till this difficulty is not overcome, Norwegian can still focus its efforts on the European and American markets. A tangible example of such focus is represented by Norwegian's new long-haul transatlantic operations from Milan, Madrid and Amsterdam which were kick started at the end of 2017.

While Norwegian is exhibiting its commitment to London Gatwick with a promised increase of 150,000 seats on transatlantic routes, the carrier is also reacting to the lack of available slots with its plans to base twelve B787-9s out of London Gatwick. **The fruitful relationship between Norwegian and London Gatwick cannot be questioned. Both partners are in condition to further benefit from this collaboration, also by leveraging the extra insight gained on their customers and network.**

⁹ As stated by Norwegian's CEO in February 2018 talking about the Airline's growth at London Gatwick airport: <https://www.ch-aviation.com/portal/news/64503-norwegian-keen-to-grow-at-gatwick-but-lacks-slots>

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The analysis carried out in this Case Study is based upon airfare data collected by Infare and publicly available data, coming from a number of sources.