# 2019 WILL BE A YEAR OF CROSSROADS FOR AVIATION INDUSTRY

**News / Airlines, Personalities**

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**2018 was an interesting year for airlines. On one hand there was the introduction of the blockchain bringing greater security to aircraft maintenance data while presenting an opportunity to one day revolutionize most aspects of aviation from training to the passenger experience. But going along with the big strides that were made in technology was the harsh contrast of a growing consolidation of many European airlines, with even some well-established airlines filing for bankruptcy. In the same vein, 2019 is gearing up to be a year of contrasts where we will continue seeing airlines filing for bankruptcy who cannot adapt to modern competition and greater regulations aimed at protecting passengers and holding airlines accountable for poor service. In more exciting developments, in the summer time there will be growth that surpasses 2018 to make 2019 a big year.**

## Bankruptcy to continue

Thousands of passengers were left stranded in foreign countries in October of 2018 when the aviation industry was rocked by news that the Cyprus based Cobalt Air suddenly ceased operations and closed its gates. The Nordic carrier Primera suffered the same fate and abruptly grounded all its aircraft as it entered bankruptcy. While disruptive to the airline industry the failure of these airlines were not unprecedented. Just a year earlier in 2017 the airlines Monarch and Air Berlin closed their doors signaling a start to the massive consolidation European airlines were about to face. 2019 will continue on this trend of consolidation with at least 3 mid-size airlines not making it through winter. As the price of a barrel of oil has shot back up from $40 in 2016 to now reaching past $100, the airlines that were barely holding on to a thin profit margin are not in a good position to stay financially stable. While many have been barely holding on for the past couple years, 2019 may be the year many decide to stop holding on.

## Proper resource allocation for passenger claims

The airlines that went bankrupt have added further proof to the claim that the current state of passengers’ reimbursement claims is a mess. Airlines have proven time and time again they cannot self-regulate on this issue with those posing the biggest risk taking the most advantage of this gray area. Auditors are no longer ignoring this pressing problem and in 2019 will likely require scheduled airlines (especially those publically traded) allocate 1% reserve for passenger claims. This will help companies to better manage passenger claims and increase the image and dependability of European airlines.

## Playing by the new IFRS rules

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The IFRS (International Financial Reporting Standards) brings financial information to investors on the global scale. IFRS is requiring companies to bring most leases on-balance in 2019. This new standard – IFRS 16 – will enable analysts to see a company's own assessment of its off-balance sheet lease liabilities. The new standard covers commercial aircraft so some airlines will be in trouble as the new prescribed methodology will require many to re-negotiate covenants with their bank. As the airlines will now be required to increase the liabilities and assets they report it will have a significant impact on their financial standing, bringing mostly negative consequences. For the airlines that have traditionally kept their leased aircraft classified as a finance and operating lease this change means the assets will be more visible on their balance sheets so they will appear to be more indebted. In addition to this structural change in the accounting of the balance sheets there will also be changes in accounting over the life of the lease contract which ultimately will mean more costs to the airline when these changes go into effect. Even into the future, managing these now on-balance assets will prove costlier over the life of the lease.

### Failure to LEAP

Projections through 2038 indicate 75% of all aircraft deliveries will be single aisle narrow body aircraft. Many of the aircraft on back order today – and there are thousands – will make up a good portion of the 2030's fleet. The airframes that are dominating on orders are the Airbus A320neo family and the Boeing 737 MAX platform. Since both these aircraft use LEAP powerplants it is imperative the engines get delivered on time; but unfortunately setbacks such as teething issues, disc forging problems, and defective turbine shroud coatings have put the engine deliveries further behind schedule that will likely continue into 2019. Amidst this problem the opportunity exists for a greater ACMI utilization in 2019 for airlines who are waiting for their deliveries to supplement their fleets with leased aircraft that are ready to fly and make a profit for the airline.

### Making it to summer

For the airlines that make it through the winter months, summer of 2019 will return respectable results to the airlines. All regions will be returning profits greater than in the summer of 2018 but the Middle East especially is shaping up to generate returns far in excess of their costs of capital. Globally, this return on capital will stabilize profits with an average return of 8.6% according to IATA. There will be many contributing factors to this profitability ranging from economic forces to political changes but one of the biggest reasons will be a drop in oil prices. This profitability will translate into many tangible effects as the airfares will remain low and unique city pairs connected by airlines are forecast to grow.

### Putting it all together

Much like the years before it 2019 will have its own unique challenges as well as carrying over the effects – both good and bad – from previous years. But at its core the theme that keeps reemerging is 2019 will be a year of crossroads. Commercial aviation is going through changes with new business models in maintenance, leasing, and the airlines themselves as well as experiencing the introduction of new technology. 2019 will be interesting as we witness the old way of doing things go up against new ways and aggressive innovation.

**04 JANUARY 2019**

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