

Developing a Competitive Aviation Sector – Lessons for Nigeria

4TH Annual Nigeria Securities & Exchange Commission
Capital Market Committee Retreat
Abuja, Nigeria
27th to 28th November, 2014

Addis Ababa, Ethiopia



Building a better
working world

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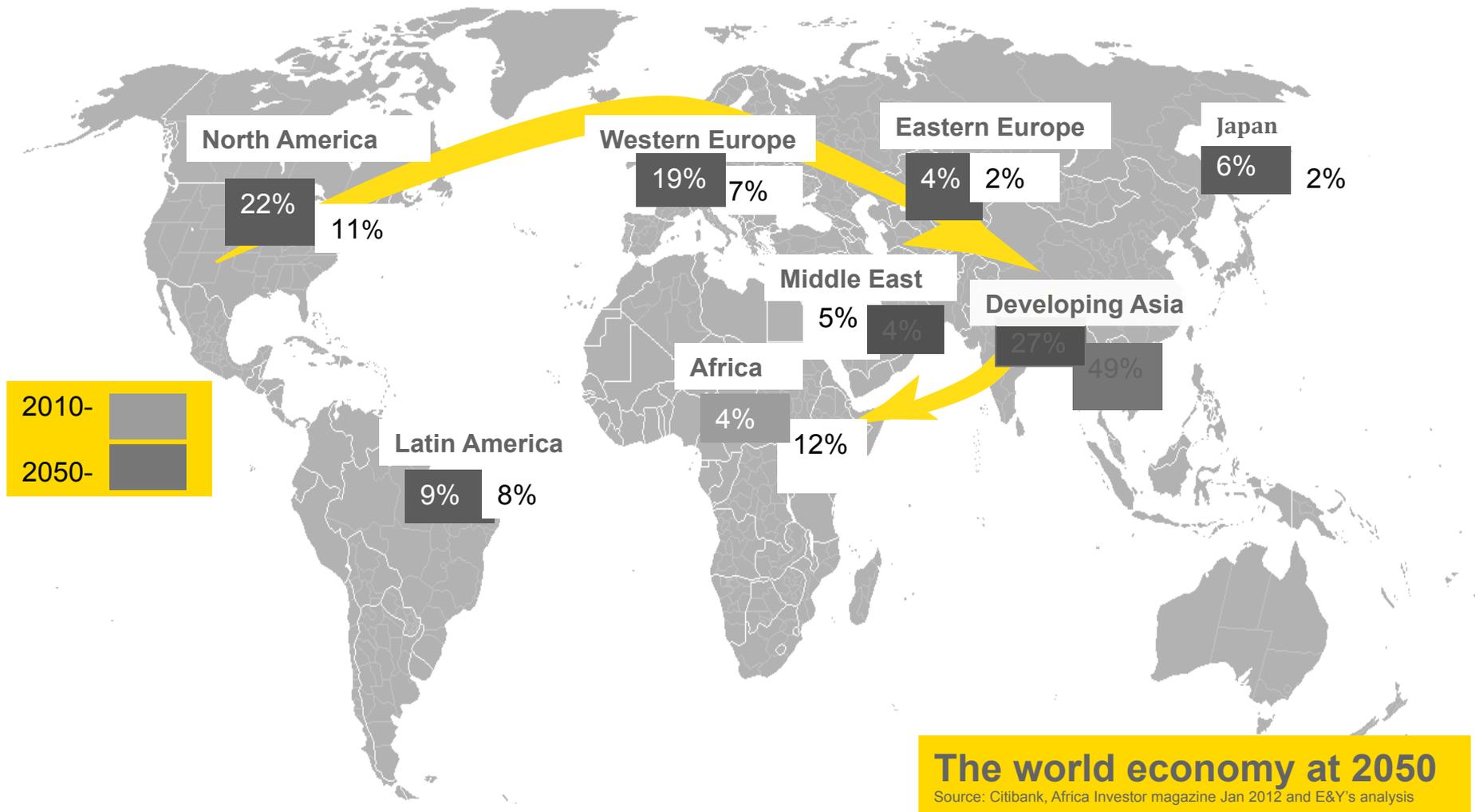
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November 2014

Economic Trends - Global Context

The accelerating shift of economic power from West to East including Africa

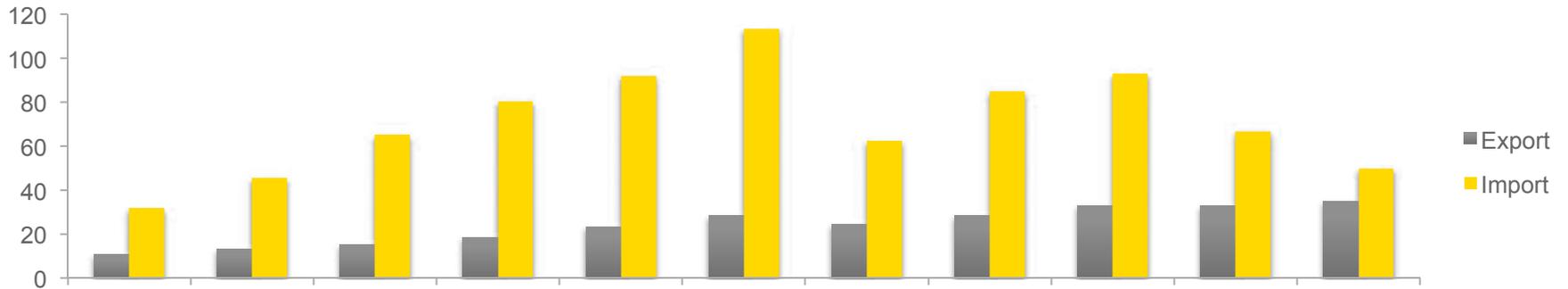


The world economy at 2050

Source: Citibank, Africa Investor magazine Jan 2012 and E&Y's analysis

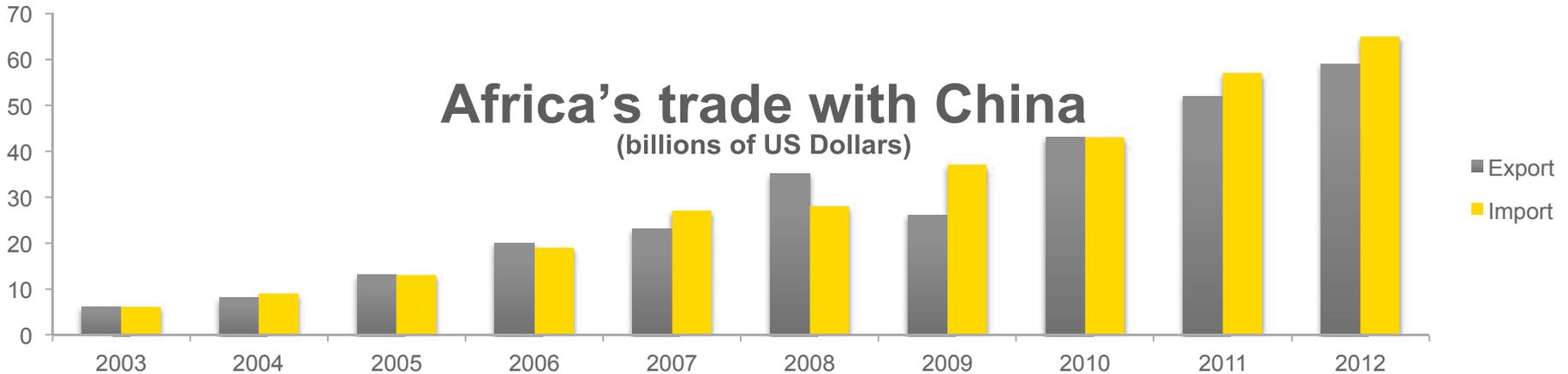
Africa's Trade with the US

(Billions of US Dollars)



Africa's trade with the US totaled \$85 billion in 2013.

Source: US Census Bureau, Foreign Trade



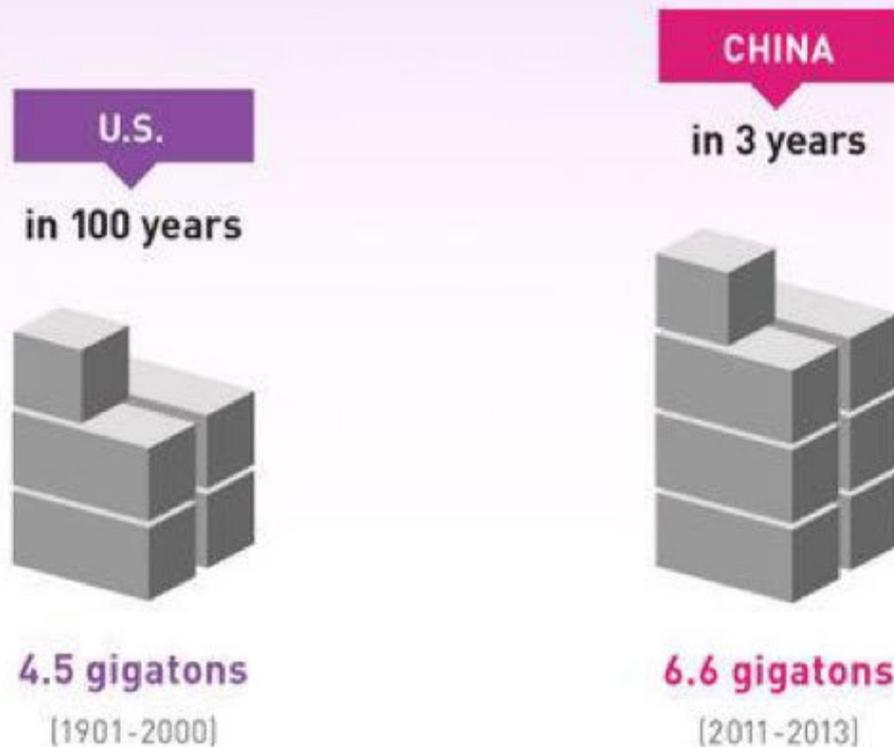
Africa's trade with China

(billions of US Dollars)

China's trade with Africa totaled over \$200 billion in 2013.

Source: UNCTAD

China used more cement in the last three years than the U.S. used in the entire 20th century.



Source: @BillGates and retweet by @AbeshaT tweet

Africa in the spotlight: U.S. Africa Leaders Summit



Africa's economy at a glance

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Africa's economy

The continent's rise is real

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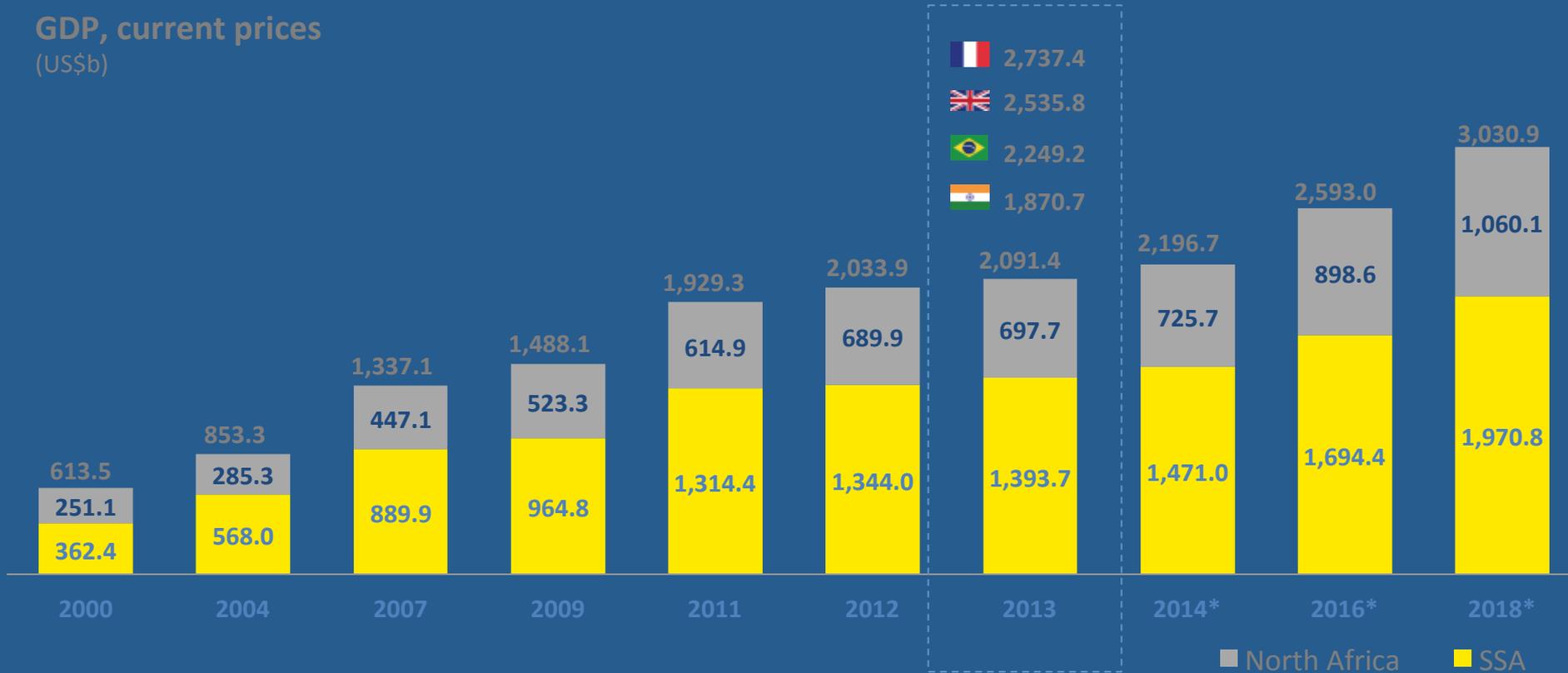
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Africa

The size of the African economy has trebled in a decade

GDP, current prices
(US\$b)

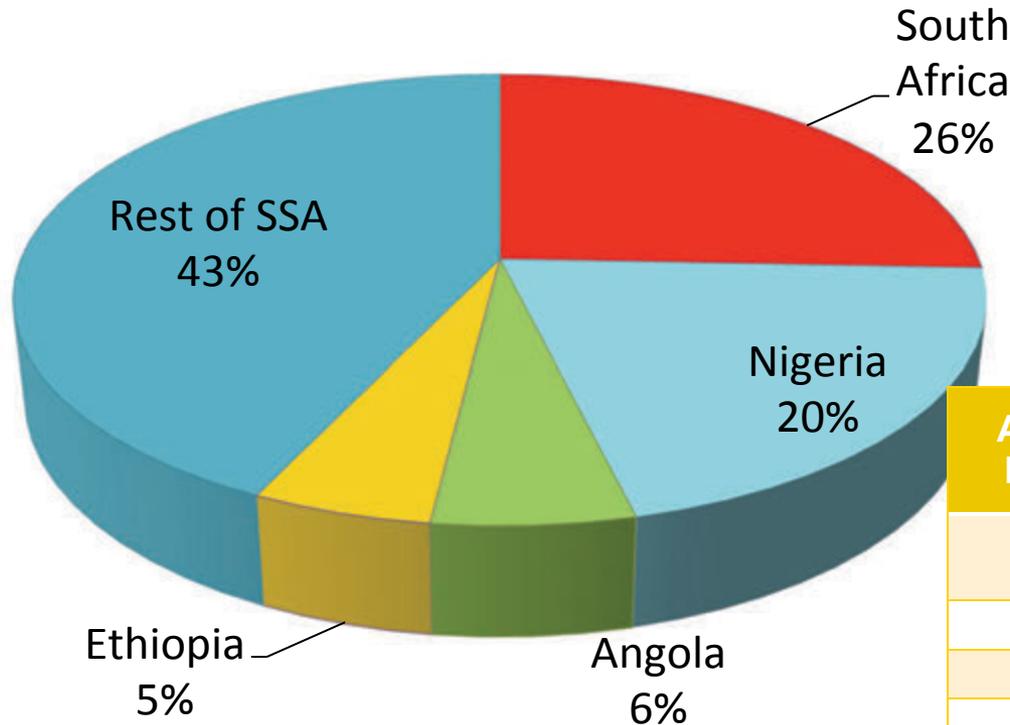


* Estimates

Note: these numbers exclude the recent rebasing of the Nigerian economy.

Source: IMF World Economic Outlook Database, April 2014.

Africa's four largest economies in 2013: Almost 60% of the Continent's total GDP



Note: Nigeria's data is before the recent rebasing.

Africa Rank	World Rank	Country	GDP – PPP (billions)
1	26	South Africa	595
2	31	Nigeria	478
3	67	Angola	132
4	69	Ethiopia	118
Total			1,323
GDP, SSA			2,311
Top 4 Countries as % of SSA			57.25%

Note 1: Only four countries in Sub-Saharan Africa have GDP greater than US\$100 billion

Note 2: GDP stated in PPP = Purchasing Power Parity.

Source: CIA World Factbook 2013

The 5 fastest growing economies in the world 2015

Africa

#1 Libya 17.1%

#2 Myanmar 10.5%

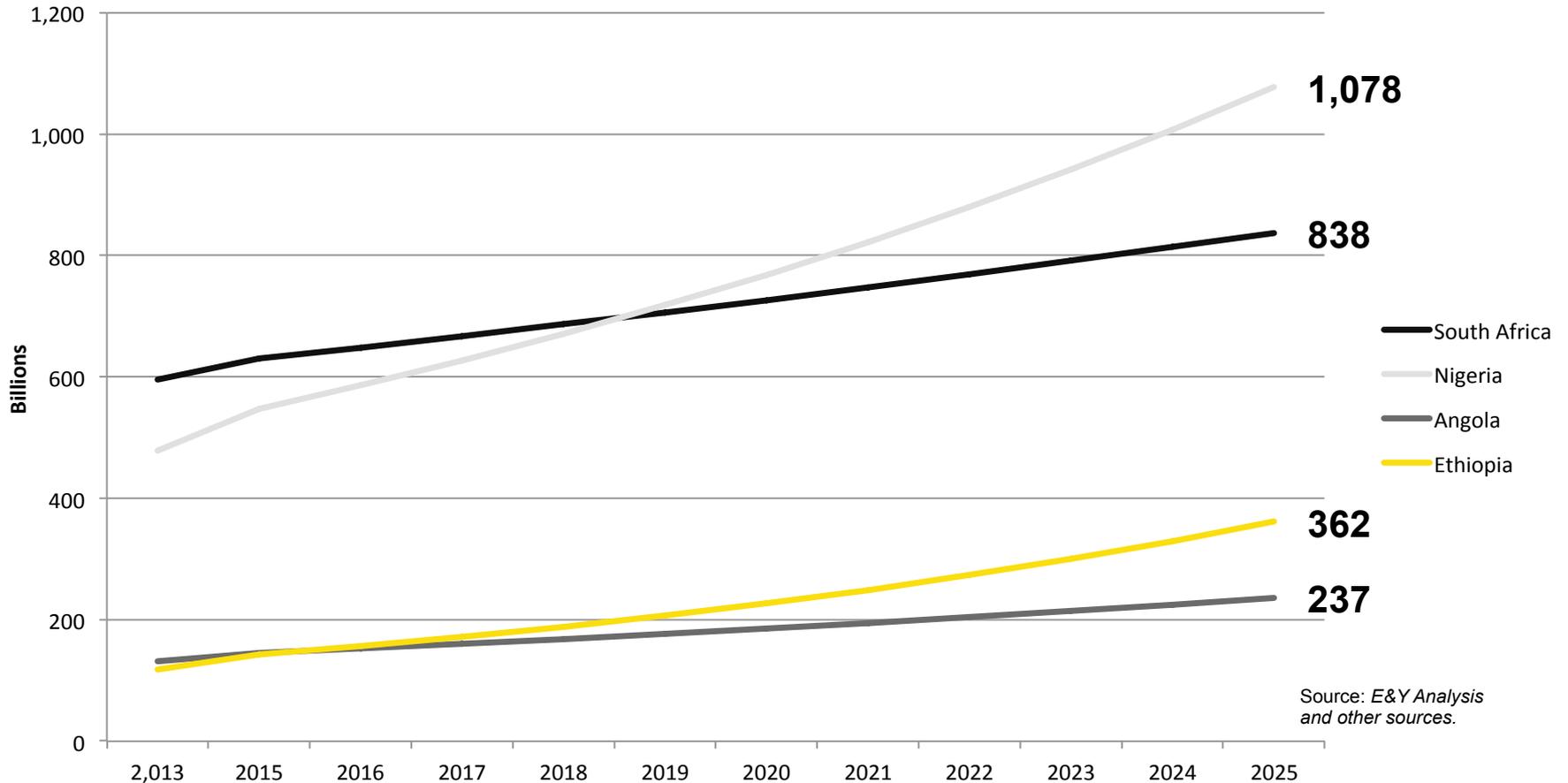
#3 Ethiopia 10.5%

#4 Qatar 9.7%

#5 Nigeria 9.3%

Source: Nasdaq/Motley fool based on IMF data November 24 2014

The 4 largest economies in Africa by 2025



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Continued growth

Five year forecast

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Africa

Five year forecast GDP growth rates (%) indicated on a colour spectrum: Green (higher) to red (lower)

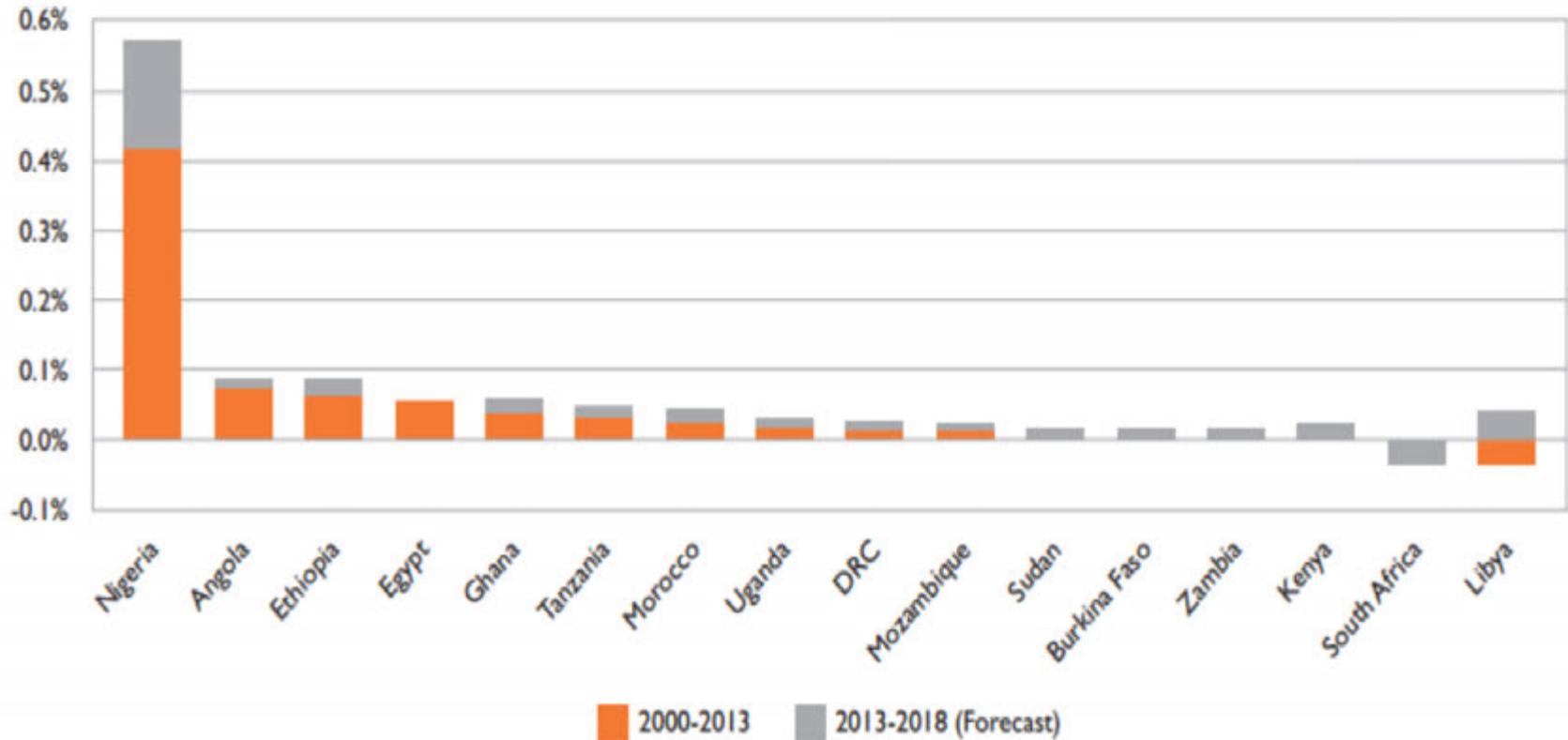


In the context of a still weak global economy, we remain positive about Africa's overall economic prospects.

Sources: Oxford Economics; EY Growing Beyond Borders.

African Countries' Share of Global GDP

Change in share of global GDP (African winners and losers)



Source: Financial Times (FT) UK based on IMF data and RisCura analysis

Africa's attractiveness

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2014 Africa attractiveness survey

Key points

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Africa

- ▶ **Dramatic overall improvement** in investor perceptions
- ▶ **Key trends** gather further momentum
 1. Growth of investment into **SSA**
 2. Rise in **Intra-African** investment
 3. **Sector diversification**
- ▶ **Urban hubs and clusters** emerge as FDI destinations
- ▶ **Perception gap** remains a barrier for new investors

Africa has steadily moved ahead of other regions

Regional attractiveness

Africa's relative attractiveness on a rise

Relative to the following markets, is Africa more or less attractive as an investment destination?



Source: EY's 2014 Africa attractiveness survey (total respondents: 503).

- ▶ Africa's stronger investment attractiveness is best explained by its own sustained growth rates in the context of slower global growth and, more recently, by structural weaknesses in many other emerging markets in the wake of the unwinding of US quantitative easing
- ▶ Africa's growth prospects are likely to remain solid, as an urbanizing and rising middle class drives demand for consumer products and improved services

Perception gap

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Enduring perception gap

Established vs. not established

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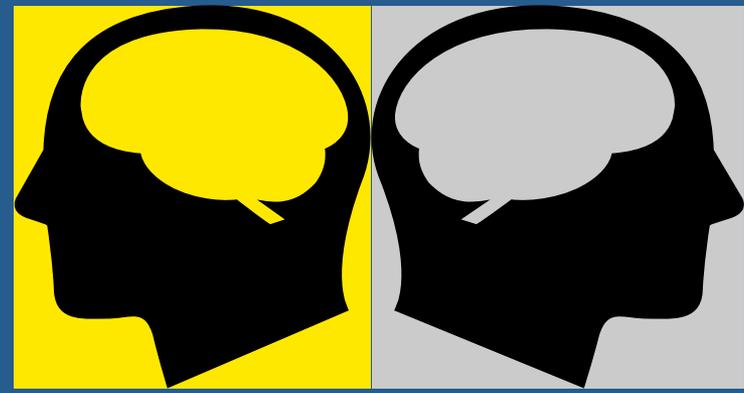
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Africa

The perception gap between those already doing business and those not remains stark

Africa is the **most** attractive destination in the world



Respondents established in Africa

Respondents not established in Africa

Africa is the **least** attractive destination in the world

Source: EY's 2014 Africa attractiveness survey (total respondents: 503).

Foreign Direct Investment (FDI)

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Actual FDI numbers

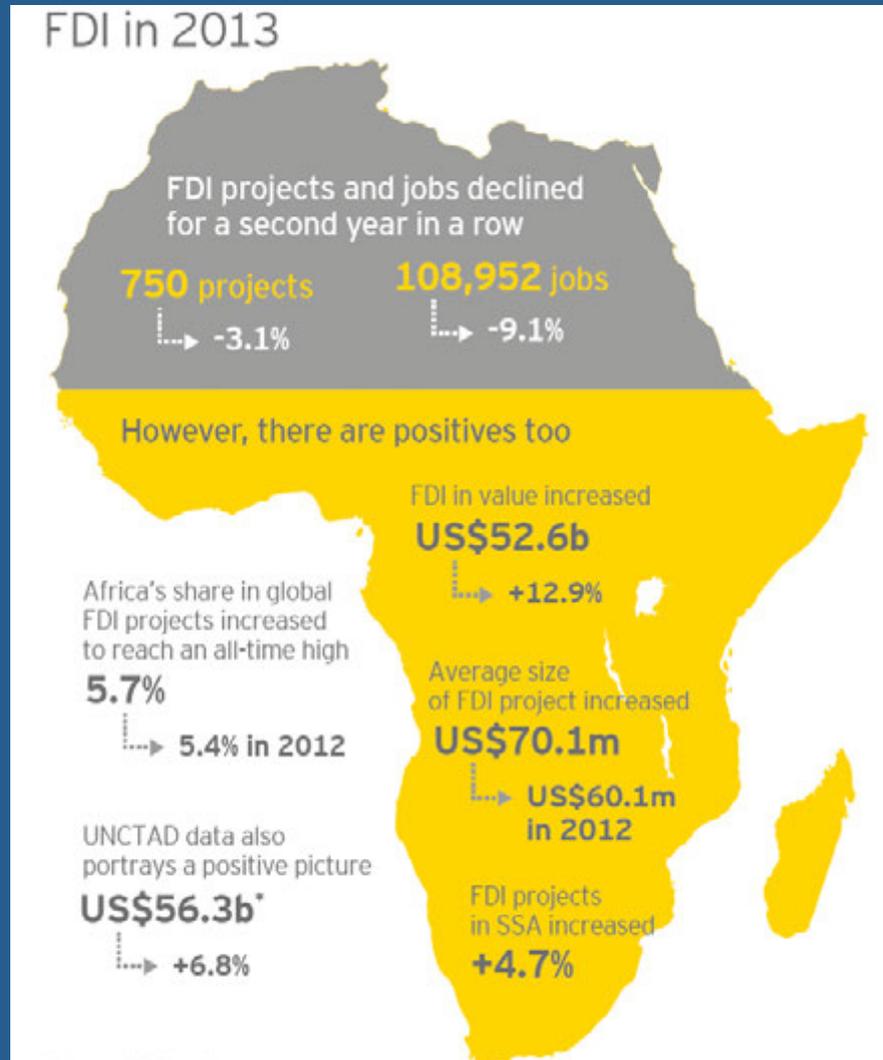
FDI value Increased by 12.9% in 2013

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Africa



Source: fDi Intelligence.

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Actual FDI numbers

FDI projects Increased by 19.5% since 2007

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FDI projects in Africa

Africa

SSA 19.5% CAGR since 2007



Source: fDi Intelligence.

Substantial reshuffle in source country FDI rankings in recent years

Top 15 source countries by FDI projects

	FDI projects			FDI amount (Share) (2007-13)	Jobs created (Share) (2007-13)
	Share (2007-13)	Share (2007-11)	Share (2012 and 2013)		
US	11.6%	11.7%	11.5%	8.0%	8.3%
UK	11.0%	10.0%	13.3%*	10.7%	9.6%
France	8.5%	10.2%	4.6%**	6.5%	6.7%
South Africa	5.9%	4.5%	9.1%*	4.3%	3.3%
India	5.6%	5.5%	5.9%	7.3%	7.1%
UAE	4.8%	4.1%	6.4%*	12.1%	6.6%
Spain	4.4%	4.8%	3.5%	3.0%	4.3%
Germany	4.1%	4.0%	4.3%	2.3%	2.9%
Portugal	2.9%	3.7%	0.9%	1.1%	1.3%
China	2.8%	2.6%	3.1%	4.2%	6.0%
Kenya	2.7%	2.6%	2.9%	1.0%	1.0%
Japan	2.6%	2.4%	3.1%	1.8%	4.0%
Switzerland	2.4%	2.6%	1.8%	2.1%	3.1%
Nigeria	1.9%	2.0%	1.7%	1.0%	1.0%
Italy	1.9%	2.2%	1.2%	2.3%	1.6%

Source: fDi Intelligence.

* More than two percentage points increase in share in FDI projects from 2007-11 average to 2012-13.

** More than two percentage points decrease in share in FDI projects from 2007-11 average to 2012-13.

The US and the UK are the largest investors in Africa

- ▶ Between 2004 and 2013, the US was the largest investor in Africa, with 768 FDI projects (12.2% of the total)
- ▶ Both the US and the UK have initiatives aimed at raising their African exposure

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Key trend

Ongoing sector diversification

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Africa

Consumer-facing industries rise in prominence

	2003-07	2013
Technology, media and telecommunications	14%	20%
Retail and consumer products	12%	17%
Financial services	12%	15%
Business services	6%	12%
Metals and mining	13%	2%
Coal, oil and natural gas	11%	3%

Share of extractive sectors in FDI projects in Africa reached an all-time low in 2013.

Although investors expect resource-driven sectors to remain the highest potential industries over the next two years, in line with what the actual numbers tell us, **infrastructure and consumer-facing sectors** are expected to increase in prominence.

Source: fDi Intelligence.

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Key trend

Intra-African investment momentum builds

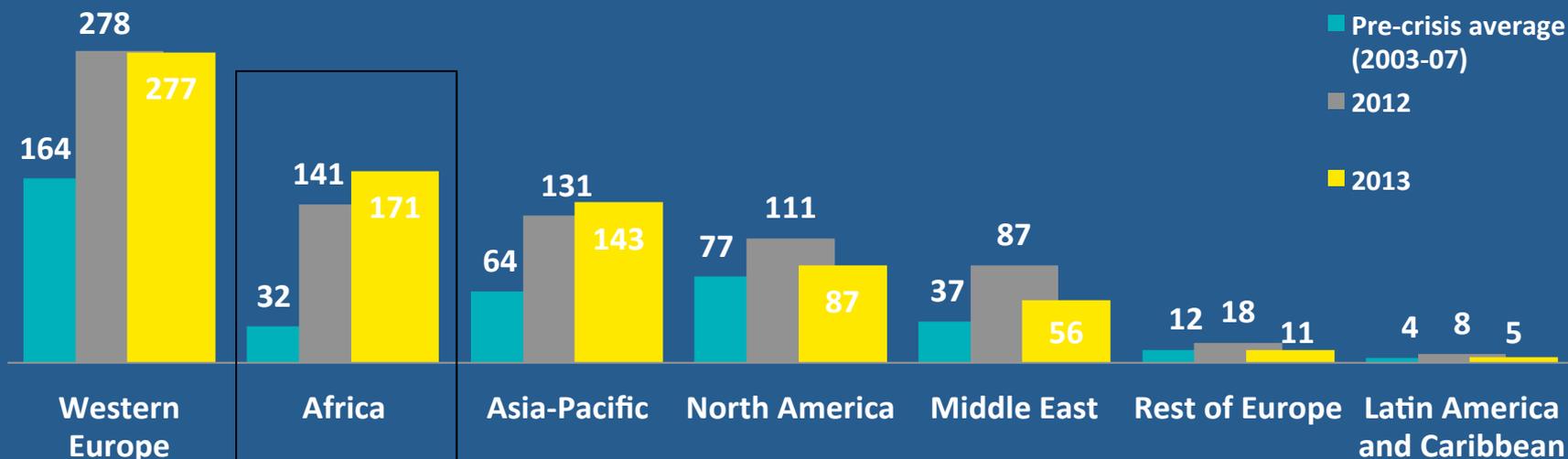
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Africa

FDI projects by source region



African investors' share of FDI projects:

- ▶ 8% in 2003
- ▶ 23% in 2013

Intra-African investors (2007-2013):

- ▶ 35% of projects from South Africa
- ▶ 16% from Kenya
- ▶ 12% from Nigeria

Positioning Nigerian aviation sector (airlines) to compete globally

Airline Stress Pendulum

Where do your Nigerian airlines place on the stress pendulum?

EY stress pendulum



1. “Collaborate to Succeed”

“Collaborate to Succeed”

- ▶ African airlines are too small and therefore MUST create “bulk” by merging and/or creating alliances to enhance their long term viability.

Airline	SAA	ET	KQ	Total - Africa's "Big 3"	EK	Africa's "Big 3" vs. EK
Revenue - millions, usd equivalent	2,921	1,888	1,218	6,027	18,363	32.82%
Net profit - thousands, usd equivalent	102.89	40.89	18.74	162.5	629.43	25.82%
Passengers - millions	8.5	4.6	3.6	16.7	34.0	49.12%

SAA: 2011 data

ET, KQ, EK: 2012 data

Passenger data for SAA excludes 1.5 m from Mango. ET and KQ data does not include affiliates passenger data

- ▶ The days of “Stand Alone” African airlines aiming to be “long haul trunk carriers” and “Flag bearers” is no longer realistic. The industry is too globalized, rapidly changing, highly safety conscience, highly regulated and too capital intensive. For example African airlines need hundreds of new airplanes in the next 20 years costing more than \$70 billion.
- ▶ **RELEVANT FACTS:** Many global carriers were convinced that they were too small to compete on their own and merged. Yet, even as stand alone, they were each several times bigger than all sub-Saharan African airlines combined. For example:
 - ▶ United - Continent
 - ▶ British Airways - Iberia
 - ▶ LAN – TAM
 - ▶ Air France - KLM

“Collaborate to Succeed”

- ▶ There will probably be 3 major airline groups in Sub-Saharan Africa by 2020 - Ethiopian Airlines, South African Airways & Kenya Airways

+

- ▶ At least one major airline group could emerge in Nigeria, but first, significant challenges must be addressed in the aviation sector in Nigeria.

- ▶ Note: major is defined as revenue of over US\$5.0 billion

2. Corporate Governance

Corporate Governance

- ▶ Airlines are businesses and regardless of the ownership (government or private), they **MUST** be run on a business model.
- ▶ There are too many examples of African airlines going bankrupt due to bad governance (i.e. interference by governments, incompetent management, etc.)
- ▶ Many African airlines have weak balance sheets and operational performances & sub-optimal or no credit experience. These pose major challenges in financing them. More reason why African airlines must be run on a commercial basis, regardless of ownership (private or state owned).

3. PPP in Aviation

PPP Investments in Aviation Infrastructure & The Supporting Institutions

- ▶ **Poor airport infrastructures** (lighting, navigation equipment, etc.) makes airline operations expensive in Africa.
- ▶ **Small airport traffic** - Very few airports in Africa have 500,000 passenger per year the level needed to make them viable.
- ▶ **Charges** - Landing fees, over flying charges, ground handling fees, etc, are high compared to the US and Europe making airline operations expensive in Africa.
- ▶ **African based financial institutions** - Capacity of African based financial institutions in PPP form should be developed to enable these institutions to serve Africa's growing aviation sector
- ▶ **Recommendations** - African governments must either invest or encourage investment (i.e. PPP model) of a sizeable percentage of their gross domestic product (GDP) in aviation infrastructure in order for their aviation sector to grow and contribute to their economies' growth.

4. Look for growth within Africa and Emerging Asia

Look for growth within Africa and Emerging Asia

- ▶ Inter-Africa trade and investment is increasing substantially
- ▶ Significant Chinese Investments into Africa + increasing number of Chinese Tourists – ADS (approved destination status)
- ▶ Expanding Indian investments in Africa
- ▶ Middle East Trade & Investments and Tourists, especially from the six oil rich GCC countries.

5. African Open Skies

African Open Skies

- ▶ If close to 20 African countries can sign “Open Skies” with the U.S., why is it difficult to make “African Open Skies” a reality?
- ▶ If the EU has Open Skies within Europe and the U.S., why can't there be “Africa Open Skies” for airlines from African Union (AU) member countries?
- ▶ BASAs amongst AU member countries must be eliminated ASAP and “African Open Skies” made effective! The Yamoussoukro Declaration was made in 1988 and the Yamoussoukro Decision concluded in 2000.

6. Investment in Human Capital (HC)

6. Investment in Human Capital (HC)

- ▶ Effective human capital development for the aviation industry can be delivered by outsourcing it to strong regional African airlines and other aviation focused organizations. For example:
 - ▶ Regional hubs for MRO and pilot training run by African carriers
 - ▶ Center for leadership training run by African carriers
 - ▶ African based learning institutions (colleges, etc.) can be used for developing aviation leadership training programs

**Our experience working with the most successful
airline in Africa**

Ethiopian is the biggest and most profitable airline in Africa



CONNECTING the world

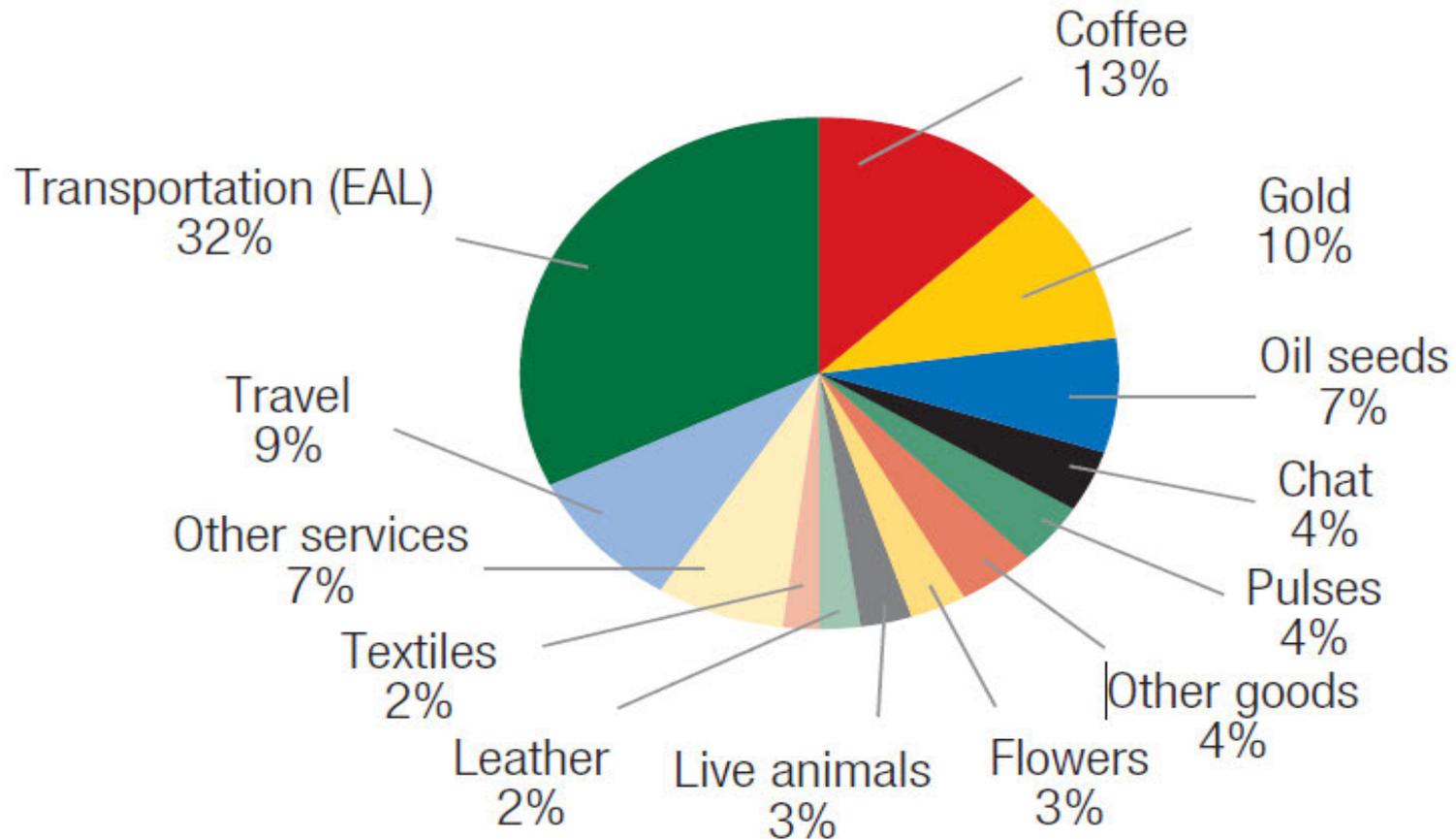
ETHIOPIAN AIRLINE'S 100% managed by Ethiopians.

RECENT #1 ACHIEVEMENTS:

- ✓ **#1** More profitable than ALL African airlines combined **;
- ✓ **#1** Largest number of aircraft in Africa; **
- ✓ **#1** Fastest growing African airline for six years in a row;
- ✓ **#1** Airline in Africa & the Middle East to fly the 787 Dreamliner and first in the WORLD after resumption of flights allowed by the U.S. FAA.
- ✓ ** = Sub Saharan Africa (SSA)

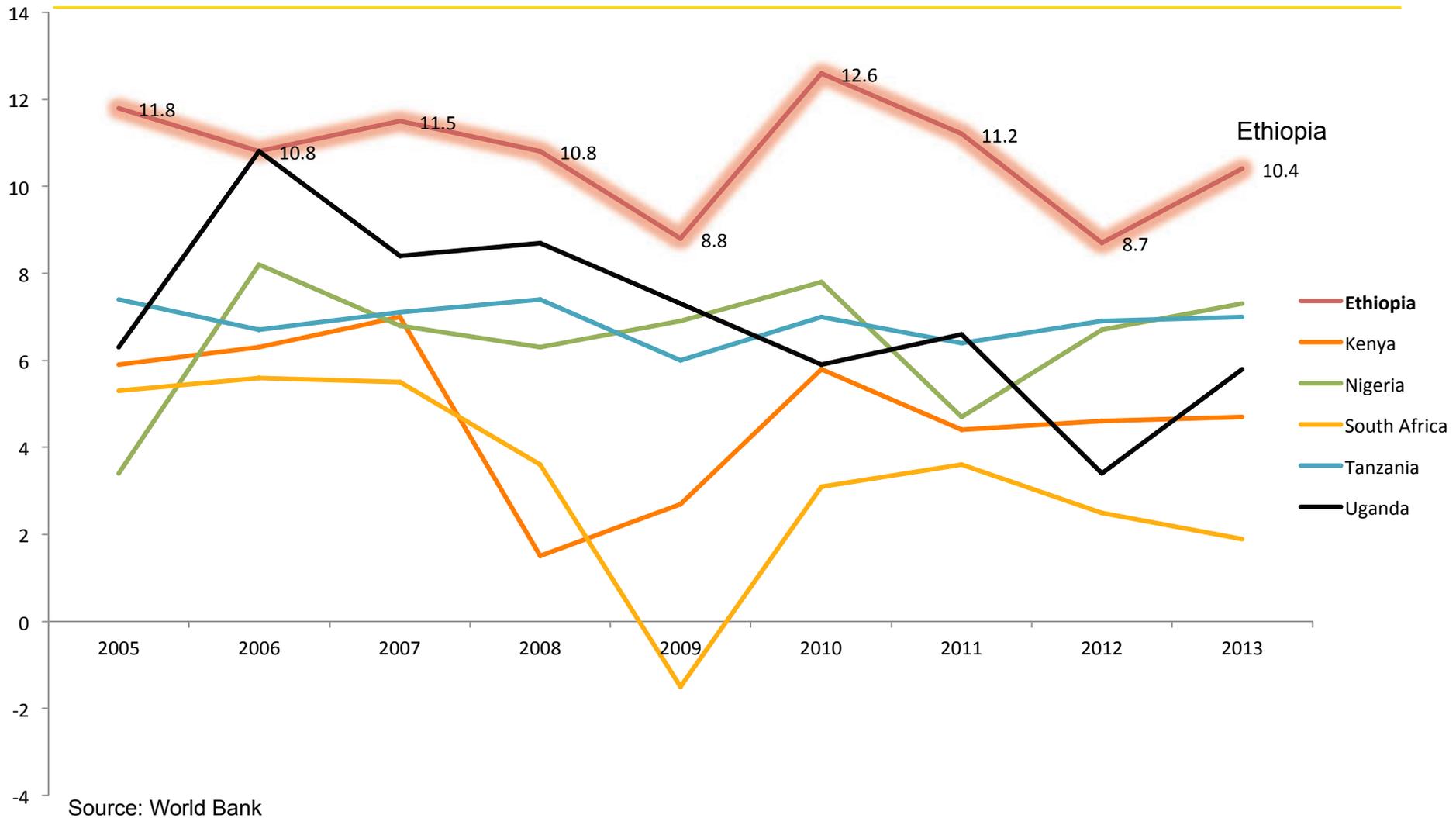
Airline	Profit (Loss) 2013
Ethiopian Airlines (ET)	\$143,000,000
South Africa Airways (SAA)	(\$42,000,000)
Kenya Airways (KQ)	(\$92,000,000)

Ethiopia's largest export is services led by Ethiopian Airlines which was three times more than coffee



Source: The World Bank's 3rd Ethiopia Economic update report, June 2014

Ethiopia's GDP growth is greater than comparative African Countries

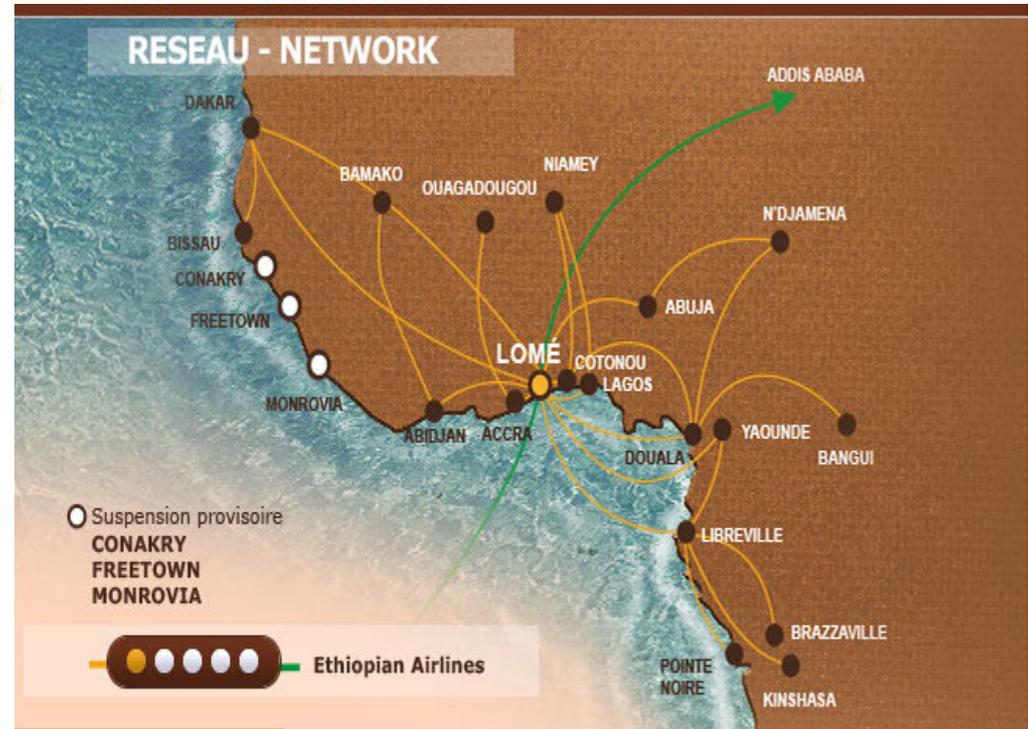


Our experience successful working startup airlines in Africa

Lessons from our experience - Successful startup airlines in Africa



Boeing 737-700 aircraft



Fleet size

8

Destinations

23

Lessons from our experience - Successful startup airlines in Africa



Started operations
January 2014



Lessons from our experience - Successful startup airlines in Africa



CONCLUSION

CONCLUSION

- ▶ **Enormous opportunities exist for African airlines in general and Nigeria in particular to grow and prosper. However, many issues have to be addressed including:**
 - ▶ **The need for Collaboration**
 - ▶ **Smart Regulations**
 - ▶ **Effective PPPs**
 - ▶ **Implementation of world class Corporate governance and**
 - ▶ **Investment in Human Capital**

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Ernst & Young in Africa



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