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## Russian passengers to flow overseas again

### Russian air transport market 2021 outlook

- **Air traffic will not grow until 2018.** Real incomes have been sliding for the fourth consecutive year, affecting air transport market indicators. In 2017, Russian air carriers will likely see their passenger turnover flat y-o-y at 215.1 bln passenger-kilometers (pkm), while the number of passengers carried is expected to decline 1% landing at 87.8 mln. In 2018, carriers will likely be supported by the 2018 FIFA World Cup, but the effect will be limited. After 2018, passenger traffic will be climbing 1–2% a year tailing recuperating household incomes, but, again, the 2014 level will be regained in the next four years. Cargo turnover and traffic are expected to gradually ascend till 2021.
- **Part of passenger flow will return to international routes.** The resumption of flights to Turkey and a possible lifting of restrictions on flights to Egypt will lead to a substantial redistribution of tourist flows between international and domestic destinations. In 2017, passenger turnover is likely to shrink 4.6% on domestic routes, but expand 3.8% on international ones (the latter has so far been declining starting 2014). International traffic boasts higher margins, so its growth may have a positive impact on the sector as a whole. However, not all of the air carriers will be able to benefit from this growth.
- **Air transport market concentration will continue to climb.** By end 2016, 10 largest air carriers boasted a market share of 93% in terms of passenger turnover and 99% in terms of cargo turnover. In the coming years, the market will likely continue to see its concentration on the upside, which may adversely affect creditworthiness of smaller regional carriers (in particular those operating mainly on subsidized routes).
- **The expected reduction in domestic air traffic may affect the performance of airports.** Redirection of part of passenger flow to international routes in 2017 could prompt a 5% decrease in the number of passengers serviced by Russian airports, while the domestic cargo segment may face a 6% decline. A gradual recovery in airport passenger flow is expected only after 2018. Financing large investment programs on the back of declining operating performance may affect airports' credit quality.

Table 1. Air traffic performance forecast

Indicator	Measurement unit	Actual				Forecast				
		2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Airlines</b>										
Passenger traffic	mln pax	84.6	93.2	92.1	88.6	87.8	90.9	91.4	93.3	95.3
<i>incl. international</i>	<i>mln pax</i>	45.3	46.9	39.5	32.2	34.5	37.3	37.3	38.3	39.1
<i>incl. domestic</i>	<i>mln pax</i>	39.2	46.3	52.6	56.4	53.2	53.6	54.1	55.1	56.2
Passenger turnover	bln pkm	225.2	241.4	226.8	215.6	215.1	223.9	226.4	231.7	236.6
<i>incl. international</i>	<i>bln pkm</i>	147.3	152.5	127.6	111.5	115.8	124.5	126.1	129.7	132.8
<i>incl. domestic</i>	<i>bln pkm</i>	77.9	88.9	99.2	104.1	99.4	99.5	100.4	102.0	103.8
Cargo traffic	th t	1,001	1,036	971	977	989	1,004	1,020	1,030	1,047
<i>incl. international</i>	<i>th t</i>	685	736	736	705	724	740	753	765	778
<i>incl. domestic</i>	<i>th t</i>	317	301	258	272	265	264	268	265	269
Cargo turnover	mln tkm	5,012	5,152	5,481	6,575	6,610	6,685	6,762	6,847	6,949
<i>incl. international</i>	<i>mln tkm</i>	3,984	4,174	4,668	5,716	5,776	5,841	5,908	5,985	6,070
<i>incl. domestic</i>	<i>mln tkm</i>	1,028	978	813	859	833	843	853	862	879
<b>Airports</b>										
Passenger traffic	mln pax	142.4	157.8	160.3	160.7	152.3	158.1	158.7	162.0	165.4
Cargo traffic	th t	944.1	880.9	769.4	840.2	789.3	788.1	799.6	794.0	806.0

Source: Federal Air Transport Agency, ACRA

By end 2016, Russian air carriers recorded a 5% decline in total passenger turnover to 215,6 bln pkm on the back of a 12.6% reduction shown by this indicator on international routes, while on domestic ones it surged 5%.

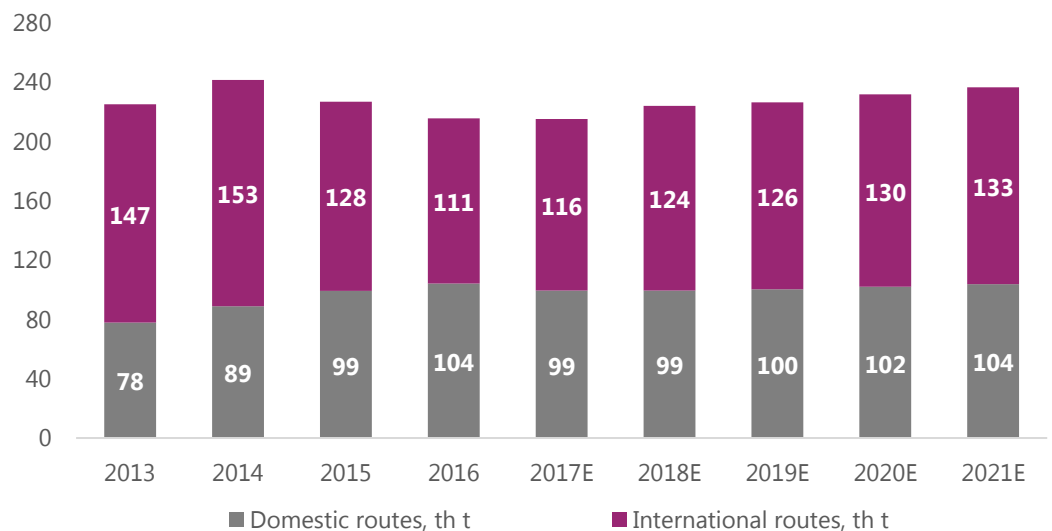
## Passenger turnover to stabilize in 2017

Despite a significant share the business segment has on the air transport market, the latter's performance came under a significant influence of changes in its tourist segment. Until 2014, domestic passenger turnover was climbing fueled, among other factors, by an increase in real disposable incomes. Starting 2014, its growth was propelled by a partial redirection of passengers from international to domestic destinations caused in turn by a number of macroeconomic and geopolitical reasons, such as a decline in personal incomes (especially in foreign currency terms), termination of flights to and from Turkey, Egypt and Ukraine, and restrictions on foreign travels for some categories of Russian citizens.

In mid-2016, the ban on charter flights to Turkey has been lifted, although this has not reflected upon international passenger turnover figures of Russian air carriers for the year. By ACRA's estimates, Russia may resume air traffic with Egypt in a year or two providing additional support to international air travel by redirecting part of the tourist flow to low-cost foreign destinations.

We expect macroeconomic indicators to stabilize in 2017, although real incomes may still show a slight decline. Despite an air travel increase in January, this may dampen domestic passenger turnover for the year by 4.6% to 99.4 bln pkm, while the figure for international routes is expected to surge 3.8% to 116 bln pkm. The 2017 total will likely remain close to the 2016 level running into 215.1 bln pkm. In 2018, fans flying to the 2018 FIFA World Cup will support the market, but the effect will be limited. In subsequent years, we expect the market to gain 1–2% a year, although it will hardly reach the 2014 level by 2021.

**Figure 1. Passenger turnover growth may be expected only starting 2018**



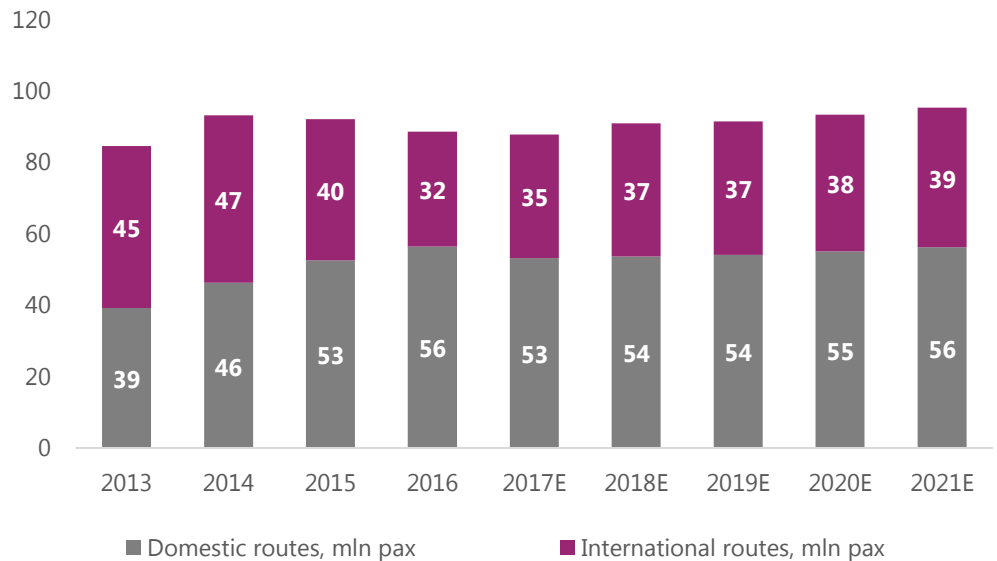
The forecast was made in compliance with [General Principles of Socioeconomic Indicators Forecasting](#).

Source: Federal Air Transport Agency, ACRA estimates

## Passenger count declines, average flight distance increases

The number of passengers carried on international routes declined faster (-19%) in 2016 than international passenger turnover (-12.6%), due to a significant change in the average flight distance per passenger, which climbed last year 7% to 3,466 km. Although redistribution of passenger flows between domestic and international routes has led to an increase in the number of passengers carried on domestic routes, this had no impact on the average flight distance per passenger (1,846 km).

**Figure 2. Number of passengers carried on domestic routes to gradually decline starting 2017**



Source: Federal Air Transport Agency, ACRA estimates

By ACRA's estimates, the renewal of charter flights to Turkey will pave the way in 2017 for a shorter average international flight distance, which, nevertheless, will remain above the 2015 level, while its further growth will hinge upon removal of restrictions on flights to Egypt and real disposable income growth. On domestic routes, a continued increase in short flight availability will help further reduce the average flight distance and may provide support to operating performance of carriers operating in this segment thanks to passengers churning from railways.

**Table 2. Average international flight distance per passenger surged dramatically in 2016**

	2013	2014	2015	2016	2017E	2018E	2019E	2020E	2021E
International, km	3,249	3,252	3,230	3,466	3,352	3,366	3,378	3,391	3,398
Domestic, km	1,985	1,921	1,888	1,846	1,867	1,859	1,855	1,851	1,846

Source: ACRA estimates

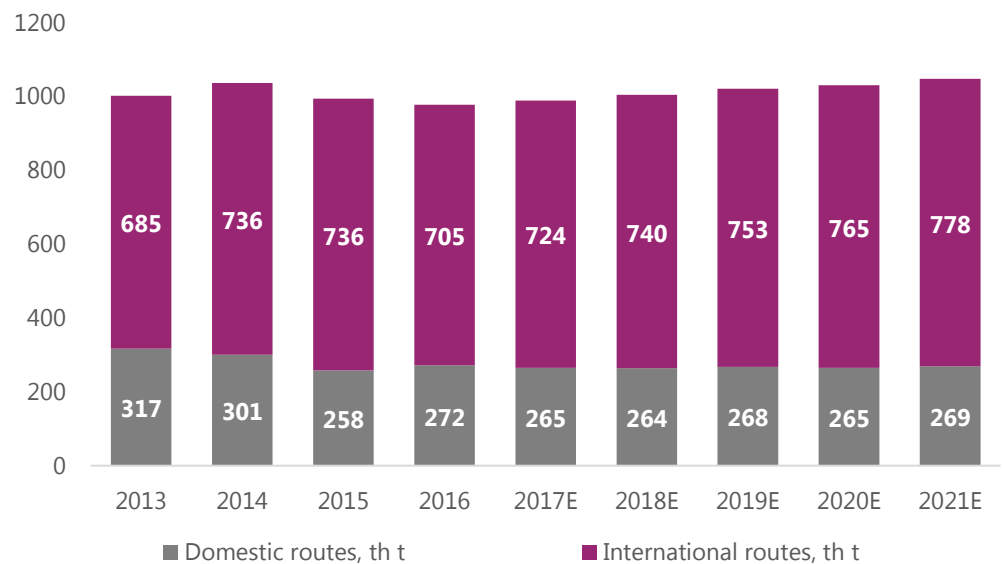
## Air freight distances increased

In 2016, cargo and mail traffic of Russian carriers totaled 977 th t which is in line with the 2015 figure. That said, international cargo traffic went down 4% while its domestic counterpart posted a 5% increase. International cargo traffic decline was offset by a surge in the average transportation distance per one ton of cargo (from 6,342 km to 8,105 km), thus leading to an international cargo turnover increase by 22% to 5,716 mln tkm. Total cargo turnover went up by 20% and equaled 6,575 mln tkm at year-end 2016.

Cargo traffic dynamics are largely determined by operating results of AirBridgeCargo, the largest player in this segment. The company accounts for 51% of total cargo traffic and 75% of total cargo turnover of Russian air carriers. In 2016, AirBridgeCargo carried 4.5% less cargo than in 2015, but its cargo turnover climbed 26% thanks to the average transportation distance.

Further change in domestic cargo traffic will be largely determined by the dynamics of fixed investments by Russian businesses. ACRA estimates that a reduction in fixed investments in 2017 may cost domestic cargo traffic as much as 3% in volume. The international segment is less dependent on Russia's macroeconomic indicators due to a high share of foreign customers, and ACRA expects a gradual increase in the volume of shipments on international flights by 2021. Geopolitical changes may have extra influence on the international cargo dynamics.

**Figure 3. Air cargo traffic to gradually increase in coming years**



Source: Federal Air Transport Agency, ACRA estimates

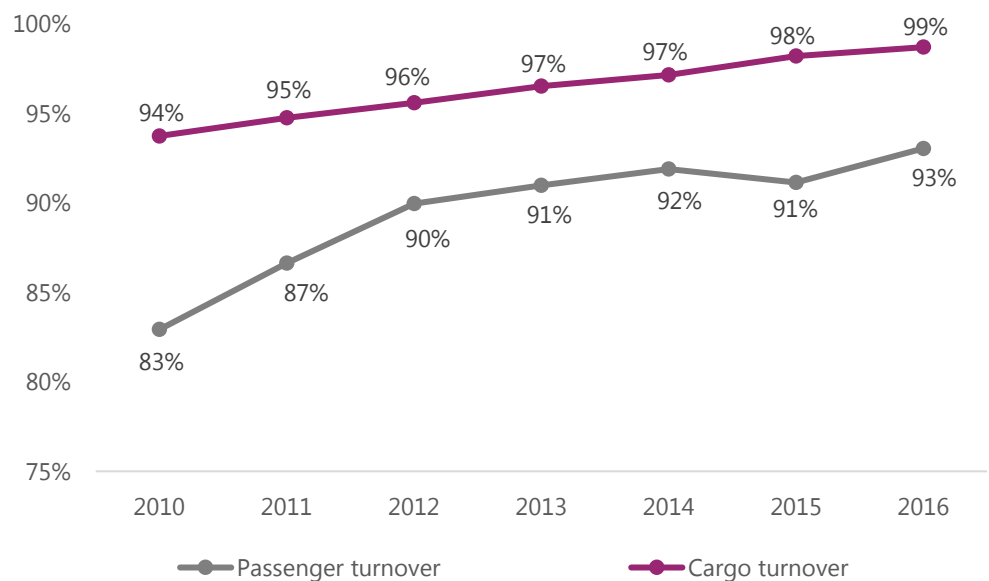
The market share of 10 largest carriers was calculated based on the consolidated operating results of Aeroflot Group (Aeroflot, Rossiya, Orenburg Airlines, Donavia, Pobeda, Aurora), Volga-Dnepr Group (AirBridgeCargo, Volga-Dnepr, Atran), and results of Siberia Airlines were increased due to results of Globus Airlines.

## Air transport market concentration to continue climbing

In recent years, the air transport market in Russia has been characterized by a growing market share held by largest players. The share of 10 largest carriers in terms of cargo turnover went up from 94% at year-end 2010 to 99% in 2016 while the share of 10 largest carriers in terms of passenger turnover increased from 83% to 93% over the same period (not including foreign carriers).

In 2016, even Aeroflot Group went through a consolidation process resulting in Donavia and Orenburg Airlines merging with Rossiya.

**Figure 4. Market share of 10 largest carriers is increasing both in cargo and in passenger segments**



Source: ACRA estimates

As a result of continuing growth in largest carriers' market share, small companies focusing on regional flights (in particular those that operate mainly on subsidized routes) and not having access to high-margin international routes fall into the risk area. Typically, such companies try to steer clear of competing directly with major market players. Inability to break into more profitable routes coupled with a declining market share may reduce flight profitability and adversely affect small carriers' credit quality. In the long run, this may force smaller carriers leave the market while major players would further build up their market share.

By ACRA estimates, by 2021, the market share of 10 largest carriers in the passenger segment may reach 95–98%, while the share of 10 largest carriers in the cargo segment could remain at the current level.

## Financing large investment programs may affect airports' credit quality

Since 2014, passenger traffic in Russian airports has been growing 1% annually due to a passenger flow shift from international to domestic destinations. From 2014 through 2016, the utmost passenger turnover increase among 25 largest airports in Russia was registered in Simferopol (+94%), Sochi (+72%), and Anapa (+41%). Excluding these airports, total passenger traffic showed a 1% decline over the period. As for the air freight segment, airports managed to show an upturn (+9%) for the first time since 2013, which is fully in line with domestic cargo traffic dynamics.

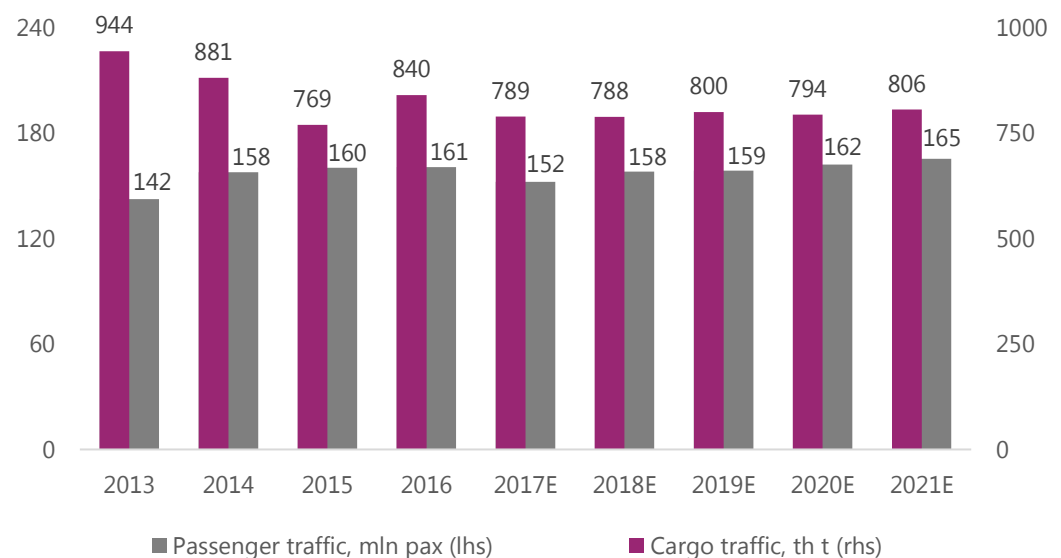
The only airport of the Moscow Air Cluster (MAC) that showed passenger turnover growth (+7.7%) in 2016 was Sheremetyevo, while for the MAC as a whole this indicator declined 2%. Cargo traffic processed by the Moscow airports in 2016 went up 14.5%.

By ACRA's estimates, in 2017, the anticipated domestic traffic decline may affect Russian airports' performance. We expect passenger and cargo traffic to shrink 5% and 6% respectively. The 2018 FIFA World Cup will exert an additional positive effect on passenger flow at Russian airports, however the related increase will not be significant. After 2018, we expect a gradual recovery of airports' passenger flow while their cargo flow will remain comparable with that of 2017.

Currently, some major investment projects are implemented or planned at some airports, in particular, at those located in cities hosting the 2018 FIFA World Cup. Significant capex will put airports' cash flows under pressure.

Cash outflows to finance investment programs' implementation and extended payback period on the back of anticipated operating performance decline may result in airports' credit quality deterioration in the near future.

**Figure 5. Airports' performance is going to dwindle in 2017**



Source: Federal Air Transport Agency, ACRA estimates

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