

After the dust has settled...

Financial fallout from the Icelandic volcano



The head of IATA (International Air Transport Association), the airlines' international trade body, estimated global losses at \$250m (£164m) per day. This does not take into account the costs of repatriating those holiday makers stranded abroad. Although flight restrictions have now been lifted the financial pain will continue to be felt for some time.

Implications – Cash and Claims

We anticipate travel and airline companies are likely to require further funding to see them through the current difficulties, as we outline below:

- Less cash in – new bookings will have reduced on the uncertainty and hence cash flows have declined. This is usually the peak season for cash generation as holidays are booked for the summer months and any shortfall is likely to have an adverse impact on future funding requirements..
- More cash out – costs of repatriating stranded holiday makers are likely to be born substantially by the airlines and tour operators.
- Insurance cover uncertainty – individual policy cover can vary between airlines, tour operators and passengers. However consumers may have further protection under the Consumer Credit Act 1975 and the credit and debit card “chargeback” scheme.

- Collateral requirements – the merchant service provider may incur higher claims under the Consumer Credit Act and any “chargeback” facility (if operated). Concern over the merchant service provider’s exposure could lead to requests for extra cash collateral to minimise exposure and hence put further pressure on funding levels.
- Impact on future bookings – uncertainty over the duration of the volcano activity may deter future overseas bookings and encourage “staycations”, particularly when combined with the World Cup.
- Claims management – to protect brand reputation a robust and consistent claims management process must be instigated, setting out the “reasonable” costs that will be met, and capable of handling high volumes of queries. In the event these costs can be recouped from corporate insurance policies then the process should incorporate the insurers requirements.

PwC have extensive experience of helping companies raise funding

(renegotiating existing debt terms as well as accessing new debt and equity) and improve working capital (through increasing the speed of collection of monies due from travel agencies and other intermediaries, improved query resolution processes and the deferral of tax liabilities through the HMRC “Time to Pay” scheme). We have extensive experience, both in the design and implementation of cost effective claims settlement processes within the insurance industry and other sectors. This includes web based solutions for claims submission.

If you would like to discuss these issues, or any others, please contact our travel industry experts, Bruce Cartwright (0131 260 4087), Ian Oakley-Smith (0207 212 6023) or Caroline Rifkind (0207 213 1033) who will be happy to meet and discuss any issues or concerns you may have.



Primary impact

The following sectors are most directly exposed to the flight restrictions and the costs of repatriating stranded holiday makers.

Airlines

Faced with steep declines in revenue due to the widespread flight restrictions in Europe many EU carriers will also be hit by the legal obligations under EC Regulation 261/2004. Carriers are aware that, in circumstances of long delays or cancellations, they will be faced with obligations not only to provide care and assistance (including, where applicable, hotel accommodation) but also reimbursement and/or re-routing.

The only positive for the airlines is that the CAA are of the view the volcano activity counts as “extraordinary circumstances” under the regulation and so no monetary compensation for delayed or cancelled flights is expected.

Those hoping the extra costs may be covered by insurance are likely to be disappointed. AON Aviation said, “Successful claims against standard airline liability insurance policies due to delays as a result of the volcanic eruption in Iceland are unlikely. This is a natural event and there has not been any actual damage to aircraft or property at this stage.”

BA and other airlines have put a request in to the EU which is considering allowing state aid for carriers in a similar manner to that provided in the aftermath of 9/11.

Currently the only winners appear to be alternative transport modes such as rail, ferries and car hire firms which are repatriating stranded holidaymakers.

Tour operators

Tour operators face similar obligations to airlines, as under the terms of the ATOL regulations which apply to all package holidays which include a flight, they must make alternative return arrangement for those already on holiday and offer an alternative date or reimburse those that were unable to go on holiday.

TUI Travel, the First Choice to Thomson holiday group, said the closure of airspace due to the ash cloud over Europe caused by the eruption of an Icelandic volcano had cost it £20m over the first four days. The company said that about 100,000 customers had been unable to return home from holiday as a result of the closure.

Flight websites

Travel comparison websites are likely to experience a drop in traffic and at least a deferral in bookings. These sites can act as principal or as agents and so may be required to reimburse holidaymakers

who were unable to travel. It is not known what protection their insurance policies may provide against these costs.

Passengers

Travel insurance cover depends on individual policy wording and many policies have treated the Volcano as an “Act of God” and will not cover extra costs of return. Other insurers have treated the situation as a “bad weather event” and will provide assistance. In either case it is up to the airlines to provide help first.

In addition refunds may be available if an individual booked by credit card (and ticket was more than £100) or if paid by debit card and their bank is part of the “chargeback” system.

Secondary impact

The following sectors could also be impacted:

Business

Logistic groups such as DHL have already re-routed deliveries to land transport. Other sectors likely to be impacted are manufacturing processes that demand just in time deliveries such as some parts of the automotive, electronics and pharmaceutical sectors. BMW has already halted production of

some models. Perishable goods such as cut flowers and some vegetables/ fruit are also likely to be affected.

Insurers are confident they will not have to pay out, because contingent business interruption, such as delayed delivery of parts to factories or construction sites, is not covered. “It’s only triggered by material damage and this has not occurred,” an Allianz spokesman said.

Airports

Reduced passenger numbers have lowered retail and catering revenues. This is likely to affect the retailers but not the airports who tend to operate as landlord and charge rent. As the majority of shops are part of major chains, the foot traffic shortfall is unlikely to have a material affect on companies overall performance. Indeed, they may also benefit as travellers are repatriated.

Airports receive a landing fee from the each passenger arriving which, for Heathrow, has seen a reduction in income of some £2m per day.

Aircraft support services

Potential fallout as many support functions are contracted out. Key areas are those for ground services including baggage handling and catering which are often outsourced from the airlines



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