



Aviation Insights Review (AIR): 2017 Global Airline Industry Performance Update

Another year of strong performance

The global airline industry has long been criticized for its inability to earn sufficient returns. But in 2016, for the second consecutive year, the industry generated approximately \$17 billion in economic profit (EP), down from the 2015 record of roughly \$25 billion.

L.E.K. Consulting defines economic profit as the surplus after-tax operating income that companies generate after charging for the capital they employ, and we use EP as an important gauge of an airline's ability to meet its shareholders' financial requirements over time. Although total shareholder returns are insightful, they depend on arbitrary start and end dates and often are governed by market movements as much as (or more than) by the idiosyncratic elements impacting the airline.

This Aviation Insights Review provides an update on the global airline industry for the period ending in 2016. Last year, the aviation industry as a whole generated a positive EP, continuing a trend that began in 2010 but really began to take hold in 2015. Figure 1 shows the top 10 performing airlines, on an EP basis, across all geographic regions for 2012-2016.

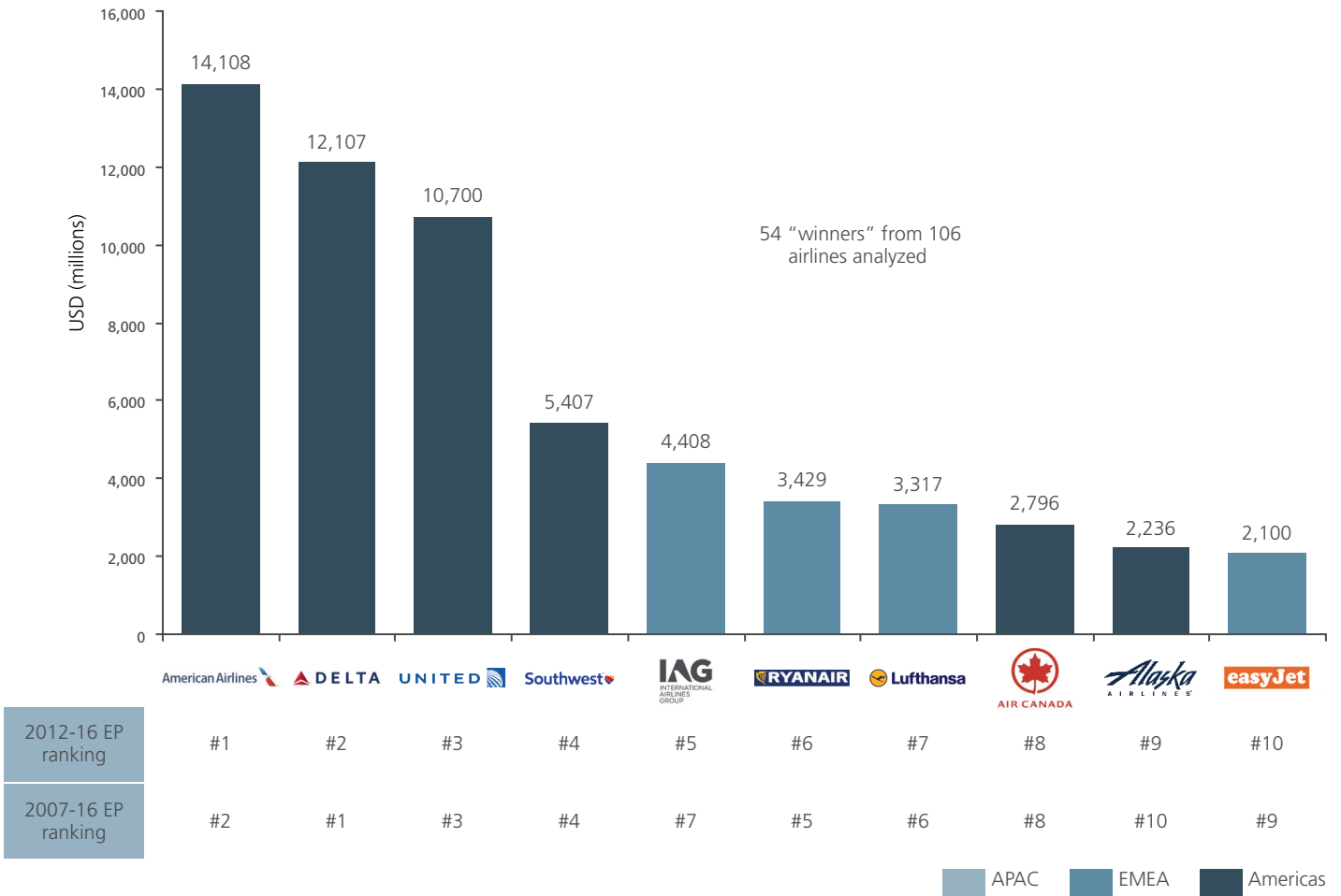
The sheer magnitude of the EP generated by the top 10 performers over the past five years is remarkable. Some additional observations:

1. Of the 106 reporting airlines that we analyzed, approximately 51%, or 54, were EP-positive in 2016.
2. As in 2015, those 54 airlines collectively generated a very robust, positive EP — more than enough to cover the laggards' negative EP — so that overall the industry generated a net EP of ~\$17 billion in 2016.
3. Low oil prices continued to be a significant contributor to EP in 2016, with the average price of oil slightly lower than in 2015 (Brent averaged ~\$44/bbl in 2016 versus ~\$53/bbl in 2015). However, oil prices are forecast to climb in 2017, creating a headwind for future profitability.
4. Ultra-low-cost carriers (ULCCs) globally have the highest EP as a percentage of revenue.
5. U.S. carriers continue to be the most lucrative airlines in the world, with all major U.S. carriers generating significant positive EP in 2016 and over the past five years.
6. The four largest U.S. airlines retained their distinction not only as the top EP earners for the past five years, but also as the four largest market-cap airlines in the world, demonstrating that the financial markets are recognizing the value these airlines are creating.

Aviation Insights Review (AIR): 2017 Global Airline Industry Performance Update was written by **Dan McKone** and **Alan Lewis**, Managing Directors, and **John Nevin**, Principal, in L.E.K.'s Travel & Transport practice. Dan, Alan and John are based in Boston.

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Figure 1
Top 10 economic profit generators, by absolute dollars (2012-2016)



Note: Airlines that had reported 2016 earnings by April 15, 2017, were included
Source: L.E.K. analysis of Capital IQ, Bloomberg, DOT Form 41; annual reports

In addition to this strong performance, we see evidence of a number of positive developments for the industry. In particular, 2017 should bear witness to:

1. Continued pursuit of international partnerships, particularly immunized joint ventures, to effectively drive international consolidation
2. Continued drive toward greater consolidation/rationalization
3. More aggressive aircraft deferrals to limit capacity growth
4. Continued product customization, with full-service carriers offering ULCC-like products (e.g., "basic" economy fares, LCC business units) and with ULCCs leveraging more

business-friendly features (e.g., major airports, flexible fares, connecting itineraries)

5. Migration to more sophisticated merchandising techniques
6. Greater personalization through significant technology investment

The success of 2016 will no doubt stimulate new forms of competitive rivalry. To maintain this healthy trajectory, the aviation industry needs to take proactive measures to continue to evolve the model and challenge the conventional wisdom that aviation cannot be a sustained profit business.

About the Authors



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John Nevin is a Principal in the Boston office of L.E.K. Consulting, focusing on the aviation and transportation sector. He helps clients address major issues facing today's airlines

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