EXECUTIVE INSIGHTS

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Aviation Insights Review (AIR) – Full Service Carriers

The global airline industry is constantly chastised for its inability to earn a long-term profit, let alone generate economic profit. But this perception isn't completely accurate. In its new Aviation Insights Review (AIR) series, L.E.K. Consulting will pay credit to those participants in the global aviation industry that have in fact generated attractive returns to shareholders – be they full service carriers, low cost carriers, regional carriers, U.S. carriers, airports, emerging market carriers, or manufacturers that have broken the mold.

As a leading strategy advisor to the aviation industry and expert on shareholder value analysis, L.E.K. uses economic profit as the relevant measure to gauge a company's ability to meet the financial requirements of its stakeholders over time – whether it's debt holders or shareholders. While total shareholder returns are insightful, they are too dependent on the random start and end dates that can be adversely affected by any number of market conditions at the time. (L.E.K. broadly defines economic profit as the surplus the company generates after charging for the capital that it employs at its relevant cost of capital rate.)

This inaugural AIR report will focus on full service carriers (FSCs) – often the part of the market that the pundits have written off as a failing business model. However over the decade of 2001-2010 when the industry suffered some significant economic blows ("black swan" events) such as the tragedy of 9/11, the outbreak of SARS and the Avian/Swine Flu, skyrocketing fuel prices in 2008, and the financial crisis of 2009/2010, there were a handful of FSCs that generated significant economic rewards to their shareholders. And as Figure 1 illustrates, the returns were significant.

Figure 1

Top-Five Highest Performing Full Service Carriers (2001-2010)

Carrier/Rank	Cumulative 10-year Economic Profit	Total Shareholder Return
1. Singapore Airlines (Singapore)	U.S. $2.9 billion	46.2%
2. LAN Airlines (Chile)	U.S. $1 billion	2,349%
3. Copa Holdings, S.A. (Panama)	U.S. $644 million	128%
4. Lufthansa (Germany)	U.S. $619 million	(14.2)%
5. Cathay Pacific Airways Limited (Hong Kong)	U.S. $253 million	124%

Source: L.E.K. Analysis

To reiterate, these are economic profit numbers – i.e., the returns generated <u>over and above</u> the returns that the shareholders required.

After an exhaustive study of the global airline industry, L.E.K. has derived a set of strategies that these winners utilize in order to drive success. Some are situational and others are deliberate strategies that underpin their superior performance, including:

- Tapping into emerging markets and being ahead of the demand curve
- Having a strong market position in a well-defined market that can include a geography or a customer segment

Aviation Insights Review (AIR) – Full Service Carriers was written by **John Thomas**, a Vice President and Head of L.E.K. Consulting's global Aviation & Travel Practice. John is also a member of IATA's Travelling Passenger Vision 2020 working group, which is a part of the Simplifying the Business initiative.

- Developing and nurturing a portfolio of complementary companies, and ensuring that each company's strategy is tailored for its individual market segment
- Innovating to stay ahead of the commoditization trend
- Consolidating to gain a value-creating scale

L.E.K. would like to commend Singapore Airlines for the tremendous amount of economic profit that it has generated during this past decade. Apart from excellent management, we believe that Singapore Airlines' two primary strategies that have sustained this superior performance are:

1. Nurturing a portfolio of assets. Singapore Airlines, like many other airlines, recognizes that "one size does not fit all." Instead, to meet changing market demands you need the right set of airlines that have quite different business models. Singapore Airlines has its flagship brand that provides a premium customer experience both within Asia and around the world. Additionally, it has the SilkAir brand that provides regional flying on thin leisure routes as well as its investment in Tiger Airways that focuses on providing the lowest cost operation for the most fare-sensitive passengers. And it's recently launched a long-haul low-cost carrier, Scoot. Added to this, Singapore Airlines has very successfully established three of its core support services into very viable standalone entities that meet the needs of Singapore Airlines as well as many other airline customers – namely SATS in the area of both above- and below-wing airport support services, SIAEC in aircraft maintenance and SIACargo providing dedicated B744 cargo lift.

2. Driving innovation. Singapore Airlines has stayed "above the commoditization fray" by continuously innovating in areas where passengers most value it. Examples include being the launch customer for the A380, First Class Suites on the A380, ultra-long haul routes, all premium-class dedicated services, and its revolutionary Business Class product launched a few years ago on the B777-300ER and A340-500 aircraft.

Singapore Airlines has proven that even under tough economic conditions in an industry that is overall unprofitable, good management and the right strategies can keep all stakeholders well rewarded.

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and analytical rigor to help clients solve their most critical business problems. Founded more than 25 years ago, L.E.K. employs more than 900 professionals in 20 offices across Europe, the Americas and Asia-Pacific. L.E.K. advises and supports global companies that are leaders in their industries – including the largest private and public sector organizations, private equity firms and emerging entrepreneurial businesses. L.E.K. helps business leaders consistently make better decisions, deliver improved business performance and create greater shareholder returns.

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