

Aviation Insights Review (AIR): 2014 Global Industry Performance Update

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 Aviation Insights Review (AIR) series, L.E.K. Consulting gives credit to those participants in the global aviation industry that have generated attractive returns to shareholders – be they full service carriers, low cost carriers, or regional carriers.

As the 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. 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 AIR report provides an update on the period ending in 2013 for the entire global industry. Given both the dramatic turnaround in the U.S. and the rapid pace of change across the entire industry over the past five years, we have provided two timeframes for comparison: the cumulative five-year financial performance ending in 2012 (Figure 1) and ending in 2013 (Figure 2). This comparison shows a growing divergence between the winners and laggards, and that the leading industry players generated significant returns in the five years ending in 2012.

A comparison of the two time frames also yielded several interesting observations:

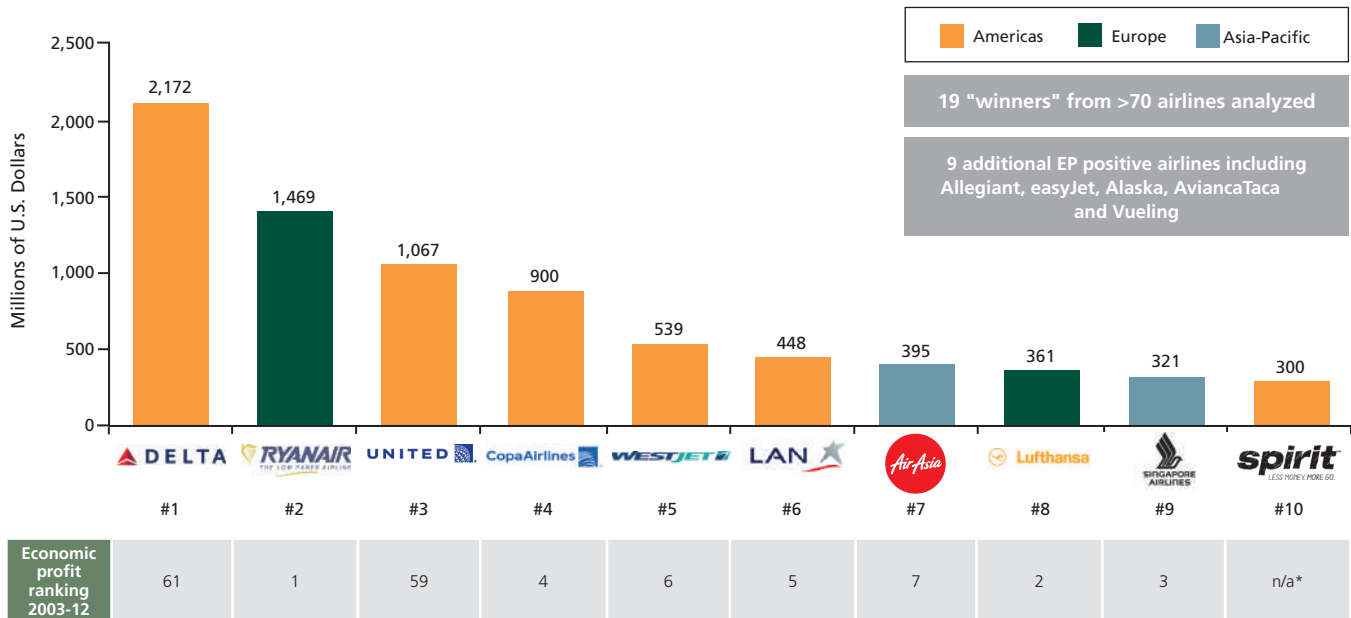


Aviation Insights Review (AIR): 2014 Global Industry Performance Update was written by **John Thomas**, a Managing Director and Partner, and a member of the Global Leadership Team at L.E.K. Consulting.

John heads L.E.K.'s global Aviation & Travel practice and is also active in our Private Equity practice. John has more than 24 years of experience in strategy, financial, commercial, operational and organizational consulting to the aviation industry. He has worked with most of the leading airlines around the world (both legacy and LCC) on a broad range of major issues. For example, he has been instrumental in the adaptation of merchandising (ancillary revenue) to the airline industry and has advised on many of the major merger and acquisition deals in the industry. He has worked with OEMs, CNS/ATMs, airports, tour operators, travel destinations, cruise lines, hotels, resorts, loyalty programs and caterers, and has extensive experience in the GA and Corporate Aviation industries. He has worked with clients in North and South America, Europe, the Middle East and the Asia-Pacific region. John is also a member of IATA's Travelling Passenger Vision 2020 working group, which is a part of the 'Simplifying the Business' initiative.

1. The list of carriers with a five-year cumulative economic profit (EP) grew in 2013 (22 versus 19 on the 2012 list).
2. The winners in the second group (Figure 2) pulled substantially away from the rest of the industry, primarily based on very strong financial results in FY 2013. The financial markets clearly see this performance as

Figure 1
Top 10 Airlines By Economic Profit (2008-2012)

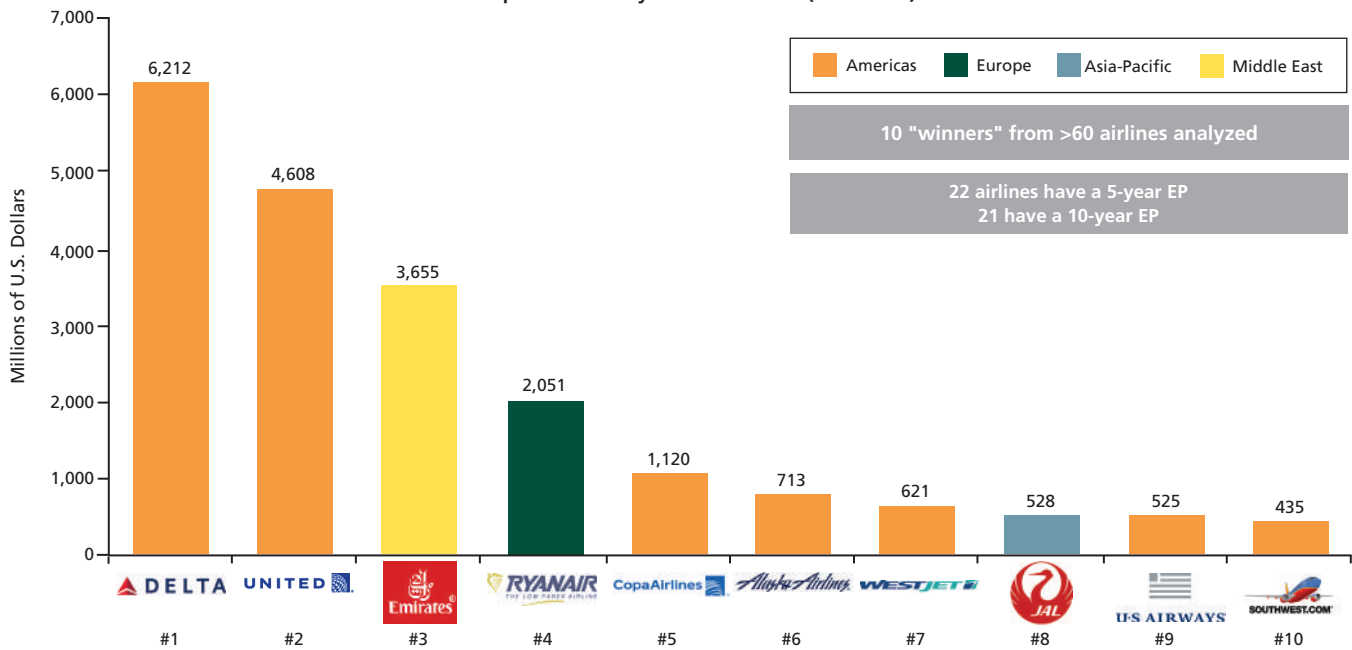


Note: * Due to lack of data availability
 Source: Capital IQ, Bloomberg, CompuStat, DOT Form 41, L.E.K. analysis

- 3. All the major U.S. carriers were EP positive for the five years ending in 2013.
- 4. Fundamental structural changes for which the industry has lobbied for decades have the potential to radically change the financial health of the industry. In the case of the U.S. the three major mergers (Delta/Northwest, United/Continental and American/US Airways) took excess structural capacity out of the industry, and the adoption of ancillary revenues took the pressure off making money on the core product (similar to the business models of lots of other highly successful industries).
- 5. The only full-service Asian carrier on the list was able to go through a managed restructuring that recast its business model to one appropriate for the current market conditions.
- 6. The list is devoid of any European full-service carriers, which is not surprising given the continued inability of European carriers to complete the fundamental market restructuring which has not only put other carriers on firmer financial footing, but also allowed them to recast their business models to generate the returns that make the airline industry appealing to investors. It also brings into question the efficacy of the M&A process in Europe. In the U.S., M&A delivered significant structural benefits that flowed straight through to the improved financial results of those airlines, but it was only achieved through a "take-no-prisoners" approach to their newly combined networks – which were not held captive by local politics.

Figure 2

Top 10 Airlines By Economic Profit (2009-2013)



Economic profit ranking 2004-13	7	10	1	2	4	8	6	59	46	27
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Note: This analysis excludes the 2013 results of the following carriers: Air Berlin, Alitalia, China Airlines, Cyprus Airways, EVA Airways, Jet, Kenya, Malaysian, Meridiana Fly, Norwegian Air Shuttle, PIA (Pakistan), PAL, and Singapore.
 Source: Capital IQ, Bloomberg, CompuStat, DOT Form 41, L.E.K. analysis

About L.E.K. Consulting Aviation Practice

L.E.K. Consulting is the premiere advisor to the global aviation industry and related aviation, airport, aerospace and travel ecosystems. Having completed more than 700 aviation engagements spanning airlines, airports, B&GA and aviation authorities, L.E.K. Consulting has guided companies across the aerospace value chain for more than 25 years. Just recently, the firm's expertise into some of the most complex and pressing challenges facing the industry helped five global carriers double their market capitalizations over the previous five years.

Our wide-ranging capabilities have evolved from a deep-seated commitment to unleash powerful revenue streams. Our expertise encompasses: airline M&A and consolidation, operations optimization, corporate and network strategy, new product development, ancillary revenue/merchandising, loyalty programs, customer flight experience, consumer engagement "Beyond the Cabin," and flight operations and optimization.

L.E.K. Consulting's unified global reach and methodical analysis provides senior industry executives with the confidence to make game-changing decisions in the face of market instability.

INSIGHTS @ WORK[®]

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 30 years ago, L.E.K. employs more than 1,000 professionals in 22 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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