



New study on airline investor returns

Regional divergence impacting overall performance

New study sheds light on airline financial sustainability...

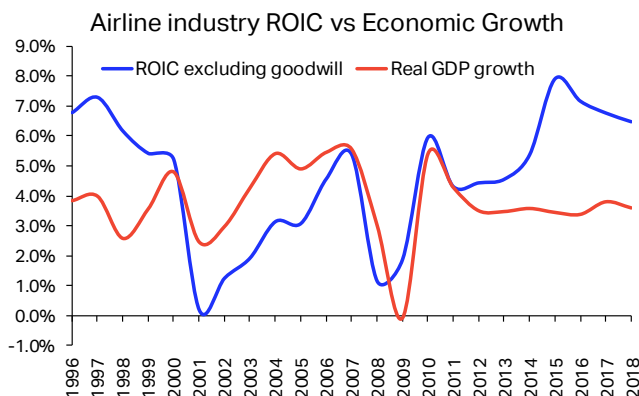
International Air Transport Association (IATA) has conducted air transport industry value chain analysis with McKinsey & Company since 2005 [See reports](#). The purpose of this analysis is to quantify the profitability along the air transport value chain and to provide actions to improve profitability of the industry. The latest study has been recently updated by McKinsey using the latest available annual data up to 2018.

Before publishing the detailed value chain analysis over the whole chain, in this preliminary short note, the recent findings regarding the profitability of airlines and the differences between our previous estimations will be discussed.

Despite headwinds, the return on invested capital has improved...

During the past five years, the global airline industry's return on invested capital (ROIC) has improved significantly. Since 2014 industry-wide ROIC increased by 2.5 ppts to an average of 6.7% compared the previous five year period of 2009-2013. Airline ROIC decoupled from the economic cycle partly due to the fall in fuel prices, but also because of structural changes to the industry and product in some regions (Figure 1). The study found that the improvement was not at the expense of suppliers (Figure 5), who mostly saw their own ROIC improve.

Figure 1: Airline industry ROIC vs global GDP growth



Source: McKinsey& Company for IATA, IMF WEO

Industry-wide ROIC reached its peak in 2015 as the average fuel prices declined to its lowest level since 2004 as fuel (c. 25%) is the largest operating expense at most airlines.

It should also be noted that although the industry-wide ROIC declined following the peak in 2015, the latest 2018 figure has been still higher than the peak of previous five-year cycle (2009-2013), due to structural improvements.

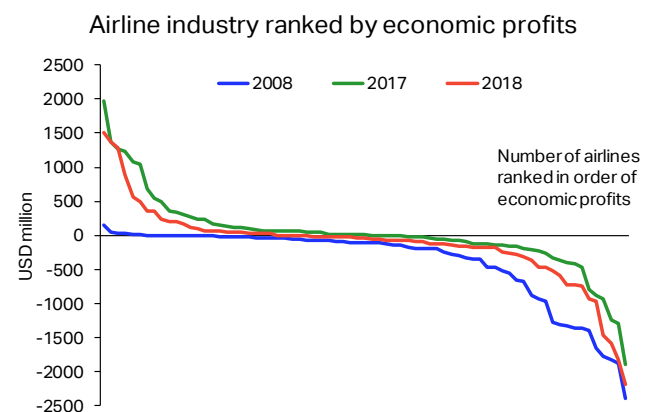
Only a few airlines create value consistently...

A relatively small number of airlines have driven the improvement in the aggregate industry-level profitability over the past decade. These airlines account for c.55% of the industry's operating profits and 45% of RPKs flown, but there are many airlines that have not shared in the improvements seen in the industry level numbers.

Figure 2 depicts the ranking of the airlines by economic profit (return on investment – cost of capital in USD terms). It shows that the improvement in profitability has been driven by small group of c. 30 airlines over the past 10 years.

Most companies placed in the middle generate just enough ROIC to meet investor expectations (the cost of capital). But there is also a group of airlines still making significant losses as indicated by the long right tail of the graph. It is this group that depress overall industry ROIC.

Figure 2: Airline industry economic profit ranking



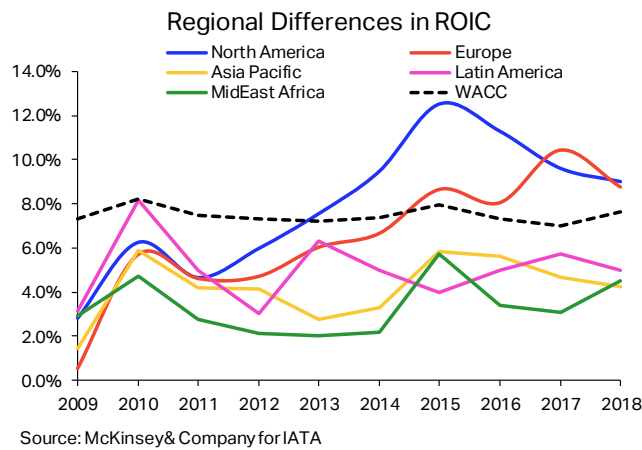
Source: McKinsey& Company for IATA

North American & European airlines are value creators...

Until 2014, industry-wide airline returns have not been as high as the industry's cost of capital in any of the regions (Figure 3). However, in the last five years, the picture has improved, albeit with considerable regional differences.

North American and European airlines have created value for their investors since 2014. In this period, North American airlines benefitted more than other regions from consolidation, a focus on returns rather than market share, and product unbundling. On the other hand, regions including Asia Pacific, Latin America, Middle East and Africa continued to destroy investor value in aggregate.

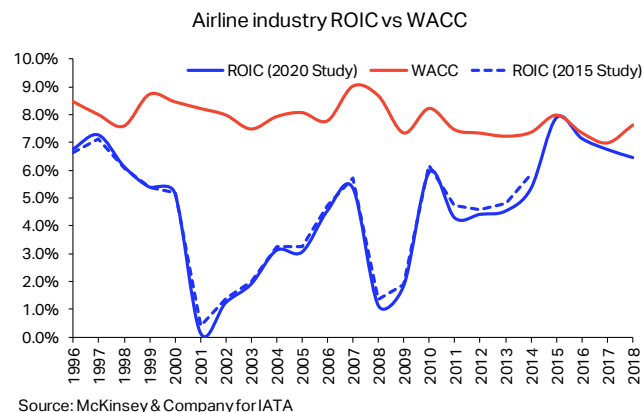
Figure 3: Regional airline industry ROIC vs weighted average cost of capital



But regional gaps in value creation impacts overall industry outcome...

Even though the carriers in North America and Europe created value for their investors, at the aggregate level we have now found that the industry as a whole has not returned its cost of capital to the investors. We had previously estimated that the industry's ROIC had exceeded its WACC since 2015, not just in the regions of North American and Europe.

Figure 4: Airline industry ROIC vs weighted average cost of capital (2015 vs 2020 studies)



This revision stemmed from two factors: First, the sample size has extended in the new study. This caused a modest downward revision in ROIC for the period before 2014 compared to the previous study conducted in 2015 and resulted in lower outcome than our estimations after 2014. The new sample includes more airlines from Asia-Pacific and Middle East-Africa regions and since these airlines have on average underperformed, this caused downward revision in ROIC. Our estimates now include new data on some of the airlines at the right-hand end of the curves in figure 2, those with relatively large economic losses.

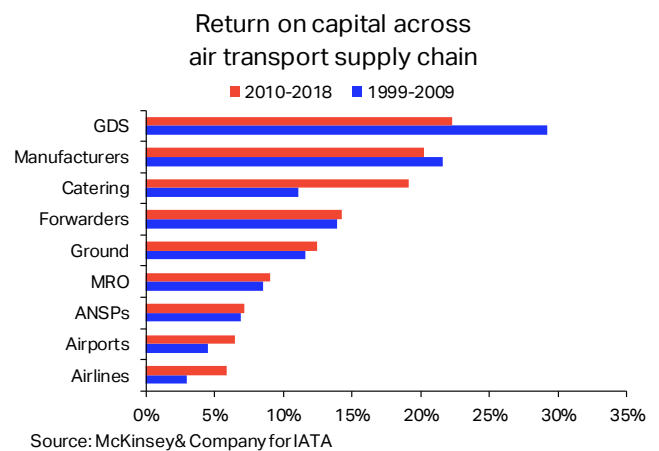
Secondly, from 2015-2018, due to the lack of or delayed information for some non-public airlines in emerging markets, there was over representation of North American airlines in our sample. Publicly open companies represent 90% of total ASKs in North America compared to c.60% in both Europe and Asia-Pacific regions which increased the weighting of stronger performing, value creating airlines in our earlier sample.

Airlines are generating value for the supply chain...

The improvement in airline profitability, since the Global Financial Crisis, has not been at the expense of suppliers. The increased business brought by airlines has supported other parts of the supply-chain leading to still-healthy returns for all suppliers. As a result, most parts of the supply-chain earned ROIC above the cost of capital, for some sectors considerably more.

Despite the improvement in airline industry profitability in recent years, there has been little change in the ranking of the returns along the value chain. Airlines remain near the bottom despite improved profitability, suggesting that problems of insufficient competition in parts of the supply chain remain.

Figure 5: Return on capital varies across air transport supply chain



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