IATA ECONOMICS' CHART OF THE WEEK

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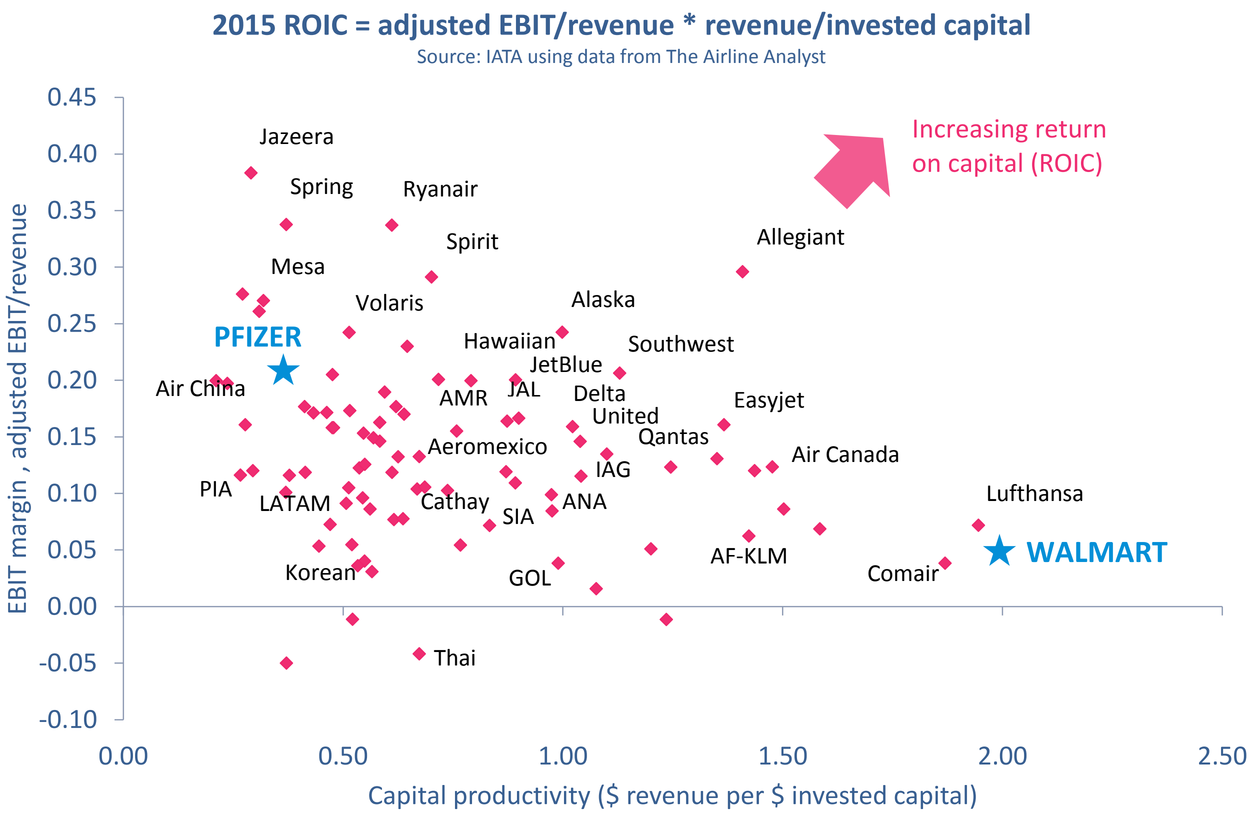
WIDE RANGE OF BUSINESS MODELS GENERATING ROIC IN 2015



- Return on Invested Capital (ROIC) consists of two parts: operating (EBIT) margin and capital productivity (the revenue generated from the capital invested). These two components of ROIC illuminate the type of business model being used by companies. For example, Walmart has very low margins but is really good at sweating its assets, maximizing revenues per $ of invested capital to get a high ROIC. Whereas Pfizer has to invest large amounts in R&D to generate revenues, but patent protection usually allows high margins. Very different business models generating similar ROIC.
- Often airline business models are described as either 'low cost' or 'legacy'. That is a huge oversimplification as can be seen in the extremely wide range of margin and capital productivity combinations shown in the chart, using 2015 data. The further out from both axes, the higher the ROIC. Allegiant led the way in 2015 with a business model that generated almost $1.50 out of every $1 invested but also generated a 30% EBIT margin (adjusted for leasing). The diversity of business models can be seen by comparing Lufthansa and JAL, both of which generated a similar ROIC. Lufthansa is out in front in terms of sweating its assets, generating nearly $2 of revenue out of each $1 invested. JAL generates less than half that from its capital but managed to produce an operating margin twice as large as Lufthansa's last year. Ryanair and Easyjet also generated similar ROIC but Easyjet's model, although producing less than half the EBIT margin of Ryanair, has double the capital productivity.
- The LCC-legacy dichotomy is obviously not a useful distinction for investors. Whatever an airline's cost base, its success in generating ROIC depends on its ability to maintain a good margin above those costs or sweating its assets or, like Allegiant, both.

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