



# Airline Industry Report

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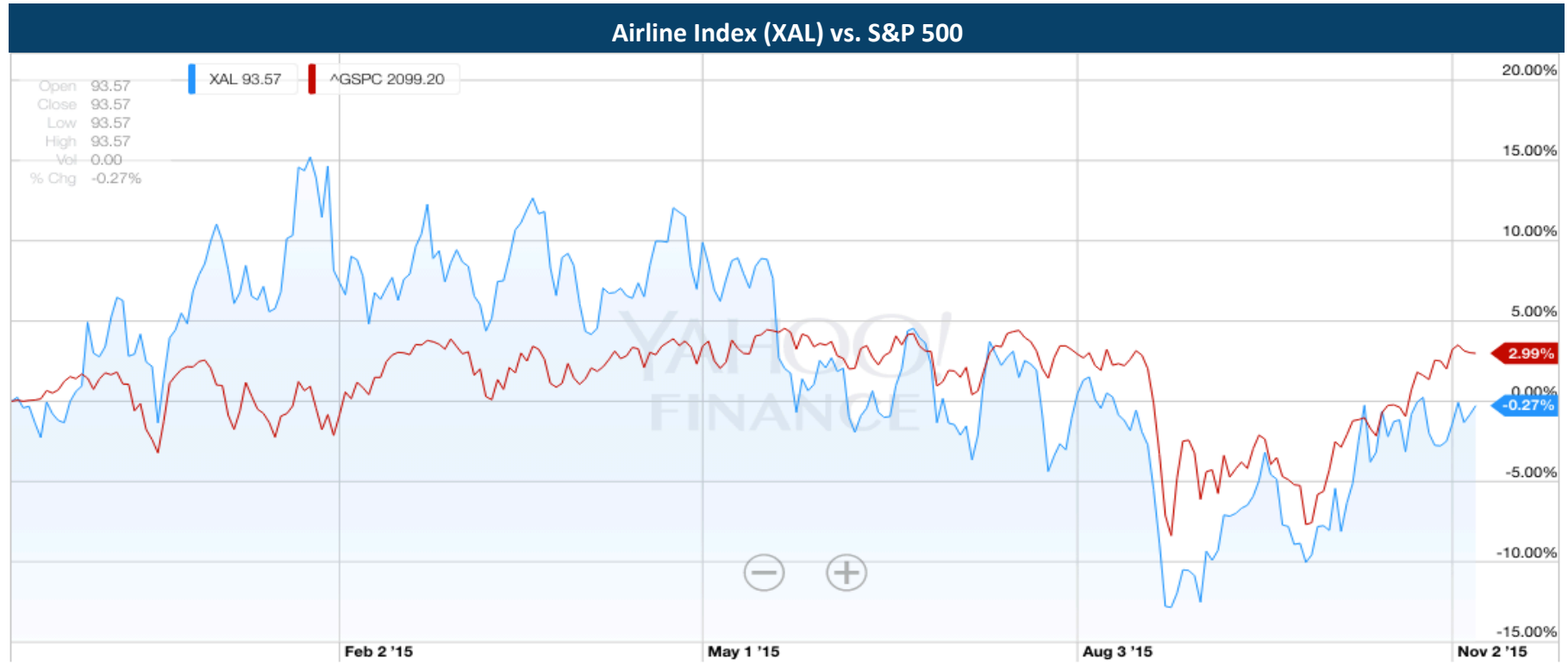
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## Topics to be discussed

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1. Airline Industry Overview and Major Players
2. Four Categories
3. Problems and Costs
4. Aviation Trends
5. Major Activities (Mergers and Acquisitions, Oil and Gas Prices)
6. Financial Analysis
7. Market Outlook and Future
8. Conclusion

# Airline Industry Overview



- The airline industry started off the year growing significantly higher than the market, yet it currently is following the market trend by only minimally slacking behind it
- There is often volatility due to oil and gas prices, as well as, consumer expectations
- Airlines have a variety of expenses both quantitative (gas, employees, pilots, consumer service, etc.) and qualitative (weather)

The airline industry is broken down into the following categories:

- **International**

- The ability to take passengers anywhere in the world and revenues over \$1 billion

- **National**

- Revenues between \$100 million and \$1 billion

- **Regional**

- Short-haul flights with revenues of less than \$100 million

- **Cargo**

- Planes that are used for the transportation of goods

# Problems and Costs of the Airline Industry

Airlines face many problems in regard to both high expenses and variable conditions.

## ▪ **Weather**

- Weather poses a really tough problem for every airline because it is extremely variable by nature. Problems with weather cause both cancellations and late arrivals, which leads to customer dissatisfaction.

## ▪ **Fuel Cost**

- Fuel costs account for the second largest expense for airlines. Fuel is both variable and volatile at times, which will be discussed in the upcoming slides.

## ▪ **Labor**

- Labor is the highest cost that airlines have and include many things, such as, pilots, flight attendants, baggage handlers, dispatchers, customer service and more

## ▪ **Airport Monopoly**

- Major airlines are forced to fly into certain airports in major cities to be competitive, which causes a monopoly on at many airports. Smaller airlines sometimes fly into the smaller more local airports.

# Aviation Trends (more trends)

There are constant changes that occur within the airline industry, which are both costly and time consuming

## ▪ **Increasing Consumer Expectations**

- Airlines need to differentiate themselves, which makes it very expensive to make even one change airline wide (entertainment features, seat comfort)

## ▪ **Pressure to Reduce Costs and Improve Operational Efficiency**

- Need to be efficient with fuel use as it accounts for 40-55% of expenses
- Need for strong operating model for customers in regard to baggage and connecting flights

## ▪ **Shifting the Airline Landscape**

- Change of the air travel center of gravity through growth in developing markets, like Latin America and Asia

## ▪ **Mobile Phones**

- Many people are using their cell phones to make reservations for flights; therefore, there will be a trend toward the use of mobile technology to engage with customers

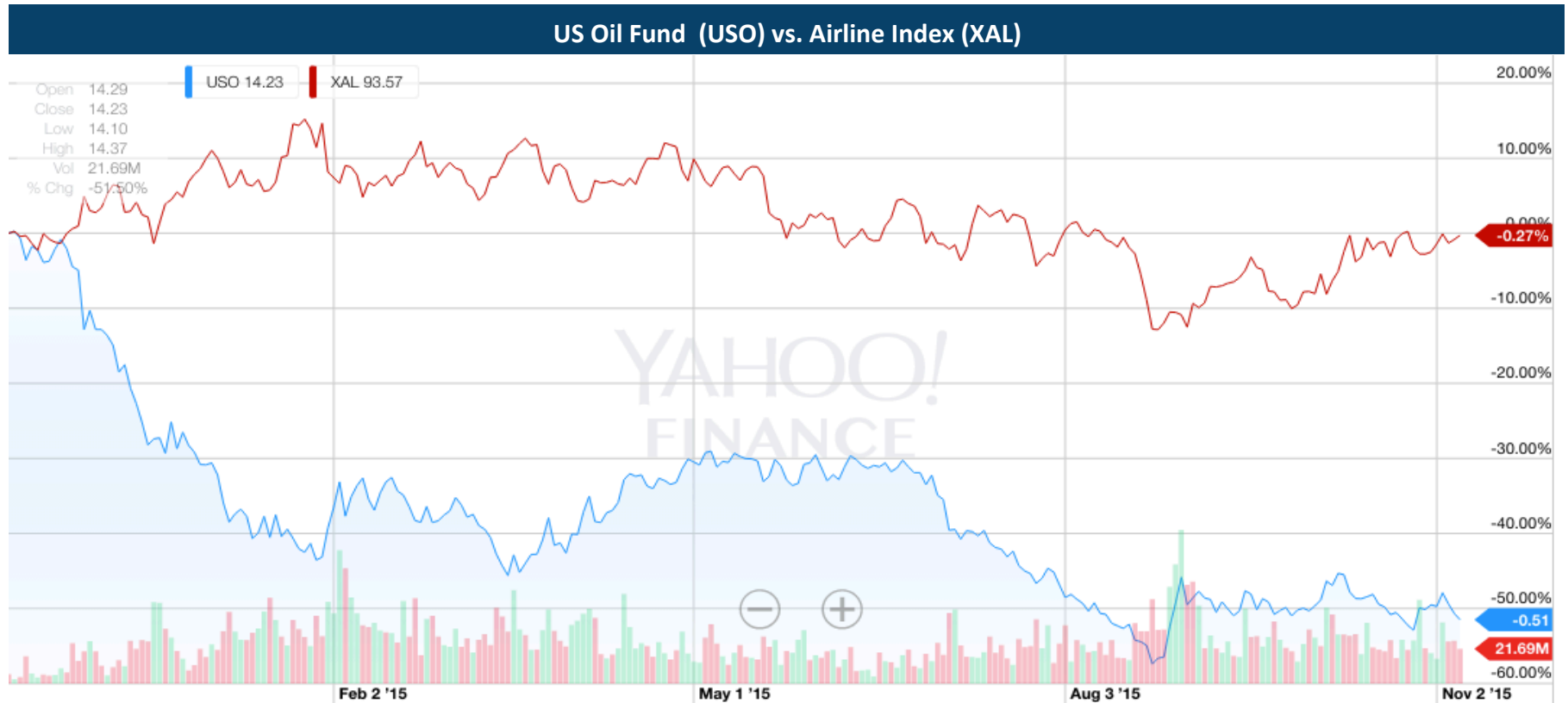
# Mergers and Acquisitions

## Mergers and Acquisitions in the Last 6 years

- July 31, 2009- Republic Airways acquires Midwest Airlines
- October 1, 2009- Republic Airways acquires Frontier Airlines
- December 31, 2009- Delta acquires Northwest Airlines
- July 1, 2010- Pinnacle Airlines and Mesaba Airlines merge
- October 1, 2010- United Airlines acquires Continental Airlines
- November 15, 2010- Skywest/SureJet is formed from the merging of Skywest, Atlantic Southwest and ExpressJet
- May 2, 2011- Southwest Airlines acquires AirTran Airways
- December 9, 2013- American Airlines acquires U.S. Airways and AMR

# Effect of Oil and Gas Prices

Current oil prices are improving airlines' bottom lines



- Declining oil prices are helping the airline industry to stay ahead of the market, as it is one of their highest costs
- There is an inverse relationship between oil & gas prices and the airline industry index
- Airlines hedge against oil to protect themselves in the long run



# Financial Analysis

Metrics for valuing and understanding the Airline Industry

- **Revenue Passenger Mile**

- A paying passenger flying one mile

- **Available Seat Mile**

- Measure of capacity
- One seat flying one mile=ASM

- **Revenue Per Available Seat Mile**

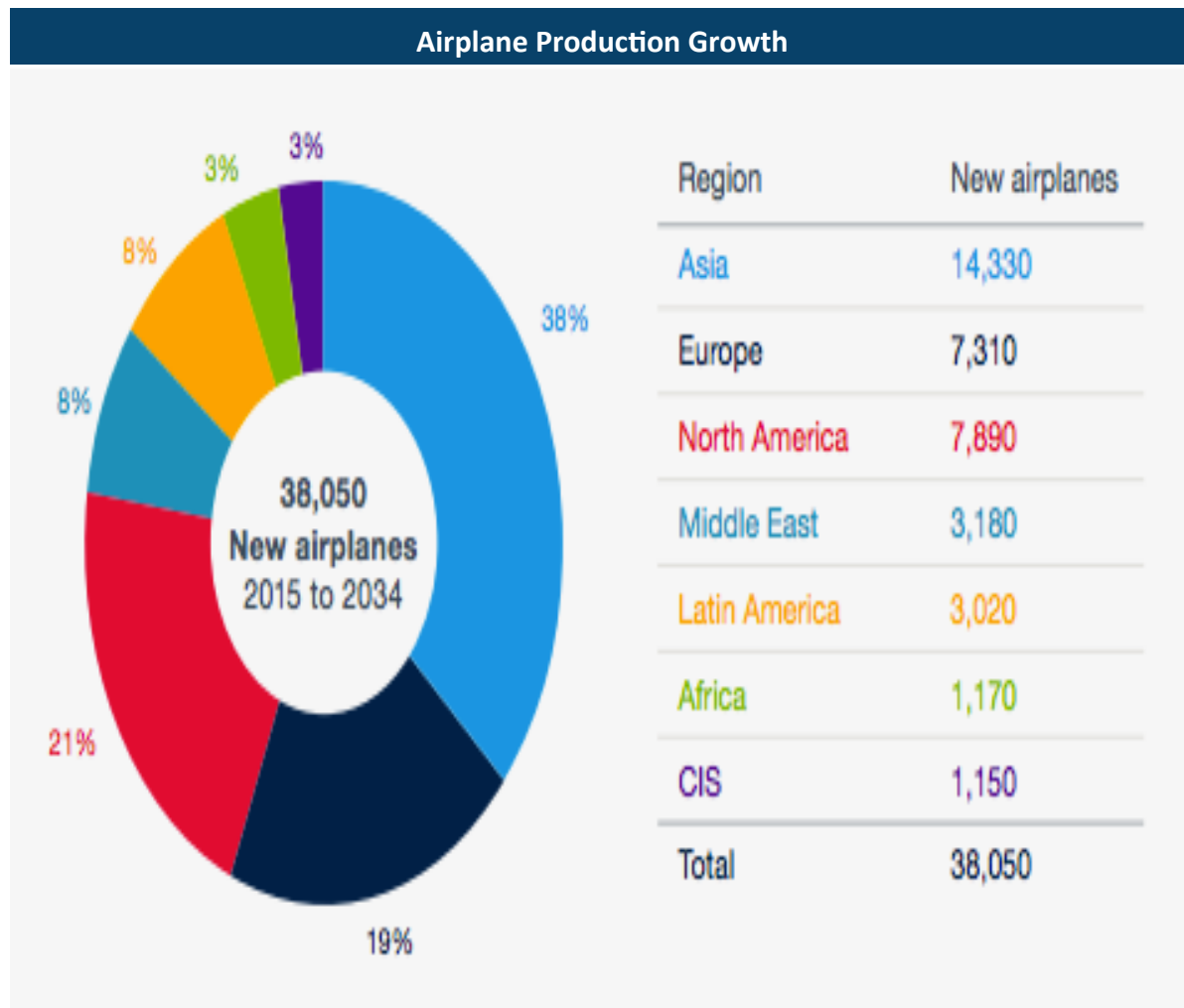
- Operating Income/ASM
- Generally, the higher RASM, the more profitable the airline is

- **EBITDAR**

- When valuing an airline company it is important to include rent expense, as it is a large expense because of renting airplanes

# Market Outlook and Future

Forecasted growth based on increased passenger traffic and reduced costs from low oil prices



- Aviation is becoming more diverse
  - 40% of new airplanes delivered are based in Asia Pacific
  - Asia becoming an emerging market because of rising income levels and increased consumer spending
- \$10s of billions expected to be saved because of lower oil prices
  - Highest industry margins in 3 decades
- Passenger traffic grew 6% in 2014, even with weak global GDP growth
  - Expecting large growth
  - Annual growth on average of 5% despite recessions, oil-price shocks, wars and security threats

# Conclusion

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## Airline Industry Final Review

- The growth of the airline industry has been fairly relative to the market in recent months
- The decline in oil prices has helped the airline industry increase profits. The chart shows the negative correlation between oil prices and the share price of the airline industry
- The growing trends of the airline industry make it both expensive and difficult to make changes
- The emerging markets in Asia and the Pacific make growth a possibility for major airlines

# G I M G



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