MarketLine Case Study

Flying high: EasyJet's strategy for success

Going head to head with legacy airlines

Reference Code: ML00017-013

Publication Date: April 2014

MarketLine

OVERVIEW

Catalyst

Low cost airline carriers, commonly known as budget airlines have been the fastest growing segment of the European airline industry since their inception in the 1990's. Such airlines are often considered as one group, competing solely on price with established flag-carrier airlines such as British Airways, Air France-KLM and Lufthansa. Yet the two largest European low cost carriers, EasyJet PLC (EasyJet) and Ryanair Holdings PLC have followed distinctly different routes to success. This case study will examine the evolution of the strategy pursued EasyJet and how the business is positioned for the future.

Summary

- EasyJet has been a notable success in recent years, in an airline industry struggling to cope with volatile fuel prices, adverse external events and increasing governmental taxes. Based upon a yield management pricing model, the business has expanded to operate 633 routes to 138 airports, while net income has risen strongly, amounting to £398m (approximately $622m) in FY2013.

- The airline has chosen to compete against legacy carriers at primary airports based on the structural cost advantage that it enjoys against legacy carriers, which often operate older, less efficient aircraft, lower load factors and higher levels of fixed costs. This presents EasyJet - benefiting from lower employee costs and streamlined operations - with a competitive advantage. Strong cost control and improving load factors have been the foundation of the company's success.

- As the travel industry changes and consumers move away from relying on travel agents, the company has taken the opportunity to generate ancillary revenue by offering travelers a range of products including hotel reservations, car rental and insurance.

- EasyJet has sought to increase business passenger numbers by improving its product proposition by introducing flexible fares, co-operating with corporate travel software platforms and offering additional services.

- A modern, fuel efficient aircraft fleet has, and continues to be a source of competitive advantage for EasyJet against legacy carriers as it provides a lower cost base and improved reliability. A new agreement with Airbus signals the introduction of A320neo from 2017 with projected fuel efficiency savings of 5% compared to the current A320 model. This provides a strong basis for continued cost reduction.

TABLE OF CONTENTS

TABLE OF FIGURES

EVALUATING A SUCCESSFUL STRATEGY

EasyJet has been a notable success in an airline industry struggling with volatile fuel prices, adverse external events and increasing governmental taxes in recent years. Based upon a yield management pricing model, the company sells tickets directly through its website to consumers. The business has expanded to operate 633 routes to 138 airports, while net income has risen strongly despite internal and external issues.

EasyJet typifies the success of low cost carriers

Since launching in 1995, EasyJet has grown strongly into a leading European short-haul airline, carrying 60.8 million passengers on 633 routes to 138 airports in 2013. The brand has grown to become synonymous with budget air travel, successfully implementing a yield management pricing model. This is a revenue management strategy companies use to manage demand for their products and services. In the case of airlines, this primarily means pricing tickets in such a way that maximizes load factor- the number of seats sold as a percentage of an aircraft's capacity. This is firstly achieved by offering very low fares to attract passengers to book earlier than they would otherwise do. In doing so, the yield- the total revenue achieved per flight can be maximized. Initial pricing can be structured according to anticipated demand, route, time and day of the flight. Software packages allow airlines to manage fares and vary up fares to the sale of the last seat, providing the opportunity to react to market conditions and maximize fare revenue. This has been combined with a focus on a low cost base, to offer attractive headline fares to travelers and frequently undercutting legacy airlines.

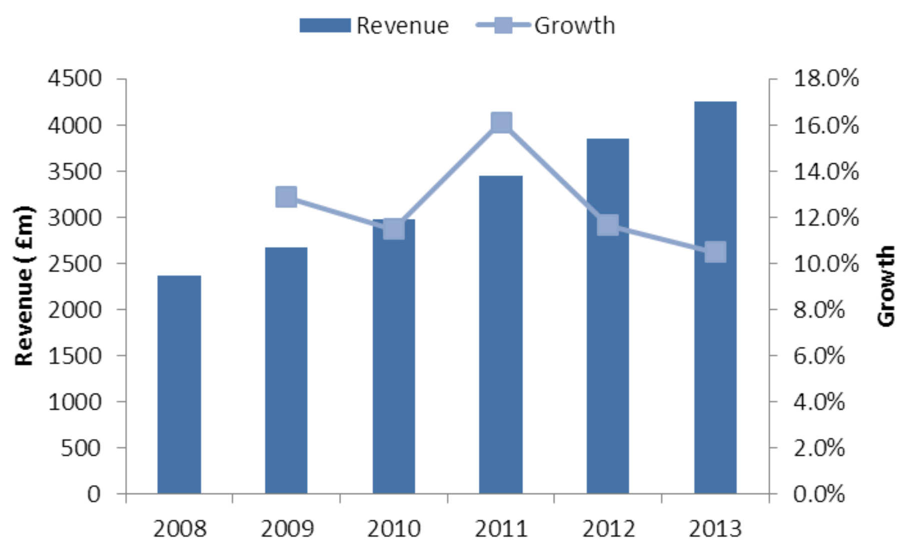
External and internal pressures have impacted upon the business

The business has not been without difficulties in recent years, both externally from unforeseeable events, such as the Icelandic volcanic ash cloud closing European airspace in 2010 which forced 7,314 flights of the airline's flights to be cancelled at an estimated cost of £65m (approximately $102m). Internally a protracted dispute with founder and largest shareholder Sir Stelios Haji-Ioannou over brand licensing and latterly aircraft purchases and shareholder returns has led to upheaval at board-level, consuming significant amounts of senior management time. Whilst the brand licensing issue has been resolved, Sir Stelios Haji-Ioannou remains a vocal critic of the company's strategy, insisting further aircraft purchases will destroy future shareholder value. The validity of such an assertion is debatable; low cost carriers have derived significant competitive advantage from investing in modern fuel efficient aircraft against legacy carriers older fleets.

Financial performance has improved significantly despite such issues

Notwithstanding these issues, EasyJet has enjoyed strong financial performance from 2008, steadily growing revenue 80% over the period to £4.3bn in FY 2013.

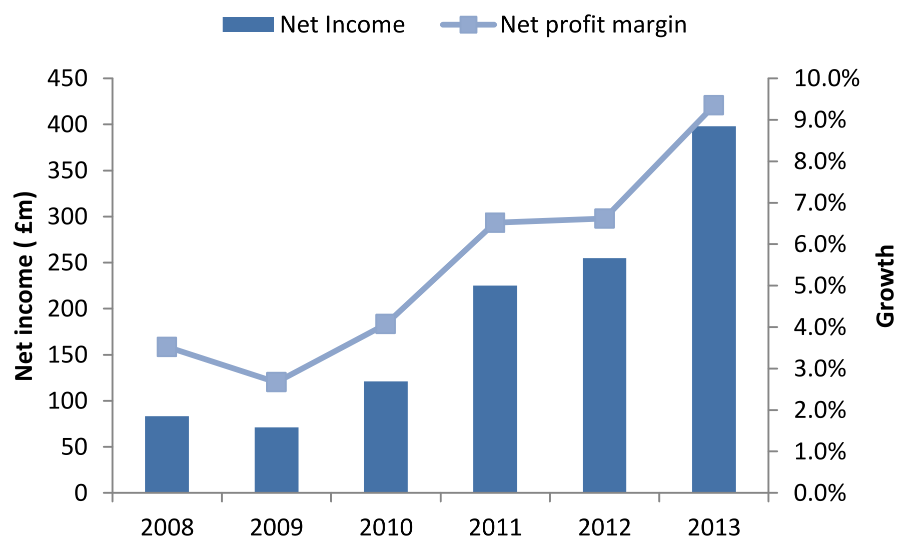
Figure 1: EasyJet revenue progression 2008-2013



SOURCE: EasyJet Annual Reports MARKETLINE

Net profit margin has also markedly improved, increasing from 2.67% in FY 2009 to 9.35% in FY 2013. This can be attributed to strong cost control management and increasing revenue per seat, from ancillary revenues such as baggage charges and on board sales

Figure 2: EasyJet net income progression 2008-2013



SOURCE: EasyJet Annual Reports MARKETLINE

A distinctive strategy has prepared the business for sustained growth

Low cost carriers are often thought of as a quasi-homogenous group competing solely on price, on a seemingly vast array of routes throughout Europe. Yet, EasyJet has taken a quite different approach to competitor Ryanair, a large Irish based low cost carrier in building a route network- focusing on primary airports, competing directly against legacy carriers on established routes. Capacity management, cost control and fuel hedging have proven to be the foundation of the airline's strong growth.

The business strategies of low cost carriers are not identical

The yield management pricing strategy that underpins the business model of low cost carriers is not as uniform as may first appear. The most successful low cost carriers have taken one of two quite different routes. Airlines such as Ryanair have remained with aggressively low fares, balanced by a low cost structure and bold approach to raising ancillary revenue. Furthermore, Ryanair has strategically built a route network on secondary airports which reduces landing fees and often attracts monetary incentives from local and regional governments who are keen to attract visitors to the area, to support their local economy.

In contrast, EasyJet has chosen to compete against legacy carriers at primary airports based on the structural cost advantage that low cost carriers benefit from. Legacy carriers often operate older, less efficient aircraft, lower load factors and higher levels of fixed costs, which present EasyJet - benefiting from lower employee costs and streamlined operations - with a competitive advantage. The fare structure is competitive, typically with a base unit price of £29.99 (approximately $47) including governmental taxes and airport charges.

EasyJet's route network is concentrated on Western Europe

The airline's route network is primarily focused on Western Europe together with selected holiday destinations in the Canary Islands, Turkey and North Africa. Central and Eastern Europe airports served are limited, for example flying to one Polish airport compared to Ryanair's 14. This reflects EasyJet's strategy of building positions in key primary airport markets, competing with legacy carriers to which it has a cost advantage.

Figure 3: EasyJet route network map

SOURCE: EasyJet website MARKETLINE

EasyJet has strong capacity share at its top 20 airports

EasyJet has an estimated 22% capacity share at its top 20 airports. The business has been strategically placed by successive management teams to achieve strong market share positions in key primary airports. This places the airline into direct competition with legacy carriers which it has a cost advantage over. This also means operating on established routes as opposed to launching new routes with uncertain demand conditions; which can be observed as a clear advantage of such an approach. EasyJet claims to have leading market share in 46% of airports served, including London Gatwick, Milan Malpensa and Geneva; and a secondary position in a further 30% including Paris Charles De Gaulle and Amsterdam.

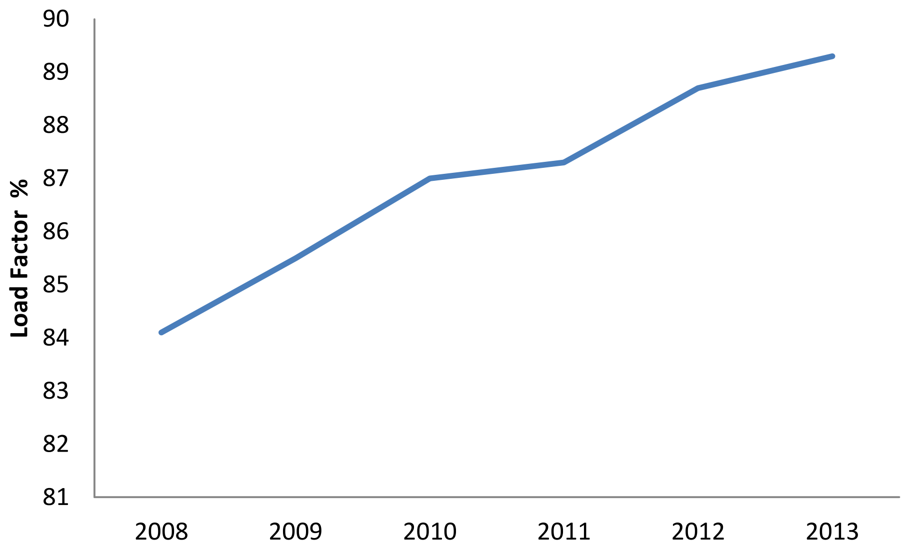
EasyJet and Ryanair are rarely direct rivals

Whilst EasyJet and its largest competitor Ryanair are commonly seen as fierce rivals, they are very rarely in direct competition on the same routes. Indirect competition is also limited- for example considering London to Munich; Ryanair's Memmingen (Munich West) destination is 70 miles from the city of Munich. The time spent and travel costs incurred reaching the alternative airport may largely negate any savings between respective fares for many, which serves to reduce the limited rivalry which does exist.

Improving load factors indicate strong capacity management

EasyJet's load factor has witnessed sustained improvement over the period 2008 to 2013, climbing to 89.3% in FY2013, comparing favorably to International Airlines Group's 77.3% load factor on comparable European short haul routes. This progress is evidence of strong capacity management, maximizing Available Seat Kilometer (ASK) revenues, a key industry financial indicator. It is notable that additional routes capacity has also been largely concentrated in existing airports, as seen in Table 1. The number of routes operated has expanded by 66.6% over 2008 to 2013, whereas total airports served increased by 25% over the same period.

Figure 4: EasyJet annual load factors 2008-2013



SOURCE: EasyJet Annual Reports — MARKETLINE

This is indicative of the business retaining clear strategic focus on primary airports, rather than competing with other low cost carriers in secondary airports.

Table 1: Passenger volumes and route data 2008-2013

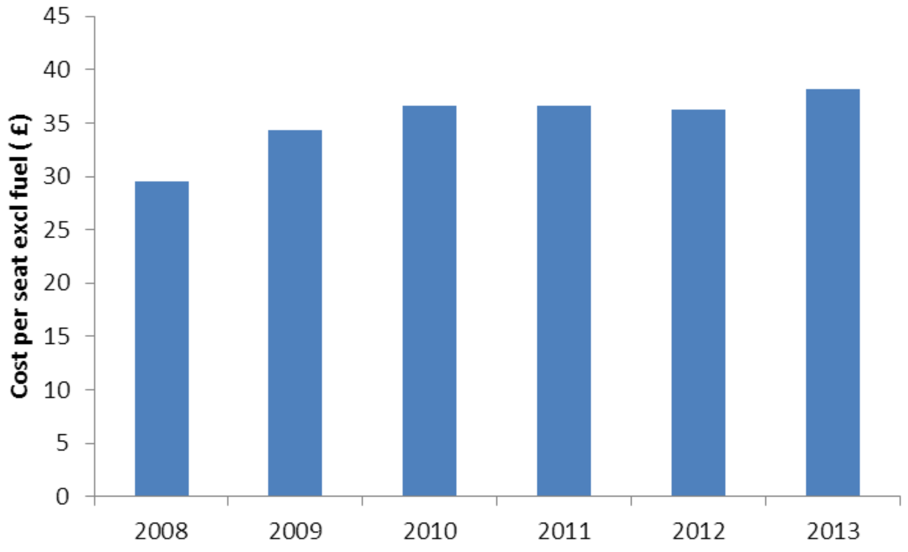
	2008	2009	2010	2011	2012	2013
Number of routes operated	380	422	509	547	605	633
Passenger volumes (millions)	43.7	45.2	56	62.5	58.4	60.8
Airports served	110	114	125	123	133	138

SOURCE: EasyJet annual reports — MARKETLINE

Cost control has been the foundation to success

Establishing and maintaining a cost advantage against competitors relies heavily upon strong cost control, which has been a key strength of EasyJet and fundamental to its success. This has been largely achieved by optimizing ground operations, efficient staff deployment and fleet management; placing costs as a key performance indicator of management. Excluding fuel, costs per seat have remained tightly controlled as seen in figure 5.

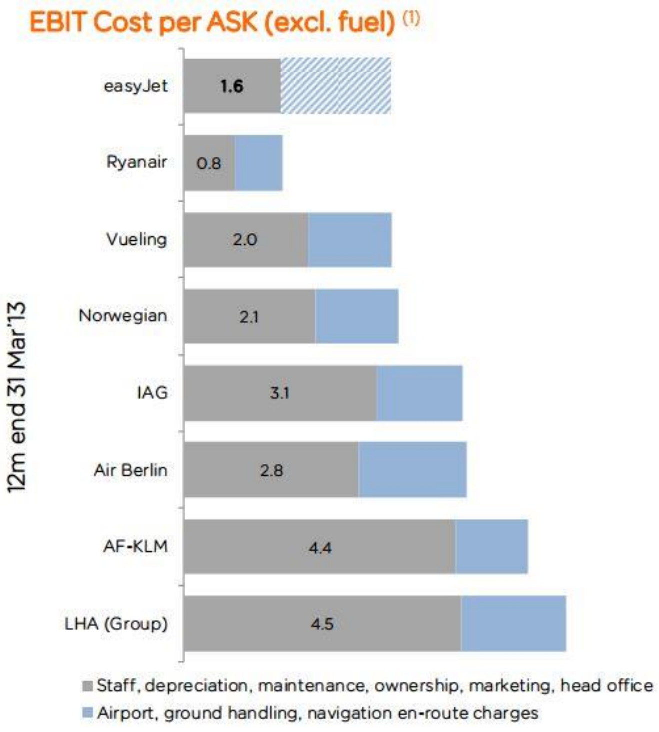
Figure 5 : EasyJet cost per seat excluding fuel 2008-2013



SOURCE: EasyJet Annual Reports MARKETLINE

Cost control can also be considered by cost per available seat kilometer (ASK), a key industry measure of comparing efficiency between airlines. Figure 6 shows that EasyJet's non-airport costs compared favorably with all legacy airlines- some 48% less than IAG and 24% lower than fellow low cost carrier Norwegian. The sizeable airport related cost compared to Ryanair for example, can largely be attributed to operating from costlier primary airports.

Figure 6 : Comparison of Airlines cost per ASK (£ pence)



SOURCE: EasyJet Annual Report MARKETLINE

Fuel hedging has moderated the risk presented by volatile fuel markets

Continual innovation is a hallmark of low cost carriers and particularly of EasyJet. Improvements often have multiple benefits – reducing operational costs while improving the passenger experience, such as mobile boarding cards. As the travel industry changes and consumers move away from relying on travel agents, the company has the opportunity to generate ancillary revenue by offering travelers a range of products including hotel reservations, car rental and insurance.

INNOVATION KEY TO COMPETITIVE ADVANTAGE

Continual innovation is a hallmark of low cost carriers and particularly of EasyJet. Improvements often have multiple benefits – reducing operational costs while improving the passenger experience, such as mobile boarding cards. As the travel industry changes and consumers move away from relying on travel agents, the company has the opportunity to generate ancillary revenue by offering travelers a range of products including hotel reservations, car rental and insurance.

Mobile boarding passes have significant potential

A mobile boarding pass facility, where passengers download a smartphone application which allows the boarding pass to be stored and scanned on a mobile device, was introduced in May 2013. Available in 102 of the airports EasyJet serves at the end of FY2013, this measure appears to be convenient for customers and is likely to cut costs associated with airport check-ins by removing the need for paper tickets, streamlining boarding procedures and reducing turnaround times thereby improving on time performance.

Figure 7 : Example of a mobile boarding pass

SOURCE: EasyJet website

MARKETLINE

Ancillary revenues are not restricted to traditional on-board sales

In April 2012, EasyJet entered into partnership with booking.com owner Priceline Inc. in and has successfully integrated the interface of hotel reservation service into the flight booking process. This allows customers to view and select accommodation which is reserved as part of the booking process, for payment at the hotel. A similar, long standing agreement with Europcar Groupe S.A provides customers with car hire services. This recognizes that whilst consumer behavior has shifted from using travel agents to booking independently; accommodation and car rental services are still required for many trips, and consumers arguably value the convenience of a single transaction and booking. Such partnerships provide EasyJet with additional revenue from commission, capitalizing on a strategic advantage – the first step of organizing a trip is logically most likely to be flights, as other components are often dependent on times of arrival and departure. This provides the opportunity to sell to the customer before they have the chance to shop around.

The business is uniquely placed to offer specialized insurance products

In addition to commission earned on car rental and hotel reservations the airline has added insurance products, currently in partnership with Allianz Group, to the booking process. In addition to offering single trip insurance, 'missed flight cover' was introduced in June 2012, providing cover for arriving up to 4 hours late for a flight, priced at £10 (approximately $15). These products typically appeal to impulse purchasers and are likely to attract higher profit margins, particularly as the 'missed flight' cover is unique to the market which means there is no competition to compare prices with. Specialist insurance products are therefore both an additional service to passengers and an additional source of ancillary revenue.

EASYJET HAS TARGETED BUSINESS TRAVELERS

European low cost carriers have historically not been favored by business passengers, as inflexible ticketing options, onerous queues and the down-market brand image of the sector as a whole deter corporate travelers. EasyJet has sought to overcome preconceptions and improved its product proposition by introducing flexible fares, co-operating with corporate travel software platforms and offering additional services.

The introduction of flexible fares has improved the product proposition for business passengers

The company introduced the business friendly initiative of 'flexi' fares in June 2011, which allow passengers to change the date and time of a flight up to two hours before the scheduled departure time; in contrast to the traditional no-refund policy of low cost carriers and often punitive fees for any changes made. This means corporate travelers can book flights with the same option to change arrangements as legacy airlines, which removes a perceived disadvantage of EasyJet.

Service improvements are not necessarily expensive to implement

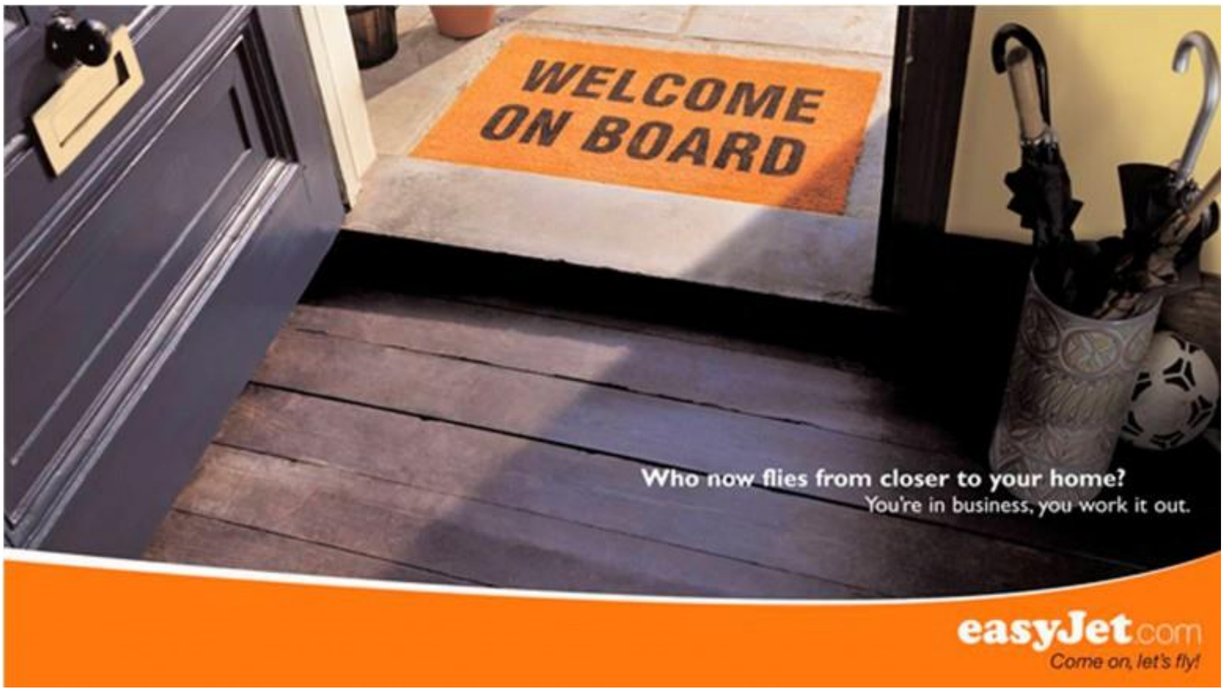
In November 2012, the airline introduced allocated seating to all flights, automatically assigned during the check-in process. Implementing this has eliminated the need to queue at the departure gate to obtain a convenient seat, which means this time can be used more productively by business passengers and improves the passenger experience.

Similarly, the continuing roll out of a fast track security service available to 'flexi' ticket holders at 35 of EasyJet's principal airports allows passengers to pass through a priority security channel; a time saving initiative which is likely to be attractive to corporate travelers. This also narrows the service advantage legacy may have compared to a low cost carrier operation, which strengthens EasyJet's position in the business travel market.

Marketing campaigns have specifically targeted the business community

The airline has conducted several advertising campaigns to improve brand awareness for business travelers focusing on the convenience of EasyJet primary airports, as seen in figure 8 and the airline's value proposition in the context of constrained commercial travel budgets. According to ITB Berlin, a leading travel trade fair, European business travel fell 1% in 2013 as companies cut back business travel spending. This is likely to mean corporate travelers are more likely to be receptive to EasyJet's services, as a way of maintaining travel commitments on a smaller personal travel budget.

Figure 8 : EasyJet 2012 business advertising campaign



SOURCE: The Bank media agency MARKETLINE

EasyJet has embraced corporate travel agencies

Low cost carriers have conventionally sold tickets principally by their respective websites, to avoid the costs associated with third party resellers such as travel agents. However, this is inconvenient for large corporations which often have dedicated corporate travel departments, or utilize travel management companies to organize business travel. From late 2007, EasyJet has increasingly embraced business travel agents, who typically utilize global distribution systems such as Travelport LP's Galileo and Amadeus software to compare flights from multiple carriers and make reservations for clients. By doing this, the company has extended its product reach and removed a potential barrier to corporate sales By adding a point-of-sale fee to these third party bookings, the company retains the primacy of the website as its principal and cheapest distribution channel.

Demonstrable progress is evident

These developments appear to have been successful in going some way to changing the image of the company- in 2013 the company renewed a corporate travel deal to retain preferred partner status with the Houses of Parliament and won the short-haul airline award at the 2014 Business Travel Awards. The airline is also gaining corporate travel market share claiming to have ten million business passengers (on a rolling 12 month basis) in FY 2013.

INVESTMENT IN THE AIRCRAFT FLEET IS CRUCIAL

Investing in modern aircraft has provided EasyJet with a competitive advantage over legacy airlines, as newer, greener planes increase fuel efficiency and therefore reduce costs. An agreement with Airbus offers the potential to match plane deliveries to market conditions, thereby avoiding over capacity.

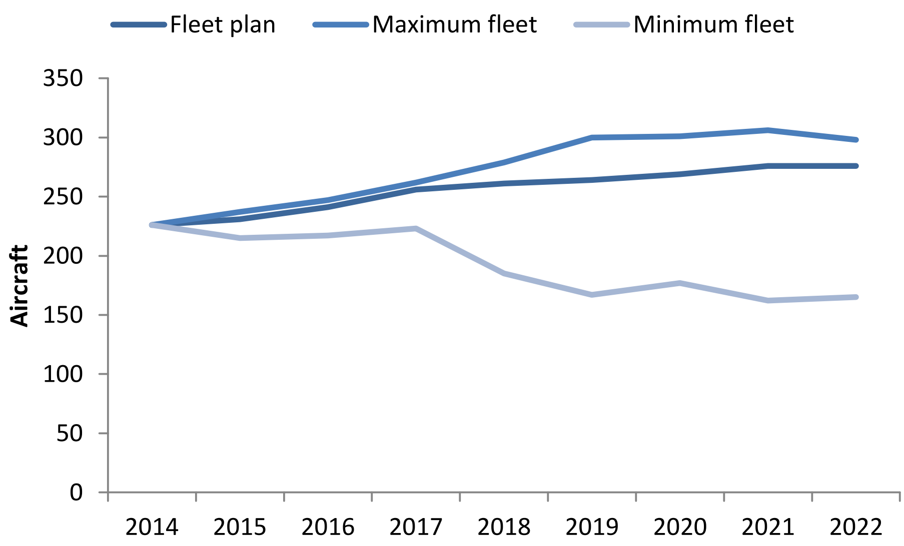
New planes can reduce costs and improve medium term prospects of the business

The aircraft fleet consisting predominantly of Airbus A319's, continues to be a source of competitive advantage for EasyJet - with an average age of 6.5 years it is younger, more fuel efficient, benefiting from lower maintenance costs and fewer mechanical faults, compared to an average Airbus A319 fleet age of 12.8 years for Air FranceKLM, Lufthansa and IAG. The new aircraft framework agreement with Airbus provides flexibility in fleet management and the opportunity to reduce the fuel bill still further.

New aircraft delivery strategy offers flexibility to meet demand

The airline undertook a lengthy process to replace and upgrade the existing fleet of Airbus A319, selecting Airbus's next generation A320neo.The framework agreement is innovative, providing flexibility in new aircraft delivery over the period 2017 to 2022. This option reduces the risk of holding surplus capacity- a problem most recently seen in the global marine shipping industry, where operators are committed to receiving new capacity, regardless of market conditions which may either render it insufficient or unnecessary.

Figure 9 : EasyJet fleet projections 2014-2022



SOURCE: EasyJet analyst presentation

MARKETLINE

Figure 9 shows EasyJet's ability to adjust the size of the fleet to suit market conditions, particularly between 2018 and 2022. This should place the business in a strong position going forward.

Fuel efficiency is vital

Whilst the prospect of new aircraft purchases have been vigorously opposed by founder and large shareholder Sir Stelios Haji-Ioannou, who has claimed that new aircraft are unnecessary and could 'screw up' the 'financial success story' of the airline; the renewal of the aircraft fleet appears crucial in maintaining market leading positions. The company estimates the new A320neo aircraft will result in estimated savings of 5%, principally from fuel; compared to the current generation A320. The principal benefit of upgrading to newer aircraft is maintaining a cost advantage against competitors by reducing cost per seat including fuel; allowing the company to offer competitive fares and retain market share.

Reducing weight lessens the fuel bill

The fuel efficiency of an aircraft can also be improved by reducing the weight of on board equipment and furnishings. The airline is examining the installation of lightweight seats and carpets together with lightweight catering and retail trollies which can deliver weight savings with a consequential reduction in costs. EasyJet is well placed to do this particularly as the fleet consists entirely of Airbus A319 and A320 aircraft, which reduces the time and cost of implementing such improvements compared to other airlines with a range of aircraft by different manufacturers.

Modern efficient aircraft allow the business to position itself as a green airline

A modern fuel efficient fleet also allows EasyJet to claim to be a green airline compared to legacy carriers which due to older aircraft have higher emissions, noise levels and fuel burn. This is useful for the public perception of the brand and for submissions to European, national and regional governments on the business case of low cost carriers and to influence future taxation on air travel.

CONCLUSIONS

EasyJet is well placed for sustainable future growth

EasyJet has taken a quite different approach to its low cost rival Ryanair in growing its operation, focusing on primary airports and often competing directly against legacy carriers on established routes. Capacity management, cost control and fuel hedging have proven to be the foundation of the airline's strong growth.

Innovation has been a hallmark of EasyJet, in its search to reduce operational costs and improve the passenger experience. The introduction of allocated seating has improved the product proposition whilst generating additional ancillary revenue, while the recent service addition of mobile boarding passes is likely to streamline passenger boarding. The airline is well positioned to continue such changes and it is conceivable that further innovation such as cashless on-board retail will follow over the next 3-5 years.

A modern, fuel efficient aircraft fleet has, and continues to be a source of competitive advantage for EasyJet against legacy carriers as it provides a lower cost base and improved reliability. The new aircraft framework agreement with Airbus provides flexibility in fleet management and the opportunity to reduce the fuel bill still further while allowing capacity to be tailored to prevailing market conditions.

European low cost carriers have historically not been favored by business passengers, as inflexible ticketing options, onerous queues and the down-market brand image of the sector as a whole deter corporate travelers. EasyJet has improved its product proposition by introducing flexible fares, co-operating with corporate travel software platforms and offering additional services. This provides a strong platform for future growth by diversifying the customer base,

The future of the airline appears bright - although the structural cost differential between low cost and legacy carriers has shrunk in recent years as the latter group has reacted to market changes, EasyJet continues to progress and remains leaner and more agile than its direct competitors. Fluctuations in oil prices and the regulatory environment - particularly taxes such as Air Passenger Duty in the UK remain a concern going forward, however the company is better positioned than legacy carriers to face such uncertainties.

APPENDIX

Sources

Deutsche Lufthansa AG Annual Report 2013

EasyJet Annual Report 2011

EasyJet Annual Report 2012

EasyJet Annual Report 2013

International Airlines Group Annual Report 2013

ITB World Travel Trends Report 2013/2014

http://www.itb-berlin.de/media/itbk/itbk_media/itbk_pdf/WTTR_Report_2014_Web.pdf

The Bank media agency

http://www.thebank.co.uk/ad/EasyJet-business-travel/

Further Reading

EasyJet plc – MarketLine Company Profile

Global Airlines – MarketLine Industry Profile

Airlines in Europe – MarketLine Industry Profile

Ask the analyst

We hope that the data and analysis in this brief will help you make informed and imaginative business decisions. If you have any questions or further requirements, MarketLine's research team may be able to help you. The MarketLine Research team can be contacted at ReachUs@MarketLine.com.

About MarketLine

At MarketLine, we deliver accurate, up-to-date insights on over 30,000 companies, 300 industries, and 215 countries, as well as the latest news and financial deal information from within your market and across the globe.

Established in 1997 when the Internet was in its infancy, we recognized the need for a convenient and reliable data service to help our clients understand local and global markets and the companies operating within them.

In today's information-rich world, sifting fact from fiction to pick out what's relevant and what's up to date has become the new 'holy grail' in business information provision.

Our 170 dedicated research professionals aggregate, analyze, and cross-check facts in line with our strict research methodology, ensuring a constant stream of new and accurate information is added to MarketLine every day..

Disclaimer

The facts of this report are believed to be correct at the time of publication but cannot be guaranteed. Please note that the findings, conclusions and recommendations that MarketLine delivers will be based on information gathered in good faith from both primary and secondary sources, whose accuracy we are not always in a position to guarantee. As such MarketLine can accept no liability whatever for actions taken based on any information that may subsequently prove to be incorrect.

MARKETLINE | CHRISTCHURCH COURT | 10-15 NEWGATE STREET | LONDON EC1A 7AZ
T: +44 20 3377 3045 | F: +44 161 238 4141
E: REACHUS@MARKETLINE.COM
WWW.MARKETLINE.COM