US airlines enjoy bonanza

Following absorption of four major carriers, and the resulting consolidation in US airline capacity, the six remaining majors are consistently reporting strong financial performance. This looks set to be enhanced through a large drop in fuel prices over the coming year.

The consolidation among US major airlines has left six large operators. These are American, Alaska, Delta, jetBlue, Southwest and United.

These six airlines now account for about 80% of revenue passenger-miles (RPMs) generated in the US. The profitability of these six airlines has improved considerably following the absorption of US Airways into American, Northwest into Delta, Continental into United, and AirTran into Southwest.

For the full 2013 year, the six majors generated 711 billion RPMs, and enjoyed a load factor of 83.6%. American, United and Delta accounted for 76.3% of this, illustrating how dominant these three airlines have become.

By comparison, jetBlue only accounts for 5% of the top six airlines' traffic volume. Southwest, although a large carrier with a fleet of 634 737s and 43 717s, has a 15% share of all US majors' scheduled traffic.

Overall, these six carriers enjoyed combined revenues of $124 billion. Operating expense was relatively low, since collective operating income or profit was $10.137 billion, a margin of 8.2%. Delta generated the largest operating profit, with $3.84 billion on revenues of $31.74 billion.

This high margin was achieved even though the six airlines systemwide had an overall annual fuel price of $3.00 per US gallon (USG). The airlines consumed a total of 12.82 billion USG, translating to an annual fuel cost of approximately $38.5 billion in fuel, equal to 33.7% of all operating expense.

A factor contributing to the airline's performance was a high passenger load factor of 83.6%, and strong yields, resulting in annual unit revenue of 14.58 cents per available seat-mile (ASM). This compares to a unit revenue per ASM (RASM) of 14.47 cents in 2011. The major airlines in 2011 actually had higher total revenues than they did in 2013.

Despite what may initially appear to be, or what some may assume to be, strong financial performance in 2013 due to high passenger yields, the biggest contributor was in fact a reduction in operating costs. This was achieved in spite of high industry-wide fuel prices.

The six major airlines continued to generate strong financial results in the first nine months of 2014. Overall, operating margin improved to 11%.

The six airlines generated an operating profit of $10.97 billion for the first nine months of 2014, indicating strong revenue growth over the full 12 months of 2013. This is best explained by a strong recovery in the US economy during 2014. American Airlines was the largest contributor, generating an operating margin of $3.42 billion, equal to an operating performance of 12.4%.

The main factor in the airlines' stronger performance in 2014 has been a slight improvement in load factor to 84.2% and yields, leading to an increase in RASM of about 0.50 cents.

By comparison, the average fuel price over the period was down marginally at $2.96 per USG, and unit cost per ASM was marginally higher than in 2013.

US airlines, and particularly the six majors, have therefore yet to enjoy the full benefits of the fast drop in crude oil and spot fuel prices during the last three months of 2014 and the start of 2015.

Spot fuel prices are down about $1.40 per USG on the first ninth months of 2014 at $1.60 per USG. Extrapolated over a full year of fuel consumption, the six major US carriers stand to benefit from a pro-rata annual saving in the region of $18 billion.

While many airlines have hedged fuel purchases, these contracts will expire over the coming year. The six majors, and all other carriers, are likely to see operating margins substantially improve.

The US airlines are already in a strong position. Load factors, passenger yields, unit revenues and operating margins are all high. The prospect of lower fuel costs would, in usual circumstances, raise concerns that new airlines would enter the market. With the US economy continuing to grow, and the benefit of low oil prices, and already high load factors, fares and yields are likely to strengthen during 2015.

Airlines in the US have enjoyed increasing profitability since 2010. The six major US airlines generated a collective operating profit of $10.97 billion in the first ninth months of 2014. This is equal to a margin of 12.4%. American Airlines accounted for $3.42 billion of the major airlines' earnings.