

# The sky's the limit

Since 2008, IdeaWorksCompany and Amadeus have worked together to produce the annual *Amadeus Yearbook of Ancillary Revenue*. 2012's report investigates a year that is well-remembered for its economic uncertainty, where ancillary revenues have soared with the help of some artful tactics

IdeaWorksCompany analysed financial statements from 108 airlines to develop a picture of the ancillary revenue activities of carriers worldwide. Of the airlines examined, 50 reported revenue details identifying ancillary activities. The carriers that comprise the 108 airlines provide financial statements or investor presentations and typically offer shares to the public. IdeaWorksCompany used a

number of resources, such as airline stock indexes, to identify these publicly-held airlines. Some of the carriers included do not offer shares to the public, but provide financial information at airline websites. Airlines which are privately owned and do not disclose financial results are not included in this analysis.

The first report on ancillary revenue was issued in 2008 with only 23 airlines

worldwide disclosing ancillary revenue activity in financial filings – and the result was a modest €1.72 billion (\$2.45 billion). Once largely limited to low-fare airlines, ancillary revenue has now become a financial necessity for airlines across the globe. Today, 50 airlines disclose ancillary revenue activity totalling €18.23 billion (\$22.64 billion). This represents ancillary revenue growth of 66% in two years from the 2009 result of €10.95 billion.

Some airlines, such as Qantas Airways and TAM, build ancillary revenue through robust frequent flier programmes and co-branded credit cards. The majority of the world's carriers, from low-fare airlines to global giants, grow ancillary revenue from a variety of sources such as checked baggage fees, buy onboard cafes, and commissions earned on the sale of hotel accommodations. While methods may vary, each airline shares a key objective: to create profits in an era of ever-rising fuel costs, while at the same time keeping fares modest in a recession-weary world.

Consumers sometimes grouse that airlines should simply increase fares to accommodate higher expenses. But, in a marketplace where air travel is often labelled a commodity, meaningful fare increases are difficult to achieve. Ancillary revenue helps airlines fill the expenses gap. This 'unbundling' method also allows carriers to offer a basic product – at the lowest price – and gain revenue by selling services which were once included in the cost of a ticket when oil prices were much lower. Airlines can also offer service enhancements that add to a traveller's comfort and convenience.

Ancillary revenue continues to grow and better retailing methods and product innovation are contributing factors. For example, Korean Airlines has literally taken retailing to new heights with the inclusion of a fully stocked 64-item duty free shop on its Airbus A380 aircraft. Korean clearly anticipates meaningful returns as ►

► Table 1: Top 10 Airlines – Ancillary Revenue as a % of Total Revenue

| Annual results – 2011 |               | Primary source | Annual results – 2010 |                    |
|-----------------------|---------------|----------------|-----------------------|--------------------|
| 33.2%                 | Spirit        | Various        | 29.2%                 | Allegiant          |
| 27.1%                 | Jet2.com      | Various        | 22.6%                 | Spirit Air         |
| 27.0%                 | Allegiant     | Various        | 22.1%                 | Ryanair            |
| 20.8%                 | easyJet       | Various        | 21.0%                 | Jet2.com           |
| 20.5%                 | Ryanair       | Various        | 20.5%                 | Tiger Airways      |
| 19.1%                 | Tiger Airways | Various        | 19.2%                 | easyJet            |
| 17.8%                 | AirAsia Group | Various        | 18.7%                 | AirAsia Group      |
| 17.0%                 | Flybe         | Various        | 18.1%                 | AirAsia X          |
| 16.5%                 | AirAsia X     | Various        | 15.7%                 | Flybe              |
| 15.3%                 | Jetstar       | Various        | 14.7%                 | United Continental |

► Table 2: Top 10 Airlines – Ancillary Revenue per Passenger (Euros)

| Annual results – 2011 |                    | Primary source | Annual results – 2010 |                    |
|-----------------------|--------------------|----------------|-----------------------|--------------------|
| €40.91                | Qantas Airways     | FFP            | €29.45                | AirAsia X          |
| €33.61                | Spirit             | Various        | €26.24                | Qantas Group*      |
| €33.30                | Jet2.com           | Various        | €24.23                | United Continental |
| €30.79                | AirAsia X          | Various        | €24.20                | Jet2.com           |
| €29.36                | United Continental | Various        | €23.20                | Allegiant          |
| €27.37                | Allegiant          | Various        | €17.76                | Spirit Airlines    |
| €19.81                | Alaska Air Group   | Various        | €17.67                | Aer Lingus         |
| €18.80                | Jetstar            | Various        | €16.72                | Alaska Air Group   |
| €17.73                | Aer Lingus         | Various        | €16.06                | Delta Air Lines    |
| €17.65                | Flybe              | Various        | €14.84                | Flybe              |

\* Qantas Group includes Jetstar.

2011 carrier results were based upon recent 12-month financial period disclosures, which may have ended during 2011 or 2012; the equivalent criteria apply for 2010 results.

evident by the carrier's decision to remove 13 passenger seats to accommodate retail activity. It's a smart and savvy innovation and those are attributes shared by other developments occurring in the ancillary revenue arena.

KLM allows passengers to pre-order upgraded meals on intercontinental flights from Amsterdam. Economy class passengers can opt for one of five selections, such as the Bella Italia meal for €12 to €15 extra. AirAsia rolled out a Red Carpet Service offering elite-style perks from a low-fare

airline. Starting at MYR 80 (€20), passengers can enjoy fast-track security, lounge access, early boarding and a ride to the plane in an electric cart. Vueling will hold the middle seat empty, board you early, and provide a drink and snack for a scant €60. United offers a MileagePlus Explorer Visa card providing a free checked bag, two annual airport lounge passes, early boarding, bonus miles and more for a \$95 annual fee the second year. Qantas sells its Q Bag Tag for AUD 49.95 (€39) as a permanent baggage tag with wireless

RFID technology that links to a traveller's booking and permits easy self-checking of bags on flights within Australia.

Low-fare airlines dominate when it comes to the percentage of total revenue that ancillary income takes (see Table 1, p4), due to the inherent statistical advantage of selling lower fares, where ancillary revenue is naturally a larger piece of the revenue pie. Spirit Airlines rose to the top of this list for 2011 based on its unbending desire to reward shareholders. The carrier broke the 30% mark, achieving a solid 33.2%.

## Case study 1: Jet2.com

|                                  |   |
|----------------------------------|---|
| <b>Source and type</b>           | Multiple ancillary revenue activities   |
| <b>Ancillary revenue</b>         | €146,524,728  |
| <b>Total revenue</b>             | €540,015,600  |
| <b>Passengers</b>                | 4,400,000   |
| <b>Information source</b>        | Dart Group Plc. Interim Report for the Half Year Ended 31 September 2011 and Dart Group Plc. Interim Report for the Year Ended 31 March 2011  |
| <b>Ancillary revenue profile</b> | <p>Jet2.com is a UK-based airline owned by the Dart Group Plc.</p> <p>Ancillary revenue per passenger increased 7% to £27.87 (€33.53) during the half year (2010: £25.93 [€31.20]), through a continued focus on pre-departure, in-flight and ancillary product sales. Jet2.com is also rapidly developing its database-driven e-marketing campaigns targeting customers with relevant retail products prior to departure.</p> <p>Ancillary revenue activity was generated from a number of sources including checked baggage charges, online seat assignment, seats with extra legroom, onboard sales, pre-order food, and commissions on car hire.</p> <p>The airline increased holiday-related ancillary revenue by adding à la carte services to the Jet2holidays booking process; customers may now order in-flight meals or book a seat with extra legroom.</p> |

## Case study 2: Qantas Airways

|                                  |  |
|----------------------------------|--|
| <b>Source and type</b>           | Multiple ancillary revenue activities  |
| <b>Ancillary revenue</b>         | €1,141,720,000   |
| <b>Total revenue</b>             | €9,602,960,000   |
| <b>Passengers</b>                | 27,907,000 (excludes Jetstar)  |
| <b>Information source</b>        | Annual Report 2011 Qantas Airways Ltd Fiscal 2011 Results – Supplementary Slides   |
| <b>Ancillary revenue profile</b> | <p>Total revenue for this period: AUD 515 million (€407.26 million). This amount was reduced to AUD 312 million (€246.75 million), to reflect Jetstar's representation of approximately 40% of the group.</p> <p>The Qantas Frequent Flyer programme achieved revenue of AUD 1,148 million (€908.03 million) for fiscal year 2011. Earnings of AUD 342 million (€270.51 million) (underlying EBIT) were achieved. Earnings growth has been driven by new products and services with key business partners, capacity increases across the flying businesses and additional revenue from new members. Billings (linked to the sale of miles) increased by 9% compared to the prior year and membership has increased 10% on the prior year to 7.9 million members as at 30 June 2011. The frequent flyer revenue was attributed to Qantas Airways.</p> <p>3.9 million seats were redeemed for flight awards (up 6% from last year) and over 500,000 products were redeemed in Qantas Frequent Flyer Store (up 48% from last year). Any seat reward redemptions now represent more than 23% of all redemptions.</p> <p>IdeaWorks estimates 2011 ancillary revenue was AUD 1,460 million (€ 1,154.45 million) represented by the AUD 1,148 million (€907.75 million) frequent flyer revenue and AUD 312 million (€246.69 million) from other activities.</p> |

Management teams are warned that Spirit's methods – such as the notorious fee for larger carry-on bags – are not for the faint of heart.

Spirit has garnered abundant negative media coverage for its bare-knuckled approach to cost cutting and fee collection. Contrary to the pundits, consumers voted favorably with their pocketbooks by giving the carrier plenty of business. A recent article in the 12 May 2012 edition of the *Wall Street Journal* reported the airline 'earned 40 percent

more per airplane than any other US airline'. That type of result only occurs when planes are filled with passengers – and revenue.

Consumers choosing a low-fare airline can pay a small fee for basic transportation, or opt for everything on the à la carte menu and pay a price comparable to those charged by a global network competitor such as American Airlines or British Airways. Navigating the booking process associated with these ancillary revenue champs constitutes a labyrinth of fee-based choices

for baggage, seat assignments, early boarding and offers for travel insurance, hotel accommodations and car rentals. Some even promote a €1 fee to have a flight itinerary sent to a passengers mobile phone. With 15 to 33% of revenue produced through these methods, ancillary revenue success is a matter of financial survival for these low-fare airlines.

Ranking airlines by ancillary revenue per passenger (see *Table 2, p4*) provides an interesting mix of global giants, ▶

### Case study 3: Allegiant

|                                   |  |
|-----------------------------------|--|
| <b>Source and type</b>            | Multiple ancillary revenue activities  |
| <b>Ancillary revenue</b>          | €169,045,170   |
| <b>Total revenue</b>              | €627,189,185   |
| <b>Passengers</b>                 | 6,175,808  |
| <b>Information source</b>         | Allegiant Travel Company, Form 10-K for the period ending 31 December 2011, and Management Presentation dated March 2012   |
| <b>Ancillary revenue profile</b>  | <p>Allegiant generates ancillary revenue from air-related charges and third-party products. Air-related revenue is generated through charges associated with purchasing tickets via the website, as well as for checked bags, advance seat assignments, priority boarding, and other services provided in conjunction with scheduled air service. Ancillary revenue is also generated by third-party products through the sale of hotel rooms, ground transportation (rental cars and hotel shuttle products), attractions and show tickets and fees received from other merchants selling products through the website. Ancillary revenue is recognised as net of amounts paid to wholesale providers, and net of travel agent commissions and credit card processing fees.</p> <p>Ancillary revenue increased 8.2% to \$209.99 million (€157.14 million) in 2011, up from \$194.0 million (€145.17 million) in 2010, driven by a 5.1% increase in ancillary revenue per scheduled service passenger from \$34.59 (€25.89) to \$36.36 (€27.21) and a 3.0% increase in scheduled service passengers.</p> <p>Allegiant earns a 28.1% gross margin on the sale of services provided by third parties (hotel rooms, rental cars, hotel shuttle products, attractions and show tickets).</p> <p>During 2011, Allegiant generated gross revenue of \$106.4 million (€79.62 million) from third-party products, which resulted in net revenue of \$29.9 million (€22.37 million).</p> <p>The airline reported the following package sales from 2011:</p> <ul style="list-style-type: none"> <li>• Hotel room nights sold: 647,716</li> <li>• Car rental days sold: 577,749</li> </ul> <p>Allegiant has the following ancillary revenue product offerings:</p> <ul style="list-style-type: none"> <li>• Allegiant believes by offering a simple base product at a low and attractive fare it can stimulate demand and generate incremental revenue as customers pay additional amounts for conveniences they value.</li> <li>• Allegiant's third-party product offerings allow customers the opportunity to purchase hotels, rental cars, show tickets, night club packages and other attractions packaged with air travel. Allegiant has contracts with Caesars Entertainment Inc and MGM MIRAGE, among others, that allow Allegiant to provide hotel rooms sold in packages to customers. In addition, Allegiant has an exclusive agreement with one rental car operator for the sale of rental cars packaged with air travel at most of its leisure destinations. Pricing of attractions, shows and tours are based on a net-pricing model.</li> </ul> |
| <b>Marketing and distribution</b> | <p>Allegiant does not sell through Expedia, Travelocity, Orbitz or any other online travel agencies nor is its product displayed and sold through the global distribution systems, which include Sabre, Galileo, Worldspan and Amadeus. This distribution strategy results in reduced expenses by avoiding the fees associated with the use of GDS distribution points. This distribution strategy also permits Allegiant to closely manage ancillary product offerings and pricing while developing and maintaining a direct relationship with customers. The direct relationship enables Allegiant to engage continuously in communications with its customers, which Allegiant believes will result in substantial benefits over time. With its own automation system, Allegiant has the ability to continually change ancillary product offerings and pricing points, which allows it to experiment to find the optimal pricing levels for various offerings.</p>  |

low-fare airlines, regional carriers and traditional network airlines in the top 10. The Qantas Frequent Flyer Program generates an amazing amount of revenue on a per-passenger basis, notably from the power of its Australian network of co-branded credit cards. The airline takes the novel approach of maintaining multiple bank relationships, unlike the usual method of selecting one bank per consumer market. The programme achieved revenue of AUD 1.148 billion (€896 million) during fiscal year 2011. With 8 million members, that's AUD 143.50 (€112) per programme member.

The airline also generates a fair amount of revenue from traditional à la carte activities. The Qantas Club collection of airport lounges posted AUD 84 million (€66 million) and retail/advertising activities contributed AUD 54 million (€42 million) during fiscal year 2011. Qantas Airways results for 2011 exclude Jetstar, which was included under the Qantas Group results listed for 2010.

Airlines have become more active retailers of travel. Jet2.com, a holiday-oriented airline based in the UK, and Allegiant Airlines in the US, appear in the top 10 list largely based upon their ability to sell vacation packages. Allegiant has dubbed itself a travel company that happens to own an airline. Visiting the Jet2.com website yields an endless buffet of holiday destinations that overwhelm the company's visual identity as an airline. This list proves there are many ways to reach the top.

The results described in this report portray the evolution that is occurring in how travel is sold to consumers. There are still hints of a gold rush mentality here. This is a shortsighted view that invites the scrutiny of regulators, the wrath of journalists and the eventual exit of customers. Best practices allow consumers to view a running total of their purchases and provide detailed descriptions of the products or services offered. Imagine yourself in a grocery store where prices are only discovered at the checkout lane or the label is intentionally blurred to disguise the ingredients. You would cry foul and never visit that shop again. This is a lesson for every airline executive wanting to make a run for the top.

Prosperous companies will make sure to serve their customers successfully – and that's the secret to keeping a positive relationship with employees, consumers and investors. ■

## Top 50 Airlines by Ancillary Revenue Results

|    | Carriers             | Ancillary revenue in euros (€) | % of total revenue | Euros (€) per passenger |
|----|----------------------|--------------------------------|--------------------|-------------------------|
| 1  | United Continental   | 4,162,655,000                  | 13.90              | 29.36                   |
| 2  | Delta                | 2,039,870,000                  | 7.20               | 12.45                   |
| 3  | American             | 1,700,965,000                  | 8.80               | 16.04                   |
| 4  | Qantas Airways       | 1,141,720,000                  | 11.90              | 40.91                   |
| 5  | Southwest            | 949,900,000                    | 7.50               | 7.45                    |
| 6  | easyJet              | 890,122,000                    | 20.80              | 16.33                   |
| 7  | Ryanair              | 886,200,000                    | 20.50              | 11.69                   |
| 8  | US Airways           | 874,230,000                    | 8.20               | 14.37                   |
| 9  | TAM Airlines         | 537,315,924                    | 10.10              | 14.26                   |
| 10 | Alaska Air Group     | 491,050,000                    | 14.10              | 19.81                   |
| 11 | JetBlue              | 430,675,000                    | 11.90              | 16.33                   |
| 12 | Air Canada           | 332,200,800                    | 3.70               | 10.38                   |
| 13 | AirAsia Group        | 327,160,341                    | 17.80              | 10.96                   |
| 14 | Jetstar              | 311,087,400                    | 15.30              | 18.80                   |
| 15 | Emirates             | 309,447,000                    | 2.30               | 9.11                    |
| 16 | Spirit               | 286,265,245                    | 33.20              | 33.61                   |
| 17 | China Eastern        | 266,555,520                    | 2.60               | 3.88                    |
| 18 | Lufthansa Group      | 197,000,000                    | 0.70               | 1.96                    |
| 19 | Allegiant            | 169,045,170                    | 27.00              | 27.37                   |
| 20 | Aer Lingus           | 168,651,000                    | 13.10              | 17.73                   |
| 21 | Norwegian            | 160,435,700                    | 11.60              | 10.22                   |
| 22 | Jet2.com             | 146,524,728                    | 27.10              | 33.30                   |
| 23 | SAS Group            | 133,200,000                    | 2.90               | 4.90                    |
| 24 | Flybe                | 129,990,000                    | 17.00              | 17.65                   |
| 25 | Aeroflot             | 113,102,500                    | 2.60               | 7.96                    |
| 26 | Frontier             | 109,398,695                    | 7.70               | 7.32                    |
| 27 | AirTran*             | 102,557,000                    | 14.30              | 13.26                   |
| 28 | Vueling              | 97,414,000                     | 11.30              | 7.91                    |
| 29 | WestJet              | 95,898,600                     | 4.00               | 5.98                    |
| 30 | AirAsia X            | 77,893,200                     | 16.50              | 30.79                   |
| 31 | China Southern       | 77,364,000                     | 0.70               | 0.96                    |
| 32 | Cebu Pacific         | 76,334,113                     | 11.80              | 6.40                    |
| 33 | Tiger Airways        | 73,568,201                     | 19.10              | 13.46                   |
| 34 | Pegasus              | 63,822,849                     | 10.10              | 5.63                    |
| 35 | Hawaiian             | 57,185,590                     | 4.30               | 6.60                    |
| 36 | LAN Airlines         | 48,964,930                     | 1.10               | 2.17                    |
| 37 | Virgin America       | 39,420,850                     | 5.10               | 8.15                    |
| 38 | Air Berlin           | 38,592,000                     | 0.90               | 1.09                    |
| 39 | South African        | 26,696,000                     | 1.30               | 3.14                    |
| 40 | GOL                  | 15,987,338                     | 0.50               | 0.44                    |
| 41 | Sun Country          | 10,871,525                     | 4.50               | 9.83                    |
| 42 | PIA Pakistan         | 10,331,280                     | 1.00               | 1.74                    |
| 43 | Jazeera Airways      | 10,195,405                     | 6.20               | 8.50                    |
| 44 | Jet Airways          | 7,834,400                      | 0.40               | 0.53                    |
| 45 | Royal Jordanian      | 7,377,500                      | 1.30               | 2.31                    |
| 46 | Air Arabia           | 7,359,933                      | 1.40               | 1.57                    |
| 47 | Air Astana           | 6,068,895                      | 1.00               | 2.02                    |
| 48 | Kingfisher           | 4,284,000                      | 0.50               | 0.36                    |
| 49 | SpiceJet             | 3,109,260                      | 0.80               | 0.36                    |
| 50 | REX Regional Express | 1,872,780                      | 1.00               | 1.56                    |

Data source: Research conducted between March and June 2012 by IdeaWorksCompany of the financial statements filed by 50 airlines worldwide.

\* AirTran results are for partial year – January through April 2011.