



## **easyJet plc: a basic analysis of the company**

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### **Introduction**

In the week that the Chairman and Founder of the company resigned from the Board of Directors, here is a brief review of easyJet plc.

easyJet plc is a new company by most standards, having been set up in 1997. In five short years and in an intensely competitive market, easyJet has grown at an impressive rate: from sales of £46 million in its financial year 1997 to sales of £357 million in financial year 2001.

### **The easyJet Model and Modus Operandi**

easyJet's basic business model is that it is a low cost airline: competing head on with the major airlines such as British Airways, KLM, Lufthansa and so on. easyJet has also found itself in competition with other low cost airlines such as RyanAir of the Republic of Ireland, Buzz and Go.

The popularity of easyJet is borne out by its trading results: after only five years it reports that 7.1 million people chose to fly easyJet in the year ended 30 September 2001. The easyJet network now consists of 35 routes serving 17 airports in 16 cities. easyJet also reports a load factor, occupancy, of 83% for the year ended 30 September 2001: an increase over 80.8% for the previous financial year.

Moreover, the company continues to expand and has announced that by May 2004 its fleet will consist of 48 aircraft.

For the year ended 30 September 2001 easyJet plc made a profit before tax of £40.1 million, up 82 per cent on last year with fares having been increased by an average of 5.8 per cent.

The airline averaged 11.5 departures per day per city across its network during September 2001 flying to 17 airports in 16 cities and operate 35 routes: in addition to the holiday maker and the price conscious traveller, easyJet believes that both its prices and its schedules are attractive to the business traveller.

easyJet's business model centres around its general low cost philosophy. That is, easyJet attempts to cut out all non value adding activities as it strives to drive costs down to the absolute minimum. Examples of how it drives its costs downwards include selling directly to its customers rather than via agents and middlemen: thus saving commission costs. The airline is also ticketless: a customer buys a ticket, 91% of which are sold over the internet (in the previous year, only 77.8% of sales were over the internet), in return for a booking reference that is then exchanged at the check in counter at the airport for a boarding pass.

easyJet has no inflight meals: a cost saving measure that cannot be much of an inconvenience to its customers since all flights are short haul: no one will suffer from acute hunger on an easyJet

flight! Nevertheless, easyJet has subcontracted catering services on its flights: customers can BUY an inflight meal and drink should they wish.

Cabin crew double up as cleaners (I'm not sure whether this includes the pilots!) and this helps easyJet to promise a turnaround time at any airport of 30 minutes rather than the 45 – 60 minutes that has traditionally been the norm.

Another cost cutting device, within the UK at least is to use smaller airports as its base. Not only are smaller airports, such as London Luton or Liverpool, cheaper to fly from than bigger airports such as Heathrow, or Manchester, they are also a lot less congested and turnaround times for aircraft are a lot shorter.

easyJet has a seat pricing policy that causes fares to rise as a flight fills up: following the hypothesis of supply and demand, if someone wants a seat so badly, they'll pay more for it than otherwise.

### **easyJet Strategy**

easyJet's strategy and business model continues to be based on six key strengths that support our competitiveness, scalability and sustainable growth:

- Commitment to safety and customer service;
- Simple fare structure - book early for low prices;
- Low unit costs;
- Strong branding;
- Multi base network - dense point-to-point services, mainly between major European airports; and
- Strong corporate culture.

### **Aircraft and Routes**

By the beginning of 2001, easyJet was operating into and out of London Luton, Liverpool and Amsterdam as well as Geneva). Its new services began linking Amsterdam to Edinburgh, Belfast, Barcelona, Glasgow, London Gatwick and Nice. It began new services linking Belfast to Edinburgh and Glasgow, and London Gatwick to Nice were begun.

In line with its low cost focus, they withdrew the Liverpool-Luton service because of the increase in charges at both those airports.

### **Employees**

easyJet has 1,600 staff and their corporate culture is based on "Orangeness" (the corporate colour): meaning they are "up for it", "passionate", "sharp", "mad about safety", and "mad about cost". 'Orange' is what makes us different.

easyJet's annual report gives accountants and cost analysts a lot to work on: they present us with their cost structure to an extent that almost takes us into the realms of management accounting.

Transforming their data into cost per £1 of revenue, we find:

Ground handling charges, including salaries costs	9.3 pence
Airport charges	11.1
Fuel	13.2
Navigation charges	6.3
Crew costs, including training	11.2
Maintenance, including reserves	7.9
Advertising	3.7
Merchant fees & incentive pay	1.9
Profit before tax	11.2

Notice: 1 fuel accounts for only 13 pence in every Pound of a ticket's price, not that significant.  
 2 despite the policy of cutting out the middleman, they still pay out almost 2 pence in the Pound on commissions.  
 3 net profit before tax is a whopping 11.2 pence in the Pound.

easyJet, unusually, publishes its creditor payment policy, as follows:

The group and the company do not follow a universal code which deals specifically with payments to suppliers but, where appropriate, their practice is to:

- agree the terms of payment at the start of business with the supplier;
- ensure that those suppliers are made aware of the terms of payment; and
- pay in accordance with its contractual and other legal obligations.

At 30 September 2001, the number of creditor days outstanding for the group was 18 days (2000: 16 days), and the company, nil days (2000: nil days).

### Initial Public Offering

On 22 November 2000, easyJet plc listed on the London Stock Exchange. A global offering of 72,450,000 new ordinary shares was offered at a price of 310 pence per share. The offering raised £210.4 million, net of fees and expenses.

Consolidated balance sheet as at 30 September	2001		2000	
	£000	£000	£000	£000
<b>Fixed assets</b>				
Intangible assets		2,995		3,163
Tangible assets		206,433		202,159
Investments		7,159		-
		<b>216,587</b>		<b>205,322</b>
<b>Current assets</b>				
Debtors	47,106		40,959	
Cash at bank and in hand	244,435		14,088	
	291,541		55,047	
Creditors: amounts falling due within one year	-113,428		-84,483	
<b>Net current assets/(liabilities)</b>		<b>178,113</b>		<b>-29,436</b>
<b>Total assets less current liabilities</b>		<b>394,700</b>		<b>175,886</b>

<b>Consolidated balance sheet</b>	<b>2001</b>	<b>2000</b>
Creditors: amounts falling due after one year	-76,289	-108,315
Provisions for liabilities and charges	-1,920	-1,854
<b>Net assets</b>	<b>316,491</b>	<b>65,717</b>
<b>Capital and reserves</b>		
Called up share capital	65,108	46,647
Share premium account	196,638	-
Profit and loss account	54,745	19,070
<b>Shareholders' funds: equity</b>	<b>316,491</b>	<b>65,717</b>

The cash that easyJet received from its IPO is still in the bank! Cash at bank and in hand is £244 million, and the IPO raised £210 million.

### Some of easyJet's Ratios

**return on capital employed (ROCE)** in 2001 was 40.113 million ÷ 316.491 million = 12.67%, down from a monster 33.64% for 2000: the 2001 ROCE has been affected by the cash mountain; if easyJet's cash balance had been at the same level as the previous year, ROCE for 2001 would have been around 56%

**current ratio** is 2.57: 1 for 2001 but only 0.65 for 2000

**IPO** we can justifiably ask easyJet why they carried out an IPO and then left all the cash in the bank? After all, their business is earning premium returns on its assets, so why borrow so much money only to earn very small returns by comparison? Moreover, the Directors decided not to pay a dividend in the year, either. Can we be cynical and suggest that the management of easyJet took the view that they should optimise their position vis a vis the stock market feeling that they might never have it so good again?

### Segmental information

The geographical analysis of turnover is as follows; and as we can see, the vast majority of easyJet's business is within and to and from the UK.

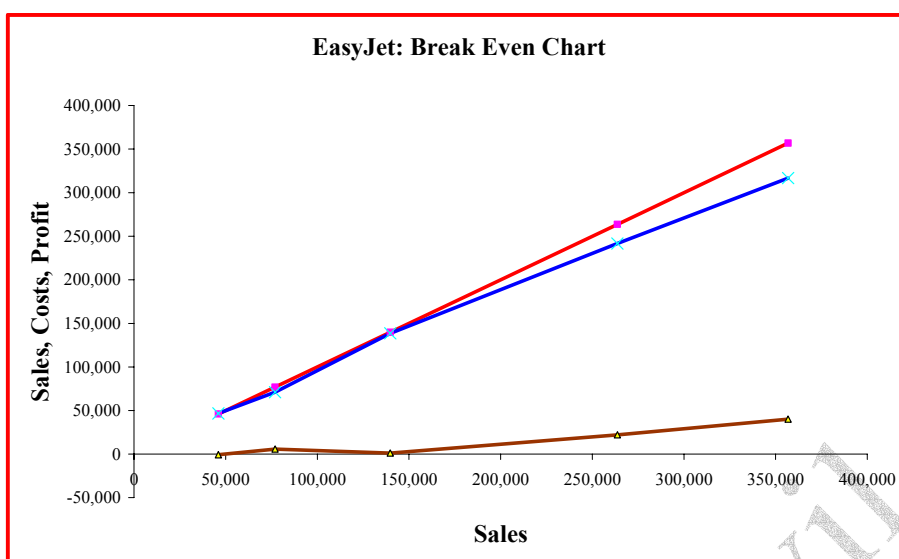
£000	<b>2001</b>	<b>2000</b>
Within the United Kingdom	86,545	73,008
Between the United Kingdom and the Rest of Europe	244,764	177,141
Within the Rest of Europe	25,550	13,545
	<b>356,859</b>	<b>263,694</b>

### Staff numbers and costs

easyJet had around 1,600 employees in 2001 and 1,140 in 2000; and their average salaries are higher than the national average wage by a good margin: in 2001, the average salary was £32,488 and in 2000 it was £31,998. These amounts include social security and pension costs, excluding these amounts, the averages fall to £28,594 and £28,183 for 2001 and 2000 respectively.

## Operating Data

Along with many other public companies, easyJet publishes historical data: in this case, its five years' worth of trading. Plotting some of these data on a graph, we can assess easyJet's break even point:



We can see that easyJet displays the profile of a typical start up company: very low profits in the early year or two and then increasing profitability. According to these data, easyJet would have to suffer a major setback to turn its current successful position around and turn in a loss.

We can also analyse the total cost data that we have derived from the historical data: easyJet's cost function is  $y = 8527.8 + 0.874\text{Sales}$ , meaning that its fixed costs are around £8.5 million and for every £1 of sales, it has variable costs of 87.4 pence.

*Please note:* these calculations are based on highly aggregated data and use ordinary least squares (regression) methods.

## Conclusion

easyJet is a success and any business that has grown in the way that easyJet has and achieved the market share that it has must be doing something right. However, I have to confess that I cannot hold our easyJet as a business model to hold out as admirable in its entirety.

I don't like the way that the airline sells itself as low cost yet in reality it is turning in ROCE ratios that traditional airlines would envy. There is no doubt that easyJet's seat prices are low, but they are not as low as they could be.

I find the IPO and the fact that the company has held onto the cash raised from it as a worrying thing. Subject to explanations to the contrary, I don't see the need for this IPO: easyJet leases its aeroplanes so the £210 million or so is just idle cash.

The directors of easyJet are rewarding themselves very handsomely indeed for a company that is only five years old and that prides itself on cutting its costs to the bone: their salaries certainly aren't cut to any bone! In 2001, the directors remunerated themselves to the tune of £912,000

with the highest paid director being paid £219,000 for the year. There are five executive directors and seven non executive directors: non executive directors are paid £25,000 a year for the privilege!

I find it worrying that Stelios, the founder of this company, has felt the need to resign from the company, citing reasons to do with stakeholder relations as the cause. Is this because the man is difficult to work with, is it because they feel the business model is suspect or is it because of a basic power play?

In spite of my personal worries over the easyJet philosophy, I can't help but applaud the way the business has succeeded; and the way that it is helping to make the life of the travelling public that much more bearable!

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