

Research @ Citi Episode 58: Airline Volatility — Smooth Skies or Turbulence

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Host: Anne Malone, North America Head of Equity Research, Citi

Guest: John Godyn, Head of Aerospace, Defense, and Airlines, Citi

Transcript:

Anne Malone (00:00)

Hi, everyone. Welcome to the Research @ Citi podcast. I'm Anne Malone, the North America Head of Equity Research at Citi. With me on the podcast today is John Godyn. He covers the airlines and aerospace and defense sectors at Citi. Today, we'll focus solely on the airlines.

John, always fun to talk to you.

John Godyn (00:17)

Thanks, Anne.

Anne Malone (00:18)

Let's start. It's around the holidays. So what are you thinking about holiday travel? And, maybe more importantly, does it matter?

John Godyn (00:27)

It definitely matters. As you said, holiday travel is a big deal. What we've seen over the last few years is that every year we're making new records in holiday travel. And I was just looking at a news blurb from the FAA and apparently this is the biggest holiday-travel season in 15 years, that we just saw coming out of Thanksgiving.

So I think we're set up for another big holiday-travel season heading into Christmas, New Year's, etc. And the good news is we've got the wind behind our backs. We had a good Thanksgiving — largely uneventful; no major, major disruptions.

Of course, there's always some disappointed travelers here and there, but no big weather events or anything like that. I think it seems like it's smooth sailing right now into the holidays. But of course, we'll see with weather and how it shapes up.

Anne Malone (01:14)

A new record just amazes me because we talked to Steve Zaccone a couple of podcasts ago about the resilient consumer, right? There's a lot: Eggs are expensive, gas is expensive. Does it surprise you that we can set new records?

John Godyn (01:20)

No. From an airline perspective, the airlines as an industry have been doing quite well this year. Industry profits are actually very solid. I think what's a little bit curious is that it hasn't been spread evenly around the carriers, and that might be something that that we talk about soon. But overall, demand for travel since COVID, as you may know, has been very robust. It's been very insensitive to the economy and sensitive to interest rates.

At the lower end, if a consumer is having affordability issues with traveling, they've got other options like Zoom, etc., to connect with people. And at the higher end, more and more I think we're seeing people press into what are segmented premium-economy-type products that the airlines are rolling out.

And even above that, frankly, Anne, business-jet and private-jet demand has been quite robust as well.

Anne Malone (02:21)

It's amazing. More directly, though, it is a blip in the course of a year, the holiday season. Does holiday travel matter to the stocks? Do people play it? Do the stocks react to it?

John Godyn (02:35)

If it becomes a strong signal of the leisure consumer, for sure, because leisure travel matters. Typically, what we see across the industry is that leisure — or what's called VFR, visiting family and relatives — that can be something along the lines of two-thirds of the total volume for airlines. It's typically about one third of the revenue with business travel, corporate travel, being the balance — where business travel is usually thought of as about one third of the volumes, but two thirds of the revenue. Of course, those tickets are much more expensive.

So when you fill up the plane with leisure passengers, when there's a strong demand signal coming out of the leisure markets — and we can see that in the holidays at times — it definitely sets a positive tone because the airlines can't do what's called yield-managing the corporate customer. Yield management is essentially optimizing prices for people that are willing to pay those prices. They can't do that if the rest of the flight isn't full of the leisure passenger.

So it definitely matters. If we have a strong holiday season, it's a good signal that the consumer may be strapped in other areas, but is willing to spend money on travel. That fills up the plane. That allows the airlines to yield-manage more aggressively in other areas of the plane, like corporate. And that overall creates a much better revenue

picture for the airlines heading into next year. So we're definitely following holiday travel closely.

Anne Malone (04:02)

Is that mixed leisure vs. business? Was that true pre-COVID? You mentioned COVID in passing. Are there a lot of changes in how travel is defined pre- and post-COVID?

John Godyn (04:15)

That's actually a great question. Those numbers that I gave you were a little bit generalized historical numbers, and frankly, post-COVID the mix has changed. What we've seen with some of the data that we track — and I'm happy to ask that question, because we did publish something called the Citi Business Travel Barometer in one of our recent pieces of research that tracks corporate quite closely — is that corporate travel is significantly lower than it was at its peak pre-COVID.

So there's no question there's been a change there. What's interesting, though, is that the leisure segment has also evolved post-COVID. When you talk to the airlines, I said one-third corporate, two-thirds leisure. What it's really become is one-third premium passenger, two-thirds leisure. A big chunk of that premium-passenger base is corporate. But another piece of it is leisure passengers who are willing to spend more for a better travel experience.

We've all seen this kind of segmentation going on between premium economy and what's called basic economy. I think a lot of people on this podcast have probably experienced that or seen that. And the airlines are doing a great job targeting these premium customers with premium product, different ancillary-revenue fees, things like that are taken care of in those more-expensive tickets. The person overall gets a much better experience. Maybe they get upgraded to first class or business class more often if they buy a certain type of ticket, etc.

And we've seen the airlines — the big airlines, at least what we call the super majors — do a great job of attacking the overall consumer wallet, segmenting it, and pushing passengers toward that premium end.

So your question was, “Have things changed after COVID?” Absolutely. As a percentage of that premium volume base, corporate is a much smaller percentage, but premium leisure has made up the difference and doesn't really seem to be changing anytime soon. The trends there are very strong.

Anne Malone (06:10)

So changed, but unlikely to change back.

John Godyn (06:14)

No. Unlikely to change back.

Anne Malone (06:18)

So, let's dig into that super major, right? That new term that I only saw once you published your launch. What's a super major?

John Godyn (06:26)

Yeah, I love that. Thank you for asking that question. "Super majors" are a term that we coined to describe Delta, American and United Airlines — those are the big network carriers.

Once upon a time, many years ago, people in the investment community would call those the legacy airlines. And that was designed to be a little bit of a jab at those carriers because there was a time where those carriers did not operate very well at all. The product was dated. The aircraft were old. The companies had struggled a lot with labor relations.

There was a time where there was a lot of mergers happening and different issues cropped up as part of those mergers. And if I take you a little bit farther back in history — actually, many of those so-called legacy airlines at one point were bankrupt.

Anne Malone (07:11)

I remember that.

John Godyn (07:12)

So, you know, this is an industry subsector that really over many decades has had a tough time. But, out of that difficulty and coming out of COVID in the last five or so years, they've really defined a new segment in the market, one that we think is characterized by a few features that are very unique to them.

Number one, they have hubs that are capacity-constrained — in our language, slot-constrained. It's very difficult today to just start up a new airline in a major hub. Those hubs are difficult to operate in. It's nuanced. And certain airlines have a very special position at a lot of these airports, right? And you know which ones those are.

Delta at Atlanta has a famous dominance over that airport. American over Dallas-Fort Worth, there's a storied history there. and United Airlines in Newark, which is a major airport in the New York area. So these dominant positions are very powerful.

The other asset that these super majors have is they have these loyalty plans. In these loyalty plans, they partner with their co-brand credit-card partners. So again, most people have one of these cards in their wallet. These cards typically do much, much better for the credit-card companies than alternative loyalty plans. And the consumer, the airline traveler, loves the product as well.

What's one reason somebody might pick up a Delta basic-economy seat, even though they know that it's not the most comfortable seat, even though they know that they won't

be able to pick exactly where in the aircraft they sit, they might not be able to get an assigned seat? And hopefully they're not traveling with bags, because they might have to pay a little extra for that. The reason they put themselves through that for some of these airlines is because they still want their loyalty miles. They still want an opportunity to gun for a vacation or a trip with their family to Hawaii or some other amazing travel destination.

So these frequent-flyer plans have really become dominant. They're growing at double-digit rates. They're contributing an unusual percentage of the revenue and earnings of these large airlines, and it really has become a competitive moat.

The last piece of the puzzle for these airlines that I think makes them a bit special, is putting the secret sauce of all of that together. You've got the right assets. You've got the right frequent-flyer plan. They are able to continue investing in technology and their aircraft in ways that the peers aren't. And they're able to deliver a complete product, almost like a different travel experience for the average consumer vs. what they're used to from a lot of what were formerly called low-cost carriers, but today we call them legacy low-cost carriers because they kind of reprise the role that the legacy airlines used to before they became the super majors. So hopefully that gives you a sense of what's going on in the industry.

Anne Malone (09:55)

So I like the visual of the word “moat,” on the super majors. Does that mean you don't see their competitive strength changing anytime soon?

John Godyn (10:05)

That's right, and I think that's key. That's why we've rebranded and relabeled those specific carriers. Because if we just went through the thought experiment of starting up a new airline today, you really couldn't face one of these super majors as your primary competitor. It would be impossible.

The startup activity occurring in airlines today is really around the edges. It's at airports you've often never heard of that are not well serviced. And that's different than history. If we just think about some major historical airline startups in the New York area — we're both here in New York — JetBlue, roughly 20 years ago, started up an airline right in JFK. They have a whole terminal to themselves in JFK.

That's the kind of competitive action that was possible over two decades ago. Something like that really couldn't happen today based on the competitive landscape as we see it. And that's why these companies have graduated from first being called legacy airlines to then being called network carriers. And today we believe they deserve the phrase “super major” — something special to really point out the fact that they're so different than they used to be.

Anne Malone (11:18)

So what happens to — and there I think are two other segments — what happens outside of a super major? How do you survive? How do you prosper in this new world order?

John Godyn (11:32)

So, in this new world order, you're right that we've defined three different segments.

First, super major.

Second, legacy low-cost carriers. And in our report, we've described Southwest Airlines and JetBlue as that type of carrier. These are low-cost carriers whose business models were essentially invented under very different assumptions, very different competitive landscape. Usually multiple decades ago, where things have really changed, they've gone through multiple cycles of labor negotiations. So their labor cost structure has really evolved. Their fleet is mature. It's not as young and efficient as it used to be. These are companies that had great business models many, many years ago, but today are showing their age and are in a different competitive situation. So again, legacy low-cost carriers.

The last group is what we've called the niche carriers. The niche carriers, every consumer has some awareness of them. It depends on where you live, you've probably run into them. But these are companies like Allegiant Airlines; Sun Country Airlines; SkyWest, which operates flying for some of the network carriers, the super majors, but also flies a little bit in its own right.

These are the niche carriers, kind of around the edges. They typically have very regionally focused operations. They typically are pursuing what's usually known as an ultra-low-cost-carrier business model, bringing some very, very low fare points to an underserved market, perhaps in a non-major market or in airports that typically don't get service from the super majors. They're really trying to stay away from competition and offer low price points as long as they possibly can.

They often have different bells and whistles associated with their business models. So Allegiant Air is famous for unbundling their fares in a very unique way, where you kind of have to pay for everything. They're also famous for doing a great job of bundling hotel and travel experiences with their fares. So, it's a very much like a leisure-destination-oriented airline.

Other airlines approach things a little differently. Sun Country is unique in the fact that they have a major cargo operation with Amazon going on right now, which is a little bit unusual for the passenger airlines that we follow.

So with the niche carriers typically staying away from competition, typically doing their own thing, typically trying to differentiate, usually for most of them, the customer feedback is positive. Unfortunately, those carriers typically are not large enough and

impactful enough to go head-to-head with super majors that are much stronger than they used to be.

Anne Malone (14:05)

So lesson learned: I am not going to successfully start an airline anytime soon.

John Godyn (14:11)

I don't think so.

Anne Malone (14:13)

So what does all that mean for M&A? It's always a question we ask about stocks. Are the super majors too big for it? Are the niche ones too niche to make it matter? What happens there?

John Godyn (14:26)

I think the landscape is very interesting in airlines today. I'll give you a quick bit of history. The biggest airline cycle as measured by profitability was an airline cycle between 2012 and roughly 2016. And consumers on the pod might remember that as a time where a lot of major airlines were merging simultaneously. It was a very unique time. We've called it the "stronger for longer" cycle, back then looking in the rear-view mirror.

And that was a time where American was merging with US Airways. Delta was on the tail end of having merged with Northwest Airlines. Southwest had purchased and was integrating a carrier called AirTran, which was very big in the Atlanta area. And United was on the tail end of merging with Continental Airlines. So every major airline — the four biggest ones, American, Delta, United, and Southwest — all had a large M&A transaction that they were digesting. And that ushered in a period of very disciplined capacity growth, very coordinated, if you will, activities across airlines that I think just reinforced a backdrop of profitability.

Now, with the airline industry being as competitive as it is, even though those competitive pressures are less today than they have been historically, it's still very competitive. There is volatility in the earnings stream. Airlines still are subject to very volatile demand trends and difficult to predict. And there are people who believe that another round of consolidation is necessary or might need to happen. And there are some signposts of that.

One typical condition that triggers consolidation in the airline industry is bankruptcies. We have a major public bankruptcy going on right now: Spirit Airlines. We'll see exactly what happens to those assets, but I think it's no secret that bankruptcy events like what we're witnessing have led to changing of hands or mergers or different opportunities to reshape and reposition those assets. And we'll see how that plays out over time.

There are other airlines that are not doing so well. Some have equities that over the last handful of years are down tremendously and have underperformed the market tremendously. As a historical fact, I would highlight Southwest and JetBlue as two of those carriers.

I don't think that any of the very large players are going to be able to merge with each other. I think those rounds have happened. But if the smaller carriers continue to struggle, I think there's definitely an opportunity for various consolidation events or M&A and a dialogue around that. And we'll see how that shapes up.

So I think the probability is actually quite high that you see large buying small, or small-to-small-type M&A with some of these carriers that have their back to the ropes right now.

Anne Malone (17:25)

OK. But when you give us that history lesson, the "stronger for longer" cycle, that disciplined capacity growth, as you named it, was that obvious then? Or is it that you get to see it now in a perspective of the 2020s?

John Godyn (17:31)

It was definitely obvious at that time. What happens when two carriers merge is those assets of both parties have to be slowly digested over time. And that ushers in a period for any individual carrier: very careful, conservative capacity growth and careful operations, very disciplined approach. You're not doing anything aggressive because you're merging two large entities.

Now imagine a scenario where four large airlines were doing that at the same time. Well, then you can very clearly visualize that the whole industry had this almost coordinated, disciplined approach that was very, very unusual.

I don't think we're going to see an event like that. Could we see a large carrier buy a small one, or purchase the assets of a small one? Yes. Could we see two large players merge like we had roughly 10 years ago? Very unlikely for regulatory reasons.

But I should add that even right now, Alaska Airlines a couple of years ago purchased Hawaiian Airlines. So around the edges we continue to see M&A among smaller and regional carriers, even to this day. This playbook continues to get executed. And I don't see it changing. I just think it's unlikely the very large players merge with each other.

Anne Malone (18:46)

OK, makes sense. There's so much space I'd love to cover, but we're going to reach the end of our time. I created a speed round, John.

John Godyn (18:55)

Sure.

Anne Malone (18:56)

This is all based on personal, all right? Window or aisle?

John Godyn (19:00)

Aisle.

Anne Malone (19:01)

Recline or no recline? That's a big debate.

John Godyn (19:05)

So this is a big debate in social media. I've seen it all around. The airlines allow you to recline. And the way that the rules work is if you're allowed to recline, you want to be careful, you want to be conscious, you want to be cognizant of the passengers around you, you want to be respectful always, but you are allowed to recline. I think people enjoy reclining seats.

And let's not forget that a lot of air travel happens during non-peak periods, what are sometimes called red-eye periods. People need to be able to shut their eyes, they need to be able to lay down, they need to be able to sleep. They need to be able to recline a little bit and get a little bit comfortable. I'm in favor of reclining.

Anne Malone (19:48)

OK, it took a while to get to that very political answer. I like that, though! Dress code for airlines: Are you pro or con PJs?

John Godyn (19:57)

Well, we've seen a lot of commentary out of the industry trying to point consumers in the direction of being a little bit more professional, a little bit more considerate. Every so often there'll be something that hits social media or hits the newswire about dress-code violations, and sometimes that gets out of hand. I think, again, people really need to respect the other passengers on the flight, and one way to show respect to each other is to dress appropriately.

Anne Malone (20:24)

All right, final question: What is it with the average airline seat size and is anyone going to address it?

John Godyn (20:32)

Well, the buzzword you're looking for, Anne, is what's called seat pitch, which is the space — the leg room, essentially — in front of you. Most economy seats, most airlines operate on a seat pitch of something around 31 or 32 inches. That's very normal. That's

very standard. And typically, if you want more, they give you the option of paying for it one way or another. Economy Plus, business class, etc.

There are a few airlines that historically have differentiated with better seat pitch. JetBlue is an example of that. It doesn't always work out financially for those airlines. Typically, adding an extra row or two is actually the better financial decision. So I'm not sure that seat pitch is changing anytime soon, unless you want to pay for it.

Anne Malone (21:20)

Fair enough. And that's probably true of most of the economy. John, you somehow made talking about airline stocks enjoyable, and I appreciate it.

This podcast was recorded on Dec. 9, 2025. Be sure to join us for our next Research @ Citi podcast.

Disclaimer (21:36)

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