CEO SPOTLIGHT

Delta's CEO Has the Right Flight Plan

The airline's shares have soared since Richard Anderson took the controls, forming global partnerships and improving customer service.

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Next month will mark 10 years since Delta Air Lines filed for bankruptcy protection, laid low by industry fare wars and management blunders. What a difference a decade has made: The nation's second-largest airline based on passengers served, Delta is thriving today after waves of industry consolidation and savvy investments in technology, employees, and international growth. The company boasts rapidly rising earnings, the highest credit rating of the legacy U.S. carriers, an excellent service record, and a loyal shareholder base.

Much of the credit for Delta's (ticker: DAL) comeback goes to CEO Richard Anderson, 60, who took the controls in September 2007, just a few months after the company's emergence from bankruptcy court. Straight-laced, cost-conscious, and fonder of Faulkner novels than management tomes, Anderson has proved to be a strategic thinker and innovator in an industry once bereft of both. In addition to offering customers more and better choices in the air, he has made some surprising moves on the ground—like buying an oil refinery from Phillips 66 (PSX) in 2012 to help control fuel costs. Despite Wall Street's initial skepticism, the purchase has paid huge dividends for Delta.

Most important, Anderson recognized early on that Delta's success would depend on forming partnerships with non-U.S. carriers and building a global route network. An airline, he says, is "essentially like the mobile-phone, railroad, or trucking business, in that it is capital intensive and has to have economies of scope and scale."

Within a year of taking charge, Anderson merged Delta with Northwest Airlines, his former employer, crucially giving the combined company a hub in Tokyo and Asian routes out of Amsterdam via Northwest's longstanding alliance with Dutch carrier KLM. The deal set the stage for a string of partnerships that has made Delta a global player; the airline and its Delta Connection partners now serve 334 destinations in 64 countries.

Following the Northwest merger, Delta expanded its European base, including links with KLM and Air France, to include a joint venture with Italy's Alitalia. It also acquired 49% of Virgin Atlantic to gain greater access to London's Heathrow Airport, a nexus of global business travel. The Virgin partnership paired Anderson with his temperamental opposite, Virgin's freewheeling founder, Richard Branson, who has made a game of slicing off the Delta chief's neckties. Anderson foiled a scissor-wielding Branson at a meeting earlier this summer by wearing a tie made of wire mesh.

Delta has ramped up its presence, as well, in fast-growing markets in Latin America and Asia. In March, the airline announced plans to launch a $1.5 billion joint venture with Mexico's Aeromexico, and recently increased its stake in the Brazilian airline GOL (GOL). Then, last month, it paid $450 million for a 3.6% stake in China Eastern Airlines (CEA), becoming the first U.S. carrier to own part of a Chinese airline. "Building Delta's presence in Asia is a real asset," says Gerald Grinstein, the company's former CEO. "Anderson has the right view from 30,000 feet."

Delta has expanded aggressively in the U.S., too, gaining coveted business travelers at New York's LaGuardia airport by swapping Washington landing rights in 2012 with U.S. Airways, now part of American Airlines Group (AAL). Today, Delta dominates the New York market with 227 daily departures from LaGuardia, more than its major competitors combined. The company, based at Atlanta's Hartsfield-Jackson airport, has tripled its U.S. hubs in recent years, to nine.

Anderson's moves have paid off handsomely for Delta investors. The stock has soared 250% since the end of 2007, to a recent $47, more than quadruple the gain of the Standard & Poor's 500 index. The company boosted its quarterly dividend in May to almost 14 cents a share from nine cents, for an annual yield of 1.2%, and announced it would buy back $5 billion of stock by 2017; dividends and buybacks are expected to return $6 billion to shareholders.

Delta also has been paying down debt. Adjusted net debt, which stood at $7.1 billion as of June 30, is down from $15 billion at the end of 2010. Management aims to reduce that number to $5 billion in 2016.

Delta's shares have slipped in recent months from a January peak of $51, due to slower-than-expected domestic growth, unfavorable currency trends, and pricing pressure. To some degree, the company failed to anticipate the market's—and the economy's—current weakness; it increased flights and seating capacity in the first half of the year. Revenue per passenger mile fell 3% in the June quarter, meaning customers spent 3% less per mile flown.

Delta earned $2.8 billion, or $3.31 a share, last year, on revenue of $40.4 billion. (Only American, with revenue of $42.7 billion is larger.) Analysts expect the company to earn $4.51 a share this year, helped by lower fuel costs, and $5.42 in 2016, as revenue climbs to $42 billion. Shares trade for nine times 2016 estimated earnings, although Anderson argues the company deserves a price/earnings ratio closer to 16, in line with P/Es accorded consumer packaged-goods companies and high-quality transportation concerns such as CSX (CSX) and United Parcel Service (UPS).

"After investing $3 billion in this airline, it will produce close to $5 billion in free cash flow," he says. "There are only 35-40 companies that are going to do better than that."

Anderson was reared in Texas in a close-knit family of seven. His father was a railroad manager and his mother, a medical-office worker. In his freshman year at Texas Tech University, he learned that both parents were dying from cancer. His maternal grandmother, who had lived with the family, was also dying. Within about a year, all were gone. "It sure did get you focused," he says.

Anderson finished college at a University of Houston satellite campus to be closer to home, taking part-time construction jobs and looking after his two younger sisters. He earned a law degree in 1982 by taking night classes at South Texas College of Law, and became a prosecutor in a district attorney's office. Motivated to find a better-paying job when his wife, Sue, also an attorney, decided to become a stay-at-home mother, he joined Continental Airlines in 1987 at the suggestion of his neighbor, Ben Hirst, then the airline's general counsel.

Anderson followed Hirst, now Delta's chief legal officer, to Northwestern in 1990, and was CEO of the airline by 2001. But he left the industry in 2004 for a job at UnitedHealth Group (UNH). "I wanted to find out about other businesses," he says.

He joined Delta's board in April 2007, and became CEO of the airline in September of that year, in a move the board regarded as a coup. "Everyone seemed to know he was best," says Daniel Carp, Delta's nonexecutive board chairman. "No one thought we could get him."

But Anderson was attracted by the opportunity not merely to run a legacy airline but to transform it into something bigger and better. He shared Carp's view, and that of Delta's creditors' committee, that consolidation was the only way to bring efficiency back to the airline industry and create value for shareholders. With a sharply reduced debt load and strong employee culture, Delta had the right platform to acquire more routes, differentiate its service, and grow. "All roads led to Atlanta," Anderson says.

Delta's overhaul has ranged far beyond acquiring Northwest and forming international alliances to encompass nearly every aspect of its business. Anderson has improved the customer experience in myriad ways, notes Carp, from upgrading the quality of plane interiors to offering more seating options to launching an app that allows passengers to track their luggage. "Anderson didn't accept that airline travel was a commodity," says Carp.

Earlier this year, Delta introduced five classes of service, or so-called branded fares, that could bring in up to $1.5 billion in additional revenue by 2018, the company says. They include basic economy, main cabin, Delta comfort (four inches of extra legroom), first class, and Delta One (flat beds), available only on certain flights.

Ironically, basic economy, with seats assigned only after check in, hasn't proved popular, despite the lower fares. Delta might have more success than competitors in up-selling seats because it is known for better service, says Duane Pfennigwerth, an analyst at Evercore ISI.

Many statistics point to its advantage. Delta was tops last year among U.S. airlines in on-time arrivals, according to the U.S. Transportation Department. It "mishandled" two bags per 1,000, half the number that went missing on American, United, and Southwest. "We had 95 days without a single canceled flight," says President Edward Bastian, who credits this record to Anderson's "amazing grasp of operations technology," adding "The other airlines, combined, had only 13."

Anderson also has been savvy about buying and refurbishing used planes, thereby lowering Delta's capital expenditures. He understands the aircraft repair and maintenance business well, having previously overseen maintenance operations at Northwest. Delta's maintenance operations are a profit center for the company, as it offers services to other, smaller carriers.

A motivated workforce arguably has played a big role in Delta's turnaround. The company has an unusually generous profit-sharing plan: It distributes 10% of profit to employees up to $2.5 billion, and 20% above that level. It paid out $1.1 billion in profit-sharing in 2014. With the exception of pilots, Delta's workforce is nonunion, albeit not for lack of the unions' trying. Most recently, the International Association of Machinists and Aerospace Workers withdrew a bid to organize flight attendants, after acknowledging some of the signatures it had collected were forged. The union said it plans to renew its effort in a year.

No matter Delta's amenities, most airline passengers have come to dread flying, given long security check-in lines, crowded planes, and rising fares. This summer, the Justice Department launched an investigation into possible price fixing among U.S. carriers to keep airfares high. Domestic fares fell more than 16% from 2000 through 2014, according to the Bureau of Transportation Statistics, but have been rising since 2009, in tandem with industry consolidation.

Anderson has a few grievances, too. He has publicly complained that Qatar Airways, Emirates, and Etihad Airways receive sizable government subsidies in violation of the bilateral Open Skies agreement, and has asked the U.S. government to intercede. The three Middle East carriers have been gaining market share internationally. "Give us an even playing field and we'll win," he says.

Anderson also has had the Export-Import Bank in his crosshairs for giving cheap financing to his foreign competitors. Air India received money for two Boeing 777s and took Delta out of the U.S.-India market by pricing tickets $300 to $400 below what Delta can charge. Delta sued the bank and lost, but the airline might prove an inadvertent winner, as the bank's budget expired on July 1 and Congress hasn't yet reauthorized funding.

Whether in the skies, on the ground, or in the courts, Anderson, the former prosecutor, argues Delta's case with zeal. Given the company's tumultuous history, and that of the industry, customers, employees, and shareholders couldn't ask for more. •