Talkin’ Consolidation—Again
Catalysts Similar to 2008; Impacts Minimal

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MIT International Center for Air Transportation

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Economic Catalysts behind Reinvigorated Consolidation Talk
Oil & Related Market Volatility

Note: Value in parentheses below year is average price paid per gallon excluding taxes, into-plane fees, pipeline tariffs and hedging costs.
Source: Air Transport Association
Jet Fuel Prices on the Rise Again
Volatile Nature of Industry’s Largest Cost Wreaks Havoc on Business Planning

Source: Air Transport Association
Another Look at the Volatility of a Barrel of Oil
Environment Policies Will Add to Costs Too

Price of Jet Kerosene + Cost of CO₂ Permits

Cost of Jet Kerosene

Source: IATA
2 Carrier Financial Positions
The US Airline Industry Has Lost $22 Billion Since 1978

1978 – 2009E
Airline Industry Profitability Elusive
Pretax Profit Margin Highly Cyclical and Well Below U.S. Corporate Average

Source: Air Transport Association
Cash Balances Are In a Safer Range Than In 2008......

Cash and Equivalent as a % of Revenues - Major Airlines

Source: Bloomberg, Airline Reports
....But At the Expense of Further Borrowing

Balance Sheet Leveraging - Median Airlines

Debt as a % of Total Capital

Source: Bloomberg
Global Context: Airlines Challenged to Cover Cost of Capital
Airlines Not in a Position to Make Large Investments in New Markets or Equipment

Source: Air Transport Association
One U.S. Passenger Airline Has Investment-Grade Credit
No Passenger Airline in the World Enjoys an A-Minus or Better Rating

Source: Air Transport Association
Between 2005 and 2008, the Market Capitalization of the US Airline Industry Showed Little Change

**May 26, 2005**
Market Cap = $22.3B

**October 24, 2009**
Market Cap = $22.9B
Today, Southwest Is No Longer Accorded the Highest Market Capitalization Among US Airlines

April 16, 2010
Market Cap = $37.4B

- Southwest: 26.6%
- Delta: 29.1%
- United: 10.2%
- Continental: 8.6%
- SkyWest: 2.2%
- jetBlue: 5.2%
- American: 7.8%
- US Airways: 3.1%
- Republic: 0.6%
- AirTran: 2.1%
- Alaska: 4.1%
- Pinnacle: 0.4%
- Mesa: 0.0%
Legacy Carrier Market Capitalization Nearly $18 Billion More than In 2005

May 26, 2005
Market Cap = $22.3B

October 24, 2009
Market Cap = $22.9B

April 16, 2010
Market Cap = $37.4B
U.S. Passenger Airlines* Market Value in Context
Market Capitalization (Billion USD) as of April 19, 2010 @ 4:00 PM EDT

* U.S. Passenger Airlines
AAI    AirTran
ALK    Alaska
AMR    American
CAL    Continental
DAL    Delta
HA     Hawaiian
J BLU  JetBlue
LCC    US Airways
LUV    Southwest
MESA   Mesa
PNCL   Pinnacle
RJ ET  Republic
SKYW   SkyWest
UAUA   United
XJT    ExpressJet

All Publicly Traded U.S. Passenger Airlines* $37.60
General Electric (GE) $202.10
Walmart (WMT) $204.50
MasterCard (MA) $257.30
Microsoft (MSFT) $272.20
ExxonMobil (XOM) $322.10
Domestic Market Economics
The Relationship in Revenue to GDP
Another New Norm?

Source: MIT Airline Data Project
DOT Data Shows Avg. Domestic Ticket Prices at 1998 Levels

U.S. CPI Rose 40.8 Percent from 3Q 1995 to 3Q 2009, Leaving Prices $98.41 “Short”

Note: BTS reports average fares based on domestic itinerary fares (round-trip or one-way for which no return is purchased). [Averages do not include frequent-flyer or “zero fares.”] Fares are based on the total ticket value, which consists of the price charged by the airlines plus any additional taxes and fees levied by an outside entity at the time of purchase.

Source: Air Transport Association
2009 Domestic Seating Capacity Fell Most Since 1942
Market Forces, Policy Resulted in Largest Post-WWII Contraction in Aviation History

* An available seat mile (ASM) is one seat flown one mile.
Source: Air Transport Association
What Is Right Mix of Regional Service Inside A Network Carrier’s Menu of Service Offerings?

U.S. Network Carrier Operations

- **American**
- **Continental**
- **Delta**
- **United**
- **US Airways**

Share of Carrier

Depts. Seats ASMs

- **Mainline**
- **Regional**

Data Source: PlaneStats.com by Oliver Wyman, MIT analysis
Who Will Be Tomorrow’s Providers?
Consolidation Is Happening - And It’s Going to Happen

- **Delta - Northwest**
  - “End to End” Merger (minimal overlap)
  - Service cutbacks primarily due to price of oil - not the merger
  - Visionary labor leader - Captain Lee Moak

- **United - US Airways**
  - Less “End to End” (more overlap and in a key city)
  - Service cutbacks would be inevitable (the regulators would be in the house)
  - Labor problems abound

- **United - Continental**
  - “End to End”
  - Few, if any, immediate cutbacks in service
  - Common pilot union
Today’s Environment As Compared To 2008

- **Oil Prices**
  - Not as high but . . . Oil will cost more in 2010

- **Economy Still Fragile**
  - Recession not declared when merger activity occurred in 2008
  - Recession not declared as having ended by the National Bureau of Economic Research (NBER)

- International competition (both oceans) will intensify with oneworld ATI

- Significant capacity pulled out of system since the Summer of 2008

- Very different administration regarding anti-trust issues

- Labor issues more complicated
Competitive Segment Overlaps Are Not What They Were in 2001

- American
- Continental
- Delta
- United
- US Airways
- Alaska
- AirTran
- jetBlue
- Southwest
- Other

Source: UBS Securities Research, Oliver Wyman Planestats.com
### Departures from U.S. Legacy Carrier Hubs/ Gateways to Respective World Regions

**Base Data Source:** Planestats.com by Oliver Wyman; MIT analysis

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<th>Africa</th>
<th>Asia</th>
<th>Canada</th>
<th>Caribbean</th>
<th>Central America</th>
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Looking Ahead:
It’s Going to Be Different
Looking Ahead

- There is nothing to fear in a merger combination exhibiting “end to end” networks

- Longer-term implications should be net positive for the industry
  - Stability is paramount

- Medium-term implications suggest continual tweaking of “just who” does US domestic flying
  - Mainline pilot scope clauses a big issue
  - 2015 marks period where significant numbers of RJ contracts expire

- Short-term implications suggest not just Legacy Carriers
  - Regional sector
    - Do not need 8-9 providers
  - LCC sector not immune
For More Information on the
MIT Airline Data Project

email: swelbar@mit.edu
or visit:
www.airlinedataproject.mit.edu
www.swelblog.com
or find me on FaceBook