Talkin' Airlines: An Economic Overview

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The Last Time I Spoke to You……

- We talked about the “Changing Face of the Global Airline Model”
  - Before $147 per barrel oil
  - Before capacity cuts became the rule and not the exception
  - Before the Great Recession
- We talked about..
  - Air Canada and reduced product complexity, consumer choice and transparency
  - Lufthansa and the growth of the LCCs and further consolidation in Europe
  - United and how alliances are a weak framework for global consolidation
  - Embraer and the growth opportunities in the “Large Small Jet” Market
  - Boeing and the importance of further liberalization in their business model

We Talked About the Elephants in the Room

- A highly fragmented – and regulated - industry earns volatile and sub-optimal returns
- Oil and its effect on the evolution of the industry
- The need to address both internal and external infrastructure issues
  - This industry sells time and every minute is important
- The absolute need to control costs
- Labor demanding increases commensurate with prior givebacks
  - Issues in Europe and the United States primarily
- The fact that emerging markets will offer growth opportunities whereas maturing markets are ...... well, maturing

A 2010 Look at Issues Impacting the Changing Face of the Global Airline Market

Economist **Henry George**,
outspoken on protectionist policies said:

“What protectionism teaches us,

is to **do to ourselves in time of peace**

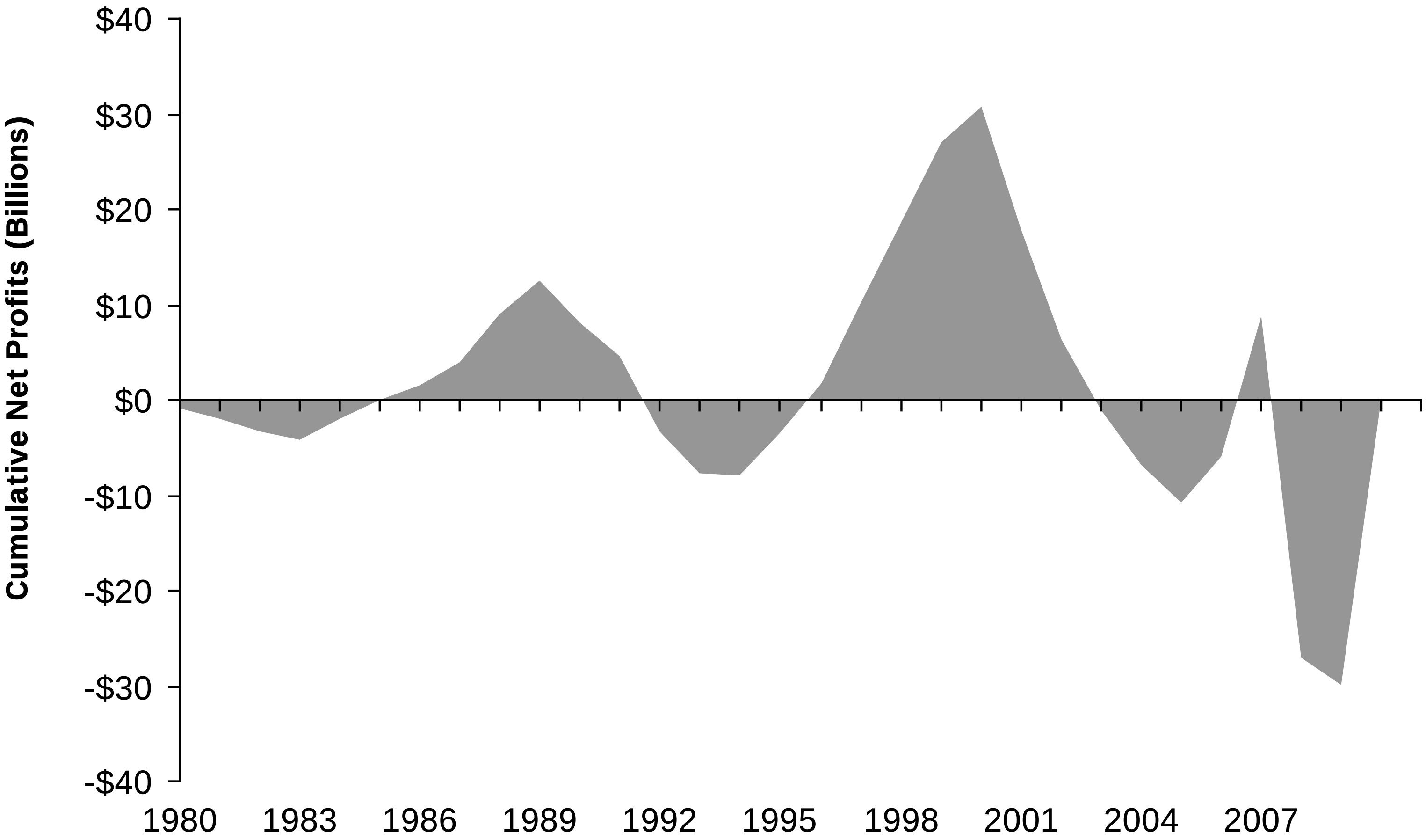
what enemies seek to do to us

in time of war”

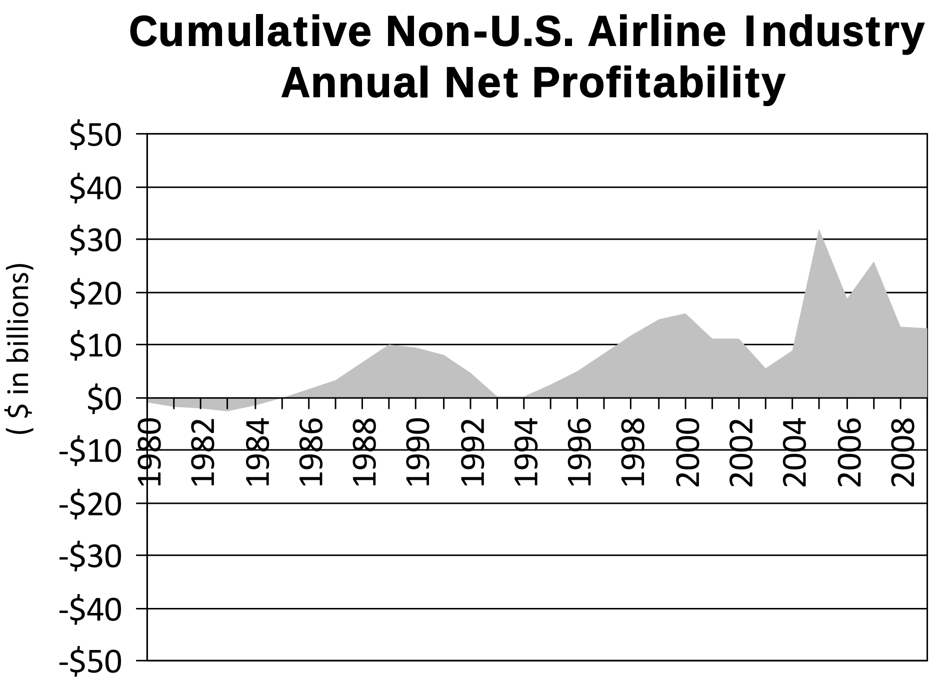
1 Industry Financial Position

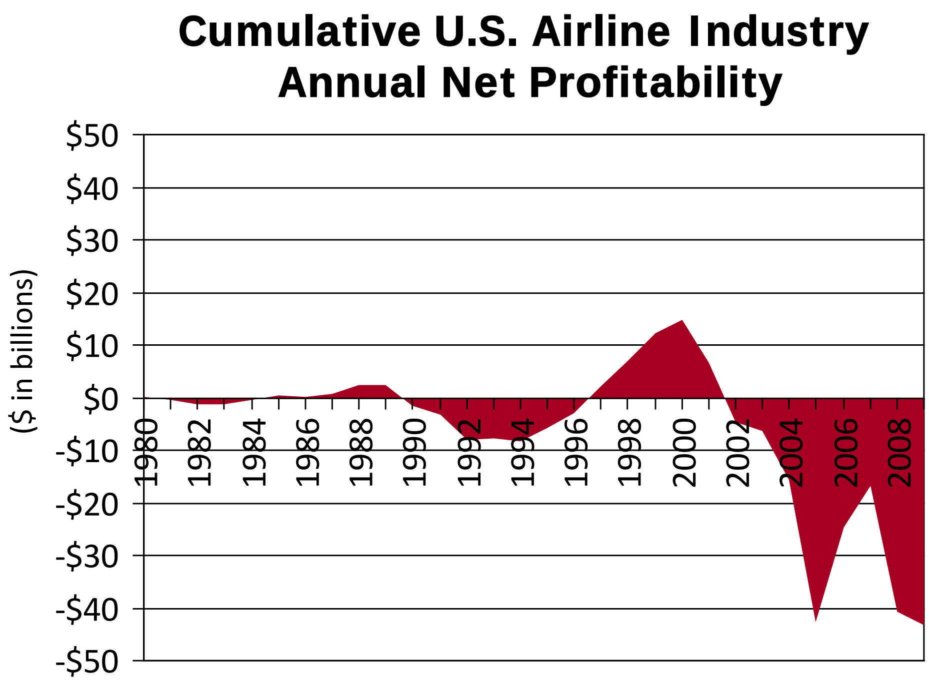
The Global Airline Industry Has Lost $30 Billion Since 1980

1980 – 2009

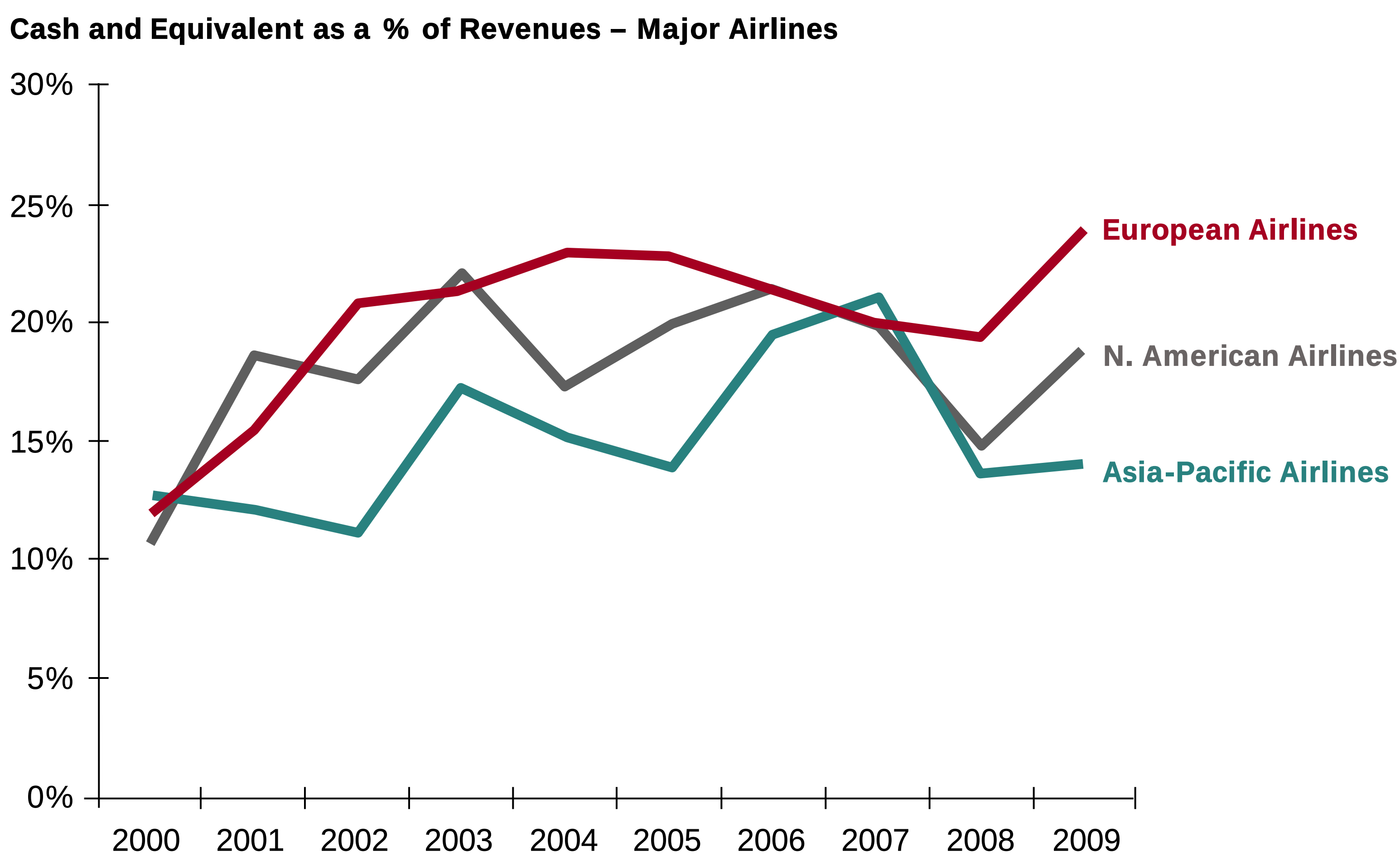


Contrasting US and Non-US Airline Industry Profitability





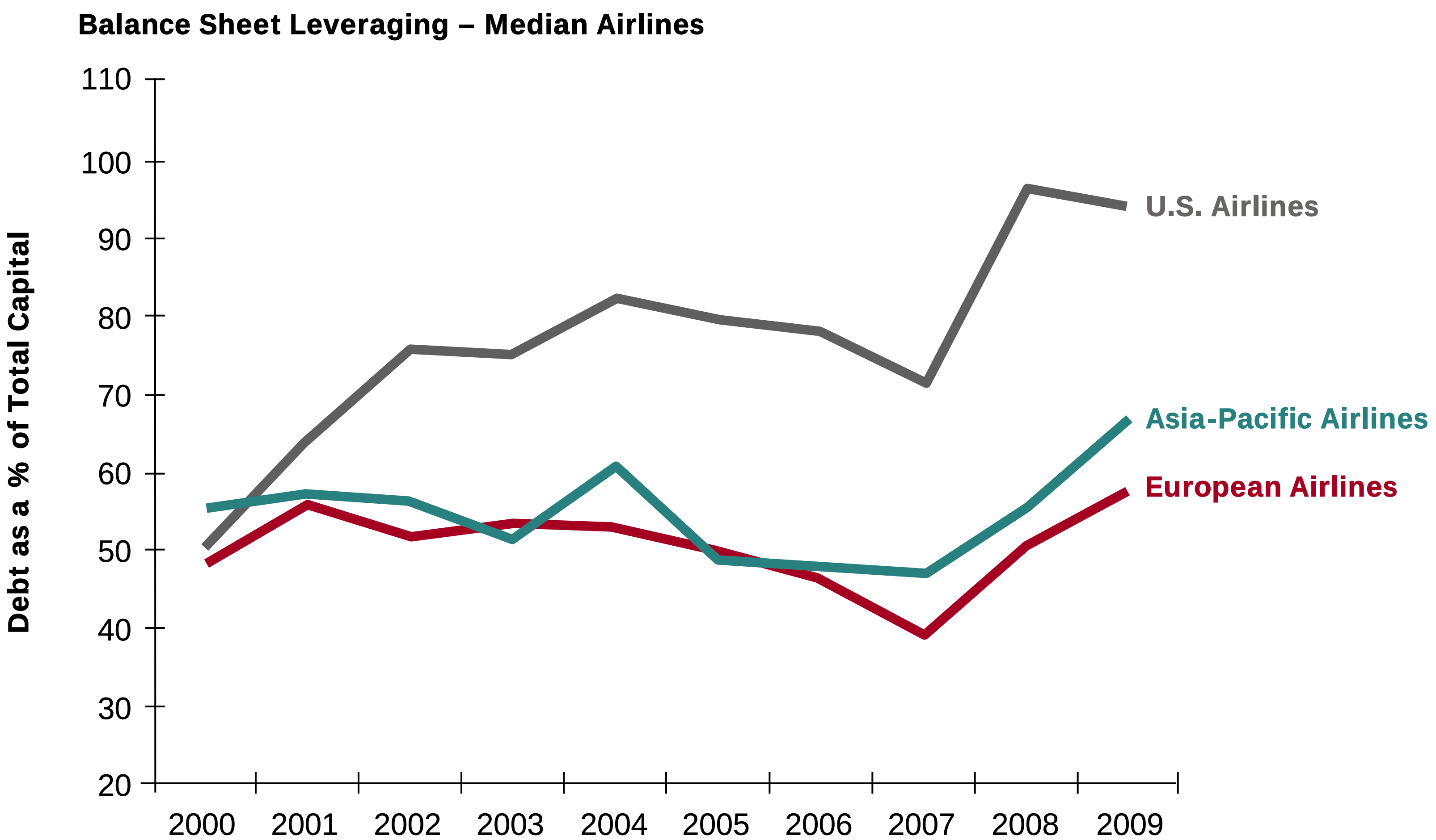
Cash Balances Are In a Safer Range Than In 2008......



Source: Bloomberg, Airline Reports

Massachusetts Institute of Technology

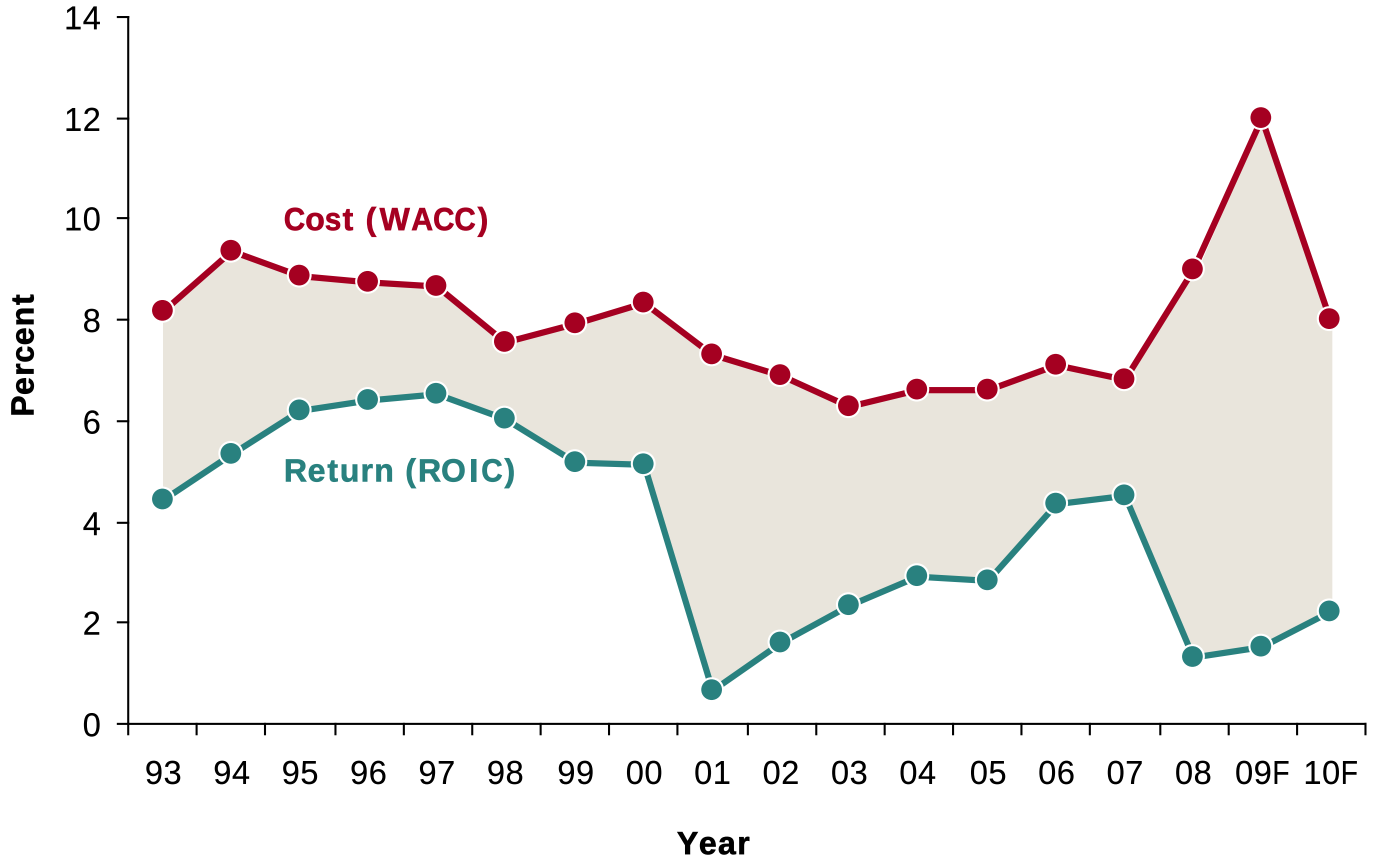
....But At the Expense of Further Borrowing



Source: Bloomberg

Global Context: Airlines Challenged to Cover the Cost of Capital

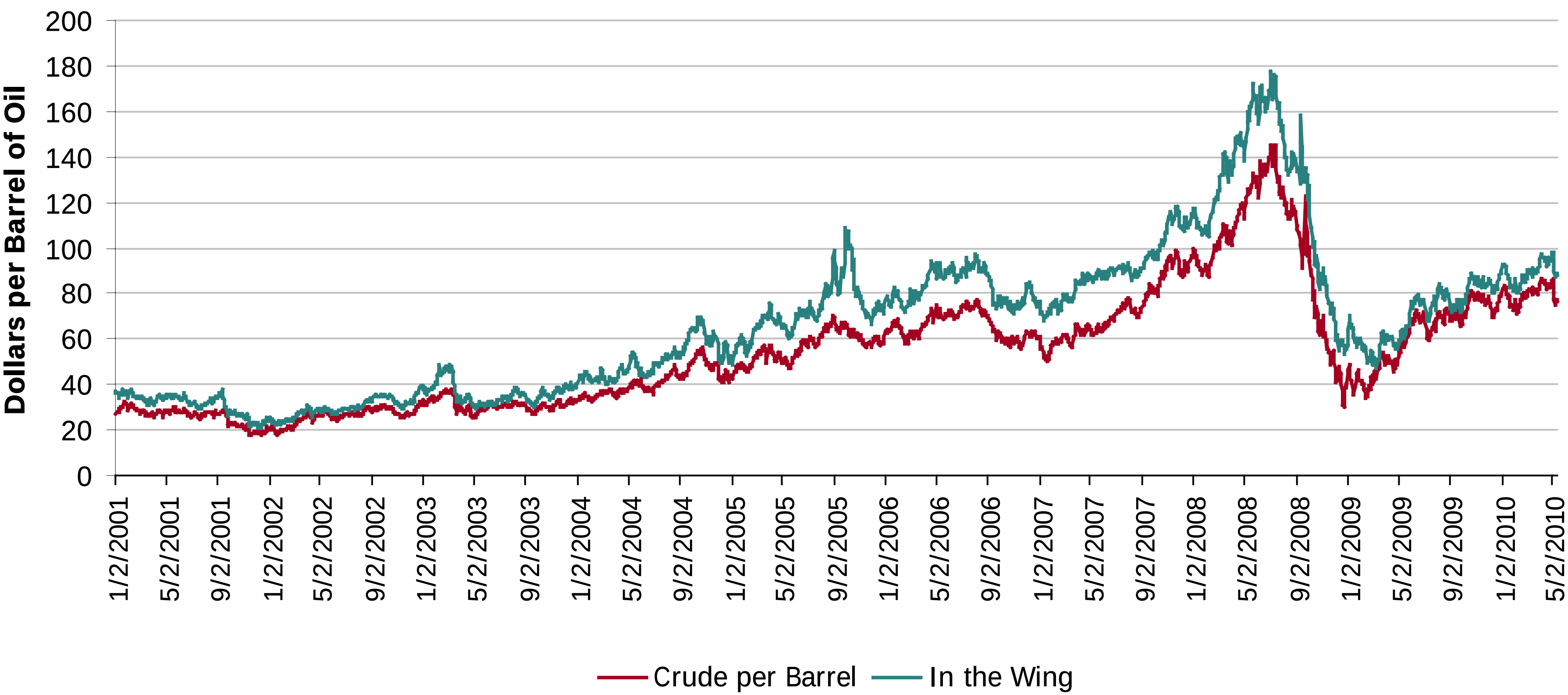
Airlines Not in a Position to Make Large Investments in New Markets or Equipment



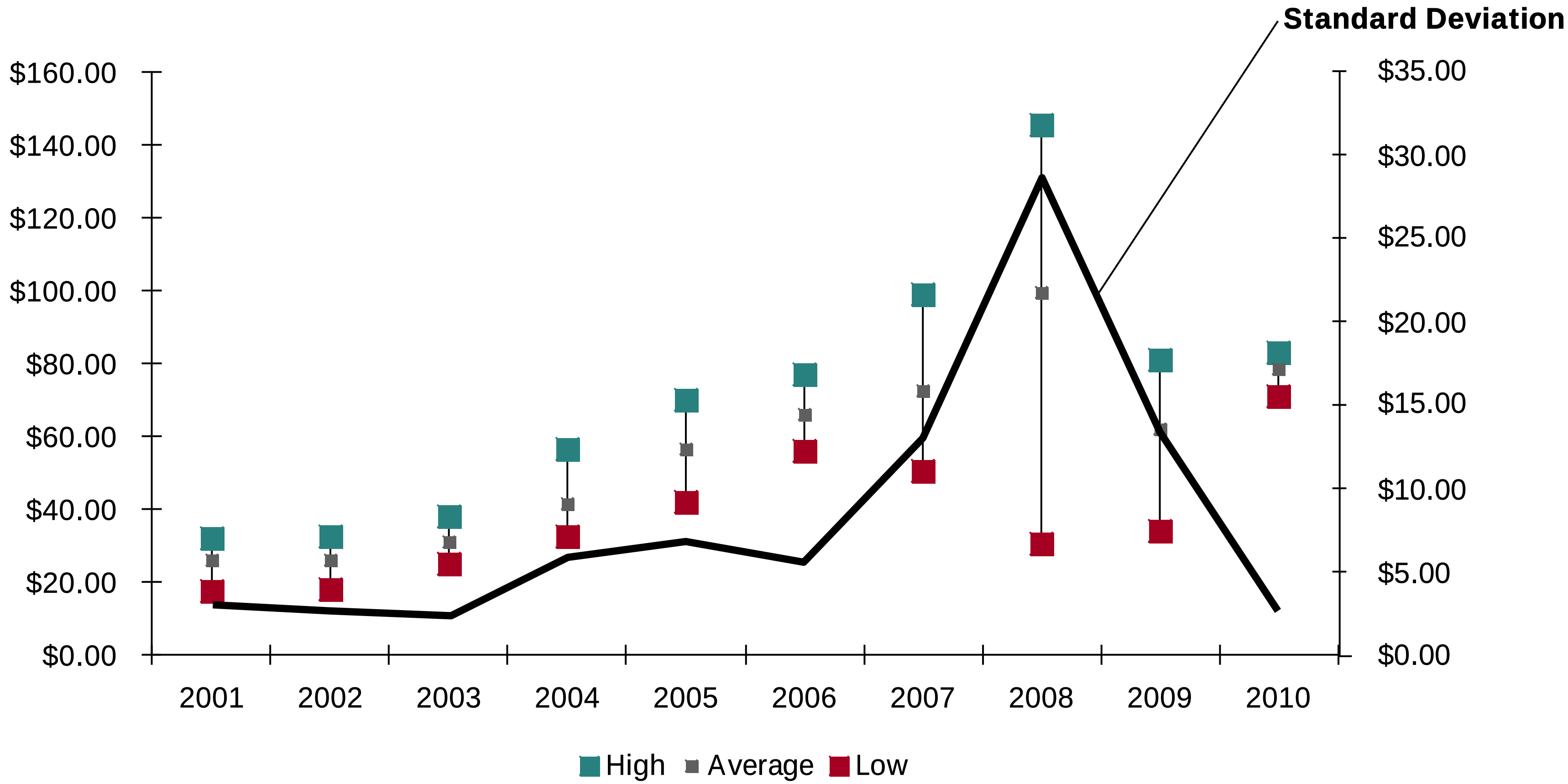
Source: Air Transport Association

2 Oil & Related Market Volatility

Oil Prices Have Forever Changed This Industry

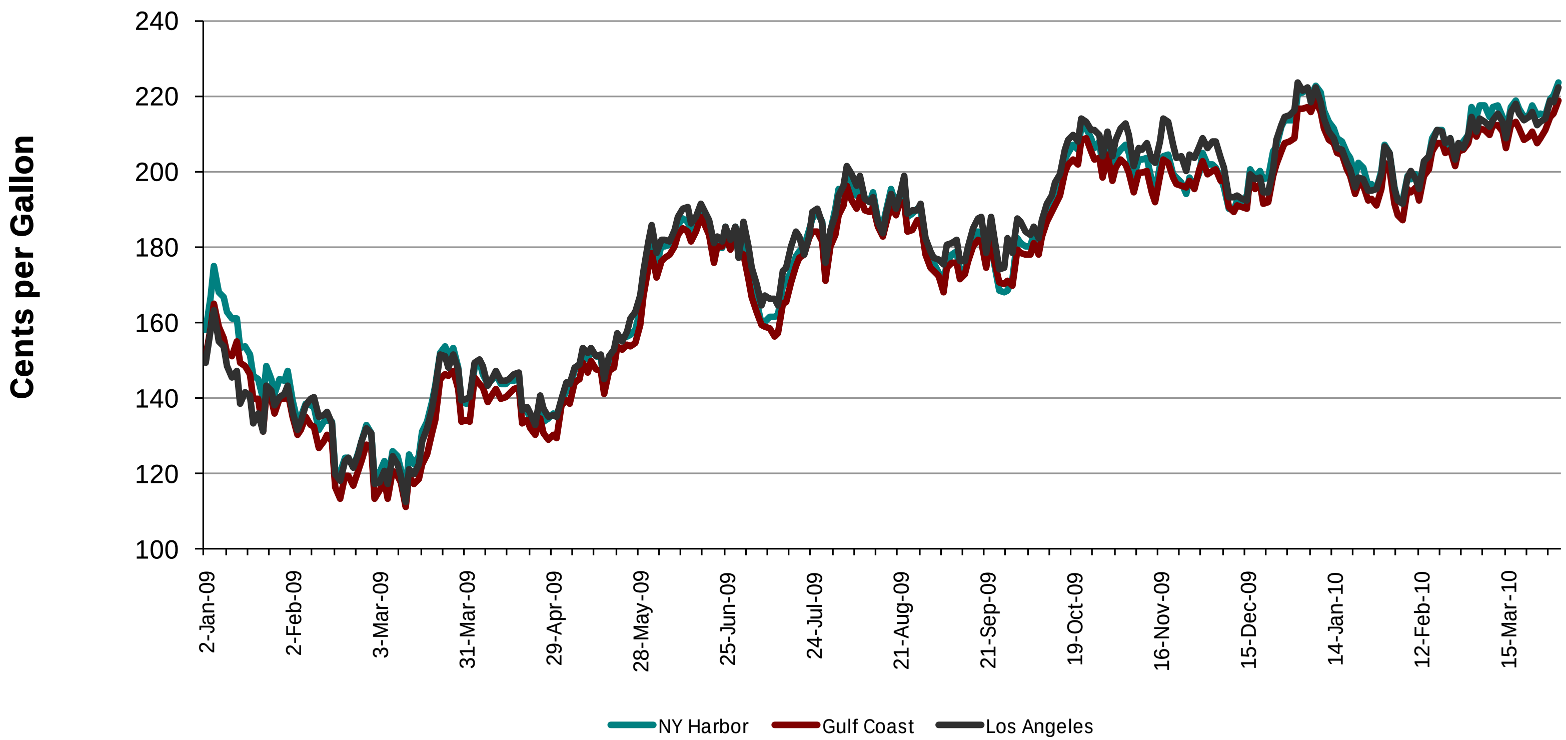


The Price Volatility of a Barrel of Oil Makes Planning Difficult



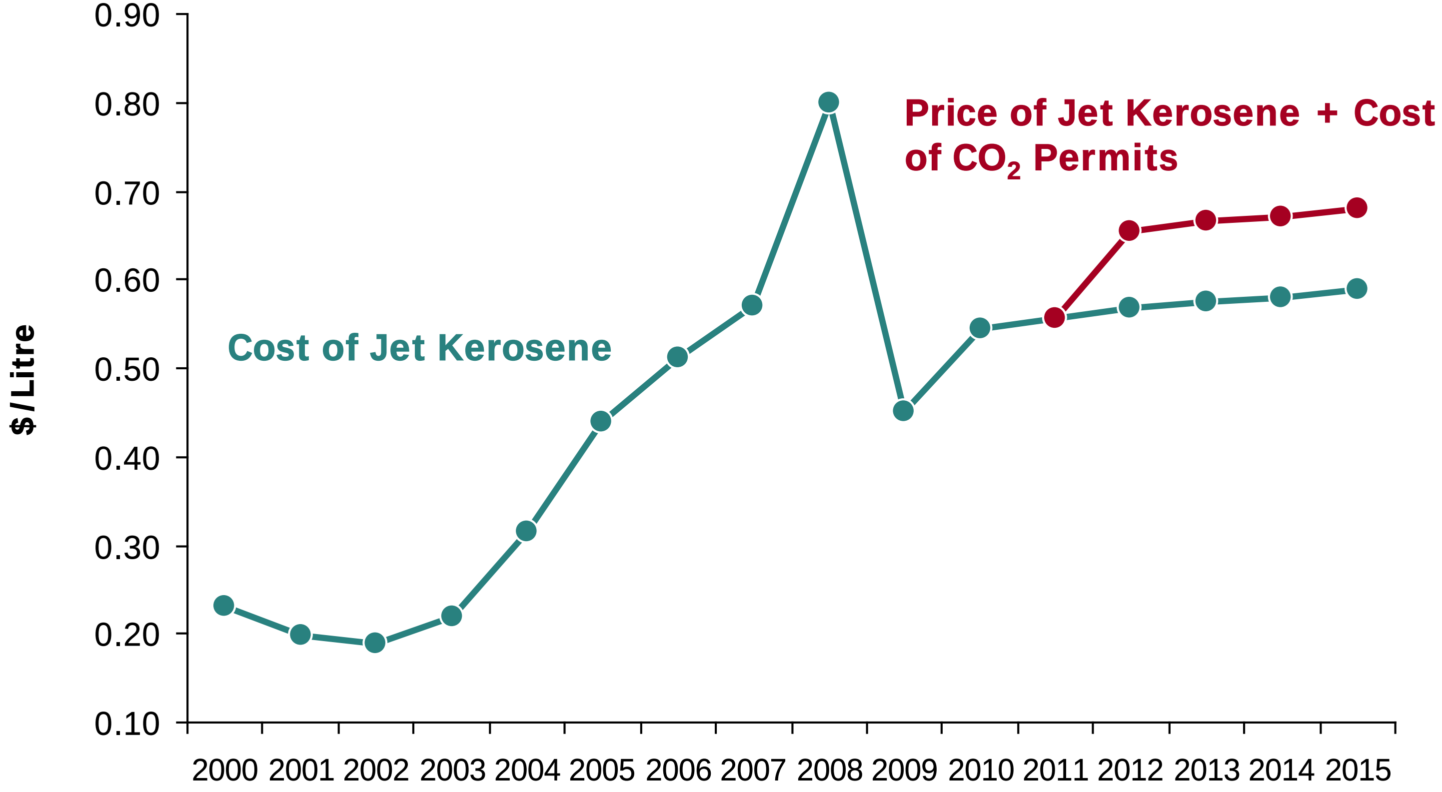
Jet Fuel Prices on the Rise Again

Despite Recent Drop in Price, the Industry's Fuel Bill Will Be Higher in 2010 than 2009



Source: Air Transport Association

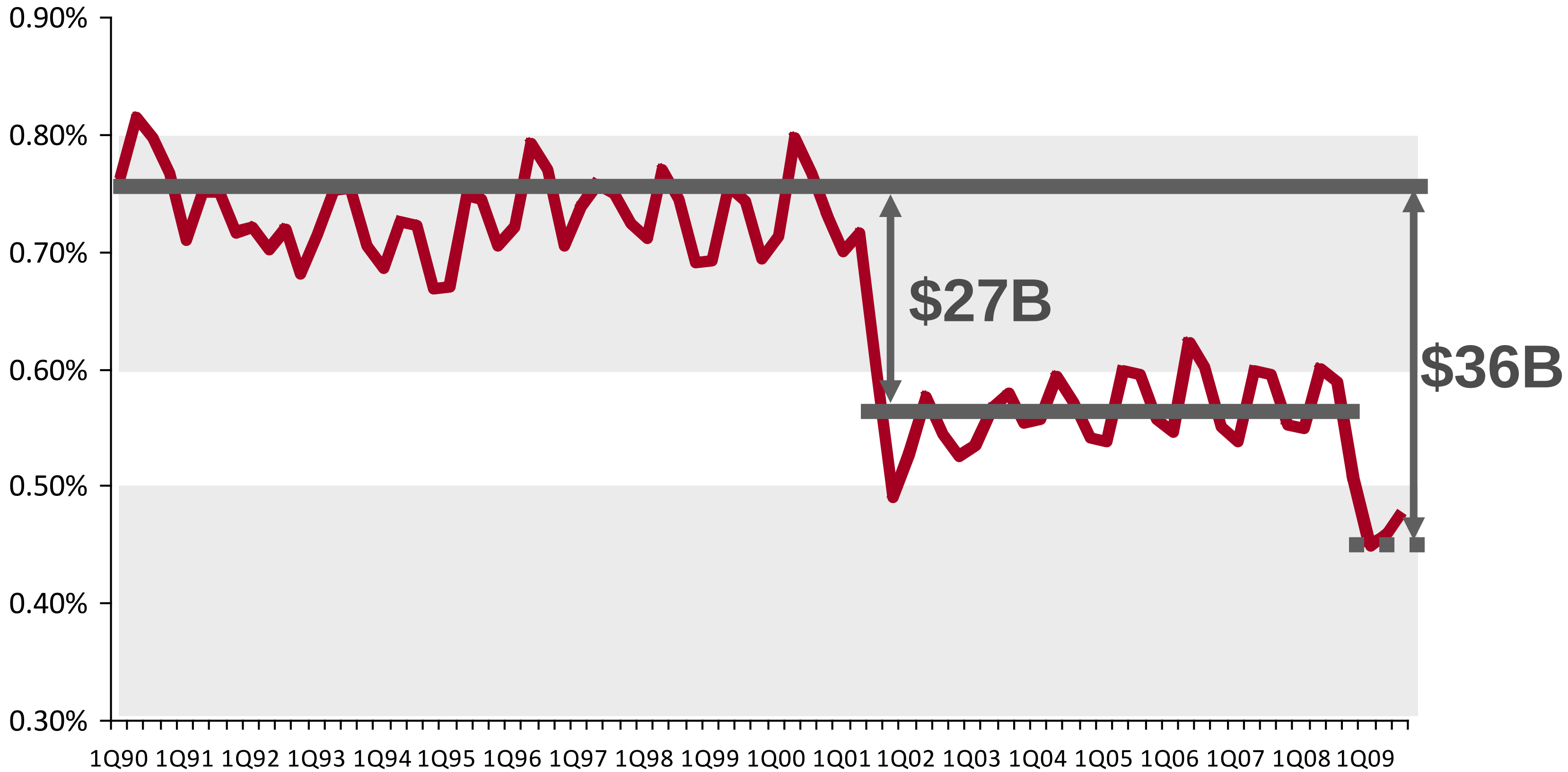
Environment Policies Will Add to Costs Too



Source: IATA

3 Underlying Economic Fundamentals

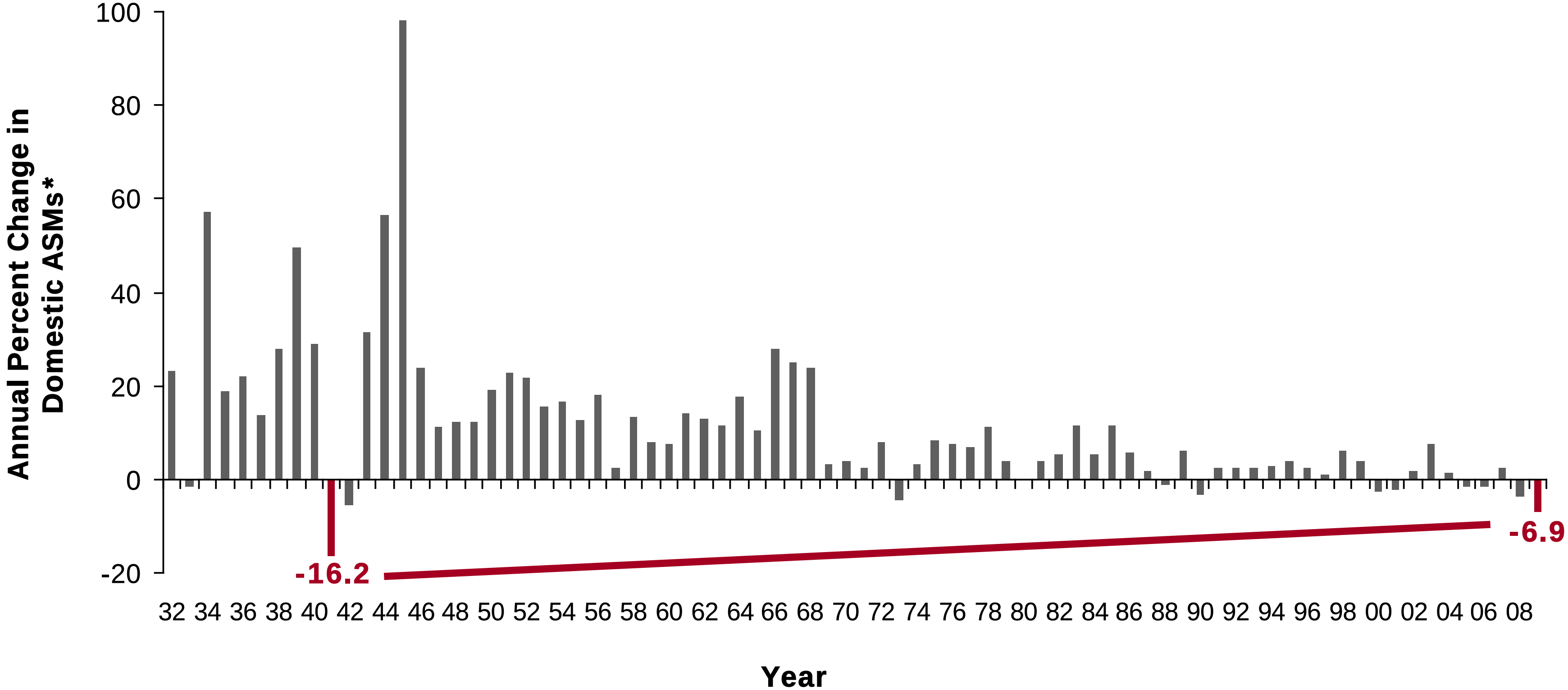
The Relationship in Revenue to GDP
Another New Norm? A Smaller Piece of a Smaller Pie?



Source: MIT Airline Data Project

2009 Domestic Seating Capacity Fell Most Since 1942

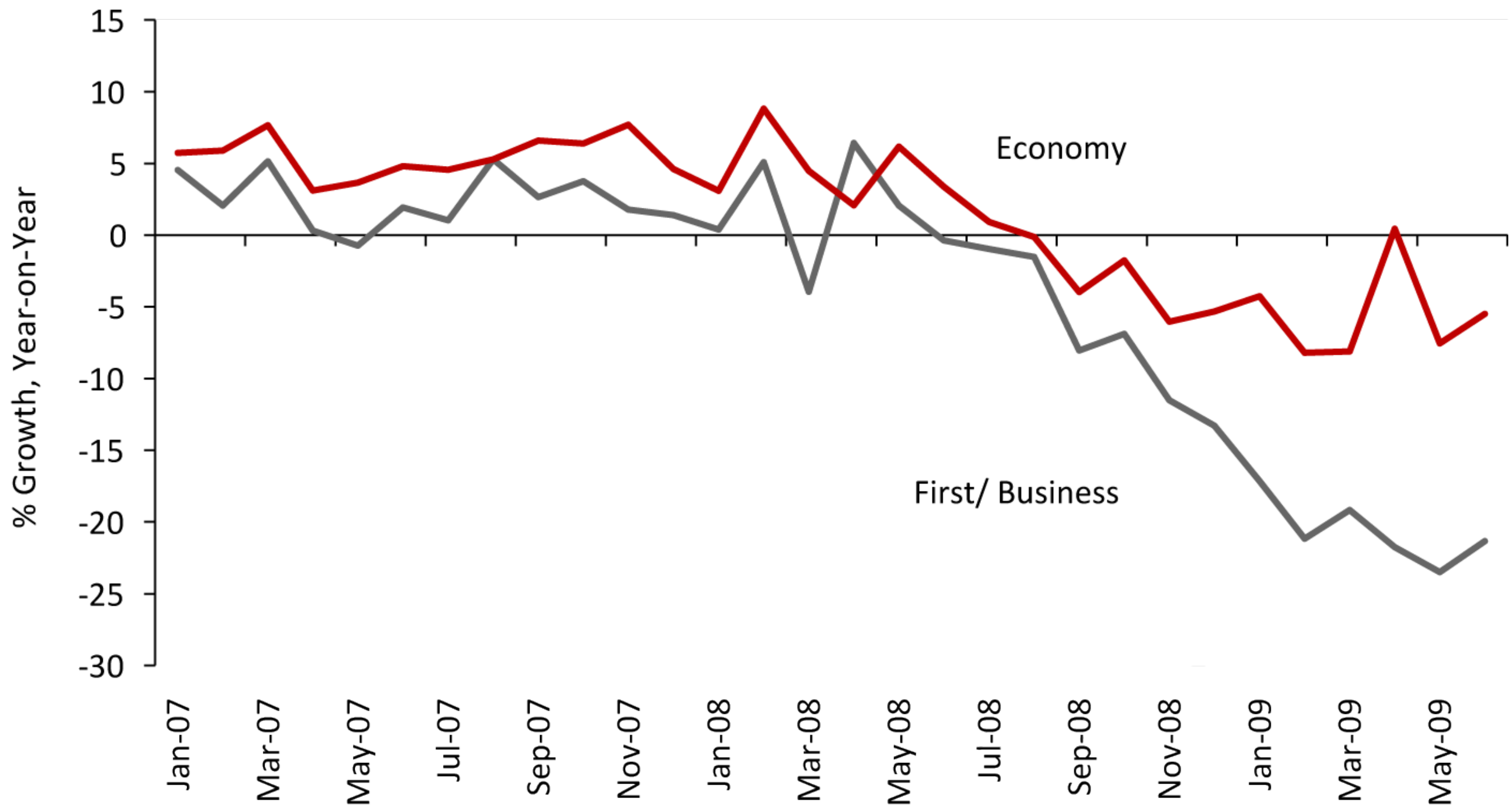
Market Forces, Policy Resulted in Largest Post-WWII Contraction in Aviation History



* An available seat mile (ASM) is one seat flown one mile.
Source: Air Transport Association

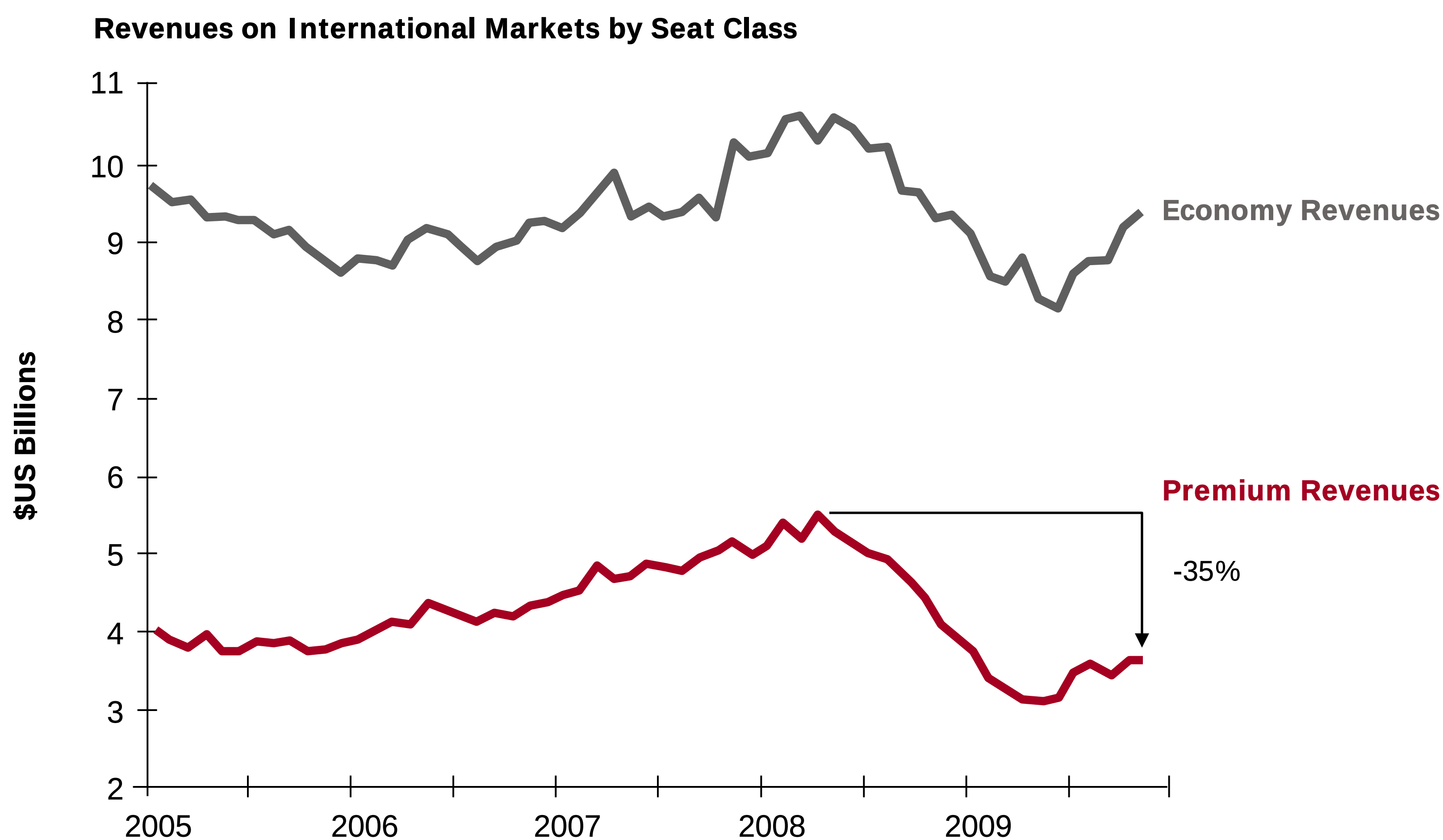
Will First / Business Class Fares Recover?

Passenger Traffic Growth by Ticket Type



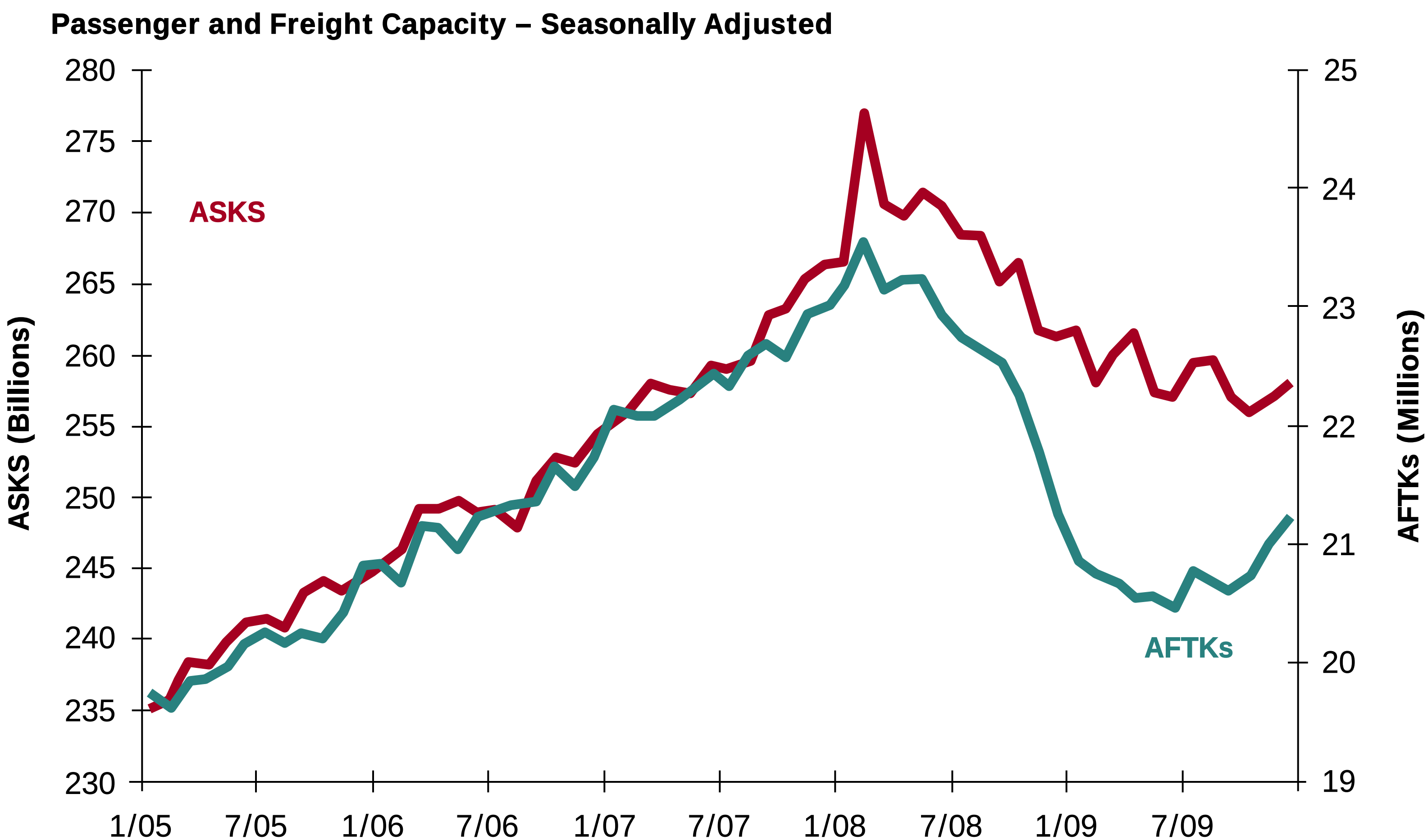
Source: IATA

Revenues Have a Long Way To Recover



Source: IATA

This Time the Global Industry Responded In Concert



Source: IATA

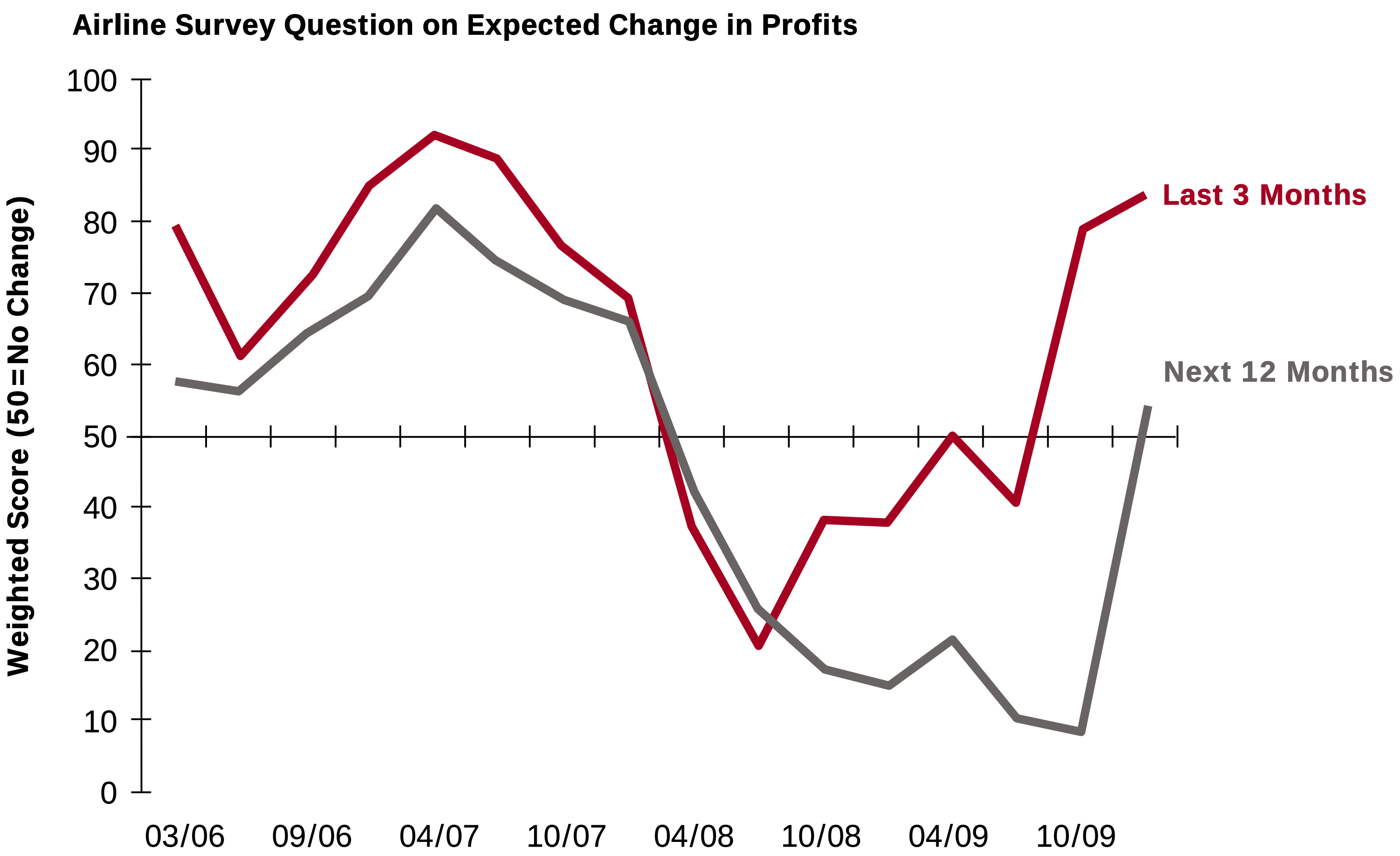
4 Some Encouraging Signs

Industry Losses in 2010 Expected to Be Much Less
Europe Is Expected to Lose the Most

System-wide global commercial airlines	EBT Margin (% Revenues) 2007	2008	2009E	2010F	Net Profits ($Billion) 2007	2008	2009E	2010F
Global	**3.9%**	**-1.6%**	**-0.1%**	**1.6%**	**12.9**	**-15.9**	**-9.4**	**-2.8**
Including exceptional items					14.7	-36.0	-9.4	-2.8
Regions								
North America	5.5%	-1.8%	1.3%	1.9%	3.7	-9.5	-3.1	-1.8
Including exceptional items					5.5	-24.3	-3.1	-1.8
Europe	4.0%	0.1%	-1.9%	-0.6%	6.4	0.1	-3.8	-2.2
Including exceptional items					6.4	-0.9	-3.8	-2.2
Asia-Pacific	2.9%	-4.7%	0.0%	3.7%	3.0	-5.0	-2.7	0.9
Including exceptional items					3.0	-9.0	-2.7	0.9
Middle East	0.0%	1.0%	-0.9%	0.2%	-0.1	-0.3	-0.5	-0.4
Latin America	2.0%	2.3%	3.9%	4.1%	0.1	-1.2	0.8	0.8
Including exceptional items					0.1	-1.5	0.8	0.8
Africa	1.0%	-0.9%	-1.7%	-0.6%	-0.2	-0.1	-0.2	-0.1

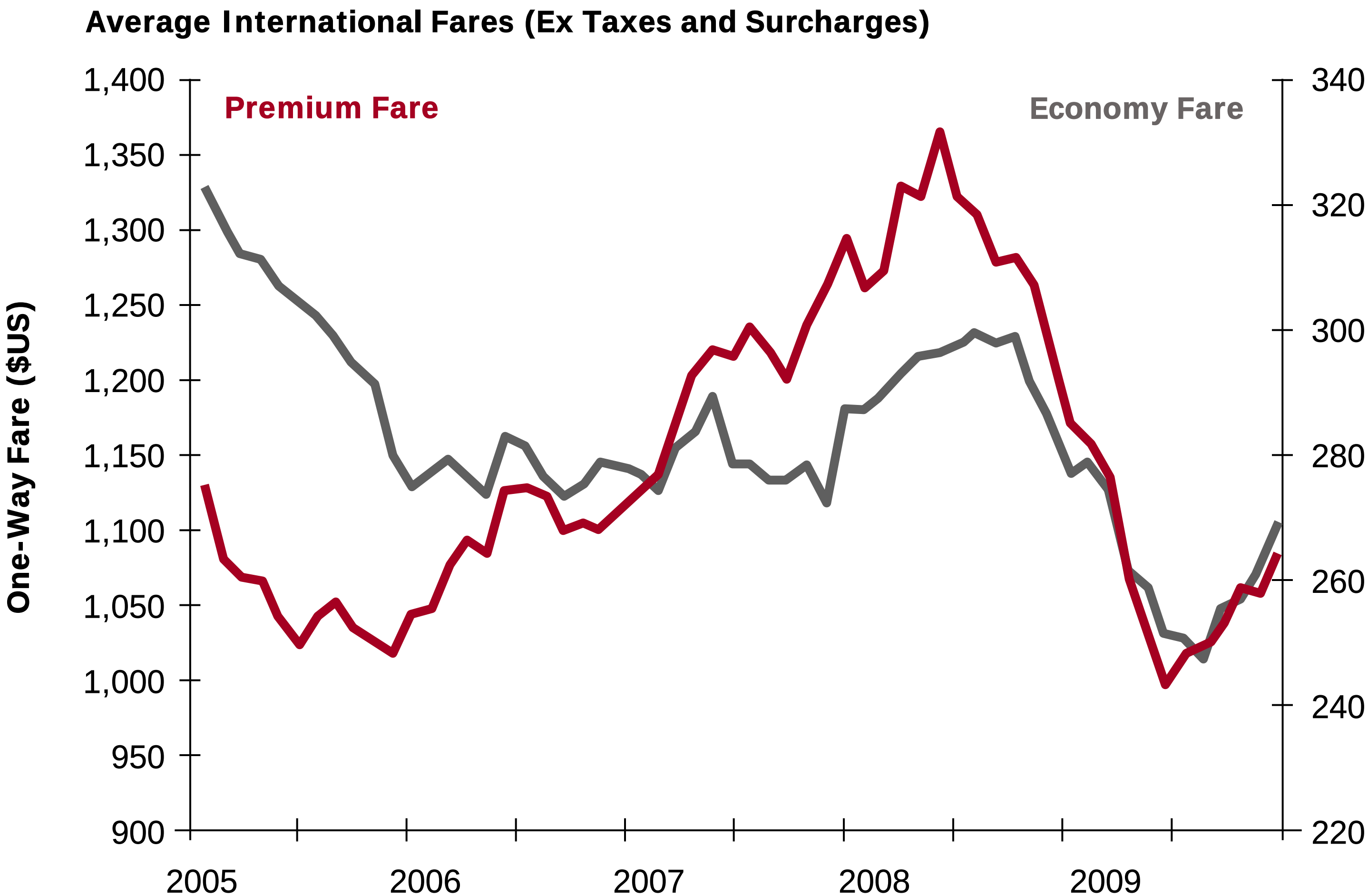
Source: IATA

Airline Confidence is Up Significantly



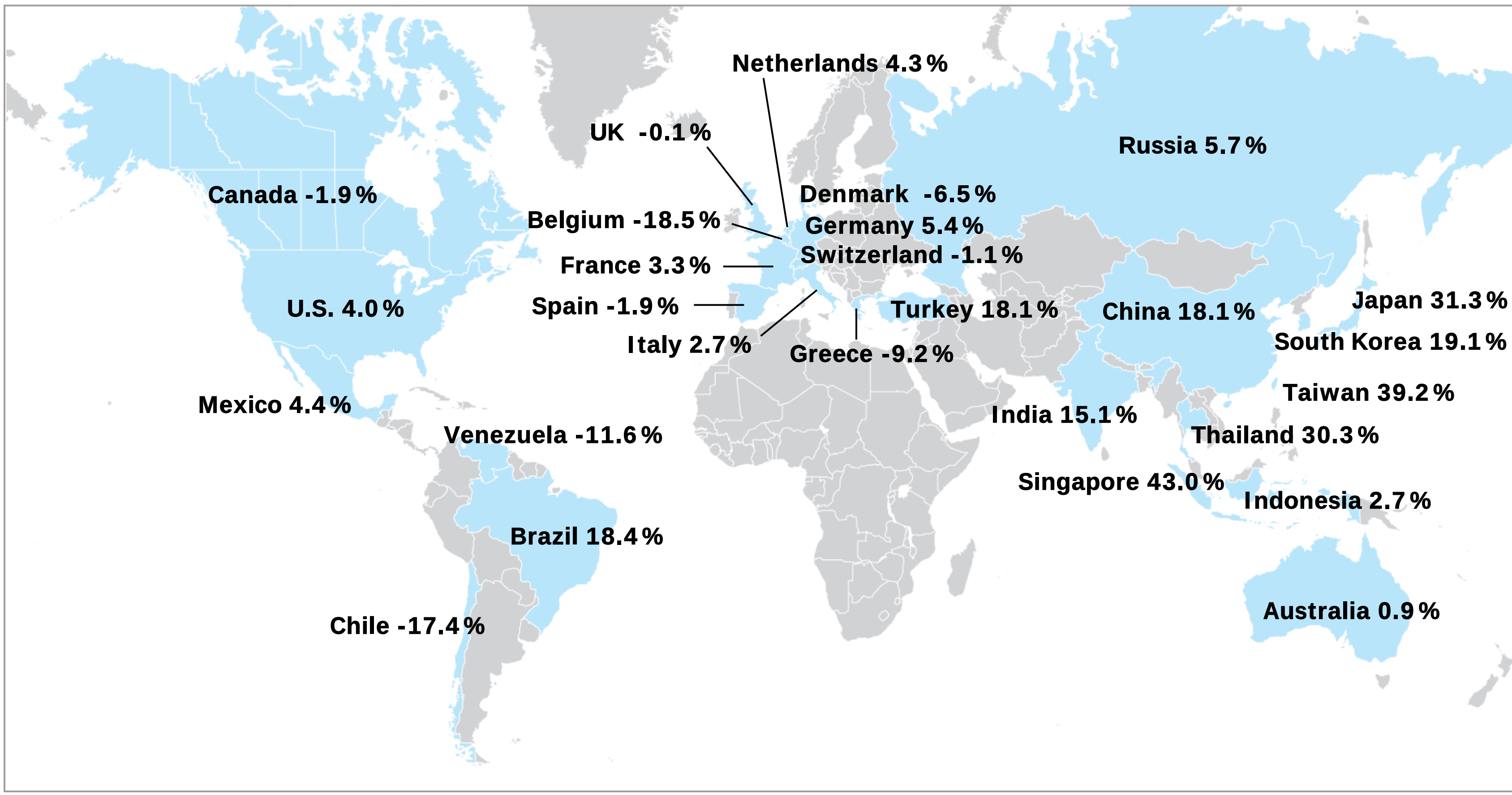
Source: IATA

Fares are Starting to Rise From their Lows



Source: IATA

Industrial Production In Asia Very Strong

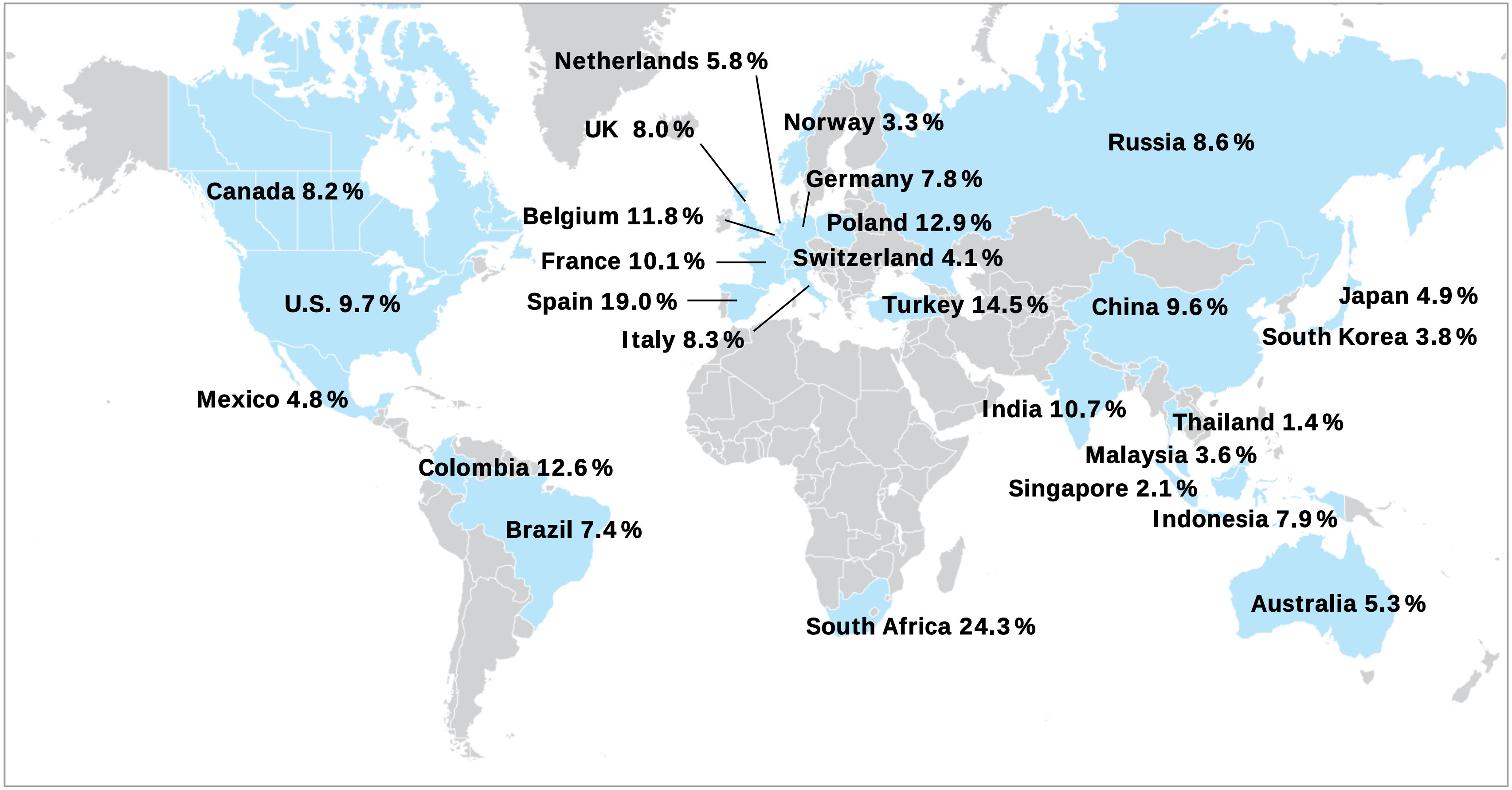


Source: Economist Intelligence Unit

5 Signs Signaling an Uneven Recovery

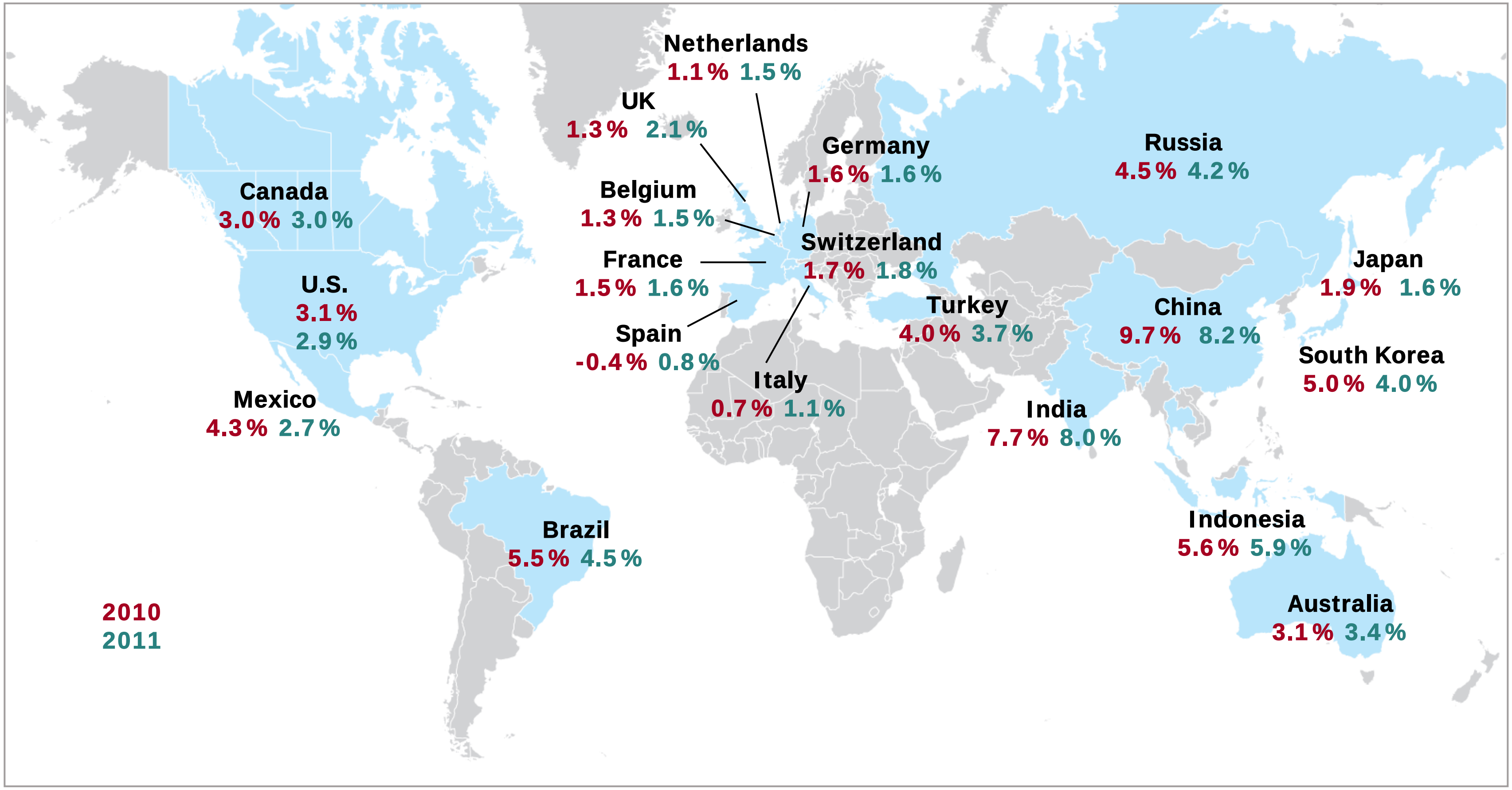
Unemployment

Weakness in Europe and North America Are Questions



Source: Economist Intelligence Unit

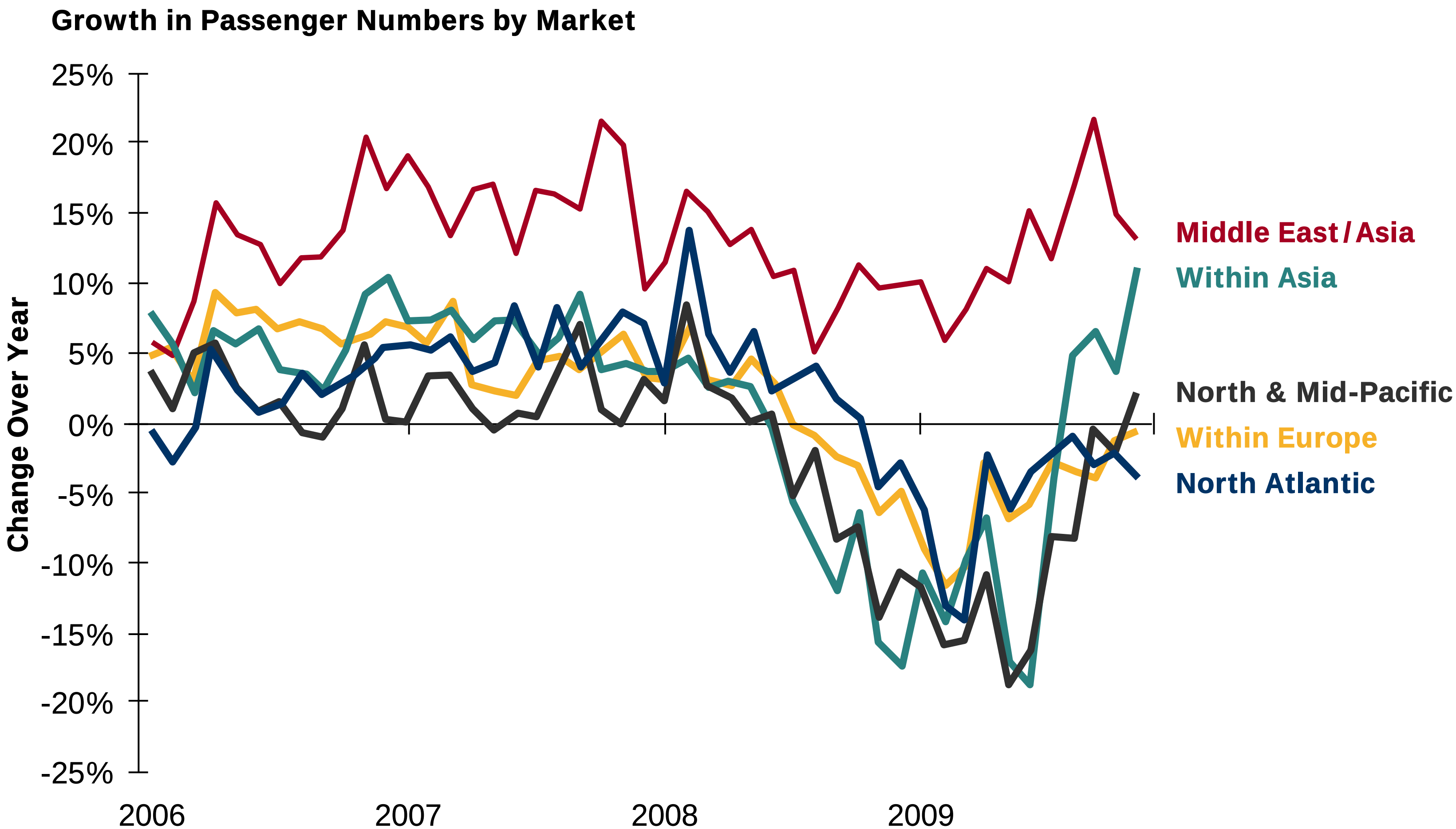
Gross Domestic Product
Relative Weakness Across the European Union



Source: Economist Intelligence Unit

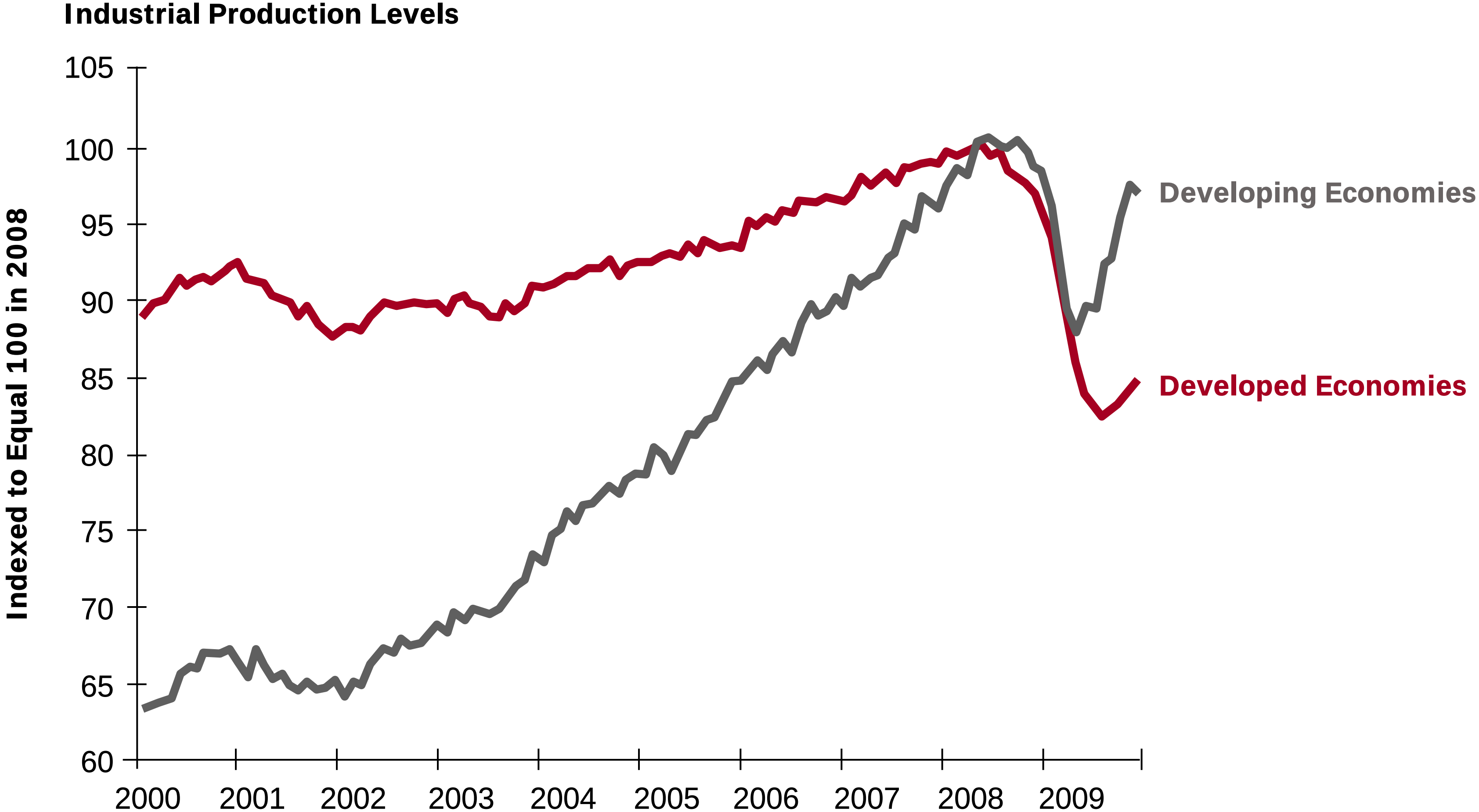
Euro:U.S. Dollar
Trend Suggests Weakening in Europe

Big Differences in Travel By Market



Source: IATA

Watch Those Developing Economies



Source: IATA

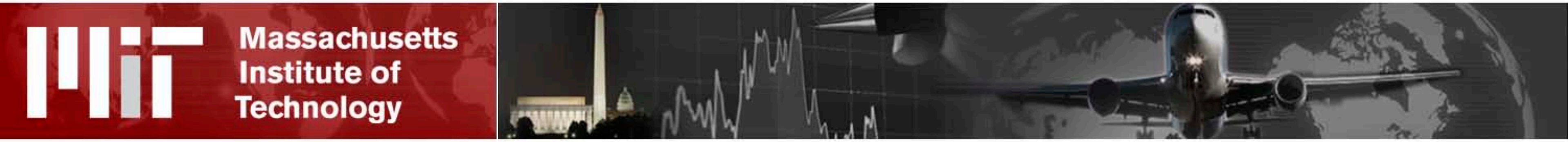
Looking Ahead:
It’s Going to Be Different

Consolidation Is Happening – And Is Going to Happen

- Europe
  - Air France/KLM
  - Lufthansa and its shopping spree
  - British Airways/Iberia
- United States
  - Republic Holdings/Midwest/Frontier
  - Delta/Northwest
  - United/Continental (pending)
- Anti-trust Immunity
  - oneworld across the Atlantic
  - STAR across the Pacific
  - oneworld across the Pacific

This Round of Consolidation Is Logical "Next Phase"

- Just like network evolution
  - From "point-to-point", to
  - Hubs and Spokes, to
  - Hub to Hub, to
  - Gateway to Gateway
- Just like previous consolidation built today's airlines
  - Regional/Country dominance (U.S. in the mid-1980's; Europe today)
    - Morphed into national footprints
      - EU
      - US
- Alliances are the competitive tool for tomorrow
  - "One step away"



So Many Questions…….,So Few Answers

- I am a layperson that does not understand much about your industries
  - The need to be cost effective as revenue environment is uncertain
  - The need to demonstrate a return on invested capital
  - The need for speed (industry sells time)
  - The need for scalability (whether through mergers or alliances)
  - The need to put customer back at the forefront
  - The need to recognize that maybe we have over-optimized????
    - Think delay propagation

Closing Remarks

- Your innovation must continually work to address the cost side of the equation for an industry susceptible to pricing pressures inherent in a hyper competitive global business
- The borders and the flags are blurring
  - We must think alliance when innovating
    - Is consolidation producing the lasting partnerships that have been missing?
- I would love to say I see a robust profit environment ahead – I do not.
  - Global interdependencies are presenting new found challenges
    - Will also be the opportunities of tomorrow

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