



## **Outlook for The Airline Industry**

### **Newest Risks, Opportunities and Players**

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## Section 1

# Industry Overview



# Amid an Improving Economy and Traffic Recovery, Profitability Still Remains Elusive

## ENVIRONMENT

- ↑ Economic Recovery
- ↑ Demand
- ↑ Cost Cutting
- ↑ Fuel

## RESULT

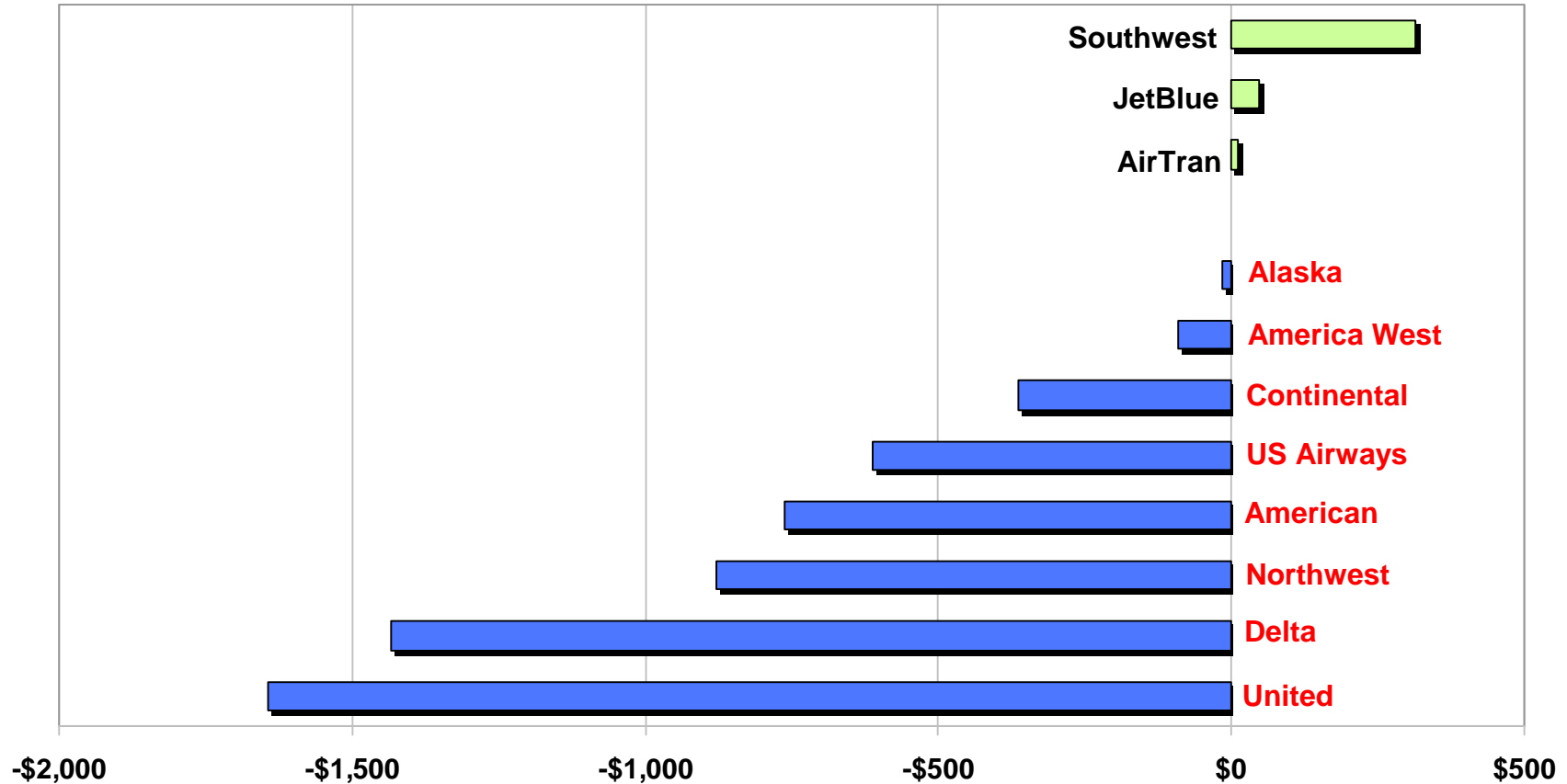
- ↓ Profitability
- ↓ Yields
- ↑ RASM
- ↑ Load Factors

***Losses are expected to continue into 2005 and 2006***

# Low Cost Carriers Were the Only Winners in 2004

## Operating Results for U.S. Scheduled Carriers CY2004

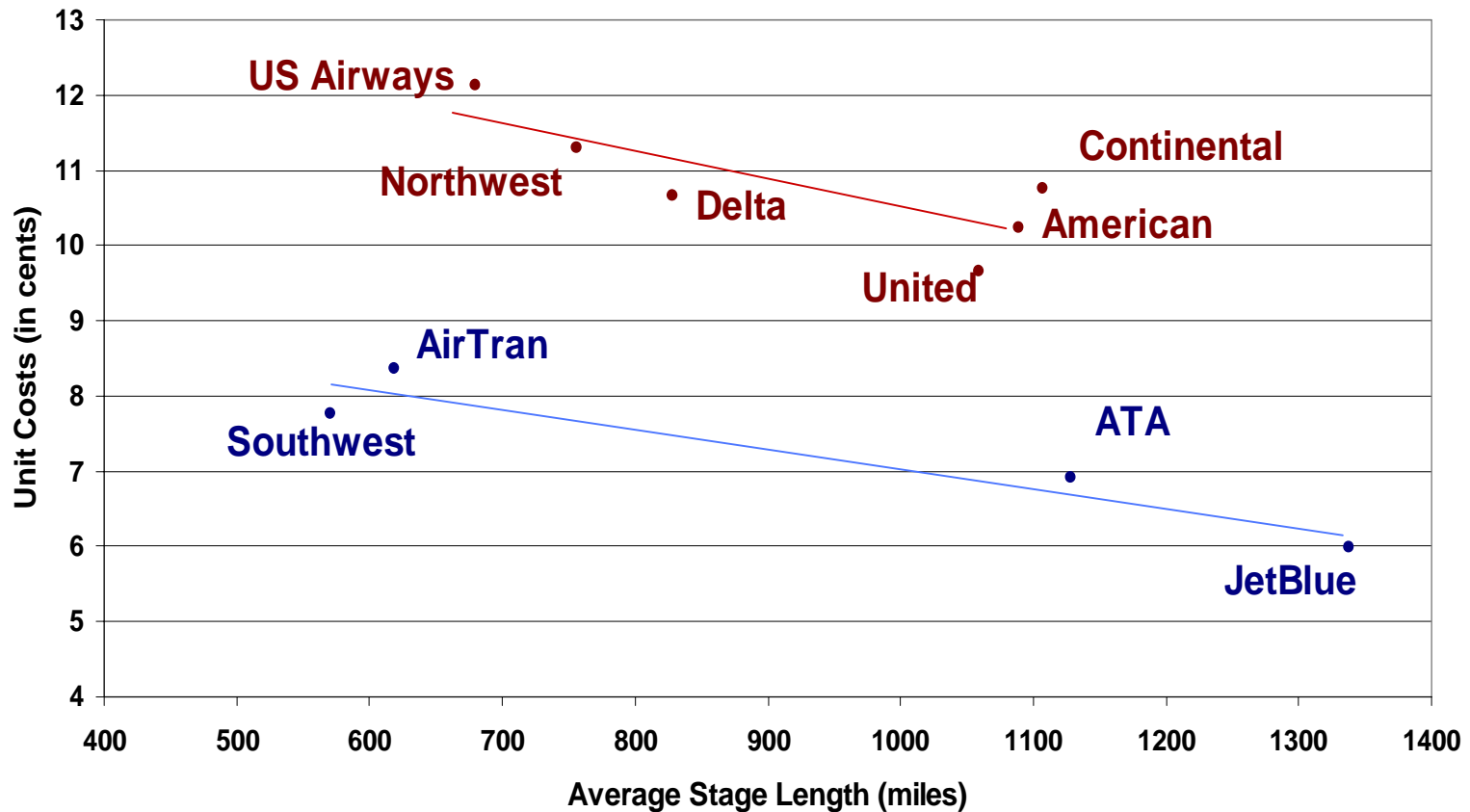
\$ Millions



***Had Southwest not hedged 80% of their fuel in 2004, they would have lost money.***

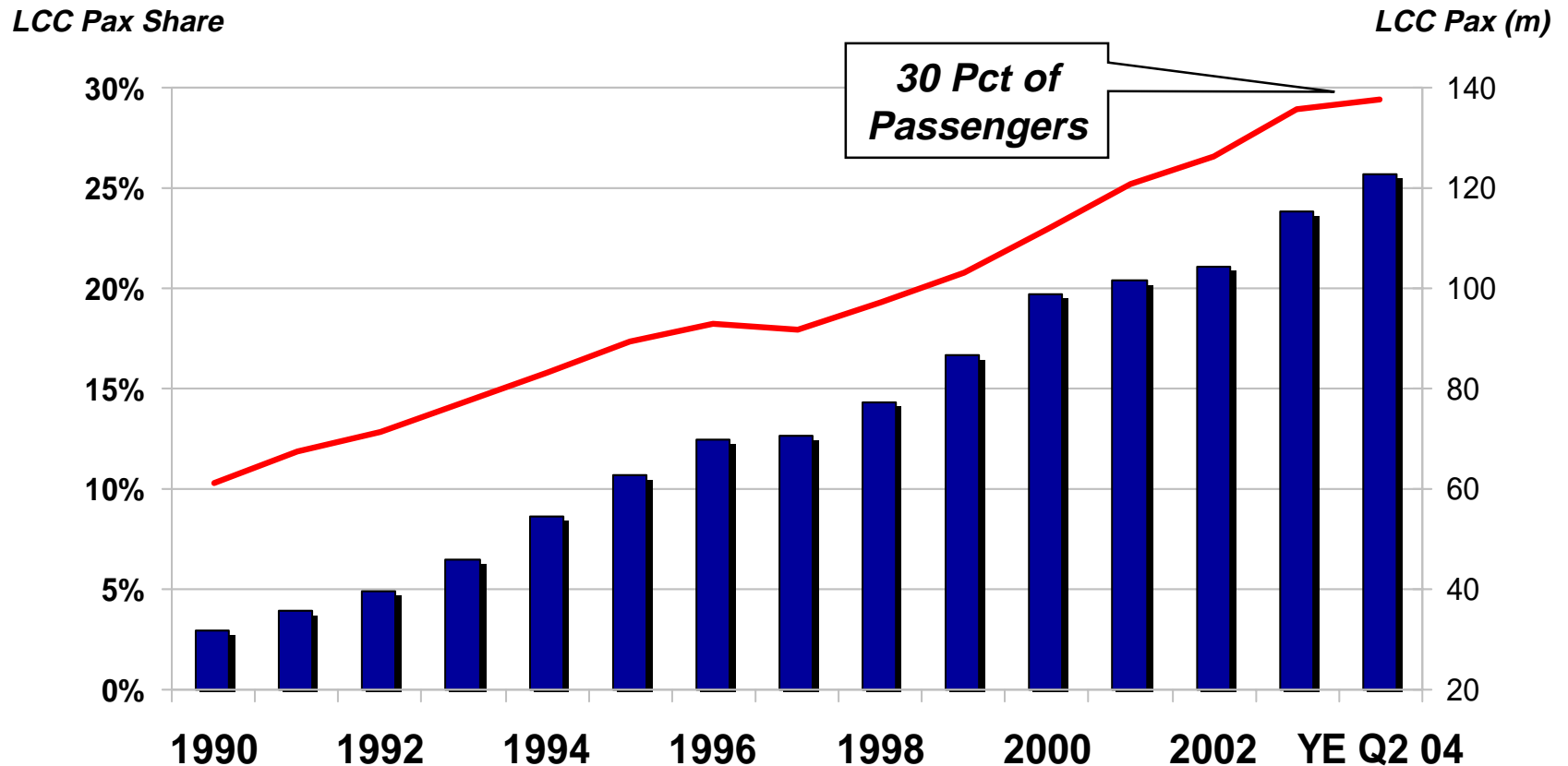
# Average Unit Costs for LCCs Remain About A Third Lower Than Those of Legacy Carriers

Domestic Unit Cost versus Trip Length for Select Legacy and Low Cost Carriers  
*Year End 3<sup>rd</sup> Quarter 2004*



# Low Cost Carriers Have Grown to Carry One Third of all US Domestic Passengers

**U.S. Low-Fare Carrier Share of Total U.S. Domestic Passengers**  
1990-2004

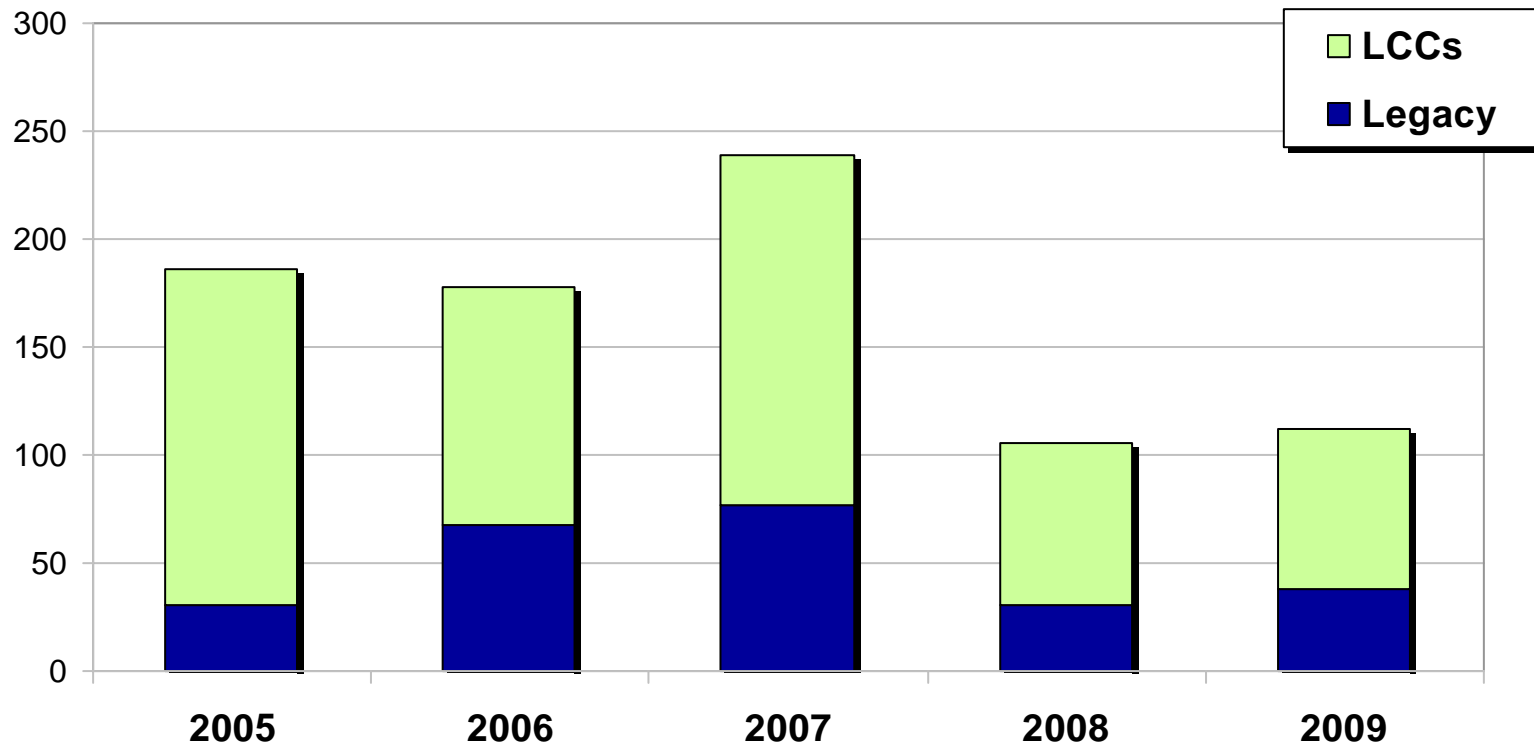


Source: US DOT DB1B database via Database Products

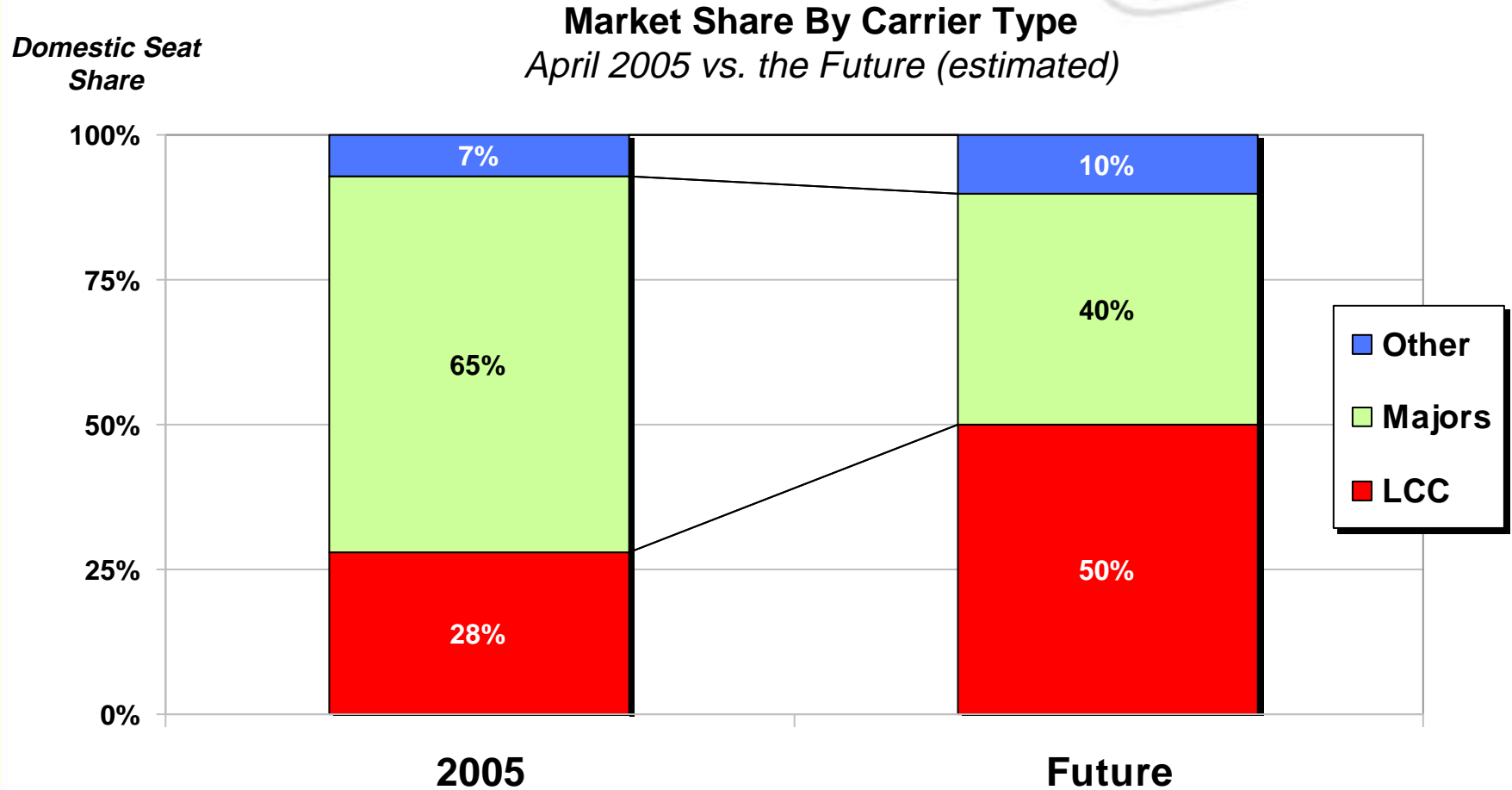
# LCCs Will Dominate Aircraft Deliveries Over the Next Five Years

## Scheduled Aircraft Deliveries 2005-2009

*Aircraft  
Deliveries*



# The Trend of North America LCC Penetration Suggests That It Will Reach 50%





## Section 2

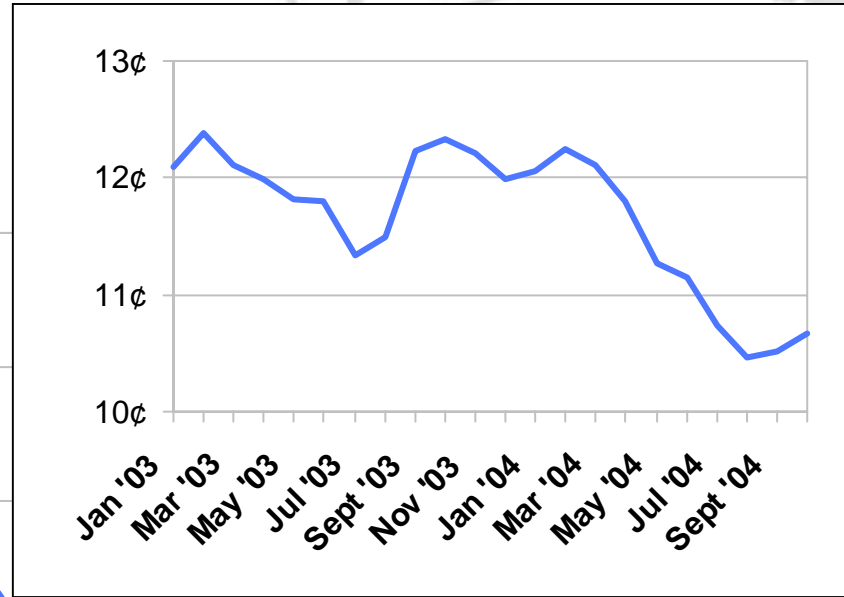
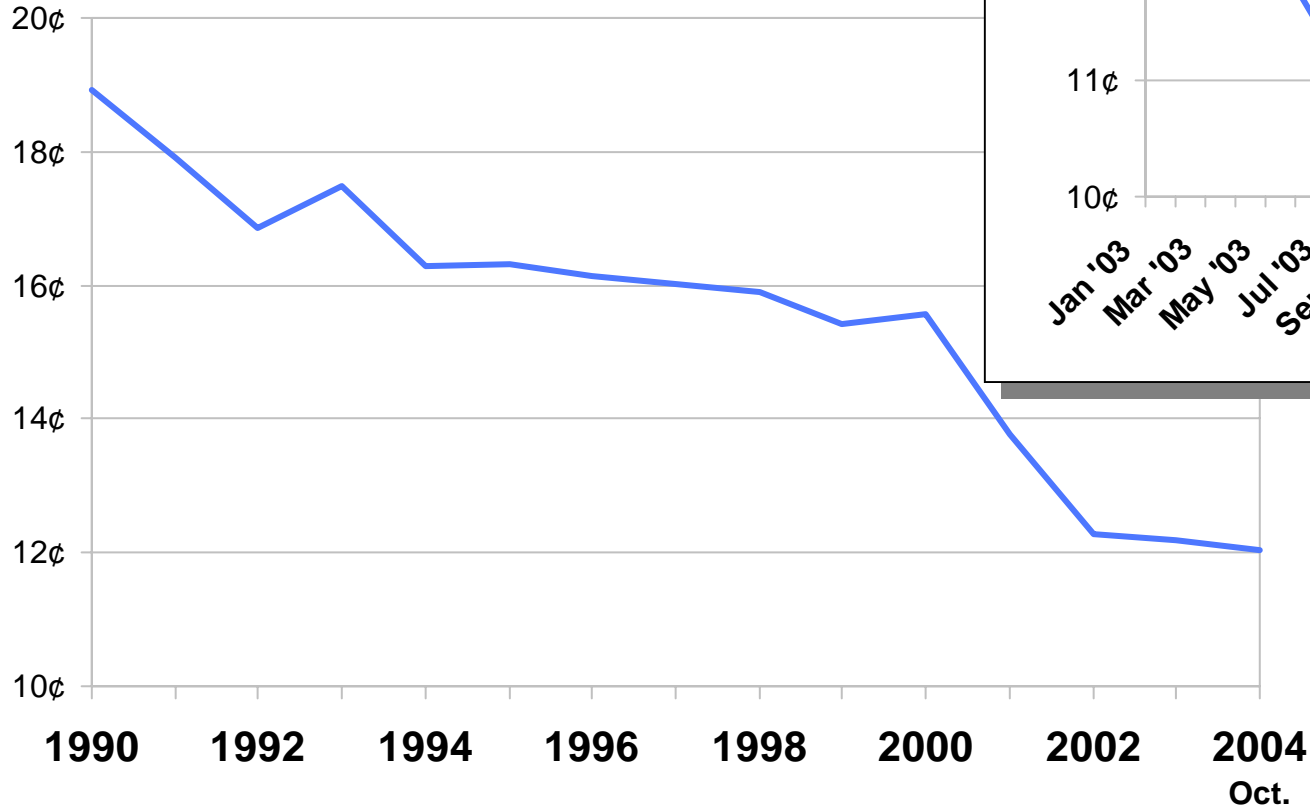
## Revenue Environment



# Yields May Have Stabilized, But Have Not Yet Shown Growth, Falling 14% in October Over the Previous Year

Monthly US Domestic Industry Yields  
January 2003 – October 2004

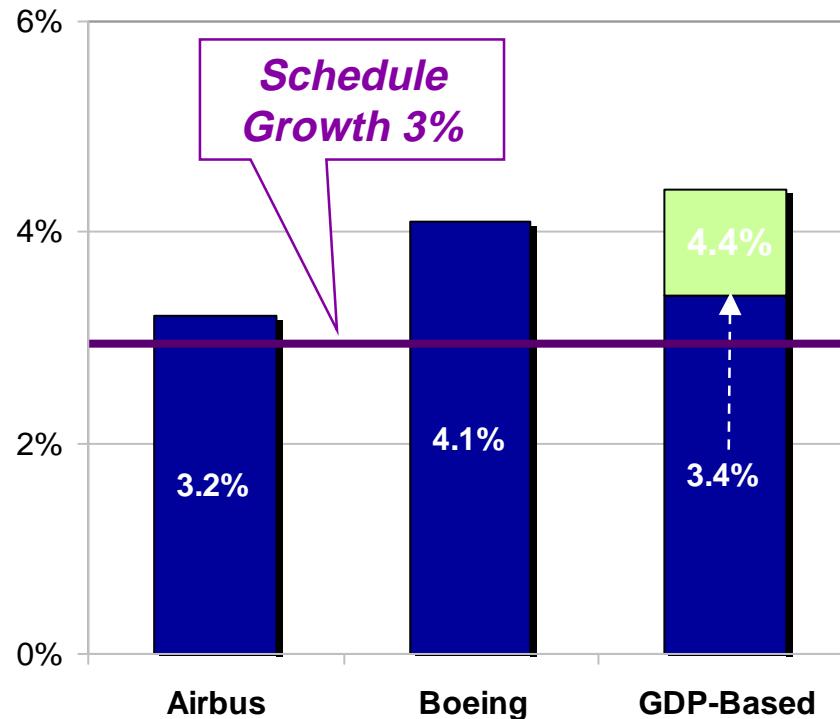
US Domestic Industry Real Passenger Yields  
1990-October 2004, in 2003 cents/RPM



# Underlying Traffic Growth in the US Is Expected to Outstrip Capacity Increases, Pointing to Some RASM Recovery

## Forecast US Passenger Traffic Growth vs. Forecast US Schedule Growth

CY2005



- **In March 2005, Legacy carriers twice increased fares to address rising fuel costs**
  - Initiated by Northwest, followed by Continental, American, Delta and America West
- **JetBlue and Southwest also followed**

Note: Intra-Region Demand Forecasts for 2004-23; GDP Forecast for 2004-06.

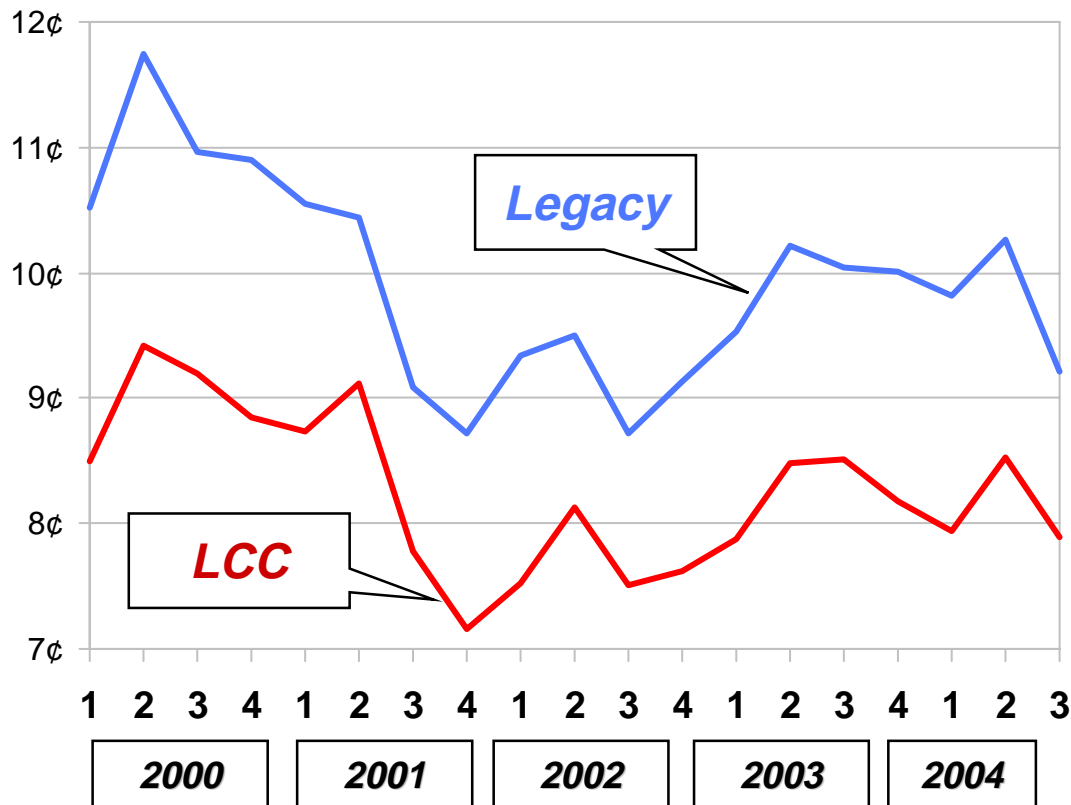
Assumes income elasticity of 1.3, as experienced in US domestic from 1984-2003.

Source: Published Traffic Forecasts; US GDP from Office of Management and Budget.

# The RASM Impact of Simplified Pricing Is Still Not Clear

## Domestic RASM for US Legacy and Low Cost Carriers

1<sup>st</sup> Quarter 2000 – 3<sup>rd</sup> Quarter 2004



- 2.5% of US Domestic passengers purchase tickets over \$500, accounting for 11.2% of revenue
- In 2005, Continental Airlines has projected a \$200m loss in revenue due partly to *Simplifares*
- LCC expansion will erode legacy pricing power in more markets

Legacy: American, Continental, Delta, Northwest, TWA, United, US Airways  
 Low Cost: ATA, AirTran, America West, Frontier, JetBlue, and Southwest

Source: US DOT Form 41 via Database Products.

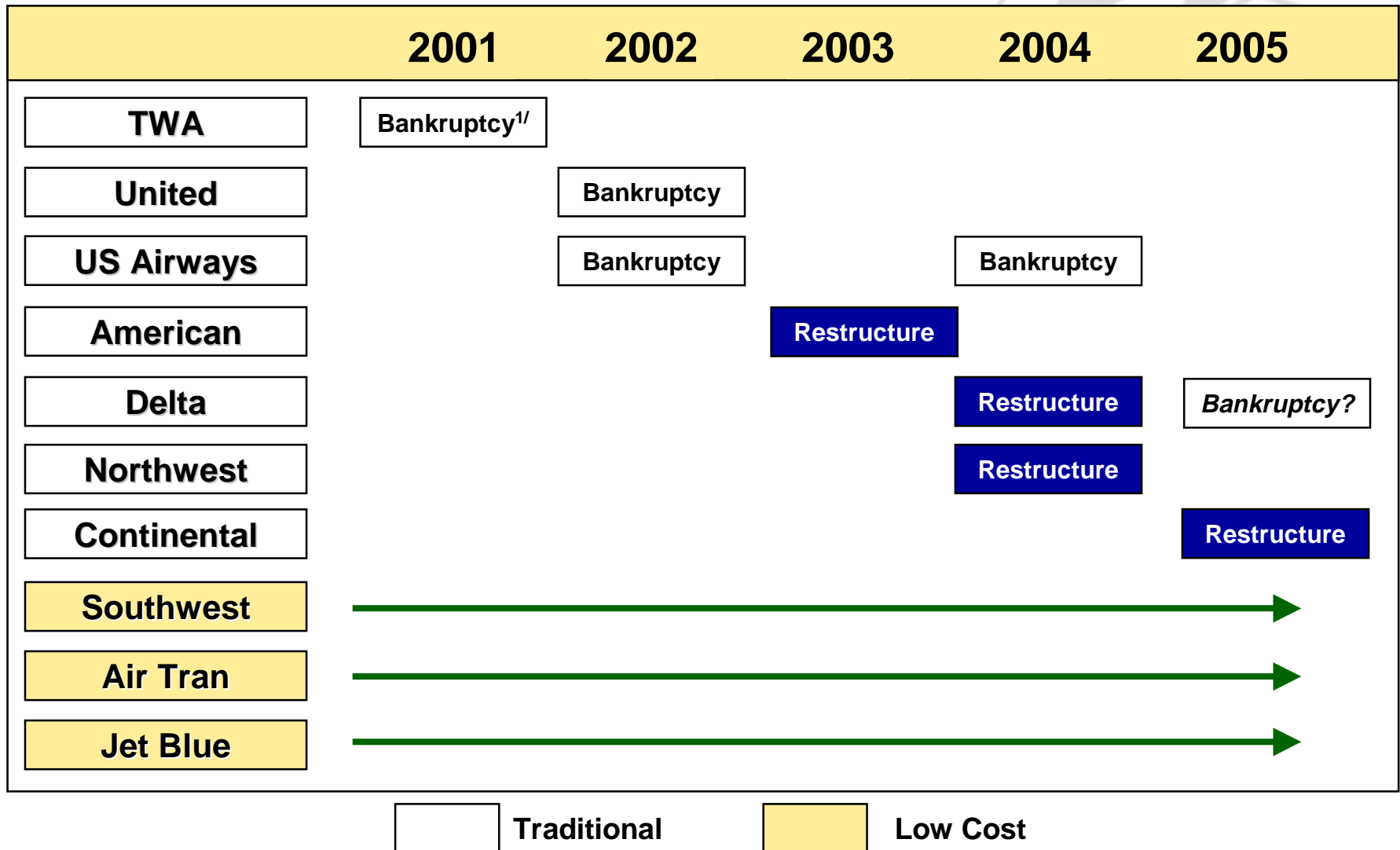


## Section 3

## Cost Environment



# All the Large Traditional Airlines Have Been Forced to Lower Their Cost Structures or Fail



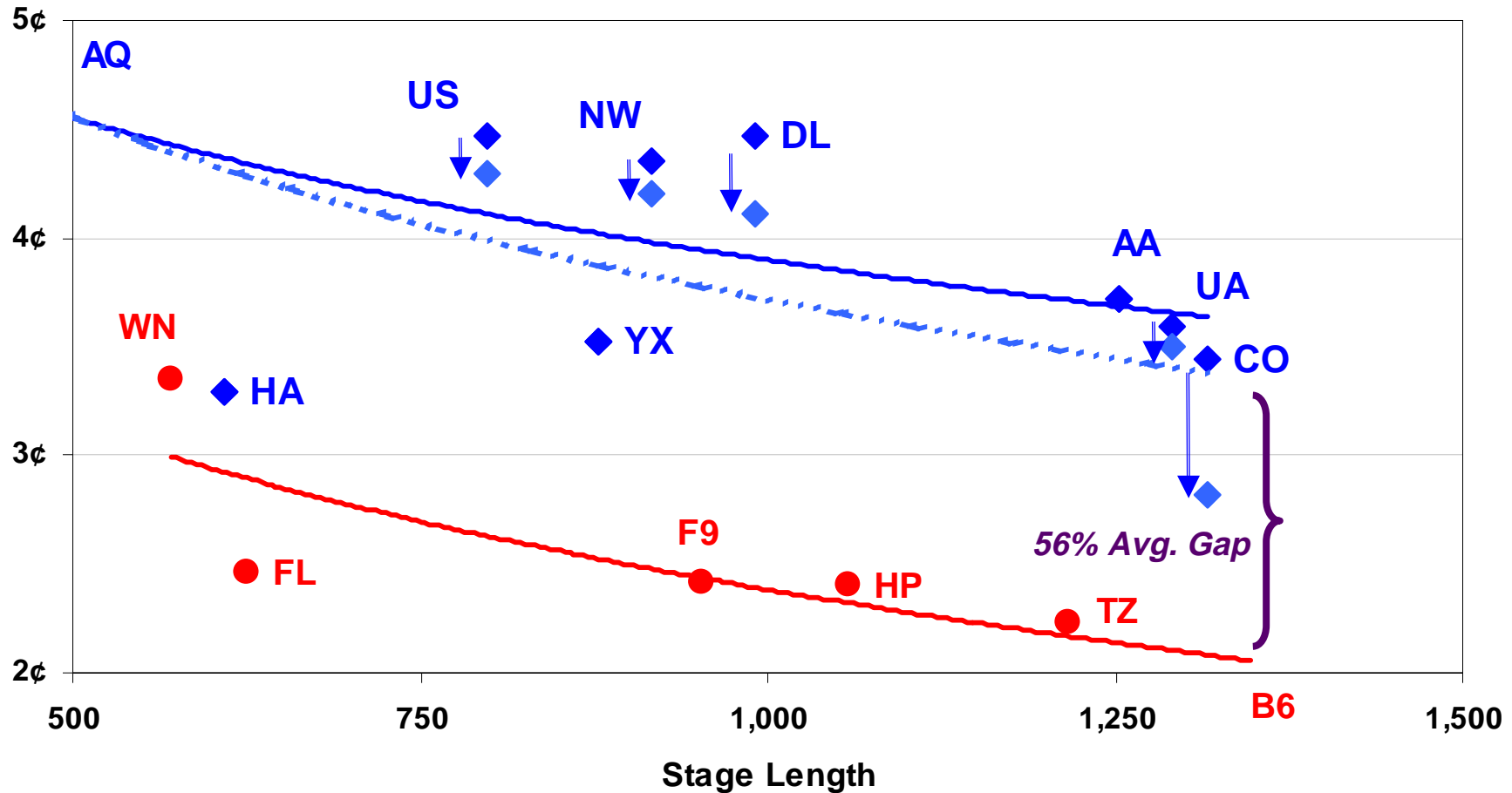
1/ TWA was subsequently merged into American Airlines

Source: Labor concessions as reported by Air Conference. News articles from Air Transport Intelligence

# Legacy Carriers Will Find That New Labor Deals Go Only Partway to Restoring Their Competitive Position

Labor CASM at US Legacy and Low Cost Carriers vs. Stage Length System, Year End 3<sup>rd</sup> Quarter 2004

Labor CASM

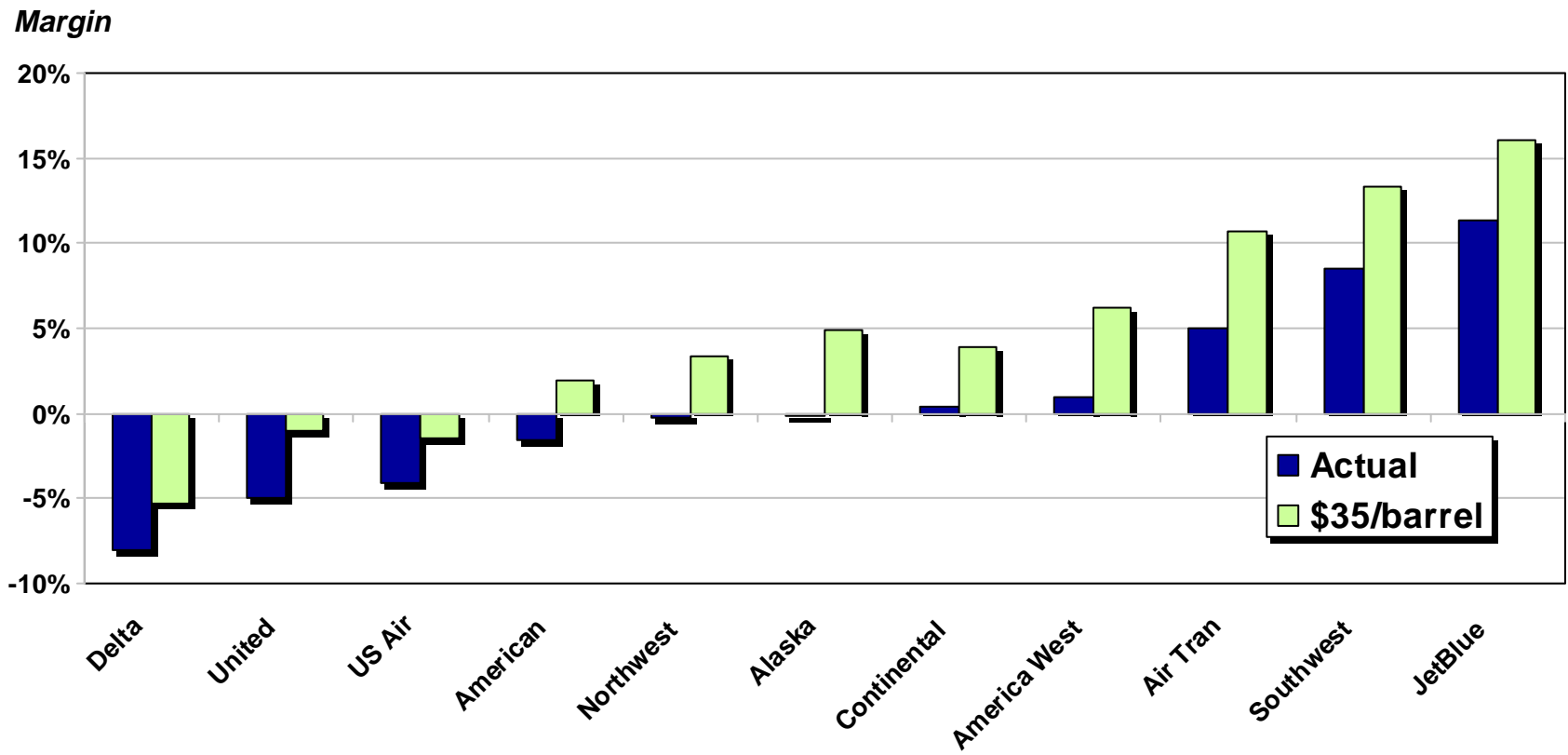


1/ Direct salaries and benefit expense.

Source: US DOT Form 41 via Database Products.

# Nor Would Lower Fuel Prices Be Sufficient to Restore Industry Profitability For All Majors

Effect of \$35/Barrel Oil on Airline Operating Results  
Year End 3<sup>rd</sup> Quarter 2004



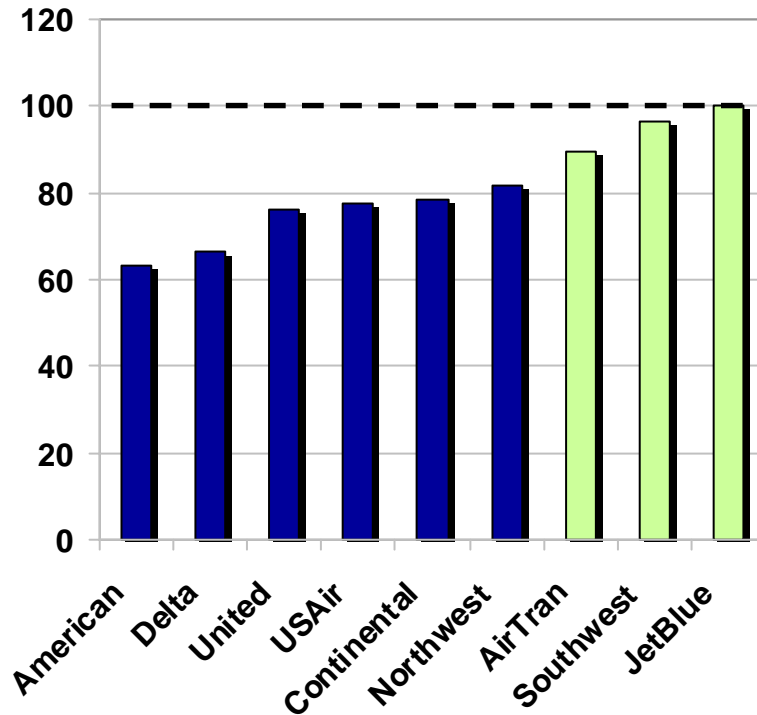
Note: 1/ Data based on reported carrier operating results

Source: US Department of Energy. US DOT, Form 41.

# ...Unless Aircraft Utilization and Labor Productivity Can Be Increased

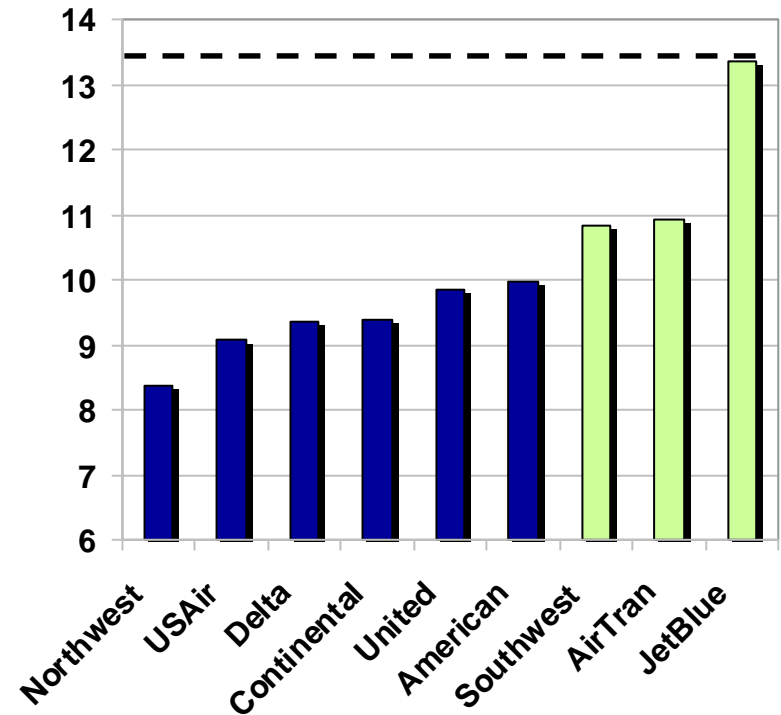
**Pilot Productivity**  
Domestic - 4<sup>th</sup> Quarter 2003

Index  
JetBlue = 100



**Daily Aircraft Utilization**  
Domestic - Year End 3<sup>rd</sup> Quarter 2004

Hours



Note: Pilot Productivity calculated as Domestic Block Hours/Pilot  
Source: US DOT Form 41.

**Section 3**

**Bankruptcy and Liquidation**



# It is Difficult to Judge Whether US Airways, Independence or Others Will Liquidate

## *US Airways*

- Recent financial investment from regional airline partners, cost cutting, and employee concessions
- Facing significant LCC competition (Southwest), must reduce costs

## *Independence*

- Announced last week that they face liquidation threats despite renegotiation with GECAS

## *Others?*

- Delta warned of potential bankruptcy in 2005 due to high fuel prices
- ATA probably saved in near term by Southwest deal

# US Airways Liquidation Would Make a Small But Measurable Impact to Support Domestic RASM

## Retirement Scenario Following US Airways Liquidation (ASMs)

	ASM (bn)	% Non- Local <sup>1/</sup>	Other Re- absorption	Retire- ment
<b>Industry - Current</b>				
Industry Capacity	713			
<b>US Airways</b>				
Shuttle	1	0%		-
Other BOS/LGA/DCA	4	20%		1
PHL	15	60%	10%	7
CLT	14	80%	15%	9
PIT	9	50%	5%	4
Total	43			22
<b>Percent of Industry</b>	<b>6.1%</b>			<b>3.0%</b>

➤ Most of US Airways' local capacity would be purchased or absorbed by other carriers

➤ Most but not all of the connecting capacity would be retired

➤ Fleet approach:

- 120 A319/320/320 (purchased - primarily abroad)
- 120 737-300/400 (retired)
- 30 757-200 (retired)

1/ SH&E estimates



## Section 5

# Hawaiian Airlines Restructuring



# Hawaiian Airlines Successfully Restructured And Is Expected to Emerge From Bankruptcy in April 2005

## ➤ **Cost Reduction Elements Include**

- Labor productivity improvements (pre-petition) valued at \$11.5 million
- Lease restructuring
- Fleet downsizing (rejected 3 aircraft from Boeing)
- Reduced fuel costs by purchasing in bulk from Asia
- Renegotiated all major third party agreements including ground handling, passenger handling and maintenance

## ➤ **Reached new labor agreements with all six labor unions**

# In Contrast to Most Other Airline Restructurings, Hawaiian Improved Revenue With a Sustainable Impact

## ➤ Inter-island Routes

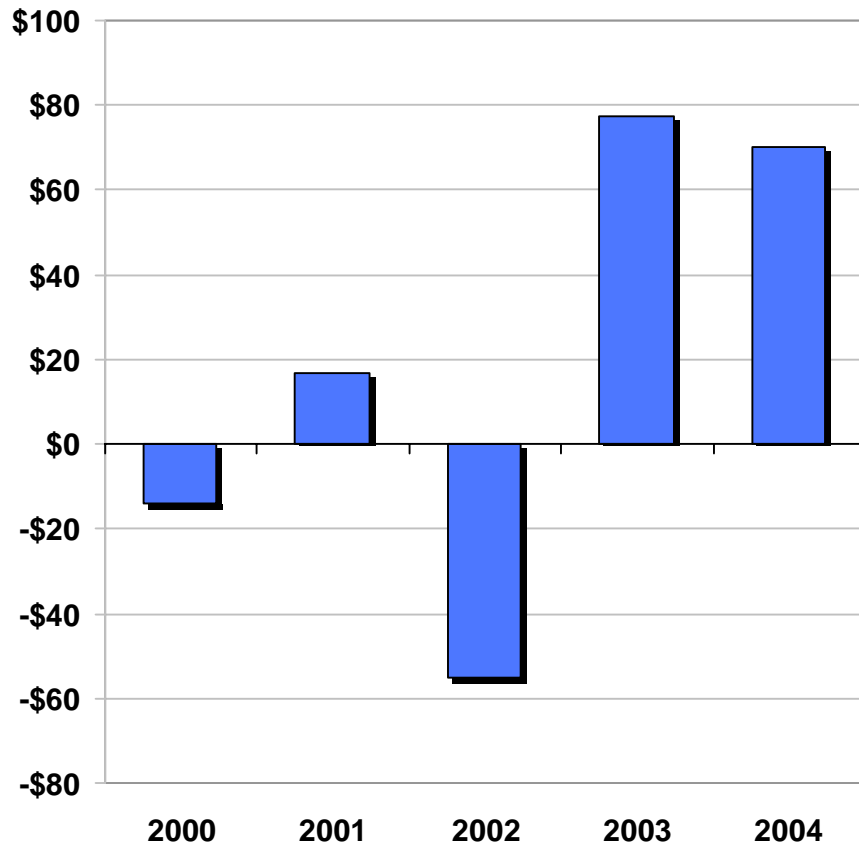
- Capacity reduction in cooperation with Aloha (25%)
- Terminated vouchers and coupons and introduced capacity controlled fares that support revenue management

## ➤ Long-Haul Routes

- Realigned route system to become only or leading nonstop service provider in some smaller markets (i.e. Sacramento)
- Reduced role of wholesalers and recaptured margin through aggressive use of HAL website
- Elevated brand positioning to justify premium pricing
- Established long-haul growth plan to increase utilization, passenger flow and hub strength

# 2004 Operating Results Represent a \$125m Turnaround In Operating Income Compared to 2002

## Hawaiian Airlines Operating Income 2000 – 2004



- Operating Income of \$70 million for 2004 on revenue of \$764 million
  - Compared to an operating loss of \$55 million on revenue of \$632 million for 2002
- Top industry on time performance since November 2003 (97% in July)
- Highest load factor in the industry for H1 2004 - 89% in June 2004



# Hawaiian's Reorganization Plan Provides a 100 cent Recovery to Unsecured Creditors

- **Creditors will receive 100% of the value of their claims, most of them in cash.**
- **Common equity held by existing shareholders is valued at \$223 million**
  - Shareholders have claim to 75.4% of HAL's common equity
  - HAL common equity is valued at \$296 million<sup>1</sup>
- **New shareholders effectively invest \$113 into HAL/HHI**
  - \$60 million via an equity rights offering
  - \$53 million via a debt offering, assumed to convert into common equity
- **Existing stockholders keep their shares, whose value has risen during the bankruptcy**
- **Employees have new negotiated contracts that trade modest wage increases for productivity gains, holding total labor costs flat**

***The Joint Trustee/Committee Auction Process  
Increased Recovery By Over \$300 million.***

<sup>1</sup>Valuation is derived by applying a 10x multiple against 2005 Net Income expected under the Proposed Plan.

Source: Hawaiian Airlines, 2002-2004.

# Conclusions

- **Legacy Carriers, facing High Fuel Prices, Simplified Fares and Increasing LCC Pressure Will Find Profitability Difficult**
  - American, Northwest and United are poised to weather the storm
  - Liquidation of US Airways remains a possibility
- **LCCs Will Continue to Expand Into Traditional Legacy Markets and Begin Exploring International Routes**
  - Consolidation among LCC players (i.e. Southwest and ATA) is expected to continue
  - LCCs will increasingly compete against each other and expand into legacy carrier hubs

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