The Evolving U.S. Domestic Market
Current cycle of industry structural changes:
How will the landscape evolve?

The Case for Consolidation

2007 32nd FAA Forecast Conference

Washington, DC

March 16, 2007

Formerly Fragmented Industries Consolidating Globally

- Consolidating globally
  - Pharmaceuticals/health care
  - IT services/software
  - Energy/refining/retailing
  - Defense/manufacturing
  - Maritime/rail/trucking/intercity bus
  - Distribution/warehousing/logistics
  - Banking/financial services/insurance
  - Lodging/hospitality
  - Telecoms/broadcasting/media
- Among those remaining fragmented
  - ***Airlines***

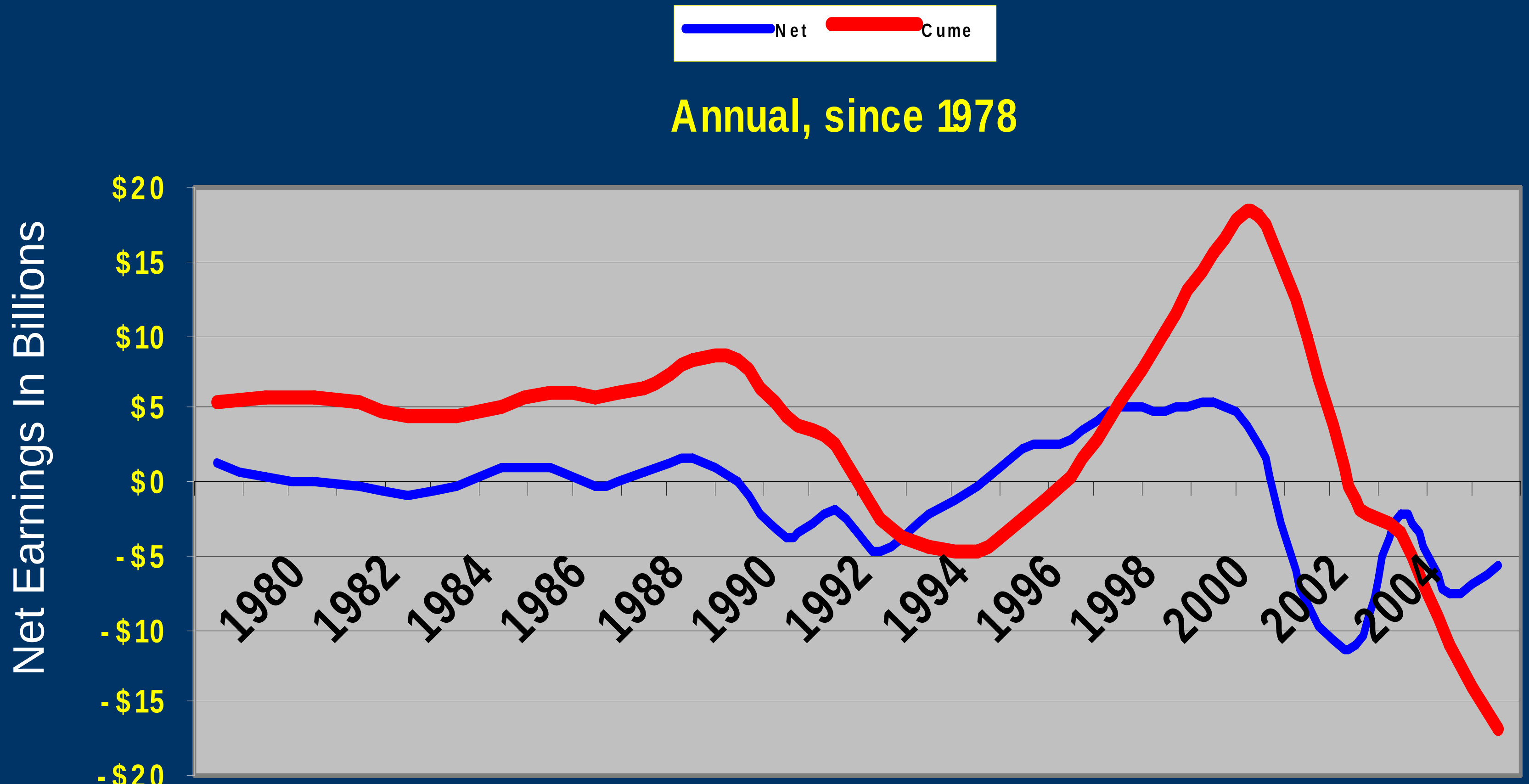
Why *not* Airlines?

- Maturing industry with “excess capacity”
- Poor balance sheets, despite restructuring
- Evolving exposure to competitive/operating/regulatory change

Once Again… Why not Airlines?

- Fragmented, obsolescent, over-leveraged industry
- Extensive “best customer” overlap
- Converging practices/processes/models
- Complementary business models, scope
- Highly competitive, nonstop and O&D
- LCCs provide institutional price discipline

Concern? Industry P&L Excursions Widen



Dangerous Profit/(Loss) Swings

- Increasing peak-trough amplitude/duration
- Alarming to traditional capital markets
- Continuing energy cost exposure/leverage
- Clearly (ought to be) a policy level concern

Threshold Conditions Favoring

- Capital markets understand roll-up economics
- Maturing networks, enduring LCCs, alliances
- “The Sky’s the Limit”: self-induced congestion
- Aging business cycle: when the music stops…

Compelling Metrics Persist

- Top 6 US networks’ domestic shares ~ 50%
- Legacy infrastructure, crushing debt load/ratings
- Mapping to 3 global alliances … (was 5)
- JET-A forward curve in contango
- Short fuse

Historical Mitigating Factors

- Desire for “organic” network ubiquity
- Incipient consolidation
- Prior value destruction: “Mergers … bad”
- ATI concerns: “old” industry environment
- Have we run out of excuses yet?

Reality: Continuous Consolidation

- Regulated era: Trunks emerge
- 1980’s initial post-deregulation scramble
- 1990’s post-Gulf War I restructuring
- Early 2000’s post-9/11 restructuring
- Next opportunity: next outgoing tide

New Formula: $M + T + B = R$

- ***Management*** … team with a clue
- ***Target*** … in restructuring
- ***Billions*** … in OPM
- ***Results*** … “No tears” (OK, not too many)

Excuses keep on coming…

- “What’s the rush?”
  - Earnings cycle improving
  - Energy prices moderating
  - Bankruptcy opportunities foreclosed
  - Million$ of reaon to stay independent

All Signs Point to Consolidation

- Music stops → consolidation
- Citizenship flex → consolidation
- Energy cost rise → consolidation
- Roll-up economics → consolidation
- LCC share expansion → consolidation
- Congestion costs/pricing → consolidation
- Consumer price resistance → consolidation
- Only questions: “What pairings, and when?”

Potential Consolidation Risks

- Small community service deterioration
- Further service quality deterioration
- Workforce integration non-trivial
- Except in egregious cases, NOT anti-trust

Consolidation necessary, inevitable

- Economics and operations driven
- Domestic and international scope
- Remaining issues are mode and timing
- First Mover Advantage already evident