Low Cost Carriers

"Thou Shalt Not Inherit the Earth"
Airline Industry Prosperity Has Always Been Closely Linked to the Health of the U.S. Economy -- A Relationship That Began to Break Down Over 30 Months Ago
What We Thought Was A Watershed Period in the Early 1990s Pales in Comparison to What We Are Currently Experiencing

Source: Dot Form 41 and Bureau of Economic Analysis

Nominal GDP

Chg Dom Rev

$13 billion loss
Domestic Market Revenue Deterioration Has Been Well Documented -- Yet is the Heart of the Catharsis
The Revenue Environment is Both Cyclic and Structural -- Adapt or Die

<table>
<thead>
<tr>
<th>Item</th>
<th>Cyclic (Short Term)</th>
<th>Structural</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Recession</td>
<td>X</td>
<td></td>
<td>Historically linked to GDP which is not down dramatically. Probably a small part of the current problem.</td>
</tr>
<tr>
<td>Post 9/11 Hassle Factor</td>
<td>X</td>
<td></td>
<td>Clearly a big factor below 500 mile trips -- low fare carrier traffic growth above 500 miles suggests may not be a big problem in the aggregate. (1)</td>
</tr>
<tr>
<td>Security Fees</td>
<td>X</td>
<td>X</td>
<td>A problem that impacts price of air travel -- depresses traffic for all carriers -- some relief may come from Congress but may be a lasting issue in the post-9/11 world.</td>
</tr>
<tr>
<td>Low Fare Carrier Penetration</td>
<td></td>
<td>X</td>
<td>Key structural change that will only get worse for the network carriers unless cost structures adjusted accordingly. Availability of low fares is shifting demand.</td>
</tr>
<tr>
<td>Disappearance of Bubble Economy</td>
<td></td>
<td>X</td>
<td>Likely to be permanent. May still be being rung out -- telecommunications infrastructure overbuilt.</td>
</tr>
<tr>
<td>Internet Marketing of Airline Seats</td>
<td></td>
<td>X</td>
<td>Has made fare offers transparent to business and leisure travelers. Genie may be out of the bottle for good.</td>
</tr>
<tr>
<td>Other Changes in Business Traveler Price Elasticity</td>
<td>X</td>
<td>X</td>
<td>Company policies have shifted to save money on travel budgets. Could be somewhat reversed in good times. First cut, last to increase. Teleconferencing may have come of age -- may not be reversible.</td>
</tr>
</tbody>
</table>

(1) In the first quarter of 2000, 28.5 percent of passenger trips and 18.9 percent of domestic revenue came from markets of less than 500 miles.
Two Distinct Groups Among the Network Carrier Segment Have Emerged -- Or is It Just Timing

| Network Carriers’ Hub Airports Domestic Nonstop Air Service Index Change Mar. 2003 vs. Sep. 01 |
|----------------------------------|----------------------------------|----------------------------------|
| US Airways                       | United                           | Continental                      |
| PIT -31%                         | IAD -38%                         | CLE -8%                          |
| CLT -24%                         | LAX -31%                         | EWR +3%                          |
| PHL -17%                         | SFO -23%                         | SLC +3%                          |
|                                  | DEN -13%                         | IAH +9%                          |
|                                  | ORD -4%                          | JFK +7%                          |
| American                         |                                 | CVG +22%                         |
| STL -56%                         |                                 | DFW+36%                          |
| ORD -15%                         |                                 |                                 |
| MIA -12%                         |                                 |                                 |
| DFW -9%                          |                                 |                                 |

Note: Changes in carrier service reflect total; changes in hub service reflect nonstop only.
Source: OAG Schedules; Eclat Air Service Model
Some Network Carriers Have Reduced Their Exposure to the LCCs -- Some Face More Competition

Increased Exposure Since 9/11 (Ranked By Exposure to All LCCs)

1. Delta (+20.2%)
2. US Airways (+11.7%)
3. Northwest (+9.1%)

Decreased Exposure

4. United (-9.0%)
5. American (-15.7%)
6. Continental (-31.0)
But the Fact Remains That the Network Carriers’ Competitive Intensity Among Themselves Dwarfs Their Respective LCC Exposure – Still Too Much Capacity?
Regarding LCC Competition, A Pattern Emerges. When the Unit Cost Gap Widens, the LCC Segment Exploits the Opportunity.
The Low Cost Carrier Segment of the Industry Has Increased Its Share of Service in Almost Every U.S. Region Since 9/11, and No Better Time Than the Past 30 Months
Low Cost Carrier Market Penetration Has Deepened Since 9/11, But the Markets Share is Concentrated in Large and Medium Hubs

We estimate that the low cost carrier segment of the industry has captured an incremental 4 percentage points of domestic market share since pre 9/11
LCC Penetration into Top 10 CMSA Markets -- September 1997

- **San Francisco**: 23%
- **Chicago**: 13%
- **Dallas/Ft. Worth**: 26%
- **Houston**: 28%
- **Los Angeles**: 24%
- **Washington**: 6%
- **New York**: 0.3%
- **Boston**: 3%
- **Philadelphia**: 0%
- **Atlanta**: 6%
- **Large Hub**:
  - **San Francisco**: 3%
  - **Los Angeles**: 18%
  - **Ontario**: 42%
- **Medium Hub**:
  - **Oakland**: 57%
  - **Long Beach**: 0%
  - **Orange County**: 11%
  - **Burbank**: 56%
- **Small Hub**:
  - **San Jose**: 38%
  - **Long Beach**: 0%
  - **Burbank**: 56%
  - **Ontario**: 42%

**Total Markets**

- **Los Angeles**: 97%
- **Chicago (ORD)**: 64%
- **Chicago (MDW)**: 0%
- **Houston (HOU)**: 68%
- **Chicago (ORD)**: 0%
- **Dallas/Ft. Worth (DFW)**: 97%
- **Washington (BWI)**: 14%
- **Newark**: 0%
- **New York (JFK)**: 1%
- **New York (LGA)**: 0%
- **Washington (DCA)**: 0%
- **Westchester County**: 0%
- **Islip**: 6%
- **Island**: 0%
LCC Penetration into Top 10 CMSA Markets -- March 2003

Swift and Sustaining

- Total San Francisco 29%
  - San Francisco 2%
  - San Jose 39%
  - Oakland 61%
- Total Los Angeles 31%
  - Los Angeles 22%
  - Burbank 64%
  - Orange County 18%
  - Long Beach 46%
- Total Chicago 17%
  - Chicago (ORD) 75%
  - Chicago (MDW) 0.3%
  - Chicago (MDW) 75%
- Total Dallas/Ft. Worth 24%
  - Dallas/Ft. Worth (DFW) 87%
  - Dallas/Ft. Worth (DAL) 3%
- Total Houston 28%
  - Houston (IAH) 3%
  - Houston (IAD) 76%
- Total New York 8%
  - New York (JFK) 22%
  - New York (LGA) 3%
  - New York (DCA) 1%
- Total Washington 17%
  - Washington (BWI) 46%
  - Washington (IAD) 3%
  - Washington (DCA) 1%
- Total Philadelphia 2%
  - Philadelphia 1%
- Total Boston 6%
  - Boston 3%
  - Providence 18%
  - New York (JFK) 22%
Has Low Hanging Fruit Been Picked? -- 97% of Domestic City Pairs Have Less Than 100 PDEWs, Accounting for Just 31% of Domestic Passenger Traffic

Note: PDEW = Passenger Per Day Each Way
Has Low Hanging Fruit Been Picked? -- 12% of LCC City Pairs Have Less Than 100 PDEWs, Accounting for Just 2% of Their Traffic

LCC Markets

- Less Than 100 PDEW
  - 12%
- Greater Than 100 PDEW
  - 88%

LCC Passengers

- Less Than 100 PDEW
  - 2%
- Greater Than 100 PDEW
  - 98%

Note: PDEW = Passenger Per Day Each Way
Has Low Hanging Fruit Been Picked? -- In Fact, City Pairs With Less Than 100 PDEWs Make Up Less Than 3% of the LCC Traffic Today

Note: PDEW = Passenger Per Day Each Way
As the Network Segment Addresses Their Respective Cost Issues, There Will Be Less Spread to Exploit
Making it Harder for the LCCs to Grow at Current Rates. In Fact, There Are Scenarios Where Some Low Cost Carriers Will Shrink
Low Cost Carriers Currently Serve 940 of the Largest City Pair Markets. If the 100 PDEW Level is the Ticket for Entry, Then Only 213 Remain

213 U.S. Markets With Over 100 PDEWs That Have No Low Cost Carrier Service

- 74 (35%) Slot Controlled
- 16 (8%) Over 2,000 Miles
- 5 (2%) Misc. Reasons

118 (55%) Remain
Only 118 Markets Are Immediate Candidates for New LCC Service, and Not Enough to Feed All of the Current Players

Those 118 Markets Would Produce An Additional 1.6% Market Share for LCC Carriers

<table>
<thead>
<tr>
<th></th>
<th>% of Current Total</th>
<th>New ASMs</th>
<th>% of Total U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>9.3%</td>
<td>10,533,680,270</td>
<td>1.6%</td>
</tr>
<tr>
<td>jetBlue</td>
<td>2.1%</td>
<td>152,314,500</td>
<td>0.0%</td>
</tr>
<tr>
<td>Frontier</td>
<td>4.6%</td>
<td>237,209,850</td>
<td>0.0%</td>
</tr>
<tr>
<td>AirTran</td>
<td>16.7%</td>
<td>1,305,218,100</td>
<td>0.2%</td>
</tr>
<tr>
<td>Southwest</td>
<td>1.9%</td>
<td>1,305,530,540</td>
<td>0.2%</td>
</tr>
<tr>
<td>New/Speculative/Other</td>
<td>n. m.</td>
<td>7,533,407,280</td>
<td>1.1%</td>
</tr>
</tbody>
</table>
If the Analysis is Correct, 118 May Be Overstating the LCC Opportunities Going Forward -- Assuming No Major Carrier Liquidations, of Course

<table>
<thead>
<tr>
<th>Description</th>
<th>Number</th>
</tr>
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<tbody>
<tr>
<td>Served By Secondary LCC Market</td>
<td>24</td>
</tr>
<tr>
<td>Hub Dominant</td>
<td>22</td>
</tr>
<tr>
<td>Hub To Hub</td>
<td>20</td>
</tr>
<tr>
<td>DFW To Wright Amendment &quot;Blocked&quot; Airports</td>
<td>9</td>
</tr>
<tr>
<td>Leisure Markets</td>
<td>6</td>
</tr>
<tr>
<td>Other</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>82</strong></td>
</tr>
</tbody>
</table>

82 Markets Are New/Speculative/Other: Here is Why
Conclusions

- It’s the economy stupid! No it’s not.

- It’s all the result of LCC growth! No it’s not.
  - During the 1997-2000 period, significant capacity growth by the network carriers resulted in multiple competitive options. Despite the cutbacks in capacity, the competitive intensity among the network carriers is significantly greater than competition from the LCC segment.

- Delta, Northwest and Continental are safe. No they’re not.
  - Balance sheet and cost issues have forced US Airways, United and American to go first. We have demonstrated the greatest opportunities for LCC expansion lie in Delta’s backyard. Northwest, finally, faces increasing LCC competition. And Continental’s balance sheet is not a picture of health. They too will have to restructure.
Conclusions (continued)

- The LCCs will grow at current rates into the foreseeable future. No they won’t.
  - Recent and ongoing restructurings will push down the network carriers respective cost curves to levels not dreamed of 18 months ago. If the cash spread is one attribute of LCC market exploitation, then the window is closing.

- All of the current LCCs will be survivors. No they won’t.
  - Only Southwest and jetBlue have real staying power.
  - AirTran is interesting. But is jetBlue smelling blood in the Georgia clay believed to be their’s or Delta’s.
  - Frontier, Spirit and ATA each have unique attributes but questionable staying power.

- There are still a myriad of market opportunities available and ready-made for the LCC segment. No there aren’t.
  - Assuming no major liquidations, of course. And assuming that the appetite for small local markets doesn’t change – or inflict the LCC version of self-diversion.
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