US Airline Competition and Consolidation 2010

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US Airline Industry Performance

• **Review: A roller-coaster decade 2000-09**
  – Rapid growth of LCCs and intense fare competition
  – Restructuring, cost cutting and productivity improvements
  – After $40 billion in losses a brief return to profits 2006-07
  – Fuel shock and financial meltdown in 2008

• **Return to profitability in 2010 and beyond**
  – How much room to cut cost or improve productivity?
  – Can capacity discipline be maintained?
  – Have LCCs reached their peak in US domestic markets?

Source: ATA data
US Carriers Cumulative Net Income Q1-Q3 2010

Source: Airline Business
US Carrier RPM Traffic Share 2009

Source: Aviation Daily, 1/21/2010
US Legacy and Low Cost Airlines

Network Legacy Carriers

- AA – American Airlines
- UA – United Airlines
- DL – Delta Air Lines (incl. NW)
- CO – Continental Airlines
- US – US Airways (incl. HP)

Low Cost Carriers

- WN – Southwest Airlines
- B6 – JetBlue Airways
- FL – AirTran Airways
- F9 – Frontier Airlines
- VX – Virgin America

- Legacy group carried 67% of total US airline traffic in 2009.
- These airlines carried another 17% of total US traffic (RPMs).
Unit Costs (excl. “Transport Related”) Spiked in 2008

CASM Ex Transport ($/ASM)

$/ASM


NLC  LCC
Non-Labor Unit Cost Difference Still About 1 Cent
The “Structural Gap”

CASM Non-labor ($/ASM)

$/ASM

$/ASM


NLC LCC
Labor Unit Costs Increasing Again for Both Sectors

CASM Labor ($/ASM)

$/ASM


NLC LCC
Aircraft Utilization Decreased in 2008 and 2009

Block-Hours per Aircraft Day


NLC LCC
LCC Employee Productivity Still 15% Higher than NLCs

- ASM per Employee


- NLC: 1,700,000, 1,900,000, 2,100,000, 2,300,000, 2,500,000, 2,700,000, 2,900,000

- LCC: 2,100,000, 2,300,000, 2,500,000, 2,700,000, 2,900,000, 3,100,000
Gap in Salaries/Benefits per Employee Disappeared in 2006
US Domestic Traffic and Capacity Growth by Year

Source: Air Transport Association
Domestic Mainline Carrier Capacity Down 28% Since 2000; Total Domestic ASMs Still 16% Lower
Network Carriers Have Cut Domestic Capacity

[Graph showing the Domestic Available Seat Miles for different network carriers from 1999 to 2010.]

- American
- Continental
- Delta + NWA
- United
- US Airways + HP
LCC Domestic Capacity Has Grown, But Leveling Off

Domestic Available Seat Miles

- Industry
- Network
- LCC
Regional Partners Carry An Increasing Proportion of Decreased Domestic Passenger Traffic
Pre-Downturn, Capacity Reduction Was Having a Positive Effect on Unit Revenue Measures

PRASM (¢) -- Domestic + Express
12 Months Ended

Source: Air Transport Association
LCCs Carry 1 in 3 US Domestic Passengers

LCC Pax Traffic V. Total Pax Volumes

LCC Market Share is still growing but leveling off, reaching 34% of total US domestic passengers in 2008
LCC Share of Domestic RPMs is Approaching 25%
Domestic Market Concentration Virtually Unchanged
Merged Southwest Larger than Delta and United in Domestic Capacity

Domestic ASM Share
First Quarter 2000

- DL 16%
- UA 15%
- AA 15%
- All Other 54%

Domestic ASM Share
Second Quarter 2009

- WN + FL 18%
- CO + UA 17%
- NW + DL 16%
- All Other 49%

Notes: Mainline only. Excludes Regional Operations.
Southwest’s Recent Growth Has Only Been Into the Largest Markets

Largest Metro Areas Without Southwest Service

- Population 1 Million +
- Population 500,000 – 1 Million
- Population Less Than 500,000
Southwest has Increased Domestic Share through Growth in Capacity (ASM) Share at Below Average Load Factors
Southwest “Share Gap” Narrowed in 2009 – Due to Extensive Marketing of No Ancillary Fees?

SHARE GAP = RPM SHARE – ASM SHARE

Southwest's Share Gap

2000 2001 2002 2003 2004 2005 2006 2007 2008 2009
Prospects for Sustained US Airline Profitability

• **Exogenous forces remain the primary drivers of profit**
  – Strong economic recovery is critical to the demand/revenue side
  – Fuel prices are climbing, continue to be the greatest wild card

• **Cost and productivity gains have leveled off and/or reversed**
  – Non-fuel and especially labor unit costs increasing for NLCs and LCCs
  – Upcoming labor negotiations will be particularly difficult

• **Return to profitability largely due to capacity management**
  – Shifts by NLCs to international flying; lower domestic capacity overall
  – Consolidation through mergers in both sectors

• **LCCs continue to grow in largest markets, albeit more slowly**
  – Their 2011+ capacity decisions will greatly affect industry performance