Five Reasons
Five Reasons Why The Airline Industry Will Never Be Profitable
Pretax Profit Margin Highly Cyclical and Well Below U.S. Corporate Average

Sources: (1) IRS Statistics of Income *(Historical Table 13)* – “Net income (less deficit)” divided by “Total receipts”; (2) ATA Cost Index
Macro Scale Drivers
US Airline Net Profit

Cyclic Industry with Exponential Growth In Volatility Since Deregulation

Data source: ATA Annual Revenue and Earnings - Net Profit and Loss
World Airlines Net Profit
(from 1978 to 2009)

Note: IATA represents 250 airlines comprising 94% of the international scheduled air traffic
World Airlines Net Profits vs. Aircraft Deliveries

Phase Lag between Airline Net Profits & Aircraft Deliveries:
Hypothesize that instability driven by capacity response phase lag

Data source: ICAO data (Profit) and SpeedNews data (Aircraft deliveries)
#1 It’s A Capacity Lead Business Model

Causes Constant Over Capacity
QSI Market Forecasting Model

• Quality of Service Index
  – Values a service relative to other service offerings
  – Allows forecasters to determine potential of new markets and services

• Developed in the 1960s

• Very accurate
Basically a Share Model

• QSI for Montreal to Ft. Lauderdale
  – Number of Nonstops $\times 1.0$  5  5.0
  – Number of Onestops $\times .33$  1  .33
  – Number of Connections $\times .03$  30  .9
  – Market QSI  6.23
Forecasting A New Service

• Montreal – Fort Lauderdale QSI 6.23

• New nonstop QSI 1.0

• New Montreal – Fort Lauderdale QSI 7.23
Demand For The New Service

Note: Demand for air travel historically grew at the same rate as GDP.

New Service  
YUL-FLL QSI  

\[ \frac{1}{7.23} = 0.138 \times 250 = 34.6 \]  

Passengers Per Day

Market Demand
Carriers Always Get Their Share

• Frustrates many a marketing department
  – Steak and eggs
  – More legroom in coach
  – Food
  – Widebody aircraft

• Why carriers focus on price not product
Impact On Current Services

Market share before $\frac{1}{6.23}$

Market share after $\frac{1}{7.23}$

5.5 Less Passengers per day
Standing Still Not An Option

- If others add, and you don’t, you lose revenue
- Can’t grow revenue without adding capacity first
- Doesn’t matter how good a product one has, one always gets your share
### Cleveland to Orlando Service and Fare Display For All Participating Carriers

More service leads to more display space
Airlines are managing demand to capacity, not capacity to demand.
#2 Airplanes Don’t Go Away

They Just Become More Efficient
U.S. Domestic ASMs and RPMs

Note: Data for 2009 - Jan to May - from DOT Form 41 available from BTS – Projected to full year 2009 based on Jan-May data

Data source: ATA for 1970-2008, "U.S. Airlines" defined as U.S. Department of Transportation (DOT) in Form 41 Financial and Traffic Reports (total of 89 airlines)
#3 Labour Leverage

Political Organization Can’t Manage Economic Reality
Politically, Short Term Trumps Long Term

- Timing of settlements
- Deciding how much is enough
Twelve Days Of Christmas

(Well, OK, fifteen)

Salary and Benefits: 66 days
Fuel: 87 days
Maintenance: 26 days
Airport Fees: 35 days
Other: 136 days
Profit: 15 days
It Takes Two To Tango

World Airlines Net Profit
(from 1978 to 2009)

It Takes Two To Tango

**World Airlines Net Profit**
(from 1978 to 2009)

*Note: IATA represents 250 airlines comprising 94% of the international scheduled air traffic*

*Data source: ICAO data (1978 to 2007) and IATA (2007-2009) Forecast from June 9th 2009*
“Why would Management agree to a contract they could not afford?”
#4 Input Costs Are Too Volatile

Revenue Cycle and Cost Cycle Out of Sync
Cost Breakdown By Category

- Fuel: 21.2%
- Labor: 25.0%
- Transport-Related Expenses: 14.0%
- Professional Services: 8.0%
- Other Operating Expenses: 7.8%
- Aircraft Rents & Ownership: 7.1%
- Non-Aircraft Rents & Ownership: 4.7%
- Interest: 4.7%
- Utilities & Office Supplies: 7.1%
- Non-Aircraft Insurance: 7.1%
- Advertising & Promotion: 4.7%
- Communication: 4.7%
- Passenger Commissions: 4.7%
- Aircraft Insurance: 4.7%
- Maintenance Material: 4.7%
- Landing Fees: 4.7%
- Food & Beverage: 4.7%
Book Revenue Now, Buy Fuel Later

Ye Old Booking Curve

![Graph showing the percent of flight capacity booked over days prior to travel.]
Fuel Volatility Very Difficult To Manage

**Fuel Cost As A Percent Of Total Cost**

- Y-axis: 0.0% to 35.0%
- X-axis: Years from 1971 to 2007
Cost Volatility and Low Margins – Not a Good Match

Total Cost By Year Indexed to Year 2000
Even In Quiet Years, Cost Jump 20 Points

Total Cost By Year Indexed to Year 2000
Not Impossible To Manage – Just Unlikely

Need large cash reserves to manage volatility
Airline CEO’s Favorite Game

Hide The Cash!
#5 Nobody Really Wants It To Be Fixed

Value Chain, Customers and Governments Benefit From The Way It Is
Inflation-Adjusted Price to Fly One Mile on U.S. Airlines

Average, in Constant 1978 Cents

Source: ATA analysis of data from the U.S. Department of Transportation and the U.S. Bureau of Labor Statistics
## One Way Fares from Montreal in 1968 and 1982

### 1968 Fares

<table>
<thead>
<tr>
<th>Destination</th>
<th>One Way Fares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Toronto</td>
<td>$34.00</td>
</tr>
<tr>
<td>Hamilton</td>
<td>$25.00</td>
</tr>
<tr>
<td>Vancouver</td>
<td>$178.00</td>
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<tr>
<td>Victoria</td>
<td>$132.00</td>
</tr>
<tr>
<td>Ottawa</td>
<td>$93.00</td>
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<tr>
<td>Vancouver</td>
<td>$128.00</td>
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<tr>
<td>Penticton</td>
<td>$19.00</td>
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<tr>
<td>Prince George</td>
<td>$10.00</td>
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<tr>
<td>Smithers</td>
<td>$19.00</td>
</tr>
<tr>
<td>Vancouver</td>
<td>$39.00</td>
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<tr>
<td>Watson Lake</td>
<td>$56.00</td>
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<tr>
<td>Whitehorse</td>
<td>$77.00</td>
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<tr>
<td>Williams Lake</td>
<td>$15.00</td>
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</tbody>
</table>

### 1982 Fares

<table>
<thead>
<tr>
<th>Destination</th>
<th>One Way Fares</th>
</tr>
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<tbody>
<tr>
<td>Toronto</td>
<td>$160.00</td>
</tr>
<tr>
<td>Vancouver</td>
<td>$594.00</td>
</tr>
</tbody>
</table>

*F—First Class. S—Standard Class. Y—Economy Class.*
Consumers Are Happy

Anywhere you can point a compass. On sale.
Our worldwide sale is on now.

| Canada: ONE-WAY Tango fares from Montreal. Travel must be completed by September 30, 2008. |
|---|---|---|---|---|---|---|---|
| Toronto | Halifax | Saint John, NB | Winnipeg | Edmonton | Vancouver | Saskatoon Regina | Victoria |
| $59 | $149 | $164 | $191 | $234 | $254 | $259 | $269 |

| USA: ONE-WAY Tango or Tango Plus fares from Montreal. Travel must be completed by September 30, 2008. |
|---|---|---|---|---|---|---|---|
| New York | Boston | Chicago | Washington, D.C. | San Francisco | Orlando | Las Vegas | Los Angeles |
| $112 | $132 | $146 | $161 | $167 | $174 | $199 | $224 |

| Sun: ONE-WAY fares from Montreal, for travel as indicated below. |
|---|---|---|---|---|---|---|---|---|---|---|
| Tampa | Deerfield Beach | Nassau | Port-of-Spain | Havana | Montego Bay | Mexico City | Barbados |

Fares displayed do not include fuel surcharge of $20-$50 one way within North America. Fuel surcharges on Sun and International routes vary from $65 to $220 each way.

These are just some of our amazing sale fares to destinations around the world.

Find your freedom online or by calling your travel agent. You can also call us at 1-888-277-2662.

Governments Are Happy

Tax Bite on a $300 One-Stop Round Trip* Has Nearly Tripled

1972 Taxes
7% ($22)*

1992 Taxes
13% ($38)*

2009 Taxes
20% ($60)*

* Sample itinerary assumes one-stop domestic round trip with maximum passenger facility charge (PFC) per airport; $300 total price includes taxes and fees. Source: ATA analysis of federal tax code
Best Way To Make Money – Service The Airline Industry
Summary

- A capacity lead model fostering commoditization
- Capacity never leaves
- Labour has leverage, but cannot manage its responsibility
- Input costs are volatile and would require a level of cash that is difficult to maintain
- Value chain does not want to see things fixed
Five Opportunities

1. Capacity driven business model
2. Airplanes don’t go away
3. Labour leverage
4. Input costs too variable
5. Nobody really wants it to be fixed
It may be dull...
but never boring