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Mergers, Alliances and Consolidation- A Path to Sustainability?

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Sustainable

- 1- able to be maintained at a certain rate or level:
 - conserving an ecological balance by avoiding depletion of natural resources:
- 2- able to be upheld or defended

Has the Air Transport Industry Ever Met
This Definition?



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Strategies and Tools for Sustainable Air Transport

Survival or Sustainability? Airline Industry Hierarchy of Needs*



* Presenter's view with apologies to Abraham Maslow



Operating Environment

- Globally, the industry continues to strive for:
 - Ability to hedge against global economic challenges such as:
 - Eurozone Crisis
 - Recession
 - Absence of long term energy and transportation policies (local, regional and global)
 - A stable supply of fuel at a viable price point
 - Capacity discipline



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OPERATING ENVIRONMENT- FUEL





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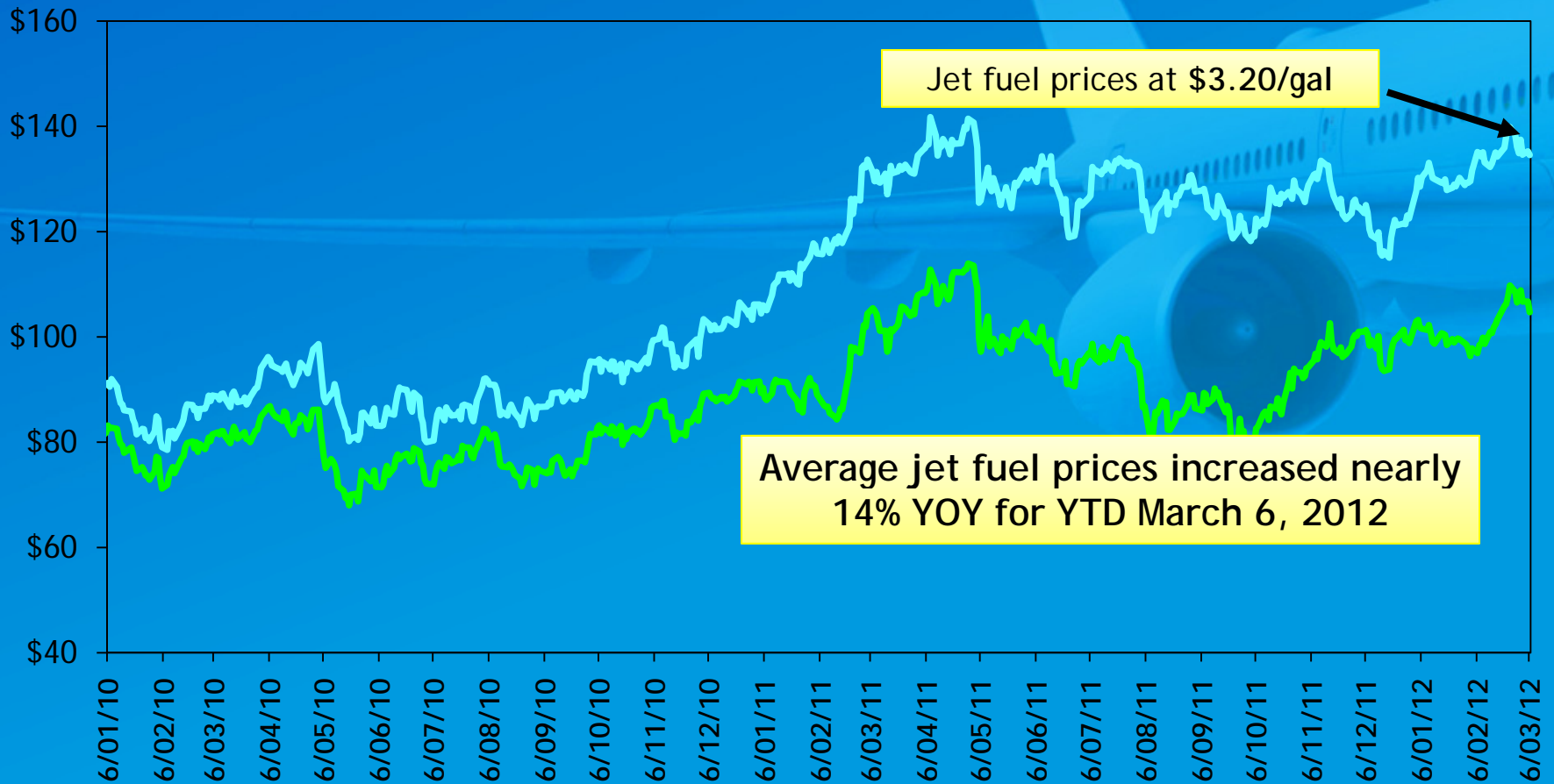
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Jet Fuel Remains An Industry Concern

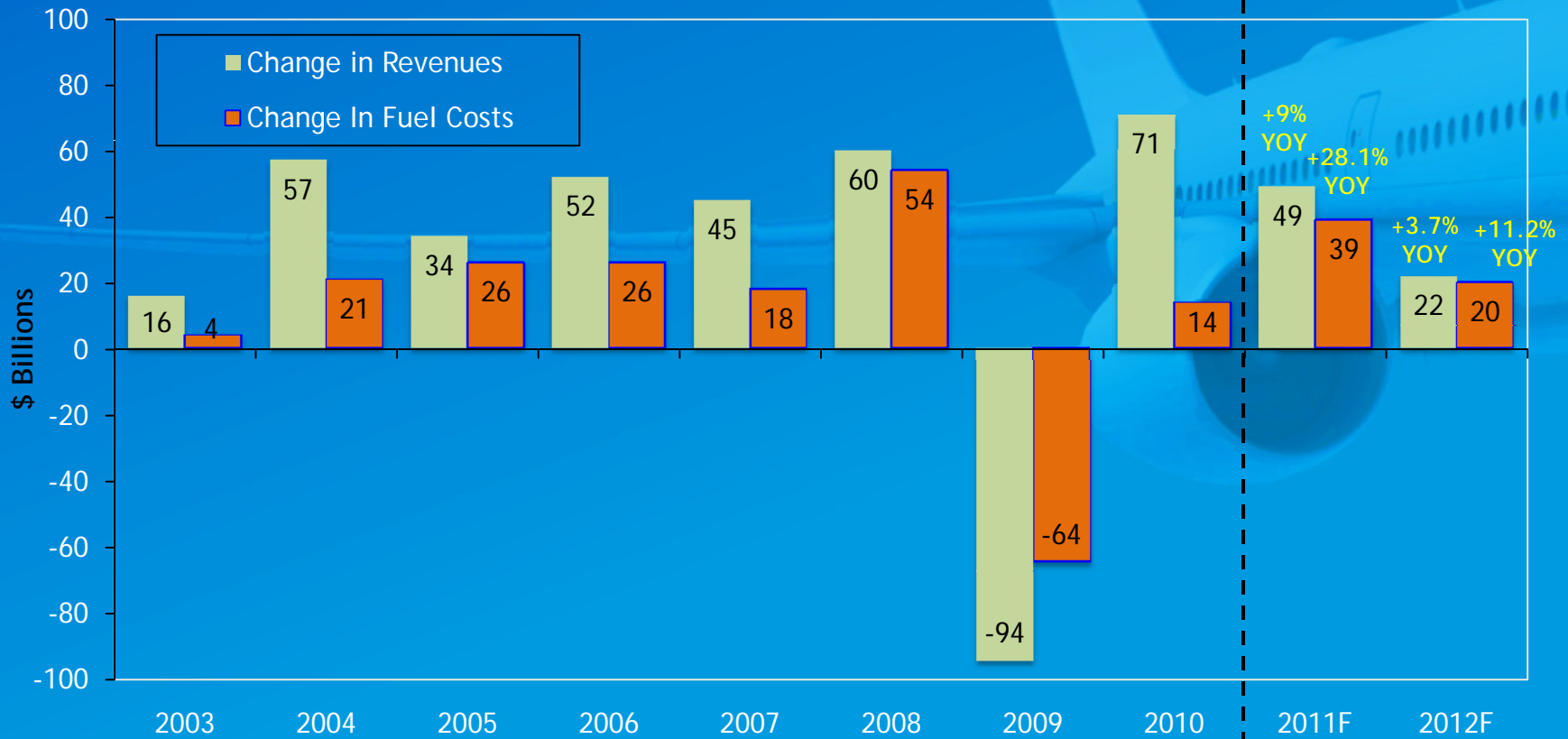
Gulf Coast Jet Fuel Average (\$ per barrel)



Source: EIA, NYMEX



Year-Over-Year Increases In Fuel Costs Will Continue To Outpace Revenue YOY Gains



*2012 forecast shown assumes Eurozone banking crisis is resolved.
Source: IATA "Financial Forecast" (December 2011)



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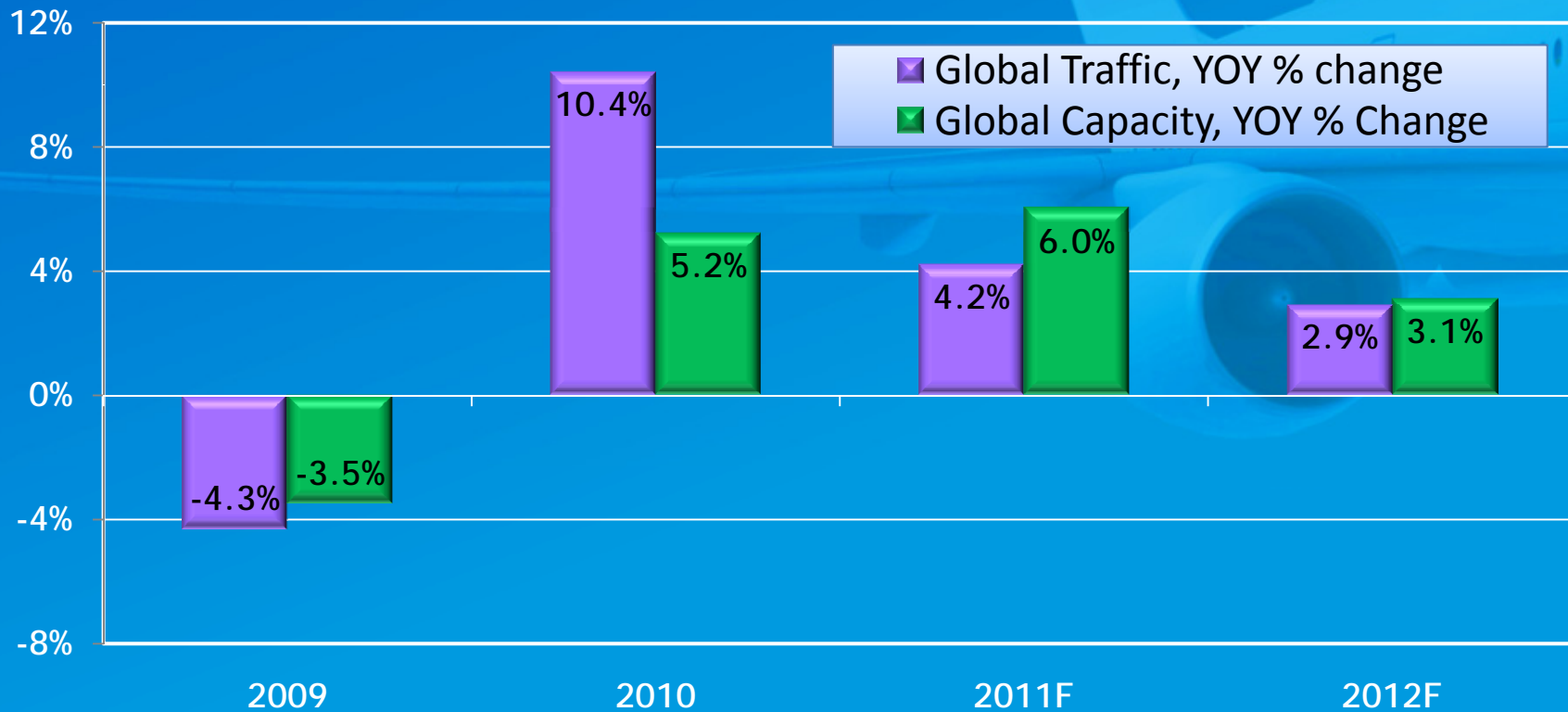
OPERATING ENVIRONMENT- CAPACITY DISCIPLINE





Capacity Re-entered The Market And Is Forecasted To Outpace Demand In 2011 and Again In 2012

System-wide Global Capacity and Traffic



*2012 forecast shown assumes Eurozone banking crisis is resolved.
Source: IATA "Financial Forecast" (December 2011)



Capacity Discipline in 2011 Proved Successful for North American Carriers

- **2012 profits to average \$1.7b for North American carriers, down from \$2.0b in 2011**
- **Capacity expected to be flat in 2012**
 - Macro indicators suggest revenue to increase just 4% in 2012
 - Risks to profitability include rising fuel prices, capacity growth, and high unemployment rates
 - AMR bankruptcy led capacity cuts to be mostly absorbed by competition
- **High fuel, while impacting profitability, not as dramatic as when fuel skyrocketed in 2008**
 - More tactical fuel hedging strategies
 - Capacity discipline
 - Fuel efficiency



Growth of Middle East Widebody Fleet Far Outpacing U.S. and European Widebody Fleet Growth



Note: U.S. includes American, Continental, Delta, Northwest, United and US Airways; Europe includes Air France, British Airways, Iberia, KLM, Lufthansa, SAS, and Virgin Atlantic; Asia/Pacific includes Cathay Pacific, China Eastern, China Southern, Air China, Air India, Jet Airways, Kingfisher; Middle East includes Emirates, Etihad, Gulf Air and Qatar

Source: OAG; includes aircraft in storage; excludes freighters and combis



Managing the Operational Environment through Mergers, Acquisitions and Alliances

- Why Alliances to begin with?
 - Given the challenges, it is a method to manage capacity in a larger system while “pooling” passengers from different systems into a larger, more effective network.
- Why not merge or acquire instead?
 - Not geo-politically feasible or legal in many countries
 - Fully developed Joint Ventures/Alliances give the same benefits without the costs of a merger



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GLOBAL ALLIANCES





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“Big 3” Alliances Continue To Expand Membership

Star Alliance

- Adria Airways
- Aegean Airlines
- Air Canada
- Air China
- Air New Zealand
- All Nippon
- Asiana Airlines
- Austrian Air Group
- Blue1
- Bmi
- Brussels Airlines
- Continental
- Croatia Airlines
- EgyptAir
- Ethiopian
- LOT Polish
- Lufthansa
- Scandinavian
- Singapore
- South African
- Swiss
- TAM
- TAP Air Portugal
- Thai Airways
- Turkish
- United Airways
- US Airways
- Avianca-TACA (2012)**
- Copa (April 2012)**
- Shenzhen Airlines (end of 2012)**

SkyTeam

- Aeroflot
- Aeromexico
- Air Europa
- Air France/KLM
- Alitalia
- China Airlines
- China Eastern
- China Southern
- CSA Czech Airlines
- Delta
- Kenya Airways
- Korean Air
- Tarom
- Vietnam Airlines
- Aerolineas Argentinas (2012)**
- Garuda Indonesia (2012)**
- Saudi Arabian (2012)**
- Middle East Airlines (2012)**
- Xiamen Airlines (2012)**

oneworld

- Air Berlin (March 2012)
- American Airlines
- British Airways
- Cathay Pacific
- Click Mexicana
- Dragonair
- Finnair
- Iberia
- Japan Airlines
- LAN Airlines
- Malev
- Mexicana
- Qantas
- Royal Jordanian
- S7 Airlines
- Kingfisher Airlines (put on hold)**
- Malaysia Airlines (2012)**

Unaligned News: Air India integration into Star suspended, now eyed by SkyTeam.
 Virgin Atlantic eyes alliance membership



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Star, The Largest Global Alliance, Continues To Expand

- **Nearly 650 million passengers traveled to 1,290 airports in 189 countries on Star Alliance carriers**
 - As of January 1, 2012, nearly \$160 billion in revenues, over 402,000 employees, and a fleet of over 4,300 aircraft
 - However, Star recently lost a member when Spanair collapsed earlier this year
- **Star looks to expand membership**
 - African expansion
 - 16 carriers (including new member Ethiopian Airlines) serving Africa and offering over 750 daily flights to 110 destinations in 48 countries
 - Eyeing Asia
 - Shenzhen Airlines is expected to join by the end of 2012 and will add five new destinations to Star's network in China
 - EVA Airways reportedly in "aggressive talks" to join Star or oneworld
 - Even if EVA joins Star, SkyTeam will remain dominant in China



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SkyTeam, 2nd Largest Alliance, Eyes Expansion In Asia/Latin America

- **487 million passengers traveled to 926 destinations in 173 countries on SkyTeam carriers**
 - Nearly 400,000 employees and over 3,500 aircraft (including those of affiliates)
- **Expanding in Asia and Latin America**
 - Xiamen Airlines will join SkyTeam in 2012, allowing the alliance to continue its dominance in China
 - SkyTeam to focus expansion plans in Brazil and India
 - SkyTeam eyes GOL, the second largest Brazilian carrier behind TAM
 - Losses in India (due to fare wars) make expanding into that market a challenge, but SkyTeam plans to gain Indian members after the market restructures
 - Also eyeing the possibility of Middle Eastern carriers, such as Etihad and Qatar, in for future members
- **Increased cooperation among members has led to antitrust probes**
 - EU opens a new probe into Trans-Atlantic JV for Air France-KLM, Delta, and Alitalia.
 - EU may then turn competition focus to Star agreement



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oneworld is Smallest Alliance – Trying to Catch Up

- **Transports nearly 300 million passengers to over 720 destinations in nearly 150 countries**
 - As of December 2011, over \$90m in total revenues and \$4.6m in net profits
- **oneworld increases market share**
 - Air Berlin to add almost 70 destinations, extending oneworld's global coverage to roughly 840 destinations in 150 countries
- ▶ **Trouble filling “white spots” in India**
 - Kingfisher Airlines' entry into the alliance is put on hold, to give the carrier time to strengthen its financial position
- **Rivals interest in American Airlines could pose problems**
 - Delta and US Airways reportedly eyeing American, now in Chapter 11 Bankruptcy protection
 - 2 years ago, American teamed up with TPG and other oneworld carriers to offer \$1.4b to Japan Airlines – to save it from the brink and ensure it stayed in oneworld
 - Could Iberia and British Airways find themselves in a similar situation to ward off bids for American from rivals?



Alliances- The Concerns

- Anti-competitive effects
 - Reduction of non-stop city pairs thus raising fares
- Concerns that not all “Stakeholders” benefit from Alliances and Joint Ventures
 - “Metal-Neutrality” important not only for anti-competitive concerns but also for acceptance by labor
 - Ensures partners concerns are addressed-- Regulator, Consumer and Labor



Barriers to Sustainability

- Competitive Landscape
 - “Federal Credit Agencies” (e.g. US Ex-Im Bank)
 - Government subsidized airlines
 - Uneven competitive playing field. For example, totally privatized airlines competing with government subsidized airlines (i.e., Gulf carriers and China)
 - Industry Tax Structure
 - Airport and other taxes that are higher than alcohol, tobacco and firearms (so called “sin” taxes)
 - Emission Trading Schemes
 - Market Access



Paths to Sustainability

Build an Environment to Thrive and Compete

- Level Up the Playing Field
 - Establish a Global Standard to Environmental Impact and Emissions Trading
 - System will only work if everyone participates and the system is not overly burdensome
 - Fair and equal access to any “Federal Credit Agency”
- Quit taxing the Air Transport industry like it’s a sin
- Eliminate Fuel Speculation



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Questions

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