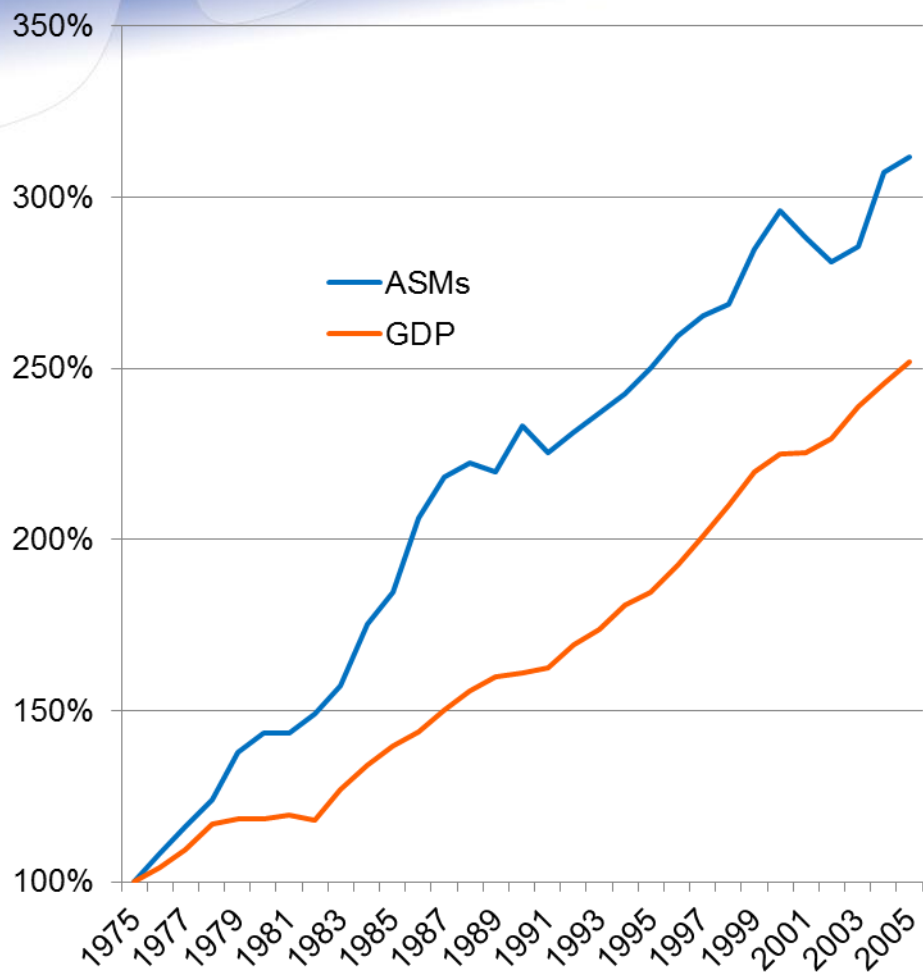


Air Service Review & A Look at the Future



Bruce E. Tarletsky
June 2011

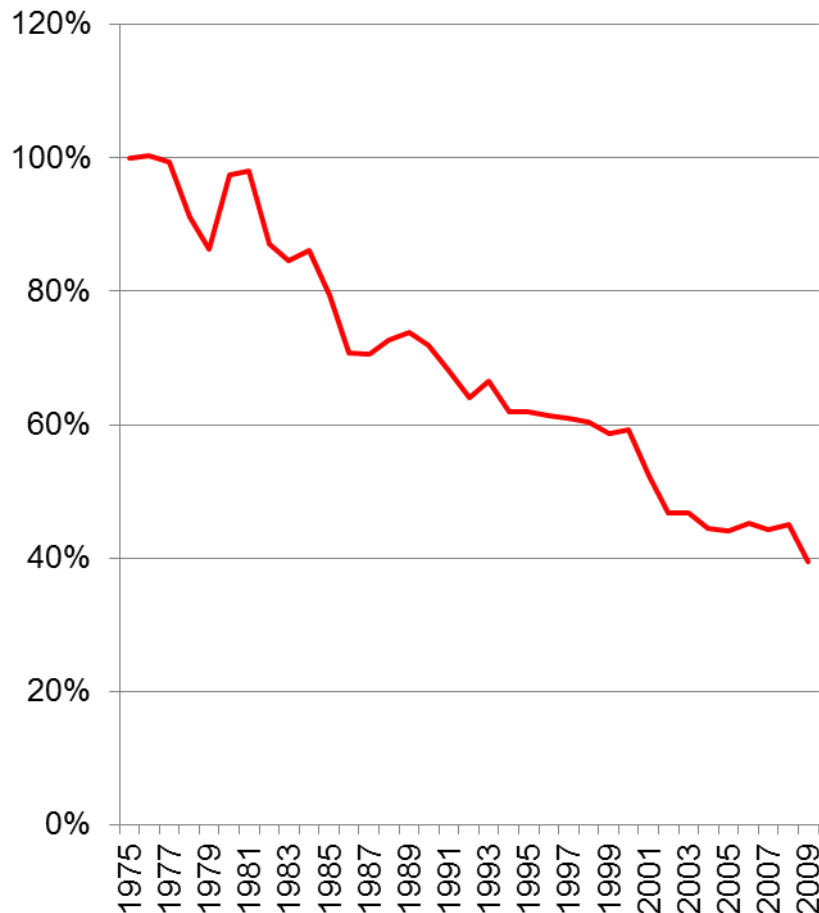
Historically, capacity outstrips demand



- **Available Seat Miles (ASMs) = airline capacity**
- **Real GDP = Economic growth**
- **Since the mid-1970's, airline capacity has far outpaced demand**
 - GDP vs ASMs
 - De-regulation in 1978
- **Also, airline travel as a % of GDP has dropped since 9/11**
 - Historically, about 1%
 - Now ranges between .7%-.8%
 - A 20%+ drop

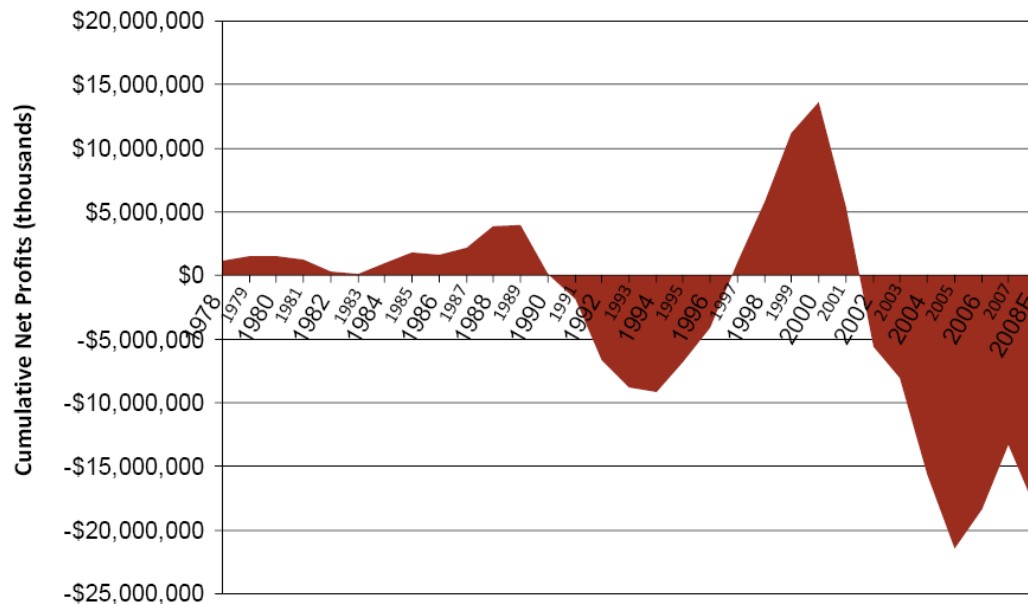
The result: Prices declined sharply

Airline Industry Yield (after inflation)
Indexed to 1975



- **Yield = Revenue per passenger mile**
- **Industry metric for price**
- **Since 1975, industry real yields are down almost 40%**
- **Even in nominal terms, 2009 yield was 11% below 1990 (20 years ago)**
- **What other goods have done (1978):**
 - College Tuition up 9-fold
 - Prescription Drugs up 6-fold
 - New car up 4 ½-fold
 - Movie ticket up 3-fold
 - Gallon of Milk up 2 ½-fold
 - Postage Stamp up 2-fold

Low Prices = Poor financial results



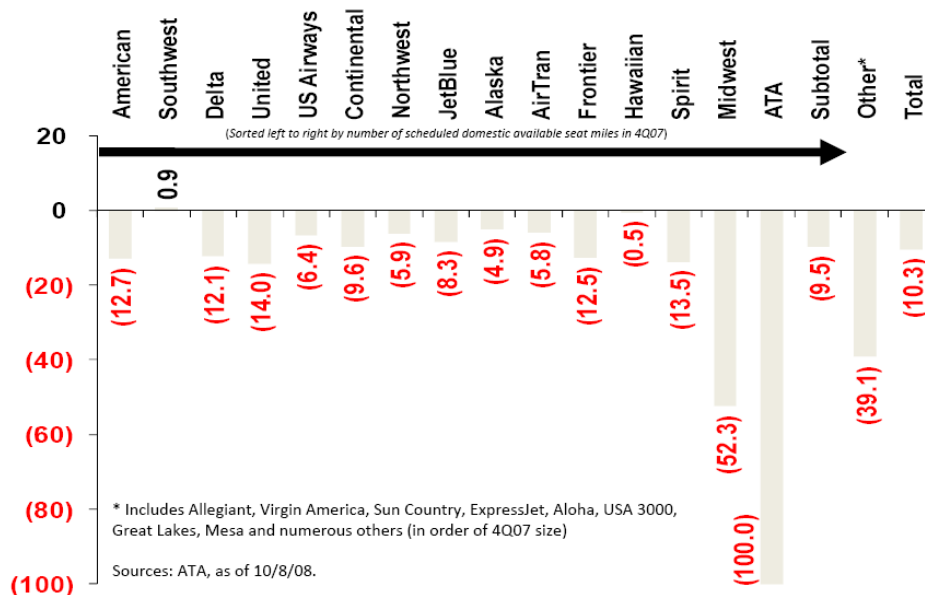
- **From 1978 – 2008, the U.S. airline industry lost money**
 - Cumulatively, about \$20 billion
- **Losses were driven by low yields (prices)**
- **Low prices were due to overcapacity**
- **Even in the best of times, margins were lackluster**
 - Peaking around 5%
 - Compared to many industries where the norm is at least 10%-20%

But, this environment was ok for airports

- **Capacity growth is good for airports**
 - Drives Landing Fees & Rents
- **More airline capacity = more passengers**
 - Great for concessions
 - PFCs
- **Also created an environment where airports wanted more capacity**
 - New/added terminal space, runway additions, etc.
 - Financing was generally available, as was cheap money
 - Same reasons aircraft were readily available, which drove much of capacity increase

But, then high fuel prices happened (2008)

Domestic Seating Capacity Cuts Span the Industry
% Change in Scheduled Domestic Available Seat Miles: 4Q08 vs. 4Q07



- Price of fuel peaked at almost \$150/bbl in 2008

- Airlines started pulling back capacity significantly

- About 10% overall
- Even LCC's cut back

- CRJ flying was really reduced

- Aircraft that drove much of growth earlier
- Good aircraft when fuel is cheap
- But not when oil is expensive

Reduced capacity = Big Yield improvement

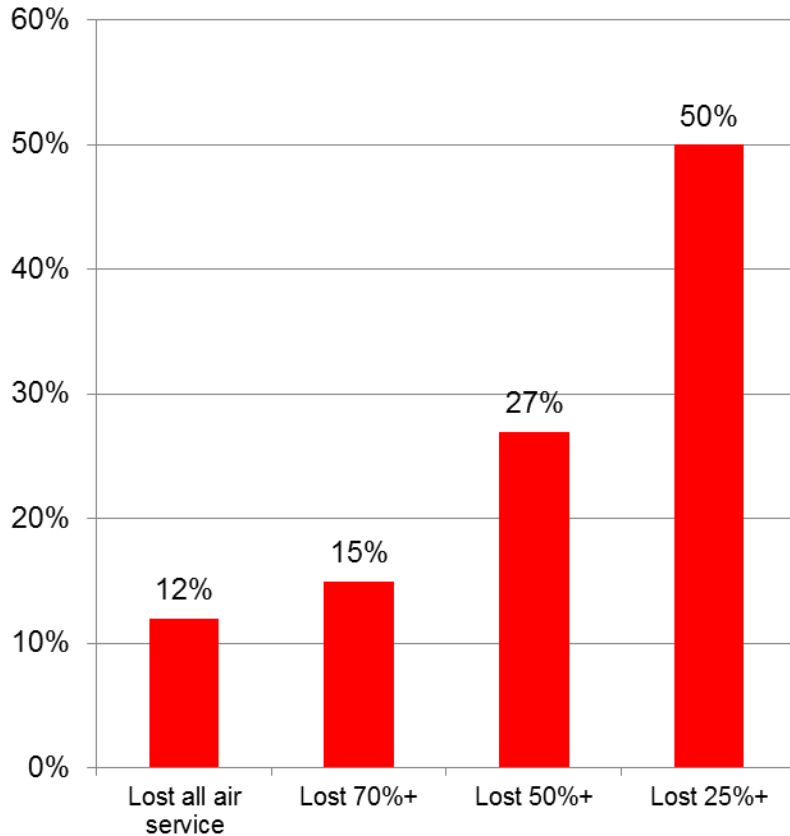
- **Industry yields were up about 15% yr/yr in 2010**
 - A historically economically-reliant industry was able to increase prices significantly in a weak economic period
 - Driven by capacity reductions
- **Airlines took advantage of continued high Load Factors**
 - Again, gave airlines the ability to increase fares
- **This trend has continued into 2011**
 - Numerous fare increases
 - Airline revenue performance has continued to be strong
 - As oil prices increased sharply early in year, airlines have announced fall capacity cutbacks; the result should be continued fare/yield increases

This environment is tough for airports...

- **Stronger yields & subsequently revenue for airlines didn't translate to improving airport economics**
 - Traffic was only up 1.3% in 2010
 - Capacity is still below CY 2000 levels
- **Much of added airport capacity sitting idle**
- **Even tougher for relatively smaller airports**
 - Particularly those reliant on smaller aircraft
 - CRJs in particular

Slowing growth has hit smaller markets hardest

**% of U.S. Cities
By Seat % Loss**

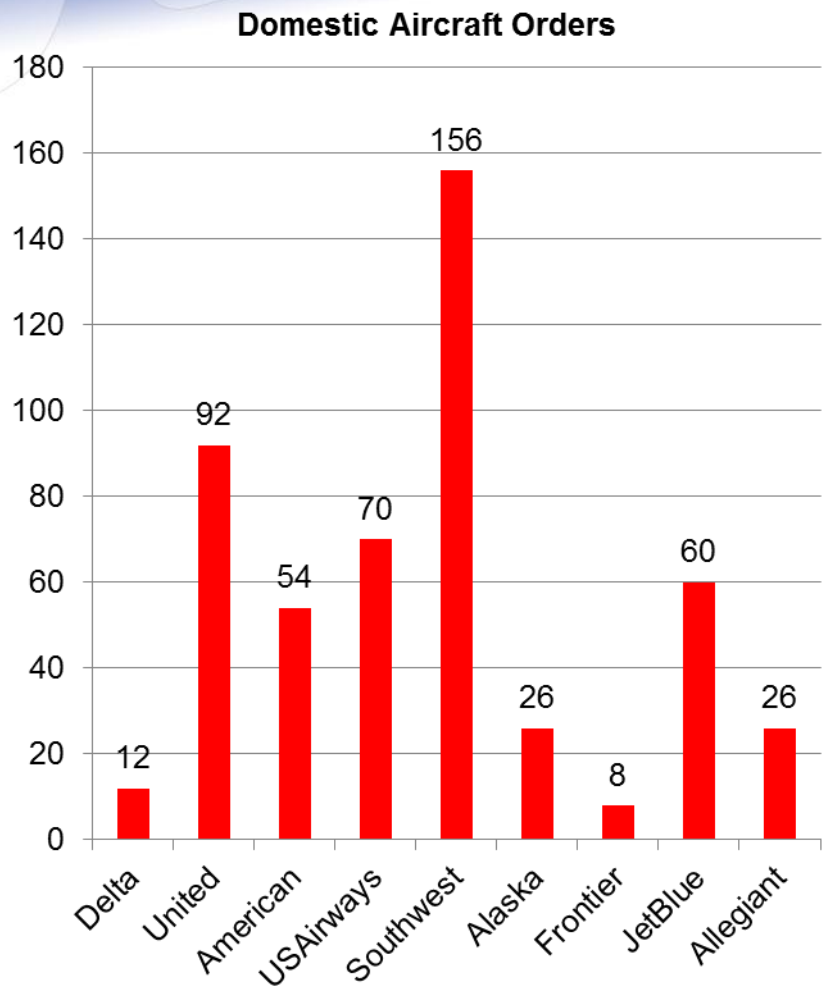


- **Most markets across U.S. have seen capacity reductions**
- **But smaller, typically shorter-haul markets have been hit the hardest**
 - 12% of U.S. airport lost all air service last decade
 - 50% of U.S. airports lost at least 50% of their seat capacity
- **Smaller markets that typically relied heavily on smaller aircraft**
 - Turboprops
 - CRJ or ERJ
- **Chart: Seat loss since CY 2000**

These recent trends are likely to continue

- **The airline industry is now a relatively mature industry**
 - Air travel demand as a % of economy has shrunk 20%+ since 9/11
- **Moderate economic growth is expected over the next few years**
- **Changing demographics**
- **Airline industry management is much more profit-oriented**
 - Better management systems = better decisions
 - More experienced in a de-regulated environment
 - They've learned from mistakes

Fleet plans speak to future growth



- **Few new aircraft = little growth**

- Aircraft orders, for most carriers, make up a very small % of current fleets
- Additionally, many of these aircraft will be replacement aircraft
- Utilization gains mostly done

- **Also, some fleet types are being reduced**

- Delta: 25% reduction in CRJs, elimination of SF3's
- Others expected to reduce CRJ flying

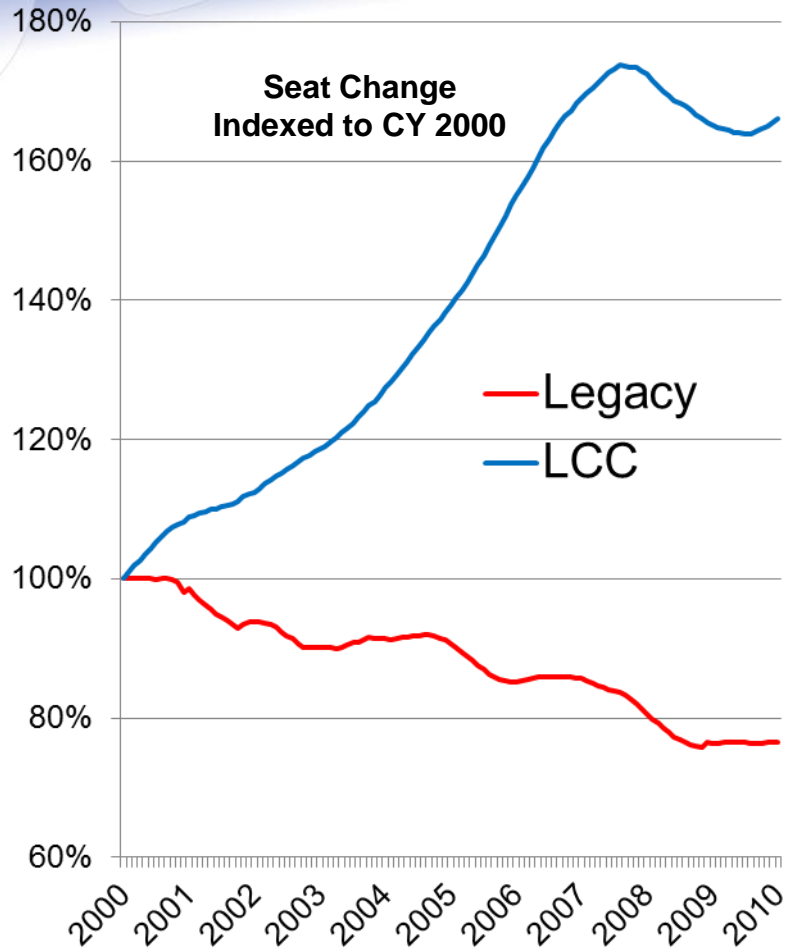
- **Delta & United are rumored to be looking at larger orders**

- Expected to mostly replace current, older fleets
- Example: Delta's DC9's are going to be retired

- **Lone bright spot: LCCs**

- Southwest/AirTran (737-700/800's)
- JetBlue (E190's)
- Allegiant (represents 50% growth in fleet)

Relative high LCC growth continues a trend



- **Legacy airlines: United, Delta, American, etc.**
- **LCC: Low Cost Carriers such as Allegiant, Southwest \ AirTran, etc.**
- **Fleet orders reflect recent trend**
 - Legacy airlines have been shrinking for 10 years
 - LCCs have, for most part, been growing sharply
- **LCCs have grown their share of industry from 15% to 28% since 2000**

Why is this important?

- **Airport Costs**

- Legacy airlines: Not a major factor in air service decisions
- LCCs: Can be a major factor

- **Function of airline cost structures/size of operations**

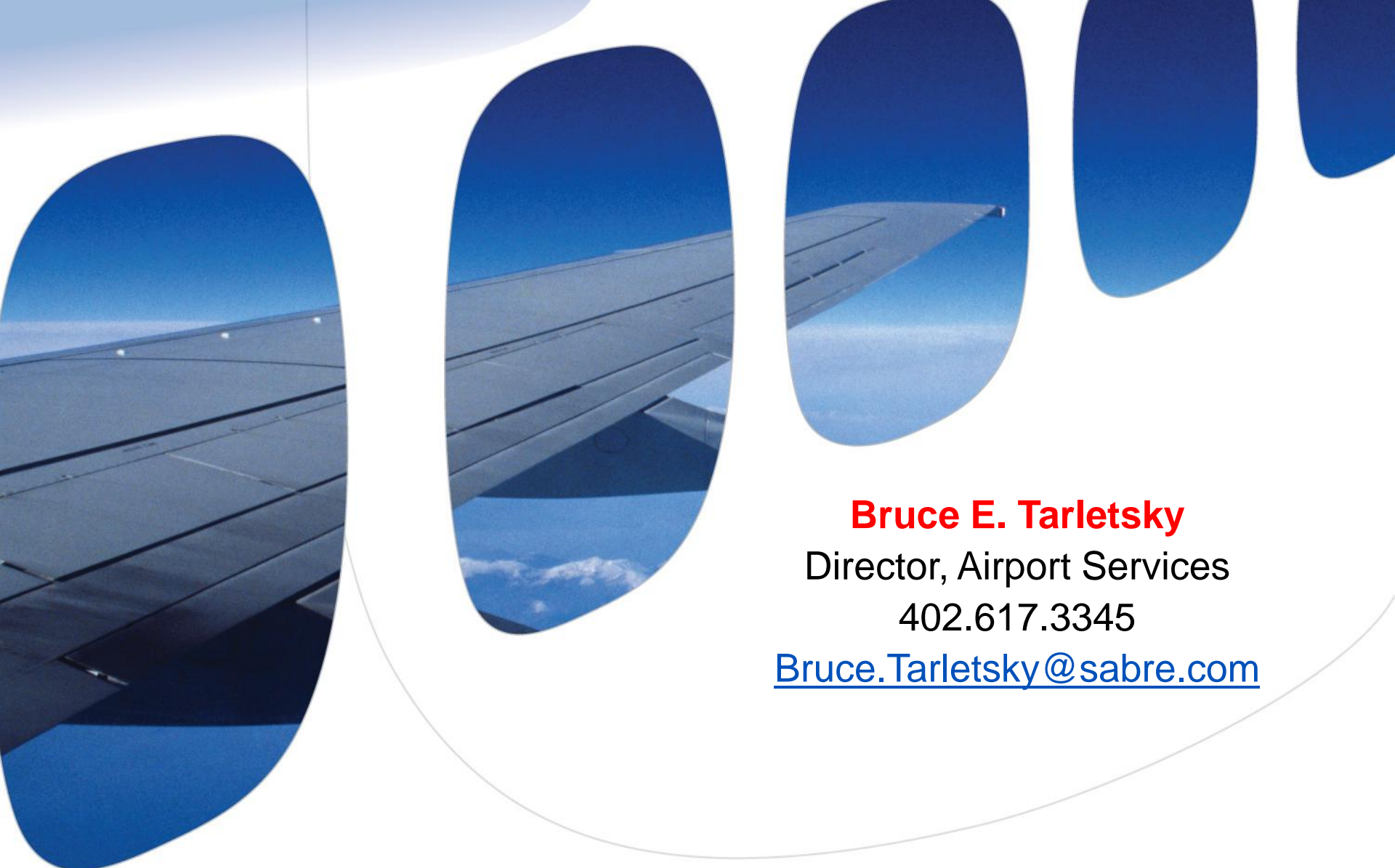
- Legacy airlines: Airport costs average 7% of total
- LCCs: Can easily average 15%-20%
 - Recent example: CPE of \$13 versus average fare of \$85

- **Airports should structure costs to favor LCCs**

- LCCs: Where growth has been and they make decisions based upon airport costs (Legacy airlines don't)
- Need to lower CPE as much as possible
 - Structuring of agreements
 - Generation of non-aviation revenue

Closing Comments

- **U.S. airline industry: Historical results**
 - Overcapacity = Unprofitable pricing
 - But, good environment for airports
- **Major changes since 2008**
 - Capacity reductions
 - Significant improvement in yields & profitability, despite economy
 - Not good for airports
- **Going forward, flat capacity growth & higher fares will be the norm**
- **The one growth segment will continue to be LCCs**
 - Structure costs/agreements to favor LCCs
 - Generation of non-aviation revenue will be more important than ever



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