

Airline Alliances, Joint Ventures and M&A Activity

Impacts of Growing Globalization in the Airline Sector

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Agenda

- AirTrav Inc.
- Genesis of alliances
- Joint ventures
- Recent M&A and forecast
- Corporate T&E implications
- Questions

- **AirTrav Inc.**
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AirTrav Inc.

- Airline/travel consultancy founded in 2001
- Headquartered in Toronto, Canada
- Associates and partners worldwide
- Consulting and research divisions
- 5 verticals including aviation and travel mgt

AirTrav Inc.

- **Travel management support:**
 - Airline and non-air supplier strategy/negotiations
 - GDS negotiations and RFP development
 - Travel technology evaluations, vendor qualification
 - Online distribution strategies

AirTrav Inc.

- We are one of North America's more sought after airline/travel sector authorities, with quotes in:
 - *Television*: BNN, CBC, CTV, Global
 - *Newswire*: Associated Press, Canadian Press, Reuters
 - *Online media*: CNBC, CNN Money, OpenJaw, TakeOffeh
 - *Radio*: CBC, Corus Radio network, Rogers Communications
 - *Print*: Canadian Business, Globe and Mail, Financial and National Post, Le Devoir, Maclean's, Montreal Gazette, Dallas Morning News, Toronto Star, Travel Press, USA Today

- AirTrav Inc.
- **Genesis of alliances**
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Genesis of Alliances

- **Interline ticketing the forerunner to alliances**
 - Origin goes back decades
 - Voluntary commercial agreements between individual airlines to handle passengers and cargo traveling on itineraries that require multiple airlines
 - Enables:
 - Joint fares, ticket endorsement/acceptance, bag transfers

Genesis of Alliances

- **... / Interline ticketing**
 - Airlines maintain their own identity
 - Some airlines do not have interlining agreements with other airlines or no airlines at all
 - Requires multiple tickets

Genesis of Alliances

- **... / Interline ticketing**
 - Interline agreements are usually specific to a reservation or Global Distribution System
 - Most online travel agencies only display itineraries that can be ticketed on their booking system(s)

Genesis of Alliances

- **... / Interline ticketing**
 - Mandated end to the use of paper tickets through IATA clearing houses by June 2008
 - Massive effort to go 100% e-ticketing successful
 - Interline e-ticketing agreements now prevail

Genesis of Alliances

- **... / Interline ticketing**
 - An airline's internal reservation system must be interline e-ticket capable, affecting:
 - Smaller/developing/new airlines, or
 - Many LCC's (i.e., Southwest)
 - WestJet now capable with deployment of new CRS
 - SabreSonic® Customer Sales & Service Solution (CSS)
 - Merchandising, multiple fares and interlining functionality

Genesis of Alliances

- **... / Interline ticketing**
 - The plating carrier collects the entire fare from the customer and is responsible for distributing the proceeds to other carriers in that itinerary
 - A plating carrier therefore gets a cash flow benefit
 - Non-plating carriers avoid paying the credit card fees and in many cases commissions where applicable
 - Predominant use of the IATA Clearing House for intra-airline settlement

Genesis of Alliances

- **... / Interline ticketing**
 - Limitations
 - No reciprocal FFP and lounge rights
 - Airlines will usually not hold flights for delayed connection passengers
 - Where only interline services are available, traffic development inferior to codesharing cooperation

Genesis of Alliances

- **Codesharing agreements**
 - Natural progression of interline cooperation
 - The term "code share" was first coined in 1989 by Qantas Airways and American Airlines
 - The term "code" refers to the identifier used in flight schedule, generally the 2-character IATA airline designator code and flight number

Genesis of Alliances

- **... / Codesharing agreements**
 - Multiple airlines sell space on the same flights
 - A seat can be purchased on one airline as if actually operated by a cooperating airline under a different flight number or code
 - Can have multiple codeshare partners on one flight
 - Codeshare partners often operate routes jointly
 - Example AC and UA on Montreal-YUL ↔ Chicago-ORD

Genesis of Alliances

- **... / Codesharing agreements**

- Allows greater access to cities than through one airline's own operated network
 - Extended reach with reduced cost and risk
- Gives passengers a larger network, access to more flights and enhanced FFP benefits
- Makes connections simpler by allowing single bookings across multiple flights

Genesis of Alliances

- **... / Codesharing agreements**
 - The airline that actually operates the flight (the one providing the plane, the crew and the ground handling services) is called the *operating carrier*
 - The company or companies that sell tickets for that flight but do not actually operate it are called *marketing carriers* or *validating carriers*

Genesis of Alliances

- **... / Codesharing agreements**
 - Example of Toronto-YYZ to London, UK-LHR
 - Operating carrier/flight number AC 0848
 - Marketing carriers/flight numbers LH 6757 / SQ 1027
 - Some national jurisdictions placed requirements on codesharing alliances to facilitate interline agreements with new entrant carriers

Genesis of Alliances

- **Global alliances**
 - World now dominated by the 3 global alliances
 - oneworld®
 - SkyTeam
 - Star Alliance network
 - Most major carriers a member in one, though some notable hold-outs remain
 - Transport over 60% of global commercial pax

Genesis of Alliances

- **... / Global alliances**

- **oneworld[®]**

- Founded in 1999 by AA/BA/CP/CX/QF
 - Third largest global alliance
 - Expansion has brought in AY/JL/LA/MA/RJ
 - Confirmed/likely/possible future members include:
 - S7 Airlines and Kingfisher Airlines
 - Gol (Brazil) and Grand Air China (previously Hainan Airlines)

Genesis of Alliances

- **... / Global alliances**

- **SkyTeam**

- Founded in 2000 by AF/AM/DL/KE
 - Second largest global alliance
 - Expansion has brought in AZ/CZ/KL/NW (now DL)/OK/SU
 - CO left for Star Alliance in 2009
 - Associate members are Air Europa and Kenya Airways
 - Confirmed/likely/possible future members include:
 - China Eastern, Vietnam Airlines, Tarom
 - Air Algérie, Air Tahiti Nui, Avianca, China Airlines, Garuda, Malaysia and Virgin Blue

Genesis of Alliances

- **... / Global alliances**

- **Star Alliance network**

- Founded in 1997 by AC/LH/SK/TG/UA
 - First and largest global alliance
 - Expansion has brought in:
BD/CA/CO/FM/JK/LO/LX/MS/NH/NZ/OS/OZ/SQ/TK/TP/SA/SN/US
 - Adria, Croatia and Blue 1 in regional network
 - Confirmed/likely/possible future members include:
 - Air India, Aegean/Olympic, TAM (Brazil)
 - Avianca, TACA, Copa Airlines, Air Malta, Ethiopian, Jet Airways, JetBlue, Luxair, Qatar Airways, Transaero and Virgin Atlantic

Genesis of Alliances

- **... / Global alliances**
 - Alliances have extensive codesharing and networked frequent flyer programs
 - With the development of alliances and their codesharing relationships, the traditional interline system is gradually losing its original importance
 - Relatively simple global alliances, as launched in the late 1990's, are giving way to broader JV's

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Joint Ventures

- Also referred to as *“strategic alliances”*
- More advanced form of alliance cooperation
- Higher level of commitment and coordination
- More benefits for members vs. simple alliances

Joint Ventures

- Most notable for attempts to gain **antitrust (“ATI”) immunity** for various joint activities
 - The U.S. grants ATI
 - Is like a shield
 - The immunised airline can raise it as an absolute defence against a third party's anti-trust lawsuit
 - Must pass D.O.T. and D.O.J. review
 - The European Commission does not grant ATI
 - Can bestow approval, but with conditions & threat of fines

Joint Ventures

- **Joint (or “strategic”) ventures can include:**
 - Coordination of pricing, capacity and schedules
 - Joint venture flights
 - Cross-partner equity involvement
 - Co-mingled assets including airport facilities
 - Including shared check-in resources

Joint Ventures

- **Joint (or “strategic”) ventures can include:**
 - Joint advertising and promotion
 - Joint procurement of fuel or other supplies
 - Alliance agreements for:
 - Corporate Travel Management Companies (TMC’s)
 - Direct corporate agreements

Joint Ventures

- **Joint (or “strategic”) ventures can include:**
 - Cooperation on inventory mgt and maintenance
 - Development of I.T. systems around...
 - Operations planning
 - Fuel efficiency
 - Pricing
 - Yield management

Joint Ventures

- **Anti-trust immunity examples:**
 - **Oneworld, as represented by AA/AY/BA/IB/RJ:**
 - Has to catch up to more integrated SkyTeam and Star
 - Proposed deeper ties include revenue sharing
 - Granted tentative approval in Feb-10 by the U.S. DOT
 - Competition issues still to be resolved with the European Commission
 - U.S. DOJ sought “slot carve-outs”
 - DOJ said ATI would limit competition and cause a monopoly
 - AA/BA/IB offered up slots at LHR/MAD/JFK/MIA earlier this year
 - AA/BA had pursued ATI for over a decade
 - Virgin Atlantic remains staunchly opposed
 - Future may include an attempt to include JL for Pacific

Joint Ventures

- **... / Anti-trust immunity examples:**
 - **SkyTeam's Atlantic Pact with AF-KL/AZ/DL/OK**
 - Approved by the U.S. DOT with no DOJ objections
 - First to achieve US ATI approval in 2002
 - KLM added in 2008
 - Elements of the Atlantic pact awaiting EC approval
 - DL-KE enjoy ATI across the Pacific

Joint Ventures

- **... / Anti-trust immunity examples:**
 - **Star Alliance**
 - Prior to the new “Atlantic Plus Plus”, AC, LH and UA enjoyed ATI
 - Enabled them to pool revenues and collectively agree on tariffs
 - Entitled the A+ agreement

Joint Ventures

- **... / Anti-trust immunity examples:**
 - **Star Alliance *Atlantic ++***
 - AC/LH/UA along with CO (moot with new merger)
 - Coordination of operations
 - Act as a single carrier for international air services, capacity sharing, sales and marketing and revenue
 - Approved by the U.S. DOT with no DOJ objections
 - E.C. probing existing and planned cooperation
 - Star now trying to bring in NH to bridge the Pacific gap with Atlantic ++

Joint Ventures

- ARTA, ASTA and ISTA have asked that dealings with independent travel distributors be excluded from any oneworld ATI
 - The U.S. DOJ dismissed most of these concerns in Star Alliance ATI proceedings in 2008-09

Joint Ventures

- The E.C. continues to investigate possible anticompetitive practices at all three alliances
 - Oct-2009 sent AA/BA/IB a "statement of objections," saying proposed cooperative agreements "may be in breach of European rules on restrictive business practices."

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Recent M&A

- **Merger & Acquisition activity**
 - **Progressive acquisition activity by Lufthansa**
 - LX/OS/SN
 - Option to convert minority BD stake to majority
 - **Delta Air Lines – Northwest Airlines**
 - Merger completed in 2008 to form largest global airline
 - December 2009 received approval for one O/C
 - Northwest brand has now disappeared

Recent M&A

- **... / Merger & Acquisition activity**
 - **BA and Iberia boards approved merger this April**
 - Expected to close by end of 2010
 - Must receive regulatory approval
 - **Continental Airlines – United Airlines**
 - Announced April of this year
 - Will leapfrog DL to be largest airline in world
 - Combined revenues on paper of USD \$29 billion

Recent M&A

- **... / Merger & Acquisition activity**
 - **AA and US unlikely partners**
 - AA could possible boost west coast by acquiring AS
 - US now a distant fourth in size
 - Other global consolidation likely
 - Further U.S. consolidation possibly at the regional carrier or LCC levels

Recent M&A

- Consolidation in Canada unlikely for now
 - Most recent failure of leisure carrier Skyservice
 - Future possibilities at leisure or Tier 3 levels
- Recently announced IPO by Porter Airlines
- Flying agreement reached between Thomas Cook Canada and Jazz Air
 - Operate 6 x B757 and add \$100 M to Jazz top line

Recent M&A

- The global and U.S. airline sector, have had enormous difficulty dealing with soaring fuel prices and the recent economic recession
- With fuel again rising, consolidation will help fix what is essentially an ailing industry
- Consolidation will not be a fix-all tonic, but it will be a step in the right direction

Recent M&A

- If CAL-DAL is approved by U.S regulatory authorities there may be increased efforts by U.S. airlines to take further costs out of their sales and product distribution channels
 - Offset to rising fuel costs and “pay” for the merger
- Such cost reductions could include:
 - Reduced agency override or loyalty bonuses
 - Some restrictions on eligibility for private fares and corporate discounts

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Corporate T&E Implications

- In support of its ATI application, oneworld has stated there is:
 - No evidence that the proposed alliance would harm consumers on nonstop overlap routes
 - No corporate customer opposed to the application
(based on an AA-Ipsos Mori survey)

Corporate T&E Implications

- **Airline positions:**

- Greater commercial & operational efficiencies
- Significant airline losses of past 10 years
- Allow individual airlines better reach in some markets
- Single point sourcing/contracting: 1-stop solution
- Still sufficient competition in the market
 - Between alliances and independents
- JV-ATI gives customers access to an unrivalled selection of routes networks, flights, fares
 - Jointly drives travel efficiencies and bottom line savings

Corporate T&E Implications

- **Corporate travel positions:**
 - Aggregation of supply hurts competition
 - Less choice
 - Higher prices
 - Less leverage (less ability to “divide and conquer”)
 - Pressure to give undo share to achieve value-add

Corporate T&E Implications

- **What do I say?**
 - Economics 101: Anytime you reduce supply, i.e., through reduced competition, choice and price will suffer
 - Aggregate discounts versus sum of parts may be less
 - Lesser issue in highly competitive markets
 - Bundling more problematic in dominant hubs

Corporate T&E Implications

- **What do I say?**
 - Trend towards JV's and single corporate contracts may be made simpler with fewer carriers due recent mergers
 - 1-stop sourcing and expanded networks good
 - However, leverage where possible multiple JV's and strong independents off each other
 - Approval of all JV's on both sides of Atlantic is key

Other

- **Canada: Air Service Agreements**
 - Canada quite active since announcing *Blue Skies* initiative in 2006
 - Many improved and new bilateral ASA's
 - Formally ratified Canada-E.U. Skies Agreement
 - Continuing saga of Canada-UAE bilateral
 - AC & EK agendas driving unprecedented lobbying efforts
- **Rising fuel costs a threat**

Questions

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