

2008 Aviation Forecast

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Disclaimer

The views and opinions expressed here my personal thoughts and observations and do not necessarily reflect those of Continental Airlines.

The Big Factors – and Unknowns

- **Fuel**
- **Labor**
- **Capacity and Air Traffic Control**
- **“Low Cost” vs. Legacy**
- **Open Skies and International Expansion**
- **“Green” and other taxes**

2008 Aviation Forecast

It's going to be an “interesting” year!

But, First a little History

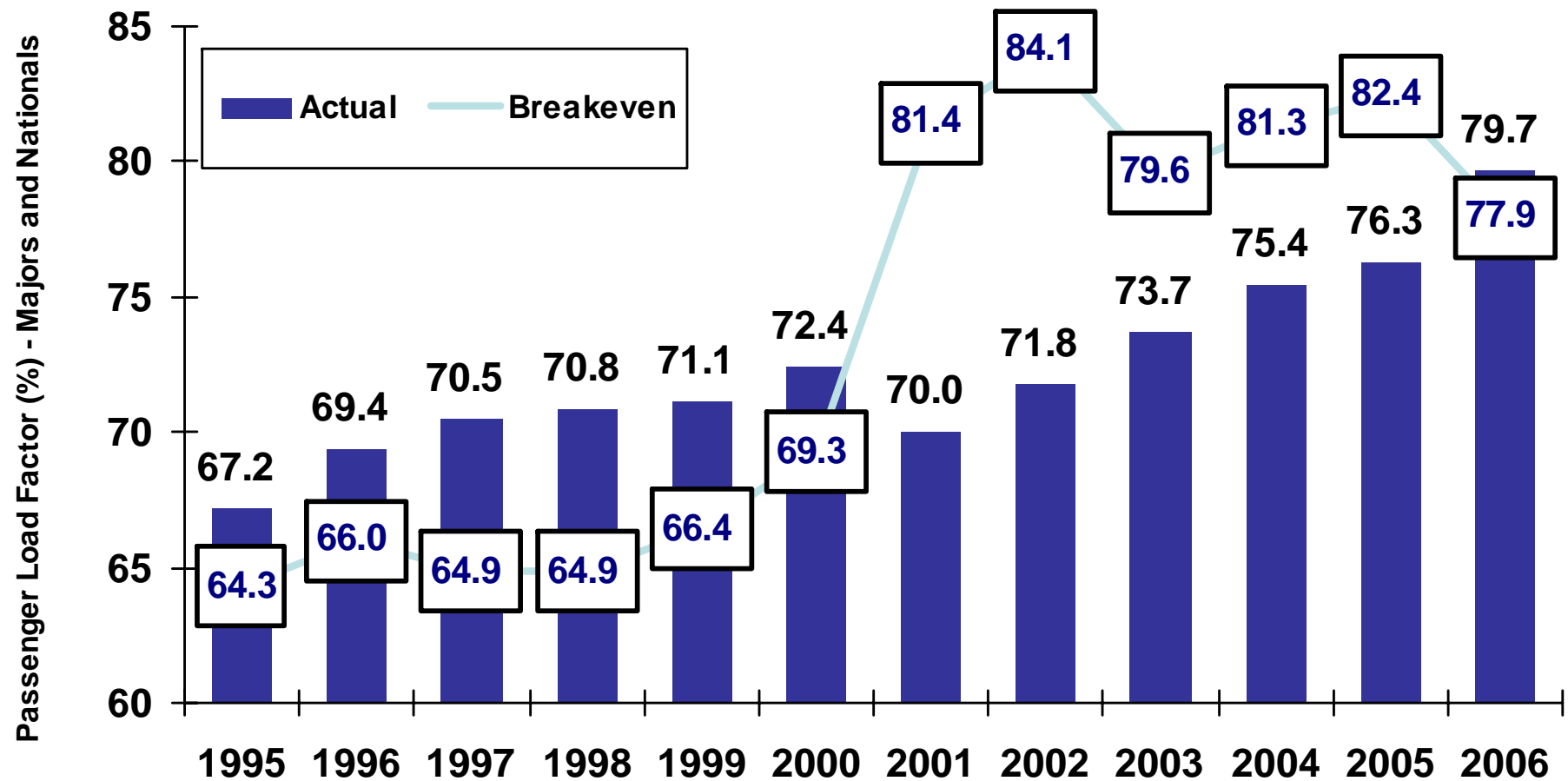
**“If a capitalist had been present at Kitty hawk,
he would have done future investors a big
favor by shooting down Orville’s first flight.”**

Warren Buffett

Changes in Prices/Cost Since 1968

	<u>Aug-68</u>	<u>Jun-07</u>	<u>Multiple Increase</u>
Domestic CPI	104.8	623.6	6.0
Domestic Airline Yields	6 cents	13.3 cents	2.2
Jet Fuel	\$0.13	\$2.08	16.0
Postage Stamps	\$0.06	\$0.42	7.0
Automobiles	\$2,450	\$22,000	9.0
College Education	\$10,400	\$91,000	8.8
Movies	\$1.25	\$8.50	6.8
Bread	\$0.22	\$1.50	6.8
Milk	\$1.21	\$3.50	2.9
Average Home Sale	\$32,000	\$230,000	7.2

“Breakeven” Load Factor a moving target



Industry Quarterly Profit/(Losses)¹ (\$MM)

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
I	\$80	(\$895)	(\$2,116)	(\$1,601)	(\$3,306)	(\$2,021)	(\$673)
II	\$1,934	\$1,692	(\$358)	(\$337)	(\$1,330)	(\$1,308)	(\$392)
III		\$944	(\$480)	(\$1,132)	(\$39)	(\$1,371)	(\$1,985)
IV		(\$79)	(\$1,833)	(\$2,559)	(\$796)	(\$2,074)	(\$3,008)
Year		\$1,662	(\$4,787)	(\$5,629)	(\$5,471)	(\$6,774)	(\$6,058)
Reported		\$751 ¹	(\$5,777) ¹	(\$9,247)	(\$2,566)	(\$11,156)	(\$6,653)

¹ Excludes reorganization charges

First Half, 2007 Industry Results

Major Carriers (\$MM)	2007		2006	
	<u>Adjusted Earnings</u> ¹	<u>Profit Margin</u> ¹	<u>Adjusted Earnings</u> ¹	<u>Profit Margin</u> ¹
NW	\$373	6.2 %	\$50	0.8 %
US Air	\$295	5.0 %	\$320	5.5 %
Southwest	\$228	4.8 %	\$337	7.5 %
Continental	\$261	3.8 %	\$162	2.5 %
American	\$398	3.5 %	\$199	1.8 %
Airtran	\$39	3.5 %	\$23	2.4 %
Delta	\$268	2.9 %	(\$182)	(2.2)%
Alaska	\$31	2.1 %	\$63	3.9 %
United	\$122	1.3 %	(\$187)	(2.0)%
JetBlue	(\$1)		(\$18)	(1.6)%

¹ Adjusted to exclude out of period and non recurring charges and credits

² Excludes reorganization fees

The Big Factors

- **Fuel**
- **Labor**
- **Capacity and Air Traffic Control**
- **“Low Cost” vs. Legacy**
- **Open Skies & International Expansion**
- **“Green” and other taxes**



The REALLY Big One..

FUEL



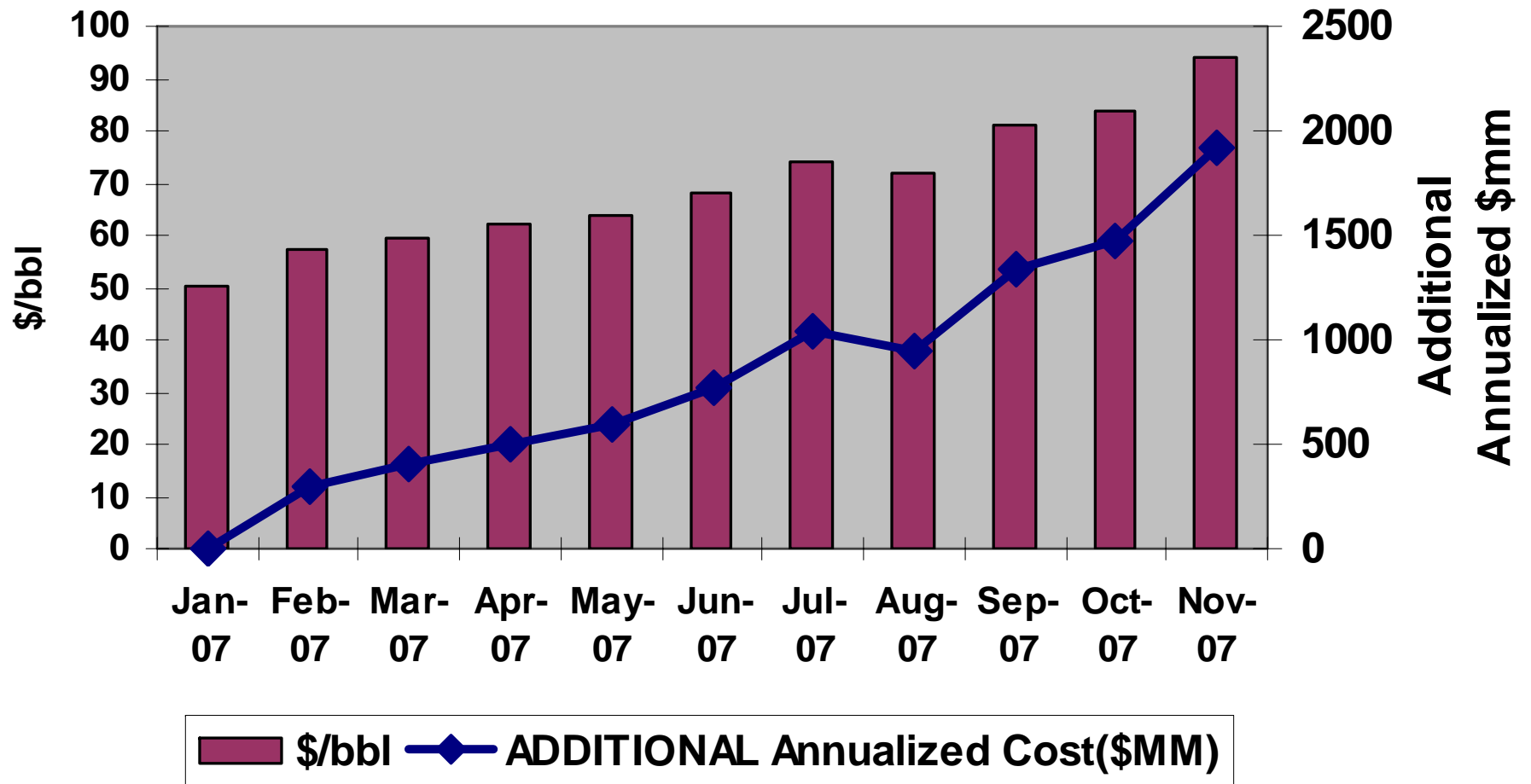
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Oil Prices



Effect of Fuel Increases



You do the Math!

- CO is a \$13 billion company
- At \$93/bbl crude oil, 2008 annualized fuel costs would be \$2 billion over what they were in Jan of 2007.

Efforts to Improve Fuel Efficiency

- Single Engine Taxi
- Winglets
- Reduce onboard weight
- Redistribute belly cargo
- Tanker extra fuel to avoid expensive locations
- Cruise longer at higher altitude
- Employ shorter, steeper approaches
- Use ground power to provide electricity rather than plane's auxiliary power unit (APU)

Change in Historical ratio of Salaries/Fuel

(\$ millions)

	<u>Salaries</u>	<u>Fuel</u>	<u>Salaries/ Fuel</u>	<u>Fuel Price</u>
2007 (6mo)	\$1,809	\$1,736	1.0	\$1.99
2006	\$3,350	\$3,569	0.9	\$2.06
2005	\$3,082	\$2,867	1.1	\$1.78

Note: In 1999 salaries and fuel accounted for 31% and 10%, respectively, of Operating Expenses.

In 2006, salaries dropped to 27% and fuel rose to 28%.

2001	\$3,021	\$1,229	2.5	\$0.82
2000	\$2,875	\$1,393	2.1	\$0.89
1999	\$2,510	\$771	3.3	\$0.47

What can we do?

- The industry has been able to pass on some fuel costs in the form of price increases / fuel surcharges
 - Increases to date have not weakened demand
 - “Low cost” carriers like Southwest have not only gone along with these increases, but have initiated them as well
- How much of business travel is “inelastic”?
- At what point do increased fares dry up demand?
- Hedging?
 - Been to Las Vegas Lately?

Labor



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Second Quarter Labor Costs/ASM

	2007		2002 Year			Five Year % Change
	<u>Amt</u>	<u>Higher / (lower) Than CO</u>	<u>Amt</u>	<u>Higher / (lower) Than CO</u>		
AMR	3.60	0.32	4.97 ¢	1.38 ¢	¢	(28%)
Alaska	3.38	0.12	5.53 ¢	1.94 ¢	¢	(39%)
Delta	3.28	0.02	4.45 ¢	0.86 ¢	¢	(26%)
US Air	3.26	0.00	5.87 ¢	2.28 ¢	¢	(44%)
Continental	3.26	-	3.59 ¢	-	¢	(9%)
Southwest	3.26	0.00	2.80 ¢	(0.79)	¢	16%
United	3.02	(0.24)	4.64 ¢	1.05 ¢	¢	(35%)
Northwest	2.80	(0.46)	4.24 ¢	0.65 ¢	¢	(34%)
America West		(see US Air)	2.35 ¢	(1.24)	¢	NA

High to Low Variance: 0.80 cents

3.52 cents

WHAT HAPPENS WHEN AN AIRLINE MAKES SOME MONEY AND BRAGS ABOUT IT ?!!

(2006)

“U.S. Airways’ second quarter profit is the highest among the major hub and spoke airlines.”

Doug Parker Group – Chairman, Pres, CEO

“U.S. Airways continues to post substantial profits on the backs of the pilots of U.S. Airways and America West, and this will no longer be tolerated.”

*Captain Jack Stephan –
Chairman of the U.S. Airways MEC*

And News story from Last Week

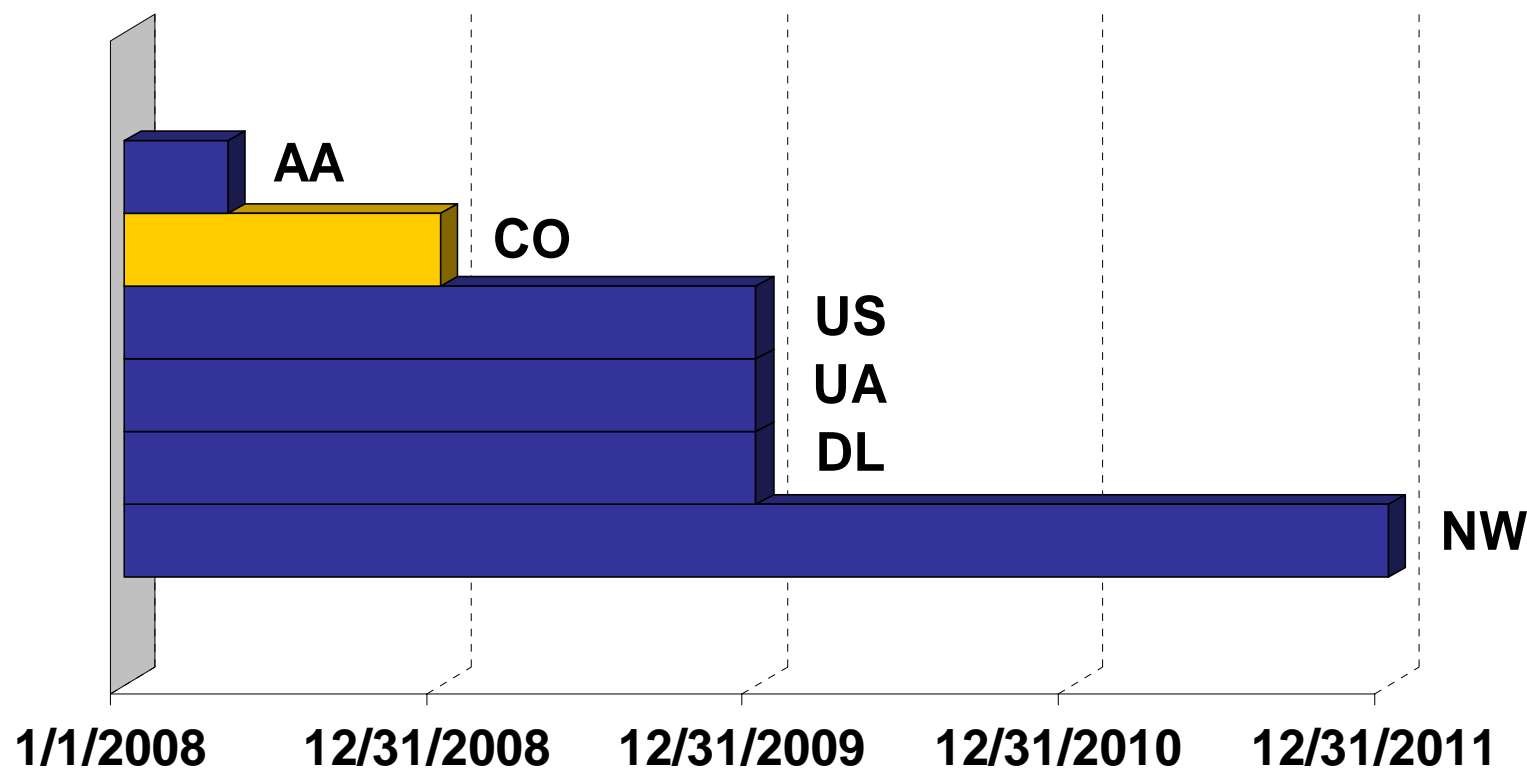
More than a year into contract negotiations, American Airlines Inc. and its pilot union are as far apart on the issues as they've ever been.

The discussions between the Allied Pilots Association and airline have been sporadic, and increasingly bitter, since they began in June 2006.

On Tuesday, the union presented the company a proposal on pay and benefits. It outlined a plan for pay "restoration," which would index pilots' pay to inflation dating back to 1992. The pilots' proposal would raise pay by 2.68 percent compounded each year for each of the past 16 years, or a total of roughly 53 percent.

The Rest aren't far behind

Pilot Contract Amendable Dates



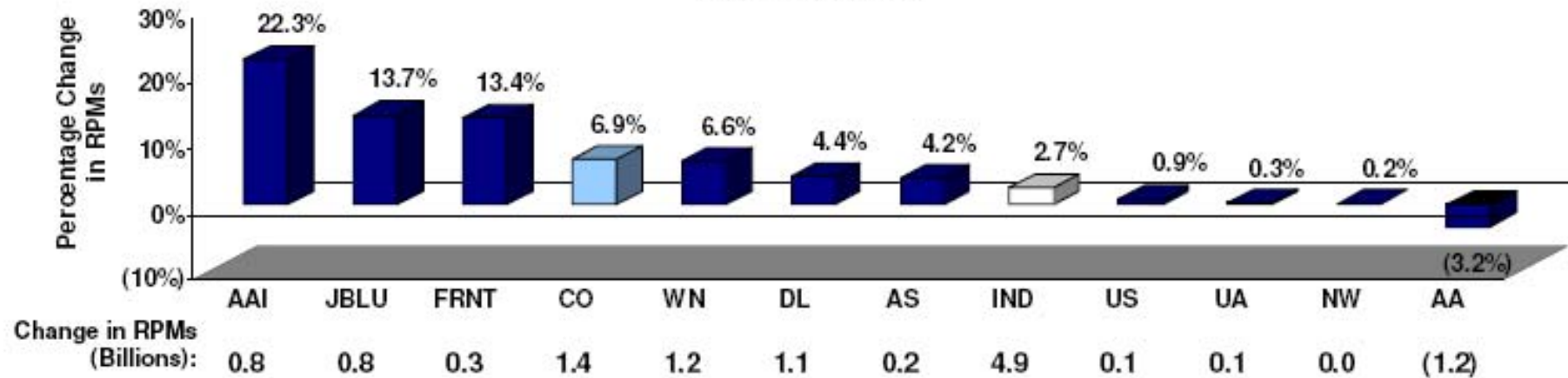
Capacity & Air Traffic Control

Capacity Issues

- NIMBY approach to new runways, flight patterns and airports
- ATC -1960's technology
 - Funding sources and methodology
 - Commercial vs. General aviation
- NY / NJ airspace redesign
 - Current design implemented in the '60s
- Growth of LCCs and International Expansion
- GPS Usage?

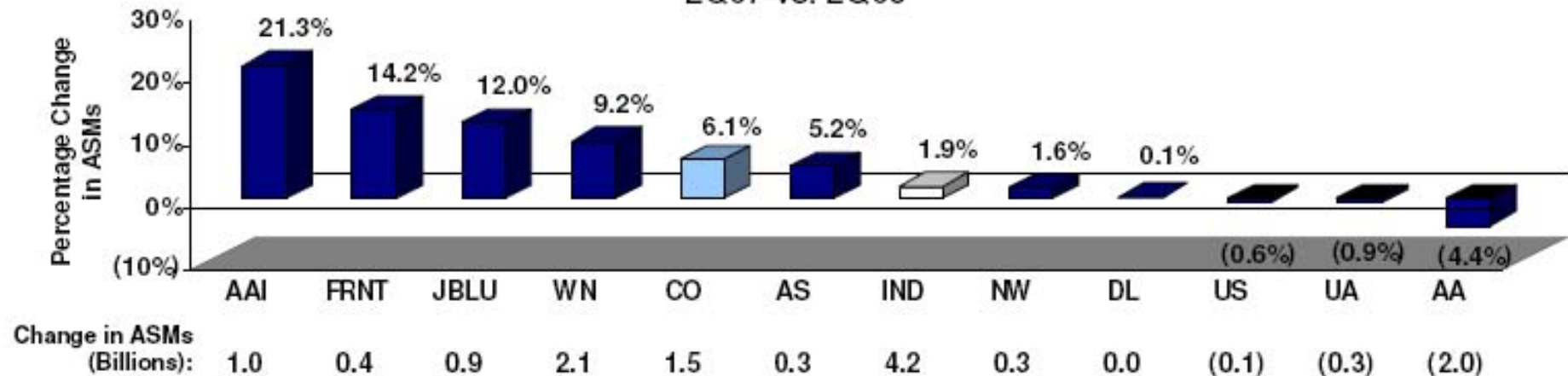
TRAFFIC: REVENUE PASSENGER MILES

2Q07 vs. 2Q06



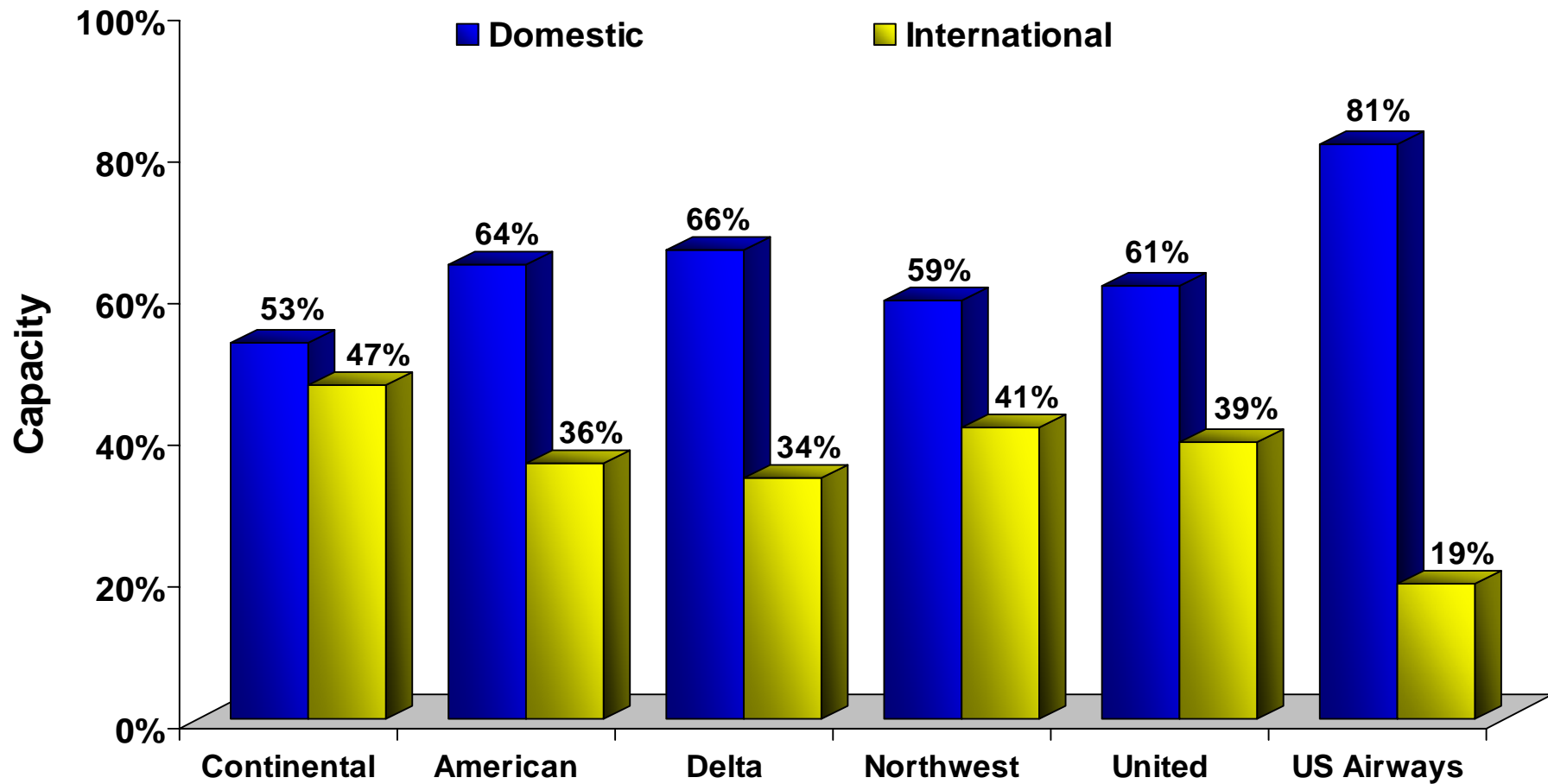
CAPACITY: AVAILABLE SEAT MILES

2Q07 vs. 2Q06



The industry average change for the Top 8 carriers in 2Q07 is 1.8% for RPMs and 0.9% for ASMs

Legacy Carriers will grow Internationally



Source: 2006 company traffic reports (mainline)

And the “LCCs” will as well

- Already growth in the Caribbean
- Jet Blue to Canada?
- Spirit to BOG?
- Southwest to Mexico?
- Single class Business flights will continue to expand across the Atlantic

Then there's NY

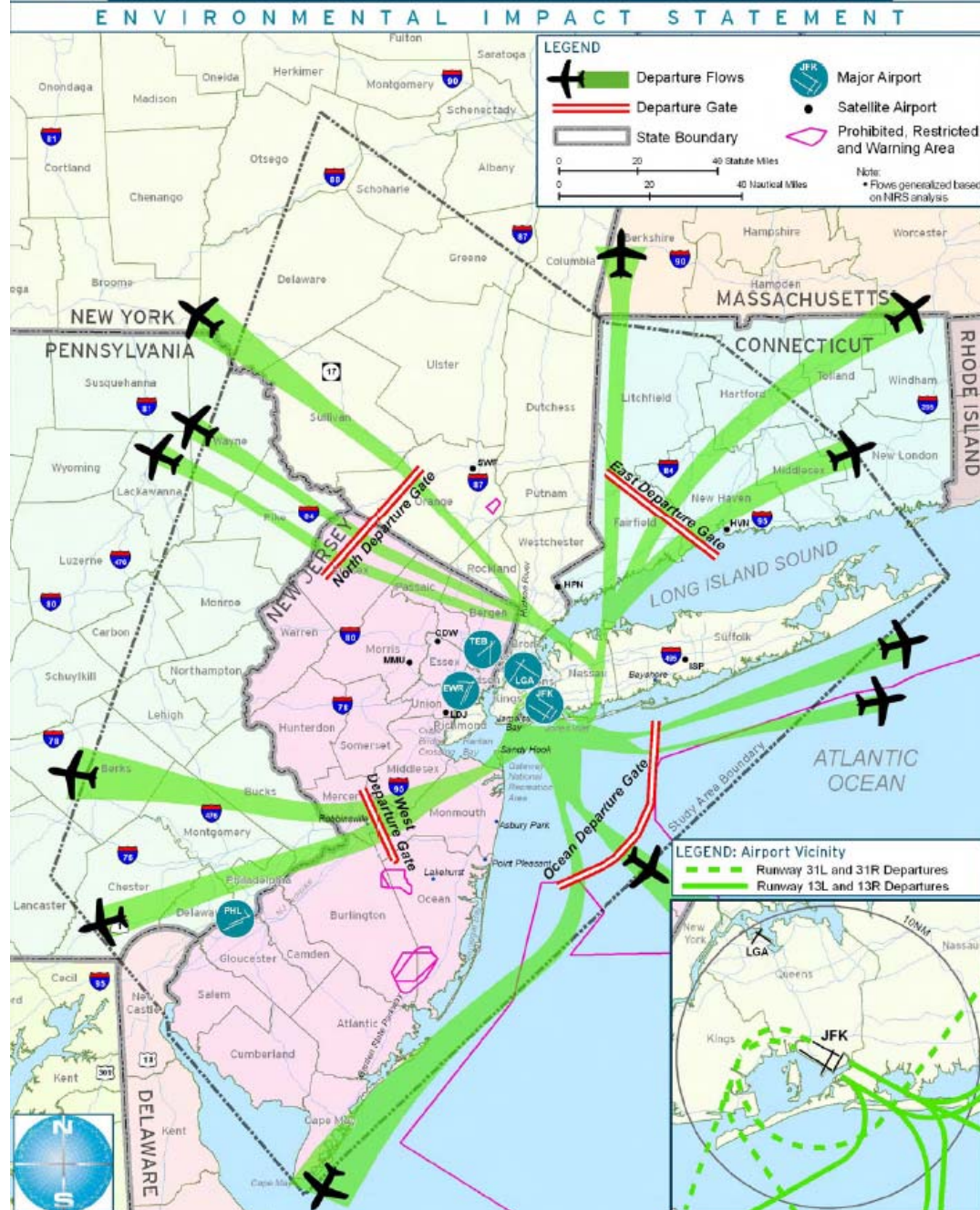
And that means JFK, LGA, EWR, PHL and Teterboro

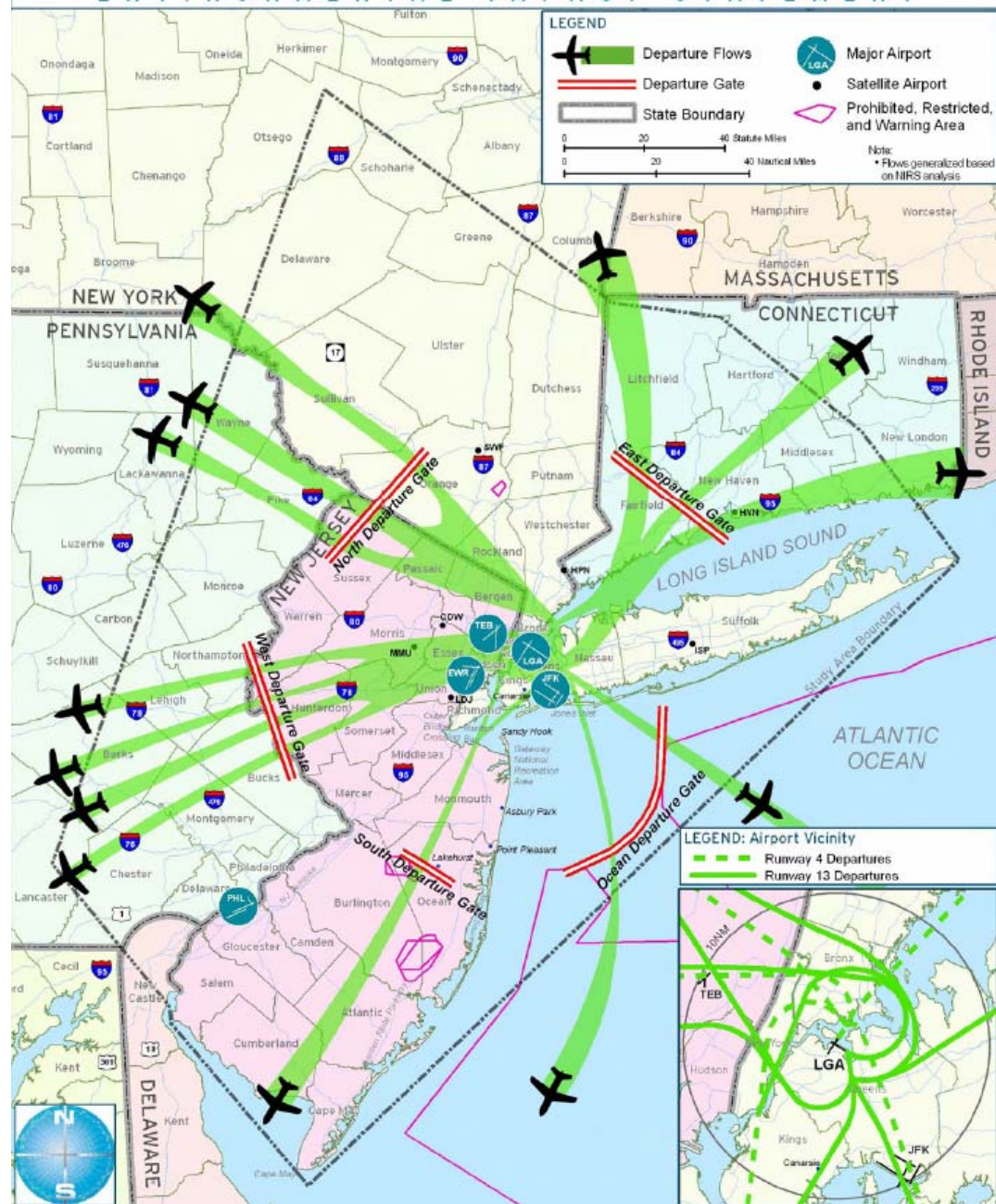
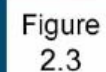
- What are the effects of capacity constraints at JFK?
 - Does that limit the growth of JBlue and DL?
 - What about Open Skies?
- Is Congestion Pricing the answer?
- Do you shove all that traffic to EWR?...
And really screw things up?



Future No Action Airspace Alternative JFK Major Departure Flows

Figure
2.1



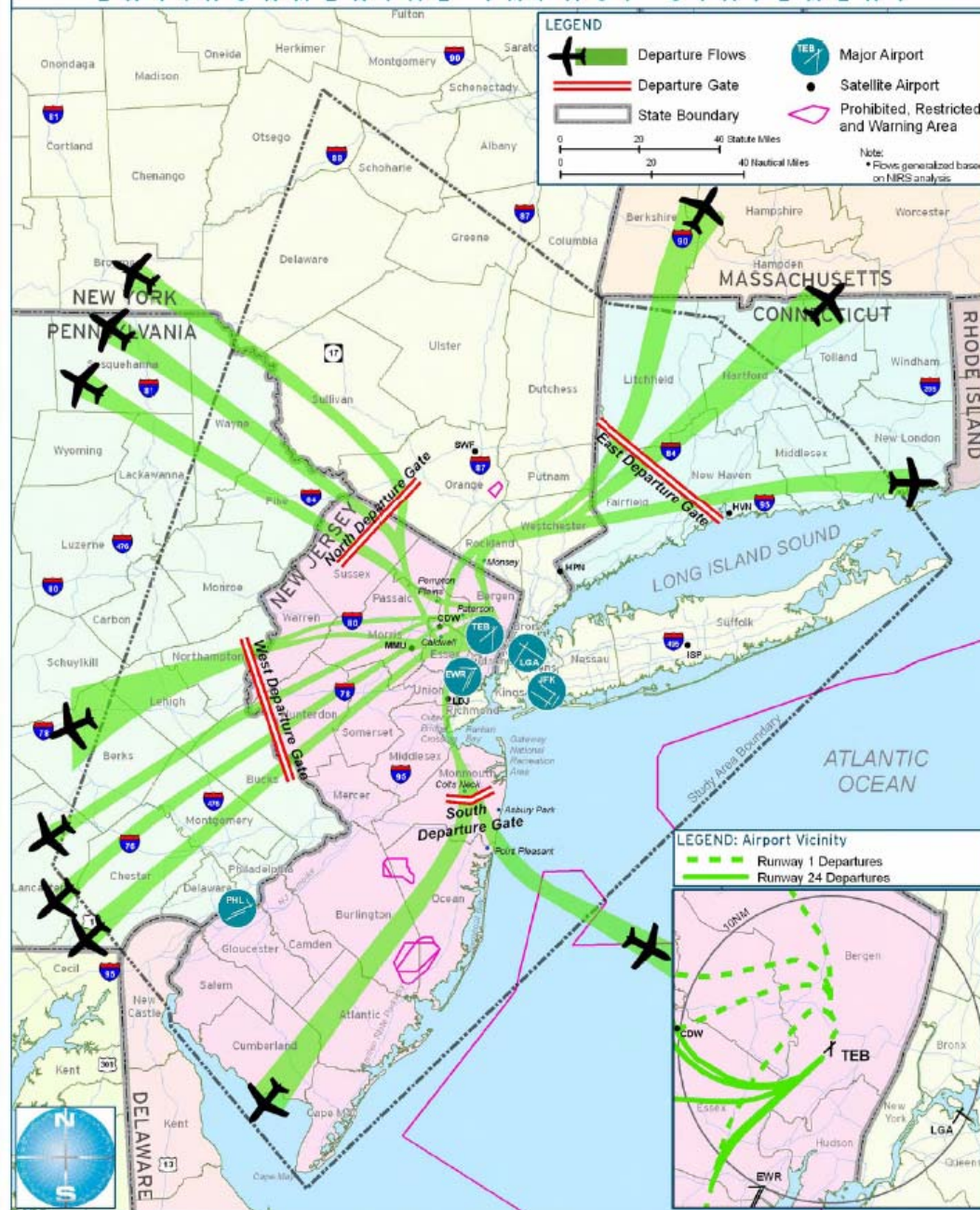




Future No Action Airspace Alternative TEB Major Departure Flows

Figure
2.7

ENVIRONMENTAL IMPACT STATEMENT



JFK, LGA & EWR flow over TEB





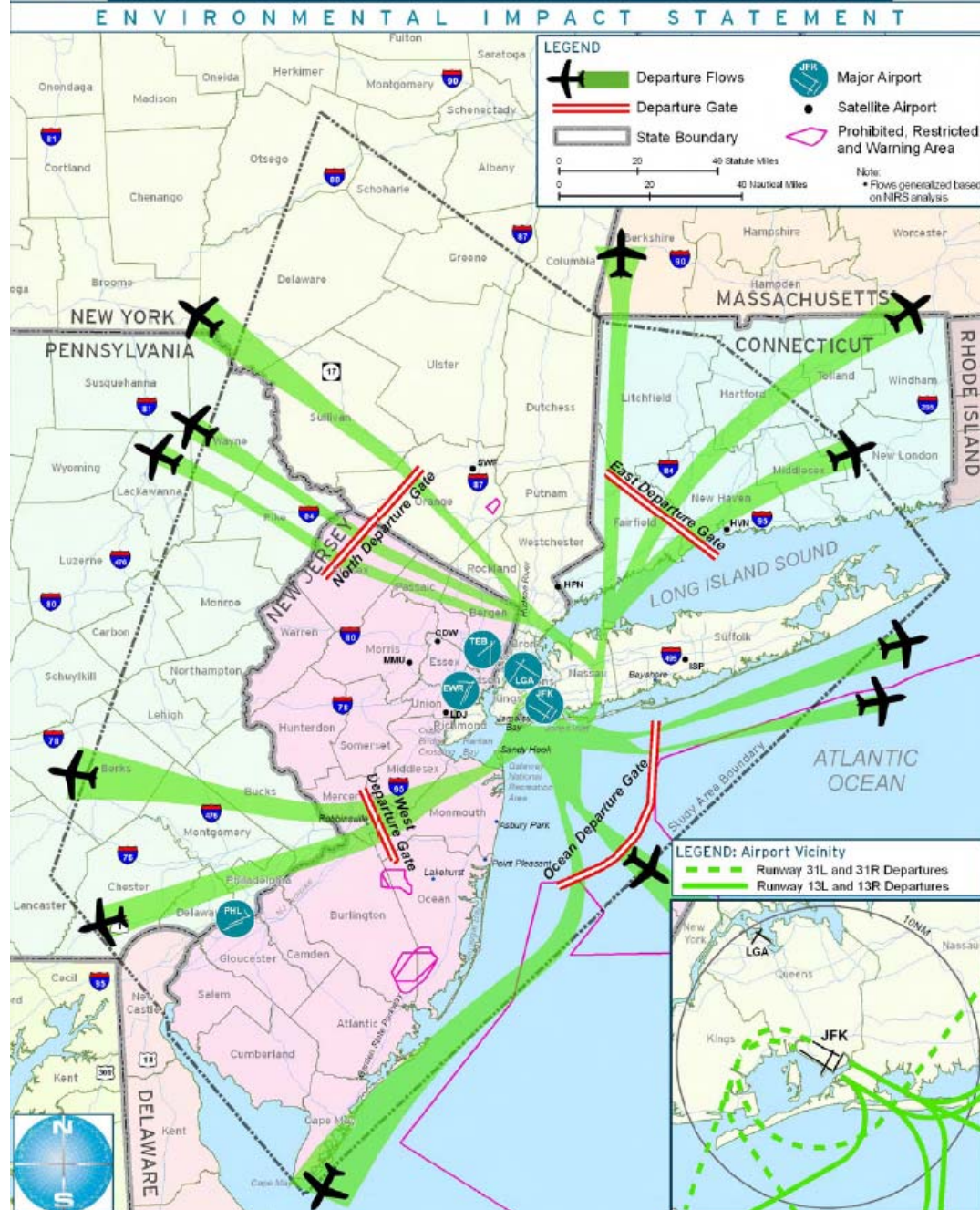
Figure 2.24





Future No Action Airspace Alternative JFK Major Departure Flows

Figure
2.1





Integrated Airspace Alternative Variation with ICC EWR Major Departure Flows

Figure
2.28

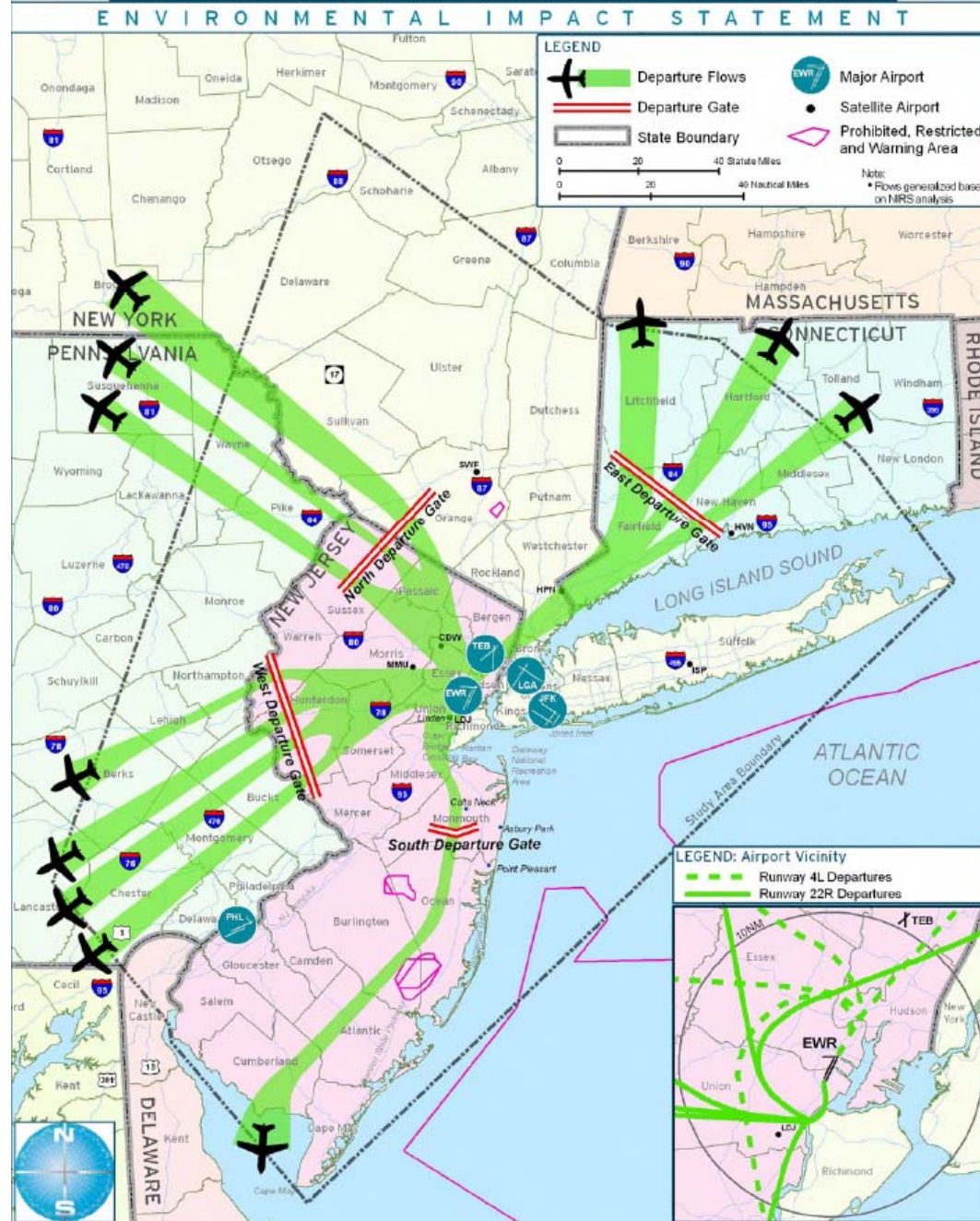
ENVIRONMENTAL IMPACT STATEMENT





Future No Action Airspace Alternative EWR Major Departure Flows

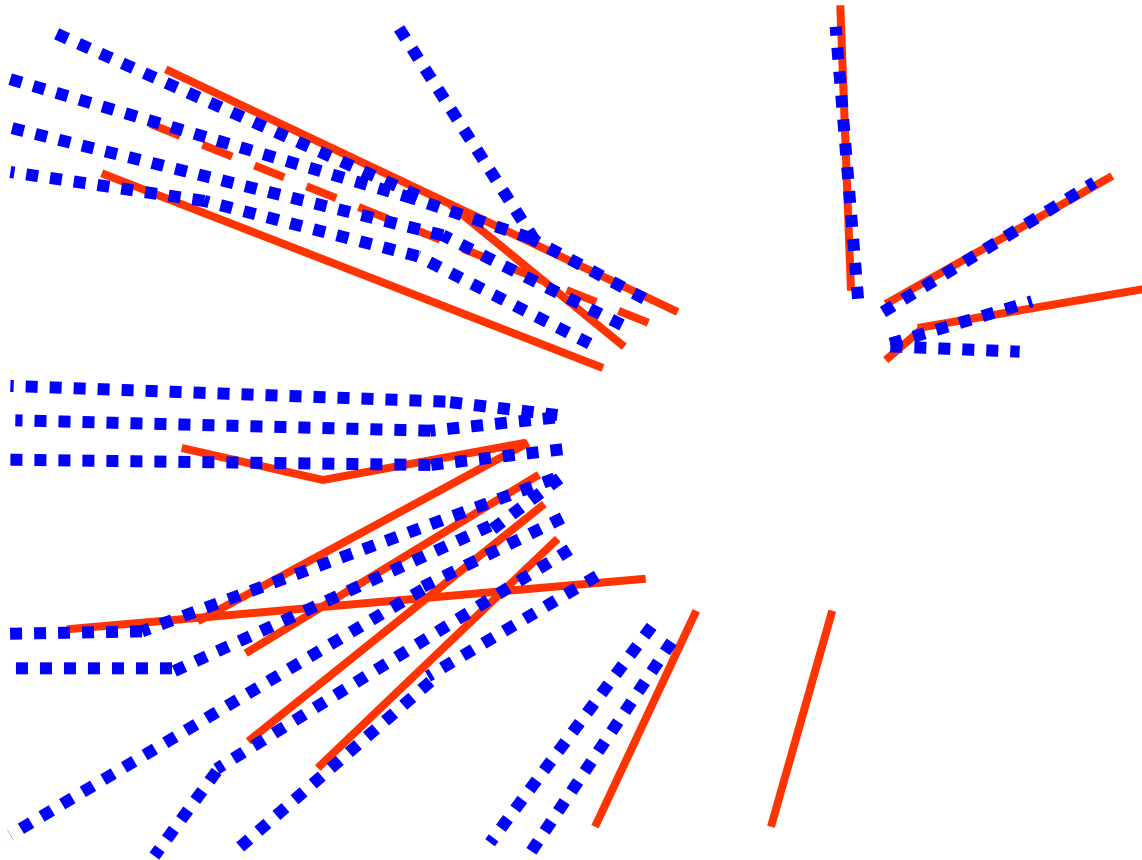
Figure
2.5



What is ICC?

After a careful consideration of all the available information, the FAA has decided to select the mitigated Preferred Alternative, known as the Integrated Airspace Alternative with Integrated Control Complex (ICC). The selected project consolidates many sectors of airspace under one Air Route Traffic Control Center (Center) and represents an innovative approach to airspace design in the NY/NJ/PHL area. The ICC uses of the 3 nautical mile separation criteria for flights in terminal airspace rather than the standard 5 mile criteria for en route airspace over a larger geographic area and up to 23,000 feet above mean sea level in some areas. The airspace will incorporate the sectors of airspace currently handled by the NY Terminal Radar Approach Control facility (TRACON) and the NY Center as well as some handled by the Washington and Boston Centers.

Increased Number of Jet Routes Reduces Delay



Current System:

- Few jet routes for departures
- Access is limited
- Competition for resources means increased delay

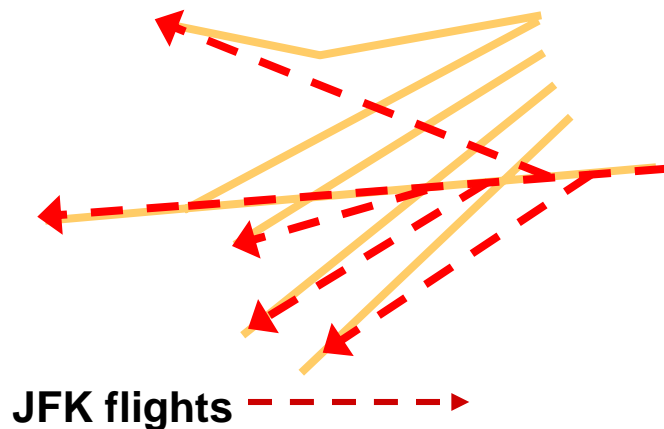
Integrated w/ ICC:

- Increased number of jet routes
- Increased number of access points
- Less competition for departures means decreased delay

JFK Access to Westgate Decreases Complexity

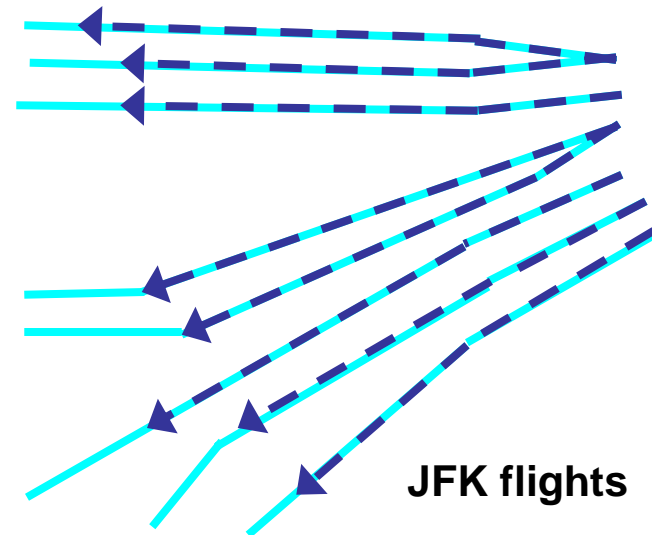
Current System:

- JFK traffic crosses through departures from LGA, EWR, TEB, etc.
- Long ground delays necessary to maintain safe and orderly flow of traffic



Integrated w/ ICC:

- Stacked flows are more efficient and less complex

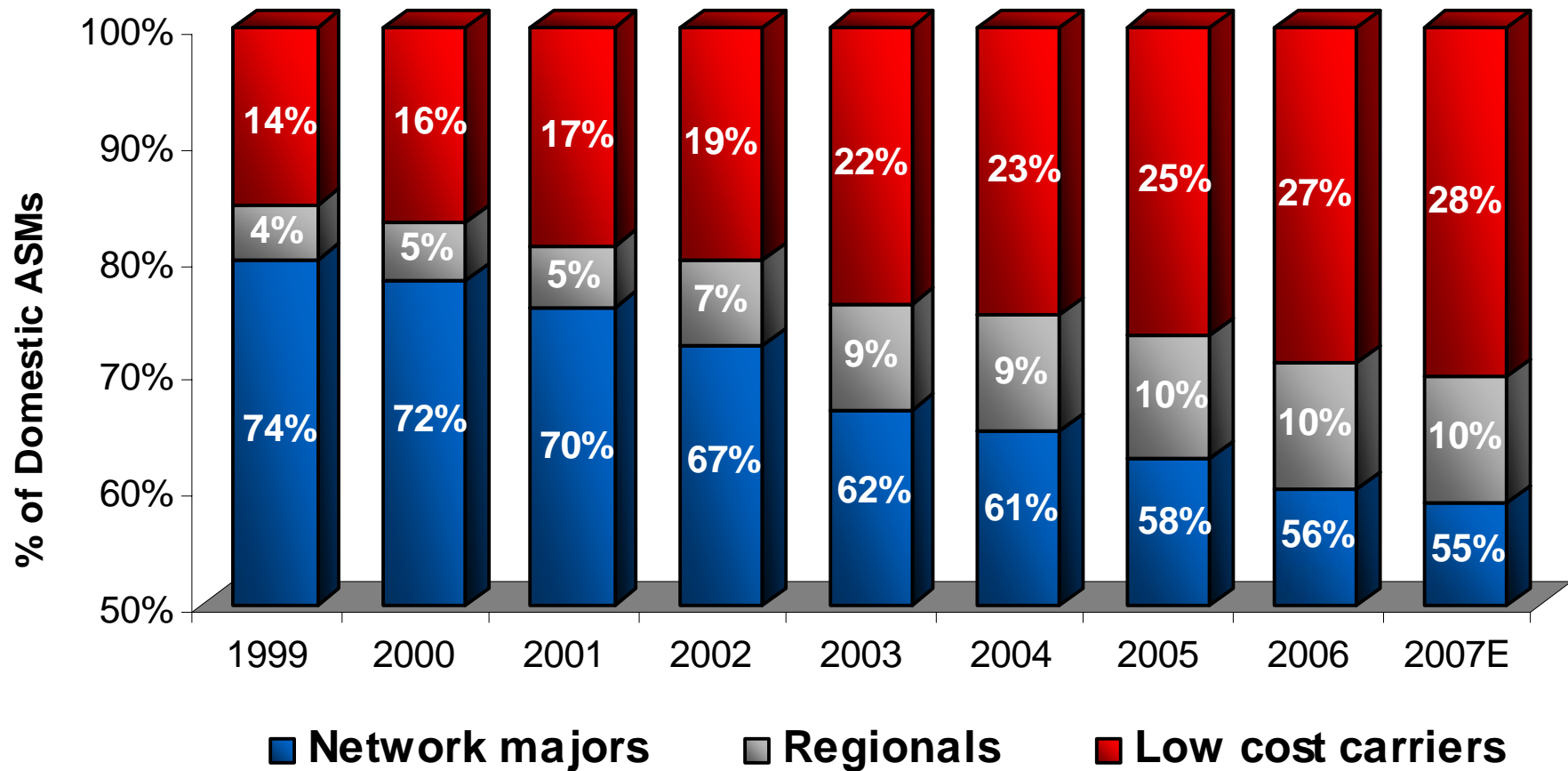


What is CO doing?

- Up-gauging aircraft
 - 60 new 737-800 & 900LR to be delivered in 2008-09
- Shifting of RJs to CLE
 - 40% increase in flights in next 2 yrs
- Introducing Q400 aircraft to take advantage of EWR cross runway
 - Takes pressure off of main runways
 - Replace RJs with larger aircraft
- De-Peaking?

“Low Cost” vs. Legacy

Domestic Market Share



What is a LCC and What is “Legacy”

The industry is undergoing an unprecedented change in it's basic make up

- Traditional / Network / Legacy / Low Cost Carriers?
- No Frills vs low Frills

Domestic Carriers vs. International?

What about EOS, MaxJet, Privat Air

How do you classify US / LCC?

Labor and Total Cost Per ASM

Adjusted for Length of Haul Second Quarter, 2007

<u>Carrier</u>	<u>Enplaned LOH</u>	<u>Total</u>		<u>LOH Adjusted</u>		<u>Labor</u>		<u>LOH Adjusted</u>	
		<u>Cost/ASM</u>	<u>Rank</u>	<u>Total Expense/ASM</u>	<u>Rank</u>	<u>Cost/ASM</u>	<u>Rank</u>	<u>Labor Cost/ASM</u>	<u>Rank</u>
(1) US Airways	856	12.49	1	10.84	7	3.26	4	2.83	6
Northwest	1154	12.29	2	12.39	4	2.80	8	2.82	7
Delta	1118	12.20	3	12.10	5	3.28	3	3.25	4
American	1219	12.08	4	12.51	3	3.60	1	3.73	1
United	1351	11.86	5	12.93	1	3.02	7	3.29	3
Continental	1359	11.73	6	12.83	2	3.26	4	3.57	2
Alaska	987	11.66	7	10.87	6	3.38	2	3.15	5
Airtran	716	9.65	8	7.66	9	1.93	10	1.53	10
Southwest	707	9.03	9	7.12	10	3.26	4	2.57	8
(2) JetBlue	1206	8.52	10	8.78	8	1.96	9	2.02	9

Median Enplaned LOH 1136

Expenses and Costs are adjusted to median PAX LOH

Rank - 1 = highest cost/expense, 7 = lowest cost/expense



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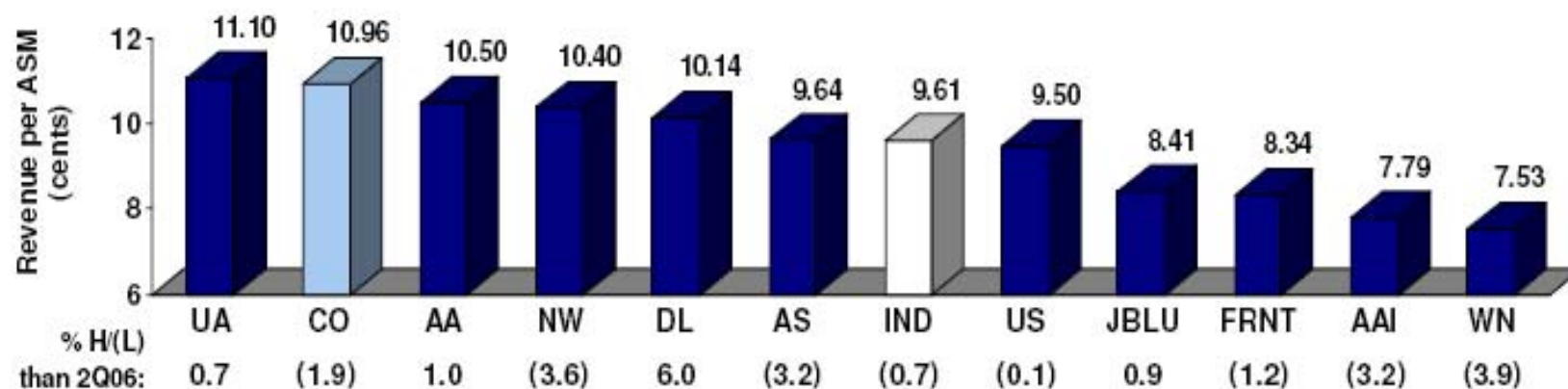
Airline Pilot Pay Rates

(12 yr F/O, Maximum Captain)

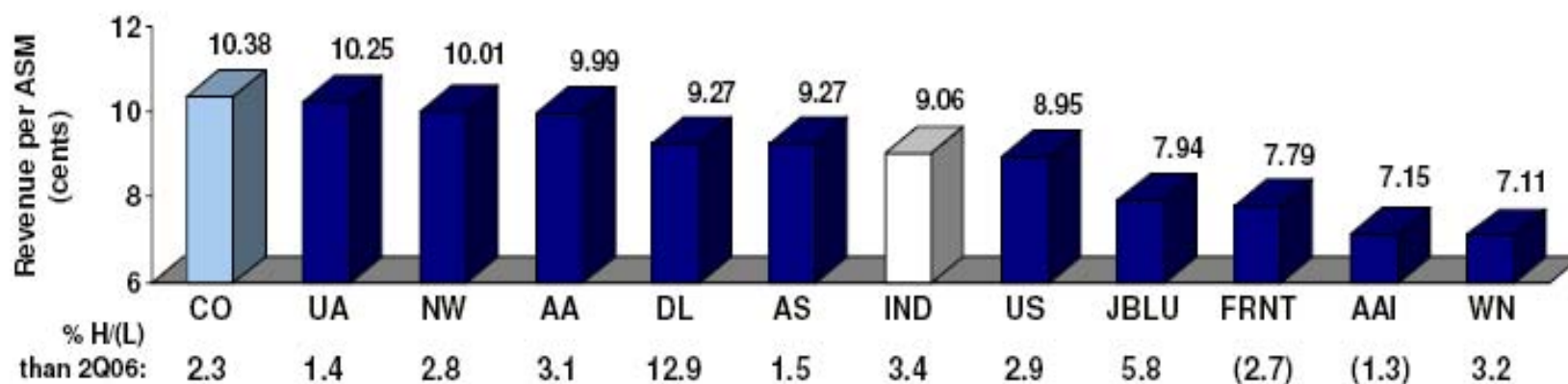
	<u>Wide Body</u>		<u>Narrow Body</u>	
	<u>F/O</u>	<u>Captain</u>	<u>F/O</u>	<u>Captain</u>
AA	\$135	\$199	\$109	\$161
CO	\$127	\$188	\$111	\$163
DL	\$129	\$186	\$103	\$151
UA	\$126	\$184	\$91	\$133
NW	\$120	\$177	\$93	\$137
US Air	\$109	\$160	\$85	\$125
Southwest			\$124	\$198
Alaska			\$89	\$154
Airtran			\$78	\$153
JetBlue			\$79	\$147

DOMESTIC LENGTH OF HAUL ADJUSTED PASSENGER REVENUE PER ASM

2Q07



LTM 2Q07



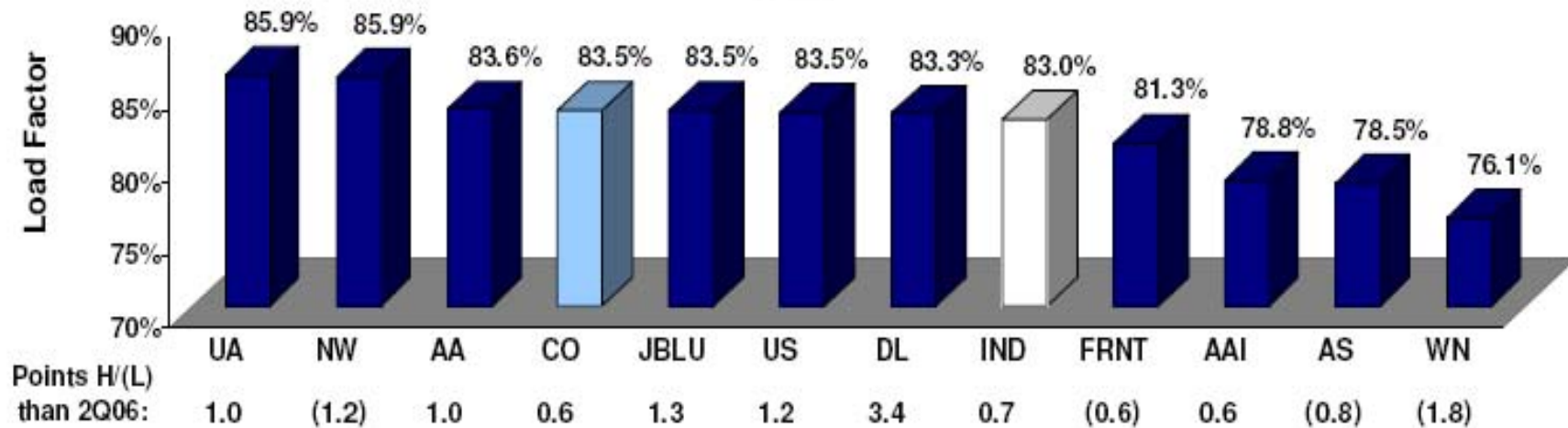
2Q07 Domestic PRASM adjusted to Continental domestic LOH of 1,225

LTM 2Q07 Domestic PRASM adjusted to Continental LTM domestic LOH of 1,227

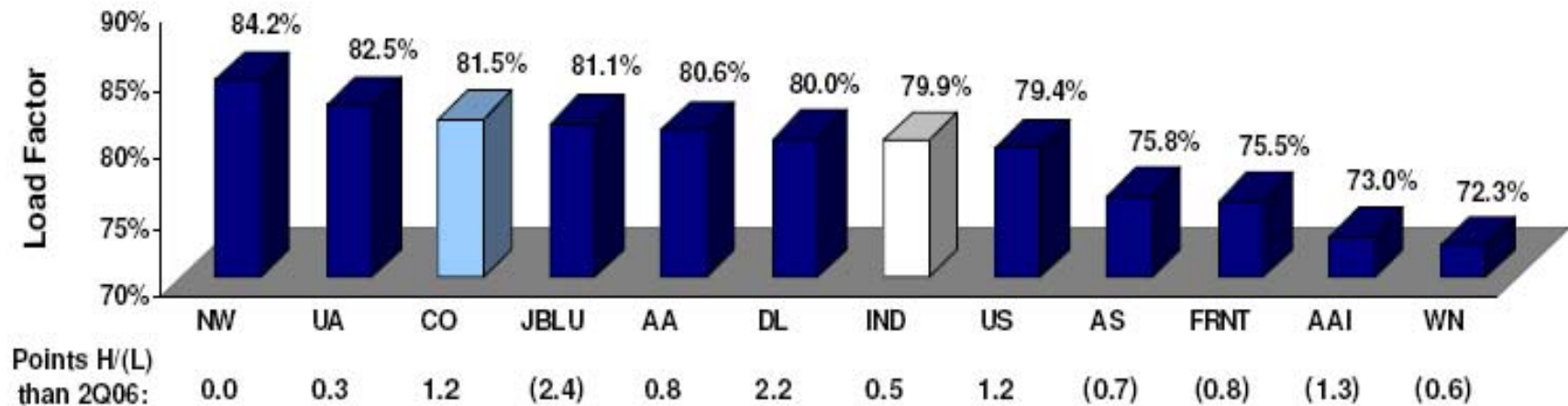
The industry average for the Top 8 carriers in 2Q07 is 9.79 and 9.23 in LTM 2Q07

LOAD FACTOR

2Q07



LTM 2Q07



The industry average for the Top 8 carriers in 2Q07 is 83.1% and 80.1% in LTM 2Q07

Continental vs. Low Cost Carriers

	Southwest			AirTran			Jet Blue		
	<u>TRASM</u>	<u>CASM</u>	<u>Diff</u>	<u>TRASM</u>	<u>CASM</u>	<u>Diff</u>	<u>TRASM</u>	<u>CASM</u>	<u>Diff</u>
2002	1.72	2.68	(0.96)	0.85	1.33	(0.48)	2.02	3.61	(1.59)
2003	1.95	2.80	(0.85)	1.08	1.92	(0.84)	2.90	4.25	(1.35)
2004	1.92	2.93	(1.01)	1.72	2.20	(0.48)	3.72	4.44	(0.72)
2005	2.13	3.25	(1.12)	1.59	1.81	(0.22)	3.85	3.95	(0.10)
2006	2.03	2.75	(0.72)	1.88	1.74	0.14	3.60	3.33	0.27
2007 Qtr I	2.39	2.65	(0.26)	1.98	1.96	0.02	3.42	2.71	0.71
Qtr II	2.20	2.70	(0.50)	1.86	2.08	(0.22)	3.49	3.21	0.28

Changing their Stripes?

- No longer just going to secondary markets
- GDS participation
 - Jet Blue
 - Southwest
 - Easy Jet
- Corporate “Deals”
 - Flexibility / Refundable?
 - Business “Perks”
- “LCCs” are looking more like Legacies every day!

Open Skies



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What Is Open Skies?

International travel is governed by aviation agreements between two countries

Typically these agreements have restrictions:

- The number of U.S. airlines permitted to fly to a foreign country – i.e. Brazil
- The number of U.S. airline flights to a foreign country – i.e. Argentina or Vietnam
- Which foreign points can be served by U.S. airlines – i.e. United Kingdom

Open Skies

The U.S. Government has implemented Open Skies agreements with 77 countries

- The Americas – 14 countries
- Europe – 22 countries
- Africa, Asia, Middle East – 41 countries

Missing are key partners such as Mexico, China, Japan and Australia

U.S. - EU

The U.S. – EU Open Skies agreement consolidates existing individual U.S. – EU aviation agreements into one document

- Single agreement provides for equity and transparency
- Includes all 27 members of the EU
- Agreement allows for total market liberalization
 - British Airways could operate nonstop between the U.S. and Spain, France, Germany, etc.

U.S. - EU

U.S. – EU Open Skies will add 11 more countries to current U.S. total of 77

- Bulgaria
- Cyprus
- Estonia
- Greece
- Hungary
- Ireland
- Latvia
- Lithuania
- Slovenia
- Spain
- United Kingdom

The other 16 EU members currently have individual Open Skies agreements with the U.S.

U.S. - EU

Open Skies agreements generate new service and consumer choices

- Agreement is estimated to generate 26 million additional passengers in the first five years of implementation
- Phase one implementation date March 30, 2008
- Phase two discussions to begin Summer 2008
- It took over 10 years to negotiate/implement phase one

London Heathrow

LHR is the most coveted international airport worldwide

- The legal right to operate at LHR is meaningless without the necessary slots and facilities
- Will LHR continue to demand a price premium?
- Or will increased competition result in a bloody price war?

“Green” and other Taxes

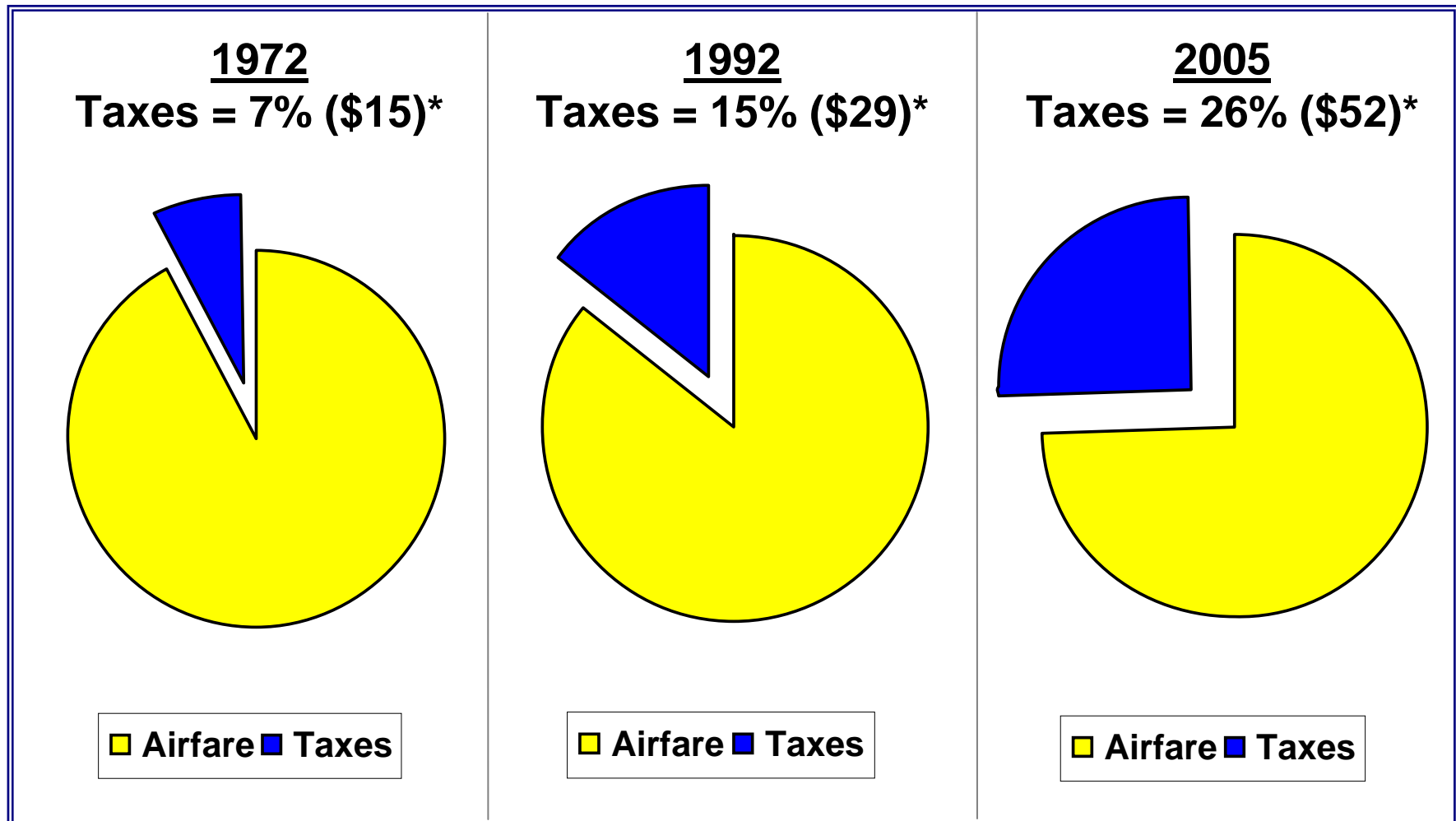


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Taxes & Fees on a \$200 Ticket* Have More Than Tripled



*Sample itinerary assumes one-stop domestic round-trip with maximum passenger facility charge (PFC) per airport; \$200 total price includes taxes and fees.

Sample Airline Taxes

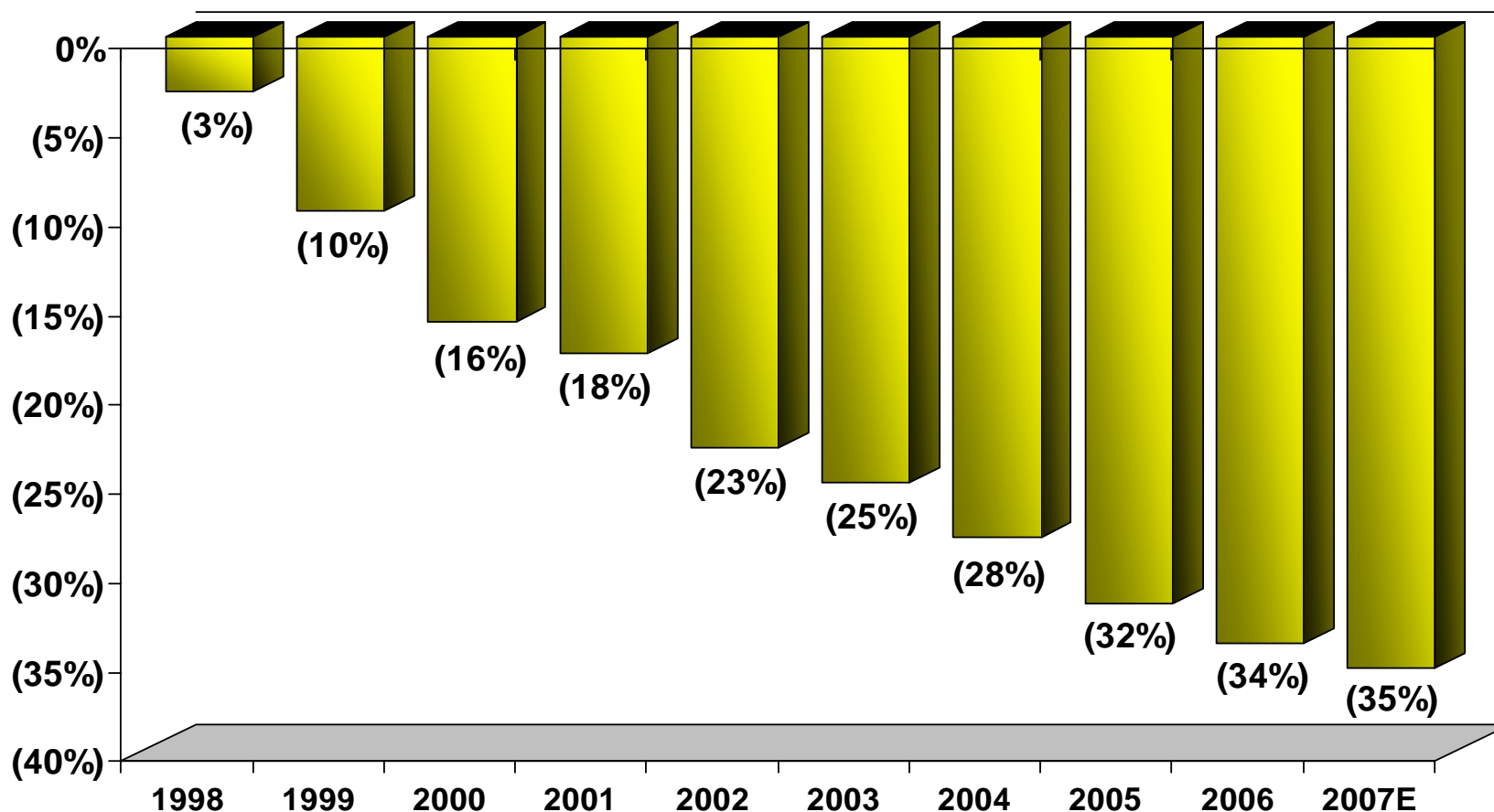
Domestic Federal Ticket Tax	7 ½%
Domestic Segment Fee	\$3.10
Security Tax – Per Segment	\$2.50 (D + I)
Passenger Facility Charge Per Segment	\$3.50 - \$4.00 (D + I)
US Int'l Arrival	\$14.50 (I)
APHIS (Heath Service Fee)	\$5.00 (I)
Sept 11 Fee	\$2.50 (I)
Immigration	\$7.00 (I)
British Departure Tax	20 GBP coach / 40 GBP B/F (UK)
Airport Fee (LGW)	7.40 GBP (UK)
Security Charge	12.96 Euros (AMS)
Service Fee	12.78 Euros (AMS)
Noise Isolation Charge	2.00 Euros (AMS)

NEW Green or Social Taxes

- The UK recently upped Departure Taxes to £40 coach & £80 business
 - Single class carriers on pay £40
 - Justification is Environment, but general funds
- The Caribbean just announced a \$5 environmental tax
- EU attempting to force non EU carriers to participate in Carbon tax and trade scheme
- France added a tax to fight AIDS in Africa
 - Because “only the rich fly”
- 13 countries recently agreed to add a tax to all airline tickets to help “impoverished” nations.
- India added a tax on all First Class/Business First passengers

Continental's Change in Greenhouse Gas Emissions

% Change in Fuel Consumption per Revenue Passenger Mile vs. 1997



What does the future hold?

Airlines will continue to see enormous pressures on costs – and will have to balance prices with capacity

Airfares will stay “flatter”, with less difference between business and leisure fares

It will be more difficult to maintain airline brand differential

Capacity constraints and airport delays will be the press issue of 2008

International is the new battleground

What does the future hold?

Strains on the ATC System

- Charters / Net Jets / Jet Taxis / Day Jets
- More Regional Jets

There will have to be equity in how the ATC system is funded and paid for

Smaller markets may lose service

As LCCs continue to grow, they will struggle with the same issues that Legacy carrier have

The terms LCC and Legacy will drop out of the airline vocabulary

In conclusion....

It's going to be an “interesting” year!

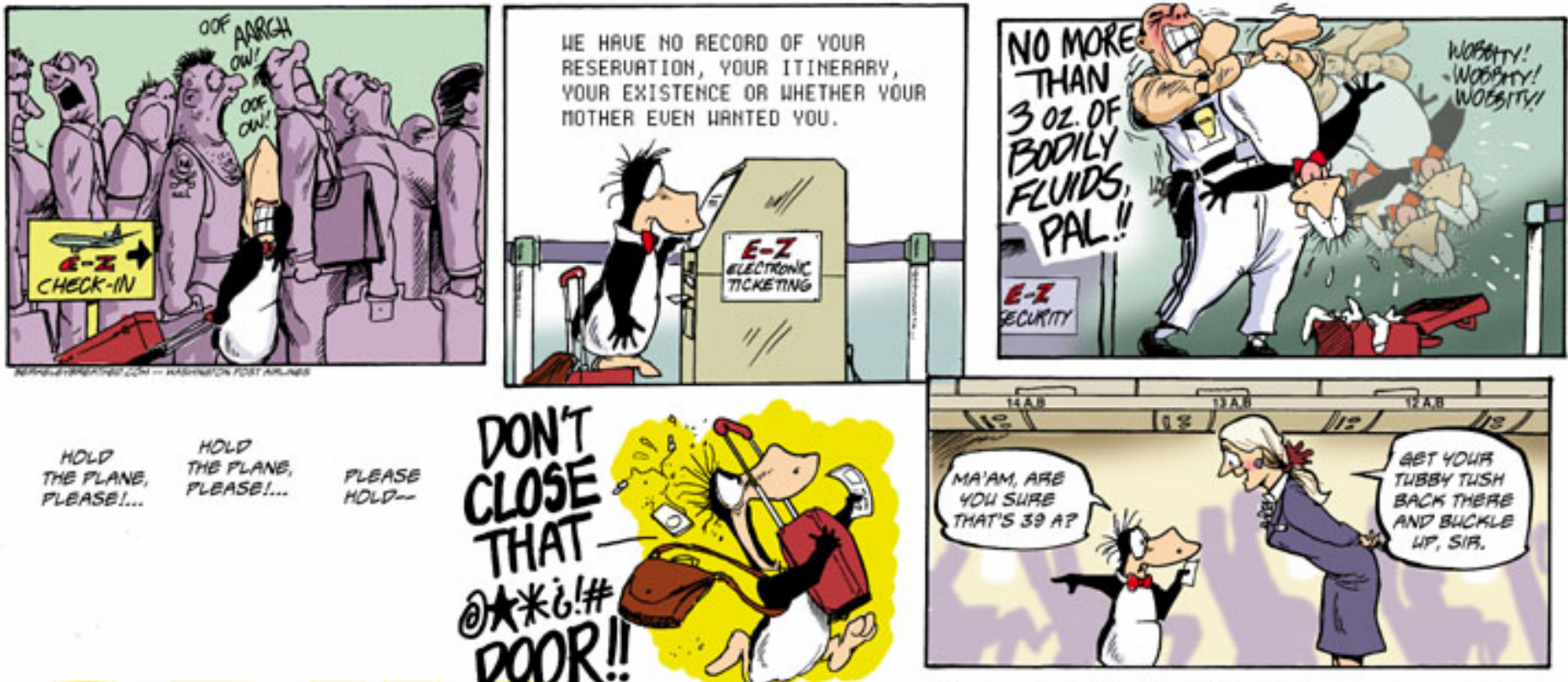
And as the ancient Chinese curse goes.....

May you live in Interesting Times!

Remember, we are all in this business because Travel is such fun!

by Berkeley Breathed

September 16, 2007



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WELL, THERE'S ONE COMFORTING THOUGHT WHEN ONE'S AIRLINE EXPERIENCE SLIPS TO HELLISH DEBACLE:



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Your Thoughts /Comments



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