

**Oil Prices and the Looming U.S. Aviation  
Industry Catastrophe:  
*A Hole In The Transport Grid***

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## At Risk

*While economic theory suggests higher and unsustainable fuels costs will lead to a smaller industry, it does not necessarily follow that the industry will reach its smaller size before collapsing along the way under the weight of higher fuel prices.*

## INTRODUCTION

As a consequence of the skyrocketing price of oil, the U.S. commercial aviation industry is in full-blown crisis and heading toward a catastrophe.

In the hopes of bringing attention to the magnitude of the oil crises, Business Travel Coalition (BTC) commissioned AirlineForecasts, LLC to provide an analysis of what oil at several different price points means in terms of lost airline jobs, reduced seat capacity and increased fare levels.

AirlineForecasts concludes that if oil prices stay anywhere near \$130/barrel, all major legacy airlines will be in default on various debt covenants by the end of 2008 or early 2009. The implication is that several large and small airlines will ultimately end up in bankruptcy, and of those, some will be forced to liquidate.

While economic theory suggests higher and unsustainable fuels costs will lead to a smaller industry, it does not necessarily follow that the industry will reach its smaller size before collapsing along the way under the weight of higher fuel prices.



## A Consequence

*With oil prices in the \$135 range, the airline industry could be forced to park upwards of 1,000 aircraft and shed over 80,000 employees, and still not return to health.*

Every \$10 increase in the price of oil results in \$4 billion in additional costs for the 40 passenger-only airlines. Oil prices have spiked to \$135/barrel from last year's \$72/barrel average. With oil prices in the \$135 range, the airline industry could be forced to park upwards of 1,000 aircraft and shed over 80,000 employees, and still not return to health. The consequences will be devastating to U.S. jobs, families, businesses, communities and our American way of life.

The U.S. airlines, and those who depend upon them, are watching with growing alarm as their cash reserves fall precipitously toward zero as the price of oil, already at unsustainable levels,



continuously spikes into uncharted territory. These airlines and their stakeholders have never faced a darker future.

With airlines gravely threatened, so is our economic well-being in the United States. Airlines are the primary source for inter-city transportation and are critical to national and local economic development, the flow of human capital, the movement of just-in-time parts for manufacturing and the transport of perishable food and other goods our economy depends upon.

The democratization of air travel and freedom of movement we have come to take for granted in the past thirty years are disappearing before our eyes, while the sad prospect of airlines once again providing transport only for the wealthy is coming into view – a view recently articulated by Herb Kelleher, the visionary founder and former chairman of discount carrier Southwest Airlines.

Stabilizing this ailing industry must become a national policy priority. Many Members of Congress, federal regulatory officials, state legislators and Governors have yet to fully appreciate the devastating impact an oil-crippled airline industry will wreak on our culture and our national and local economies.

There are many serious problems facing the airline industry, some self-inflicted and others beyond its control. These problems need to be addressed in the fullness of time by policymakers. However, skyrocketing fuel prices is the immediate, heart-stopping crisis that threatens the very existence of this industry, one which is as vital as the electrical power grid. It's a looming catastrophe that deserves urgent attention.

## QUANTITATIVE ANALYSIS

Based on analysis by AirlineForecasts, most airlines will be in violation of minimum fixed charge coverage ratios or/and minimum cash balances with lenders by the end of this year, given \$130 plus oil. This situation would drive multiple carriers into bankruptcy.

### Findings include:

- The top 10 U.S. airlines will spend almost \$25 billion in higher fuel costs this year over last year when jet fuel averaged \$2.11 per gallon. Fuel hedge benefits could offset \$5 to \$6 billion of the increased fuel costs.
- Earnings for the group, when one-time reorganization charges are removed, were less than \$4 billion in 2007. The group could lose as much as \$9 billion over the next 12 months if the current range of oil prices holds.
- Industry fares will have to increase at least 20% - across the board and on average - just to cover the dramatic gap-up in fuel costs from 2007. This is not possible given the level of uneconomic seat capacity in the system today.
- The upshot of higher fares is less traffic, and given a reasonable estimate of price elasticity, the industry will eventually be forced to shrink its seat capacity by 15% to 20%. However, there is no guarantee that a transition to a smaller, more expensive (for the consumer) airline industry would be successful and sustainable.
- Airlines have the ability to raise some cash, and moreover, suppliers such as aircraft manufacturers, leasing companies and travel management companies will have an incentive to support large airlines that provide a stream of value. Nevertheless, without a swift reduction in the price of fuel, the industry is headed toward a massive failure that will result in more bankruptcies, including liquidations.



# The Burden

*The airlines are on pace to spend \$30 billion more on jet fuel in 2008 versus 2007.*



The impact of sky-high oil prices at \$130 to \$140 levels could result in the loss of 75,000 to 85,000 direct airline industry jobs, many of which are high-paying, including 11,500 pilot positions. To cover oil prices at these levels, fares would have to go up 21% to 24% and airline seat capacity reduced by 18% to 20%. Were oil to climb toward \$200, as some analysts predict, the damage escalates and the airline industry could be forced to shrink 35% or more.

The airlines are on pace to spend \$30 billion more on jet fuel in 2008 versus 2007. At best, and based upon the past four-year top-line revenue increases, the airline industry will be able to generate only \$3 billion in fare increases to offset this higher cost. What's more, all the extra-bag charges and other fees implemented by airlines recently will only yield \$1 to \$1.5 billion at the industry level. Airlines can attempt to radically shrink capacity, but given the competitive situation they face, it's highly unlikely that they will have the ability to reduce capacity to levels that will allow them earn a normal, risk-adjusted rate of return. Instead, absent direct policy intervention, the likelihood is that there will be more bankruptcies, including some liquidations.

## Fuel Cost Impact on Jobs, Fares & Capacity

(systemwide for 40 passenger-only airlines)

Oil price	Jet fuel Costs	Industry Fuel costs	Increase in Fuel costs	Per passenger req'd price incr	req'd price incr	Loss of Jobs	Reduction in Capacity
\$/bbl	\$/gal	(\$millions)	(\$millions)	(\$)	(percentage)		
100	3.1	51,375	17,481	24	13%	44,300	11%
110	3.3	55,327	21,433	29	16%	54,315	13%
120	3.6	59,279	25,385	34	18%	64,329	15%
<b>130</b>	<b>3.8</b>	<b>63,231</b>	<b>29,337</b>	<b>40</b>	<b>21%</b>	<b>74,344</b>	<b>18%</b>
<b>140</b>	<b>4.0</b>	<b>67,183</b>	<b>33,289</b>	<b>45</b>	<b>24%</b>	<b>84,359</b>	<b>20%</b>
150	4.3	71,135	37,241	50	27%	94,374	23%
170	4.8	79,039	45,145	61	33%	114,403	28%
200	5.5	90,894	57,000	77	41%	144,448	35%

Per passenger price is based on revenue per enplaned passenger

Loss of jobs and capacity is based on estimated price elasticity of demand

The increase in fuel costs do not include fuel hedge benefits and is relative to 2007

Source: AirlineForecasts

Note: The following earnings estimates are nothing more than a snapshot based on current assumptions. The tables are for illustrative purposes only to assess the status quo scenario.

## 2008 Earnings: \$9 billion in Pre-Tax losses

	Total Revenue	Operating Earnings	Operating Margins	Pre-Tax Earnings	Pre-Tax Margins
	(\$millions)	(\$millions)		(\$millions)	
1 Southwest	11,025	421	3.8%	313	2.8%
2 Alaska	3,690	(130)	-3.5%	(163)	-4.4%
3 Delta	20,900	(769)	-3.7%	(1,266)	-6.1%
4 Northwest	13,700	(684)	-5.0%	(997)	-7.3%
5 AirTran	2,650	(155)	-5.8%	(207)	-7.8%
6 JetBlue	3,400	(129)	-3.8%	(277)	-8.2%
7 United *	21,000	(1,896)	-9.0%	(1,946)	-9.3%
8 US Airways	12,780	(1,224)	-9.6%	(1,269)	-9.9%
9 Continental	15,300	(1,427)	-9.3%	(1,597)	-10.4%
10 American	20,239	(1,862)	-9.2%	(2,229)	-11.0%
<b>Top 10</b>	<b>124,684</b>	<b>\$ (7,854)</b>	<b>-6.3%</b>	<b>\$ (9,638)</b>	<b>-7.7%</b>

Earnings estimates based on \$133 oil

\* United's estimates are an average of several sell-side analysts

Source: AirlineForecasts

## 2009 Earnings: \$8 billion in losses

	Total Revenue	Operating Earnings	Operating Margins	Pre-Tax Earnings	Pre-Tax Margins
	(\$millions)	(\$millions)		(\$millions)	
1 Southwest	12,024	518	4.3%	395	3.3%
2 Delta	21,000	(540)	-2.6%	(1,059)	-5.0%
3 Northwest	14,130	(397)	-2.8%	(799)	-5.7%
4 United *	21,450	(1,161)	-5.4%	(1,431)	-6.7%
5 American	24,400	(1,019)	-4.2%	(1,651)	-6.8%
6 Alaska	3,700	(245)	-6.6%	(304)	-8.2%
7 Continental	15,600	(925)	-5.9%	(1,327)	-8.5%
8 Jetblue	3,435	(119)	-3.5%	(293)	-8.5%
9 AirTran	2,650	(208)	-7.8%	(255)	-9.6%
10 US Airways	12,200	(1,065)	-8.7%	(1,263)	-10.4%
<b>Top 10</b>	<b>130,589</b>	<b>\$ (5,162)</b>	<b>-4.0%</b>	<b>\$ (7,988)</b>	<b>-6.1%</b>

Earnings estimates based on \$132 oil

\* United's estimates are an average of several sell-side analysts

Source: AirlineForecasts



# No Break

*The industry only had one year of profitability...to begin the balance sheet repair work before it was plunged into deep losses again in 2008.*

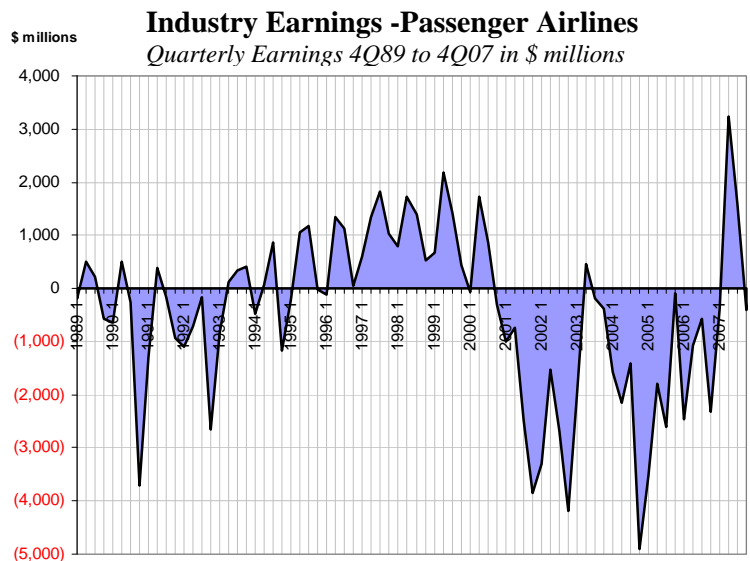
## HISTORICAL CONTEXT

To fully grasp the gravity of the current situation, it's useful to reference some historic context. During the airline industry cyclical downturn in the early 1990s, the industry lost a cumulative \$12 billion between the fourth quarter of 1990 and the first quarter of 1993. What followed were 6 years of profits sufficient for airlines to repair damaged balance sheets. (US Airways even repurchased \$2 billion of its stock.)



The most recent downturn in 2000 lasted until 2006 and reported net losses were over \$44 billion. The industry only had one year of profitability, in 2007, at less than \$4 billion, to begin the balance sheet repair work before it was plunged into deep losses again in 2008. Importantly, during this most recent downturn, significant costs were taken out of the industry, and for many airlines, virtually all assets were mortgaged. Most airlines have little flexibility now as they face both a slowing economy and record-setting jet fuel prices.

Airlines have been able to generate top-line revenue improvements averaging only \$2.7 billion in each of the past 4 years on a \$122 billion total [average] revenue base. The top ten airlines need to raise fares 20%, or \$24 billion at least, but cannot. The pharmaceutical industry recently imposed an across-the-board price increase of 20% to its customers (large industrial companies) to cover increased direct and indirect energy costs. However, 60% to 70% of airline customers, namely leisure travelers, spend money on airlines as a discretionary matter; they are very price sensitive.



Source: AirlineForecasts

## CONCLUSION

As the price of fuel skyrockets, the U.S. airline industry stands on a ledge, staring into an abyss. Before time runs out on the nation's air carriers, policymakers must adopt new energy policy priorities with great purpose and haste.

The trend lines cannot be ignored. Fuel has become the number one expense for U.S. carriers, siphoning off 40 cents or more of every dollar of revenue, and rising. The price of oil has nearly doubled in the last several months to over \$130/barrel, and carriers are unlikely to be able to raise airfares or cut capacity sufficiently to adapt their operations to this reality. Instead, as AirlineForecasts' analysis shows, the U.S. airline industry, as we know it, cannot survive at existing fuel price levels, and certainly not at the higher levels some analysts are predicting for this summer and beyond.

Brand name legacy carriers that we and American communities from coast-to-coast have depended upon for decades to provide us with affordable, frequent air service are running out of cash, and therefore, toward a date with bankruptcy, and even liquidation. The consequences of the hole this will leave in our nation's transportation grid will be extremely profound for our economy, society and culture.

A catastrophic result for U.S. airlines can be averted if policymakers, particularly in the White House and Congress, step up purposefully to address this monumental challenge. There is still time to make a difference. This is important not only for airlines and their passengers, but also for every business that uses oil products.

In the weeks ahead, BTC will work with its allies to bring forward to Congress and the Administration some specific proposals that will help address the near and long-term implications of the aviation fuel crisis.

We urgently need a new energy policy that will give the airlines a fighting chance to survive and recover -- and serve all members of the traveling public for many years to come.

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