

Southwest/AirTran Merger Revisited

An Independent Metrics Overview ATL: Life After AirTran



A Boyd Group International Research Report

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Background

In October 2010, Boyd Group International accomplished the first (and for all intents and purposes the only) in-depth review of the outcomes of the Southwest acquisition of AirTran.

The firm had earlier accomplished comprehensive reviews of this potential transaction, and had concluded that the merger made sense, based on known and expected conditions in the airline industry. The combination gave Southwest access to a large hub operation at ATL that provided revenue generation across entirely new traffic flows. It gave WN access to a number of emerging regional markets that, in the absence of the ATL traffic made possible by the merger, it could not likely enter. And, despite the myths promulgated by many in the financial world, the B-717s did have a fit in a growing Southwest.

In the time since that analysis, several factors have now come to light in regard to the future outcomes of this merger. First, it's now clear that WN's cost structure and operational system isn't as easily mated to the AirTran system. Work rules at WN do not permit the flexibility that AirTran enjoyed, and, hence, many of the markets in the AirTran system simply cannot be operated profitably by Southwest. The B-717s, an initial apparent fit for replacement of aging and similar size 737-500s, are fuel efficient, but not as maintenance-efficient as needed. In October 2010, it was clear in our report that if WN was to take advantage of the AirTran flows at Atlanta, it would be absolutely essential that Southwest operate ATL as a banked connecting hub. Southwest has now indicated this will not be the case, and as a result, there is no question that the merger will result in fewer passengers through Atlanta Jackson-Hartsfield. Estimates in this analysis indicate nearly 5% of ATL traffic will be spilled off to other connecting hubs.

These and other emerging factors will result in major changes at ATL in regard to service and capacity. To be sure, the entry of Southwest represents a tenant at ATL that is one of the nation's best-managed and most ethical companies. But it is in business to make money, and it will adjust its ATL operations to that end. And that end does not necessarily point to additional traffic growth at ATL. It is the nature of the airline business

This report has been accomplished entirely independently by Boyd Group International, Inc., and is based on analyses and projections deemed reliable, but due to the dynamic nature of the subject matter, are not guaranteed.

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Assumptions

- Southwest will retain all of the local O&D carried by AirTran. This is admittedly optimistic, in that some FL/ ATL markets have already been dropped.
- Southwest will, as it has indicated, pull down the FL hubbing operations. Connectivity between WN flights will be predominantly random.
- There is no factor in this analysis that addresses the possible consumer reactions to the very different service product of Southwest v AirTran. The elimination of seat selection, XM-Radio, and a business cabin offering could have effects on consumer decisions going forward.
- There will not be any material fare stimulation with the entry of Southwest at ATL. AirTran has already done so in 24 of the top 25 ATL O&D markets. The potential for new nonstops to other markets with the entry of WN is certainly there, but it is limited by the lack of connecting traffic support.
- No review has been made of the potential of an aggressive marketing counter-strike by Delta. The new Delta has considerable management DNA from Continental and Northwest, and it is possible that the airline may see the change in product offered by Southwest an opportunity to gain market share at ATL.



Hard Realities

- AirTran today represents approximately 14.1 million passengers through Atlanta. It does so by operating in a predominantly “banked” flight schedule, facilitating connections at ATL.
- Over 60% - 8.6 million - of AirTran’s traffic is comprised of connecting passengers. This “flow” traffic supports the 180+ daily AirTran departures. In fact, the connecting traffic accounts for the capacity equivalent of over 100 of the 180 daily FL departures.
- Southwest, however, has made clear that it intends to “wind down” the FL connecting operations. Without question, this means that when the dust settles from the merger, the WN operation will represent fewer passengers than the current AirTran schedule.
- Southwest has already indicated a reduction in total daily flight operations compared to AirTran levels at ATL. This signals that WN will fundamentally restructure – and in some cases, drop – a portion of the route/revenue generation that AirTran now operates



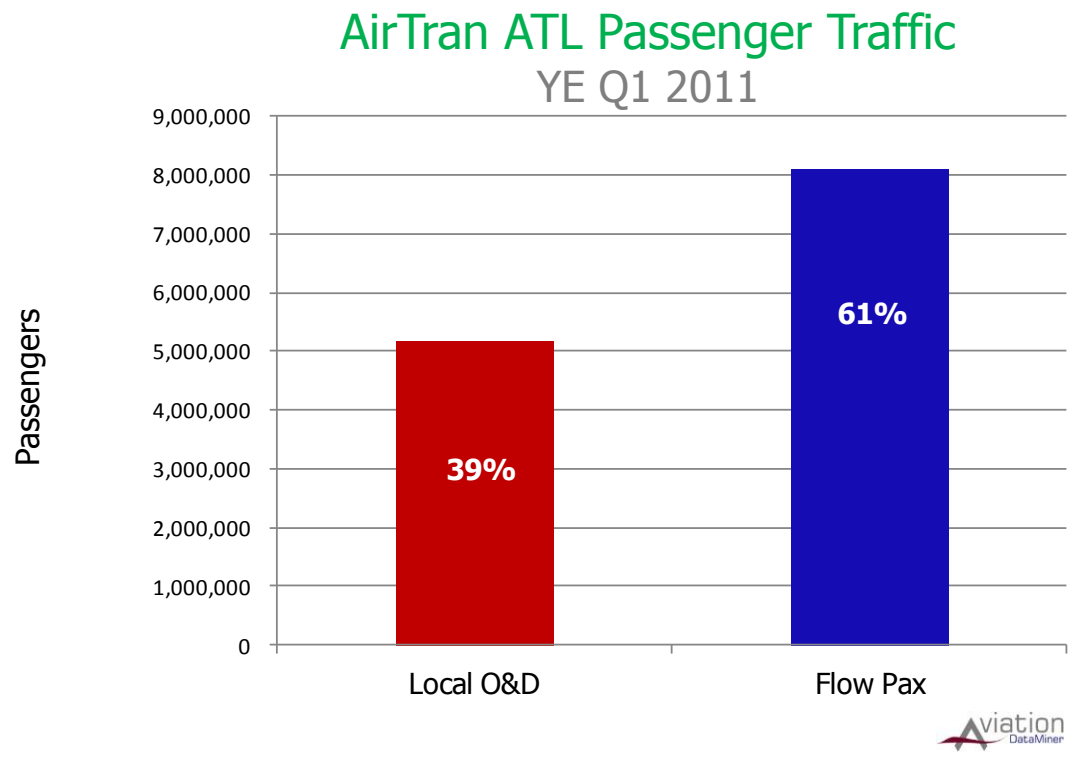
Hard Realities

- Hypothetically, without any connecting traffic in the mix, AirTran's ATL operation appears to support only 30 markets with a frequency of 2 or more flights per day. This would indicate approximately 110 to 120 daily flights – segments - down from the 360 made possible with AirTran's connecting hub. (180 daily departures)
- As a practical matter, however, there will be some connectivity with any WN/ATL schedule, but at best (most) it would represent support for capacity in the range of 170 – 180 daily flights – equating to perhaps as few as 90 daily ATL departures
- Atlanta is not new territory for low fare stimulation. The “Southwest effect” – market stimulation with low fares – has largely already been registered at ATL by lower-cost AirTran. Twenty-four of the top 25 O&D markets are already “stimulated” by AirTran. The remainder have only limited potential for nonstop service that is not already operated by AirTran.

Hard Realities

- Southwest inherits a route system from AirTran, parts of which it simply cannot operate as cost-efficiently as did AirTran, which could outsource ground handling. Southwest cannot, and its union agreements do not allow other operational and cost flexibilities enjoyed by AirTran.
- Funnel-Route Strategy. ATL does represent strong new system revenues. Southwest can aggressively “funnel” connecting flows over MDW, BNA, DEN, SLC, MCI, to generate maximum ATL O&D revenues across its system.
- The hard conclusion: The Southwest-AirTran merger will result in lower enplanement levels at ATL, and will end low-fare flights at several communities where AirTran’s costs allowed viable service, but where the costs and operational systems at WN cannot.

Current AirTran Passenger Traffic at ATL



The Picture is Clear: ATL AirTran capacity is dependent on connecting flow traffic; Any change in strategy to focus only on local O&D will necessitate the loss of air service to some communities which can not support nonstops based on local O&D alone.

Top FL/ATL Nonstop Markets Ranked By Connecting Passengers

For Southwest to maintain the levels of current FL frequency in these markets, it must retain current connecting traffic carried by FL. (It has indicated it will not.)

Short of that, there needs to be strong fare stimulation – which has already taken place with AirTran service.

Flow Rank (Pax)	Airport	Total Pax	Local O&D	Connect	Pct LCL	Pct Connect
1	MCO	202,517	53,555	148,962	26.4%	73.6%
2	DFW	136,775	35,888	100,887	26.2%	73.8%
3	TPA	139,161	43,503	95,658	31.3%	68.7%
4	HOU	135,791	41,539	94,252	30.6%	69.4%
5	FLL	158,715	77,718	80,997	49.0%	51.0%
6	RSW	80,944	14,838	66,106	18.3%	81.7%
7	LGA	155,839	96,606	59,233	62.0%	38.0%
8	LAS	95,767	37,007	58,760	38.6%	61.4%
9	MSP	90,495	32,115	58,380	35.5%	64.5%
10	DCA	108,537	53,491	55,046	49.3%	50.7%
11	BWI	122,113	70,264	51,849	57.5%	42.5%
12	MKE	82,082	30,625	51,457	37.3%	62.7%
13	MDW	110,865	59,428	51,437	53.6%	46.4%
14	JAX	67,927	16,700	51,227	24.6%	75.4%
15	PHF	76,179	25,372	50,807	33.3%	66.7%
16	SFO	88,453	37,769	50,684	42.7%	57.3%
17	PNS	52,968	5,410	47,558	10.2%	89.8%
18	MEM	65,065	17,736	47,329	27.3%	72.7%
19	CAK	72,817	25,857	46,960	35.5%	64.5%
20	RDU	68,619	24,950	43,669	36.4%	63.6%
21	MSY	65,803	22,850	42,953	34.7%	65.3%
22	BMI	54,742	11,891	42,851	21.7%	78.3%
23	CLT	46,225	3,710	42,515	8.0%	92.0%
24	DTW	77,527	35,138	42,389	45.3%	54.7%
25	IND	60,535	18,468	42,067	30.5%	69.5%

Data: 2Q 2011 Analyzed by Aviation DataMiner™



Top FL/ATL Nonstop Markets Ranked By Percent of Connecting Passengers

If Southwest is not going to bank connections, several of these markets will be problematic for continued nonstop service from Atlanta...

Open questions are the airports not already served from other WN points. With its costs and labor agreements, is not likely WN will keep open a station for only 2-4 flights from ATL.

Flow Rank (Pax)	Airport	Total Pax	Local O&D	Connect	Pct LCL	Pct Connect
1	CLT	46,225	3,710	42,515	8.0%	92.0%
2	PNS	52,968	5,410	47,558	10.2%	89.8%
3	RSW	80,944	14,838	66,106	18.3%	81.7%
4	SRQ	39,891	8,011	31,880	20.1%	79.9%
5	BMI	54,742	11,891	42,851	21.7%	78.3%
6	JAX	67,927	16,700	51,227	24.6%	75.4%
7	DFW	136,775	35,888	100,887	26.2%	73.8%
8	MCO	202,517	53,555	148,962	26.4%	73.6%
9	BKG	33,556	9,096	24,460	27.1%	72.9%
10	MEM	65,065	17,736	47,329	27.3%	72.7%
11	IND	60,535	18,468	42,067	30.5%	69.5%
12	HOU	135,791	41,539	94,252	30.6%	69.4%
13	TPA	139,161	43,503	95,658	31.3%	68.7%
14	IAD	57,607	18,260	39,347	31.7%	68.3%
15	DAY	53,279	16,963	36,316	31.8%	68.2%
16	ROC	36,893	12,072	24,821	32.7%	67.3%
17	SAT	60,740	20,031	40,709	33.0%	67.0%
18	PHF	76,179	25,372	50,807	33.3%	66.7%
19	SJU	53,025	18,051	34,974	34.0%	66.0%
20	CMH	33,758	11,621	22,137	34.4%	65.6%
21	MSY	65,803	22,850	42,953	34.7%	65.3%
22	MSP	90,495	32,115	58,380	35.5%	64.5%
23	CAK	72,817	25,857	46,960	35.5%	64.5%
24	RDU	68,619	24,950	43,669	36.4%	63.6%
25	PIT	65,927	24,018	41,909	36.4%	63.6%

Note: BMI and DFW are already on the cancel list.

Data: 2Q 2011 Analyzed by Aviation DataMiner™



Without Connecting Traffic, Southwest ATL Frequencies Would Be Less Than Half Of AirTran Today. Without Any Connecting Flows, Only 12 Markets Can Support More Than One Daily Round Trip

- Assumes hypothetically no connecting passengers...
- One-way segments shown (one RT = 2 segments). ATL-DAL is estimated
- Odd-numbered supportable segments lowered to nearest number divisible by 2 to represent round trip potential.
- Assumes current FL average passengers per flight (110)
- Assumes that fare levels are not increased from FL levels

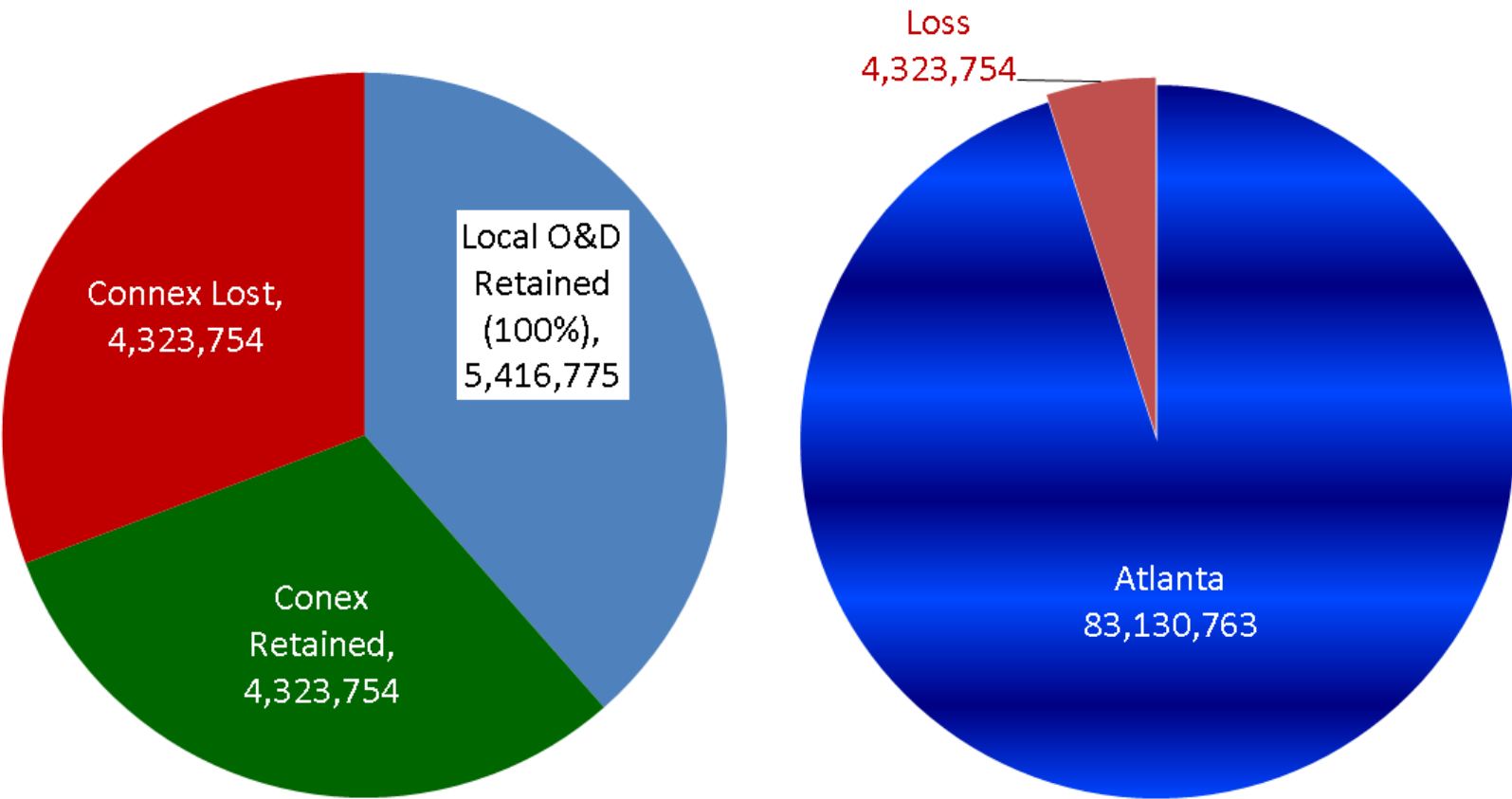
Clearly, there will be natural connections to WN, increasing supportable capacity, but in the absence of intentional banking, they will be far below any level to support current FL capacity.

Open Question: How much FL connecting traffic will be spilled to Delta & to other hubsites?

	Market	Total FL Pax	Connect	Pct LCL	LCL Pax	Segments Supported	Current FL Segments
1	LGA	155,839	59,233	62.0%	96,606	9.0	18.0
2	FLL	158,715	80,997	49.0%	77,718	6.0	16.0
3	BWI	122,113	51,849	57.5%	70,264	6.0	14.0
4	MDW	110,865	51,437	53.6%	59,428	6.0	14.0
5	MCO	202,517	148,962	26.4%	53,555	4.0	18.0
6	DCA	108,537	55,046	49.3%	53,491	4.0	12.0
7	BOS	86,005	33,092	61.5%	52,913	5.0	10.0
8	PHL	91,524	40,490	55.8%	51,034	5.0	10.0
9	LAX	91,455	41,709	54.4%	49,746	5.0	8.0
10	TPA	139,161	95,658	31.3%	43,503	4.0	16.0
11	HOU	135,791	94,252	30.6%	41,539	4.0	10.0
12	SFO	88,453	50,684	42.7%	37,769	2.0	6.0
13	LAS	95,767	58,760	38.6%	37,007	2.0	6.0
14	DFW (DAL)	136,775	100,887	26.2%	35,888	12.0	
15	DTW	77,527	42,389	45.3%	35,138	2.0	6.0
16	MSP	90,495	58,380	35.5%	32,115	2.0	8.0
17	HPN	51,539	20,468	60.3%	31,071	2.0	4.0
18	MKE	82,082	51,457	37.3%	30,625	2.0	4.0
19	DEN	60,881	30,790	49.4%	30,091	2.0	4.0
20	CAK	72,817	46,960	35.5%	25,857	2.0	8.0
21	PHF	76,179	50,807	33.3%	25,372	2.0	6.0
22	RDU	68,619	43,669	36.4%	24,950	2.0	6.0
23	MCI	59,786	35,113	41.3%	24,673	2.0	4.0
24	PIT	65,927	41,909	36.4%	24,018	2.0	8.0
25	MSY	65,803	42,953	34.7%	22,850	2.0	8.0
26	RIC	61,133	38,706	36.7%	22,427	2.0	8.0
27	FNT	54,386	33,223	38.9%	21,163	2.0	6.0
28	BUF	53,940	33,100	38.6%	20,840	2.0	6.0
29	STL	53,488	32,770	38.7%	20,718	2.0	4.0
30	SAT	60,740	40,709	33.0%	20,031	2.0	6.0
		2,778,859	1,606,457		1,172,402	106.0	254.0

Data: 2Q 2011 Analyzed by Aviation DataMiner™

Loss of 50% of FL Connect Pax = 4.9% of ATL Traffic



Loss of this flow traffic to will depend on the re-capture by Delta at ATL

Data: Full year ending 2Q 2011, includes local O&D and connecting passengers.
Analyzed by Aviation DataMiner™



The Question Remains: What Will Happen to All of the Displaced FL Connecting Passengers?

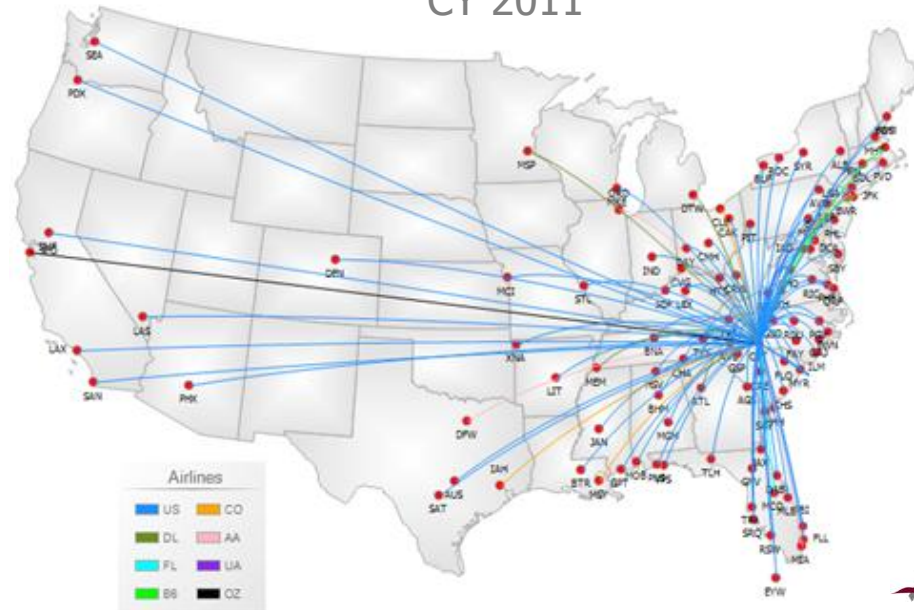
- The Boyd Group International believes that of the approximate 8.6 million connecting AirTran passengers at ATL, WN will capture no more than 50%.
- Delta will capture some of the displaced passengers by default, as they are the major carrier at the ATL hub
 - However, Delta is decreasing capacity in 2012 and its planes are already experiencing high load factors
 - Delta may capture 10% of these passengers, but the majority will shift to other connecting hubs
- It is logical that US Airways will attract a substantial share of the lost FL connecting flows
 - By extension, the STAR Alliance will benefit since it is the major alliance at the CLT hub. This represents a downside of the merger to SkyTeam member Delta at ATL

CLT and the STAR Alliance Will Benefit

- Competing Delta hubs are being reduced. What DL/ATL cannot absorb from the FL hub pull-down will go to the competition – and US Airways is the main player in the region
 - MEM daily departures decreasing from 164 to 149 by the beginning of 2012; nonstop destinations decreasing from 65 to 58 during the same time period
 - CVG capacity pull down has been ongoing and clearly does not play a major role in the future as a stalwart Delta hub
- CLT is the logical hub from a geographical standpoint to capture the majority of the connecting passenger traffic foregone by Southwest
 - Excellent connectivity at CLT which can compensate for lost connections over ATL

CLT Air Service Pattern

CY 2011

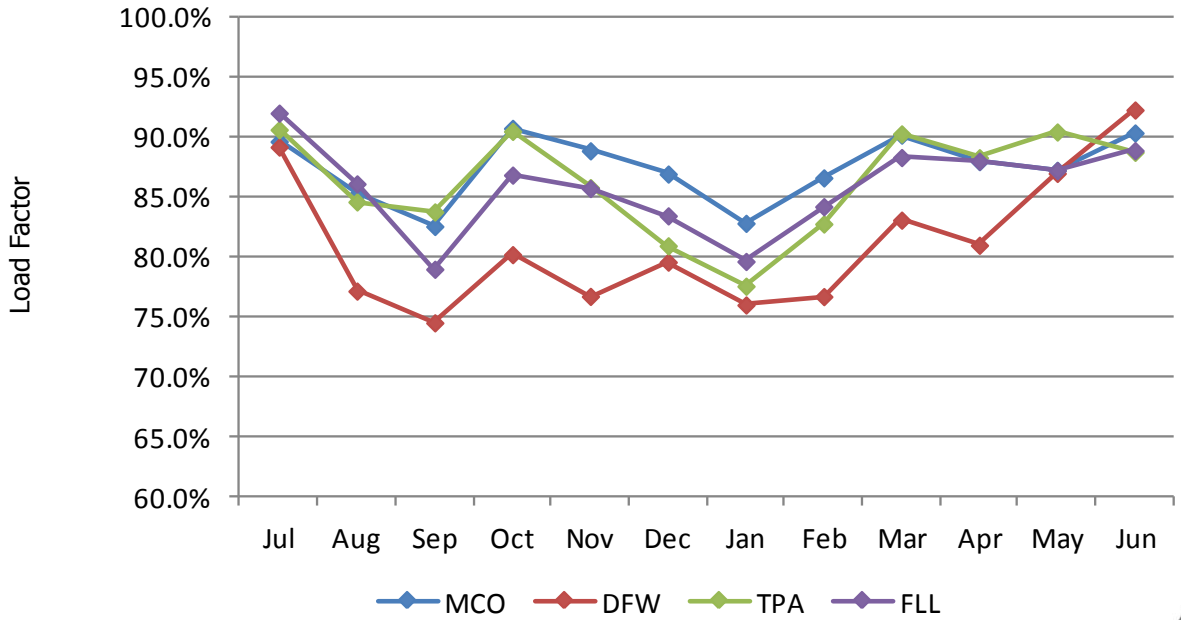


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Delta ATL: Cannot Absorb All The Lost Flow Pax

- Delta load factors to the AirTran top connecting destinations over ATL are very high
 - Delta will surely capture some of the spilled WN connecting traffic, but with limited ability to expand the ATL hub it will not benefit as much as the CLT hub and the STAR Alliance
 - Scheduled departures in 2011 are down 3.5% vs 2010 at ATL, but seats are up 2.0% illustrating the concerted effort to fly fewer regional jets

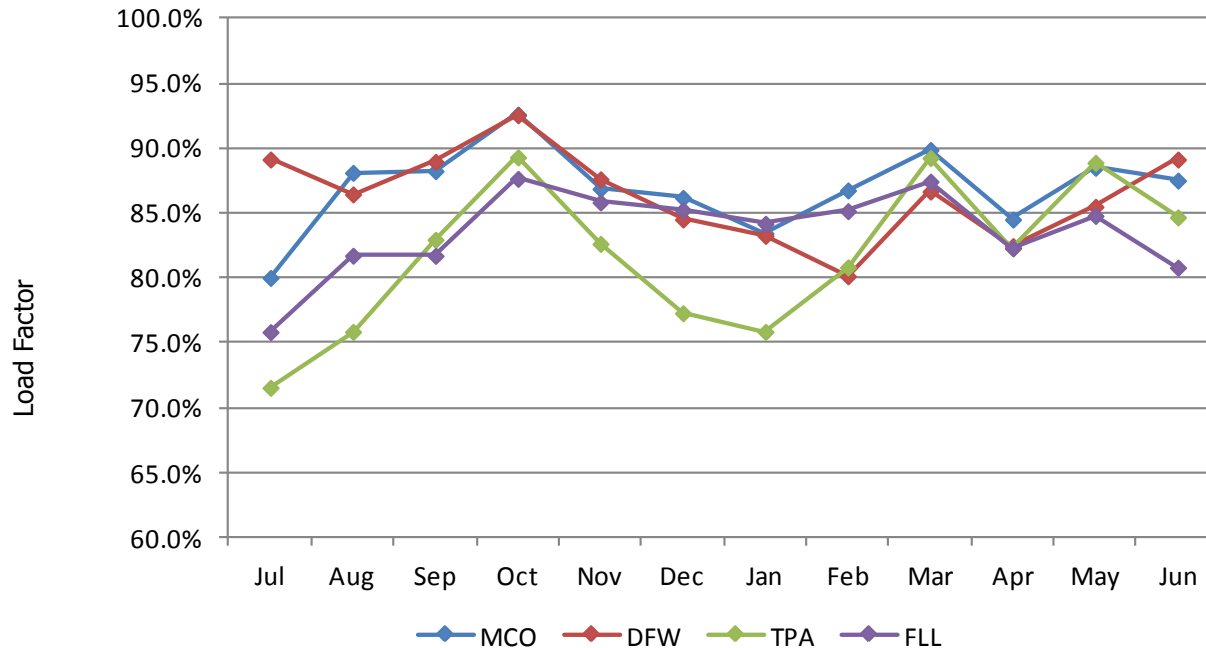
Delta ATL Load Factors to Top AirTran
Connecting Destinations over ATL
YE Q2 2011



US Airways CLT: New Opportunity

- Current US Airways load factors to the AirTran top connecting destinations over ATL are high, indicating there may be opportunity for increased frequency/gauge at CLT to capture these passengers

US Airways CLT Load Factors to Top AirTran
Connecting Destinations over ATL
YE Q2 2011



Conclusion: What The Future Holds at ATL

- The merged Southwest/AirTran strategy of depending on ATL local O&D will reduce ATL enplanements by at least 4.3 million, based on spilled connecting passengers
- The total scope of the WN operation at ATL is unclear, based on the high levels of current nonstop service at ATL (Delta and other carriers) and the clear requirement that connecting traffic is essential to meeting the competition, particularly from DL
- The hard truth is that some smaller communities currently served by AirTran at ATL will likely be eliminated in the process, which will also displace numerous connecting passengers over ATL on the current AirTran network
- These displaced passengers will need to connect at a different hub, and the logical beneficiary will be the US Airways and STAR Alliance hub at CLT
- ATL enplanements stand to decrease by 5-10% due to the new Southwest strategy of focusing on local O&D