



\$4 Billion and Counting:

Restructuring at the World's Biggest Airline

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Outline

- How Did the Need Arise?
- When Did We Realize It?
- What Solutions Have Been Tried Before?
- What Did American Airlines Do?
- Is It Working?
- What's Next?

How Did The Need Arise?

- Regulation
 - Controlled Prices
 - Service Competition
 - Regulation for Parity



How Did The Need Arise?

- Regulation
- High Fixed/Low Marginal Costs
 - Food
 - Comfort
 - Convenience

How Did The Need Arise?

- Regulation
- High Fixed/Low Marginal Costs
- Highly Trained, Heavily Unionized Employees
 - Pattern Bargaining
 - Difficulty Withstanding (even) a Strike (threat)
 - Seniority-based pay structure “punishes” carriers with more senior workforce

How Did The Need Arise?

- Regulation
- High Fixed/Low Marginal Costs
- Highly Trained, Heavily Unionized Employees
- Highly Cyclical Industry
 - Long lead time on aircraft delivery

How Did The Need Arise?

- Regulation
- High Fixed/Low Marginal Costs
- Highly Trained, Heavily Unionized Employees
- Highly Cyclical Industry
- Customers Value Network Scope
 - Carriers desire to add capacity is a classic Prisoner's Dilemma



When Did We Realize It?

- In the 1980s
 - Southwest emerges as a force
 - Others (PeopleExpress/NY Air) come and go
 - Eastern/Pan Am/Western/Air Cal disappear
- In the 1990s
 - Transition Plan
 - Value Pricing
 - Internet
- In the 2000s
 - LCCs
 - Corporate Travel Management
 - 9/11

What Solutions Have Been Tried Before?

- Simplification
- Downsizing
- Bankruptcy
- Near-Bankruptcy



What Did AA Do/Are We Doing?

- Simplification
- Downsizing
- Near-Bankruptcy





Restructuring at American





AA Restructuring Timeline

- 2001**
 - Business Travel drops sharply in 2001Q1
 - 9/11 - Company identifies first \$1Bil in savings
- 2002**
 - Don Carty forms Cost Reduction Team
 - Team sets additional \$4 Billion target
 - Unions engaged, as bankruptcy threat looms
- 2003**
 - Deadlines set, as cash dwindles
 - \$1.8 Billion cost reduction deals struck
 - The Perfect Storm subsides, as costs plunge, revenue rebounds (modestly), and financing opportunities return
- 2004**
 - Margins are better, but not good



What Did We Do?

- Schedule Efficiency
 - Hub Depeaking
 - Aircraft Utilization

What Did We Do?

- Schedule Efficiency
- Simplification
 - Fleet standardization (types and configurations)
 - Food service
 - Onboard products



What Did We Do?

- Schedule Efficiency
- Simplification
- Automation/Self-Service
 - Kiosks for Self Service at Airports
 - Voice Response Systems in Res
 - Web functionality

What Did We Do?

- Schedule Efficiency
- Simplification
- Automation/Self-Service
- Distribution Costs
 - EveryFare
 - Web Fare deals with GDS's
 - AA.com functionality/promotion

What Did We Do? - continued

- And, of course, labor deals
- Unionized employees
 - Salary reductions
 - Work rule changes, resulting in layoffs
 - Benefits changes
- Non-union employees
 - Similar changes
 - Layoffs, resulting in more workload

Is It Working?

- Our unit cost (excluding fuel) are down 20%
 - Now the lowest among the big, legacy carriers
- Our margins are much improved, although still (slightly) negative
- The capital markets are, once again, open to us

What's Next?

- The first \$4 Billion is not yet done
- We are already working on the next tranche of cost savings
 - ORD Restructure
- Probably never done

