

Airlines

AMR v6.0: Additional Thoughts on Consolidation

We are underwhelmed with AMR's standalone restructuring plan, insofar as it fails to adequately address the decade-long marginalization of its domestic network, in our view. For this reason, we now ascribe a higher probability that AMR ultimately engages in industry consolidation – and whether or not this happens in court or post exit is likely dependent on whether the creditors' committee (notably labor and the PBGC) can be won over by potential suitors. As an update to our early January piece, we believe the merits and regulatory challenges of an LCC-AMR combination warrant further consideration, whereas DAL-AMR continues to strike us as a high-risk, lower-probability outcome. Additionally, we more fully address "pensionomics" – our framework for analyzing certain issues related to the math and economic implications of AMR's "freeze" versus the "terminate" pension dilemma.

- **We hope to see you next week.** Please join us March 13-15 for the J.P. Morgan Aviation, Transportation & Defense conference in New York. Alaska, Delta, JetBlue, Southwest, United Continental, US Airways, Air Canada, Copa, easyJet, GOL, AerCap, Aircastle, Air Lease, Avolon, CIT, FLY, Bombardier, Boeing, and EADS, among other presenters, should be of interest to airline and aircraft investors.
- **We'll start with the usual caveats.** The Wall Street Journal (January 12th and 13th) postulated on AMR's consolidation prospects, citing ongoing merger reviews by US Airways and Delta. As AMR remains well inside its exclusivity period, we don't believe further consolidation is likely imminent. But there's little to prevent US Airways and Delta from starting to engage AMR's creditors' committee (particularly the Pension Benefit Guaranty Corporation or PBGC and labor), alliance members, and investors. The second half of 2012 could well be defined by these efforts. Our focus, for now, is on the network merits of AMR-inclusive consolidation.
- **We're underwhelmed with aspects of AMR's restructuring plan.** AMR's proposal to mark labor costs to market and terminate its pension is consistent with our initial views. Where the plan falls short, in our opinion, is in addressing the decade-long marginalization of its domestic market. AMR's proposed \$1 billion of incremental revenue, comprising merely increased code-sharing and larger RJs, strikes us as ambitious, and would not solve what we see as its domestic deficiencies relative to superior network alternatives available at Delta and United.
- **AMR's RASM has been sliding for quite some time.** At various points over the past decade, AMR has enjoyed a RASM premium to both Legacies and Discounters. But a sharp deterioration has taken place over the past several years. It is unclear if AMR's standalone plan adequately addresses this phenomenon.
- **Delta and United networks offer more to corporate travelers.** We examined several smaller cities east of the Mississippi and in most examples found Delta and United offer several hub options. In AMR's case, well, one can easily get to Chicago. For many, this is adequate if headed to California, but insufficient if headed to most points in Asia, Europe, or Latin America. While AMR hopes to dominate local hub markets, feed to/from said hubs appears lacking, in our view.

See page 13 for analyst certification and important disclosures.

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- **From a network and regulatory perspective, LCC-AMR makes sense to us.** Based on our analysis, AMR has fallen to 4th place in the largest non-hub Eastern and Western markets, though maintains a #2 rank in the Midwest. An LCC-AMR combination would likely rank #2 in the East and West, and #1 in Midwest.
- **We see substantially greater regulatory risks of DAL-AMR vs. LCC-AMR.** US Airways and AMR overlap in just 13 domestic markets, consistent with United-Continental and Delta-Northwest, and below Southwest-AirTran's 21. But Delta and AMR overlap in 69 markets, 28 of which would be reduced to a single carrier, and 38 of which are anchored to New York. As we've noted in the past, the likely regulatory carve-outs implied by Delta-AMR would be significant, in our view.
- **LCC-AMR doesn't rock the alliance boat.** IAG CEO Willie Walsh recently cited significant antitrust issues associated with a potential Delta-American combination, while leaving the door open, in our view, to a US Airways-American tie-up. We aren't surprised. Adding US Airways' Philadelphia hub and potentially Charlotte to oneworld would net 33 new Eastern US cities for British Airways (International Airlines Group) that AMR doesn't presently serve. Unlike Delta-American, which would significantly disrupt the alliance triumvirate and potentially disturb European regulators, US Airways-American is unlikely to pose any such hurdle, in our view.
- **But Delta likely has significantly deeper pockets than US Airways.** Ultimately, we believe Delta has significantly greater access to capital and credit to pursue consolidation than does US Airways. Whether this emboldens Delta to pursue a deal of significant regulatory uncertainty is unclear to us – Delta remains tight-lipped on the topic. Overall, US Airways-AMR appears more feasible from a network and regulatory perspective than does Delta-AMR, but that's not to imply AMR entering into a potential transaction with either is a foregone conclusion.
- **Ultimately, it may not be AMR's call.** AMR sat out the industry's recent consolidation cycle and prefers to stay the independent course going forward, based on recent comments. But from the outset of its bankruptcy, we've felt a potential suitor could look to court not only the three unions on the AMR creditors' committee, but the PBGC itself. A scenario in which merger synergies are partially shared with unions and a pension termination is avoided could potentially sway the committee in favor of consolidation, in our view. And of course, Delta and Northwest resisted merger temptation until after completing their reorganizations. While US Airways likely may prefer a pre-emergence transaction (based on the precedent of its 2006 bid for Delta), a successful AMR reorganization does not necessarily assure the wheels of industry consolidation grind to a halt, though it could slow the process.
- **Introducing "pensionomics."** We explain our rather simplistic but hopefully effective framework for analyzing some of the issues related to the math and economic implications of the "freeze" versus the "terminate" pension dilemma. AMR management, potential AMR suitors, labor, the PBGC, and other stakeholders are likely to spend a lot of time considering the implications of different pension outcomes as they pertain to AMR valuation and, more importantly, AMR's ultimate fate.

Investment Thesis

We don't believe the wheels of consolidation have stopped spinning

AMR opted to sit out the industry's consolidation cycle, and as evidenced by recent management comments prefers to stay the independent course going forward. As part of this effort, American is targeting \$1 billion of incremental annual revenue, roughly one-third of which is expected to come in the form of increased domestic and international code-sharing, the rest from a more relaxed scope clause allowing the use of larger regional jets.

We are skeptical in this regard. For starters, the implied ~\$700 million of RJ benefit could end up being temporary share shift, in our view. Few residents of Savannah are expected to get off the couch and fly to Dallas merely because American has up-gauged to larger RJs with first class cabins. However, *existing passengers* originating in Savannah may well choose an improved American product via Dallas vs. the existing 50-seat options that exist via Chicago and Houston. It appears that American's analysis assumes United (in this particular example) likely would turn a blind eye and allow its Savannah share to migrate to American. On the contrary, we would expect United, Delta, and others to respond to any product-related share shift with their own combinations of pricing, schedule, and product enhancements . . . suggesting that, over time, American's ~\$700 million of incremental revenue, in all likelihood, will simply be competed away.

Secondly, American's \$1 billion revenue plan seems to offer little (based on what's been publicly disclosed) in regards to halting AMR share erosion in non-hub markets. Granted, American hopes to dominate the local market in its cornerstone hub markets and in theory could succeed in JFK, Chicago, Dallas, Los Angeles, and Miami. But demand in the hundreds of smaller US cities is still likely to gravitate to the more robust global networks afforded by Delta and United (keep reading).

Enter potential consolidation. As we discussed in [AMR v5.0](#), AMR appears "in play," with both Delta and US Airways having reportedly retained advisors to assess possible bids for AMR. **With AMR well inside its exclusivity period, we don't believe anything is likely imminent.** That said, there's little to prevent US Airways and Delta from starting to engage members of AMR's creditors' committee (particularly the labor unions and the PBGC), alliance members, and investors. In fact, we would be surprised if consolidation (specifically related to AMR) did not form the preponderance of investor focus near term, and share some of our own network observations in this report. We look forward to any associated company commentary at next week's [J.P. Morgan Aviation, Transportation & Defense Conference](#) in New York.

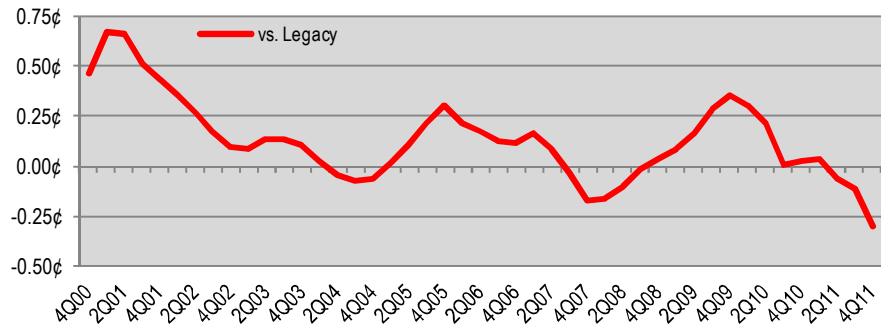
There seems little doubt that AMR RASM is in trouble

From time to time over the past decade, AMR has maintained a modest RASM premium to both its Legacy and Discount peers. Relative to Legacies in particular, AMR was able to strengthen its relative RASM until around the end of 2009, at which point it began a precipitous decline (see Figure 1) that even its long-awaited antitrust immunity with British Airways (in late 2010) doesn't appear to have

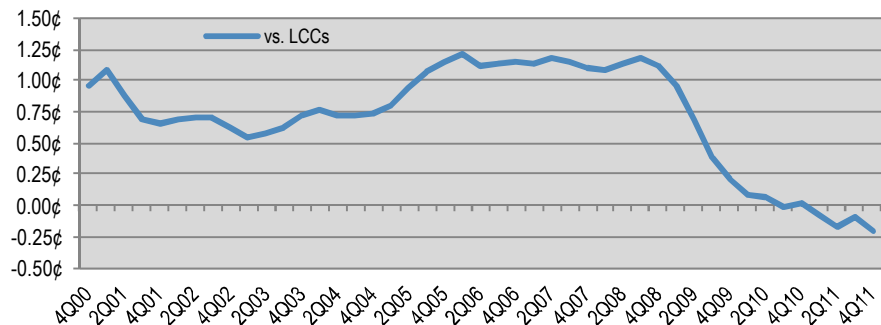
reversed. Relative to Discounters, AMR also exhibited a significant decline, and in 2011 operated at a modest *deficit*.

Figure 1: AMR's RASM Has Steadily Eroded Relative to its Legacy and Discounter Peers

AMR RASM Relative to Legacy Airlines



AMR RASM Relative to Low Cost Carriers



Source: Company filings and J.P. Morgan.

AMR's RASM deterioration is a function, in part, of sitting out consolidation

The acceleration in AMR's relative RASM decline appears broadly coincident with the increased pace of industry consolidation: US Airways-America West in 2005, Delta-Northwest in 2008, United-Continental in 2010, and (to a lesser extent) Southwest-AirTran in 2011. Basically, Delta and United, in particular, appear to offer more to high-yielding corporate travelers. We took a random sample of small to moderate non-hub East Coast cities, and found that, in most examples, Delta and United simply bring more to the corporate table (see Figure 2 on the next page).

For example, imagine a corporate manager in Buffalo, New York. Buffalo is well-served, with daily Delta departures to Atlanta, Detroit, JFK, LGA, and Minneapolis. This puts corporate travelers within a single stop of most of the world's major cities: South America via Atlanta, Europe via JFK, Asia via Detroit, and so forth. Similarly, the United footprint offers Buffalo-originating travelers similar one-stop destinations via connections in Chicago, Cleveland, Newark, and Washington.

Enter American. From Buffalo, American offers daily service to Chicago. That's it. While no doubt sufficient for the West Coast-bound traveler, the *global* traveler (likely the least price sensitive and most profitable) is unlikely to choose American. From Albany the example is starker still: American doesn't serve the capital of New York. While AMR's network offering in certain markets appears adequate (e.g.,

Pittsburgh), we believe the corporate appeal of its network is significantly handicapped against that of Delta and United.

Figure 2: Delta and United Tend to Offer More Hub Alternatives in Smaller Markets

Small to Moderate East Coast Hubs

Cities		AA	DL	UAL
Albany	ALB	-	DTW	IAD
			JFK	ORD
			LGA	
			MSP	
Baton Rouge	BTR	DFW	ATL	IAH
			MEM	
Buffalo	BUF	ORD	ATL	IAD
			DTW	ORD
			JFK	CLE
			LGA	EWR
			MSP	
Burlington	BTV	-	DTW	IAD
			JFK	ORD
			LGA	CLE
				EWR
Columbia	CAE	DFW	ATL	IAD
			DTW	ORD
			LGA	IAH
Greensboro	GSO	DFW	ATL	IAD
			MIA	ORD
			DTW	EWR
			LGA	IAH
Pittsburgh	PIT	DFW	ATL	DEN
			JFK	IAD
			MIA	LAX
			ORD	ORD
			MEM	SFO
			MSP	CLE
Providence	PVD	-	ATL	IAD
			DTW	ORD
			MSP	CLE
				EWR
Raleigh/Durham	RDU	DFW	ATL	IAD
			JFK	ORD
			MIA	CLE
			ORD	EWR
			LAX	IAH
			LGA	
			MEM	
MSP				
Richmond	RIC	DFW	ATL	IAD
			MIA	ORD
			ORD	CLE
			JFK	EWR
			LGA	IAH
	MSP			

Source: OAG and J.P. Morgan.

American is #4 in the East and West, #2 in Midwest

To further understand AMR’s RASM deterioration, we looked at the nation’s largest non-hub markets, broken down by geography. As shown in Figure 3, American has slipped to 4th place in both East and West Coast markets, while it has maintained a respectable #2 position in the Midwest. We believe this also explains its revenue deterioration, and is unlikely to be addressed simply through American’s plans to dominate the local markets in JFK, Chicago, Dallas, Los Angeles, and Miami. Furthermore, as United more fully integrates Continental’s network into its own, further share slippage at AMR is likely, in our view.

Figure 3: American Has Slipped to #4 in the East and West

% Market Share by Region, Based on the Top Non-Hub Markets

Airlines	East	Airlines	MidWest	Airlines	West
1 DL	25.5%	1 WN	23.6%	1 WN	22.5%
2 WN	20.7%	2 AA	22.7%	2 UA	16.0%
3 UA	12.9%	3 DL	21.5%	3 DL	15.1%
4 AA	11.6%	4 UA	10.2%	4 AA	13.8%
5 US	11.3%	5 US	4.7%	5 AS	13.3%
6 B6	7.4%	6 F9	1.7%	6 US	8.1%
7 F9	0.4%	7 B6	0.5%	7 F9	1.8%
8 AS	0.3%	8 AS	0.4%	8 B6	1.3%

Source: OD1A and J.P. Morgan.

Note: Market share based on LTM 3Q11 revenue.

Legend: AA = American, AS = Alaska, B6 = JetBlue, DL = Delta, F9 = Frontier, UA = United-Continental, US = US Airways, WN = Southwest.

We believe a merger partner could address AMR’s domestic network challenge

From a network, alliance, and regulatory perspective, US Airways-AMR appears more achievable to us than does Delta-AMR. Granted, Delta likely has significantly greater access to capital and credit to pursue consolidation than does US Airways. But, as the smaller of the two potential partners, US Airways would appear to address most of AMR’s domestic network challenges while likely meeting the least regulatory resistance and proving the least disruptive to the current framework of global alliances.

The network perspective is simple enough

As previously mentioned, US Airways-AMR would vault the combined entity to a #2 position in non-hub revenue share among the largest Eastern and Western cities, and #1 in the Midwest. Admittedly, the paucity of Asian service remains a challenge, relative to the Pacific-laden options afforded by Delta and United. In this regard, we believe the combined entity would need to pursue organic growth, through the acquisition of Boeing 787s and 777-300ERs, both of which AMR currently has on order (42 787s and 10 777-300ERs).

US Airways-AMR appears less problematic from an alliance perspective

Delta-AMR poses a significant alliance challenge, in our view, as it implies either a defection from SkyTeam by Delta or a defection from oneworld by AMR. Granted, the winning alliance would probably be thrilled by such an outcome, though we question the willingness of regulators (particularly in Europe) to approve a transaction that would harm Air France/KLM (the scenario in which Delta defects) or British Airways (the scenario in which AMR defects). Indeed, recent comments from

IAG’s CEO, Willie Walsh, seem to confirm as much, while simultaneously leaving the door open (in our opinion) to US Airways-AMR.

*“There has been speculation around a potential bid by Delta and US Airways. And I think there have been other names being mentioned. Our view is that this is always a possibility. **Delta-American Airlines would be a phenomenal entity, but would face, I think, very significant antitrust issues in the U.S. Whether that would be possible or not, it’s just really difficult to call. So it’s an interesting one to look at. US Airways and American, that’s potentially a positive development. I’m sure American would want to control that and they’re not very enthusiastic about the sounds that have come from Doug Parker of US Airways.**”*

– William (“Willie”) Walsh, CEO International Consolidated Airlines Group, Q4 2011 Earnings Call (02-29-2012)

Additionally, adding Philadelphia (which British Airways already serves) and Charlotte (which it does not) to the oneworld alliance would net 33 additional Eastern cities to the alliance that AMR presently does not serve. Furthermore, we would not view the defection of US Airways from the Star Alliance to oneworld as material given US Airways domestic participation in Star has been significantly marginalized, in our view, by United’s merger with Continental.

Figure 4: There Are 33 Eastern Cities that US Airways Could Link to oneworld that AMR Can’t

Airports that US Airways Serves from PHL/CLT that AMR Does Not

Cities	Codes	Cities	Codes
Allentown	ABE	Long Island	ISP
Albany	ALB	Ithaca	ITH
Asheville	AVL	Lynchburg	LYH
Wilkes Barre/Scranton	AVP	Manchester (Boston Regional)	MHT
Binghamton	BGM	Melbourne	MLB
Bangor	BGR	Myrtle Beach	MYR
Burlington	BTV	Jacksonville	OAJ
Akron/Canton	CAK	Greenville	PGV
Daytona Beach	DAB	Newport News/Wmbg	PHF
Elmira	ELM	Providence	PVD
Erie	ERI	Portland	PWM
New Bern	EWN	Roanoke	ROA
Florence	FLO	Salisbury/Ocean City	SBY
Hilton Head Isl.	HHH	State College	SCE
Huntington	HTS	Sarasota/Bradenton	SRQ
New Haven	HVN	Newburgh	SWF
Williamsport (Regional)	IPT		

Source: OAG and J.P. Morgan.

The regulatory case seems fairly straightforward

The US Department of Justice has cleared several mergers in which overlapping domestic competition is limited to just a few dozen segments (typically hub-to-hub flying, such as Atlanta to Detroit). For example, Delta-Northwest overlapped in just 12 markets, only four of which were left with a single carrier post-merger. In the case

of United-Continental, the total was 14, eight of which were left with a single carrier. Southwest-AirTran posed a slightly greater challenge though was ultimately approved, despite 21 overlapping markets (principally to/from Baltimore and Orlando) with 15 single-carrier routes.

US Airways-AMR therefore appears consistent with recent DOJ precedent: 13 overlapping domestic markets, eight of which would be left with a single carrier post-merger. However, Delta-AMR appears problematic to us: 69 markets in common, 28 of which would be left with just one carrier, and 38 of which are anchored to New York. While we can't be certain that this would exceed DOJ's comfort level, we would envision a likely significant number of DOJ-mandated carve-outs, potentially requiring the involvement of Southwest, JetBlue, and/or other Discount airlines (which, for example, would potentially dilute the merger benefits in New York).

Figure 5: US Airways-AMR Appears Consistent with Recent Mergers, Based on Domestic Overlap

Domestic Non-Stop Overlaps

	Pre-merger	Following a merger, the number of non-stops with...		
		3 or more carriers	2 carriers	Single Carrier
US Airways/American*	13	1	4	8
Delta/American*	69	14	27	28
Southwest/AirTran	21	1	5	15
United/Continental	14	2	4	8
Delta/Northwest	12	5	3	4

Source: OAG and J.P. Morgan.

Figure 6: There Are 13 Domestic Nonstops that US Airways and AMR Have in Common

Illustrative LCC/AMR Merger Impact on Overlapping Non-Stop Markets

	Origin - Destination	Carriers	# of carriers serving city pair	
			Current	After Merger
1	BNA-DCA Nashville - Washington DC	AA US	2	1
2	CLT-DFW Charlotte - Dallas/Ft. Worth	AA US	2	1
3	CLT-LGA Charlotte - New York	AA US DL	3	2
4	CLT-MIA Charlotte - Miami	AA US	2	1
5	CLT-ORD Charlotte - Chicago	AA US UA	3	2
6	DCA-DFW Washington DC - Dallas/Ft. Worth	AA US	2	1
7	DCA-RDU Washington DC - Raleigh/Durham	AA US	2	1
8	DFW-PHL Dallas/Ft. Worth - Philadelphia	AA US	2	1
9	DFW-PHX Dallas/Ft. Worth - Phoenix	AA US	2	1
10	LAX-PHX Los Angeles - Phoenix	AA US DL UA WN	5	4
11	MIA-PHL Miami - Philadelphia	AA US	2	1
12	ORD-PHL Chicago - Philadelphia	AA US UA	3	2
13	ORD-PHX Chicago - Phoenix	AA US UA	3	2
% of non-stop markets with only 1 carrier			--	61.5%

Source: OAG and J.P. Morgan.

Legend: AA = American, DL = Delta, UA = United-Continental, US = US Airways, WN = Southwest.

Ultimately, it isn't necessarily up to AMR

AMR chose to sit out the industry's most recent consolidation cycle (post Reno Air in 1999 and TWA in 2001). We believe the network marginalization and resulting RASM deterioration associated with this stance speaks for itself. Regardless, AMR management currently intends to stick with a network plan largely unchanged relative to its pre-Chapter 11 Cornerstone plan, albeit with larger RJs and more code-sharing thrown in.

Ultimately, it may not be AMR management's call. As noted, the disclosure by Delta and US Airways that advisors have been retained may potentially be a first step to

engaging with AMR’s creditors’ committee. Whether sufficient potential merger synergies would be shared with AMR’s unions by a degree sufficient to attract their support is unclear to us – though given the fractured relationship we believe exists between AMR management and its union, this strategy could potentially have merit.

Watch the Pension Benefit Guaranty Corporation

Similarly, when facing a potential termination of its existing pensions (which we believe would be the largest such default/termination ever), the PBGC may prove willing to entertain similar discussions with potential suitors.

Keep in mind that seven out of eight DAL-sponsored pension plans (legacy DL and legacy NW) were frozen rather than terminated during their respective restructurings (and the pilot plan termination was roughly six years ago in 2006). Only the legacy UA plans within current UAL were terminated (back in 2005), while all four major legacy CO plans remain in place (pilots frozen, three others still active). The table below from the AMR restructuring website does a nice job of summarizing the airline pension landscape.

Figure 7: Summary of Airline Pension Landscape

Defined Benefit Pension Plans									
Airline	AA	CO	DL	UA	US	NW	B6	WN	FL
Pilots	Termination Proposed	Frozen	Terminated 2006	Terminated 2005	Terminated 2003	Frozen 2006	No	No	No
Flight Attendants	Termination Proposed	Yes	Frozen 2005	Terminated 2005	Terminated 2005	Frozen 2006	No	No	No
M&E	Termination Proposed	Yes	Frozen 2005	Terminated 2005	Terminated 2005	Frozen 2006	No	No	No
Agents & Reps	Termination Proposed	Yes	Frozen 2005	Terminated 2005	Terminated 2005	Frozen 2006	No	No	No

Source: <http://www.restructuringamr.com/our-people-retirement.asp>.

Since the 2005 UA terminations and the 2006 DL pilots termination, the PBGC solvency situation has only deteriorated further (\$26bn underfunded last year, with AMR’s potential termination a ~\$9bn hit).

Given the recent success at UAL and DAL in generating at least a modest return on invested capital despite these airlines’ smaller but nonetheless still significant pension burdens, we think AMR’s insistence that it “must terminate pensions to survive” could ultimately fall on deaf ears with the court (and of course with labor) . . . and, more importantly, with Washington.

Recall that The Pension Protection Act of 2006 allows airlines with non-frozen pension plans and >80% funding to use an 8.25%¹ discount rate through 2017 (a benefit that the PBGC estimated recently saved AMR \$2.1bn over the last six years). Furthermore, under the 2010 Pension Relief Act, airlines are afforded a 15-year amortization period on pension underfunding.

We have written repeatedly about this in-place relief and the potential for Congress to step in with further tweaks to the pension laws if such actions could lead to a non-termination outcome for the PBGC in the AMR case. Any suitor (LCC or DAL, for example) that proposes a hard freeze rather than a pure termination might be able to

¹ Airlines with frozen plans, such as Delta, are afforded use of an 8.85% discount rate.

win the favor of the AMR creditors' committee versus an AMR standalone plan based on a termination.

This is complicated. LCC's unions have already seen their pensions terminated. In our view, any potential deal between LCC and AMR likely would need to include a significant level of compensation to appease labor on both sides (and while we don't explore potential synergies in this note, we think the headline synergy estimate from a LCC-AMR combination is likely to be large enough to allow the savings to be shared significantly with both labor and other stakeholders). On the DAL side, any pension discussion must also consider the issue of labor unionization risk and the fact that DAL pilots have already seen their plan terminated.

Also keep in mind that DAL management is on record with comments that, had they known the stock market would subsequently perform as poorly as it did post their emergence from the court process in April 2007, a harder push would have been made to terminate pensions beyond just the pilots plan (DAL is guiding to a not-insignificant \$650-675mm in 2012 pension funding).

Each of the AMR plans are fairly equally underfunded. Some have asked about the potential that AMR might choose to terminate only certain plans. While the pilots have the most at risk given their higher all-in compensation and therefore higher promised benefits versus the PBGC caps on paid benefits under termination scenarios, we don't have enough information to opine on the economics of terminating certain plans over others.

We expect to hear a lot more about the pension situation over the course of the coming months. We would not be surprised if LCC were to include in a formal bid for AMR a pension freeze proposal dependent on an extension of the discount rate relief beyond 2017 and perhaps more importantly the underfunded amortization period beyond 2025 (see below for why this matters most). While this would require an act of Congress and some may consider any tweaks to the already-relaxed airline-specific pension rules "corporate welfare," the alternative of full termination might be more troublesome. We think DAL would be less likely to incorporate a pension freeze into any potential bid for AMR, but we certainly expect it to consider how it too likely could court the PBGC as well.

"Pensionomics"

For those invested in or considering AMR unsecured debt and claims (the future AMR equity), "pensionomics" are a very real consideration and something we plan to spend a lot more time on going forward. Below we outline a framework for how one might want to start considering the math of the pension burden and PBGC situation, ignoring for now the very real possibility of the PBGC under a termination receiving both secured and unsecured claims and future compensation in the form of promissory notes (as realized in the UAL case). Under a termination, we doubt the PBGC would want to own/control ~50% of AMR's future equity and the negotiated outcome would therefore likely seek to avoid this.

First, let's review a full termination scenario. We estimate an AMR unsecured claims pool of \$8 billion excluding the PBGC claim (an estimate, of course, that could change as claims are validated), or potentially \$15bn+ with some sort of negotiated claim with the PBGC. In AMR v4.0, we laid out our framework for AMR exit run-rate EBITDAR in the \$2.5-\$3.0bn range . . . a conservative estimate made before

AMR laid out its own ambitious “\$3bn by 2017” improvement plan (\$1bn in revenue, \$2bn in cost). We think a revised fair estimate for AMR exit EBITDAR is \$3.0-\$3.5bn, so we use \$3.25bn as a midpoint. At a 5x post-emergence EBITDAR multiple (a multiple higher than the current trading levels for UAL and DAL, but one we think is deserved and expected in our opinion as more investors revisit the sector; see AMR v4.0 for our EBITDAR multiple discussion), AMR would be valued at \$16.25bn plus projected cash of \$3.5bn (down from today’s ~\$4bn and of course dependent on oil and timing of cost savings) for total enterprise value of \$19.75bn. We must net \$14bn in estimated secured claims (simply an estimate, this number can certainly change as well depending on how the 7.5% routes/slots/gates bonds are settled and AMR’s progress on aircraft) for a “residual” \$5.75bn in value left over for the unsecured claims. If the unsecured claims pool is \$15bn, this implies future value of 38%, which when adjusted for time value is pretty close to the current low \$0.30 market on AMR unsecured debt/claims. Keep in mind that this analysis includes any premium (value creation) under a potential LCC or DAL merger offer, so even if the plans are terminated, AMR unsecured holders could realize significant upside still (while downside could result from an oil spike taking its toll on exit EBITDAR assumptions, for example).

If we switch gears and assume the pension plans are capped and frozen rather than terminated, EBITDA must be adjusted for the pension burden. And therein lies the rub. AMR wouldn’t have to fully amortize the full \$9bn termination figure but would likely need to address maybe two-thirds of it when the pension math and discount rate relief kick in, say \$6bn, though the 2025 amortization expiry (this \$6bn estimate is also roughly the same as the GAAP pension underfunded amount per AMR’s 2010 10K). Simple math tell us that this ~\$460mm average annual burden should be deducted from the EBITDAR run-rate, taking our estimate at its midpoint down to ~\$2.8bn (ignoring for now the net interplay between the shift of employee retirement costs from the defined benefit plan to the replacement defined contribution plans). Using a slightly lower 4.75x multiple to reflect the added risk of the ongoing pension burden, we calculate \$13.3bn plus the same \$3.5bn in cash for total enterprise value in this case of \$16.8bn. Deducting the same \$14bn in secured claims leaves us with \$2.8bn to satisfy the now much smaller \$8bn claims pool, or 35% recovery. Note that this recovery is in the same ballpark as the prior scenario, and all else being equal stakeholders would prefer of course the scenario in which the enterprise is not burdened with the ongoing pension cost.

However, if AMR were allowed to amortize the pension deficit over 25 years beginning upon exit, then the annual burden could be reduced to only \$240mm (the same \$6bn over 25 years), leaving adjusted EBITDAR of ~\$3.0bn (again ignoring the DB vs. DC cost adjustments). Running through the same math, the recovery would improve to 47%. More to come as we tweak this analysis once the section 1113 (rejection of collective bargaining agreements) and section 1114 (retiree benefits) battle heats up, but hopefully we’ve outlined some of these issues and how they impact our view on AMR claims value going forward.

Figure 8: The List of Overlapping Delta and AMR Domestic Nonstops Is Exhaustive

Illustrative DAL/AMR Merger Impact on Overlapping Non-Stop Markets

	Origin - Destination	Carriers	# of carriers serving city pair		
			Current	After Merger	
1	ATL-DFW	Atlanta - Dallas/Ft Worth	AA DL NK	3	2
2	ATL-LGA	Atlanta - New York	AA DL FL	3	2
3	ATL-MIA	Atlanta - Miami	AA DL	2	1
4	ATL-ORD	Atlanta - Chicago	AA DL UA	3	2
5	AUS-JFK	Austin - New York	AA DL B6	3	2
6	BNA-JFK	Nashville - New York	AA DL	2	1
7	BNA-LGA	Nashville - New York	AA DL	2	1
8	BOS-JFK	Boston - New York	AA DL B6	3	2
9	BWI-JFK	Baltimore - New York	AA DL	2	1
10	CLE-JFK	Cleveland - New York	AA DL	2	1
11	CLE-LGA	Cleveland - New York	AA DL UA	3	2
12	CLT-LGA	Charlotte - New York	AA DL US	3	2
13	CMH-JFK	Columbus - New York	AA DL	2	1
14	CMH-LGA	Columbus - New York	AA DL	2	1
15	CVG-DFW	Cincinnati - Dallas/Ft Worth	AA DL	2	1
16	CVG-JFK	Cincinnati - New York	AA DL	2	1
17	CVG-MIA	Cincinnati - Miami	AA DL	2	1
18	CVG-ORD	Cincinnati - Chicago	AA DL UA	3	2
19	DCA-JFK	Washington DC - New York	AA DL	2	1
20	DFW-DTW	Dallas/Ft. Worth - Detroit	AA DL	2	1
21	DFW-JFK	Dallas/Ft. Worth - New York	AA DL	2	1
22	DFW-LGA	Dallas/Ft. Worth - New York	AA DL NK	3	2
23	DFW-MEM	Dallas/Ft. Worth - Memphis	AA DL	2	1
24	DFW-MSP	Dallas/Ft. Worth - Minneapolis/St. Paul	AA DL SY	3	2
25	DFW-SLC	Dallas/Ft. Worth - Salt Lake City	AA DL	2	1
26	DTW-LGA	Detroit - New York	AA DL NK	3	2
27	DTW-MIA	Detroit - Miami	AA DL	2	1
28	DTW-ORD	Detroit - Chicago	AA DL NK UA	4	3
29	FLL-JFK	Ft. Lauderdale - New York	AA DL B6	3	2
30	HNL-LAX	Honolulu Oahu - Los Angeles	AA DL UA HA	4	3
31	IAD-JFK	Washington DC - New York	AA DL B6 UA	4	3
32	IAD-LGA	Washington DC - New York	AA DL UA US	4	3
33	IND-JFK	Indianapolis - New York	AA DL	2	1
34	JFK-LAS	New York - Las Vegas	AA DL VX B6	4	3
35	JFK-LAX	New York - Los Angeles	AA DL UA VX B6	5	4
36	JFK-MCO	New York - Orlando	AA DL B6	3	2
37	JFK-MIA	New York - Miami	AA DL	2	1
38	JFK-ORD	New York - Chicago	AA DL B6	3	2
39	JFK-ORF	New York - Norfolk/Va.Bch/Wrbg	AA DL	2	1
40	JFK-PIT	New York - Pittsburgh	AA DL B6	3	2
41	JFK-RDU	New York - Raleigh/Durham	AA DL B6	3	2
42	JFK-SAN	New York - San Diego	AA DL B6	3	2
43	JFK-SEA	New York - Seattle/Tacoma	AA DL B6	3	2
44	JFK-SFO	New York - San Francisco	AA DL UA VX B6	5	4
45	JFK-SJU	New York - San Juan	AA DL B6	3	2
46	JFK-TPA	New York - Tampa	AA DL B6	3	2
47	KOA-LAX	Kona Hawaii - Los Angeles	AA DL UA	3	2
48	LAS-LAX	Las Vegas - Los Angeles	AA DL NK UA WN	5	4
49	LAX-LIH	Los Angeles - Lihue Kauai	AA DL UA	3	2
50	LAX-MCO	Los Angeles - Orlando	AA DL UA VX	4	3
51	LAX-MIA	Los Angeles - Miami	AA DL	2	1
52	LAX-OGG	Los Angeles - Kahului Maui	AA DL UA	3	2
53	LAX-PHX	Los Angeles - Phoenix	AA DL US UA WN	5	4
54	LAX-SAN	Los Angeles - San Diego	AA DL UA	3	2
55	LAX-SFO	Los Angeles - San Francisco	AA DL UA WN VX	5	4
56	LAX-SLC	Los Angeles - Salt Lake City	AA DL UA WN	4	3
57	LAX-SMF	Los Angeles - Sacramento	AA DL UA WN	4	3
58	LGA-MIA	New York - Miami	AA DL	2	1
59	LGA-MSP	New York - Minneapolis/St Paul	AA DL	2	1
60	LGA-ORD	New York - Chicago	AA DL NK UA	4	3
61	LGA-RDU	New York - Raleigh/Durham	AA DL	2	1
62	LGA-STL	New York - St. Louis	AA DL	2	1
63	MCO-MIA	Orlando - Miami	AA DL	2	1
64	MEM-MIA	Memphis - Miami	AA DL	2	1
65	MEM-ORD	Memphis - Chicago	AA DL UA	3	2
66	MIA-MSP	Miami - Minneapolis/St. Paul	AA DL	2	1
67	MIA-TPA	Miami - Tampa	AA DL	2	1
68	MSP-ORD	Minneapolis/St Paul - Chicago	AA DL UA	3	2
69	ORD-SLC	Chicago - Salt Lake City	AA DL UA	3	2
% of non-stop markets with only 1 carrier				--	40.6%

Source: OAG and J.P. Morgan estimates.

Legend: AA = American, B6 = JetBlue, DL = Delta, HA = Hawaiian, NK = Spirit, SY = Sun Country, UA = United Continental, VX = Virgin America.

Companies Recommended in This Report (all prices in this report as of market close on 06 March 2012)

AMR Corp. (AAMRQ/\$0.45/), Delta Air Lines, Inc. (DAL/\$9.36/Overweight), JetBlue Airways Corp. (JBLU/\$4.96/Overweight), Southwest Airlines Co. (LUV/\$8.60/Neutral), US Airways Group, Inc. (LCC/\$6.88/Overweight), United Continental Holdings, Inc. (UAL/\$19.88/Overweight)

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Conflict of Interest

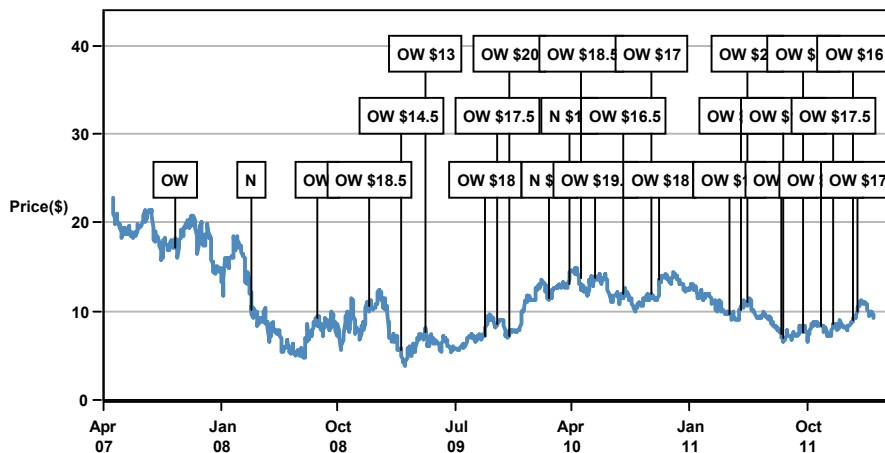
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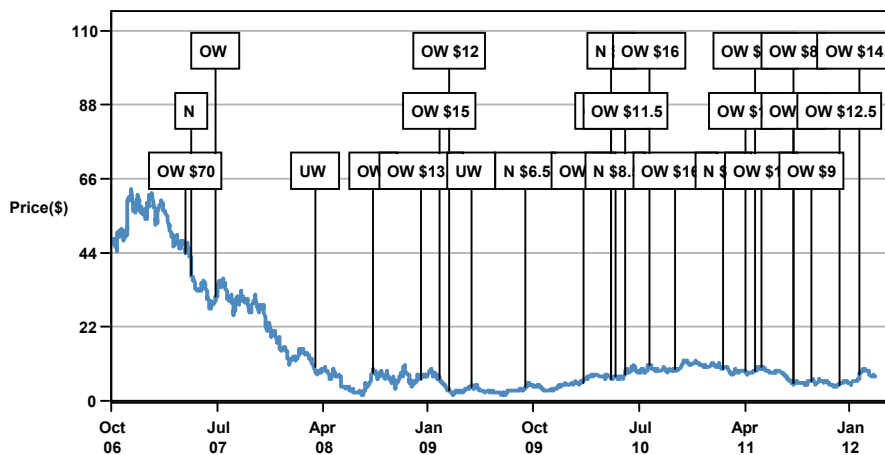
Delta Air Lines, Inc. (DAL, DAL US) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Sep 18, 2007.

Date	Rating	Share Price (\$)	Price Target (\$)
18-Sep-07	OW	17.15	-
12-Mar-08	N	10.13	-
12-Aug-08	OW	9.24	-
12-Dec-08	OW	10.50	18.50
27-Feb-09	OW	5.69	14.50
22-Apr-09	OW	7.65	13.00
10-Sep-09	OW	7.33	18.00
09-Oct-09	OW	8.67	17.50
03-Nov-09	OW	7.22	20.00
04-Feb-10	N	11.46	13.00
22-Mar-10	N	13.07	14.00
19-Apr-10	OW	13.87	18.50
25-May-10	OW	13.84	19.50
29-Jul-10	OW	11.88	16.50
01-Oct-10	OW	12.01	17.00
20-Oct-10	OW	13.53	18.00
01-Apr-11	OW	9.80	16.00
29-Apr-11	OW	10.07	18.50
16-May-11	OW	11.00	20.00
03-Aug-11	OW	7.55	16.00
04-Aug-11	OW	7.02	15.50
23-Sep-11	OW	7.58	15.00
02-Nov-11	OW	8.25	15.50
01-Dec-11	OW	8.52	17.50
18-Jan-12	OW	8.92	16.00
25-Jan-12	OW	9.96	17.00

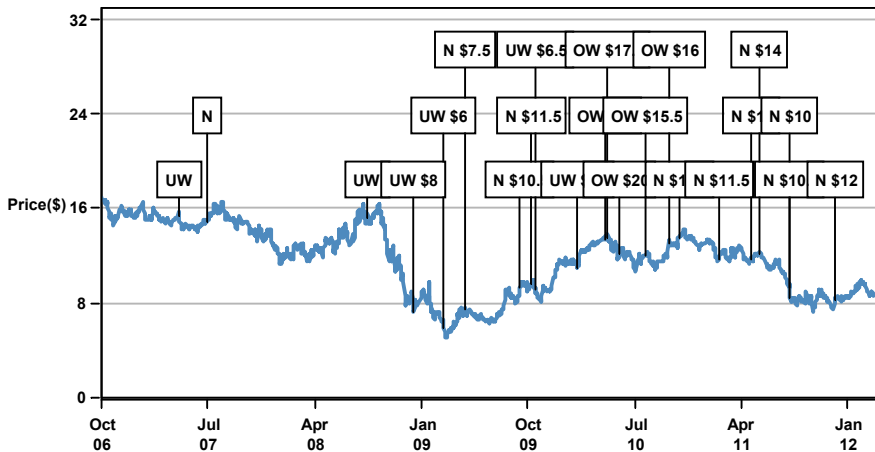
US Airways Group, Inc. (LCC, LCC US) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Break in coverage Apr 27, 2007 - Jun 28, 2007.

Date	Rating	Share Price (\$)	Price Target (\$)
12-Apr-07	OW	44.12	70.00
27-Apr-07	N	37.18	--
28-Jun-07	OW	31.00	--
12-Mar-08	UW	9.98	--
12-Aug-08	OW	8.39	--
12-Dec-08	OW	6.68	13.50
30-Jan-09	OW	6.47	15.00
27-Feb-09	OW	2.85	12.00
22-Apr-09	UW	4.36	--
10-Sep-09	N	4.02	6.50
04-Feb-10	OW	5.49	9.00
19-Apr-10	OW	7.15	11.00
22-Apr-10	N	6.76	8.00
28-Apr-10	N	7.32	8.50
25-May-10	OW	7.81	11.50
29-Jul-10	OW	10.66	16.00
01-Oct-10	OW	9.25	16.50
04-Feb-11	N	9.59	12.00
01-Apr-11	OW	8.78	12.00
29-Apr-11	OW	9.09	13.50
16-May-11	OW	9.94	18.00
03-Aug-11	OW	5.52	9.00
04-Aug-11	OW	5.52	8.00
23-Sep-11	OW	5.73	9.00
01-Dec-11	OW	4.94	12.50
25-Jan-12	OW	7.52	14.50

Southwest Airlines Co. (LUV, LUV US) Price Chart



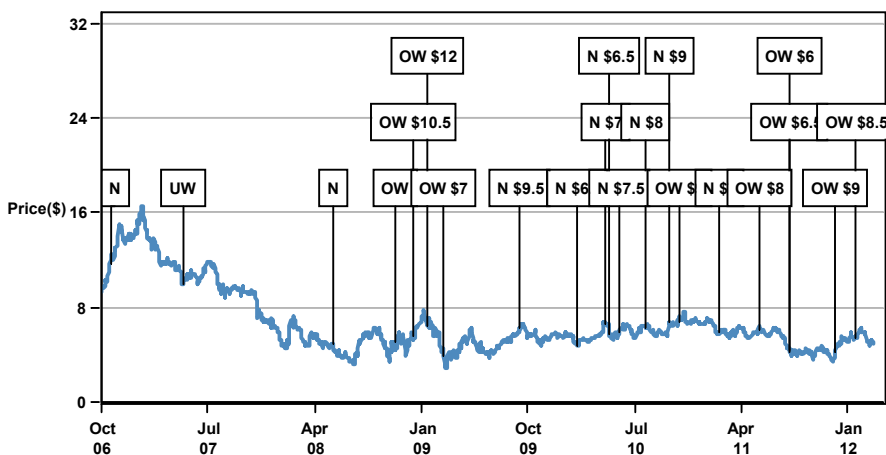
Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Apr 19, 2007.

23-Sep-11	OW	19.24	36.00
02-Nov-11	OW	18.81	39.00
01-Dec-11	OW	19.12	45.00
18-Jan-12	OW	18.25	43.50
26-Jan-12	OW	20.41	42.00

Date	Rating	Share Price (\$)	Price Target (\$)
19-Apr-07	UW	15.37	-
28-Jun-07	N	14.93	-
12-Aug-08	UW	15.27	-
12-Dec-08	UW	7.30	8.00
27-Feb-09	UW	5.89	6.00
22-Apr-09	N	7.47	7.50
10-Sep-09	N	9.25	10.50
09-Oct-09	N	9.72	11.50
19-Oct-09	UW	9.19	6.50
04-Feb-10	UW	11.03	12.00
19-Apr-10	OW	13.38	17.00
22-Apr-10	OW	13.58	17.50
25-May-10	OW	12.16	20.00
29-Jul-10	OW	12.01	15.50
01-Oct-10	OW	13.07	16.00
25-Oct-10	N	13.47	15.50
04-Feb-11	N	11.68	11.50
29-Apr-11	N	11.75	11.00
16-May-11	N	12.14	14.00
03-Aug-11	N	9.39	10.50
04-Aug-11	N	8.47	10.00
01-Dec-11	N	8.33	12.00

Date	Rating	Share Price (\$)	Price Target (\$)
25-Oct-06	N	11.67	-
27-Apr-07	UW	10.00	-
19-May-08	N	4.87	-
23-Oct-08	OW	5.02	-
12-Dec-08	OW	5.55	10.50
14-Jan-09	OW	6.44	12.00
27-Feb-09	OW	3.81	7.00
10-Sep-09	N	6.19	9.50
04-Feb-10	N	4.72	6.50
19-Apr-10	N	6.63	7.00
28-Apr-10	N	5.77	6.50
25-May-10	N	5.90	7.50
29-Jul-10	N	6.33	8.00
01-Oct-10	N	6.69	9.00
25-Oct-10	OW	6.84	9.00
04-Feb-11	N	5.93	7.00
16-May-11	OW	6.14	8.00
03-Aug-11	OW	4.40	6.50
04-Aug-11	OW	4.18	6.00
01-Dec-11	OW	4.30	9.00
18-Jan-12	OW	5.38	8.50

JetBlue Airways Corp. (JBLU, JBLU US) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Oct 25, 2006.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

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IB clients*	72%	62%	58%

*Percentage of investment banking clients in each rating category.

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