

US American is Clear For Takeoff

We think AMR bondholders and US Airways Shareholders are poised to benefit.

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Delta (DAL) ★★★			
Moat: None	Moat Trend: Stable		
Currency: USD	Credit Rating: B-		
Mkt Cap: 10.03 B	Uncertainty: Extreme		
Mkt Price: 10.61	Fair Value: 11.00		
	2011A	2012E	2013E
Cons EPS	1.01	2.28	2.70
P/E	10.5x	4.7x	3.9x

Southwest (LUV) ★★★★			
Moat: None	Moat Trend: Stable		
Currency: USD	Credit Rating: BBB-		
Mkt Cap: 6.86 B	Uncertainty: Very High		
Mkt Price: 8.8	Fair Value: 12.00		
	2011A	2012E	2013E
Cons EPS	0.43	0.71	1.03
P/E	20.5x	12.4x	8.5x

United-Continental (UAL) ★★★			
Moat: None	Moat Trend: Stable		
Currency: USD	Credit Rating: B		
Mkt Cap: 7.93 B	Uncertainty: Extreme		
Mkt Price: 23.53	Fair Value: 24.00		
	2011A	2012E	2013E
Cons EPS	3.49	4.03	5.66
P/E	6.7x	5.8x	4.2x

US Airways (LCC) ★★★			
Moat: None	Moat Trend: Stable		
Currency: USD	Credit Rating: CCC		
Mkt Cap: 2.05 B	Uncertainty: Extreme		
Mkt Price: 11.78	Fair Value: 8.50		
	2011A	2012E	2013E
Cons EPS	0.68	2.44	2.94
P/E	17.3x	4.8x	4.0x

EXECUTIVE SUMMARY

AMR (AAMRQ) entered Chapter 11 mostly to cleanse its bloated cost structure; however, we think the tenets behind its potential standalone plan will not repair its deteriorating revenue performance. Therefore, we think merging with **US Airways (LCC)** is essential for AMR to shrink its \$2 billion revenue gap versus the industry. Collectively, we expect higher revenue and lower wages will result in a \$22 billion reorganization value for AMR through a US Airways-AMR merger, \$4 billion (or 20%) higher than our estimate for AMR standalone. Our reorganization value increases \$700 million when we incorporate tax considerations. This implies a 73% recovery rate for creditors with impaired liabilities, which includes senior unsecured bondholders. However, current AMR shareholders will be wiped out.

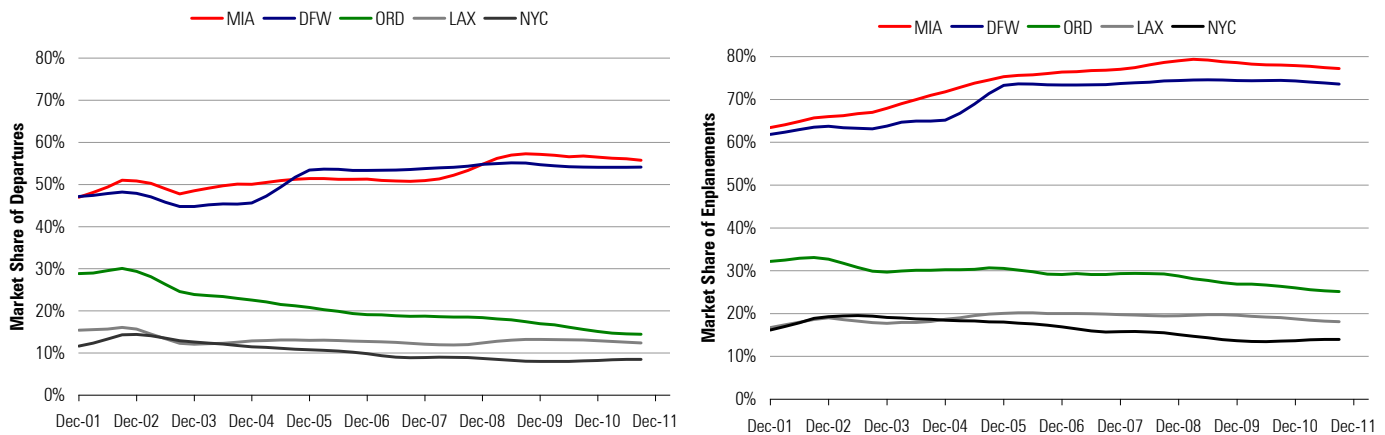
KEY TAKEAWAYS

- ▶ AMR has a network disadvantage today, which has resulted in a substantial revenue disadvantage.
- ▶ A combined AMR-LCC eliminates the weaknesses present in each standalone airline and we project revenue synergies of \$1.5 billion annually.
- ▶ We estimate that AMR bondholders with impaired claims face a 21% downside if AMR doesn't merge with US Airways and a 41% upside if a merger occurs based on current trading levels; AMR shareholders get wiped out regardless; and US Airways shareholders have 30% downside with no deal and 59% upside if a deal occurs and the entity achieves all of our projected synergies.

AMR's Size Advantage and Revenue Premium Have Shrunk Over Time

AMR once possessed the largest domestic airline network. Over time, the negative effects of the 9/11 attacks, the emergence of **Southwest (LUV)**, and the mergers between **Delta-Northwest (DAL)**, and **United-Continental (UAL)** ultimately led to AMR's network deterioration. Exhibit 1 shows AMR's market share--defined by the number of departures (flights) and the number of enplanements (passengers) at its major hubs Miami (MIA) Dallas/Ft. Worth (DFW), Chicago (ORD), and New York (the summation of EWR, JFK, and LGA).

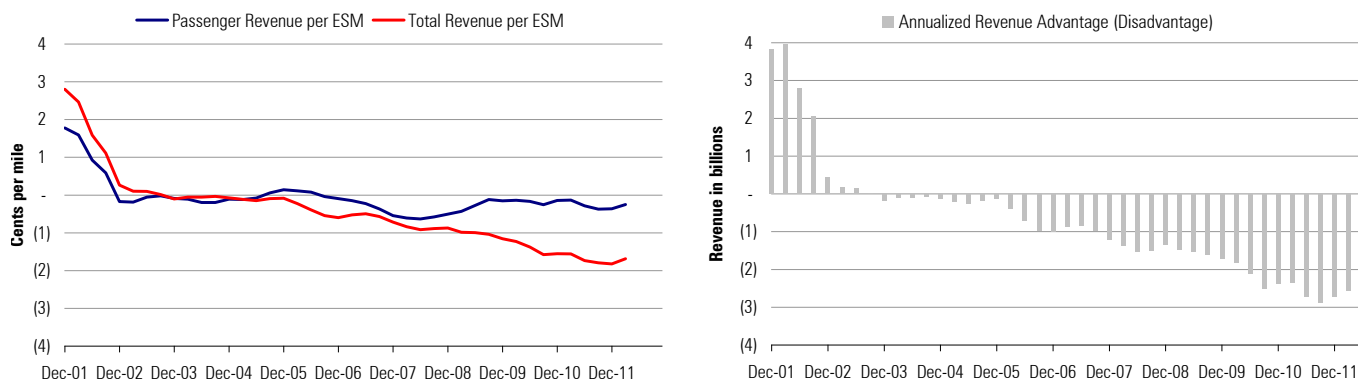
Exhibit 1: AMR's Rolling 12-month Market Share at Miami, Dallas/Ft. Worth, O'Hare, LAX, and NYC



Sources: Company filings, Bureau of Transportation Statistics T-3 database, and Morningstar Estimates

AMR lost market share in three of its hubs (New York, Chicago, and Los Angeles) as it decreased its fleet size post 9/11. AMR operated 608 mainline aircraft in 2011, down 40% from the 881 it operated in 2001. All legacy carriers shrunk their fleets over this span, but AMR's competitors combined forces (Delta and Northwest in 2008 and United and Continental in 2010) to lessen the overall fleet reduction. Over time, a smaller network makes it difficult to operate an efficient hub-and-spoke system. Unlike point-to-point, hub-and-spoke requires a strong hub presence to shuttle passengers from distant markets to fill planes. A larger presence allows an airline to increase flight frequency, attract more higher-paying business customers, and increase its revenue performance. AMR's smaller size caused its revenue premium to wane, as measured by passenger revenue and total revenue per seat mile adjusted for stage length (known as per equivalent seat mile or per ESM)--see Exhibit 2. We adjust for stage length because it improves comparability by normalizing financial metrics that are affected by flight length.

Exhibit 2: AMR's Passenger and Total Revenue Differential per Seat Mile Adjusted for Stage Length



Sources: Company filings, Bureau of Transportation Statistics T-1 database, and Morningstar Estimates

The left chart in Exhibit 2 shows, on a per ESM basis, AMR's passenger and total revenue--which includes, regional, cargo, and other revenue such as checked baggage fees--differential versus United, Continental, Delta, Northwest, and US Airways. AMR went from generating a 3-cent (or \$4 billion annualized) revenue premium to a 2-cent (or \$2 billion annualized) revenue disadvantage today.

AMR's Reorganization Plan is Unlikely to Accomplish Much Revenue Generation

AMR's plan envisions generating \$1 billion in additional revenue by 2017. To achieve this, AMR will alter work-related contracts and loosen or eliminate regional flying scope clauses. Additionally, AMR will increase daily departures at JFK airport to 500 by 2015 from roughly 100 today.

While laudable, we understand this plan will be difficult to achieve due to slot restrictions at JFK. Slot restrictions date back to the 1960s and were implemented so the government could control flight congestion at busy airports, such as LaGuardia (LGA) and Reagan National Airport (DCA). JFK was historically slotted during part of the day, but the government slotted it all day beginning in 2008. These restrictions make it difficult and costly to gain slots at JFK. For instance, Delta has tried to create a hub in New York via JFK and LGA but has struggled to acquire enough slots, and we doubt international carriers will forgo access to New York cheaply. Further, AMR likely would need to invest \$1 billion to add enough additional terminal capacity. We don't believe AMR can expand at JFK, so the weak East Coast presence will persist. Therefore, we think AMR will not achieve the targeted \$1 billion in additional revenue as a standalone entity.

AMR's Labor Disadvantage Remains Immense

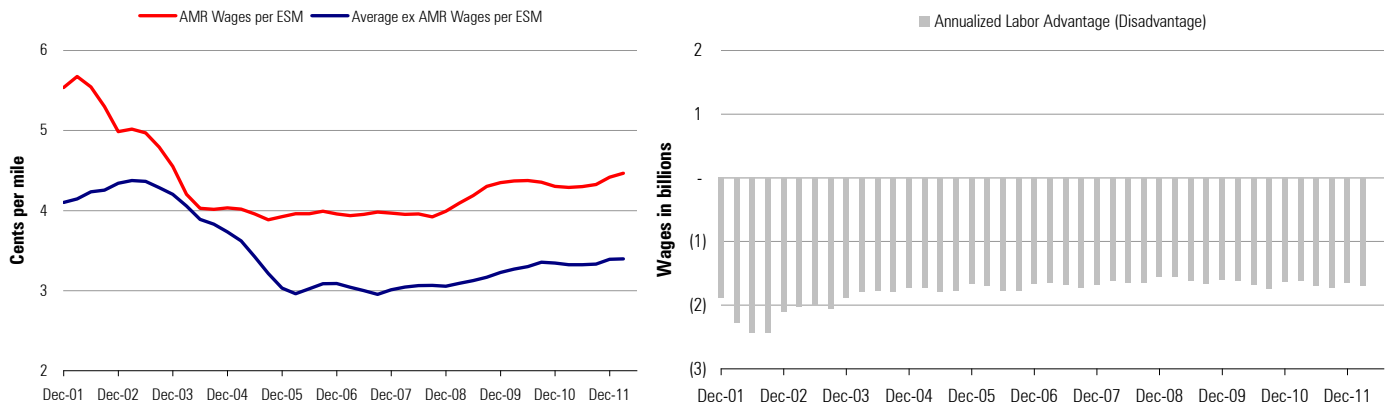
AMR did not file for bankruptcy post 9/11, but instead extracted roughly \$1.25 billion in labor concessions. This reduced AMR's labor costs, but the rate per ESM remained in excess of the industry average (left chart in Exhibit 3).

Publically, AMR said the cost disadvantage was \$800 million, but the company asked for \$1.25 billion in labor concession during bankruptcy, which is consistent with our estimated \$1.5 billion disadvantage (right chart in

Exhibit 3). We arrived at our estimate by multiplying the wage difference per ESM and multiplying it by the annualized number of available seat miles (ASM) flown by AMR.

Work-related items also contribute to AMR's disadvantage. AMR has contractual obligations on the amount of maintenance and repair work that the company can outsource. Compared with contractors, in-house employees receive higher wages and better benefits, including pensions. AMR estimates that its competitors utilize outside vendors for repair and maintenance work roughly 4 times more than AMR.

Exhibit 3: AMR's Labor Costs per Seat Mile Adjusted for Stage Length



Sources: Company filings, Bureau of Transportation Statistics, and Morningstar Estimates

Another problem, according to AMR, is the Transport Workers Union (TWU) ASM cap. The rule stipulates that regional jets can account for no more than 6% of mainline flights at airports AMR currently operates. Mainline flights are those operated by an AMR's main operating unit, rather than by its regional alliances, regional code-shares or regional subsidiaries. Additionally, scope clauses in AMR's pilot contracts prohibit the regional airline from flying more than 47 aircraft with more than 50 seats. Collectively, these restrictions hinder AMR's ability to fly the appropriate size aircraft, so AMR incurs higher wage expenses due to higher-paid pilots as a result.

The final problem is the underfunded pension plan. AMR entered bankruptcy with an underfunded pension of approximately \$9.2 billion. As of the first quarter, the deficit increased to \$9.4 billion. Per the Pension Benefit Guarantee Corporation (PBGC), AMR's liability is \$10.2 billion--plan assets worth \$8.3 compared with an \$18.5 billion liability.

We believe the pension liability could be higher for two reasons. First, the Pension Protection Act of 2006 allowed AMR to use a discount rate of 8.25% through 2017 because it was an airline that didn't freeze its pension plan. Also, the Pension Relief Act of 2010 allowed AMR to defer the catch-up payments over a 15-year amortization period. Second, we believe AMR's monthly payments are lower because the pension is classified as a Liability Subject to Compromise, or LSTC. AMR has decided to peruse a plan freeze, which may limit the appreciation in the liability, however.

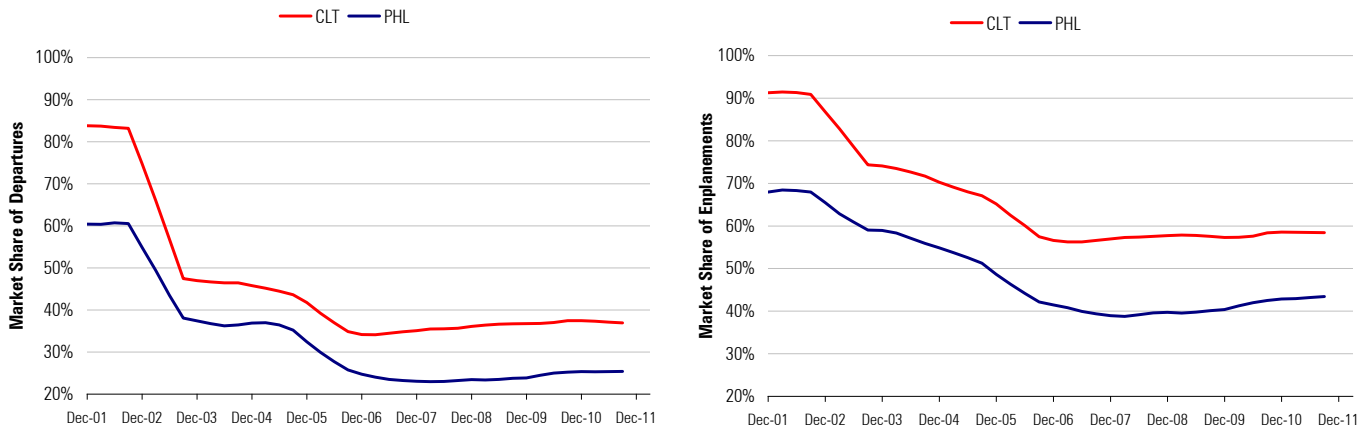
AMR's Cost Savings Are Likely to Stem From Job Cuts

AMR's reorganization plan contemplates reducing costs by \$2 billion. To achieve the cost cuts, AMR will lower union head count by 13,000 workers. We estimate the head count reduction will shave nearly \$1.1 billion based on AMR's 2011 average annual wage of approximately \$88,000. AMR also believes it could reduce non-union head count 30% by restructuring management functions. Based on about 88,000 workers, a non-union participation rate of around 20%, and an average wage of \$88,000 per employee, the removal of roughly 5,300 non-union employees could result in annualized pre-tax cost savings of nearly \$465 million. These two head count moves would generate savings, in our opinion, equal to nearly 80% of AMR's stated cost savings plan of \$2 billion. We expect canceling and renegotiating leases on better terms, accelerating the fleet modernization plan, and optimizing aircraft size will generate the remaining savings.

Merging with US Airways Will Create an East Coast Powerhouse

US Airways still has a strong presence on the East Coast via its Charlotte (CLT) and Philadelphia (PHL) hubs, which together represent 67% of the company's traffic. Exhibit 4 shows US Airways' strong share of passengers and departures at both airports. Interestingly, US Airways, although mostly a domestic carrier, flies to more European destinations out of PHL than AMR does out of JFK, further indicating AMR's weak East Coast footprint. Thus, we think combining the carriers will expand revenue since AMR will benefit from US Airways' east coast presence and US Airways will benefit from AMR's Latin American exposure in Miami and Dallas.

Exhibit 4: US Airways' Rolling 12-month Market Share at Charlotte and Philadelphia Airports

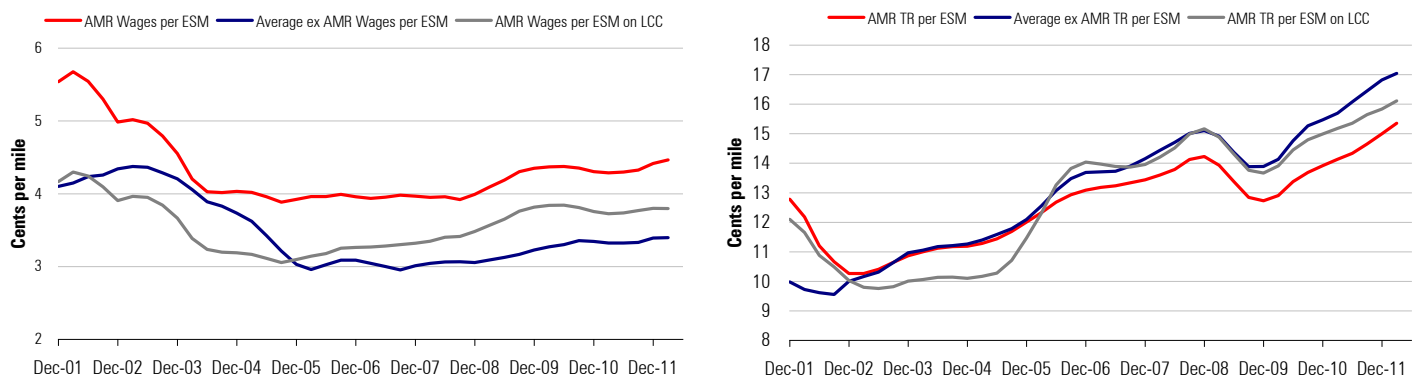


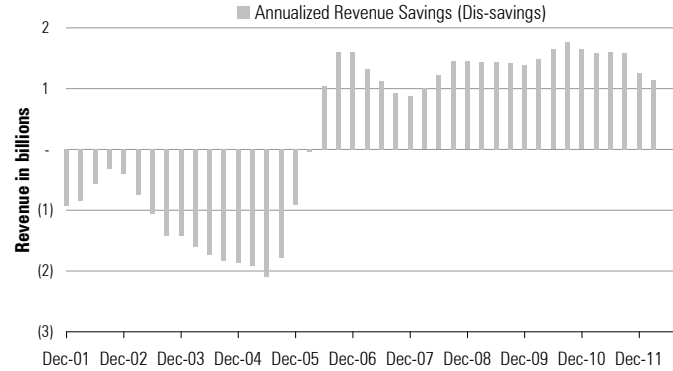
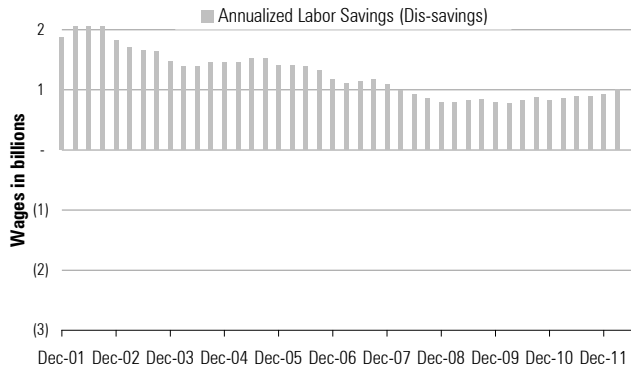
Sources: Company filings, Bureau of Transportation Statistics, and Morningstar Estimates

Combining the Carriers Helps Each Other Remedy a Weakness as Standalone Companies

We believe the increased East Coast presence will enable AMR to shrink its revenue gap and lower its salary costs. To estimate the potential savings, we've employed US Airways' wages and total revenue profile per ESM onto AMR's network. As Exhibit 5 below shows, assuming that AMR operated with US Airways' network, AMR's wage and revenue disadvantage would have improved by \$1 billion and \$1.25 billion, respectively.

Exhibit 5: AMR's Wages and Revenue Generation Transposed on US Airways' Network





Sources: Company filings, Bureau of Transportation Statistics, and Morningstar Estimates

AMR w/LCC's Profile Will Generate Approximately \$1.5 Billion in Annual Revenue Synergies

Going forward, the larger network will make AMR-US Airways a strong contender for corporate clients. We project the revenue performance will stem mostly from regional operations, as flying fewer planes with more passengers will benefit revenue performance. Our research suggests that AMR was offering the lowest fares before its November bankruptcy filing. We suspect AMR priced irrationally as it struggled to cover its fixed costs. Post bankruptcy, AMR's incentive to chase passengers should subside. We expect regional flying and other revenue sources, such as reservation change fees and checked baggage fees, will benefit the most from a larger combined network--Exhibit 6 below.

Exhibit 6: AMR w/LCC Profile Revenue Synergies versus AMR Standalone

Projections	2012e	2013e	2014e	2015e	2016e	CAGR
AMR w/LCC's Profile						
Mainline	\$ 18,349	\$ 18,991	\$ 19,560	\$ 20,048	\$ 20,756	3.0%
Regional	3,999	4,426	4,492	4,560	4,628	11.2%
Cargo	699	681	668	658	655	-1.4%
Other	2,554	2,602	2,719	2,839	2,961	2.6%
Total Revenue	\$ 25,600	\$ 26,700	\$ 27,439	\$ 28,104	\$ 29,000	3.9%
AMR Standalone						
Mainline	\$ 18,349	\$ 18,433	\$ 19,084	\$ 19,564	\$ 20,056	2.2%
Regional	2,666	2,986	3,334	3,673	4,019	8.1%
Cargo	699	681	668	658	648	-1.6%
Other	2,086	2,239	2,425	2,602	2,783	1.3%
Total Revenue	\$ 23,799	\$ 24,340	\$ 25,510	\$ 26,497	\$ 27,505	2.8%
Gains from Merger	\$ 1,801	\$ 2,360	\$ 1,929	\$ 1,607	\$ 1,494	NA

Sources: Company filings and Morningstar Estimates

Collectively, we project that AMR w/LCC's Profile could expand its revenue at a 3.9% CAGR over the next five years, in line with our industry average CAGR of 3.9%, but above our AMR Standalone projection of 2.8%.

AMR w/LCC's Profile Will Extract Fewer Labor Concessions than AMR Standalone

We expect similar wage rates and labor rules with AMR Standalone and AMR-LCC. AMR has already lowered its wages by 80 cents post bankruptcy, and we expect the company's cost profile will shrink further by canceling unnecessary leases and renegotiating leases on better terms.

However, the labor savings will be less under AMR w/LCC's Profile. The Allied Pilots' Association estimates that fewer labor concessions will benefit the pilots by about \$130 million under an AMR-US Airways merger, which is consistent with our \$155 million benefit. In total, slightly higher wage rates for AMR w/LCC's Profile results in a modest CASM disadvantage for AMR-US Airways compared with AMR standalone--see Exhibit 7 below.

Exhibit 7: AMR w/LCC's Profile Will Have a Modest CASM Disadvantage to AMR Standalone

Projections	2012e	2013e	2014e	2015e	2016e
AMR -LCC					
Wages	4.70¢	4.40¢	4.30¢	4.35¢	4.40¢
Other Rentals	0.87	0.90	0.95	1.00	1.05
Maintenance and Repairs	0.71	0.75	0.80	0.90	0.95
Commissions	0.75	0.77	0.78	0.78	0.80
Depreciation	0.70	0.75	0.85	0.95	1.00
Aircraft rentals	0.38	0.30	0.35	0.45	0.50
Food service	0.33	0.35	0.40	0.45	0.50
Other operating	1.85	1.95	2.00	2.10	2.15
CASM ex Fuel & One-time	10.28¢	10.17¢	10.43¢	10.98¢	11.35¢
AMR Standalone					
Wages	4.70	4.20	4.25	4.30	4.30
Other Rentals	0.87	0.90	0.95	1.00	1.05
Maintenance and Repairs	0.71	0.75	0.80	0.90	0.95
Commissions	0.68	0.65	0.67	0.69	0.71
Depreciation	0.70	0.75	0.85	0.95	1.00
Aircraft rentals	0.38	0.30	0.35	0.45	0.50
Food service	0.33	0.35	0.40	0.45	0.50
Other operating	1.85	1.95	2.00	2.10	2.15
CASM ex Fuel & One-time	10.21¢	9.85¢	10.27¢	10.84¢	11.16¢
Cost Disadvantage	-0.07¢	-0.32¢	-0.15¢	-0.14¢	-0.19¢

Sources: Company filings and Morningstar Estimates

AMR Will be a More Profitable Airline Combined with US Airways

Using our projected revenue and CASM estimates, we expect that AMR w/LCC Profile will be a more profitable than AMR Standalone--see Exhibit 8.

Exhibit 8: Projected Financial Metrics of AMR-LCC and AMR Standalone

Projections	2012	2013	2014	2015	2016
AMR -LCC					
Revenue	\$25,600	\$26,700	\$27,439	\$28,104	\$29,000
Operating Income	1,936	2,903	2,715	1,958	1,701
EBITDAR	3,631	4,537	4,466	3,904	3,777
Margins					
Operating	7.6%	10.9%	9.9%	7.0%	5.9%
EBITDAR	14.2%	17.0%	16.3%	13.9%	13.0%
AMR Standalone					
Revenue	\$23,799	\$24,340	\$25,510	\$26,497	\$27,505
Operating Income	237	1,229	1,287	986	1,066
EBITDAR	1,830	2,650	2,837	2,734	2,940
Margins					
Operating	1.0%	5.0%	5.0%	3.7%	3.9%
EBITDAR	7.7%	10.9%	11.1%	10.3%	10.7%

Sources: Morningstar Estimates

We use 2016 EBITDAR as our estimate for normalized earnings over an economic cycle. We compared current adjusted EV/EBITDAR multiples for the domestic airlines, but expect that the uncertainty surrounding the bankruptcy proceedings will result in AMR trading at a discount versus the industry average. As a result, we employ a base case adjusted EV/EBITDAR multiple of 4.5 times for AMR. We calculated our enterprise value by converting operating leases to capital leases by multiplying next year's annual aircraft rent by seven.

Exhibit 9: Airline Industry Enterprise Values

Entity	Enterprise Value	Op. Rent Leases	Rent Adj. EV	EBITDA	Aircraft Rent	EBITDAR	EV/EBITDA	Adj EV/EBITDAR
DAL	\$ 17,722	\$ 2,107	\$ 19,829	\$ 4,664	\$ 301	\$ 4,965	3.8x	4.0x
LCC	6,475	4,596	11,071	1,006	657	1,662	6.4	6.7
LUV	8,745	2,726	11,471	1,804	389	2,193	4.8	5.2
UAL	19,218	7,162	26,380	3,791	1,023	4,814	5.1	5.5
Total	\$ 52,160	\$ 16,591	\$ 68,750	\$ 11,264	\$ 2,370	\$ 13,634	4.6x	5.0x

Sources: Thomson Reuters, and Morningstar Estimates

AMR's Reorganization Value is Worth Approximately 20% More as a Merged Entity with US Airways

Based on normalized EBITDAR and our 4.5 adjusted EV/EBITDAR multiple, we estimate the enterprise value of AMR w/LCC's Profile worth \$17 billion, approximately 30% higher than our \$13.2 billion estimate for AMR Standalone. Adding AMR's \$4.8 billion in cash at the end of the March quarter to our enterprise value brings us to a reorganization value of \$22 billion for AMR w/LCC's Profile and \$18 billion for AMR Standalone. Additionally, AMR had approximately \$8.6 billion in secured debt and other priority liabilities and \$15 billion in liabilities subject to compromise, or LSTC.

We assume that AMR emerges from bankruptcy with the existing \$8.6 billion in on-balance sheet secured debt (providing a full recovery for secured creditors) and another \$4 billion in capitalized operating leases. This suggests a residual value (reorganization value less debt) of \$9.3 billion in the case of AMR-LCC and \$5.5 billion for AMR Standalone. This implies a recovery rate of 62% for the merged entity and 37% for the standalone--Exhibit 10 below.

Exhibit 10: AMR Recovery Analysis

Figures	AMR Standalone	AMR-LCC	Change \$	Change %
Normalized EBITDAR	\$ 2,940	\$ 3,777	\$ 838	28.5%
EBITDAR Multiple	4.5x	4.5x	-	0.0%
Enterprise Value	\$ 13,228	\$ 16,998	\$ 3,770	28.5%
Plus Cash	4,819	4,819	-	0.0%
Reorganization Value	\$ 18,047	\$ 21,817	\$ 3,770	20.9%
Debt Recovery				
Secured and Other Priority Debt	\$ 8,550	\$ 8,550	\$ -	0.0%
Capitalized Operating Leases	3,983	3,983	-	0.0%
Residual Value	\$ 5,514	\$ 9,284	\$ 3,770	68.4%
Liabilities Subject to Compromise	15,001	15,001	-	0.0%
Loss (Residual value - LSTC)	\$ (9,487)	\$ (5,717)	\$ 3,770	-39.7%
Unsecured Recovery (RV/LSTC)	37.0%	62.0%	\$ 3,770	67.6%

Sources: Company filings, Thomson Reuters, and Morningstar Estimates

LSTC represents largely the unsecured claims of various creditors, and we expect these claimants to recover any residual value of the firm in the form of equity. Exhibit 11 lists the composition of LSTC per AMR's first quarter 10-Q.

Exhibit 11: AMR Liabilities Subject to Compromise

Liability	Amount
Long-term Debt:	
Secured and other debt	\$ 1,212
6.25% senior convertible notes due 2014	460
Other senior unsecured bonds	566
Total Long-term Debt	\$ 2,238
Aircraft lease and other obligations	2,830
Pension and postretirement benefits	9,430
Accounts Payable and Accrued Liabilities	511
Other	(8)
Total Liabilities Subject to Compromise	\$ 15,001

Sources: Company filings, and Morningstar Estimates

Of the bonds still trading in the market, the 6.25% senior convertible bonds are the largest and most liquid. These are actively traded and represent a good proxy for how the market views the expected recovery of the unsecured claims. The 6.25% bonds recently traded at a price of 52, or slightly over half of par (source: Advantage Data). Assuming that bondholders require a 25% return on this bond due to the high-risk equity-like nature of these bankruptcy claims over a 1-year holding period, this price suggests that the recovery value in one year would be 65, which is consistent with our impaired creditors' recovery before tax implications.

Section 382 Tax Implications Suggest that US Airways Should Acquire AMR

Tax implications affect company value since change of control, which can apply during bankruptcies, reduce the present value of existing Net Operating Losses (NOLs)--Section 382 Limitation. AMR's deferred tax asset (DTA) was \$2.4 billion in December 2011, and increased \$600 million during the March quarter. We assume this increase was due to AMR's net loss, increasing the NOL to \$3 billion. Assuming a 35% statutory tax rate, AMR can shield itself from a tax liability for the first \$8.6 billion in pre-tax income generation. However, AMR will incur income taxes on \$5.8 billion in cancellation of debt income (CODI), which is the difference between LSTC and our estimated residual value--Exhibit 10. This reduces AMR's NOL post-bankruptcy to approximately \$2.8 billion.

Exhibit 12: AMR's Reorganization Value Including Net Operating Losses

Figures	AMR Buys LCC	LCC Buys AMR	Change \$	Change %
Unsecured Debt Recovery				
Residual Value pre NOLs	\$ 9,284	\$ 9,284	\$ -	0.0%
Liabilities Subject to Compromise	15,001	15,001	-	0.0%
CODI (LSTC-Residual value)	\$ (5,717)	\$ (5,717)	\$ -	0.0%
Net Operating Loss Balance				
AMR's NOL pre CODI	\$ 8,571	\$ 8,571	\$ -	0.0%
CODI	(5,717)	(5,717)	-	0.0%
AMR's Remaining NOL (CODI-NOL)	\$ 2,855	\$ 2,855	\$ -	0.0%
US Airways' NOL	5,286	5,286	-	0.0%
Combined NOLs	\$ 8,140	\$ 8,140	\$ -	0.0%
Present Value of NOLs				
Present Value of AMR's NOL	\$ 766	\$ 303	\$ (464)	-60.5%
Present Value of LCC's NOL	115	1,300	1,184	1028.7%
Total NOL Present value	\$ 882	\$ 1,602	\$ 721	81.8%
Residual Value pre NOLs	9,284	9,284	-	0.0%
Residual Value Post NOLs	\$ 10,166	\$ 10,887	\$ 721	7.1%
Recovery Rates				
Unsecured Recovery Rate pre NOLs	62.0%	62.0%	-	0.0%
Unsecured Recovery Rate post NOLs	68.0%	73.0%	\$ 721	7.4%

Sources: Company filings, and Morningstar Estimates

We estimate that the present value of the NOLs increase by \$700 million to \$1.6 billion if US Airways acquires AMR. The tax attributes increase the total value of the firm \$700 million with an US Airways purchase and increases the recovery rate to 73% from 62% pre-tax attributes. We estimate the residual value of AMR Standalone NOLs increases \$600 million to a recovery rate of 41% versus 37% without taxes.

A Pro Forma Look at the Merged Capital Structure and Credit Stats

Exhibit 13 shows our estimate of AMR's capital structure after bankruptcy proceedings, which includes our revenue and EBITDAR synergies from the merger with LCC (PF AMR). We then show PF AMR as part of a fully merged entity with US Airways (PF LCC). Exhibit 14 then compares PF LCC versus its major domestic legacy peers, utilizing balance sheet data as of the first quarter of 2012 and full-year 2012 forecast EBITDAR.

Exhibit 13: US American Capital Structure

Figures	AMR	Deal	PF AMR	LCC	PF LCC
Revenues - 2012e	\$ 23,799	\$ 1,801	\$ 25,600	\$ 13,736	\$ 39,336
EBITDAR	1,830	1,801	3,631	1,663	5,294
EBITDAR margin	7.7%		14.2%	12.1%	13.5%
Cash	4,819	-	4,819	2,190	7,009
Secured Debt & Other	8,550	-	8,550	4,078	12,628
LSTC/Other debt	15,001	(15,001)	-	545	545
Total Debt	\$ 23,551	\$ (15,001)	\$ 8,550	\$ 4,623	\$ 13,173
Equity	-	5,514	5,514	200	5,714

Sources: Company filings, and Morningstar Estimates

Exhibit 14: Comparable Credit Analysis

Figures	PF LCC	DAL	UAL
Morningstar Credit Rating	NR	B-	B
Revenues - 2012e	\$ 39,336	\$ 36,975	\$ 38,954
EBITDAR	5,294	4,965	4,814
EBITDAR margin	13.5%	13.4%	12.4%
Cash	\$ 7,009	\$ 3,870	\$ 7,273
% Revenues	17.8%	10.5%	18.7%
Total Debt	13,173	13,376	12,436
Net Total Debt	6,164	9,506	5,163
Aircraft Rent Adj TD/EBITDAR	4.1x	3.1x	4.1x
Net Aircraft Rent Adj TD/EBITDAR	2.8x	2.3x	2.6x

Sources: Company filings, and Morningstar Estimates

The three carriers compare very well in top line, margins, and leverage. We expect our credit rating on LCC (current rating: CCC) to move up either in line with DAL or UAL. Importantly, US Airways' only unsecured bond of note is its \$172.5 million 7.25% convertible senior notes due in 2014, trading recently at a price of 290. These are well in-the-money given a strike price of \$4.57. This bond moves directly in line with the stock and offers investors the benefit of the coupon payment.

Is There Anything Left for Equity Holders?

Our base case assumes that the creditors with impaired claims recover approximately 73% of their liability and shareholders recover nothing. Increasing the EV/EBITDAR multiple by half a turn while leaving our normalized EBITDAR margin unchanged increases the recovery rate approximately 12 percentage points; a similar decrease lowers the recovery rate by 13 percentage points. Increasing the normalized EBITDAR margin 50 basis points boosts the recovery rate 4 percentage points while decreasing the margin 50 basis points lowers the recovery rate by 5 percentage points, leaving the EV/EBITDAR multiple unchanged.

Exhibit 15: AMR Impaired Creditors Recovery Scenario Analysis

		Recovery Rates Among Different Scenarios						
		Normalized EBITDAR Margin						
		11.5%	12.0%	12.5%	13.0%	13.5%	14.0%	14.5%
EBITDAR Multiple	3.0x	26.0%	29.0%	32.0%	35.0%	38.0%	41.0%	43.0%
	3.5x	37.0%	41.0%	44.0%	47.0%	51.0%	54.0%	58.0%
	4.0x	48.0%	52.0%	56.0%	60.0%	64.0%	68.0%	72.0%
	4.5x	60.0%	64.0%	68.0%	73.0%	77.0%	81.0%	86.0%
	5.0x	71.0%	75.0%	80.0%	85.0%	90.0%	95.0%	100.0%
	5.5x	82.0%	87.0%	92.0%	98.0%	103.0%	108.0%	114.0%
	6.0x	93.0%	99.0%	105.0%	110.0%	116.0%	122.0%	128.0%

Sources: Morningstar Estimates

Our analysis shows that in eight scenarios the recovery amount is above 100%, implying that existing AMR equity holders receive a residual payout. We note that these types of valuations would likely need court approval, which we view as highly unlikely. Still, the table does suggest potential upside scenarios for the impaired claimants, whom we expect will get all of the new equity.

We Think US Airways Should Propose as Much Overvalued Equity Currency as the Market Allows

We believe the potential value of an AMR-LCC merger is responsible for this increase so the market is overvaluing US Airways. Rumors first surfaced on April 19 that US Airways had reached a deal with American Airlines' labor unions to win support for a possible AMR-US Airways merger--a labor deal was subsequently announced on April 20. The announcement helped the stock appreciate almost \$3.50 per share (or 40%) to \$12. As a result, we think US Airways would benefit shareholders if it proposed an all-equity deal would benefit We believe US Airways has the potential to increase its stock price between 26% and 59% if it offers an all equity deal and acquires AMR for \$5.5 billion, which is our estimate residual value of AMR Standalone.

Exhibit 16: US Airways Value Creation

Figure	High Price	Median Price	Morningstar Price
AMR Standalone Value	\$ 5,514	\$ 5,514	\$ 5,514
Issue Price	11.00	9.75	8.50
Shares Issued	501	566	649
LCC Outstanding Shares	164	164	164
Total LCC Shares	665	729	813
LCC Equity Value	1,801	1,596	1,392
AMR Standalone Value	5,514	5,514	5,514
Combined Equity Value	\$ 7,316	\$ 7,111	\$ 6,906
AMR-LCC Recovery Value	3,770	3,770	3,770
Present Value of NOLs	1,602	1,602	1,602
Total LCC Value	\$ 12,688	\$ 12,483	\$ 12,278
Value Creation (Total LCC-Combined)	5,372	5,372	5,372
Value Creation per Share	8.08	7.37	6.61
Issue Price	11.00	9.75	8.50
Combined Equity Value	\$ 19.08	\$ 17.12	\$ 15.11
Premium over \$12 market price	59.0%	43.0%	26.0%

Sources: Morningstar Estimates

Concluding Thoughts

Our base case recovery assumptions for AMR unsecured bondholders range from \$0.41 without a deal to \$0.73 if US Airways acquires AMR. Based on the current \$0.52 bond price, this implies downside risk of 21% and upside of 41%. Based on the current stock price, we think LCC could fall 24% to \$8.50 (our fair value estimate) if no deal emerges. US Airways' stock price could rise 71% to \$19 if US Airways raises equity at \$11 per share, acquires AMR for \$5.5 billion, and achieves our projected synergies.

Ultimately, we believe that AMR and LCC will merge. US Airways has done a commendable job bolstering on-time performance and running a better airline. We believe these improvements have lowered its cost structure by nearly \$800 million per year. However, we still think that US Airways needs to beef up its international network, and we view a merger with AMR as nearly essential for both companies to compete in a domestic airline industry dominated by United-Continental, Delta, and Southwest.

AMR has received a court extension to file its plan of reorganization by the end of September, and media reports have said that management wants the company to emerge from bankruptcy by the end of the year. We expect US Airways will unveil its plan no sooner than October, and wouldn't be surprised if the companies announce a merger agreement shortly thereafter.

Exhibit 17: Morningstar Airline Coverage List

Company	Full Ticker	Star Rating	Market Cap (m)	Stock Price	Fair Value Estimate	Economic Moat	Forward P/E	Exchange/Currency	Morningstar Analyst
Air Canada	AC.B	★★★★★	252	0.91	2.00	None	6.1	CAN/CAD	neal.dihora@morningstar.com
Air France-KLM	AF	★★★★★	996	3.38	6.00	None	NA	FRA/EUR	neal.dihora@morningstar.com
Delta Air Lines Inc	DAL	★★★	9,015	10.61	11.00	None	3.8	USA/USD	basili.alukos@morningstar.com
Southwest Airlines Co	LUV	★★★★★	6,756	8.80	12.00	None	8.5	USA/USD	basili.alukos@morningstar.com
US Airways Group Inc	LCC	★★★	1,912	11.78	8.50	None	3.8	USA/USD	basili.alukos@morningstar.com
United Continental Holdings Inc	UAL	★★★	7,813	23.53	24.00	None	3.9	USA/USD	basili.alukos@morningstar.com

Sources: Company filings and Morningstar Estimates