

Loyalty Communities: The hidden Value for Airlines?

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2

Agenda

- Why do Investors look at FFPs?
- What drives the Value in FFPs?
- How to successfully unlock FFP Value?

3

Question Nr.1



How much time
does your CEO
spend in
understanding
and developing
the airline's FFP
business?

4

Question Nr. 2

-2.56

-0.66

-3.13

-1.25

-4.82

-2.07

-2.98

-1.10

Airline Investors have a Issue

In 2007 the traditional airlines lost one third of their market cap.

Company	Market Cap ^{*)}		Lost Value ^{*)}	In %
	1. Jan. 07	20. Nov. 07		
American Airlines	7.53	4.97	-2.56	-34%
United	5.10	4.44	-0.66	-13%
US Airways	4.89	1.76	-3.13	-64%
Delta Airlines	5.45	4.20	-1.25	-23%
British Airways	12.68	7.86	-4.82	-38%
Air France-KLM	11.51	9.44	-2.07	-18%
Lufthansa	14.91	11.93	-2.98	-20%
Air Canada (H)	3.92	2.82	-1.10	-28%

^{*)} Billion USD

6

Air Canada made a bold Step with Aeroplan

Aeroplan is the first stock-quoted FFP. It has doubled its value since the IPO.

Aeroplan Income Fund (Public, TSE:AER.UN) - [Add to Portfolio](#) - [Discuss AER.UN](#)

22.00

0.00 (0.00%)

Open: N/A
High: 22.00
Low: 22.00
Vol: 0.00

Mkt Cap: 4.40B
52Wk High: 23.87
52Wk Low: 15.20
Avg Vol: N/A

P/E: N/A
F P/E: N/A
Beta: N/A
EPS: -0.26

Dividend: N/A
Yield: N/A
Shares: 200.00M
Inst. Own: N/A

Aeroplan +27%

[Historical Prices](#) [Link to chart](#)



Air Canada -28%

Investors see a big Opportunity

Applying Aeroplan figures, FFPs represent a multi billion USD opportunity.

Company	Market Cap Airline 20. Nov. 07	Loyalty Program Value			
		Mio Members	Value per Member	Program Value	in % of Airline Value
Air Canada (H)	2.82	8	530	4.35	154%
American Airlines	4.97	56	200	11.2	225%
United	4.44	46	200	9.2	207%
US Airways	1.76	32	200	6.4	364%
Delta Airlines	4.20	36	200	7.2	171%
British Airways	7.86	8	200	1.6	20%
Air France-KLM	9.44	12	200	2.4	25%
Lufthansa	11.93	14	200	2.8	23%

¹ Billion USD

Investors push Airlines Executives

In recent times investors have publicly pushed airlines to spin-off their FFP.



Bloomberg, Nov. 15, 2007

American Air's „Hidden Asset“ May Top Carrier's Value

... Carriers are responding to pressure as airline shares have underperformed the Standard & Poor's 500 Index by 22 percent this year.

Reykjavik-based FL Group hf, AMR's third-biggest shareholder, urged American to sell its frequent-flier program in an open letter to AMR's board in September.

“This has the potential to become a sustainable source of value creation if it's done in the right way,” FL Group CEO Hannes Smarason said in an interview...

Airline Executives start to act...

FFP spin-offs a considered around the globe.



 **UNITED**

Chicago Tribune, Sep. 26, 2007

UAL board looking at asset sales

... United Chief Executive Glenn Tilton told analysts during an earnings call in July that the airline was looking into strategic options for Mileage Plus, United's 45 million-member frequent-flier program.

 **U-S AIRWAYS**

Market Watch, Oct 25, 2007

US Airways may spin off frequent flier plan

US Airways joined the swelling ranks of senior airline executives considering spinning off their frequent flier programs, CEO Doug Parker said on a discussing US Airways' (LCC) third-quarter profit.

 **QANTAS**

ATW, July 19, 2007

Qantas considers holding company and spin-offs

It also is looking at spin-offs of its loyalty program. Management has flagged a large dividend payout, but it is expected to be only half the A\$4 billion (\$3.49 billion) that APA planned to take if its bid was successful.

 **nwa**

ATW Oct 30 2007

NWA posts \$244 m profit, frequent-flier sale?

President and CEO Doug Steenland hailed the "remarkable turnaround" and said one possible way of growing shareholder value, is to spin off the WorldPerks frequent-flier program.

10

What is the Magic behind?



Frequent Flyer Program Value

Over time airlines have developed a very profitable community business.



Internal FFP Value

• Company revenue as is	1000
• Loyalty effect on sales (8-18%)	1180
+ Margin on sales (e.g., 30%)	54
- Cost of operation (0.1-2%)	20
= Net Profit	34

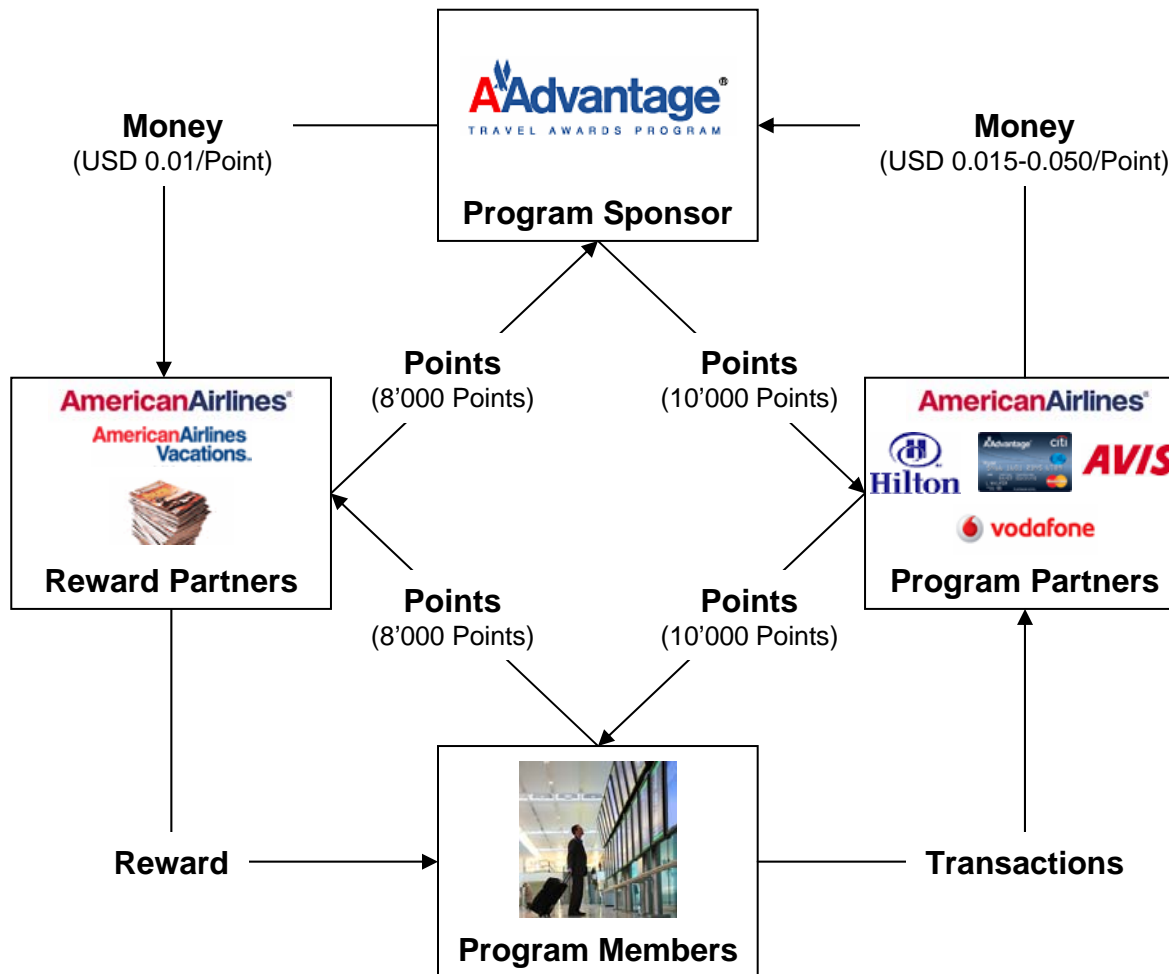


External FFP Value

Miles sold to partners	1000
- Cost of operations	100
- Cost of rewards	700
= Net Profit	200

Mechanism in advanced Programs

Points and money flows between four program roles.



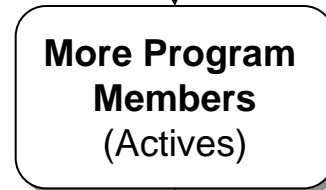
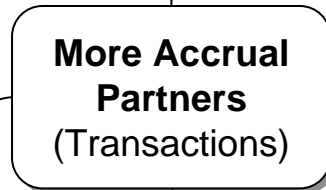
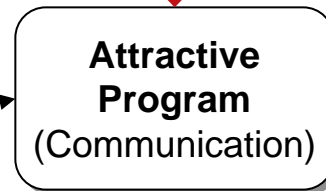
The Virtuous Circle

An attractive value proposition for members builds the core of the community business

Member Value Proposition



Program Effect



Program Value



The current Situation in most FFPs



The current Situation in most FFPs

The current FFP setup gives wrong incentives and limits the value creation dramatically.

- No visibility of FFP true profit and cost
 - Accrual partner revenue not reported in financial statement
 - Miles cost unknown to airline marketing & sales organization
 - Reward cost unknown to FFP (free seat)
 - Required investments in capabilities and technologies could not be justified
- Lack of reward availability
 - Declining customer satisfaction as loyalty currency loses its value
 - Declining accrual partner satisfaction
 - Accounting policies prevent attractive non-flight offerings
- Lack of analytical marketing service skills
 - Critical CRM capabilities to optimize FFP value not established

Steps to unlock FFP Value



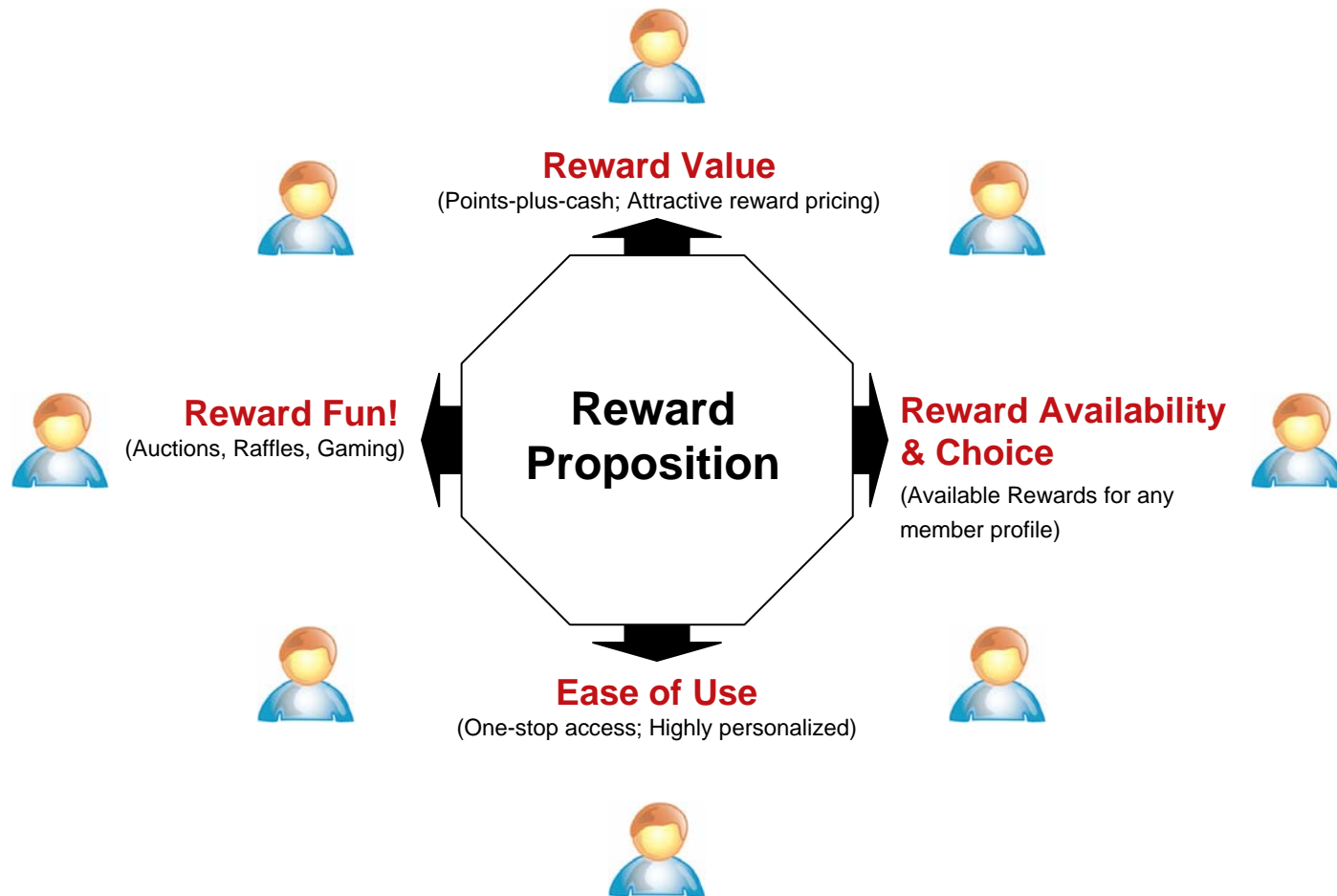
Steps to unlock the Value

Unlocking FFP value costs far less than a new aircraft!

1. Separate the airline and FFP business
 - Create a FFP business unit with own P&L
 - Establish an arms-length relation with the airline (sell your miles and buy the reward seats at market price)
2. Improve the Member value proposition
 - Improve reward proposition
 - Improve accrual opportunities
 - Personalized member communication
3. Improve the Accrual Partner value proposition
 - Improve member insight and analytics
 - Improve marketing R.O.I measurement and reporting
 - Improve your non airline industry knowledge
4. Improve your operational excellence
 - Improve reward management
 - Improve liability management
 - Improve operating management

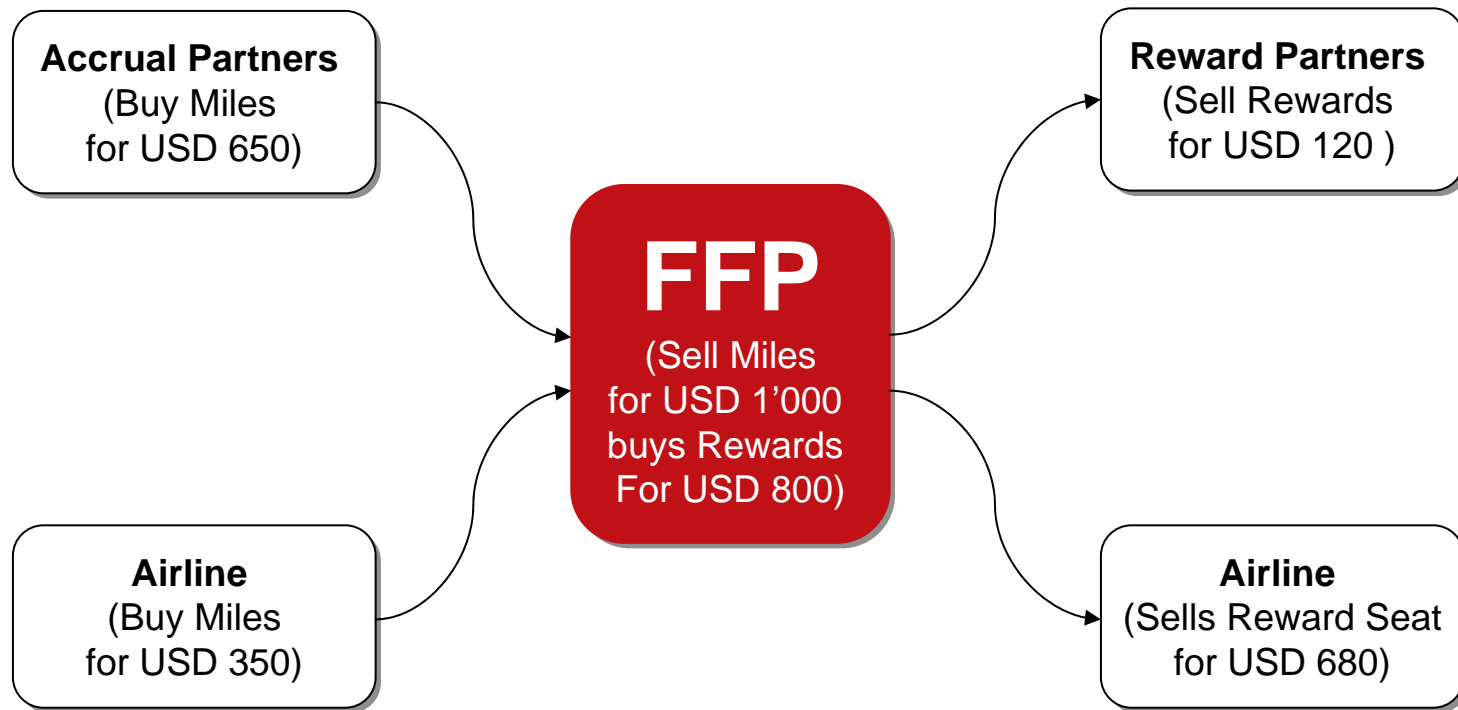
Improve Reward Proposition

Available rewards make a member more loyal to you and your accrual partners.



Does it pay for the Airline?

Frequent buyers can be very profitable for the airline.



Balance for the Airline: + USD 330

Additional Benefits for the Airline

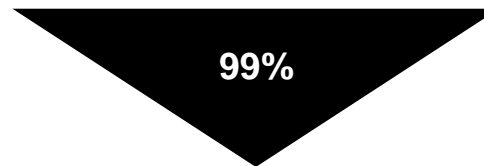
An attractive loyalty community offers the airline

- **More effective Marketing Tools**
 - Improved customer insight
 - Improved direct communication towards members
 - Lots of opportunities for positive communication messages
 - More (more) loyal customers
- **Attractive distribution channel**
 - To push distressed inventory
 - Less price sensitive
 - Incremental passenger revenue from reward seats
 - Attracts new customer segments
- **Reduced complexity in Revenue Management**
 - Commercial demand and reward demand managed as on demand

Question Nr.1: CEO Commitment

Airline top management should dedicate its time to where most value is created.

Top Management Time Investment



Airline Management

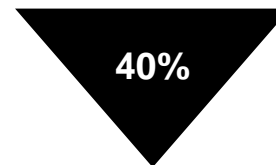
- Capacity deployment
- Network optimization
- Revenue management
- Reservation systems
- Cost management
- Debt financing
- Labor relations
- Safety & Maintenance
- Customer service
- Product design
- Marketing communication



FFP Management

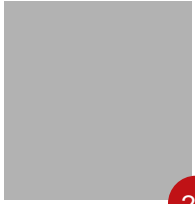
- Relationship management
- Airline management
- Partner marketing (coalition)
- CRM analytics
- Program design
- Campaign management
- Media effectiveness
- Reward management
- Channel optimization
- Liability management
- Breakage management

Airline Potential Value Generation



Wrap-up

- There is tremendous value potential in FFP programs.
- The key value driver in a FFP are happy members.
- Key success factors to successfully unlock the value are
 1. An organizational set-up that provides a value oriented reporting and steering environment.
 2. A member value proposition based on recognition, rich accrual opportunities and relevant rewards.
 3. An accrual partner value proposition that helps the partner to access new customers, retain and intensify existing relationships and give them a better customer insight.
 4. Top Management support



23

... and don't forget...



Loylogic...

... makes miles & points more
valuable than money!

Thank you!