Contact: Jay Sorensen
For inquiries: 414-961-1939

U.S. Airline Frequent Flier Reward Liability Grew More Than $378 Million in 2004 Industry Analysis from IdeaWorks

Comparison of U.S. based carriers reveals total liability now exceeds $3.8 billion, representing a 10.8% increase over 2003.

April 25, 2005, Shorewood, WI. The IdeaWorks Company has compiled frequent flyer reward liability reported by 14 U.S. based airlines in publicly filed annual reports for 2004. This Industry Analysis represents an expanded version of a similar report issued one year ago and includes a year-over-year comparison of frequent flier program statistics.

The airlines included in the survey are: AirTran Airways, Alaska Airlines, America West Airlines, American Airlines, ATA Airlines, Continental Airlines, Delta Air Lines, Frontier Airlines, jetBlue Airways, Midwest Airlines, Northwest Airlines, Southwest Airlines, United Airlines and US Airways. As a group, these airlines represent nearly 88% of the revenue passenger miles flown by U.S. based airlines.[a]

Total frequent flier reward liability was estimated to have increased for the U.S. airline industry during 2004. This change is consistent with the decreased reward travel noted in the recently released Industry Analysis titled: **Frequent Fliers Had Their Wings Clipped During 2004 With 314,000 Fewer Reward Tickets**. Frequent flier members redeemed fewer rewards during 2004, which resulted in greater deferral of reward liabilities to the future.

Information compiled in this comparison includes **1) Liability for Future Reward Travel,** and **2) Unused Miles and Points**. Activity reported for 2004 was compared to prior-year activity reviewed in the Industry Analysis released by IdeaWorks on April 5, 2004.

The source for disclosure for each airline included in the survey was primarily Form 10-K annual reports. As indicated throughout this report, some estimates were calculated using averages from a subset of disclosing airlines. Statistics for 2003 were updated when changes were noted in the 2004 annual reports or were communicated to IdeaWorks by airline management.

Liability for Future Reward Travel

The total liability for future reward travel benefits reported by the ten U.S. based airlines making Form 10-K disclosures was nearly US$3.4 billion at the end of 2004. Airlines are sorted in descending order by their reported 2004 frequent flier liability:

Table 1 Reporting Airlines	2004 FFP Liability	2003 FFP Liability	2004 vs. 2003
American Airlines	$1,400,000,000	$1,200,000,000	+16.7%
United Airlines	$840,000,000	$717,000,000	+17.2%
Alaska Airlines	$409,200,000	$336,000,000	+21.8%
Northwest Airlines	$215,000,000	$119,000,000	+80.7%
Delta Air Lines	$211,000,000	$229,000,000	-7.9%
Continental Airlines	$195,000,000	not reported	n/a
US Airways	$73,000,000	$85,000,000	-14.1%
ATA Airlines	$1,400,000	$700,000	+100.0%
jetBlue	$800,000	$600,000	+33.3%
Frontier Airlines[b]	$584,000	$283,000	+106.4%

IdeaWorks has estimated the liability associated with the four carriers not making Form 10-K disclosures to be in excess of US$528 million. **When combined, total estimated liability is in excess of US$ 3.87 billion for the fourteen carriers in the survey and represents an increase of 10.8% over 2003.** This estimate is based upon an average liability per revenue passenger mile among the airlines making Form 10-K disclosures. RPMs, as they are commonly called in the airline industry, are defined as the number of miles flown by the total number of ticketed passengers.

Eleven of the fourteen airlines further defined the liability associated with reward travel by estimating the number of reward tickets outstanding at the end of 2004. Airlines are sorted in descending order by the reported number of tickets outstanding:

Table 2 Reporting Airlines	2004 Rewards Outstanding	2003 Rewards Outstanding	2004 vs. 2003
Delta Air Lines	15,000,000	14,300,000	+4.9%
United Airlines	10,200,000	9,700,000	+5.2%
American Airlines	10,000,000	9,300,000	+7.5%
US Airways	4,000,000	6,272,000	-36.2%
Northwest Airlines	3,800,000	7,180,000	-47.1%
Alaska Airlines	2,493,000	2,353,000	+5.9%
Continental Airlines	2,100,000	not reported	n/a
Southwest Airlines	1,400,000	1,453,000	-3.6%
Midwest Airlines	136,000	178,000	-23.6%
jetBlue	88,000	not reported	n/a
Frontier Airlines	47,600	14,615	+225.7%

The total number of tickets outstanding and not yet redeemed by frequent flyer program members for the 11 airlines listed in **Table 2** is in excess of 49 million roundtrips. Disclosing airlines typically defined reward travel as representing their base reward level for domestic travel (such as 25,000 miles).

Airlines assign a value to unused reward travel, which usually represents the average incremental cost to provide roundtrip transportation for one additional passenger. Typically this ranges from US$10-20 and includes the cost of fuel, commissary, reservations and insurance and does not include a contribution to overhead, aircraft cost or profit.

Unused Miles and Points

Seven of the 14 airlines disclosed the spoilage factor used to calculate the liability assigned for future reward travel. IdeaWorks calculated the overall average for these seven airlines to be 30.6% using a weighted average formula.

The statistic reflects the natural spoilage which occurs in reward programs. Miles accrued by frequent flyer program members may remain unused for many reasons such as the loss of paper reward certificates by members, the impact of expiration dates on miles and rewards, or members simply ceasing to participate in a program.

The following seven airlines disclosed their frequent flyer reward spoilage factors in the Form 10-K reports filed with the U.S. Securities and Exchange Commission. Airlines are sorted in descending order by their reported percentage of unused miles:

Table 3 Reporting Airlines	2004 % of Miles Unused	2003 % of Miles Unused	2004 vs. 2003
jetBlue	70.0%	65.0%	+5.00%
Delta Air Lines	46.7%	28.6%	+18.1%
Midwest Airlines	24.0%	24.0%	no change
US Airways	20.0%	20.0%	no change
United Airlines	17.6%	17.8%	-0.20%
Southwest Airlines	14.0%	14.0%	no change
Alaska Airlines	12.0%	12.0%	no change

Several airlines noted changes to the formulas used to determine frequent flier liabilities and the methods used to account for reward expenses. For example, **Table 3** lists Delta's decision to increase the number of expiring miles to 46.7%; this contributed to Delta's liability decrease for 2004. But for many carriers, details describing the changed formulas and methods were rarely provided in the Form 10-K annual reports.

These changes impacted the reliability of projecting frequent flier program liability. Airlines traditionally estimated the number of miles or points outstanding, applied a factor to account for unused reward tickets and calculated total liability on the basis of the incremental cost of carrying a reward passenger. As indicated in many 2004 annual reports, this simple method no longer meets the scrutiny of airline accountants.

Credit Cards and Airline Alliances Impact Liability

Two new factors have dramatically impacted frequent flier programs: co-branded credit cards and airline alliances.

The overwhelming presence of co-branded credit cards is generally viewed as creating a flood of new miles and points. . . and revenues. Alaska Airlines revealed in its 2004 annual report more than 60% of its frequent flier liability can be attributed to the sale of miles to partners; co-branded credit cards usually dominate the partner revenue category. Frontier disclosed it earned fees in excess of US$4.2 million from its co-branded credit card during its 2004 fiscal year ended March 31, 2004.

The purchase of reward tickets from alliance partners increased for some carriers during 2004. Northwest described a liability increase of US$77 million caused by the purchase of a greater than anticipated quantity of rewards for travel on partner airlines. This trend was also apparent at United Airlines, which experienced higher reward redemption on partner airlines; 23% of miles were redeemed on partners in 2004 versus 22% during 2003. Continental charged an additional US$18 million to its books in 2004, which was attributed to reward redemptions on alliance carriers. Alaska noted 38,000 more tickets were redeemed on partner airlines during 2004.

Observations and Conclusions

2004 presented a challenging scenario - - increased reward liabilities, increased load factors and increased losses. The long-term solution may include an increased reliance on alliance partners for reward redemption and perhaps non-airline rewards such as merchandise and hotel stays. This strategy would require cash expenditure for rewards and that is something the airlines have always sought to avoid . . . especially in today's economic environment.

Clearly, airlines are concerned about these developments. They are delighted by the revenues generated by co-branded credit card programs. Yet they are challenged by the need to provide increased availability for reward travelers on their own airlines. Perhaps members have started to rely more on partner airlines for reward travel.

For many frequent travelers, reward redemption is likely to become increasingly challenging during 2005 as many airlines continue to place greater emphasis on revenue generation through ticket sales at the expense of allocating seat inventory for frequent flier reward travel.

About IdeaWorks: IdeaWorks was founded in 1996 as a consulting organization building brands through innovation in product, partnership and marketing and, building profits through financial improvement and restructuring. Its international client list includes the hotel, airline, marine, railroad, consumer products and health care sectors. IdeaWorks specializes in brand development, customer service improvement, customer research, competitive analysis, creating partner-marketing strategies, cost reduction programs and business restructuring. IdeaWorks brings value as a consultant by researching the expectations of the customer, learning from the wisdom of the client organization and applying innovative ideas to create solutions for clients and consumers. Learn more by visiting: www.IdeaWorksCompany.com

Sources for the Frequent Flier Program Analysis: Unless indicated otherwise, all data is from the most recent Form 10-K filed with the SEC by each airline.

Disclosure: IdeaWorks makes every effort to ensure the quality of the information available in this report. Before relying on the information, readers should obtain any appropriate professional advice relevant to their particular circumstances. This Industry Analysis was independently produced and has not been completed as work on behalf of a client company. IdeaWorks cannot guarantee, and assumes no legal liability or responsibility for the accuracy, currency or completeness of the information.

Endnotes:

---

[a] 2004 projected activity from the Air Transport Association web site at Air-Transport.org and reflects the activity of U.S. scheduled passenger airlines.

[b] Frontier's fiscal year ended March 31, 2004. All other airlines listed base their fiscal year on the calendar year.