The Advantageous Merger?

QUT REAL WORLD CONSULTING

Your current challenge

- How does Alaska Airlines (AA) successfully merge with Virgin America (VA) in order to:
  - Combine operations efficiently
  - Avoid brand equity loss
  - Reap the synergy of the two cultures
  - Create value for shareholders

Imagine this future…

Alaskan Airlines has successfully leveraged the merger with Virgin America

- Increase revenue by 115%
- Significant growth in brand equity
- Considered the “go-to” airline

Pillars of our strategy

1. Rebrand Virgin America
2. Create synergies between cultures
3. Cross pollenate to create operational efficiencies
4. Improve customer experience

Introducing:

ALASKAN ADVANTAGE AIRLINES (AVA)

Introductions

- QUT Real World Consulting's Senior Team:
  - Justin Bindman
  - Arbess Balbarias
  - Sarah Goulding
  - Cameron Jones

Overview

- External factors
- Internal capabilities
- Options
- Recommended Strategy
- Value proposition
- Implementation Strategy
- Financial Analysis

External influences

External influences: Market Drivers

Technology

- ✓ Integration software becoming more accessible and cost effective

Economic

- ✓ Volatile fuel prices
- ✓ More M&A due to disruption - consolidation of firms

Social

- ✓ Increase in air travel as preferred choice
- ✓ Increase in globalization
- ✓ Differentiated market across the Us
- ✓ Millennial priorities are changing

External influences

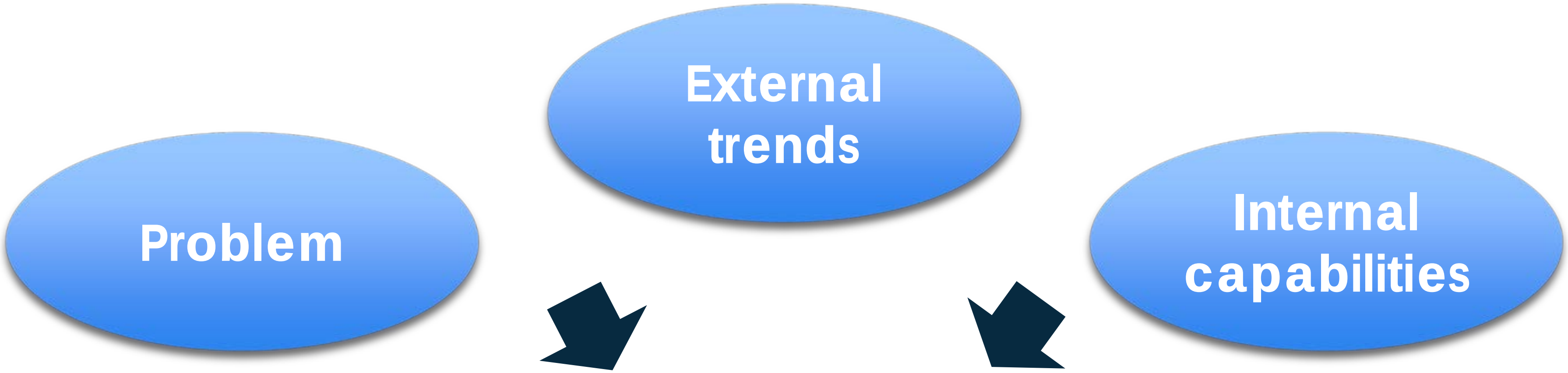
Influence	Importance	Impact	
Different demographics: • Tech savvy adults • Millennial youngsters • Folksy/ traditional	Market segment demands differ	✓	Potential to maximize value by accessing multiple segments
Brand awareness	Increasing and maintaining reputation	✓	Keeping customers and growing market share
Big four airlines: • American Airlines • Delta Airlines • United Airlines • Southwest Airlines	Competitive rivalry	✗	Potential to increase competitiveness

Internal capability analysis

Internal capability analysis

Key capabilities	AA		VA
Reliability	Operational excellence	Value add →	
Innovation	Customer experience	↔ Synergy	Customer experience
Destinations	Extensive	Value add →	Limited
Brand reputation	Reliable, respectable, folksy	↔ Synergy	Young, stylish, flamboyant
Internal cultural value		← Value add	Strong alignment with brand; dedicated staff

Options Analysis



<u>4 KEY SUCCESS FACTORS</u>:

Company value

Brand reputation

Operational efficiencies

Cultural Impact

Options Analysis

1
Create a new unifying brand

2
Status quo
(2 current brands)

3
Absorb VA brand
(into AA)

4
Rebrand VA
(aligned with AA)

<u>ASSESSED 4 KEY SUCCESS FACTORS</u>:

Company value

Brand reputation

Operational efficiencies

Cultural Impact

Option 1: Unifying brand

Option summary:	Dissolve both existing brands, create a new, unifying brand

	Impact	**Rationale**
Company value	↓	Significant capital investment required – erodes value
Brand reputation	↓	Potential to take the best of both brands BUT, erodes value of both brands
Operational efficiencies	↑	Potential to create significant efficient
Cultural Impact	→	Opportunity to create a new, unified culture, BUT may also be some resistance

Recommendation:	**Do not pursue this option**

Option 2: Status Quo

Option summary:	Maintain AA and VA under current brands

	Impact	Rationale
Company value	→	No investment in rebranding; both companies performing well – BUT there are operational inefficiencies
Brand reputation	↑	Value of both brands remains
Operational efficiencies	↓	Will create significant inefficiencies
Cultural Impact	→	Cultures maintained, BUT silos create some issues and opportunities to integrate

Recommendation:	**Do not pursue this option**

Option 3: Absorb VA into AA

Option summary:	VA brand no longer exists

	Impact	Rationale
Company value	→	AA value overall likely to increase; rebranding of VA required; potential lost revenue resulting from VA brand loss
Brand reputation	↓	VA is no longer differentiated
Operational efficiencies	↑	Will be realized over time
Cultural Impact	↓	Virgin culture extremely strong

Recommendation:	**Do not pursue this option**

Option 4: Rebrand VA

Option summary:	VA brand no longer exists; is rebranded to Alaskan AdVantage Airlines (AvA) to align with AA but maintain its differentiation

	Impact	**Rationale**
Company value	↑	AA value overall likely to increase; rebranding of VA required; maintain VA customers
Brand reputation	↑	VA capabilities remain differentiated; may upset some customers
Operational efficiencies	↑	Will be realized over time
Cultural Impact	→	Virgin name strong; staff may resist change, but they will maintain cultural elements. ***Will achieve cultural synergies.***

Recommendation:	**Pursue this option**

Recommended Approach: Rebrand VA

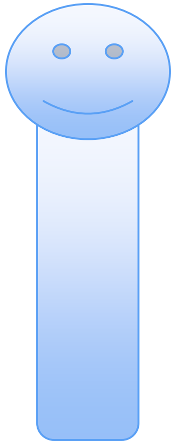
Pillars & benefits of the strategy		
1	Create **Alaska AdVantage Airlines (AVA)** brand	VA qualities remain differentiated, but now aligned to AA
2	Implement Cultural Enhancement Program	Synergies are realized
3	Integrate business operations: IT, fleet	Efficiency gains
4	Enhanced customer experience	Synergies in combining internal capabilities

Value proposition - customer

VA

<u>Name</u>: Teresa
<u>Age</u>: 27
<u>Prof</u>.: IT Consultant
<u>Travel Patterns</u>:
LA to NYC twice a month on business
<u>Issues</u>: Critical that she's on time; last 5 flights there has bene a 45min-2 hour delay

AA



<u>Name</u>: Richard
<u>Age</u>: 53
<u>Prof</u>.: Alaska
<u>Travel Patterns</u>:
Portland – monthly
Honolulu – once a year
<u>Issues</u>:
Baggage lost and mishandled; flight has been bumped the last 3 months

What matters to them both?

Value proposition - customer

- Customer service
- Flight reliability
- Inflight options
- Cost/ Value for money
- Access to destinations

Through synergies created all are enhanced

Value proposition - customer

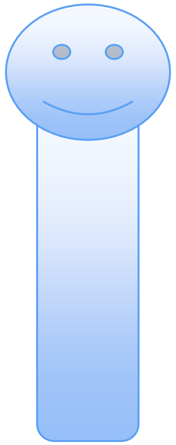
AvA

On time

Professional

Relaxed

AA



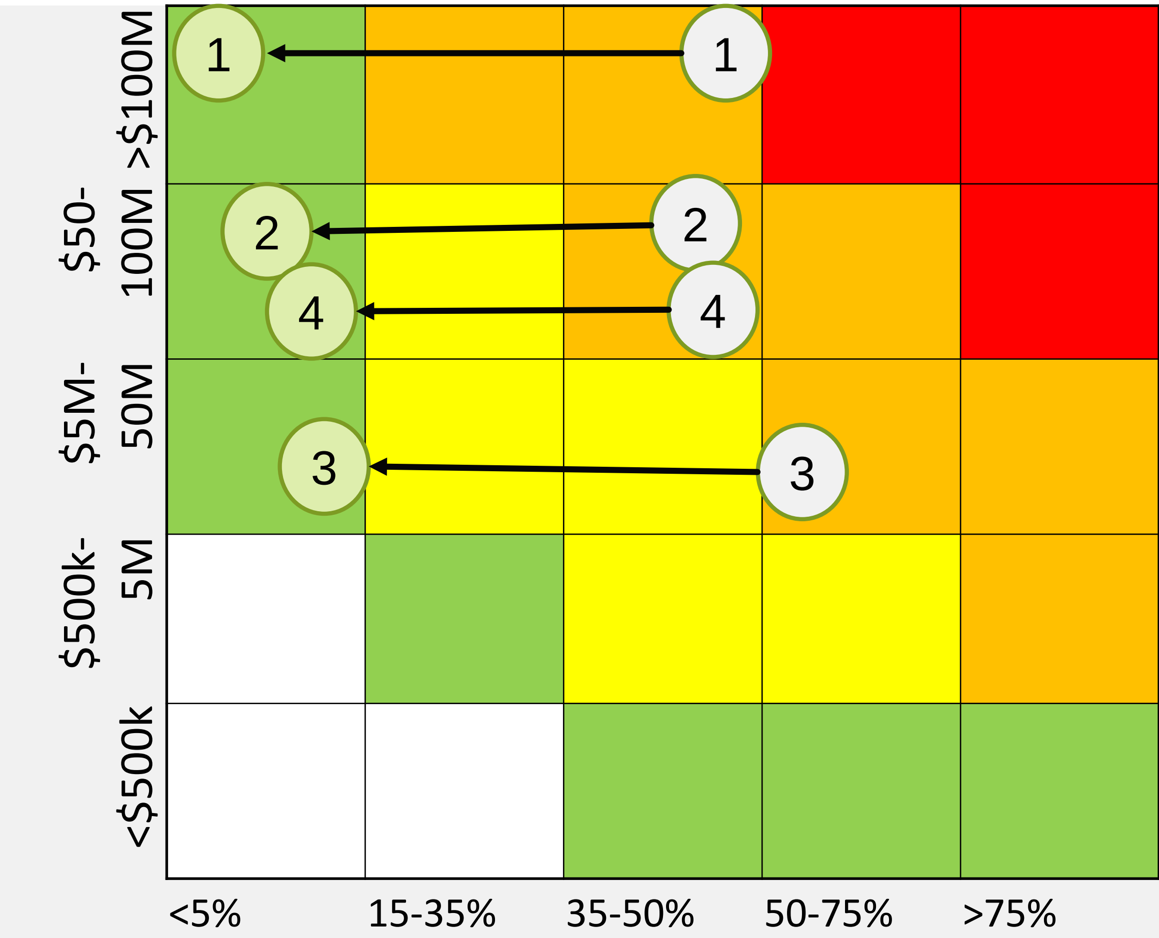
Confident that he'll get his bag

Air travel suddenly seems more fun

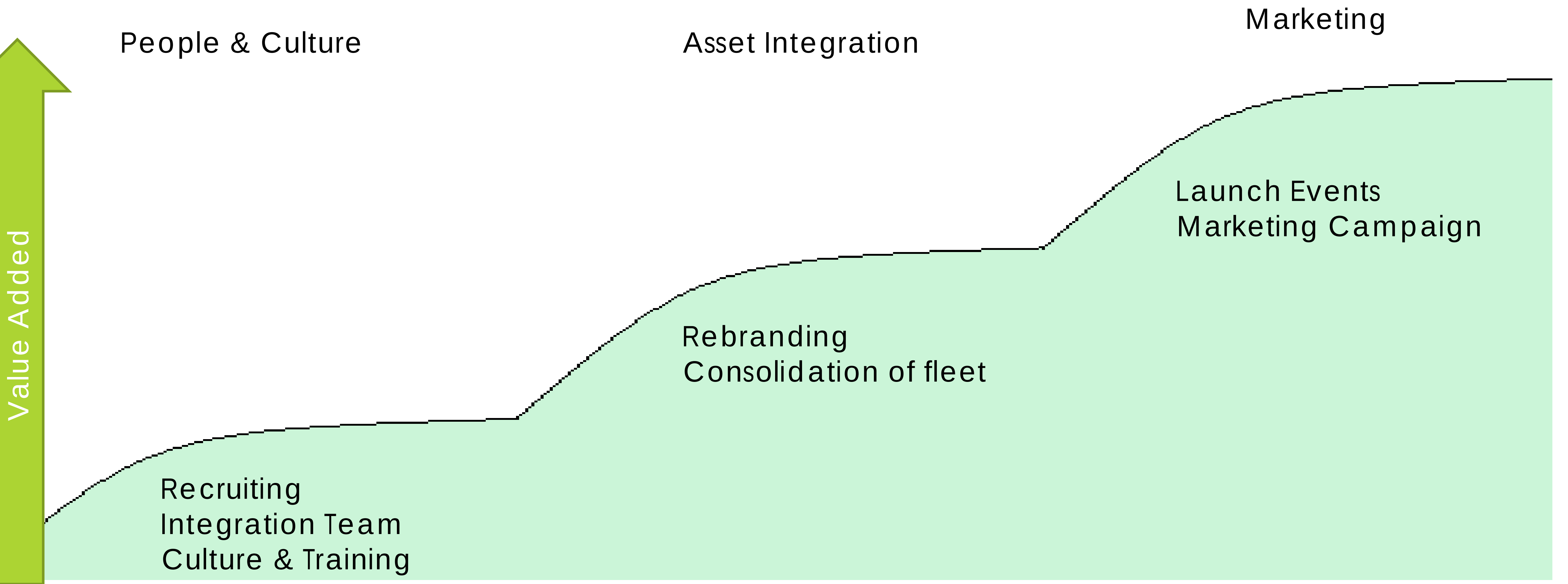
Risk and Implementation Plan

Risk Analysis

#	Risk	Score	Mitigation	Score
1	Alienating existing loyal customers leads to lower revenues	High	Maintain product suite, recruit culture integration team, heavy marketing.	Low
2	Multiple aircraft fleets will increase maintenance costs	High	When lease ends, consolidate fleet to Boeing	Low
3	Staff retention issues occur due to integration and cultural changes	High	Recruit integration and culture team.	Low
4	Differing IT platforms leads to inefficiencies	High	Create middleware platform to bridge gaps.	Low



Implementation Strategy



Implementation Plan

Strategy	Tactic	Phase I 2016	Phase II 2017	Phase III 2018
People & Culture	Recruiting for Cultural Enhancement	$1.5	$1.6	$2.0
	Recruiting for Integration Task Force	$1.4	$1.4	$1.3
	Learning & Development - Training	$6.5	$4.5	$4.5

Implementation Plan

Strategy	Tactic	Phase I 2016	Phase II 2017	Phase III 2018
People & Culture	Recruiting for Cultural Enhancement	$1.5	$1.6	$2.0
	Recruiting for Integration Task Force	$1.4	$1.4	$1.3
	Learning & Development - Training	$6.5	$4.5	$4.5
Asset Integration	IT middleware platform integration	$55.0	$45.0	
	Rebrand & Consolidation of existing Fleet (63) & Assets	$65.0	$25.0	

Implementation Plan

Strategy	Tactic	Phase I 2016	Phase II 2017	Phase III 2018
People & Culture	Recruiting for Cultural Enhancement	$1.5	$1.6	$2.0
	Recruiting for Integration Task Force	$1.4	$1.4	$1.3
	Learning & Development - Training	$6.5	$4.5	$4.5
Asset Integration	IT middleware platform integration	$55.0	$45.0	
	Rebrand & Consolidation of existing Fleet (63) & Assets	$65.0	$25.0	
Marketing	Product Launch Events	$6.6		
	Brand Ambassadors	$4.5		
	Marketing Campaign	$14.5	$27.5	$32.2
	Totals (In $M)	$155.0	$105.0	$40.0

Financial Analysis – Assumptions

Combined customer base of 39M

Expenses will be lowered relatively by economy of scale - maintenance, fuel etc.

Integration costs expected to be $300-350M

$22M annual royalty fee to Virgin for Brand Image

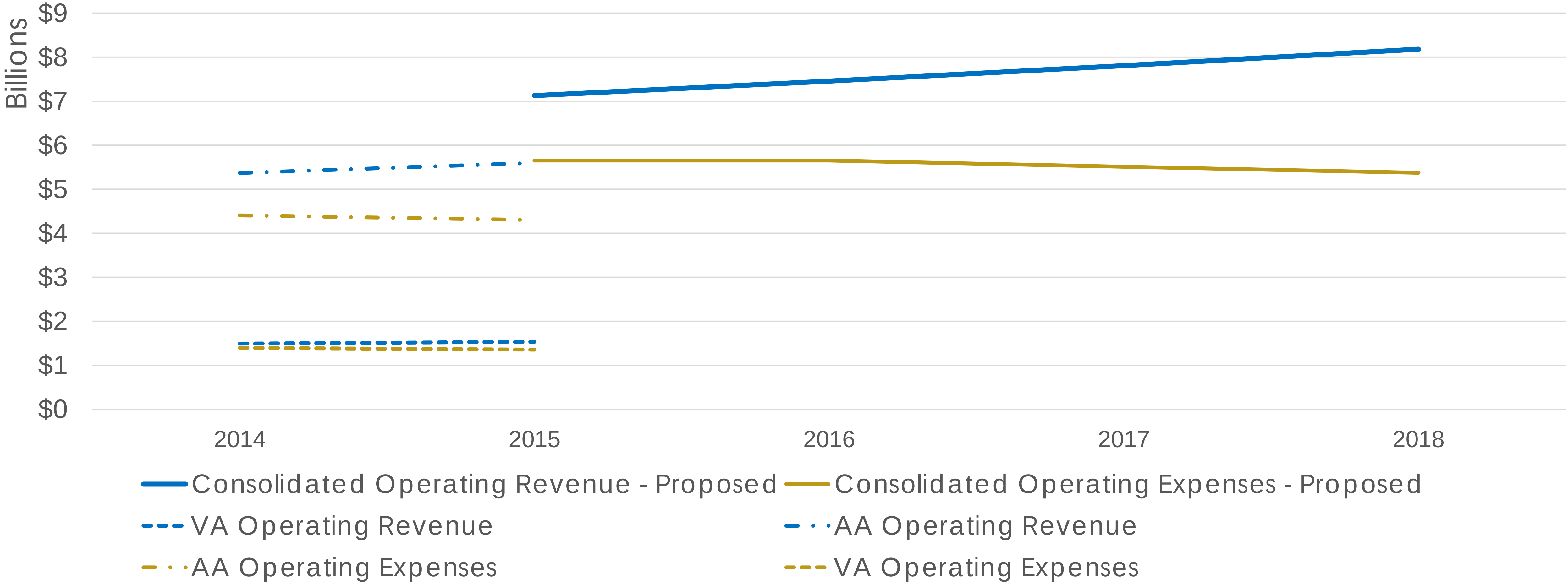
90% of the synergies of the acquisition will be gained as is

West Coast Market Share 22%

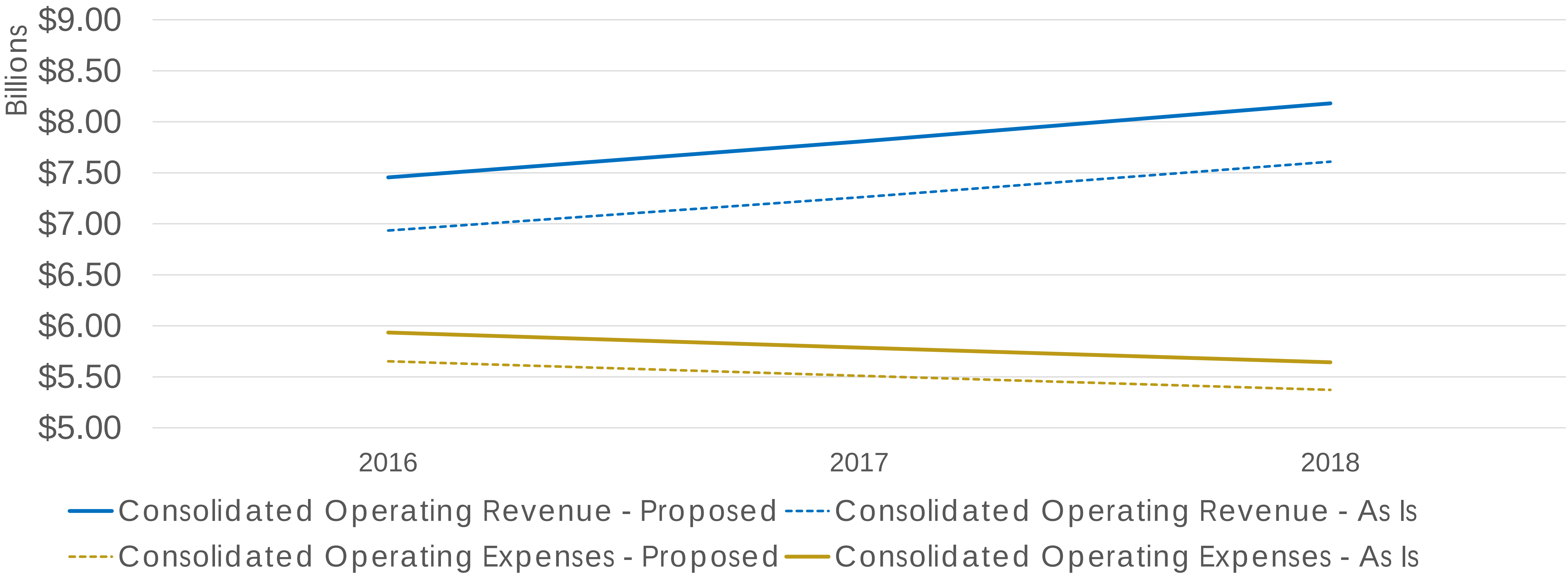
Financial Analysis – Overview

in $M	2013	2014	2015	2016	2017	2018
AA Operating Revenue	$5,156	$5,368	$5,598			
		104.1%	104.3%			
VA Operating Revenue	$1,425	$1,490	$1,530			
		104.6%	102.7%			
Consolidated Operating Revenue - Proposed			$7,128	$7,456	$7,806	$8,181
				104.6%	104.7%	104.8%
Consolidated Operating Revenue - As Is			$7,128	$6,934	$7,260	$7,608
				97.3%	103.7%	103.7%
AA Operating Expenses	$4,318	$4,406	$4,300			
VA Operating Expenses	$1,344	$1,394	$1,352			
Consolidated Operating Expenses - Proposed			$5,652	$5,652	$5,511	$5,373
Consolidated Operating Expenses - As Is			$5,652	$5,935	$5,786	$5,642
CAPEX				$ 155	$ 105	$ 40
AA Net Income	$508	$605	$848			
		119%	140%			
VA Net Income	$10	$61	$168			
		610%	275%			
Consolidated Net Income - Proposed			$959	$1,072	$1,424	$1,799
				111.7%	132.9%	126.4%
Consolidated Net Income - As Is			$959	$650	$958	$1,278
				67.7%	102.5%	103.0%

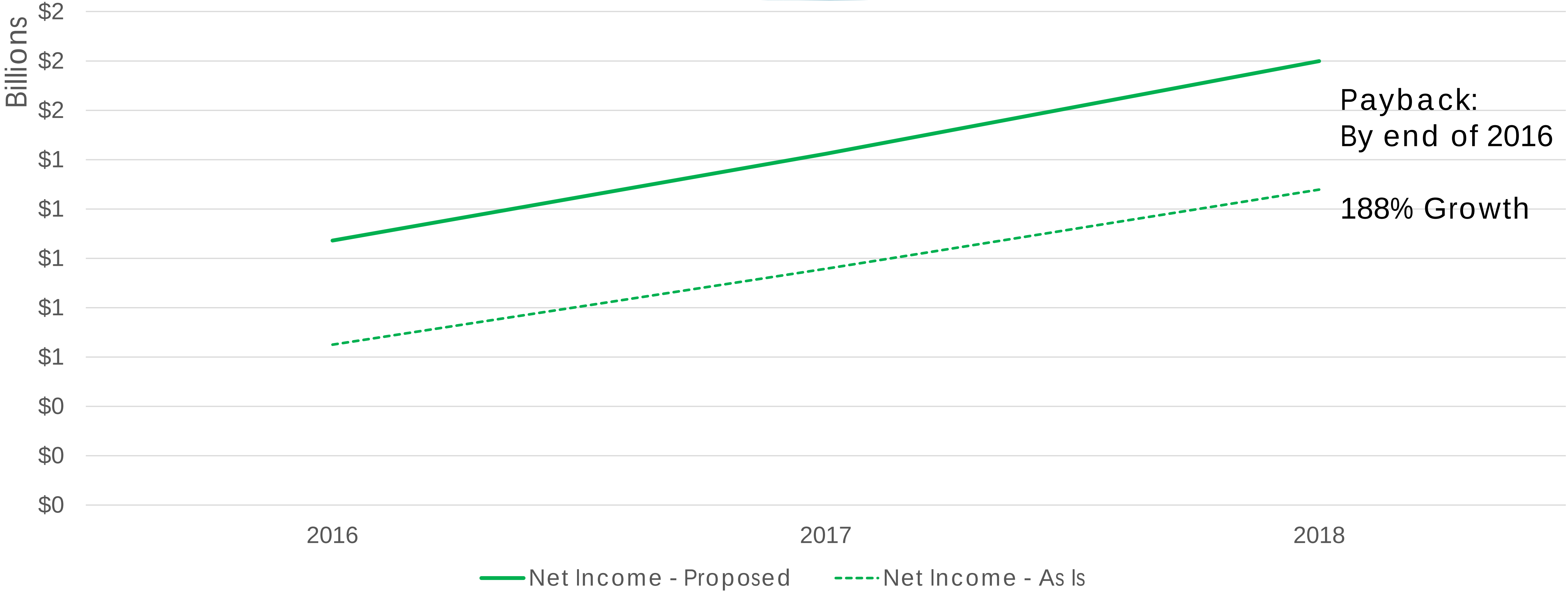
Financial Analysis – Revenue & Expenses



Financial Analysis – Revenue & Expenses



Financial Analysis – Profits



Payback:
By end of 2016

188% Growth

Your opportunity

Your opportunity

- Differing demands from different market segments
- Two airlines with strong, complimentary internal capabilities
- Both airlines are profitable, BUT there is a risk of alienating customers through the merger
- Robust and thorough mitigation strategy can should you from that risk

Your Opportunity

Following the pillars of our strategy:

- Maintain Alaskan Airlines
- Launch AvA

ALASKAN ADVANTAGE AIRLINES (AVA)