

Alaska & Virgin Airlines: The Route to Success

Signal Consulting

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Agenda

- ▶ Mandate
- ▶ Key Issues
- ▶ Objectives
- ▶ Recommendation
- ▶ Analysis
- ▶ Alternatives
- ▶ Implementation
- ▶ Risk and Mitigations
- ▶ Question

Mandate

Develop a Strategy to
ensure successful
integration of Virgin
America and Alaska
Airlines

Key Issues

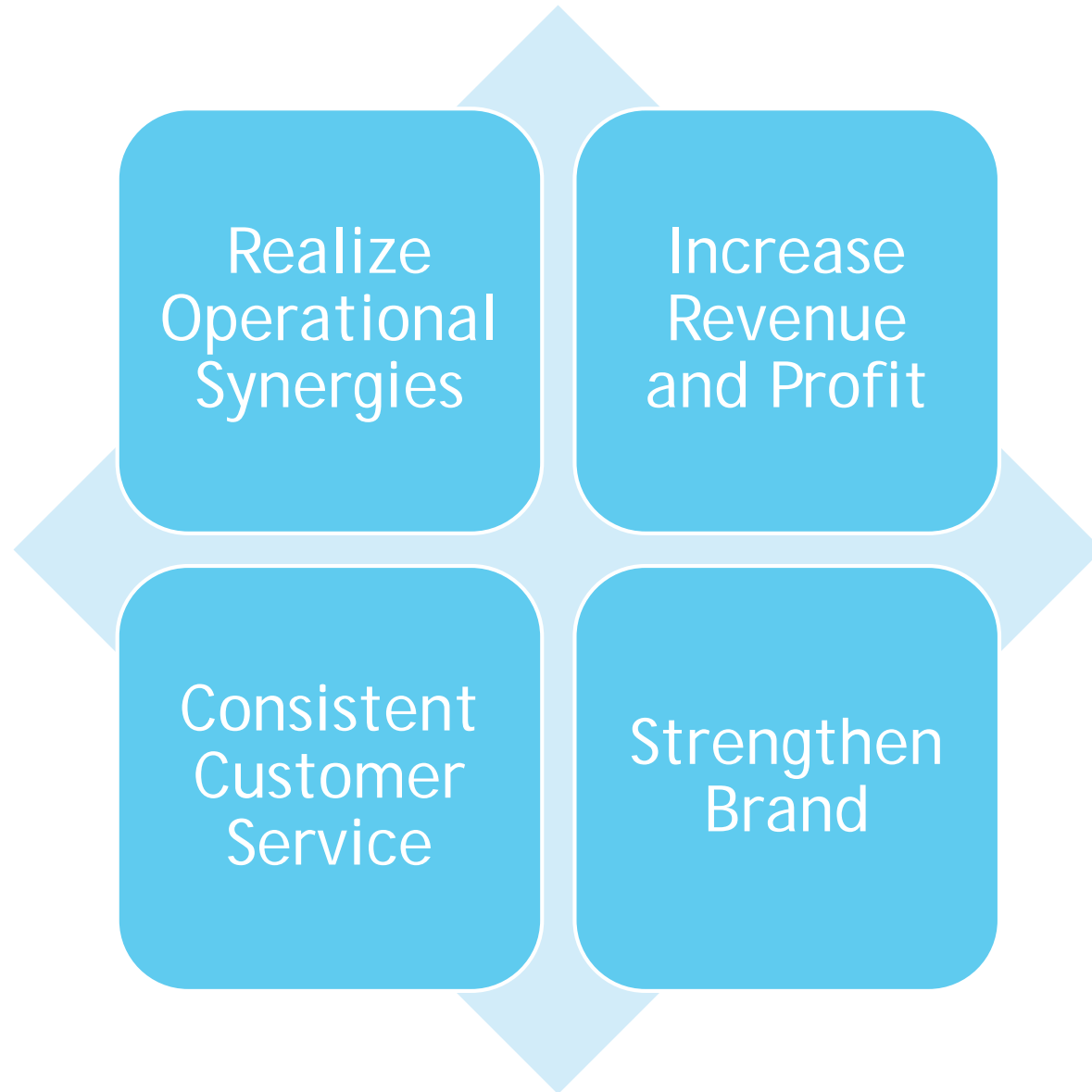
Competition

Integration

- Company Culture
- IT systems
- Operational

Shareholders expectations

Objectives



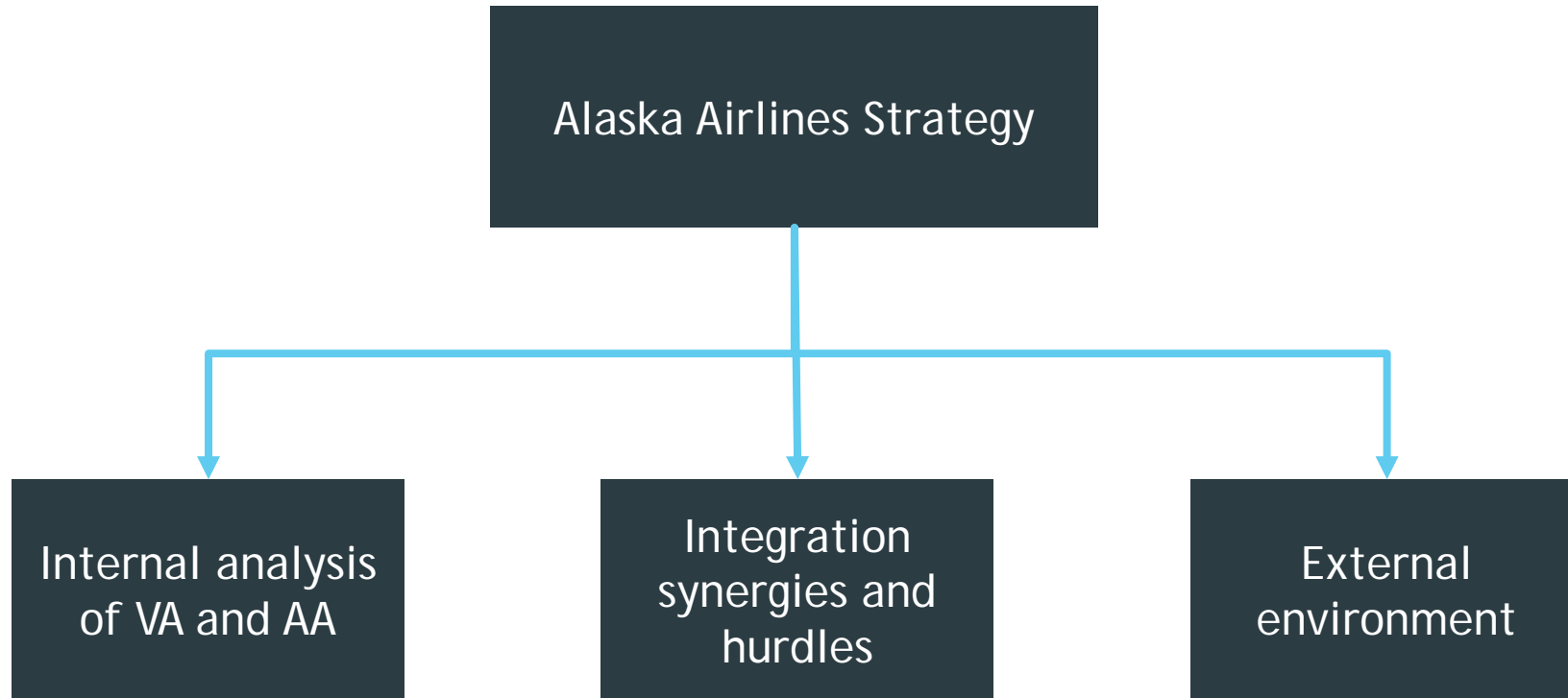
Recommendation

Build the Alaska Airlines brand while incorporating key components of Virgin America's strengths

Analysis

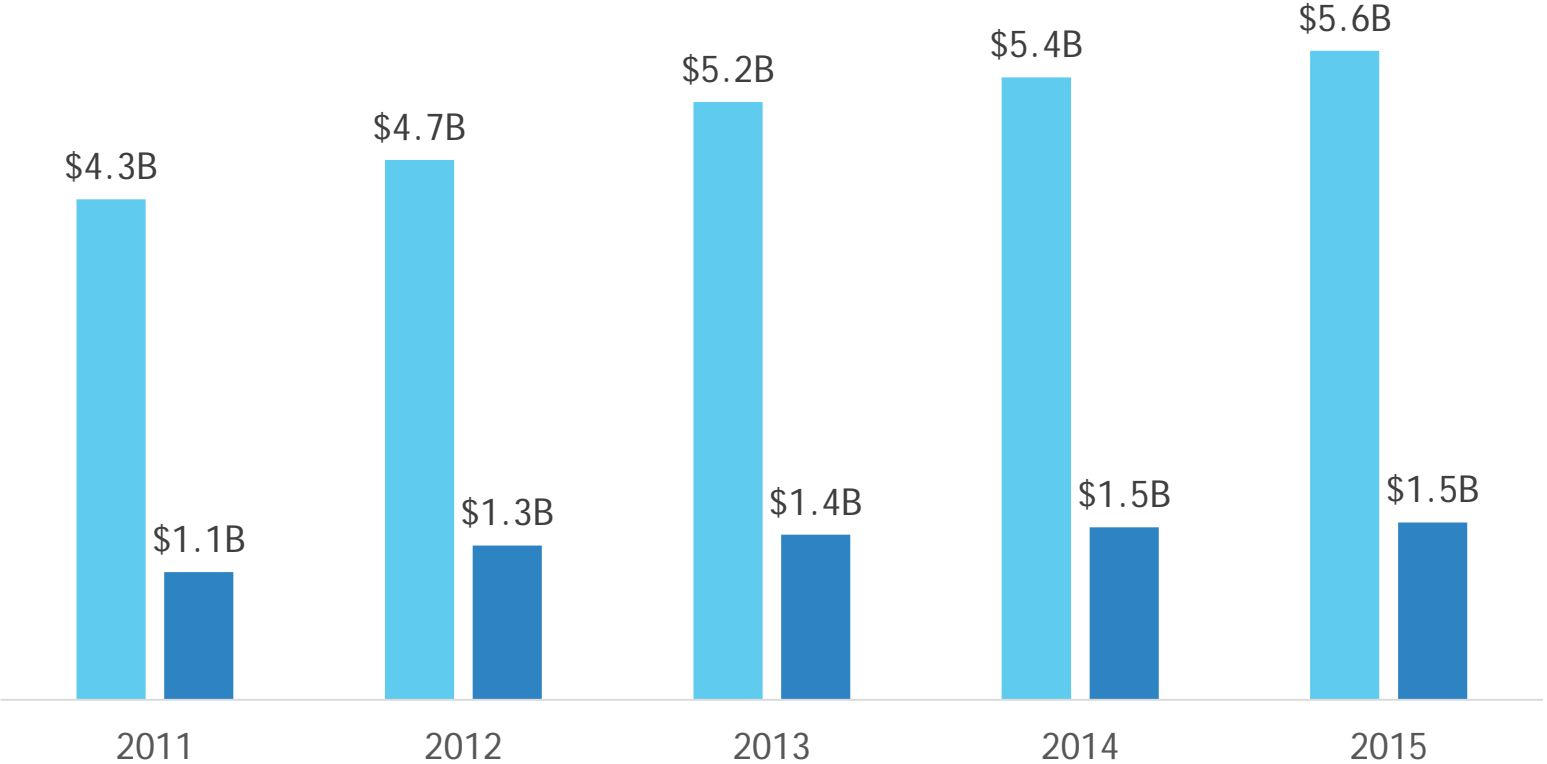
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Three-pronged analysis



Internal - Strong financial growth

Alaska Airlines - Revenue (2011 - 2015)



5-year
revenue
growth:

AA: 30%
VA: 39%

Internal analysis - KPIs

| | Alaska | Virgin |
|-------------------|-------------------|------------------|
| Customer Base | 32 million annual | 7 million annual |
| Fleet Size | 223 aircraft | 64 aircraft |
| Destinations | 112 | 24 |
| 2015 revenue | \$5.6 billion | \$3,000 billion |
| Seat miles (2016) | 35,753 | 14,595 |
| 2015 net income | \$848 million | \$340.5 million |

Alaska brand has significantly more reach and scale

Internal - Competencies and Culture

Alaska

- Innovative technology
- Customer experience
- Streamlined cost structure
- Strong financial growth
- “For the same price, you get more”

Virgin

- Unique, modern experience
- Culture of innovation
- Award-winning service
- Strong financial growth
- “Younger and cheekier”

The creation of synergies

Alaska and Virgin

Culture of growth and innovation

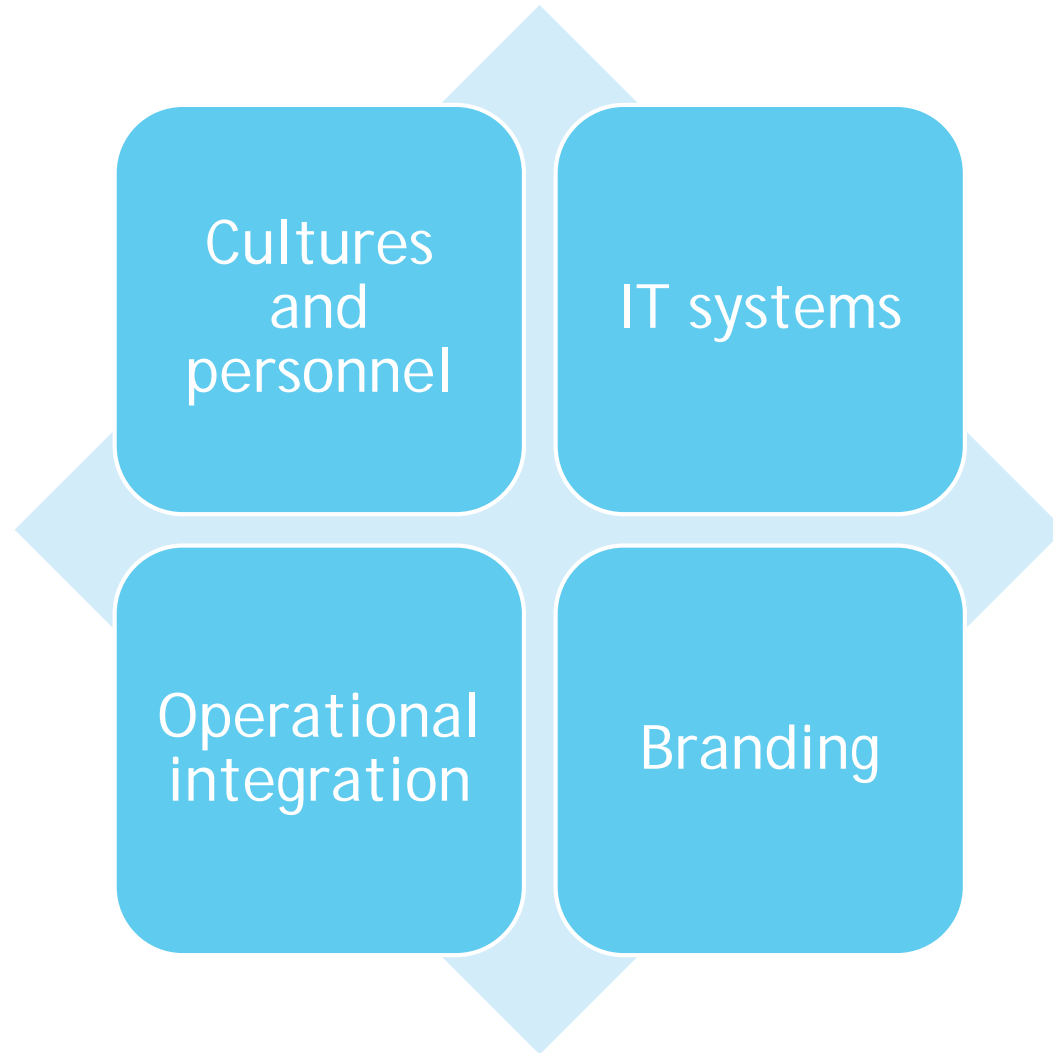
Strength in customer service

Operational cost savings

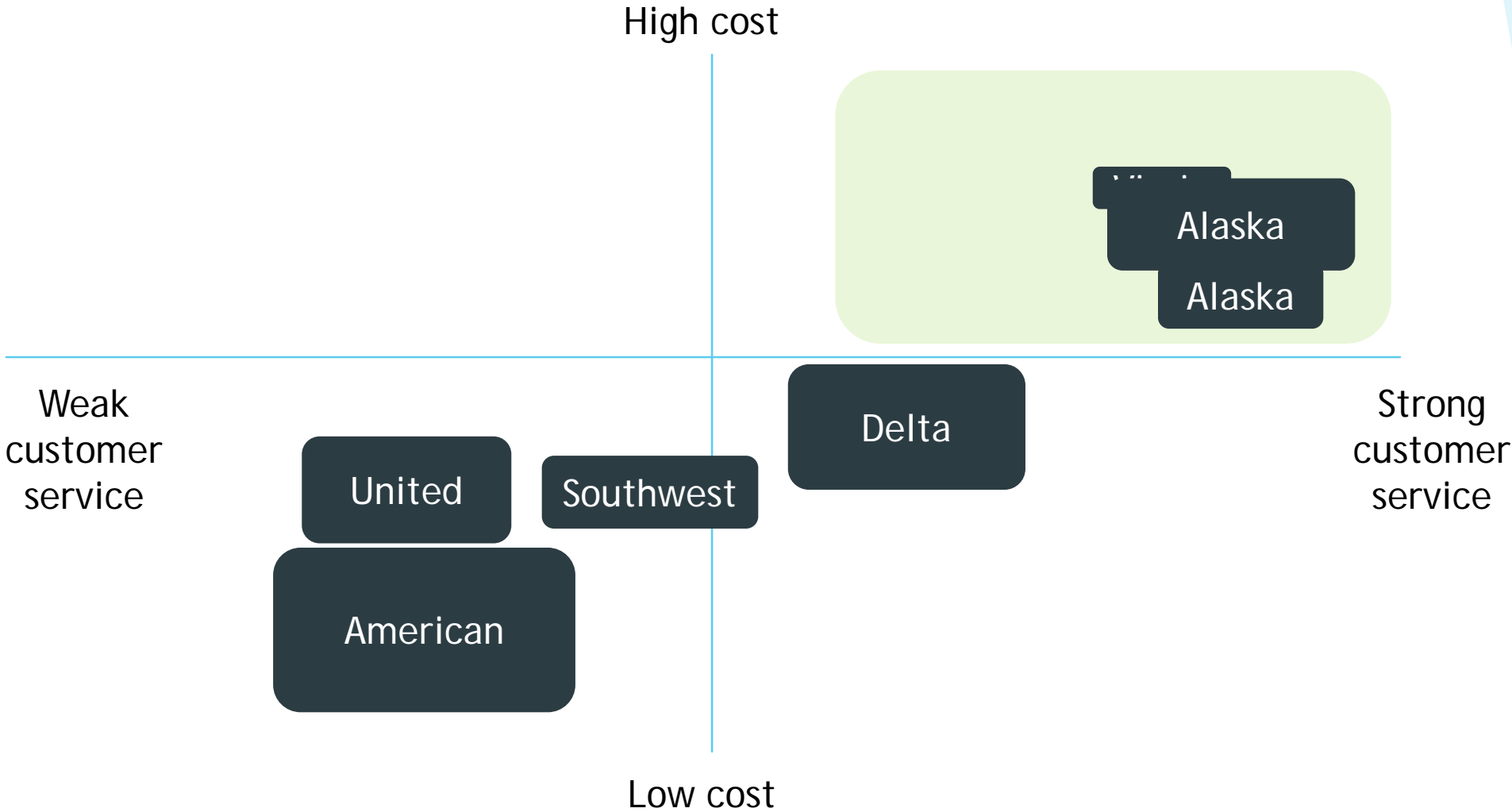
Customer bases and capacity

Route network with low crossover

The hurdles to overcome



External - Competition



External - what can go wrong

- ▶ United / Continental merger- driven by financial instability
 - ▶ **IT systems integration**
 - ▶ Underestimated the complexity
 - ▶ Multiple nationwide crashes
 - ▶ **Culture**
 - ▶ Ignored this as an issue
 - ▶ **Unions**
 - ▶ Difficulty in combining - grounded flights

Alternatives



Maintain Separate Brands



- Individual Brand Equity



- Operational Cost
- Culture Silos

Develop New Brand



- Operational Synergies



- Loss of Brand Equity

Use Virgin America Brand



- Culture
- Trendy



- Limited Customer base
- Operational Cost

Use Alaska Airlines Brand

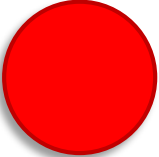
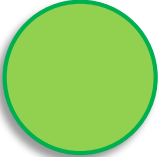
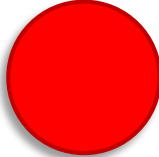
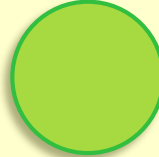
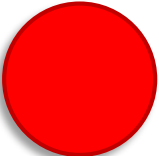
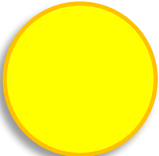
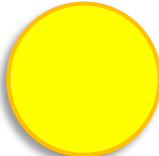
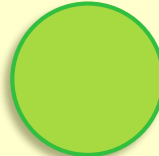
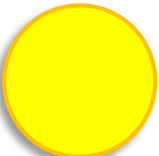
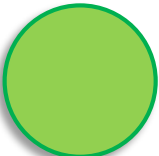
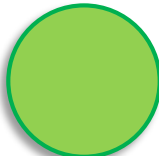
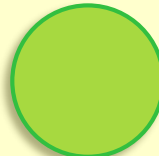
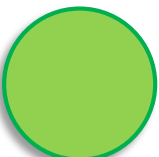
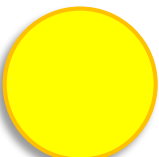
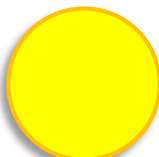
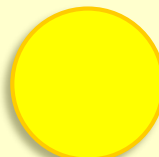


- Larger customer base
- Operational Cost



- Loss of Virgin Brand

Alternative Comparison

| | Separate | Develop New Brand | Maintain Virgin Brand | Maintain Alaska Brand |
|-------------------------|---|---|---|---|
| Operational Synergies |  |  |  |  |
| Revenue & Profitability |  |  |  |  |
| Customer Service |  |  |  |  |
| Strong Brand |  |  |  |  |

Recommendation

Build the Alaska Airlines brand while incorporating key components of Virgin America's strengths

Implementation

Taking off with the Alaska Airlines Brand

The Route to Success

Milestones

Short (Early 2017)

- Announce Brand Strategy

Medium (2017-2020)

- Service integration & cross selling
- Single operating certificate

Long (2020+)

- Transition routes to AA

Brand Decision

Build on brand equity
with things that matter to
A LOT of people

#1 Airline Scorecard, The Wall Street Journal

On time | On your way | Smile on your face

Crafting a Culture

- ▶ Open and honest
- ▶ Create excitement
- ▶ VA employees on committees...

You've rocked with Richard?
But are you ready to help Alaska Airlines
take off?

We are looking for the best and brightest to
work together to build the Alaska Airlines brand!

You're hip and we're friendly.

Together we can build more and give our
customers more!

You in?

Integrating VA Services

| | Value | Cost | Timeline |
|------------------------|-------|------|----------|
| Loyalty Program | | | Complete |
| Crew Service | ++ | | Short |
| Information Technology | ++++ | -- | Medium |
| Red Entertainment | +++ | --- | Long |
| Chef Menu | + | - | X |

Cross Selling From Virgin to Alaska

Co-Brand
VA

Combined
Flight
Search

Credits for
VA users

Come fly with Alaska Airlines

- ▶ \$100 credit
- ▶ Top 10% VA frequent flyers
- ▶ 400,000 customers

NEW CUSTOMERS

- ▶ Targeted Advertising
 - ▶ Airport
 - ▶ Online: SEO, travel & social media
- ▶ Price + Unique Service value proposition

2020 Fleet & Route Transition

Transition when
VA leases expire
(Boeing 737)

VA routes
become AA

Operational Integration Focus Areas

- ▶ IT Systems - Common Sabre System
- ▶ Unions - New collective agreements
- ▶ Procurement
 - ▶ Better fuel contracts
 - ▶ Economies of scale

Talent Plan - Special Teams

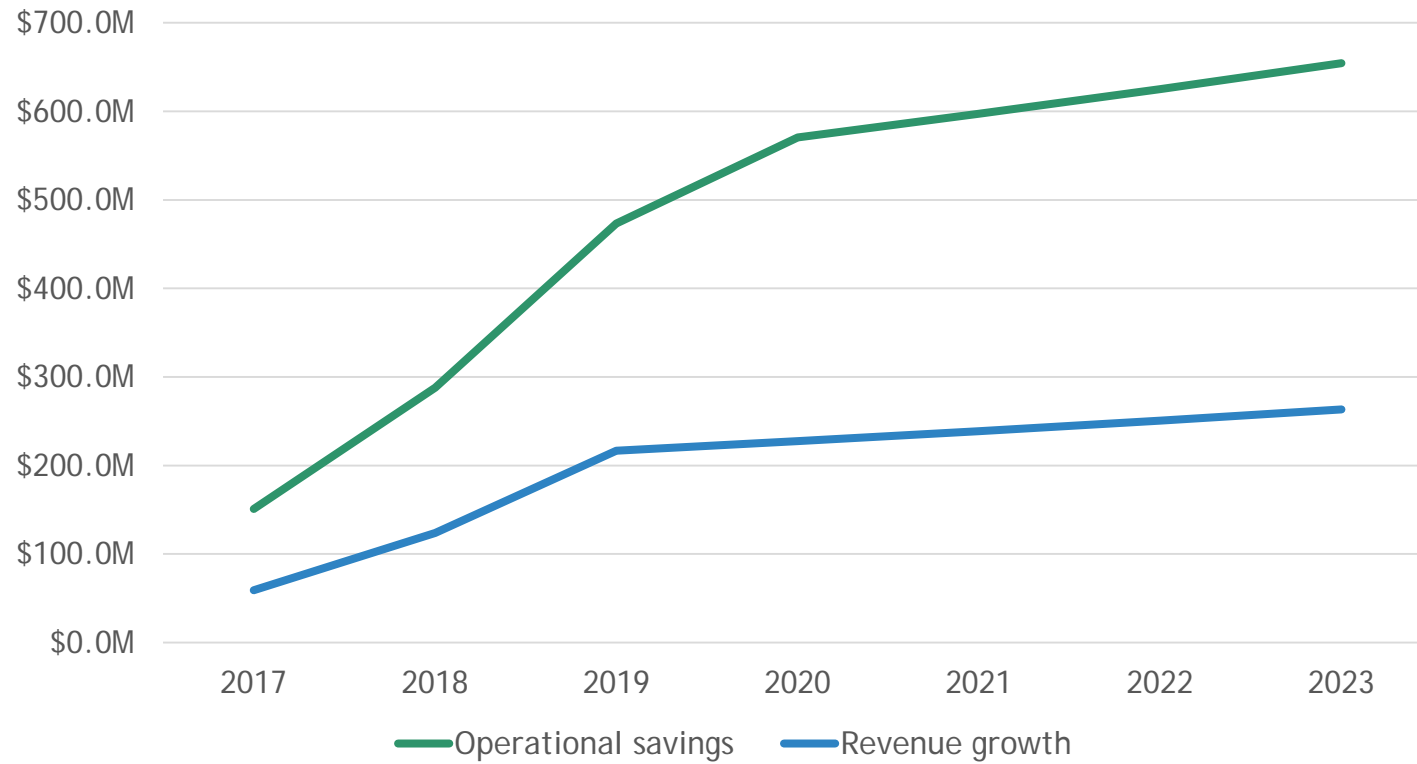
- ▶ Branding
- ▶ Culture
- ▶ Service integration
- ▶ Logistics & IT
- ▶ Union negotiations
- ▶ Purchasing

Budget

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|------------------------------|--------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Loyalty program | \$40 | \$20 | \$20 | \$20 | \$20 | \$20 | \$20 |
| Advertising | \$10 | \$10 | \$10 | \$10 | \$10 | \$10 | \$10 |
| Integration costs | \$350 | | | | | | |
| Additional integration costs | \$25 | | | \$25 | | | |
| Total | \$425 | \$30 | \$30 | \$55 | \$30 | \$30 | \$30 |

What does good look like?

Estimated revenue increases and cost savings



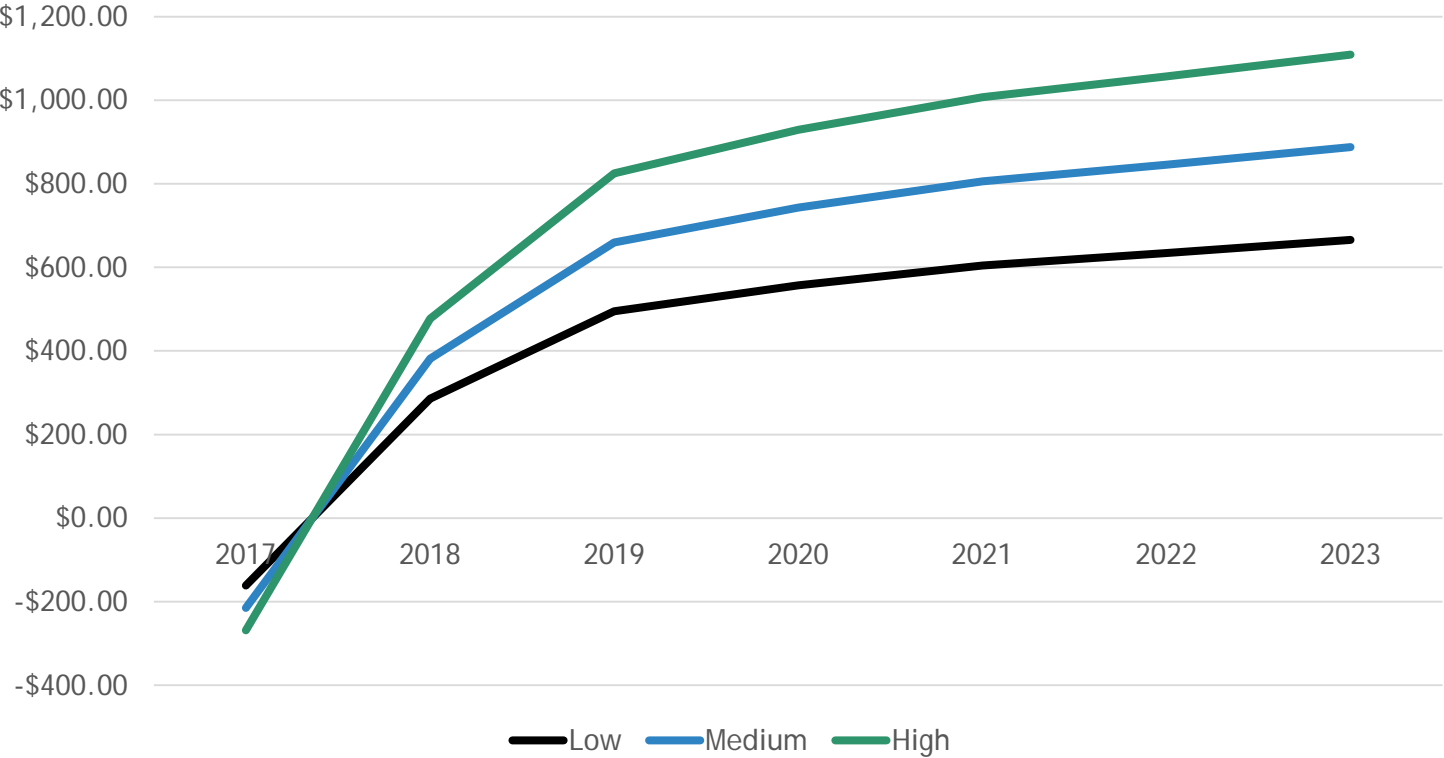
Operational savings (2023):
\$654.2M

Incremental revenue (2023):
\$263.2M

Operational savings goal by 2018

Profitability scenarios

Profitability scenarios through 2023



Incremental profit by 2023

High: \$1.1B

Med: \$887M

Low: \$665M

Total deal value: \$4B recovered by 2023

Risks and Mitigations

Risks and Mitigation

Risks

Competition

Economy

Low conversion

Probability

High

Med

Med

Mitigation

Leverage unique value prop

Streamline routes
Maintain low cost

Increase marketing

Conclusion

Realize Operational Synergies

- Eliminate redundancies
- Procurement scale

Increase revenue and profit

- Larger route network

Consistent customer service

- Training and development

Strengthen Brand

- Differentiating on services

Questions

Signal

Assumptions – medium scenario

Analyzed size of cost categories to determine potential operational savings

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|----------------------------|-------|-------|-------|-------|-------|-------|-------|
| Operations savings | | | | | | | |
| Leveraging best practices | 0.50% | 1% | 2% | 2% | 2% | 2% | 2% |
| Route redundancy | 0.50% | 1% | 2.00% | 3% | 3% | 3% | 3% |
| Internal redundancies | 1.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% |
| Maintenance/Fuel | \$20M | \$30M | \$40M | \$40M | \$40M | \$40M | \$40M |
| Royalties | | | | | \$22M | \$22M | \$22M |
| | | | | | | | |
| Revenue drivers | | | | | | | |
| Loyalty program incentives | 0.5% | 1% | 2% | 2% | 2% | 2% | 2% |
| Advertising | 0.25% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% |