

WHY GEORGIA DEPENDS ON DELTA

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DR. RAJEEV DHAWAN, DIRECTOR

**ECONOMIC FORECASTING CENTER
J. MACK ROBINSON COLLEGE OF BUSINESS
GEORGIA STATE UNIVERSITY
ATLANTA, USA**



KRISTIN W. DIVER, ASST. DIRECTOR

On July 14, my staff and I attended a speech given by Gerald Grinstein, CEO of Delta, at the Commerce Club in Atlanta. Not surprisingly, he had positive words to say about Delta's turnaround plan and is hoping to lead the company out of bankruptcy by mid-2007. According to Delta's September 22nd press release, the company hopes to shave \$3 billion a year off operating expenses. Of this amount, roughly a billion will come from each of the following areas: renegotiating plane leases and reducing its fleet, reducing headcount and cutting salaries and benefits, and increasing fleet efficiencies. One of Delta's key strategies is to fly to more international destinations, which usually commands a higher price per passenger. Prior to restructuring, the percentage of Delta's international destinations was 27% of all destinations. According to press releases, Delta eventually hopes to reach 40%.

I applaud Delta for this savvy strategy, in fact, I recommended they do just this in an Op-Ed piece in the Atlanta Journal-Constitution in December 2004 titled "Big Airlines Ought to Stop Flying Solo". Delta's low-cost competitors, such as Southwest, JetBlue and AirTran, have been extremely effective in running a shuttle service of 737s that hold 100-200 passengers and fly a maximum of 2,700 miles, such as from Atlanta to Los Angeles. Prior to declaring bankruptcy, it was impossible for Delta to adequately compete on pricing because of its higher cost structure. Fortunately for Delta, none of the low-cost carriers (so far) own larger planes that can travel greater distances, virtually excluding them from the lucrative transatlantic or transpacific destinations.

We decided to take a closer at Delta's current international destinations to see if, realistically, Delta can expand their international offerings as much as they say. Delta's key advantage is its fleet of 767s and 777s,

large planes that carry at least 200 passengers and can fly between 6,400 and 7,500 miles. To put this in perspective, a flight from Atlanta to Paris is 4,400 miles. A flight from Atlanta to Tokyo is 6,800. According to the annual 10-K report for 2005, Delta owns or leases 649 planes, of which 104 are 767s and eight are 777s, the only planes capable of traveling such long distances. Table A is a chart of Delta's fleet, plus the average age of each plane.

My staff carried out some good, old-fashioned analysis of Delta's latest schedule on their website dated July 1, 2006 and divided Delta's international destinations into two broad categories: Delta flights and SkyTeam partner flights. We realized that while the Skyteam flights may benefit Delta's customers because it broadens their destination possibilities, the

Table A

Delta's Current Fleet

Aircraft	# of Planes	Average Age
767-200	4	23
767-300	24	15
767-300ER	59	10
767-400ER	21	5
777-200ER	8	6
LONG RANGE	116	10
737-200	29	21
737-300	7	20
737-800	71	5
757-200	121	14
MID-RANGE	228	12
MD-88	120	16
MD-90	16	10
CRJ-100/200	142	7
CRJ-700	27	2
SHORT-RANGE	305	10

Source: Delta's 2005 10-K report

Table B
Delta's International Routes

Departure City	Trans-Atlantic/Pacific	North America	Central/South America	Caribbean	TOTAL
Atlanta	31	20	16	22	89
NYC	20	4	2	4	31
Cincinnati	5	2	2	4	14
Los Angeles	2	2	2	0	6
Wash, DC	0	3	3	0	6
Salt Lake City	0	4	0	0	4
Boston	0	1	0	2	3
Chicago	1	0	0	1	2
Other Cities	3	3	0	8	14
TOTAL	62	39	25	41	169

Source: Delta's July 1, 2006 flight schedule

true cash infusion comes from a passenger purchasing a ticket on a Delta plane. Therefore, we counted all international destinations, but for our analysis, we strictly paid attention to only Delta flights. We then separated the destinations into four categories: Trans-Atlantic/Pacific flights, North American flights (only Mexico and Canada, no domestic), Central/South American flights and Caribbean flights. Table B above has the detailed breakdown.

Delta has 169 daily flights to international destinations, of which 62 are the long-range Trans-Atlantic/Pacific flights. We mentioned above that Delta has about 116 long-range planes. It might initially seem that with 62 flights and 116 planes, Delta can easily double their international destinations because they have 60 planes sitting idle, correct? Not quite. First of all, these long-range flights take time. From the U.S. East Coast to Western Europe, it is at least seven hours of flight time. Even if the plane were to refuel, take on a new crew and return, it would still be at least another seven hours back to the U.S. Logistically, this means that one plane can only do one roundtrip flight a day, not two.

Not only that, this one plane per day from the U.S. East Coast – Western Europe leg is the best-case scenario logistically. Once you cross the Pacific or go farther east beyond Western Europe, when flight time extends to 10, 12 or 15 hours, as is the case between New York to Tokyo, the most routes a plane can do is no longer once a day and back, but more like once every two days. Therefore, to fly the longer routes on a daily basis, Delta must dedicate two planes per route, not just one. Additionally, considering that planes are routinely taken out of their flying schedule for routine maintenance, sud-

denly, Delta's "excess" capacity of 60 planes no longer seems so roomy. In fact, this proves that Delta's current international capacity is already bursting at the seams!

Additionally, more than half of Delta's current 767s are over 10 years old! According to Grinstein, for each additional year that a plane is in operation, it loses 1% in fuel efficiency. With so many older planes, Delta is consuming more gas per mile than AirTran, who owns an entire fleet of new planes. But wait, let's not forget that Delta has five new fuel-efficient 777 planes on order – to be delivered by 2009. That's great, but not all that comforting because they could ideally use 75 planes

to replace all their 767s that are over 10 years old. During the Q&A at Grinstein's speech, I asked whether he was planning to buy any new planes – and his answer sent a warning signal. In bankruptcy court, Delta must clear all new expenses through a budget committee. My fear is that the committee cares more about recouping lost money for its creditors than about the future strategic viability of Delta. Let's hope they buy into Grinstein's international vision and are willing to approve billions of dollars in funding for new planes. We need to keep our fingers crossed on this issue.

Given that Boeing received 1,000 orders for planes in 2005 and another 517 so far for the first six months of 2006, they are making planes as fast as they can produce them. Not only that, because of the demand, any sweet financing deals are a thing of the past and nothing less than cold hard cash will push an order up the delivery chain. Unfortunately for Delta, their initial bankruptcy turnaround plan called for oil at \$63 a barrel. According to Grinstein, every dollar above \$63/barrel costs Delta an additional \$80 million. With oil hovering at \$75 a barrel for the last couple months, that's already almost a billion extra dollars for fuel that Delta now needs to come up with in addition to its projected \$3 billion in savings before it can emerge from bankruptcy. Given the current conflict in Lebanon, the price of a barrel of oil isn't coming down anytime soon and even our three-year forecast has it consistently above \$60.

In conclusion, while Delta's efforts to expand internationally are certainly the right path to a more profitable airline, the company is constrained by its fleet of older, long-range planes and a lack of cash to purchase new ones. We have seen Delta announce a plethora of new international destinations over the last year, but without new long-range planes, I think they're flying all they can.