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Airlines Mull Frequent-Flier Spinoffs

IdeaWorks contributed information to this article - - see italics.

CHARLOTTE, N.C. -- Anybody want to buy a frequent-flier program?

That shouldn't be a problem. Not to say that legacy airlines move in lockstep, but in the past month, five of the six have said they are evaluating frequent-flier program spinoffs.

This movement has two principal sets of backers. One is made of investors such as the Icelandic company FL Group, which has apparently lost money by choosing the wrong time to buy 9.1% of the shares of American parent AMR (AMR) . In September, CEO Hannes Smarason wrote AMR a letter urging a quick spinoff.

"We believe that there is no time to lose," he noted.

The other group that champions spinoffs is made of investment banks "looking for fees," according to US Airways (LCC) CEO Doug Parker. The airline, though skeptical, is reviewing a spinoff, promoted by "people coming and making pitches to us about it," Parker said last month.

But clearly, many industry insiders see value in spinning off mileage programs.

"To a certain extent, these programs print money," says Jay Sorensen, president of the airline marketing consultant IdeaWorks. They sell miles that cost little to produce but have vast appeal. United (UAUA) says Mileage Plus 2006 revenue was \$600 million. Revenue from American Advantage is believed to exceed \$1 billion. Founded in 1981, Advantage was the first frequent-flier program, and it was quickly copied by competitors.

The biggest buyers are credit card companies, which distribute miles to their customers. "The rise of the credit card had a bigger impact than anything else in the history of the frequent-flier program," Sorensen said. "It unleashed wheelbarrows full of money for the airlines."

At Advantage, about half of the accumulated miles in 57 million accounts originate with sources other than flying. In general, Sorensen said, about a third of program revenues results from flying.

Reaching Highflying Consumers

Frequent fliers, it appears, make desirable cardholders. In 2004, a unit of American Express (AXP) agreed to provide Delta (DAL) with up to \$600 million in return for SkyMiles that could be offered to its customers.

At the time, Delta was trying -- unsuccessfully, as it turned out -- to avoid bankruptcy. In a prepared statement, American Express said the portfolio "represents a very attractive, high-spending, loyal card member base with excellent credit quality."

The 2005 spinoff of Air Canada's Aeroplan appears to offer a successful blueprint. In two years, Aeroplan's market capitalization doubled to about \$4 billion. That is a strong argument for spinoff backers, but many aviation experts say it bears little relevance to what might happen in the U.S.

"Aeroplan stock has done very well, but the dynamics in Canada are much different, because Aeroplan has much greater prominence among consumers than any single U.S. program," says Forrester Research analyst Henry Harteveltdt. Essentially, most Canadians who fly are members. Additionally, Harteveltdt says, airlines face losing both control and revenue if they spin off the programs.

Airlines display varying levels of interest. Parker of US Airways and Delta CEO Richard Anderson both suggest that frequent-flier spinoffs are a diversion that should be delayed until the industry consolidates. United seems amenable but appears committed to spin off its maintenance program first. Northwest (NWA) CEO Doug Steenland also seems amenable and is among those who say the Aeroplan spinoff is, in fact, a blueprint.

American seems cool to the idea. Its program "is an integral part of American airlines," says spokesman Tim Smith. American, like most carriers, has said that it wants to disclose more program results but that it first must conduct a review. "It's hard to measure the halo effect" of luring customers, Smith says.

In 2006, Advantage awarded free travel to 2.6 million passengers, about 7.5% of the airline's total. Another 1.4 million passengers used miles for upgrades. The program reported a liability of \$1.6 billion, primarily for unused miles.

Harteveltdt suggests the legacy reviews will lead, in most cases, to breaking out frequent-flier program results for financial reports.

"In the past, airlines haven't wanted to call attention to this because they fear tipping their hands to competitors," he says. "But by not doing that, they have missed an opportunity to show investors that they have some very valuable assets."