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Frequent Fliers Had Their Wings Clipped During 2004 With 314,000 Fewer Reward Tickets Industry Analysis from IdeaWorks

Analysis of top U.S. airlines reveals frequent flier reward travel dropped during a period of increased capacity and record breaking load factors.

April 20, 2005, Shorewood, WI. For the second year, the IdeaWorks Company has compiled frequent flier program statistics reported by 14 U.S. based airlines in their publicly-filed Form 10-K annual reports. 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 activity.

The airlines included in the survey are: AirTran Airways, Alaska Airlines, America West Airlines, American Airlines, ATA, 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

Reward travel dropped during 2004 when compared to 2003. This trend is contrary to the significant growth experienced by the industry in 2004. By almost any measure the industry grew in terms of passengers carried and seat capacity. As a result, reward travel became an increasingly smaller component of overall passenger activity.

Information compiled in this comparison includes **1) Frequent Flier Reward Use, 2) Percentage of Passengers Using Rewards** and **3) Measuring Reward Presence - Rewards per Billion ASM**. Activity reported for 2004 was compared to prior-year activity as reviewed in the Industry Analysis released by IdeaWorks on March 29, 2004. The disclosure source 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.

Frequent Flier Reward Use

IdeaWorks estimates over **14.7 million passengers traveled during 2004 using frequent flier travel rewards** on the 14 airlines included in the survey. This represents a 2.1% decrease from 2003 in which IdeaWorks estimated 15 million passengers traveled using frequent flier rewards.

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The following airlines, unless otherwise noted, provided frequent flier reward data in their Form 10-K annual reports filed with the U.S. Securities and Exchange Commission. Airlines are sorted in descending order by 2004 reward travel:

Table 1	2004	2003	2004
Reporting Airlines	Reward	Reward	versus
	Travel	Travel	2003
Delta Air Lines	2,900,000	2,800,000	+3.6%
American Airlines	2,600,000	2,500,000	+4.0%
Southwest Airlines	2,500,000	2,500,000	no change
United Airlines	1,700,000	2,000,000	-15.0%
US Airways	1,500,000	1,200,000	+25.0%
Northwest Airlines	1,380,000	1,408,000	-2.0%
Continental Airlines	1,200,000	1,742,427	-17.0%
Alaska Airlines	631,000	606,000	+4.1%
America West Airlines	104,000	143,000	-17.0%
Midwest Airlines	69,000	64,000	+7.8%
AirTran Airways	66,000	43,000	+53.5%
jetBlue	20,000	not reported	n/a
ATA	15,000	no program	n/a

Data for AirTran and ATA was reported directly by each carrier to IdeaWorks. Statistics for Continental and America West are estimates that rely upon components of their financial reporting such as reward travel as a percentage of RPMs and average passenger trip length.^b Activity for Frontier Airlines has been included in the annual total for the group of 14 airlines but this calculation is not deemed sufficiently reliable for individual presentation in a year-over-year comparison.

Comparing the 14 airlines on the basis of reward travel generated mixed results. Six of the airlines reported an increased number of reward travelers for 2004 and four reported decreased reward travel activity compared to 2003. Southwest reported the same volume of reward passengers at 2.5 million for 2004 and 2003.

Percentage of Passengers Using Rewards

Measuring reward activity as a percentage of total revenue passenger miles is another method for comparing frequent flier program activity. 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.^c It is also a popular method for airlines to describe the impact of free travel on the generation of passenger revenues.

Airlines hope the disclosure of a modest percentage will support the assumption that reward travel rarely prevents the sale of tickets. Airlines use sophisticated software that helps plan the allotment of seats available for sale and those made available for frequent flier rewards. Southwest Airlines is a notable exception because it makes all seats available for reward redemption.

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Eleven of the 14 airlines in the survey directly disclosed the impact of reward travel in their Form 10-K filings as a percentage of total RPMs. Airlines are sorted in descending order by 2004 results:

Table 2	2004	2003	2004
Reporting Airlines	Rewards as % of RPMs	Rewards as % of RPMs	versus 2003
Delta Air Lines	8.0%	9.0%	-11.1%
US Airways	8.0%	7.0%	+14.3%
American Airlines	7.5%	7.8%	-3.8%
United Airlines	7.4%	9.0%	-17.8%
Alaska Airlines	7.3%	8.7%	-16.1
Southwest Airlines	7.1%	7.5%	-5.3%
Northwest Airlines	6.9%	7.5%	-8.0%
Continental Airlines	5.6%	7.6%	-26.3%
Midwest Airlines	5.0%	5.0%	no change
America West Airlines	1.5%	2.1%	-28.6%
AirTran Airways	1.0%	0.8%	+25.0%
jetBlue	"less than 1%"	not reported	n/a
ATA	0.1%	no program	n/a

AirTran and ATA did not specifically disclose a percentage in their annual reports. The percentages for these carriers are based upon the number of reward tickets redeemed and the average passenger trip length reported by the airlines. Financial disclosure by Frontier was not sufficient to permit a calculation of the percentage of travelers using rewards.

Using RPMs as a measure of comparison reveals a distinct year-over-year trend. With few exceptions, it demonstrates a drop in reward travel relative to overall passenger activity. In effect, the number of RPMs occupied by reward travelers experienced a 11.4% drop among the 14 airlines in 2004.

Measuring Reward Presence - Rewards per Billion ASM

RPMs portray the "size" of an airline based upon the factors of passengers carried and mileage flown. Available seat miles, called ASMs, portray the "capacity" of an airline based upon the seats available for sale and the mileage flown by an airline's fleet. ASMs provide a very interesting dimension for comparing frequent flier programs and airlines.

Airline growth is often portrayed as an increase of ASMs; which can indicate more flights, larger aircraft and longer flight distances. Presumably, more ASMs can represent the capacity to sell more tickets and carry more reward travelers. Comparing reward travel against ASMs provides an indicator of the overall presence of reward travelers on an airline.

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IdeaWorks has developed a statistic to describe overall reward presence - - **Rewards per Billion ASM** describes the occurrence of reward passengers per each billion ASMs flown by an airline. This statistic accounts for the capacity growth of an airline and presumably the increased ability to carry reward passengers. Airlines are sorted in descending order by 2004 results:

Table 3	2004	2003	2004
Reporting Airlines	Rewards per Billion ASM	Rewards per Billion ASM	versus 2003
Southwest Airlines	32,465	34,765	-6.6%
Alaska Airlines	28,323	29,123	-2.7%
US Airways	27,782	23,272	+19.4%
Delta Air Lines	22,324	23,245	-4.0%
Midwest Airlines	18,827	21,113	-10.8%
Northwest Airlines	15,080	15,807	-4.6%
American Airlines	14,942	15,132	-1.3%
Continental Airlines	14,723	19,004	-22.5%
United Airlines	11,693	14,645	-20.2%
AirTran Airways	5,498	4,255	+29.2%
America West Airlines	3,442	5,129	-32.9%
jetBlue	1,053	not reported	n/a
ATA	724	no program	n/a

With two exceptions, the relative measure of reward travel dropped among all carriers significantly during 2004. The drop was especially significant among three of the airlines: Continental, United and America West.

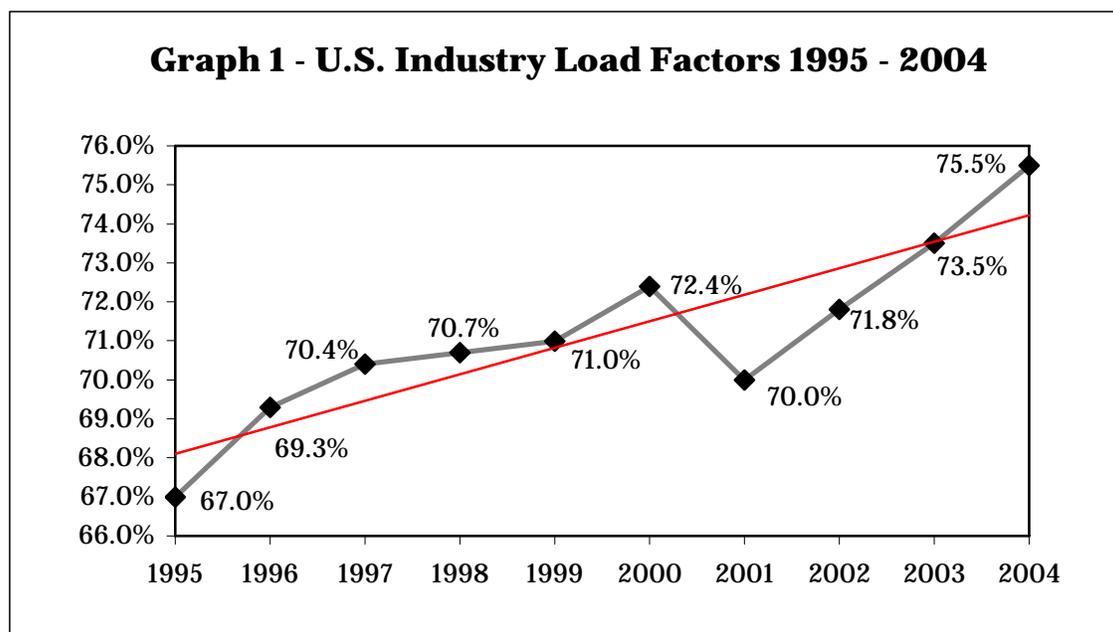
Measuring the Growth of the Airline Industry

2004 was a record year for the U.S. airline industry in terms of ASMs. U.S. airlines generated an amazing 969 billion ASMs during 2004, representing an increase of 8.4% over 2003.^d Fortunately for the airlines, the increased capacity was filled to record levels with passengers. The industry load factor for 2004 was 75.5%; this represents the percentage of ASMs occupied by revenue-producing passengers. Please refer to **Graph 1** to view the industry-wide load factor increase that has occurred for the prior 10-year period. These statistics represent a modern-day record; the U.S. airline industry has never sold more tickets nor flown more miles than it did in 2004.^e

As a group, the 14 airlines in this analysis experienced a 6.9% growth in ASMs during 2004. Each of the 14 airlines grew in capacity and all carried more fare-paying passengers. Meanwhile, RPMs for the group of 14 airlines grew nearly 10% for 2004. These results suggest frequent flier activity would also increase - - with more passengers earning miles and points, and redeeming accumulated balances for free travel. However, caution must be exercised when making assumptions. Airlines don't report accrual statistics for their frequent flier programs; airlines only report free travel redemption and reward liability.

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With the exception of 2001 and 2002, the U.S. airline industry has experienced continuing load factor increases - - a trend which is likely to continue for the near term - - as shown in this graph of statistics provided by the Air Transport Association:^f



Observations and Conclusions

The drop in raw numbers of reward travelers provided an early indication that a change occurred in the airline industry. Further examination by comparing “Rewards per RPMs” revealed an additional indication of decreased reward travel. This industry-wide trend was confirmed by applying the “Rewards per Billion ASM” statistic.

Record passenger results for 2004 have not led to record amounts of reward travel. On a relative basis, the results have been the opposite of what normally would be expected. Overall growth of the airline industry should produce more frequent flier participation and ultimately more reward travel.

The record load factor achieved by the industry in 2004 is a very important element in this analysis. Just as critical are the record losses; the Air Transport Association estimates the U.S. airline industry lost more than US\$9.1 billion during 2004^g. Losses from the last four years have produced a spreadsheet busting loss of US\$32 billion.

Adding these elements together portrays an industry which has expanded significantly, has filled its airplanes to record levels - - but is not charging fares sufficient to cover its costs. **It should not be surprising the industry has sought to sell every seat it can - - even those that once were saved for frequent flier reward travel.** However, it would be unfair to paint the entire industry with a single brush.

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Clearly by any measure, the legacy airlines, such as American, Delta and United, carry more reward travelers than low fare airlines such as AirTran and America West. In particular, Alaska appears to be especially generous with reward travel. Southwest has renegade tendencies; it's a low fare airline that has the highest score for "Rewards per Billion ASM."

US Airways provides anecdotal evidence about a "run-on-the-bank" or the rush by members to redeem rewards before the contemplated shutdown of an airline. US Airways reported dramatic reward travel increases by every measure. Very likely, a surge in reward redemptions occurred while the airline was rumored to be teetering on the verge of shutdown. As recommended by several consumer experts, members must've cashed in their miles for what probably generated a record reward travel year for US Airways.

AirTran also demonstrated reward travel increases by every measure. This was likely caused by the maturing of its A-Plus Reward program as more and more members reached reward levels through tenure. As year-over-year statistics become available for other newer programs, such as trueBlue (jetBlue) and ATA Travel Rewards, these too are likely to show significant increases in reward activity and member growth.

Graph 1 provides ample evidence of future trends for frequent flier reward travel. Reward availability will continue to be squeezed by increasing load factors as the airline industry struggles to generate profits. The legacy airlines are likely to continue to shrink the presence of reward travelers as measured by Rewards per Billion ASMs. Low fare airlines are likely to carry more reward travelers as their frequent flier programs mature.

The breaking point is the impact on reward liability. IdeaWorks will soon issue its second annual report on frequent flier program liabilities: "**U.S. Airline Frequent Flier Reward Liability Grows More Than \$378 Million in 2004 – Industry Analysis from IdeaWorks.**" As the title indicates, many airlines appear to have pushed reward fulfillment to the future in their desire to generate immediate revenues from the sale of seats.

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

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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. Frontier's fiscal year ends March 31; all other airlines coincide with the calendar year.

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 Caution is advised regarding the application of average trip length to calculate frequent flier reward activity as it may not accurately reflect the average trip length taken by reward travelers.

^c All RPMs in this analysis are reported by carrier at the DOT Bureau of Transportation Statistics web site and are based upon the Form 41 report.

^d 2004 projected Available Seat Miles (ASMs) reported by the Air Transport Association web site at Air-Transport.org and reflects the activity of U.S. scheduled airlines since 1937.

^e 2004 projected Load Factor reported by the Air Transport Association web site at Air-Transport.org and reflects the activity of U.S. scheduled airlines since 1937.

^f Load factor statistics available from the Air Transport Association web site at Air-Transport.org and reflects the activity of U.S. scheduled passenger airlines.

^g Annual profit and loss statistics available from the Air Transport Association web site at Air-Transport.org and reflects the activity of U.S. scheduled passenger airlines.