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Delta Air Lines, Inc. (DAL)

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CORPORATE PARTICIPANTS

Paul A. Jacobson
Chief Financial Officer & Executive Vice President

MANAGEMENT DISCUSSION SECTION

Unverified Participant

Next up in this room we've got Delta Air Lines and with us Paul Jacobson is the Chief Financial Officer for Delta. He has got prepared comments, and then we'll maybe have time for a little Q&A. And there will be a break out after the session. Thanks, Paul.

Paul A. Jacobson
Chief Financial Officer & Executive Vice President

Okay. Great. Well good afternoon, everybody. I hope you're enjoying the conference so far. I think this is our first time here at this event, and we're very pleased to see so many new faces. There are some familiar ones here too, but so many new faces garnering interest in this industry. We are webcast today too. So I want to make sure that you know that if you do ask a question, you'll be on the webcast as well.

You know the – oh, we don't have our slides. But Safe Harbor statement, we do have forward-looking statements in this presentation. You can refer to our financials at delta.com/investor relations for any details that you'd like.

The Delta story is one that is intriguing to me for many reasons. I have been a fan of this industry since long before it became cool. If you remember those old songs, I was country when country wasn't cool. I wanted really nothing more than to work in an airline industry since was 7 years old. I've been with Delta for 18 years. And I think that history will show that there probably hasn't been a more transformative period in an industry or at a company across industries than what you've seen happen at Delta over the last 20 years, particularly over the last 10 years.

Those of you who know the airline industry probably don't have a good taste in your mouth from what it has historically been. But if you're not familiar with the story, it is markedly different than what we've ever seen before in this industry, certainly in the world post deregulation of 1978.

And that has come about through a lot of painful ups and down, a lot of transformative change that has occurred in the industry, both in terms of what has happened individually at Delta, but also within the industry landscape as well. And probably the biggest catalyst for that has been consolidation. So coming out of the restructuring that we saw in the middle part of the last decade, airlines really got their P&Ls and cost structures in order that paved the way for consolidation to occur.

And what consolidation has done is effectively produced network scale that airlines could never amass organically on their own. If you followed the industry back in the late 1990s and through that period of cyclicality, you'll know that everything was about increasing share, increasing scale, and really, really levering up the balance sheet in

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order to do it. Taking new airplanes at a time when we had peak operating cash flow and really not managing the business for free cash flow or margin, but managing it to make it as big as it possibly could. That's a recipe for disaster in a world with as much cyclicality as we had seen.

Yet we had to find a way to create scale and dimensions in the industry to put ourselves as an airline in a position where we could actually drive margin performance around us. Versus having many constituencies, manufacturers, government, et cetera, all getting their fair returns, while the airline shareholders were left with whatever was left over, sometimes nothing. And scale has done that.

So we've actually managed to increase our revenues about 20%, despite having 20% fewer in departures, 5% fewer seats, and 12% fewer aircraft since the date of the merger. This has provided tremendous operating leverage within the business, because we can carry more people with fewer airplanes and fewer capital investment throughout the network through the use of our hub structure. And actually flow passengers through in a much, much more capital efficient manner.

And what that has meant is sustainable cash flow has actually allowed us to invest in the product. And that product investment is ultimately what's going to pave the way for sustainability in the future.

So if you've seen Delta's reliability and operational performance, it's at levels that have never been – never before been seen at Delta on a scale that has never been – before been seen at Delta. And that comes through many years of investment, many years of investing in the culture, and investing in the people of Delta to go out and do a job better than they've ever done it before. And that's actually driving into a unit revenue premium that we see over our competitors domestically.

Simply put there are more people that are willing to pay a higher premium to fly on Delta as a result of that service and product investment. But that's nothing if we can't create sustainability. If there's one argument against this industry that has been borne out over the past, it has been all about cyclicality. And if you don't believe that this industry is different this time, and this is just yet another peak in an often vicious cycle, that means the peaks are higher than they've ever been and the valleys are lower than they've ever been.

We think that's different this time, because we think we do have sustainability, both in earnings and cash flow. And we've driven a long-term plan, which we announced in May. And this presentation is publicly available if you haven't seen it on our website, talking about our long-term capital deployment philosophy and our long-term view of earnings going back over the next sort of 3 years through 2018.

We see a recipe that's going to allow us to sustainably and consistently generate $4 billion to $5 billion a year in free cash flow, which is coming off of basically $7 billion to $8 billion of operating cash flow and about 50% of that reinvested back into the business. And that free cash flow is a strong, strong driver of how we're managing the business and puts us in about the top 10% of S&P industrials, despite having a significant discount to the S&P industrial complex on our earnings stream.

And you've seen that. This slide shows you really since – just year over year we continue to deliver that leading operational reliability, which is actually driving expansion in all of the key metrics. Now this here has been [ph] predicated (6:37) by the trade-off between fair prices and fuel prices, with fuel prices being down as significantly they are, and top line revenues essentially flat. It has led to significant margin expansion.

But as we look forward to 2016 we will lap a sizable portion of our 2015 hedge losses and will pave the way for additional margin expansion opportunities into 2016, which will allow us to continue to return cash to shareholders and continue to improve our balance sheet by lowering our debt.

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This quarter we've taken steps to try to reverse the trend of negative RASM. And while fuel prices have continued to decline, as we've been striving toward this, we're certainly putting ourselves in a position where we're trying to drive better unit revenue performance heading into 2016 and through the year to help us expand our margins faster than our competitors.

So when you look at one of the historical criticisms of the industry, it has been around capacity discipline and growing too fast too quickly in the wrong environment and facing that capacity growth against a cycle that ultimately reverses itself.

If you think big picture fuel prices in the fourth quarter are down about 50% year over year, and Delta's global system capacity is flat. So we're actually targeting a little bit of overweight investment in the U.S. and scaling back internationally. But from a global perspective we have flat capacity against a world where oil prices are in the low $50s to high $40s. That is about as disciplined as you can imagine.

And where we are growing we're growing in pockets where we have opportunities to continue to realize benefits from prior investments. Cities like Seattle, Los Angeles, New York, where we've heavily invested over the last few years. And there are still opportunities to continue to benefit from that improved presence and increased presence to be able to grow in those markets, while also improving our unit revenues and enhancing our domestic unit revenue premium.

But the biggest opportunity now and into 2016 is the international network. And based on where you look regionally there are different challenges that present themselves. But overall the international framework is really centered on overcapacity in various regions and a very, very strong dollar against virtually any currency that you may choose to compare it to is providing some headwinds.

We start to lap some of those currency headwinds in the current environment, as we get into the middle part of 2016. And we should see some improvement there, assuming the status quo environment. But what we need to do is to continue to react and to be as nimble as we can to try to use our assets in the most capital efficient way that we can, wherever that might be in the globe.

Talked a little bit about the fuel tailwind. For the end of 2015 we're about 35% lower than where we were in the first half of 2015, largely because of a bit of an [ph] outsized hedge loss versus the industry that you saw in the first 6 months. Having passed that in the third quarter we printed a fuel price that was better than industry average. And we expect to be in a similar position for the fourth quarter and certainly into 2016, as we begin to lap those hedge losses.

We also have the Trainer refinery, which over the last 12 months has produced a profit over $300 million. And we expect to have a $300 million profit at Trainer for all of 2015. As a reminder that was an investment that we made 3 years ago for $150 million purchase price. And we're now producing over 40,000 barrels a day of jet fuel at that refinery, which is exactly in line with what we thought it could do when we purchased that.

That combination of jet fuel production, which is keeping jet prices down by increased supply, but also through the direct profit that we're generating at the refinery, being able to capture that margin for ourselves, is a unique benefit that Delta and only Delta has. And we can continue to leverage as we go forward into the future.

And that's just going to be a part of going forward and continuing to drive margin expansion. But it really centers around these three pieces. Efficient revenue capacity growth, continuing to be measured and disciplined. We always approach our planning process against a backdrop of an assumed increasing oil price environment,

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because we want to make sure that when we're planning for future periods, we're not predicating on an assumption that's going to result in over capacity or over growth. And have us to – force us to be in a position where we have to scale back the amount of investment that we put in the offseason in order to try to staff those peaks.

So by growing in a disciplined way and by assuming conservative assumptions around your number one input cost, that helps to keep capacity discipline in place. And really, really helps to drive efficiency and better utilization and more tactical targeting of opportunities where they may exist.

The second piece of it is to continue to maintain and grow our unit revenue premium. This comes about through a very conscious investment in operational performance, product investment, and investment in our people. We believe our people provide the framework of good customer service. And when we do that our customers are going to reward our shareholders with more loyalty, more brand loyalty, and a better revenue premium as a result of that.

That virtuous circle we refer to as one that has worked very, very well for us. And we have a more engaged workforce who's going above and beyond the call of duty in order to exceed our customers' expectations every single day.

And when you do that and you combine that with the investment tools and the operational performance, that puts us in a position where year to date we've already broken – nearly broken the record for domestic completion factor days. Where for example in the month of September, we cancelled only 13 flights in the entire month of September. That is head and shoulders above our competitors and put us in a position where we can actually go out and provide guarantees to corporate customers and corporate travelers to say that we're going to have operational performance that's better than our competitors. And that's going to translate to more value for you, your firm, and your passengers, and your customers that you put on Delta.

Continuing to do that and emphasize that operational performance and that value [audio gap] (13:41) going to allow us to continue to drive that revenue premium and put us in a position of strength against our competitors.

And lastly, this is still very much the airline industry. We have to be disciplined on costs. We have to maximize the benefits of scale by utilizing our size and our scope to go out and get better deals to leverage opportunities in the marketplace, where perhaps there had historically been margin leakage accruing to suppliers or to various constituencies. We can capture more of that ourselves and focus on driving that cost performance every single way that we can.

So when we do that, when we leverage supply chain, when we utilize technology, when we utilize the best maintenance staff in the business that can take our capital efficient fleet and drive better reliability, drive better operational performance, drive better customer service scores, all on a lower cost base, we know we've got the recipe for success.

But ultimately it comes down to giving customers what they value. That's what's going to drive the revenue growth. So when you see the investments that we've made and you've seen initiatives like Branded Fares, where we offer customers the opportunity to buy up to an experience that they may better prefer and to pay for those things that they value, and to not pay for those things that they don't, within an operating box that we can execute consistently and effectively every single time. You can see that we're actually going to continue to drive incremental benefit.

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Our Branded Fares initiative, which is just really kind of in the beginning stages, is expected to generate $1.5 billion in incremental annual revenue by 2018. And a lot of that flows straight to the bottom line, because we can continue to do that within the framework of the performance and the investment that we were already making today.

On the cost side we've got to continue to focus on productivity. We started this journey a couple of years ago when we said, our unit costs we're going to keep below a 2% annual growth rate. By keeping capacity growth disciplined and by keeping cost growth below the rate of inflation, it should provide us with a platform to continue to expand our margins. We've exceeded those expectations in 2015. And while 2016 may be a little bit more of a challenging year, given the geography shift that we've seen with profit sharing and how we think about that, we still feel comfortable that we'll be able to keep our unit cost below that 2% level into 2016 and beyond.

By focusing on driving operating efficiencies and operating leverage into the business, what we're able to do is to provide a very similar base load of capacity at a much, much lower and more efficient cost base.

And continuing to do that year-in and year-out is helping us to keep that unit cost growth down at a level that is much, much more consistent – much more consistent and much more sustainable. And we have the financial plan in place in order to continue to drive that productivity. But ultimately I think if we can point to a couple things that are different this time than we've ever seen before in this industry, it would be one of those points. An airline that's actually focused on shareholder value and an airline that actually focused on driving that value and that cash flow back to shareholders in a consistent, prudent manner.

Airlines in this industry have always proven that they can generate cash in good times. They've never proven that they can consistently hold that through a cycle. And they've never proven adept at being able to distribute that cash back to shareholders. So under the old model shareholders were left to cling to theoretical value during peak cycles and just hope against hope against dilution during the bad cycles, when a highly levered balance sheet meant that convertibles and follow on equity issuances were the only source of capital when times got tight.

We decided to do it differently. And we embarked upon this process in 2013, where we effectively became the first airline to pay a real meaningful dividend. And we said that we were committed to doing that, and we were committed to growing that, and we were committing – committed to allocating cash back to shareholders. And we're doing that in a very balanced measured way, because we still have to improve the balance sheet. We still have to fund the underfunded pension plan. And we still got to put ourselves in a position where this type of success is sustainable. And we believe that can't be done without a solid, high-quality investment-grade type balance sheet, similar to what you see from other high-quality companies.

And all we've done since then is we paid down more than $10 billion in debt since 2009. We've taken our annual interest expense from $1.3 billion to almost – it should be below $400 million a year in – as a run rate in 2016. And we've made progress, significant progress, such that we're only one notch away from investment grade, from S&P and Fitch. And we see that goal in sight.

And we've done it while also embarking upon a path to return cash to shareholders. We've now returned more than $4 billion back to shareholders since 2012. And we're working under a $5 billion buyback authorization through 2017 as well as two consecutive 50% increases in that dividend that we announced in 2013. And as we continue to deploy at least 50% of our free cash flow back to shareholders, we're going to hit our goal long term and continue to drive that shareholder value.

The second piece of the thesis, and I think what becomes really my favorite piece, is this slide on page 11 that shows the history of this business. And it really graphically depicts what I mentioned earlier. That if you go back to

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the last peak cycle in this industry in the late 1990s and 2000, you see the red line. Delta generated on a combined basis about $4 billion of operating cash flow. That was a record for the industry. And certainly more than anybody had ever done at that time.

But the big difference back then versus where we are today is we were actually adding debt to the balance sheet. So here we were, a company that had generated more cash than it had ever generated before, in a very known cyclical business was actually adding debt to the balance sheet at a time that it was generating more profits and more cash flow. Clearly not a sustainable business model when you think about that.

And sure enough when you went through the post 9/11 era, all that debt was still there, while the demand was not. And you see what happens and what has created that cyclicality.

So since creating this consolidation framework and driving the business for better operating cash performance, we've also been very disciplined with our capital expenditures. And that gap now that you see generating that free cash flow is what has allowed us to pay down debt off that balance sheet. And sustainably and permanently improve our leverage, so that we can be a much more longer term investment and a much more stable investment for people that historically have looked at this as a cyclical business, because de-risking the balance sheet is one of those things that we can control. I don't think we'll ever take the cycles out of the industry, but we can improve the performance through the cycle of the business.

And as we sit here and think about what are the catalysts to get us to a valuation that is more similar than – more similar to other S&P industrials, one of those catalysts is prove that we can do it through a recession. And prove that we're not going to lose and give all this money back.

So we focus on sustainability. We focused on driving free cash flow and getting those cushions established [ph] for whenever (21:49) we have to weather that next storm, because we know there will be one. This is the airline industry and something will happen.

But the winning recipe and the winning formula are going to be for that company that can anticipate what that might be and be in a position to be able to weather that storm and create that sustainability through that cycle. And that's the recipe that we're on right now.

And certainly the plan as we move forward and what we're trying to do for the long term is to drive that value to more core industrial performance, similar to what you've done and what you've seen in other businesses. And really, really try to drive that long-term reputational improvement for the industry that has struggled for so long.

I've spoken very, very quickly. I've tried to leave a couple minutes for questions. But we're very proud of what the 80,000 Delta employees have accomplished. We've never seen anything like this before. And Richard [Anderson] likes to quote the Road Less Traveled, and when you're on that road less traveled, there is no map you can point to, other than the core values of investing in our people, who are going to invest in the product, who are going to provide the returns for the shareholders over the long term.

So thank you. And I think we might have time for a couple of questions.

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QUESTION AND ANSWER SECTION

Q

Questions from the audience? I'll tee one up. You're 5 years into your integration with Northwest Airlines, which was obviously a transformative acquisition for Delta. Where are you in terms of innings of a ballgame in terms of the cost realization or the synergies from that? And then maybe for the last 1.5 minutes here frame up for the audience how you're [ph] competitively (23:30) positioned in a – relative to the other major carriers from an oil, labor, and kind of fleet/facilities standpoint?

Paul A. Jacobson
Chief Financial Officer & Executive Vice President

A

Sure. So we actually – we closed the merger with Northwest in 2008 and have made steady progress. I would say that we don't talk about a world pre-merger and post-merger anymore, because we've pretty much lapped everything that we thought we were going to do as part of that merger.

But I think we're still in the fairly early stages of understanding what it means to be a truly global airline with the scale that we have. Going out and realizing opportunities to capture margin for ourselves that historically had leaked out of the enterprise and into other companies or suppliers. We've proven very adept at that, but there's still a lot of room to go.

The reality is doing business with Delta on the global scale, where we carry 170 million passengers a year, has a whole lot more value today than it ever did before. And we've got to continue to leverage that strength. And there are still opportunities to do that over time. And you're certainly going to see that – see us on that trajectory over the future.

Q

Excellent. One question in the back?

Q

As a refiner are you lobbying to uphold the crude oil export ban?

Paul A. Jacobson
Chief Financial Officer & Executive Vice President

A

As a refiner are we lobbying to uphold the crude oil export ban? We as a PADD 1 refiner, we are aligned with other northeastern refineries on that [audio gap] (25:08). And we believe that there is a sizable, sizable disadvantage to northeastern refiners in a world where crude oil can be exported on – in an arbitraged way to Europe. And products brought back in a much cheaper way.

So we're interested in a model of fairness. And we're interested in ultimately as a refiner, you've got to remember we have a bit of a unique [ph] perspective (25:33), because we are the only refiner on the planet that actually

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wants refining margins to go down, because we have a – basically we are short 4 billion gallons of jet fuel every year into perpetuity as an airline.

So the refinery is a unique animal within Delta. But ultimately we want everything to be positioned to have the lowest fuel prices that we can.

Q

Thank you. Thank you, Paul. There will be a breakout right outside.

Paul A. Jacobson
Chief Financial Officer & Executive Vice President

A

Okay. Great. Well thank...

Unverified Participant

And next up in this room we have Spirit Airlines. Thanks.

Paul A. Jacobson
Chief Financial Officer & Executive Vice President

Great. Thank you for your time and your attention. Thanks everybody.

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