Message

**From**: Garner, Cory [Cory.Garner@aa.com]
**Sent**: 5/15/2015 3:19:30 PM
**To**: Wilson, Thomas [Thomas.Wilson@aa.com]
**Subject**: Final Deck for Monday
**Attachments**: Farelogix Update for Doug Staff - FINAL 05.18.15.pptx

Andrew's view is that this doesn't necessarily need to be routed as a pre-read, but he did want to make sure that you provided Derek with the latest draft. Attached is the final version.

How do you want to divide labor? The first 9 slides are probably best suited for me to deliver. Do you want slides 10 and 11?

American Airlines

Cory M. Garner
Managing Director, Distribution & Data Commercialization
817.931.2612 Office

PLAINTIFF EXHIBIT
PX453

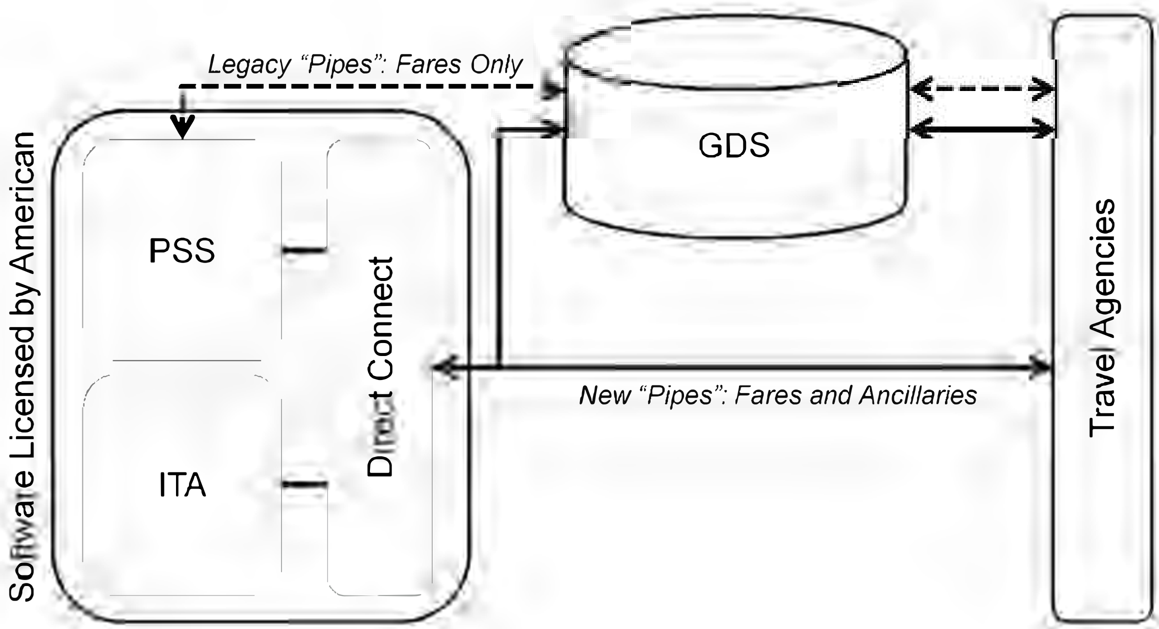
American Airlines U·S AIRWAYS

# Farelogix Update

# What Does Farelogix Do for Us Today?

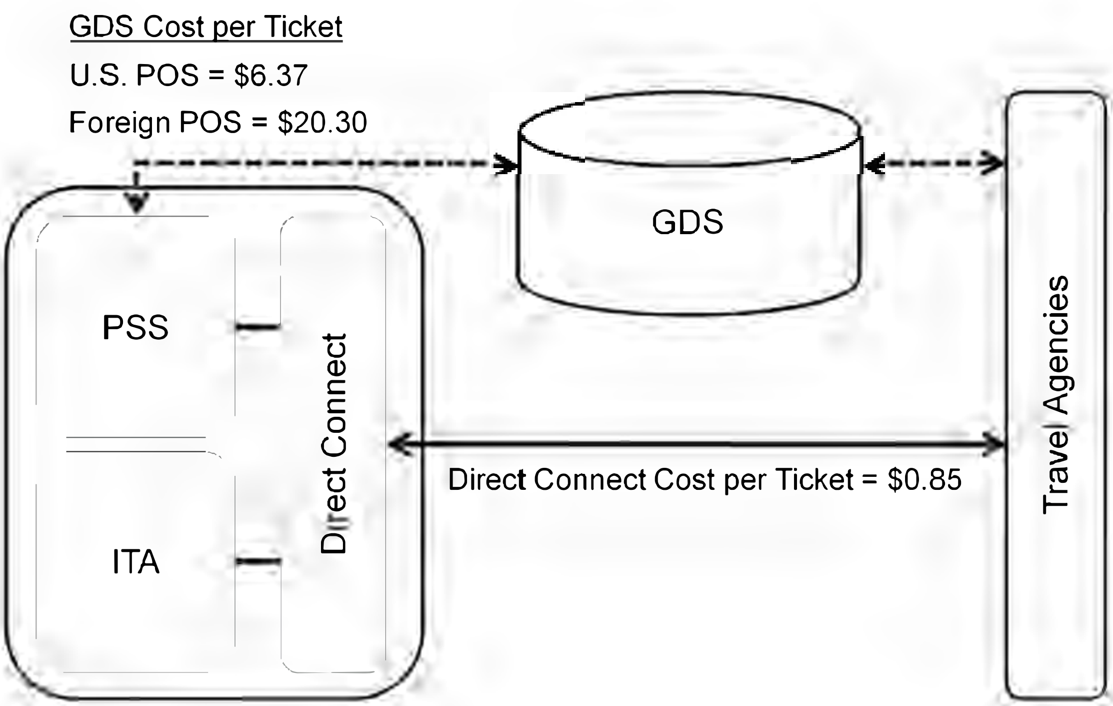
We license "direct connect" technology from them, which adds value by:

- Enabling ancillary distribution via GDSs (beginning later this year)
- Providing a low cost substitute for GDSs



# GDS vs. Direct Connect Cost Comparison

The direct connect costs 87% less in the U.S. and 96% less elsewhere



# Direct Connect Cost Benefits

All online travel agencies (OTAs) in the U.S. except Expedia/Travelocity use the direct connect

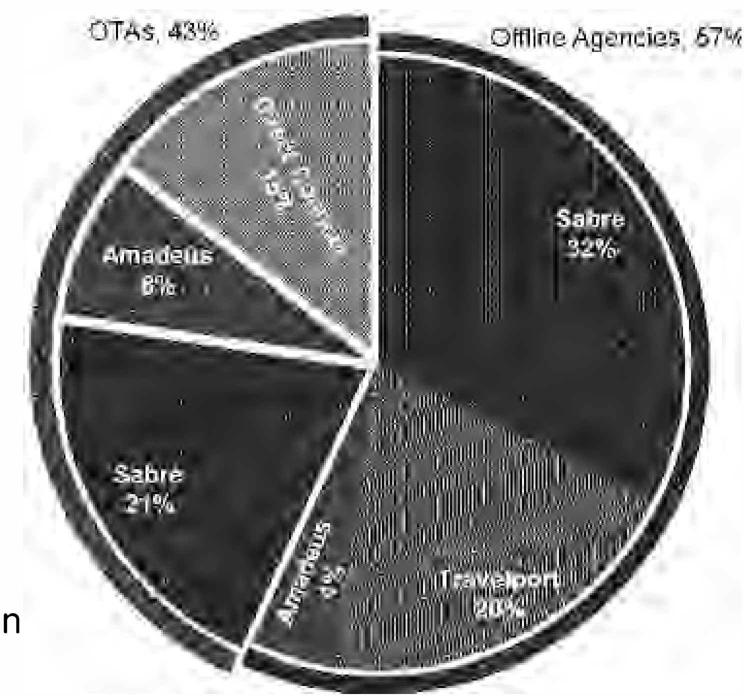
- 15% of all agency bookings, or approximately 6M tickets/year
- Cost savings vs. GDS: $35M/year

Because we offer a direct connect option, we refuse to pay any OTA's GDS costs

- 29% of all agency bookings, or approximately 12M tickets/year
- Cost savings vs. GDS: $66M/year

In total, we avoid $101M/year in GDS costs as a result of our direct connect strategy

U.S. POS Travel Agency AA Booking Share



LAA Pre-DC Costs YE Aug 2010 – Expedia $8.11/tkt, Orbitz $9.85/tkt

LUS Costs 2013 – Expedia $9.54/tkt, Orbitz $7.54/tkt (lower than LAA due to SupplierLink)

Post-DC Costs – Expedia $3.85/tkt, Orbitz $3.85/tkt



# Farelogix Product Lines & Users

| Product | What it Does | Known Users |
|---|---|---|
| Airline Commerce Gateway (a.k.a. FLX Direct Connect) | Allows an airline to distribute its fares and ancillaries to travel agencies via, or as a substitute for, GDSs | AA, UA, AC, LH, EK, WS |
| FLX Merchandise | Multi-channel shopping engine for ancillaries and loyalty redemption | UA, DL, AC, HA |
| FLX Shop & Price | Multi-channel fare shopping engine | OA (Olympic) |
| SPRK Content Aggregation Platform | Travel agency software which combines GDS and non-GDS content sources into a single display on the web or in a call center | Priceline, Orbitz |

# Potential Sale of Farelogix

Sandler Capital, which controls Farelogix, has hired Evercore as its financial advisors to evaluate a potential sale of the company

The following are the most likely outcomes:

1. Sandler chooses not to sell
2. Sandler chooses to sell to a GDS
3. Sandler chooses to sell to a coalition of airlines

Because Farelogix claims that it no longer requires capital contributions from Sandler and its top line is growing at 100% per annum, we believe Sandler is not a motivated seller at this time

We believe the GDSs are interested but not yet serious

- In March, Farelogix and its financial advisors hinted that conversations with each of the GDSs have already occurred
- We have since heard a rumor that one of the GDSs recently made a lowball offer

# Direct Impact of a GDS Acquisition

We anticipate that a GDS would eliminate our direct connect by:

- Refusing to make enhancements and ultimately ceasing all technology support
- Refusing to sign or extend agreements under which OTAs pay GDS fees
- Insisting upon new contractual terms in the next round of negotiations which limit American's ability to offer a direct connect alternative and/or require a travel agency to pay GDS fees (Sabre – 2017, Amadeus – 2018, Travelport – 2020)

With the direct connect competitive threat extinguished, we expect all other GDSs would similarly refuse to allow agencies to pay booking fees

As a result, we would begin paying GDS fees for OTA bookings at the expiry of our current OTA deals (largely 2015 or early 2016) through at least the end of our next Sabre GDS contract (2022)

The NPV cost impact would be in excess of $500M, assuming we have a new direct connect before 2022 and can undo Sabre's restrictive terms

# Direct Connect Replacement Options

Since no other company offers a direct connect solution and none are expected to enter the market, we would need to build our own

The size and complexity of a 1:1 replacement would be formidable

- Shopping, booking, ticketing, and servicing for fares and ancillaries
- A call center application in addition to the direct connect “pipe” itself
- Certification to settle via ARC/BSP in 109 countries
- Scale to handle volume greater than AA.com, plus active-active disaster recovery
- Technical support desk

IT estimates very roughly that a new direct connect would require at least $6M and 2-3 years to develop, excluding the time required to sign/implement the first travel agency

The long lead time to implement a replacement would foreclose upon our ability to avoid the impact of a GDS acquisition

# Other Impacts of a GDS Acquisition

If the GDSs elect to raise rates in reaction to reduced competition, each 10 percentage points would equate to about $90M on an NPV basis

There are other offsetting direct impacts

- Cost savings from lower OTA commission payments – about $30M/yr for a 50% reduction
- Lost ancillary revenue from delayed/suboptimal GDS integrations – also about $30M/yr for a 50% reduction in selling performance
- Net benefit of building versus buying the direct connect – precise quantification TBD

We would also suffer indirect impacts driven by the opportunity cost of losing access to Farelogix technology

- Forgone incremental penetration of the direct connect in offline and/or foreign markets
- Loss of a fare shopping competitor that is not controlled by a GDS or Google
- Missed opportunity to repurpose Farelogix technology into a viable GDS new entrant or at least a sufficient deterrent against future GDS rate increases

# The ARC Coalition of Carriers

The Airlines Reporting Corporation (ARC) processes and settles the ticket sales of travel agencies in the U.S., and is owned equally by AA, AC, AS, B6, DL, HA, UA, and WN

ARC management and the shareholding ARC carriers (less B6 and WN) have formed a coalition to evaluate a potential bid for Farelogix

American's goals in participating in the coalition are to:

1. Be prepared with an airline-sponsored counterproposal should Farelogix receive a serious bid from a GDS
2. Spread the cost of acquiring Farelogix across a critical mass of carriers
3. Maintain sufficient control over Farelogix to ensure that it is operated in accordance with our strategic goals

The coalition is still in its infancy, having held only an introductory meeting with Farelogix and Evercore

# Next Steps

ARC management is leading the initial groundwork

- They are in the process of identifying a law firm and a financial advisor to represent the coalition, which we expect to co-fund together with the participating shareholders
- We may also hire our own financial advisor, as United intends to do

We anticipate that coalition will convene again within two months to discuss the fundamentals of a proposal

- Governance structure
- Valuation methodologies (current consensus is $150-350M)

We will return with a complete business case should the situation escalate and call for a significant investment from American



American Airlines U·S AIRWAYS

May 18, 2015

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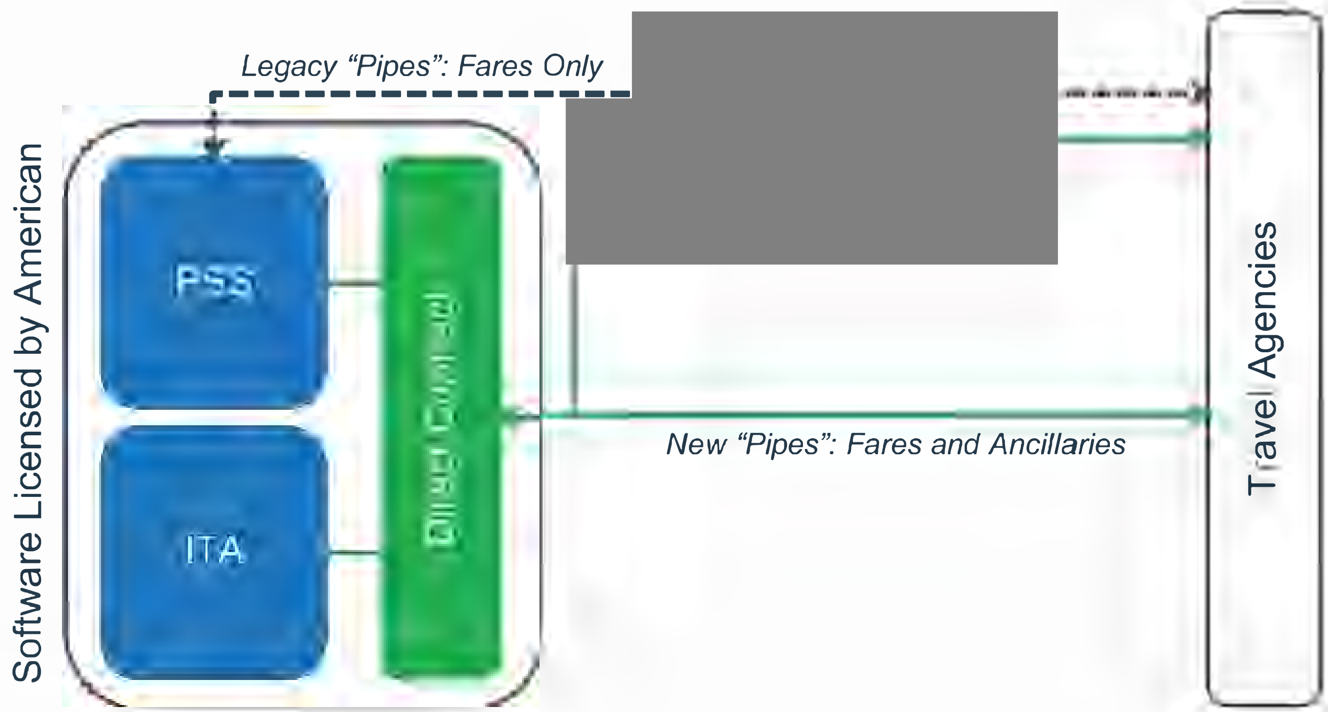

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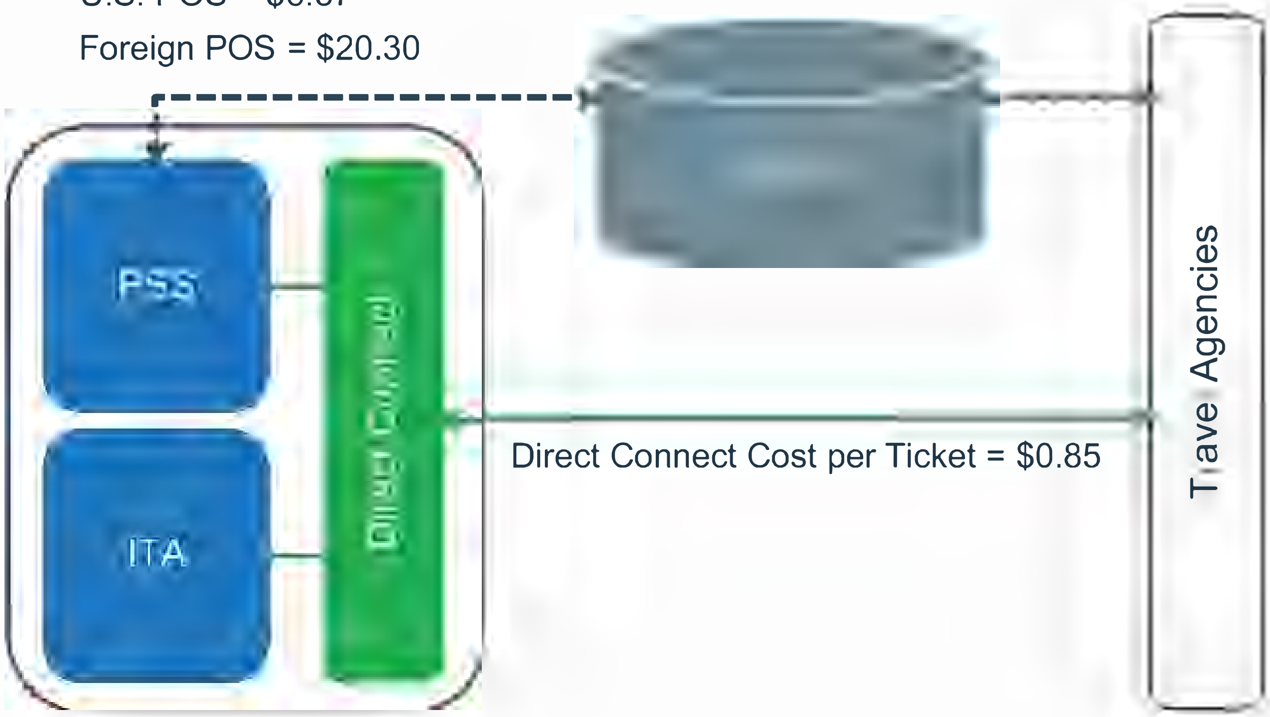
<u>GDS Cost per Ticket</u>

U.S. POS = $6.37

Foreign POS = $20.30



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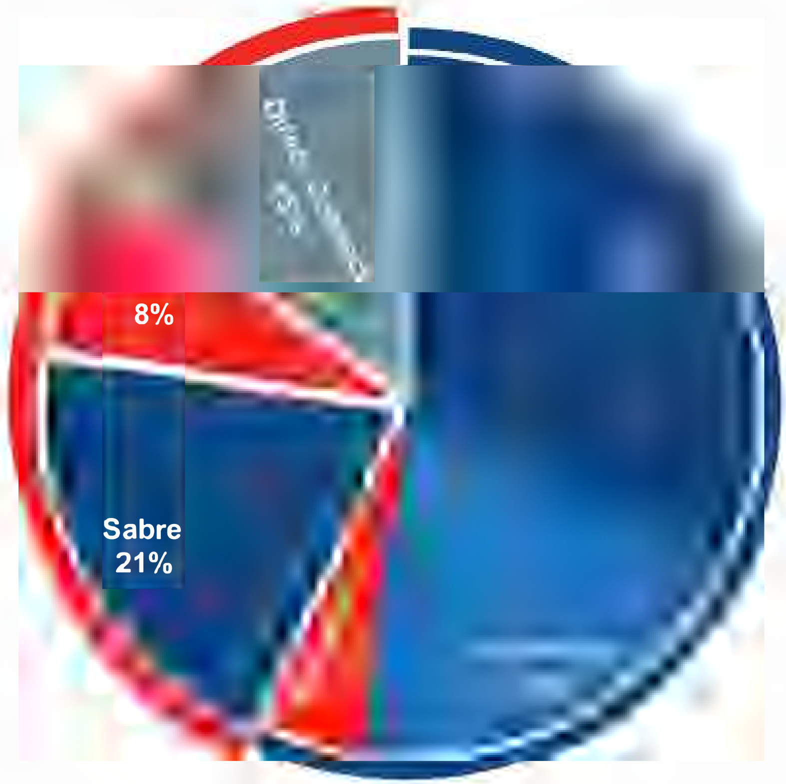




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