AirTrav Research Opinion

FOR IMMEDIATE RELEASE – Research Opinion

Air Canada (TSX: AC.A, AC.B)
Benchmarking Pilot Productivity

TORONTO (AirTrav Distribution, 24 May 2012, 08hrs45 EDT) – During the course of ongoing talks between Air Canada (TSX: AC.A, AC.B) and its pilot group no information has been disclosed regarding employee productivity. Toronto-based AirTrav Inc. has experience in airline flight operations and has used this knowledge to compile an analysis of pilot productivity at Air Canada.[1]

Importance of productivity in the airline sector

In the labour-intensive airline sector, productivity improvement is a key performance driver ("KPD"). With flight operations, pilot productivity represents not just a cost element but one that facilitates operational flexibility. Unlike pure financial metrics like wages and benefits, pilot productivity is a non-financial KPD that can have a multiplier effect on bottom line results. It is therefore important for any good management team to balance financial and non-financial KPDs to deliver enhanced shareholder value.

If pilots conducted similar flying levels with less staffing or additional flying with the same staffing, all safety factors considered, improved productivity would result in a variety of better outcomes.

Outcomes could include lower costs, higher revenues (from incremental flying afforded by a more efficient pilot work-force), higher operating contributions (where growth in flying outpaces growth in pilot headcounts), or any combination thereof. In all cases the airline's bottom line would be positively impacted.

Pilot productivity should also be viewed as a tangible component of effective asset management. A key maxim for airline sector profitability dictates that expensive aircraft "assets" (implying on or off-balance sheet financed) must be utilized efficiently and profitably.

Higher pilot productivity can help improve aircraft utilization though subject to management's effectiveness at scheduling aircraft efficiently. Positive actions from both sides can help squeeze more revenue flying into each day that in turn boosts contribution margins. This implies that pilots play more than just an operational mission specialist's role, but also make critical contributions to an airline's asset management efforts that influence return on assets (ROA).

Three years of improving pilot productivity

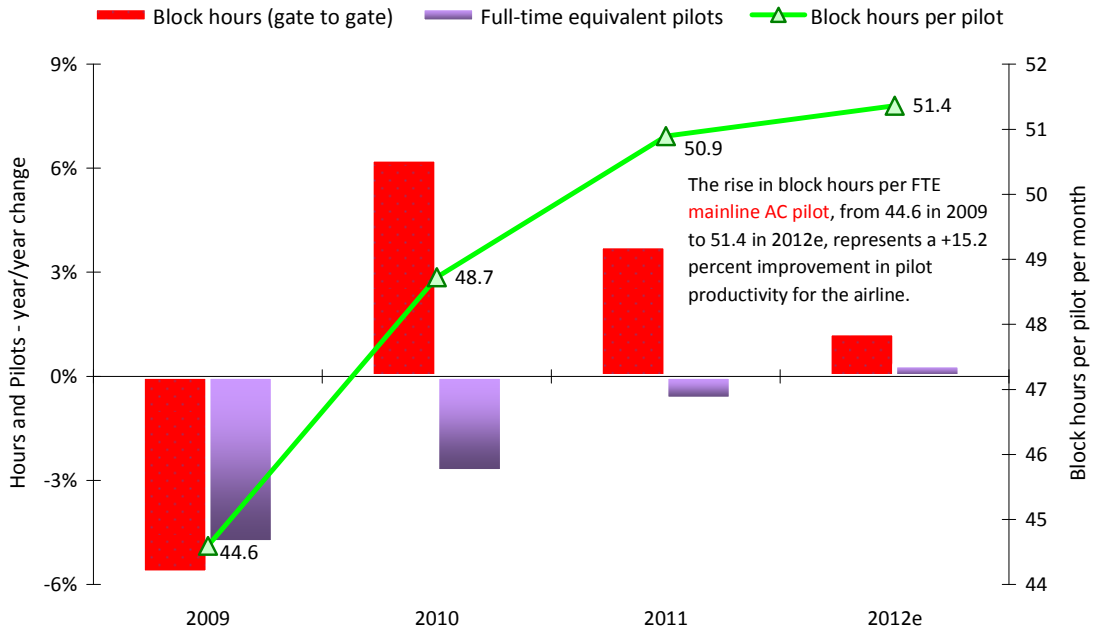
Based on publicly available data for block hours (flying plus airport taxiing time) and pilot staffing, as shown in Figure 1 below Air Canada mainline pilots posted impressive productivity gains between 2009 and 2011, and should post a further gain in 2012 based on estimates from AirTrav Inc.

Figure 1 shows a 15.2 percent rise in pilot productivity from 2009 to 2012e. Regardless of the KPD behind the productivity gain the airline will have benefited.

This performance improvement, along with a 2009 pay freeze and concessions the pilot group made to help Air Canada quickly exit bankruptcy protection in 2004, collectively amount to a significant financial contribution over the past eight years.

[1] This analysis considers Air Canada "mainline" operations only. It excludes flying performed by Jazz Air, a wholly owned subsidiary of Chorus Aviation Inc. (TSX: CHR.A, CHR.B), under a capacity purchase agreement ("CPA") with Air Canada, and also excludes flying conducted by several other regional carriers on behalf of Air Canada.

Figure 1: Air Canada Mainline Operations – increasing pilot productivity [NB]



Sources: **(1)** 2009-2011 Air Canada mainline block hours from Statistics Canada, CANSIM Table 401-0043, "Operational statistics for major Canadian airlines, level IA, by airline"; and from Statistics Canada Catalogue no. 51-004-X, "Civil Aviation, Monthly Key Operating Statistics, Major Canadian Air Carriers". **(2)** 2009-2011 Air Canada mainline full-time equivalent pilots (FTE) from the Air Canada Annual Information Form, 2009-2011 editions. **(3)** 2012e Air Canada mainline block hours and FTE's estimated by AirTrav Inc. based on trend analysis and Air Canada management guidance (1Q-2012 public update) on the range of 2012 capacity increases.

Notes:

[1] As opposed to the "stick time" productivity measure used and defined in Figure 2 below, this Figure 1 takes total aircraft "block hours" (flying time plus taxiing time), converts block hours to Captain plus First Officer crew hours (multiplies block hours by two), divides by the full-time equivalent pilot count, then divides by twelve to get a monthly number of block hours per FTE pilot. Block hours per FTE pilot do not take into account the relief pilots and augmentation required to operate long-haul flights.

[2] Block hours per pilot FTE and pilot stick time do not take into consideration various non-flying pay elements such as training, sick time, deadheading to perform required flying, vacations and statutory holidays.

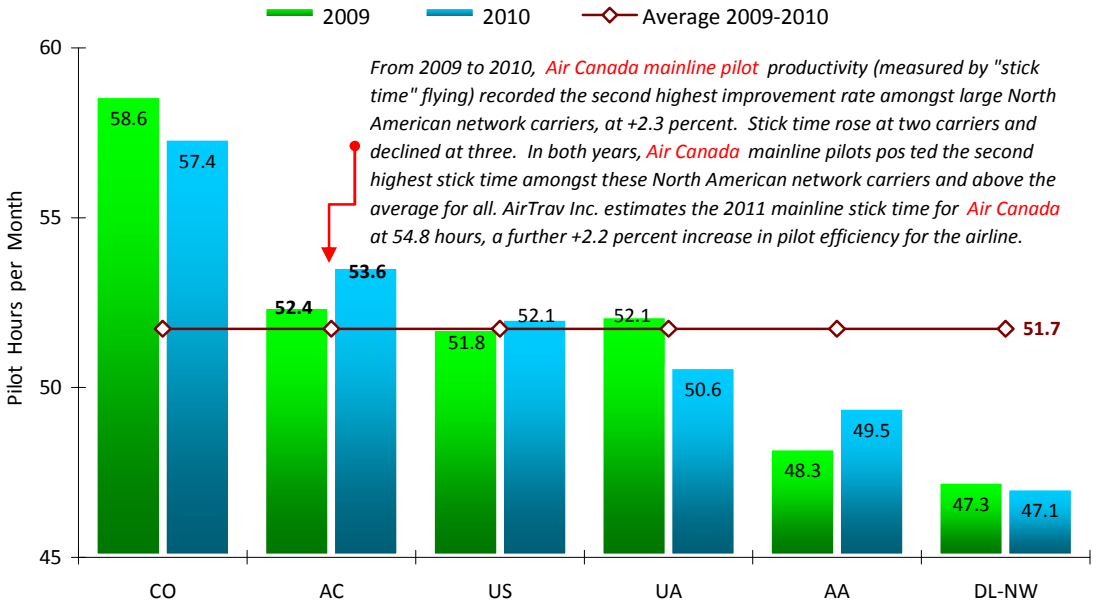
Unfortunately, poor earnings, a laggard stock price and sustained labour turmoil belay the continued benefit enjoyed by the company and other stakeholders from the ongoing effects of concessions and productivity improvements. Perhaps it is time for new thinking on this file.

Air Canada pilot performance: second place amongst North American peers

It is also important to understand the productivity of Air Canada pilots in the context of other large North America network carriers. Figure 2 below considers "stick time", which is a slightly different measurement than block hours per pilot used in Figure 1. Stick time calculates not just the block hours of Captains and First Officers but also the block hours of Relief Pilots used to augment long-haul flight operations.

Most Canadians are compensated for performing their job function, in addition to training, vacation, statutory holidays, breaks, and illnesses. By comparison "stick time" only reflects a pilot's operational work as performed in the aircraft flight deck (and which has limitations for safety reasons) and excludes other factors such as training.

Figure 2: "Stick Time" – North American Network Airlines [NB]



Sources: (1) 2009 and 2010 US air carrier data from US Department of Transport (DOT) Form 41, Schedules P10 and T2 block hours per pilot, modified for flight deck crew augmentation for long-haul operations as follows: a) 14 Code of Federal Regulations (CFR) Federal Aviation Regulations (FAR) Part 121 Subparts pertaining to Flight Duty Periods (FDP) and flight crew augmentation requirements (excluding effects of new augmentation limits effective Jan. 2012 as per Part 117, FAA Final Rule RIN 2120-AJ58); and b) Estimates by AirTrav Inc. pertaining to profile and extent of long-haul flight operations by carrier. **(2)** Air Canada 2009-2010 data based on the following: a) Statistics Canada block hours for Air Canada mainline operations per Statistics Canada Catalogue no. 51-004-X. "Civil Aviation, Monthly Key Operating Statistics, Major Canadian Air Carriers", multiplied by two to get Captain plus First Officer Crew hours; b) Air Canada FTE pilot counts from the Air Canada Annual Information Form, 2009-2011 editions; and c) Modifications to account for relief pilots and augmentation estimated by AirTrav Inc. based on known augmentation levels (see Note 2 below) and Air Canada's schedule of long-haul flight operations.

Notes:

[1] "Stick time" takes into account relief pilots and pilot augmentation for FDP limitations, often related to long-haul operations.

[2] Per Sources note (1) above, US air carrier flight augmentation rules are subject to Suparts of 14 CFR Part 121 prior to January 2012 (FAR Part 117 not applicable as the new Final Rule was effective Jan. 2012). According to Transport Canada, relief pilots are used at Air Canada (for augmentation) according to terms of the collective agreement. The most recent contract between Air Canada and its pilots can be found at the Human Resources and Skills Development Canada website, Labour department page.

[3] Legend: AA=American Airlines; AC=Air Canada (mainline); CO=Continental Airlines; DL-NW=merged Delta Air Lines and Northwest Airlines; UA=United Airlines; US=US Airways. "Block hour"= elapsed time between push back from the departure airport gate, and when aircraft brakes are put on at the arrival airport gate (block time is essentially flying plus taxiing time).

Network airlines whose operations are subject to flight deck crew augmentation would normally see pilot stick time hours per month higher than the broad measurement of block hours per pilot.

Figure 2 does not take into account large North American low cost carriers (LCCs). While these LCCs have large networks, they are predominantly domestic airlines with no long-haul trans-oceanic flights that fall under the regulatory jurisdiction of augmented operations. With no relief pilots required and with shorter average flight durations that drive faster aircraft turn-around times and higher aircraft utilization, LCCs naturally post higher block hours per pilot.

These and other factors would make for imbalanced pilot productivity comparisons between traditional network airlines and LCCs.

The merger between Continental Airlines and United Airlines was completed on November 30, 2011. As such, Figure 2 data for 2009 and 2010 shows both carriers separately.

The merger between Delta Air Lines and Northwest Airlines was completed on January 31, 2010, As such, "DL-NW" shown in Figure 2 merges separate data for Delta and Northwest in 2009 (with weighting based on the respective size of both airlines) and represents the merged entity in 2010.

According to Figure 2, the monthly stick time of Air Canada mainline pilots was second highest amongst large Canadian and American non-LCC network airlines in 2009 and 2010. As of the date of this Research Opinion, 2011 data for American carriers was only available for US Airways. As such no comparative figures are provided for 2011 except for an AirTrav estimate of Air Canada's position in that year based on trend analysis of publicly available data.

From 2009 to 2010, Air Canada stick time productivity rose 2.3 percent to 53.6 hours per month, the second highest rise amongst the three airlines – Air Canada, American Airlines and US Airways – posting pilot stick time increases. Stick time at Continental Airlines, Delta Air Lines (including Northwest Airlines) and United Airlines declined from 2009 to 2010.

AirTrav's estimate of pilot stick time for 2011 is 54.8 hours, which represents a further 2.2 percent improvement in productivity, again taking into consideration all pilot categories. Air Canada's pilots have demonstrated a strong, competitive position amongst their North American peers and this should be recognized in the context of the airline's efforts to improve bottom line financial performance.

Alternate approaches and conclusions

The onus and imperative for improved productivity are not the sole purview of the pilot community – many tools and initiatives are available to any airline including Air Canada to improve the productivity of its flight operations. However, the management team must ensure that corporate initiatives are aligned within the appropriate planning time horizon.

For example, short-term decisions should be aligned with short-term goals without losing sight of the objectives required to achieve long-term sustainable shareholder value. Mis-alignment of short and long-term goals, which may include the pursuit of inappropriate interim goals, may have a neutralizing effect on the achievement of long-term targets.

The combined operational-asset management role performed by pilots should be elevated in prominence not just at Air Canada but at airlines globally, with management more proactively leveraging the high degree of training, education and competency of their flight deck crews.

Given the productivity gains outlined herein, it seems prudent to introduce innovative thinking that challenges the status quo, seeking opportunities for new incentives rather than a traditional reliance on cost reduction that has thus far strained relations.

In one such scenario an alternate incentive scheme would positively re-engage pilots by leveraging their demonstrated ability to manage increased productivity. This would constitute a win-win for both parties, whereby financial incentives to safely improve productivity would be more closely aligned with near-term corporate airline goals such as efficient asset management and the longer-term target of enhancing shareholder value.

Whereas elements of executive management compensation may be linked to EBITDAR[2] results rather than to specific performance of the company's underlying assets, recognition of pilots through the latter approach should yield positive results for the overall company.

[2] EBITDAR is earnings before interest, taxes, depreciation and amortization, and aircraft rent.

Pilot management of improved company asset deployment would help drive improved ROA results. That, ironically, would support executive performance targets and bolster the same EBITDAR metric used widely in the financial community to benchmark airline performance.

Management must create, capture and preserve shareholder value by balancing non-financial and financial goals, and by ensuring long-term objectives are appropriately structured. In the case of Air Canada, it could start by elevating the critical short and long term supporting roles its pilot fulfill and by recognizing those efforts with appropriately aligned and valued incentives.

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NOTE TO EDITORS – Charts accompanying this release are available separately from AirTrav Inc.

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