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Delta Air Lines, Inc. (DAL)

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MANAGEMENT DISCUSSION SECTION

Jamie N. Baker

Analyst, JPMorgan Securities LLC

Hey, good morning, everybody. My name is Jamie Baker, I cover the aircraft lessors and North American Airlines here at JPMorgan. Thank you for helping us get this event back on track following yesterday's meteorological mayhem.

I do want to especially thank the team from Delta and the teams from American and United for pulling out all the stops and making sure that they actually got in here positioning on Monday. I really appreciate your commitment to this conference. But more importantly, it reflects the commitments to their owners and prospective owners in the room. So, thank you all around.

We hope to make very good use of your time today. We do have a couple of holes here and there, it's the best we could do, juggling all the various companies. But as is customary, we will kick-off the Airline Day of the ATI event with Delta Air Lines. We've got a formidable team here. Gary Chase is joining us; Jill Greer; we've got Elizabeth Lippitt here. And most importantly in this instance, Paul Jacobson, Executive VP and CFO of Delta.

I will turn the cockpit over to you and look forward to hearing what you have to say about the Delta story. Welcome. Thanks, Paul.

Paul A. Jacobson

Chief Financial Officer & Executive Vice President, Delta Air Lines, Inc.

Thanks, all. I appreciate it. Thanks, Jamie, and good morning, everybody. Thank you all for being here and love hearing some of the stories of how people have trudged through the last couple of days. I also want to acknowledge that we have Jenny Winter here, from our Air Line Pilots Association, Investor Relations Group. We're always thrilled to have her here and welcome her back to the conference circuit after a new baby. So, we're glad to have you back, Jenny. Thank you.

Also before I get started, I'd like to give a little bit of a shout out to the Delta people across the system, particularly in the Northeast. Their relentless focus on customer service continued to show through especially through the storms of yesterday. While maintaining our safe and efficient operation that's focused on customers, we continued to operate through the day in Washington D.C. when most other airlines were shutdown as well as the government. We showed that it was still possible to get some things done in the face of a nor'easter.

But also importantly for the people of the New York area, we were the last flight in and the first flight out in each of Philadelphia, Newark, JFK and La Guardia. So, hats off to our operational teams for really, really focusing on the customer and making sure that no matter what might befall us, we can go through it. And of course, that wouldn't be possible without the cooperation and the coordination and the great efforts of the port authority and all our partners at the surrounding airports who just did an amazing job in the face of tremendous adversity. So, thanks to all of that who is involved and thanks to all the Delta people. We have a clicker. Is it just? Thank you.

Today's presentation does contain some forward-looking statements and those forward-looking statements are subject to certain risks. As we all know, those risks are highlighted in the 10-K which you can find in our SEC filings, as well as on ir.delta.com.

So, our journey is pretty consistent with what you've seen from us in years past. This is a long journey, one that is not undertaken lightly and one that we're all deeply committed to at Delta. And that is to introduce three concepts that are relatively foreign to the history of the airline industry. That is consistency, sustainability and durability in the business.

We all know that this industry has been prone to generate significant cash flow in the past. Every single time that has been followed with record losses. We do think that this time is different and it starts with consistently producing the strong results.

For the first time in our history over the last several years, we've had a consistent ability to invest in the operation, invest in the product, invest in our reliability and invest in our people, which is ultimately providing more of a consistent foundation in customer service which we see time and again yielding better results on the revenue line.

When you combined that with our network and our partnerships throughout the world, that's been the leading edge in our recovery as we've emerged over the last 10 years from historically a revenue discount to the industry to one of a solid and what we think is sustainable revenue premium even through the business cycle.

That being said as we said on the earnings call, and going back to Investor Day, 2017 is a little bit of a transition year. We're entering the year with fuel cost accelerating faster than any other quarter that they will this year. Even with the decline, we're still \$20 a barrel, north of where we were in the first quarter of last year. And while the revenue environment is improving and we see that steadily in the trends, it's not picking up fast enough to cover those costs as well as the increased costs of labor across the board and across the industry.

The good news is, we expect the greatest pressure to be in the current quarter that we're in. And as we work through the year, our goal is to consistently expand margins through the rest of the year and put us back on that trajectory to work our way back up to the 17% to 19% operating margin that we highlighted in our long-term plans.

And of course, I'd be remiss if I didn't focus on another key ingredient that is part of our recovery and that is balanced capital deployment. That's important for our shareholders. It's also mostly important for our employees and our customers. By creating a balanced, sustainable cash flow deployment strategy that focuses on solid improvements in the balance sheet, we're going to improve our flexibility and our durability to be able to withstand

whatever shocks might happen in the business. Because, as we know, as much as we want to solve uncertainty there are no'casters, there are other things that happen that we need to continue to be ready for and we need to continue to adjust for. A fortress balance sheet is the way to do that to ensure we can have consistent capital deployment through the cycle and take risk out of the business and we remain committed to doing that through 2020.

That consistency is really evident in the results as you've seen since, really, kind of emerging since about the 2010 timeframe. But most importantly, all we've done over the last several years is, continue to set records and pre-tax profit, pre-tax margin, returns to shareholders across the board. We think these trend lines, obviously with 2017 being a transition year, are going to increase and we're going to continue to be on that trajectory that we need to be. In fact, if you look back at our history and you look at the average margins that we've seen since consolidation, in the period from 2008 to 2012, while we significantly underperformed the most recent five years, a lot of structural improvements have occurred over that time period to lay the foundation for the types of margins that we're seeing right now.

It's not just low fuel prices that have driven this result. Over half of that benefit is due to the revenue premium that we've managed to turnaround, the fact that we have insignificant fuel hedging losses going forward. And also importantly, the fact that our interest expense burden is down almost \$1 billion per year from 2009, again, evidence of driving that sustainability in the business. So that even in periods where we see over the last couple of years, where RASM hasn't quite been up to the standards that we all expect, we're still able to produce these consistent results going forward and that's the key part of the thesis going forward.

A big part of that is also the fact that we've paid down debt and continue to do so. We had a creative transaction last week, which I'll spend a little bit of time talking about, but we remain absolutely committed to both, our pension and debt funding goals as evidenced by the allocation that we give it in our capital and our free cash flow, but that doesn't leave out our shareholders and that's probably the most important fundamental difference.

We always know that airlines have been able to produce significant levels of free cash flow, but up until the recent history shareholders never participated in that and anything other than theoretical value. Because when airlines were generating record levels of free cash flow, investment was up, leverage was up. And when the time came to not buy those airplanes, there was no more cash flow to allocate to shareholders. We believe in a consistent allocation of capital to shareholders, which you've seen in our dividend policy as well as our goal to target at least 70% of our free cash flow to return to shareholders, which gives us that ability to do that while still paying down the debt and funding the balance sheet.

As I mentioned, 2017 is a bit of a transition year, but capacity discipline is really laying the groundwork to help us out of that transition as quickly as possible and get us back on the path of expanding our margins. Our system capacity growth as we've guided for the year is expected to be about 1%, which is, we think the appropriate level to balance supply and demand, while also making that progress towards our long-term targets. We're committed to that level as we work our way back up to the 17% to 19% level. This is not a short-term journey. This is one that we're going to work to aggressively and we think it's the right target for the business for the future.

And the key to that is really getting back on the path of expanding our margins going forward as early as this year to set us back on that path of where we need to be to go forward. The good news is, we think the environment is supportive of that improving revenue, not only from the industry perspective, but also the specific Delta initiatives that are underway this year and into the future. Those revenue trends, as you can see from this trend line, despite the revision to our guidance last week, we still feel like we're on this trend line that really kind of began to show

improvement throughout the year, in accordance with the typical lag of fuel recovery that we see, but also importantly from the extra boost that everybody seems to have gotten in the fourth quarter.

The domestic supply environment or capacity environment for 2017 is much more closely aligned to GDP than where it's been in the years past, heading in and consistent with the overall theme that I think you hear throughout the industry, that margin expansion is important to everybody. And those demand trends have continued into the year despite the fact that we didn't reach the sort of optimistic inflection that maybe we thought we would see in the February-March timeframe to hit that original guidance level. We're still confident that we're on the trends and as the comparisons starts to improve and get a little bit easier throughout the year, we think we're on that trend line that's going to get us to margin expansion for the rest of the year.

There are a lot of Delta-specific initiatives that we continue to crank through. We've had very good success with this since inception as we look at things like the branded fares strategy or our co-brand partnership with American Express. Each of those are expected to generate \$300 million of incremental value in 2017, helping to pave that way, not only to recover out of what we've seen and help total revenues catch up to fuel and increased cost, but also diversifying the foundation a bit and focusing in not necessarily on what the raw ticket price is, but creating opportunities for customers to buy up for things that they value.

I think there's one thing, if you know about the emerging generation and overall demographics is that people are generally willing to spend money on things that they value and experiences they value. And what the airline has done and what we've been able to do with the branded fares initiative as well as the cabin segmentation is to create those value opportunities such that seats on an airplane are no longer a commodity. You have a lot of opportunities to tailor-make your selection of what you want your experience to be, creating additional revenue opportunities for us.

We'll also continue to leverage our key alliances going forward. Pleased that we've just completed the tender offer, and are now the official owners of 49% of Aeromexico, we will continue to move forward and execute the joint venture with them and we expect the results to be very strong for both of us going forward, and really creating that foundational position in the Latin American region, as well as a renewed expanded relationship with Korea as we spent a good bit of time talking about the restructuring that's necessary in the Pacific as a result of the liberalization of Haneda and the fact that we had a hub operation at Narita. The Korean Air partnership will serve as a great connecting point and a great feeder for each other through the deep Southeast Asia region, to supplement our partnership with China Eastern and China Southern very nicely from Mainland China.

And most importantly, we need to continue to invest in products and services that our customers value. That's what's driving our revenue premium. And that's what ultimately is going to help us shake the history of the challenges that the airline industry has had, not only from the investor's eyes, but from the customer's eyes as well. Make no mistake; our plan is to de-commoditize the airline industry and us within it, such that we create differentiated value against, it's just an airplane seat. We believe and experience on Delta through our reliability, our investments in our product, our investments in our people and the customer service that they provide, serve as the foundation for creating a very differentiated higher value experience on Delta than you can get on our competitors. And we're going to continue to invest in that going forward.

Loyalty is a big, big part of that, and we continue to focus not only on our partnership with American Express, but also driving loyalty for our customers because at the end of the day, a co-branded credit card is worth only the currency that it provides for the cardholders and what they can do. Our partnership with American Express, we believe, has created the world's most valuable airline co-brand portfolio. And we drive approximately \$3 billion of

incremental value this year using just through that card. That comes through a variety of relationships with American Express. We benefit from their diversified portfolio.

Predominantly, that is the co-brand card, it's also membership rewards, it's also travel agency business and they are the largest merchant processor that we have. So, there are synergies all throughout that relationship that give us the ability to execute value all the way through the P&L. And we're going to continue to drive that value, and we think with the growth that we're seeing in card acquisitions as well as the spend for cards, that we're in a position where we can expand this revenue base by a billion dollars over the next several years, which comes at an obviously a significantly greater margin than the base level of business going forward.

So, we're very proud of this relationship. We think this is an increasingly important part of the overall credit story as the brand continues to add power to this loyalty program, and the loyalty program then helps to fuel additional benefits as a result of that.

I'd be remiss if I didn't say that it's also about cost and probably one of the things I'm proudest of over the last several years is the effort of the operation and the finance partnership that we have deeply through the operation to create innovative ways to go drive efficiency into the business. This is more than just a cost-cutting program because cost-cutting programs in the airline industry have an aura about them or have a stigma attached to them because traditionally that's meant taking things away.

And when you view things as cost centers, there's only two ways to reduce the cost center. One is to buy less of it or, two, is to pay less for that product. Is there an element of that? Sure. But it's being driven through a very different lens than what has historically been done.

Historically, what was done is go take everything you can out of the system and nothing is sacred. Employees' salaries aren't sacred. Employee numbers aren't sacred. Customer amenities, investments and reliability aren't sacred. As I often tell our employees in settings and presentations like this, the worst thing we could do is start undoing the investments that we've made in the customer, in the product, in the reliability and in our people. Because if we take away the benefits that we've added, the service enhancements that we've added, we under invest in reliability and lower the bar on our own performance and pursuit of a unit cost goal. It will be worse in the eyes of our customers than if we had never done it at all, because it will represent just another betrayal in the long history of the airline industry where you've done something and taken it away just as I was getting used to it, and just as I was getting ready to continue to pay you value and give you value, and ascribe value to your product.

So cost efficiency today, and cost cutting today means better ways of doing business, going behind the scenes and finding those cost-cutting opportunities that are invisible to our customers. You don't see what happens behind the curtain because we're doing it more efficiently. But you see the results of it every day, because we're able to invest in things like reliability and service recovery, onboard services, meals, while keeping the overall cost inflation in the business down.

And this comes through a lot of innovation and it comes through a lot of hard work and rolling up your sleeves. This year, we'll drive about \$1.5 billion of productivity into the business in an effort to keep our costs at that 2% to 3% level this year. That cost level is a little bit heightened because of the reduced capacity and if you follow our long-term story, what we've said is, we think unit costs can consistently be below 2% with growth at around the 2% level.

So through the reduced utilization of our assets this year, as we try to balance supply and demand in pursuit of higher margins, that's putting a little bit of pressure on the CASM line. And as I've joked with Jamie, we could

absolutely hit our cost goals, might not necessarily like the way we go about it. So, 2% to 3% fits our goals very, very nicely and we feel good in a transition year, that we're making the right trade-offs between further investment in the product and driving efficiencies out of the business.

The good news is the cost story remains very much intact. The foundation of that cost efficiency has been our up-gauging strategy which is [DG1], you follow Delta you understand that since 2012 through 2016, our average gauge went up by about 5% over that time period. That gauging rate has generated what we estimate to be about \$350 million a year in cost savings at the foundational level, just from more efficiency. One takeoff and landing produces more units, and that's the highest cost in the business, is producing a cycle. So, the more units per cycle you can produce, the more efficient you're going to be going forward in the business.

As we go forward into 2016 and 2020, that average gauge will actually increase by about 7%, keeping that foundation intact for the next several years, which gives us good line of sight on our cost discipline. And that's going to be an important factor in continuing to expand and reach our margin goals over the next few years.

This slide that shows the history of cash flow is arguably my favorite slide. I think nothing distills down what's different about the way we're running the company than in the years past than what this slide is. You've seen it before. The red line represents operating cash flow. The grey bars represent CapEx.

And if you go back to the last peak cycle in the industry without judgment as to whether we're in a peak cycle or not for those of you that are taking detailed notes, but if you go back to the last time the airline was generating peak cash flows, you see that despite the fact that we were taking in more cash than at any point we had ever done in our history, we were actually adding leverage to the balance sheet through over investment; over investment in aircraft; over investment in things that ultimately were not sustainable with the top-of-cycle behavior that you saw historically. That leverage obviously came back to significantly haunt us going forward and, ultimately, not only us, but the way that the industry collapsed upon itself with that type of leverage.

So, in 2010 through 2016, we're managing the business very differently. We're managing the business for operating cash flow and margin, sure, but also we're managing the business for free cash flow. We've been able to maintain a lot of CapEx discipline through the synergies and the scale that we've been able to achieve. We managed our fleet a little bit differently, but that's based on the productivity and the quality of people that we have at Delta.

A lot of times people say, well, your CapEx is down simply because you fly older airplanes. The response to that is we fly older airplanes because we can, because despite the fact that we've got a higher fleet age than many of our competitors, we actually drive better reliability, lower maintenance unit cost and better customer services. If you could do that on a lower capital base, you are meant to do that all day long. It does not mean necessarily that we have a bow wave of CapEx coming.

We believe that, given the track record and what we've been able to do, that this relationship between operating cash flow and CapEx is sustainable going forward. In fact, we said pretty clearly, we expect that our CapEx budget will be approximately 50% of our operating cash flow. So, those numbers have gone up over the last several years, but they've gone up in a responsible manner in line with the increased cash generation that we've had, which has allowed us to maintain our focus on our balance sheet and our capital return to shareholders.

And ultimately, if that cash flow starts to subside a little bit, our fleet and the barbell strategy that we have, and by that I mean we've got a lot of new airplanes and we have a lot of old airplanes, puts us in a position of unique flexibility to respond swiftly to any recessionary pressures or anything that we might see on the horizon. We don't

see that, but we do think flexibility is a key element to continuing to drive that durability and sustainability in the business. And that cumulative free cash flow of \$17 billion has been used very wisely in an effort to continue to build that foundation and also create a sustainable stream of cash back to our shareowners as a credit and as a deference to the fact that that's why we're all here is to drive those returns to our shareholders going forward.

The investment grade balance sheet and the ratings that we've gotten have also allowed us to use our balance sheet in creative ways that aren't available to others necessarily in the industry; nothing more evident than what we did last week. It might seem counterintuitive, that is I'm sitting up here talking about delevering the business, that I'm also going to boast about how we were able to issue \$2 billion of unsecured debt in the marketplace at our lowest coupon ever, whether it's secured convertibles, you name it. 2.875% coupon on a three-year piece of debt is the cheapest debt that Delta has ever raised in its history and we were able to do it on an unsecured basis.

But we did that not to leverage the markets, not to increase our debt because we can, that's old behavior. We did this as a financial exercise, because we remain committed to two things through 2020. We remain committed to funding our pension and considering that that plan is hard frozen, making sure that ultimately with the help of some potential additional interest rate increases over the next few years puts that in a position where it's 100% funded. It's immunized. We meet our commitments to all of our retirees and those vested beneficiaries, but it's never going to require another \$1 of operating cash flow from Delta. We have the cash now. We're generating the cash now. It's our duty to fund that, so it doesn't become a problem later.

By putting \$2 billion into the plan, all we're doing is advanced funding contributions that we've committed to over the next three years and putting that money to work earlier and sooner. And ultimately, that's going to result in a better funded status in 2020, regardless of what interest rates do, but as we cut down the future contribution, we'll no longer make \$1.2 billion a year in contributions. We'll bring that down to \$500 million a year, which frees up \$2.1 billion of cash flow over the next three years, which allows us, in turn, to pay off that debt that we just issued. Such that, when we get to 2020, we'll still achieve our \$4 billion net adjusted debt goal, but by our estimates, our pension plan, by putting that money to work, will have an extra 5 to 10 points of incremental funded status.

When you combine that with the prospect of higher interest rates, if interest rates were to go up by 200 basis points between now and 2020, certainly not an unreasonable assumption and we'll get a little bit more color from the Fed meeting later today. That 200 basis point increase would increase our funded status in 2020 to approximately 95%, certainly within shouting distance of getting that issue resolved permanently, freeing up that cash flow for our shareholders and, ultimately, to help to transition as we go into becoming a full cash tax payer.

So, it's not coincidental, but as we focus on 2020 for our pension goals and our balance sheet goals that we also expect to be transitioning out and fully utilize our NOLs over that time period. By completing our debt and our pension funding strategies by that time, we hope to ease the transition into becoming a full cash tax payer, such that, that incremental draw on cash from paying taxes isn't consumed or doesn't force us to reduce either CapEx or reduce returns of capital to shareholders.

So, there's a method to the madness here as we try to transition. And, again, that focus is on consistency and sustainability, even as we transition through a major milestone of utilizing our net operating losses. And I can't stress enough, the goal and the desire and the commitment of the management team to consistently return cash to shareholders. This isn't a case of the fact that we think the stock is so incredibly undervalued, we need to raise to repurchase every share that we can today. We do think the stock is undervalued, you've heard that from us before and I think many of you share that sentiment as well, but we think, ultimately, at the end of the day, the key

to unlocking that value is consistency, doing the same thing year in and year out and casting away that doubt and the aspersions of our past and our history.

And as we continue to work and build that model of consistency, we think the valuation will follow over time. We've consistently increased the dividend going forward since its inception in 2013 and we remain committed across the company to continuing to increase that dividend and making it more and more of an important piece of the capital return strategy. That capital return strategy and the dividend is a key component, because it enforces and reinforces to the market our commitment and our view of the durability and sustainability of the business model. And as we've taken that up, we continue to reinforce that message of durability going forward.

We do plan to complete our \$5 billion share repurchase by the middle of this year. Once again that will be ahead of our expected deadline when the program was announced. This will be about six months ahead and ultimately is in line with what we talk about in terms of our commitment to return 70% of free cash flow. We'll have more information to come about both of those as we get closer to the Capital Markets Day and through the summer as we complete those programs. So, stay tuned for more of that as we continue down that phase.

But we think the opportunity improving the durability remains great. We've showed many different metrics. As I've said to many of you in this room and in other presentations, we understand the discount to the industry. That came about through decades of lack of proper stewardship or lack of appropriate returns in the business. Make no mistake, we do think it is different this time and we're doing everything in our power to continue to run Delta differently and consistently, so we can provide that foundation to provide more confidence in the future cash flows and the consistency of those cash flows going forward.

Thank you for your time. Thanks for your attention. Thank you all for making it here. Love to hear some of the stories about how you did, but ultimately, we appreciate your continued focus and interest in Delta.

And with that, we've got a few minutes for some questions and answers. Thank you.

QUESTION AND ANSWER SECTION

Kirk D. Simpson

Senior Financial Analyst, Delta Air Lines, Inc.

Q

[indiscernible] (30:43) seems like you had to pick up in December, carry through into January and has that started to moderate a little bit more several weeks or is it similar to what you saw post that pickup? Thanks.

Paul A. Jacobson

Chief Financial Officer & Executive Vice President, Delta Air Lines, Inc.

A

Sure. Thanks for that question. Ultimately, as I said in the remarks, we see ourselves still on that trend line that we saw in December and I think, as you look at the guidance revision in the comments that we made last week, I think we were guilty of probably building a little bit too much optimism in an additional inflection as the comp got a little bit easier in February and March. But remember, a year ago, there was a lot of noise in the U.S. fare structures around combinability and things like that. But ultimately, that noise aside, we still feel like we're on that trend line that's ultimately leading to the RASM recovery we need in order to have the confidence to expand our margins this year and nothing has changed from that.

Mark S. Streeter

Analyst, JPMorgan Securities LLC

Q

Paul, Mark Streeter from JPMorgan. Good morning. You took the investment grade rating out for a spin. It was very successful in funding the – refunding the pension plan as you mentioned. How should we think about your use of the capital markets going forward to fund CapEx? You obviously have secured debt through EETC's very cost effective. You now have this unsecured debt. Should we expect you to be building unencumbered assets buying airplanes with cash and so forth or what's going to be that mix going forward?

Paul A. Jacobson

Chief Financial Officer & Executive Vice President, Delta Air Lines, Inc.

A

Sure, Mark. It's great to see you. Thanks for joining us this morning. Ultimately, with the strategy that allows us, that focuses 50% of our operating cash flow to be reinvested back in the business, it puts us on an ultimate platform of flexibility. When you have that strategy, you can always pay cash for your assets going forward and we expect to continue to do that going forward. We have done some aircraft leasing around the edges. That's the result of the fact that we took our lease portfolio down to really, really low levels in the single digits on a percentage basis through the initial delevering phase. That's where some of the greatest opportunities were.

And as we continue to target being about 25% of our leased fleet for flexibility, for residual value management, et cetera, we're going to continue to lease a little bit going forward. From an overall perspective, we continue to believe that unencumbered assets are a very, very good key for sustainability. It provides the ultimate rainy day fund, it's not cash that's subject to leakage, but at the same time, it can be easily transferable into value, should you need it.

So, as we continue to look at our forward calendar of maturities against our \$4 billion net adjusted debt goal, I expect that we will have some maturities that we refinance instead of just paying off, considering that a sizeable portion of that matures over the next five years and we'll take a look at the markets. But certainly the unsecured markets are available, they're cheap, it provides a very good platform for us to build up that base to ensure flexibility going forward. And we intend to continue to do that.

Mark S. Streeter

Analyst, JPMorgan Securities LLC

Q

And then just one more from me, article on the tape from Reuters about hiring some consultants to explore, perhaps selling the refinery or maybe the long term sort of places the refinery within the company. Can you just give us an update from your perspective on how it's been working with the refinery and what this article is referencing to in terms of what we should be expecting to share from Delta?

Paul A. Jacobson

Chief Financial Officer & Executive Vice President, Delta Air Lines, Inc.

A

Sure. And I will be very tempered in my remarks, given my reaction to the article. If you read the article, the quote coming from the company in there is very consistent with everything that we've said and nothing has changed. We believe the refinery continues to be a strong benefit to Delta, not only in terms of the cost of jet fuel, but also control of supply in the Northeast region, which during events like this, gives us even more confidence in our ability to supply the fuel that we need, particularly to the Northeastern regions, at an effective cost.

You've seen our history in our overall fuel costs because the refinery is a piece of the overall fuel strategy in which we've consistently been able to deliver an un-hedged cost advantage to the industry, sometimes as high as \$0.07 to \$0.08 per gallon and that's – the refinery is a big part of that. The article references a study with a consultant – yes, we hire consultants; we hire consultants a lot in terms of helping us to answer questions.

And the questions that we have over five years is to make sure that we are continuing to quantify the value that we see the refinery bringing us, which is how much of an impact do we have on the supply markets and what can we continue to do in an effort to bring jet fuel cost down. What are the effects of various refinery closures in the Northeast, and what that would do, because a key part of that thesis, if you remember in 2012, was the fact that many of these refineries closed or were slated for closure, which was going to put additional pressure on the jet fuel markets.

Also, we know from our pressure testing that refinery valuations have generally gone up across the space. And with the improvements that we've made into the refinery, not only in terms of its capabilities to produce higher margin products, but also the added benefit and operational performance that we've provided to the refinery. We wanted to assess how much value that we've created.

So, we do these internal studies all the time. I think the connection that somebody tried to draw between that and the refinery strategy are not only false, but they go against everything we've said publicly and privately to everybody involved. So, I'd like to take this opportunity to absolutely reinforce our commitment to the refinery as a strategy and to the people that work hard and have given their lives to the refining industry in Philadelphia and what they've done to help that trainer strategy in a very unique deployment. Thank you.

Mark S. Streeter

Analyst, JPMorgan Securities LLC

Q

And just one other one. In terms of the pension fund analysis that you walk through with funding and so on, what's your assumed rate of return on pension fund assets that you use for that? Thanks.

Paul A. Jacobson

Chief Financial Officer & Executive Vice President, Delta Air Lines, Inc.

A

So, our expected rate of return across the portfolio of assets is about 8.9%. I expect that over time, ultimately, as you get closer to being fully funded, we start to work towards indemnification strategies and liability-driven

management strategies. Given the benefits that we've had of airline funding and the underfunded status, we don't want to abuse that, but we've been in a position to take a little bit more risk in that portfolio, which has ultimately benefited us over its history. The good news about this is not only are we able to reduce our forward contributions to the plan, but this actually completes all of our minimum required funding under airline relief. So, if you look, legally our obligation is satisfied through 2024.

We think this is a very responsible and good stewardship use of that flexibility that was given to us and a great example of the partnership that when laws are passed to help save plans and there's responsible stewardship of that flexibility, that ultimately that's the right answer for the long-term and we're proud that we've been able to do this well ahead of schedule.

Q

Can you comment on how your regulatory agenda has changed, if at all, in light of the political developments in Washington and elsewhere?

Paul A. Jacobson

Chief Financial Officer & Executive Vice President, Delta Air Lines, Inc.

A

Sure. I think if you look at the administration and what they've said publicly, there's obviously a desire of the administration to ease the regulatory burden on businesses and I think we're encouraged by the President's willing ear to listen. The airline CEOs and airport officials being invited to the White House from all sources, being reported on that meeting. It was a very, very good listening session, in which a lot of things were aired and a lot of ideas are out there.

So, we think, ultimately, there are opportunities; won't get into specifics, but we are, obviously, putting together our list of things that we think can help make the – ease the burden on the industry and also help provide that flexibility for us to ultimately serve customers better. That's our end mission as a customer service business, is to continue to do that. And as long as we can continue to behave responsibly, then ultimately we think that there are some regulatory burdens that can be lifted that we can still do.

I'm also very encouraged by the idea of tax reform. I think that one for this industry in particular, given the fact that we are all U.S.-centric and through the laws, we have to continue to be, through the bilateral tax treaties internationally. We have a sizable share, if not substantially all of our revenues that are subject to U.S. taxes. So, any relief in that space would be good.

We're watching very, very closely all the issues surrounding that, including border adjustability and continuing to develop our positions on that in partnership with both, the White House as well as Congress, and working through our Governmental Affairs Office to make sure that we understand all of the consequences intended or otherwise to what that might be. So, we expect that we'll get some good relief. And, ultimately, as many corporations do that, it will continue to be easier to do business here and we look forward to that.

Jamie N. Baker

Analyst, JPMorgan Securities LLC

Q

Hey, Paul, a quick question for me. You touched only briefly in the presentation on cabin segmentation, which in my mind is the next big thing for the industry. I think that the profit contribution and segmentation could very well match, if not slightly exceed the contribution that bag fees, for example, make. Am I too bullish on this

phenomenon and I always like asking questions and you can publicly say, Jamie you're wrong, so tell me that I'm wrong to be as bold up as I am on this phenomenon.

Paul A. Jacobson

Chief Financial Officer & Executive Vice President, Delta Air Lines, Inc.

A

Sure. No. I think this is a very, very tight sort of pivot point for the industry as a whole. As you see, more and more airlines adopting that. But our view of it is simply that, historically we always on one side of our – talked out of one side of our mouth that we don't want to viewed as a commodity yet, the way we sold of our product was 100% commodity-oriented, opening up the entire seat maps such that the leisure customer that booked at the lowest fare got the choice of premium seats, while the business traveler that paid the most for his or her ticket ends up in the middle seat in row 36.

So ultimately, what brand segmentation does or cabin segmentation does is, de-commoditizes that product and ultimately redefines our focus point, not from the seat on the airplane, but rather the experience that we can deliver to the customer, not only through just the flight, but through the boarding process, through the loyalty program, through the flexibility and through innovative ways like CLEAR that can help us through ease our customers' burden through security lines. Those types of partnerships across the board create opportunities to not only drive more value in the loyalty equation, but also drive more value and more choice in each of the purchasing path decisions whether you want to sit in First Class on this trip by paying a First Class upgrade fee or you want priority boarding, because you've got some important things in your carry-on and you want to ensure that there's going to be carry-on space, so you pay out for priority boarding.

By changing the focus point to the experience, it's much more customer-focused and customer-centric than any time in our past. And I think across industries, not just ours, but – not just the travel industry, but across all of corporate America and really just business, when you give customers choice and choices that they value, they're much more willing to pay for that and to invest in their own experience if they're given that opportunity. So, I think the opportunity is tremendous just by changing the focal point of how we sell the product.

Jamie N. Baker

Analyst, JPMorgan Securities LLC

Q

And a final question for me related to labor. I mean, you talked about the flexibility with having a largely non-union workforce for a franchise. The one downside to that from a modeling perspective is that we never really know when there's going to be cost escalation or employee investments as you put it, in the non-pilot group. The benefit of being fully unionized is, we can mark our calendars, here's the amendable date, and we can make estimates as to escalation that comes thereafter. How should we be thinking about non-pilot labor cost escalation between now and when the pilot contract becomes amendable? Thanks.

Paul A. Jacobson

Chief Financial Officer & Executive Vice President, Delta Air Lines, Inc.

A

Well, I think wages and employee investments are a key part of our strategy. Ultimately in a service business, it comes down to how motivated are people to serve our customers. At Delta, we're unique in that I think our employees come to work every day looking for ways to surprise and delight our customer bases and to see can I do it a little bit better than I did yesterday.

As evidence of that, we got a very nice letter from Warren Buffett, Ed did, in which he attached a copy of a handwritten thank you note he had gotten from a Delta flight attendant personally thanking him for his investment,

not only in the company, but in her. And her commitment and her pledge to do everything that she can every day to provide him with a return on his investment. That's how special the Delta culture is and how unique it is.

We believe ultimately that that culture deserves the highest pay and the best pay package in the industry regardless of work group and we remain committed to doing that, not only through base rates, but through our profit sharing program, which we believe incents our employees to serve our customers in very creative ways each and every day.

So, I think, you'll continue to see sustained increases over time. I think it's not unlike modeling from time-to-time administrative SG&A-type inflation going forward. But importantly, I think, what you've seen over the last 24 months has been sort of a systematic rate reset across all of the industry. The good news for Delta is, we were at or near the top in most categories.

So, as we preserve that even as the industry has raised the bar, our cost inflation has been somewhat modest compared to others as a testament to the fact that we've already been there consistently. So, this is an area, where we'll continue to invest in and we'll continue to drive as much predictability as we can for you going forward, but you can count on it. It's something that we remain committed to.

So, I think that concludes our time. But thank you all again for your attendance and hope you enjoyed the conference and you enjoyed the presentations today. Thank you.

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