COMPANY AUDIT – AMERICAN AIRLINES (AAL)

Table of Contents

1. EXECUTIVE SUMMARY

American Airlines is now the largest airlines in the world after the merger with US Airways in 2013. Their fleet totals 1,494 planes and and operate a total of 3,400 flights daily, primarily out of their 5 major hub locations in Chicago, Miami, Los Angeles, New York City and Dallas. The airline itself was formed in 1930 as a consolidation of 82 air couriers and other small aviation-related businesses with a primary focus of being a small mail operator that also allowed for limited passenger travel. Since the merger with US Airways American Airlines net income and overall revenue has increased dramatically, from a negative net income in 2013, to seeing over 200% growth the following year. Similar trends continued the following year in 2015 in terms of overall revenue and net income growth for the company.

The comparative advantage that American Airlines holds beyond having the largest fleet domestically, is its unique offering it provides its customers that are looking to travel internationally. American Airlines is a member of the oneworld alliance, which is comprised of 45 airlines working together to offer seamless travel options on a global scale. The airlines work as a team to provide round trip travel for its customers, as opposed to them having to search for separate flight's on their own due to travel limitations of today's aircraft, while still being able to receive full rewards benefits of flying with airlines that are members of this network. Currently their management is focused on maintaining customer safety, modernizing their fleet and reducing their overall carbon footprint when it comes to operating efficiency.

American Airlines new business program, Flight plan 2020, is primarily geared toward providing an overall better experience for their customer with a goal of gaining customer loyalty and increasing their overall market share in the airline industry, maintaining profit levels and continuing to be a good place to work for its employees. Although the airlines is faced with constraints regarding regulations and labor unions, they are continuously pushing forward in order to be a leader in the industry. This shows with their overall performance the last three years against the market, with their stock rising over 87% whereas the S&P 500 only grew over 27%. The overall stock value of American Airlines has increased significantly since the merger with US Airways in 2013, however year to date performance is down which will be explained in greater detail later in this document. We will also show how American compares to its major competitors in terms of stock value, revenue amongst other components. With how competitive and elastic the airline market is today, it is extremely important for American Airlines to maintain a strong pulse of the market and with its emphasis on reducing its overall operating expenses, this will only benefit them in the long run in terms of being more appealing to its customer base. This document includes a SWOT analysis that will showcase the current position of the airline and where there are opportunities for continued growth. Throughout examining American Airlines, there are several areas of improvement in which will help strengthen their position to travelers with the hope of gaining an increase in market share from their competitors.

2. HISTORY

American Airlines was formed as a result of the consolidation of 82 air couriers and other small aviation-related businesses in 1930. The consolidation that became American Airlines, began with Embry-Riddle Company, an airmail service company founded in 1925 in Cincinnati, Ohio. The Embry-Riddle Company’s need for capital to expand led to their acquisition by Fairchild Aircraft Corporation.

In 1929, Fairchild Aircraft Corporation organized The Aviation Corporation (AVCO), a company with the goal of financing small aviation mail operators. After a year of growth and organizational complications, The Aviation Corporation formed American Airways in 1930, in an effort to streamline its organizational structure. By 1931, American Airways became a successful company with several mail contracts that allowed passengers to travel exclusively on American Airway's airplanes.

The success of American Airways came to a halt after changes to the airline industry, which included the cancellation of air mail contracts, were introduced by President Franklin D. Roosevelt in 1934. However, after a failed attempt to have the Army Air Corps fly the mail, President Roosevelt renewed the mail contracts with airline companies but stipulated that The Aviation Corporation had to be broken up. The break up led to The Aviation Corporation selling off a majority of its share of American Airways.

To move on from the changes imposed upon the company, American Airways changed its name to American Airlines on April 11, 1934 and appointed Cyrus R. Smith as the new president. The forward thinking and vision of a transcontinental airline by Mr. Smith, has earned him the credit for the development of the Douglas Sleeper Transport (DSTs); an aircraft that combined the features of the cabin space of the largest and speed of the fastest aircraft at the time. The Douglas Sleeper Transport creation is regarded as significant in the history of U.S. aviation.

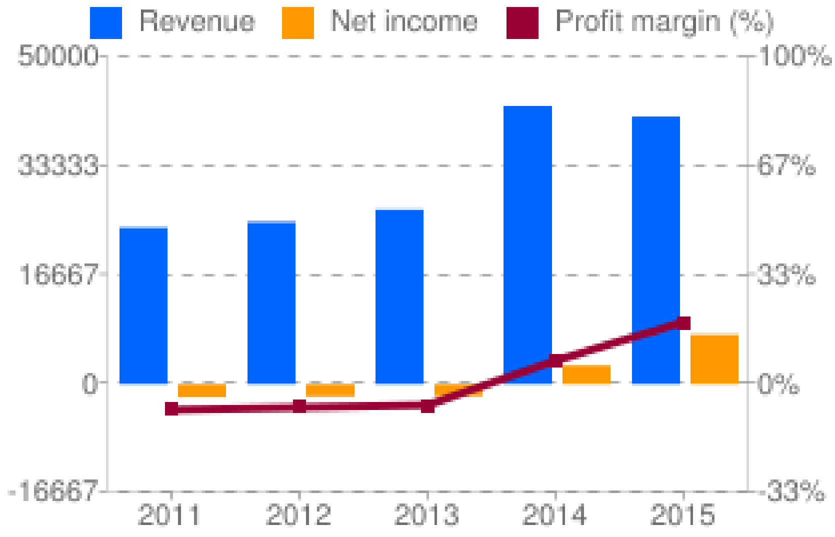
After taking delivery of the new Douglas Sleeper Transports, American Airlines announced services named American Eagle and the American Arrow that had set new standards for nonstop passenger flights in 1936. By 1939, American Airlines passenger volume increased significantly and they were flying the most passenger-miles of any domestic airline.

Over the next several decades, American Airlines continued to advance and make key improvements in various areas of operations. Some of these important advancements included the following:

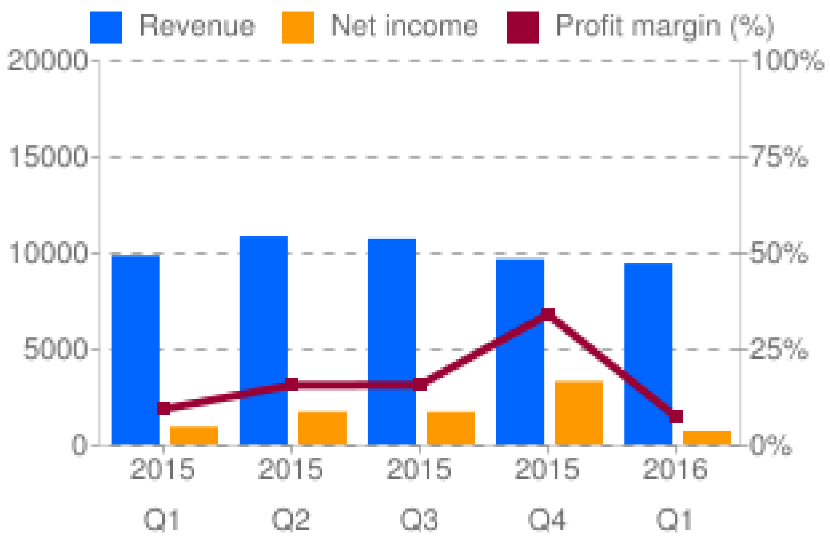
- Becoming the only airline in the United States with a completely post-war fleet of pressurized passenger airplanes in 1949.
- Pioneering nonstop transcontinental service in both directions across the United States in 1953
- In 1959, American Airlines introduced the first U.S. designed turboprop airplane and became the first airline to offer coast-to-coast jet service with the Boeing 707.
- Through a merger with Trans Caribbean Airways, American Airlines gained its first Caribbean routes in 1970.
- In 1981, American Airlines introduced AADVANTAGE travel awards program, a revolutionary marketing program to reward frequent fliers.
- In 1989, American Airlines opened its seventh hub in Miami.
- In 2001, American Airlines completed acquisitions of TWA's assets.
- In 2013, American Airlines became the world's biggest airline after the merger with US Airways.
- In 2014, American Eagle changed its name to Envoy Air, operating over 1,800 flights a day serving 159 cities – being the world's largest regional airline.

After approximately 90 years of being tested and proven as a company, American Airlines now flies more passengers than any other U.S. rival. In addition to outperforming its rivals, since the US Airways merger in 2013, American Airlines has reported a record profit for nine straight quarters.

American Airlines Income Statement Chart: Annual Data



American Airlines Income Statement Chart: Quarterly Data



Source: Google Finance, AAL Financial Section

3. BUSINESS MODEL

COMPARATIVE ADVANTAGE

When looking at the comparative advantage that American Airlines holds over the competition, the area that stands out is the fleet size. After the merger with US Airways in 2013, American has a fleet of 1,494 active planes, doubling the fleet size of its three major competitors, Southwest, United and Delta, making them the largest airline in the world. With a fleet this large, American Airlines is able to provide aggressive ticket pricing and more flight options than any other company in the industry, allowing them to operate roughly 3,400 flights daily and just over half a million passengers.

American Airlines is seen as a dominant firm oligopoly in the airline industry because of their overall market share, allowing them to be a price maker when it comes to setting the dollar value on airline travel domestically and internationally. Considering the competitive nature of the market and the elastic state of the economy domestically and internationally, however, American Airlines has to avoid setting arbitrarily high prices in order to avoid losing customers to their competitors.

The airline operates primarily out of 5 major hubs strategically placed hub locations throughout the United States, Chicago, Miami, Los Angeles, New York City and Dallas. There is a reason for selecting these specific locations as their main operating locations, American Airlines target market consists heavily of business men and women traveling domestically and internationally for work. Each one of these hubs, known as their “cornerstone markets”, are major economic leaders in the US economy. Chicago is home to 9.5 million people and 4.5 million jobs a $500-billion-dollar economy and is known as the financial center of the Midwest. It is home to more than 400 major corporate headquarters and has over 240,000 businesses.

Dallas ranks second in the US from revenue generated from Fortune 500 companies and has the fourth largest labor force in the US. New York has the most Fortune 500 companies in America, with 43 corporate headquarters in the city, and ranks fourth of Global 500 companies with 18. Miami has more than 500 multinational corporations, and home to four Fortune 500 companies. Los Angeles is known as one of the major entertainment hubs in the world and home to six Fortune 500 companies. It is clear to see why American Airlines selected these cities as their major operating hubs in the US with their focus being on large economic markets.

Another major advantage that American Airline offers to its customers is the ability to provide round the globe service through the oneworld alliance, a partnership between 15 major airlines and 30 affiliate airlines. This network allows customers to go to American Airlines website and book their airfare directly to their destination, utilizing the partner and affiliate airlines to create a one stop shop for booking roundtrip airfare. Booking outside the network would have the customer book one flight to a major international airport, and the having to see what flights are available at the airport that are traveling to their end destination.

The vision of the oneworld alliance is to make global traveling smoother for its customers, and this process certainly does so for the customers. The other benefit of utilizing this network for American Airlines customers is the ability to still receive travel rewards while utilizing the partner airlines, as opposed to only receiving benefits for a portion of the distance traveled. An example would be if you were flying from New York to Moscow with American Airlines.

The oneworld program would provide you a roundtrip travel solution to and from your destination along with receiving the full travel benefit for the roundtrip flight, utilizing partner airlines to take you to your international destination where your flight connects. For your travel rewards, you would obtain points for the entire trip, NYC to Moscow as opposed to just NYC to a connecting airport such as London. The network itself offers its customers 14,000 flight's per day from a fleet of 3,500 planes to 900 destinations and 150 different countries. This network accounts for $130 billion in annual revenues and is responsible for moving 550 million passengers a year. The reason for the emergence of airline networks is consumers today are looking to travel more, and with technology limitations in air planes, it is impossible for one network to service all international markets.

MANAGEMENT FOCUS

When examining the major focus of American Airlines top management there are a few critical areas in which they are directing the majority of their attention. First priority is always going to be safety for the passengers and making sure that the planes that are moving their customers are in proper working condition. Beyond that there has been a large emphasis placed on modernizing their large fleet in order to provide a better in-flight experience for their passengers. American Airlines is looking to close the gap between some of their competitors with providing individual TV's, in-flight wifi, upgraded seating and more legroom. Another major focus is to continue to search for strategic airline partnerships to be added to the oneworld alliance to provide more destinations to their portfolio. This not only allows them to provide more travel options for their passengers but also helps with gaining exposure to an increased number of international markets through the alliance and building/creating brand awareness overseas.

American Airlines also places a heavy emphasis on giving back to the communities, both domestically and internationally through multiple charities pertaining to children, military and communities. The final point of management emphasis pertains to reducing the carbon footprint and increasing their operating efficiency for planes and utilities. American Airlines last year saved 146 million gallons of gasoline by making their aircrafts lighter, using one engine for taxiing on runways, retiring older and inefficient aircrafts and upgrading their planes engines with new models from Rolls Royce. Even though some of these changes might seem small, it is clear to see that over time they add up significantly.

The installation on Winglets has also proven to be a major improvement on aircraft operating efficiency for American, and will be something they look to implement on more aircrafts moving forward. Last year they installed winglets on 240 planes and saw savings on 66 million gallons of fuel and avoided 700,000 tons of CO_2 emissions. CO_2 emission is something that all airlines have made a point to reduce and since 1978 all US airline operators have helped reduce 3.4 billion tons of CO_2 emissions into our atmosphere.

American is also looking to increase its savings in utilities on aircrafts, hangars and facilities with implementing the latest technology in order to reduce their overall operating expenses as well as having a strong focus on waste management and recycling onboard flights and on the ground at their facilities. With these initiatives put in place, the reduction operating expenses will allow for American Airlines to provide even better pricing to their customers because of the reduction in their overall business expenses they incur on a daily basis, thus enhancing their position in the market with the goal of an increased market share in the airline industry.

4. OBJECTIVES AND CONSTRAINTS

As a result of AAL declaring chapter 11 in order to restructure, American has come up with a new business model – named Flight Plan 2020 as a response to changing macroeconomic trends and industry standards. The main objectives of the company can be narrowed down to five: investing wisely, earning customer loyalty, strengthen and defend their global network, be a good work place, and fly profitably.

Investing wisely is instrumental in American Airlines being able to achieve the other four objectives. Everyday American depends on their employees, aircraft, facilities, and technological infrastructure. As a company they must continue to invest in these areas in order to succeed in the long term; for example, in an industry with very high fixed costs (fleet of airplanes) and American being one of the oldest airlines around, means they constantly need to be upgrading their fleet with newer and more efficient planes - in terms of space, flight experience and operating costs.

Additionally, American operates in an industry with very high price elasticity, and thus customer brand loyalty is tough to obtain. Therefore, American needs to deliver value for every customer and successfully differentiate the airline. For this American must continue to introduce innovative products and services to enhance the travel experience for customer and position American as the premier airline of high-value travelers.

Airlines face constant threats from every corner of the world therefore it is of upmost importance American strengthens and defends their global network. American’s network alignment around their cornerstone hubs of DFW, Chicago, Miami, New York, and Los Angeles strengthens their domestic foothold in a competitive industry. At the same time their relationship with the oneworld alliance strengthens their global network.

As a lesson learned from their dealings with the three main worker unions associations APA (Allied Pilot Association), APFA (Association of Professional Flight Attendants), and TWU (Transport Workers Union) American has realized they do not only need to reward their employees financially but also with optimal working conditions and growth opportunities within the company.

American Airlines being a public company has the constant pressure from investors to deliver value through their financial performance. This ties in the previous four objectives into the last one. The new business model is designed to improve travel experience, better the employment situation at work all the while by delivering strong financial performance in terms of profitable results. To ensure this, American needs to be constantly looking to cut costs, improve operating efficiency (through technology), and generate additional revenue for the company in order to sustain the business, grow and create job security. Additionally, as a corporation they need to assess the risk and opportunities of the global economy, which with currency fluctuations can significantly affect international travel. In short the Flight Plan 2020 provides clear direction for the alignment between the corporate responsibility efforts and the business objectives.

The main challenge of the industry is safety. In the telecom industry the phone call is not connected nothing happens, in the airline industry if the flight doesn’t make it to the destination people can die. As a result of the risk of planes not making the destination even governments get involved in the safety checks and set the regulations to ensure the safety of civilians. Therefore, American being a global airline faces the challenge of being affected by several different regulations and policies that involve every aspect of their business. New regulations, particularly in the carbon emission have forced every airline to virtually revamp whole fleets of aircraft in order to be compliant with European Union emission regulations for example. As a business American must therefore must involve themselves in the dialogue with regulators in order to ensure and preview new changes to regulations affecting the whole business, this way investment can have a better timing and technological advances can be used to comply with regulations at a lower cost.

Besides the challenge of operating every flight safely American must also deal with cost disadvantage compared to other international airlines (labor), the uncertainty of the economy and revenue picture, intense competition from peers and volatile fuel prices, thus in order to be as successful as American has been for the past 90 years, it needs to become a more flexible and efficient airline to better deliver value to their customers.

5. LABOR INCENTIVES

American has a board of directors of 12 members, all of whom are considered independent with the exception of the Chairman. To help fulfill its responsibilities the Board of Directors has four outstanding committees- Audit Committee, Corporate Governance Committee, Compensation Committee, and Diversity Committee all are formed by independent directors.

The compensation committee in particular establishes and implements executive compensation objectives and approves all executive compensation, while determining metrics for performance-based awards for executives.

The main objectives of the executive compensation program are to:

- Reward achievement of goals
- Provide compensation that enables management to attract, motivate, reward and retain talented leaders
- Align the compensation goals with the interest of stockholders through stock-based compensation
- Sustain a pay-for-performance approach in which variable compensation is a substantial portion of each leader's compensation

Last year the top five earners as reported to the Securities Exchange Commission (SEC):

- W. Douglas Parker, CEO – $11,418,547
- Derek J. Kerr, CFO – $5,220,943
- J. Scott Kirby, President – $8,301,783
- Robert D. Isom, COO – $6,168,618
- Stephen L. Johnson, Corporate Affairs – $5,091,032

As a result of the restructuring the company is still going through employee incentives had to also be restructured accordingly. To ensure employee performance is reward and aligned with American's new business model, a profit0sharing plan has been implemented in the form that up to 15% of pre-tax income will be distributed along the workforce.

American operates in a very unique industry that combines highly technical aspects of aviation and engineering with many social nuances of customer services and hospitality. In this business environment, employees benefit from broad, multidisciplinary training and career development options to prepare them for meaningful growth opportunities within the company.

In financial terms employees receive health, life, disability, and retirement benefits. These benefits are also extended to direct family members of employees. Being an airline, American offers deeply discounted travel fares to all employees and rewards strong performance with both financial and non-financial incentives.

General employee incentives are built around two main objectives; customer care and financial performance. Every month employees are eligible for Customer Experience Awards of up to $100, if company-wide customer service goals are reached. Similarly, each year employees may receive an annual performance bonus if American achieves an overall pre-tax earnings margin of at least 5 percent.

6. UNDERSTANDING THE MARKETS

Ever since the merger, American Airlines stock valuation has increased significantly as shown in graphic. below.   In fact, American Airline is one of the best performer airline in the industry with 87.72% increase in stock value versus a 27.74% increase in the market (S&P 500).   This was all possible due to American Airways airways acquisition of American Airlines back in 2013, where of course, American Airlines name was kept.   These two giant airlines merge to create the largest airline in the world in terms of total fleet and market share.

3-year stock performance vs. S&P 500

Now, if we look a little closer at American Airlines performance for this year in graphic below, it is clear that the stock in underperforming. There are a couple of factors that could be attributed to the underperformance of this company, which are: 1) a slow Latin-American economy; 2) a strong US dollar; and 3) capacity exceeding current demand.

YTD stock performance vs. S&P 500

Now, to expand on this issues:

1) Slow Latin-American economy: many US based airlines, including American Airlines, anticipated that the Latin-America revenue was going to continue to

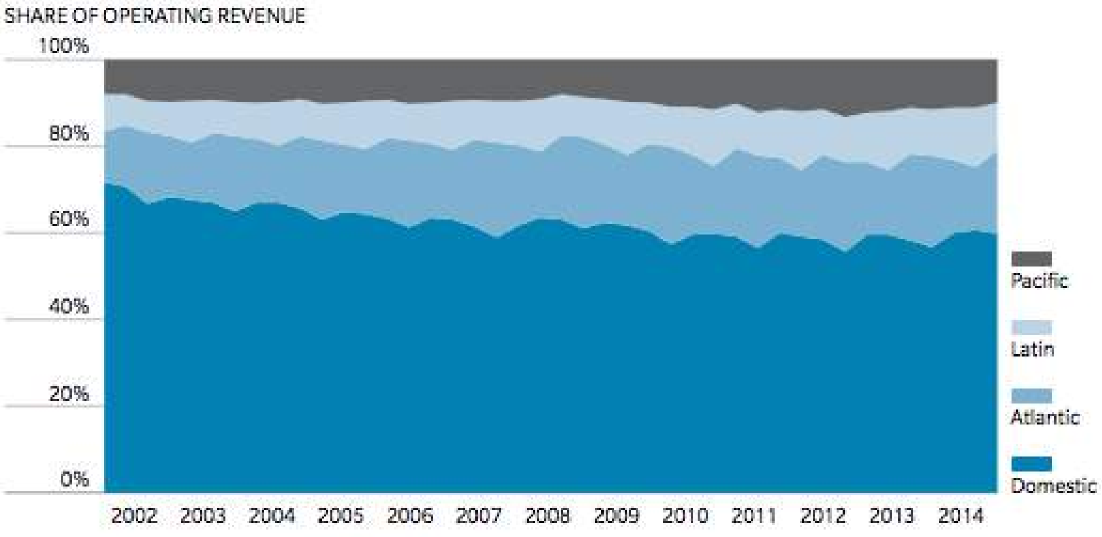
grow as it was growing back in 2013 and 2014 with greatest increase in Central America (Mexico) and the Caribbean. However, lately the Latin-American economy has been very slow and the revenues for US airlines from Latin-American flights has been decreasing. As shown below, Latin-America represents approximately 11% of US network share of operating revenue. Therefore, some analysts suggest that a portion of the underperformance of this stock can be attributed to the downturn on this economy.

Exhibit 41a: US Network Carrier Share of Operating Revenue by Geographic Area, YE Q2 2009/2013/2014

YE Q2	DOMESTIC	ATLANTIC	LATIN	PACIFIC
YE Q2 2009	61.6%	19.1%	10.2%	9.2%
YE Q2 2013	58.2%	18.2%	11.5%	12.1%
YE Q2 2014	59.3%	18.0%	11.7%	10.9%

Source: PlaneStats.com > Form 41 Financials > P1.2 Income Statement for all reporting carriers (excluding transport revenue)

Exhibit 41: US Network Carrier Share of Operating Revenue by Geographic Area, Q1 2002–Q2 2014

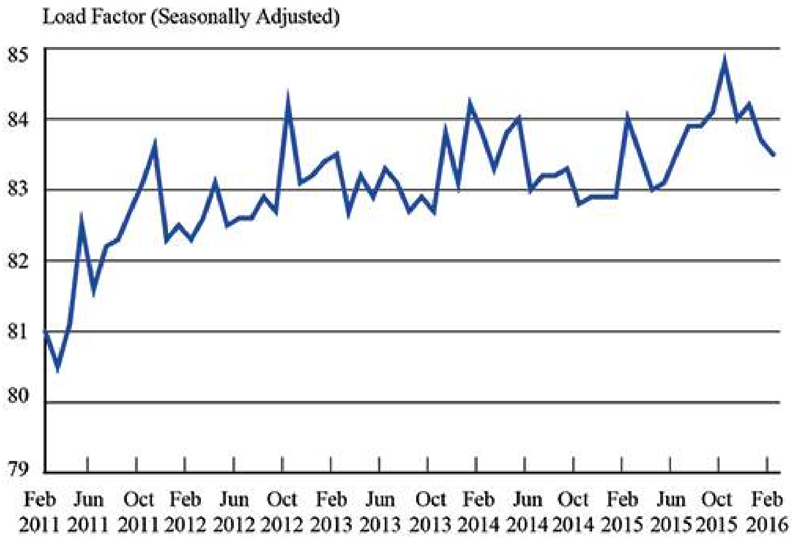


Source: PlaneStats.com > Form 41 Financials > P1.2 Income Statement for all reporting carriers (excluding transport revenue)

2) Strong US dollar vs. foreign currencies: revenues generated in foreign cunrrency

by American Airlines are worth less at home.

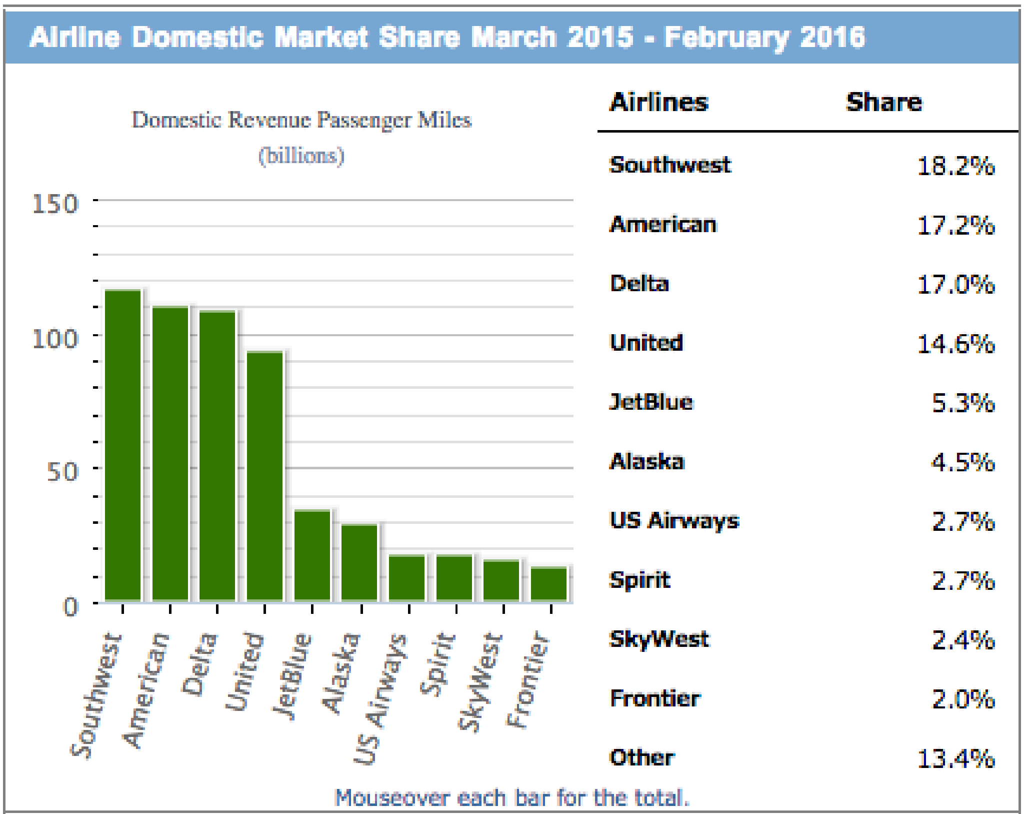
3) Capacity exceeding current demand: when capacity growth exceeds demand growth, the result can be a fall in capacity utilization. As mentioned in an article from the Market Realist - ***U****S Airlines Capacity Growth Outpaces Demand, Load Factor Drops, 2015;* the capacity utilization in airlines is measured with the passenger load factor which is calculated dividing the traffic by the capcity of the airline. It is also an key factor to measure efficincy of an airline. Several US airlines saw a steep decline in the Load Factor in 2016, as shown in graphic below, which was considered to many analyst as a sign of overcapacity on many US airlines, including American Airlines.



Load Factor for US airlines (Seasonally Adjusted) – data from the United States Department of Transportation

7. COMPETITORS

The main competitors of American Airlines are Delta Airlines (DAL), Southwest Airlines (LUV), and United Continental Holdings (UAL). Together, these four giants control the US market share with over 65%, as shown in graphic below. Since the merger, American Airlines has been fighting these airlines to reach number one in domestic market share which is currently held by Southwest Airlines with an 18.2%.



Market share based on Revenue Passenger Miles March 2015 - February 2016.

Now, looking a little more in depth into these four giant airlines, we can see their stock performance for the year in the graphic below. American Airlines is down 21.75%, followed by UAL and DAL which are also underperforming. However, American's biggest competitor, LUV, is actually up 1.32%for the year.

Southwest has been able to stay in the positive numbers as it has shown lately good numbers to investors. As mentioned in the article *Can Southwest Airlines Continue Its Strong Operational Performance in 2016?, 2016* from the Market Realist, in the fourth quarter of 2015, Southwest Airlines saw a handsome 11.1% YoY (year-over-year) growth in traffic, and gained 8.9% in revenue. The airline showed a strong 2015 year, both operationally and financially. They have also been very stringent about capacity growth, ensuring that is always in line with demand. In 4Q15 capacity grew by 8.3% Yoy, yet for fiscal 2015, capacity growth stood at 7.2% YoY. This approach resulted in a better utilization of its existing capacity. In fact, Southwest's load factor improved by over two points from 82% in 4Q14 to a record of 84.1% in 4Q15.

Nonetheless, the entire US Airline industry has been struggling this year which can be seen in the graphic below as the stock value for these four airline giants slides down.

YTD stock performance – AAL, LUV, DAL, and UAL

8. MARGINAL ANALYSIS

OPTIMAL SIZE OF LABOR FORCE / OUTSOURCING

At this time, American Airlines has the highest number of employees in the industry. Yet, surprisingly enough, their "Revenue Per Employee" is the lowest one in the industry at $0.34 as of 03/31/2016, while their "Net Income Per Employee" is one of the highest with at $62,261.60, as shown in graphic below.

After further research to complete this company audit, we discovered that American Airlines' takes care of maintenance operations in-house; it does not have to send out work to be accomplished. While other airlines in the industry outsource most of their maintenance work, American Airlines works hard to keep those jobs in house. As mentioned in American Airlines' site, *"this puts them in an industry-leading position, doing 80 to 90 percent of all of its maintenance work and **100 percent of its heavy maintence.** By comparison, in 2008 the Department of Transportation **reported nine U.S. airlines outsourced more than 70 percent of their major aircraft maintenance** in 2007."*

This is one of the reasons behind American's high "Net Income Per Employee" despite of its low "Revenue Per Employee" which at first glance, may appear to be a negative indicator.

American Airlines is at a point where additional labor force would be beneficial only if its market share increases; internationally or domestically. Even though American has the largest number of employees in the industry, it is operating efficiently as it handles various business lines within the company (vertical integration), which in turn increases its profit margin.

Trade Selected Chart Selected Add Selected to Watch List	Show Competitors AAL	Change | Delete DAL	Change | Delete LUV	Change | Delete UAL
	Trade Add to Watch List	Trade Add to Watch List	Trade Add to Watch List	Trade Add to Watch List
Name	**AMERICAN AIRLINES GROUP INC**	**DELTA AIR LINES INC**	**SOUTHWEST AIRLINES CO.**	**UNITED CONTINENTAL HOLDINGS INC**
Last Trade	**$31.80** 4:00 pm 06/13/2016	**$40.57** 4:00 pm 06/13/2016	**$42.16** 4:00 pm 06/13/2016	**$44.06** 4:00 pm 06/13/2016
Change	-1.34 (-4.04%) 4:00 pm 06/13/2016	-1.47 (-3.50%) 4:00 pm 06/13/2016	-1.47 (-3.37%) 4:00 pm 06/13/2016	-2.02 (-4.38%) 4:00 pm 06/13/2016
Price (52 Weeks)	46.50 31.80 30.81	52.26 40.57 40.00	49.58 42.16 32.36	61.56 44.06 43.78
Market Capitalization	$19.4B	$32.4B	$27.9B	$15.6B
Employees (Full Time)	118,500	82,949	49,583	84,000
Net Income Per Employee	$62,261.60 03/31/2016	$56,974.77 03/31/2016	$45,156.61 03/31/2016	$85,059.52 03/31/2016
Revenue Per Employee	$0.34 03/31/2016	$0.49 03/31/2016	$0.40 03/31/2016	$0.45 03/31/2016
Total Revenue (TTM)	$9.4B	$9.3B	$4.7B	$8.2B

PRICING POLICIES

Through this audit, we have learned that American Airlines uses price discrimination by consumer type as a profit-maximizing strategy. For flight tickets, this company charges higher prices the closer to the date of the flight. Even if there are seats available in the flight, the ticket price will continue to raise the closer it gets to the day of departure. One reason for this price discrimination strategy is that business travelers are less elastic (if not inelastic) than leisure travelers. A business traveler will most likely pay a higher markup price than a leisure traveler. American Airlines, along with other airlines in the industry take advantage of this fact and increase markups closer to the date of the flight, and therefore, increase profits as well.

American Airlines can be looked at as a Dominant Firm Oligopoly. American, along with three other giants, have over 65% of the domestic market share and therefore, they are price setters with very little competition from other small fishes (smaller airlines) in the market. These large firms operate as a monopoly, setting their price and output to maximize their profits. On the other hand, the smaller airlines may be acting as perfect competitors, just taking the price set by the four giant airlines.

Despite of the fact that American Airlines has a market share large enough to set price in the Airline Industry, they cannot charge arbitrarily high prices as this would allow new competitors to enter the market; in which case American may start losing market share to these new entrants.

MARKET PRESENCE

American's international market presence has increased significantly through the **one**world program. As previously mentioned in section 3 – BUSINESS MODEL, American Airlines, through this program, offers flights to over 1,000 destinations and over 150 countries with a fleet of over 3,500 airplanes. This program has allowed American to increase their international presence since the year 1999 when was originated. However, in order to increase global market share, American shall enter in negotiations with other countries to strategically open an international hub. This will increase their international presence, as well as their international flight traffic.

Now, regarding domestic market presence, American airlines is positioned as number two, with a 17.2% market share as per the United States Department of Transportation. American shall continue to compete against Southwest Airlines for the highest domestic market share.

Back in 2013 the Department of Justice (DOJ) sued American, challenging the merger with US Airways. This was done by the DOJ as a mechanism to maintain competition across the airline industry and keep fair airfares for passengers. At that time, American was headed to be the airline with the largest domestic market share. As a result of this lawsuit, American's flight traffic decreased significantly, specially in Washington DC. American Airlines shall slowly recover that flight traffic and boost revenues by increasing domestic market share.

ONLINE SALES VS. STORE SALES

For the past 10 years American Airlines has managed to move out of physical stores for flight ticket sales. To date, all ticket sales are completed online through their website (www.aa.com) or other non-American Airlines' websites such as Expedia, Kayak, Orbitz, etc., which make their profits out of a small fee. Additionally, American Airlines has increased their sales by using social media sites for advertisements, such as Twitter, Facebook and Instagram. This online sales only activity has decreased the overhead cost of American Airlines as this process is automated.

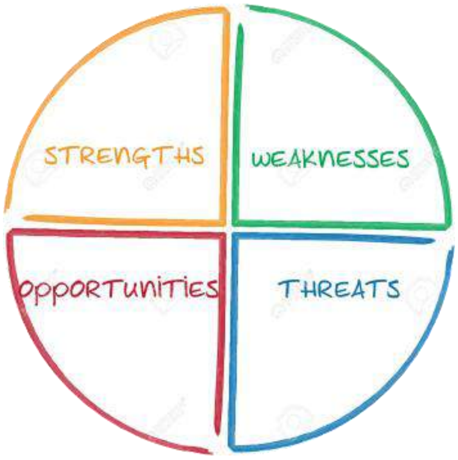
9. SWOT ANALYSIS

Strengths

1. Largest fleet (1,494 airplanes) in the world
2. Strong Hubs in conerstone markets – Dallas, Chicago, LA, NY (JFK), and Miami
3. Frequent-flier (AAdvantage) recognized as the best customer loyalty program
4. Wide reach – flights to over 150 countries and over 1,000 destinations

Opportunities

1. Newer planes with new price structures – better customer experience
2. On pace to be the most energy efficient airline in world (engine replacement program)
3. Partnerships with other airlines strengthens international network – **one**world



Weaknesses

1. Financial Position this year may push investors out
2. Losing market share to other big competitors – Southwest and Delta
3. Inability to compete in international flights
4. High leverage risk from fleet improvements

Threats

1. Volatility of the oil market
2. The innovation and growth of travel substitutes and video conferencing
3. Substantial cost disadvantage to competitors
4. Accelerating impact of global economic uncertainty – revenue instability
5. Frequent-flier stealing programs

SUGGESTIONS FOR EXPANDING AND IMPROVING PERFORMANCE

The current state of the airline industry appears to be promising with signs of growth, yet, with strong competition, profitability continues to be a challenge for American Airlines. The company's executives expressed that American Airline was the slowest growing airline in the U.S. in 2015, despite being the world's largest airline. This challenge is attributed to multiple factors, such as a slowing Latin America economy, a strong U.S. dollar versus foreign currencies and capacity exceeding current demand. Addressing these challenges will require an effective profitability strategies and efficient execution over time.

Collectively, American Airlines challenges are causing a decline in unit revenue, the amount earned for each passenger flown a mile. A decline in unit revenue is a key contributor in the company's low profitability.

To combat this challenge, American Airlines should plan to focus on implementing a few strategies targeted at different levels of its customer base, particularly a new pricing policy.

Some of the strategies that American Airlines are currently planning to implement are as follows:

- An initiative is to introduce a long-haul premium economy section among U.S. airlines in late 2016. The goal with the premium economy plan is to offer a middle-ground for customers who are looking for a comfortable option in terms of seat and price between economy and business class.
- A plan to move from a miles-based to a spending-based loyalty program to reduce the

amount of award tickets for customers who buy the lowest fares.

- A basic economy fare for the more price sensitive customers, a strategy that was proven effective for Delta Air Lines.

Based on the success that rivals of American Airlines have seen with similar strategies and pricing policies, American Airlines are optimistic that the implementation of such strategies and policies will prove to be effective for the company.

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