

spirit

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How far has ancillary revenue come for airlines and what is the future?

- Over a decade ago, most airlines had a few key profit centers beyond ticket revenues
 - Frequent flyer mile sales
 - Change fees
 - Excess baggage
 - Cargo
- Airlines developed elaborate, complex means of extracting optimal revenue, but principally these strategies were all designed around ticket revenues
 - Revenue Management
 - Travel Agency and corporate travel incentives
 - CRM solutions
 - And on and on and on, but these strategies almost always centered around maximizing passenger revenue

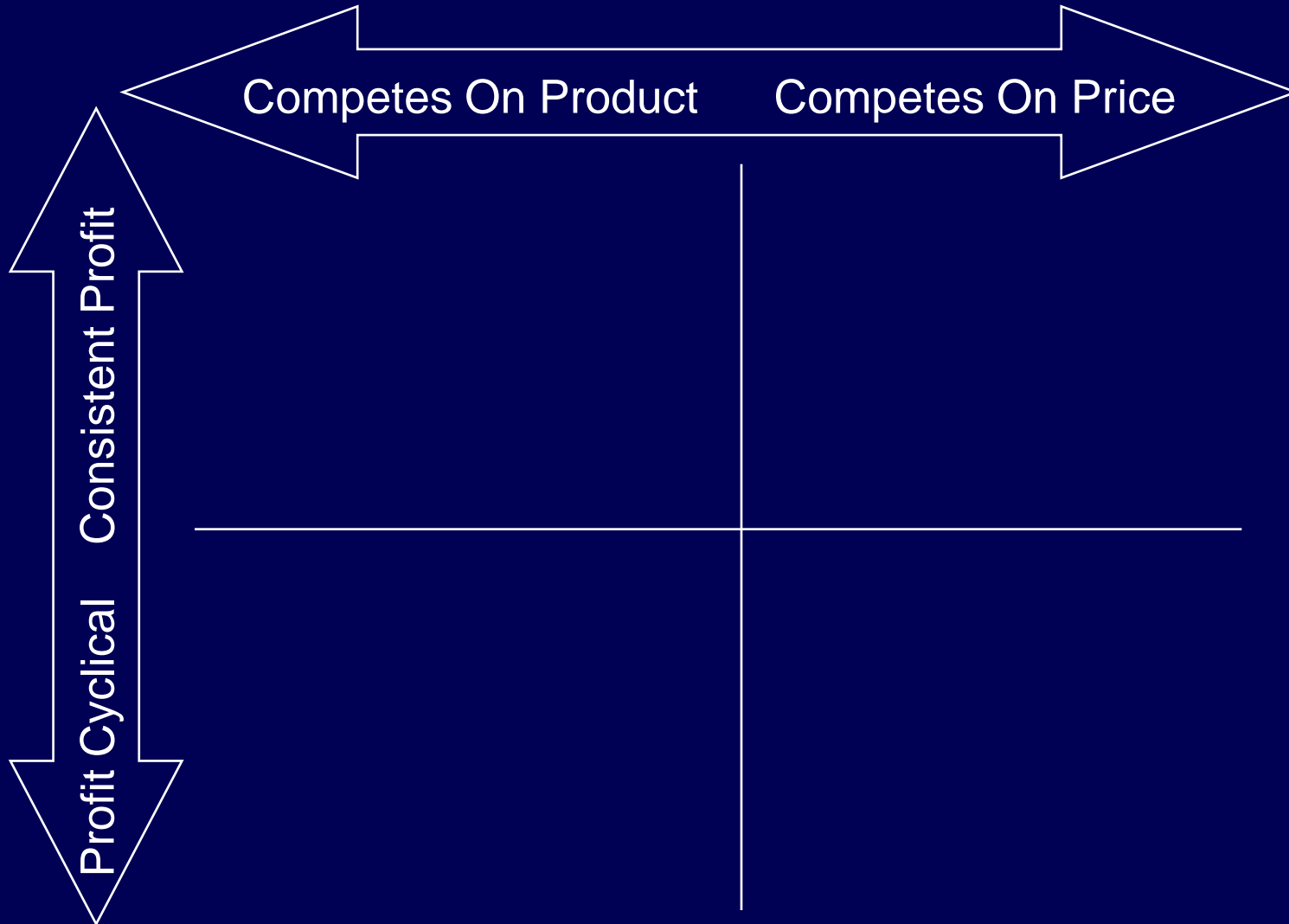
Up until a few years ago Spirit was no different than the average airline (we lost money too)

- Prior to 2006 we focused on classic revenue strategies and didn't have the necessary cost focus
- Our costs were not that great
- Our revenues were not that great
- To be honest, we were not that successful

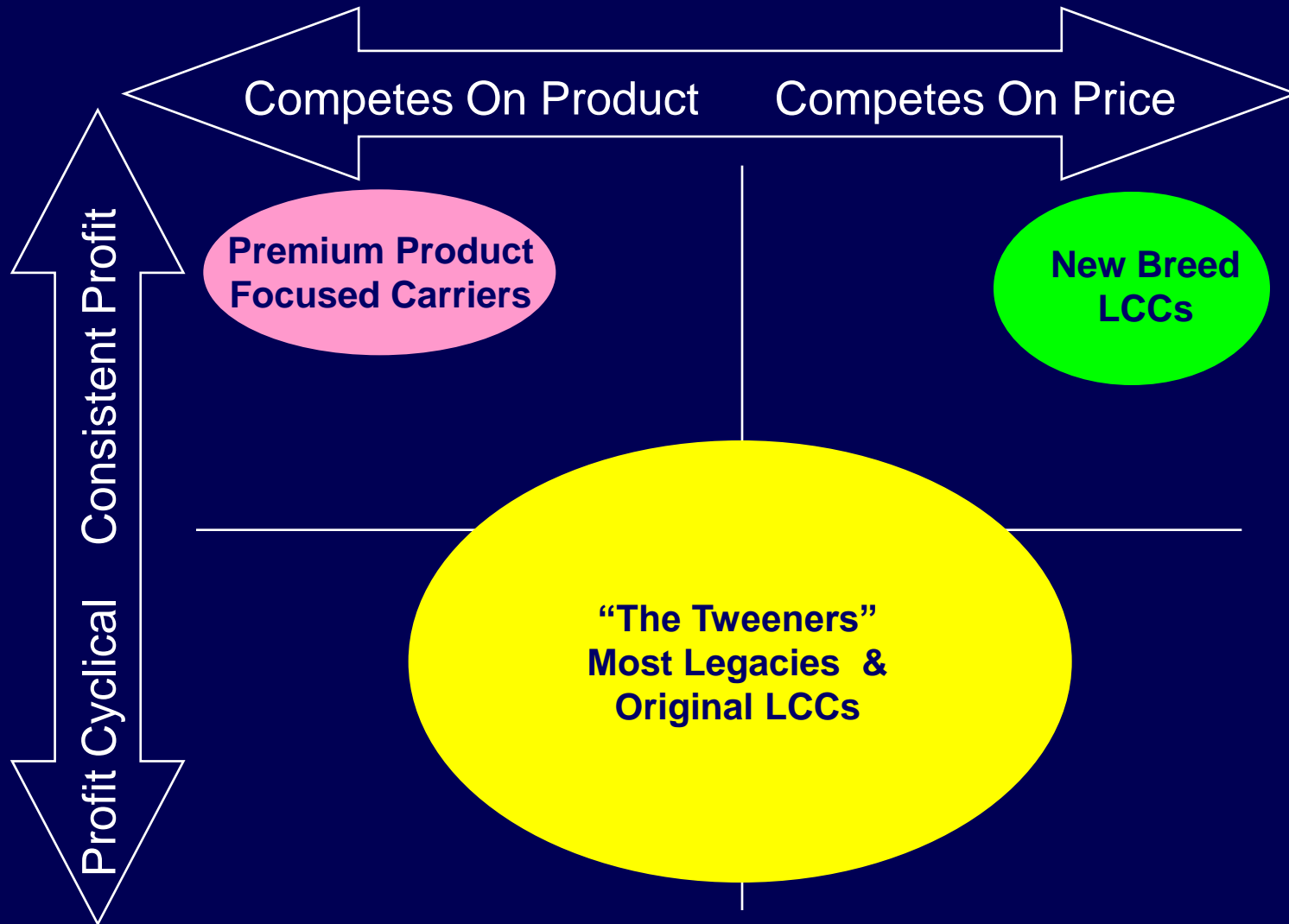
Building The Strategy

- Spirit's Strategy Was Developed Based On A Detailed Study Of Airlines Around The World
- Critical Attention Paid To Studying Each Airline's Long Term Financial Success Compared Against:
 - Product Features Ranging From Bare Bones To Premium
 - Product Consistency Across Portfolio
 - Revenue Premiums Associated With Corresponding Product Costs
 - Fundamental Cost Structures And Profits With & Without Fuel Hedging

Over The Past Ten Years, We Found That All Carriers Easily Fit On This Grid



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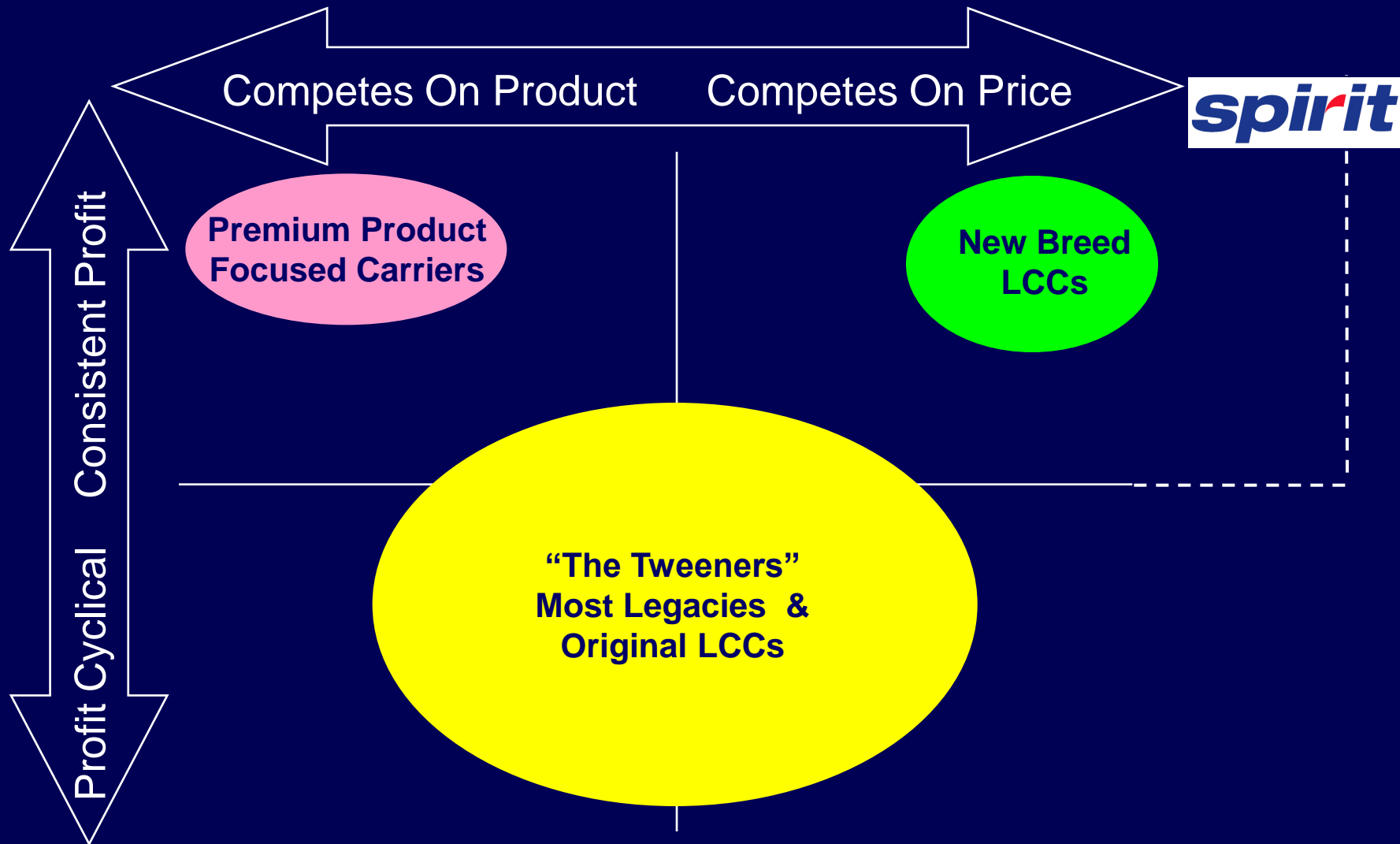


The “Tweener” Problem

- Long Term Financially Successful Airlines Have Clearly Defined Positions As Either Carriers That Compete On Product Or Carriers That Compete On Price
- **Successful Product Centric Carriers** Know Their Customer And Deliver A High Expectation, High Priced Product That More Than Covers Associated Product Expenses
- **Successful Price Centric Carriers** Know Their Customer And Deliver A Low Price And Choose To Ignore The “High Touch” Customer And Thus Don’t Incur Extra Product Expenses, Allowing Them To Keep Costs Low
- **“Tweeners”** Generally Fall Short Of Investing Enough In Their Product To Obtain The Revenue Premium Necessary To Cover The Associated Product Costs And/Or Choose To Attempt To Aggressively Compete With Low Fare Competition With Cost Structures That Cannot Successfully Compete With Low Costs

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Spirit Is Resetting The Boundary For Competing On Price

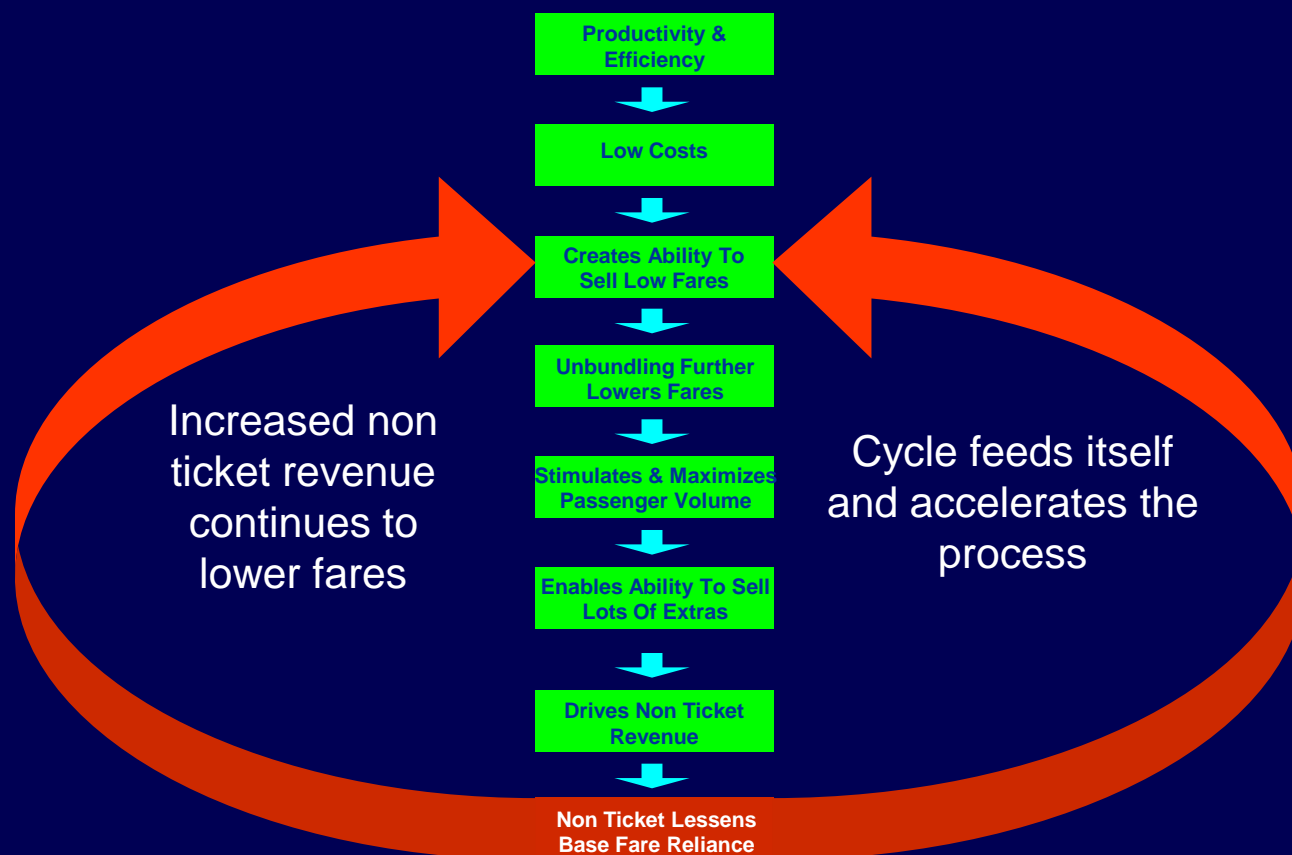


We are dedicated to winning on price

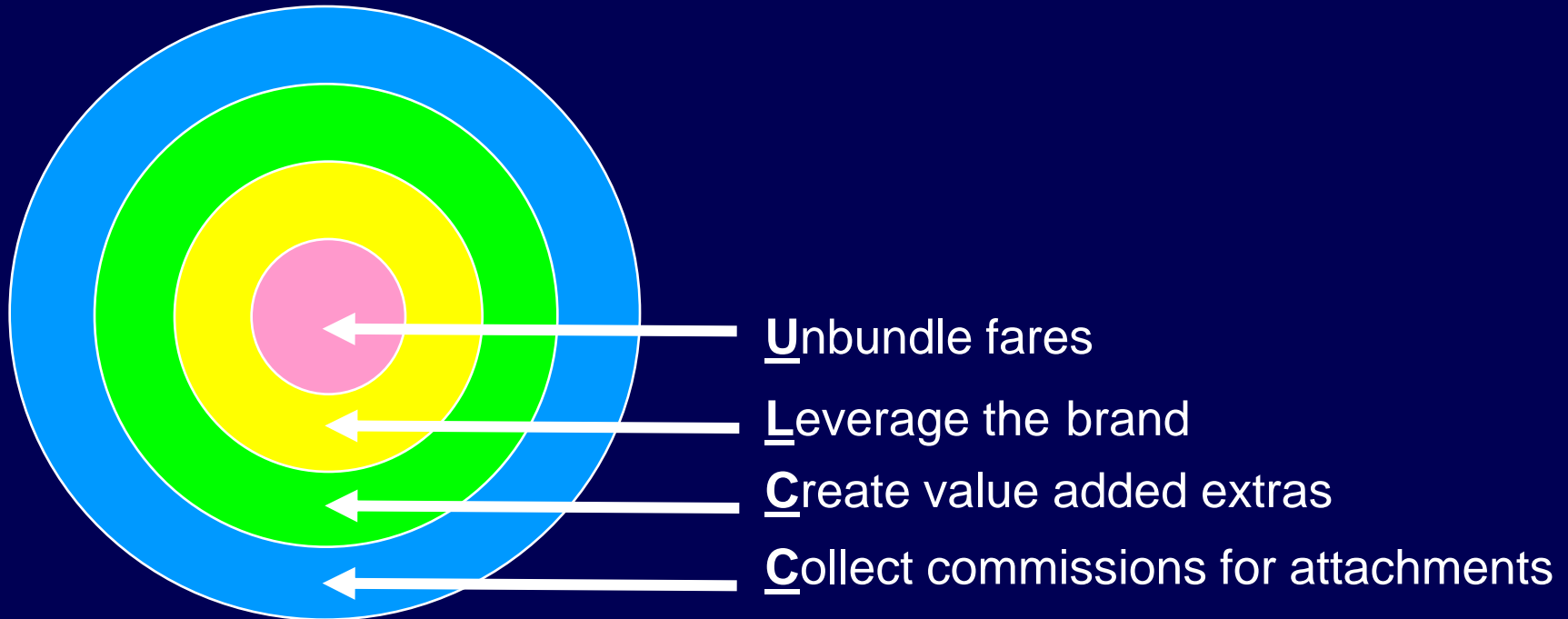
- **It's Easy To Be A Low Fare Carrier, It's Hard To Be A Low Cost Carrier**
- **Competing On Price Is Easy To Do When You Have The Lowest Costs**
 - **Our BRUTAL Cost Controls Are Producing A Sustainable Cost Structure Lower Than ANY Of Our Competitors, Ensuring We Are Never Looking Over Our Back**
- **Spirit Doesn't Have To Worry About Average Fares, That's For Product Centric Companies To Do**
- **Spirit Ignores Product Centric Customers Because They Impede Our Ability To Keep Our Costs Low**

Our strategy to compete on price creates a winning cycle

- Spirit's non-ticket strategy "cycle" lowers fares which stimulates passenger demand while creating more opportunities to sell value added products
- The cycle feeds itself and accelerates the process



Four Key Strategies Drive Spirit's Non-Ticket Revenue Model



Unbundle Fares



- Unbundling fares removes elements of the airline fare product which historically were included in the base fare
 - Examples: baggage, snacks, non-alcoholic beverages, seat assignments
- Primary benefits
 - Unbundled fares drive the base fare lower, helping stimulating demand
 - We have found an elasticity trigger for fares >\$99 one-way on many short to medium haul routes and unbundling allows us to keep our fares low, keeping demand strong
 - Generally, these are among the easiest products to implement
 - Once the primary purchase decision is made (ticket purchase), there is less pricing elasticity for secondary add-ons. Cruise lines, amusement parks, hotels, auto manufacturers and more have capitalized on this for decades.
- Dependencies: passenger volume, technology, training & incentives
- Incrementality: assume erosion of ticket yields

Leveraging The Spirit Brand



- Spirit's brand positioning, reach & relevance enables the ability to drive revenues not directly associated with travel itineraries
 - Examples: FREE Spirit MasterCard, \$9 Fare Club, ambient media, web advertising
- Primary benefits
 - These revenue streams are not tied as directly to passenger volumes and thus provide a stable revenue flow, helping to mitigate seasonal cash fluctuations
 - Drives customer retention, lowering distribution costs while driving revenues
- Dependencies: overall brand position, route network, web traffic, email subscribers, dedicated staff to manage operations
- Incrementality: brand products are considered 100% incremental revenue as they are never considered part of a competitive bundled fare

Create Value Added Extras



- Extras are products provided by Spirit that were historically never considered part of the base fare
- Examples: “jump the line”, big front seat, change fees, liquor & people magazine
- Primary benefits
 - Improves customer experience through value adds while creating profit centers
- Dependencies: passenger volumes, technology, product optimization (onboard), front line management, training & incentives
- Incrementality: considered 100% incremental revenue as the products from this category would not be considered part of a competitive bundled fare

Commissions For Travel Attachments



- By gaining a greater share of a customer's total travel spend, we gain commissions by distributing 3rd party products & services
 - Examples: hotels, cars, cruises, travel insurance, airport parking, tours
- Primary benefits
 - Easily understood and valued by customers
 - Increases spiritair.com customer relevance and provides one-stop shopping
 - Enhances ability to penetrate heavy leisure destinations where nets or bulk hotel rates are still the norm
 - Considerable growth potential with the best industry performers gaining >70% attachment rate of some products
- Dependencies: critical mass, technology, 3rd party contract negotiations, technology, website optimization, technology and most importantly technology
- Incrementality: travel attachments are considered 100%

Biggest Mistakes To Date



- Not dedicating resources, if you want 30% non-ticket revenue, then dedicate 30% of your commercial staff to non-ticket
- Not recognizing early enough that the best online retailers are not powered by airline reservations platforms
- Outsourcing to 3rd parties to do critical functions such as selling
- Wasting time with various legacy business models wanting to get into the new non-ticket game, if it doesn't work, don't waste time
- Availability bias: assuming customers think like us or value the same things we do
- Emulating other airlines that “supposedly” were successful
- Not rolling it out fast enough
 - Our non-ticket model is a recipe that tastes better when consumed together, certain negative customer reactions happen, so get it all out at once and get as much benefit as possible when you take the pain
- Not educating and training our customers/employees enough

Greatest Successes To Date



- Staffing dedicated strategy & operations people to non-ticket businesses while developing an airline culture that understands the non-ticket revenue strategy and delivers new ideas constantly
 - Hiring employees with diverse, retail, consumer marketing backgrounds
- Adopting the best practices of amazon.com and bestbuy.com rather than another airline websites
 - Our industry is not the global leader for online marketing
- Looking to Chili's and TGI Fridays for ways to improve liquor sales rather than Gate Gourmet or LSG
 - We run a bar with 7M+ annual customers; don't ask a catering company how to sell 28¢ products for \$5, work with successful liquor sellers
- Learning from Costco & Sam's Club

Greatest Successes To Date



- Building IT systems outside airline reservations systems
- Copying legacy products & services given for free and charging for them
 - Example: Big Front Seat
- Bottom line: we achieved the greatest traction when we began running each of these programs as independent businesses

Greatest Successes To Date



- There are more ideas and opportunities than can ever be exploited, so the trick for us has been gaining enough skill and judgment to gauge success probabilities in order to prioritize all the opportunities
- Our formula used for ranking opportunities:

$$\frac{\left(\text{Annual Potential Customers} \times \text{Transaction Probability} \times \text{Value Per Transaction} \right) - \text{Implementation Costs}}{\text{Ongoing Resources \& Costs}} = \text{ROI}$$

Ongoing Resources & Costs

- Just like advertising and where you should fly, everyone has an idea for what you should be doing for non-ticket revenue. But only you and your team can determine what will work for your airline in your markets and only you can develop the skill to pick the best winners as well as ensure they succeed by running them as businesses.

“Spirit’s Sweet 16”

- Vikram Raman will talk a little later about our view of the customer cycle and when as well as where we focus our selling efforts
- Sorry, this is a two part feature. Stay tuned...

We have talked about the past leading up to the present, and you are probably wondering, has it worked?

We started from humble beginnings with our non-ticket per passenger

- 2005 \$ 3
- 2006 \$10
- 2007 \$16
- 2008 \$25
- 2009E \$30+

By year end we will have grown our non-ticket revenue per passenger by 1000%

*All numbers are year end run rate per one-way passenger

Are we done? Is \$30 enough? Of course not.

- We are dedicated to competing on price so we will not stop until \$9 becomes our most popular fare for travel
- Using the four parts of the Spirit strategy (Unbundling, Attachments, Value Added Extras & Brand) we believe the potential for non-ticket revenues in the future is near infinite
- We won't get there this year or even next year, but we are working towards what we believe is an achievable goal.
- For proprietary reasons, we cannot share the details, but the future is not measured by \$ per passenger, but as a % of revenue.
 - We believe it is theoretically possible for some airline models to achieve over 80% of revenue from non-ticket sources.

Thoughts about the future (just our opinion)

- Some carriers will produce the majority of their revenue from non-ticket sources
 - These will likely only be new breed ULCCs like Spirit
- “Tweeners” will continue to be a shrinking portion of the industry but these carriers will still produce a modest portion of their revenue from non-ticket sources
- Product focused carriers focused on premium customers will likely back away from some recently initiated non-ticket strategies
 - If you have above average fares, the customer feels nickel and dimed from non-ticket tactics and therefore these two strategies do not mix well

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