Improving the Competitiveness of Michigan for Air Service

DELTA

Economic Importance of Airlines

Air transport has become an essential economic and social conduit throughout the world. Beyond the benefits of fast and inexpensive transcontinental travel, air transport also has become a vital form of shipping for high value goods that need to come to market quickly… Their main infrastructure needs are at the beginning and end of their destinations, and can be built to create large economies of scale.

-World Bank (www.worldbank.org/airtransport)

"Aviation is the glue that keeps the global economy together."

-Dr. Mark Zandi, Chief Economist & Co-Founder, Moody's Economy.com (Aug. 2008)

"Every day, the airline industry propels the economic takeoff of our nation. It is the great enabler, knitting together all corners of the country, facilitating the movement of people and goods that is the backbone of economic growth. It also firmly embeds us in that awesome process of globalization that is defining the 21st century."

-Daniel Yergin, Author, *Commanding Heights: The Battle for the World Economy*

Background on Delta in Michigan

- Delta and Northwest Airlines merged in October 2008
- The combined company has operated in Michigan since 1958 and has operated a hub in Detroit since 1987
- DTW is Delta's 2nd largest hub behind ATL
- Delta operates at 12 of the 17 commercial airports in Michigan
- Delta is the largest carrier at Detroit Metropolitan Wayne County Airport, offering customers more than 458 peak-day departures to about 133 nonstop destinations. With nonstop service to Shanghai and Beijing, China; Seoul-Incheon, South Korea; Tokyo and Nagoya, Japan; Detroit has emerged as a major gateway to Asia for Delta
- Delta has more than 7,500 employees in Michigan, employs another 2,500 through subsidiaries and connection carriers, and helps support over 18,000 jobs at Detroit Metro Airport
- DTW is currently the #3 gateway to Asia in the United States, after ORD and SFO. Well positioned to grow to #1 if the right economic climate can be achieved

State of the Airline Industry

"Indeed, if a farsighted capitalist had been present at Kitty Hawk, he would have done his successors a huge favor by shooting Orville down." – Warren Buffett

Since deregulation (1979) the US Airline industry has posted net **losses of over $60 Billion**, with the majority of those losses coming in the last fifteen years

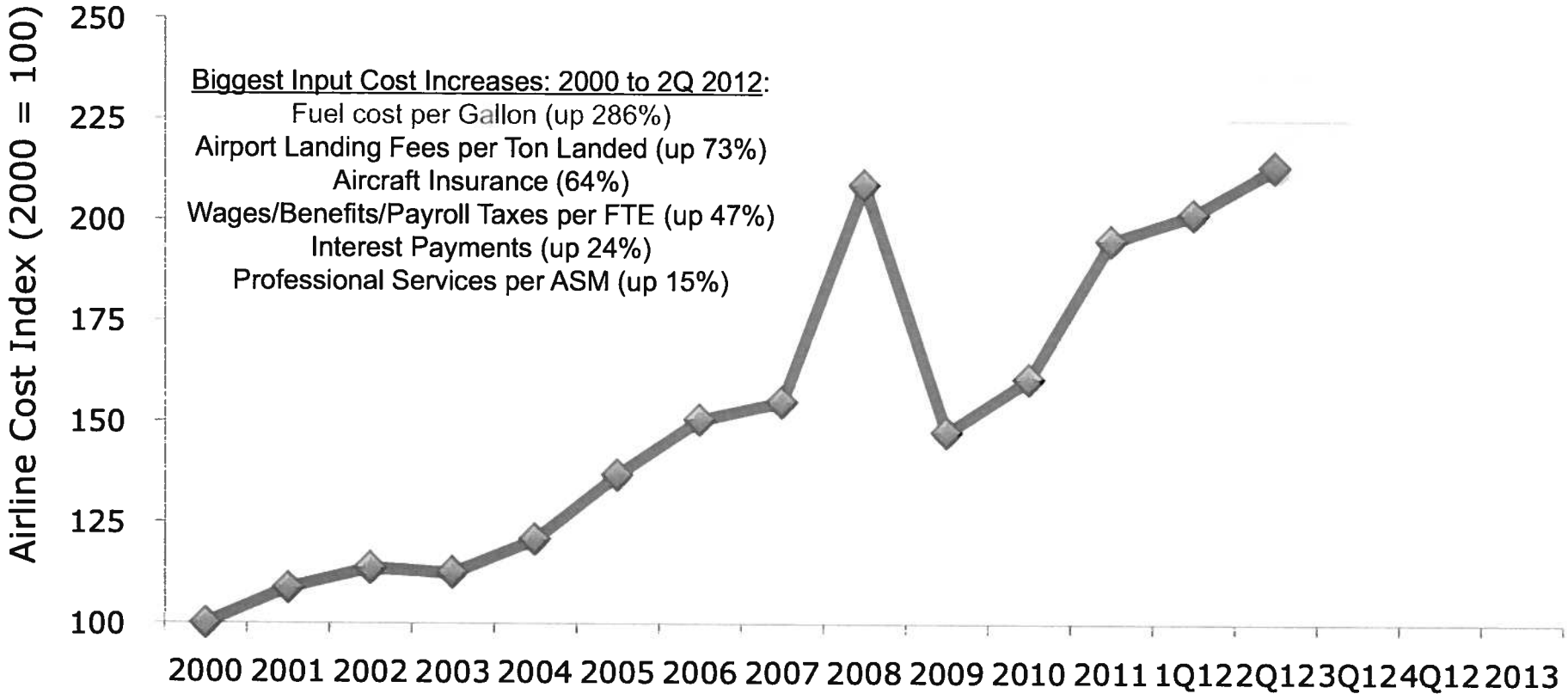
All US Airlines still considered "Speculative" investment grade (<BBB-)

The airlines remain one of the most heavily taxed industries in the US, exceeding even alcohol and tobacco in terms of percentages

The average tax on a $300 ticket is about 20%, or $61

From 2000 to 2Q 2012, Costs Faced by U.S. Passenger Airlines Rose 113 Percent

Carriers Forced to Respond to Surging Cost of Inputs to Production

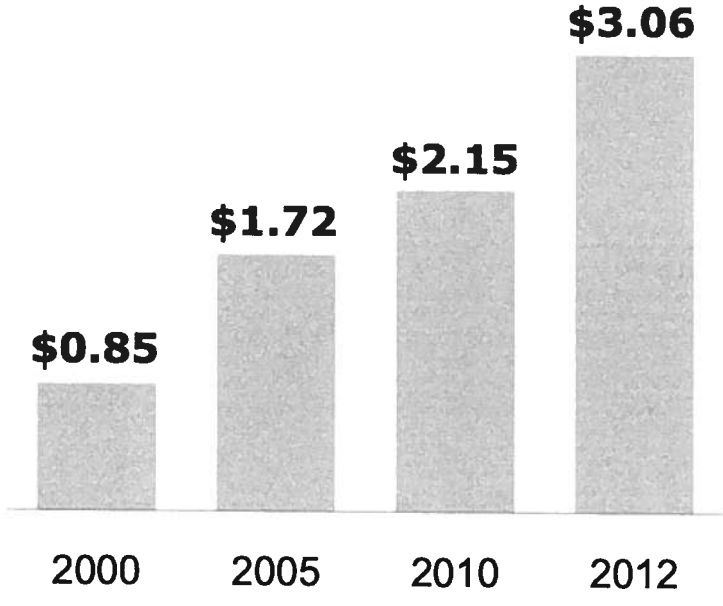


Source: A4A analysis of data from the Bureau of Transportation Statistics

U.S. Airlines Incurred More Than $50 Billion in Fuel Costs in 2012

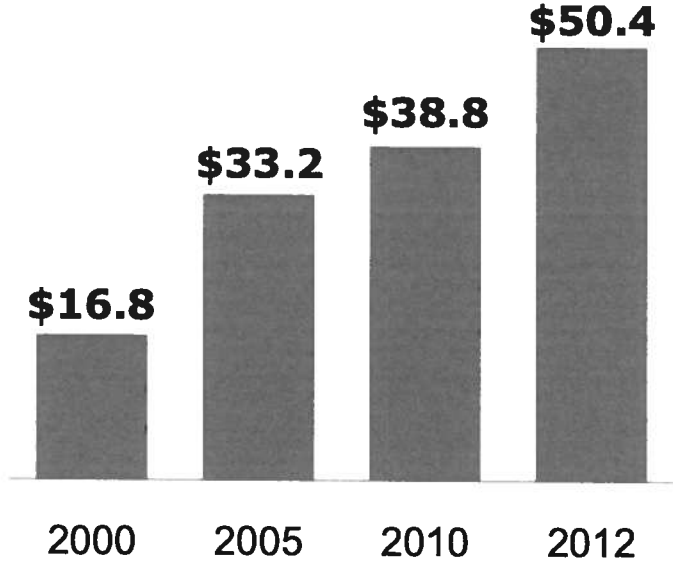
Average Spot Price of Jet Fuel Has Risen 260 Percent Since 2000 and 42 Percent Since 2010

Due to Rising Prices . . .
Dollars per Gallon (U.S. Gulf Coast)



Source: Energy Information Administration

. . . Incurring Higher Costs
Billion U.S. Dollars per Year

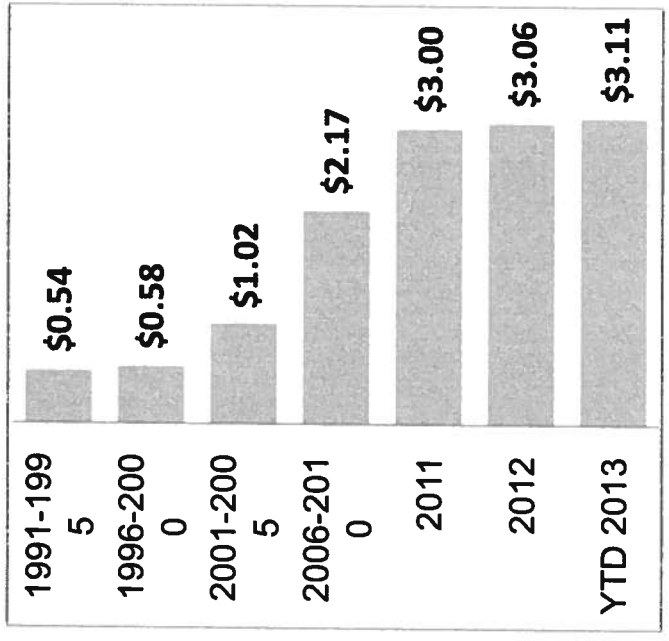


Source: BTS for U.S. airlines

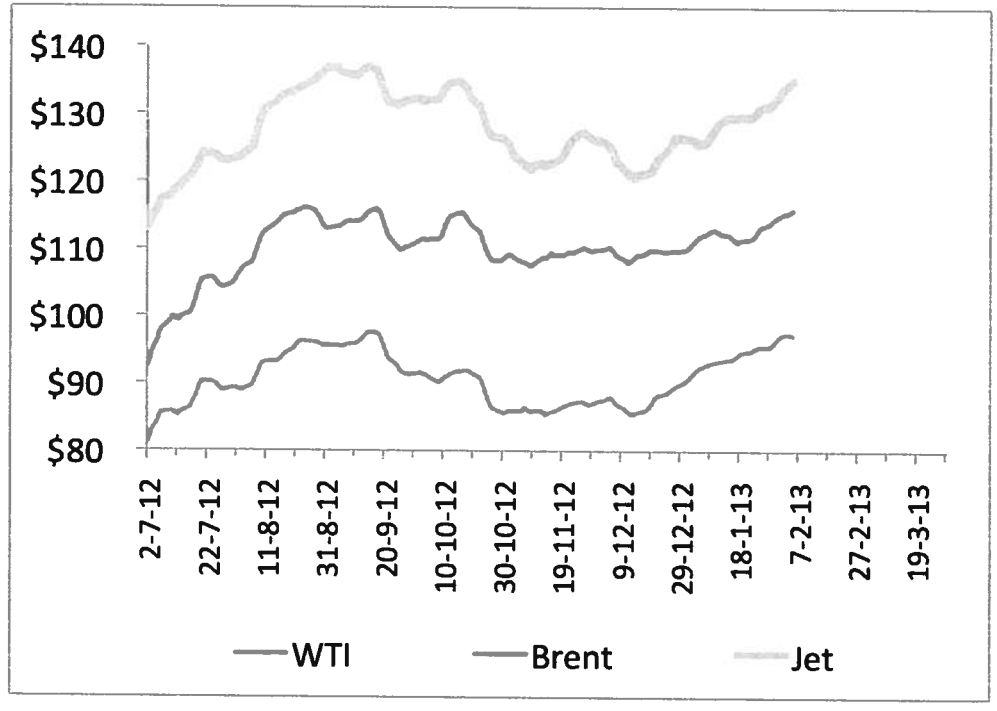
Average Annual Price of Jet Fuel Reached All-Time High in 2012

Continues to Rise into 2013

Price per Gallon (Gulf Coast Jet Fuel)



Price per Barrel (Five-Day Moving Average)



Source: A4A and EIA (for WTI and Brent crude oil and U.S. Gulf Coast jet fuel)

Impact of Fuel on Delta Air Lines

- Jet fuel is Delta's single largest operating expense (about 35% of operating costs, or $12B)
- From 2011 to 2012, despite aggressive management in the industry, Delta's fuel bill grew from $11.5 Billion to $12 Billion
- Every $1 increase in the cost of a barrel of oil equates to a roughly $100M increase in the annual cost of fuel
- In recent years, price volatility for fuel has increased dramatically, making planning for fuel cost increasingly difficult
- Delta's fuel management strategy is all encompassing
  - Hedging program
  - Self-management of long term contracts and delivery
  - Aggressive conservation programs both on the ground and in the air
  - Airspace redesign initiatives in partnership with FAA
  - Purchase of oil refinery in Trainer, PA

Fuel Tax Burden in Michigan

Michigan fuel tax rates:

1. Sales tax: 6%
2. Excise tax: 3.0 cents per gallon (cpg), less 1.5 cpg credit for fuel purchased for interstate flights
3. Underground Storage Tank Fee: 0.875 cpg
4. Combined effective rate (at a fuel price of $3.15 per gallon): 21.3 cpg

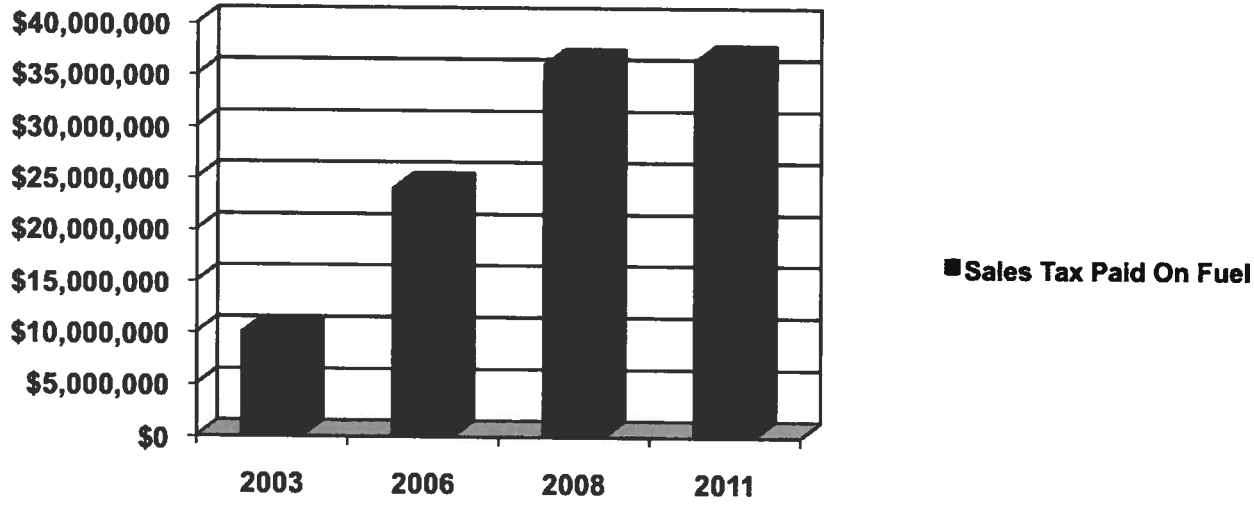
Based on a fuel price of $3.15 per gallon, estimated annual Michigan fuel tax liability is approximately $41M*, comprised of:

1. Sales tax: $36.4M
2. Excise tax: $2.9M
3. Environmental tax: $1.7M

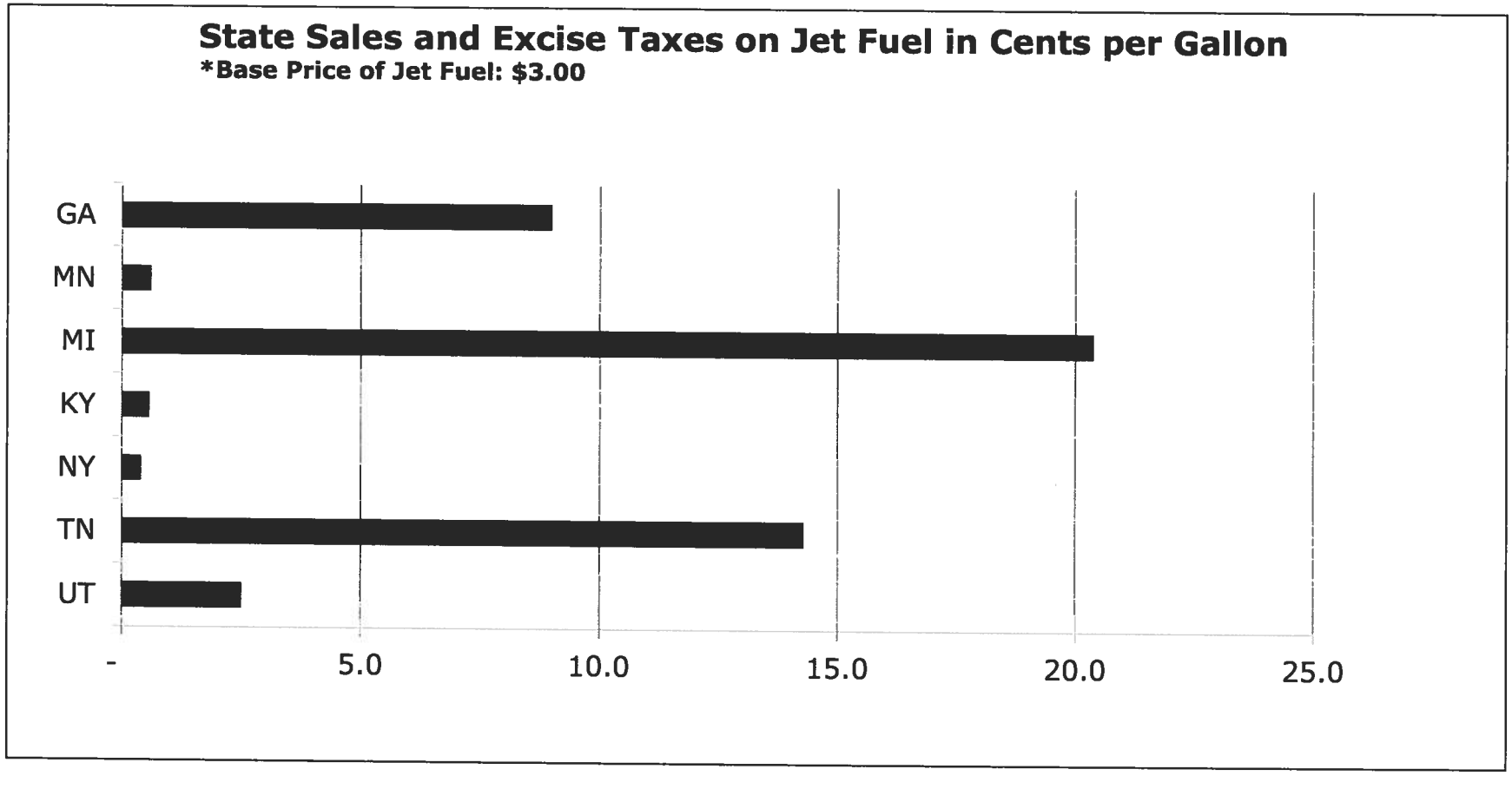
Michigan fuel taxes increase Delta's cost of fuel in Michigan by 6.75%

Dramatic Increase in Sales Tax Liability

- Michigan sales tax on fuel burden has increased because it is charged as a percent of cost rather than a fixed cost per gallon
- 2012 sales tax burden was $34 Million



MI taxes on jet fuel highest of all Delta hubs



MI Has the Highest Effective Tax Rate of all Delta Hubs

Georgia

- 3% sales tax (rate effective July 1, 2012)
- In April 2012, at Delta's request, the GA Legislature reduced the state tax on aviation fuel from 4% to 3%, the rate in effect in 1987

Minnesota

- 0.5 cent per gallon excise tax (over 200,000 gallons), plus 0.1 cent per gallon environmental fee

Kentucky

- 7% sales tax (capped at $1 million per year)

Tennessee

- 4.5% sales tax
- 1.4 cents per gallon excise tax on fuel burned in Tennessee and 1/20 cent per gallon excise tax on fuel exported

New York

- 6.8 cents per gallon excise tax, but only applied to fuel burned in New York, reducing the effective rate on fuel purchased in New York to less than 0.5 cent per gallon

Utah

- 2.5 cents per gallon excise tax

Michigan's Tax Burden Puts Delta at a Competitive Disadvantage to Other Airlines

Colorado (Hub for United and Southwest)

- Sales tax: 2.9%
- Excise tax: 4 cpg (City of Denver)

New Jersey (Hub for United/Continental)

- No sales tax on jet fuel
- Excise tax: 4 cpg, but applied only to fuel burned in New Jersey (effective tax rate on fuel purchased in NJ is less than 0.5 cpg)

Texas (Hubs for American, United/Continental and Southwest)

- No sales tax
- No excise tax

What's Good for Delta is Good for Michigan

When Delta does well, so do our customers, the communities we serve and our employees. In 2012:

- #1 in on-time performance, completion factor and missed bag ratio
- Invested over $1.5 Billion in on-board product
- Paid out $372 Million in profit sharing and $91.2 Million in Shared Rewards to our employees worldwide.
- Over $42 Million in Detroit profit sharing alone*
- Maintained levels of service in Michigan similar to 2011 levels

* 2012 Profit sharing paid in 2013

Reduce MI Sales Tax on Jet Fuel to Improve Competitiveness

- Reduce the sales tax on jet fuel from 6% to 4% to improve the competitiveness of Michigan in aviation
- Michigan would still be the highest tax rate amongst it's hubs, but would improve the competitiveness by reducing the gap between hubs