



Strategy of an Highly Efficient Network Carrier

Alitalia case

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Director Corporate Business Development

CONTENTS

- 1. Competitive scenario**
- 2. Alitalia profile**
- 3. Highly efficient network carrier**
 - a) The business model
 - b) Alitalia Vision and positioning
- 4. Alitalia Corporate strategy**
 - a) Business portfolio and general strategies
 - b) Key targets
 - c) Growth profile – Passenger Domestic, International, Intercontinental, Cargo Business
 - d) Alliance system
- 5. Innovative industrial model: The deconsolidation of Non–core activity**
 - a) Alitalia Servizi spin-off
 - b) Rationale and main benefits to the airline
 - c) Terms of agreement with Fintecna
 - d) First results in cost reduction and flexibility
- 6. Current strategic issues**
 - a) Business Portfolio enlargement – The acquisition of Volare / Air Europe
 - b) Business Portfolio repositioning
 - c) Alitalia industrial model
 - d) Alitalia Group Industrial Plan
- 7. Appendix**

CONTENTS

- 1. Competitive scenario**
2. Alitalia profile
3. Highly efficient network carrier
4. Alitalia Corporate strategy
5. Innovative industrial model: The deconsolidation of Non-core activity
6. Current strategic issues
7. Appendix

Competitive scenario Overview

European market overview

- As per IATA global passenger forecast, in 2006-2009 **traffic within Europe** is expected to grow at an average annual rate of **+5%**
- In the same period **traffic flows between Europe and the main regions worldwide** are expected to grow at an average annual rate of **+5.3 / + 5.9%** (Europe-Asia Pacific shows the strongest forecasted growth)
- In the next years Europe will experience a **further expansion of Low Cost carriers** , at an estimated average annual rate of +15% in terms of ASK
- **Pressure on yield and fuel prices dynamics** will continue to impose to airlines a strong **focus on efficiency and productivity**
- **Competition from high speed train** will become more relevant in the short term (EU Trans Europe project)
- **East European markets shows an interesting potential**
- **Regulatory framework in substantial evolution** (revision of third phase of liberalization, US/EU negotiation on open sky, launch of European Common Area)

Alitalia current market share

- **50%** of domestic market
- **35%** of short/medium haul flows from/to Italy
- **24%** of long haul flows from/to Italy

CONTENTS

1. Competitive scenario
- 2. Alitalia profile**
3. Highly efficient network carrier
4. Alitalia Corporate strategy
5. Innovative industrial model: The deconsolidation of Non-core activity
6. Current strategic issues
7. Appendix

Destinations

101

Countries

51

Daily Departures

812

Annual Passengers - year 2005

23.9 million

Fleet

187 (Dec 31st 2005)

Operating Revenue - year 2005

4.2 €billion

Employees

11,174 (Dec 31st 2005)

Ownership - June 2006

Ministry for the Economy and Finance: 49.9%

Walter Capital management LLP: 10.2%

Newton Investment Management LTD: 5.2%

Air France/KLM: 2%

Norges bank : 2%

Public: 30.7%

CONTENTS

1. Competitive scenario
2. Alitalia profile
- 3. Highly efficient network carrier**
4. Alitalia Corporate strategy
5. Innovative industrial model: The deconsolidation of Non-core activity
6. Current strategic issues
7. Appendix

Highly Efficient Network Carrier

The business model

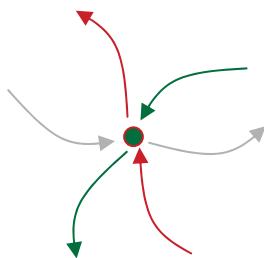
Business models

Main characteristics



Mega / Global Carrier

- Very large long-haul fleet scale with strong wide body weight
- Locations in “geographic cross-roads” of international traffic



Network Carrier

- Significant natural flows
- Mixed operation of short/medium and long-haul routes, on a lower industrial scale vs. global carriers
- High productivity and lean organization

- Network carrier model perfectly tailored to Alitalia characteristics
- Alitalia to drastically improve efficiency in order to achieve long-term sustainability



Low-cost

- Only point-to-point connections
- No long-haul network and fleet
- Very low cost structure (especially labour)

Highly Efficient Network Carrier

Alitalia vision and positioning

Alitalia Business model

“Highly efficient” network carrier

- Leader in the Italian market (50% of traffic share)
- Favorable position to capture connecting traffic in Eastern European, Mediterranean and Middle Eastern markets (56% of Malpensa and 40% of Fiumicino traffic is connecting)
- Port of entry to Italy/Europe for “natural” international and intercontinental flows (35% share on international, 24% on intercontinental)

Commercial implications

- Focus on local demand from/to Italy and leverage on natural connecting flows via Malpensa and Fiumicino
- Portfolio of additional, value-added customer services (Frequent Flyer Program, VIP Lounge, catering, etc.)
- Alliances with partner carriers (code-sharing, Frequent Flyer Program integration, etc.)

Industrial implications

- Industrial reengineering focused on efficiency:
 - Increase aircraft utilization
 - Increase crew productivity
- Cost reduction in all company areas in line with international best practices

CONTENTS

1. Competitive scenario
2. Alitalia profile
3. Highly efficient network carrier
- 4. Alitalia Corporate strategy**
5. Innovative industrial model: The deconsolidation of Non-core activity
6. Current strategic issues
7. Appendix

Alitalia Corporate Strategy

Business Portfolio and general strategies

- **Focusing on core Passenger and Cargo air transport businesses**, by placing all non core activities in Alitalia Servizi (which Alitalia deconsolidated by owning only 49% of voting rights)
- In **Passenger** business, strengthening the **leadership in domestic market, investing in high – grow international and intercontinental markets**, as well as consolidating the position in markets already served
- In **Cargo** business, significantly **increasing the capacity** and improving the market share in strategic markets, such as **North America and Asia**
- **Improving efficiency**, including more efficient use of the fleet, increasing flight and ground personnel productivity, reducing labor costs, the cost of providing goods and services and distribution costs
- **Developing AZ role in the strategic alliance system**, both as part of the global SkyTeam Alliance and within the contest of the consolidation process in the industry
- **Renewing and developing the fleet**, both in term of size and from the perspective of technological development and on board comfort

Alitalia Corporate Strategy

Key targets

Restructuring Phase

Relaunch Phase

Actions

- Reduced complexity with strong focus on core business (Alitalia Servizi spin-off)
- Maximised asset productivity without acquiring new fleet
- Reached new labour agreements to increase productivity and decrease costs
- Reduced purchasing costs
- Selective new fleet acquisition
- Further strengthening of competitive position
- Opening of new destinations and increase in frequencies

Key results to be achieved

- Reduction of personnel from 20,500 FTE (1) to 9,100
- Unit costs down 24% (2)
- Increase productivity by 27% for Pilots and 33% for Flight Attendants (3)
- Increase of passenger aircraft utilisation by approx. 10% (4)
- Realignment of EBITDAR to network carrier best performers
- Active role in the ongoing European airline consolidation process

- (1) 2004 figures : Alitalia + Alitalia Servizi
 (2) Pro forma CATK excluding fuel cost
 (3) Block hours/pilot and Block hours/attendant
 (4) hours/day/aircraft

Alitalia Corporate strategy

Alliance system and evolution



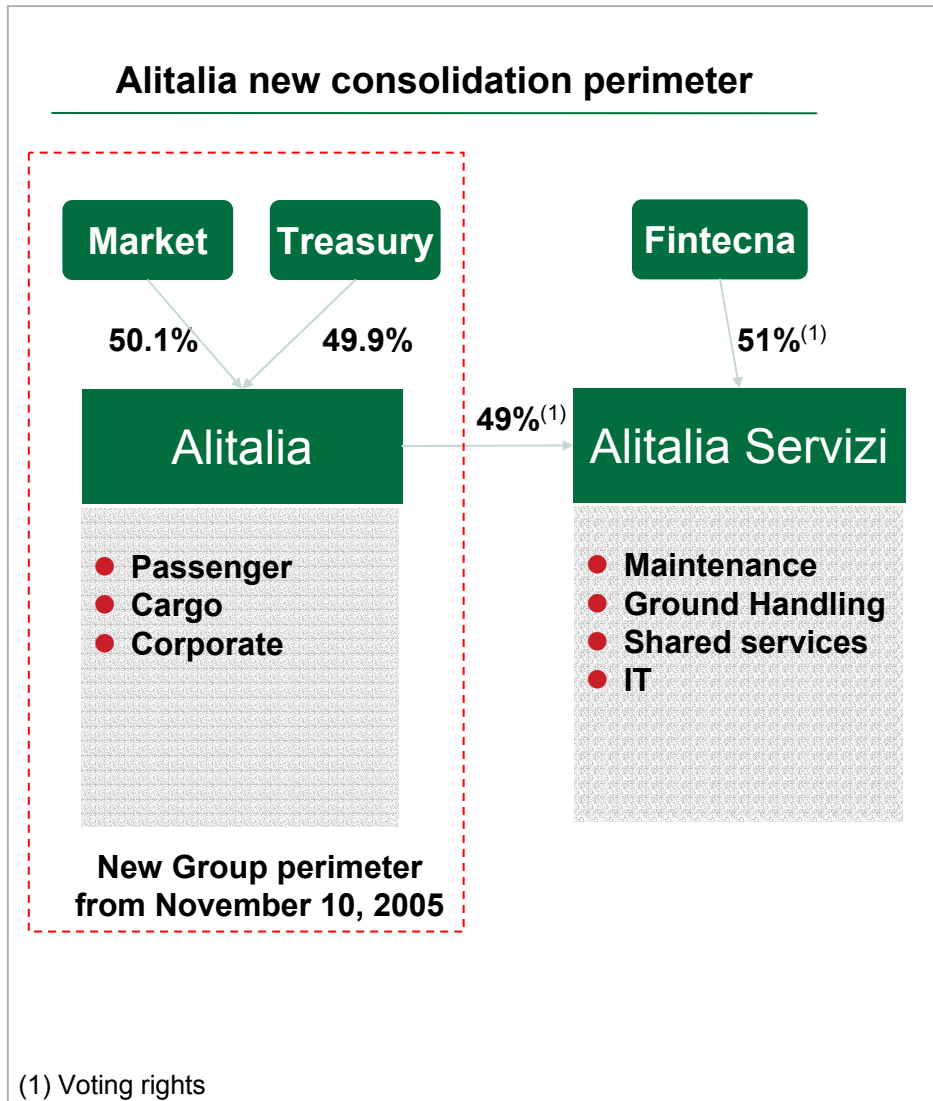
- **Alitalia has been full member of the SkyTeam alliance since 2001 (passengers and cargo)**
- **The SkyTeam Alliance:**
 - 10 carriers
 - 17% of market share (total passengers worldwide)
 - 728 destinations
 - N. 1 Alliance in North Atlantic
- **General advantages:**
 - Allows frequent flyer coordination and bilateral code sharing with each member
 - Increases load factor and unit revenues
 - Increases commercial appeal of Alitalia product
 - Allows Alitalia to have a global presence and provide global brand visibility
 - Increases bargaining power with international suppliers
- **Extensive cooperation with Air France:**
 - Full joint venture on the Italy / France bundle
 - Extensive code sharing beyond the hubs Charles de Gaulle, Malpensa and Fiumicino

CONTENTS

1. Competitive scenario
2. Alitalia profile
3. Highly efficient network carrier
4. Alitalia Corporate strategy
- 5. Innovative industrial model: The deconsolidation of Non-core activity**
6. Current strategic issues
7. Appendix

Innovative industrial model: The deconsolidation of Non- Core Activity

Alitalia Servizi spin-off



- In May 2005 Alitalia non core activities (maintenance, ground handling, shared service and information technologies) were contributed into a newco called Alitalia Servizi
- In November 2005 Fintecna underwrote a dedicated Alitalia Servizi capital increase in order to obtain a 49% stake (51% of voting rights)
- Along the plan, Fintecna will underwrite 100% of preferred shares, that will be issued in various tranches
- Since the acquisition by Fintecna of the majority of voting rights (November 10, 2005), Alitalia deconsolidated Alitalia Servizi as shown in Alitalia 2005 financial statements

Innovative industrial model: The deconsolidation of Non- Core Activity

Rationale and main benefits to the airline

Rationale	Description
Focus on core business	<ul style="list-style-type: none"> ● Focus of Alitalia management team on airline core business: <ul style="list-style-type: none"> – More resources on implementation of turnaround – Greater capacity to quickly react to market trends
Variabilization of cost structure	<ul style="list-style-type: none"> ● Variabilization of costs related to service activities which will increase Alitalia flexibility to adapt to market changes
Service contract at market prices	<ul style="list-style-type: none"> ● Unit cost reduction through service level agreements prices set at market levels capturing the benefits from day 1 with an exclusivity principle but without guaranteed volumes
Transfer of implementation risk	<ul style="list-style-type: none"> ● Partnership with Fintecna allows the transfer of all turnaround risks: Alitalia will only pay a limited contribution (higher service price) in case Alitalia Servizi does not completely meet its turnaround targets
Financial support	<ul style="list-style-type: none"> ● Funding by Fintecna through capital increases of €220m of the future capital needs of the businesses transferred to Alitalia Servizi
Additional upside	<ul style="list-style-type: none"> ● Through an earn out scheme Alitalia will keep part of the potential upside from the disposal program of Alitalia Servizi businesses above agreed target

Innovative industrial model: The deconsolidation of Non- Core Activity

Terms of the agreement with Fintecna

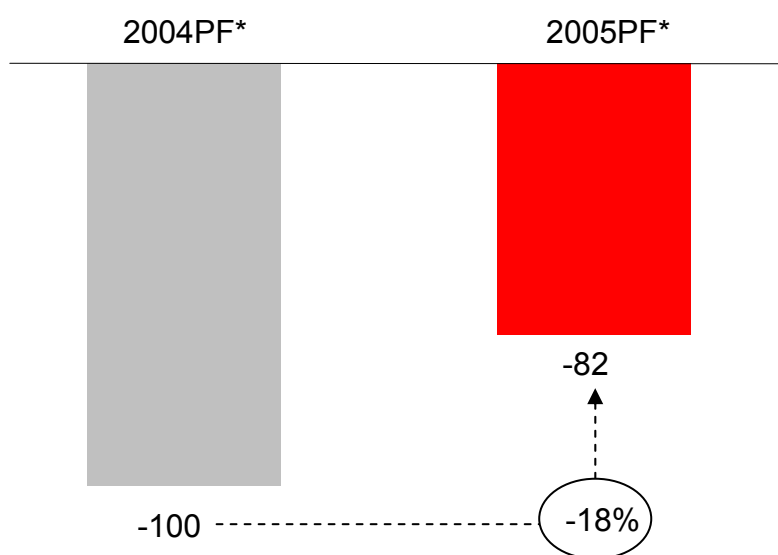
- Alitalia was diluted by Fintecna which now owns a stake of 49% (51% of voting rights). This stake will increase through subscription of subsequent capital increases, which will cover future Alitalia Servizi financial needs.
- No financial debt of Alitalia has been passed on to Alitalia Servizi⁽¹⁾
- Alitalia Servizi is already implementing a turnaround plan, leading to its financial equilibrium

(1) Except for €24 million euro of the maintenance subsidiary Atitech SpA.

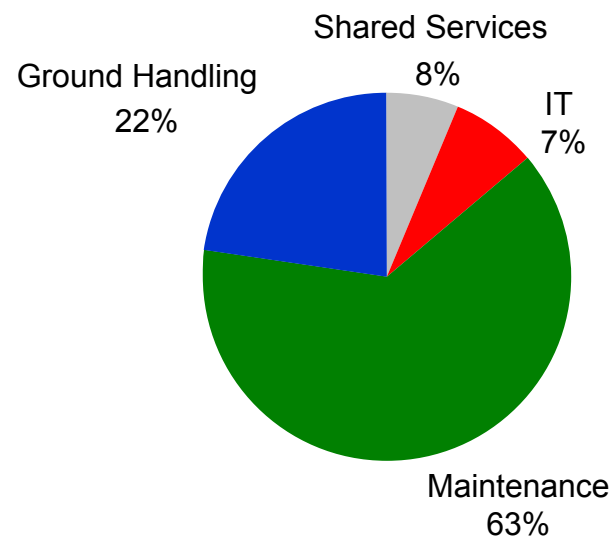
Innovative industrial model: The deconsolidation of Non- Core Activity

First results in cost reduction and flexibility (1)

Service unit costs from Alitalia Servizi (2004PF=100)



Split of Alitalia Servizi 2005PF invoice to Alitalia

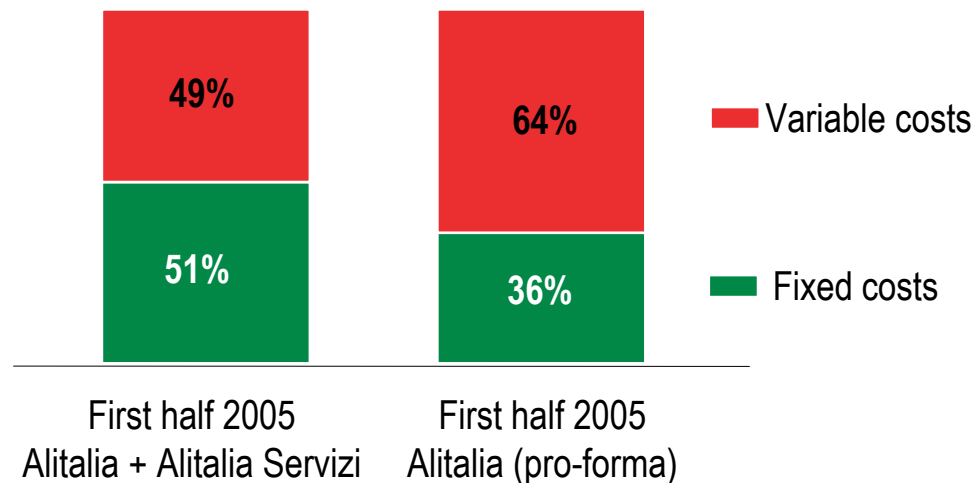


- Positive effects from Alitalia Servizi spin off on 2005 pro-forma accounts show a 18% decrease vs previous unit internal costs (2004)
- 2005 pro forma invoice from Alitalia Servizi of approximately 600 million euros
- 2006 invoice from Alitalia Servizi expected to grow less than half of 2006 ATKs growth

Innovative industrial model: The deconsolidation of Non- Core Activity

First results in cost reduction and flexibility (2)

Alitalia total cost evolution (fixed vs variable)



- Variable cost weight on total increased immediately by 15pp
- Before the deconsolidation, the cost structure related to non-core activities was as follows:
Labour (50%), Materials/Services/others (42%), Depreciation (8%)

CONTENTS

1. Competitive scenario
2. Alitalia profile
3. Highly efficient network carrier
4. Alitalia Corporate strategy
5. Innovative industrial model: The deconsolidation of Non-core activity
- 6. Current strategic issues**
7. Appendix

Current strategic issues

Business Portfolio enlargement – The acquisition on Volare/Air Europe

In april 2006 Alitalia won the public bid for the acquisition of Volare Group, operating on medium-short haul scheduled services, with the brand Volareweb, and Leisure long haul services, with the brand Air Europe

Strategic goals of the acquisition

- Defending and strengthening AZ position on its key markets
- Widen selling proposition to penetrate different market segments (new ones: Price Sensitive and Leisure)
- Increasing the capacity of the Group in facing the LCC expansion from/to and within Italy

Volare and Air Europe Business Plans will be defined in the short term in order to leverage on the their competitive cost structure and brand value, within the general corporate strategy of Alitalia Group

Current strategic issues

Business Portfolio enlargement – The acquisition on Volare/Air Europe

Brand / Rights

- **Brand name: Volareweb and Air Europe**
- **2 Flight codes: VA and PE with associated slots in Milan Linate and other major Italian airports**
- **Traffic rights for flights from Italy to Mauritius, Cuba, Mexico (Mexico City and Cancun), Maldives and Sri Lanka (Colombo)**

Resources

- **Leasing contracts for 5 aircraft (1 B767 for long haul and 4 A320 for short medium haul)**
- **Approximately 650 employees of whom 70% flight personnel (pilots and flight attendants)**

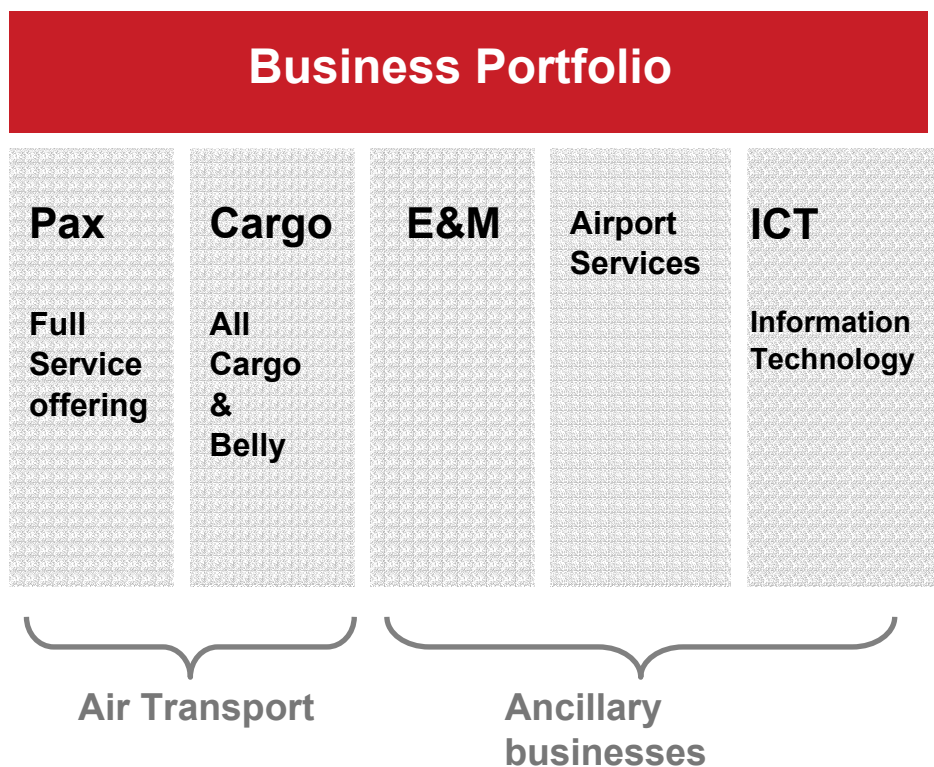
Deal details

- **None of the previous Volare Group SpA liabilities was transferred to Alitalia but the severance fund for employees as of November 2004 (approximately 0.7 million euros)**
- **Price offered: 38 million euros**
- **Alitalia obliged to maintain current employment levels for two years**

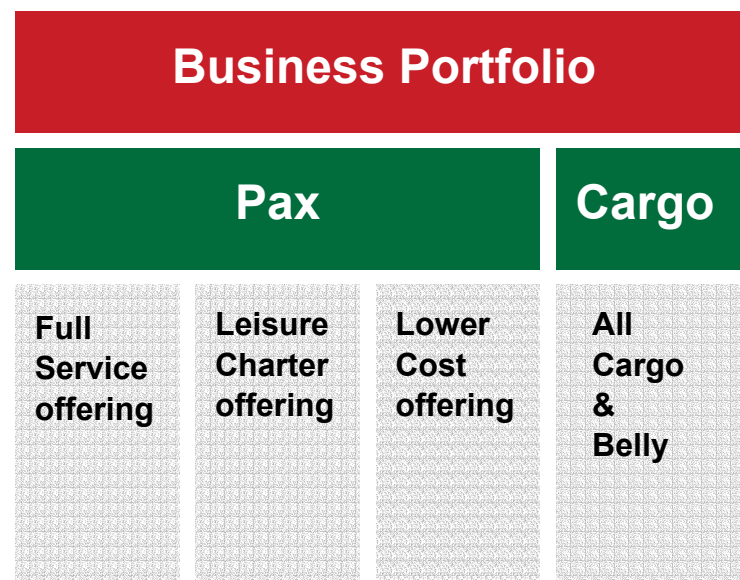
Current strategic issues

Business Portfolio repositioning

Previous Model



Current Model

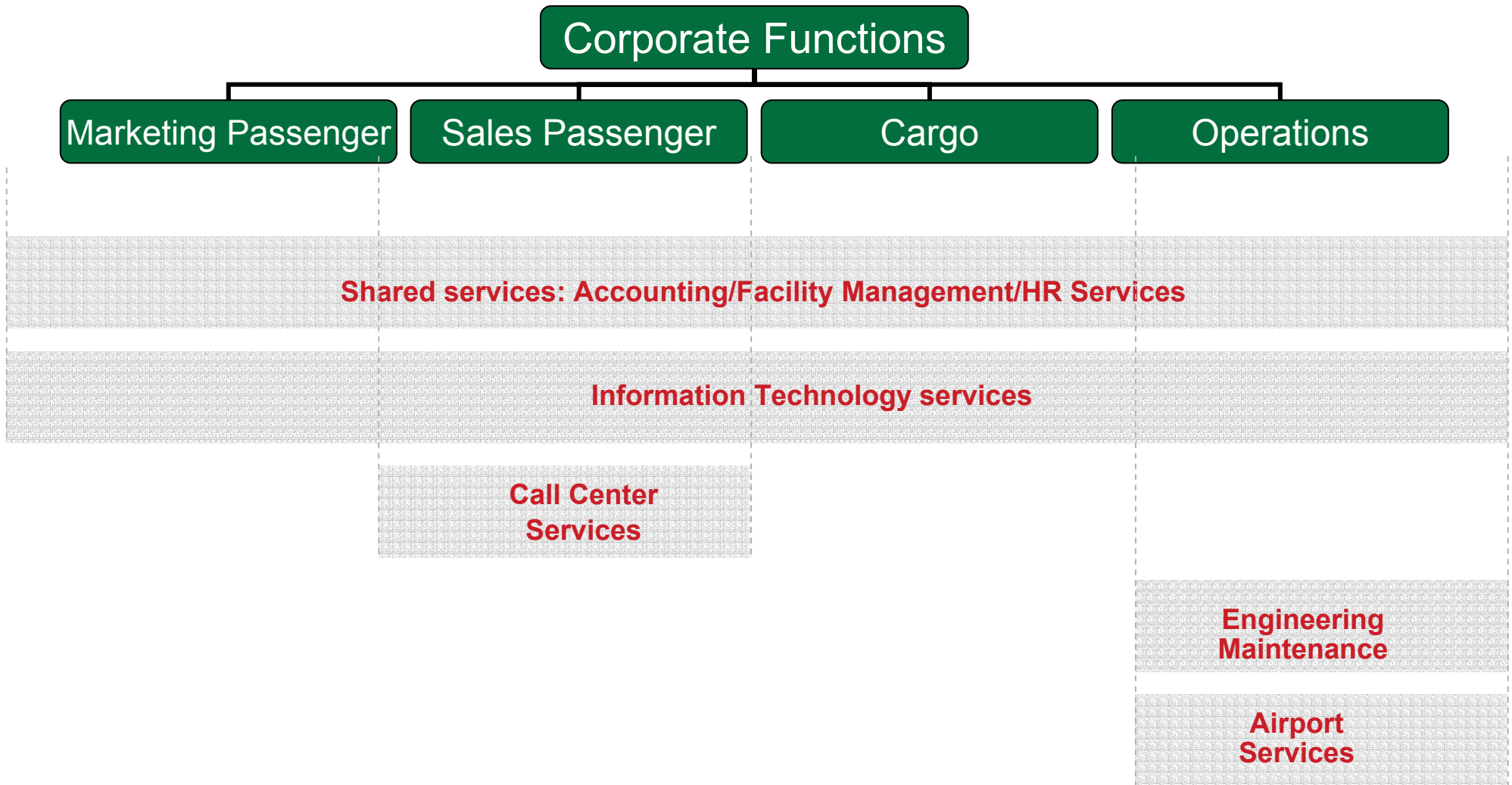


Outsourced services

E&M	Airport Services	ICT	Shared services			
			Accounting	HR services	Call center	Facility management

Current strategic issues

Alitalia Industrial model



Services Outsourced from AZ Servizi

Current strategic issues

Alitalia Group Industrial Plan

**Alitalia Group
Industrial Plan
will be updated
in the short term,
in order to**

- Launch additional measures and project to secure the full achievements of planned key targets, facing the business scenario dynamics
- Develop and manage the new Business Portfolio, enlarged by the Volare and Air Europe acquisition
- Develop the alliance strategy for the next years

CONTENTS

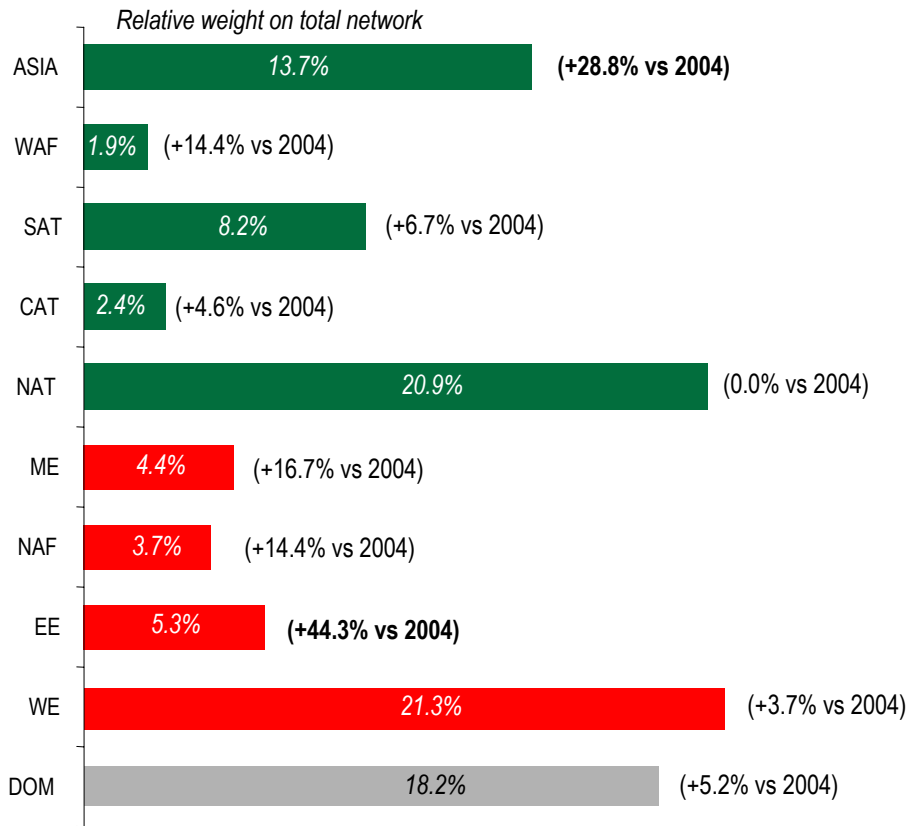
1. Competitive scenario
2. Alitalia profile
3. Highly efficient network carrier
4. Alitalia Corporate strategy
5. Innovative industrial model: The deconsolidation of Non-core activity
6. Current strategic issues
7. **Appendix**

- Alitalia business performance 2005 vs 2004
 - Passenger
 - Cargo

- Alitalia business performance 1H 2006 vs 1H 2005
 - Passenger
 - Cargo

Passenger business (2005 performance vs 2004)

53.1 bln ASKs (+9.1% vs 2004)

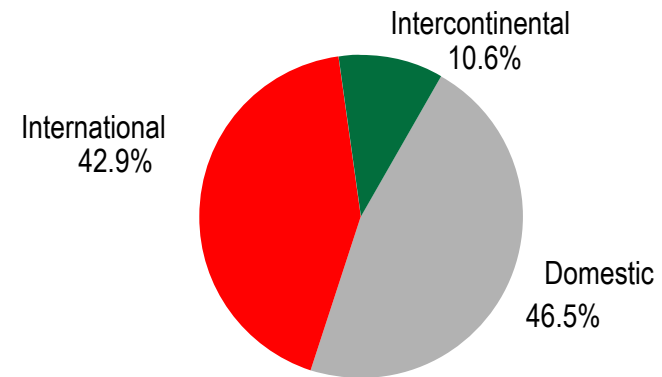


DOM: Domestic Italy
EE: Eastern Europe
ME: Middle East
CAT: Center Atlantic

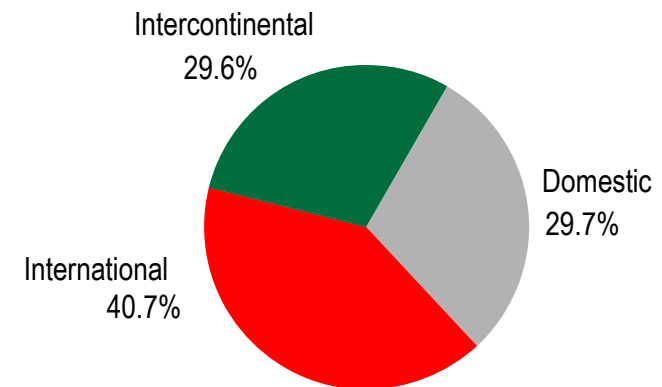
WE: Western Europe
NAF: North Africa
NAT: North Atlantic

ASIA: Far East
SAT: South Atlantic
WAF: West Africa

23.9 mln passengers (+7.8% vs 2004)

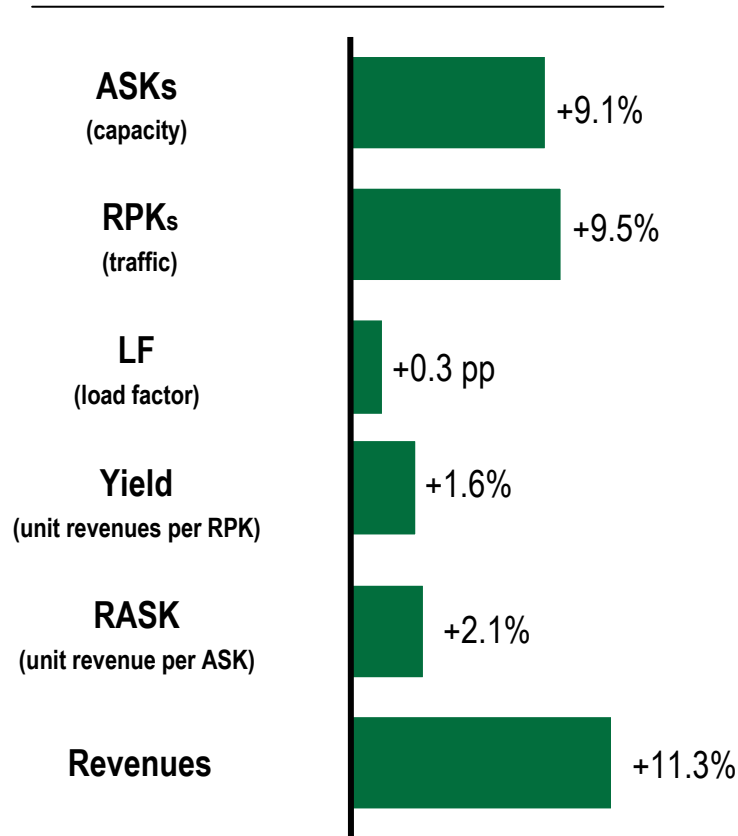


3,55 bln Passenger Traffic Revenues (+11,3% vs 2004)



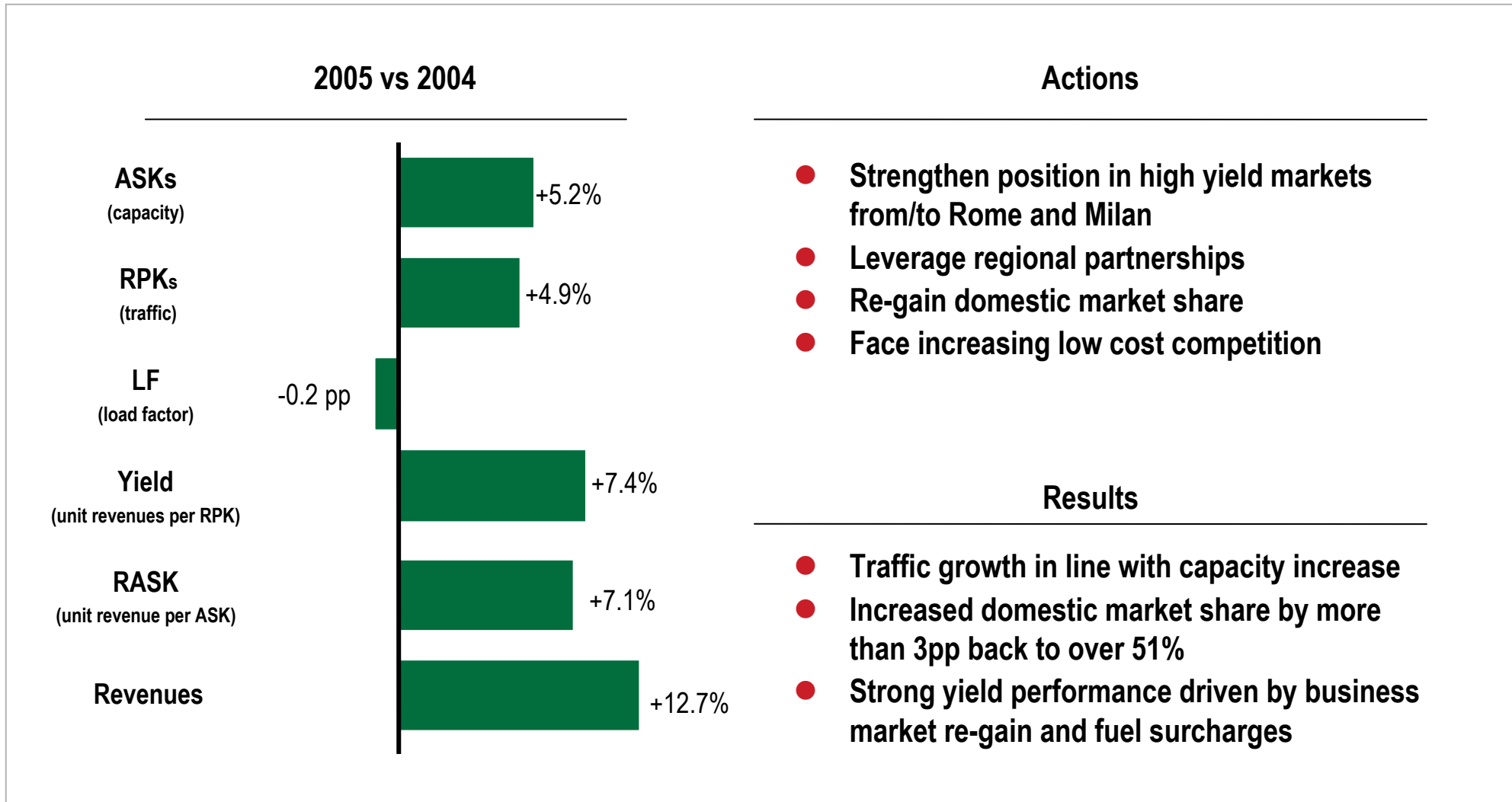
Total passenger network 2005 results

2005 vs 2004

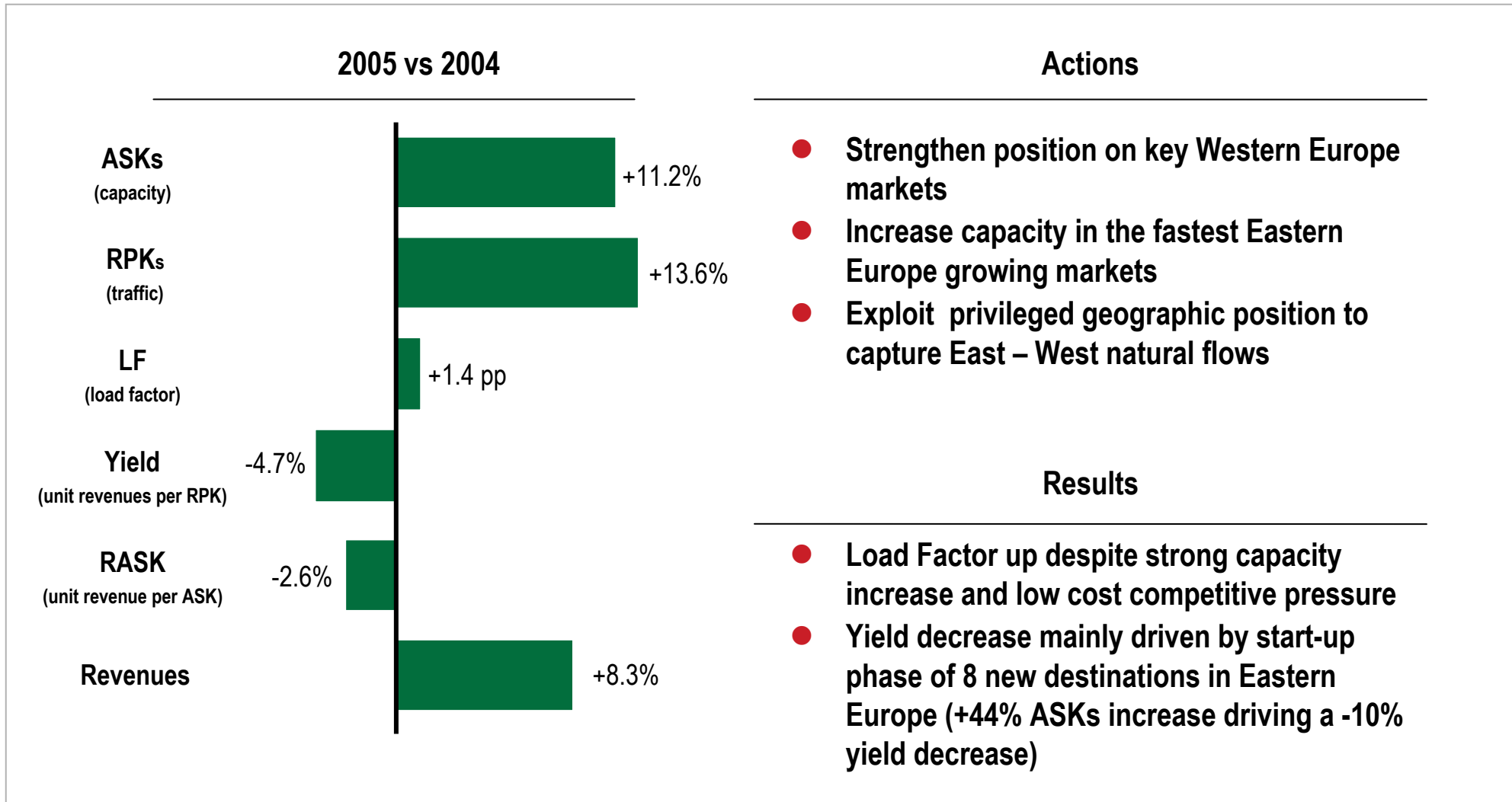


- Very good overall 2005 performance confirming success of the network positioning
- 2005 last quarter total network revenue performance lower than expected due to cancellations but still showing the strongest RASK increase vs 2004

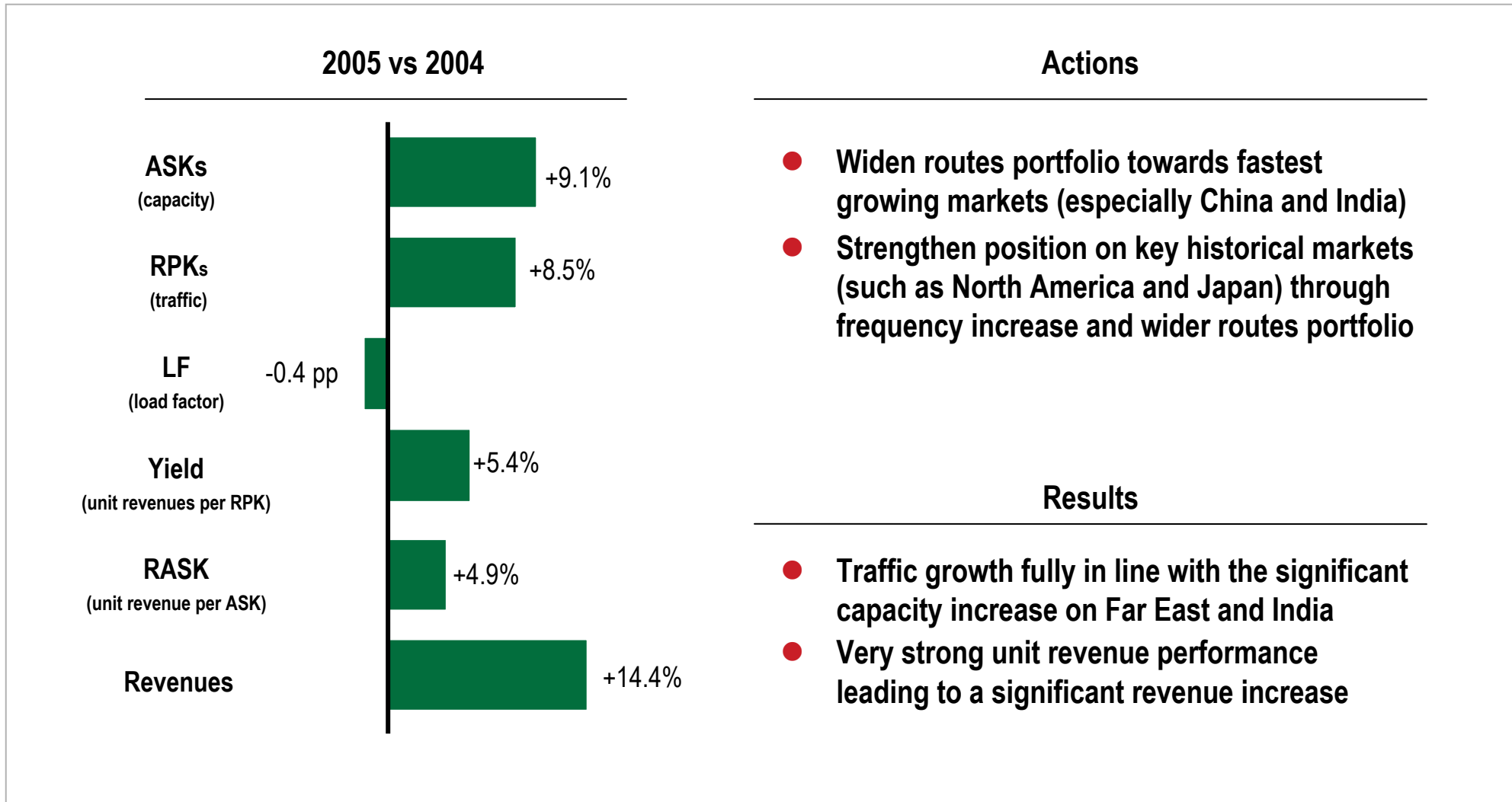
Domestic passenger network 2005 results



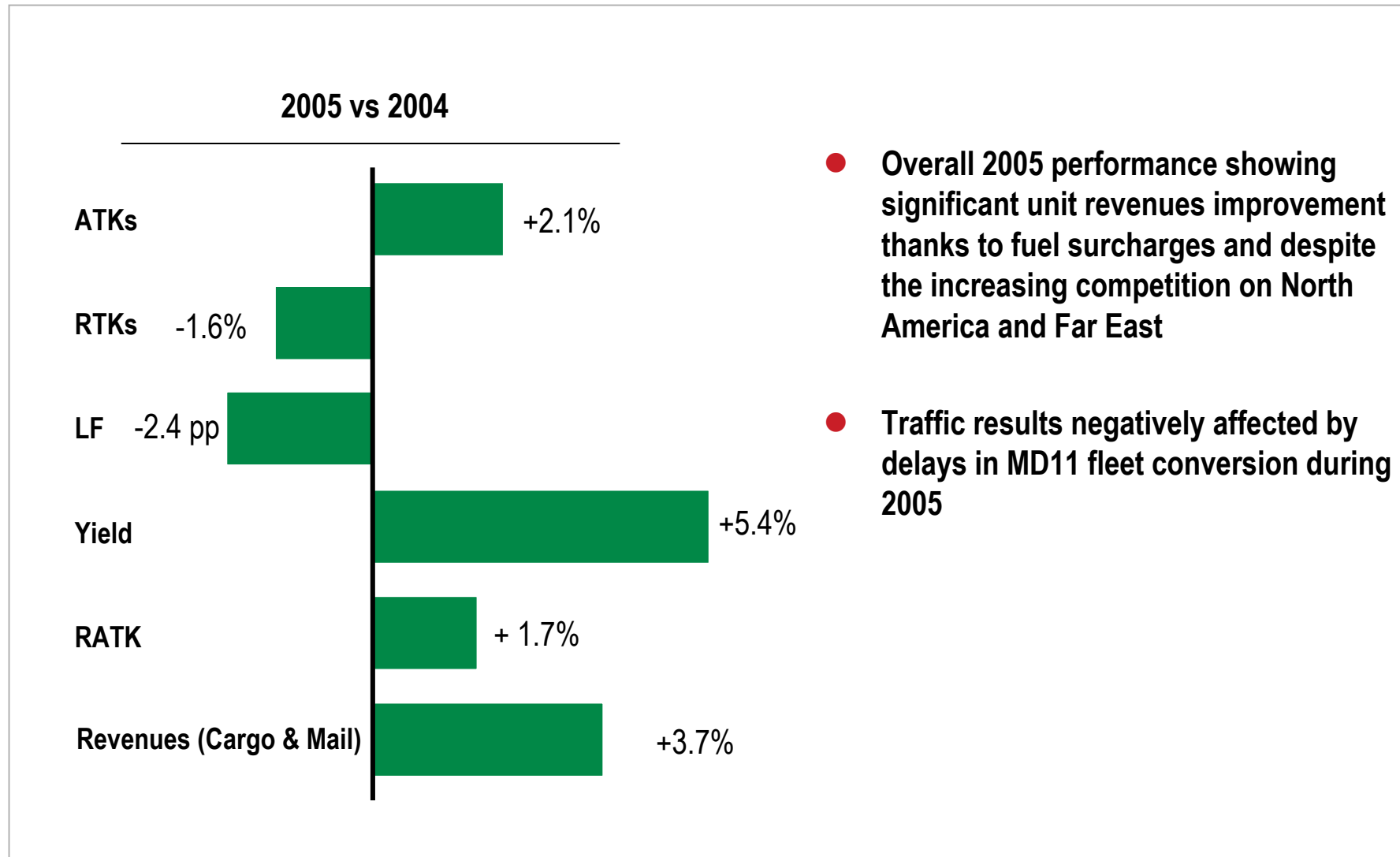
International passenger network 2005 results



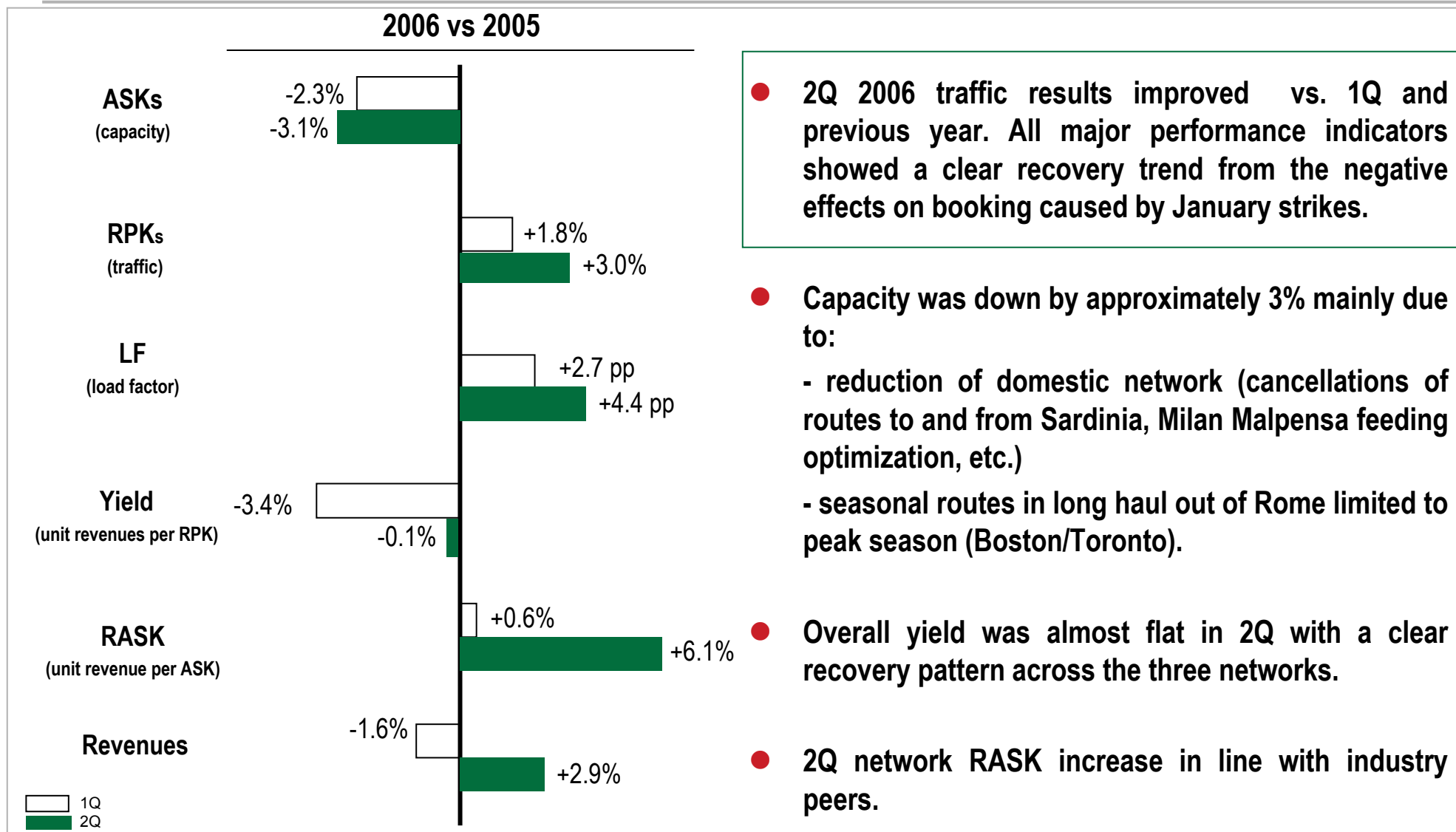
Intercontinental passenger network 2005 results



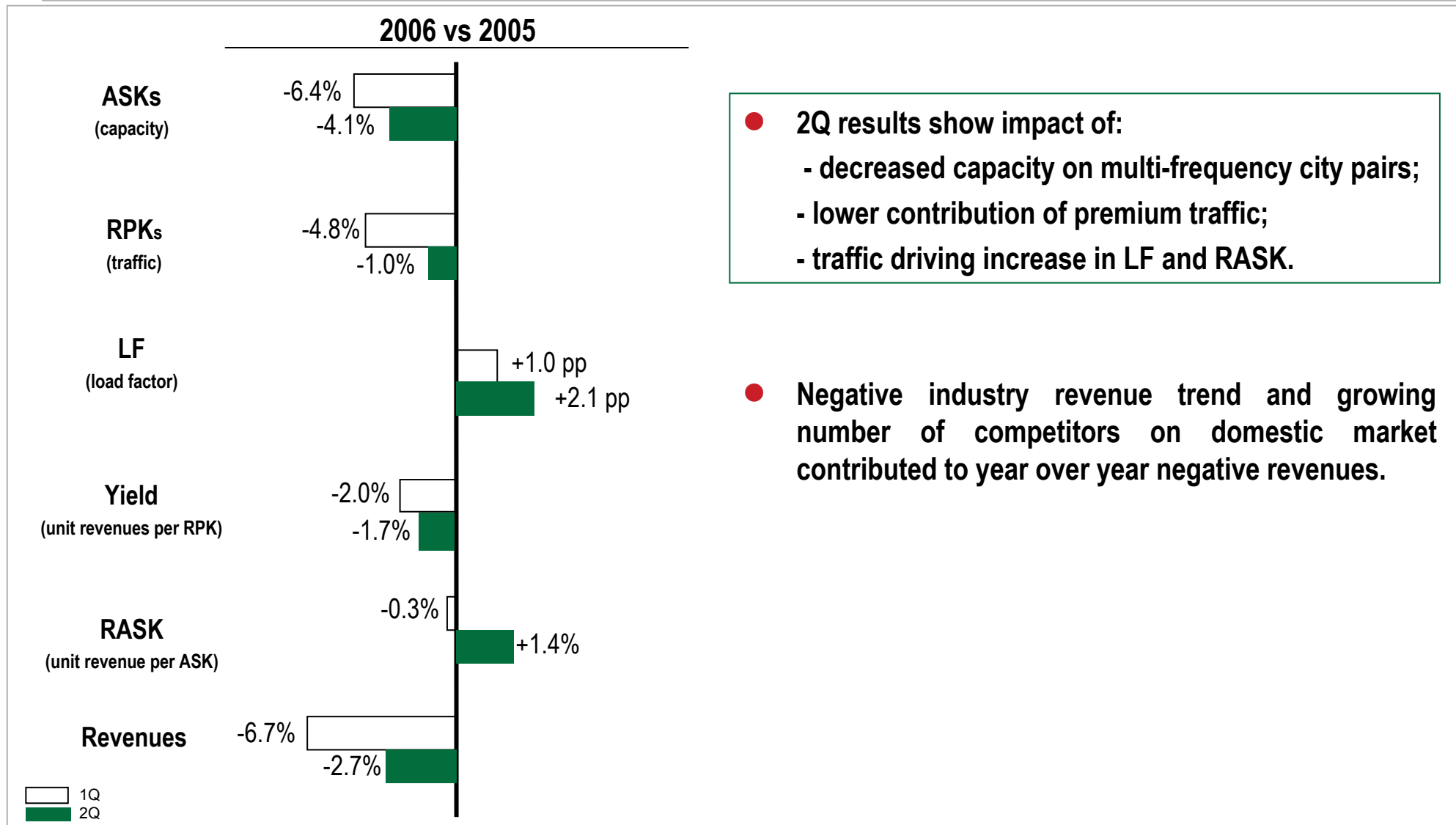
Cargo 2005 results



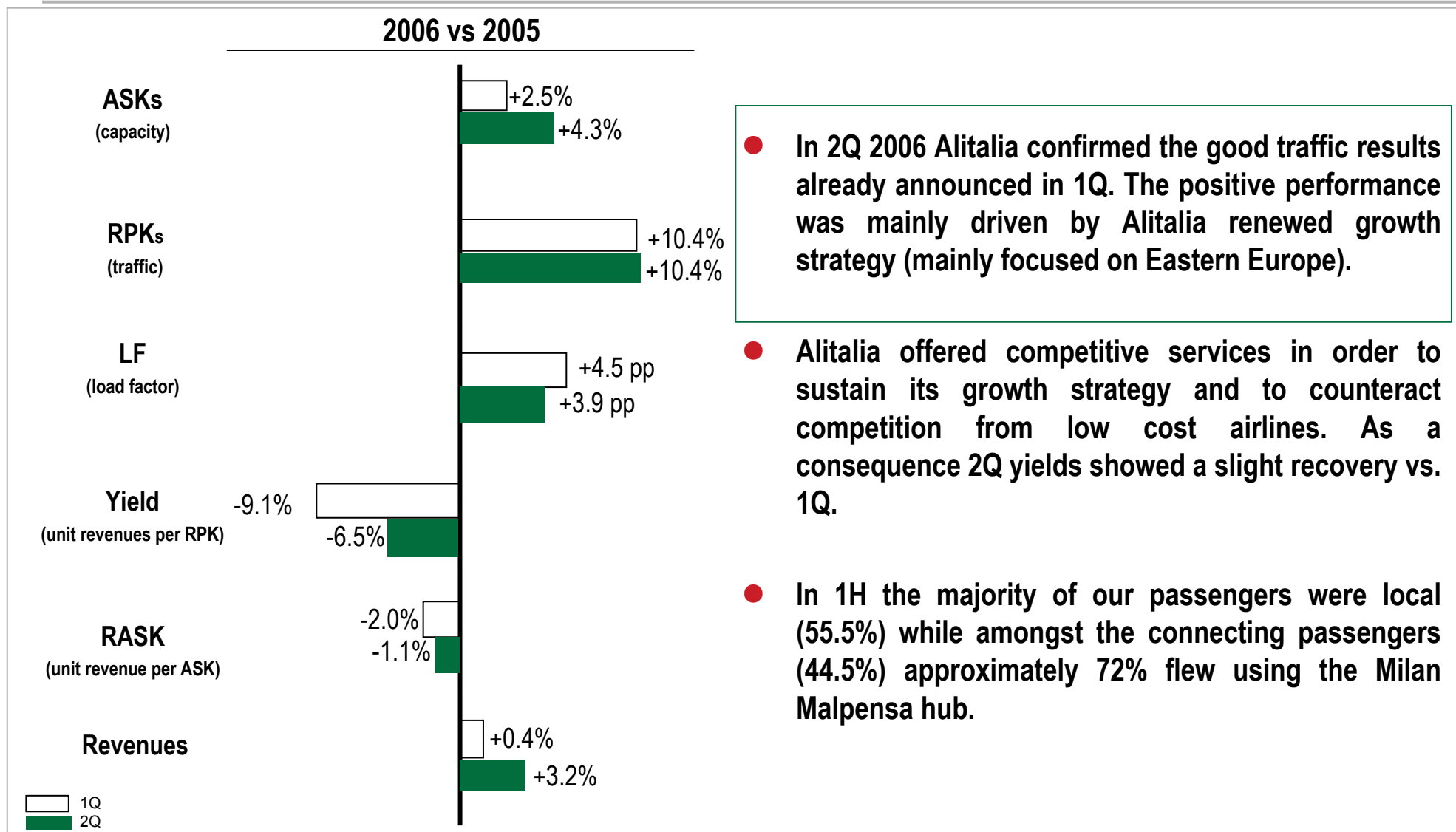
Total passenger network first half 2006 results



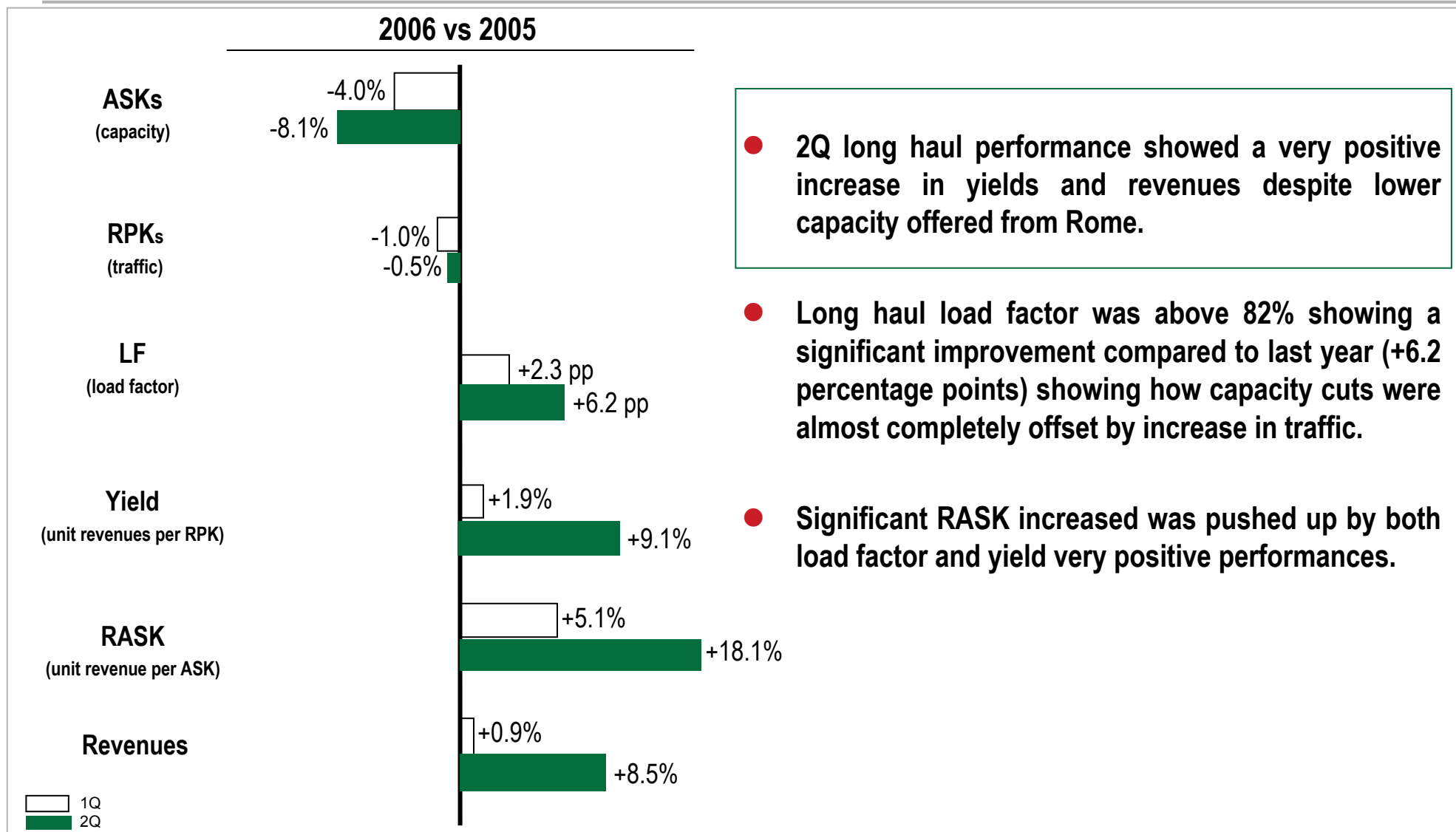
Domestic passenger network first half 2006 results



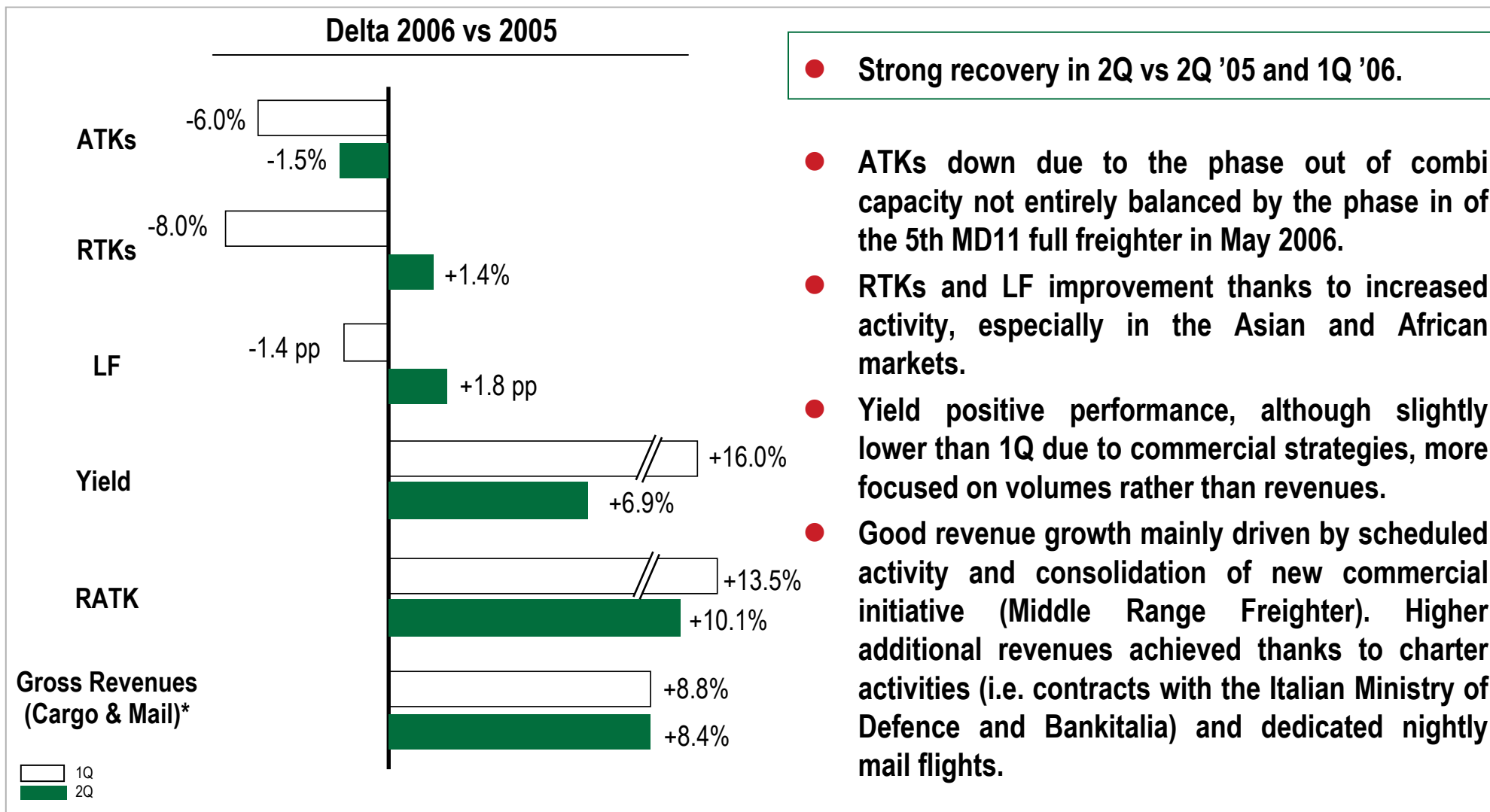
International passenger network first half 2006 results



Intercontinental passenger network first half 2006 results



Cargo first half 2006 results



- Strong recovery in 2Q vs 2Q '05 and 1Q '06.

- ATKs down due to the phase out of combi capacity not entirely balanced by the phase in of the 5th MD11 full freighter in May 2006.
- RTKs and LF improvement thanks to increased activity, especially in the Asian and African markets.
- Yield positive performance, although slightly lower than 1Q due to commercial strategies, more focused on volumes rather than revenues.
- Good revenue growth mainly driven by scheduled activity and consolidation of new commercial initiative (Middle Range Freighter). Higher additional revenues achieved thanks to charter activities (i.e. contracts with the Italian Ministry of Defence and Bankitalia) and dedicated nightly mail flights.

* Charter, Nightly mail, Surcharges included