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THE TRANSFORMER

A conversation with …

W. Douglas Parker, Chairman, President and CEO, US Airways

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BACK TO THE **FUTURE**

SAS has restructured itself to be more flexible and compete effectively in its home markets.

■ By Marco Contento | *Ascend* Contributor

FOR SCANDINAVIAN AIRLINES SYSTEM, WHAT'S OLD IS NEW AGAIN. The airline, which formed when several local carriers joined forces after World War II, has in some ways returned to its roots by once again dividing its operations across its home region to become more flexible and better able to compete.

In 2004, as SAS continued grappling with the challenges facing the industry, it divided into four separate airlines — SAS Denmark, SAS Sweden, SAS Braathens and SAS International Airlines. The advantage of establishing four distinct carriers was not only to respond faster to market needs and lead the market with new initiatives rather than react but also to tailor individual initiatives to each individual airline.

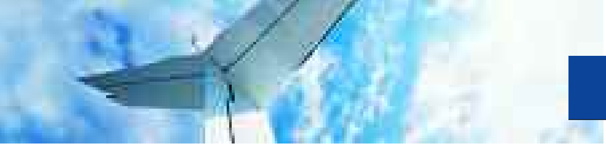
Although the individual airlines share departmental responsibilities in areas such as information technology, human resources and finance, each division is equipped with its own hub, fleet and crews to:

- Reduce complexity for each hub,
- Increase efficiency,
- Increase transparency,
- Allocate dedicated fleets,
- Optimize each hub individually rather than optimizing across the entire network.

Breaking into separate airlines was part of a larger reorganization with a reshaped brand strategy. As part of the restructuring, designed to introduce clearly divided business areas driven by a focus on decentralization and transparency as well as individual responsibility for earnings, the SAS Group split into five core units:

- SAS Airline Businesses — The four individual SAS-branded carriers with hubs in Copenhagen, Denmark; Stockholm, Sweden; and a regional hub in Oslo, Norway, which combine to form the fourth-largest airline group in Europe, carrying 24 million passengers with 200 aircraft;
- Subsidiary & Affiliated Airlines — Independently operated carriers in which the SAS Group has an ownership stake, including Spanair, Blue 1, Widerøe, Estonian Air and airBaltic, which combined carried 8.6 million passengers last year to 73 destinations using 97 aircraft;
- Airline Support Businesses — Companies including SAS Cargo, SAS Ground Services and SAS Technical Services, which account for 21 percent of the operating revenue of the SAS Group;
- Airline Related Businesses — Associated organizations including SAS Flight Academy, Jetpak, European Aeronautical Group, SAS Business Opportunities and SAS Media that generated 2.9 billion SEK (US$3.8 million) in operating revenue in 2004;
- Hotels — Rezidor SAS, tracing back to 1960 when SAS opened its first hotel in Copenhagen, which operates 190 hotels in 47 countries under five brands: Radisson, Country Inn, Cerruti, Park Inn and Regent.

Photos courtesy of Ted Fahn and SAS



"We started by creating a clearer structure so that each company on its own power can develop its core activities according to the logic of its own business," said SAS Group Executive Vice President and Chief Financial Officer Gunilla Berg. "You could say that we are 'normalizing' the SAS Group's structure to resemble that of other groups. Giving companies their own responsibility for earnings is a strategy that has proved successful in other companies even within the group. Clearer responsibility for earnings is vital but requires a well-functioning and integrated management model. Such a model is now in place group wide."

SAS's restructuring for the modern airline environment has some ties to its earliest days when it began as a group of separate airlines.

The airline traces its roots to 1918 when a Danish air taxi company, Det Danske Luftfartselskab, was founded. In 1946, DDL united with Det Norske Luftfartselskap A/S and Svensk Interkontinetal Lufttrafik AB to form SAS. After five years of cooperation, the three airlines formed a consortium that has lasted more than 50 years.

With the industry downturn in 2001, however, SAS was forced to rethink its structure and take various measures to transform the company. Not only did the airline face financial challenges, it also faced increasing competition, particularly from low-cost carriers. To understand the magnitude of competition in that region, compare Scandinavia with a similarly sized area of western Europe. Scandinavia, including Finland, has a land mass of a little less than 1.2 million square kilometers, which is comparable to the combined size of the United Kingdom, France and Germany. However, while those three countries have a combined population of more than 200 million, Scandinavia, including Finland, has slightly more than 24 million.

Despite the relatively small population, travelers have a choice of more than 25 airlines offering intra-regional services, not counting other international carriers that connect the region with other markets. With most competitors offering point-to-point service, they have a significant impact on SAS's hub-and-spoke network structure.

Faced with these challenges, four years ago SAS began restructuring its operations. Although the next three years proved difficult financially, its turnaround efforts laid the foundation for its improved performance this year.

In 2001, the airline established SAS AB, the new holding company of SAS Group. As a result, various divisions and majority-owned subsidiaries were spun off. SAS sold 285,000 square meters of airport properties, such as warehouses and hangars, to investors as part of a program to free capital. In 2003, the airline sold its properties in Frösundavik, Sweden, as part of a sell-and-lease-back agreement.

On the information technology side, SAS sold SMART, the Scandinavian Tour Operator Portal, in which it held 95 percent of the shares, to Amadeus in mid 2002. At the end of 2003, Scandinavian IT Group, which was a large division serving not only SAS but several other carriers with reservations and inventory technology, was sold to Danish CSC, which continues to manage all IT requirements of the SAS Group.

The spin offs were part of the SAS Group's decision to focus on its core operations.

"We are releasing capital that can be used for airline operations, among other purposes, while at the same time we are letting a professional property-management company acquire the office properties," said SAS Chief Executive Officer Jörgen Lindegaard.

Focusing on the core airline business led SAS to expand its ownership interests in other carriers. In 2002, SAS increased its stake in Spanair, which it launched in 1986, by an additional 25 percent, giving it 73.9 percent majority ownership. The following year, SAS increased its stake to 93.9 percent as it continued to shift its focus to its airline business by strategically investing in existing and new partners.

In December 2001, SAS Group acquired Braathens, then the dominant player in the domestic Norwegian market. In mid 2002, SAS increased its ownership in Widerøe, another local Norwegian carrier, from 63.3 percent to 96.4 percent.

In late 2003, the airline group acquired 49 percent minority share in Estonian Air, a Baltic carrier with predominantly local traffic that feeds into SAS's Scandinavian and long-haul networks. Since then, expansion in the Baltic states and Finland has proven important in SAS Group's positioning in the area, including its involvement in airBaltic, Latvia and Air Botnia, the wholly owned Finnish company that was renamed Blue 1 in 2004.

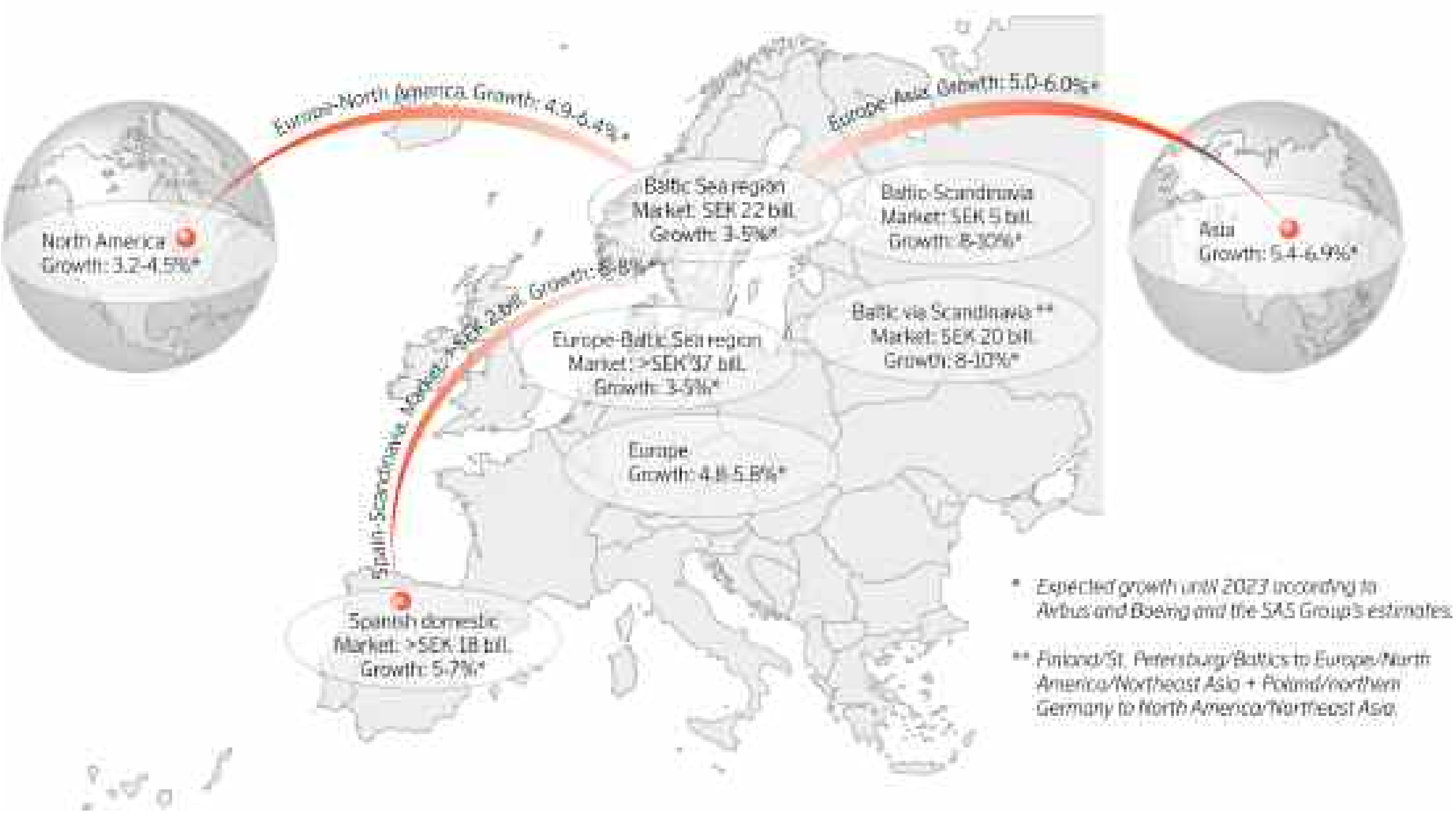
Widerøe, Blue 1 and Braathens play a significant role in SAS's strategy by complementing its regional networks through the addition of new point-to-point routes as well as feeding the airline's European and long-haul networks. SAS also maintains an ownership interest in Spanair. While Spanair has only mar-

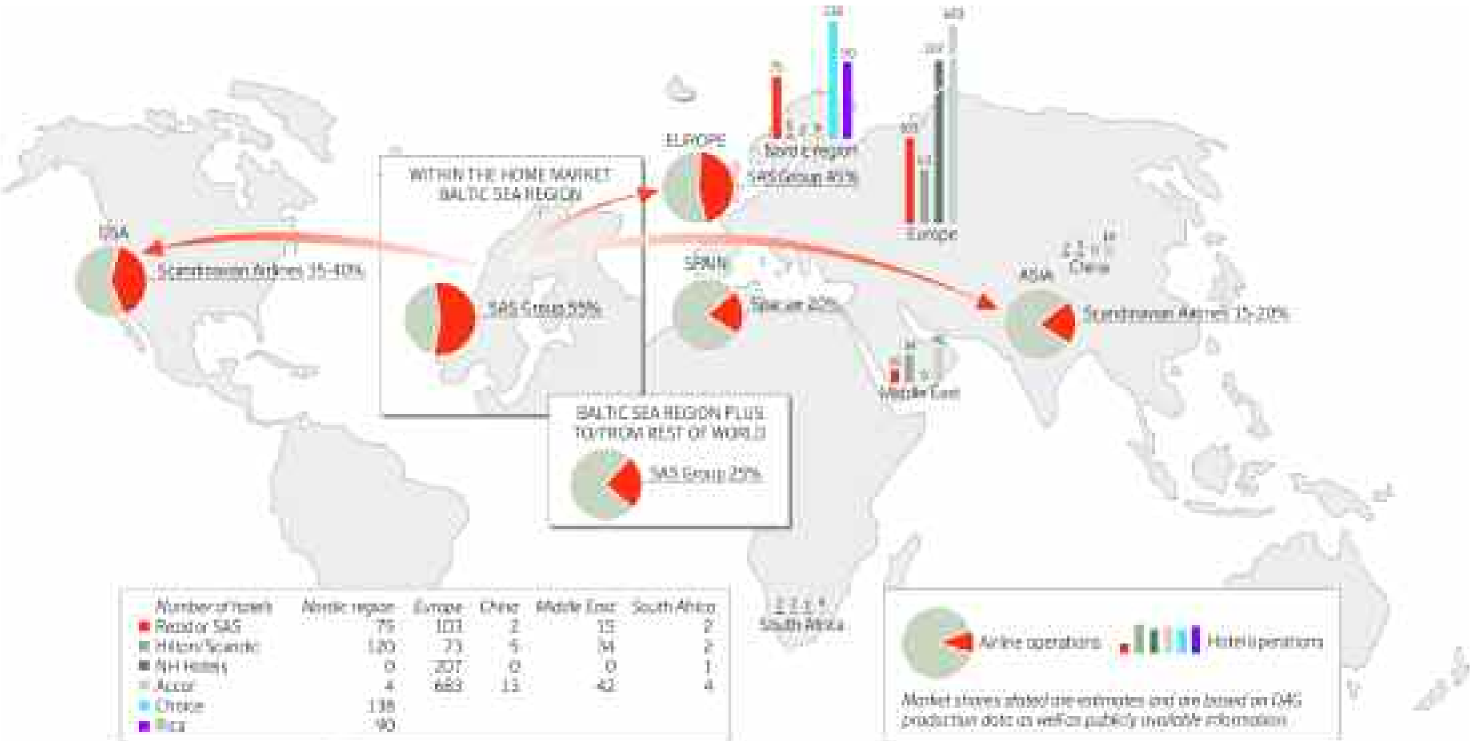
Left: As part of the SAS Group's restructuring, it split into five operating businesses — SAS Airline Businesses, Subsidiary & Affiliated Airlines, Airline Support Businesses, Airline Related Businesses, and Hotels — making each group responsible for its own earnings.

Right Top: Many of the key markets that SAS serves are expected to grow significantly during the next couple of decades, and SAS is positioning itself to take advantage of the increased traffic.

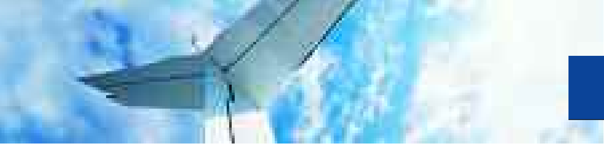
Right Bottom: The SAS Group, which considers the Baltic Sea region its home market with 55 percent market share, also conducts airline operations activities in other regions, as well as other airline-related businesses and hotel operations.

Graphics courtesy of SAS





Number of hotels	Nordic region	Europe	China	Middle East	South Africa
Rezidor SAS	79	103	2	15	2
Hilton/Scandic	120	73	5	34	2
NH Hotels	0	207	0	0	1
Accor	4	683	13	42	4
Choice	138				
Rica	90				



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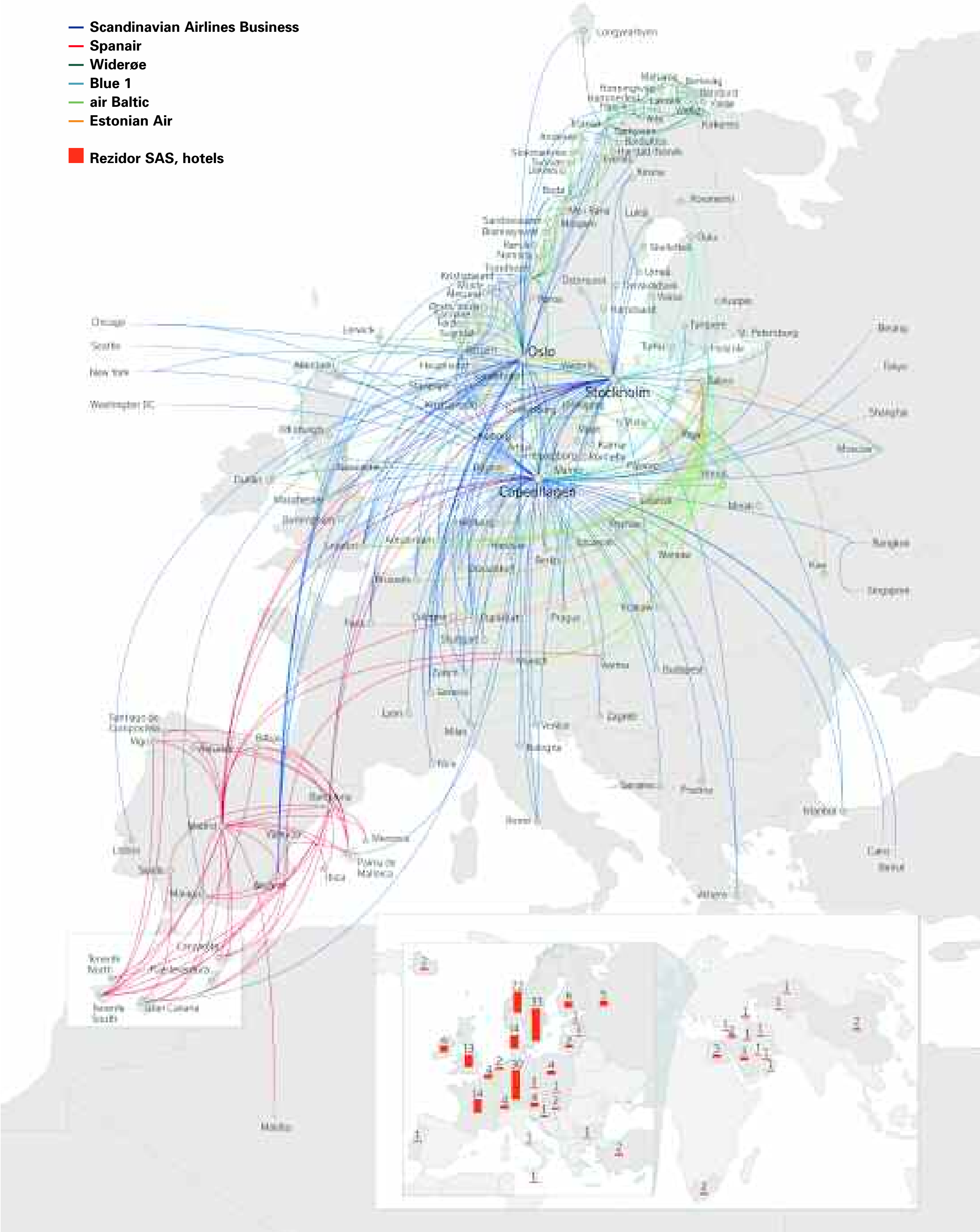

Scandinavian Airlines Business
Spanair
Widerøe
Blue 1
air Baltic
Estonian Air
Rezidor SAS, hotels
Oslo
Stockholm
Copenhagen

Left: With three members of the Star Alliance (Scandinavian Airlines, Spanair and Blue 1) and three other airlines within its group (Widerøe, airBaltic and Estonian Air), the SAS Group has an extensive network of approximately 1,445 daily departures to 146 destinations. The Group also has companies that support airline operations as well as a hotel operation.

Right: The SAS Group's strong brand, which includes various travel entities such as airlines, hotels, cargo services, and ground services, enables customers to recognize the SAS Group, even when traveling on an airline that is not a primary user of the SAS master brand, such as Spanair or Blue 1. The SAS master brand signifies efficient, flexible travel solutions and attentive service.

Top: Company officials hope by organizing its operations into five businesses positions the SAS group for a successful journey with a smooth landing.

Bottom: SAS Group management team, back row from left: John Dueholm, Scandinavian Airlines Businesses; CEO Jörgen Lindegaard; Bernhard Rikardsen, Corporate Administration & Support; Front row from left: Gunnar Reitan, Subsidiary & Affiliated Airlines and Hotels, and Gunilla Berg, CFO.

ginal impact on the Scandinavian market, it helps contribute to the airline's overall success. SAS also has a minority participation in Skyways and cooperates commercially with it on its predominantly domestic-Sweden network.

The airline continued its efforts to revamp its business with "Turnaround 2005," a plan to return to profitability, which is expected to generate 14 billion SEK (US$1.8 billion) from 2003 to 2006. By the end of 2004, SAS had successfully implemented changes that will have an impact on earnings of 11.9 billion SEK (US$1.6 billion), bringing down unit costs by 26 percent compared to the end of 2002.

Today, SAS continues to change the way it does business.

"The yield stabilization that started at the end of the third quarter of 2004 has continued through the first quarter of 2005," Lindegaard said. "The high oil prices were compensated by fare adjustments. The emphasis now is on improving the cabin factor through capacity adjustments and a more aggressive commercial focus. Scandinavian Airlines Denmark and Scandinavian Airlines International are focusing on development of Copenhagen as a traffic hub. In Sweden, we launched 'Nya Inrikesflyget' (a new domestic concept) at the end of March, which has been a major sales success from the start with more than 100,000 ticket reservations on our new, simplified Web site by the end of April. The other airlines in the SAS Group have developed as planned and strengthened their market positions."

SAS Group's total net income improved by approximately 400 million SEK (US$53 million) in the first quarter of the year compared to the same period in 2004; the unit cost decreased an additional 7.5 percent. The new price concept in Sweden alone saw loads for SAS Sweden jump by 11.6 percent. Despite rising fuel costs, the SAS Group reported a successful second quarter when group earnings (before capital gains and non-recurring items) jumped dramatically to 579 million SEK (US$76 million).

What Lies Ahead?

On the cost side, SAS will continue pursuing productivity increases for its flight crews. SAS Ground Services and Technical Services are also in the focus to deliver savings. And with the intended shift to direct sales channels, distribution costs with its global distribution system partners will also be reviewed.

On the product side, changes keep dominating. Following the success of its Nya Inrikesflyget concept for Sweden, which is based on one-way fares, SAS introduced the same for Europe, making it the first huge network carrier in Europe to introduce such a radical change.

As a result of Turnaround 2005 and its ongoing restructuring efforts, SAS appears to be on track to return to profitability after four consecutive years of losses.

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