METROPOLITAN AIRPORTS COMMISSION

FINANCIAL ANALYSIS OF NORTHWEST

NOVEMBER 10, 1991

Pursuant to 1991 Laws, Chapter 350

Consultant's Report prepared for the Metropolitan Airports Commission

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Washington, DC 20006

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Price Waterhouse

November 10, 1991

Mr. Hugh K. Schilling, Chairman
Metropolitan Airports Commission
6040 28th Avenue South
Minneapolis, Minnesota 55450

Dear Mr. Schilling:

At the request of the Metropolitan Airports Commission ("MAC" or the "Commission"), we have completed an analysis of the financial condition of Northwest in accordance with Chapter 350, Minnesota Laws of 1991 (the "Statute"). This report provides our assessment of the current financial condition of Northwest and the Company's ability to meet its future debt service obligations, including those relating to the proposed financing between MAC and the Company (the "Financing"), as required by the Statute.

The corporate structure of Northwest includes Wings Holdings Inc. ("Wings"), NWA Inc., Northwest Airlines, Inc., and several additional operating subsidiaries. Wings is the holding company that acquired NWA Inc. on February 23, 1989 (the "Acquisition" or "Wings Acquisition"). NWA Inc. is the parent company of Northwest Airlines, Inc. and the other operating subsidiaries. Throughout this report we have referred to "Northwest" or the "Company" as inclusive of all of these entities.

To perform our analyses, we used and relied upon the historical and prospective information provided by the Company, information on the industry prepared by Airline Economics, Inc. ("AEI") and other sources such as Boeing, the Federal Aviation Administration ("FAA") and industry analyst reports, and information obtained from public sources, some of which is presented in this report. We assumed such information was reasonably prepared, complete, and accurate in all material respects. Management has represented to us that the prospective information provided to us reflects management's best estimates and judgements regarding the expected future financial performance of the Company. We have not been engaged to compile, review, or examine such historical or prospective information in accordance with standards established by the American Institute of Certified Public Accountants. Accordingly, we do not express an accountant's or auditor's opinion on the financial position or results of operation or any other form of assurance on the ability of the Company to meet its obligations with respect to the Financing or otherwise.

This report is intended solely for use by the Commission pursuant to its obligation under the Statute in connection with the Financing and is not intended to be used or relied upon for any other purpose or by any third party. Other than as required by law or judicial process, this report is not to be quoted or referred to, in whole or in part, without our written consent, in any registration statement, prospectus or proxy statement, or in any other written document used in connection with the offering or sale of securities, or for any other purpose. We assume no responsibility to update this report for events and circumstances occurring after the date of this report.

The Statute mandates an assessment of the Company's financial condition, including the ability of the Company to meet its obligations over the term of the Financing. Section I of this report presents an overview of the legislation mandating this project and our scope and approach in analyzing Northwest's financial condition. Our work has been limited to an evaluation of the financial condition of Northwest, as required by the Statute. We have not addressed the various other issues that could be considered by MAC in evaluating the Financing, including, but not limited to:

- Economic development;
- Employment guarantees; and
- Public policy concerns.

Following the Acquisition, Northwest developed an aggressive strategy to improve the performance of the Company. This strategy was developed by the new management team that was put in place following the Acquisition and focused on improving performance while increasing capacity and market share. In addition, this strategy was developed to take advantage of the favorable industry conditions forecasted by industry analysts that were to follow the current period of consolidation. The key elements of this strategy are as follows:

- Acquire a proportionate share of the market left by exiting carriers;

- Implement a program to improve customer preference;
- Take advantage of the well-established route structure, particularly in the growing Pacific market;
- Improve the operating assets of the Company through an aggressive program of aircraft acquisition and non-aircraft capital expenditures;
- Improve employee relations; and
- Invest selectively in targeted opportunities so as to leverage existing routes and expand service.

The two years following the Acquisition have not provided sufficient time for the full results of this strategy to be seen. However, the most recent financial and operating results of Northwest compare favorably with the other major carriers. Our analysis of the financial condition of Northwest based on its strategy, its recent financial results, and management's expectation of its future performance is presented in the remainder of this report.

An assessment of Northwest's financial condition involves an understanding of the airline industry and Northwest's position within the industry, an analysis of the Company's historical financial and operating performance, and an assessment of Northwest's prospects for future performance. In assessing the Company's ability to meet its obligations over the term of the Financing, as required by the Statute, we have considered those factors relevant to a determination of whether the Company can meet its financial obligations as they come due. Within the requirements of the Statute, we have considered earned revenues and other resources that may be expected to be available to the Company in the normal course of business, including proceeds from financing transactions and the sale of assets ("Available Revenues"). We have not considered the potential value or the adequacy of collateral that could be liquidated in the event of default in order to pay in arrears the financial obligations of the Company.

In connection with the proposed Financing, MAC engaged Airline Economics, Inc. to prepare an analysis of the US airline industry and the relative position of Northwest within the industry. The AEI report, entitled "Status of the US Airline Industry and Northwest Airlines," is included for the convenience of the reader as Appendix I of this report. We used and relied upon this report and the work of AEI in our analysis of the financial condition of Northwest.

A summary of the airline industry and Northwest's position within the industry is included in Section II. As discussed in Section II, the years 1978 through 1984 following deregulation resulted in heavy losses and several airline bankruptcies and mergers. Record profits followed during 1985 to 1988. The weak economy, overcapacity, increasing fuel prices, the Persian Gulf conflict, and other factors from 1989 through mid-1991 have produced record losses for the industry. Northwest has shared in these changing fortunes of the industry. Airline industry analysts, including AEI, expect that continued consolidation and favorable economic conditions should result in an industry turnaround in 1992 and that profits should attain the record levels experienced in 1985 to 1988 during the next three to five years.

To analyze Northwest's historical performance, we reviewed information concerning that performance from 1977 through 1990 and for the eight-month period ending August 31, 1991. Our assessment of the current financial condition of Northwest is presented in Section III of this report.

As described in Section III, we believe the Wings Acquisition and the subsequent two years of losses have left Northwest highly leveraged and thinly capitalized. The Company incurred $3.1 billion in debt as a result of the Acquisition in 1989. While a considerable amount of the original debt has been repaid, our analysis shows that most of the repayments have been offset by incurring new debt obligations involving assets acquired by Wings, such as the Airbus, GE/SNECMA, and UTC loans and the Japanese land mortgage. The proposed MAC Financing is another such transaction. The total outstanding balance of Acquisition-related obligations was $2.6 billion as of August 31, 1991.

In addition, due to losses incurred subsequent to the Acquisition, the Company has negative retained earnings of $560 million as of August 31, 1991. This has resulted in a depletion of most of the contributed equity capital. As reported in the Company's internal unaudited financial statements dated August 31, 1991, the common stockholders' equity was a deficit of $335 million, and total common and preferred stockholders' equity reduced to $176 million.

In assessing the Company's future financial condition, we analyzed information provided by Northwest and AEI and information obtained from public sources concerning the prospects for Northwest and the industry. Our assessment relied primarily on the Financial Plan ("Financial Plan" or the "Plan") prepared by Northwest, dated August 12, 1991. In general, this Plan projects the operating and financial performance of Northwest for the five-year period 1991 through 1995 based on various assumptions of management. Our analysis of this Plan is presented in Section IV of this report.

Management has represented to us that the Financial Plan reflects management's expectations regarding the events most likely to occur in the airline industry and management's expected course of action to direct Northwest during the planning period. Management has also represented to us that they believe the underlying assumptions are reasonable and appropriate; the assumptions reflect management's best estimates and judgements regarding the expected future financial performance of the Company; and all significant information relevant to this Plan has been provided to us in connection with our work.

During the course of our work, the Company has been mentioned in the press regarding financial transactions with a number of carriers, including:

- Investments in or loans to a number of troubled airlines including America West, Hawaiian Air, and the Trump Shuttle;

- New or expanded alliances with international airlines including British Airways, KLM, and Quantas; and

- Merger between Northwest and Continental.

In addition, the Company has recently announced the pending acquisition of Midway Airlines. The terms of this acquisition are not yet final.

The Financial Plan does not assume the completion of any of these potential transactions, including the Midway acquisition, and our analysis did not consider the merits, feasibility, or likelihood of any such transactions. Accordingly, in the event that any of these or similar transactions were completed, it would represent a change in the Financial Plan and, depending on the size and structure of such transaction, may affect the resulting financial condition of Northwest.

Based solely on the Financial Plan, the Company projects that Available Revenues will be at least sufficient during each year of the term of the Financial Plan, 1991 to 1995, to pay when due all financial obligations of the airline corporation. If the economic and other financial conditions projected in the Financial Plan for 1995 continue throughout the term of the Financing, the future financial condition of the Company and its Available Revenues, as projected by the Company, would be sufficient to allow the Company to continue to meet its financial obligations over the remaining period of the Financing.

Inherent in the Company's Financial Plan is the successful renegotiation of the covenants related to the Acquisition loan made by a syndicate of lenders represented by Banker's Trust (the "Senior Bank Debt"). The Senior Bank Debt represents a significant portion of the Company's non-operating financial obligations over the next five years. The Company has informed us that they are not expected to meet some of the Senior Bank Debt financial covenants in the near future and throughout the remaining term of the Financial Plan.

There will usually be differences between the projected and actual results in any plan that presents prospective financial information because events and circumstances frequently do not occur as expected, and those differences may be material. As described in Section IV of our report, we believe many of the assumptions underlying the Financial Plan are overly optimistic and may not be achieved. In order to evaluate the possible financial impact on Northwest should such variances occur, we performed certain sensitivity analyses on several key assumptions, including the following:

- The airline industry will operate in favorable economic conditions and will not be adversely affected by major external events;

- Passenger revenues will increase substantially;

- Manageable expenses will increase at a slower rate than revenue; thus profit margins will increase over historical levels; and

- Favorable aircraft financing will allow the Company to complete sale/leaseback transactions in excess of purchase price.

An improvement in the overall economy is a prerequisite to the anticipated industry turnaround. However, the most recent national economic reports indicate that the long-awaited improvement in the economy is not occurring as rapidly as expected. Several airlines continue to report lower than expected revenues and earnings and have announced cutbacks in aircraft acquisition programs and other actions in response to these results. The susceptibility of the airline industry to overall economic conditions and other factors outside the control of the industry is likely to affect adversely the industry periodically during the term of the Financial Plan.

Although industry analysts generally concur that industry-wide airline revenues will increase during the term of the Plan, the Plan is predicated on increases that significantly exceed these industry levels. The larger increases in Plan revenues result from disproportionately higher system-wide passenger yields, growth in the Pacific region, and increases in market share. The net result is an assumed rate of revenue growth for Northwest that is far greater than that anticipated for the industry.

In addition to higher revenues, the Plan assumes that operating margins will increase substantially based on expense growth that is slower than the rate of revenue growth and on relatively stable fuel prices. Larger margins on higher revenues produce levels of Plan profitability that, along with the excess cash flow provided by the Plan sale/leaseback transactions, allow the Company to meet its financial obligations over the Plan period.

In evaluating the possible financial impact on Northwest if unfavorable variances in these factors occur, we considered how the Financial Plan would change should Northwest achieve levels more consistent with industry forecasts for these assumptions. While revenues declined by up to seventeen percent for 1995 as a result of such changes, management outlined a series of alternative operating expense and capital expenditure assumptions that would be more consistent with the slower rate of revenue growth and that would offset much of the reduction in revenue. The remaining shortfall in cash flow was assumed by management to be made up by funds provided by the sale of accounts receivable, on-time repayment of certain debt obligations that were assumed to be paid early in the Plan, and other financings, including the MAC Financing, that were not included in the Plan. In general, even under these assumptions the Company continues to project that Available Revenues will be sufficient to pay its financial obligations during the term of the Financial Plan.

In the event that the strong performance of the airline industry anticipated by industry analysts is not achieved during 1991 to 1995 or that Northwest is not successful in performing at levels comparable to the industry, the Company would face even lower levels of revenue, profitability, and cash flow. This would require the Company to implement further operating expense and capital expenditure reductions and to undertake additional financing transactions beyond those outlined above to provide funds to pay its financial obligations. Typically, such transactions would include refinancing of maturing obligations.

The major existing commitments that require the Company to make large payments throughout the 1991 to 2000 time period include:

- Remaining portions of the Senior Bank Debt maturing over the next six years;
- Airbus and GE/SNECMA loans due over the next six years;
- Redemption of preferred stock issues in 1998 and 1999; and
- The Japanese land mortgage maturing in 2000.

While the preferred stock redemptions and the Japanese land mortgage are scheduled to be paid, these obligations have certain nonpayment provisions. The preferred stock redemption is "mandatory" at the specified dates only if funds are available and, thereafter, only when funds become available. The Japanese land mortgage is non-recourse to the Company and, in the event payment is not made, would result only in the loss of the property serving as collateral.

In addition, the Company plans to spend billions of dollars on capital expenditures throughout the 1991 to 2000 time period, primarily for the acquisition of new aircraft to replace its aging fleet, to provide increased capacity, and to meet federal noise reduction standards. The 1991 to 1995 portion of this capital expenditure program is included in the Plan. The amount required during 1996 to 2000 and beyond will be dependent on the events in the industry as they evolve throughout the Plan period.

Management has outlined a series of debt and equity financing alternatives should additional capital be required either during the 1991 to 1995 Plan period or during the longer term 1996 to 2000 capital planning horizon. Northwest believes these alternatives would provide it with the flexibility to continue to meet its financial obligations if circumstances demand. Such on-going planning is especially important given Northwest's highly leveraged position in an industry that is dominated by many factors outside of the control of management that can dramatically affect its financial performance. The non-equity financing alternatives outlined by management are:

- Refinancing the remaining balance of the Senior Bank Debt;
- Renegotiating the mandatory redemption in 1998 and 1999 of the two classes of preferred stock;
- Refinancing the Japanese land mortgage;
- Raising additional cash through further aircraft sale/leaseback transactions; and
- Raising additional cash through further real estate sale/leaseback transactions.

In addition, management also believes that it should be able to raise additional equity through a public or private stock offering.

The amount of funds that may be available through these alternatives at any point in time and at acceptable terms cannot be specifically evaluated as it is not appropriate to evaluate such alternatives beyond a three-to-five year planning time frame. However, assuming the occurrence of the favorable economic and industry conditions projected by industry analysts, Northwest's ability to achieve industry results, and the availability of financing alternatives, such as those identified by management above, throughout the term of the Financing, the future financial condition of the Company should allow Northwest to continue to meet its financial obligations over the remaining period of the Financing. Additional discussion concerning the sensitivity analyses performed and the financing alternatives considered is included in Section IV.

In summary, Northwest has recently incurred large losses, continues to hold a large portion of its Acquisition-related debt, and has little equity. In addition, its prospects for the future are dependent on many circumstances that it does not control. Given this current position, management has outlined a Financial Plan and expense reduction and financing alternatives should the Plan not be achieved. Notwithstanding the financial flexibility suggested by the alternatives outlined above, the current and prospective financial condition of Northwest is such that the proposed Financing has significant elements of risk.

Recognizing the financial risk to MAC should it proceed with the Financing, the Commission must balance the financial risk against the economic development and public policy objectives that must also be considered in undertaking this Financing. MAC should also pursue agreements with Northwest as part of the Financing that would allow MAC to partially mitigate its financial risk through an appropriate combination of the following:

- Collateral sufficient to protect MAC's financial exposure;

- Financial covenants that would enable MAC to monitor the financial performance of Northwest;

- Restrictive covenants that would constrain the level of certain cash transactions that could be detrimental to the Financing, such as redemption of preferred stock or payment of dividends or other distributions; and

- Repayment provisions that would ensure the Financing is repaid in total or proportionately in the event of significant changes in the Company.

In addition, MAC should require that Northwest obtain a waiver from Banker's Trust concerning the financial covenants associated with the Senior Bank Debt that the Company is not expected to meet. Obtaining a waiver is necessary, based on the Company's Financial Plan, in order to avoid possible default.

In referring to our report, reference should be made to this letter and the accompanying Sections I, II, III, and IV that together comprise the Price Waterhouse report to MAC on the financial condition of Northwest. Reference should also be made to the Airline Economics, Inc. report on the airline industry, included as Appendix I of this document.

* * * * *

We appreciate the opportunity to work with representatives of MAC and Northwest on this most important project.

Yours very truly,

Price Waterhouse

METROPOLITAN AIRPORTS COMMISSION

FINANCIAL ANALYSIS OF NORTHWEST

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I. OVERVIEW, SCOPE AND APPROACH

A. Overview and Statutory Requirement

At the request of the Metropolitan Airports Commission, we have completed an analysis of the financial condition of Northwest and its affiliated companies. The corporate structure of Northwest includes Wings Holdings Inc., the holding company of NWA Inc. NWA Inc. is the parent company of Northwest Airlines, Inc. and the other operating subsidiaries including:

- Northwest Aerospace Training Corp. (NATCO);
- Northwest Aircraft, Inc.;
- MLT Vacations, Inc.;
- Cardinal Insurance Company;
- Northwest Pars, Inc.; and
- Northwest Computer Services, Inc.

Throughout this report we have referred to "Northwest" or the "Company." All such references are inclusive of the affiliated companies.

This analysis was performed in connection with a proposed financing transaction between MAC and Northwest, primarily involving the sale by Northwest of the NATCO pilot training facility and related equipment and other facilities located adjacent to the Minneapolis/St. Paul International Airport (MSP) to MAC. The proposed purchase is to be financed by General Obligation Bonds and Revenue Bonds to be issued by MAC. Debt service on these bonds is to be provided through the lease payments to be made by Northwest to MAC for these facilities.

The proposed MAC Financing is part of an overall economic package for the Company that was authorized under Minnesota Laws 1991, Chapter 350 (the "Statute"). Article 2, subdivision 3(a) of the Statute provides that:

> "Before the commission may issue the revenue bonds described in subdivision 1, the commission must receive, in form and substance satisfactory to the commission ... a written report ... on the financial condition of the airline corporation ... projecting available revenues of the airline corporation at least sufficient during each year of the term of

> the proposed revenue bonds to pay when due all financial obligations of the airline corporation under the revenue agreements and leases described in subdivision 1 and stating the factors on which the projection is based;"

In general, the Statute requires an assessment of the Company's financial condition. In performing such an assessment in accordance with the requirements of the Statute, it is necessary to first define several of the terms used by the Statute in context of Northwest and the proposed Financing. Accordingly, in order to provide the required basis for our work, we have used the following definitions for purposes of this report:

- The term "financial condition" includes an analysis of those factors relevant to a determination of whether the Company can, in the normal course of business, meet its financial obligations as they come due.

- The term "available revenues" includes earned revenue and other resources that may be expected to be made available to the Company in the normal course of business, including proceeds from financing or refinancing transactions and the sale of assets.

- The term "during each year of the term of the proposed revenue bonds" recognizes that businesses are subject to economic cycles that can affect year-to-year financial results and that the ability to forecast beyond a normal business planning horizon of three to five years is generally not appropriate and that, except for preexisting commitments that extend beyond this planning time frame, such estimates would be unreliable.

- The term "financial obligations" includes both the leases described in subdivision 1 of the Statute to be entered into as a part of this Financing transaction as well as all other payment obligations of the Company that if not made would result in a default. Obligations which are non-recourse to the Company or are payable after the due date on a "when available" basis are not considered to be within the definition of the Statute.

The remainder of this Section presents our approach and scope in analyzing Northwest's financial condition. In connection with the proposed Financing transaction, MAC has engaged Airline Economics, Inc. to prepare an analysis of the US airline industry and the relative position of Northwest within the industry. The AEI report, entitled "Status of the US Airline Industry and Northwest Airlines," is included as Appendix I to this report. Section II includes a summary of the airline industry and Northwest's position in the industry. Our assessment of Northwest's current financial condition is included in Section III. Our analysis of management's Financial Plan for 1991 - 1995 is detailed in Section IV.

In referring to our report, reference should be made to the accompanying letter and Sections I, II, III, and IV that together comprise the Price Waterhouse report to MAC on the financial condition of Northwest. Reference should also be made to the AEI report on the airline industry, included as Appendix I of this document.

B. Approach and Scope

Our approach in analyzing the financial condition of Northwest involved developing an understanding of the following:

- The airline industry;
- Northwest's position within the airline industry;
- Northwest's historical financial and operating performance; and
- Prospects for future financial and operating performance based on Northwest management's five-year Financial Plan.

Our fact-finding efforts for this engagement involved a review of Company documents, external information, and management interviews. While on-site at Northwest, we read a variety of documents including historical financial and operating statements, loan documents, actuarial reports, the five-year Financial Plan and supplemental schedules, and management reports. We also developed an understanding of the financial models supporting the preparation of the Financial Plan. In addition, we reviewed information on the industry prepared by sources other than Northwest including the Federal Aviation Administration, Boeing, AEI, and a variety of industry analysts. Our interviews included Northwest's senior management team and a representative of ALPA. A list of individuals interviewed is found in Exhibit I-A.

Our analysis involved an evaluation of the information obtained in Company documents, interviews, and other industry sources. This included analysis of Northwest's and its competitors' historical performance using various trend and ratio analysis. In assessing the Company's Financial Plan, we evaluated key assumptions that significantly affected future operating results and the sensitivity of changes in those assumptions on the Company's financial performance. Additional insight into the industry, competitor performance, and industry and Northwest prospects for the future was provided by AEI.

We separated our evaluation of the Company's Plan concerning its expectation for future financial performance into distinct time periods to understand the various factors influencing the Company's financial condition and to match these respective time frames with the planning cycle and the availability of information:

- the first 1-2 years, referred to as the "operating cycle," is based on recent historical trends and short-term assumptions contained in management's Financial Plan;

- the 3-5 year period or "business planning cycle" is based on information and assumptions contained in management's Financial Plan;

- the period comprising years 6-10 may be considered the long-term capital planning horizon and includes information on prior capital commitments, potential capital expenditures, and long-term financing needs with little, if any, information on the potential operating and financial performance of the Company; and

- the period following the tenth year for which there is essentially no specific information that can be evaluated and relies exclusively on the continuation of Company and industry trends occurring in the 1-5 and 6-10 year periods.

During the course of our work, Northwest has been mentioned in the press regarding financial transactions with a number of carriers. The transactions mentioned involve acquisitions or mergers or some form of investments or loans in exchange for routes, management agreements, or other alliances. The airlines include:

- America West;

- British Airways;

- Continental;

- Hawaiian Air;

- KLM;

- Pan Am;

- Quantas; and

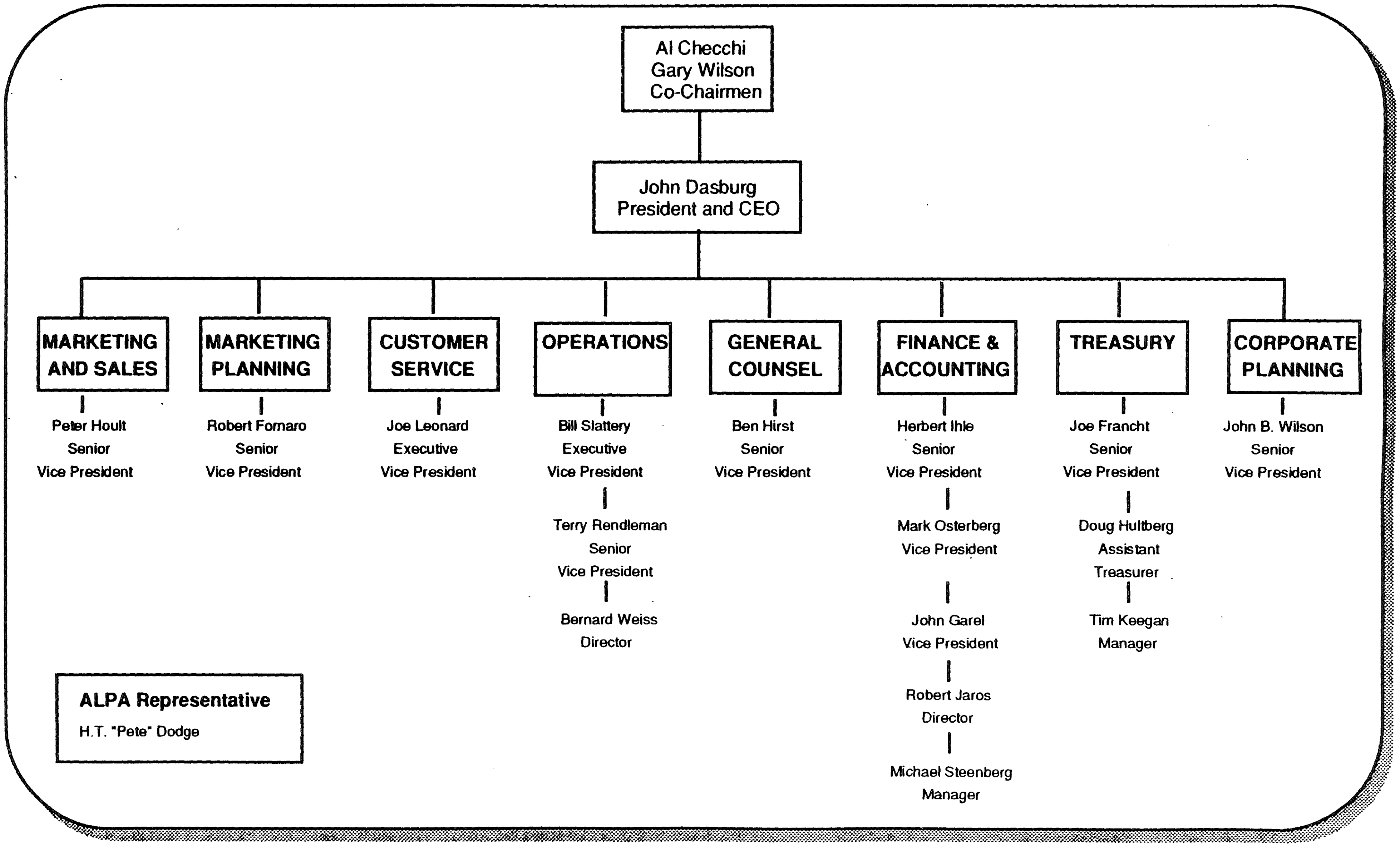
- Trump Shuttle.

In addition, the Company has recently announced the pending acquisition of Midway Airlines. The terms of this acquisition are not yet final.

The Company's Financial Plan does not assume the completion of any of these potential transactions, including the Midway acquisition, and our analysis did not consider the merits, feasibility, or likelihood of any such transactions. Accordingly, in the event that any of these or similar transactions were completed, it would represent a change in the Financial Plan and, depending on the size and structure of such transaction, may affect the resulting financial condition of Northwest.

Northwest Interviews

Exhibit I-A



II. INDUSTRY

A. Industry Assessment

In connection with the proposed Financing transaction, MAC has engaged Airline Economics, Inc. to prepare an analysis of the US airline industry and the position of Northwest within the industry. The AEI report entitled "Status of the US Airline Industry and Northwest Airlines," is included as Appendix I. A summary of the airline industry's prior performance and Northwest's position within the industry is provided below.

The airline industry has undergone significant changes since deregulation in 1978. In the years immediately following deregulation, the US economy endured a recession. The recession severely impacted the airline industry and by 1983 consolidation was occurring within the industry. Heavy losses through the recession and into 1983 - 1984 forced several carriers into bankruptcy or mergers. This consolidation continued throughout the 1980's producing eleven dominant carriers.

The eleven dominant carriers earned record profits in 1985-88, but profits subsided in 1989 and early 1990 as overcapacity, increasing fuel prices and a general reduction in passenger traffic affected the industry. The Persian Gulf conflict and skyrocketing fuel prices dramatically escalated the industry downturn as costs soared and passenger traffic declined. Airlines attempted to recover some of the higher fuel costs through higher airfares only to see the higher fares further depress passenger traffic. The result was record losses for the industry in the last half of 1990 and first half of 1991. These events accelerated the consolidation process as four additional major airlines entered bankruptcy, and Eastern discontinued operations.

As a result of mergers and bankruptcies within the industry, American, Delta, and United now dominate the industry with a collective 56% market share. Northwest is ranked fourth with 12.8% of the market, Continental is ranked fifth with 10.3% of the market and USAir is ranked sixth with 8.3% of the market.

Dominance of the industry by American, Delta and United is increasing with the current acquisitions of assets from failing and bankrupt carriers. These latest acquisitions will provide American, United and Delta with a dominating global presence. Northwest is also globalizing its route network.

Industry sources believe the future of the industry will turn to globalization of air transportation. The US carriers have a strong presence in the world market. As this presence increases, it is anticipated the government will relax regulations on air rights for foreign carriers and liberalize the air route authorities in various parts of the world. US carriers would like to see foreign countries open their skies for participation in foreign domestic markets. In exchange they would be willing to allow foreign carriers to operate in US domestic markets. This position is favored because the carriers believe their strong presence in the United States can be protected while simultaneously expanding their access to and within the Atlantic and Pacific regions.

Industry expansion is evidenced by the extensive orders and options for new aircraft. Large quantities of aircraft are on order by American, Delta and United. However, these quantities may change as management reacts to the changes in demand and financial conditions. Carriers may be able to manage the increases in capacity by pacing the retirement and purchases of aircraft.

AEI's outlook for the industry is favorable. According to AEI, continued consolidation and favorable economic conditions should result in an industry turnaround sometime in 1992. Profitability should attain the record levels experienced during 1985 -1988 over the next three to five years. However, recent operating results at several major airlines and news articles suggest the level of consolidation necessary to return to desired profitability levels may not be occurring as rapidly as expected.

B. Northwest's Industry Position

In order to compare the historic operating performance of Northwest relative to trends over time and to competitors in the industry, the following four factors are commonly used:

- Available seat miles;
- Passenger load factor;
- Passenger yield; and
- Cost per available seat mile.

Northwest is generally considered to be the fourth largest US carrier, ranking behind American, Delta and United. Northwest is currently the largest US carrier in the Pacific and also provides service in the Atlantic and most major cities in the US Presented below is an analysis of Northwest's results from 1987 to 1990, along with comparative data for several of the largest domestic airlines, using these four factors.

<u>Available seat miles</u> (ASMs) represent the industry's capacity to provide passenger service. ASMs is calculated as the total of all seats on all flights times the number of

miles flown during the year. Increases in ASMs represent growth in an airline's ability to provide services and, possibly, increase market share. Increases in available seat miles or capacity also provides the opportunity for the Company to generate more revenue. As shown in Exhibit II-A and II-B:

- ASMs have grown from 22.9 billion in 1977 to 77.3 billion in 1990. This is an average annual growth of approximately 9.8%. The largest single increase in available seat miles occurred with the acquisition of Republic in 1986.

- The growth in ASMs from 1986 to 1990 elevated Northwest from approximately number ten in market share to number four behind American, United and Delta.

- Northwest's growth in ASMs from 1987 to 1990 was 6.1%.

Passenger load factor indicates how well an airline is using its capacity. It is stated as a percentage and represents the number of seats used by paying customers during a flight. Exhibit II-C and II-D show:

- Load factor increased from 64.4% in 1987 to 66.6% in 1990. The Company's average load factor for the four year period was 65.4%. Increases in load factors are an indication the Company is utilizing capacity in a more efficient manner or experiencing a higher passenger demand.

- Northwest's load factor has been generally consistent with the industry and increased slightly in 1990 over 1989 to lead the top five carriers.

Passenger yield measures how much revenue is earned on one revenue passenger mile. Revenue passenger miles are determined by multiplying the available seat miles by the load factor. Average passenger yield earned over a year is an important factor in determining both revenues and profitability. Historical results suggest an inverse relationship between load factor and yield (i.e., higher load factors are generally associated with lower average yields). Thus, as load factors increase indicating increased utilization of capacity, revenue passenger miles will increase. However, if the additional seats are filled with passengers paying lower air fares, passenger yields will decline. The percentage increase in passenger revenue will then be less than the percentage increase in revenue passenger miles. In addition, the route structure of an airline heavily influences passenger yields with long-haul routes generally having lower yields than short-haul routes. See Exhibits II-E and II-F.

- Northwest's passenger yields grew an average of 3.6% a year from 11.05 cents in 1987 to 12.31 cents in 1990.

- Northwest's system-wide passenger yields remained stable in the 1989 and 1990 periods but lagged behind American, Delta, and United in 1990. These carriers experienced growth in yields from 1989 to 1990, whereas Northwest did not.

- Northwest's Domestic passenger yield was higher than industry prior to the Acquisition and slightly lower than industry following the Acquisition as shown below:

Table II-1
Domestic Passenger Yield
(in cents)

	1987	1988	1989	1990
Northwest	11.73	12.54	13.02	13.24
Industry	11.20	12.23	13.07	13.25
Premium	.53	.31	(.05)	(.01)

Source: FAA Report
Northwest Financial and
Statistical Report 1987, 1989
Northwest Financial Plan

<u>Cost per ASM</u> measures the cost of operations per available seat mile. (Operational costs do not include depreciation, aircraft rental expenses, and interest.) Exhibit II-G shows:

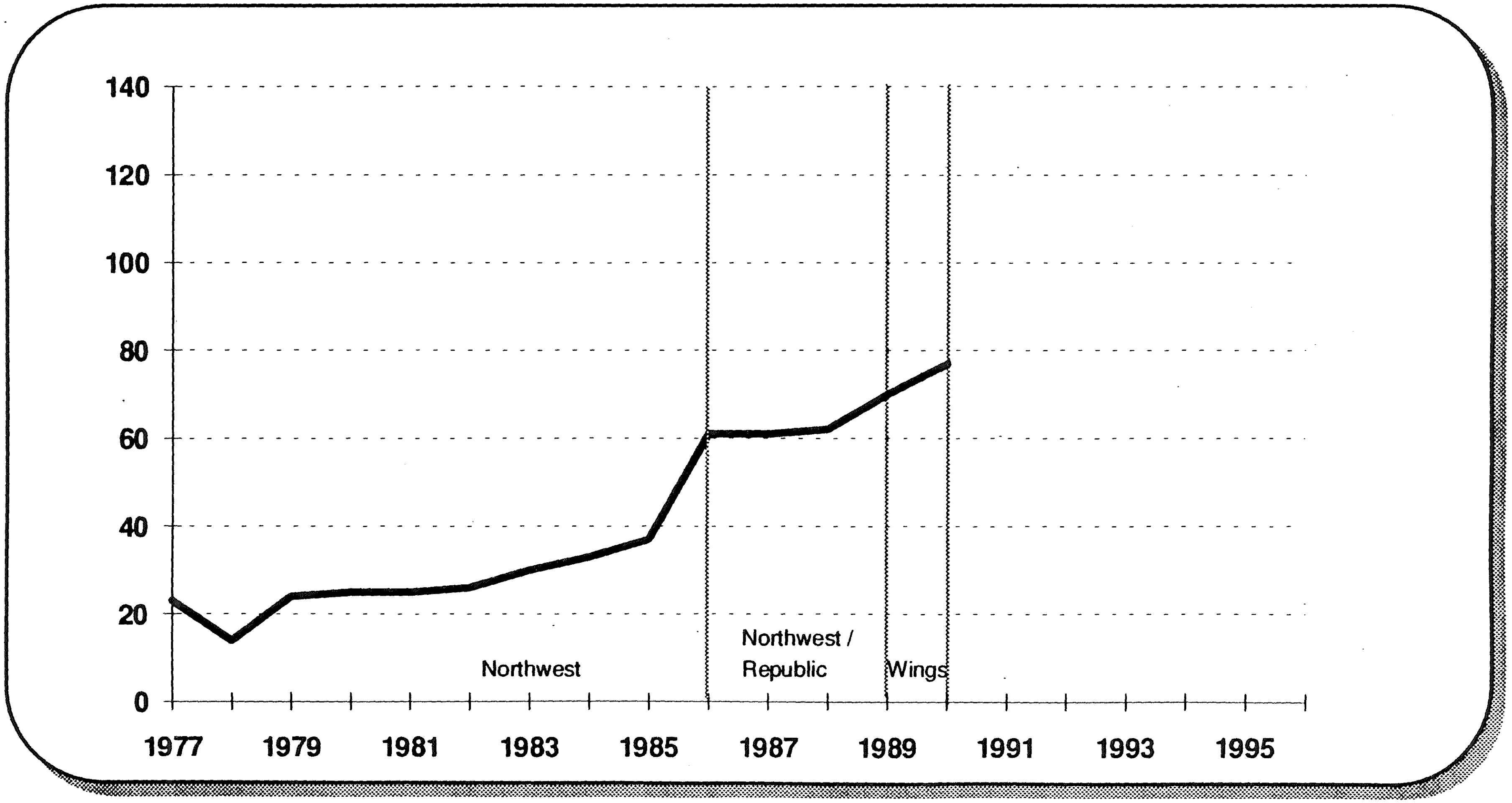
- Cost per ASM increased from 7.9 cents in 1987 to 9.4 cents in 1990. This is an average annual growth of 6.0%.

- At 6.0%, costs of operations have increased at a faster rate than the 3.6% increase in yield.

- Northwest's cost per ASM is within the range of the major carriers. This indicates the Company's operating expenses are consistent with the larger airlines. 1989 to 1990 cost per ASM for Northwest increased by approximately the same magnitude as did United's and American's.

Exhibit II-A

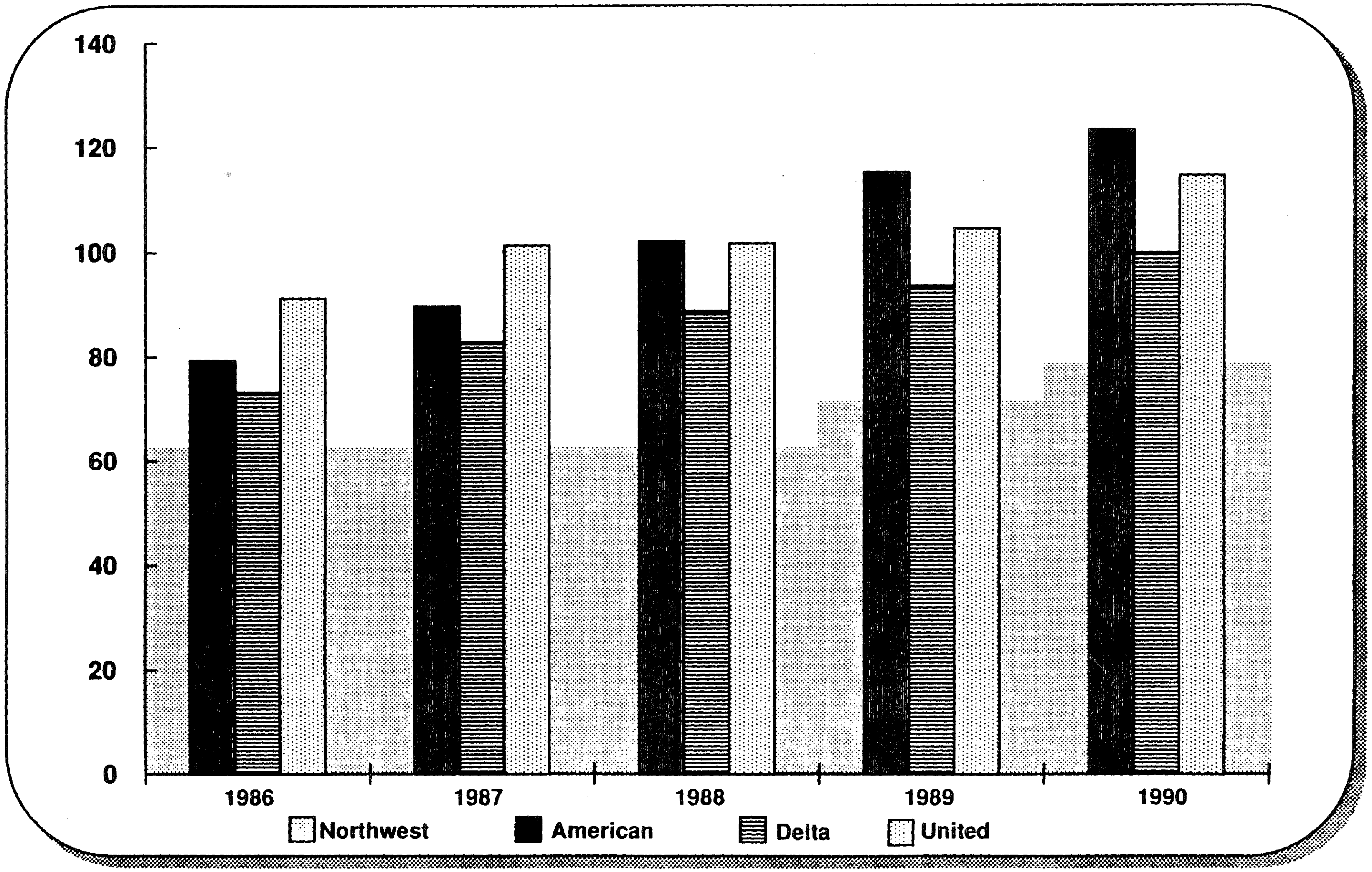
Northwest
Historical System-Wide Available Seat Miles
(in billions)



Sources: Northwest 1986 Annual Report
Northwest Financial and Statistical Reports, 1987 and 1989
Northwest Five Year Financial Plan, August 12, 1991

Exhibit II-B

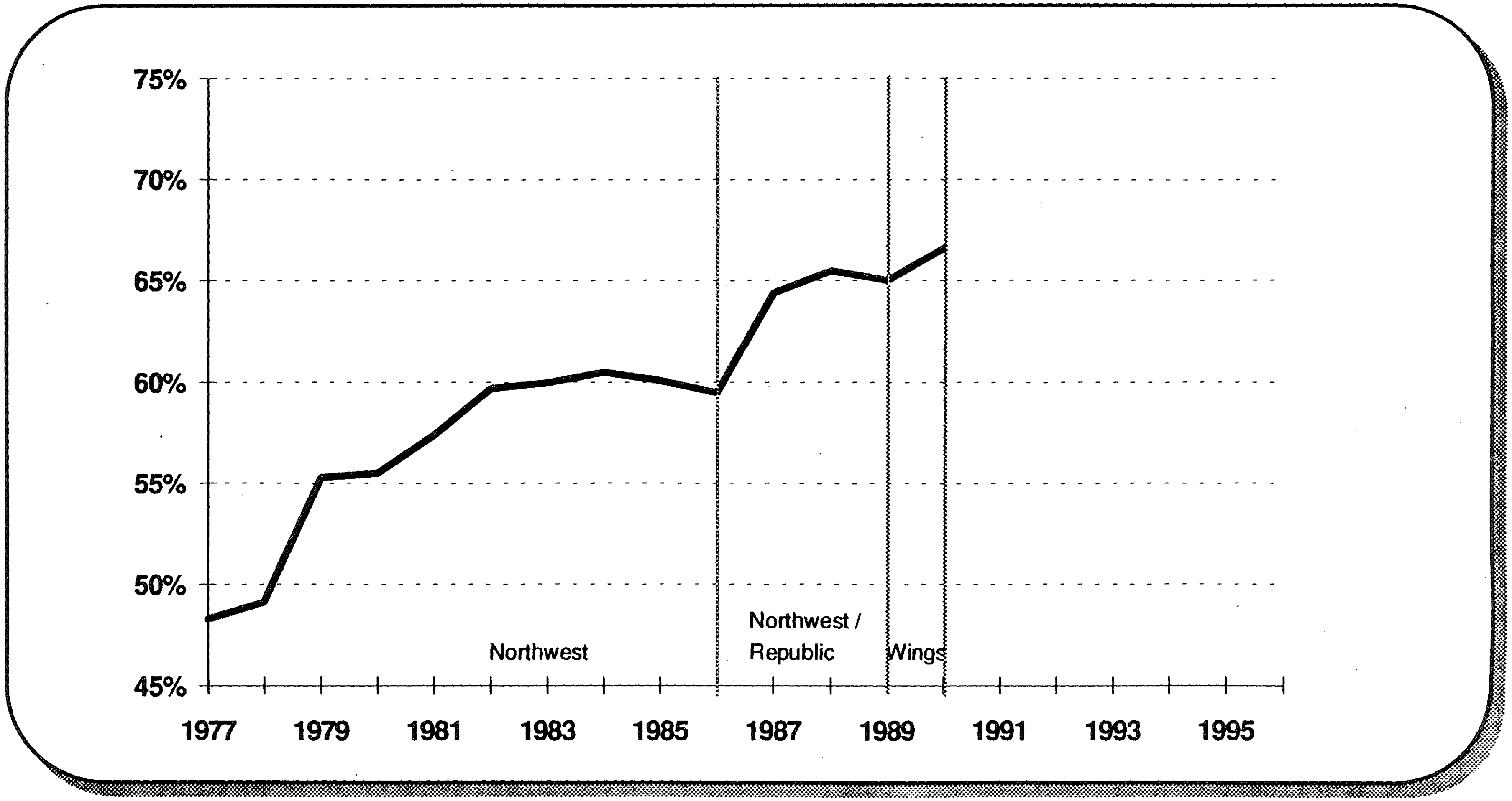
Northwest
Industry Available Seat Miles
(in billions)



Source: Airline Economics

Northwest
Historical System-Wide Load Factors

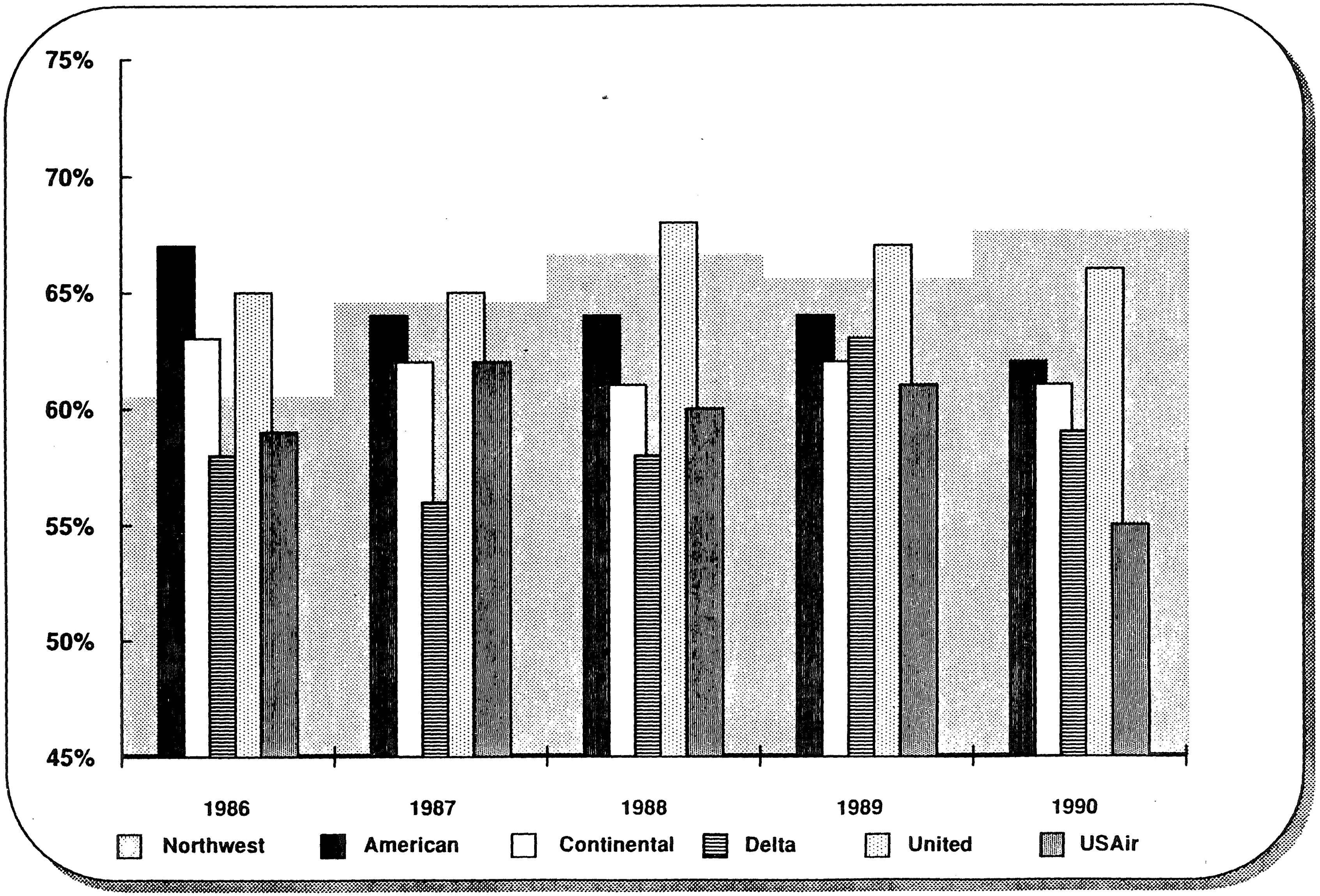
Exhibit II-C



Sources: Northwest 1986 Annual Report
Northwest Financial and Statistical Reports, 1987 and 1989
Northwest Five Year Financial Plan, August 12, 1991

Exhibit II-D

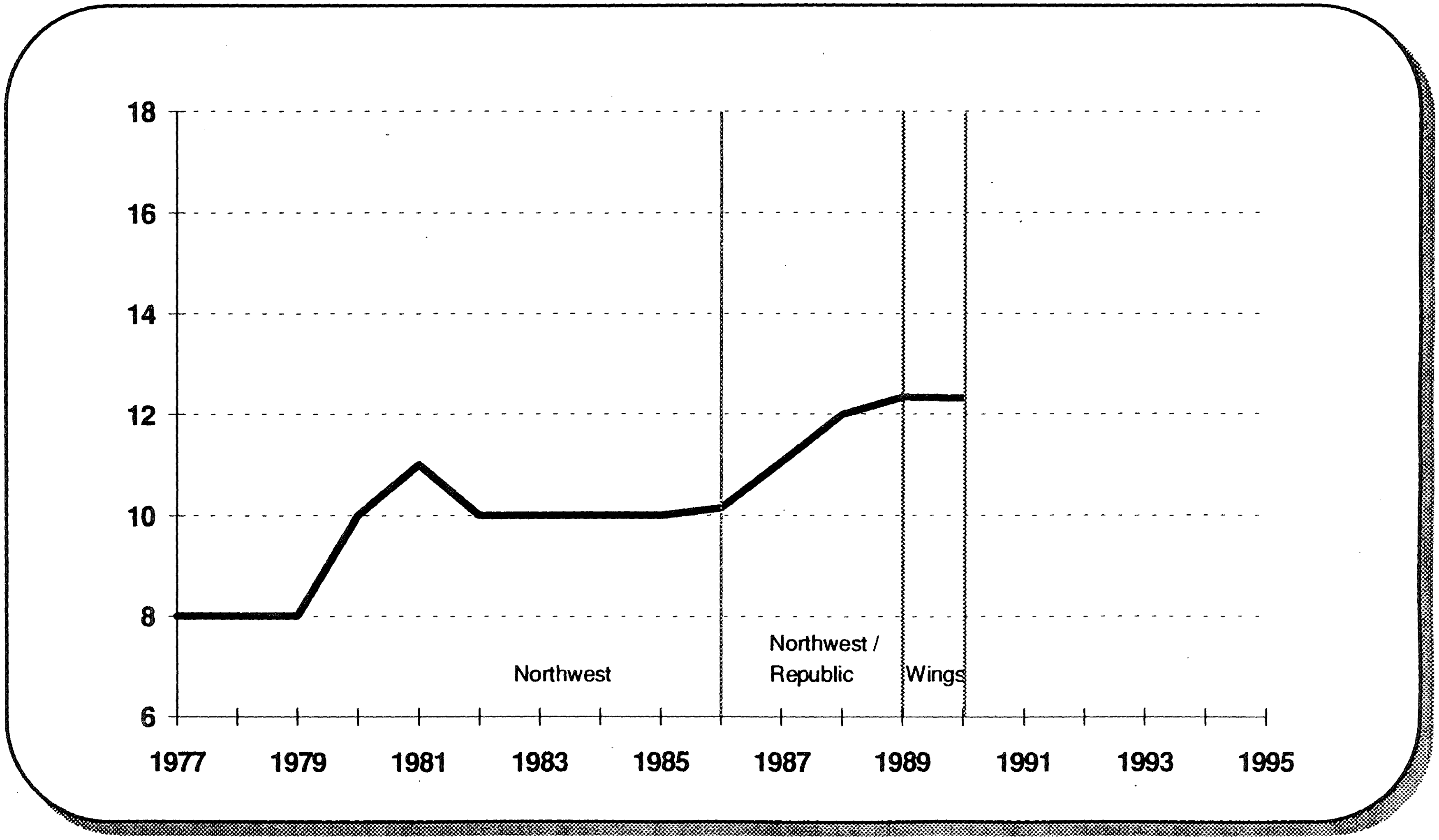
Northwest
Industry Load Factors



Source: Airline Economics

Northwest
Historical System-Wide Passenger Yield
(in cents)

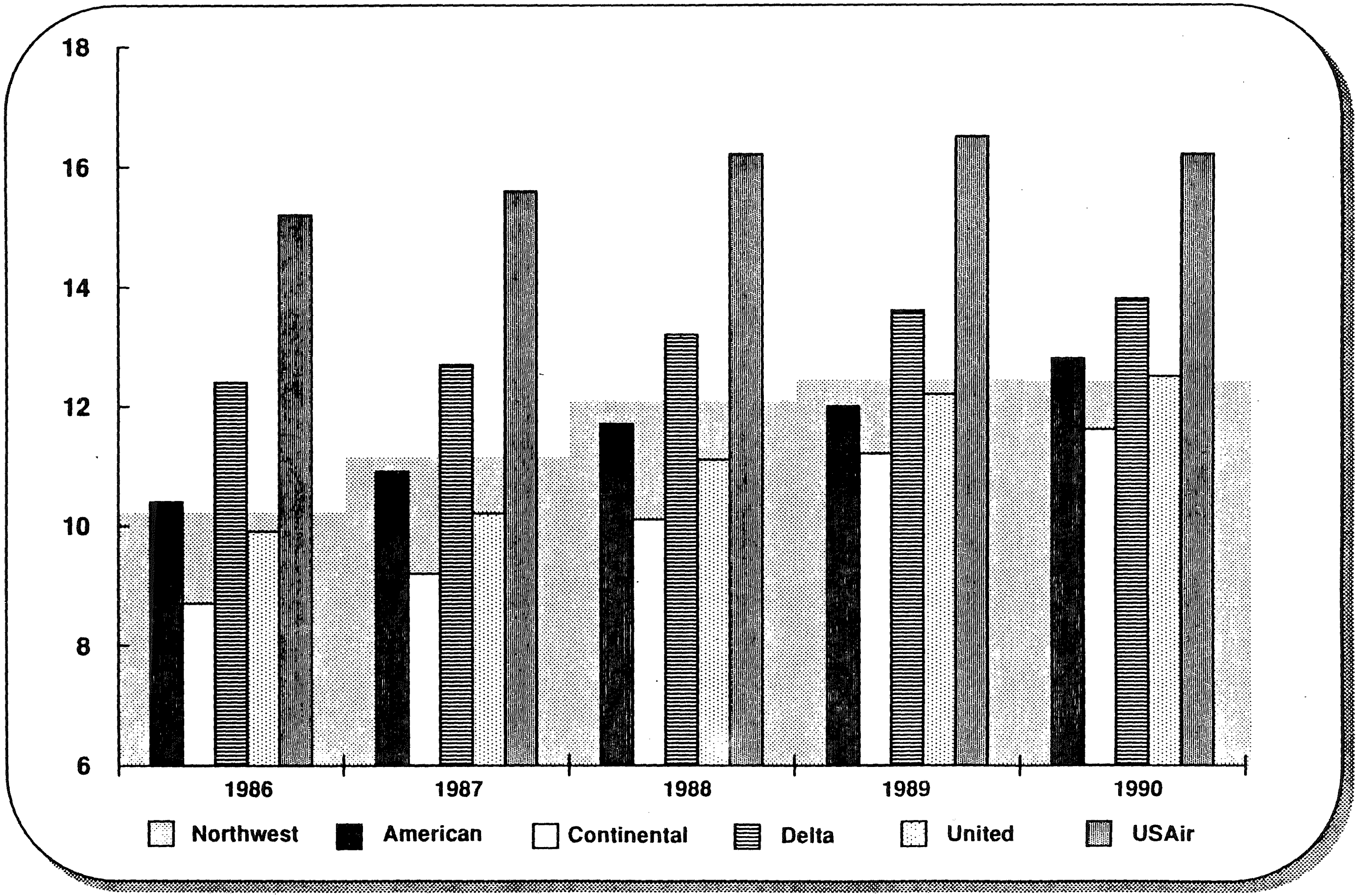
Exhibit II-E



Sources: Northwest 1986 Annual Report
Northwest Financial and Statistical Reports, 1987 and 1989
Northwest Five Year Financial Plan, August 12, 1991

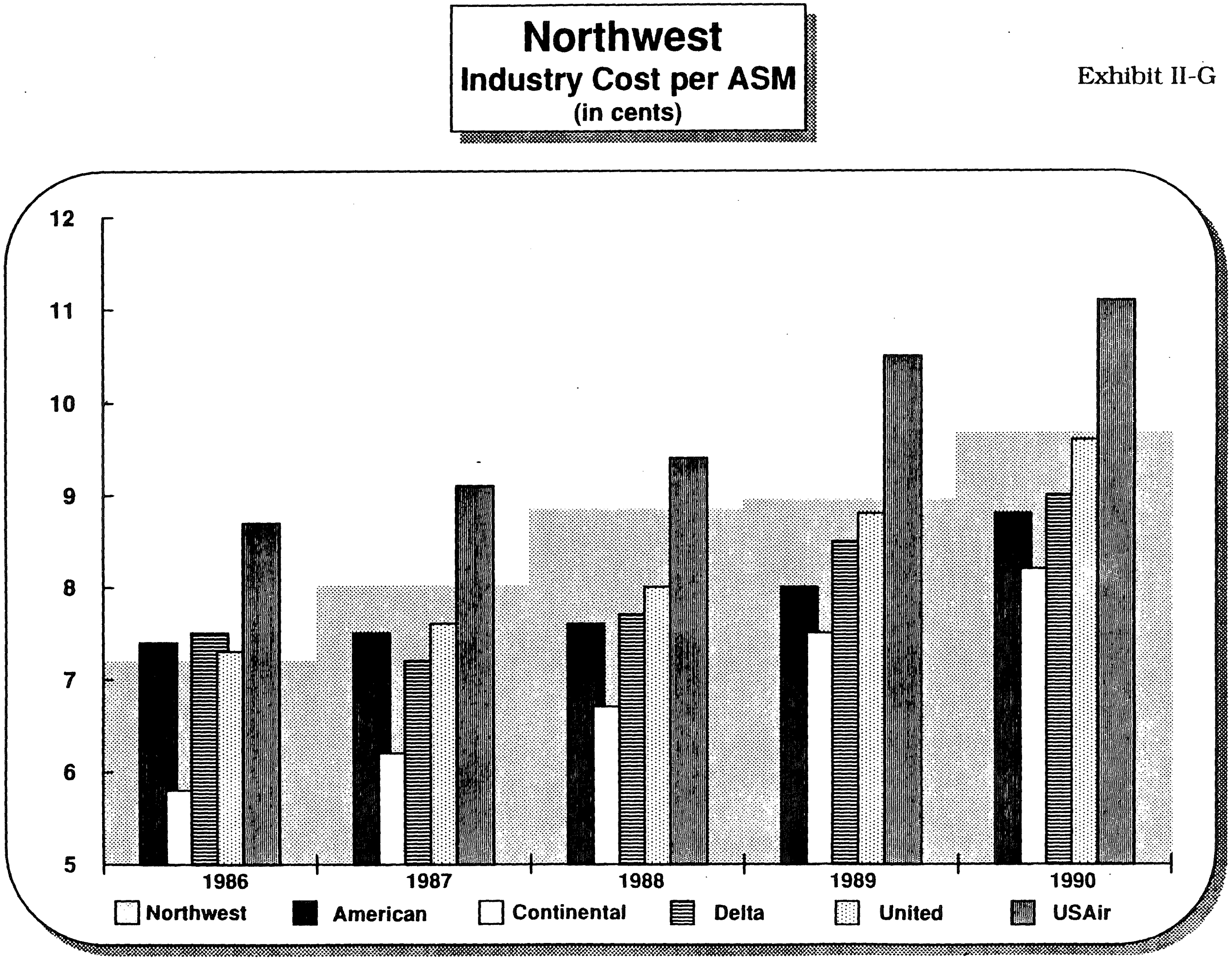
Exhibit II-F

Northwest
Industry Passenger Yield
(in cents)



Source: Airline Economics

Exhibit II-G



Source: Airline Economics

III. CURRENT FINANCIAL CONDITION ASSESSMENT

For purposes of assessing Northwest's current financial condition, we analyzed the Company's historical financial performance and the Company's position in the airline industry. The factors we considered in analyzing Northwest's current financial performance and condition include the following:

- Operating results;
- Sources and uses of cash;
- Equity structure;
- Composition and age of property and equipment; and
- Other obligations, including off-balance sheet financing transactions.

A summary of our analyses of these factors is presented below. A comparative analysis of the Company's financial results and position with other major carriers is also presented.

A. Operating Results

To evaluate current operating results, we analyzed the Company's annual financial performance from 1977 to 1990 and eight month performance ending August 31, 1991. For comparative purposes, we present selected historical financial results comparing the most recent four year period 1987 through 1990. Because of the acquisition of Republic in 1986 and the Wings Acquisition in 1989, the financial results in these two years include the impact of these transactions. Fiscal years 1987 and 1988 results are inclusive of the Republic acquisition. The only full year following the Acquisition is 1990. However, 1990 was affected by the Persian Gulf conflict.

The most recent available financial data is for the period ended August 31, 1991. When compared to the 1990 results for the same period, it provides a comparative indication of the most recent performance of Northwest. However, as the Persian Gulf conflict started on August 2, 1990, the 1990 results through August were only marginally affected by it. By comparison, the 1991 eight month results include several months of active conflict and the transition period following the secession of hostilities.

As is illustrated in Exhibit III-A, the Company's operations over the period 1987 to 1991 are characterized by:

- An increase in operating revenues from $5.1 billion in 1987 to $7.4 billion in 1990. This is an annual average growth of 13.0%. Eight month results for 1990 to 1991 show a revenue growth of 3.6%.

- Manageable expenses include salaries and benefits, fuel, commissions, maintenance, landing fees, non-aircraft rents and depreciation, and other. Manageable expenses increased from $4.6 billion in 1987 to $6.9 billion in 1990. This is an annual average growth rate of 14.8%. Manageable expenses during this period increased on the average 1.8% more than operating revenues.

- Income contribution, defined as revenues less manageable expenses, increased from $536 million in 1987 to $775 million in 1989. However, it declined to $466 million in 1990. Eight month results show a $104 million decline from $530 million in 1990 to $426 million in 1991.

- Ownership costs include aircraft rents and depreciation, and interest expense. Ownership costs increased from $445 million in 1987 to $941 million in 1990. The income contribution generated from 1986 to 1989 provided sufficient funds to cover ownership costs. However in 1990, the year following the Acquisition, income from operations was insufficient to cover the increases in interest and aircraft rental payments. Ownership costs for the eight months ending August 31 remained stable from 1990 to 1991.

- Net earnings increased from $103 million in 1987 to $135 million in 1988 the two years prior to the Acquisition. Net earnings declined in 1989 to $67 million. In 1990 the Company incurred a net loss of $302 million due to the increasing costs of interest and aircraft rental associated with transactions from the Acquisition and the effects of the Persian Gulf conflict. Eight month results for 1991 show a decline from a loss of $48 million in 1990 to a 1991 loss of $126 million.

Retained earnings over this period amounted to negative $560 million. This has reduced the Company's common stockholders' equity to negative $153 million as of December 31, 1990 and negative $335 million as of August 31, 1991. Total common and preferred equity at August 31, 1991 was positive $176 million.

Exhibit III-B depicts historical earnings and losses over the fourteen-year period from 1977 to 1990. Years 1977 to 1985 reflect only Northwest results and have not been restated to add in the separate Republic results.

B. Sources and Uses of Cash

The presentation of a Company's cash flows can be divided into three principal areas:

- Cash flows from operations - the net earnings (losses) for the period with adjustments for any non-cash changes that were incurred such as depreciation and amortization and changes in working capital.
- Cash flows from financing activities reflects the proceeds from the sale (purchase) of any stock and the issuance (repayment) of any debt obligations.
- Cash flows from investing activities includes expenditures made by the Company for capital expenditures, acquisitions, or other long-term investments.

While Northwest has incurred net losses in the two years following the Acquisition, the Company has generated positive cash flow from operations of $571 million from February 23, 1989, the date of the Acquisition, through August 31, 1991, as shown below.

Table III-1
Cash Flow From Operations
February 23, 1989 to August 31, 1991
($ in millions)

Net earnings	$(439)
Depreciation and amortization	765
Net change in working capital	302
Other adjustments	(57)
Total cash flow from operations	$571

Source: Northwest Financial Statements

As the table indicates, over half of the cash generated by the business was due to changes in working capital. A further analysis of the change in working capital shows a large portion resulted from an increase in working capital liabilities from $1.6 billion to $1.9 billion over the period.

The Company has used cash flow from operations and from financing activities to fund investing activities including the Acquisition, aircraft purchases, and other costs. These investing activities were as follows:

Table III-2
Cash Flow From Investing Activities
February 23, 1989 to August 31, 1991
($ in millions)

Acquisition costs	$(3,403)
Additions to property and equipment	(1,472)
Other	(152)
Total cash flow from investing	$(5,027)

Source: Northwest Financial Statements

Because of the magnitude of the Acquisition and subsequent aircraft purchases, the Company has used financing activities such as increasing debt and issuing new stock to generate the additional cash that was needed. These financing activities were as follows:

Table III-3
Cash Flow From Financing Activities
February 23, 1989 to August 31, 1991
($ in millions)

	Acquisition-Related	Other	Total
Net increase in debt	$2,367	$1,603	$3,970
Initial issuance of stock	666	0	666
Payments of preferred dividends	0	(60)	(60)
Other	0	(93)	(93)
Total cash flow from financing	$3,033	$1,450	$4,483

Source: Northwest Financial Statements

By adding the total cash flows from operations, investing and financing, the change in the cash flow can be calculated. From February 23, 1989 to August 31, 1991, cash (including cash equivalents and marketable securities) increased from $0 to $27 million. As illustrated above, the Company has obtained a substantial amount of cash from financing activities. This cash was used in the Acquisition to purchase the NWA shares and for capital expenditures.

As noted earlier, the Company incurred $3.1 billion of senior bank debt to finance the Acquisition. As of August 31, 1991, the outstanding balance of the Senior Bank Debt was $1.425 billion:

Table III-4

Senior Bank Debt Outstanding Balance

($ in millions)

Senior Bank Debt, original balance	$3,100
Repayment - 1989	(442)
Repayment - 1990	(1,231)
Repayment - 1991	(2)
Senior Bank Debt, Aug. 31 balance	$1,425

Source: Northwest Financial Statements

Although it is impossible to determine the exact sources of the cash used to repay the Senior Bank Debt, it appears the following were used to fund repayments:

Table III-5
New Acquisition-Related Obligations
($ in millions)

Proceeds of Airbus and GE/SNECMA loans	$ 500
Proceeds of UTC loans	100
Proceeds of Japanese land mortgage	379
Operating leases resulting from sale/leaseback transactions of existing property	227
New Acquisition-related obligations	1,206
Internally-generated funds	469
Total payments of Senior Bank Debt	$1,675

Source: Northwest Financial Statements

Based on this analysis, the Company has reduced the total Acquisition-related debt by approximately $469 million. The majority of the reduction was financed by cash flow from operations including earnings and changes in working capital. However, new obligations of $1.2 billion were incurred to reduce the Senior Bank Debt balance as of August 31, 1991. Thus, the total outstanding balance of Acquisition-related obligations is $2.6 billion. This amount is comprised of the current Senior Bank Debt balance of $1.4 billion and new obligations of $1.2 billion.

C. Equity Structure

The equity structure of the Company includes both preferred and common stock. Common shares are held as follows:

Table III-6
Common Stock Ownership as of August 1, 1991
(percentage of total shares)

Shareholders	Total Common
Checchi	21.9%
Wilson	21.9%
Malek	1.3%
Bankers Trust	11.0%
Blum	10.0%
Bright Star	14.0%
KLM	20.0%

Source: 8/1/91 Stock Holdings by Shareholder prepared by Northwest

Based on the allocation of voting shares, Checchi and Wilson control Northwest. Bankers Trust owns a large portion of the non-voting shares. Bright Star and KLM are non-US residents and together hold the maximum amount of voting common shares allowed to be held by foreigners, 24.99%. KLM also owns primarily non-voting shares. There have been no capital contributions by the common shareholders since the Acquisition. There also have been no dividends distributed to common shareholders since the Acquisition.

Holders of preferred stock are not allowed to vote regarding the Company's decisions. They have the right to receive annual stated dividends at the rate of 14% in the form of cash or stock. Both the Series A and B stock are redeemable. All outstanding shares of Series A stock must be redeemed prior to any redemption of the Series B stock. Series A is redeemable in full at the earlier of July 26, 1998 or the change in control of the Company. Series B is redeemable at any time in whole or in part, as long as all of the Series A stock is redeemed, and if not redeemed earlier, is redeemable at the earlier of July 26, 1999 or the change in control of the Company. The preferred stockholders are:

Table III-7
Preferred Stock Ownership as of August 1, 1991
(number of shares owned)

Shareholders	Series A	Series B
Bankers Trust	0	1,314
Blum	0	1,314
Elders	0	1,314
KLM	5,000	1,273

Source: 8/1/91 Stock Holdings by Shareholder prepared by Northwest

The redemption price for each share of preferred stock is $50,000 (see Section IV-H "Capital Structure").

In 1990 and year-to-date August 1991, the Company issued the following dividends:

- In 1990, the Company paid cash dividends of $28 million to Series A preferred stockholders.

- In 1990, the Company issued stock dividends of $29 million to Series B preferred stockholders and paid cash dividends of $1.6 million. The cash dividends were paid because the Company does not issue partial shares of stock.

- In the first eight months of 1991, the Company paid cash dividends of $30 million to Series A preferred stockholders.

- In the first eight months of 1991, the Company paid stock dividends of $25 million and cash dividends of $800 thousand to Series B preferred stockholders.

D. *Composition and Age of Property and Equipment*

As of December 31, 1990, Northwest operated a fleet of 332 passenger aircraft and 350 passenger aircraft as of August 31, 1991 (Exhibit III-C). Federal regulations and aircraft manufacturer technical bulletins call for regular maintenance checks on all aircraft at various points in the life of the aircraft. The two regulations affecting Northwest's fleet are: (1) federal regulation of Stage 2 aircraft and (2) maintenance of aging (25 years old) aircraft. Stage 2 aircraft have older technology, are less fuel efficient, generally require three-person flight crews, and most importantly, are noisier during takeoff and landing. The most significant regulation affecting Northwest is the phase out of Stage 2 aircraft.

Issues the Company must address while complying with Stage 2 federal regulations are:

- Stage 2 aircraft are to be retired or retrofitted and additional Stage 3 aircraft are to be purchased to comply with the regulations by the year 2000.

- Aircraft retirements may need to be accelerated since planned aircraft retirements will reduce the percentage of Stage 2 aircraft to 22% of the fleet in 1999. Federal regulations require reduction to 15% by 2000.

- All retired aircraft must be replaced in order maintain the same capacity, i.e., ASMs. For growth in volume and market share, net additions over retirements are required.

- Costs of compliance with Stage 2 regulations are the purchase price of a new plane or the price of a hushkit for those aircraft that can be so outfitted.

At the end of 1990, approximately 63% of Northwest's fleet are Stage 2 aircraft, compared with 33% of American's fleet, 53% of Delta's fleet and 66% of United's fleet. Northwest is implementing a program of planned retirement and replacement of Stage 2 aircraft to meet regulations and as of August 31, 1991 had reduced its Stage 2 aircraft to 62%.

Northwest has implemented a maintenance program (ARMAR) to meet the maintenance standards for aging aircraft. This program provides for:

- Overhaul of the aircraft according to FAA regulations in stages. Portions of the overhaul are completed during regular maintenance checks; and

- Costs of overhaul are spread over the life of the aircraft by staging; estimated total cost of an aging aircraft overhaul is up to $10 million.

Six aircraft in the Northwest fleet need to meet aging aircraft regulations. In addition, older models of aircraft will require additional modification in the upcoming years. Northwest is managing compliance and the costs of compliance for aging aircraft with the ARMAR program. This program reduces maintenance costs and down time of the aircraft. Additionally, it saves the cost of purchasing a new aircraft through renovation of older aircraft. Currently, Northwest has completely overhauled four of the six aging aircraft and two are in the process of being overhauled.

E. Other Obligations

A major source of financing for the airline industry is operating leases for aircraft, commonly referred to as "off-balance sheet" financing as they are not reported as a liability on the balance sheet but are disclosed in the footnotes. The Company leases certain aircraft, terminals, land and buildings at airports, reservations offices, and other property and equipment under operating leases. The Company did not lease aircraft until late 1986 when it assumed the operating leases from Republic. Subsequent to the Acquisition, the Company has incurred additional aircraft operating leases through several sale/leaseback transactions.

Although operating lease obligations are not reflected on the balance sheet, the obligation calls for regularly scheduled payments. Operating lease payments for the Company almost doubled from 1987 to 1990. The Company's annual lease obligations in 1990 were $364 million. This compares to 1988, the last full year before the Acquisition of $245 million and $44 million in 1985 before the Republic merger. The 1990 annual report disclosed that the Company will incur average minimum operating lease obligations of $334 million annually over the next five years.

F. Northwest's Comparative Financial Position

Northwest's current financial condition can also be evaluated by comparing the Company's financial performance with that of other airlines using certain financial ratios. Ratios show how various elements of assets, liabilities, equity, revenues, and expenses can be examined as of a point in time or as trends over a period of time.

We calculated six ratios that address the ability to generate funds, ability to pay current obligations, and overall financial leverage. We have performed these comparisons using 1989, 1990, and six-month 1991 data, as of June 30, 1991, where possible. Quarterly reports for the nine months ending September 30, 1991 are not yet publicly available. Also, we have used 1989 as the first comparative year because the December 31, 1989 Balance Sheet reflects the Wings Acquisition. The ratios are as follows:

- Revenue per employee;
- Times interest earned;
- Operating margin;
- Cash flow coverage;
- Debt to equity; and
- Debt to total capital.

Typically, the largest asset base a company has is its employees. To analyze how effectively the air carriers utilized their employees, the relationship between revenues and employees was examined. Table III-8 illustrates revenue earned per employee for each of the airlines is consistent from 1989 to 1990. Northwest earned the largest dollar amount per employee.

Table III-8
Revenue per Employee
($ in thousands)

	1989	1990
Northwest	$164	$169
American	115	114
Delta	138	137
United	142	149
USAir	125	134

Source: Northwest Financial Statements
1990/1991 Company Annual Reports
June 30, 1991 Company 10Q and Quarterly Reports

Times interest earned shows the relationship of earnings before interest and taxes (EBIT) to interest on long term debt. Earnings before interest and taxes represents profit available to meet interest expense. A ratio of 1 means that interest expense can first be met with EBIT. Exhibit III-D illustrates in 1989 four of the five carriers generated sufficient EBIT to cover interest expense. In 1989 Northwest generated EBIT to cover 1.3 times interest expense, which is significantly behind the times interest earned by American, United and Delta. In 1990 economic and worldwide events took their toll on the airlines. Only American generated positive EBIT. Northwest's 1990 earnings before interest and taxes were negative. For the six months ended June 30, 1991, all of the airlines generated a negative EBIT.

Profitability ratios are calculated to evaluate the ability of a company to earn profits. An operating margin reflects the unused percentage of revenues after costs of operations are deducted. 1989 was a profitable year for the airline industry as is illustrated in Table III-9. Each of the airlines except USAir generated at least 4% more revenues than expenses incurred. Economic developments of 1990 caused four of the five airlines to expend more than was earned. Northwest's change in operating margin from 1989 to 1990 is fairly consistent with the negative change incurred by United and American and was not as large as the negative change incurred by Delta and USAir. As of the six months ended June 30, 1991 Northwest's operating margin is comparable with the other carriers.

Table III-9
Operating Margins
(in percent)

	1989	1990	Six months 6/30/91
Northwest	4.0	(1.8)	(3.2)
American	7.1	1.1	(2.7)
Delta	4.9	(4.9)	(1.3)
United	4.7	(0.3)	(3.7)
USAir	0.3	(7.6)	(5.8)

Source: Northwest Financial Statements
1990/1991 Company Annual Reports
June 30, 1991 Company 10Q and Quarterly Reports

Cash flow coverage ratio is calculated to analyze the ability of an airline to cover interest and aircraft rental. Cash flow coverage ratios were calculated by adding back to net income depreciation, interest expense, and aircraft rental and dividing the total by interest expense and aircraft rental. A ratio of 1 means that interest expense and aircraft rental can be met by cash flow. Exhibit III-E illustrates in 1989 four of the five carriers generated sufficient cash flow to cover in excess of 2 times interest expense and aircraft rental. Along with the other carriers, Northwest's ratio of cash flow decreased substantially in 1990. However, as of June 30, 1991 Northwest's decrease was less than that of American and United.

The capital structure of a company consists of long-term debt and equity. Analysis of the composition of these two elements can provide insight into the extent to which debt rather than equity is used to finance assets. Debt to equity and debt to total capital ratios are calculated to measure financial leverage.

Debt to equity measures the number of times the shareholders' capital has been leveraged by the use of debt. A high ratio signifies a substantial use of debt and limited use of equity to finance assets. Exhibit III-F shows that Northwest has a substantially higher ratio of debt to equity than the other four carriers. This is due to the large amount of Acquisition-related debt and minimal equity. America, Delta, United, and USAir all have similar amounts of long-term debt and substantially greater amounts of equity.

Because a large portion of debt held by Northwest was incurred to purchase the Company, to evaluate Northwest on a more comparable basis to the other carriers we recalculated debt to equity without the $2.4 billion Acquisition-related balance sheet debt. Without the effects of the Acquisition-related debt, Northwest's debt to equity ratio would be within the range of the other carriers. However, as is also shown on Exhibit III-F, Northwest's ratios were still much higher than those of the other carriers due to the effects of minimal equity. Northwest had stockholders' equity of only $141 million at June 30, 1991 while the other major carriers have several billion dollars in equity. This has a dramatic effect on the calculation.

Exhibit III-G shows the ratio of debt to total capital using balance sheet debt only. The ratio of debt to total capital including the estimated present value of operating lease obligations as part of debt is shown on Exhibit III-H. Aircraft used by carriers are commonly financed through operating leases. These leases have the effect of increasing the obligations owed by an entity without those obligations showing on the balance sheet. The ratios including operating lease obligations for American, Delta, United, and USAir increased substantially over the ratios excluding operating lease obligations. However, Northwest's ratio only increases marginally. The high percentage increases indicate American, Delta, United, and USAir have a much greater percentage of off-balance sheet financing than does Northwest.

G. Summary of Current Financial Condition

The Wings Acquisition of Northwest in 1989 followed one of the industry's most profitable years. However, worsening economic conditions and unforeseen events in the two years following the Acquisition have resulted in significant losses for the industry and the Company. This has prevented the Company from making any significant reduction in the level of debt outstanding, although the Company has restructured a major portion of the Acquisition-related financing.

The Company remains highly leveraged and thinly capitalized with over $4.2 billion in long-term debt and $176 million in stockholders' equity at August 31, 1991. Because of the net losses incurred over the last two years, the majority of cash flow generated by the Company has been from changes in working capital and the assumption of new obligations. These funds have been used to reduce the Senior Bank Debt financing. In addition, the Company has entered into a number of sale/leaseback transactions which removed additional liabilities reported on the balance sheet, but increased the Company's costs of ownership for the future.

Northwest's ability to generate funds is comparable to the four other carriers evaluated and its operating margins remain within range of the other carriers. Additionally, Northwest's cash flow continues to be sufficient to cover interest expense and aircraft rental. As a continuing result of the Acquisition, Northwest's debt ratios reflect a higher percentage of debt than the other carriers. However, the other carriers have a greater percentage of off-balance sheet financing.

Exhibit III-A

Northwest
Consolidated Statements of Operations
(in millions)

	Annual (A)					Eight Months Ended 8/31 (B)	
	1986	1987	1988	1989	1990	1990	1991
Operating revenues	$ 3,589	$ 5,142	$ 5,650	$ 6,575	$7,426	$ 4,941	$ 5,121
Manageable expenses	3,158	4,532	5,006	5,800	6,960	4,411	4,695
Income contribution	431	610	644	775	466	530	426
Ownership costs	341	519	490	713	941	614	635
Earnings/(loss) after ownership costs	90	91	154	63	(475)	(84)	(209)
Other income/(expense)	12	85	59	13	10	10	15
Income tax expense/(benefit)	25	73	78	9	(163)	(26)	(66)
Net earnings/(loss)	$ 77	$ 103	$ 135	$ 67	$ (302)	$ (48)	$ (126)

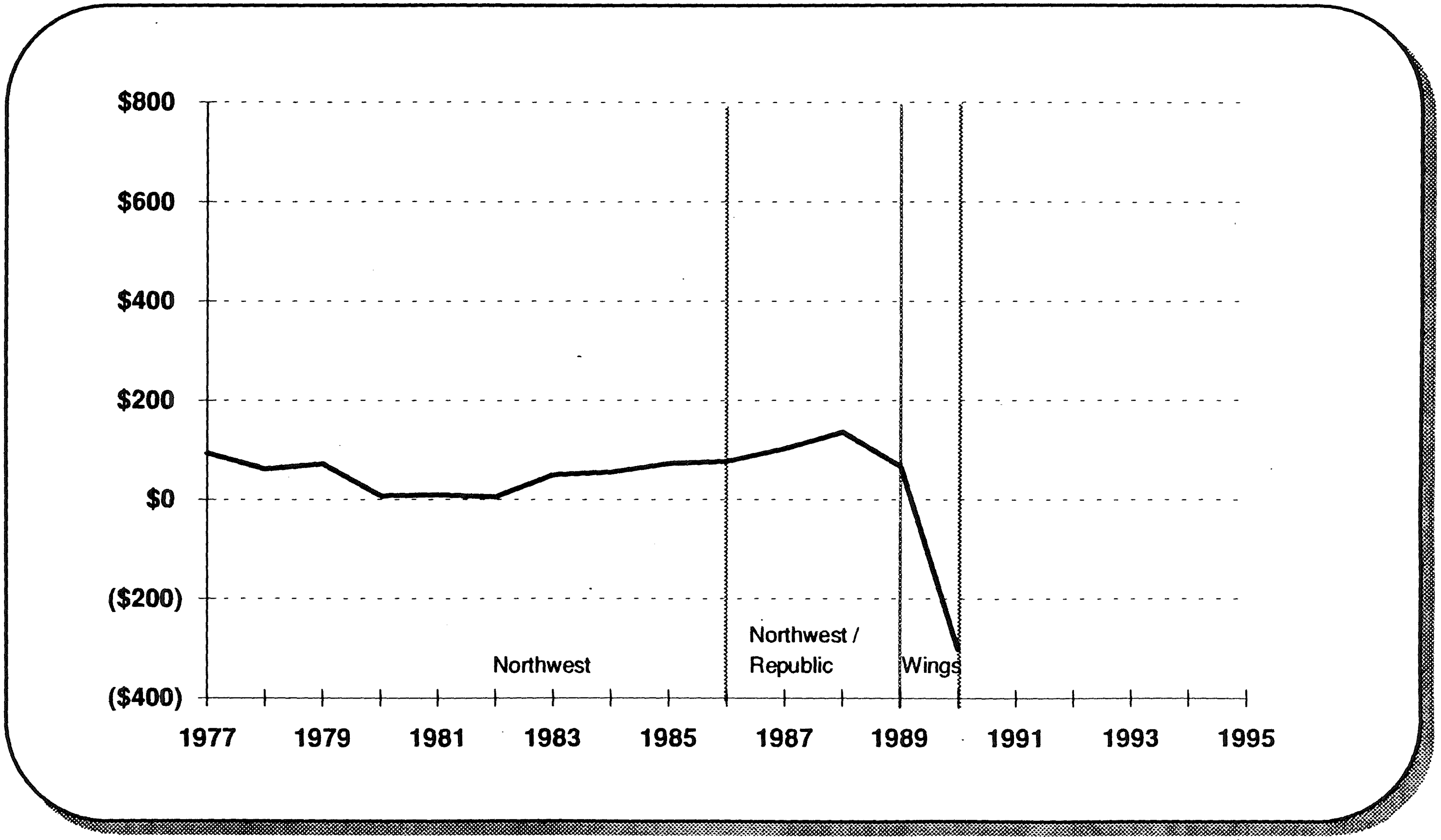
Sources: (A) - Northwest 1986 Annual Report.

- Northwest Financial and Statistical Reports, December 1987 and 1989.
- Northwest Five Year Financial Plan, August 12, 1991.

(B) Northwest Financial and Statistical Reports, August, 1991.

Northwest
Historical Net Earnings & Losses
(in millions)

Exhibit III-B



Sources: Northwest 1986 Annual Report
Northwest Financial and Statistical Reports, 1987 and 1989
Northwest Five Year Financial Plan, August 12, 1991

Northwest
Fleet Mix

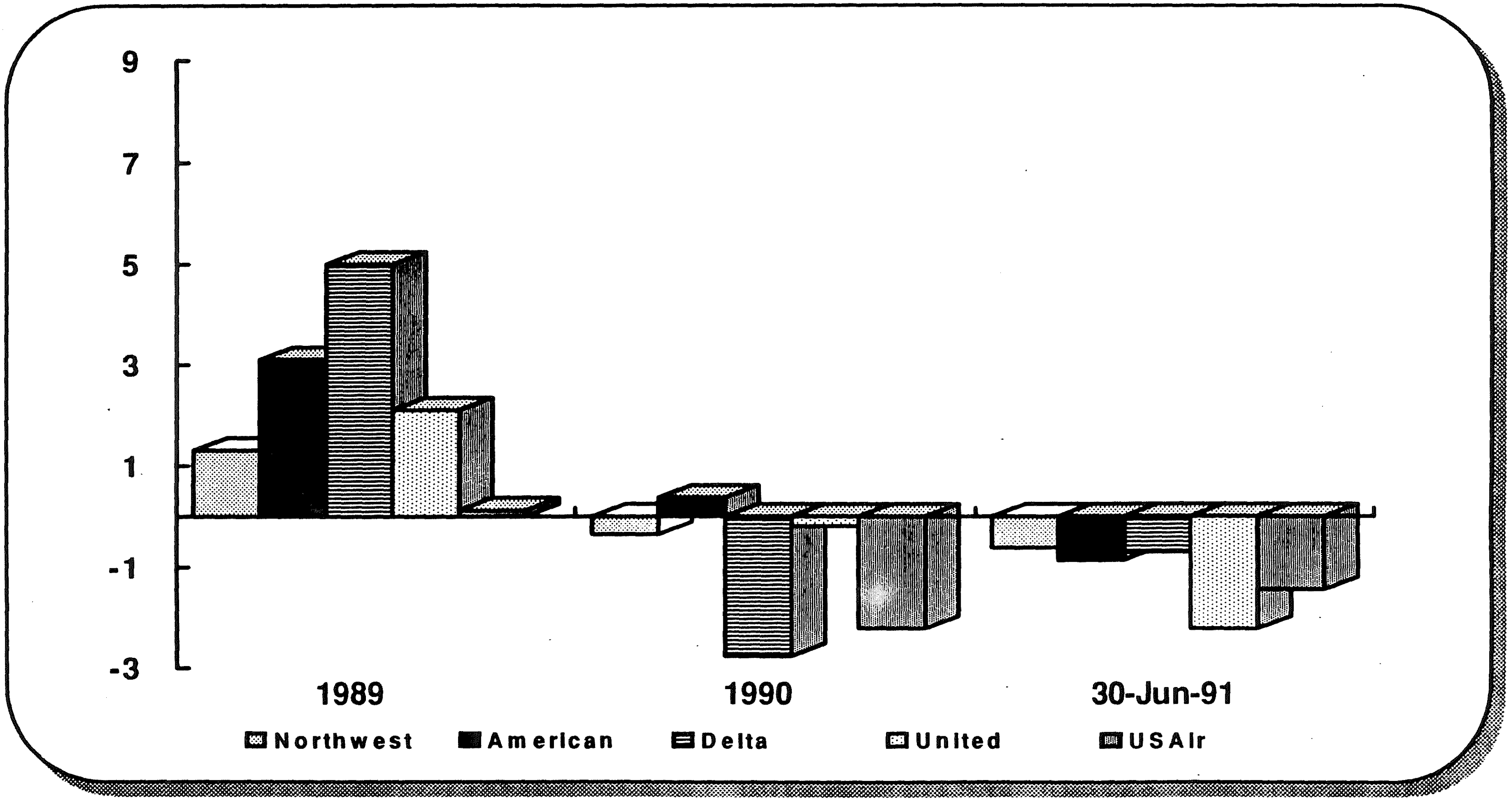
Exhibit III-C

AIRCRAFT TYPE	1990	8/31/91
STAGE 2 AIRCRAFT		
DC-9	139	146
B-727	71	70
Total Stage 2	210	216
STAGE 3 AIRCRAFT		
A320	11	20
B-757	33	33
DC-10	20	23
B-747	50	8
Total Stage 3	122	134
Total Stage 2	210	216
Total Aircraft	332	350
STAGE 2 AS A % OF TOTAL	63.3%	61.7%
STAGE 3 AS A % OF TOTAL	36.8%	38.3%

Sources: Northwest Five Year Financial Plan, August 12, 1991
Northwest Financial and Statistical Report, August 31, 1991

Exhibit III-D

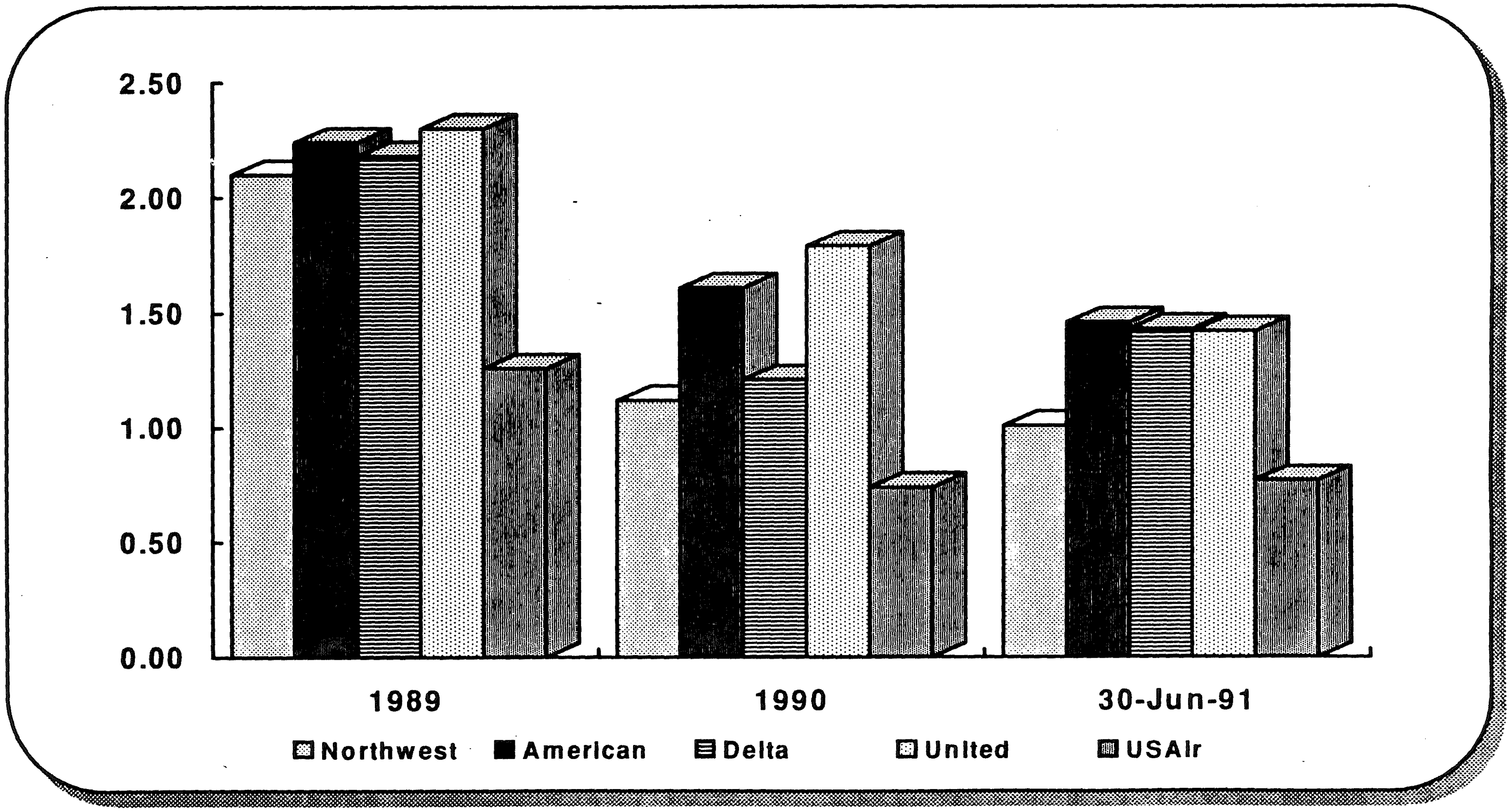
Northwest
Times Interest Earned
EBIT To Annual Interest Payments Ratio



Sources: Northwest Financial Statements
1990/1991 Company Annual Reports
June 30, 1991 Company 10Q or Quarterly Reports

Northwest
Cash Flow Coverage

Exhibit III-E



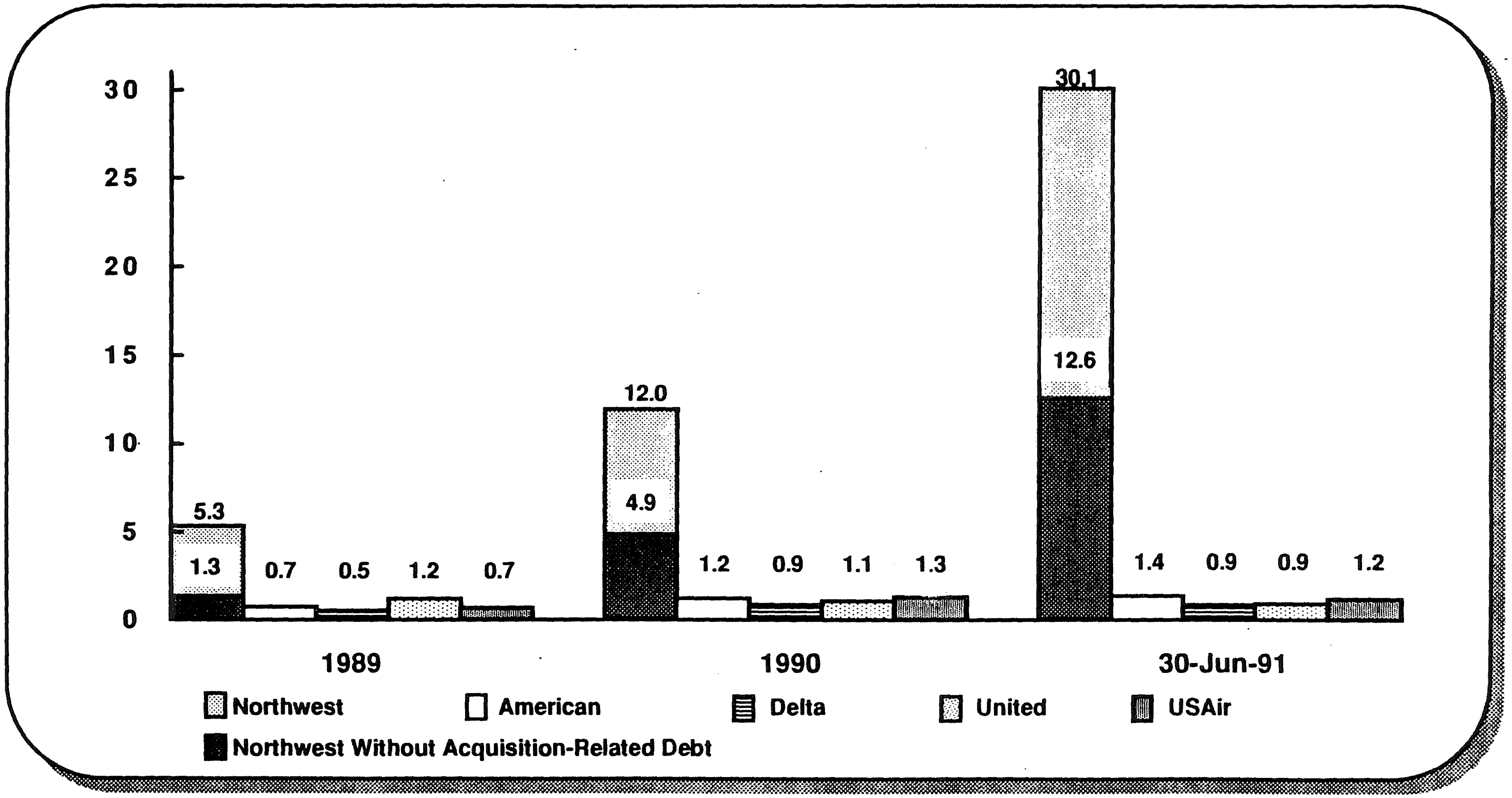
Sources: Northwest Financial Statements
1990/1991 Company Annual Reports
June 30, 1991 Company 10Q or Quarterly Reports

Northwest

Debt[1] To Equity[2] Comparison

With and Without Acquisition-Related Debt

Exhibit III-F

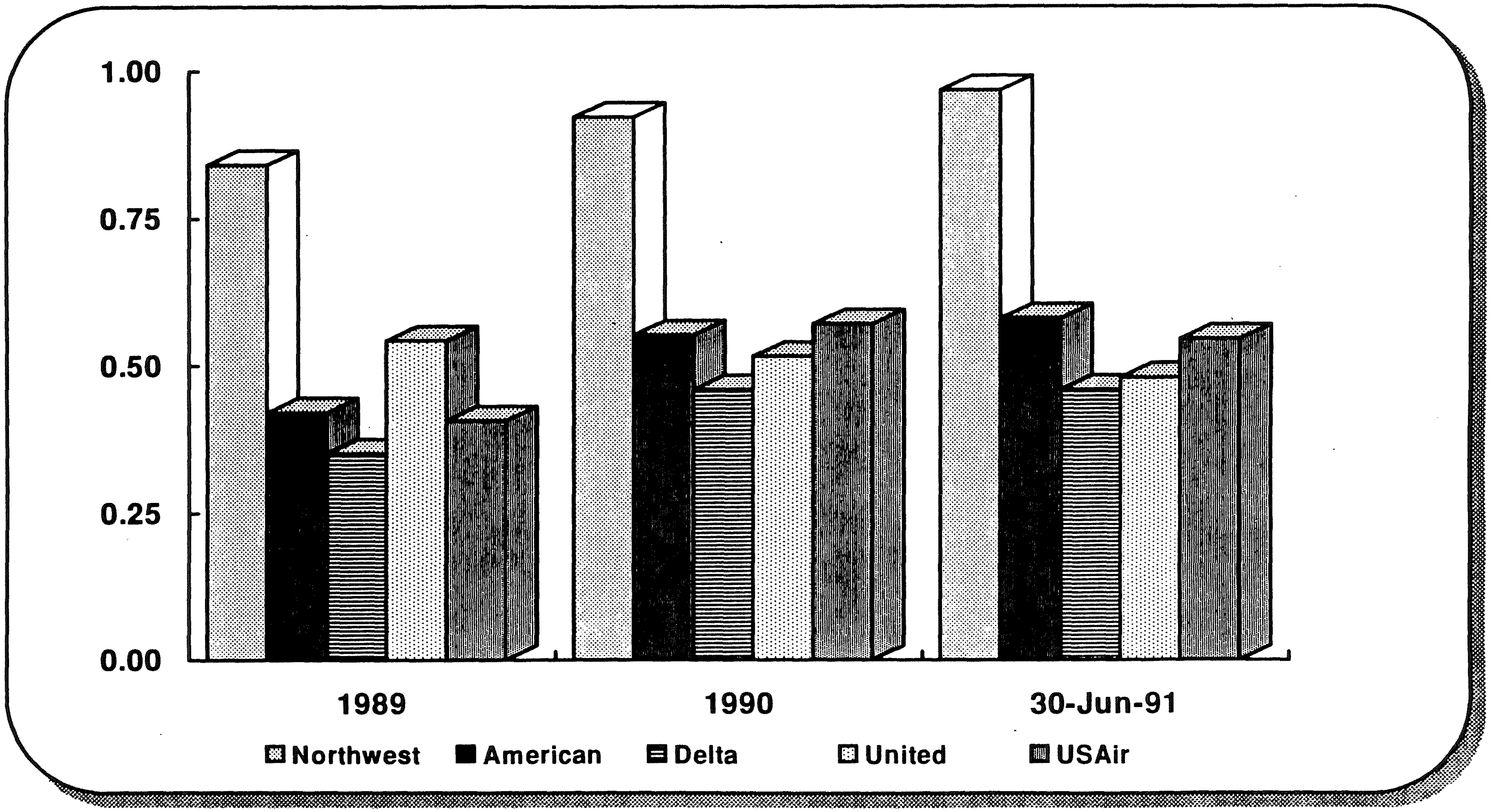


Sources: Northwest Financial Statements
1990/1991 Company Annual Reports
June 30, 1991 Company 10Q or Quarterly Reports

Notes: 1) Debt is defined as Short-Term and Long-Term Debt, Capital Leases, and Land Mortgages.
2) Equity is defined as Preferred Stock and Common Stockholders' Equity.

Northwest
Debt[1] To Total Capital[2] Comparison
Without Operating Leases

Exhibit III-G

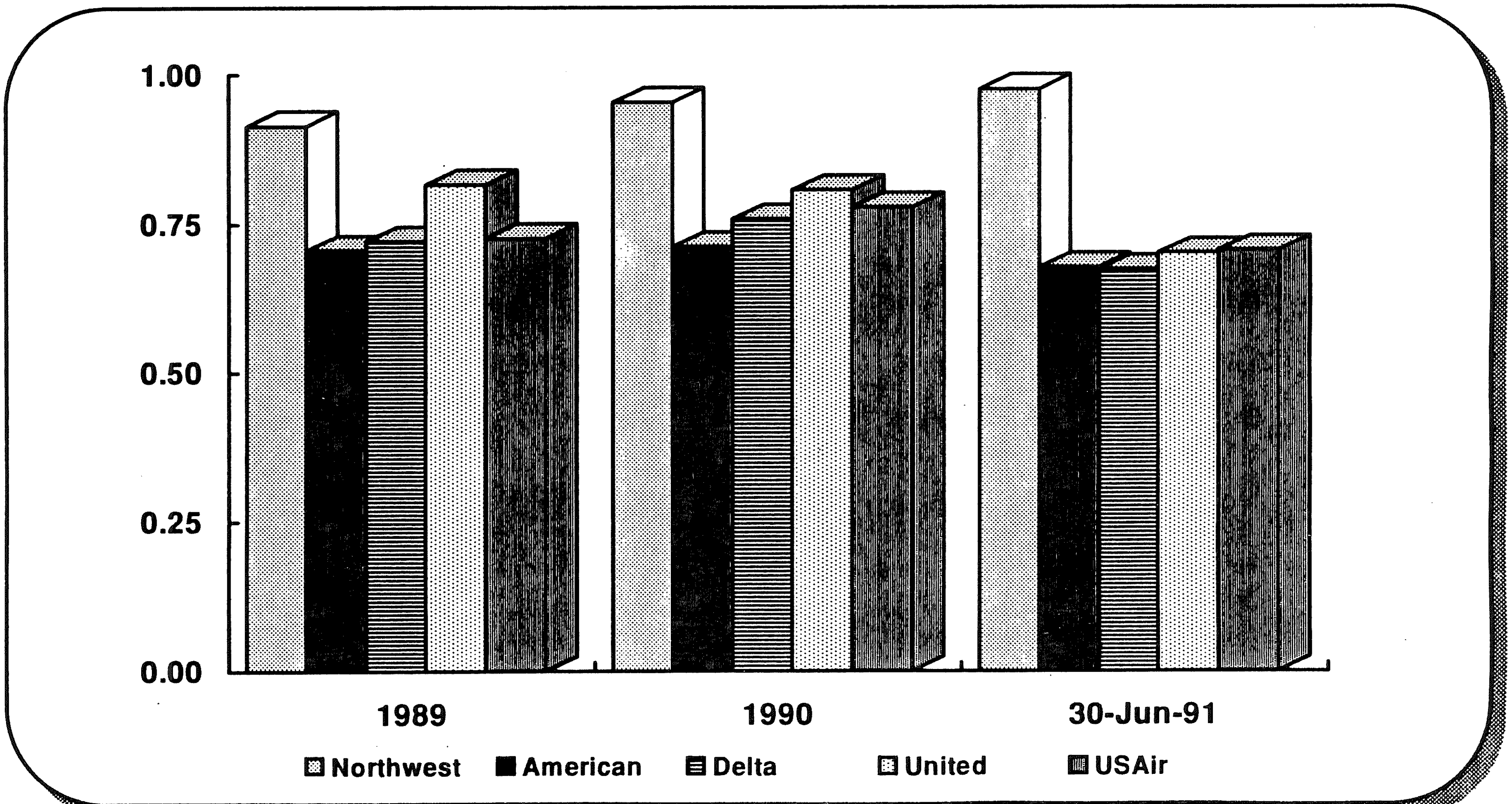


Sources: Northwest Financial Statements
1990/1991 Company Annual Reports
June 30, 1991 Company 10Q or Quarterly Reports

Notes: 1) Debt is defined as Short-Term and Long-Term Debt, Capital Leases, and Land Mortgages.
2) Equity is defined as Preferred Stock and Common Stockholders' Equity.

Northwest
Debt[1] To Total Capital[2] Comparison
With Operating Leases

Exhibit III-H



Sources: Northwest Financial Statements
1990/1991 Company Annual Reports
June 30, 1991 Company 10Q or Quarterly Reports

Notes: 1) Debt is defined as Short-Term and Long-Term Debt, Capital Leases, and Land Mortgages.
2) Equity is defined as Preferred Stock and Common Stockholders' Equity.

IV. FUTURE FINANCIAL CONDITION ASSESSMENT

In connection with the proposed financial transaction, Northwest has defined its corporate strategy and prepared a related Financial Plan for the period from 1991 to 1995. This Plan presents the Company's expectations of financial and operating results during the five-year Plan horizon, given their defined strategy and their expected actions to implement this strategy. Underlying this Plan are various assumptions concerning the key factors and events which will affect the airline industry and Northwest.

We have used and relied upon this Financial Plan to conduct an assessment of the Company's future financial condition. We assume the Financial Plan represents management's expectations regarding the events most likely to occur in the airline industry and management's expected course of action to direct Northwest during the planning period. Management has represented to us that it believes the underlying assumptions are reasonable and appropriate; that the assumptions reflect management's best estimate and judgements regarding the expected future financial performance of the Company; and that all significant information relevant to this Plan has been provided to us in connection with our work.

In summary, the Plan calls for:

- Substantially higher revenue based on increases in available seat miles and yields;
- Higher margins based on relatively stable costs; and
- Substantial positive cash flow to be used to repay the Acquisition debt and to fund other financial commitments.

The Financial Plan contains a number of assumptions regarding the future performance of Northwest. In this section, we describe and evaluate key factors concerning Company's assumptions on:

- The Economy and Industry;
- Northwest's Business Objectives;
- Revenues;

- Manageable Expenses and Costs of Ownership;
- Net Earnings;
- Sources and Uses of Cash; and
- Capital Structure.

To evaluate the Financial Plan, we analyzed the underlying support related to these assumptions and compared the Plan to historical operating results and industry prospects as outlined by AEI, Boeing, and the FAA.

A summary of our analysis of the Plan assumptions, expected performance, and results follows.

A. The Economy and Industry

Conditions within the domestic and global economy typically affect the earnings of airlines. Additionally, events within the airline industry can affect all carriers. Management assumes the following events will occur in the next five years:

- The economy will recover and expand over the 1991 - 1995 time frame presented in the Financial Plan;
- Consolidation of the airline industry in the Domestic market will curtail supply while an expanding economy will increase demand resulting in significant increases in passenger yields; and
- The airline industry will not be adversely affected by major external events, such as but not limited to: renewed conflict in the Middle East, acts of terrorism, and the loosening of regulations concerning worldwide air service.

Economic Recovery

Northwest assumes the economy will recover in 1992. Management estimates GNP will grow 3% in 1992 and 1993 and 2.7% in 1994 and 1995. The comparative projections of Airline Economics, Boeing, the FAA and Northwest are:

Table IV-1
Projected GNP Growth

	1992	1993	1994	1995
Airline Economics	2.5%	3.0%	3.0%	3.5%
Boeing	2.0%	3.0%	2.8%	2.8%
FAA	2.4%	3.4%	3.1%	3.0%
Northwest	3.0%	3.0%	2.7%	2.7%

Source: AEI, Boeing, FAA Material and Northwest Financial Plan

Projected increases in GNP are used by Northwest to estimate the demand for air service. Northwest and a consulting firm prepared an analysis to determine the historical relationships between GNP and supply of air service to passenger revenue. Based on this relationship, the Company forecasts that increases in GNP drive demand and then a favorable supply and demand relationship contribute to increases in passenger revenues. We compared Northwest's projected passenger revenues with historical trends and industry projections prepared by other sources (see Section IV-C, "Revenues").

An estimate of inflation, as measured by the Consumer Price Index ("CPI"), is used by Northwest to project revenues and expenses. Northwest anticipates that inflation will be significantly higher than it has been in recent years. Airline Economics and the

FAA project lower rates of inflation than does Northwest. The respective inflation rates are as follows:

Table IV-2
Projected Inflation

	1992	1993	1994	1995
Airline Economics	4.0%	3.5%	3.5%	3.5%
Boeing[1]	3.5%	3.5%	3.5%	3.5%
FAA[2]	4.0%	4.5%	4.5%	4.5%
Northwest	5.0%	5.0%	5.0%	5.0%

Source: AEI, Boeing, FAA Material and Northwest Financial Plan

(1) Boeing estimates are based on telephone interview with Marketing Research Department at Boeing.

(2) The FAA does not quote inflation rates by year after 1992. It does state the long-term inflation rate from 1992 to 2002 will be 4.7% but the FAA's graph illustrates inflation will be low from 1992 to 1996 and then rise in the remaining years. Based on the graph, it appears the FAA believes inflation will be somewhat lower than 4.7% during the Plan period.

Based on the Company's assumption that it can pass through the effects of inflation, higher inflation rates would provide greater cash flows with which to pay existing debt obligations.

Industry Consolidation

Consolidation has been occurring since the US airline industry was deregulated in 1978. Subsequent to deregulation, a number of airlines merged and several airlines failed. As a result, airline capacity has not grown as quickly as it did before deregulation. For a discussion of the airline industry, see Section II.

Underlying its Plan, Northwest assumes:

- The industry will continue to consolidate until only four to five major airlines dominate the Domestic market;

- 27% of the aircraft operated by the five "essentially bankrupt" carriers will no longer be in operation by the end of 1995; and

- A large portion of aircraft orders and options will not be executed because of the failure of several carriers and difficulties for the surviving carriers in obtaining favorable financing. This action would result in a further constraint on growth in supply.

AEI believes the industry is poised for a dramatic upturn in 1992 to 1996. This is attributable in part to the effects of consolidation and the recurring economic cycle in which years of heavy losses are followed by periods of expansion. AEI forecasts a downturn for the industry in 1997 to 1998 and resumed expansion through the year 2000.

External Events

The Company's Financial Plan assumes that no major external events will affect its operations during the period of the Plan. Potential events include, among others: renewed conflict in the Middle East, threats of terrorism, and easing of regulations concerning foreign air service. Based on the operating results achieved by the industry during the Persian Gulf conflict, a resumption of conflict or the perceived threat of terrorism would further weaken the airline carriers.

Another threat to the industry would be the loosening of regulations by the US to allow foreign air carriers to service domestic flights. Currently, foreign air carriers are allowed to transport passengers from foreign airports to domestic destinations (e.g., Tokyo to Minneapolis/St. Paul) but are not allowed to transport passengers between domestic destinations (e.g., Minneapolis/St. Paul to Chicago). However, US carriers can transport passengers between destinations within Asia or Europe (e.g., Tokyo to Korea and Great Britain to Germany). If the US allows foreign carriers to provide domestic service, the competition in the airline industry will increase. As a result passenger revenues could decrease dramatically. Additionally, if Asia, especially Japan, began restricting air service provided by US carriers, passenger revenues earned by US carriers in the Pacific would decrease dramatically. Furthermore, the easing of current restrictions could also diminish the value of Northwest's routes to the Pacific.

Summary

Northwest assumes the economy will recover and it will be one of the survivors in the industry. After the failing airlines exit, Northwest believes the survivors will enjoy rising passenger yields with service provided by a limited number of carriers. The Company also assumes it will be able to pass along the full effects of rising inflation to passengers, and no major external events will affect its operations during 1991 to 1995.

B. Northwest Business Objectives

In order to respond to economic and industry factors affecting the airline, Northwest plans to:

- Participate in the consolidation of the airline industry by acquiring a proportionate share of exiting carriers and earn its "fair share" of the revenues generated by the industry.
- Become the "airline of preference" by improving customer service through the customer preference program Northwest has recently undertaken.
- Increase its capacity by acquiring new, larger aircraft.
- Successfully negotiate labor agreements with the three major unions without any disruptions in service.
- Retain continued access to a controlled Pacific market.

These business planning assumptions are the basis for the Company's Financial Plan. More specific revenue and expense assumptions and our analysis follow.

C. Revenues

Passenger revenue represents the largest source of cash for Northwest. Passenger revenue assumptions can be analyzed based on: (1) the operating statistics which determine system-wide passenger revenue and (2) the Company's passenger revenues in the regions it serves.

Passenger revenue is determined by the Company's pricing, utilization, and capacity. Yield measures how much revenue is earned on one passenger mile and is the result of pricing, utilization, and capacity. Utilization is measured by load factor and is expressed as the percentage of seats occupied on an aircraft. Capacity is expressed as the number of miles flown times the number of seats and is reported as available seat miles (ASMs). In its Financial Plan, Northwest projects the following system-wide statistics:

- Yield will increase from 12.61 cents in 1991 to 16.87 cents in 1995.

- Load factor will fall slightly, then remain constant at 64.2% to 64.9%.

- ASMs will rise approximately 8.8% annually, resulting in a net increase in market share.

Because Northwest serves three different regions of the world (Domestic, Pacific and Atlantic), it is affected by the global economy. Therefore, it is also important to analyze the passenger revenues projected by region. In its Financial Plan, the Company projects:

- Domestic passenger yield will increase faster than inflation.

- Northwest will have a higher Domestic passenger yield than the industry average.

- The Company's share of the Domestic market will increase from 8.7% in 1990 to 10.4% in 1995, or an increase of 1.7 percentage points.

- Demand in the Pacific region will grow approximately 11.7% annually with overall passenger revenue growth exceeding 20.6% annually.

- Northwest will continue to have a small share of the Atlantic market, although its market share will increase.

System-wide Operating Statistics

Because of the large number of miles flown by airlines, passenger revenues are extremely sensitive to changes in passenger yields. From 1987 to 1990, the average annual growth of Northwest's system-wide passenger yield was 3.6%. Northwest projects its average annual growth in passenger yields will double to 6.5% from 1990 to 1995 (Exhibit IV-A). Northwest's projected passenger yields are:

Table IV-3
System-wide Passenger Yields
(in cents)

	1991	1992	1993	1994	1995
System-wide	12.61	13.68	14.70	16.11	16.87

Source: Northwest Financial Plan

Other industry sources project the airline industry will earn lower system-wide passenger yields during the projected period:

Table IV-4
Projected System-wide Passenger Yields
(in cents)

	1992	1993	1994	1995	Annual Growth From 1990
Airline Economics	13.60	14.10	14.70	15.30	4.4%
FAA Domestic[1]	13.93	14.49	15.07	15.67	5.1%
Northwest	13.68	14.70	16.11	16.87	6.5%

Source: AEI, FAA Material and Northwest Financial Plan

(1) 1993 through 1995 rates are estimated based on the FAA's projected growth rate of 4.2%. Based on the graph presented, it appears the FAA is projecting stable growth from 1991 to 1995.

Passenger revenues are also sensitive to relatively small changes in load factors. In the last three years, Northwest's average load factor has been 65.7%. Northwest projects its system-wide load factor will drop slightly then remain relatively constant in a range of 64.2% to 64.9% from 1991 to 1995. (Exhibit IV-B) Northwest's projection appears comparable to load factors projected by industry sources. AEI projects the industry will achieve system-wide load factors of 64.4%

Average annual growth of the Company's ASMs for the previous ten years was 12%. It is important to note that the acquisition of Republic Airlines increased ASMs significantly in 1986. From 1987 to 1990 Northwest's growth was 8.0%. The projected average annual growth for the next five years is 9.2%. In order to attain this growth, the Company plans to spend $7.5 billion from 1991 to 1995 to purchase new aircraft. This will increase ASMs or capacity from 77.3 billion in 1990 to 119.9 billion in 1995 (Exhibit IV-C). Northwest's projected growth in ASMs will increase overall system-wide market share from 11.1% in 1990 to 14.6% in 1995.

Because of Northwest's passenger yield and capacity growth assumptions, system-wide passenger revenues are projected to increase at a much faster rate than has occurred historically (Exhibit IV-D). The following subsections discuss the assumptions that affect regional passenger revenues.

Domestic Passenger Revenue

Northwest earns approximately 62% of its passenger revenues from Domestic service. The Company relies on the following assumptions to project Domestic passenger revenue:

- Real passenger yield (adjusted to eliminate the effects of inflation) will increase;
- The industry will be able to pass along the full effects of inflation to Domestic passengers by raising fares proportionately; and
- Northwest will earn passenger yields that are higher than the industry average.

The Company projects real passenger yield will increase approximately 0.5% annually from 1990 to 1995. Real yields have fallen dramatically since 1977 but have stabilized in more recent years as shown in Exhibit IV-E. AEI projects real passenger yields will remain stable in the future. Boeing projects the real yield will rise by an average of 1.1% per year from 1989 to 1993 and then decrease by 0.5% per year through the year 2000. The FAA predicts real yields will decline 0.5% annually from 1990 to 2002.

Northwest projects that as a result it will be able to pass through inflation increases. If inflation was 5% and the Company could pass along the full effects of inflation to customers, yields would rise 5% in response. In general, airlines, including Northwest, have historically not been able to pass along the full effects of inflation to passengers (Exhibit IV-F).

The Company's Domestic passenger yield projections range from slightly higher than 13 cents in 1991 to above 17 cents in 1995, a 6.8% compounded growth. Since the Acquisition, Northwest has earned lower passenger yields than the Domestic industry average. However, the Company projects it will earn passenger yields that are higher than its estimates of the industry average in the Plan period by amounts ranging from approximately 0.2 cents to 0.8 cents.

Although the premiums Northwest projects appear small, passenger revenue is very sensitive to passenger yield because of the large number of miles flown. Based on our analysis of the Plan, a change in passenger yield of only one-tenth of one cent would change Domestic passenger revenue by approximately $40 million (based on 1995 assumptions).

However, trends toward unpublished fares are expected to exert downward pressure on passenger yields. Carriers are competing for increases in traffic by offering lower fares through special promotions and to specific groups. Thus, fewer passengers are paying published fares. According to Northwest, unpublished fares place downward pressure on yields, thus making it difficult to achieve projected revenues.

Management projects load factors will remain stable, but capacity will rise from 47.2 billion ASMs in 1990 to 65.5 billion ASMs in 1995. Market share of ASM's is projected to increase from 8.5% in 1990 to 10.9% in 1995. Market share of revenues is projected to increase from 8.7% in 1990 to 10.4% in 1995. This indicates Northwest would be able to achieve passenger yields and/or load factors consistent with its competitors.

Pacific Passenger Revenue

The Pacific region represents Northwest's second largest source of passenger revenues. Northwest projects demand (RPMs) in this region will grow 11.7% per year over the next five years (Exhibit IV-G). In the last three years, the average growth in demand in this region was 16.9%. The high growth was primarily due to increases in the number of Japanese travelers.

AEI indicates demand in the Pacific market should continue to expand at an 8-10% annual growth rate. Boeing projects annual economic growth (as measured by Gross

Domestic Product) in Asia will continue to be strong at 4-5% through 1995 (a decline of 1% over the past five years). However, Boeing believes Japan's economic growth will decline to 3% in 1991 and 1992 because of higher interest rates, dropping equity and real estate values, decrease in exports caused by the weak US economy and the rising yen, and high oil prices. After 1992 Boeing predicts Japan's economic growth will increase to 4% through 1995.

The Company's Domestic passenger yield projections range from slightly higher than 13 cents in 1991 to above 17 cents in 1995, a 6.8% compounded growth. Since the Acquisition, Northwest has earned lower passenger yields than the Domestic industry average.

Northwest estimates its average annual growth of ASMs in the Pacific to be 13.1%. Coupled with the projected increase in passenger yields from 12.20 cents in 1990 to slightly higher than 17 cents in 1995. Passenger revenues for the Pacific are estimated to have a total average annual growth rate of 20.6%. (Exhibit IV-H)

In 1990, Northwest's share of the revenues of the Pacific region was 0.9% higher than its share of capacity. This indicates Northwest was able to achieve passenger yields and/or load factors on its Pacific routes higher than its competitors'. In 1995, Northwest projects its share of revenues will be approximately 1.5% higher than its share of capacity.

Atlantic Passenger Revenue

Northwest's historical route system has been in the Pacific with limited service in the Atlantic. In fact, only 6.2% of the Company's capacity is for the Atlantic region. Servicing routes in the region is important to Northwest in order to maintain a global presence, but it is not a focus of its business strategy. Northwest plans to maintain a small share of the Atlantic market. The Company projects average annual growth of revenue in this region will be 14.1% from 1992 to 1995. Northwest believes growth will be aided by its alliance with KLM. Passenger revenues in this region grew 14.7% in the last three years.

Other Revenue

A portion of historical and projected revenues are from cargo and other services. Because Northwest is one of the few carriers providing this service, it appears to be a lucrative business for the Company. Cargo revenues are projected to increase 9.1% on average per year through 1995 compared to 7.3% over the period 1987 to 1990.

Summary

In summary, the significant assumptions made by Northwest with respect to revenue include:

- Domestic passenger yields will rise faster than inflation. This assumption is not consistent with the historical trend. Boeing predicts that yields will also increase, but other industry sources predict stable or declining inflation-adjusted passenger yields.

- Northwest's Domestic passenger yields will be higher than the industry averages. Since the Acquisition, Northwest's Domestic passenger yields have been lower than the industry averages.

- Northwest's system-wide market share will increase from 11.1% to 14.6%. This assumption relies upon the timing of the consolidation of the airline industry.

- Demand in the Pacific will grow approximately 11.7% annually, and passenger revenues will increase 20.6%.

- Northwest will continue to have a small share of the Atlantic market, although its market share will increase. The Company believes this growth will be aided by its alliance with KLM.

D. Manageable Expenses

Manageable expenses includes such items as salaries and benefits, fuel, commissions, maintenance, landing fees, and non-aircraft rents. The Company considers manageable expenses to be adjustable if the operating and financial environment changes.

Manageable expenses were $7 billion during 1990. They are projected to increase an average of 11.7% per year during the next five years. The following are Northwest's pertinent assumptions:

- The growth rate of manageable expenses will be lower than the growth rate of revenues;

- Fuel prices will remain stable over the projection period;

- The Company will experience an annual 3% payroll productivity improvement; and

- End of the Gulf war plus change in traffic mix will result in lower overall commission rates.

Historically, costs have increased faster than revenues have increased. In its Financial Plan, the Company assumes it can contain the growth of costs by effective cost management. As discussed previously, the projections do not reflect the potential impact of events which cannot be controlled by the Company.

Fuel expense is affected by worldwide events and the actions of the oil-producing countries. Northwest assumes Iraq and Kuwait will resume production quickly and the OPEC countries will resist calls to decrease production. As a result, fuel expenses will increase only slightly faster than inflation, 5.3% per year from 1992 to 1995. From 1986 to the period initially prior to the Persian Gulf conflict, fuel expenses were relatively stable. The FAA predicts "plentiful and affordable fuel" from 1991 to 2002.

Salaries and benefits are projected to increase an average of 10.4% per year from 1991 to 1995. The average annual increase for salaries and benefits from 1987 to 1990 was 12.2% Management projects payroll costs will increase at the rate of inflation. However, some of these costs will be offset by a 3% payroll annual productivity increase. The annual productivity increase will come from areas such as an improvement of operations in maintenance, smaller flight crews for the newer aircraft, and hiring of new, lower paid, employees. As a result of the 3% payroll annual productivity increase, salaries and benefits will increase at a slower pace than the previous three-year period.

Northwest's commission expenses are projected by region. Commission expense is projected to be 10.5% of revenues for the Domestic region, and 12.5% of revenues for the Atlantic region. Commissions for the Pacific region are considerably higher. Northwest considers the incremental cost of the ticket for the additional services to be an incentive commission. Therefore, the average annual commission expense of 34.9% in the Pacific region is higher than those in the other two regions.

Northwest projects it will experience overall lower commission rates due to an increase in traffic and a change in traffic mix to the business class traveler. Overall commission expenses are projected to increase at an average rate of 17.9% for the period from 1991 to 1995. The growth rate for commission expense increased 2.5% more than revenue increases for the period. However, historically commission expenses have grown 1.0% slower than revenues.

In summary, the Company projects it will be able to control costs so that total manageable expenses will increase more slowly than will revenues. Although some expenses are projected to increase faster than revenues, these increases will be offset by expenses that are increasing at a much slower rate than revenues. Additionally, management does not predict any significant events will occur in the economy that would result in substantially higher manageable expenses.

E. Costs of Ownership

Northwest classifies depreciation, interest expense and aircraft rentals as costs of ownership. The assumptions that will affect costs of ownership are:

- Purchases of new aircraft and retirement of old aircraft;
- Increase in aircraft debt financing;
- Reduction in Senior Bank Debt; and
- Increase in aircraft operating leases as a result of sale/leaseback transactions.

These assumptions are discussed more thoroughly in Section IV, "Sources and Uses of Cash".

Depreciation expense will increase if new aircraft are purchased and ownership is retained (see Section IV-G, "Sources and Uses of Cash"). Depreciation is an accounting entry to record the reduction of value that results as assets are used. Depreciation is not a cash payment. However, most depreciation is deductible for tax purposes. Therefore, depreciation provides a benefit because it reduces the amount of taxes paid.

Debt incurred for aircraft purchases and other purposes are projected to almost double from 1990 to 1995 (see Section IV-G, "Sources and Uses of Cash"). Repayment of the Senior Bank Debt will reduce some interest payments. However, the large amount of new debt projected to be incurred causes total interest expense to increase. Interest expense is projected to increase from $340 million in 1990 to $694 million in 1995.

Additionally, sale/leaseback transactions will cause aircraft rental expense to increase dramatically. In 1990 aircraft rental expense was $228 million. Projected 1995 aircraft rental expense is $425 million.

In summary, Northwest's projected fleet plan and capital structure assumptions will increase the costs of ownership which must be paid by the Company. However, Northwest projects the increase in ownership costs will be offset by decreases in certain management expenses. As illustrated in the following table, Boeing supports the assumptions that fuel costs, flight salaries, maintenance expense and other indirect costs will account for smaller percentages of operating costs in the future.

Table IV-5
Operating Cost Distribution
(percentage of total)

	1970	1980	1990	2000
Fuel	12.2%	31.0%	18.2%	5.1%
Crew	13.1%	11.0%	8.8%	7.7%
Maintenance	13.7%	9.0%	10.4%	9.0%
Airplane Investment	12.3%	5.0%	7.8%	13.6%
Indirects	48.7%	44.0%	54.8%	54.6%
Total	100.0%	100.0%	100.0%	100.0%

Source: Boeing

F. Net Earnings

From 1977 to 1988, Northwest's net earnings remained relatively stable. After the acquisition of Republic, Northwest's profit margins and growth in earnings were:

Table IV-6
Historical Net Earnings and Profit Margins
($ in millions)

	1986	1987	1988	1989	1990
Revenues	$3,589	$5,142	$5,650	$6,575	$7,426
Net Earnings	$77	$103	$135	$67	($302)
Profit Margin	2.2%	2.0%	2.4%	1.0%	-4.1%

Source: Northwest Financial Statements

Net earnings increased substantially after the addition of the Republic assets. The average profit margin in 1986 to 1988 was 2.2%. After the Wing's Acquisition, Northwest's net earnings growth and profit margins dropped as a result of higher interest payments and problems affecting the industry.

The Company projects net earnings will increase significantly over historical net earnings (Exhibit IV-I). Following are the projected statistics for net earnings:

Table IV-7
Projected Net Earnings and Profit Margins
($ in millions)

	1991	1992	1993	1994	1995
Revenues	$7,784	$8,980	$10,388	$12,507	$14,795
Net Earnings	($253)	($60)	$140	$385	$647
Profit Margin	-3.3%	-0.1%	1.4%	3.1%	4.4%

Source: Northwest Financial Plan

Based on historical information and industry sources, the projected profit margin percentages appear high in the later years. From 1986 to 1990, Northwest's profit margin ranged from -4.1% to 2.4%. Northwest's average profit margin was 0.3%. During the industry's most profitable year, 1988, Northwest's profit margin was 2.4%.

G. *Sources and Uses of Cash*

The sources of Northwest's projected cash flow are:

Table IV-8
Sources of Projected Cash Flow
(Cumulative 1991 to 1995)
($ in millions)

	Total	%
Net income	$ 859	7.5%
Depreciation	2,383	20.8%
Proceeds of sale/leaseback transactions	2,233	19.5%
Net change in debt excluding Senior Bank Debt	4,531	39.6%
Other (including net working capital changes)	1,448	12.6%
Total	$11,454	100.0%

Source: Northwest Financial Plan

As discussed previously, depreciation is a non-cash expense. Net income plus depreciation can be used to measure the amount of cash generated by operations, net of working capital changes and other miscellaneous charges. Most of the remaining cash flow sources are increases in obligations.

The Company is planning to incur the following new obligations during the projected period:

- $5.1 billion to purchase new aircraft;
- $2.2 billion of operating leases for new aircraft as a result of sale/leaseback transactions;
- $77 million to purchase aircraft engines;
- Up to $539 million of long-term financing; and

- Up to $127 million of short-term borrowings as provided by the Company's revolving credit facility.

Northwest is assuming that they will finance 75% of the new aircraft with debt. The other 25% of new aircraft will be purchased and financed through sale/leaseback transactions to third parties. These leases are long term operating leases. In accordance with generally accepted accounting principles, these operating leases will not be included on the Company's balance sheet.

The Company assumes new aircraft can be sold to third parties at a price above Northwest's purchase price. As a result, Northwest will generate additional funds that can be used to repay the Senior Bank Debt in accordance with the provisions of the loan documents. Sale/leaseback transactions are popular in the industry and airlines have benefitted from these transactions in the past. Although Northwest has previously negotiated sale/leaseback transactions, the market for this type of transaction may be limited in the future, especially at a premium over purchase price. If Northwest cannot negotiate the sale/leaseback transactions at a price premium as projected, the cash flow of the Company will decrease by approximately $300 million over the projected period.

In addition to the significant increase in debt from aircraft purchases, the Company expects to borrow an additional $77 million from an aircraft engine manufacturer.

Northwest projects cash shortages during the 1991 and 1992 periods. The Company plans to borrow $127 million to cover these shortages. Northwest can borrow up to $600 million of short-term borrowings from its revolving credit facility, which is financed by the Senior Bank Debt lenders. Northwest plans to repay the revolving credit facility by 1994.

Northwest plans to use its cash flow for the following purposes:

Table IV-9
Uses of Projected Cash Flow
(Cumulative 1991 - 1995)
($ in millions)

	Total	%
Aircraft capital expenditures	$ 7,521	67.0%
Non-aircraft capital expenditures	2,100	18.7%
Payment of Senior Bank Debt	1,442	12.8%
Preferred stock dividends	171	1.5%
Total	$11,234	100.0%

Source: Northwest Financial Plan

Capital expenditures represent approximately 85% of the uses of cash flow during the projected period. Most of the capital expenditures will be for aircraft. According to the Financial Plan, Northwest projects the following changes in fleet size (See Exhibit IV-J for the detailed fleet plan.):

Table IV-10
Fleet Plan for 1991 to 1995
(number of aircraft)

	Narrow Body	Wide Body	Total
1990 Fleet	262	70	332
Sell or Retire	(79)	0	(79)
Purchase	129	44	173
Proposed 1995 Fleet	312	114	426

Source: Northwest Financial Plan

As discussed in the Section IV-C, "Revenues," Northwest must increase its fleet size in order to increase market share. Additionally, the Company must comply with federal regulations concerning the retirement of older, noisier aircraft ("Stage 2 aircraft"). Currently, approximately 63% of Northwest's airplanes are Stage 2 aircraft.

According to the fleet plan, Northwest will be in compliance with federal regulations in the time span covered by the Financial Plan. In order to comply with Stage 2 regulations and increase its fleet size, Northwest plans to acquire $7.5 billion in aircraft during the 1991 to 1995 period.

The Company also plans to repay the Senior Bank Debt and pay cash and stock dividends to preferred shareholders during the projected period. Northwest will have to use earnings from operations or other proceeds in order to implement these plans.

In summary, the largest projected source of cash during 1991 to 1995 is increases in debt and operating lease obligations. The largest projected use of cash is capital expenditures. Based on the Company's projections, cash will increase from $31 million in 1991 to $419 million in 1995.

H. Capital Structure

Capital structure includes the Company's long-term interest-bearing debt and equity. The following are management's assumptions with regard to changes in capital structure:

- The company will repay the Senior Bank Debt and reduce the outstanding balance of other Acquisition-related obligations;

- Fleet expansion will be funded by new debt financing and operating leases; and

- Aircraft operating leases will be available, and lessors will buy the aircraft from Northwest at a premium over purchase price.

Interest and principal payments due will increase because of the large increase in interest-bearing debts and principal payments due during the projection period. Operating lease payments due on leased aircraft will also increase significantly.

In addition to debt service and aircraft rental payments, Northwest is obligated to redeem the Series A and B preferred stockholders in 1998 and 1999, respectively. The total cost of redemption for Series A preferred stock will be $250 million. Assuming only stock dividends are paid to Series B preferred stockholders through August 1995, as permitted by the Certificate of Designation, the estimated 1999 redemption cost will be $450 million. The annual cash dividend for Series B preferred will be approximately $60 million starting in 1996.

The following schedule detailing payments on existing obligations was developed based on the assumption that Northwest will repay all debt and redeem all preferred stock as scheduled. (The amounts shown do not include interest except for amounts associated with the accrual of interest on the Japanese land mortgage and stock dividends.) Debt service payments are low in 1991 and 1992, but increase substantially through the projection period. In the five years after the projection period the Company must generate substantial cash for debt service and preferred stock redemptions. The projected total of principal payments due on existing debt, capital leases and preferred stock redemption:

Table IV-11
Payments on Existing Obligations
($ in millions)

Years	Acquisition-Related Obligations	Other Obligations	New Obligations	Total
1991	$ 0	$ 100	$0	$ 100
1992	124	139	84	347
1993	380	170	72	622
1994	428	76	283	787
1995	428	63	445	936
Total 1991-1995	$1,360	$548	$884	$2,792
1996	$ 447	$ 352	$311	$1,110
1997	120	71	212	403
1998	250	69	234	553
1999	450	72	259	781
2000	891	74	286	1,251
Total 1996-2000	$2,158	$638	$1,302	$4,098

Source: Northwest Debt and Preferred Stock Amortization Schedule

While the Japanese land mortgage of $891 million due in 2000 and the preferred stock redemptions of $250 million in 1998 and $450 million in 1999 are currently scheduled, these obligations have unique characteristics. The Japanese land mortgage is non-recourse to the Company and, in the event payment is not made, would result only in the loss of the property serving as collateral. However, there may be Japanese capital gains tax implications.

The preferred stock issue is unusual in that it has a mandatory redemption provision which if not met requires repayment when funds are available. There do not appear to be any restrictive terms that would prevent the Company from continuing its operations or paying other financial obligations in the event that it did not redeem the preferred stock in 1998 and 1999.

Wings replaced most of Northwest's common equity with debt by performing a leveraged buyout. Because of the small amount of common equity paid in by shareholders and subsequent net losses, the Company had a common equity deficit of $335 million as of August 31, 1991. The Financial Plan projects common equity will remain in a deficit position through 1994. By the end of 1995, common equity is projected to be positive $304 million.

The projected change in capital structure and ratios are:

Table IV-12
Change in Capital Structure and Ratios
($ in millions)

	1990	1995
Long-term debt	$ 3,904	$ 7,116
Preferred stockholders equity	$ 486	$ 716
Common stockholders equity	$ (153)	$ 304
Total assets	$ 7,664	$13,979
Long-term debt to equity ratio	11.7	7.0
Long-term debt to total assets ratio	51%	51%
Common equity to total assets ratio	-2%	2%

Source: Northwest Financial Statements

Despite the projected repayment of the Senior Bank Debt and improvements in earnings, the Company will remain highly leveraged and thinly capitalized in 1995 (Exhibit IV-K). Common equity will only represent 2% of total assets. The debt to equity ratio will improve from 11.7 times in 1990 to 7.0 times in 1991 but long-term debt will remain stable as a percentage of total assets from at 51%. Northwest will continue to use a large amount of its cash flow to pay principal and interest payments in the years after 1995. Additionally, the Company will have to pay rental payments for aircraft used under operating leases.

I. Covenants

The Senior Bank Debt documents provide that Northwest comply with specified negative financial covenants. The Company assumes it will negotiate with the Senior Bank Debt lenders to ease or eliminate certain financial covenants that, according to Northwest's projections, the Company will not be in compliance with by December 31, 1991 and during the Plan period. While the Company projects that it will not be in compliance with certain of these covenants, the Company will be required to implement specific actions throughout the term of the Plan to remain in compliance. The following discussion is based on the covenants currently in force.

The four significant covenants stated in the Senior Bank Debt agreements are:

- Section 9.05 - Capital expenditures;
- Section 9.11 - Cumulative consolidated EBDIRAT;
- Section 9.12 - Fixed charge coverage ratio; and
- Section 9.14 - Leverage ratio.

Section 9.05 limits the amount Northwest can expend each year for aircraft and non-aircraft capital assets. Northwest's business strategy plans for aggressive expansion of its fleet. Based on the purchases outlined in the Financial Plan, the Company forecasts it will not be in compliance with this covenant beginning in 1993 and continuing through 1995. Over this five-year period, management can make certain adjustments in the timing of these expenditures to maintain compliance. In total, the Plan shortfall that can not be made up through changes in the timing of asset purchases is approximately $500 million out of a total capital plan of approximately $4 billion. Any assets not falling within the covenant levels will need to be deferred or the covenants will need to be amended to levels that can be met.

Section 9.11 provides for minimum levels of cumulative post-Acquisition consolidated EBDIRAT. "EBDIRAT" is earnings before depreciation, interest, rental payments, amortization, other miscellaneous non-cash charges, and taxes. Because the loan was negotiated before the merger, the basis for this calculation is pre-merger accounting policies and values. Per Northwest's projections, the Company will have an excess cumulative EBDIRAT of only $23 million at the end of 1991 on a $1.8 billion requirement. Even a small shortfall in 1991 profits will result in Northwest not being in compliance with this covenant as of December 31, 1991. The cumulative EBDIRAT requirement increases substantially throughout the projection period. Although the Plan calls for this covenant to be met throughout the Plan period, as discussed in Section IV-J "Sensitivity Analysis," the level of profitability could vary significantly from the Plan, causing this covenant not to be met.

Section 9.12 provides for minimum fixed charge coverage ratios. This ratio is calculated by dividing: (a) the total of consolidated EBDIRAT, net cash proceeds from asset sales, financing proceeds, and change in working capital; by (b) consolidated interest expense, rental payments, and cash capital expenditures. The Company's projections show that Northwest will not comply with this covenant in any of the projected years. Many variables affect this ratio. Management will need to adjust its level of financing and spending for several of these variables, such as capital expenditures and aircraft rental payments, to manage its compliance with this covenant, based on the actual level of EBDIRAT.

Section 9.14 provides for minimum leverage ratios. This ratio is calculated by dividing: (a) short and long term debt plus capitalized lease obligations; by (b) net worth (common and preferred stock plus retained earnings). According to the Plan, this leverage ratio covenant will be complied with in 1993, 1994, and 1995. Because of the large losses incurred by Northwest during the past two years, its negative retained earnings nearly exceed its common and preferred stock capitalization. As a result, the denominator in this calculation is quite small compared to the numerator. Therefore, even small changes in earnings significantly affect this calculation.

As of June 30, 1991, the Company was in compliance with all of the above covenants. However, by December 31, 1991, Northwest will probably be unable to comply with two or three of these covenants. According to the Financial Plan, Northwest will not be in compliance with the fixed coverage ratio and leverage ratio. In addition, it is highly likely the Company will not comply with cumulative consolidated EBDIRAT. The Company plans to use a portion of the proposed MAC Financing to make optional prepayments to the Senior Bank Debt lenders. As a result, Northwest expects the lenders will amend the covenants so the Company will not default on the covenants in 1991 and during the remainder of the Plan period.

J. Sensitivity Analysis

Throughout Section IV, we have described the key factors and assumptions of Northwest's Financial Plan as well as the projected operating and financial results. If achieved throughout the 1991 to 1995 period, this Plan will allow the Company to:

- Meet all operating and non-operating obligations;
- Repay all financial obligations maturing during the term of the Plan, including the Senior Bank Debt;
- Expend $9.6 billion for the purchase of new aircraft and other capital assets;
- React to external factors that may adversely affect the industry; and
- Improve its financial condition to be more competitive in the future.

The Company's Plan is highly dependent on a number of events occurring within the airline industry and within the Company. In analyzing the Plan assumptions, we noted a number of the assumptions that appear overly optimistic when compared to historical results or industry analyst forecasts. These include:

- The airline industry will not be adversely affected by major external events and consolidation of the Domestic airline industry will occur rapidly;
- Industry passenger yields will be over 17 cents in 1995 (compared to other industry estimates of approximately 15.3 to 15.7 cents), and Northwest will obtain higher passenger yields than the industry average;
- Passenger revenue in the Pacific region will increase 20.6% annually during the five year period;
- System-wide market share of ASM's will increase from 11.1% in 1990 to 14.6% in 1995;
- Manageable expenses will increase at a slower rate than revenue and fuel prices will remain stable, thus the income contribution margin will increase over historical levels of approximately 11.8% from 1989, 6.3% in 1990 to 18.1% in 1995; and

- Favorable aircraft financing will allow the Company to sell one-fourth of its new aircraft to lessors at a price above actual purchase price.

There will usually be differences between projected and actual results in any plan that presents prospective financial information because events and circumstances frequently do not occur as expected, and those differences may be material. At our request, Northwest prepared a variety of sensitivity analyses so that we could understand how their Plan responded to changes in key assumptions. As part of that process a sensitivity analysis was conducted that reduced the Company's projected passenger revenues to levels that more closely parallel industry analyst forecasts. Specifically, this included changes in the following assumptions:

- Achieving system-wide passenger yields over the five-year period consistent with AEI projections of 15.3 cents in 1995 versus Plan of 16.87 cents;

- Inflation estimates of 3.5% annually versus Plan of 5.0%;

- Continued growth in Pacific ASMs at a 9 percent annual growth rate versus Plan average of 14.4%;

- Continued growth in Domestic ASMs in 1995 of 8.6% versus Plan of 16.9%; and

- Sale/leaseback transactions at actual purchase price of aircraft acquired.

The cumulative effect of the sensitivity analysis over the 1991-1995 period was to:

- Decrease passenger revenue by $4.8 billion or 9%;

- Decrease net income by $814 million or 95%; and

- Decrease cash flow from operations by $1.248 billion or 28%.

Exhibits IV-L, IV-M, and IV-N show the affects of the change in passenger revenues, operating margin, and net earnings and losses compared to Plan. Both of these comparisons in the Company's financial results show significant decreases from the

Plan. The changes are especially evident in 1995 after five years of cumulative effects. Overall, the following 1995 percentage changes compared to Plan resulted:

Table IV-13
Sensitivity Analysis
Change in 1995 Results
Plan vs. Sensitivity Analysis
($ in millions)

	Dollars	% Change
Total revenue	$2,514	(17%)
Operating margin	950	(35%)
Net income	461	(71%)
Cash flow from operations	713	(42%)

Source: Northwest Operations Financial Plan Sensitivity Analysis

In response to the reduction in revenue and cash flow from the sensitivity analysis, management made the following changes in operating, capital expenditure, and financing assumptions:

- Commission and advertising expense would decrease proportionally with the decline in revenues;
- The reduced level of inflation would cause a corresponding decrease in manageable expenses;
- A 2% payroll productivity improvement (in addition to the Plan's 3% payroll productivity improvement) would be achieved;
- A reduction in variable expenses due to lower ASMs;
- A reduction in payroll expense at one-half the decrease in ASMs as higher unit labor costs would be expected from slower growth as hiring of new, lower paid employees would be curtailed; and
- Reduction in aircraft and non-aircraft capital expenditures consistent with slower growth.

The $3.58 billion difference between the $4.83 billion shortfall in revenue and $1.25 billion shortfall in cash flow from operations represents the reductions in expenses and changes in working capital as projected by the Company, as shown below:

Table IV-14
Sensitivity Analysis
Changes in Operating Results
($ in millions)

Revenue	$(4,827)
Manageable expenses	3,132
Ownership costs	351
Other income	21
Income taxes	510
Depreciation	(128)
Working capital changes	(307)
Cash flow from operations	$(1,248)

Source: Northwest Financial Plan Sensitivity Analysis

This analysis indicates that under the above assumptions, management believes that cash flow from operations would be reduced by approximately $.26 for every one dollar shortfall in revenue. The reduction in manageable expenses alone is almost two-thirds of the change in revenues.

In order to fund the $1.248 billion decrease in cash flow from operations and the $282 million in sale/leaseback premiums over purchase price for a total reduction in cash flow of $1.530 billion, the Company made the following adjustments in capital expenditures and financing options:

Table IV-15
Sensitivity Analysis
Investing and Financing Adjustments
($ in millions)

Total reduction in cash flow	$(1,530)
Adjustments which generate cash	
Reduction in capital expenditures	2,528
Sale of accounts receivable	200
Credit facility borrowing	65
Defer Senior Bank Debt prepayment	198
MAC Financing	320
Reduction of cash balance	419
	3,730
Adjustments which require cash	
Reduction in sale/leaseback proceeds	(554)
Reduction in other liabilities, net	(1,646)
	(2,200)
Net adjustment	$ 0

This analysis illustrates the flexibility the Company believes it has to adjust to economic and industry conditions that are less favorable than the Financial Plan but more consistent with industry analyst forecasts.

Variance in the other key assumptions will have a similar impact on the Company's performance over the period. For example, a change in each of the following factors independently would result in the following estimated results:

- Each one-tenth of one cent decrease in yield could decrease total passenger revenue by as much as $77 million, based on 1995 assumptions.

- Each one-half of one percent decline in Domestic market share would reduce revenue by $262 million; and

- A one percent decrease in profit margin would decrease operating income by $545 million.

This analysis illustrates that the Company's future financial performance is highly dependent on the achievement of a number of assumptions.

According to the Plan, the Company will generate enough cash flow to meet its obligations, including the Senior Bank Debt. However, in the event it does not generate the amount of cash projected, Northwest may have to exercise additional financial flexibility. The sensitivity analysis described earlier showed how the Company would anticipate reacting to industry assumptions that were favorable but not as favorable as the Company's Plan. In the event that the strong performance of the airline industry anticipated by industry analysts is not achieved during 1991 to 1995 or that Northwest is not successful in performing at levels comparable to the industry, the Company would face even lower levels of revenue, profitability, and cash flow. This would require the Company to implement further operating and capital expenditure reductions and incur additional financing transactions beyond those outlined above to provide funds to pay its financial obligations.

Management has outlined a series of debt and equity financing alternatives should additional capital be required during the 1991 to 1995 Plan period or during the longer term 1996 to 2000 capital planning horizon. Northwest believes these alternatives could provide it with the flexibility to continue to meet its financial obligations if circumstances demand. The financing alternatives include:

- Refinancing the Senior Bank Debt - The Company has reduced the Senior Bank Debt from its initial balance of $3.1 billion to $1.4 billion through a series of early prepayments. Management believes that at levels below $1 billion, the Company may be able to renegotiate the terms and conditions, including the repayment schedule, for the residual balance.

- Refinancing the Japanese land mortgage - The Japanese land mortgage is a non-recourse loan that is secured by prime real estate in Tokyo. In the event the Company cannot meet this obligation of $891 million when it matures in 2000, the result would be the sale or transfer of the land to the lender for the full value of the loan. Thus, the Company would not be subject to any further payments other than possibly the Japanese capital gains tax on the sale. The failure to pay this loan in a sense resembles a deferred sale of the property. A second alternative would be to refinance or seek additional financing in lieu of repayment.

- Deferring the mandatory preferred stock redemption - The preferred stock issues are redeemable by the Company by 1998 and 1999 for a total of $700 million. However, the preferred stock agreements provide that in the event the Company is unable to meet the mandatory redemption obligation, it is bound to discharge the obligation as soon as it is able to do so.

- Raise additional cash through the sale/leaseback of assets - The Company owns a number of wide-body aircraft and certain real estate properties that could be used to raise cash, as necessary. The Company has indicated that discussions have been held with investment bankers regarding over $500 million in potential sale/leaseback transactions.

- Sale of accounts receivable - The Company has accounts receivables from the sale of tickets through credit cards that could provide $200 million in cash on a non-recourse basis.

- Issue equity - The Company is currently privately held but has received unsolicited proposals to sell portions of the Company over the past year. The amounts have varied depending on the structure of the transactions from $150 million to over $1 billion. While any future sale would be highly dependent on market conditions and Company performance at the time, management believes that a common stock offering could be an additional means of raising capital.

In addition to the above, the Company would always have the option of selling assets to raise cash to meet its financial obligations. The amount of funds that may be available through these alternatives at any point in time and at acceptable terms cannot be specifically evaluated as it is not appropriate to evaluate such alternatives beyond a three-to-five year planning time frame. However, these items illustrate the financial flexibility management believes exists to address any unexpected events.

K. Summary of Findings

The airline industry has experienced significant volatility over the past decade. Consequently, the industry is consolidating and only a handful of the once-dominant carriers remain. Industry profitability has been severely impaired because a number of struggling airlines have engaged in fare wars to protect their market share. Northwest management believes failing carriers will be eliminated in the near future. Thus, Northwest and three or four other major airlines will remain as the nation's dominant carriers. As a result, the industry will recover and passenger yields will rise dramatically from 1990 to 1995. Profitability will improve because of higher airfares and controlled increases in operating costs. To a degree, this optimistic view is shared by industry analysts, including Airline Economics and Boeing.

AEI believes the airline industry will recover during the next several years. They forecast increases in passenger yields and traffic over the next 3-4 years with a return to normal cyclical patterns in subsequent years. Boeing projects demand for air travel will grow moderately but yields will decline in real terms (adjusted for inflation). The FAA believes demand and passenger yields will rise moderately.

Although the prospects for the industry appear favorable, the timing associated with achieving consolidation in the industry that is sufficient to achieve greater control of passenger yields may not occur as quickly as projected by Northwest. Recent articles suggest the benefits of consolidation are years away and the struggling airlines will continue to exert downward pressure on airfares.

Within this economic backdrop, Northwest prepared a Financial Plan that makes various assumptions, including that the Company will gain from the pending consolidation by increasing capacity; increase airfares as a result of its customer preference program targeted to the business travelers; and benefit from the continued growth in the Pacific market. Based solely on this Financial Plan, the Company projects that Available Revenues will be at least sufficient during each year of the term of the Financial Plan, 1991 to 1995, to pay when due all financial obligations of the airline corporation. If the economic and other financial conditions projected in the Financial Plan for 1995 continue throughout the term of the Financing, the future financial condition of the Company and its Available Revenues, as projected by the Company, would be sufficient to allow the Company to continue to meet its financial obligations over the remaining period of the Financing.

According to the Plan, the Company will repay a majority of its Acquisition-related financing by the end of 1995 and will be able to generate sufficient cash flow to purchase additional aircraft, react better to external forces and to meet its other obligations.

Our analysis of Northwest's current financial condition and five-year Financial Plan indicates Northwest's ability to meet its financial obligations over the next five years is highly dependent on economic recovery, industry consolidation, and its ability to attain a significant increase in market share. In the event that some of these favorable conditions do not occur, Northwest will need to reduce operating expenses, capital expenditures, and seek additional financing.

Refinancing is a normal business practice because companies generally seek to expand rather than decrease their capital structure. The implicit financial risk is that Northwest may not be able to negotiate a viable restructuring or recapitalization because of its operating performance and high debt load. To better understand the issues facing the Company during the time frame contemplated in the MAC Financing, the following section describes key events which may occur.

Over the next operating cycle (1-2 years), the Company is required to make only minimal debt repayments and is committed to purchase relatively few aircraft. If the economy recovers, the Senior Bank Debt is restructured, and the $600 million revolving credit line remains available, the Company should be able to meet its obligations during this period.

During the latter stages of its business planning horizon (3-5 years), the Company faces significant debt repayment obligations, aircraft purchase commitments, and other capital expenditures that amount to almost $10 billion. As discussed in previous subsections, passenger yields, market share, and Pacific growth rates (among others) below Plan levels could reduce overall cash to meet these obligations and require the Company to implement many of the cost reductions outlined in the sensitivity analysis. Assuming the availability of the alternative financings to make up any shortfall in cash flow, such as the sale of accounts receivable, on-time repayment of certain debt obligations that were assumed to be paid early in the Plan, and other financings, including the MAC Financing, that were not included in the Plan, the Company continues to project that Available Revenues will be sufficient to pay its financial obligations during the term of the Financial Plan.

In the subsequent time horizon (5-10 years), the Company continues to face substantial obligations. Specifically, these include aircraft purchase commitments and options, redemption of preferred stock, and repayment of the Japanese land mortgage. Northwest's repayment obligations during 1996 to 2000 from existing and new obligations total $4.1 billion. This amount is comprised of $1.205 billion existing debt, $1.302 billion new debt, $700 million redeemable preferred stock, and $891 million non-recourse Japanese land mortgage.

The Company's performance beyond the 10-year time frame will be dependent on a continuation of Company and industry trends occurring in the 1-5 and 6-10 year periods.

The Acquisition-related financing is the significant item that differentiates Northwest from other airlines. In general, it appears unreasonable to assume that a company financed primarily with debt could repay the debt within 5-10 years with excess operating cash generated by that company. This would be very difficult for any company, especially one in a competitive and cyclical industry such as the airline industry.

Management has outlined a series of debt and equity financing alternatives should additional capital be required either during the 1991 to 1995 Plan period or during the longer term 1996 to 2000 capital planning horizon. Northwest believes these alternatives would provide it with the flexibility to continue to meet its financial obligations if circumstances demand. The amount of funds that may be available through these alternatives at any point in time and at acceptable terms cannot be specifically evaluated as it is not appropriate to evaluate such alternatives beyond a three-to-five year planning time frame. However, assuming the occurrence of the favorable economic and industry conditions projected by industry analysts, Northwest's ability to achieve industry results, and the availability of financing alternatives, such as those identified by management, throughout the term of the Financing, the future financial condition of the Company should allow Northwest to continue to meet its financial obligations over the remaining period of the Financing.

In summary, Northwest has recently incurred large losses, continues to hold a large portion of its Acquisition-related debt, and has little equity. In addition, its prospects for the future are dependent on many circumstances that it does not control. Given this current position, management has outlined a Financial Plan and expense reduction and financing alternatives should the Plan not be achieved. Notwithstanding the financial flexibility suggested by these alternatives, the current and prospective financial condition of Northwest is such that the proposed Financing has significant elements of risk.

Recognizing the financial risk to MAC should it proceed with the Financing, the Commission must balance the financial risk against the economic development and public policy objectives that must also be considered in undertaking this Financing. MAC should also pursue agreements with Northwest as part of the Financing that would allow MAC to partially mitigate its financial risk through an appropriate combination of the following:

- Collateral sufficient to protect MAC's financial exposure;

- Financial covenants that would enable MAC to monitor the financial performance of Northwest;

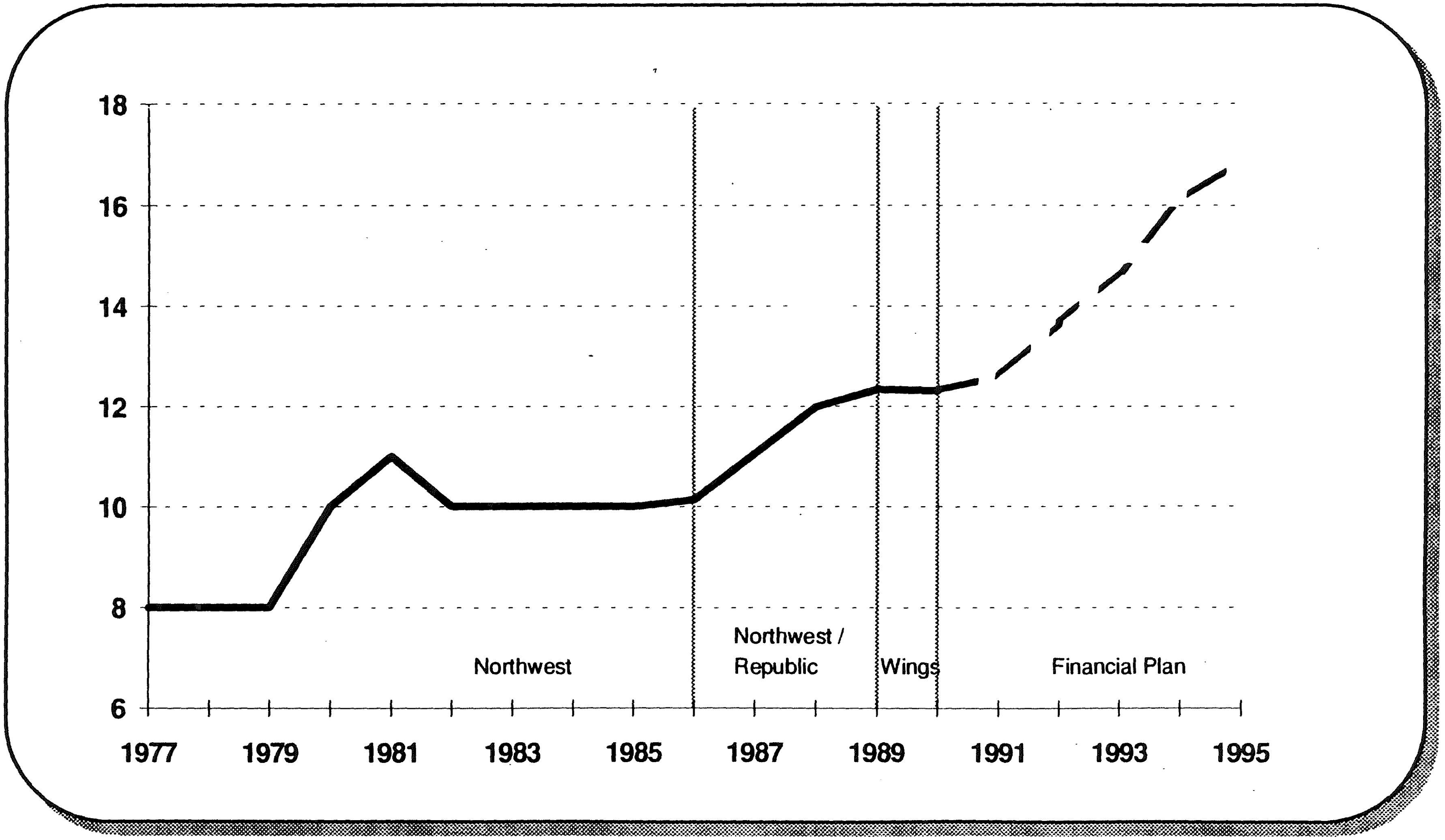
- Restrictive covenants that would constrain the level of certain cash transactions that could be detrimental to the Financing, such as redemption of preferred stock or payment of dividends or other distributions; and

- Repayment provisions that would ensure the Financing is repaid in total or proportionately in the event of significant changes in the Company.

In addition, MAC should require that Northwest obtain a waiver from Banker's Trust concerning the financial covenants associated with the Senior Bank Debt that the Company is not expected to meet. The obtaining of a waiver is necessary, based on the Company's Financial Plan, in order to avoid possible default.

Northwest
Historical & Projected System-Wide Passenger Yield
(in cents)

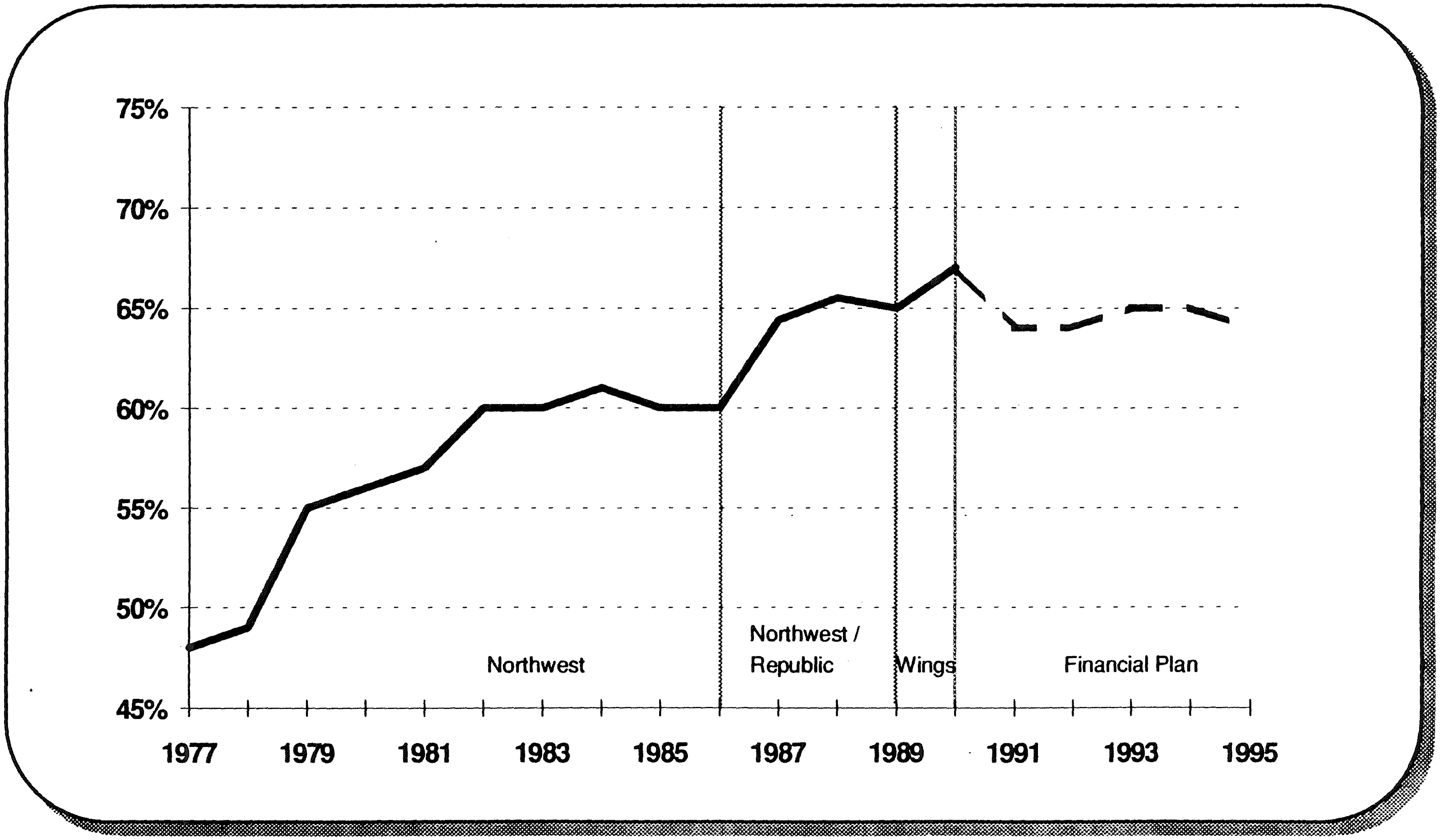
Exhibit IV-A



Sources: Northwest 1986 Annual Report
Northwest Financial and Statistical Reports, 1987 and 1989
Northwest Five Year Financial Plan, August 12, 1991

Northwest
Historical & Projected System-Wide Load Factors

Exhibit IV-B

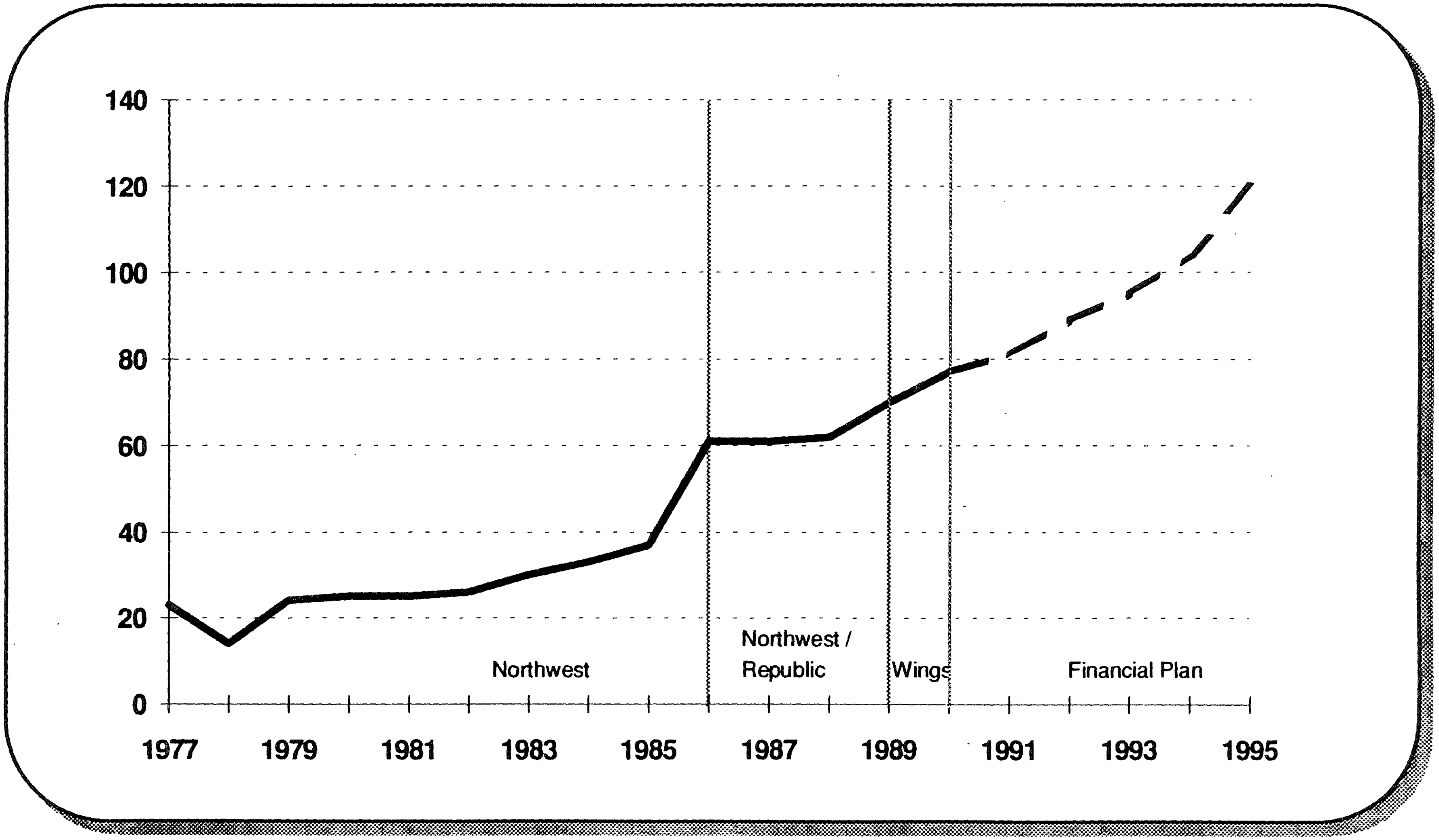


77

Sources: Northwest 1986 Annual Report
Northwest Financial and Statistical Reports, 1987 and 1989
Northwest Five Year Financial Plan, August 12, 1991

Exhibit IV-C

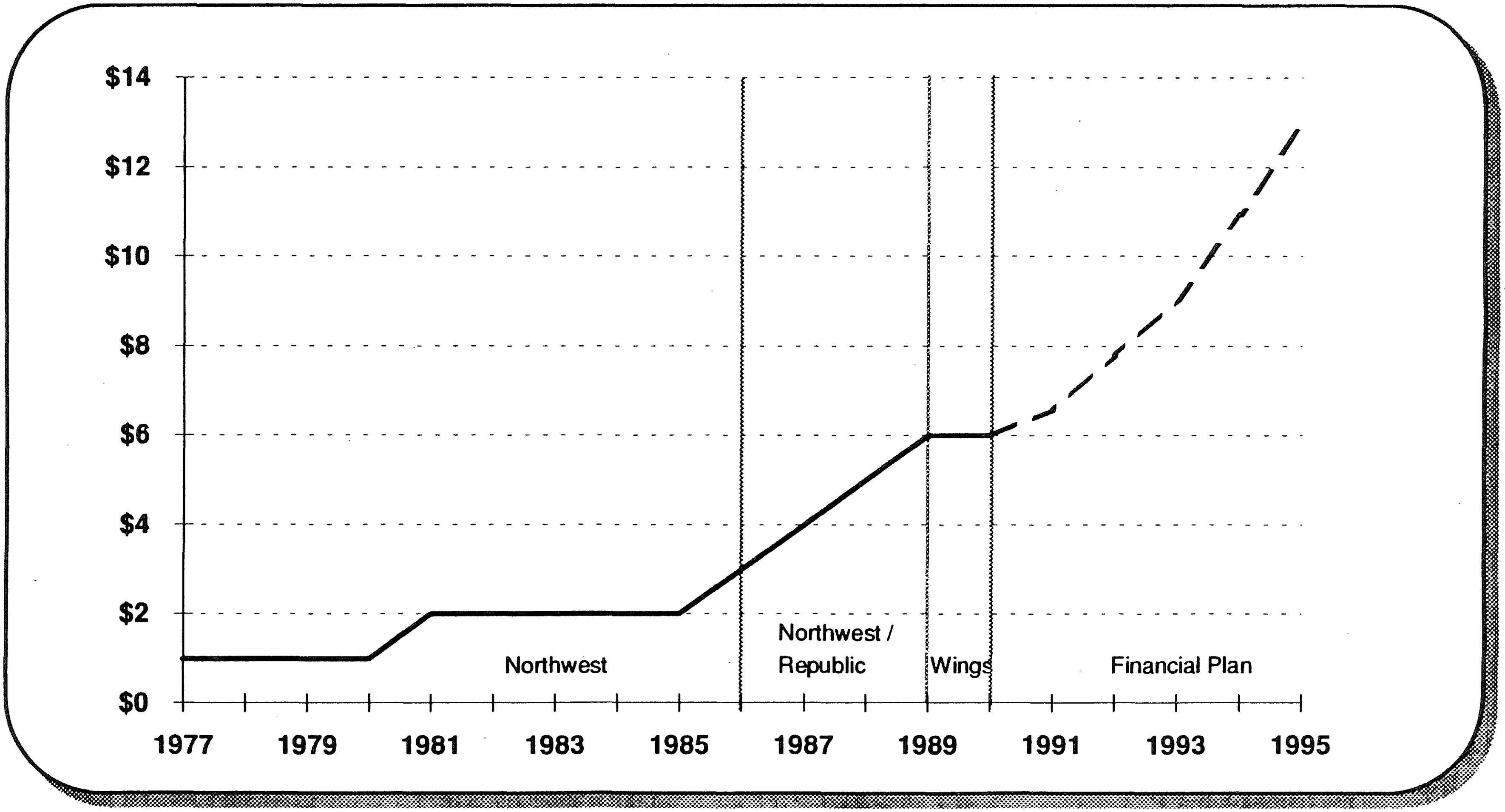
Northwest
Historical & Projected System-Wide Available Seat Miles
(in billions)



Sources: Northwest 1986 Annual Report
Northwest Financial and Statistical Reports, 1987 and 1989
Northwest Five Year Financial Plan, August 12, 1991

Northwest
Historical & Projected System-Wide Passenger Revenues
(in billions)

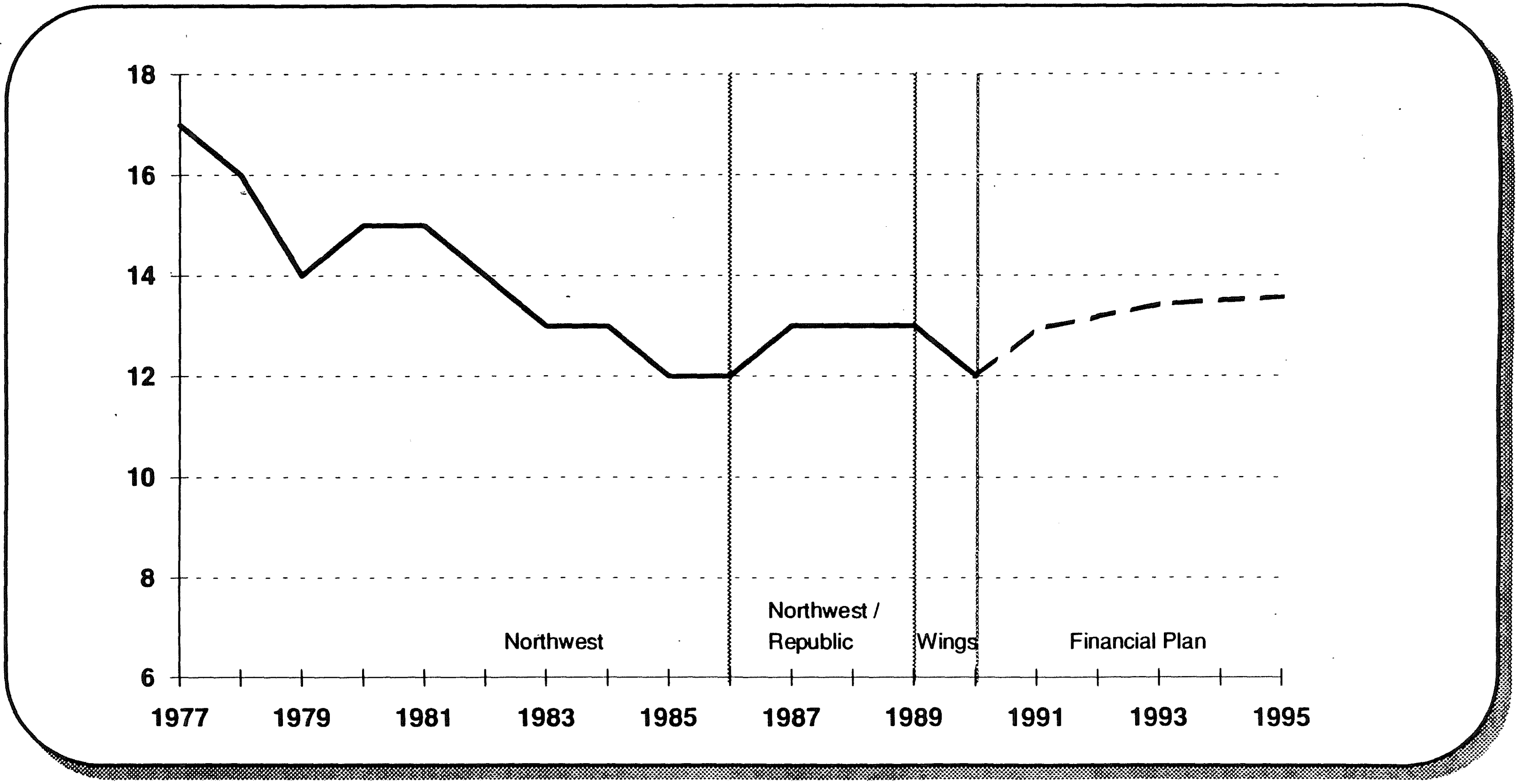
Exhibit IV-D



Sources: Northwest 1986 Annual Report
Northwest Financial and Statistical Reports, 1987 and 1989
Northwest Five Year Financial Plan, August 12, 1991

Northwest
Historical & Projected Industry Yields in 1990 Dollars
(in cents)

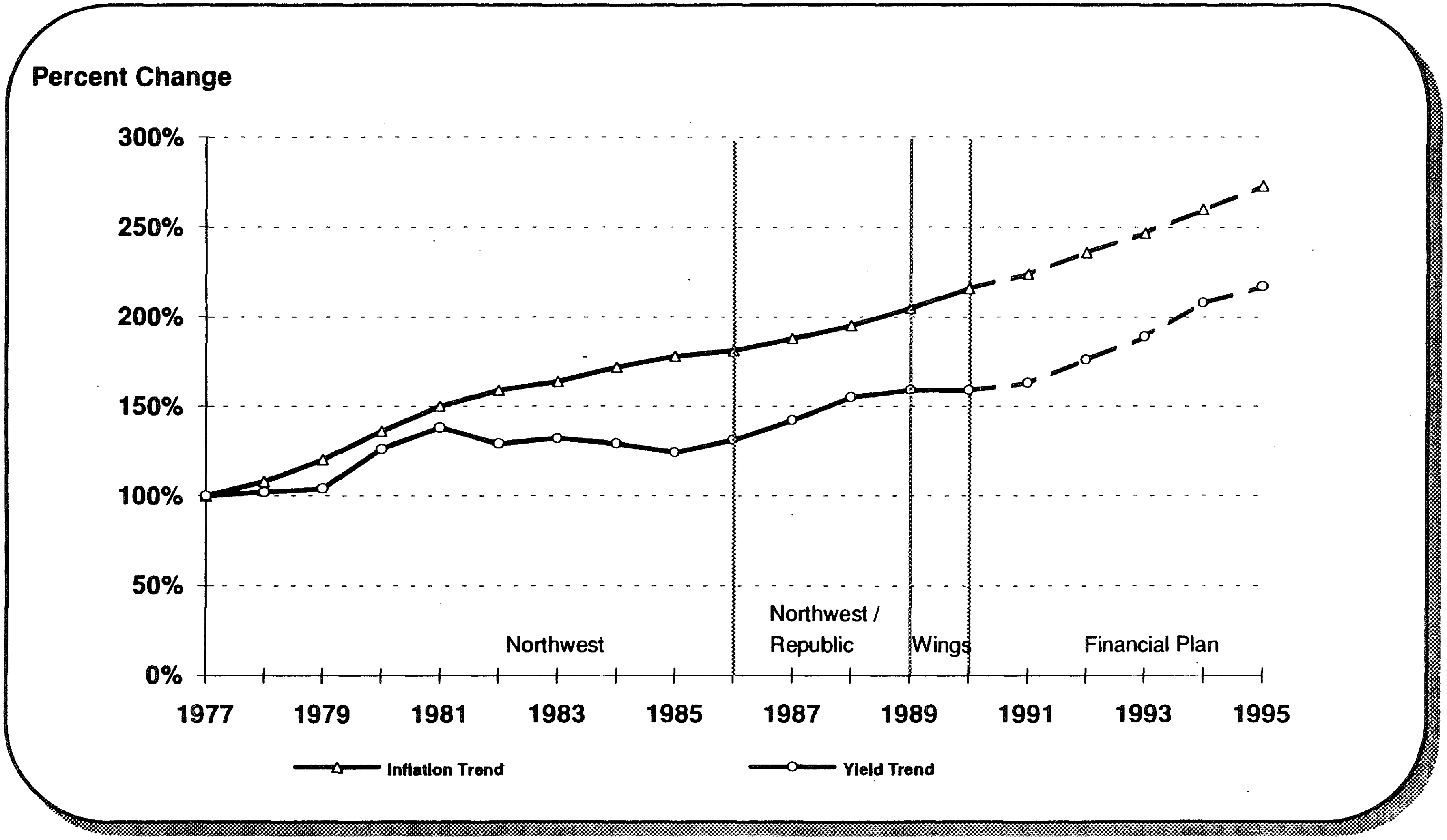
Exhibit IV-E



Sources: <u>Economic Report of the President, 1991</u>
Northwest 1986 Annual Report
Northwest Financial and Statistical Reports, 1987 and 1989
Northwest Five Year Financial Plan, August 12, 1991

Northwest
Historical & Projected Inflation & Yield Trends

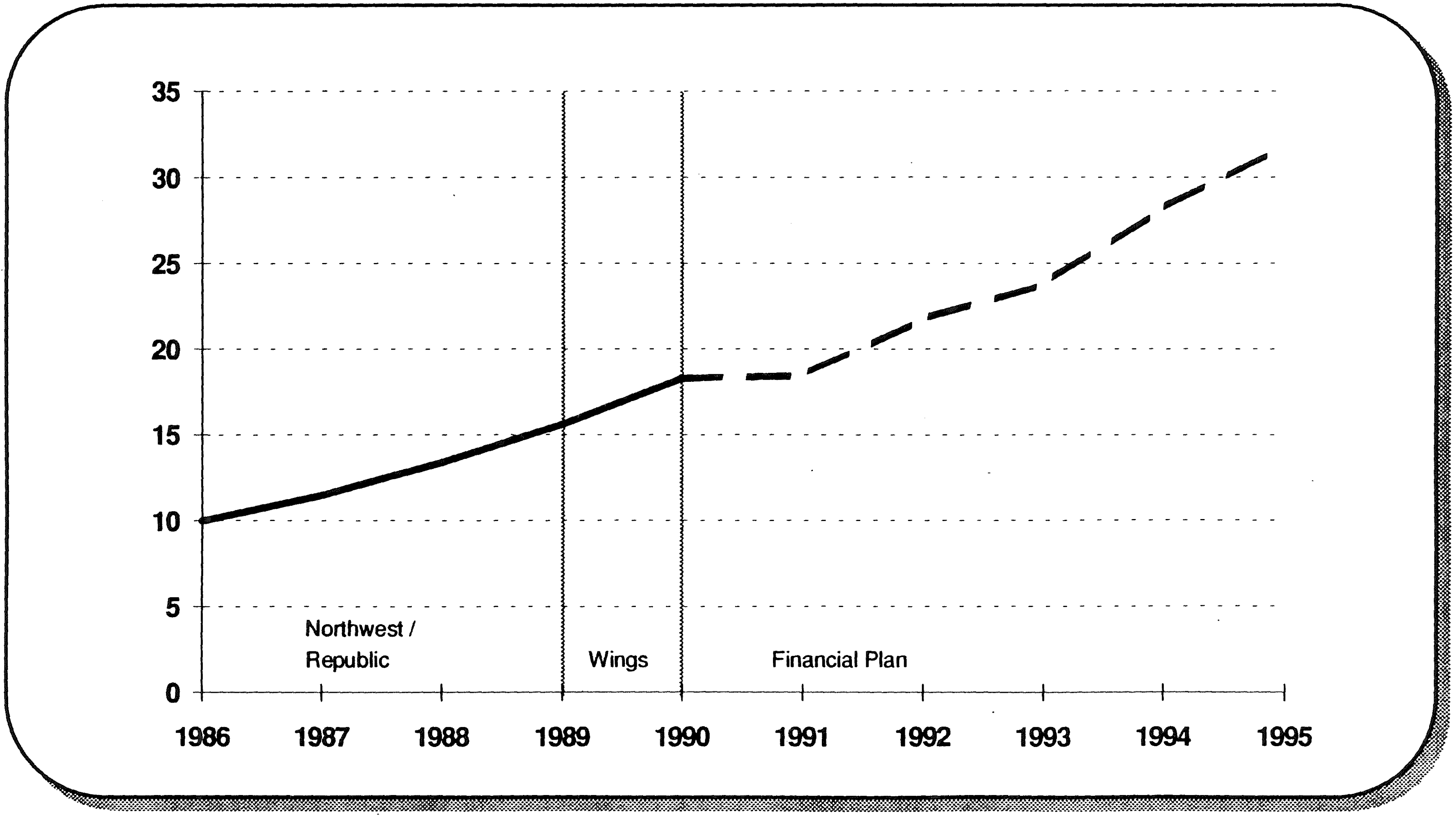
Exhibit IV-F



Sources: Economic Report of the President, 1991
Northwest Financial and Statistical Reports, 1989-1990
Northwest Five Year Financial Plan, August 12, 1991
Northwest 1986 Annual Report

Northwest
Pacific Market Revenue Passenger Miles
(in billions)

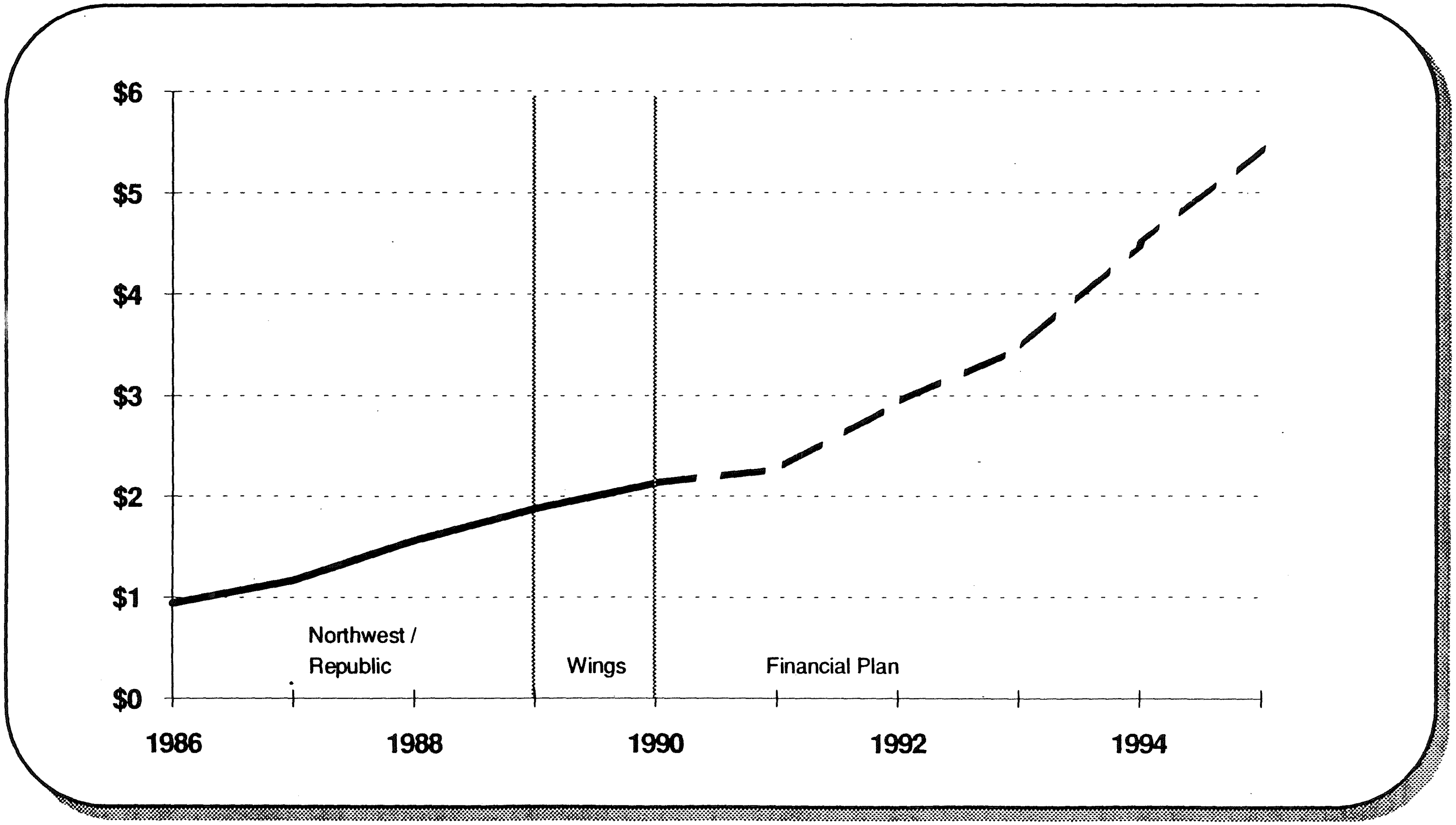
Exhibit IV-G



Sources: Northwest 1986 Annual Report
Northwest Financial and Statistical Reports, 1987 and 1989
Northwest Five Year Financial Plan, August 12, 1991

Northwest
Pacific Market Passenger Revenues
(in billions)

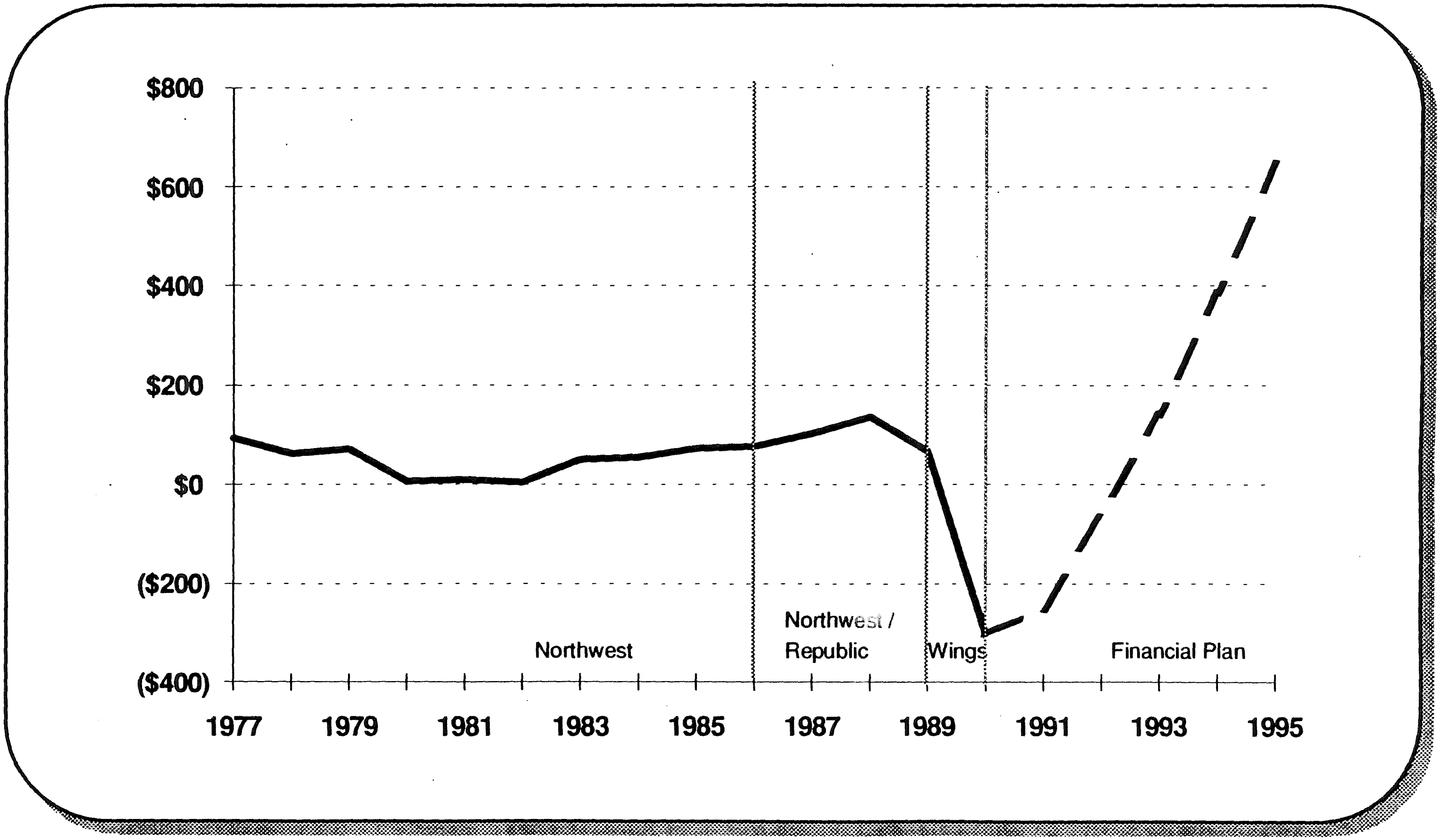
Exhibit IV-H



Sources: Northwest 1986 Annual Report
Northwest Financial and Statistical Reports, 1987 and 1989
Northwest Five Year Financial Plan, August 12, 1991

Northwest
Historical and Projected Net Earnings and Losses
(in millions)

Exhibit IV-I



Sources: Northwest 1986 Annual Report
Northwest Financial and Statistical Reports, 1987 and 1989
Northwest Five Year Financial Plan, August 12, 1991

Northwest
Fleet Plan

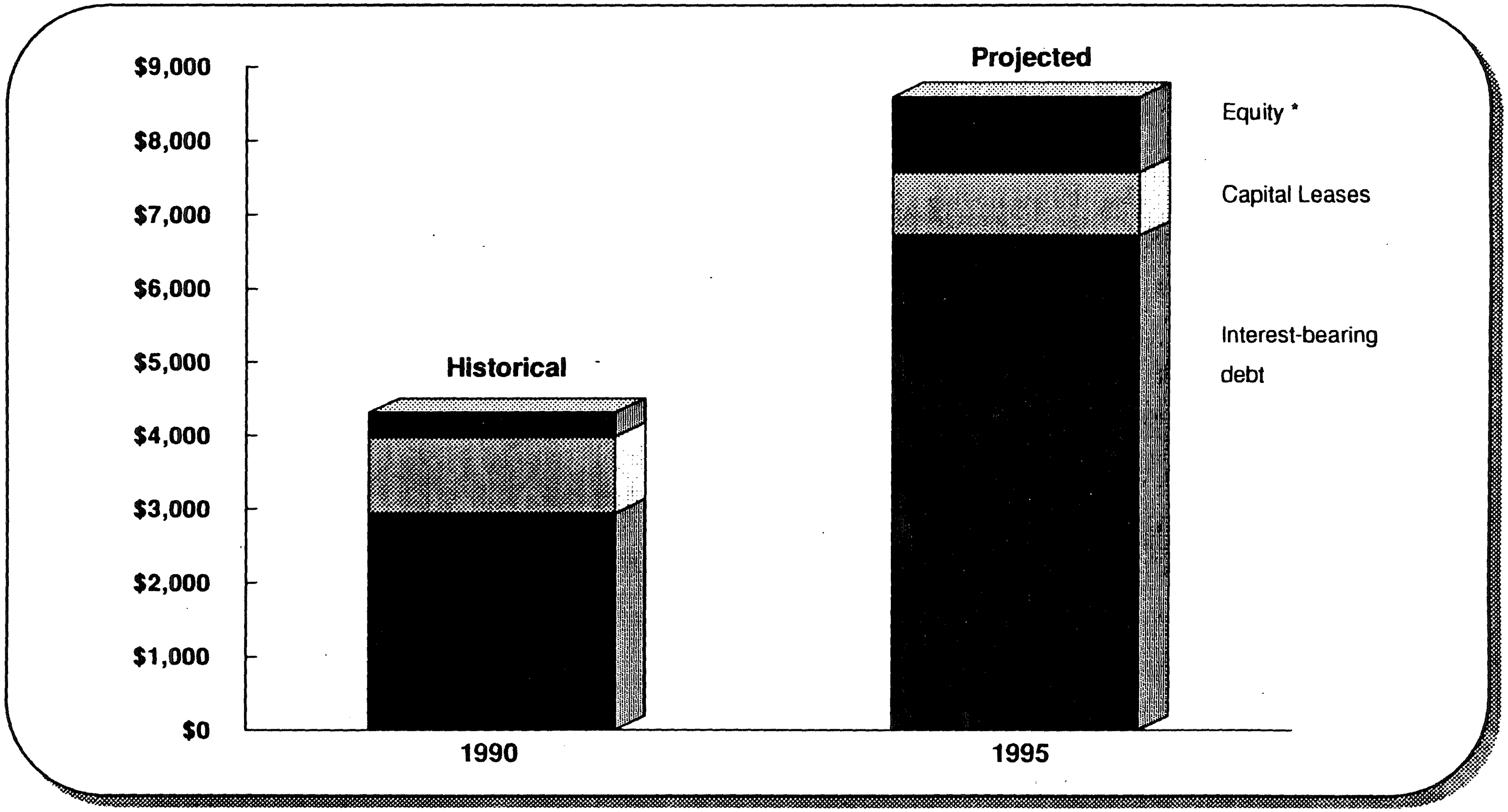
Exhibit IV-J

AIRCRAFT TYPE	1990	1995	1999
STAGE 2 AIRCRAFT			
DC-9	139	115	75
B-727	71	35	35
Total Stage 2	210	150	110
STAGE 3 AIRCRAFT			
A320/A321	11	100	120
B-757	33	62	95
DC-10	20	28	28
B-747	50	56	48
MD80	8	0	0
A330/A340	0	30	44
New '110 Seat'	0	0	56
Total Stage 3	122	276	391
Total Stage 2	210	150	110
Total Aircraft	332	426	501
STAGE 2 AS A % OF TOTAL	63.3%	35.2%	22.0%
STAGE 3 AS A % OF TOTAL	36.8%	64.8%	78.0%

Source: Northwest Financial Plan, August 12, 1991

Northwest
Comparison of Historical & Projected Capital Financing
(in millions)

Exhibit IV-K

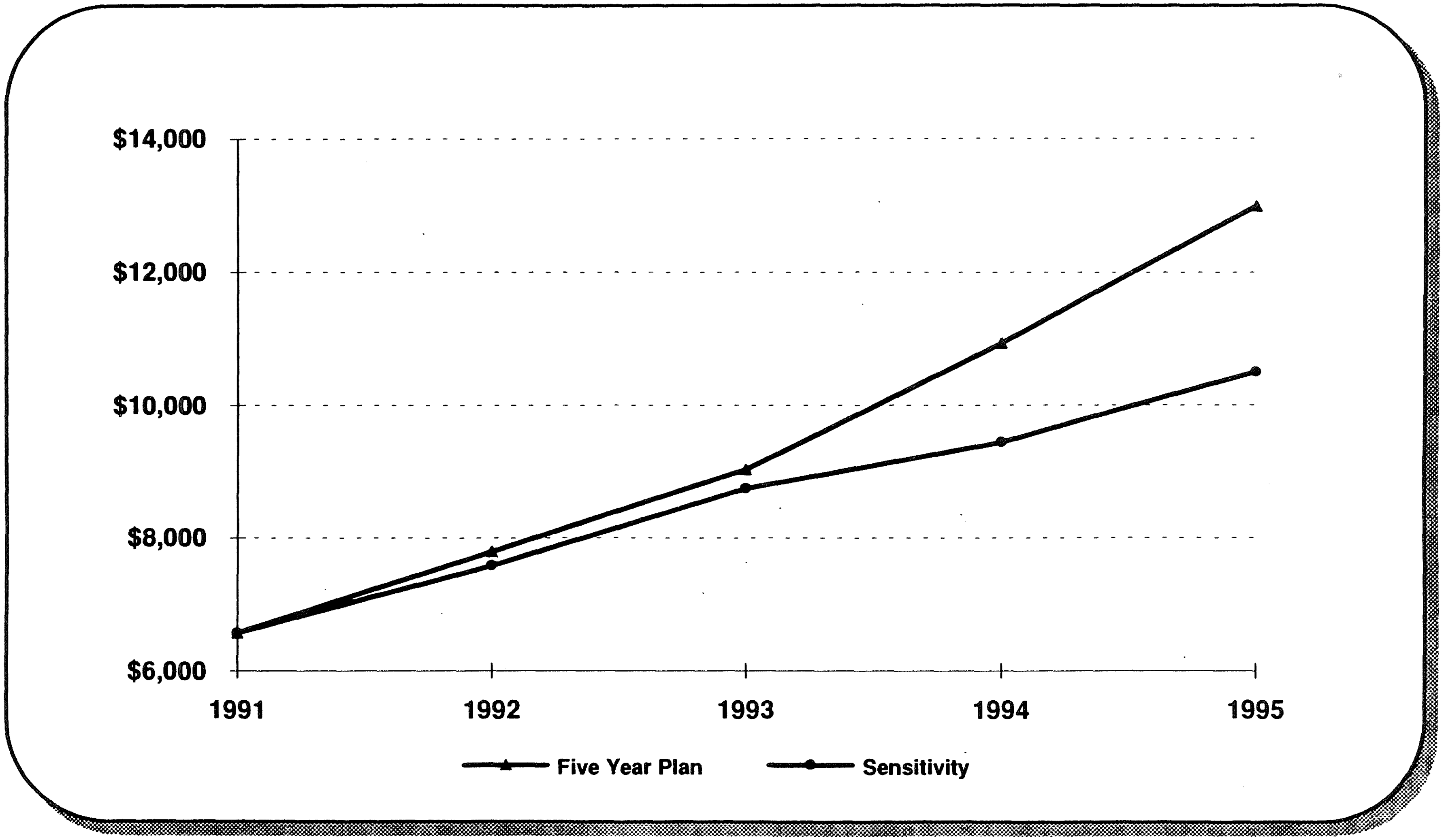


Note: 1990 Equity includes Preferred Equity of $486 and Common Equity of ($153). Projected 1995 Equity includes Preferred Equity of $716 and Common Equity of $304.

Sources: Northwest 1990 Annual Report
Northwest Audited Financial Statements, December 31, 1990
Northwest Five Year Financial Plan, August 12, 1991

Exhibit IV-L

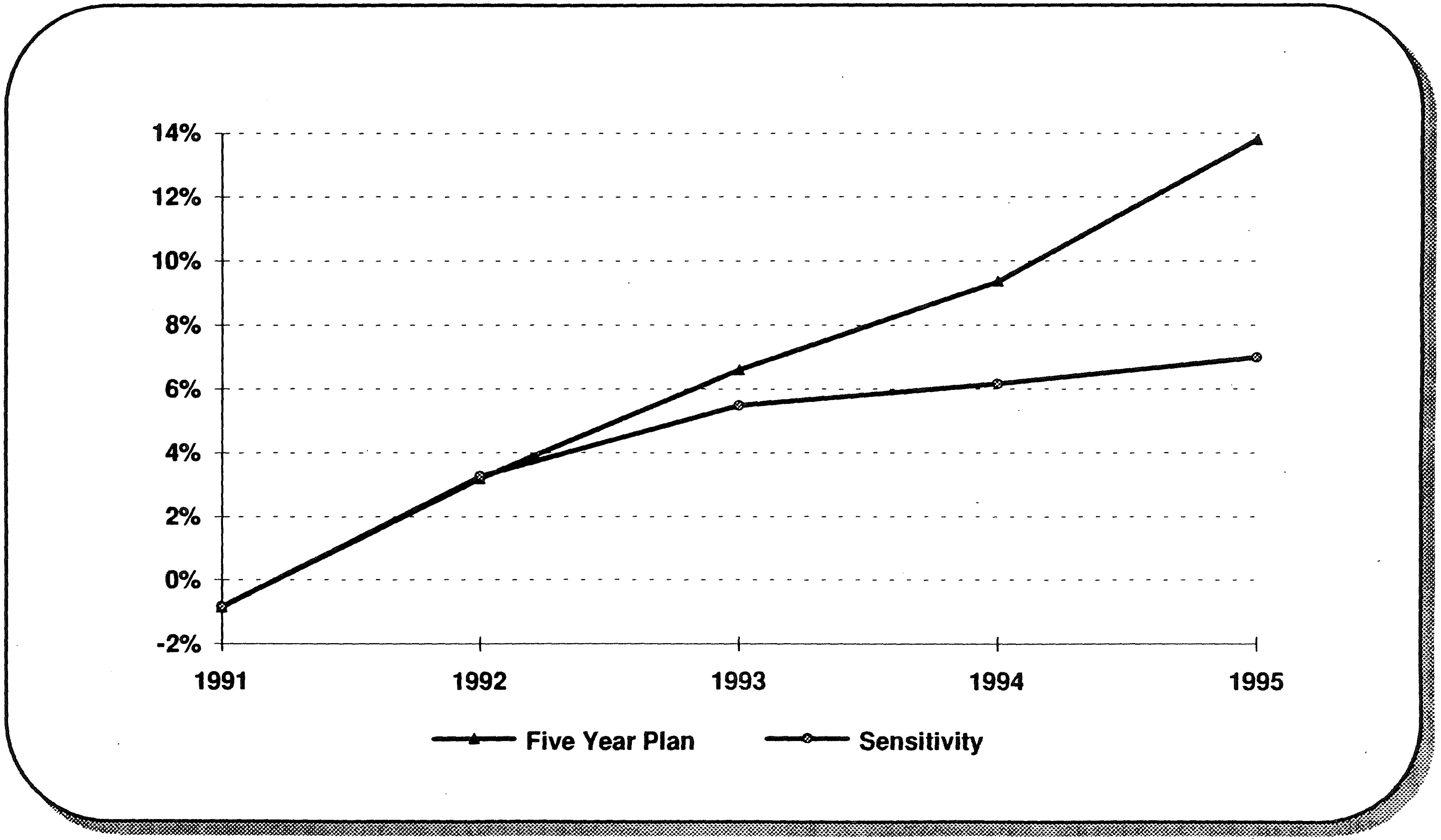
Northwest
Sensitivity Analysis
Passenger Revenues



Sources: Northwest Five Year Financial Plan, August 12, 1991
Northwest Five Year Financial Plan Supplemental Schedule, October 29, 1991

Northwest
Sensitivity Analysis
Operating Margin

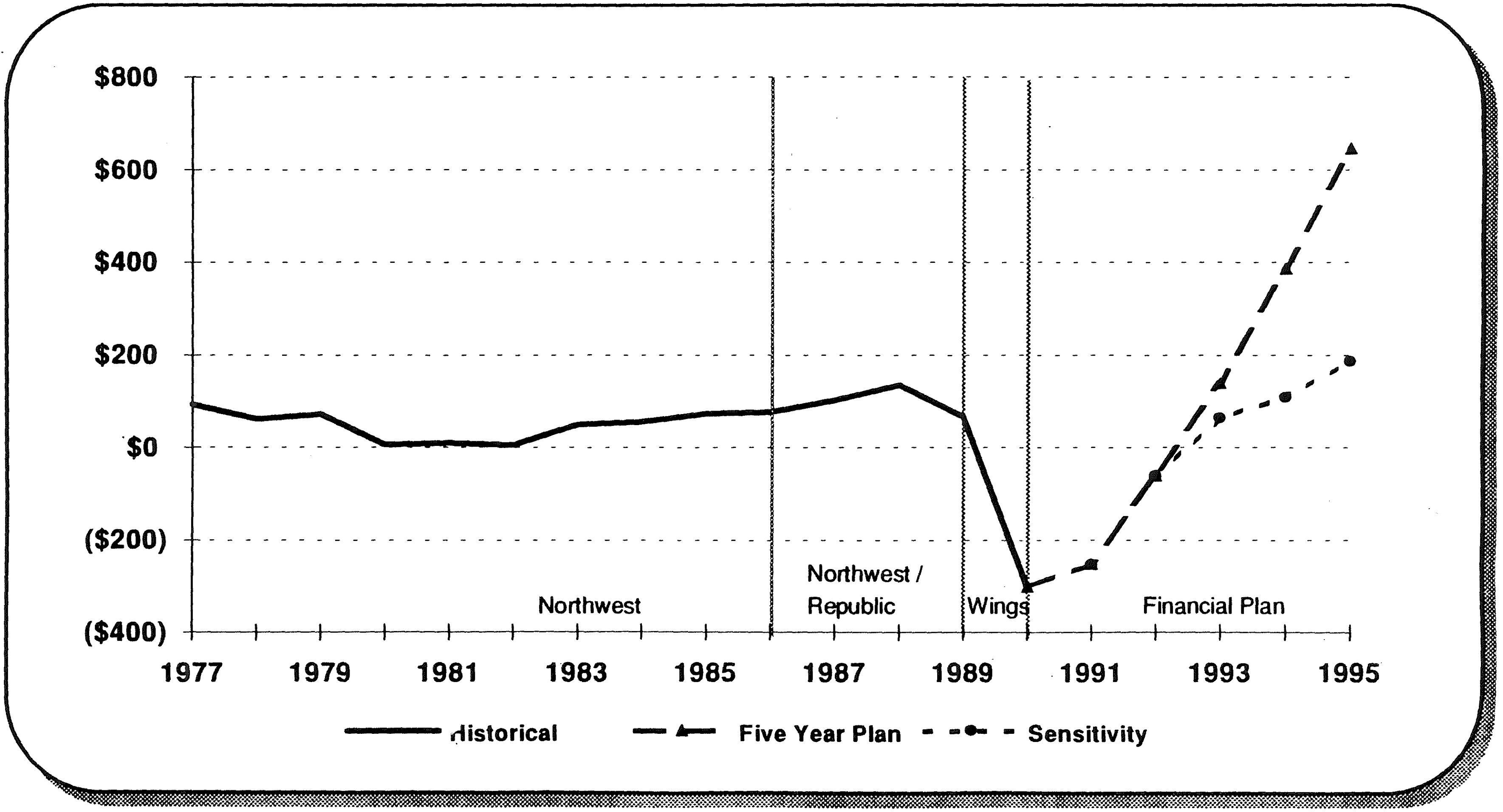
Exhibit IV-M



Sources: Northwest Five Year Financial Plan, August 12, 1991
Northwest Five Year Financial Plan Supplemental Schedule, October 29, 1991

Northwest
Sensitivity Analysis
Historical & Projected Net Earnings & Losses
(in millions)

Exhibit IV-N



Sources: Northwest 1986 Annual Report
Northwest Financial and Statistical Reports, 1987 and 1989
Northwest Five Year Financial Plan, August 12, 1991

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Chairman

Lee R. Howard
Chief Executive Officer

Harold "Hap" Pareti
President and
Chief Operating Officer

Russell Thayer
Senior Vice President

Status of the US Airline Industry

and

Northwest Airlines

Prepared by:

Airline Economics, Inc.
1130 Connecticut Avenue
Washington, DC 20036

This paper discusses the historical, current and future competitive and financial status of the US airline industry and the relative position of Northwest Airlines within this industry. It is intended to present a picture of the industry as it stands today; a forecast of the industry's future, and the prospects for Northwest Airlines within this context. Along with the financial data being reviewed and prepared by Price Waterhouse, this paper addresses those competitive and financial issues that are pertinent for MAC in addressing the proposed bond financing for Northwest.

I. STATUS OF THE US AIRLINE INDUSTRY

A. HISTORICAL FINANCIAL PERFORMANCE - Prior to passage of the Airline Deregulation Act in 1978, the U.S. airline industry was heavily regulated. The Civil Aeronautics Board (CAB) controlled routes, pricing and new entry. These controls resulted in the larger trunk carriers carrying approximately 90% of domestic passengers and income levels were essentially controlled to "reasonable" levels by governmental influence. Since deregulation in October 1978, the US airline industry has gone through significant changes. The power of airline managements to make the decisions regarding route entry and prices, coupled with the impact of external events, resulted in a very cyclical 12-year period, with years of heavy losses and years of significant profits. Deregulation and the external economic and political events all played significant roles in these results.

The years immediately following deregulation were marked by a severe recession in the US economy. This economic downturn came at a time when the industry was undergoing major expansion as a result of deregulation. The result was a period of heavy losses in the U.S. airline industry, which provided the first wave of consolidation. The recession had an immediate impact on certain carriers that were operating at that time. The original Braniff, which had been very profitable during the 1970s, found the combination of its massive expansion under deregulation and the recession extremely negative. The result was its initial bankruptcy in May 1983. It was also during this period that Continental Airlines, facing sudden new competition on all its major routes, experienced heavy losses, and its initial bankruptcy in September 1984. Other airlines which went through a difficult period included Western, Republic, Eastern, TWA and Pan Am. As a result, all of these carriers were thrust into eventual bankruptcy or a merger with another carrier.

This period of uncertainty and heavy losses led to a consolidation in the airline industry in the mid-1980s. A number of carriers merged under a program adopted by the US Department of Transportation that permitted a series of airline mergers. Of particular significance to Minneapolis-St. Paul was the merger of Northwest and Republic. This merger was followed by other major acquisitions including the acquisition of Pan Am's Pacific Division by United, the merger of Delta and Western, Air California and American, USAir's acquisition of PSA and Piedmont, and Texas Air's acquisition of Eastern, Continental, People Express, Frontier and certain commuter airlines.

This series of mergers and acquisitions produced an industry dominated by 11 carriers. The largest at that time were Texas Air, American, United and Delta. They were followed by Northwest, USAir, TWA and Pan Am. Smaller niche operators such as Midway, Southwest and Alaska continued to survive. In this same period (1986-1989), the airline industry experienced record profits, climaxing in 1988 when the industry had profits of $2.8 billion on combined revenues of $56.1 billion. The most profitable airlines were United with operating profits of $800 million, American with $690 million and Delta with $550 million.

During 1988, Northwest earned an operating profit of $350 million. These profits and resulting cash flows, along with the strong unencumbered assets on Northwest's balance sheet, provided a unique opportunity for a leveraged buy out of the airline. The assets on the airline's books, which included a large number of aircraft that could be sold and leased back and valuable land and international route authority had huge cash values. Coupled with the 1988 operating profit available to pay down the acquisition debt, Northwest was an attractive target for new ownership. The purchase of Northwest by the Checchi group in July 1989 was the result. Along with its merger with Republic two years earlier, the takeover in 1989 significantly changed the character of Northwest during this period. With the failure of the United LBO, Northwest became the only major surviving carrier to experience a change of control during this highly profitable period in the airline industry.

Following projections, the profits of the 1987-89 period continued through the first half of 1990. However, circumstances changed dramatically in August 1990 with the invasion of Kuwait by Iraq. Overnight, fuel expenses for the airline industry more than doubled. From a level of $18 per barrel of crude before the invasion (which equated to a $.60 cost per gallon), the price increased quickly to $25 a barrel and then eventually to almost $40. At $40 per barrel, the cost of fuel increased to approximately $1.25 per gallon and the fuel related expense for the airline industry increased $12 billion on an annualized basis at these fuel price levels. When fuel prices leveled off in the $25-30 per barrel range in the latter half of 1990 and early 1991, the U.S. airline industry continued to have added annual fuel costs of approximately $8 billion.

The airlines attempted to offset these fuel price increases with increases in passenger fares. Fare increases totaling twenty-one (21%) percent were put in place between September 1990 and March 1991. The effect of these price increases was a downturn in passenger traffic as many business and vacation travelers decided not to travel in face of the higher costs of air travel and the security risks surrounding the war. The increase in the average fare per passenger was offset by a commensurate decrease in passenger load factors.

The result of the fuel price increases and the downturn in passenger traffic was a record operating loss of $2.0 billion for the US airline industry in 1990. Net losses, including Continental's charge of $2.2 billion, were in excess of $4.5 billion. Since the industry had earned almost $1 billion in the first half of 1990, the last two quarters of the year produced operating losses in excess of $3 billion. These results have continued through the first half of 1991. The first quarter of 1991 resulted in the airline industry losing $1.5 billion. The second quarter improved somewhat, but the industry loss was $300 million. The very strong airlines, such as American and Delta, have reported minimal operating profits for the second quarter. In contrast, Continental has reported losses of $109 million and USAir $57 million. It is Airline Economics' view that the airline industry will experience an operating loss of approximately $1.6 billion for 1991.

B. CONSOLIDATION - These heavy losses have resulted in further consolidation of the airline industry. Over the past year, Eastern Airlines has discontinued operations and begun liquidation. Pan Am has filed for Chapter 11 bankruptcy protection and sold most of its assets to United and Delta. It will attempt to survive as a Latin American air carrier with a single hub at Miami. Bankruptcy filings have also been made by Midway, Continental and America West. TWA has agreed to a "prepackaged" bankruptcy for filing in early 1992 as part of its debt restructuring. Indeed, over 18% of the industry's RPM's are flown by carriers in bankruptcy.

As a result of the consolidation, mergers, asset sell-offs and liquidations, the industry is now dominated by American, Delta and United with a collective 56% and growing market share. They are followed by Northwest, Continental and USAir with approximately 28% of the industry's revenue passenger miles (RPMs). The final 16% of the industry is spread among the remaining carriers including TWA, Pan Am, Southwest, America West, Alaska, Midway and the other small air carriers. Moreover, the dominance of American, Delta and United will increase further with their acquisition of the Pan Am and TWA assets in the Atlantic and American's acquisition of Eastern's Latin American Division last summer and their substantial fleet expansion programs. The combination of these acquisitions has resulted in United establishing a major presence at London's Heathrow Airport along with its strong presence in the Pacific. American has added London to its already expansive European authority, which complements its strong system into Latin America. Finally, Delta's acquisition of Pan Am's extensive European operation will result in a strong presence by Delta in both the Atlantic and Pacific markets. Consequently, the three major carriers will combine an almost 60% market share in the United States with a strong dominating US presence in the three major global markets of Europe, Latin America and Asia.

Northwest Airlines is the other major U.S. carrier which is attempting to globalize its route network. Northwest still remains the largest US carrier in the Pacific and has recently extended its route authority into Australia with nonstop service to Sydney from

Honolulu and future nonstop service from Los Angeles. It has also added new services between Guam, Saipan and Japan. In the Atlantic, Northwest maintains a relatively good service pattern from its Minneapolis, Detroit and Boston gateway cities, and is attempting to increase service with the addition of Detroit-London authority. The close working relationship between Northwest and KLM has resulted in the coordination of schedules and marketing programs between Northwest's US-Europe operations and the strong intra-Europe service pattern of KLM. KLM has also instituted code-sharing service with Northwest between Amsterdam and Minneapolis/St. Paul as well as shortly to Detroit from Amsterdam.

The remaining carriers in this middle group of participants are USAir and Continental. USAir has experienced heavy losses over the past two years from its acquisition of Piedmont and PSA and the downturn in the economy. These losses have resulted in a cut-back in service by USAir and a restructuring of its route system. In the first half of 1991, USAir reduced losses over its 1990 results but it announced on September 26, 1991 that the 1991 loss will exceed $500 million and 1992 "will not be much better". It is our view that in the short term USAir will continue to be a major participant in the industry as the result of its downsizing and liquidation to cash of many assets, but it will need to look to align itself with one of the other major US or European airlines. It does not have the balance sheet, aircraft delivery schedule or extensive international route system that will be necessary to compete with American, Delta or United.

Continental is once again in Chapter 11 bankruptcy as it was from 1984-1986. It appears from recent results that the airline lost approximately $109 million in the second quarter of 1991, has had severe cash flow problems and continues to experience heavy losses. Recent reports indicate that Continental will be downsizing its system in an attempt to recover and achieve profitability or merge with another airline, possibly Northwest. It has also once again changed senior management in an effort to cut costs and survive. With these recent events, it is our view that Continental will not be a major competitor in its own right.

With the exception of the niche operators like Southwest and Alaska Airlines, which are not global competitors, the only remaining US airlines are TWA and Pan Am. It now appears that Pan Am's only basis for survival is as an international carrier with a single hub in Miami, Florida with Delta as a 45 percent shareholder. TWA, with its prepackaged bankruptcy for early 1992 and the restructuring of its debt, reflects the fact that its current route system and cost structure are not viable. TWA will continue to sell off its valuable assets and look to merge with another airline in order to continue operations.

This describes the US airline industry as it is today. It is an industry that is currently dominated by three airlines -- American, Delta and United -- with Northwest as a strong fourth place carrier and USAir in a fifth position.

As we have seen, the US airline industry has gone through significant consolidation over the past year. This consolidation is producing a 3-5 mega-air carrier industry. As it relates to Minneapolis-St. Paul and the State of Minnesota, a three carrier industry would not include Northwest. On the other hand, to have Northwest as one of the four major global carriers in the US industry would be a strong boost to Minneapolis-St. Paul and Minnesota as the headquarters of one of the world's largest airlines.

C. <u>THE FUTURE</u> -The future of the US airline industry will be shaped by the economy and the globalization of the air transportation system. It is our view that by the second quarter of 1992, the airline industry will recover from the effects of the Gulf War and the recession, and begin to achieve substantial earnings. These earnings will grow to parallel those experienced by US manufacturing industries and climax in operating profits (defined as passenger revenues less operating expenses and excluding interest expense and taxes) in the range of 6-8% of revenues by the 1994-1997 period. American, Delta and United, with their fleet programs and yield management system, should generate revenues in the $15-20 billion annual range. For Northwest, revenues should approximate $10 billion by 1995. Based on historical results, these revenues should result in a strong earnings pattern for a 3-4 year period to at least 1997. It is hard to project beyond that date as so many events are uncertain at this time. History, however, demonstrates that 3-4 year positive cycles are often followed by 2-year downturns which would suggest positive results in 1993-97 followed by a downturn in the latter years of this decade.

In order to provide a picture of the U.S. airline industry for the balance of this decade, Airline Economics has prepared an industry forecast. This forecast is set forth on page 11 below and in Exhibit A. The assumptions underlying this forecast are also set forth in Exhibit A attached. This forecast is based on the underlying assumption that real GNP growth reaches 2.5% in 1992 and grows to 4% in 1996. As a result, RPMs are forecasted to grow 4-6% annually from 1992-1996; followed by an economic downturn in 1997-1998, and a rapid economic recovery in 1999-2000.

This forecast reflects a profitable industry in the decade of the 1990s; a result of seat capacity management by airlines and price discipline under an oligopolistic industry. Instead of expanding as rapidly as possible to control market share, the now dominant airlines will expand more in relation to market demand. Cheap, low fares intended primarily to produce quick cash flow to failing airlines will be replaced by selective pricing programs designed to maximize revenues relative to demand.

As the following chart indicates, Airline Economics views an industry growing from today's $65 billion in operating revenues to $98 billion in 1995 and $136 billion in 2000. Available seat miles (the industry's measure of capacity) will grow from today's 728 billion to 1.1 trillion in 2000. Load factors will remain in the 65 percent range as airlines manage capacity additions to maintain load factors at approximately this level. Yields will grow from 12.7 cents today to 15.3 cents in 1995 and near 18 cents in 2000. Costs per available seat mile will increase from 9.6 cents today to over 12 cents in 2000.

Operating profit for the industry will approach $8 billion in 1995 and 1996 and, after declining in 1997-98 during an economic downturn, should exceed $8 billion by 2000. The bases behind these assumptions are set forth in Exhibit A.

It is Airline Economics' basic premise that yields, the reflection of airline pricing, will continue to increase at approximately the rate of increase in the CPI. Price increases will always be dampened by the airline's ability to add new capacity into the market as demand increases. By accepting new deliveries and managing the pace of retirement of older aircraft, the industry through this decade can manage capacity increases within a broad range.

Airline Forecast: U.S. Scheduled Airlines

1988-2000

	1988a*	1989a	1990a	1991e	1992e	1993e	1994e	1995e	1996e	1997e	1998e	1999e	2000e
RPMs	419.8	422.3	456.9	464.5	487.7	517.0	548.0	575.4	598.4	619.4	631.8	657.0	696.4
% ΔRPMs	4.7	0.6	8.2	1.7	5.0	6.0	6.0	5.0	4.0	3.5	2.0	4.0	6.0
Yield	11.9	12.6	12.7	12.9	13.6	14.1	14.7	15.3	15.9	16.4	16.7	17.2	17.8
% ΔYield	7.2	5.9	0.8	1.6	5.0	4.0	4.0	4.5	4.0	3.0	2.0	3.0	3.0
ASMs	671.8	662.4	728.6	721.1	757.2	810.2	850.7	893.2	937.9	975.4	1,004.6	1,044.8	1,086.6
% ΔASMs	4.5	(1.4)	10.0	(1.0)	5.0	7.0	5.0	5.0	5.0	4.0	3.0	4.0	4.0
Cost per ASM	7.9	8.8	9.3	9.6	9.6	9.8	10.0	10.3	10.6	11.0	11.4	11.7	12.0
% Δ Unit Cost	5.3	11.4	5.7	3.0	0.0	2.0	2.0	3.0	3.0	3.5	3.5	3.0	3.0
Load Factor (%)	62.5	63.8	62.7	64.4	64.4	63.8	64.4	64.4	63.8	63.5	62.9	62.9	64.1
Op Revenue ($)	56.1	59.6	65.1	67.2	73.9	81.2	89.5	97.9	105.7	112.6	117.1	125.3	136.5
% Δ Op Rev	11.3	6.2	9.2	3.3	9.9	10.0	10.1	9.4	8.0	6.5	4.0	7.0	9.0
Op Expenses ($)	53.3	58.3	67.5	68.8	71.6	78.1	83.5	90.1	97.4	104.7	111.7	119.4	127.7
% Δ Op Exp	9.9	9.4	15.8	1.9	4.0	9.1	6.9	8.0	8.1	7.5	6.6	6.9	7.0
Op Profit/(Loss)	2.8	1.3	(2.5)	(1.6)	2.3	3.2	6.0	7.7	8.3	7.8	5.4	5.9	8.8
Op Margin (%)	5.0	2.1	(3.8)	(2.4)	3.1	3.9	6.7	7.9	7.8	6.9	4.6	4.7	6.5

*a= Actual Data
e= Estimated Data
NOTE: Numbers are expressed in billions, except for
yield and Cost per ASM, which are in cents.

The growth forecasted is a product of the massive aircraft delivery schedules under contract by the major air carriers. American Airlines, with a forecasted 614 aircraft at the end of 1991, has 198 aircraft to be delivered in the next three years. While they currently plan to retire 65 aircraft, these retirements could be delayed if traffic demand warranted. United has 164 aircraft to be delivered in that same period while planning to retire 98. Delta has 125 deliveries and plans to retire 85. These numbers suggest significant latitude in managing capacity increases in the near term. It should be noted that these numbers are constantly changing as airline managements react to the marketplace.

It is also clear that the industry will define itself in a global arena. The recent acquisition of extensive European authority by American, Delta and United, coupled with their strong presence in other parts of the world and with Northwest's strong presence in the Pacific, will result in a US airline industry that has a strong global presence. We expect that as the US carriers extend their route systems into Europe and the Pacific, the government liberalization of air route authority in those parts of the world will be complemented by a liberalization of air rights for foreign carriers in the United States. The long held policy against cabotage may be liberated on a case-by-case basis as either individual foreign countries or the new European economic community open its skies for local participation by the US airlines in exchange for equal rights of its carriers to carry local passengers between points in the United States. With strong hubs throughout the US, the major US airlines favor this approach as they feel they can both protect their US position while at the same time expanding broadly throughout Europe and the Pacific.

This globalization process will also result in the extension of US route systems into Eastern Europe and the Soviet Union. These parts of the world are undergoing significant change which will result in increased air transportation opportunities. The US and European carriers will undoubtedly attempt to position themselves to take advantage of the growth and development in these areas commensurate with an increase in hard currency. Recent efforts by British Airways to establish a Russian airline (Air Russia) is indicative of the many efforts that will be undertaken in these parts of the world.

Along with the global expansion of their route systems, the US airline industry should also continue to play a dominant role in the expansion of Computer Reservations Systems (CRS) to airlines in locations throughout the world. The positions of Sabre, Covia and Worldspan, the respective systems of American, United and the consortium of Delta, Northwest and TWA, have already established themselves in strong fashion within the United States and are expanding rapidly in the overseas market. As Delta extends its new Pan Am European authority, this will result in expansion of the Worldspan system to other locations throughout Europe. Likewise, Delta will use its alliance with Pan Am to expand the rights of its CRS system into Latin America. When combined with the strength of Northwest in the Pacific, Worldspan has a strong position as a worldwide computer reservation system. This is important in terms of distribution of an airline's product to travel agents and corporate travel departments in locations throughout the world.

Along with the forecast economic results and global expansion of the US airline industry, it is also apparent that the future holds strong growth by the US carriers as a result of the massive equipment orders that are in place. At the present time United

Airlines has on order an option for $45 billion of new aircraft and American, Delta and Northwest have approximately $23 billion of aircraft each on order. These are substantial fleets that will not only replace the current Stage 2 aircraft but will also result in significant increases in fleet size and new areas of growth. This aircraft development program will define itself in a strong presence by these carriers in points throughout Europe and the Pacific. An interesting factor to recognize with these equipment orders on behalf of the major US airlines is that they involve a combination of long haul, wide-bodied aircraft along with short-haul aircraft of the B737, F100 and A320 variety which will be used to provide short-haul services into the carriers major hubs. This is in contrast to the equipment on order by many of the large foreign carriers which is primarily of the former, large wide-body type. To Airline Economics, this is indicative of a continuing strategy on the part of the US carriers to establish hub networks throughout the world similar to what they have done within the United States since deregulation. This traffic feed from all parts of the world into hubs, not only in the United States but also potentially in Europe and the Pacific will provide a strong competitive position for the US airlines. The support of foreign carriers by their own nationals could be diminished by a strong network of feeder services by US carriers that can support long-haul flying and therefore provide a competitive advantage over the foreign competitor.

These circumstances point to an industry that will experience the type of global change that we have seen over the past decade in the United States. It is our view that airline consolidation will similarly take place globally, and those carriers with the equipment, route structures and strong balance sheets will be the survivors. Among the US airlines, certainly American, Delta and United will be among this group. As to Northwest and USAir, it is our view that Northwest is better positioned to be part of this larger group so long as it can realize the earnings and cash flow necessary to compete in a global environment. Its strength in the Pacific is now being coupled with a stronger US presence in order to be a more effective worldwide competitor. In the case of USAir, a restructuring of its US system needs to be coupled with strong marketing alliances in both the Atlantic and Pacific. If it is able to maintain that strength, coupled with its strong US route system (particularly in the East) it may be in the position to similarly be a worldwide competitor.

II. STATUS OF NORTHWEST AIRLINES

Northwest Airlines has experienced the same fate as the other US carriers over the course of the past year. The leveraged buy out of the company in July 1989 resulted in significant new debt on the balance sheet which has a high associated interest expense (for more detail see Price Waterhouse report). Since July 1989, Northwest has paid down approximately $1.6 billion of this debt thereby leaving a balance of $1.4 billion. However, most of that paydown of bank debt has simply been transferred to off-Balance Sheet leases (with the fixed charges for interest being transferred to lease payments) or has resulted in the replacement of LBO debt with new debt, such as the Airbus loan. Coupled with the operating losses of the past year, Northwest has been limited in its ability to service these fixed charges while continuing to grow and expand. This has, in turn, limited its ability to capitalize on acquiring assets from ailing airlines.

From Airline Economics' perspective, it appears that Northwest was particularly hit hard at the outset of the Gulf War in the 4th quarter of 1990 and then, to its credit, recovered quickly through cost savings and a redeployment of its assets to minimize its losses in the first six months of 1991. In 1990, Northwest experienced an operating loss of $141.7 million. In an industry that lost $2 billion, the loss on Northwest's part, especially in comparison to the results at the other major carriers, is in line with the effects of the Gulf War. By contrast, USAir, Continental, Pan Am, TWA and Eastern suffered extraordinarily high losses which impacted their long-term future.

In the case of Northwest, the loss in 1990 was reduced significantly in the first quarter of 1991. During this period, Northwest correctly redeployed certain of its large wide-body aircraft to the US Government effort in the Persian Gulf and as a result held its operating loss to $62 million. This is in contrast to American, Delta and United which experienced losses in excess of $200 million each during the first quarter of 1991. These efforts on behalf of Northwest have continued into the second quarter of 1991. In results that were recently announced, Northwest earned a $33 million profit in the second quarter of 1991. This compares to Delta and American who achieved a loss of $70 million and a profit of $10 million, respectively, for this same period. Likewise, United Airlines had a profit in the second quarter but it was well below historical performance. By contrast, Continental, the fifth largest US airline, reported a loss of $110 million in the second quarter of 1991 and USAir's results were a negative $57 million. From initial reports of traffic results, it appears that the third quarter of 1991 will be profitable for Northwest.

While the first quarter results do not parallel its experience in 1990 or prior years, because of the unique circumstances surrounding the Gulf War and the slow recovery of the economy, reported financial results indicate that Northwest has taken steps both internally and with respect to the utilization of its aircraft fleet so as to minimize its losses and redirect the company toward a position of profitability. The second quarter results were particularly encouraging in view of the other air carrier's performance. It appears that the third quarter will similarly be a profitable quarter for Northwest.

Northwest currently provides about 11% of the industry available seat miles. <u>If Northwest were able to maintain that industry capacity share</u>, Northwest would be generating operating revenues of about $10 billion in 1995 and $15 billion in 2000. Yields, if they mirrored Airline Economic's estimates of industry increases from current levels, would be about 15 cents in 1995 and 17 cents in 2000. Unit operating costs would be about 10.5 cents per available seat mile in 1995 and 12.5 cents in 2000.

Whether these operating indicators of revenue and expenses are sufficient to meet the needs of Northwest to repay current obligations as well as its LBO debt and the proposed MAC bonds cannot be fully assessed by Airline Economics without access to financial data at the Wings Holding level. It would appear, however, that its aircraft acquisition would depend highly on leasing and the availability of lease financing to Northwest.

It is our view that Northwest is well positioned with a strong Pacific route system and a reasonably good domestic system to take advantage of the expected recovery in the air travel market. Clearly, Northwest will be more vulnerable than its major competitors to economic down cycles or other external influences affecting the industry because of its thin capitalization and high leverage. Absent any short term negatives, however, Northwest should enjoy improving profitability through the remainder of the decade and enjoy the profit fruits of being one of the few remaining major U.S. airlines.

Airline Forecast: U.S. Scheduled Airlines

1988-2000

The forecast on page 7 has been prepared by Airline Economics, Inc. (AEI), a Washington, DC aviation consulting and financial services firm. AEI has had considerable experience in preparing airline forecasts, and prepares the annual international forecast for the International Air Transport Association (IATA). AEI publishes the Airline Quarterly, the IATA Quarterly and the Blue Chip Airline Financial Indicators.

This forecast is prepared based on AEI's knowledge of the industry and using certain assumptions as shall be described. The airline industry, historically and by its nature, has been a volatile industry subject to change from numerous external factors beyond its control. This forecast should be taken as a long-term guide, but the reader should realize that short-term fluctuations may occur.

The principal assumptions used in this forecast are discussed as follows:

1. General Economic Conditions

The forecast assumes a slow economic recovery from the current recession. Real GNP growth will increase slowly from 2.5 percent in 1992 to 4.0 percent in 1996.

The U.S. business community will focus on restructuring and cost reduction and attempt to regain world competitiveness. Employment growth will be slow, particularly in major corporations, and many companies will continue to reduce headcount to improve productivity. The Soviet Union and Eastern Europe will be grappling with the changes to free market economies, but will not be in a position to make a significant contribution to the world economy.

The sluggish economy will act as a brake on inflation, and the "core" CPI annual increase will remain in the 3.0 to 4.0 percent range until the end of the decade. Interest rates will continue to decline as lenders perceive that inflation will be minimal.

There will be a modest economic downturn in 1997-98 as a perceived pick-up in inflation and money supply prompts the Federal Reserve to slow monetary growth and the economy.

In 1999, however, a strong economic recovery will begin stimulated by lower interest rates and capital investment. Much of this investment will be in response to new market opportunities in the former Soviet sphere, coupled with a very competitive U.S. business infrastructure.

The airline industry will complete its consolidation in this period with 4-5 U.S. airlines dominating the domestic market and holding a major market share internationally. The industry will behave as an oligopoly, and investor returns will soon be similar to those obtained in U.S. business enterprise generally. In this environment, airlines will be less cyclical, and shouldn't experience the heavy losses during economic downturns as they have in the past. Net profits should average 4-6 percent of operating revenues over the long-term.

2. Operating Revenues

Airlines passenger revenues are a function of passenger traffic carried (expressed as "Revenue Passenger Miles" "RPMs") and the price paid per seat mile(yield). Cargo and other revenues generally range from 7-9 percent of passenger revenues, and are expected to remain in the same proportion.

Yield is a function of the fares charged and the mix of traffic between full fare passengers and passengers traveling on one of many discount fares. Yield has been very volatile in the past as airlines have resorted to rampant discounting at times when traffic was weak. Generally, the added volume stimulated by the increased discounts has not been sufficient to offset the reduced prices.

With the industry achieving oligopoly status, this practice of uneconomic discounting will be reduced. Some additional discounting will undoubtedly occur in weak economic periods, but it will be more contained than in the past.

AEI believes that annual yield increases in the 1992-96 period will exceed the inflation rate by 1-1.5 percentage points. This is a "catch-up" period when airline fares begin to reflect oligopoly pricing and economic rates. In 1992, the elimination of many of the discounts of 1990-91 will increase yields by 5 percent in that year. By 1997 and beyond, annual yield increases will approximate the CPI increase.

Revenue Passenger Miles (RPMs) will grow at a pace in excess of GNP growth throughout the forecast period. This is in response to industry capacity increases, high traffic growth rates in international markets, and general economic growth. The demographics of the "baby-boom" generation, now entering the ages where travel replaces housing, school tuitions and other similar expenses in the family budget, bodes well for increased leisure air travel. Increasing real household incomes as inflation remains moderate will also stimulate travel.

The results of increased yields and passenger traffic will boost annual airline revenue increases in the 8-10 percent range through 1996, moderating through an economic downturn in 1997-98, but turning up again strongly in 1999-2000.

Operating Expenses

Operating expenses are a function of increased seat capacity ("available seat miles", "ASMs") and the unit cost per ASM. Labor, fuel, maintenance, travel agency commissions and aircraft ownership costs constitute about 85-88 percent of operating expenses.

In recent years, particularly in 1990 and 1991, as a result of the Persian Gulf crisis, dramatic increases in fuel prices have driven airline costs up sharply. This cost has come down sharply, but is still above pre-Iraqui invasion levels. Fuel prices are expected to continue to increase annually slightly above the CPI increase, as restricted supplies and a shortage of refining capacity for jet fuel tightens demand.

Labor cost increases have mitigated in recent years as airlines have been successful in limiting wage increases and improving productivity. New two-man crew aircraft are rapidly replacing three-man crews, and new larger aircraft are spreading crew costs over more seats. On the other side, an aging work force is escalating annual seniority pay increases in addition to the annual cost-of-living increases. On balance, unit labor costs will continue to increase moderately over the coming years.

Maintenance costs are remaining relatively constant on a unit cost basis. Older, high maintenance aircraft are being phased out, and the maintenance cost on new aircraft is being mitigated in the early years when maintenance requirements are low and manufacturer's warranties cover much of the work.

Ownership costs are one of the fastest rising airline costs. New aircraft, some costing over $100 million each, are increasing rental or depreciation costs. More significantly, the cost per seat purchased has been rising rapidly. Today, airlines pay as much as $250,000 per seat for an aircraft, about 30 percent more than five years ago. This is increasing the unit ownership cost of the new fleets.

Travel agency commissions account for about 10 percent of an airline's costs, and have been rising slowly in recent years. About 80 percent of an airline's revenues now come through travel agents, and the competition among airlines for the agent's business has created overrides and special incentive commissions that increase the effective commission rate.

The net effect is that AEI expects airline unit cost per ASM to continue to increase over the next decade at approximately 3.0-3.5 percent per year. This will be somewhat in excess of the CPI increase, and will continue to exert pressure on airline fares.

The increase in capacity stems from huge aircraft orders by the major airlines. American, Delta and United have annual deliveries over the next five years of new aircraft equal to 15-20 percent of their current fleets. While many of these new units will go to replace older aircraft, much will go into expansion. Other airlines may not be as aggressive as the three biggest airlines, but overall, airline seat capacity will continue to grow at a 4-5 percent rate annually for the foreseeable future.

In down cycles, like 1990-91, some deliveries can be postponed, but only serve to increase capacity at a later date. Thus, the one percent decrease in capacity in 1991 will be offset by the 7 percent increase in capacity in 1993.

Operating Profits

The airline industry has long suffered from insufficient return on assets resulting from its cyclical nature. With the increased concentration in the industry and oligopoly formation, operating profits should finally begin to resemble the returns for U.S. business generally. Historically, the five percent operating margin that was only achieved in the best years should become the average return over many years. Good years should see operating margins in the 7-9 percent range, while down years will be in the three percent range.

Operating profits in this range, based on the growth in revenues, will result in industry operating profits of $6.0 to $8.3 billion between 1994 and 1996. These are unprecedented results for the industry and should fuel additional long-term growth. The benefits of the consolidation in the 1980s will be achieved by the surviving airlines in the 1990s.

Airline Forecast: U.S. Scheduled Airlines

1988-2000

	1988a*	1989a	1990a	1991e	1992e	1993e	1994e	1995e	1996e	1997e	1998e	1999e	2000e
RPMs	419.8	422.3	456.9	464.5	487.7	517.0	548.0	575.4	598.4	619.4	631.8	657.0	696.4
% ΔRPMs	4.7	0.6	8.2	1.7	5.0	6.0	6.0	5.0	4.0	3.5	2.0	4.0	6.0
Yield	11.9	12.6	12.7	12.9	13.6	14.1	14.7	15.3	15.9	16.4	16.7	17.2	17.8
% ΔYield	7.2	5.9	0.8	1.6	5.0	4.0	4.0	4.5	4.0	3.0	2.0	3.0	3.0
ASMs	671.8	662.4	728.6	721.1	757.2	810.2	850.7	893.2	937.9	975.4	1,004.6	1,044.8	1,086.6
% ΔASMs	4.5	(1.4)	10.0	(1.0)	5.0	7.0	5.0	5.0	5.0	4.0	3.0	4.0	4.0
Cost per ASM	7.9	8.8	9.3	9.6	9.6	9.8	10.0	10.3	10.6	11.0	11.4	11.7	12.0
% Δ Unit Cost	5.3	11.4	5.7	3.0	0.0	2.0	2.0	3.0	3.0	3.5	3.5	3.0	3.0
Load Factor (%)	62.5	63.8	62.7	64.4	64.4	63.8	64.4	64.4	63.8	63.5	62.9	62.9	64.1
Op Revenue ($)	56.1	59.6	65.1	67.2	73.9	81.2	89.5	97.9	105.7	112.6	117.1	125.3	136.5
% Δ Op Rev	11.3	6.2	9.2	3.3	9.9	10.0	10.1	9.4	8.0	6.5	4.0	7.0	9.0
Op Expenses ($)	53.3	58.3	67.5	68.8	71.6	78.1	83.5	90.1	97.4	104.7	111.7	119.4	127.7
% Δ Op Exp	9.9	9.4	15.8	1.9	4.0	9.1	6.9	8.0	8.1	7.5	6.6	6.9	7.0
Op Profit/(Loss)	2.8	1.3	(2.5)	(1.6)	2.3	3.2	6.0	7.7	8.3	7.8	5.4	5.9	8.8
Op Margin (%)	5.0	2.1	(3.8)	(2.4)	3.1	3.9	6.7	7.9	7.8	6.9	4.6	4.7	6.5

*a= Actual Data
e= Estimated Data
NOTE: Numbers are expressed in billions, except for yield and Cost per ASM, which are in cents.