


American Airlines' Takeover of TWA and Its Corporate Restructuring after the Tragedy of September 11th, 2001

Rumor of an American Airlines takeover of Trans World Airlines (TWA) first surfaced in the Wall Street Journal on January 8, 2001. The official announcement of a takeover came two days later when American filed legal documents at the Securities Exchange Commission (SEC). Then American Airlines CEO, Don Carty, hailed the strategic move as something that would enhance the value of the newly merged company. We examine the news of American's operations and its financial performance during three separate periods: the TWA takeover, the aftermath of September 11th and the corporate restructuring of 2003.

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This article chronicles American's takeover of TWA, its struggles subsequent to the tragedy of September 11th, 2001 and ultimately the restructuring that occurred as the airlines hovered near bankruptcy.

It may always be debated whether American's takeover of TWA realized the strategic benefits envisioned by Carty and other company officers. However, one simple way to assess the economic value of a takeover or any corporate event is to look at the stock market's reaction around the time of its announcement. The stock market measures investors' beliefs about the future profitability of a firm. Thus, if a consensus of individuals believe a corporate change will lead to increased profitability, we would expect to see the stock price rise upon disclosure of the event.

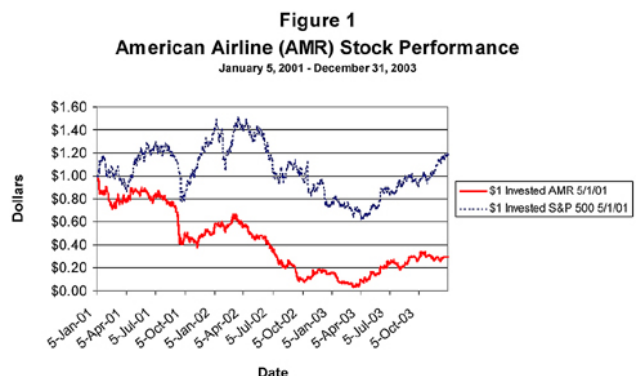
To get an idea of American's stock performance beginning with the TWA takeover, Figure 1 graphs the value of an initial \$1 investment over time. Starting on January 5, 2001, the \$1 investment in American (stock ticker symbol, AMR) immediately dropped in value with the announcement of the takeover. After leveling off for a period, the tragedy of the terrorist attacks on September 11th, 2001 caused airline stocks to fall precipitously. A week after the tragedy, the beginning of the year investment in American Airlines was worth only \$.41. Following some

encouraging economic news and U. S. government guarantees of airline company loans, American's stock price quickly began to rebound. However, bleak corporate news in 2002 along with mounting losses led American to the brink of bankruptcy. By the end of March 2003, the initial investment in AMR stock was worth only \$.04. After management upheaval and major corporate restructuring, American's fortune began to take a turn for the better, and by the end of 2003, it appeared the company was well on its way to financial recovery. Over the same period of time, the U. S. stock market as measured by the Standard and Poor 500 index (S&P 500) also suffered because of the events of September 11th. However, positive economic news throughout the last half of 2003 meant that a \$1 investment in the market at the beginning of 2001 was worth \$1.18 on December 31st of



American Airlines Boeing 767-300ER at Aruba
Photo by Hubert Croes

2003. As Figure 1 illustrates, American's economic value was tied to the general economy, but company specific news clearly caused the airline's fortunes to diverge from that of the market. In the remainder of this article, we examine the news of American's operations and its financial performance during three separate periods: the TWA takeover, the aftermath of September 11th and the corporate restructuring of 2003.



The Takeover of TWA

At the beginning of 2001, TWA announced that it would file for Chapter 11 bankruptcy and accept a buyout offer by AMR, the parent company of American Airlines. The terms of the acquisition included a \$500 million payout to TWA and the assumption of \$3 billion of debt. Not long after the announcement, rivals Continental and Northwest Airlines objected to the takeover, and TWA declared that it was willing to look at better offers. After pressure by the TWA pilots to accept American's offer, the company agreed to AMR's terms over a competing bid by Jet Acquisitions Group, Inc.

In mid-March, the U. S. Bankruptcy court and Department of Justice approved the sale of TWA's assets to AMR, and the airlines completed the acquisition on April 9, 2001. In AMR's 2000 Annual Report, then CEO Don Carty hailed the takeover as a strategic move that was part of the company's network building efforts. Airline industry experts, however, suggested that network building was only part of the reason for the takeover; in fact, another important reason was to derail UAL's (United Airlines) proposed purchase of US Air. While the takeover of TWA allowed American to help craft the restructuring of the airline industry, it is not clear that this merger was in the best interest of AMR shareholders.

Table 1 reports daily AMR stock returns from January 8, 2001, the date of the rumor of a TWA takeover, to April 9, 2001, the date that the acquisition was completed. Returns during this time period give the notion of



*A former Trans World Airlines McDonnell-Douglas MD83 departing Aruba
Photo: Hubert Croes*

investors' beliefs about the economic value of the takeover. As we have seen earlier, however, it is important to disentangle the effects of company specific news from information about the market in general. Thus, Table 1 subtracts the returns of the S&P 500 from daily AMR returns to yield market adjusted returns. These adjusted returns may then be added up over time to produce cumulative adjusted returns (CARs) which measure the total effect of all takeover news on the value of AMR stock.

The results in Table 1 clearly illustrate that the initial reaction of the market to American's proposed takeover of TWA was negative. Rumor of the takeover on January 8th, 2001 caused AMR stock to fall 9.85% on a market adjusted basis. By January 10th, the announcement day ($t=0$), American's stock had fallen a total of 21.13% after adjusting for market returns. As

the takeover terms filtered through the news, American's market adjusted returns continued to fall; ten days after the initial announcement, the total effect of the news was a decline of 29.12% in shareholder value. Over February and March news about the takeover and whether it would be approved by the federal authorities caused American's price to fluctuate. On March 1, cumulative

adjusted returns had fallen more than 36%, but when the acquisition was complete, the total effect was a fall of 15.55%. The end result is that the market did not believe the American-TWA merger was a value enhancing move. Investors thought that future profitability would decline after the merger, with a reasonable estimate of lost value being somewhere between 15% and 35%. However, this estimate was predicated on the economics of the airlines industry in the spring of 2001. No one could foresee the tragic events that would happen on September 11th and the lasting effects it would have on airline travel.

American Airlines Following September 11th

On September 11th, 2001, four terrorist plane crashes brought commercial air traffic to a halt. Despite new security measures, customer demand for air travel fell significantly, and accordingly, airlines reduced their flight schedules. Despite some cost savings from smaller operations and government guarantees of loans, losses mounted in the airlines industry. The terrorist tragedy and resulting losses eventually led United Airlines and US Airways to declare bankruptcy. The response of AMR's stock price to September 11th was severe and immediate.

Figure 2 illustrates a loss of 40% to American's stock price in the first week following the attacks. This fall in shareholder value was similar to the decline in stock price of Southwest

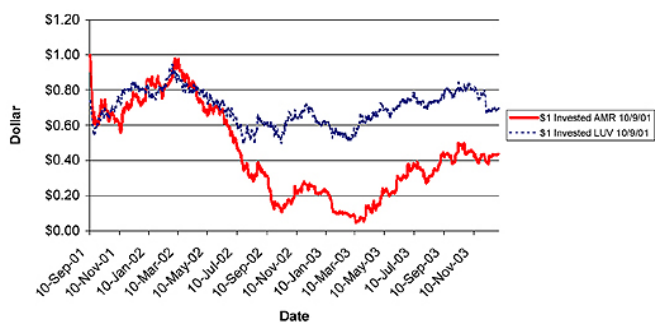
Table 1
Market Adjusted Returns for American Airlines
Around Time of TWA Takeover

Date	Day, t	Market Adjusted Returns*	CAR**
8-Jan-01	-2	-0.0985	-0.0985
9-Jan-01	-1	-0.0329	-0.1314
10-Jan-01	0	-0.0799	-0.2113
11-Jan-01	1	-0.0214	-0.2328
12-Jan-01	2	-0.0554	-0.2882
16-Jan-01	3	0.0138	-0.2744
17-Jan-01	4	-0.0294	-0.3038
18-Jan-01	5	0.0204	-0.2833
19-Jan-01	6	-0.0260	-0.3093
22-Jan-01	7	-0.0214	-0.3308
23-Jan-01	8	0.0480	-0.2828
24-Jan-01	9	-0.0257	-0.3085
25-Jan-01	10	0.0173	-0.2912
1-Feb-01	15	0.0051	-0.1152
1-Mar-01	34	-0.1127	-0.3603
2-Apr-01	56	-0.0108	-0.1315
9-Apr-01	61	-0.0020	-0.1555

* Market Adjusted Returns = AMR returns - S&P 500 returns

**CAR = cumulative adjusted returns from day -2 to day t

Figure 2
American Airlines (AMR) vs. Southwest Airlines (LUV)
Stock Performance
 September 10, 2001 - December 31, 2003



Airlines, a company that had been doing well prior to September 11th. While the market value of both companies (and the airline industry as a whole) recovered in the spring of 2002, subsequent news from American caused its stock price to diverge from Southwest's for the remainder of the year.

Losses at American continued to pile up in 2002 and at the beginning of the third quarter, the airlines announced that it would reduce capacity, retire some of its fleet including nine of its TWA 767-300 aircraft and eliminate 7,000 jobs. Around the same time, American restated its book value and confirmed a charge-off of \$1.4 billion to reflect matters related to its acquisition of TWA and Reno Air. As American entered 2003, CEO Carty announced that continuing losses were unsustainable and the airlines would seek labor saving concessions from its unions. In March of 2003, American teetered on the brink of bankruptcy, and the dire financial situation led unions to agree to a \$1.8 billion labor savings one month later.

With new labor agreements in place, American seemed ready to emerge from its string of earnings losses. However, one week after announcing

chief executive officer, thus beginning a new chapter in corporate history.

American Airlines after Corporate Restructuring in 2003

The takeover of TWA initially increased the fleet size of American more than 20%. Table 2 illustrates the change in the size of American's operation from before the takeover through the end of 2003. While it is clear that cost saving measures and downsizing of American operations began subsequent to the September 11th tragedy, significant restructuring came after the selection of Arpey as company CEO. Under his leadership, American announced a turnaround plan to facilitate the company's return to profitability.

At the end of 2003, the number of owned and leased aircraft fell to virtually the same number as the company had prior to its takeover of TWA. Revenue passenger miles also reflected a corporate downsizing; while larger than the pre-takeover figure, revenue passenger miles in 2003 declined from its 2002 level. AMR's

fourth quarter earnings statement noted that as part of its cost saving measures, the airlines closed its St. Louis reservation center, reduced the size of its St. Louis hub and accelerated the retirement of TWA aircraft. In less than three years after the takeover, American had sold or closed a number of TWA assets and operations.

Given that American Airlines of today, in many respects, resembles the company prior to its takeover of TWA, the question arises why did the airlines acquire TWA?

While the stock market reaction suggests that the takeover was not a value enhancing move, we'll never really know whether the company would

Table 2
Size of American Airlines Operations 2000 – 2003*

	2000	2001 ¹	2002	2003
Number of AMR Aircraft	978	1229	1179	972
Revenue Passenger Miles (in millions)	116594	120606	121747	120328

** All figures include American Eagle data.*

¹ Includes acquisition of TWA assets completed on April 9, 2001.

have realized the anticipated strategic benefits of the merger. The tragic events of September 11th caused a dramatic change in the economic landscape of the travel industry and affected the operations of all airline companies. What is known with more certainty is that after standing on the brink of bankruptcy, the company's stock price has rebounded nicely (as seen in Figure 2). Corporate restructuring in 2003 has led to improved conditions at American Airlines with the prospect of future profitable years.

