



## Internal Memorandum

**Date:** March 23, 2004

**To:** Delta Leaders, Shareowners, Customers and Employees

**From:** John F. Smith, Jr., Presiding Director  
Leo F. Mullin, Chairman of the Board  
Gerald Grinstein, Chief Executive Officer

**Subject:** ANNUAL REPORT 2003 LETTER TO SHAREOWNERS, CUSTOMERS AND EMPLOYEES

During 2004, Delta marks its 75<sup>th</sup> year of operation. Earlier portions of this annual report recount the growth of our airline from a tiny crop duster to a global carrier, and the spirit of our employees who throughout the years have been the heart of Delta. Even as we celebrate such proud accomplishments, however, our company remains focused on the future and the challenges of the rapidly changing airline industry. We are pursuing a strategy that addresses these issues. Our course of action is intended to allow our airline to regain a strong competitive position, achieve long-term sustained profitability, and move forward to Delta's 100<sup>th</sup> anniversary -- and beyond.

As many of you may know, Delta's leadership structure is undergoing changes involving the three signatories of this letter as a result of Leo Mullin's decision to retire from Delta as of May 1, 2004. Jerry Grinstein, a 16-year veteran of Delta's Board of Directors, became Chief Executive Officer at the beginning of 2004. Jack Smith, a current board member and presiding director, will become the non-executive chairman of the board at the 2004 shareowners' meeting in April. The three of us have worked closely together for many years. In recent months we have concentrated our efforts on ensuring a smooth transition and determining the best strategic direction for Delta, as this document outlines.

### **A permanently altered marketplace**

Delta faces significant challenges and important decisions in the period ahead as a result of an aviation environment that has been dramatically and permanently altered. The events of September 11, 2001, served as a springboard for many of these changes – but clear market demand for low fares as well as new developments within the low-cost carrier model have made these changes permanent. As a result, Delta has reached a crucial juncture that will determine our ability to compete effectively over the long term.

Low-cost carriers first gained significant market position during the economic downturn of the early 1990s, reflecting a more price-sensitive market. These carriers generally shared certain characteristics, including reduced fares due to lower costs; minimal debt loads; targeted high-traffic point-to-point routes rather than high-cost, hub-and-spoke operations; employees with low seniority and limited benefits; and minimal passenger amenities. Despite the bare-bones nature of these operations, service was typically reliable based on the simpler point-to-point systems, and fares were very competitive, in keeping with the carriers' low cost structure.

Low-cost carriers generally remained niche players throughout the extended boom time of the mid- and late-90s. Meanwhile, costs at the major hub-and-spoke airlines, including Delta, continued to climb. The stronger traffic during this period and business travelers' willingness to absorb higher air fares successfully masked the growing disparity in cost structure between the network airlines and the low-cost carriers – at least temporarily.

Following September 11, however, these trends came to an abrupt halt. Passenger traffic and revenue plummeted. Corporate travel budgets were sliced. Network airlines' losses and debt mounted. As low-cost carriers began to grow again in the once-more price-conscious environment, fares fell to levels last seen in the early 90s. Network carriers were required to match those fares in order to compete, which inevitably resulted in continuing losses.

What has changed? Two important factors have permanently altered the airline industry and its traditional cycles. First, the internet has transferred pricing power from the airlines to the customer. Second, even more importantly, a new low-cost business model has emerged that offers passengers both lower fares and attractive amenities -- as well as strategic adjustments in route structure. JetBlue is operating transcontinental flights; Southwest has altered its 30-year strategy of avoiding major hub airports and will now fly from Philadelphia; and AirTran has announced plans to install in-flight entertainment, to note a few examples.

As the new low-cost-carrier business model continues to succeed and grow, the customer and investor base for such airlines will also grow, and the number of competitors will multiply. In the meantime, it has yet to be determined if network airlines can continue to obtain a fare premium – at least in some markets – based on their more extensive global networks and more attractive frequent flyer programs. It is clear, however, that the number of routes where this is possible and the amount of premium is shrinking.

### **Regaining a strong competitive position**

Even before the events of September 11, Delta was keenly aware of the importance of maintaining a strong competitive position. Through diligent and consistent commitment to cost management, our airline regularly achieved unit operating costs that were among the lowest of the network carriers. Following September 11, we moved quickly to institute a program of additional innovative cost reduction and revenue generation initiatives, setting as our goal a 15% improvement in fuel-neutralized unit costs. Last year, this effort produced substantial benefits. The program remains in place in 2004, driven by a high degree of corporate commitment and urgency.

Despite this progress, however, Delta's losses have continued, totaling more than \$3 billion for the 2001-2003 period. While some airlines have succeeded in significantly reducing their costs through restructuring as a result of bankruptcy or near-bankruptcy, our unit costs in 2003 grew from among the lowest of the network carriers to among the highest. The disparity between Delta and other network carriers is the result of pilot costs which are significantly higher than our competitors. We believe it is essential for Delta to reduce these costs if we are to compete effectively in the current marketplace.

At the time of this report, Delta and the Air Line Pilots Association (ALPA), which represents our pilots, are engaged in discussions to address this issue, but no agreement has been reached. Because Delta's goal is to regain a competitive industry position and achieve sustained profitability, our company's frequently stated position is that any agreement with ALPA must allow Delta to compete and succeed over the long-term.

### **Additional steps towards sustained profitability**

Clearly, the most pressing requirement for Delta is to achieve a cost structure that is fully competitive in the current airline marketplace. At the same time, however, our company is taking steps that:

- Address our debt load
- Reassess our business plan
- Ensure excellent customer service by giving Delta employees the tools needed to provide that service

#### *Debt load*

By the end of 2003, Delta's debt load had increased significantly, our shareowners' equity was negative, and most of our aircraft were encumbered. Repairing the damage to our balance sheet requires a comprehensive strategy that not only addresses costs but also establishes a realistic, disciplined plan which, over time, rebuilds our financial position. Delta is engaged in this process now, and we are committed to seeing it through to completion.

#### *Strategic reassessment*

As part of Jerry Grinstein's new role at Delta and the intensifying competitive pressures occurring in the airline industry, we initiated a full strategic reassessment of our company's business plan at the end of 2003. The purpose of this project, which is in progress, is to review every aspect of our operation, our resources, and our strategy to ensure we have an updated, accurate understanding of Delta's strengths and how to best build upon them. The process is intended not only to review the current strategy, but also to rethink our competitive effectiveness. Our objective is to ensure that we have in place by the middle of 2004 a comprehensive, realistic business strategy that addresses the industry environment and Delta's overarching goal of long-term, sustained success.

#### *Customer service*

Commitment to excellent customer service was a founding principle when Delta's first passenger flight departed 75 years ago. Today, the airline business continues to be a highly competitive service industry. Delta's success depends on the performance of our employees who have the responsibility each day to deliver superior service to our passengers. Providing Delta people with the tools and the support they need to do the jobs they know so well how to do – and want to do – is crucial if we are to restore service and customer relationships to the highest possible level.

Some essential components of this effort are already in place. We've invested in innovative technology to improve our customers' airport experience. We've shortened or eliminated the time spent waiting in line for routine service related to passenger check-in and boarding as well as flight delays. At the same time, we're ensuring that Delta agents or telephone access to assistance is close by should unexpected problems arise.

In addition, refurbished aircraft interiors and new uniforms are on track to bring a fresh new look to Delta. We're also renovating some facilities, including recently announced improvements at our New York–JFK terminal. These are essential investments to maintain competitiveness and better serve Delta's customers.

### **Looking ahead**

Delta now stands at a crucial crossroad, fully aware of the difficulties and dangers ahead. Despite these challenges, we believe our company can succeed. We are addressing the immediate issues of running a great airline, as indicated by service-related operational statistics that are the best in our history and rising customer approval rankings. At the same time, we are taking the steps necessary to position our company for the long term.

Every company holds within its collective hands the power to shape the future. Given the skilled, dedicated, committed spirit that has long-characterized the people of Delta Air Lines, we believe the shape of the future will be a proud achievement shared by the team today and for generations to come.

Gerald Grinstein  
Chief Executive Officer

Leo F. Mullin  
Chairman of the Board

John F. Smith, Jr.  
Presiding Director

### **A Note of Sincere Appreciation**

On behalf of Delta's Board of Directors, the current management team, and our airline and its subsidiaries' 70,600 employees worldwide, we would like to add a note of sincere appreciation to Leo Mullin for his service and significant contributions to our company.

During the first years of Leo's tenure, he successfully directed efforts to rebuild our airline's spirit, its focus on customers, and its financial standing. Following the tragic events of September 11, 2001, Leo led the company and the industry with strength and determination through the most unsettled time in aviation history. He has been the primary architect in the construction of Delta's network of international and domestic partnerships, including the fast-growing SkyTeam global alliance and our expanding marketing relationships with Continental and Northwest. In addition, Leo successfully established Atlanta as a new gateway to Latin America. Under his leadership, Delta emerged as a technology leader, using innovative approaches to significantly improve customer service and reduce costs.

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We are enormously grateful to Leo for the role he has played in these achievements and many more, and for the character, courage, and commitment which have characterized his career with Delta. He has made important and lasting contributions to this company, and we wish him and his family the very best in the years to come.

Original signed by  
Gerald Grinstein  
Chief Executive Officer

Original signed by  
John F. Smith, Jr.  
Presiding Director