

Analysis of Total Airline Purchase Spend

Aircraft Maintenance Outsourcing Expo 2008 May 7 & 8 London England

Prepared by:
**Donald P. Schenk: dpschenk@aca-assoc.com
545 Fifth Ave
New York, NY 10017
+1-212-808-4420**





A review of trends
in the airline and
commercial jet
aircraft industries.



Raytheon



Alitalia



BOEING



- Objective
 - Identify differences in spending patterns between long haul and short haul airlines
 - Estimate global airline spending patterns
- Methodology -- what measure of spend to use?
- Data selection process Methodology
- Examine data
- Compare short haul and long haul spending
- Consider implications
- Estimate global airline spending patterns
- Concluding observations



- Analyze differences in spending by long & short haul carriers
- Find data that is reliable and comparable
- Adjust data to account for known differences
- The data challenge
 - Detailed public data limited to US DOT
 - Airline's age, fleet, bankruptcy, etc. affect costs
 - Choice
 - American Airlines (long haul) vs Southwest (short haul)
 - Data source **The Airline Monitor**





- No bankruptcy
- Same regulations
- Same labor environment
- Stage Length -- 1,251 miles
- Employees -- 78,447
- Aircraft -- 662
- Fuel cost -- \$2.05
- Load factor -- 82%
- Airline started -- 1930



- No bankruptcy
- Same regulations
- Same labor environment
- Stage length -- 631 miles
- Employees -- 33,876
- Aircraft -- 495
- Fuel cost -- \$1.70
- Load factor -- 73%
- Airline started -- 1971



* 3Qtrs 2007



- Daily utilization -- 10.0 hrs
- Employees/aircraft -- 119
- Unions - Yes
- Pay/ employee -- \$78,264
- Rev/ employee -- \$259,605
- Age of fleet -- 13.7 years
- # of aircraft models -- 6
- Avg seats/aircraft --177



- Daily utilization -- 11.3 hrs
- Employees/aircraft -- 168
- Unions - Yes
- Pay/ employee -- \$94,788
- Rev/ employee -- \$290,753
- Age of fleet -- 9.5 years
- # of aircraft models -- 1
- Avg seats/aircraft --136



* 3Qtrs 2007

Adjusted to Equalize Fuel Expense

- Adjusted Southwest fuel cost to equal AA's - reduces Southwest's operating margin from 8% to 3%
- Viewed as a percent of revenues spend differences are different, but not that significant
- Fuel has replaced labor as the largest expense category and would be ~40% of revenues at today's fuel prices
- Fuel and labor savings must drive most decisions

3Qs 2007 Expenses as % Revenue		
		
Total Revenues \$ m	\$20,365	\$9,850
Labor	30%	33%
Fuel	27%	30%*
Facil & A/C Ownership	11%	10%
Outside Services	10%	6%
Food	3%	0%
Outside Maintenance	2%	5%
Landing Fees	2%	3%
Commissions	2%	0%
Maintenance Material	2%	1%
Personnel Exp.	1%	2%
Other	1%	3%
Communications	1%	0%
Advertising	1%	2%
Insurance	1%	1%
Total Expenses	96%	97%
Operating Margin	4%	3%*



Source: The Airline Monitor & ACA estimates
 * Adjusted fuel cost/gallon to AA's reduces Southwest Pre Tax margin from 8% to 3%



Maintenance Expenses



- American maintenance labor cost significantly higher than Southwest
- The sum of the three maintenance cost components represent ~9% of revenues for both carriers

3Q 2007 Labor Expense By Function

		
Labor % Revenues	30%	33%
Salaries	% Total Labor	
Management	2%	5%
Flight Operations	30%	37%
Maintenance	12%	4%
Traffic Services	17%	19%
Other	7%	4%
Total Salaries	69%	69%
Benefits	31%	31%
Total Labor	100%	100%

Source: Form 41



3Qs 2007 Maintenance components % Revenues

		
Maintenance Material	1.6%	1.1%
Outside Maintenance	2.4%	5.3%
Maintenance Labor	5.2%	2.1%
Total	9.3%	8.5%

Source: Form 41



Aggregate Maintenance Costs

3Q 2007 Expenses as % Revenue Separate Maintenance		
		
Fuel	27%	30%*
Non Maintenance Labor	25%	31%
Facil & A/C Ownership	11%	10%
Outside Services	10%	6%
Maintenance	9%	9%
Food	3%	0%
Landing Fees	2%	3%
Commissions	2%	0%
Personnel Costs	1%	2%
Other	1%	3%
Communications	1%	0%
Advertising	1%	2%
Insurance	1%	1%

Source: Form 41 & ACA estimates
* Adjusted Southwest fuel cost/gallon to AA's

- Maintenance is 3rd or 4th largest expense category
- New generation aircraft could significantly increase pretax profits; level depends on acquisition cost



ICAO Expense Estimate

ACA Estimate of ICAO Expenses Based on 2007 Revenue		
	% Revenue Av AA, SW	ICAO \$ Million
Total Revenues \$ m	100%	\$485,000*
Fuel	29%	\$138,439
Non Maintenance Labor	28%	\$134,174
Facilities & A/C Ownership	11%	\$52,939
Maintenance	9%	\$43,160
Outside Services	8%	\$38,558
Other	2%	\$11,357
Landing Fees	2%	\$11,230
Personnel Exp	2%	\$7,445
Advertising	1%	\$6,822
Food	1%	\$6,763
Commissions	1%	\$4,534
Communications	1%	\$3,689
Insurance	1%	\$2,636

Source: *IATA

- Apply average of AA & SW expense % to ICAO 2007 estimated revenue
- Overhaul & Maintenance Magazine's Annual MRO business forecast (April 2008 issue) estimates \$45 billion for 2008 against \$41 billion for 2007, a 10% rise.



- Fuel prices are airlines' overwhelming challenge
- Fuel costs could create the next financial crisis
- High ticket prices are hurting passenger demand
- Older aircraft are being retired at an increasing rate
- Less flying and retirement of older aircraft will reduce near term growth in maintenance demand
- High oil prices increase importance of engine performance
- Airline managements will be even tougher negotiators than in the past.
- Ebulent MRO forecasts may be hard to match
- Maybe this will provide the impetus to start partnering with MROs to wring excess costs from the system - but that is for my presentation tomorrow.....

