



Airline Industry's Leading Challenges

Jeff Knittel, President, Transportation Finance
Stuart Feil, Editorial Director, Forbes Insights

Elliott Forrest: Welcome to **5 Minute Capital**, CIT's executive insight series, which takes on financial issues in about five minutes.

Today we're discussing the first in a two-part series focused on **CIT's 2011 Global Aerospace Outlook study** (www.cit.com/aerospaceoutlook).

We welcome to the studio **Jeff Knittel**, President of **Transportation Finance** at CIT, and **Stuart Feil**, editorial director of Forbes Insights. Thank you both for being here.

Stuart Feil: Thank you.

Jeff Knittel: Thank you, Elliott.

Forrest: Let me start with you, Stuart. For our listeners who have not had a chance to read the report yet, what's the focus and methodology behind it?

Feil: This is our 2011 aerospace industry outlook. We wanted to speak in this one to executives at airlines around the globe so it is not U.S.-centric, it is not Euro-centric, it is global. We actually received responses from 136 executives around the world to really understand what issues airlines are facing right now in terms of their bottom lines, in terms of how they are managing their fleets, and where they are going with all of this.

Forrest: Give us some of the top-line findings, Jeff.

Knittel: When you look at the survey it does correlate with some of the things we are seeing in the industry itself. Over the last ten years clearly, driving costs down has been critical to the success of the airlines and, as you have seen over the past several years, it's become more and more important. The recession—the lack of revenue for that period of time—has forced airlines to become more efficient. With that, they have looked at opportunistic ways to drive their costs down. Now, given that backdrop, and the fact that the cost of fuel itself is increasing, it has

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been a very challenging environment. Airlines have been very creative in coming up with ways to not only cut costs, but also in ways to enhance their revenue streams.

Forrest: One of the words that came out in the survey was that they are in survival mode. Do you want to talk about that?

Knittel: Well, I think that historically, especially in the last two years, that has been the case. If you look at western Europe, if you look at the United States, airlines have been looking at ways to hoard cash to put them in a position to succeed. When you look at the Australasia area, what we're seeing is more of an opportunistic approach. They are looking more at revenue growth. They are looking at growth in general—whether it be larger airplanes, whether it be more frequency—the outlook in that region tends to be more positive in general.

Feil: You know one of the things, Elliott, that we saw was dealing with the recession and the number of planes or percentage of a fleet that was grounded during that time. The image is that maybe there was a great amount of contraction during those two years, but if you turn and look at emerging markets, if you look at Asia, as Jeff was saying, half of the respondents outside of Europe and the United States said they were increasing their number of seats over the past two years. They were increasing the number of routes, they were purchasing more airplanes.

Forrest: I wonder if you could talk a little bit more about the major concern from these airline executives. More than competition from each other, they are talking about fuel costs. Could you talk a little bit about that?

Feil: One of the things we asked about was the top challenges they are facing and, by far, number one was rising fuel costs. Another thing we asked about was whether they are going to acquire new technology, whether it's going to be their acquiring or leasing more energy-efficient aircraft. Eighty-three percent indicated that over the next five years they would like to do that. Now we also saw, and this was sort of interesting, 68% said, in spite of that, they wanted to take a wait-and-see attitude. So there is an enormous amount of pent-up demand for the new technology.

Forrest: Jeff, maybe you could talk about that?

Knittel: There are really two ways we look at this in terms of de-risking their business. One is the capital market solution, which is airlines going out and purchasing hedges. Some do it in greater amounts than others, but airlines in general are looking at ways to take the risk out. The other, which relates to some of the issues you talked about earlier from the survey, Stuart, has to do with specific operational hedges. And those operational hedges look at ways to make the airline itself more efficient, driving cost down. Technology obviously drives cost down. They're looking at trying to bring that in and it's just not aircraft technology. One of the biggest issues the airlines face is that a major part of their cost structure is something out of their control and really controlled by the governments of the world—that's the air traffic control system and infrastructure, the runways and the like. As

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airlines try to reduce the amount of fuel, which obviously reduces the amount of carbon emissions, which is a good thing, one of the things that they run up against is the inability to be as efficient as they would like because of an inefficient air traffic control system. That puts a lot of pressure on their ability to attain their goals and ultimately run an efficient airline, which helps to lower ticket prices.

Forrest: Earlier, Stuart commented on some of the diverging trends between the U.S. and European markets and emerging markets. Do you have thoughts on that as well?

Knittel: The airlines in the western world are under much more pressure to control costs. You have legacy airlines that are looking at consolidation today. The Delta/Northwest merger, the Continental/United merger, and now we're seeing, even in the low-cost world, the Southwest and Air Tran mergers coming about. That's all a way helping on the revenue side, but, more important driving down costs by becoming more efficient. As they have a bigger system they have more levers to pull to drive down those costs and ultimately increase profitability and shareholder value.

Feil: Jeff, one of the things we talked about is the idea that outside of the United States and Europe, typically those airlines you used to think of almost as part of the secondary market are now among the first that are purchasing new technology. Is that what you are seeing on the ground?

Knittel: It is. And I think it has in some ways to do with airlines taking a very optimistic approach in those areas. They are looking for new technology and they have, in some cases, the ability to raise very efficient capital. When you can raise capital efficiently, it gives you an advantage to go out and buy new technology. Now leasing, the business that we're in, allows airlines to obtain that technology, more quickly, so to speak without a big capital outlay.

Forrest: Jeff Knittel, President of Transportation Finance at CIT, and Stuart Feil, Editorial Director of Forbes Insights. Thank you so much for your insights.

Feil: Thank you.

Knittel: Thank you.

Forrest: You can get more insights from the 2011 Aerospace Outlook by downloading the report at cit.com/aerospaceoutlook. Thanks for listening, I'm Elliott Forrest. This has been a production of CIT.



C. Jeffrey Knittel is President of **Transportation Finance**, a diversified organization that provides financing solutions for the aerospace and rail industries, including commercial airlines, business aircraft operators, aerospace and defense manufacturers and suppliers, railroads, and shippers.