Aviation Business Conference:

Buying and Selling Aviation Service Businesses

BY AMY B. KORANDA

One of the most thought-provoking Aviation Business Conference sessions, "Buying and Selling Aviation Service Businesses," provided an overview of how the industry has been reshaped over the years by factors including shifting demand for aviation support services, FBO consolidation and emerging competition. This informational session was led by Mark Chambers, Managing Partner with Aviation Resource Group International (ARGI)—a group whose in-depth industry analysis includes tracking demand for aviation services, the number of FBOs, their makeup, transaction metrics and implications for buyers and sellers.

Following Mark's presentation, *ABJ* was given a rare look into ARGI's analysis of aviation business changes over the past 15 years. And truth be told, when Mark Chambers, Steve Dennis (Chairman, ARGI) and I sat down to discuss ARGI's analysis, Mark said they spent more than 100 hours verifying the data to ensure its accuracy. This begged the question, 'Why is this in-depth analysis only done every 15 years?' Both Mark and Steve responded the process is so extensive that it's hard to find time, but perhaps they'd consider doing it every five years because it's such important information about the industry.

Chambers explained that, over the past 15 years, the demand for piston-related aviation services has declined by 40 percent. This can be partially attributed to the cost of more sophisticated airplanes and increasing operating costs. The demand for turbine-related aviation services nearly doubled in five-years before flattening out for the remainder of the 15 year period. The good news is that growth of aviation services is improving and specialization is broadening services; in 1985 growth was zero, by 2000 growth was about 1 percent per year, and by 2015 growth has improved to over 2 percent per year. This bears repeating—demand for piston related services is declining while turbine-related services are growing, as is specialization.

According to ARGI's analysis, aviation service businesses are increasingly specialized and more business-minded and each segment of the industry presents its own challenges. FBO operators are challenged because businesses are built on leased land, have increased competition (the previous stop and the next stop), and must pay attention to the "middle line in order to remain

Mark Chambers, Aviation Resource Group International, leads the "Buying and Selling Aviation Businesses" session.

profitable." MROs compete with OEMs (original equipment manufacturer) but there are a limited number of providers and Part 145 startup costs are astronomical. Charter/Management Operators (CMOs) are consolidating and ARGI describes them as "bigger is getting better." Chambers pointed out, FBOs grow by adding locations, most often by acquiring existing FBOs (decentralized growth), while MROs and CMOs grow in a more centralized fashion.

Chambers said available airports grew slightly along with FBO services. ARGI defines available airports as those 'for public use with at least 3,000 feet of hard-surface runway.' In 2000, there were 3,376 airports with 83 percent offering FBO services and in 2015 a total of 3,462 airports

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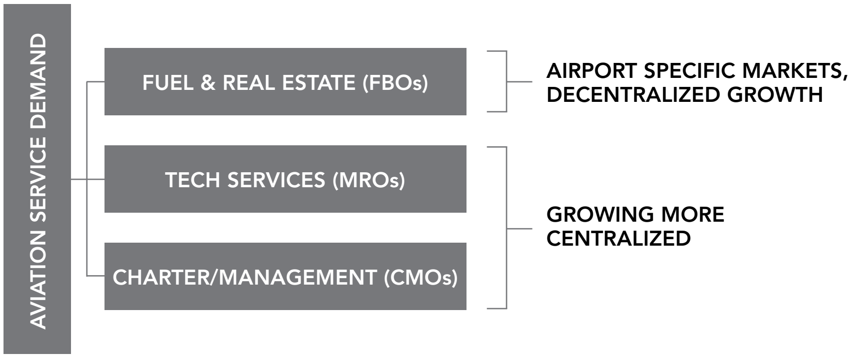
FBO COMPANIES GROW BY ADDING LOCATIONS, MOST OFTEN BY ACQUISITION OF AN EXISTING FBO…MROS AND CMOS ARE GROWING MORE CENTRALLY.



Source: Aviation Resource Group International

(an increase of 86 airports) with 85 percent offering FBO services. Of great interest is that 21 percent of airports extended their runways totaling 655,000 feet of runway length. When asked why, Chambers said—"AIP" (Airport Improvement Program), which has accounted for almost a billion dollars' worth of pavement extensions over a 15-year period.

It's important to differentiate between small and large airports. Small airports, defined as having a runway less than 5,000 feet, are feeling the decline over the past 15 years of piston-related demand and the spread of self-serve fuel, resulting in a 32 percent decline in third party FBOs. Large airports, with runways greater than 5,000 feet, offer FBO services predominantly by third party FBOs (60 percent). And, as one might expect, larger airports with more turbine activity have stronger demands for FBO services; but demand at third party FBOs is still down 17 percent. Much of the decline at larger airports is due to consolidation at half of the airports with multiple FBOs. Additionally, net consolidation has accounted for 33 percent fewer third party FBOs over the past 15 years. There are a few airports that increased the number of FBOs but far fewer than those that decreased the number.

According to the analysis, airports are seeking fewer, stronger and more responsible FBO operators. Updated facilities are widely needed and wanted, while airports understand consolidation is crucial to the FBOs existence and profitability. Pricing needs to be competitive yet support improvements and well-trained staff. Both the airport and FBO have a mutual concern on the length of lease terms for needed capital expenditures. Because it is better understood by both parties, this is a main negotiating point to achieve a win-win for both the airport and FBO operator.

Chambers talked about metrics underlying aviation service transactions and the importance of the P/E multiple (price earnings). But P/E multiples of FBOs vary a great deal (5 – 20+) with about 80 percent of the deals struck falling within these ranges. Buyers/sellers need to factor in growth, as the S&P 500 does, when considering these varying P/E multiples. He said, "Valuations fluctuate in the S&P 500 just like in aviation services with Western Union (WU) trading at a P/E of 14 and NetFlix (NFLX) at 129, so analysts have introduced growth, or a P/E/G metric, to normalize how value is determined." Chambers uses the data below to complete the comparison showing how a P/E/G ratio is more meaningful.

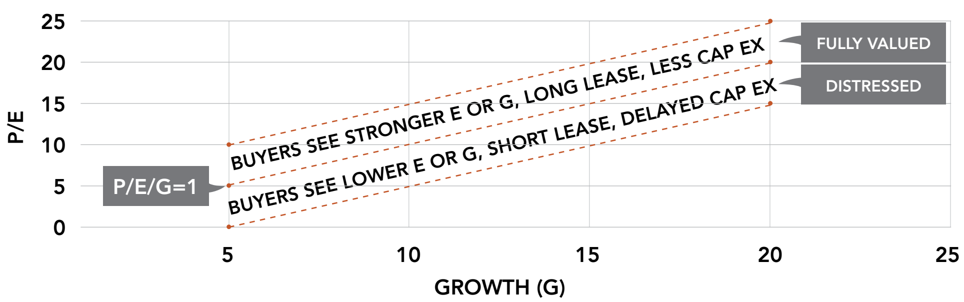
Ultimately it's the P/E/G ratio (price to earnings to growth) that must be examined because of highly variable P/E multiples that determine whether or not the business can sustain growth in support of

> "Private investment for new and updated facilities should be supported by airports with extended lease terms," said Chambers.

	P/E MULTIPLE	GROWTH	P/E/G
Western Union (WU)	x14	+14%	1.0
Lowe's (LOW)	x26	+28%	.93
NetFlix (NFLX)	x129	+134%	.96

P/E MULTIPLES ARE USEFUL FOR NEGOTIATING PRICE, BUT HIGHLY VARIABLE. BETTER TO CONSIDER GROWTH, AND P/E/G.

BUYER'S & SELLER'S PERSPECTIVEOF P/E/G



Source: Aviation Resource Group International

the multiple. Chambers observed, "It is not like closely-held aviation companies are valued like large publicly traded entities. Instead the take-away is that highly variable P/E multiples can be made more meaningful by considering growth, growth of earnings that is...and the other important lesson is to have a growth story for your business to support stronger P/E multiples just like NetFlix having a compelling growth story based on original programming like "House of Cards"...so as a seller ask yourself how your business is growing, because that is a big part of what the buyer will want to know."

Chambers recommended conference attendees: "Develop a coherent plan to grow the business so that buyers see a stronger "G" to support a more desirable P/E multiple."

Chambers showed the relationship between P/E multiples and growth of earnings emerging for aviation services such that a 5 percent growth rate might support a 5 P/E multiple, a 10 percent growth supporting a 10 P/E multiple, and so on, along the P/E/G ratio equaling 1.

The best buyers will assess earnings and growth, and real estate aspects as being strong resulting in a "fully valued" transaction, equaling or exceeding a seller's expectations.

For other deals, buyers might assess weaker earnings and growth, or short lease terms resulting in "distressed" valuations. "Sellers will, of course, want to position themselves for a fully valued transaction, but distressed deals also happen as the best outcome for some sellers," said Chambers.

On larger airports, demand for FBO services is "regrowing" and buying/selling interest is recovering from the 2008-2010 downturn. When asked about FBO opportunities, Chambers said, "The industry is offering opportunities for everyone, not just the large chains as many might believe. ARGI's 2015 analysis indicates that chains own 16 percent of the third party FBOs on larger airports." Buyers typically look for size, stability and value and are made up of the chains, consolidators and a few new entrants. "In many cases, the independent FBO, with an in-depth understanding of the local business and players, is in the best position to consolidate an over-supplied market," according to Chambers.

Chambers and Dennis share a passion for the industry and are intimately familiar with the general aviation service industry and its influential players. Both are deliberate in their approach, yet very thoughtful and quiet when needed in a business where transactions take from one to four years to finalize. ARGI supports the industry in many ways recently joining with the Meisinger family and Air Associates of Kansas City to donate $6,000 to NATA's foundation (NATF), specifically to the Dan L. Meisinger Sr. Memorial Learn to Fly Scholarship. NATA President and CEO, Tom Hendricks thanked them for "their wonderful generosity to a great and worthy cause."

ARGI and Mark Chambers' presentation slides are available at www.argi.com, "ARGI Inner Circle." The username is **nata** and password is **argi15**. **A**

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