

PMA AND THE “NEW NORMAL”

by

David Doll

ddollconsulting.com

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David Doll Consulting

1080 Sun Valley Drive, Woodland Park, CO 80863

Phone 719-686-9332 E-mail ddollpe@foothill.net

The New Normal

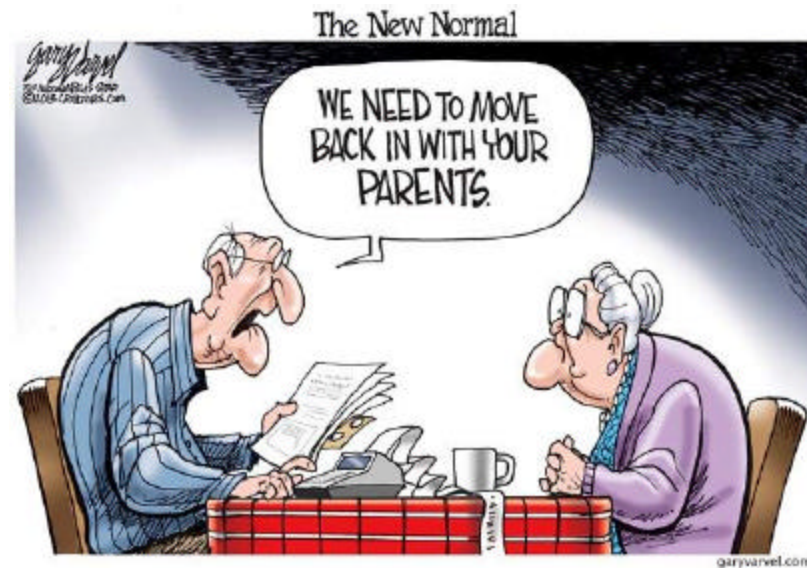
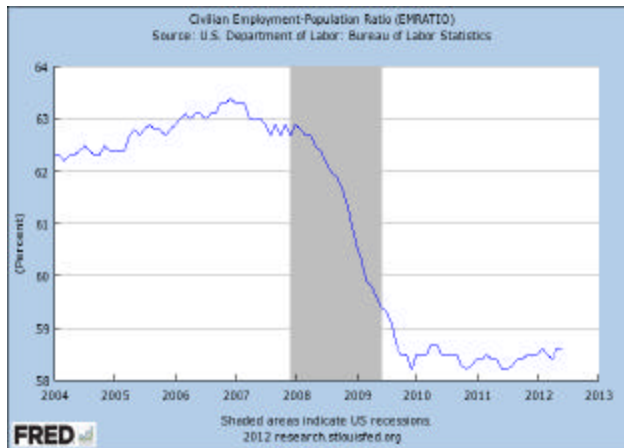
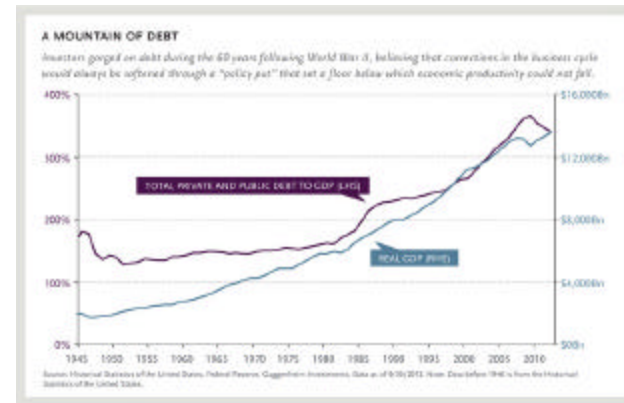
The New Normal Economy

Airlines Cope With The New Normal

PMA Opportunities In The New Normal

What The Heck Is “The New Normal”

- We keep hearing about “The New Normal”.
- There is even a silly TV show called “The New Normal”.



The term appears to be designed to reduce expectations

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The “New Normal” Economy



- The “New Normal” economy is over-leveraged.
 - National governments around the world have over promised on benefits and entitlements.
 - Our state and local governments are in hock to their employee unions.
 - Individuals purchased the good life on credit and are now facing college tuition, eldercare, and/or retirement.
- The current financial crisis began in 2008 when financial institutions managed to leverage the leveraging, and the bubble burst. (Example: The value of Credit Default Swaps exceeded the value of the GDP of the entire world!)



This “New Normal” global economic malaise is not expected to run its course until after 2015.

The Good News In A Limp Economy

- **The short term future is expected to look like the short term past.**
 - **U.S. : GDP will grow at about 1.5%.**
 - Continued slow expansion of the economy.
 - Housing and real estate continue to rebound.
 - Qualitative easing continues.
 - Disposable income declines due to tax increases.
 - Manufacturing becomes increasingly competitive.
 - **Europe: GDP grows at about 0.3%**
 - The PIGS are somewhat stabilized.
 - The year starts with a recession.
 - Some growth expected by year end.
 - Continued stagflation is the rule.



More Good News

- **Developing Nations: GDP grows at 5%**
 - BRIC plus Latin America, Middle East, and Africa.
 - Initial growth spurt in developing nations has been curbed by the worldwide economic malaise and counterproductive government interventions.

Worldwide GDP growth in 2013 is expected to be an anemic 3% driven largely by growth in the developing nations

The Bad News Is The Risk Things Will Get Worse

- **Central banks around the world are pumping out money to prop up economies.**
 - **When everyone does it, the risk of hyperinflation due to rapid currency devaluation is reduced.**
 - **Inflation of hard commodities, such as oil, is a risk.**
- **U.S. has not made significant progress in coping with debt and unfunded liabilities.**
 - **Nation on a short road to a \$1Trillion/year interest payment.**
 - **Government addiction to O.P.M. along with denial of problem.**
 - **Republicans may lack courage to “just say no”.**



More Risks

- **Europe has not solved its problems either.**
 - **High public and private debt remain.**
 - **Stagnation, outright recession, fiscal austerity, credit crunch, and chronic current accounts deficits remain the “New Normal”.**
- **China is relying on monetary and fiscal stimulus to prop up an unstable growth strategy.**
 - **Employment is generated by subsidizing our spending habits.**
 - **Risk of hard landing for their economy.**
- **Emerging markets may accelerate their economic slide by increasing government interference in free markets.**
 - **Expanding state capitalism, resource nationalization, and financial protectionism all damage growth.**

In my opinion the risks are medium to long term and will play out over the next five to ten years. In the short term political wrangling over what to do may introduce enough uncertainty to trim our tepid recovery by half a point.

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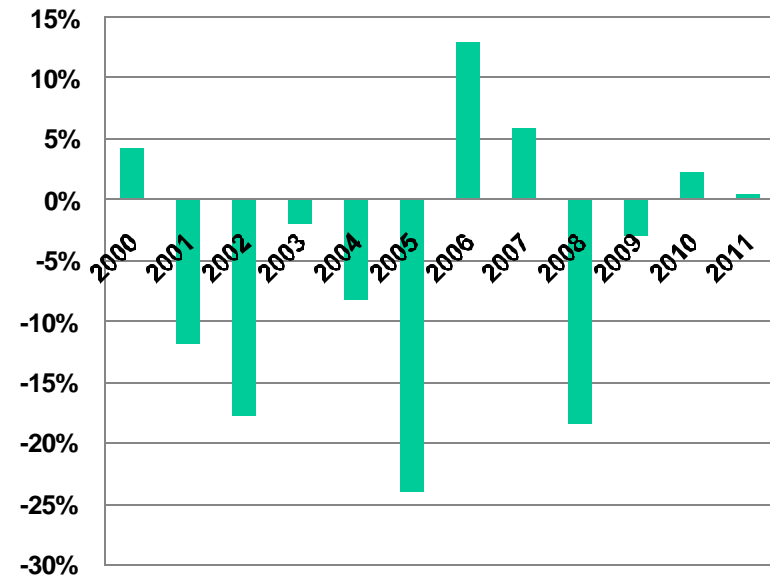
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Airlines Are Coping Well With “The New Normal”

- For airlines the Great Recession occurred after the attacks in 2001.
- The 9/11 terrorist attacks launched a 4 year recession in the travel industry.
- The 2008 financial collapse centered around the housing industry.
- The current economic crisis acted as a typical 18 month recession on the airline industry.

U.S. Airline Profitability

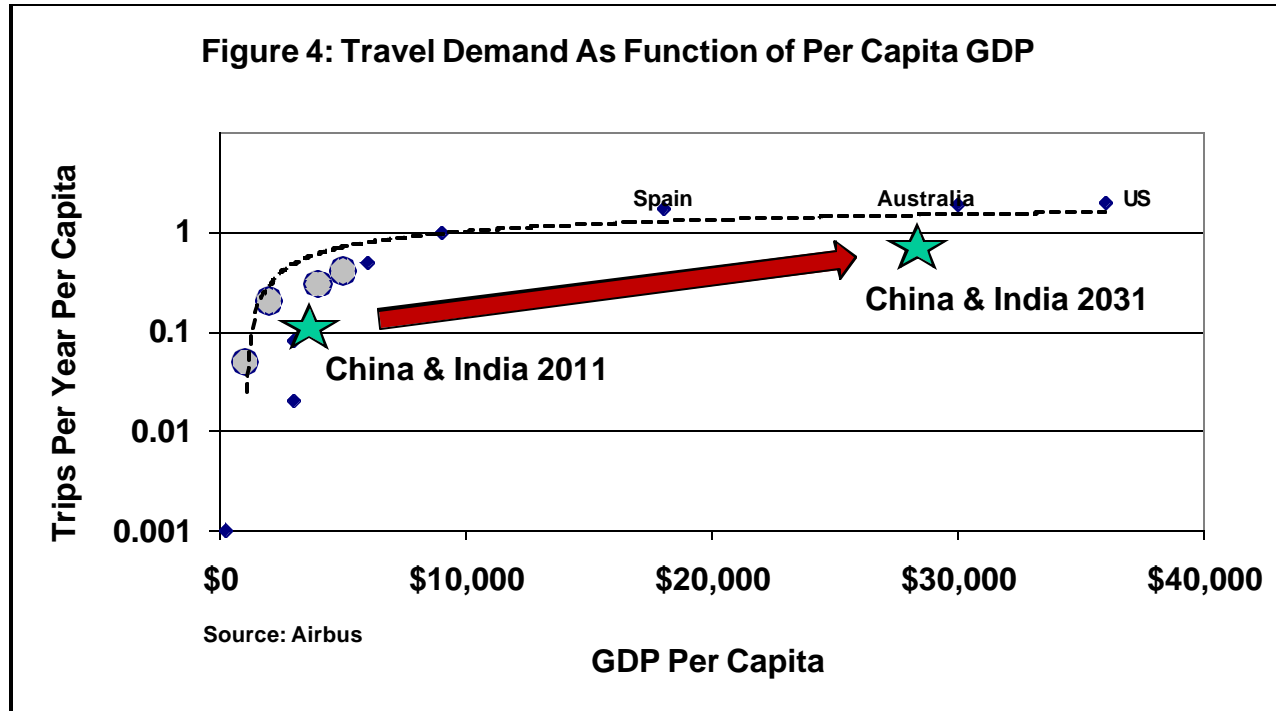


Source: A4A

Mergers Are Changing The Airline Landscape In The U.S.

- **6 Major carriers soon will be three.**
 - **Delta + Northwest = Delta**
 - **United + Continental = United**
 - **American + USAirways = American (probably)**
- **The mergers should produce more robust carriers that will be better able to cope with “The New Normal” power triad of comfortable adversaries.**
 - **Big government**
 - **Big business**
 - **Big labor**
- **To be successful the mergers must produce efficiencies rather than internal conflict.**
- **The resulting reorganization can affect the purchasing and processing of PMA.**

The Most Significant Airline Growth Will Occur In The Developing Nations



- Asia will combine GDP growth with improved standard of living leading to a 460% increase in their propensity to travel.
- Between 2012 and 2031 more than 1/3 of all new aircraft will be delivered to Asia-Pacific airlines.

Airlines Emerged From The 2001 Recession Better Able To Manage Lean Times

- **Airlines have become more disciplined in managing capacity.**
 - **No longer buying market share.**
 - **Currently U.S. airlines are offering 9% fewer seats than in 2007.**
 - **Load factors are typically above 80%.**
- **A la carte services were adopted to provide additional streams of revenue.**
 - **Customers are offered a menu, and they can select the level of service they want to pay for.**
 - **A la carte services added \$8.06 in revenue per passenger in 2011.**
- **Airlines are increasingly turning to lessors to provide financial flexibility while renewing their fleets.**
 - **An estimated 40% of aircraft are on operating leases today.**
 - **ILFC estimates that soon half the fleet will be leased.**

While The Airlines Were Becoming More Efficient, They Set Records For Passenger Service

- **The 2012 safety record for Western-built aircraft was the best in history.**
- **Airlines For America documented some of the service levels:**
 - **On-time arrival rate 81.9%**
 - **Involuntary denied boardings .99/100,000 passengers**
 - **Mishandled bags 3.09/1000 passengers**
 - **Flight cancellations 1.29%**

**In 2012 airlines received only 1.18 complaints per 100,000 passengers.
In comparison AMTRAK earned 627.5 complaints per 100,000.**

For All Of This Success, U.S. Airlines Earned A Dismal 21¢ Per Passenger

- **Pushed by fuel U.S. airline costs have risen by 113% since 2000.**
 - Expenditures on fuel rose by 286%
 - Airlines spent more than \$50 billion on fuel in 2012.
 - Fuel costs are expected to continue their upward trend.
 - Iran poses a wildcard in the near term future.
 - Delta has purchased their own fuel refinery.
- **Airlines pay 17 different taxes and fees to the government.**
 - \$19 billion in 2012 – about 20% of the cost of a domestic ticket.
 - Carbon taxes are a threat in the future.



Many of the more significant costs of doing business are beyond the control of airline management. Airlines are looking hard for opportunities to reduce costs.

ALL Airlines Now Feel The Need For Cost Containment

- **The continuing economic malaise means that increased profitability must come from increased efficiency and savings.**
- **Low cost carriers are losing their traditional operating cost advantage as their fleets age.**
 - **Operating cost growth is outpacing revenue growth.**
 - **LCCs are feeling the pinch of annual part price increases.**
 - **Executives are concerned with lack of competition in the supply chain.**
- **Cargo carriers, which were immune to the 9/11 airline depression, were damaged by the current Great Recession.**
 - **The IATA measured a 1.5% drop in air cargo last year.**
 - **FedEx is deferring aircraft deliveries and offering buyouts to senior executives.**

Today there is no segment of the commercial airline industry that does not recognize the need for significant cost savings.

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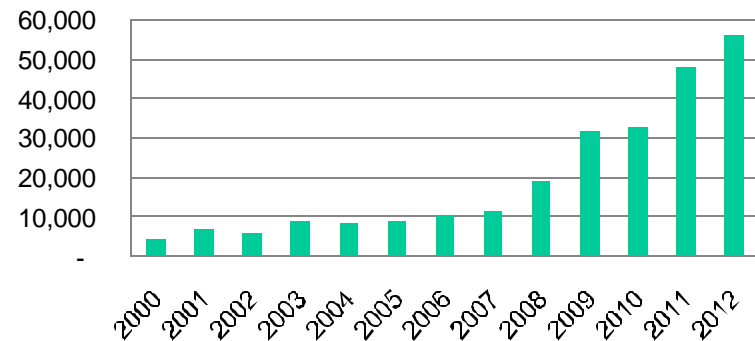
PMA Entrepreneurs Have Positioned The Industry Well To Exploit “The New Normal”

- **Consolidation of PMA suppliers has increased the technical capability, support, and financial stability of remaining suppliers.**
- **PMA suppliers have made significant efforts to educate airlines on the benefits and reliability of PMA products .**
- **The reliability and safety performance of PMA products has built confidence within both regulators and customers around the world.**
- **Suppliers are also building organizations to provide local presence in developing regions.**
- **MARPA efforts promote industry improvement and acceptance.**
 - **Coordination with the FAA to produce improvements in Continuing Operational Safety support for PMA.**
 - **Coordination with the FAA to develop streamlined approval process for PMA parts.**
 - **Establishing dialog with lessors and ISTAT appraisers to increase acceptance of PMA in the leasing community.**

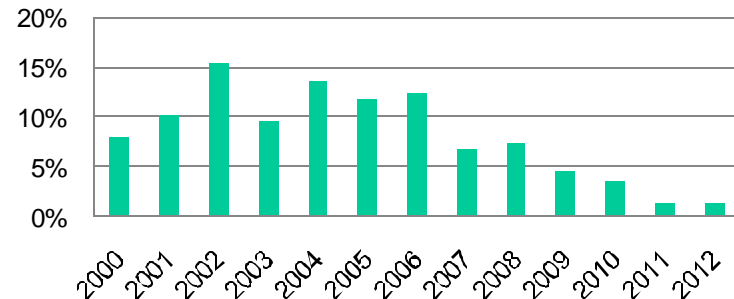
Fleet Changeover Will Be A Challenge For PMA Suppliers

- We are now in the initial stages of a technology driven fleet changeover.
- Several years are required for PMA to begin penetration of new aircraft types.
- OEMs are improving defensive measures to make penetration more difficult.
- In recent years PMA suppliers have been moving engineering resources to non-engine applications with lower OEM barriers.

Engineered PMAs Issued



% of Engineered PMAs Issued for Engines



Airline Mergers Mean Changes To Procurement

- Airlines intend to wring efficiencies out of the combined organizations resulting from mergers.
- New organizations may not have experience with PMA and may not understand its value or reputation for quality.
 - The Delta-Northwest merger combined a centralized program and a decentralized program to end up with a single centralized program to manage PMA.
 - The United-Continental merger moved from a focused PMA program to a decentralized program.
 - It is still too early to know what will result from an American-US Airways merger.

PMA suppliers must have their packages of success stories and statistics on savings and performance ready to help bring new airline players up to speed.

With All Of Its Challenges, The Next Few Years Can Be A Good Time For PMA

- ➔ **While “The New Normal” economy offers only tepid performance, economists guess that it will be stable over the next few years.**
- ➔ **All airlines, including LCCs and cargo carriers, need cost savings and are more focused on obtaining them.**
- ➔ **The entrepreneurs that run the PMA industry have done a good job of positioning themselves to assist airlines in achieving their maintenance material cost cutting goals.**