

Airline bankruptcy potential?

July 2, 2009

Are Airlines Going Bankrupt Again?

Let's see if I have this correct? Many airlines have reduced seat capacity by a record amount. Recent traffic demands are showing at or near historically high load factors.

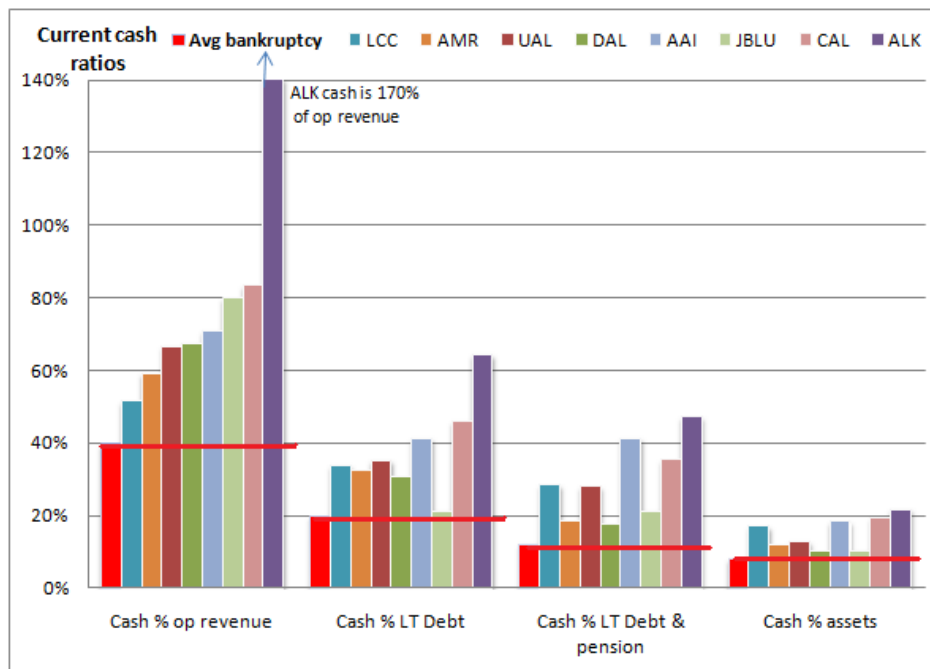
And some of these same airlines are now rumored to be looking at bankruptcy again?

Without doubt the balance sheets of most airlines are weak. If fuel prices continue up and/or we experience another global event similar to 911, it's likely the airline industry will race to the courthouse with Chapter 11 bankruptcy filings. At the same time, I believe there are enough positives to suggest recent analyst estimates for the industry are too negative.

Looking at the largest US airlines since 911, United, Northwest and Delta filed bankruptcy. USAir filed twice. American and Continental talked about it before they were able to restructure outside of bankruptcy. Southwest had fuel hedges which provided the cushion to avoid most of the financial turmoil experienced by the rest of the industry.

In my analysis of the airlines that filed bankruptcy and restructured, I calculated some average –benchmarks- that can be used to project the current financial weakness relative to the more recent airline bankruptcies.

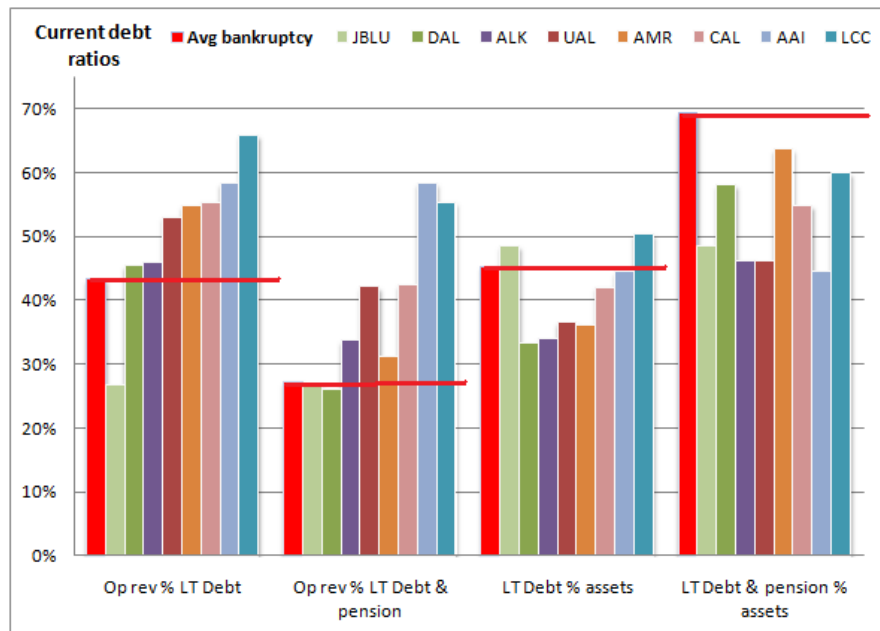
The chart below provides the 1st quarter 2009 cash ratios as they compare to the pre-bankruptcy averages (*note: not all airlines were used to conclude the averages*)



Airline bankruptcy potential?

My analysis shows none of the airlines are currently in a critical cash position (Cash includes unrestricted cash and short term investments).

The chart below provides 1st quarter 2009 debt ratios to total operating revenue and assets as a comparison to recent bankruptcies. (Note: not all airlines were used to conclude the averages. LT debt includes capital leases. Pension includes post-retirement obligations).



Using debt ratios noted above, some airlines are currently at or below the averages just prior to the more recent bankruptcy filings.

Projecting which, if any, airlines are approaching bankruptcy should consider weakness in both cash and debt ratios.

Before looking into the future for solutions, it's important to review the past.

Year 2008 operating revenues -for the airlines noted above- were around \$3 billion more than year 2000. Over the same time period, employee wage/benefits dropped by nearly \$6 billion. 150,000 jobs (over 32%) have been lost just from the airlines noted above. It would seem -labor- has paid more than their share to keep this industry alive.

Everyday media articles and some analysts point to a variety of reasons why airlines aren't profitable. To me, after reviewing airline industry financials, it is obvious air fares are simply too low to support the on-going fixed and variable costs of one of this country's most important business sectors. Safety, schedule reliability and customer service comes at a price. These should not be compromised for cheap fares.

Disclaimer- The above opinions should not be used to determine the worth of any stock or investment. At the time of writing, the author and his family hold stock and derivative positions in AMR.

####