

ECONOMIC OUTLOOK 2008 MID-YEAR REPORT

Aviation And Aerospace Industries Face Uncertainty

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Jet fuel prices have surged from \$90.93 per barrel in 2007 to about \$137.27 per barrel this year – and fuel now accounts for 35 to 50 percent of an airline’s expenses, according to the Air Transport Association (ATA). But soaring fuel prices impact both the aviation and commercial aerospace sectors.

A recent 5.5 percent drop in The Boeing Company’s stock – its steepest decline in two years – suggests slow growth in the years ahead. The drop occurred after Richard Safran, a Goldman Sachs analyst, downgraded the whole commercial aerospace sector from “neutral” to “cautious.”

According to industry experts, Boeing stock is down 34 percent from its all-time high of \$107.80 last July, due to delays on its 787 Dreamliner program (a more fuel-efficient commercial jet expected to enter the market in late 2009) and general concern about high oil prices. Safran put a \$60 price target on the stock for the next 12 months, but said there is substantial risk the stock could go lower.

But Boeing could have a second chance to bid on a \$35 billion contract with the U.S. Air Force to provide next-generation aerial refueling tankers. The Government Accountability Office (GAO) recently found that the Air Force had “made a number of significant errors that could have affected the outcome of what was a close competition,” in awarding the contract to Northrop Grumman Systems Corporation.

“We recommend that the Air Force reopen discussions with the offerors, obtain revised proposals, re-evaluate the revised proposals and make a new source selection decision, consistent with this decision,” according to the GAO report. “If Boeing’s proposal is selected for award, the Air Force should terminate the contract awarded to Northrop Grumman.”

On February 29, the Air Force selected Northrop Grumman to provide its KC-45 tanker, a next-generation aerial refueling tanker, which would be assembled in Alabama. Production of the aircraft would create nearly 7,500 jobs and generate an additional \$363.7 million in California alone, according to Randy Belote, vice president of corporate and international communications at Northrop. Currently, Northrop employs 28,446 people in the state.

“The KC-45 is needed now, and Northrop Grumman is ready now to provide it,” Paul Meyer, Northrop’s vice president of air mobility systems and the KC-45 program manager, said in a

recent press release. “Should the Air Force choose to proceed with our existing contract, we are ready to get to work. Northrop Grumman offered the superior tanker, and nothing in the GAO analysis contradicts this essential truth.”

Meanwhile, the future of Boeing’s C-17 program hinges on the June 30 approval of a roughly \$165 billion Supplemental Appropriations Act, which includes an order for 15 more C-17 Globemaster airlifters. Boeing will now extend the production to August 2010.

“We continue to see strong interest in C-17s in the international market. With NATO (the North Atlantic Treaty Organization) expressing interest in acquiring three C-17s, we believe this reflects a strong international desire for [its] advanced capabilities,” said Jerry Drelling, spokesperson for Boeing’s C-17 program. “The long-term market looks very positive. There [couldn’t] be an international [market] without the foundation of a healthy U.S. Air Force C-17 production line.”

According to Drelling, there are currently 188 C-17s in service worldwide – the U.S. Air Force has 174, the Royal Air Force has six, and the Royal Australian Air Force and Canadian Forces each owns four.

“Support for the C-17 remains strong because it has proven itself repeatedly as the airlifter of choice in Iraq and Afghanistan,” he added. “The C-17 played a major role in providing humanitarian aid to China in the wake of a devastating earthquake and in cyclone-ravaged Myanmar.”

Gulfstream Aerospace, a subsidiary of General Dynamics, recently completed its 200th G550/G500 jet at its manufacturing plant in Savannah, Georgia. The business jet will be outfitted and painted at the company’s completion facility in Long Beach. The aircraft has been in service since 2003 and is said to have a nearly 100 percent annual dispatch reliability rate.

Aviation And Satellites

“The nation’s airlines expect to lose in the range of \$10 billion this year – a loss on par with the worst year in this industry’s history, [and] high fuel prices are the sole reason,” John Meenan, ATA’s executive vice president and CEO, recently testified to the Senate Committee on Commerce, Science and Transportation.

“Unlike the temporary revenue hits from 9/11 and other one-time demand shocks, the airlines now are facing a massive structural cost increase,” he added. “Not even Chapter 11 can lower

the price of fuel. More than 14,000 airline jobs have been cut so far this year, and that is just the tip of the iceberg. Scores of communities stand to lose all scheduled air service by early next year. More airlines – in addition to the nine that have already filed for bankruptcy or stopped operating – may simply shut down.”

The effect is also evident locally and with newer airlines, such as JetBlue Airways and ExpressJet. But the niche market at Long Beach Airport (LGB) hasn't impacted flight schedules this summer, with all 41 allocated slots currently in use. JetBlue recently added service to San Jose and Seattle but has delayed service out of Los Angeles International Airport.

JetBlue has 814 employees, including its flight crew, in the Long Beach area and 141 aircraft in its nationwide fleet. Bryan Baldwin, manager of corporate communications at JetBlue, said the company views the current price of fuel as the new “normal” and is looking to adapt its business model accordingly.

“We're not going to rely on the hope that the cost of fuel comes down, because that's not a smart way to operate or run a business,” he said. “We had originally projected growth for this year to be between five to eight percent year-over-year, and we have reduced that to three to five percent for 2008.”

The airline posted a 2.8 percent decline in its capacity during the fourth quarter, which has prompted it to consider reducing certain flights during off-peak times and slow down its rate of entry into the market – especially if it involves opening up a brand-new city. The company has also passed some of the increased operational costs to its customers, including a 22.4 percent average rise in overall fares.

“We have participated in several industrywide fare increases,” Baldwin explained. “Our average fare for the first quarter 2008 was \$135.64, [and] for the first quarter 2007 it was \$110.79.”

In addition, it implemented a second checked-bag fee of \$20 on June 1, while the phone reservations booking fee increased from \$10 per person to \$15. Baldwin said the company has not implemented companywide layoffs.

ExpressJet, LGB's newest commuter airline, posted a 58 percent load factor in May; however, it recently announced a roughly 30 percent decrease in its flight schedule beginning August 23. ExpressJet spokesperson Kristy Nicholas said the company will reevaluate its schedule in November; she noted that ExpressJet has not increased fees for extra baggage.

According to AirServ President Kevin McAchren, whose company provides ground support at LGB, two charter companies he once serviced have recently ceased operations at the airport. Champion Air shut down May 31, while ATA Airlines filed for bankruptcy in April.

“We're seeing a diminishing customer base, which is not a good thing,” he said. “We're concerned about that and we're concerned about any increases in the price of fuel. . . . We have to fuel the equipment that services the airplanes, and we're seeing that as a larger and larger percentage of what we spend every month.”

McAchren also noted a decline in general aviation due to rising fuel costs and the bankruptcy filing of Silver State

Helicopters, which ceased its nationwide operations in February. The company operated about six aircraft out of LGB for student pilot instruction.

Although LGB's allocated carrier slots are at capacity, 13 commuter slots remain available. “In the current economic climate, I really don't expect that to change. I don't expect any new carriers to come in and ask for slots right now,” said Christine Edwards, assistant airport manager at LGB. “Long Beach is kind of a niche market, and while everyone here is struggling with the fuel prices, . . . this small market seems to be productive for the carriers.”

LGB's passenger traffic declined 7.9 percent from May last year, although Edwards said load factors remain high. Airline passenger load factors for May are Alaska at 80 percent, Delta/Skywest at 81 percent, JetBlue at 76 percent and US Airways at 76 percent.

Long Beach Flight Center, a fixed based operation (FBO), competes for customers with other FBOs, such as Signature Flight Support, Long Beach Jet Center and AirFlite Aviation Services. According to General Manager Bill Cripe, Flight Center purchases fuel from an independent supplier on a weekly basis, which accounts for a significant portion of its annual expenses.

“We haven't seen a huge drop-off [in activity], but we haven't seen an increase either,” Cripe said, noting that Flight Center focuses on competitive pricing and customer service.

Meanwhile, delays continue for LGB's terminal improvement plans. The Long Beach Unified School District did not appeal a judge's decision that ruled in favor of the airport and the validity of its environmental impact report; however, the Parent Teacher Association (PTA) filed an appeal on May 13, according to PTA attorney John Eastman, who doesn't expect it to go to appellate court until late summer or fall.

Busy Schedule Ahead For Sea Launch

Paula Korn, director of communications at Sea Launch, said it has successfully launched four satellites between its Sea Launch and Land Launch services, while five more are scheduled for the remainder of the year.

“It's a very unpredictable business, [and] it kind of goes between ebbs and flows,” she said. “It's very competitive, and all the launch providers are very busy. Customers are really anxious to fly their satellites.”

“What happens after 2010 is relative to demand,” Korn added. “Some of it has to do with the cycle of satellites needing to be replaced because they are designed usually for a 12- to 15-year life period. . . . [And] some of it is just changing, evolving technology.”

Korn noted that it could take several years to build and launch a satellite, and the company is focusing on successful execution and staying on schedule. ■