Airline Industry - Key Success Factors

BUSINESS RISK ASSESSMENT

Market Position
The analysis covers comprehensive examinations of the company's business and market position within the market served, including its routes network; the attractiveness of the markets; and its competitive advantage in those markets, particularly for commercial airlines. Factors we consider when analyzing route networks include the company's access to major markets, particularly those with high business travel and the main tourist destinations; alliances with other airlines; and the position of hubs to accommodate connecting flights. We also assess the company's share of traffic on its largest routes in determining its business position within the industry. We view that airlines with a significant market share at an airport tend to carry a high share of traffic. For airlines that also provide, or solely focus on chartered flight services, we assess the tenor of the contract and the length of the relationship with its existing clients, as they can be indicators for revenue stability. The company's capability and track record in obtaining new assignments is also assessed. We also assess service standards and reputation, which determine the level of customer preference.

Fleet Profile
A comprehensive analysis of fleet profiles is highly required, as the capability to deliver good quality of service should largely depend on fleet quality. A company with a larger fleet usually benefits from broader business opportunities, more efficient maintenance costs, and a better business reputation. Fleet age is one of the most important factors for quality of service. A young fleet requires a relatively lower cost of maintenance and provides a higher degree of operational safety. The assessment also includes capacity, type, and the manufacturer of the fleet. Maintenance and replacement or disposal policies are also assessed. The secondary market price of the fleet is another important factor we assess.

Diversification
The analysis covers detailed assessments of the company's diversification, which is primarily based on the geographical diversity of its flights distribution, the types of passengers carried (business or leisure), and the types of services. Large airlines tend to have better business diversification as they will serve a larger number of customers in different geographic locations with a higher degree of fleet variety. This diversity should reduce volatility and maintain the stability of cash flow performance through the business and economic cycles. We also assess the revenue proportion of non-passenger services, including cargo, travel agent, hotel, and other services.

Operating Management
The analysis covers intensive risk assessments of the company's revenue generation and cost structure through the evaluation of its ability in managing its capacity utilization and pricing. We also assess the quality of management, including managing its human resources and usage of the latest technology. The analysis includes assessment of the management's ability to run and expand the business efficiently, set manageable tariffs and discounts, its attitude toward safety and human resource skills, compliance with regulations (local and international), operating efficiency or cost control policy, and labor relations track record. The analysis on operating margins (EBIT and EBITDA) is also assessed by comparing the company's ratios with other players in the same industry or other industry with similar characteristic, which is important in analyzing the company's competitiveness. The analysis is helpful to measure operating efficiency.
FINANCIAL RISK ASSESSMENT

Financial Policy
The analysis includes a review of management's philosophy, strategy and policies toward financial risk (historical, current and future). It also includes examination of management's financial targets (growth, leverage, debt structure and dividend policy), hedging and other policies in an effort to reduce the company's overall financial risk (historical vs. future). The company's track record on fulfilling its previous financial obligations is also examined to determine the degree of its commitments and willingness and consistency to pay obligations on a timely basis.

Capital Structure
The analysis covers careful examination of the company's historical, current and projected leverage (total and net debt in relation to equity and EBITDA), debt structures and composition (rupiah vs. foreign currencies, short-term debt vs. long-term debt, fixed rate vs. floating rate). Management of its liabilities is also thoroughly reviewed.

Cash Flow Protection and Liquidity
The analysis covers thorough reviews of the company's cash flow generation and capability to meet its short-term and long-term financial obligations. The degree of its debt-servicing capability level is measured by the company's interest and debt coverage ratio. The degree of its liquidity in fulfilling its short-term liabilities relative to its sources of cash is also thoroughly assessed. The sources of cash are assessed, which include cash balance, estimated cash from operations, unused credit facilities, and other sources of cash. The uses of cash other than short-term liabilities, such as capital expenditure, are also assessed.

Financial Flexibility
The analysis covers combined evaluations of all the financial measures above to arrive at an overall view of the company's financial health. Analysis of other related factors or figures that are not specifically examined above, such as insurance coverage, restrictive covenants in loan/bond agreements or parental linkage and support, are also covered. Other analytical tasks covered are the evaluation of the company's options under stress, including contingency plans and other capabilities and flexibility to deal with various adverse scenarios. Shareholder support and commitment are also greatly considered.
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