

Airline Finance

By Peter S. Morrell

A book review by Krzysztof Rycombel

When reaching for this book I expected a comprehensive text on airline finance providing explanations for the singularities of the airline industry also regarding the accountancy approach. After reading it I have to admit that the Airline Finance book by Peter S. Morrell satisfied my expectations as a source of information providing general understanding of all areas of airline finance supported by examples from the air transport industry. However, I would be rather careful when calling it a sophisticated and authoritative guide for analysts in financial institutions and consultancies.

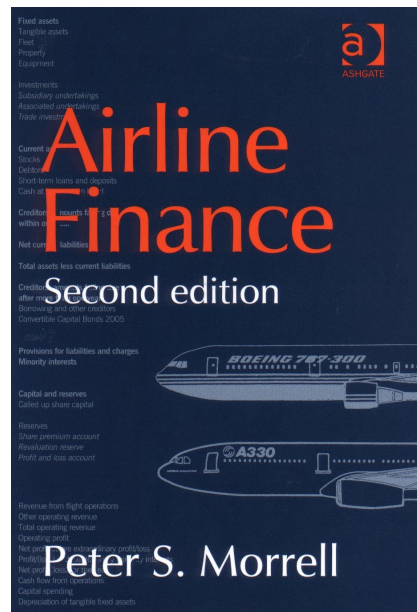
The second edition of Airline Finance (2002) reflects recent research on the whole airline industry. The book presents new sections on Cash Value Added and aircraft leasing and updated chapters on cost of airline equity capital and airline privatization. Let us have a closer look on the content of the book. The book consists of eleven chapters covering particular aspects of airline finance concerning not only general overview of the world airline performance and prospects but also specific financial issues of an airline backed by examples from the industry. At the back of the book we can find the bibliography, index and very useful glossary of terms.

The first part, Industry Financial Performance, discusses the financial trends and recent developments in the airline industry. One will find

world airline financial results contrasted with the airline traffic growth and world GDP growth over the past decade, factors affecting financial results, section on asset utilization and key financial issues identified by world airlines.

Part two, Airline Financial Statements, provides step by step analysis of the financial statements with British Airways as an example. The British Airways accounts are contrasted however with those of other airlines in order to present different accounting formats and conventions. Even though the book addresses specific airline accounting aspects such as treatment of frequent flyer programs and aircraft leases (as few text do), the author presents the financial statements with insufficient in-depth analysis of the particularities of the airline finance, what could be of great value to financial consultants interested in the airline industry.

The following chapter, Airline Financial Ratios, presents the performance ratios, which are calculated to assess past trends or to compare different airlines. Along with presenting earnings ratios, risk or solvency ratios, liquidity and stock market ratios, the author provides us with inter-airline comparison of these ratios and describes some problems with the interpretation and comparison such as: distortion of comparative data, differences in accounting treatment or "window dressing".



The next chapter deals with the valuation of an airline, its route rights and airport slots in particular. Author describes some of the key techniques of company valuation and applies them to the airline industry. After presenting the valuation of intangible and tangible assets and the valuation of the airline as a total supported with the worked examples, ratings agencies are presented with regard to the airline industry.

The fifth chapter, Airline Privatization, discusses the financial aspects of airline privatization. Author provides various methods of airline privatization and gives examples of world airlines for each of them. We can read here about privatization of British Airways, Lufthansa, Kenya Airways, Iberia and Air France.

An elaborate part of the book is based on airline financial planning and appraisal, which ranges from the short-term preparation of budgets to long-term planning. In particular it discusses the main long-term financial goals of an airline, namely, the evaluation of the expected future financial condition of the company and the estimation of future requirements for finance.

There is a separate part for Foreign Currency and Fuel Price Exposure, which covers topics such as: exchange rate volatility, airline trading and balance sheet exposure to currency movements, fuel price exposure and foreign exchange risk management. Author describes in this chapter the mechanisms and importance of hedging and derivatives and supports his ideas with practical examples from the airline industry.

Industry sources of finance are dealt with in the next three chapters. After providing general understanding of internal and external finance available to airlines author discusses the institutions, which are involved in aircraft finance. The chapter is followed by practical examples of calculation of term loan repayment amount, calculation of book profit and effect of prepayments to manufacturers. Leasing and aircraft securitisation are examined in some detail and constitute separate parts of the book. After defining a lease contract author discusses different forms of leases giving examples of world airlines' choices in this field in the past few years. In the next chapter on securitisation author discusses and gives advantages and disadvantages of the conversion of predictable cash flows into securities over the 1990s'.

Industry financial prospects are touched on in the last chapter, under the same name. I found this part especially interesting, as I could learn about world air traffic and airline operating result forecasts. Also capital expenditure projections and financial requirement forecasts of world airline or discussion of future aircraft financing sources might be of great interest to industry specialists and consultants dealing with procurement of funds for the airlines.

To summarize, I want to stress that the Airline Finance book is a well written text providing the essentials to understanding all areas of airline finance and can be treated as a key resource for students of airline management. However, some areas

of airline finance are discussed in insufficient depth to meet the expectations of accountants and industry specialists. But as the author states in the Preface, if the book does not fully cover some topics, they will be directed to other texts to explore more complex topics further.

About the author

Peter S. Morrell is Head of the Air Transport Group, College of Aeronautics, Cranfield University, UK. He was formerly Joint Editor of the Journal of Air Transport Management, and has graduate degrees from the University of Cambridge, UK and Massachusetts Institute of Technology, USA.

About the reviewer

Krzysztof Rycombel is a student of Warsaw School of Economics, majoring in finance and banking and specializing in corporate finance. He studied for one semester at University of Amsterdam and took part in Airline Economics and Airport Economics courses. His thesis covers the financial analysis of PLL LOT Polish Airlines. Currently he is working for Ernst & Young Corporate Finance in Poland.



Some other publications of Peter S. Morrell:

- 'Airport privatisation in Europe: slow progress?', paper to International Conference on the Development of air and space science in the 21st century, Seoul, 1 November 2002
- 'An evaluation of airline cost of equity capital and its determination using beta values', paper with Sheelah Turner to 6th ATRS World Conference in Seattle, 14-16 July 2002
- 'The end of history for Sabena', The Wall Street Journal Europe, November 8, 2001
- 'The social impact on civil aviation of events subsequent to 11 September 2001', briefing paper with Dr Fariba Alamdari for discussion at the Think Tank on the Impact of the 11 September Events for Civil Aviation, 29-30 October 2001, International Labour Office, Geneva
- 'Capital productivity and the role of capital intensity in airline labour productivity', accepted for publication in the Handbook of Airline Economics, 2nd Edition, ed. Darryl Jenkins, McGraw Hill, 2001
- Cranfield vocational training programmes in air transport management, 1st Aviation Management Education and Research Conference, Concordia University, Montreal, 16-17 July 2001
- 'Evaluating environmental related charge mechanisms and the subsequent social welfare impacts', paper with Cherie H-Y Lu to 9th World Conference on Transport Research (WCTR), Seoul, Korea, 22-27 July 2001
- 'The impact of air transport trends on airports', paper to the 2nd Annual Airport Finance and Development Conference, Euromoney Seminars, London, 7 June 2001