

Public valuations on the rise



Aviation companies have seen rising revenues during the first and second quarter of 2011, but this monetary boost hasn't increased multiples or private-deal activity. Although the total enterprise value (TEV) (or the market value sum of debt and equity) reached a new high in the first quarter of 2011, the EBITDA multiples (TEV/earnings before interest, taxes, depreciation and amortization) have reached new lows so far this year.

Higher interest rates, rising unemployment and ballooning fuel costs, mixed with potential changes in the tax code at the end of 2012 and the likelihood of future inflation, have depressed earnings expectations; discount rates have been increased, and multiples are down. With multiples at their lowest level in the past six years, and private merger and acquisition activity relatively low, issues remain. Will these numbers stay depressed, or will they start to recover? If so, for whom?

Capital Alliance has analyzed data from public transportation and logistics companies and individual deal transactions reported by CAP IQ.

There were approximately 27 public aviation companies in the data. The companies included the six major carriers with more than \$10 billion a year in revenues; 13 regional companies; and eight cargo-and-specialized companies, two of which were FedEx and UPS. An additional 150 aviation-related mergers and acquisitions during the past several years were reviewed as well.

This exploration found that public valuations should increase for all segments, perhaps substantially, as they revert to mean levels after having been driven down due to numerous uncertainties and risks. The largest opportunity appears to be in companies in the regional and cargo-and-specialty categories.

Perhaps the most attractive opportunities are in the private-specialty companies. Whether acquired by public or private companies, private transactions offer real promise. True, they

just may take a little longer to identify and close, but they still should be worth the effort for all parties.

Past trends and performance

The U.S. recession dealt a huge blow to airlines. Fortunately, these carriers are starting to rebound financially. In fact, revenues rose steadily through 2008, declined in 2009, and resumed their upward trend, reaching new highs in the first half of 2011.

EBITDA started falling earlier than revenues. It dropped precipitously in 2008 and remained there through most of 2009 before rebounding to its current high. TEV started its descent the earliest; it hit its lowest level during the first quarter of 2009, then climbed to a new high in the first quarter of 2011, only to decline slightly in the second quarter.

Despite all of the record-high financial measures, valuations have declined. Two common measures of



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value include the price-to-earnings ratio, which measures the value of equity, and the EBITDA multiple, which assesses the total value of the firm. The price-to-earnings ratio rallied from its bottom early in 2009 to a new high in the third quarter of 2010, then declined rapidly. EBITDA multiples also rallied off their 2008 second quarter low, stalled in 2009, then declined. At the end of the second quarter of this year, they reached a multiplier of 5.2 times, a new low.

A review of aviation-related mergers and acquisitions confirms the lack of industry excitement. More than nine deals per quarter were closed between 2006 and the middle of 2008; this dropped to five deals per quarter through year-end 2010. In 2011, four deals were completed

in each of the first two quarters. In addition, while financial buyers closed 25 percent of the deals in the past, they only completed 12 percent this year.

Outlook

There are hundreds of smaller and mid-sized specialty companies with strong market positions and excellent finances. Niche markets — cargo handling, flight training and maintenance services — offer substantial opportunities for future growth, industry consolidation, cost economies and EBITDA expansion. Those with above-average growth prospects will be more highly valued than the average competitor. Transaction volumes should pick up over the next year.

Valuations are determined by expected future cash flows adjusted for risk. Looking at the industry, it is difficult to see how the major and regional airlines will significantly change their past patterns. As such, their valuations will likely stay within historic ranges.

A few regional players will offer significant future growth and returns, faring better than average. The cargo segment offers above-average growth — particularly internationally — and much stronger balance sheets. Expect to see some of these cargo companies do very well over time. **ACW**

— *Michael S. Galardi is a senior vice president of Dallas-based Capital Alliance*

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