THE FRACTIONAL market

special report

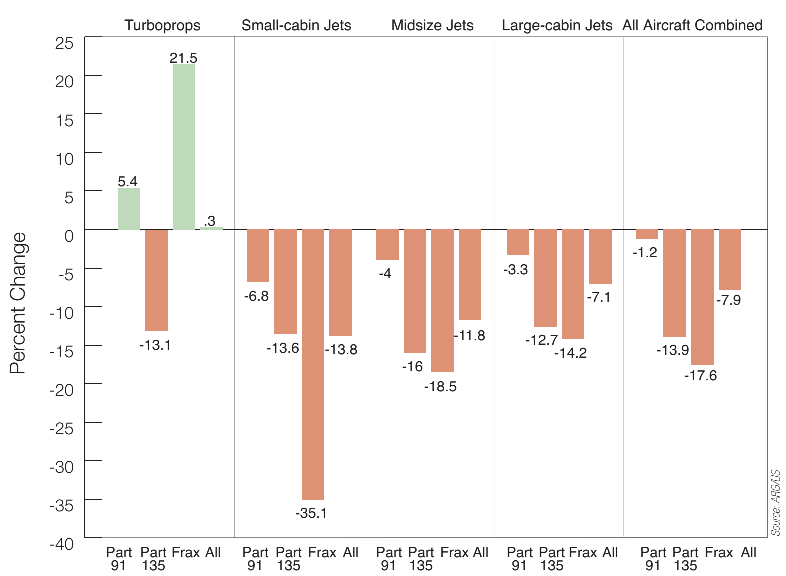
Recession raises questions about the viability of the fractional model

by Matt Thurber

The recession has dealt an enormous blow to the fractional share industry. Rapidly declining used-aircraft prices and fewer flying hours have affected the industry to the point that most fractional operators have shrunk during the past year, deferred new aircraft deliveries, cut staffing and explored new ways to keep flying. Business has been so bad at the fractionals that some pundits are questioning whether the business model is broken.

That huge changes have occurred among the fractionals was evident when holding company Berkshire Hathaway released second-quarter financial results for its NetJets property in early August. Compared with the first six months of last year, this year NetJets revenues declined $550 million or 43 percent, according to Berkshire Hathaway. "The declines reflected an 81-percent decline in aircraft sales as well as a 22-percent decline in flight operations revenues primarily due to lower flight revenue hours."

Graph 1: Business Aircraft Activity (hours flown)
July 2009 vs July 2008



For the first six months this year, pretax losses at NetJets were $349 million, reflecting asset writedown and other downsizing costs of $447 million during that period. Last year in the first quarter, NetJets recorded $45 million in pre-tax earnings, compared with a $96 million loss in the same period this year. According to Berkshire Hathaway, "NetJets owns more airplanes than is required for its present level of operations and further downsizing will be required unless demand rebounds."

On August 4, NetJets announced that Richard Santulli, founder and chairman of the company, resigned, although he plans to remain with the company for a year as a consultant. Berkshire Hathaway bought NetJets in 1998 for $725 million. Following Santulli's departure, David Sokol, chairman of Berkshire Hathaway's MidAmerican Energy Holdings, was named chairman and interim CEO of NetJets.

As this issue went to press, NetJets announced staff reductions of 5 percent, and the company has implemented other cost-cutting moves, such as moving the corporate headquarters to Columbus, Ohio, where operations are located. In addition, there have been numerous executive changes. The company promoted Ben Murray from president of NetJets subsidiary Executive Jet Management to NetJets president and COO; and Bill Noe from president of NetJets International to NetJets North America president, overseeing NetJets Aviation, NetJets International, charter/management subsidiary Executive Jet Management and NetJets Large Aircraft. Jim Christiansen remains president of NetJets Aviation.

Broken Business Model?

The surprising news that Richard Santulli, widely considered the father of fractional aircraft ownership, is leaving the company raised a weighty question: is the fractional share business model broken? That question is underscored by the huge losses at NetJets and scuttlebutt that the company is finally undertaking the process of matching its resources to the customer base and amount of flying. Most of the fractionals have consistently laid off employees as business soured, but some speculate that Santulli was protective of employees to the point that it might have interfered with rightsizing measures during the recession.

NetJets declined to comment as this article was being written. One source obtained by **AIN**, however, indicated that the company has taken steps to dispose of its Citation 560 fleet. According to data provided by Paris-based fractional researcher Pierre Parvaud, as of the end of June, NetJets had 76 Citation 560s and a total fleet of 500 jets.

The fractional business model is broken, asserts Michael Riegel, a former Bombardier executive who now runs AviationIQ. “There are a lot of irate consumers monitoring what’s going on,” he said. Net sales of fractional shares have been declining steadily, went negative in 2008 and have dropped quickly year-to-date. “The decline has been going on for seven years,” Riegel said, and the fractional industry is not, as some have suggested, experiencing a blip due to the recession. “Can the business model be fixed?” he asked. “Yes, but changes are needed.”

The fractional industry could be compared to real estate timeshares, which suffered from a reputation as bad investments long before the current recession began. While fractional shares of aircraft may be at risk of that perception, Riegel said, the fact remains that people still need to fly. “At the moment, they’re not being treated very well.”

What that means, he explained, is that in a time when costs ought to be dropping, shareowners are facing price increases across every aspect of share ownership. The amount that owners receive for their used shares when they exit programs is much lower, due to rapidly dropping used aircraft prices, Riegel said. “Hourly fees are up well ahead of inflation, and the cost of being an owner is far higher than before. A lot of owners are saying it’s become too expensive and they don’t want to keep doing this. The industry has dug itself into a hole.”

The main attraction of the fractional industry has always been that it offered lower barriers to entry for new business aviation users and an easy way to add supplemental lift for companies and owners that didn’t need to buy another full airplane. Fractional providers offered better service than many charter operators, Riegel said, but with fractional costs rising, many travelers are shifting to high-quality charter operators.

In the case of NetJets, some of its problems are because its business is so complex, he explained. “NetJets in particular has tried to be all things to all people.” The company’s Marquis jet card program, free flights outside the normal service area and need to buy charter to fulfill fractional flight requests layered in additional costs, he said, “and it’s not surprising they dived into the red. The only way to dig out is to try to make money by selling shares.” But for many of the fractional providers, share sales are nonexistent.

Although NetJets’ Marquis jet card sales offset some of the shareowner departures, “card activity creates as many problems as it solves,” Riegel said. Across the fractional industry, he explained, there are an average of nine to 10 owners per airplane, and each of those owners places a certain amount of demand on each airplane. Marquis jet card buyers, however, average about 20 per airplane. “The more card business you do, the more people can demand the airplane,” he said.

NetJets’ losses for the first six months of this year translate into nearly $700,000 per airplane. “Those are terrifying numbers,” Riegel said. “Almost anything they do [to fix the problem] is going to take years.”

Riegel, who launched AviationIQ as a consumer club aimed at helping fractional share owners gain more buying power by working together, thinks that there remains a need for the fractional concept but that the major providers need to revise their business models. NetJets, he said, has too many airplanes to serve its customers and should cut its fleet to 160 to 170 airplanes, which may be what the company is doing with the reported disposal of its Citation 560 fleet. NetJets was not able to confirm that information by press time.

According to Riegel, NetJets is allowing some owners to idle their shares by stopping flying, letting them retain ownership of the share but not charging the monthly management fee. He expects these aircraft–which he estimates to number approximately 160–to sit idle for a few months before NetJets asks the owners to resume paying management fees or sell their shares. “Many will pull the plug,” he said, having held their shares in the hope that used aircraft prices would recover. “We’re not going to see significant recovery for another 18 months. A lot of owners will punch out and worsen the problem for the fractionals.”

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While many of the fractionals have suffered during the recession, Avantair has seen increased demand for its turboprop Avanti, which sips jet-A but gives passengers a comfortable cabin.

Fractional Players

Avantair

Avantair reports its fiscal year results in mid-September, so the latest numbers were not available for this report. But, said Avantair president and CEO Steve Santo, “We have had record sales in July and have been doing really well financially.” The ARG/US TraqPak numbers bolster Avantair’s claim, showing consistently positive flight hours for the fractional turboprop segment (which also includes Executive AirShare and PlaneSense). “We continue to see people leaving other higher-cost fractionals and charter card companies and coming to us for value,” he said.

Avantair CEO Steve Santo

The economy is affecting Avantair, and Santo said that the company sold no new shares during the first three months of this year, although Avantair Edge charter card and Axis block charter sales have grown rapidly and resales of used shares continue to be strong.

One factor that is attracting former owners of shares in jets at the major fractionals to Avantair, Santo said, is the much lower hourly cost for Avantair’s fleet of Piaggio Avanti twin turboprops. When owners factor in the cost of ownership of a jet share, including monthly management fees, fuel surcharges, hourly cost plus the added expense of an asset that is rapidly decreasing in value, flying in a roomy and fast Avanti at half the hourly cost suddenly looks much more attractive. One Avantair customer who left one of the jet fractional companies paid $400,000 for a one-sixteenth jet share and left the program after selling the share for $68,000, according to Santo. “The residual values become part of your hourly cost,” he said.

Much of the growth at Avantair is from card and block charter customers, with sales in the Edge and Axis programs up 81 percent year over year, according to Santo. People who can afford to buy fractional shares still have a need to travel, but they are wary of owning capital assets. “Everybody is looking at costs,” he said.

Unlike the jet fractional companies, Avantair does not guarantee to buy back used shares at the end of the contract period. “Buybacks have really driven down the values of aircraft,” Santo said. “Guaranteed buybacks are certain death.” Avantair does help customers remarket their share if they don’t want to renew their contract or if they want to buy a share in a newer Avanti. During the first quarter, Avantair had 18 customers come up for renewal, and 17 renewed, while the remaining share is for sale. “We’re not getting the kind of defections other companies are seeing,” he said, “because we’re at the bottom of the food chain.”

Avantair had 55 aircraft as of mid-August, according to Santo. Revenues have climbed significantly, up 15.7 percent for the first quarter of this year compared with the same period last year. The climb in revenue came from increased sales of shares (up 12.8 percent), a 20.2-percent increase in maintenance and management fees and 49.7-percent-higher revenue from sales of Edge card and Axis Club memberships. Maintenance costs have dropped because of cost-cutting measures such as doing more heavy maintenance in-house at Avantair’s three FBOs, at the Clearwater, Fla., headquarters; in Camarillo, Calif.; and Caldwell, N.J. Night shifts at those facilities allow maintenance to be done more efficiently, when the fleet generally doesn’t fly. Avantair also is leaving JSSI’s maintenance cost-per-hour program and switching to Dallas Airmotive for engine maintenance. “For us, [JSSI] did a terrific job,” said Santo, “and they are awesome to work with, but we got to a size in terms of the fleet where it’s better for us not to pay a middleman.”

Through 2013, Avantair is committed to buying another 55 aircraft from Piaggio and should receive five or six new Avantis by the end of this year.

CitationShares

Woody Harford, senior v-p and chief revenue officer for CitationShares, believes his company has transitioned into something more than a fractional share provider and operator. “Our business model has evolved to the point where we’re not just in the fractional business,” he said. “Our business is providing private transport, whether through owning a whole airplane, a jet share, jet card or through our corporate solutions supplemental lift product.” Customers have access to a fleet “of around 80 jets,” he said, “so we don’t look at ourselves as a fractional company.” [Note: Fractional market researcher Pierre Parvaud’s end-of-June figures show CitationShares with 73 aircraft, 16 of which are core company-owned and 57 owned by shareowners (*see Graphs 4 and 4a on page 26*).]

“We’re pretty well balanced between fractional owners and whole aircraft owners, and we manage a fair number of full aircraft owners,” Harford said. Having the whole aircraft available to fly charters to fulfill Vector jet card flights or provide supplemental lift to shareowners when their share aircraft isn’t available is a distinct advantage, he said. “Because we’re managing our own customers’ aircraft, it alleviates pressure to find lift outside the fleet. Our customers don’t feel like they’re being chartered because the flights are flown by CitationShares pilots in CitationShares aircraft. It’s a win-win.”

To further the marketplace’s perception of CitationShares as serving the “private aviation” market, the company announced on August 6 that it hired former General Motors executive director of worldwide travel services Ken Emerick as a consultant to help it reach out to corporate flight departments. Emerick will be responsible for “developing relationships with flight department leaders around the country and sharing with them the full range of programs that CitationShares has to service their need to become even more efficient and effective,” according to CitationShares. “We found there’s been a high level of interest with a fair number of large corporate aviation departments,” Harford said.

June and July have turned positive for sales, according to Harford, and at the same time CitationShares has continued trimming staff to match the level of customer flying. In June CitationShares

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Given the slowdown in fractional share sales and customer flying at NetJets and the other major fractional operators such as CitationShares, Flexjet and Flight Options, it's unlikely that the aviation industry will see orders to the tune of NetJets' $1 billion order for 96 new Cessnas announced at the 2007 Paris Air Show. Indeed, OEMs have acknowledged large reductions in backlogs, and fractional operators are deferring new purchases as they struggle to size their infrastructures to match customer demand more efficiently and cost effectively.

Flying on the Mend

The news isn't all bad, and some recent statistics support the prevailing view that the aviation industry is bumping along the bottom and poised for a rebound. According to flight-tracking service FlightAware, fractional flying activity climbed 11.1 percent in July versus June 2009, although compared to the previous July, the fractional segment's activity was down by 17.1 percent. ARG/US's TraqPak evaluation of business aircraft activity reflects a similar drop in fractional activity during July 2009 versus July 2008, with a 17.6-percent decline. ARG/US further breaks that down into aircraft categories, showing that small-cabin jet activity dropped the most, while turboprop activity grew 21.5 percent *(see*

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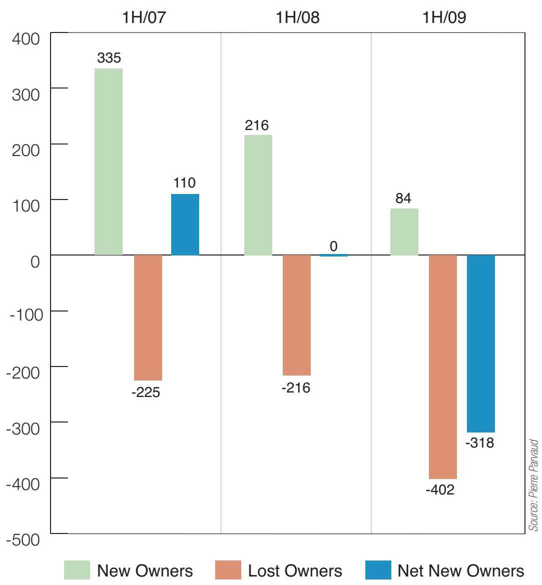
Provider Flexjet has seen a drop in traditional fractional business, offset by an increase in jet card sales and leases.

Graph 2: First Half 2009 Shareholders

Graph 2a: Number of Fractional Owners–Totals 1H/07–1H/09



Fractional Players

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laid off 41 office staff and furloughed 52 pilots, about 16 percent of the company's employees.

According to Harford, most shareowners that needed to sell their shares to raise some capital have done so by now. "We've seen significant stabilization of people exiting," he said, "and we're under budget for those giving notice and wanting to leave." Some continue to fly by purchasing Vector jet cards.

To help make the process of owning a share easier, from late March until June 30 CitationShares offered buyers of used shares a 100-percent residual value guarantee plus special pricing on used shares. The program required that owners exercise the guarantee from the 13th month through the 36th month of the contract. "The guaranteed program gave people confidence that we stood behind the value [of CitationShares share ownership]," said Harford. "We had a huge take-up."

Harford did not provide specific figures for deferred orders of new jets, but noted that being part of Cessna helps the company adjust its new aircraft needs as the economy fluctuates. "As our demand expands, working with our parent company, we can find our way to get aircraft [as necessary]," he said. "It's in our collective best interest. We're flexible. Part of our mission is to make sure we can take care of customers and bring them into the Cessna family. We're feeling bullish about the future; as long as we're willing to modify the business

Fractional owners benefit from a consistency their charter counterparts do not. When they get to the airport, they can expect to find their specific airplane and a familiar crew.

model to meet the needs of our customers there's no reason we can't be successful."

Although CitationShares acknowledged that it planned a big announcement sometime in the third or fourth quarter, no information was available by the time this issue went to press. The company declined to comment on reports that **AIN** received from industry experts that it plans to change its name to CitationAir and focus on a variety of business aviation transportation options and not on fractional shares. CitationShares has registered the trademark CitationAir with the U.S. Patent and Trademark Office. In the application, dated March 12, 2009, the description of goods and services is as follows: "Aircraft ownership and management services, namely arranging and coordinating the purchase and sale of aircraft by multiple owners for sole or joint ownership of the aircraft; offering fractional ownership programs to others; enabling travelers to pre-purchase and use blocks of airplane hours; and managing aircraft ownership for others."

Executive AirShare

This small regional fractional-share operator continues to grow steadily and cautiously, with most of the new growth occurring in the company's new fleet of Embraer Phenom 100 very light jets. As of mid-August, Executive AirShare had taken delivery of four Phenom 100s this year, and another five were expected to be delivered by year-end, as well as at least one Phenom 300. Executive AirShare's 19-airplane fleet consists of four Phenom 100s, five Beechjets, five King Air 350s and five King Air C90s. The company is headquartered in Kansas City, Mo., and has bases in Kansas and Texas, with plans to open a new location in South Texas with one of the new Phenom 100s.

"I'm pleased we're a lean company and have stuck to our guns with a regional concept," said Keith Plumb, president and COO. The first Phenom 100 is being used as a demonstrator and the other three are already fully sold in fractions. Some Beechjet shareowners are trading in shares for the Phenom 100, which the company did not expect, as the Phenom 300s are expected to replace the Beechjets eventually. Although Executive AirShare's first Phenom 300 (for a managed customer) will be delivered this year shortly after Embraer receives certification, fractional operations in the 300 won't begin until early 2011. "We'll probably sell one of our Beechjets this year," he said, "then two next year."

During the first quarter of this year, business was quite slow, according to Plumb, but in June, flight revenues jumped by $70,000 compared with June 2008, primarily due to the addition of the Phenom 100 to the fleet.

Executive AirShare is also seeing a number of buyers who have left larger national fractional programs in favor of meeting their travel needs with a strategically placed regional fleet. "We've definitely found our niche," said Plumb, "a regional fractional with lower costs, basing where customers are located."

Still, Executive AirShare isn't immune to the recession and has lost a handful of customers this year to financial distress. However, none of the buyers of Phenom 100 shares has cancelled.

Besides being a regional operator with a small fleet, Executive AirShare also owns a separate charter certificate holder, Executive Flight Services in Fort Worth, Texas, which flies a Falcon 50EX and Gulfstream G150. For shareowners who need a larger jet occasionally, being able to move into the Falcon or Gulfstream, Plumb said, "is a good fit for everybody. They know the aircraft is maintained by us, crewed by us and managed by the same company that manages their share."

Executive AirShare has no charter card program. "We believe cards dilute the level of service

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Graph 1 on page 20). It is interesting to note that according to ARG/US, fractional aircraft activity decreased the most in that time period, compared with Part 91 and 135 operations.

According to J.P. Morgan's monthly business jet activity analysis, business aircraft flight operations grew during July, to 304,000, the first time that number was higher than 300,000 since November 2008. "Monthly flight ops are now up 16 percent off the February bottom," the report noted, "and have increased sequentially for three consecutive months." Flight operations, however, are still depressed below the historical level of 360,000 per month and for July are down 15 percent on a year-to-year basis.

Most fractional operators are either not large enough parts of their publicly traded parent companies to warrant release of detailed statistics or are privately held and do not share such information. Publicly traded Avantair does release relatively detailed information on its operation, at least compared with NetJets, Bombardier-owned Flexjet and Cessna-majority owned CitationShares. Flight Options, Executive AirShare and PlaneSense are privately held. None of the major fractional operators divulges detailed fleet information publicly.

France-based researcher Parvaud analyzes the activity on the public FAA Registry to determine what is happening to the fleets of the major U.S.-based fractional operators. According to Parvaud, 2009 is shaping up to be a bad year for most of the fractionals.

During the first half of last year, according to Parvaud's statistics, the five national U.S. fractional operators–Avantair, CitationShares, Flexjet, Flight Options and NetJets–broke even in number of shareowners added and lost. Thus,

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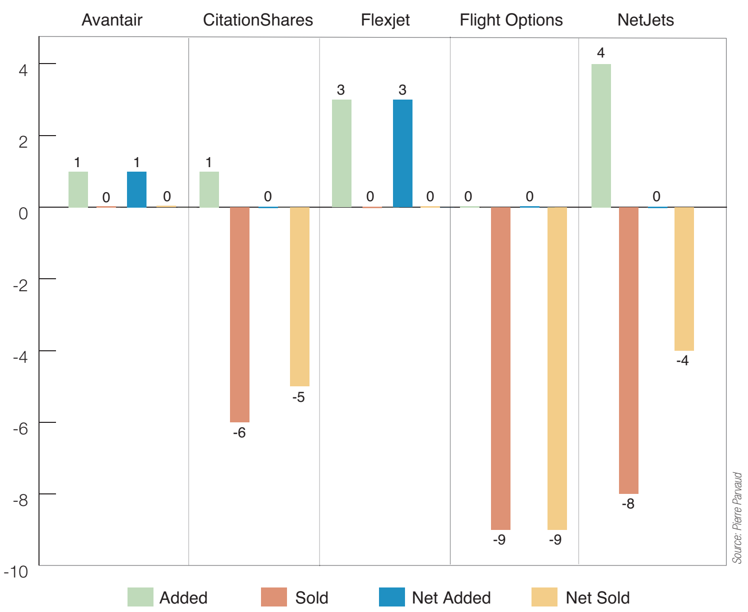
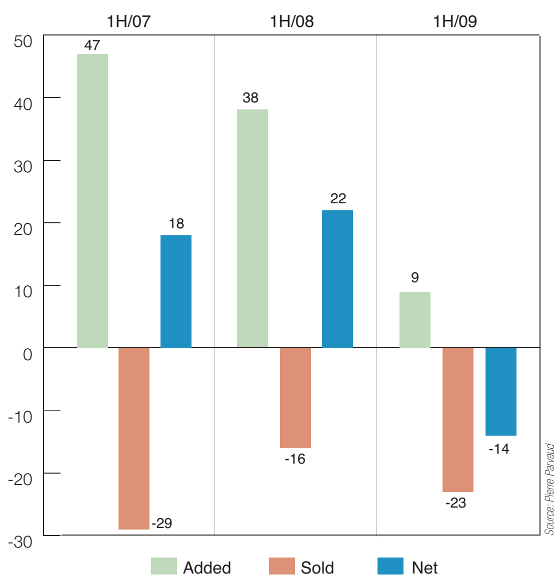
Graph 3: Fractional Aircraft Acquisitions and Sales 1H/09



Graph 3a: Fractional Aircraft Fleet Status 1H/07–1H/09



Fractional Players

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provided to shareowners," he said. "Cards are used to try to maintain revenue streams, to the detriment of selling a share."

Earlier this year, Executive AirShare eliminated peak days for shareowners, who pay for a certain number of days per year rather than by the flying hour. "A national model will not permit [customers] to do that," said Plumb. "It's theirs for a day and gives them ultimate schedule flexibility."

For the first six months of this year versus the same period last year, Executive AirShare's total revenues were down by $100,000. "We're pleased with that," said Plumb. "In this economy we see that as a success. We're doing all right; we're disciplined in our strategy and hopefully poised for bigger and better things in the second half."

Flexjet

Like CitationShares and other fractional providers, Bombardier's Flexjet also focuses on more than just fractional shares, according to Fred Reid, president of Flexjet and Skyjet. "It's important to step back and understand we at Flexjet are in a number of businesses," he said. These include fractional shares, aircraft leases, jet cards and retail charter via sister company Skyjet. Flexjet One is a whole-aircraft ownership program under which Flexjet contractually purchases a set number of charter hours from the owner so that owner enjoys a predictable annual income.


Fred Reid, president of Flexjet and Skyjet

This year, sales of traditional fractional shares have been soft, according to Reid, but that drop has been counterbalanced by "an unexpected surge in jet card sales" and growing numbers of leases. This is driven by buyers' quest for more flexibility in the way they own and use aircraft assets during the financial turmoil.

"I do not subscribe to the notion that fractional is dead," Reid said. Looking at Flexjet and not including whole-aircraft owners, fractional shares still make up 85 percent of Flexjet's business, he said.


Flexjet had more than 100 airplanes in its fleet at the end of June, compared with 96 at the same time last year.

Flexjet's walk-away lease program has grown in popularity, according to Reid, and accounts for an increasing number of fractional-share sales. Under the walk-away program, buyers can leave a lease with no consequences after 90 days. The upfront commitment is much lower because the buyer is leasing the aircraft or the fractional share, although per-hour costs tend to be slightly higher than a traditional fractional share, he explained.

Business aviation is suffering now from a significant amount of under-flying by customers, Reid said, "whether they own aircraft or fractional shares or in some cases even with jet cards." Although the amount of flying by customers "has recovered somewhat," he added, "and is trending upward, we are seeing the under-flying is still there."

For Flexjet, this trend is helping the company sell fractional shares to business aircraft operators that might be avoiding adding another aircraft to their fleet. "We're seeing some flow of corporate business into our coffers," said Reid, with companies buying fractional shares for needed additional flight hours. And Flexjet is also seeing owners selling their shares and moving into jet cards. At the same time, several dozen new customers become new business aviation adopters by chartering from Skyjet, then learning about fractional shares and buying from Flexjet.

According to research by Paris-based fractional analyst Pierre Parvaud, Flexjet's fleet grew to 103 aircraft by the end of June this year compared with 96 at the end of the same period last year although more of those (20) are core aircraft (*see Graphs 4 and 4a on page 26*). In December last year and January this year, Flexjet experienced higher than normal exits from its fractional program, according to Reid.

"We took quick action in terms of attractive extension programs, and the consequence was rapid and strong stabilization of our customer base." Basically, Flexjet offered some customers the opportunity to keep their shares at the same cost so they wouldn't have to consider selling their share at what have become lower fair market values or buy a new share at a higher cost. Flexjet also offers a 15-percent discount on qualifying round-trips where owners return on the same or the next day. "That program was developed as a response to owner feedback for more affordable short-term travel," he said.

Flexjet has also laid off personnel in response to the recession, both flight crew and staff at the company's headquarters in Richardson, Texas. The company has also deferred some new aircraft orders and "disposed of used aircraft," Reid said. "Exits have somewhat exceeded entries so we're not [expanding] the fleet now."

Flight Options

Last year, the financial meltdown that swept the world "took us all by surprise," said Flight Options vice president of sales and marketing Jay Heublein. "By November we began to realize that we had no idea how long it was going to last. Based on what we saw, it didn't look good, and it got a lot worse."

Flight Options developed an action plan last November and quickly started scaling operations to match the business that was taking place. This included laying off pilots, maintenance personnel and administrative support staff. "Those decisions were difficult," he said, "and they involve changing peoples' lives." Ultimately, the goal is to

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while sales efforts delivered 216 new shareowners during that period, the same number left the programs.

In the second half of last year, the effects of the recession hit home, and while the five fractional operators managed to sell shares to 168 new owners, 360 owners were lost, for a net negative of 192 shareowners for the second half and the entire year. In the first half of 2009 (the latest date for which information was available), the trend accelerated, with 402 owners lost versus 84 added, for a net loss of 318 shareowners *(see Graphs 2 and 2a on page 22)*.

CitationShares operates a fleet of nearly 80 aircraft. In an effort to keep up with market demand, it is becoming an ownership and management provider.

Most of the fractional operators added aircraft during the first half of 2009 but, except for Avantair and Flexjet, disposed of more than they added *(see Graphs 3 and 3a on page24)*. The total of negative 14 aircraft added during the first half contrasts markedly with the 18 and 22 net aircraft added to the five operators' fleets during the same periods in 2007 and 2008, respectively.

Overall, however, the major fractionals' total fleet numbers have remained relatively stable, when comparing the end of June 2008 to the

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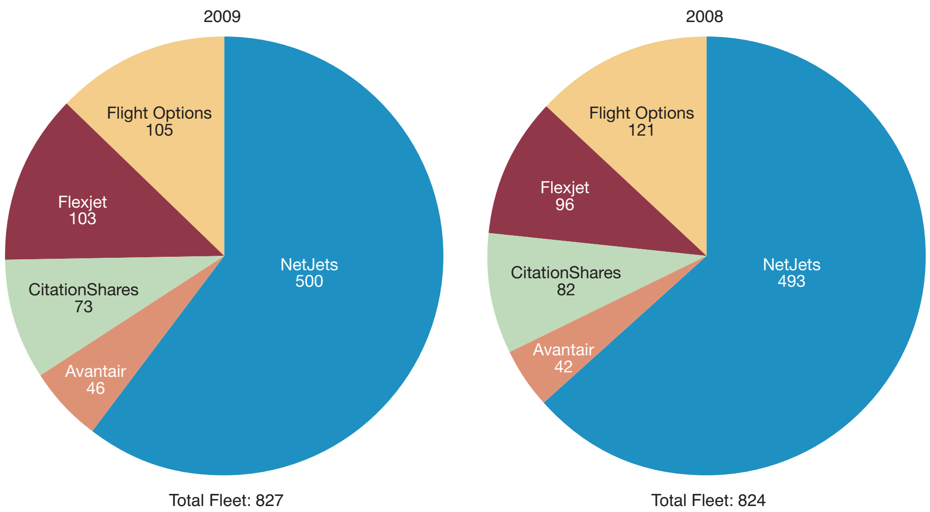
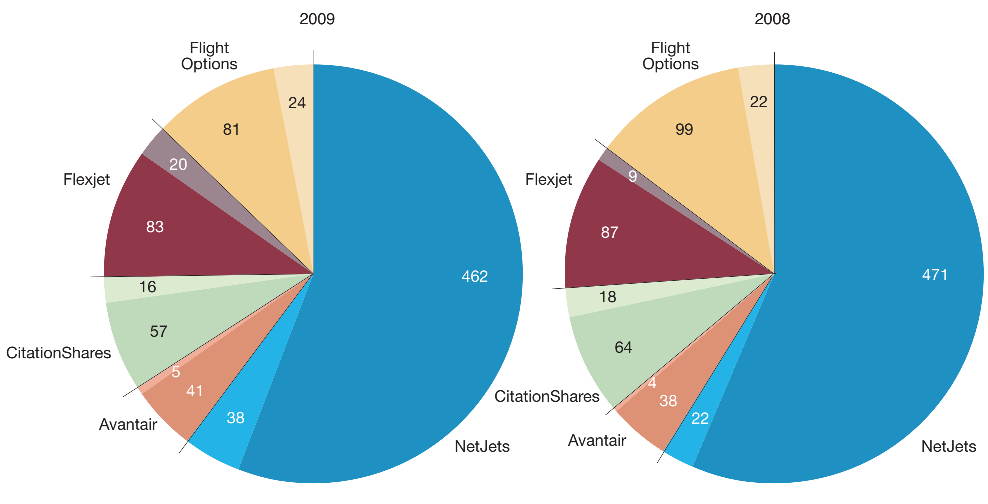
Graph 4: Fractional Fleet Numbers



* As of June 30
Source: Pierre Parvaud

**Graph 4a: Frax Fleet Composition–
Aircraft Bought by Shareowners vs Core Fleet**



Dark: Customer Fleet
Light: Core Aircraft
Source: Pierre Parvaud

Fractional Players

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bring all those employees back to Flight Options. But to do that, "We have to protect the organism in that process," he said.

Flying is also down at Flight Options and there are more airplanes available, according to CEO Michael Silvestro. But Flight Options has also seen an uptrend in buyers who don't want to own an airplane outright or who plan to fly less and see a fractional share as meeting their needs. Aiding the fractional cause is the issue of visibility. "We have to be sensitive to the fact that it's been politically incorrect to own an airplane," he said. "The industry's had a black eye, and there are a lot of people who just don't want to own an airplane today. We've seen a little bump because of that."

The Flight Options fleet has shrunk, according to Parvaud's research (*see Graphs 4 and 4a, this page*). For the first six months of this year, the fleet dropped to a total of 105 airplanes, down 16 from the same period last year. The core Flight Options fleet grew by two aircraft to 24 total, up two from last year, so most of the attrition resulted in aircraft leaving the fleet.

"There are more airplanes for sale today as a percentage of the in-service fleet than ever before," said Silvestro. "The market has certainly seen a decline in values–precipitously–in the last nine months."

Another way of looking at fractional ownership, according to Heublein, is that in terms of owning a capital asset such as an airplane during a recession, having a one-sixteenth-share exposure financially is much easier to handle than owning an entire airplane. "If you're a buyer, the opportunities are unprecedented," he said. "This will spur new growth into our world."

Flight Options, which started as a lower-cost provider offering shares of used airplanes, will later this year take delivery of its first Embraer Phenom 300, likely either the first or one of the first Phenom 300s to enter service. The jet will begin flying fractional shareowners right away, according to Heublein. "It is a game-changing airplane. We're excited to get that first airplane, and it's going to drive excitement." Flight Options has ordered 100 Phenom 300s and has options on 50 more.

Flight Options has no specific plans to phase out airplanes in its fleet as the Phenom 300 comes online. "We'll let the marketplace dictate what our product mix looks like, and the quantity," Heublein said.

The company recently introduced the Jet Pass Select 25-hour jet card tied to a specific aircraft type. "It's a great value compared with some of the other options," said Heublein. Instead of buying a jet card to provide access to the entire model lineup from Hawker Beechcraft 400XPs to the Embraer Legacy 600, Jet Pass Select is restricted to one aircraft type, so the per-hour cost is lower because customers can't choose to fly other aircraft types. "It's as much as 30 percent less than what a competitor would offer for the same service," he said.

PlaneSense

Like Avantair, PlaneSense, the regional Pilatus PC-12 fractional-share operator based in Portsmouth, N.H., benefits from customers' desire not to own expensive capital assets. A share of a single-engine PC-12 is much less costly than one for a jet or twin-engine turboprop.

"PlaneSense is in a sweet spot," said George Antoniadis, president and CEO of Alpha Flying, which manages the PlaneSense fractional program. "Clearly buyers and users are trying to streamline or optimize their expenses and their asset commitments. In that environment, we believe our program, being most cost effective, is going to benefit." Like Avantair and Executive AirShare, PlaneSense has gained customers who have left the more expensive jet fractional programs.

For PlaneSense, keeping costs low isn't just about having the lowest-cost airplane or implementing cost-cutting procedures only during a recession. "It's not something you do occasionally," Antoniadis explained. "We always need to be looking to optimize our costs and our operation. Like everybody in this downturn, we have had to roll up our sleeves a little bit more, but it's always high on our minds. That's why we think we can deliver a cost-effective program with a high service level."

PlaneSense's business is holding steady, according to Antoniadis. "We've had some customers request to exit, but remarketed shares have all been placed with new customers. We've seen a healthy intake of new customers, particularly since April, both in remarketed shares and new shares." The PlaneSense fleet has shrunk slightly since last year, down to 32 PC-12s, which includes five core aircraft. Flight hours had dropped but are picking back up, and Antoniadis expected August numbers to be nearly the same as flight hours flown during the same month last year.

While cost is always an issue when operating any kind of aircraft, Antoniadis doesn't believe that fractional share owners and potential customers are shying away or not flying just because of the expense. "The driver is still the severe recession," he said. People who can afford to fly are choosing not to, and it did not help that some politicians jumped on the populist bandwagon suggesting that private flying is somehow not appropriate. "There was a witch hunt for a while," he said.

PlaneSense doesn't guarantee to repurchase shares from owners but, said Antoniadis, "we will always facilitate people who want to exit. We want people to be happy." So far this year about 3 percent of shareowners asked for help in remarketing their shares, he said, "and we've managed to place all of them. We want to be able to show that there is a secondary market that is viable and workable, and we've proved it."

PlaneSense is not immune to the recession and last year reduced its workforce by about 10 percent, which included 7 percent related to normal attrition. PlaneSense has also deferred some PC-12 orders, although the company planned to take delivery of three new PC-12s by year-end. PlaneSense retires aircraft after about five years of flying, and the average age of its PC-12 fleet is about three years.

Earlier this year, PlaneSense expanded its territory to include parts of Texas and Oklahoma as well as new destinations in the Bahamas. *–M.T.*

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end of June 2009 *(see Graphs 4 and 4a on page 26)*.

While the numbers for the first half of this year are dismal, the fractional share industry remains a key component of general aviation, accounting for a significant portion of the overall fleet, thousands of jobs and hours flown on behalf of customers and an important entry point for new consumers of business aviation travel. For the fractional operators, their business model is not so much broken as more in need of adjustment to reflect the reality of the current economic downturn, according to industry observers. No one on the outside knows if the massive losses at NetJets have soured Berkshire Hathaway chairman Warren Buffett on his company's investment in the fractional share industry, but the fact remains that every operator has many remaining shareowners who need service and operators continue to add innovative features and programs to attract new buyers.

Regional provider Executive AirShare operates a fleet of 19 airplanes, including four Phenom 100s, from bases in Kansas and Texas.

The Weakest Link

Consultant Brian Foley Associates has commented, "The fractional business is a marginally workable business model when times are good. Look how long it took NetJets to become profitable. The fractional model doesn't work so well in a downturn."

Brian Foley, market analyst

He sees the model as the weak link in the industry order chain. In fact, he issued a press release on September 19 last year warning that business jet "deliveries will fall precipitously from peak and could take many years to return to [pre-correction] levels. The OEMs have grown fat, dumb and happy with their current order backlogs and are oblivious to how quickly things will change."

Part of the problem, Foley explained, is that the many start-up air-taxi and fractional companies were weak links in the order chain. Indeed, the August news that European fractional start-up Jet Republic had run out of funding and cancelled its order for 110 Learjet 60XRs underscores Foley's observations.

The fractional business model suffers from overexposure, too many players in what is a small marketplace, according to Foley. "I think the demand for fractional shares might have been overestimated," he said. "It may even be analogous to VLJs, where early providers talked up the market to the point where others decided to get in on it, but core demand wasn't there."

In North America, Foley said, "We've largely met that demand." Even though the fractional industry points out that many companies and wealthy individuals could afford to own a fractional share, he added, "I fall back on the data. Fractionals ramped up quickly in the late 1990s then started smoothing out. Lately the fleet hasn't increased at all. That tells me a lot of the current demand has been satisfied."

Foley believes that the fractional providers need to learn how to operate efficiently in a mature, not a growing, industry. When the industry was growing, providers sold aircraft at list price and used the difference between the discounted amount they paid for the aircraft and the list price to subsidize operations. If fractional providers are going to survive, they need to improve their efficiency and charge enough to shareowners so that when a downturn occurs they still make money, or at least lose less, he said.

Foley predicts "there's a big shakeup coming," with one of the big three making a major announcement. "Fractionals will survive, but there will be fewer players, which is better for those remaining." There will always be a need for some owners to keep their use of business aircraft "under the radar," he said, "and fractionals are a great way to do that, but eventually they have to find a way to remain profitable while in the mature stage." ❏