

HOLDING
ON TO
REVENUE

R.
C.A.
C.C.
+ C.M.

P.

PREPARED BY:

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Preface

We are at a point where business ability has to supplement operating agility as the critical skill behind successful commercial helicopter operations. The Helicopter Association International (HAI) is helping members to make this transition and to maintain viability in this tough economic period. A number of HAI committee and staff activities have provided some degree of assistance, including: lobbying to slow down restrictive regulations, encouraging reductions in direct operating costs, encouraging improved products, advocating a realistic oversight of the private/public controversy, and supporting new laws on fuel taxes as they relate to helicopter operators.

As a part of this continuing thrust, the HAI Economics Committee developed this booklet to help operators with the basic business skills which are essential today. The formula, below, is a key to remembering the basic business skills.

R. - Revenue
C.A. - Cost Awareness
C.C. - Cost Controls
+ C.M. - Cost Management
P. - Profit

Profits, individually and correctly calculated for each operator, are the only path to stability and viability. Achieving cash flow at any cost is the path to financial suicide.

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INTRODUCTION

This booklet is intended to be an outline for use by operators in determining the financial viability of a specific operation. The outline is based on the equation " $R + CA + CC + CM = P$ ". The components of the equation, identified below, appear in many business plans.

R. Revenues are funds generated through marketing or sales effort. Activities under this heading include: proper contract preparation, job costing, and selling within the companies' operating capabilities. A salesman without proper knowledge and control is equal to an unguided missile.

C.A. Cost Awareness must include knowledge of the many costs of business such as: overhead, insurance, payroll, direct operating costs, occupancy costs, marketing costs, interest, legal costs, depreciation, and inventory.

C.C. Cost Control involves being aware of all costs and making the effort to reduce them wherever possible without sacrificing safety, capability and reliability.

C.M. Cash Management is management of the revenues received and dollars paid out. It also involves investing excess cash to create more profit.

P. Profit is the difference between income received and expenses paid. Generally, the concept of retaining profits is applied to the following normal business functions.

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MANAGEMENT

The process starts here, because business activities do not function properly without proper management. Management has the responsibility to make those decisions that affect the entire business, and thus, ultimately the "bottom line", i.e. profit. Small companies may have "working managers", a person who works on the line in addition to performing management functions. In those situations, cost related only to the latter function would be a management cost. Management costs usually fall into the category of overhead.

Overhead - Expert management and guidance are the keys to controlling the cost of overhead, with top management diligently monitoring each situation on a constant basis.

Overhead consists of the cost of supporting the following items.

- (A) Management
- (B) Administrative Personnel
- (C) Buildings
- (D) Utilities
- (E) Supplies and Furniture
- (F) Communications
- (G) Legal and Auditing Services
- (H) Marketing or Sales Costs
- (I) Contingencies

Regardless of whether the company intends to expand and grow, or to remain at a certain size, all aspects of overhead must be considered when developing a business plan. As business grows, normally overhead grows. Therefore revenues have to grow to support the additional overhead and business plans need to provide such growth.

With the exception of those attributed to ownership or top management, costs related to every item listed above are controllable. Consider, for example, costs related to buildings or premises. The decision to lease short term, long term, or

to buy, can only be made knowing the full aspects of the work opportunity, and some aspects of this may be changing. For instance, in the past, certain long term customer groups demanded the permanent establishment of a base prior to placing an operator on the qualified bid list. When the economy turned down, customers relaxed those standards to bring in more bidders. Hence, today an operator can reduce overhead if he or she does not have to provide a permanent base on the premises.

Insurance costs can be included under several categories; however, the acquisition of insurance is the responsibility of top management. Over recent years a number of changes have taken place in liability insurance that affect insurance coverage drastically. Liability coverage costs have taken quantum jumps over the last three or four years, particularly in purchasing special coverage such as excess liability and chemical liability.

Excess liability is additional liability coverage which is added to an underlying liability policy to meet customers' required limits. Normally customers will reassess their needs when the cost burden of excess liability is placed in front of them. When needed, excess liability can be purchased on a case by case basis, and it is not necessary to cover the entire fleet.

Chemical liability is virtually unavailable, and is definitely not available to the levels once required by the customer groups involved. Liability for the use of chemicals should be put on the customers' shoulders, especially where, to create competition, in a single season, customers have lowered requirements from two million in coverage to three hundred thousand. Because the customer normally recommends and purchases the chemicals to be applied, contracts for chemical work should place liability directly on the customer.

Insurance deductibles have changed considerably over the years. At one time, they were a percentage of the loss, whether it was a partial or total loss. Now the deductible in all policies reflects a percentage of the insured value, for any size loss. Suppose you operate a fleet of five helicopters and insure each one for

\$500,000 and your hull rate is 10%. Theoretically, your insurance cost would be \$250,000. If your deductible is 10% of the insured value, you are self-insured for \$50,000 per helicopter and up to \$250,000 for your fleet of five helicopters. Now suppose you had four incidents during the year, each one costing \$75,000 to repair. The insurance company paid \$25,000 and you paid \$50,000 for each repair. Therefore, your insurance premium @ \$250,000 plus your self insurance @ \$200,000 creates a total insurance cost of \$450,000. Your actual insurance rate is eighteen percent. For what? The insurance company paid out only \$100,000. Wouldn't you have been better off totally self-insured? We realize this is a simple example, but it does happen, and it does point out how carefully you must analyze insurance costs prior to developing your business plans.

Lay-up insurance, particularly for seasonal operators, has also escalated for no apparent reason. Why should a fixed base aircraft sales group have rates of, for example, one-half to one percent for the aircraft on their sales lots, when some operators are paying, two percent for aircraft placed in hangars during their idle season? An insurance broker should be required to justify such an illogical discrepancy.

Strong safety programs are the solution to some of the insurance problems. Management should be aware of this and place in motion programs that work. Management should then emphasize these programs during negotiations at the time insurance coverage is being renewed. In most cases it will help cut costs.

In summary, overhead costs can be controlled through complete analysis of each segment that affects it. The essence is simply that top management has the ultimate responsibility for the overall business plan.

FINANCES

Every operator, no matter the size, should have expert financial "money management", to maximize income from revenues and investments, while carefully controlling money flowing out.

Financing, to supply the funds to purchase equipment or capital improvements, is a function involving the expenditure of money. Like other uses of money, this outflow needs to be carefully analyzed and controlled.

The three basic sources of funds for financing are:

1. Personal (or Business) capital,
2. Bank capital, and
3. Venture capital.

Personal capital, any form of material wealth belonging to a person which is available for use in the production of more wealth, or business capital, money or property accumulated in business, are generally the sources most readily available for financing acquisitions or improvements. Usually, this form of self-financing, or internal financing, is unincumbered by stringent interest or pay back terms. Because heavy penalties are not attached, repayment is easily ignored, the true cost of self-financing is not recognized and money flows from the business without the requisite control.

Bank capital is available to qualifying borrowers under structured repayment terms and interest rates. Venture or risk capital, sometimes simpler to obtain than bank capital, can be the most dangerous form of financing because it will normally carry the highest interest rates of any source available. Earnings can be retained through careful financial planning and timely acquisition of funds from the most reasonable source.

Revenue is derived from an actual or understood contract. Sources of revenue include:

1. Short term lease agreements,

2. Long term lease agreements,
3. Dry lease agreements,
4. Contract application agreements,
5. Daily contracts,
6. Ad hoc work, and
7. Maintenance performed for outside parties.

Agreements used will spell out the terms between operator and customer.

Who pays for:

1. Fuel,
2. Housing and per diem,
3. Insurance,
4. Additional crews,
5. Ferry flights or mobilization,
6. Landing fees,
7. Customs, licenses, taxes, and
8. Other extraordinary items?

Does the operator receive pay:

1. Monthly in advance,
2. Bimonthly,
3. Net on receipt of invoice,
4. Net thirty days,
5. Discount for prompt payment, or
6. Cash in advance?

Who is responsible for:

1. Liability claims made by third parties,
2. Force majeure, an unexpected or uncontrollable event,
3. Contract duration,
4. Maintenance downtime,
5. Weather days,

6. Medical facilities, and
7. Other extraordinary items?

All of the contract terms are important because they spell out the way in which the operator obtains revenues. Beyond that, they state when the operator will be paid, and to what extent the operator may be liable for any action while participating on the contract.

One of the most important clauses sets the duration of the contract. If a customer can cancel a two-year contract with ten days notice for any reason, then it is a ten day contract, especially if there are no early cancellation penalties.

The next most important clause is the indemnification clause. The operator should never consent to pay for someone else's negligence. A good clause indemnifies both the operator and the customer for the other's negligence on a mutual basis.

Contract terms, however, do not guarantee that the customer can pay, or if he or she will pay on time. Credit checks should be made on every customer no matter what the relationship may be between company and customer. In running a credit check the operator is not questioning the customer's integrity but simply using proper business judgement.

The operator must make the money flow. No matter how well the contract terms are written, if the operator does not follow through with timely invoicing, the effectiveness of that contract is compromised.

Invoices should be prepared and sent on the day stated by the contract. Any delay means the operator will be without the cash that much longer. Accurate daily reporting of flight time is the foundation for accurate invoicing. Internal communication must supply accurate information to the accounting department. Credibility is lost when a customer questions an invoice because it has been prepared on the basis of misinformation.

It is very important that persons handling invoicing and accounts receivable are in direct communication with those handling customers' accounts payable. The

better the working relationship is between these people the faster cash will flow. In many operations, these functions will be handled by the same person.

Experience teaches us that some payments will be made at the latest possible date. Allowing customers to develop a habit of late payment can lead to a poor relationship if the operator finally cracks down and requires on-time payment. Aging accounts receivable is very important. It should be a common practice to follow up delinquent accounts with documentation. A service or interest charge for late payment should be clearly stated on the invoice and understood by all parties.

When the cash starts to flow the object is to hold onto the money as long as possible. The longer the money remains in the bank under a daily interest drawing agreement the more interest it will earn. Cash creating additional cash during transition indicates good business planning. Because some banks offer better terms than others, accounts should be reviewed periodically to confirm that the money is deposited under the best circumstances. Holding cash as long as possible helps to avoid unexpected cash drains that could otherwise place the operator in a precarious position with suppliers and banks. Money in the bank also enables the operator to take advantage of opportunities that might otherwise have been lost for lack of cash.

When controlling cash flow it is important to respect the terms of obligations. It is unwise to overpay, pay bills prior to their due date or pay incorrect billings, but obligations should be met on a timely basis. Timely payments keep suppliers and bankers content. Suppliers are the life blood of an operation and the bank is the heart. If an evaluation by either of them results in a poor credit risk report, the operation can be severed from the sources that keep it working.

A cash management team, organized with a budget and cash disbursement plan, should control disbursements to prevent a cash crisis from affecting the operation. The ability to manage monies flowing in and out will prevent crisis management, a management style that defeats most companies. Operators who manage effectively will evolve as the new leaders of our industry in the future.

EQUIPMENT AND MATERIEL

For every operator, the largest amount of cash outlay goes to acquiring the machines they operate, and the materiel they use.

Equipment can be readily obtained, especially today. Beyond outright purchase, several lease schemes are available that seem attractive. They may be good business or they may well amount to entrapment. If the equipment lease is firm, without skip payments or early cancellation clauses, the operation may well be left with lease payments long after revenues cease. Ownership is costly when holding idle assets between contracts.

The business plan of the company will reflect the desired company position. Is the goal to be a growth company with equity assets, or is it to be a service company earning what profits may be available without equity asset goals?

If asset building is the goal, then careful selection of equipment must also be the goal. Proven models with proven multiple use must be chosen, so in the event one market turns down, the equipment can be used in another. There are two other advantages of ownership, the ability to hold assets at lesser cost and the opportunity to realize cash from equity when the assets are sold. Also, there may be a marketing advantage. When the operator has neither lease payments nor financing payments, he or she is relieved from certain obligations for cash that might otherwise force the operator to sell services below cost.

An aspect of equipment ownership is depreciation. Depreciation is a cost. It is real, especially in the present economic period. Helicopters no longer appreciate as they did during the early years of helicopter activity. In the early years many operators depended upon the resale of appreciated machines to obtain profits. That position is no longer reality.

The need for proper job costing is now a reality. Instead of depending on profits from asset disposal, each operator must make an operating profit. If the goal is to profit from an expanding or temporary market, without long-term

corporate growth, then leasing is probably the answer.

Some lease options are:

1. Long term, 8 to 10 year, equity leasing with minimal buy out,
2. Long term financial leasing without an equity position,
3. Variable term leases by certain manufacturers to fit the contract term of the operator,
4. Long term financial leasing with the manufacturer taking the recourse if the operator fails, and
5. Short term leases for basically ad hoc type needs.

To avoid being obligated to a non-reversible commitment, it is wise to have someone, preferably legal counsel, review the lease carefully. Whether buying or leasing, the operator must plan and cost for revenues that produce profits, otherwise neither course of action will produce viability.

Materiel purchasing and retention can well be the highest cost center. Materiel inventory used in daily maintenance embodies an usually high cost. Extensive management is required to control cost overruns and inventory buildup.

Inventory holding analysis by the aviation industry has shown that costs per year run between 30 and 40 percent of value on hand. Careful planning enables the operator to buy what is needed when it's needed. Projecting overhauls and major maintenance on a daily basis is essential. Contingencies must be part of the planning as a cost factor. Most components do not run the full factory recommended time between overhauls (TBO).

Due to variables in operations, manufacturers' projected operating costs are usually well under those experienced in the field. To aid operators in estimating operating costs, manufacturers and operators, through Aerospace Industries Association of America (AIA) and HAI, have published a cost analysis booklet, Guide for the Presentation of Helicopter Operating Cost Estimates, which is available upon request from HAI.

The purchasing department of every operation should be schooled to take advantage of the following:

1. Manufacturer discounts,
2. Service company discounts,
3. Service policy adjustments,
4. Special promotional sales,
5. Inventory trade back allowances,
6. Barter trades with brokers and manufacturers, and
7. Warranty.

By employing the above marketing incentives, the operator can affect the outflow of cash.

Probably, warranty is the most important of the items listed above.

Each manufacturer adds a percentage of the purchase price to all sales to cover warranty. The operator paid for the warranty when the equipment was purchased. The operator's goal should be to claim and collect at least 10 percent of all dollars spent for equipment and materiel during the course of each year. Most operators, however small, can easily justify a full-time warranty claim clerk.

PERSONNEL

Quality personnel in the proper place is key to viable operations and knowing the personnel costs of an overall operation is vital to retaining revenue. Analysis of a comfortable situation with "adequate staffing" may likely reveal over staffing.

It is a difficult task for personnel management to know the exact cost associated with each individual. If you ask most middle managers for the cost of a person in their area, they will answer, "Oh, we pay them [so much] per month". What a person is paid is usually only the tip of the iceberg.

Overall knowledge of actual costs and management control of those costs is vital.

Personnel costs include:

1. Salary,
2. Payroll taxes,
3. Social Security benefits,
4. Sickness relief,
5. Government contract (relief periods),
6. Travel expenses,
7. Training expenses,
8. Vacation,
9. Workmen's Comp. insurance,
10. Remote station benefits,
11. New government regulation, and
12. Fringe benefits:
 - (A) Medical insurance
 - (B) Pension plans
 - (C) Life insurance
 - (D) Profit sharing

Generally speaking, most organizations will find, after careful consideration, that salary is less than 50% of their actual man power cost. It is often hard to be honest in the analysis of personnel costs.

Payroll costs can be controlled, but not easily. Use of the following control factors may aid in the task.

Control factors include:

1. A payroll to revenue percentage below 30%,
2. Part time help where applicable,
3. Contract personnel for short term contracts,
4. Outside consultants,
5. Turnover control, and
6. Employee recognition.

MARKETING

As has been previously stated, marketing is the starting point of revenue flow. The world has to know what is offered before it can buy. Sales is a function of marketing.

Each employee in an organization has to understand that he or she is a salesman. They represent the organization wherever they are, and will present an image to the customer base that reflects directly back to the organization. The manager has to implant that message in each employee because an unprepared salesman is like an unguided missile. They must be able to present the company philosophy to the public at all times.

Although, the need for professional sales personnel varies with each operator, all salesmen need to be professional.

Salesmen need certain information, skills and personality traits, such as:

1. Corporate philosophy,
2. Proper cost knowledge,
3. Corporate capabilities,
4. Contractual requirements,
5. Motivation, and
6. Company loyalty.

Salesmen must understand the company objective and the strategy for obtaining it. Secondly, the sales personnel must be self-motivated. A manager can only supply so much external stimulus. The balance has to come from within. Thirdly, and most importantly, sales personnel must work for the company and not the customer.

The revenue line starts with sales personnel. Top management must realize this and provide the stimulus and training to create a professional marketing approach.

THE BOTTOM LINE

If there is to be a bottom line to this article, it is that we must all become business people with a professional approach. The leaders of the future will have to place the emotion and romance of aviation in second place behind professional business planning. We must develop professional disciplines in order to build stability and vitality in our industry .

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