



INSIGHTS

Having called Wichita “home” for more than 10 years, I can say without hesitation that there are few places like it. People are genuinely friendly, modest, can-do practical - and aviation-centric. With proverbial “kerosene in the veins”, generation after generation has succeeded in making a good living while residing in a safe, vibrant community and building some of the safest, most reliable aircraft in the industry. Times change, and Wichita and Wichitans always seem to roll with the inevitable punches that come with being a leader.

The fortunes of Wichitans have been tied to different industries over the years, including cattle, oil, and aviation. From humble beginnings, the local industry grew dramatically during World War II, reaching a delivery peak of a remarkable 29 B-29 Superfortresses per week. When times are good and especially when they are not so good, the talk around town is for the need to diversify the local economy away from aircraft manufacturing. But who isn't drawn by the allure of interesting, well-paid work, where people witness the results of their labors literally flying in front of their eyes? With so few things still “Made in America”, it is reassuring to know that there are still centers of excellence like Wichita where the future is being designed, engineeredand built.



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Change in the Air Capital

For many years, Wichita, KS has been the self-described “Air Capital of The World”, a moniker that befits a city with a high concentration of economic activity directly and indirectly linked to aircraft production. In fact, Wichita has been considered one of the very few aerospace “clusters” in the world, joined by the likes of much larger centers including Seattle, Montreal, Toulouse, and Dallas. Beyond Cessna, Beechcraft and Learjet, Spirit AeroSystems leads a host of supplier companies that includes hundreds of machine shops, tool & die specialists, aerospace engineering research and development organizations, and the sparkling new National Center for Aviation Training (NCAT). Today, companies such as Spirit AeroSystems and Airbus North America Engineering – primarily supplying aerostructures and engineering services for commercial aircraft programs – are accelerating. Those more focused on business and general aviation are wondering when the “good old days” will return.

Like a well-worn re-rerun of *The Wizard of Oz*, the people of Wichita have seen this movie many times before, with employment levels in aircraft production and supplier companies riding a proverbial roller coaster for much of the 85+ years that airplanes have been built in the

community.

With the sharp downturn in sales of the types of business and general aviation aircraft that Wichita currently specializes in – especially light and mid-size business jets, and piston aircraft – employment levels have plummeted from their recent highs in 2007-2008. The question on many people’s minds is: when will the light and mid-size jet segment of the market rebound, and when will Wichita return to its former status, when its OEMs were producing about half of the world’s production of GA and business jet aircraft?



What a Difference 10 Years Makes

In 2003, the business and general aviation industry was in the early stages of recovering from a sharp demand downturn, largely the result of the bursting of the “dot-com bubble” in 2000. Ten years ago, the General Aviation Manufacturers Association (GAMA) reported that new factory business & GA deliveries reached 2,686 units, including 1,896 pistons, 272 turboprops, and 518 business jets. The shares of new delivery units from Wichita and Independence, KS factories were an impressive 35% (piston), 51% (turboprop), and 59% (business jet).

Fast-forward to the 1st half of 2013, and the shares of deliveries attributable to Wichita and Independence have fallen modestly for pistons (down to 31%) but more sharply for turboprops (down to 37%) and especially



for jets (down to 23%). Factors that explain the differences include the demise of Hawker Beechcraft's jet portfolio, the introduction of new competition from Embraer, the sharp reduction in residual values for trade-in, tougher aircraft lending standards, more limited access to asset-based financing, and the introduction of a new class of single-engine turboprop aircraft for agricultural spraying (none of which are built in Kansas). Perhaps most importantly, we note that customers have shown a pronounced preference for larger, longer-range aircraft, whether to replace an existing aircraft or as their initial purchase, and this has shifted their attention up-market. According to JETNET iQ Global Business Aviation Surveys, this preference for larger aircraft will continue for the foreseeable future, with purchase intentions highest for mid-size and larger aircraft over the next 5 years. We remain bullish on the sales prospects for the new larger-cabin models under development at Cessna (Citation Latitude and Longitude) and at Bombardier (Learjet 85, Challenger 350, and anything Global), some of which will generate jobs and activity in and around Wichita. The sooner these aircraft can be certified, the better.....as soon as the FAA returns to work.

Another Cluster

Just a couple of hours drive south of Wichita along Interstate I-35, Oklahoma City, OK, the Federal Aviation Administration's aircraft registration office, the world's largest, is normally a very busy place. As of today, it is closed - an unexpected victim of self-inflicted gunshot wounds in the federal government budget battles paralyzing Washington, D.C., where across-the-aisle compromise for progress' sake has served the country well for 230+

years. Oklahoma City, which experiences more than its fair share of fierce weather, is once again at the epicenter of a storm, this one brought upon it by political leaders who appear unconcerned with the downwind consequences of their actions. This October tornado is another sad, conjured shock in the slow, choppy trajectory of business and general aviation since late 2008.

At the beginning of Q4 2013, the shutdown of the U.S. Government means that, at least for the time being, U.S. aircraft deliveries (encompassing domestic deliveries, exports and imports) cannot occur, aircraft sales cannot be registered, and (incredibly) aircraft accidents cannot even be properly investigated.

This is not what leadership looks like. Uncertainty surrounding the economic and regulatory environment continues to be aviation's Public Enemy No. 1 - the primary factor restraining aircraft owners and operators from purchasing new aircraft, according to on-going research by JETNET iQ. For customers and aviation-oriented communities, and for those involved in designing, building, buying, selling, and supporting general aviation and business aircraft, can it get more unpredictable than this?

It is no wonder that business leaders continue to regard ever-safe cash as a vital part of their investment portfolios. U.S. Federal Reserve Board data suggest that non-bank corporations are holding almost \$1.8 trillion in cash or cash-like assets, with liquid asset ratios (liquid assets as a % of short-term liabilities) hovering around 50%, up from 38% ten years ago.

According to the U.S. Bureau of Economic Analysis, corporate profits have been growing at a faster rate than the overall U.S. economy for many years. Up until 2008, corporate profits have been good leading indicators of business aircraft orders, but this correlation has not held true since then. Over the last 5 years, corporate profits in the U.S. have grown at 9.4% CAGR, almost 4X the growth rate of the overall economy as measured by GDP, while sales and deliveries of aircraft have fluttered. Companies have been effectively cutting costs by reducing capital spending, lowering headcount, delaying purchasing, eliminating overhead, and outsourcing. This has generated productivity that, combined with lower tax rates, has bolstered corporation's bottom lines. But when will corporations decide to purchase aircraft again?



