

Airline Financial Analysis

Student name

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Author note

Introduction

JetBlue Airways Corporation (NASDAQ: JBLU) is an American low-cost airline. The company is headquartered in the Forest Hills neighborhood of the New York City borough of Queens. Its main base is John F. Kennedy International Airport, also in Queens. In 2001, JetBlue began a focus city operation at Long Beach Airport in Long Beach, California, and another at Boston's Logan International Airport, in 2004. It also has focus city operations at Fort Lauderdale – Hollywood International Airport, Orlando International Airport and at Luis Muñoz Marín International Airport in San Juan. The airline mainly serves destinations in the United States, along with flights to the Caribbean, The Bahamas, Bermuda, Colombia, Costa Rica, Dominican Republic, Jamaica, and Mexico. As of November 19, 2010, JetBlue serves 63 destinations in 22 states (including Puerto Rico), and eleven countries in the Caribbean and Latin America (Barger, 2010).

AIRLINE FINANCIAL ANALYSIS

JETBLUE AIRWAYS CORPORATION
CONSOLIDATED BALANCE SHEETS
(In millions, except share data)

	December 31,	
	2010	2009
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 465	\$ 896
Investment securities	495	240
Receivables, less allowance (2010-\$6; 2009-\$6;)	84	81
Inventories, less allowance (2010-\$4; 2009-\$3)	49	40
Restricted cash	3	13
Prepaid expenses	148	147
Other	27	43
Deferred income taxes	89	74
Total current assets	1,360	1,534
PROPERTY AND EQUIPMENT		
Flight equipment	4,320	4,170
Predelivery deposits for flight equipment	178	139
	4,498	4,309
Less accumulated depreciation	679	540
	3,819	3,769
Other property and equipment	491	515
Less accumulated depreciation	178	169
	313	346
Assets constructed for others	558	549
Less accumulated amortization	49	26
	509	523
Total property and equipment	4,641	4,638
OTHER ASSETS		
Investment securities	133	6
Restricted cash	65	64
Other	394	307
Total other assets	592	377
TOTAL ASSETS	\$6,593	\$6,549

AIRLINE FINANCIAL ANALYSIS

JETBLUE AIRWAYS CORPORATION
CONSOLIDATED BALANCE SHEETS
(In millions, except share data)

	December 31,	
	2010	2009
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 104	\$ 93
Air traffic liability	514	443
Accrued salaries, wages and benefits	147	121
Other accrued liabilities	137	116
Current maturities of long-term debt and capital leases	183	384
Total current liabilities	1,085	1,157
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS	2,850	2,920
CONSTRUCTION OBLIGATION	533	529
DEFERRED TAXES AND OTHER LIABILITIES		
Deferred income taxes	327	259
Other	144	138
	471	397
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred stock, \$.01 par value; 25,000,000 shares authorized, none issued	—	—
Common stock, \$.01 par value; 900,000,000 and 500,000,000 shares authorized, 322,272,207 and 318,592,283 shares issued and 294,687,308 and 291,490,758 shares outstanding in 2010 and 2009, respectively	3	3
Treasury stock, at cost; 27,585,367 and 27,102,136 shares in 2010 and 2009, respectively	(4)	(2)
Additional paid-in capital	1,446	1,422
Retained earnings	219	122
Accumulated other comprehensive income (loss), net of taxes	(10)	1
Total stockholders' equity	1,654	1,546
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$6,593	\$6,549

AIRLINE FINANCIAL ANALYSIS

JETBLUE AIRWAYS CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except per share amounts)

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
OPERATING REVENUES			
Passenger	\$3,412	\$2,934	\$3,060
Other	<u>367</u>	<u>358</u>	<u>332</u>
Total operating revenues	3,779	3,292	3,392
OPERATING EXPENSES			
Aircraft fuel and related taxes (\$39, \$34, and \$45 in 2010, 2009, and 2008, respectively)	1,115	945	1,397
Salaries, wages and benefits	891	776	694
Landing fees and other rents	228	213	199
Depreciation and amortization	220	228	205
Aircraft rent	126	126	129
Sales and marketing	179	151	151
Maintenance materials and repairs	172	149	127
Other operating expenses	<u>515</u>	<u>419</u>	<u>377</u>
Total operating expenses	<u>3,446</u>	<u>3,007</u>	<u>3,279</u>
OPERATING INCOME	333	285	113
OTHER INCOME (EXPENSE)			
Interest expense	(180)	(198)	(245)
Capitalized interest	4	7	48
Interest income and other	<u>4</u>	<u>10</u>	<u>(5)</u>
Total other income (expense)	<u>(172)</u>	<u>(181)</u>	<u>(202)</u>
INCOME (LOSS) BEFORE INCOME TAXES	161	104	(89)
Income tax expense (benefit)	<u>64</u>	<u>43</u>	<u>(5)</u>
NET INCOME (LOSS)	<u>\$ 97</u>	<u>\$ 61</u>	<u>\$ (84)</u>
EARNINGS (LOSS) PER COMMON SHARE:			
Basic	<u>\$ 0.36</u>	<u>\$ 0.24</u>	<u>\$ (0.37)</u>
Diluted	<u>\$ 0.31</u>	<u>\$ 0.21</u>	<u>\$ (0.37)</u>

AIRLINE FINANCIAL ANALYSIS

JETBLUE AIRWAYS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)

	Year Ended December 31,		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	\$ 97	\$ 61	\$ (84)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Deferred income taxes	62	42	(6)
Depreciation	194	190	189
Amortization	36	44	21
Stock-based compensation	17	16	16
Gains on sale of flight equipment and extinguishment of debt	—	(3)	(45)
Collateral returned (deposits) for derivative instruments	(13)	132	(149)
Auction rate securities impairment, net	—	—	53
Restricted cash returned by (paid for) business partners	5	65	(70)
Changes in certain operating assets and liabilities:			
Decrease (Increase) in receivables	(4)	3	4
Decrease (Increase) in inventories, prepaid and other	(4)	(43)	(10)
Increase in air traffic liability	70	4	15
Increase (Decrease) in accounts payable and other accrued liabilities	27	(66)	15
Other, net	36	41	34
Net cash provided by (used in) operating activities	<u>523</u>	<u>486</u>	<u>(17)</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Capital expenditures	(249)	(434)	(654)
Predelivery deposits for flight equipment	(50)	(32)	(49)
Refund of predelivery deposits for flight equipment	—	5	—
Proceeds from sale of flight equipment	—	58	299
Assets constructed for others	(14)	(47)	(142)
Purchase of held-to-maturity investments	(866)	(22)	—
Proceeds from maturities of held-to-maturity investments	414	—	—
Purchase of available-for-sale securities	(1,069)	(636)	(69)
Sale of available-for-sale securities	1,052	486	—
Sale of auction rate securities	85	175	397
Return of (deposits for) security deposits	1	(10)	1
Increase in restricted cash and other assets, net	—	—	(30)
Net cash used in investing activities	<u>(696)</u>	<u>(457)</u>	<u>(247)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from:			
Issuance of common stock	9	120	320
Issuance of long-term debt	116	446	716
Aircraft sale and leaseback transactions	—	—	26
Short-term borrowings	—	10	17
Borrowings collateralized by ARS	20	3	163
Construction obligation	15	49	138
Repayment of:			
Long-term debt and capital lease obligations	(333)	(180)	(673)
Short-term borrowings	—	(20)	(52)
Borrowings collateralized by ARS	(76)	(110)	—
Construction obligation	(5)	—	—
Other, net	(4)	(12)	(20)
Net cash provided by (used in) financing activities	<u>(258)</u>	<u>306</u>	<u>635</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(431)	335	371
Cash and cash equivalents at beginning of period	<u>896</u>	<u>561</u>	<u>190</u>
Cash and cash equivalents at end of period	<u>\$ 465</u>	<u>\$ 896</u>	<u>\$ 561</u>

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(a) Calculate some financial ratios for the airlines for the last two years and include:

i. Liquidity ratios

$$\text{Cash Flow Liquidity Ratio (2010)} = \frac{\text{cash Flow from operating activities} + \text{Cash} + \text{Market Securities}}{\text{Total Current liabilities}}$$

$$= \frac{523 + 465 + 696}{1085}$$

$$= 1.55$$

$$\text{Cash Flow Liquidity Ratio (2009)} = \frac{\text{cash Flow from operating activities} + \text{Cash} + \text{Market Securities}}{\text{Total Current liabilities}}$$

$$= \frac{896 + 486 + 457}{1157}$$

$$= 1.59$$

Current ratio

$$\text{Current Ratio (2010)} = \frac{\text{Total Current Assets}}{\text{Total Current Liabilities}}$$

$$= \frac{1360}{1085}$$

$$= 1.3$$

$$\text{Current Ratio (2009)} = \frac{\text{Total Current Assets}}{\text{Total Current Liabilities}}$$

$$= \frac{1534}{1157}$$

$$= 1.3$$

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Quick ratio

$$\begin{aligned} \text{Quick Ratio (2010)} &= \frac{\text{Cash \& Equivalents} + \text{trade Receivables}}{\text{Total current Liabilities}} \\ &= \frac{465 + 84}{1085} \\ &= 0.5 \end{aligned}$$

$$\begin{aligned} \text{Quick Ratio (2009)} &= \frac{\text{Cash \& Equivalents} + \text{trade Receivables}}{\text{Total current Liabilities}} \\ &= \frac{896 + 81}{1157} \\ &= 0.8 \end{aligned}$$

Profit margin

$$\begin{aligned} \text{Profit Margin (2010)} &= \frac{\text{Net Income (or Profit)}}{\text{Total Revenue}} \\ &= \frac{97}{3779} \\ &= 0.025 \end{aligned}$$

$$\begin{aligned} \text{Profit Margin (2009)} &= \frac{\text{Net Income (or Profit)}}{\text{Total Revenue}} \\ &= \frac{61}{3292} \\ &= 0.019 \end{aligned}$$

iii. Receivable collection period

$$\begin{aligned} \text{Receivable collection period (2010)} &= \frac{\text{average accounts receivable}}{\text{annual sales}/365\text{days}} \\ &= \frac{84}{1137/365} \\ &= 27 \end{aligned}$$

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Receivable collection period (2009) = $\frac{\text{average accounts receivable}}{\text{annual sales}/365\text{days}}$

$$= \frac{81}{722/365}$$

$$=41$$

(b) Evaluate the risk profile of the airline, and examine the sources of risk.

Changes in trade and industry

The company has incurred loss through attempts to bargain work contracts, changing flight schedules and sucking employees, as well as considering other efficiency and cost-cutting measures. Since 2005, JetBlue airline industry has experienced significant consolidation and liquidations. The worldwide trade and industry depression and the associated hostile conditions like high redundancy rates, a controlled credit market, inadequate accommodation facilities and rise in the cost of doing business can decrease spending for both leisure and business travel. The hostile environment could also force an airline's ability to raise fares to counteract increased fuel, labor, and other costs (Barger, 2009).

Attacks from terrorist

In case of a terrorist assault, whether or not successful, there is the likelihood of the industry experiencing increased security requirements and significantly reduced demand and harm to the industry.

Competitive risks due to the longer-term nature of the fleet order book.

Through the company uses composites, next-generation engine technologies, and other innovations, it is competitively disadvantaged because it has existing extensive fleet commitments that would prohibit it from adopting new technologies on an expedited basis.

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i. What information and data are most useful in answering this question?

The most useful information in answering this question are; security concerns, competition and economic changes

ii. Calculate debt to total asset ratio

$$\text{Debt to asset Ratio (2010)} = \frac{\text{Total Liabilities}}{\text{Total assets}}$$

$$= \frac{4939}{6593}$$

$$= 0.7$$

$$\text{Debt to asset Ratio (2009)} = \frac{\text{Total Liabilities}}{\text{Total assets}}$$

$$= \frac{5003}{6549}$$

$$= 0.8$$

iii. Calculate debt equity ratio

$$\text{Debt to Equity Ratio (2010)} = \frac{\text{Total Liabilities}}{\text{Total Equity}}$$

$$= \frac{4939}{1654}$$

$$= 3.0$$

$$\text{Debt to Equity Ratio (2009)} = \frac{\text{Total Liabilities}}{\text{Total Equity}}$$

$$= \frac{5003}{1546}$$

$$= 3.2$$

iv. Estimate EBIT

EBIT = Revenue – Operating expenses) + Non-operating income

$$\text{EBIT (2010)} = 3779 - 3446 + 172$$

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$$=505$$

$$\text{EBIT (2009)} = 3292 - 3007 + 181$$

$$=466$$

Therefore the EBIT can be estimated as $\left(\frac{505+466}{2}\right)$

$$=485.5$$

(c) Analyze its capital structure, and decide whether the airline is under or over leveraged.

$$\text{Leverage Ratio (2010)} = \frac{\text{Stockholders Equity}}{\text{Average Total Assets}}$$

$$= \frac{1654}{6593}$$

$$=0.3$$

$$\text{Leverage Ratio (2009)} = \frac{\text{Stockholders Equity}}{\text{Average Total Assets}}$$

$$= \frac{1546}{6549}$$

$$=0.2$$

From company analysis, the leverage ratio rose from 0.2 to 0.3 in 2009 and 2010, respectively. This indicates that the company is financially unhealthy

i. Calculate Altman Z-score.

A	Es tEBIT/Total Assets	x. 3.3	-4 to +8.0
B	Net Sales /Total Assets	x 0.999	-4 to +8.0
C	Market Value of Equity / Total Liabilities	x 0.6	-4 to +8.0
D	Working Capital/Total Assets	x 1.2	-4 to +8.0

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E	Retained Earnings /Total Assets	x1.4	-4 to +8.0
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$$\text{Z-Score (2010)} = \mathbf{A} \times 3.3 + \mathbf{B} \times 0.99 + \mathbf{C} \times 0.6 + \mathbf{D} \times 1.2 + \mathbf{E} \times 1.4$$

$$=0.08 \times 3.3 + 0.15 \times 0.99 + 0.1 \times 0.6 + 0.03 \times 1.2 + 0.03 \times 1.4$$

$$=0.5$$

$$\text{Z-Score (2009)} = \mathbf{A} \times 3.3 + \mathbf{B} \times 0.99 + \mathbf{C} \times 0.6 + \mathbf{D} \times 1.2 + \mathbf{E} \times 1.4$$

$$=0.07 \times 3.3 + 0.09 \times 0.99 + 0.1 \times 0.6 + 0.07 \times 1.2 + 0.02 \times 1.4$$

$$=0.5$$

In general, the lower the score, the higher the odds of bankruptcy. When Z-Score is above 3, the firm is considered to be doing well hence not likely to enter bankruptcy. Blue Jet Company is bound to bankruptcy.

(d) Examine its dividend policy, and decide whether more or less should be paid in dividends.

To maintain its income to fund the expansion of its business, the firm will not pay dividends on its common stock. The Board of Directors will decide on when to compensate cash dividends in compliance with the set laws. This will rely on the outcome of operations, fiscal situation, and other significant factors considered by our Board of Directors.

(e) Firm Value.

Our proposition value elements include:

High-Quality Service and Product: JetBlue customers enjoy a distinctive flying experience onboard, this includes friendly, award-winning, and customer service oriented employees, new

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aircraft, sizeable leather seats with the most legroom in coach and entertainment available for purchase. Our offerings onboard include free and unlimited brand name snacks and beverages and specially-designed products for our overnight flights. We endeavor to communicate openly and honestly with customers about delays and service disruptions. In 2007 we introduced the JetBlue Airways Customer Bill of Rights that protects customers who experience avoidable inconveniences compensation (Berger, 2009).

Operating Cost: Our cost structure allows us to present fares lower than our competitors. Our focus is on maintaining low operating costs relative to the superior product offerings of the JetBlue Experience. On December 31, 2010, our rate per available seat mile, excluding fuel, of 6.71 cents was among the lowest reported by all other major U.S. airlines. The factors contributing to our competitive unit cost are high aircraft utilization, low distribution costs, productive workforce, and new and efficient aircraft.

Brand Strength. We have created a widely renowned brand different from our competitor, which makes us safe, reliable, value-added airline deals with customer service and provides a high-quality travel experience. Likewise, we believe customer awareness of our brand has led to the success of our marketing efforts and made us promote ourselves as a preferred marketing partner with companies across many different industries (JetBlue Airways Corporation (JBLU)).

Empower of our people: we have a vibrant service-oriented company culture for our five fundamental values which are: Safety, Caring, Integrity, Fun, and Passion. We aim at hiring, retaining and developing friendly, helpful, team-oriented and devoted people to give the best JetBlue experience to our customers. This is our success determinant.

(f) Restructure the airline and revalue it.

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We plan to refresh our business model to curb against the shifting demands of the market place and to get new revenue opportunities. We continued to take a measured approach to our capital spending by making sound value-adding investments that we believe will position JetBlue well for the long-term. To that end, we entered the year with strategic goals that outlined vital initiatives in three areas:

- **Keep Our Edge.** Invest in tools that will empower our business, and make the direct relationship we enjoy with all crew members a true competitive advantage.
- **Build a Low Cost Culture.** Maximize asset utilization, invest capital where there is an immediate and sustainable return and run an efficient operation, deliver and refresh the JetBlue Experience.
- **Grow JetBlue's reputation for service.** Continually revive the products and experiences for our customers which will attract new customers and earn their loyalty (Berger, 2009).

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