

HIDDEN RISKS IN AVIATION PART 2: VENDOR AND TRANSACTION CONSIDERATIONS

Jeff Agur | December 2019

In our last newsletter, we visited a number of financial risks which exist within your organization. This article will address financial risk among your key external vendors as well as during aircraft transactions.

Working with Your Vendors – Management Companies

Management companies play an important role in aircraft ownership and operations. There are many flavors and sizes to fit most any owner's preference. At the same time, the maturity of their financial stewardship and reporting varies.

Transparency – The single biggest theme to financial strain between the owner and the management company is transparency. The common gap is understanding the sources of profit for the management company and feeling it is fair. Be sure to understand their business model and sources of profit.

"Pass-Through" is a common term used in expense management. Yet, in this arrangement what motivates the management company to manage the cost to the owner's benefit? Let's take crew salaries as an example. As a pass-through expense, what motivates the management company to keep salaries aligned with the market versus over-inflated?

Reporting - The ability to show how every penny is received and spent along with proper backup is important. Granted, it's not easy and requires resources. Maintenance is one of your largest budget line items. It is also one of the most complicated. Your management company should be able to project your annual maintenance expense within reason and explain their procurement process. And if your management company conducts maintenance, acknowledge that a conflict of interest exists.

Working with Your Vendors – Charter

When buying charter, there are several considerations to ensure you are protected financially.

Broker versus Operator – When soliciting a quote, be sure you know who you are working with. The good news is that, effective 2019, the DOT has put greater protections in place for the public to know if they are working with a broker or an operator. But when working with a broker, know that there is an additional layer in the process. And that layer has a financial influence in the form of a brokerage or referral fee.

There is no standardization to the quoting process. Be sure you get an itemized quote and read the fine print in the charter agreement. Things to look for include:

- Are you being billed block hours or flight hours?
- Is ferry time included to relocate the aircraft?
- Are there fees such as overnight, flight attendant, Wi-Fi?
- Are there minimums such as short-leg or hourly minimums?

Charter aircraft can break. If your charter aircraft experiences a mechanical issue, who is financially responsible for the replacement aircraft?

Aircraft Transactions

When purchasing an asset that costs millions of dollars, the financial risks can be large. There are a number of things to consider.

Aircraft Selection – Unlike charter brokerage, aircraft brokerage is not regulated. Standards are evolving and maturing. But for now, recognize that hundreds of thousands, even millions can be at stake for a broker on a specific aircraft. Your acquisition process should survey the entire market, if only to understand the market conditions.

"Friendly Deals" are a fast way to strain or even end a friendship. While the tone of the transaction can be friendly, each party should be looking out for their own interests. The most important element is no shortcuts!

Pre-Buy Inspections – An example of a shortcut is bypassing the pre-buy inspection. This is like buying a home sight-unseen. So much can go wrong. Even if the aircraft is represented as having a recent pre-buy inspection or major inspection, this is still no reason to skip this important step.

Deal structures also play an important financial consideration. Specifically, is the transaction a "back-to-back" transaction? With this approach, the broker is "flipping" the aircraft via two transactions and making margin on the difference. In this case, what if the middle person cannot perform? Which purchase agreement governs the transaction? What are the sales tax implications?

In each case, establish a robust procurement process to select the best vendor or acquire your next aircraft. Also be sure to create a procurement team of professionals to examine the financial, legal, operational, and regulatory elements. Contact us to learn more and avoid these financial pitfalls!



To learn more, contact VanAllen today.