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NEWS & INSIGHTS

One Jet, 16 Owners, Big Problems

NetJets, Flexjet, and other fractional operators have severe growing pains

When FractionAir Inc. opened for business in 2002, its possibilities seemed endless. The Nashville company, which sold fractional interests in private jets, was backed by a who's who of Tennessee business and politics, including former Democratic U.S. Representative Bob Clement. Over time the venture's impressive customer list boasted former Vice-President Al Gore, ex-Dallas Cowboys star Troy Aikman, and Tennessee Titans coach Jeff Fisher. But by last fall, FractionAir was grounded, with its creditors and jet owners busy filing lawsuits to recoup whatever they could of their investments after the business proved more difficult than anticipated.

FractionAir's experience illustrates the growing pains facing the $6 billion industry. Despite brisk demand--more than 5,000 individuals and businesses now own fractional interests in private jets, up from 730 in 1997--the companies operating these services, including NetJets, Bombadier Flexjet, and Flight Options, have collectively lost hundreds of millions of dollars in recent years. "Given the demand, it makes no sense that the operators are losing money," laments Steven F. O'Neill, CEO of Greenwich (Conn.)-based CitationShares, which operates a fleet of 81 Cessna jets.

Why the losses? Industry experts say the business model has vexing problems. For one thing, providing a ready, waiting jet for a multitude of customers--many jets are now sold in increments as small as 1/16th--is more complicated than it may appear. Experts estimate that more than 25% of an average plane's air time is spent flying empty to pick up the customer. And because many people travel at the same peak times--the day before major holidays, or Monday mornings--operators have too often been forced to turn to the costly charter market just to meet their contractual demands. NetJets Inc., for instance, estimates it spent $200 million chartering extra jets in 2005, though it says it cut its charter outlays to less than $100 million last year.

Analysts add that a good portion of the existing stock of business jets, such as the Hawker 1000 and Cessna Citation Ultra, were built for corporate users who flew them less than 300 hours a year, not for the roughly 1,100 hours that most fractional operators wring out of an average plane. The unfortunate result: chronic maintenance and excessive downtime. "A lot of these light business jets were not designed to be flown like a commercial airplane," says Mike Riegel, a former Flexjet executive who now advises fliers purchasing fractional stakes. And experts say that private jet operators, in their quest to gain market share, were way too aggressive with their own jet acquisitions, which in turn forced them to discount their rates to lure customers. "The fractional players have been just like the commercial airlines--they've been pricing just to fill seats," says Richard L. Aboulafia, vice-president at Teal Group Corp., an aerospace consulting firm based in Fairfax, Va.

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Executives at the fractional operators say they're optimistic. Many claim they've begun phasing out older gas-guzzling planes in favor of newer, more efficient jets like the Falcon 2000 and the Cessna XL. And a number of companies have started to reward the plane owners for traveling off peak, which has reduced reliance on costly charters to meet demand. NetJets CEO Richard T. Santulli says his company cut its use of charters from 8% in 2005 to just 1.75% last year, a move that analysts believe enabled the Berkshire Hathaway Inc. subsidiary to turn a profit in 2006 after losses in three of the four previous years. "Contrary to what everyone says, the model works," says Santulli. "We will continue to be profitable."

Longer-term, many analysts still believe a shakeout is possible. Says UBS (UBS)aerospace analyst David Strauss: "The best thing that could happen to this industry is consolidation--taking out a couple of the lesser players who just hold down prices."

By Dean Foust