GRADUATE SCHOOL OF BUSINESS
STANFORD UNIVERSITY

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FLORIDA AIR, INC.

It was May 15th, 1994. Dan Stilton and Scott Bettor, the President and Chief Financial Officer of Florida Air, had some significant problems. It had been almost two years since Dan, with the help of his wife, Joan, had written the original business plan for Florida Air, a regional, small-plane, charter airline to serve West Palm Beach and surrounding communities. A lot had happened in that time: Dan had taken on two partners, Scott Bettor and Henry Tellsworth; the business concept had changed to a scheduled regional carrier; investors had been found and lost; and a considerable amount of time and money had been spent.

The road over the last two years had been filled with highs and lows, but now things were beginning to look darker than ever. The most immediate problem was that the $100,000 Florida Air had raised to cover expenses while looking for investors had all but run out. Dan and Joan had depleted most of their savings ($120,000), and both Dan and Scott had amassed considerable credit card debt (together over $50,000) that neither could repay. In addition, a major airline had just announced plans to begin service to some of Florida Air's targeted markets. As a result, one very promising $300,000 investor, the city of Lakeland, had withdrawn its preliminary commitment, and some of the company's other likely sources of capital were starting to get cold feet. Making matters worse, Scott and Dan were seriously contemplating asking their third partner, Henry, to leave the business, despite the fact that his departure would leave a noticeable gap in the company's management team.

Dan and Scott had some difficult decisions to make in the coming weeks. Should they continue their attempt to get Florida Air off the ground? If so, should they change their approach for raising capital? Should they ask Henry to leave? How would they fill the gap that losing Henry's airline experience would create?

Florida Air: the beginning

The idea for Florida Air began with Dan's personal commuting problems in 1991. Dan was an entrepreneur who left the University of Florida in 1986 during his senior year to begin a career in real estate. Dan and Joan Stilton lived outside of West Palm Beach, Florida, and Dan had to commute regularly to Tallahassee and Orlando, where most of his customers and properties were located. He often found the commute difficult and time consuming. It required him to drive forty minutes to the Miami airport and then take an inconveniently scheduled flight to his final destination. Since Dan made the journey frequently, he became acquainted with a group of business people who were as frustrated as he was with their current transportation options. One day, as Dan described the situation to his wife, Joan came up with the idea of "Florida Air," a car pool that would use an airplane rather than a mini-van.

The real estate business had hit rock bottom in the South, and to keep up his income, Dan entered the business of buying and selling airplanes. In doing so Dan developed a general understanding of the aviation business and a keen interest in the airline industry. Given this interest, some encouragement from his wife, and the lack of opportunities in the real estate market, Dan decided to take a serious look at putting together a charter airline.

By the summer of 1992, Dan's real estate activities had dwindled further, and he and his wife agreed that Dan should devote full time to putting Florida Air together while Joan continued to pursue her career as a lawyer and support the family. The going was tough at first, but Dan was sure it would only take 6 to 8 months to get things moving. Over the coming year Dan learned a great deal about the airline industry and raising capital. He conducted some of his own informal market analysis and prepared a document describing the business concept. With these in hand Dan approached a group of his former real estate associates and banking connections to raise the $750,000 needed to finance the business. Unfortunately, by September 1993, after over a year of effort, things had not progressed very far. All of Dan's real estate contacts were either without money or uninterested in owning part of a start-up airline, and without revenues or assets banks were not willing to even talk about financing so risky a venture.

Dan, determined to make his idea work, decided it was time to increase the pace and call in some "professionals."

Single unaffiliated airline seeks hard-working manager

Dan knew he needed more horsepower and someone with airline experience to get things started. He decided to place an ad in the newspaper looking for a consultant. The ad ran in late September, 1993, in the regional edition of the Wall Street Journal:

Wanted

Airline industry consultant. Start-up airline in West Palm Beach area is seeking a seasoned airline executive to assist with development of marketing and fund raising plans. Must have general business and airline industry experience. All interested parties should forward a cover letter and resume to:

Florida Air
Personnel Department
1431 Lindbergh Blvd.
Stack River, FL 53125

By the middle of October Dan had received 20 resumes from a range of people including university professors and airline baggage handlers. Unfortunately, only two of the responses looked even remotely promising.

The first was Henry Hamilton Tellsworth III. Henry came from a wealthy New England family and had a stellar resume with extensive industry experience. He appeared to be the answer to many of Florida Air's problems. When he responded to Dan's ad, he had just finished a year-long tenure as a marketing director at Hilton Hotels. He had graduated with honors from an Ivy League school in 1981. He had advanced quickly through the ranks of one of the largest and most prestigious advertising agencies in New York. In fact, he had been so well regarded by one of his clients (TWA) that he was asked to join their marketing department. Henry had worked at TWA for four years after which (in four subsequent jobs) he spent time as a member of the in-house advertising and marketing teams at Continental, Pan Am, Midway Airlines, and USAir.

The second interesting response was from Scott Bettor, who had a strong resume but no experience with airlines. Scott had recently received his MBA from the Stanford Business School and was working on a number of start-up ideas of his own when he came across Dan's ad in the Wall Street Journal. In addition to having spent a number of years as a consultant at an international consulting and accounting firm, he had started and run his own company. In his cover letter, Scott had readily identified his lack of airline experience as a weakness, but expressed his long-time interest in the industry. Dan liked Scott's entrepreneurial and educational background and was impressed with Henry's extensive industry experience. He decided to talk with both candidates and see which one made more sense for Florida Air.

Dan was pleased with both Scott and Henry and before the interviews were over he had agreed to hire them both as consultants at the rate of $35 per hour each for 20 hours per week. Scott and Henry began work on October 17, 1993. The first week of work consisted of a series of 12-hour brain-storming sessions intended to bring them up to speed and to develop plans for going forward. By the second day of working together, the business had begun to take on a new shape. Henry talked at length about his experience with scheduled flight airlines and all of the benefits that Florida Air would experience from changing its concept to this format. Dan and Scott readily agreed, and by the end of the week, the team was charged with enthusiasm and ready to make Florida Air, a scheduled regional commuter airline, an operating reality.

The team immediately divided up responsibilities and began working. Scott's primary tasks were to research the industry, put together a revised set of projected financial statements and help raise capital. Henry was charged with writing the marketing plan and coming up with industry contacts who could be helpful in fund-raising and operations. Dan would continue looking for capital, work with Scott and Henry on their projects, and direct the effort to create a new business plan that would attract investors.

Consultants turned partners

By Thanksgiving Day of 1993 Dan and Joan Stilton had reassessed their financial position and had determined they could not pay Scott and Henry the consulting fees they had promised. However, a great deal had been accomplished in the past month and a half, and enthusiasm from everybody involved had grown tremendously. Dan approached Scott and Henry with a proposal that they continue working for Florida Air but as equity partners. After a short discussion, all three expressed their belief in the concept and its chances for success. Sure that they would work out the details when the appropriate time came, the team shook hands and agreed to proceed as partners and work without pay to launch Florida Air. Dan continued acting as President. Scott took the official role of Chief Financial Officer, and Henry became the company's Director of Marketing.

A search for capital and credibility

By December of 1993 the partners had made considerable progress. The team had developed a business plan, complete with financial projections and an estimate of the capital needed ($1 million). All that was needed now were investors.

Dan and Scott decided they would feel more comfortable having outside investors in the venture before offering it to family and friends. From the outset, Henry was guarded about his network and wanted to see more progress before he started calling in favors from people he knew. Therefore, the team decided that the best chance to raise capital was to approach individuals with enough airline experience to appreciate the benefits of the idea. They researched the industry, and through articles in magazines and a few conversations with industry experts were able to identify a dozen people who had both the background and capital necessary to be serious candidates. Relying on persistence and an occasional connection, Scott and Dan made contact with the majority of these people and arranged a number of meetings.

One of the people identified early on as a likely candidate was Jason Daulton. Jason had started and run the largest regional airline on the East Coast. He was young and aggressive and sounded very interested in the idea. During the meeting Jason was intrigued by the concept and its potential profits but requested more details on how the team planned to operate the business. He wanted to know how Florida Air would handle maintenance in the outlying markets; what approach was envisioned for scheduling; and how the economics of a specific route would change with a $0.10 per gallon increase in fuel prices or a 10% decrease in load factor. He also questioned some of the plan's base assumptions about the attractiveness of specific targeted markets. By the end of the meeting Dan and Scott had learned a great deal about the business and received a number of suggestions to improve the plan. However, by this time Jason's enthusiasm had dwindled, and he offered only a wish of good luck at the close of the meeting.

After having gone through the list of industry-related people, Dan and Scott had enough new ideas (but no capital commitments) to revise the business plan and fine tune the financial projections. With the help of a few connections from Henry, Florida Air had even established an advisory board with several former CEOs and senior executives from major industry players. Scott and Dan also conducted some additional industry research and market analysis that Henry had not been able to complete. By the end of December there were still no investors, but the right type and configuration of aircraft had been selected, some initial routes had been changed, and a frequent flyer plan had been discussed. Based on these assumptions, Florida Air would require $1.5 million in working capital to start operations (See **Exhibit I**).

Together Dan, Scott and Henry decided the next most likely investors were individuals who would benefit directly from the service. They decided to contact wealthy people in the markets where Florida Air planned to operate. Dan and Scott approached accountants and bankers to identify high-net-worth individuals who lived or vacationed in the resort communities of Florida, and cold-called every person they could find that fit the appropriate profile. While most people were congenial and interested in using the service, no one expressed an interest in funding a start-up airline. Most people said that the investment requirements were too large or that they needed to liquidate other investments before they would have any money available.

Many cold calls later, somewhat discouraged and still without investors, Dan and Scott decided that perhaps they needed to approach institutional sources of funding to finance a venture this large. With the few contacts that Scott had, they called a number of major pension funds and investment banks. They found that getting a call returned was difficult, and those who did take the time to talk often laughed. “No airlines — no way,” “You miss our minimum investment size by $19 million,” or “We don’t do that sort of thing” were among the responses they heard.

Unsure where to turn, Dan decided in January of 1994 to put another ad in the Wall Street Journal, this time seeking capital:

Wanted

Capital. High growth potential regional airline is seeking a small group of qualified investors to get in on the ground floor of a fantastic opportunity. High returns possible from this quickly growing, highly profitable investment opportunity. For more information write:

Florida Air
Investor Relations Department
1431 Lindbergh Blvd.
Stack River, FL 53125

The response was even greater than expected, numbering almost two dozen letters. However, after a few phone calls and three or four meetings, it was obvious most were not the sources of capital Florida Air wanted. One group was looking for a place to park some cash for awhile, but they didn't want any records kept. Another group offered to take whatever money Florida Air had already raised and double it every two months by investing in short-term, high-return investments. The remainder were intermediaries who said they thought the idea was the best they had heard in a long time, and they could easily raise the money with their investor networks in only two months. Florida Air would have to do little of the work, and the money would be in the bank in six to eight weeks. All that was needed was a small \$10,000 - \$35,000 retainer as a down payment against the commission of 3% on funds raised, and the process would then begin. Scott and Dan contemplated talking with some of these groups, but agreed on a policy of not dealing with anyone who required an up-front payment for raising capital.

In desperation, Scott sent out a mailing to 100 local alumni from his business school, looking for someone with money and an interest in the idea. There were two responses, but no investors.

While success with investors had not materialized, the team had received a positive response from some people. Banks and insurance companies who had heard about the new airline solicited its business by taking Don, Scott and Henry on golf outings and out to lavish dinners. Local TV stations and newspapers called and asked for a press conference or a live interview. The local Chamber of Commerce in one of the smaller towns that the company planned to serve threw a party in Florida Air's honor, complete with parade and square dance.

Despite all this activity and interest, no sources of funding had materialized. Dan and Scott agreed they needed credibility not only with chambers of commerce and insurance companies, but also with investors. The team decided to try to "bootstrap" that credibility by continuing to make progress in operations until such time as a capital commitment would be forthcoming. First and foremost, they reasoned that to be an airline, Florida Air needed planes, so they set out to find some.

"We have no money and no access to credit, but we would like to buy some of your airplanes," was a pitch that the salesman at Fairchild Aircraft Incorporated had never heard before, but Dan had reasoned that an honest, up-front approach was the best chance Florida Air had. The Fairchild representative, while not impressed by the company's financial condition, was intrigued enough to want to hear more. Dan sent him the latest version of the business plan via Federal Express and hoped for the best. Two days later he called to set up a meeting, and said he had a number of planes which would meet Florida Air's needs. Fairchild's officers were impressed with the business plan and the detailed understanding that Dan and Scott had of the market and the business. Fairchild agreed to sell four aircraft to Florida Air with no money down. Fairchild even offered to help develop Florida Air's paint scheme, pay for expenses in taking potential investors and clients on flights to outlying markets, and leave one airplane at Florida Air's offices to show potential investors.

Encouraged and energized by a major victory, the search for capital began anew. The partners tried to leverage their commitment from Fairchild. But by now it was the beginning of February, and Dan was running out of money to pay rent and utilities on the office <u>and</u> his house. Not sure what to do, Scott called one of his friends, Ken Crow, who had raised money to start his business two years earlier. Ken suggested that Scott talk with one of his investors, Karen Ellison, and offered to make an introduction and put in a good word. Karen liked the team and was impressed by the business plan, the partners' enthusiasm, and their ability to finance the $10 million in aircraft. Over their second beer she agreed to write a check for $100,000 to keep the idea going.

With two successes under their belts and enough money to pay the partners a small salary ($2,500 per month each), they were recommitted to making the venture a success. They approached the local office of a prominent national law firm and explained to one of the partners that Florida Air had recently raised capital from an investor and had commitments from an airplane manufacturer and needed to formalize the structure of its business. After some discussions with Dan and Scott, and conversations with Fairchild, the firm agreed to take Florida Air as a client on a contingent-fee basis. Florida Air would incur fees at the firm's normal rates, but would only have to pay for the services once all of the capital had been raised.

One partner in particular, Mike Talent, was so intrigued by the idea he agreed to introduce Dan and Scott to some of his contacts who might be interested in funding the venture. Their first such meeting was with Bob Heathman, the founder and CEO of a large Florida-based fertilizer company. He had amassed a substantial personal fortune from selling his business and was now retired. Though initially skeptical about the idea, he talked with Florida Air's lawyers and had dinner with Karen Ellison. Bob then told Scott and Dan he was willing to invest $200,000 if Florida Air could raise the rest of the $1.5 million that they needed.

Scott and Dan also continued to follow up miscellaneous investor leads, including several from doctors and lawyers. While these people knew nothing about the airline business, they were encouraging and typically said, "I would rather not be the first investor you have, but give me a call when you get ready to close the deal and I'll be willing to put up $25,000 - $50,000." These names were placed alongside those of other individuals to whom Dan and Scott had talked who had made similar statements, in the rapidly expanding "Interested but Not Now" file."

Dan and Scott also approached accounting firms in each of the markets Florida Air planned to serve. They explained to these firms that the Company intended to use suppliers and service providers in each of the communities in which they operated. They asked for references of business owners who might be potential investors. One accounting firm, Aston & Aston, in Lakeland, Florida, suggested Clayton Field, a local orange baron. Clayton expressed interest in the idea from the outset. He would be a frequent user of the service and thought it would certainly facilitate the commute to and from his plant by Latin American buyers and sellers who operated in Southern Florida. He expressed an interest in funding the Company for half a million dollars. The announcement that Clayton Field was supporting the venture made front page news and created excitement in the community. So much excitement, in fact, that when Dan and Scott came to visit again, they were greeted by the local TV station. In addition, the community had nearly $3 million in a business development fund, and the supervisors believed direct air service connecting the area with Southern Florida had the potential to bring the community millions of dollars in tourist and business revenue. The community's board of supervisors was going to vote on a plan to give Florida Air a

$300,000 low-interest loan at their next scheduled meeting in May. Newspapers had already endorsed the idea, and the supervisors' finance subcommittee had placed the Florida Air proposal at the top of their list.

By the beginning of May, Florida Air had rough commitments from investors totaling $1 million ($200,000 from Bob Heathman, $300,000 from the city of Lakeland, and $500,000 from Clayton Field) of the $1.5 million being sought. While Karen Ellison's $100,000 was nearly exhausted, the team was encouraged and poised to raise the final capital needed to get things started.

Henry Hamilton Tellsworth III

While things seemed to be moving along well in the risk capital arena, all was not running smoothly at the office. When Henry joined the team at Florida Air, Dan was so impressed with Henry's credentials, industry experience, and list of contacts that Dan felt lucky Henry had even entertained the idea of coming on board. In Dan's mind, hiring Henry had been quite a coup. Henry certainly knew the industry jargon, and he had access to some of the biggest names in the airline business.

Unfortunately, Henry's initial contributions were short lived. While he was honest and likable, he never seemed to come up with the results the business needed. When Dan or Scott asked about progress and results of market research, Henry suggested Florida Air hire someone from outside to help with these projects. When Henry did have an idea he would usually come to Scott and Dan with suggestions about what needed to be done, but seemed to want their approval before taking any action, and often wanted to pass off names and contacts for someone else to follow up. It appeared to Scott and Dan that Henry spent a great deal of time talking with people who did market studies and evaluated reservation systems. Dan recalled an incident wherein he had asked Henry to conduct some market research on what students at Florida State University (FSU) would be willing to pay for tickets to Tampa, Orlando, or Miami. He clearly recalled Henry's response:

> "Well, I've looked into that, and there is a company in Atlanta that will do a telephone survey for the market. It will cost around $10,000, and we should have the data in a few weeks. I think this is really the only way."

Eventually Dan and Scott went to FSU themselves, set up a table at registration, and asked students to fill out a brief survey.

In addition to Henry's different approach to doing business, Dan and Scott were becoming increasingly concerned about Henry's dedication. While Scott and Dan were working together 10 or 12 hours a day and eating more meals at the office than at home, Henry frequently arrived at the office around nine or ten in the morning and read the Wall Street Journal. He frequently missed meetings with potential investors because of social engagements and seemed unwilling to travel out of town because of "personal reasons" that always seemed to arise. Eventually, he became a big drag on morale, but Dan and Scott
were concerned about pushing Henry too hard and losing the only industry experience Florida Air had.

A turn for the worse

By the beginning of May a formal ownership agreement had finally been prepared by the lawyers, and the question of equity had to be addressed by the partners. As President, Dan worked out a plan giving Karen Ellison 5% of the company for her initial investment (an arrangement that satisfied Karen, provided that her ownership share would be diluted only after the $1.5 million had been raised) and created a schedule dividing up the company's shares as follows:

- $1.5 million investors 45%
- Dan 25%
- Scott 15%
- Henry 5%
- New management 5%
- Karen Ellison 5%

Henry was outraged at the division. While he explained that he didn't need the money (he had more than enough family money to sustain his lifestyle for quite some time), it was a matter of principle. Henry was sure he deserved more of the company for his efforts than Dan had offered, and was even more certain that Scott, with no industry experience, shouldn't be entitled to a bigger piece of the venture than he was. Dan had to explain to Henry why Scott had added more value than he had, including Scott's relationship with Karen Ellison, and the importance of all of the work that Scott had done. Henry eventually listened, but he was still upset. After the discussion, things began to worsen with Henry on a daily basis, and he seemed more and more de-motivated. Henry started showing up at the office even later, missing more meetings, and taking longer to make calls he promised to make. When Dan and Scott confronted him about it, he became very angry and defensive.

Making matters worse, time was running out on the financing front. Florida Air had only fifteen thousand dollars left to keep the office open and pay expenses. The money would last about 30 days (maybe 45 days, if Henry left). Even more concerning was the fact that two weeks earlier a major airline had announced plans to serve some of Florida Air's routes. As a result, the city of Lakeland had unexpectedly voted against offering Florida Air the $300,000 loan, believing that the city shouldn't give a company money to provide service in competition with an established airline. Clayton Field had also called and expressed concern over the prospect that competition might make the business unprofitable.

Something had to be done about Henry and the company's investors. Dan and Scott knew that if they asked Henry to leave, they would have to return to the people who had committed money and explain not only how Florida Air planned to address the new competition, but why the most experienced member of the team had left. They also knew that, given the company's current condition, finding airline expertise would be difficult and that at least on paper Henry would be a valuable asset in attracting investors.

Things seemed to be falling apart, and Dan and Scott didn't have a lot of time to pull the business together. Actions had to be taken immediately, but they were unsure how to proceed.

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Florida Air

I. EXECUTIVE SUMMARY

The Opportunity

Florida Air has been established to provide frequent and affordable commuter air service between underserved Florida markets and the South Florida area via the convenient West Palm Beach Airport.

Utilizing 19-passenger twin-engine turbo-props, Florida Air plans to initiate service from West Palm Beach to Orlando, Lakeland, and Tallahassee by the end of 1994. In addition to offering convenient point-to-point service between West Palm Beach and these communities, Florida Air will coordinate its flight schedule to facilitate connections on major jet airlines in order to generate connecting passenger traffic.

The Florida Air business strategy involves four major elements:

- *Careful selection of underserved markets:* Florida Air will seek to avoid direct competition with the major airlines and their affiliated regional carriers in all markets.

- *Competitive pricing:* Fares will provide consumers with a recognizable advantage over their commuting alternatives.

- *Simplicity:* Operations and procedures will be streamlined to produce the leanest possible organization. For example, Florida Air will maintain a simple fare structure to promote simplicity of operations and consumer understanding. Contract employees will be utilized whenever possible to eliminate fixed overhead.

- *Reliable and Convenient Service:* Florida Air will buy Fairchild Metro 19-passenger aircraft based on their performance, cost, safety history, ease of maintenance, and proven customer appeal. Frequent service will be attractive to both the business and pleasure markets.

In addition to the founding partners, Florida Air has also assembled an experienced management advisory board to assist management during the formation and operation of the airline. Their backgrounds are profiled below:

- Kevin Green: Mr. Green has spent his entire 35 year career in the airline industry with both jet and turbo-prop regional air carriers. Most recently Mr. Green served as Senior Vice President and Chief Operating Officer of Rite Brothers Transportation. Previously he served with Canada Airlines as Director of Community and Public Affairs, Cowbell Air as Director of Marketing and Public Affairs, and People's Express Airlines as System Cargo Sales Manager, District Sales Manager, and Customer Service Manager.

- Jeffrey Rosin: Mr. Rosin, President and CEO of Hamilton Airlines, brings over 27 years of jet and commuter airline management experience to Florida Air. After holding various positions with American Airlines, Pan American World Airways, and Republic Airlines, Mr. Rosin launched both the West Coast Shuttle and New York Shuttle, serving as President and COO of each carrier. Mr. Rosin also served as President and CEO of Little Wings, a Texas-based commuter carrier which operated a fleet of Fairchild Metros. Mr. Rosin has served as President and CEO of Hamilton Airlines since mid-1993.

Summary Financial Projections

Management is projecting that the airline will fly a total of 119,970 passengers system-wide in Year 1 with a weighted average load factor of 46.49%. Gross sales from passenger service and all other sources are projected to be $7,233,613. First year operations will break even in the sixth month (the ninth month following financing) when the company's lowest cash position will be $515,000.

In Years 2 - 5, the airline's weighted average load factors are expected to be 52.14%, 53.61%, 51.97%, and 51.98%, respectively. Passenger volumes are projected to increase to 273,773 passengers in Year 2, 352,054 passengers in Year 3, 391,644 passengers in Year 4, and 439,016 passengers in Year 5 due to stabilizing load factors and the addition of new routes.

Exhibit 1
Summary Sales and Earnings

	Year 1	Year 2	Year 3	Year 4	Year 5
Revenues					
Scheduled Passenger Service	$6,700,867	$15,277,987	$19,839,290	$22,839,300	$26,133,864
Charters	$180,000	$180,000	$180,000	$180,000	$180,000
Cargo/Other	$352,746	$657,908	$780,337	$861,399	$917,664
Total	$7,233,613	$16,115,895	$20,799,627	$23,880,699	$27,231,528
Cost of Sales	$4,297,161	$8,682,080	$11,026,862	$13,247,229	$14,453,053
Gross Margin	$2,936,453	$7,433,816	$9,772,765	$10,633,470	$12,778,475
Selling, General & Administrative	$3,327,830	$6,225,219	$7,473,767	$8,480,311	$9,967,442
Net Earnings	($391,378)	$1,208,596	$2,298,998	$2,153,159	$2,811,033

Proposed Funding

Florida Air is raising $1,500,000 in operating capital to achieve its growth targets based on the forecasted earnings and expenses detailed in this plan. Management has designed a financing strategy to meet the needs of both the company and investors. Florida Air proposes that the entire balance of its operating capital requirements be raised through the sale of preferred stock in thirty units of $50,000 each.

Florida Air will actively seek to gain liquidity for its stockholders within the first five years of operations through: 1) a merger or buy-out; 2) an initial public offering, or 3) a stock repurchase program. In addition to a high current return and the potential for significant capital gains, investors in Florida Air and their immediate families will also gain the privilege of traveling for free, on a space-available basis, on Florida Air's flights.

Florida Air has already secured a commitment from Fairchild Acceptance Corporation, Inc. for approximately $10,680,000 in financing for four used Fairchild Metro airliners.

II. THE U.S. REGIONAL AIRLINE INDUSTRY

Section II of the plan has intentionally been removed from this document.

III. THE COMPANY AND BUSINESS STRATEGY

Florida Air has been established to provide frequent and affordable commuter air service between underserved Florida markets and the West Palm Beach Airport.

Utilizing 19-passenger twin-engine turbo-props, Florida Air plans to initiate service from West Palm Beach to Orlando, Lakeland, and Tallahassee in the first four months of flight operations. Florida Air will seek to avoid direct competition with the major airlines and their affiliated regional carriers in all markets. Operations and procedures will be streamlined to produce the leanest possible organization. Growth will occur as soon as business on existing routes has stabilized or become profitable.

West Palm Beach Airport

West Palm Beach Airport was selected as the base of Florida Air's operations for its central location, convenience, and connecting passenger potential.

West Palm Beach Airport (PBI), is the fastest growing airport in the South Florida Area, and serves the entire South Florida Area. Five and a half million passengers used PBI in the 12 months ending December 31, 1993 -- a 14.6% increase over the previous year.

Routes

Florida Air plans to fly two city-pair segments when it begins operations: West Palm Beach - Orlando, and West Palm Beach - Lakeland. In its third month Florida Air will add service between West Palm Beach and Tallahassee, and then in the fourth month add service between West Palm Beach and Gainesville. The market opportunities for selected routes are described below.

West Palm Beach - Orlando (PBI - ORL)

Stabilized Average One-Way Fare: $59
Projected First Year Average Load Factor: 48.75%
Projected First Year Passenger Volume: 39,214

Florida Air expects to fly six round-trip flights each day between West Palm Beach and Orlando. The following demographic and market factors make Orlando an appealing destination for Florida Air:

- *Market Need:* US Express suspended service between MIA and Orlando on November 1, 1993 despite superior operating results. For example, US Express' load factor in October, 1993 was 67% operating two 30-passenger planes with two round trips per day and a minimum one-way fare of $95.[1] Much of this volume represented local travel rather than connecting traffic, explaining why US Express redeployed its assets on routes which would feed its jet operations. This passenger demand has not disappeared because of the suspension of service. In fact, demand should be significantly greater when Florida Air initiates service at lower fares.

- Omega Air, operating as Southern Express, will begin service from MIA to Orlando with a 19-passenger turbo-prop once a day beginning April 18, 1994. Management believes that such a modest increase in supply between the South Florida and Orlando, coupled with the constraints that Omega Air has as an affiliated carrier, will not negatively impact Florida Air's traffic and revenue forecasts.

- *Tourist Destination:* Numerous activities, including Disney World and MGM Studios draw over 5 million visitors to Orlando year-round. In addition to theme parks, Orlando supports an increasing amount of the movie industry, as well as summer water sports and hiking.[2]

- *Community Support:* Orlando has expressed a willingness to support Florida Air's operations in a variety of ways including waiving landing fees and terminal rent, incorporating Florida Air into their marketing and promotional activities, and arranging for free shuttle service for Florida Air passengers to some of the local tourist attractions.

- *Imperfect Alternatives:* The journey to Orlando from the South Florida can take a considerable amount of time on weekends when the highway backs up with bumper-to-bumper traffic. Florida Air will be able to deliver visitors and their families to

[1] Great America Aviation, Inc.
[2] Orlando Visitors Authority

Orlando in approximately two hours, effectively adding more recreation time to a visitor's weekend.

West Palm Beach - Lakeland(PBI - LAK)

Stabilized Average Fare: $89
Projected First Year Average Load Factor: 39.58%
Projected First Year Passenger Volume: 21,851

Florida Air will fly five round-trip flights each weekday and four weekend round-trip flights between West Palm Beach and Lakeland beginning in the third month of operations. The following demographic and market factors make Lakeland an appealing destination for Florida Air:

- *Underserved Market:* In 1992 approximately 80,000 scheduled service passengers enplaned and deplaned in Lakeland.[3] US Express has since abandoned this market leaving Lakeland without any scheduled air service.

- *Imperfect Alternatives:* Pasco County residents (population of 225,000) must currently pay a $393 walk-up fare to fly round-trip to Miami from Clearwater. In addition to providing a travel alternative to residents and business people, frequent and moderately priced Florida Air service should also spur tourist demand on this route. Visitors are attracted to Paso County's pristine beauty where six wild rivers run through the county's 400,000 acres of parks.

- *Community Support:* The city of Lakeland has actively recruited Florida Air to provide air service to the community. After management's presentation to community leaders during a meeting of the Lakeland Economic Alliance, the mayor of Lakeland organized a task force dedicated solely to attracting and assisting Florida Air. This task force has been instrumental in identifying likely local investors in addition to bulk cargo and bulk ticket purchasers. Inspiringly, Florida Air's visit was featured in the evening news on both major local networks' broadcasts and was front-page news the next day in the local newspaper.

Potential for Expansion

Florida Air intends to add destinations to its route structure opportunistically as the economics of each city pair warrant. Florida Air has conservatively projected that the airline will open two new stations annually after its first year of operations. Route selection will ultimately depend on some market factors (such as competitive service) which cannot be predicted here.

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[3] Pasco County Airport Management

Competition

Florida Air will seek to avoid direct competition with another scheduled airline in all of the city pairs it serves. At this time management knows of no other carriers which are planning to initiate service on Florida Air's proposed routes.

The likelihood of Florida Air encountering direct competition from existing airlines is negligible. Airlines flying significant jet equipment, such as United or American with their large jet fleet, will not target routes which are suitable for the 19-passenger Fairchild Metro. Florida Air views these operations as symbiotic partners.

Direct competition from affiliated commuter carriers such as US Express and Wings East is also unlikely because of the incentive arrangements between major and commuter partners. Affiliated commuter carriers are compensated for flying *connecting* passengers, not simply revenue passengers, by their major airline partners in order to produce a profit on the combined segments.

Potential competition from new market entrants is, in management's opinion, a more significant threat. Like Florida Air, such new entrants will be in a position to skim niche markets which affiliated commuter carriers will not serve.

Because of its low air fares, Florida Air's primary non-airline competition will be the ground transportation alternatives available to the traveler. As such, management has priced its flights to be equal to or competitive with ground transportation alternatives.

Marketing, Communications & Sales

<u>Marketing</u>

Florida Air's marketing position is to provide the best transportation value for travel between South Florida and Florida Air's markets. The airline will market to three distinct segments: business travelers, pleasure travelers, and the travel trade (travel agents and corporate travel managers). The following is a brief summary of how Florida Air will achieve its sales goals in each target market:

- *Business travelers*
  - Print ads in business publications
  - Spot buys in drive-time radio
  - Frequent flyer program
  - Direct sales
  - Discounted ticket books
  - Press releases to industry publications
  - Print ads in company newsletters

- *Pleasure travelers*
  - Print ads in newspaper travel sections
  - Radio spot buys, contests, and promotions

- Frequent flyer program
- Co-ops with hotels and resorts
- Tie-ins with Visa, MasterCard, and American Express
- 800 Number
- Press releases to consumer publications

- *Travel trade*
  - Apollo and SABRE reservation systems
  - OAG and ABC timetable publications
  - Print ads in Travel Age
    Press releases to industry publications
  - Direct sales
  - Receptions
  - Direct mail
  - Familiarization trips

<u>Fares</u>

Florida Air will be the value leader by offering fares which are low enough to compete with driving and other ground transportation alternatives. In addition to the clear value this offers to all travelers who already travel Florida Air's designated routes by car or bus, we expect this strategy to stimulate the market and expand the overall pool of air travelers.

In addition to value, Florida Air intends to maintain a simple pricing structure in order to promote simplicity of operations and consumer decision making. To attract and retain business travelers, Florida Air will offer corporate discounts on bulk ticket purchases.

Exhibit 2
Sample Fares and Alternative Commuter Services

Route	*Introductory Fare*	*Average One-Way Fare*	*Alternative Service*	*Alternative One-Way Fare*
West Palm Beach - Orlando	$39	$59	Greyhound Bus (6 1/2 hours) Omega Air from MIA (April 18)	$30 $202 +
West Palm Beach - Lakeland	$59	$89	Greyhound bus (one transfer) US Express from MIA	$37.50 $69 - 300+

Note: Alternative services and fares accurate as of March 1, 1994

IV. OPERATIONS

Section IV of the plan has intentionally been removed from this document.

V. RISK FACTORS

With no history of operations or earnings, Florida Air represents a speculative investment opportunity involving a high degree of risk. Recognition of these risks, evaluation of their severity, and proper contingency planning for their possible occurrence have been considered in Florida Air's planning. Risks include, but are not limited to, the following discussion of specific risk factors (in no particular order):

Risk 1: Delays in Start-up - Florida Air could be subject to delays in receiving FAA approval of its pending application for airline status under the Federal Aviation Regulations. Florida Air may also be subject to delays in receiving its certification from the Department of Transportation.

Risk 2: Availability of Landing Slots - The communities and airports which Florida Air will serve have ultimate authority over the availability and use of their airports. The airline can make no assurance that it will maintain authority over the rights and privileges in these locations as discussed in this business plan.

Risk 3: Dependence on Management - Execution of Florida Air's business strategy will be heavily dependent on the efforts of the founders and other individuals managing the business. The loss of the services of any officer could adversely affect the conduct of the

Florida Air's business. Potential loss of their expertise because of death or disability will be minimized through key-man insurance policies.

Risk 4: Adequacy of Funding - No assurances can be made that Florida Air's net investment proceeds will be sufficient to meet the company's operational and expansion requirements during the five years contemplated in this business plan.

Risk 5: No Assurance of Profitability - There is no assurance that Florida Air's operations will be profitable or even adequate to meet fixed and operating expenses or to generate any income to pay dividends to shareholders.

Risk 6: Competition - Florida Air could be subject to predatory pricing, scheduling or other direct competition by other airlines and transportation services. All such actions could adversely affect the company's operations.

Risk 7: Legislative and Regulatory Changes - Legal and regulatory changes may adversely affect Florida Air's business operations.

Risk 8: Future Business Environment - A general economic downturn or the loss of a major air carrier's service into West Palm Beach Airport could result in depressed passenger volumes for Florida Air. Similarly, the entry of additional carriers into Florida Air's markets could adversely affect the airline's business operations.

Risk 9: Aircraft Maintenance/Accidents - Though Florida Air will maintain insurance against catastrophic engine events and will perform all necessary maintenance, unforeseen mechanical problems with aircraft might cause higher than forecasted repair expenses and disruptions in service. In addition, the occurrence of an accident could also result in unforeseen expenses and an indefinite suspension of service.

Risk 10: Fuel Price - Increases in fuel price will adversely affect the company's operation

VI. FINANCE

Proposed Funding

Florida Air is raising $1,500,000 in operating capital to achieve its growth targets based on the forecasted earnings and expenses detailed in this plan. Management has designed a financing strategy to meet the needs of both the company and investors. Florida Air proposes that the entire balance of its operating capital requirements be raised through the sale of preferred stock in thirty units of $50,000 each.

Florida Air anticipates that it will gain liquidity for its stockholders within the first five years of operations through: 1) a merger or buy-out; 2) an initial public offering, or 3) a stock repurchase program. In addition to a high current return and the potential for significant capital gains, investors in Florida Air and their immediate families will also gain the privilege of traveling for free, on a space-available basis, on any Florida Air flights.

Florida Air has already secured a commitment from Fairchild Acceptance Corporation, Inc. for approximately $10,680,000 in financing for the four Fairchild Metros.

Sources and Uses of Funds

Florida Air anticipates raising the entire $1,500,000 from external sources. Exhibit 3 below provides a summary of the sources and applications of new funds.

Exhibit 3
Sources & Uses of Funds (First Year)

Sources		***Uses***	
Amount	*Terms*	*Amount*	*Applications*
$1,500,000	• Preferred Stock	$112,500	• Allowance for Fundraising Fees
		$872,500	• Operations
		$515,000	• Reserve (Lowest Cash Balance)
$1,500,000		$1,500,000	

Florida Air

Study Questions

1. *Evaluate Florida Air's search for capital. What if any key mistakes were made?*

2. *Evaluate Dan's evolving relationships with Scott and Henry. What "principles of best practices" did he overlook?*

3. *What alternatives do Dan and Scott have now? What should they do regarding the lost investors? Continuing the business and raising capital? Henry? Identify and assess the risks of each proposed plan of action.*

4. *As an advisor to the business at its inception, what specific steps, and in what order, would you have recommended to Dan in order to start and fund Florida Air?*