

carrier. This implies that whenever airline traffic increases above expectations, profits will soar. Similarly, when traffic falls below amounts which had been planned for, huge losses can be experienced.

Moderately High Financial Leverage. Financial leverage is the relationship between debt and equity financing for a firm. A firm is said to be highly levered when it has large amounts of debt relative to the stockholders' equity. In such a situation, small increases in net profit can be magnified into very large increases in return for the shareholder. Similarly, small losses will be magnified into very poor returns for the shareholder. The airline industry has relatively high financial leverage, although not as high as in some industries, such as the financial sector. Within the airline industry, there is considerable variation in the degree of financial leverage. Typically, liabilities represent two to four times the value of shareholder net worth. However, some carriers, such as Continental Airline Holdings, have ratios which are very high. Table 2 gives an example of the financial leverage of a sample of air carriers.

Asset Turnover of Unity. Asset turnover is the ratio of the value of a firm's annual revenues to the value of its assets. Industries such as retail and wholesale trade have asset turnovers typically between two and ten times per year. Manufacturing industries generally have asset turnovers between one and two. The airline industry tends to have asset turnovers of approximately unity. This means that the revenues received each year are roughly equal to the value of assets used to provide services to its customers. Table 3 gives asset turnover ratios for selected carriers.

Changing Cash Flow Relationship. Traditionally, airlines owned their own aircraft. Because aircraft were purchased with cash and depreciated over the life of