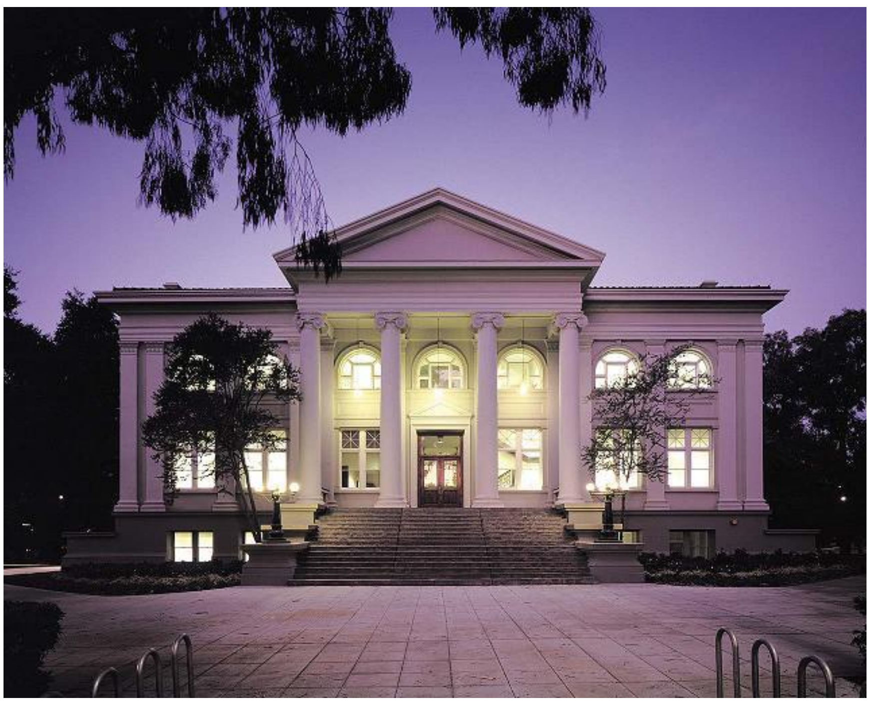
Virgin America Inc.

CLIENT REPORT

SONTAG SOLUTIONS



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Executive Summary

Sontag Solutions believes that Virgin Airlines is poised for greatness, as a new entrant into the airline industry. The higher cost structures of traditional airlines, like American and Delta, coupled with tighter business travel budgets, has provided expansion opportunities for low-cost airlines, such as Virgin America.

Virgin competes as a low-fare carrier, but distinguishes itself from rivals by providing first-class service and myriad in-flight entertainment options. Virgin America provides service to about 25 cities, mainly in the US, but also in Mexico. Given that Virgin is relatively young, it is not surprising that its network of routes is rather small. However, expansion into international markets while maintaining its award winning service is of vital importance for the future of Virgin America.

Specifically, Virgin Airlines needs to convince passengers that it can provide the quality travel experiences it promise, and capitalize on its networks and aircraft fleet, securing a healthy financial future.

Virgin's success will ride on its ability to smoothly expand networks and fleets. By focusing on these objectives, Virgin should be able to use their award winning service, customer loyalty, and the superior fuel efficiency of their newer aircrafts to gain profitability and a competitive position within the airline industry.

Moving forward, our consultants have identified four key areas in which company management must succeed: Expansion, maintaining the quality of service, focused marketing, and financial performance. As a new entrant to the airline industry, Virgin's potential for success may be of boundless potential.

Company Background

Virgin America Inc., is a low-cost airline, which provides scheduled air travel services in the continental United States and Mexico. An offspring of Sir Richard Branson's Virgin Group, Virgin America took flight just as high fuel prices and a recession rocked the airline industry. When it was established, the carrier launched service from San Francisco to Los Angeles and New York, and now serves more than a dozen destinations in the US as well as Canada and Mexico with a fleet of 50-plus Airbus A320 jets.

The company was formerly known as Best Air Holdings, Inc., and changed its name to Virgin America Inc. Virgin America Inc. was incorporated in 2004 and is headquartered in Burlingame, California. The Company employs around 2428 employees as of September 2014.The airline listed on the NASDAQ stock exchange on November of 2014, selling 13.3M shares at $23 per share to raise roughly $307 million for the company in its initial public offering.[1] The company's current CEO is David Cush.

Known for its mood-lit cabins, three beautifully designed classes of service and innovative fleet wide amenities — like Red, an in-flight entertainment system that allows guests to control what they watch, when and what they want to eat or drink, and what they want to listen to via touch-screen or remote control.[2] There is also WiFi, and power outlets at every seat. Virgin America has built a loyal base of flyers and earned a host of awards since launching in 2007.

As of March 31, 2014, Virgin America operated through a fleet of 53 Airbus single-aisle aircraft, including ten Airbus A319s and 43 Airbus A320s, allowing the company to provide service to 21 airports. Below is a map illustrating Virgin's network route.

[1] Schwartzberg, "Virgin America."
[2] "Virgin America's Success Story."

Source: SEC VA 10-K

The majority of Virgin America's routes operate to and from focus cities such as Los Angeles and San Francisco. The current network, as seen in the map above, is a mix of long-haul, transcontinental service combined with short-haul West coast service and select Mexico leisure destinations (Los Cabos, Puerto Vallarta, and Cancun).

Virgin America offers fewer destinations than some of its competitors, and consequently carries only a fraction of the total passengers of rivals such as Southwest, Delta, American Airlines, and JetBlue Airways. Overall, US airlines are flying high, as lower oil prices have recently led to an increase in profits.

Virgin America Financials

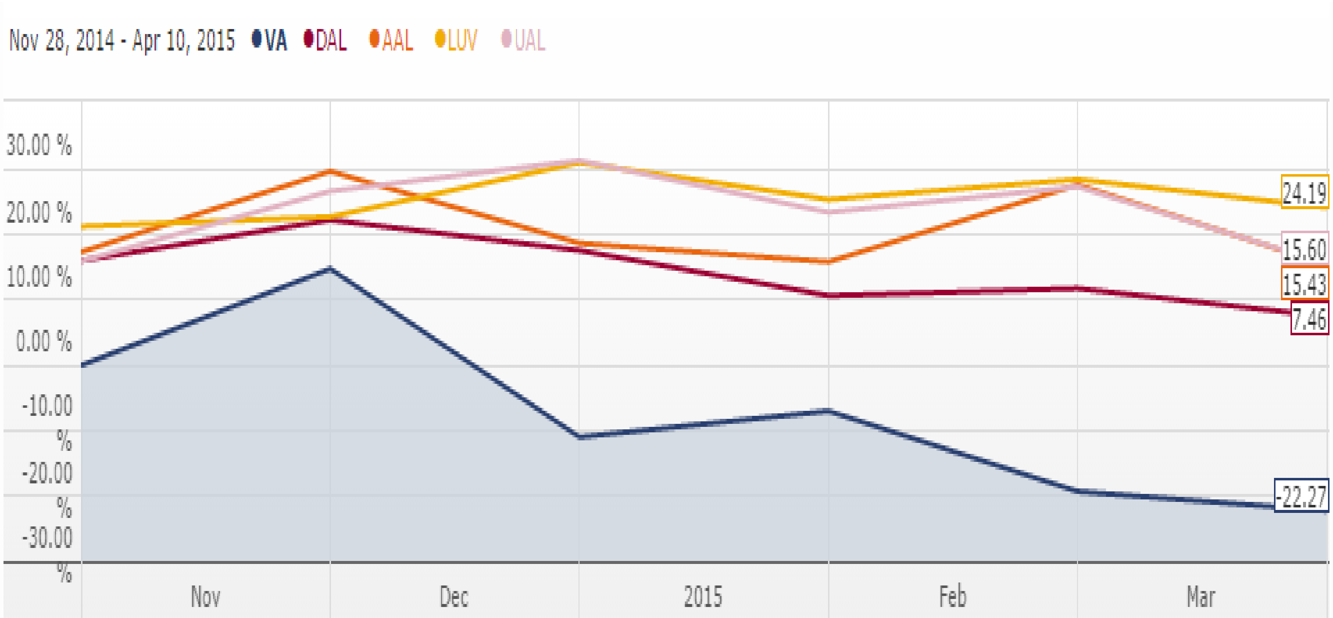
Given that Virgin America went public a mere five months ago, November of 2014, most of the following financial information comes from the S-1 form filed prior to their IPO and the most current 10-K filled in March 03,2015. The performance and changes in financial position of Virgin America read as follows.

Key Statistics

Valuation Measures	
Market Cap (intraday)[5]:	1.26B
Enterprise Value (Apr 12, 2015)[3]:	998.43M
Trailing P/E (ttm, intraday):	4.11
Forward P/E (fye Dec 31, 2016)[1]:	7.01
PEG Ratio (5 yr expected)[1]:	0.09
Price/Sales (ttm):	0.86
Price/Book (mrq):	2.78
Enterprise Value/Revenue (ttm)[3]:	0.67
Enterprise Value/EBITDA (ttm)[6]:	7.91

Source: Yahoo Finance

The table above is a brief overview of key valuation measures. A quick analysis shows that Virgin America's Price to Earnings Ratio (P/E) is roughly five times below the industry's average of 20.08. EBIT / Enterprise Value is not bad but the higher the EBITDA margin, the less operating expenses eat into a company's bottom line, leading to a more profitable operation.



Source: Market Data from Morningstar, Inc.

Looking at the growth of the stock price in comparison to the top four major carriers in the US market, Delta (LUV), Southwest (LUV), United Continental (UAL), and American Airlines (AAL), it is not hard to see that since Virgin America's IPO its stock price has had a declining growth that is currently at negative 22.27 %. The other four airlines have had an average growth in their stock of 15.67 %, with Southwest leading the pack at a high 24.19 % growth.

If, the growth of the price of the stock is a major determinant of a company's performance, Virgin America seems not to be preforming as well as it can be. Although, the actual price of Virgin America's stock is above that of its original public offering in late November, the company's stock has fluctuated in the high twenties and low thirties but has not shown major growth or improvements.

Income Statement

Period Ending	Dec 31, 2014	Dec 31, 2013	Dec 31, 2012
Total Revenue	**1,489,967**	**1,424,678**	**1,332,837**
Cost of Revenue	876,656	893,581	943,400
Gross Profit	**613,311**	**531,097**	**389,437**
Operating Expenses			
Research Development	-	-	-
Selling General and Administrative	502,410	436,253	409,910
Non Recurring	-	-	-
Others	14,486	13,963	11,260
Total Operating Expenses	-	-	-
Operating Income or Loss	**96,415**	**80,881**	**(31,733)**
Income from Continuing Operations			
Total Other Income/Expenses Net	(276)	339	294
Earnings Before Interest And Taxes	96,139	81,220	(31,439)
Interest Expense	34,851	70,759	113,934
Income Before Tax	61,288	10,461	(145,373)
Income Tax Expense	1,179	317	15
Minority Interest	-	-	-
Net Income From Continuing Ops	60,109	10,144	(145,388)
Non-recurring Events			
Discontinued Operations	-	-	-
Extraordinary Items	-	-	-
Effect Of Accounting Changes	-	-	-
Other Items	-	-	-
Net Income	**60,109**	**10,144**	**(145,388)**
Preferred Stock And Other Adjustments	-	-	-
Net Income Applicable To Common Shares	**60,109**	**10,144**	**(145,388)**

All numbers listed are in thousands
Source: Virgin America Annual Report, 2015

The Income statement for Virgin America reports profits of $96.42M for 2014 (had been operating at a loss since 2009). Sales revenue reached a total of $1.48B. Expenses for Virgin America were $1.03B, these include sales and the various expenses incurred during the stated period (2014). Most of Virgins’ expenses are due to aircraft fuel costs and maintenance, as is the case for most airlines.

Balance Sheet

Period Ending	Dec 31, 2014	Dec 31, 2013	Dec 31, 2012
Assets			
Current Assets			
Cash And Cash Equivalents	394,643	155,659	76,018
Short Term Investments	-	-	-
Net Receivables	13,851	13,708	9,846
Inventory	-	-	-
Other Current Assets	30,437	113,328	113,362
Total Current Assets	**438,931**	**282,695**	**199,226**
Long Term Investments	-	-	-
Property Plant and Equipment	167,487	136,241	134,660
Goodwill	-	-	-
Intangible Assets	-	-	-
Accumulated Amortization	-	-	-
Other Assets	393,758	282,060	177,136
Deferred Long Term Asset Charges	-	-	-
Total Assets	**1,000,176**	**700,996**	**511,022**
Liabilities			
Current Liabilities			
Accounts Payable	52,821	43,997	42,867
Short/Current Long Term Debt	33,824	-	3,969
Other Current Liabilities	251,202	212,642	179,867
Total Current Liabilities	**337,847**	**256,639**	**226,703**
Long Term Debt	96,264	747,431	853,065
Other Liabilities	106,812	59,547	40,772
Deferred Long Term Liability Charges	-	-	-
Minority Interest	-	-	-
Negative Goodwill	-	-	-
Total Liabilities	**540,923**	**1,063,617**	**1,120,540**
Stockholders' Equity			
Misc Stocks Options Warrants	-	21,406	21,406
Redeemable Preferred Stock	-	-	-
Preferred Stock	-	-	-
Common Stock	431	8	8
Retained Earnings	(753,016)	(813,125)	(823,269)
Treasury Stock	-	-	-
Capital Surplus	1,237,944	427,434	193,545
Other Stockholder Equity	(26,106)	1,656	(1,208)
Total Stockholder Equity	**459,253**	**(384,027)**	**(630,924)**
Net Tangible Assets	**459,253**	**(384,027)**	**(630,924)**

All numbers listed are in thousands
Source: Virgin America Annual Report, 2015

Virgin's consolidated balance sheet gives the following figures, the company has roughly 1B in assets, and $394.64M of those assets are in liquid cash. As for its total liabilities, the company has $540.92M of outstanding debt. Roughly 18 % of the stated debt is long term ($96.26M). Virgin America has a total of 43.18M shares of common stock outstanding priced as of April 12, 2015 at $29.29, roughly $8 above their IPO price. This gives the company a Market Value of approximately $1.26B compared to its book value of $660.3M.

Cash Flow

Period Ending	Dec 31, 2014	Dec 31, 2013	Dec 31, 2012
Net Income	**60,109**	**10,144**	**(145,388)**
Operating Activities, Cash Flows Provided By or Used In			
Depreciation	14,486	13,963	11,260
Adjustments To Net Income	38,211	55,959	98,844
Changes In Accounts Receivables	(5,065)	(1,050)	6,943
Changes In Liabilities	17,121	24,985	11,112
Changes In Inventories	-	-	-
Changes In Other Operating Activities	10,743	(53,398)	(33,416)
Total Cash Flow From Operating Activities	**135,605**	**50,603**	**(50,645)**
Investing Activities, Cash Flows Provided By or Used In			
Capital Expenditures	(55,160)	(41,996)	(27,184)
Investments	-	-	-
Other Cash flows from Investing Activities	-	-	-
Total Cash Flows From Investing Activities	**(55,160)**	**(41,996)**	**(27,184)**
Financing Activities, Cash Flows Provided By or Used In			
Dividends Paid	-	-	-
Sale Purchase of Stock	277,621	3	45
Net Borrowings	(116,523)	71,031	(6,013)
Other Cash Flows from Financing Activities	-	-	-
Total Cash Flows From Financing Activities	**158,539**	**71,034**	**(5,968)**
Effect Of Exchange Rate Changes	-	-	-
Change In Cash and Cash Equivalents	**238,984**	**79,641**	**(83,797)**

All numbers listed are in thousands
Source: Virgin America Annual Report, 2015

As for the statement of cash flow regarding Virgin America, particularly its operating, investing, and financing activities read as follows. Net cash provided by operating activities as of December 31, 2014 was a total of $135.6 M, a rather positive statistic being that virgin America had been unprofitable in 2009 through 2012. Investing activities such as acquisition of property and equipment and intangible assets has cost Virgin America roughly $55.1M in 2014, highest figure since 2011. Finally, financing activities for 2014 have had a net increase in cash and cash equivalents of $158.5M. After accounting for debt Virgin America has $154.17M of levered free cash flow which it can use to pay for its expansion or simply use for dividend payments, which is unlikely due to its recent IPO.

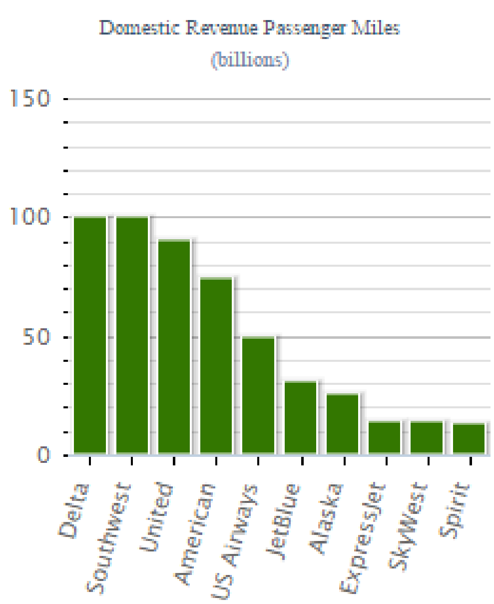
Competitive Analysis (Five Forces Framework)

Internal Rivalries

The US airline industry has experienced substantial consolidation after a string of blockbuster mergers and acquisitions: Delta Air and Northwest (2008), United Airlines and Continental Airlines (2010), Southwest Airlines and AirTran (2010), and US Airways and American Airlines (2013).[3] Such combinations are designed to improve the efficiency and financial stability of major carriers.

Virgin American faces intense competition within the industry. The top four major carriers – Delta, Southwest, United, and American Airlines now control over 60% of the domestic US market. The following table from the Bureau of Transportation Statistics illustrates the industry's competitive landscape in terms of market share based on revenue passenger-miles.[4]

Airline Domestic Market Share December 2013 - November 2014



Airlines	Share
Delta	16.8%
Southwest	16.8%
United	15.1%
American	12.4%
US Airways	8.4%
JetBlue	5.1%
Alaska	4.3%
ExpressJet	2.4%
SkyWest	2.3%
Spirit	2.1%
Other	14.3%

Market share based on Revenue Passenger Miles December 2013 - November 2014.

[3] *Hoover's Industry Report*.
[4] "Financial Data for US Carriers."

The top major carriers pose stiff competition for smaller carriers such as Virgin America, JetBlue, and Southwest, which adopt a point-to-point model rather than hub-and-spoke. The smaller carriers only focus on existing "cash cow" routes and often times use secondary airports in major cities. The newer carriers have also cleverly chosen to use a single or very few models of airplanes, which substantially reduces pilot training and plane maintenance costs.
Within the smaller carriers, the top three competitors for Virgin America are American Airlines Group, JetBlue, and Southwest all of which have a quantifiable share of the domestic airline market compared to Virgin America.

Bargaining power of suppliers

The suppliers of Virgin American include but are not limited to: aircraft manufacturers such as Airbus, labor, air space, and fuel companies.

Aircraft manufacturers:
Aircraft manufacturers have significant bargaining power against Virgin American and other airline companies in general. The large commercial jet airliner market is a duopoly between Boeing and Airbus. Manufacturers of smaller aircraft for regional airlines, with seating capacities of 20 to 150, include Bombardier and Embraer. In the case of Virgin American, its current fleet consists of 53 Airbus planes, making Airbus its primary supplier. And according to Virgin America's order book, the company is awaiting on more Airbus family jets in order to further increase Virgin America's fleet size.

Labor:
Most airline workers belong to one of a dozen major unions. The larger unions include the Association of Flight Attendants, the Air Line Pilots Association, and the International Association of Machinists and Aerospace Workers. Pilots, cabin crew, and ground personnel have bargaining power mainly due to the labor agreements at the time of industry regulation. Additionally, unions that represent FAA-certified pilots and mechanics have a significant voice in labor issues, due to these employees' importance to airlines.

Air Space:

Air space is the portion of the atmosphere controlled by a country above its territory. Airline companies have little power when it comes bargaining with governments and their administration of controlled airspace. In light of the popularity of environmental movements, airlines can expect tight policy implementations.

Fuel:

Fuel is a commodity traded in large quantity every day in the market. There are many players in this market but no one single firm has influential power. No exception, Virgin American is a large fuel consumer, most of its expenses come from fuel consumption, but it is too small to have any bargaining power against the price that is set within the market.

Bargaining Power of Buyers

Customers often have many options to choose from when purchasing tickets on popular routes. Therefore it is extremely difficult for one airline company to change pricing. Online ticketing has made airfares so transparent that it is extremely difficult, if not impossible, for single airlines to get away with fare hikes. Customers' collective shifting choices can force airlines to drop prices back to competitive levels and reverse attempts to raise prices. At the same time, however, each individual customer has little power to negotiate price with any one airline. All this is due to the competitiveness of airline industry.

Threat of New Entrants

There are significant barriers to entry in the Airline Industry, including but not limited to fixed investment, a complexity of operations, and regulations. Entry requires substantial capital expenditure and investment, being that the Airline industry is highly tangible due in large part to costly aircrafts and infrastructure. Furthermore, operating an airline requires significant government certification. Even for eligible players, entry is not a particularly appealing option - most airlines have been performing poorly in terms of profitability.[5]

[5] Division, "Airline Operations and Traffic - The 2012 Statistical Abstract - U.S. Census Bureau."

Also, ports at major airports are scarce resources that are often locked into long-term contracts with existing airlines. Exit from the industry can also present challenges. It is often hard to resell the planes at market value. In addition, airlines usually commit to long-term leases with airports and aircraft manufacturers, and terminating contracts early can be extremely costly. Given the analysis above, threat of new entrants within the Airline Industry is relatively low.

Threat of Substitutes

Substitutes for using commercial air travel include but are not limited to driving, trains, video/audio-conferencing technology, and private jets. The closest substitutes to air travel would be driving and riding express trains to reach a destination. The development of video-conferencing technology such as Skype has reduced business demand for travel. Rather than taking a 6-hour flight from New York City to Los Angeles, businessmen can simply turn on their computer and have a virtual face-to-face conversation with clients. Improved video-conferencing technology could further decrease in business air travel. Lastly, for wealthy individuals, flying private jets remains an attractive option; Airlines can expect to lose many of their high net worth customers to this more luxurious alternative.

SWOT Analysis

Strengths	**Weaknesses**
• Services and quality of flights • Young, stylish brand • Stable Route Network • Low-Cost Operating Structure	• Cumulative losses • Market share in terms of capacity by carrier • Airline network • Limited Fleet size (53)
Opportunities • Positive brand awareness allows it to capitalize on its fan base. • International Market • More market opportunities	**Threats** • Airline Network • Fuel Cost • Security concerns • Availability of Assets

Strength:

Services and quality of flights are among the best in the U.S:

Virgin America is the highest-quality major airline in the United States, according to the 2013 Airline Quality Rating report, an annual study of airline performance.[6] According to CAPA's Fleet Database, Virgin has the most modern aircraft in the US industry, along with Spirit. Its all-leased, all-A320 family has an average fleet age of 5.5 years, and in contrast to airlines with multiple aircraft types, Virgin America's product offering is identical on every Airbus 320-family aircraft, allowing for the same enhanced travel experience on every flight.

[6] "Virgin America Named Top U.S. Carrier for 3rd Year in a Row."

The young, stylish brand:

Virgin America's stylish aircraft interior design, avid embrace of in-flight technology and young, energetic staff account for much of its popularity. It builds a passionate fan base, which is rarely seen in the airline industry. Its freshly designed safety video, presented entirely in music and dance, got over 10 million views in YouTube.[7]

Stable Route Network:

The majority of Virgin America's routes have remained intact, where the 6.3 million passengers travelling to and from LAX and SFO represented 45% and 53% of Virgin America's total passengers. It did have short-lived service from Los Angeles and San Francisco to Toronto that ended in 2011, though, and both routes were cancelled less than a year after launch. Furthermore as Virgin America starts to fly from San Francisco to Hawaii at the beginning of November, its route network will further stabilize and continue to increase in size.[8]

Low-Cost Operating Structure:

Key components of a low cost structure include modern, fuel-efficient single-aircraft fleet, high aircraft utilization, point-to-point operations, and a productive and engaged workforce. Components, all of which Virgin America prides itself in. If, Virgin America is committed to maintaining this disciplined cost structure it will continue to improve its competitive cost position in future years as the company grows and further leverages its existing infrastructure.

Weakness:

Cumulative losses:

Virgin America had been unprofitable in 2009 through 2012. Since 2007, Virgin America has recorded a net loss of $671.3 million and an operating loss of $447.3 million. Though net cash provided by operating activities as of September 30, 2014 was brought to positive, 34.6M dollars, it still needs to demonstrate that the positive profit it gained is not simply a short term aberration.

[7] "Corporate Fact Sheet - About."
[8] "Virgin America Announces Flights to Hawaii."

Little market share in terms of capacity by carrier:
3% of the capacity in LAX and 5% of the capacity in SFO are carried by Virgin. However, United and American Airline carry twice as much capacity in those places. In general, Virgin America is not ceasing a great portion of the airline market and must find a way to increase its share if the Virgin America is to be successful in the future.

Airline network:
Compared to United or American, Virgin has a much narrower airline network. Although, Virgin America's network is stable there is a great need for Virgin America to expand its routes. By expanding, domestically and internally it could achieve a desire market share and increase its profits. In essence, Virgin America has a limited airline network that must be expanded.

Opportunities:

Virgin's positive brand awareness:
By capitalizing the Virgin brand, Virgin America can save its promotional costs and retain its customers more effectively compared to its competitors. The positive brand awareness enables Virgin to differentiate its products, so that it will no longer count purely on price competition.

International Market:
Virgin has a well-connected network in SFO and LAX, but doesn't offer many international flights. However the high quality service that Virgin has as well as its young and energetic brand will be attractive to international visitors as well. Therefore, Virgin should partner with airlines of other countries to develop international routes that can provide the same "Virgin" experience.

More market opportunities:
US tourism spending on passenger air transportation, an indicator of airline revenues, increased 3.7 percent in the third quarter of 2014 compared to the same period in 2013, according to Hoover. As virgin America begins to fly into destination such as Honolulu and the island of Maui at the end of this year, Virgin America will possibly see another source of revenue stream.

Threats:

Airline Network:

Other airlines belong to much larger airline networks such as Sky Team or Star Alliance, which include more international airlines. Compared to its competitors, Virgin only has a network of 5 partner airlines. The limitations of Virgin America's airline network are a detrimental factor that must be tackled, if Virgin America is to be a successful competitor in the airline industry. However, the FAA, DOT, and TSA impose various fees on the industry, and can interfere with airline operations. To expand operations, airlines need to get route permission from DOT and gates from local airports.

Fuel cost:

Virgin America has been and in the future may be adversely affected by the price and availability of aircraft fuel. Aircraft fuel is the number one expense for Virgin America. High fuel costs and increases in fuel prices or a shortage or disruption in the supply of aircraft fuel would have a material adverse effect on Virgin.

Security concerns:

Threatened or actual terrorist attacks or security concerns involving airlines could adversely affect business for Virgin America. Past terrorist attacks against airlines have caused substantial revenue losses and increased security costs. Therefore, any actual or threatened terrorist attack or security breach, even if not directly against Virgin America, could negatively impact Virgin by weakening the demand for air travel and resulting in increased safety and security costs for Virgin America and the airline industry in general.[9]

Availability for Airbus to deliver the A320 neo without delays:

Airbus is still in the final production/testing stages for the A320neo.[10] Issues may be revealed that could result in groundings of the A320neos. Production issues may arise and result in a delay in the delivery of the new aircraft, delaying Virgin's ability to grow and expand.

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[9] "TSA Pre✓® Airlines & Airports."

[10] "A320 Aircraft: Setting The Single-Aisle standards"

Strategic Recommendations

Expansion:

It is of great importance for Virgin America to grow its routes along with its fleet. Looking ahead, Virgin's expansion plans calls for investment that capitalizes on the single-aisle aircrafts with low operating costs and fuel-efficiency. Because of high fuel costs, newer planes and engines are designed to be as efficient as possible. Airlines are eager to replace older gas-guzzlers with new fuel-efficient planes, and aircraft companies are competing to manufacture the most fuel-efficient models. Airbus, supplier to Virgin, is developing the A320neo, which is expected to be 15 % more efficient than its predecessors, while planes from Boeing's upcoming 737MAX series are said to be 13 % more efficient than the best single-aisle aircraft available.

Furthermore, air traffic in emerging economies is growing rapidly and providing new revenue opportunities for airlines. Markets in Asia, the Middle East, Africa, and Latin America have experienced much higher growth rates than established economies in North America and Europe in recent years. Due to air service agreements and government regulations that limit foreign airlines from carrying passengers beyond international gateway cities, carriers typically form international joint ventures and alliances to facilitate the exchange of passengers between route networks.

It is vital that Virgin America invest on new fuel-efficient planes as it expands. Along with taking advantage of more fuel- efficient planes, Virgin America should consider the growing international consumer base as it expands.

Quality of service:

It is essential that the Virgin America maintains its quality of service as it expands and seeks to carve a niche in the crowded US air travel market. Virgin should continue to focus extra attention and resources on their customers, now more than ever before. Success for Virgin America will require extra effort on the part of management in order to secure brand equity and customer loyalty. As a low-cost carrier it must continue to compete with the pricing schedules of low-cost competitors and it must rely on the quality of its services to impress passengers as well.

Focus on Marketing:

Its service isn’t drastically different from that of competitors (JetBlue), so Virgin America needs to make customer’s believe it is through marketing. Travelers who are price sensitive often choose an airline because it offers the lowest price. However, some travelers will develop brand loyalty and choose flights where price may not be the foremost factor. Virgin America needs to capture these travelers by getting them onto planes through marketing, and keeping them as return customers through quality of service and brand loyalty.

Financial Performance:

Virgin must continue to improve its financial performance. After posting net losses of $100 million in 2011 and $145 million in 2012, Virgin America generated $10 million in profits for 2013. Its revenues climbed 7% from $1.3 billion in 2012 to $1.4 billion in 2013. Along with improvements to its financial well-being, the company must try to cease a greater share of the airline industry market.