CULTURAL SHIFT AT CHC HELICOPTER CORPORATION: CHALLENGES AND OPPORTUNITIES IN AN ERA OF RADICAL CHANGE

by

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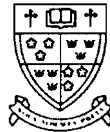

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ABSTRACT

CHC has thrived in an environment of change since inception in 1987. Changes that took place in 2005 and 2006, however, were far broader. In 2005-2006, CHC's organizational structure changed, helicopter technology advanced, customer attitudes shifted and corporate strategy changed. Additionally, CHC founder, controlling shareholder and Executive Chairman Craig L. Dobbin died.

These changes were taxing for CHC's senior management team, which shrank over the 2005-2006 period but successfully managed most major change issues. CHC's long-term position in the helicopter services industry remains strong.

In the short term, challenges remain. Cultural change within CHC has not been addressed. This project examines how recent changes impact the short term and long-term strength of CHC and how ongoing cultural change may affect the company's performance. It recommends that additional resources be added to the senior executive team to address short-term challenges such as cash flow, employee retention and recruitment.

Keywords: CHC; helicopter; management; culture; change.

Subject Terms: organizational transformation; workplace cultural change; restructuring; employee attitudes

EXECUTIVE SUMMARY

CHC is the world's largest helicopter services company, with $1.15 billion in annual revenue and more than $1 billion in market capital (as at April 30, 2007). CHC boasts the largest combined volume of helicopter transportation, leasing and support services performed on an annual basis. The company's principal business is helicopter transportation in support of the offshore oil and gas industry. CHC is the leading provider of helicopter services to that sector, providing regular offshore transportation services to approximately 500 offshore platforms, rigs, installations and ships worldwide. CHC is also a leader in helicopter search and rescue and emergency medical services, providing a complete range of services to national and regional governments and to oil and gas companies worldwide.

The company employs 3,814 and owns or operates 255 aircraft in 35 countries. CHC has grown rapidly since inception in 1987, largely through major acquisitions financed by bank debt, equity, bonds, sale-leasebacks of aircraft and strategic divestitures. The company has been rapidly growing its revenues every year since 1998. Earnings matched revenue growth until 2005, but since that time earnings have remained flat.

Until 2004, CHC divisions were run as quasi-independent companies. In September 2004 CHC embarked upon a major restructuring initiative, called Good-to-Great, or G2G, which united the flight operations divisions and created a

central helicopter support and asset-ownership company, called Heli-One. The goal of the restructuring initiative was to achieve significant operations savings, increase purchasing power, reduce borrowing costs and improve the overall skill and knowledge base in order to create an industry leader with significant competitive advantages.

The restructuring initiative did not achieve these goals. It has not been called a failure, however, because so many *additional* changes – both internal and external – occurred simultaneously, that a true measure of the impact of restructuring was not possible. Among those simultaneous changes are:

- A major increase in demand for services;
- The rapid, unprecedented introduction of advanced new helicopter types;
- Tremendous process controls change brought about by U.S. Sarbanes Oxley legislation;
- A radical change in the way CHC grew the business;
- The departure of key executives.

With so many changes occurring, the restructuring initiative was simply taken off the table. But the impact was monumental for support and administrative staff. Restructuring changed the way CHC did business. It changed the way all employees interacted with each other and with customers. Hundreds of employees were moved across the country or around the world. Hundreds of job descriptions changed, compensation incentives changed. For

most employees, the restructuring represented a major cultural change in their work environment. Yet nowhere in Company documents is the 2004-2005 restructuring initiative recorded as a major event in company's history.

CHC's history, business strength and culture was largely entrepreneurial and tactical from 1987 to 2005. In order to take full advantage of the opportunities created through the 2004 restructuring initiative CHC must acknowledge the strengths and attributes that allowed it to become world leader in the first place, review its new structure to determine if these strengths and attributes are threatened and take action to ensure these issues are addressed. Of particular interest to this project are the changes that have occurred at the senior executive level and how well these changes reflect the new challenges facing CHC and the cultural change that is taking place and will continue to take place.

The paper provides an analysis of CHC's management strategy with respect to continued expansion in a changing cultural environment. It recommendations adding additional resources to the small, heavily taxed senior executive team. The preference would be to add highly experienced executives from outside the company, even outside the industry. The new executives should also be capable at managing corporate cultural change.

Changing business conditions are also reviewed and growth forecasts are studied to verify that the long-term growth strategy, particularly in the offshore oil and gas sector, is viable. The paper concludes that CHC's current position and

growth prospects in the helicopter services industry are highly attractive, but that cultural changes represent a threat to opportunities.

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This paper owes a great debt of gratitude to all at CHC head office, most importantly to Craig Dobbin, an inspiration to so many and a great mentor to more 3500 employees around the world. Craig Dobbin provided the support necessary for this project, and made the decisions that made its writing possible. The amazing corporation that is CHC simply would not exist without the vision and the powers of persuasion of Craig Dobbin.

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GLOSSARY

AW139	AgustaWestland 139, a modern, twin-engine helicopter capable of transporting up to 13 passengers, used primarily to transport offshore workers.
BHS	Brazilian Helicopter Services, based in Rio de Janeiro. CHC acquired an equity stake in BIH in 2007.
BIH	British International Helicopters, also 'Brintel,' CHC's first European acquisition, in 1994. Name changed to CHC Scotia in 2000.
Bond Helicopters	Independent UK-based offshore helicopter services company, acquired by HSG in 1997 and subsequently acquired by CHC as part of 1999 HSG acquisition.
Brintel	*See BIH*
Bristow	Formally Bristow Helicopter Group, and formerly Offshore Logistics (OLOG), CHC's a US-based international helicopter services company, and CHC's chief rival
CAPEX	Capital Expenditure
EMS	Emergency Medical Services.
EO	European Operations, one of two CHC Helicopter Corporation flying divisions.
EC225	Eurocopter 225, a large twin-engine helicopter capable of carrying 20 passengers. This new helicopter type was introduced in 2007.
G2G	'Good-to-Great,' a major corporate restructuring initiative launched by CHC in 2004.
GO	Global Operations, one of two CHC Helicopter Corporation flying divisions.
Heli-One	CHC's helicopter support division, created in 2004.
H1	Heli-One.
HSG	Helicopter Services Group, Norway-based international helicopter services company acquired by CHC in 1999
IPO	Initial Public Offering.
Mbl	Millions of barrels of oil.

MCA	Maritime Coastguard Agency, the UK government agency involved in the privatization of the UK coastguard helicopter service.
MHS	Malaysian Helicopter Services, a Heli-One customer
MultiFabs	Formerly a division of CHC, maker of cold-water survival equipment, name changed to Survival-One in 2005, sold in 2007.
NOK	Norwegian kroner.
OEM	Original equipment manufacturer.
Okanagan Helicopters	Founded in 1947, Canada's largest helicopter services company until its purchase by CHC in 1987.
OLOG	US-based international helicopter services company and CHC's chief rival; name changed to Bristow Helicopter Group in 2006.
OPEX	Operating expenditure.
PHI	Petroleum Helicopters Inc., a US-based helicopter services company
R&O	Repair and Overhaul, regular maintenance procedures for helicopter components
S&P TSX index	Standard and Poor's index, a ranking of Canada's top companies trading on the Toronto Stock Exchange
SAR	Search and Rescue
Sarbanes Oxley	The Sarbanes Oxley (SOX) Act of 2002 was signed into law in the United States July 30, 2002. The act established strict new financial reporting and auditing policies for companies with dealings in the US.
Sealand	Sealand Helicopters, a small, Newfoundland-based offshore helicopter services company founded by Craig Dobbin in 1977, became CHC in 1987
SOX	See Sarbanes Oxley.
Toronto Helicopters	Small helicopter services company, acquired by CHC in 1987.

1 INTRODUCTION – A BRIEF HISTORY OF CHC

The purpose of this project is to demonstrate that CHC Helicopter Corporation has undergone a fundamental cultural and structural change while at the same time managing unprecedented change in its business environment. These changes have placed a tremendous strain on the small senior executive team. This additional strain, combined with an unresolved restructuring initiative, could weaken CHC at a time when changing market conditions provide tremendous opportunities for continued growth.

CHC was created in 1987 through the purchase of Okanagan Helicopters and Toronto Helicopters – financed through an initial public offering on the Toronto Stock Exchange – and their merger with Sealand Helicopters, a Newfoundland-based helicopter company started by St. John's entrepreneur Craig L. Dobbin. The deal, like many to come, was orchestrated by Dobbin. For the most part the CHC story is a story of Dobbin's acquisitions.

CHC's major acquisitions include: Vancouver-based Okanagan Helicopters in 1987, British International Helicopters in 1993-94; Helicopter Services Group in 1999 (which included Helikopter Services of Stavanger, Norway, Bond Helicopters of Aberdeen, Scotland, Lloyd Helicopters of Australia and Court Helicopters of South Africa); Schreiner Aviation Group in 2004; a stake in Brazilian Helicopter Services in 2006; and Heli-Dyne of Texas later in 2006. In addition to strategic acquisitions CHC has expanded its operations in each

market it has entered and has disposed of several non-core assets to help finance further growth.

After the Helicopter Services Group acquisition in 1999, CHC began integrating its global operations around the world under one banner, and in 2000 became the first helicopter services company to market global operations under one brand, although divisions were still largely independently managed.

CHC created several new companies in its history including Vector Aerospace, a helicopter repair and overhaul (R&O) division which in 1998 was sold through a $300 million IPO on the Toronto Stock Exchange. Other companies created by CHC include CHC Composites, a small aerospace components manufacturer in Gander, Canada; Canadian Helicopters, which was sold to a management-led group for $130 million in 2000; Survival-One, a supplier of cold water survival suits sold in 2007 and; Heli-One, the world's leading R&O centre for the civilian offshore helicopter market, which remains a strategic division within the CHC Group and owns all of CHC's helicopter assets, which it leases to the flying divisions at a fixed rate.

CHC is the most geographically diverse helicopter company in the world, and largest by annual revenue. It has one major rival of equivalent size, US-based Bristow Helicopters Group, formerly OLOG (Offshore Logistics), which has slightly lower annual revenue (as of 2006) but a larger fleet of helicopters and a stronger balance sheet, which will be discussed later. Both CHC and Bristow are heavily dependent on the offshore oil and gas industry. Approximately 70 percent of CHC's business involves providing helicopter support to the oil and gas

industry using medium and heavy aircraft such as the Super Puma MKII, Sikorsky S-76C+ and the new Sikorsky S-92. Most of this support involves the transportation of crews to offshore facilities. The remaining 30 percent of revenue is made up of helicopter leasing, search and rescue (SAR) and emergency medical (EMS) services, repair and overhaul, training and ad hoc helicopter services.

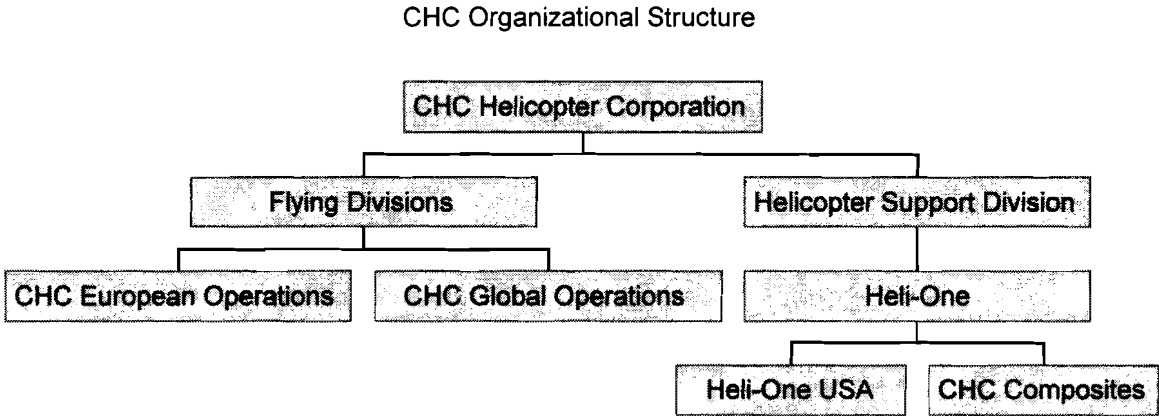
Bristow and CHC provide an interesting comparative study. While CHC was restructuring under G2G in 2005 Bristow faced its own demons. Then called OLOG, the company was under investigation for alleged corrupt practices in foreign jurisdictions by US securities regulators. It then failed its first Sarbanes Oxley audit. Ultimately, OLOG replaced its entire senior executive and changed the company name. Soon after, it drastically improved its financial disclosure. At one time in 2005, CHC and OLOG had nearly identical share prices, (though the former was overvalued and the latter undervalued). By 2007, Bristow was nearly double CHC's share price.

Bristow trades on the New York Stock Exchange under the symbol BRS. CHC Helicopter Corporation trades on the Toronto Stock Exchange (TSX) under the symbols FLY.A and FLY.B; and on NYSE under the symbol FLI. Market capitalization for the Company ranged from $1.03 billion to $1.35 billion in the first seven months of 2007.

1.1 CHC Structure

In 2005 CHC brought all helicopter operations under two divisional structures, European and Global Operations, and created a new helicopter support division, Heli-One, to support the CHC fleet and third-party operators (see Figure 1). Under this structure the flying divisions, European Operations and Global Operations do not own the helicopters. The support division, Heli-One, owns all the assets and leases helicopters to the flying divisions at a discounted market rate set by the corporate head office.

Figure 1 – CHC Organizational Structure



Source: CHC Investor Presentation, Q3, 2007

1.1.1 Global Operations

Under the Global Operations structure, CHC has combined helicopter operations in Africa, Asia, Australia and the Americas. This new division is led by Ms. Christine Baird, who has been with the company for 25 years, most recently serving as President of CHC Helicopters International. Ms. Baird traditionally led her division with a very personable hands-on style, meeting with all employees regularly and visiting customers often. The restructuring made this difficult, if not impossible, by tripling the number of staff and customers. The creation of the

Heli-One support division also created a third group for Ms. Baird to deal with, the internal supplier.

1.1.2 European Operations

In early 2005 CHC completed the restructuring of its North Sea and European helicopter operations, bringing operations from five European countries under one management structure, CHC European Operations. During that year, CHC appointed Mr. Keith Mullett as Managing Director, CHC European Operations. Mr. Mullett has served the Company for seven years, previously as Director, Financial Services, CHC Europe. Mr. Mullett's arrival was challenging for the 1,200 employees in Europe. He faced a group that was fiercely proud if its independence in the Norwegian operation, formerly Helikopter Service AS.

1.1.3 Heli-One Helicopter Support Division

Combining all of CHC's internal support functions and workshops, as well as CHC Composites and recent acquisitions AeroTurbine Support Ltd (2005) and Heli-Dyne (2006), Heli-One provides helicopter leasing and helicopter support services to civilian and military helicopter operators worldwide. These support services include integrated logistics, engineering and design, base maintenance, safety equipment, inventory management, parts supply, and repair and overhaul services for engines and components. Heli-One is led by Mr. Neil Calvert, who began his career as a helicopter engineer and has served the Company for more than 20 years, most recently as Managing Director, European Operations. Mr. Calvert's employees came from existing repair and overhaul (R&O) shops, from

other R&O companies, and were reclassified from the old flying divisions, often begrudgingly.

1.1.4 Corporate Head Office

The real power at CHC Helicopter Corporation is wielded at the corporate head office in Vancouver. From 1987 until his death in 2006, Craig L. Dobbin was the controlling shareholder of the company. He served variously as president, chief executive officer, chairman, executive chairman or combinations of these roles. Only once during his tenure did he ever step back from the major decision-making process and that was for a brief period in 1997 when he underwent a lifesaving lung transplant operation. Upon recovering, he said he would never give up control again.

The second-most powerful individual in the company is Sylvain Allard, a 25-year veteran and former pilot at CHC, currently serving as president and chief executive officer. Allard runs the company with relative newcomer Rick Davis, senior vice-president and chief financial officer. Throughout the company's major acquisition and disposition era, however, the CFO post was held by Jo Mark Zurel, a top-ranked chartered accountant, whose abrupt departure in 2006 would further complicate the company's transformation.

CHC is in a business in which highly complex, multi-million dollar flying assets play a critical role for every dollar of revenue earned. However, it is the character and skill of the individuals running the company and the interactions between those individuals that have shaped CHC and helped it to become a

world leader. Technological innovation and market conditions have evolved, particularly in the last few years, but historically have played smaller roles in the CHC story.

1.1.4.1 Driving Growth

In the exciting, tumultuous, rapid growth phase from 1997 to 2005 CHC's market capital increased 20-fold. The fleet changed from mostly small onshore helicopters to almost exclusively heavy, twin-engine offshore machines. Revenues quadrupled. The shareholder base switched from predominantly wealthy individuals to major institutions. The number of countries in which CHC operated doubled. Change was a way of life for CHC employees but there had been predictability to the change. New companies were bought and given their mandate: make money.

In 2005 the scope of change accelerated. A major technological shift occurred as a new generation of aircraft was introduced, buoyed by rising oil prices and oil companies' willingness to invest in new technology. Corporate governance practices intensified as Enron and WorldCom fell and subsequent US Sarbanes Oxley legislation came into law. Most significantly, CHC transformed from a group of independently run enterprises into a centrally managed global corporation.

Throughout all of these changes, the CHC senior executive team and the corporate *modus operandi* changed very little. Remarkably, a small group of individuals operating without outside influence brought CHC from its humble beginnings to its position as global leader in a completely new business

environment, under a completely new corporate structure. This paper examines the characters and corporate structure as well as the market conditions and business environment that define the CHC change story. It explores whether they remain a good fit as the company enters its next phase of more mature growth.

2 EXPANSION: THE PRIMARY DRIVER OF CHANGE

2.1 Targeting the Prey

On a cold April day in St. John's, Newfoundland, in 1999, CHC Chairman and Controlling Shareholder Craig Dobbin met with his longest-serving employee, President Sylvain Allard, and longest-serving CFO, Jo Mark Zurel (who earned the CFO longevity record after just two years in the job). They met to discuss plans to rebuild a moribund CHC. Craig Dobbin and his senior executives were doing what they had always done: quietly planning a merger that would reshape the entire company. By 1999, major upheaval had become a constant at CHC whenever times were tough.

CHC was suffering from low prices and lost contracts. This time, the resurgence was to be fuelled by consolidation of the helicopter services industry in the North Sea, the world's most important offshore oil and gas market, where three suppliers were involved in a bidding war. CHC Helicopter Corporation, Offshore Logistics (OLOG) of the U.S. (which changed its name to Bristow Helicopters in 2006) and Helicopter Services Group (HSG) of Norway had little power. The three were bidding contracts at low rates simply to keep their expensive assets flying. As Craig Dobbin told a magazine reporter after he made a bid for a major competitor two months later, that three operators in the North Sea was simply too many. The major oil and gas companies were playing the suppliers against each other quite effectively.

"The three of us have been eating each other's lunch," Dobbin said at the time. "There's just not room for three, and that's been recognized by the oil patch." [i]

The oil patch may have recognized it, and industry analysts certainly recognized it, but the UK Competition Commission had only a few years earlier rejected a proposed merger of two UK operators.[ii] Ignoring precedent as he always had, Craig Dobbin initially had his key executives examine the merits of a debt-financed acquisition of Aberdeen-based Bond Helicopters. Bond was a subsidiary of Norway's HSG, and was the newest operator on the UK side of the North Sea. Even though oil prices were below $10 a barrel and HSG's share price had tumbled from 90 NOK to 30 NOK in 1998[iii] (and was still falling in 1999). Dobbin and his executive team deemed it unlikely the Oslo-based North Sea leader would willingly sell its money-losing UK subsidiary to an aggressive Canadian upstart. HSG demonstrated bitterness toward CHC in 1996 when CEO Lars Harlem claimed the two companies were not on level playing field,. He pointied out that national airline licensing regulations allowed a North American operator to acquire a European subsidiary, but prevented Europeans from acquiring North Americans. "Unfair competition is the result," Harlem stated.[iv]

Despite the apparent injustice and the Competition Commission objection, Dobbin kept working toward consolidation – regardless of the risk. Dobbin realized that Harlem was not likely to sell Bond, but quickly recognized an ever better opportunity – a hostile takeover of the entire HSG group. It was the mouse eating the cat. HSG's 1998 revenue was $580 million. CHC's revenue for the

fiscal year ending April 30 1999 was just $242 million. HSG was the biggest player in the North Sea and had major subsidiaries in Australia and Africa. CHC's European subsidiary was weak and its international operations small. It would be a massively leveraged takeover – pushing CHC's debt above $600 million and debt-to-equity ratio above 6:1. Furthermore, aggressive debt reduction requirements, in the form of warrants, would result in CHC giving its lenders a 10 percent stake in the company if debt ratios were not significantly reduced within a year[v]. In other words Dobbin was gambling the company. The idea of taking over HSG offered Dobbin an opportunity to act on the three principles that he consistently quoted in his business speeches and letters:

- Turn adversity into opportunity.
- Don't take no for an answer.
- Time is the enemy.[vi]

The adversity in this case was the near certainty that a deal to acquire Bond Helicopters could not succeed. The answer "No" was the precedent set by the UK Competition Commission when it denied a nearly identical merger attempt in the helicopter services sector. The race against time was the inevitable rise in share price that occurs when a market gets wind of a pending takeover. Dobbin wasted not a single day and began acquiring HSG shares and launching a takeover bid immediately.

Understanding the HSG takeover story is critical to understanding CHC culture as well as its strengths and weaknesses. The 1999 takeover story

provides valuable insight for an analysis of CHC's corporate culture and growth strategy in 2007. In 1999 CHC's core culture was entrepreneurial. Its core strengths included flexibility, corporate due diligence, mergers, acquisitions, negotiations and an ability to take action. Understanding the acquisition – and CHC's remarkable acquisition strategy – also helps reveal weaknesses in CHC's corporate and management structure.

2.2 The Deal that Changed the (helicopter services) World

Norwegian securities laws allowed investors to acquire up to 20 percent of a company before making their intentions – and their actions – publicly known. (Canadian and U.S. laws require full disclosure at 10 percent ownership.) With HSG shares wallowing at all-time lows in the spring of 1999, and oil prices below $10 a barrel, CHC was able to set up a Norwegian shell company and quietly acquire more than 19 percent of its major competitor to become the largest single shareholder. To get the remaining 81 percent, Dobbin, Allard and Zurel immediately flew to Norway to meet with institutional investors to convince them to part with their shares at an all-time low price. To achieve this, Dobbin had to convince HSG investors that he would win a price war in the North Sea. In other words he had to convince HSG shareholders that he was willing to suffer in the short term – and make them suffer even more – in order to win in the long term.

Dobbin was well known as a hardened negotiator. He had the tools and the bravado to go further than his opposition. Dobbin had total control of CHC through a multi-vote share structure he had created years earlier. Dobbin owned approximately 95 percent of the company's B shares, which carry 10 votes each.

A class shares receive one vote each. With 23 percent of the equity, Dobbin controlled more than 60 percent of the vote. No one could gain control of the company without his personal agreement. HSG, on the other hand, was widely held, with a more equitable one-vote-per-share structure. No institution held more than 10 per cent. Norwegian law, however, required that European nationals control the company, a requirement consistent throughout Europe. On the surface it appeared a Canadian company, under the control of a Canadian citizen who was most unwilling to relinquish that control, could not possibly succeed in a takeover bid. Dobbin, however, had faced this dilemma before.

In 1994 when Dobbin made a bid for British International Helicopters Ltd., he was told by transport regulators that majority ownership had to be European. Remarkably, Dobbin found a way to acquire honorary Irish citizenship, through a passport-for-cash-investment deal. (CHC endowed a chair for $1 million at University College in Dublin.) His citizenship, combined with CHC's dual-vote share structure and a unique loan that gave Dobbin a new block of ordinary shares, allowed CHC to meet European ownership requirements.

CHC eventually acquired all share in HSG for approximately $562 million, including outstanding debt. "I should tell you we made a hell of a buy," Dobbin said in an interview soon after the acquisition. "We got it at a good price and we got a good company. Nobody buys a company for below book value. We got it below."[vii]

2.2.1 Post-acquisition Strategy

The senior executive team at CHC performed due diligence, negotiated the deal, arranged incredibly leveraged financing and met stringent regulatory requirements all within a few months. But they had much more work to do, namely convince the UK Competition Commission to allow the takeover and quickly find buyers for HSG's non-core assets in order to prevent the triggering of warrants that would significantly dilute CHC stock. Completing so many challenging tasks at once meant CHC's new divisions had to run relatively autonomously. However divisions were given significantly increased earnings targets while the executive team concentrated on the divestiture exercise. CHC hired its No. 1 legal counsel, Noel Clarke, as full time Senior Vice President and Corporate Secretary.

Clarke orchestrated the sale of three major non-core subsidiaries at healthy prices. Even the company's brand name flagship, Canadian Helicopters Limited, was sold to reduce debt and eliminate lower-margin, higher-risk onshore operations. The Company also quickly sold 12 aircraft, several of which were leased back into the fleet, a strategic leverage move that allowed CHC to effectively keep debt off the balance sheet and meet the debt-reduction targets established by its lenders. These sale-leasebacks would become a significant source of cash and off-balance-sheet financing in the years to come.

The end result of the HSG acquisition and subsequent divestitures was the successful creation of the world's largest offshore helicopter services company. CHC shares would rise from less than $2 in 1999 to a high of $30 in

2004 (prices reflect 2004 2-for-1 spilt). Market capital increased from $45 million to more than $1 billion. For a time, CHC owned the best five-year total return rate on the TSX S&P index.[viii] CHC benefited not only from a huge increase in offshore activity fuelled by higher oil prices, but also from a rising US dollar. CHC's international customers paid in US dollars, while a majority of its international wage expense and much of it borrowing costs were in Canadian dollars. The foreign exchange rate boon would not last, however.

For many industry observers, and for many at CHC, the HSG acquisition is seen as the most important turning point in CHC history – the most significant change. While the acquisition did change the look of the company and more than doubled the company's size, it represented a continuation of Craig Dobbin's management style. After HSG, staff at head office could expect more of the same, and staff at the new divisions saw few changes in their reporting structure and in the way they carried out business.

2.3 Operations Woes and Acquisition as Solution

Despite the tremendous success up to and immediately after the HSG acquisition, the Company had not had to demonstrate a great deal of hands-on operations management expertise. While the purpose of this paper is not to evaluate management's operational performance, it is worth highlighting three specific business stories that demonstrate the company's vulnerability and management's ability to weather adversity through expansion:

2.3.1 Adversity 1: The Fall and Rise of Sealand

In the summer of 1987 offshore exploration on Canada's East Coast halted, virtually bankrupting Dobbin's first helicopter company, Sealand Helicopters. Sealand managers, along with Dobbin's son Mark, who was 26 at the time and Sealand's international marketing manager, tried to convince the senior Dobbin to cut costs and streamline operations in order to survive. Instead, Dobbin opted to try to grow, making a bid for Okanagan Helicopters Ltd. "It was one of the largest (helicopter service companies) in the world, and we were an insolvent Newfoundland company," Mark Dobbin said. "I can remember being in Dad's office and forcefully arguing that this was lunacy." But Dobbin went ahead and made a $28-million offer for the company, conditional on financing few people thought he could arrange. He raised $44 million through a public offering, giving the company some much-needed money as well. It was one of the last public offerings on the Toronto Stock Exchange before the crash of 1987.[ix]

2.3.2 Adversity 2: United Nations Pulls the Rug Out

In 1994 CHC's International division was awarded a multi-year contract by the United Nations for 42 small and medium helicopters. The division devoted much of its resources to acquiring the aircraft and training crew. Soon after the contract was awarded, the UN abruptly cancelled all but five helicopters, with just 30 days notice, a standard term under most commercial helicopter contracts, but one never previously, nor subsequently, imposed on CHC. CHC's financial year was saved by the acquisition that year of UK subsidiary BIH, which added $72.3 million to CHC's fiscal 2005 revenue.[x]

2.3.3 Adversity 3: Losing the Shell Game

In June 1998 Shell UK declined to renew or extend a major contract with CHC's BIH subsidiary. The loss in annual revenue was $52 million, representing approximately 50 percent of the European division's 1998 revenue and more than 20 percent of the company's total annual revenue.[xi] The loss would have been devastating to CHC's financial results were it not for the 1998 spin-off of a Repair and Overhaul company, Vector Aerospace, in a $306 million IPO that gave CHC the capital required to spearhead the HSG acquisition.

These three crises represent the three greatest challenges to CHC management in its 30-year history. In each case disaster was averted through a timely acquisition. By 2004, however, the helicopter services industry had reached a high degree of consolidation. There simply were no large helicopter services companies left to buy. The ultimate acquisition would be CHC buying Bristow, or Bristow buying CHC. But such an acquisition faced three obstacles:

1. Fair competition regulators in the US and UK would almost certainly take a more critical look at the creation of such a monopoly;
2. Oil and gas companies would likely consider starting their own helicopter support operations to avoid relying on a monopolistic giant, and;
3. The financing required for such a takeover would be gargantuan.

. Still, the possibility could not be totally discounted, since unlikely acquisitions played such an important role in the history of CHC.

2.4 Summary of Acquisitions

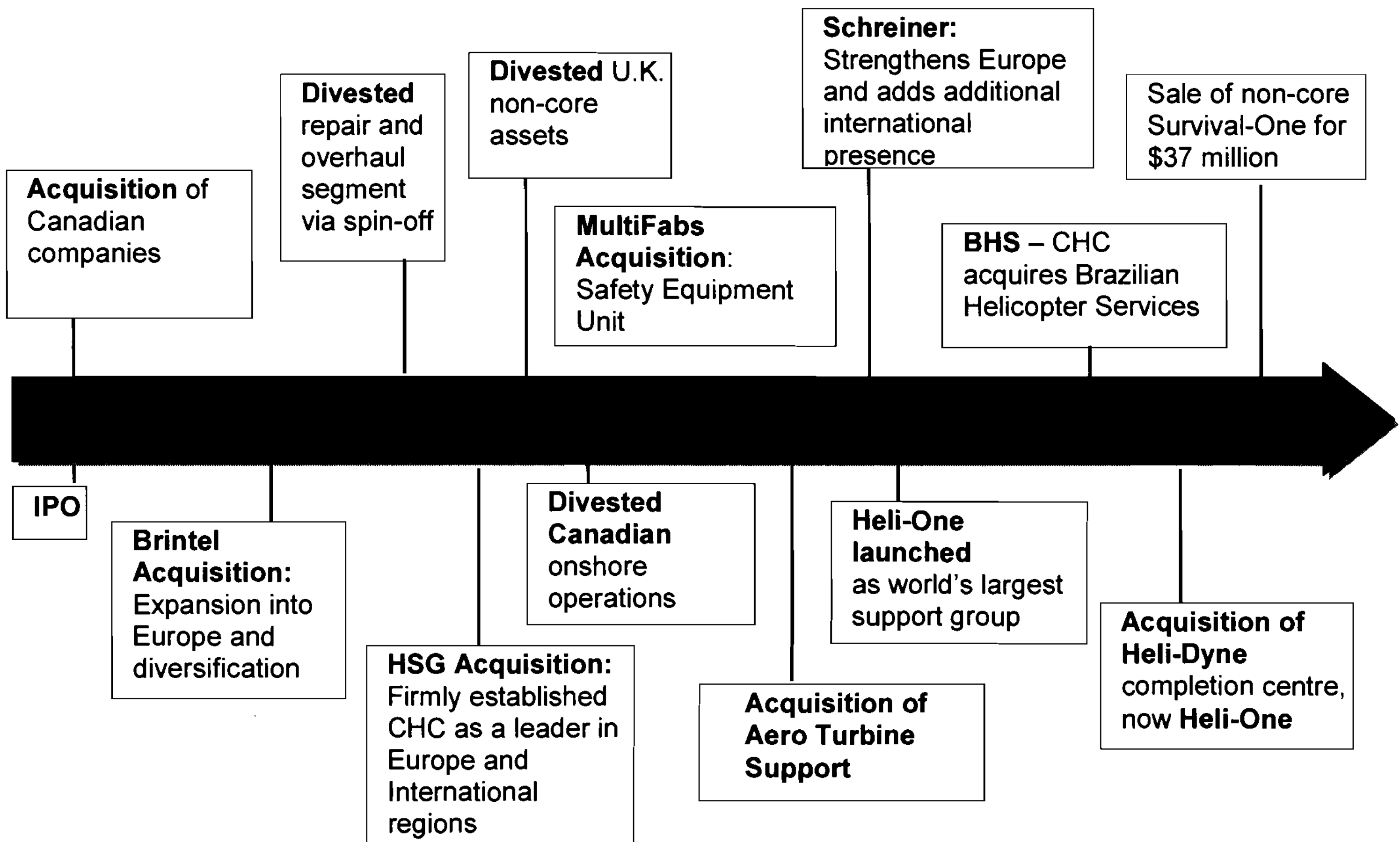
The company was founded and built almost entirely through acquisition (see Figure 2, page 19). In 1987 Craig Dobbin coordinated the TSE Initial Public Offering that merged his Sealand Helicopters with Canada's largest helicopter company, Okanagan, along with Toronto Helicopters and soon thereafter Ranger and Viking Helicopters. Industry observers suggested he would never complete the deal, but with the multi-vote share structure Mr. Dobbin not only pulled it off, he ended up with control of one of the world's major helicopter services companies and embarked upon his mission of consolidation. In 1994 he acquired British International, defying a regulatory requirement for European citizenship by obtaining an Irish passport. In 1999 he orchestrated the HSG acquisition as outlined above.

After the acquisition of HSG, several smaller acquisitions were made:

- Medium-size operator Schreiner Aviation in 2004 (45 aircraft);
- Brazilian Helicopter Services in 2006 (15 aircraft);
- Aero Turbine Services in 2004 (small engine overhaul facility);
- MultiFabs in 2005 (survival suit manufacturer) and;
- Heli-Dyne (US-based aircraft completion centre) in late 2006.

. In 2007 Multifabs was sold, raising much-needed cash (see Figure 2, page 19).

Figure 2 – CHC Timeline – Acquisition and Divestiture History



Source: CHC Investor Presentation, Fourth Quarter, 2007

2.5 Changing the Nature of Change

After the Schreiner acquisition, a change of an entirely different type took place. CHC underwent a major corporate transformation through a restructuring initiative called Good-to-Great. Through this process, CHC was transformed from a regionally managed group of companies, to a centrally managed corporation. In addition CHC embarked upon a period of strong *organic* growth as opposed to its previous history of growth through acquisition. As we shall see, this was the most significant structural and cultural change in the company's history.

The acquisition history is critically important for two reasons. First, it defined CHC's strategy, in terms of proactive growth initiatives and reactive defensive mechanisms, for almost 30 years. Second, it demonstrated that management's core strength was in mergers and acquisition, corporate analysis, and financing – more so than operations. For most of those 30 years, dating back to Craig Dobbin's founding of Sealand in 1977, the companies acquired operated with relatively minimal interference from head office. Flight operations were run from the regional offices. Aircraft acquisitions and maintenance contracts were, for the most part, handled regionally. This structure, though perhaps not as efficient as having one globally run enterprise, did allow the small senior executive team to concentrate on its true strength, mergers, acquisitions and corporation building. It also allowed the divisions to retain their own cultural identities.

Was CHC boxed into a corner, where the near-complete consolidation of the industry had eliminated the management team's most reliable defence against adversity or downturn? Or was having the same management team and structure an advantage in the event of another significant challenge? This group and management style had survived adversity so many times, it might be the perfect model for taking the company through the next major upheaval. Before attempting to answer these questions, it is critical to fully understand CHC management, history, its core business and market conditions. Regardless of management style and culture, CHC's core business and outlook must be strong if the company is to successfully manage change associated with its restructuring initiative and new pattern for growth.

3 INTERNAL CHANGE AT CHC

3.1 Major Change Factors

3.1.1 Management – 1987-2004

The turning point for CHC came in 2004. Corporate Governance legislation and attitudes in North America shifted in 2004, forcing companies such as CHC to ensure that a majority of board members were not related to the Company. At the 2004 Annual General Meeting, CHC accepted the resignation of five directors closely connected to Craig Dobbin and welcomed four new independent directors. In 2004 CHC acquired Schreiner Aviation, its last major acquisition, although smaller acquisitions continued. It was the year CHC embarked upon the Good-to-Great restructuring initiative, which attempted to change the corporation from a group of largely independent companies to a centrally run enterprise. It was also the year Craig Dobbin, at age 69, handed the role of Chief Executive Officer to his trusted right-hand man, Sylvain Allard. Although Craig Dobbin remained in charge, and took a new title as Executive Chairman, he relinquished some of his authority.

Until that point, CHC's success was defined by corporation building through aggressive, often risky, mergers, acquisitions and divestitures. Although CHC had become a large multi-national corporation, key success factors, from a management perspective, from 1987 until 2004, mirrored Craig L. Dobbin's personal success factors. Dobbin controlled the company, appointed the Board

of Directors, called all the shots and hired executives willing to follow his lead. When key executives disagreed with Craig Dobbin, they were usually shown the door. Dobbin's key success factors include: timing, negotiation skills, an ability to maintain control, an understanding of competitive forces, extreme competitiveness, drive and determination. Even as far back as 1980, when Dobbin's private helicopter company operated a handful of helicopters in Newfoundland, he let it be known his goal was to build the largest helicopter company in the world.

In 2004 CHC's key executives were all hand picked by Craig Dobbin. Virtually all were life-long CHC employees, smart and loyal staff members who had been with CHC their entire careers. The top executives in 2004 were:

- Craig L. Dobbin, founder, majority shareholder and Executive Chairman. Founded his first helicopter company in 1977, went public (but kept control) in 1987, died October 2006.
- Sylvain Allard, President and CEO (as of Nov. 2004): started as Dobbin's pilot, moved up through organization working closely with Craig Dobbin the entire time.
- Jo Mark Zurel, CFO: first came to CHC as auditor with Doane Raymond, hired by the company, moved quickly through ranks to become Chief Financial Officer in 1994, worked closely with Allard through the company's most rapid and most successful growth period. Departed in 2006.

- Christine Baird, President, Global Operations: started as Craig Dobbin's secretary in 1981, entrepreneurial, driven, creates a family-like environment in her division, remains very hands-on with customers and partners.
- Neil Calvert, President Heli-One: started as helicopter mechanic, appointed by Craig Dobbin, has served the company for his entire career, surrounds himself with a small, loyal group of staff in tight-knit group.
- Keith Mullett, President, European Operations: started career as CHC head office accountant, moved to Europe in 2004, appointed head of European Operations by Craig Dobbin.
- Noel Clarke, Senior Vice-President and Corporate Secretary. Worked for independent law firm as CHC advisor for many years, hired in 1999, removed by Dobbin in 2004.

3.1.2 Management – 2004-2007

In 2004 CHC senior management saw an opportunity to increase buying power and create synergies through centralization. The Good to Great (G2G) restructuring initiative was introduced to management by a small group of outside consultants and implemented by the senior executive. In a 2005 letter to employees CEO Sylvain Allard said: "In the long-term our restructuring strategy will allow CHC to bid more competitively on existing contracts and to gain access to a wide range of new work within our industry. These are exciting times, with

much growth ahead. I fully expect CHC to continue to grow for decades, and to provide sustainable employment opportunities and rewards to an increasing number of professionals."[xii]

3.1.2.1 Brain Drain

During this time period, no new expertise was added at the executive level. In fact resources decreased. Prior to the 2004 restructuring, CHC's inner circle consisted of four key personnel, Chairman (Dobbin), President (Allard), CFO (Zurel) and VP Legal Affairs (Clarke). In addition seven regional presidents met semi-annually with executives for strategy sessions. In the acquisition era the VP Legal Affairs played a key role in running the company, since strategy was tied to acquisitions and dispositions. Post-G2G, the VP Legal Affairs was removed and replaced by a newcomer less involved in running the company. In 2006 the long-serving CFO resigned and was replaced by an internal manager who had been with the company for three years but had been well known to Craig Dobbin as Corporate Controller at Vector Aerospace, the Repair and Overhaul company CHC created in 1998. In addition presidents of old divisions Schreiner, CHC Australia and CHC Africa left the company in 2004 and 2005. In 2007 the Vice-President Human Relations and Director of Communications departed and their positions have been intentionally left vacant.

By 2007, the senior executive inner circle consisted of the CEO and CFO, with additional strategic input from the Presidents of CHC Global, Heli-One and CHC Europe. In terms of inter-personal relationships the presidents of the two main growth divisions, CHC Global and Heli-One, are known to be adversaries

as a result of their forced supplier-customer relationship. Heli-One provides CHC Global Operations with aircraft support at a fixed internal rate under a mandatory contract.

Of the five key executives, four have been with the company their entire careers and none has management or executive experience outside the CHC organization.

3.1.2.2 Shrinking Inner Circle

Both before and after the change in structure, CHC senior executives tended to keep tight control on decision-making, calling upon Vice-president-level managers generally for specific tasks and assigned projects. This limited control system worked well while CHC was a collection of acquisitions, run almost independently by divisional managers. Public company acquisition strategies are necessarily well-guarded secrets. Non-executive management understood they could not always be told of pending material changes such as a major acquisition.

Perhaps due to the smaller, semi-independent structure prior to 2004-2005, employee retention was high and departures of senior staff was rare. By 2006, middle managers, administration staff, pilots and aircraft engineers were slightly more difficult to recruit and retain. Reduced employee retention was most likely caused by a combination of the larger, less-personal corporate structure and an increasingly robust job market. With so many new staff, however, the average level of experience was down significantly, putting increased strain on employees. Additionally, CHC management faced huge demands from its SOX

compliance initiative in 2006 and 2007. With fewer executives, newer middle management, far greater administrative demands from the SOX program, unprecedented growth and the death of Craig Dobbin in late 2006, the challenges facing the executive team in 2007 were significant.

3.2 Weathering Change in the Global Helicopter Services Industry

3.2.1 Helicopter Services Success Factors

Evidence of merger activity in the 1990s indicates that size and access to capital are among the most critical success factors in the offshore helicopter market. Financial evidence shows that contract rates and profitability increased with consolidation.[xiii] Other factors for success in the industry are: enhanced safety systems, reputation, access to capital, economies of scale and sound financial management.

Michael Porter argues that companies must choose between differentiation and price, but cannot offer both.[xiv] In the offshore helicopter industry, however, oil and gas companies appear to have created a situation, through the prequalification bidding process, where operators must *first* differentiate to get into the game, and *second,* employ a low price strategy to win. This is, in effect, what CHC does. This prequalification bidding process would undergo a major change in Europe in 2005, creating new challenges for both CHC and its competitor Bristow (see Section 5.3.2 Pricing Issues).

3.2.1.1 Differentiation

CHC's goal is to first employ a differentiation strategy to obtain the right to bid by employing the following:

1. Develop the most advanced safety systems in the world (through investment but also by divesting of more dangerous small, single-engine helicopter services, which improves overall safety ratings);

2. Acquire the most advanced, most modern fleet of civilian helicopters anywhere (and tie up production lines if possible, so no other operator can acquire aircraft[1])

3. Offer multinational oil companies one standard of service around the world;

4. Provide back-up aircraft and systems that smaller operators cannot match.

Size allows CHC (and its global competitor Bristow) to offer all of the above. Smaller companies cannot provide modern aircraft, do not spend as much on safety and cannot provide global service. Smaller operators are therefore only able to bid on contracts in frontier regions where standards (and revenues) are not as high.

[1] CHC has never acknowledged a strategy of securing more aircraft than it needs in order to prevent smaller companies from obtaining them. However, the company has used its purchasing power to order as many aircraft as Eurocopter can provide through to 2012.

3.2.1.2 Price Competition

So the above success factors allow CHC (and its major competitor) to win certain international contracts *and* to get into the bidding game in more mature markets such as the North Sea. In the North Sea in particular, however, CHC must win on price. Here the company tries to gain the necessary price advantage through its in-house repair and overhaul service, Heli-One – which the competitor cannot match. CHC's R&O function was also intended to provide the company with greater aircraft availability than the competitor, however, this was not the case in fiscal 2007 – in large part due to the lack of availability of spare parts from the OEMs.[xv] One of the driving factors behind the creation of the new Heli-One division was to increase CHC's ability to compete on price.

Bristow has divested its Repair and Overhaul (R&O) unit and instead concentrates on its financial structure to compete more cost effectively. R&O service should not be considered a differentiation factor, since the service is highly regulated and offered by the original manufacturers at identical service levels. Without the capital requirements of an R&O function, Bristow has been able to more effectively finance its aircraft in recent years, largely by issuing equity, as opposed to CHC's use of lease financing. If interest rates increase, Bristow will have a pricing advantage.

3.3 Rapid Growth as a Constant Management Preference

CHC shareholders have always expected major expansion from Craig Dobbin and CHC. Unlocking the details of CHC's corporate strategy, however, is not as simple as it may seem. From 1977, when Craig L. Dobbin founded his first

helicopter services company, until his death in October 2006, the Newfoundland entrepreneur was totally in command of CHC's strategic plan. Mr. Dobbin was a bold, skilful, almost legendary negotiator and dealmaker. Among his most famous axioms was the line "Never take no for an answer." Contrary to popular negotiating tactics, he counselled his executives never to worry about the losses the party on the other side of the table might suffer. He advised his managers not to be embarrassed about making ridiculously low offers. Mr. Dobbin was extraordinarily successful with this strategy and CHC's growth was aligned perfectly with his strengths.

By 2006, the strategy had changed from one of up-and-down acquisition growth to one of steady organic growth. Instead of growing almost exclusively by buying other companies, CHC would now grow by buying individual aircraft, winning and expanding contracts and slowly building a large third-party Repair and Overhaul business. Even as late as 2005, the Company spoke of continued acquisitions[xvi] and in fact acquired a 9 percent stake in a competing Repair and Overhaul facility, Vector Aerospace. CHC ultimately sold its stake in Vector and opted instead to build an R&O centre from scratch at Boundary Bay, Vancouver. In the 2006 Annual Report CHC Executive Shareholder Craig Dobbin stated that CHC had surpassed the $1 billion mark in revenue, adding:

"... as we move toward the next billion, I wish to emphasize that we are firmly in control of our destiny .... We are now at the beginning of another growth cycle, entering the most rapid phase of *organic* growth in the company's history. ... I believe we can double the size of this Company within five years."[xvii]

3.3.1.1 Changing of the Guard

Following Craig Dobbin's death three months after the Report was filed, new chairman Mark Dobbin (Dobbin's eldest son) emphasized he was following the strategic direction established by his father. Additionally, CEO Sylvain Allard, stated in a memo to staff that he would "continue to build and expand CHC with the drive and determination that Mr. Dobbin instilled in all of us."[xviii] When the Executive Chairman died, his son chose the lesser title Chairman and acknowledged he would not play a role in the day-to-day running of the company the way his father had.

3.3.1.2 Executive Strategy

In addition to the above strategy statements CHC executives have indicated during investor conference calls that the company had organic growth plans as follows:

- Increase the fleet by approximately 100 aircraft by 2012, from 225 to 325, largely through lease financing;
- Increase margins in all business segments;
- Increase the rates it charges customers;
- Build a new Repair and Overhaul facility in Boundary Bay, BC, by 2008, to expand third-party work;
- Increase third-party leasing.

For the purposes of this project, I will assume that the company's overall growth target is a doubling of revenues from $1 billion to $2 billion by the end of fiscal 2012 through the above-listed tactics.

3.3.2 Resources

3.3.2.1 Organizational Resources after Restructuring

CHC's expansion plans are clearly ambitious. As a result of the 2004 organizational change and merger of six fairly autonomous operating companies into three centrally controlled divisions, CHC had visions of significantly improved margins and higher earnings. The G2G program was aimed at creating operational synergies and increased group buying power. CHC's senior executives determined the best way to achieve these efficiencies and smoother organic growth was to reduce the number of flying divisions to two, and to move all assets to the expanded repair and overhaul division, Heli-One. Specifically, this involved:

1. Moving the St. John's Corporate head office to Vancouver alongside the Global Operations office;

2. Eliminating regional divisions and eliminating regional head offices in Cape Town, Adelaide, Stavanger and Amsterdam;

3. Expanding Aberdeen and Vancouver regional head offices and establishing them as divisional headquarters for CHC Europe and CHC Global, respectively;

4. Eliminating the Stavanger R&O administration office and re-establishing it in Vancouver, as a 'Total Helicopter Support' company that would own and control all aircraft in the fleet (previously each regional division bought or leased and sold aircraft as needed).

The CHC offices in Vancouver recruited industry professionals from Europe and elsewhere, and recruited business staff locally. Staff increased from about 200 to 400 in two years in order to meet the demands of rapid growth and restructuring. Staff turnover increased during this period to almost 25 percent, compared to less than 10 percent. At the same time, animosity developed between Global Operations Division and the Heli-One support division. This friction results from Global Operations' senior executives' belief that they could either do the job of Heli-One more cost effectively, or engage the services of another third-party support company at better rates than the mandatory internal CHC rate.

3.3.2.2 Financial Resources

Assuming the annual report message of doubling the Company's revenues in five years is an accurate description of corporate strategy, we can make a judgement about CHC's ability to finance this level of organic growth. First, we can assume rate increases will make a contribution to growth. Both CHC and its major rival Bristow have announced in conference calls that they intend to raise rates. (Bristow is targeting 10 percent over the next year.) Since oil and gas and SAR customers are demanding, and willing to pay for, new technology, additional rate increases can be reasonably forecast. Assuming 10

percent is acceptable in the first year, and subsequent increases average five percent, the cumulative rate increase would be 34 percent, bringing revenues to $1.34 billion. This leaves $660 million in revenue to be raised (or 66 percent) by increasing the fleet and third-party R&O work. Assuming third party R&O work remains proportionately the same at 16 percent of revenue, it will account for $320 million in five years, leaving $340 million to be generated with new aircraft. Using the current average of $5 million revenue generation per aircraft[xix], multiplied by 1.34 to account for revenue increases (therefore $6.7 million per aircraft by 2011), CHC will require 51 new aircraft to meet its target.

The aircraft are not impossible to obtain. In fact CHC currently has contracts, orders and options for 71 new aircraft over the next five years.[xx] The approximate capital requirement for 51 aircraft is $610 million. As of January 31, 2007, CHC had unused cash and credit facilities totalling $174.4 million. However, the company's plan is to lease the majority of the aircraft and use cash and borrowing capacity for other capital requirements such as a new R&O facility in Boundary Bay and for working capital. CHC is currently in negotiation to secure $385 million in leasing capacity with three major financial institutions, and the lease financing available is expected to increase as aircraft are put to work and income increases.

However, the working capital required to fund continued growth is significant. While revenues increased significantly in the organic growth phase, earnings and cash flow did not (See Figure 3, page 35).

Figure 3 – Revenue, Earnings and Cashflow 2004-2007

	2004	2005	2006	2007
Revenue	$720	$903	$997	$1,150
Net Earnings	$64	$63	$91	$44
Cashflow from Operations	$91	$138	$32	$43

Source: CHC Helicopter Corporation Annual Reports 2005-2007

The following growth costs have been cited in recent CHC financial documents as contributors to decreased earnings during this period of rapid growth:

- Crew training costs;
- Aircraft acquisition deposits;
- Unexpected maintenance associated with the introduction of new aircraft types;
- Penalties associated with late delivery of aircraft and aircraft downtime;
- Pilot strikes and work-to-rule situations associated with pilot shortage;

- Foreign exchange losses.

3.3.2.3 Off-balance Sheet Financing (Leasing)

CHC Chief Executive Allard announced in the fiscal 2007 third quarter conference call that the company had received commitments from leasing companies to provide sufficient lease-financing for all the aircraft on order for the current year. The company expects that lease financing will continue to be available as long as CHC continues to expand successfully. So the resources appear to be there for the aircraft required to meet growth projections.

However, leasing is a relatively secure form of lending. Well-maintained helicopters typically increase in value over time and the lessor's financing is secured by these appreciating assets. CHC also requires bank financing and bonds to finance day-to-day operations, working capital and major expansions such as the Boundary Bay facility and workshops. Banks demand sound financial performance and bonds have restrictive covenants that, if broken, lead to massive financial penalties. It is not possible to calculate at what point the bond covenants may be broken without inside information, but there have been a few negative indicators in the company's recent financial results.

3.3.2.4 Declining Earnings, Cash Flow

The company earned $44 million on revenue of $1.15 billion in 2007 compared to $91 million in 2006 and more in 2005 (See Figure 3, page 35). Operating cash flow for the fourth quarter 2007 was negative $41 million, dragging the year's cash flow down significantly. In addition the company's

debt:equity ratio has crept over the past few years, from 1:1 in 2003 to approximately 2:1 in 2007.

The company acknowledges that bottom-line decreases are due to the high cost of growth and that it is investing for the future. This is a valid argument. However, if cash flow continues to decline and lease and borrowing costs significantly increase, the company will not be able to finance the aircraft required to meet growth requirements. Put more simply, growth will come to a halt if the current situation does not change, since each new aircraft adds new growth costs. Management has stated, however, that it will be charging its customers some costs up-front, in advance of new aircraft acquisitions, in order to reduce the financial burden of training staff and acquiring support infrastructure for new technology aircraft. CEO Allard has also stated maintenance issues associated with the introduction of new aircraft will decrease and some of these costs will be passed back to the manufacturers.

4 EXTERNAL CHANGES: CONTINUED GROWTH IN THE FORECAST

4.1 Oil and Gas Supply and Demand Forecasts

Of critical interest to CHC Helicopter Corporation are forecasts for global energy demand and forecasts for the associated offshore oil and gas production that will help meet that demand. Of all energy forecasts available, the US Energy Information Administration's (EIA) International Energy Outlook (2007) may be considered the most reliable. The United States is not only the world's largest energy consumer, it imports more oil and gas than any other nation and has the greatest available resources to devote to the study of energy demand. So with the most at stake and the highest capacity to understand the issues, the US government is likely to produce the best forecasts. Even if one were to consider that the United States government might alter its forecasts for political reasons, other researchers have corroborated many of its projections. For example, Sickles and Hultberg compared their economic modelling techniques to those of the US government and found the government's numbers valid:

"Clearly our modelling effort has succeeded in closely replicating the forecasts from the (US) Department of Energy, an agency of the federal government with substantially more resources than those devoted to our modelling exercise."[xxi]

4.1.1 International Energy Outlook

The EIA forecasts a 42 percent increase in the global consumption of liquid fuels, from 83 million barrels per day in 2004 to 118 million barrels per day in 2030.[xxii] The agency forecasts a 17 percent growth rate to 97 million barrels per day by 2015. In arriving at this forecast the EIA projects declining oil prices (to $49 per barrel) to 2014, followed by steadily rising prices to 2030. The agency has also built high oil price and low oil price scenarios, in which the 2030 liquid fuel consumption rate rises to 103 million barrels and 134 million barrels per day, respectively. Although these numbers appear large, they represent compound annual increases of only 0.7 to 1.7 percent over the period. One of the reasons for this relatively low overall growth rate is the EIA's forecast that oil consumption will decline as a percentage of total energy consumption. So, while global demand for energy is expected to grow 71 percent, production of liquid fuels will grow by just 42 percent, with the gap being made up by increased production of coal, tar sands hydrocarbons, natural gas, nuclear power and others.[xxiii] What significantly increases the potential growth rate for an offshore services company like CHC Helicopter, is a potential increase in the percentage of liquid fuel production from offshore sources.

Oil production from OPEC countries is expected to increase far more than that from non-OPEC countries, but of greater interest to CHC is exactly where the production will come from. The details provided in the EIA forecast will have dramatic consequences for CHC Helicopter. For example production from the UK – traditionally CHC's largest market – is forecast to decline from its current level

of 2.5 million barrels per day to just 0.5 million barrels by 2030. Similarly, offshore oil production from Norway is forecast to decline from 3 million barrels per day to 1.4 million barrels per day in 2030. Production for the UK and Norway peaked in 1999 and 2001, respectively. This represents a monumental shift for CHC. Currently the North Sea provides approximately 50 percent of CHC's total revenue. Assuming CHC's revenues are expected to double again before 2015 and that the forecasted production decline occurs on a linear basis, the North Sea will represent just 12.5 percent of CHC revenue by 2030.

4.2 Offshore Production Forecasts

Currently CHC has most of its asset base located in Europe – the most expensive, advanced aircraft are located here. It has its largest repair and overhaul facility in Europe and its most experienced pilots and crew are located in the EU. Europe also represents the company's highest cost environment.

Although the US government may be considered the best source for forecasting, others predict similar, or even greater decline in North Sea production. British Geochemist and Geologist Euan Mearns, for example, predicts UK offshore production will drop to 0.5 million barrels per day before 2025, under a steady production decline rate of 7.6 percent per annum.[xxiv] Mearns bases his argument on the idea that the UK production peak of 1999 was a false peak, created by improved pre-production technology and methodology. Mearns argues the employment of jack-up rigs to pre-drill wells while production platforms were still under construction in the late 1990s allowed new fields to reach maximum production capacity much earlier. The result was a blip of

increased production while new fields and older fields reached peak production at the same time.

So if the North Sea will rapidly become less and less important to offshore oil and gas services companies, where will increased activity come from? According to the EIA Energy Outlook, the majority of increase in oil production will come from non-OECD countries. For example, production from the Caspian Basin is expected to more than double to 4.4 million barrels per day by 2015 and increase steadily thereafter.[xxv] Other significant increases/decreases from the IEA are as follows:

- Angola and Nigeria increasing from a combined 4.1 million barrels per day to 7.6 million by 2015 and 9.2 million by 2030;
- Brazil increasing from 1.9 mmb/d to 4.4 million in 2030 and;
- Algerian and Libyan production increasing from 3.8 mmb/d to 5 mmb/d by 2030.

The majority of this oil will come from the offshore sector.

4.2.1 Natural Gas

Natural gas production is forecast to increase more rapidly than oil and other liquids production, with a 63 percent increase projected for the 2004-2030 period.[xxvi] This translates to a two percent compound growth rate. The IEA forecasts that 90 percent of this increase will come from non-OECD countries, further emphasizing the importance of establishing good working relationships in countries in these frontier regions. The greatest increase is expected to come

from the Middle East and Russia (particularly the Caspian Basin) and West Africa, South America and Central America. CHC is well positioned in most of the offshore markets associated with these regions.

Production in Europe is expected to decrease slightly, with increases forecast for Norway, where CHC has the majority of the offshore helicopter services market. Reflecting this forecast, CHC announced on June 29, 2007, that it has received the largest helicopter services contract ever awarded, a $1 billion award that will see Statoil add new aircraft and significantly upgrade its fleet commencing in 2009 and 2010[xxvii]. This award should help soften the blue of decreasing activity in the North Sea

4.3 CHC Positioning and Strategy

CHC is well positioned in all of the above major growth markets. However, its major competitor Bristow, is also well positioned in these regions, although less so than CHC in Brazil. Where Bristow has the edge, however, is in its largest base of operations. While CHC is the dominant player in the North Sea, with about 64 percent of the market compared to Bristow's 30 percent, Bristow is a major player in the Gulf of Mexico, where CHC has no presence whatsoever. The EIA's forecast for the Gulf represents far less of a doomsday scenario than for the North Sea. Total US and Mexican production is forecast to remain virtually flat at 12.6 mmb/d. This figure, however, reflects a slight decrease in onshore production and slight increase in offshore Gulf of Mexico production as promising deepwater projects come on stream.

Although CHC is likely better positioned than its competitor in the growing regions, it will be more significantly impacted by a shrinking home base. For both companies, establishing a foothold in the emerging regions is critical, and costly. For CHC, it is perhaps more critical, since the European market may be all but gone by 2030. Both companies are also trying to increase their helicopter search and rescue (SAR) activity in Europe, particularly through a major government-civilian harmonization project proposed by the UK Maritime Coastguard Agency (MCA). The project calls for up to 30 additional SAR and EMS helicopters to be provided by the private sector starting in 2012.

4.4 Helicopter Service Demand as a Function of Oil Production

While oil production forecasts provide a good indicator of growth potential for offshore services companies, they do not provide a complete picture. Several factors will determine what percentage of new production comes from the offshore sector, including: technological developments, OPEC production decisions, geopolitical stability, conversion of other fuels to liquids (coal, tar sands, natural gas) and new discoveries. The most recognized forecaster in the offshore oil and gas sector is arguably Douglas-Westwood, which publishes an annual World Offshore Oil & Gas Production & Spend Forecast report. In a 2007 summary of the report Douglas-Westwood published the following figures and projections (see Figure 4, page 44):[xxviii]

Figure 4 – Global Offshore Oil and Gas Production Forecasts

	Crude Oil (mbl)	Natural Gas (mbl oil equivalent)	Total
1991	19.5	7.5	27
2006	26.5	14.9	41.4
2011	35	28	63

Source: Douglas-Westwood Global Offshore Prospects, 11 January 2007

While oil production is forecast to increase at just 0.7-1.7 per cent per annum, *offshore* oil and gas production is forecast to increase from 41.4 million barrels in 2006 to 63 million barrels in 2011 (see Figure 4). This increase represents a whopping 8.5 percent on a year-over-year basis, driven largely by a doubling of offshore natural gas production. These figures may be optimistic, however, given that Douglas-Westwood's own figures indicate offshore production increased by a more modest 2.9 percent a year-over-year basis between 1991 and 2006. Nevertheless, Douglas-Westwood's offshore Operations Expenditure (OPEX) forecast also shows a 50 percent increase between 2006-2011, corroborating its production forecast:

"... OPEX will likely increase by more than 50 percent through to 2011 as a result of increased output and a higher share of more expensive oil. In 2006 OPEX accounted for 40 percent of global offshore spending but its share is forecast to begin rising again in 2007 and by 2011 spending on CAPEX and OPEX the glossary would include these as well as any acronyms & abbreviations could be approximately equal."[xxix]

4.4.1 Operations Expenditure

According to the Chief Executive Officer of CHC Helicopter Corporation, OPEX forecasts are the best indicator of helicopter demand in the oil and gas sector.[xxx] Senior management at competitor Bristow Helicopters appear to concur. In its 2007 Fourth Quarter and Year End investor conference call Bristow stated that 92 percent of its revenue was directly related to Offshore Oil and Gas OPEX figures. It is difficult to say whether these OPEX increases will relate as directly to helicopter service costs going forward. Offshore production platforms typically operate at a steady state for much of their production lives. Historically, OPEX expenses have been relatively stable over the life of a project. Now, however, the North Sea is a mature, declining market and oil prices are near all-time highs. As a result, oil companies are investing more in operations, taking advantage of new technology and high prices to extract every last drop of oil out of old fields.

If the bulk of OPEX spending is in support of onshore activity, such as engineering and planning, for example, helicopter flight hours will not increase as dramatically as 8.5 percent each year. If, however, the bulk of the OPEX spending is at the source of production, say for example for increases in primary refining from platforms or additional offshore drilling, then helicopter operators will benefit greatly.

For the purposes of this paper, I will accept the Bristow calculation that helicopter revenues increase at 92 percent of the rate of offshore OPEX figures. The forecasted 8.5 percent increase in OPEX therefore translates to an increase

of 7.8 percent, year-over-year, for helicopter flight operations. Additional rate increases related to improvements in technology and inflation, plus increased helicopter work in other sectors such as search and rescue, make offshore helicopter industry an attractive one.

4.5 Increased Market Demand

Globally, oil production is expected to increase by about 1.5 percent per year, and natural gas by about two percent per year for the next 25 years. Offshore production, however, is forecast to increase by about 8.5 percent annually, at least until 2011, the forecast period for which respected forecasts are available. This is expected to translate to an increase in helicopter services spending of about 7.8 percent per year. Over the long term, however, spending will decrease in Europe – CHC's major market and home to the majority of its assets – and increase rapidly in the rest of the world, particularly non-OECD countries in West Africa, Southeast Asia, South America and around the Caspian Sea. CHC must be prepared for this fundamental shift in its core geographical distribution.

4.5.1 Market Demand and Growth Projections

Do the above-mentioned demand forecasts translate to the demand for at least 51 more CHC aircraft in the oil and gas and search and rescue sectors, which would be required for CHC to achieve its growth target? I will accept the argument that helicopter transportation services to offshore oil and gas rigs is a regular expense and increases proportionately with total operational expenses.

Assuming CHC retains its existing market share, the Douglas-Westwood forecast of a 52 percent OPEX increase would lead to revenue increases of $572 million (($1B - $160M R&O) x 0.52). Additionally, the UK Coastguard Harmonization project will create a new European helicopter service requirement of an estimated $120 million per year. As the current provider of helicopter SAR services to the UK and Irish Coastguards, CHC could be reasonably expected to win half this work. That $60 million per annum figure, combined with $340 million in rate increases and $160 million in third-party R&O increases, mean CHC's revenue could reach $2.23 billion in five years.

As discussed above, the bulk of that revenue growth will come from areas outside CHC's strongest, most established base in Europe. Although oil and gas production will decline, European revenue will continue to grow in the short term due to rate increases from new technology aircraft and significant increases in search and rescue work. European revenue for fiscal 2007 was approximately $530 million. If European revenues declined at Mearn's forecast 7.6 percent, revenues would drop to $357 in five years. However, rate increases for new technology should average five percent per annum and inflation should add another two-to-three percent, effectively neutralizing the production decline. A new UK search and rescue contract commencing July 2007 will add approximately $50-$60 million in annual revenue by 2011, bringing European revenue close to $600 million. The next major search and rescue contract – 'UK Harmonized SAR' – commences in 2011 or 2012 and should add another $60-$100 million in annual revenue.

4.5.2 Paradigm Shift

So the situation in Europe may be summarized as follows: offshore oil and gas support revenues should remain neutral for approximately five years, but then begin to decline as operators complete their fleet renewal programs. Offshore search and rescue work will increase significantly in fiscal 2008 and then jump again in 2011. As a percentage of total European revenue, search and rescue operations will increase from just five percent today to 30 to 40 percent (and rising) after 2012.[2] Ten years from now, SAR operations could represent 50 percent of European revenue. More significantly, European operations, which today represent 50 percent of revenues, will represent just 25 percent of CHC revenues.

CHC is well positioned to make the change in Europe. The division is currently executing a formal plan to transfer the skills and knowledge developed on the Irish Coastguard SAR contract to the new contract for UK SAR. The transition plan involves setting up a mobile SAR base dedicated to training crews and converting crews from oil and gas support to SAR support work. The plan is on schedule an expected to be complete with no hiccups. The successful completion of this transfer should make the 2011 transfer even easier. The decline in offshore oil and gas support should not present any financial costs, as natural attrition and retirement will make forced layoffs and additional compensation unnecessary.

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[2] As at June 30, 2007, CHC's Irish Coast Guard contract was valued at approximately $25 million per year. The first UK SAR contract would add $50-$60 million per year from fiscal 2008 and the subsequent UK harmonized SAR contract would add another $60-$100 million per annum from 2012.

4.5.2.1 CHC Growth Outside of Europe

The natural consequence of the European situation is that revenues from the rest of the CHC world will have to triple in order for CHC's total revenue to double.

Fortunately, CHC is well positioned to make the shift from a Euro-centric company to a more global company with new core business units in Africa, Asia and the Americas (see Figure 5). CHC has established strong partnerships with local operating companies in Nigeria, Thailand, Brazil, Azerbaijan and India. Partnerships are as follows (see Figure 5):

Figure 5 – CHC International Partners

Country	CHC partner	Relationship
Nigeria	Aero Contractors of Nigeria (ACN)	40% equity stake, plus contracts
Thailand	Thai Aviation Services (TAS	Contractual
Brazil	Brazilian Helicopter Services (BHS)	Minority stake, plus contracts
Azerbaijan	East-West Helicopters	Equity stake, plus contracts
India	CHC Helicopters (India)	49% equity stake

Source: CHC Helicopter Corporation.

In other regions, such as Malaysia and Mexico, CHC and Heli-One have long-term contracts with local operators. In the case of Mexico CHC, through Heli-One, simply leases helicopters to another operator, and does not have any employees in the country, under what is called a dry lease. The other major type of lease is a wet lease, where CHC provides crew and maintenance personnel as well as other services such as safety management.

4.5.2.2 Relationship Building

The challenge in operating in most jurisdictions is that, like Canada and Europe, many nations do not allow foreign nationals to hold airline operating licenses. For this reason, CHC and its US-based competitors must partner with local firms. As we have seen, CHC was able to overcome the nationality issue in Europe through the Dobbins' dual citizenship and the special share structure. Obviously this would be impossible in a large number of countries. Good relationships with local operators and regulators, therefore, are critical to the future success of CHC.

CHC has done an excellent job of building these relationships through its Global Operations division. Key staff, such as GO President Christine Baird, are constantly travelling, meeting with the owners of partner companies and seeking new partners in countries targeted by the business development group. However, as organic growth continues, the traditional CHC method of relationship-building by the divisional president becomes more challenging. G2G made this hands-on approach difficult. Continued organic growth may make it impossible.

Additionally, CHC has embarked upon a pro-active national recruitment and training program. CHC recruits pilots and aircraft engineers in countries with virtually no aviation training infrastructure and few adequately trained personnel. CHC's Global Operations division highlighted this strategic approach in a recent bid document:

"Globally, CHC utilizes local personnel, facilities, vendors, and service providers to the maximum extent possible. We pride ourselves on having an

excellent reputation for maximizing local content, which is recognized by our host countries worldwide. Through our partnership with long established Aero Contractors of Nigeria (ACN) we are confident to exceed the companies' expectation of local supply procurement and to provide new technology to both the industry and citizens of Nigeria."[xxxi]

The emphasis on hiring and training nationals is not only good from a social perspective, it solves the problem of a pilot and aircraft engineer shortage, which may be developing in North America and Europe. To fully leverage its training strategy, CHC is exploring the possibility of establishing a global training centre in Vancouver which would not only train CHC crews, but could be used to generate additional revenue from the training of third-party customers. Training crews overseas and establishing a new training centre is expensive, however, and may put additional strain on the company's cash flow and balance sheet in the short term. A fully functional helicopter simulator, for example, could cost above $4 million.

An alternative approach to the partnership model would be to establish local dummy companies, usually local law firms, which appear to be controlled by nationals of the country involved, but are actually under the control of CHC head office through various internal agreements. Ironically, this strategy is better suited to jurisdictions with well-developed legal systems, such as Europe. In Europe and North America complex ownership structures operate above-board and have been thoroughly tested. CHC's multi-vote shares held by the Dobbin family are

just such an example. The Dobbins hold only 22 percent of the value of CHC, but are viewed by European authorities as the legitimate majority owners due to a multi-vote share structure which gives them 60 percent of the vote.

In OECD countries, however, expert legal opinions may be difficult to obtain and unreliable. Therefore a complicated share structure designed to get around nationality requirements may not be a safe long-term solution.

4.5.3 Growth at Heli-One

External indicators for growth in the repair and overhaul and general helicopter support business are equally positive. Energy consultants PFC Energy Limited have forecast a global demand for more than 400 new helicopters in next five years in the oil and gas and Emergency Medical Services (EMS) sector.[xxxii] Much of the EMS demand is expected to come from North America. Heli-One is currently the world's largest helicopter support and R&O company other than the manufacturers (OEMs), and is building a new R&O facility in Boundary Bay that will be one of the largest in North America. Heli-One has more R&O licences than almost any other R&O company, and through its CHC connections is able to acquire R&O licences for new technology aircraft more easily than competitors. Furthermore, its costs are already lower than the OEM's, so it is well-positioned to expand over the next five years.

The major challenge facing Heli-One will be the cost-effective hiring and training of new employees in Canada's most expensive city, greater Vancouver. When the Boundary Bay facility was budgeted, the Canadian dollar was trading

at 80 cents US and had been below 70 cents for years. In addition to higher-than forecast wages versus the US low-cost China is now entering the aerospace arena, with a planned Airbus assembly plant[xxxiii] to kick-start an industry. If the major European and US helicopter manufacturers look to China for their repair and overhaul facilities, CHC's one-time cost advantage could become a liability.

5 CHC'S ROLE IN A CHANGING INDUSTRY

5.1 Scope of Business

Using revenue as a measure, CHC Helicopter Corporation is the largest player in the helicopter services business, with $1.15 billion in annual revenue. Approximately 70 percent of the Company's business involves providing transportation services to the global offshore oil and gas industry. Ten percent involves helicopter search and rescue (SAR) work, 14 percent is helicopter support such a third-party leasing and repair and overhaul (R&O), and the remainder is training and other services. To oversimplify, CHC is a bus company for the oil rigs, transporting oil and gas personnel to offshore platforms. Heli-One is the bus depot.

In reality, however, CHC is one of the most complicated companies of its size, operating 255 aircraft, each of which may contain up to 40,000 components subject to myriads of regulations. It employs 3,800, people, operates in 35 countries and earns revenue in a dozen currencies. It finances its activity through equity, bonds, credit facilities and leases, moves funds and assets through approximately 100 legal entities. It is structured as a public company trading on both the New York and Toronto Stock Exchanges with a multi-class stock structure that gives one family contentious voting control.

While the business has always changed and evolved, the rise in oil prices in 2004 heralded a significant change in oil company attitudes towards spending.

For the first time in more than 20 years, offshore oil and gas companies were willing to support helicopter operators' wholesale introduction of new aircraft types. Not since the introduction of the Super Puma family of heavy aircraft in the 1980s had entire new types entered the fleet. From 2004, however, three entirely new aircraft types were on the table: the AW139, S-92 and EC225. All would be introduced on oil company contracts within three years.

At the same time, a resurgence in safety awareness developed. Safety has always been a priority in the offshore sector, but the bar was raised again in 2005 when oil and gas companies began asking suppliers to review their operations, determine where the highest standard of safety was and apply it worldwide. While CHC's restructuring and centralization placed the company in a good position to meet this new requirement, it also added a new burden of responsibility to the senior executive team. As a pilot, CEO Sylvain Allard makes safety a key priority. However, increased safety management has placed increased demand on the CEO. For example, the company now hosts an annual three-day industry-wide safety conference that takes the CEO away from his regular duties for a significant period of time.

5.2 Customers

There are approximately 28 independent and multi-national oil and gas (O&G) companies operating in the North Sea including some of the world's largest, most powerful companies, such as ExxonMobil, Shell, BP, Conoco Phillips and others. The North Sea is CHC's largest market; it is served by CHC's European Operations divisions, based in Aberdeen. Beginning in 2004, this

market began to change. Large operators such as BP began exiting the North Sea, and smaller operators with special skills entered the market.

All other offshore oil and gas markets are served by CHC's Global Operations division. It operates in 30 countries, serving about 50 customers, approximately half of which are national oil companies, such as Petrobras in Brazil and in NNPC in Nigeria. The offshore oil and gas industry is currently booming, with offshore O&G companies expected to increase capital expenditures by 40 percent over the next five years and operating expenditures by 50 percent. Global Operations is expected to surpass European Operations and become CHC's largest divisions by the end of 2008.

Heli-One leases and supports aircraft for CHC and provides the same services to third-party customers such as European Air Forces and small helicopter operators. Both CHC Europe and CHC Global provide helicopter SAR and Emergency Medical Services (EMS) to governments.

5.3 Evolution of Competitive Forces

In the early 1990s all three major North Sea operators saw their profit margins decline as customers increased their buying power with longer-term contracts. An attempt was made at consolidation when OLOG attempted to acquire BIH in 1992. The matter went before the UK Competition Commission. OLOG argued that a duopoly would still provide a high degree of competition because the sealed bid tender process created a situation equivalent to a market with several competitors.Furthermore, oil companies could start up a third rival

helicopter firm if prices rose to unacceptable rates, OLOG argued. The oil companies countered that barriers to entry were high because of the expertise required.

The Commission did not clearly answer the question of whether expertise was a legitimate barrier to entry, but disallowed the acquisition due primarily to limited availability of hangar space at regional airports. This decision paved the way for CHC to acquire BIH in 1993-1994 and ensured there were three UK operators as opposed to two. Over the next five years, profits continued to fall. HSG saw its pre-tax profit-to-revenue ratio fall from 12 percent in 1994 to four percent in 1998, and its yield on equity fall from 16 percent to five percent over the same period[xxxiv]. Other operators experienced similar declines.

In 1999 consolidation was attempted again, when CHC made a bid for HSG. HSG shareholders quickly agreed to the sale, due to five years of diminishing returns and pressure from CHC's senior executive. Again the UK competition Commission deliberated, but this time decided it was possible for a potential third player to obtain hangar space at Aberdeen and other airports, and that a duopoly would permit a similarly competitive environment. One of the major customers, BP, had argued again that it did not have the expertise to start its own operator, but this time the Commission clearly stated the expertise barrier-to-entry argument "not to be credible."

After the acquisition, however, contract rates increased by as much as 35 percent. Customer power appeared to have decreased significantly. For example, in the 24 months after the 1999 merger of CHC and HSG, the

combined company did not lose a single incumbent bid to its competitor, yet it raised its rates on every single contract. For the three-month period ending January 31, 2001, CHC's earnings (EBITDA) as a percentage of revenue increased to 17.7 percent from 14.2 percent a year earlier, and it announced several major contract renewals at rate increases. At the same time, OLOG continued to raise its prices, and also successfully renewed its contracts.

The two operators appeared to be tacitly cooperating, reducing customer-buying power by communicating through their public documents. In fact both companies began publishing target rates of return equal to the highest in the oil and gas services sector, almost 20 percent, sending an unequivocal message that they were raising prices. The larger contracts with major oil companies tend to establish rates that would be applied to ad hoc work and smaller contract awards, so that higher contract awards created further revenue increases. But diminished customer power is not something the oil giants were willing to put up with.

5.3.1 Customer Revenge

First, BP brought back a third player. It did this by inviting the former owners of the original Bond Helicopters back into the market, awarding them an unprecedented 10-year, $250 million contract at guaranteed rates. This guarantee allowed Bond to overcome one of the highest barriers to entry: capital for new aircraft. The contract also provided money for training, which Bond would need. Finally, BP awarded the contract in August, 2002, a full two years before

the existing contract with CHC was to expire, allowing Bond the time it needed to set up the operations.

The third player in this rivalry story was major supplier Eurocopter. Before Bond re-entered the market, the existing North Sea helicopter fleet was operating at near capacity. Helicopter manufacturers had said production lines were full and that two years' lead time was required for they could begin new orders. However, Bond and BP negotiated with Eurocopter for a second production line to be put in place so that Bond could by-pass the apparent helicopter supply constraint and get the equipment it needed to win the major contract. Although Bond was able to perform services for BP, it would be years before it could handle another major contract effectively. In fact Bond has not won a major contract since.

5.3.2 Pricing Issues

Oil companies minimize differentiation among helicopter service companies by enforcing a strict pre-bid qualification process. Operators must meet specific standards before they are permitted to bid on a contract. These include minimum number of years' experience for pilots and engineers, proven safety systems, training etc. In large markets similar operating costs due to a common pilot's union for all operators, identical fuel costs and identical costs for helicopter spares, which make up a significant portion of total costs. Fixed costs are also similar due to the proportionately high financing charges associated with aircraft.

Switching costs are low if customers make the switch when contracts are tendered, which is typically every 3-7 years. These long-term contracts become critical for survival of helicopter operators, further strengthening customer power. Although there are relatively few helicopter operators, customers are so large and powerful they are capable of vertically integrating downward to create a new helicopter company if pricing is too high – or to prop up a new entrant as we saw with BP and Bond.

In 2005 oil companies demonstrated other ways to increase their power: larger contracts and an electronic bidding process. In early 2005 Shell combined two large contracts into one massive contract and introduced e-bidding, a process by which competitors would submit their bids electronically and then be offered an opportunity to lower their bids online. Although the formal bid and prequalification process took place over nine months, the e-bid price reduction period was condensed to a 30-minute frenzy, where emotions ran high.

The combined contract was so large that a loss by incumbent OLOG would have been devastating to its North Sea business. Predictably, CHC and Bristow lowered their bids significantly during the process. Ultimately, CHC dropped out of the bidding after 12 price reductions totalling more than £9 million, or CDN$20 million over the five-year contract. OLOG won the contract, but ultimately, Shell won the power struggle.

5.4 Barriers to Entry

Offshore and SAR Helicopter operators require a fleet of several multi-million-dollar, specialized aircraft (offshore-configured aircraft typically have millions of dollars in sunk-cost enhancements). Contract requirements also include:

Years or even decades of offshore experience,

Complex safety systems,

Access to licensed repair and overhaul facilities and,

Airline operating licences, which are granted only to companies majority-owned by nationals of that country.

Operators are also governed by numerous national aviation standards, international laws and aircraft manufacturer procedures. Finally, they come under the jurisdiction of numerous department of transportation standards, US corporate governance laws, and oil and gas company policies, which include regular, rigorous audits.

5.5 Suppliers

CHC's major suppliers are the world's largest manufacturers (OEMs) of helicopters. They provide not only new aircraft off the assembly line but also post-delivery maintenance services and spare parts – which are significant when one considers helicopter parts are replaced or overhauled, on average, four time more often than fixed wing parts. There are only four main suppliers: Sikorsky, Eurocopter, AgustaWestland and Bell. In many cases the customer prescribes

exactly which helicopter type it wants on a contract, even specifying the maximum age or if it must be a new machine. The capital cost of aircraft is huge for operators. For example, CHC's aircraft leasing costs, financing charges and amortization costs were $47.5 million in the third quarter of fiscal 2007 on revenue of $253 million. Parts supply is controlled by the OEMs. Repair, overhaul and licensing of aircraft is also tightly controlled and most major repairs, inspections or overhauls may only be performed by the OEM or one of a handful of other licensed facilities. CHC must often obtain training services from suppliers, which in the case of brand new helicopter types can only be obtained from the OEMs.

The bargaining power of helicopter manufacturers is closely related to the end-users' demand for new equipment. This situation is caused in large part by the fact the helicopters, when serviced properly, last virtually forever. CHC has aircraft in the fleet that have been flying for more than 40 years. These aircraft are safe, reliable and easy to operate, since every single moving part, and virtually every single part, will have been replaced or rebuilt several times. If CHC's customers are willing to fly these older aircraft, the company can significantly reduce the number of new aircraft it requires to meet contractual demand, and supplier power is lessened. If, however, customers are demanding only new technology aircraft, CHC must obtain these aircraft from its small group of suppliers, and supplier power is enhanced. In the high oil price era of 2004-2007 customers are demanding new aircraft. Not only are new aircraft prices up, manufacturers are demanding more for spares and taking longer to deliver them.

5.5.1 Dealing with Suppliers

Although there are only four suppliers, there are at least two competing types available for each segment of customer demand (for example Sikorsky S92 and Eurocopter EC225 in heavy helicopter, offshore market). CHC uses some of the same tactics the oil companies use in contract negotiations: orders are secured well in advance and purchasing power is increased through negotiation of large contracts for multiple orders. Most recently CHC secured more than one-quarter of total assembly production for the new EC225. Furthermore, manufacturers are not interested in operating the aircraft, nor could they easily obtain the expertise and licences to do so. Finally, OEMs obtain much of the necessary R&D investment from military orders.

With respect to repair and overhaul licences, CHC negotiates many of these licences into its aircraft purchase contracts and in many cases is the only non-OEM provider of these services. CHC has chosen to expand its R&O capabilities to further mitigate the power of suppliers. Training is also negotiated at the same time as major aircraft purchase contracts.

5.6 One Way Home

CHC aircraft fly to more than 500 offshore platforms, drilling rigs, FPSOs, seismic vessels and tankers worldwide[xxxv]. The majority of these facilities are in harsh, cold-water environments such as the North Sea, North Atlantic and South Indian Ocean. Distances from shore to platforms ranges from 20 km to 315 km. Unpredictable sea states make float plane transportation unsafe and unreliable. Transportation by boat is generally not an option due to seasickness and the

dangers of transporting crews from sea to platforms, which are not equipped to handle boat passengers. Offshore exploration is moving further offshore to deeper waters, making the threat of ship transportation even more remote. One known potential alternative for offshore transportation and over-water search and rescue is new tilt-rotor technology aircraft. CHC is prepared to embrace this technology should it ever become feasible. CHC is so confident of its position as a supplier of an essential service that it briefly employed the marketing slogan: "Two Weeks On, Two Weeks Off ... One Way Home."

5.7 Staying Ahead of the Competition

CHC has one truly global competitor, OLOG, which recently changed its name to Bristow Helicopter Group (annual revenue in Canadian dollars: $903 million) and several weaker competitors in individual markets. In the North Sea (representing 50 percent of CHC's business) CHC and its global rival, Bristow Helicopters Group, control about 90 percent of the market.

There have never been more than three offshore helicopter operators per country in this market, which consists primarily of the UK and Norwegian sectors and to a lesser extent the Dutch, Danish and Irish sectors. The UK market existed as a duopoly from its beginnings in the late 1940s until the mid-1970s when a third company, Bond Helicopters, entered the market. The Norwegian market has been a duopoly virtually since inception in 1947. In 1999 CHC's purchase of HSG created a duopoly across both the Norwegian and UK sectors. Although barriers to entry were higher than ever due to higher safety demands, BP proved it had the power to create a new operator if it so wished. The threat

remains, however, that CHC or OLOG will purchase the new entrant Bond, bringing the market back to two competitors.

In International markets there are several smaller regional competitors such as:

Lider Aviacao, which competes with CHC's Brazilian division;

Cougar Helicopters in Eastern Canada;

Malaysian Helicopter Services (MHS);

Various national helicopter companies in places such as India, and Angola.

The creation of CHC's independent leasing and R&O division, Heli-One, has allowed the company to lease helicopter and support services into these markers when it cannot compete as an operator. Heli-One leases aircraft to Cougar, MHS and others.

Also competing internationally are two U.S.-based publicly traded companies, PHI and Seacor, which have good access to capital and their own R&O capabilities and therefore represent a greater competitive threat. PHI revenues from the international sector are approximately $20 million on a twelve-month trailing basis, making it a small player. However, vast experience in the US gives PHI the safety systems and experience to compete internationally. The company has stated its intention to go after this growing market: "We are pursuing certain international projects, and as a result, have dedicated certain of the aircraft on order to the International segment."[xxxvi]

Seacor is also primarily a US operator and does not provide international revenue figures. More significant, however, is Seacor's Jan. 5, 2007 acquisition of Keystone Helicopter Corporation, a helicopter completion and R&O centre which competes directly with Heli-One's support services. Heli-One recently acquired a completion centre of its own in November 2006. CHC is the only helicopter services company competing in both the international operations sector and third-party repair and overhaul sector.

5.7.1 Controlling the Means of Production

Restricting the competitive ability of smaller rivals is the limited availability of new technology heavy and medium aircraft from the major manufacturers. Although it is not a stated CHC or Bristow policy to gobble up all aircraft coming off the assembly lines of major manufacturers, this is essentially what the two giants have done, booking orders well beyond 2010. CHC's recently announced contract to purchase 24 new EC225 aircraft at $27 million apiece over five years would secure more than 25 percent of Eurocopter's EC225 production. Bristow has similar orders, which combined with military orders virtually block the smaller competitors from acquiring the modern aircraft the customers are demanding.

5.8 Industry attractiveness

The offshore helicopter services industry is an attractive industry. Customers are powerful, but are experiencing extremely high growth. Barriers to entry are high, so once a company is established, profitability is relatively secure.

Suppliers have some power, but industry leaders such as CHC and Bristow are able to mitigate that power by negotiating large contracts.

5.8.1 Opportunities

In International markets CHC likely has an opportunity to increase prices. There are two main reasons for this. First, differentiation factors are critical (particularly safety and availability of back-up aircraft), allowing CHC to further distance itself from smaller competitors. Second, helicopter transportation is an essential service for which there are no substitutes Of course higher profits may also invite more competition to the market from either the oil companies themselves or small operators who will gain access to capital as market conditions improve.

In the North Sea an opportunity exists to consolidate once again and reduce the market to a duopoly, which will likely allow further price increases (at least ternporarily). In fact in its most recent quarterly report, Bristow Helicopters revealed that it had invested $2 million in studying a potential acquisition but that it had decided against it. Rumour in the industry is that Bristow was going to acquire Bond. Since the deal fell through, CHC could take a look at this opportunity. CHC also has an opportunity, through better management, to achieve the aircraft availability increases and cost savings it first envisioned when it created Heli-One.

5.8.2 Threats

Two major external threats facing CHC as it embarks on it mission of organic growth are the strength of helicopter manufacturers and the ability of the competition to underbid. CHC has to some extent mitigated the threat of powerful manufacturers. The company has secured large orders of aircraft to eliminate price volatility and prevent competitors from buying the aircraft its customers demand. Industry rivalry is more of a threat. Although CHC and Bristow are emphasizing their differentiation, they are also significantly increasing costs. Cost increases have been acceptable over the past several years as the price of oil has risen and demand increased. However, customer power – as demonstrated by BP's willingness to prop up another operator – is the most critical force in this industry. When demand for oil subsides, customers are likely to exert power once again, and any operator that does not have its costs under control will be at risk. For CHC, with a significant portion of its costs dependent upon interest rates (leasing costs), the threat could be out of its control. It is therefore critical that CHC maximize its potential cost savings in other areas, particularly on R&O, to counter any increase in interest rates.

CHC faces three major challenges as it plans to grow in line with, or more rapidly than, the expanding offshore oil and gas industry:

1. Financial – CHC must stop the earnings slide and negative cash flow during the growth phase so that financial institutions will continue to provide funding for new aircraft and maintaining cash flow to fund ongoing operations;

2. Training and hiring the staff it needs to accommodate growth, and;

3. Providing the leadership necessary to motivate staff during difficult growth period and run the organization in a cost-effective manner.

5.8.2.1 Leadership

Despite changing from a wheeling and dealing entrepreneurial company to a mature, process-driven enterprise, CHC has not had to add an additional layer of executives to the corporate team. In fact it has decreased the number of executives and vice-presidents over the last few years. CHC head office had just two senior executives and three vice-president-level executives as of June 2007. Despite major structural changes in the company, the head office has not had to change the way it operates – with a small group making all the key decisions. This small structure allows the company to remain flexible despite significant growth. Will this nimble, entrepreneurial approach to management allow CHC to remain the market leader, or might it leave them short-handed as the company faces increasing challenges associated with rapid growth, a new structure and changing environment? We have examined growth and now must look at the business environment and company structure to help answer this question.

5.8.2.2 Implications for Change at CHC

These are boom times for CHC. As cyclical as the oil and gas industry is, the 2005-2007 period is one of the strongest in its history, with a strong likelihood of high demand for services for years to come. The helicopter search and rescue (SAR) market has never looked better. The UK government is about to initiate the world's largest civilian helicopter coastguard service (UK Maritime

Coastguard Agency (MCA) Harmonization Project, commencing 2012) and CHC is well positioned to win the majority of that work and transform its European Operation into a major SAR operation. Other governments are also considering coastguard privatization.

CHC's position in the market is extremely strong. Between them, CHC and Bristow have tied up the order books for most of the heavy and medium new-technology helicopters being manufactured over the next three years. Customers seem comfortable with the duopoly, at least for the time being.

Other changes are less positive. Increased regulatory pressure from Sarbanes Oxley represents a major tax on limited employee resources. Increased safety management responsibilities take up valuable senior executive time. The high financial cost of organic growth has not been adequately dealt with.

All of the above add up a tremendous opportunity, but a tremendous workload for CHC senior executives and staff. To tap into the positive changes ahead, the company must have a solid organizational structure. The questions CHC must ask itself are:

- Did the G2G restructuring initiative create the best possible structure for the mission CHC is embarking on?
- Was G2G carried through to the end, or has it in fact not been completed?
- Did G2G create any problems that need addressing?

- Does the company have enough resources to successfully navigate five more years of organic growth?

Only by thoroughly examining the new structure can CHC determine if they are prepared for the next few years of growth and positioned to outperform Bristow.

6 CHC RESTRUCTURING – OBSERVATIONS AND RECOMMENATIONS FOR MANAGING CHANGE

6.1 Cultural Shift

The goal of CHC's 2004 G2G initiative was to improve efficiency and group buying power and to provide one standard of service to multinational oil and gas customers, who had requested simplicity and global standards. To implement the changes, a committee of 20 middle managers from several countries and divisions was brought to Vancouver for a week in June 2004 to "Determine the shape of the new CHC." Their task was to outline how the new CHC would be built; however, they were required to follow specific directives of senior management.

The restructuring program was communicated to all staff worldwide through a series of five letters from the CEO or president e-mailed to all staff over a period of about six months. The program was deemed complete by October 31, 2005. During and after the G2G program, CHC expanded its fleet by about 25 percent, representing the largest period of organic growth in company history.

In order to evaluate change management at CHC and make recommendations it is worthwhile first determining what type of change was taking place and whether the change management program should have been declared complete. There are two change processes at play: ongoing lifecycle change and a major transformation associated with G2G.

6.1.1 Lifecycle Change

Using Greiner's Lifecycle model[xxxvii] to assess ongoing change, CHC is in a phase of rapid organic growth – the first time the firm has grown dramatically without acquisition. According to Greiner's model, major organic growth warrants:

1. A change in management capabilities and,
2. New processes for delegation, planning, organization and structure.

CHC met the second condition, adding layers of organizational structure and new processes (particularly with creation of asset-owning helicopter support division, Heli-One). It is further assessing and changing approximately 1,200 internal processes that have been identified through its SOX-compliance project.[xxxviii]

But what the company has not addressed is Greiner's first requirement: changing senior management capabilities. CHC is, and always has been, controlled and run by a very small group of senior executives, with limited input from divisional presidents, and only occasional input from managers at the VP level. The CFO change in 2006 saw one Canadian finance expert replaced with another – with less experience. This limited control system worked well while CHC was a collection of acquisitions, run almost independently by divisional managers. But the senior team has limited experience in personnel management, team building, or communications.

6.1.2 Transformational Change

The G2G program was a straightforward company-transforming event. An ideal model for analyzing this change process is the seminal work on the subject, Kotter's Eight Steps to Transformational Change.[xxxix] Kotter's empirical research makes his work relevant to the CHC case. He has watched more than 100 companies try to remake themselves into significantly better companies[xl]. In most cases, the transformation effort fails. Kotter states the basic goal of transformational change is: "to make fundamental changes in how the business is conducted in order to help cope with a new, more challenging market environment."[xli] This was precisely the goal of the CHC G2G program.

6.1.3 Analysis of Change – Kotter's Eight Steps

6.1.3.1 Sense of Urgency

The first of John Kotter's Eight Steps to successful transformation is "Establishing a sense of Urgency." Kotter argues that a minimum 75 percent of senior management must be absolutely convinced that business as usual is not viable. He states that more than half of the companies observed failed at this first stage. This is critical evidence for CHC, which was recording record profits and trading at record prices at the time of the change initiative. G2G was important – necessary to meet the future needs of major customer – but not naturally perceived as urgent.

Kotter's urgency requirement is not merely theoretical. Perhaps the best example of the urgency principle is CEO Carlos Ghosn's turnaround of Nissan of 2001-2004. When Ghosn arrived at the nearly bankrupt Japanese car

manufacturer, he remarked: "For so many years changes need to be made but nobody made them, that's why my first task was to instil a sense of urgency."[xlii]

CHC did not have the luxury of near-bankruptcy to instil a sense of urgency. Kotter points out that the 50 percent early failure rate is due, in part, to executives' fear that "moral will drop," or "the stock will sink."[xliii] This is precisely what happened at CHC. Executives worried that employees at the newly acquired Schreiner division would react negatively to bad news. Even the name of the program "Good to great," implied there was nothing wrong. In fact the program earned other nicknames among employees: "Great to Good" and "Bad to Worse."

The fact is CHC's acquisitions were possible because the firms it bought were priced below book value; the only rational explanation for this is that they were underperforming. CHC recognized this, but did not communicate it effectively – to avoid hurting the feelings of acquisition employees or depressing the stock price.

6.1.3.2 Steps 2, 3, 4: Teamwork, Vision and Communications

The next three items on Kotter's list are:

- (2) Establish a powerful coalition – assemble a groupprovide it with authority and encourage teamwork;
- (3) Create a vision – the vision must direct the change effort and include specific strategies for achieving goals;

- (4) Communicate the vision relentlessly – use every vehicle possible and use the coalition as an example.

CHC hit all of these buttons, but not hard enough. The coalition of 20 middle managers was together for only a week and given no real power. The vision was a vague "To be the best," and the company did not "develop strategies for achieving that vision."[xliv] Communication of the program was minimal, consisting in entirety of e-mails sent to staff from the president or CEO over a period of one year.

6.1.3.3 Steps 4-8: Getting Down to Work

The second four of Kotter's Eight Steps come from deeper within the organization and lead to specific actions, as follows:

- (5) Empower Others to Act – involves removing obstacles under the old structure and encouraging risk-taking;
- (6) Create Short Term Wins – plan for visible improvements and reward those responsible;
- (7) Consolidate Improvements and Produce More Change – hire and promote employees who implement the vision, add new projects and themes

- (8) Institutionalize New Approaches – develop the link between successful change and corporate success, plan for leadership succession.[xlv]

CHC did not get to the second phase of Kotter's Eight Steps to Transforming Your Organization. The restructuring initiative was deemed complete once the organizational changes were complete.

6.1.4 Transformation Recommendations

CHC should build an implementation plan based on Kotter's Eight Steps In the following recommendations, several of Kotter's steps have been combined and a new step, transparency, has been added. This new set of six steps may be easier to manage and more pertinent to CHC than Kotter's original list:

1. Adopt Kotter's philosophy – and follow Ghosn's admission – that **establishing a sense of urgency is paramount**. It could be argued that the past four quarters are the worst in company history. Costs are out of control. Debt levels are extremely high, leaving little room to manoeuvre. A 'growth at all costs' philosophy as thrown accountability out the window. Doubters will argue that shareholders will jump ship, but the reality is, they will abandon CHC even more quickly and permanently if the company continues to struggle financially. Employees may also continue to leave.

2. **Establish and empower coalition groups.** This critical step comes up again and again in business case study, including Kotter, Duck (Managing Change: The Art of Balancing)[xlvi] and Carlos Ghosn. Ghosn's Cross-Functional Teams (CFTs) were seen as a key tactic to "revitalize the spirit of the company from the inside out,"[xlvii] just what CHC needs. CHC must leverage the expertise of its 3500 employees to fix its many problems. Not only will this empower disenfranchised staff, it will likely lead to meaningful solutions to some of the spending and logistics problems. CFTs will also help end some of the animosity between GO and H1.

3. **Communicate a Vision.** CHC does not have a clearly defined vision statement or mission statement. Although there are several vague statements floating around different divisions of the company, there is no clear, inspiring message. The new CHC has two distinct cultures: a customer service culture at the flight operations level and a performance culture at the corporate level. Well-cornmunicated vision statements should celebrate and promote these cultural values. The new Heli-One support group does not yet have a distinct culture, but should perhaps develop a mission statement around its support function, to build a nurturing, supportive culture.

4. **Establish measurable short-term goals.** Kotter calls them short-term wins. In a performance-based culture short-term wins are critical. CHC must communicate its targets, such as a firm implementation date for a new employee share purchase plan, a cost-reduction plan bench-marked against the competitor, a specific plan to measurably improve parts distribution and so on. With short-term goals, the company will also have messages for continuous communication.
5. **Continue the change initiative and institutionalize change mechanisms.** With G2G, CHC committed the classic error of declaring victory before the horses were out of the gate. Kotter states that transformation can take 5-10 years, and that "declaring the war won can be catastrophic."[xlviii] CHC called it over after 18 months. It is not too late to kick-start the transformation, but the longer senior executives wait, the worse the lingering problems will become.

6. **Transparency**: Not one of Kotter's eight steps, but perhaps a universal strategy for change. Ghosn called transparency "one of the most important issues facing business in the 21st century,"[xlix] and said it was one of the most significant strategies used to turn around Nissan. CHC downplays the negative performance of the last four quarters to staff and investors and senior executives appear to have convinced themselves that the problems are all external. It's time for some hard truths. The first thing senior executives should do is encourage open, honest dialogue from middle management, through coalitions or even by simply inviting open criticism. When it was suggested that senior executives hold open forums and invite employees to ask questions, management insisted questions would have to be screened so that no 'unproductive' questions would be asked. Only when senior executives are willing to listen to employees can transparency begin.

6.1.5 Packaging the New Change Program

These six steps could be packaged as a continuation of the G2G process and communicated to senior management. Senior executives should acknowledge the fact that the company is still in the middle of a major transformation and cultural shift. Management could then conduct basic employee research to determine the best way to roll out another program without creating scepticism among change-weary employees.

Employees are probably not in the mood for another formal change program such as G2G. The revived change initiative should therefore be

packaged as an internal program. It should be seen to be coming from the CEO, a former pilot, well respected through the ranks. Since CHC's culture is really becoming a performance culture, the change program could be built as a performance enhancement initiative.

6.1.6 Change Management Report Card

The CHC change management program known as G2G was an excellent idea. It recognized the need for major transformation as the company grew from a collection of regional enterprises into a global operation. The concept was good but G2G was defined and implemented by financial managers and did not go far enough. From a financial management perspective, all G2G restructuring charges ended in after the second quarter of fiscal 2006. This was because, in the world of financial accounting standards, restructuring charges generally do not last more than 12-18 months. So when divisions and corporate head office could no longer charge items to 'restructuring,' the financially minded executives could not help but consider the program to be over.

However, from a change management perspective, G2G was just beginning: new divisions were still finding their roles, systems for moving parts and aircraft were just evolving and the dynamics between operations and support had not been established. And although the company has been hit by high foreign exchange charges and several one-time items, one cannot ignore the fact that the four quarters since the 'end' of the restructuring initiative represent the lowest 12-month earnings period (net income before taxes) since 2003, despite being a period of record high revenues.

Anecdotally, there is tremendous discord between the support division and the operations divisions. At the operations level, stories are constantly circulating about wrong parts being shipped, grounded aircraft being ignored and support costs being far higher than they were. From Heli-One's point of view, the operators are ordering aircraft without firm contracts and failing to properly manage inventories. Both sides complain the others' costs are too high. Employees state they are overworked and underappreciated. As the company grows, several of the long-time employees, remembering the smaller, family-like division's structure of a few years ago, have made comments such as 'there's no heart left in this company,' and 'our culture has been destroyed.'[l]

6.1.6.1 Cultural Change

Senior executives can no longer ignore these issues and assume the growing pains will disappear on their own. Changing culture is the most challenging aspect of corporate change and managing cultural change requires a long-term, strategic approach. The company has grown, the business environment has changed and the informal, family culture could not be sustained when smaller regional divisions were dismantled. At the corporate level, the thin, entrepreneurial culture became impractical when corporate head office began playing a direct role in the running of the operations divisions in 2004-07. The entrepreneurial culture became impossible when founder, controlling shareholder and Executive Chairman Craig Dobbin died in 2006. Systems have been put in place, but new executive competencies have not expanded, cultural change has

not been addressed, and the concentrated G2G change management program has not been carried through to completion.

6.1.6.2 Cost of Change

The CFO and CEO have asked shareholders to be patient and offered the following explanations for diminishing earnings and cash flow:

- Several one-time, unavoidable incidents have negatively impacted results;
- Growth is costly in the short term;
- Negative Foreign Exchange impact is costly and unavoidable;
- Sarbanes Oxley compliance is costly;
- Systems inefficiencies are being corrected;
- Increased profitability is just around the corner.

This message was communicated to employees through the company Intranet. In mid-2007 CHC senior executives further indicated that they are willing to begin a dialogue of change with employees. On May 1 CEO Sylvain Allard sent a message to all staff outlining a '7 Goals' program to improve performance and inviting staff to submit suggestions to improve efficiency and reduce costs. Employees welcomed the message and none seemed to object to an initiative to reduce spending. CHC executives should follow up this initiative with a strategic performance plan and implementation and make the 7 goals an

integral part of a rigorous change program. The 7 goals program actually looks a lot like John Kotter's step No. 6 – Planning for and Creating Short-Term Wins.

7 CHC EXPANSION – OBSERVATIONS AND RECOMMENDATIONS FOR MANAGING GROWTH

7.1.1 Tools for Change

CHC's entrepreneurial, swashbuckling founder Craig Dobbin was never one to look back. His style, and CHC's style, was to simply get bigger, fast. All current senior executives were weaned on this style of business development. By 2007, however, there were no helicopter operators of significant size left to buy (ruling out Bristow for reasons stated in Section 2.3.3, Page 8), yet demand for services remained high.

CHC was forced to grow organically. The only way to continue with the historical acquisition strategy would be to expand into other lines of business, which would likely not be acceptable to investors. So CHC is faced with changing the way it does business. This change requires a whole new tool box of resources. These new resources are required at a time when high growth costs resulted in limited financial resources.

The bottom line is CHC needs new business ideas. For this to happen, the company must add new senior executives who can offer a fresh perspective to the current leadership.

7.1.2 International Relations

As discussed above, CHC's Global Operations Division will soon become the largest corporate division as rapid growth continues and the European market shrinks. CHC Global has expanded successfully over the last three years. The company should continue to place emphasis on good relationship-building and national training programs. But due to the pending critical importance of global markets, CHC should consider hiring a senior executive with specific international relations experience. Additionally, CHC should have good access to international legal expertise, either internally or through an established partner.

7.1.3 Heli-One

One of the reasons for the creation of the Heli-One structure was to allow CHC to dry-lease aircraft into jurisdictions where it could not gain an operating licence due to nationality requirements. Some markets will always remain closed. CHC should keep the Heli-One leasing structure intact, even if other parts of the business (R&O or logistics, for example) are sold. This may not be as unlikely or speculative as it seems, since CHC has a history of selling off its R&O division (sale of Vector Aerospace, 1998).

7.1.4 Leasing

History has shown that aircraft can have 30-year lifespans. Often, CHC aircraft are tied to one location due to lender's demands (for example a leasing company may offer a good lease rate but require that the aircraft only be operated in Europe). CHC must ensure that all leased aircraft, and all owned

aircraft subject to lender's conditions, are approved for relocation to countries in which CHC is likely to operate.

7.1.5 Global Task Force

If Douglas-Westwood's 8.5 percent offshore annual growth forecast is correct, and Mearn's 7.6 percent UK offshore decline forecast is correct, CHC should see its European fleet decrease by approximately 25 aircraft and its international fleet increase by 35 aircraft by 2011. Although the projected UK Harmonized SAR project may pick up some of these aircraft starting in 2012, the estimated value of assets to be moved is approximately $500 million, and the number of staff associated with those aircraft is approximately 300. There will likely be retirements of aircraft and personnel in that period, but CHC should create a task force to analyse how to best manage the gradual transformation of the company and ensure knowledge transfer.

7.1.6 Remaining Competitive

Differentiation has allowed CHC to prosper in International markets and stay in the bidding in the European market. Pricing power has allowed CHC to thrive in Europe. However, Customer power is high and CHC's greatest threat is further exertion of that power, which may occur when the current high demand for oil declines. To help mitigate this threat, CHC should improve cost controls now, while business is growing and maximize profits and flexibility to be prepared for the downturn.

CHC is in a strong position in a growing market. But does the company have the financial strength to take full advantage of its position and to remain the world leader?

7.2 Financial Results and Potential Equity Offering

As discussed above, CHC's financial strength weakened in the 2005-2006 period as the company expanded. The company attributed reduced earnings and cashflow, and increased debt ratios and leverage, to the high cost of growth. Growth costs include: acquiring new technology aircraft, recruiting and training staff to operate and maintain new aircraft, acquiring major spare components, increased interest rates and higher administration costs. While the long-term prospects remain extremely strong, financial pressure in the short term is intense.

As earnings fell in 2006-2007, CHC saw signs that industry analysts were losing patience with the high-cost-of-growth story. While the majority of the nine analysts that covered the stock remained its champions, three did not. RBC Capital Markets Angela Guo maintained a rather unusual 'Sell' recommendation for most of the 2005-2006 period. Research Capital Corp. Analyst Jacques Kavafian downgraded from a 'Buy' to a 'Hold' (actually a euphemism for 'Sell' at Research Capital Corp.) in late 2006. A third analyst stopped covering the CHC story altogether, claiming the high growth cost story was too difficult to sell to his clients. The high cost of SOX compliance combined with the high risk of the helicopter business in frontier markets such as West Africa meant that investor confidence was increasingly under threat.

CHC may have been given just the reprieve it needed with the billion-dollar helicopter services contract announced June 29, 2007. This contract, combined with positive forecasts for global offshore oil expansion, excellent opportunities in search and rescue and a spill-over increase in repair and overhaul, make the period from 2009-2012 look even more positive. Shortly after the contract announcement, CHC shares jumped to a 52-week high.

As observed in Chapter 3, however, operating cash flow entered negative territory in 2007 to the tune of more than $40 million, despite the sale of Survival One business unit during the year. While aircraft leasing seems secure, bonds and long-term financing costs could increase drastically if negative cash flow continues. The company's Standard and Poor's credit rating, would almost certainly drop if negative cash flow continues through fiscal 2008, triggering an automatic increase in borrowing costs. The end result is the company may not be able to competitively borrow the cash required for ongoing projects such as the Boundary Bay R&O facility – or even for ongoing working capital requirements – despite the fact that investor confidence has improved recently. In addition to creating financial stress the short–term cash shortage undoubtedly creates stress for the corporate treasury team. Let us not forget that CHC head office employees are working in a competitive job market in Vancouver, and may opt for less stressful jobs, leaving CHC without the senior staff it requires.

This potential short-term crisis could be averted through an equity offering – but one major snag remains: The Dobbin family's control of the company rests in its 60-percent control of the voting shares. If a significant amount of equity was

raised, the Dobbins would lose control and could be subject to a corporate takeover. Accepting CHC Chairman Mark Dobbin's assertion that he will continue to grow the company as his father had, the Dobbins appear unlikely to give up that control. Furthermore, CHC's European operating licences depend upon the Dobbin family's Irish citizenship.

An alternative is to issue a relatively small amount of equity, enough to pull CHC out of its cash flow crunch without jeopardising Dobbin control or operating licences. With 42.7 million shares outstanding as at April 30, 2006[li], CHC can issue a maximum 9 million shares while maintaining Dobbin control. The actual amount would be less depending on the total value of outstanding warrants and convertible shares. CHC has previously ignored the equity option due to dilution and the relatively small amount of money it could raise. But this option became more attractive, particularly as the share price approached $30, its highest ever, apart from a temporary peak that occurred in 2006 when Craig Dobbin briefly considered selling his shares.

Should an equity offering be viable at $30 per share, CHC may be able to raise more than $200 million, minus equity commissions and administration fees. This financing, although dilutive, would allow CHC to confidently survive fiscal 2008 and bridge the gap to 2009, when new oil and gas contracts in Norway commence and the major UK SAR contract reaches maximum value.

Further research is required, but CHC should commence an equity offer analysis immediately to determine exactly how much equity can be issued without jeopardising control, and forecast the anticipated price of that offering. In

Craig Dobbin's heyday he once decided on a Monday that the company was going to issue equity. Lawyers were contacted immediately and the press release announcing the offering as out by the end of the week. CHC executives should rekindle that Craig Dobbin attitude and make an equity offering a reality as soon as possible.

8 CONCLUSION

Under the leadership of Craig Dobbin, CHC was an entrepreneurial firm built through strategic acquisition and disposition. The fact that if flew helicopters was secondary to the buying and selling of companies. CHC behaved more like a holding company than a helicopter operator, but operated at a rapid pace under Craig Dobbin. Unlike holding companies, CHC stuck to on line of business, helicopter service. Each success verified the business model. The 1999 HSG acquisition was the ultimate takeover, more then doubling the size of the business. Craig Dobbin thrived on adversity and responded well to crisis. One might even argue the relatively strong, stable market conditions of 2004-2006 eliminated the incentive to do what he did best – orchestrate the bid deals. The continuous mergers and acquisitions may have also disguised flaws in the company's performance, such as a reliance on a strong US dollar for international success.

In the post-2004 era CHC did not face crises so much as it faced changes on many fronts, from customer demand to aircraft technology to SOX compliance. The G2G initiative was to address the maturing and consolidation of the global helicopter services industry, but somewhere along the line, it fizzled. A restructuring initiative did not have the business sex appeal of a major corporate take-over.

While G2G faded away the senior executive shrank. For various reasons, key managers and executives left. In 2006 Craig Dobbin passed away. But demands on those running the company intensified. Demand for new aircraft accelerated in all markets. Prospects in the oil and gas sector were stronger than ever. The easy solution of buying another company to meet that demand was no longer an option. The business was suddenly far more complicated.

But CHC has proved resilient. The company has shored up its leadership position with some shrewd moves such as tying up production lines of new helicopters so that competitors cannot easily supply the aircraft types customers are demanding. It has emerged as the search and rescue leader, taking that title away from Bristow. It survived the e-bidding war, and won the largest helicopter services contract ever in Norway.

CHC managed to achieve all this, but financial results were not what they should have been in the red-hot oil and gas services sector. CHC still faces significant challenges in the short term. Financial strain due to the high cost of introducing new aircraft will continue to pose a threat to sustainable growth and increasing interest rates represents a significant threat to profitability due to the company's highly leveraged position and dependency on aircraft leasing. Employee retention will continue to be an issue as pilots and engineers retire and the overall job market remains strong. High training costs, particularly for pilots, make employee retention a critical issue for the company as it expands.

But the greatest threat to CHC's aggressive growth targets is the effectiveness of the corporate structure and its senior executive. Under financial

pressure due to G2G's failure to generate synergies and cost-savings, and due to the high cost of new aircraft introduction, senior management appears to be further cutting the size of its senior executive and senior management team. This was done at a time when demands on these key personnel were increasing significantly.

Senior executives are expected to be in high demand. At CHC, however, senior executives are in perpetual demand, as there are simply too few at the top to act on all pressing issues. Until the changes that started with G2G are fully addressed, CHC remains at risk of losing key management personnel. To best address this issue, CHC needs a senior executive who has change management experience – and the ear and confidence of the CEO.

The loss of Craig Dobbin cannot be underestimated. In addition to providing guidance to the company Craig Dobbin was CEO Sylvain Allard's mentor for 25 years. Replacing a great mentor, or acknowledging the loss that one feels at the loss of a mentor, is not a topic likely to emerge at board meetings – particularly at a time when a company is facing change on virtually every business front. For this reason, a formal organization transformation exercise is of paramount importance for CHC. Without it, the loss of the company's founder and the impact of cultural change on employee retention will not be addressed.

CHC is also facing a financial challenge that requires additional resources at the senior executive level. Mark Dobbin and the rest of the Dobbin family cannot provide the type of ownership guidance that Craig Dobbin once provided. Craig Dobbin was passionate about CHC and adamant that as long as

he could run the business, he would run the business. Now the controlling shareholder is not one individual, but five – Craig Dobbin's five children, each with unrelated business interests of their own. CHC Chairman Mark Dobbin appears very much interested in carrying on the family tradition, but he must act in the interest of all four other shareholders. None of the four has expressed any interest in playing an active role in CHC.

This knowledge is, of course, known to shareholders and employees. One must consider therefore that at least some shareholders anticipate a sale of CHC, and therefore place a slightly higher premium on the stock. This, in turn, places increased demands on the company to perform, and increased pressure on the executives to deliver. One must also consider that this knowledge adds another element of uncertainty for staff.

These pressures, combined with the incomplete G2G exercise, increase the need for a formal transformation exercise. At the very least, such an exercise would give focus to a company that no longer focuses on mergers and acquisitions. The exercise would provide clear direction to staff and investors. The absence of action will produce negative results. Employees may focus on potential sale speculation, or see nothing but increased work ahead. Either way, employees will not be as focused and motivated as they might otherwise be.

CHC has a fantastic opportunity. It is in a most-enviable position in a high growth industry with tremendous barriers to entry and a functional duopoly. The addition of an experienced senior executive with external change management experience will allow the company to better capitalize on its strong position and

surge ahead as world leader. The strong, but presently undermanned team would then be better able to meet its target of more than $2 billion in revenue. It would be better able to secure growing, sustainable earnings.

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