Things Are Changing...

...So how should a corporation respond?

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Jay Mesinger compares the current market for business aircraft to the ups and downs experienced during the previous 15-or-so years and sees some very distinct differences.

In 2007, when we first started to feel the winds of our industry shift, market characteristics seemed to change all at once. One day we had huge demand for aircraft but limited supply and large premiums were paid for like-new aircraft. Delivery positions for new aircraft traded like commodities as backlogs grew. Then all of a sudden everything stopped. Activity ground to a halt. Prices began to tumble and orders for new aircraft were canceled. Backlogs shrunk, and people started to withdraw from transactions for pre-owned aircraft that were well under way. It was frightening. There was no blueprint or manual for how to survive this dilemma. In fact there was no way to forecast the depth of what was about to happen. People were actually walking away from large deposits just to cancel a deal.

I likened this phenomenon to a high school prom with boys on one side of the gymnasium staring at girls on the other side, but no one was dancing. Sellers felt that the market meltdown was temporary, so they were unwilling to take less for their aircraft even though all signals pointed down. Buyers were certain they had no need to pay the current pricing, so nothing happened. Our industry did not move. Jobs were lost and loans were being called or borrowers were being notified that additional funds were required to bring debt-to-equity ratios more in line with current market conditions.

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HOW ARE YOU ADAPTING TO MARKET CHANGE?

COMPARING MARKET DYNAMICS

In the 1999 downturn, which was precipitated by a weakening economy in Asia and bursting of the Dot-Com bubble, many factors were different. First and foremost our industry in 1999 was simply not as big as it was in 2007. During the recovery from 2002 through 2007 the market for business aircraft grew in large part because of emerging markets. Russia,

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China and the Middle East all added dramatically to the industry size. The smaller 1999 market experienced a fall that was nowhere near as quick or steep as the decline in aircraft pricing we saw in 2007. In fact the 1999 downturn was the first time in my career that I could suggest a buyer consider a new aircraft rather than one that was pre-owned. Then the delta between a new and pre-owned aircraft was not as great as it is today. Also, in the period between 1999 and 2002 most manufacturers had "White Tails" sitting on the ramps.

Immediately prior to the 2007 meltdown, the price of a pre-owned aircraft for immediately delivery was very high—in fact in some cases higher than the list price of a new model that was not available due to the OEM's substantial backlog. Purchasing new was an attractive choice for those buyers who had secured favorable delivery positions.

Today, as I talk to mature flight departments as well as first time buyers, promoting new rather than pre-owned is a much tougher sell. Buyers look at the pricing of the pre-owned aircraft and the choice is clear. Pre-owned wins out far too often. This situation creates continued hardships for the Original Equipment Manufacturers. The mix of new vs. pre-owned business jet transactions for 2007 and today reflects this change in market dynamics; while the number of sales in 2007 and 2013 are almost identical, new outsold pre-owned by a ratio approaching 2 to 1 in 2007. The comparable ratio for 2013 was 0.66 to 1.

LESSONS LEARNED

The current health of our industry is good on many fronts. When aircraft sell, regardless of new or pre-owned, jobs are created. Pilots are hired, and maintenance facilities are engaged for pre-buys and modifications. Insurance policies are sold. Brokers are hired, hangars are rented and fuel is sold. All such activity is very positive. I know the manufacturers are working to bring to the market new products that offer more capability and efficiency to meet emerging mission requirements, and those OEMs that do so will experience faster recovery.

Another lesson learned from operators during this downturn is that great value remains in aircraft that have flown beyond their warranty terms or exceeded their depreciable life. The past culture of so many corporations was that the predictable time to transition from the current aircraft to a new one was based on warranty and depreciation. This rule-of-thumb changed after the 2007 downturn and may never revert back. The useful life of the current in-service aircraft is long, and aircraft transition is focused now more on change in mission and capability than merely age.

I think the next several quarters will be very telling with respect to aircraft prices stabilizing. Remember, flat will be the sign of a new Up Market!

Do you have any questions or opinions on the above topic? Get them answered/published in World Aircraft Sales Magazine. Email feedback to: Jack@avbuyer.com

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