

Future Residual Values

A New Challenge, Acronym & Metric

How do you project future residual values when you have more aircraft iterations and brand-new clean-sheet aircraft being built, creating a more frequent new aircraft buying cycle, asks Jay Mesinger.

If it were easy, everyone would be doing it! Of course, I refer to the role of the aircraft broker in advising, buying and selling. Well, here we go again: a new challenge, working to predict future residual values at a time in our industry with more impacting factors than ever before... Faster-paced aircraft innovation will drive a more frequent new aircraft buying cycle. That will mean that more used, but capable aircraft will be flowing into the pre-owned market at a faster pace. Owner's concerns about how new aircraft in a market affect the value of older versions are not new, they are just going to be a reality we face more frequently than ever before.

I met with an Asset Management Specialist from one of the largest aircraft lending institutions in October. He said the exact same thing a few other Asset Specialists have said to me lately: they are finding it increasingly difficult to establish residual values. In fact many have simply thrown up their arms and do not even try to set this critical future benchmark. They articulate the same reason: too many new aircraft models and iterations confusing the metrics and evaluation.

The Challenge: With the spread so great between pre-owned prices and new, many buyers have been reluctant to buy new aircraft because without much new innovation over the last ten years, older versions of the same aircraft that are still delivering new provide the same benefit for a lot less money. Many manufacturers have struggled to sell new aircraft against pre-owned options. Many owners have also decided to just invest in their aircraft - upgrading avionics and modernizing with new paint and interior rather than buying new.

The OEMs have, however, worked to solve this problem of longer ownership cycles by creating new aircraft models that offer large enough differences to make buyers realize that their new needs cannot be met by simply modernizing what they have. These include greater fuel efficiency, improved engine performance, wing development, flight deck performance, and increased cabin environments and management systems. Bombardier's Global 7000 and 8000; Dassault's Falcon 5X and 8X; Embraer's Legacy 450 and 500s; the Gulfstream G500, G600 and G650ER; and others are all raising the bar significantly.

So why the challenge? Because, as new aircraft are designed and delivered, and the pace of innovation of new aircraft increases, we have a universe of potential aircraft options that are very competitive with few mission fulfillment differences, but significantly different price points...

This competitive landscape of aircraft is interconnected. As more new aircraft are released and the older versions enter the pre-owned market with prices that continue to be pushed down, it is challenging to predict where any single aircraft's future is headed without considering many new and evolving factors.

The Acronym ALM (Aircraft Lifecycle Management): Everyone gets excited when visiting the Manufacturer's displays at trade show events, but the post-show conversations we have with clients tends to center on "what is my current airplane's value going to do when this new model comes out?"

It's a fair question, but one that is hard to determine and should not be answered quickly and without complete industry input. We must begin a dialog with the key participants of our industry to build what can be a set of guidelines and metrics for this assessment.

- How will manufacturers discuss this with customers?
- How will lenders accept this incredible number of product iterations and begin to build residual value components with renewed confidence?
- How will customers feel about the discussions?

Aircraft may depreciate at a faster rate than they have ever done before. There are only so many buyers in the world and the OEMs are, as they should be, fighting to increase the sale of new aircraft and shorten buying cycles. After all, it is through new aircraft cycles that they will survive and we need the new innovation in the industry. This does, however, increase the flow of pre-owned aircraft in the market and pricing pressure falls from the top of the market down through the smallest and oldest aircraft.

We'll see newer, bigger, more capable aircraft piling up at various price points throughout the pre-owned market going forward. Of course, buyers should never buy more than what they need to complete their mission, but the increasing flow of newer, good pre-owned aircraft will continue to confuse the already muddled aircraft markets.

The Metrics: We are having these important discussions with the key industry participants. We're working to build our internal metrics. And, while the discussion about future projected residual values has always been a part of our discussion, it has started to take a different tone and be based on a different set of metrics.

I do believe that it is not just the new airplanes or the near-new aircraft that will be impacted by the influx of product iterations and developments, it will trickle down to every airplane that is being bought and sold. We as an industry cannot, and will not abandon what is critical to any asset management. Residual Value. But we will need to evaluate a greater set of factors within a new metric. ■

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