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A new lease of life

Older turboprops are enjoying strong demand in niche markets. But their small jet cousins, and Boeing classics, are finding the going a bit tougher as fuel prices remain high, finds **Keith Mwanalushi**

As an aircraft ages, and is no longer required by its owner, there are several routes to retirement. Right at the end of the line is recycling – a new life as a beer can. More profitably, an aircraft can be stripped for spare parts, or, better still, sold or leased to another operator. And of course, the value will depend on age, demand and availability. But with residual values currently looking weak on certain types, as fuel prices continue to rise, clever remarketing and lease strategies will become more critical.

Leasing has become an increasingly attractive option for aircraft operators of all shapes and sizes. Currently, 33% of western-built jets are on operating lease. This is a growing figure expected to level off at about 35% to 40% over time, according to aviation consultancy Ascend.

The turboprop sector has demonstrated the strongest resilience in terms of values due to the lack of supply. Aircraft remarketing specialist Airstream International indicates that the market is challenging for regional jets, but stronger for turboprops, especially the Dash-8 range, and all variants of the ATRs and it sees improving opportunities for smaller types, such as the Saab 340, Dornier328 and Embraer 120.

By and large, the ATRs seem to have better secondary prospects. Owen Geach, commercial director at the International Bureau of Aviation (IBA) observes that the manufacturer has done a sleek job in terms of marketing, financing, and supporting customers of both newly delivered ATRs and those on the secondary market.

He says: "Traditionally the market has been very tight, there are only a handful of ATRs that are effectively on the market. They tend to get placed more quickly than other aircraft in the competing sector." He points out that even with Kingfisher Airlines returning 30 aircraft the market will still be able to absorb that sort of quantity. "That gives you an idea of the resilience of the ATRs.

"In terms of retirement age residual value, a good point to make is that the ATR 42 also makes for a good freighter conversion candidate. So there is effectively a third market after its primary and secondary market."

ATR spare parts, particularly engines, propellers and landing gear also enjoy a second wind. "Again, it's a tight market, primarily manufacturer controlled," says Geach. "There are only a few suppliers, so ATR material sells quickly."

Geach saw this recently with the sale of Alitalia material. "We ended up in a very competitive auction with two or three bidders paying many millions of dollars

StarPeru now operates 9 BAe 146s. The Latin American market is proving receptive to the aircraft type
photo: BAE Systems

With more than 1,630 CRJs still in service, spares for the CRJ 200 are plentiful *photo: Bombardier*

for an ATR 42 spares package. I would say it is the most sought-after regional aircraft in terms of spare parts."

UK-based Skyworld Aviation specialises in aircraft remarketing and airline fleet management. Managing director Chris Beer has also observed the trend. "The Saab 340, ATR 42/72 and Dash 8 markets are all showing movement despite the moderately high availability. The high number of operators of the ATR product has sustained the market so we see the ATR 42 and ATR 72 as showing the greatest potential for remarketing. Due to the volume of ATRs produced, which are largely still in operation, the pricing has remained at a relatively consistent level."

The Saab 340 first flew in 1983, but declining sales forced production to end in 1998. Skyworld has concluded over 100 Saab 340 transactions.

"We have seen some older regional turboprops, especially the Saab 340As, move into alternative cargo roles. About 25% of the original Saab 340A fleet are now cargo converted and are mainly operating in central/eastern Europe and the Caribbean area," adds Beer. He further notes that there is a growing movement of older turboprops, particularly Saabs, into areas outside of Europe and North America as markets open globally.

President and CEO of Saab Aircraft Leasing, Michael Magnusson, agrees. "We are getting interest from some new places we have not done business before. In the last year, we have placed aircraft in Mongolia and Thailand for example. At the same time, we still have interest from North America."

Magnusson adds that the lower capital cost and lack of new aircraft has created steady demand for 30 to 50 seaters. "The markets that can support a switch from turboprops to regional jets have already done so, which means the routes that are still flown by turboprops are only economically feasible with turboprops, and even more so with oil at $100 per barrel. We are working to extend the life of the Saab 340 from 60,000 hours to 75,000. It's already at 90,000 cycles."

Beer says that the Saab 340 B model has not had the same cargo interest as the A model, mainly due to the capital cost being significantly higher. "By comparison there have been relatively few sale transactions involving the B model during the last few years, and only one Saab 340B has undergone a cargo conversion."

Beer adds that current values of the A model lie between $1.25 million and $1.60 million, the lower figure being a run out non-European operated aircraft. B models are still achieving prices of between $1.75 million and $2.5 million.

Regional Express Airlines (Rex) of Australia has leased 25 Saab 340B-plus aircraft in the largest lease deal for the type. The 'B-plus' version has a redesigned extended wing to increase flight performance and fuel efficiency. These have been put into service as of 2010. With the delivery of these 340B-pluses, some of the older aircraft have been phased out of the fleet, including all Saab 340As.

In terms of general availability, Skyworld Aviation has observed that during the economic downturn in 2009/10, availability of regional aircraft became significantly higher, which induced an overall drop in price across regional types. Beer stresses that over the last six months or so, this availability has begun to tighten up as the lower pricing has attracted new entrants into the market.

"There is still high availability of aircraft across the board but there is continuing demand which was different from a year ago, and this is resulting in a high turnover of aircraft on the market. From our own experience during the last few months, we are seeing more credible enquiries and fewer brokers come into the office, particularly from less-established operators in developing markets," says Beer.

IBA's Geach sees the greatest challenge in the 50-seat regional jet market. He points to the Bombardier CRJ 100/200 as being available in mass with comparatively few sales, with many being sold off for tear down. "I would include the ERJ 145 in that bracket – not so many opportunities, plenty of aircraft available and a tough time certainly for the manufacturers and owners of those aircraft."

Geach gives examples of LOT Polish Airlines, which put its ERJ 145 portfolio up for sale, as well as about 25 ex-Alitalia aircraft that are parked in France waiting to go into service in the Ukraine. "A substantial portion of the world fleet is currently parked or out of service, and that obviously has an impact on both lease rates and values."

Rob Sheridan, vice president, asset management at Bombardier Commercial Aircraft not surprisingly, has a different view. "In fact, we're seeing an increased level of ▶

Sheridan: seeing increased interest *photo: Bombardier*

Geach: sees challenges for small jets *photo: IBA*

interest for all pre-owned CRJ models from traditional and emerging sectors of the aviation industry around the globe. There are over 1,630 CRJ aircraft in service today so from a parts commonality perspective, it's a big selling feature."

He adds: "From a lessor's point of view, CRJ aircraft are attractive because they can be used to explore breakthrough markets or used in applications in airline services, corporate/shuttle conversions and package freighters versions."

Earlier this year Air Namibia began to take delivery of the first of three ERJ-135s. The remarketed ERJs are leased from the Embraer ECC leasing company, replacing an ageing but popular fleet of four Beechcraft 1900Ds.

As airlines expect to see sustained higher fuel prices this may tip the balance between capital cost and operating costs in favour of operating newer aircraft – a philosophy that has worked for LCCs such as Ryanair.

Rob Morris, vice president marketing and analysis at BAE Systems Asset Management, agrees that higher fuel prices can alter the cost balance of an aircraft between fixed and variable, based upon fuel burn, but he also highlights other issues to consider. "As for the point at which the balance tips between fixed and variable, this is of course dependent upon the aircraft type and network performance."

To illustrate his point, Morris notes that in 2008, a barrel of crude oil was sky-high at $375. With jet fuel prices at $3.67 per gallon, an Avro RJ85 operating 2,000 hours per year on a 500km sector was able to demonstrate a $65,000 per month operating cost advantage over the same sized Embraer E190. With all things being equal, his calculation showed that at the time, jet fuel prices would need to reach $11.1 per gallon for the capital cost advantage of the RJ85 to be overturned in favour of the fuel burn advantage of the newer Embraer.

"So as you can see, I take issue with the statement that the balance has now been tipped," says Morris. "We are constantly analysing the performance of our own portfolio of BAe 146 and Avro RJ against competing aircraft types."

Morris also explains that the BAe 146 and Avro RJ fleet in operation has declined by about 15% over the past couple of years, to some extent due to fuel prices, and in particular the current uncertainty allied with the memory of the high prices seen in 2008. "This is not a trend we expect to continue in the near and medium term. Despite this apparent trend we have continued to see sales success for the aircraft through the past couple of years."

Figures from BAe show that the company made 44 aircraft transactions in 2009, which included 29 BAe146/RJ aircraft. This figure shot up to 52 transactions last year, of which 41 were jets. "I think this illustrates that we can continue to find placements for the aircraft, both lease and sale, across a number of market sectors."

Naturally, the future performance of the BAe asset management business will largely depend on the Fortress Investment Group that is expected to buy the business by the third quarter of 2011.

The cascade effect of airline upgrades to newer generation Boeing 737s will see a number of 737 classics come onto the market over the next two years, according to IBA. "We are already seeing the impact of that," says Geach. "A year ago, a 12-year old 737 would have sold for around $8 to $9 million. We are aware of one identical example involving a 12-year old 737, where the seller was struggling to get more than $4 million, literally in the space of a year. Due to market liquidity, the demand and hence the offer price for a 737 classic has fallen dramatically."

Ascend has similar figures. Paul Sheridan, head of risk advisory, emphasises that current market values for early 737s and Airbus A320s are low, typically between $4 and $8 million, but all below $10 million. More than 10% of the fleet is now in storage.

"It's hard to find many positive things to say about the market for these aircraft. With high oil prices in the back of every fleet planner's mind, the cost of acquiring any classic aircraft will have to be low to offset the higher operating costs. We saw the same thing happen with the MD-80s. There are still over 2,000 737 and A320 classics in

The A320 saga

European cargo airline West Atlantic was the launch operator for the A320 P2F. An initial three aircraft were expected to be leased from AerCap with deliveries over the coming three years. However, with the recent announcement to terminate the A320/A321 freighter conversion programme by Airbus and its partners, conversion focus will likely return to the 737 classics and A310s. According to Airbus, recent market developments, including the success of the upcoming A320neo, have resulted in more demand for A320 passenger aircraft and less for freighter versions in this category.

SA Airlink has rolled over its earlier fleet of four BAe 146-200s in favour of newer RJ185s sourced from BAE Systems *photo: BAE Systems*

BAE Systems completed a new lease for six RJ100s with Swiss late last year, and the airline will operate the type -20 in its fleet – until the arrival of the Bombardier C Series in 2016 *photo: BAE Systems*

service around the world however, so they won't be disappearing overnight," he says.

Yet there are limited opportunities to place older types in locations that would have previously snapped them up – such as Brazil, Russia, China and Africa. These regions now have age restrictions in place that range between 12 and 20 years, significantly affecting demand.

The industry has also witnessed some newer 737s going onto the secondary market partly due to the fleet strategies of airlines such as Ryanair. Geach says: "With the likes of Ryanair there is a very clever game. They ordered 737-800s in mass, negotiated substantial discounts, possibly 40% on the list price from Boeing, and just a couple of years later they are now selling these aircraft and probably expecting to get not far from what they paid for them." ■