

Signs of an aircraft market recession emerge

The next five years will see more than 1,000 aircraft being retired from primary carriers. This combined with signs of declining airline profitability indicate the possibility of a surplus of used aircraft.

The first indications of a downturn in the aircraft market have emerged in recent months. A number of aircraft of several types have become available on the market and there are few signs the majority will be acquired over a short period.

Deliveries of new aircraft have been a record high this year and are forecast to peak even higher in 2000, subject to cancellations. The average number of new aircraft deliveries required to satisfy retirements and traffic growth is about 500 units a year, although this number steadily climbs.

The exceedence of this number by 300 and 400 units over 1999 and 2000 means deliveries will decline in 2001, as indicated by the number of outstanding firm orders.

The reduction in new aircraft deliveries is just one area of the aircraft market expected to suffer. There is also an excess of used aircraft.

Widebody market

The DC-10, praised for its durability and quality as a freighter, has always had a strong secondary market and values. Acquisition of a large number by

Continental earlier in the 1990s increased market values. A glut of DC-10s on the used market was also avoided when FedEx made plans to acquire all of American's and United's -10s. This removed the spectre of a DC-10-10 overhang and collapsing values of other models. Northwest's acquisition also kept the DC-10 market healthy.

Many have been advocating that large numbers of DC-10-30s would be converted to freighters. The aircraft's performance in this role has certainly led many to believe in the DC-10 as an investment prospect. FedEx, however, is the only freight operator with a large fleet. Gemini Air Cargo has six, but is now buying MD-11s. Das Air Cargo is one of the few other small DC-10F operators. A few more fleets may emerge, but these will be small.

Omega Air of Ireland has agreed to acquire all of Japan Airlines' DC-10-40s. Some have already been converted and leased to Challengair Cargo. These are expected to be returned, now the airline has been bought by UPS.

The British Airways fleet of eight aircraft were bought in summer 1998, and a few converted to freighter. Continental, meanwhile, has begun to return its aircraft to lessors and its fleet of

30 will come on to the market over the next few years.

Garuda now has five -30s on the market. This number could soon be joined once the merger between Air Canada and Canadian has been resolved. There is an excess of capacity on the Canadian market. Consolidation is likely to see the disposal of Canadian's DC-10s before most other types. This ignores the effect of other fleets belonging to carriers such as Iberia and Japan Air System coming on to the market in the next few years as they take delivery of replacements.

Although freighter aircraft in the DC-10's and 747's size bracket is expected to grow by 550 units in the next 20 years, the number of DC-10s on the used market will exceed those converted to freighter and sold into other used markets. One final consideration over the DC-10 market is the impending retirement of MD-11s, which can be acquired for as little as \$40 million. Many DC-10s could therefore get parked.

There are indications of freighter conversion programmes being launched for the 767-200 and -300. The 767 could be a good freight contender, but the combined number of 767s/A300s/A310s will again exceed the requirement for conversions. Values of several types could come under pressure.

The 747 used market is at one of its lowest levels. Although about 100 747-200s are expected to get converted over the next 10 years, there are more than 200 still in passenger service, or already on the secondary market. This includes Garuda's fleet. Major fleets have been retired in recent years, including more than 30 by BA and United. This has



The number of DC-10s and 747s being retired by major carriers exceeds predictions of the number that will be converted to freighters. Market values for these are already at low levels and are likely to fall further.

already forced the collapse of the 747 market and its associated engines and components.

BA is also undergoing a downsizing strategy and may retire its -200 fleet earlier than originally expected. Other airlines have already gone through a similar process, such as United and Continental which have taken smaller 777s as replacements.

The excess of 747s has pushed -200 values down to just \$6-15 million, depending on engine model and maintenance status. Total aircraft values are equal to just the market value of their engines. Further retirements will not be eased by an equal number of freight conversions and so 747 values will be forced even lower, possibly to scrap level.

Narrowbody market

There are also prospects of a large number of narrowbodies entering the used market over the coming years.

The eventual ordering of the last 727 replacements earlier this decade by United, Continental, Delta, American and USAirways will see several hundred 727s coming onto the market for another five years. Fortunately the 727 is still popular in the freight market and 200-300 are predicted to go through freighter conversion.

The 737s and A320s ordered to replace 727s will also displace older 737s, DC-9s and MD-80s. The 737 and DC-9 have always enjoyed a strong secondary market, but this is likely to change.

South American airlines are now ordering larger numbers of new aircraft and DC-9s are unlikely to be converted to freighters. The 737-200 is also unpopular as a freight conversion candidate. One possible market for 737-300s and -400s is to replace the 727-100F fleet. This will not be before 737 values have fallen enough. Although 737-300s and -400s are not yet being retired, USAirways is one operator which has made order commitments to replace its fleet.

There is, however, an excess of 737-300/-400s on the market. UK carriers AB Airlines and Debonair both left 737s on the market when they ceased operations recently, as did Norwegian operator Color Air when it failed.

The 737 is also declining in popularity with European operators. Examples are Aero Lloyd and British Midland.

One narrowbody due to retire by several hundred units is the MD-80. Although appreciated for economic efficiency, noise compliance and durability, a secondary market has simply not materialised. Some have tried to promote freighter conversion. The MD-80's cabin cross section, however, is likely



Several hundred MD-80s are due to come onto the secondary market over the next five to 10 years. So far there are still no signs of a strong secondary market for the aircraft.

to persuade most against a freighter conversion programme.

The MD-80 is not only expected to come onto the used market from the US majors, but also European airlines such as Finnair and Alitalia. These have both ordered A320/21s as replacements.

Airline profitability

Unlike the early 1990s, aircraft retirements now due are a result of replacements not made during the last airline profitability peak. A glut of used aircraft will thus occur despite strong airline financial performance in recent years.

Airline profitability is in a fragile position, however. Fuel prices are rising and increasing competition and capacity has seen unit revenues for US domestic operations decrease by almost 1.0 cent per available seat-mile since a summer peak. Forecasts by Merrill Lynch are for a further fall of another 1.0 cent.

Fuel prices have increased by 25%. This is not to an excessive level, since fuel prices have been low for a few years. This has been a major factor in high airline

profitability. A one cent rise in the price of fuel, however, equates to a rise in US industry costs of about \$190 million. Some of the recent rises have been avoided by fuel hedging. Fuel prices have increased by about nine to 15 cents per US gallon over the past year. US airline profits are therefore down on the third quarter 1999 compared to the previous year.

Falling airline profits and excessive capacity growth could then result in corrective action. This will precipitate an earlier fall-out of older narrowbodies, overcrowding the used aircraft market more than already anticipated.

Overall it is clear that even without predicting an airline downturn, a large number of aircraft will come onto the used market in the next five years. This will exceed all possible secondary markets and values will suffer. The numbers could be large and persist for several years.

