

The surplus parts market comes of age

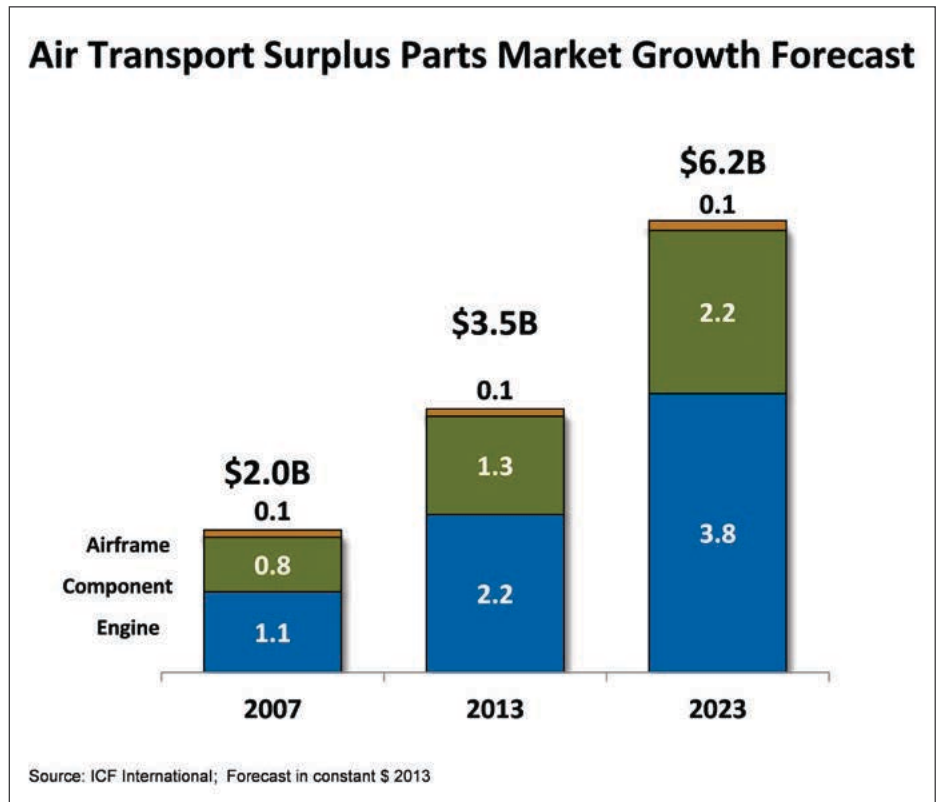
Analysis by Kevin Michaels, VP, ICF International

New service parts, or “spare” parts, are the lifeblood of commercial aerospace industry profits. Annual consumption is in excess of \$20 Billion in the air transport sector alone, and most OEMs garner the lion’s share of their profits from this vital aftermarket revenue stream. Commercial aerospace is the ultimate “razor-razor blade” business model.

Alternatives to new OEM parts are therefore a big deal. PMA parts are the best known, yet have achieved a modest 2% market share after decades of effort. A less glamorous, but fast-growing alternative is surplus parts, which have emerged as the key threat to the OEM service parts revenue stream. My firm has studied the surplus parts market extensively and estimates annual consumption is \$3.5 billion – about six times as large as PMA parts and a 12% market share. Moreover, the use of surplus parts is poised to grow significantly over the next decade. ICF’s nominal scenario is for surplus parts usage to reach \$6.2 billion by 2023 (constant dollars) – a 5.6% annual growth rate.

Several factors will fuel the growth. With savings of 30% or more versus OEM new list prices, customer demand continues to increase – particularly with airlines that were loath to use surplus parts in the past and won’t consider PMA. Surplus parts supply will also expand with an expected wave of aircraft retirements. ICF anticipates up to 1,000 retirements per year later this decade, up from just over 600 today. Also underpinning the growth is the changing nature of the surplus parts supplier business model itself, which has transformed from a cadre small, agile and capital-constrained parts “traders” to large, integrated suppliers with ample access to capital.

Notably, engine OEMs and aircraft lessors have become major participants and comprise five of the six largest surplus dealers today: GE (including GECAS), Pratt & Whitney, CFM Materials, GA Telesis and AeroTurbine (owned by ILFC). System OEMs have been slower to participate, exceptions being Rockwell Collins and Honeywell. As a result, these well-heeled suppliers can proactively pursue aircraft part-outs to ensure inventory availability on new generation aircraft. Today, over 80% of surplus parts come from aircraft part-outs, up from 55% a decade ago. For lessors, surplus parts are a useful extension of their business model. A 15-year old aircraft, for example, might be worth more parted-out than leased to another operator.



Not surprisingly, the lure of relatively quick returns from aircraft part-outs is also attracting outside capital. GA Telesis, for example, recently raised \$500 million from institutional and private clients to establish a new aviation investment vehicle focused on part-outs. Private equity and hedge funds are also investing. Some industry veterans worry that too much capital is pursuing part-outs and inflating used aircraft acquisition prices to unsustainable levels as well as surplus supply.

What do these changes mean for OEMs, and their all-important service parts revenue streams? First, OEMs must pay greater attention to their service parts businesses – particularly for mature and sunset aircraft. In these phases of the aircraft life cycle, service parts list prices are out whack with market realities after years of automatic price increases. Parts availability for some OEMs is poor, which increases customer demand for surplus parts (and PMA). OEMs also need to recognize the need for tailored maintenance work scopes integrating surplus parts should airlines demand this. Rolls-Royce, for example, recently introduced TotalCare Flex, a service offering tailors the maintenance work scope for mature and sunset engines. Finally, many OEMs must decide whether or not to participate in the surplus mar-

ket directly. While the largest engine and avionics OEMs have taken the plunge, dozens of other OEMs must determine their role in the surplus market: participate, partner or monitor?

For independent MROs, surplus parts are a mixed blessing. On one hand, they create an opportunity for price differentiation and low cost supply for rotatable banks. However in some instances surplus retailers effectively compete with MRO services and may reduce maintenance demand for mature aircraft models.

Finally, for operators, surplus parts provide a rare chance to attack aircraft maintenance costs, which account for 15-18% of an airline’s operating costs. Some large airlines are buying and parting out aircraft themselves (Delta MD90s are a good example) while others are demanding revised work scopes from their suppliers.

Whether surplus parts reach our \$6.2B estimate by 2023 remains to be seen, but it is clear that this OEM service part alternative has come of age as a key element of the global MRO industry.

Global Eagle Entertainment, a worldwide leading provider of content, connectivity and digital media solutions to airlines, has been selected by **WestJet** to manage its inflight content services. WestJet is currently overhauling its existing inflight entertainment (IFE) system and replacing it with a wireless IFE solution. Global Eagle Entertainment (GEE) will provide a broad array of content that can be accessed by passengers using their personal electronic devices or tablets rented from the airline. Through this long-term agreement, GEE will provide a selection of current movies and television, including a wide catalog of engaging and entertaining programs, beginning in the first quarter of 2015.

AerData, the provider of lease management, records management and engine fleet planning software announces that **Air Serbia**, the national airline of the Republic of Serbia, has selected AerData's STREAM software. STREAM (Secure Technical Records for Electronic Asset Management) is the industry's foremost web-based solution used by some of the world's largest airlines, lessors and MROs to manage aircraft and engine records. AerData was acquired by **The Boeing Company** and became part of **Boeing Commercial Aviation Services** in May, 2014. AerData products are now part of the inte-

grated suite of aviation services marketed as the Boeing Edge. These include parts, training, engineering, maintenance and software solutions that increase the efficiency and profitability of airlines and leasing companies.

Volartec welcomed two new Alkym customers to the APAC region. Both are based in Indonesia and are part of the same group. The MRO company **Aero Nusantara Indonesia (ANI)** has selected Alkym to replace their existing MRO IT solution. At the same time **Xpress Air** with their strong links to ANI will also benefit from the fully integrated solution provided by Volartec.

Garmin International reported the certification of an Automatic Dependent Surveillance-Broadcast (ADS-B) solution for the Gulfstream G150, bringing **NextGen** compliance to this versatile mid-sized business jet. The Garmin GTX 3000 Mode S Extended Squitter (ES) remote transponder and GDL 88 ADS-B datalink combine to fulfill global ADS-B requirements while meeting the stringent demands of business and transport category aircraft. This cost-effective ADS-B upgrade meets the immediate needs of business aircraft that have limited options to address global airspace requirements.

People On The Move



Dennis Orzel
Photo: PAS Technologie

PAS Technologies announced that industry veteran **Dennis Orzel** has rejoined the company's senior leadership team as Chief Operating Officer. In this role, Mr. Orzel will be responsible for all product development targeting top line

growth while leading the engineering and program management functions. He will be based in Middletown, Connecticut. PAS Technologies specializes in providing cost-effective original equipment manufacturing (OEM) and maintenance, repair, and overhaul (MRO) products, services and solutions for the commercial and military aerospace, Industrial Gas Turbine (IGT), and oil and gas (O&G) markets.

AJW Aviation announced the appointment of **Danielle Kaskel** as the new Senior Manager for Business Development – North America, based in the Miami office. In her new role at AJW, Danielle will focus on developing the Company's relationships with new customers while seeking key opportunities to ensure its corporate success across the competitive marketplace in the Americas. Danielle is an experienced business development professional, with a history of sales and management success. Prior to joining AJW, she was Business Development Manager at AeroTurbine where

she first started as sales representative in 2010.

SR Technics announced that **Frank Walschot**, Head of Engine Services, has been promoted to Chief Operating Officer as of January 1st, 2015. Commenting on Frank Walschot's appointment, SR Technic's CEO **André Wall** said: "There is no doubt that Frank is the right person to ensure that our global operations will be based on known and valued safety and quality standards. SR Technics is a business with big ambitions and a clear strategy for growth. His appointment allows me to spend more time driving innovations and strategic relationships with customers and partners as we take our global corporate strategy forward."

Tom Williams, presently Executive Vice President Programmes at Airbus, will succeed **Günter Butschek** as Airbus Chief Operating Officer (COO) and will become a member of the Group Executive Committee of Airbus Group. Butschek has decided to leave the Group at the end of 2014 in order to pursue other career opportunities. **Didier Evrard**, currently Head of the A350 XWB programme, will succeed Williams and in this new function will become a member of the Executive Committee of Airbus. He remains A350 XWB programme director until his successor is appointed. **Klaus Richter**, Chief Procurement Officer of Airbus and Airbus Group, has been promoted to become a member of the Group Executive Com-

mittee of Airbus Group. In addition, he will become the national representative for Airbus in Germany.



David Brigante
Photo: ATR

David Brigante has been appointed as new Senior Vice-President of the new Procurement directorate of ATR. He will be in charge of the contract negotiations with the suppliers of the aircraft manufacturer and will report to ATR's Chief

Executive Officer **Patrick de Castelbajac**. He will sit on the Executive Committee. During his career, he has held a number of successive different positions within Alenia Aermacchi. Since the end of 2012 he was Senior Vice-President Customer Support and Services, being responsible for the logistics support of all military programs in Alenia Aermacchi. Previously, between 2010 and 2012 he was Senior Vice-President Procurement, and was in charge of all products and programs. From 2008 to 2010 he held the position of Senior Vice-President Industrial Control and Planning, while between 2009 and 2010 he was also in charge of the Commercial Programs of Alenia. He joined Alenia in 1988, and up to 2008 he had covered responsibilities from contract management to sales activities always within the commercial field for aerostructures.