

# Parts Pricing Puzzles

What goes up might not come down. **By Henry Canaday**

The pricing of aircraft parts depends on inflation, productivity improvements in manufacturing, part quality enhancements and the balance between supply and demand. Prices to individual purchasers depend on the competition they face and the strategic choices they employ.

General inflation remains low in 2012 and part markets appear to be coming into better balance as a result. But part prices still vary substantially by model and part type. And purchasing strategy makes a big difference. Smart buyers look at all options, including parts manufacturer approval (PMA), used parts where possible and long-term contracts that offer some modicum of price protection. Simply waiting for original equipment manufacturers (OEM) to announce part-price increases and then paying these has become far too costly.

Wedbush Securities' latest Commercial MRO Survey Report sees maintenance backlogs softer but fundamentals still holding up pretty well in 2012. But it is worried about MRO work in the second half of 2012.

The report notes that part sales rose strongly in the fourth quarter of 2011, up 5.6% from a year earlier, and will grow more than 5% in the first half of 2012. But the urgency in part restocking, seen in mid-2011, is over. Pricing power of part suppliers may weaken this year. "I expect a moderate low- to mid-single-digit increase in OEM prices, about 3-5% in 2012," says Ken Herbert, Wedbush research VP.

Herbert reckons that 5% is about the normal rate of OEM part-price

escalation, and airlines usually do not have much choice except to pay it.

Carriers may get a better deal from used parts on older aircraft that have been parted out. And for new aircraft, some airlines get price protection under long-term contracts.

"Some airlines are in a bad spot,"

COMPANIES may have stopped destocking material, but Wedbush does not expect them to restock or purchase ahead of demand similar to what happened in mid-2011.

Herbert says. "Major carriers that provide cost-per-hour (CPH) maintenance to other airlines may get hit by higher-than-expected OEM part prices and have to renegotiate their CPH deals."

In the small portion of markets threatened by PMAs, OEMs may cut prices 5-20% to maintain their shares or offer bundles of discounted parts to keep customers from seeking favorable PMA deals. But these actions are limited by PMA shares. "They are a drop in the bucket, although every day they get a little bigger," Herbert notes. Moreover, airlines have to staff up to either buy PMAs or use them as a competitive counter to OEM pricing strength.

Herbert reports that part lead times worsened in the second half of 2011 but he senses they are improving.

CPH deals are growing, with non-engine manufacturers like Goodrich

joining the push. Resistance comes from some carriers that do not want to commit to five-year deals because they are not confident of traffic over that long a period.

John Holmes, division president of AAR Allen Asset Management, has seen a big slide in prices for parts on old aircraft—Boeing 737 Classics, Boeing 757s and older Airbus A320s—in the last few years. "There are lots of parts out there for these models," Holmes notes. "I expect that will stabilize now. I am not saying we are at the bottom. But we have seen the bottom with the market saturated with parts."

Some older aircraft have been parted out and more are on offer. Holmes believes pricing may moderate in the second half of the year. He sees pricing for low-dollar, high-demand parts as more stable, but softer demand for high-dollar, low-demand parts

Holmes predicts no change in lead times in getting parts from OEMs in 2012. "Orderbooks are full, so there will still be long lead times. That helps us in the aftermarket."

AAR has not seen nearly as much restocking as had occurred historically, because buyers that need parts for older aircraft know these will be available. "But for new parts that they might have trouble getting, there might be more restocking."

Holmes says OEMs are defending against PMAs by offering better pricing in some cases. "They are willing to negotiate deals with us that keep us from using PMAs, but also keep us competitive," Holmes says. "Several component OEMs are doing this, they are reacting to the threat." AAR supplies PMAs on its flight-hour programs if the customer allows or requests them.

Spirit AeroSystems produces structures for fuselages and under-wing



**Spirit AeroSystems works as an authorized PMA manufacturer for Boeing and also competes with the larger manufacturer.**

components like thrust reversers and pylons for Boeing aircraft. Tom Nicholas, senior manager and spare parts segment leader, says Spirit supplies new and used parts. The company works as an authorized PMA manufacturer for Boeing and also competes with the larger manufacturer.

Nicholas sees both upward and downward pressure on part prices, depending on part type. "Prices for specialty items are up, because there are few suppliers and they are near capacity. Non-specialty pricing is down." He says this difference applies pretty much across-the-board, for both old and new models.

As an authorized PMA-maker, Spirit competes mostly with Boeing and has been adding to its share of the market. A increasing share of Spirit's sales is under long-term agreements.



**"Older-generation engine part prices will remain soft, while new-generation engines and parts carry a very high sell price relative to their catalog list price," says Todd Jensen, Chromalloy.**

"We are more competitively priced than Boeing," Nicholas says. "And we can give better pricing and discounting under long-term agreements."

Todd Jensen, director of inventory management at Chromalloy Material Solutions, predicts pricing for older-generation engine parts will remain soft as long as operators continue to upgrade to newer-generation, more



fuel-efficient engines. "Pricing in surplus-part markets is simply supply relative to demand," he says. "Older-generation engine part prices will remain soft, while new-generation engines and parts carry a very high sell price relative to their catalog list price."

Jensen says engine OEMs have been increasing part prices consistently and he does not believe 2012 will be any exception.

On lead times, Jensen believes OEMs may remain "behind the curve" in forecasting demand for new-generation engines, while surplus markets cannot fill the gap. "We feel the lead

time for these parts will lengthen. But this should not be an issue for older-generation parts."

Overall, Jensen expects OEMs to gain share in the engine aftermarket as they aggressively sign airlines to total-care packages.

"Independent MROs must find new ways to gain market share, and that may mean alignment and partnering with OEMs."

Heico Co-President Eric Mendelson has not seen any part restocking yet. "The bump in demand was due to taking aircraft out of the desert, putting them back in service, catching up on maintenance

and doing regular checks," he says. "Inventories are still pretty lean."

Mendelson expects there eventually will be some restocking. "It depends on the recovery. If there is another recession, it won't happen soon." But an up-cycle will hasten the orders, he says.

OEMs continue to raise prices at the same rate, if not faster, than they have in the past, according to Mendelson. "Tell me another industry [that gets] a 7% year-over-year increase, and prices double in 10 years." He sees lead times on part orders remaining stable. "OEMs are consistent with their catalogue. They have a monopoly, so they don't have to be to prompt. We do not have a monopoly, so we have to be faster."

Mendelson expects PMAs' share of the aftermarket to continue upward, but because the portion is so small, this will not have much of an affect on OEMs. "They have pricing power on 90% of the market and will try to lock up new models as they always have done. But people will always want alternatives. We expect to do well in PMAs after initial provisioning. We are not worried that they will lock it up."

Non-engine part prices are segmented by aircraft, says John Avery, director of supply chain services at A J Walter Aviation. "Prices on 777 parts are holding up very well. Pricing for 747-400 parts is strong and peaking

now, but not likely to stay that way as more are torn down," he adds.

Major airlines tend to buy parts for new aircraft up front and so are less important in the aftermarket, except for replenishment needs. The start-ups count the most in this market, Avery says. He notes that new parts are still expensive, although there are some bargains to be had.

Part pricing for older 757s, 737 Classics and early A320s is soft, especially for low-usage items. "But fast-movers and AOG [aircraft-on-ground] part prices are higher," Avery says.

Avery thinks lead times for 787 parts should be satisfactory. "They have had three years to get ready, so they should be on time." He thinks OEMs generally do a good job on lead times.

But, "If a troubled airline defers orders for a hundred jets, that could ripple through the food chain," he says.

Avery sees airlines using leaner stocks than they did before the oil shock and recession. "They learned how to be smart and do not want to go back to being stupid."

AJW has been gaining market share for some time because airlines do not want to pay premium prices from OEMs. AJW parts out aircraft and repairs parts for durable wing time. It now has 370 aircraft under component support with either flight-hour or other agreements. Avery says the repair shops AJW uses are getting more competitive, not just on price but on what he calls "intelligent offerings where they share



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the risk with us."

Steve Williams, AJW's director of engine services, sees prices for engine parts remaining steady because demand is steady, even on older models like 737 Classics. "They put the engines in shops and now when they come out, they need parts," he says. "The difference between engine parts and airframe components is that components


have no life-limited parts. And if you have a part on a 727 that fits a 747 you can still put it on. That affects pricing"

On lead times, the accident at the Japanese nuclear power plant last year affected some OEMs, for example Rolls-Royce, but effective backup plans were put in place.

Williams says engine OEMs pretty much know their demand five years ahead of time. And for some older engines, airlines are downsizing spare stocks, cutting down from four to three and then to two.

Engine OEMs are increasing their interest in the aftermarket, but AJW partners with them because "they need used parts too," Williams emphasizes.

PMA business in engines remains pretty steady as PMAs on Belac's high-pressure turbine blades have been accepted by at least some airlines, Williams says. "Emotions have been overcome. It's the leasing companies now, since some airlines don't use PMAs. Leasing companies will force operators to use OEM parts, since the leasing company does not spend the maintenance money."

AJW does not use PMAs in its pools, because not all participants accept them, but does use them in other transactions. 

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