

Not Just Another "State of the Market" Article



Not a single day goes by without callers asking me about the state or condition of the market. Are we at the bottom? Are the prices starting to firm up? Is demand outpacing supply? As I speak daily to my fellow aircraft sales professionals, I

get varied input. Some say their phone activity is terrible. Some say activity is up, but they are not closing planes. Some say they have never experienced a better year. All say, "prices are down with no vision of rising." What follows is an examination of two of the drivers affecting this unanimous declaration.

"NEW VERSUS 'LIKE-NEW'"

Of late, my company has been involved with several sales and acquisitions of "like-new" aircraft. In today's market, unlike in years past, there is significant downward pricing pressure on "like-new" aircraft from the opportunities available to buy new aircraft. A few years ago the sheer availability factor of "like-new" aircraft made their value almost exactly, if not more than, the cost of a new aircraft that a buyer had to wait for. I define "like-new" to be current to one-year-old aircraft.

As you will quickly see, the pressures that are placed on these "like-new" aircraft have great effects on everything down line. One downward pricing pressure is the new tax bill providing 30% accelerated depreciation on new equipment. I recently built a present value formula to identify the difference of a new \$38,000,000 plane against one that I am selling. The airplane that I am selling has only been in service for less than six months, but it does not have the advantage of the new accelerated depreciation. The difference in value was approximately \$880,000 off the top.

Additionally, due to the economic downturn over the past year and a half and the uncertainty of the future, manufacturers are having many aircraft orders placed years ago cancelled. This is

resulting in an increase in the amount of new and available inventory on the market. The manufacturers have to sell these airplanes and they can afford to do so at an alarmingly discounted rate just to get them off their books. In some cases, discounts on the new equipment are as much as 11-15% off of full retail value. People who ordered their now "like-new" airplanes years ago and took delivery of them over the past year for full retail prices have very tough competition if they are looking to sell now. They are competing against brand new airplanes, available today at extremely discounted prices, an additional 30% accelerated depreciation, full warranties, training and other benefits. The only way that the "like-new" aircraft can compete is with price. Imagine paying full retail prices a year ago and having to take millions less today for almost the same airplane. It is clear to see why down line prices are taking such a hit from this reality.

CORPORATE SCANDALS AND THE RESTATING OF CORPORATE EARNINGS

The restating of corporate earnings and the scandals at Enron, WorldCom, Tyco and other companies are affecting everyone daily. What does this mean? It significantly contributes to our already weakened economy, but it also directly affects aircraft sales, prices and supply; here is how. I have directly seen two very large corporations affected in two different ways. One was about to add to their fleet. The hunt was on and the time was right; they were buyers in a buyer's market. Then earnings restatements by other companies in the same industry pulled their stock

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down drastically thereby halting the acquisition process. That took a serious buyer of big equipment out of the market and caused sellers to lose a valuable commodity, the buyer.

Additionally, when earnings are restated and companies are involved in scandals the trickle-down affect hurts more than just that company. The stockholders, the suppliers, the buyers, the partners, the banks, everyone is affected. And so it goes.

Another huge company that I work with, after restating earnings and having debt reclassified will be forced to sell some of their aircraft. This will ultimately create more supply. Even worse, due to the company's need to reduce debt and produce liquidity quickly, the aircraft will be priced aggressively, not to leave money on the table, but to be the next planes sold. Thus, more supply and downward pricing pressure is felt.

We have not seen the end of the restating of earnings or the pricing pressure it places on the market. Simply put, our market is not well. It is active and sales are being made. As I have, however, said many times in the past - do not mistake this sales activity for a healthy market. From all of this, many buyers are finding a sort of internal confidence that they are not overpaying for their aircraft. Consequently, they are buying and activity for some is picking up. This is a good thing. It is, however, sort of a strange way to describe confidence.

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