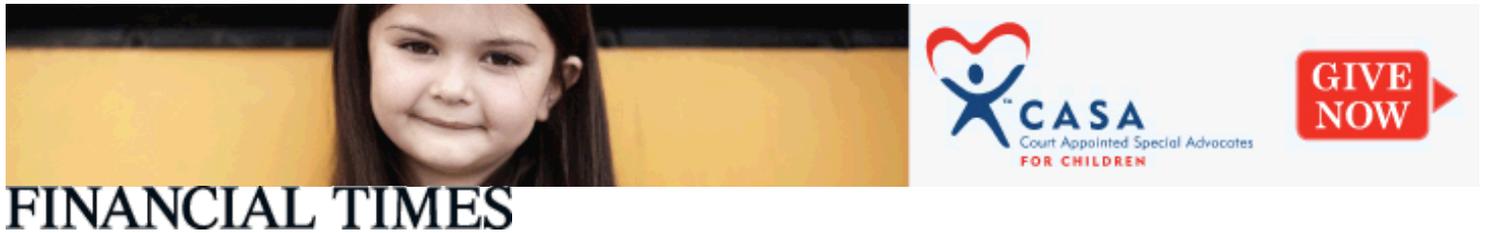


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June 19, 2011 4:19 pm

Spare parts: Where old aircraft go for a course in recycling

By Jeremy Lemer

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At AJ Walter Aviation's new engine division just north of Cardiff, Wales, Steve Williams, director of technical purchasing, is excitedly awaiting a delivery of a batch of five aircraft.

When they arrive over the next few months, the Boeing 737 classics will be dismantled. The CFM engines will be removed and leased or sold to airlines, or chopped into parts and traded to maintenance and repair organisations around the world.

The airframes will be passed to another AJW unit for reuse, or, more likely, disassembly. Valuable parts such as landing gear and avionics will go into AJW's warehouses, while scrap metal will be sold for recycling.

Mr Williams hopes the jets will be the first of many. AJW established the engine business in January but has ambitious growth targets. Within three years it expects the unit to have revenues of \$200m and represent 30 per cent of the part management company's sales.

While much attention has focused on the growing demand for new aircraft amid the wobbly global recovery, a small band of financial investors and industry experts have chosen to specialise at the other end of the cycle – squeezing value from old aircraft.

AJW is the latest of a handful of companies that have entered the "part-out" segment, drawing

attention from private equity and hedge funds. Since the global recession began, industry veterans have established AerFin in the UK and AerSale in the US.

In early 2010, for example, AerSale raised \$250m in equity from Green Equity Investors V, part of Leonard Green & Partners, and laid out plans to buy more than \$1bn of aviation assets over the next five years.

The Aircraft Fleet Recycling Association, a non-profit organisation, predicts that over the next 20 years up to 12,000 aircraft, or 600 a year, will need to be dismantled as the global fleet ages, oil prices rise and demand for air travel increases.

Experts estimate that about 70 per cent of an aircraft can be recovered. At that level, older fuel guzzling aircraft are worth more as parts and scrap than they are intact and flying passengers around the world.

Behind the new money lies a shrewd assessment about the state of the aviation industry and the market for used parts. Executives are betting that they can buy relatively cheap aircraft and profit as airlines fly more, and demand for spares recovers.

Indeed, aircraft values remain depressed after the multi-year recession. Meanwhile, the aftermarket for parts is finally seeing growth after a prolonged slump. RBC Capital expects aftermarket revenues at leading manufacturers to grow up to 12 per cent in 2011.

At the same time, existing outfits have been snapped up by companies with very different goals. In 2006 General Electric's aircraft-leasing business purchased the Memphis Group while AerCap, the listed leasing group, bought AeroTurbine.

For such leasing companies, investments in "parting out" aircraft represent a defensive move, a way to hedge against a fall in demand for older planes. If no one wants to rent their assets, they can always turn them into valuable spare parts.

Kevin Michaels, of Aero Strategy, an aviation consultancy, notes that the leasing and parts trading businesses have gradually merged. Lessors have acquired part-out companies while part-out groups such as GA Telesis have moved into leasing.

For GA Telesis, the shift to purchase aircraft that are leased to airlines was driven by a need to secure a steady supply of parts for the future. GA Telesis currently has a pipeline that extends out to 2017, says Abdol Moabery, founder and chief executive.

Whatever the motivation for entering the teardown sector, to be successful executives require knowledge of every nut and bolt on an aircraft in order to exploit differences between the cost of an aircraft and its value as spare parts.

Vast databases provided by Aeroxchange and partsbase.com give airlines almost perfect visibility

into the availability of parts, but prices can change rapidly and long-term predictions that must factor in fuel prices and new aircraft performance are tough.

“One day a part can have no value and then the next day, because there is just one in Europe, the price can multiply by 10. There are no rules for this,” says Martin Fraissignes, AFRA’s director and general manager of Chateauroux Air Centre.

The work of dismantling the aircraft is mostly done by engineering specialists, such as Avocet in Florida and Air Salvage International in the UK. Part-out groups often give the work to airline repair shops in order to build relationships with potential clients.

Certain long-term trends have also combined to boost the sector.

In particular a decade-long squeeze on airline profits has made leading carriers focus on driving down the cost of maintenance and repairs by using second-hand rather than new spare parts.

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