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TO STOCK OR NOT TO STOCK

Surplus inventory
management

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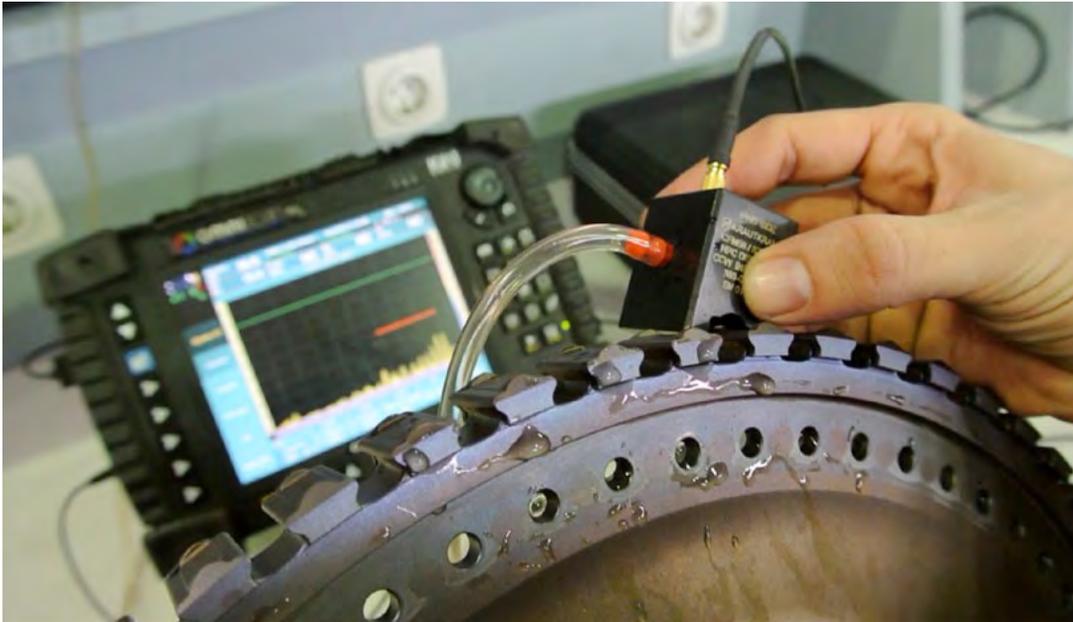
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To stock or not to stock....

Analysis by **Keith Mwanalushi**

Spare parts are the lifeblood of operational reliability for aircraft operators but where surplus inventories are concerned there is need to have the right solutions to dispose of such inventory accordingly. **AviTrader MRO** speaks to the key players in the business.



The value of surplus inventories represents challenges to airlines.

Photo: Iberia Maintenance

Spare parts inventory management and optimisation brings together the diverse disciplines of maintenance management, inventory management, storeroom management, supply chain, procurement and logistics. Often, developing the know-how to manage this type of inventory requires specialist training and development.

The sheer nature of the aviation industry makes inventory management even more critical. Of particular interest is the management of surplus inventory. The value of surplus spare parts inventory is often overlooked by some owners so what strategies should airlines be looking at to best monetise their excess inventories?

"Sometimes owners and operators leave it too late to realise the maximum value of their inventory. It is important to sell the value as early as possible," states Shane Tingey, sales director at AJW Aviation. "People will monitor larger assets like engines and plan the exit and life profiles of this material but forget the larger inventories until it becomes surplus and then try a bulk sale recovering cents on the dollar. The material needs to be monitored to ensure its configuration is of the highest possible standard and disposed of in a managed way to suit the fleet changes.

The owner should also look to swap their older inventories for newer more fleet appropriate," says Tingey.

Mike Cazaz from New Jersey-based Werner Aero Services thinks the best strategy for turning inventory into cash is for airlines to use a third party to buy it and lease back to the airline. "This can be bundled as a complete logistic solution that will include inventory management, either on an hourly rate basis of fixed monthly fee. However, surplus unwanted inventory should be sold to the aftermarket as soon as possible as most of it may lose its value over time if it stays on the shelves," Cazaz suggests.

Over at the Magnetic MRO headquarters in Tallinn, Estonia, Simona Verbiene – head of spare parts suggests that when airlines know that certain aircraft types will soon be retired from the fleet, they should start taking more parts on exchange basis - instead of purchasing components - "Such a strategy will not increase the existing stock and requires less additional capital employed. Exchanges in general are an effective way to increase efficiency and avoid huge depreciation and the loss of value of assets," she comments.

Another opinion from back in the U.S. and simi-

lar to that of Cazaz is for airlines to consign to well-known parts distributors with an established network and expertise in the asset type. Mark Brown, SVP for asset management at Apollo Aviation Group says if the inventory is less desirable surplus type assets, utilising a smaller parts distributor is beneficial as "they will place more focus on this type of inventory." He adds that a secondary strategy is for the airline to sell inventory in-house, utilising inventory parts systems such as Inventory Locator Service (ILS). "These surplus efforts need to be based on current market values and not acquisition or book value to be successful," Brown asserts.

Clearly, the value of surplus inventories represents challenges

to airlines as there are many factors that come into play. Tom Covella, group president at STS Component Solutions highlights these factors that include obsolescence due to component upgrades and replacement, fleets in transition due to new fleet strategies, excess expendable and consumable material from scheduled maintenance visits as well as excess inventory based



Cazaz - Complete logistic solution that include inventory management. Photo: Werner Aero Services

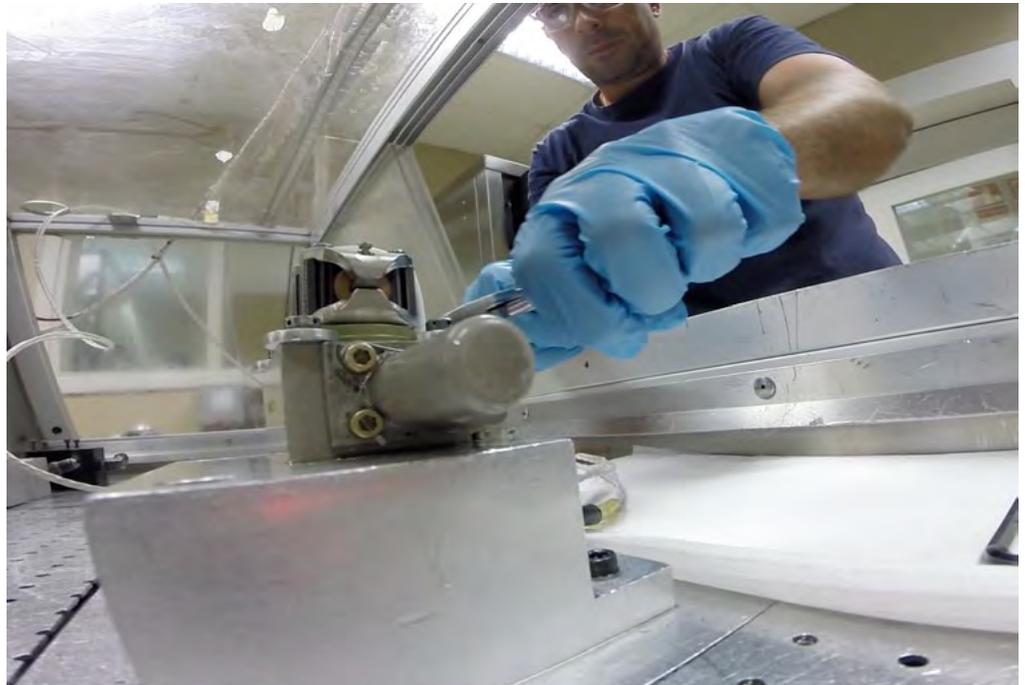
on demand and utilisation. "From our experience, these are all factors that contribute to the surplus inventories airlines face. STS Component Solutions has worked with many major airlines by providing market assessments with the 'true' market value of this excess inventory alongside strategies needed to maximise the ROI," Covella notes.

Acquisitions and mergers within the airline industry are increasingly common - new owners have to make decisions on thousands of jet spares after the merger or acquisition. In such situations, supposedly, there are numerous considerations in terms of stock disposal and/or relocation. "In such a situation there is a big risk to get over-priced slow-moving inventory," believes Idas Juronis, head of components and materials sales at FL Technics.

Juronis adds that the stock must be analysed as thoroughly as possible in order to correctly evaluate inventory's net realisable value (as it might differ significantly from the book-value). For new parts Juronis says prices from OEMs and distributors price lists need to be compared against the book-values. "Aftermarket prices are even harder to check as they are fluctuating more on spot supply-demand market. Therefore it is always easier to include a trading company [unless the airline itself does a lot of purchasing/selling], which has more up-to-date data on pricing," he continues.

Covella argues that as airlines integrate as a result of a merger, a core strategy should always be evaluating the consolidation of inventories at line stations, maintenance facilities and major hubs. "When airlines have a large global network this becomes more and more of a challenge, but with improved forecasting tools, consistent review of inventory utilisation and demand, as well as a good supplier network that is aligned with the airline, these key factors can reduce the risk of excess inventory build-up.

"From a stock disposal perspective, airlines are often faced with resource challenges when attempting to determine the best approach in handling this situation. The decision of book value versus market value needs to be analysed before a strategy can be developed. However, given the current price of oil, I believe airlines have some latitude in their favour that may allow them to financially absorb the variances they face in cov-



Stock must be analysed as thoroughly as possible.

Photo: Iberia Maintenance

ering the gap between book value and market value," Covella tells *AviTrader MRO*.

It seems though, that systems for selling surplus aircraft parts are largely driven by policies designed to dispose of the parts quickly. However, many excess inventories are actually obsolete and/or slow moving throughout the market. Alejandro Ceballos, manager for AOG and customer support at Iberia Maintenance in Madrid replies

quicker for slow movers if the aircraft is being disassembled more often."

Tingey from AJW jumps into the conversation saying most of the slow moving and obsolete inventories that are out there now are brought about by the owner waiting until the aircraft have been retired and then moving onto the inventory to discover he still has enough to support the complete fleet and that little maintenance or modification has been carried out. "The value of the inventory is negligible and only one or two parts can really be sold in the complete package so the owner will get little or nothing from the sale and the inventory specialist will end up recommending scrap or consignment with an ultimate scrappage of the parts once any value if any has been extracted,"

Tingey observes.

Simona Verbiene from Magnetic MRO brings it back to the issue of book value versus market value. "The Airlines should do accruals to cover the loss of value for obsolete components, which means implementation of more aggressive accounting. In this case, stock value will be close to the real value of the stock. So the biggest challenge – loss of value and also avoid the dead stock which in most cases is a result of budget driven purchases, mistakes and a lack of purchase experience," Verbiene explains.

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Simona Verbiene – head of spare parts, Magnetic MRO

by saying one of the main problems is the saturation of the surplus market with obsolete fleet parts. Ceballos says the challenge is to market the stock when there is "still a significant demand" in order to move that stock faster and at a reasonable price.

Derk-Jan van Heerden, general manager at AELS an aircraft end of life solutions provider in The Netherlands thinks the biggest challenge is the problem of value. "Some airlines have a book value associated to spare parts that not always match with market value. A sale can in some cases result in a loss because of this. Values drop

In terms of aircraft types seeing greater demand for disposal, Cazaz points firstly to the four engine widebody market with the 747-400 and A340s continuing to be retired and generating a surplus of parts, generally due to the continued operational cost penalty (notwithstanding the recent price declines in oil, and therefore aviation fuel prices) compared to widebody twins.

Mr Brown from Apollo highlights demand for used parts especially from in-production aircraft types typically 777, 737NG, A330 and A320 variants. "Primarily this is because a large volume of these types of aircraft are in service, requiring regular maintenance, coupled with the relatively small amount of retirement/part-outs of these types of aircraft which creates a favourable supply and demand balance for the used parts business. The type of part that is usually in high demand is that which has a high repair cost which cause the part to be beyond economical repair (BER) or is life limited and out of serviceable time creating high scrap rates. Regulatory Airworthy Directives (ADs) and Service Bulletins (S/Bs) Issued by the FAA can also effect replacement and repair cost causing units to BER," Brown specifies.

At Iberia Maintenance they have seen that the demand for MD8X, B757 and A340 stock decrease. On the other hand, they observe the A320 to have a wide market but somehow saturated due to the retirement of classic models which are being replaced by new models.



Aldas Juronis, Head of FL Technics Components and Materials Sales.

It is natural that inventory owners are keener to reduce the level of inventories of aircraft types which are retiring, and whose fleet is diminishing throughout the market, according to Juronis from FL Technics. He says keeping such inventory is a risk to face a very big drop in parts' values in



Parts exchanges are seen as an attractive solution.

Photo: Iberia Maintenance

the near future due to decreasing demand. For example, Juronis cites that owners are more cautious with Boeing 737 Classics inventories than Boeing 737NGs.

The different trends described above show that there are various dynamics that come into play in the surplus parts sector but are there any deliberate systems in place that enhance the value of surplus inventories? All the respondents say they are actively involved in enhancing value in one form or another.

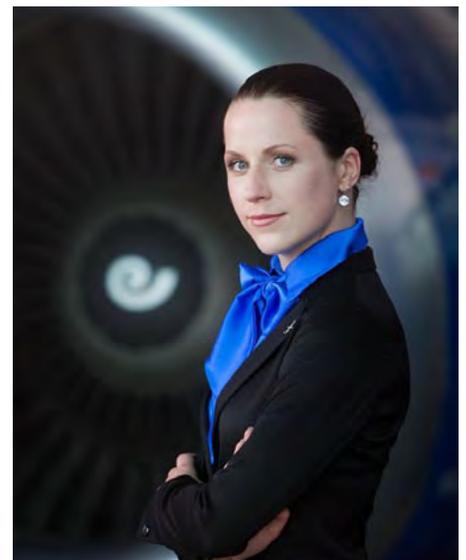
Brown responds: "Apollo Aviation consigns its aircraft parts inventories. We enhance the value of the inventories by specifically targeting the asset type to the best distributor for that type in a partnership relationship. We enhance this relationship by employing in-house product managers for airframe, engine and landing gear components. This allows us to be knowledgeable of the values of parts and inventories and provides us with the technical knowledge to understand which parts can be upgraded or have enhanced value. With this knowledge, coupled with controls in credit risk, insurance, valuations and sales forecasting in our consignment agreements, we effectively monetise the inventory."

According to Covella STS has spent a great deal of time and invested a considerable amount of resources to develop home-grown databases and analytical tools to help the company determine the value of surplus inventories.

"We have been able to automate and refine this process in an effort to provide key figures and

insight so that we can make fast and accurate determinations on the value of inventories," Covella indicates. He adds that this in-house capability has afforded the company a "great opportunity" to provide services to all airline business partners while also offering them "a good determination of market demand on their excess inventories.

"This, in turn, affords our partners the luxury of not only looking at their internal demand and consumption; it also yields a broader perspective within the global market so that they can determine a more in-depth approach to their assessment of excess inventories," Covella sums up.



Verbiene says proper provision and analysis of stock should be done to create a financial logic. Photo: Magnetic MRO