WHY THE WORLD'S RICHEST AIRLINES ARE SNATCHING UP SECOND-HAND PLANES

News / Airlines

It’s a tale that could be dubbed “From Russia to Love.”

Two Boeing Co. 737 jetliners swooped onto a factory airfield near Seattle in March, the last of the models once flown by a collapsed Russian carrier. They were headed for makeovers to erase the Cyrillic logos and any other trace of Transaero Airlines. Next stop: Dallas’s Love Field, where hometown carrier Southwest Airlines Co. is on a record shopping spree.

The imports are integral to what Jon Stephens, Southwest’s director of fleet transactions, describes as a “beautiful plan” to swap out some of its oldest models without spending lavishly. The carrier’s in the middle of acquiring 83 used Boeing 737-700s from around the world, the largest such haul in its more than four-decade history.

Southwest and its U.S. competitors — now awash in cash after earning record profits last year — are scouring developing nations for second-hand jetliners as cheap fuel makes older, less efficient aircraft more economical to operate. That bucks the traditional flow of hand-me-down planes from North American carriers to counterparts in emerging-market countries and makes an already volatile market for Boeing Co. and Airbus Group SE more unpredictable.

“If you’ve got excess things with wings, you are probably trying to sell it in the U.S. right now,” said George Ferguson, senior air transport analyst at *Bloomberg Intelligence*.

Driving the shift is the collapse of crude prices. While the commodities downturn has clipped economies from Russia to Brazil, lower fuel costs helped U.S. airlines earn almost $19 billion last year.

China, Brazil

United Continental Holdings Inc. is importing as many as two dozen used Airbus A319s from China. Delta Air Lines Inc., which pioneered the strategy, is studying taking used 737s as its Brazilian alliance partner, Gol Linhas Aereas Inteligentes SA, shrinks and restructures operations.

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IMAGE: BLOOMBERG

The carriers haven’t cut back on new aircraft orders, either, in a buyer’s market for cutting-edge jets. Because the used planes don't need to be flown heavily to recoup capital costs, they can be added selectively to routes "so airlines have more schedule flexibility and can improve on-time performance," said George Dimitroff, head of valuations for Ascend Flightglobal Consultancy.

Older planes lost their stigma in the U.S. during the last 15 years as four of the largest airlines filed for bankruptcy. To cut costs, they deferred orders and made do with planes they previously would have swapped for newer models. They've expanded the practice even as fortunes have reversed this decade, taking advantage of sophisticated maintenance operations to extend service.

Fuel bills

Used-jet imports to North America jumped 29 percent to 198 airplanes last year with Southwest leading the way, followed by Allegiant Travel Co. and Delta, according to Ascend data.

Lower fuel bills mean airlines are hanging onto older single-aisle jets rather than parking or scrapping them. Of the smallest Airbus and Boeing models, only one A319 and no 737-700s have been disassembled for parts this year, compared with a total of 17 in 2015, according to Ascend.

"It's partly a function of oil and lease expense and there's actually demand by airlines like United and Southwest that want to acquire these airplanes and fly them," Dimitroff said. "They're more valuable as fliers than a collection of parts."

Aircraft market

The trend is adding to a topsy-turvy global aviation market for the leading manufacturers, Boeing and Airbus. They already face slowing sales as airlines navigate currency fluctuations and sub-$50-a-barrel oil, which has reduced the incentive to buy more fuel-efficient aircraft.

With fewer single-aisle jets retired to aviation boneyards, there's a risk of a glutted market as Boeing and Airbus boost monthly output of single-aisle jetliners to about 60 apiece by the end of the decade from the present pace of 42. Lessors haven't yet found airline customers for more than 900 narrow-body aircraft on order over the next five years, according to a March 29 report by Goldman Sachs Group Inc.

"I look at two guys producing narrow-bodies at 60 per month and I'm thinking this is just not going to work out well," said aviation consultant Robert Mann.

For now, Boeing hasn't seen demand slip for its workhorse 737 jetliners. In fact, more orders are expected since about 700 narrow-bodies are already past the 25-year mark, when planes typically are parked. That should prompt a wave of retirements.

"Airlines that are buying used aircraft are also buying our new airplanes," said Randy Tinseth, Boeing's vice president for marketing. "We are not seeing any new trends that would change future demand."

Still hunting

But the trading in used jets can skew the forces of supply and demand. Prices for decade-old Boeing 737-700 jetliners actually rose last year as Southwest dominated the market. The planemaker has delivered 1,116 of the -700, the smallest jet in its current lineup, and Southwest will fly nearly half of them by the time its spree winds down in 2018.

Southwest is on the prowl for more used aircraft even though it has ordered 200 of the 737 Max, upgraded planes due to make their commercial debut next year. The Dallas-based carrier also struck a deal with Boeing for 33 new 737-800s late last year.

“If the economics don’t work, we’ll go new,” Stephens, the Southwest fleet executive, said of the airline’s jet strategy. “That’s the trump card we hold. The leasing community knows that and knows what the Southwest deal is.”

The airline bought used planes as far back as the 1970s, the decade in which it began flights. But the low-cost carrier never thought seriously about making older planes a competitive weapon until about three years ago. Stephens’s team saw a glut of deeply discounted Boeing 737-700s as the perfect replacement for smaller Boeing 717s that Southwest planned to offload to Delta.

Replacing classics

Prices and lease terms were so attractive that Southwest also decided to use the second-hand planes to help replace 737 Classics, older, crack-prone jets whose upkeep costs were soaring. A dispute with its pilots union was also a factor as the carrier accelerated its retirement date for the planes by four years to 2017.

The carrier turned to AerCap Holdings NV, the largest independent lessor, to help find planes coming onto the market. As Transaero, then Russia’s second-largest airline, spiraled into crisis late last year, AerCap flew the planes to Ireland and eventually to the U.S. After makeovers, they will look like every other Southwest jet.

“There are a lot of reasons why it makes sense,” Stephens said. “It’s been a beautiful plan to replace the 717s, and bridging to the Max is huge. It positions us very, very well.”

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