MRO MARKET FACES HEADWINDS DESPITE ROBUST AIRCRAFT REFURB WORK

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It seems that not a week goes by without an airline revealing newly **refurbished** interiors on some subfleet. But while aircraft modifications continue apace, requirements for maintenance, repair and overhaul (**MRO**) facilities over the near term are actually plateauing or declining.

This is largely due to lower demand as the result of a new generation of more reliable aircraft coming on line with longer gaps between maintenance cycles, says Lufthansa Technik, one of the world's largest MRO providers, with over 26,000 staff in thirty locations globally.

Technik is not alone its its assessment. The Cavok consultancy warned this spring that the presence of more planes with advanced technology means decreased demand for MRO**,** **as reported by Consultancy.uk**. Cavok advised MRO suppliers that they "will need aggressive and innovative plans for growth" if they want to remain competitive in the market in the next couple of years.

Moreover, evidence suggests that airlines have become "better at managing their maintenance costs", suggested JP Morgan yesterday in a new deep dive report about the aftermarket. Among other factors, JP Morgan cited airlines' use of health monitoring technologies (e.g., sensors) and predictive maintenance software; and better operating practices (e.g., de-rating engine power, better cleaning of engines). Industry should expect further improvement in this regard in the coming years as airlines use broadband connectivity to bolster maintenance proficiencies.

Aircraft refurbishment work – while robust – is quite simply not enough to pull MRO out of the doldrums in the near-term. Indeed, as a result of the fall in demand, some MRO operators are reducing or shuttering facilities. Qantas, for example, **closed its Boeing 747 heavy maintenance base** in Avalon near Melbourne in early 2014 as its fleet has fallen to nearly single digits from a peak of 36 747s in 2004.

Many of the arguments around maintenance bases and their growth opportunities involve the balance between cost, safety, and offshoring of work, something with which Lufthansa Technik is intimately familiar.

Runway Girl Network queried Lufthansa Technik CEO Johannes Bussmann on whether, in his opinion, European MRO locations could compete on cost, with particular reference to the costs in the US given Airbus' **new final assembly line in Mobile, Alabama**. "Europeans can, yes. We have a lot of neighbour countries that have skilled workers, good education systems and reasonable cost positions. And that's actually where our base maintenance stations are: on the outskirts of Europe, because there are opportunities there," Bussmann said.

"We just opened in Puerto Rico," Bussmann noted of Lufthansa Technik's US operations. "We've done now the first check there already, and we're quite happy, even though the country is in a difficult situation. We hope that we can contribute to development in their industry."

But have countries like France, Germany and the UK essentially priced themselves out of the market with higher labour costs?

"I think that really depends on the technology required. For base maintenance and testing, that's already been distributed for ten years now. There are a couple of small outlets that still do it: holding a strategic capability there in order to do special things at short notice and so on, but the big programs are outside," Bussmann said of the largest European markets.

The real issue – as Apple CEO Steve Jobs outlined to President Barack Obama in 2012 – is one of skills and technology. "Apple's executives believe the vast scale of overseas factories as well as the flexibility, diligence and industrial skills of foreign workers have so outpaced their American counterparts that 'Made in the U.S. A.' is no longer a viable option for most Apple products," summed up *The New York Times* **in its coverage of the meeting**.

Bussmann makes a similar point about the skills, investment and facilities in locations that many in western Europe or the US might object to as offshoring: "If you look at high technology, investment in testers and skilled workers is extremely high. And there the labour costs are not that different, but the skill of the people, the throughput that you can run, that is what drives the economics."

One of the issues in the Qantas case was the perception (stoked by some with skin in that particular game) that maintenance was being outsourced to certain countries without Australia's long history of commercial aviation. RGN asked Bussmann whether Lufthansa Technik was seeing any carriers wishing to restrict the geographies in which their aircraft were maintained, for public relations or any other purposes. "On a case-by-case basis you have that, really seldom," he replied. "Maybe sometimes they've had a bad experience, not so much with countries but with individual companies — they say 'we've had a bad experience there, I don't want my aircraft going there'."

According to Bussmann, there are few qualms about conducting maintenance in countries like Russia and China either. "It's actually the opposite way around: we have China and we have Russia and we have Turkey, which have identified the aviation industry as a core strategic industry for their economy, and until they're building aircraft locally they want to in-source MRO within the country. That’s especially strong in those three countries.”

Specific to the aircraft interiors refurbishment business, there are plenty of examples of robust activity for this type of specialized work at the world’s favored MRO facilities (Technik among them). But even strong demand isn’t necessarily enough to insulate interiors suppliers from other near-term pressures.

Take B/E Aerospace, for example, which is among the major suppliers feeding the need for premium and economy class seating, lavs and other cabin fittings in the refurbishment market. The company recently **announced it will take a $30 million charge** associated with cost-cutting measures, including facilities closures, product rationalization, workforce reductions and program discontinuance, following last year’s KLX Aerospace spinoff. “The plan that management outlined in late 2015/early 2016 has come under consistent pressure, despite optimistic commentary on the January earnings call: first, management lowered 2015 sales guidance on the April call and then [B/E Aerospace] offered 2016 sales guidance for only 1-2% on the July call. While [this] charge may be a natural outgrowth of focusing on margins, we wonder whether anything has changed over the past two months to prompt this action,” said JP Morgan. B/E Aerospace management still sees sales acceleration in 2017 in line with faster widebody delivery growth and supplier furnished equipment sales, it noted.

More broadly, it’s clear that despite the torrent of press releases from airlines about aircraft cabin refurbs, the near-term outlook for MRO as a whole isn’t quite as rosy as it might seem. Given the forecast, it would seem that understanding the careful mix of locations, efficiency and skillsets will be a smart move for MRO operators and their clients, if they are to remain competitive.

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