

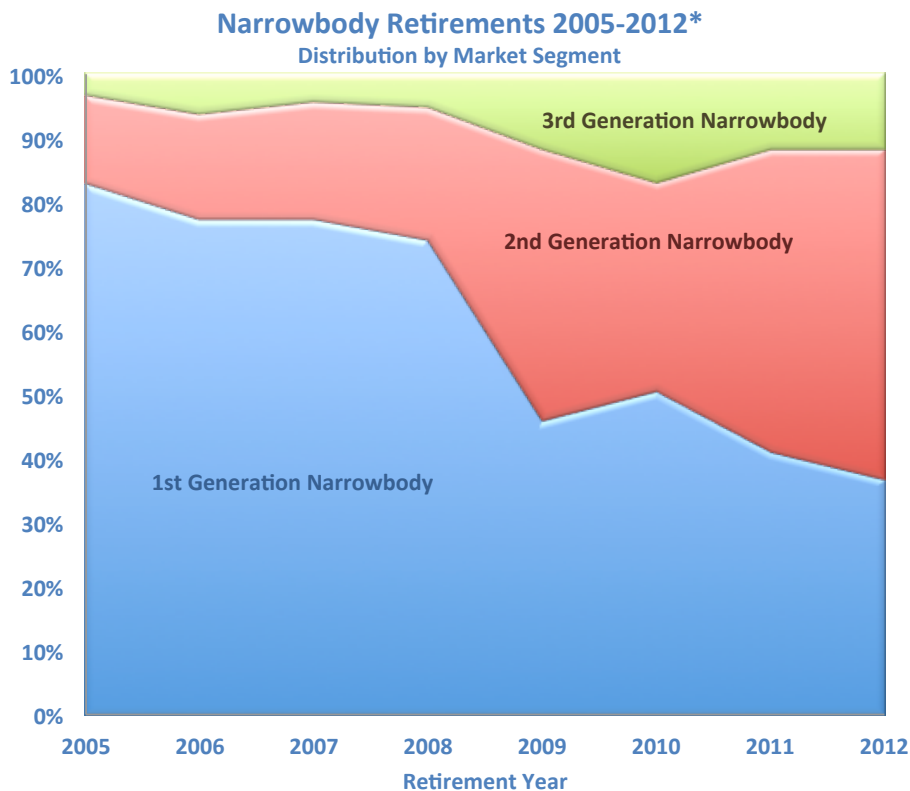
Will there be an early demise for 3rd Generation Narrowbodies?

There has been a lively discussion recently on the whether the economic useful life of a commercial aircraft is declining. Given the financial significance of useful life from an accounting perspective, any change to current policies should be carefully considered. Is there reason to consider a change?

Given the blistering pace of narrowbody deliveries that occurred over the last few years and a global economy that has experienced numerous weak spots, it is natural to speculate that a supply/demand imbalance may have developed resulting in used aircraft heading to the desert earlier than in times past. Some have questioned whether we are experiencing more than the typical used aircraft market cycle that has occurred several times over the last three decades. Dick Forsberg at Avolon published a thorough analysis on this subject last September. My comments here are not intended to supplant the Avolon conclusions, but merely to highlight that market concerns regarding economic useful life may not yet be warranted.

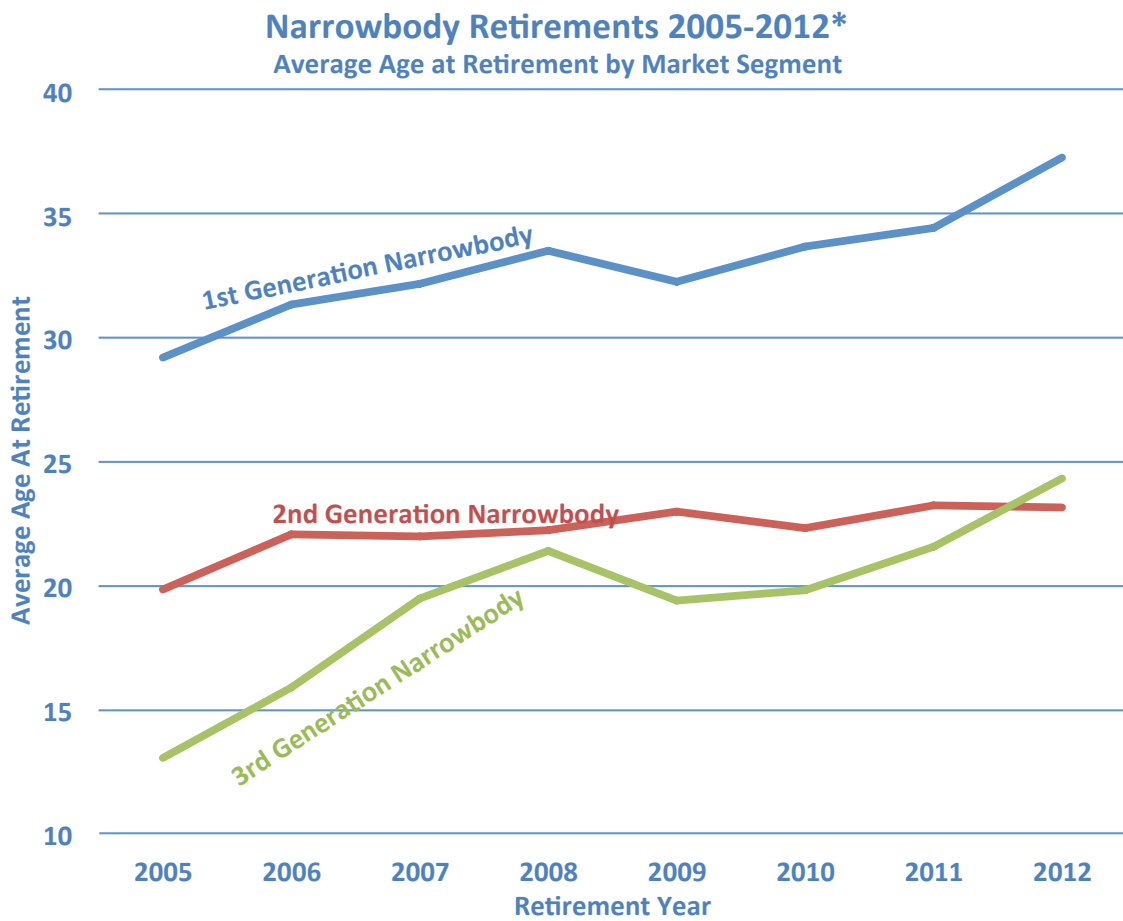
In reviewing the narrowbody retirement over the last seven years (2005-12), the narrowbody market is split into three segments:

- A. 1st Generation – 727, 737 (JT8D), DC9 and F28
- B. 2nd Generation – 737 Classic and MD80
- C. 3rd Generation – 737NG, 757, A320 Family and MD90



In terms of distribution of the 2,100 aircraft retired over this seven-year period, the market is behaving in a predictable fashion. 1st generation aircraft as a percentage of the whole are declining as the oldest fleet population declines. 2nd generation aircraft are taking over as the dominant segment as the fleet fully enters typical retirement age range. Finally, 3rd generation retirements are comprised of a small number of premature retirements but mostly aircraft reaching typical retirement age. If these later generation aircraft were being retired earlier, we could expect to see a larger proportional increase of retirements in this segment.

A review of the average age at retirement by narrowbody segment also indicates a continuation of the historical pattern, rather than a shift towards younger retirements.



**Western built narrowbody pax excluding Region*

At first glance, however, it appears that the 2nd generation segment is not following the 1st generation and instead leveling off at a retirement in age in the 20-25 year range. This segment, composed of 737 Classics and MD80s, is being retired mainly from a handful of large US carriers who are replacing them with 737NGs and A320s. For example, this segment includes 300 MD80 retirements, an aircraft handicapped by high fuel burn and no secondary passenger market. Given the new aircraft delivery forecast



and the lack of a secondary market, 2nd generation early retirements are likely to continue.

The 3rd generation segment retirements are following a normal historical pattern with no dramatic evidence of shorter economic lives. Early retirements in this segment are the exception rather than the rule. Looking forward there are no dramatic signs in the rate of growth, new aircraft deliveries, fuel price and technological obsolescence that indicate a change to historical narrowbody retirement patterns. In reviewing forecast demand, the 737 MAX and A320 NEO are more likely intended for growth rather than replacement of 3rd generation narrowbodies. While lessors may be currently be suffering from weak rentals of these aircraft, there is not a compelling argument to alter their useful economic lives.

For those interested in a more in depth look at this subject I urge you to read the Avolon report and attend the ISTAT Americas conference next month where the topic will most certainly be discussed.

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