

Ian Gurekian, Chief Risk Officer at Waypoint Leasing, shares his view on the current downturn in the market



“History does not repeat itself, but it often rhymes.” – This familiar quote, frequently attributed to Mark Twain, is a worthwhile reminder that cyclical industries tend to remain cyclical and that the various phases of our business cycle remain alive and

well along with lessons to be learned from prior downturns. This is not the first time that the oil and gas sector has experienced a retrenchment, nor is it the first time that helicopter manufacturers have had to scale back their production or that values have seen oscillations. At the bottom of every cycle, however, investors test their mettle and for some, in the darkest of moments, it becomes easy to hate the assets you once loved and look to greener pastures.

Such has been the experience we’ve all endured to varying degrees in 2015 and 2016. After a long period of expansion where production rates were routinely increased to accommodate demand, the oil and gas helicopter industry is experiencing a significant, but not unprecedented, contraction phase of its cycle. And at the bottom of every cycle, when the future looks most bleak, many fair-weather investors will exit the sector while those with a more long-term view of the industry learn some painful lessons, make necessary corrections and plan for the future. With respect to making the necessary corrections, it is worth noting the difference between the supply-side reaction of the

oil and gas industry, versus the supply-side reaction of the helicopter industry. Much of what drove the O&G space to overcapacity was the continued supply of oil (i.e. lack of supply correction) so as to maintain market share in the face of slower, but still growing, demand. In the helicopter space, supply has reacted far quicker to a decline in demand. This is a very significant piece of the S&D equation. After having increased deliveries by 20% p.a. from 2004 to 2014, helicopter OEMs have all but stopped production and delivery of O&G Heavies and Mediums in a bid to right-size the market. It is also to ensure that the installed fleet continue to operate as many hours as possible to drive higher utilization and therefore parts revenue, which carries higher margins than unit sales do. While there is certainly excess supply in the market today, this almost immediate and dramatic decline in new production will meaningfully impact the rate at which the helicopter space corrects its S&D imbalance.

Having been raised in the “fixed-wing” world (a seemingly dirty word in the helicopter industry), there are some parallels and lessons learned that are worth considering. The first of those is that fixed wing commercial aviation is also cyclical, and Boeing and Airbus both learned tough lessons on the production line during several major downturns. Ramping production up and down by 30-40% was costly, inefficient, and wreaked havoc on their suppliers who depended largely on that production base. During the next expansion phase (2003-2008), Boeing and Airbus took a different tack and allowed the backlog of firm orders to expand well beyond the traditional 1-3-year window to and up to as long as 5 years for some types. They did not

raise production rates commensurate with demand during the expansion phase. When the inevitable contraction phase of their cycle came in 2009 (as it always does), they effectively held production flat while drawing from and rearranging their backlog customers. Value declines for in-production types were more muted than in prior cycles, suppliers took less pain, and both OEMs were able to continue production through the cycle. While there are certainly differences to be highlighted between the asset classes, there are enough similarities to suggest that helicopter OEMs take a more measured approach to production and allow the backlogs of firm orders to stretch out a little further during the next expansion phase of the helicopter industry.

The second parallel that is worth noting relates to when older assets are retired from their primary purpose. If one considers the newer assets to be the “top half” of the barrel, and the older second or third-tier assets to be the “bottom half” of the barrel, then it should go without saying that during any major downturn or correction that the bottom half would get retired first. But the real question is if they get retired before, on, or after their estimated economic useful life. For fixed-wing assets, the rule-of-thumb economic life was 25 years. If the downturn occurs before the bottom half reach that age, they are retired prematurely (think 737 Classics in 2005-2008). If assets mature to that age during boom times, operators kept them flying longer than originally anticipated (think DC-9s and 727s in the late '90s going into 2001). Such has also been the case with O&G helicopter assets. Despite the advent of newer, safer and more efficient types (like the S-92 and AW139) being delivered into the market in the 2005 timeframe, demand was such that it made economic sense to keep many helicopters flying in their primary role (O&G) well past their initially anticipated economic useful life. Examples like older Bell 412s, previous generation S-76s and earlier-gen AS332s all saw continued demand and productive use during the heavy expansionary years from 2004-2014. Their retirements were extended in some cases well past their prime, and their transition to secondary roles were delayed. But today, during this

downturn, those assets are finally being retired from O&G service. Of an estimated 1,375 offshore units, (mediums and heavies), approximately half of them are old, obsolete, or in their declining phase of O&G economic life. The “top half” of the barrel today consists of 500-600 best-in-class and in-production O&G machines (72% of the Waypoint fleet) as well as up-and-coming types such as the AW189 and H175 that are in their relative infancy. These assets, such as Waypoint’s large fleet of S-92s and AW139s, have a long O&G life ahead of them replacing the now aged fleet of prior-generation types.

The IOCs are today driving a focused cost reduction initiative across the board. New-technology assets provide technological advancements over yesterday’s fleet that allow operators to offer greater efficiencies through higher utilization, reduced overall maintenance costs and better reliability, with safety being a given. Lessors like Waypoint, who are committed to the industry through the cycle and for the long-term, provide a diversified risk profile to the lending community resulting in increased liquidity to the market that many individual operators would not readily be able to avail of at this stage of the downturn. Eventually good times will attract new fair-weather investors, but for those of us still committed to the space today, there are enough green shoots appearing on the horizon to remind ourselves that this phase of the cycle will pass.

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