Industry Top Trends Update

Aerospace and Defense

Will summer travel restrictions delay recovery?

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What's changed?

Commercial aerospace revenue and earnings began to stabilize after sharp declines in 2020. Although demand for commercial passenger aircraft remains weak, aircraft manufactures have largely reached planned lower production rates and further cuts are unlikely. Earnings and cash flow are also starting to benefit from last year's cost-reduction efforts. However, if the European summer travel window remains partially shut, this could add pressure.

Airbus is well positioned to capitalize on the recovery. After entering the pandemic in a strong financial position and lowering production rates through 2020, we expect Airbus' free operating cash flow (FOCF) to be slightly positive in 2021 despite the ongoing adverse operating conditions. In coming years, we project Airbus will gradually improve cash flow generation and generate positive FOCF.

European governments' rising defense budgets continue to support sales. European defense spending is set to exceed $300 billion in 2021, with the U.K., Germany, France, and Italy spending on average 4% more than in 2020. Near-term prospects for defense spending in Europe therefore look robust. Despite the pandemic, governments continue to boost spending to modernize their defense capabilities in the face of rising threats.

How is recovery taking shape?

Demand for narrowbody (single aisle) planes will lead recovery. Domestic travel is likely to recover faster than long-haul international travel, so narrowbody demand will likely recover before that for widebodies (twin aisle). Airbus has said it could increase production of its A320neo and A220 narrowbodies in the latter part of 2021 if demand warrants. Widebody production will likely remain very low through at least 2022, and rates could be cut further if government travel restrictions remain in place. As flying increases, demand for aftermarket parts and services should also rise.

Credit ratios for commercial aerospace firms will take a few years to recover. Despite likely increases in revenue and earnings over the next year, credit ratios are unlikely to reach 2019 levels until 2023 or later. However, this will vary based on a company's mix of commercial/military, original equipment manufacturer (OEM)/aftermarket, and narrowbody/widebody sales.

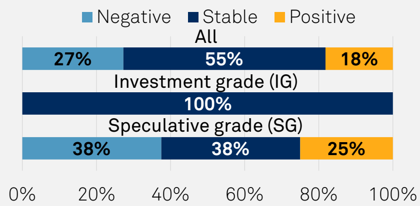
Defense contractors should see steady or improving ratios. Few firms were materially impacted by the pandemic and near-term demand remains solid. Improving earnings and cash flow could be offset by mergers and acquisitions or higher shareholder returns.

What are the key risks around the baseline?

New waves of COVID-19 disrupting air travel recovery. The European summer holiday season hangs in the balance, with continuous government-led changes to travel restrictions dragging down the expected numbers of flights at a critical time of the financial year for airlines. Whether this knocks on to OEMs and results in further production cuts is unclear at this stage.

Supply chain issues slow recovery in build rates. Many suppliers took significant actions to reduce costs during the pandemic and may not have cash to invest in working capital to support higher rates. They may also have difficulty finding workers with the necessary skills or need to raise wages to attract employees.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	3	8	11
Downgrades	0	1	1
Upgrades	0	1	1

Ratings data as of end-June 2021. *Year to date.

COVID-19 Heat Map

Commercial Aerospace		
Estimated recovery to 2019 credit metrics		>2023
Potential negative long-term industry disruption		Yes
2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
25%-50%	40%-60%	10%-25%
2021 Estimates Versus 2019		
Revenue decline	EBITDA decline	
20%-30%	30%-40%	

Defense Contractors		
Estimated recovery to 2019 credit metrics		No decline
Potential negative long-term industry disruption		Yes
2020 Versus 2019		
Revenue decline	EBITDA decline	Incremental borrowings
0%-5%	No decline	No increase
2021 Estimates Versus 2019		
Revenue decline	EBITDA decline	
0%-10%	>2019	