Industry Top Trends Update

Aerospace and Defense

Commercial aerospace no longer losing altitude

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What's changed?

Commercial aerospace revenues and earnings begin to stabilize after large declines in 2020. Although demand for jetliners remains weak, aircraft manufacturers have largely reached planned lower production rates and further cuts are unlikely. Earnings and cash flow are also starting to benefit from cost-reduction efforts taken last year.

Key Boeing programs still having issues. After resuming 737 MAX deliveries in December 2020, Boeing had to temporarily halt production due to an electrical issue. Deliveries of the 787 paused in late 2020 due to quality issues, resumed briefly in 2021 but had to pause again in May pending regulatory approval of the fix.

The fiscal 2022 U.S. defense budget request supports near-term sales growth. Total spending budget is up 1.6%, with growth in R&D but lower procurement spending. So far, no major program cuts, but some spending priorities have shifted.

How is recovery taking shape?

Narrowbody demand to lead recovery. Higher domestic travel in the U.S. and other countries with high vaccination rates should support increasing production of narrowbody aircraft in 2022. Widebody production likely to remain weak until international travel restrictions dropped. As flying increases, demand for aftermarket parts and services should also grow.

Credit ratios for commercial aerospace firms will take a few years to recover. Despite likely increases in revenues 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, OEM/aftermarket, and narrowbody/widebody sales.

Defense contractors should see steady or improving ratios. Few firms were materially affected by the pandemic and near-term demand remains solid. Growing earnings and cash flow could be offset by higher M&A or shareholder returns.

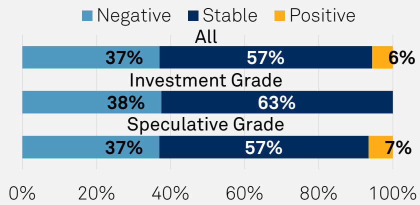
What are the key risks around the baseline?

New virus outbreaks disrupt air travel recovery. The recovery in air travel is already going to be very uneven around the world and outbreaks like in India could stall the improvement, perhaps leading to a renewed round of aircraft order cancellations or deferrals.

Further issues on the MAX or 787. An extended delay in receiving approval to resume 787 deliveries could result in further production cuts. Similarly, additional issues on the MAX could disrupt Boeing's plans for gradual production increases.

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 (YTD)

	IG	SG	All
Ratings	8	47	55
Downgrades	2	5	7
Upgrades	1	2	3

Ratings data as of end-June, 2021

COVID-19 Heat Map

Commercial Aerospace	
Estimated Recovery To 2019 Credit Metrics	>2023
Potential Negative Long-Term Industry Disruption	Yes

2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
25% to 50%	40% to 60%	10% to 25%

2021 Estimates v. 2019	
Revenue Decline	EBITDA Decline
30% to 40%	30% to 40%

Defense Contractors	
Estimated Recovery To 2019 Credit Metrics	No decline
Potential Negative Long-Term Industry Disruption	Yes

2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
No decline	No decline	No increase

2021 Estimates v. 2019	
Revenue Decline	EBITDA Decline
>2019	>2019