AlixPartners

# CAN THE COMMERCIAL AEROSPACE PROFIT POOL SNAP BACK TO BLACK THIS YEAR?

The AlixPartners A&D Minute

For the first time in decades, the commercial aerospace profit pool was negative in 2020, slumping to a notable $18 billion EBIT loss. While the worst of the crisis caused by COVID-19 is likely in the rearview mirror, analyzing the total industry profitability as well as individual segment and company performance provides hints at when the industry overall might expect to get back in the black.

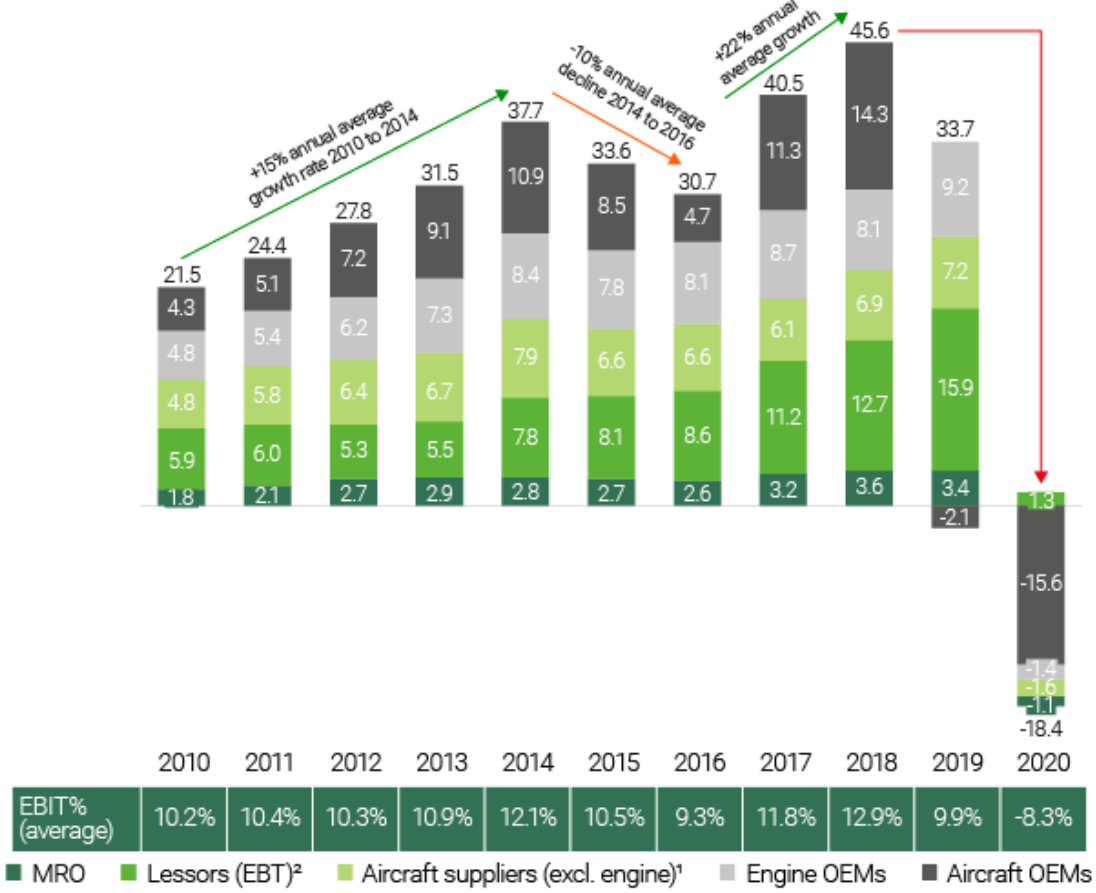
According to AlixPartners analysis, $52 billion worth of EBIT margin was lost in 2020 versus 2019, a year that had already been affected by the Boeing 737 MAX grounding and subsequent stopping of deliveries.

The main driver was the decline in industry revenue, which we estimate dropped 35% year-on-year. Aircraft deliveries fell from 1,243 in 2019 to 723 in 2020 (a decline of 42%), including a more than 50% drop for widebody planes. Also, the highly profitable aftermarket was severely affected, as global ASK (available seat kilometers) dropped by 56% and airlines pushed green-time management to the limit and in general postponed discretionary spending on such things as cabin modifications.

In 2018, at its all-time peak, the industry generated almost $46 billion in EBIT, of which Airbus and Boeing captured approximately one-third. Investors and leaders worldwide are now wondering if commercial aerospace can reach these profitability levels again and, if so, when? A review of performance by segment reveals factors that could prolong the road to profitability recovery.

**FIGURE 1: COMMERCIAL AEROSPACE INDUSTRY PROFIT POOL LOST $52 BILLION IN 2020**

Commercial aerospace profit pool (EBIT) – $ billion, 2010 to 2020




Source: AlixPartners analysis on company annual reports, ICF, CPMI

1. Aircraft suppliers including equipment, material, aerostructures, and cabin suppliers

2. Considered EBT for lessors (earning before taxes), instead of EBIT, as interest rate is a relevant cost

3. Non-US company revenue converted to USD at average spot rate, excluding Airbus, where hedging rate is partly used. Profit pool based on average EBIT% per segment; Engine OEMs/suppliers and equipment OEMs include MRO/aftersales business; MROs exclude OEM business; material suppliers include raw material, castings, forgings.

## FEW POSITIVE CONTRIBUTORS TO AN OVERALL NEGATIVE POOL

Aircraft OEMs on average saw one of the largest drops, with EBIT margin falling to negative 21%, driven by low aircraft deliveries. Boeing, affected by well-known issues on the 737 MAX and more recent challenges on the 787 program, ended the year with only 157 aircraft deliveries, a far cry from the more than 800 in 2018. As a result, commercial revenue fell by $18 billion, with an eye-popping negative 56% margin. Airbus did relatively better, achieving 566 aircraft deliveries and containing the EBIT decline to a negative 4%.

Engine OEM profitability on average was a negative 3.6%, but performance varied among the major players. Safran, MTU Aero Engines, and to a lesser extent General Electric, were able to quickly pivot at the onset of the pandemic and remained profitable in 2020. Meanwhile, Rolls Royce, deeply tied to the fate of the widebody delivery and MRO market, drove down the profitability of the entire segment, generating an EBIT of negative 51%.

Lessors, in the last decade one of the most profitable sectors in the industry, on average finished the year in the black, but revenues started dropping sharply only in the third quarter of 2020, as the cumulative impact of payment holidays, rate negotiations, and "power-by-the-hour" deals.

Revenues for MRO players were down 53% from 2019, more than any other segment, but overall, the sector demonstrated a certain resilience by limiting the EBIT loss to a negative 5%. Sustained traffic for cargo and freighter conversions helped.

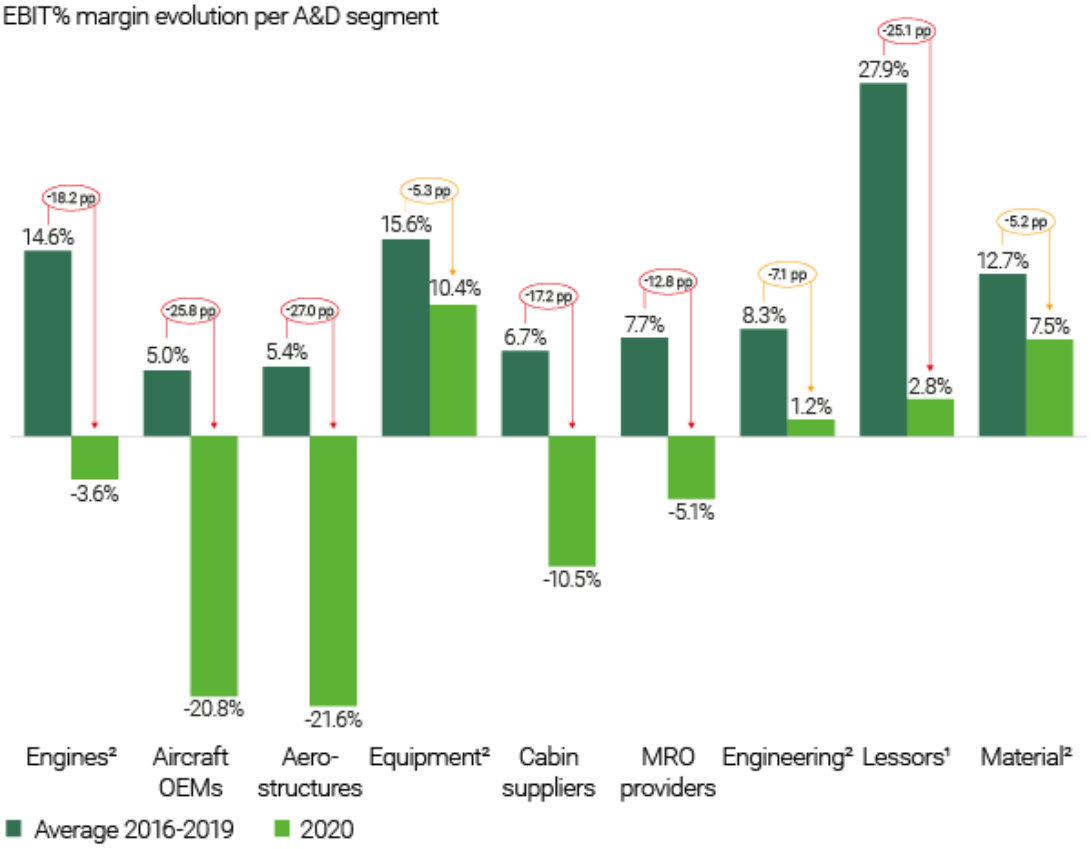
Aerostructures suppliers on average were already in a weak position before the pandemic, and closed 2020 as the worst performers, with an EBIT of negative 22%. While several players are currently in the midst of restructurings, the number of companies in administrative procedures has been low. TECT Aerospace has been so far the most notable player filing for Chapter 11.

Several cabin suppliers were dealing with operational issues in the years prior to the crisis, with a significant impact on the margin. As their profitability is tied mainly to widebody market and aftermarket upgrades, companies in this segment are likely facing a longer road to recovery.

Equipment tier-1s and material suppliers, on the other hand, were on average less impacted segments in the industry and managed to maintain a positive, while reduced, margin.

**FIGURE 2: AEROSTRUCTURES AND AIRCRAFT OEMs LEAD PROFITABILITY DROP**

EBIT% margin evolution per A&D segment




Source: AlixPartners analysis on company annual reports, ICF, CPMI

1. Considered EBT for lessors (earning before taxes), instead of EBIT, as interest rate is a relevant cost. Lessors have a specific asset management business model

2. For a limited number of companies in the sample, revenue may include a limited share of defense business

## SEVERAL FACTORS WILL LIKELY AFFECT THE INDUSTRY PROFITABILITY IN THE COMING YEARS

There is optimism today for a return to pre-pandemic normalcy in the commercial aerospace industry. Recent announcements of bullish production rate outlooks generated excitement on Wall Street and the financial community. Some investors are even wondering if, given the significant cost reduction efforts undertaken across the industry in the past year and a half, aerospace companies can emerge from the crisis even more profitable than before. While production rate increases and structural cost improvements are needed to restore and beat pre-pandemic profitability, the following factors could affect industry profitability for some time:

- Narrowbody vs. widebody mix: announced rate increases are related only to narrowbody aircraft. For widebodies, the outlook is rather depressed for a good part of the decade. In many segments, starting with aircraft OEMs, the competition on widebody programs was softer and the margin historically higher. Companies that traditionally derive a significant portion of their profit from widebodies, like Boeing, Rolls Royce, and cabin suppliers, are hoping for a fast recovery, but this is unlikely.
- Pricing pressure: the aircraft market is shifting to a buyer's market. Airbus and Boeing are not only competing fiercely with each other, but also with lessors trying to remarket off-lease assets. The combination of high inventory levels and the need to keep the production line running is likely to generate a price war, dragging down both aircraft prices and lease rates. In this environment, cash-strapped airlines can exert their leverage to extract concessions and discounts as they seek to rebuild their fleets. Even as headlines tout big sales numbers for new planes, the margin contribution on these orders will likely remain low.
- Supply chain health: in the last decade, OEMs successfully expanded their share of the profit pool with aggressive cost reduction programs, but such actions may be harder to achieve now, considering the weakened state of the supply chain. Many suppliers are distressed and therefore unlikely to be able to support further cost reductions. OEMs and tier-1s will have to reshape and consolidate more proactively the supply chain if they want to secure the ramp-up and at the same time reduce costs.
- Macro-economic drivers: price for some of the key commodities, e.g., aluminum, has been trending up as demand resumes. An extended rally would likely have ripple effects through the value chain. While supplier contracts often include clauses to pass through raw material fluctuations, the overall industry margin will be affected if those increases are not transferred into the aircraft price.
- Ramp-up uncertainties: achieving the announced production rate for narrowbodies will require one of the steepest ramp-ups in aerospace history. Recent experiences taught us that a lot could go wrong with so many moving pieces. Engine delays, supplier issues at any stage of the value chain, or an equivalent of automotive "chip"-shortages are examples of potential hurdles that could affect the ramp-up and, therefore, margin recovery.
- Lessors impairment charges: while several lessors took significant impairments in 2020 (e.g., over $1.5 billion for the combined GECAS and AerCap), some recorded much smaller charges. At some point, many lessors will need to mark their assets to market and realize the asset value losses, with a potentially multi-billion-dollar negative impact on the industry profit pool.

With so many issues applying downward pressure, we expect that industry profitability in 2021 will barely reach breakeven or perhaps even fall short. The return to the 2018 record profitability might need to wait until the second half of the decade and will require, among other things, a shift in the industry's mindset from "price escalation" to "continuous cost reduction." The entire value chain needs to collaboratively work on reducing aircraft unit cost, leveraging on win-win opportunities such as technical cost reduction and digital transformation.

**FOR A DEEPER DIVE INTO THE COMMERCIAL AEROSPACE PROFITABILITY OUTLOOK AND TO DISCUSS HOW TO SET YOUR COMPANY UP FOR SUCCESS NO MATTER WHAT LIES AHEAD, CONTACT:**

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**ABOUT US**

For nearly forty years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.