



# FITCH EXPECTS TO RATE BOEING'S SENIOR NOTES 'A'

News / Finance



**Fitch Ratings** expects to assign an 'A' long-term rating to The **Boeing** Company's (BA) proposed issuance of approximately \$900 million of senior unsecured notes. The notes will be issued in three parts, with maturities of 2020, 2022, and 2025. Proceeds will be used for general corporate purposes.

The Rating Outlook is Stable. The ratings cover approximately \$9 billion of debt (\$6.6 billion attributable to BA and \$2.4 billion attributable to Boeing Capital Corporation (BCC)). Of the amount attributable to BCC, Fitch estimates that approximately \$1.3 billion consists of debt originally issued by BCC and subsequently guaranteed by BA, with the remainder consisting of intercompany loans from BA to BCC.

## KEY RATING DRIVERS

Boeing's debt ratings are supported by its competitive positions in the commercial aerospace and defense sectors, financial flexibility, liquidity position, access to capital markets, high barriers to entry in its key businesses, and large backlog (\$485 billion). Debt reduction has also supported the ratings, with Boeing paying down \$3.3 billion of debt over the past three years. The company has \$1.1 billion of debt maturing in 2016, which Fitch expects the company will retire with cash.

The ratings are also supported by the company's demonstrated ability to withstand very challenging periods such as the post-9/11 downturn, the most recent economic recession, and the 787/747-8 development delays. Boeing has also earned credit for successfully lowering its risk profile by shifting a substantial number of employees to defined contribution plans, successfully executing a significant number of aircraft production rate changes, and signing long-term labor agreements.

Rating concerns include low margin levels for the rating category; the outlook for U.S. defense spending; the aging of some of Boeing's defense programs; some remaining risks with the 787 program; the size of the company's pension deficit on a GAAP basis (\$17.3 billion, but more than 100% funded on an ERISA basis); and the susceptibility of the commercial aerospace industry to shocks such as terrorism and disease. Also, the company's portfolio is less balanced than it once was, as commercial growth has reduced defense revenues to approximately one-third of consolidated revenues.

The Stable Outlook reflects Boeing's financial flexibility, liquidity, and backlog. A Positive Outlook could be driven by continued improvement in Boeing's credit profile from higher commercial aircraft deliveries, further progress on 787 program risk retirement, and U.S. defense spending stabilization. Several initiatives to boost margins, if successful, also could drive positive rating actions.

However, more aggressive cash deployment to shareholders, defense spending uncertainty, and the need to bring down 787 costs make an outlook change unwarranted at this time. BA's focus on share repurchases (\$6 billion in 2014 and \$6 billion in the first nine months of 2015) and dividend increases (up 88% in the past two years) is coming at the expense of debt reductions and pension contributions. Although BA's performance in 2015 has generally exceeded Fitch's expectations, the allocation of cash toward shareholder actions instead of debt reduction could slow the improvement in BA's credit profile.

The Large Commercial Aircraft (LCA) market is in the middle of a strong upturn which will drive higher revenues and cash generation at Boeing Commercial Airplanes (BCA). A large order book, overbooked delivery slots, new airplane model deliveries, delivery acceleration requests, and geographic diversity are elements of this outlook. Since 2010 BCA's revenues have nearly doubled and unit deliveries increased 56% as the company executed 10 production rate changes. Fitch believes support for higher production rates persists because of the large backlog (5,656 aircraft worth approximately \$426 billion at the end of September) and strong orders. Fitch expects BA's commercial deliveries will be 755 aircraft in 2015 and 765 aircraft in 2016. BCA's focus over the next two years will be executing the deliveries of the large backlog, lowering 787 costs, and completing the development of several derivative aircraft models.

The 787 program remains a key driver of Boeing's growth and competitive position, and it has been a sizeable start-up business within the Boeing enterprise, growing to a Fitch-estimated \$12 billion to \$13 billion of revenues in about four years. Fitch believes the bulk of the risks have been retired, and Boeing has estimated the program will begin contributing positive cash flow later in 2015.

Concerns remain about the program's profitability and large inventory level, which reached \$41.5 billion at the end of September. The inventory included \$28.3 billion of deferred production costs accumulated through the use of program accounting. Deferred production per aircraft has been gradually declining. While many risks have been retired, the program is still developing in some areas including the plan to raise production to 12/month from 10/month in late 2016, the launch of the 787-10, and need to stabilize parts of the supply chain.

Fitch considers Boeing's defense portfolio to be of mixed quality, with some solid and growing programs offset by a group of aging programs, including the F-15, F-18, and the C-17. Fitch believes these older programs need to be replaced with new opportunities to avoid restructuring actions later this decade. There are several upcoming program competitions that would help BA maintain its leading position in the U.S. defense sector. The most important of these is the Long Range Strike Bomber, which could be announced soon. International defense sales (40% of the defense backlog) could also help maintain BA's overall defense position, as could the U.S. Air Force's tanker program, although this program has been subject to more than \$1.25 billion of charges to date.

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