AVIATION GIANTS FLY HIGH EVEN AS AIRLINER ORDERS GO INTO FREEFALL

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Year after year, Airbus and Boeing seem to have been able to declare record orders, flying high on the back of an apparently never-ending boom.

Reporting on their annual sales and delivery performances recently, however, the two global giants of commercial aviation appeared to signal that a hard landing is near.

Seattle-based Boeing announced a net 768 orders in 2015, almost halving the previous year's figure of 1,432. A few days later, pan-European group Airbus confirmed the trend with 1,036 orders, against 1,456 a year earlier.

Such seemingly disastrous sales declines would almost certainly cause shares to crash in most businesses.

Yet the plane-making industry is not like most businesses and, while both Airbus and Boeing shares have retreated slightly since posting their annual numbers, such a decline was mostly in line with the wider market.

"Both companies have got big, fat order books," says John Strickland, an independent air transport

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consultant. “Until recently, we’ve seen record orders come in at big set-pieces at air shows. The order cycle can’t grow at those rates for ever.”

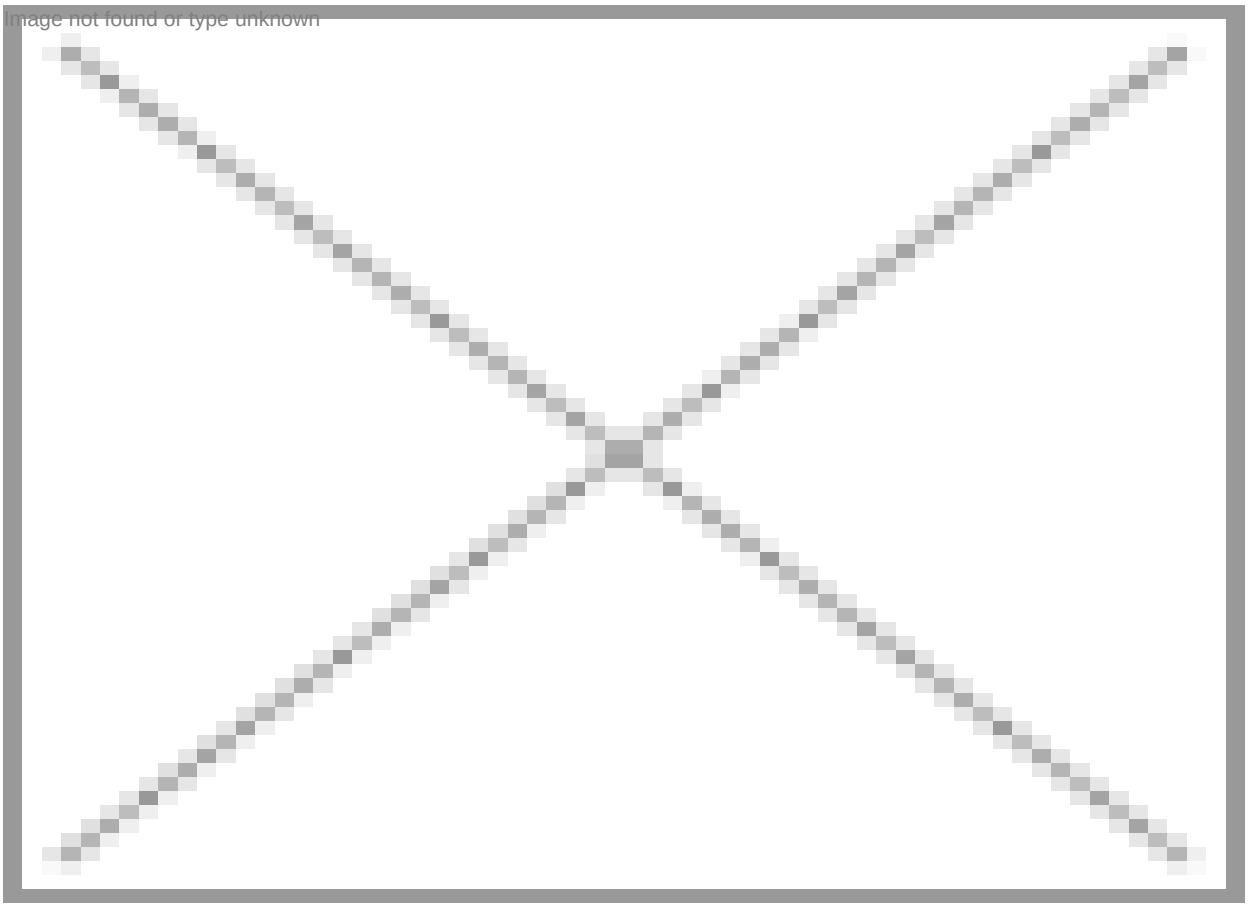

Photo: Bloomberg

The scale of those order backlogs is stunning. Customers have signed up for almost 6,800 of Airbus’s jets with a list price of almost $1?trillion (£700bn), while Boeing has 5,800 airliners in waiting, worth about $850bn.

These order books are approaching 10 years’ work in hand at current production rates.

“Half the world’s population – about 3bn people – have not yet flown. There’s still plenty of demand,” says Tom Captain, global aerospace and defence leader for Deloitte, who estimates about 35,000 new airliners will be needed over the next 20 years to meet the new appetite for flight. “This is not a bubble that’s bursting.”

Oil prices are also a driver. “Airlines needed to reduce their fuel bills and modern aircraft burn considerably less fuel,” says Strickland.

The slowdown in orders may even be good for the industry. Suppliers to Airbus and Boeing are under huge pressure to increase output to meet the demand for new airliners, which can create problems as these smaller companies struggle to meet deadlines.

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An example of this came when Airbus chief Fabrice Bregier publicly criticised Zodiac, which supplies aircraft interiors. He described Zodiac as “in a ditch”, causing Airbus to “suffer a lot” as delays meant it missed deliveries for its latest A350 jet. Boeing has suffered similar problems, and the troubled introduction into service of its 787 jet has partly been blamed on its outsourcing so much work, with problematic components – particularly a new type of battery – coming from subcontractors operating away from its direct control.

“The biggest challenge for the aircraft manufacturers is managing their supply chain,” says Captain, who adds both Airbus and Boeing have learnt “some hard lessons” as they tried to ramp up output, only to discover the smaller companies proved to be choke points.

“In the industry, the system has shifted from ‘Build this part for me’ to a risk-sharing partnership,” he adds, attributing the change to the constant demand for ever-lower air fares. “Now it’s a case of manufacturers telling their suppliers ‘You design the part, decide how to make it – and at a lower cost for us. Oh, and you also have to hold the inventory – and by the way, you won’t get paid until we get paid’.

“There’s a lot of pain being experienced in the industry right now, and it’s just like the manufacturing industry went through 20 years ago.”

In this tougher environment for the businesses feeding into Airbus and Boeing, a slowdown in orders might offer some respite for supply chains.

“There’s a limit to how far you can push supply chains,” says aerospace analyst Howard Wheeldon. “Maybe we’re almost at that limit and the order books coming down a bit is no bad thing, as it give suppliers a breather and chance to catch up.”

One consequence of this flat-out world driven by lower ticket prices is further M&A activity as suppliers look to cut costs in the face of the squeeze being felt from Airbus and Boeing. Captain predicts “consolidation and disruption” over the next few years as economies of scale are sought.

While this might sound a bleak future, it’s anything but that, according to Wheeldon.

“You could paint a picture that lower sales over the next two or three years are a problem, but the truth is because of the high cost of oil, orders have been dramatically higher than anyone could have imagined,” he says.

Captain puts it another way. “Airbus and Boeing could not sell a single plane for a year and still have eight or nine years’ work to do,” he says.

While markets might look to the future in terms of sales of new aircraft, a better indication of the health of Airbus and Boeing is actual deliveries.

“It’s only when they hand over the aircraft that the manufacturers get paid,” says Wheeldon. “And delivery numbers are still rising.”

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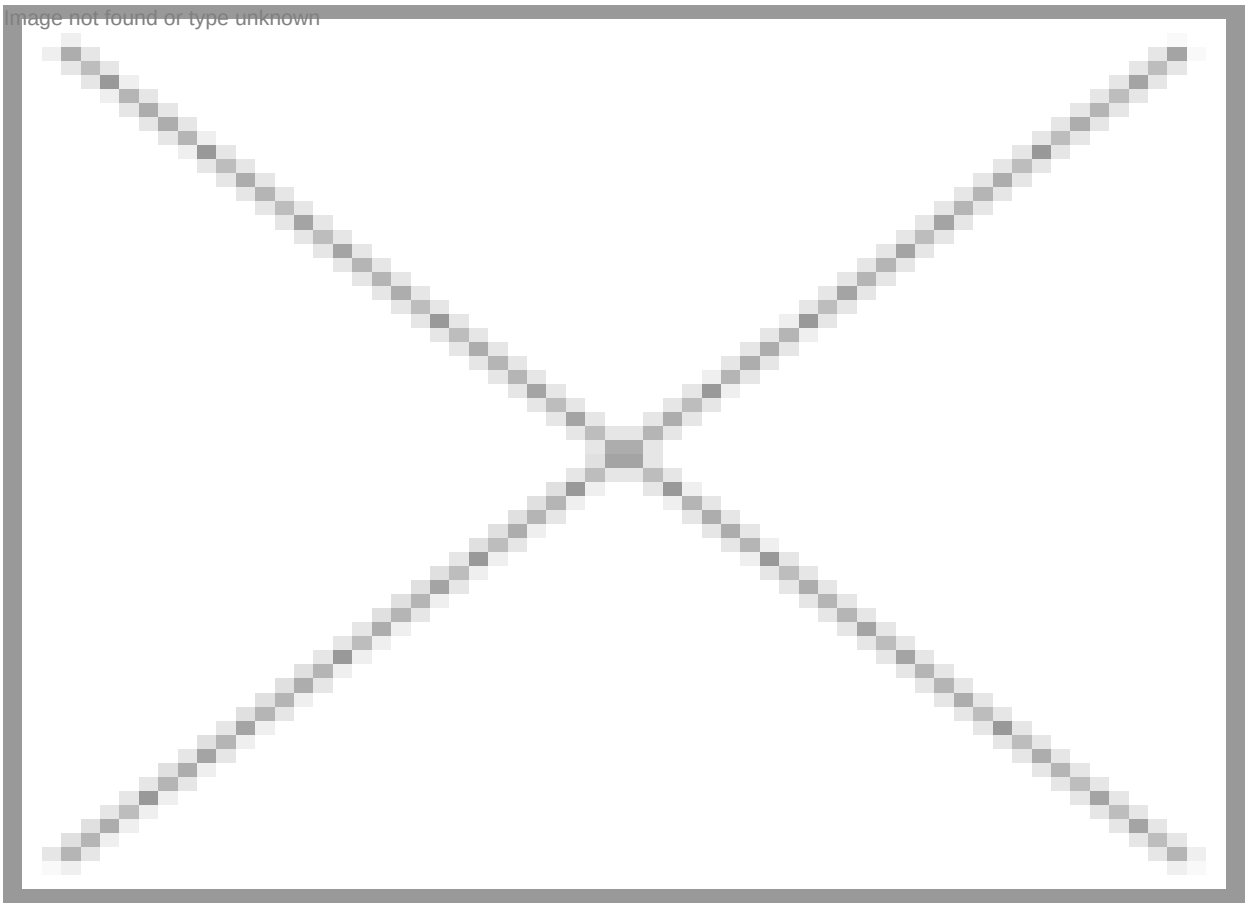

Photo: Boeing

Both Airbus and Boeing reported record deliveries in 2015, with airlines taking 635 jets from the European group and 762 from its rival.

“Delivery is the reality for aircraft manufacturers,” says Strickland, though he warns it can be a double-edged sword if the rate at which new aircraft roll out the hangar door doesn’t reflect the current market.

“It’s great to have such a big order book, but this tends to be a cyclical market,” he adds.

“You don’t want new jets to be arriving just as a downturn hits.”

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