

Commercial Aerospace

ISTAT 2023: Turning a page to the next chapter in commercial aerospace

Industry Overview

ISTAT Americas 2023: Turning to what's next

On Monday we attended the ISTAT Americas (International Society of Transport Aircraft Financing) Conference in San Diego, CA. This note covers our key takeaways from the event and the Air Lease hosted dinner on Monday night. Across the day the emerging themes were not focused on the Covid-led downturn, but instead on the challenges and opportunities the industry is grappling with today. Although the Covid pandemic may have accelerated trends and could have lasting consequences on travel and companies' strategic decisions (from both balance sheet and war-gaming perspectives) it is now being viewed in the rearview mirror. Management attention is now focused on the potential implications of tensions with China (i.e. Geopolitics), the impact of inflation and rising interest rates (i.e. the cost of financing and access to capital), and ongoing supply chain and labor woes.

Demand recovery is not homogenous; WB vs. int rates

Recovering air traffic coupled with the OEM production delays are resulting in an ideal environment for lessors and lease rates. Last year lessors financed 60% of Airbus' deliveries. But while a rising tide lifts all ships, the demand recovery is not homogenous. Rate improvements vary by aircraft type and are supply/demand driven, a more influential driver than interest rates and/or inflation. Of note is that the change in lease rates lags the increase in interest rates on the way up but also the decrease in rates on the way down. This can be attributed to the date of lease rate negotiation and the psychology of the airlines as they look backwards while negotiating. With the increase in interest rates the next question becomes – will the widebody recovery play out as expected or will the rate of change in interest rates make it more challenging.

One supply chain – two conflicting forces

The implications of the supply chain challenges are multi-fold. The same supply chain services both OEMs and MROs and the hole is still being dug. While anyone can throw out a date for when these challenges are behind us, the truth is no one knows. For the engines, the time on wing performance coupled with the lacking MRO capacity is increasing turnaround time. But, the supply chain issues are affecting lead times beyond just engines just as increased regulatory oversight in making it more difficult for OEMs to get things done. Subsequently companies are building in more cushion and being more cautious which ultimately is a costly strategy. While cutting costs and early retirement packages may have been economic necessities at the beginning of the pandemic, the industry is now seeing the consequences of these actions. Both Airbus and GE mentioned they are delving deeper into the supply chain. GE, for example, has allocated 20% of its engineering staff to figuring out the challenges.

See Inside note for ESG, retirements and Pilot Wages/Shortage notes

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WB: Widebodies

MRO: Maintenance Repair &
Overhaul

Takeaways continued...

Delayed aircraft retirements & the overhang of replacement needs

Since 2015 there are more than 1,500 delayed aircraft retirements with more than 3,000 in-service aircraft at the average retirement age. Historically 2.5% of the fleet was retired every year. But more recently retirements have trended closer to 1.5% of the fleet. This mismatch is likely attributed to the disconnect between supply and demand. Airbus, for example, has 12 years of production in its backlog vs. 8 years during the 2008-13 timeframe (ideal is 10 years), as the supply chain issues have prevented a faster ramp up in deliveries and production. Resolving the supply chain bottlenecks will likely be key to increasing production and deliveries, and reducing the average age of the in-service fleet.

ESG – does the Emperor have no clothes?

Per usual, airlines' push to carbon neutral by 2050 was a hot talking point. But there is a dichotomy between the push/desire to get there and the reality of getting there. When the latest iteration of engines was developed the focus on was fuel burn improvement. But with the recent news around the support for and reliability of these new engines, the maintenance implications may outweigh the fuel burn advantages. The next generation of engines is expected to provide yet another 20% improvement in fuel efficiency. But some panelists raised the concern that perhaps the primary focus on fuel efficiency is a bit myopic. Afterall, it seems no one is talking about the environmental implications of generating energy via charging power sources. Is coal powering the charging stations? Have we come full circle? Furthermore, while there is much discussion around the push for climate friendly initiatives, audience polling made it clear that a very large majority do not want to pay for it.

Pilot wages and the shortage misnomer

Over the last five years wages for regional jet pilots have doubled and are up 50-70% vs. last year. The competition for pilots has been exacerbated by pay. However, training for many airlines is a bigger issue than hiring. As Republic Airways noted, they have many new pilot hires coming into the industry. The big imbalance is with captains vs. first officers. It takes 15-16 months to get a first officer through training and to be upgraded to a captain. It takes a day for a pilot to resign and leave for another airline. Consequently, airlines are finding new ways to build airline enthusiasts within the school system at younger and younger ages, hoping they can eventually train them and bring them into the system.

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