

Aerospace & Defense

Aircraft Finance Dublin: We need more airplanes

Industry Overview

Takeaways from the Global Aircraft Finance Conference

We attended the Growth Frontiers Global Aircraft Finance Conference in Dublin. The Dublin conference is the aviation finance equivalent of the Paris Airshow. Quite literally most of the aircraft finance industry – more than 5000 aircraft finance professionals from banks, leasing companies, airlines, appraisers and the like – gather in Dublin for a week of presentations, meetings, and events. In our experience the event offers a good read on the current state of the market for commercial aircraft. This note summarizes our key takeaways from the event.

The world needs more commercial jets

Simply stated, there are not enough aircraft. This is especially the case for narrowbody jets, but widebody aircraft are starting to sell out as well. Demand for narrowbodies is simply off the charts and for widebodies it has picked up substantially. Most lessors have their aircraft placed out for multiple years. Many at least three years, some even further out. The leasing community would take more positions at the OEMs if they were available, but they are not. 2024 is seen as a potentially big year for widebody jet orders.

Aircraft values are rising; book values are too low

Supply constraints are so high that OEM stated production rates are largely seen as not achievable. As a result, lessor book values of aircraft are well below realized mark-to-market values. This suggests the publicly traded lessors should trade at a premium over book. To be clear, this is usually not the case – typically it's the other way around with lessors holding aircraft at more aggressive book valuations. We expect lessors to continue to book gains on individual aircraft and fleet sales.

It's a seller's market

It is clearly a seller's market and, per one lessor's comments to us, the leasing community is not in a price-taking market, but rather a price setting one. New technology narrowbody jet lease rates are up +12% year on year and widebody lease rates are up 8%, while old technology narrowbody jets lease rates are up 20% and widebody lease rates are up 30%, based on average appraiser increases in 2023 lease rates. The old technology is up greater than the new technology because they started at a much lower base. Lease rates are expected to continue to increase in 2024.

Everyone is worried about Boeing

Everyone we spoke to is astonished by Boeing's current situation. They are worried about Boeing's ability to right itself. There is unanimous agreement that a massively dominate Airbus is not good for the industry and a healthy Boeing is required to balance the scales. That said, there were differing views on whether there is room for a third major aircraft OEM. Most agree the market size could easily support a third one, but the costs associated with entering the market and developing a new jet is a moat too wide for many to cross.

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Many don't trust that Boeing can execute a new jet well

As for Boeing righting itself by launching a new aircraft, there is a lot of skepticism. Given that Boeing's last two new aircraft, one clean sheet (787) and one a derivative (737 Max), were both grounded within the first 18 months post entry into service, many don't trust that Boeing can do it. Expectations are not high for the 777X staying on its current timetable and some expect it to be grounded within its first two years of commercial service. Further, with backlogs sold out as far as they are, in some cases nearly a decade, some feel that the industry (both Boeing and Airbus), lack a true incentive to innovate on a new aircraft today.

Price objective basis & risk

Boeing (BA; B-2-9, \$209.38)

Our PO of \$225 is based on the 2026e FCF of \$13/share and relative discount to the S&P500 of 0.8x (about half standard deviation above historical average). In our view, a multiple roughly in line with the historical average fairly reflects the looming aerospace recovery, strong demand for commercial jets, defense opportunities, and the lack of dividend.

Upside risks to our PO are the possible involvement of an activist shareholder, better-than-expected cash margins at 787 and/or MAX programs, the company's ability to sustain 777 delivery rates through the bridge to 777X, lower-than-expected 777X, future single-aisle and middle-of-the-market aircraft development costs.

Downside risks to our PO are as follows: Tight competition for engineering talent in the current labor market could make new product development more challenging. Execution risk on new programs and production ramp-ups (737MAX, 777X, KC-46) could result in cost overruns and margin contractions. Changes in trade policy that end in a trade war. A sharp and prolonged surge in oil prices to above \$100/bbl would be negative to aircraft demand. A downturn in commercial aviation, due to an exogenous factor, could adversely affect financial results. As aircraft are priced in USD, an unexpected rapid revaluation in the dollar could significantly affect order activity. Also, a strong dollar could improve Airbus' competitive advantage. 787 fixes could take longer than expected.

Analyst Certification

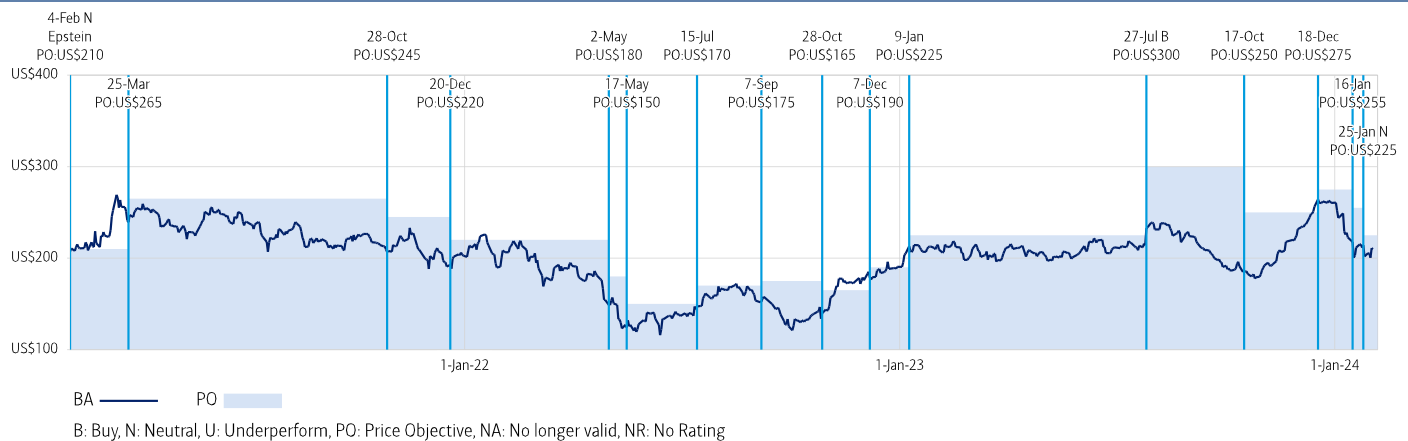
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	Spirit AeroSys-A	SPR	SPR US	Ronald J. Epstein
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Boeing (BA) Price Chart

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Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	31	62.00%	Buy	23	74.19%
Hold	11	22.00%	Hold	9	81.82%
Sell	8	16.00%	Sell	6	75.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
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Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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