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Aerospace & Defence | Europe

Deja Vu? Downturn Playbook

Whether US tariffs are a short-term negotiating tactic or a more structural shift in US policy remains to be seen, but share price gyrations reflect the uncertainty. We look at what has happened in prior downturns, and update our tariff exposure table. We continue to prefer Defence>OE>AM.

Key Takeaways

- Prior downturns (ex-COVID) have driven air traffic demand -25% and capacity -15% on average, and EU Aero shares down >50%, primarily driven by a derating.
- Is this time different? There is potential for tariffs to impact different global regions - and therefore air traffic trends - unevenly.
- What's in the price? EU Aero shares are down 14% since 2 April (all derating). There is clearly more downside risk if we enter a recessionary environment.
- We update our tariff exposures table - we now estimate sales of goods exported to the US range from 3-20% for Aerospace names, and 1-5% for Defence names.
- How To Be Positioned? We maintain our preference for Defence over Commercial OE (supply risk) over Commercial Aftermarket (demand and supply risk).

Deja Vu? What Has Happened in the Past? We look at three previous economic shocks to air traffic demand over the last 25 years: 9/11, Gulf War II, and the GFC. We exclude COVID as an extreme outlier. On average, air traffic demand (measured by RPKs) fell by 25%, with capacity (measured by ASKs) falling 16% (see [Exhibit 1](#) and [Exhibit 2](#)). While EU Aerospace share prices fell significantly more, down 52% on average, this was primarily driven by a derating rather than lower estimates, with EPS (FY1) estimates falling 12% on average. We highlight that on each occasion, Airbus' fundamentals proved more resilient than the share price reaction would have suggested. EPS (FY1) estimates fell 13% on average over the three periods, compared to the shares, which fell 63% on average, underperforming aftermarket names Rolls Royce (-51% on avg.) and Safran (-42% on avg.).

What Could Be Different This Time? Not All Fleets Are Created Equal: We acknowledge the potential for tariffs to impact different global regions unevenly, although this is highly dependent on many variables where we have low visibility at present. In a similar fashion, commercial aircraft and their engines have varying exposures to different regions, each of which could reflect the economic impact of tariffs. We therefore provide a breakdown of key engine fleets by region below (see [Exhibit 4](#)), highlighting several major programmes have more than 30% of the total fleet in the Asia Pacific region – CFM56, GE90, GEnx, LEAP, PW4000, Trent 700/1000/XWB. We note that the probability of a recession has notably risen in the US with our [US economists](#) looking for growth in real GDP to be down 70bps (Q4/Q4) this year, from 1.5% to 0.8%. For now, the base case remains that the US economy will slow but avoid a prolonged contraction. In other regions, our [Asian](#)

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AEROSPACE & DEFENCE

Europe

Industry View

Attractive

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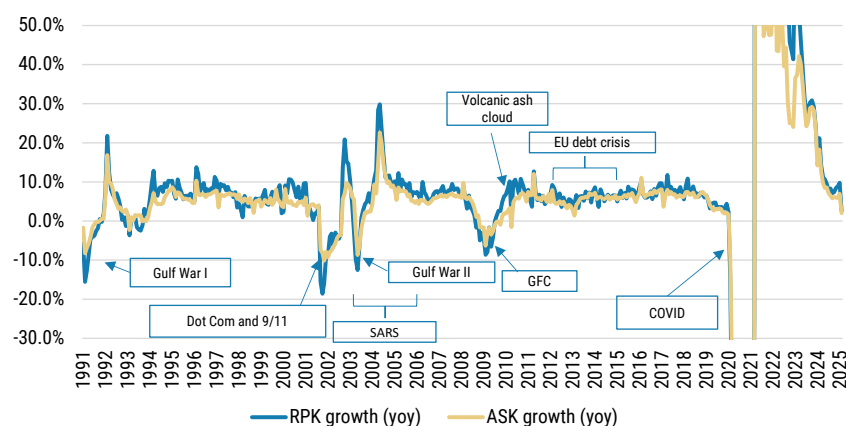
Economists believe the growth drag will be bigger than the 100bps deceleration seen in 2018-2019; while our **European Economists** see a potential reduction of 60-120bps.

What's Being Priced? Back to Basics: Share prices are naturally volatile following last week's tariff announcement. While they reflect the uncertainty posed, we believe there is significant further downside in a recessionary environment, similar to the prior downturns described above. If such a scenario begins to transpire, we think basic valuation and balance sheet metrics become more useful. Looking at EV/Sales in **Exhibit 1**, we find Airbus and MTU Aero Engines are both trading close to their respective 10-year average multiples, with all names still trading significantly above historical troughs. Looking at Net Debt/EBITDA, we note Melrose as the most levered on 2.3x Net Debt / EBITDA for FY24, with the other names having relatively stronger balance sheets, including Rolls Royce, Safran, and Airbus in net cash positions.

We Update Our Tariff Exposures Table (see **Exhibit 3):** Reflecting new learnings, we now estimate sales of goods exported to the US range from 3-20% for Aerospace names, and 1-5% for Defence names. We therefore continue to see Commercial Aftermarket names as most exposed (both directly and indirectly through economic uncertainty), with Defence names generally insulated given their more local-for-local manufacturing and supply chain setup for US exposure. A bear case scenario of the impact on EBIT of our coverage names were they to absorb the impact of tariffs is also shown, although we highlight this ignores (i) the ability to pass-through tariffs to customers, or to renegotiate contracts under certain circumstances; (ii) reduced tariffs on products with a minimum 20% US content; and (iii) other mitigating actions that could reduce the potential impact.

Still Many Tariff Unknowns: Multiple areas of uncertainty include: (i) the applicability of the WTO's ATCA (Agreement on Trade in Civil Aircraft), allowing for tariff-free trade in aircraft, engines, and related parts between signatories; (ii) the applicability of the WTO-brokered truce between the US and the EU regarding tariffs on Airbus and Boeing aircraft; and (iii) coverage of the exemption of aerospace products under the USMCA (United States-Mexico-Canada Agreement), which include parts of airplanes and helicopters, propellers, rotors, undercarriages, satellites, spacecraft, and suborbital and launch vehicles. We highlight that US aerospace manufacturing trades at a surplus, and the US Aerospace Industries Association has asked the US Trade Representative for a national security exemption from the tariffs.

Exhibit 1: Air Traffic: demand and supply have historically grown at ~5% annually, but several shocks have driven 15-25% downturns, excluding COVID-19 as an extreme outlier



Source: IATA (Updated to Feb 2025), Morgan Stanley Research

Exhibit 2: Prior downturns drove sector share prices down 52% on average, compared to -14% since the US Tariff announcement on 2 April last week

<i>EU Aerospace</i>	Share price	RPK	ASK	EPS (FY1)	PE (FY1)
9/11	-55%	-32%	-20%	-15%	-36%
Gulf War II	-43%	-16%	-11%	-10%	-49%
GFC	-58%	-26%	-16%	-12%	-67%
Average	-52%	-25%	-16%	-12%	-51%
US Tariffs (2025)	-14%			-1%	-15%

Source: Datastream, Morgan Stanley Research

Exhibit 3: US Revenue Exposure and Bear Case Tariff Impact Scenarios

Company	2025 MG Estimates													
	US revenue exposure (FY24)	o.w. Services	o.w. Goods local to local	o.w. Goods exported to the US	US Goods exported as % group sales	Revenue group	Adj. EBIT	US Goods exported revenue	o.w. excluded (USMCA)	US Goods exported revenue subject to tariffs	Tariffs +10%	Tariffs +15%	Tariffs +20%	Tariffs +25%
Aerospace														
Airbus	24%	10%	60%	30%	7%	75,392	7,296	5,428	0%	5,428	4,885	4,614	4,343	4,071
											(7%)	(11%)	(15%)	(19%)
Melrose Industries	64%	0%	80%	20%	13%	3,741	462	479	10%	431	388	366	345	323
											(11%)	(16%)	(21%)	(27%)
MTU Aero Engines	70%	67%	5%	28%	20%	8,603	1,194	1,686	0%	1,686	1,518	1,433	1,349	1,265
											(14%)	(21%)	(28%)	(35%)
Safran	25%	15%	15%	70%	18%	30,741	4,998	5,380	33%	3,604	3,244	3,064	2,884	2,703
											(7%)	(11%)	(14%)	(18%)
Rolls Royce	29%	50%	40%	10%	3%	15,122	2,712	555	0%	555	499	471	444	416
											(2%)	(3%)	(4%)	(5%)
Defense														
BAC Systems	44%	0%	98%	2%	1%	31,143	3,369	274	0%	274	247	233	219	206
											(1%)	(1%)	(2%)	(2%)
Cessault Aviation	16%	50%	18%	33%	5%	6,759	600	351	0%	351	316	299	281	264
											(6%)	(9%)	(12%)	(15%)
Hensoldt	2%	0%	0%	100%	2%	2,618	357	52	0%	52	47	45	42	39
											(1%)	(2%)	(3%)	(4%)
Leonardo	26%	20%	65%	15%	4%	19,328	1,634	754	0%	754	678	641	603	565
											(5%)	(7%)	(9%)	(12%)
Rheinmetall	8%	0%	90%	10%	1%	12,366	1,951	99	0%	99	89	84	79	74
											(1%)	(1%)	(1%)	(1%)
Thales	13%	10%	70%	20%	3%	22,055	2,701	556	0%	556	500	472	445	417
											(2%)	(3%)	(4%)	(5%)

Note: US revenue exposure for MTU Aero Engines, Melrose, Airbus, Thales, Rheinmetall and Hensoldt are North America

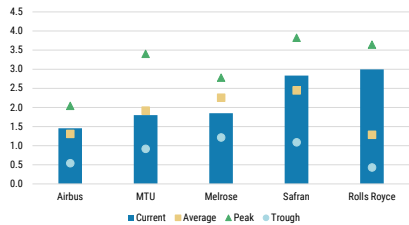
Source: Company reports, Morgan Stanley estimates (e)

Exhibit 4: Commercial Engine Fleet - Split By Region

Engine	Europe	Latin America	Middle East	North America	Africa	Asia Pacific	Parked
	In-Service						
AE 3007	3%	4%	3%	34%	16%	1%	39%
CF6	30%	4%	5%	18%	2%	24%	17%
CF34	13%	4%	1%	47%	3%	12%	20%
CFM56-5B	31%	6%	5%	14%	2%	36%	6%
CFM56-7B	22%	4%	1%	30%	3%	35%	4%
GE90	22%	1%	26%	9%	2%	31%	8%
GENx	13%	3%	17%	23%	5%	38%	2%
GP7200	0%	0%	77%	0%	0%	3%	19%
LEAP-1A	25%	7%	7%	8%	2%	48%	3%
LEAP-1B	21%	11%	5%	42%	2%	18%	2%
PW1100G	17%	8%	1%	17%	0%	22%	35%
PW1900G	30%	20%	3%	25%	0%	3%	20%
PW2000	3%	0%	0%	80%	0%	0%	17%
PW4000	6%	1%	2%	40%	1%	31%	19%
RB211	19%	0%	0%	55%	0%	3%	23%
Trent 500	14%	5%	9%	0%	0%	0%	72%
Trent 700	16%	2%	7%	10%	3%	49%	14%
Trent 800	18%	0%	4%	33%	1%	13%	31%
Trent 900	19%	0%	34%	0%	0%	28%	19%
Trent 1000	27%	13%	6%	0%	5%	43%	7%
Trent 7000	44%	4%	4%	21%	3%	19%	4%
Trent XWB	30%	1%	10%	6%	4%	48%	2%
V2500	21%	8%	4%	24%	1%	35%	8%

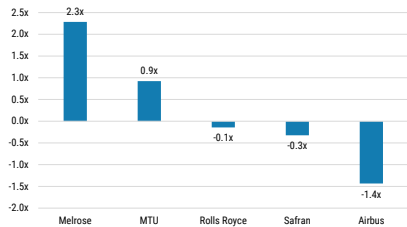
Source: Cirium, Morgan Stanley Research

Exhibit 5: Aerospace sector currently trades at 2.1x FY1 EV/Sales, vs an average trough at 1.0x the last 10 years (Melrose since May-2023, when it became a standalone A&D company).



Source: Datastream, Morgan Stanley.

Exhibit 6: Balance sheets across the industry remain robust, with Melrose relatively more levered with a FY24 Net Debt/EBITDA of 2.3x.



Source: Company reports.

Exhibit 7: Prior downturn by EU Aerospace companies covered by MS

11 September 2001	Share price	EPS	FY1 EV/Sales	FY1 EV/EBIT	FY1 P/E
Airbus	-61%	11%	-51%	-47%	-65%
Melrose	-	-	-	-	-
MTU Aero Engines	-	-	-	-	-
Safran	-54%	-42%	-31%	-20%	5%
Rolls-Royce	-50%	-13%	-45%	-42%	-49%
Average	-55%	-15%	-42%	-36%	-36%

Gulf War II (2003-2004)	Share price	EPS	FY1 EV/Sales	FY1 EV/EBIT	FY1 P/E
Airbus	-63%	-22%	-40%	-45%	-52%
Melrose	-	-	-	-	-
MTU Aero Engines	-	-	-	-	-
Safran	-9%	47%	-21%	-45%	-38%
Rolls-Royce	-57%	-57%	-44%	-17%	-57%
Average	-43%	-10%	-35%	-36%	-49%

GFC (2007-2009)	Share price	EPS	FY1 EV/Sales	FY1 EV/EBIT	FY1 P/E
Airbus	-65%	-27%	-100%	-100%	-94%
Melrose	-	-	-	-	-
MTU Aero Engines	-59%	30%	-58%	-52%	-68%
Safran	-62%	-20%	-53%	-52%	-53%
Rolls-Royce	-46%	-30%	-64%	-58%	-51%
Average	-58%	-12%	-69%	-65%	-67%

US Tariffs (2Apr25 to 8Apr25)	Share price	EPS	FY1 EV/Sales	FY1 EV/EBIT	FY1 P/E
Airbus	-14%	-1%	-16%	-16%	-13%
Melrose	-14%	0%	-14%	-14%	-17%
MTU Aero Engines	-16%	-1%	-16%	-16%	-15%
Safran	-14%	-2%	-17%	-17%	-12%
Rolls-Royce	-10%	1%	-16%	-16%	-17%
Average	-14%	-1%	-16%	-16%	-15%

Source: Datastream, Morgan Stanley Research

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Underweight/Sell	598	16%	81	10%	14%	227	13%
Total	3,799		848			1726	

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INDUSTRY COVERAGE: Aerospace & Defence

COMPANY (TICKER)	RATING (AS OF)	PRICE* (04/08/2025)
Marie-Ange Riggio		
Melrose Industries PLC (MRON.L)	E (09/06/2024)	407p
Rheinmetall AG (RHMG.DE)	O (07/03/2024)	€1,315.50
Ross Law, CFA		
Airbus SE (AIR.PA)	O (06/13/2023)	€140.24
BAE Systems PLC (BAES.L)	O (06/13/2023)	1,567p
Dassault Aviation SA (AM.PA)	E (06/13/2023)	€284.20
Hensoldt AG (HAGG.DE)	U (06/13/2023)	€60.55
Leonardo SpA (LDOF.MI)	O (01/16/2025)	€41.95
MTU Aero Engines AG (MTXGn.DE)	E (06/13/2023)	€281.10
Rolls-Royce Holdings PLC (RR.L)	O (11/08/2023)	679p
Safran SA (SAF.PA)	E (01/16/2025)	€211.40
Thales SA (TCFP.PA)	E (01/24/2024)	€240.20

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* Historical prices are not split adjusted.