



Before Paris Show, Optimism About Backlogs and Deliveries, Not Orders

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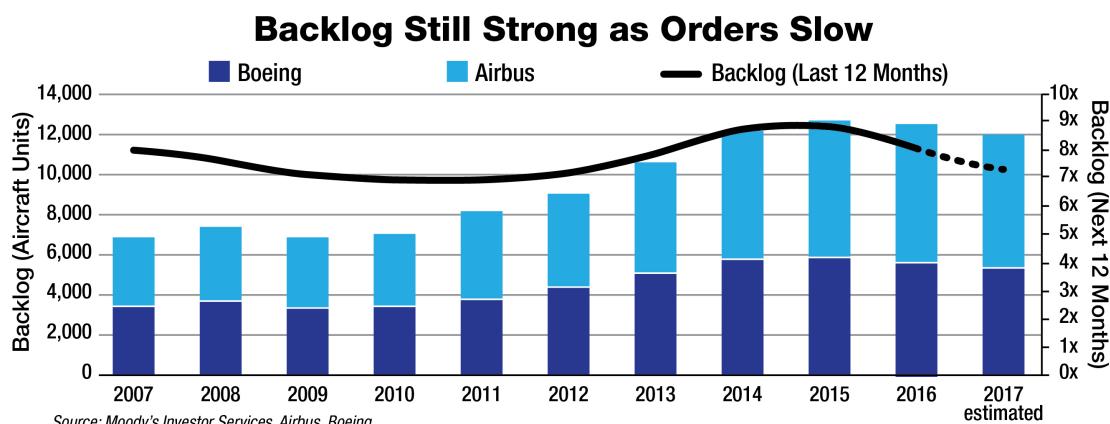
With backlogs looking good and deliveries expected to climb, new orders take a backseat

Like the rest of the economic world, commercial aerospace has been climbing a wall of worry for years.

By now it is clear that new orders for [large commercial aircraft \(LCA\)](#) are at least dipping. The combined book-to-bill rates for [Airbus](#) and [Boeing](#), the leading original equipment manufacturers (OEM), fell below the psychologically important 1.0x mark in 2016 for the first time since 2009. Cutbacks in higher-margin widebodies were especially alarming.

Worse yet, with Canadian, Chinese and Russian “upstarts” continuing to press into their base marketplace, the Airbus-Boeing LCA duopoly looks increasingly challenged. Season all of that with political volatility across the West and a slew of aerospace-sensitive issues heating up, like trade protectionism and state sponsorship, and the future is looking bleaker for a number of reasons.

Not so, according to new analyses from financial forecasters. As their reports pile up ahead of the Paris Air Show, analysts instead say industry’s trajectory is actually elevated, starting with a tailwind from the record backlog of LCA work, as well as growing production rates.



“Fewer commercial aircraft orders than deliveries is not a risk for a few years because of the current backlog of about eight years and still low cancellation rates,” Moody’s Investor Services says in a May 17 report. “The 7-9% increase that we expect in large commercial airplane deliveries over the next 12-18 months is supported by the significant combined order backlog of Airbus and Boeing’s large commercial aircraft, which was close to record levels at the end of 2016.”

Moody’s believes there are several factors underpinning industry’s production resilience, starting with “historically low” cancellation rates of 3% or below and “solid” airline fundamentals. “Lower oil prices appear to have had only a modest effect on cancellations for next-generation aircraft,” they say. Meanwhile, “shrinkage” in

export credit agency support has not materially hurt LCA demand as private-sector financing and even the airlines themselves have filled the void.

This isn't to say that the backlog is untouched by macroeconomic conditions. Combined, airlines and lessors are 17% over-ordered when it comes to LCAs, according to a May 16 analysis from UBS. But that is better than before and equates to less than two years of the eight-year backlog.

Of the two OEMs, Airbus appears more vulnerable. "While Airbus carries a much larger backlog, we estimate its largest customers are more over-ordered, by 26% of their combined backlog, as compared to Boeing's largest customers, by 2%," UBS says.

The most over-ordered airlines across OEMs include Lion Air, [AirAsia](#), IndiGo, VietJet and [Avianca](#). By comparison, [Delta Air Lines](#), [Southwest Airlines](#), [China Eastern Airlines](#), [China Southern Airlines](#) and [United Airlines](#) all look under-ordered. Delta, of course, is now well-known for using older aircraft on purpose.

By type, narrowbody aircraft led the over-order surplus at 21% of the current backlog, starting with the [A320](#). By region, China is responsible for the majority of over-ordering. North America, by contrast, is under-ordered by roughly 900 aircraft.

To work through the excess orders, the global fleet of aircraft would have to expand at a 6% compound annual growth rate for another seven years, at least. That implies a passenger traffic growth rate of about 7%, according to UBS. While few industry observers believe such a traffic rate will be achieved or sustained, few see it falling from current levels, either. Traffic grew at 6% or more over the past few years, UBS notes.

For Cowen and Co. analysts, that is one key reason why 2017-19 delivery schedules for single-aisles and the "heavily" backlogged Airbus [A350](#) and [Boeing 787](#) look secure. In a May 16 report on Boeing specifically, they say the future looks bright for the OEM—or at least its shareholders—despite a checkered history with production cycles.

"Given Boeing's erratic cash-flow history, one can understand bears' concern of a potential production downturn," Cowen says. "What's not appreciated is that the combination of robust backlog, favorable productivity set-up, derivative research and development focus, and a defense upswing offer more durable cash-flow visibility than in prior cycles."

To be sure, all of these reports are educated guesses on where industry is going. But their conventional wisdom seems widespread: This new-order slowdown will be different because of backlogs and deliveries. New orders may become the old topic at the air show, because increasingly it seems we are looking back to the future.

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