

Commentary

Boeing Crisis Impinging on the Airline Sector's Growth Plans

Morningstar DBRS

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Key Highlights

1. We expect the re-emergence of safety concerns at Boeing to materially affect the company, including its ability to make timely deliveries, which is already affecting airlines.
2. Airlines' growth plans are being slashed because of delivery delays, and operational disruptions may occur. These disruptions could result in higher airfares, and decarbonization targets could be affected because of delays in fleet modernization.
3. The airline sector's challenges could be slightly positive for the air cargo sector, which is struggling because of low load factors/yields, as Boeing's delivery delays may limit further capacity expansion.

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Overview

Boeing is back in the spotlight over safety issues following the Alaska Airlines midair door plug blowout in January, as well as a few other safety-related incidents in early 2024, including the sudden mid-air drop of a Boeing 787 aircraft operated by LATAM Airlines that resulted in several injuries. This is not unprecedented for Boeing; its 737 MAX aircraft fleet was grounded for approximately 1.5 years following two plane crashes in 2018 and 2019. We expect the re-emergence of safety concerns to materially affect Boeing, including its ability to make timely deliveries, which is already affecting the airline sector's growth plans.

Immediately after the Alaska Airlines incident, the Federal Aviation Administration (FAA), the United States' civil aviation regulator, temporarily grounded all Boeing 737 MAX 9 aircraft,¹ which were later cleared to fly. However, given the findings, the FAA halted Boeing from increasing its production rate for 737 MAX aircraft until the quality issues had been addressed. The company has also been subject to investigations by the FAA and the U.S. Department of Justice. In March, Boeing's Chief Executive Officer announced he will be retiring at the end of 2024, and there has been a reshuffling at the board and executive management levels.

Overall, this situation has resulted in Boeing materially switching focus toward safety issues. This is affecting aircraft deliveries, which are already much slower than in the past. Certification of remaining Boeing 737 MAX aircraft models could also become challenging. Both airline and lessor customers have expressed concern and frustration with Boeing's ongoing issues, which could affect business relationships and future product orders.

Combining Boeing's recent issues with existing post-coronavirus supply chain issues at aircraft manufacturers, aircraft delivery delays are further worsening and may persist for a few years. This could affect the airline sector in several ways, including (1) the sector's growth being affected because of lower capacity; (2) operational disruptions as airlines may need to revisit flight schedules, particularly for the upcoming summer season; (3) airfares may rise further because of demand-supply imbalance; and (4) decarbonization targets could be missed because of delays in fleet modernization. That said, these challenges could be slightly positive for the struggling cargo sector, which is suffering from low load factors, as capacity expansion may be limited.

1. See our commentary *Temporary Grounding of Certain Boeing 737 MAX 9s Highlights Airlines Sector Vulnerability to Operational Disruptions*, published on January 8, 2024, for further details.

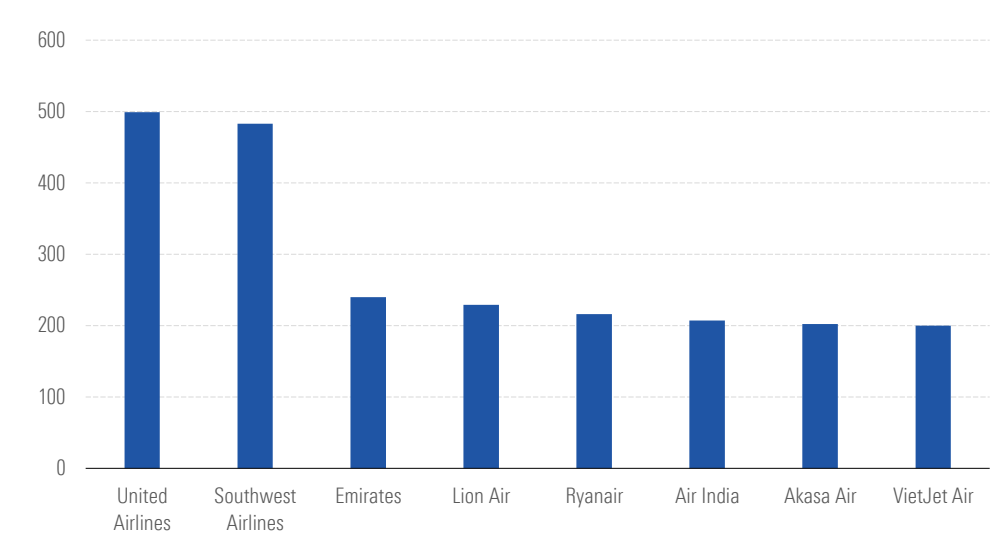
Impact on Airlines' Growth Plans

The airline sector has recently recovered to close to pre-pandemic activity levels, and the sector has been preparing for strong growth in the coming years (the International Air Transport Association (IATA) expects 2024 capacity growth at 9%) with many airlines placing orders with aircraft manufacturers. Boeing currently has a backlog of 6,177 aircraft, while Airbus' backlog stands at around 8,552 aircraft. At 2023 production rates, it will take these companies more than 11 years to fulfill these orders. With orders materially surpassing deliveries along with slower-than-expected production rates, the backlog is likely to continue growing over the next several years.

With Boeing deliveries being further impeded by recent safety issues, airlines’ growth plans for the coming years are being materially affected. Delivery delays may also cause some operational challenges as airline customers may have to revisit their already published schedules, most pressingly for summer 2024, and may leave some airlines in an overstaffed situation. For example, United Airlines (United) recently indicated it would offer pilots a voluntary unpaid leave program next month to reduce excess staffing as a result of delivery delays. Southwest Airlines (Southwest) has reduced its upcoming schedules and stopped pilot and crew hiring because of Boeing aircraft delivery delays; Delta Air Lines has extended its expected Boeing 737 Max 10 deliveries to 2027 because of certification issues, and Ryanair has cut its summer 2024 schedule as it now expects fewer deliveries from Boeing.

Airlines that have the biggest order books with Boeing include United and Southwest, but many airlines depend on Boeing partially or completely for their growth plans.

Exhibit 1 Airlines With Largest Number of Unfilled Orders With Boeing (# of Aircraft)



Sources: Boeing, Morningstar DBRS.
Based on contractual commitments at the end of February 2024, unadjusted for ASC 606.

Fleet Modernization Could Be Delayed, Affecting Decarbonization Targets

Decarbonization is one of the key focus areas for airlines in the coming years, as the sector has pledged to achieve net-zero carbon emissions by 2050. While sustainable aviation fuel is likely to be the major driver of emissions reduction over the medium to long term, airlines' near-term decarbonization strategies rely significantly on fleet modernization to improve fuel and carbon efficiencies. With delayed deliveries, those plans may not materialize as per expectations, and, therefore, some airlines could miss their near-term decarbonization targets. For airlines that have issued sustainability-linked bonds and have committed to certain levels of emissions reduction, higher interest expenses could result if those targets are not met.

Slightly Positive for the Air Cargo Sector

The cargo sector has been struggling post-pandemic because of low load factors and yields, driven by increases in the belly hold capacity of passenger aircraft as grounded planes came back in operation after the pandemic. Demand has also been affected by the weaker macroeconomic environment and rotation of consumer demand from goods to services.

Delayed deliveries from Boeing could limit further expansion of commercial aircraft belly hold capacity and could also reduce the number of freighters being added to the capacity, including conversions. We believe this could be supportive for cargo load factors and yields but is unlikely to result in a material uptick for the sector's profitability unless air cargo demand also improves.

Credit Implications

In our commentary *Global Airlines 2024 Outlook: Cruising Through a Challenging Environment, But Watch Out for the Headwinds* published on January 3, 2024, we expected the airline sector to continue its growth trajectory, with high-single-digit growth in 2024 despite a weaker macroeconomic environment. However, with Boeing's recent issues as well as existing capacity constraints, that growth forecast may be optimistic. Delivery delays could also pressure the recovery of margins, which are still slightly lower than pre-pandemic levels industrywide (as per the IATA, 2023 EBIT margins were at 4.5% compared with 5.2% in 2019).

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