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Aerospace finance key to new orders

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More than \$30bn (£19.6bn) worth of commercial aircraft deals have been signed during the early stages of the Farnborough air show.

Plenty more deals are expected over the next few days, yet the exuberance here is tempered by a sense of uncertainty.

Statements by the UK's business secretary, Vince Cable, who came to see the aerial acrobatics on Monday, aptly summarised the mood.

Mr Cable said the UK's aerospace industry was "at the forefront" of the government's efforts to rebalance the economy by focusing more on manufacturing and exports.

But at the same time, he warned that ever tighter budget constraints meant that UK defence procurement would be cut, thus reducing the flow of money from the government to aerospace and defence companies going forward.

Deferred orders

Mr Cable's talk of "painful decisions" brought back memories of a recent past.

Many here recall with horror the order droughts at last year's Paris air show, as well as here at Farnborough two years ago.

During the last two years, airlines have been forced to adjust to a sharp fall in passenger numbers.

The fall-off in business travel was particularly hard to cope with as this was where they were making most of their profits.

Few airlines actually cancelled their orders, however, though "there were at least 320 deferrals of aircraft deliveries announced in 2009", according to Paul Sheridan, head of risk advisory at Ascend, an aerospace consultancy.

Boom and bust

As a consequence, at the press conferences here at Farnborough - where airline executives often sit shoulder to shoulder with the aircraft makers' bosses - you can almost sense how the manufacturers have become more confident.

There has been a change in the power balance between aircraft manufacturers and airlines, according to Mr Sheridan.

"There must be less scope for more deferrals this year," he explains.

"Not many airlines can play the deferrals card twice."

This year, therefore, the airlines are left with just one option if they are cautious about buying new planes: they must cancel rather than defer - a strategy that in itself carries great risks.

Airlines that cancel their orders not only lose their deposit.

In addition, they will have to move to the back of the queue for new planes, thus they risk not having the right type and number of aircraft when the market eventually recovers.

This risk becomes even more grave if rival carriers suddenly start ordering planes again, as the queue just gets longer.

"Within the industry we are all believers in the cycle," observes Mr Sheridan.

"And it is an article of faith for most that now is a good time to buy."

Persistent credit crunch

However, a desire to buy aircraft and a belief that the market is about to turn will not necessarily translate into an ability to raise funds.

After all, private financiers generally have little patience for the gut feelings of aerospace professionals.

So the airlines are having to convince "the people who control the money, whether they are investors in leases or senior managers and senior risk officers in banks, that this is a good time to invest in the industry", explains Mr Sheridan.

That is not an easy task, given that "the financiers also have shipping, rail, infrastructure and leveraged teams shouting in their ears that they're at the bottom of their cycle, that asset values are going to go up as profitability improves and that now is the time to buy", he adds.

Riding to the rescue

Fortunately, for both airlines and manufacturers, the banks are not the only ones offering finance.

"Last year was difficult," recalls Accenture's Damian Lasou. "But the order books of both Airbus and Boeing weathered the downturn quite well."

By the end of June, the two largest aircraft makers in the world had a combined backlog of 6,555 aeroplanes, representing a fall of just 10% from the peak seen two years ago.

Such strong performance through a credit crunch was achieved because aircraft manufacturers, concerned about the lack of credit available in the market, started lending money to their own customers during 2009.

"We had set aside about \$1bn so that we could do potential financing of new aircraft deliveries," Randy Tinseth, Boeing Commercial Airplanes' marketing chief, tells BBC News.

Airbus set aside 1bn euros (\$1.3bn; £850m), says the chief executive of Airbus' parent company, Louis Gallois.

Undersubscribed loans

But both Mr Tinseth and Mr Gallois say their financing was not used up during the year, largely because different countries' credit export agencies offered

extensive financial support or loan guarantees to airlines to keep aircraft deliveries going.

Consequently, the manufacturers have been able to scale back the financing they were prepared to provide, Mr Gallois explains.

Airbus' customers only used about 450m euros of the credit set aside to help them buy Airbus products, he says.

Boeing's facility was also under-subscribed, Mr Tinseth says.

"Actually, we found - through the work of credit export agencies, through the debt market coming back - we only provided \$800m of financing," he says.

"This year we've set aside about \$500m to potentially do financing of aircraft," Mr Tinseth continues.

"We see that market getting stronger."

Mr Gallois agrees. "This year, we have set aside 1bn euros again, but we will not reach that level," he says.

'First to recover'

In spite of such optimism, analysts point out that concerns of a funding gap remain.

"Right now, the biggest threat to this industry is the airline customers' profitability," says Paolo Carmassi, president of Honeywell Aerospace.

Commercial banks will still be expected to finance aircraft orders to the tune of \$13-16bn this year, according to an estimate by Ascend.

"It is here that any funding gaps will materialise," Mr Sheridan reasons.

"The biggest risk to continued commercial bank lending is undoubtedly that of a large airline bankruptcy," he continues, though he does not think this is likely to happen this year.

Instead, he says, "the real problem for 2010 lies with older aircraft".

"It is next to impossible to get financing on anything over five years of age at the moment."

Such concerns may well be real, but their magnitude should not be exaggerated, warns Boeing's Mr Tinseth.

"The aviation market was one of the last sectors to be hit by the credit crunch and we're already seeing that it is one of the first to recover," he says.



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