Commercial Aviation

Is surging demand for air travel an opportunity for mid-sized aerospace manufacturers?

A phrase that frequent airline travelers hate to hear is when the pilot suggests they stay in their seats because "We are running into a bit of chop."

The same could be said of air carriers' efforts to meet burgeoning demand.

Andrew Carolus
Managing Director
Investment Banking

Adam Oakley
Managing Director
Investment Banking

Steve Simon
Vice President
Investment Banking

Commercial air travel continues to surge as the world puts the pandemic in the rearview mirror. Halfway through 2023, Revenue-Passenger Kilometers ("RPKs"), an essential metric for the commercial aviation industry, continues to climb. In fact, global RPKs are only 12.0% off their 2019, pre-COVID levels. While all regions continue to see growth, the International Air Transport Association (IATA) reports that the global recovery to pre-COVID levels is currently being pushed by demand within the Asia Pacific region.

Such demand suggests that a robust and sustained commercial aviation recovery is likely as both Boeing and Airbus have reported heavy backlogs for their commercial jets of all sizes.

The one bit of turbulence that could prevent airlines from taking full advantage of surging demand going forward: there simply aren't enough planes.

Record orders suggest an expectation for sustained demand

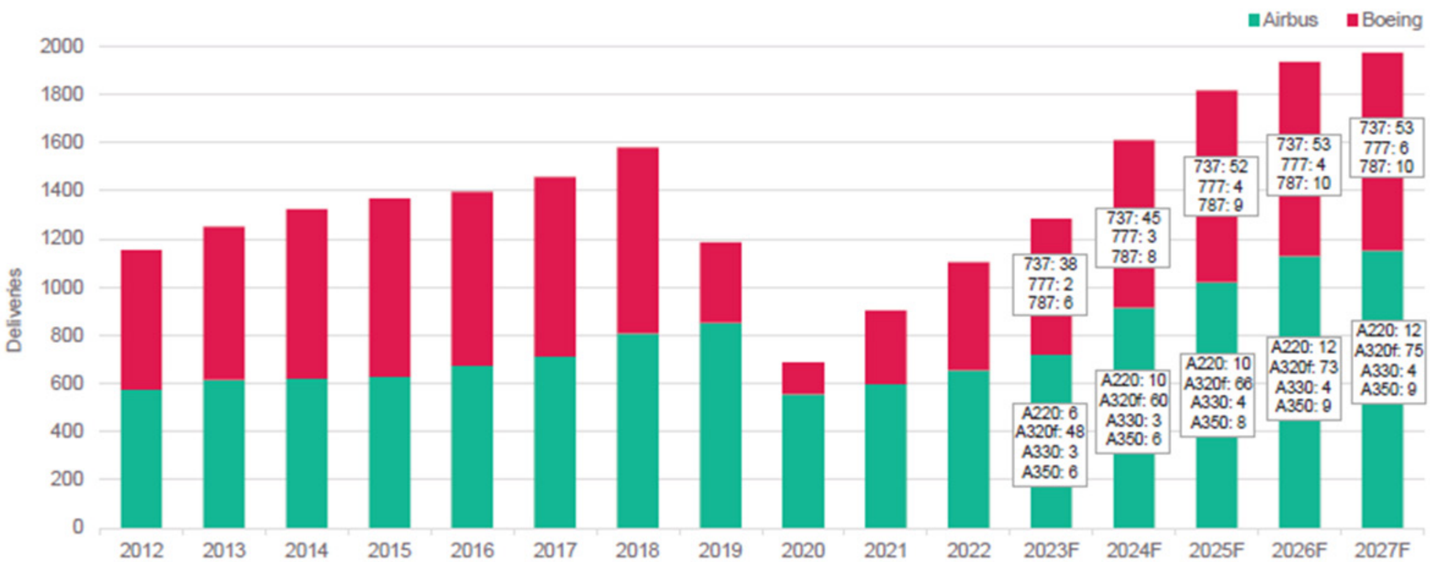
This year during the Paris Air Show, there was much buzz around the increased new aircraft booking orders, including a record 500-plane deal between Indian airline IndiGo and Airbus for A320neos. In total, Airbus left Paris with 801 new orders and Boeing with 230. Although Airbus was the clear winner coming out of the Air Show, the industry might be the true winner given the optimism stemming from the number of orders received and the perceived continued revival of the commercial airline industry.

The bad news is that the large airplane manufacturers are struggling to meet demand. As we received finalized 2022 numbers, it was apparent that last year's delivery volumes failed to meet initial benchmark targets due to supply chain challenges and workforce shortages.

Delivery volumes failed to match initial targets due to supply chain issues, 2018 totals unlikely to be exceeded before 2024

Although both Boeing and Airbus have improved on their delivery performance throughout the first half of 2023, many industry executives are still seeing stubborn supply chain issues limiting manufacturing capabilities.

CHART 1: **2022 DELIVERY VOLUMES FAILED TO MATCH INITIAL TARGETS DUE TO SUPPLY CHAIN ISSUES, 2018 TOTALS UNLIKELY TO BE EXCEEDED BEFORE 2024**



Source: Cirium Fleets Analyzer and 2022 Cirium Fleet Forecast for 2023-27 (amended for recent market developments), boxes show average monthly deliveries..

Airbus commercial aircraft order backlog

The challenges stemming from supply chain uncertainty are further exacerbated by an aging inventory of airplanes, most notably relatively few young single-aisle aircraft, and by the lingering effects of COVID. During the pandemic, OEMs had to reduce capacity, particularly in air travel subsectors. These scale-back actions echoed throughout the Aerospace & Defense supply chain ecosystem, resulting in lower earnings and cash flow for OEMs as well as their suppliers. As such, although consumer demand is in a period of sustained growth, meeting the demand is tempering a full-blown recovery.

JetBlue's CFO, Ursula Hurley, stated, "I think we're all well aware that they're struggling from ramp up challenges driven by manpower and supply chain." Similarly, Boeing CEO Dave Calhoun noted that, "we're not anticipating or suggesting that the supply chain world is going to get much better in the near term. We expect it will continue to be challenged over the course of 2023." Those challenges have prevented Boeing and its counterparts from further increasing production, driving a stubborn and growing backlog.

To help ensure the necessary resources are available when needed, many OEMs and their manufacturing partners have begun placing orders for parts well in advance of when they normally would do so. In turn, this has created surging demand and an expanding backlog for many suppliers even further into the future.

CHART 2: **AIRBUS: COMMERCIAL AIRCRAFT ORDER BACKLOG** (Jan-2019 to Jan-2023)

Source: CAPA – Centre for Aviation and Airbus.

MROs: A possible solution and a fertile ground for M&As?

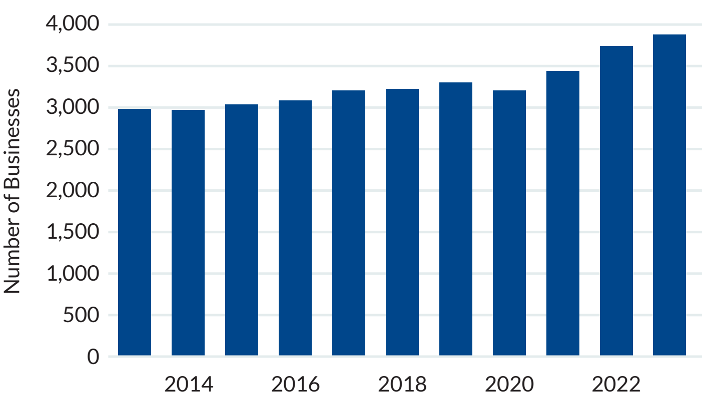
Given the increasing demand and capped capacity, the question for commercial air carriers is: how to keep supply issues from hindering business? One way is to keep existing aircraft flying longer.

For commercial aviation, we anticipate an investor bias skewed towards maintenance, repair, and overhaul businesses ("MRO") as the industry continues to grapple with lagging new jet supply and long delays for upkeep on current fleets. MRO businesses, and those servicing these businesses, are well-positioned to capitalize on a growing backlog and increased focus from key airline executives on securing more airplanes. According to GlobeNewswire, the aircraft aftermarket parts market is poised to reach USD $43.3B by 2030: a 7.63% CAGR.

The MRO segment of the Aerospace sector is a classic play for private equity firms and others who are adept at buying and merging smaller companies to build strategic partnerships. It's extremely technical and new firms have high barriers to entry.

It is also highly fragmented. In the US alone, there are currently nearly 4,000 MRO businesses.[1]

CHART 3: **NUMBER OF MRO BUSINESSES IN THE US**



Source: Ibisworld. Data as of February 2023.

> The number of businesses in the Aircraft MRO industry in the US has grown 3.8% per year between 2018–2023.[1]

Big demand equals big opportunity for M&As

Growing backlogs are providing companies with an enormous opportunity to invest and grow their business. Many middle market manufacturing businesses have begun implementing technologies to ease burdens brought on by labor shortages, such as labor-reducing machinery or data analytics to improve production. Investments in these areas are often rewarded upon a sale of the business as buyers typically have favorable views of well-invested, modern operations that can circumvent potential business disruptions.

On thing is certain: as the demand for air travel continues to increase globally, we expect expanding opportunities for private equity firms and MROs to grow their businesses through consolidation, strategic alliances and acquisition.

1. IBISWorld. |

Advantages

Trusted | We take a long-term approach to client relationships and serve as a resource as they consider strategy, financing, growth and liquidity

Connected | Longstanding relationships with executive decision makers at the relevant strategic, private equity and lending participants in the industry

Experienced | Successful track-record of communicating a company's unique attributes through a custom process rather than a one size fits all approach

Exclusive | Our exclusive focus on the middle market provides the insight needed to relate to entrepreneurial business owners and their management teams

Other sector concentrations

In addition to aerospace and defense, we are a dedicated advisor to a wide array of middle-market companies and have developed an in-depth expertise in a range of industries, including:

- Business services
- Consumer and retail
- Distribution and supply chain
- Food, beverage and agribusiness
- Healthcare
- Industrials
- Paper, plastics and packaging
- Technology

About Mesirow

Mesirow is an independent, employee-owned financial services firm founded in 1937. Headquartered in Chicago, with locations around the world, we serve clients through a personal, custom approach to reaching financial goals and acting as a force for social good. With capabilities spanning Global Investment Management, Capital Markets & Investment Banking, and Advisory Services, we invest in what matters: our clients, our communities and our culture. To learn more, visit mesirow.com and follow us on LinkedIn.

Contact us

Andrew Carolus
312.595.7802
andrew.carolus@mesirow.com

Adam Oakley
312.595.6692
adam.oakley@mesirow.com

Steve Simon
312.595.6722
steve.simon@mesirow.com

LEARN MORE

20231009-3158555-10012871