

## Aerospace Climbs Into A Supercycle

BY [JAMES DETAR](#), INVESTOR'S BUSINESS DAILY  
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When **Southwest Airlines** (NYSE:[LUV](#)) said Wednesday that it was upgrading its order for 31 737-700s, due from **Boeing** (NYSE:[BA](#)) in 2016, to larger 737-800s, it fit right into the recent trend driving a historical increase in aerospace demand.

The upgrade will increase capacity of the delivered aircraft by 22%, with which the airline intends to boost its returns on routes to Mexico, South America and the Caribbean. It's the most recent flash in a night-and-day shift for an industry that throttled its spending on new planes for a decade as the U.S. and global economies scraped through a series of recessions.

Airline budgets buckled through a cavalcade of meltdowns beginning with the 2000 dot-com crash, continuing with the 9/11 attacks and bottoming in 2009 with the Great Recession. In 2011, the Budget Control Act crimped the military side of the industry, placing a cap on defense spending, including new aircraft.



Captain Bruce Johnson in the cockpit of American Airlines' first Boeing 787 Dreamliner, one of the new, high-tech aircraft driving a historic.

Those combined setbacks fed a vast reservoir of pent-up demand. As the U.S. and other nations exited the recession, commercial global air travel rebounded, and air

carriers large and small scrambled to add new capacity and more efficient aircraft. The result has driven the aerospace industry into what could be called a supercycle.

"It's the largest cycle in the aerospace industry we have ever seen," Sterne Agee CRT analyst Peter Arment told IBD. "Boeing and Airbus have eight-year order backlogs totaling over 12,000 planes."

The backlog has never been that long before, Arment said. "It's usually been only a few years."

According to the Aerospace Industries Association, industry sales rose to \$228.4 billion in 2014, up from \$219.4 billion the prior year as "sales of commercial aircraft again paced the industry." The AIA expects sales to jump to \$240 billion this year.

### **A Fortified Supply Chain**

Airlines began retiring aging planes at a faster clip this decade, placing orders for technologically-advanced, fuel-efficient aircraft. At the same time, the previous long-term aircraft cycle ended, and Boeing and **Airbus** (OTCPK:[EADSY](#)), which have a virtual duopoly on the market for large jetliners, rolled out advanced new models.

They opened the door to big, long-term gains for independent aerospace suppliers such as **TransDigm Group** (NYSE:[TDG](#)), a maker of actuators and controls; aircraft communications equipment maker **Rockwell Collins** (NYSE:[COL](#)); and **Spirit AeroSystems** (NYSE:[SPR](#)), which makes fuselage, propulsion and wing systems. Large diversified manufacturers such as **General Electric** (NYSE:[GE](#)) and **Alcoa** (NYSE:[AA](#)) have also focused their sights on taking a larger share of the increasingly friendly skies.

General Electric's GE Aviation [business](#), based outside of Cincinnati in Evendale, Ohio, makes engines for many Boeing and Airbus planes, including Boeing's 787 Dreamliner. The Dreamliner is the first jetliner built with 50% composite materials, 20% aluminum and 30% other materials, making it lighter and about 20% more fuel-efficient than its predecessor.

"GE Aviation is entering one of the most important execution phases of its history," General Electric CEO Jeffrey Immelt told the Cincinnati Enquirer in March. "We have 15,000 commercial engines in our backlog for delivery over the next few years, and that includes the (next-generation, fuel-efficient) LEAP engine, being developed by our joint company (CFM International) with Snecma of France."

### **Decade of Renewal**

Bill Fitzgerald, GE Aviation's Vice President of Commercial Engines Operation, told IBD, "It's a decade of portfolio renewal" for GE Aviation.

As aircraft makers rush to develop more advanced planes, GE is rolling out new engines to power them.

Among them is the Leading Edge Aviation Propulsion, or LEAP, engine for single-aisle, narrow-body planes, the biggest category of jetliners. "We have over 8,000 LEAP engines on order and 18 months to two years before we answer those."

"We've got eight new technology-separate factories in eight locations that give us manufacturing scale," for LEAP and other new engines, Fitzgerald said. "And we will open one or possibly two more plants this year."

GE shares shot up nearly 11% on April 10 after it announced plans to shed the bulk of its GE Capital financing unit to focus on its industrial businesses, including aviation.

Alcoa has made three acquisitions recently to drive deeper into the aerospace market.

Last November, it made its biggest purchase, jet engine parts maker Firth Rixson, for about \$2.85 billion. On the company's April 9 quarterly earnings call, Alcoa CEO Klaus Kleinfeld said, "The airline fundamentals are very solid, with a 7% increase in passenger demand projected and 4.3% higher cargo demand" expected this year.

Alcoa shares have languished amid weak prices for commodity items such as rolled aluminum. It booked \$158 million in restructuring charges in Q1, in part for cutting smelting capacity at its Brazilian operations amid weak prices and oversupply.

Its stock is down about 20% from its 2015 high of 17.10 on Feb. 5. Still, it has reported triple-digit profit growth the last four quarters in a row, including a 211% jump in Q1.

### **Independent Suppliers**

TransDigm, a maker of actuators, controls, ignition systems and other components, on May 5 reported fiscal Q2 earnings that beat estimates, and its 2015 earnings guidance topped views. Revenue was lighter than expected as softness in business jets and the helicopter aftermarket offset the strong commercial market.

"All in all, a good quarter," Chief Executive Nick Howley told analysts on the earnings call. "Our operating results were strong, we closed on two solid acquisitions, and we expect (a third), Pexco, to close soon. When Pexco closes, we will have invested about \$1.3 billion in good, solid aero businesses with strong value-generation prospects over a 90-day period."

TransDigm shares were trading at fresh highs on Friday, up 16% year-to-date and more than 1600% above their low in late November 2008.

Aviation electronics maker Rockwell Collins late last year expanded its business with Boeing and said that it expected 2015 revenue to rise to between \$5.2 billion and \$5.3 billion, up from \$4.98 billion in 2014.

On May 4, Rockwell said that Airbus had selected its communications gear for the A320 and A330 aircraft families. On May 11, Rockwell and nine undisclosed airlines around

the globe launched a trial program for a new tracking system that it says will allow carriers "to track aircraft in some of the most remote regions of the world."

Rockwell on April 23 met analyst Q2 earnings estimates and beat revenue views, pushing shares up 1.5% for the day. The stock is trading tight and flat, below an April 29 high and its 10-week moving average.

Spirit AeroSystems uses metals from Alcoa and others to make large aerostructures and components for Boeing, Airbus and other manufacturers.

On April 29, the Wichita, Kan.-based company reported first-quarter earnings of \$1 per share, beating estimates by 8 cents. Revenue edged up to \$1.74 billion, topping views for \$1.67 billion, boosted by robust commercial aircraft sales.

Spirit, which is on the IBD 50 list of top-rated stocks, is also trading in a tight range between its 10-week line and new highs.

### **Future Looks Bright**

Aerospace suppliers are positioned for continued growth well into the next decade, according to market research firm Forecast International.

The global oil glut has cut fuel costs for airlines and consumers, leading to more spending and more air travel, and boosting the need for more planes. For aerospace suppliers, the huge backlogs at Boeing and Airbus point to continued growth.

"When you look at a 10-year window, that's good stability. You want to get tapped into that," said Richard Pettibone, senior analyst for Forecast International.

Boeing, in its "Current Market Outlook 2014-2033" report published last year, said, "We forecast long-term demand for 36,770 new airplanes, valued at \$5.2 trillion."

The majority of those planes (58%) won't just replace aging aircraft but will be for fleet growth, "which stimulates expansion in emerging markets and development of innovative airline business models," Boeing said.

"The aerospace supply industry is going to be humming along at a steady state for the next three to five years," Pettibone said.

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