
# Accenture Commercial Aerospace Insight Report – 2Q16

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# Executive summary:

## 2016 headwinds pushing growth out to 2017

**While many are bullish on the commercial aerospace market, it does face some immediate headwinds that are tempering the gains made over the past few years.**

The current softness in new orders may mean that operators who do come to the table enjoy more of a buyers' market.

Flat production capacity, coupled with the ongoing production ramp-up, will continue to put pressure on cost and drive additional investments in efficiency, production automation, cost visibility, and supplier development.

Lagging aircraft retirements and additional shop visits for older platforms will provide more opportunity for cost-competitive third-party MROs and perhaps delay OEMs' ability to differentiate with proprietary service offerings targeted at newer platforms.

Forecast commercial aerospace growth is largely being driven from North America and Asia, with major OEMs claiming that cyclical ups and downs are smoothing out. Unlike in recent years, growth year-to-year has also slowed, with the second quarter of 2016 projected to have 12.7% growth QoQ, but shrink by -0.3% YoY. The last half of 2016 looks to be spent catching up with 2015 levels, leading to an overall 0.8% 2016 YoY growth rate.

Looking further ahead, 2017 is shaping up to deliver 6.0% annualized growth. However, industry executives we polled remain concerned about geo-political risks. Over the next 12 months, these concerns are focused on increased political instability and worsening economic conditions.

While there has been some belt-tightening at a few companies, production capacity and employment are both relatively stable compared with 2015 levels. Both are expected to increase during 2017. Major areas of cost – materials and labor – have remained much the same as 2015, with a slight decrease projected for 2017.

Overall, the econometric modeling that Accenture has carried out, together with the results from our poll of aerospace executives, support the case for a slowdown in 2016 air traffic growth compared to 2015, with 2017 picking up.

We are also likely to see a slowing in the number of aircraft retirements as lower fuel prices positively impact the economic basis for maintaining older aircrafts in service.

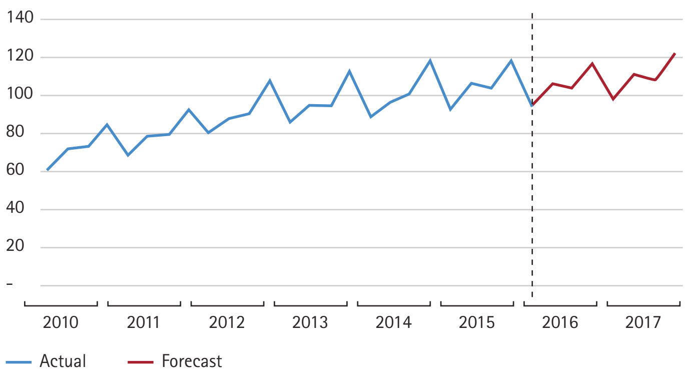
# Global outlook:

## Demand pauses, but 2H16 growth to bring the year up to 2015 levels

**New aircraft deliveries softened in the first quarter of 2016, with Airbus and Boeing 1Q16 deliveries down 7% and 5% YoY respectively.**

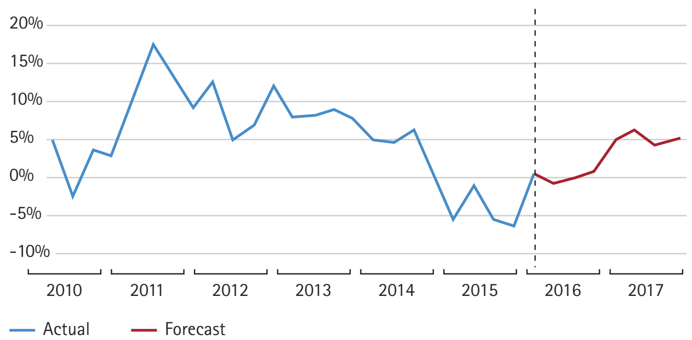
But there was a healthy aftermarket, apparently driven mainly by airline traffic and older fleets continuing to fly. These same factors are shoring up the overall commercial aerospace market, with both North America and Asia Pacific driving global demand.

### Global Commercial Aerospace Index (USD, 2014 = 100)




12.7% QoQ / -0.3% YoY growth rates are predicted for 2Q16, with the last half of 2016 spent catching up with 2015 levels, and showing an overall 0.8% 2016 YoY growth rate.

### Global Commercial Aerospace Index Performance (quarterly YoY percent change)




1Q16 demand dipped, but we predict that this will be offset by a stronger remainder of 2016, with EOY demand slightly ahead of 2015.

## Production outlook: Intelligently keeping up with current and future rate increases

Although there is some belt-tightening at a few companies versus 2015 levels, 2016 production capacity and employment are both relatively stable (and expected to increase during 2017). This is being mainly driven by narrow-body production rate increases and the supplier network support that these require. These trends are backed up by our aerospace executive poll. That said, there are ongoing examples of suppliers not being able to keep up with current demand.

### Production Capacity Outlook

| Next 6 months | Next 12 months | Next 18 months |
|---|---|---|
| Flat | Rising | Rising |

While production input costs are important, we are seeing rapid change in how those inputs are transformed into final products, as well as maximizing capacity utilization. 81% of aerospace and defense executives in our Technology Vision 2016 survey are planning "moderate" to "extensive" automation of production.

## Production inputs: Cost reductions anticipated

2016 material and labor costs are relatively stable versus 2015 levels, with a slight decrease expected during 2017. Our aerospace executive poll supports these trends where materials are concerned, although executives are anticipating an increase in labor costs over a 12-18 month timeframe.

### Production Input Cost Outlook

| Next 6 months | Next 12 months | Next 18 months |
|---|---|---|
| Flat | Decreasing | Decreasing |

An additional nuance is an anticipated shift in workforce skills highlighted in our recent Technology Vision 2016 survey of aerospace executives. 72% believe that the proportion of workers in their organization will shift in favor of more flexible, multi-skilled employees.

## Business cycle stance: Flat with a promising 2017

Our predictions for relatively soft demand over a 6-12 month time-horizon (with an improvement in 2017) are supported by econometric modeling and our aerospace executive poll.

### Business Cycle Stance Outlook

| Next 6 months | Next 12 months | Next 18 months |
|---|---|---|
| Flat | Rising | Rising |

This outlook is, however, tempered by executive concerns around political instability and worsening economic conditions.

## Aircraft operations: The fleets keep flying, driving MRO demand

The likelihood of a slowdown in 2016 air traffic growth compared to 2015, with an uptick in 2017, is supported by econometric modeling and by our aerospace executive poll.

### Aircraft Operations Activity Outlook

| Next 6 months | Next 12 months | Next 18 months |
|---|---|---|
| Flat | Rising | Rising |

While this would normally lead to reduced short-term MRO demand, an anticipated slowdown in aircraft retirements due to lower fuel costs could shore up MRO activity (older aircrafts require additional maintenance to keep them in the air).

# Risks:

## What keeps aerospace executives up at night?

### Geopolitical risks continue to weigh on industry executives' minds.

In the next 12 months, political instability and worsening economic conditions are indeed identified as key areas of concern.

Looking at a 12-24 month time-horizon, terrorism and regional armed conflicts loom larger as risk concerns. Interest and exchange rates are seen as low-risk areas, but concerns over these increase in the longer term.

| | Next 6 Months | Next 12 Months | Next 2 Years |
|---|---|---|---|
| Political instability | High | High | High |
| Worsening economic conditions | Medium | High | High |
| Terrorism | Medium | Medium | High |
| Regional armed conflicts | Medium | Medium | High |
| Interest rate changes | Low | Low | Medium |
| Exchange rate changes | Low | Low | Medium |

# North America outlook:

## Rebounding from flat to YoY growth

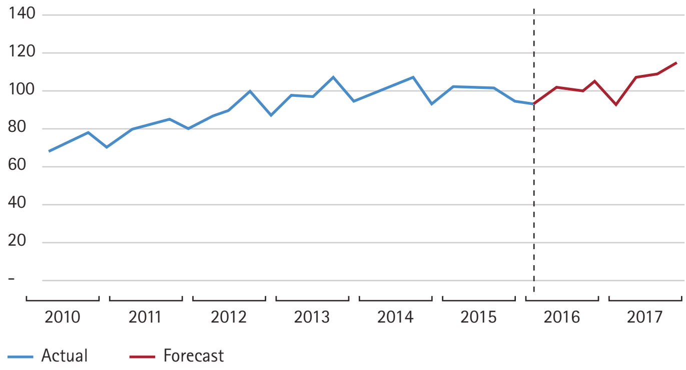
### 2016 North America aerospace demand is expected to be flat overall.

Rest-of-year gains will offset disappointing demand in 1Q16, with a forecast 0.8% YoY increase over 2015 actuals. 7.4% QoQ / -1.3% YoY growth rates are projected for 2Q16, with the last half of 2016 spent catching up with 2015 levels.

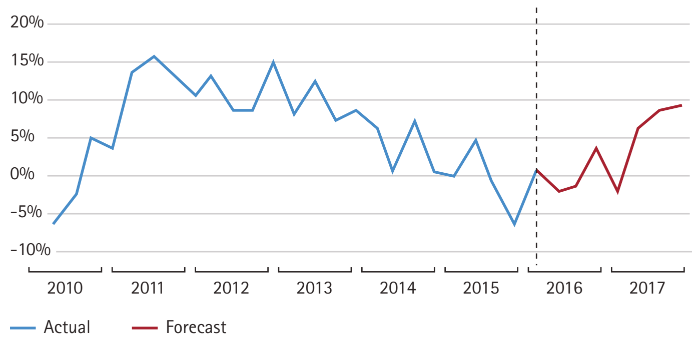
Looking further ahead, 2017 should be stronger, 7.1% ahead of 2015 levels. Like 2016, we are forecasting a challenging 1Q17, with the rest of the year spent offsetting this first quarter, resulting in an overall better year.

| 2Q16 | 2016 | 2017 |
|---|---|---|
| Flat | Flat | Rising |

North America Commercial Aerospace Index (USD, 2014 = 100)




North America Commercial Aerospace Index Performance (quarterly YoY percent change)



# Asia Pacific outlook:
## Continued growth

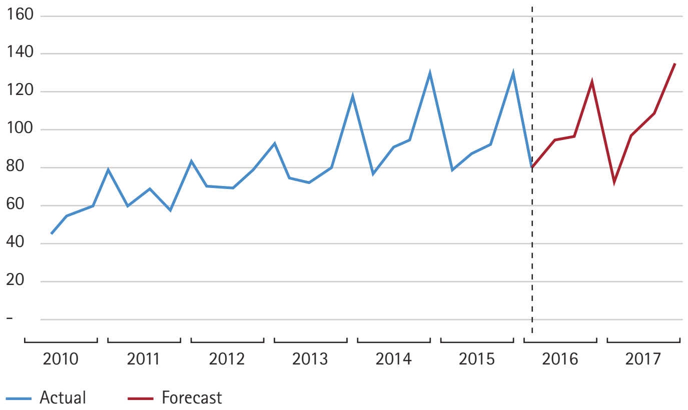
### 2016 Asia Pacific aerospace demand is expected to increase.

Although end-of-year gains will be offset by disappointing demand in 1Q16, the year is forecasted to finish 2.0% up versus 2015 actuals. 15.6% QoQ* / 6.6% YoY growth rates are projected for 2Q16.

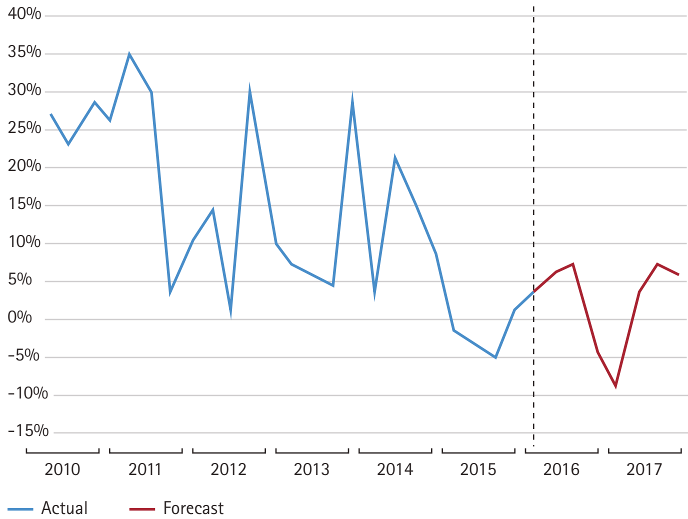
Looking further ahead, 2017 looks set to be stronger, at 5.1% ahead of 2015 levels.

| 2Q16 | 2016 | 2017 |
|---|---|---|
| Flat | Rising | Rising |

Asia Pacific Commercial Aerospace Index (Yuan, 2014 = 100)




Asia Pacific Commercial Aerospace Index Performance (quarterly YoY percent change)




*Note that due to half-year reporting periods for most Asia aerospace companies, quarterly results are amplified when compared to other regions.

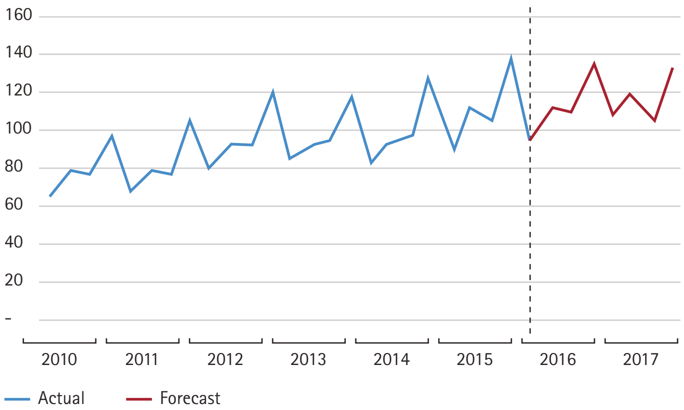
# Europe, Africa, Middle East and Latin America outlook:

## 2016 growth remains challenging

**2016 Europe, Africa, Middle East and Latin America aerospace demand is forecasted to be flat compared to 2015 actuals, with rest-of-year gains offsetting disappointing demand in 1Q16.**

2Q16 is projected to show 20.1% QoQ / 0.3% YoY growth rates, with the last half of 2016 spent catching up with 2015 levels.

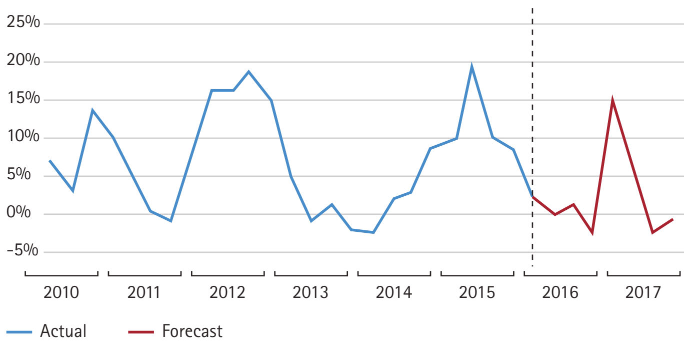
### Europe, Africa, Middle East and Latin America Commercial Aerospace Index (Euro, 2014 = 100)




| 2Q16 | 2016 | 2017 |
|---|---|---|
| Rising | Flat | Rising |

Looking further ahead, 2017 should be stronger, 3.9% ahead of 2015 levels. Like 2016, we are forecasting a challenging 1Q17 (although less challenging than 1Q16 this year). The rest of the year will be spent offsetting the challenging first quarter. Overall, we are predicting an improvement on 2016 performance.

### Europe, Africa, Middle East and Latin America Commercial Aerospace Index Performance (quarterly YoY percent change)




# Implications:

## Stay the course

**While demand may have dipped recently, we see it picking up again over the latter half of 2016, and would expect increased aircraft production to further stress the supply chain.**

We are also likely to see further increases in 2017 and beyond. Aftermarket demand will continue as it remains economic to keep older aircrafts in operation. Support for those fleets will likely continue at steady levels.

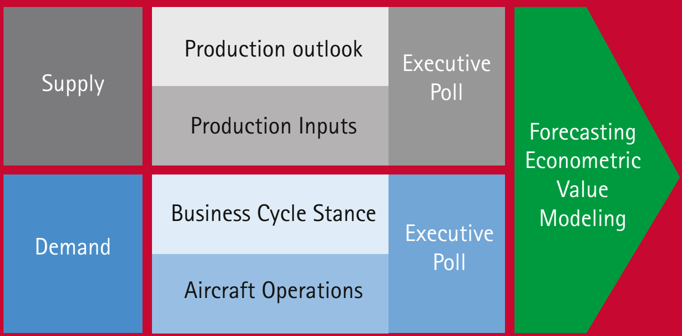
The current softness in new orders may make for more of a buyers' market for those operators that do come to the table. Deep order books will afford some negotiating position for OEMs, but bragging rights on winning the orders battle is always a powerful pull.

Near-term flat production capacity, coupled with the ongoing production ramp-up, will continue to put pressure on cost and drive additional investments in efficiency, production automation, cost visibility, and supplier development.

The lagging of retirements and additional shop visits of older platforms will provide additional opportunity for cost-competitive third-party MROs and perhaps delay the ability of OEMs to differentiate with proprietary service offerings targeted at newer platforms.

## About The Accenture Commercial Aerospace Insight Report

Combining sophisticated econometric modeling methodologies to drive quantitative quarterly forecasts on the health of the commercial aviation market, together with insights from leading industry executives worldwide, the "Accenture Commercial Aerospace Insight Report" provides a unique perspective on short and medium-term trends and drivers in this market. Instead of focusing solely on OEM sales, the report covers a wide range of activities, from suppliers to MRO.




**Notes:**

Regional forecasts are in the highest-impact regional currency with the global index aggregated in US dollars, using current exchange rates (at time of writing). The index baseline year is 2014, both regional and global indices are based from this year.

To complement the econometric modeling, executives at major commercial aerospace companies were polled to get their insights on future supply and demand outlook. The outlook indicators in this report are based on the combination of the econometric modeling and the executive poll.

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## About Accenture Research

Accenture Research is a global team of industry and digital analysts who create data-driven insights to identify disruptors, opportunities and risks for Accenture and its clients. Using innovative business research techniques such as economic value modeling, analytics, crowdsourcing, expert networks, surveys, data visualization and research with academic and business partners, they create hundreds of points of view published by Accenture every year.

## About Accenture

Accenture is a leading global professional services company, providing a broad range of services and solutions in strategy, consulting, digital, technology and operations. Combining unmatched experience and specialized skills across more than 40 industries and all business functions—underpinned by the world's largest delivery network—Accenture works at the intersection of business and technology to help clients improve their performance and create sustainable value for their stakeholders. With approximately 373,000 people serving clients in more than 120 countries, Accenture drives innovation to improve the way the world works and lives. Visit us at www.accenture.com.



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