Boeing's debt binge over the past year poses concerns on outlook moving forward

by NUS-CRI Market Monitoring Team

- **Amidst recovery optimism, Boeing took advantage of low borrowing costs to refinance and raise cash buffers**
- **The relatively elevated NUS-CRI Forward PD forewarns challenges pertaining to the company's highly leveraged position and possible refinancing risks in the future**

The coming of the USD 1.9tn fiscal stimulus and stable vaccination rollout have revitalised optimism on recovery. Riding on the positive sentiments, Boeing, the US domiciled Aerospace Original Equipment Manufacturer, raised over USD 13.8bn of debt in Feb 2021 to shore up its balance sheet. The amount exceeded the initial intent to raise a minimum USD 10bn to assure stakeholders that the firm is able to meet its short term obligations. Along with the return to service of Boeing's flagship programme, 737 MAX, the firm will finally be able to deliver its orders and alleviate pressure on inventory. The company's continuous debt binge over the past 12 months, however, has made its balance sheet increasingly geared. This phenomenon, coupled with possible increase in cost of borrowing, may contribute to the worsening credit outlook for the company as demonstrated by the NUS-CRI Aggregate (median) Forward 1-year PD (Forward PD[1]) in Figure 1b. As such, the relatively elevated credit profile and deteriorating credit outlook indicated by the NUS-CRI 1-year Probability of Default and Forward PD warrant caution.

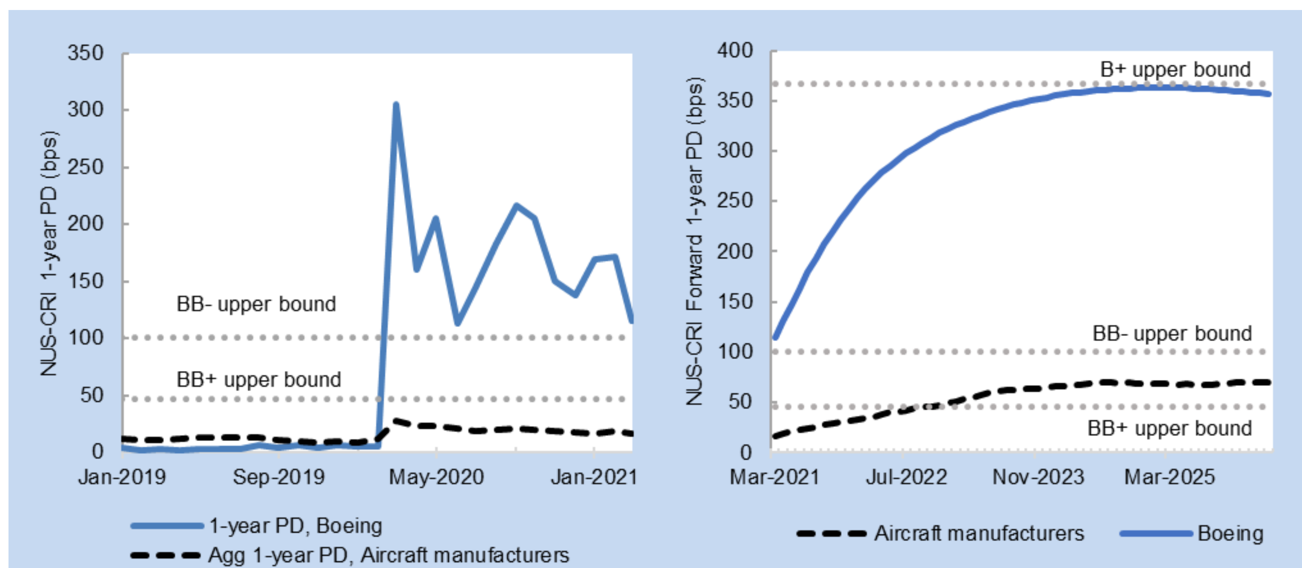

Figure 1a (LHS): Monthly NUS-CRI 1-year PD for Boeing and all publicly-listed Aircraft manufacturers with reference to PDiR 2.0 bounds[2]. Figure 1b (RHS): Corresponding NUS-CRI Forward 1-Year PD based on data feed as of Mar 2021 with reference to PDiR 2.0 bounds. *Source: NUS-CRI*

[1] The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similarly to a forward interest rate. For example, the 6-month Forward 1-year PD is the probability that the firm defaults during the period from 6 months onwards to 18 months –this is conditional on the firm's survival in the next 6 months.

[2] The Probability of Default implied rating version 2.0 (PDiR2.0) provides a more familiar interpretation through mapping the NUS-CRI 1-year PDs to the S&P letter grades. The method targets S&P's historical credit rating migration experience exhibited by its global corporate rating pool instead of relying solely on the reported default rates

The NUS-CRI 1-year PD in Figure 1a points to a notable difference in credit risks between Boeing and the global aircraft manufacturer industry. Reasons that might account for the spread include Boeing's drastic increase in its leverage compared to its peers and its ongoing complications with the 737 MAX product line. To maintain their ability to tide through the drawn out downturn due to the pandemic, Boeing looked to raise funding through the debt capital market and financial institutions. In Feb 2021, the company raised USD 9.8bn in bonds, which coupled with its existing USD 63.6bn total debt, makes the company's balance sheet increasingly geared. While Boeing's total debt to total asset ratio increased from 21.4% in 2019 to 42.7% in 2020, the median total debt to total asset ratio for publicly-listed aircraft manufacturers was 23.4% at the end of 2020 (21.4% in 2019), showing a wide difference in leverage positions for the industry. Along with other recent credit facilities drawn, Boeing has witnessed an increase in interest payments from USD 722mn in 2019 to USD 2.16bn in 2020. As we can see from Figure 2a, Boeing's ability to service its debt and coupon payments using operating income has weakened, with operating losses in Q4 2020 reaching USD 8bn.

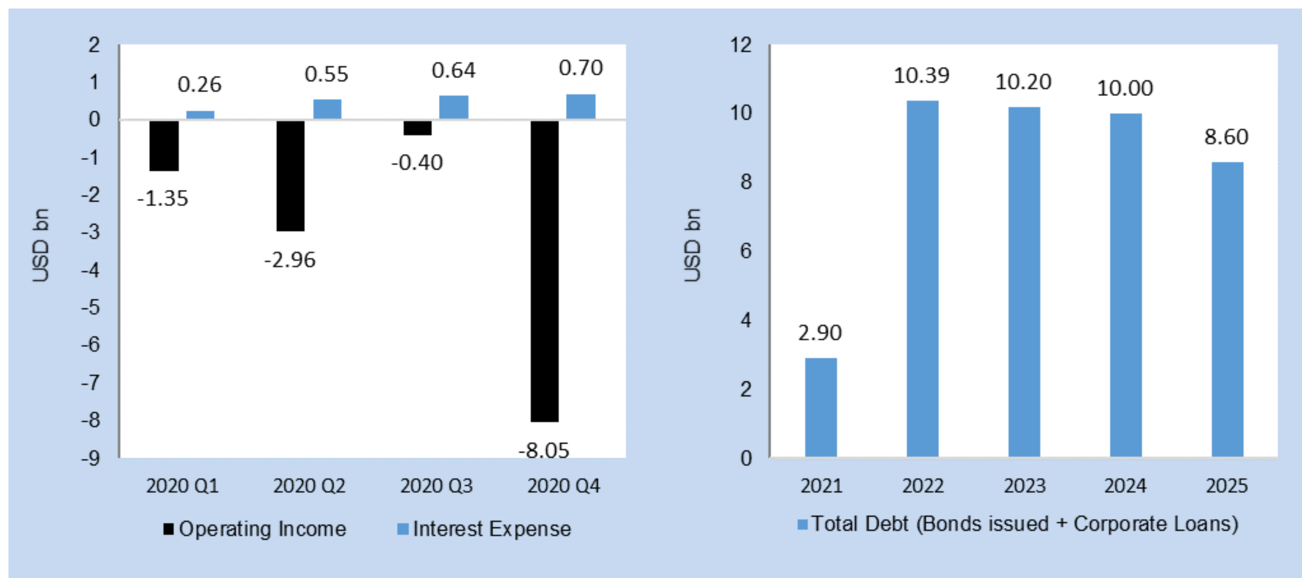

Figure 2a (LHS): Quarterly operating incomes and interest expenses for Boeing in 2020. Figure 2b (RHS): Breakdown of debt amounts maturing by year. *Source: Bloomberg, Boeing Financial Statements*

Furthermore, Boeing's ability to refinance its upcoming debt dues might be hampered as the markets expect the Fed to increase rates faster than expected, demonstrated by the rising term structure of US treasury yields. This, in turn, would make borrowing costs more expensive for Boeing. Boeing's management has indicated that they have no intention to further refinance or issue more debt in the short-term due to ample liquidity. However, should the bounce-back in operational performance take longer than expected, Boeing may be backed into a corner without no choice but to borrow more at higher costs. This would further delay its management efforts to deleverage, especially with USD 23.5bn of debts maturing by 2023 (See Figure 2b).

Aside from leverage, Boeing also faces worsening cash flows. Boeing is currently producing and holding more than it can sell. From 2019 alone, deliveries have fallen by 47% and, correspondingly, revenue fell by 24% last year. Along with the dampened demand, Boeing has to cope with pent up inventory which would also require financing. This has accelerated the rate of cash burn experienced by the firm. In Q4 2020, Boeing burned through USD 4.3bn of cash, leading to a total cash burn of USD 19.7bn in 2020. These issues can be partially attributed to the COVID-19 pandemic which has resulted in a substantial downward shift of commercial demand domestically and internationally.

Looking ahead, the expectations of a recovery to pre-pandemic levels are up in the air as individual and corporate fliers adapt to the new normal. Prior to the COVID-19 pandemic, Boeing was already struggling to navigate issues with the delivery of 737 MAX. The project stands for a substantial proportion of the firm's order book. The high-profile crashes back in 2018 and 2019 have led to the programme being grounded for the past 2 years. This was made worse by the pandemic as airlines have been raising concessions, delaying deliveries

and halting the purchase of more carriers. At the onset of the pandemic, Boeing's 1-year PD has spiked from 12bps in early Mar 2020 to 294bps by the middle of the same month.

While Boeing's increasingly geared nature warrants caution, silver linings can be found. Regulations on the 737 MAX have been lifted for the programme to return to service. As recovery takes hold, the firm has a large order backlog to fill and more orders to come. Following United Airlines' purchase of 25 jets in Feb 2021, the firm potentially is up for a multi-billion dollar agreement to sell the 737 aircraft to Southwest Airlines. Beyond commercial businesses, Boeing's top line can find support from its contracts with the government.

Raising debt today seems to be necessary granted the uncertainty around the business. The management is cognizant of the need to deleverage and has made plans for it through free cash flow generation. However, a big part of Boeing's ability to improve their credit is contingent on the pace of air traffic recovery and the fulfilment of 737 MAX orders. Air traffic is not expected to return to pre-pandemic levels until 2023. While 737 MAX has been allowed to return to service, there remains a hurdle in delivery logistically. Should these pain points be alleviated, Boeing will then be granted the bandwidth to deleverage. The company should also be wary as new strains of the virus could lead to sluggish growth in air travel going forward, which in turn, further complicates Boeing's recovery plan.

Credit News

Global investors seek freeze on China chip champion's foreign assets

Mar 22. International bondholders are seeking to freeze Tsinghua Unigroup's overseas assets. The Beijing-backed semiconductor group defaulted in November last year on its domestically issued bond, triggering concerns over cross-defaults of offshore notes worth about USD 2.4bn. Lawyers representing a Hong Kong-based group of Tsinghua bondholders have issued a statement in claims in Hong Kong's high court, which marked the first step to "put a hold on offshore assets" owned by Tsinghua before any moves inside China to restructure the company. Should it succeed, the order could prevent Tsinghua from selling offshore assets to use the proceeds to pay off its onshore debts. (FT)

Catastrophe debt market gets first dedicated volcano bonds

Mar 12. The Danish Red Cross has sponsored the first dedicated insurance against volcanic eruptions. The project's partners aim to raise USD 3mn, with partners such as Schroder Investment Management. The payout uses a quantitative model to predict where the funds will be used based on the height of ash clouds and prevailing winds after a volcanic eruption. This bond paves the way for other securities linked to climate change, which have been increasingly under the purview of the markets post the onset of the COVID-19 pandemic. The bond will cover 10 volcanoes and will offer higher yields should a climate-linked catastrophe occur. (Bloomberg)

Airlines tap stock and bond markets as they prepare for surge in bookings

Mar 19. With major openings reopening worldwide, airlines are increasingly taking part in debt and equity issuances. Investors have reacted positively to this, as they hope for higher returns from the bounce-back after the pandemic. This has led to the equity prices of US airlines such as Delta and United to surge by more than 60 percent since October last year after debt and equity prices of travel and leisure companies went into freefall during the pandemic. IAG plans to issue 4-year and 8-year bonds, which will yield 2.75 and 3.75 percent respectively. This is a stark contrast to the condition during the height of the pandemic when the firm's bonds yielded 8 percent. The equity market has also performed well, with the US airline Sun Country's equity offering experienced an oversubscription of 15 times. The company remains optimistic about its prospects, with its bookings returning to pre-coronavirus levels. (FT)

Treasury sell-off sweeps in to US corporate bond market

Mar 16. The aggregate yield on investment-grade issuances from the US ticked up to 2.8% last week. The corresponding dip in prices has marked the debt capital market's worst performance since Mar 2020. Optimism riding on the ongoing recovery and vaccination rollout has fueled expectations of inflation. This has dampened investors' expectations of the real value of cash flows. This is especially pertinent for better-graded papers with lower risk premiums. While recovery is great for corporate credit, the sentiments have already been priced in as such there is little space to cushion the rising rates. (FT)

Nikola plans to raise up to USD 100mn from investors

Mar 16. Electric-vehicle startup Nikola, which has been plagued by legal troubles, plans to raise USD 100mn in stock. Funds will be used for building a factory, developing a commercial scale for battery and fuel cell-powered semi-trucks, and advancing hydrogen fueling infrastructure. This follows industry-wide efforts to capture a growing market, which currently has a market value of USD 5tn. Concerns have also been raised after a short seller's report called the company 'an intricate fraud', tanking the company's market capitalization from USD 37bn in June 2020 to USD 7bn in March 2021. Nikola spent USD 28mn in legal fees last year and reports losses of USD 574mn. (FT)

Gategroup says debt revamp wins creditor backing (Reuters)

Mexico to absorb Pemex debt payments in latest round of help (Reuters)

British Airways owner readying its first bond with a junk rating (Bloomberg)

Regulatory Updates

Federal Reserve to end emergency capital relief for big banks

Mar 19. The Fed recently decided to end the easing of capital requirements for big banks, despite lobbies for an extension. This would mean that banks would now have to increase their holdings to hold more capital or reduce their holdings of treasuries and deposits from lenders. Investors are wary of the implications of this decision, which could make the USD 21tn market more volatile. However, in light of this, the Fed agreed to consider tweaking the rules further and did not require banks to follow these rules immediately. They are also cautious, as the changes in the rule could incentivize banks to hold riskier assets, as the metrics used do not take asset risk into account. Banks would now have to react to changes in customer deposits going forward, and may even consider providing negative interest rates to corporate depositors. (WSJ)

BOJ to widen interest rate target range to support bank profits

Mar 18. From the Bank of Japan's (BOJ) last policy meeting, the central bank is now looking to let long-term interest rates fluctuate more within a larger controlled range of 0.25%. Formerly, the range was tied to 0.2%. In doing so, they hope to allow banks to benefit from larger interest margins. This allows the financial institutions to better reap profits that they have been starved of due to the low-interest rate environment. A review by the BOJ found that they could allow the band to go wider up to 0.5% around the long-term interest target without hindering the effectiveness of their monetary policy. Moreover, they are also looking to stop the open market purchase of exchange-traded funds during times of normalcy. (Nikkei Asia)

China seen standing pat on lending LPR benchmark for 11th month (Reuters)

Russia lifts interest rates amid rising inflation, geopolitical risks (Reuters)

Published weekly by Credit Research Initiative – NUS | Disclaimer
Contributing Editors: Yao Xuan, Anthony Prayugo