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**2008-09 Outlook for the aeronautics
An analysis by Euler Hermes**

According to the world leading credit insurer's analysis, air carriers' results will deteriorate further in 2008 and 2009 due to slower growth in air traffic and significantly higher fuel costs. However the momentum remains positive for the leading aircraft manufacturers, which are unlikely to be affected before 2010.

2008 and 2009 will be a difficult time for air carriers

▪ Air traffic is closely correlated to global economic growth

The marked slowdown in the global economy in 2008, and above all in 2009, will result in slower growth in air traffic, which will drop to well below its long-term rate, estimated at 4.5% a year over the past thirty years (see chart below). "Passenger traffic is expected to grow by only 3.5% this year and by just 1% in 2009", said Nicolas Lioret, aviation sector analyst at Euler Hermes SFAC, French subsidiary of the world's leading credit insurance firm Euler Hermes.

▪ Oil prices will remain high and the rise in fuel costs will be only partly passed on to ticket prices
After peaking at an historical high of more than \$144 a barrel at the beginning of July, crude oil prices have recently dropped back to below \$100 per barrel. However, Euler Hermes expects oil prices to stabilise at a high level.

▪ Earnings will deteriorate further in the sector

Air transport prices are expected to rise by 3% in 2008 and 2.5% in 2009. At the same time, fuel costs will increase by 34% this year, to \$182bn, and by 17% to \$213bn in 2009. "The operating margin in the sector will be negative (-2.5%) for the first time since 2003", says Lioret.

▪ 2008: business failures will reach a level similar to that in 2003

The number of business failures and flight suspensions is expected to rise sharply this year, with almost sixty airlines defaulting, a level not reached since 2003. 24 different nationalities are concerned, with the United States accounting for a record of 12 business failures.

▪ The low-cost model will survive at the cost of alliances and restructuring, which will not be without pain

With ten or so failures as at mid-September 2008, low-cost companies have also been affected by the drastic rise in oil prices. However, these companies are likely to survive the present crisis as their business model is well established and they have high penetration rates, with market shares of around 30% in Western Europe and the United States.

Aircraft manufacturers will not feel the impact before 2010, but in the short term European manufacturers still face the issue of the dollar/euro exchange rate

- A limited impact on order books for the moment

Air carriers introduced various measures at the beginning of the summer to restore their profitability, but for the moment these have had little impact on manufacturers' well-filled order books.

- Deliveries will peak in 2010, followed by what looks set to be a limited downturn

Deliveries will continue to accelerate until 2010 for both Airbus and Boeing. Further out, the two aircraft manufacturers may decide not to step up the pace of deliveries given the slowdown currently underway. However, a number of factors will limit the downturn to -25% on average compared with -40% on average during previous downturns.

- Momentum still positive for the global majors

Profitability is expected to remain at satisfactory levels in 2008.

- Although the dollar strengthened recently, it remains weak against the euro which continues to penalise European constructors

The dollar weakened against the euro by a further 9.5% on average this year, which continues to penalise European aircraft and equipment manufacturers, whose profitability will be further eroded by the currency effect this year.

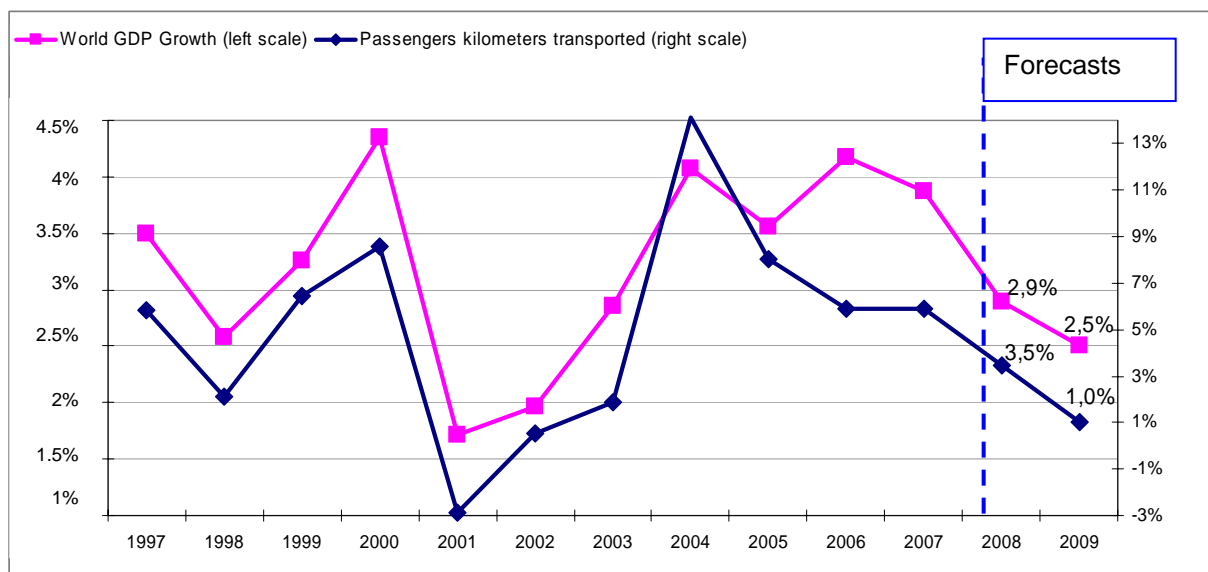
- At the very end of the chain, the French subcontractors continue to benefit from the momentum in the aircraft industry but they will need to adapt to increasing purchases outside the euro zone

The subcontractors have managed to take advantage of the upturn in deliveries following the significant investments made in 2004 and 2005. 2007 was a good year and 2008 is expected to remain positive with operating margins staying up at around 7.5%.

"The necessity of reducing costs will force players to adapt, notably through business combinations (so as to be able to respond to larger calls for tender), by relocating abroad for the activities with least value added, by becoming more competitive and diversifying their customer bases" said Euler Hermes SFAC analyst Nicolas Lioret.

Chart:

2008-2009 Growth set to fall below the long-term average



Sources: ICAO and Euler Hermes SFAC forecasts

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