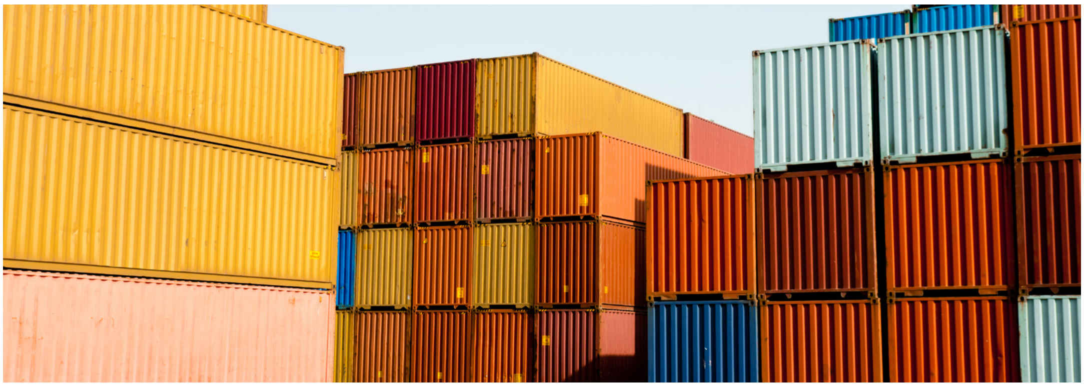
S&P Global
Ratings

Industry Top Trends 2021

Transportation

New Travel Restrictions Signal Challenging Months Ahead



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What's changed?

A renewed surge in COVID-19 cases is holding back airline recovery. Rapid increases in new cases, particularly in Europe and the U.S., are prompting renewed travel restrictions and lockdowns.

Freight transportation is faring better. Railroads, trucking, and package express did not fall nearly as much as passenger airlines, and they have picked up with economic conditions. Some are benefiting from the shift to e-commerce.

Shipping is recovering. Rapid recovery in global trade volumes and more resilient freight rates lead to stronger profits for container liners. Tanker rates will likely underperform a strong first half 2020, but remain profitable, and dry bulk shipping rates should recover gradually as China's economy bounces back.

What are the key assumptions for 2021?

Progress against COVID-19 is key. Reports that at least one vaccine for COVID-19 could be approved by year-end 2020 are promising, but widespread availability and acceptance may not occur until mid-2021.

Economic conditions will drive demand. The economic recovery in China has been impressive, but growth is likely to slow after a third-quarter 2020 bounce in the U.S. and Europe. This is important for freight transportation.

Continued access to capital markets could be crucial. News of vaccine progress has buoyed capital markets, which could be vital for companies continuing to burn cash over a difficult winter period.

What are the key baseline risks?

Pandemic-related uncertainty. There is a high degree of uncertainty about the evolution of the coronavirus and the effectiveness of countermeasures against it.

Fiscal and monetary policies and trade policy. A change in the U.S. presidency could ease some trade tensions, but Congressional agreement on further fiscal stimulus is probably more important in the near term.

Brexit related issues. The U.K.'s departure from the EU single market on Jan. 1, 2021 will likely lead to trade disruption, higher trade costs, and a less efficient labor market.

Ratings trends and outlook

Global Transportation

Chart 1

Ratings distribution by region

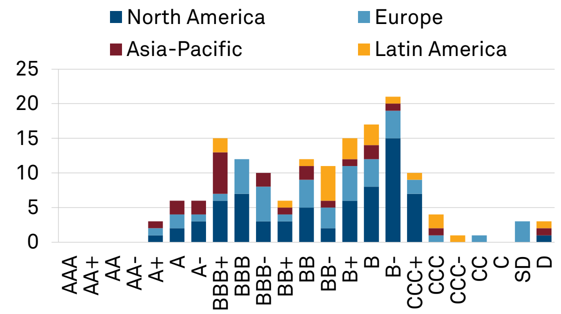


Chart 2

Ratings distribution by subsector

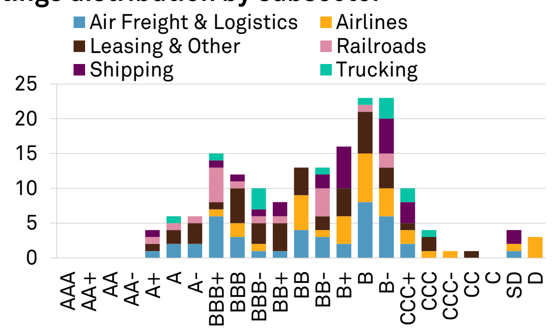


Chart 3

Ratings outlooks by region

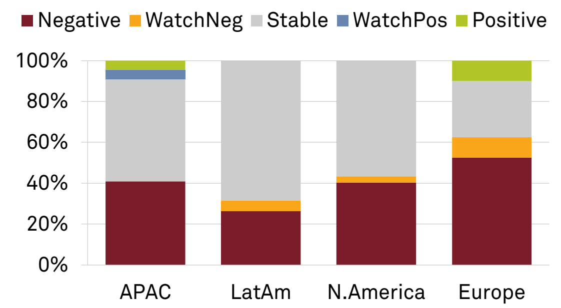


Chart 4

Ratings outlooks by subsector

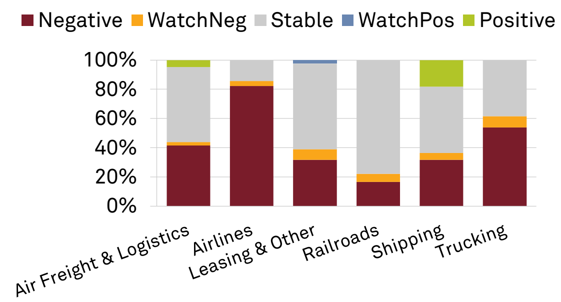


Chart 5

Ratings outlooks net bias by region

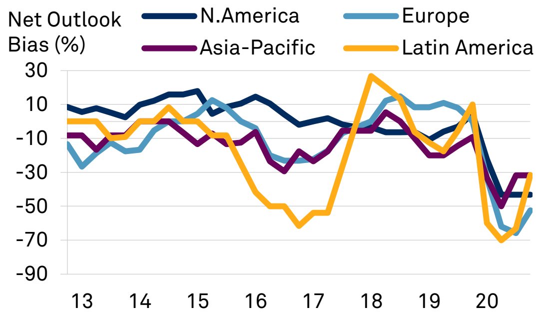


Chart 6

Ratings net outlook bias by subsector

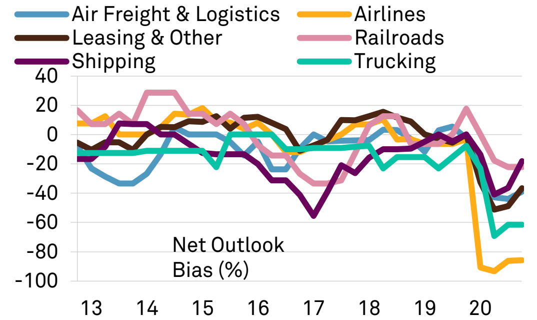


Chart 7

Ratings outlooks

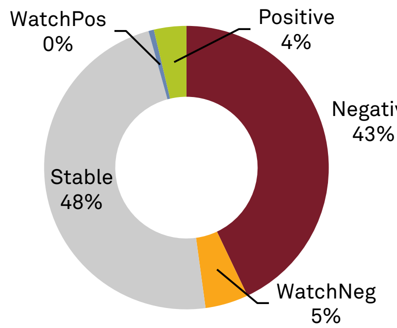
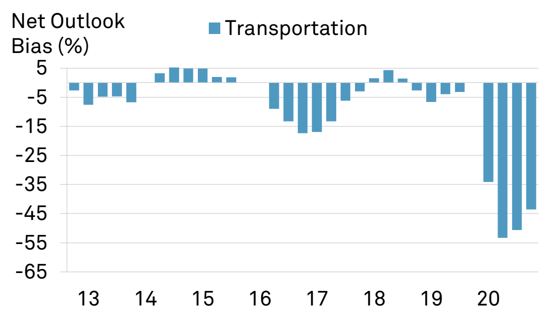


Chart 8

Ratings net outlook bias



Source: S&P Global Ratings. Ratings data measured at quarter end. Data for Q4 2020 is end October, 2020.

Shape of recovery

Table 1

Sector Outlook Heatmap

	Sensitivities and structural factors			Shape of recovery			
	COVID-19 sensitivity	Effect if no vaccine in 2021	Long-term effect on business risk profile	Revenue decline – 2021 vs. 2019	EBITDA decline – 2021 vs. 2019	Revenue recovery to 2019 levels	Credit metric recovery to 2019 levels
Transportation							
Airlines	High	High	Negative	40%-60%	60%-80%	2024	2024+
Shipping	Moderate	Moderate	Neutral	>2019	>2019	2021	2021
Rail and trucking	Moderate	Moderate	Neutral	5%-15%	5%-15%	2022	2022
Leasing	Moderate	Moderate	Neutral	0%-5%	0%-5%	2022	2022

Source: S&P Global Ratings.

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

This report does not constitute a rating action.

Airlines

Ratings trends and outlook

2020 has seen plunging revenues and heavy losses for almost all global airlines, and we forecast only a partial recovery in 2021. Government aid and receptive capital markets have been crucial for many to maintain adequate liquidity. We have lowered ratings on all airlines, and at least some further downgrades are likely with a renewed surge in COVID-19 cases during the northern hemisphere winter. However, initial reports about vaccine progress provide an encouraging light at the end of the tunnel.

Assumptions about 2021 and beyond

1. Revenues should pick up, but they may be only half of 2019 levels.

Airlines cut flights sharply in response to the collapse in demand, but more seats are empty, and fares are lower even so. 2021 is likely to be a year of two halves, with a positive trend overall relative to 2020, as progress on testing and vaccines limits risks and eases travel restrictions. Economic recovery should help as well, but it is secondary to progress against the coronavirus.

2. Domestic leisure travel will lead; business and international travel will lag.

Domestic (or, where possible, regional) leisure travel picked up first and should continue to lead the recovery in 2021. Business travel and international (particularly intercontinental) travel will take longer, and some business demand may be lost permanently to videoconferencing, as businesses scrutinize their budgets and fast-track their environmental agendas. Unfortunately for airlines, business and international flying are the most profitable.

3. Liquidity is key to riding out the storm.

Airlines with access to government support and capital markets have been able to build up cash, despite their heavy losses. With cash breakeven results unlikely before second-quarter 2021, cash levels will likely decline somewhat for most airlines. Aside from a few strong low-cost airlines, unencumbered collateral to secure further borrowing is dwindling, so a turnaround in operating results is crucial.

The recovery in demand for air travel will vary by region. China and some other Asian countries are bouncing back strongly already. Domestic travel in Latin America is somewhat better, North America is experiencing a soft recovery, and the outlook is weakest in Europe. These differences somewhat reflect the trend of virus cases, though the correlation is not perfect. Europe has been particularly hard hit because it is densely populated, and almost all air travel, even short trips, are cross-border and thus vulnerable to travel restrictions and quarantine requirements. The U.S. domestic market is much larger, and although some states have imposed restrictions and quarantines, they are inconsistent and not easily enforceable. This reflects the federal structure of the U.S. government, where virus responses mostly rest with states and in some cases, cities.

U.S. airlines have amassed impressive amounts of cash, thanks to generous federal aid (cash and borrowing) and surprisingly receptive banks and capital markets. The industry and airline unions are lobbying for another round of payroll aid, but its fate is uncertain in a divided and partisan political landscape in Washington, D.C. For most airlines, the end of the third calendar quarter probably represented a high point in liquidity (cash and committed credit facilities), which will likely trend down as cash outflows continue, albeit at a narrowing rate. Even if cash turns positive, credit ratios will remain burdened with debt added during the crisis, and upgrades will not come quickly.

European cases of COVID-19 escalated following the summer, leading to a second wave of lockdowns, which was particularly punishing for the sector. It disrupted the fragile air traffic recovery (for at least domestic and some intra-European leisure travel), which was showing some bumpy progress in July, August, and September. Most planes were grounded again in Europe throughout November, and European airlines face a difficult winter ahead. They have received a colossal amount of state aid, providing much needed liquidity and ultimately supporting the survival of many airlines. News of vaccine progress has buoyed the capital markets, which will help the higher-rated airlines ensure they have liquidity to get through the winter and beyond. Extended employee furlough schemes should also help.

Latin American airlines, even major "flag carriers" (large airlines that are the principal providers of international air service for a country), have received less government aid than those in some other regions. This, and the steep decline in international travel, have resulted in bankruptcy for several of the region's largest and strongest airlines: Latam Airlines Group S.A., Grupo Aeromexico S.A.B. de C.V., and Avianca Holdings S.A. However, we expect that these airlines will reorganize in bankruptcy and survive.

Credit metrics and financial policy

We expect that credit measures for almost all the airlines we rate will be negative in 2020, reflecting negative EBITDA and funds from operations. This should improve to positive, but most will remain very stretched in 2021. For those airlines whose liquidity appears sufficient to carry them through 2020, we have been focusing on 2021 expected performance and begun to consider anticipated further progress in 2022. We currently have negative outlooks or negative CreditWatch listings on nearly all airlines, reflecting the continuing downside risk because of extremely depressed industry conditions. We do not expect that credit measures will return to 2019 levels until 2024 at the earliest, though we acknowledge considerable uncertainty about the industry's future.

Financial policy has become more constrained than it was in 2019 and the preceding several years, when airlines could consider dividends and sometimes large share repurchases. Government aid often comes with conditions, such as no dividends or buybacks until government borrowings are repaid. Willingness to issue common shares at depressed prices in 2020 demonstrated a recognized need to repair balance sheets and such offerings' favorable impression on potential creditors. Mostly, equity offerings have been part of a broader effort to raise liquidity, with the benefits for capital structure a longer-run consideration.

Key risks and opportunities around the baseline

1. Will vaccines come to the rescue?

Restoring passenger confidence requires progress on vaccines, virus testing, and airline health precautions.

2. The economy still matters.

Although the pandemic is still the most serious obstacle to airline recovery, the path of global and national economies influences demand for air travel. Prolonged elevated unemployment may curb spending on travel.

3. How much of the pandemic-related damage is permanent?

Some of the changes caused by the response to the pandemic, especially widespread use of videoconferencing for business meetings, may cause a lasting loss of air travel demand, but it is difficult to determine how serious this will be. Many people and companies expect the environmental agenda will be accelerated. Typically, air travel bounces back relatively quickly after disruption, but this is the most serious disruption the industry has ever faced.

Reports of progress on vaccines are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability and acceptance of effective immunization, which could come by the middle of 2021. Accordingly, we foresee a difficult first half of 2021, but air traffic should recover faster in the second half.

The state of the global economy will gradually assume more importance in determining air traffic demand as efforts to combat COVID-19 gain traction. In countries where economies are bouncing back quickly, as in China, this supports better demand for air travel. Weak or prolonged recoveries in other countries could represent a drag on airline performance, particularly once the virus is no longer the primary constraint.

Most business travel is for some form of client contact and relations, so we expect a majority of business travel will return eventually as vaccines, testing, and other measures restore confidence among passengers and corporations. However, even a modest loss of such travelers hurts airlines disproportionately because business fliers pay higher ticket prices, on average. The same is true to some extent for international travel, which has been hit hard by the pandemic. Although a large portion of this travel should return eventually, countries may be quicker to impose travel restrictions when communicable diseases break out in the future. These trends could cause us to reassess the competitive positions of airlines that rely heavily on business and international passengers.

Shipping

Ratings trends and outlook

The COVID-19 pandemic and the subsequent recession have had a less severe effect on global trade than we previously anticipated. The movement of essential goods, strong pickup in e-commerce, and shift of consumer spending to tangible goods from services have supported the recovery of container shipping volumes from mid-2020. Stringent capacity management by container liners and lower-than-expected bunker fuel prices will offset the low-single-digit decline in demand this year, resulting in stronger-than-expected earnings and credit metrics for the container shipping companies we rate. Combined with the favorable supply-and-demand fundamentals we expect in 2021, this prompted our assignment of positive outlooks to three container liners, with one upgraded at the same time.

Tanker rates began to decline from mid-2020 after a strong first half, due to sluggish oil demand as a result of pandemic-related disruptions and the subsequent effects on the global economy. That said, we expect tanker rates to remain at profitable levels in 2021. Dry bulk shipping rates should rebound from depressed levels during 2021, stimulated by rising commodities imports into China. The ratings and outlooks on some of our rated oil and dry bulk shipping companies have changed this year, but mainly because of refinancing concerns and less so because of trading conditions.

Assumptions about 2021 and beyond

1. Annual volume growth rates turn positive for container liners.

The most recent reporting by leading industry players indicates a sharper-than-expected demand recovery and firm freight rates. As such, we have revised our base case to incorporate positive industry fundamentals continuing in the fourth-quarter 2020 and 2021. We now forecast a year over year drop in shipped volumes of up to 5%-10% in 2020 and an increase of 5% in 2021, based on global GDP growth trends.

2. Dry bulk rates to gradually recover in 2021.

A likely structural rebalancing of supply-and-demand conditions--supported by the Chinese government's stimulus measures and more subdued global fleet growth at low-single-digit rates--points to more favorable dry bulk shipping rate conditions next year (likely extending into 2022), which we incorporate into our base case.

3. Tanker charter rates remain at profitable levels.

We expect delivery of new tankers will shrink in 2021 and 2022, with the historically low orderbook of crude tankers accounting for 8% of total global fleet and product tankers accounting for 7% (30-year lows). This, combined with gradually recovering oil trade volumes, should result in tanker rates remaining well above operating expense breakeven levels, but underperforming the strong first half of 2020.

In our view, containership supply growth will stay muted in the coming quarters. With no incentive to place new large orders amid subdued contracting and ordering activity since late 2015, the containership order book is at a historical low--8.5% of the total global fleet. Combined with funding constraints, more stringent regulation on sulfur emissions (permitting only 0.5% sulfur emission from January 2020), and COVID-19-related disruptions (such as delays in new-build ship deliveries, ship maintenance and repair works, and scrubber retrofits), this has translated into tighter supply conditions, better utilization rates, and healthy freight rates. Following the COVID-19 outbreak, container liners quickly cut back on sailing to and from China, and they continue to adjust capacity, idle ships, or travel longer routes during the typical slack seasons. These measures signify the capacity management by container liners that we would expect from an industry that has been through several rounds of consolidation in recent years.

The Chinese government's stimulus measures to prop up the country's economy amid the pandemic include the construction of highways and social housing, which indicate a need for dry bulk commodities such as iron ore and coal. Accelerating ship scrapping, combined with ships out of service because of significant delays in dry-docking work and scrubber retrofitting, could result in supply-and-demand growth moving toward equilibrium during the fourth quarter, which is typically the strongest, supporting charter rates. In 2021, we believe demand growth will likely exceed capacity growth. In our forecast, we assume China's imports of dry bulk commodities will stabilize and underpin low-single-digit global trade growth. Supply growth will be marginal because of the all-time-low order book (accounting for 7% of the global fleet, the lowest level in three decades, according to Clarkson Research) and extremely subdued new ship ordering year-to-date. This likely structural rebalancing of supply-and-demand conditions points to more favorable rate conditions next year (likely extending into 2022), which we incorporate into our base case. For example, we forecast an average time charter rate for Capesize vessels at $19,000/day-$20,000/day in 2021, up from the $14,000/day-$15,000/day we forecast in 2020.

Large tankers returning to service after being tied up in floating storage will add tonnage to the network and counterbalance the effects from shrinking delivery of new tankers in 2021. At the same time, global oil demand will rebound gradually to reach 5%-6% growth in 2021, according to the International Energy Agency Oil Market Report of October 2020. We think crude and product tanker demand will follow this pace. The likely tightening supply-and-demand conditions should keep tanker rates profitable.

Credit metrics and financial policy

Most of our rated container shipping companies should improve free operating cash flow and reduce debt, resulting in stronger credit metrics. We believe container liners may achieve less-volatile earnings, continue lowering net debt, and expand financial flexibility with improved credit measures for external growth or to absorb potential unforeseen setbacks. We believe they will likely retain access to debt markets (or equity markets in the case of listed issuers) for treasury management purposes. Dividends and share buybacks will accelerate but in a balanced manner closely tied to cash flow generation. On the other hand, financial profiles of most tanker and dry bulk operators we rate will likely not improve significantly in the short term, while their looming bullet maturities remain our major concern.

Capital expenditure (capex) will likely stay low in 2021 and be limited to opportunistic acquisitions of single ships, mainly to rejuvenate the fleet. Growth capex in the container liner segment may increase by 2022, depending on the pace of trade volume recovery.

Merger and acquisition activity will likely be limited. In the oil and dry bulk shipping subsectors, we expect that expansion will mainly occur through direct acquisition of new ships and second-hand vessels (frequently from ship owners and operators in financial distress). Still, some operators might decide to merge their fleets in an effort to realize cost efficiencies, a stronger bargaining position, and enhanced capacity for further growth. There have been several recent mergers among affiliates in dry bulk shipping, and larger, publicly listed companies could target smaller, struggling companies. Container shipping has been through several rounds of consolidation in recent years. Notably, the five largest container shipping companies together have a market share of about 65%, up from 30% about 15 years ago. Bolt-on and complementary acquisitions of logistics companies by container liners to broaden and enhance their service offerings are also possible.

Key risks or opportunities around the baseline

1. Sluggish trade volumes.

A slower-than-expected recovery in global trade volumes, a key engine of shipping growth, would damage an industry that struggles to bring supply and demand into balance.

2. A spike in bunker fuel prices could harm ship operators' profits.

Because prices for bunker fuel track prices for crude oil very closely, if oil prices trended markedly above our assumptions, the resulting higher bunker price could hamper shipping companies' cash flows if they are unable to pass on the cost inflation to customers.

3. Shrinking new ship supply.

Ship orderbooks have been dwindling the past few years to reach historical lows across the main shipping segments. This is because muted orders of new ships in recent years did not keep pace with deliveries. This has supported firmer freight/charter rates, but a renewed surge in orders, which has happened before, could undermine the healthy supply-and-demand balance.

We forecast solid growth in developing economies to stimulate global trade in 2021, though there are risks in the demand outlook. For example, we forecast that Asia-Pacific's GDP will rebound swiftly to 6.2% growth in 2021 after contracting 1.6% in 2020, which we incorporate in our base case. Sluggish commodity imports and consumption from China in particular would harm the shipping industry.

A spike in bunker fuel prices could wipe away the upside coming from the likely tightening/recovering supply-and-demand conditions, unless the added cost is successfully passed through to customers. Dry bulk, tanker, and gas carrier operators are protected from rising fuel prices if they operate vessels under bareboat- or time-charter contracts, whereby the charterer typically pays the bunker fuel bill as per contractual agreement. However, spot operators--which enter into short-term charters, often for a single voyage at market rates--and container liners bear the fuel risk.

Low new orders have translated into much tighter supply conditions, which we expect to continue in 2021, propping up freight and charter rates. Persistent funding constraints, potential pandemic-related disruptions, and more stringent regulation on sulfur emissions (permitting only 0.5% sulfur emission from January 2020) that result in uncertainties over costs and benefits of various technologies and fuels to power ships, should limit ordering in 2021. A surge in new vessel orders remains a risk to a still fragile demand-and-supply balance, but only in the medium term, because a vessel ordered today would unlikely be delivered before mid-2022.

Railroads

Ratings trends and outlook

Our ratings and outlooks on the large North American freight railroads and on trucking operators remain mostly stable. Demand for freight transportation has improved since the height of the pandemic in the second quarter, as economic restrictions ease and consumer spending improves. Most railroads reduced debt-financed share repurchases and continued to improve operating efficiency, which has helped support credit metrics. We expect freight demand will continue its fairly strong recovery in 2021, assuming customers continue to replenish inventories and industrial production picks up.

Assumptions about 2021 and beyond

1. Railroad carload volumes return to growth.

Certain types of rail traffic have experienced sharp declines during the pandemic, such as autos (which declined because of factory closures) and coal (which has become less price competitive amid low natural gas prices). We believe volumes will grow in 2021, assuming higher industrial production, economic growth, and favorable year-over-year comparisons.

2. Operating efficiency remains a key focus.

Most railroads continue to implement precision scheduled railroading (PSR). As volumes return, we expect companies will continue to improve network efficiency and control variable costs. We believe this should benefit profitability and cash flow. For railroads such as CSX Corp. that are further along in PSR implementation, we expect a greater focus on revenue growth initiatives.

3. Trucking capacity will remain tight.

Trucking companies have benefited from a continued capacity shortage, which has led to higher freight rates. We expect this market dynamic to continue into 2021. Higher truck pricing should benefit railroads' intermodal business, which tends to compete more closely with trucking for longer trips.

We expect rail carload volumes will increase in 2021, as the U.S. economy returns to growth and competing trucking capacity remains tight. Railroads derive a greater portion of revenue from commodities and materials used in industrial production, such as chemicals, metals, and coal, than do truckers. As industrial demand improves in 2021, we expect railroads to benefit. In addition, grain shipments, which have remained mostly stable throughout the pandemic, should benefit from increased exports. We expect consumer demand to recover, albeit at a slower rate than in third-quarter 2020. This should benefit intermodal shipments, because they are more exposed to consumer goods and e-commerce. Intermodal should also benefit from international container imports, which we expect will increase through at least the first half of 2021.

PSR remains a priority at most railroads. This focus on improving operating efficiency involves more uniform and tightly scheduled train operations, which in turn reduces requirements for train yards, crews, and locomotives. We expect operating ratios (operating expenses, including depreciation, as a percent of revenue) will improve in 2021, after weakening slightly in 2020, as companies continue to increase train length, reduce time in terminals, and improve fuel efficiency. For most Class I railroads that were slower to adopt PSR, we expect improvement to stem mainly from lower costs. However, for earlier adopters such as CSX, we believe revenue growth will contribute more improvement.

Credit metrics and financial policy

Credit metrics should improve somewhat in 2021 on revenue growth and a continued focus on operating efficiency. Most railroads increased their cash balances and reduced share repurchases in 2020 because of uncertainty surrounding the COVID-19 pandemic. As macroeconomic conditions stabilize, we expect companies will resume share repurchases, financed at first with excess cash on hand and then with incremental debt. To the extent that cash flow generation benefits from improved operating efficiency or reduced asset intensity resulting from PSR, we expect companies will use incremental cash for shareholder rewards, rather than to repay debt. The outlook for trucking companies is generally favorable, but this can vary significantly depending on the commodities they carry, and credit measures are mostly weaker than those of rated railroads.

Key risks or opportunities around the baseline

1. Weaker economic activity reduces demand for freight transportation.

Additional widespread economic shutdowns amid further outbreaks of COVID-19 could reduce demand for truck and rail transportation, as in second-quarter 2020. Similarly, a slower improvement in industrial production levels could limit revenue recovery for less-than-truckload and rail shipments, which tend to have lower exposure to consumer sectors.

2. Coal volumes decline further.

Coal demand remains in secular decline because of increased environmental regulations and price competition from natural gas. This decline accelerated in 2020 as natural gas prices decreased, utility demand weakened, and global industrial production fell. We expect volumes will recover somewhat in 2021 but remain below pre-pandemic levels. However, volumes could decline further if economic shutdowns outside the U.S. continue to pressure export coal demand, or if more stringent environmental regulations are introduced in the U.S.

3. Increased scrutiny on emissions leads a modal shift to rail.

Amid greater interest in environmental emissions, railroads could take market share from trucking on some shipments, especially for longer distances. Railroads are improving their fuel efficiency under PSR, and improved service metrics could make rail a more compelling option for some shippers. On the other hand, alternative fuel and electric trucks could partially offset rail's environmental advantages.

Total traffic volume among North American railroads fell about 9% from 2019 through the beginning of November 2020, which represents an improvement from second quarter comparisons. If authorities institute renewed widespread restrictions following a rise in coronavirus cases, revenue growth in 2021 could be delayed. We expect that companies would respond by reducing share repurchases and discretionary capex in that event.

Historically, railroads have performed relatively well during recessionary periods. Customers often have limited choice of alternative transportation modes, and companies can reallocate cash away from significant share repurchase programs in order to maintain liquidity and repay debt. Therefore, we believe Class I railroads are well-positioned to deal with a delayed economic recovery.

Transportation Equipment Leasing

Ratings trends and outlook

Our ratings and outlooks on the transportation equipment lessors are a mixed bag. For the most part, sectors associated with passenger travel (e.g., aircraft lessors and car renters) have negative outlooks, based on our expectation that airline passenger traffic will only partially recover in 2021. However, outlooks on sectors associated with freight (e.g., railcar lessors, truck lessors, and marine cargo container lessors) have remained stable through the pandemic, and we expect this trend to continue. At the same time, most transportation equipment lessors have maintained strong access to liquidity, in some cases at record low rates, and we expect this market access to continue in 2021.

Assumptions about 2021 and beyond

1. Airline passenger travel will only partially recover in 2021.

Revenue and cash flow have declined for aircraft lessors as many of their airline customers have requested lease deferrals or have even ceased operations, though aircraft lessors expect some recovery in deferred lease payments in 2021. Revenues and cash flow for car renters have also declined because of sharply reduced demand at airports. However, unlike aircraft lessors, car renters have been able to reduce their fleets quickly in response to weaker demand.

2. Cargo transportation capacity will remain constrained in 2021.

Demand for freight transportation was stronger than expected in the second half of 2020, which caught lessors of freight transportation equipment short of capacity. Lessors had reduced their capital spending plans based on the decline in global GDP. While we expect capital spending to increase, we expect lessors to remain disciplined in adding to capacity.

3. Liquidity will remain strong for most sectors.

Despite their exposure to the distressed airline industry, aircraft lessors have been able to raise substantial funding--most of it unsecured--in the capital markets. Other leasing sectors have also enjoyed access, on both a secured and unsecured basis. Liquidity should remain strong with access to various funding sources, reduced capital spending levels, and spread-out debt maturities.

Although we expect airline passenger traffic to only partially recover in 2021, we expect aircraft lessors to collect a portion of lease revenues deferred from 2020. Airline traffic has started to recover in Asia-Pacific, and short-haul leisure traffic has picked up more quickly than business or long-haul international flying globally. Thus, we expect demand to remain weak for widebody aircraft (used on international routes), particularly for older widebody aircraft, which could result in further impairment charges. Fortunately, almost all rated lessors have mostly new technology aircraft in their portfolios, demand for which should recover with air traffic. Given their continued access to capital, aircraft lessors should continue to take advantage of sale and leaseback opportunities with airlines they expect will be in a strong position when demand returns. Lease rates will likely continue to face pressure in 2021 and remain a significant negative factor for our industry outlook. This affects aircraft put on new leases as old ones expire, and on aircraft repossessed from defaulting airline customers and put out on new leases. In some cases, lessors have had to agree to "power by the hour" agreements, under which airline customers pay only for when they use the leased aircraft. Historically, aircraft values and lease rates have lagged changes in travel demand, and decline further as cumulative excess supply builds up during the downturn. Therefore, we expect that the pressure on aircraft lessors, while not nearly as bad as that on their airline customers, could last through 2021 even if air traffic accelerates.

Despite their large exposure to airport operations, car renters have successfully shrunk their fleets, and they are benefiting from healthy demand outside of airports. After a brief fall in used car prices in second-quarter 2020, prices rebounded very strongly (with auto production temporarily reduced, demand for used cars spiked). This benefits car renters, which hold most vehicles for only about a year and consequently sell large numbers of cars. This appears in their income statements as a reduction in depreciation expense (gains on sale are netted against depreciation expense).

For lessors that serve freight transportation companies, the strength in demand for cargo capacity in the second half of 2020 caught many by surprise, as they had reduced their capital spending in the first half of the year to meet anticipated weak demand. As a result, there has been a shortage of capacity to handle the growth in cargo, especially that related to e-commerce. Marine cargo container and chassis lessors, truck lessors, and intermodal railcar lessors have all benefited. With manufacturing capacity constrained, especially for marine cargo containers and trucks, we expect demand, utilization, and pricing to remain strong well into 2021.

Credit metrics and financial policy

For aircraft lessors and car renters, we expect credit metrics to recover somewhat in 2021--after a sharp decline in 2020--but not to historic levels. For aircraft lessors, the decline this year will be caused primarily by lower revenues because of lease rent deferrals and lower rates on lease renewals. For car renters, it will also be caused by weak, albeit recovering, demand at airports. Credit metrics should be relatively stable or even improve in 2021. For all sectors, debt levels will be lower than previously expected, in large part because of reduced capital spending. For example, aircraft lessors have deferred or canceled aircraft orders totaling billions of dollars over the next few years.

We don't foresee any material revisions to financial policy in these sectors. Typically, these companies are countercyclical in terms of their credit metrics, in that when demand weakens, they reduce capital spending and debt while maintaining relatively stable cash flow, aiding their credit metrics. This time should be no different for most, aside from the aircraft lessors. Many leasing companies have accessed the capital markets over the past six months, on both a secured and unsecured basis, at record low pricing, and we expect this trend to continue in 2021. In addition, many have substantial unencumbered assets that they could use for secured financing, if needed.

Key risks or opportunities around the baseline

1. A larger-than-expected number of airline failures.

If airline traffic does not recover in 2021 as expected, more airlines could fail, causing demand for aircraft to decline. For lessors, this would cause more lease restructurings, aircraft repossessions, lower lease rates, and aircraft impairment charges. This would likely result in a delayed recovery in credit metrics and potentially some downgrades.

2.The used car market weakens.

Car renters have benefited from record high used car prices in 2020. We expect used car prices to remain strong in 2021, though at somewhat lower levels than in the second half of 2020. If used car prices weaken, car renters' depreciation expense would increase, hurting profitability. This could also result in a shortfall for debt repayment on their asset-backed financings, which they use to finance a substantial portion of their fleets.

3. Access to the capital markets becomes constrained.

The leasing sector is very capital intensive, and it relies on access to capital at attractive pricing. Capital markets have been very receptive in 2020, on both a secured and unsecured basis, with record low pricing. However, constrained access could result in higher pricing and an increase in interest expense, as well as the inability to refinance upcoming debt maturities and acquire new equipment.

While there are some risks to our base case, there are also opportunities that would benefit transportation equipment lessors. Better-than-expected airline traffic would help the revenues and balance sheets of the aircraft lessors' airline customers, increasing demand and ultimately lease rates and revenues. This would also help the car renters' revenues. Continued strong demand for freight transportation would help utilization and lease rates for marine cargo container lessors, truck lessors, and railcar lessors, if capacity remains constrained. Finally, continued strong access to capital will aid these companies' liquidity and interest expense, offsetting some of the damage from reduced revenues.

Related Research

- SLIDES: S&P Global Ratings' Transportation And Aerospace Defense Roundtable, Dec. 1, 2020
- As COVID-19 Cases Increase, Global Air Traffic Recovery Slows, Nov. 12, 2020

Industry Forecasts

Global Transportation

Chart 9

Revenue growth (local currency)

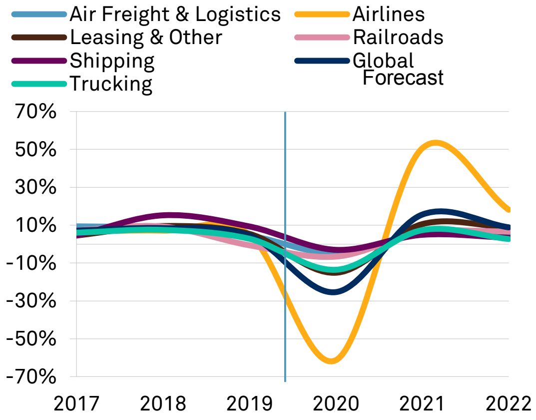


Chart 10

EBITDA margin (adjusted)

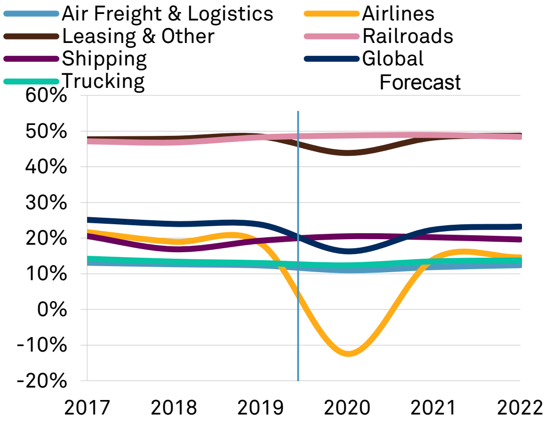


Chart 11

Debt / EBITDA (median, adjusted)

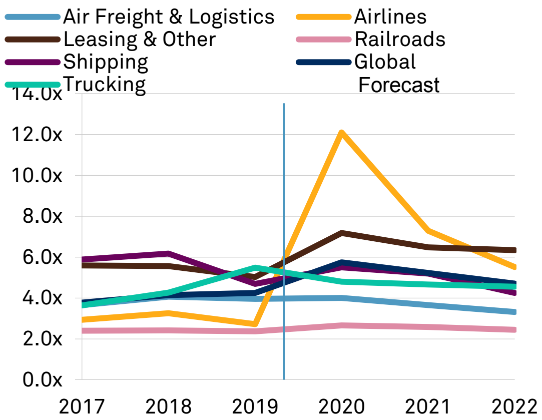
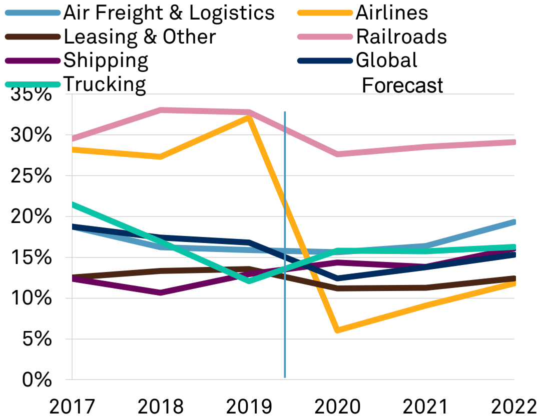


Chart 12

FFO / Debt (median, adjusted)



Source: S&P Global Ratings. Revenue growth shows local currency growth weighted by prior-year common-currency revenue-share. All other figures are converted into U.S. Dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations.

Cash, Debt, And Returns

Global Transportation

Chart 13

Cash flow and primary uses

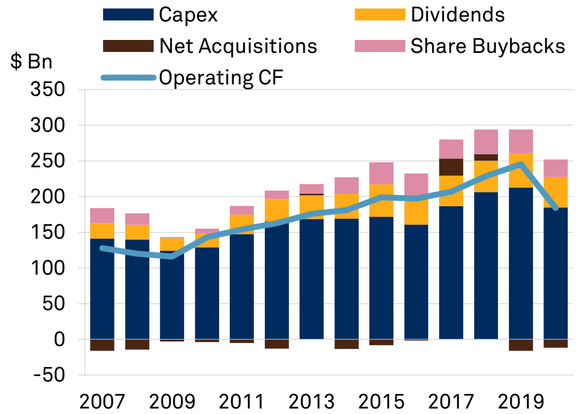


Chart 14

Return on capital employed

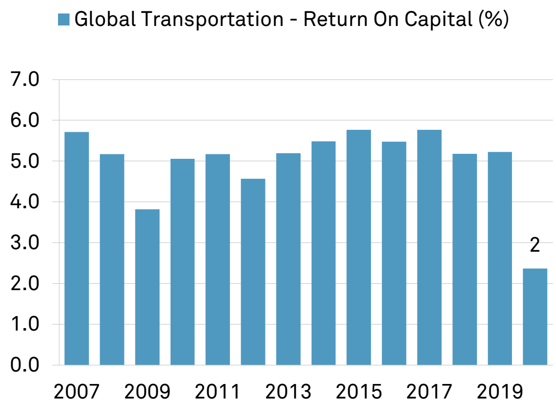


Chart 15

Fixed versus variable rate exposure

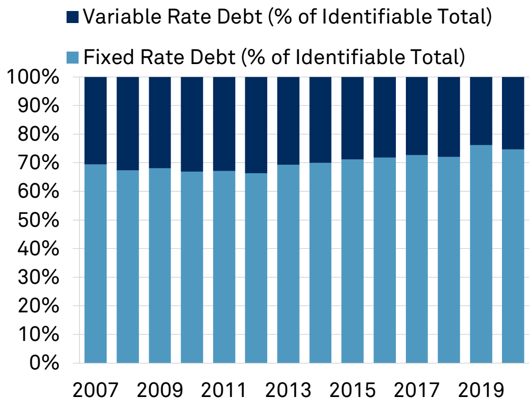


Chart 16

Long term debt term structure

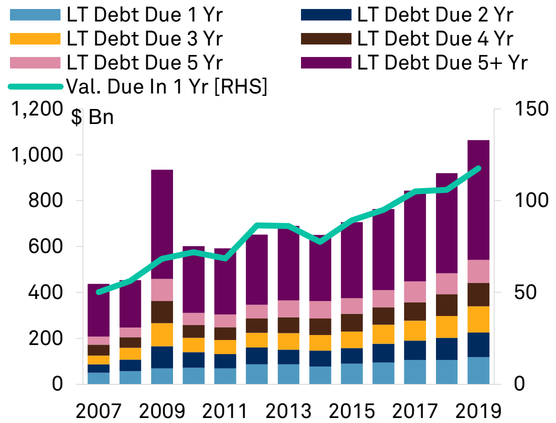


Chart 17

Cash and equivalents / Total assets

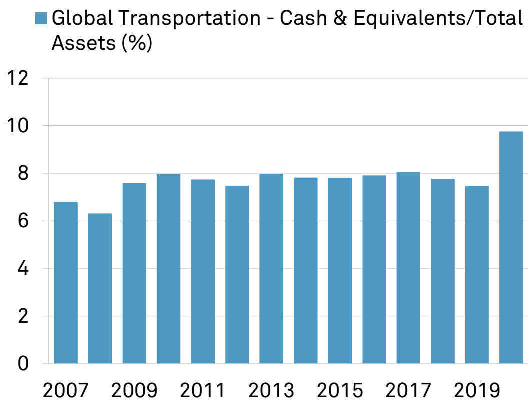
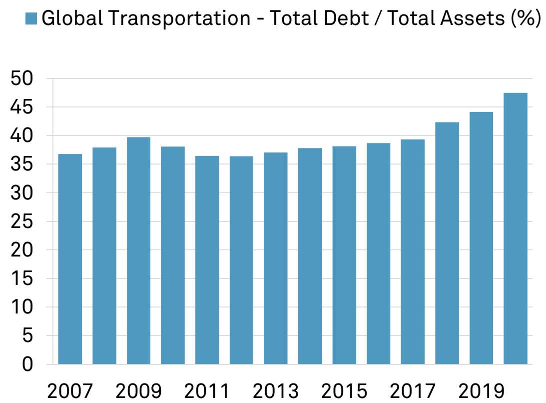


Chart 18

Total debt / Total assets



Source: S&P Global Market Intelligence, S&P Global Ratings calculations. Most recent (2020) figures are using last twelve months (LTM) data.