



UP, DOWN OR SIDEWAYS – THE COMMERCIAL AERO BUSINESS LOOK- AHEAD

VIDEO TRANSCRIPT

Michael Bruno: Hello and welcome to Aviation Week's Check 6 Podcast with Accenture. I'm Michael Bruno, Senior Business Editor. It's been a roller coaster ride in aerospace and defense over the last year. From how to keep up with demand to how to keep the lights on, and now, how to restructure and even rebound. The A&D sector has seen it all since this time last year, when COVID-19 was just beginning to become an inescapable worldwide problem. One year on, how is industry responding and what do A&D leaders think about what will happen in the coming months and years?

The new Commercial Aerospace Insight Report from Accenture offers us new in-depth assessments of where the sector is headed, and joining us to talk about them are John Schmidt, Accenture's Global A&D Lead, and Jeff Wheless, Global A&D Research Leader. John, Jeff. Welcome back.

John Schmidt: Thanks, Michael. Good to be here.

Jeff Wheless: Thanks, Michael.

Michael Bruno: So John, I want to start with you, I'm going to put you on the spot because, before we dive into the Accenture Commercial Insight Report, I want you to help us set the context. We've just been through a year that this industry, uh, maybe has never seen, and I think certainly most people working in the industry right now could never have imagined it. So, if you had to step back and provide sort of a one-word description. Sort of a state-of-the-union answer, how would you describe the state of

A&D? And a year ago, when COVID-19 began, would this have surprised you?

John Schmidt: Well, Michael, a year ago, I'd say the word was shock. Or, actually, if I could coin a new word, I would call it shock-fusion. The combination of shock and confusion. I think executives were dealing with a crisis unfolding at a fast rate, which none of us have never dealt with before. And yet, today, if I had to use a word, I think I'd use optimism. We see that in the survey results, and we're going to talk about them today, where a year ago, folks were putting all of their upside in 18 to 24 months, or even maybe in some cases farther out. Now we see that executives are looking at growth maybe six months out. I think optimism came through loud and clear in the executive survey we just completed and, um, looking forward to sharing some more of the results with you.

Michael Bruno: Great, thanks for setting that scene there, John. Okay, Jeff, here we are. Let's get into the Accenture report. The report includes survey results from a proprietary poll that Accenture regularly takes of A&D executives. And it looks like there are distinct differences in how industry leaders are viewing the near-term, mid-term, and let's call it post-pandemic era. So what have you found so far?



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Jeff Wheless: Well, that's a great observation, Michael, and we surveyed executives at OEMs, tier one suppliers, MRO providers around the world, so we've captured a big part of the value chain in that. And over the past year, we've gone from full thrust to full stop and, and now thankfully we're taxiing for take-off, it looks like it's a pretty big change, I think, in sentiment from last year. And, you know, looking at today, it's a bit of a split if we look at how folks are seeing the next six months. We've got about 40% of executives saying, "Hey, things are still challenging." And then 60%, the, the rest saying, "Hey, we're holding our own and we may actually see some growth in that short time frame."

And that view trends upwards, so if we look at later in the year, it's a, it's about 50/50 in terms of there's going to be growth. And then ultimately as you know, we look at 2022, everybody's jumping on the bandwagon, the growth bandwagon for 2022. 80% are saying they got growth on their mind for their business. As we look at that, I think, ultimately that really tees up what is the billion dollar question in all this in terms of what are we going to do to set up for that growth?

Michael Bruno: John, Accenture sees commercial aircraft deliveries between 900 and 1,100 airliners for 2021, which, while that is more than 2020's total, is down from the 1,200 or so in 2019, even as the MAX crisis was raging. But there's a lot of variability in there between narrow-body and wide-body, so what do you see happening in the wide bodies in particular?

John Schmidt: Well, Michael, I think we're seeing with wide-bodies is really a continuation on at theme that started, uh, even prior to COVID. So if we go back to our survey results back in, in 2019 right before COVID really hit us we were already seeing downward pressure on wide-bodies in terms of orders. We were looking at rates and the potential for having rates reduced. And so, now as we start coming out of the COVID situation looking at the light at the end of the tunnel we have continued pressure just based on all the restrictions on international travel and then how fast those may or how slow those may change over time compared to what's happening domestically. And then the continuation of that theme of the pressure on wide-bodies.

So you know if I think back to 2019 and I think even now a third of the folks we surveyed see potential for further decline in wide-body deliveries versus 2020 and that contrasts to 83% seeing the same or better delivery levels for narrow-bodies this year.

Michael Bruno: So John I'm going to stick with you for the moment as we turn to the supply chain which is responsible for about two-thirds of the spend on any given aircraft program and near in dear in my heart so it's always worth turning to. Let's start with the top-line view. The Accenture report notes that the supplier base is observing overall production cuts of 30% to 50% compared to pre-pandemic levels depending on the aircraft program.

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So let's be honest, nobody wants to see those kinds of business conditions ahead of them. What do aerospace executives expect when it comes to production?

John Schmidt: Well, I think what we're seeing on the production side just about what folks said about their demand side. I mean 88% of the surveyed executives expect their production capacity to remain the same or decrease over the next six months or so, and the reflex is slow and aero body production ramp up and the continued pressure on the tier ones. On the supplier side, OEMs and tier ones continue to assess the ability to build critical components. We saw that. And ensure production schedule and can rebalance as demand changes.

You know, the executives told us that supplier delivery and quality drop-off, you know, significantly from 2019, which was then 90% of on-time, on-quality, to a 2020 71% of on-time, on-quality. And then they're now telling us of lower current level of 66% confidence in their suppliers. I know folks that work through supply chain, and that's reflected in more optimistic views of suppliers upping their gain to a more pre-pandemic level of 95% on-quality in 2022. There's work to be done.

Michael Bruno: So Jeff, I want to turn to you because well, it's not all bad news, right? There are at least some benefits out of what has emerged. Like, the cost of doing business. What are you finding?

Jeff Wheless: That's right, Michael. And I think for 2021 and, and going into early 2022, executives are, are s- seeing that the cost are going to be about the same. 75% of them were saying that and that's across the board for talent, materials, parts, major subsystems and that's essentially a continuation from last year. And, now that said, if we start looking in 2022 that sentiment almost flip-flops and so, with over 60% of folks saying prices are going to increase. Costs are going to increase across talents, materials, and parts. And so, I think as we see that price increase, it'll certainly be interesting to see if those price increases, cost increases, rejuvenate, you know, more interest around vertical integration and corresponding M&A, especially as John mentioned earlier, if the suppliers are not upping their game on delivery and quality.

Michael Bruno: All right, well, this is great insight, and what I love about it is that it's real. We've talked about rays of hope, but there's also some real cleared-eyed expectation of what the future looks like. This sort of sets up our next question about where does this all lead for aerospace and defense? We're back with John Schmidt, Accenture's Global A&D Lead, and Jeff Wheless, Global A&D Research Leader, talking about the Commercial Aerospace Inside Report and its latest findings. John, there's a guy in Chicago who once said something about never letting a good crisis go to waste. I mentioned that because, according to the report, while COVID-19 would be enough to qualify as a once-in-a-lifetime experience, it seems commercial aerospace is wrestling with a couple of historic changes all at the same time. So what else is occupying aerospace executive's minds and how has COVID-19 affected those issues?



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John Schmidt: Well, Michael, environmental sustainability remains right up there as a top issue. Not just for things like green aircraft and hybrid propulsion and aviation biofuels, but also for how aircraft and engines are designed and manufactured. In fact, we're starting to see sustainability come into play in how executives are being compensated, especially in Europe. Folks are working on keeping the lights on last year and so that was their primary focus, and as such, we saw sustainability as a short-term priority, you know, take a bit of a step back. Meaning that, it went from being very important to just simply important, but the overall combination of the executives saying they are both important or very important stayed relatively the same. So, this is emerging as a key industry challenge that we need to unite around, and 60% of their executives that we surveyed saw sustainability as an increasingly important topic of the next three years, which goes along with the overall theme of optimism that we're seeing for 2022.

Michael Bruno: So John, there's another one that you and I have talked about before that's tied to this sustainability issue, we've talked a lot about in the past about the digitalization of the industry, and that was a known necessity long before COVID-19 and, and before even the flight-shaming movement that came just a couple of years ago. But now it seems as if it's for real, right? Technology investments are seen as a response to both COVID and sustainability.

John Schmidt: Well, I think it is. And, and in fact in the early stages of the, you know, our COVID situation, going back, looking at April and May when I was having discussions with executives across the C-Suite, you know, I heard so many times that, "I wish we would've gone faster. I wish we'd be more in the cloud. I wish we were employing AI more across the organization." And, you know the types of digital technologies that aerospace companies are investing in, you know, today, really hasn't changed much in the past 12 months. But the mix and cadence has been fundamentally altered. Cloud, artificial intelligence, industrial internode things are all areas that enable quite a bit in terms of flexible workforce both for the front office and the factory floor. Process improvements, cost takeout. You know, another thing to note, technology also drives a sustainability agenda. Since our industry, really drives more efficiency through aircraft design, engines, and operations, which then drive lower environmental impact.

Michael Bruno: Jeff, I think in the quote unquote normal times I'd ask this next question as almost a sort of check-in-the-box item, but there are a lot of good reasons for aerospace executives to be losing sleep these days. So what has Accenture found that keeps them up at night?



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Jeff Wheless: Well, Michael I think it's really about uncertainty. What's going to happen next? And so uncertainty dominates the, the themes of risk that keeps folks up at night. And that's due to the pandemic. It's due to the potential for worsening economic conditions. And so, I think those two areas are the ones that lead the pack for the foreseeable future both immediately and then we also saw long-term. Over the next two to three years. Those are the things that executives are worried about. And it's very different from say, two years ago, when we looked at, you know, what were the risks? You know, worsening economic conditions, I mean those were viewed as a might be, could-be kind of issue. And now those are hitting us front and center in terms of things to think about. And so as we look at changing operations and looking at how things get implemented for growth, you know, that things need to be taken into account, the uncertainty.

Michael Bruno: All right, so John, what could be done for these stressed out executives?

John Schmidt: Well, I think we're seeing a shift on how executives and their companies see themselves, their relationship with their workforce, and with society in general. If you look at today, executives told us they are more focused on financial and customer experience as the top areas to measure themselves and communicate on. Over the next three years, the executives also are telling us about their expectation for a dramatic shift in what is

measured and communicated on. Adding in sustainability, which we talked about, talent development, inclusion, diversity, and to use financial and customer performance elements as a component of an overall way of looking at how each of these companies really contributes and drives value for its many stakeholders. These additions are important topics, they're not new, but now becoming board level. And I think there are areas that I'm expecting to see our aerospace industry companies to make significant strides on.

Michael Bruno: Terrific. Well, we're going to have to leave it there with a little bit of a ray of hope which is a great place to leave it off. That's going to be a wrap for this edition of Check 6 With Accenture. Jeff, John, thank you for joining me today.

Michael Bruno: Be sure to check out the new Accenture Commercial Aerospace Inside Report and join at Aviation Week again soon for another edition of Check 6, which is available for download on iTunes, Google Play, Spotify, and Stitcher. Have a great rest of your day.

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