Welcome to the quarterly review of the top themes discussed by leaders of 31 advanced manufacturing (AM) sector companies (including those from the A&D, IP and chemical subsectors) during public earnings calls with analysts in July and August 2020. This update tracks the movement of these themes from quarter to quarter to provide a perspective on shifts in the AM landscape.

Themes that stood out include the following:

- **Financial initiatives**, which remained at No. 2 this quarter. Research and development (R&D) investments reflected a wide range of perspectives. Some manufacturers are remaining committed in order to keep their innovation pipelines full ahead of economic recovery. Others are pulling back as part of cost reduction efforts. Share buyback and dividend activity is resuming as short-term liquidity pressures have stabilized since Q1.

- **Operating costs**, which moved up to No. 3 this quarter. Targets for cost management programs were increased by many companies. Restructuring programs, a rise in offshoring and new automation efforts are expected to help manufacturers reach these new targets by the end of the year. Some companies are rolling out client-focused solutions on an internal basis, which may lead to service quality innovations and improvements as manufacturers become their own clients.

- **Culture and talent**, which moved down to No. 6 this quarter. While leaders were vocal in remaining committed to the safety and well-being of their employees, a growing number of manufacturers are responding to COVID-19 outbreaks at their facilities and worker concerns about risk. Discussions about workforce management are shifting away from employee impact and are focusing on enterprise-level cost savings from reduced headcount. Travel restrictions are easing overhead costs but also creating difficulties in contract fulfillment. Manufacturers that lose sight of the value of their talent are at significant risk of losing their competitive edge when markets recover.

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Manufacturers reduce costs and look to long-term growth as COVID-19 pressures end markets

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Jerry Gootee
EY Global Advanced Manufacturing Sector Leader
### Key themes

#### 1. Developments in end markets

**Trends in key customer segments impacting demand for products and services**

- Automotive, aerospace, and oil and gas were named most often as end markets severely affected in the first half of 2020 due to COVID-19 and record low oil prices.
- Industrial demand was down significantly on reduced overall economic activity. Many customers are deferring large projects as they conserve liquidity.
- Packaging, pharmaceuticals, food and beverage, and household products continued to drive demand as economies emerge from stay-at-home orders.
- High demand for personal protective equipment (PPE), testing kits and medical supplies boosted sales of specialized materials.

#### 2. Financial initiatives

**Capital management and deployment**

- R&D investments varied widely. Some manufacturers are maintaining their commitments to R&D spending in preparation for a gradual return to industrial growth, while others are pulling back by as much as 30% to reduce operating costs or are investing in high-growth product categories only.
- Debt maturing within the next 12 months is being replaced with longer-term maturity dates.
- Share buyback and dividend activity is resuming, though liquidity and balance sheet strength remain top of mind.

#### 3. Operating costs

**Focus on managing costs in all parts of the organization**

- Cost savings targets have been raised at many companies.
- Discretionary spending, including employee travel and investment in large projects, is down.
- Headcount reductions, internal realignments, offshoring and an increased use of automation are supporting greater operational efficiency. Some manufacturers are implementing their own automation systems rather than working with outside providers.
For companies that do not change their forecasting methods to meet changing demand, scenario planning for both near-term operations and long-term capital allocation will be fatally flawed.

Loren Garruto, EY Global and Americas Corporate Finance Leader

Critical projects
Production updates and milestones for key projects crucial to company strategy

- Defense contracts and deliveries of military equipment and services have been a consistent source of growth for A&D companies. Many commercial aerospace projects and deliveries have been reduced and/or delayed.
- At chemical and industrial manufacturers, capex reductions have put many facility and IT systems projects on hold.

Culture and talent
Workforce management and transformation

- Companies are continuing to implement new safety procedures at facilities, including their own services offered to clients, in response to COVID-19 and to support employees working remotely.
- COVID-19 outbreaks and work stoppages related to safety concerns continue to affect productivity for some companies.
- Headcount reductions are likely to continue into 2H. While leaders were focused last quarter on emphasizing sacrifice at all organizational levels, workforce reduction was discussed in 2Q with a stronger focus on overall cost savings potential.
- Travel restrictions, while saving operating costs, are creating challenges for some companies when specialized teams are prohibited from traveling to client sites to fulfill contracts.

Manufacturing workers are the unsung heroes of the COVID-19 pandemic. This crisis is an opportunity to usher in a new way of working that could ultimately benefit your business, your employees and your customers.

Jerry Gootee, EY Global Advanced Manufacturing Sector Leader

Working capital and cash flow management
Changes observed from the prior quarter

- Inventory reduction will be an area of focus in 2H, especially for aerospace companies, in managing working capital.
- While receivables have been a focus of working capital improvement programs in previous quarters, manufacturers are trying to balance overdue receivable levels without putting destabilizing financial pressure on clients.

Geographic developments — growth markets
Market conditions in Asia-Pacific, Latin America, and the Middle East and Africa

- Revenue growth in China in many product categories was higher than in any other country or region, reversing 1Q declines.
- Demand for defense equipment and services from countries in the Middle East continued to grow.
- Major Asia-Pacific and Latin American economies, especially India, Brazil and Mexico, are facing growth challenges as COVID-19 cases rise.
Changes in production rates
Management of facilities and production lines

- Production lines serving end markets with especially sharp drops in activity, such as aerospace and automotive, are operating at reduced levels to control operating costs and inventory.
- At the same time, production of pandemic supplies is operating at full capacity. Companies that expanded operations temporarily are considering long-term commitments to serving new markets.

Business reorganization/restructuring
Transforming company structures to meet strategic goals and market demands

- To meet increased cost savings goals, internal structures are being streamlined, especially for business units serving challenged end markets.
- Many companies are divesting non-core or underperforming business units to generate cash and strengthen balance sheets, allowing them to focus more closely on core operations.

Lessons learned from the global financial crisis show that active divestors outperformed non-divestors by 24 percentage points in median total shareholder return (TSR) in the 8 years following that crisis.

Rich Mills, EY Global and Americas Sell and Separate Leader

Companies included in the analysis
The identification of the top 10 themes are based solely on an examination of earnings calls held from July to August 2020.

- ABB Ltd.
- Airbus SE
- Akzo Nobel NV
- BAE Systems plc
- BASF SE
- Boeing Company
- Bombardier, Inc.
- Carrier Global Corporation
- Clariant AG
- Covestro AG
- Danaher Corporation
- Dow Chemical Company
- DuPont de Nemours, Inc.
- Eaton Corporation plc
- Flowserve Corporation
- FMC Corporation
- General Dynamics Corporation
- General Electric Company
- Honeywell International, Inc.
- Johnson Controls International plc
- Leonardo S.p.A.
- Lockheed Martin Corporation
- Mitsubishi Chemical Holdings Corporation
- Northrop Grumman Corporation
- Otis Worldwide Corporation
- PPG Industries, Inc.
- Raytheon Technologies Corporation
- Safran SA
- Siemens AG
- Solvay SA
- Textron, Inc.

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