



Advanced Manufacturing Quarterly

Analyst themes from
earnings calls

August 2020

Cost management has once again become a top priority for aerospace and defense (A&D), chemical and industrial products (IP) companies in response to an industrial environment challenged by COVID-19 pandemic. To bring down costs, manufacturers are using all tools at their disposal, including implementations of their own client services in-house. Headcount reductions are expected to continue into 2H20 as leaders face exceptionally complex workforce management questions.

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

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 1Q.
- ▶ **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.

Jerry Gootee
EY Global Advanced Manufacturing Sector Leader

Top 10 themes from quarterly earnings calls

2Q20			1Q20	
↔	1.	Developments in end markets	1.	Developments in end markets
↔	2.	Financial initiatives	2.	Financial initiatives
↑	3.	Operating costs	3.	Culture and talent
↔	4.	Change in financial outlook	4.	Change in financial outlook
↑	5.	Critical projects	5.	Operating costs
↓	6.	Culture and talent	6.	Working capital and cash flow management
↓	7.	Working capital and cash flow management	7.	Supply chain management
↑	8.	Geographic developments – growth markets	8.	Critical projects
↔	9.	Changes in production rates	9.	Changes in production rates
New	10.	Business reorganization/restructuring	10.	Geographic developments – growth markets

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.



4 Change in financial outlook

Changing forecasts for revenues or earnings per share

- ▶ Outlooks are once again being issued by many companies that withdrew them in 1Q20 out of pandemic-related uncertainty.
- ▶ Revenues for most industrial segments in 2H20 are expected to be below 2H19 levels.
- ▶ Several manufacturers are predicting gradual movement toward an overall recovery in 2021.
- ▶ The automotive and aerospace industries are expected to require more time to recover (by 2022 and 2024, respectively).



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



5 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.



6 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



7 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.



8 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.



9 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.



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

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