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Advanced Manufacturing Quarterly

Analyst themes from
earnings calls

May 2020

As COVID-19 quickly became a global threat in 1Q20, manufacturers found themselves facing complex decisions in a business environment that changed daily. Employees needed to be supported while working in facilities and at home. Liquidity needed to be preserved. Supply chains needed to deliver. Aerospace and defense (A&D), industrial products (IP) and chemical companies are preparing to weather the storm.

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Workforce, liquidity and supply chain issues drive priorities for manufacturers after COVID-19

Welcome to the quarterly review of the top themes discussed by leaders of 22 advanced manufacturing (AM) sector companies (including those from the A&D, IP and chemical subsectors) during public earnings calls with analysts in April and May 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. As COVID-19 evolved from a regional to a global threat, manufacturers took immediate measures to increase their access to cash and reduce near-term debt obligations. Capital expenditures are being postponed as companies tighten cost control efforts. Leaders are taking a more conservative approach to returning capital to shareholders, delaying share buyback programs, and in some cases reducing or eliminating dividends.
- ▶ **Culture and talent**, new to the list at No. 3 this quarter. Many earnings calls opened with leadership statements about commitments to employee safety. New protocols are being implemented at plants to reduce the possibility of transmission. As a remote workforce delivered greater levels of productivity than expected, leaders are recognizing the possibility of long-term change in manufacturing workplaces. Though headcount reduction continues to be part of cost control at some companies, leaders are making clear that layoffs are a last resort.
- ▶ **Supply chain management**, also new to the list at No. 7. The experience of suppliers in China in closing down and re-opening is providing companies in the rest of the world a view of what lies ahead. Manufacturers are in close communication with their suppliers to keep liquidity issues from closing down operations. Companies in all regions have become more aware than ever of the importance of transparency and flexibility in their supply chains – and where their own systems need improvement.

Jerry Gootee

EY Global Advanced Manufacturing Sector Leader

Top 10 themes from quarterly earnings calls

1Q20			4Q19	
↔	1.	Developments in end markets	1.	Developments in end markets
↔	2.	Financial initiatives	2.	Financial initiatives
New	3.	Culture and talent	3.	Working capital and cash flow management
↔	4.	Change in financial outlook	4.	Change in financial outlook
↔	5.	Cost reduction	5.	Cost reduction
↓	6.	Working capital and cash flow management	6.	External disruptions
New	7.	Supply chain management	7.	Geographic developments – growth markets
↑	8.	Critical projects	8.	Geographic developments – developed markets
New	9.	Changes in production rates	9.	Divestitures
↓	10.	Geographic developments – growth markets	10.	Critical projects

Key themes

↔ 1 Developments in end markets

Trends in key customer segments impacting demand for products and services

- ▶ Automotive, oil and gas, and airlines were named most often as end markets severely affected in early 2020 due to COVID-19 and record low oil prices.
- ▶ Pharmaceuticals, food and beverage, household products, and consumer electronics experienced sales growth as much of the world's population was placed under stay-at-home orders.
- ▶ Increased demand for personal protective equipment (PPE), testing kits and medical supplies boosted sales of specialized materials.
- ▶ Long-term shifts in airline passenger traffic may increase demand for narrow-body jets while grounding many widebody jets permanently.

↔ 2 Financial initiatives

Capital management and deployment

- ▶ New credit facilities and loans are helping companies manage liquidity risks.
- ▶ Debt maturing within the next 12 months is being replaced with longer-term maturity dates.
- ▶ Capital expenditures, including enterprise-wide transformations and facility construction projects, are being postponed.
- ▶ Share buyback programs and dividend payments have been reduced or eliminated by some peers.



It is going to be critical for companies to understand and control their liquidity positioning in order to sustain the company through the crisis and prepare for the recovery.

David Gale, EY Global Advanced Manufacturing Transactions Leader

New

3 Culture and talent

Workforce management and transformation

- ▶ Leaders made clear that employee health was a top priority, often opening calls with a statement of commitment to worker safety.
- ▶ Heightened cleaning procedures, social distancing protocols and contact tracing are being implemented at plants.
- ▶ Several leaders said that the productivity of employees working from home has been high and will influence work location policies going forward.
- ▶ While executives are taking pay cuts and looking for other ways to lower costs, some manufacturers are reducing headcount, especially if end markets are expected to be slow for some time.



4 Change in financial outlook

Changing forecasts for revenues or earnings per share

- ▶ Firmwide financial guidance for future quarters and full-year 2020 has been withdrawn by many peers. Some have kept forecasts but widened projected ranges.
- ▶ Many peers are expecting global end market demand to fall to a low point in 2Q20.
- ▶ Auto build activity is projected to fall by 40% year-on-year in 2Q. Commercial aerospace is also expected to be down significantly.
- ▶ Business unit growth sometimes appears close to flat, but it can reflect the simultaneous effects of high demand for one product category (such as PPE) and lowered demand for others.



5 Cost reduction

Focus on controlling costs in all parts of the organization

- ▶ Ongoing productivity and cost control programs are continuing at most companies. Some programs have raised cost savings targets.
- ▶ Leaders are speaking about headcount reductions as a last resort for controlling costs and making clear that they, too, are making sacrifices through compensation reductions.
- ▶ Transformation programs intended to reduce operating costs overall, such as enterprise resource planning (ERP) system implementations, are paused at a few companies to reduce capex in the short term.
- ▶ Low oil prices and restrictions on employee travel are providing cost tailwinds.



Supply chain analytics are critical to support data-driven (rather than emotion-driven) decision-making during this time of volatility.

Sven Dharmani, EY Global Advanced Manufacturing & Mobility Supply Chain Leader



6 Working capital and cash flow management

Changes observed from the prior quarter

- ▶ While receivables have been a focus of working capital improvement programs in previous quarters, manufacturers are trying to balance rising overdue receivable levels with a focus on preserving long-term customer relationships.
- ▶ Increasing inventory levels have been a challenge in managing working capital, especially for aerospace companies.

New

7 Supply chain management

Optimization of supplier relationships, costs and transparency

- ▶ Facility closures and re-openings in China have disrupted global supply chains but are also providing insights on what lies ahead for Europe and North America.
- ▶ Differences among local regulations, such as the definitions of essential businesses (those that can stay open during a lockdown) and restrictions on exports, are creating bottlenecks.
- ▶ Several companies are working closely with suppliers to protect their financial stability.
- ▶ Supply chain transparency has become an area of intense interest as manufacturers learn where their systems need improvement.



8 Critical projects

Production updates and milestones for key projects crucial to company strategy

- ▶ COVID-19 response teams have been formed to address the needs of employees and communities, coordinating support at both global and local levels.
- ▶ Many manufacturers have repurposed assets to launch or increase production of key pandemic supplies, such as respirators, face shields, ventilators and components, and sanitizers.
- ▶ Capex reductions have put many facility and IT systems projects on hold.
- ▶ Defense contracts and deliveries of military equipment and services are continuing as planned in most countries.



9 Changes in production rates

Management of facilities and production lines

- ▶ Plant shutdowns, either under local governmental orders or in response to COVID-19 outbreaks at individual facilities, have disrupted supply chains and order deliveries worldwide.
- ▶ Production lines serving customer segments with especially sharp drops in activity, such as automotive, are being idled to control operating costs and inventory.
- ▶ At the same time, production of pandemic supplies is operating at full capacity. Some companies are expanding operations or converting production lines to increase output of most-needed items.



10 Geographic developments – growth markets

Market conditions in Asia-Pacific, Latin America, and the Middle East and Africa

- ▶ Revenue declines in major Asia-Pacific economies, especially China, in 1Q20 are expected to reverse in 2Q as businesses reopen.
- ▶ The strategic importance of supply chain operations in China, India and other Asia-Pacific countries was recognized by many manufacturers.
- ▶ Growth in Latin America in segments such as crop protection chemicals was robust in 1Q.

Companies included in the analysis

The identification of the top 10 themes is based solely on an examination of earnings calls held from April to May 2020.

- ▶ ABB Ltd.
- ▶ Airbus SE
- ▶ Akzo Nobel NV
- ▶ BASF SE
- ▶ Boeing Company
- ▶ 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
- ▶ Lockheed Martin Corporation
- ▶ Northrop Grumman Corporation
- ▶ PPG Industries, Inc.
- ▶ Raytheon Technologies Corporation
- ▶ Solvay SA

EY contacts



Randy Miller
EY Global Advanced Manufacturing & Mobility Industry Leader
+1 313 628 8642
randall.miller@ey.com



Jerry Gootee
EY Global Advanced Manufacturing Sector Leader
+1 216 583 8647
jerome.gootee@ey.com



David Gale
EY Global Advanced Manufacturing Transactions Leader
+1 612 371 8482
david.gale@ey.com



Dr.-Ing. Frank Jenner
EY Global Chemical Industry Leader
+49 621 4208 1800
frank.jenner@de.ey.com

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