



Check 6 with Accenture. Why the commercial aerospace outlook isn't as bad as you think.

AUDIO TRANSCRIPT

00:07 - 01:03

Joe Anselmo

Welcome to check six with Accenture. A special edition of the check six podcast, brought to you by Accenture. I'm Joe Anselmo, aviation week's editorial director and editor in chief of Aviation Week and Space Technology magazine. Twice a year, Accenture updates its outlook for the commercial aerospace industry and looks ahead to the future. It's time for another update, and this one contains a mix of good news, bad news, and a dose of we don't know.

The "we don't know", being the impact of the ongoing strike by Boeing machinists to shut down production lines in Seattle.

Joining me to break this all down are John Schmidt, the leader of Accenture's global aerospace and defense practice, and Jeff Wheless, who leads growth and strategy research in the firm's A&D practice. John, let's start with you. You've been sharing your predictions on check six now for eight years.

It's certainly a much different industry today than it was in 2016. And yet some similarities as well. What are the headlines from your latest report?

01:04 - 02:25

John Schmidt

Well, Joe, you make me feel old when you say something like that out there. But yes, we have been running this now every, every six months for eight years. And I think you summed it up too.

And what we're going to hear in today's report, let me give you the headlines right now. The big one is that we're going to see revenues get back just past 2019 levels for the first time since Covid. So that's the big one. Having said that, growth overall will be modest. Although some surprises in there, I think we're going to probe into that.

So I won't do all that. Thunder. We're also finding that the executives that we survey as part of this every six months activity, we're very optimistic on aftermarket. And in fact, aftermarket, especially in the US and in Europe, is really what's helping drive up those revenues, as you mentioned, as deliveries look like they may be a little bit down this year compared to prior year for the first time since Covid.

And then, of course, supply chain. I don't know that we've had a single one of these surveys where supply chain wasn't one of the things being highlighted this time. We had 94% of the executives reporting production delays, with parts shortages and 83% reporting quality issues. So a little bit of a different take on what's going on supply chain. But those are the big ones for back to pre-COVID 19 growth in terms of revenues.

We're back to you know, aftermarket powering, you know, what is going on in industry right now making up for the shortage in deliveries and supply chain, supply chain, supply chain.

02:26 - 02:40

Joe Anselmo

And there was a staggering number in there that, the Asia Pacific market compared to 2019 is 54% bigger compared to only 3% growth in North America. That really struck me.

02:41 - 03:24

John Schmidt

Yeah, it's quite an amazing statistic. And, you know, maybe I'll just take kind of one crack at it. If you look at what happened to post-Covid, Asia Pacific has been very slow getting back and coming back. And still today, when you look at international routes well below where they used to be. But, you know, again, we're looking at the revenues of the companies in these regions.

And there's a few other things that are starting to buoy that region. A. Pass and traffic's going back B. You have Comac starting to really deliver on its aircraft, even though modestly and within the Chinese kind of national boundaries. But there's things there that are pushing that market. They have them getting a little bit

of a call, a giddyup to get back to where they were in 2019, whereas the US and Europe have already had a lot of that rebound happening. I know, Jeff, you want put some more color on those numbers.

03:25 - 03:57

Jeff Wheless

Oh yeah. And you know, certainly even gear today we've seen air traffic rose 17% which is fueling MRO. And so folks like SK engineering they've got 20% year over year growth. So quite a quite a bit of growth happening this year. And then we're also seeing a lot of traditional European North American aerospace companies placing big bets on the Asia Pacific, in terms of investing. Textron is expanding their operations in Australia. Safran is opening up new MRO in Singapore. So a lot of activity going on over in the Asia-Pacific region.

03:58 - 04:09

Joe Anselmo

So, Jeff, it sounds like your headline is MRO to the rescue because obviously deliveries that Boeing and Airbus had forecast are not going to come in anywhere near particularly for Boeing, that they were supposed to.

04:09 - 04:52

Jeff Wheless

Oh yeah, I mean, that's really what's saved this year in terms of the growth. The at least 3% growth, we still don't know the full impact on the Boeing Machine strike, but aftermarket has really been in overdrive and been, you know, a large driver for for many reasons on that. And so you know, the airlines are keeping the old aircraft up and running longer.

And so a lot of demand, and that's, you know, fueling some of the action supply chain. And then the other thing is inventory build up. So certainly people have been looking at just in case, instead of just in time in terms of inventory build up to build some resiliency in their production. And so when things pool back up, they'll be able to get back up and running hopefully faster and have a very strong fiscal year 25.

04:54 - 05:48

John Schmidt

Interestingly, Joe, when we were looking at the survey results, you know, the executives are, I would say, cautiously optimistic, right. And while everybody's kind of relieved to see revenues trending up overall and certainly certain segments, but they're certainly not out of the woods. And there's a lot of focus that we're seeing. And we're hearing this from our clients as well.

On the short term challenges. You know, things like the labor unrest we're seeing Boeing and extending down to Textron and what might be coming at other companies. As you look at other union workforces and agreements coming up, the quality concerns that we're seeing, the volatility we've been seeing in the overall economy itself, you know, so that's kind of got them on the cautious side.

Longer term it seems like everybody's really positive, especially as the investments. And so the digital tools a lot of these companies have been making a lot of our clients for making, you know, around AI, for instance, to help them really be able to deal with disruptions and be able improve resiliency in their operations.

05:49 - 06:08

Joe Anselmo

Okay, positive there on the negative side, supply chain sentiment, we were talking about supply chain challenges before Covid 19 here.

We've certainly been talking about them nonstop ever since. Can you guys help quantify for our listeners? Everyone knows what the problems are. Are they getting worse or are they getting better or staying the same?

06:09 - 07:41

John Schmidt

I think it's an interesting question. Are they getting worse or better? It seems like they're staying the same, but they're worse in some places as they get better in others.

It seems like Jeff uses this term a lot, so I'll steal it. Yep. Whac-a-mole right. It's just a constant game of whac-a-mole, and it's definitely the Achilles heel for the industry right now. I mean, you know, bluntly, it's a tough road and it's going to be a tough road for, for some time. And it's only going to get tougher as things at Boeing continue to go unsettled.

So I mean, every executive we talk to talks about supply chain and disruptions is a major challenge. You know, the fact that 94% of the executives are, you know, moderate to severe impacts and parts shortages is actually sort of shocking. I'm surprised it's not 100%. And it's not just about availability. We're hearing now quality issues are any another layer to complexity.

And all this stuff just starts to build on each other. So now having said that, you know, some companies are handling is better than others. There are a number of companies have made a lot of investments in what I call their digital core digital tools. You know, really, even since Covid and they are seeing themselves in a much better position, it's shocking when we survey, we find out that literally 55% of the companies are still relying on outdated manual processes to track suppliers and exchange data.

I mean, it's really hard to be able to deal with all the disruptions in the UK, whether it be caused by a parts shortage or quality issue that drops out on the assembly floor. When you're dealing with offline data spread sheets, hot lists on paper. I mean, this is just not the way to run the railroad. If you want to use that phrase here in 2024,

07:42 - 07:47

Joe Anselmo

were there any other takeaways from those respondents that made you go, wow, I think one of the biggest things to me was looking at the rotation of the categories in terms of what's coming up.

07:48 - 08:30

Jeff Wheless

We thought we had solved semiconductors from Covid and here it is. Think wow, next year, you know, today about 40% of folks are having challenges getting all the right semiconductors for their products. And that's expected to go up to 60% next year. And advanced alloys in that same group of almost 50% higher in terms of folks concerned about being able to get the parts for their production and then ongoing things like titanium those are well known challenges that have been ongoing for a while, but we're rotating through. Different categories are coming up again. We thought we had solved. So lots of work still to be had in terms of building resiliency and building up quality.

08:31 - 08:55

Joe Anselmo

I mentioned at the beginning the but the uncertainties caused by the Boeing strike, I mean, we have forecasters internally at aviation think they're just tearing their hair out because they're trying to put up projections from next year.

And you can't with this huge uncertainty. I mean, early on it looked like it might just be a hiccup if the management could end the strike when a couple of weeks. But that hasn't happened and it's really starting to drag on. How bad is this going to be for the industry?

08:57 - 09:41

John Schmidt

We look at the entire value chain in terms of suppliers, MRO. And so when we looked at wow, we're going to, you know, we're going to really be cutting aircraft deliveries this year potentially. And so but even with that, we're still projecting at least a 3% year over year growth. And I think that reflects the health of the industry and other demand. So it's not decimating the industry with that strike.

It's obviously, hugely impactful in terms of at the personal level and at the business level. But we do have a very strong and global industry that we look at. So we could see some growth above that 3%, but that we're estimating, hey, this strike could go on for still some time. You know, we still got runway for having, you know, some growth this year.

09:42 - 09:53

Joe Anselmo

I mean that's kind of amazing that I mean, maybe that's your big headline right there. We've had deliveries plummet huge headwinds. And yet you're saying industry is still going to grow this year overall on top line.

09:54 - 10:25

John Schmidt

Well, remember we're a function and a way of the commercial airline industry. And the commercial airline industry has been continuing to come along as we mentioned the beginning, right now, Asia is starting to come back in terms of, you know, RP case.

And that's a big driver. So those aircraft that are staying in service longer are being used in a different way than they are intended originally, because of the lack of new aircraft coming from Boeing or Airbus. It's going to drive more MRO. And that's, you know, exactly what we're seeing in terms of where the where the growth is.

If you kind of start peeling across the value chain. And most recent survey.

10:27 - 10:34

Joe Anselmo

The companies that responded to you, talked about their supply chain problems. What are they doing to address those problems?

10:35 - 13:18

John Schmidt

Well, I think there's a lot of different things, right? I mean, one, I'm going to just start at the top level. And I think you covered this really well. When your podcast was it earlier this week, maybe last week, when you were talking about, the impact of the strike at Boeing and the bullwhip effect somebody mentioned, and it's something it's very well known. It was, you know, how lead us how lead and Stanford, you know, came up with that in a paper a long time ago, maybe two decades ago.

And that's the big risk we have for the suppliers in the commercial market. The guys who are at the end of the supply chain. You remember that? The bullet that. Right. A little switch of the handle. And by the end of the whip, you get a huge response. Right. It's going to be a big challenge. These are smaller suppliers.

You know, when the cash stops coming in. I mean, all the things that we are worried about in Covid are starting to come back now. And the longer that strike goes on, the more it's going to, you know, because it can disruption. Now, what are they doing about it? I mentioned 55%. Over half of them are still trying to fight this war in kind of the last decade or even two decades worth of, technology, using paper and running around trying to figure out what the answers are.

And if you think your researchers are pulling their hair out, try being a planner trying to deal with that. You know, the implications of that. These striking inequality issues are happening. You know, the ones that are doing it well, the ones that have made the investments to move into what we call a strong digital core, that digital center of your enterprise that you can draw on to then be able to use things like AI or Gen AI, generate insights and improve resiliency.

I mean, there's a lot of different products out there that can work in a stack to help a client get real visibility. And one of the things we're doing now with a couple of companies in commercial is we're moving towards Gen AI, where we can start changing the nature of work. And this is a very big fundamental concept. It's not eliminating humans, but it's changing the nature of the work that's done.

So, if you think about the jobs of a supply planner, demand planner, production planner, you know, three different roles tapping into three different silos of data. Typically, in any large enterprise. Now with Gen AI, we can bring all that together, because if we have that digital course, the data is all there, available, timely, accurate, and you have a Gen AI two on top of it.

You can change the nature of what planning really means and really take step function improvements in how you deal with, you know, inputs that cause you to have to make changes. You know, you're looking at what's going on in bill material, what's going on, sources of supply. Look at where the, you know, insertion points on the floor. I mean, all that being done with the help of AI in other words, we call that augmentation, right, versus automation. And if those companies that are really going to be able to come out of this in the best position, because they're really going to be able to understand the implications of handling whether it's stuck on here and start coming in alternate source, what have you.

13:19 - 13:36

Joe Anselmo

Really interesting, John at the beginning said, I made him feel old. I'm old enough that I was a business editor covering the downturn of 2008 2009. That was a crisis of demand for this industry. We're sort of a it's sort of flipped on its head, hasn't it? Now we're sort of in a crisis of supply, just not enough supply to meet all the demand.

13:37 - 13:52

John Schmidt

You know, we used to say that you're either chasing orders or chasing parts, right. And for the last, I don't know, maybe decade or more, it seems like just chasing parts. And so I think if we had to pick a problem, though, we'd all rather chase the parts and chase the orders. Right now. Yes, it's and said and certainly there's implications.

13:53 - 13:36

Joe Anselmo

Hey, Jeff, when you guys do this survey, you always tweak it with a couple new questions. And, one of your new

questions this time was around allocation. Tell us a little bit about that?

13:37 - 14:52

Jeff Wheless

Right. No, it's interesting because certainly the we're all seeing the supply chain challenges. But then what are they doing with you got parts coming in on the dock. What are you going to do with them. So when we asked folks about that, it was really focused on about 50% are sending that to new production on there, and then about 30% are allocating, basically between new production and aftermarket.

And I think we're seeing that reflected. For example, if you look at the MRO market, looking at parts prices and, you know, in terms of then, using Breiman or other parts that are pulled from other aircraft, and so people are getting creative on part. So I think we're seeing that seeing the effect of those management, decisions in terms of new parts production then impacting the MRO market as well as new production.

14:53 - 14:55

Joe Anselmo

And what is keeping executives up at night.

14:56 - 17:30

Jeff Wheless

Well, that is one of my favorite parts of, of the report. When we get the results back, you know, because it's a it's really two parts of the econometric modelling, right? You can get all kinds of sources, data and look at and slice and dice it, which we do, which helps us get to our index. But the other side, the second is sentiment that makes it kind of really, you know, quite interesting.

And, the one thing that's consistently keeping them up at night is really just uncertainty, right? It's whether it's supply chain labor unrest, economic volatility. I mean, if we break it down and you think about those three things, I mean, first the supply chain disruptions, you know, they're parts material shortages. They're widespread. We've got the quality issues.

You know, I mean executives know that delays in one part of the chain can ripple through to the entire production schedule. And so we're trying to help figure out how you deal with all that. And we talked a little bit about some of the digital tools that people have put in place. And so again, when we looked at the results, 94% were concerned about severe impacts and I am shocked that was not 100% because when I'm talking to clients out in the market, everybody is concerned about that. And then we look at labor unrest. I mean, this is a big concern, right? Especially here in North America. I mean, we're in the middle of the machine strikes at Boeing. We talked about a couple of times today. And it's causing ripple effects already affecting the entire sector.

Boeing has had to cut their production targets. The suppliers are feeling the squeeze. I mean you have Textron and also dealing with the strike going on right now. Frankly this is a warning shot, I think, to all the companies out there that have unionized workforces, maybe even those without unionized workers forces, to be tapping in to understanding how is your workforce feeling, you know, where are they at right now?

I mean, I think Michael actually made this exact point on your podcast earlier. It was all foretold by what happened at spirit AeroSystems. So now don't miss the memo and start tapping into your workforce. And then finally, economic

volatility. I mean, whether it's inflation, raw material costs, fluctuating currencies, not forget interest rates. I mean, on the bright side, you know, maybe the prospect of some cuts in interest rates, you know, be offering some short-term relief.

Maybe they'll need to in the longer term, leave, you know, but at the end of the day, when we think about what do you do when you're dealing with volatility, it goes back to what kind of tools can you put into the hands of the people who need to have access, and you need to be able to look at a digital twin, to be able to look at how they're going to respond.

And those companies that have invested or are investing in a digital core for investing in AI and Gen AI are investing and looking at the changing nature of how work can be done using some of these tools. Those are the ones that are gonna be the best positioned to deal with those kinds of disruptions, you know, going on in the future, whether it's a strike or if it's anything else happening out there in the world at large.

17:31 - 18:01

Joe Anselmo

John, thanks for bringing us up to speed, Jeff. You as well. On an industry that seems to be changing almost by the day. So this was a really insightful update, and the report is being finalized and will be posted on Accenture's website. My understanding sometime later this month. So listeners who want to read more, keep an eye out for that.

For now, that's a wrap for this edition of check six with Accenture. A special thanks to John and Jeff for sharing their insights and answering my questions to our listeners. Thank you for your time and have a great week.

18:02 - 18:21

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