



Finding a silver lining amid the COVID-19 wreckage; Lessons from prior crises

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The shock from the coronavirus pandemic to the aerospace and defence (A&D) industry has been swift and painful.

Air travel has essentially ground to a standstill during the economic lockdown. Two-thirds of the global airline fleet were parked by mid-May, up from a mere 6 per cent at the beginning of 2020. Companies are deferring or cancelling new aircraft deliveries, substantially reducing investments, and accelerating the permanent retirement of older aircraft. Jobs and revenues have been lost, bailouts and financing packages are imminent.



After 9/11, it took three years before airline capacity recovered, and six years before airlines turned profitable, with cumulative net losses from 2001 to 2005 at US\$60.6 billion, according to a recent Wall Street Journal article.

At least, the need to modernize fleets with more efficient aircraft after 9/11 helped create a surge in demand, bolstering the OEMs, something that we aren't certain that we will see to the same extent this time.

So far we are seeing stable defence budgets, but there is always the possibility that defence funding among G7 countries will be diverted or deferred to pay for hefty fiscal stimulus packages. If this occurs, it would be yet another blow to the A&D industry.

And, it would be a further setback in Canada, where our combat fleets and defence systems require upgrading and the A&D industry has made so many positive strides in recent years to modernize and innovate.

While this COVID-19 shock is unique, lessons from prior shocks like the 9/11 terrorist attacks and the 2008-09 global financial crisis are still relevant. The most-important lesson is, companies that took rapid action fared much better than the ones that simply took shelter.

Companies that made rapid, yet thoughtful strategic cost reductions, rather than across-the-board reductions fared better. They reshaped and repositioned their business to fit the new reality. They right-sized operations and selectively divested assets. While they reduced overhead, they still maintained – and sometimes increased – investments for next-generation programs. Some also pursued acquisition opportunities, obtaining assets and capabilities at low multiples.

Those that delayed taking action, hoping for a fast recovery – or in today’s world, a return to near normalcy – fared much worse. They lost the ability to shape their own destinies.

With an inevitable second wave in this pandemic on the horizon, companies – and defence agencies in light of potential funding constraints – should consider the following actions to position themselves for the coming quarters and the longer term.

- Aggressively re-examine the businesses. Run stress tests to identify exposures to realign costs and preserve cash. Find opportunities for right-sizing, deferring projects, and divesting or sun-setting assets as needed.
- Create a mitigation action plan to protect the company’s financial position and operations based on scenarios which factor in timing and potential economic impacts, including further lockdowns and restricted access to markets and suppliers. This will be especially important for the next 12-to-18 months until a vaccine emerges and amid current geopolitical trade tensions.
- Reshape activities, footprint, and the organization to the new reality. Do not take a simple “reduction in place” approach to cut headcount or other costs.
- Manage the supply chain proactively and identify key risks, such as delivery, quality, and potential liquidity challenges in order to prepare to intervene with or assist suppliers. The greatest single cost for A&D companies is typically direct material (procurement and sub-contracts for programs and products).
- Identify where and how you need to reposition for the future. Examine where you should restructure the supply base to alternative partners, where needed.
- Keep investing in cyber security defences. This is not the time to lower your guard given the spike in phishing, ransomware, and espionage attacks.

These actions may feel extreme after more than a decade of sustained growth in both commercial and defence markets.

But, the A&D companies that most successfully navigated previous downturns were better positioned for the next cycle and delivered better shareholder returns during the recovery.

They took advantage of the opportunity to recalibrate and fundamentally reshape themselves during the inflection points. They positioned themselves for growth in new areas by freeing up investment capacity by keeping an eye to the future and the return of customer demand.

While a hard reset may be required, I am confident silver linings can be found even in these uncertain times.

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