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INSIDER'S PERSPECTIVE

AEROSTRUCTURES

Aerostructure players at a crossroads

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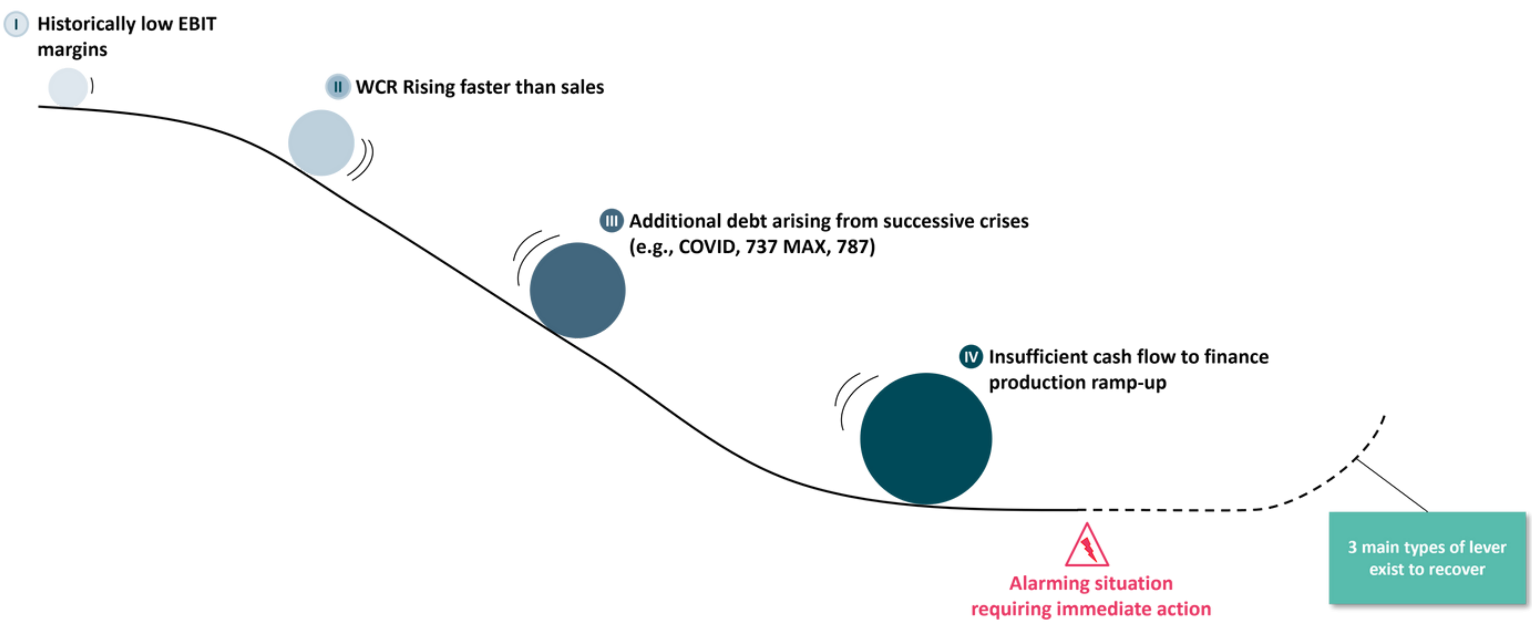
Aerostructure suppliers have been hit by one crisis after another for several years now. Their debt is piling up inexorably. Some small players already went bankrupt, while others of international stature are in the process of being restructured.
For them is essential to return to a healthy financial situation as quickly as possible, so as to support the air transportation recovery and the production ramp-up and, preserve or strengthen its market position.

The manufacturing of aerostructures is a capital-intensive, highly competitive business, with low operating margins and high working capital requirements (WCR). The succession of crises such as the B787, B737 Max, Covid, recent limitation of B737 MAX production ramp-up following quality problems, has had a major impact on all players in this market. Debt levels are historically high.

The operating cash flow generated is insufficient to finance all requirements: higher interest payments on debt, debt repayment, recruitment and training, investments linked to increased production rates, research and development in some cases. Aerostructures players have relied and continue to rely on debt.

Snowball Effect on the aerostructure market



i Operating margins have recovered and stand at 5.2% in 2022, still 2.5p.p. below the 7.7% mark in 2019.

ii Working capital requirements continue to rise (+22% WCR from 2019 to 2022), while over the same period sales have only increased by an average of +5%. The increase in WCR was mainly due to two factors:

- The cash conversion cycle increased by 15 days to 131 days in 2022 from 116 days in 2019
- Inventory levels remain high in 2022, with a coverage of 108 days, an increase of 21 days on 2019 levels

iii Debt levels are historically high and have exploded since 2019:

- On average, the capital employed of aerostructure players are mainly financed by debt, in 2022, the financial structure will be 58% net debt and 42% equity.
- The aerostructures players have also been severely weakened by the Covid crisis, and the number of companies in financial distressed (i.e., whose Operating Profit is negative or less than interest payable) doubled between 2019 and 2022, from 19% in 2019 to 36% in 2022 in our sample of analysis(*).

iv Overall, operating cash flow has fallen from 2 to 0.5 billion euros(*) between 2019 and 2022, after dropping to 0 in 2021. These cash flows are not sufficient to cover investment needs, particularly in a context where aircraft manufacturers are pulling on the entire supply chain to ram-up production. This forces all players to maintain and expand their production facilities.

(*) on the sample of 56 companies analyzed

The main levers to improve your financial health

The situation is alarming and requires immediate action tailored to the specific situation of each player. The magnitude of the measures to be undertaken needs to consider both the scale of the financial problem and the speed of execution of the action plan.

Three main types of levers need to be activated in concert:

Competitiveness levers

- Be strong on your fundamentals:
  1. Ensure satisfactory operational performance (i.e., on-time and on-quality delivery). It might seems obvious, but without delivery there's no sales, exposure to penalties and catch-up costs, and potential disqualification from customer tenders. In these troubled times, being a reliable supplier becomes a competitive advantage
  2. Strengthen core competencies such as production management, supplier management, configuration management and compliance, planning, program management, especially at a time when significant recruitment is needed

- Reconsider the scope of activity through 'Make or Buy' or 'Low Cost Country' thinking

- Draw up a plan to improve production costs such as purchasing, subcontracting, productivity, processes, non-quality, inventory and work-in-progress

- Define a plan for adapting fixed costs to meet new economic conditions

Revenue levers

- Renegotiate prices and contractual terms with customers, to offset inflation (e.g., raw material, energy, wages) provided it can be demonstrated based on facts
- Negotiate a contribution to the impact of the postponement of production rate cuts, for a minimum period allowing the competitiveness plan to produce its effects

Financing levers

- Negotiate the financing by customers of all or part of the investments required to support production ramp-up and working capital requirements
- Negotiate public aid/subsidies or customer partnerships for the investments required for decarbonization
- Consider debt refinancing or even recapitalization

Impact examples

on missions led by CYLAD

Competitiveness levers

>10M€ potential recurring gains for a Tier 1 subcontractor thanks to a Make or Buy strategy

+35% On Time Delivery increase (OTD), from 68% to 92%, for a Tier 1 supplier

Revenue levers

92% of the inflation underwent on purchasing transfered to the customers thanks to the renegotiation of contracts with a tier 1 supplier, after 3 months

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About CYLAD

Independent consulting firm, CYLAD advises executives from industries and associated services to overcome performance, transformation and growth challenges. The firm combines Consulting Methodology with Senior Experts' experience for sustainable results for its clients of all sizes, offering a comprehensive range of services. Apart from Integrated Technology Companies, CYLAD supports especially the Aerospace & Defence, Pharmaceutical/Health, Energy, Electronics and Transportation sectors.

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