

## A STRUGGLING AIRLINE INDUSTRY GETS HIT BY ANOTHER CRISIS

The AlixPartners A&D Minute

COVID-19 is a developing humanitarian crisis. As dramatic travel restrictions designed to limit the spread of the virus continue around the world, a majority of commercial air travel has come to a glaring halt. The confinement measures and isolation requirements are essential in curtailing its spread and saving lives, but they have also complicated the future of an already-stressed industry. While the commercial aerospace industry has historically been cyclical, it has never before been hit by an event of this magnitude across as many geographies in one fell swoop. The so-called “aviation super cycle” of the last two decades that saw almost uninterrupted growth, fueled in large part by China and India, is over.

Most airlines have cut both domestic and international capacity drastically. In Europe, Lufthansa has gradually grounded 95% of its fleet, while Norwegian Air canceled 85% of its flights and announced that it would lay off 90% of its staff at time of writing. Delta Air Lines has significantly cut capacity, deciding to park almost 300 aircraft and delay deliveries of new jets. Others are also pulling back significantly. Of American’s fleet of 149 widebody jets, at least 135 are expected to be grounded. The world is likely to stay much less connected for a long time, and the overall drop in travel demand may last for many months.

Many airlines do not have the liquidity needed to survive a demand decline of this magnitude, even for a short duration. In the worst-case scenario, several airlines—especially in Europe and Asia—will be forced into bankruptcy. This will reduce orders in backlog to zero, while saturating the used-aircraft market with cheap planes. Significantly cheaper oil is also making older generations of aircraft more competitive, and many airlines may decide to extend their life rather than obtain new ones.

There is widespread uncertainty around when the current crisis will end, resulting in airlines already asking their respective national governments for bailouts and rescue packages.

The commercial aerospace supply chain was already vulnerable because of the issues arising from the 737 MAX situation. This perfect storm means that the demand for deliveries of new aircraft is trending to zero, and the aftermarket business has also collapsed. The industry needs to react quickly and fight for survival.

To manage through this crisis, there are several critical tactics that aerospace companies must employ over the next weeks and months:

**Protect your workforce:** Considering the human scale of this crisis, protecting your employees should be top priority. Prepare to have an extended work-from-home arrangement in place for corporate staff, which both safeguards their health and reduces on-site presence to a bare minimum of staff that is critical to operations. For these essential staff, create fixed teams that work in shifts, adding virtual handover and enough time gaps between shifts to reduce person-to-person contact and enable cleaning and sanitization of the workplace. Stay in close contact with local and federal administration as well as health authorities.

**Stay in close contact with your customers:** Share business scenarios, challenge assumptions, request visibility on their plans, inform them about any COVID-related changes or practices, and closely follow developments to be able to continue to stress-test your business assumptions.

**Understand and forecast your cash situation:** Managing cash should be a high priority. Project your cash balance up to early 2021 with a 13-week cash model. Model your cash position scenarios over the next six, nine, and 12

months of business disruption and create clear contingency plans for each situation. These should include a range of outcomes, including the worst-case scenarios, and must establish a disciplined decision process for stepping from one set of actions to another as the situation changes. Understand that this will need to be evaluated regularly as the situation remains dynamic. Create a thoughtful plan before going for any cash infusion through a government bailout. Several industries that are critical for the restart of the economy will ask the government for support, and there will be understandable scrutiny on the viability of every business plan and whether funds deployed will support a solid business in the future.

**Consider if you need to reduce production rates, now:** Reassess your backlog and customer needs and quickly adjust your industrial system by cascading decisions to suppliers. Most airlines have already announced that they will not take deliveries of new aircraft for a while and, as a result, equipment manufacturers will cut production rates quickly. However, as you cut down or halt production, take the time to create a restart plan and make sure production processes and statuses are well documented to support easy startup, whenever it happens. Use this time to perform maintenance work, and possibly assess how you could make your operations much leaner.

**Add flexibility to production system:** Get ready to either reduce or halt the production rate, and then ramp it back up again as the situation evolves. This is also a good time to conduct design-to-cost workshops and introduce product improvement without affecting production schedules, with an eye on easing margins.

**De-risk your supply chain:** Establish a supply chain watch tower and act quickly to stabilize your supply chain. For single source parts, be ready to support your critical suppliers financially and operationally—monitor the situation closely and consider that you may need to adjust your production rate based on what they are able to produce. For dual source parts, assess readiness of alternative suppliers to increase rates and prepare to dynamically reallocate volumes. Some suppliers with long lead times, such as in forgings, may be especially affected. Also assess human capital risks to the supply chain. Ensure suppliers are properly documenting production processes and status, so that if you have to restart, take over, or transfer, you are properly equipped.

**Run your business in survival mode:** This means assuming strong leadership with the main goal to have a business after the crisis is over. This will require extraordinary measures and decisiveness, including cutting discretionary spending for the time and rescaling the overhead to a new normal level of revenue. Communicate regularly to the team about what you are doing and why. This attitude of self-help will put you in a good spot if you need to have access to government-funded liquidity.

To manage the current emergency and its future consequences, aerospace players must act quickly to protect their workforce and the business. In a crisis like this, it is paramount to build an accurate weekly rolling cash forecast and take drastic measures to ensure liquidity or reduce risks. Having a solid viability plan will also be mandatory to seek any kind of private or government financial assistance.

Aerospace executives around the world are now dealing with several dilemmas:

- What planning scenarios should I use and what actions should I implement for each?
- How do I get past the cash crunch until volumes ramp back up?
- Do I have a solid and viable plan to support any request for government assistance?
- Do I have adequate cash management capabilities?

**FOR A DEEPER DISCUSSION ABOUT THE CHALLENGES AND SOLUTIONS ASSOCIATED WITH THE COVID-19 CRISIS, CONTACT:**

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These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.

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