

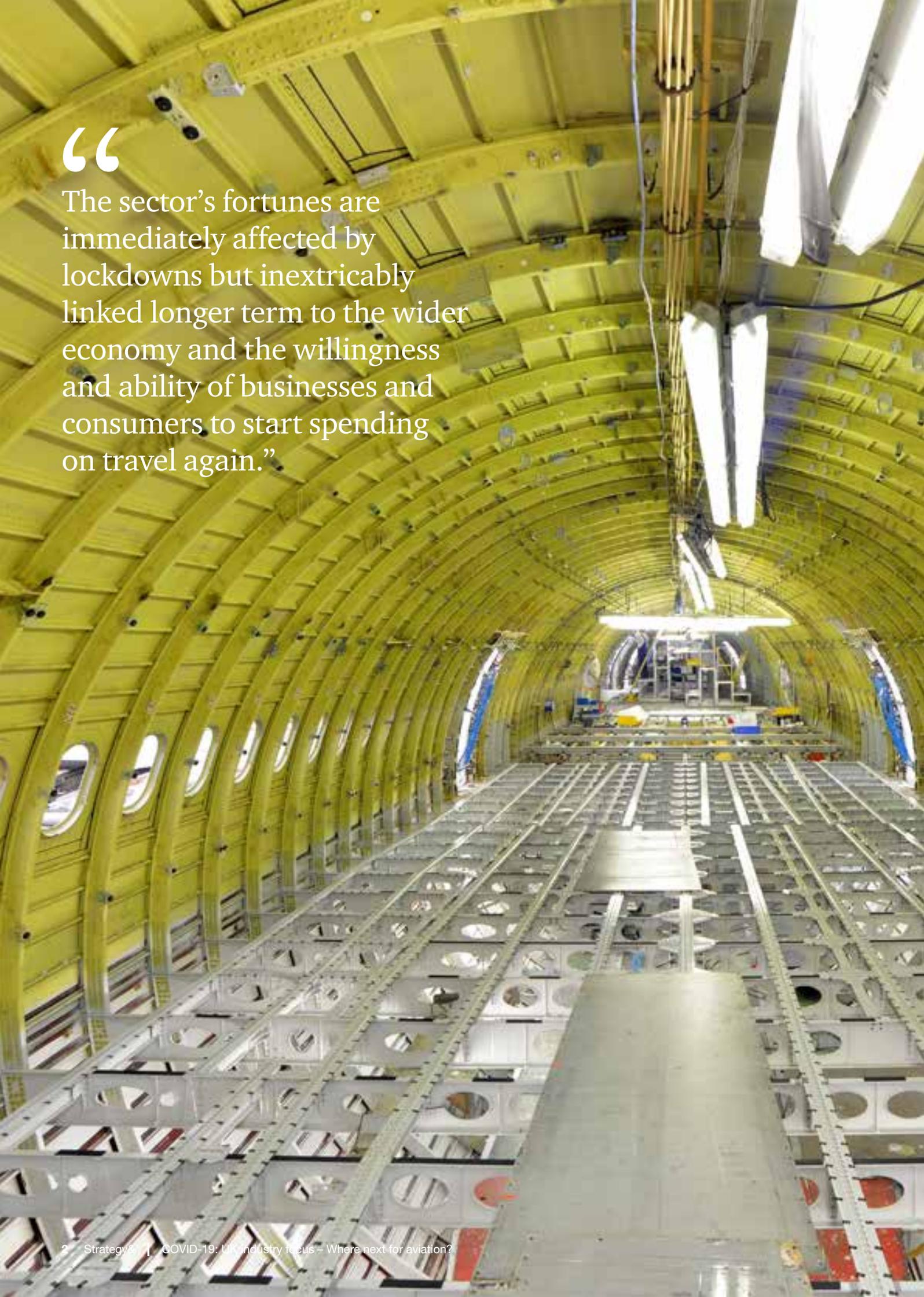
strategy&

Part of the PwC network

COVID-19: UK industry focus

Where next for aviation?



The image shows the interior of an aircraft fuselage during construction. The structure is a complex, curved metal framework with numerous circular and rectangular cutouts. The walls are a yellowish-green color, and the floor is a grid of metal beams. The perspective is from the front of the fuselage looking down the length of the cabin. The lighting is bright, highlighting the metallic surfaces and the intricate details of the construction.

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Where we are today

The word ‘unprecedented’ is being used a lot to describe the effect of COVID-19, but it barely feels strong enough to describe the negative impact on the aviation industry.



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Historic events have shown how fragile the industry is when flights grind to a halt and demand slows significantly, but what the sector is experiencing as a result of COVID-19 is far in excess of anything that has gone before and well in excess of what many would have feared possible.

This crisis not only impacts airlines, it impacts aircraft manufacturers and maintenance, repair and overhaul (MRO) providers and their extended respective supply chains. Businesses leasing aircraft are also hit, as are airport operators and all the retailers and businesses within terminal buildings. The impact also reaches into local communities around airports and manufacturers, as employees at every single business are affected.

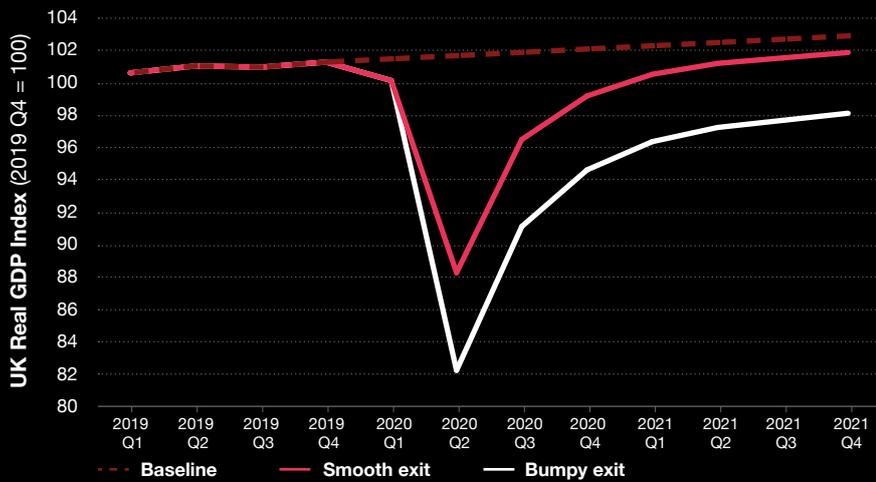
The International Air Transport Association (IATA) reports an estimated 25 million jobs supported by air travel are at risk due to COVID-19 globally.

Worse still, it is unclear how long the pain will last as the sector's fortunes are immediately affected by lockdowns and travel restrictions but inextricably linked longer term to the wider economy and the willingness and ability of businesses and consumers to start spending on travel again.

Our economic modelling suggests UK GDP is likely to contract over Q2 by between 10% and 16%. We predict the aviation industry itself will be hit harder, with a drop in GVA of between 34% and 67% depending on the length of the lockdown.

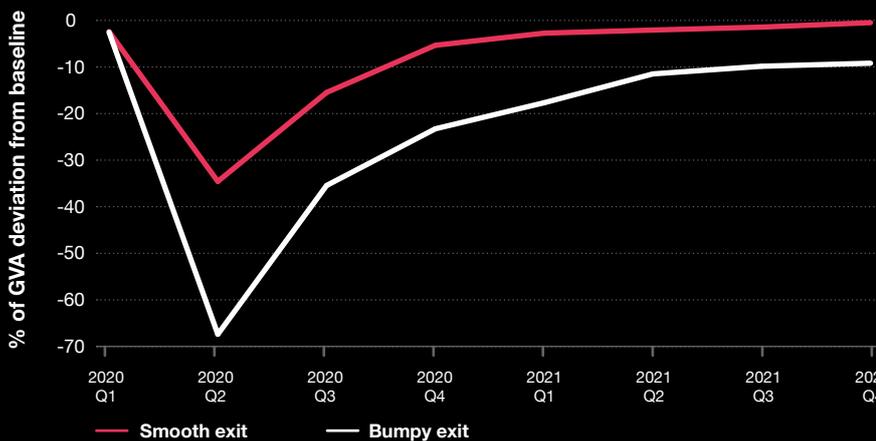
25m
jobs supported by
air travel are at risk
due to COVID-19
globally, IATA reports

UK GDP index (Q4 2019 = 100), quarterly levels in each scenario



Source: Strategy& UK Economic Analysis May 2020

Impact of COVID-19 on Aviation GVA by scenario



Source: Strategy& UK Economic Analysis April 2020

These figures are accurate for the following ONS classification sectors: air and spacecraft and related machinery and air transport services

For airlines, passenger volumes were down 20% in February and continued to fall sharply to be down 59.5% in March, according to Airports Council International (ACI) data. IATA forecasts airline passenger revenues will fall by \$314bn in 2020 (a 55% drop on 2019). For airports, ACI forecasts European airports will see 700 million fewer passengers in 2020. Some regional airports in the UK have shut their doors, except for emergency services.

221,000

Current no. of sector employees

'Total number of employees' represents the total number of employees in the aviation sector. These figures are deduced from ONS data, specifically the Business Register and Employment Survey 2018 provisional.

High

Jobs at risk RAG rating

'Jobs at risk' rating reflects the analysis conducted by the International Labour Organisation. They assessed the global impacts of COVID-19 on different sectors, assessing those most likely to lay off workers due to lower cash flow.

38%

of workers normally come into physically close contact with >20 fellow workers

Physically close contact is defined as a distance of 2m. Source: PwC Research QuantiBus April 2020.

52%

of workers can work from home

The Work From Home index is based on a survey carried out by PwC Research, and is the equivalent to the % of respondents saying they can work from home.

What are we learning?

An instant hit calls for immediate action

Many parts of the airline industry were already operating fairly inefficiently pre-crisis. As such, the immediate drop in passenger numbers and bookings has hit hard and demanded an immediate response.

Some airlines moved quickly to restructure or refinance. Some lobbied governments for extra support or applied for government-backed loans. Some have already gone out of business.

Reactions across the industry include: British Airways agreeing a deal to furlough more than 30,000 workers and announcing 12,000 redundancies; UK budget airline Flybe, which was already at risk, went out of business early in the crisis; Norwegian Air is seeking Nkr3bn (£228m) in government funding; Lufthansa was quick to axe its low-cost arm, Germanwings; and Easyjet has taken £600m from the UK's Covid Corporate Financing Facility.

Other airlines are putting aircraft into storage in anticipation of them not returning to service in the foreseeable future. Travel industry data and analytics firm Cirium estimates more than 8,500 passenger aircraft have been placed into storage so far. That equates to around a third of the total global passenger fleet.

Lessors are feeling the sudden shock of falling cash flow, exacerbated by airline bankruptcy and deferrals or defaults on lease payments. Analysts at JPMorgan Chase say as much as 15% of revenue could disappear this year.

Manufacturers are scaling back. Production of large commercial aircraft has been cut by between 30% and 50%, driven by deferred and cancelled airline orders. On 29 April, when [Boeing posted](#) a first quarter operating loss of \$1.7bn and Airbus announced losses of [€481m](#), Airbus CEO Guillaume Faury described the situation as “the gravest crisis the aerospace industry has ever known”.

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People may never fly the same again

The response to the pandemic across sectors has seen many workforces switch to remote home-working. Those doing so successfully will inevitably wonder how much of old ways of working were more habit than necessity. The same will be true for people reassessing the role of business travel, while employers looking to make savings may also resist switching business travel back on.

Consumers too will be watching their budgets and it may be a long time before many who have been furloughed or made redundant during the crisis are able to think about booking holidays.

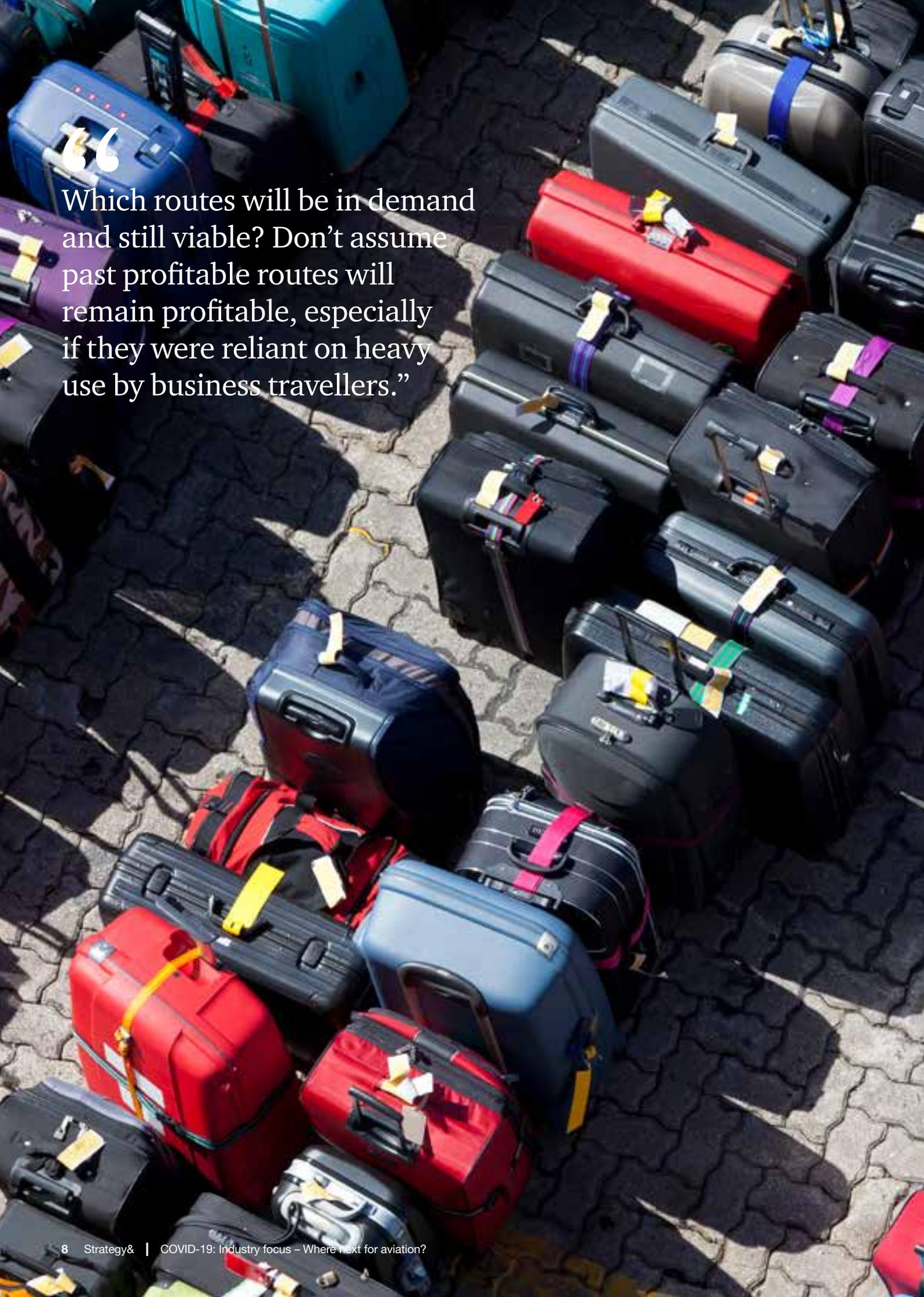
Rainchecks rather than refunds

Although customers are legally entitled to a refund, under UK/EU law, if flights are cancelled, many airlines are offering customers vouchers to rebook flights, in an attempt to retain booking money and keep customers engaged with the idea of flying again as soon as is feasible. Companies making such offers need to ensure customers are confident they'll be able to book without quibbles and their preferred routes will be available. They also need to prepare for the fact many returning flyers will therefore not be 'paying' customers when things pick up, but rather those cashing in vouchers.

There are few silver linings

Among the few positives for the industry is the current low cost of fuel, linked to falling oil prices.

According to IATA analysis, there will be a 31% fall in hedged fuel prices, lowering the considerable, variable costs that airlines have had to wrestle with for years. Providing oil prices remain low this may prove one of very few silver linings for the sector and will help companies assess which routes may be most economical to run as they begin to plan for the post-COVID-19 world.



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How do we respond?

Plan to emerge smarter, if not stronger

Air travel will pick up. Even if customers return gradually, in far lower numbers, they will return. As such, businesses should be planning now for what that may look like.

Which routes will be in demand and still viable? Don't assume past profitable routes will remain profitable, especially if they were reliant on heavy use by business travellers. Consider the profiles of customers likely to still be travelling. The most viable consumers are likely to be those who have been employed through the crisis, while the budget and business ends of the scale may be hardest hit.

That may dictate not only what routes need to be planned and provided for, but the rate at which airports are brought back into service. BA has already indicated it may not return to Gatwick post-crisis. Virgin Atlantic has also stated it will stop operating from Gatwick. Fewer routes are inevitable and may funnel customers more towards the largest airports. That will play into the hands of flag-carrying airlines, who may be further aided by competitor exits, making the market less competitive and opening up opportunities to take on new landing slots and attract talent to fill gaps left in their workforces by lengthy furloughing and redundancies.

Airlines, suppliers, manufacturers and lessors should also be working more collaboratively well ahead of potential back to business scenarios to ensure there is the flexibility to scale up fleets that are ready for service when needed. This may necessitate resolving disputes about payments and supply quickly and without recourse to courts.

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Embed new ways of working

Few, if any businesses, could have anticipated the impact COVID-19 is having on the industry. But it has served a stark reminder that crisis-readiness must be embedded into every part of the sector, with clear plans and capability to scale back if required.

Manufacturers should be reviewing their supply chains and looking at where they can exert greater control, what they can bring closer to home and what technologies, such as 3D printing, can be used more to create greater agility in the supply chain.

Technology will also have a part to play in training and onboarding staff as the need for crews and ground staff picks up again; from getting pilots' hours up in flight simulators to exploring the role of technologies such as VR and AR in maintenance and safety training.

Make scale count

According to analysis by HSBC, the COVID-19 crisis will speed up airline-industry consolidation. Larger players in better health will be in a position to drive that consolidation, acquiring the businesses or assets of smaller competitors across airlines, lessors and airports.

In the short term some planned mergers and acquisitions, based on pre-crisis valuations have been called off. The \$6.4bn Hexcel and Woodward merger has been called off, as has Boeing's \$4.2bn deal to buy 80% of Embraer.

But at the depths of the crisis, and as we emerge from it, valuations and a need to sell will be more in tune. Acquisitions in the airport industry, particularly where airports are state-owned, may present a useful win-win, as governments will be looking to bring in funding.

However, acquirers across the industry should be careful about driving too hard a bargain, as they could be seen to be exploiting a crisis, which will bring significant reputational ramifications.

Focus on reputation

Aviation perennially walks a fine line in terms of reputation. Businesses who can defend, or even build their reputation with consumers, businesses, partners and government during the crisis may find they emerge in a stronger position than others.

The sector has moved quickly to aid in the production of equipment needed to combat COVID-19. Airbus, BAE Systems, GKN Aerospace, Meggitt, Rolls-Royce and Thales Group are contributing to VentilatorChallengeUK, a UK-government-led initiative to develop and produce ventilators. Airbus and Boeing are also manufacturing frames for face shields needed by medical workers. Similarly, airlines and their catering suppliers have been rerouting surplus meals to charities.

Airlines and airport operators can also build important customer trust by showing they have proactively incorporated new safety procedures and best practice, for employees and customers. Reassuring customers post-lockdown, but while the virus is still at large, may bring more flyers back through the gates more quickly.

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Plan for a leaner future

There are few silver linings, but the industry can use this time to right-size issues they brought into the crisis. They can pare back their business to remove unprofitable routes and streamline, acquire to transform their offerings, develop their commitment to environmental targets and build stronger customer relationships where they have burnished their reputations.

Transformation in the industry was arguably long overdue, but it has taken a devastating catalyst to make that happen.

None of this is easy reading, but there are steps the industry can take to help weather the storm. Air travel will pick up, at some point, in some form. The winners will be those businesses who give themselves the best chance of being around when it does, and the greatest flexibility to adapt to whatever that looks like.

Who to talk to

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