Bank of Ireland Sectors Team Manufacturing 2021 H1 Insights

July 2021

Bank of Ireland

Classification: Green

Executive Summary

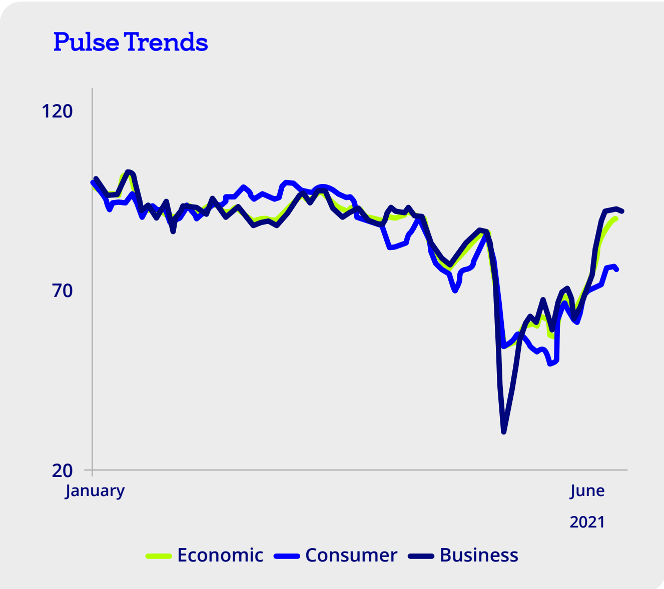
After a sluggish start in January and February on the back of the post-Christmas lockdown, and what was always going to be a sub optimal Brexit deal, the first half of 2021 was marked by a surge in manufacturing activity. Order intake and output performance has soared driven by high demand as economies reopen and vaccine rollout gathers pace. Strong Q1 results across major industrial players reflected this positive momentum with YOY results upward trending across key indicators. The most recent CSO data from period Jan-April 2021 shows industrial output is up YOY by 25% for modern industries and 12% up for traditional respectively. Overall Manufacturing turnover was up 20.2% on prior year. The major inhibitor to this growth has been supply chain delays and disruption caused by a confluence of COVID-19, Brexit, container availability and transport interruptions. 2020 will be remembered as the year that truly exposed the fragility of Global supply chains; supply chain resilience became the new topic in boardrooms as the industry challenged the value of Globalisation. Ultimately at least in the short to medium term security of supply will trump lower cost global options as manufacturers start to reconfigure their supply chains to achieve great resilience and lower risks.

Summary of Key Impacts

- **Covid-19 Pandemic:** The COVID-19 pandemic has affected every company in a very individual manner based on supply chain design, market demand dynamics, seasonality, market access and factory operations restrictions. While factories are back and running, COVID-19 has brought into sharp focus safety and well-being of personnel. While safety has always been a number 1 priority for Manufacturing, COVID-19 has added the requirement of temperature testing, rapid antigen testing, increased workplace cleanliness and contact tracing.
- **Factory Operations:** Compared to pre COVID-19 levels, factory operations have without doubt experienced drops in productivity with the new rules of COVID-19 such as social distancing, testing, remote working all impact the "cut and thrust" and "problem solving " nature of manufacturing operations. However manufacturing has proven time and time again to be agile and creative in its response. Part of the solution has been the acceleration of the digital agenda.
- **Funding Activity:** Despite the headwinds of COVID-19 and accompanying caution around cash conservation, funding approvals are still comparable to 2020. With longer end to end cash conversion cycles due to extended supply chain lead times, businesses are more focused on working capital requirements than investment. Correspondingly drawdowns are lower driven in part by negative interest rates on cash balances.
- **Brexit:** Depending on the level of UK exposure, businesses have been impacted to different degrees. Q4 2020 stockpiling in fear of an unknown Brexit deal and anticipated paperwork burden triggered an initial dramatic drop in imports from UK of 60% in January 2021. This has improved somewhat with latest CSO data showing a YOY drop of 39% for period Jan to April. Land bridge traffic through UK from EU has also seen a huge volume drop as businesses have chosen direct transport routes to safeguard supplies. Manufacturers have de risked their Brexit exposure through a mixture of higher stock levels, direct transport routes, supplier substitution and in house technology transfer.
- **Green Agenda:** The Irish government approved a Landmark Climate bill on the 23rd of March 2021 which is currently before Seanad Éireann. The bill commits to deliver 50% reduction in carbon emissions by 2030 and net carbon neutral by 2050.
- **Digital Agenda:** In the spirit of Agility and continuous improvement, the acceleration of tech and digital transformation of Manufacturing is the next big disruptor and game changer for the sector. COVID-19 has acted as an accelerant for adoption of digital technologies as companies adapt to new ways of working. A greater online, digital and data presence combined with higher levels of automation will gain momentum as manufacturers seek new ways to stay ahead of competition.
- **Supply Chain:** Supply chain resilience is the new mantra and topic of senior leadership teams and boardrooms alike. Given the choice between best cost source and secure supply source the latter now wins out.
- **Inflation:** Inflation of input costs has dominated Q2 with steel, wood, plastic resin all experiencing double digit price hikes in region of +30%. Disruption in container availability caused by COVID-19 and related transport interruptions drove container prices up by 547%.

Key Trends and Metrics for Irish Manufacturing Sector

A number of Indicators and surveys all point to very positive environment for manufacturing underpinned by high demand, buoyant order books and record production output levels.



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Industry Pulse

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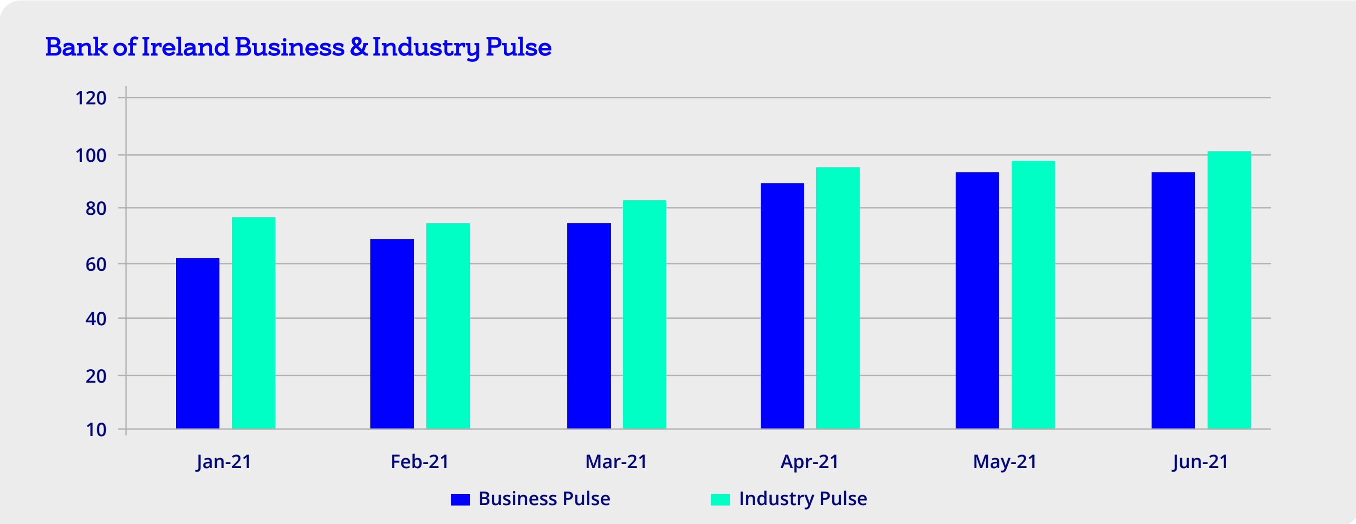
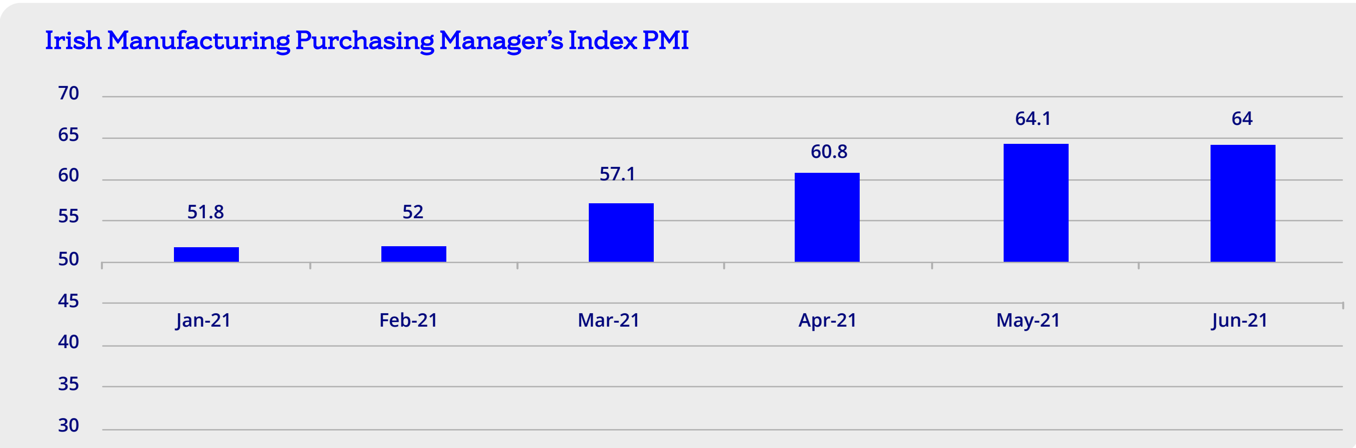
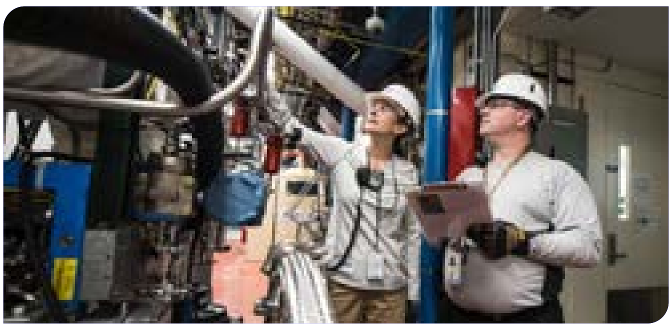


In June 2021 BOI Industry Pulse, a survey of 300 companies measured a near record of 100, reflecting strong orders and output and also growth in employment in the sector as vaccine rolls out and global economies return to pre pandemic expansion mode.



As per AIB Irish Manufacturing PMI, Q2 recorded a surge and boom in manufacturing activity with record headline numbers above 60 and 4 of the 5 underlying PMI drivers in very positive territory. The challenge is supplier delivery times which significantly increased due to Brexit, COVID-19, container availability and transport interruptions. Double normal lead-times is not uncommon. PMI is a survey of 250 manufacturing companies and a result greater than 50 represents expansion. A result greater than 60 represents very strong growth and mirrors the strong global manufacturing performance with PMI figures of 64.2, 63.1 and 62.6 for UK, Eurozone, and US, respectively as global economies bounce back.



PMI	64	↑
PMI Drivers		**Trend**
New orders		↑
Output		↑
Employment		↑
Suppliers delivery times		↓
Stock of purchases		↑
SME Growth outlook		↑

Industrial Output, Turnover and Imports and Exports

As per table 1 Industry output and turnover shows double digit YOY growth reflecting the boom in manufacturing across both modern and traditional sectors.

	February 2021 - April 2021	
Manufacturing, Production & Turnover	**% change on previous period**	**Annual % change**
Production	0.9	21.9
Modern	1.2	25.0
Traditional	1.8	12.0
Turnover	8.1	20.2

Table 1 Source: CSO

Imports and exports performance are summarised in graphic (Table 2) for period Jan – Apr 2021. The headline number shows a dramatic drop in imports from UK since Brexit further exacerbated by stockpiling in Q4 2020. Exports while down (overall -5%), in all regions except UK should see upward trend in H2 as the higher manufacturing performance in Q2 2021 translates into higher exports for H2 2021. IBEC reports an export increase of 25% from €60Bn to €75Bn when volumes from overseas Irish firms are included. Also evident is a significant increase in cross border trade in wake of the NI protocol.

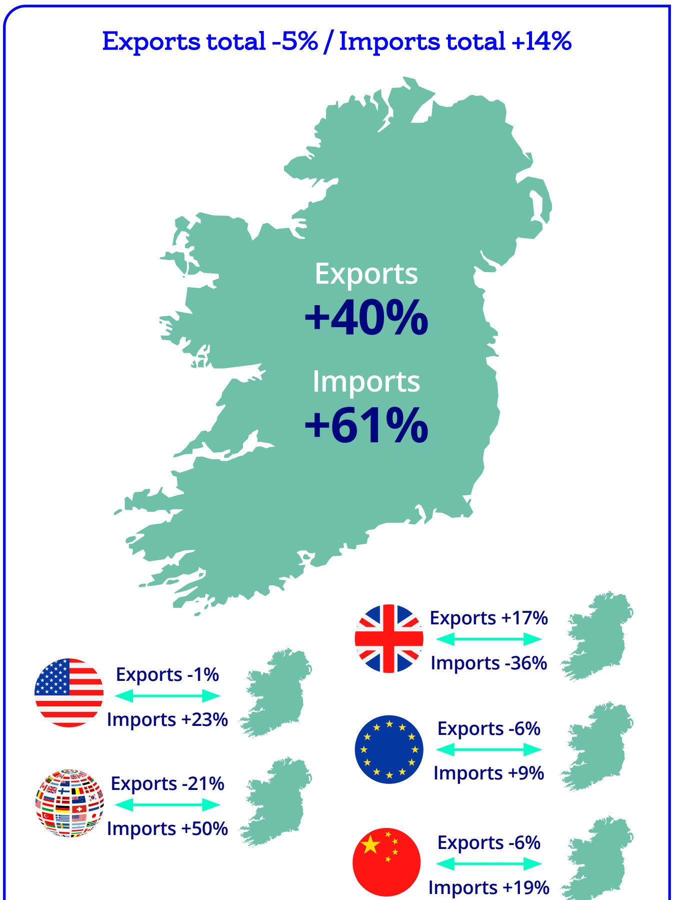
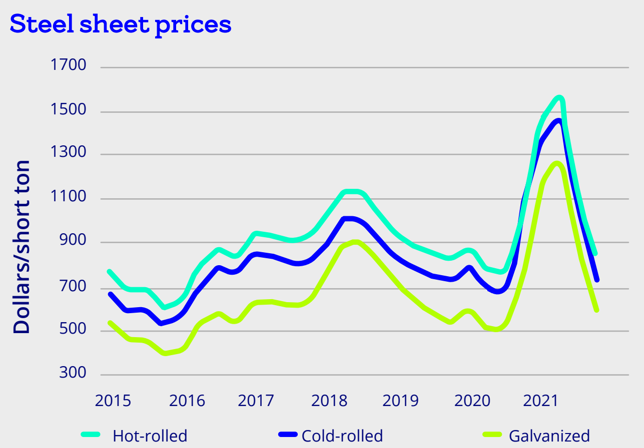


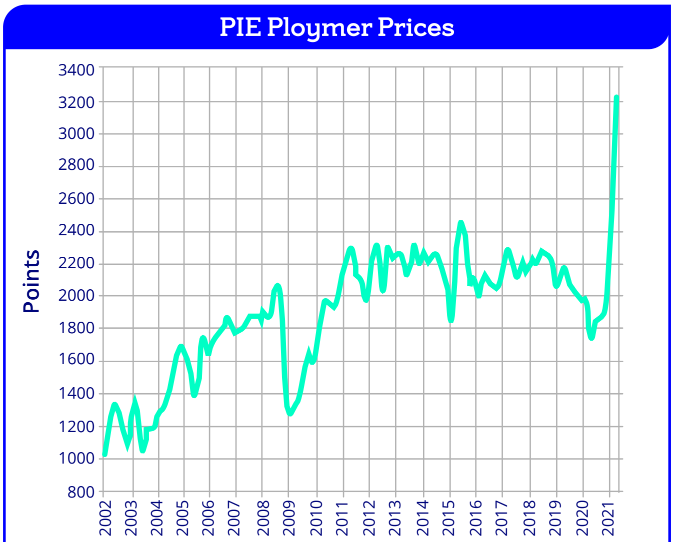
Table 2: Source: CSO

Headwinds of Supply Chain Shortages and Input Price Inflation

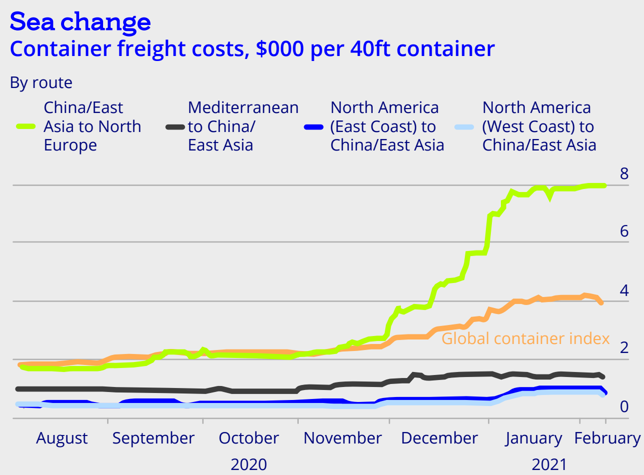
Notwithstanding the booming performance of manufacturing in Q2, manufacturers continue to be heavily impacted by supply chain shortages. The perfect storm of COVID-19, Brexit, container shortages, high demand, transport bottlenecks are all driving lead times and input prices in one direction. Inflation rates have accelerated successively for 6 months with Steel, Plastic resin, timber all experiencing double digit price hikes in H1 2021. Container prices from Asia are 547% higher than pre Covid levels. As employment continues to grow with 9 consecutive months of increases, anecdotal evidence is strong of a war on talent in certain high tech sub sectors driving labour costs inflation. All of these inflation drivers are triggering higher output prices which will pass through to end users.



Source: IHS Markit ©2021 IHS Markit



Source: PlasticPortal.eu



Sources: Freight Baltic Index, Refinitiv Datastream

Supply Chain Resilience – Brexit and Covid Impacts

The fragility of global supply chains and just in time low stock models was seriously exposed by impacts of COVID-19 and Brexit for Irish manufacturing SMEs. Supply chain resilience dominated discussions with continuity of supply winning out over pre COVID-19 priorities such as low inventories and best landed cost. A recent "Trade in Transition" report led by the Economist Intelligence unit, found that globally 83% of global companies are reorganising their most critical supply chains using a combination of supplier substitution, alternative freight partners, price negotiations, and changing supplier locations. Closer to home, a CSO survey of 1920 SME respondents of which 138 were from the industrial sector recorded that 47% regarded transport of goods from UK to be their biggest concern and 13% of respondents had sought new suppliers in response to this risk. In parallel many manufacturers have moved many commodities including plastic resin to EU distributors to bypass the Brexit impact.

As well as COVID-19 induced supply constraints of input components, supply chains have also been interrupted by the freight disruptions of container shortages, port capacity constraints, and availability of truck drivers. UK reports a loss of 100,000 drivers due to Brexit and COVID-19 with many drivers returning to their home countries. At a recent 'Haulage Strategy Consultation' workshop chaired by IBEC, 90% of the discussion was around severe driver shortages due to high driver turnover, difficulty with work permits for non EU countries and high insurance costs for new drivers. Apart from delays for manufacturing inputs there is the very visible consequence of food wastage in the short shelf life space.

In the medium to long term companies must weigh up the costs, risks and times to reconfigure their supply chains with time substitution taking anywhere from 6-18months depending on how bespoke and complex the components are.

Survey Roundup – Growth Outlook sentiment continues positive.

Despite the headwinds of COVID-19 and Brexit, different surveys confirm positive outlook for H2 2020 and beyond. A recent PWC CEO survey reported positive sentiment among 49% of Irish respondents and 76% Global respondents compared to just 16% and 22% respectively this time last year. An Inter trade Ireland survey of 775 businesses across Ireland found 55% were planning investment in digital, marketing and R&D over the coming year.

In summary rolling 12 month outlook continues very upbeat but expect it to soften in H2 2021 as supply catches up with demand.

Industrial Property Demand

CBRE in its latest research, forecasts an exceptionally busy period for H2 2021. Much of the activity is underpinned by increased demand for logistics and distribution centres which ties in with the whole topic of improving supply chain resilience outlined above. Demand for high quality industrial premises is buoyant with rents in capital at €113/sqm up 3% on last year. Currently there are 40 industrial planning permissions in the works across Ireland.

Funding Activity in the Sector

- Bank of Ireland Business Banking H1 2021 approvals are €12m (8%) ahead of last year supported by strong asset finance activity However drawdowns for the same period are slightly behind as SMEs focus on cash conservation and high working capital needs associated with higher inventories.
- As vaccine roll out continues and economies reopen fully, we expect drawdowns to catch up as SMEs cannot continue to delay necessary investments. H2 2021 should see a higher run rate of both approvals and drawdowns.
- Three significant deals in H1 with total value in excess of €12m were in refrigeration, packaging and medical devices sectors to meet funding and growth requirements for acquisition, bespoke assets and facility upgrades.

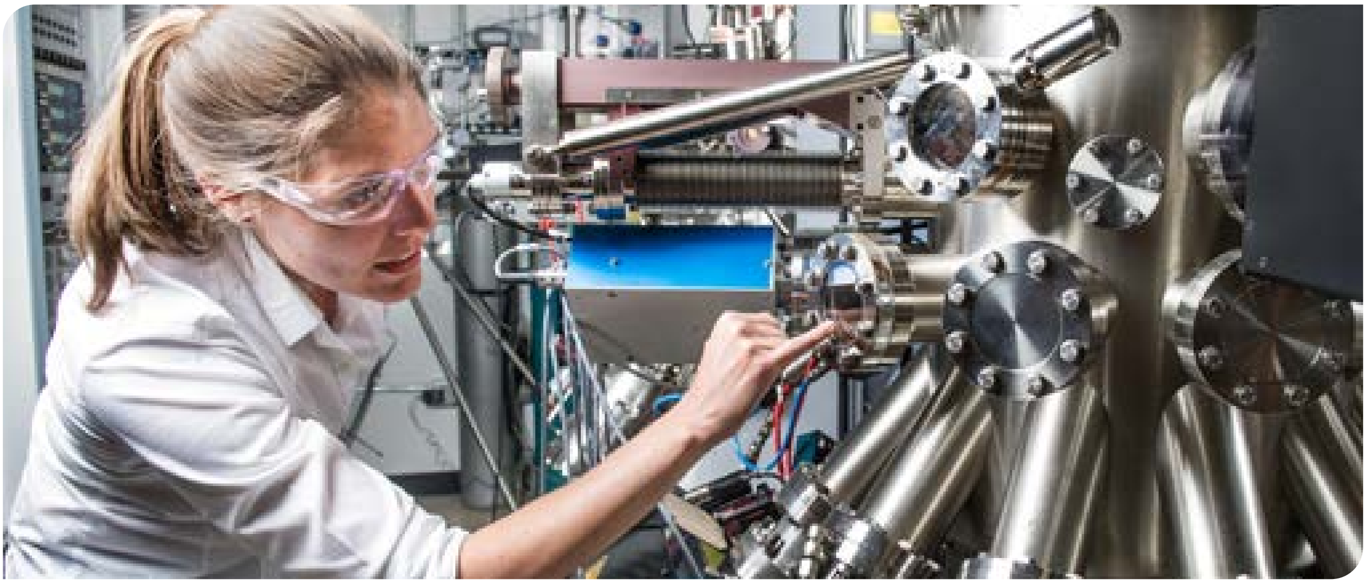
Manufacturing H2 Outlook

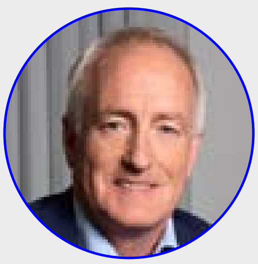
Tailwinds

- The fundamentals for continued Irish manufacturing growth are strong. Strong demand, healthy order books, high output levels all support a continued surge across the manufacturing landscape.
- Bank of Ireland's chief economist has recently revised 2021 GDP projections upwards to +5.8%. Similar strong growth levels are forecast by OECD for EU of 4.3%, UK +7.2%, US +6.9% and China +8.5% respectively.
- PMI data for Irish manufacturing is at record levels. This is mirrored across the globe with the global composite PMI hitting an eleven year high of 56.3 in April 2021.
- Manufacturing employment is high which may translate in medium term to certain skillset shortages.
- Sentiment across manufacturers continues positive.
- The shocks of COVID-19 and Brexit have triggered and accelerated many positive changes, including remote working, acceleration of digital, supplier substitution, new customers and technology transfers, all of which would have otherwise being long fingered or not happened at all.

Headwinds

- Supply chain shortages and continued disruption is likely to continue through H2 2021 as it takes time to add capacity and reconfigure critical supply chains. Taking a 5 year view expect supply chains to be less global, more local and regional and operate within a digital ecosystem with great data visibility to better manage shocks.
- Inflation of inputs will also continue through H2 2021. Perhaps transitionary for some commodities, many elevated input prices will be "sticky" and slow to revert to pre pandemic levels.
- Labour inflation and competition for talent will feature in H2 2021 as the immediate priority will be customer orders fulfilment.
- Freight costs and HGV driver shortage are reaching crisis point and might need special intervention.
- Brexit while moving to the rear view mirror it has not fully gone away for many SMEs. As grace "no inspection" periods expire in Q4 2021 and depending on latest negotiations outcome, many SMEs will have to adapt to new ways of working or pivot their supply chains.
- Manufacturing SMEs are likely to be very busy and stretched in H2 2021. Remote working models will continue. Special attention should be given to personnel safety and wellbeing with leadership grounded in empathy and flexibility.





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Conor joined Bank of Ireland in 2021. He is an accomplished senior executive and brings with him significant business and manufacturing experience gained both In Ireland and internationally. He has a strong track record of business plan delivery, scaling and turnaround and is an expert practitioner in Lean thinking, supply chain best practice and cost management in the Manufacturing sector.

Conor held various senior positions in Cargotec, a global manufacturer of Industrial Equipment for Cargo handling and transport having worked in Ireland, China and Finland.

Prior to Cargotec, Conor worked in the automotive sector with Iralco Automotive and Magna Donnelly in Ireland and Opel AG in Germany. He holds an MBA from Michael Smurfit School of Business, a Mechanical Engineering Degree from UCD, and a Diploma in Business Coaching from Smurfit Executive Development.

Sources: CSO, Gov.ie, IBEC, Bank of Ireland, The Economist, IHS Markit, PlasticPortal, AIB, TIME, Guardian, Inter Trade Ireland, PWC, CBRE, Gartner, J.P. Morgan