Global Civil and Military Helicopter Market

Helicopter Manufacturers to Stand the Test of Financial Volatility

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Introduction

At the start of writing this paper one month ago, the market was enjoying an optimistic moment: Vladimir Putin was emphasising the Russian government commitment towards procuring circa 1000 helicopters for the Russian Armed Forces, India was expecting to go ahead with procurement and delivery of 900 helicopters, and the US were announcing the potential order of 650 plus MH60’s. It was almost a perfect picture, alluding with the same optimism shared a few years ago, when market trends for both civil and military helicopters were showing positive growth signs. The replacement cycle of the global ageing fleet and growing disposable income in emerging markets were heightening the market demand. However, the world financial crisis has considerably downgraded market promises for the next 10 years. Apart from fleet size reduction and increasing Research & Development spending in renewable energies to cut the overreliance on oil, the current financial context will certainly be the biggest challenge that leading Original Equipment Manufacturers (OEMs) will have to overcome.

The world financial crisis and growing distrust of the global banking system is indeed threatening OEMs’ very own existence, as it questions the end users and the industry’s borrowing capacities, revives protectionism barriers and even State warranties. Since the financial crisis is impacting the global helicopter market earlier than expected, the global helicopter market revenue forecast growth at a CAGR of 2.40 per cent could be reversed and worsen at a greater pace.

These perspectives draw a dark picture, wherein the helicopter market is more vulnerable than it seemed. The immediate consequences affect deeply the volume of scheduled platforms to be delivered, future opportunities, and ultimately challenges competitors’ market position. Nevertheless, some leading OEMs have undertaken innovative business strategies to adapt their structures to counter financial instability, such as hybrid banking set-ups and/or asset diversification through joint ventures.

In light of the crisis and the impacts on the helicopter market and the competitive landscape, this paper discusses the validity of the OEMs’ strategies and potential options. Some plans are still under negotiations, such as the European OEMs’ attempt to protect their liquidity against the potential collapse of the single currency. Other strategies may have already shown a positive outcome that would be worth imitating by competitors in order to remain to seize the next market opportunities.

Global Helicopter Market Overview: Fewer Platforms than Expected

Initial Frost & Sullivan previsions were planning the end of the fleet replacement cycle by the end of this decade. In the light of the financial crisis, Frost & Sullivan expects current procurement military and civil programmes to be significantly reduced and delayed, hence postponing the end of the replacement cycle to 2020-2025 and deferring prospects in new procurement programmes.
Exceptions to this challenge are the Middle East and Asia Pacific regions, which are for now, minimally impacted. Although, the slowing growth rate in the developing markets of India and China may spell a different outcome by the end of this decade.

Figures 1 & 2: Global Military and Civil Helicopter Market Segmentation, Total Market, 2012 and Forecast Total Market by 2021

As illustrated above, the military sector continues to represent the biggest segment within the helicopter market. However, the government segment is likely to increase in units numbers (figure 2), not only because of upcoming armed forces reduction, but also because improving homeland security capabilities is a growing concern globally. As a result, the military market share is expected to diminish by 4.6 per cent, as the consequent shift in market share for parapublic’s advantage.

The decreasing military segment is a challenge for the defence industry, such that OEMs will have to adapt their production to a diminishing fleet size and more intense competition against other OEMs for smaller procurement programmes. Conversely, it potentially creates interesting investment opportunities across the commercial and governmental sectors in emerging markets, like in South East Asia, where countries are improving their capabilities for border control and maritime surveillance.

To add to the challenges imposed by the financial crisis, there is a shift in end user requirements that compromises procurement volumes. Frost & Sullivan research indicates that in-demand military and civil sectors will increasingly focus on multipurpose/multifunctional platforms. Intermediate (Maximum Take Off Weigh (MTOW) between 5,000 and 8,000 kg) and medium helicopters (MTOW between 8,000 and 15,000 kg) will be most in demand for both civil (figure 3) and military end-users (figure 4), since this range includes the most versatile and technologically advanced multi-role platforms, like the Ka-62 or the AW139M.
Apart from technical considerations, end users have expressed their requirements to the industry by mostly selecting Intermediate and Medium helicopters. Budget constraints require end users to rationalise their fleet capabilities and optimise maintenance costs, such that the availability of the platforms is not compromised when it comes to delivering critical missions. Simpler fleet configurations are aimed at generating operational and cost efficiencies, leveraging a responsive and integrated supply chain to support operations. However, modern intermediate and medium platforms are increasingly more complex to operate and maintain; OEMs should expect a growing demand from end users for adapted maintenance facilities and to train their personnel.
Civil and Military Helicopter Competitive Landscape Overview: The OEM’s Fragile Market Position

Considering the market opportunities stated above, Frost & Sullivan expects traditional leading competitors, such as Bell or Russian Helicopters, to maintain their positions in the global helicopter market. The American OEMs will maintain globally their leadership for the next 10 years, mainly within the military field.

Regarding the military market, Boeing and Sikorsky will have the most significant growth compared to other competitors (Figure 6, 2021), due to important procurements in India. Russian Helicopters growth will remain steady, driven by a strong domestic market demand and procurements in Saudi Arabia, India and China. ‘Others’ competitors, which include regional OEMs such as Hindustan Aeronautics Limited and Korean Aerospace Industries, will progressively increase their market share during the forecast period.

Figures 5 & 6: Global Military Helicopter Market, Main Competitor Market Shares 2012 and Forecast Market Shares by 2021, based on active units.

Similarly, the competitive landscape across the civil market will witness the growth of Eurocopter (Figures 7 & 8), which has established a large distribution and Maintenance Repair and Overhaul (MRO) network, especially targeting maintenance activities across Latin America (through Helibras), South East Asia (Indonesia, Malaysia and Singapore) and China.
However, these forecasts could change if the financial crisis were to get any worse with either the potential collapse of the European currency or the U.S. Department of Defence Sequestration plan approval. Apart from a terrible impact on platform volume, this context could benefit state-owned regional competitors, such as Hindustan Aeronautics Limited, Korean Aerospace Industries, Changhe Aircraft and Harbin. Indeed, the leading regional OEMs, which represent almost four per cent of the global market, could significantly strengthen their positions as emerging global competitors. These OEMs are not only benefitting from the market trend in favour of more affordable platforms (based on unit price), they also benefit from the perception of low-cost manufacturing (the pricing tends to look artificially cheaper since manufacturing is in many cases subsidised, as illustrated by the example of HAL DHRUV ALH). These two factors could increase the market size of the original competitors, while Western OEMs tackle the ongoing financial pressures.

This explains why leading OEMs are presently exploring new business strategies to limit the impact of the helicopter demand slowdown and the regional OEMs aggressive market posture.

**European OEMs Moving towards Hybrid Banking Structures to Protect their Liquidity**

While American OEMs are facing important restrictions due to the Department of Defence budget cuts, European OEMs settled in the Eurozone need to take drastic measures to stay ahead of the euro debt crisis. A few months ago, Eurocopter’s parent company, EADS, expressed its intention to have its own banking licence.
EADS is driven by a need to protect its liquid assets, whilst directly interacting with the European Central Bank, meaning that the company and its subsidiaries would no longer depend on the French, Spanish and German banking systems. However, this is a mammoth undertaking to execute and complete.

As an example, this could require transposing loans contracted with French and Spanish banks for important helicopter procurement, like the EC-725 programmes in Brazil in 2009. Moreover, European governments could express some reluctance, as the EADS strategy could trigger unforeseen challenges at national levels. Although no further action in that direction has been stated, the complicated relationships between France and Germany and the potential collapse of the Euro could speed up this process. Such intentions are indicative of the challenges the OEMs today face. Nonetheless, as always industry is trying to show resilience, exploring alternate financial mechanisms to support sustained growth.

In the meantime, other Western European OEMs with some of their assets across the Eurozone, like AgustaWestland, are exposed to the financial situation in Italy and the region. The pan-European enterprise, NH Industries, which brings together Germany, France, Italy and Netherlands, is similarly vulnerable to the European market uncertainty. However, the possible end of the European currency remains the main focus, as it triggers numerous issues that governments and OEMs would have to consider:

- Could existing procurement programmes stated in Euro be changed?
- Which currency would be applicable?
- Regarding the civil and military aftermarket, how would the Support in Service (SIS) contracts, such as Total Service Solutions and Contracting for Availability, be affected?
- How would a change of currency impact the platform readiness requirement and the quality of service delivered?

Unless alternate solutions are explored, these circumstances might prevent European OEMs from increasing their market shares at a pace that they would have planned for. However, they shouldn’t be the only ones, as other leading OEMs globally have similar exposure to risk, albeit in varying degrees.

**American Private Equity Group Attempts to Reduce Financial Exposure**

The recent affair of the American Aircraft company, Hawker Beechcraft, seeking bankruptcy protection and its possible sale to the Chinese group Superior Aviation has highlighted how much American aerospace and defence companies are financially exposed. As a matter of fact, this is not only about the global economic circumstances and dropping sales, but also about their own financial structure that might not survive the crisis. Some of these companies are directly monitored by financial firms such as private equity groups, and ultimately more exposed to global financial turmoil. As other aerospace companies, like the American AVX Aircraft or even helicopter maintenance companies, such as the Spanish INAER, Hawker Beechcraft has been owned by two American private equity groups.
This is a widespread financial structure across the industry that may have shown its advantages through lucrative times, but it is now clearly demonstrating its limits.

The North American economy remains severely impacted by the 2008 crisis and since there is not yet any sign of recovery, this is now slowly impacting the American helicopter market. As it is likely that the Hawker Beechcraft scenario could be transposed into the helicopter market, American private equity groups and related OEMs are considering new strategies. Among available solutions, financial partnerships with emerging markets have been the most profitable option, as illustrated by the Quest Investment Group partnership with Ukraine in the United Arab Emirates to develop a new helicopter.

This American approach may be easier to implement as it may not necessarily raise national government concerns, whereas European OEMs would need national endorsements to set up hybrid banking licences. Nonetheless, from a global perspective, leading OEMs would have to strongly assess their targets, as emerging markets are experiencing lower market growth than expected, especially in Latin America and Asia Pacific, where markets are heavily reliant on global financial stability. The recent downgrade of many Brazilian financial institutions and the common fears about Chinese market speculations are new concerns that must be taken into account.

**Russian Collaborative R&D Approach to Secure its Competitiveness**

In the past 10 years, major OEMs gathered their resources to optimise cost and risk sharing at different levels of the supply chain. Based on the example of NH Industries and the European Helicopter NH90 developed originally for NATO, leading American manufacturers Sikorsky, Bell and Boeing, and niche market company participant AVX Aircraft Company, are working together on the Joint Multi-Role program. This program aims to design and produce the next generation of helicopter for the U.S. Army. Such an approach rationalises Research & Development costs to share core business competencies between manufacturers and ultimately lighten risks for the end users and/or a single industry participant. Nevertheless, this market strategy has only been valid at a country (U.S.) or organisational scale (NH 90), as illustrated previously in this paper.

Still, the financial crisis could change this perspective, potentially giving way to new interregional projects. Two years after the first successful joint venture, Helivert, to assemble the AW 139 helicopter, AgustaWestland and Russian Helicopters are taking a step further by agreeing to jointly develop a new single-engine helicopter. On the one hand, this strategy offers multiple benefits to AgustaWestland, as it is diversifying its financial assets by collaborating with a state-owned company and is gaining new market share across Central Asia, India and China, which are Russian Helicopters’ traditional privileged markets. On the other hand, the Russian company is also increasing its network to strengthen its competitive position, gaining certifications and access to previously “challenging markets.” Russian Helicopters seems to be full throttle behind this strategy, as it also signed several new joint ventures in Asia Pacific, mainly in China, like the Sichuan Lantian Helicopter Company.
However, leading OEMs have to carefully consider that major regional competitors are also looking to expand their networks by potentially building new partnerships. In this context, several new bilateral defence agreements under negotiations between Brazil, Turkey and South Korea could enhance cooperation between their domestic manufacturers, since regional OEMs are now participating on open tenders against intense global competition. For example, Turkish Aerospace Industries are competing against Bell and Boeing to provide attack helicopters to South Korea.

Yet, before evaluating the rationale behind this strategy, it is essential that the industry and end users take into consideration the exact nature of OEMs’ structures. While Brazilian, Polish and Turkish OEMs may appear as the next generation of leading competitors, they are still depending on their parent company, which are the main global OEMs, like Eurocopter, Sikorsky, and AgustaWestland.

This market strategy seems to be the most efficient for both leading and regional competitors, as it provides several benefits for the regional competitors, such as:

- Reducing their financial vulnerability, which is due to their limited market penetration and heavy dependence on the local economy
- Increasing their technical know how, easing conditions of transfer of technologies and ultimately augmenting their market sizes

Similarly, for the global competitors, this approach provides a critical protection:

- It diversifies their skills sets and financial assets across regions to limit the impact of the financial crisis on their market shares
- It enhances their position and enables them to compete indirectly for interesting market opportunities, which might be only open to certain competitors, due to the growing barriers of protectionism and geopolitical concerns

**Conclusions and Recommendations**

In light of the financial crisis and its immediate impacts on the global helicopter market, Frost & Sullivan has identified the following critical success factors for organisations that are looking to maintain their growth and to secure new income revenues:

1. **Focus investments in Support in Service capabilities:** With an expected global growth of market revenue at a CAGR of at least 2.46 per cent for the next 10 years, the aftermarket segment offers opportunities in outsourcing maintenance activities since both military and civil end users are looking for cost-effective solutions.
2. **Target platform life extension programmes**: The general slowdown in new helicopter procurement and budget constraints could lead end users to increasingly demand platform remanufacture and modernisation plans, triggering important revenue streams to OEMs.

3. **Expand platform and critical maintenance facilities and demand in emerging markets**: Frost & Sullivan expects market demand for new platforms to steadily grow across West Latin America, Central Asia and South West Africa. By increasing their local presences, OEMs could design new bespoke procurement models and get a better understanding of local end users’ specific platform requirements, which could lead to new R&D projects.

Finally, it is in the best interest of OEMs to consider the joint approach strategy to widen their portfolio and invest in advanced R&D. This should protect their liquidity and potentially keep away financial and liquidity risks. Forming new cross-regional alliances with competitors for joint ventures, collaborative partnerships in R&D, and assembling and testing new platforms is likely to be the way forward. This strategy not only offers to diversify the choice of available currencies and hence contractual stability, but also is a warrant of liquidity and solidness against financial volatility.

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