



Covid 19:

Impact on aviation market

The air transport market is one of the sectors most affected by the Covid-19 health crisis.

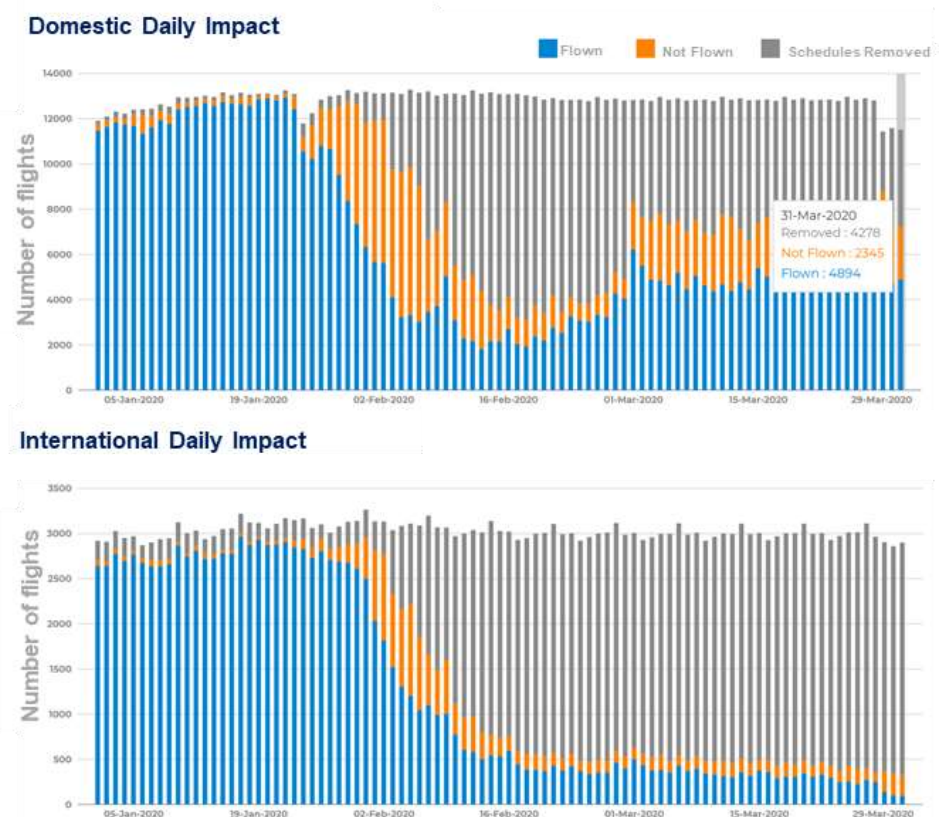
There have been shutdowns on a global scale. India, China, France, Italy, New Zealand, Poland, South Africa or the UK, amongst others, have implemented the world's largest and most restrictive mass quarantines. Some countries have closed their borders and others have locked down entire regions or cities.

Passenger air transport is **both a local and global market** and all components are affected.

Graph 1 illustrates **both the domestic and international market** impacts in the Chinese market.

In the first quarter in China, there was a 49% decrease in the number of domestic flights and 58% drop in the number of international flights (source Cirium at 31/03/2020).

More globally, the IATA (International Air Transport Association) **estimates a decrease in global traffic of 38%** in 2020 (expressed in RPK, Revenue Passenger Kilometres) and **\$252bn in airline revenues**. According to IATA, **airlines will burn through \$61bn of cash** during the 2nd quarter (including \$35bn in tickets due to be refunded). As airlines usually have only two months of cash on their balance sheets, **the outbreak puts them in a very precarious position**.



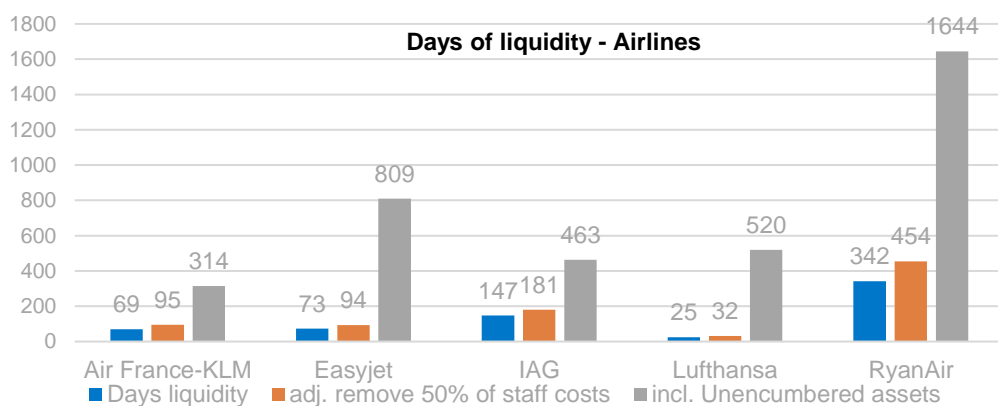
Graph 1 - Source: Cirium as of 01/04/2020

From the very first days of lockdowns or borders closings, **most airlines have taken measures to deal with the decrease or even cessation of their activity, and the consequent significant cash consumption:**

- **Drawdown of credit lines** or **raising new money through equity, convertible bonds** (Singapore Airlines) or credits (US airlines).
- **Sales & Leases Back** or **financing on unencumbered assets**: at the end of March, LATAM issued a S&LB RFP for 48 aircraft.
- Request **rent deferrals** or **reductions** from banks and aircraft lessors.
- **Part-time work, pay reduction** or **voluntary unpaid leave**: British Airways has agreements to temporarily reduce pilots' pay by 50%. It is also looking to suspend almost 80% of its cabin crew, engineers and office staff.
- Negotiations with aircraft manufacturers to **get back Pre-Delivery Payments**, but this has little chance of succeeding.
- **Recovery of maintenance reserves** or **security deposits** paid to operating lessors.
- **Incentivization of passengers to rebook** their flights directly by **waiving changing** fees or providing refundable vouchers to **avoid direct reimbursement**.
- **Postponement** of aircraft **deliveries**.

Liquidity is key

All these actions intend to **increase airlines' liquidity** which is clearly their key to survival. The standard **liquidity of airlines is around two months of revenues**. For Air France-KLM, the **50% cut to monthly staff costs** would increase their **liquidity from 69 to 95 days**. Taking into account **the use of unencumbered assets** (though financings or sale and lease back), the French/Dutch group could benefit from 314 days of liquidity.



Graph 2 - Source: Credit Suisse estimates as of 2nd of April 2020

As **an exception**, the Hungarian **LCC Wizz Air** has reported around 1.5 years of liquidity and has confirmed taking delivery of 15 Airbus aircraft this year. Of course, its CEO has called for governments not to help "mismanaged" airlines.

Governments support

Governments, seem to have realized **the seriousness of the situation** for an industry which **represents 3.6%¹ of their Global GDP** (including tourism):

- **Singapore** has announced a **SGD19bn (\$13bn) funding package for its flag carrier**. The package includes a SGD4bn bridge loan by DBS; SGD5.3bn in equity; and SGD9.7bn of convertible bonds underwritten by Temasek, the Singaporean Sovereign Wealth Fund.
- **US Airlines**: the **CARES Act** signed on 27th of March include **\$50bn in relief** for the passenger airline industry, through a combination of **grants** (\$25bn used for payroll) and **loans** (\$25bn)... As of April 3rd, six publicly traded airlines applied for payroll grants (Allegiant, American, Delta, JetBlue, Southwest and United).
- The **Swedish** and **Danish** governments have agreed to **jointly provide guarantees of DKK3bn to enable SAS to borrow money**.

¹ ATAG report 2018

- The **Italian** government intends to **nationalize Alitalia**.
- The **Norwegian** government has **suspended national aviation taxes** and granted **NOK3bn to Norwegian Air Shuttle**.
- The **Dubai government** announced on March 31st its plan to **inject equity in Emirates**, while Rival **Qatar Airways** (which is still operating aircraft) has decided to tap its government for a **bailout**.
- **Korea Development Bank** has announced a **\$572Mn support** to Korean LCCs.
- **India** plans to **inject \$1.6bn** in the aviation sector.
- **EasyJet** has issued **£600Mn commercial paper** through the **Covid-19 Corporate Financing Facility** implemented by **UK Government**.
- **Air France-KLM** will benefit from a **€6bn loan guaranteed by French and Dutch states**.

On the public side, the **Eurocontrol Member States** have agreed to **defer the payment of up to €1.1bn of air traffic control fees** due for payment in the coming months.

Operating lessors have also understood that it was their own interest to **agree on rent deferrals**. For example, Avolon, an Irish lessor, has disclosed that **more than 80%** of its customers have **requested relief from payment obligations**. Of course, **negotiations with lessors can be very different from one airline to another**. Lessors are seemingly willing to **negotiate only with the airlines for which they trust their ability to survive the crisis**. As such, current aircraft repossession on the Mexican Low-cost carrier Interjet is a bad sign for airline's future.

On their side, **banks have received less demand, so far**. As **lessors can waive leases promptly**, they have been contacted first by airlines in search of quick cash. Instead, they have been asked for new money by financing unencumbered aircraft.

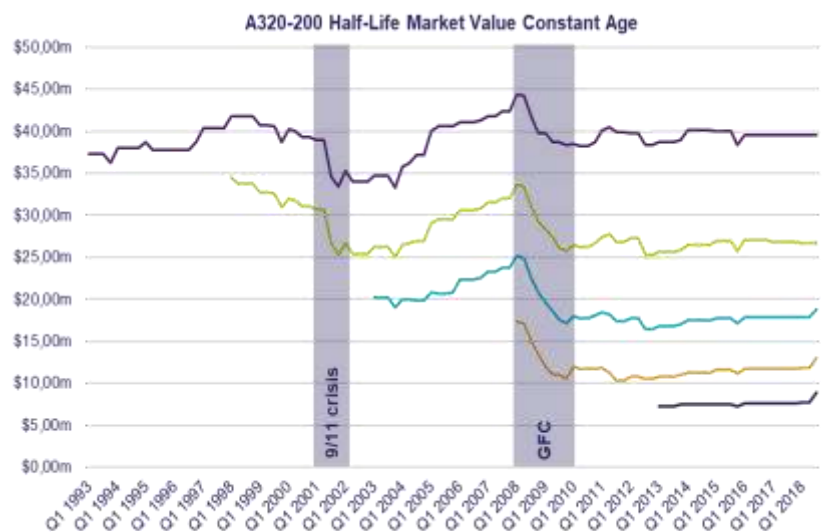
No doubt, these actors, as well as governments, have understood **the gravity of today's situation**. The support of the industry though rent/loan **instalment relief is crucial to avoiding a large number of bankruptcies**, which would lead to massive **aircraft repossessions** and consequently a **dramatic fall in aircraft values**.

Nevertheless, **some bankruptcies are expected**. The British **Flybe was the first airline to collapse** in the earliest day of the outbreak; however, it's important to note the airline was already on life support for months prior, and **Covid-19 was simply the final straw**. On March 31st, Miami Air International, a Floridian charter company, filed for Chapter 11 bankruptcy protection, following cancelled contracts (due to sport seasons suspensions). The most recent one, on 6th of April, was the Swedish regional airline, Braathens Regional Airlines that announced its filing for bankruptcy protection.

Aircraft values

At this stage, **aircraft appraisers are collating information**, they cannot formulate value evolution yet. Instead, **they base their analysis on values' behaviour during the previous crisis**: aircraft values experienced different decreases, according to aircraft type.

Thus, the most favoured narrowbody aircraft showed **a cut of 15 to 20% of its value during 9/11 and SARS**. The current crisis is unprecedented and the disruption to market values and lease rates **will be on a much bigger scale** than previously experienced.



Graph 3 - Source: Ascend 08/2018

Which elements impact market values?

Impact on value

- **Increase in airlines failures** and aircraft **coming in the market**
- The **number of leases ending outweighs the number of new leases** (for the first time in 30 years)
- **Increase in sale & leaseback** from airlines trying to raise funds
- **Opportunistic buyers**
- **Decommissioning of older aircraft**
- **Production of new aircraft will decrease**, in the context of the 737Max issue



Some airlines have announced the **decommissioning of older aircraft**, even though low fuel costs would tend to favour older aircraft. 2020 will probably **see an acceleration of this trend**:

American Airlines is retiring 155 aircraft around 20 years of age.

Lufthansa will cut its fleet by 42 units, across the whole airline group: this includes A380, A340-300, A340-600 and 747-400, which are operationally uneconomic. But it also includes around 20 A320s, **demonstrating Lufthansa's assessment that air traffic will not recover quickly**.

Outlook

The most recent events that impacted air travel and tourism (terrorist attacks in Paris or in Turkey) have demonstrated the resilience of passengers, with a quick recovery of air travel towards these destinations.

With the Covid-19 outbreak, **the end of the crisis looks more complicated**, with **a long and difficult recovery**. Even if improvements in the health situation allow activity to resume in June, **the demand for tourism will probably be weak this summer**. In the absence of a vaccine or a cure, the fear the virus will persist could negatively impact the desire to travel, even after the difficult period of confinement. **The rebound is also likely to be hampered by economic insecurity and the decline in purchasing power due the global economic crisis**. Travel businesses will also be impacted, as companies may seek to control their expenses.

After the summer, airlines will have to face the winter season, which is generally a low season, synonymous with cash consumption. So, the **difficulties faced by airlines may last until the 2021 summer season**. **Those who cannot count on state support will suffer and will probably be taken over by competitors**.

Nevertheless, **markets seem confident on airlines' capacity** (at least the largest ones) to face the current situation, as demonstrated by graph 4 below.



Graph 4 - Source: Ostrum as of 10/04/2020

Comparing the peak experienced by the ViX, the *fear index*, and an airlines' CDS index demonstrates that, in a context where market concern is as serious today as in 2008 (ViX), the confidence in airlines is better today than in 2008 (CDS).

What is the situation for lenders?

Weaker credits are mostly addressed by lessors, rather than banks. Still, lenders will probably face some bankruptcies and will have to repossess aircraft in a context of degraded aircraft values. Given the severity of the current crisis, **recoveries may not reach the historical levels² experienced by aircraft lenders in the past.**

Currently, investment opportunities arise from airlines aiming to secure their cash position, either through **unsecured transactions or through the financing of unencumbered aircraft.** These opportunities must be looked over cautiously, as we are still flying in a foggy environment: **aircraft values have not yet evolved, credits have not yet deteriorated, margins have evolved but can still increase.**

When the situation has stabilized, there will be some **opportunity to invest in aircraft secured debts with new market standards** (in terms of Loan to Value (LTV), covenants and margins), **based on lower aircraft values.**

We are closely monitoring the evolution of the following factors:

- **Airline failures and the number of aircraft concerned.**
- **Stored fleet:** in the lockdown period, these statistics are not necessarily relevant, but **when air traffic resumes, it will be the feature that most impacts aircraft value.**
- **Aircraft value:** the key parameter in an asset-based lending perspective.
- **Investment opportunities** to keep an eye on **the market evolution.**

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² 98.7% of median recovery rate, AWG study published on 14/10/2016

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