

Aviation: preparing for the return of travel

Ensuring sustainable growth after the storm

2021





In this report

The aviation industry has been significantly impacted by the disruption and travel restrictions resulting from the COVID-19 pandemic. With a huge portion of the global fleet of passenger aircraft still sitting idle, the beginning of large-scale public vaccination programmes and airline-launched testing is a source of optimism among airlines, lessors, airports and support businesses.

From liquidity to debt and restructuring, we address the diverse and complex challenges faced by airlines, leasing companies and aircraft funds in particular. We also consider implications for employers and how financial planning for the medium and long term will be affected.

We will cover:



Liquidity



Operating costs



Debt and restructuring



Positioning for sustainable growth



What Grant Thornton is doing to help airlines and leasing companies

Challenges and growth opportunities

COVID-19 has been an unprecedented shock to the global aviation industry, affecting all companies and geographies. 2020 saw international passenger traffic fall by 60% back to 2003 levels¹. This shock to airline passenger numbers has had significant implications for all aspects of the aviation value chain, including airport operations and support services. With the International Air Transport Association predicting that the airline industry is going to remain cash negative throughout 2021 with a potential cash burn of \$75 billion², it is clear that preparing the industry to safely restart will take careful planning.

Liquidity

Cash flow management and forecasting is an ongoing and serious challenge for airlines, lessors and support businesses. Those businesses that were well capitalised with strong balance sheets before the pandemic, are going to be more resilient to both the short-term drop in revenue and the potential period of depressed demand that may follow in the medium- and long-term. Despite a large-scale drop in revenues, the aviation sector still has large fixed and operating costs (heightened due to COVID-19), and an immediate priority for many has been scaling down cash requirements and increasing liquidity.

Several factors are making cash flow forecasting difficult. Firstly, many companies are utilising government schemes to pay wages and other fixed costs, but it is currently unclear how long this will be available and at what scale.

Secondly, there is still a large degree of uncertainty around how long current travel restrictions will last and what the effect on consumer and business appetites will be. With some predictions stating we are unlikely to fully recover to pre-crisis levels of activity until 2023, it is clear that the effects will be felt long after restrictions on travel are lifted.

For lessors in particular, COVID-19 represents an unprecedented attack on the industry's business model. With airlines all over the world affected, leasing companies have seen a sharp drop in rental income. In a bid to reduce operating costs and increase liquidity, many airlines are requesting payment deferrals or looking to return aircraft. Lessors are reluctant to take aircraft back, as in every part of the world affected, they currently have very limited options as to where to redeploy them.

Operating costs

For aviation, the principal way to lower operating costs has been to reduce staff levels. Large numbers of employees across the industry, from engineers to cabin crew, have been placed on government furlough schemes. While this reduced an immediate source of pressure, it is only a temporary solution and could have long-term effects.

A number of large airlines have announced the intention to lay off considerable numbers of staff, despite the current levels of government assistance. We are working with managers and owners to ensure that their future ability to operate is not adversely affected, particularly with regards to staff with specialised skills. While the picture is challenging for airlines, lessors have even less room for manoeuvre. Wide-spread disruption is exposing problems with the industry's underlying business model, particularly the large amounts of debt leasing companies tend to have to service and the inability to move their aircraft to other regions or white label operators.

Debt and restructuring

For airlines, the capital debt accrued through the ownership or leasing of aircraft represents a large part of their fixed costs. With lessors largely unwilling to take their planes back, airlines have an opportunity to renegotiate the terms of their arrangements with both leasing companies and financiers. Depending on their position, lessors may be willing to provide deferrals or rate cuts. While many lessors initially agreed to three month deferrals on their payments, this is not a viable long-term solution.

Some airlines are already taking measures that would have previously been considered extraordinary. Boeing announced in May 2020 that they successfully issued a USD 25 billion bond to ensure liquidity. Norwegian Air, as another example, announced a debt-for-equity swap deal with bondholders in the same month. It also remains to be seen whether banks will be willing to, or forced to, write off some investments.

For leasing companies, which typically have between 70% and 80% debt on each of their aircraft, COVID-19 could result in many filing for bankruptcy or going into liquidation and administration. With such large repayments of principles and interest, and deferred or reduced rent payments, many lessors will be forced to try and draw down funds, secure additional finance or restructure their debt obligations.

Leasing companies also need to look closely at how exposed they are to creditors, or potential Chapter 11 or protective shielding procedures under other legislation. If they have the ability to reduce their operations or restructure, these actions need to be clearly expressed to stakeholders as part of the company's strategy going forward.

The reduced travel caused by COVID-19 will make it difficult to initiate secondary market transactions with white label dry- or wet-lease operators or securitisation of slots. Agreeing restructuring or insolvency procedures with all creditors and stakeholders will also prove challenging. Joint efforts between all market participants are needed to implement innovative solutions appropriate to the COVID-19 disruption.

We see derivative restructuring and individual 'automatic stay' schemes, backed with specific securitisation and structured risk mitigation as key instruments to weather short- and mid-term challenges. Synthetic reinsurance structures could also support all stakeholders to more adequately manage operational risk.

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1. International Civil Aviation Organization 2020 – www.icao.int
2. International Air Transport Association 2021 – www.iata.org

Positioning for sustainable growth

While there is still significant uncertainty about what a return to business will look like, it is important for operators to begin planning for a return of consumer and business demand. For airlines, any strategies need to examine what level of social distancing or reduced passenger levels they can feasibly operate with. For smaller companies with shallow cash reserves, the choice may be to exit, undergo a significant restructure, or enter into a consolidation agreement with a larger operator.

Creating and retaining a segment of loyal customers will emerge as a key strategic priority. A wide range of considerations will need to take place, including: operating under strict safety rules, flying to selected COVID-safe destinations, introducing more individual travel advice and support, offering enhanced experiences, flexibility with loyalty programs or offering lower fares in the short and long run to strategic elements of the customer base.

The pandemic creates an opportunity for airlines to fundamentally restructure their business and operating models. For instance, United Airlines recently announced its intent to acquire a number of air taxis as a way to engage with customers earlier in their journey.

For airlines, new dynamic global networks and shared fleet management and pricing modelling can help to overcome the mid-and long-term pressure – enabling the operating models to be more resilient to market volatility.

German airline Lufthansa and Deutsche Bahn, the German railroad company, announced their intention to revitalise their cooperation in airline railway station check-in and rail feeder lines to airports.

Integrated travel and mobility concepts will also increase business opportunities for travel companies, transforming vacations from unconnected stand-alone-products into a more comprehensive mobility and travel experience.

Shifting profit drivers and operating models

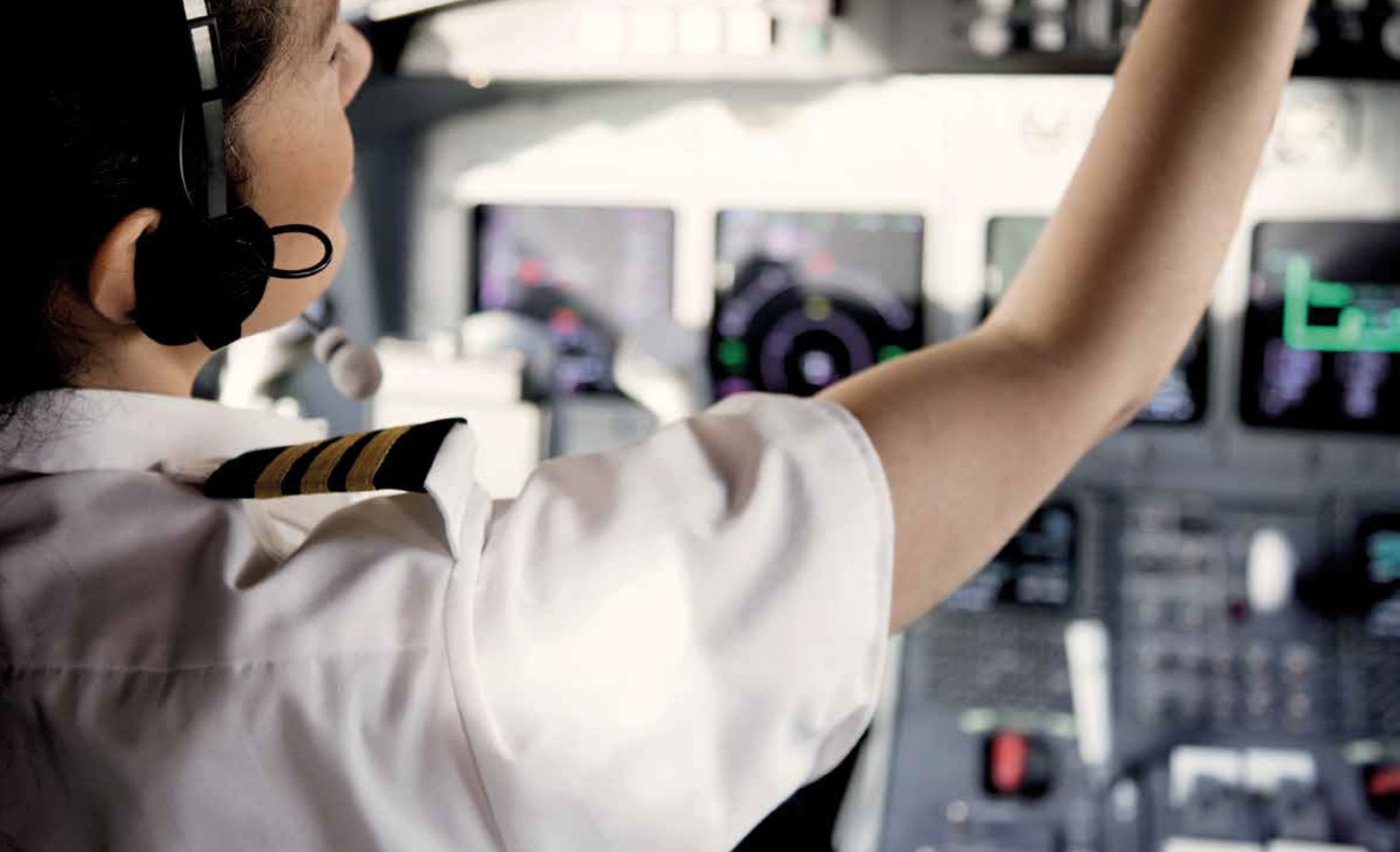
It is possible that there will be a fundamental shift in what drives profitability. Most major airlines depend on business travellers but there is a definite possibility that business travel may never return to pre-pandemic levels and that most new travellers will be GenZ. This market was characterised by overcapacity before COVID-19 – in which air travel was booked as a commodity. This market could be transformed into sustainable and more individualised travel offerings for increasingly environmentally conscious customers.

How airlines can shift their business models to account for these changes in their significantly more digitally-inclined customer base should be high on airline executives' agendas as demand begins to return.

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New digitalised target operating models connected with travel companies can better manage aircraft fleet and capacity utilisation, as well as ticket pricing. Such models can also give oversight of the amount of risk exposure taken as a result of air fuel and hedging positions.





Critical considerations as you plan for the future

The value chain of the aviation industry is highly interconnected with other industry groups and domestic, regional and global economic and social activity. Many of the forces impacting the industry are driven by factors outside of the owner, lessor or operator's control; this complexity has been highlighted by the impact of COVID-19.

Current market conditions are clearly driving liquidity and operational challenges, but can also provide opportunities to those with strong balance sheets and access to supportive lenders and special situations investors. The interconnectivity of the aviation industry drives the need for well thought-through, integrated solutions that critically address the needs of multiple stakeholders. This is particularly relevant where there is a separation between asset ownership, the lessor, the operator and the funders, with added complexity from financial markets regulatory interactions.

Advisors from our network of Grant Thornton member firms can help you to define the next steps in your planning. We consider the questions on the following page highlight the more important areas to focus on as you assess, protect and restore value - some will be more relevant to your business than others. Wherever you are in the world, our advisors can help you define and build your tailored response.

Key questions to consider





How Grant Thornton's solutions can help you

'Grant Thornton' is a network of member firms around the world. Our approach focuses on supporting you to assess, protect and restore value in your business. We start by helping you regain control by stabilising the business, while developing a robust and realistic turnaround plan, and longer-term strategic plans. Grant Thornton member firm advisors draw upon deep expertise across many different areas, customised to your specific needs.

Successful turnarounds require the development of a credible plan that has been stress-tested against various scenarios, along with a transparent communication strategy that meets the needs of all stakeholders. Building trust, and not breaking promises, will be critical if the plan is to be realised.



Stabilisation, turnaround, growth support, and business plan assessment

In the early stages of a turnaround the right support is necessary to create financial stability, assess cashflow and identify opportunities to improve short-term liquidity.

Through independent diagnostic analysis and challenge, we provide you with a clear understanding of the options available, including strategic and tactical opportunities.

This crucial activity provides comfort and support to management teams and can underpin the credibility of the turnaround and long-term strategic plans as part of the assessment process of financial stakeholders.

Grant Thornton member firms regularly work with leadership teams to support the effective delivery of their plans.

Helping your business respond to COVID-19

We are immersed in the aviation industry and our professionals are uniquely positioned to assist you in all aspects of the creation and execution of your turnaround plan.

1

You are supported by fully integrated, highly experienced teams, which are recognised for their quality and ability to flex to the sensitive needs of our clients' individual circumstances

2

We will take a holistic view of the challenges you face and deliver targeted solutions throughout the various elements of the aviation value chain including ownership and funding

3

We will work closely with you to implement performance and working capital improvements and drive effective restructuring strategies. These include providing independent critique of refinancing proposals and acting as a respected bridge between lenders and the senior management team

4

Our experience of effective divestment/investment strategies for investors, funders and corporates will help you identify and maximise opportunities for value creation or protection and to improve liquidity availability if necessary

5

Regardless of the complexity of your group structures, or the international footprint, we have aviation hubs as well as a global network of Grant Thornton member firms and market-leading teams in all the key offshore financial centres, to be able to advise on all leading practices

6

We are at the heart of the development of cross-border restructuring legislation, giving our clients access to leading-edge and best practice restructuring solutions

Contacts

Get in touch with our aviation professionals or visit grantthornton.sa to find out more.



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