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## *Governments step in to buoy airline recovery*





# *The market has solid fundamentals to remain resilient*

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There have been some recovery signs, showing that there is light at the end of the tunnel for airlines, the worst is over, and the market has solid fundamentals to remain resilient.

While some carriers are still relying on state aid, those with smart restructuring plans and intentions to upgrade fleets to newer, more fuel-efficient aircraft may present opportunities for lessors. Leasing aircraft instead of owning them outright will provide airlines more flexibility whilst they are recovering from the worst of the pandemic.

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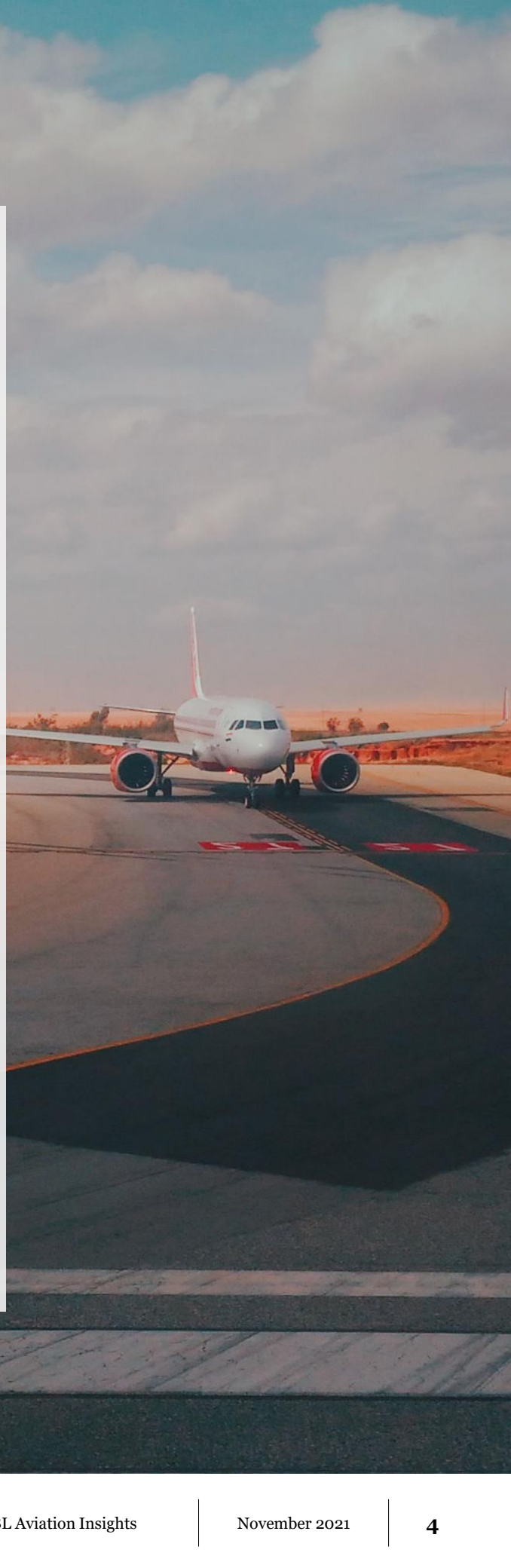


# *Introduction*

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Aviation conferences have finally gone back to being in-person. In mid-September, industry executives convened at the Airline Economics Growth Frontiers conference and Airfinance Journal's Reconnect events in London. Airline leaders met at the start of October in Boston, U.S., for the 77th IATA Annual General Meeting and World Air Transport Summit, the airline body's first in-person event since June 2019. While it has been good for the industry to connect in person again, much has changed since the last physical conferences took place.

The industry is no longer in rude health; it is now in recovery mode. Governments have had to step in to ensure the survival of airlines, as many would have struggled to keep flying if it was not for governments coming to their rescue. Indeed, a few airlines were already struggling before the pandemic.



# State support for airlines

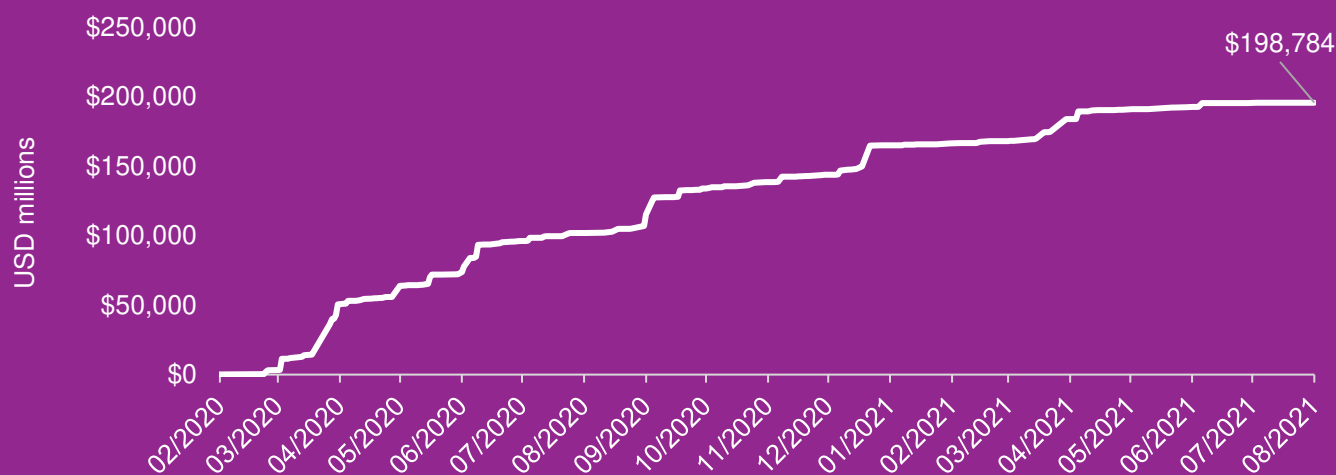


Figure 1. Confirmed state support for airlines, timeline to 30th September 2021. Source: Ishka research.

The International Air Transport Association (IATA) said in March 2020, as the coronavirus pandemic was shutting down society, that the world's airlines may need up to \$200 billion in government support to see them through the crisis (1). Then-IATA director general and CEO Alexandre de Juniac estimated last November that another \$70-80 billion would be needed to stabilise the industry before airlines would start making profit again.

That forecast has proved to be relatively accurate so far. Governments around the world have provided more than 230 airlines with \$198.78 billion in state aid since the start of the pandemic, according to Ishka data (2). Ishka predicts that the figure could soon surpass \$206 billion, but there are indications that the industry is recovering, with some airlines beginning to turn a profit again.

Even though many economies have started to open up again, having vaccinated much of their population and driven down COVID-19 fatalities, airlines in these countries are still asking for bailouts to make up for their lost business.

For example, in an interview with Portuguese magazine *Sábado* in late September, Portugal's finance minister João Leão said that the

government plans to inject a further €990 million into state carrier TAP in 2022, an amount already provided for in the next national budget. In 2021, the government injected €970 million into the Portuguese carrier, which is looking to restructure to adapt to the pandemic (3).

Qatar Airways said on September 27 that it received \$3 billion in state aid to weather the travel downturn, after it reported an overall loss of \$4.1 billion for the year to March 31. Last year the airline parked 10 of its A380s as the pandemic pummelled the industry and said it would only use five of them once they returned to service.

State bailouts are likely to continue until the sustained profitability returns. A study by Ocorian released in May (4) found that 81 percent of capital markets investors expect to see more regional carriers receiving government bailouts, while 74 percent expected more state bailouts of national airlines. Of the respondents, 57 percent predicted the sector will be targeted by private equity as a recovery play, leading to additional M&A. As well as state support, airlines will need private sector funding, and, with many of the banks not closing many aviation finance transactions at the moment, private equity will likely fill the void.

The report envisions cash rich, state-sponsored carriers as potential buyers of smaller airlines that need financial support, as well as private capital funds. Airlines may also have the option of raising capital against alternative assets like aircraft, engines, hangars, and landing slots.

## Where is the aid coming from?

Governments all over the world have been helping their carriers. In the United States, airlines avoided bankruptcies and cuts with some \$74 billion in government COVID-19 aid.

Airlines received the aid from three measures, including the Trump administration’s CARES Act and the Biden administration’s American Rescue Plan, to bolster their balance sheets and to retain staff.

Data collected by Ishka up to September 30 found that the North American governments gave the most aid to airlines during the pandemic, contributing \$93.4 billion since March 2020. European governments came second, altogether giving at least \$50.2 billion, whilst Asia-Pacific came third, earmarking \$40.8 billion.

Latin American and Caribbean governments provided the smallest amount of state support, with only \$380 million in total. This was followed by African governments contributing \$3.7 billion to airline bailouts and Middle Eastern governments allocating \$8.27 billion. Looking at the individual airlines and governments involved, it is clear that many carriers in wealthier countries had access to state aid, while carriers in the poorer countries often did not.

## Airline state aid by region

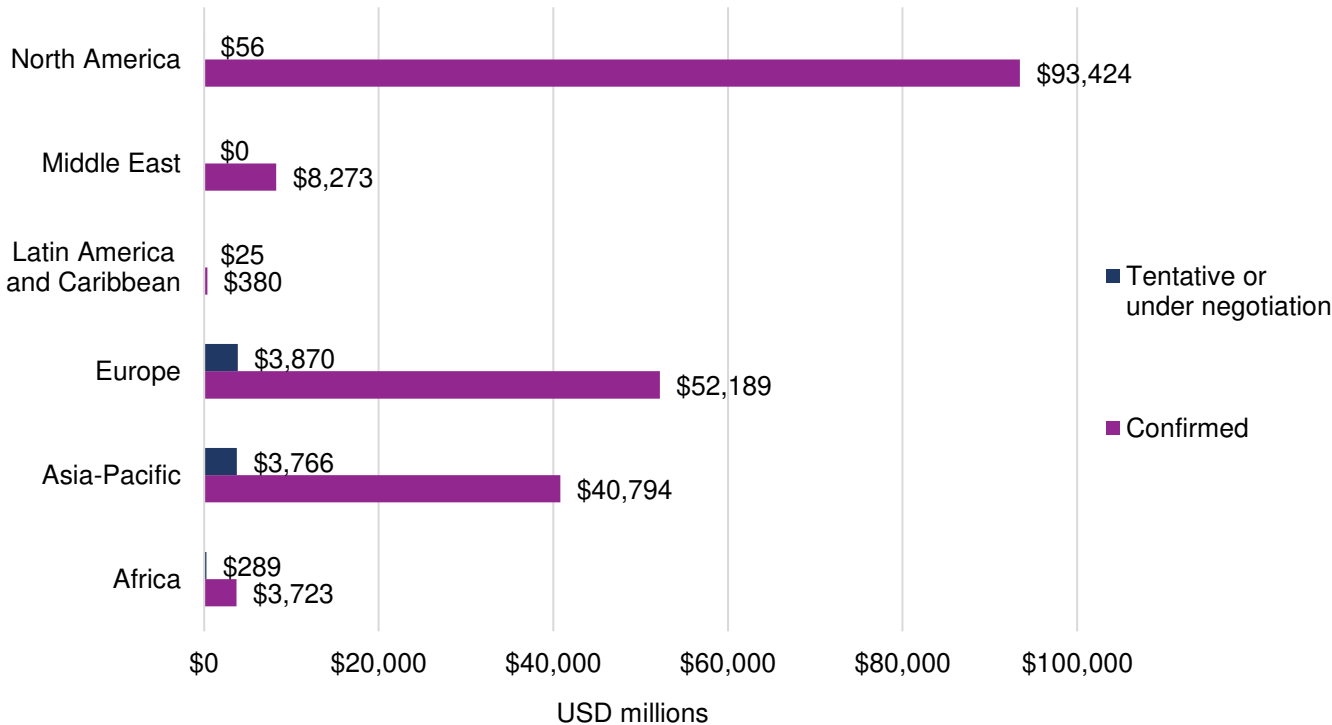


Figure 2. Covid-19 airline state aid by region (updated 30th September 2021). Source: Ishka research.

# What does the state aid look like?

State aid can take on different forms. According to Ishka data, 48 percent of state aid since the start of the pandemic (\$94.82 billion) took the form of debt, 27 percent was categorised as grants/other (\$52.64 billion), 18 percent took the form of equity (\$35.99 billion) and 6 percent (\$11.01 billion) was hybrid financing. A further \$2.32 billion or 1 percent, took the form of tax/fee waivers.

Before the pandemic, many governments were attempting to relinquish control of state carriers, but they have since gone back to increasing their airline ownership. For example, September was a crucial month for Italy’s flag carrier Alitalia, which has been beset with financial difficulties for years. On September 11, the European Commission founded Italia Trasporto Aereo (ITA), a new state carrier that will take over Alitalia’s assets. ITA was set up to give the carrier a fresh start, and get around the issue to Alitalia having to repay illegal state aid and to allow the EC to inject €1.35 billion (\$1.59 billion) into ITA by the state “in line with market conditions”.

During the pandemic, many airlines have had to cut capacity and rethink their fleets to raise capital. Having to pay off loans on an aircraft that spends almost all its time on the tarmac is not good business. Fleet downscaling by many airlines will have a long-term impact on the market, changing the operation of carriers and the way investors view them.

This industry-wide retrenchment of fleets will present both challenges and opportunities for lessors. For example, ITA plans to operate a single fleet of Airbus jets – on October 1 the airline announced it would buy 28 jets directly from Airbus and acquire another 56 aircraft from lessors. Thirty-one of the leased aircraft will be leased from Air Lease Corporation but the other 25 have not been finalised or publicly announced (5), giving other lessors the opportunity to place their aircraft with the airline.

*It is likely that the industry will see more bailout agreements with climate conditions in the future.*

## Forms of COVID-19 state aid

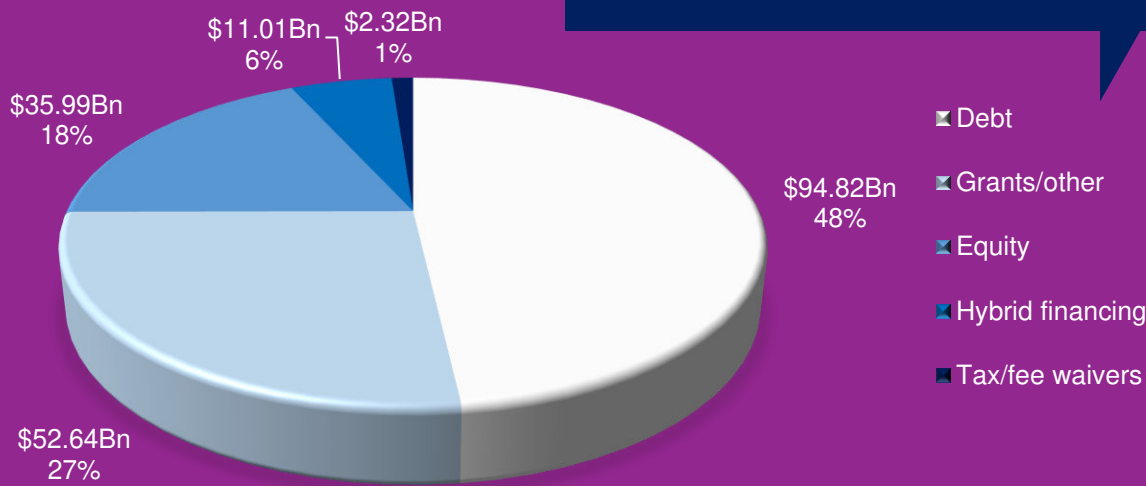


Figure 3. Forms of Covid-19 airline state aid (updated 30th September 2021). Source: Ishka data.



# Bailout conditions

Some of the government airline aid deals seen over the last two years have come with strings attached, such as the state taking a portion of the equity of the airline. Air Canada managed to make a \$5.9 billion deal with the federal government consisting of low interest loans and the government taking a \$500 million equity stake in the carrier. Another condition that is often stipulated in such deals is using some of the money to guarantee refunds for customers whose tickets were cancelled due to COVID-19 travel restrictions.

In Europe, labour and environmental concerns are high on the political agenda. Yet despite European lawmakers making a lot of noise about climate change, binding climate conditions attached to government bailouts are still rare. However, there is increasing pressure from climate activists over how airlines are being bailed out by governments, with many demanding that there be environmental conditions stipulated as part bailout loans. Moreover, long-haul flight emissions are not regulated and there have been campaigners that have pushed for taxation of airlines' emissions beyond international borders.

**Given global commitments by governments towards net zero emissions, such as the European Union's pledge to get there by 2050, it looks likely that the industry will see more bailout agreements with climate conditions in the future.**

Long-haul and flag carriers have tended to receive the most generous bailouts. The big three U.S. airlines — American, Delta and United — are the airlines that received the largest government bailouts since March 2020, according to the Ishka data. American received around \$20.34 billion, while United received \$18.39 billion and Delta received \$11.9 billion. In Europe, Air France received the most state aid with \$9.05 billion and Lufthansa received the second most, with \$7.74 billion.

Some governments have been less lenient on airlines when it comes to financial aid. Canadian low-cost carrier WestJet said in July that after months of negotiations, it officially ended talks with the federal government about an aid package to help the airline during the pandemic. The airline made a statement the day after Canada's government announced plans to reopen the border to fully vaccinated U.S. citizens from August and to other international vaccinated travellers from September.

Kenya Airways has also had a recent request for aid rejected. It had its Kshs 55 billion (\$500 million) aid request rejected by the country's treasury, allAfrica reported on September 11 (6). The airline's chief executive Allan Kilavuka said in March that the government — the airline's main shareholder owning 48.9 percent of the business — has only provided Ksh25 million (\$227,270 million), since the last financial year. In 2020, Treasury Cabinet Secretary Ukur Yatani said the government wanted to fully renationalise the airline, which would provide a long-term solution for the carrier's financial challenges. However, moves to approve this in parliament have been stalled as other domestic issues took priority.

## Flag carriers received the largest bailouts

<b>\$20.34Bn</b>	<i>American Airlines</i>
<b>\$18.39Bn</b>	<i>United Airlines</i>
<b>\$11.9Bn</b>	<i>Delta Airlines</i>
<b>\$9.05Bn</b>	<i>Air France</i>
<b>\$7.74Bn</b>	<i>Lufthansa</i>



# Level playing field

Of course, the question of financial support is at the centre of the level playing field debate that we have seen across the industry for decades. Over the years, U.S. and European airlines have tried to lobby their governments for more state support, complaining that the big three Gulf carriers — Emirates, Etihad, and Qatar — had received more state help, giving them an unfair competitive advantage. Given European and North American airlines have been the biggest beneficiaries of state aid during the pandemic, it seems unlikely that this argument would hold the same weight now.

Governments also have domestic and international competition at airports to think about. Many of the airlines that received the highest amounts of state support over the pandemic, such as Air France, have had to cede some airport slots in return for aid, so as not to create an unfair competitive advantage. The carrier gave up 18 daily slots at Paris-Orly (7), a congested airport where Air France has considerable market share. Other airlines can now access these slots, creating more choice and competitive prices for consumers.

## Recovery signs

Although the pandemic has dampened demand and forced many carriers to re-route, reduce their flying frequency and terminate leases early, the low-cost carrier model looks like it will continue to be a success after the pandemic.

GlobalData predicted in February that low-cost carriers will lead the post-COVID recovery in the aviation industry due to their aggressive cost cutting, giving them a larger price advantage than pre-pandemic (8).

The data company said the pandemic had heightened concerns over consumers' personal finances, with 87 percent of GlobalData's COVID-19 recovery survey saying they were 'extremely', 'quite', or 'slightly' concerned about their personal finances. Low-cost carriers (LCCs) can offer competitive prices and often undercut the legacy carriers on shorter routes, giving them the advantage with consumers.

Through the crisis, LCCs have shown a high degree of flexibility and ability to re-route their networks in accordance with travel restrictions. For example, Wizz Air quickly added capacity from the UK to the Canary Islands in September last year, a month before the Spanish islands were added to the travel corridor list.

The GlobalData survey noted easyJet's sale-and-leaseback agreements struck during the pandemic have given the airline a high degree of fleet flexibility, following their previous focus on unencumbered assets. Having more unencumbered assets makes it easier to raise money in the capital markets at low rates but can offer less fleet flexibility during a pandemic. The sale-leasebacks for easyJet put it in a much stronger position than legacy carriers that have retired aircraft in their fleet, the survey said.

Some airlines are beginning to turn profits again as the industry begins to come out of the worst of the crisis. In the U.S., both Delta and American Airlines posted profits for the second quarter of the year, their first profits since the start of the pandemic. However, the \$1.5 billion federal stimulus money helped propel the two carriers to profit, showing that despite signs of promise, the industry is not completely out of the woods yet.

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