Grant Thornton

Aviation

Global

Trends

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 levels[1]. 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 billion[2], 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 financers. 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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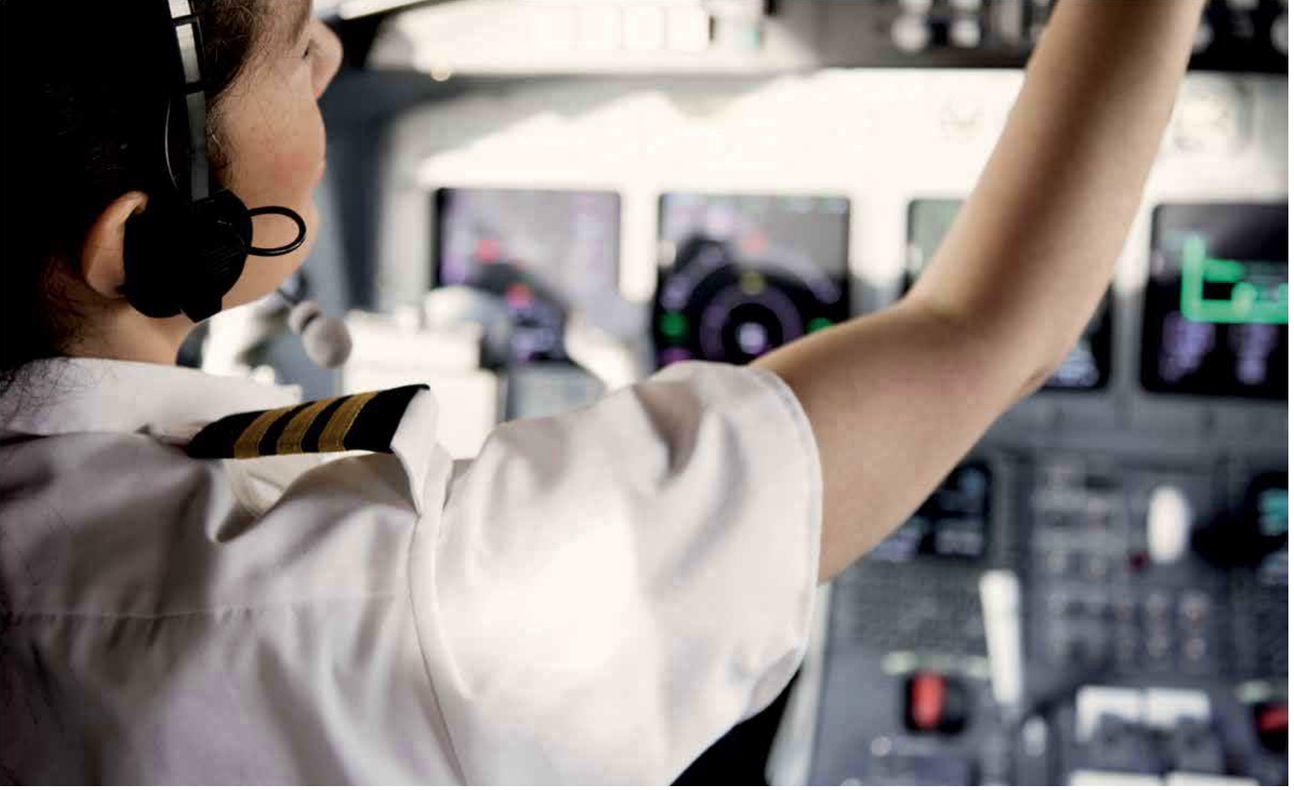
New digitalised target operating models connected with travel companies can better manage aircraft fleet and capacity utilisation, as well as ticket pricing. Such models can also give oversight of the amount of risk exposure taken as a result of air fuel and hedging positions.



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

Assess	Protect	Restore

Liquidity, refinancing and communicating the plan

- How much time does my business have before covenants are breached/liquidity runs out?
- How can I effectively manage liquidity, what sources of short-term finance/funding are available? What options are available to restructure my existing debt obligations?
- How can pinch points like rental/lease payments and debt service/repayments be managed/ negotiated?
- What sources of finance are available (including government support) and how do I access them at speed and at the right price?
- What is the turnaround plan and how can this be best positioned and negotiated with my stakeholders?
- What is the right communication strategy for my people, customers, suppliers and financial stakeholders?

Taking advantage of opportunities

- Are there any attractive investment opportunities driven by market conditions?
- How can I position myself to be ready to take advantage of these opportunities?
- What were the lessons learned in 2020 and how should I reset my longer term strategy to address the opportunities to deliver sustainable growth?
- What capabilities or presence do I need to acquire into my business?
- How can I transfom the old business model, such as changing into a new digital mobility network services model, simultaneously reducing CO^2 emissions and so meeting key customers' sustainability concerns?
- Who do I need in order to create new mobility network business models?
- How can I create highly individual travel and mobility solutions and experiences?

Operations and performance improvement

- How will I restart operations effectively and attract business?
- How can I retain the people critical to my business?
- How can I make the business as operationally efficient as possible given likely passenger numbers and overcapacity in the short to medium term?
- How can frequent-flyer programme claims be efficiently restructured along with the need to focus on profitable fleet management?
- How can I align landing slots to more flexible customer behaviour and focus more on profitable destinations?
- How can I reduce operating costs, such as manual onboarding and identification, by using video identification solutions?

Governance, risk and compliance

- How can the brand's reputation be protected?
- How do my corporate governance structures need to change to account for new stakeholders, such as government bodies?
- To what extent can and should I, as a governmental shareholder, introduce programs (such as CO^2 reduction programs) by not infringing fundamental corporate law principles?
- How can I ensure compliance with flight licenses?
- What risk does the 'new normal' for working remotely and delivering services bring to the business?
- Is my cybersecurity strategy robust?

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.

Our solutions

Aviation business model transformation

We provide comprehensive business model transformation consulting, unlocking the potential of digitaliised mobility network solutions for the increasingly important customer segment GenZ.

Operational and financial restructuring

Our multi-disciplinary operational and financial restructuring specialists provide support to realise significant business process improvement, implement new rapid target operating model alignment, operational simplification and delineation, divest non-core businesses and design new capital structures aligned to the dynamics of the business. Our experience also includes design and implementation of leasing platforms and pricing processes.

Contracts management data quality review

Our team has reviewed over 1,000 lease contracts and associated operational data. We use our expertise to provide assurance over the data in your CMS and reduce exposure in divestment and default scenarios. Our CMS experts are familiar with contract documents, complex cross-border financing arrangements including OTC derivative structures and hedging, technical documents and AerData's CMS, AMT Sybex's Leasepoint and proprietary systems.

Debt advisory

We provide specialist advice on the raising and refinancing of debt, including Asset-Backed (including landing slots) Securitisation. Through our deep understanding of the international funding landscape, including its local regulatory frameworks, and detailed knowledge of the credit process, we devise tailored funding solutions as part of a sustainable capital structure in line with the strategic ambition of our clients.

Exit strategy services

We apply a tailored methodology and fully project-manage and implement the sale or closure of underperforming or non-core corporate entities at maximum value.

Aviation financial modelling

We use a best practice, standardised approach for our model build and review engagements. Our deliverables are robust, well-structured and easily understood. Our team has the technical expertise and industry experience to provide transparency on maintenance-related cash flow forecasts, liquidity forecasting models, calculation of intangibles, lease, buy or hold analysis, transfer-pricing models, fleet analysis, optimum fleet deployment analysis and securitisations. We have developed AI technology which can be deployed for COVID-19 real-time AMT management and risk modelling.

Valuations to support financial reporting requirements, lending decisions and other transactions

We provide valuations to support asset-backed financing, including valuing shares and intangible assets, and provide periodic valuations of assets to confirm that the terms of the loan agreement continue to be met. For mergers, acquisitions, restructuring and proposed financial structures, we provide an independent view on value, delivering robust advice within the constraints placed by the deal deadlines.

M&A support

We provide advice and manage transactions associated with the acquisition or disposal of distressed and non-distressed assets or businesses, frequently to short timescales. Our team helps businesses navigate complex transactions – whether buying or selling, restructuring or providing capital solutions – always with competence, speed and agility. From deal strategy and valuation, to evaluating the financial, IT, tax, commercial and operational issues affecting performance and identifying strategic alternatives, we address concerns, manage risk, support the structuring of the purchase agreement and help our clients seize opportunities.

Asset recovery and tracing

Asset recovery and tracing normally form part of formal insolvency processes such as liquidations, or are carried out in support of ongoing litigation or fraud investigations. We use specialised approaches to identify and recover misappropriated assets, including those held in offshore trusts, to provide cost-effective value recovery.

Business process and back office outsourcing, and Shared Service Centres

Increasingly, large organisations are looking to fully outsource their transactional end-to-end finance and accounting processes, leaving them free to focus their finance resources on important strategic business value. We typically commit to reduce costs and/or improve productivity and quality. We advise on optimising finance and accounting processes, and can take our recommendations through to implementation, whether this involves building a full-scale Business Process Outsourced delivery capability or setting up a Shared Services Centre.

We also provide outsourced accounting, payroll, human resource and tax services to domestic SMEs or local branches of international organisations. Our services are managed centrally to deliver a consistent experience for our clients, however widespread their operations. We use innovative technology to give our clients access to their data; the same technology gives our clients access to new, cost-effective offshore platforms.

Corporate insolvency

Where a business cannot be saved or where a formal insolvency process is required to affect a restructuring, we provide advice and support to distressed companies, their creditors and other stakeholders in order to protect assets and maximise recoveries. In some situations, we take on the role of Chief Restructuring Officer.

Pension schemes solvency

In many parts of the world, we offer a specialist capability to advise corporates and trustees on the solvency of pension schemes.

Enterprise risk management

Our enterprise risk management (ERM) specialists help organisations implement the leading approach to managing and optimising risk. We are able to tailor the approach to our client's individual challenge and create bespoke strategies that work, enabling them to strategically identify, analyse and monitor potential risk to their organisation.

Global compliance partnering

Our global compliance partnering solution delivers all local statutory financial reporting, centralised statutory audits, tax compliance, payroll administration and local country filings for multinational organisations through a single point of contact. We are the leading adviser to dynamic organisations delivering solutions that improve reporting efficiency and enhance risk management. Providing full transparency, real-time monitoring and highlighting upcoming deadlines, we enable local and central management teams to ensure full compliance at all times.

Cybersecurity

Our cybersecurity solutions are designed for clients seeking to address a variety of complex security requirements. We can help organisations assess their security vulnerability, establish or improve their IT security processes and remediate breaches or compliance failures.

Financial reporting advisory

We provide clear and practical solutions to address complex accounting and financial reporting issues. We support businesses in navigating the accounting and reporting of government stimulus packages. We're also able to help navigate the accounting and reporting of complex areas including leases, impairment and going concern.

Restructuring tax

Our restructuring tax teams specialise in providing tax advice in all aspects of restructuring scenarios. In particular, this includes advising on the tax aspects of:

- independent business reviews, options reviews and contingency planning
- business restructuring, e.g. debt restructuring
- mergers and acquisitions
- disposals of trade and assets or wind down of businesses
- corporate insolvencies
- fraud investigations.

Credentials

In this section, we share examples of relevant credentials from member firms in the Grant Thornton network.

Financial restructuring

Client business description: Two connected and internationally operating European airlines including subsidiaries in the fields of aviation, aircraft maintenance and in-flight catering. They were hit by substantial economic disruption, high debt and overcapacities which resulted from previous acquisitions. A group insolvency was imminent.

Engagement description: Grant Thornton experts acted as the key turnaround manager and brought in strategic, restructuring and aviation operational expertise. Grant Thornton also acted as debt restructuring advisors and negotiator with many international stakeholders, including: governmental bodies and regulators, shareholders, bondholders, aircraft investors and lessors and the trade unions. The goal was to rapidly stabilise the balance sheet and to enable a prudent restart.

Challenge: The engagement was under immense time constraints and public as well as governmental pressure was continuously increasing. Insolvency threatened on a daily basis.

Solution: Our passionate team of experts brought in their long-standing operational aviation expertise and ran an agile, holistic approach covering: financial consulting, audit and tax advisory, finance and capital markets advisory, banking and air law advisory with an initial key focus on liquidity and financial instrument restructuring.

Our specialists significantly reduced the exposure of jet fuel hedging transactions and ensured constant fuel supply for smooth operations. They also restructured intra-group OTC derivative hedging and guarantee schemes and established a less risky balance sheet. Our experts also established landmark innovation for immediate airport slot securitisation, cut the cost of flight routes and reorganised slots under EASA, ETOPS, FAA, IATA, WSG's or ICAO and local airport and aviation regulation. To mitigate intra-year volatilities and market risk, aircraft were transferred to a secondary white label market operator applying securitised wet-lease agreements.

As a mid-term solution, Grant Thornton successfully separated the cargo and in-flight catering activities, partially with a blind auction bidder processes. In addition, Grant Thornton helped to reorganise and adjust the mid- and long-term business and target operating models.

Outcome: Grant Thornton substantially healed and stabilised the short-, mid-and long-term balance sheet and helped to avert insolvency. From this basis the client was able to successfully refocus its brand and could start over with a technically efficient fleet and efficient leasing arrangements.

Aircraft fund restructuring

Client business description: Leading European aircraft fund for institutional and private investors with long-term leasing scheme arrangements with global business carriers for high SMO aircraft.

Engagement description: The engagement arose as a result of airlines not being able to reach the expected RPM and the fund for private investors being impacted by a NAV downturn with the risk of closure and liquidation. Grant Thornton's specialists advised the fund in air law, leasing and structured finance restructuring within the aviation and financial markets multi-jurisdictional regulatory frameworks. Our experts also advised on civil laws and regulatory driven litigation, and have undertaken a supervisory risk analysis. In addition, Grant Thornton supported the design of a structured framework for careful and transparent investor communication.

Challenge: In a short timeframe, various laws and regulations had to be reviewed and translated into robust fund administration processes. This work drove the need for various operational changes. Detailed instruments for 35 key jurisdictions also had to be reviewed for litigation risk.

A further challenge was designing a sustainable restructuring plan which met both aviation and financial markets regulation; this included negotiation with various aviation and financial market regulators acting in different jurisdictions.

Solution: Deploying Grant Thornton's global network and our dedicated multi-disciplinary aviation and financial market experts, we rapidly established fund restructuring solutions which were accepted by the airlines and the regulators. Broad regulatory management experience formed the basis for trusted and forward-looking negotiations which brought recovery for all stakeholders. In addition, this enabled our experts to identify and propose the most effective structures for adjusting the SMO and recovering the RPM based on a newly agreed leasing and operating model.

Outcome: We quickly helped our client to initiate valuable negotiations with all stakeholders and establish a model for assessing the impact of changes to the aircraft and route profile. As a result, our client extended their timeframe and mitigated the impact of financial loss, this being the basis for long-term financial recovery.

Pricing model for acquisition of aircraft

Client business description: The client was an established aircraft trading and leasing company that specialised in narrow-body mid-life aircraft. The company have been actively looking to expand and rejuvenate its fleet.

Engagement description: Our multi-disciplinary aviation team was requested to produce an aircraft pricing model on an Excel platform based off the company's operations and processes.

Challenge: The model was to produce an IRR based off the assumed aircraft purchase price and lease attached to the aircraft. As well as this the model had to use fly forward analysis to predict the maintenance condition of the aircraft upon lease end and thus the metal value of the aircraft on return, along with the functionality to adjust the IRR should the lease be extended at the lease end date or should the aircraft be sold. Detailed cash flows and debt payment schedules also had to be included.

Solution: Key attributes of our Aviation Advisory modelling team include understanding of opaque areas such as maintenance reserves, reimbursements and redelivery conditions as well as a deep knowledge of contract and technical documents. This meant we could produce a model that could overcome the challenges presented to this company and see potential pitfalls before they arose during the model build process.

Outcome: Assignment ongoing.

Aviation network and operations optimisation

Client business description: A leading European airline which was faced by network failures and increasing incident management costs including cost intensive on-ground support and replacement bookings at key hubs. This was aggravated because the client was seeing increased levels of route losses following increased competition from low cost carriers in the intra-European shuttle market.

Engagement description: Grant Thornton's multi-disciplinary aviation team was asked to support our client's specialists in remodeling the aviation network; looking to optimise the key hubs' routes and on-ground operations. The engagement was intentionally designed as a mixed-team programme in order to effectively capture historic flight data and experience.

Challenge: Grant Thornton's experts had to rapidly integrate with the client's teams to support in the assessment of future passenger number projections and the design of an optimal operating model.

Solution: Alongside the management team, Grant Thornton developed new network, LTO, and RPM modelling based on AI based predictive analytics and forecast PROS. Our experts successfully supported the client in implementing an aggressive operational restructuring, in time for an impending slot re-allocation, delivering the right fit of ground-handling and hub operational design.

Outcome: Through team integration and the provision of embedded subject matter experts, Grant Thornton were able to effectively analyse numerous scenarios. We delivered strong expertise which enabled the airline to strategically push a new RPM model which generated higher margin on competitive routes.

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

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