



Asset Management

Aviation Newsletter – Q3 2019

Aviation Highlights for Q3 2019

- The Boeing 737 Max continues to make headlines as Boeing continues to work on a solution. Boeing is still optimistic to finalise the approval process by the end of 2019 and deliveries starting again at the end of 2019/ beginning of 2020.
 - The airline sector has experienced further defaults in Q3 with heavyweights like Thomas Cook and smaller airlines like XL Airways and Aigle Azure in France.
 - Airline stocks increased in Q3 again after a slight dip in August, back to the level of the beginning of the year; the Kerosene spot prices decreased with slight fluctuations, and general economic uncertainty remained comparably high.
 - Passenger numbers grew below the long-term average and load factors have decreased from their record highs.
 - Prime Capital was able to close USD 50m to aviation debt in the third quarter. The underlying airlines are based in Asia, Africa and Europe, with spreads between 210 Bps and 260 Bps (over USD swap).
- ➔ **Conclusion:** The continuing downward trend of passenger growth reflects the current uncertainty in the economic and political environment. In the liquid market spreads have already further widened, as spreads in the illiquid loan market also start to pick up. We are still seeing, a divergence between airlines perceived to have a better credit and airlines which might have a weaker financial position. This has led spreads to increase for assets with Tier 2 or 3 airlines, still providing high quality collateral. We currently see a generic spread for a narrow-body loan around 240 Bps.

Prime Capital's Aviation Track Record**Q3 Summary**

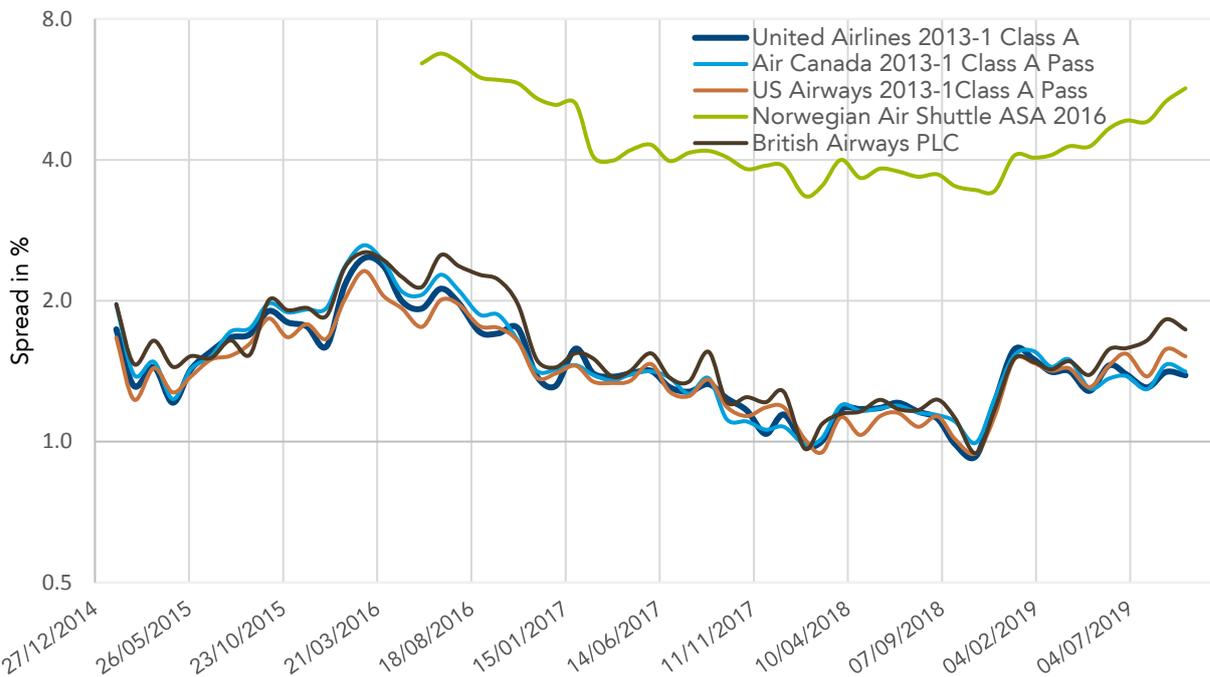
The airline sector did not calm down in the third quarter of 2019. This included the ongoing crisis at Boeing, which also now extends to some of its NG models as well as further bankruptcies in Europe. In September and October three further airlines had to declare bankruptcy, XL Airways and Aigle Azur in France and most notably the travel group Thomas Cook in UK. The Thomas Cook bankruptcy has been called the first casualty of Brexit and has dragged its airline subsidiary with it. Its German subsidiary Condor, received a bridge loan from the German government of EUR 380m and will continue operations. According to market sources the aircraft fleet of Thomas Cook Airlines comprised of 27 Airbus A321 and 7 Airbus A330 was absorbed by the market within days. Boeing has to deal with yet another issue concerning the B737 NG model, i.e. the predecessor of the troubled 737 Max variant. On some of the aircraft structural cracks on the wings have been discovered, which will have to be repaired outside of the regular maintenance cycle. IBA estimates the repair to cost about USD 250k with a downtime of six weeks for each aircraft. The 737 Max grounding is still ongoing, but Boeing seems to be optimistic, that the aircraft will still be recertified in 2019. Also the major airlines using this model have not yet amended their flight schedules further than the End of Q1 2020. Boeing was actually able to show a profit for the Q3 2019, despite lower than expected deliveries. Some airlines have already announced, that they intend to claim damages against Boeing for the downtime of their B737 Max. Norwegian has made recent headlines as the airline yet again struggles with liquidity issues. Boeing received further bad news in Q3 as the planned joint venture with Embraer will likely be further delayed due to anti-trust investigations by European Authorities.

Sustainability has also been widely discussed in the industry, from the consumer side as well as from the airline side. Airlines acknowledge the increasing awareness of passengers in times of "flight shaming", which is a common topic in Northern Europe. The industry has picked up on the topic and is actively working on solutions. CORSIA the carbon offsetting scheme by ICAO (International Civil Aviation Organization) has been further progressed, this however only covers international flights. Some countries have presented their own concepts this year for example the German Umweltbundesamt.

Financing Terms

EETC* spreads overall for major airlines slightly increased by 8 to 14 Bps in Q3. However, Norwegian spreads increased significantly due to concerns regarding the rapid expansion as well as the increased input costs. Norwegian is continually struggling with its large order pipeline and increasing input costs. Norwegian negotiated a bond restructure in Q3 to enhance its liquidity. In the loan market, spreads have slightly widened especially for lower tier credits. Nevertheless the spreads in the illiquid market still provide a premium of 50 Bps to 100 Bps compared to EETC's.

EETCs Spreads



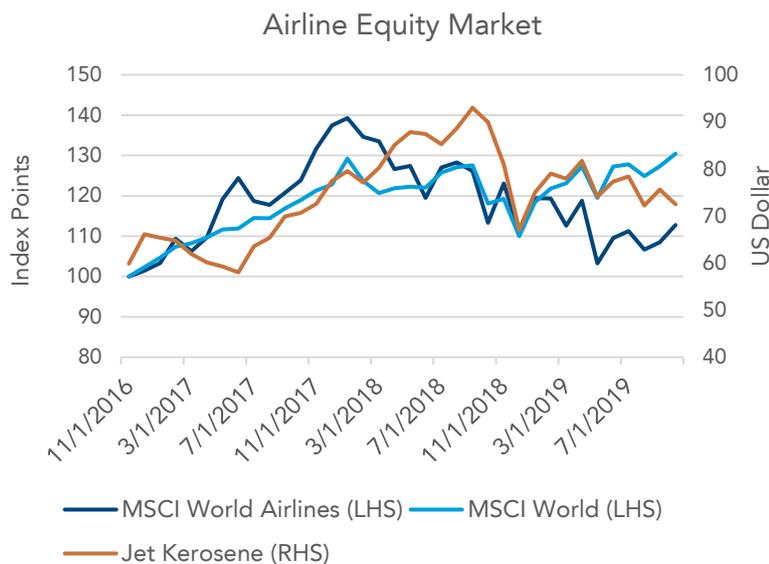
Source: PCAG Research based on Bloomberg Data / the spread is calculated as the difference between the yield and the respective Swap rate

* EETCs are publicly-issued bonds, with full recourse to the airline and backed by liens on a portfolio of aircraft

Airline Market

The preliminary Q3 2019 airline financial data gathered by IATA confirms a steady development in earnings on a global basis. Global airline share prices climbed in Q3 by 1.3%, while global equities have been up 2.1% over the same period. The third quarter was marked by improved profit margins and raised prospects for earnings in Europe and Asia-Pacific. Contrary, airline financial Q3 results worsened in North and Latin America. However, even though

Jet Kerosene prices decreased further, looking forward rising costs are the main concern and this is expected to put pressure on profits in the last quarter of the year.

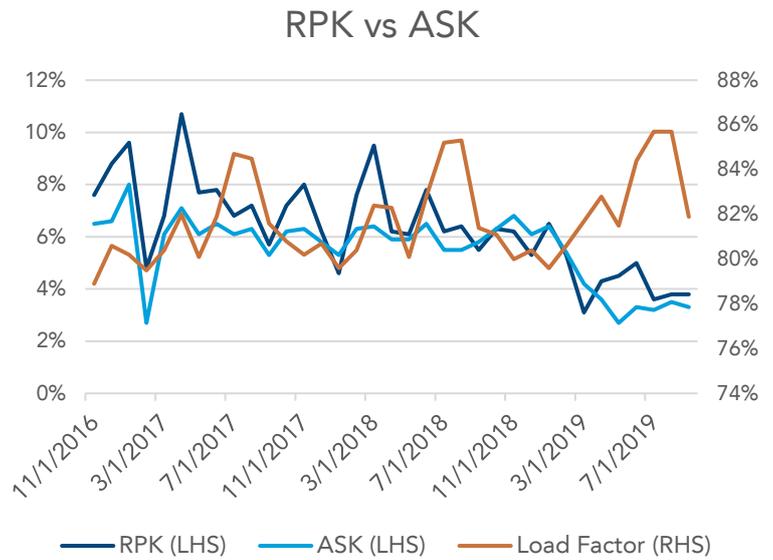


According to IATA, passenger yields increased slightly in August with the support of both economy and premium class. However, the global yield is still 2.7% lower compared to its level of a year ago. Due to the imminent impact trade uncertainties and adverse economic developments, premium cabin yields had been moving downward in the last four months. However, this was reversed in Q3, not implying that it is a trend change. Economy class yields also increased in Q3 by 0.4% continuing the trend of recent months.

Source: Bloomberg

Commercial Aviation

Global revenues passenger kilometers (RPK) measuring the total demand of passenger traffic, increased by 3.8% (y-o-y) in September down from 5.0% in June. The RPK growth is currently significantly below the 5-year average of 7% and also below the 10-year average. Available seat kilometers (ASK) increased by 3.5% year-on-year in September, while the load factor slightly decreased to 81.9% diverging from its all-time highs in 2018. The growth has significantly slowed during the past month, in line with economic expectations. IATA expects a growth around 5% for the year 2019. The annual growth is currently below expectations, but partially made up by the high-season contribution in the summer. The load factor has stabilized, likely due to further consolidation in the airline industry. Higher oil prices will cause further consolidation, due to competitive pricing and declining margins.



Source: IATA, Air Passenger Market Analysis Sep 2019, P.1. Available [here](#).

About Prime Capital's Private Debt Team

Prime Capital has been a pioneer in making aviation debt accessible to institutional investors and has since been expanding its Private Debt capabilities into Corporate Lending, Infrastructure and Real Estate financing and expects significant further asset growth in these areas.

Prime Capital's Private Debt Team manages more than EUR 2bn across these asset classes for institutional investors.

Further information about Prime Capital AG can be found on the web site www.primecapital-ag.com

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Source of Data (05 November, 2019): Prime Capital AG, Bloomberg, IATA, Airline Economics,

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