PRIME CAPITAL

Aviation Debt

Newsletter Q2 2021

Global Aviation Market Q2 2021 - Overview

> The airline sector recovered slightly during the first quarter of 2021. This is largely due to a rebound in domestic travel stemming from China. Bookings also increased, but the market remains bifurcated: Domestic travels gains faster traction than its international pendant.

> According to IATA, pre-COVID passenger levels are not going to be regained until 2024. But as the pandemic now is set to ease, most carriers are expected to turn cash positive in the second half of 2021.

> With Tier 1 carriers in Europe and low-cost airlines in the United States, players from both end of the spectrum returned to the capital markets for fresh funding during the quarter.

> The secondary market has become more active, especially around special or distressed situations, with debt exposure and claims being monetized and specialized investors taking advantage of the opportunity.

> Conclusion: The airline industry is optimistic about increased demand, even if it significantly lags pre-Covid levels. As noted above IATA has slightly revised its forecast and given the progress of vaccinations in Europe and the US expects some airlines to turn cash positive quicker. Senior spreads have slightly tightened due to intensified competition for good names and lenders willing to close new transactions. Deals for Tier 2 or 3 airlines continue to be rare while the market for Tier 1 names remains active. We currently see a generic spread for a narrowbody loan around 370 bps. Spreads for top names have further tightened. More complex structures still remain attractively priced, as lenders are mostly looking for standard structures. Alternative lenders are looking to take opportunity of the fact, that banks still remain cautious and may be limited in the risk they can take.

Aviation Debt – Market Summary

During the first quarter of 2021, a recovery in the airline sector could be observed. Passenger traffic slightly improved, but remained significantly below pre-COVID levels. This improvement is largely due to a rebound in domestic travel stemming from China, where COVID-19 restrictions have been lifted widely in late February. This is consistent with IATAs observations that a global pickup in bookings for domestic travel is recorded (QoQ: +30%). Nevertheless, their international equivalent remains stable at low levels. But the situation is set to improve. The jump in domestic bookings already indicates the strong pent-up demand in travel, but uncertainty and current restrictions hinder a further recovery into the summer. Once roadmaps for easing COVID-19 restrictions are set and proper policies implemented, we expect to see a similar jump in international bookings. Following recent news that the UK set out a way out of the lockdown restrictions, bookings from UK to Greece and Spain for the summer period more than tripled.

Financing Terms

Regarding financing terms, airlines have seen an improvement in the markets so far this year. The MSCI World airlines index has gained more than 20% since the start of 2021 (See Figure 2), supporting airlines' arguments in issuing fresh debt. Specifically for Q1 '21, Ishka finds that airlines globally successfully accessed the debt markets. Unsecured issuances reached USD 19.4bn, marking a QoQ increase of +83% and a YoY increase of +47%. Interesting deals include EasyJets USD 1.4bn issuance, oversubscribed and priced at a 1.875% coupon. Another deal was Wizz Air's USD 594m debut issuance paying 1.350% to investors. The low yields attained by EasyJet and Wizz indicate, that the available liquidity in the markets starts to extend towards the airline industry. In the future, we expect the market to remain fragmented. Strong Tier 1 carriers will continue to be able to command low spreads, while the rest of the market will be forced to pay heightened prices.

Compared to their pre-COVID levels, spreads for Tier 1 airline issuances remained on elevated levels. Figure 1 depicts this: QoQ figures slightly declined whereas the YoY increase amounts to +75bps. LTVs increased slightly. Liquidity needs are likely to be of lesser importance going forward, implying that Sale and Lease Back transactions will scale back in the months to come. But, given that airlines start to recognize that re-fleeting with the most environmentally friendly and fuel efficient aircrafts will be key to their long term success and future, there will be opportunities going forward.

This is supported by the fact, that banks retracted from the market, offering opportunities for investors, who are able to analyse asset risk appropriately. This is especially true for higher-LTV deals, as there seems to be a lack of supply for these tranches since the COVID-19 pandemic struck. Amongst others, alternative lenders stand ready to fill this gap.

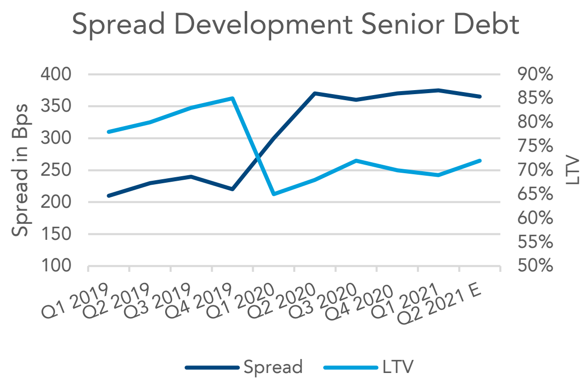

Figure 1, Source: Prime Capital Research

Lessors and remarketers show optimism to place more aircrafts on proper lease terms by 2022. As of right now, many lessors agreed to initial "power-by-the-hour" contracts for the next 12 months, which will return to normal conditions afterwards.

Airline Equity Market

Resurging COVID-19 cases throughout the winter substantially impacted Q4 '20 earnings of almost all airlines. This is evidenced by their share price performance which remains well below pre-pandemic levels. Furthermore, the gap between the sector and the global economy remains wide, as Figure 2 shows. But it should be noted, that the difference between airlines and the wider economy is not increasing for now. Instead, the MSCI World Airlines co-moves with the overall index, pointing towards a possible recovery. In fact, North American carriers already started to close the gap, as the vaccine rollout in the region gained pace.

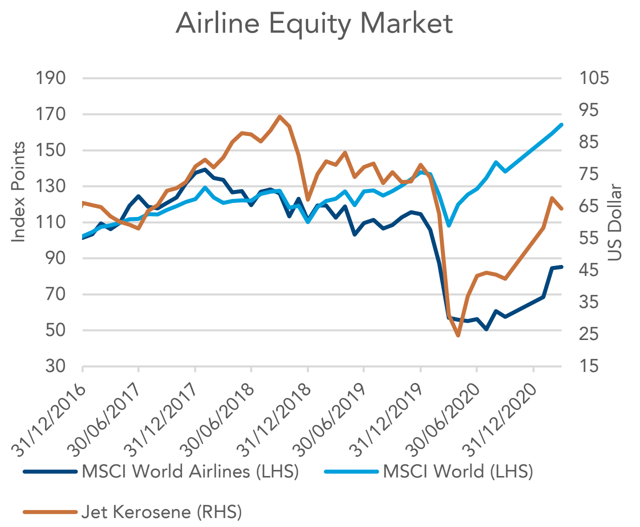

Figure 2, Source: Bloomberg

Fuel prices increased by more than +25% during Q1 '21, reflecting the increased activity across the world and approached their pre-pandemic heights. As long as the recovery of RPKs (Figure 3) remains subdued, heightened fuel prices will continue to pose a challenge on the bottom line of carriers worldwide – appx. 25% of airlines' OpEx are due to fuel.

Notable ECM activity during the quarter was limited to the North American market, further demonstrating its strong mix of government support (CARES act) and pent-up demand. On March 16th, Sun Country Airlines sold appx. nine million shares for USD 24, as Apollo took its former Portfolio Company public. Furthermore, March 31st saw the next ultra-low-cost carrier debuting. Frontier Group Holdings started trading at USD 19 per share on the NASDAQ.

Commercial Aviation

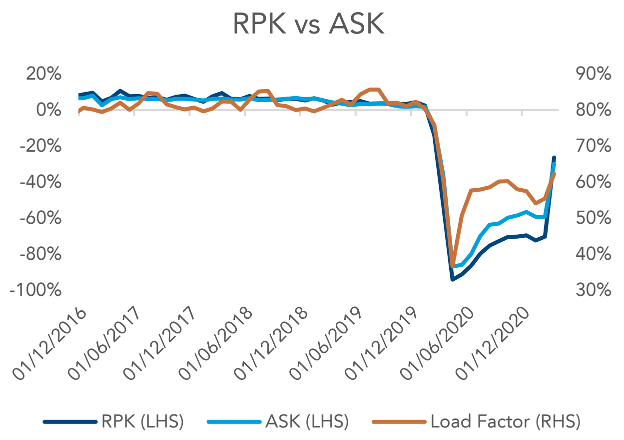

Figure 3, Source: IATA

Industry-wide revenue passenger-kilometres (RPKs) as an indicator for global passenger demand were 67% lower compared to their pre-crisis level in March 2019 whereas available seat kilometres (ASKs) are a bit more elevated at a decrease of -57% (See Figure 3). In terms of load factors, Q1 '21 saw a slight pickup of roughly +8%, compared to a YoY increase of +70%. As the outlook for the industry grew better over the last summer, the new wave of lockdowns during fall and winter left its mark on the figures. Nevertheless, the underlying trends remain slightly bullish as restrictions are set to ease soon. Albeit those numbers are rather weak, they still represent progress (appx. 5pp) compared to previous quarters.

Given IATAs forecast, we expect airlines to turn cash positive while RPKs and ASKs climb during the second half of 2021. Previously, market participants estimated the turning point in Q4 '21 but as the vaccine rollout across the world accelerates, this will probably arrive sooner than expected. Still, global RPK levels won't be regained until around 2024 – given that the full-scale deployment of COVID-19 vaccines will allow air travel to rise back substantially in late 2021 and in 2022.

New owner for Condor

Three months before the first COVID-19 case was reported in Wuhan, Thomas Cook filed for bankruptcy in UK and its subsidiary Condor was put up for sale.

In early 2020, Condor signed an investment agreement with LOT Polish Airlines. However, as every airline around the globe, LOT was heavily impacted by the COVID-19 pandemic and hence the deal was not finalised.

Condor was able to secure state support to stay afloat. In 2019, the airline received a EUR 380m bridge-loan from the German government to get through, the anyway tough, winter season. As part of general economic support during the COVID-19 pandemic, the airline received further EUR 550m, under the German COVID- relief programme. About half of which was used to pay back the initial bridge financing.

In November 2020, Condor secured creditor approval to execute its reorganisation plan exiting the protection, which had given it immunity from creditors' claims resulting from its parents company collapse in September 2019.

After more than one year of search for a new owner, it was announced in Mid-May 2021 that the British private equity fund Attestor has acquired 51% of Condor and will invest EUR 200m in equity. It was also announced, that Attestor will provide an additional EUR 250m for fleet modernisation. Condor currently operates a widebody-fleet of Boeing 757 and 767, with an average age of 22 years and 24 years respectively. The airline is evaluating options from Boeing's 787 to Airbus' A330. The remaining 49% percent of the airline will remain with a government owned vehicle for now. However Attestor retains the right to purchase the remaining share at a later date.

It is rumoured that Attestor was not the highest bidder and certainly not the one with the highest profile. Other bidders included Apollo and Bain Capital. However Attestor apparently was the fastest, also in terms of putting up the actual money.

The news came at the right time for Condor, as travel is starting to pick up again, the new money should help the airline to successfully ramp up operations and to profit from increasing demand.

The Condor deal shows that investors are actively back in the market, taking advantage of the still limited liquidity.

About Prime Capital's Private Debt Team

Our aviation team, which has been active in the Aviation Debt market for many years, has already carried out transactions of more than USD 1bln. The Private Debt Team additionally invests in Commercial Real Estate, Infrastructure Debt and Corporate Lending. We expect significant further asset growth in these areas, while providing satisfactory risk adjusted returns to our largely institutional investors.

Further information about Prime Capital AG can be found on the web site
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