



Asset Management

## *Aviation Newsletter – Q2 2019*

### Aviation Highlights for Q2 2019

- The Boeing 737 Max8 continues to make headlines as Boeing continues to work on a solution. Some airlines have taken the aircraft out of their schedules until the end of the year.
  - Airlines have been reducing their profit expectations and IATA is cutting the global forecast for airline profits by one fifth.
  - Airline stocks increased in Q2 again after a slight dip in May, back to the level of the beginning of the year; the Kerosene spot prices remained largely on the same level with slight fluctuations, and general economic uncertainty remained comparably high.
  - Passenger numbers grew below the long term average and have managed to outpace capacity growth, supporting high load factors across the globe.
  - Prime Capital was able to close and commit USD 25m to aviation debt in the second quarter. The underlying airlines are based in Asia, with spreads between 190 Bps and 210 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 currently 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 narrowbody loan around 230 Bps.

## Prime Capital's Aviation Track Record



## Q2 Summary

In the second quarter, aviation continued to make headlines in the press. In particular, the continuing grounding of the Boeing 737 Max8 has caused headlines. This has also been the main topic at this year's Air Show in Paris. At the Air Show, Airbus was able to book new orders and has taken over the title as the world's leading aircraft manufacturer from Boeing. However Boeing was also able to book a large order. IAG has placed an order for 200 B737 Max8 and Max10 aircraft, confirming the confidence of the industry, that the aircraft type will become a fixture in global fleets in the long term. In general, as expected, fewer aircraft were ordered compared to the previous year, which is the continuation of the trend since the beginning of the year and reflects the already large order books of the aircraft manufacturers. Boeing is working in parallel to solve the software problem of the B737 Max8. While the authorities are not committing themselves to a firm timetable, the airlines are currently expecting the flight ban to be lifted in autumn (October or November) or latest at the beginning of next year. Ryanair has decided to change the aircraft designation internally and now calls the aircraft Boeing 737-"8200" instead of "Max8". While the solution takes longer than originally anticipated, it is no surprise as regulators will not take any chance for another crash. The grounding has caused Boeings largest quarterly loss in history of USD 3.4bn, due to USD 4.9bn of provisions the company booked in anticipation of damage claims and other costs handling the B737 Max crisis.

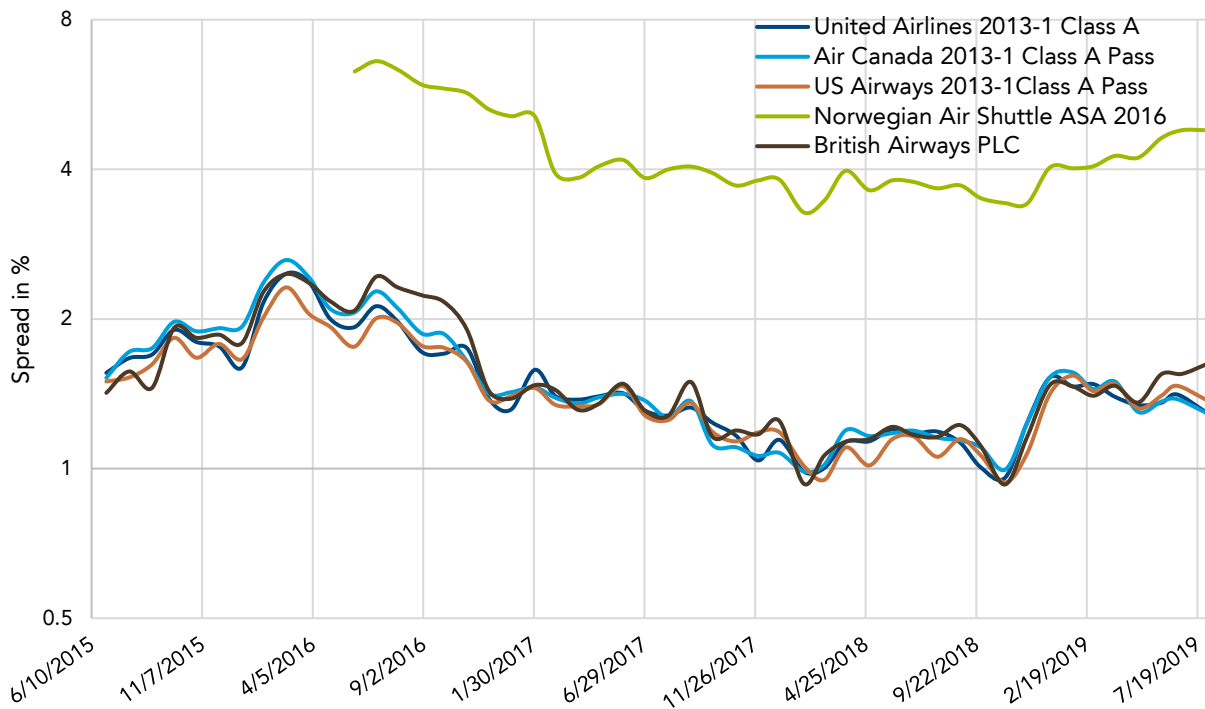
Several airlines have announced falling profits including Lufthansa and Ryanair. This is in line with IATA cutting its forecast for global airline profits from USD 35bn to USD 28bn. The main reasons being the continuing trade war between the US and China, as well as the continued grounding of the B737 Max8. North America is projected to be the most profitable region. Delta Airlines has even raised its profit outlook for 2019 due to strong demand.

Columbian Airline Avianca has caused headlines in Q2, as the airlines parent company defaulted on a loan it had received from United Airlines. As the loan had been secured with the shares of the airline, the default has caused United now being the majority shareholder of the airline. It seems, that the consolidation in the airline industry, which started in the US around 2011, now also happens across continents.

## Financing Terms

EETC\* spreads overall remained stable in Q2. However, Norwegian spreads increased significantly due to concerns regarding the rapid expansion as well as the increased input costs. Norwegian is still struggling with its large order pipeline and increasing input costs. This is exacerbated by its significant portion of B737 Max8 in the fleet, which are grounded for the time being. In the loan market, so far there are not many signs of spread widening, nevertheless the spreads in the illiquid market still provide a premium of 50 Bps to 100 Bps compared to EETC's.

### EETCs Spreads

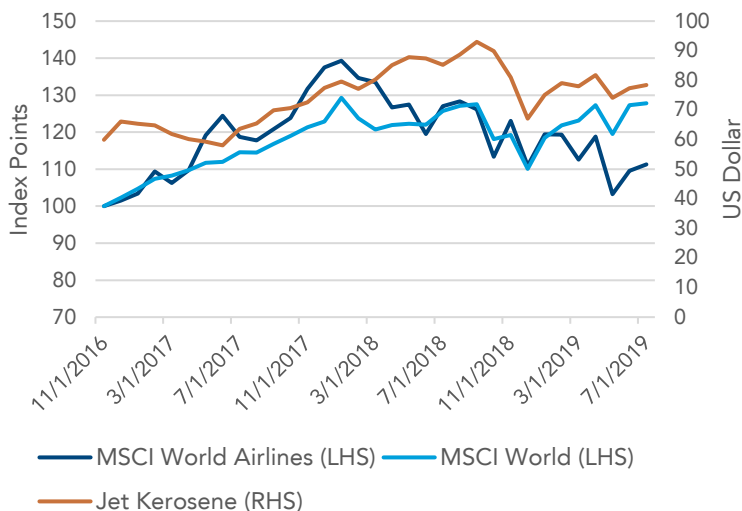


Source: PCAG Research based on Bloomberg Data / the spread is calculated as the difference between the yield and the respective Swap rate

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

### Airline Market

#### Airline Equity Market

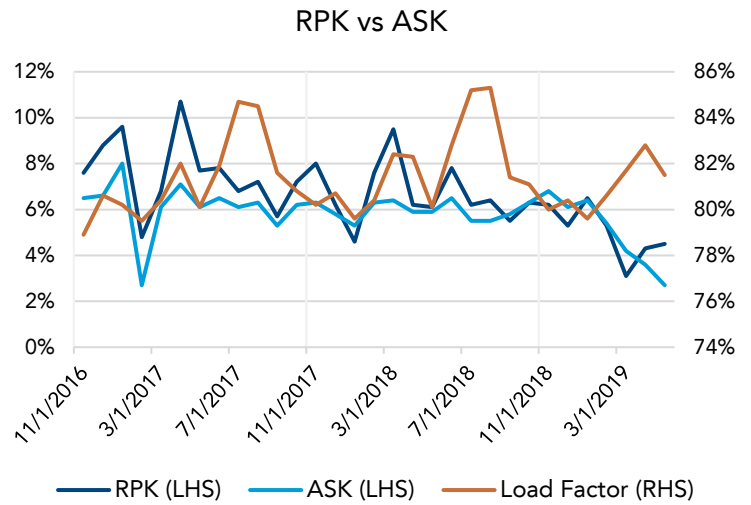


Source: Bloomberg

The preliminary Q1 2019 airline financial data gathered by IATA confirm a further decrease in earnings on a global basis. Global airline share prices recovered in June by 6.0% after a sharp decrease of -10% in May, while global equities have been up 14.7%. Q2 2019 began with better than expected profit figures and raised prospects for earnings in North America. While profitability in Europe and Latin America further declined. EBIT margins improved in Asia Pacific due to growing revenues and stable operating costs. According to IATA passenger yields have increased in April, the first time in four months, due to relatively stable passenger demand, which allowed the airlines to reflect at least some increased costs. It is important to note, that the global comparison masks the regional differences described above and is mainly driven by the US Airlines.

### Commercial Aviation

Global revenues passenger kilometers (RPK) measuring the total demand of passenger traffic, increased by 4.5% (yoy) in May up from 3.1% in March. 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 2.7% year-on-year in May, while the load factor slightly decreased to 81.5% which is still close the all-time highs in 2018. The growth has significantly slowed during the past month, in line with economic expectations. IATA expects a growth around 6% for the year 2019. The growth is currently below expectations, but the high-season in the summer is still to come. 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 May 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](http://www.primecapital-ag.com)

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Source of Data (08 August, 2019): Prime Capital AG, Bloomberg, IATA, Airline Economics,

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