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Week of 28th March-2022 : Airline Situation Report.

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AIRLINE SITUATION REPORT

Week of 28th March 2022

This report is the seventy-fourth in a series of supplements to Ishka's Airline Credit Profiles (ACP) subscription-based service. It delivers 'The Ishka View' on the near-term performance of airlines under today's extraordinary market circumstances.
Drawing on the unique set of ACP's data points, this report examines which airlines remain stronger credits in the weeks ahead, which airlines are on watch, and which are seriously exposed to the ongoing impact of COVID-19 and other tangible events

IMPACT INTELLIGENCE 21st – 31st March 2022

KEY TAKEAWAYS… While US airlines have announced airfare increases (as strong pent-up demand has given the carriers pricing power) their European counterparts are utilising hedging strategies to mitigate the immediate effects of the oil price surge. However, they too have started raising fares via fuel surcharges, targeting long-haul flights. This week we review how Europe's three major airline groups, **Lufthansa**, **IAG** and **Air France-KLM** have performed in the final quarter of 2021.

US airlines have seen demand return strongly since the start of March 2022, with the mainline carriers **Delta**, **United** and **American** reporting some of the highest ticket sales ever earlier in the month. This gives them some flexibility to raise fares to offset the high fuel prices and balance the risk of disincentivizing demand, particularly as most US carriers, with the exception of **Southwest** and **Alaska**, do not use hedging to manage fuel price risk. Their peers across the Atlantic, which have significantly smaller domestic markets than US airlines, have been relatively subdued regarding demand – although many are reporting being close to pre-pandemic capacity for the upcoming Easter and Summer holiday travel periods. However, similar to their US counterparts, they are starting to feel the effect of rising fuel prices. Amongst the main European carriers, **Ryanair** has 80% of its fuel consumption for 2022 hedged at US$63 a barrel. **Wizz Air,** which was until recently unhedged, in early March announced that it was capping its fuel cost exposure with zero-cost hedges for four months; the locked fuel prices are however, likely to be higher than Ryanair. Meanwhile **Lufthansa** has 63% of its fuel consumption for 2022 hedged at US$74 a barrel, while **British Airways** is 60% hedged for the full year - the airline did not reveal at what price. Air France-KLM, which has hedged 72% of its Q1 2022 fuel consumption and 63% of its Q2 2022 consumption, will also add a fuel surcharge on long-haul ticket prices that will vary depending on destination and travel class. Lufthansa has followed suit, adding surcharges on all of its long-haul routes. The price increase encompasses all group airlines, including Eurowings Discover, Swiss and Austrian. Airlines globally have announced similar fare increases, including Emirates, Japan Airways and Air New Zealand, which announced a 5% increase on international fares citing rising oil prices and general inflation costs – New Zealand's borders still remain closed to international travellers.

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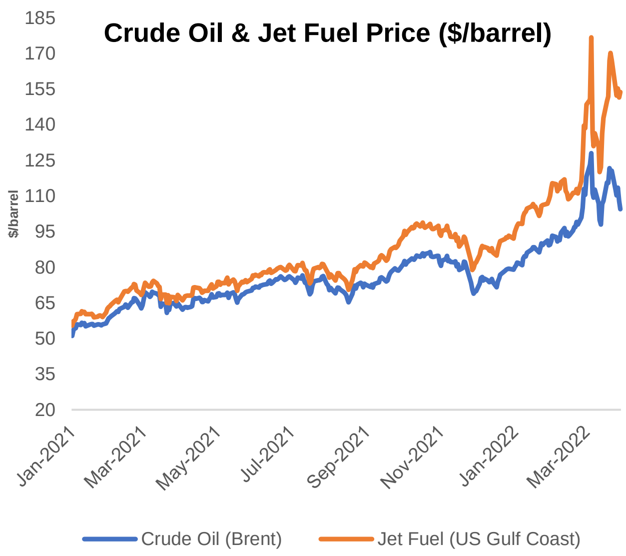
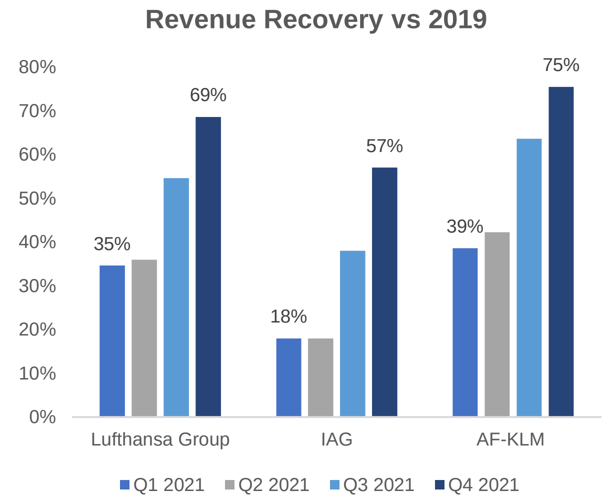
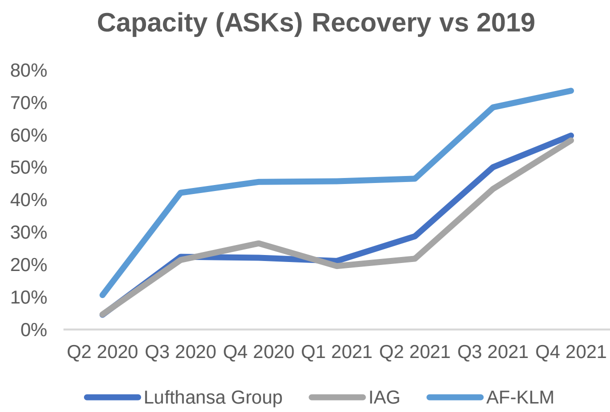
KEY CHARTS THIS WEEK

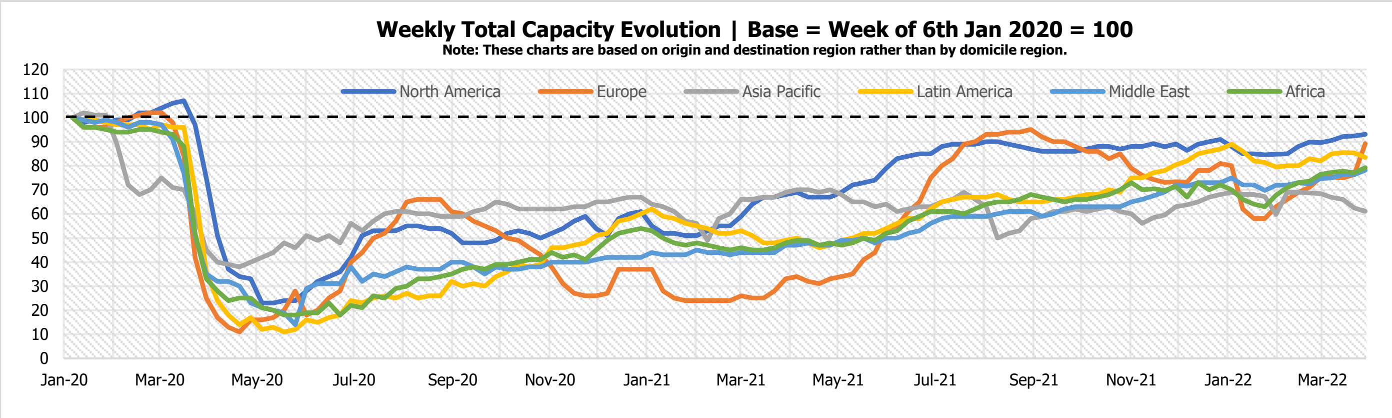


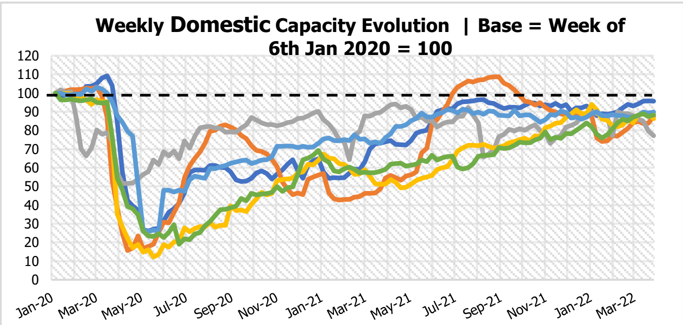


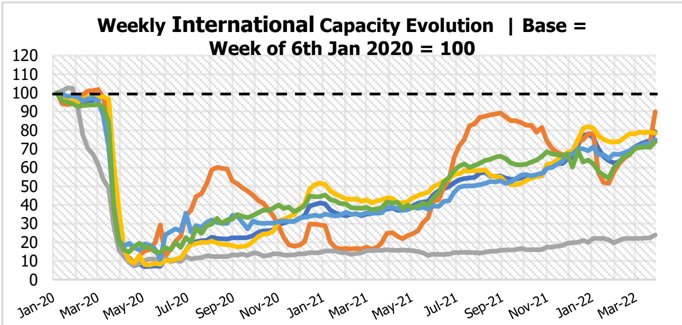


Source: Airline financial reports, Bloomberg and Ishka calculations.

CAPACITY SITUATION - THE WEEK OF 28th March 2022







Source: OAG Data and Ishka Calculations.

CAPACITY EVOLUTION – THE ISHKA VIEW

KEY TAKEAWAYS... Global capacity has been a bit volatile in recent weeks. After hovering around the 82m mark for nearly a month, it fell by a million in the Week of 21st March before recovering once again to more than 83m in the Week of 28th March.

The main drivers of the volatility have been developments in China and Western Europe. The former, which continues to deal with its most severe COVID outbreak, has put several cities under lockdown including Shanghai. Therefore, it is no surprise that airline capacity in China has trended downwards in recent weeks, by ca. 16% in the Week of 14th and ca. 10% in the Week of 28th March. Positively though, most other key markets in Asia Pacific exhibited strong growth in recent weeks, which offset some of the decline in China.

Capacity trends in Western Europe, particularly in the Week of 28th March were even more encouraging. Most markets saw a double-digit w/w increase with overall capacity across the whole continent up by nearly 17% despite a near 26% reduction in Russia.

Elsewhere, the Middle East and Africa also saw growth (between 2-3%, w/w) in the Week of 28th March, however, Latin America saw a downward adjustment of a similar margin mainly driven by adjustments by LATAM Airlines Group across several markets. There were no notable changes across North America.

AIRLINES IN THE FIRING LINE

KEY TAKEAWAYS... **Czech Airlines'** restructuring plan has been approved by its creditors. Elsewhere, potential local investors are showing interest in **Air Austral.**

Smartwings Group's restructuring plan for **Czech Airlines,** which was approved by a Czech insolvency court in February, has also been approved by the airline's creditors. As part of the plan, a new entity, Prague City Air, which was founded two months earlier by the Smartwings owners, Jiri Šimáne and Roman Vik, will provide the Czech carrier with a CZK125m (US$5.6m) loan to repay part of its dues. The airline's two secured creditors, which had claims of CZK92m and CZK55m, will have 59% and 75% of their claims honoured, while unsecured creditors will only receive 4.6% of their claims paid. One of CSA's biggest creditors, Airbus, has been asked to withdraw its claim of CZK17b (US$770m) for uncollected aircraft. Prague City Air will also provide a CZK15m loan to fund CSA's operations.

Air Austral will receive a EUR6m loan from Caisse des dépôts et de Consignation (CDC), a French public sector financial institution. It is expected the funds will provide the airline with sufficient liquidity until May 2022. It is also understood that a group of local Réunion investors have shown interest in the airline. In November 2021, the local government made a callout to potential local investors to prevent it from merging with Corsair. The Region Council of Réunion is analysing the proposals and is expected to make a decision by the end of June 2022.

Performance and response

Continued from page 1…

Across the Tasman, **Qantas** CEO Alan Joyce has also announced a likely price increase of around 7% in response to the rising fuel prices. The carrier has hedged 90% of its fuel costs until the end of June 2022 and 50% in the following quarter, giving it a bit of time. The success of hedging, however, depends on many factors and it is not guaranteed, especially in a volatile price environment. There is also a risk that airlines which have hedged a large portion of their fuel consumption for a longer period end up paying higher fuel prices should oil prices fall.

Lufthansa Group reported another challenging year in 2021, despite an improving operating environment and more passenger traffic y-o-y; the number of passengers carried were still only around a third of pre-pandemic level. Positively however, total revenue recovered at a stronger rate than passenger traffic, reaching 46% of its 2019 levels, driven by the strong performance of the group's cargo business. Lufthansa Cargo, which generated over 40% more revenue during the year than in 2020, recorded an adjusted EBIT of EUR1.5b, double the amount recorded in the previous year, mainly due to further yield increases and cost efficiency improvements. Lufthansa's MRO unit, Lufthansa Technik also performed strongly and remained profitable, benefiting from the increasing demand related to the industry recovery. The catering and inflight services unit, LSG Group, was supported by the recovery in the North American market but nevertheless slipped marginally into the red.

Lufthansa Group's main business, its Network Airlines segment which includes Lufthansa, SWISS, Austrian Airlines, Brussels Airlines, remained most affected by the pandemic. Demand for flights to European holiday destinations and long-haul leisure destinations rose during Summer 2021 and later, following the relaxation of travel restrictions to the US also increased on routes to North America. However, a rise in COVID-19 infections in the group's home markets later in the year as well as the emergence of the Omicron variant negatively impacted demand towards the end of 2021. The Eurowings business unit, which is positioned by the group as a "value carrier" with an exclusive focus on point-to-point business and leisure traffic in Europe was faced with the same challenges as the network carriers. However, in contrast to the other airlines in the group, it managed to reduce its unit costs (CASK) close to pre-pandemic levels despite significantly lower capacity and traffic. Its restructuring programme, 'NEW', which commenced in 2019, has been intensified during the pandemic, with changes made across the fleet, retiring older aircraft earlier and moving towards a fleet of Airbus A320s. A thinner corporate structure has seen the management team reduce by 25%, while government sponsored short-term working was adapted to mitigate lower market demand during the year. Moving forward, the group is shifting more capacity to its airlines with lower cost as it expects higher productivity to drive unit costs down. Its leisure focused airline Eurowings will take over more of the touristic routes from the Network Airlines, while regional carriers like Lufthansa CityLine, Edelweiss and Air Dolomiti will take over more short haul routes.

Within the network airlines, capacity and traffic recovery was relatively similar at LH, SWISS & Austrian, with the three airlines deploying between 40-42% of their pre-pandemic capacity and capturing between 28-30% of the traffic. In terms of revenue, SWISS recovered the largest portion (41%) of pre-pandemic revenue, while LH recovered the smallest (31%). More importantly, both traffic (RPKs) and capacity (ASKs) relative to 2019 recovered each quarter during the course of the year, although in the last quarter traffic slowed down slightly q-o-q as a result of the Omicron disruptions.

IAG's operations and financial performance continued to be impacted by the global travel restrictions with various markets being affected at different times in 2021. In October and November, the airline group saw its long-haul bookings reach 80% of pre-pandemic levels, with the opening of the North Atlantic corridor playing a main role. However, a surge in Omicron infections in late November and December had an immediate effect on traffic and near-term bookings. Nevertheless, IAG expects the North Atlantic routes to reach full 2019 capacity level by summer 2022. Bookings for the Easter and Summer holiday periods are also understood to be strong. The group started 2021 flying just under 20% of its 2019 capacity (measured in ASKs) in the first quarter gradually restoring capacity as travel restrictions eased, and demand returned. It ended the year with 58% of pre-pandemic capacity in Q4 2021. However, load factors remained significantly below pre-COVID levels. Overall, the group returned only 36% of its 2019 capacity for full-year 2021 and carried 28% of the traffic (measured in RPKs).

The group's best performers continued to be Iberia and Vueling throughout the year, thanks to the strong recovery of the leisure market. Starting from the third quarter Iberia returned to profitability at an operating level while Vueling reached breakeven. Premium leisure performed well at both Iberia and British Airways with both airlines seeing the first signs of recovery in business travel, also from around the third quarter, particularly on the North Atlantic routes. Aer Lingus was the weakest performer throughout the year as it was exposed to stricter travel restrictions in Ireland. IAG saw the strongest recovery on its domestic operations (UK and Spain) followed by the Latin America and Caribbean region. Capacity and traffic recovered to almost 94% and 83% respectively on the domestic market in Q4 2021, while in the Latin America and Caribbean region, capacity and traffic returned to 68% and 64% of Q4 2019 level respectively. Recovery on the vital North Atlantic route is also expected heading into summer 2022, which is particularly important for British Airways, which has lagged behind Iberia. For full year 2021, Iberia carried almost half of its 2019 passenger numbers, while BA carried under a quarter. Positively however, BA has also seen strong q-o-q recovery since Q3 2021 with the opening of the transatlantic market. IAG, like Lufthansa, reported record revenues from its cargo business unit, IAG Cargo, up 50% on 2019 level and accounting for 20% of the group's total 2021 revenue (Lufthansa: 25%). The business unit expects to also return more of its passenger belly hold network as capacity is restored.

Operationally, **Air France-KLM** continually outperformed both IAG and Lufthansa in 2021, returning capacity (in ASKs) more aggressively and capturing more of the pre-pandemic traffic (in RPKs) and passenger numbers each quarter during the year. While AF-KLM started the year carrying around 20% of its pre-pandemic passenger numbers in Q1, it ended the year carrying 65% of its Q4 2019 passenger numbers in the last quarter. In comparison, both LH Group and IAG started the year carrying around 10% of pre-pandemic passenger numbers, and ended the year carrying just above half of their pre-COVID passenger numbers respectively in Q4 2021. However, this does not appear to have translated to better financial performance at AF-KLM compared to its other two peers.

The positive operational trend in the second half of the year was driven by long-haul traffic following the easing of travel restrictions and reopening of the US border. Short and medium haul routes which performed well during the summer months were negatively affected by the Omicron variant later in the year. The group's low-cost unit, Transavia, has recovered, as expected, better than the network airlines Air France and KLM, with a particularly strong performance in Q4 2021, despite the disruptions in December. The low-cost unit managed to return almost its full Q4 2019 capacity in the last quarter and carried 93% of the pre-pandemic passengers. Unit revenues in the last quarter exceeded Q4 2019 level, albeit marginally, enabling the airline to recover 96% of its Q4 2019 revenues in the last quarter of 2021. Positively unit costs also improved during the quarter, although they remained marginally above pre-pandemic level.

Additional details on the European airline groups are available online on the Airline Credit Profiles webpage.

Air New Zealand has announced a NZD2.2b (US$1.5b) recapitalisation package consisting of three parts. NZD1.2b will be raised via a pro rata rights offering allowing existing shareholders to purchase additional shares at a discounted share price in which the government will participate in order to retain its 51% stake. The second part of the package consists of NZD600m issuance of redeemable shares to the New Zealand Government and the final part is a NZD400m government loan to replace the existing loan facility. Earlier, the airline was awarded a further 12-month subsidy of NZD180m (US$125m) for cargo flights under the government's MIAC (Maintaining International Air Connectivity) Scheme. The subsidy will support freight capacity from 1st April 2022 for 60 flights per week to destinations including Los Angeles, Vancouver, Hong Kong, Shanghai and main Australian ports.

Aeroméxico has concluded its restructuring plan and emerged from Chapter 11 bankruptcy protection with the equity of the reorganised company at ca. US$2.6b, after it gained access to US$1.5b in new capital. The largest shareholders of the company are Apollo Global Management and Delta Air Lines as well as existing and new Mexican investors with a joint group voting control. A group of funds which were part of the ad hoc groups of creditors are also shareholders after investing ca. US$720m in new capital. While a new board of directors has been formed consisting mainly of Mexican nationals, existing CEO, Andres Conesa and chairman Javier Arrigunaga will remain in their respective posts. The airline also announced plans to invest US$5b in fleet modernisation over the next five years.

LATAM's bankruptcy process has also made progress, with the airline receiving court approval for its Chapter 11 Disclosure Statement. The airline now needs to seek creditor approval, after which the court will evaluate the restructuring plan in May 2022. LATAM hopes to emerge from Chapter 11 in the second half of 2022.

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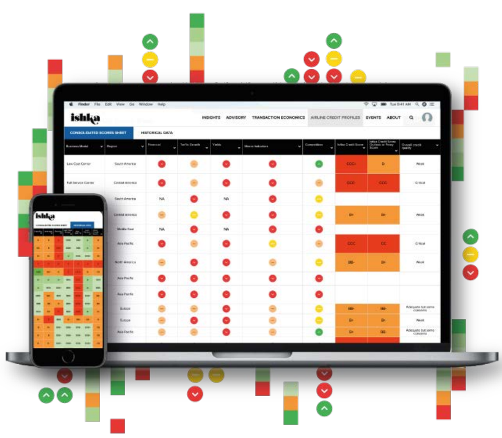
Airline Credit Profiles



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