



Aviation Finance

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Potential Opportunities in Challenged Markets

In this brief insight, we highlight how Covid-19 is likely to be a catalyst for investors to access potentially attractive opportunities in a relatively stable asset class.

Air traffic demand has collapsed in 2020 due to the spread of the Covid-19 and the lockdown measures imposed in many countries. It is estimated that it will take up to 3 to 4 years to return to 2019 levels of air passenger traffic¹. We believe this will result in a surplus of commercial aircraft that is estimated to be 20% of the actual commercial fleet of c. 24,000². As it takes time for air travel demand to recover, we expect there will be a fall in aircraft value of between 5-25%³ depending on the type and vintage. Who will be the most affected? Most likely it will impact the leasing companies and airlines as they are the two main owners of aircraft, but also aircraft debt or equity investors.

Historically we have seen aircraft finance gain popularity amongst investors, as investments are underpinned by what we believe are stable aircraft values. Despite it being a depreciating asset it is important to highlight that an aircraft typically has a long, useful life of around 25 years. Moreover, there is a secondary market for these assets meaning that they can be moved from one operator to another across geographies with relative ease. These features enable aircraft owners to borrow c.70%-80% against an aircraft value.

In theory, a fall in the value of an aircraft can result in significant losses for the aircraft owners, mainly airlines and leasing companies. However, lease contracts are typically non-cancellable with fixed lease rentals payable during the lease term and therefore a fall in aircraft values should not result in a fire sale for aircraft owners so long as the airline or lessee is solvent and fulfilling its obligations under the lease contract.



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Alok joined Muzinich in February 2020 and is the Global Head of Aviation Finance. He has over 20 years of experience in structured finance and prior to joining Muzinich was head of aviation finance at Investec, a FTSE 250 investment bank. He worked for nearly 14 years in Investec and was one of the founding members of the aviation finance business. He was instrumental in building their aviation finance fund platform and also established aviation debt funds for institutional investors. Alok has extensive industry relationships across financial institutions, leasing companies, manufacturers and airlines and is a regular speaker at aviation conferences. He earned a Bachelor of Commerce (Hons) from Calcutta University and is a qualified Chartered Accountant, MBA (Finance) from India.

1. Source: IATA, Covid-19 outlook as of May 13, 2020.
2. Source: Boeing Commercial Market Outlook and Airbus Global Market Forecast as of September 12, 2019.
3. Source: Ascend by Cirum Inside Track on Volumes: Commercial Aircraft Issues 90-96 April to June 2020.

In the past few months the effects of this crisis on economies and particularly on the travel industry have been felt globally with airlines seeking deferrals of their lease rentals. A deferral or a haircut affects the aircraft value, as the new lease rental may not be sufficient to provide any income to aircraft owners after debt repayment, or in some cases to even cover the asset depreciation. Some airlines have filed for bankruptcy or initiated a voluntary restructuring with their lenders and lessors, while others are looking for ways to adjust their fleet size to current passenger demand. What this means is that some airlines will be likely to return aircraft at the end of their lease contracts in the next 12 to 24 months. However, a returned aircraft due to a lease expiry or bankruptcy will be difficult to transition to another operator in the current environment, and is therefore likely to further affect the aircraft's value.

This creates a surplus in the market as more aircraft will need to be potentially transitioned, which in turn will also put additional pressure on the value of lease rentals. As a result of lower, new lease rentals, aircraft values will likely be set on a new floor.

The impact of over supply will vary depending on the type of aircraft; for example, we believe wide-bodies (aircraft that can accommodate two passenger aisles) will be less impacted than old technology narrow-body (aircraft that can only accommodate one passenger aisle).

Currently, the focus has been on liquidity and survival of airlines. But, over the next 12 to 24 months, we believe the impact will be more evident on aircraft values and as a result on aircraft owners. Those with high leverage and/or an ageing fleet are likely to be more impacted. For investors who are underweight the sector, or missed out on the asset class pre-COVID-19, it could be an attractive opportunity to enter a relatively stable asset class when distressed owners are forced to sell quality assets.

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