

## More Aid Offered To Airlines as Pandemic Continues to Depress Demand

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Original post [here](#).

For four months, social distancing measures have hobbled the airline industry with depressed demand, grounded flights, and net losses. Ridership remains low, held down by travel prohibitions between countries that normally supply heavily trafficked routes. With persistent losses and pessimistic future forecasts, several European airlines have now received aid from their governments to maintain solvency for those companies critical to industry supply chains.

In March 2020, industry-wide revenue for passenger air fare dropped to [nearly half](#) the revenues a year prior. The dramatic shock, in an industry characterized by high fixed costs with little room for volatile revenues, immediately required interventions from governments around the world. For many privately owned air carriers, [these interventions](#), typically in the form of tax reductions and payroll support, provided quick relief.

While some countries have stopped there, the United States and some countries in Europe have used the temporary relief provided by payroll support subsidies to negotiate more complex deals for aid in exchange for equity or warrants. By late April, many European airlines negotiated some form of aid from their home country governments; now two more airlines join the group, with an additional \$10 billion in credit guarantees, state loans, and capital investment.

**Figure 1.** Allocated aid to airlines in Europe.

Airline	Allocated in Local Currency*	Local Currency to USD	Aid in Dollars
EasyJet	£600	1.28	\$768
Norwegian Air Shuttle	NOK 3000	0.11	\$330
SAS (Norway)	NOK 1500	0.11	\$165
Widerøe and other airlines	NOK 1500	0.11	\$165
Swedish Credit Guarantee	SEK 5000	0.11	\$550
SAS (Sweden)	SEK 1500	0.11	\$165
FinnAir	€600	1.17	\$702
SAS (Denmark)	€137	1.17	\$160.29

Alitalia	€500	1.17	\$585
KLM (The Netherlands)	€3,400	1.17	\$3,978
Deutsche Lufthansa	€6,000	1.17	\$7,020
		Total	\$14,423.29

(\*) millions

The Netherlands has approved [€3.4 billion](#) in state loans and guarantees for KLM, part of the Air France-KLM travel group. Germany will provide a capital investment of [€6 billion](#) to Deutsche Lufthansa AG (DLH), the parent company for the Lufthansa Group. These measures complement the [renationalization of Alitalia](#) by the Italian government, which was announced in March.

The Netherlands has utilized a mixture of state loan guarantees and state loans to aid KLM. Of the allocated €3.4 billion, €2.4 billion will be state guaranteed bank loans while the last €1 billion will be a direct loan from the state. The direct loan from the state runs in tranches through 2025, with maturities ranging from nine months to five years.

For KLM, the loans come with a suite of additional terms. KLM must reduce costs by 15 percent. Employees who make more than three times the average salary at the company must reduce their salary by at least 20 percent. Employees who earn less are also asked to take salary reductions, though at a lesser rate. While the loans from this package are outstanding, KLM cannot pay dividends to shareholders or bonuses to its employees. The air carrier must also reduce its annual evening flights by 7,000 to 25,000. As an environmental requirement, KLM must reduce the aviation sector's carbon emissions by 50% of 2005 levels by 2030. Finally, the Dutch government asked parent company Air France-KLM and both of its subsidiaries to substantively reorganize to reduce costs.

Unlike the Netherlands, Germany has injected capital into Lufthansa through Lufthansa's parent company, DLH, in exchange for equity. Of the €6 billion allocated:

- €300 million is in new equity, equivalent to 20% of Lufthansa's share capital,
- €4.7 billion is in non-convertible, non-voting equity, and
- €1 billion is in a non-voting convertible debt instrument.

The government will conduct the recapitalization through the Economic Stabilization Fund, a fund specifically set up to aid companies directly affected by the coronavirus outbreak. As part of its recapitalization plan, Deutsche Lufthansa AG will redeem all outstanding equity and debt by 2026. It must also suspend dividends and share buybacks while the German government has ownership over DLH debt and equity. Also,

until the state redeems 75% of its outstanding capital, DLH cannot pay bonuses to management.

The agreement between DLH and the German government extends further than the arrangements that other governments have made. DLH is not permitted to purchase stakes in competitors or subsidize troubled subsidiaries. To help other carriers compete with the airline aided by the state, the government has required DLH to divest from 24 slots a day at two of its hub airports--Frankfurt and Munich--making the slots available to competitors. Accompanying the €6 billion state aid package is a €3 billion state guarantee of any private loans taken by DLH.

Some European airlines are already partially owned by governments in their home countries. Prior to the additional recapitalization, the Dutch government [owned](#) 14.3% of Air France-KLM shares, matching the French stake. FinnAir enjoys status as Finland's flag carrier, with the Prime Minister's office as the [largest shareholder](#) of the company, owning [56% of shares](#). Because of the extant government stakes in these carriers, the leadership of these companies might feel more comfortable with additional conditions imposed by new government assistance, as in the case of the Dutch assistance to KLM.

In comparison, Lufthansa's CEO [expressed concerns](#) about government interventions affecting the airline's ability to remain competitive if there were too many constraints. Leadership may [have found comfort](#) in the deal's "silent participation" clause, which prevents the German government from selling Lufthansa shares on third-party markets.

In a related vein, Virgin Atlantic's reluctance to rely on government funding has led its CEO and Founder, Richard Branson, to [sell stakes](#) in part of its parent organization to keep it profitable. After months of fundraising, the airline recently agreed to a [\\$1.2 billion rescue deal](#) funded exclusively by private markets.

A similar trend may be playing out in the United States, where airlines and suppliers have left billions of dollars in government aid outstanding while searching for other sources of funds. [Executives](#) originally [balked](#) at Treasury Secretary Mnuchin's insistence that companies that took the available loans would be required to provide some form of equity to the government, a practice the government relied on during the Global Financial Crisis with positive outcomes.

Federal Reserve lending facilities remain untapped by major airlines, though the announcement of these facilities [opened up private markets](#) to debt issuances from troubled carriers. On June 25, American Airlines [issued \\$2.5 billion](#) in senior secured notes, due in 2025, at an 11.75% interest rate. United Airlines [issued \\$1 billion of stock](#) in April and [an additional \\$1 billion worth](#) of shares in late June. Southwest Airlines has improved its capital position by relying on a mixture of equity and debt

issuances. The airline [sold](#) \$1 billion in common stock and \$1.6 billion in convertible senior notes in late April.

Other airlines and air companies relied largely on bond issuances. Boeing Company [issued \\$25 billion](#) worth of corporate bonds in May, following Delta's [\\$3.5 billion](#) bond issuance. Delta's bond issuances come at a high cost--in addition to high interest rates, the company pledged landing slots at Kennedy, Heathrow, and LaGuardia airports as collateral.

As of June 25, Treasury had dispensed [over \\$25 billion](#) in support to passenger air, cargo air, and airline supply companies through its Payroll Support Program (PSP), a [section of the CARES Act](#) that provides grants to air carriers and affiliates to continue paying employees during depressed flight demand. Treasury has dispensed funds to over three hundred passenger air carriers of all sizes. Almost all of the support was in the form of grants. However, for the largest 13 carriers, which accounted for \$6 billion in disbursements, a portion was in the form of loans and they were required to provide warrants for shares in exchange. In total, passenger airlines have claimed nearly all allocated aid to them by the PSP, with approximately [\\$800 million still outstanding](#). Cargo air carriers have received \$640 billion, while eligible contractors have received \$1.4 billion.

Funding is still available through the Emergency Relief Program (ERP), through which the government may provide secured loans to eligible aviation industry participants that show they have exhausted market options. As of June 16, Treasury had received [190 applications](#) for loans under the ERP. On July 2, Treasury [announced](#) five airlines were in line to receive loans under the ERP: American Airlines, Frontier Airlines, Hawaiian Airlines, SkyWest Airlines, and Spirit Airlines. Though terms aren't finalized, American Airlines disclosed the same day that it expects to [receive \\$4.75 billion](#) in loans from the Treasury under the CARES Act, increasing its liquidity position to \$15 billion. Other airlines have yet to disclose information on anticipated loan terms or size.

However, despite having raised funds from the market and received Treasury aid, US airlines are still struggling to stay profitable. United Airlines was the recipient of [\\$3.5 billion in grants](#) and a \$1.5 billion loan in exchange for warrants through the PSP, however, it announced on July 8th that it would [involuntarily furlough half of its US workforce](#)--or 36,000 employees--beginning on October 1st, if demand stays depressed. Hawaiian Airlines also expects to [reduce employee headcount](#) largely based on its forecast of prolonged reduced ridership: it has a planning assumption that there will be a 10-15% reduction in its anticipated flight schedule for the summer of 2021 (as compared to historical averages). Even after receiving aid from the Treasury, American Airlines has notified employees of the possibility of furloughing [25,000 staff](#) in the coming months and has [threatened to cancel orders](#) of Boeing's 737 MAX jet.

[Several other major US airlines are](#) in a similar situation, with earnings reports revealing the extent of the economic pain. On July 20, United Airlines reported a [\\$1.6 billion loss](#) in Q2, with analysts [warning against](#) holding airline stocks. Delta Airlines, expected to perform strongest of the group, faced a [90% drop in revenues](#) at its lowest point in Q2. JetBlue Airways also [faced losses](#), and the company expects revenue to drop 80% in the third quarter. American Airlines posted a [86% drop](#) in revenues year over year. Analysts [expect](#) a slow recovery, with prolonged losses into late 2020, if not longer.

For some troubled European airlines, analysts predict similar challenges. Andrea Giuricin, a transport economist, expressed concerns that nationalisation [will not provide](#) the foundation that some airlines need to compete in an already depressed and competitive market. An example is Alitalia, which in comparison to competitors flies smaller planes that can hold fewer passengers, leaving the airline vulnerable to losses on routes profitable for larger airlines. The airline also comparatively has more ground personnel protected by strong unions, while falling behind in international flights to Italy. The Italian government hasn't yet announced the final restructuring plan for renationalisation.

As the rate of air travel struggles to return to pre-crisis levels due to the continued persistence of the virus, many airlines fight to remain profitable. The industry continues to face high fixed costs and any ability to adjust current expenses does not directly align with drops in revenue creating cash flow challenges and [making them especially vulnerable to economic shocks](#). The terrorist attacks of 9/11, after which passenger demand dropped dramatically once US airspace reopened, showed that the industry might [require state aid](#) to avoid bankruptcy and restore operations to pre-shock levels; in that circumstance such aid was provided.

Strategies used by several Asian governments demonstrate that there are other options for state aid that can address high fixed costs rather than directly mitigating the effects of lost income. The Singaporean [government](#) plans to spend S\$15.1 billion (\$10.6 billion) on a program paying 75% of all employee wages in the industry up to S\$4,600 (\$3,200) per month. In Korea, the government [guaranteed aircraft lease deposits](#) for airlines. The government also reduced occupancy taxes. The Hong Kong Airport Authority (HKAA) allocated [HK\\$50 million](#) (\$6.5 million) to fund retraining for up to 25,000 airport staff on unpaid leave.

As airlines are critical industries that play key roles in transportation and supply chains for passengers and cargo, governments will likely adopt multiple strategies to keep local air carriers afloat. The persistence of the pandemic, which some commenters predict may last into mid-2021, may require multiple interventions in the air industry during the coming months.