

Aviation: reaching new heights

Ensuring sustainable growth after the storm





Malta's aviation sector

Over several decades, the Maltese aviation sector witnessed significant growth driven by an ever-increasing demand from people wanting to move in and out of Malta, and a growing aviation support services sector that today includes maintenance, repair and overhaul (MRO) services, flight training, aircraft spray painting, and many others.

By 2019, the last full calendar year before the COVID-19 pandemic, Malta's aviation sector contributed no less than €600 million towards the Maltese economy and carried over 7 million passengers. The pandemic has had a significant negative impact on the Maltese aviation sector. As a consequence of the health-motivated travel bans imposed by governments worldwide, the year-on-year passenger movements at the Malta International Airport (MIA) fell from 7.3 million in 2019 to 1.7 million in 2020, and air traffic movements fell from 51,916 in 2019 to 18,982 in 2020. Post-pandemic, the aviation industry have been recovering such that passenger movements reached 2.5 million (2021) and 3.7 million (Jan-Aug 2022), that is almost 50% of 2019 movements. In parallel, air traffic movements increased to 23,395 (2021) and to 26,450 (Jan-Aug 2022).

The recently proposed Civil Aviation Policy for Malta maps out Malta's policy up to 2030 and seeks to reap the best possible share of the forecast growth in global aviation. The Policy has been formulated in a way that makes it sufficiently flexible to adapt to market changes. It identifies broad long-term strategic objectives that do not only address current needs of the Maltese aviation sector, but also to prepare for the future needs and opportunities that the sector offers. This is intended to ensure that Maltese aviation sector continues to grow in a sustainable manner once the aviation sector recovers from the negative impacts of the COVID-19 pandemic.

In this report we will cover:



Liquidity



Operating costs



Debt and restructuring



Positioning for sustainable growth



What Grant Thornton is doing to help airlines and leasing companies

Challenges and growth opportunities

COVID-19 has been an unprecedented shock to the global aviation industry, affecting all companies and geographies. 2020 saw international passenger traffic fall by 60% back to 2003 levels¹. This shock to airline passenger numbers has had significant implications for all aspects of the aviation value chain, including airport operations and support services. With the International Air Transport Association predicting that the airline industry is going to remain cash negative throughout 2021 with a potential cash burn of \$75 billion², it is clear that preparing the industry to safely restart will take careful planning.

According to an outlook on the industry published by the Air Transport Association (IATA) in June 2022:

- Industry losses are expected to be \$9.7 billion, for a net loss margin of 1.2%, compared to losses of \$137.7 billion (36.0% net loss margin) registered in 2020 and \$42.1 billion (8.3% net loss margin) in 2021;
- Industry-wide profitability goals for 2023 seem encouraging, with North America already bound to deliver an \$8.8 billion profit in 2022;
- The aviation industry is increasingly committing to emissions reductions, with net delivery of over 1,200 aircraft in 2022;
- Passenger numbers are expected to reach 83% of pre-pandemic levels in 2022.

Industry drivers

Revenues: passenger revenues are expected to increase in 2022 and account for \$498 billion of industry revenues, against \$239 billion generated in 2021.

Over 3.8 billion people are expected to travel in 2022, with revenue passenger kilometers (RPKs) reaching 82.4% of 2019 traffic, while yields are expected to rise 5.6%.

Cargo yields are expected to fall 10.4% compared with 2021. Revenues are expected to account for \$191 billion of industry revenues. Overall, over 68 million tonnes of cargo will be transported in 2022, which constitutes a record high.

Expenses: with the conflict in Ukraine keeping prices for Brent crude oil high, fuel will be the largest expenditure in 2022 (\$192 billion, which accounts for 24% of overall costs). Airlines are expected to consume 321 billion liters of fuel in 2022.

Labor will be the second highest operational cost for the sector. While direct employment is still below the 2.93 million jobs of 2019, figures are expected to reach 2.7 million, up 4.3% from 2021.

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1. International Civil Aviation Organization 2020- www.icao.int

2. International Air Transport Association 2021 - www.iata.org

What we are seeing in the market

Negotiated return of excess aircraft: airlines and lessors have taken a proactive approach to renegotiate existing lease obligations and, in some cases, reach an agreement upon the managed return of aircraft and their components, reaching an amicable solution on the redelivery conditions.

Negotiation on terms of lease: to ensure their survival and avoid going through the process of repossession, airlines have the option of approaching lessors to negotiate the terms of their lease in the following ways:

- Deferral of rent;
- Reduced rental fee;
- Power by the Hour (PBH).

Contentious return of assets: where the lessor and airline are not able to reach an agreement, lessors have opted to elect their rights to repossess an aircraft. For jurisdictions that are signatories to the Cape Town Convention, this is a standardized process.

Conversely, certain airlines have entered formal insolvency proceedings and have chosen to disclaim their lease contracts under this process and returned the planes. Some of these airlines are Thai Airways, Nok Airways, Philippine Airlines, Virgin Australia, LATAM and Avianca.

For lessors in particular, COVID-19 represented an unprecedented attack on the industry's business model. With airlines all over the world affected, leasing companies have seen a sharp drop in rental income. In a bid to reduce operating costs and increase liquidity, many airlines are requesting payment deferrals or looking to return aircraft. Lessors are reluctant to take airplanes back, as in every part of the world affected, they currently have very limited options as to where to redeploy them.

Debt and restructuring

For airlines, the capital debt accrued through the ownership or leasing of aircraft represents a large part of their fixed costs. With lessors largely unwilling to take their planes back, airlines have an opportunity to renegotiate the terms of their arrangements with both leasing companies and financiers. Depending on their position, lessors may be willing to provide deferrals or rate cuts. While many lessors initially agreed to three month deferrals on their payments, this is not a viable long term solution.

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Positioning for sustainable growth

The pandemic created an opportunity for airlines to fundamentally restructure their business and operating models and embrace sustainable initiatives.

For instance, United Airlines announced its intent to acquire a number of air taxis as a way to engage with customers earlier in their journey.

German airline Lufthansa and Deutsche Bahn, the German railroad company, announced their intention to revitalise their cooperation in airline railway station check-in and rail feeder lines to airports.

In September 2022, ITA Airways launched its Airbus A350-900 which is powered by 20% SAF (Sustainable Aviation Fuel) and contains a biogenic component developed by Eni.

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Shifting profit drivers and operating models

How airlines can shift their business models to account for these changes in their significantly more digitally-inclined customer base should be high on airline executives' agendas as demand begins to return.

For airlines, new dynamic global networks, shared fleet management and pricing modelling can help to overcome the mid-and long-term pressure – enabling the operating models to be more resilient to market volatility.

New digitalised target operating models connected with travel companies can better manage aircraft fleet and capacity utilisation, as well as ticket pricing. Such models can also give oversight of the amount of risk exposure taken as a result of air fuel and hedging positions.





Critical considerations as you plan for the future

The value chain of the aviation industry is highly interconnected with other industry groups and domestic, regional and global economic and social activity. Many of the forces impacting the industry are driven by factors outside of the owner, lessor or operator's control; this complexity has been highlighted by the impact of COVID-19.

Current market conditions are clearly driving liquidity and operational challenges, but can also provide opportunities to those with strong balance sheets and access to supportive lenders and special situations investors. The interconnectivity of the aviation industry drives the need for well thought-through, integrated solutions that critically address the needs of multiple stakeholders. This is particularly relevant where there is a separation between asset ownership, the lessor, the operator and the funders, with added complexity from financial markets regulatory interactions.

Advisors from our network of Grant Thornton member firms can help you to define the next steps in your planning. We consider the questions on the following page highlight the more important areas to focus on as you assess, protect and restore value - some will be more relevant to your business than others. Wherever you are in the world, our advisors can help you define and build your tailored response.

Key questions to consider

Assess



Liquidity, refinancing and communicating the plan

- How much time does my business have before covenants are breached/liquidity runs out?
- How can I effectively manage liquidity, what sources of short-term finance/funding are available? What options are available to restructure my existing debt obligations?
- How can pinch points like rental/lease payments and debt service/repayments be managed/negotiated?
- What sources of finance are available (including government support) and how do I access them at speed and at the right price?
- What is the turnaround plan and how can this be best positioned and negotiated with my stakeholders?
- What is the right communication strategy for my people, customers, suppliers and financial stakeholders?

Protect



Taking advantage of opportunities

- Are there any attractive investment opportunities driven by market conditions?
- How can I position myself to be ready to take advantage of these opportunities?
- What were the lessons learned in 2020 and how should I reset my longer term strategy to address the opportunities to deliver sustainable growth?
- What capabilities or presence do I need to acquire into my business?
- How can I transform the old business model, such as changing into a new digital mobility network services model, simultaneously reducing CO² emissions and so meeting key customers' sustainability concerns?
 - Who do I need in order to create new mobility network business models?
 - How can I create highly individual travel and mobility solutions and experiences?



Operations and performance improvement

- How will I restart operations effectively and attract business?
- How can I retain the people critical to my business?
- How can I make the business as operationally efficient as possible given likely passenger numbers and overcapacity in the short to medium term?
- How can frequent-flyer programme claims be efficiently restructured along with the need to focus on profitable fleet management?
- How can I align landing slots to more flexible customer behaviour and focus more on profitable destinations?
- How can I reduce operating costs, such as manual onboarding and identification, by using video identification solutions?



Governance, risk and compliance

- How can the brand's reputation be protected?
- How do my corporate governance structures need to change to account for new stakeholders, such as government bodies?
- To what extent can and should I, as a governmental shareholder, introduce programs (such as CO² reduction programs) by not infringing fundamental corporate law principles?
- How can I ensure compliance with flight licenses?
- What risk does the 'new normal' for working remotely and delivering services bring to the business?
- Is my cybersecurity strategy robust?

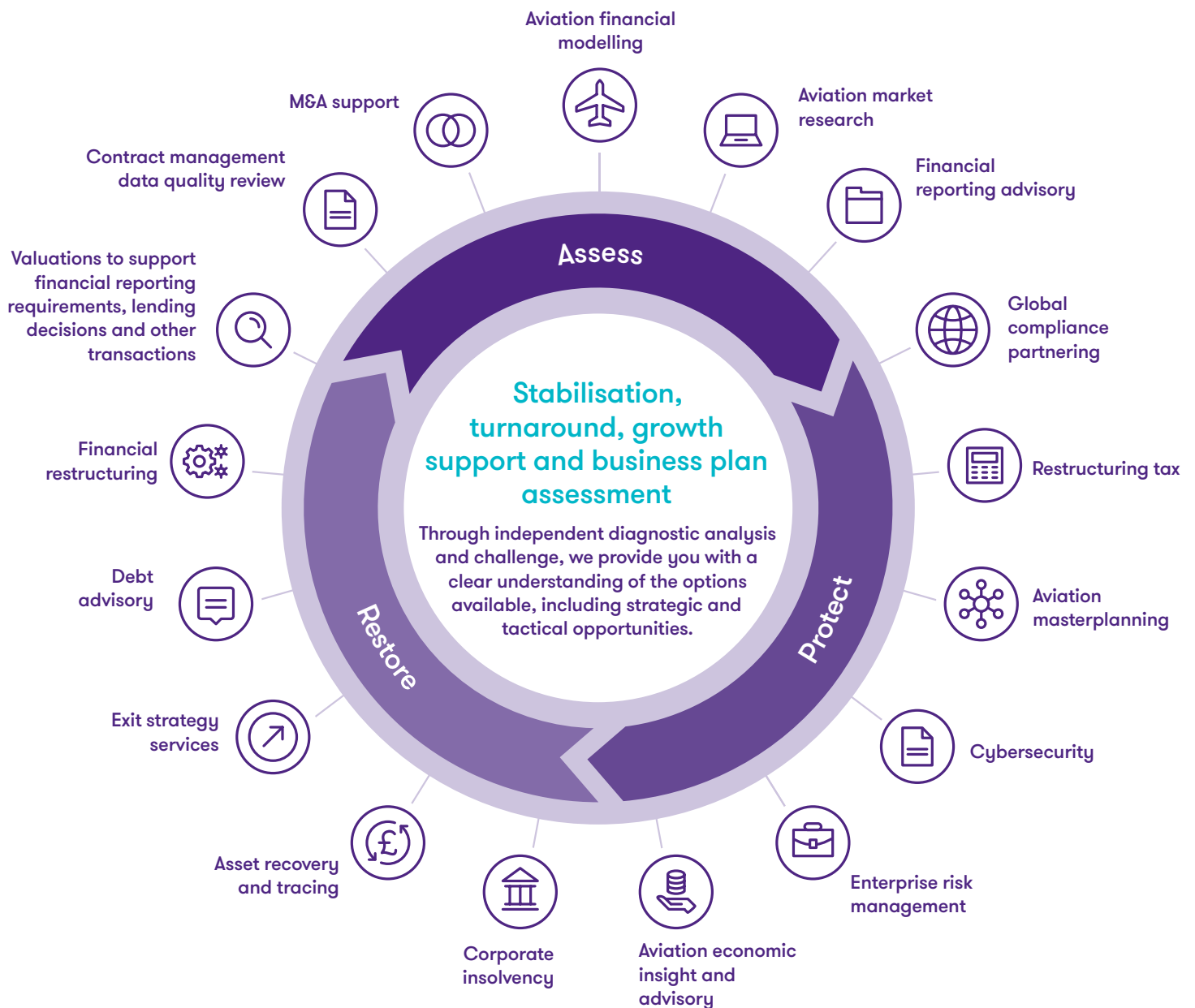




How Grant Thornton's solutions can help you

'Grant Thornton' is a network of member firms around the world. Our approach focuses on supporting you to assess, protect and restore value in your business. We start by helping you regain control by stabilising the business, while developing a robust and realistic turnaround plan, and longer-term strategic plans. Grant Thornton member firm advisors draw upon deep expertise across many different areas, customised to your specific needs.

Successful turnarounds require the development of a credible plan that has been stress-tested against various scenarios, along with a transparent communication strategy that meets the needs of all stakeholders. Building trust, and not breaking promises, will be critical if the plan is to be realised.



Stabilisation, turnaround, growth support, and business plan assessment

In the early stages of a turnaround the right support is necessary to create financial stability, assess cashflow and identify opportunities to improve short-term liquidity.

Through independent diagnostic analysis and challenge, we provide you with a clear understanding of the options available, including strategic and tactical opportunities.

This crucial activity provides comfort and support to management teams and can underpin the credibility of the turnaround and long-term strategic plans as part of the assessment process of financial stakeholders.

Grant Thornton member firms regularly work with leadership teams to support the effective delivery of their plans.

Our solutions



Financial restructuring

Our multi-disciplinary financial restructuring specialists provide support to realise significant business process improvement, implement new rapid target operating model alignment, divest non-core businesses and design new capital structures aligned to the dynamics of the business. Our experience also includes design and implementation of leasing platforms and pricing processes.



Contracts management data quality review

Our team has reviewed over 1,000 lease contracts and associated operational data. We use our expertise to provide assurance over the data in your CMS and reduce exposure in divestment and default scenarios. Our CMS experts are familiar with contract documents, complex cross-border financing arrangements including OTC derivative structures and hedging, technical documents and AerData's CMS, AMT Sybex's Leasepoint and proprietary systems.



Debt advisory

We provide specialist advice on the raising and refinancing of debt, including Asset-Backed (including landing slots) Securitisation. Through our deep understanding of the international funding landscape, including its local regulatory frameworks, and detailed knowledge of the credit process, we devise tailored funding solutions as part of a sustainable capital structure in line with the strategic ambition of our clients.



Exit strategy services

We apply a tailored methodology and fully project-manage and implement the sale or closure of underperforming or non-core corporate entities at maximum value.



Aviation financial modelling

We use a best practice, standardised approach for our model build and review engagements. Our deliverables are robust, well-structured and easily understood. Our team has the technical expertise and industry experience to provide transparency on maintenance-related cash flow forecasts, liquidity forecasting models, calculation of intangibles, lease, buy or hold analysis, transfer-pricing models, fleet analysis, optimum fleet deployment analysis and securitisations. We have developed AI technology which can be deployed for COVID-19 real-time AMT management and risk modelling.



Valuations to support financial reporting requirements, lending decisions and other transactions

We provide valuations to support asset-backed financing, including valuing shares and intangible assets, and provide periodic valuations of assets to confirm that the terms of the loan agreement continue to be met. For mergers, acquisitions, restructuring and proposed financial structures, we provide an independent view on value, delivering robust advice within the constraints placed by the deal deadlines.



M&A support

We provide advice and manage transactions associated with the acquisition or disposal of distressed and non-distressed assets or businesses, frequently to short timescales. Our team helps businesses navigate complex transactions – whether buying or selling, restructuring or providing capital solutions – always with competence, speed and agility. From deal strategy and valuation, to evaluating the financial, IT, tax, commercial and operational issues affecting performance and identifying strategic alternatives, we address concerns, manage risk, support the structuring of the purchase agreement and help our clients seize opportunities.



Asset recovery and tracing

Asset recovery and tracing normally form part of formal insolvency processes such as liquidations, or are carried out in support of ongoing litigation or fraud investigations. We use specialised approaches to identify and recover misappropriated assets, including those held in offshore trusts, to provide cost-effective value recovery.



Corporate insolvency

Where a business cannot be saved or where a formal insolvency process is required to affect a restructuring, we provide advice and support to distressed companies, their creditors and other stakeholders in order to protect assets and maximise recoveries. In some situations, we take on the role of Chief Restructuring Officer.



Enterprise risk management

Our enterprise risk management (ERM) specialists help organisations implement the leading approach to managing and optimising risk. We are able to tailor the approach to our client's individual challenge and create bespoke strategies that work, enabling them to strategically identify, analyse and monitor potential risk to their organisation.



Global compliance partnering

Our global compliance partnering solution delivers all local statutory financial reporting, centralised statutory audits, tax compliance, payroll administration and local country filings for multinational organisations through a single point of contact. We are the leading adviser to dynamic organisations delivering solutions that improve reporting efficiency and enhance risk management. Providing full transparency, real-time monitoring and highlighting upcoming deadlines, we enable local and central management teams to ensure full compliance at all times.



Financial reporting advisory

We provide clear and practical solutions to address complex accounting and financial reporting issues. We support businesses in navigating the accounting and reporting of government stimulus packages. We're also able to help navigate the accounting and reporting of complex areas including leases, impairment and going concern.



Restructuring tax

Our restructuring tax teams specialise in providing tax advice in all aspects of restructuring scenarios. In particular, this includes advising on the tax aspects of:

- independent business reviews, options reviews and contingency planning;
- business restructuring, e.g. debt restructuring;
- mergers and acquisitions;
- disposals of trade and assets or wind down of businesses ;
- corporate insolvencies;
- fraud investigations.



Aviation market research

Our economic advisory team has experience and expertise in conducting aviation specific market research. Primary data collection experience includes assessing public perceptions and gathering key industry player insights. Leveraging secondary data sources to provide insight into the sector.



Aviation masterplanning

Our advisory team has experience in aviation master planning, which involves a combination of economic and financial advisory services to identify the interconnectivity and interdependence of the sector taking the limited resources into consideration (labour, land, capital and entrepreneurship) at a regional, national and global level.



Aviation economic insight and advisory

Our economic advisory team has extensive experience in conducting economic impact assessments for both public and private sector clients – including aviation sector operators. Our team measures the broad economic and social benefits and costs of aviation specific investments to help decision makers make informed choices.



Cybersecurity

Our cybersecurity solutions are designed for clients seeking to address a variety of complex security requirements. We can help organisations assess their security vulnerability, establish or improve their IT security processes and remediate breaches or compliance failures.



Credentials

In this section, we share examples of relevant projects entrusted to Grant Thornton Malta.



Airport zone strategy plan

Malta Industrial Parks: In 2018, Grant Thornton was entrusted by Malta Industrial Parks (MIP) to draft a cost-benefit analysis (CBA) and assist in the development of an Aviation Masterplan, also known as the Airport Zone Strategy Plan (AZSP). The plan focuses on the regeneration of underutilised sites at the Malta International Airport into a high-quality sustainable commercial aviation cluster.

The plan requires sizeable investments at the Malta International Airport, including runway improvement, a new engine run-up bay, a passenger terminal extension and offices among other projects. Overall, Malta would witness a substantial expansion of the current airport and airfield, along with new ancillary facilities entailing an estimated expenditure of €2 billion.

The project was split across five stages:

- Stage 1 – Information collection and literature review;
- Stage 2 – Stakeholder consultation;
- Stage 3 – Analysis of primary and secondary data;
- Stage 4 – Concept development to explore options, pre-determined criteria and implementation;
- Stage 5 – CBA including the economic and financial feasibility studies;
- Stage 6 – Drafting of Masterplan.

Grant Thornton carried out this engagement as a consortium led by local architecture firm iAS, and German aviation master planners amd.sigma and airsight.



Economic contribution of aviation sector

Aviation Advisory Committee & Ministry for Tourism:

In 2019, Grant Thornton was commissioned by the Aviation Advisory Committee (AAC) and the Ministry for Tourism to prepare an economic impact study, whose objective was to inform policymakers about the significance of the aviation sector to the Maltese economy.

The study involved an input-output model of the Maltese and quantifying the sector's economic contribution, in terms of the direct, indirect, induced and catalytic impact of every service provider within the aviation sector.

A great level of detailed data was obtained from various sources, including the National Statistics Office and publicly available information on financial statements of key players within the sector. The study also entailed the preparation of an outlook and an analysis of the environmental impact of aviation activities in Malta.

In 2021, Grant Thornton was commissioned by the AAC and the Ministry for Transport, Infrastructure and Capital Projects to update the study on the aviation sector's contribution to the Maltese economy, bearing in mind the implications of the COVID-19 pandemic. A similar methodology was applied as that of the previous study.

Additionally, stakeholder consultations were carried out to obtain a deeper understanding of the outlook of the aviation sector and to gauge the general views of economic operators and service providers within the aviation sector.



Aviation research, development and innovation

Institute of Aerospace Technologies: Grant Thornton had been appointed as consultants for the University of Malta by MCST under the FUSION programme, specifically to assess the ability to commercialise a technology being developed by the Institute of Aerospace Technologies. The technology targeting the identified industry concerns, the Project proposes a novel concept of automation within the sector.

Services provided include:

- **Market research:** identification of perspective users and customer readiness towards the technology; identification of geographical targets; primary and secondary market identification and analysis; assessment of industry trends; competitor/substitute analysis; PESTEL analysis; and assessment of barriers to entry;
- **Product development costing:** assessment of commercialisation options; review of operational assumptions; forecast market trends based on market research; assessment of an appropriate internal rate of return; preparation of financial projections; and breakeven analysis by setting price to levels that meet IRR under various scenarios;

- **Economic impact assessment:** estimation of output, incomes, employment, productivity and overall contribution of the Project; and potential welfare effects and their respective values;
- **Risk profile:** identification of drivers and pressures; sensitivity analysis; individual scenario analysis; combined scenario analysis; and Monte-Carlo analysis results.



Tax, audit and assurance services

In addition to the aforementioned projects, our teams have provided a vast array of different services to major players in the aviation industry.

Tax services: for easyJet Malta Limited (part of the easyJet Group) and Ryanair DAC (part of Ryanair Holdings plc);

Audit and assurance services: provision of audit and assurance services for AirX, a Malta-based private charter airline.



Financial restructuring

Financial restructuring for two connected and internationally operating European airlines including subsidiaries in the fields of aviation, aircraft maintenance and in-flight catering. The companies were hit by substantial economic disruption, high debt and overcapacities which resulted from previous acquisitions. A group insolvency was imminent.

Grant Thornton experts acted as the key turnaround manager and brought in strategic, restructuring and aviation operational expertise. Grant Thornton also acted as debt restructuring advisors and negotiator with international stakeholders, including: governmental bodies and regulators, shareholders, bondholders, aircraft investors and lessors and trade unions. The goal was to rapidly stabilise the balance sheet and to enable a prudent restart.

Grant Thornton substantially healed and stabilised the short, mid and long-term balance sheet and helped to avert insolvency. From this basis the client was able to successfully refocus its brand and could start over with a technically efficient fleet and efficient leasing arrangements.



Aviation network operations optimisation

The client was a leading European airline which was faced by network failures and increasing incident management costs, including cost intensive on-ground support and replacement bookings at key hubs. This was aggravated because the client was seeing increased levels of route losses following increased competition from low cost carriers in the intra-European shuttle market.

Grant Thornton supported the client's specialists in remodeling the aviation network; looking to optimise the key hubs' routes and on-ground operations. The engagement was intentionally designed as a mixed-team programme in order to effectively capture historic flight data and experience.

Through team integration and the provision of embedded subject matter experts, we were able to effectively analyse numerous scenarios. We delivered strong expertise which enabled the airline to strategically push a new RPM model which generated higher margin on competitive routes.



Pricing model for acquisition of aircraft

The client was an established aircraft trading and leasing company that specialised in narrow-body mid-life aircraft. The company have been actively looking to expand and rejuvenate its fleet.

Our multi-disciplinary aviation team was requested to produce an aircraft pricing model on an Excel platform based off the company's operations and processes.

The model was to produce an IRR based off the assumed aircraft purchase price and lease attached to the aircraft. As well as this the model had to use fly forward analysis to predict the maintenance condition of the aircraft upon lease end and this thus the metal value of the aircraft on return, along with the functionality to adjust the IRR should the lease be extended at the lease end date or should the aircraft be sold. Detailed cash flows and debt payment schedules also had to be included.



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