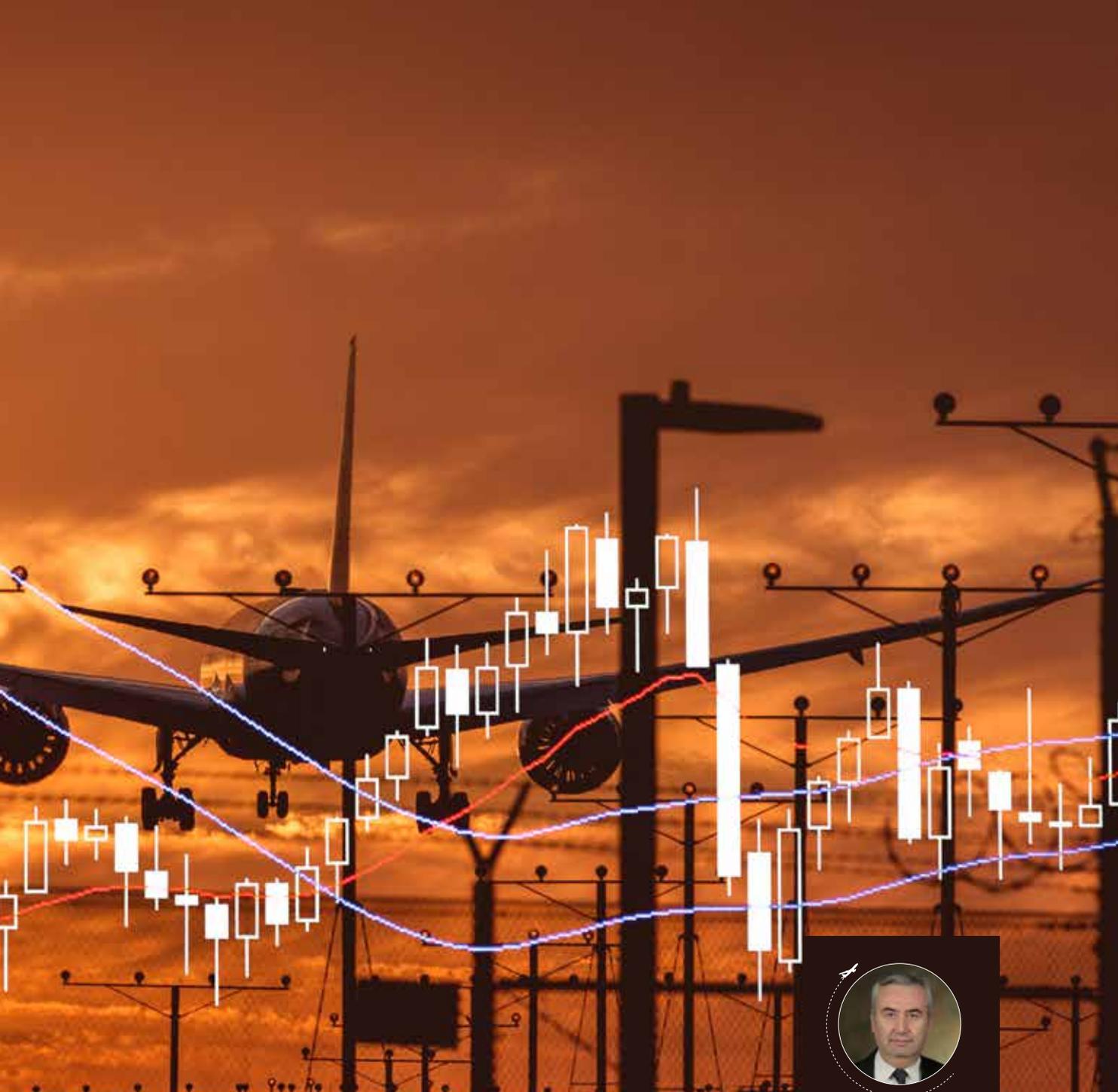




Will the Effects of COVID-19 Cause Irreversible Damage to the Aviation Industry?



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The pandemic-induced uncertainty makes predicting almost impossible. News about the vaccines developed against the coronavirus in the last quarter of the year raises hope that there's light at the end of the tunnel. Health experts and officials say the problem will be almost over by the winter next year. But even at this point, the uncertainty and unpredictability in the tourism and aviation industry still persists.

After the turbulent summer season, it is now widely believed that aviation may not return to normal for many years. Even if there is a glimmer of hope, airlines find it difficult to set their strategies because the fog of uncertainty still surrounds us. How the industry will develop in a post-pandemic world is still one of the big unknowns.

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SALES In Millions of USD Table-1	Sep-18	Sep-19	Sep-20	Değ.18/20	Değ.19/20
EasyJet plc	2.421	2.485	405	-83%	-84%
Gol Linhas Aéreas Int. S.A.	716	893	174	-76%	-81%
Singapore Airlines Limited	2.971	3.055	599	-80%	-80%
United Airlines Holdings, Inc.	11.003	11.380	2.489	-77%	-78%
Delta Air Lines, Inc.	11.953	12.560	3.062	-74%	-76%
American Airlines Group Inc.	11.559	11.911	3.173	-73%	-73%
Deutsche Lufthansa AG	11.561	11.018	3.119	-73%	-72%
Pegasus Airlines	603	726	206	-66%	-72%
Southwest Airlines Co.	5.575	5.639	1.793	-68%	-68%
Air France-KLM SA	8.759	8.294	2.960	-66%	-64%
Ryanair Holdings plc	3.203	3.355	1.232	-62%	-63%
Turkish Airlines	3.954	3.990	1.526	-61%	-62%
China Eastern Airlines Cor. Ltd.	4.871	4.844	2.529	-48%	-48%
Air China Limited	5.625	5.284	2.770	-51%	-48%
China Southern Airlines Co.Ltd.	6.018	6.119	3.886	-35%	-36%
TOTAL	90.793	91.553	29.922	-67%	-67%

As I mentioned in my previous articles, airline companies are the common component of the industry. Therefore, like many others, I believe it is necessary to focus on airlines in order to see the impact of the pandemic on the industry. For this reason, I tried to examine the figures of some

airlines as of the end of June in order to understand their financial situation during the pandemic.

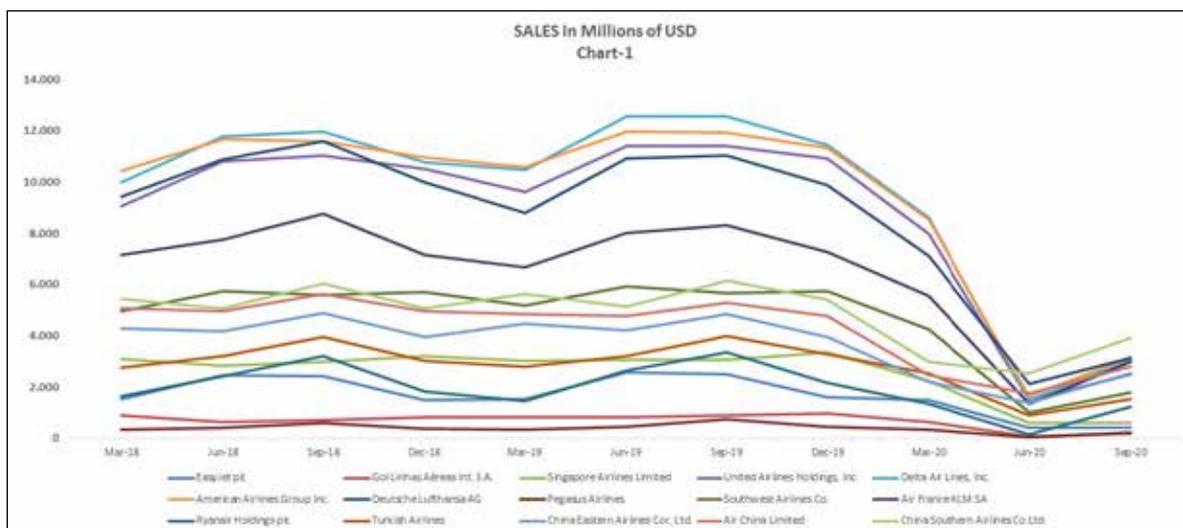
As we all know, September marks the end of the peak season both in tourism and the aviation industry. Generally, the third quarter financial outlook of the airlines in

the northern hemisphere is of great significance in terms of evaluating their performance in figures. The real success of companies shows itself during this period of high travel demand. In the following quarter, there is a decline in sales and profitability. In general, the most positive

figures for the related year are generated at the end of September. Thus, we can see the effects of the pandemic more clearly over the September-end data.

I would like to present some points in order to evaluate the course of the industry with 15 publicly listed companies whose financial data was published at the end of September. I also wanted to include some other companies such as Qatar Airways and Emirates, but I couldn't access their financial data. I will try to outline the changes in the activities and fiscal structures of the companies through some tables and graphs.

When we look at the activities of the companies only in Q3 (not cumulative) of the last three years, we can see in **Table-1** how company sales show a change in years. Accordingly, the total sales of the 15 companies



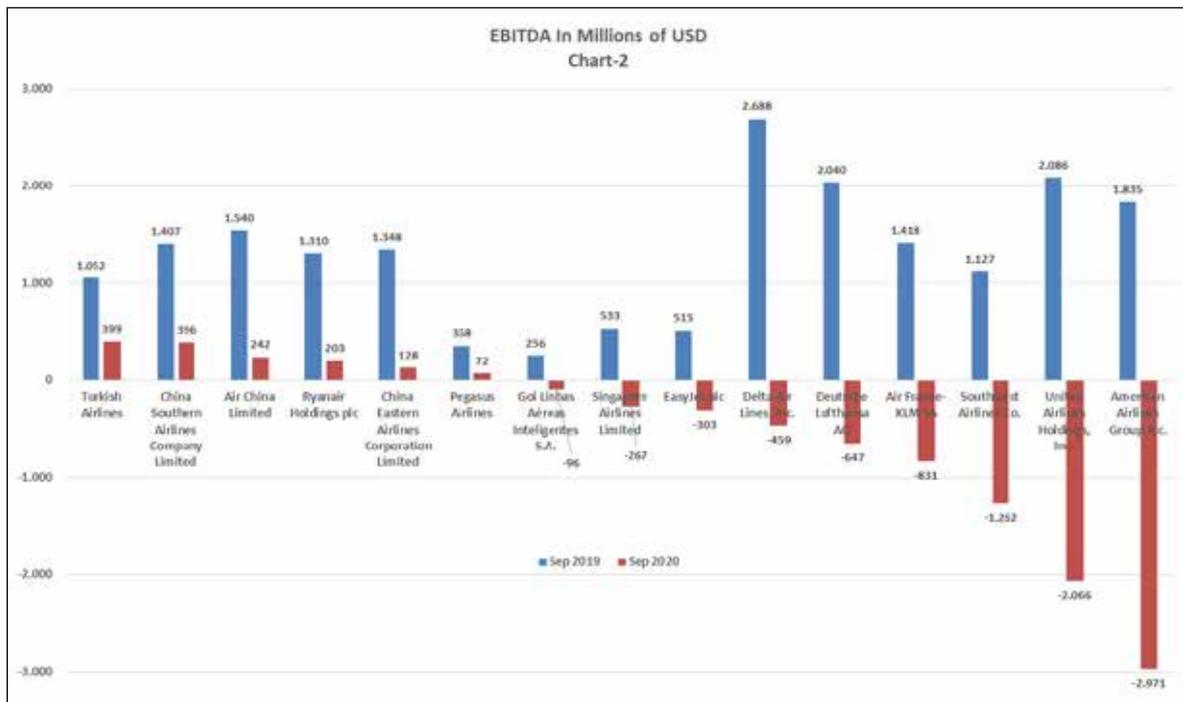
decreased by 67% compared to September turnovers both in 2018 and 2019. EasyJet, GOL and Singapore Airlines are the companies with the highest losses of 80% or more in their sales. While US airline companies have the highest turnover among these airlines in 2019, we see that this has changed after the pandemic. In 2020 Q3, the company with the highest turnover among 15 companies was China Southern Airlines with US\$ 3.9 billion, while American Airlines was the second with US\$ 3.2 billion and Lufthansa was the third with US\$ 3.1 billion. As can be seen from the table, Chinese airlines have the lowest decline in turnover compared to other companies. The course of turnover since the beginning

EBITDA Margin.% Table-2	Sep-18	Sep-19	Sep-20
Pegasus Airlines	33%	49%	35%
Turkish Airlines	27%	26%	26%
Ryanair Holdings plc	40%	39%	16%
China Southern Airlines Company Limited	20%	23%	10%
Air China Limited	26%	29%	9%
China Eastern Airlines Corporation Limited	26%	28%	5%
Delta Air Lines, Inc.	19%	21%	-15%
Deutsche Lufthansa AG	19%	19%	-21%
Air France-KLM SA	19%	17%	-28%
Singapore Airlines Limited	14%	17%	-45%
Gol Linhas Aéreas Inteligentes S.A.	12%	29%	-55%
Southwest Airlines Co.	20%	20%	-70%
EasyJet plc	19%	21%	-75%
United Airlines Holdings, Inc.	16%	18%	-83%
American Airlines Group Inc.	15%	15%	-94%

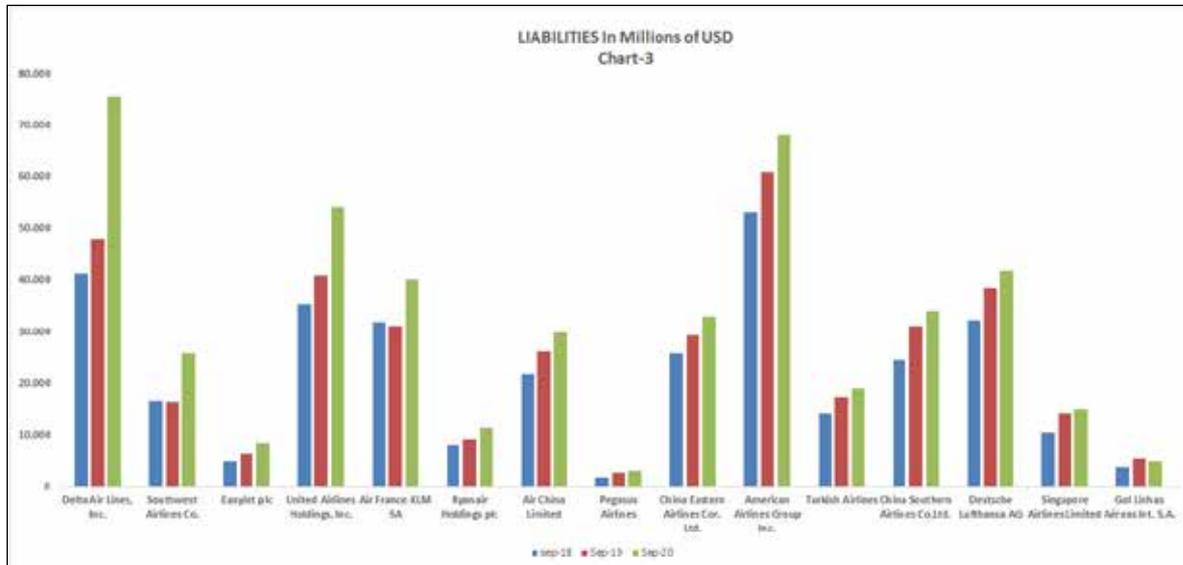
of 2018 and the sharp decline since June 2020 are clearly seen in **Chart-1**. When we examine the comparison made in similar periods in sales over the real operating profits (EBITDA),

we see that the EBITDA profit of airline companies decreased by 138% in total compared to September 2019. This loss is greater than the rate of decline in sales. Realizing the highest EBITDA

profit of US\$ 2.7 billion in 2019 Q3 among 15 airlines, Delta Airlines recorded a loss of US\$ 459 million in 2020 Q3. The profitability ranking among companies has also changed compared



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to the previous year with the effects of the pandemic. With an EBITDA profit of over US\$1 billion in the same period of the previous year, the profitability of Turkish Airlines declined by 62% to US\$ 399 million in 2020 Q3. However, Turkish Airlines has achieved the best results among 15 airlines with

such profitability. On the other hand, while Turkish companies maintained the EBITDA margin, it is seen in **Table-2** that other companies' margins declined considerably and some of them took dropped into negative figures.

It is also noteworthy in

Chart-2 that the companies with high EBITDA profits in Q3 of the previous year were the airlines with the highest losses in Q3 after the pandemic. While these companies (except Ryanair) appear as US and European airline companies, it is seen that Chinese companies do not incur losses despite

the substantial profitability loss. We can also say that the pandemic causes permanent damage to airline companies that encounter high EBITDA loss. It will be difficult to compensate for this loss over many years, with the damages to occur in the coming winter season.

Many of the airline companies, the sales and operating profitability of which declined or even turned into losses, strived to endure this tough period through funds generated in the past and/or through borrowing. As a natural outcome, their working capital and fiscal structures weakened.

The total level of debt of the 15 companies increased from US\$ 377.6 billion in 2019 Q3 to US\$ 464.8 billion in 2020 Q3 with an increase of 23%. **Chart-3** illustrates the funds borrowed by companies in Q3 in the last three years.

EQUITY In Millions of USD Table-3	Sep-18	Sep-19	Sep-20
EasyJet plc	4.214	3.670	2.450
Gol Linhas Aéreas Int. S.A.	-1.115	-1.826	-2.517
Singapore Airlines Limited	10.550	8.825	11.460
United Airlines Holdings, Inc.	9.469	11.301	7.003
Delta Air Lines, Inc.	13.704	15.068	3.357
American Airlines Group Inc.	-568	160	-5.528
Deutsche Lufthansa AG	13.287	9.801	3.925
Pegasus Airlines	743	842	761
Southwest Airlines Co.	10.153	9.931	9.769
Air France-KLM SA	3.822	1.933	-5.480
Ryanair Holdings plc	6.335	6.929	5.838
Turkish Airlines	6.012	6.637	5.710
China Eastern Airlines Cor. Ltd.	8.985	10.036	8.809
Air China Limited	15.038	14.233	12.913
China Southern Airlines Co.Ltd.	11.591	11.000	12.376
TOTAL	112.218	108.539	70.847

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As the debts of Singapore Airlines and China Southern Airlines increased during the pandemic, their equities also increased. While the equities of other companies significantly depleted, the equities of some turned negative. The equity changes of the companies in the last three years can be seen in **Table-3**. In general terms, the distribution of liabilities has changed in favor of debts as a result of the increase in the borrowing of companies and/or the depletion of their equity.

In other words, I think there is an effort to overcome the impact of pandemic by financing assets through borrowing. This shows us that the financing costs that will arise as a result of the high indebtedness of companies in the medium and long term will pose a significant challenge in compensating their losses during the pandemic period. The financing costs to be incurred while trying to recover in the future should also be managed well. Another drawback may arise regarding the maturity structure of borrowed funds. Maturity mismatch between assets and liabilities may also cause trouble in corporate cash management in the medium and long term. Although it is a solution to overcome the difficulties in the short term, borrowing with an inappropriate maturity structure (short-term borrowing) may lead to more severe problems

Current ratio - Table-4	Sep-18	Sep-19	Sep-20	+/-
Southwest Airlines Co.	0,71	0,65	2,07	+
Singapore Airlines Limited	0,72	0,41	1,30	+
Delta Air Lines, Inc.	0,37	0,34	1,27	+
United Airlines Holdings, Inc.	0,63	0,54	1,04	+
Pegasus Airlines	1,76	1,37	0,96	-
Ryanair Holdings plc	1,25	1,27	0,86	-
American Airlines Group Inc.	0,58	0,49	0,74	+
EasyJet plc	0,97	0,79	0,67	-
Air France-KLM SA	0,78	0,68	0,62	-
Deutsche Lufthansa AG	0,78	0,68	0,62	-
Turkish Airlines	1,05	0,74	0,61	-
China Southern Airlines Co.Ltd.	0,37	0,19	0,34	+
Air China Limited	0,33	0,33	0,28	-
Gol Linhas Aéreas Int. S.A.	0,46	0,47	0,24	-
China Eastern Airlines Cor. Ltd.	0,27	0,26	0,24	-

in the next period. On the other hand, companies that have to overcome the crisis by investing in short-term assets through long-term borrowing may have low profitability in the future. This means that the loss will be compensated over a longer period than expected. Needless to say, we assume that companies will not undergo another crisis in the future.

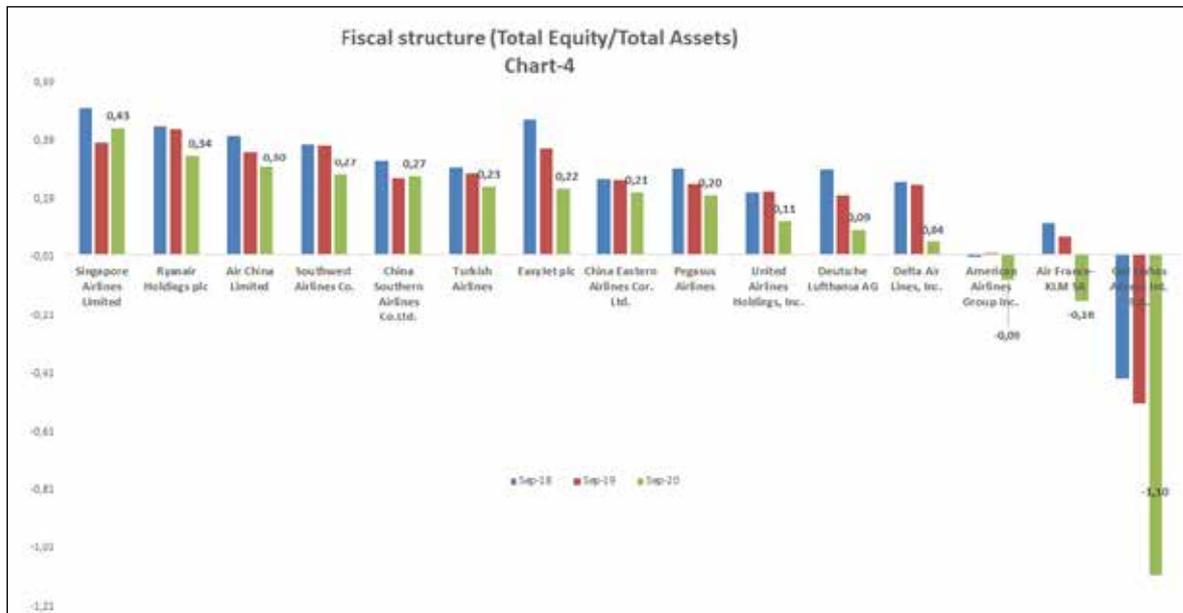
Looking at the adequacy of companies' working capital after the equity increase and / or borrowing can also give us an idea on maturity matching. When we look at the data of the current ratio in Q3 over the last three years, which shows the capacity of companies in **Table-4** to pay their short-term liabilities with

current assets, it is seen that there are increases in US companies and Singapore Airlines and decreases in many other companies. In other words, we can say the significant portion of the funds, which US companies acquired through borrowing and Singapore Airlines through equity increase, was used in short-term assets. Although China Southern Airlines' current ratio increased compared to 2019, when we look at the average for the last two years, no significant increase has been recorded.

When we also look at the change in the fiscal structures of companies after borrowing due to the pandemic, we can clearly see the change in the resource structure stated

above in favor of borrowing in **Chart-4**. It is possible to say that the fiscal structures of all companies are negatively affected, except for Singapore Airlines, whose resource structure is sound in terms of equity, and China Southern, which has not undergone a significant change compared to previous years. The fact that companies prefer to overcome the pandemic through borrowing (some of which comprises state aid) actually means that they defer the problem in a sense, as we previously stated. The more deterioration in fiscal structure compared to previous years, the more severe the problems and their duration will become in the following period. Fulfilling part of

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the resource needs by increasing equity will make it easier to solve the problems and will enable companies to return to their pre-pandemic situation (number of passengers, market share, etc.) sooner. Despite the fact that borrowing is a solution in the short term, it can lead the related company to lag behind its strong competitors in the post-pandemic period.

On the other hand, as it will be difficult to put any other securities in place except share transfer in return for unpaid debts, we will probably see partial nationalization and / or airline companies to be owned by financial institutions in the future.

Certainly, it would be quite assertive to make a definitive judgment on the overall aviation

industry, based only on the balance sheets and income statements of the 15 airline companies of which we are trying to examine changes in their sales volumes, operating profitability, borrowing, fiscal structure and working capital before and after the pandemic. However, the figures of some companies, which have an important place in the global aviation industry and in their own region, give us the opportunity to make some comments and draw inferences.

I don't want to make a generalization, but it seems that American and European network airlines have been suffering more from the pandemic than other companies and it will be difficult for them to overcome the impacts of the pandemic for a long while. On the other hand, the working capital

of these companies did not show a considerable change or were stronger than the pre-pandemic period. Therefore, it is quite positive for these companies that there will be no problems in terms of cash management and managing short-term liabilities.

The remaining companies will possibly recover much more quickly in the aftermath of the pandemic. We see that these companies are the ones that entered into the pandemic process with a strong financial structure and / or successfully have managed their operating profitability in this process. Turkish Airlines and Pegasus Airlines also are included in this group. We can also say that the Turkish companies will have the competitive advantage after the pandemic, if they

do not make any strategy mistakes and do not suffer any significant damage during the winter season.

Chinese companies are also in an advantageous position, but the negative outlook on their working capital adequacy creates the impression that they may have difficulties in cash flow management in the short term. Among the 15 companies, we can easily say that the companies with the potential to make the biggest moves after the pandemic are Singapore Airlines, the second is Turkish Airlines and the third is Ryanair, and they are followed by low-cost carriers.

Note: Sources used for financial data of companies: <https://seekingalpha.com/> and Bloomberg 