

Effects of COVID-19 on Credit Risk and Crisis Aftermath of Airline Industry Public Project Summary

Central European University, MS Finance, Capstone Project Summary

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June 15, 2020

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Abstract

We have experienced a serious COVID-19 crisis starting from the beginning of 2020, having its disruptive impact on economies and businesses. We are all well-informed about the costs of the COVID-19 pandemic in different business sectors. The airline industry is especially hard hit by the pandemic resulted in devastating losses and increased credit risks.

This capstone project investigates the financial performance of six North American airline companies and their credit metrics after the coronavirus outbreak. This study introduces the literature review on recent financial performance, recent credit ratings, and companies' combative activities. The project investigates two main research questions related to the understanding of current credit risk metrics of the North American airline companies and recovery timeline after the COVID-19 crisis. In addition to these, there will be discount cash flow and relative valuations of the actual share price of the airline company.

Keywords: COVID-19 crisis; airlines; credit risk.

Introduction

The project was prepared to provide an updated brief overview of the current COVID-19 impact on the airline business, its direct effect on the slow down on the industry, financial slackening, and management measures taken against the crisis. The credit professionals, who are involved in rating the creditworthiness of the airline industry, actively observe the up-to-date developments, news within the sector on which the sector heavily depends on.

Recently, the credit risk exposure of airlines escalated enormously due to the crisis and thus increased the closer scrutiny. This project will provide a general overview of the abovementioned topics and will also try to broaden the topic of what steps companies' management has taken to address the financial destabilization and the timeline to get back to the previous performances. This project will consider also look closely how credit metrics have changed due to the pandemic and will provide the projections for the next several years.

Moreover, the paper will provide detailed DCF and relative valuation calculations on the share price. The project will conclude with the economists' predictions on the economy which has a direct implication of the airline's performance.

Literature Review

The aircraft business has confronted a critical antagonistic effect because of movement limitations. Numerous states have quarantines, bans, and limitations for residents of or voyagers to the most influenced territories. With outstandingly low voyages, limitations have had a deteriorative monetary and social effect on the air carrier segment across numerous locales.

The COVID-19 pandemic caused unprecedented hard times – eleven airlines have gone into bankruptcy, administration, or Chapter 11 protection 1. The zero revenues and recurring expenses make companies extremely vulnerable.

The Colombian air carrier Avianca, the world's second established aircraft, declared financial insolvency assurance due to the "unforeseeable effect of the COVID-19 pandemic," as per an announcement discharged on its website in May 2020. The motivation to petition for financial protection was to ensure and safeguard activities during the continuous pandemic. According to the announcement, Avianca legitimately provides working opportunities for 21,000 individuals all through Latin America. About 90% of nations where Avianca works are under complete or partial travel limitations, as indicated by extra data on the website. "Avianca is confronting the most testing emergency in 100-year history as we explore the impacts of the COVID19 pandemic," said Anko van der Werff, the organization's CEO.

Trump's management, under the \$2.3 trillion CARES Act 2, supported by extra liquidity to carriers. Trump said that aircrafts are qualified for \$25 billion in hard cash for pay sheets; freight transporters can get \$4 billion while air terminal contractual workers like cooks and plane cleaners are qualified for \$3 billion. The biggest six carriers, like American Airlines, United Airlines, Delta Air Lines, Southwest Airlines, JetBlue Airways, and Alaska Airlines will get 90% of the bailout. Nonetheless, it's not obvious how the organizations will reimburse the low-interest credit.

Undoubtfully, the pandemic is reflected in the share prices of the companies which plunged in the first quarter of 2020. The S&P 500 Airline Industry index has fallen 64.6% from 2019 levels.

Just in the first quarter of 2020, Berkshire Hathaway confronted \$5 billion cleared off the estimation of its aircraft possessions. The organization possessed 8%-11% of the largest four US carriers — American Airlines, Delta Air Lines, Southwest Airlines, and United Airlines. The group of four's market capitalizations was down approximately by 52% in the initial three months of 2020. Accordingly, the company sold the whole stake in the carrier business.

As of December, Berkshire held 42.5 million (10% stake) American Airlines shares, 58.9 million (9.2% stake) Delta Air Line, 51.3 million (10.1% stake) Southwest, and 21.9 million (7.6% stake) United Airlines. The stocks were down 62.9%, 58.7%, 45.8%, and 69.7%, consecutively in the first three months of the year 2020.

Findings and Conclusion

The discoveries show nearly naught incomes, lower than zero margins, and surprisingly high leverage peaks in 2020, just as negative cash flow coverage. These have brought about diminished per share valuations by financial specialists which worth offers three to multiple times lower than pre-COVID times. However, the aircrafts are very little autonomous than cutting their costs, arranged capital consumptions, including by delaying ventures regarded non-basic to the Company's tasks, suspending the offer repurchases, just as raising capital through new borrowings.

The coronavirus perseverance must be hindered by the making of an antibody. The US authorities and researchers foresee that an antibody to forestall COVID-19 will be prepared in the primary portion of the year 2021. The bounce-back of the carrier execution is relied upon to happen subsequently. The empowering factor is that 23 organizations are working at the development of the immunization.

Until that immunization is worldwide, the significance of the decrease in rush hour gridlock identified with the pandemic is causing enormous “cash burns” for carriers. A significant stretch of discouraged aircraft traffic joined with obligation raised to oversee liquidity, will make all transporters work with debilitated credit measurements and diminished monetary adaptability in any event through 2021. For the present, it's expected that a measured pace of recovery in demand and passenger volumes should begin in the third quarter before a steady rebound to somewhat normal levels at the end of the 2021 fiscal year.

It's expected that 2021 traffic to recover to about 80-90% of 2019 levels, however, this is subject to impressive vulnerability. From the credit risk perspective, all the quantitative scores will be severally hurt unless the international borders are open to handle international flights. By then, the companies are exposed to cash burns which are slightly mitigated by support with additional liquidity from the US government under the CARES Act framework. Furtherly, returning to the previous financial performance will take several years and cash flow coverage over debt levels will be kept low due.

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