Value of airline assets takes a nose-dive

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US airlines charged into debt markets after the pandemic began in an effort to weather an unprecedented collapse in demand. Investors have snapped up deal after deal, their money secured by jets, routes and take-off and landing slots all worth billions on paper.

But with a recovery in air travel years away, how much could aviation assets fetch in a sale today?

Lenders acknowledge little appetite for repossessing aeroplanes that, because capacity outstrips demand for air travel, can only be sold or leased at a discount, or worse, will cost money as they sit in storage. Meanwhile, slots, gates and routes — SGR in industry parlance — retain value as long as an airline continues to operate, or if another airline wants to buy them. The pandemic increases the likelihood of airline bankruptcies while reducing the number of ready buyers, as survivors struggle to preserve cash.

"Aircraft, and slots, gates and routes, no longer have the same value they did at the end of January this year," said Ernie Arvai, president of AirInsight Group. "Aircraft, as with many other assets, are subject to the laws of supply and demand."

Or as Nick Pastushan, chief executive of aviation finance company Warbird Capital, put it: "You might have a very wide spread between what's on paper and what a third-party investor would be willing to write a cheque for."

US airlines are racing to shore up their balance sheets as they individually burn through tens of millions in cash each day. Fortified by US government backing in the form of a $50bn industry bailout in March, the airlines turned to the capital markets and banks.

Delta Air Lines, the strongest legacy carrier in financial terms, raised $5bn in April through a combination of bonds and loans backed by slots at airports in New York and London's Heathrow.

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American Airlines raised $4.5bn — $2.5bn in the form of debt secured by slots at Heathrow and New York John F Kennedy airports and routes to the Caribbean, Mexico and other destinations worldwide. Altogether, the first-lien collateral was appraised at between $7.5bn and $13.3bn, and second lien between $6.5bn and $11.7bn.

The industry expects a lengthy downturn. Airline executives and analysts are forecasts it will take three years or more for demand to recover to 2019 levels.

Sinking demand from passengers has led to falling demand for planes. About 43 per cent of the global aircraft fleet is parked, according to Cirium, an aviation data consultancy. Airlines are deferring deliveries — even Qatar Airways, "the airline that always wants 50 of everything", noted Richard Aboulafia, analyst at Teal Group. When legendary investor Warren Buffett dumped his airline stocks, he said carriers had "too many planes".

A long-lived asset, aircraft value stems from the cash generated from operations, which determines lease rates. Youcef Berour Minarro, analyst at aviation consultancy IBA, said jet values overall had shrunk between 20 per cent and 30 per cent because of the pandemic. Values for wide-bodied aircraft, used for the intercontinental routes where demand recovery is expected to be slowest, are falling faster. Airlines are weeding through their fleets to retire the oldest planes.

Collateral values for aircraft older than two decades are falling fast, since "the threat is that in bankruptcy [as] collateral they're not as valuable", said a senior aviation banker at a large Wall Street firm. In fact, a bond deal offered by United in May was scuttled partly because investors sniffed at the older aircraft offered as security.

Newer aircraft can secure a loan for up to 60 per cent of appraised value, the banker said. Before the coronavirus crisis it would have been up to 75 per cent. Older planes command a loan-to-value ratio of less than 40 per cent, compared with 50 per cent before the crisis.

Mr Pastushan estimates a $600bn hit to aircraft values/net present value cash flows across the more than 20,000 planes that existed in the global fleet at the start of 2020.

For take-off and landing slots at busy airports, value lies in scarcity. James Halstead, a partner at consultancy Aviation Strategy, said during good times a pair of daily slots at London's Heathrow sold for between $20m and $40m, falling to a tenth of that during bad times. Oman Air paid $75m in 2016 for a pair of slots.

Airlines hold slots for years for their strategic importance, which protected their valuation from extreme fluctuation, said Anne Correa, vice-president of airline and airport services at appraiser and consultancy Morten, Beyer & Agnew.

“This (pandemic) is worse than anybody’s worst-case scenario,” Ms Correa said. “That being said, we always do incorporate the cycle . . . We do not expect there to be much volatility with slots. With routes, there could be some.”

Lenders were confident that slots would not depreciate, even in a US bankruptcy, the banker said. There is less certainty about how courts outside the US would treat the collateral.

The crisis had not altered how lenders valued aircraft or SGR, a different banker at another Wall Street firm said. “If you believe people are going to continue to travel, and we do . . . then it’s just a matter of figuring out what are the assets that are going to be needed going forward.”

But investors who have bought airline debt, even with double-digit interest rates and collateral, are “implicitly betting the airline will survive”, Mr Pastushan said. They are underestimating how little a traffic drop it takes for an airline to go bankrupt as well as the sums required to keep one operating through 12 or 18 months of low traffic.

An airline bankruptcy forces bondholders to try to monetise their collateral. Creditors can store planes against the day it is profitable to sell or operate them, but SGR need to be sold to an airline to realise their value. As airlines hoard cash, that could prove tricky.

“Who could you sell it to? Who has the money?” Mr Pastushan said. “If one of those airlines fails, those bondholders are going to take a bath . . . The traditional view is these things are scarce, and they have value because these route rights are profitable, and in normal times that is true. But we’re not in normal times.”

Additional reporting by Eric Platt in New York