

New scenarios under study to save Air France-KLM



## I Letter from the Director Air France-KLM

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N°781, November 9, 2020

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### *Editorial*

*Dear Readers*

*On Monday, November 9, the announcement of a potentially effective vaccine against Covid-19 turned the news upside down.*

*You will find the details of this announcement in the "Bonus Article" section.*

*There are still steps to be taken before this vaccine is validated and put into production. Until then, let us continue to respect the "barrier" measures.*

*Good reading François*

### *Monday's Press Review*

#### > **New scenarios under study to save Air France-KLM**

(source La Lettre A) November 3 - While the air transport crisis will continue for several more months, Bercy is working on new support for Air France-KLM. All avenues remain open, but **two options are currently on the table** for Bruno Le Maire, Minister of Finance, and

Martin Vial, State Equity Commissioner and director of the Franco-Dutch group. **The first is to convert part of the €3 billion shareholder loan granted by France in May into quasi-equity. The second**, led by Mickaël Nogal, Member of Parliament (La République en marche), concerns the **extension of the amortization period for the 4 billion euro state-guaranteed loans (PGE).**

The first measure would enable the French State to strengthen the solvency of Air France-KLM without having to mobilize additional financing. **One of the hypotheses would involve the issue of perpetual subordinated bonds which, with no repayment due date, are treated as equity.** This solution generates very high interest rates, but overall equivalent to those of the shareholder loan (7% for the first four years, rising to 7.75% thereafter).

Air France-KLM, headed by Canadian Ben Smith since 2018, had already carried out a similar operation in **2015. The group had issued €403 million in perpetual bonds to private investors, which were redeemed on September 1.**

The extension of the EMP amortization period would also allow Air France-KLM to breathe easier from a strictly accounting point of view. Currently between one and five years, this amortization period could be extended to between five and ten years. However, this would not delay the repayment term, currently one year, with the possibility of extending it to three years (...)

These two options for cleaning up Air France-KLM's balance sheet are easier to implement than **recapitalization**, but the latter option is **still being studied in both Paris and The Hague.** Wopke Hoekstra, the Dutch Minister of Finance, has not hesitated to make several statements to this effect in recent months.

**However, any recapitalization would require an agreement between the four main shareholders of the group:** the French State (14.3%), the Dutch State (14%), Delta Airlines (8.8%) and China Eastern Airlines (8.8%). This could give rise to tough negotiations, especially if the current balance is disturbed as a result of the transaction.

Relations within the Board of Directors have been strained since the coup de force carried out by the Dutch government in February 2019. The Dutch government had acquired 14% of Air France-KLM's capital in the greatest secrecy. **The French government included a 5.5% step up on the interest rate on its shareholder loan to force its incorporation into the capital if necessary**, but also to counter any new capital maneuver on the part of the Dutch if it was carried out without their consent.

**A capital increase through the issue of shares on the market seems to be excluded for the time being:** this operation would be very risky in view of the Group's current market capitalization. This has

been divided by three since February and has fallen below 1.2 billion euros.

For the time being, Air France-KLM still has a little time left with more than 12 billion euros in cash. In September, Ben Smith estimated in the press that he would be able to last a year thanks to the aid already obtained from the States. So far, the group has only drawn 4 billion euros out of the 7 billion euros of aid from the French State for Air France and 900 million euros out of the 3.4 billion euros of aid from the Dutch State for KLM (...).

**My comment :** *Some details about this article :*

*The perpetual bonds mentioned in the article had been subscribed in 2015 for an amount of 600 million euros. A first tranche had been repaid a year ago. The remainder (403 million euros) was repaid in October 2020.*

*The 5.5% step up is an increase in the rate of the loan granted by the French State in the event that : :*

- (i) the shareholders' meeting refuses to approve a capital increase proposed by the Board of Directors that would allow all or part of the amount of the shareholder loan to be incorporated into the Company's share capital, (*
- ii) the shareholders' meeting approves a capital increase without the agreement of the French State that does not allow all or part of the shareholder loan to be incorporated into the share capital (*
- iii) a third party not acting in concert with the French State comes to hold, alone or in concert, 20% of the Company's share capital*

## > **Air France's recapitalization is taking shape**

(source: Le Journal du Dimanche) November 9 - Winter promises to be long, very long for Air France. The 7 billion euros injected by the French government, the 7,500 job cuts expected and the reduction of flights to 35% will not be enough. **The airline is heading straight for a new capital injection.** Bercy's teams are confirming to the JDD that they are working on a transaction while the group, advised by the investment bank of brothers Yoël and Michael Zaoui, is studying the options for this inevitable recapitalization. It should be done in two stages, with a first operation by the end of the year, and could involve hybrid debt, as EDF did last year. In addition to the French State and Air France, the Dutch State, a shareholder of the group, must validate the project.

(...) Air France also had to review flight management. The only watchword: no plane takes off if it is not profitable. "We used to build the

company's five-year route plan and determine the one-year program with minor adjustments," says Olivier Piette, network director. He now thinks in fifteen days, depending on the costs associated with each takeoff. Everything is weighed in the balance: crews, taxes, ground personnel and especially fuel. Like all airline groups, Air France did not anticipate the drop in traffic and has to pay for fuel that it does not use. **On long-haul flights, in September and October, Olivier Piette's teams managed to maintain more flights than Air France, British Airways or Lufthansa competitors, who were severely impacted by the halt in traffic to North America. They compensated by taking advantage of revenues from the Cargo business, as freight prices took off with the overall decline in the number of available aircraft. It is these flights that enabled the company to maintain 30 to 40% of its business.**

***My comment:** The recapitalization of the Air France-KLM group is inevitable. Week after week, until the official announcement, the financial experts will express their views on the subject.*

*I can only reiterate my comment of last week:*

*How will the recapitalization take place? Chief Financial Officer Frédéric Gagey was as clear as possible, given the constraints imposed by the stock market gendarme.*

*Several solutions are being studied, most of which have already been implemented earlier this year in other airlines (Lufthansa, SAS, Alitalia, Norwegian, Singapore Airlines, TAP).*

## **> KLM: 3.4 billion euro support plan from the Netherlands receives final approval**

(source Agefi-Dow Jones) 6 November - The air transport group Air France-KLM announced Friday that the Dutch government's 3.4 billion euro support plan for its Dutch subsidiary KLM had received final approval.

The plan, which includes 2.4 billion euros in loans guaranteed by the Netherlands and 1 billion euros in shareholder loans, had been conditioned by The Hague on a series of elements, including the acceptance by KLM's unions of austerity measures.

But the VNV and FNV unions had not yet given their approval last weekend, which prompted the Dutch government to freeze the support plan. Since then, KLM has signed an agreement with the VNV and FNV, which joined six other trade unions.

**The collective agreements signed with the eight unions "define the austerity measures that will apply until the beginning of 2022, for pilots, and until the end of 2022, for ground and cabin staff,"** Air France-KLM explained.

"It was particularly important to specify the contribution that all KLM employees would make to the airline's cost-cutting efforts throughout the duration of the loan. **To meet this demand without having to resume negotiations, a 'commitment clause' was inserted in the agreements between KLM and the unions,**" the company explained. "KLM and the eight unions have thus met an essential requirement, by guaranteeing the final approval of the 3.4 billion loan by the Dutch State," Air France-KLM concluded.

***My comment:** The KLM trade unions had agreed in principle to the austerity measures on 1 October. Faced with the accelerating health crisis, the Dutch government wanted to increase the duration of the commitments.*

*The additional commitment clause signed by the unions does not change the duration of the agreements. For more details, read the article below.*

### **> Approval of KLM restructuring plan (Approbation du plan de restructuration de KLM)**

(source Dutch Ministry of Finance, translated with DeepL) November 6 - (...)  
**After receiving the restructuring plan, the Cabinet identified a number of points to be taken into account.**

**Firstly, there were agreements with the trade unions only for part of the duration of the aid. KLM has since received a written commitment from the unions that after this period and for the duration of the support program, a contribution to cost reduction will be made through the terms and conditions of employment.**

In addition, further savings were necessary for the years 2023-2025 in order to achieve the required 15% reduction in the influenceable costs in these years as well.

This point of attention was discussed with the external consultant and KLM.

The external consultant indicated that it is usual for an airline to have a restructuring plan in which the short-term actions are elaborated in detail and the long-term actions are more "high level".

Generally, these "high level" actions are refined and developed in detail as the plan progresses.

In response to this concern, KLM has drawn up an addendum to the restructuring plan, which includes additional savings for the period 2023-2025, which will also enable the envisaged cost reduction to be achieved during this period. The external consultant has validated the addendum to the restructuring plan and confirms that KLM complies with the conditions set. Taking into account this addendum and the commitment of the trade unions, the firm concludes that the restructuring plan meets the conditions set by the Dutch State.

(...)

***My comment:*** This article is an excerpt from the public letter sent by the Dutch Minister of Finance to MPs.

*This long letter (seven pages) contains the main elements of KLM's restructuring plan. In addition to the commitments made by the trade unions, the key points are detailed :*

- . Reducing the workforce and increasing productivity*
- . KLM labor cost reduction*
- . Fleet renewal and agreements with supply chain partners*
- . Sustainability and quality of life*

*The efforts required of KLM are for the most part of the same nature as those required of Air France. The differences in the efforts made by employees stem from the different employment and remuneration conditions between the two countries. But no one is spared.*

### > **Covid:** Lufthansa goes into virtual obstruction

(source Les Échos) November 5 - **The Lufthansa Group** will end the year in near obscurity. To limit the financial haemorrhage, the leading European air transport group, which includes, in addition to the German airline, Austrian Airlines, Swiss and Brussels Airlines, **will only put a maximum of 25% of its 2019 offer on line in the fourth quarter**, leaving 125 aircraft on the ground. It is hoped to gradually increase this percentage to 50% for the full year 2021 in the third quarter, "if the evolution of the pandemic allows it," the press release states. By way of comparison, the IAG Group, although equally in a bad way, plans to offer 30% of its offer in the fourth quarter, while Air France and KLM expect 35% and 45% of activity respectively. The Lufthansa Group's move comes after a catastrophic third quarter, during which the

Lufthansa Group's offer fell to 22% of the 2019 level, with aircraft flying half empty.

**In three months, the group has thus burned 2.1 billion euros in cash, twice as much as Air France-KLM**, mainly due to reimbursements for cancelled flights, which amounted to 2 billion euros. For the first nine months of the year, Lufthansa's net loss already stands at 5.6 billion euros, for revenues of 11 billion euros (compared to 28 billion euros for the same period in 2019). And this net loss is expected to increase further in the fourth quarter, with exceptional charges related to redundancy plans currently under negotiation (...).

Financially, **Lufthansa has enough to hold on with 10.1 billion euros in cash on hand**, including 6.3 billion euros in state-guaranteed loans - still unused. Its cargo business is generating profits (169 million euros this quarter), helping to keep lines in operation. In addition, the group has apparently already repaid 90% of the millions of flights cancelled since the beginning of the crisis.

**The CEO of Lufthansa group**, Carsten Spohr (...) was **nevertheless rather optimistic** (...). **According to him, business travel will resume as soon as the covid tests are generalized** in airports (...). In his view, the resumption of business traffic will benefit above all companies with powerful international hubs (...).

***My comment:** After the CEO of Emirates, it is the turn of the CEO of Lufthansa to be optimistic about the return of business customers.*

## > Spain approves 475 million euro loan to Air Europa

(source Belga) November 4 - This is the first time that a fund created for strategic companies hard hit by the coronavirus pandemic is being used, said the minister (...).

During the first wave of the pandemic, **Air Europa had already received 140 million euros from the state**, the newspaper El Pais also recalled.

Montero said the **government would now have a say in the sale of the company or in potential alliances. This could have an impact on the agreement reached last year by the Spanish airline Iberia to take over Air Europa for 1 billion euros.**

British Airways' parent company, International Airlines Group (IAG), to which Iberia also belongs, would however demand a substantial price reduction from the owner of Air Europa, the holding company Globalia, due to the collapse of air traffic caused by the coronavirus pandemic, according to several media (...).

## > EasyJet and Ryanair drastically reduce their flights this winter

(source Business Insider) November 6 - Airlines are still suffering. **EasyJet announced** on Friday, November 6 **that it is reducing its flight capacity for the last three months of this year to "20% at most" of** what it originally planned for this period, in response to the containment measures imposed across Europe to combat the Covid-19 pandemic (...).

Its "low-cost" competitor **Ryanair** also continues to reduce its flight capacity for the coming months, and **now expects to** reduce it by up to **40% compared to last winter's level**, as the UK, France, Germany and Ireland, among others, close their savings for several weeks.

**EasyJet also reports the sale of 11 A320 aircraft for £130.7 million to** boost liquidity in the midst of the pandemic and historic aviation crisis. The transactions call for these aircraft to be sold to companies specializing in aircraft leasing. **EasyJet intends to sign a contract with these companies to lease the aircraft and continue to use them.**

After finalization of these disposals, the carrier will retain 141 aircraft that are fully owned, representing 41% of its fleet. At the end of October, EasyJet had already announced that it was solidifying its cash position through the sale of nine aircraft for more than £300 million, including A320s (...).

***My comment:** The low-cost airlines seemed to suffer less from the crisis than the large groups.*

*The second wave of the epidemic invalidates this observation. They are reducing their capacities as much as the large groups.*

## > Sight navigation

(source Le Journal de l'Aviation) November 3 - The announcement of reconfinement has fallen and the airlines' vision has become even more short-sighted. A particularly glaring situation when Air France announced last weekend that it had no outlook on its flight schedule beyond the weekend . Not that this vision has had the opportunity to be long since the beginning of the crisis. But after an almost encouraging summer and despite a marked slowdown in the recovery of traffic from the end of August, the sector had hoped that the autumn would be marked by a relatively stable plateau.

**Eurocontrol had sounded the early warning: its managing director Eamonn Brennan revised Europe's traffic forecasts drastically**



**downwards in September and warned that he would certainly have to revise them again.** The low-cost airlines, too, in search of bookings as passengers increasingly book at the last minute, announced major reductions in flight schedules, already drawn up at levels well below those of 2019.

**The increasing number of reconfinement announcements, initiated by Ireland and now increasingly followed, killed all hope for the fourth quarter.** Traditionally more difficult than the third in normal times, it will seriously worsen the situation for airlines.

**In France, the second wave of the covid-19 epidemic comes as the moratoria on taxes and charges that were granted to support the sector in the first wave come to an end, while airline debt has exploded and the question of repayment of government-guaranteed loans is beginning to arise for the companies that benefited from them.** The liquidity crisis is greater than ever and is sparing no one.

Air France recently explained that it was losing ten million euros a day. Even if the company has managed to reduce its costs, it estimates that it has enough to last less than a year with its cash flow (...).

**The possibility of having enough cash to hold out until next summer's opportunities is more than most other French airlines can hope for,** which are also calling for more attention and support from a State whose coffers are empty. **Sketching a six-month strategy has become a dream,** company directors said last week.

But in this persistent fog, there is a diffuse glimmer: the sector is still able to interest investors, as shown by the CMA group's entry into the capital of the Dubreuil group or the possible rescue of Corsair by ultramarine investors. Beyond the promise of restructuring and despite the immediate difficulties, there is still a promise for the future of air transport.

***My comment:** After the health crisis we are experiencing, the need for air travel will continue.*

*The urgency is to ensure the survival of most airlines during this crisis. Then will come the time for recovery and the problem of reimbursing aid.*

*States, airlines and their main shareholders are already studying mechanisms to overcome this difficulty. Recapitalization is one possible response. Debt rescheduling is another.*

**> Covid-19: in the wake of the airlines, airports are swaying.**

(source AFP ) 5 November - **European airports on Thursday demanded urgent and specific measures from the European Union, just like the airlines, worrying about the short-term solvency of the smaller ones in the face of a situation that is deteriorating with the worsening of the Covid-19 crisis (...).**

The organization, which represents 500 airports in 46 European countries, estimates that in the coming months nearly 200 regional airports may be in a state of insolvency due to the persistent weakness of air traffic due to border closures and traffic restrictions in the face of the new wave of Covid-19 (...).

According to the ACI, Europe's larger airports and "hubs" "are not immune from significant financial risk" after cutting costs "to the bone" and using the financial markets to consolidate their accounts.

To enable them to hold their ground, the ACI calls in particular for state aid to companies to be paid until the end of 2021 (...).

The ACI also calls for a specific plan for aviation that would allow aid to be paid as long as measures restricting movement are maintained in Europe. (...)

) **In September**, world air traffic was down 72.8% (measured in revenue passenger kilometers, or RPKs) compared to the same period in 2019, compared to -75.2% in August, according to IATA.

As in August, **only 12% of international routes were operated. This collapse of long-haul will probably lead to a transformation of the business model of airports**, stressed the head of ACI Europe.

On the other hand, domestic connections recorded a slight improvement in September (-43.3% against -50.7% in August) with a near return to normal in China and Russia.

In Europe, traffic was down 75.8% in September compared with the same period in 2019.

***My comment:** European airports are suffering, as are airlines.*

*In France, a question arises: should we keep so many small airports when there is a larger airport less than 100 km away?*

## **The Bonus Article**

### **> Covid-19: Pfizer says its vaccine is 90 percent effective**

(source Les Échos) November 9 - In biology, more than anywhere else, caution is called for. That doesn't stop us from rejoicing when good news comes along. **In any case, the pharmaceutical laboratory Pfizer does not hesitate to communicate the first good, preliminary**

**results of its Covid-19 candidate vaccine**, developed in collaboration with the German biotech company BioNTech.

According to the American pharmaceutical giant, the treatment would be "90% effective". This percentage comes from the first results of the phase III study launched last July and having enrolled more than 43,500 participants to date.

The announcement has boosted BioNTech's share price on the Frankfurt Stock Exchange by 25%. Pfizer shares were up more than 7% in New York.

#### *28-day efficacy*

**However, reason must be kept.** This initial analysis was conducted after 94 cases of Covid-19 were observed in the trial cohort. Originally, Pfizer planned to analyze the first results after only 32 contaminations, but **medical experts remain very skeptical about making data comparisons so early in the trial.** As a result, other laboratories are planning to wait for more cases to start their analyses.

The efficacy of Pfizer and BioNTech's new messenger RNA vaccine candidate (a new technology) was measured by comparing the number of participants infected with the new coronavirus in the vaccine group to the placebo group "seven days after the second dose" and 28 days after the first dose, the two companies said in a joint statement.

#### *An mRNA-based vaccine*

"This means that protection is obtained 28 days after the start of vaccination, which must be done in two doses," they analyze. It should be noted that as the study continues, the percentage of final vaccine efficacy may vary. Still, Pfizer and BioNTech are pleased. With the efficacy of the first vaccines expected to be between 60 percent and 70 percent, "more than 90 percent is an extraordinary result," said BioNTech CEO Ugur Sahin.

An mRNA-based vaccine involves expressing a protein with known protective abilities (called a protein subunit) by attaching it to a part of the virus' genetic code, RNA. A non-viral vector that will bring the desired information about the virus to the immune system. The body then learns to recognize it and produce an immune response.

#### ***Up to 1.3 billion doses in 2021.***

Pending the final results of the trial, and because they assure that they have not found any serious safety concerns for the candidate vaccine,

the **two laboratories will apply for emergency licensure from the FDA**, the U.S. health agency. **The request will be made "after the required safety milestone has been reached, which is expected to occur in the third week of November,"** they say.

Both the United States and the European Union have signed a contract with BioNTech and Pfizer to acquire up to 600 million doses of vaccine for the United States and 300 million doses for Europe. The two laboratories are working in parallel with the trial on the development of their industrial platform in order to mass-produce the vaccines. "Based on current projections, **we expect to produce up to 50 million doses worldwide in 2020 and up to 1.3 billion in 2021,**" they said.

*Other candidates in the race*

Other vaccine candidates have also received pre-orders from the European Union and/or the United States. These include the vaccine developed by AstraZeneca in collaboration with Oxford University and the US biotech company Moderna. Both are also in stage III clinical trials but have not yet reported any preliminary results.

***My comment:*** Finally some good news. Even if this announcement is to be taken with caution, it is a sign of the good progress in the search for a vaccine...

## ***End of the press review***

### **> My comment on the evolution of the Air France-KLM share price**

The **Air France-KLM share is at 3.92 euros** at the close of trading on Monday 9 November. **It is up sharply by +32.88%** over one week. The announcement of a possible vaccine against Covid-19 explains this price surge, which affected all airlines.

Before the coronavirus epidemic, the Air France-KLM share was at 9.93 euros.

**The average (the consensus) of analysts for AF-KLM shares is 2.96 euros.** The highest target price is 5 euros, the lowest is 1 euro. You can find on my blog the details of the analysts' consensus. I no longer take into account the opinions of analysts prior to the beginning of the health crisis.

**The barrel of Brent oil (North Sea) is up sharply from \$4 to \$43.**

Again, the announcement of a possible vaccine is the cause. At the beginning of the coronavirus epidemic, it was at \$69.

**This indicative information in no way constitutes an incitement to sell or a solicitation to buy Air France-KLM shares.**

You can react to this press review or provide me with any information or thoughts that will help me better carry out my duties as a director of the Air France-KLM group.

**You can ask me, by return, any question related to the Air France-KLM group or to employee shareholding...**

See you soon.

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**| François Robardet**

**Director Air France-KLM representing employee shareholders PNC and PS.**

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This press review deals with subjects related to Air France-KLM shareholding.

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