

Repaying government loans will be difficult.



I Letter from the Director Air France-KLM

François Robardet Representative of employee and former employee shareholders PS and PNC

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Monday's Press Review

> **Benjamin Smith, CEO of Air France-KLM: "Repaying government loans will be difficult".**

(source L'Express) February 4 - In the two and a half years since he landed in France, **Benjamin Smith** has become a Parisian. (...) If the crisis is disrupting the profound transformation he had begun, the CEO of the Air France-KLM group is determined to keep his neck in the game.

He **would like to have Air France flight crews vaccinated quickly and is awaiting a response from the government on this subject**, but he also knows that the project is titanic: competitiveness, a fierce battle against low-cost competition, recomposition of the domestic market, employment? For an hour and a half in his very special "franglais", Benjamin Smith detailed the group's flight plan. Exclusive interview.

After a year of pandemic, is the survival of Air France-KLM at stake?
Benjamin Smith: No, **the support of our two shareholders guarantees us sufficient short-term liquidity**. Now the situation is changing every day. Today, we do not expect to return to pre-crisis traffic for another four years. Let's face it: we can't guarantee anything 100%, and the support of France and the Netherlands is not a blank

check.

(...)

In terms of sales, what do you expect in the coming months?

For the next twelve months, given the health uncertainties and questions about the closure of certain borders, we lack visibility.

Our customers fall into three main categories: there are those who travel to visit their friends; tourists; and finally, business customers. Demand remains very strong for the first two even though tourists will have lost purchasing power. **The big question mark is the business clientele.** But I remain optimistic.

How many planes do you manage to fly every day?

We have a fleet of 530 aircraft, and 15 to 20% of them are completely inactive at the moment. Before the pandemic, aircraft could fly 17 hours a day, today it may be as little as an hour or two every other day.

Keeping the planes on the ground is very expensive, so we try to avoid it as much as possible.

(...)

The State shareholder has helped you by guaranteeing a 4 billion euro loan, and by granting you a credit line of another 3 billion. When do you intend to repay them?

We have even received more than 10 billion euros, since KLM has received more than 3 billion euros in aid from the Dutch government.

The support of our two shareholder states is essential. Governments have understood the advantage that an airline represents in terms of sovereignty, to ensure the repatriation of their citizens or the delivery of masks and vaccines. It is a very valuable asset. But 7 billion euros is more than the group's net debt before the pandemic [Editor's note: 6 billion euros of net debt as of December 31]. **When will we be able to repay it? Let's not hide the fact: in the short and medium term, it seems difficult.**

(...)

In order to "stabilize the company, recapitalization appears more urgent than ever..."

This is a crucial scenario, and we are confident that it will be completed before our General Meeting next May. Our two main shareholders are in discussion and this project will of course have to get the green light from the European Commission. But we **have to move quickly. We are the last ones in Europe not to have done so. Lufthansa has been recapitalized, as has British Airways.** Air France-KLM can no longer waste any more time. With the Chairman of the Board of Directors, Anne-Marie Couderc, we are working on it every day.

(...)

In exchange for its support, what conditions does the government

impose on you?

First of all, that our companies go much further and much faster in environmental matters. Air France must also be more competitive. **The condition is that its unit costs must come down to the same level as those of Lufthansa and British Airways, without including the high levels of taxes and charges in France.** The measures taken before the crisis had already produced results: between January and February 2020, Air France had already reduced its costs by nearly 3%. This was above our expectations.

Can the current crisis jeopardize the unity of the Air France-KLM group?

More than ever, the **unity and cohesion of the Group are needed** to overcome this exceptional crisis. No airline could survive alone in a situation like the one we are experiencing. **Our transformation is driven by the need to work even better together.**

In the name of competition, the European Commission will inevitably ask for quid pro quos in exchange for this state aid. Transfers of "slots" to other companies, for example?

This is what Brussels asked Lufthansa in exchange for its recapitalization. But beware: **we will make sure that the quid pro quo is proportionate.** (...) We would not understand if drastic measures were imposed on us that would weaken our position in Paris.

Except that the leader Ryanair is not present in Paris: for the Irish airline, this may finally be the opportunity for it to gain a foothold at Roissy or Orly?

Yes, it's possible. (...) **I find it hard to accept that we are being forced to give up slots for good to rivals who, we can be sure, are going to come out on top. That would be responding to a temporary crisis by weakening us structurally for the long term. It makes no sense.**

So you're counting on Transavia to reverse the trend?

Yes (...). With Transavia, we have a company that has the same structural costs as easyJet [Editor's note: Transavia subcontracts ground staff].

Are you thinking of opening bases elsewhere than in France or the Netherlands?

First of all, we need to transform our domestic market. **We have a big plan to develop Transavia in Orly**, where the company will take over Hop's activities. Even if its slots will remain limited. **Our next project for Transavia is to link secondary cities without going through Paris**, such as Nantes-Marseille or Brest-Toulouse, for example. **The third**

step will be to expand Transavia in these regional metropolises in order to connect them with other European destinations. Finally, we will look to see if we have opportunities to open bases elsewhere. If, in the short term, there is a possibility to do something, we will study it, of course. But the number one priority is first to absorb the losses here in France. We will add eight aircraft to the Transavia fleet by June.

KLM has just announced a new cut of 1,000 positions. Should we expect a similar measure at Air France?

We've already announced that 8,500 jobs will be cut in France, which is unprecedented at Air France [editor's note: 41,000 employees at the end of 2019]. We were surprised by the number of people who have already volunteered, both among pilots and commercial pilots. It seems that there is still a demand from some employees, particularly because of the age pyramid. So, to answer your question, **if the circumstances lend themselves to it, we could indeed think about it.**

The transportation regulatory authority has validated the 2.5% increase in airport taxes for 2021. Given the situation, do you understand this decision?

No, **it's completely crazy.** Look at what is happening in other countries, other airports. How can you ask for an increase at a time like this? **It doesn't make sense. It does not live up to the relationship we have established with Aéroports de Paris.** The expenses are already significant and the group already contributes a lot to their financial results.

Airports should do everything possible to serve their customers, who are first and foremost the passengers. I get the impression that sometimes ADP focuses more on shopping and duty free than on the customer experience. We discuss this with them.

> Countdown for Air France

(source Le Journal du Dimanche) February 7 - **After two exchanges over the last few days, including one on Friday, Bruno Le Maire and Margrethe Vestager should have reached the end of negotiations on the recapitalization of Air France, an operation subject to the green light from Brussels.** The Minister of the Economy and the European Commissioner in charge of competition have increased exchanges to find a compromise.

Vestager has agreed to new aid from the French State to the national airline on condition that it returns flight slots to Orly. They will be offered to its competitors.

At Air France, it is believed that this amounts to obtaining financial aid on the one hand, but on the other hand to being penalized when the resumption of activity occurs. The Company also believes that it has already made concessions. In particular, to benefit from the State-guaranteed loan, it had to give up operating flights to destinations served by the TGV high-speed train and committed to greening its fleet.

Before Bruno Le Maire, Commissioner Vestager had dealt directly with Angela Merkel, again on the issue of state aid to the airline industry. **This summer, Lufthansa had to give up slots to obtain aid from the German State. And the Chancellor had intervened to ease Brussels' demands. She would have succeeded in halving the number of slots demanded at not just one airport, as in France, but two.** "Air France would like the Commission to apply the same rule of proportionality and claim only 24 slots from it," deciphers someone close to the dossier.

For Air France-KLM, time is running out. The group has a first meeting with investors on February 18 for the presentation of the 2020 results and the 2021 outlook. In May, for its general meeting, the recapitalization operation must be ready. The approval from Brussels should not be delayed any longer.

My comment: *Negotiations on the terms and conditions of the Air France recapitalization are tense, as are the negotiations for the recapitalization of KLM.*

While the press only insists on the importance for Air France of the transfer of slots to Orly, other conditions are under discussion.

As the parallel with Lufthansa comes up regularly, I invite you to (re)read my [Flash n°83](#) which details seven of the conditions imposed by the European Commission on the German airline:

- (i) Conditions relating to the necessity, appropriateness and size of the intervention*
- (ii) Conditions relating to the entry of the State into the capital of the companies and remuneration(*
- iii) Conditions relating to the exit of the State from the capital of the companies concerned(*
- iv) Conditions relating to governance(*
- v) Prohibition of cross-subsidies and acquisitions(*
- vi) Commitments to preserve effective competition(*

> **Air France: Djebbari wants a balanced agreement with Brussels to validate the recapitalization**

(source La Tribune) February 7 - **That Air France-KLM be forced to release takeoff and landing slots in exchange for a guarantee by Brussels of the recapitalization of the group by the French government as requested by the European Commission, it is out of the question, said Friday, the Minister Delegate for Transport Jean-Baptiste Djebbari. "**

It is out of the question that the Air France-KLM group, because of the recapitalization, finds itself burdened in competitiveness and is weakened by a negotiation that would not be balanced," he said, adding that "the government's objective [was] to reach a balanced agreement," he said, while La Tribune revealed last Tuesday that Brussels demanded from Air France and KLM transfers of slots at Orly and Amsterdam to validate the recapitalization

(...)

Hit hard by the health crisis, Air France-KLM has already received substantial public aid in the form of loans: 10.4 billion euros, including 7 direct loans or guaranteed by the French State, 14.3% shareholder, and 3.4 billion from the Dutch State, 14% shareholder.

Today, **the recapitalization envisaged by the French State aims to strengthen the company's equity and balance sheet** by converting the debt related to the €3 billion shareholder loan into hybrid bonds, which, in the scheme chosen by the group, are considered as equity and not as debt.

This conversion would strengthen Air France's shareholders' equity without increasing the 14.3% stake held by the State in the capital of Air France-KLM. The pattern is the same at KLM, but the conversion of the Dutch government loan is for a lesser amount of one billion euros. Again, this does not affect the level of the Dutch participation in Air France-KLM's capital (14%). These two operations must be accompanied by a capital increase (...). The French government intends to participate in these operations, but it will not exceed 30%, to avoid having to launch a public takeover bid on the remaining capital, as required by French regulations when this threshold is crossed.

For the European Commission, "if Member States intended to provide recapitalization aid of more than 250 million euros to a company that is very powerful in the markets in which it operates, they had to propose additional measures to preserve effective competition".

The management of Air France-KLM has indicated that it is totally opposed to this concession.

(...)

Several French unions have also denounced any possible willingness to hand over the precious slots.

***My comment:** The French and Dutch ministers, the leaders of the Air France-KLM group, most of the unions make similar comments to those of the Minister of Transport J-B Djebbari (on LCI on 07/02/21) :*

"For 15 years, Europe has not been able to curb social and fiscal dumping in the air industry. Competition, yes. But I refuse that the takeover only benefits low-cost companies that exploit the grey areas of European law".

The European Commission specifies that the conditions it imposes . "are aimed at limiting distortions of competition" and . "give the possibility for competing carriers to enter these markets, which guarantees fair prices and greater choice for European consumers".

It would be well advised to ensure that new entrants (as well as existing carriers) comply with the rules in force (non-exhaustive list):
. no disguised subsidies from local authorities,
. no selling at a loss,
. compliance with social and tax rules.

> Hoekstra ziet nu meer nadelen dan voordelen aan zelfstandig KLM (Hoekstra now sees more disadvantages than advantages to KLM's independence)

(source ANP translated with Deepl) February 3 - **An independent future for KLM is currently not in the interest of the company or the Netherlands. This is the opinion of Finance Minister Wopke Hoekstra, who has considered this option partly at the insistence of the Dutch Lower House.** "Such a scheme really has more disadvantages than advantages," he says.

KLM and its sister airline Air France are in a very difficult situation because of the Covid-19 pandemic. The Dutch and French governments have come to the company's rescue with billions in emergency loans. It is expected that even more support will be needed in the long term. **Hoekstra says he is working "very closely" with his French**

colleague **Bruno Le Maire**.

(...)

Last year, the majority of the Lower House voted in favour of a motion introduced by PVV MP Tony van Dijck, calling on the cabinet to explore all options, including the separation of KLM from the airline group. Hoekstra says he has complied with the law and does not want to close any routes "for eternity". "But we don't think, in the waters where we are now, that it is wise for the company or for the Netherlands."

My comment: *In a recent interview, Dutch Finance Minister Wopke Hoekstra acknowledged that KLM had benefited more from the Air France-KLM group than its "sister company".*

His new stance is likely to extinguish the latest attempts by the Franco-Dutch group to break up.

> **Air France signs a contract with Pratt & Whitney for Airbus A220 GTFs and their maintenance**

(source: Le Journal de l'Aviation) February 1 - **Pratt & Whitney announced that the Air France-KLM group has signed a contract to acquire the PW1500Gs that will power Air France's fleet of 60 Airbus A220-300 aircraft. The contract covers more than 120 GTFs. The contract is also accompanied by a long-term service agreement under which engine maintenance will be performed by AFI KLM E&M with the support of Pratt & Whitney.**

A year ago, Air France CEO Anne Rigail indicated that the group's MRO division would take over maintenance of the A220s, and that she also wanted to maintain the engines. She said at the time that "discussions with the engine manufacturer are now over to determine how to industrialize maintenance.

The first A220 is expected in September 2021. The aircraft will replace the French airline's A318 and A319.

My comment: *For the specialists, the GTF (Geared TurboFan) is the dual-flow turbofan engine that will power Air France's A220-300s.*

The signature of the contract enabling Air France to maintain these engines was eagerly awaited. It opens up job prospects for many AFI KLM E&M employees.

> **China: losses of 4.65 billion dollars for the 3 major airlines**

(source Business Travel) February 2 - **Air China, China Eastern and**

China Southern forecast they will lose more than 30 billion yuan (US\$4.65 billion) in 2020.

(...)

This announcement comes despite strong domestic demand in the second half of 2020 in the world's second largest economy.

Although domestic flights had to face a temporary weakness at the end of the year due to a resumption of the epidemic in some places, domestic flights recorded figures similar to those before the pandemic. However, international traffic to China fell by more than 80% due to strict government controls, the Global Times reported.

The national airline Air China expects a net loss of \$2-2.5 billion for 2020, compared with a net profit of \$1 billion the previous year. **China Eastern expects a net loss of \$1.5 to \$2 billion, compared with \$0.5 billion in 2019.** For

its part, China Southern, the country's largest carrier, estimates that its net loss will be around \$1.2 to \$1.7 billion, compared with \$0.4 billion in 2019.

(...)

My comment: Several factors explain the heavy losses recorded by Chinese airlines.

Weak international traffic is the first cause of losses.

A second cause is the practice of an aggressive pricing policy in 2020 on the Chinese domestic network. Many Chinese airlines had launched unlimited flight packages to boost business.

> **Lufthansa: a €1.6 billion bond to repay KfW**

(source: Cercle Finance) February 5 - **Lufthansa issued a 1.6 billion euro bond to repay a loan from the German development bank Kreditanstalt fuer Wiederaufbau (KfW)** ahead of schedule, the airline group said this morning.

The bond was placed in two tranches, the first with a four-year term until 2025 and an amount of 750 million euros, bearing interest at 2.875% per annum. The

second tranche has a term of seven years, until 2028, with an amount of 850 million euro and a repayment rate of 3.75% per annum.

Lufthansa said the funds will be used to repay the €1 billion loan from KfW, which means that the company will recover the aircraft pledged as collateral for the loan. The

refinancing will also reduce financing costs, the company said.

At the end of the third quarter, Lufthansa had 10.1 billion euros in cash

and cash equivalents.

My comment: *The funds obtained through this bond issue will enable Lufthansa to spread out the payment of its debt, contracted in May 2020 as part of its €9 billion rescue plan.*

This is the second time in a few months that Lufthansa has successfully tapped the financial market. In November 2020, Lufthansa obtained 525 million euros through a convertible bond issue maturing in 2025.

> **Boeing forced to significantly reduce firm orders for its 777X**

(source Boursier com) February 2 - **Boeing officially has only 191 firm orders for its 777X.** The U.S. aircraft manufacturer said last night that more than one-third (118 units) of orders for its future wide-body aircraft are no longer considered firm under accounting rules that require it to regularly assess their viability. "Delays on the 737 MAX and 777X programs have resulted, and may continue to result, in the right for customers to terminate orders and/or substitute orders for other Boeing aircraft," the manufacturer said in a regulatory document.

Boeing announced last week that it will take a \$6.5 billion charge on the 777X program due to lower-than-expected demand and a longer, more costly certification process. The first deliveries of the aircraft have also been delayed by one year, to the end of 2023 at the earliest.

Emirates, Qatar Airways, Etihad Airways, British Airways, Cathay Pacific Airways and Singapore Airlines are among the airlines that have opted for the 777X.

My comment: *According to the Bloomberg agency, Emirates (the 777X's biggest client) is looking to transfer between 30 and 40 of its 115 777X commitments to the B787 Dreamliner model.*

If this announcement is confirmed, it will reinforce the thesis that the economic model of Gulf companies is running out of steam.

Even before the health crisis, the long-haul / long-haul hub model, based on the use of wide-body aircraft, had shown its limitations.

> **Rolls-Royce continues to test its engines with 100% sustainable fuel**

(source Le Journal de l'Aviation) February 1 - Rolls-Royce continues to

explore the path of sustainable fuels to reduce the environmental footprint of aviation and move towards its goal of zero net CO2 emissions by 2050. The engine manufacturer announced on February 1 that it has conducted initial tests with a Pearl 700 powered solely by sustainable aviation fuel (SAF).

The tests were conducted at the Dahlewitz facility in Germany. They follow another ground test campaign carried out in December 2020 on a Trent 1000 demonstrator incorporating ALECSys (Advanced Low Emissions Combustion System) technology. **Rolls-Royce wants to show that its entire current engine range is capable of operating safely on sustainable fuels, while their use is only certified for a 50-50 blend with conventional kerosene at maximum.**

In both tests, the SAF used is that produced by World Energy from greases and oils from agricultural waste. According to the Californian company, its use "does not require any modifications to aircraft or engine fuel systems, distribution infrastructures or storage facilities". When unmixed, it could reduce an engine's CO2 emissions by up to 75% over its lifecycle (at the current level of technology), Rolls-Royce estimates. It is already used in commercial aviation in blends with Jet A1 engines, notably by Air France from San Francisco. The fuel is supplied by Shell and delivered by SkyNRG.

The Pearl 700 is currently under development to power Gulfstream's G700 aircraft, five prototypes of which are currently undergoing flight tests. The Pearl 700 features the Advance 2 body and a new low-pressure system that increases takeoff thrust by 8% and delivers 5% more thrust than the BR725.

***My comment :** Last minute : KLM has just announced that it has completed the world's first flight partially powered by synthetic kerosene. You will have more details in next week's letter.*

End of the press review

> Advice for employee and former employee shareholders

Annual statements from Natixis and/or Société Générale are currently being sent out. By default, these statements are sent by post.

You will find on my [navigaction](#) website the access modalities to the managers' websites.

To avoid forgetting to change your contact details each time you change your postal address, **I advise you to enter a personal e-mail address.** It will be used for all correspondence with the management bodies.

Keep all the documents relating to your Air France-KLM shares in one place: all your correspondence received from the various managers, Natixis, Société Générale, your personal financial institution if you purchased your shares through it.

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

The **Air France-KLM share is at 5.06 euros** at the close of trading on Monday 8 February. It is up +4.05% over one week. Since the end of November 2020, the share price has remained around 5 euros.

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 3.31 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 from \$4 to \$60. It has been rising steadily since the end of October 2020.

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 employees and former employee shareholders PNC and PS.

You can find me on my twitter account @FrRobardet

When I was elected, I received the support of the CFDT and the UNPNCCThis

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

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