



| Flash Info from the Air France-KLM Director

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employee and former employee
shareholders PS and PNC

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Recapitalization: instructions for use

Dear Readers

*A recapitalization refers to an operation by which a company will strengthen its **equity capital**.*

As I indicated last week, I propose to examine this type of operation through the example of Lufthansa.

Here is the summary of this flash:

- (1) A company's equity capital*
- (2) Why recapitalize?*
- (3) Recapitalization by capital increase: example of Lufthansa*
- (4) Counterparties to the Lufthansa recapitalization operation*

Thank you for your loyalty François Continuing to comply with containment measures

> The equity of a company

Details on shareholders' equity : (mentioned in my letter 778, source : [droit-finances_com](#))

Equity is a term derived from the accounting and financial language that refers to the equity contributed by a company's shareholders. This equity is contributed in the form of a sum of money at the time of the company's incorporation or subsequently. It can also be dividends that are not redistributed and left at the disposal of the company. The role of equity capital is twofold. On the one hand, it is used to finance part of the investment. On the other hand, it serves as a guarantee for the company's creditors who agree to finance the other part of the investment.

To put it simply, the share capital of a company represents the funds contributed at the time of its creation. The equity capital is initially equal to the share capital. Then, year after year, profits and losses are added to it (among other things). When a company goes from one deficit year to the next, it reduces its equity.

In the current situation, **airlines are incurring losses that considerably reduce their equity.**

> Why recapitalize?

When a company's equity is less than half of its share capital, it means that it no longer has the means to finance its investments or its operating cycle. **It can then decide either to dissolve the company or to continue its activity for two years** (the maximum allowed by the regulations) to give it time to rebuild its equity capital.

For the second solution, the company can increase its capital, or find solutions to generate sufficient profits to reach the previous level of shareholders' equity (source [journaldunet](#)).

> Recapitalization through a capital increase: example of Lufthansa (DLH)

At the end of May 2020 (see my letter 758) **an agreement was reached between Berlin and Brussels for the Lufthansa rescue plan, amounting to 9 billion euros. It included a recapitalization component of 6 billion euros.**

In a public document ([presscorner/detail/en/ip_20_1179](#)), the European Commission details this plan:

The German recapitalisation measure Germany notified the Commission under the Temporary Framework of a €6 billion

recapitalisation of DLH [Lufthansa]. The plan comprises:

- (i) a capital participation of €300 million through the subscription of new shares by the State, corresponding to 20% of DLH [Lufthansa]'s share capital; (
- ii) a silent participation of €4.7 billion which has the characteristics of a non-convertible equity instrument; and (
- iii) a silent participation of €1 billion which has the characteristics of a convertible debt instrument;

My comment: *Contrary to popular belief, the issue of new shares represented a tiny part of the recapitalization operation (300 million euros out of 6 billion euros, or 5% of the total operation). Shareholder dilution was therefore relatively low.*

In addition, Germany guaranteed a 3 billion euro loan.

> Counterparties to the Lufthansa recapitalization transaction

Lufthansa has been required to pay a large number of counterparties. Seven of them are presented in the European Commission's document

(i) Conditions relating to the necessity, appropriateness and size of the intervention:

The measure will not exceed the minimum necessary to ensure the viability of DLH and to restore its pre-pandemic equity position. In assessing the proportionality of the recapitalisation measure, the Commission has taken into account DLH's capital and liquidity needs at group level.

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(ii) Conditions relating to the State's entry into the companies' capital and remuneration:

The recapitalisation aid will help to avoid the insolvency of DLH, which would have serious consequences for employment, connectivity and foreign trade volumes in Germany. The State will receive an appropriate remuneration for the investment and additional mechanisms are foreseen to induce DLH to buy back the State and silent participations.

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(iii) Conditions relating to the exit of the State from the capital of the companies concerned:

Germany has submitted a business plan drawn up by DLH aimed at repaying both the loan and the recapitalisation instruments by 2026. Germany also undertook to draw up a credible exit strategy within 12 months of the granting of the aid, unless the State intervention is

reduced to less than 25 % of equity by that time. If there are doubts about the exit of the State six years after receipt of the recapitalization aid, a restructuring plan for DLH will be notified to the Commission.

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(iv) Conditions relating to governance:

Until the complete exit of the State from the capital, DLH is subject to a ban on dividends and share buybacks. In addition, as long as at least 75% of the recapitalization is not repaid, a strict limitation on the remuneration of the members of their management applies, including a prohibition on the payment of bonuses. These conditions are also intended to encourage DLH and its owners to buy back the shares held by the State as soon as the economic situation permits.

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(v) Prohibition of cross-subsidies and acquisitions:

In order to ensure that DLH does not unduly benefit from recapitalization aid granted by the State to the detriment of fair competition in the single market, it is prohibited to use the aid to support the economic activities of integrated companies that were in financial difficulties before December 31, 2019. In addition, as long as at least 75% of the recapitalization is not repaid, DLH is in principle prohibited from acquiring a stake of more than 10% from competitors or other players in the same line of business.

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(vi) Commitments to maintain effective competition:

DLH, which will benefit from a recapitalization measure of more than 250 million euros, has significant market power in the relevant markets where it operates. Prior to the COVID-19 pandemic, its Munich and Frankfurt hubs were saturated, with the result that it did not have sufficient landing and take-off slots. Therefore, in accordance with the requirements of the Temporary Framework, additional measures to preserve effective competition are required. These include the divestiture of up to 24 slots per day at the Frankfurt and Munich hub airports and additional related assets to allow competing carriers to base a maximum of four aircraft at each of these airports. These measures would allow viable entry or expansion of other airlines' operations at these airports, to the benefit of consumers and effective competition.

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(vii) Public transparency and information:

DLH will be required to publish information on the use of the aid received, including how the aid received supports the company's activities, in accordance with national and EU obligations on ecological and digital transformation.

My comment: *Two points particularly catch my attention.*

The first concerns the prohibition of cross-subsidies. Lufthansa subsidiaries in difficulty before the health crisis could not benefit from these subsidies.

Brussels Airlines, Swiss and Austrian were not concerned. All three benefited from aid measures from their states and from Lufthansa. Thus, Lufthansa provided Swiss with 200 million Swiss francs in cash, issued a capital injunction of 170 million euros in Brussels Airlines and 150 million euros in Austrian.

The second point concerns the preservation of the exercise of competition. At Lufthansa's two main airports, which were saturated before the crisis (Munich and Frankfurt), the German airline will have to give up slots to allow competing carriers to base up to four aircraft on each of these two airports.

End of Flash

You can react to this flash or send me any information or thoughts that will help me better carry out my role as a director of the Air France-KLM group.

See you soon.

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| François Robardet

Administrator Air France-KLM representing employee shareholders PS and PNCYou can find me on my twitter account @FrRobardet

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subjects related to Air France-KLM shareholding. If

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