



| Air France-KLM Administrator's Flash Info

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Recapitalization of Air France for 4 billion euros

Dear readers

Air France is to be recapitalized to the tune of 4 billion euros, with the support of the French government and China Eastern. The Dutch government is not involved at this stage, as it is preparing the recapitalization plan for KLM. As for Delta Air Lines, having received government aid in the United States, it cannot participate in this operation.

Here is the summary of this flash:

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Thank you for your loyalty François Continuing to respect the containment measures

> **The equity of a company**

Clarification of the equity capital : (source : [droit-finances_com](#))

The equity is a term coming from the accounting and financial language which indicates the equity brought by the shareholders of a company. This equity is brought in the form of money at the time of the constitution of the company or later. It can also be the dividends not redistributed and left at the disposal of the company. The role of equity capital is twofold. On the one hand, it serves to finance part of the investment. On the other hand, it serves as a guarantee to the company's creditors who agree to finance the other part of the investment.

In simple terms, the share capital of a company represents the funds brought in at the time of its creation. The equity is initially equal to the share capital. Then, year after year, profits and losses (among other things) are added to it. When a company makes a loss year after year, it reduces its equity.

In the current situation, **airlines are making losses which considerably reduce their equity.**

Why recapitalize?

When a company's equity is less than half of its share capital, it means that it can no longer afford 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** (this is the maximum allowed by the regulations) to give it time to reconstitute its equity.

For the second solution, the company can carry out a capital increase, or find solutions allowing to generate sufficient profits to reach the previous level of equity (source [journaldunet](#))

> Recapitalization of Air France: what the European Commission says

At the beginning of May 2020 (see [my letter 753](#)) **an agreement was reached between Paris and Brussels for the rescue plan of Air France, for 7 billion euros. It included a subordinated shareholder loan of €3 billion granted to the company by the French state, as well as a state guarantee for loans of €4 billion.**

In a public document ([presscorner/detail/en/ip_21_1581](#)), the European Commission details this plan:

The Air France recapitalisation

France has notified the Commission, under the temporary framework, of a recapitalisation of Air France and its holding company for a maximum amount of €4 billion. **The recapitalisation by France, which is part of the first stage of the group's recapitalisation plan, involves**

- (i) **the conversion of the €3 billion state loan** already granted by France (approved by the Commission in May 2020 under number 57082) **into a hybrid capital instrument**; and
- (ii) **a capital injection by the state**, through the subscription of new shares in a share capital increase open to existing shareholders and the market, up to a maximum of €1 billion depending on the size of this operation.

KLM, the other strategic subsidiary of the Air France-KLM group, will not benefit from the aid.

***My comment:** The recapitalization concerns Air France. For technical reasons (it is the Air France-KLM group which is listed on the stock exchange) some of the actions envisaged concern Air France-KLM.*

The proceeds of these operations will obviously be transferred to Air France. This explains why the Dutch State is not participating in this recapitalization.

In a joint communication, the Dutch and French governments have also stated that the Dutch government is negotiating with the European Commission on the conditions for a recapitalization of KLM.

> Counterparts to the Air France recapitalization operation

Numerous compensatory measures have been imposed on Air France. Seven of them are presented in the European Commission's document

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

The capital injection will not exceed the minimum necessary to ensure the viability of Air France and its holding company and to restore the equity position that existed prior to the COVID-19 pandemic.

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

The recapitalization aid will prevent the insolvency of Air France and its

holding company, which would have serious consequences for employment, connectivity and France's foreign trade. The French State will receive an appropriate remuneration for the investment, and additional mechanisms have been put in place to encourage Air France and its holding company to buy back the State's equity stake resulting from the recapitalization.

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

France has undertaken to draw up a credible exit strategy within 12 months of the granting of the aid, unless the State's intervention is reduced to less than 25% of the equity capital by then. If the State's shareholding in the holding company is not substantially reduced, in accordance with the provisions of the temporary framework, at the end of a period of six years following receipt of the recapitalisation aid, a restructuring plan for Air France will be notified to the Commission

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(iv) Conditions relating to governance:

As long as the recapitalisation has not been fully repaid, Air France and its holding company are subject to a ban on dividends, the payment of non-mandatory coupons and share buybacks. In addition, until at least 75% of the recapitalization is repaid (in accordance with the provisions of the temporary framework), a strict limitation on the remuneration of their management applies, including a ban on bonus payments. These conditions are also intended to encourage Air France, its holding company and its owners to buy back the State's stake obtained as a result of the recapitalization as soon as the economic situation allows.

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(v) Prohibition of cross-subsidies and acquisitions:

To ensure that Air France and its holding company do not unduly benefit from the recapitalization aid granted by the State to the detriment of fair competition in the single market, they are prohibited from using the aid to support economic activities of integrated companies that were in financial difficulty before December 31, 2019. In addition, until at least 75% of the recapitalization is repaid, **Air France and its holding company are in principle prohibited from acquiring a stake of more than 10% in competitors** or other players in the same sector.

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(vi) Commitments to preserve effective competition:

Air France will benefit from a recapitalisation measure of more than EUR 250 million and has significant market power at Paris Orly airport, where Air France has a strong presence. Structurally, this airport is very saturated, which means that airlines cannot access the landing and

take-off slots they require for their operations at the airport. Therefore, in accordance with the requirements of the temporary framework, additional measures to safeguard effective competition are necessary. This concerns the **provision by Air France of 18 slots per day at Paris Orly airport to a competing carrier**. The competitive measures proposed by France must allow the entry or permanent expansion of an airline competing with Air France at Orly, to the benefit of consumers. **In addition, these measures require that the airline in question has a base for its aircraft and crews at Orly, in compliance with European and national labor laws.**

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(vii) Public transparency and information:

Air France and its holding company will have to publish information on the use of the aid received, including how the aid received contributes to the company's activities, in line with national and EU obligations on green and digital transformation

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(viii) Monitoring:

A trustee, to be appointed by Air France and its holding company before 5 May 2021, will monitor and ensure, as instructed by the Commission, compliance with the various commitments. The trustee will report periodically to the Commission.

My comment: *Two points particularly catch my attention, as they were not included in the official counterparts to the recapitalization of Lufthansa.*

The first point concerns THE airline that will benefit from the slots returned by the Air France Group: this airline will have to comply with European and French legislation.

To the great displeasure of Ryanair, which in a press release immediately indicated that "This last tranche of State aid to Air France combined with these inefficient solutions will harm competition in the air transport market for decades to come".

The second point concerns the appointment of an agent: he will be responsible for verifying compliance with the conditions imposed by the European Commission, including those concerning the company that will recover the eighteen slots.

> [Air France-KLM press release](#)

Air France-KLM announces a capital strengthening plan to strengthen its balance sheet, prepare for the recovery and

reposition the group on a sustainable financial path

- The Air France-KLM Group announces the following measures concerning Air France, which have been approved by the European Commission in its decision to authorize a €4 billion transaction by the French State to recapitalize Air France and its Holding:

. A capital increase of up to €1 billion, with a priority subscription period for shareholders, subject to market conditions and prior approval of the prospectus by the Autorité des marchés financiers (the "AMF") and,

. Simultaneously, the conversion of the French State's direct loan of €3 billion drawn down into a perpetual hybrid bond instrument.

- The Dutch government is continuing discussions with the European Commission regarding potential measures to strengthen KLM's capital base. - **Other measures to strengthen the group's capital are currently under consideration**, with several measures to be taken before the 2022 Annual General Meeting.

On April 5, **the Board of Directors of the Air France-KLM group approved a plan to start restoring the group's negative equity and to further strengthen its cash position:**

Capital increase with priority subscription period for shareholders

- **The group intends to launch a capital increase** (...) launched without preferential subscription rights but with a priority period for shareholders, within the limits of the nineteenth resolution approved by the Annual General Meeting on May 26, 2020, allowing existing shareholders not to be diluted, by subscribing for shares during the priority period up to the amount of their stake in Air France-KLM's capital. The offer will be composed of a private placement with institutional investors, a public offering and a priority period allowing all shareholders to participate in this transaction. - **The French State undertakes to participate in the capital increase while keeping its stake strictly below 30% of the share capital and voting rights.** - **China Eastern Airlines intends to participate while maintaining its stake strictly below 10% of the share capital**, in the context of strengthening strategic cooperation with the Group.

- The Dutch government, which holds 14.0% of the share capital, has informed the Group that it will not subscribe to the capital increase.

- Delta Airlines, which holds 8.8% of the share capital, has informed the Group that it will not subscribe to this capital increase due to the current CARES Act framework in the United States. - **This transaction will**

improve the Group's equity by 1 billion euros under IFRS and French GAAP, **and provide the same amount of cash to the Group for the benefit of Air France.**

Simultaneously, the full conversion of the €3 billion loan from the French State into a hybrid perpetual bond ("Titres Super Subordonnés"):

- The €3 billion direct loan granted by the French State to Air France via Air France-KLM at the end of May 2020 will be converted into Titres Super Subordonnés of the same nominal amount to Air France via Air France-KLM, enabling the Group to restore part of its equity under IFRS accounting standards. -

This transaction will improve the Group's equity by €3 billion under IFRS accounting standards, with **no cash impact**, while increasing the Group's flexibility in its mandatory debt repayment profile spread over time (with a non-call period ranging from 4 to 6 years).

The Dutch State has approved this package of actions and has indicated that it is pursuing discussions with the European Commission on potential capital strengthening measures for KLM.

Together with the expected EBITDA recovery, this first step of the capital strengthening measures will gradually help the Group to reduce the Net Debt/EBITDA ratio below 3.0x by 2023.

Additional measures to further strengthen the balance sheet are currently under consideration, with several measures to be taken before the 2022 Annual General Meeting, given that the Group's equity will remain negative after this first step.

These measures could include the issuance of appropriate amounts of new equity as well as proportionate quasi-equity instruments, subject to market conditions. The deeply subordinated notes subscribed by the French State resulting from this first stage of recapitalization could be used to underwrite (by way of debt compensation) the Group's future equity or quasi-equity capital raising.

The objective of these additional measures will be to further strengthen the Group's equity position and reduce its net debt/EBITDA ratio to approximately 2.0x by 2023. To achieve this, **specific delegations would be required and submitted to the Group's next General Meeting, scheduled for May 26.**

In addition, the EUR 4 billion loan guaranteed by the French State (Prêt Garantie par l'Etat "PGE") has been extended with a final maturity date now set at 2023. 2.4 billion loan guaranteed by the Dutch State has a maturity date of 2025. These elements smooth the debt repayment profile of the group and its airlines, with a gradual extension of the

maturity profile. (...)

My comment: *The capital strengthening plan as presented by the Air France-KLM group has two stages.*

The first stage, amounting to 4 billion euros, is detailed in the press release above. At the end of this stage, Air France will have an additional €1 billion in cash.

The second stage, which is still being studied, could be announced before the next General Meeting on May 26. It would partly respond to a request from the European Commission: that France commit to developing a credible exit strategy within 12 months.

This second step would enable us to obtain a net debt/EBITDA ratio close to 2.0x in 2023.

Note:

The net financial debt to EBITDA ratio shows the number of years required for the company to be able to repay its financial debt with its EBITDA. For comparison, this ratio was 1.5x in the two years prior to the health crisis.

A ratio of 2.0x reflects a healthy financial situation. The company is then able to finance its investments at attractive conditions.

End of the Flash

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

See you soon.

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| François Robardet

**Administrator Air France-KLM representing the
employee shareholders PS and PNC
You can find me on my twitter
account @FrRobardet**

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

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