Norwegian: Case of Non-classical Lessor Restructurings

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Norwegian Air Shuttle SAS ("Norweigan") was founded in 1993 has a history of pivoting from its regional airline origins to a low cost carrier in 2002 and expanding into the long-haul low cost business model in late 2009. It has splashed the world with one of the largest aircraft orders out of Europe with both Boeing 737MAX and Airbus A320neo narrowbodies. It had started experienced troubles even before COVID starting in late 2018 which resulted in some base closings and cancelation of almost all of its Airbus order. While it officially entered administration in Ireland on November 18th, the announcement was during the coverage of the recertification of the Boeing 737MAX in the US. While this was the official filing, it had attempted direct restructurings before this in April.

Normally when companies go into bankruptcy protection, there are two forms. Traditional restructurings of companies are for those who are deemed salvageable or liquidation for those deemed non-salvageable

and their assets are sold off to repay creditors. One of the major reasons companies enter bankruptcy is that there is not enough cashflow to service the debt load, especially negative equity companies. Sometimes, companies are net asset rich even after accounting for the debt positions but have poor cashflow to sustain servicing these commitments.

Before entering bankruptcy protection, there are usually negotiations behind the scenes to see if a pre-arranged deal can be completed. If so, the company can avoid dragging out the process by briefly entering administrative and exiting quickly or even avoiding it altogether with the pre-negotiated deal. If pre-negotiations are not successful, the company might not have too many remaining choices but to file for administration.

If the company is deemed viable, an injection of funding is given by a third or even related party to the company while it is in administration to continue to operate while the company's finances are being restructured through the system whether through court or by the appointed administrator. These funds normally called debtor in possession (DIP) financing are usually in the form of debt but it can also be in the form of equity as well and is intended to be temporary until the final restructuring is complete and the company exits administrative protections with a new capital structure.

The whole process can vary but can take a long time depending on the complexities requiring sliming down the debt to a more manageable and sustainable level through some combination of debt write-off, conversion of the debt to equity and injection of equity. There are many interests involved here with different creditor classes with respective seniority, secured or non-secured over specific assets of the company so this can be quite complicated!

For the Norweigian situation, the Norweigan government offered state loan guarantee aid up to NOK3bn (~$300mn) and to qualify, Norweigian announced a large round of debt and operating lease restructuring started in late April even without officially entering into bankruptcy protection and became the "New Norwegian". As part of this, the airline planned to look to resume operating around 115 aircraft which was 30%+ decrease in the number of aircraft before COVID as demand rebounded. In May 2020, many lessors (including AerCap, BOC Aviation, among others) agreed to this debt for equity swap and collectively became the largest shareholders of the airline. This is a rare but not unheard of case. It had happened previously during the large round of US-based airline restructurings. The total converted debt to equity swap overall was NOK 12.7bn (~$1.3bn).

It is interesting to note the agreement for conversion as operating leases are hell or high water leases which means the airline pays no matter what unless it becomes insolvent or there is a direct bilateral agreement with the lessor as this was the case. As in this case, the insolvency dilemma was an overhang in discussions, there is normally a dance between the needs of the going forward fleet plans and cost reductions that can be negotiated with the lessors.

These types of discussions are normally done before filing and also

during the restructuring process, where the airline in administration could accept or reject the operating leases and the respective aircraft. If the aircraft is rejected, then the remaining amount owed to the lessor would be added to the other unsecured creditor obligation class. If the lease (and the aircraft) is accepted, the agreement could be the original lease or more likely on lower renegotiated terms. Norwegian previously had more than 160 aircraft in its fleet before COVID.

In essence, through the debt for equity swap, the lessor goes from a senior secured position to the lowest seniority position in the capital structure, the equity. It is not going from one form of debt to another lower form of debt seniority but to the highest of the at-risk capital tier. While this is not normally palatable for the lessors, there are not much better alternatives and this provides some advantages to them. One of the major upsides for the lessor is to agree for the airline to 'accept' their lease and continue operating (and paying for) the aircraft but more likely on renegotiated terms. The upside is that the lessors avoid the costs associated with repossessing the aircraft and the downtime, parking, insurance and other costs associated with holding the aircraft while it is being remarketed. That's not including costs of any potential transition or interior/technical changes demanded by any subsequent airline if one can be found quickly especially during these COVID times. There is an oversupply of parked aircraft at the moment.

What are some of the factors for decision making must the lessors go through before making this difficult decision? The main consideration is the viability of the airline post-administration. As a converted equity holder, the lessor by itself would most likely not be one of the majority holders and would be a minority shareholder. In this particular case, the lessors collectively became the majority shareholders but the minority on a standalone basis. In addition, if the lessor hopes to recoup their original amounts owed, they would need the airline to continue prospering so they can eventually sell off the equity.

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Another consideration is the costs of the leased aircraft. While a renegotiated agreement might be on worse terms than the original agreement, some upsides are that the term might be extended from the original. This of course is predicated on the fact that the airline expected to do well after exiting restructuring. Also, all of the alternative scenario costs need to be considered both in real money spent as well as time costs of personnel. Some of these would be include costs for the returned aircraft; flight crew and technicians for the ferry flights, parking, insurance upkeep fees. Other things to consider are any MRO costs if that's needed and if the relevant government are actually available to do the transition paperwork. A lot of times during COVID, some aviation authorities were not working or working very slowly in their approvals of paperwork needed for a transition. Other things to consider are the opportunity costs of rent from downtime and any additional remarketing or technical costs needed to get it to the next home.

Another consideration is that one the owner, the lessor, itself and its own financial state. Is the aircraft backed by its own respective debt and what are those terms? Is the aircraft managed and not owned? Are there lessor liquidity considerations to be taken into account? All of these are built into the considerations that need to be weighed carefully in any proposed case of a debt for equity swap.

To get to an understanding of all of the alternatives, airlines and all of their financial backers, debt holders, operating lessors and others need to have enhanced communication to be able to adeptly navigate these tough conditions that COVID has brought on the industry. In Norwegian's case, the airline was one of greater than 45 airlines entering bankruptcies administration or liquidation as of November according to the author's research. Before the filing for bankruptcy protection, both the Norweigan government and the Swedish government did not approve bailout funds for the airline and there were no cash injections available from other investors which led Norweigan to file. This might mean another round of debt to equity restructuring to get even more solid footing for the airline. This might mean potentially more pain for those who have already experienced it so short time ago in the first round of debt restructuring. Hopefully, the lessors have already sold down some of its converted equity as it's worth substantially less with the most recent filing. Without coordination, worse circumstances can be had for all. Once restructuring has taken place, we can continue to be on a road for recovery.

**All opinions expressed are the authors' own. The author is an investor turned full time finance professor at New York University Shanghai, where he teaches and focuses on cross-border investing and financing along with a specialty in real assets and aviation. He is also Chairman of China Aviation Valuation Advisors and the only Senior ISTAT Certified Appraiser based in N. Asia. His book, "Aircraft Valuation: Airplane Investments As An Asset Class" was recently published and his research website is www.davidyuda.com.*