

**Baker
McKenzie.**

The Aviation DealSCAPE
Executing Transactions in 2021

**TRANSACTIONAL
POWERHOUSE**

Leading and closing complex deals – every day

Opportunity for Recovery & Reinvention

The new dealSCAPE

A new vision of the future must redefine corporate strategy in the aviation industry, with new opportunities arising from disruption. For many organizations, the fastest route to recovery and reinvention is through transactions — divesting to access liquidity and preserve cash position, managing digital system requirements arising from COVID-19, transforming the customer experience, and reshaping fleets and operations to suit new demands.

It is both more important and more difficult to execute business critical transactions now. The imperative to transform sustainably is in sharper focus, but routes to executing viable deals are less clear. Distressed assets are expected to flood the market, deal timelines are being frustrated by ongoing Covid-19 restrictions and uncertainty and many organizations are finding it challenging to predict the shape and tenor of their recovery.

In this briefing, we explore the defining characteristics of aviation transactions in 2021 and introduce a framework to understand new legal complexity and stress-test plans in an evolving market.

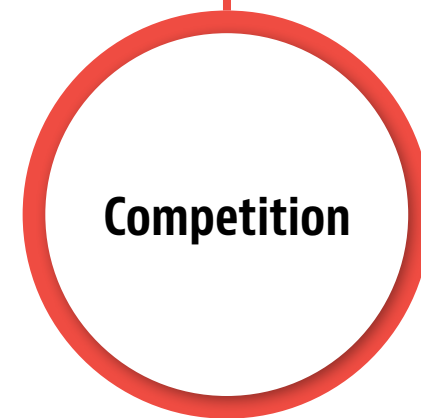
Aviation DealSCAPE Trends



Strategy

M&A will rebuild the industry

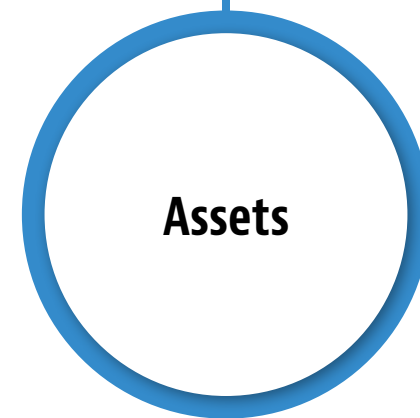
With balance sheets and credit lines exhausted, M&A will provide the capital required to stabilize aviation businesses and transform operating models.



Competition

A buyers' market

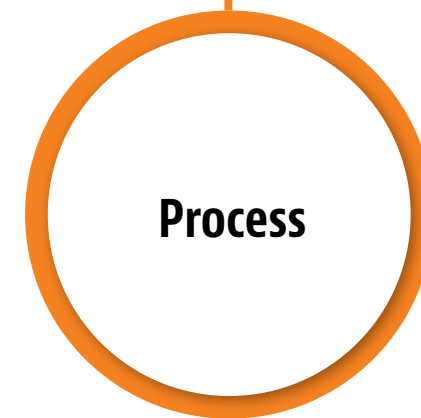
Low asset valuations will attract cash-rich financial buyers, but many will hold off from distressed transactions until debts have been restructured.



Assets

Distressed deal activity will drive consolidation

Consolidation is already happening in the fragmented aircraft leasing market, with financially stretched businesses becoming the target of larger, cash-rich lessors.



Process

New routes to solvency

Robust restructuring plans and resourceful action will support short-term survival.



Environment, Social & Governance

Shaking off a reputation for greenwashing

Emerging engine, airframe and fuel technologies and ESG incentives present an opportunity for the aviation industry to put sustainability at the heart of future operations.

Aviation Market Factfile

- ✓ The International Civil Aviation Organization (ICAO) estimates that seating capacity fell by around **50%** last year, leaving just **1.8 billion passengers** taking flights through 2020, compared with around **USD 4.5 billion** in 2019. Asia Pacific was the hardest hit of any global region.
- ✓ The latest AP Passenger Confidence Tracker reports that **93% of airline passengers** in the region say their travel routines have changed forever as a result of the pandemic.
- ✓ The S&P 500 Airlines Industry index has almost **halved** in value since the start of 2020.
- ✓ Global deal value in the aviation industry fell **66%** from Q4 2019 to Q1 2020, to a total of **USD 4.6 billion**, according to Mergermarket data.
- ✓ The International Air Transport Association (IATA) estimates that up to **USD 200 billion** will be required to save the industry.
- ✓ **47% of dealmakers** in the Industrial, Manufacturing & Transportation industry predict an increase in M&A activity in AP this year, according to Baker McKenzie research. **91%** also predict an increase in distressed transactions specifically.

1 Strategy | M&A will rebuild the industry



Trend

A majority of aviation businesses are prioritizing financial resilience and flexibility to hold off insolvency. Cash is being preserved to cover high fixed costs rather than pursuing M&A.

COVID-19 has highlighted existing inefficiencies in aviation operating models and has accelerated the imperative to radically transform the customer experience and product delivery.



Opportunity

Aviation businesses are likely to require funds in addition to the finance secured from governments and bond markets. Capital will have to come from equity, with balance sheets and credit lines already maxed out. In light of overcapacity, rationalization will provide the opportunity to raise funds via divestments.

A comprehensive digital transformation strategy is essential to meet the new challenges aviation businesses face. M&A will provide the fastest route to build the technology and digital capability needed to deliver a contactless and frictionless passenger experience post COVID-19. As airlines recover, biometrics and digital passports will become a top priority, with some organizations entering into strategic partnership to test new travel pass apps.



Legal considerations

Businesses will need to be creative as they restructure to stabilize the business and attract investors looking to acquire distressed assets. Longer-term, transactions will be required to rebuild the aviation industry, triggering an evaluation of companies' long-term M&A strategies.

IP ownership, monetization and data protection will be a more significant responsibility for airlines, airports and partners, becoming a key M&A risk factor as well as a driver of value. Addressing privacy risk and IP ownership early on will be critical to deal success.

2 Competition | A buyers' market



Trend

A shift from a sellers' to buyers' market is likely to attract investors hoping to position themselves ahead of the recovery and capitalize on low asset prices. With most strategic investors focused on stabilizing their own business, private equity will drive deal activity.

JVs and mergers will provide a lifeline for many distressed aviation businesses, especially those having to respond to further industry consolidation.



Opportunity

Restructuring to get investment-ready will be essential for distressed aviation businesses looking to maximize valuation. With cross-border deals heavily regulated, buyers will refrain from complex and risky transactions until debts are restructured and financial upside outweighs any regulatory complexity.

Some governments have granted temporary exemptions from competition rules. There is evidence of such pragmatism in APAC countries, with South Korea and Malaysia, indicating that mergers between rivals could be allowed if required to save the two airlines.



Legal considerations

Cross-border transactions are heavily regulated in the global aviation sector, with many restrictions attached to acquiring assets. Such limitations will make some deals untenable, regardless of the financials.

Deal parties will need to seek antitrust immunity, clearly demonstrating how such JVs and mergers will benefit the consumer. However, increasingly stringent and complex competition regimes in the region stack the odds against these type of aviation deals, even in extraordinary times.

3 Assets | Distressed deal activity will drive consolidation



Trend

Rationalization to address overcapacity will drive M&A transactions among distressed aviation businesses.

Consolidation is already happening in the fragmented aircraft leasing industry with BOC Aviation — the aircraft leasing unit of the Bank of China — actively seeking out deals to consolidate the market.



Opportunity

Buyers of distressed businesses are likely to wait until debts are restructured before actively pursuing deals. However, some transactions have come to market in AP attracting early movers' attention looking to do deals ahead of full Covid-19 recovery.

Consolidation could pick up pace as more significant numbers of leasing companies are stretched financially, becoming targets for cash-rich lessors or merging with rivals to compete.






Legal considerations

Buyers will carefully need to assess the resilience of complex aviation businesses and their global supply chains, protecting their investment with creative, non-traditional deal structures.

Further consolidation of the aircraft leasing industry will attract regulators' attention in AP, and navigating rising and increasingly complex competition regimes in the region may be challenging.

4 Process | New routes to solvency

 Trend	 Opportunity	 Legal considerations
<p>Unsustainable levels of debt are building across much of the airline industry as businesses try to hold off insolvency.</p>	<p>As the path to recovery becomes clearer, cash-rich financial investors will provide distressed aviation business with much needed capital. Experienced investors are queuing up in anticipation of attractive valuations and the opportunity to create real value in distressed aviation transactions.</p>	<p>Investors must deliver robust restructuring plans to bring financial metrics back into line with long-term solvency and profitability. This will require bold and urgent action to right-size fleets, restructure business models and recapitalize businesses.</p>
<p>Airlines are chasing higher freight rates, expanding their commercial freight operations by repurposing grounded aircraft for cargo flights.</p>	<p>Express shipping, which often relies on sending goods by air, has expanded rapidly during the pandemic as households turn to home deliveries. Legacy airlines are planning their networks based on where they can fly goods and have exploited regulatory exemptions allowing freight to fill passenger seats.</p>	<p>Organizations that have been able to find alternative routes to revenue have an advantage as they prepare to carve-out assets and restructure operations. However, as emergency regulatory exemptions lift, this is unlikely to be a long-term fix.</p>

5 Environment, Social & Governance | Shaking off a reputation for greenwashing



Trend

Investors are giving more weight to ESG factors when deploying capital.

There is a growing political, industrial and regulatory appetite to improve environmental performance within the aviation sector. The industry has set extremely challenging targets to meet net-zero carbon goals, including a 50% reduction in emissions by 2050.



Opportunity

Investors will increasingly favor aviation businesses with high ESG ratings — signalling more resilience and creating long-term business bets. ESG incentives in financing and investment present an opportunity for the aviation industry to shake off its reputation for greenwashing and to positively impact environmental sustainability over the long-term.

New engine, airframe and fuel technologies have allowed the industry to make great strides in reducing aircraft's environmental impact. Many of these technologies are still in their infancy, requiring further long-term investment to be viable solutions. However, ESG investors may be prepared to step forward and invest in these early-stage technologies.



Legal considerations

In addition to standard due diligence, aviation businesses should expect more in-depth sustainability reviews. ESG factors likely to be considered when assessing investments include carbon footprint, water and other resource use, waste generation, employment equity, suppliers and consumer protection, business ethics, board diversity and executive pay.

Predicting the success of pioneering, early-stage technology businesses is problematic, leading investors to protect their interests via minority investments. But minority investment is not without risk — particularly in relation to IP rights. Investors must ensure they have the appropriate rights to protect their investment throughout the lifecycle and control the exit process.

6 Key Contacts & Links



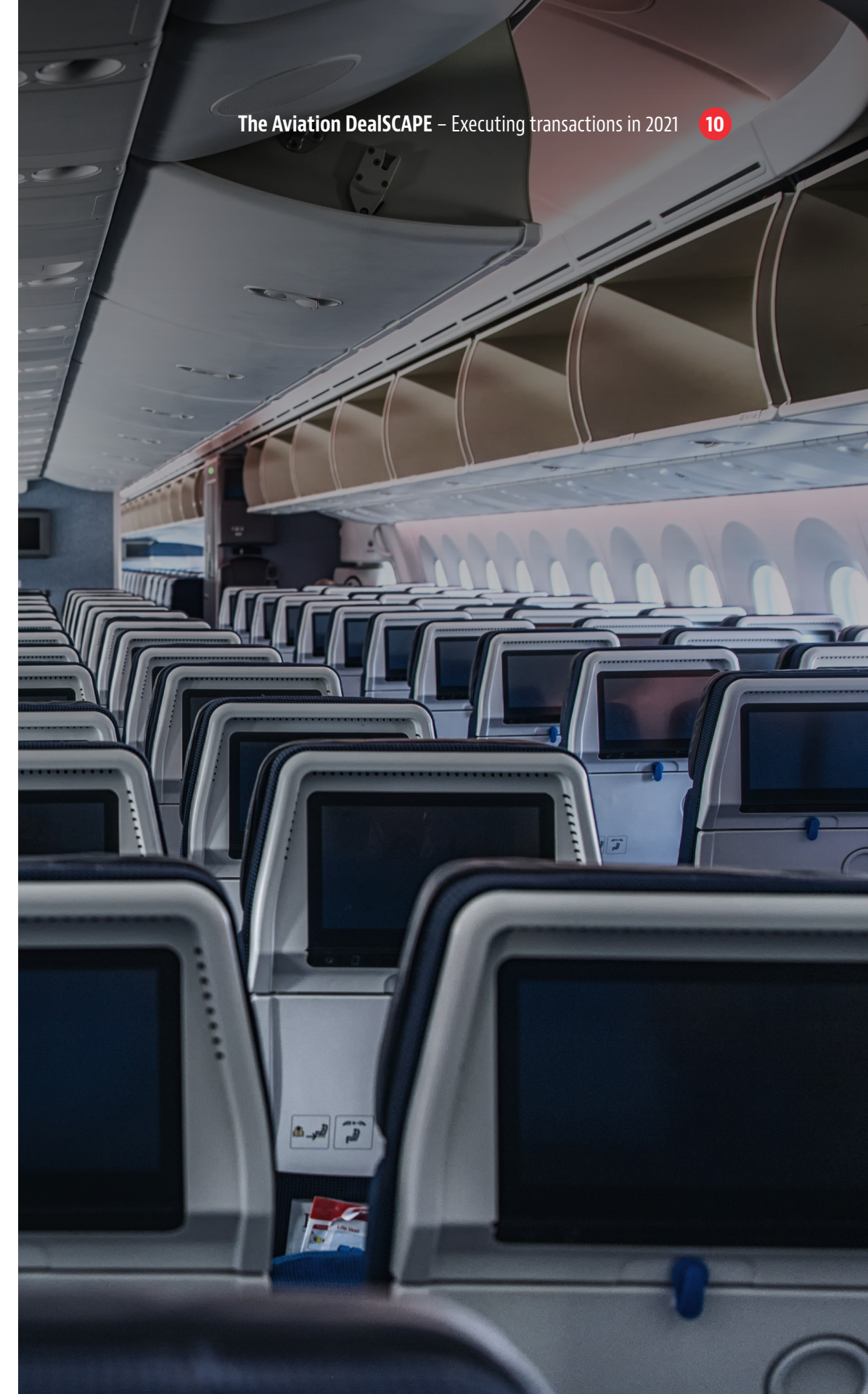
Yaeko Hodaka
Partner, Tokyo
yaeko.hodaka@bakermckenzie.com



Cherrie Shi
Partner, Shanghai
cherrie.shi@bakermckenziefenxun.com



Brian Chia
Partner, Kuala Lumpur
brian.chia@wongpartners.com



Leading and closing complex deals - every day

We are a transactional powerhouse providing commercially-focused, end to end legal advice to maximize deal certainty and secure the intended value of transactions. Our 2,500 lawyers combine money market sophistication with local market excellence. We lead on major transactions with expertise spanning banking and finance, capital markets, corporate finance, restructuring, funds, M&A, private equity and projects. The combination of deep sector expertise, and our ability to work seamlessly across each of the countries where we operate, means we add unique value in shaping, negotiating and closing the deal.

bakermckenzie.com/transactional