

THE EXECUTIVESPOTLIGHT



66



ZEPHYRUS
AVIATION CAPITAL

As soon as there is a vaccine or improved medical treatment, which is expected within the next 12 months, the industry anticipates a full recovery.

DAMOND'AGOSTINO
PRESIDENT & CEO

Do you expect the aviation industry to make a full recovery?

In my opinion, and many expert's opinion, it is absolutely not a question of if, but when. Obviously, the industry has never experienced anything to this degree before, but you can take previous shock events and apply what has happened in the past with what we expect to happen in the future. With 9/11, SARS, MERS, the global financial crisis, etc., there was doubt among many as to whether the industry would ever come back and it did, every time, at levels even higher than before those events. Clearly, COVID is a different beast, but people want to travel and are accustomed to traveling. If you look back at June/July, when restrictions began to ease and be lifted, global flight bookings immediately went through the roof, almost to record levels in terms of average daily bookings. People now more than ever want to travel, it has been taken for granted for decades, and people realize that. As soon as there is a vaccine or improved medical treatment, which is expected within the next 12 months, the industry anticipates a full recovery.

Will business travel ever come back? And if so, how will it be different?

For decades, there have been countless inventions or events that have caused people to speculate that business travel would die. Fax machines, email, video conferencing, 9/11, etc. The reality is business travel always comes back, and usually comes back stronger. The reason being, as humans, we are wired for in person interaction. ZOOM is great, the tech is super helpful, and yes, many will opt for a ZOOM call opposed to travel in some instances. However, there is a certain human interaction and connection achieved from in person meetings that cannot be achieved through a screen.

As far as the question of how business travel will be different, I expect airlines may expand their premium economy capacity, or develop a mid-tier class while shrinking the business class cabin. After the financial crisis many airlines removed the international first-class cabin and expanded business class, I expect something similar to that.

Do you foresee mergers and acquisitions coming out of this?

I think we are going to see significant consolidation among airlines, lessors, suppliers and just broadly speaking throughout the industry. Many of the smaller, less financially stable carriers are just going to go away. Some will be consolidation candidates to larger carriers. Most of the consolidation, however, will be in the mid-tier space of the airline industry, and we may see some consolidation by the flag carrier airlines around the world. That has been the typical trend going back to the period post 9/11 as well as after the '08-'09 financial crisis.

Is there more government aid or assistance on the horizon for the airlines?

Speaking globally, I think there is more to come. As of early October, there are several large economies that haven't yet provided assistance to their carriers. Fall and winter tend to be a slower, more difficult time for the industry due to a decline in leisure travel. I think governments that haven't provided any support to date may need to do so in the coming months. And, the United States, like other countries, may very well need to provide a second round of aid to get airlines to the other side of the pandemic.

What countries or regions are going to come back to normal flying levels first?

China is probably the furthest along as far as a domestic travel recovery. Their domestic capacity (the number and size of flying aircraft) is almost what it was pre-COVID, however the load factors, the number of people getting on those planes, is down 15-20% of what it was before the virus. Northeast Asia in general is fairing fairly well in terms of domestic travel. Towards the latter half of summer, Europe had a meaningful recovery, however, with recent rises in infections, Europe has begun to slow back down. Similar to Europe, Canada had a strong domestic rebound this summer, but with a second wave gaining strength, travel is softening again.

Have the OEM's halted production of new aircraft?

Airbus and Boeing, and to a lesser extent Embraer, have scaled back their production of new aircraft by about a third for the next 12-18 months. If you include the issues with the MAX and the pause on production of that aircraft, all in you're looking at a drop of more than 50% of new aircraft coming into the system this year, and about a 30-40% decline next year.

How is Zephyrus positioned to be successful in this current environment?

We started the business during an industry up cycle, and we knew the industry would turn in the near future, but obviously COVID was not in our plan or our forecast. When we began building out the original portfolio and our platform in September 2018, we set it up expecting to be coming into an industry downturn, so we focused on building a team that had experience managing aircraft through industry down cycles, and installed systems and processes to handle a weaker market.

What does Zephyrus do different that market competitors?

In the current environment, a lot of leasing companies are painting how they are handling lease restructurings and requests for customer assistance with a broad brush. Regardless of the client, aircraft, airline, region, they are implementing the same plan and strategy across the board. They have hundreds of aircraft to manage, and with limited people and bandwidth, it's the easiest option. For Zephyrus, because we have approximately 25

aircraft, we've been able to look at each of our transactions with a very customized, tailored approach to implement a plan that works best for both parties. With most, it's been providing a payment restructuring plan that will provide Zephyrus with value down the road.

Where is the next opportunity set?

Large and mid-tier airlines have done a really good job of quickly raising debt and have found interesting way to collateralize that debt. As much as that helps them in the near term with survival, that is expensive money, and there is a limit to how much they can collateralize, and how much debt they can raise and still operate in a fiscally responsible manner. As time goes on, the most likely avenue for airlines is to monetize their aircraft through sale leasebacks to a company like Zephyrus, where they will be able to continue to operate the aircraft while paying a monthly rent to us. Our solution to the airlines will be to provide them with needed capital in a structure that will allow them to continue to operate their aircraft. Catastrophic worldwide events like this generally always lead to dislocation in the market, creating opportunity. For better or worse, Zephyrus measures our team experience in decades, not years. From the management team down, we have all experienced a number of these cycles, and the down cycles always create a number of interesting and attractive opportunities. We know travel will come back, and people will get on airplanes again. We know demand for aircraft will rebound. Down times like these provide opportunities to get into assets and to build a portfolio at a lower entry point and with more attractive risk adjusted returns.

How do you expect the leasing industry to change given the current environment?

I expect there will be significant consolidation. New players that entered the industry within the last five years will have an uphill battle due to a lack of experience, in particular during a down market. Often those companies did transactions that were extremely thin on the margin and were not appropriately risk priced. Many of those organizations will either exit or will have learned a very steep lesson. I believe this creates another opportunity for Zephyrus, as those investors look to sell their portfolio of aircraft.

What do you need to do to be successful during these times?

You need to have a high degree of expertise and knowledge of the asset and the underlying metal, and the value construct of that metal. You need to have a deep understanding of the dynamic and situation that the customer is in, what's a need and what's a nice to have when they ask for help. And, as discussed earlier, you most importantly need to have experience in going through these cycles.