



Photo credit: H. Gousse, Airbus

Hong Kong Airlines on the Brink

Author: Ryan Cross

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Key Concepts:

- Hong Kong Airlines undertook aggressive fleet expansion to launch long-haul low-cost routes.
- Diminished air travel in Hong Kong, caused by ongoing civil unrest, exacerbated the airline's problems.
- To comply with new requirements set by Hong Kong's civil aviation authority last week, the company obtained a \$568 million USD capital injection from the HNA Group. This will allow it to continue operations.

Escalating Financial Pressures

Hong Kong Airlines has slogged through a series of difficulties during the past year. The company reached a nadir on December 2 when Hong Kong's civil aviation authority gave it a tight deadline to remedy its financial position or risk losing its operating license. This announcement by the Air Transport Licensing Authority (ATLA) forced the operator to raise additional capital and preserve its cash reserves within just five days. Since the airline successfully met ATLA's benchmarks before its December 7 deadline, the agency will not revoke the airline's operating license, thereby allowing it to operate normally in the immediate future.¹

Established in 2006, Hong Kong Airlines set its focus on Asia's lucrative low-cost air travel market. It built a route network spanning four continents and grew its all-Airbus passenger fleet to nearly forty aircraft. HNA Group, its part-owner, controls a range of subsidiary airlines including Hainan Airlines.

Two factors explain the airline's financial challenges. First, difficulties began when the company struggled to make its long-haul low-cost flights commercially viable. In October 2018, it started eliminating services to Australia. During 2018, the company lost approximately \$380 million USD.² The airline later cancelled its New Zealand service.

By the end of November 2019, it jettisoned the remaining routes to North America. At present, the company's schedule includes flights to two remaining North American destinations through February 2020, but recent developments place that plan in doubt.

Second, the airline's crisis deepened alongside the extensive civil strife which caused Hong Kong's commercial aviation market to soften. Massive anti-government protests have enveloped the Chinese territory since June. Hence, the airline faced lower passenger volumes throughout the second half of 2019.

In a statement it released on December 2, the company blamed the protests for its woes: "As weak travel demand resulting from the social unrest in Hong Kong has continued to affect our business and revenue, Hong Kong Airlines has reduced its capacity and flights in the coming months as well as further consolidated its network under the challenging business environment."³

Enduring political turmoil has not only hurt Hong Kong Airlines, but all of the city's air travel sector. In October 2019 alone, passenger traffic at the Hong Kong International Airport fell 13% from the same month of 2018. The facility experienced 6.1% fewer flight movements, and cargo throughput fell 5.5%.

Hong Kong's dominant carrier, Cathay Pacific, endured a 7.1% passenger traffic decrease in October.⁴ While transfer traffic buoyed the carrier, its inbound passenger traffic plummeted 35% year-on-year. Cathay Pacific owns HK Express, a low-cost carrier which directly competes with Hong Kong Airlines.

Now in their seventh month, the demonstrations may impact the carrier's busy winter holiday travel season. The airline's crucial routes to mainland China—the likely focal point of its turnaround strategy—could continue to underperform. In reaction to the protests, bookings by mainland Chinese to Hong Kong have fallen.

Long-Haul Low-Cost Model

After several years trying to make its business model work, Hong Kong Airlines gave up on its attempt to offer long-haul low-cost flights. In retrospect, its overambitious network expansion and unaffordable acquisition costs for new widebody aircraft jeopardized its entire business, including the stronger intra-Asian division.

Recent airline collapses demonstrate how long-haul low-cost operators struggle more than their traditional counterparts. In 2018 and 2019, five airlines operating under comparable business models collapsed:



Denmark • October 2018



Iceland • March 2019



France • September 2019

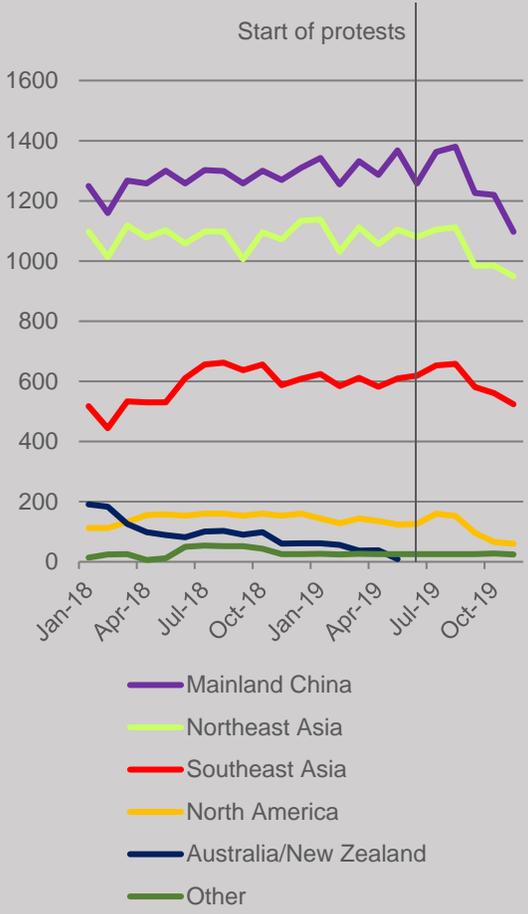


France • September 2019



United Kingdom • September 2019

Hong Kong Airlines' Scheduled Passenger Flights by Region, 2018-19



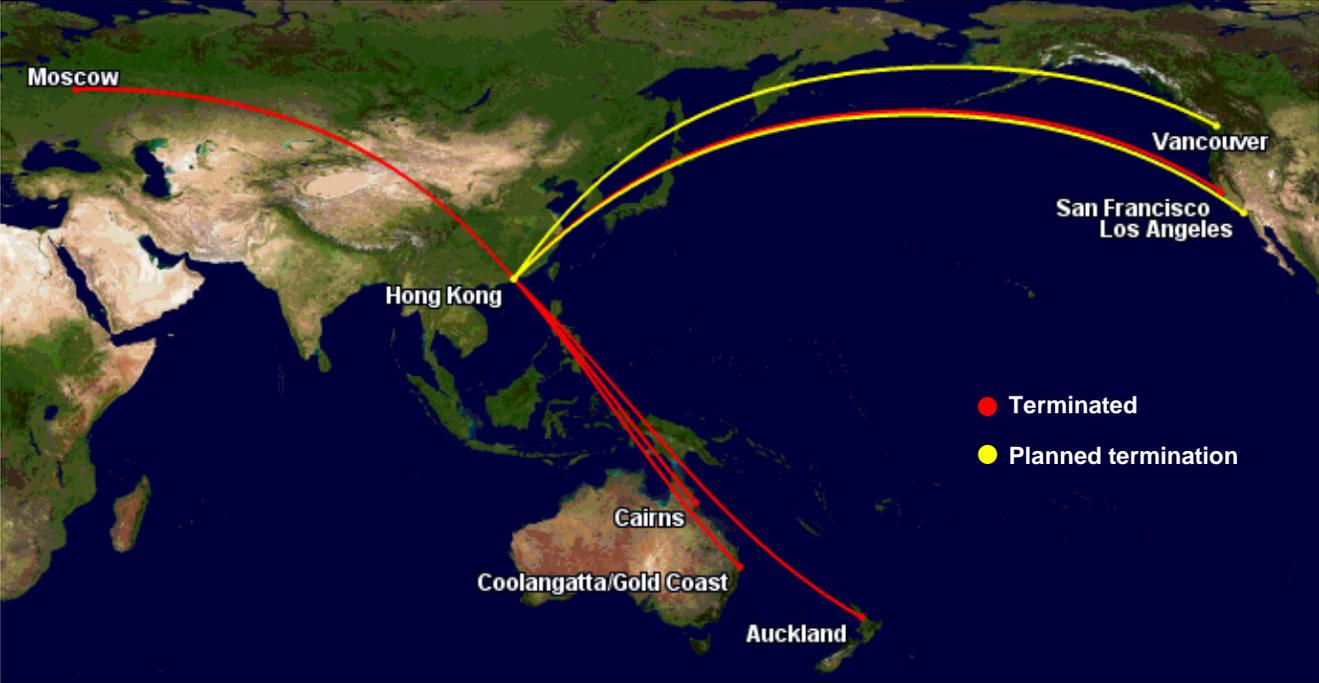
Hong Kong Airlines' Scheduled Passenger Flights by Aircraft



Timeline of the Airline's Crisis, 2018 – 2019

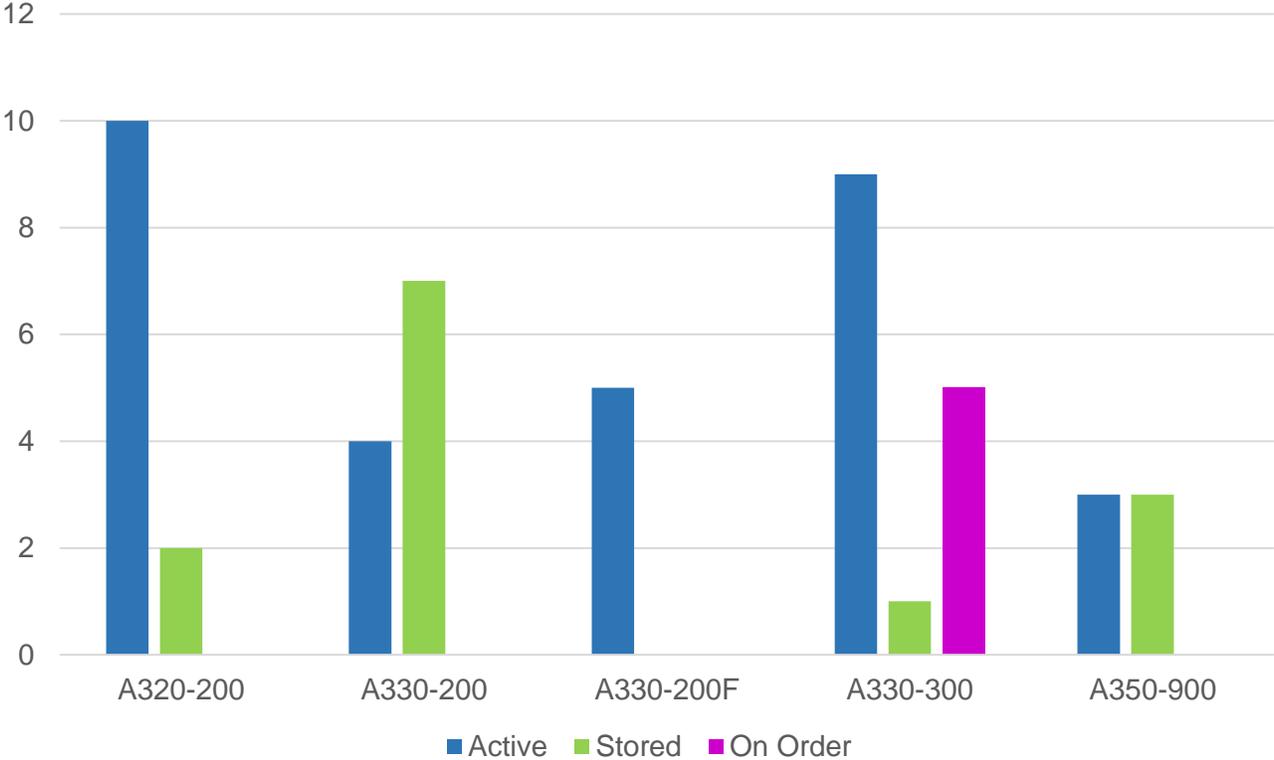
- October 28, 2018** The airline ceased flights to Cairns and the Gold Coast.⁵
- December 21** Scrutiny of the airline's financial status began. It stated it would continue normal operations.⁶
- January 5, 2019** The airline denied rumors that it would file for bankruptcy.⁷
- February 25** AerCap and an undisclosed lessor sued the airline over unpaid leases on two and six aircraft, respectively.⁸
- March 2** The airline set out plans to cut its active fleet to 28 aircraft by placing most of its Airbus A330-200 aircraft into storage.⁹
- May 22** The airline ceased flights to Auckland.¹⁰
- June 9** The first large anti-government protest march occurred in Hong Kong.¹¹
- April 17 – 23** The airline experienced a management shakeup amid disputes by its shareholder entities.¹²
- August 12** Mass protests forced the temporary closure of Hong Kong International Airport and cancellation of all flights.¹³
- November 4** The airline announced the suspension of flights to Los Angeles in February 2020.¹⁴
- November 28** The airline delayed wage payments for November for 1,600 staff, 45% of its workforce.¹⁵
- November 29** The airline announced the suspension of flights to Ho Chi Minh City, Tianjin, and Vancouver in February 2020.¹⁶ This cut will eliminate North America from its route network.
- November 30** To save money, the airline shut down its in-flight entertainment system.¹⁷
- December 2** ATLA gave the airline five days to remediate its finances. The HNA Group took a \$568 million USD loan from Chinese state-owned banks "... to pay staff salaries, aircraft leases, fuel, airport charges and other costs..."¹⁸
- December 3** The airline's CEO, Sun Jianfeng, pledged to continue paying staff salaries and avoid layoffs.¹⁹
- December 4** The airline stated that it reached a preliminary cash injection plan.²⁰
- December 5** Sun Jianfeng claimed that the airline would obtain the last-minute cash injection "within one or two days."²¹
- December 6** Prior to ATLA's deadline, the airline received the necessary cash injection from the HNA Group.²²
- December 7** ATLA announced that the airline had met both of its financial requirements and would not lose its operating license certificate.²³

Defunct Long-Haul Passenger Routes²⁴



Fleet Summary

The STAR Fleet database in mba's REDBOOK platform provides detailed information on all Hong Kong Airlines aircraft.



Leasing Companies with Exposure to Hong Kong Airlines

REDBOOK provides industry-trusted aircraft valuations data from mba's expert appraisals team. This data quantifies the exposure of the lessors which own aircraft placed with Hong Kong Airlines:

Leasing Company	Owned Aircraft (Active & Stored)	Total Current Market Value (Full Life; MM USD)
AerCap	4x A350-900	550.7
ALAFCO	2x A350-900	284.7
BOC Aviation	2x A320-200; 2x A330-200F	197.7
Grupo Marsans	3x A330-200	179.7
Lease Corporation International	2x A330-300	132.9
DAE Capital	2x A330-300	132.2
Aircastle	2x A330-200F	119.5
Avolon	2x A330-200	75.2
DVB Bank	1x A330-300	67.9
Intrepid Aviation	1x A330-200F	59.3
Sumitomo Mitsui Financial Group	1x A320-200	38.9
Total	24 Aircraft	1,838.7

Conclusions

The year-long decline of Hong Kong Airlines led the company to the precipice. Even though the company successfully met ATLA's mandate before the December 7 deadline, eleven aircraft leasing companies will closely watch what the airline does next. Lessors AerCap, ALAFCO, and BOC Aviation have the largest exposure.

The six A350-900 XWB aircraft operated by Hong Kong Airlines constitute its most valuable lessor-owned assets. ALAFCO owns only two A350 aircraft—both leased to Hong Kong Airlines—comprising 28.5% of its entire widebody fleet. Meanwhile, AerCap owns another 22 A350 aircraft besides the four aircraft that it placed with Hong Kong Airlines.

Although the HNA Group stepped in with a significant loan to Hong Kong Airlines to prevent its immediate collapse, the future of the airline is uncertain. It has already eliminated its long-haul business to save money. The emergency funds boosted its financial situation, but the company has no control over protests which continue to inhibit its inbound passenger traffic.

Taking into account the unknown results of the city's prolonged civil unrest, the airline's path to recovery appears highly challenging. Aircraft lessors, along with the rest of the industry, will be highly vigilant to see whether the operator can execute a successful turnaround.

¹ <https://www.reuters.com/article/us-hna-group-hk-airlines/hong-kong-airlines-told-to-improve-finances-or-risk-losing-license-idUSKBN1Y60CC>

² <https://www.scmp.com/news/hong-kong/transport/article/3040836/crisis-hit-hong-kong-airlines-expecting-substantial-amount>

³ https://www.hongkongairlines.com/en_CN/media/detail?id=10005575163_269

⁴ <https://news.cathaypacific.com/cathay-pacific-releases-combined-traffic-figures-for-october-2019>

⁵ <https://www.business traveller.com/business-travel/2018/06/05/hong-kong-airlines-is-axing-its-gold-coast-cairns-flights/>

⁶ https://www.hongkongairlines.com/en_HK/media/detail?id=10005566439_269

⁷ https://www.hongkongairlines.com/en_HK/media/detail?id=10005566914_269

⁸ <https://www.forbes.com/sites/willhorton/2019/12/01/cathay-pacific-wont-benefit-if-hong-kong-airlines-stops-flying/#6e616fc37c8>; <https://www.scmp.com/news/hong-kong/transport/article/2187611/hong-kong-airlines-sued-hk150-million-unpaid-fees-rented>

⁹ <https://www.scmp.com/news/hong-kong/hong-kong-economy/article/2188340/embattled-hong-kong-airlines-could-be-set-cut-its>

¹⁰ <https://www.scmp.com/news/hong-kong/transport/article/2186124/hong-kong-airlines-scraps-auckland-flights-and-turns-back>; <https://australianaviation.com.au/2019/02/hong-kong-airlines-ending-flights-to-auckland/>

¹¹ <https://www.nytimes.com/2019/06/09/world/asia/hong-kong-extradition-protest.html>

¹² https://www.hongkongairlines.com/en_HK/media/detail?id=10005570299_269;

https://www.hongkongairlines.com/en_HK/media/detail?id=10005570362_269

¹³ <https://www.wsj.com/articles/hong-kongs-cathay-pacific-warns-airline-staff-they-could-be-fired-for-supporting-protests-11565609566>

¹⁴ https://www.hongkongairlines.com/en_HK/media/detail?id=10005574591_269

¹⁵ <https://www.scmp.com/news/hong-kong/transport/article/3039808/hong-kong-airlines-fails-pay-november-salaries-time-almost>

¹⁶ https://www.hongkongairlines.com/en_HK/media/detail?id=10005575087_269

¹⁷ <https://www.reuters.com/article/us-hna-group-hk-airlines/hong-kong-airlines-told-to-improve-finances-or-risk-losing-license-idUSKBN1Y60CC>

¹⁸ https://www.hongkongairlines.com/en_HK/media/detail?id=10005575163_269;

<https://www.forbes.com/sites/willhorton/2019/12/02/hna-receives-568m-loan-will-it-go-to-hong-kong-airlines/#58f44b0f779b>; <https://www.scmp.com/news/hong-kong/transport/article/3040836/crisis-hit-hong-kong-airlines-expecting-substantial-amount>

¹⁹ <https://www.scmp.com/news/hong-kong/transport/article/3040307/owner-failing-hong-kong-airlines-gets-hk44-billion-loan>

²⁰ <https://www.bloomberg.com/news/articles/2019-12-04/hong-kong-airlines-plans-injection-will-pay-salaries-thursday>

²¹ <https://www.scmp.com/news/hong-kong/transport/article/3040836/crisis-hit-hong-kong-airlines-expecting-substantial-amount>; <https://www.business traveller.com/business-travel/2019/12/05/struggling-hong-kong-airlines-to-get-cash-injection/>

²² <https://www.caixinglobal.com/2019-12-06/hna-backed-hong-kong-airlines-gets-last-minute-lifeline-sources-say-101491625.html>

²³ https://www.hongkongairlines.com/en_HK/media/detail?id=10005575163_269;

<https://www.info.gov.hk/gia/general/201912/07/P2019120700461.htm?fontSize=1>

²⁴ Map generated by the Great Circle Mapper (www.gcmap.com) - copyright © Karl L. Swartz.

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