MOODY'S ANALYTICS

DEFAULT CASE STUDY
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Flybe Group Plc

**ABOUT**

Flybe Group Plc, a UK airline with hubs in Manchester and Birmingham, ceased operations on March 5, 2020 as travel disruption caused by COVID-19 compounded the firm's financial troubles.


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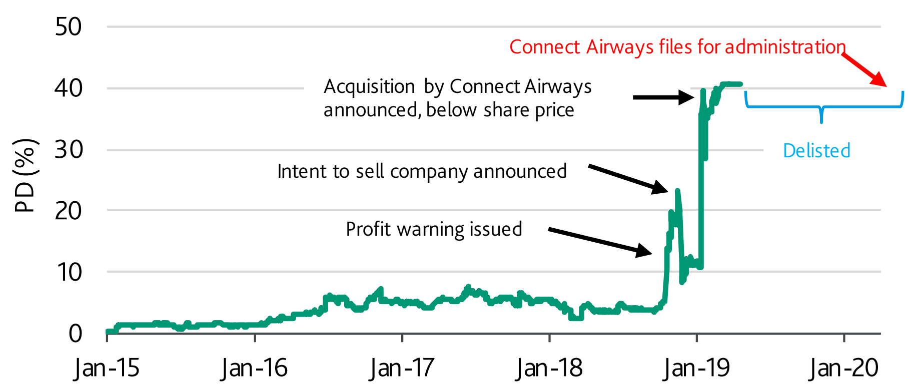
# COVID-19 Disruption Pushes Flybe Group Plc Into Bankruptcy

Flybe Group Plc, a UK-based airline carrier, filed for administration on March 5, 2020, as it faced a cash shortage from travel disruptions caused by the COVID-19 pandemic. In this report, we leverage Moody's Analytics public-firm probability of default (PD) metrics to analyze whether this default was foreseeable and to look at possible implications for the airline sector more broadly.[1]

## What can a credit risk model tell us about Flybe?

Flybe Group was in financial difficulty many months before COVID-19 struck, culminating in the sale to Connect Airways, a private consortium, in February 2019. Figure 1 highlights some of these recent milestones, alongside our one-year probability of default measure.

Figure 1 Flybe Group Plc's One-Year Probability of Default (%)

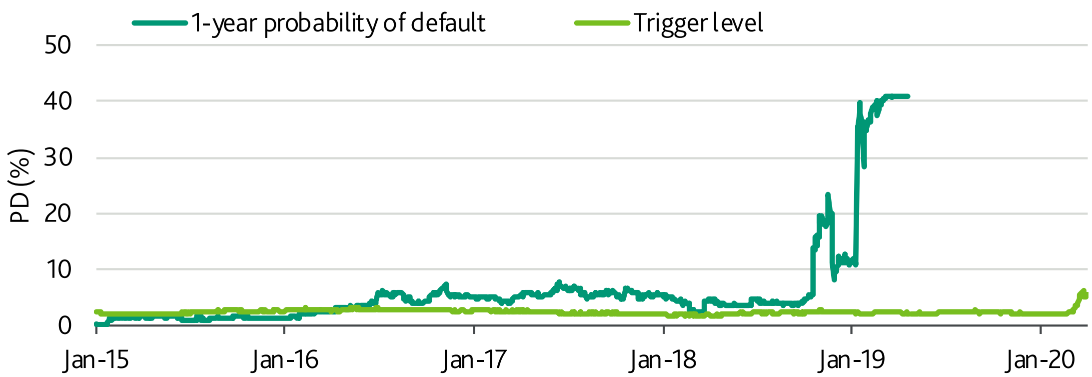



Our public-firm probability of default metric uses a company's stock price as a data input. We cannot currently produce a PD measure for Flybe, since it was delisted from the London Stock Exchange in April 2019. Nevertheless, the company's credit risk trends before this event allow us to assess whether the firm's subsequent default was indicated ahead of time. Flybe's one-year probability of default was 41% just prior to delisting, close to the maximum measure of 50%, confirming that the company was high risk at the time.

## When did Flybe first show signs of credit deterioration?

To provide an actionable metric for each firm, we produce an early-warning monitoring "trigger," calibrated by country and industry. This trigger indicates a credit risk level above which a company may be considered an elevated default risk. Flybe exceeded its trigger three years prior to default and moved well above it in subsequent months (Figure 2).

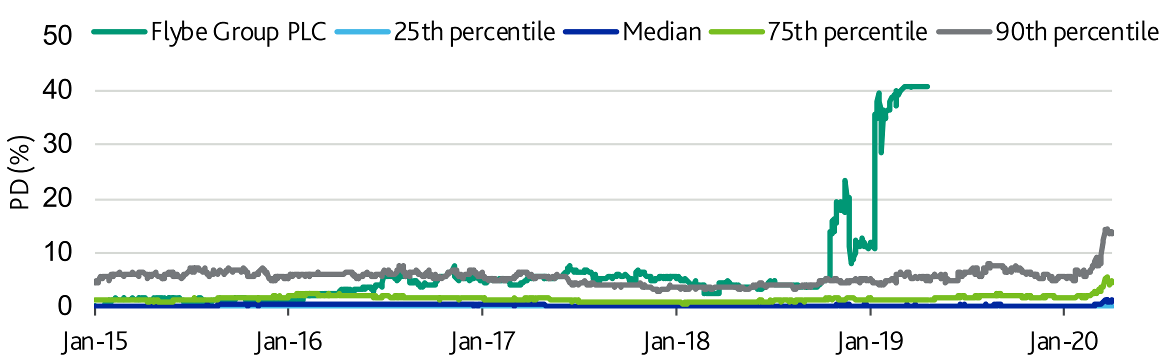
Figure 2 Flybe's PD vs. Trigger Level (%)




## Flybe's performance relative to its peers

We can gain additional insight into a company's credit profile by comparing it with its industry peers; a company performing worse than its peer group may have additional firm-specific problems driving its credit risk higher. Figure 3 shows Flybe's PD relative to 168 publicly traded air transportation firms, globally. Flybe moved briefly above the 90th percentile of the group in 2017 and early 2018, before moving permanently above it in late 2018, confirming that it was riskier than almost all of its peers.

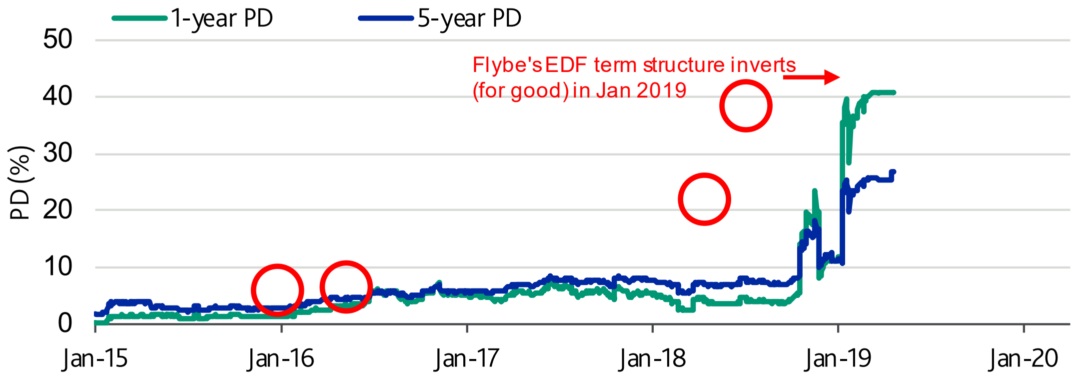
Figure 3 Flybe's PD vs. Air Transportation Industry (%)




## Flybe's PD term structure

This section shows Flybe's one-year probability of default relative to its five-year probability of default. Similar to a bond yield curve, we expect firms with sound credit to have short-term risk that is lower than long-term risk—an inverted PD curve points to heightened default risk. Flybe's term structure inverted several times, albeit briefly, providing a warning sign of default risk, before becoming permanently inverted in January 2019 (Figure 4).

Figure 4 PD term structure (%)




Taken together, Flybe's PD and associated metrics confirm that it experienced elevated default risk at the time of the Connect Airways purchase in early 2019. Even though we have been unable to produce a PD metric since its delisting, we should not be surprised that COVID-19's disruption to the airline industry caused Flybe to default.

## Are there broader lessons for the air transportation industry?

Flybe's collapse occurred soon after travel restrictions related to the COVID-19 pandemic began to affect the global economy, with the airline industry one of the most immediately and severely affected. In this instance, the financial blow exposed Flybe's existing credit weaknesses. But what does the initial default of Flybe mean, if anything, for the rest of the airline industry?

To answer this question, we use aggregate industry-level data (similar to Figure 3) to examine risk at the 75th percentile of the PD distribution—most defaulters are above the 75th percentile of their peer group at the time of default. Figure 5 shows the top 5 industries, ranked by the percentage change in the 75th percentile PD from January 20, 2020 when COVID-19 began to affect financial markets globally, to April 7, 2020.

Figure 5 Global industries ranked by increase in 75th percentile PD

| | Industry | 75th Percentile Pd | | | |
|---|---|---|---|---|---|
| | | April 7 | Jan 20 | Percentage Change | Absolute Change |
| 1 | Utilities, Gas | 2.8% | 0.8% | 262.0% | 2.0% |
| 2 | Air Transportation | 4.9% | 1.7% | 188.7% | 3.2% |
| 3 | Broadcast Media | 6.7% | 3.0% | 127.3% | 3.8% |
| 4 | Lessors | 2.4% | 1.1% | 126.0% | 1.3% |
| 5 | Furniture & Appliances | 3.9% | 1.8% | 120.5% | 2.1% |

The trend is concerning for air transportation firms. The Utilities, Gas sector has experienced the largest relative increase in default risk since the COVID-19 crisis began, as firms struggle due to weaker demand and lower prices. Consumer-facing industries such as Furniture & Appliances and Broadcast Media have also seen credit risk increases as household spending declines. Yet the Air Transportation sector stood out heading into the crisis, and it has been highly sensitive to developments so far. Given the uncertainty surrounding the COVID-19 outlook, there is considerable downside risk to the economy. If these risks materialize, the Air Transportation industry appears to be highly exposed, with further defaults likely.

## Conclusion

Flybe Group Plc's recent default should not have come as a surprise. The company's credit metrics showed elevated default risk—the revenue shock caused by the COVID-19 outbreak exposed the company's existing financial weaknesses. More broadly, the airline industry was moderately risky heading into the crisis, and it remains highly sensitive to COVID-19 developments. Further adverse shocks will likely result in more airline sector defaults.