



REPUBLIC OF KENYA THE NATIONAL TREASURY

SESSIONAL PAPER NO. 3 OF 2017

GOVERNMENT GUARANTEE OF USD 750 MILLION (EQUIVALENT TO KES 75.26 BILLION) IN SUPPORT OF RESTRUCTURING OF KENYA AIRWAYS

1. In accordance with the provisions of the Public Financial Management Act, 2012, section 58 (1) of the Laws of Kenya, the following information is laid before the National Assembly for consideration and approval.
2. The Kenya Airways PLC (formerly Kenya Airways Ltd) is a limited liability company established under the Companies Act in which the Government owns 29.8% of the issued ordinary shares. It is, therefore, a Government linked corporation.
3. Kenya Airways PLC (KQ), the Kenyan National Carrier has grown significantly over the last 15 years - from a turnover of KShs 25 billion in 2002 to KShs 100 billion in 2011. In the same period, profitability improved significantly - at one point KQ had the second highest operating margin globally.
4. In 2011, on the back of this significant growth, KQ embarked on a fleet modernization, financing and expansion programme based on a market outlook largely based on the projected business expansion and growth into Asia. This saw the fleet growing from 32 aircraft in 2011 to 45 in 2015.
5. Of the total fleet growth, seven (7) aircraft and one (1) aircraft engine (six (6) Boeing 787-8 aircraft, one (1) Boeing 777-300ER aircraft and one (1) General Electric GEnx-1/B70/75 spare engine) were primarily financed from loans obtained from two international banks, namely Citibank N.A. and JP Morgan Chase Bank N.A., through a special purpose vehicle christened Tsavo Aircraft Financing LLC, a Delaware limited liability company, as the lessor. The loans

were guaranteed by the Export-Import Bank of the United States (US Exim), an official export credit agency of the United States.

6. In order to finance pre-delivery payments for some of the ordered aircraft, Kenya Airways obtained short term facilities from eleven (11) local banks, being Equity Bank, Jamii Bora Bank, Kenya Commercial Bank, Commercial Bank of Africa, I&M Bank, National Bank of Kenya, Diamond Trust Bank, Co-operative Bank, NIC Bank, Chase Bank and Eco Bank.
7. In the post 2012 period, however, the overall market context changed significantly, marked by downturns in traditional tourism source markets for Kenya, terrorism related advisories impacting Kenya, increased costs from the fleet acquired, and unprecedented competitive pressures, the results of which led to significant losses that have eroded the capital of the company thereby threatening its survival and occasioning the need to restructure KQ, both operationally and financially.
8. With full support and indulgence of the Government and other stakeholders, the Kenya Airways PLC has negotiated a financial restructuring plan whose primary objectives are (i) to reduce financial leverage, i.e., to reduce the inordinate level of indebtedness and create capital structure aligned to the company's asset levels to enable KQ to trade on its own balance sheet going forward, and (ii) to increase the airline's liquidity to ensure that it can operate normally like any other corporate going forward. This substantial deleveraging will be sufficient to attract strategic investors.
9. The financial restructuring is supported by the turnaround plan initiated in 2015. The turnaround is already bearing fruit, as demonstrated by the full year results for 2016/17. The operating margin improved by KShs.5 billion to KShs.900 million from an operating loss of KShs.4.1 billion.
10. The preferred financial restructuring option entails a Solvent Consensual Inter-Conditional Restructuring, which creates the incentives to ensure that all the relevant stakeholders of the company contribute to the restructuring to achieve a mutually beneficial outcome. It is inter-conditional on every one of them agreeing to the restructure. The restructuring framework is expected to

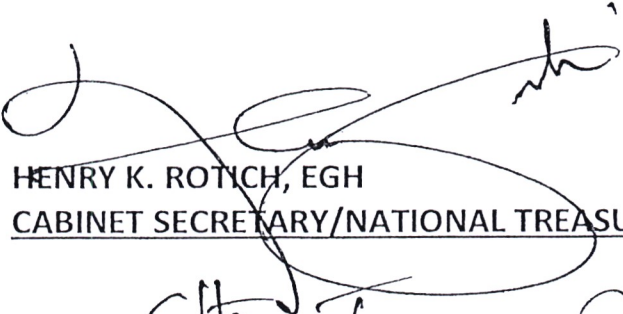
yield permanent and temporary liquidity of approximately US\$ 1 billion and reduce the debt from over US\$2 billion to almost US\$1.2 billion.

11. To facilitate this transaction, GoK will convert its debt US\$243 million plus accrued interest to equity. GoK will also provide a guarantee amounting to US\$750 million to cover both US Exim and the participating local banks to the tune of US\$525 million and US\$225 million, respectively. These guarantees are a contingent liability required to secure future funding of KQ. They avoid any cash bailout and consequential request from all stakeholders to receive cash. GoK will receive additional shares in KQ in consideration for providing the guarantees.
12. Although the total guarantee is sized at US\$750 million, the most likely downside case in a going-concern scenario is a US\$75 million draw down on the guarantee to the local banks in 10 years under the financial structure. This would arise in the event that the share price of KQ does not fully recover to the value that a sale of the shares held under the financial structure does not meet the debt service obligations of the banks.
13. However, in a liquidation scenario, the downside rises to US\$280 million, mainly on account of exposure under the guarantee to Kenyan banks, as the US Exim portion is asset backed (comprising the newest fleet in KQ). In a liquidation situation, the aircrafts which have value would be sold with only a minimal residual risk exposure to GoK.
14. It is important to note that once KQ is restructured and is back to financial stability, it will be able to meet its financial obligations, mitigating GoK risk. It has been determined, through an independent third party, that there is a business case for a restructured Kenya Airways. The independent third party has also supported the restructuring proposal by KQ's transaction advisors.
15. In addition, Kenya Airways, as a strong home-based carrier, is fully aligned with the government's ambition for Nairobi as an integrated regional hub, due to its geographically optimal location. Notably,

- a. The Government has made significant investment in developing and upgrading aviation infrastructure (e.g. airports, air navigation, etc.) to support the vision.
 - b. The development of the KQ network, creating an efficient gateway to and from Nairobi, enhances Nairobi's attractiveness as an international centre of business and investment. Currently, there are in excess of 35 headquarters of international institutions based in the city.
 - c. The development of the KQ network with its renewed focus on Africa creates all the gateways to and from Nairobi, making it an efficient aviation hub supporting the Vision 2030 objective to also make Nairobi a financial, as well as conference tourism, hub and increase the access to key tourism destinations.
 - d. As a national carrier and a recognized African brand, KQ represents the country, and indeed the continent, in the global aviation industry.
 - e. In other jurisdictions, airlines are at the centre of country positioning strategy. Indeed, the integrated regional hub strategy is strongly pursued by countries such as the Gulf States, Turkey, China and Ethiopia.
16. It is also worth noting that countries normally intervene and save their airlines when they are in financial distress. Examples of airlines restructured with significant sovereign support include Olympic (Greece), Japan Airlines, Air New Zealand, South African, Malaysian and Pakistan International Airlines.
17. Against this background, it is critical that Government supports the restructuring efforts of Kenya Airways.
18. The current total contingent liabilities of the Government of Kenya in respect to the Public Financial Management Act, 2012 section 58 (2) (f) amount to KShs 57.68 billion and with the proposed guarantee of a sum equivalent to KShs 75.26 billion the aggregate amount will be KShs 132.94 billion. This, together with the stock of outstanding debt, is within the debt limit set by Parliament.

19. The National Assembly is requested to approve the Kenya Government Guarantee amounting to USD750 million (equivalent to KShs 75.26 billion), for the restructuring of Kenya Airways PLC, as follows:-

- (i) A Guarantee of USD 525 million to US Exim Bank in order to deliver liquidity savings to KQ over five (5) years.
- (ii) A Guarantee of USD 225 million to local Kenyan banks, primarily to support working capital requirements.



HENRY K. ROTICH, EGH
CABINET SECRETARY/NATIONAL TREASURY

DATE.....

6th June 2017.

REPUBLIC OF KENYA



THE NATIONAL ASSEMBLY

ELEVENTH PARLIAMENT – FIFTH SESSION

Notice of Motion

SPECIAL MOTION – (Leader of the Majority Party)

APPROVAL OF GOVERNMENT GUARANTEE TO SUPPORT THE
RESTRUCTURING OF KENYA AIRWAYS

THAT, pursuant to the provisions of Article 213 of the Constitution, and sections 50 and 58 of the *Public Finance Management Act (CAP 412C)*, this House notes *Sessional Paper No. 3 of 2017 on Government Guarantee in support of Restructuring of Kenya Airways*, and approves the Government of Kenya Guarantee of United States Dollars (\$) 750 million, equivalent to Kshs 75.26 billion at the current exchange rate, to the US Exim Bank and eleven (11) local banks, for the restructuring of Kenya Airways PLC.

THE HON. ADEN DUALE, EGH, MP
LEADER OF THE MAJORITY PARTY

Date:

7/6/2017

The motion has a Money Bill effect in accordance with Article 114 of the Constitution.

Paper Laid on the
Table of the House
by the Leader of
the Majority Party
on Wednesday
7th June 2017
(Afternoon)

07 JUN 2017



① Manjara DL8.
Also sent
8 26/06

REPUBLIC OF KENYA

THE NATIONAL TREASURY

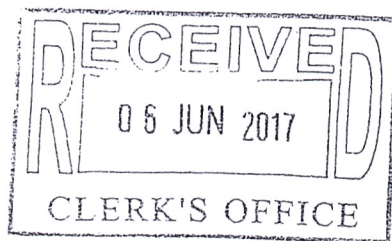
www.treasury.go.ke
FAX NO. 310833
Telephone: 2252299
When replying please quote:

The National Treasury
P.O. Box 30007
NAIROBI

Ref: No. ZZ/MOF 168/07

Date: 05 June 2017

Mr. Michael Sialai
Clerk of the National Assembly
Parliament Buildings
NAIROBI



② Mrs. Wanjohi
- Please prepare letter
by 10th June 2017
B-AC for the
10th Dec 2017

Dear

Mr. Sialai

RE: REQUEST FOR THE APPROVAL OF THE NATIONAL ASSEMBLY FOR
GUARANTEES AMOUNTING TO USD.750 MILLION TO SUPPORT THE
RESTRUCTURING OF KENYA AIRWAYS

The Cabinet approved the framework for the restructuring of Kenya Airways at its meeting held on 29 May, 2017.

The Cabinet further authorized the Cabinet Secretary/National Treasury to obtain approval from the National Assembly, in line with the requirements of the law, for Guarantees totaling USD 750 million required to support the KQ restructuring.

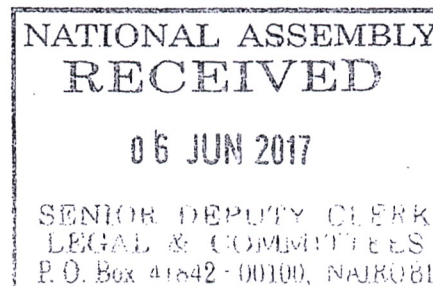
Pursuant to the provisions of the PFM Act.58f, please find herewith a Sessional Paper in respect of this request. Please facilitate the laying of this request before the National Assembly at the earliest opportunity.

Yours

Sincerely

Dr. Kamau Thugge, CBS

PRINCIPAL SECRETARY/NATIONAL TREASURY



ISO 9001:2008
Certified.

cc. Prof Paul Maringa Mwangi
Principal Secretary
Ministry of Transport & Infrastructure
NAIROBI