Paper 47

Settlement Scheme For Debt Financing Using Mezzanine With Warrants (Study Case: PT Garuda Indonesia (Persero) Tbk)

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Abstract - **Since the spread of Covid 19 in China in December 2019, all sectors have been affected by COVID-19, including the aviation industry. This resulted in a decrease in the number of flight passengers and decreased the company's operational and financial performance, including PT Garuda Indonesia (Persero) Tbk. Furthermore, the decline in the company's performance resulted in it experiencing liquidity difficulties and an inability to pay its short-term liabilities. The research was conducted to solve those problems with the case study research method, where the authors searched for and collected publicly available data and performed simulations that could be applied by PT Garuda Indonesia (Persero) Tbk. This problem can be solved using a mezzanine with warrants scheme, where the company will lend money to private equity, and interest payments will be paid yearly. In addition, at maturity, the mezzanine loan will be converted as collateral with a value that meets the agreed internal rate of return. The warrants will be exercised into shares. Therefore, the private equity shares ownership of PT Garuda Indonesia (Persero) Tbk.**

Keywords - **Debt Financing, Financial Restructuring, Mezzanine**

I. INTRODUCTION

The Covid-19 pandemic has spread to almost all countries in the world which affects various businesses. To compress the spread of Covid-19, numerous countries have implemented national lockdowns such as England, Croatia, Argentina, Pakistan, New Zealand. Then some countries only carry out local lockdowns such as the US and Brazil. Indonesia, Japan, and several other countries only restrict the activities of citizens (Dunford et al., 2020). In 2021, after a new variant of the Covid-19 virus was discovered and spread, several countries such as Singapore re-imposed the lockdown that they had implemented (Park, 2021). So that, the Covid-19 pandemic has disrupted people's lives and created several changes (Thomas et al., 2021). There are still uncertainties for the long run for varied aspects as well as business.

One of the sectors that have been severely affected by the COVID-19 pandemic is the aviation industry (Pallini, 2020). From the consumer side, passengers avoid flights to prevent being exposed to COVID-19. From the regulator's point of view, making policies related to regional closures and the existence of strict protocols related to travel. Lockdown policies that have implemented by many countries forced airlines to stop services. Overall, the COVID-19 pandemic has resulted in a significant reduction in travel (Ozbilen et al., 2021).

At the beginning of the pandemic when many countries-imposed lockdowns, many airlines cancelled their flights suddenly. For instance, from January to February 2020, PT Angkasa Pura (Persero) reported that as many as 12,703 flights with an estimated number of 1.67 million passengers were cancelled at 15 airports throughout Indonesia (Mufti, 2020). From April 2020 to May 2020, the number of passengers in Indonesia fell -89.62% (Soelasih and Sumani, 2020). The cancellation also occurred in other countries. The year 2020 was the start of a disaster for the aviation industry. 2020 is the year when the COVID-19 outbreak spreads throughout the world, so many countries have implemented lockdowns and travel restrictions for their citizens.

The International Air Transport Association (IATA) said that global passenger traffic for 2020 showed demand (RPK or revenue passenger per kilometre) fell by -65.9% YoY compared to 2019 which was the most significant decrease in traffic in aviation history. In 2020, flight traffic for airlines in the Asia Pacific decreased by -80.3% YoY compared to 2019. The Covid-19 pandemic caused the aviation industry in 2020 to experience negative growth. Although going forward, the government is also trying to continue to provide fiscal and monetary stimulus and provide vaccines that can help reduce infection rates.

The number of international passengers in 2020 was -75.6% below 2019. Capacity (Available Seat Kilometres) in 2020 decreased by -68.1% YoY and load factor decreased by 19.2 points YoY. Meanwhile, the number of domestic passengers in 2020 fell -48.8% YoY compared to 2019. Available Seat Kilometres to fell to -35.7% YoY and load factor decreased by 17 percentage points to 66.6%. Meanwhile, IATA estimates that in 2021 there will be an increase of 50.4% compared to 2020, but this increase is only at the level of 50.6% of the flight traffic in 2019.

Garuda Indonesia's domestic market share declined by -9.34 percentage points, while Citilink's domestic market share climbed by 1.29 percentage points, for a total decrease of -8.05 percentage points for the Garuda

Indonesia Group. Garuda Indonesia Group's market share on international flight routes increased by 0.83 percentage points year on year in 2019.

Until now, the economic conditions in Indonesia and the world are still affected by the Covid-19 pandemic. This directly affects the operational performance and financial performance of PT Garuda Indonesia Tbk. The number of passengers as of December 2020 Garuda's Group decreased significantly by 66.11% YoY compared to the number of passengers before the pandemic. The decline in the number of passengers was caused by many countries and regions in Indonesia that imposed travel restrictions. The decrease in the number of passengers was also followed by a decrease in the amount of cargo.

According to IATA, this condition will occur for the next 5 (five) years to return the number of passengers to their pre-pandemic state. Although there was a decrease in revenue during the Covid-19 pandemic, it was not followed by a decrease in operational expenses, causing PT Garuda Indonesia (Persero) Tbk to experience a net loss and a decrease in company liquidity. In addition, the amount of cash and cash equivalents of PT Garuda Indonesia (Persero) Tbk during the pandemic decreased compared to before the pandemic.

However, the significant decline in revenue during the COVID-19 pandemic was not accompanied by a decrease in operating expenses incurred, causing PT Garuda Indonesia to experience a net loss and negative impact on the company's equity as well as a decrease in liquidity and a decrease in the level of cash equivalents of Garuda Indonesia if compared to conditions in 2019 before COVID-19 took place.

Problems related to liquidity risk indicate a risk that arises where the position of cash inflows of PT Garuda Indonesia (Persero) Tbk from short-term income is not sufficient to meet cash outflows for short-term expenses. As a result, the company experiences liquidity and delays the payment of various maturing liabilities.

Until now, PT Garuda Indonesia (Persero) Tbk has postponed its debt payment obligations, among others, to PT My Indo Airlines, PT Mitra Buana Koorporindo, and several other companies. In addition, the company also received a lawsuit for default related to the delay in payment of aircraft leases to AerCap Ireland Limited, SMBC Aviation Capital Limited, and Helice Leasing S.A.S. The company's difficult liquidity has also caused PT Garuda Indonesia (Persero) Tbk to be unable to make payments of principal and interest related to the USD 500 million Sukuk. Thus far, the company is proposing to change the maturity of the Sukuk from June 3, 2020, to June 3, 2023.

Table 1 - INTEREST BEARING DEBT OF PT GARUDA INDONESIA (PERSERO) TBK FY19 – 9M21

In Million IDR	30-Sep-21	31-Dec-20	31-Dec-19
Short-term loans	948,577,908	805,272,996	984,853,063
Factoring liabilities	-	94,019,723	54,570,560
Long-term loans	80,669,209	51,068,979	141,779,239
Lease liabilities	1,949,948,178	1,505,258,580	52,533,237
Bonds payable	494,390,666	492,074,369	498,996,741
Asset-backed securitisation loan	66,034,063	25,522,846	25,897,408
Mandatory convertible bonds	69,746,056	-	-
Long-term loans	378,717,038	248,159,518	1,597,426
Lease liabilities	3,959,206,867	4,493,564,698	35,340
Asset-backed securitisation loan	-	51,045,692	77,692,229
Total	**7,947,289,985**	**7,765,987,401**	**1,837,955,243**

To overcome this, the researcher offers a financing option through mezzanine financing, which is a hybrid financing instrument whose position is lower than that of a senior loan or does not require collateral. The issuance of mezzanine financing is also much less complicated than other debt financing or equity financing options. In addition, researchers also offer options with mezzanine financing combined with warrants which are considered an equity kicker for private investors or strategic investors.

II. METHODOLOGY

Case study research is becoming more common among qualitative researchers (Thomas, 2011). Researchers who use the case study method must first determine the research setting for their case (industry, region, etc.). Researchers must prove that this case study is a phenomenon and interesting to study. Therefore, researchers should be able to determine how case studies will need to emphasize how they can make a theoretical contribution against their chosen research background and whether this contribution can be generalized through replication.

Once the research setting is selected, the researcher must consider which companies to include and which issues to choose within each company. Continuing the research theme related to financial restructuring, the researchers need to determine the criteria used to select the company. The company was chosen because they are currently undergoing a lawsuit process related to debt restructuring. Case selection is essential not only for empirical studies but also for a literature review so that the latter will be able to justify and frame empirical studies.

As mentioned in the background, several studies on corporate debt restructuring in several countries have been conducted. Therefore, this raises the author's interest in researching the settlement of debts of PT Garuda

Indonesia (Persero) Tbk. Following a thorough examination of the literature, the authors chose the case study as the major research approach. A qualitative technique was used to gather, analyse, and conclude all data (Yin, 2011). Case study research is an empirical method that delves deeply into contemporary events in real-world contexts. When the boundaries between phenomena and context are unclear, the case study method is extremely useful.

A common criticism of the case study method is the lack of documentation and standards regarding the methodology. At the same time, the case study method is one of the most widely used methods to understand contemporary phenomena – both formally and of course informally in learning something and developing new research theories and hypotheses. This method still lacks credibility and substantial literature explaining how to conduct case studies and maintain research forms as valid investigation forms (Yin 2018).

The features of case study research relate to technically different situations with more variables of interest than data points where pre-existing theory will assist in guiding development, design, data collection, and data analysis (Yin, 2018). Therefore, the author uses a conceptual framework that has been developed by Yin (2018) as a basic outline as follows:

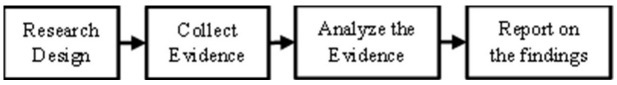

Fig. 1. Methodology.

III. RESULTS

A. Financial Projection

Estimation of the company's future financial outcomes is required to serve as the basis for calculating free cash flow, which will be used for stock valuation. As a result, the income statement will be predicted and used to generate the inputs. as the subject of projection, the following key accounts will be estimated operating revenue, operating expense, finance income, finance cost, depreciation expense, income tax expense

The primary assumption used to calculate the projected operating revenue is passenger revenue based on the growth in the number of passengers, revenue-passenger kilometres (RPK), the number of aircraft, an average of available kilometres (ASK), and an average ticket price. For cargo revenue, the significant assumptions used are the amount of cargo and the cargo price. For other income in operating revenue, the assumption used is the average growth of the last five years.

The assumptions used for operating expenses will be based primarily on operating revenue percentages based on historical performance before covid. Assumptions Finance income is based on the value of deposit interest, and the assumption of finance costs is the average interest paid by the company. Finally, the income tax expense assumption will use the income tax rate in Indonesia is 22%.

The balance sheet summarizes the company's fundamental situation based on its resources, commitments, and equity. The balance sheet forecast will be prepared to aid in the estimation of inputs utilized in stock valuation in the coming years. The following accounts will be projected Cash and Cash Equivalent, Trade Receivables-Related Parties, Trade Receivables-Third Parties, Inventory, Fixed Asset, Trade Payables – Related Parties, Trade Payables – Third Parties, Accruals, Long Term Trade Payables, Interest Bearing Debt, Mezzanine Financing, Share Capital, Retained Earning.

By using the average financial ratio and comparing the specific accounts to its historical performance indicators, the assumptions employed in forecasting the balance sheet are derived based on its historical performance. Some balance sheet accounts are assumed to be flat.

B. Cash Available for Debt Services and Debt Sizing

From the results of the calculation of Cash Available for Debt Services, using the EBITDA formula reduced by tax minus or added by Changes in Working Capital and reduced by Acquisition of Assets

Table 2 - CASH OF AVAILABLE OF DEBT SERVICES (CFADS)

Period	CFADS (in full USD)	Discount Rate	PV of CFADS (in full USD)
0	122,999,935	1.00	122,999,935
1	199,158,016	1.06	188,426,568
2	804,805,460	1.12	720,409,790
3	829,572,700	1.18	702,566,584
4	562,644,947	1.25	450,828,961
5	811,806,008	1.32	615,423,380
6	840,257,260	1.39	602,668,301
7	437,419,748	1.47	296,830,694
8	899,012,950	1.56	577,192,548
9	966,953,737	1.65	587,360,599
Total	**6,474,630,763**		**4,864,707,361**

For ten years, the value of GIAA's Cash Available for Debt Services is only USD 6.47 billion, and if we present the value, it is only worth USD 4.86 billion. At the same time, the total interest-bearing debt from GIAA is USD 7.95 billion. This shows that the GIAA still needs funds arounds of USD 3.08 billion to pay off the interest-bearing debt.

Table 3 - SIMULATION OF DEBT SIZING

	A	B = D0	C	D = A+B-C
Year	CFADS	Beginning Balance	Total Debt + Interest	Cash Ending Balance
2021	122,999,935	41,699,860	47,584,695	117,115,100
2022	199,158,016	117,115,100	2,798,837,858	(2,482,564,742)
2023	804,805,460	(2,482,564,742)	1,039,056,774	(2,716,816,056)
2024	829,572,700	(2,716,816,056)	975,051,383	(2,862,294,739)
2025	562,644,947	(2,862,294,739)	970,845,509	(3,270,495,300)
2026	811,806,008	(3,270,495,300)	457,569,887	(2,916,259,179)
2027	840,257,260	(2,916,259,179)	281,555,269	(2,357,557,188)
2028	437,419,748	(2,357,557,188)	99,797,323	(2,019,934,763)
2029	899,012,950	(2,019,934,763)	98,938,406	(1,219,860,218)
2030	966,953,737	(1,219,860,218)	97,077,418	(349,983,900)

If GIAA does not take corporate action, the result is that from 2022 to 2030, GIAA will experience a negative cash ending balance. The maximum value of the negative cash ending balance will occur in 2025, which is USD 3.27 billion. This shows that GIAA will go bankrupt because it is unable to pay its obligations.

C. Debt Sizing with Mezzanine with Warrant

If using a mezzanine with warrants, it is assumed that GIAA will obtain financing from 2022 to 2025 in the amount of USD 3.75 billion and pay interest of USD 617.5 million, assuming an interest rate of 5% p.a, then from 2021 to 2030, GIAA will not experience a negative cash ending balance.

Table 4 - SIMULATION OF DEBT SIZING WITH MEZZANINE

	A	B = F0	C	D	E	F=
						A+B-C+D-E
Year	CFADS (in USD Million)	Beginning Balance (in USD Million)	Total Debt + Interest (in USD Million)	Mezzanine (in USD Million)	Interest Paid (in USD Million)	Cash Ending Balance (in USD Million)
2021	179	42	48	-	-	173
2022	1,214	173	2,799	2,530	-	1,118
2023	977	1,118	1,039	360	127	1,289
2024	944	1,289	975	290	145	1,404
2025	925	1,404	971	570	159	1,769
2026	838	1,769	458	-	188	1,962
2027	800	1,962	282	-	-	2,480
2028	843	2,480	100	-	-	3,223
2029	861	3,223	99	-	-	3,986
2030	894	3,986	97	-	-	4,783
Total	**7,581**	-	**6,769**	**3,750**	**618**	-

D. Valuation of PT Garuda Indonesia (Persero) Tbk

The Discounted Cash Flow valuation method is used to calculate the company's intrinsic value as the present value of predicted future cash flows. The total cash flow from operations accessible after depreciation, costs, taxes, working capital, and capital expenditures is known as free cash flow to firm (FCFF).

The FCFF formula is as follows:

=EBIT – Tax + Depreciation or Amortization – Changes in Working Capital (1)

First, we need to compute the Profit Before Interest and Tax (EBIT), which we can get by referring to the income statement and the reduction of tax expense, which will then be identified as Net Operating Profit After Tax (NOPAT). Furthermore, depreciation expense or amortization expense is added because the expense does not affect the cash flow performance. After that, there is a reduction or addition of changes in working capital. And finally, the reduction of Capital Expenditure (CAPEX). CAPEX is obtained by determining the movement of Property, Plant & Equipment plus depreciation costs.

The findings of the FCFF computation at the end of forecasting will then be used to calculate the company's terminal value by multiplying the most recent cash flow (year 10) by the terminal growth rate. The terminal growth rate utilized by the author in this computation is 3.04 percent, which is based on the OECD's forecasted compound annual growth rate of Indonesia's GDP growth from 2031 to 2060. Indonesia's GDP in 2031 is estimated to reach USD 5.52 trillion, and in 2060 it will reach USD 12.3 trillion. The terminal value obtained is USD 32.7 billion, and if the present value is USD 22.1 billion, the value of the Sum of PV from 2022 to 2030 is USD 4.4 billion.

Valuation =

PV of Terminal Value + Sum of PV of FCFF + Cash – Debt (2)

Valuation of PT Garuda Indonesia (Persero) Tbk =

USD 22,130,390,647 + USD 4,418,069,895 + USD 41,699,860 - USD 7,947,289,985 = USD 18,642,870,417

WACC is calculated by using equation 3. WACC is used as discounting forecast cash flow. To calculate WACC, Cost of Debt and Cost of Equity must be defined first.

WACC =

Cost of Equity Equity/(Equity+Debt) + Cost of Debt (1 – tax rate) (Debt)/(Equity+Debt) (3)

The total debt used is the total interest-bearing debt owned by PT Garuda Indonesia (Persero) Tbk, which is USD 7.94 billion. Meanwhile, the total equity uses the last market value and cannot use the equity value because PT Garuda Indonesia (Persero) Tbk has a negative equity value.

To calculate the market value in USD, the following formula is used:

Market Value =

Last Price x Number of Shareholder Share / IDR/USD (4)

Market Value =

IDR 222 x 25,886,576,254 / Rp14,661 =

USD 391,980,078

Therefore, debt portion is 95.20% from (7.94 Billion/ (USD 391.9 Million + 7.94 Billion) and equity portion is 4.80% from (USD 391.9 Million / (USD 391.9 Million + 7.94 Billion).

In conclusion, WACC value is as follows:

WACC = 16.36% x 4.80%+ 5,70% x (1 – 22%) x 95.20% = 5.01%

GIAA obtains the range of interest rates varies widely. The minimum value of the interest rate is 0.21% p.a. GIAA obtained the rate from the Japan Finance Corporation, which is a special loan. Meanwhile, the highest rate is the rate that comes from PT Bank Negara Indonesia (Persero) Tbk, which is 10.75% p.a. If the interest is calculated using the average, a value of 5.69% will be obtained. The average calculation result is equivalent to the weighted average of loans obtained by GIAA, which is 5.70%. The weighted factor of the Weighted Average of the Interest Rate is the number of existing GIAA loans.

The cost of equity is the return expected by investors to decide that the investment made meets the capital return requirement. In calculating the cost of equity, we can use the capital asset pricing model so that we get the following equation:

Cost of Equity =

Risk-Free + Beta x (Expected Market Return – Risk-Free Rate) (4)

The Risk-Free Rate is the rate of return assumed to have a risk close to zero. In this case, the risk-free rate used is the Indonesian Government Bonds Yield 10 Years per 22 May 2022. The risk-free rate is 7.22%. At the same time, Beta is used to calculate the calculated risk based on the company's stock price regressed. The beta stock used for GIAA is 1.49.

The beta stock results from calculations carried out by PT Pemeringkat Efek Indonesia or PEFINDO per 19 May 2022. The risk premium value is 6.12%. This figure comes from the calculation of the equity risk premium in Indonesia, which is calculated by Aswath Damodaran, a professor from New York University in the field of Finance.

From these assumptions, the cost of equity from GIAA is obtained as follows:

Cost of Equity = 7.22% + 1.49 x 6.12% = 16.36%

Table 5 - COST OF EQUITY

Risk Free Rate	7.22%
Risk Premium	6.12%
Stock Beta	1.49
Cost of Equity	**16.36%**

E. Warrant Exercise

Assuming private equity will get an internal rate of return (IRR) of 20%, in year 6, private equity will get warrants worth USD 7.39 billion in 2027.

Table 6 - CALCULATION OF INTERNAL RATE OF RETURN

Year		**1**	**2**	**3**	**4**	**5**	**6**
Description/ Period	**Unit**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**
Principal	US$ M	(2,530)	(360)	(290)	(570)	-	-
Interest	US$ M	-	127	145	159	188	-
Equity Kicker (Warrant)	US$ M	-	-	-	-	-	7,398
Cash Inflow (Outflow)	US$ M	**(2,530)**	**(234)**	**(146)**	**(411)**	**188**	**7,398**
IRR	**20.00%**						

If it is assumed that the total outstanding share of GIAA is 25.89 billion shares, the fair value of GIAA is IDR 10,300 per share, then the fair value of warrants is IDR 8,300 if the private equity exercise price is IDR 2,000. The warrant value of USD 5.93 billion will be divided by the value of the fair value warrant so that private equity will get 12.7 billion shares of GIAA shares.

Table 7 - WARRANTY EXERCISE

Description	**Unit**	**Amount**
Total Share Outstanding	Share	25,886,576,254
USD/IDR	IDR	14,250
Fair Value Price 2027F	IDR/Number of Shares	10,300
Exercise Price	IDR/Number of Shares	2,000
Fair Value Warrant	IDR/Number of Shares	8,300
Number of Share	Number of Shares	**12,701,212,482**

When private equity converts warrants into GIAA shares, the government also converts bonds and shares to get a total of 825.2 million shares. Therefore, after the conversion, GIAA's shareholders will be diluted. The government's share ownership will decrease to 41.85%

from 60.54%, PT Trans Airways' shares in GIAA will be 18.56% from 28.26%, and public shares will be diluted to 7.36% from 11.20%. Finally, private equity will get 32.23% ownership in GIAA

Table 8 - SHARE CONVERSION

Shareholders	Before Conversion		Conversion	After Conversion	
	No. of Shares (Million)	%	No. of Shares (Million)	No. of Shares (Million)	%
Government	15,671	60.54%	825	16,496	41.85%
PT Trans Airways	7,317	28.26%		7,317	18.56%
Public	2,899	11.20%		2,899	7.36%
Private Equity			12,701	12,701	32.23%
Total	**25,887**	**100.00%**	**13,526**	**39,413**	**100.00%**

IV. DISCUSSION

Mezzanine financing is a hybrid financing scheme between debt and equity that can be used by PT Garuda Indonesia (Persero) Tbk to resolve its liquidity problems. The advantage of Mezzanine financing is that the administrative process to obtain financing is relatively easier than senior loans. In addition, the position of mezzanine financing, which is more junior than bank loans, means that PT Garuda Indonesia (Persero) Tbk does not need to provide collateral to the lenders, namely private equity.

Until now, many assets of PT Garuda Indonesia (Persero) have been pledged to banks or other debtors such as receivables, inventory, fixed assets, and even revenue received by PT Garuda Indonesia (Persero) in the future. Even so, there is a fundamental weakness of mezzanine financing, namely the high-interest rate, which is far above senior loans such as bank loans. To overcome this weakness, an option is offered to replace part of the value of the interest into warrants which can then be exercised into shares.

V. CONCLUSION

From the scenarios above, it can be concluded that the high dilution rate is caused by the smaller the value of cash interest provided, the higher the internal rate return expected by Private Equity and the low value of PT Garuda Indonesia's valuation at the time of the exercising warrant.

On the other hand, the dilution rate will be lower if the value of the cash interest given is high, the value of the internal rate return expected by Private Equity, and the higher the valuation value of PT Garuda Indonesia (Persero) Tbk at the time of the exercising warrant. In addition to raising funds from private equity, PT Garuda Indonesia (Persero) Tbk still has to make several efforts to resolve the Company's liquidity problems.

Mezzanines have been widely applied in various countries by private organizations and state institutions (Sazonov et al., 2016). For instance, the German State Bank spent 800 Million Euros on the ERP-Innovation Program. In France, the OCEO Institute issued 930 million euros for Intangible Expenses, and the Development Bank of Canada gave 500 million euros of Mezzanine to its debtors.

Several things can be done by PT Garuda Indonesia (Persero) Tbk to improve and improve operational and financial performance. Those things are reviewing flight routes, reduction of operational aircraft, negotiating with the government, debt negotiation with Stated Owned Enterprise (SOE), and negotiation related to Lease Payment.

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