Convertible Issuance in the Pandemic

Southwest Airlines

With the onset of COVID-19 and the resultant economic shutdowns across the globe, a number of issuers from different industries sought financing in the convertible market. Many businesses faced higher cash flow burn rates and lower revenue due to required shutdowns, in-person capacity restrictions, and reduced consumer spending. These companies often turned to convertibles to provide needed liquidity bridges, demonstrating Advent's long-held belief that the convertible market serves as an important vehicle for financing in times of need.

Southwest Airlines

Southwest Airlines is a dominant low-cost carrier in the U.S., with a 23 percent market share of domestic air travel. When the global pandemic subsides, Southwest may be poised to benefit relative to legacy carriers, as its revenue is significantly more levered to U.S. domestic leisure travel. The company's average travel length is only 750 miles[1] versus international and business-oriented trip lengths of peer carriers that average approximately 1,100 miles.[2]

Corporate travel appears to have a slow recovery ahead, because shifts in technology and telecom infrastructure have allowed corporations to be surprisingly effective at conducting business virtually. According to an October 2020 Barclays Business Travel Survey, recent business travelers estimate that videoconferencing technology could replace as much as 24 to 34 percent of their prior business travel. In contrast, signs of pent-up demand for domestic leisure travel are beginning to appear.

Limited avenues for consumer spending have buoyed the savings rate, and the travel industry may be primed to recover as consumer wallet share shifts back to a historical spending mix. Carriers are adding additional flights around Thanksgiving, and 2021 booking announcements made by some leisure companies signal that volumes for the second half of 2021 are consistent with pre-COVID historical averages. Investors are watching these trends closely as the pandemic cycles its way through the dynamics of spread and containment. As the market looks forward to a widely distributed, safe and effective vaccine, there appears to be limited secular change to leisure demand.

When the pandemic halted travel in April, Southwest responded by issuing a $2.3 billion 1.25 percent convertible note due in 2025. The purpose of this convertible was to help enable the company to successfully navigate through the economic storm. With this and other additional capital, the airline appears to have a long liquidity runway of approximately 19 months as of November 2020, assuming revenues are

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Why Advent?

- **25 years of global investment experience and a robust research platform makes it well positioned to navigate the convertible and high-yield asset classes.**
- **Convertible bonds' embedded options provide exposure to volatility and can benefit from an increase in market gyrations, both up and down.**
- **Advent's institutional expertise in managing convertibles and high yield is accessible to individual investors through the Advent Convertible and Income Fund (AVK).**

1 Southwest Airlines Corporate Fact Sheet, July 23, 2020. 2 Oliver Wyman Airline Economic Analysis, 2018-2019 Edition.

down 80-85 percent reflective of the March-April timeframe. With the rebound in traffic since then, the company is guiding towards a cash burn rate at half of the worst-case scenario experienced in 2Q 2020. Southwest's current cash balance as of November 2020 stands at 13.6 billion dollars, providing the company with liquidity to wait for the potential distribution of a vaccine and a potential economic recovery. Southwest is using its strengthened financial position to invest in new routes at airports it previously did not have a presence, such as Chicago O'Hare and Houston Bush, in an effort to win market share and continue its strategy of the past 45 years.

Southwest's convertible issuance highlights the flexibility that the asset class can offer to companies throughout market cycles. As a resourceful component of the financing ecosystem, the convertible market filled a funding gap that helped this hard-hit airline to preserve its balance sheet and mitigate cash burn during an unprecedented shock to demand as it waits for its domestic leisure customers to begin traveling again.

The potential impacts of the COVID-19 outbreak are increasingly uncertain, difficult to assess and impossible to predict, and may result in significant losses. Any adverse event could materially and negatively impact the airline industry.

As of 10.31.2020, Advent Convertible and Income Fund (AVK) has 1.15% of its portfolio allocated to Southwest Airlines.

Net asset value (NAV) is the value of all fund assets (less liabilities) divided by the number of common shares outstanding. Market price is the price at which a fund trades on an exchange. Shareholders purchase and sell closed-end funds at the market price, not NAV. A closed-end fund's premium/discount valuation is calculated as market price minus NAV, divided by NAV.

General Risk Warnings Investments in fixed-income instruments are subject to the possibility that interest rates could rise, causing their values to decline. High yield and unrated debt securities are at a greater risk of default than investment grade bonds and may be less liquid, which may increase volatility. Convertible securities may not be suitable for all investors. Although all markets are prone to change over time, the generally high rate at which convertible securities are retired (through mandatory or scheduled conversions by issuers or through voluntary redemptions by holders) and replaced with newly issued convertibles may cause the convertible securities market to change more rapidly than other markets. For example, a concentration of available convertible securities in a few economic sectors could elevate the sensitivity of the convertible securities market to the volatility of the equity markets and to the specific risks of those sectors. Moreover, convertible securities with innovative structures, such as mandatory-conversion securities and equity-linked securities, have increased the sensitivity of the convertible securities market to the volatility of the equity markets and to the special risks of those innovations, which may include risks different from, and possibly greater than, those associated with traditional convertible securities. A convertible security may be subject to redemption at the option of the issuer at a price set in the governing instrument of the convertible security. If a convertible security held by the fund is subject to such redemption option and is called for redemption, the fund must allow the issuer to redeem the security, convert it into the underlying common stock, or sell the security to a third party. As a result of the conversion feature, convertible securities typically offer lower interest rates than if the securities were not convertible. During periods of rising interest rates, it is possible that the potential for capital gain on convertible securities may be less than that of a common stock equivalent if the yield on the convertible security is at a level that would cause it to sell at discount. Also, in the absence of adequate anti-dilution provisions in a convertible security, dilution in the value of the fund's holding may occur in the event the underlying stock is subdivided, additional securities are issued, a stock dividend is declared, or the issuer enters into another type of corporate transaction which increases its outstanding securities.

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