

Irish Time Feb 2010 – Aircraft Leasing Weathers the storm

While the global airline industry may be in freefall, with the prolonged recession and decline in consumer spending hurting carriers around the world, one related sector which continues to weather the storm is aviation finance. This means that Ireland, as the leading global centre, is going strong, boosted by new start-ups from the likes of the Slattery brothers.

Ireland has been a hotbed for aviation finance since the days of GPA, and while that company may have met its demise in the early 1990s, it spawned the emergence of a new industry, clustering in Shannon and Dublin.

Today, some 30 lessors are active in the market, including leading players in the industry such as RBS Aviation Capital, AerCap, and AWAS, managing over 3,000 aircraft worth about €83 billion, and the Irish industry has seen innovations such as aircraft lease securitisations and the establishment of an aviation fund by Amentum Capital.

Globally, the sector has boomed over the past two decades, buoyed by airlines increasingly choosing the leasing option. Back in 1990, just 5 per cent of global commercial aircraft were leased, but today the figure is said to be closer to 35 per cent.

While you might expect the industry to suffer severely from the aviation downturn, typically leasing companies do well in downturns because in addition to getting better prices on aircraft from manufacturers, they also have a larger customer base, as airlines opt to lease, rather than buy, aircraft.

However, this particular downturn comes with an added crunch on credit, and as Ken Rush, a partner with Matheson Ormsby Prentice, points out, it had been predicted that the credit crunch would result in a funding gap within the aviation finance sector of between \$7 billion and \$15 billion (€5 billion-€11 billion) during 2009.

But this never materialised, he adds, thanks largely to the willingness of the export credit agencies on either side of the Atlantic to step up and provide finance, which meant that the impact of the credit crunch was not felt as acutely as in other sectors.

In Europe, the European Export Credit Agencies (ECAs), such as the French Coface and German Hermes, provided support; in the US, the Export Import Bank of the United States (EXIM), a US government-guaranteed capital markets structure whereby EXIM guarantees a bond offering, was used to fund the acquisition of new aircraft.

“This structure, first used towards the end of 2009, is of significance to the aviation finance sector as it facilitates access to global capital markets, thereby providing an alternative source of finance to qualifying entities within the sector,” explains Rush.

John Slattery, chief executive of new start-up Greenstone Aviation, says that the export agencies “stepped up to the plate significantly”; and while 2009 may have been a very tight year, he adds that these export credit agencies gave huge support. Another key factor in keeping the business airborne was investment from China.

Meanwhile, the difficult credit environment is not putting off new entrants. In late 2008, Atlas Air Worldwide set up a Dublin-based aircraft-leasing unit, Titan Aviation Leasing; last June, Slattery, who was integral to getting RBS’s aviation unit to take off, set out on his own. With \$100 million in private equity investment he set up Greenstone Aviation, which will focus on sale and leaseback.

More recently, his brother Domhnal also announced a return to leasing. Having tried to get Jetbird, his air taxi service, off the ground, Slattery is going back to the sector where he first made his name with IAMG, which was later sold to Royal Bank of Scotland to become RBS Aviation Capital. His new venture, Avolon, which hopes to raise \$800 million, has been set up with a \$250 million investment from Oak Hill Capital Partners.

Back at Greenstone, seven months on from its launch, Slattery says that progress is “largely on track”, and the firm anticipates making another announcement regarding additional investment soon. This capital injection, which Slattery says is a “multiple of the initial investment”, will bring it closer to its €500 million equity target.

Greenstone’s model involves “acquiring new aircraft as they deliver to airlines and contemporaneously leasing them back to airlines”, says Slattery, adding that the firm will probably close on its first aircraft transaction this April. By the end of 2012, Slattery hopes to have a portfolio valued at some \$3 billion, with the average age of aircraft under a year and a half.

Slattery is full of praise for Dublin as an aviation finance centre, saying its business advantages are not replicated in any other city around the world. “We didn’t pick Ireland because I’m Irish, but because it’s the easiest place in the world to set up a leasing business,” he says, adding that while he had looked at quite a number of jurisdictions around the world, Ireland was chosen because of unique selling points such as the range of withholding tax treaties. The low corporation tax rate is also critical. “The current Government’s view of almost characterising corporate tax as a brand of Ireland is very important for investors when looking at investing in an Irish-based company,” he says.

On the flipside, he is concerned that the upward pressure on personal taxes will make it more challenging to keep experienced people in Ireland, and to attract them here.

Looking into 2010, Rush is optimistic about prospects for the aviation sector, and expects export credit agencies to continue to finance at the same level as they did in 2009. Nevertheless, he envisages that banks will remain selective about what entities and asset class they will finance. “Robust customer credit and a highly tradable asset class will remain key lending criteria for financiers in 2010,” he says, although he adds that the more competitive pricing on export credit transactions may cause a fall in commercial debt pricing.

Improving credit conditions should mean more activity on the MA front. While Shannon-based Genesis Lease and AerCap are set to merge in a €1 billion deal, the uncertain economic environment is likely to be holding back other possible deals.

Last year, Royal Bank of Scotland (RBS) announced that RBS Aviation Capital, its Dublin-based aviation leasing subsidiary and one of the world's largest, was no longer a core asset and it would be looking to dispose of it. Since then, its saleability may have fallen following purges from the Slattery brothers. Last summer, three executives left John Slattery's old firm to join Greenstone, while more recently seven executives left to join his brother's Avolon.

Similarly, ILFC, one of the founding companies of the sector along with Tony Ryan's GPA, is also for sale, as it ran into serious difficulties following the problems its parent AIG ran into during the credit crisis. It now looks likely to be sold in portions.

One potential obstacle on the road to full recovery will be the collapse of a major player. "During this downcycle the aviation industry has not seen a true bankruptcy of a significant carrier, and should this occur in 2010 it may have an impact on the willingness of commercial debt providers to lend," says Rush.

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