

Aviation finance and the Irish Stock Exchange

Aviation finance is a fast growing and dynamic element of the financial services industry noted [Joe Gill who sits on the Primary Markets Advisory Group of the Irish Stock Exchange](#). It operates in a global market where demand for aircraft is growing strongly and capital requirements are large and long term in nature.



Joe Gill

IRELAND LIES at the centre of the global air finance sector where it is home for over 50% of a leasing industry that accounts for up to 45% of annual commercial aircraft deliveries. Over 35 leasing companies are headquartered in Ireland from where they own a fleet of over 5,000 aircraft operated by airlines across the globe. These leasing companies also have orders for over 3,000 aircraft.

Funding needs for the commercial aircraft market are enormous. Each year, over US\$110bn worth of aircraft are delivered worldwide and this annual pace of activity is expected to continue during the next decade. Indeed, in the 2012–15 period new aircraft valued at over US\$300bn have to be financed, which is equivalent to over 50% of the entire funding needs for aircraft between 1992 and 2012. In addition, the existing installed fleet of commercial aircraft require re-financing which amounts to billions of dollars each year.

This funding requirement is met by finance from investors and lenders drawn from geographies around the globe. Alongside equity funding, which accounts for a relatively small element of the financing stack, debt providers are a key and growing component of the aircraft funding market.

Boeing estimates that after US\$104bn of aircraft deliveries in 2013, and US\$112bn in 2014, average deliveries in the 2015–18 period will be US\$132bn.

The debt market, which dominates aircraft finance, originates around commercial and capital market providers. The latter has grown strongly in recent years as institutional investors have increased their appetite for assets that provide consistent returns that are materially in excess of those available from money markets in an environment where Central Banks worldwide have lowered interest rates to record lows.

The Irish Stock Exchange (ISE) is committed to exploring a range of opportunities to facilitate and support the provision of capital to the commercial aircraft market. This varies from its existing platforms that provide low-cost and efficient listing regimes for aviation assets to evolving new products and services that can help investors access aviation assets through a regulatory approved structure.

Already, over US\$20bn of aviation assets are listed on the Irish market in Dublin. These include Enhanced Equipment Trust Certificates (EETCs), Asset Backed Securities (ABS) and unsecured bonds issued by airlines including IAG, Ryanair and Emirates, and lessors including Avolon and Milestone Aviation. Equity issues listed in Dublin include Europe's largest low-cost airline Ryanair and the Irish carrier Aer Lingus. The Dublin Airport Authority also has a bond listed on the ISE.

Aircraft leasing is growing in appeal to airlines because it allows managers to focus on customer facing activities while conservatively managing the balance sheet and technology risks associated with aircraft. By opting for a lease, airlines can avoid the heavy up-front and capital costs of acquiring an aircraft and

they have no exposure to the cyclical and value volatility that is attached to the aircraft market.

Instead, they effectively outsource fleet funding to a lessor that helps shape aircraft selection, procurement and funding strategies. This helps an airline keep its fleet at an optimal average age while preserving cash-flows and balance-sheet headroom for investment elsewhere in the business.

Typically, airlines lease aircraft for seven years although this period has been extended to up to 10 or 12 years in recent transactions. The lessor, which owns aircraft, oversees the recoupment of rental income from an airline and oversees the technical management of the aircraft during its lease period.

Lessors enter the aircraft market in three primary ways; (1) they acquire aircraft directly from a manufacturer; (2) they acquire aircraft from an airline and lease them back to that carrier (so called sale-and-leaseback transactions); and (3) they acquire aircraft from other owners who already have them on lease to airlines. By adopting this approach, a lessor can develop a portfolio of aircraft that can be grown or reduced depending on management's view of the economics in aircraft ownership.

Lessors have differing business models. Some focus on new or almost new aircraft with a bias towards short-haul aircraft such as the Boeing B737 or Airbus A320. Others have portfolios that are older as they deem value exists in aircraft that are mid-life in age. Yet others focus on aircraft engines or helicopters.

Leasing companies also have differing capital structures. Some are part of large global financial corporations. Others are stand-alone entities backed by private equity investors.

Examples of all these business models exist in Ireland and virtually all of them have set out strategies to expand significantly over coming years. The rise in orders for aircraft and the growing share of the aircraft market held by lessors is fuelling the expansion of the air finance industry.

Against this background the need for financial capital is clear and growing. Aircraft are, by definition, long life capital intensive assets that generate sustained returns in a growing global marketplace. Institutional investors have developed an improved risk appetite for aircraft assets in both equity and debt form. This is evolving into increased issuance by leasing companies and airlines of capital market type instruments.

To date, this active segment of the financial services market is focused largely on dollar-denominated assets as aircraft are traded around the world using the US currency. With large pools of capital resident in other key currencies, and aircraft operating in airlines that are centred in those currency blocks, the scope to develop aircraft financing structures that tap currencies other than the dollar is material.

The opportunity for the ISE lies in developing a suite of services that facilitate the issuance and trading of instruments used to fund aviation assets. The ISE has established relationships with leading exchanges in the US, Europe and Asia. It has also invested heavily in technology to support the efficient and safe administration, pricing and monitoring of debt and equity instruments that

is cost competitive in an international context.

The ISE is located in the jurisdiction that is a global leader in air finance due to a history of skills and services development in support of air finance. In addition, the Irish Government has adopted progressive policies towards creating a legal ownership framework for aircraft investors that is unparalleled internationally. The ISE, therefore, is well positioned to provide the infrastructure needed to complement Ireland's strengths in aviation finance and help expand the capital-raising capabilities of the sector.

Debt continues to dominate the funding stack in aircraft financing with cash and equity accounting for only 20% of the financing pie. Sources of debt include commercial banks, export credit agencies, lessors, capital markets and manufacturers. Export credit agency support is being curtailed due to political agendas while manufacturers are focused on deploying capital within their own companies instead of allocating it in support of aircraft purchases.

Additionally, commercial banks that were strong in aircraft funding prior to the global financial crisis have reduced their balance-sheet tolerance for aircraft assets. These drivers are raising the importance of capital markets as a source of finance for the sector.

The growing share of aircraft funding being supplied by capital markets, rising demand for commercial aircraft worldwide and the increased share of deliveries financed by leasing companies provide the ingredients for a period of solid growth in aviation finance. Ireland, and its stock exchange, are marketing their capabilities and services to help expand and solidify the State's key role in this expanding industry.

Note about the author:

Joe Gill sits on the Primary Markets Advisory Group of the Irish Stock Exchange. He is Director of Corporate Broking with Goodbody Stockbrokers where he advises a number of companies listed on the Irish market. He is also Chairman of the Irish State agency Enterprise Ireland's Aviation Forum which promotes initiatives in support of the air finance industry in Ireland.

This article was written by Joe Gill, Director of Corporate Broking, Goodbody Stockbrokers, Block B, Ballsbridge Park, Ballsbridge, Dublin 4, Ireland.
Tel: +353 1 6419449. Email: joe.r.gill@goodbody.ie.
Website: www.goodbody.ie