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Woes of Aircraft Leasing Companies Could Mean Higher Ticket Prices

By NICOLA CLARK

PARIS — They own or manage more than one-third of the airliners in the sky and, despite the turmoil in the global economy, are still turning significant profits.

Yet many of the world's biggest jet-leasing companies — top customers for Boeing and Airbus — are sinking in debt and scrambling for cash. Several are now up for sale but having difficulty attracting buyers.

When the dust eventually settles, analysts say, many lessors will probably face higher borrowing costs. And that could increase the cost of flying for airlines and passengers.

“There is a lot of disarray,” said Ron Wainshal, chief executive of Aircastle, a leasing company with a fleet of around 130 commercial jets.

Historically, aircraft-leasing companies have tended to profit from downturns, when airlines put off orders for expensive new planes in favor of taking them on lease until business improves. They have also capitalized on dips in demand to negotiate better prices from aircraft manufacturers.

But the current environment has placed many lessors in a bind. As passenger and freight traffic began to tumble this year, airlines started parking their own jets by the hundreds and returning leased planes once their contracts expired. The financial crisis that began last year, meanwhile, made it almost impossible for leasing companies to raise the cash they needed to refinance debt on existing planes and to pay for new ones they had contracted to buy.

International Lease Finance Corp., or I.L.F.C., a unit of the troubled insurer American International Group, is among the more high-profile victims. Although it reported a 10 percent rise in second-quarter net profit, to \$237 million, I.L.F.C., the world's second-largest lessor by fleet size, after GE Commercial Aviation Services, a unit of General Electric, has been unable to gain access to the capital markets since its parent company sought a \$180 billion bailout from the United States government late last year.

A.I.G. has been looking to sell I.L.F.C. and other noncore assets as part of its restructuring. But the sale effort has been hampered by a number of factors, including roughly \$32 billion in outstanding debt that will need to be rolled over in the next two to four years.

“A big issue for everybody today is refinancing debt as it comes due,” said Mr. Wainshal, the chief of Aircastle, which is based in Stamford, Connecticut. “I think being bigger is now actually much worse because of the difficulty in lining up a larger pool of funds.”

I.L.F.C. is not alone. CIT Group, another struggling American finance group, is looking to sell its CIT Aerospace leasing subsidiary, while Babcock & Brown Aircraft Management and Allco Finance Group, both of Australia, are also up for sale by parents that filed for bankruptcy this year. Last month, Royal Bank of Scotland — the recipient of a British government bailout worth £20 billion, or about \$31.9 billion — said it had hired Goldman Sachs to help find a buyer for its RBS Aviation Capital unit.

Over the past two decades, aircraft leasing has grown from a niche market to a \$150 billion industry. Such companies own or manage 34 percent of the roughly 18,000 commercial airliners flying today, according to Ascend, an aviation consulting firm in London.

The lessors up for sale own a total portfolio of more than 1,800 planes, valued at about \$57 billion. But analysts say the value of those assets is declining rapidly. Over the last 12 months, commercial aircraft values have fallen by an average of about 15 percent to 20 percent, according to Ascend. For planes older than 10 years, appraised values have dropped by as much as 35 percent.

“Market conditions are still highly uncertain, especially for older equipment,” said Richard Aboulaflia, an analyst at the Teal Group, an aerospace consulting firm based in Virginia. “It’s tough to gauge the outlook of a company’s value when you don’t know when asset values will stop falling.”

Adding to the pressure on values is the steady stream of new planes coming off assembly lines at Boeing and Airbus. Airlines have taken roughly 2,000 airplanes out of their fleets over the past year, but manufacturers have delivered 1,000 new planes in the same period, said Eddy Pieniazek, a director at Ascend.

“All indications are that asset values will stay soft and lease rates will do likewise, especially as we head into the winter,” when air traffic traditionally falls, Mr. Pieniazek said.

Patrick Harris, president of HMG Aviation, an aviation finance consultant and aircraft appraiser in Boca Raton, Florida, said: “This is not an environment in which to be selling any hard assets. People are not coming to the table willingly.”

Which is why anyone who has the resources to wait out the crisis, will, analysts said. A.I.G. and Royal Bank of Scotland are now majority-owned by their respective governments, which gives them significant breathing room.

“A private enterprise would have been forced to sell a business like I.L.F.C. at a huge loss,” said Adam Pilarski, an economist and senior vice president at Avitas, an aviation consulting firm in Chantilly, Virginia. “Governments can wait until the market picks up.”

There have been some hints recently that investors and lenders are growing more confident about the aviation sector in general amid signs the declines in air traffic may be slowing. Delta Air Lines and American Airlines, for example, raised a combined \$950 million from the sale of high-yield bonds last month, while Qatar Airways said on Sept. 29 that it had secured two loans worth \$700 million from European and Japanese banks for the purchase of new planes.

Yet when money does start to flow back to leasing companies, some said it was unlikely to come at the same low rates the industry enjoyed in the past.

I.L.F.C., for example, used to be able to borrow very cheaply in the U.S. commercial paper market by virtue of the triple-A credit rating attached to A.I.G. before the crisis. Whoever ends up buying the company will — in addition to taking on mountains of existing debt — need to come up with a different financing model that most likely will involve borrowing money on more expensive terms.

“Anybody that ends up acquiring I.L.F.C. or RBS or CIT is going to have to deal with that issue,” said John McMahon, chief executive of Genesis Lease, an Irish lessor that last month was acquired by the Dutch company AerCap Holdings for just over \$300 million in stock.

Analysts predicted that the higher costs of capital would translate into higher lease rates and other fees that lessors typically charge airlines for the use of their aircraft. “The cost of leasing will be going up,” said Mr.

Pilarski, the Avitas economist. “This will increase the cost of flying.”

Some small- and mid-sized leasing companies could follow the lead of AerCap and Genesis Lease, merging in the hope of lowering their funding and operating costs through larger economies of scale, some analysts said.

“There are certainly merits to scale,” said Mr. McMahon, the Genesis Lease chief.

Most agree that when the industry does finally emerge from its turmoil, the landscape will look a bit different. Having been badly burned twice in the last decade — by the September 2001 terrorist attacks and the current financial crisis — many airlines are moving toward leasing more of their planes, rather than buying them directly from manufacturers.

“Lessors will reorder themselves and I think they will eventually end up with a bigger share of aircraft ownership than they have now,” said Mr. Wainshal, the Aircastle chief. “Within 10 years, they’ll probably own half the market. A lot of that will be for financial reasons, but also because operationally it gives airlines much greater flexibility.”

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