

AIG's aviation arm seen luring sovereign funds

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By Tim Hepher

PARIS (Reuters) - A forced sale of the aircraft leasing arm of AIG -- the world's second largest -- could attract interest from China or sovereign oil funds, but would probably be beyond the reach of aviation rivals, analysts and aviation executives said on Tuesday.

Shares in American International Group Inc (AIG.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) see-sawed for a second day before closing down 21 percent as the U.S. insurer, once the world's biggest by market value, battled to survive the Wall Street turmoil that brought down investment bank Lehman Brothers (LEH.P: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)).

AIG faces a cash crisis after credit downgrades that may force it to raise as much as \$20 billion.

The squeeze stirred speculation it may have to make a distressed sale of assets including the profitable International Leasing Finance Corp.

Smarting from high oil prices and credit woes that have grounded half a dozen airlines this year, the industry found itself digesting the stunning prospect that a healthy aviation superpower might be forced into a change of ownership.

Aircraft lessor ILFC, operating in an industry that flies on credit, owns 947 planes worth \$55 billion and the word of its CEO and founder, Steven Udvar-Hazy, is seen as law in the design workshops of both Airbus (EAD.PA: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) and Boeing (BA.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)).

The firm he founded in 1973 made a \$604 million profit last year and has ridden out most of the boom and bust cycles in a cutthroat industry, but its fortunes are tied to those of AIG.

ILFC could be worth \$5 billion to \$6 billion based on the valuations of smaller listed lessors like AerCap Holdings (AER.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) and Genesis Lease (GLS.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)), Wachovia Capital Markets said in a note to clients.

On peak multiples that could rise to \$7 billion to \$8 billion.

However, Wachovia said AIG could have to pay some \$3 billion to cancel deferred tax liabilities, reducing the attractiveness of a sale that many in aviation see as a last resort for AIG.

"The universe of potential buyers -- even for a premier franchise -- appears limited as few would be willing to assume the risk of \$50 billion in aircraft assets and commitments to buy \$18 billion more," Wachovia analyst Gary Liebowitz wrote.

"We do not believe there is sufficient bank lending capacity to support a merger with an existing lessor, Liebowitz said.

"The most likely buyers could include private equity funds or sovereign wealth funds," he added, putting a query on China and the Middle East.

Only lessor GE Commercial Aviation Services (GECAS) has a bigger fleet than ILFC, but GE already has significant exposure to aviation through GECAS and its engine and components units.

Both GE (GE.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) and ILFC declined comment.

STRONG ASSETS

Airlines in Asia and the Gulf are still expanding their fleets, even as Western carriers face what British Airways (BAY.L: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) chief Willie Walsh calls their worst crisis.

Funds such as Abu Dhabi's Mubadala have invested in the sector, while local airline Etihad is among Gulf carriers investing billions in new jets.

In December 2006, Bank of China bought Asia's largest lessor, Singapore Aircraft Leasing Enterprise, for \$965 million.

"It depends how stressed AIG are, but if ILFC were sold it would be a good chance to pick up strong assets. It is a profitable company," said Les Weal, head of valuations and appraisals at UK-based aviation consultancy Ascend.

ILFC's importance in aviation stems from the need of airlines to save cash on capital spending and to renew fleets regularly to keep up with environmental and other pressures.

Recent falls in U.S. interest rates have provided a boon to lessors who generally rent out planes at fixed rates.

"The leasing industry has a significantly different risk profile from airlines," said Klaus Heinemann, Chief Executive Officer of Amsterdam-based AerCap, a rival to ILFC.

"Our contract revenue is typically for 10-12 years, while airlines face significant short-term changes in revenues."

As long as oil prices stay near where they are, lessors may benefit from upgrades to newer and more fuel-saving planes even while the weakest players in the airline industry go bust.

Over 20 percent of the world's fleet is over 21 years old.

"Oil at \$90-100 a barrel is low enough not to cause unbearable trouble to most, yet high enough to accelerate the retirement of old and inefficient aircraft," Heinemann said.

He declined to make any comment on ILFC, which is the largest buyer of Boeing's (BA.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) fuel-saving 787 Dreamliner.

Some are less optimistic. Airline woes have led to a sharp drop in demand for new planes after three strong years. And if too many airlines go broke, aircraft asset values could fall sharply, which would ultimately be bad news for lessors.

Monthly lease rates have fallen by 2 to 10 percent in the past year on in-production narrow-body jets, according to Ascend. The market resale value has fallen by up to 14 percent.

The number of grounded planes being stored in the U.S. desert, many of which may never fly again as they are inefficient, is rising again after falling during a recent industry boom.

Over 1,000 jets have been taken out of service this year due to retirements or capacity cuts, according to Ascend.

(Reporting by Tim Hepher; Additional reporting by Bill Rigby; Editing by Ted Kerr)