Diversification pays

Burgeoning aircraft lessor, China Aviation Leasing Company, is expanding its sources of funding as it reaches out into the international marketplace. Victoria Tozer-Pennington reports.

China Aviation Leasing Company (CALC) has been very busy delivering on its promise to diversify its sources of funding to help finance its large orderbook.

Since the start of 2016, CALC has succeeded in a number of financing firsts. In June 2016, the lessor issued its first US dollar-denominated unsecured three-year bond worth US$300 million and closed a US$195 million debut syndicated loan facility with a consortium of six banks, which was used to part finance pre-delivery payments of A320s to be delivered in 2019 and 2020. Branching out even further in July, CALC closed a debut Japanese Operating Lease with a Call Option (JOLCO) transaction for two new A320s delivered to Pegasus Airlines in June. This was the first time such a structure has been used to finance equity for aircraft taken on operating lease by a Turkish carrier. Capitalising on the success of its debut bond issuance, CALC launched a second $300 million unsecured and unrated five-year bond issuance in August, with more favourable terms. To cap off the year to date, CALC closed a series of lease receivables transactions.

This is an impressive array of funding sources, all completed in a relatively short timescale. During the first half of the year, the Chinese leasing company reported a 61.5% increase in revenue to HK$1,026.6 million. Profit before income tax was up by 112.4% year-on-year to HK$335.2 million, compared to HK$157.8 million in the year-ago period. Chen Shuang, Chairman and Chief Executive Officer of CALC, attributed the strong performance to the company’s “unique business model”, which has been backed by its continued globalisation efforts and financing innovation. The long list of funding firsts above demonstrates the lessor’s dedication to diversifying its sources of funding to fuel its aggressive growth trajectory.

CALC is particularly pleased with the successful closing of the first JOLCO by an aircraft lessor into Turkey, which was arranged by Asset Brok’Air, with Credit Agricole-CIB as debt arranger, facility agent and security trustee.

Speaking to Airline Economics, Christian McCormick, managing director of finance at CALC, is justifiably proud of this particular deal. “This deal was quite an accomplishment as it was the first time a JOLCO has ever been used by a lessor to put an aircraft into
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Mc Cormick also praised CA-CIB for its role on the deal, not least for its patience. “CA-CIB were very cooperative and waited patiently, keeping the authorizations in place, so that we could gradually structure the deal.” He adds that the “hero” of the deal was JOLCO arranger, Asset Brok’Air, which structured the deal.

The aviation industry is famed for its innovation and, with this deal, CALC has opened up a new source of funding for aircraft lessors into Turkey. “Our entire team had a real desire to achieve something new,” says McCormick. “There is an awful lot of aircraft going into Turkey at the moment and this deal provides lessors access to new sources of funding for Turkish operators. The biggest issue for lessors is equity and equity is expensive; opening up Japanese equity for aircraft lessors provides advantages for all.”

Although there are economic advantages when utilising a JOLCO structure, one of the main problems for aircraft lessors is that they can be quite restrictive, particularly when changing owners. “That is why many lessors do not finance their aircraft using JOLCOs,” says McCormick. “It is very complex to change the owner of the aircraft and the lessee of the aircraft during the lease term, which means selling a JOLCO lease to another entity is very difficult.”

The product is therefore not ideal for many smaller lessors that seek to sell off their portfolios in large chunks, he adds. “For long-term players in the leasing industry, however, this is a great product.”

Turkey,” he said. “Although there have been plenty of JOLCOs for Turkish carrier by banks, no lessor has actually completed a JOLCO for an airline into Turkey, primarily because it requires an incredible amount of structuring under Turkish law to make it possible. We have achieved that. Many large law firms told us that it couldn’t be done but fortunately we stuck to it and were successful.”

CALC was advised by Watson Farley & Williams, Bezen & Partners and A&L Goodbody. Asset Brok’Air’s legal counsel was K&L Gates, while CA-CIB was advised by Clifford Chance. Tax advisors on the deal were AK Denetim and Price Waterhouse Coopers.

“On such a complex transaction we need to have an extremely cooperative set of counsel, both in Turkey and outside. Watson Farley Williams were tremendous because they shared our innovative and creative mindset,” says McCormick. “They enjoy the idea of being innovators and doing something new. They wanted to challenge some of the legal advice out there that said that this couldn’t be done, and their challenge was right.”

McCormick points to some “scary moments” at times when working with some aspects of Turkish law, which can be applied differently by the various authorities. “There was an awful lot of lobbying required, but we had patience and met with the right people to discover how the laws apply on this structure. We would move forward slowly through negotiations and discussions, learn the application of the law, and then work to implement our structure quite well,” he says, adding that “it took an awful lot of time and patience.”
CALC is continuing to expand outside of its domestic borders, with aircraft placed with Pegasus, Air Macau and now All Nippon Airlines. In the first six months of this year, CALC delivered seven aircraft to airline clients and grew its aircraft portfolio to 70. Among the seven aircraft delivered, two A320s went to Pegasus, its first European client, one A320 was delivered to its first Southeast Asian airline Jetstar Pacific in July 2016, taking CALC’s fleet size to 71. The lessor expects its fleet to reach 81 aircraft by the year end. CALC has already signed and secured all lease agreements for the aircraft to be delivered in 2016. In expectation of a fast growing leasing market, CALC is currently on schedule to reach 173-strong fleet by 2022 and the lessor would further continue its fleet expansion plan in number and in variety, such as the latest MOU with COMAC over an order of 60 ARJ21-700 series aircraft signed in July 2016.

Going forward, CALC says that it will continue to develop overseas airlines while further enhancing its relationships with top-tier Chinese airline groups. In particular, the company intends to further expand its client coverage into previously untapped markets, as demonstrated by its recent entry to the Japanese market through its collaboration with ANA. The high growth of emerging markets is also a key area of focus for the group to expand its client base.

To support its international expansion, CALC remains focused on diversifying its funding options with innovative financing alternatives. As briefly mentioned above, in August CALC also entered into two separate lease receivables transactions, financing a total of seven aircraft. CALC first dipped into this space in 2013 but has used it several times this year to release capital and diversify its sources of funding. On August 1, 2016, CALC closed a rental realisation transaction for three aircraft, which was structured into senior and junior tranches. At the end of August, CALC followed this up with a similarly-structured deal for four aircraft for a total consideration of US$153.5 million, and another at the end of September for a further four aircraft for a total consideration of approximately US$103.5 million. The tiered tranching structure serves to keep the all-in-costs at a lower level for CALC.

“CALC first ingeniously designed the aircraft capital securitisation products to meet the demand of Chinese investors in 2013,” said Winnie Liu, Deputy CEO and Chief Commercial Officer of CALC. “Aircraft lease receivables has been an important part of our regular business and financing strategies that we committed to pursue. We are glad to see this repeating and continuous model is well received by the market. The rise in the number of realisation transactions underlines the ever-growing knowledge and confidence in the aircraft leasing industry, as well as the increasing demand of US dollar-denominated aircraft finance products with stable return.”

These sorts of deals enable the company to release cash – which it badly needs to fund its constant and large aircraft delivery stream. “It’s a great product,” says McCormick. “By selling the rental streams over time we are generating cash for the company in advance. We have done it in the past with our Chinese deals with Chinese banks because they understand better, the quality of the risk that is being taken on the Chinese airlines. We may eventually consider this structure for our international portfolio, but not yet as the portfolio is small.”

In common with its leasing company peers, CALC has tapped into the capital markets to raise debt. In April 2016, the company issued its debut bond, US$300 million three-year bonds with interest of 5.9% per annum. “Our debut issuance was oversubscribed almost twofold and the arranger advised us to double the size,” says McCormick. “We decided not to do that, first of all because we have plenty of cash but we also determined that it would be better to wait for the bonds to begin to trade and let the market get comfortable with the CALC name. This strategy was confirmed because the coupon decreased on the second issuance.”

The second similarly-sized issuance of five-year, unrated and unsecured bonds, priced at 4.9% per annum, was aided by favourable market conditions.
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CALC has a constant need for cash since financing pre-delivery payments on its large orderbook is a major issue. “When you have facilities to refinance your PDPs, it gives you incredible flexibility, and most of all, it gives you the ability to respond very quickly to opportunities. Opportunities today involve taking over PDP obligations, either that are taken by airlines who wanted to sell or by taking aircraft that become available from the manufacturers,” explains McCormick.

“This opportunistic strategy requires volume. We want to be able to have that flexibility; issuing bonds gives us that cash cushion to pursue opportunities whenever they may arise.”

CALC has 100 aircraft due to be delivered between now and in the next three to four years, which will bring its fleet up to 170 aircraft by 2020. Those are impressive numbers and an impressive growth curve but McCormick says: “It’s clearly not enough; our ambitions are quite a bit higher than that. We are looking for other aircraft as is everyone else. The advantage we have is we are not looking as desperately as others because we have such a large order backlog. We don’t have to fight in the awful battle that is going on among leasing companies, which is driving up capital costs and driving down lease rates. The idea is to fight that battle without being too desperate about winning it, because even when you win, you hurt yourself.”

CALC has already placed aircraft deliveries 18 months out but it is working on placing those aircraft delivering in 2018, with a strong focus on attracting more international operators. In August, CALC sealed a deal with All Nippon Airways to lease one A320, which will be subleased to its low-cost regional subsidiary Vanilla Air. The aircraft is expected to be delivered in August 2017.

CALC is also starting to deliver aircraft to Jetstar, with two taken so far, which have been funded using a bridge financing with a view to closing a refinancing soon. Many more international customers are on the horizon.

“We have another deal close to completion for a number of aircraft and we are continuing to scout the world for customers,” says McCormick.