

AIG may want to sell ILFC but does anyone want to buy it?

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It should be a fascinating party. ILFC, the aircraft leasing company, is celebrating its 35th birthday on Saturday at the Steven F. Udvar-Hazy Center, part of the Smithsonian National Air and Space Museum in Washington.

Over 500 people are expected to attend the centre, which has been funded by and named after the lessor's founder and CEO. It could not have happened during a worse week.

In the last two days the future of AIG, the insurance company that owns ILFC, has become uncertain. The world's most valuable aircraft lessor may need to be sold to save its parent. The only problem is that very few companies - or even countries - can afford it.

Like most aircraft lessors (and homeowners) ILFC owns the equity portion of the aircraft and finances the rest with debt. ILFC has until now, always benefited from having an double-A rated parent which has allowed it to raise cheap unsecured and secured debt. AIG has also offered implicit and explicit guarantees in the past.

Most bankers and lessors believe that AIG would sell ILFC for less than \$7.4 billion. However, any buyer would need to raise over \$40 billion in total to refinance the debt.

This amount of money is simply not available in the aircraft loan, aircraft securitization or leveraged finance markets, immediately ruling out private equity buyers or smaller lessors. Some analysts have speculated that GE Aviation Capital Services, the other one of the two dominant aircraft lessors, will buy ILFC.

However, even if the deal made sense commercially – and the amount of risk involved in owning 2000 aircraft would be huge - antitrust regulations in the US and Europe mean that any deal is almost certain to be blocked. "We do not comment on rumours," said an official spokesman for Gecas.

This basically leaves sovereign wealth funds, Chinese banks and Berkshire Hathaway as the only possible bidders. A number of Chinese banks – particularly ICBC, Bank of China and China Development Bank - are already involved in aircraft leasing and would love to own ILFC. But senior officials at Chinese banks doubt the government would allow them to invest \$40 billion overseas. "The golden period has gone," says one senior Chinese bank official. "A year ago we would have said 'yes' straight away. Now the policy is not to spend so much on acquisitions." AIG is very well connected in China and might be able to get the Communist Party to make an exception for ILFC but there would be no chance of any deal closing quickly.

Sovereign wealth funds have been key investors in US financial institutions and could be interested in ILFC. The favourite candidate is Saudi Arabia. Saudi Basic Industries Corp. - the country's largest public company - which is 70% owned by the government recently bought GE's plastics division. The country is also looking at creating a sovereign wealth fund. Aircraft could also be viewed as a hedge against oil prices. Kuwait could also be interested for the same reason.

Dubai has already launched Dubai Aerospace Enterprise and although the Dubai government has committed \$10 billion in equity for aviation it will need this for its orders. Abu Dhabi owns Waha Leasing. Qatar Investment Authority is known to want to restrict its aviation investment to Qatar Airways. Some bankers have tipped Singapore's Temasek as one possible buyer. Temasek has already made money from aircraft leasing when it sold Singapore Aircraft Leasing Enterprise to Bank of China.

The one investment fund that could afford to buy ILFC is Berkshire Hathaway. Warren Buffet is rumoured to have looked at the business earlier this year (before they announced that AIG was backing it). He also has close relationships with AIG and knows the ILFC management team socially.

ILFC could fit Buffet's four tests of a good investment: it is an easily understandable business; it has favourable long-term economics; it has a very able management team; and it would probably go for a sensible price tag.

However, \$40 billion is still a lot of money, even for Buffett. It is also worth dispelling the myth about Buffett and aviation. He did indeed write: "If a farsighted capitalist had been present at Kitty Hawk, he would have done his successors a huge favor by shooting Orville down." But he made money on US Airways and has since invested in FlightSafety and NetJets.

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ILFC is profitable, regarded as a well managed company and is one of two market leaders in aircraft leasing. However, its size makes it almost impossible to sell as a single entity. It may be possible to get cash by selling some aircraft but other lessors are also having trouble raising debt. Anyone who is interested in the whole company is no doubt very welcome at the Air and Space Museum on Saturday.

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