AIRFINANCE GLOBAL

Can Chinese aircraft lessors become global lessors?

03/03/2009

As established international lessors struggle, Chinese leasing companies – backed by rich banking parents – have new opportunities to compete internationally. But much will depend on the government and whether it will loosen the regulatory burdens that have confined lessors to the domestic arena.

China has always been a tough place for an aircraft leasing company to be based. There are complicated tax issues, less financing options available and the country has a tough regulatory environment. But there are plus points. China is one of the fastest aviation markets in the world so there are plenty of opportunities for new deals and compared to the serious funding and ownership problems that many of the world's largest lessors face, Chinese lessors have it relatively easy.

"There are lots of opportunities for Chinese leasing companies at the moment," says Johnny Lau, global head of aviation at ICBC Leasing. "Chinese airlines need a lot of support for the high number of orders they have made and banks which own leasing companies have much more flexibility in a tight global liquidity environment. There are many transactions available for leasing companies." ICBC Leasing is working on four deals that it hopes to close by the start of April.

In March 2007, the China Banking Regulatory Commission lifted a decade-long ban on commercial banks investing in financial leasing companies.

But Lau concedes that the local leasing market is not as free and unrestricted as others around the globe. "There are lots of issues – chiefly regulatory and tax restrictions – and more sophistication is required before lessors can really excel in the market."

With everything from aircraft orders, fleet introductions and bank loans coming under the regulatory eye of the government, Chinese lessors lack the freedoms of their free-flying rivals in the West.

Lessors are also affected by business tax. For operating leasing it is 5% of the whole rental amount. Consequently, local lessors prefer finance leases where the airline can purchase the asset.

"Chinese lessors are afraid of keeping assets," says Susan Guo of HSH Nordbank. "This is in stark contrast to the likes of Gecas and Genesis." A further obstacle lies in the fact that an aircraft cannot be imported without government approval. As such, local lessors – with the exception of Dragon Leasing – do not place aircraft orders and opt instead for sale/leaseback transactions with a finance lease attached.

A further problem lies in financing restrictions. Compared to foreign lessors that enjoy a diversity of funding sources including corporate bonds, asset backed securities, private equity capital and funds, Chinese companies rely on bank loans and limited capital. "This makes the cost for them far higher than foreign lessors and makes them less competitive than foreign lessors," says Yingchen Guo of HSH Nordbank. "The Chinese government realises this and is trying to open more funding resources to local lessors."

Leasing companies have recently been calling for the government to lift some of these burdens. The reality, however, is that the industry's contribution to GDP is not yet substantial enough to force a change. But if the government wants leasing companies to become major world players it will have to loosen the regulatory noose tied tightly around their necks.

There are some positive signs. The aviation industry as a whole has received substantial injections of capital from the government as part of the stimulus package designed to reinvigorate the economy.

But the fact remains that, paralysed in a restrictive regulatory environment, local aircraft lessors have long been the poorer siblings to their larger US and Irish-based counterparts. Excluding BOC Aviation and Dragon Leasing, which are registered in Singapore and Hong Kong, lessors' operations have been in the main confined to providing finance leases for domestic airlines, with the line between financier and lessor not always clear.

Are domestic leasing companies really lessors?

With the five leasing companies owned by banks - including ICBC Leasing, CBD Leasing and Bank of Communications specialising predominantly in finance leasing, can they really be regarded as true aircraft lessors?

"I actually asked some of the banks this very question – what is the point in setting up a subsidiary company? It only seems to make sense to set up a new company if it is going to be doing a different business," says Susan Guo of HSH Nordbank. "But these leasing subsidiaries were set up as general leasing companies, rather than aircraft leasing companies. Look at ICBC Leasing – aircraft leasing is just part of a wider business remit, including big ticket equipment, construction and electricity."

Another banker working in the region who did not want to be named thinks local Chinese lessors lack the scope to be considered real aircraft leasing companies.

"A lessor should have a diversified exposure to a range of countries and the ability to transfer assets internationally," he said. "Other than Bank of China and Dragon, Chinese lessors are subsidiaries of banks doing domestic work and focusing on the financing of aircraft."

Buy or build a lessor?

If the likes of IBCB and CBD Leasing are to compete with the major international players, one option is to follow Bank of China's lead and purchase a foreign lessor.

Lau insists he is concentrating on acquiring assets and not companies. Before purchasing leasing companies, the first step for local lessors is to start doing foreign transactions. A number of Chinese lessor's are about to close their first foreign deals. Yinchen Guo thinks this will create a precedent. "It will open the door for other lessors." She says it is essential for a local lessor to buy a foreign leasing company if it is to compete on the global stage. "Its extremely hard to grow to that level organically – it would take forever. And local lessors do not have the expertise to do it on their own, so it is far better to buy a company with an aircraft fleet, mix of lessees and skilled management."

She thinks it is inevitable that a Chinese lessor will acquire a foreign leasing company. And there has perhaps never been a better time to do so.

Chinese leasing companies worth watching

BOC Aviation

Based in Singapore BOC Aviation is the only Chinese-owned leasing aircraft in the world's top 10 by volume and the only one with a truly international outlook. "Our rivals are the likes of Gecas, ILFC, RBS," says Robert Martin, chief executive of BOC Aviation, "We are a market-driven, global lessor and have to achieve a return on equity target set by our shareholder."

BOC Aviation has never been busier as its counter-cyclical strategy, put in place in August 2007, of buying aircraft at good prices comes to fruition. Martin says business is better than ever. "The market is obviously very challenging and liquidity is very tight, but we already raised liquidity so we can play where others cannot," he says. "We've never had so much business – we have airlines calling us and can therefore concentrate on top tier carriers." The lessor has just closed a sale/leaseback deal with Alaska Airlines for six 737-800s and is on target to close more deals in the coming months.

Martin stresses that BOC Aviation is a global, as opposed to Chinese, lessor. "BOC Aviation has the benefit of being 100% owned by the third largest bank in the world in terms of market capitalisation.

In addition to the benefits of being owned by Bank of China, Martin points to the lessor's ongoing relationship with banks, export credit agencies and airlines. "Airlines have confidence in our ability to deliver," he says. "But it takes a long time to achieve this."

"They have an ability to seize good opportunities and are doing very well," says Nick Parrot, head of aviation finance, Aisa Pacific, at BNP Paribas.

BOC Aviation owns 85 aircraft, manages 19, and has 70 aircraft on order. Bank of China acquired Singapore Aircraft Leasing Enterprise in 2007 from Temasek, Singapore's sovereign wealth fund (14.5%), Singapore Airlines (35.5%), Germany's West LB Bank (35.5%), Temasek Holdings (14.5%) and the Government of Singapore Investment Corporation (14.5%). The bank beat strong bids from Allco, Dubai Aerospace and Standard Chartered.

No senior member of staff has left BOC Aviation since it was taken over.

Bank of Communications

Bank of Communications is one of China's oldest banks and is the nation's fifth largest lender. The bank formed an aviation department after the China Securities Regulatory Commisssion issued new licenses in 2007 but it has not closed any major leases. It did, however, close a $1.5 billion unsecured loan for China Eastern in December.

The leasing arm is based in Shanghai.

"They seem very keen to get into the space," says one US banker. "Saying that, they have rejected everything we have offered them!"

ICBC Leasing

Established in November 2007, ICBC Leasing has a fleet of 14 aircraft and is expecting to close more deals in March. The lessor closed a finance lease with Yangtze River Express for two 747-400SFs in November last year, which followed a finance lease with China Eastern Airlines for three A340-300s. Johnny Lau, global head of aviation, says the lessor is concentrating on acquiring assets. Speaking at Airfinance Journal's conference in Hong Kong in November, CEO Cong Lin said ICBC Leasing is looking to expand internationally and finance foreign airlines.

Dragon Leasing

The Beijing-based aircraft leasing company was established in 2006 as a joint venture between Aercap and China Aviation Supplies Holding Company and Calyon. The lessor plans to build a portfolio worth $1 billion over next few years. Recently taken delivery of its first directly purchased aircraft from Airbus on lease to Air France as part of a 13 aircraft order.

Changjiang Leasing

Became one of the earliest Chinese-incorporated lessors doing finance leases. Closed a sale/leaseback transaction in 2005 for a 737-300 in collaboration with China Xinhua Airlines and Shanghai International Trust & Investment.

The lessor has received much support from Chinese banks. In 2006, Changjiang recieved financing from China Development Bank for a sale/leaseback deal for four 737-800s and four A319s for a total amount.

The lessor also received support from China Construction Bank for two ERJ145s totalling. In 2007, Changjiang launched the first trust product for aircraft pre-delivery payment financing in China. That year also saw the lessor close an operating lease of an A319 to Hainan Airlines, financed by ICBC.

Minsheng Leasing

Minsheng, China's seventh largest bank, established its leasing subsidiary in April 2008. The lessor is based in Tianjin. The lessor also leases aircraft, ships and construction equipment. Minsheng holds an 81% stake in the lessor, with the investment arm of Tianjin Free Trade owning the remaining stake.

China Merchants Bank

The Shanghai-registered leasing company was established in 2007. The leasing arm is solely funded by China Merchants Bank. The main areas of business are aircraft, ships and large equipment.

CCB Financial leasing: Financial leasing joint venture between China Construction Bank and Bank of America. When established in 2007 it was China's largest financial leasing company.

China Aircraft Leasing Company (CALC)

The Hong Kong-based company was established in 2006 to provide finance leasing, operating leasing and fleet financial solutions for the Greater China region. In July last year, the lessor closed a sale/leaseback deal with China Southern Airlines for an A321. ICBC financed the deal.

CDB Leasing

As part of an effort to diversify its business and expand into financial leasing, China Development Bank acquired Shenzen Financial Leasing in 2008. Shenzehen was established in 1999.

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