

Feature: Researching equity in leasing sector

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The only publicly listed aircraft lessors - AerCap, Airastle, Air Lease Corporation (ALC) and Fly Leasing - have a combined equity market capitalization of \$4.9 billion. About 15 analysts cover these four lessors, but not all of the analysts cover each leasing company. German airline Lufthansa alone has 28 analysts covering it.

Typically a bank or investment firm's equity research department is responsible for designating coverage of a particular sector. The decisions are usually motivated by a firm's investor clients and what it thinks clients would be interested in investing.

More analysis might attract more investors to the industry.

"If we had more leasing companies that came to the market and were listed, you would see the level of coverage increase meaningfully," says Aengus Kelly, chief executive officer, AerCap. "Then investors would understand the true value of this business and the true risks and rewards associated with it."

AerCap, with a market capitalization of \$1.5 billion, benefits from the most coverage with 14 analysts.

Andy Cronin, chief financial officer, Avolon, says the four operating lessors generate quite a large quantity of high-quality research. However, the overall amount of public lessor equity is disproportionately small compared to the overall size of the leasing sector "particularly when considering the importance of leasing to the overall aviation industry.

The sector's coverage is based on the market cap, which is small compared with other sectors. Andrew Light, analyst, Citi, says there are simply not enough listed companies for analysts to cover.

"Equity research departments would want the aircraft leasing sector equity market cap to rise upwards of \$15 billion to \$20 billion to justify an equity research analyst to focus solely on the sector," says Light.

He covers three of the listed lessors, excluding ALC, as part of his airline and airport coverage. Keeping an eye on the leasing sector, he says, gives him a global perspective on the aviation industry.

"I can usually get better management contact with lessors than I would with an airline," he adds.

Citi monitors the three initial leasing companies because it was involved in the launch of the first four initial public offerings (IPOs). But normally, the research departments are independent from their banking activities.

Increasing coverage

To attract more analysts to cover the sector, it seems obvious that more companies need to become public. It is not simply a matter of quantity, but also a question of quality.

In April ALC raised \$805 million with its IPO, increasing this to \$868 million after underwriters exercised an over-allotment option.

The launch not only brought attention to a sector that is exceedingly in need of capital, but also it highlighted the resilience of the sector, as well as the assets "even through a downturn.

Big numbers, more attention

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If larger legacy leasing companies such as CIT Aerospace, RBS Aviation Capital and Awas went public, they would significantly increase the market cap of the sector. Combined, the three companies have nearly 800 aircraft worth about \$22.4 billion, according to figures from *Airfinance Journal's* 2011 Operating Lease Survey.

"ILFC coming to the market in particular would be positive because of its scale," says Kelly. The California-based lessor has 933 aircraft worth \$38.1 billion, according to the 2011 Operating Lease Survey.

After much speculation, the company filed for an IPO in early September. American International Group (AIG), ILFC's parent company, intends selling 20% of the lessor and the remaining 80% within the next three years.

ILFC is the second-largest lessor by fleet value, with 1,029 owned and managed aircraft worth almost \$38.1 billion.

Jackson Square Aviation (JSA) and Avolon have also acknowledged the benefits in going public.

The lack of analysts is less of a deterrent for Cronin, who says the overall market environment and the depth of the equity available is a greater concern.

However, the volume of analyst coverage plays a part in attracting investors.

"Investor appetite and analyst coverage is linked and it's hard to separate the two because investor appetite is driven by their knowledge of the sector - which is aided by analyst coverage - and the market conditions and fundamentals. If the sector has a lot of analyst coverage but no depth in investor appetite, then you're not going to launch a deal," says Cronin. "Conversely, it is difficult to get a lot of market depth without sufficient analyst coverage."

Leasing niche

Helene Becker, analyst, Dahlman Rose, says having four listed companies in the sector should be enough to have adequate coverage. However, the nuance of the sector dissuades analysts from covering it.

The sell side has difficulty figuring out where to place the sector, whether it should be in financial services, transportation, aerospace or other leasing companies. "Sometimes banks don't know who covers it, so no one covers it," says Becker.

Becker, who covers airlines and container leasing companies, does not deny that having more companies go public will be good for the sector because it will attract more analysts.

Easy leasing

Compared to the airline industry, the aircraft-leasing sector is more straightforward and not as complicated to model, according to Light.

With airlines, models have to be devised and continually updated to account for oil price fluctuations, revenue and yields, which is difficult to predict because demand can be affected by many uncontrollable and unforeseen factors such as natural disasters or war.

Leasing companies' earnings tend to be more predictable than airlines and therefore easier to model, if most of their aircraft are placed - though they too can be hit by the cyclicity of the industry because they lease to airlines. However, they maintain relative security through a downturn because of long-term leases and a diversified portfolio. "If a company has contracted revenue for several years, the earnings forecast really should not change much from one period to another, except maybe for maintenance reserve accounting reasons," says Light.

When it comes to maintenance reserves, lessors cannot assess the revenue on such payments until an aircraft is returned at the end of a lease.

"For an analyst to predict that can be difficult and it can make a difference between whether a company exceeds quarterly earnings expectations or underperforms them," says Light.

Ryan McKenna, strategic planning and investor relations, ALC, says his experience dealing with analysts has been positive, although the analysts' experience and knowledge varies. In some cases he has spoken with analysts who knew the sector well and wanted to jump straight into modelling questions surrounding lease rate factors and maintenance reserves, while others preferred to begin with a broader industry discussion.

"Analysts draw from experiences gained through covering different spaces and bring fresh perspectives when analyzing the sector," says McKenna.

Many industry insiders say there are not enough equity analysts in the sector, but McKenna disagrees.

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"I don't think there is a lack of equity research coverage in the sector. They publish a lot of excellent work and I hope it continues," he adds.

In terms of publicly traded aircraft lessors, the sector is still in its infancy with the first of the four existing lessors, AerCap, going public only in 2005.

The sector only has room to grow. With the launch of ILFC's initial public offering and others believed to be considering flotations as the markets return to relative stability, more analysts are bound to come to the sector.

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		AerCap	Aircastle	Air Lease Corp	Fly Leasing
Bank	Analyst				
BofA Merrill Lynch	Glenn Engel	X			
Barclays Capital	Gary Chase	X		X	
Citi	Andrew Light	X	X		X
Credit Suisse	Gregory Lewis	X	X	X	
Dahlman Rose	Helane Becker	X	X		X
Deutsche Bank	Michael Linenberg	X			
Evercore Partners	Arren Cyganovich	X	X	X	
FBR Capital markets	Scott Valentin	X	X	X	
Goldman Sachs	Justine Fishner	X	X		
JPMorgan	Jamie Baker	X	X	X	X
Keefe, Bruyette & Woods	Sameer Gokhale	X	X		X

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Macquarie	Smitha Balasubramanian			X	
Morgan Stanley	William Greene	X			
RBC Capital Markets	Jason Arnold	X		X	
Wells Fargo	Gary Liebowitz	X	X	X	
Total		14	9	8	4
<i>Source: Company websites</i>					

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