



# AIRFINANCE JOURNAL EVENTS

DAY  
**1**  
Tuesday  
31<sup>st</sup> Oct 2017

18<sup>th</sup> Annual Asia Pacific Airfinance Conference Conrad Hong Kong – 31<sup>st</sup> October - 2<sup>nd</sup> November 2017

## Flydubai continues to diversify 737 funding sources

**A**fter tapping the commercial debt market for the first time in late 2013, and previously relying on operating leases, Flydubai now moves to tax lease financing structures.

Flydubai is further widening its bank relationships to support its growth plans.

The Dubai-based carrier closed its first Japanese operating lease with call option (Jolco) structure in late August with French bank Credit Agricole Corporate & Investment Bank (CA-CIB) acting as the sole arranger of the transaction. As well as being Flydubai's first Jolco, the transaction also was the first Jolco financing for a Boeing 737 Max aircraft.

CA-CIB was also involved in Flydubai's inaugural Sukuk transaction in 2014, which saw the carrier raising \$500 million. CA-CIB, Dubai Islamic Bank, Emirates NBD, HSBC, National Bank of Abu Dhabi, Noor Bank and Standard Chartered were the arrangers of the Reg S benchmark dollar-denominated bond.

Proceeds from the Sukuk bond, which had a five-year term and priced at 3.776%, equivalent to 200 basis points over the five-year US dollar mid-swaps, financed deliveries in 2015 and 2016.

Flydubai began operations in June 2009 after it took delivery of its first 737-800 from an order of 50 from Boeing.

### Operating leases

The carrier relied on operating leases in the first three years of its operations.

Flydubai tapped the market for sale and leaseback deals with eight-year tenors with initial partners like Avolon, BBAM/Fly Leasing, GECAS, MCAP and SMBC Aviation Capital.

It enjoys good relationships with the leasing community and over the years, the carrier extended its pool of leasing companies with the addition of DAE Aerospace, CDB Leasing, FPG Amentum, Jackson Square Aviation and Pembroke Group.

But Flydubai started to diversify its funding sources away from sale and leaseback deals in 2012 after securing a

loan agreement with Export-Import Bank of the United States (Ex-Im Bank) for three deliveries.

The following year it secured its first commercial debt facility with a syndicate of five banks to finance six new 737-800s that delivered in 2013 and 2014.

The commercial bank loan facility was structured as finance leases over a 10- to 12-year term. The \$228 million financing transaction was arranged by Norddeutsche Landesbank Girozentrale (Nord/LB), CA-CIB, Gulf International Bank, PK AirFinance Japan (GE Capital Aviation Services) and Landesbank Hessen-Thüringen Girozentrale (Helaba).

The funding was "attractively priced" to



the market with an option for the interest rate to be floating or fixed during the term of the loan, according to Flydubai.

The mandate was awarded to three bank groups, with each group of banks taking two aircraft, spread equally over the two years.

"We received firm interest for 34 aircraft from 10 groups of banks, comprising mix of local, regional and international banks/financial institutions," said the carrier at the time.

The strong response to the request for proposal (RFP) was reflective of strong appetite from local, regional and international banks and financial institutions for Flydubai credit and their confidence in Dubai as an aviation hub.

In January 2014, the Dubai-based carrier finalised an order for 75 737 Max 8s and 11 737-800 Next Generation aircraft, along with the purchase rights for 25 more 737 Max aircraft.

The carrier's RFP in 2015 covered its last batch of 737-800s and the first five Max 8s.

The RFP included all types of financing, including sale/leasebacks, finance leases, German tax leases, French tax leases, Jols and Jolcos. At the time Flydubai wanted to have "40-50%" of the aircraft on sale-and-leasebacks.

### Financing the Max

The last batch of 737-800s was mainly financed via sale-and-leasebacks.

The Dubai-based carrier became the first Middle Eastern airline to receive the 737 Max in July. The first delivery was financed in the commercial banking market with its second delivery was financed in late August by French bank CA-CIB as the overall arranger, lender, facility agent and security trustee of a Japanese Operating Lease with Call Option (Jolco). – you said this at the beginning. May be good to avoid the repetition.

Flydubai also closed an insurance-backed loan to support three Boeing 737 Max 8 deliveries, market sources tell *Airfinance Journal*.

SMBC is the lender on the deal.

The first aircraft under this package delivered early in October while the remaining two units were scheduled for late October and November.

The loan makes use of the Aircraft Finance Insurance Consortium (AFIC), an insurance framework managed by US insurance broker Marsh that was created in the absence of export credit support. AFIC includes four insurance companies: Allianz, AXIS Capital, Sompo International (formerly Endurance) and Fidelis. Together they provide insurance against non-payment of the principal and interest on loans provided to airlines and leasing companies for the purchase of aircraft. ▲

# Industry overview: Key financials

This time last year Airfinance Journal reported that many of the world's airlines had enjoyed a stellar 12-18 month run of improving profitability. Revenues had reached close to \$600 billion. More noticeable was the 30.7% increase in EBITDAR (earnings before tax, depreciation, debt and rental costs) and the 261% increase in net income to a record \$40.6 billion.

The story this year remains positive. Amidst many predictions that the growth cycle was reaching its peak, revenues grew 4.5% and EBITDAR by 6.7% leading to EBITDAR Margin edging upwards to 21.5%. So far so good, but net income fell 17%

to \$33.8 billion. A closer look at the data confirms that the decline is almost entirely accounted for by tax credits at American and United and hedging gains at Delta in 2015 that were not repeated in 2016. So, 2016 clearly can be considered as good a year as 2015 from a profitability perspective.

On the leverage front the trend was also favourable, despite the record capital expenditure. Although adjusted net debt increased by 12.6% to \$477 billion, leverage (measured as adjusted net debt/EBITDAR) rose only marginally from 3.4 times to 3.6 times. Fixed charge coverage declined from 3.3 times to 3.2 times.

*The story this year remains positive. Amidst many predictions that the growth cycle was reaching its peak, revenues grew 4.5% and EBITDAR by 6.7% leading to EBITDAR Margin edging upwards to 21.5%.*

Figure 1: Global airline industry<sup>1</sup> key financials

\$m	Financial periods ending in				
	2012/13	2013/14 <sup>2</sup>	2014/15	2015/16	2016/17
Total revenue	545,111	535,827	589,317	598,967	626,050
% change		-1.7%	10.0%	1.6%	4.5%
EBITDAR	76,628	81,078	96,404	126,001	134,443
% change		5.8%	18.9%	30.7%	6.7%
Net income	6,369	6,532	11,234	40,568	33,836
% change		2.6%	72.0%	261.1%	-16.6%
Adjusted net debt	342,528	344,954	392,283	424,159	477,521
% change		0.7%	13.7%	8.1%	12.6%
Net fixed charges	31,626	31,842	34,731	37,973	42,552
EBITDAR margin	14.1%	15.1%	16.4%	21.0%	21.50%
EBITDAR/net fixed charges (x)	2.4	2.5	2.8	3.3	3.2
Unrestricted cash/Total revenues	17.4%	18.3%	16.0%	16.5%	16.8%
Adjusted net debt/EBITDAR (x)	4.5	4.3	4.1	3.4	3.6
Parent groups with positive net income	13,960	14,748	19,254	45,795	37,259
Parent groups with negative net income	(7,591)	(8,216)	(8,020)	(5,227)	(3,423)
Total	6,369	6,532	11,234	40,568	33,836
Parent groups with positive net income	85	86	74	93	101
Parent groups with negative net income	35	34	44	29	27
<sup>3</sup> Number of parent groups	120	120	118	122	128

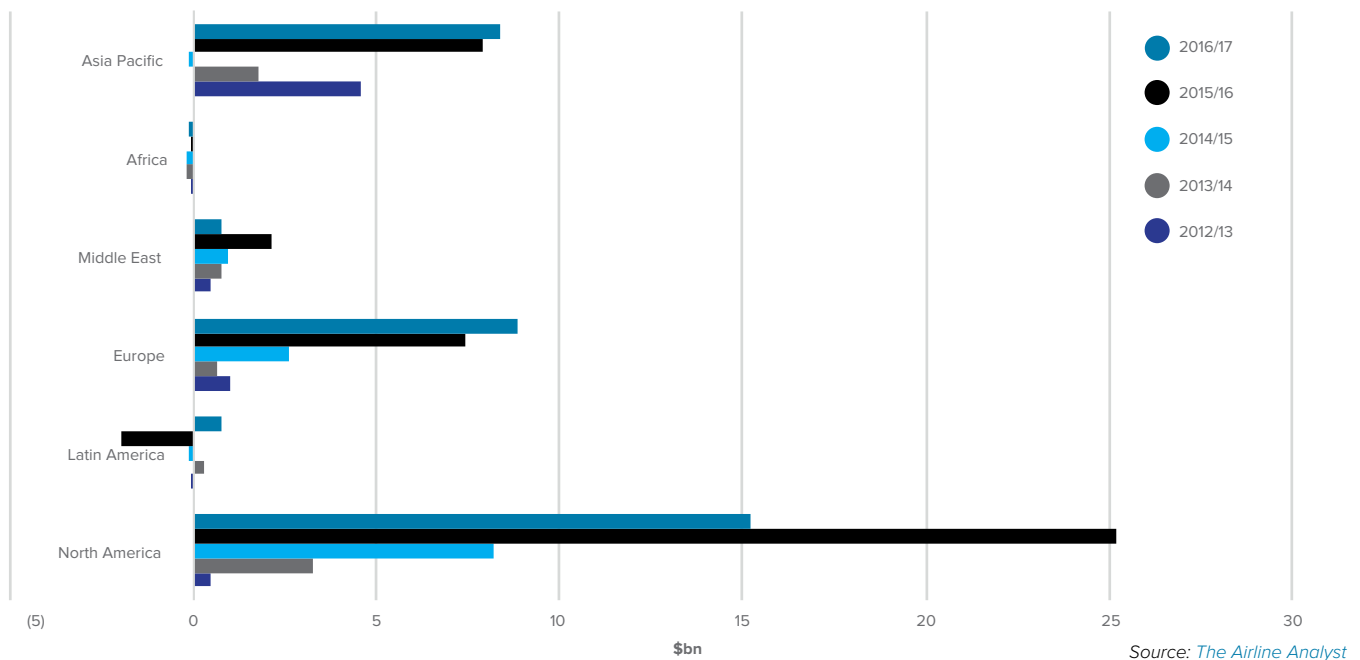
<sup>1</sup> Aggregate values for airline groups included in study

<sup>2</sup> 2013/14 excludes Delta's \$8.3 billion tax credit

<sup>3</sup> Number of parent groups varies due to consolidation (US Airways, Tigerair, Vueling, Aer Lingus), IPOs (Indigo and Wizz Air), de-consolidation (Frontier) and financials for additional airlines becoming available.

Source: The Airline Analyst

Figure 2 - Net income by major region



The only indicator which has not improved over the last five years is liquidity as a percentage of revenues, which remains at the 16.8% level, equivalent to only about two months' worth of liquidity. Given the cost to carry, a number of airlines have been reducing cash on balance sheet in favour of committed liquidity facilities. Another factor reducing liquidity has been special dividends and stock buybacks by a significant number of airlines.

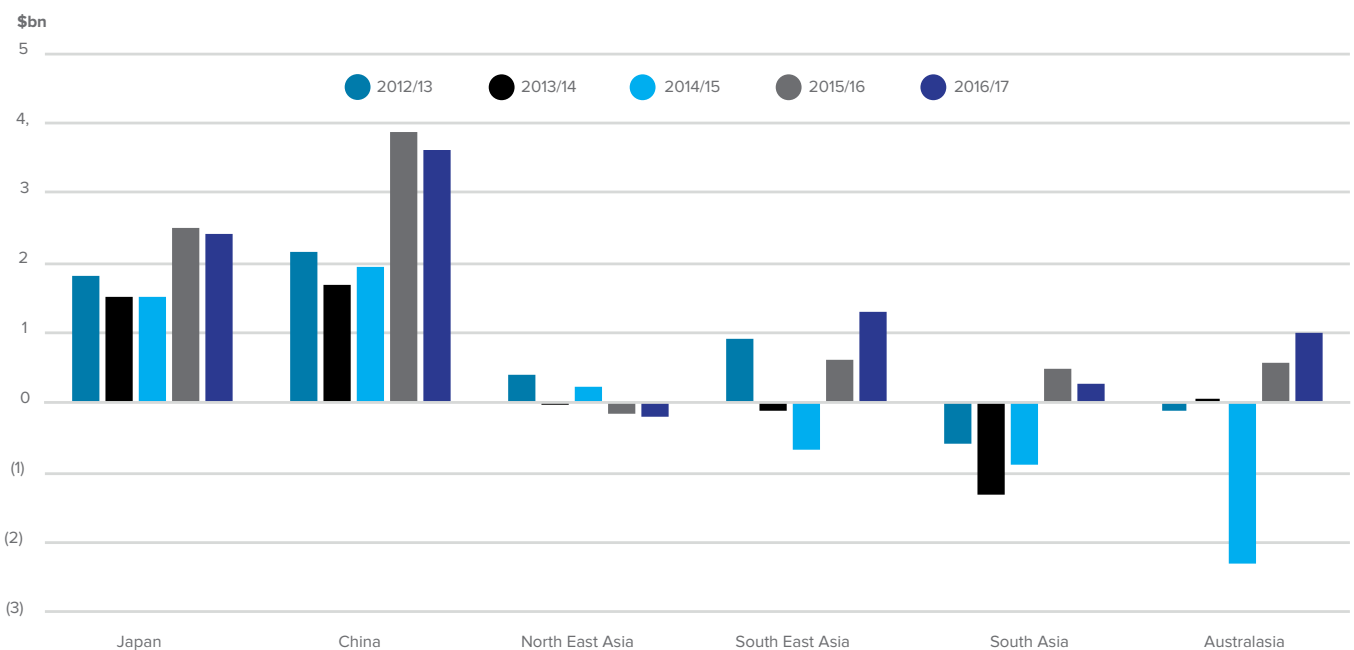
Figure 2 shows net income broken down by region and illustrates clearly that

the fall in profitability in the latest year was primarily driven by North American and Middle Eastern carriers. All of the other regions improved year-on-year. While the aggregate figures are impressive, not all regions or all airlines have achieved such a significant improvement in their performance. Of the 128 airline groups in the study, 27 made aggregate net losses of \$3.4 billion. The loss makers tended to be in countries with weak economic conditions like Brazil or where excess capacity and competition have impacted profitability, such as South East Asia.

It is also helpful to look at the breakdown of the Asia Pacific numbers by sub-region as there are huge differences that tend to be camouflaged in the aggregates.

This is presented in Figure 3 and shows clearly the large, stable and growing contributions from Japan and China and the volatile and often marginal profitability from the other sub-regions. That said, we can see the significant improvement in 2016/17 from South East Asia (driven by AirAsia) and Australasia (driven by Qantas and Air New Zealand). ▲

Figure 3 - Asia-Pacific net income by sub-region



Source: The Airline Analyst

# Analysis: Revenue and income

Top 50 by Total revenue

Rank	Airline	\$m
1	American Airlines Group	40,180
2	Delta Air Lines	39,639
3	Lufthansa Group	38,548
4	United Continental Holdings	36,556
5	Air France-KLM	29,418
6	IAG	26,720
7	Emirates	23,022
8	Southwest Airlines	20,425
9	Lufthansa Parent	18,268
10	Air France	18,253
11	China Southern Airlines	17,104
12	Air China	16,979
13	ANA Holdings	15,954
14	British Airways	15,133
15	China Eastern Airlines	14,712
16	Qantas Airways	12,903
17	Cathay Pacific	11,867
18	Air Canada	11,682
19	Japan Airlines	11,650
20	KLM	11,603
21	Qatar Airways	10,987
22	SIA Group	10,912
23	Korean Air Lines	10,455
24	Turkish Airlines	9,907
25	LATAM Airlines Group	9,527
26	Aeroflot	8,200
27	Ryanair	7,871
28	Jetblue	6,632
29	Easyjet	6,174
30	Hainan Airlines	6,051
31	Alaska Air Group	5,931
32	Iberia	5,436
33	Thai Airways	5,422
34	Asiana Airlines	5,136
35	SAS	4,870
36	EVA Airways	4,786
37	UPS Airlines	4,771
38	China Airlines	4,667
39	Swiss International Air Lines	4,517
40	Air Berlin	4,489
41	TAM	4,486
42	Avianca Holdings	4,138
43	Virgin Australia	3,986
44	Air New Zealand	3,887
45	Garuda Indonesia	3,864
46	Jet Airways	3,562
47	Norwegian Air Shuttle	3,297
48	Westjet	3,282
49	Xiamen Airlines	3,256
50	GOL	3,161

Top 50 by Net income

Rank	Airline	\$m
1	Delta Air Lines	4,373
2	American Airlines Group	2,676
3	IAG	2,286
4	United Continental Holdings	2,263
5	Southwest Airlines	2,244
6	Lufthansa Group	2,103
7	British Airways	1,757
8	Ryanair	1,558
9	Japan Airlines	1,484
10	Lufthansa Parent	1,384
11	Air China	1,013
12	Air France-KLM	938
13	ANA Holdings	893
14	Qantas Airways	820
15	Alaska Air Group	814
16	Jetblue	759
17	China Southern Airlines	750
18	Air Canada	697
19	China Eastern Airlines	669
20	Aeroflot	619
21	KLM	612
22	Easyjet	565
23	Qatar Airways	550
24	Air France	527
25	Airasia	479
26	Hainan Airlines	467
27	Thomson Airways	393
28	Air New Zealand	344
29	Emirates	340
30	Copa Holdings	335
31	Swiss International Air Lines	326
32	Wizz Air	291
33	GOL	272
34	SIA Group	265
35	Spirit Airlines	265
36	Ethiopian Airlines	265
37	Indigo	261
38	Virgin Atlantic Airways	237
39	Hawaiian Airlines	235
40	Westjet	235
41	Xiamen Airlines	233
42	Thomas Cook Airlines	227
43	Allegiant Travel Company	220
44	Frontier Airlines	203
45	Volaris	197
46	Cebu Pacific	194
47	Juneyao Airlines	186
48	Iberia	181
49	SAS	163
50	Sichuan Airlines	159

Top 50 by Net income margin

Rank	Airline	\$m
1	Airasia	29.9%
2	Jazeera Airways	20.4%
3	Ryanair	19.8%
4	Thomas Cook Airlines	17.2%
5	Allegiant Travel Company	16.1%
6	Cebu Pacific	15.8%
7	Thomson Airways	15.7%
8	Wizz Air	15.7%
9	Copa Holdings	15.1%
10	Volaris	15.0%
11	VietJet Air	14.5%
12	Alaska Air Group	13.7%
13	Air Arabia	12.8%
14	Japan Airlines	12.7%
15	Silkair	12.6%
16	Juneyao Airlines	12.6%
17	Frontier Airlines	11.8%
18	British Airways	11.6%
19	Jetblue	11.4%
20	Spirit Airlines	11.4%
21	Spring Airlines	11.3%
22	Ethiopian Airlines	11.3%
23	Delta Air Lines	11.0%
24	Southwest Airlines	11.0%
25	Thai Airasia	10.5%
26	Hawaiian Airlines	9.6%
27	Easyjet	9.1%
28	Indigo	8.9%
29	Air New Zealand	8.9%
30	Fiji Airways	8.8%
31	Chorus Aviation	8.8%
32	Euroatlantic Airways	8.7%
33	GOL	8.6%
34	IAG	8.6%
35	Omni Air International	8.2%
36	Virgin Atlantic Airways	8.0%
37	Utair	7.8%
38	Hainan Airlines	7.7%
39	Lufthansa Parent	7.6%
40	Aeroflot	7.6%
41	Swiss International Air Lines	7.2%
42	Mesa Airlines	7.2%
43	Westjet	7.2%
44	Xiamen Airlines	7.1%
45	Jeju Air	7.1%
46	Spicejet	7.0%
47	Icelandair	6.9%
48	Kalitta Air	6.9%
49	Jet2.com	6.9%
50	American Airlines Group	6.7%

Source: *The Airline Analyst*

# A million reason\$ to fly ATR.



## That's why we're the Regional Leader.



ATR / 72-600



ATR / 42-600

[atr-aircraft.com](http://atr-aircraft.com)

Choosing ATR's solutions generates \$1 million of savings annually, per aircraft, compared to their direct competitors. This explains the vast success of the program and its leadership in terms of orders, deliveries, backlog, operator base, investor's opinion and residual value retention.



# ATR

PROPELLING THE NEXT CONNECTION

# ATR ready for Chinese adventure

*Airfinance Journal talks to ATR's chief executive officer, Christian Scherer, about the Franco-Italian manufacturer's breakthrough in the Chinese market.*

**A**TR is bullish about the growth potential of China's regional aircraft market, foreseeing demand for 300 new turboprops in the country by 2035.

The Franco-Italian manufacturer anticipates 800 new regional routes in China, particularly in less-densely populated cities and regions, where road and rail infrastructure is less developed and there is lower traffic demand.

Over the next 20 years, the 61-80-seat segment will account for 270 new turboprop deliveries, according to the manufacturer's forecast. The remaining 30 deliveries will be in the 40-60-seat segment.

ATR estimates that regional aircraft only represent 2.3% of the nearly 3,000-aircraft fleet operating in China, compared with 25% worldwide.

In addition, there is also strong potential to develop air services to 100 small airports that account for only 1.6% of total traffic in China.

Sales in China had been almost non-existent for ATR until June 2017, when the manufacturer signed two letters of intent for the ATR42-600 model with Chinese customers.

Shaanxi Tianju Investment committed for up to 10 ATR42-600s to develop commuter services in the province of Xinjiang.

And Xuzhou Hantong Aviation Development agreed to purchase three ATR42-600s to develop commuter services in the province of Jiangsu.

The manufacturer believes development of the regional air transport network in China will stimulate demand, while an improved air transportation network of airports serving all regions of the country is a clear aim of the state. The Chinese government

forecasts the development of some 70 new airports within the next five years, a substantial addition to the 200 airports currently operating in the country.

China has been a strategic partner and supplier for ATR for nearly 20 years. Xi'an

thanks to hard work, as well as the proven and enduring quality of the aircraft. The re-establishment of the local commercial team helped provide a better understanding of the market, in addition to further developing better working

Its unrivalled economics and operational flexibility make it perfect for both the developing regional and general aviation markets as it supports a variety of different business models. China recognises the importance of general aviation and the ATR -600 series is the ideal tool to increase the connectivity of communities throughout the country.

The import VAT tax was never really the sole factor in slowing ATR's sales in China. Particularly as, since the introduction of the new tax regulations in 2013, airlines are now able to claim it back from the tax on their revenue."

**Do airport constraints also limit turboprop sales in China, if airlines prefer to use slots for larger aircraft?**

**Scherer:** "Airport constraints are not really an issue for ATR as we are focusing on a totally different market segment. Today, some 100 small airports account for only 1.6% of the whole traffic in China, highlighting a need to develop regional connectivity throughout the country. Furthermore, out of China's approximately 3,000 aircraft only 2.3% are regional aircraft meaning that regional routes are often inefficiently operated by aircraft that are larger than necessary. For many routes, the higher trip costs of larger aircraft are not offset by higher revenues; hence sustainability relies on government subsidies. Effectively, it's like trying to crack a nut with a sledgehammer, you will get the job done but will the outcome really have been worth the effort? Utilising ATR turboprops would provide optimised load factors and decreased seat costs. The introduction of the ATR -600 series aircraft, with its superior economics, would support the Chinese market to deliver on its potential



Aircraft Industry (XAC), a subsidiary of AVIC, provides substantial fuselage sections along with parts of the wings of ATR aircraft.

In late 2015, the manufacturer opened a representative office in Beijing. *Airfinance Journal* asks *Christian Scherer* why the time is now right to pitch its 50-78-seat turboprops to Chinese airlines.

**Import tax on aircraft in China has slowed sales for years. What triggered recent orders at the Paris air show?**

**Scherer:** "Commercial progress has been achieved

relations with the CAAC (Civil Aviation Administration of China). This has further deepened our understanding of the country's regional and general aviation markets. In the short term we are focusing on general aviation as a strategy to reintroduce the ATR into China as quickly as possible.

As soon as Chinese carriers have the chance to see and experience the quality of this aircraft, as well as witnessing the impact that it will have on their business, they too will understand what we already know; that this is the right aircraft for China.

profitably and sustainably.”

**Has local competition (Xian MA turboprops) or the Russia’s 64-seat Ilyushin 114-300 been a hurdle for potential western OEM sales in China?**

**Scherer:** “In any market, competitors are always going to be an obstacle to be overcome as they will offer products with different advantages but frankly competition is not something that we are terribly afraid of at ATR. Competition is something that simply drives us to be better. We are confident in the quality of our product and we are dedicated to its continuous improvement so we expect it to be an attractive prospect for Chinese operators and airlines in markets all over the world, for many years to come.

The market forecast for the next 20 years suggests that there will be a need for 300 new turboprops in China, so clearly there is market big enough for more than one

manufacturer. Furthermore, for the last 20 years, ATR has developed a significant industrial programme with AVIC’s XAC for the supply of key aircraft sections for the ATR so co-operation is clearly possible and beneficial.”



**How would Shaanxi Tianju Investment and Xuzhou Hantong Aviation Development use the ATR42-600s?**

**Scherer:** “The advanced commercial discussions with these companies remain ongoing. Both airlines will operate commuter services with a 30-seat configuration in the general

aviation segment, enhancing regional connectivity with quick, efficient flights to the country’s smaller regions. The ATR42-600 is an exceptionally versatile aircraft that can support a range of business models but it is

worth remembering that it is a proven route opener so naturally we tend to think that Chinese airlines will use it to institute and solidify networks with profitable operations.”

**After this breakthrough in the Chinese market, what are ATR’s hopes for selling 70-seat turboprops?**

**Scherer:** “Following the

certification of the ATR-600 series and the introduction of the ATR42-600 in general aviation configuration, the arrival of the ATR72-600 would be a natural development. As the market leader in regional aviation, for us it makes perfect sense that Chinese regional operators will quickly understand the value of the ATR72-600, the preferred choice of airlines globally since 2011.

Elsewhere in every other market, given a level playing field, it is the ATR72-600 that has prospered and there is certainly no reason why this trend wouldn’t continue in China. Our analysis shows there is a market for 270 70-seat aircraft required to develop routes before 2035 and we would expect our aircraft to once again come out on top. It is more modern and more comfortable than any of its so-called rivals, so the real question is: ‘Why should Chinese operators and passengers have to settle for anything less than the best?’^

**zeevo**

**KNOWS**

AIRCRAFT LEASING



**RIGHT TECHNOLOGY.  
RIGHT SOLUTION  
FOR GROWTH.**

With Zeevo as your trusted partner, you will empower your business with the expertise and innovation to drive your leasing platform forward. Our solutions are scalable and sustainable, tailored to your growth objectives, depth of resources, and the technologies your business needs to grow.

**ZEEVOGROUP.COM**

FOLLOW US @ f in

# Cathay Pacific key metrics show further deterioration

**C**athay Pacific Airways's key metrics defined by *Airfinance Journal's* Financial Ratings have deteriorated over the past 12 months.

The Hong Kong-based carrier reported a loss of HK\$2.05 billion (\$262 million) for the first six months of 2017, reversing a HK\$353 million profit for the same period in 2016. "Fundamental structural changes within the airline industry continue to affect the operating environment for our airlines and created difficult operating conditions in the first half of 2017," the carrier said in a statement.

"Intense competition with other airlines was the most significant [challenge]. Other major adverse factors were higher fuel prices (including the effect of our hedging), the adverse effect of the strength of the Hong Kong dollar on revenues denominated in other currencies, and higher aircraft maintenance costs."

In the financial year ending 31 December 2016, Cathay Pacific swung to an annual loss of HK\$575 million compared with a HK\$6 billion profit in the year-earlier period. Cash flow from operations declined from HK\$16 billion to HK\$6.1 billion in 2016.

The carrier's financial condition, as assessed by Financial Ratings, has downgraded by 2.1 notches to CCC+ over the past 12 months.

Cathay top the 10 most deteriorated airlines over this time period, above Malaysia Airlines (2 notches down) and Austrian/Volaris (1.6 notches down).

Ebitdar margin (earnings before interest, tax, depreciation, amortisation and rental costs) as a percentage of total revenues decreased to 9.9% from 16.2% since August 2016.

In Ebitdar margin terms, Cathay ranks 113th out of 150 airline entities in Financial Ratings.

"Strong competition from other airlines and the adverse effect of the strength of the

Hong Kong dollar are expected to continue to put pressure on yield," says Cathay Pacific.

As a result, Cathay launched its biggest strategic review in decades and said it would undergo a three-year programme of corporate transformation with the intention of achieving returns above the cost of capital.

Other key metrics highlight a deterioration of the carrier's financials.

Fixed charge cover, which represents the number of times Ebitdar covers the sum of net interest expense plus aircraft rent, has deteriorated to 1.8 times from 3.8 times over the past 12 months. At August 2015 it was 4.2.

At this year's interim results, John Slosar, chairman of Cathay Pacific said that the airline does not expect the operating environment in the second half of 2017 to improve materially.

"In particular, the passenger business will continue to be affected by strong competition from other airlines and our results are expected to be adversely affected by higher fuel prices and our fuel hedging positions."

"However, the outlook for the cargo business is good and we expect robust demand and growth in cargo capacity, yield and load factor in the second half of this year."

"We expect to see the benefits of our transformation in the second half of 2017, and the effects will accelerate in 2018. The previous quote is quite long and may lose the reader; it may be best to paraphrase some of it."

"We are addressing the industry challenges through our corporate transformation and by expanding our route network, increasing frequencies on our most popular routes and buying more fuel-efficient aircraft. This will help us to increase productivity and to reduce costs while improving the quality of our services to

customers."

In May 2017, Cathay announced a reorganisation of its head office, with associated redundancy costs of approximately HK\$224 million as part of the corporate transformation programme.

Over the past year passenger revenue has decreased by 3.9% primarily due to a 5.2% fall to HK\$51.5 cents in yield and a 0.5% decrease in passengers carried, partially offset by a 0.2% points increase in load factor. In the meantime, the combined cost per available tonnes kilometres of Cathay Pacific and Cathay Dragon has increased 5.4% to HK\$3.14.

Its liquidity position has also been affected over the past year and it represented 18.6% of last 12 months revenues at 30 June 2017, versus 21.3% a year ago.

Cash and cash equivalents at 30 June totalled HK\$4.745 billion down from HK6.565 billion at a year earlier.

Leverage has more than doubled to 9.2 times over the past year.

Net borrowings (after liquid funds) increased by 10.4% to HK\$55.04 billion.

Current and non-current long term loans have increased by more than HK\$3 billion to HK\$72.3 billion over the past 12 months, reflecting the investment in the carrier's fleet.

While the Hong Kong flag

carrier states in its financial statements that it had a net debt/equity ratio of 1.04 at 30 June 2017 (up from 0.9 as at 31 December 2016), Cathay does not include the value of its operating leases, which bring the ratio up to 1.38 (based on an eight times multiple of operating lease rents).

"Airline analysts adjust leverage for aircraft operating leases. Cathay does not do that. They are among a diminishing group of airlines that don't offer an 'adjusted' figure," explains Mike Duff, managing director of *The Airline Analyst*.

Cathay's adjusted net debt to Ebitdar at year-end 2016 came out at 9.2 times. By comparison, Qantas and Singapore Airlines were 1.6 times.

"This is the one figure about Cathay that really got my attention. Historically, they have got up to 6.3 times – but that was in 2008 during the global financial crisis," says Duff. He adds: "Cathay is now close to its highest leverage, despite the industry not being in crisis. In fact, a lot of airlines are making record profits. But Cathay are not; they made a loss." Cathay has for years made a virtue of how its leverage will fluctuate within a 10 year industry cycle, but will always return to the historic lows, according to Duff. "Repeating this will be a challenge," says Duff. ▲





*GEARED FOR THE FUTURE.  
TRANSFORMING AVIATION TODAY.*



### **THE PUREPOWER® GEARED TURBOFAN™ ENGINE**

Airline operators are excited about the breakthrough fuel savings and significant noise reduction they're seeing from the GTF innovation today. Cleaner, greener and quieter.

Experience the engine that's geared for the future — flying today.

Learn more at [pw.utc.com](http://pw.utc.com)



**GO BEYOND**

A UNITED TECHNOLOGIES COMPANY

# Fly steers steady course in tumultuous leasing market

**A** year of heavyweight consolidation in the leasing industry has not made “any difference” to market conditions yet, according to the chief executive officer of Fly Leasing.

Prior to its takeover of AWAS, DAE Capital had a similar-sized fleet to Fly, but Colm Barrington makes light of the Middle East-based lessor catapulting ahead: “At least AWAS and DAE aren’t both competing against us!” he says.

“On a longer-term basis, larger companies that do become investment grade can possibly finance themselves a little more cheaply and that is something we have to be concerned about, but that’s why we’re sticking so much of our financing into the secured market which is cheaper for us.”

Another problem for smaller lessors – at least according to DAE Capital – is that they lack the scale to offer

comprehensive solutions to large airlines.

DAE’s chief executive officer Foriz Tirapore, told Airfinance Journal in September:

“Increasingly, clients want to deal with bigger, strongly capitalised lessors who can sit across the table from them and offer a comprehensive range of solutions to help them grow their business and manage their fleet to adapt to changing market conditions.”

Barrington counters that Fly is backed by the BBAM group, which manages over 400 aircraft, and also has access to the extra financial clout of Japanese bank Nomura Babcock & Brown and Incline Aviation, an \$881 million private equity aircraft fund that BBAM finalised in September.

“In several of our recent sale-and-leasebacks we have worked with these parties to offer larger deals to the airlines,” he says.

Examples include an Air India deal where Fly, Nomura Babcock & Brown and Incline shared a nine-aircraft sale and leaseback, and a recent deal with an Asian carrier where Fly and Incline split an eight-aircraft sale and leaseback down the middle.

## New competition

A bigger worry for Barrington is the proliferation of new Chinese lessors; he suggests these risk distorting the sale and leaseback market by offering unrealistic terms for new aircraft purchases.

“They are deploying capital at what appear to be very low rates, reflected in their offering sale-and-leaseback terms that don’t appear to make sense. The assumption is that they want to get into US dollar assets that are offshore,” says Barrington.

“Most don’t yet have platforms and may lack knowledge of the true costs

involved in operating leasing. They may also have unrealistic expectations about residual values,” he adds.

The huge influx of Chinese money into leasing is a particular concern for Fly, which doesn’t have any outstanding orders with manufacturers and instead looks to the sale and leaseback market in which the new players are particularly active.

For its sale and leaseback additions, Fly has maintained a lease rate factor of above 0.8% per month, although Barrington recalls some “pretty horrific” stories of how low some factors have sunk.

“One has heard of airlines getting below 0.6% per month but we don’t think you can make money in this business at below 0.6% unless you don’t care about the cost of your capital and unless you’re making very bullish assumptions about residual value,” he warns.

## Hong Kong. Daily. Non-Stop.



Download our World Aircraft Repossession Index:



**Acquisitions and financing**

The lessor’s portfolio currently stands at 82 aircraft, which the lessor aims to raise to 85-90 units by the end of the year. Having deployed \$459 million in the first half, Barrington is confident that the lessor will meet its target of \$750 million worth of aircraft acquisitions this year.

Financing for additional aircraft will continue to be a mix of secured and unsecured debt, with Fly likely to maintain a rough ratio of 75% secured and 25% unsecured, Barrington predicts.

And while the lessor is slightly more leveraged than its peers, Barrington says this is compensated for by its preference for secured debt and the low cost of that debt.

“Instead of having these big one-off hits every few years when you have to refinance these big unsecured debts, we amortise our security over the life of the lease,” he comments.

Nonetheless, Fly will continue to tap the unsecured markets for “operational flexibility”. And although unsecured debt is more expensive for FLY, the

lessor may soon refinance about \$350 million of 2020 notes to lock in current low interest rates.

“We have some make-whole premiums which fall due towards the end of the year, whereby we could repay some of the unsecured debt. They ratchet down every year, so... we will consider refinancing those notes and raising new debt in the market over the next few weeks maybe, and then repaying that debt when the make-whole ratchets down in December.”

Its acquisition strategy will continue to focus on the used aircraft and sale and leaseback markets, as Fly doesn’t consider direct orders a good strategy for a public company, given the cyclical nature of the airline market.

“Every time we enter into a deal we know the price of an aircraft, the name of the lessee, the term of the lease, the rental amount, the security deposit, the documentation and what the financing is in terms of amount term and price,” comments Barrington.

“So the only imponderable

we have when entering into a secondary market acquisition or a sale and leaseback is what the residual value will be and we normally make pretty conservative assumptions on that,” he adds.

**Portfolio balance**

With no aircraft sales imminent, Fly’s residual estimates are unlikely to be tested soon, although the lessor has been divesting older aircraft from its portfolio over the past two years.

At the end of June, its portfolio comprised 41 Boeing 737s, five 787s, two 777s, three 757s, 25 Airbus A320-family aircraft, three A330s and two A340s.

“We see ourselves as a narrowbody lessor,” says Barrington, adding: “We will only get into widebody transactions with the right type of aircraft – the 777, 787, A330-300 or A350 – with relatively good credits, on relatively long-term leases of 10-12 years, and if we can support them with attractive financing.”

On the narrowbody front, Fly has moved into new technology with the acquisition of two 737

Max aircraft. Barrington says that the lessor will keep its proportion of new-generation aircraft similar to those of its rivals

“There aren’t many delivered yet and as they are delivered we will be active in that market,” he says.

Unlike many larger lessors, though, Fly doesn’t have any order positions for A320neo or 737 Max aircraft. This leaves it reliant on the competitive sale-and-leaseback market, which might restrict its access to more efficient aircraft in the event of a fuel price rise.

Current costs dynamics, however, favour Fly’s approach, says Barrington.

“I think they are more exposed to lease rates for their future orders for Maxes and Neos because fuel prices are low and most people think they are likely to stay low.

“We moved out of the 737-300/400 and older Airbus aircraft more rapidly than most into the newer A320 models and the next-generation 737s, and we will move from the NG into the Max over time,” he adds. ^

Where to find us

Airfinance Journal #AFJHK

Conrad Hong Kong • Tuesday 31<sup>st</sup> October - Thursday 2<sup>nd</sup> November 2017

Airfinance Journal



**Laura Mueller**  
Managing Director  
*Airfinance Journal*



**Olivier Bonnassies**  
Managing Director  
*Airfinance Journal*



**Michael Duff**  
Managing Director  
*The Airline Analyst*



**Jack Dutton**  
Editor  
*Airfinance Journal*



**Michael Allen**  
Asia finance editor  
*Airfinance Journal*

Events Team



**Candice Chevillard**  
Head of Events



**Andrew Allen**  
Head of Event Sales



**Fan Yeung**  
General Manager - Asia



**Fiona So**  
Operations Manager

Advertising



**Chris Gardner**  
Advertising Manager

Sales Team



**Chris Welding**  
London



**Oliver Goodwin**  
London



**Harry Sakhrani**  
Hong Kong



## Pre-Conference The Airline Briefing & Networking Day

31st October 2017  
Grand Ballroom, Conrad Hong Kong

**0830 Registration and networking coffee**

**0930 Chairmen's opening remarks**

**Laura Mueller**, Managing Director, **Airfinance Journal**

**Olivier Bonnassies**, Managing Director, **Airfinance Journal**

**0940 Airline presentation**

- Traffic volume – inbound vs outbound
- Competition from LCCs
- Qantas financial performance in 2017

**Cecilia Ho**, Treasurer Risk Management, **Qantas Airways**



**1010 Airline presentation**

**Amelia G. Anderson**, Managing Director, Assistant Treasurer, **American Airlines**



**1040 Networking coffee break**

**1110 Airline presentation**

**Gerry Laderman**, Senior Vice President - Finance, Procurement & Treasurer, **United Airlines**



**1140 Asia as a major sources of financing to Turkish Airline**

- Current state of domestic passenger market
- Fleet composition and financing plan
- Sources of new financing from Asian financial institutions
- Where is the future growth for Middle Eastern carriers?

**Murat Seker**, CFO, **Turkish Airline**



**1210 Where do a European carrier see the opportunities for the passenger growth?**

- Outlook for European passenger market
- Fleet and route plans
- Financial performance
- Where is the future growth for Germania?

**Johannes Klinsmann**, Managing Director, **Germania's group holding Germania Beteiligungsgesellschaft mbH**



**1240 Lunch sponsored by BNP Paribas**



**BNP PARIBAS**

The bank for a changing world

**1430 The return of Spice Jet: Who will be the winners and losers in India's LCCs sector**

Spicejet

- Competitive landscape in airlines sector
- Key successful factors for LCCs in India
- Source of financing for India LCCs
- Future fleet planning

**Kiran Koteswar**, Chief Financial Officer, **Spice Jet**

**1500 Where is the Mongolia passenger market going?**



- Travel forecast
- Source of financing in absence of ECA guarantee
- Key challenges and opportunities facing the carries

**Ganbold Namsrajav**, Vice President of Flight and Technical Operations, **MIAT Mongolian Airlines**

**1530 Networking coffee break**

**1600 Capturing the opportunities in a growing LCCs market in India**

IndiGo

- India growth story
- Fleet composition and order book
- Financing strategy
- Competitor landscape

**Riyaz Peermohamed**, Chief Aircraft Acquisition & Financing Officer, **IndiGo**

**1630 Presentation: The financial summary of the Airline Briefing Day**

**Michael Duff**, Managing Director, **The Airline Analyst**

**1700 Chairman's closing remarks followed by GECAS cocktail reception**



**GECAS**