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GECAS targets expansion and ongoing filial status

GECAS is returning to net buyer status in 2018 after spending the past three years shedding more assets than it acquired.

The world's largest lessor by fleet size has been divesting about $4 billion-worth of assets each year during the past 36 months, while investing a similar amount. However, factor in depreciation, and the balance sheet has been gradually declining during this time but "only modestly by a few billion dollars", GECAS chief executive officer Alec Burger tells *Airfinance Journal* in an interview.

Now, the lessor is changing its focus and preparing to ramp up its asset purchases.

"This is the last year of selling more than originating. Over the next two to three years, the balance sheet is going to start growing after running at an elevated sales path where we were selling almost as much as were originating," says Burger.

This shift will see GECAS return to a "more normalised rate" of sales of a "couple of billion dollars-worth of transactions each year", he adds.

It plans on originating $5 billion to $6 billion in aircraft transactions, including sale-and-leaseback deals and aircraft from its order pipeline.

GECAS will also build its off-balance sheet portfolio through separate transactions, such as those through its newly announced $2 billion sidecar with Caisse de dépôt et placement du Québec, which was unveiled at the Paris air show.

Einn Volant Aircraft Leasing (EVAL) is subject to customary approvals and expected to close in the second part of the year. By 2020, Burger hopes EVAL will grow to $25 billion-worth of total assets.

He favours the "customer side" angle to the sidecar because it allows GECAS to ease its exposure limits.

"We have reached our concentration limits with many of our customers, so EVAL makes it possible to do a little more business with them," he adds.

Powerplant sidestep

EVAL will also allow GECAS to diversify its asset mix and move beyond GE-powered aircraft, which makes up a large proportion of its fleet.

"We will do a bit more non-GE product as part of the sidecar, but we haven't said how much that will be," adds Burger.

EVAL will also allow GECAS to expand its customer scope because of its low cost of capital.

"The cheaper funding will enable us to finance some really good credits or typically the slightly lower returning

Alec Burger, chief executive officer, GECAS

stuff. So, I view this as completely additive to our business," he says.

To return to net buyer status, GECAS must focus on winning deals in an increasingly competitive environment.

"You saw that at the air show, this is a very competitive space. You show up for new campaigns, and 10 people are at the table on a good day. The competition is very stiff," says Burger.

However, that type of business is not the kind GECAS is looking to grow. "You won't see us competing with sale and leasebacks in China. That is not somewhere where we need to be competing for deals."

Instead, GECAS will continue to "gain traction" by working with GE on joint campaigns with GE Aviation. "We have a deep domain and a linkage to GE Aviation. That works for us, to use our in-house capability to look for and win new transactions."

GE Aviation reported a 3% uptick in commercial engine

Source: Boeing

orders during the quarter because of LEAP and GEnx sales, partially offset by lower GE90 and CF6 orders. It reported $1.7 billion of new commercial engine orders, including $932 million for LEAP, $206 million for CF34, $138 million for GE90 and $166 million of GEnx orders. CFM orders were also up 13% to $186 million.

GECAS, meanwhile, reported a 3% dip in total assets for the three months to 30 June, compared with the year-earlier period.

The Norwalk, Connecticut-based lessor had second-quarter total assets of $39 billion.

Net earnings at the lessor improved 1% to $369 million compared with the second quarter of 2016.

General Electric, its parent company, has not broken down revenue figures for GECAS since it announced plans to leave the financial sector through the sale of certain GE Capital assets in 2015.

Burger insists the return to modest growth is "a really big deal". He says: "As part of an employee-engagement perspective, being part of something that is shrinking is not energising, but now we are changing that. If you look at our expected activity on a depreciation run rate, we will be building the balance sheet to the tune of a billion a year over the next two to three years, and that is on-balance sheet.

At the same time, we are building the off-balance sheet, so that is a big sign of confidence from our parent regarding growing our business."

This nod of encouragement from GE is a welcome sign during a period of change at the corporate level.

GE reported a 45% drop in earnings per share for the second quarter of the year, in its last set of results before Jeff Immelt, chief executive officer (CEO) for almost 16 years, stepped down.

John Flannery, the former president and chief executive of GE Healthcare, replaced Immelt as CEO on 1 August.

Flannery is said to be considering a variety of options for GE, which has lagged behind its peers in share price and cashflow performance in recent years.

Though Flannery's plans for GE are uncertain, Burger maintains that GECAS' positioning within the GE family is sound.

"GECAS is a great GE business, not a great business, but a great GE business. We have had incredibly consistent returns, earnings, this ability to withstand cycles and then we have this industry that we all agree is growing and that is extremely global," he says.

The potential loss of human capital, though, does concern him.

"There is no more economic capital than human capital, and this is not specific to aviation. I saw this in real estate; there is a continued fight for the right people. That is one of the things that worry me," says Burger, who adds: "When it comes to people, it pays to be paranoid. I feel really proud that the turnover has been extremely low at GECAS, but I want to keep it that way."

GECAS finds extra gear with new sidecar

GECAS' decision to unveil a $2 billion sidecar vehicle on the first day of the Paris air show was a curious move: Air shows are traditionally used by lessors to unveil equipment orders, not financial arrangements with Canadian pension fund managers.

But like the show's order announcements, GECAS' sidecar with Caisse de dépôt et placement du Québec (CDPQ) was a long time in the making.

Sources indicate its final shortlist included three parties: a sovereign wealth fund, an insurance company and CDPQ.

GECAS had originally sought $500 million in equity to supplement $1.5 billion of debt it would source in the marketplace. However, CDPQ won the tender by offering to fund 90% of the debt and equity of the $2 billion transaction, thus removing any need for third-party help.

No doubt the vehicle ticks several boxes for GECAS, making it more competitive in a space crowded with new investors.

First, it allows GECAS to diversify its funding sources with low-cost capital. The aircraft-leasing sector continues to attract investors on the hunt for yield in a low-interest-rate environment, and cheap capital is crucial to compete with these new entrants, which are backed by attractive funding costs.

As part of the deal, CDPQ will provide money over four years to create an aircraft leasing and financing platform, Einn Volant Aircraft Leasing, EVAL, alongside GECAS. The pension fund indicates the $2 billion in funding could increase over time.

Of course, GECAS can access cash via its parent company and GE Treasury, but the lessor is prudent to diversify its sources. Memories are still fresh of the falling out between American International Group and International Lease Finance (ILF) during the 2008 financial crisis. Relationships with parent companies can change and additional pockets of cash could help mitigate any funding shifts.

Also, with a new GE chief recently appointed, and more changes on the cards, the vehicle gives GECAS funding certainty. John Flannery, who took over from Jeff Immelt on 1 August, is said to be considering a variety of options for GE, which has lagged behind its peers in share price and cashflow performance in recent years. With Flannery's plans for GE uncertain, GECAS is wise to secure additional capital to avoid a potential battle with other GE businesses for shared internal funding lines.

Backed by low-cost capital, EVAL also allows GECAS to better compete in the cut-throat sale-and-leaseback market alongside the placement of its new aircraft order positions.

A banking source notes that return expectations on the sidecar are likely to be "much lower" than GECAS' own return requirements, allowing the lessor to "compete with other lessors on tier-one airline names".

GECAS says EVAL enables it to "grow and overcome credit concentrations" because the lessor will not be funding on its own balance sheet.

"Given the size of aircraft transactions, you can quickly hit your risk appetite, and this allows us to manage our credit constraints while continuing to grow the business with new-technology aircraft orders," adds the lessor.

Indeed, the sidecar must have provided GECAS with the confidence to top up its orderbook at the 2017 Paris air show, after years of what its chief executive officer, Alec Burger, has called "elevated sales".

The lessor secured commitments for 100 Airbus A320neos, equipped with CFM engines, due to be delivered from 2020 to 2024.

It also unveiled plans to convert 20 of its current Boeing 737 Max 8 orders to the larger 10 variant. GECAS has orders for 170 Max aircraft and is the largest customer among lessors for the type.

In the past two years, GECAS has sold about $8 billion-worth of aircraft, even as rivals have significantly expanded their operations. These sales have included portfolio deals with Aviation Capital Group, Goshawk, China Construction Bank Leasing and, more recently, Avolon. That deal involved the $2 billion disposal of 45 units to the HNA-owned lessor.

Finally, the sidecar allows GECAS to rack up additional income by acting as a servicer for the new leasing platform.

"It's a perfect deal for GECAS," says a source commenting on the transaction. "Pension funds are searching for long-term stable income and, as aviation leasing matures, it is being viewed as quasi-infrastructure."

The deal marks the first aviation investment for CDPQ, an institutional investor which manages several public and para-public pension plans and insurance programmes in Québec.

A banking source notes that aviation leasing offers pension funds unlevered returns of 6.5% to 8%.

GECAS echoes this view of pension funds as natural aviation investors, noting that the $2 billion platform allows CDPQ to "target attractive aircraft leasing returns" in a post-crisis environment dominated by soft yields.

A lessor source points out that GECAS' return-on-equity ratios are likely to improve with the sidecar "all the while using other people's money, so what could make for a better deal?"

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