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What’s on the mind of GECAS’s leaders?

GECAS executives tell *Airfinance Journal* about the challenges and opportunities in the leasing and finance market.

In the more than 50 years since its initial aircraft lease, Norwalk, Connecticut-based GECAS has built up the biggest portfolio in global aviation. More than just aircraft, though, it has added a broad array of financial and other services to its core operating leasing offer in a bid to provide its customers the most tailored solutions possible. Debt finance, engine leasing, helicopter leasing and part-out are just some of its extra capabilities, while the lessor’s ongoing relationship with GE Capital means it is never short of funding.

Nonetheless, GECAS cannot afford complacency at a time when deep-pocketed competitors are expanding and eyeing greater market share. In response, the lessor has diversified its funding sources and established new relationships and customers in the fastest-growing air travel markets. At the same time, it has maintained a sharp focus on its core business of placing, monitoring and transferring aircraft to ensure customers retain their faith in GECAS’s ability to execute even the most complex leasing deals.

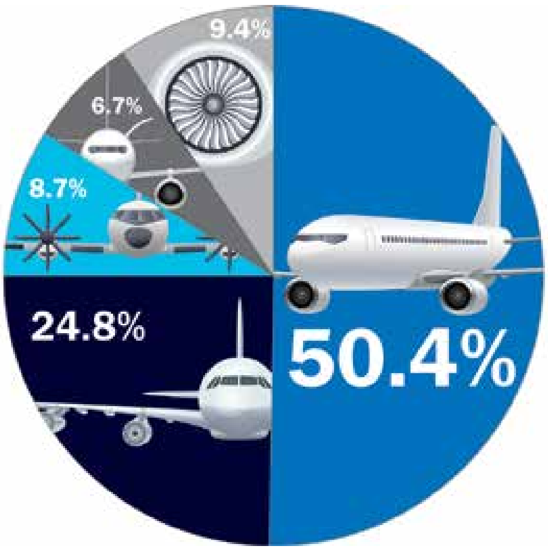
Here, in a roundtable discussion with *Airfinance Journal*, GECAS leaders outline the challenges and opportunities in their domains of the leasing and finance market. From booming emerging economies to Chinese trade tensions; from the rise of no-frills carriers in Latin America to consolidation in Europe; and from changing investor appetites to risk management, their thoughts provide a comprehensive overview of the global leasing market and how it might evolve in the coming decades.

Leasing has become a cornerstone of aircraft procurement, with about 40% of the global fleet now on operating lease. Can we expect such growth to continue and what does this mean for GECAS?

Declan Kelly, chief commercial officer, GECAS: Air traffic growth has proved to be remarkably resilient. Mature markets such as the United States and Europe may be expanding more slowly than in the past, but that’s more than compensated for by wider opportunities in other parts of the world such as China and the rest of Asia. With this global expansion of the industry there’s obviously a strategic opportunity for lessors to grow and serve commercial aircraft operators.

That said, the past few years have been a period of retrenchment for some of the big lessors. Our main competitors have tapered down their books with us, but now they are targeting growth and we need to grow alongside them. That’s not for vanity’s sake or bragging rights – we must remain in the top tier of competitors to stay relevant and keep our purchasing power with the OEMs [original equipment manufacturers]. If you’re just in the sale-and-leaseback market it’s difficult to give

GECAS portfolio by type (Q2 2018)



your customers what they want, when they want it. Also, if you're only competing for cheap money on sale and leasebacks, then that's a race to the bottom.

What really excites me about GECAS's future is that we can pursue multiple avenues for growth. We are looking to rebuild and, in fact, grow our aircraft under GECAS management with serviced entities which allow us to grow with more speed than using our balance sheet alone. In June, for example, we closed a $587 million asset-backed securitisation that covers 24 aircraft on lease to 16 airlines in 15 countries. From that we'll draw servicing fees and capital to pump into new acquisitions. Another example is Einn Volant Aircraft Leasing, our $2 billion sidecar with Caisse de dépôt et placement du Québec. Clearly, investors trust us to manage those assets effectively because of our unmatched pedigree in aircraft leasing and everything that brings with it: our technical acumen, our customer network and our success whatever the stage of the business cycle.

After a period of selling aircraft, what are GECAS's plans for its portfolio?

Alec Burger, president, GE Capital, and president and chief executive officer (CEO), GECAS: For the past few years GECAS has taken advantage of the tremendous sellers' market that has existed, but as we move forward GECAS is targeting growth. Over the next two to three years, our balance sheet will expand again after a period in which we were selling almost as much as we were originating. We weren't alone in that, however: in recent years other large lessors have taken advantage of the sellers' market to reduce their fleet sizes and clean up their portfolios.

As GECAS starts to grow again, will it be via direct orders, sale and leasebacks or portfolio purchases?

Burger: We're looking to deploy between $6 billion and $7 billion of capital in 2018 alone. That's a big number to satisfy so, yes, we may consider other portfolios. On the OEM side, our orderbook is heavily skewed towards narrowbodies. We have 10 Boeing 787s on order and the rest are Airbus A320s or Boeing 737s. When we look at supply and demand characteristics, we're very comfortable with that position. For widebody aircraft, we are currently satisfied with the returns we generate from sale and leasebacks, which have allowed us to maintain quite a strong widebody presence.

We will continue to monitor changes in the market to evaluate if a widebody new order makes sense for us in the future. Buying new aircraft from airlines makes less sense for narrowbodies, though, because the sale-and-leaseback market has become extremely competitive, resulting in fewer opportunities that will generate the profits we require. Our overall growth plan is a combination of sale and leaseback with the appropriate risk/reward balance, direct order and potential portfolio plays.

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GECAS is the world's largest lessor by fleet size and that scale clearly gives the company an unrivalled product offering. What else does the company provide airlines beyond traditional leasing?

Dan Rosenthal, executive vice-president (EVP), financing and products, president and CEO, Milestone Aviation: It may sound a bit clichéd, but GECAS genuinely does offer more than money. Serving well over 200 airlines around the world, there is no one-size-fits-all approach and we always focus on delivering solutions for each individual customer. A low-cost carrier in Latin America has a very different web of stakeholders and interests than one in North America and to meet any airline's specific needs – which are often more complex than a bare-bones purchase and leaseback – we have developed a toolkit of products and services unmatched in the industry.

That toolkit cracks open parts of the market that sometimes appear inaccessible to mainstream lessors. That's where our ability to adapt to a customer's individual financing needs is crucial. Our flexibility extends across the board. We can take on the larger and more complicated deals, offer a debt component, predelivery payments and forward commitments. We can leverage the scale of our portfolio and orderbook to rationalise fleets and keep them young. One way is at lease expiry, when we can offer a different aircraft rather than a lease extension. Meanwhile, our engine leasing business helps minimise down time.

Furthermore, our ability to reposition aircraft through our global network means we can offer take-outs — where an operator wants to replace existing equipment with, for example, Boeing 737 NGs to Max. Our scale allows us to find a new home for the NGs. All lessors can tap market liquidity to chase a one-off deal, but managing a portfolio of scale, building the expertise to serve each individual customer and sticking with them through multiple cycles – that's the value our customers rely on and that's what truly differentiates GECAS.

GECAS has launched some heavyweight sidecar vehicles for aircraft leasing in recent years. How do these alternative structures fit into the company's growth plans and are they a response to evolving demands from investors?

Greg Conlon, EVP, trading and business development, GECAS: In the global search for yield there are only a few big-ticket asset classes. Shipping, hydrocarbons and aircraft are probably the main examples and of those only the aircraft market has stayed strong. Aircraft leasing is a beacon for investors hungry 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. Institutional investors have plenty of capital-chasing investment and aircraft continue to offer them a greater risk-reward return than other opportunities in the current environment.

At the same time, investors have become more sophisticated and demanding. They are seeking opportunities that meet today's investment criteria, which means the asset-backed securitisations of the past may no longer be suitable. Of course, they still work for some, but the new serviced structures have more investor activity and allow for a broader range of portfolio management options. This has drawn in new players such as Canadian pension fund CDPQ, which chose us for its first-ever aviation investment – our $2 billion sidecar, Einn Volant Aircraft Leasing.

That is one of a few sidecar transactions GECAS has launched so far, and each has seen a tremendous amount of interest from the investment community. Pension funds, banks, sovereign wealth funds, insurance companies and others have lined up to partner with us given our global reach and servicing capabilities and that's great for long-term sustainability. More importantly, partner investors diversify our funding and give us access to cheap capital, which in turn allows us to stay competitive with other lessors and remain active in areas such as the sale-and-leaseback market. 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.

What is GECAS's approach to portfolio composition and credit risk, and how will this change as new-technology aircraft enter the global fleet?

Virginia Fox, chief risk officer, GECAS: GECAS has an investment framework that filters opportunities by asset, credit and country/region to manage the amount of risk we assume at the portfolio level. It's inevitable that some

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airlines will default, but prudent upfront risk management and our ability to work pro-actively with lessees when things go wrong coupled with the huge network of potential customers and our expertise in placing aircraft means that we are well positioned to manage any fallout.

At present, GECAS's portfolio comprises more than 50% narrowbodies and about 25% widebodies by fleet value, and is well diversified across all regions. Our longer-term portfolio plan is built with an eye toward technology, economic and demographic trends, as well as anticipated customer preferences. So this would take into account factors such as Asia's growing middle class, aircraft fuel efficiency and the ongoing spread of low-cost airlines, among many others.

Transactions are assessed within this overall portfolio plan, requiring GECAS to balance meeting purely financial targets with working towards our preferred future portfolio. If we do this right, we finish each year having both met financial targets and having strengthened our portfolio.

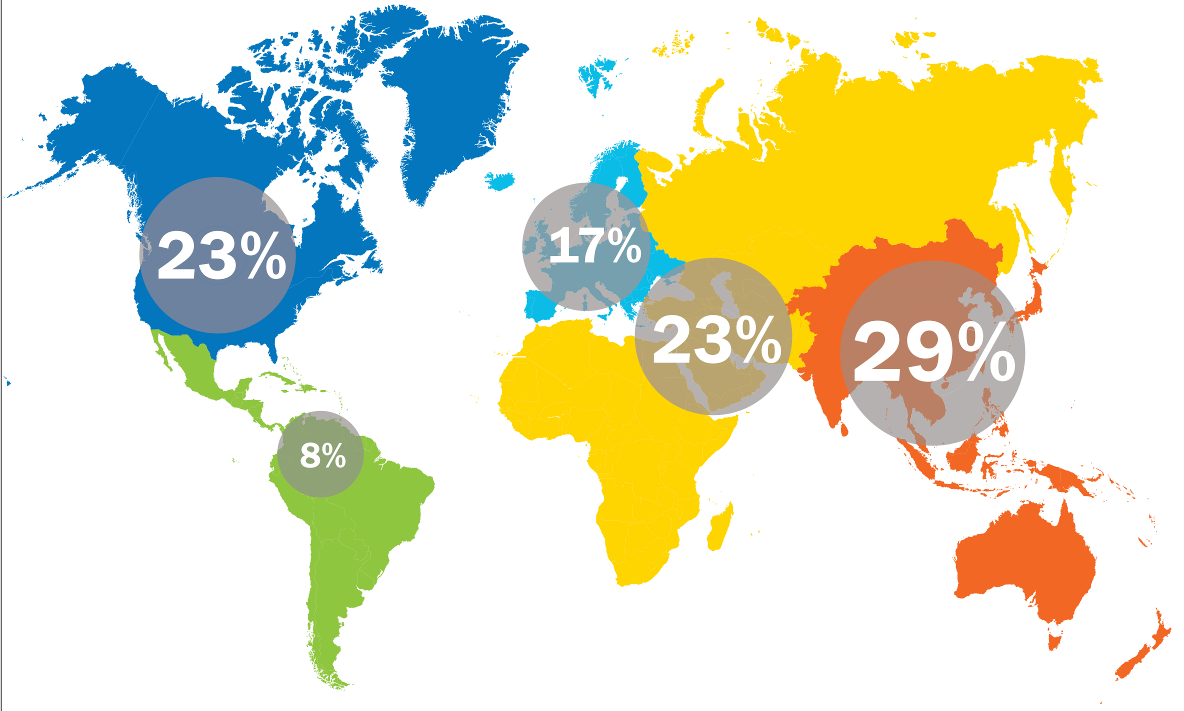
Why has GECAS supplemented its operating leasing with alternative asset finance solutions and what benefits do its customers gain from this?

Paul Meijers, president, PK AirFinance: GECAS may be most famous for operating leasing but our skills on the debt finance side are considerable. PK AirFinance has operated under GECAS since 2000 and has a portfolio of debt secured by 320 aircraft.

Asset-based lending by PK AirFinance is a great complement to our operating lease offering. Not only can we leverage the strength of GECAS's global network for asset management to give us a true asset-based focus, but also we can offer airlines multiple financing package solutions including debt on aircraft or engines along with our leasing offerings.

Many GECAS customers want a mix of debt and lease finance. Some airlines want to build up their balance sheets by investing in aircraft assets. More control of the ownership of their assets gives them more flexibility – for instance, to raise capital on unencumbered assets to pay for predelivery payments on new equipment. Airlines clearly appreciate our ability to provide this, and, as an example, Lion Air agreed a financing deal for 51 narrowbody aircraft with leases from GECAS and debt from PK AirFinance earlier this year. We have seen many airlines start their operations with leased aircraft but at some stage they want to build up their balance sheet and

GECAS fleet by region (Q2 2018)



start owning some assets – Easyjet is a good example. There are many ways to approach the financing of an aircraft and each airline will have its own criteria at various stages of its development. To meet these, PK AirFinance offers various structured financing solutions to airlines in addition to our offering to third-party lessors.

While working jointly with GECAS is an important part of PK's business, the biggest part is standalone financing to airlines and leasing companies, as sole lender, as part of syndicates, or on occasion in cooperation with junior lenders. Given its establishment in Japan – which goes back more than 20 years – PK has ample experience from tax-driven structures such as Japanese operating leases and Japanese operating leases with call options [Jolcos].

Through the unrivalled experience of GECAS in working worldwide, PK is very open to working in all types of jurisdictions. As an example, PK recently acted as majority co-lender in a Jolco transaction for an African flag carrier.

Alongside its aircraft business, GECAS has the largest engine leasing operation in the world. How do the dynamics of the engine leasing market differ and what do you expect going forward?

Tom Slattery, senior vice-president, engines, GECAS: Engine leasing is the structured financing and provisioning of spare commercial jet engines. It is still an evolving business and has additional dynamics to aircraft leasing. For one thing, there are far fewer players: engine leasing is still limited to a handful of independent lessors and the major OEM-affiliated leasing companies, which have a large market share.

Another big difference from aircraft leasing is the demand cycle for spare engines. Aircraft demand is driven by fleet replacement and passenger travel growth. Typically, equipment is retired and replaced with new on 20- to 25-year cycles. Spare engine demand, on the other hand, is influenced by reliability and maintenance cycles. In addition, useful lives can be significantly longer with older engines having the same utility value as new engines of the same type.

Despite our connection to GE, GECAS leases engines from all commercial engine manufacturers. At the same time, we are the market leader for GE equipment. GECAS and our sister company, Shannon Engine Support, provides spares to all of GE Aviation and CFMI's customers. For example, GECAS has a significant investment in the newest technology LEAP 1A and LEAP 1B engines supporting the entry-into-service programme. These engines are also available for commercial lease. In time, that will prove a significant advantage because the LEAP engine is present on about two-thirds of new narrowbody aircraft. OEMs, through their maintenance agreements, are taking reliability responsibility, including spare engine provision, as necessary. This reduces the impetus for airlines to buy their own spares and makes the lessors' relationship with the OEM a key channel to market.

Looking ahead, we foresee some new entrants to the leasing business. As mobile assets with predictable returns and durable values, engines appeal to institutional investors, although new players should be wary of the daunting technical barriers to entry. Maintenance is a much more significant part of the value equation than it is in aircraft leasing and there are a vast array of engine builds and upgrades. Airlines today are also more willing to take risks with spares because of improved engine reliability and a deeper market for short-term leases. Overall, though, I welcome new entrants. They provide more funding options and increase liquidity, which are net positives for the engine leasing market.

To what extent have emerging markets taken off in recent years and is there a risk of over-heating in these economies' air travel markets?

Mike Jones, EVP, emerging markets, GECAS: It's difficult to overstate the importance of emerging markets to GECAS. We have 453 owned and managed aircraft with operators in emerging markets, which is about the same exposure we have to the US and almost twice our aircraft count in Europe.

Clearly, the market has its own characteristics and one must consider risks related to credit, jurisdiction and currency – to name a few – but we manage these with a very diverse customer base of 129 operators, versus just 21 in the US. To ensure quick responses and better understanding of those customers and their markets, we have 99 employees spread across many regional offices.

As in most other regions, low-cost carriers have stimulated massive traffic growth in emerging markets, with airlines such as Airasia, Indigo, Lion Air and Vietjet having a huge impact. Crucially, these and others are still getting more first-time passengers in the air, whereas in places such as Europe and the US annual traffic increases are more sedate. Accordingly, emerging markets have been a huge growth engine for GECAS over the years as we shift focus from the more mature regions to faster-growing ones.

Given that long-term growth in emerging markets is driven by demographics, a ballooning middle class and, still, a low ratio of aircraft to people, the potential for leasing in such regions remains enormous. Other factors include the relative paucity of alternative transport options and, often, a lack of land transport routes. Big risks remain, of course, notably currency volatility, yield pressures and infrastructure demands. Therefore, it's essential to understand local markets well – and we have 19 nationalities working in our Singapore office to do just that – but the upside and long-term potential cannot be ignored by any successful lessor.

Where do you see opportunities in Europe and Canada, and how much difficulty have airline bankruptcies plus Brexit uncertainty caused GECAS?

Declan Hartnett, EVP, Europe and Canada, GECAS: The past 12-18 months have seen a bit of turbulence for European carriers, notably a bankruptcy administration at Alitalia and failures at Monarch and Air Berlin. Bringing our technical abilities to bear in support of redeployment of our aircraft at Air Berlin and with their strong cooperation, we completed the transition and repositioning of our fleet there with alternate carriers in a remarkably short space of time. Given our belief there will be a flag carrier for a market as large as Italy and that with the appropriate ownership and cost structure Alitalia could be a very viable enterprise, GECAS is keen to see them succeed.

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While part of a natural evolution of the industry, these failures have led to others picking up market share, notably Lufthansa, Easyjet and Ryanair. Europe appears to be approaching its next big round of consolidation with all three of its big network airline groups – Air France-KLM, Lufthansa and IAG – positioning themselves accordingly. The result might be greater customer concentration for GECAS in Europe, but consolidation also benefits us since we are one of only a few lessors with the scale and product choice to meet all the requirements of massive carriers.

Changes are a natural part of the industry, but with the scale, expertise and relationships we've developed at GECAS, we're able to support our customers to promote the best possible outcomes regardless of the situation.

That said, Brexit remains a worry because time is running out for negotiations and a no-deal scenario would cause extraordinary disruption to UK flights and Airbus production. However, I think the industry is confident that some form of aviation arrangement will be reached – the alternative is almost inconceivable!

How are Chinese operators meeting passenger demand and what obstacles to growth do recent geopolitical tensions pose in the country?

Li Liu, EVP, Greater China, GECAS: China has been a growth engine for the leasing industry for many years and its airlines account for about one-quarter of GECAS's leased portfolio. Although traffic is not increasing at quite the rate of a decade ago, in recent years China's airline sector has still boasted doubled-digit growth that is the envy of most other countries. This is great news for lessors, although competition for deals remains fierce.

Many of the new entrants to leasing are from China and most focus on leasing to Chinese airlines. Furthermore, most are backed by financial institutions with extremely deep pockets and a hunger to scale up their fleets rapidly. This combination has made it difficult for more cautious players who are taking a long-term approach to competing in the sale-and-leaseback market.

It is unclear how the current China/US trade dispute will impact the aviation market because the tariffs imposed by China have not yet impacted Boeing. What is certain, though, is that China will require huge numbers of additional aircraft in the next decades – demand that will be too high for Airbus to satisfy alone, even if supplemented by the Comac C919, which will need another few years to deliver. Therefore, it isn't feasible for Chinese airlines to rely on one source only; to grow they will need Boeing aircraft and the 737 Max in particular, and if China imposes a tariff it will only hurt its own airlines in the near term. That said, if the trade war doesn't stop, it will damage not only Chinese airlines but also Boeing and other American OEMs because China is sure to remain one of the world's largest aviation markets.

Where are the main opportunities for GECAS in the highly developed US market?

Chris Damianos, EVP, US, GECAS: The US is a very mature market and while growth is not as aggressive as in other regions, given the scale of the overall US fleet even an incremental rise from the base is meaningful. It creates significant demand and provides opportunities to keep lessors very active. As the largest lessor in the US, with more than 450 aircraft positioned with most of the operators and a history dating back more than 30 years, our footprint is substantial. The GECAS track record and credibility is noteworthy and one which airline operators look to for certainty of execution.

Not only does our new orderbook support the fleet needs of airlines, but also our long-term relationships provide us insight into the specific requirements of each operator and the opportunity to provide customised solutions that truly meet their needs as those needs evolve. With rising fuel prices, for instance, we're detecting a growing appetite for new aircraft from US airlines and we're well placed to meet that with our big orderbooks for re-engined Boeing and Airbus narrowbodies.

In contrast, until about a year ago a feature of the US market was demand for mid-life aircraft as airlines sought to fill capacity gaps at lower lease rates and take advantage of relatively low oil prices. GECAS classifies about one-third of its narrowbody fleet as mid-life, which matches up pretty well with the number of US-based narrowbodies in the same bracket.

Despite recent trending towards newer models, mid-life aircraft are still popular and we welcome opportunities to acquire them. If airlines want to shed 12-year-old narrowbodies to replace them with newer aircraft then we are very interested in picking up any well-maintained 737NGs or A320s. Once you refresh the interior and the aircraft has the latest IFE [in-flight entertainment] and wi-fi, it becomes a great value proposition for airlines.

It works for us, too, because we have various end-of-life options that offer reassurance for residual values. Our subsidiary, Asset Management Services, supplies the booming market for used serviceable material, and they tell me there's not enough end-of-life aircraft on the market to keep them satisfied. Another outlet for mature equipment is freighter conversion, which can feed further lease revenues because GECAS is the world's biggest lessor of freighters.

How much momentum is left in the growth of low-cost carriers (LCCs) in Central and South America and what factors might constrain the development of these LCCs?

Luis Da Silva, SVP, Latin America and Caribbean, GECAS: In Latin America there are two different dynamics at work. Brazil and Mexico have well-established low-cost sectors where LCCs account for the majority of departing seats. Given the size of those countries it's unsurprising that Gol and Azul in Brazil, as well as Volaris, Interjet and Viva Aerobus in Mexico, are among the biggest and most successful LCCs in the region. Meanwhile, in Colombia, Peru, Chile and Argentina a new wave of start-ups is following the ultra-low-cost model pioneered by the likes of Spirit in the US. These include Wingo in Colombia, the Viva group in Colombia and Peru, Jetsmart and Sky Airline in Chile, and Flybondi in Argentina. European carrier Norwegian also plans to start operations in Argentina.

The business case for these airlines rests on the fact that air travel in South America is still expensive compared with other parts of the world. Yet its growing middle class wants and needs affordable air travel because of their own aspirations and the huge distances between major population centres. Until now many have relied on long-distance buses – there isn't much rail infrastructure – but the new wave of airlines is trying to tempt them off these by offering comparable fares.

All the new ultra-low-cost carriers have big ambitions, but some are still to start operating while others only have a handful of aircraft. If they are going to become a significant demand source for aircraft they will have to overcome multiple challenges in the region. Airport infrastructure is limited and most of the most popular airports are slot-constrained. On top of that, there are very high departure taxes and fuel levies, which limit their ability to cut fares and stimulate new business.

There is no open-skies policy in the region either, which presents another hurdle – liberalisation in Europe underpinned the massive success of LCCs there and Latin America would greatly benefit from something similar. Another concern is currency fluctuations, which can be hugely damaging for a new operator's bottom line, especially because they tend to rely on leased aircraft paid for in dollars.

What about the big picture: how do the nuances of each regional market combine to inform GECAS about global aircraft demand through the next decade?

Burger: I don't expect any problems finding leasing customers for our aircraft. Airlines across the board look strong and demand for aircraft remains solid. Our current portfolio and orders are for the most in-demand new-technology aircraft that have a large customer base. On top of that, our success and longevity in the industry has been — and will continue to be — the domain expertise of our team.

GECAS wins deals by leveraging its relationships, focusing on larger tenders our competitors can't win, and using our key advantage of breadth of service. Nothing will change in those respects.

Above & Beyond

GECAS provides clients across the globe with deep domain expertise and the broadest offerings in aviation finance.

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