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Virgin Australia's A$1bn revamp should give Avation a lift

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The company's major customer has received a big financial boost.

The UK-listed plane leasing firm Avation PLC (LON:AVAP) should be a beneficiary of the restructuring of Virgin Australia, according to analysts.

Virgin is slashing costs and strengthening its balance sheet with an injection of A$1bn from its major shareholders.

It is also performing a 'pivot' (a forced strategy change to you and me) to focus on opportunities in China.

So far as Avation is concerned, Virgin Australia is the firm's largest revenue source, although its overall impact on the group is reducing as the lease portfolio grows.

The key for the London-quoted group is the significant strengthening of Virgin's balance sheet and, by extension, the receding credit risk posed by the airline.

This alone should positively affect both Avation's share and bond price.

Consider this too: Virgin's new Chinese investors provide expansion opportunities as well as capital, which should bode well for aircraft leasing companies such as Avation.

One analyst, who did not wish to be named, told Proactive: "While Avation, as it has added scale over the past year, has reduced its concentration risk with Virgin Australia, the improved financial position of Virgin Australia is extremely positive for Avation's risk profile."

At 11am, the shares were in a holding pattern as they changed hands for 137.3p each, which values the business at just under £78mln.

The company has a very specific niche – single aisle, twin engine planes such as the Airbus 320 and the French-Italian ATR 72 600, used by 75% of the world's carriers for short-haul trips. The latter makes up two-thirds of the company's fleet.

The firm has a fleet of 39, and as well as Virgin Australia its client roster includes Air France, Britain's FlyBe, holiday firm Thomas Cook and Air Berlin.

Companies such as Avation, and its American rivals Airlease, Aircastle and Avolon, will acquire an aircraft then lease it on – the airline will then take care of all the maintenance.

The skill comes in sourcing the finance, the right aircraft and mitigating the risks involved with the transaction.

The model, when stripped down, is a little like the template used by property firms.

Avation finances its acquisitions using 75% senior, secured bank debt. A typical plane might be leased on the basis of repaying back to Avation around 144% of the acquisition price over the 12 years of a contract.

The aircraft can then be leased out for another 12 years, albeit at lower rate than a brand-spanking-new airliner.

Somewhat counter-intuitively though (and a quirk of depreciation rates versus lease income), the older models yield more than the new inventory.

Avation mitigates the risk posed by a sharp rise in interest rates by borrowing over the term of the lease, rather than over two or three years and constantly refinancing. That way it always knows it will receive more in lease payments than it shells out to the banks.

The banks, meanwhile, are keen to finance leasing deals because a new plane appreciates in value when it is leased out.

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[http://www.proactiveinvestors.co.uk/companies/news/127153/virgin-australia-s-a1bn-revamp-should-give-avation-a-lift-127153.html]