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# Avation Interview - Is Aircraft Leasing on the Ascent? - Master Investor

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*As seen in this month's issue of Master Investor Magazine.*

*An Interview with Richard Wolanski, Finance Director of Avation.*

**Master Investor: Good morning, Richard, and thanks for taking the time to give our readers an opportunity to get to know**

**Avation (AVAP) better. Could you begin by giving our readers a brief overview of Avation and its history for the benefit of the uninitiated?**

***Richard Wolanski:*** *Avation PLC (AVAP) is a Singapore based commercial aircraft lessor. The company owns a fleet of 29 commercial passenger aircraft which are on operating leases to seven airlines in the Asia/Pacific region and Europe. Aircraft are typically leased to airlines for periods as long as 12 years, resulting in high visibility of future earnings.*

*The company was founded in 2006 by Executive Chairman Jeff Chatfield, the former Executive Chairman of a regional Australian airline, Skywest Airlines. Avation was originally formed to provide leasing facilities to Skywest. When Skywest was acquired by Virgin Australia in 2013, this provided Chatfield with the time and focus to evolve Avation into a high-growth global aircraft-leasing company. While the company had developed a very profitable business model, the step into the global leasing market resulted in high fleet-growth and a dramatic increase in revenues and earnings in recent years.*

*Avation is about to enter the fastest phase of fleet-growth in the history of the company, with contracts in place set to expand the fleet by at least 60% over the next 18 months.*

**MI: Warren Buffett famously observed that the airline industry as a whole has never made a profit. Nevertheless, the International Civil Aviation Organization estimates that air**

**travel is set to double over the next fifteen years. Would it be fair to describe Avation as a 'picks and shovels' play on that growth? What specific attributes does the aircraft leasing business have that are attractive to equity investors?**

***RW:*** *The airline industry has endured a difficult 15-year period but proved to be resilient in the face of high fuel prices and business cycle downturns, as well as exogenous factors such as the terrorist attacks of 9/11 and international epidemics such as SARS and Ebola. This resilience has been driven by a doubling of passenger traffic in the same period, which has resulted in high demand for new aircraft, with the trend set to continue for the longer term. As such the aircraft leasing industry has benefited from the dual drivers of a requirement for much greater numbers of aircraft but also a trend for airlines to prefer leasing aircraft over owning assets. Most people are unaware that today every second new aircraft delivered to airlines is owned by an aircraft leasing company. This is beyond 'picks and shovels'; this is an industry shift such that aircraft lessors are now intrinsic in the supply of assets to the industry.*

*For equity investors, our business is able to provide the holy grail of both high profitability and high growth. Investors have a tangible connection to aircraft assets and have the comfort of knowing the assets of which they are the effective owners. These assets are deployed for long-term leases to generate long-term returns. Our fleet growth is highly visible through announcements of new aircraft being added to the fleet every 6-8 weeks, so investors will have regular confirmation of the building of our business. They also know that while many airlines themselves may not always be profitable,* *Avation, and indeed the aircraft leasing industry as a whole, has a very strong history of growth and profitability.*

**MI: In order to give readers a feel for the mechanics of the business, can you take us through, step by step, the life cycle of a typical lease contract?**

***RW:*** *Our business model is very simple. Aircraft have an economic life of around 25 years. Income is earned on the lease rate (which may be contracted for up to 12 years), less expenses related to the depreciation of the aircraft over time as well as the financing costs related to the acquisition and capitalisation of the aircraft fleet and the administration of the leasing operations. As a result, the long-term, fixed-rate cash flows generated by the leasing model lend themselves to relatively high earnings visibility. After the initial lease period the aircraft are re-leased or can be sold. Avation's business model is such that the aircraft are typically fully owned before the first lease has expired, which is less than half way through the asset's economic life. The aircraft can then generate unlevered returns for the remainder of its life or can be refinanced to release capital to fund further growth.*

*It is important to note that the airline is responsible for all other costs including maintenance, insurance, fuel, pilots and crew.*

**MI: Nineteen out of the 29 aircraft that make up the current Avation fleet are ATR-72s, and the firm has orders for a further ten of these aircraft. What is it that makes the ATR-72 so attractive to Avation and its customers?**

***RW:*** *Avation was instrumental in introducing the ATR-72 aircraft to the Asia-Pacific region as a result of its leasing activity with Virgin Australia, and the company is the second largest ATR lessor in the Asia-Pacific region.*

*The ATR-72 is the best-selling under-90-seat regional aircraft in the world since 2005. ATR has sold more than 1,500 aircraft since its inception generating more than 25 million flight hours. ATRs are currently flown by over 190 operators in more than 90 countries at more than 5,000 flights per day.*

*Since introducing the ATR-72 model in 1988, ATR has delivered 750 ATR-72s world-wide, and the model has proven to be a cost-effective short-haul aircraft with high residual value. Demand for the ATR aircraft has led to a current production backlog of 300 aircraft (90% of which comprise ATR-72s), or more than three years at the current production rate.*

*Looking beyond the contracted growth of 11 aircraft before the end of 2016, Avation also holds options on 22 additional ATR-72s that the company can exercise starting in 2017. These further aircraft will be a source of meaningful growth over the next several years and continue to support Avation's growth story.*

**MI: Lessors have been big beneficiaries of cheap liquidity in recent years. With interest rates looking set to begin to rise from historic lows – and with the cost of debt being the group's single largest operating expense – how is Avation positioning itself for such a development?**

***RW:*** *Because lease rates are generally fixed over the term of the lease, financing also tends to be fixed rate. This means that each aircraft when financed and deployed has no exposure to interest rate rises over the term of the lease.*

*Over the longer term the industry has seen lease rates increase with increased interest rates as typically improving economies result in better economics for airlines which in turn drives demand for aircraft and resultant lease rates. A fundamental objective of the business is to protect the net margin (the difference between the lease yield on the asset and the cost of debt used to acquire that aircraft), which is supported by the correlation between lease rates and interest rates.*

**MI: Historically, Avation has been very reliant on a single customer (Virgin Australia/Skywest). However, more recently the company has been successful in diversifying its customer base. How is the firm currently positioned in terms of its customer base and its geographical footprint, and how can we expect these to evolve in future?**

***RW:*** *Given the origin of the company the concentration with Virgin Australia is understandable. The strong order book for the next year will see a minimum of the next seven fleet additions to other airlines, thereby significantly reducing this concentration through natural growth. A key goal of the company is to continue to add new airline customers to continue diversification of revenue sources. Virgin Australia are a strong, profitable well run airline in a friendly jurisdiction, so we look forward to continuing to supply aircraft in the* *future as the airline continues to grow, as we do with all our partner airlines.*

**MI: Speaking of evolution, Avation recently successfully accessed the US debt markets for the first time and raised US$100m. How significant is this for the company's future?**

***RW:*** *This is a great question. The successful US debt issue is a massive step forward for the company. Aircraft lessors use debt to fund aircraft purchases and the US bond market is the largest wholesale debt market on the planet. The successful debt issue means that Avation has all but eliminated the financing risk associated with the aggressive fleet growth that it has contracted over the next 18 months, and also has a future source of funding from 2017 and beyond. This means that we have the planes ordered, the airlines waiting to take delivery of them, and we now have the financing to fund the 11 aircraft on order. Furthermore we have the ability to access capital to grow beyond the 11 contracted aircraft we have for delivery by the end of 2016, so our growth could easily exceed our expectations through opportunistic acquisition of additional aircraft.*

**MI: According to the International Air Transport Association, returns from leasing aircraft were 9% a year on average from 2004 through 2011, while those from running an airline were just 4%; and yet it is the latter that captures the imaginations of investors. Is there anything on the horizon that could change investors' perceptions of the aircraft leasing industry?**

***RW:*** *I think it simply comes down to investor awareness. Our experience is that a significant proportion of investors have very little knowledge or understanding of the aircraft leasing industry even though on a yearly basis it funds approximately US$60 Billion of aircraft purchases. I would invite investors to review our financials which can be found at [www.avation.net](http://www.avation.net) and they will see that our returns have historically been significantly higher than the industry average.*

*In the last couple of years we have looked for new methods of building investor awareness with an increasingly sophisticated retail investor market and have found events like Master Investor and direct to investor publications such as this an increasingly important mechanism for building investor awareness.*

**JF: Many industry commentators and participants believe that M&A activity is likely to accelerate in the sector in the coming years. Is Avation significant enough to become a target, or indeed might it even play the role of consolidator itself?**

***RW:*** *Avation is focused on delivering its bold growth targets to deliver continued revenue and earnings growth for shareholders. As it does this there is real potential for economies of scale to improve shareholder returns. Our role is to maximise shareholder returns through increased earnings and dividends and provide liquidity as we grow. We believe there is enough organic growth in our industry for years to come. As for the aspirations of the other players, I can't comment.*