

BUY

Price **132p**

Target Price **206p**

Reuters/BBG AVAP.L / AVAP.LN
 Index FTSE AIM
 Sector Diversified Financials
 Market Cap £70m
 Shares in Issue 52.4m
 NAV \$111m
 Gearing 2.3x
 Interest Cover 2.0x

| Performance | All-Share | Sector |
|-------------|-------------|--------|
| 1 month: | -6% | -5% |
| 3 months: | +8% | +3% |
| 12 months: | +44% | +25% |
| High/Low | 165p / 102p | |

Key Data:

EPS CAGR 3-year 61%
 ROAE 12.7%
 Free Cashflow Yield n.a

Last Results Sep 2014

Next Results Feb 2014

Next Event AGM Nov 14



Source: Capital IQ

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*WH Ireland acts as Broker to this company

Marketing Communication

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Avation *

Jet aircraft deal, change in depreciation policy, earnings upgrade

Avation, the aircraft leasing business, has announced it has entered into conditional agreements for the purchase and lease of two new Airbus A321 aircraft with Thomas Cook Airlines Limited. It will also be changing its depreciation policy to bring it closer into line with its peer group. The impact of the depreciation policy change on reported numbers is expected to be minimal whilst the aircraft deal will be earnings enhancing in FY16. Our FY15 PBT estimates remain unchanged although we have slightly upgraded EPS to reflect recent purchases of shares in Capital Lease Aviation. We have increased FY16 PBT by \$1m. We retain our buy recommendation and TP of 206p.

- Avation has entered into conditional agreements for the purchase and lease of two new Airbus A321 aircraft with Thomas Cook Airlines Limited. The aircraft are comprised of a part of Thomas Cook's previously announced fleet renewal program. The aircraft are due to be delivered new from Airbus in February and March 2016. The term of the leases is initially 12 years (longer than Avation's normal 10 year term) with further 6 year options, with the revenue from the leases at typical commercial lease rates.
- This is the biggest deal in Avation's history and is also important strategically as it moves its business into the jet market which is over fifty times the size of the turboprop market where the group's recent growth has been focused. The cost of the two planes will be around \$100m. We expect the yield from the aircraft will be slightly lower than for the turboprop aircraft, however because of the large size of the deal we anticipate that the group will be able to fund this at more attractive rates than the average on its current portfolio resulting in the net yield on investment being broadly similar. A321's are popular aircraft with good residual values. Assuming the aircraft are delivered on time we estimate the deal will enhance PBT by around \$1m in 2016 and by around \$3.8m in a full year. This equates to approximately a 20%-25% increase in assets, revenue and earnings compared to FY14 and is in addition to the 8 ATR's expected to be delivered before the end of FY15.
- Avation is changing its depreciation policy to depreciate new aircraft over a useful life of 25 years to an estimated residual value based on 15% of new cost. When Avation buys second hand aircraft, it will depreciate the cost of the aircraft over the remaining period to 25 years from the date of manufacture to estimated scrap value. The previous policy involved useful lives of 30 years. We calculate the impact from reducing the length of depreciation on a new aircraft by 5 years will almost entirely (98%) be offset by the increase in residual value.

Continued...

| Y/E June (forex £/\$ 1.61) | 2013A | 2014A | 2015E | 2016E |
|----------------------------|-------|-------|-------------|-------------|
| Revenue (\$m) | 42.7 | 52.3 | 63.1 | 79.2 (76.0) |
| Adj. PTP. (\$m) | 14.0 | 16.6 | 21.2 | 24.2 (23.2) |
| Adj. EPS fd.(¢) | 23.2 | 27.4 | 34.9 (34.2) | 40.9 (37.2) |
| P/E (x) | 9.2 | 7.8 | 6.1 | 5.2 |
| EV/EBITDA (x) | 9.1 | 7.3 | 8.4 | 8.5 |
| DPS (¢) | 1.8 | 2.0 | 2.2 | 2.4 |
| Yield (%) | 0.8 | 0.9 | 1.0 | 1.1 |
| NBV (¢) | 201 | 227 | 254 | 293 |
| Price / Book | 1.1 | 0.9 | 0.8 | 0.7 |

Source: WH Ireland estimates

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- Avation has continued to buy shares in CLA its quoted subsidiary with its shareholding now increased to over 95%. We anticipate the group will raise its stake further and in due course will de-list the business which should lead to future cost savings. The acquisition of shares enhances NAV and earnings with the additional cost of financing the shares more than offset by the reduction in minority charge and other likely cost savings. The boost in Avation's balance sheet should also be positive for its borrowing capability and costs.
- Avation currently trades at a discount to its peer group on most metrics. Aircraft leasing businesses are most commonly valued in relation to NBV. We estimate Avation currently trades on 0.9x 6/14 NBV (c.f. 1.1x sector average) falling to 0.8x in FY15. However, Avation currently has options over 27 new ATR aircraft (in addition to the 5 deliveries scheduled in FY15) taking fleet growth potentially to over 60 aircraft. These are currently shown as having no value in its balance sheet however two planes were sold during the year for an estimated profit in excess of US\$1.4m each implying assets could be understated by around \$38m (c.f. FY14 NBV of US\$111m).
- We estimate Avation currently trades on a forward P/E of 6.1x this compares with most US peers on a June 2015 P/E of 7-13x and none of those peers has the Avation growth trajectory. Our base case estimates do not include any jets other than the A321's that Avation might acquire through sale and leaseback of new aircraft from airlines or purchase off other lessors with leases attached which could represent further upside.

Financial Estimates

Income Statement

| Year end June | 2013A | 2014A | 2015E | 2016E |
|--|--------------|---------------|---------------|---------------|
| | (\$m) | (\$m) | (\$m) | (\$m) |
| Revenue | 42.7 | 52.3 | 63.1 | 79.2 |
| Cost of sales | -0.8 | 0.0 | 0.0 | 0.0 |
| Gross profit | 41.9 | 52.3 | 63.1 | 79.2 |
| <i>Gross margin</i> | <i>98.1%</i> | <i>100.0%</i> | <i>100.0%</i> | <i>100.0%</i> |
| Other income | 1.8 | 4.0 | 0.0 | 0.0 |
| Total income | 43.8 | 56.3 | 63.1 | 79.2 |
| Admin & Op.expenses (excl. D.A.) | -5.4 | -7.6 | -6.0 | -6.5 |
| Other | 0.0 | 0.0 | 0.0 | 0.0 |
| Adj. EBITDA | 38.3 | 48.7 | 57.1 | 72.7 |
| Depreciation | -11.4 | -15.3 | -18.0 | -23.2 |
| Adj. EBITA | 27.0 | 33.5 | 39.1 | 49.4 |
| Amortisation | 0.0 | 0.0 | 0.0 | 0.0 |
| Adj. Operating profit (EBIT) | 27.0 | 33.5 | 39.1 | 49.4 |
| Net interest | -13.0 | -16.9 | -17.9 | -25.3 |
| Adj. Profit before tax | 14.0 | 16.6 | 21.2 | 24.2 |
| Taxation | -2.0 | -2.3 | -2.1 | -2.4 |
| Adj. Profit after tax | 12.0 | 14.3 | 19.1 | 21.8 |
| Non-controlling interest (CLA 95% owned) | -1.4 | -1.0 | -0.8 | -0.3 |
| Adj. Profit attributable | 10.5 | 13.3 | 18.3 | 21.5 |
| Av. shares in issue (Diluted) | 45.2 | 48.6 | 52.3 | 52.4 |
| Av. shares in issue (Basic) | 45.2 | 48.6 | 52.3 | 52.4 |
| Y/E shares in issue | 48.8 | 48.8 | 52.4 | 52.4 |
| Adjusted EPS (Basic) | 23.2 | 27.4 | 34.9 | 40.9 |
| Adjusted EPS (Diluted) | 23.2 | 27.4 | 34.9 | 40.9 |
| Reported EPS (Diluted) | 23.2 | 27.4 | 34.9 | 40.9 |

Source: WHI Estimates

Financial Estimates (Cont...)

Cash Flow

| Year end June | 2013A | 2014A | 2015E | 2016E |
|---|---------------|--------------|---------------|---------------|
| | (\$m) | (\$m) | (\$m) | (\$m) |
| PBT | 14.0 | 16.6 | 21.2 | 24.2 |
| Add back Interest | 12.4 | 16.6 | 17.9 | 25.3 |
| Add back associates | 0.0 | 0.0 | 0.0 | 0.0 |
| Operating profit | 26.4 | 33.2 | 39.1 | 49.4 |
| Add back Depreciation | 11.4 | 15.3 | 18.0 | 23.2 |
| Add back Amortisation | 0.0 | 0.0 | 0.0 | 0.0 |
| Add back Share option charge | 0.0 | 0.0 | 0.0 | 0.0 |
| EBITDAS | 37.7 | 48.4 | 57.1 | 72.7 |
| Other / Exceptional | 1.9 | -2.7 | 0.0 | 0.0 |
| Operating profit before WCAP | 39.6 | 45.7 | 57.1 | 72.7 |
| Movement in working capital | -2.1 | -2.3 | 1.5 | 2.3 |
| Net cash flow from operating activities | 37.5 | 43.4 | 58.6 | 75.0 |
| Net interest | -11.1 | -14.9 | -17.9 | -25.3 |
| Tax paid | -1.0 | -0.9 | -2.1 | -2.4 |
| Net cash from operating activities | 25.4 | 27.6 | 38.6 | 47.3 |
| Net capital expenditure | -134.1 | -32.8 | -160.0 | -180.0 |
| Purchase of intangibles | 0.0 | 0.0 | 0.0 | 0.0 |
| Free cash flow | -108.7 | -5.2 | -121.4 | -132.7 |
| Net acquisitions & disposals (tangible) | 1.1 | -1.1 | 0.0 | 0.0 |
| Net acquisitions & disposals (intangible) | 0.0 | 0.0 | 0.0 | 0.0 |
| Ordinary dividends paid | -0.7 | -0.9 | -1.0 | -1.1 |
| Dividends to / from subsidiaries and associates | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | -7.7 | -0.5 | 0.0 | 0.0 |
| Forex | 0.0 | 0.0 | 0.0 | 0.0 |
| Share issue | 6.6 | 0.3 | 4.1 | 0.0 |
| Change in net cash | -109.4 | -7.4 | -118.3 | -133.8 |
| Opening net Cash (Debt) | -134.4 | -243.8 | -251.3 | -369.6 |
| Closing net Cash (Debt) | -243.8 | -251.3 | -369.6 | -503.4 |
| Movement on Net Assets | 2013A | 2014A | 2015E | 2016E |
| | (\$m) | (\$m) | (\$m) | (\$m) |
| Opening net assets | 82.2 | 98.2 | 110.8 | 132.9 |
| Profit for the year | 12.0 | 14.3 | 19.1 | 21.8 |
| Dividends | -0.7 | -0.9 | -1.0 | -1.1 |
| Goodwill / Forex | 0.0 | 0.0 | 0.0 | 0.0 |
| Share issue | 6.6 | 0.3 | 4.1 | 0.0 |
| Share based payment | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | -1.8 | -1.1 | 0.0 | 0.0 |
| Closing Net Assets | 98.2 | 110.8 | 132.9 | 153.6 |

Source: WHI Estimates

Financial Estimates (Cont...)

Balance Sheet

| Year end June | 2013A | 2014A | 2015E | 2016E |
|--------------------------------------|--------------|--------------|--------------|---------------|
| | (\$m) | (\$m) | (\$m) | (\$m) |
| Cash | 19.6 | 23.4 | -94.9 | -228.7 |
| Trade receivables | 6.3 | 2.8 | 3.8 | 5.3 |
| Prepayments | 1.1 | 2.2 | 2.2 | 2.2 |
| Inventories | 0.0 | 0.0 | 0.0 | 0.0 |
| Current assets | 27.1 | 28.4 | -89.0 | -221.3 |
| Goodwill and intangibles | 2.4 | 2.4 | 2.4 | 2.4 |
| Property plant & equipment | 347.2 | 367.3 | 509.3 | 666.1 |
| Trade & other receivables | 17.7 | 17.6 | 17.6 | 17.6 |
| Non current assets | 367.3 | 387.3 | 529.3 | 686.0 |
| Total assets | 394.4 | 415.6 | 440.3 | 464.8 |
| Borrowings | 24.2 | 55.7 | 55.7 | 55.7 |
| Trade and other payables | 12.1 | 12.6 | 15.1 | 19.0 |
| Current tax liabilities & provisions | 4.7 | 1.1 | 1.1 | 1.1 |
| Other | 0.2 | 0.3 | 0.3 | 0.3 |
| Current liabilities | 41.3 | 69.7 | 72.2 | 76.0 |
| Borrowings | 239.2 | 219.0 | 219.0 | 219.0 |
| Other non-current | 10.5 | 9.8 | 9.8 | 9.8 |
| Deferred tax | 5.2 | 6.4 | 6.4 | 6.4 |
| Non-current liabilities | 254.9 | 235.2 | 235.2 | 235.2 |
| Net assets | 98.2 | 110.8 | 132.9 | 153.6 |
| Minority interest | -17.0 | -14.7 | -15.5 | -15.8 |
| Shareholders equity | 81.2 | 96.1 | 117.5 | 137.8 |

Source: WHI Estimates

Peer Group Comparison

| Company | Country (listing) | Mkt Cap (US\$m) | EV (US\$m) | EV/Rev Hist | P/E Hist | P/E Fwd | Price/book Hist | Next Year End |
|-----------------------|-------------------|-----------------|------------|-------------|----------|---------|-----------------|---------------|
| AerCap Holdings N.V. | New York | 7,936 | 37,630 | 36.0x | 14.7x | 7.4x | 1.8x | Jun 2015 |
| Air Lease Corporation | New York | 3,263 | 9,303 | 10.8x | 17.7x | 12.7x | 1.3x | Jun 2015 |
| Aircastle LTD | New York | 1,380 | 5,015 | 7.2x | 42.6x | 9.5x | 0.8x | Jun 2015 |
| FLY Leasing Limited | New York | 475 | 2,680 | 7.5x | 7.6x | 7.9x | 0.6x | Jun 2015 |

Source: Capital IQ / WHI

Disclosures

WH Ireland Recommendation Definitions

Buy

Expected to outperform the FTSE All Share by 15% or more over the next 12 months.

Outperform

Expected to outperform the FTSE All Share by 5/15% over the next 12 months.

Market Perform

Expected to perform in line with the FTSE All Share over the next 12 months.

Underperform

Expected to underperform the FTSE All Share by 5/15% or more over the next 12 months.

Sell

Expected to underperform the FTSE All Share by 15% or more over the next 12 months.

Speculative Buy

The stock has considerable level of upside but there is a higher than average degree of risk.

Share Price Target

The share price target is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon.

Stock Rating Distribution

As at the quarter ending 31 Mar 2014 the distribution of all our published recommendations is as follows:

| Recommendation | Total Stocks | Percentage % | Corporate |
|-----------------|--------------|--------------|-----------|
| Buy | 49 | 63 | 26 |
| Speculative Buy | 15 | 19 | 12 |
| Outperform | 4 | 5 | 3 |
| Market Perform | 8 | 11 | 3 |
| Underperform | 1 | 1 | 0 |
| Sell | 1 | 2 | 0 |
| Total | 78 | 100 | 44 |

This table demonstrates the distribution of WH Ireland recommendations. The first column illustrates the distribution in absolute terms with the second showing the percentages.

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*WH Ireland acts as broker and/or Nomad to Avation

#WH Ireland makes markets in this company

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Analyst Certification

The research analyst or analysts attest that the views expressed in this research report accurately reflect his or her personal views about the subject security and issuer.

Companies Mentioned

| Company Name | Recommendation | Price | Date/Time |
|--------------|----------------|---------|-----------|
| AerCap | n/a | \$38.21 | 17/10/14 |
| Air Lease | n/a | \$31.87 | 17/10/14 |
| Aircastle | n/a | \$17.04 | 17/10/14 |
| Avation | Buy | 132p | 17/10/14 |
| Fly Leasing | n/a | \$11.47 | 17/10/14 |

Share Price Date/Time

| Company Name | Recommendation | Price | Date/Time |
|--------------|----------------|-------|-----------|
| | | | |

Summary of Company Notes

| | |
|---------|---------|
| Avation | 22/9/14 |
|---------|---------|

Summary of Security Recommendations

| Recommendation | From | To | Analyst |
|----------------|------|----|---------|
| | | | |

Current Analyst (CA), Previous Analyst (PA)

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