



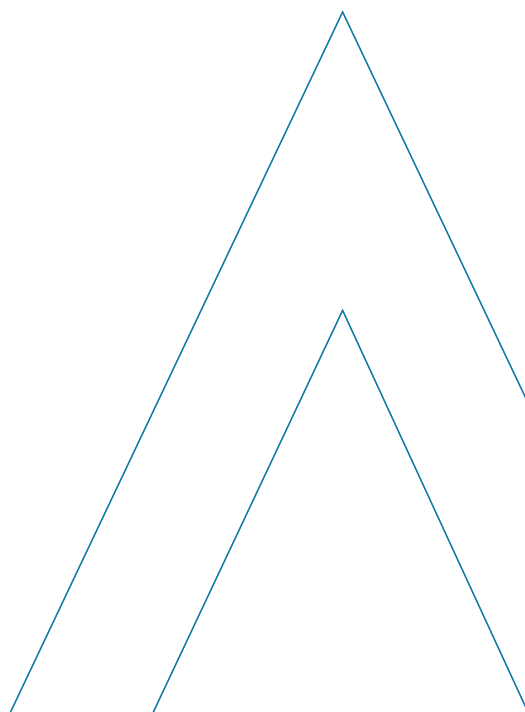
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ORIX Aviation steps up for Avolon

The senior management
explain the thinking
behind the deal



ORIX Aviation steps up for Avolon

The Dublin-based lessor's move to take a 30% stake in Avolon, a company with a fleet three times its size, surprised many in the leasing industry. **Jack Dutton** speaks to the lessors' senior management about the deal.



Japanese-owned lessor ORIX Aviation's move to buy a 30% stake in Avolon for \$2.2 billion is the latest in a series of divestments made by the Irish lessor's once acquisitive parent, HNA Group.

The Chinese conglomerate has shed nearly \$17 billion in assets since 2017 after a multi-year asset binge.

The whole process began with a conversation between Avolon's chief executive officer, Domhnal Slattery, and James Meyler, chief executive officer of ORIX Aviation Hong Kong, in January in an informal setting about the aspirations for their businesses.

"ORIX Aviation and Avolon have

been strong trading partners for the past three or four years with 45 aircraft valued at \$3 billion being traded between both companies," says Meyler, in an interview with *Airfinance Journal*.

He adds: "In knowing the Avolon business well from our close working relationship, we knew there was limited overlap in our business models which made it a fit."

Rumours first emerged at *Airfinance Journal's* Hong Kong event last November that parts or the entire Avolon portfolio could be sold to a rival lessor, with AerCap and CDB Aviation being touted as possible suitors.

The rumour mill started again this year with various media reports indicating that HNA had contacted parties “in the last couple of months” about buying a slice of the lessor. Hong Kong-based CK Holdings and NWS were rumoured as potential buyers.

However, Slattery was quick to deny these rumours on the day of the announcement, saying there was never any formal sales process in place. He insisted that sales talks only ever occurred with ORIX, which will finance the acquisition out of cash from the ORIX Group. The deal is expected to close in November.

Deal challenges

“I think valuation is important,” says Slattery. “This transaction has been valued at a slight premium to our book value, but it’s had a very significant premium on Bohai’s price to book.” Bohai Capital is Avolon’s direct parent.

According to Avolon, the HNA-owned lessor has an enterprise value of \$23.7 billion based on its 31 March status.

He adds: “Bohai’s stock price has had its challenges after the last number of weeks after it effectively started trading again. Bohai’s price is trading at a deep discount to book, so this is a really smart transaction from the Bohai investor’s perspective.”

Although some market participants were surprised that ORIX ended up investing in Avolon, the lessor has been in the space for 28 years and its parent, ORIX Corporation, has been consistently lending and investing in airlines and aviation since 1978. ORIX Corporation has also invested in airports and worked with companies such as Vinci Airports, which operates 36 airports globally.

Unlike Avolon, ORIX Aviation has a long-term shareholding structure, being the industry’s longest single shareholder-owned leasing business. ORIX Aviation combines larger aviation investments with asset management, which attracts both domestic Japanese and international investors, as well as traditional aircraft acquisition and leasing. In the financial year ending 31 March 2018, the lessor executed \$4.2 billion in transactions and has closed more than \$30 billion in deals over the past 15 years.

Meyler says that the main challenges ORIX experienced when negotiating the deal was defining the “insulation framework” structure for Avolon as a fully funded and capitalised entity, independent of its troubled parent HNA Group.

Japanese endorsement

Meyler believes the deal will increase Avolon’s foothold in the Japanese market.

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James Meyler, chief executive officer, ORIX Aviation Hong Kong

endorsement of the Avolon business model and franchise,” he says.

Although Avolon already has several Japanese banks as part of its lending syndicate, Slattery also believes that the ORIX stake is likely to improve the Japanese market’s perception of the HNA-owned lessor, on both the bond investor side or on the debt side.

“ORIX is probably the most active distributor/syndicator in the Japanese investor market and has been for a very long time,” says Slattery. “So, whether that’s the single investor, Jol [Japanese operating lease], ORIX are right up there.”

He adds: “The great opportunity for Avolon is to have ORIX further turbocharge the level of activity in Japan so it becomes the premier distributor of aircraft in the Japanese investor market, which over many cycles and decades has proven to be a very resilient market. It’s perhaps the deepest single market in the world for acquiring aircraft, be it corporate entities or be it high net-worth individuals.”

Complementary or competitive?

The main benefit for Avolon in having ORIX as a minority shareholder is the latter’s investment-grade status.

“ORIX fitted the profile of the investor that would effectively remove any structural impediments to our roadmap to investment grade,” says Slattery. “And we believe this transaction will achieve that and you’ll see that any structural impediment of Avolon getting to investment grade has effectively been removed as a consequence of this transaction.”

The deal is the largest-ever single dollar ticket for a minority investment in an aircraft leasing company. Slattery says he was “convinced” that only a lessor with ORIX’s scale, balance sheet, liquidity and commitment to the leasing sector would be able to write a ticket of that size.

Shareholders of Bohai Capital still need to approve the deal, which includes a governance framework with significant protections for the minority shareholder.

However, ORIX does not have a right to purchase a larger stake of Avolon at a predetermined price.

“You should think about this split at 70 to 30% being a long-term stable split of the ownership of the business,” says Slattery. “I think it’s fair to say, and I think this will be brought out in the rating agency releases when they come out over the next few hours, that ORIX has got a series of minority shareholder protections that have got them very comfortable with their minority position.”

Slattery says that those minority shareholder protections have also assisted the agencies in becoming comfortable with decoupling Avolon’s credit rating from its parent’s rating. He says the deal will take away the structural impediments of Avolon getting to investment grade.

“For the foreseeable future, 70 to 30% is what you’ll be looking at,” he adds.

Although both lessors have traded many aircraft in the past, David Power, chief executive officer of ORIX Aviation, insists that the businesses are more complementary than competitive.

“When we looked at the opportunity, we could see that our businesses are very complementary and the areas of overlap are minimal. That was very positive for each of the parties; it also helps given the strength of ORIX Corporation and the

investment-grade aspirations of Avolon.”

Power says the deal will create “a win-win situation”, although both businesses will continue to be run separately.

As a 30% shareholder in Avolon, ORIX will benefit from the Chinese-owned lessor’s cash flows and profits. Meyler, who is also deputy chief executive officer and chief commercial officer of ORIX Aviation Group, says his company will also benefit from the returns made from Avolon’s orderbook, but it will not be taking any of the orders itself.

Meyler says: “We’re buying into the business plan that Avolon has set out and we want Avolon to keep growing, increase in value and reach investment grade. That’s very much our target for the investment. ORIX Aviation will continue to grow by its business plan.”

However, there will be areas of synergy. “We imagine in future there will be opportunities for us to cooperate on various types of transactions, especially in the Japanese market where ORIX is one of the key players,” says Meyler.

He adds that these transactions are likely to be aircraft trades.

ORIX has moved from owning and managing 100 aircraft eight years ago to 230 aircraft today. The lessor plans to grow to more than 300 aircraft in the next three years. Avolon, on the other hand, eventually looks to become the world’s largest aircraft lessor. Its owned, managed and committed fleet was 890 aircraft at 30 June, making it the third largest behind GECAS and AerCap.

HNA’s motivations

Slattery insists that the deal was commercially rather than politically motivated. He says conversations were held purely between HNA Group, Bohai, ORIX and Avolon, and they had nothing to do with China looking to sell off parts of the HNA portfolio to reduce its debt burden.

He indicated in an investor call in August that HNA had no interest in selling a controlling interest in Avolon.

On completion of the transaction, the revised Avolon board will comprise two ORIX directors, three Bohai directors, with Slattery as executive director and one independent director.

“Having dealt with the HNA and Bohai group in this process, it is fair to say that they are a well-run and professional organisation working diligently to restructure their business model in line with their circumstances. This deal is assisting that process,” says Meyler.

“People need to remember that Avolon is fully funded from an equity perspective and is very much a standalone global entity. As such, Avolon is a real success story for HNA and fits its core aviation industry business focus. We expect them to



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Domhnall Slattery, chief executive officer, Avolon

continue as a valued partner.”

The fact that ORIX acquired a minority stake rather than a majority stake in Avolon raised some eyebrows in the market, because it still allows Bohai and HNA to have majority control over the business. However, Meyler seems comfortable with this.

“HNA and Bohai bring real value to the table in terms of the ORIX Group’s position with the manufacturers and their knowledge and experience in the airline and airport sectors,” says Meyler.

“ORIX Aviation has certain minority shareholder protections that, in essence, give us rights over key business decisions. Both ORIX Aviation and the rating agencies comfortable that this transaction decouples

Avolon from HNA and gives ORIX Aviation a powerful position at the board table with two board seats,” he adds.

Putting dollars to work

For Avolon, the deal “accelerates its roadmap” towards becoming an investment grade-rated lessor. As one of the largest buyers of aircraft in the world, becoming investment grade will allow the lessor to buy aircraft at lower prices and access cheaper debt, accelerating its growth. It also presents a significant deleveraging opportunity for its parent Bohai Leasing.

Slattery does not expect HNA Group to extract any further capital from Avolon. “Just normal on-the-run dividend flow over years,” he adds, “so I think we’re in a different phase of the company’s development now that ORIX has come to the table.”

For ORIX, which is primarily focused on mid-life aircraft and asset management rather than new aircraft acquisitions from the original equipment manufacturers, it provides an opportunity for it to put its dollars to work.

“It’s an inflation hedge – inflation is now back on the radar and so if you want to put a significant amount of dollars to work – and I think \$2.2 billion in anybody’s terminology is a big number – Avolon allowed them to put it to work in scale,” says Slattery.

ORIX has been through many industry cycles and events, including 9/11 and the financial crisis of 2008. Meyler says the lessor has had a strong past couple of years.

“We’ve added almost 100 aircraft over the last couple of years to our owned and managed portfolio,” he adds. “We’re now at just under 230 aircraft owned and managed, worth \$10 billion. Our business model is quite unique but also it’s complementary to the likes of Avolon where it has the orderbook.

“ORIX Aviation has bought into other investments in the past – airlines and airports; we’re an investor in aviation. We see this as a very good investment and return on our equity as expected. Even if the business is completely run independently to our business plan, we expect the return on investment to be good and that’s accretive to our own business because we’ll have 30% of their business.”

Although Slattery says that the stakeholder structure of Avolon will not change in the short term, Power has not ruled out increasing ORIX’s stake in Avolon sometime in the future. Asked whether ORIX would consider eventually doing so, Power says: “We are committed to this space and if the right opportunity comes along to increase our investment in this space, we will certainly plan to take advantage of that opportunity.” ▲