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SLB terms 'are being eroded'

Jackson Square's Toby Bright on airline pricing power, widebody transitions and OEM orders

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Sale-and-leaseback terms 'are being eroded'

Toby Bright, chief executive officer of Jackson Square Aviation, waxes lyrical with **Jack Dutton** about how airline-pricing power is changing and a potential order from the San Francisco-based lessor.

Toby Bright, president and chief executive officer of Jackson Square Aviation (JSA), reminisces about the halcyon days of 2010, when there was less pressure on the sale-and-leaseback market and some of the larger players were not yet in the business.

"When we started this company in 2010, all the legacy lessors were out of the sale-leaseback business," he tells *Airfinance Journal*. "GECAS had just been restructured and was worried about its orderbook. ILFC was restructuring, but Hazy [Steven Udvar-Házy, founder of Air Lease Corporation] hadn't quite got started yet. He came in later in 2010 or 2011, but we were seeing him in the sale-and-leaseback market. CIT was in bankruptcy; ACG wasn't doing sale and leasebacks."

With JSA starting around the same time as Avolon, Bright says the two companies pretty much had the sale-and-leaseback market to themselves.

"I dream of those days; those were great days, to do what we were able to do with the airlines in 2010, 2011, 2012. Gradually, the legacy lessors sorted out their orderbooks, their funding and got back into the sale-leaseback market, and, of course, since then, another 100 leasing companies have joined in from China and elsewhere," adds Bright.

Unlike Avolon, JSA is not set on becoming one of the world's largest leasing companies. "We want to be at about 200 airplanes by 2020," says Bright. "We're not trying to become the biggest; we just want to run a solid business and generate good returns for our shareholders."

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Toby Bright, president and chief executive officer, Jackson Square Aviation

JSA owns 149 aircraft and has 19 aircraft arriving over the next couple of years, as of 1 February 2018. It has a further two managed aircraft, taking its committed fleet to 170 overall. It has 48 airline customers based in 26 countries.

What has stopped JSA from growing at a quicker rate is the company's discipline of maintaining a young fleet with long lease terms attached. At just over three years old on average, it has one of the youngest fleets in the industry. To retain that youthfulness, the lessor is selling aircraft at almost half the rate it is originating them. It intends to add between 30 and 40 aircraft this year but also sell about 15.

"It's been like that the last two or three years," says Bright. "Between when we started the company in 2010 and when we sold it to Mitsubishi UFJ Lease & Finance (MUL) in 2013, we didn't do a lot of sales in that period; we were just growing. But since MUL purchased us, we've been focused on selling to reduce the risk in the fleet and also to show regains."

Bright also notes it has been a good market to sell aircraft over the past few years, and that he sees his company as a business that focuses on customer relationships. Before starting JSA, the management team was at Pegasus Aviation, a California-based lessor sold to AWAS in 2007. Bright was previously at Boeing for 28 years, enabling him to establish many airline relationships.

Before the turn of the year, Bright saw aircraft leasing as a relationship business. "Last year, the business we won was almost entirely repeat business. We were able to go back to customers we had worked with previously and add a few more airplanes because it came down to being a reliable partner and someone they knew they could count on to execute deals."

Only two months into 2018, however, Bright is wondering if those relationships will help the company as much this year. "It's fiercely competitive out there and there's so many products for airlines to choose from, so I'd like to think that relationships still matter but we have to prove that to ourselves again this year."

Unlike most lessors, the company has acquired almost all its aircraft through sale and leasebacks, aside from some aircraft bought in the secondary market from other lessors.

Potential order

Although JSA has never placed an order for new aircraft, Bright says the prospect of one looks more likely as the sale-and-leaseback market heats up.

"Up until this year, we hadn't seen the deals we thought would work for us compared to what we were seeing in the sale-and-leaseback market. So far, we have not ordered aircraft, but I think sooner or later this company will probably order aircraft and it will make sense for us."

One of Bright's main reservations about new orders is how long aircraft take to be delivered. "The lead times that are involved these days, ordering now for deliveries in 2023... it's hard to make a case for that. Right now, it feels like we're at the top of the market, which also tells me that it's not a good time to buy airplanes. We should take advantage of downturns to purchase aircraft."

If the lessor was to make an order, it would be for narrowbodies. Bright does not outline the number of aircraft or timeframe for such an order, instead saying it depends on the attractiveness of the deal. The lessor's fleet is roughly split 50-50 between Boeing and Airbus aircraft, so Bright says an order would be from one of the big two original equipment manufacturers.

"I think the first order for us would be a moderate order; it wouldn't be a gigantic order of anything. There's a lot of work to be done internally with our shareholders to make a case for ordering aircraft but I believe that eventually we will decide that makes sense."

"A year or two years ago, we were bidding on some widebodies from one of our customers in the Middle East. The guidance we got from them was: 'Guys, you're not doing too bad – you're number 42 of 80 bidders.

Toby Bright, president and chief executive officer, Jackson Square Aviation

JSA favours sale and leasebacks for a number of reasons. "We know what we're getting and it's near-term business. We know the airline needs the airplane, as they've ordered it and they intend to take it. We also know the pricing of the airplane and the market conditions, so it's a much less risky way to do business than worrying about airplanes out several years in the future."

On top of that, a lessor ordering an aircraft has to deal with pricing escalation, predelivery payments and an often-unknown future market for the aircraft.

But with lease rates at record lows, how does JSA make the economics of sale and leasebacks work? "We have a low cost of funding from various sources and we rely on that," says Bright.

He adds: "We also do business with a wide range of credits. We do some deals with airlines like British Airways, Delta or American [with] lower margins, but then, on the other end of the credit scale, you do deals with airlines with weaker credits, but you get paid for that by taking the credit risk."

JSA was one of the first lessors to acquire widebodies in the sale-and-leaseback market, at a time when many lessors were focused on narrowbodies. Bright says the lessor has about 27% of its fleet value in widebodies, but can have up to 35% if required. JSA also differentiates itself from some lessors by providing financing for predelivery payments.

"In the past, we've been able to build a portfolio that gives us the kind of gains we are looking for, but it's got tougher every single year. I jokingly say that every year since 2010, I wish I could do the deals that I did last year. The business has got tougher every single year for eight years."

'Ferocious' competition

Bright describes sale-and-leaseback competition as "ferocious". He shares an anecdote with *Airfinance Journal* about one of the airline's Middle Eastern customers: "A year or two years ago, we were bidding on some widebodies from one of our customers in the Middle East. The guidance we got from them was: 'Guys, you're not doing too bad – you're number 42 of 80 bidders'. We still laugh about that but it's true that there is a lot of competition."

That said, recently he has observed airlines limiting competition on sale-and-leaseback request for proposals. "It's a lot of work for them to evaluate 40, 50, 80 bids, so recently we've seen airlines go out to a smaller group, but the competition is still ferocious and they know they can get a good deal from 10 or 12 bidders, instead of 40."

The competition seems to be industry wide. During the week of the 20th Annual Global Airfinance Conference in Dublin in January, Bright met with a major US airline that had bids for narrowbodies below 0.6 lease rate factors. Bright has also seen a plethora of weaker-credit airlines around the world attract very aggressive offers.

"What concerns me is that it's not just lease rate factors that are being negotiated away; we're seeing pressure on other contract terms, too. So terms we've always held firm in our lease documents are now being eroded away in negotiations because the airlines have the power to do that.

"Those things worry me more than lease rate factors. I believe this is a cyclical market. I believe the market will change and lease rate factors will come back up at some point. But I worry about all these other contract issues, because once you give those away, they're very hard to get back with your customers."

Bright is experiencing airlines that never previously requested half-life return conditions now ask for them. Before, only the major airlines would demand half-life return conditions.

"There's all kinds of contract terms that get whittled away when there's this much competition. Lease terms, for example, tend to be getting shorter. In 2010 and 2011, most of the deals we were doing were 10- and 12-year terms and now most of our deals are eight years and we get a lot of requests for six-year deals, which, so far, we haven't really done."

Although there have been some examples of airlines taking longer leases, such as Gulf Air's Boeing 787s from DAE Capital and Saudia leasing A330s from IAFC for 15 years in 2016, Bright has seen few airlines leasing aircraft for longer terms.

Financing strategy

The majority of JSA's financing comes from its parent, MUL Group. In 2013, when MUL first purchased JSA, it provided 100% of the financing for the lessor. But for the past few years, JSA has been financing about six aircraft a year with commercial banks, both Asian and European.

"We're sitting on a lot of cash right now because of our private placement financing," says Bright. "So we've been telling the banks that in the second half of the year we'll be out talking to them again."

The lessor also uses financing from MUFG, the owner of MUL. MUFG and Citi were the placement agents on the $300 million private placement the lessor closed in August 2017. The deal was split between two tranches, which are seven and 10 years in tenor. It was the San Francisco-based lessor's first foray into the private placement market.

Despite increasing competition, JSA had a busy second half of 2017 in the sale-and-leaseback market. In July 2017, it delivered one 787-8 on operating lease to Ethiopian Airlines. In October, it closed a predelivery payment facility with Aeromexico for five new Boeing 737 Max 8s and delivered one A321 on sale and leaseback to Frontier Airlines. Over the second half of 2017, it also closed sale and leasebacks with airlines including Go Air, Lion Air and Sky Angkor Airlines in Cambodia.

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>
> **Toby Bright**, president and chief executive officer, Jackson Square Aviation

So far, the beginning of this year has been slightly less active, but Bright says he has completed a deal with an Indian carrier, after the signing of a letter of intent last year. JSA also closed a sale and leaseback for three A320neos delivered to Scandinavian Airlines System at the beginning of February.

Selling aircraft down

JSA is not looking at the asset-backed securitisation (ABS) market to sell off some of the older aircraft in its fleet. "We've had some discussions about it, but right now we're not looking at that. If you look at the age and quality of our fleet, we don't think that works in the ABS market, so it's not a consideration for us at the moment."

However, Bright has taken advantage of the buoyant aircraft trading market among lessors and airlines to sell down some of the lessor's higher-risk aircraft and older equipment. JSA has traded portfolios with some of the established lessors, as well as start-ups.

Although narrowbodies are proving very liquid in today's market, widebodies are harder to transition. To avoid any risk associated with finding a new lessee, JSA usually tries to sell widebodies before their lease terms are up.

"We did some 777 deals with Emirates and Air France back in 2011. They were very attractive deals for us and these were long-term, 12-year leases," says Bright. "We're focused on selling those down right now and we do have a couple of LOIs [letters of intent] on some of these widebodies. We know how to transition airplanes. We know that it can be expensive, so our preference is to sell the airplanes down before the lease term's out."

Although there have been some concerns in the market about the influx of A330s and 777s coming off lease in the coming years, some lessors seem unfazed. For example, Aengus Kelly, chief executive officer of AerCap, said in an on-stage interview with *Airfinance Journal* in January that the Irish lessor transitions a widebody aircraft every three days.

Bright thinks market concern about placing widebodies is not all rational, because competitors such as AerCap are finding homes for the aircraft with new lessees.

He says: "I understand that old Air Berlin airplanes got remarketed and this is working the way it's supposed to where airplanes go onto a second lessee somewhere. I haven't heard any horror stories about widebody transitions but I do see a lot of hand-wringing about them."

Bright believes any full-service leasing company should be prepared to transition all its aircraft to other lessees, whether narrowbody or widebody.

"You can reduce your risk by selling down airplanes, but the company needs to have the expertise and be prepared to transition airplanes when it needs to. So yes, we like to avoid transitioning, particularly widebodies… but if it came down to it, I think we have expertise to do that."

Welcome distraction

Operating lessors were kept busy in 2017 when they had to transition a lot of aircraft that were placed with airlines which went bankrupt.

These included Vim Airlines, Monarch Airlines and Air Berlin. Bright says that he sees the cases of Air Berlin and Monarch as success stories for Jackson Square Aviation.

"Air Berlin was one of our very first customers and we at one point had seven airplanes there," he says. "But we saw that they were a weaker customer and we had moved all our airplanes out of Air Berlin before they went under and they helped us. We worked with them closely and I've known those guys since my days at Boeing. When they went under we had already transitioned our airplanes."

JSA also had aircraft at Monarch, which it sold within a few months of the UK airline going bankrupt in October 2017. Some market observers believe the bankruptcies of Monarch and Air Berlin marked a new round of European airline consolidation.

Bright anticipates there to be further consolidation in 2018 in the leasing market. With market sources telling *Airfinance Journal* that Intrepid Aviation and Sky Leasing are on the block, the leasing industry may well look different this time next year.

Bright believes both businesses will trade in the coming year. Although interest rate rises may put such deals at risk, he thinks there is enough liquidity available chasing assets.

Although he will not comment on rumours of General Electric and HNA divesting from their leasing subsidiaries, Bright welcomes them.

"We like seeing the large lessors distracted by trades and selling their company," he says. "I don't wish this on anybody or my friends in the industry, but we're okay with these guys being distracted on other things as it gives us more chance to win some competitive business."