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HELICOPTER LEASING

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Helicopter Leasing
Challenges & Opportunities!

Article by Aubrey Point & Gary Fitzgerald

Pure operating leasing is a relatively new, but fast growing, financial product in the helicopter world. The numerous benefits of operating leasing are matched by some substantial challenges that are inherent in the structure of the helicopter operator industry. This article aims to explain these challenges and opportunities for operators and investors alike.

THE BENEFITS

As a general rule, operating leases bring operators several advantages over owning helicopters outright. Owning helicopters entails tying up substantial amounts of capital during the operating life of the helicopter. Leasing helicopters requires nearly no initial capital outlay, except for a deposit that is returned at the end of the lease. Secondly, the operator does not take any residual-value risk on leased helicopters; the investor takes the risk and rewards of any future value fluctuations. In addition, because the operating lessor orders the helicopters, the operators are shielded from the risk of lengthy speculative orders, as helicopters offered by operating lessors are available at shorter notice, which is often in-line with tender or operational requirements. Thirdly, the operator benefits from a much greater flexibility of lease term that is not the case with owned machines. The investors take the risk of remarketing the helicopter at the end of a lease term, but the operator always has the option to extend a lease. In some specific circumstances the lease may also be terminated early, for example, if the underlying service contract is not renewed as expected.

From an investor perspective, helicopters are relatively attractive machines to lease, as they are generally fairly liquid assets, both in terms of multiple operators and multiple roles. This, in theory, creates a wide potential market for placement. This liquidity is in large part created by a helicopter's versatility to be physically converted for different roles such as offshore, medical evacuation, fire fighting, etc. As a result of this liquidity, and their inherent

technical refurbishment value, helicopters often maintain stable values through their life cycle.

Finally, helicopters provide a decent 'bite-size' investment volume as a function of due diligence and oversight resources required. Lower value transactions are generally viewed with less interest, unless they can be 'scaled up' efficiently. There are substantial economies of scale created with a larger leasing portfolio, which can be financed more efficiently (cheaply) than individual helicopters.

THE CHALLENGES

The creditworthiness, or underlying credit quality, of many potential helicopter lessees is relatively weak compared with the airline or shipping market. A few major helicopter operators, who have credit ratings comparable to mid-to-high tier airlines, dominate the helicopter operating market. However, the remainder of helicopter operators are considered to have a lower / weaker creditworthiness, which creates challenges for investors, such as a higher risk of non-payment / default. This risk should, in theory, be covered by a higher premium. But growing competition in the helicopter lease space may translate into inadequate coverage of this premium.

Secondly, there is a fairly fundamental mismatch between the typical helicopter operator contracts, which tend to be short-term (2-5 years renewable), and the long-term funds (on average 10-15 years) typically required for a profitable and sustainable leasing business.

A key difference with aircraft fixed-wing leasing is the nature of the underlying asset and the value fluctuation of helicopters. A large commercial jet has a relatively stable fixed-line value decline from new to 20-25 years old (at which point it flattens out at scrap value). Helicopters are entirely different, with a much larger component of value intrinsic in the past usage / future potential of the individual parts fitted to the helicopter. As a result, a poorly maintained helicopter or overused machine could rapidly lose its value, even for a helicopter as young as five years old. This would never be the case with a commercial jet.

From the operator's perspective, operating leasing can end up looking relatively inflexible if their operating contracts are cancelled prematurely, or if the market changes for one reason or another. Terminating an operating lease before expiry can involve extremely high cancellation fees, whereas owners of their own helicopters can generally offload their machines to other markets.

Another challenge is the small number of helicopter lessors and relative immaturity of helicopter operating leasing, which reduces liquidity. Although this brings obvious opportunities if structured correctly, the risk is the market may not reach a critical mass and may not be widely accepted by the general operator base. By comparison, the fixed-wing leasing sector is a very mature industry, with approximately 40% of the world's commercial aircraft fleet currently under operating lease. There are well over 100 firms specializing in this form of investment and the market is very liquid.

Finally, the interchangeability of roles performed by helicopters, often involves hefty engineering and logistics challenges to equip and reconfigure machines. Conversion costs can be a substantial percentage of the value of the underlying asset, and such costs are much higher than what is experienced in the commercial aircraft industry.

IN CONCLUSION

Investors in the helicopter-leasing sector need an appreciation of the inherent technical value in helicopters and their future potential market. This requirement is far more critical than, for example, what an equivalent investor needs in the large commercial jet market.

Despite the multiple roles a helicopter can perform during its operating life, the market is far more fragmented than first meets the eye. A critical requirement for investors is that they partner with a highly skilled team of helicopter experts and portfolio servicers with a truly global commercial reach. This will make a major difference as leased portfolios grow and age.

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ABOUT AVINCO:

With a very substantial presence in the fixed-wing leasing sector, and as a leading player in the helicopter trading world, Avinco is well positioned to play an important role in the growing helicopter leasing environment. With approx. $480-million worth of leased fixed-wing aircraft under management, Avinco is projected to be amongst the top 50 large commercial aircraft asset managers by the end of 2013. This presence is being extended to the helicopter-leasing sector, where Avinco is partnering with various investors to structure leases and acquire helicopter portfolios.