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Talking Bonds

Following on from the article in Issue 25 on corporate bond issuance, *Airline Economics* speaks to Robert Martin, chief executive of BOC Aviation, about the lessor's financing strategy.

In March 2015, the global aircraft leasing company, BOC Aviation, launched its inaugural issuance of Rule 144A/Regulation S US$750 million five-year fixed rate senior unsecured notes, which was issued under BOC Aviation's US$5 billion Global Medium Term Note (GMTN) Program.

This is BOC Aviation's largest bond transaction to date. Over the past three years, the company has been steadily growing the capital markets portion of its overall debt financing portfolio, from 5% to 28% of its total debt portfolio today. The largest share of its portfolio remains commercial bank debt, which it has traditionally used for its funding needs, with export credit-guaranteed funding comprising around 20% of its total portfolio. BOC Aviation's debt portfolio

will continue to change since the lessor has another US$2bn remaining to issue under its US$5bn GMTN program.

Robert Martin, chief executive of BOC Aviation, stresses that he will ensure the company's sources of debt remain global and diverse.

"In our industry, you need to make sure that you maintain your access to debt at all points in the cycle," says Martin. "The idea is that we have two significant sources of debt during the good times: the bond market and the commercial bank market. So if the cycle turns, we have those sources of funding with export credit as a backstop and our parent company Bank of China."

"We have traditionally maintained a very wide group of commercial banks – at one point we had over 50 banks in the commercial debt group – but over time

we realised that by getting a rating we could extend into new markets," he adds.

BOC Aviation has been issuing unrated debt in the Singapore market since 2000 but in September 2012 it decided to do so on a rated basis when it received its inaugural credit ratings of A- from Fitch and BBB from S&P. S&P raised its long-term corporate credit rating for BOC Aviation to A- in March of this year, which has benefitted its pricing power in the global markets as well as open up a new pool of investors.

"We were pleasantly surprised by the impact of the S&P rating on pricing," says Martin. "We saw significantly tightening of the pricing in the previous bond issues and the 144A – the all-in was just over 3% for five year money at a fixed rate and now our 10 year was around 4% all-in, in US dollar terms."

Under its EMTN programme, which was upsized from US$2bn to US$5bn and later converted to a GMTN programme in March this year (see box for full issuance history), BOC Aviation has issued just over US$3bn of capital markets debt in several currencies.

"Traditionally our industry is based on US dollars but there is an additional pool of non-US dollar investors out there we have to tap into to," says Martin. "Whenever we do a non-US dollar denominated deal, we swap it back immediately into US dollars. If we watch the cross currency swap market at the same time as we do the bond issue, we have seen a pick-up of as much as 40 basis points per annum by issuing in other currencies and immediately swapping back into US dollars. Provided we swap it back immediately, we don't run any currency risk at all."

Martin intends to continue to issue in other currencies that the US dollar to tap into those additional pools of capital. "It is a matter of where are the cross currency rates versus the US dollar but in theory we certainly will look at issuing in Euros at some point, possibly the Japanese Yen market – we have even looked last year at New Zealand dollars. Since we received our A- rating from S&P as well Fitch, our bonds are in a new category of investments."

Martin expects the company's capital markets debt share to continue to move up to around 50% over the next few years, but since BOC Aviation still has its remaining amortising debt in place, it will take some time for that to happen.

"Incrementally it will look as though we are raising more debt capital markets just because we have a proportion of amortising debt in place," he says. "We are very cautious – as a company we always look at our overall debt repayment profile. For a leasing company this is the most important part of our overall financial planning. When you move from amortising bank debt to more debt capital markets, you need to spread out the debt balloons very carefully. So when we decide which tenor do we want to do our next capital markets deal, part of it is driven by looking to our overall debt amortisation."

> **"We have been a big proponent of getting our industry to be seen to be investment grade wherever we can. And that is definitely happening. In Asia-Pacific, investors tend to look at us in the same bucket as financial institutions. We need to position ourselves as investors in aircraft that take cashflow risk on airlines..."**
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> *Robert Martin, BOC Aviation*

In terms of the size of future issuances, Martin is keen to make sure the volumes remain substantial – at least US$100 million – but states that more than US$1bn at once is unlikely since he is conscious of the balloon risk at the end

of the deal. "The maximum we would ever do at once would be $1bn because we want to spread out the maturities," he says.

Like currencies, different tenors attract a different pool of investors. "We plan to issue bonds of anywhere between five to 10 years," says Martin. "Then we will be watching the differential rates and the shape of the yield curve in the five and 10 years, which will tell us which way to go. On the long end, investors tend to be more insurance companies, while the more liquid five-year paper tends to attract fund managers, private banks and even corporates."

With its wide issuance, BOC Aviation has seen first-hand the increased appetite from insurers for longer tenor bonds from aircraft lessors. "There is definite interest from insurance companies in the aircraft leasing sector," says Martin. "When we went out with our five-year deal in March 2015, a lot of the feedback we got from the insurance companies is that they would prefer the longer tenor if possible – both because it is matching their liabilities and because they want the overall higher yield."

Fuelling this demand is also the liberalisation of what insurance companies can invest in, particularly in Asia. "We can feel that from some of the reverse enquiries we are getting," says Martin, adding that this interest increased further once BOC Aviation received its second A rating.

This interest will continue. As the middle classes start to emerge across Asia Pacific, one of the things they start to do is buy insurance. The insurers then have large amount of float they are looking to invest and they know they will be holding the funds for a long period of time before they are drawn down, particularly life insurance companies. That means they are looking for opportunities to invest. Aircraft lessors particularly are gaining in popularity as investors become more aware of the benefits of the industry for its long-term stable returns.

We are spending a lot of time conducting investor education," says Martin. "We are also encouraging other leasing companies in Asia to get credit ratings as well. The more companies that do so, the more interest there will be in the sector. We have been a big proponent of getting our industry to be seen to be investment grade wherever we can. And that is definitely happening. In Asia-Pacific, investors tend to look at us in the same bucket as financial institutions. We need to position ourselves as investors in aircraft that take cashflow risk on airlines so that investors understand that we are no different to a property REIT for example. It is very important to get the message across that when people buy a leasing company they are buying a diversified portfolio of aircraft and leases."

For BOC Aviation, having BOC in its name gave the company instant brand recognition, particularly in Asia Pacific, which was the reason why it first issued capital markets debt in the Reg S market before it went to the 144A market. This has proven to be a successful strategy. When BOC Aviation went to market for its 144A transaction in March of this year, it started the issue in New York during the Asian morning time on Monday, and before New York had even opened it had $4.5bn of orders from Asia-Pacific and Europe. When the US opened, the total book went to $5.5bn within two hours. "In the end, we intentionally wanted to get to the US investors but Asia knew we were going to the US," says Martin. "You get this strange dynamic where Asian investors try to get their orders in early, so we tightened the pricing then and split it 50:50 between US and Asian investors."

He adds: "Our intention with this first deal was to open up our US book as much as possible to US institutional investors – the large pension funds, insurers and asset managers – but we also needed to keep our Asian investors happy, which is why we have done some private placements in Asia as well."

BOC Aviation intends to raise around US$1bn this year in the debt capital markets, and it has fulfilled US$750 million of that already. Martin expects the company will issue some more Singapore dollar denominated bonds this year as well as further private placements as the year goes on.


Robert Martin, BOC Aviation

The flurry of bond issuances is a deliberate strategy by BOC Aviation to ensure it capitalises on the strong debt markets in advance of any interest rate rises in the US that could impact pricing.

"The threat of US interest rate rises is one of the reasons for us going early to market this year with fixed rate bond placements," says Martin. "We are one of the few leasing companies that has the majority of its leases on floating rate. That is why we have had a large component of bank debt as it is a natural hedge for that floating rate component. We are using the bonds to naturally hedge our 30-40% fixed-rate leases. We don't run much interest rate risk, the floating rate is a natural hedge and the fixed rate is at least 50% hedged. We never want to be 100% hedged though because we are constantly selling aircraft out of the portfolio, and if we were 100% hedged we would end up having to break hedges."

Martin doesn't feel the need to diversify BOC Aviation's sources of debt any further. "We have looked at Islamic debt from time to time but economically it has never made sense for us," he says. "The bond markets are so efficient – our average cost of funds are just over 2% - Islamic products just can't get there at those rates. And we don't need it. The beauty of the US debt capital market is that it is so deep in terms of funding that you can raise large volumes there very effectively. We will look at other alternatives but they have to be competitively priced to make sense for us."

Another advantage of issuing such a large amount of capital markets debt and reducing its reliance on bank debt is that the cost of that bank debt is falling. Martin says that the company's cost of bank debt is now below Libor+100bps for long-term secured debt.

As previously mentioned, Martin wants to ensure all forms of funding remain open for the company but it has used export credit since 2012. "With the upfront fees where they are, and while we are in a liquid market, we won't be doing any export credit deals," he says. "Export credit still has a very important role to play in the industry when a downturn comes but it is not politically acceptable these days for the export credit industry to be pumping out volumes during the upturn of the liquidity cycle."

That said, Martin is keeping a sharp eye on where banking regulation is going in the longer term: "We want to keep a balance in our funding sources. We mustn't close down any source of debt because none of us knows what the regulatory environment is going to be like in five years' time. At the moment there is a heavy focus on the banking sector but we don't know whether that will shift to the insurance sector in terms in what they can invest in in the future or the major players in the capital markets. We keep an open mind about that and we are happy with the 50:50 split of our debt funding sources in the medium term."

BOC Aviation is actively working on an asset backed securitisation transaction (ABS). The size of the deal, which is being arranged by Citi, is expected to be between $750 million and $1bn in size.

"For us it is expensive funding," says Martin, "so we would only use this as a sales strategy. It is an average portfolio and we will be the servicer."

The deal is being coordinated by Steven Townsend out of BOC Aviation's London office and is expected to launch around July.

For the immediate future, BOC Aviation's emphasis remains on funding its high volume of new deliveries. Last year the lessor took 57 new deliveries, which are all fully placed. Martin states that about 70% of its 2016 deliveries have been placed and the company is entering its next planning phase as the delivery dates for the A320neos and 737max aircraft draws closer.

"Most of our business is placement business," says Martin. "While liquidity is high, we have pretty strict pricing discipline here in terms of what we are prepared to pay for our aircraft. We won't be competitive price wise in a lot of spot sale-leaseback situations. Where we are prepared to differentiate ourselves is that we are prepared to do pre-delivery financing as part of our deals. This means we can start to look at deliveries two-three years out. We do volume when we work on transactions – we placed eight 777s with Thai Airways and eight A330s and four A320s with Iberia when it was going through tough times. We tend to compete by staying away from the crowd. We do occasionally [bid on sale-leasebacks] just to check on our pricing levels – but most of the time we come 13 out of 15. We see this every cycle. Our view is that our day will come."

For widebodies, BOC Aviation tends to do back-to-back deals so when it places an order, it already knows which customer it will place the aircraft with and under what terms. "The reason we do that is all about relative aircraft liquidity. For a 737 or A320 we know that market very well, once you begin to move up in aircraft size the number of aircraft operators and investors when you come to sell the aircraft becomes less, so we tend to be a little more cautious," adds Martin.

BOC Aviation placed two large orders in 2014 – 50 737Max8s, 30 737-800s and 43 A320-family aircraft, and as such Martin says they will not place and further large orders. "Over the last two years, we have been picking up aircraft from airlines with excess orders – last year we picked up eight planes from low-cost carriers in South East Asia and placed them in other parts of the world. That's the way we are adding incremental aircraft to our book. Already we are up to 39 deliveries now this year in total. That's a comfortable number for us."

BOC Aviation debt capital markets issuance history

In September 2012, BOC Aviation issued its debut US$500 million 2.875% Five Year Senior Unsecured Notes due 2017. This was issued off the company's US$2 billion Euro Medium Term Note Programme (EMTN Programme), which was listed on the Singapore Exchange Securities Trading Limited (SGX-ST). The notes had a fixed interest coupon of 2.875% p.a. and a yield of 2.978% p.a., representing a spread of 2.35% p.a. over the 5-year US Treasury note. The notes issuance was eight times oversubscribed. The notes were distributed 81% in Asia and 19% in Europe and Middle East, comprising 170 high quality fixed income accounts: 47% to asset and fund managers, 28% to banks, 19% to private banks and 6% to insurance companies.

In February 2013, BOC Aviation closed its first 10-year senior unsecured notes issuance, which was a private placement of US$50 million arranged by HSBC again issued off BOC Aviation's US$2 billion EMTN Programme. The notes priced at par and had a fixed interest coupon of 4.3% per annum with interest payable semi-annually in arrears.

BOC Aviation's third EMTN issuance came one month later with S$75 million 2% senior unsecured notes due 2015 issuance, arranged by United Overseas Bank (UOB). The unsecured notes were rated BBB- by Standard & Poor's.

In May 2013, BOC Aviation closed a US$350 million 4.375% 10-Year senior unsecured notes due 2023 issuance, which was jointly arranged by BOC International, Citigroup, HSBC and JPMorgan. These US dollar denominated notes have a fixed interest coupon of 4.375% p.a., with interest payable semi-annually in arrears. The yield to investors is 4.401% p.a., representing a spread of 2.70% p.a. over 10-year US Treasury notes. This transaction was more than six times subscribed with an orderbook aggregating US$2.25 billion. The unsecured notes were rated BBB- by S&P, and A- by Fitch.

Orders were received from more than 150 high quality fixed income accounts, while the notes were distributed 85% in Asia and 15% in Europe. Some 31% were allocated to insurers, 29% to asset and fund managers, 10% to banks, 23% to private banks and 7% to corporate and others.

Demand was so high for this 10-year paper that BOC Aviation reopened the issuance to issue a further US$150 million to tap into unfilled investor demand. The re-opened issuance was more than six times subscribed with orders exceeding US$900 million.

Carrying the same coupon rate of 4.375% per annum and the same maturity date of 2 May 2023 as the existing bonds, the additional US$150 million in new Notes were priced to yield 4.265% p.a. with a spread of 263 basis points p.a. over 10-year Treasury notes, with interest payable semi-annually in arrears. The additional Notes were arranged by BOC International and HSBC as joint bookrunners. Again there was a broad allocation, with insurance companies taking 43%, 38% to funds and asset managers, 12% to private banks and 7% to banks and other investors.

This pattern was echoed in November 2013, when BOC Aviation's first five-year offshore Chinese renminbi bond was re-opened and upsized from RMB1 billion to RMB1.5 billion to fulfil investor demand. The milestone bond carried a coupon of 4.5% p.a. The original deal, jointly arranged by BOC International, HSBC and Standard Chartered Bank, was 3.5 times subscribed with an order book from 60 high quality fixed income accounts. The notes were distributed 56% in Hong Kong, 27% in Singapore, 11% in Taiwan and 6% in Europe and others, with 53% going to private banks and banks, 26% to insurers and sovereign funds, 16% to asset managers and fund managers, and 5% to corporate and others.

The RMB500 million additional transaction that closed a few weeks later, arranged by the same group of banks, carried the same coupon and priced to yield 4.387% p.a.

Following the success of this transaction, BOC Aviation tapped the 10-year renminbi bond market just a few months later in February 2014, which was the private placement of RMB300 million of 10-year senior unsecured fixed rate notes arranged by DBS Bank.

These notes priced at par with a fixed interest coupon of 5.5% per annum.

Given the success of its bond issuance to this point, it is unsurprising that the lessor took the decision to increase its EMTN programme from US$2bn to US$5bn in April 2014. BOC Aviation then immediately issued US$300 million 3.875% five-year senior unsecured notes due 2019.

Arranged by joint global coordinators BOC International, Citigroup and HSBC, with BNP Paribas, BOC International, Citigroup, DBS Bank, HSBC, JPMorgan and Morgan Stanley as lead managers and joint bookrunners, the US dollar denominated notes have a fixed interest coupon of 3.875% p.a., with the yield to investors of 4.107% p.a., representing at the time a spread of 2.40% p.a. over five-year US Treasury notes. Orders for these notes came from over 90 accounts and were distributed 75% in Asia and 25% in Europe, with 36% allocated to asset and fund managers, 31% to private banks, 15% to banks, 15% to insurers and 3% to corporates and others.

In July 2014, BOC Aviation issued its first Australian dollar denominated bond. The A$150 million 5.5-year fixed rate senior unsecured notes due 2020 issuance, arranged by Westpac, carries a coupon of 5.375% p.a. and pays a yield to investors of 5.469% p.a. This issuance again proven popular and was later upsized to A$200 million.

One month later the lessor again tapped the Australian dollar bond market with a A$125 million 6.5-year fixed rate senior unsecured notes due 2021, with a coupon of 5.375% p.a and a yield of 5.421%. This deal too was subsequently upsized to A$200 million.

BOC Aviation closed off 2014 with a further renminbi issuance. The RMB1.5 billion four-year fixed rate senior unsecured notes have at a coupon of 4.2% p.a. Orders totalled RMB4.5 billion from 99 accounts. On this occasion 46% of the notes went to asset managers and fund managers, 23% to insurers, 20% to private banks and 11% to banks.

The lessor closed a privately placed renmibi bond in February 2015. The offshore RMB250 million five-year fixed rate senior unsecured notes, arranged by DBS Bank, priced at par with a fixed interest coupon of 4.7% p.a.

In March, BOC Aviation converted its US$5 billion EMTN programme to a US$5 billion Global Medium Term Note Program (GMTN Program) to tap the deep US capital markets. Citigroup, HSBC and JPMorgan are arrangers for the GMTN Program, and act as dealers together with BOC International.

BOC Aviation's long-term corporate credit rating was then upgraded to A- from BBB with stable outlook by S&P. Shortly after this, the lessor launched its first Rule 144A/Regulation S US$750 million five-year fixed rate senior unsecured notes due 2020 at a coupon of 3% p.a and a yield of 3.118%, representing a spread of 170 basis points per annum over five-year US Treasury. In terms of distribution, the Notes were allocated to 284 accounts in the United States (50%), Asia (39%) as well as Europe and Middle East (11%).