Recent private equity **investment in aviation**

Private equity has been upping its game in aviation, writes **David Berkery**, Partner, A&L Goodbody.

Investment by private equity (PE) funds in the aviation sector is not a new phenomenon. PE houses such as Oaktree, CarVal, Terra Firma, Cerberus, Apollo and Fortress have owned or part-owned some of the largest aircraft leasing companies for years. But recently the risk profile and yield potential offered by aviation has attracted even more private equity investment, using a variety of different investment structures.

As the aviation industry grappled with the near worldwide halt of commercial aviation in 2020, new debt funding became increasingly difficult for most leasing companies to source but there remained a plethora of equity investors looking for the right investment opportunity.

Before the onset of Covid-19, there was massive year-on-year increase of the aviation asset-backed securities (ABS) market during the 2014 to 2019 period. It reflected the appetite among private equity firms to acquire aviation debt. While tradable E-Notes (issued under Rule 144A of the US Securities Act as securities of ABS vehicles) were not without their problems when it came to secondary trading, this product did introduce new and different equity investors to the aircraft leasing sector.

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Limited partnerships

The most traditional method of raising private equity funds is to form a limited partnership with a defined investment strategy and a trusted general partner to manage the investment. These types of fund raises have been a crucial element in the growth strategy of numerous PE-backed leasing companies.

A typical investment strategy would be to access a warehouse facility to lever up the equity investment, acquire a portfolio of aircraft (either in a single acquisition or over a period of time) and then to take out the warehouse debt using an ABS or another cheaper form of long-term financing.

This type of equity raise has been frequently used by US-based platforms and asset managers, such as Aero Capital Solutions ($200 million equity raise in 2019 and $413 million in 2020), Castlelake, Apollo and Carlyle.

Raising equity through unregulated fund structures has some potential disadvantages, however, particularly when it comes to attracting investment from European investors and those who are limited to investments into regulated vehicles. Typically, investment by European investors in these types of funds needs to be on a “reverse-solicitation” basis, meaning the investor comes “at its own exclusive initiative” to the investment manager rather than the manager marketing the fund to them.

Given the amount of available capital there has been for aviation in recent years, this has not been a major concern for private equity-backed platforms. But it is clear that there would be advantages to using a regulated vehicle such as an Irish Collective Asset-management Vehicle or an Irish Investment Limited Partnership to raise an aviation fund, and we expect to see a lot more interest in these types of vehicles.

Sidecar joint ventures

Over the past few years, sidecar joint ventures have become more and more popular in the aviation sector. These structures typically marry a passive investor with capital to deploy, but lacking an aircraft leasing platform with the expertise and resources of an existing aircraft lessor.

A good example of this was the $2 billion Einn Volant structure created in 2017 between Caisse de dépôt et placement du Québec, a leading institutional asset manager, and GE Capital Aviation Services Limited (GECAS). More recently, GECAS entered into a similar arrangement with PIMCO, creating a $3 billion leasing investment platform. In both cases, the platform vehicle was an Irish entity capitalised using profit participating notes.

From the perspective of the private equity investors, they benefitted from world-class experience and expertise, access to the marketing network of a global lessor and improved access to warehouse and other financing.

From the perspective of the leasing company, aside from the new equity which is being invested into the vehicle and the ongoing servicing fees being generated, they can use the sidecar vehicle to allow them to do deals which may have otherwise triggered concertation concerns.

For example, an airline in Russia issues a request for proposal for a six-aircraft sale and leaseback transaction but the leasing company could trigger a concentration limit default if it leased more than four aircraft to airlines in that country. Working with the sidecar investors, the leasing company could still do that six-aircraft deal but on the basis that two of the sisterships would go into the sidecar vehicle instead.

Sidecar deals are structured to align interests between the parties as much as possible so that it is to everyone’s benefit that the platform succeeds. It was not surprising to see Kennedy Lewis team-up with Arena Aviation, Corrum Capital Management enter into a joint venture with Sirius Aviation in early 2021 and before that Avolon, CALC and Air Lease Corporation enter into sidecar arrangements with investors.

Loan book acquisitions
Even before the economic impact of the Covid-19 pandemic hit the aviation sector, the changes to global bank capital requirements imposed by Basel IV prompted certain banks to reassess their aviation lending platforms.

In 2019, it was reported that DVB Bank's aviation loan book was on the market and a suite of private equity investors expressed interest in acquiring the book. Similarly, General Electric's sale of PK Airfinance drew the attention of multiple private equity firms before its ultimate acquisition by Apollo Global Management and its insurance company affiliate, Athene.

As the effects of the pandemic took hold, certain other lenders in the sector looked to exit, and private equity investors saw value in the opportunities which emerged. In May 2021, funds managed by Stonepeak Infrastructure Partners and Sydney-based Bellinger Asset Management agreed to acquire a $1.1 billion performing aircraft loan portfolio (secured by 159 aircraft) from National Australia Bank.

Soon afterwards, funds managed by KKR launched a new lending platform (AV Airfinance) with a team of established aviation professionals and acquired an almost $800 million portfolio of aviation loans from CIT Group.

Also in 2021, alternative asset manager Entrust Global and investment firm Strategic Value Partners acquired DVB Bank's aviation asset management and investment businesses.

Despite the differences between aircraft portfolio acquisitions and secured loan portfolio acquisitions, the processes have been relatively similar:

- private equity investors have sought out expertise (either through a joint venture with an existing platform or by launching a new platform with experienced professionals);
- the new vehicle has sourced either a warehouse loan or an acquisition financing allowing it to leverage-up the equity commitment;
- the portfolio of loans has been acquired from the previous lender; and
- the vehicles have looked at ways of taking out the expensive acquisition financing either through a modified ABS, a collateralised loan obligation or a hybrid of the two.

It is reasonable to think we will see this model adopted by others if more traditional lenders in the sector seek to sell some or all of their positions.

New leasing platforms
A different strategy adopted by other investors has been to identify key individuals in the industry and to build a new platform around them. Bain Capital announced in early 2020 that it would provide capital to support a new leasing and asset management platform (Griffin Global Asset Management) with Ryan McKenna as chief executive officer of the new venture. Griffin has gone on to close a $1 billion warehouse facility enabling it to build its portfolio of aircraft and aircraft loans.

Another example of this can be seen in the M&G Investments equity investment in Sky Leasing under the executive leadership of Austin Wiley in 2019. By the middle of 2021, Sky Leasing had secured a $600 million warehouse facility (later upsized by an incremental $150 million), acquired a portfolio of young Airbus and Boeing aircraft and taken out the warehouse debt through its SLAM 2021-1 ABS with record low pricing on the senior tranche.

A similar approach was used in the formation of new US lessor Vmo with funds managed by Ares Private Equity attracting some of the original founders of Vx Capital Partners to launch a new leasing platform.

Existing platforms
There are many upsides to starting a new platform from scratch but depending on market conditions, growing a portfolio (let alone a team) can take time. This can be avoided by acquiring an existing platform, as was the case in CarVal Investors' acquisition of a 90% stake in Aergo Capital in 2014.

More recently, funds managed by Oaktree Capital Management adopted this approach when they invested in existing regional aircraft leasing platform Azorra Aviation based out of Fort Lauderdale, Florida.

In speaking with private equity firms looking to invest in the sector through the acquisition of an existing platform, it is clear that the make-up of the management team is more important than the make-up of the aircraft portfolio. Negotiations for this type of investment can frequently centre on ensuring that the management team remains in place after the investment has been made.

Other types of investment
Perhaps the most straight-forward investment into the aviation leasing and finance sector is to buy publically traded stock of listed aircraft lessors. This investment typically offers very limited execution risk and a clear path to exit in the future. However, a number of factors may make this option less attractive:

- since Avolon Holdings' delisting in 2016, the acquisition by Marubeni and Mizuho of publically traded Aircastle and, most recently, Carlyle Aviation Partners' acquisition of Fly Leasing, there are a limited number of listed aircraft lessors remaining in which to invest;
- the ABS tradable E-Note gave investors a taste for increased transparency and detailed information, an ability to influence management of the portfolio and (subject to limited substitution and reinvestment rights) a defined portfolio of aircraft into which it was investing; and
- this type of investment will be more sensitive to general conditions prevailing in the equity markets and, as the early days of the pandemic demonstrated, stock prices can be prone to greater fluctuation than the metal underpinning the investment.

ABS debt and E-Notes have also proven to be attractive investment tools for private equity investors over the years and the rapid post-pandemic return of the ABS market was testament to this. While it is unlikely we will see tradable E-Notes return in the near future, single third-party equity holder deals have a lot to offer investors.

In essence, these deals are similar to the sidecar joint ventures that have proven very popular recently. But instead of investing in a blind portfolio supported by a warehouse loan, the investor would have the benefit of due diligence on the defined aircraft portfolio while still inputting on the terms of the external debt and working with the servicer of its choice. Once trading conditions improve and large portfolio sales return, this type of structure may make a comeback.

Opportunities in a distressed environment
As certain airlines and leasing companies have faced distress, opportunities have arisen for private equity investors whose investment criteria tend to be more flexible than those of institutional lenders. As a number of airlines filed for Chapter 11 protection in 2020, private equity investors took the opportunity to provide debtor-in-possession financing on a super-senior secured basis.

Similarly, as secured lenders, bolstered by protections afforded by the Cape Town Convention, seek to exercise enforcement rights against insolvent airlines or lessors, private equity investors are watching closely for opportunities to acquire aircraft in distressed market conditions.

*A&L Goodbody acted as Irish counsel on transactions cited in the article. All factual information contained in this article is already in the public domain.

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