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Research Update:

Aviation Capital Group Upgraded To 'A-' From 'BBB-' On Improved Status Within Pacific Life Insurance Co., Outlook Stable

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Overview

- We recently revised our assessment of aircraft lessor Aviation Capital Group Corp.'s (ACG) importance to its parent, Pacific Life Insurance Co., to strategically important from moderately strategic under our Group Rating Methodology, based on the level of commitment, support, and earnings diversification that the company provides to Pacific Life Group, Pacific Life Insurance's parent.
- We also revised our stand-alone credit profile on ACG to 'bbb-' from 'bb+' based on the company's improved credit metrics.
- Therefore, we are raising our ratings on Aviation Capital Group Corp. to 'A-' from 'BBB-'.
- The stable outlook reflects our expectation that ACG's credit metrics will remain relatively consistent as the company continues to benefit from strong earnings and cash flow, despite the incremental debt it has taken on to fund new fleet acquisitions. We believe the company will maintain a funds from operations (FFO)-to-debt ratio of around 10%-11% through 2017.

Rating Action

On July 11, 2016, S&P Global Ratings raised all of its ratings on Newport Beach, Calif.-based Aviation Capital Group Corp., including our corporate credit rating, to 'A-' from 'BBB-'. The outlook is stable.

Rationale

The upgrade predominantly reflects that we have revised our view of ACG's group status to its parent, Pacific Life Insurance Co., to strategically important from moderately strategic under our Group Rating Methodology, which is based on the level of commitment, support, and earnings diversification that the company provides to Pacific Life Group, Pacific Life Insurance's parent. In addition, we have revised our stand-alone credit profile on ACG to 'bbb-' from 'bb+' based on the company's improved credit metrics, which we expect it will maintain through 2017. The company's EBITDA interest coverage metric has averaged around 3x and its FFO-to-debt ratio has averaged around 11% over the last year supported by its increasing earnings and cash flow and relatively stable debt levels.

Over the next few years, ACG will be accepting delivery of a relatively small number of committed new aircraft; however, we expect that the company will continue to take advantage of opportunistic acquisitions. Despite the incremental debt it will take on to fund these purchases, we expect that the company's earnings and cash flow will improve and provide it with relatively stable credit metrics through 2017. We expect that ACG will maintain a FFO-to-debt ratio of around 10%-11%, an EBITDA interest coverage metric of around 3x, and a debt-to-capital ratio in the high-70% area over this period.

Aircraft lessors' credit ratios, similar to those of other transportation equipment lessors, are typically weaker than those of comparably rated industrial companies. However, these companies typically generate relatively strong and stable cash flow to service their high levels of debt. On this basis, we assess the company's financial risk profile as significant.

ACG is a wholly owned subsidiary of Pacific Life Insurance Co. We consider ACG to be strategically important to its parent under our Group Rating Methodology, and thus we rate ACG three notches higher than our 'bbb-' stand-alone credit profile on the company.

We assess the company's business risk profile as satisfactory based on its position as a major provider of aircraft operating leases and as an owner of new technology aircraft with relatively stable asset values. The company's fleet comprises more than 260 owned and managed aircraft leased to about 100 airlines in approximately 45 countries. In terms of fleet size, this places ACG in the second tier of aircraft lessors, which includes Babcock & Brown Air Ltd. (including Fly Leasing Ltd.), AWAS Aviation Capital Ltd., C2 Aviation Capital Inc. (CIT Aerospace International), SMBC Aviation Capital Ltd., Aircastle Ltd., BOC (Bank of China) Aviation Ltd., and Air Lease Corp. Each of these companies' aircraft fleets are much smaller than those of GE Capital Aviation Services (GECAS) and AerCap Holdings N.V. (which acquired International Lease Finance Corp. in May 2014), based on the number of aircraft and value of their fleets, yet the aircraft lessors in the second tier still have substantial operations and compete effectively. ACG also faces the inherent risks of cyclical demand and lease rates for its aircraft.

ACG's fleet comprises primarily Airbus A320s and Boeing B737s, with a relatively young average fleet age of about six years. The company's portfolio is well diversified both geographically and in terms of its customer base. ACG's committed orders total about 100 aircraft to be delivered through 2021.

Our base-case scenario assumes the following:
- Global GDP growth of 3.4% in 2016 and 3.7% in 2017;
- Committed capital spending for new aircraft deliveries as well as opportunistic spending for aircraft in 2016 and 2017; and
- Relatively stable margins.

Based on these assumptions, we arrive at the following credit measures for 2016 and 2017:
- Relatively stable FFO to debt of about 10%-11%;

- Relatively stable EBITDA interest coverage of around 3x; and
- Relatively stable debt to capital in the high-70% area.

ACG does not disclose its financial results publicly.

Liquidity

We believe that ACG has sufficient sources of liquidity to cover its needs over the next year. The company has availability under its $1.7 billion revolving credit facility that matures in 2020 and modest committed capital spending for new aircraft.

Principal liquidity sources:

- Cash;
- Our expectation for FFO of at least $600 million a year in both 2016 and 2017;
- Access to various bank and export credit agency financings to fund new aircraft purchases;
- Proceeds from aircraft sales; and
- Potential further unsecured capital market financings.

Principal liquidity uses:

- Debt maturities; and
- Capital expenditures for new aircraft.

Outlook

The stable outlook on ACG reflect our expectation that the company's credit metrics will remain relatively consistent on continued strong earnings and cash flow despite the incremental debt it will take on to fund new fleet acquisitions. We believe that the company will maintain an FFO-to-debt ratio of around 10%-11% through 2017.

Upside scenario

Although unlikely, we could upgrade ACG over the next two years if it is able to attain a FFO-to-debt ratio of at least 12% on a sustained basis, which could occur because of stronger-than-expected earnings and cash flow on higher-than-expected lease rates or a lower-than-expected level of debt leverage.

Downside scenario

Although unlikely, we could lower our ratings on ACG over the next two years if its FFO-to-debt ratio declines below 9% on a sustained basis. This could occur if global economic weakness causes the demand for the company's aircraft to decline, which would likely pressure its lease rates and cash flow.

Related Criteria And Research

Related Criteria

- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

- For Transportation Equipment Lessors, Multiyear Leases Aid Cash Flow And Ratings Stability, Oct. 18, 2006

Ratings List

Upgraded; Outlook Action

	To	From
Aviation Capital Group Corp.		
Corporate Credit Rating	A-/Stable/--	BBB-/Positive/--

Upgraded

	To	From
Aviation Capital Group Corp.		
Senior Unsecured	A-	BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column.