

**Rating Action: Moody's confirms the Baa2 long-term senior unsecured rating of Aviation Capital Group, concluding review; outlook is negative**

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21 Sep 2020

New York, September 21, 2020 -- Moody's Investors Service, ("Moody's") has confirmed the Baa2 long-term issuer and senior unsecured ratings of Aviation Capital Group LLC (ACG). The company's outlook is negative. This concludes Moody's review of ACG's ratings initiated on 1 June 2020 to evaluate the impact of the global downturn in air travel on the company's credit profile.

The disruption in air travel globally is related to the coronavirus pandemic, which Moody's regards as a social risk under its environmental, social and governance (ESG) framework, given the substantial implications for public health and safety.

**Confirmations:**

..Issuer: Aviation Capital Group LLC

....LT Issuer Rating, Confirmed at Baa2

....Senior Unsecured Regular Bond/Debenture, Confirmed at Baa2

....Commercial Paper, Confirmed at P-2

**Outlook Actions:**

..Issuer: Aviation Capital Group LLC

....Outlook, Changed To Negative From Rating Under Review

**RATINGS RATIONALE**

Moody's confirmation of ACG's Baa2 long-term ratings reflects the company's conservative recent-vintage narrow-body commercial aircraft fleet, its strong equity capital position, as well as its strong primary and alternate liquidity which together well-position the company to effectively manage the severe downturn in global commercial aviation and generate strong operating results once the recovery in air travel begins to mature, which Moody's estimates will occur in 2023. ACG has a long history of stable, profitable operations on a risk-adjusted basis and maintains debt-to-equity leverage materially below peer average. The confirmation also reflects the stable long-term ownership of ACG's parent Tokyo Century Corporation, which consolidated its 100% ownership of ACG in December 2019 after having held a minority interest for several years. Moody's expects that Tokyo Century will continue to be supportive of ACG's conservative financial posture. Credit challenges include the significant downturn in the aviation sector that weakens airline credit quality and threatens the stability of ACG's earnings and cash flow.

A differentiating ACG strength is its conservative fleet investment strategy that Moody's expects will result in lower risks to the company's earnings, cash flow and fleet value during the downturn compared to peers. ACG's \$10.1 billion fleet of 266 aircraft at 30 June 2020 had an average age of 5.3 years compared to a rated peer median of 6.3 years and an average remaining lease term of 6.8 years, the same as the rated peer median. Notably, 86% of ACG's fleet is comprised of recent vintage narrow-body aircraft, which have a large global user base and more stable demand characteristics compared to wide-body aircraft. ACG's fleet composition reduces its residual value and remarketing risks compared to competitors with higher exposure to older aircraft and wide-body models. This is especially important given that a higher percentage of ACG's leases (by net book value) mature during the downturn than certain peers.

Moody's expects that leasing will remain an important source of aircraft acquisition capital for the airline industry and that recovery will provide new leasing opportunities that will help to revive cash flows and earnings. Moody's also anticipates that demand for narrow-body aircraft will recover sooner than for wide-body aircraft as air travel demand strengthens, which should provide ACG earlier opportunity to restore weakened revenue levels compared to lessors needing to remarket a higher number of wide-body aircraft.

ACG's conservative capital profile is also a credit strength compared to peer aircraft leasing companies, particularly given the company's less risky aircraft fleet composition. ACG's ratio of debt to tangible equity of 2.0x at 30 June 2020 was materially lower than rated peers, whose ratios range from 2.3x to 3.1x at the same reporting date. Moody's expects that ACG will continue to maintain a strong capital cushion with debt-to-tangible equity leverage of less than 2.5x, which is a key support of the company's ratings. Moody's expects that Tokyo Century will be supportive of ACG's conservative financial targets.

ACG has taken several measures to strengthen its liquidity in recent months, including issuing long-term debt, repaying short-term debt outstanding, arranging new backup borrowing capacity, and reducing and restructuring aircraft purchase commitments. Moody's estimates that ACG's liquidity resources are sufficient to cover 170% of the company's 12-month cash needs for debt repayment, aircraft acquisitions and operating expenses as of 31 August 2020 on a pro forma basis. ACG issued \$1 billion in senior unsecured notes in July, repaid \$348 billion in commercial paper outstanding, deferred or canceled about \$1.3 billion of aircraft purchase commitments and obtained a new \$600 million three-year borrowing facility from parent Tokyo Century. ACG's primary liquidity coverage is moderately lower than certain investment grade rated peers in part due to proportionately high maturities of senior unsecured notes in Q1 2021. However, ACG's low reliance on secured funding has resulted in a largely unencumbered aircraft fleet, which provides for a strong secondary liquidity cushion, given the quality of the aircraft in the fleet. Moody's expects that ACG will continue to pursue liquidity and liability management actions that will preserve its strong liquidity runway during the downturn. A liquidity coverage ratio that declines to less than 150% during the downturn could result in a rating downgrade.

A challenge for ACG and other aircraft leasing companies is navigating the unprecedented decline in the aviation sector that has accompanied the global coronavirus pandemic. Moody's expects that air passenger demand will recover strongly toward 2019 levels during 2023, but during the interim weak airline performance will result in higher lease defaults and lower leased aircraft utilization and lease rates, negatively affecting lessors' rental revenues, earnings and cash flows through 2022. As a result of these challenges, Moody's has lowered its assessment of aircraft lessors' operating environment to Ba1 from Baa2 to reflect lower expected industry stability.

Lessors have accommodated airlines by agreeing to short-term deferrals of a portion of lease payments in exchange for repayment with interest on an agreed schedule. As of 30 June 2020, ACG had agreed with airline customers to temporarily defer rental collections totaling \$64 million, which represents about 6.4% of the company's 2019 rental revenues. This is a smaller percentage compared to certain competitors, but Moody's expects that many weakened airlines will press for extensions of existing rent deferral agreements and repayment schedules, extending the temporary weakening of ACG's operating cash flow. Revenue declines associated with defaulted leases and the increased difficulty of redeploying aircraft into alternate lease arrangements given the weak demand environment will further weaken operating cash flows until leased aircraft demand strengthens as air travel volumes recover.

ACG's negative outlook reflects Moody's expectations of a more extended and weaker recovery in air travel that results in higher risks to earnings, cash flow, liquidity and capital positions.

Moody's regards the coronavirus outbreak as a social risk under its ESG framework, given the substantial implications for public health and safety. Today's rating action reflect the negative effects on ACG of the breadth and severity of the shock, and the deterioration in credit quality, profitability, capital and liquidity it has triggered.

#### FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

A ratings upgrade is unlikely over the next 12-18 months given the negative outlook but ACG's ratings could be upgraded if: 1) the company maintains liquidity coverage consistently stronger than the average of investment-grade peers, 2) the company generates stable profits and cash flow at margins considerably stronger compared to historical levels while maintaining a conservative fleet composition; 3) fleet residual value risks materially decline and lease maturities become more evenly distributed, and 4) the company's management of capital remains strong, resulting in a debt-to-equity leverage ratio less than 2.5x.

ACG's ratings could be downgraded if: 1) liquidity coverage of expenditures and debt maturities (one-year horizon) declines to less than 150%, 2) profitability and cash flow decline materially or fail to strengthen adequately during the aviation sector recovery; 3) debt-to-tangible equity leverage increases to more than 2.5x; 4) fleet composition results in materially higher residual risks.

The principal methodology used in these ratings was Finance Companies Methodology published in November 2019 and available at [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_1187099](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1187099) . Alternatively, please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

## REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_79004](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004).

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_1133569](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569) .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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