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BOC Aviation Credit Research



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BOC Aviation Could Widen If Fitch Downgrades China: Credit React

(Bloomberg Intelligence) --

RECENT EVENT REACTION:

BOC Aviation's credit spreads could be pressured if Fitch potentially

downgrades China's sovereign rating due to concerns about contingent liabilities, as indicated by the rating agency. Fitch anchors the lessor's credit rating to that of its majority owner, Bank of China, which in turn is derived from the sovereign rating. BOC Aviation is currently rated A- by Fitch and S&P. The lessor's composite rating would be the lower of the two as it doesn't have a Moody's rating.

(08/16/23)

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1. BOC Aviation: Credit Outlook

THESIS: BOC Aviation's low-A rated bonds offer much better value than its A rated majority owner, Bank of China, yet trade very tight to global peers, and this relative spread relationship is unlikely to change in 2023. The lessor could continue to enjoy a significant funding advantage over peers and most airlines due to its owner, which also provides a liquidity backstop. The company will likely be an active issuer in 2023 despite a slowdown in capital spending due to delivery delays, after a subdued 2022. (05/02/23)

Credit Considerations

Credit Checklist

2. Delivery Delays Could Keep BOC Aviation Capex, Leverage in Check

BOC Aviation's leverage, at 2.9x in 4Q, could improve further as aircraft-delivery delays at Boeing and Airbus likely keep capital spending in check and support its ratings. S&P's A- issuer rating is sensitive to the stand-alone and includes three notches of uplift for Bank of China's 70% stake. The delays could be positive for credit spreads as well, through favorable market technicals. The company could lean heavily on the bond market for funding needs in 2023 due to improved market conditions, after relying on the bank-loan market last year. That could make BOC Aviation a net issuer this year, compared with scheduled maturities of \$1.8 billion.

Earnings growth may be driven mostly by fleet expansion as the tailwind from higher lease rates is offset by the headwind from rising funding costs. (05/02/23)

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BOC Aviation's Credit Checklist

Credit Drivers	Outlook	Outlook Trend	Weighting* (%)
Earnings & Cash Flow	■	↓	20
Leverage & Financial Policies	■	↑	20
Competitive Landscape	■	↔	15
M&A	■	↔	10
Event Risk	■	↔	10
Stock Performance	■	↓	5
Debt Maturities	■	↓	20
Valuation	■	↔	N.A.

■ Unfavorable
 ■ Neutral
 ■ Favorable

*This represents the view of Bloomberg Intelligence based on current market conditions and doesn't represent any interpretation of future events

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Source: Bloomberg Intelligence

Credit Drivers: Weakest Leverage But Highest Rated

BOC Aviation May Eke Out a Small Profit In 2022 Despite 1H Loss

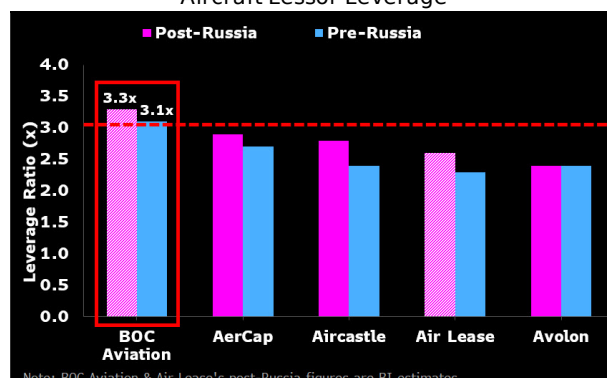
BOC Aviation's low-A rating and dividend may come into focus as its Russia exposure could relegate the lessor to its first net loss in 1H and trim recurring revenue as well. The looming 1H loss may cause the company's worst-in-sector leverage to deteriorate further and potentially take a bite out of its 2022 dividend. (05/19/22)

3. Russia Exposure Impairment Loss on the Cards for 1H

BOC Aviation could post its first ever net loss in 1H as it may need to write off its entire net exposure to Russian airlines following Russia's aircraft grab. The looming 1H loss could be about \$200 million and push the lessor's debt-equity ratio up to about 3.2-3.4x, a level that leaves little room for debt-funded growth, but which could be addressed by issuing a perpetual. The lessor could still post a modest profit in 2022 due to the post-Covid recovery in aviation and the global shortage of aircraft, which has led to improved rents and gains from asset sales.

BOC Aviation's net exposure to Russia dropped to \$589 million in 1Q and now accounts for 2.5% of total assets after it recovered a freighter and drew down all the related collateral. We expect insurance claims to eventually cover some, but not all, of the losses. (05/19/22)

Aircraft Lessor Leverage



Source: Company Filings, Bloomberg Intelligence

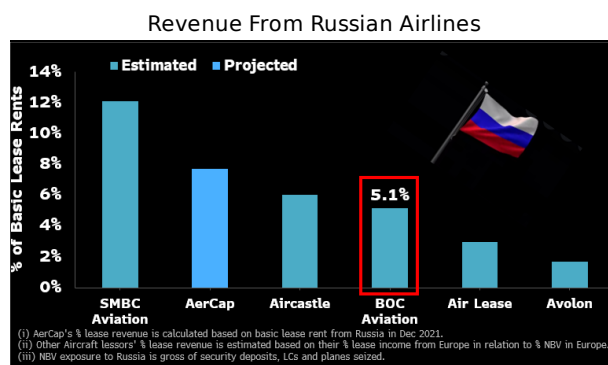
4. Loss of Lease Rent From Russia Exit Adds to Woes

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The loss of Russian lease rents, while not a credit event by itself, could add to the sector's potential revenue headwinds, which include aircraft delivery delays and the myriad impacts linked to higher fuel costs. Replacing the lost revenue via new business may also lead to further balance sheet expansion and higher leverage. BOC Aviation's revenue may drop by about \$90-\$100 million a year, which is about 5% of recurring revenue, due to the cancellation of leases to comply with the sanctions imposed on Russia. The impact on Ebit should be higher, at around 7%, as financing costs for the aircraft stuck in Russia remain on the books.

We don't anticipate foreign aircraft lessors returning to the Russian market for the foreseeable future due to sanctions and other restrictions. (05/19/22)

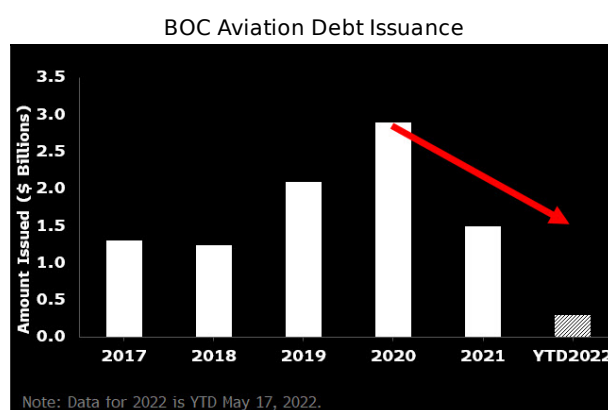


Source: Company Filings, Bloomberg Intelligence

5. Delivery Delays May Keep Issuance in Check

BOC Aviation may issue about \$1.2-\$1.7 billion of long-term debt in 2022 against scheduled maturities of \$1 billion, which would be roughly in-line with the \$1.5 billion that it issued in 2021, but well below the 2019-20 run rate of \$2.6-\$2.9 billion a year due to delivery delays at aircraft manufacturers. Although the lessor intends to raise its capex to about \$3 billion from \$2.1 billion in 2021, particularly to offset the loss revenue from Russia, it could be tough due to persistent aircraft delivery delays. BOC Aviation may look to pre-fund some of its 2023 maturities given the \$2.2 billion coming due that year.

The firm's plans to sell about \$1 billion of aircraft in 2022 should reduce issuance needs by a commensurate amount. (05/19/22)



Source: Bloomberg Intelligence

Relative Valuation: As a Lessor or a Chinese SOE?

BOC Aviation Appears to Have More Relative Value Than Parent

BOC Aviation's A- rated bonds appear to have more relative value and incremental spread pickup when compared to its A rated majority owner, Bank of China, and they trade in line with A rated

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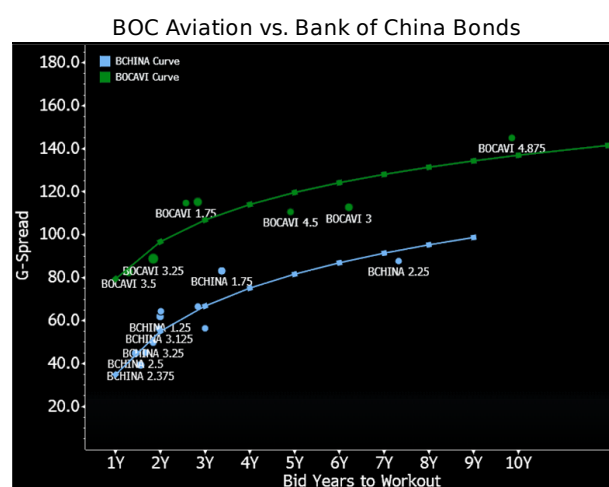
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corporates. But the lessor's credit spreads have less room to improve than lower-rated peers AerCap, Air Lease and Avolon. (06/28/23)

6. BOC Aviation's Spread Pickup vs. Parent

BOC Aviation's A-/A- rated cash bonds have better relative value and about 30 basis points of incremental spread vs. its A1/A/A rated majority owner, Bank of China. Though Bank of China doesn't guarantee BOC Aviation's bonds, it still owns 70% of the firm. S&P and Fitch view the lessor as a strategically important subsidiary of BOC, and Fitch has even anchored its credit rating to that of its majority owner with a one-notch differential. The incremental spread pickup is now just 30 bps, after widening to almost 70 bps in 2022 due to a write-off of Russia exposure.

We don't see the relationship between Bank of China and BOC Aviation changing in a meaningful way, beyond BOC potentially reducing its ownership stake to 65% from 70%, an option that it currently has. (06/28/23)



Source: FIW <GO>, Bloomberg Intelligence

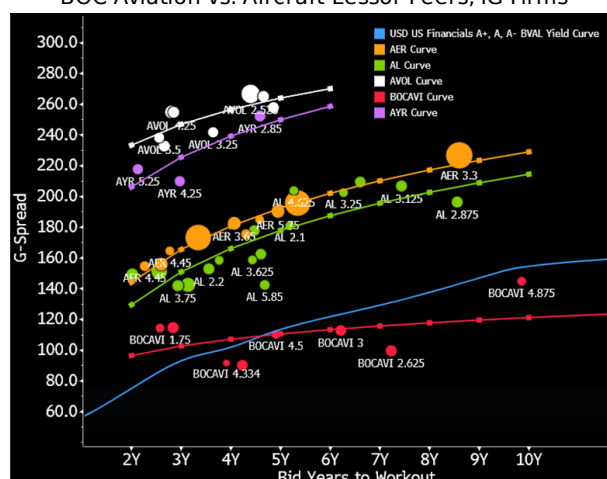
7. Other Lessors Offer More Relative Value

BOC Aviation's lower-rated peers, AerCap, Air Lease, Aircastle and Avolon, have more relative value and still higher yields. But those higher yields could come with more volatility, and BOC Aviation is the only lessor with a credit rating in the A bucket, which could be a criterion for certain investors. Bank of China's 70% stake in BOC Aviation reduces the lessor's equity-market volatility. The A- rating could meet the investment objectives of ratings-sensitive investors such as insurers, which might expand the lessor's investor base.

BOC Aviation's cash bonds have tightened to trade in line with A rated investment-grade corporates after spreads gapped out in 2022 due to Russia-related headwinds and uncertainty. (06/28/23)

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BOC Aviation vs. Aircraft-Lessor Peers, IG Firms



Source: FIW <GO>, Bloomberg Intelligence

Earnings Review

Earnings Review

8. BOC Aviation Core Profits Might Have Risen Over 15%: 1H Preview

Contributing Analysts Tim Bacchus (Aviation) & Eric Zhu (Aviation)

BOC Aviation's 1H core net profit, which excludes any impact of a writedown related to aircraft in Russia, might have risen more than 15% year-on-year. Income would have been spurred by higher net lease yields as the company signed a total of 45 leasing commitments over January-June, amounting to close to 10% of its owned and managed fleet. Revenue from sale of aircraft might have declined in 1H after it sold only four planes, including one to a lessee upon delivery, vs. 22 a year ago.

BOC Aviation's finance expense might have led cost increases and risen to more than 35% of its total as the company took delivery of an additional 16 planes in 1H amid rising interest rates. Financing expense accounted for 33% of total expenditure in 2022. (08/16/23)

Key Points:

- BOC Aviation Might Have Booked Core Net-Profit Increase of More Than 15% Year-on-Year as Net Lease Yield Rose
- Ability to Hike Yields on Unplaced Aircraft and Lease Extensions Should Persist on Strong Demand for Aircraft
- Net Lease Yield Will Likely Rise Above 7% in 2023, Powered by Higher Rates for New Leasing Commitments
- Related Revenue and Profit Gains From Aircraft Sales Will Likely Be Weighted Toward 2H

Additional Resources:

- Analyzer | BI »
- Earnings Calendar | EVTS »
- Company Outlook | BICO »

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