SMBC Aviation Capital Limited

Full Rating Report

Ratings

SMBC Aviation Capital Limited

Long-Term IDR[a]	A–

SMBC Aviation Capital Finance DAC

Long-Term IDR[a]	A–
Senior Unsecured Notes[a]	A–

[a]Upgraded from ‘BBB+’ on May 11, 2017.

Outlook

Stable[a]

[a]Revised from Negative on May 11, 2017.

Financial Data

(USD Mil.)	3/31/17	3/31/16
Total Assets	10,636.5	9,922.0
Total Debt	7,253.8	6,836.6
Total Equity	1,786.3	1,471.1
Debt/Tangible Common Equity (x)	4.1	4.7
Total Comprehensive Income	315.2	148.6
EBITDA	987	862
ROAA (%)	3.1	1.5
ROAE (%)	19.4	10.6
EBITDA/Interest Expense (x)	3.3	3.2

Related Research

2017 Outlook: Finance and Leasing Companies (November 2016)

Aircraft Leasing Industry Overview (January 2017)

2017 Outlook: Global Aerospace & Defense

Large Equipment Leasing: Rating Attribute Analysis (September 2014)

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Key Rating Drivers

Strong Majority Owner Linkage: SMBC Aviation Capital’s (SMBC AC) ‘A–’ rating is based primarily on the company’s strong linkage with its majority owner, Sumitomo Mitsui Financial Group, Inc. (SMFG, Long-Term IDR of ‘A’/Stable). On May 11, 2017, Fitch Ratings upgraded SMBC AC’s Long-Term IDR to one notch below SMFG's Long-Term IDR to reflect that SMFG demonstrates an increasingly strong propensity to support SMBC AC. Group funding comprised 56.9% of SMBC AC’s total debt as of March 31, 2017, and SMBC AC is majority owned by SMFG.

Strategically Important Subsidiary: Fitch considers SMBC AC to be a strategically important subsidiary of SMFG as defined under the agency’s “Global Non-Bank Financial Institutions Rating Criteria,” dated March 2017. SMBC AC has a proven track record of profitability under SMFG's ownership and also exhibits an integrated strategy, consistent branding and parent company representation on its board of directors.

Outlook Revision: The Stable Rating Outlook for SMBC AC is consistent with the Rating Outlook on SMFG's Long-Term IDRs. The Stable Rating Outlook on the Long-Term IDRs of SMFG and its core banking subsidiary, Sumitomo Mitsui Banking Corporation (SMBC), stems from Fitch's view that Japan's sovereign rating (Long-Term IDR of ‘A’/Stable) now effectively supports these entities' Viability Ratings.

Established Track Record: SMBC AC (and its predecessor organization) has built a well-established aircraft leasing franchise over the past 16 years, with profitability in every year of operation (excluding the effect of one-off breakage costs in relation to acquisition refinancing in FY13), limited asset impairment charges and stable lease rates. The company has an experienced management team, an institutional structure capable of supporting a large aircraft fleet and a well-diversified customer base.

Quality Aircraft Fleet: Fitch considers the quality of the aircraft fleet a significant strength, as it is largely unencumbered and predominantly comprises in-demand and fuel-efficient narrowbody Boeing and Airbus aircraft (top models as of March 31, 2017 were B737-800 [43.1% of net book value] and A320-200 [34.8%]). As of March 31, 2017, the weighted average age of the fleet was low at 4.5 years. SMBC AC has demonstrated the ability and discipline to execute aircraft sales successfully through various market environments, which Fitch views positively.

Concentrated Funding, High Leverage: SMBC AC's funding profile, which exhibits concentration with parent funding sources, and its elevated balance sheet leverage counterbalance its stand-alone strengths. Third-party funding represented 43.1% of SMBC AC's total debt funding as of March 31, 2017. Leverage (debt to tangible equity) was 4.1x at March 31, 2017, which has trended down but remains high compared to the peer average.

Rating Sensitivities

SMFG Ratings: SMBC AC’s ratings are primarily sensitive to changes in SMFG's ratings, given the one-notch differential between the IDRs of SMFG and SMBC AC.

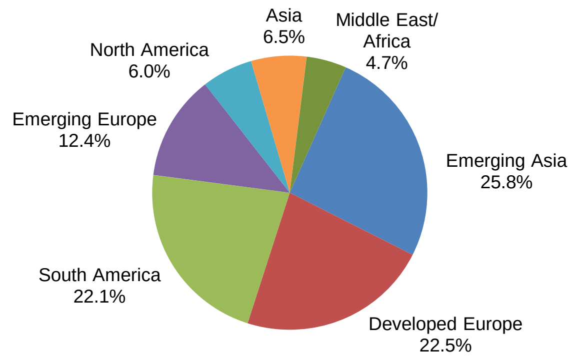
Support from SMFG: Although not expected by Fitch, SMBC AC's ratings could be adversely affected should SMFG seek to dispose of or meaningfully reduce its investment in SMBC AC, or should there be any other developments that are perceived by Fitch to alter SMFG's willingness or ability to provide support to SMBC AC.

Operating Environment

Sovereign Rating

SMBC AC is based in the Republic of Ireland (‘A–’/Stable); however, as is the case with all aircraft lessors, its global customer base has sovereign exposure to a wide variety of countries and regions. As such, SMBC AC is exposed to the variabilities of countries and regions in which it operates, many of which are developing markets subject to elevated economic (and potentially political) volatility.

Regional Distribution of Lessees as Percentage of Net Book Value
(As of March 31, 2017)



Source: SMBC Aviation Capital Limited.

SMBC AC’s parent company is domiciled in Japan. Japan’s Long-Term Foreign and Local Currency IDRs were affirmed at ‘A’ on April 27, 2017. The Rating Outlook was revised to Stable from Negative.

Japan's improving economic outlook has outpaced its trajectory of rising public debt. Revised economic data show the economy is larger and growing at a faster rate than previously indicated. A cyclical upturn is also underway, underpinned by near-term fiscal support and strengthening external demand. Fitch projects the gross general government debt/GDP (GGGD/GDP) ratio to rise to 238% in 2024, from 230% in 2016, compared with Fitch's previously projected increase to 260% from 245% in its June 2016 review.

Economic and Business Environment

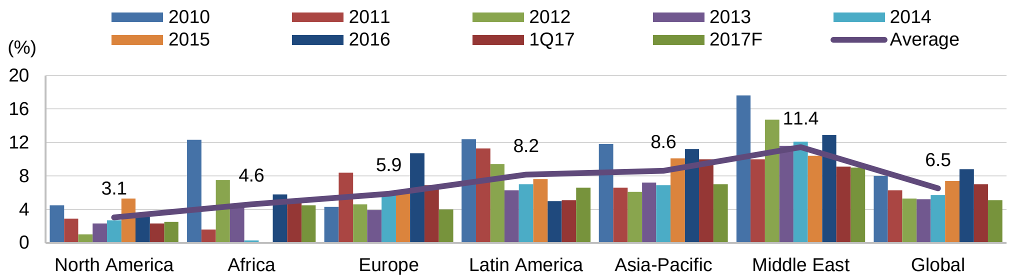
In 2017, aircraft lessors should continue to benefit from strong growth in global air traffic. Moderate increases in energy prices will reduce airline profitability, although airline sector outlooks in most regions, including Latin America, are stable. Airlines continue to adopt leasing as a form of financing, and lease yields may increase as interest rates move up. Fitch expects large commercial aircraft deliveries to increase by 8% in 2017 and thereafter approach a peak in 2018. Aircraft manufacturers have generally remained rational despite cyclicality in orders. Some recent pricing pressure on widebody aircraft could continue in 2017, although most aircraft lessors are more exposed to liquid narrowbody aircraft.

Airline load factors, although down slightly from the levels reached in 2015, remain above 83%, which is a historically high level for the industry. Revenue passenger kilometers (RPK) are anticipated to grow by 5.1% in 2017, according to the International Air Transport Association (IATA). The rate of growth for RPK is expected to weaken in all regions except for Europe and Latin America, although first-quarter 2017 exceeded expectations, with RPK growing 7.0% globally. This growth underpins demand for commercial aircraft owned by lessors, airlines and other institutions. The Asia-Pacific market is expected continue leading air traffic through 2035, according to Airbus, and will make up 36% of world RPK from 30% in 2015.

Related Criteria

Global Non-Bank Financial Institutions Rating Criteria (March 2017)

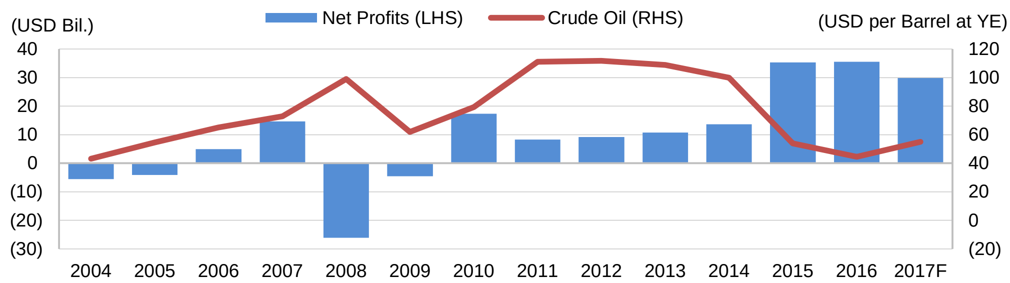
Passenger Traffic by Region
(% YoY Change in RPK)



YoY – Year-over-year. RPK – Revenue passenger kilometers. F – Forecast. Note: 2017F–2017 IATA forecast as of Dec. 31, 2016.
Sources: IATA and Fitch.

Low oil prices have generally benefited aircraft lessors thus far, boosting airlines' profitability, thereby keeping utilization rates high and repossession activity low. Despite a recent increase in energy prices, Fitch views current oil prices as sufficiently favorable for aircraft lessors in the sense that they are low enough to support airlines' profitability, but not so low as to invalidate the fuel efficiency benefits of next generation aircraft.

Worldwide Airline Profitability Trends



YE – Year end. F – Forecast. Note: 2017F – 2017 IATA forecast.
Sources: IATA, Fitch.

Airlines have increasingly utilized leasing of aircraft rather than ownership over the past few decades. According to Ascend, the percentage of the global aircraft fleet under an operating lease increased to over 40% of the in-service fleet in 2015 from approximately 20% in 1995. In 2016, Ascend stated that lessors would need to acquire 6,600 new aircraft, or 57% of all new deliveries, to retain their current market share by 2022. To increase market share to 50%, lessors would need to acquire 75% of all new deliveries through 2022. Fitch believes it will be challenging for lessors to acquire 75% of new deliveries, as sustained low fuel prices could result in stronger airline profitability and the potential for airlines to moderate their use of operating leases.

Financial markets remain accommodative, but the status of export credit agencies and Basel IV reforms are potential intermediate-term financing risks. The finalization of Basel III reforms, or Basel IV, was expected at year-end 2016, but has been delayed. Depending on the likelihood of these changes and the length of the delay, banks may continue their funding for aviation in the near term.

Financial Market Development

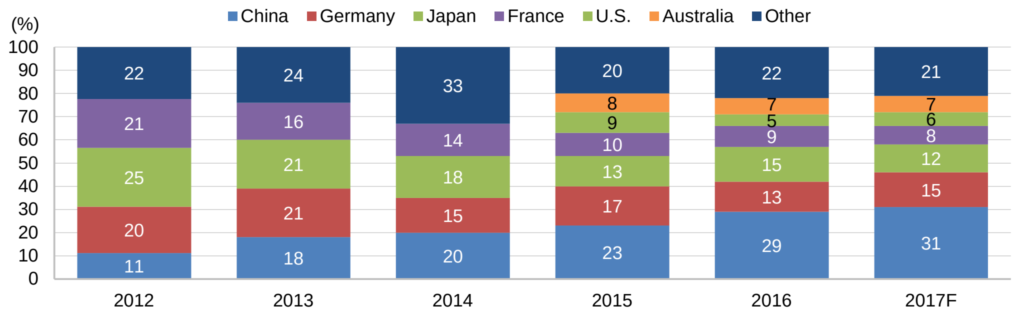
Fitch expects that the largely supportive aircraft finance market in 2016 will continue through 2017. Aircraft lessors completed eight unsecured note offerings totaling USD4.85 billion in 2016, and issuance to date in 2017 has already surpassed those totals, given increased funding needs (orders, capital expenditures and debt maturities). Unsecured bond offerings have aggregated USD6.2 billion through June 2017 and have been completed by Air Lease Corporation, Aviation Capital Group LLC, AerCap Holdings N.V., Avolon Holdings Limited and BOC Aviation Limited.

The enhanced equipment trust certificate (EETC) and asset-backed securities (ABS) markets remain active as well, notably with the American Airlines Pass Through Trust Certificates Series 2017-1 EETC transaction and Thunderbolt Aircraft Lease Limited and Thunderbolt Aircraft Lease US LLC ABS offering, which was issued to fund aircraft serviced by Air Lease Corporation and one of its affiliates.

Overall, Fitch expects that the financing requirement for new aircraft should be USD120 billion to USD125 billion in 2017. Lessors will continue to rely on capital markets and bank debt for the majority of their funding.

According to Boeing Capital Corporation, commercial bank financing in China is expected to reach 31% of total volume in 2017, up from 29% in 2016. The status on export credit agencies in the U.S. and Europe is a watch item, along with the potential impact on the balance sheet at the Airbus and Boeing. Basel IV reforms are an intermediate-term risk.

Source of Commercial Bank Debt for Financing Aircraft Deliveries



F – Forecast. Note: U.S. and Australia included in Other prior to 2015.
Source: Boeing Capital Corp. "Current Aircraft Finance Market Outlook 2017."

Regulatory Framework

Aircraft lessors are typically lightly regulated relative to financial institutions, but SMBC AC is owned by a global systemically important financial institution, which is therefore subject to robust regulation.

Lessors such as SMBC AC are regulated by governmental entities concerning operational safety, while lessees are also responsible for compliance with all applicable laws, and regulations with respect to the aircraft. SMBC AC's regulatory compliance framework relates to the policies of SMFG, the laws and regulations of Ireland, contractual obligations and international laws and regulations.

SMBC AC's international operations expose it to trade and economic sanctions and other restrictions imposed by various governments, particularly in the Asia-Pacific region, as they require governmental approval before foreign persons may make investments in domestic businesses and also limit the extent of any such investments.

Governmental regulations regarding aircraft and engine noise and emissions levels apply based on where the relevant airframe is registered and where the aircraft is operated. For example, jurisdictions throughout the world have adopted regulations that require all aircraft to comply with noise level standards. In addition to more stringent noise restrictions, the U.S., European Union (EU) and other jurisdictions are beginning to impose more stringent limits on the emission of nitrogen oxide, carbon monoxide and carbon dioxide from engines.

Environmental regulations impacting SMBC AC relate to the discharge of materials into the air, water and ground, and the generation, storage, handling, use, transportation and disposal of hazardous materials.

The Cape Town Convention (CTC), which went into effect on March 1, 2006, established an international legal framework to facilitate financing of mobile equipment, including aircraft, and established an international registry for international interests in aircraft. The treaty has been ratified by more than 50 states, including the U.S., China, India, Russia and the EU. The CTC has had a positive effect on the aircraft finance industry, with export credit agencies granting a fee discount to borrowers in countries that have ratified the treaty and made certain declarations. The CTC has also served as the legal framework for EETC issuances by Doric (backed by leases to Emirates) in 2012 and 2013, Air Canada in 2013 and 2015, Turkish Airlines in 2015, and several privately rated transactions. It has also served as part of the legal framework in several transactions that crossed two jurisdictions, including the Virgin Australia transaction in 2013 (New Zealand) and the Latam EETC in 2015 (Brazil).

Company Profile

Franchise

Since its formation under the Royal Bank of Scotland (RBS) in 2001, SMBC AC has developed a leading platform and grown into a top-five lessor with a global reach. In 2012, a deal was reached with SMBC, Sumitomo Mitsui Finance and Leasing Co. Ltd. (SMFL) and Sumitomo Corporation (SC) to acquire the company for USD7.3 billion. Below is a timeline of notable events for the company.

In March 2013, SMBC AC was merged with other SMFL leasing divisions. The merger was a part of SMFG's overall initiative to integrate the entire group product offering to airlines and investors under a single brand. The initiative involved various legal entities including leasing (SMBC AC), tax equity (SMFL), debt (SMBC) and investor relations and asset management (SC). These services are marketed to airlines through the SMBC AC relationship managers, offering increased cross-selling opportunities as well as stronger negotiating positions with airlines. Fitch views this structure as an enhancement of SMBC AC's strategic importance to SMFG.

SMBC Aviation Capital Timeline

2001	RBS Group creates Lombard Aviation Capital. Offices opened in Dublin, New York and Hong Kong.
2003	Re-branded as RBS Aviation Capital. Company commits to purchase its 100th aircraft.
2005	Company places first direct order with Airbus and Boeing for 50 aircraft for delivery from 2006–2009.
2006	Company takes delivery of 200th aircraft. New offices opened in Toulouse and Seattle.
2007	Closes first capital markets transaction in a 36-aircraft securitization. Tokyo office opened.
2008	Order placed with Airbus and Boeing for 95 additional aircraft for delivery from 2010–2015.
2010	Company places 43 aircraft, secures nine sale leasebacks and sells 16 aircraft.
2012	Business acquired by consortium of SMBC, SMFL and SC. Business rebranded as SMBC Aviation Capital.
2013	Business merged with other Sumitomo leasing divisions SAAM/SMAC.
2014	Order placed with Airbus for 110 A320neo and five A320ceo for delivery between 2017 and 2022. Order placed with Boeing for 80 B737 Max 8 aircraft for delivery between 2018 and 2022.
2015	USD600 million revolving credit facility established.
2016	Issuance of USD500 million unsecured inaugural bond.

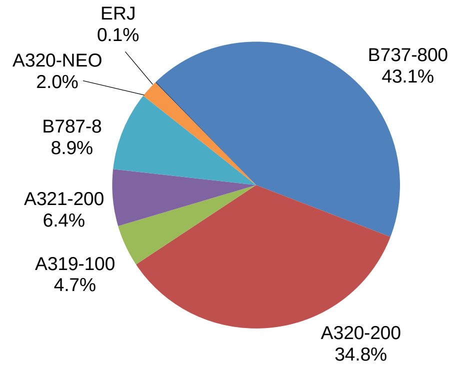
Source: SMBC AC.

SMBC AC currently has three entities in three different countries: Ireland, the U.K. and Australia; however, the majority of business is conducted through the Irish entity where SMBC AC is based.

Business Model

SMBC AC's leasing model centers on maintaining young, in-demand and fuel-efficient narrowbody Boeing and Airbus aircraft. As of March 31, 2017, top models were B737-800 (43.1% of net book value), Airbus A320-200 (34.8%), B787-8 (8.8%), A321-200 (6.4%) and A319-100 (4.7%). As of March 31, 2017, the weighted average age of the fleet was 4.5 years, which is low when compared with that of the rated aircraft lessor peer group. The company has demonstrated the ability and discipline to execute aircraft sales successfully through various market environments, which Fitch views positively. Moreover, it has committed deliveries of 215 aircraft including 110 A320neo and 90 B737-MAX. Although it is focused on popular narrowbody models, the company has acquired certain widebody models it views as attractive through sale leaseback transactions, including Airbus A350 and Boeing 787-9 aircraft. The fuel efficiency characteristics of these aircraft types are aligned with SMBC AC's criteria in regard to the liquidity of its assets.

SMBC AC Portfolio by Aircraft Type
(As of March 31, 2017)



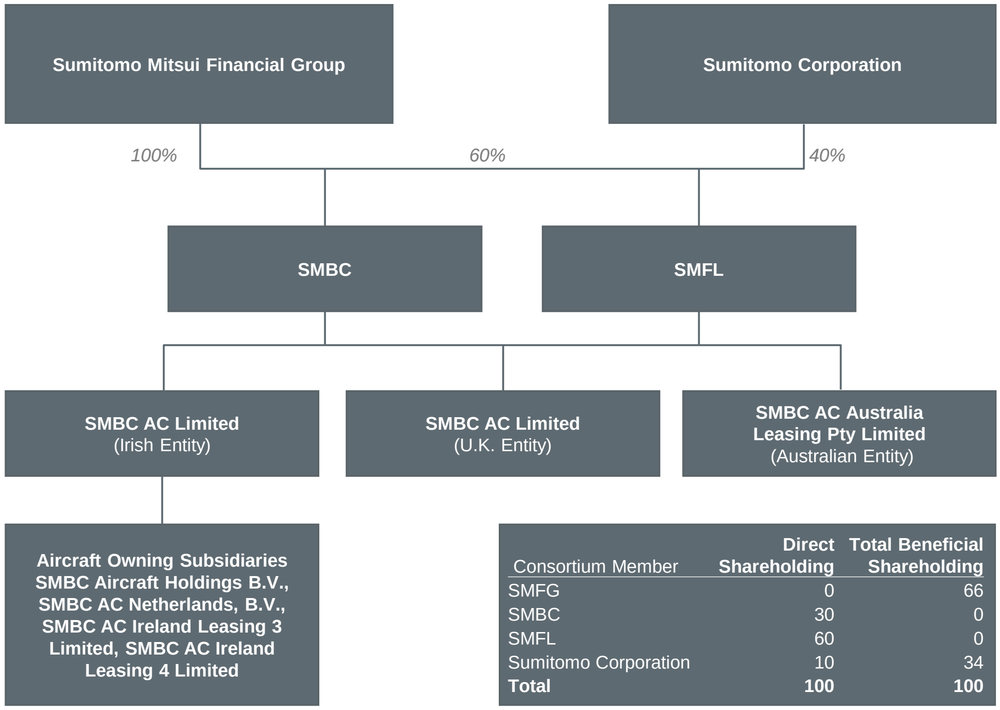
Source: Company reports.

The company's aircraft trading platform allows it to maintain the young age of its fleet, validate the book values of its aircraft and generate incremental profit gains in most years. Fitch believes SMBC AC's willingness to sell aircraft throughout the cycle shows discipline and adherence to maintaining a target fleet age and quality, and the company has sold aircraft assets at gains since the inception of the current ownership.

Organizational Structure

SMBC AC is owned by a consortium of three members, comprising SMBC (30%), SMFL (60%) and SC (10%). As SMFL is owned 60% by SMFG and 40% by SC, SMFG has an effective controlling stake of 66% beneficial ownership, while SC has an effective interest of 34%.

Ownership Structure — SMBC Aviation Capital Limited



Consortium Member	Direct Shareholding	Total Beneficial Shareholding
SMFG	0	66
SMBC	30	0
SMFL	60	0
Sumitomo Corporation	10	34
Total	**100**	**100**

Source: Company filings, Fitch.

Sumitomo Mitsui Financial Group, Inc. (Long-Term IDR of 'A'/Stable)

SMFG was created in 2002 as a holding company for SMBC and is one of the largest financial services institutions in the world, with assets of approximately JPY197.8 trillion as of March 31, 2017. SMFG is listed on the Tokyo, New York and Nagoya stock exchanges. The companies of SMFG offer a diverse range of financial services, centering on banking operations, and include credit card services, leasing, information services and securities.

Sumitomo Mitsui Banking Corporation (Long-Term IDR of 'A'/Stable)

SMBC was established in April 2001 through the merger of two leading banks, The Sakura Bank, Limited and The Sumitomo Bank, Limited. SMBC has more than 400 years' history and today is one of the largest banks in Japan. In March 2003, SMBC merged with the Wakashio Bank, Ltd. SMBC's competitive advantages include a strong customer base and an extensive lineup of financial products and services that leverage the expertise of strategic group companies in specialized areas.

Sumitomo Mitsui Finance and Leasing Co. Ltd.

SMFL was created in 2007 through the merger of two leasing companies owned by SMFG and SC to provide equipment finance and operating lease products. SMFL is the primary company through which SMFG and SC hold their shareholding in SMBC AC.

Sumitomo Corporation

SC is one of the largest trading companies in the world, with total assets of JPY3.3 trillion as of March 31, 2017. The company can trace its roots back to the 17th century and today operates in a variety of business fields, with investments in 800 companies globally. SC has engaged in the aircraft leasing business since the 1990s.

Management and Strategy

Management Quality

SMBC AC has an experienced management team, which has worked together for over 15 years and has successfully withstood the cyclical industry downturns during this period. Peter Barrett, SMBC AC's current CEO, has held this position since 2004 and joined SMBC AC's predecessor organization in 2001 as its chief operating officer. He has over 28 years of industry experience. Barry Flannery, the company's chief financial officer, has over 21 years of industry experience and co-founded the company that became SMBC AC. His former responsibilities included airline marketing in Asia, risk management and aircraft trading.

Strategic Objectives

In September 2016, SMFG publicly stated that aircraft leasing and financing (that is, SMBC AC) are high-profit assets that meet the needs of their investors, and Fitch believes that SMBC AC remains an important part of SMFG's product origination and distribution business strategy.

SMBC AC's key strategic objectives are maintaining a liquid and diversified fleet, generating a return on assets (ROA) exceeding 2% and supporting SMFG's objective of expanding its international airline client base. Fitch believes that the aforementioned strategic objectives are sufficiently well articulated, reasonably achievable and in line with other bank-owned lessors.

Execution

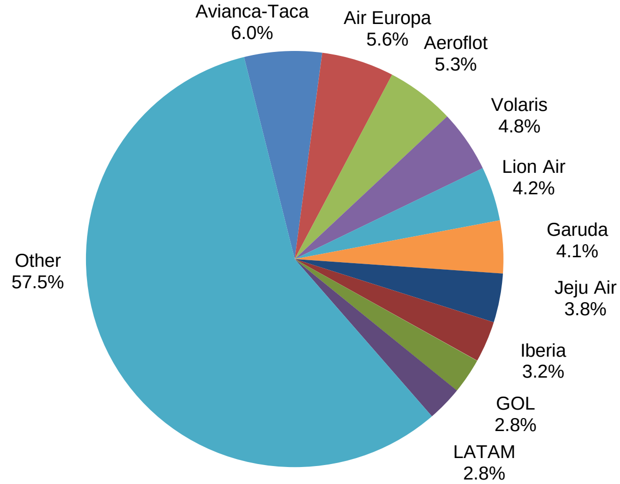
SMBC AC has had a proven track record of profitability under SMFG's ownership for approximately five years. Furthermore, the company has built a well-established aircraft leasing franchise over the past 16 years, with profitability in every year of operation, excluding the effect of one-off breakage costs in relation to acquisition refinancing in FY13. SMBC AC has exhibited incremental growth over the years, a very high utilization rate above 99% and a limited number of repossessions. A high proportion of SMBC AC's fleet has been traded annually since 2006. During the year ended March 31, 2017, the company sold 35 aircraft, including Boeing 737NGs, Airbus A320 family and Embraer E170s that had an average age of 9.8 years. This evidences execution against the company's objectives with respect to fleet composition and age.

Risk Appetite

Underwriting Standards

Fitch regards SMBC AC's underwriting standards as sound, as evidenced by the quality of its lessee base and its low repossession history. SMBC AC primarily focuses on three key aspects when underwriting a lease: asset analysis; lessee counterparty analysis; and transaction analysis and structuring (that is, risk-adjusted return, lease conditions). All leases are evaluated by various company groups, including credit and risk management, technical and legal teams. SMBC AC's lessee base is well diversified by both airline and by country, which Fitch views favorably. SMBC AC's top lessee by net book value as of March 31, 2017 was Avianca. Other top lessees were Air Europa, Public Joint Stock Company Aeroflot - Russian Airlines (Aeroflot) and Concesionaria Vuela Compañía de Aviación, S.A.B. de C.V. (Volaris).

Top Lessees by Net Book Value
(As of March 31, 2017)



Source: Company reports.

Risk Controls

SMBC AC's board of directors has overall responsibility for the establishment and oversight of the company's risk management framework. The company's board of directors has three committees in place: the asset value review committee, the maintenance review board and the portfolio management committee. All committees meet on a quarterly basis, and the portfolio management committee and asset value review committee are both attended by shareholders. SMBC AC also manages in-house models for the purpose of measuring the liquidity of every aircraft in the market using a combination of both public and proprietary data.

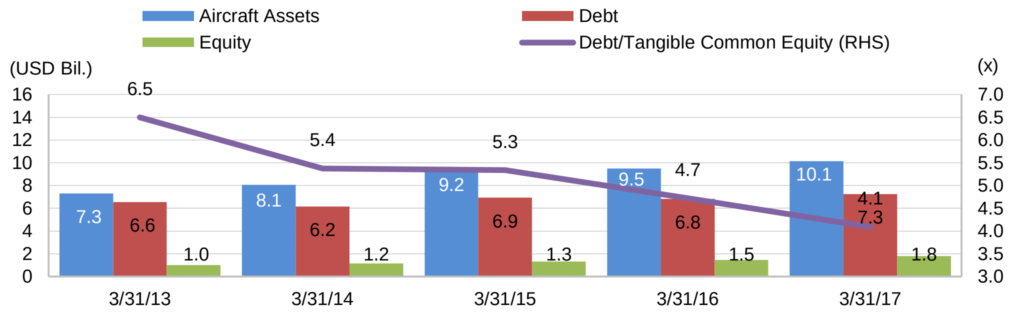
The company seeks to manage its credit risk through various processes. An approval of credit exposure must be granted prior to the advance or extension of credit. A credit risk assessment of the customer and related credit facilities is undertaken prior to approval of credit exposure. All credit exposures are monitored and managed, and the company endeavors to identify customers with emerging credit problems in advance. Fitch views these risk controls as appropriate.

Growth

As of March 31, 2017, the company owned 216 aircraft valued at USD10.1 billion, on lease to airline customers in 41 countries. Its total owned and managed portfolio included 455 planes. As of the same date, the company had commitments to purchase 212 aircraft over the next five years, which is manageable relative to the existing fleet.

The company's growth was constrained at the tail end of its ownership under RBS due to uncertainty over the parent company's plans; however, the company has resumed expansion in the past several years and anticipates continued compounded annual growth of aircraft assets net book value through 2021, driven by order book deliveries, principally for narrowbody aircraft, offset moderately by discretionary disposals. Growth is viewed as achievable as a result of SMBC AC's strong platform, experienced management team and track record of performance, although managing the currently competitive environment and the company's large order book will be critical considerations for the rating.

Growth



Source: SMBC Aviation Capital Limited, Fitch.

Market Risk

The company's most significant market risk exposure is to fluctuations in the value of its fleet, which SMBC AC attempts to manage and mitigate via its active monitoring and trading of its portfolio. Other market risks relate to currency risk, interest rate risk, liquidity risk and credit risk.

The company attempts to manage cash flow currency risk by either matching the lease currency and the associated financing, or entering into currency swaps or forwards over the life of the lease. Most of the company's financial instruments are in U.S. dollars with the exception of certain bank accounts held in euro and sterling, obligations under finance leases in euro and certain receivables and payables in euro and sterling.

The company's interest rate risk is due to the differentials between its lease terms and its borrowings. The company's policy is to seek to minimize interest rate risk when entering into leasing transactions through the use of match funding, including the use of derivative financial instruments such as floating-to-fixed interest rate swaps. SMBC AC's hedging capabilities are further augmented by its relationship with SMFG and SMBC.

Financial Profile

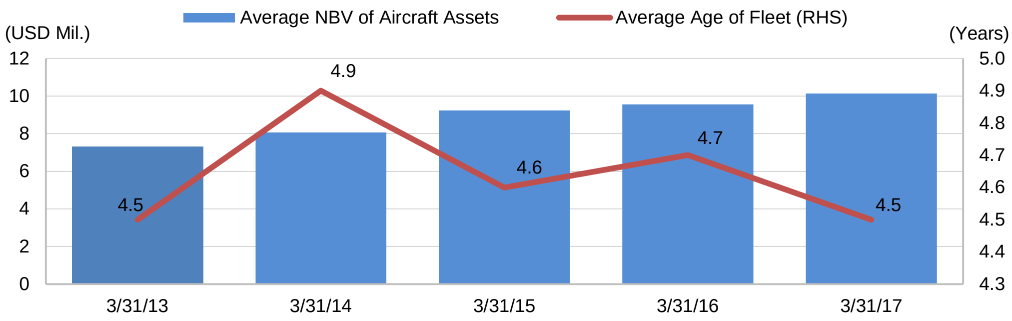
Asset Quality

SMBC AC's fleet mainly consists of Boeing B737 NG and Airbus A320 aircraft families, which represented 43.1% and 47.9% of net book value, respectively, as of March 31, 2017. Fitch considers these to be among the most liquid and popular aircraft in the market, with some exposure to the Boeing 787 family (8.9% of net book value) and Embraer regional jets (0.1%).

The weighted average age of the fleet was approximately 4.5 years. The company has been able to sustain an attractive fleet profile during periods of shock to the aviation sector (for example, recession, terrorism, disease) and ownership changes. Based on the evidence of recent orders that have been made, Fitch believes asset quality will remain strong as the company has been able to dispose of midlife aircraft to an array of buyers including other aircraft lessors, airlines and large financial institutions. SMBC AC's impairments have generally represented less than 0.5% of total aircraft asset annually since inception, which is at the low end compared to the peer group.

Moreover, it has committed deliveries of 215 aircraft including 115 A320neo and 90 B737-MAX, which should allow the company to migrate more heavily toward a fleet comprising next generation aircraft over the next five years.

Average NBV of Aircraft Assets and Average Fleet Age



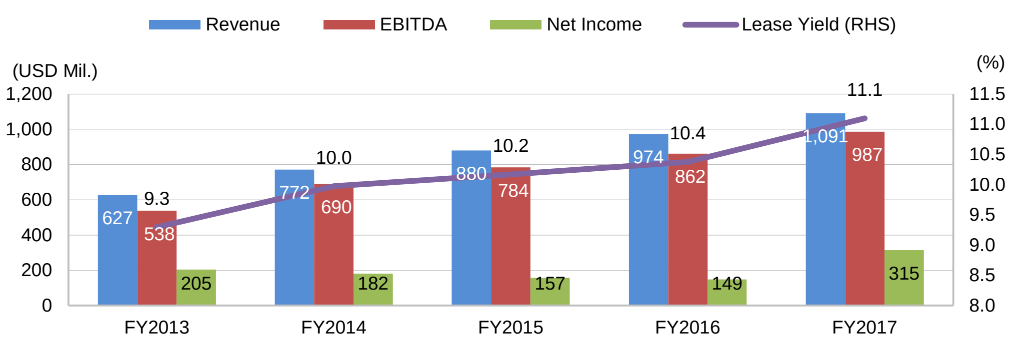
Source: SMBC AC Limited and Fitch.

Earnings and Profitability

Despite sector cyclicality, SMBC AC's core profitability has been and is expected to remain fairly steady. The loss incurred in FY13 (the only one in the company's history) was prompted by substantial financing breakage costs in relation to the acquisition by SMBC, which Fitch views as non-recurring.

Lease yields have generally ranged in the 10%–11% range and are expected to remain in that range due to high cash flow generation from aircraft held under operating leases along with its attractively priced order book. As of March 31, 2017, the weighted average remaining lease term for the portfolio was 6.4 years.

Earnings and Lease Yield



Source: SMBC Aviation Capital Limited, Fitch.

Fitch regards the company's depreciation policy as fairly conservative. Aircraft are depreciated to the expected maintenance condition of the aircraft at the end of each useful economic life (UEL), which is measured in five-year increments, representative of the average period SMBC AC expects to hold each of its aircraft. The residual net book value at each UEL is established using a present value of:

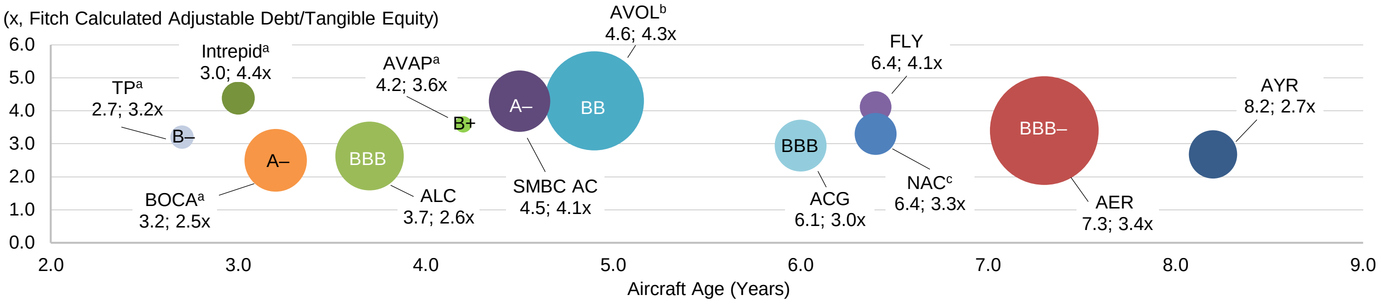
- SMBC AC future value model (half-life).
- End of lease physical condition relative to half-life.
- End of lease re-delivery adjustment.

IFRS does not permit reversal of depreciation, so funds at expiration are taken as maintenance income to the profit and loss at that point with the depreciation charge increased by the same amount. The company recalculates and resets monthly depreciation at each lease commencement (new UEL) and at each UEL point during a lease, with depreciation recognized on a straight-line basis between UEL points. If the lessor is required to make a contribution to maintenance to the next lessee to cover maintenance utility consumed by the previous lessee, then a lessor contribution liability is set up at commencement of the lease and the corresponding lease incentive asset is amortized to profit and loss against lease rentals over the relevant lease term.

Capitalization and Leverage

The company's balance sheet is characterized by relatively high leverage, a reflection of the owner being the principal finance provider. Leverage, defined as debt to tangible equity, was 4.1x at March 31, 2017, in line with the 'bbb' quantitative benchmark for broader balance sheet-intensive finance and leasing companies but 'bb' category for aircraft lessors given the monoline nature of the business. Fitch expects that SMBC AC's balance sheet leverage is likely to remain higher than the peer average.

Aircraft Lessors' Leverage and Fleet Age
(At March 31, 2017)



[a]Represents Dec. 31, 2016. [b]Represents March 31, 2017 pro forma for the CIT commercial aircraft transaction. [c]Represents June 30, 2016. AER – AerCap Holdings N.V. ALC – Air Lease Corporation. AYR – Aircastle Limited. AVAP – Avation Plc. ACG – Aviation Capital Group Corp. BOCA – BOC Aviation Limited. FLY – FLY Leasing Limited. Intrepid – Intrepid Aviation Group Holdings, LLC. NAC – Nordic Aviation Capital A/S. SMBC AC – SMBC Aviation Capital Limited. TP – Transportation Partners Pte. Ltd. Note: Bubble sizes represent fleet book values at March 31, 2017. Bubbles without ratings are not publicly rated by Fitch.
Source: Company reports and Fitch.

Funding, Liquidity and Coverage

Funding

SMBC AC's funding is drawn principally from unsecured debt and equity, each primarily provided (or guaranteed) by its shareholders. Third-party funding has expanded over the past several years, which Fitch views favorably, and includes secured debt with export credit agencies, unsecured bank loans and corporate bonds. Third-party funding represented 43.1% of total debt as of March 31, 2017. That said, high levels of parent-provided funding further reinforce the alignment of SMBC AC's ratings with the parent and the likelihood of support.

The company also has a third-party revolving credit facility totaling USD600 million, with SMBC AC's approval required for the lenders to be able to reduce the facility size. Initially the revolver had been viewed by the company as a contingency funding source, but the terms are sufficiently attractive that the company may make more active use of it in the future. In addition, the majority of the fleet is unencumbered, increasing flexibility in a stress scenario. As of March 31, 2017, secured debt represented 3.6% of total debt and 2.5% of total assets.

On July 19, 2016, SMBC AC issued USD500 million of 2.65% five-year senior unsecured notes in an inaugural offering. Proceeds from the offering were used for general corporate purposes, which included purchasing aircraft and the repayment of existing indebtedness. Fitch believes that additional unsecured bond offerings are likely in the future as SMBC AC looks to diversify its funding, which Fitch would view favorably in the context of SMBC AC's stand-alone credit profile.

The stand-alone funding profile is viewed as relatively weak since it exhibits concentration with parent funding sources, although it is predominantly funded on an unsecured basis.

Liquidity

Fitch believes the company had an adequate liquidity position as of March 31, 2017. As of March 31, 2017, total liquidity sources (unsecured revolver availability, shareholder facility, contracted sales, unrestricted cash and estimated operating cash flow) exceed liquidity uses (debt maturities and capital expenditures) over the next 12 months.

Coverage

EBITDA coverage of interest expense was 3.3x in FY17 and 3.2x in both FY16 and FY15, which Fitch views as adequate for the rating.

Factors Impacting Institutional Support

Strategically Important Subsidiary

The May 11, 2017 upgrade of SMBC AC’s ratings reflected Fitch's assessment that SMFG demonstrates an increasingly strong propensity to support SMBC AC given that group funding comprised 56.9% of total debt as of March 31, 2017 and SMBC AC is majority owned by SMFG. Fitch considers SMBC AC to be a strategically important subsidiary of SMFG as defined under the agency’s “Global Non-Bank Financial Institutions Rating Criteria,” dated March 2017. This consideration results in a rating one to two notches lower than the parent company's Long-Term IDR. In SMBC AC's case, the IDR is now notched down once from SMFG's Long-Term IDR, reflecting that SMBC AC has a proven track record of profitability under SMFG's ownership, SMBC AC also exhibits an integrated strategy, consistent branding and parent company representation on its board of directors.

Ability of Parent to Support Subsidiary

SMBC AC presently represents less than 1% of SMFG’s total assets, and SMFG is highly rated (Long-Term IDR ‘A’), so its ability to support is not a constraint.

Propensity of Parent to Support Subsidiary

There are no formal support agreements, guarantees or cross-default clauses in SMBC AC’s funding agreements, and the company is domiciled in a different jurisdiction than SMFG. However, since SMBC AC’s funding is drawn principally from unsecured debt and equity, each primarily provided (or guaranteed) by its shareholders, Fitch believes this increases the likelihood of parent support. Given the shared branding and broader strategic relationships with airlines and manufacturers, SMFG and SMBC would be exposed to material reputational damage were they not to provide support to SMBC AC during a period of stress.

Balance Sheets — SMBC Aviation Capital Limited

(USD 000)	3/31/14	3/31/15	3/31/16	3/31/17
Assets:				
Non-Current Assets				
Property, Plant and Equipment	8,063,511	9,232,836	9,550,921	10,141,783
Goodwill and Intangible Assets	19,694	24,768	22,017	12,558
Loan Receivables	80,088	78,524	0	0
Derivative Financial Instruments	7,102	2,947	420	16,339
Lease Incentive Assets	41,169	55,802	69,695	95,376
Current Assets				
Finance Lease Receivables	3,818	0	0	0
Loan Receivables	1,564	1,564	0	0
Trade and Other Receivables	54,735	39,074	51,524	67,891
Cash And Cash Equivalents	397,523	255,859	204,737	278,393
Derivative Financial Instruments	0	2,199	235	6
Lease Incentive Assets	20,353	20,594	22,449	24,165
Available for Sale Assets	2,889	0	0	0
Total Assets	**8,692,446**	**9,714,167**	**9,921,998**	**10,636,511**
Liabilities and Equity:				
Current Liabilities				
Trade and Other Payables	242,347	307,071	485,983	488,812
Obligations Under Finance Leases	49,369	48,389	54,723	59,556
Borrowings	334,557	994,529	612,745	571,861
Derivative Financial Instruments	2,391	586	547	0
Non-Current Liabilities				
Trade and Other Payables	458,571	515,915	482,818	505,573
Obligations Under Finance Leases	394,772	340,999	286,584	227,028
Borrowings	5,816,788	5,930,002	6,223,833	6,681,890
Deferred Tax Liabilities	214,842	236,997	259,902	294,198
Derivative Financial Instruments	13,756	17,183	43,799	21,320
Total Liabilities	**7,527,393**	**8,391,671**	**8,450,934**	**8,850,238**
Share Capital	187,513	187,513	187,513	187,513
Other Components of Equity	204,756	197,718	171,244	215,725
Profit and Loss Account	772,784	937,265	1,112,307	1,383,035
Total Equity	**1,165,053**	**1,322,496**	**1,471,064**	**1,786,273**
Total Liabilities and Equity	**8,692,446**	**9,714,167**	**9,921,998**	**10,636,511**

Source: SMBC Aviation Capital Limited.

Income Statements — SMBC Aviation Capital Limited

	Year Ended			
(USD 000)	3/31/14	3/31/15	3/31/16	3/31/17
Income:				
Revenue	747,645	839,403	916,819	1,020,258
Other Operating Income	24,307	40,450	57,661	70,312
Total	**771,952**	**879,853**	**974,480**	**1,090,570**
Expenses:				
Depreciation	(250,384)	(285,801)	(320,967)	(347,736)
Impairment	(26,171)	(52,237)	(61,279)	(20,598)
Operating Expenses	(84,848)	(103,653)	(118,027)	(109,252)
Net Trading Income/(Expense)	(932)	2,356	(811)	398
Profit from Operating Activities	409,617	440,518	473,396	613,382
Finance Costs				
Interest Income	81,551	56,328	37,219	33,977
Interest Expense	(275,784)	(296,487)	(292,050)	(315,689)
Break Losses	(3,151)	(6,115)	(14,700)	(19,185)
Net Finance Costs	**(197,384)**	**(246,274)**	**(269,531)**	**(300,897)**
Profit/(Loss) before Taxation	212,233	194,244	203,865	312,485
Tax Expense	(35,927)	(29,763)	(28,823)	(41,757)
Profit/(Loss) from Continuing Operations	176,306	164,481	175,042	270,728
Other Comprehensive Income				
Effective portion of Changes in Fair Value of Cash Flow Hedges	5,894	(7,813)	(30,258)	50,880
Movement in Fair Value of Available for Sale Assets	272	(272)	0	0
Tax on Other Comprehensive Income	(765)	1,047	3,784	(6,399)
Other Comprehensive Income, Net of Tax	**5,401**	**(7,038)**	**(26,474)**	**44,481**
Total Comprehensive Income/(Loss)	**181,707**	**157,443**	**148,568**	**315,209**

Source: SMBC Aviation Capital Limited.