FitchRatings

Fitch Affirms SMBC Aviation at 'A-'; Stable Outlook

Fitch Ratings - Chicago - 15 July 2019: Fitch Ratings has affirmed SMBC Aviation Capital Limited's (SMBC AC) Long-Term Issuer Default Rating (IDR) at 'A-' and SMBC Aviation Capital Finance DAC's Long-Term IDR and senior unsecured notes ratings at 'A-'. The Rating Outlook is Stable.

Fitch has taken these actions in conjunction with today's aircraft leasing industry peer review, which includes nine publicly rated firms. For more commentary on the sector review, please see "Fitch Completes Aircraft Lessor Peer Review," available at 'www.fitchratings.com'.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
SMBC Aviation Capital Finance DAC	LT IDR A- ⭘ Affirmed		A- ⭘
senior unsecured	LT A- Affirmed		A-
SMBC Aviation Capital Limited	LT IDR A- ⭘ Affirmed		A- ⭘

Key Rating Drivers

IDRS AND SENIOR DEBT
The rating affirmations primarily reflect the continued institutional support linkage between SMBC AC and Sumitomo Mitsui Financial Group, Inc. (SMFG; 'A'/Stable), which has 66% beneficial ownership of SMBC AC. Fitch considers SMBC AC to be a strategically important subsidiary of SMFG as defined under the 'Non-Bank Financial Institutions Rating Criteria', resulting in a rating one notch below SMFG's Long-Term IDR.

SMBC AC's credit qualities on a standalone basis include its strong franchise in global aircraft leasing, its experienced management team and its young and in demand fleet. Its financial profile has also strengthened in the year to end-March 2019, via its owners' injection during the period of an additional USD1 billion of capital, and its issuance of an additional USD500 million of senior unsecured notes, giving a debt profile less reliant than previously on intra-group sources, and which is now almost exclusively unsecured. Rating constraints applicable to the broader aircraft leasing industry include the monoline nature of the business; vulnerability to exogenous shocks; potential exposure to residual value risk; sensitivity to oil prices and dependence on wholesale funding sources.

In November 2018, SMBC AC's ownership structure was modified. Sumitomo Mitsui Finance and Leasing Company, Limited (SMFL) increased its stake to 68% from 60% and Sumitomo Mitsui Banking Corporation (SMBC, a 100% subsidiary of SMFG) raised its participation to 32% from 30%, while Sumitomo Corporation (SC) relinquished its previous 10% direct holding. However, simultaneous adjustments to the control of SMFL, now a 50:50 joint venture between SMFG and SC (previously 60:40), left SMBC AC's ultimate beneficial ownership unchanged at 66:34 between SMFG and SC.

Fitch's view of SMBC AC as a strategically important subsidiary of SMFG reflects that SMBC AC has a proven track record of profitability and funding support under SMFG's ownership, together with an integrated strategy, consistent branding and parent company representation on its board of directors. Fitch believes that SMBC AC remains an important part of SMFG's product origination and distribution business strategy, despite SMBC AC being small relative to the broader organization and operating in a different jurisdiction to SMFG.

In November 2018, SMBC AC's shareholders provided it with USD1 billion of new long-term capital, in the form of USD700 million of preferred equity (shared between SMFL and SMBC) and a USD300 million subordinated loan from SMBC. The preference shares may be paid a 7.5% non-cumulative preferential share dividend in any financial year, at SMBC AC's discretion. The subordinated loan has an initial 16-year term and bears interest at a floating rate, averaging 6.89% in the period to end-March 2019. Fitch regards the capital injection as a demonstration of continuing long-term shareholder support.

SMBC AC's aircraft leasing franchise dates back beyond its present name and ownership, and has significant scale. At March 31, 2019, the firm had 729 owned, managed and committed aircraft, making it one of the world's top five aircraft lessors. Fitch believes that size provides the larger lessors with greater purchasing/negotiating power, diversification benefits and increased channels via which to re-lease planes when needed. SMBC AC has an experienced management team and a customer base well diversified by both operator type and geography. At March 31, 2019, the top three lessees were Avianca Holdings S.A. (6.6% of net book value; IDR 'B-'; Rating Watch Negative), Asiana Airlines, Inc (6.4%), and Air Europa Lineas Aereas, S.A.U. (5.1%), with no other lessee exceeding 4.4%.

Fitch considers the quality of SMBC AC's fleet a strength, as it is very largely unencumbered and predominantly comprised of young, in demand and fuel-efficient narrowbody Boeing and Airbus aircraft. At March 31, 2019, 36.6% of the fleet by net book value comprised new technology planes, with the remaining 63.4% exclusively the popular A320 family and B737-800 aircraft. The weighted average age of the fleet was 4.2 years, which is low compared with the rated peer group. Of committed deliveries of 314 aircraft, a further 312 were new technology. The large order book entails some placement risk, but at March 31, 2019, all deliveries for the year ahead had been allocated.

SMBC AC's leverage has trended downward in recent years, principally as a result of the retention of the profits made. With the additional benefit of the capital injection, debt to tangible equity (inclusive of the subordinated loan) reduced to 2.4x at March 31, 2019, from around 3.6x at March 31, 2018.

SMBC AC's funding profile retains some concentration within parental sources, but the third-party element rose above 50% of total financing in the year to March 31, 2019, principally as a result of the July 2018 sale of USD500 million of 4.125% five-year senior unsecured notes, supplementing two issuances of similar size in previous years. The company had USD3.8 billion of available liquidity at March 31, 2019, and in April 2019 issued a further USD500 million of 3.55% five-year senior unsecured notes. Over 99% of year-end debt was unsecured.

SMBC AC has been profitable throughout its history (excluding the effect of one-off breakage costs in relation to acquisition refinancing in the year ended March 31, 2013), reporting limited asset impairment charges and stable lease rates. At March 31, 2019 the company had a weighted average remaining lease term of 6.9 years, a long-term profile which compares favorably with peers.

SMBC AC has demonstrated the ability and discipline to execute aircraft sales through the market cycle, which Fitch views favorably. During the year ended March 31, 2019, the company sold 30 owned aircraft with an average age of 9.5 years, and signed contracts or letters of intent to sell another 14 aircraft (average age of 9.3 years) expected to close over the coming months.

SMBC Aviation Capital Finance DAC's IDR is equalized with SMBC AC's IDR, reflecting the full and unconditional guarantee of SMBC Aviation Capital Finance DAC's obligations by SMBC AC.

The senior unsecured note rating is equalized with SMBC AC's IDR, reflecting Fitch's expectation of average recovery prospects given that the substantial majority of the company's consolidated debt is unsecured.

The Stable Outlook is aligned with the Outlook for SMFG, and also reflects Fitch's expectation that SMBC AC's franchise position, fleet strategy, leverage and unencumbered asset profile will not change materially over the Outlook horizon.

Rating Sensitivities

IDRS AND SENIOR DEBT
SMBC AC and SMBC Aviation Capital Finance DAC's ratings are primarily sensitive to changes in SMFG's ratings given Fitch's view that SMBC AC is a strategically important subsidiary of 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, resulting in significant influence by minority shareholders, or should there be any other developments within SMFG which are perceived by Fitch to alter SMFG's willingness or ability to provide support to SMBC AC. Negative rating action could also be taken if SMBC AC's operating performance deteriorates, thereby not delivering the return on investment envisaged by SMFG, which could affect Fitch's assessment of the propensity of SMFG to provide support to SMBC AC, in case of need.

The rating for the senior unsecured notes is sensitive to changes in SMBC AC's IDR and the level of unencumbered balance sheet assets available in a stress scenario, relative to outstanding unsecured debt. A decline in the level of unencumbered asset coverage combined with a material increase in the use of secured debt could result in the unsecured debt being notched down from the IDR.

Additional information is available on www.fitchratings.com

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Applicable Criteria

Non-Bank Financial Institutions Rating Criteria (pub. 12 Oct 2018)

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