DUBLIN 2018 REVIEW
REGIONAL AVIATION TO REMAIN A SPECIALIST NICHE

FEBRUARY 2018

The **regional aircraft space received only limited attention in Dublin** with one keynote address by John Slattery, President and CEO, Embraer Commercial Aviation and a regional aircraft panel, which reflects the fact that **regional aviation continues to be treated as a relatively small part of the wider aviation industry**.

Nevertheless, there are **7,500 regional jets and turboprops in operation worldwide**: hardly a small market!

regional jets & turboprops in operation worldwide

How can regional aircraft assist capacity management in a flat or declining market?

The **regional aircraft manufacturers** Bombardier and Embraer **believe** that their newest offerings, **the C-Series and the E2**, often referred to as crossover narrow body jets below 150 seats, **can address the risk of overcapacity**.

After the 2008 financial crisis, the current generation of regional jets did provide applications for airlines seeking to manage the down-turn in demand by replacing larger narrow bodies in certain high frequency markets, such as the New York to Boston route. During the current cycle of growth, many of these have reverted to larger aircraft so that any renewed contraction in demand could even benefit regional aircraft types.

Slattery contends that **the new E2 family** provides much improved economics compared to the E1, so the aircraft is **optimised for a slower growth environment by combining strong economics with the right capacity to meet demand**. In a slowing market this can be replacing larger capacity aircraft while maintaining frequency; or in a growth market, their smaller capacity is optimised for developing new routes.

Regional Aircraft Leasing and Finance

From a leasing and finance standpoint, the wider aviation industry can be characterised by **continued strong levels of liquidity and an increasing number of lenders**, thus providing airlines and lessors with leverage. Fresh equity and new lenders were a continuing feature of 2017. However, a larger number of financial participants has also led to greater competition. **Airlines have benefited from historically low lease rate factors for narrow body aircraft** in particular, and lending margins for banks have narrowed considerably over the past year although interest rates have started to move upwards.

The market dynamics of the regional sector have always been somewhat **different**. The wider leasing community perceives the regional market to be narrower and requiring a different skill set to the larger aircraft market, as a result the number of competitors in the sector is more limited. Indeed, many of the mainstream lessors whose focus is centred around narrow body aircraft consider regional aircraft to be non-core business. Many have either sold their exposure or intend to do so. Consequently, **competition amongst regional aircraft lessors is limited to a handful of active participants**. Within the sector there are also those that focus on new generation aircraft and those that concentrate more on mid-life aircraft. This further fragments the regional segment.

Regional aircraft finance panellists concurred that **this less competitive landscape continues to mean that lease rates are less under pressure than for larger aircraft**. This has encouraged some new capital into the regional aircraft leasing space but nothing remotely close to the amounts invested in narrow body sector. Furthermore, **from a human resources perspective, there are also far fewer regional aircraft specialists whilst the market itself is more labour intensive**, which creates an additional barrier to entry in the sector.

Panellists also agreed that **residual values of regional aircraft are just as stable if not stronger than those of larger aircraft**. There are a number of reasons for this including that regional aircraft have longer economic lives than larger aircraft. Furthermore, regional aircraft are less generic. Each regional type has specific mission capability characteristics so that while an A320 and a B737 are head to head competitors, an ATR72 and a DHC8Q-400 are designed for different markets so that they compete less directly. This helps value retention.

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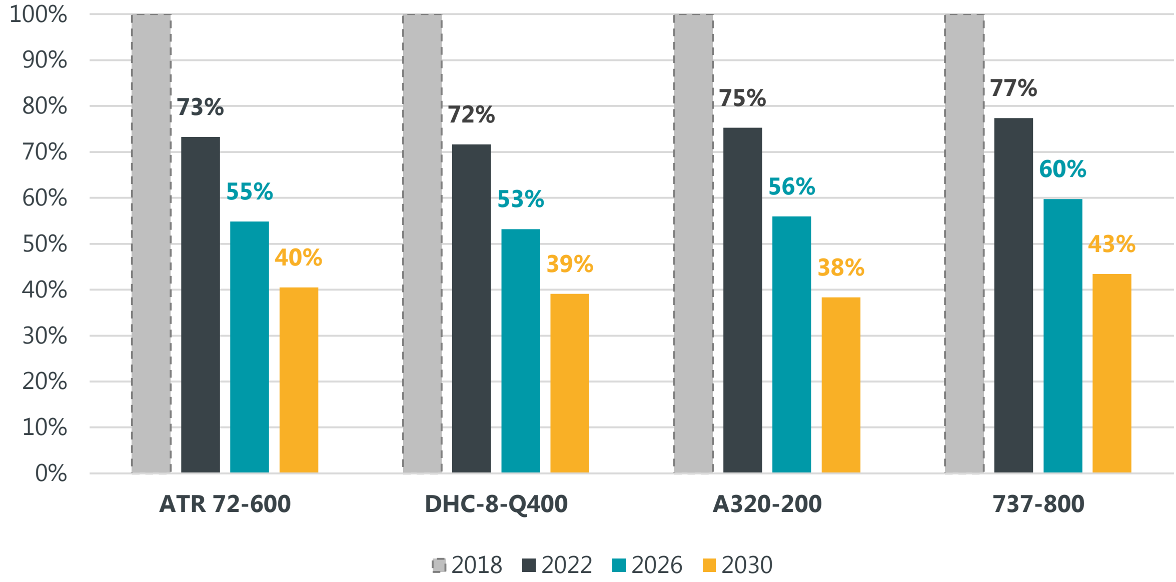
FMV expressed as percentage of 2018 BV



Assumption
YoM: 2018

The Sharpwings Viewpoint

In the **regional jet space, a substantial portion of the 70-110 seat fleets** are reaching the end of their first leases and many **will need to transition to new secondary operators over the coming years**. For example, the largest portion of current generation E190 jets entered service between 2007 and 2010. The first replacements in this fleet are now starting and these aircraft are now moving on to second operators. This includes some existing operators that have chosen to keep E1s for the long-term and new carriers in emerging markets. **The challenge for both the OEMs and the leasing community is to manage this transition in time and budget so that existing aircraft find the right homes.**

The **turboprop space is highly specialised with almost no major lessor participation** except GECAS. After a period of more restrained growth **the order book for both incumbent OEMs has grown more strongly over the past year**. ATR's backlog has strengthened its Asian dominance with a substantial commitment from Indigo and it has successfully re-entered the US market with Silver Airways and Fedex. Meanwhile the DHC8Q-400 has also secured substantial orders with Spicejet and others, including Philippine Airlines. An increasing proportion of these deliveries will be funded by lessors. **This generates financing opportunities and challenges for lessors specialising in this market**.

Meanwhile, the brief period during which lessors over-ordered ATR72-600s without obvious lessees has passed and this capacity has now been largely absorbed, albeit at the cost of the older ATR72-500 fleet. Consequently, **the depressed lease rates that were common for new aircraft in 2016 and 2017 are now recovering**.

A further new development in the turboprop arena concerns the growing cargo market. A previous consensus believed that this was primarily an outlet for older converted aircraft and it is true that the volume of ATR conversions has grown substantially over the last year. However, Fedex announced an order for new ATR72-600s with a large door in 2017 so modern turboprops will also shortly serve cargo applications.

In summary, while regional aircraft leasing has always been primarily the domain of specialists, there have been brief forays into the regional space by some large lessors such as ALC. These players have now exited the market or are still doing so, causing continued consolidation ensuring **the regional jet and turboprop leasing space remains in the hands of relatively few experts**.

Regional aircraft leasing has its own challenges and opportunities in the months and years ahead

A final thought

The Sharpwings believes **the current focus on leasing company core business from an aircraft types perspective will remain for the foreseeable future unless other leasing business models emerge**.

It may be possible to imagine that a lessor could **develop a strategy focused on the needs of airline customers** rather than certain types of aircraft. **If a more volatile passenger demand environment emerges**, there may be a case for lessors to **offer a suite of aircraft with different capacities**, which would **require a portfolio of both regional and narrow body aircraft types**.

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