HELIICOPTER OPERATING LEASING COMES OF AGE

Following the lead of Milestone Aviation Group, which was formed in August of 2010 and in three years has become a major source for the financing of helicopters, a number of additional helicopter operating lessors have recently been launched. These new helicopter lessors include Lease Corporation International (LCI), a commercial aircraft operating lessor that entered the helicopter leasing business in 2012, and Waypoint Leasing and Macquarie Rotorcraft Leasing, both established as helicopter lessors in 2013.

Helicopter leasing is not new, dating back over 30 years. However, until recently most leasing of helicopters was by helicopter operators leasing or selling excess lift to other operators as a means of generating additional returns on their investment. An example of such an operator is ERA Group Inc.

ERA’s primary business is conducted through its helicopter leasing subsidiary, ERA Helicopters LLC. ERA Helicopters transports personnel and supplies to offshore oil and gas drilling rigs and platforms in the Gulf of Mexico and Alaska and other locations with its fleet of medium and heavy lift twin-engine turbine helicopters. In 2014, ERA formed its leasing subsidiary, ERA Leasing LLC, and has built up a substantial fleet of leased helicopters; however, ERA’s primary business continues to be the servicing of the offshore oil and gas industry as a helicopter operator.

Milestone Aviation, LCI, Waypoint Leasing and Macquarie Rotorcraft represent a new breed of helicopter operating lessors that are investing in helicopters not for their own operations but as long-term investments to be leased to operators under operating leases. Initially, these new lessors intend to focus on a large segment of medium and heavy lift twin-turbine helicopters leased to operators servicing offshore oil and gas drilling rigs and platforms, which are supported by contracts with major oil and gas companies. These helicopters, which include Sikorsky S-76s and S-92s, Eurocopter EC225s and AS332Ls and AgustaWestland AW139s, have large price tags (e.g., the cost for a new fully equipped S-92 exceeds US$250m). Obtaining financing for these helicopters from commercial banks or other traditional financing sources can be a difficult challenge. The new lessors are stepping in to fill the gap.

Richard Santussi, founder of NetJets, started Milestone Aviation Group and placement of an order for AgustaWestland AW139, AW169 and AW189 helicopters. Earlier in 2013, Milestone Aviation raised US$187.4m for the export of Sikorsky aircraft in a US Ex-Im Bank guaranteed bond financing that was the first Ex-Im Bank capital markets financing for helicopters and the first Ex-Im Bank supported transaction for a helicopter operating lessor. These types of financings originated in the commercial aircraft sector suggesting that these new helicopter lessors will borrow from strategies developed by commercial aircraft lessors.

LCI was also an early entrant in the helicopter operating lease business. LCI, privately owned by the Libra Group, a shipping conglomerate, was formed in 2004 as a commercial aircraft lessor. In 2011, LCI entered the helicopter leasing business by placing a speculative order for AgustaWestland AW139, AW169 and AW189 helicopters.

Like Milestone Aviation, LCI is focused on acquiring medium to heavy lift twin-turbine helicopters for lease to operators servicing the offshore oil and gas industry, as well as the emergency medical services and law enforcement sectors.

Waypoint Leasing was launched earlier this year by Ed Wlodarczka, former CEO of ERA Group, with US$350m of capital from Michael Dell’s MSD Capital, George Soros’ Quantum Strategic Partners Fund Management and Cartesius Capital Group and placement of an order for AgustaWestland helicopters, including AW139s, AW169s and AW189s. Waypoint Leasing also initially is focusing on medium and heavy lift twin-turbine helicopters, although it plans to diversify its fleet with helicopters servicing other sectors.

Macquarie Rotorcraft also was launched in 2013. Macquarie Rotorcraft is owned by Macquarie Group headquartered in Australia, which also owns Macquarie AirFinance, a commercial aircraft operating lessor. Macquarie Rotorcraft also plans to focus on medium and heavy lift twin-turbine helicopters servicing the offshore oil and gas industry. Macquarie Rotorcraft has not placed any speculative orders, and has indicated that it plans to acquire helicopters primarily through sale/leaseback transactions.

Milestone Aviation’s move into the helicopter operating lease business was bold and opportunistic, coming at a time when financing for helicopters, particularly those operating outside the US, from commercial banks and other traditional sources was not readily available. All of the new lessors appear to be long-term investors who are optimistic that helicopters, particularly the medium to heavy lift twin-engine helicopters to be leased to operators servicing the offshore oil and gas industry, will retain their value while generating strong lease rates. This optimism is attributable to a number of factors including the following:

1. With crude oil prices holding at over US$100 per barrel, drilling operations are moving farther offshore to extract oil and gas. There is a high demand for newer helicopters that...
can transport personnel and supplies safely to and from drilling rigs and platforms that can be located hundreds of miles offshore. The demand for helicopters servicing the offshore oil and gas industry is outpacing supply, and presents a good opportunity for investors focused on value retention. Ascend forecasts that the number of deep water offshore oil and gas drilling platforms with helicopter decks will double from around 250 today to over 500 by 2020, and that the annual production of medium to heavy lift twin-turbine helicopters supporting the offshore industry will increase from its current level of around 100 per year to around 180 per year by 2022.

2. The operators of helicopters servicing the offshore industry transport personnel and supplies to drilling rigs and platforms under multi-year contracts with major government-owned and public oil and gas companies. Although the contracts with oil and gas companies are often limited to five years, the lessees believe that there is a strong likelihood that these contracts will be renewed.

3. Helicopters have long useful lives and retain high residual values, particularly relative to commercial aircraft and business jets. According to Ascend, over 75% of helicopters remain in operation after 25 years and over 50% remain in operation after 40 years. Unlike jet aircraft, helicopters are non-pressurised and do not incur the airframe stress and fatigue that jets with pressurised cabins suffer. Helicopters consist of thousands of moving parts that are continually being repaired and replaced, much like jet engines, in order to stay in operation. Helicopters serving the offshore industry are typically subject to maintenance contracts with the manufacturers and the lessees intend to require that these contracts be assigned to the lessors. The oil and gas companies being serviced by these helicopters have a large stake in assuring that the helicopters carrying their personnel are maintained in a safe condition.

4. The two largest helicopter operators servicing the offshore industry, CHC Helicopter and Bristow Group, have each taken helicopters on lease from Milestone Aviation, signaling an acceptance of operating leasing as a part of the mix of financing options to finance operator’s fleets. While the new helicopter lessors initially are focusing on the offshore oil and gas industry, this is not their sole strategy. The orders with AgustaWestland by both CHC and Waypoint Leasing included medium lift helicopters designed to service other sectors such as emergency medical services. Waypoint Leasing has indicated that diversifying its portfolio is part of its business strategy. Over time, the helicopter lessors are likely to differentiate themselves from each other, just as has happened with commercial aircraft operating lessors.

5. Whether helicopter lessors will dominate the order books of the manufacturers for the medium to heavy lift twin-turbine helicopters is in the future is yet to be seen. In the near term, there is little capacity for increased production and the focus of lessors may be on sale/leaseback transactions, which are likely to become quite competitive, particularly if additional leasing companies are launched.

While the future for the new helicopter lessors looks promising, there are a number of issues that the helicopter leasing industry will have to face. Perhaps foremost among them are whether additional lessors will enter this sector and, if so, how many helicopter leasing companies can be sustained. At the growth in production levels forecast by Ascend for helicopters servicing the offshore industry, it is likely that a number of lessors will face going forward, including the following:

1. A number of countries impose restrictions on the age of aircraft that may be imported, without distinguishing between fixed wing aircraft and helicopters. Some oil and gas companies, including Petroleus, impose age restrictions on the helicopters that may be awarded contracts. Will these age restrictions be enforced and, if so, how will they affect the economic lives of helicopters exceeding the age restrictions?

2. Will technological innovations, accidents and other incidents or safety or environmental regulations result in reduced economic lives of certain helicopters? The recent crash of an Eurocopter AS332L in the North Sea and the temporary grounding of this helicopter type, and prior accidents involving Eurocopter EC225s, demonstrate how accidents can impact a helicopter type.

3. There have been reports that there may be some interest in exploring the development of offshore base stations that would be supplied by larger helicopters with smaller helicopters servicing offshore drilling rigs and platforms from the base stations. The development of such base stations or other innovations could impact the mix of helicopters required to service the offshore oil and gas industry.

While helicopters historically have had long useful lives and high residual values, it is yet to be seen whether these historical trends will continue, or what unforeseen changes will impact the helicopter leasing industry. To paraphrase the mathematician John Allen Paulos, the only certainty is uncertainty. That has been the case for the commercial aircraft leasing industry and will almost certainly be the case for the helicopter leasing industry. Which of the new helicopter leasing companies will survive and prosper will likely depend on how they respond to this uncertainty.