CIT Executive Spotlight

Q&A

C. Jeffrey Knittel, President
Transportation Finance

Aerospace Industry Update

Q: What impact, if any, did CIT's restructuring have on your business operations?

A: At the end of the day, it was business as usual. We continued to make deliveries and serve our customer base with very little impact on our day-to-day business operations. In fact, we even added new relationships as our business performed well in what proved to be a turbulent time for the entire industry and the financial markets.

Q: How have you continued to differentiate CIT Aerospace in the marketplace?

A: As one of the world's leading providers of aircraft leasing, our focus remains on building strong, long-lasting relationships with our customers, as well as our finance and manufacturing partners. It's also important to have an attractive portfolio, one that has a young fleet and consists of aircraft that are fuel efficient and in demand. This year we will add 20 new Airbus and Boeing aircraft totaling approximately $1 billion. Once you have the product people want, it's important to be able to create the flexible financing solutions so that our customers can lease the aircraft.

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Q: How has turmoil in the financial markets over the last two years impacted aerospace suppliers?

A: While the large aircraft manufacturers have weathered the turmoil reasonably well, due in no small part to the participation of U.S. and European export credit support, the supply chain has been more impacted by the slowdown and delivery deferrals in some significant aircraft platforms than it has by the turmoil in the financial markets.

Debt is harder to obtain and is more expensive, but most suppliers have managed that aspect of their business. However, many suppliers had geared up for production of aircraft like the Boeing 787 and 747-8, Airbus A350, and Hawker 4000, all of which have experienced delayed introductions into service resulting in underutilized capital expenditures.

The turmoil itself has decreased economic activity, which has put pressure on those companies that are tied to the level of airline activity, such as repair shops and flight training schools.

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Q: Have your clients' capital needs changed over the past 12 months? What are your expectations over the next year?

A: As with most industries, many airlines have been focused on amassing cash to see them through the current economic turbulence. With the global economy appearing to be in recovery, we expect to see less emphasis on working capital and more on aircraft financing. We anticipate that government-supported export financing will also moderate in the coming year as traditional bank funding becomes more attractive.

Q: How have lessors' access to capital changed? Will this continue to evolve?

A: The most striking change has been the shift from unsecured to secured financing. And while financing for all types of aircraft has been challenging in the recent past, financing for used aircraft transactions has been especially difficult. We see this situation improving over time, but expect financing of used aircraft to carry higher yield and equity participation requirements than in the past.

Q: What financial structures are in vogue today, or being pioneered?

A: The tried-and-true structures of operating leases and asset-backed financing remain the mainstays of aircraft financing. With short-term rates at historic lows, we are seeing some return to floating rate leases indexed to short-term interest rates, but this is not widespread.

Q: Where do you see the current market demand – domestically and globally?

A: For the last two years, domestic air travel has been flat or shrinking as high oil prices and depressed consumer spending limited demand. Now we are seeing traffic and yield pick up and we expect demand for additional aircraft capacity to return to the U.S. market. On the global front, high air traffic growth particularly in China, India, the Middle East, and Latin America is driving market demand for new aircraft. Europe is exhibiting slower growth as the lingering impact from the Icelandic volcanic ash cloud, sovereign debt issues, and pressure on the euro continues to weigh on European economies.

Q: Do you expect to see consolidation in the sector, i.e. commercial, aerospace and defense?

A: You will see both consolidations and new entrants in the aircraft leasing and financing space. Operating leasing continues to remain a very attractive aircraft financing and acquisition solution for the airline industry, and the dynamism of the aircraft leasing sector is a tribute to that.

On the aerospace and defense front, many experts expect that the core budget for the Department of Defense will grow only modestly with highly publicized reductions in the procurement of major weapon systems and platforms. Wartime supplemental budgets will begin to shrink as the conflicts in Iraq and Afghanistan eventually slow down. These dynamics, coupled with the renewed government emphasis on "insourcing" portions of the contracting business, will likely drive companies to fight harder for the budget dollars. This should lead to consolidation in growth areas such as complex data management, C4ISR (Command, Control, Communication, Computers, Intelligence, Surveillance and Reconnaissance) and cyber security.

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Q: What is the role of governments and government agencies now?

A: The export credit agencies of the U.S. and Europe continue to play a key role in maintaining the funding needed to keep new aircraft deliveries on track. Governments also are huge acquirers of defense systems on which many smaller suppliers depend, thus fiscal situations of governments become a constraint. With greater initiatives to reduce carbon emissions, governments could affect choices by airlines of which aircraft to fly, and the trend toward greater taxation on the aviation industry is making air travel more expensive.

Q: What hedging and risk management strategies are emerging, and what risks are most pressing?

A: With fuel prices high, but relatively stable, there appears to be less emphasis on fuel hedging on the part of airlines. For aircraft leasing, the greatest risk is always the risk of an unanticipated event such as an act of war that could cause a long-term reduction in the demand for air travel. Additionally there is the risk of default from a lessee. This risk can be managed by having a fleet of aircraft that are easily transferrable from one lessee to another, and by maintaining close ties with lessees and taking early action if a lessee starts exhibiting signs of financial or operational stress.

C. Jeffrey Knittel is President of **Transportation Finance** at CIT. He is responsible for the management of four groups: Commercial Airlines; Business Aircraft; Leveraged Finance, Transportation (collectively CIT Aerospace), and CIT Rail. CIT Aerospace provides financing solutions to a broad spectrum of the global aerospace value chain, ranging from operators of commercial and business aircraft to manufacturers and suppliers in the aerospace and defense industries as well as financial institutions. CIT owns or finances a fleet of more than 300 commercial aircraft.