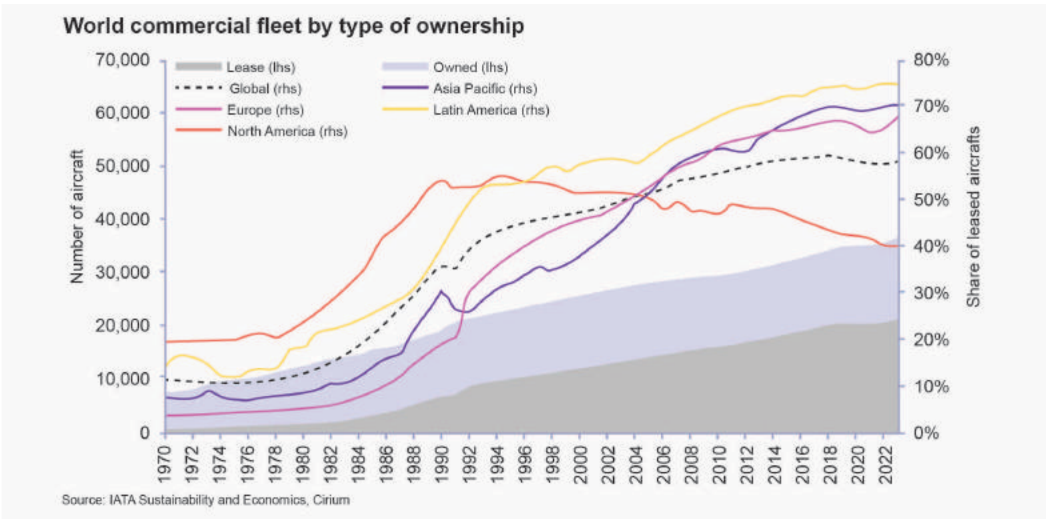
Aircraft Acquisition in Africa:
Any Lessons Learned?

Acquiring and maintaining an aircraft fleet in Africa poses unique challenges, from securing financing to navigating country risk issues and managing congested delivery timelines. These challenges are further compounded by evolving market trends and the need for strategic fleet renewal. In this article, we explore the lessons learned from past experiences and propose strategies for African airlines to navigate the complex landscape of aircraft acquisition.

Ms. Sindy Foster, Principal Managing Partner, Avaero Capital Partners

Aircraft Acquisition Finance: Global Perspective

Airlines have a choice between buying their aircraft or leasing them. There are effectively two types of leases: an operating lease which is a contractual arrangement which permits the use of an asset without transferring ownership rights of the asset. Operating lease includes dry lease (aircraft only), damp lease (some crew), or wet leases (aircraft, crew, maintenance and insurance (ACMI). A finance lease is a contract that permits the use of an asset, and transfers ownership after the lease period is complete, and the lessor meets all other contract obligations. Operating leases typically will allow you to deduct lease payments as an operating expense, while finance leases enable you to claim depreciation and interest expenses as tax deductions.



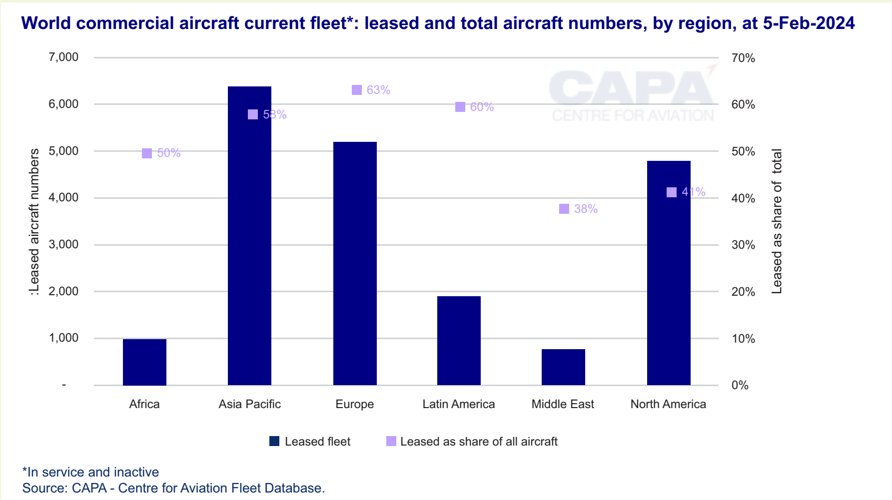
https://www.iata.org/en/iata-repository/publications/economic-reports/more-aircraft-are-leased-than-owned-by-airlines-globally/#:~:text=World%20commercial%20fleet%20by%20type%20of%20ownership&text=Leasing%20has%20emerged%20as%20the,the%2050%25%20mark%20in%202004.

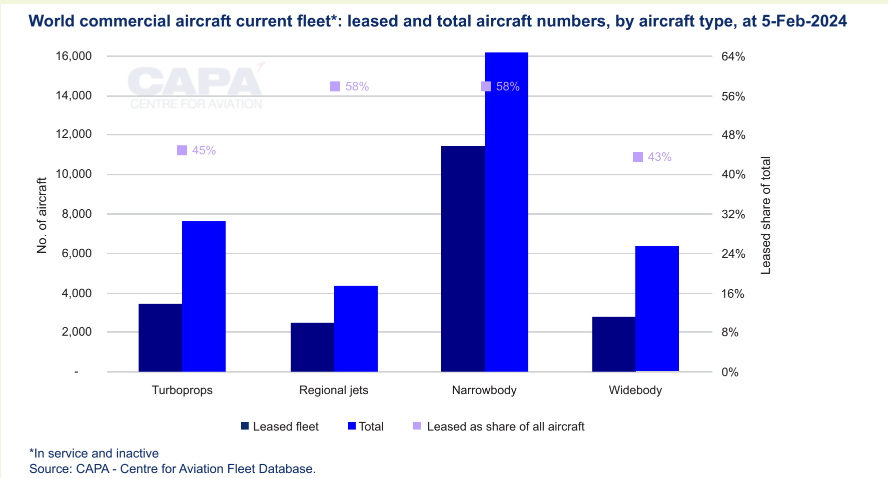
Airlines have a choice between buying their aircraft or leasing them. There are effectively two types of leases: an operating lease which is a contractual arrangement which permits the use of an asset without transferring ownership rights of the asset. Operating lease includes dry lease (aircraft only), damp lease (some crew), or wet leases (aircraft, crew, maintenance and insurance (ACMI).

The share of leased aircraft has continued to grow through and beyond the COVID era against a background of increased debt incurred during the pandemic. Although, there is a difference in statistics surrounding ownership statistics from different providers. In addition, there are geographic differences in the percentage of leased vs owned aircraft as shown by a recent IATA report published in April 2024 and also by CAPA which published their report in February 2024.

The ratio of finance leases and operating leases will differ by airline, by airline type and by geography for reasons we will delve into further below.

Often the percentage of leased aircraft is given as the overriding indicator of airline success, with 70% being misrepresented by some as the global average, with Europe, Asia Pacific and Latin America leading the way. When in reality the global average is around 53-60%, largely in part to the fact that North America averages 40%. Due to better access to capital in North America, lease percentage has gone down from 50% to 40% since 2010.
Aircraft leasing in equilibrium at just over half the world fleet | CAPA (centreforaviation.com)
The CAPA report also showed variances in type of aircraft differences within continents and countries largely based on business model. Airlines which prioritise fleet renewal and age of fleet will often go down the leasing model. But airlines which are focused on longer term profit objectives, or airlines which operate wide body aircraft, will often have a higher percentage of owned aircraft.





Leasing helps airlines reduce indebtedness, helps with cash retention and gives them greater financial agility by allowing them to pay a small fraction of the aircrafts value each month. It allows dynamic expansion without huge capital expenditure which many airlines have benefited from. However, despite some bizarre narratives expounded in some countries in Africa purchasing aircraft can also make sense too. Particularly if the aircraft gets grounded (like during the pandemic), or due to a network planning or regulatory issue, the airline does not have to continuously pay for the lease as it already owns the aircraft.

Purchasing directly from manufactures usually results in a lower overall total cost per aircraft. Airlines who own their aircraft can raise finance by taking loans against these aircraft, a benefit which is not available to lessees. But whilst the list or discounted cost of purchasing an aircraft is often bandied about, it is the total cost including finance costs, i.e. the cost of capital and interest payment cost which is more the driver of purchase vs lease arrangement in most territories.
If all things being equal, but the cost of

Overland Airways is in the process of fleet renewal

capital or interest is high, leasing might be a more favourable option. If a finance lease or dry leasing is an option, that would be the preferred leasing option in that scenario. But in many African countries, that is not an option, therefore wet lease is the prevailing solution. Some argue that this is the worse case scenario, but what matters is regardless of the cost the question to ask is there enough consumer demand and at what price? And the follow up question to this is, will this revenue be enough to cover your costs and make a profit? For me the worse case scenario (if you have done your numbers correctly), is not being able to meet demand, thereby leaving money on the table.

Or even worse not doing your numbers properly so that you are meeting demand and not making any money! How you meet that demand is really a numbers thing. Some airlines choose the lease route, other the purchase route, but the vast majority choose a combination of both.
It's not a coincidence that according to a report published by Visible Alpha at 30 April 2024, the three North American airlines Delta Air Lines, United Airlines and American Airlines are in the top five airlines by Operating Income. And Delta Air Lines which owns 75% of its fleet is considered the most profitable airline in the world by market capitalisation of $26.3bn. Delta has historically preferred purchasing or leasing used aircraft or using older-generation models to keep acquisition costs down. However, the success of this model is achieved through Delta's investment in an extensive MRO organisation.

The Evolution of Aircraft Acquisition in Africa:

Whilst it is true that airlines globally have been reducing cash acquisition of aircraft, Africa is still behind the curve due to lack of financial instruments. Historically, aircraft acquisition in Africa has been hindered by various factors, including the high cost of financing and country risk considerations. African airlines often face difficulty securing favourable financing terms due to perceived instability in some regions and limited access to capital markets. Against this backdrop, air travel demand has bounced back to near pre-pandemic levels, or more in some cases. Although this increase in consumer demand has been constrained by capacity issues to do with maintenance, spares and aircraft delivery delays.

Depleted fleets due to maintenance and parts delays, grounded aircraft for technical and regulatory issues has led to rising costs of travel, which in turn has had the effect of reducing travel demand below what it could be. Whilst demand has seemingly 'bounced back' it should not be overlooked that Africa is a low passenger traffic, high operating cost, high passenger fare environment, which results in low profitability for airlines overall. Therefore, the choice of aircraft type is critical for African airlines, considering factors such as operating costs, route networks, and infrastructure limitations. Many African carriers have historically operated older, less fuel-efficient aircraft, which can result in higher maintenance costs and reduced competitiveness. However, there is a growing trend towards fleet modernization and the adoption of more fuel-efficient aircraft types, driven by both economic and environmental considerations.

Despite all of these factors the region is considered to represent significant opportunities for growth in aircraft acquisition and acquisition by lease, in particular due to financing challenges across the continent.
However, issues surrounding the implementation of The Cape Town Agreement leading to repossession of aircraft in the event of default can be a complex and costly process, which is a deterrent for potential dry lease arrangements leaving some territories in Africa subject to lessor blacklisting. In countries such as Nigeria, debt financed acquisition is the norm. Once established, wet or damp leased aircraft can be added for short term capacity issues. However, some airlines such as Green Africa successfully obtained leased aircraft to commence operations.

Challenges in the Current Landscape:

In recent years, African airlines have faced additional challenges in aircraft acquisition, including congested delivery timelines and increased competition for new aircraft from global airlines and leasing companies with better access to capital. Post-pandemic Africa has emerged as a vibrant market with promising growth potential. The growth of air travel in Africa has led to a surge in demand for new aircraft which are suitable for regional and long-haul destinations, resulting in longer wait times for delivery (as Africa is competing with global airlines with bigger orders and deeper pockets). This can pose significant challenges for airlines seeking to expand their fleets or replace aging aircraft within a reasonable timeframe. However, whilst aircraft leasing and aviation financing firms are strategically expanding their portfolios to take advantage of the opportunities, they also have to overcome their own cost hurdles, and the lack of unified regulatory systems and country risk assessments to achieve the anticipated results.
Currently, OEM manufacturing and delivery schedules are constrained, interest rates even for lessors are high, and due to travel growth and fleet renewal requirements demand for leased aircraft is high, this will result in higher leasing rates.

Africa is already constrained by access to forex, with high cost of capital and interest rates, unfortunately the pressure on costs will continue for the foreseeable future. The softening of consumer demand due to reduction in disposable income as African countries suffer interest rate and inflationary pressures will inevitably come to re-balance supply/demand.

Debt and equity, and access to capital markets are crucial sources of funding for aircraft acquisition. When deciding whether to own or lease aircraft, access to capital is a key consideration. The less opportunity there is to access capital the more reliance there will be on leasing. In Africa, private airlines struggle to access capital at the rates enjoyed by airlines around the world, which can access capital in low single digits, giving them huge cost advantages. Private equity, venture capital and capital markets are difficult or non-existent pathways to secure funding in Africa, this leads to a high number of national airlines who in theory can access capital at lower rates. However, this structure is no guarantee of growth, and often leads to debt filled airlines on the continent, with only a few examples of national airlines generating profit and growing fleet and networks. There have been plans for an aircraft leasing company focused on Africa with a project led by African Development Bank in development, so perhaps this will make access to leased aircraft easier for African airlines in the future. Some countries are also exploring local options.

> **In recent years, African airlines have faced additional challenges in aircraft acquisition, including congested delivery timelines and increased competition for new aircraft from global airlines and leasing companies with better access to capital. Post-pandemic Africa has emerged as a vibrant market with promising growth potential.**

Strategies for Success:

Despite the challenges, there are several strategies that African airlines can employ to navigate the complexities of aircraft acquisition and fleet renewal:

1. Corporate Governance: Corporate structures and corporate governance norms (or lack there of) in Africa make it difficult to attract the scale of capital at affordable rates, but it is important for African airlines to establish credible accounting and financial practices in order to be able to attract more sustainable financing options.

2. Diversification of Financing Sources: Borrowing from commercial banks at high interest rates is unsustainable for exponential growth. Therefore, African airlines should explore a range of financing options, including export credit agencies, leasing companies, and private investors. Sovereign backed leasing companies or institutional investor backed long term funding would be beneficial for acquisition funding. Diversifying financing sources can help mitigate forex risk or country risk and can improve access to capital, allowing airlines to secure more favourable terms and conditions.

3. Strategic Fleet Planning: Airlines typically will conduct market analysis and route planning at the commencement of operations, but fleet optimization to determine the most suitable aircraft types for their operations is a continual process. Some airlines are committed to single manufacturer models for cost rationalisation. Whether an airline has a mixed fleet or single type fleet optimisation may involve retiring older, less efficient aircraft and investing in modern, fuel-efficient models that offer lower operating costs and improved performance.

4. Collaborative Partnerships: Collaboration with other airlines, maintenance providers, and leasing companies can provide access to shared resources and economies of scale. By pooling resources and expertise, airlines can reduce costs and improve operational efficiency, ultimately enhancing their competitiveness in the market.

5. Embracing Digital Solutions: The adoption of digital technologies, such as predictive maintenance, data analytics, and fleet management software, can streamline operations and optimize aircraft utilization. By harnessing the power of data to guide timing of acquisitions, airlines can identify cost-saving opportunities and enhance the reliability and safety of their fleets.

6. Agility and Adaptability: In an increasingly volatile market environment, agility and adaptability are essential for success. Airlines should remain flexible in their fleet planning and be prepared to adjust their strategies in response to changing market dynamics, regulatory requirements, and customer preferences.

Conclusion:

Aircraft acquisition in Africa presents unique challenges, but also opportunities for growth and innovation. The use of leasing to acquire aircraft can provide flexibility for airlines, allowing them to select the right aircraft to meet capacity without taking on significant cost and risk. Lessors may also be able to provide aircraft sooner than OEMs due to advanced bulk orders. It does come at a higher cost which needs to be taken into consideration. By learning from past experiences and embracing strategic planning and collaboration, Africa can overcome the obstacles of financing, country risk, and congested delivery timelines. With better understanding of the rationale behind the different models adopted by global airlines, a proactive approach and a commitment to excellence, African carriers can build modern, efficient fleets that drive sustainable growth and connectivity across the continent.