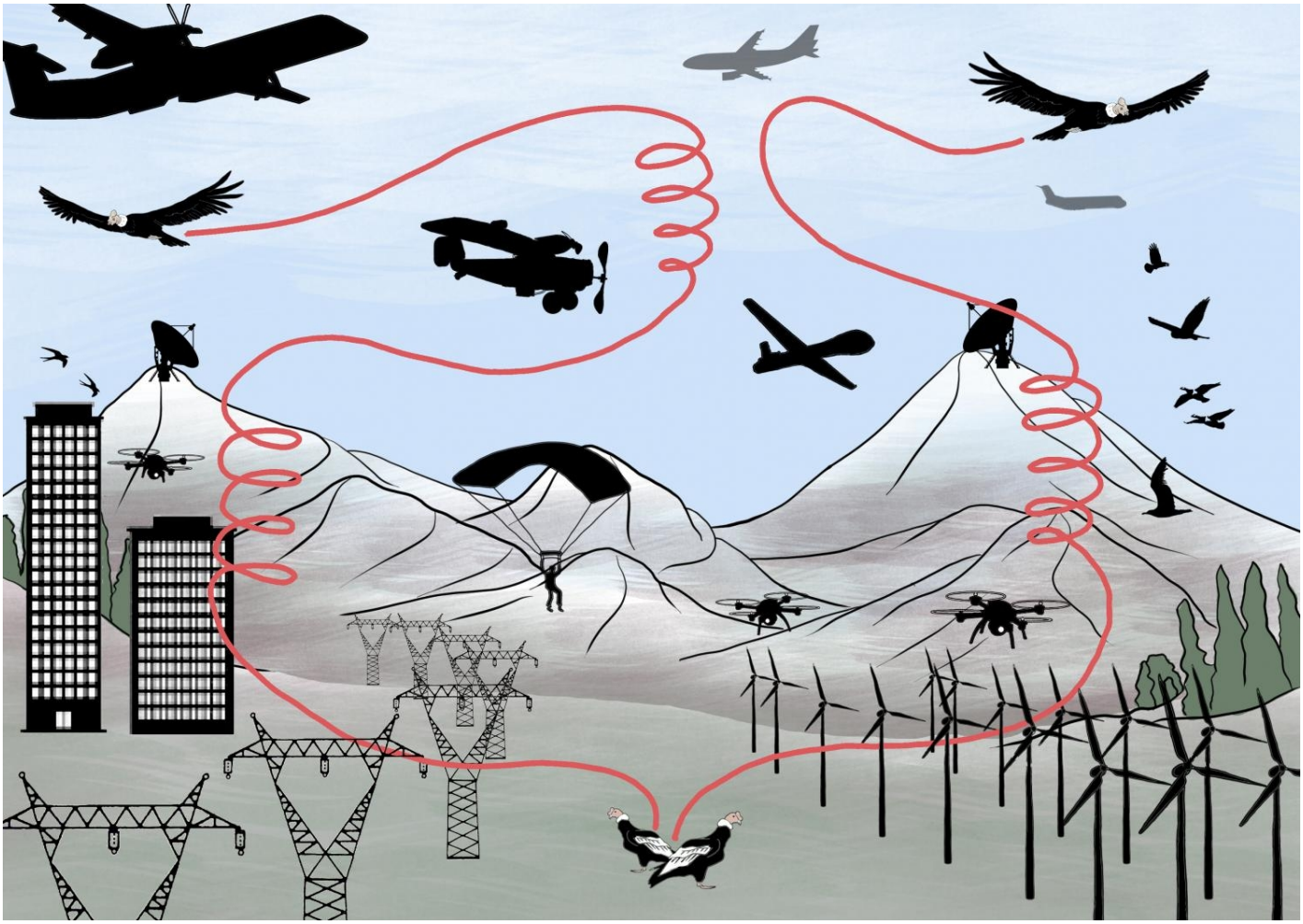
CROWDED SKIES RISK A HARD LANDING: CUT-THROAT COMPETITION IN CHINESE AVIATION ATTRACTS CORRUPTION SUSPICIONS

News /



A graft investigation into China Southern Airlines chairman Si Xianmin and five other senior executives in the biggest corruption probe to date in the world's fastest-growing aviation market has shed light on the sudden rise to prominence of domestic aircraft leasing companies.

From very little presence a few years ago in a market dominated by western firms, mainland leasing companies have found their way into the world's top ranks as they compete to provide planes to fuel the growth of the top domestic airlines.

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But the meteoric growth of some companies appears to have attracted the attention of the nation's anti-graft authorities. The South China Morning Post has found a number of executives at Chinese leasing companies linked with China Southern have been probed since the Central Commission of Discipline Inspection visited the airline late last year.

"The amount of money at stake in aviation is too big. And many people who deal with these contracts are just modestly paid. There are bound to be people overcome by their greed if the internal controls of the company are not good," said Johnny Lau, an industry veteran who recently returned to his native Hong Kong to run his own consultancy business, Astro Leasing. He was previously aviation head at two of the mainland's largest leasing firms, ICBC Leasing and Minsheng Financial Leasing.

Before 2007, the year mainland banking regulators started allowing banks to set up their own leasing subsidiaries, the domestic aircraft leasing market was dominated by Western firms including Gecas and AerCap.

Leasing takes the depreciation cost and risk of an expensive plane off an airline's balance sheet. It also provides airlines with an aircraft procurement channel, as lessors tend to have better access to cheap funding than airlines given their strong cash flow. Lessors acquire their fleet from other lessors, airlines, or from the manufacturer.

The monthly rental for an Airbus A320 plane is typically around US$350,000, meaning a 10-year contract for one plane amounts to US$42 million, making aircraft leasing a trillion-dollar business globally, as half of the world's forecast need for 38,050 more planes in the next two decades are expected to be leased.

According to industry consultancy Flightglobal Ascend, the fleet size of Chinese leasing firms has grown from virtually none to more than 1,000 in the past 10 years, with the majority of those planes leased to Chinese airlines. China Southern had 400 of its 638 planes on lease as of the end of June, according to its 2015 interim report.

Bank-owned lessors such as BOC Aviation, ICBC Leasing and CDB Leasing have grown to rank among the world's top 20 , while HNA Group's Bohai Leasing is poised to become the new world number three after a landmark US$7.6 billion acquisition of Irish lessor Avolon.

But since the graft probe into China Southern began late last year, leasing circles have been shaken up by frequent news of people being asked for "assistance in investigations", according to industry insiders.

One such case involved China Aircraft Leasing Group's founder and former chief Mike Poon Ho-Man. Poon, who recently reappeared in Hong Kong, had been missing for six months, with industry sources saying he was being held in the mainland in connection with the China Southern probe.

A message requesting a phone call that was left by the Post at a secretarial service for Poon was not answered. China Aircraft Leasing Group leased seven planes to the airline between 2007 and 2013, according to company documents.

Another Hong Kong-based businessman, Ma Ah-tung, who also had ties to China Southern and acted as a middleman in leasing deals, was lying low, according to sources.

Ma is connected with Comsys Leasing, a Tianjin-based leasing company founded in 2010 that

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ordered 20 Chinese-made ARJ21 regional jets last November. Comsys had a fleet of 26 planes in service, including 17 leased to China Southern, according to Flightglobal Ascend.

"Comsys never had anything to do with Ma in terms of ownership or anything else," Comsys president and owner Cheng Gang told the Post. He added that Comsys "had business dealings with Ma", but did not elaborate.

Ma's company secretary and shareholder, Cheung Chun-kui, said his boss "is on a trip" and declined further comment.

Wang Chong and Wu Rongyang, who were until last last year chairman and vice president respectively at CDB Leasing, a unit of China Development Bank that is planning an IPO in Hong Kong, had also been investigated in relation to 30 Embraer regional jets worth US$1.25 billion the company leased to China Southern, sources said.

A CDB Leasing spokesperson said both Wang and Wu had left the company last year "for personal reasons" and declined further comment. A mobile number that belonged to Wu is no longer in service, while the Post has not managed to contact Wang.

While almost every leasing executive interviewed said the business was clean, the process of securing aircraft leasing contracts and bank financing are two areas where there loopholes.

"Procurement power is key in any business, but probably particularly so in aviation in China," said one industry executive, who asked to remain anonymous.

"People who can bring deals can command a lot of power as it is big money involved. These are people hired by leasing companies to work as 'originators'".

A contract usually started with an open request for proposals from the airline's fleet procurement department and ended with a final choice that could be decided by a few senior figures at an airline, industry insiders said.

That power can lie anywhere between the level of the department manager, or the chief financial officer, or all the way to the top, depending on the size of the contract and the airline. "There will be several rounds of back-and-forth negotiation on the pricing and terms with the shortlisted contenders. But in the end you may never know why you lost to a competitor," said another leasing executive.

Another leasing company executive told of a mainland airline's chief financial officer accepting payment of five million yuan in exchange for awarding a leasing contract to one of the executive's competitors.

"What is five million yuan compared with US$50 million? It is nothing," the executive said, referring to the potential value of a leasing contract for one narrow-body plane. The story could not be independently verified.

But all stressed that bribery was not part of normal practice.

"Of course, good guanxi [connections] never hurts in China. But aircraft are a big, serious commitment for any airline, and there are many risks associated with the lessor. It is not a discretionary choice to be easily swayed by payouts," said one leasing executive. "Also, it is a small circle, so reputation matters and stories travel far."

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One of those interviewed expressed disappointment. "I hate those few bad apples in the bunch that contaminate our business," the person said. "China needs so many planes, there is so much business out there for everybody if you just follow the rules. Why break the law?"



Founder and Chairman of China Aircraft Leasing Group (CALC), Mike Poon Ho-man. Photo: SCMP Pictures

Mike Poon Ho-man, 42, kept a high-profile and was widely known as savvy and ambitious, according to people who worked with him.

Before his mysterious disappearance earlier this year, he told Reuters of his ambitious plan to acquire European airports.

His asset management firm, Friedmann Pacific Asset Management, had just led a Chinese consortium in winning a EUR308 million (HK$2.6 billion) bid for a 49.99 percent stake in the Toulouse airport, where Airbus is based, which had sparked strong local opposition in France.

Poon is a political adviser for the northeastern Heilongjiang province, where his founding business partner for China Aircraft Leasing Group, Winnie Liu Wan-ting, is from and where the company is investing US$2 billion to build an aircraft disassembly plant, the first of its kind in China.

China Aircraft Leasing Group listed on the Hong Kong stock exchange in June 2014, becoming Asia's first listed aircraft lessor in an IPO that raised HK$580 million.

In December the same year, the company became Airbus's 12th largest customer in the world within just eight years of its foundation with a landmark 100-plane order worth US$10.2 billion.

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That accounted for more than half of the 197 planes ordered by mainland lessors in that year.

Poon founded Friedmann Pacific Investment Group in 1998, where he is the chairman. He graduated from the University of Hong Kong in 1995 with a bachelor's degree in Engineering, obtained an CFA in 2002 and an EMBA from Tsinghua University in 2005. He and his wife Christina Ng remain the second largest shareholder China Aircraft with a 33.08 percent stake. The Post's calls to Poon's mobile were not answered and a message left with the secretarial service operator requesting a return call was ignored.



Ma Ah-tung, owner of then-Times China Infrastructure, now renamed Ma Brothers Republic & Holding, which set up a joint venture with China Southern in 1994.

Ma Ah-tung's aviation links date back to at least as early as 1994. That is when China Southern set up a joint venture in Zhuhai with his company, Times China Infrastructure, now renamed Ma Brothers Republic & Holding, according to China Southern's listing prospectus and Hong Kong's company registry.

Both Ma and a shareholder in his company, Cheung Chun-kui, were mentioned in a report in mainland magazine Caixin Weekly in 2013 in connection with a bribery scandal that ended with a China Eastern Airlines manager, Chen Xin, being sentenced to life in jail in that year. The magazine said Chen had accepted bribes of 12 million yuan for aircraft and engine procurement contracts.

The report said Rolls-Royce and other Western aircraft engine makers used middlemen like Ma, who were their distribution agents in China, for under-the-table dealings with mainland airlines' procurement managers in exchange for selecting their product.

"According to court documents ... at the end of 2007, Cheung converted US$97,500 for Chen into

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Hong Kong dollars and gave the sum to him at Shenzhen airport. Even though the contracts for these B787 planes were eventually cancelled, Chen did not return the money," said the report.

A spokeswoman for Rolls-Royce told the South China Morning Post the company no longer used any agents.

Ma's name was also found in a 2008 Chongqing Evening News report, where he was stressing his commitment to education and philanthropy as a member of the Chongqing committee of the Chinese People's Political Consultative Conference (CPPCC).

Ma appears to have closed his company's Hong Kong office. When the Post visited the Hong Kong registered address of Ma Brothers Republic & Holdings in Admiralty, it found a new occupant who had moved in earlier this year.

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SOURCE: SOUTH CHINA MORNING POST
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