FINANCIAL INSTITUTIONS AND SERVICES

Airline Finance in the Global World

Faruk Dayi, PhD
Editor



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Preface

With globalization, it is seen that the removal of borders between countries, freedom of travel and technological developments have affected the travel habits of passengers. With airline transportation, domestic and international travel carried out in a fast and comfortable way. Airline transportation is intensely preferred especially for long-distance travels. Demand for air travel increases every year, and airline companies increase the supply of seats to meet the demand. In order to expand their flight networks, companies make new investments and seek financial resources. It is observed that they mainly prefer foreign resources to finance their investments. It is recommended that companies establish an effective risk management mechanism. The financing costs of high investments, effective debt management and efficient use of financial resources reveal the importance of financial management in airline companies. This airline finance book, an important need for airline companies, includes different topics and aims to contribute to the literature.

In Chapter 1, the impact of airlines' internal and external financing decisions on fixed asset investments is discussed. Chapter 2 analyzes the financial performance of Star Alliance member airlines using the Entropy Based Edas Method. Chapter 3 evaluates the relationship between carbon markets and airline financing sources. Chapter 4 investigates the liquidity levels of airlines in Europe. Chapter 5 examines the financial structures of airlines in Europe. Chapter 6 assesses airlines' aircraft and fleet investment programs on case studies. Chapter 7 explores the financial failures of airline companies. Chapter 8 provides a bibliometric analysis of research on airline economics and finance. Chapter 9 focuses on the determination and optimization of airline companies' financial risk management strategies. Chapter 10 deals with the relationship between airline companies' working capital management and their profitability. Chapter 11 analyzes the financial performance of airline companies using trend analysis. Chapter 12 discusses the financial and non-financial factors affecting the market value of airline

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companies. Chapter 13 provides a sensitivity analysis of twitter data in airline financing. Chapter 14 investigates the relationships between international airline investment portfolios based on different business models. Chapter 15 evaluates the relationship between the airline index and various indices. Chapter 16 presents a bibliometric analysis of studies examining the financial performance of airlines. Chapter 17 discusses the transformative potential of smart contracts in airlines' aircraft leasing. Chapter 18 investigates the brand equity of airline companies. Chapter 19 examines the relationship between the stock value of airline companies and oil prices. Chapter 20 analyzes airline investments. Chapter 21 reviews the impact of financial technology on airline financing. Finally, Chapter 22 addresses sustainability finance methods and practices in aviation.

In the literature, books on airline finance are mostly theoretical in nature. This book examines the current problems faced by global airline companies through empirical methods. This publication is expected to provide a different perspective to airline companies, related institutions and organizations, investors, managers, public administration, academicians and readers. I hope that it will be useful to all authors and readers.

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Chapter 6

General Structural Approaches to Financing Aircraft and Fleet Investment Programmes for Airlines: A Case for FINNAIR and AAL Airlines

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Abstract

The objective of this desk and field analysis inquiry is to provide a broad range of technical and practical understanding of a very delicate area of banking, namely Aviation Finance. The first part aims to provide insight into the 'structural issues' of financing acquisitions with complicated product features as a basis for resolving the 'bankability' issues on the financial institutions' side. The second part of our paper will address the implementation of the general credit structuring approaches to financing aircraft or fleet investment programmes for airlines from the point of view of global banking practices. This part of the knowledge is generally considered 'proprietary information' on the side of the global bank, which is inherent in our case studies. By providing extensive structured financing, an aviation company might create enormous econo-financial value for the airline it belongs to. This value might also be enhanced with

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the support of ECA Finance or Leveraged Aircraft Leasing alternatives. This article aims to contribute to the academic literature by providing extensive insight and knowledge of banking and capital market practices, where additional market value is created with the help of sophisticated funding solutions. The methodology involves a descriptive analysis of financing alternatives fed with a general framework that explains the structural issues of all banking and capital market solutions for aircraft finance. In this regard, we will consolidate our overview of the instrument with two case studies of Finnair from Financing Solutions and, alternatively, the case of Jet Inc. of AAL Airlines for the Leveraged Aircraft Leasing alternative. As with all investment decisions, capital investments in the aviation industry are not without risks, as we recently witnessed during the COVID-19 crisis. Therefore, an airline company's present and future faith might be exposed to a wide range of risks. However, the authors believe that a thorough understanding of the forces and financing alternatives that affect the airline industry and the demand for various aircraft types will allow finance professionals and bankers to make more prudent and effective decisions within the aviation industry. Last but not least is the fact that market-based financing and the implementation of structured leasing solutions will offer a paradigm shift and enhanced value transferred from the financial services to the aviation industry.

Keywords: airline finance, structured aircraft finance, syndicated bank loan financing, asset securitization, ECA financing, leveraged leasing, operational leasing, financial leasing

Introduction

In recent decades, the airline industry has undergone profound changes and alterations in recent years. These structural changes are traced back to the deregulatory and evolutionary developments of the aviation industry. The change initiative started with the big aircraft-producing companies in the early 1970s in the United States, which received approval to produce commercial long-haul aircraft from the Government (Pels, 2008). Deregulation opened the doors to new players and sparked a surge in competition. Low-cost carriers and Gulf-based airlines have emerged with innovative and aggressive business models, reshaping the industry's landscape. These industry dynamics have caused significant upheaval, leading to crises for many traditional airlines.

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Some iconic carriers have ceased operations, while others have undergone mergers and acquisitions, fundamentally altering the "business landscape" (Castiglioni et al., 2018). The intensifying competition, external influences, and governmental political interventions have persuaded airlines to adopt various strategies. These strategies encompass various approaches to international expansion (Albers et al., 2010), growth endeavors achieved through mergers and acquisitions (Anwar, 2015), strategic partnerships, and outsourcing of domestic and secondary lines (Gillen et al., 2015). Additionally, there is a notable tendency to form global airline alliances to become a giant airline operating on an international hub (Gaggero & Bartolini, 2012).

The airline industry serves nearly every corner of the world and plays a crucial role in shaping the global economy. It is a significant economic force, impacting its operations and related sectors such as aircraft manufacturing and tourism (Button, 2008). Few industries command as much attention and scrutiny as airlines, captivating stakeholders ranging from industry insiders to government policymakers, the media, and its vast user base, each with their positive or negative stories about air travel experiences (Belobaba & Odoni, 2009). Throughout its evolution, the industry has thrived on technological breakthroughs, notably the advent of commercial jet aircraft in the 1950s and the subsequent "jumbo jets" in the 1970s. However, this growth unfolded in a heavily regulated landscape worldwide, where technological progress and governmental policies often overshadowed considerations of profitability and competition (Reddy & Chandrasekhar, 2021).

Drivers and Patterns of Airline Finance

In the modern era, securing financing for 'billions of dollars in flight and ground equipment' presents a considerable challenge to the airline industry. Historically, this industry has demonstrated cyclical earning patterns, frequently resulting in less than optimal investment returns (Vasigh et al., 2018). Although exceptions exist, many airlines have trouble generating adequate cash flows to meet long-term capital requirements.

Furthermore, the escalation of debt-to-equity ratios among numerous carriers has adversely impacted their creditworthiness. This phenomenon constrains access to external funding and engenders heightened option fees and progressive payment obligations from manufacturers, occasionally amounting to 25% of the aircraft's price over several years preceding delivery.

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The paradigm shift introduced by deregulation fundamentally reshaped the operational terrain of air carriers, necessitating increased managerial awareness in marketing strategies, strategic delineation, cost effectiveness, and competitive positioning. The deregulation stemmed partly from the notion that airlines, like other companies, should autonomously navigate the market without public subsidies. However, even within a deregulated environment, concerns persist about the financial robustness of airlines (Morrell, 2007). The fiscal stability of the industry significantly molds the character of individual firms in the short term and fundamentally configures their enduring structure and efficacy.

In the immediate timeframe, beleaguered firms may resort to offering fares below compensatory levels to address exigent cash requirements, imperiling the profitability and viability of other carriers over the long haul. Although initial fare reductions may benefit passengers, well-managed carriers must ultimately recalibrate fares to offset losses and ensure a sustainable return on investment, thereby preserving the industry's capital inflow. Furthermore, the collapse of a particular carrier disrupts air service, incurring tangible costs for corporate and recreational travelers (Du et al., 2024). In the long term, while the survival of any single firm may not be a national priority, the failure of a significant number of carriers can lead to increased market concentration, resulting in insufficient competition. The optimal number of firms needed for a competitive industry remains a topic of debate (Abate et al., 2020). Equally crucial is the extent to which existing airlines serve similar markets and compete vigorously in pricing and service. A smaller number of national carriers competing across major airports may exert stronger competitive pressures to control costs and fares than a larger number of carriers operating in less extensive networks. However, fewer firms also increase the risk of forming and enforcing a tight oligopoly, limiting industry output and raising prices beyond what would be seen in a truly competitive market. A critical component of a profitable and mutually favorable aircraft transaction lies in securing an optimal financing structure that mitigates risk for all involved parties. This balanced approach establishes a solid foundation to maximize returns while maintaining predictability. Aircraft financing structures establish the relationship between aircraft users (such as airlines) and various funding entities (including lessors, lenders, and investors), which take on exposure in exchange for anticipated returns. When structuring aircraft leasing or financing deals, the objective is to allocate risks and rewards according to the preferences of the deal sponsors involved (ACC Aviation, 2024).

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Depending on the selected deal structure, an array of involved gatherings may encompass the different participants in each financial debt, equity, or leasing transaction, as well as insurers and guarantors (Robins et al., 2012). Over recent decades, professionals from the leasing, lending, and legal sectors, along with insurers and regulators, have collaboratively devised structures capable of facilitating a wide array of aviation investments and transactions. These structures range from straightforward unsecured loans and operating leases to intricately designed capital market products. The accessibility of suitable funding and efficient financial administration are crucial elements of any thriving airline enterprise. Airlines must secure substantial capital to initiate operations, expand their aircraft fleet, invest in new aviation technology, develop innovative in-flight amenities (such as upgraded seating or aircraft interiors), and explore new markets. Airlines that do not secure adequate financing and sustain their operations face the risk of acquisition by competitors or operational shutdown. This chapter aims to highlight key aspects of airline finance. It delves into various funding sources available to airlines, particularly aircraft acquisition financing. Furthermore, it delineates the arrangement and substance of airline financial statements, delves into financial ratios, deliberates on chosen financial risk mitigation tactics, and scrutinizes the implications of financial insolvency, which could fluctuate depending on the country of operation (Bisset, 2017). One of the key elements in airline finance revolves around the acquisition of aircraft. Boeing (2015) estimates that an estimated 38,050 new aircraft, valued at approximately US$5,200 billion, will be required by 2033. The financial burden associated with the acquisition of aircrafts presents a significant obstacle for airlines. Fortunately, there are a variety of options for airlines to finance these acquisitions (Budd & Ison, 2020). Depending on the type of financing required and the loan duration, airlines can acquire various aircraft financing sources. The final choice depends partly on the availability of funding sources and how well the funding sources and associated costs align with the adopted business model. The business model plays a crucial role in guiding the selection process by delineating acceptable costs to maintain profitability and determining manageable levels of debt (gearing) that will not jeopardize the business (Markhvida, 2015).

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The Financing of an Aircraft

Boeing Aircraft Finance Cluster Model

One of the major driving forces that reshapes the airline industries in all the regions mentioned above is the financing patterns and products available for aircraft deliveries from 2022 to 2042. Methodologically, the funding patterns of the aviation industry are based on the categorization of aeroplane deliveries for 90 seats or more. According to Boeing's CAFMO report from 2023, the Commercial Aircraft Finance Market focuses exclusively on providing permanent financing solutions for new commercial aeroplane deliveries. Refinancing activities are explicitly excluded from the range of financing alternatives within this market group. Consequently, the sources of financing for newly born aircraft are divided as follows.

1. *Cash and equity infusion* incorporates cash equity injection for alternative financing frameworks.
2. *Capital Markets*: These are supported by structured debt capital market transactions. Such financing can be used for direct or indirect delivery financing. It can be issued by mandating an investment bank to launch the deal successfully on a global basis.
3. *Bank Loans*: Commercial bank loans secured by aircraft or unsecured form the basis of this financing option, which can be used for direct or indirect delivery financing.
4. *Export Credit (ECA Funding):* ECA deals are the most common form of long-term capital investment funding. Aircraft provided to countries bounded by "sovereign or political risks" are covered by a guarantee from an export credit agency. With the funding bank together, ECA transactions are easy to launch on debt capital markets, commercial bank loans, and bond transactions.
5. *Credit Enhancement (Securitizations):* Securitizations are based on the existing or future flow of airline receivables that are repackaged and sold to special purpose vehicles (SPV). Based on these receivables, the SPV can issue a bond or a capital market instrument to investors in the airline portfolio. Financing in this category is fortified by a surety insurance policy, a guarantee, or secured further by another commercial credit enhancement structure.

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Financial Standing of Aircraft Leasing Companies

Having performed a retrospective analysis of financing alternatives until 2022, Moody's global outlook for 2024 predicts a stable aviation leasing sector despite the outlook for nonbank finance companies remaining negative for 2024, with slow economic growth eroding asset quality in many sectors and high interest rates keeping operating conditions generally subdued. In contrast, the leasing sector gives us a more resilient financial position than conventional nonbank financial companies as leasing belongs to the 'asset-backed' lending category. The operating performance of the airline industry supports the outlook for aircraft lessors. Investment-grade aircraft lessors have strong prospects for sustaining net income/average assets profitability above 1% in 2024, and some will reach prepandemic historical levels of 2.5% - 3.5%.

Aircraft and Fleet Investment Programmes for Airlines: A Case for Finnair

Aircraft and airline finance is a two-way street. Those cash flows and assets are backed by alternative security structures such as take-or-pay contracts, tolling agreements, and/or a long-term operations contract coupled with proven underlying assets (Nevitt & Fabozzi, 1995). As aircrafts are long-term capital requiring investments and conventional financing is not adequate to make an aviation finance deal feasible, various debt and capital instruments are derived to make the deal attractive for conventional debt lenders or to attract investors to enhance return and deter risks of aviation finance. In the following sections, we have summarized five potential financing mechanisms that a global bank should recommend to Finnair to consider as alternative funding solutions, individually or in combination with each other. All the options below suit Finnair fleet financing for Finnair.

- *Syndicated Bank Loan Financing:* In recent years, the Nordic syndicated loan markets have experienced a significant decrease in margin levels. This trend is characterized by syndicated credit facilities, where multiple banks collaborate to provide a loan or support facility to a customer. These facilities are structured on a prorata basis and adhere to identical terms and conditions outlined in a single credit agreement.

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- *Unsecured Capital Market Financing:* In assessing Finnair's funding sources, the broker bank recommends evaluating the global fixed income markets. Bond financing for airlines provides the following benefits. Long maturities from 10-30 years, attractive fixed rates, bullet or amortizing repayment schedules, diversification of bank sources, passive lenders as investors, and availability of secured or unsecured financing. A deal size of 150 million USD of unsecured bonds or a greater amount with bullet maturities, rated with a BBB+ rating, to be placed for US and European investors would suit Finnair. Finnair can tap the US capital market investors by issuing bonds in the 144 A format. The Finnair home market can be tapped with long-term, fixed-rate, euro-dominated bonds.
- *Asset Securitization:* Asset securitization can offer an attractive combination of public-market funding and bank funding. In such a scheme, Finnair would finance its aircraft purchases in the bond or CP (commercial paper) markets through an offshore special purpose funding vehicle, which would be credit-enhanced via facility ratings. The originating bank has developed an asset-backed aircraft finance application for its securitization conduit. It finds itself in the US CP market and can finance assets for long tenures on a committed basis for 10 to 20 years.
- *Export Credit Agency (ECA)* financing is a distinctive way of providing long-term financing for multisource export financing. For Finnair, Boeing may offer an ECA facility to be backed by US Exim, or Airbus may arrange funding from European ECAs such as Hermes in Germany, Coface in France, or ECGD in England. ECA financing allows 100% financing of aircraft, as opposed to the 80% maximum advance rate in the case of standard aircraft-secured borrowing. Whether this will be a significant consideration for Finnair will depend on the availability and conditions of alternative financing sources. However, given that the 15% tied commercial loans are usually priced competitively at market rates, it might be beneficial to use 100% financing with comprehensive coverage for a country (none for Finland) and credit risks of the airline company. ECA procedures can be lengthy with respect to direct bank funding.
- *Leveraged Leases:* Long-term aircraft financing is often combined with a tax-based cross-border lease to reduce the effective cost to the operator. This reduction stems from tax efficiencies realized at the

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level of the foreign aircraft lessor. Lease structures that could be attractive in the current environment include German, Japanese, and US Leveraged Leases. In recent years, another internal source of funds has emerged through converting existing assets. This method, closely related to the development of leases, offers advantages when the second-hand market is robust. It may involve outright equipment sales or sale-and-leaseback transactions. The latter option enables airlines to leverage the increased aircraft value for further acquisitions and eliminate older aircraft from their balance sheets. In contrast, values are elevated, investments are made in other airlines, or internal operations are bolstered, which is particularly beneficial for undercapitalized airlines (Merrill, 2020).

Credit Structuring of an Aircraft Multi-Sourcing Funding Facility

Introduction to the Fundamental Analysis of Aviation Markets

The first part of our study established the theoretical foundations of aircraft financing. The empirical part will elaborate on aircraft financing from this point of view.

Understanding the Airline Industry in its Regional Context

Historically, airlines were exposed to governmental industrial policy measures in a heavily regulated environment. The aviation business was nurtured by the establishment of state-owned airline companies, and a race to become a 'giant airline' phenomenon started with the liberalization in the US in 1978 (Baroux, 2013). Fundamentally, air transport requires immense airports designed as connection platforms or 'hubs' to combine the main carriers with well-designed and operationally efficient movement infrastructures to be filled with the increasing number of passengers. In this sense, Europe is seriously handicapped by the lack of space and lower growth rates. The 10-year growth forecast for gross domestic product is 1.8%, and traffic rates are 3.6% for 2024-2034 (Wyman, 2023). Asia and the Middle East are the latest zones to enter the pipeline in this context, driven by the remarkable growth in air transport on this continent. Completely new airports have been built within the Asia-Pacific and Eurasia regions, Istanbul Airport being the major hub

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combining Europe, the Middle East, and Asia. They have been designed to operate on a central system with all modern techniques. Although India was laggard in these developments a decade ago, it is now the leading country in the world to grow the aviation industry to unprecedented levels by global standards. India is already the third largest aviation market by volume, projected to be the third largest overall by 2026. With more than 500 million projected passengers by 2030, the government wants to create aviation hubs as an alternative to Dubai (The Economist, 2023). China deserves special attention here. China's projected traffic growth puts it on a course to compete with North America and become the largest aviation market during the forecast period of 2022-2042. China's airlines are forecast to absorb 9,590 aircraft from the projected fleet size of 48,505.

JET Inc./AAL Airlines, Aircraft Finance Banking Facility

Every loan starts with a call from an account officer at the financial institution where prospective or existing clients are assigned to them. An account officer provides a consistent platform for the borrower's officers or CFOs. Having analyzed the basic risks of its prospective or existing clients, the account officer, as the 'deal originator' and the "product leaders" in a bank, would assemble the basic package of terms for the required/proposed loan terms. This origination process covers the fundamentals and spirit of the deal.

Terms of the Facility (Term Sheet) and Commitment Letter

Every loan process requires the existence of a term sheet (TS). A term sheet is a basic document that describes the initial terms and covenants of a deal in a nonbinding way of writing. The TS is usually legally 'non-binding' and is usually attached to a 'mandate letter' or a 'commitment letter. 'If a loan facility is likely to be particularly complicated, a term sheet serves as a helpful summary of the main provisions for the parties. The commitment letter (also known as a 'mandate letter') is a letter from the bank that arranges the loan for the borrower. Contrary to the term sheet, it contains terms that need to be legally binding before the loan itself is executed, and it usually has the term sheet attached as an appendix. The intention is that the term sheet and the commitment letter, if needed, be signed and returned by the borrower within a few days so that the account officer can start structuring the facility (Adams, 2012, p. 14).

The terms of the Facility are as follows:
Lender: C-Leasing Company

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Borrower: JET Inc.
Facility size: $ 4,600,000. -
Structure (s): There are two parallel-running external funding facilities and an "equity kick" within the deal.

1. Debt Facility: This consists of an equally amortizing 66-month, fixed-rate, nonrecourse loan to the borrower JET Inc. The monthly rentals are $98,712 payable in advance and net of the rental payments made under the lease profile.
2. Leasing Facility: Jet Inc. arranges a corresponding 'dry lease facility' with 66 months of rentals of $115,000. - payable in advance.
3. Equity Participation and Cash Injection: $ 1,200.00 - JET Inc. being the primary investor inside the deal.

Security: Primary - First priority security interest in the aircraft, assignment of the underlying lease agreement, and associated contracts thereon.
Secondary: Subordination of equity through investor/owner indemnity; CAA registration noting C-Leasing's interest in the aircraft; loss payee on the lessee insurance policy; charge over the engine and airframe reserve and rental accounts.

Lessor: JET Inc.
Lessee: AAL Airlines.

Repayment Terms: 66 monthly rentals of $ 115,000 are payable in advance and collected directly at C-Leasing.

Down payment: $ 200,000. - upfront.
Pricing: 12% p.a.+ 3% spread.
Commitment Fee: 1 % payable upfront.
Seller: Export Air Leasing
Sale price: $6,000,000.

The Structure of the Facility
The facility is structured as a *non-recourse loan* to the borrower 'Jet Inc.' with performance by the underlying lessee, AAL Airlines. AAL would serve as the main 'credit base' for repayment and the ultimate obligor, where funds flowing out of the leasing transaction would help close and repay the debt from

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C-Leasing. C-Leasing provides the senior debt in this transaction, the equity to be supplied by the borrower, Jet Inc. Due to matching the loan payments with the lease-rental profile, this facility is effectively a full-payoff, medium-term lease secured by a pledge on the aircraft rather than the title to the asset. *C- Leasing will assume the credit risk in the transaction, the drawdown will be made from the C-Bank Treasury in the UK, and the rentals will be paid directly to C-Leasing's account in the UK. The lease and loan documentation will be drafted by the counsel of C-Leasing in the UK, a private law firm. The security will be perfected through a full lease assignment, a first security interest granted under the loan, and a pledge on the aircraft*. Furthermore, C-Leasing's interest in the aircraft will be noted in the CAA registration, and the insurance policy will recognize this interest as a 'loss payee position'. A diagram of a typical secured loan structure used in aircraft financing cases is the C-Leasing set out in Figure 1.

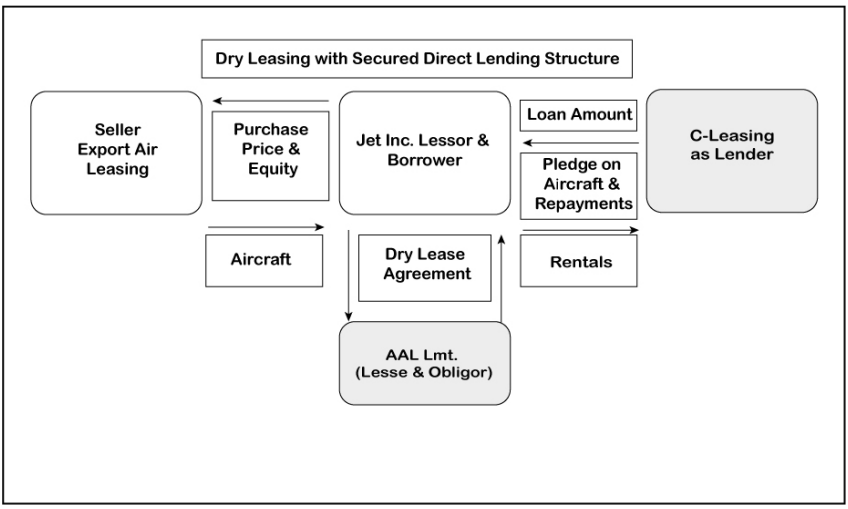

Figure 1. Structure of a Dry & Leveraged Lease with Supportive Credit Facility.

Description of the Obligor/Borrower (AAL Airlines)

Originally established in 1983, the company's principal activity is operating an international cargo airline with 27 employees, 12 of whom are aircrew and 15 ground personnel, using two Boeing 707s and a BAC 1-11. The chairman is a former RAF pilot (Royal Air Force) who also reorganized the modern Saudi Arabian Royal Air Force.

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Company Operations and Competition

Currently, AAL operates 90 hours per week and has a budget of 2,300 flying hours a year. Their BAC 1-11 is being used on an open-ended contract for DHL. The Boeing 707s fly to Hong Kong, Johannesburg, Accra, and Chicago.

Equipment Valuation

In July 1955, the U.S. Air Force permitted Boeing Aircraft Corp. to build commercial versions of a military transport jet, the KC-135. The resultant production of the 707 and 720 series aircraft was initiated, and this series of aircraft dominated WW Airlines. The appraisal values range from $ 5,000,000 to $6,200,000 with modifications.

Collateral Analysis

Collateral analysis is performed based on two alternative values. The low wholesale value is $ 5,000M, and the higher retail value is $ 6,200 M. Both prices, including the collateral value at the end of the leasing term and the engine scrap value, which is estimated at a conservative $ 3,500M, should be verified by independent aircraft valuation companies. Wholesale Value Analysis is the required benchmark according to the credit policy. This comprises in Table 1:

Table 1. Wholesale Value Analysis

Year End	Net Principal Funded (In this. USD)	Low Wholesale Collateral Value (In thsd. USD)	Safety Cushion (In thsd. USD)
0	4,600	5,000	400
1	3,764	4,750	986
2	2,927	4,500	1,573
3	2,091	4,250	2,159
4	1,254	4,000	2,746
5	419	3,750	3,331
6	0	3,500	3,500

Documentation, Insurance, and Security Issues

The principal documentation governing this transaction includes the following: Lease agreement between Anglo Airlines Ltd (Lessee) and Jet Inc., Loan Agreement, Promissory Note, and granting of security interest between C-Leasing Lmt. (Lender) and AAL Airlines Ltd. (Borrower). Assignment of the lease agreement and associated contracts. Owners' equity subordination letter. All documentation is drafted by professional law offices and is governed

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by English law. The lease has been drafted as a “Hell of High-Water Lease (England) or a “Triple Net Lease (US) in which all obligations rest with the lease. The security over the aircraft is perfected through an assignment of the lease and the priority security interest granted under the pledge.

Conclusion and Discussions for Finnair

The rationale for lending that governs this transaction is primarily the cash flow of the lease as the initial source of repayment. But foremost, the strong asset protection provided by the value of the collateral, which even in the worst scenario results in a full recovery of the C- Leasing investment. This aircraft is an essential business investment that will be operated by a company that, although only in existence for five successful trading years, is managed by personnel. Although the syndicated bank loan market is, at this point, liquid, receptive to good quality borrowers, and attractively priced, the bank’s management recommends that for the financing of the upcoming aircraft purchase programme. Finnair considers the US and European capital markets. The bank’s relationship manager believes that tapping these institutional investor markets can be very interesting for the following reasons.

1. Competitive pricing level for every long tenor (10, 20, or 30 years).
2. The possibility of borrowing on an unsecured basis to preserve maximum flexibility both operationally and financially, and
3. The possibility of structuring amortization schemes according to Finnair’s wishes (balloon or bullet repayments). If the preference is for a leveraged lease structure, this can also be combined with capital market funding. However, in this case, the aircraft security would need to be given to the lenders.

Consequently, the bank’s debt/capital markets origination team would conclude that the Euro 144a market offers the most attractive financing. To match the aircraft delivery profile and minimize the drawn cost, the originating bank could issue several different tranches, affording Finnair a wide investor base and range of maturity profiles. Once the current aircraft delivery programme is complete, Finnair can prepay all or part of its corporate revolver at no cost.

Finnair’s comparatively old short-haul fleet and inflationary pressure on the cost base that might weigh on further profitability improvement are

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business risk profile constraints. The average age of the Finnair fleet operated in 2023 was 12.5 years, which is comparable to Deutsche Lufthansa AG (Lufthansa; BBB-/Stable/A-3), Air France-KLM SA (BB + / Stable / -), and International Consolidated Airlines Group (IAG; BBB- / Stable / -). S&Ps believe the old fleet might increasingly weigh on the airline's competitive position and profitability, particularly given the more stringent environmental regulation. Finnair is actively considering this; however, no new aircraft orders have been placed (S&P, 2024). However, the global bank believes that the above-mentioned options are the most attractive opportunities considering the given market conditions, Finnair's credit standing (BB+), and the assumed financing requirements to reinvigorate the company's competitiveness. In this regard, BB+ is a speculative grade where the above-mentioned alternatives are market-optimal for the BBB rating or higher ratings. To achieve this rating target, new security structures must be added to existing lower-rated transactions.

Disclaimer

None.

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