

Annual aircraft deliveries to airlines are expected to reach almost 1,000 units in 2005 and have a delivery value of \$50-55 billion. This places a high demand for financing, especially when many airlines are experiencing financial weakness

Financing for aircraft deliveries in 2005

The return to profitability by some airlines and the increase in traffic volumes indicates that the airline industry is in the upturn phase of a new cycle. New aircraft need to be delivered in the next two years to accommodate traffic growth and old aircraft retirements. The number of new deliveries will exceed those of the past three to four years. How many aircraft will be delivered? What will be their capital cost and how will they be financed?

Delivery breakdown

According to *Avsoft*, 978 commercial jet aircraft will be delivered in 2005, including jetliners delivered by Airbus and Boeing, and regional jets (RJs) by Bombardier and Embraer.

So far 720 aircraft have been scheduled for delivery in 2006, but orders placed during 2005 will include some delivery positions for 2006. Deliveries in 2006 are likely to exceed those in 2005, considering industry recoveries.

Aircraft deliveries reached their peak in 2001, after the transport industry had already started in the downturn phase of the cycle. There were 1,113 deliveries in 2001 and 1,026 in 2002, including RJs. Deliveries were stable in the following two years at about 920 each.

It is estimated that capital spending will reach \$50-55 billion in 2005 and 2006, and it is expected to keep increasing at least until 2009.

The total of 978 aircraft due for delivery in 2005 comprise 738 jetliners and 240 RJs. Of these, 520 jetliners and 237 RJs are being delivered to airlines, and 218 jetliners and three RJs are being delivered to lessors. The breakdown of deliveries by type to airlines in global regions is summarised (*see table, page 8*).

Overall, these 978 deliveries have a calculated capital value of \$50-55 billion, based on an average discount of 25% on manufacturer list prices.

The assumed average delivery values for each type are as follows:

● A320 family	\$45 million
● A330/340	\$135 million
● A300-600	\$90 million
● 737NG	\$43 million
● 767	\$90 million
● 777	\$145 million
● 747	\$165 million
● BRAD CRJ	\$21 million
● ERJ-135/-145	\$19 million
● Other RJs	\$18 million
● ERJ-170/-190	\$25 million

The number of aircraft being delivered and their values are summarised (*see table, page 8*). The A320 accounts for the largest delivery value at \$13.2 billion, followed by the A330/340 at \$11.76 billion. The 260 737NGs have a delivery value of about \$10.79 billion, while Boeing widebodies collectively have a value of \$11.08 billion. These four main groups of jetliners total 738 aircraft and have a delivery value of about \$47 billion (*see table, page 8*).

Another 240 RJs will be delivered with a value of about \$5 billion (*see table, page 8*).

Lessors

The 221 aircraft being delivered to lessors in 2005 have an approximate value of \$13.3 billion, accounting for about 25% of the total for 2005. These deliveries are summarised (*see table, page 8*).

Financing techniques

Once lessors' 221 aircraft deliveries have been considered, airlines will have to finance about \$38 billion of aircraft deliveries. This financing requirement will be split between internal and external financing.

Internal financing will originate from airline cashflows, derived from profits and book depreciation. Profits and cashflow for many carriers, and the industry as a whole, were weak in 2004, leaving airlines with relatively little cash to internally finance deliveries in 2005.

The industry is divided, however, between airlines making respectable profits and those still struggling with weak revenue streams and losses. North American legacy carriers collectively have the worst financial performance, and are therefore taking delivery of few new aircraft in 2005 and 2006.

Low-cost airlines in North America and Europe enjoy some of the best financial performance in the industry, and are taking delivery of a large percentage of new aircraft over the next two years. Airlines in the Asia Pacific and Middle East also have respectable financial performance and account for some of the largest aircraft deliveries in 2005 and 2006.

The general financial weakness of airlines means internal financing will account for a smaller portion of aircraft than normal. Besides deliveries of new aircraft scheduled for the operating lessors, they will finance additional aircraft with sale and leaseback transactions. This now accounts for a large portion of aircraft financings.

Airlines will have to consider other external sources of financing, including straight debt financing, finance leases and

BREAKDOWN OF AIRCRAFT DELIVERIES & FINANCING REQUIREMENTS FOR 2005

Aircraft type	A320	A330/340	737NG	767/777 /747	RJs
Aircraft numbers					
Airline deliveries					
Europe	69	19	41	5	38
North America	39	13	80		175
Asia Pacific	60	25	41	36	21
Africa/Middle East	10	15	8	8	
Other	9	14	17	11	3
Total airlines	187	86	187	60	237
Lessor deliveries	109	18	73	18	3
Total	296	104	260	78	240
Delivery value \$ '000s of millions					
Airline deliveries					
Europe	3,105	2,565	1,763	1,045	798
North America	1,755	1,365	3,440		3,951
Asia Pacific	2,610	3,375	1,763	6,090	189
Africa/Middle East	450	2,025	344	1,160	
Other	400		344		
Lessor deliveries	4,900	2,430	3,140	2,790	60
Total delivery value	13,220	11,760	10,794	11,085	4,998

EETCs.

In the 1980s and 1990s, finance leasing was the most popular method to fund an airline's aircraft delivery. "Unlike the past, the contribution from tax-based leasing will be relatively small, especially on a 'cross-border' basis," says Ian Hosier, global head of transportation finance at IntesaBci. "That is because the respective tax authorities around the world have progressively tightened and restricted the eligible schemes."

The Enhanced Equipment Trust Certificates (EETC) is an efficient method for US carriers to collect a large amount of capital to fund aircraft and spare parts. "For large EETC issuances where the relatively high up-front transaction costs can be spread over the big deal, EETCs are certainly the cheapest way to go. For smaller EETC issuances, it gets pretty expensive on a relative basis because of the high transaction costs," explains Roland Scheinberg, partner at Vedder Price Kaufman & Kammholz, P.C. Scheinberg was counsel of jetBlue's two EETC issuances in 2004.

A closer analysis of the distribution of aircraft deliveries between airlines in 2005 will indicate how they are going to be financed.

Europe

European airlines will take delivery of 69 A320s and 41 737NGs direct from the manufacturers, and 19 Airbus widebodies and five 767s/777s; thereby making a total of 136 aircraft. This will have a value of about \$8.03 billion (*see table, this page*), based on a 25% list price discount. European airlines are taking delivery of the second largest number of aircraft, including from lessors.

The capital spending in A320 family and 737NG aircraft will be \$ 4.9 billion: 60% of the total. While many European airlines reported losses in the past three years, they are expected to regain profitability this year.

European legacy airlines, which include Air France, Iberia, British Airways (BA), Lufthansa, Aer Lingus and Cargolux, will take delivery of 41 aircraft valued at \$3.9 billion. How can these legacy airlines finance these deliveries?

One of the financial sources is these airlines' relatively strong balance sheets. Lufthansa, for example, which will receive four A330s valued at \$440 million, is estimated to show an operating profit of Euro 383 million in 2004 and Euro 332 million in 2005.

Cashflow has mainly been generated from depreciation in recent years, although net income has also contributed. In 2002 and 2003, Lufthansa's depreciation was \$1.08 billion and \$1.30 billion, respectively. Lufthansa also generated a small net income in both of these years. Depreciation in 2004 is expected to be about \$1.6 billion. With this cashflow, it is easy for Lufthansa to finance these deliveries.

BA will only take delivery of one A320 and one A319 in 2005. Over the past five years, BA's capital annual expenditure has declined from a high of \$1.6 billion in 1999 to a historic low of \$346 million in 2004. Depreciation also declined over the same period. BA is expected to generate an operating profit of at least \$900 million in 2005.

Air France/KLM will receive four A320 family aircraft, five A330s, three 777s and one 747 in 2005, with a total delivery value of about \$1.45 billion. As of 31st December 2004, this group's net debt to equity stood at 102%, 9% lower than a year before, which is strong compared to most legacy carriers. It is worth noting that this carrier has Euro 3 billion of net cash on its balance sheet, equivalent to 16% of annual revenue. It would be logical to conclude that growth will not be a problem. In the 2004/05 financial year, this carrier is expected to make a profit of Euro 482 million. Based on its strong cashflow, low debt/equity ratio and moderate profit prospects, this group can take delivery of these aircraft without much difficulty.

European low-cost airlines will take delivery of 40 A320s and 31 737s in 2005, valued at \$3.1 billion (*see table, this page*). Some low-cost airlines have a weak financial position, and so financing aircraft can be difficult for them.

Ryanair and easyJet, however, are two of the most successful low-cost airlines in Europe, and have settled this problem successfully. EasyJet ordered 120 A319s in 2000 with an estimated 50% price discount. In 2004 it made a sale and leaseback deal with SALE for six aircraft allowing it to generate additional cash.

EasyJet also obtained loans from RBS and other European banks to fund the deal. "The 38 aircraft not yet financed, which are primarily 2006 and 2007 deliveries, will be financed over the next two years. EasyJet has a request for a proposal in the market seeking offers to finance 11 of the 38 aircraft," says Derek Patterson, group treasurer at easyJet.

Ryanair will take 30 737s this year valued at about \$1.30 billion. Financing these aircraft is a comparably easy task for Ryanair for two reasons. The first is that Ryanair got a good price when it made a deal with Boeing soon after September 11th 2001. The second is the carrier's strong financial performance,

Narrowbodies being delivered to low-cost European airlines will account for one of the largest portions of financing for commercial aircraft in 2005. EasyJet has used sale and leasebacks to finance some of its aircraft deliveries, while Ryanair will take delivery of 30 737-800s in 2005.

reporting operating profits of Euro 239.4 million and Euro 206.6 million in 2003 and 2004 respectively. It is expected to make an operating profit of Euro 218.3 million in 2005.

The carrier's annual depreciation in 2003 and 2004 was Euro 76.9 million and Euro 98.1 million. Capital expenditure during 2002, 2003 and 2004 was \$313.6 million, \$346.2 million and \$512.1 million respectively. Correspondingly, it took delivery of 10, 14 and 24 737s during the past three years. In the next few years, it will take delivery of up to another 83 737-800s. Ryanair will thus experience an increase in capital expenditure over the next five years. If Ryanair only depends on internal financial sources, it will face severe financial distress. Hence, Ryanair announced that 20% of its latest order for 70 737-800s will come from operating leases. The financing methods used by Ryanair and easyJet together are typical of European low-cost airlines' approach to aircraft financing. Low-cost airlines are in a strong position to negotiate a good price with aircraft and engine manufacturers. They can also use several financial methods to fund deliveries, based on lessors' high expectations of their financial performance.

North America

Airlines in North America attract attention because of the major airlines' struggle with poor financial performance and bankruptcy protection. The absence of aircraft orders is a consequence of the recession in this industry.

North American carriers are expected to take delivery of 132 aircraft delivered in 2005. This includes 80 737s and 39 A320s. Their value accounts for about 75% of the total value of the aircraft deliveries in the continent in 2005. The only widebody aircraft to be delivered are A330s and A300s for Northwest and United Parcel Service. No Boeing widebodies will be delivered in 2005.

The majority of narrowbody deliveries will be to low-cost airlines: 25 out of 39 A320 family, and 51 out of 70 737NGs they will a delivery value of about \$3.3 billion.

Jetblue will take 15 A320s in 2005 and 19 in 2006, valued at about \$1.53 billion. Jetblue took delivery of 16 A320s



each year between 2001 and 2003. Meanwhile it reported an operating profit of \$37.2 million, \$303 million and \$425.7 million in the same three years. In the same period the airline's capital expenditure increased from \$287.9 million to \$732.9 million and debt growth rates were 111.5%, 90.1% and 55.7%.

Jetblue's increasing capital expenditure and declining debt growth rates indicate that it has tried to finance fewer aircraft deliveries with debt. Last year jetBlue twice issued Enhanced Equipment Trust Certificates (EETCs) and collected a total of \$929 million to finance 28 A320s. JetBlue can finance its aircraft deliveries in 2005 and 2006 with this cash in hand. "JetBlue will likely come back into the (EETC) market, and Southwest, given their very large order book, may come in as well," says Scheinberg.

Southwest Airlines will take delivery of 33 737-800s in 2005, and 23 in 2006, valued at \$2.4 billion. To finance these aircraft and other investments, Southwest completed a \$350 million unsecured offering, priced at 119 bp (Libor plus 75). After the deal, Southwest's senior unsecured notes totalled to about \$1 billion. As of December, 2004, this carrier has \$1.3 billion at hand, which makes financing the huge delivery straightforward.

Westjet's financial reputation has been damaged by taking early delivery of 737-800s to replace older and fully-depreciated 737-200s. To get these deliveries, WestJet had to accelerate the replacement of the 737-200s and consequently reported an additional depreciation charge of \$47.6 million related to their write-down in the fourth

quarter of 2004. WestJet reported 31 consecutive quarters of profitability, until the last quarter of 2004 when it reported an operating loss of \$19 million.

WestJet plans to replace 18 737-200s with five 737-600s, six 737-700s and five 737-800s over the next twelve months. Despite the loss in the last quarter of 2004, the new aircraft will allow it to make an annual operating cost saving of \$30 million.

Leasing arrangements for the 737-700 deliveries will be provided by Aviation Capital Group (ACG), while Pegasus Aviation Finance Company will provide leasing arrangements on the 737-800 deliveries. The remaining seven aircraft to be received in 2005 (- four 737-700s and three 737-600s), will be financed with loan-guarantee support from the Export-Import Bank of the United States (Ex-Im).

US legacy carriers, which used to be big buyers of aircraft and are now in financial distress, are managing to finance this year's comparably smaller delivery valued at \$3.2 billion. Capital expenditure of US major airlines, except Southwest, declined over the past five years. Vaughn Cordle, president at Airlineforecasts estimates that with the exception of Southwest, major airlines will report a loss of about \$3.5 billion, and aircraft rent will be \$4.6 billion for the 2004 financial year.

This downward trend in capital expenditure reflects the decreasing order backlog of legacy carriers. Among all legacy carriers, Northwest will take the largest delivery of six A330-200s and four A319s, with a total value of \$802 million. Northwest is expected to pay \$55 million for capital lease rentals and \$595 million for operating lease rentals. Northwest will take seven A319s, two



Emirates has close the first ever Japanese operating lease on an A340-500, which has been arranged by Orix on a 13-year term.

A320s and six A330-200s in 2006 valued at \$1.03 billion.

Northwest is expected to report a net loss of \$505 million in the 2004/05 financial year. As of December 31st 2004, Northwest has \$2.5 billion in cash. Airbus will finance Northwest's A330 deliveries.

Continental Airlines will receive seven 737-800s and Delta Airlines 10. These two carriers are expected to report a combined loss of \$3.5 billion for the 2004/05 financial year, but their cash position remained strong at about \$3.56 billion at the end of 2004. It is therefore not too difficult for them to finance these deliveries.

Asia & Pacific

Demand for air transport in Asia & Pacific is soaring and the airline industry is experiencing unprecedented prosperity. The number and value of aircraft deliveries in this region is consequently the highest of all global regions. Sixty A320s, 41 737s, 25 A330s/A340s, 14 747s and 22 767s/777s, with total value of about \$13.9 billion, will be delivered to this region in 2005. Interestingly, the financial requirement for narrowbody aircraft is about \$4.5 billion, half the amount required to finance widebody aircraft.

Thanks to strong demand and several consecutive years' profit, this region's airlines have the widest choice of methods to finance aircraft deliveries.

Singapore Airlines (SIA) will receive two 747s and three 777s in 2005, and five 777s and six A380s in 2006, with a total value of about \$2.3 billion. So far SIA has not disclosed the detail of how to finance these aircraft. However, as no

change in this carrier's aircraft financing policy has been announced, some clues could be found through reviewing its financial methods.

SIA took delivery of three A340s, four 777s and two 747s valued at \$1.0 billion in 2004. Its total capital expenditure was \$2.7 billion, 12.8% lower than the year before. Internally generated cashflow was \$3.3 billion, equal to 1.24 times its capital expenditure. About 94% of the capital expenditure was for aircraft delivered in 2004. In addition, progress payments were made for aircraft scheduled for delivery between 2004 and 2009. Progress payments were \$2.5 billion in 2004 and will be \$2.9 billion in 2005.

"SIA is expected to report a profit of S\$1.4 billion (\$350 million) in this financial year," says Timothy Ross, analyst at UBS. With such a strong financial position, SIA will still use the cashflow generated from net profit, depreciation and aircraft disposals to finance new deliveries. The financial methods would be a mix of purchases, financial leases and sale and leaseback transactions. Cathay Pacific is expected to make a profit of HK\$ 4.2 billion (\$600 million), and other incumbents in this region will remain profitable. Most financial instruments are available to them to finance their aircraft deliveries because of their strong balance sheets.

Most small and medium airlines in this region will finance aircraft deliveries with a mix of direct bank loans, finance leases and operating leases. Airlines have a wide range of financial methods at their disposal for financing aircraft deliveries due to expectations of high traffic growth rates and profitability in this region.

Air Deccan placed orders in

December 2004 for 30 additional A320s in addition to the five it would have received at the end of February 2005. The A320 order could be financed through sale and leaseback deals. Some small airlines would like to use initial public offerings (IPO) to collect enough capital to finance their aircraft deliveries. India's Jet Airways has launched a roadshow for its planned share sale and has set price targets that value the offering at up to Rs19.4 billion (\$444 million). Its prospectus shows it intends to order 10 more 737-800s for delivery in 2006 and 2007, adding that a refundable security deposit was paid to Boeing in December.

Africa & Middle East

Airlines in Africa are poorer than those in the Middle East, and their high-risk status means that few financial instruments are available to them.

Airlines in Africa and the Middle East will only take delivery of 10 A320s, eight 737s, 15 A330s/A300s and eight 767s/777s, valued at about \$4 billion. Most narrowbody aircraft will go to the small airlines like Jazeera Airways and Air Algerie. South African Airways will take six A319s through loans from RBS and other banks.

Emirates will take two A340s, Qatar Airways will take three A330s and Etihad Airways will take five 777s in 2005.

Emirates has closed the first ever Japanese operating lease (JOL) on an A340-500. The \$138 million lease finances the airline's eighth A340-500 from an order of 10. Orix arranged the equity for the 13-year JOL.

The National Bank of Abu Dhabi has signed an agreement with United Arab Emirates' Etihad Airways to syndicate the financing of its order of five Boeing 777-300ER aircraft. The bank is acting as lead arranger on the \$1 billion deal, which will involve a consortium of both local and foreign banks. However, 2006 will see at least four A380s being allocated to the region. Emirates Airlines has firmed its A380 orders and the first four will be delivered in 2006. Although Emirates is its launch customer for the aircraft, the Dubai airline is using corporate funds to make pre-delivery payments and has no plans to arrange financing. The will be backed by export credit agency support. **AC**