

Author: Patrick J Harris

Executive Vice President Business Development

Mercury Aviation Partners, LLC

Boca Raton, Florida, USA

Tel: 561-447 9404

Cell: 561-702 7849

Email: pharris@mercuryaviation.net

Web: www.mercuryaviation.net

Brief Biography:

PATRICK HARRIS: Executive Vice President Business Development

Patrick Harris is the Executive Vice President Business Development and cofounder of MAP. Prior to starting MAP Harris was the founder and Chief Executive Office of HMG Aviation Inc. Established in 1996 HMG Aviation focused on new business development and asset management including restructuring distressed aircraft financing transactions.

Company Profile:

The Mercury Aviation Partners, LLC partners have managed portfolios with values in excess of \$3 billion covering a wide spectrum of narrow bodies and widebodies, ranging from Fokker 50's to B747's. Managed more than 300 aircraft movements including sale and lease back, financial leases, lease renewals, deliveries

Financing Difficult Aircraft Transactions

When a business sector or asset class is profitable investors chase transactions. For the airline industry the \$41 billion in losses airlines reported between 2000 and 2006 makes for a complex investing environment. These losses resulted from razor thin operating margins, between 1% and 2.5% and uncontrollable variables such as terrorism, oil prices, interest rates, performance of the global economy and politics. Airlines have been relying on a variety of structures ranging from export credit agency support to asset based financing as sources for fleet financing.

Banks motivated by aerospace sector performance

Over 1,000 new commercial aircraft were delivered last year valued at more than \$65 billion. Deliveries will likely approach 1,100 in 2007 valued at more than \$70 billion and these deliveries will require financing.

Traffic and cargo levels fundamental to financing

On a global basis the rate of growth in traffic was 5.6% in 2006 and the estimate for 2007 is in the order of 5.0% for passengers and 6%-plus for cargo. As for revenue IATA projects that growth will slow to 4.6% in 2007 down from 8% in 2006 as the global economy slows.

Cargo traffic growth projections encourages freighter aircraft investment

The slower than expected 3% growth in cargo lift in 2005 and 2006 was, in part attributed to high spot jet fuel prices. That situation is expected to reverse itself from 2007 onward.

Rebuilding balance sheet & restructuring is fundamental to financing

Carriers have been rebuilding balance sheets by cutting capacity and slashing costs. As a result traffic and profits have been showing signs of recovery. The cost restructuring

process in North America peaked in 2006 as Delta and Northwest reduced costs by \$5.5 billion.

Lenders confidence will grow as airline profits build.

IATA expects the global airline industry to earn \$2.5 billion in 2007 a dramatic turnaround from the loss of \$3.25 billion in 2005 and the \$500 million loss in 2006. The Air Transport Association (ATA) reports that US carriers lost \$5.67 billion in 2005 which turned to a net profit of \$2-\$3 billion in 2006 and profits will likely reach \$4 to \$5 billion in 2007. Calyon Securities analyst Ray Neidl expects the U.S. airline industry to post \$6 billion in profits in 2007. His estimate doesn't rely on falling fuel prices. Carriers in Europe, Asia and South America are also projecting healthy profits for 2007. The only regions expecting to report losses going forward are the Middle East, the Caribbean and the select counties in the CIS.

Merger activity attracts new investor pool

The promise of profits has been creating a flurry of merger activity involving Aer Lingus, ATA, Delta Air Lines, Midway, Northwest, Mesaba, Qantas and it's a process that is likely to accelerate fleet changes as the industry outlook and financial performance continue to improve.

Profits in a high fuel cost environment adds to investor confidence

The cost of fuel is the greatest unknown impacted by so many external factors such as supply disruption, political intervention and terrorism. It is a risk that investors have to accept because it represents 25% of a carriers operating cost. IATA has based its 2007 projections of industry profits on an assumption that price of a barrel of oil, at \$60 dollars, will hold at levels similar or below those of 2006. According to the ATA a one percentage point change in the price of jet fuel impacts the industry by about \$190 million annually. Data from the US Energy Information Administration in October 2006, points to the U.S. airline industry consuming 3.4% less fuel than over the same period in the previous year while spot fuel prices rose by as much as 42%. By January 2007 IATA reported that oil prices were down 20% compared to the August 2006 peak and a report by the Oil Price Information Service indicated that jet fuel prices were at \$1.60 a gallon, their lowest level since July 2005 when the price hit \$2.25. If oil prices hold at current levels throughout the year then the high spot fuel prices that slowed cargo growth in 2005/06 will be less of an issue.

Freighter aircraft conversions will meet most capacity requirements

Boeing projects that the demand for freighters will grow as the air cargo market expands by an average of 6.1% annually over the next twenty years. According to Boeing's 2006/2007 global air cargo forecast this demand will translate into the global freighter fleet expanding from 1,789 to 3,563 aircraft during the 20 year period. Boeing calculates that the majority of that expansion will come from widebodies such as the A330, A380, B747, B767 and B777 which will grow from a market share of 50% of capacity today to 64% within 20 years and that this fleet will account for 90% of cargo capacity. Of the expanded freighter fleet 2,217 will be passenger aircraft that will be converted to freighter mode and 776 will come of the production line as freighters.

Export credit agencies will finance new freighters

An estimated 80% of all new aircraft and engine export deliveries will be funded by world's Export Credit Agencies and Investment Insurance Agencies. They provide four main financing services including loan guarantees to banks that provide financing of

commercial loans to aircraft exporters; insurance that protects aircraft exporters against defaults by foreign airlines because of political and commercial risks including foreign exchange risk; loan guarantees to banks providing financing to importers of aircraft, and direct loans to foreign airlines. The vast majority of the 776 or so aircraft that come directly off the production line will be A330s, A380s, B747s, B767s and B777s financed by export credit agencies or by the larger international aerospace banks.

Asset based investors will fund cargo aircraft conversions

The opportunity for creative financing solutions will be for the 2,217 used passenger aircraft that will be converted to freighter configuration over the next twenty years. This market is attracting investors in search of higher returns.

Guidelines for freighter aircraft investing

The key to successful investing will be in selecting the right aircraft and then using the appropriate investment structure to finance the transaction. A few general guidelines must be considered. Firstly that to be a successful freighter an aircraft must be a successful passenger aircraft. Secondly the threshold for converting an aircraft to freighter is when it is between 15 and 20 years. Applying these two guidelines would exclude aircraft such as the B707, DC8, DC10-10 and the L1011. Aircraft such as the A300, A310, B757, B767, B747 and MD11 would be worthy of a second look. On the turboprop side the ATR42, ATR72 and EMB120 would be added to the list.

The turboprop freighter market needs special consideration as this is a niche market where it is very difficult to use conventional lending structures. A case study presented at the Cargo Facts Conference in 2006 addressed the financing needs of cargo feeder airlines that use turboprops. A total of 770 turboprop freighters are in service worldwide. Of these 440 are in North America, 160 are in Europe and the remainder are spread around the globe. As Table Four illustrates the turboprop freighter fleet is old and in need of replacement but no new turboprop freighter designs are on offer by manufacturers. This is forcing regional airlines to convert used passenger aircraft to freighters. This presents special opportunities for investor searching out a niche aircraft investment class and who are willing to take asset risk that offers commensurate returns. A used ATR42 freighter costs in the order of \$4 million. However, few cargo carriers are able to compete for lift with passenger operators and are regularly outbid for available passenger aircraft that could be freighter conversion candidates because passenger carriers are able to pay more which raises the question why? The answer lies in the economics of the operation. According to the case study presented at Cargo Facts, turboprop cargo operators fly a freighter an average of 60 hours per month compared to the 200 hours flown by the same aircraft in passenger configuration. This partially explains the underlying strength of turboprop residual values over and above the conventional wisdom that turboprop prices improved in 2005/06 because of higher fuel prices. To date cargo operators have tended to rely on local banks for funding because of lack of interest from aerospace banks creating a market niche that for investors can offer high returns for asset based investors.

Conclusion.

Optimistic assessments of near term airline profits are generating considerable interest for the financing of new and used freighter aircraft. The conversion of passenger aircraft to freighters has attracted a following of asset based investors focused on aircraft that offer high returns on investment. Industry experts point to risks that need to be managed if

investor confidence in the aircraft trading market is to be sustained. One key risk to monitor in the next few years is that capacity growth could outpace GDP growth. For the moment the consensus view is that this will not occur.