



Aviation platform – geared to most efficient services!



Today, DVB is one of the largest providers of recourse and non-recourse commercial debt to the aviation industry worldwide. With its unique business model the Bank has managed all cycles in the aviation markets. DVB's Aviation Finance team has been offering an impressive track record for many years and coped with a lot of challenges such as 9/11, SARS and the world economic crisis in 2008/2009. Can DVB's significant success story in aviation finance be sustained in times of the sovereign debt crisis?



Bertrand Grabowski, Member of DVB's Board of Managing Directors, is inter alia responsible for the Bank's Aviation Finance. In the following interview with Elisabeth Winter, DVB's Manager Investor Relations, he reflects upon the challenging market environment and speaks about his discerning vision.



Bertrand, is the sovereign debt crisis in the euro-zone and a potential US dollar crunch starting to impact the aviation industry – and where does DVB stand in this scenario?



It is clear – the sovereign debt crisis in Europe and the situation in the US have an impact on the global aviation finance business. But actually the effect we are experiencing on the funding side at the moment is composed of two elements: firstly, the so-called sovereign debt crisis, and secondly, the upcoming new Basel III standards. Regarding the later and for the purpose of “keeping their house in order” banks need to cope with this complex set of regulations – this is true for our competitors and for DVB itself. In times like these, it becomes of strategic importance to identify the most appropriate deal structures and to decide on which activity you want to privilege versus others. In that process, many banks decided that they would not put a top priority on lending activities that consume long-term US dollar funding. So, yes – there is a direct impact of the sovereign debt crisis on our business, but I would say it just accelerates whatever is coming from Basel III. On our side, DVB's capital resources already meet recently discussed Basel III requirements as the Bank offers a high-quality core capital which solely includes issued share capital and capital reserves but no hybrid capital. As to the strategic choices regarding which activity DVB wants to preserve: we are a transportation bank. Financing transportation assets is our “raison d'être” and this is supported by our shareholders.

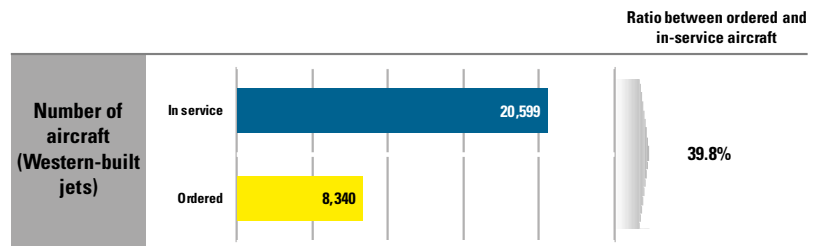
Let me further comment on the much heralded case of the French aviation banks' funding structure which is oriented mainly on rather short-term refinancing. A review published by Barclays Capital in summer 2011 states that 60% of those banks' funding structures show a maturity profile of less than six months. So clearly, once there is a confidence shock in the financial markets, it is becoming increasingly difficult for these banks to refinance themselves and they might eventually have to withdraw from the aviation finance market as well as from the shipping finance and the project finance market. Please bear in mind, this "shock-wave scenario" is not only specific for the sovereign debt crisis but for any serious confidence loss in the global financial markets.

? | Is the aviation industry also suffering from an imbalance between high supply and weaker demand comparable to the shipping industry?

Well, there is no excess supply in the aviation industry comparable to the prevailing oversupply in some segments of the shipping industry which results in that significant volatility of ship values. The aviation industry itself remains a "twofold monopoly" of Boeing and Airbus. This competitive situation usually brings a bit more rational to the supply side which is a very balancing factor.

However, at the moment there is a very strong anticipation from the manufacturers that the market will grow again and, therefore, they are increasing their production rates especially for narrowbody aircraft. As a result, each month more than 40 Boeing aircraft (mainly from the B737 family) and 40 Airbus aircraft (mainly from the A320 family) come out of the supply chain in Europe and the US. That really is a significant number. So, are there too many aircraft? Probably yes, and in fact the ratio between ordered and in-service aircraft (Western-built jets) grows steadily and was at 39.8% on 14 September 2011.

Aircraft orders



Source: CASE data base, Airclaims, 14 September 2011

Of course manufacturers state that the demand is due to rise mainly for two reasons: firstly, Asia is outgrowing the economic crisis and, secondly, there is a huge replacement need for equipment in the US. The average fleet age of US-American airlines is about 14 years, so there is an evident demand. To what extent the actual fleet substitution in the US will be commensurate with the production rate, jury is still out on that point. DVB's opinion is in line with the UBS research, which was published in June this year, pointing out that roughly 10–15% of the current order book can be deemed to be "overbooking". How is this further overhang going to be absorbed? Well, "White Tails" (i. e. aircraft produced without a buyer, sitting on the tarmac in Hamburg or Seattle) are probably excluded as export credit agencies (ECA) will always do their utmost for new aircraft to be financed. But this inflow of new equipment mainly requires older aircraft to be decommissioned earlier than scheduled. Therefore, we cannot exclude some impact on residual value for those older aircraft, or on lease rates that go along with it.



Bertrand, how has the competition in global aviation finance changed and developed since 2008?

With regard to competition we must differentiate between the financing of new versus older aircraft.

In general the competition in the financing of new aircraft did not change very much over the past few years:

- Firstly, there are loans from commercial banks and funds from the capital market.
- Secondly, there is cash from airlines and lessors.
- Thirdly, there is the commitment of the ECAs.

The proportion between those three sources has changed though. In 2008 – before the global economic crisis – the ECAs held a market share of 20%, which in 2009 to 2011 increased to a portion of 30–35% on the new aircraft front. Thus, ECAs are further substituting loans from commercial banks. Since spring 2011 we have seen banks retreating from the aviation finance market, and the question remains whether or not this pullback will be of a permanent nature (like for HSH Nordbank and Société Générale) or just temporary (like the French banks BNP, Natixis and Calyon). To my mind, this is the start of a definite pullout of some banks from this market segment. I am quite sure that we will see further changes in 2011/2012. But DVB will stay active, of course.

The situation in the older aircraft financing world has changed immensely over the past few years – and much to the good of DVB: the number of banks prepared to finance aircraft which are 7 to 15 years old reduced dramatically and for the time being only PK Finance and DVB are willing and even more importantly able to finance such equipment. The rest of our bank competitors in this market segment has just disappeared.

Let me add that market participants like airlines and lessors are realising now that there is a price to be paid due to the prevailing conditions of high liquidity cost and the risk premium.



What are the prerequisites for DVB's long-standing success in the international aviation industry and what are our biggest differentiators from our competition?



"We are the only bank which has passionately built a platform of knowledge..."

Bertrand Grabowski, Member of DVB's Board of Managing Directors

The prerequisite for DVB's long-standing success is expertise. In fact "it is all about expertise" – this is the crucial factor which we have built up over the past five years. DVB defines itself as an asset-based lender. This is our brand. This is our franchise. This is what we are recognised for by all market participants from investors to airlines, from manufacturers to lessors. We are the only bank which has passionately built a platform of know-ledge over the past five years that

corresponds effectively to our brand as an asset financier. No competitor complements the key product of aviation financing with a research team, an advisory team, an asset management team, an investment management team or a TES.

Our Aviation platform offers our clients complex, tailor-made and integrated solutions. ❶ So our platform expertise is really unique. It's very clear: we are an asset finance entity. As a lender we are prepared to take some residual value risk exposure and I think in this respect there are less than half a dozen of financial institutions willing to act similarly. Our brand is very differentiated and unparalleled. We are unique and the market recognises that.

❶ Aviation Finance – integrated platform solutions



As I often say, we are not (only) managing a portfolio, we are managing a brand and a franchise. This implies that portfolio growth is not the key criteria for our success. But profitability and brand recognition, which is nothing but building up tomorrow's profitability, are.



Can you please elaborate on the specific benefit of Aviation Asset Management, TES Aviation services and of DVB's Aviation Investment Management for the Bank and for our clients!

Our Aviation Asset Management team provides the full range of Aircraft Management Services – this being aircraft remarketing, lease management, and technical and general consultancy services – to airlines, lessors, investors, bondholders and financial institutions active in the sector. It does also act for the Bank itself in Structured Asset Financing and for the Deucalion Aviation Funds. It is backed in this activity by extensive market knowledge and established industry relationships. Services are provided either as a fully packaged solution or on a standalone basis to best suit the needs of its customers.

TES is an active purchaser and/or manager of aircraft and aero engines to service its growing engine part-out, parts sales and aero engine leasing businesses. As an aircraft matures, the percentage of the aircraft value that resides in the engines gradually increases to the point where ultimately the part-out of the aircraft becomes commercially viable. TES actively identifies such opportunities which (supplemented by engine lease revenue streams) present an opportunity for an aircraft or engine to be dismantled for its constituent parts.

Our Aviation Investment Management (AIM) acts primarily as the investment adviser to the Deucalion Aviation Funds, which consist of a series of actively managed closed-end funds. These funds act as the investment vehicles through which DVB and private investors together invest in aviation equity investments. As advisers to the funds, AIM is responsible for sourcing and managing aviation investments and assets. Each of the funds has an independent board of directors. DVB is not represented on any of these boards and does not control any of the funds. The funds initiated by DVB are geared towards professional investors.

What do these services bring for us internally? They add to our specific platform knowledge that everybody in DVB's Aviation Finance division is able to tap. That means that relationship managers are e. g. able to ask their colleagues from the other platform corner:

- What do you think about such an aircraft?
- How do you think that all this can finance itself?
- Is the capital market a solution for this specific lessor?
- Will those engines still be worth something when it comes to the end of the aircraft's life cycle?

And this exchange of expertise and experience is absolutely crucial for us in order to be able to sell our platform knowledge to the outside world. We also benefit from our platform internally with regard to handling risk positions. I think for the last five years Aviation Finance has been manoeuvring its risk situation very smartly. We did not experience any significant credit accidents. This nearly flawless track record is mainly due to the fact that every deal proposal is intensely discussed in our Deal Committee. All aviation teams forming our unique platform participate herein, so our manifold expertise is combined as everybody looks at a potential deal from their own angle and perspective, contributing their own experience. So the more people look at a specific transaction sharing their individual expertise, the smaller the risk in terms of credit becomes.

What is the platform's benefit for our clients? I believe our clients come to us because they like DVB's cheque book, our funding capacities – and this is not putting anybody to shame. But the aviation industry knows that DVB is a partner capable of even complex structuring. Our clients appreciate DVB's offer of combined capital and expertise. We successfully developed our Advisory business, we stepped up structuring, we stepped up research and we stepped up asset management. In the long run it is our most efficient blend of capital and services that our clients would like to see put into action for them – and they experience it in action.

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How about the current demand for DVB's capital and services and looking ahead to the year-end 2011, do you expect DVB's Aviation Finance to be as profitable as in 2010?



"We will remain a smart lender... we are delighted with our new business..."

Bertrand Grabowski, Member of DVB's Board of Managing Directors

We will remain a smart lender with an advisory and service platform which works in addition to our lending business. The beauty of our Aviation Finance business is that we were able to deal consistently and effectively throughout all market cycles and even during the world economic crisis. As stated before – this is what our clients like and our products and services are much sought-after.

And yes, we are delighted with our new business. During the course of H1 2011, we originated 22 new deals with an aggregate volume of €1.0 billion (H1 2010: 17 new transactions with a total volume of €0.7 billion). The average interest margin on this new business remained high at 353 basis points (H1 2010: 377 basis points). Due to strong new business, net interest income after credit losses developed favourably and rose by 6.0% from €36.6 million to €38.8 million, while allowances for credit losses remained marginal at €0.4 million. Net fee and commission income, which primarily includes fees and commission from new Aviation Finance business and – to an increasing extent asset management and advisory fees – posted another increase to €16.9 million, up 14.2%. After all, total income rose by 7.5% from €51.9 million to €55.8 million. This resulted in a consolidated net income before taxes of €48.2 million, up 6.6%. We see these positive income trends prevailing during the last few months, so I believe that we will accomplish a very good result in 2011.

The only concern I have – and it is good to always have some concerns in order to not be too self-confident – are those turbulences mentioned earlier affecting second-hand aircraft values. With the lasting strong supply of new aircraft and due to the fact that less liquidity is available for financing second-hand aircraft, I assume that we will see some residual values on the second-hand aircraft market going down significantly.

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What about the present risk situation in our Aviation Finance portfolio and with regard to allowances for credit losses – what do you expect?

We have very limited points of tension in the aviation portfolio – in fact there are only three cases that cause concern.

We have one client who has been the darling of investors, banks and manufacturers for a couple of years. We have two aircraft with them and so far they have always continued to pay us, but a lot of time and resources are spent to manage and monitor the situation. The second point of tension is a residual value exposure that we have on aircraft which are outdated (A340s), but in this case we are in a joint venture with the manufacturer. However, those aircraft are going to be returned to the lessor and the redeployment of those aircraft is going to be a challenge. The third point of tension is more on the investment management

side where we are in the final phase of exiting and selling a complex programme of cargo aircraft, but at least for a few more months this needs our full attention.

The rest of our aviation transactions are absolutely manageable and the provisioning we have constituted should be plenty enough to cover that.

? | **Bertrand, last but not least – what is your vision for DVB's Aviation Finance business in 2012 and indeed beyond?**

I think there are two issues.

Firstly, do we think that the existing aviation platform is completed? Do we need to add some more expertise? And if yes, does this imply staffing up our teams? We as a team carefully reviewed the market opportunities and we came to the mutual conclusion that the platform is close to perfection as it is – at least for the time being. So, in terms of expertise we will not stretch ourselves beyond what we have achieved so far.

Secondly, can we better assess the aviation markets using our platform and can we better capitalise on the platform's output? The answer to those questions is "Yes" as there is always room for improvement. We have made fantastic progress to cross-fertilise between the various teams. It works very well for the benefit of the Bank but equally important for the benefit of all staff who enjoy learning more from any corner of our platform. But I think we can still achieve higher productivity. So, possibly the only challenge I see for the teams is to derive even more competitive advantages from the platform than we have done in the past.

But to draw a conclusion: our aviation platform works beautifully – much to our clients advantage.

! | **Thank you very much, Bertrand!**

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