

# Introducing DVB's Aviation Asset Management team

Transport finance bank DVB has put the final pieces of a 'one-stop shop' model in place within its aviation division. Nick Moore, VP aviation asset management, reports.



*In spite of the difficult market conditions in the aftermath of September 11 DVB were able to lease a number of A319s, in the above case to KTHY (Cyprus-Turkish Airlines).*

On December 19, 2006, a press release issued by transport finance bank DVB announced the arrival of a key team from BAE Systems to form a new 'Aviation Asset Management' platform with effect from January 1, 2007. For DVB, this represented a very significant move and formed the final piece of a model that had been painstakingly pieced together over a period of 18 months.

Founded in Berlin in 1923, DVB started its transformation into a global transport finance specialist in 1998, and it is now in the 'progression phase' of its strategy. This involves the development of new revenue streams as DVB moves toward its long-stated goal of having a 'cycle-neutral' approach to the aviation market while providing a one-stop shop (covering capital and services) for aviation finance clients.

DVB is somewhat unique in being a dedicated transport finance bank, focused on providing financing solely to the aviation, shipping and land transport sectors. Its aviation division is one of the largest providers of recourse and limited-recourse debt (senior and junior) to passenger/cargo airlines and aircraft operating lessors worldwide, with a total

investment of around \$4bn financing over 700 aircraft. (The bank is keen to point out that unlike most of the well-known aviation banks, which have portfolios backed by export credits, DVB's portfolio is entirely 'at risk'; taking this into account makes it comparable to the largest bank players in the industry.)

In addition, DVB provides equity and mezzanine debt for aircraft, engines and aviation-related investments through a managed investment fund called Deucalion, which currently has over \$1bn in assets under management. Through this fund, it has been a shareholder for the past three years in AirAsia, and it is currently finalising a similar pre-IPO investment opportunity in Europe.

Being a dedicated transport finance bank means that, unlike many other banks, DVB will not exit the aviation market during the downturns that are an established part of the industry cycle. Perhaps because it has also realised that in today's market there is little money to be made on very tight-margin lending to blue-chip airlines, or from joining the ever-increasing competition to lend to the developing markets of India and the Far East, DVB has taken the full-service

concept another step through the development of its own in-house research function (AIR), a Financial Consultancy team (AFC) which includes a JOL equity-sourcing unit, and, in January 2007, the Asset Management team (AAM) that completes its one-stop-shop platform.

The close links between the relationship lending teams, AIR, AFC and AAM ensures that each part of DVB is kept in the loop about current market activity and so can provide its respective clients with valuable insights into the aircraft finance and leasing market, through its participation as a financier of aircraft for both airlines and operating lessors/investors, as a trader of used assets through its AAM division and as industry 'ear to the ground' via its AIR and AFC teams.

Where knowledge is power, DVB has become very powerful indeed. Asset knowledge enables the bank itself to avoid hidden asset risks resulting from substandard individual aircraft specifications, maintenance status, etc. It also has the ability to manage work-outs of asset security and so can control risks during industry crises, as demonstrated in 2001-2004, during which period the



bank stayed open for business. Having this full suite of in-house expertise means the bank can not only stay open for business for its lending and investment business, but offer valuable additional research, advice and asset-management services to other investors and owners of aviation assets throughout all parts of the cycle.

#### *Why have an in-house research function?*

Unlike most aviation banks, DVB's focus is more on the asset than the credit, so the risk profiles of its transactions are driven by the value of the underlying asset at the start of the transaction, at any point in its life and at lease/financing term-end. Consequently AIR focuses on the equipment market, closely following both new and used commercial jet markets. For an asset-based lender or an aircraft investor, the aircraft's value and liquidity are the two main issues. The usual characteristics (age, type, operator base, powerplant type) are studied and, in addition to using the standard industry 'blue books', AIR has developed its own internal methodology to project future aircraft values based on the anticipated profile of the aircraft type's life cycle.

The AIR team is already working closely with the Aviation Asset Management team to further refine its modelling, taking input from the AAM team on aspects such as value enhancements due to specification changes, current trading conditions for certain types and modelling of the actual maintenance-adjusted value of a target aircraft. This close working relationship,

which is already bringing benefits to DVB in terms of a better understanding of their lending parameters in what is becoming an ever-more heated market, is just one advantage of the newly-built integrated platform.

#### *What is DVB Aviation Asset Management's role?*

DVB's Aviation Asset Management team now consists of the experienced team from BAE Systems that was responsible for the development of that company's Aircraft Trading & Management Services business. Where the DVB team has strength is in its background of having worked for OEM aircraft and powerplant operating lessors, through which it gained valuable experience in dealing directly with airline operators.

AAM has been brought into the bank to provide remarketing, lease management, technical services and asset/airline advisory services, principally to third-party owners and lessors of aircraft. It also provides support where requested to the DVB Aviation teams. Its close working relationships with banks has also led to the development of its own in-house 'maintenance value forecasting' model, which is used to predict the maintenance-adjusted future profile of a specific aircraft, taking into account next due maintenance checks and component overhaul timetable. This model goes some way toward answering that perennial favourite question of aviation financiers "Where does this aircraft sit relative to a half-life appraised value?"

DVB's board of directors has already set some challenging targets for the new AAM team. Whilst it is recognised that the team will provide specific advice to the DVB Aviation team on all aspects of the business, it is the external third-party activity by which AAM will earn its keep. Through the continuing active marketing of the full range of asset-management services it can provide to clients around the world, AAM is central to the one-stop-shop concept.

'Asset management' has always been very broad description of a range of activities relating to the management of aircraft, covering everything from aircraft sourcing and remarketing on behalf of clients to the day-to-day administration and management of leases, as well as

technical services including pre-delivery activity, in-service inspection programmes and the redelivery process at the end of each lease.

One important element of the asset manager's role is 'remarketing'. For many, remarketing is only performed in the event of a 'distressed asset' situation, usually arising from the bankruptcy of the lessee and the need for the owner/lessor to start earning lease income as soon as possible to cover its outstanding payments.

DVB's head of AAM Jon Skirrow is keen to point out that, in reality, remarketing is an ongoing activity driven by the market, opportunity and the owner's strategy: "The question of when will always depend on knowledge of the market at the time: customer base, attractiveness of asset, prevailing rates and the client's financial requirements. Hence there are four options: sell; lease; lease, then sell when market conditions allow; or sell with a lease attached. In each case AAM is able to evaluate and cost the options available and, based on its experience, present the preferred options to its clients."

#### *Asset Management in practice*

The Asset Management team has already tasted its first success of 2007 through being an integral part of the full-service offer made to Cargolux which resulted in the setting up of an aircraft joint venture company 'Freighter Leasing SA'. This was an innovative sale lease-back transaction under which the operator of the three 747-400 Freighters involved, Cargolux Airlines, formed a joint interest in the JV Company with financial partners Deucalion Limited (advised by DVB Bank), HSH Nordbank and KfW IPEX-Bank. The purpose of Freighter Leasing is to facilitate Cargolux's announced refueling effort, which aims at gradually replacing a 747-400F fleet with more efficient 747-8s.

Freighter Leasing has purchased from Cargolux three units of its existing fleet and will lease the same aircraft back to Cargolux under short leases due to expire on the 747-8 delivery dates in 2010 and 2011. DVB's Aviation Asset Management team will then act as the lease manager and remarketing agent of Freighter Leasing.

The AAM team has also brought into DVB a wealth of experience gained from a range of different transactions concluded while the team was part of BAE. It acted for different US EETC structures to provide remarketing and advisory services in relation to 757s in operation with US Airways and ATA. In respect of the US Airways aircraft, it contacted over 100 potential purchasers and solicited around 20 offers from which it was able to produce a shortlist of three for review by the owners. The team carried out the negotiations with the respective bidders and assisted with the drafting of the final LOI pertaining to the aircraft being sold to US aviation investor Q Aviation. The successful sale enabled the owners to exit US Airways risk in between the airline's first and second stints in Chapter 11 bankruptcy protection. Other aircraft owned by other bondholders became less attractive due to that second Chapter 11 filing.

As a result of its successful activity on the US Airways 757s, an additional appointment was received to provide a combination of advice and remarketing services to other EETC structures with 757s in operation with Indianapolis-based airline ATA in preparation for renegotiation under Chapter 11 proceedings.

The bondholders took a proactive approach appointing the team to negotiate directly with ATA to reach terms agreeable to both parties across five 757s, including the payment of reserves to maintain the half-life maintenance condition of the aircraft so that when the opportunity arose to sell the aircraft, a purchaser would be assured of a half-life or better condition. Early 2007 saw conclusion of the sale of four of the aircraft on behalf of the three different EETC trusts.

As a third example of its activities, the AAM team acted as the lease manager on behalf of a consortium of European banks for a fleet of seven A320s in operation with low-cost Italian operator Volare. It advised the consortium to take a proactive approach to lease management as previous experience had shown the difficulties in recovering aircraft from Italy in the event of bankruptcy.

When the banks finally reached a decision to repossess the aircraft it gave

the team just three days to put an effective plan in place. Forty-five people were deployed to seven different European cities on the same day with instructions to serve notices onboard terminating the leases on arrival in the relevant city. A specific day was selected such that the opportunity to recover the majority of the fleet outside of Italy would be maximised. Though each aircraft and airport presented several difficult issues to address, the team was ultimately successful in recovering the aircraft and the owners were able to make the aircraft available for remarketing within six weeks of Volare ceasing business.

As a final example, the AAM team was in October 2001 appointed as project manager for a bank consortium that had four A319s and one A321 in operation with Sabena. It recovered all five aircraft from Brussels, commenced an active remarketing campaign to secure new operators and carried out the contract negotiations. During this process it was appointed by a second consortium of banks that had three other A319s with Sabena. In spite of the then-difficult conditions prevailing in the market, deals were duly signed with Corsica-based CCM Airlines (for two of the A319s), SN Brussels (two), KTHY (one) and Meridiana in Italy (the final three).

There followed a lease-management period. Services included the management of payment obligations including raising of invoices and payment of funds to the consortium banks. The team had originally advised the banks that a 'lease, hold, sell' strategy was their best option amid the challenging market

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conditions of 2001/2 and that as the market recovered opportunities would arise to sell the assets. This approach bore fruit in late 2006 and early 2007 when terms were secured for the sale of all eight aircraft. It is hoped that transactions will be completed during the first quarter of 2007, concluding the team's role as asset manager for these aircraft.

The length of time from the initial appointment in 2001 to the final sale of the assets in 2007 demonstrates the merits of appointing a team committed to the business and willing to take a long-term view to derive the greatest value for their clients.

The wide range of activities it is now performing for its aviation customer base puts DVB in a strong position both to take advantage of the continuing enthusiasm for new aircraft funding, where its aviation advisory and research teams can provide input, and to provide longer-term management and 'exit' strategies through the AAM team. There are undoubtedly great opportunities for DVB to increase sales of its suite of advisory services to third parties, especially those relatively new to the market or who have no intention or inclination to develop their own bespoke departments.

Perhaps only time will tell whether the 'one-stop shop' strategy will produce the 'cycle neutral' approach that DVB Aviation board member Bertrand Grabowski is seeking: "Our cycle-neutral and one-stop shop approach means we can support our clients at any point in the industry cycle with the right combination of capital and services that they need and offer a complete service that may not be easily found at our competitors."