

# Investing in Distressed Aircraft

by Ziki Slav

(Aviation Summit Conference, New York City, Fall 2008)

# Meet the Characters:

The Owner

The Lender

The Distressed  
Investor

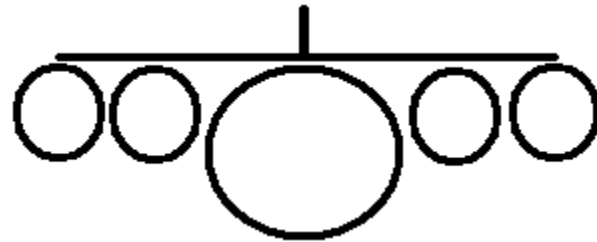
Mr. Tax Investor

Mr. Prudent Lender

Mr. I. M. Sharpe



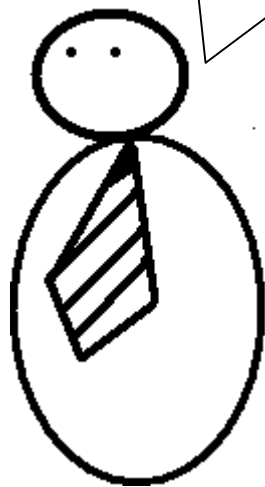
# The Collateral: a Great Aircraft



Mr. Tax Investor Buys the Aircraft for  
\$100MM and Borrows \$95MM Against It

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I can lend you only \$95MM,  
and you'll pay me Libor.



# Mr. Tax Investor Buys the Aircraft for \$100MM and Borrows \$95MM Against It

I can lend you only \$95MM,  
and you'll pay me Libor.



You're killing me,  
but I'll take it  
anyways.



# Mr. Tax Investor then Leases His Aircraft to Awesome Airlines (AA)

## Lease Agreement

Term: 30 Years  
Rate: \$1.0MM/Month  
SLV: \$140MM

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Awesome Airlines  
(AA)

## Tax Indemnity Agreement

If Mr. Tax Investor  
recaptures tax losses due to  
our failure to perform, we,  
Awesome Airlines, will  
indemnify him for his  
losses.

# Mr. Tax Investor is Very Happy

I put almost no money down!



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I'm getting this huge tax depreciation



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I'm getting this huge tax depreciation

As well as some rental income and residual value



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As well as some rental income and residual value

Plus, there's no way AA  
Ever files for bankruptcy!



# AA Files for Bankruptcy

Hi, may I speak to Mr. Tax Investor?



# AA Files for Bankruptcy

Hi, may I speak to Mr. Tax Investor?

This is he...



# AA Files for Bankruptcy

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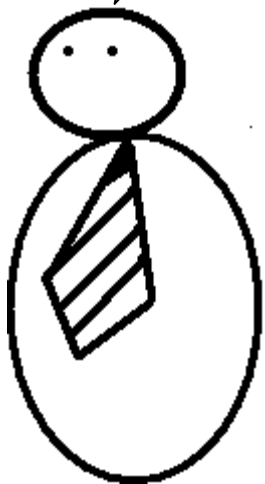
This is he...

Oh, hey, this is AA.  
We're rejecting your  
lease. You can come  
pick up your crappy  
aircraft.



# Mr. Tax Investor Meets his Banker

You owe me \$95MM, and you're in default.



# Mr. Tax Investor Meets his Banker

You owe me \$95MM, and you're in default.

You know I don't have that kind of dough..

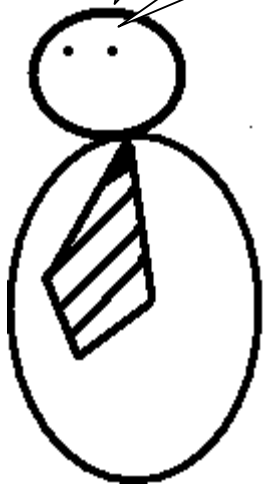


# Mr. Tax Investor Meets his Banker

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Can't you sell the aircraft?



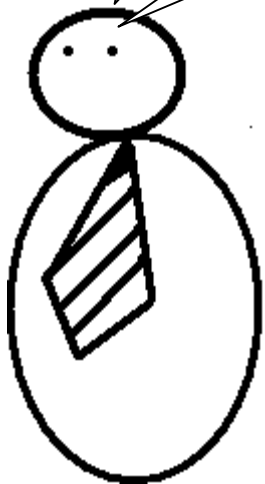
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I'm going to foreclose then.



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Can't you give me more time?



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Can't you give me more time?

#\*&% No!



# Mr. Tax Investor is Upset

Not only am I going to lose my investment,



# Mr. Tax Investor is Upset

Not only am I going to lose my investment,

But I'm also going to be hit with this taxable gain from debt forgiveness.



# Mr. Tax Investor is Upset

Not only am I going to lose my investment,

But I'm also going to be hit with this taxable gain from debt forgiveness.

I'm really screwed!



# Mr. Prudent Lender is Upset Too

I have this \$95MM non-performing Loan,



# Mr. Prudent Lender is Upset Too

I have this \$95MM non-performing Loan,

Backed by an \$80MM asset...



# Mr. Prudent Lender is Upset Too

I have this \$95MM non-performing Loan,

Backed by an \$80MM asset...

Still beats sub-prime though!!



Mr. I. M. Sharpe Decides to look at the Sitch



# Mr. I. M. Sharpe Decides to look at the Sitch

So, on the asset side we have:



# Mr. I. M. Sharpe Decides to look at the Sitch

So, on the asset side we have:

1 Aircraft, and

1 Defaulted Lease Agreement



# Mr. I. M. Sharpe Decides to look at the Sitch

On the liability side we have:

\$95MM of debt (plus accrued interest and expenses)



# First – Let's Value the Aircraft

Assuming half-life condition, what  
am I going to do with this asset?



# First – Let's Value the Aircraft

Assuming half-life condition, what am I going to do with this asset?

- Lease it back to AA on different terms?
- Flip it?
- Re-lease to someone else?
- Freighter it?
- Part it out?



# First – Let's Value the Aircraft

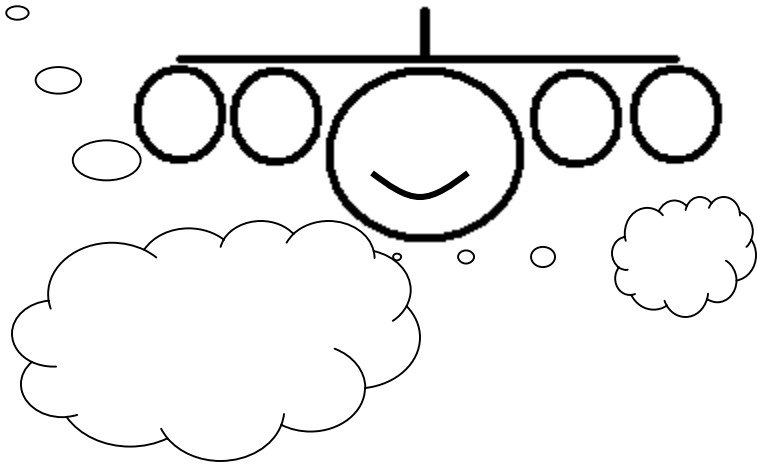
What do we know about the condition of the aircraft?



# First – Let's Value the Aircraft

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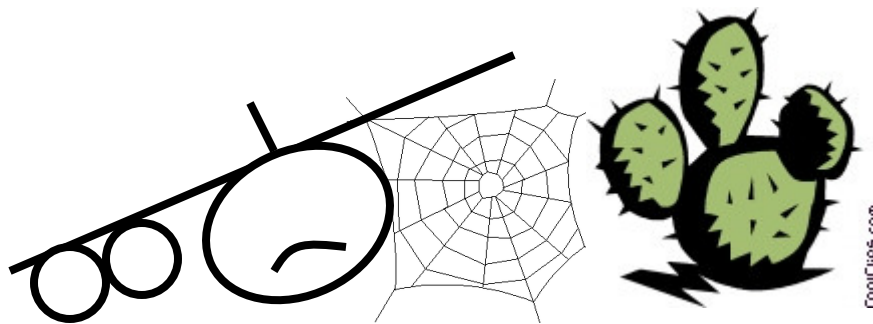
Is it like this?



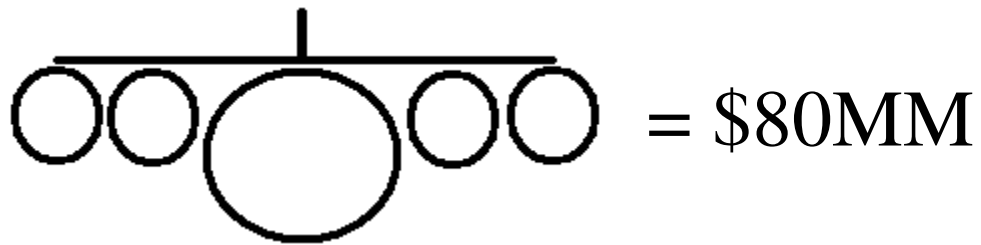
# First – Let's Value the Aircraft

What do we know about the condition of the aircraft?

or like this?



# Mr. Sharpe Values the Metal at \$80MM



## Next – Let's Value the Deficiency Claim

Awesome Airlines' failure to perform on the lease, created an unsecured deficiency claim against the bankruptcy estate.



# Next – Let's Value the Deficiency Claim

Size of claim x Recovery =  
Value of claim



# What is the Size of the Claim?



# What is the Size of the Claim?

One method:

SLV (from Lease)  $\Rightarrow$  \$140MM

Minus

Value of aircraft  $\Rightarrow$  \$80MM

Equals

Deficiency Claim of \$60MM



# What will be Unsecured Recovery at AA?



Based on his Extensive Bankruptcy Analysis, Mr. Sharpe Expects Unsecured Recovery to be 50 cent/Dollar.



Now Mr. Sharpe Can Value the Entire  
Transaction



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The aircraft is worth \$80MM



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The claim is worth:  
 $\$60\text{MM} \times 50/100 = \$30\text{MM}$



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Total Value:  $\$80 + \$30 =$   
 $\$110\text{MM}$



Conclusion: Mr. Sharpe will Try to Purchase the Equity from Mr. Tax Investor, and Pay Off the Debt



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Your equity is worthless. I'll pay you \$50 for it.

I know it's worthless, but I still want \$1,000 for it.



# Conclusion: Mr. Sharpe will Try to Purchase the Equity from Mr. Tax Investor, and Pay Off the Debt

Your equity is worthless. I'll pay you \$50 for it.

I know it's worthless, but I still want \$1,000 for it.

You're tough. OK.  
Done.



# Mr. I. M. Sharpe is Happy

I paid \$1,000 for the equity, and



# Mr. I. M. Sharpe is Happy

I paid \$1,000 for the equity, and

I'm going to pay off the debt  
for another \$95MM



# Mr. I. M. Sharpe is Happy

I paid \$1,000 for the equity, and

I'm going to pay off the debt  
for another \$95MM

I'm ending up paying \$95.001MM  
for an asset that's worth \$110MM.



The End

