No limits

Doric Alpha is the first successful EETC for a non-US company, Victoria Tozer-Pennington digs into the details of the deal.

George Mallory famously answered the question of why he wanted to climb Mount Everest with an irritated: "Because it's there". As an amateur mountaineer, Lapidus, managing director of Doric, is used to overcoming physical challenges and when he was reminded of the many obstacles to a non-US airline issuing Enhanced Equipment Trust Certificates (EETCs), he pressed forward keeping his eye on the goal and successfully closed the first EETC for a non-US company in July.

"Many people said that this deal would never happen," says Lapidus. "Those we initially pitched the idea to didn't understand the direction we wanted to take as there were many hurdles to overcome – Emirates would not be the issuer, instead the entity Doric Alpha [Doric Nimrod Air Finance Alpha Limited] would be, the fact that the underlying credit, Emirates, doesn't have a rating, the Cape Town Treaty in the UAE was yet to be tested... Goldman Sachs understood the ideology of the deal straight away. Maintaining that deal philosophy was essential to getting the deal done."

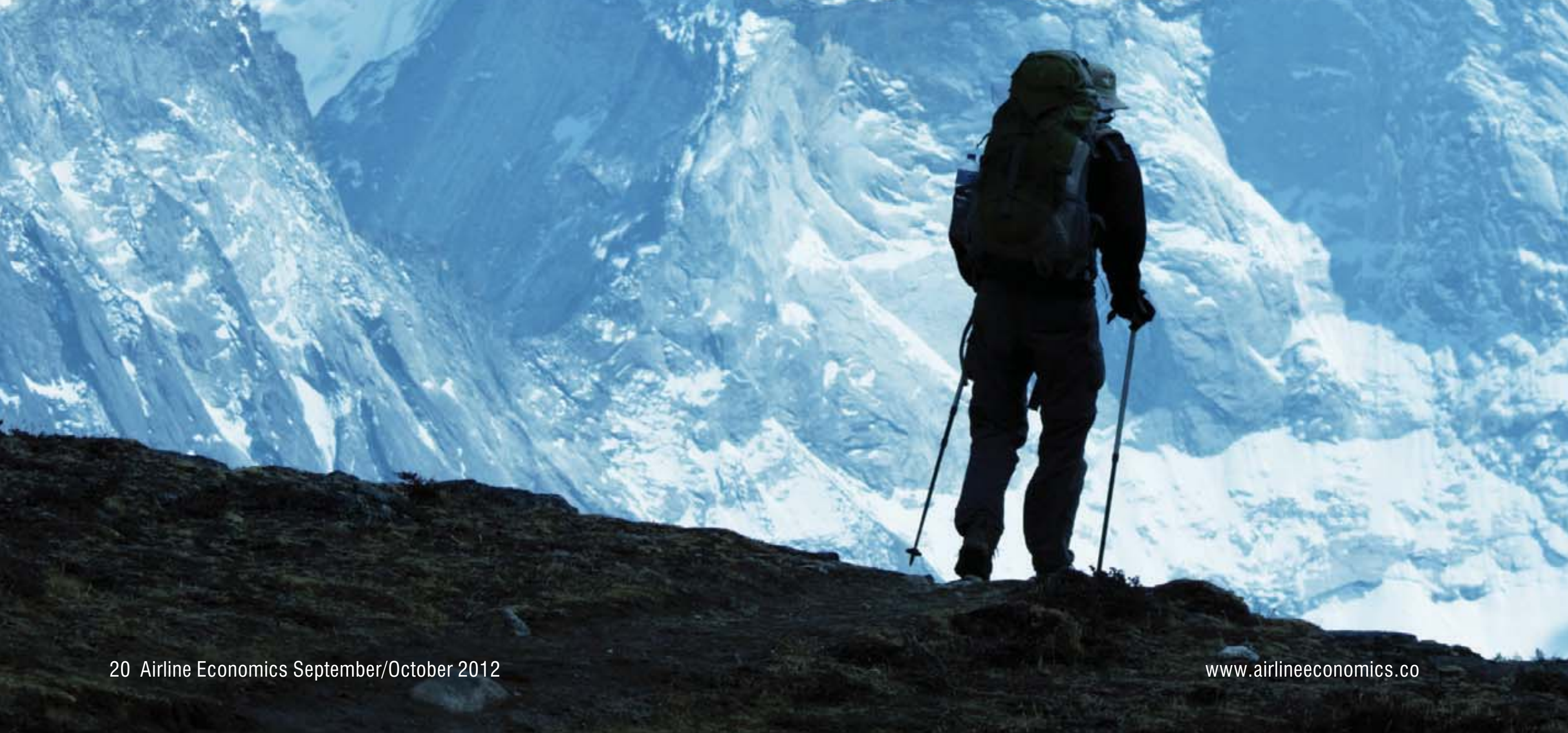
On July 29, Doric Nimrod Air Finance Alpha Limited (Doric Alpha), a wholly-owned subsidiary of Doric Nimrod Air Two Limited (DNA2), announced that it received a rating from Moody's of A3 and Baa3 for its Class A and Class B EETCs, respectively, for its $587.5million offering.

The $434 million Class A certificates priced at 5.125% with a final maturity of November 30, 2022, while the $154 million Class B certificates priced at 6.500% with a final maturity of May 30, 2019. Goldman Sachs was the sole structuring agent and sole bookrunner. Milbank acted as legal counsel for Doric Alpha on the transaction, while Hughes Hubbard advised Goldman Sachs. Clifford Chance provided a legal opinion for Doric Alpha on the efficacy of the Cape Town Convention Alternative A as adopted by the United Arab Emirates.

The funds raised financed four A380s to be delivered between October and November 2012 and leased to Emirates on four separate twelve-year operating leases. The first aircraft delivered on Monday, October 1 – the 25th A380 in Emirates operations. The monthly rentals due under the lease will be split into a US dollar component, sized to meet the scheduled interest and principal payments of the certificates, and a sterling component that will service Doric Alpha's equity.

The transaction was three times oversubscribed and closed with a diversified pool of 37 institutional investors participating in the offerings: 74% asset managers, 9% pension funds, 12% fund managers, 3% insurance companies and 2% banks. This transaction also had a global appeal with the distribution by investment volume being 75% USA, 20% Europe and 5% Asia, involving a number of first-time EETC investors.

Doric (formerly Doric Asset Finance) is getting a reputation for working on innovative transactions for the aviation finance community. From financing several A380s in the German KG market to raising equity for A380s in the UK market with Nimrod Capital via special purposes entities: Doric Nimrod Air One (DNA1), which listed on the London Stock Exchange in December 2010, and Doric Nimrod Air Two (DNA2), which listed on July 14, 2011 and issued additional C Shares on March 27, 2012. Doric Alpha is a wholly-owned subsidiary of DNA2.



"Doric has a reputation for being willing to work on cutting edge transactions so they were the perfect company to be involved in this transaction," says Drew Fine, partner at Milbank, which represented Doric Alpha in the deal. "This was a great situation for launching a new financing product for the industry. We were all on the same page from the beginning – Mark [Lapidus] made it very clear from the outset what we were trying to accomplish, what our philosophy was and made sure that everyone was following the same path."

Goldman Sachs had been speaking to Emirates for a long time about the possibility of its issuing an EETC. Radha Tilton, vice president in the structure finance group at Goldman Sachs, says: "Emirates is the perfect airline for an EETC product but their reluctance to gain a corporate rating was well known so to make this deal work we first had to take out the ratings issue. That was the initial challenge that Mark [Lapidus] pushed us very hard on."

The Goldman Sachs team held lengthy discussions with the credit rating agencies (CRAs) over how to rate a deal without first rating the airline. "You don't necessarily need an airline rating because it is a structured deal and we would be providing all of the relevant disclosures and all the relevant due diligence that is required on Emirates," says Tilton. "We did a lot of work with the three CRAs to figure this out. Once we worked through that issue the only remaining challenge was to get Emirates comfortable with the 144A diligence process."

Although Doric Alpha was the issuer of the EETC transaction, because Emirates is the lessee on the integral operating leases for the four A380s, it is the underlying credit and as such played a significant role during the structuring of the deal. "We had been saying for two or three years that we would love to issue an EETC but three things had put us off in the past, one of which was the rating requirement," says Brian Jeffery, senior vice president, corporate treasury, Emirates Airline. "We don't mind the disclosure and we don't mind people looking through our books (in fact we were subjected to a thorough 10b-5 analysis and opinion from US Counsel), we just don't like the end result of a formal disclosed corporate rating, which involves being judged by other people who may not have the same opinion as us or investors about our business. Following the downturn in Dubai for example, all Dubai companies were treated in the same way and everybody was downgraded."

The due diligence process by credit rating agency Moody's on Emirates for this EETC was very thorough, which is clearly demonstrated in the research analysis published by Moody's on June 21, 2012. Emirates willingness to undergo such a stringent investigation process proves Jeffery's assertion that Emirates was certainly not averse to full disclosure of its books to the rating agency.

It was not only the perceived rating requirement that initially put Emirates off issuing an EETC, as Jeffery explains: "When we talked to banks in the past about doing a straight EETC, we were told that we would only get a loan to value (LTV) of about 55-70% of the base value of the aircraft. Due to our BFE [buyer-furnished equipment] and our inflight entertainment systems we actually pay quite a lot for our aircraft. So at that kind of rate we would only be getting about 60-65% of what the aircraft costs, and given the number of

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Amateur mountaineer and Managing Director of Doric

aircraft that we have coming, we just can't afford to just have 60-65% of that value coming to us on delivery. It's hard enough trying to find 15-20% of each aircraft cost on each delivery, but when you have to find 35% or more, that's a significant amount when you've got 36 aircraft due for delivery this year."

The final obstacle for Emirates issuing its own EETC was the Cape Town Convention. Although the United Arab Emirates had adopted Cape Town, it was untested, which would have concerned potential investors.

"We didn't have any doubt about Cape Town," says Jeffery, "but we understood that investors might, which was massively proven during the roadshow. A lot of the questions were about how the structure and how Cape Town managed to get us to the same position as Section 1110 of the US Bankruptcy Code. In the end we convinced investors, aided of course by a very supportive legal opinion."

"Those were the main three things that always put us off issuing an EETC and that is why we take our hats off to Goldman and to Doric. They were the only ones that came to us with a structure that satisfied all our concerns. It was tailored to what we wanted rather than what other banks were interested in and what the markets would demand. So we achieved 100% LTV instead of 60% thanks to Doric's equity from the UK, we got Cape Town acceptance and we avoided being rated. We still are not rated, and it's not even an undisclosed rating, we are not rated full stop."

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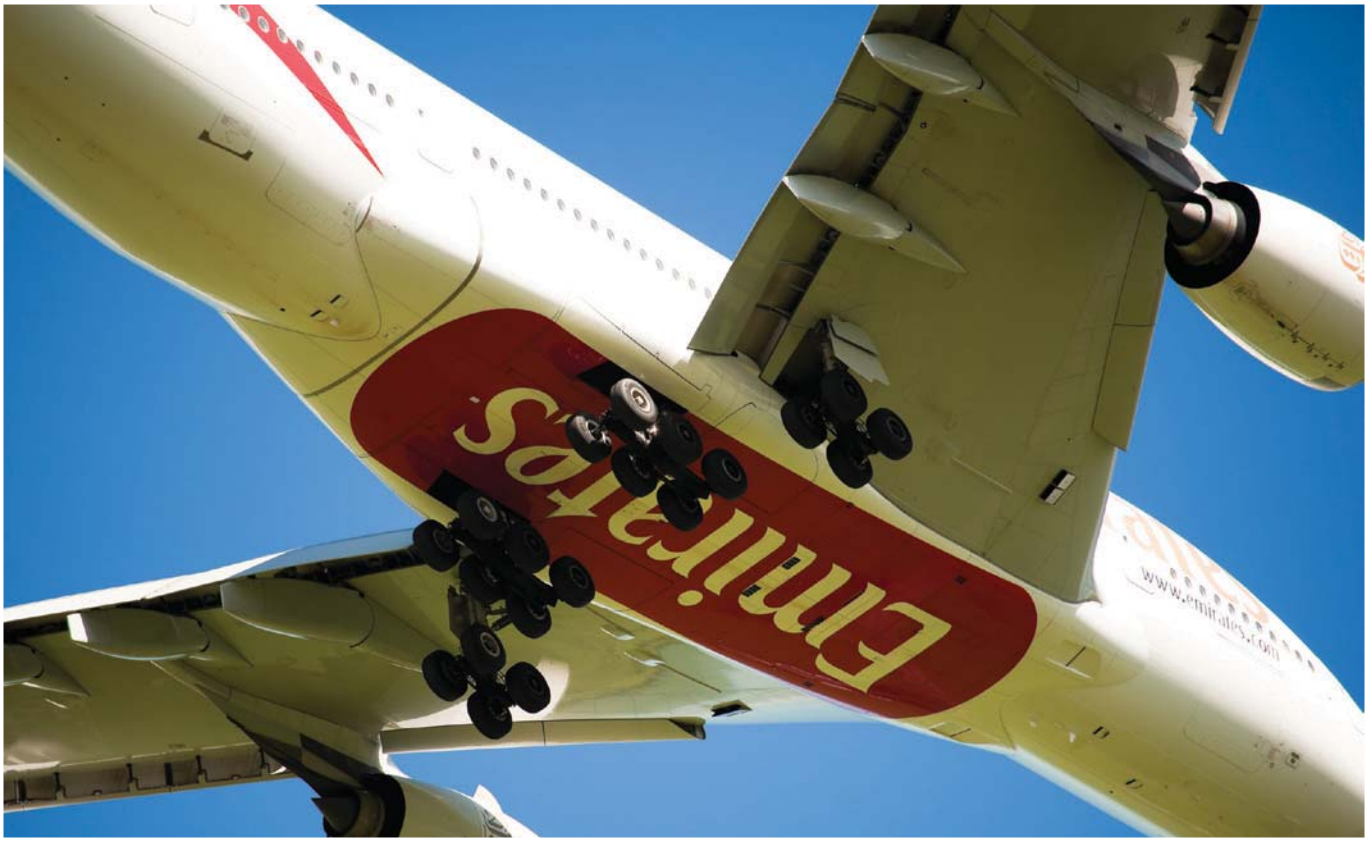
> ***Brian Jeffery, SVP Corporate Treasury, Emirates Airline***

As the A tranche was awarded with the highest rating post-financial crisis to any EETC, Moody's must have been confident in the quality of the lessee and the extent of the airline's disclosure. The airline was also subjected to a thorough review by Goldman's counsel Hughes Hubbard.

"As Doric Alpha was a new issuer in the US capital markets, it took a little more time to comply with the various US securities law requirements," says Steven Chung, partner at Hughes Hubbard, "including the relevant due diligence on Doric Alpha and Emirates, preparing the underlying offering memorandum and working through the various securities indemnities and related representations that were asked of Doric Alpha and Emirates. All of that takes companies a little bit of getting used to. Doric Alpha and Emirates had to get all of their relevant documents ready for us to be diligenced so that we as underwriter's counsel, could conduct the requisite due diligence to be able to issue our 10b-5 letter."

Structurally the DNAA transaction is similar to old US leveraged leases, which were effectively diminished along with other tax-advantaged products by the 2004 American Jobs Creation Act.

"These documents and the way the deal was structured, other than the one nuanced difference that it was structured as a leveraged operating lease, is more or less exactly the same as the US airline



deals that are done today," says Chung. "We didn't change much at all – the papers are very similar to the papers that US airlines use today. The only difference is instead of being supported by Section 1110, the deal was supported by Cape Town Article XI, Alternative A of the Protocol. All of the other words are exactly the same."

A special purpose entity – Doric Alpha – will own the four A380 aircraft and will also be the lessor on four separate operating leases to Emirates. The aircraft in those four leases are all cross-defaulted and cross-collateralised with each other. Investors do not buy the equipment notes that are issued by Doric Alpha, instead they buy the certificates issued by a pass-through trust, which buys the four different equipment notes that are cross-defaulted and cross-collateralised and then the Trust issues certificates to the investors. The investors therefore get the benefit of all four aircraft and all four leases. This is one of the reasons why the deal can secure an "enhanced" rating.

"One of the reasons that EETCs are "enhanced" is because in addition to the credit quality of the underlying credit (ie Emirates, the lessee) and the value of the pledged collateral, the certificates also receive the enhanced benefits of the bankruptcy protection under Cape Town, as well as the benefits of a liquidity facility and because the assets are cross-defaulted and cross-collateralised," explains Chung.

The liquidity facility in an EETC transaction is there to ensure the continued payment of interest on the EETCs during the remarketing period following a default by the lessee. The Doric Alpha EETC has a liquidity facility of 24 months duration – typical EETC deals have an 18-month liquidity facility.

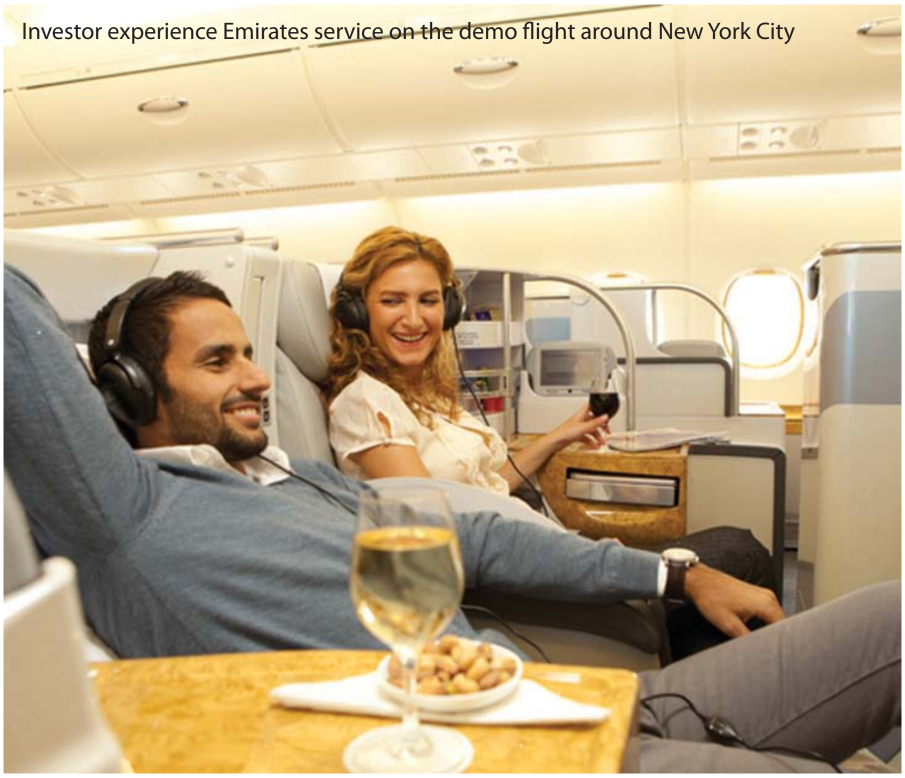
GETTING COMFORTABLE WITH CAPE TOWN

The most difficult challenge of the deal was getting Moody's and investors comfortable that Alternative A of the Cape Town Convention as implemented by the UAE would work exactly the same as Section 1110 of the US Federal Bankruptcy Code.

Section 1110 is a unique aspect of the US Federal Bankruptcy Code that gives investors and creditors comfort that if that airline were to file for bankruptcy, within 60 days of filing, the airline would either have to return the aircraft or settle all obligations under the underlying lease. Although Alternative A in Article XI of the Cape Town Convention reads almost exactly the same as Section 1110, it has not yet been tested in a default situation, whereas, due to the many airline bankruptcies in the US, Section 1110 has been tested many times and has been proven to work as it was designed giving investors and CRAs a strong level of comfort. Cape Town Alternative A is structured the same as Section 1110 but it has not yet been tested.

"The critical thing that investors and the CRAs were looking for was that the UAE has implemented Article XI, Alternative A of the Protocol in a manner that would hold-up in the event of an airline bankruptcy. However, as Alternative A has not yet been tested in the UAE, it was extremely critical to have UAE counsel provide a legal opinion, similar to the Section 1110 opinions provided by US airline counsel, which gave investors and rating agencies comfort that if the lessee were to declare bankruptcy, they would receive the benefits of Article XI, Alternative A of the Protocol and the maximum 'waiting period' of 60 days as specified by the UAE when it adopted Cape Town," says

Investor experience Emirates service on the demo flight around New York City



Chung. "Clifford Chance's legal opinion shows that Article XI, Alternative A of the Protocol is good and effective law in the UAE."

Clifford Chance provided the UAE / Dubai analysis on enforceability, repossession and the Cape Town Analysis, which was used as part of the discussions the law firm had with Moody's on the jurisdictional review.

Chung added: "The Clifford Chance precise jurisdictional memorandum gave comfort that although many aspects of Cape Town have not yet been tested in the UAE, there are other elements of Cape Town that have, such as the implementation of the use of IDERAs by the General Civil Aviation Authority in the UAE. Moreover the fact that the UAE has adopted other international conventions, such as the Montreal Convention, in a manner that was applied consistently with the actual wording of the law as adopted in the UAE, showed precedent that the UAE has been true to its word."

"The lessor's ability to repossess the aircraft as an owner under local law gave additional comfort to both investors and Moody's", adds Lapidus.

Antony Single, Counsel, Clifford Chance, based in Abu Dhabi. "We have worked on a number of complex aviation financing structures in the Middle East but it is always exciting to be part of an innovative transaction particularly where complex challenges are overcome utilising our local understanding and depth of international experience. The rating analysis necessarily is a detailed process, and this was the first Cape Town EETC, but having an understanding of that process will definitely assist on future transactions. In this case we confirmed it is possible for non-US airlines to effectively lower their funding costs on capital market deals through properly adopting Alternative A options under the Cape Town convention, which benefited both Doric Alpha and Emirates here, but should bring wider benefits for the market in general."

The jurisdictional memo coupled with the cross-collateralised EETC structure and full disclosure by Emirates to Moody's can be credited for the high credit rating on the deal, which was especially surprising for the rating agency given their somewhat negative view of the asset, which it regards as less liquid due to the small number of operators and so reduced secondary market.

Airbus aircraft were always going to be a tough sell into the US capital markets that have been fed a steady dose of Boeing aircraft EETCs. However, Emirates and Airbus spared their valuable time to help promote their A380 aircraft to potential investors by arranging a demonstration flight onboard an Emirates A380 from New York's JFK airport.

"The final challenge was the asset – the A380," says Goldman's Tilton. "Most European investors love it, because most Europeans have flown on the A380, US investors have not. It is a big plane; it is new. There are not that many flying, there are few operators, there is no obvious secondary market yet – when you look at those statistics investors were hesitant. Airbus was incredibly helpful in working with investors and the rating agencies on the asset. We held an event to allay those concerns that Emirates moved mountains to organise."

On the Tuesday in the middle of the roadshow, Emirates and Airbus hosted the one-hour demo flight, where investors were free to wander around and see the first class cabins, economy class, the bar in the back, and experience the Emirates service.

John Leahy, Chief Operating Officer-Customers for Airbus, says "Tim Clark was nice enough to give us access to his aircraft for us to arrange a demo flight around the New York City area with the potential investors on-board. When we landed about an hour later, we went to the Emirates lounge which had views of the Emirates A380, the Singapore Airlines A380 as well as the Korean Air A380 aircraft all sitting next to one or two 747s – giving a dramatic view of new generation versus the old generation aircraft."

In the lounge, Leahy gave a presentation on the business case for the A380 from the airlines' and investors' point of view and the market demand for the A380 over cocktails and hors d'oeuvres.

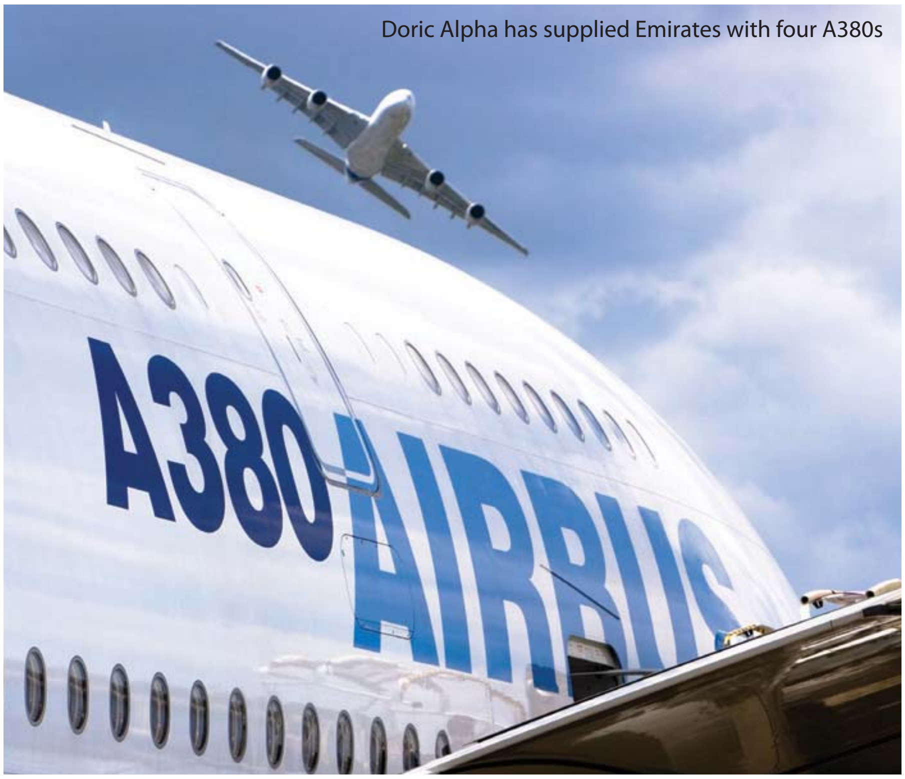
Tilton says that John Leahy's great presentation on the A380 showed why the A380 is a game-changing aircraft. "He answered investors' questions about the aircraft, such as concerns about cracks on wing rib feet that they had read about in the papers," she says. "When you spoke to investors after the flight, they were enthusiastic about the aircraft and the presentation helped to convince some investors that were hesitant about investing in the EETC. Now they understand the potential of the asset, why people like it and why airlines are buying it. Leahy corrected all of the myths about the aircraft."

Jeffery states that Emirates was more than happy to stage this event but hoped that it would not be necessary for every subsequent issuance. "I hope not, because it was a hell of a job," he says. "We knew it would be a huge undertaking, and it took a lot of work and a lot of co-ordination from many departments within Emirates, from flight ops to Cabin Crew to the ground facilities at JFK, the flight scheduling, through our network control, everybody was involved. But it was absolutely worth it."

The Airbus presentation certainty helped sway investors as a few days afterwards, the deal closed three times oversubscribed. Leahy is modest about the role he took, however: "Our most challenging part of this transaction was making sure that even though we were initially told that the demo flight was the 28th aircraft in line for take-off, we managed to take off earlier to avoid spending the next hour on the ground and risk the airplane departing late that evening for Dubai."

More seriously Leahy praised the work done by Doric and Goldman Sachs to get the deal closed, saying: "We are delighted with Doric and what they've managed to do. They are a small but cutting edge team and we are very proud to be working with them. The first new deal by definition is always the most difficult. Whenever you get into a new market like the US capital markets that tend to be a little closed you find people doing deals that they are familiar with, preferring not to rock the boat. But in this case, the way the deal is pricing in the secondary markets [the notes are trading in the secondary market by an improvement of 75bps on the Class A and 90bps on the Class B notes] it's a good endorsement that the people that jumped in up front did ok."

The EETC was priced relating to the number of "firsts" present in the deal. "It was the first deal backed by A380s, the first Emirates name, the first US dollar international EETC, which also relied on Cape Town," says Tilton. "Even leveraged lease transactions didn't have an asset



Doric Alpha has supplied Emirates with four A380s

manager, so the presence of Doric was a first and investors needed to understand what their role was in the deal. So there was a lot of firsts, which carry a premium. Also because it is a new deal, investors put in a week of work when usually they would take a few hours on a regular US EETC. There was no direct comparison trading in the market to use as a datapoint for new issue pricing. But if Doric were to come back today and do another deal with Emirates, the secondary trading levels for Doric Alpha 2012-1 would provide a very transparent comparison to use in determining where that new deal will price."

Emirates too expects the next issuance to price more tightly but it recognised the first deal would carry a premium: "The price was absolutely fine and we were very pleased with it," says Jeffery. "We were certainly very impressed by Doric and the structuring and Goldman with the execution. And Goldman worked extremely hard in helping us to get that price down."

Jeffery considers all of the work on this deal as an investment in the airline's future. "We have a lot of aircraft coming, and this is an investment in the future. This deal has also opened up the US investor market for us, not just the EETC market."

He adds: "For us, the biggest satisfaction about the transaction is putting a first benchmark international EETC deal on the market. Too many people were waiting for the perfect international deal to put into this market but this is a market that is never going to be completely standardised – it's never going to be like the corporate investment grade bond market where you have a rating attached… there will always be issues relating to jurisdiction, asset class, credit etc. From our perspective it was great to have everyone happy with the deal."

Other airlines are looking at this market since and before this deal closed. The word EETC is starting to appear in more RFPs issued by international airlines, and there are some airlines that are close to closure. Future deals will not all have to include an asset manager in the case of Doric and indeed the next deal to close is more likely to be a traditional airline-issued EETC but by a non-US carrier and perhaps not even in a jurisdiction which has adopted Cape Town Alternative A. So long as the jurisdiction concerned has a tried and tested bankruptcy regime in place, EETC deals can and will get done – even if they need to have longer liquidity facilities and precise legal opinions issued.