

## ***Glossary of Financial Terms***

This glossary contains definitions of nearly 200 Accounting, Financing, and Investing terms commonly used in aviation finance.

**ACCELERATED DEPRECIATION**

The practice of depreciating an asset more in earlier than in later years. This allows a company to reduce its tax payments, improving cash-flow during the early years of an asset's use.

**ACCRUAL**

An accounting method where expense incurred and income earned for a given fiscal year are shown in the books even though they may not have been paid or received in that year. A prime example in aviation is the (often optional) practice of accruing for major maintenance each year.

**ACQUISITION**

The purchase of an asset, or of another company, by a corporation. Similar to a merger, though mergers are usually 'friendly' and involve the exchange of equity rather than outright purchase of shares from the acquired firm's shareholders. The jargon refers to 'M&A': mergers and acquisitions.

**ACRS: ACCELERATED COST RECOVERY SYSTEM**

The accelerated depreciation method used under U.S. tax law. Establishes rules for depreciating different types of assets using variants of double declining balance depreciation.

**AMORTISATION**

The progressive reduction of debt through repayments or installments

**ANNUAL PERCENTAGE RATE (APR)**

The annual interest rate taking into account periodic compounding of interest and any fees charged. Also known as the Effective Interest Rate.

**ANNUITY STYLE**

A loan structure with equal payments of interest and principal. Also known as "mortgage style."

**APPRAISAL**

The process of estimating fair market value of an asset by using historical data and comparable recent sales transactions for a specific aircraft. Two well-known appraisal firms in aviation are Airclaims and Avmark.

**ASSET**

A physical or intangible good having commercial or exchange value, such as cash, receivables, inventories, equipment, investments, goodwill...

**ASSET-BASED FINANCE**

Financing extended to a borrower with primary focus on the value of the assets financed, rather than the general creditworthiness of the borrower: cf. Corporate Finance

**ASSET-BACKED COMMERCIAL PAPER (ABCP)**

Short-term notes (see Commercial paper) which are secured by a fixed asset such as an aircraft.

**ASSET-VALUE GUARANTEE**

A generic term referring to assurance from a third party (usually the manufacturer) of the future fair market value of an aircraft.

**AVAILABLE SEAT KILOMETRES (ASK)**

Number of seats available multiplied by the flight distance

## ***Glossary of Financial Terms***

**AVAILABLE TONNE KILOMETRES (ATK)**

Number of tonnes available on each sector multiplied by the flight distance. Can include baggage, pax and freight, providing a lowest common denominator for overall capacity

**BACKSTOP FINANCING**

A promise from the seller of an asset to make financing available to the buyer, including providing the financing herself as a last resort.

**BACK-TO-BACK LEASE**

Leasing structure where the aircraft is leased to an intermediate lessor and the sub-leased to the actual user.

**BALANCE SHEET**

The company's assets, liabilities and equity are reported on the balance sheet. Total assets must be equal to total liabilities + total stockholder's equity. Many items such as operating leases do not appear on the balance sheet. 'Strengthening the balance sheet' means reducing debts and eliminating undervalued assets.

**BALLOON**

Final payment on a lease or loan that is substantially larger than the preceding payments, expressed as a percentage of the loan amount: ex., 'a 10% balloon.' Interest is paid on the entire amount outstanding during repayment, but the 10% principal payment is made when the loan matures.

**BANKRUPTCY**

A situation in which a company does not have sufficient cash to pay its debtors, and seeks protection from the courts to continue operating, or to have its assets liquidated.

**BARGAIN PURCHASE OPTION**

An option to purchase the leased asset at a price which is lower than expected fair market value at a specified date (usually the end of the lease period), which makes the option appear nearly certain to be exercised

**BASIS POINT (bp)**

Measure used in discussing interest rates. One percentage point (1%) = 100 basis points (100bps).

**BOND**

A debt obligation backed by collateral or simply by the proven creditworthiness of the borrower. Unlike traditional bank loans, bonds pay interest only until maturity, when the company pays back the principal amount. Maturities of bonds generally range from 5 to 20 years, though recently, companies have begun issuing 50-year bonds.

**BOOK VALUE**

The value of an asset stated on the company's balance sheet, reflecting the original price reduced by annual depreciation. Aircraft book values can in some instances be revalued to reflect market values.

**BOOKING**

The act of accounting for an economic event. For example, 'booking a purchase' means adding the asset to the company's accounts.

## ***Glossary of Financial Terms***

### **BOOKRUNNER**

The commercial arm of a share, bond, or commercial paper issue. The bookrunner is responsible for actually selling the securities to its clients, usually on a “best efforts” basis. This means that any unsold securities are simply returned to the issuing company.

### **BREAKAGE COSTS**

Financial costs of terminating a lease or loan, including the uncertain return from reinvesting the proceeds of an early repayment.

### **BULLET**

A loan structure in which all of the principal is repaid at maturity

### **BURDENSOME BUYOUT**

Allows the lessee to purchase the leased equipment at a predetermined value in excess of the termination value in the event the payments under the tax or general indemnity clauses become too heavy.

### **BUYER FURNISHED EQUIPMENT (BFE)**

Equipment which is on the aircraft at delivery, but which is purchased separately by the buyer in addition to the aircraft price. Banks often resist financing BFE for weaker airlines.

### **CABOTAGE**

Also known as the eighth freedom of the air, in which an airline picks up and discharges passengers or freight in a state outside its place of registry.

### **CALL OPTION**

An option to purchase an asset at a set price at some time in the future.

### **CAPITAL COST**

The portion of the cost of operating an aircraft derived from the asset itself: primarily, depreciation expense and financing costs. Not to be confused with cost of capital, which is the financial cost of raising money in the markets.

### **CAPITAL LEASE**

A lease where the aircraft must be stated on the airline's balance-sheet. In the U.S., a lease is a capital lease when any of the following are true:

- ownership of the aircraft transfers to the lessee at maturity
- there is a bargain purchase option
- the lease covers 75% of the aircraft's life
- lease payment present value is 90% or more of the aircraft's value

### **CAPITAL STRUCTURE**

The financing mix of long-term debt and stockholders' equity, measured by the debt-equity ratio. It is one of the critical parameters of financial strategy.

### **CAPITALISE**

The practice of considering a cash outlay as constituting an asset to be depreciated over time. When a company capitalises costs such as R&D, it improves short-term profits by providing for future depreciation of the costs over time.

### **CASH FLOW**

All the changes that affect the cash account during an accounting year. The statement of cash-flows included in annual reports analyzes all changes affecting cash in the categories of operations, investments, and financing.

## ***Glossary of Financial Terms***

### **CLOSING**

The moment at which a loan takes contractual effect, and payment is made by the bank. Also known as drawdown.

### **CODE SHARING**

An agreement where one airline's flights are linked in a reservation system under the flight number of another airline. This allows each airline to sell tickets on a single flight.

### **COLLATERAL**

Security for a lender: an aircraft serves as collateral, and is repossessed in a case of default.

### **COMMERCIAL PAPER**

A generic term referring to short-term debt securities issued by rated corporations. Commercial notes bear interest, are repayable at a fixed date (usually 90 days), and are usually rated by a well-know rating agency. For these reasons, they can be traded among banks or in the money markets.

### **COMMITMENT FEE**

Lender's charge for agreeing to hold credit available at a given rate over a specified time period.

### **COMPOUND INTEREST**

Interest earned on principal plus the interest that was earned earlier.

### **CONDITIONS PRECEDENT**

Requirements in terms of lessee performance on prior contractual obligations, as well as aircraft condition and legal status, which must be met prior to a lease becoming legally binding.

### **CONSOLIDATED FINANCIAL STATEMENT**

Financial statement that brings together all assets, liabilities, and operating accounts of a parent company and the subsidiaries in which it has a controlling interest.

### **CONTINGENT LIABILITY**

An uncertain debt, an estimate of a future payment which may or may not have to be made. One example is manufacturer guarantees to airlines or banks of the future residual value of aircraft, another example is frequent flyer miles earned but not used.

### **CONTROLLING INTEREST**

A parent company is generally said to have a controlling interest - and must consolidate the subsidiary for financial reporting - when it owns a voting majority of a subsidiary company's shares.

### **CORPORATE FINANCE**

Financing with primary focus on the general creditworthiness (track record, financial results) of the borrower. Consists of loan and security issues, both shares and bonds, as well as advisory services.

### **COST OF CAPITAL**

The overall financial cost to a company, expressed as a percentage yield, taking into account its capital structure, the interest rate it pays on debt, and the cost of its equity. Cost of equity is the most difficult to estimate, because most common stock does not pay a fixed percentage dividend.

## ***Glossary of Financial Terms***

### **COST STRUCTURE**

The relative amounts of different types of costs a company incurs. Cost accountants work to divide costs into fixed and variable components. One of the largest difficulties facing airlines is that their cost structure is largely fixed in the short term. A potential solution lies in Activity Based Costing, which identifies the drivers of fixed costs.

### **COUPON**

Interest on a debt security the issuer promises to pay to the holder until maturity, expressed as an annual percentage of face value.

### **CREDIT MEMO**

An agreement from the manufacturer to reduce the overall cost of an asset to the purchaser, while not reducing the invoice price. Usually takes the form of a credit against the price of goods and services to be used in the future. Can be viewed as partial financing of the purchase.

### **CREDIT RATING**

Formal evaluation of an company's financial statements to evaluate its capability to repay debts. Very important in determining the interests rate at which the company can borrow. Well-known rating agencies include Moody's, Standard & Poor (S&P), Duff & Phelps, IBCA.

### **CREDIT-BAIL**

A form of lease used in France, under which the tax benefits of ownership remain with the lessor. The purchase option is usually 5-10%

### **CREDITWORTHINESS**

A company is considered credit-worthy when its longevity, financial strength and record of repayments show that it is likely to meet its financial obligations in the future.

### **CROSS BORDER FINANCING**

Financing involving lenders and borrowers located in two different countries (or more).

### **CROSS COLLATERALISATION**

A stucture where each aircraft in a pool stands as collateral for the debt relating to the whole pool, as in a group of aircraft financed by a syndicate of lenders. Among other things, this allows proceeds from the sale of certain aircraft to cover potential shortfalls in later sales

### **CROSS DEFAULT**

A contractual condition where default on a loan or lease obligation constitutes a default on other loans or leases. Strong protection for asset-based financiers.

### **CURRENT FAIR MARKET VALUE**

An estimate of today's market value for an aircraft, conducted by an International Society of Transport Aircraft Traders (ISTAT) member, in accordance with the ISTAT rules. These 'desktop' valuations do not involve a physical inspection of the aircraft or its records, and assume that the aircraft is at half life and can be sold on a free and open market with a 12-18 month marketing period.

### **DEBT-EQUITY RATIO**

Total long-term debt divided by total stockholder's equity. Can also be measured as debt divided by debt+equity. This is a measure of the financial risk or leverage of the company. The higher this ratio, the more financial leverage the firm has.

## ***Glossary of Financial Terms***

### **DECLINING BALANCE METHOD**

Depreciation of assets by applying a percentage charge to the book value at the beginning of the period. The percentage is usually 1 divided by the number of years over which the asset is depreciated. In Double Declining Balance, the rate charged is twice the straight-line rate.

### **DEFAULT**

The failure to make payments on a loan or a bond as scheduled. Can result in repossession of the asset.

### **DEFEASANCE**

The prepayment of financial obligations, usually through a third party. The third party assumes the repayment of the loan, and the lenders either have recourse to the original borrower (economic defeasance), or do not (legal defeasance).

### **DEPRECIATION**

The systematic reduction of the book value of fixed assets, such as plant and equipment, so as to allocate the cost over their economic life. Depreciation reduces taxable income but does not reduce cash.

### **DERIVATIVE INSTRUMENT**

Financial instrument whose value is based on another security. For example, a stock option is a derivative instrument because its value derives from the value an underlying share, share index, or future.

### **DIRECT OPERATING COSTS (DOC)**

The well-known concept of the cost of operating the aircraft, which is divided by seat-km or ton-km to calculate average costs. The difficulty of this approach is that most DOC (especially capital cost) are fixed, not variable. Forgetting this fact can lead airlines to make faulty decisions like overinvestment in aircraft.

### **DISCOUNT**

The action of calculating the present value of a future cash-flow using the formula  
$$\text{Present Value} = \text{Future Value} / (1 + \text{Discount Rate})^{\text{number of periods}}$$

### **DISCOUNT RATE**

The rate used to calculate the present value of a series of cash-flows in the future. This rate is critically important for calculating the net present value in investment appraisal, and it is difficult to estimate because of uncertainty about the risk of the future cash-flows. The overall rate a company uses as its discount rate is called its cost of capital (not to be confused with capital cost)

### **DISCOUNTED CASH FLOW (DCF)**

The generic term referring to estimation and discounting of future cash flows to estimate their value in today's terms.

### **DOUBLE-DIP FINANCING**

Financing arrangements which make use of the tax shield of depreciating an aircraft in two jurisdictions. In these highly complex legal arrangements, the aircraft may be "owned" two different countries, and depreciated in both.

### **DOUBLE TAX TREATY**

Bilateral agreement between countries which relieves companies and individuals from paying tax on the same income in both countries.

## ***Glossary of Financial Terms***

### **DOWN PAYMENTS**

Amounts paid to the manufacturer in advance of delivery of the aircraft according to an agreed schedule. These payments help finance the manufacturing of the aircraft. Also known as Pre-delivery payments (PDP)

### **DRY LEASE**

A short-term lease of the aircraft, not including the crew, insurance and maintenance.

### **ECONOMIC LIFE**

The estimated number of years an asset may be used profitably, used to calculate asset depreciation and determination of lease status (financing lease vs. operating lease). Estimates may be provided by independent appraisers or specified by the accounting authorities.

### **ENCUMBERED ASSETS**

Assets such as aircraft are said to be encumbered when there are numerous creditor claims against them, such as mortgages, shop visit invoices, or lease obligations. These of course reduce the airline's flexibility to market or the aircraft

### **ENHANCED ETC**

An ETC with the addition of structuring techniques which provide superior credit protection over the airline's secured and unsecured creditors.

### **EONIA ((Euro OverNight Index Average)**

Interest rate for overnight, interbank borrowing and lending in the euro area, computed as a weighted average of all overnight unsecured lending transactions in the interbank market, initiated within the euro area by the contributing panel banks.

### **EQUIPMENT TRUST CERTIFICATE (ETC)**

Securities representing the debt portion of an aircraft financing, usually 80% of the acquisition cost. The airline may retain the 20% equity portion of the aircraft through its own funds, or may lease the aircraft from a third party owner participant.

### **EQUITY**

Ownership interest in a company, including money invested and any accumulated profits of the company. The financial instrument is stock or shares, as opposed to bonds.

### **EQUITY PARTICIPANT**

Investor in a lease seeking the tax benefits resulting from ownership as distinct from the debt participants, who are seeking principal and interest repayment.

### **ESCALATION**

The practice of adjusting the price paid for an aircraft to account for the effect of changing production costs during the manufacturing period.

### **EURIBOR (Euro Interbank Offered Rate)**

The interest rate at which euro interbank term deposits within the euro zone are offered by one first-rate bank to another first-rate bank

### **EURO**

The currency of the European Union, due to assume full status in 2002. Will become a major reserve currency and in time aircraft may be purchased and financed in euros.

## ***Glossary of Financial Terms***

### **EURODOLLARS**

US dollars deposited or lent by banks outside the US. The huge increase in Eurodollars coincided with the oil shocks of the 1970's when "petro-dollars" flooded European banks. Today, many currencies are held in deposits outside their home country : these are called by convention Eurocurrencies.

### **EVENT OF DEFAULT**

A precise occurrence which causes a borrower to be in default for a loan contract. Can include operational considerations such as maintenance status or operating the aircraft outside permitted countries, as well as contractual clauses such as defaulting on another loan contract - known as a "cross-default".

### **EXCHANGE RATE**

The rate at which currencies can be bought or sold, expressed in a second currency (e.g., Frf / DM). Since 1973, the world monetary system functions essentially with floating exchange rates, with some exceptions such as the European Monetary System and the fixed rate euro zone.

### **EXPENSE**

As a noun, refers to the periodic cash outlays and non-cash charges or business operations. As a verb, it means to charge costs as current expenses. This important concept relates to the decision on whether to capitalise a cash outflow as an asset, or to consider the cash outflow as an expense in the current period: 'We expense all our development costs' means that we consider them current expenses, rather than an asset to be depreciated over time.

### **EXPORT CREDIT**

Loan insurance or guarantees by quasi-governmental Export Credit Agencies (ECAs) such as COFACE (France), HERMES (Germany), ECGD (UK), EXIMBANK (US), JEXIMBANK (Japan), Canada's Export Development Corporation (EDC), and PROEX (Brazil). These guarantees can reduce the cost or improve the availability of aircraft financing for airlines outside the country of manufacture.

### **EXPOSURE**

The potential loss to a lender or lessor if a loan or lease becomes uncollectible. Net exposure is the potential financial loss minus the estimated fair market value of the asset which is repossessed.

### **FACE VALUE**

The amount printed on the face of a bond, which is paid back at maturity, and which is used in calculating the coupon payment

### **FAIR MARKET VALUE**

A generic term for an estimate of the market value of an asset at some point in its useful life. Such estimates are made by independent appraisers and by such organizations as Airclaims, Avmark and others. For more details, see Current Fair Market Value

### **FINANCE LEASE**

A lease of an aircraft over the majority of its economic life. Risks and rewards of ownership belong to the lessee over time, though lessors retain the right to repossess in the event of a default. Under International Accounting Standards and US rules, finance leases must be stated on the airline's balance-sheet, while operating leases may be off-balance-sheet: see Capital Lease for the U.S. rules.

### **FINANCIAL LEVERAGE**

The amount of debt, and therefore FIXED interest expense, a firm has. Leverage enhances returns for shareholders in good years, but also increases the volatility (risk) of the firm's profits.



## ***Glossary of Financial Terms***

### **FIRST LIEN**

The first, or senior, security interest against an asset

### **FIRST LOSS DEFICIENCY GUARANTEE**

A guarantee against a certain amount (or 'slice') of loss resulting from the default, repossession and resale of an aircraft. The guarantor is usually the manufacturer(s).

### **FIVE FREEDOMS OF THE AIR**

The original five landing rights defined under the Chicago Convention in 1944:

- 1) the right to fly over the territory of a foreign nation
  - 2) the right to land on the territory of a foreign nation for refuelling or repairs
  - 3) the right to unload passengers and cargo in a foreign nation
  - 4) the right to load passengers and cargo in a foreign nation for travel to the home nation
  - 5) the right to carry passengers and cargo from one foreign nation to another, given a route origination or destination in the home country
- To this list, three more have been identified, but not universally agreed:
- 6) carry passengers and cargo between foreign countries by connecting in the home country
  - 7) carry passengers and cargo between two foreign countries, without connecting in the home country
  - 8) carry passengers and cargo wholly within a foreign country

### **FLOATING RATE RENTAL**

Lease payments which are subject to upward or downward adjustments during the lease term, with reference to an base interest rate such as LIBOR.

### **FOREIGN EXCHANGE (FOREX)**

A generic term for foreign currency markets.

### **FORWARD MARKET**

Market on which currencies or other assets are traded for a future date. Commonly used to assure an exchange rate.

### **FULL PAYOUT LOAN**

A loan structure in which principal and interest are fully paid off in regular payments (or installments) over its term. Also known as a P+I loan.

### **FUNDING**

The practice of providing money for transactions. Can be used in a global sense "the funding gap" or need for financing, as well as at a transaction level: we say that a loan is "funded" when the proceeds are made available.

### **GEARING**

See LEVERAGE

### **GOODWILL**

An asset which represents the excess over the book value of the assets, paid in a company acquisition. If the book value of the acquired company is €100m, and we pay €150m for it, we will have goodwill of €50m, an intangible asset which is usually amortised over time.

### **GROSSING UP**

The requirement to increase payments to compensate for deductions of tax at the source of income, so that the net amount received is equal to the contractual amount payable.

## ***Glossary of Financial Terms***

### **GROUPEMENT D'INTERET ECONOMIQUE**

Literally Grouping of Economic Interests, a French legal entity similar to a partnership. GIEs publish no accounts or results of their own, all profits and losses flowing through to the partner companies. Transparent for tax and reporting purposes, GIEs are commonly used for syndicated tax based leases.

### **HALF LIFE**

A component is in half life condition when it is exactly midway between scheduled overhaul or replacement.

### **HEAD LEASE**

The primary lease in an asset management structure, where a third party (often the manufacturer) continues to make payments to the primary lessor, while putting the asset out on sub lease to an airline.

### **HEDGE/HEDGING**

Strategy used to offset risks. As a product, it is an insurance policy which in exchange for a premium protects the company from changes in fuel prices, exchange rates, interest rates. A perfect or natural hedge is one eliminating the possibility of future gain or loss based on movements in uncontrollable markets such as interest rates or forex. An example of this is matching US\$ revenue against US\$ expenses, eliminating forex risk for these cash flows.

### **HELL OR HIGH WATER CLAUSE**

A clause in a lease which states the unconditional obligation of the lessee to pay, regardless of any event affecting the equipment or any change in the circumstances of the lessee.

### **HIRE PURCHASE AGREEMENT**

A lease with a purchase option at the end.

### **HUB AND SPOKE**

A synchronised wave of arrivals followed by a wave of departures from a 'hub' airport. This maximises the number of one-stop connecting flights from 'spoke' cities.

### **HURDLE RATE**

The rate used to calculate Net Present Value in investment projects: often, a simplified estimate of the company's cost of capital.

### **INCOTERMS**

Internationally-recognised delivery conditions for exported goods. The most important describe where title and responsibility for the goods transfers from buyer to seller.

Cost Insurance Freight (CIF): seller is responsible for all transport and related costs (including duties and tariffs) to the home base of the buyer.

Ex-works - title transfers immediately when the goods leave the final assembly line

Free on Board (FOB): the seller is responsible for transport to the ship which carries the goods to their final destination.

### **INCUR**

An expense is incurred when the event which caused the expense has happened. This means that the expense should be considered in the current period's result, even if the invoice has not been paid.

## ***Glossary of Financial Terms***

### **INDEMNITY**

A provision where one party to a contract compensates the other for loss resulting from certain occurrences, eg., the non-achievement of the desired tax treatment of a transaction. See Tax Indemnity.

### **INSTALLMENT**

An amount paid at a regular interval ( ex : loan installment or lease installment).

### **INSTITUTIONAL INVESTORS**

Investors such as banks, insurance companies, trusts, pension funds, foundations, and educational, charitable, and religious institutions

### **INTERMEDIATION**

The basic business of banks, intermediation is collecting savings in the form of deposits, and loaning the funds on to companies and individuals, thus permitting the individual depositor to reduce her overall risk.

### **INTERNAL RATE OF RETURN**

The discount rate which equates present and future costs and returns on a net present value basis. The rate at which NPV = 0.

### **INVESTMENT BANK**

Firms which are specialised in corporate finance products such as bonds and shares, often having expertise in both issuing and trading such products. A third area of expertise is Mergers and Acquisitions (M&A). Examples are Goldman Sachs, Lehman Brothers, Jardine Fleming, Lazard Frères Dresdner-Kleinwort Benson, Crédit Suisse First Boston, and many others.

### **JAPANESE LEVERAGED LEASE (JLL)**

A leveraged lease structure which takes advantage of large amounts of investor capital and generous tax shields available in Japan to reduce the overall lease payment to the airline. In recent years, most tax provisions allowing JLLs have been eliminated.

### **JUNIOR ISSUE**

Debt or equity that is subordinate in claim to another issue in terms of dividends, interest, principal, or security in the event of liquidation.

### **LANDING RIGHTS**

The legal right to land in a country is usually negotiated on a bilateral – and highly political – basis between countries. The basis is these discussions are so-called ownership caps and the Five Freedoms defined in this glossary. Most landing rights agreements require that local shareholders hold 50% of the shares in an airline. This is a major block to free competition in the sector. Some successful attempts to more broad “open skies” agreements (such as within the E.U. are slowly opening up the air transport market to true competition.

### **LARGE AIRCRAFT SECTOR UNDERSTANDING (LASU)**

An inter-governmental agreement regarding government-guaranteed financing of commercial aircraft. LASU terms are intended to govern the interest rates, maturities and amounts financed by export credit agencies (ECAs).

### **LEARNING CURVE**

Experience shows that major manufacturing programmes experience much higher costs in the early phase of production than in later years, as production processes improve. This reduction in costs is graphed as a negatively-sloped, exponential curve

## ***Glossary of Financial Terms***

### **LEASE**

A contract to operate an aircraft over a specified time period in exchange for rental payments. The lessee is the airline that operates the aircraft and pays the rentals, while the lessor remains the legal owner.

### **LETTER OF CREDIT**

A bank product which guarantees payment to the seller of goods or services. Concretely, the buyer's bank agrees to pay the seller's bank the invoiced amount, upon presentation of documents proving the goods were accepted by the buyer. Letters of credit should be irrevocable, and usually confirmed by the seller's bank.

### **LEVERAGE**

A term derived from the physics notion of doing more work with less effort, leverage refers to the relative amount of fixed costs in a company's cost structure. There are two aspects: operating leverage (fixed operating costs), and financial leverage (fixed interest costs from debt).

### **LEVERAGED BUY-OUT**

The acquisition of a company using large amounts of debt to finance the deal. After the buy-out, the debt is loaded onto the acquired company's balance sheet.

### **LEVERAGED LEASE**

A long term lease for an aircraft involving three parties, a lessee, a lessor, and a long-term creditor. The lessor borrows most of the money to purchase the asset on a non-recourse basis, granting a mortgage and assigning lease payments to the lenders. As owner of the asset, the lessor is entitled to tax deductions for depreciation on the asset and interest on the loan.

### **LIABILITY**

A debt of the company, which may be due in under one year (Current Liability), over one year (Long-term Debt), or may be an uncertain debt (Contingent Liability).

### **LIBOR (London Interbank Offer Rate)**

As its name suggests, it is the interest rate at which banks loan U.S. dollars to one another in London. It is the critical rate for determining aircraft financing: loans and are often priced at LIBOR for a given maturity, plus a spread representing the risk premium. Example: Six-month LIBOR + 50 basis points. You also have the PIBOR in Paris, the MIBOR in Madrid, and others.

### **LIQUIDATION**

The process of turning assets into cash. Usually, refers to selling the assets of a company which has declared bankruptcy.

### **LIQUIDITY**

Refers to the amount of ready cash a company has to pay its debts, and to the ability of an asset to be sold for cash.

### **LIQUIDITY FACILITY**

A dedicated source of short-term financing provided by banks, sufficient to pay, for example, interest payments over 18 months in the event of default. This facility is typically provided by a top-rated bank, an reassures investors in securitisations that they will continue to receive their revenue during the time taken to remarket an aircraft.

### **LOAD FACTOR**

Ratio of used to available capacity: passenger-kilometres / available seat-kilometres or tonne-kilometres / available tonne-kilometres. A critical operating measure balanced against revenue yield.

## ***Glossary of Financial Terms***

**LOAN TO VALUE RATIO (LTV)**

The percentage of an aircraft's appraised market value that is financed by a loan. The inverse of the LTV is the Collateral Coverage Ratio. Important in assuring Enhanced ETC holders that they may repossess the aircraft in the event of default.

**LONG-TERM DEBT**

A debt of the company payable in more than one year.

**MANAGEMENT FEE**

Fee payable to the agent of a financing upon closing to remunerate its management of the transaction. A portion of this fee may be paid by the agent to the members of the financing syndicate.

**MANDATE**

The final agreement or approval by the borrowers regarding the lending syndicate. Several months before delivery, the mandate is given to the banks' or finance houses offering the most attractive financing terms.

**MANUFACTURER SUPPORT**

A very broad term referring to manufacturer assistance in financing aircraft, including helping to obtain export credit financing, providing asset value guarantees and/or direct financing of purchases or leases.

**MATURITY**

The length of time from inception of a loan to its full repayment. Also refers to the date of such repayment. A loan reaches maturity when it is fully repaid

**MATURITY DATE**

Date on which the principal amount of a note, draft, acceptance, bond, or other debt instrument becomes due and payable.

**MERGER**

A "friendly" business combination where the assets and liabilities of the merging companies are combined. Financially preferable to an acquisition, because there is not goodwill to amortise against future profits.

**MINIMUM LEASE PAYMENTS**

Payments which the lessee is required to make on leased property, including residual value guaranteed the lessor but excluding insurance, maintenance and taxes.

**NEGATIVE PLEDGE CAUSE**

A clause in a loan agreement preventing the airline from pledging an aircraft as security for an other loan.

**NET PRESENT VALUE (NPV)**

The value today of a series of cash-flows in the future, used to evaluate the profitability of investments. NPV is calculated by estimating the cash-flows, then discounting them back to the present day using the firm's cost of capital.

**NET WORTH**

The difference between the value of a company's assets, and its liabilities or debts. The net worth of a company is equal to shareholders' equity.

## ***Glossary of Financial Terms***

### **NOMINAL INTEREST RATE**

Apparent interest rate per annum, not taking inflation into account. This is the rate stated in a loan agreement, not including fees

### **NON-RECOURSE FINANCE**

Borrowing where the lender's rights do not extend to all of the borrowers assets or those assets constitute all the relevant equipment.

### **OFF-BALANCE SHEET FINANCING**

Financial commitments - debts - not reported on the balance sheet but explained in footnotes to the financial statements.

### **OWNERSHIP CAPS**

The limit of foreign shareholding in an airline. In the U.S., the 25% cap has prevented companies such as BA from gaining the foothold they would like in the country. In another example, New Zealand agreed in 2001 to raise their cap to save ANZ from near disaster. Most landing rights agreements require that local shareholders hold 50% of the shares in an airline. This is a major block to free competition in the sector.

### **OPEN-ENDED LEASE**

Lease which contains a provision for the extension of the lease on pre-determined terms after the end of the fixed period.

### **OPERATING CYCLE**

Refers to the process of running a business: spending cash for raw materials and production, turning the finished goods into sales on credit, and finally customer credits into cash.

### **OPERATING LEASE**

This form of lease is for a period substantially less than the aircraft's expected economic life. Operating leases can help increase fleet flexibility, while reducing the financing burden on the operator. In an operating lease the asset and its associated debt (liability) do not appear on the company's financial statements.

### **OPTION**

As with an aircraft purchase option, a financial option gives the holder the right to purchase (or sell) a security within a given time period. Often used to manage the variability in foreign currency values.

### **OPTION FINANCE**

A financing structure which allows the airline either to return the aircraft at a certain date without penalty or continue to operate it, thus providing operating lease balance sheet treatment with the option of a finance lease. These option dates are known as Return Windows.

### **OUTSTANDING BALANCE**

The principal balance of a loan at a certain point in time.

### **PARENT**

A company which has a controlling interest in another company. Parent-subsidiary structures are often used in aircraft financing to gain tax advantages, while limiting the exposure of the parent.

### **PARI PASSU**

Partners in a loan transaction are said to be Pari Passu when potential losses are shared by each partner according to her proportionate share in the loan. Concretely, a 35% loan participation creates exposure equal to 35% of the total.

## ***Glossary of Financial Terms***

### **PARTNERING**

The practice of sharing risks with suppliers and subcontractors, as opposed to offering fixed contracts for components and services. Under these arrangements, development costs are shared, and often the partner must adjust its production to actual orders of aircraft.

### **PAYMENT OR ANNUITY**

The periodic payments in the future corresponding to the principal of a loan made today, taking into account the effect of compound interest.

### **POOLING**

An arrangement under which engines and spare parts can be swapped either on a title retention or a title exchange basis.

### **PRESENT VALUE**

The amount of a loan, which corresponds to a series of payments in the future, discounted at the contractual rate of interest.

### **PRICE/EARNINGS RATIO (PER)**

Price of a stock divided by its earnings per share. The price/earnings ratio, also known as the earnings multiple, gives investors an idea of how much they are paying for a company's earning power. For example, a PER of 20 indicates the market is willing to pay for 20 years' earnings at the current level.

### **PRIMARY PERIOD**

The time during which a financial lessor expects to recover the full capital cost of the asset, plus borrowing costs and profit. Also used to distinguish the initial lease period from renewals.

### **PRIME RATE**

The rate at which banks lend to their best customers. Bank loans are often priced in terms of Prime plus a spread, (eg., Prime + 1,5%).

### **PRINCIPAL**

The capital which is loaned. Depending on arrangements, loan payments can be 'P+I' (principal plus interest), or bullet (payment of principal at maturity).

### **PRIVATE PLACEMENT**

Sale of stocks, bonds, or other investments directly to a group of institutional investors such as insurance companies, and/or to a private investors. In a private placement, the company is less obligated in publishing financial information which competitors may use.

### **PROGRAMME ACCOUNTING**

The practice of booking the production costs of an aircraft programme using an estimated per-aircraft cost over the life of the programme. Since these programmes usually have steep learning curves, actual costs will be higher than these average costs in early years, and lower in later years.

### **PRE-DELIVERY PAYMENTS (PDP)**

Amounts paid to the manufacturer in advance of delivery of the aircraft according to an agreed schedule. These payments help finance the manufacturing of the aircraft.

### **PROMISSORY NOTE**

A promise to pay instead of a cash payment, specifying the amount to be paid, the due date or maturity, and the interest rate to be paid by the borrower. Used by the strongest airlines to avoid making cash down payments on aircraft. See also Commercial Paper.

## ***Glossary of Financial Terms***

### **PROVISION**

The action of setting up a reserve, or contingent liability, to cover future business or financial risks. Provisions allow a company to cushion its future profits against catastrophic losses. Similarly, banks built partial provisions against problem loans.

### **PRUDENTIAL RULES**

Guidelines set by a company's auditors and senior management, regarding the appropriate policies and accounting treatment of critical items like maintenance expense accruals (for airlines), and contingent liabilities (for manufacturers).

### **PUBLIC OFFERING**

Offering of new securities to the investment public, usually through an investment bank or a syndicate of several investment banks, at a public offering price agreed upon between the issuer and the bankers. Public offering is distinguished from private placement of securities, and carries substantially higher disclosure requirements.

### **PURCHASE AGREEMENT**

A commitment from the purchaser to acquire the asset under stated terms. Can be used as collateral for short-terms financing (e.g. down payment financing).

### **RATING**

See Credit Rating

### **REAL INTEREST RATE**

The rate of interest taking into account the effects of inflation. Formally, the real interest rate is  $(1+\text{nominal})/(1+\text{inflation})$ : it is approximately the nominal interest rate minus the inflation rate.

### **REAR-END LOADING**

The practice of constructing a rental schedule where the larger payments are made toward the end of the lease.

### **RECEIVABLES**

Refers to all the credits owed to a company or a bank by its customers. In recent years, banks have developed the two practices of 'selling receivables' to investors, and of grouping these loans into packages and issuing securities backed by the receivables, a practice known as securitisation.

### **RECOURSE**

The extent to which a lender may demand repayment from another party to the transaction in the event of default. For example, a bank may sell loans to investors, but if the investors have recourse, for example of 20% of the amount sold, the originating bank must pay this 20% in case the borrower defaults. Non-recourse loans to investor SPV's are usually part of leveraged lease transactions.

### **REPOSSESSION**

Act of taking back an asset if payments are not made by the purchaser or lessee. Repossession of aircraft can be difficult, sometimes causing financiers to place limits on where the plane may be operated.

### **RESIDUAL SHARING**

An agreement to divide residual value risks and rewards between two or more parties



## ***Glossary of Financial Terms***

### **RESIDUAL VALUE**

The fair market value of an asset at any time during its life. Often refers to the estimated value at the end of a lease, or operation, cycle. As its name suggests, a Residual Value Guarantee (RVG) assures a minimum market value for the aircraft at a specific point in time.

### **RETURN WINDOW**

The date or dates at which an aircraft financed under option finance can be returned to the lessor at the airline's option, with no penalty.

### **REVENUE YIELD**

A measure of pricing strategy and market conditions: Revenue / Passenger-kilometre or Revenue / tonne-kilometre. The trade-off between revenue yield and load is a central issue in the marketing and operations of airline services. Often, domestic flights have higher loads and yields than international flights. Strategically, many airlines try to use domestic routes to subsidize entry into new regions.

### **REVOLVING CREDIT**

A loan which is used on an as-needed basis, up to a contractual limit. See also, "Standby Credit Facility."

### **RISK**

This 'four-letter word' is at the heart of banking: a borrower's 'risk profile' determines his rate of interest and the level of security required. Types of risk include credit risk (the risk the company cannot or will not pay), political risk or country risk in the operating environment, and industry risk specific to the sector, which is quite high in the airline business.

### **RISK PRICING**

This relatively new concept in leasing attempts to rationalise setting of lease rates by balancing the risks of the deal against competitive market forces, which sometimes have led lessors into financial difficulties.

### **SALE LEASE-BACK (SLB)**

A transaction where the owner of an asset sells it to another company, then leases it back for operation. Can produce profits for the seller in times when aircraft market values are good, which is known as "unlocking hidden equity" in the jargon. Another major benefit is the up-front cash received from the sale.

### **SALVAGE VALUE**

The book value of an asset after depreciation has been completed. Not the same as residual value, which refers to future market prices.

### **SECURED DEBT**

Debt guaranteed by the pledge of assets or other collateral.

### **SECURITISATION**

The process of issuing debt securities whose value is backed by assets, either financial or physical. The original securitisations concerned housing loans, so-called Mortgage-backed Securities) In aviation, securities backed by the cash-flows of leases and the value of aircraft have been successfully sold to investors. An example of this are the Equipment Trust Certificates (ETC's) used in U.S. aircraft financing deals.

### **SECURITY**

This word has two distinct meanings, for lenders and in capital markets:

## ***Glossary of Financial Terms***

- Lending: assets offered by a debtor to a lender to 'guarantee' a loan are called security or collateral. For instance, the security behind a mortgage loan is the real estate being purchased with the proceeds of the loan. If the debt is not repaid, the lender may repossess the security and resell it.

- Capital Markets: Certificates issued by a government or corporation which offer a return or yield, and which often represent a claim on the assets in the case of liquidation.

### **SELLER FURNISHED EQUIPMENT**

Equipment such as seats which would normally be purchased separately by the buyer are known as Buyer Furnished Equipment (BFE). By purchasing and including the equipment in the invoice price, manufacturers may help airlines obtain financing for the "SFE".

### **SENIOR DEBT**

Loans or debt securities that have claim prior to junior obligations and equity on a corporation's assets in the event of liquidation.

### **SHAREHOLDERS' EQUITY**

The sum of the money invested in a company, and the accumulated profits.

### **SOVEREIGN RISK**

Risk of default based on the political situation in the borrowers' home country. Also known as country risk.

### **SPECIAL PURPOSE VEHICLE (SPV)**

A legal entity set up to purchase and lease assets, often used to generate a tax shield (from interest and depreciation expense exceeding lease revenue) which can be offset against profits of the parent company.

### **SPOT MARKET**

Market in which commodities such as oil, basic foods and currencies are sold for cash and delivered immediately.

### **SPREAD**

In general, the difference between two interest rates or yields. Bankers think in terms of the spread between the cost of funds and the loan yield, which is equivalent to a gross profit margin in industry. Loans are also priced in terms of a spread, by adding a margin to a base rate such as LIBOR.

### **STANDBY CREDIT FACILITY**

An loan which is made available to the customer on as as-needed basis. When the customer requires the money she 'draws' or uses the amount of credit needed, up to the contractual limit.

### **STRAIGHT-LINE DEPRECIATION**

A depreciation method where the annual depreciation charge is constant over the estimated useful life of the asset. For example, to depreciate €100m straight-line over 20 years, we charge €5m per year as a tax-deductible expense. Sometimes, straight-line is used to refer to constant-principal loan amortisation.

### **STATEMENT OF CASH FLOWS**

This relatively new statement in financial reporting provides insight into the firm's operating, investing and financing strategies. It is usually presented in three categories:

- Operating cash-flow includes operating cash-flow and changes in working capital;
- Investing cash-flow reports asset acquisitions and sales and financial investments;
- Financing cash-flow states all cash raised - or repaid - by borrowing or by issuing stock

## ***Glossary of Financial Terms***

### **STEP RENTALS**

Lease payments which vary from one to another, usually done for cash-flow or tax reasons.

### **STIPULATED LOSS VALUE**

The amount which must be paid to the lessor of an asset in the event a lessee breaks a lease before its contractual finish, whether through voluntary termination, default or in the event of a total loss of the aircraft.

### **STOCK**

In British English, refers to the merchandise in manufacture or on hand for sale or use, such as fuel and spare parts: cf. inventories (U.S.).

In U.S. English, it is generic term referring to ownership investments in a company, or equity investments. Divided into common stock or voting stock, and preferred stock.

### **STRUCTURED FINANCE**

As its name suggests, financing arrangements which involve a variety of different vehicles such as loans, finance leases and/or operating leases. Objectives of airlines, lenders and investors are met by optimising the legal forms and balance sheets of the parties to the transactions.

### **SUB LEASE**

The lease to the end user in an asset management structure, where a third party (often the manufacturer) continues to make payments on the head lease to the asset's owner, while sub-leasing the aircraft to an airline or other operator.

### **SUBORDINATED**

Junior in claim on assets to other debt, that is, repayable only after other debts with a higher claim have been satisfied.

### **SWAP**

Transactions involving an exchange of cash-flows between two contracting parties. In an interest-rate swap, parties exchange fixed-rate and floating-rate loan payments. Swaps are also common for currencies: local currency are exchanged against over a specified period.

### **SYNDICATED LOAN**

In aircraft financing, risk is shared among a 'syndicating' group of banks. There will usually be a lead bank who arranges the deal, and several associated banks.

### **TAX INDEMNITY**

Clause in a tax lease providing for increases in lease payments in the event of circumstances which adversely affect the lessor's ability to claim the anticipated tax benefits on the depreciation or interest deductions.

### **TAX LEASE**

A leasing arrangement where the tax savings from depreciation and interest expense of a special purpose vehicle (SPV) are used to reduce the overall cost of leasing the asset to the airline. Practically identical to the leveraged lease.

### **TAX SHIELD**

By generating non-cash expenses such as depreciation, aircraft and other assets reduce profits, but also reduce income taxes, creating a tax shield. Interest expense is also a tax shield. Tax shields can be used when a company is profitable, or during a legally stipulated carry-forward period.

## ***Glossary of Financial Terms***

### **TRADE**

To carry out a transaction of buying or selling a stock, a bond, or a commodity future contract. A trade is consummated when a buyer and seller agree on a price at which the trade will be executed.

### **TREASURIES**

Tradable debt obligations of the government, secured by its reliability as a borrower and issued at various schedules and maturities.

1. Treasury bills -short-term securities with maturities of one year or less;
2. Treasury notes -intermediate securities with maturities of 1 to 10 years.
3. Treasury bonds -long-term debt instruments with maturities of 10 years or longer

The rate on these securities is often used as a base rate to price loans, to which banks add a spread

### **UNWIND**

The process of taking apart a complex deal. Legal and international issues can often cause unwinding to be a painful process, causing significant downtime for the aircraft while the lawyers figure things out and negotiate a solution.

### **WALKAWAY LEASE**

A lease that allows the lessee to return the aircraft at specified times without penalty. See Option Finance and Return Window

### **WET LEASE**

A short-term lease for seasonal needs, including the aircraft, crew, insurance and maintenance (ACIM) during the period of the lease.

### **WITHHOLDING TAX**

The tax on financial income earned in a foreign country, withheld at the source and paid to the government of the host country. Lease payments may have to be grossed up to compensate the lessor for these taxes.

### **WORLD TRADE ORGANISATION (WTO)**

A supranational body which helps arbitrate disputes on open trade among countries.

### **WORKING CAPITAL**

Money invested by a company in its operations (cash), its customers (accounts receivable or debtors), and its production capability (inventories or stocks). The term net working capital refers to these assets minus the short-term debts - or 'current liabilities' - used to finance them. Working capital finances the operating cycle of a business.

### **WRITE DOWN**

The act of reducing the value of an asset from the balance sheet. For example, airlines often must write down the value of its investments in unsuccessful subsidiaries.

### **WRITE OFF**

The act of removing an asset from the balance sheet. For example 'write off an loan' means to consider all or part of the loan as an expense in the current year, which of course reduces profits. Banks progressively build provisions against problem loans, but they will only write off bad credits when they have no other alternative.

### **YIELD**

The rate of interest, or 'rate of return' on a loan, a bond or a stock.  
- For loans, the rate of interest plus the effect of fees;

## ***Glossary of Financial Terms***

- For bonds, yield to maturity (YTM) takes into account the price of the bond, the total of annual interest payments, the capital to be repaid, and the amount of time remaining until maturity
- For shares, the yield is composed of the dividend payments plus any change in price of the stock.
- In aircraft lease finance, refers to the rate at which positive cash flows from lease payments permit recovery of the investment in the asset