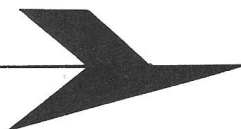


# European Aviation Consulting

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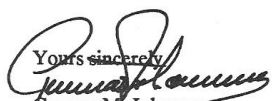
DATE:

Stavanger  
August 5, 1991

**THE ENCLOSED PRE-PROJECT STUDY REPORT HAS BEEN PREPARED AFTER THE MEETING IN LONDON 25. JULY 1991.**

**IT HAS BEEN PREPARED BY:**

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Yours sincerely,  
  
Gunnar M. Johannessen  
for European Aviation Consulting

Enclosure

E-A-C FOR SOLIDITY, COMFORT AND SAFETY



## PURCHASING AIRCRAFT

There are about 1,200 new and used passenger aircraft available on the market today, the problem is that there are nearly no buyers. Obviously, it is a buyers market. Declining traffic, in reaction to the Persian Gulf war and recessions throughout the world have, combined with more stringent noise-emissions and maintenance standards, slashed the values of older generation aircraft like f.i. the Boeing 727. This is one of the reasons we recommend to buy rather than lease. By surveying the market we believe that it is quite possible to do a very favourable deal.

## LEASING AIRCRAFT

The trend today by well established medium (and up) sized airlines is to lease rather than buy. Leasing aircraft brings a mixed bag of benefits and drawbacks. Leasing allows established airlines to re-equip their fleets without the huge capital outlays associated with the purchasing of new aircraft. On the other hand, it tends to understate their true degree of indebtedness. It allows them to accumulate cash that otherwise would go toward buying new airplanes, but it removes the cash cushion that is provided by depreciation and amortization. One outcome of the trend to lease is that net income has grown as a percentage of cash flow (cashflow is composed largely of net income and non cash expense items such as depreciation). This leaves cash flow more vulnerable to downturns in profitability. Also, since leasing is classified as an operating expense, it tends to drive up unit costs. Finally, airlines that lease do not benefit from any gain on the eventual resale of the aircraft to another operator.

To lease an aircraft the leasing company will require either deposit of a certain amount of cash, or a bank guarantee. How much cash, or how big a bank guarantee normally depends on the size of the lease and the customers quality. Today lenders are concentrating on fitting the financial package to the quality of the customers credit.

The following is a short description of the most common ways of leasing aircraft:

**DRY LEASE**, is a lease where the operator only lease the aircraft. All other parts of the operation of the aircraft is to be taken care of and paid for by the operator, f.i. crew, maintenance, fuel and fees.

As mentioned above, the leasing company will require cash deposit or a bank guarantee to secure their interest, apart from the lease payment. Please also bear in mind that full independence and freedom to take vital decisions will be limited.

**WET LEASE**, is a lease where the leasing company provide the aircraft with crew and maintenance. This lease can also be made to include fuel and all operating expenses.

It is our opinion that this type of lease is not very favourable to the operation that we are discussing here, because you, as the operator, will be left with no control over the personnel and/or equipment. This lease also leaves very little room for profit to the operator.

**LEASE/PURCHASE**, is usually a lease where some of the lease payment are set aside for a contracted future purchase of the aircraft. On a long term this type of lease is better than the two types of leases discussed above. The biggest disadvantage with this type of lease is that the money set aside by the leasing company may be lost if plans change.

**CONCLUSION.** If Eritrea wants to establish their own national airline it is our clear suggestion to you to purchase rather than lease aircraft. As mentioned above the "price tag" on used aircraft today is very low compared to the real value of the aircraft. Older generation jet aircraft such as f.i. the Boeing 727-200/737-200 and McDonnell Douglas DC-9 still have many years of valuable service to operators. However, such an aircraft, like all other aircraft of this generation, has received "aging aircraft" airworthiness directives that means rather extensive and expensive modifications to the airframes and engines (noise). Nevertheless, such an aircraft with and updated status in the areas mentioned above and a "fresh" heavy maintenance check still has a reasonable price, and about four years of service until next heavy maintenance.

Finally, we are sure that your country has qualified personnel home or abroad that can be trained to operate Eritrea's own aircraft (and airline).

#### **SETTING UP AN OFFSHORE COMPANY IN CYPRUS**

As we have discussed earlier, we propose to initially register an aircraft in Cyprus, and also to use Cyprus as the main hub outside Eritrea. In order to operate on Cypriot register the aircraft must be certified by the Cypriot Civil Aviation Authority once a year, and it is necessary to establish an offshore company there. The timeframe in order to establish this company is approximately 3 weeks.

When Eritrea receive the ICAO membership it is no longer necessary to use Cyprus as the country of registry, and the aircraft can be transferred to the Eritrean registry.

#### **APPLICATION FOR ICAO MEMBERSHIP**

Through one of our contacts with long experience in dealing with ICAO business we have received information that it is fully possible to apply for an ICAO membership before Eritrea is officially approved by the UN. Eritrea will then receive a special membership on a contracted basis that will be changed to a full membership once Eritrea is fully approved by UN. We will receive the required information in the near future about what is necessary for an application to be submitted to ICAO under this condition.

We hope that the above information gave you a little bit more knowledge about the subject, but we will not hesitate to say that we feel it is the time to do a meeting similar to the one held in London last month, so that we can discuss all the areas you feel uncertain about, especially all the aspects by getting initially established f.i. in Cyprus. This meeting does not necessarily need to be held in London, we may suggest Asmara or in Cyprus (or somewhere else).

