Closed-End Aircraft Funds
Airbus A380 – Part-out as final option

The first Airbus A380 has been dismantled and will be sold as spare parts. A new lessee or buyer could not be found following expiry of the 10-year lease in October 2017. For investors, this is likely to mean a modest end to their investment.

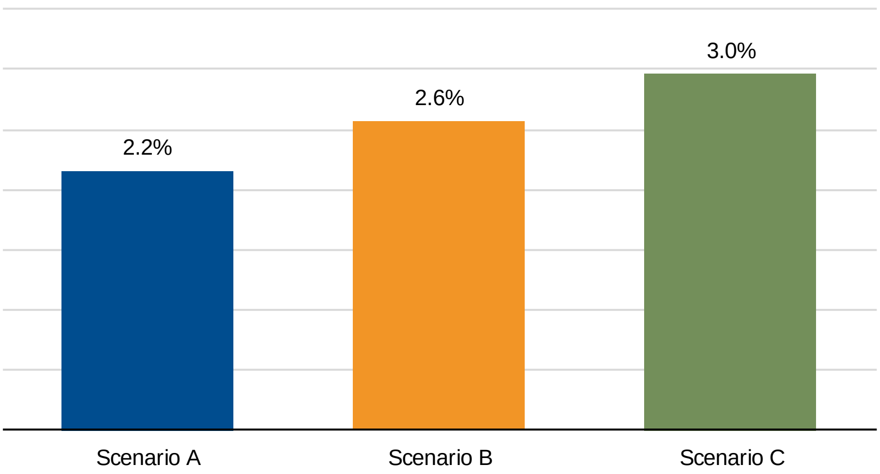
The aircraft is owned by DS 129, a closed-end fund launched in 2007 by fund provider Dr. Peters. After the 10-year lease agreement with Singapore Airlines expired, no subsequent lease agreement could be concluded and the fund was unable to sell the aircraft, so the fund's shareholders have decided to sell the A380 in parts (part-out).

Management of the fund has outlined three scenarios, with possible sale revenues of between USD 64m and USD 74m. Investors should receive their pay-outs in 2019 and 2020, following repayment of the remaining senior loans. In USD, the fund's trading currency, the cumulative distributions would be 128% (scenario A), 133% (scenario B) and 138% (scenario C), following an original commitment of 105%. The resulting returns are shown in figure 1.

Even the most pessimistic scenario presented by Dr. Peters should result in positive returns, however. Although expected returns are well below those anticipated at the time of the fund's launch (originally expected to be between 7% and 8% p.a.), investors are unlikely to suffer losses despite the negative developments. That said, the scenarios outlined are uncertain because no A380 has yet been sold in individual parts.

Secondary investors in closed-end funds are also reacting to the decision to part-out. The reduced uncertainty and the improved predictability regarding potential returns has resulted in increasing trading prices. Nevertheless, even with the spike in prices, fund shares continue to be traded at a high risk-discount. This shows that the market still lacks sufficient historical values to validate price estimates for A380 components.

Figure 1: Forecast returns (p.a.)* for DS 129 investors



Source: fund documentation; Presented by: Scope Analysis; As of: 15.07.2018

* The scenarios are calculated for USD-investors. For EUR-investors, returns would be above the values presented here because of the exchange rate development to date (see more on this below).

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Sale of components the only viable alternative

The first Airbus A380 lease agreement expired in October 2017. The aircraft is owned by the closed-end fund DS 129, issued by fund provider Dr. Peters in 2007. After the expiry of the 10-year lease, no subsequent lease agreement could be concluded for the aircraft.

Leasing of engines provisionally secures liquidity and debt service

However, the engines were leased to manufacturer Rolls Royce, so liquidity and scheduled debt repayments are secure for the time being. Nevertheless, this solution provided no cost-covering and therefore is not a long-term solution because of debt service yet to be performed on the bank loans.

The management of the fund had three options:

- Lease the A380 to an airline
- Sell the aircraft
- Sell the aircraft in individual parts (part-out)

According to Dr. Peters, no new lessee could be found at short notice; potential lessees either had no current demand for the A380 or were unable to present a convincing plan. It was also not possible to sell the aircraft.

Overwhelming majority of investors agree to part-out

The option to sell the aircraft in parts was presented to investors as the only viable alternative. DS 129 shareholders and those of its equally-affected sister fund agreed to part-out the A380 by overwhelming majorities (>99%).

The decision to part-out means the engine lease agreement with Rolls Royce will be extended until the end of 2020 under existing conditions, after which the engines will be sold. The rest of the A380's components are also expected to be sold by the end of 2020.

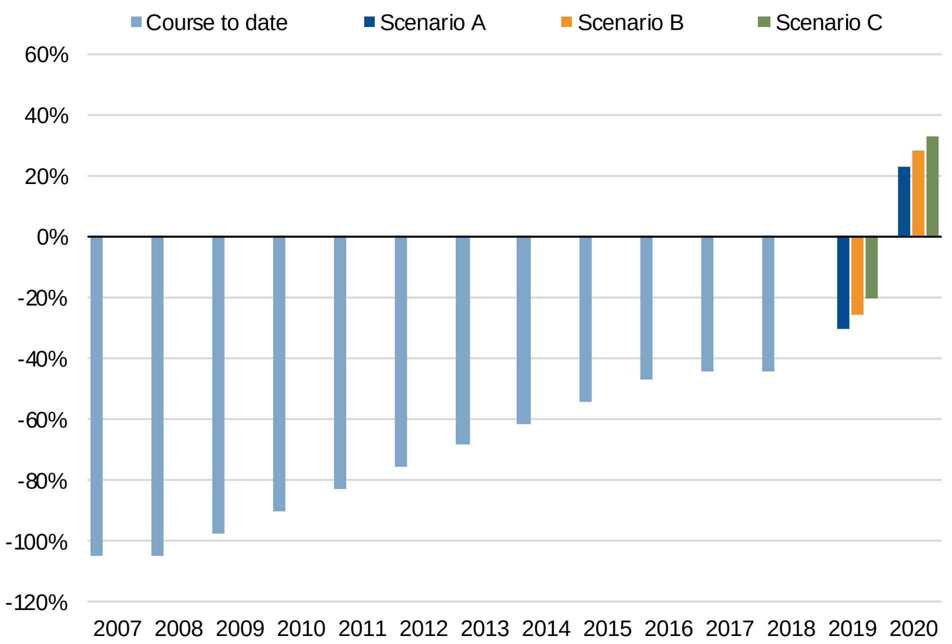
Three scenarios have been put forward

The fund's management has outlined three possible capital return scenarios:

- Scenario A: Sales revenues of USD 64m (USD 40m from the sale of components, in addition to 4 x USD 6m from the sale of the engines)
- Scenario B: Sales revenues of USD 69m (USD 45m from the sale of components, in addition to 4 x USD 6m from the sale of the engines)
- Scenario C: Sales revenues of USD 74m (USD 50m from the sale of components, in addition to 4 x USD 6m from the sale of the engines)

Investors are expected to receive the pay-outs from these sales in 2019 and 2020, which would result in the following for their capital accounts:

Figure 2: Idealised capital accounts for DS 129 investors (in USD)



Source: fund documentation; Presented by: Scope Analysis; As of: 15.07.2018

* The scenarios are presented for USD-investors. For EUR-investors, return scenarios would be above the values presented here because of the exchange rate development to date.

It is assumed that investors joined in 2007 and have paid the usual premium of five percent.

Up to and including 2016, the scheduled pay-out of 7.75% p.a. was made, after which it initially had to be reduced and then stopped because of the uncertainty surrounding what would happen after expiry of the lease agreement with Singapore Airlines.

Proceeds from the sale of the components and engines will initially be used to repay bank loans and then be distributed to investors following the senior loans' redemptions in 2019 and 2020.

Positive performance in all three scenarios

In USD – the fund's trading currency – the cumulative distributions would be 128% (scenario A), 133% (scenario B) and 138% (scenario C) following an original commitment of 105%. The resulting returns are shown in figure 1 above.

Even the most pessimistic scenario presented by Dr. Peters should result in positive returns. Although expected returns are well below those anticipated at the time of the fund's launch (originally expected to be between 7% and 8% p.a.), investors are unlikely to suffer losses – despite the negative developments. Nevertheless, the scenarios outlined remain uncertain because no A380 has yet been sold in individual parts. Additionally, the fund's term in all three scenarios has been reduced by four years compared with the originally planned term.

Exchange rate plays into the hands of Euro investors

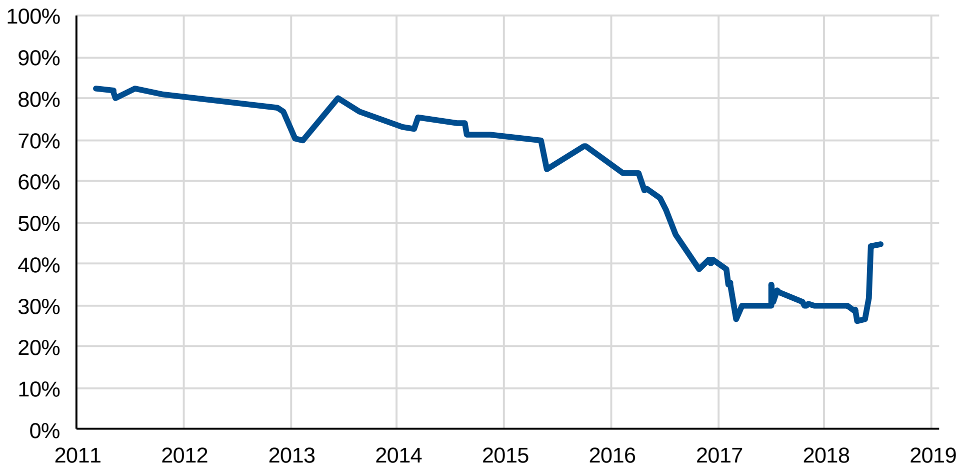
Exchange-rate developments have been a positive – at least for investors who switch their pay-outs into EUR. The weak Euro during the fund term has played into the hands of investors. In 2008, the average exchange rate was 1.47 EUR/USD. When this report was originally written (15 July 2018), it was 1.17. As a result, the actual returns from the three outlined scenarios will be higher for EUR investors.

Secondary market – "part-out" decision increases share prices

As expected, investors in closed-end fund secondaries are reacting to the decision to part-out. The reduced uncertainty as well as the improved predictability regarding potential returns and the remaining fund term is clearly reflected in the trading prices – see figure 3.

Although the secondary market is significantly less liquid (compared with securities exchanges), trading prices are a good indicator of uncertainty.

Figure 3: A380 fund historical price performance



Source: Fondsbörse Deutschland Beteiligungsmakler AG; Presented by: Scope Analysis; As of: 15.07.2018

Should the weakest (A) of the three scenarios occur (distributions of 14.5% in 2019 and 53.25% in 2020), secondary market investors could still expect a very high gross return even at an entry price of 45% in July 2018 (at the current level of around 20% p.a.).

Risk discount on shares remains high

Nevertheless, despite the spike in prices, fund shares continue to be traded at a high risk-discount. This shows that the market still lacks sufficient historical values to validly estimate possible prices for the A380 components.

Expert valuations of A380 falls further

The challenge presented by the lack of historical values concerns not only individual components but also the whole A380.

Figure 4 shows the forecast future base values of a significantly newer A380 built in 2014. (The part-out A380 mentioned in the rest of the report was already built in 2007).

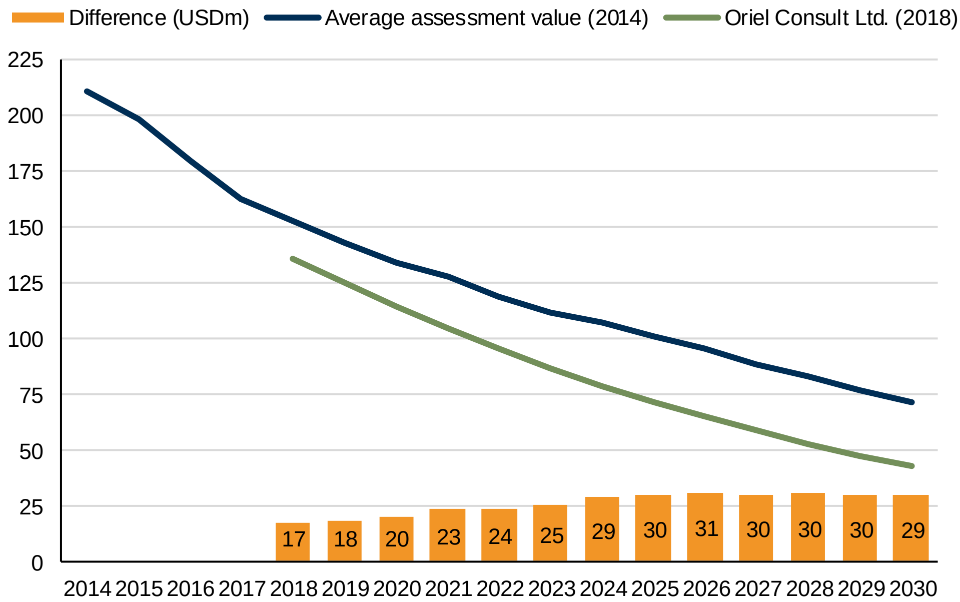
Current expert valuations of the A380 up to USD 30m below 2014 valuations

It shows that expert valuations have significantly fallen in the past four years, even though views on the A380 had turned gloomy by 2014 and there was a strong sense that the aircraft would not match original expectations. This was considered in the evaluations at the time. Expert assessments from 2007 would have assumed more positive developments.

The figure below shows both the average value from three assessments in 2014 as well as the current valuation for the same aircraft from July 2018. The bars show the differences between the two time series in USDm.

Assuming a typically-structured financing for this A380, equity capital of around USD 100m can be expected. The difference between the time series therefore shows a possible pay-out difference of up to 31% for investors in the event of the sale of the aircraft.

Figure 4: Difference between A380 valuations – 2014 versus 2018 (in USDm)



Source: Scope Analysis, ORIEL; Presented by: Scope Analysis; As of: 15.07.2018
Future Half-Life Base Values

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