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FINANCIAL TRENDS IN COMMERCIAL AVIATION

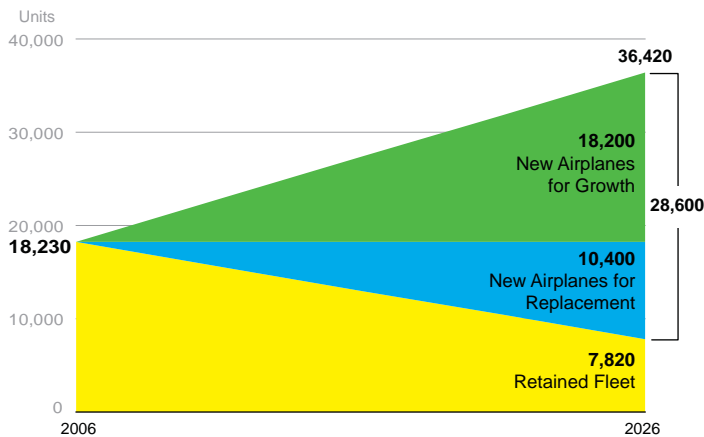
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Growing Demand and Fleet Renewal Generate \$2.8 Trillion in Financing Opportunities

Beneath this deceptively familiar headline, Boeing unveils the 2007 Current Market Outlook. As in previous forecasts, we project that demand for air transport will continue strong. Over the next 20 years, passenger traffic will rise 5% per year as air cargo traffic rises 6.1% per year, creating a need for 28,600 new airplane deliveries. Fanned by the rapid development of markets in the Asia-Pacific region and supported by a looming need to replace older airplanes, this requirement for new airplanes represents \$2.8 trillion dollars worth of financing opportunities.

Requirement for 28,600 New Airplanes



High fuel prices encourage airlines to replace older airplanes with new, more efficient airplanes. An additional 18,200 airplanes will be needed to support growing air transport demand.

An understanding of the drivers behind these overall market figures is essential, not only to guide strategic business decisions at Boeing, but to help our airline customers plan their fleets, and to help aircraft financiers and investors evaluate and manage economic risk.

Boeing spends a great deal of time analyzing geopolitical and economic volatility and its impact on our business. Yet, looking back over the past 20 years, we see that air traffic grew at an average annual rate of 4.8%, increasing by a factor of 2.5 – despite several recessions, the 1991 gulf war, the Asian currency crisis, the downturn after the September 11 attacks, and the SARS epidemic.

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Diversifying Airplane Market Moderates Investment Risk

By Walt Skowronski

This is the time of year when Boeing publishes its annual Current Market Outlook. Our airline customers use this analysis to assess future demand and to evolve their strategies. Our aircraft financier customers use the same information to evaluate their portfolios and to appropriately adjust their risk management strategies.

Liberalization of airline markets, rapidly developing economies in Asia, and great global liquidity are all driving unprecedented global aircraft demand. The diversification of the global fleet and demand should be a moderating influence on the cyclical nature of the aviation industry. Of course, liberalization also brings increased competition, which encourages airlines to develop innovative business strategies. The aviation industry will likely gain stability as the spectrum of airline business models becomes broader and more diverse.



Walter E. Skowronski
President, Boeing Capital Corporation

The diversification of airplane demand makes the world's most mobile asset even more mobile. Rapid economic growth in the Asia-Pacific region, as well as in the Commonwealth of Independent States, Middle East, Latin America and Africa, should smooth out the peaks and valleys of demand that affect individual regions.

Airplanes are good investments, but the best investment is an airplane that is designed to hold its long-term value by taking maximum advantage of the diversifying market. The recently introduced 737-900ER is a prime example. Lion Air, based in Jakarta, Indonesia, has ordered 60 of the newest member of the 737 family to serve its extensive domestic route structure, connecting the islands of Indonesia and reaching out to Singapore and Malaysia.

Yet the 737-900ER's excellent fuel economy and greater passenger capacity make it equally attractive to a broad range of operators across the globe. For instance, the 737-900ER's range and ability to carry 31 more passengers than the highly successful 737-800 make the -900ER the ideal replacement for older airplanes, such as the 757, that are currently flying U.S. domestic routes. This level of flexibility makes the 737-900ER a valuable asset in airline fleets anywhere in the world, keeping long-term asset values high and providing investors with a large pool of potential resale or leasing customers. ■

Capital Markets Validate the New 737-900ER

Delivery of the first of 60 Boeing Next-Generation 737-900ER (Extended Range) airplanes to launch customer Lion Air in April validated Boeing's single-aisle product strategy and underscored the importance of asset-based airplane financing.

Lion Air benefited from aggressive competition among aircraft financiers, including investors and lessors, anxious for the opportunity to underwrite the acquisition and do sale/lease-back transactions. HSH Nordbank won the mandate to finance the first deliveries of this new member of the 737 family.

The first U.S. deliveries will be to Continental Airlines, which will receive 27 of the new models beginning in January 2008. The Continental orders are financed in capital markets through the issuance of a \$1.15 billion Enhanced Equipment Trust Certificate (EETC). This unwrapped EETC, a capital debt financing structure that takes into account the risk associated with both the aircraft and the borrower, generated very competitive terms and pricing that clearly demonstrated the market's enthusiasm for the new airplane product.



Through May 2007, the 737-900ER has garnered 169 firm orders from eight customers. Thanks to an 8.7-foot (2.7m) stretch, the 737-900ER carries up to 220 passengers in a single-class configuration and is able to serve most of the same routes as the 737-800. The option of adding either one or two auxiliary fuel tanks can extend the 737-900ER's range to 3,200 nautical miles (5,925 km).

"It's a 737-800 on steroids," said Kostya Zolotusky, managing director of Capital Markets Development for Boeing Capital Corporation. "The airplane has similar range and economics to the -800, but with some 31 additional seats, the -900ER offers a significant revenue upside."

Both airlines and financiers appreciate the high degree of commonality among members of the Next-Generation 737 family. From the standpoint of crew training, airplane maintenance and spare parts, the new 737-900ER is virtually the same airplane as the other three members of the current 737 family.

737-900ER Investor's Checklist

- ☑ Breadth of customers and base
- ☑ 737 family commonality
- ☑ Easy to reconfigure, transition to other operators
- ☑ Ideal complement to 737-800
- ☑ 737-800 range and economics with significant revenue upside
- ☑ Potential 757 replacement
- ☑ Large remarketing customer pool
- ☑ Perfect for the low-cost airline business model
- ☑ Applicable to multi-class and high-density models
- ☑ Strong residual values
- ☑ Ideal replacement for older single-aisle airplanes

This commonality means lower total operating costs for airlines and a large global pool of potential remarketing customers. More than 100 current operators of the 737-800 would be logical candidates to take advantage of the 737-900ER's economics, range and larger size.

Current operators of the Boeing 757 represent an additional potential market for the 737-900ER. Today, only about 3% of 757 flights make use of the 757's ability to fly beyond the 737-900ER's range of 3,230 nautical miles. In fact, all domestic U.S. routes that the 757 currently flies are within the range of the 737-900ER. The 737-900ER's operating cost advantage makes it a strong candidate to fly those routes. Moreover, the 757 makes an excellent standard-body freighter and, as pressure grows to convert 757s from passenger to freighter service, the 737-900ER, with nearly the same passenger payload as the 757, is the obvious replacement.

Instrumental in the evolution of the low-cost airline business model, the 737-800 is the gold standard of single-aisle jetliners. The new 737-900ER is the 737-800's ideal complement. With excellent trip costs and unbeatable seat-mile costs, the 737-900ER offers airlines and financiers a low-risk, economical way to meet growing demand. The large and successful installed base of 737 jetliners and the looming requirements to replace older single-aisle airplanes makes the 737-900ER a valuable asset in an aviation

GoldCare Flexes its Service

Boeing has expanded its offerings for the 787 GoldCare lifecycle support service, reflecting customer feedback for increased flexibility. The new offerings all offer GoldCare's signature benefits of maximizing airplane availability while maintaining airplane values, lowering costs and delivering predictable per-flight-hour pricing. The four new service offerings include GoldCare:

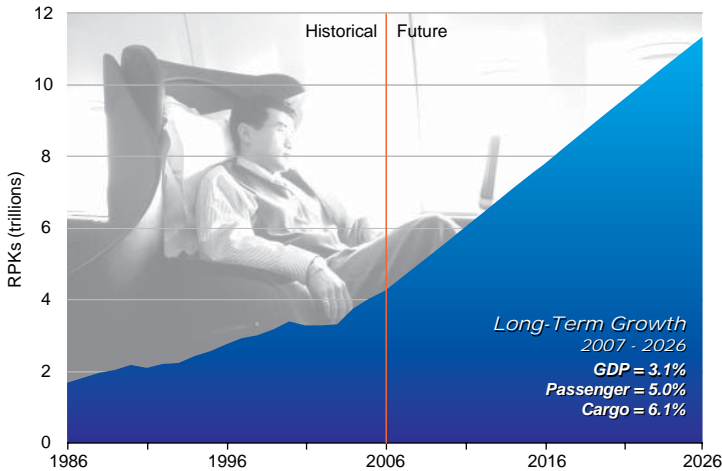
- Enterprise – a lifecycle management solution including Planning & Control, Engineering and Material Management services and scheduled maintenance
- Planning & Control – managing scheduling and including GoldCare Engineering
- Engineering – managing maintenance, reliability and configuration programs
- Material Management – integrated spares supply chain service, including repair and overhaul of components. ■

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Though we are unable to predict all the challenges that will crop up during the next 20 years, we can project with some confidence that, on average, air traffic will grow at an annual rate of 5.0%, driven by 3.1% growth of the global economy. At this rate, the number of revenue passenger kilometers flown will nearly triple by 2026.

Several developments will help financiers manage economic risk during the next 20 years. First, the airplane market is becoming more diverse geographically.

Strong Air Transport Demand Reflects Economic Growth



Despite several recessions, the 1991 Gulf War, the Asian currency crisis, the downturn after the September 11 attacks, and the SARS epidemic, air traffic growth reflected world economic growth during the past 20 years. The trend will continue during the next 20 years despite any unpredictable temporary reversals that will occur.

Consistent with this development, this year's forecast includes the fleet of the Commonwealth of Independent States for the first time. Inclusion of the CIS fleet contributes to the increased projection for passenger fleet, freighter fleet, and total fleet numbers for this year, compared to last year's report.

Fueling the diversification of the market is the Asia-Pacific region, which will become a third major presence, alongside traditional market giants North America and Europe. Together, the three regions will account for more than 80% of airplane delivery value over the next 20 years, with about a third going to Asia-Pacific and a quarter each to North America and Europe, including the CIS. The important Middle East market, and rapidly growing Latin America and Africa markets, though small compared to the top three markets, will account for 15% of the delivery dollars through 2026. This diversity of demand presents more opportunities for airplane owners to place airplane assets in the event of a regional downturn.

Second, global liberalization is driving the evolution of airline business models. A wider diversity of business strategies will allow the industry as a whole to withstand a downturn that affects primarily one airline type.

Third, a very large and rapidly growing global fleet will require a continuous replacement of older airplanes. Roughly 35% of the demand for new airplanes will come from replacement of older airplanes. Replacing older airplanes with new, fuel-efficient airplanes, such as the 787, will help airlines and the industry meet future environmental standards and regulations.

Several market forces will remain stable. The majority of low-cost carriers will continue to rely primarily on single-aisle airplanes. Low-cost carriers in short-haul markets will generate 37% of the world's demand for new airplanes.

Global and broad network carriers will generate 54% of the demand for new airplanes. Network carriers will continue to rely on mid-size twin-aisle airplanes for long-haul service, both to increase frequency and expand nonstop service to new markets. Particularly within Asia, mid-size twin-aisle jets will augment service on high-density routes currently served by larger airplanes. Together, single- and twin-aisle airplanes in the 100- to 400-seat categories will account for almost all of the growth over the next 20 years. Boeing product strategy emphasizes this rapidly growing sector, while continuing to recognize the important replacement market for airplanes above 400 seats.

Air cargo carriers will continue to operate about 11% of the world airplane fleet, as the freighter fleet doubles in size from 1,980 freighters to 3,980 freighters during the next 20 years. About three quarters of the freighters will be converted from passenger and combi airplanes. The 870 projected new production freighters delivered during the period will be valued at nearly \$200 billion.

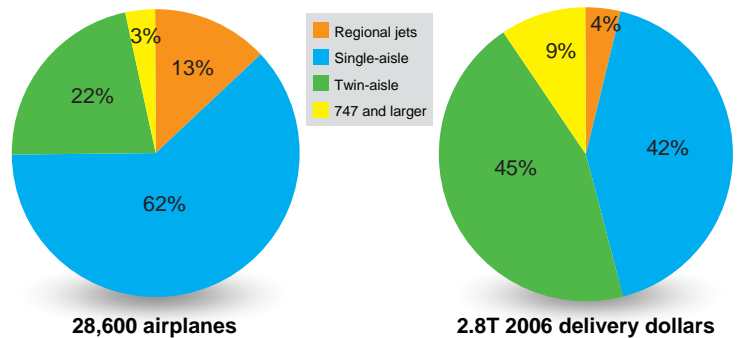
About 61% of the air cargo fleet additions will be widebody airplanes. Many operators, particularly express carriers, tend to replace retiring standard-body freighters with widebody airplanes, which will contribute to an increase in widebody share, from 58% today to 64% in 2026.

Air traffic growth rates will vary from region to region, with the rapidly expanding economies of the Asia-Pacific region leading the established economies of North America and Europe.

Airlines purchase airplanes in response to specific market demands. In Europe, where air traffic growth will average 4.6% per year, a proliferation of long-haul frequencies to Asia and across the Atlantic will drive twin-aisle airplanes to rise from a 15% share to a 20% share of the European fleet. Continued rise of low-cost carriers, flying short distances within Europe, will give single-aisle airplanes the largest share of new airplane orders.

In the Asia-Pacific region, where the air traffic growth rate ex-

Requirement Share by Airplane Category



Single-aisle airplanes dominate deliveries, while twin-aisle airplanes claim the largest investment share. Together, single-aisle and twin-aisle airplanes represent 84% of the new airplane requirement and 87% of the investment value.

ceeds the world average, the largest and fastest growing segment of the market comprises the routes within the region. This includes the domestic China market, which is projected to exceed the world

Noteworthy Developments

Boeing Program Update:

787:

- Boeing announces 787 rollout for July 8, 2007, with first flight in late August/September and first delivery to ANA in May 2008
- 787 assembly line opens in Everett following deliveries of first major assembly sections
- Systems integration begins in Seattle
- 787's GEnx engine logs more than 100 flight hours

777:

- 777 freighter reaches 50 percent design completion
- 777 fleet reaches 1 million flights under ETOPS rules
- 777-200LR marks first year in revenue service

747:

- 747 program surpasses 1,500 orders

737:

- Boeing 737-900ER receives FAA certification
- Boeing delivers first 737-900ER to launch customer Lion Air

CAS:

- GOL, Southwest, Caribbean Airlines, Turkish Airlines order Maintenance Performance Toolbox
- Boeing opens new Integrated Materials Management center in Singapore; Nippon Cargo signs for IMM spare parts program

Airplane Orders:

Recent order announcements since March 12, 2007, include:

- **787s:** Virgin Atlantic (15-787s), Air Canada (23-787s, 23 options), Moscow's S7 Group (15-787-8s), Royal Jordanian (2-787-8s, 2 options), JAL (5-787-8s), LCAL (1-787-9 previously unidentified), Avianca Airlines (10-787s previously unidentified), Czech Travel Service (1-787, 1 purchase right), ALAFCO (12-787-8s, 6-787-8 purchase rights), Continental (5-787-9s), Europe's TUI Group (11-787s previously unidentified), Aviation Capital (5-787s previously unidentified), Arik Air (3-787-9s), First Choice (4-787-8 options exercised)
- **777s:** Virgin Blue (6-777-300ERs, 6 options, 1 lease), Oak Hill Capital Partners (6-777 Freighters), Nigeria's Arik Air (2-777-300ERs, 2-777-200LRs), British Airways (4-777-200ERs), Philippine Airlines (4-777-300ERs)
- **747s:** Cargolux (3-747-8 freighters, 2 options, 10 purchase rights), Volga-Dnepr (5-747-8 freighters, 5 purchase rights previously unidentified)
- **737s:** Ryanair (27-737s), AirTran (15-737-700s), Panama's Copa Airlines (4-737-800s), SpiceJet (10-737NGs), Russia's S7 Group (10-737-800s previously unidentified, 10 purchase rights), CIT Aerospace (5-737-700s), Sky Europe (5-737-700 options exercised), ALAFCO (6-737-800s, 6 purchase rights), TUI Group (50-737NGs previously unidentified), Virgin Blue (5-737-800s previously unidentified), Aviation Capital (15-737NGs), Alaska (1-737-800), Southwest (2-737-700s)
- **BBJs:** One 787 VIP plane from Hong Kong real estate tycoon Joseph Lau, one 737 BBJ from European private jet company Ocean Sky

average to grow at an annual rate of almost 9%.

A strong and growing global economy will drive vibrant growth in the aviation industry over the next 20 years. Liberalization of markets and the establishment of new international financing structures will enhance the liquidity of airplane assets and provide new ways to manage economic risk effectively.

Boeing Capital Corporation is actively engaged with industry organizations working to enhance the commercial airplane financing environment. We're dedicated to bringing airplane investors and financiers together with airline customers to facilitate all types of airplane transactions, including sales, leases, title transfers, and airplane upgrades and conversions. ■



Celebrating the "grand opening" of its 787 final assembly facility in Everett, Wash., Boeing workers assemble the 787's very large composite structures using portable tools rather than traditional monuments and overhead cranes.

Please direct questions or feedback to the following:

Drew Magill, Director - Marketing
Boeing Commercial Airplanes
206-766-2109

Kostya Zolotusky, Managing Director
Capital Markets Development
Boeing Capital Corporation
425-965-4053

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