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Update Friday Tanker meetings

From: Gordon, Robert W
Sent: Saturday, April 27, 2002 1:29 PM
To: Palmer, James F
Cc: Simons, Randall R
Subject: Update: Friday Tanker meetings

Jim,

This may be a one-martini memo for you. I'll keep it short and address events in sequence rather than importance. I am copying this to Randy so he can correct any errors or add more color.

1. 7:00am met with the A&M team to review strategy for the day. Spong, Simons, Ferguson, Gower, Sams. A) reviewed chart showing Darleen the five open issues which negatively impact a successful financing. The importance of the fifth issue, impact of Munitions List on residual value is agreed to by all. B) Tanker pricing of $154mm v.s. USAF counter offer of $88mm. C) the negative influence of Babcock & Brown.

2. the 8:30am private meeting with Darleen which was to proceed the 10:00am formal review was canceled.

3. 10:00am 3-hour presentation to Darleen to review the status of the IPT negotiations. Meeting was generally constructive. Darleen understood the outstanding issues and encouraged the IPT team to press on. She did not reveal her thoughts on the tanker pricing gap, but merely inquired about the nature of the gap in the mod pricing. The handshake agreement date has slipped to May 17. Good discussion on Munitions List particularly with the presence of Gen. Essex's senior staffer who came up with possible ways to address State Dept. concerns. (A&M still doubtful). Darleen assigned each of the many outstanding issues to specific senior USAF personnel. Babcock & Brown was able to insert one offensive comment: "in a few days we will present financing alternatives which will save the USAF money" Translation: SSMB is not as good as B&B therefore delay any decisons. It is interesting to note that since we have not discussed pricing with the USAF how B&B can save them money.

4. At the conclusion of the 10:00am meeting Darleen asked for a private meeting with B&B. We presumed she wanted to tell them to stay "in the box." Following that meeting she wanted to meet privately with A&M.

5. At the end of the day I met with Randy, Gower, and Sams for a debrief of the private meeting with Darleen:

a) Darleen has assigned the financing of the 4 x BBJ's to Babcock & Brown. BCC will not attend the Darleen meeting in Long Beach next Weds.

b) Darleen needs a 10-year lease for political cover. She apparently understands this may not be the best business case. She clearly does not yet appreciate the huge impact on the purchase option price or the fact that equity investors will not be covered by residual value i.e. money will not be attracted. At this point I am fairly certain that B&B has had a hand in this, and that their "better" deal will be to force Boeing to take on a large RVG (that is only my asumption).

I have asked SSMB to develop 10-year alternatives. The first and best idea will be to reinsert into the term sheet our original idea of a 6 + 4 lease with renewal subject to Congressional approval. We originally thought that was a good idea, and certainly gives the USAF attractive pricing and low purchase option. However, this may not give her enough political coverage. This weekend we are creating financial models for a straight ten year lease, but as you know, we have only certain variables to work with, and as we improve one of them we have a negative impact on others.

The two memos below between me and SSMB are merely the initial thinking of how we begin to structure the 10-year models.

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On Tuesaday I am meeting with Jill Richling and accountants to discuss BCC's possible equity investment in the lease. I eventually will want a written opinion from Jill and/or Deloitte that our investment will not force the entire transaction on to our balance sheet.

On Wednesday I will be in Renton for a meeting on Residual Value. Steve Novak and a group from BCA and BCA Trading will help us through this issue. After we complete our internal analysis we will eventually need a third-party appraisal to support the bonds. We also need an internal estimate before we go the rating agencies for an initial meeting.

On Thursday SSMB and I will be back in D.C.

Bob

-----Original Message-----
From: Gordon, Robert W
Sent: Saturday, April 27, 2002 10:55 AM
To: 'GPL Mail'; Gordon, Robert W; Dillon Thomas F; Roy Chandran; Roy Chandran; Frank Mora; Glover, Ronald J
Cc: Sams, James R; House, Jack M; Gower, Bob
Subject: RE: 10 year lease

Greg,

Thanks for your thoughts. Here are my initial reactions:

1. We definetly need to pursue the 6 + 4 option since it represents the best business case, is best for the taxpayer, provides the lowest purchase option to the USAF, and may provide Darleen with the political cover she apparently needs.

2. The 10 year deal with high-low rent payments needs to be pursued, but we do need to show the USAF something. I have the following concerns with what you described below:

a) lowering the return on the equity to 10% pre tax destroys shareholder value for Boeing and presumably the other equity investors. My marching orders are to at least keep our shareholders neutral. 10% effectively has the same result as lowering the price on the planes, and, given the current pricing discussions, it doesn't look like we will have much excess profit margin.

b) If the equity and Tranche A investors will see a FMV insufficient to cover their positions, I believe that will be a non-starter. Furthermore, even if Boeing were to accept the equity risk of being under-collarteralized, I suspect the post-Enron accounting industry will have additional ammunition to make us put the entire transaction on our balance sheet (I am meeting with our accountants on Tuesday).

I am at home most of the weekend (310) 544-2700. But you and your team deserve 48 hours of R&R. Call me any time or we can schedule something for first thing Monday morning.

Bob

-----Original Message-----
From: GPL Mail [mailto:g.plee@bellatlantic.net]

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Update Friday Tanker meetings

Sent: Saturday, April 27, 2002 6:37 AM
To: Robert Gordon; Thomas Dillon; Roy Chandran; Roy Chandran; Frank Mora; Ronald Glover
Subject: 10 year lease

Bob, I received your message. I am very sorry about the BBJ and I agree that the decision to use B&B on that transaction will impact the Tanker program in a negative way.

Regarding Ms. Druyen's request for a 10 yr lease, do you think that the 6 plus 4 year renewal (with the legislative authority as a cp) will not fly? Perhaps we need to show the economics of that case, which is the most efficient and which will have the lowest effective rate for her.

Alternatively, do you think that we could simply have a 10 year lease in which the rent is approx. $26 mm (in arrears) for the first 6 years and then 0 thereafter? We have run some cases in which the rent is dramatically High-Low, with $32 mm rent in the first years declining in the last 4 yrs to $6 mm and lower. Even if this is acceptable, the problem with these scenarios is that in order to make them work, (1) the equity will need to accept much lower returns (10%) and (2) the equity will still need to accept a residual value exposure which will undercollateralized by the expected FMV of the aircraft. In addition, the compulsion for purchase is weakened since the PO at the end of the lease will be much larger than 1.5 or 2 x the last year's rent.

If we can credibly use a much higher FMV curve than that of 767 freighter, then perhaps the PO exposure may be marketable.

Of course, during our marketing effort on the equity, we will be pressing for targeted returns of 10% or less, but this approach will probably require much higher reliance on Boeing and GE/UT than the market.

Frank, please take a look at the model i have attached. I used an arrears payment assumption and layed out four or five scenarios of 10 year rent paying down class G, A, and equity.

I can be reached on my cell phone 917 660 2486 or at gregorypleee@mac.com. My blackberry doesn't seem to work down here. I can also be reached at 561 582 2800 room 1621.

thanks

Greg