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1. Welcome

Capital Aviation was founded in 2011 as an aviation advisory and service company with a vision of acquiring its own fleet of commercial aircraft to lease to airlines worldwide. Since 2010 new lessors have emerge and flourished as the demand for aircraft leasing continues to grow. As aircraft orders and deliveries continue to rise to record levels and passenger growth continues to steadily increase, lessors are playing an even greater role in the aviation community. We are excited to be in a position to take advantage of the current global aviation environment and invite you to connect with us through our website at www.capitalaviation.net or email us at info@capitalaviation.net. I look forward to having you on board!

Ryan Sullivan,
Managing Director, Capital Aviation

Ryan Sullivan has been involved in the Aviation Industry for 19 years, has been trading aircraft for over 10 years and is a member of the International Society of Transport Aircraft Traders (ISTAT). Ryan has a wide industry experience as an aircraft owner and operator, holds an MBA (Finance) as well as being a qualified and experienced Airbus A320 airline captain. Ryan has had various roles in aircraft sales and management in general aviation, VIP flight operations, LCCs and legacy airlines prior to co-founding Capital Aviation.

As Managing Director of Capital Aviation, Ryan is responsible for sourcing new deals and maintaining ongoing client relationships. He is also responsible for delivering financing pipelines and funding strategies in order to achieve planned growth.

Frank Rehrl
Commercial Director

Frank Rehrl has over 30 years aviation industry experience and over 35 years’ experience as a company director. Within aviation, he has worked in a variety of roles. These roles include Chief Pilot, head of training and standards, as well as senior executive roles for an airline, aircraft maintenance workshop, service and flight planning provider and aircraft management firms.

As Co-Founder and Commercial Director, Frank is responsible for the asset life cycle including pre purchase activities, ongoing management, return from lease and redeployment. Frank also monitors the portfolio risk and balance and sets portfolio management criteria. Frank is a member of the International Society of Transport Aircraft Traders (ISTAT). In addition to aviation, Frank has been Director of various companies including building, property, lubricant manufacturing, advertising and an engineering business.
2. Opportunity

In January this year Airbus delivered the first new generation A320 NEO to Lufthansa and Boeing’s latest version of the 737, the 737 MAX flew for the first time. Deliveries of the Boeing 737 Max are scheduled for the second half of 2017 with Southwest airlines the launch customer.

Despite the current low cost of jet fuel, commercial aviation has not wavered in its growing demand for new and more efficient aircraft resulting in record orders and backlogs for single aisle jets. This trend is no longer being driven by airlines trying to reduce their largest expense, fuel, but by an ever expanding middle class wishing to travel by air. Lower fuel prices, however, do translate into lower ticket prices, which in turn further stimulates demand for air travel and in turn new aircraft. The investment backdrop remains strong as manufacturers slightly increase production rates of new aircraft in an effort to meet demand and reduce their record order backlogs.

The current backlog in Asia-Pacific will provide lessors opportunities for the next 7 years. With such strong growth contained in one geographical region, this opens the door for new lessors without increasing competition or diminishing returns, as lessors will not over expose themselves to any single region or airline.

As rates in many nations are at or near zero, while some are even negative, aircraft leasing offers investors the opportunity to generate yields which are unavailable in other asset classes without compromising risk. Aircraft leasing investments can offer greater yield and lower risk compared to airline issued bonds, as lessors invest into a pool of different aircraft operated by different airlines spread over a diverse geographical area.

Since the sub-prime crisis in 2007, private equity has been quick to respond to the opportunities created by rapidly expanding demand for new aircraft. PE firms were quick to explore these investment opportunities and have established themselves in the market and generated superior returns for investors. Avolon is backed by Cinven, CVC, GIC and Oak Hill. Oaktree funded Jackson Square Aviation’s start up, Carlyle’s invested in RPK, Cerberus Capital invested in AerCap, and Terra Firma’s investment in AWAS have all enjoyed strong returns and in many cases greatly increased their investment or exited and made large returns. Traditionally conservative banks in Australia are now participating in aircraft finance with the Commonwealth Bank of Australia being the largest shareholder in Air Lease Corp.

In 2011 and 2012, three new lessors entered the market, Air Lease Corp, Avolon and Jackson Square Aviation. During the last 5 years they have amassed a combined fleet of 527 aircraft worth $18.7 Bn (as of Dec 2015).

For some of the traditional aviation Banks and Export Credit Agencies (ECA) lending is now constrained due to Basel III banking regulations which came into effect in 2013. The Capital market has been quick to fill this space and fund over 50% of all new aircraft deliveries. Investors are attracted by stable asset backed investments, with strong returns. We see this trend continuing as demand grows and manufacturers increase production to fulfil record order backlogs. We estimate that at least $10 Bn in new funding sources will be required yearly for the short to medium term.

As some of the traditional European banks have reduced lending, banks from Australia, China, Japan and Korea have entered the market. With an increasing diversity of commercial banks competing to fund aircraft deliveries and strong participation from the capital markets, we believe this can only enhance our business, rather than having to compete for finance with existing lessors in the small pool of traditional aircraft financing community.

Aircraft leases provide investors with fixed incomes for long periods, providing stable returns which are not dependent on greater market forces. The assets are maintained by the lessee throughout the lease period and are subject to a strict regulatory environment which serves to protect the value of the asset. This in turn enables us to accurately predict future values and forecast long term returns.

**Why Invest in Aircraft Leasing?**

- Truly global and mobile assets
- Stable cash flow backed by long term contracts
- Efficiently deploys large amounts of capital
- Predictable long term returns based on forecast future values
- Highly regulated industry keeping assets maintained
- Assets secured through international laws and treaties
- Low volatility compared to listed equities
- Geographically diversified investments

www.capitalaviation.net/invest
3. Summary

This document provides general information and our views on the aircraft leasing industry. The information contained throughout includes opinions, recent developments, historical data and the market outlook according to Capital Aviation, the International Bureau of Aviation (IBA), Airbus, Boeing and the International Civil Aviation Organisation (ICAO) amongst others. It is our view that the aircraft leasing industry provides a low risk opportunity to invest in the growth of global air travel and demand for commercial aircraft, while benefiting from the security of aircraft asset ownership.

Growing Aircraft Leasing Trend
Currently there are approximately 11,000 commercial aircraft leased worldwide, up from approximately 3700 aircraft in 2000. Leasing is predicted to account for 50% of aircraft by 2020, up from 35% in 2014.

Long term Demand for Air Travel
Air travel has grown at 6% p.a. since 2010 and averaged over 5% p.a. since the beginning of the industry. This growth has continued despite wars, terrorist attacks and recessions. Growth is predicted to continue at or near historic rates for the next 20 years.

Improving Market Conditions
Lease yields are improving, especially for used narrow body jet aircraft. In addition, new aircraft average initial lease durations are extending, further improving long term yields, while aircraft values remain relatively steady.

Secure Industry
Well managed aircraft leasing companies, underpinned by stable aircraft assets, have a track record of consistent profitability even in bear markets.

4. Attractive Fundamentals

The aviation market is a global growth industry that has historically doubled every 15 years. This trend is forecasted to continue over the next 15 years between 2015 and 2030. For over 30 years air travel has grown at an annual compounding growth rate of over 5%, despite world economic and political events. Aviation has weathered economic downturns in the past and recovery has followed quickly. Between 2010 and 2015 annual growth was 6.0% outperforming the historical trend by 20%.

Revenue Passenger Kilometres (trillion)

During the last 40 years there has only been three periods of negative growth, however the industry has reliably returned to its long-term growth rate of over 5% per annum. It is anticipated that this trend will continue long term.

Capital Aviation predicts the market will double again in the next 15 years. According to Airbus “Flying on Demand” 2014-2033 forecast, the expectation is that world air traffic will grow at an average of 4.7% annually, with a 5.2% average annual increase in the first decade and a 4.2% average growth for the second.

Source: ICAO (RPK, Revenue Passenger Kilometers)
As the growing population in the emerging markets take to the skies, the outlook ahead is positive. Boeing predict that China will overtake North America and Europe to become the largest travel market with average growth of 6.6% for the next 20 years. Both Airbus and Boeing forecast air travel to continue to grow at or near historic rates. Boeing predicts airline passenger traffic to grow at 4.9% per annum from 2015-2034, while air cargo traffic will grow at 4.7% over the same period. Airbus predicts similar growth with revenue passenger kilometres doubling within the next 15 years.

4.1. Demand for Aircraft

The continued passenger growth forecast is favorable for aircraft demand long term. Airbus predicts the forecast growth over the next 20 years will double the current commercial aircraft fleet and 32,585 new aircraft worth US$4.9t will be required. Over the same period Boeing’s prediction is that 38,050 new commercial aircraft will be produced, worth US$5.6t.
4.2. Limited Aircraft Supply

Aircraft Production (annual, Airbus and Boeing)

Demand is strong and waiting periods are long for the most common and desirable aircraft, the Airbus A320 and Boeing 737 series aircraft. This is especially so over the next few years, despite both manufacturers increasing production rates. With such robust growth in the airline industry combined with fleet replacements, we see production of 1500+ aircraft per annum in line with current demand.

Source: Airbus and Boeing

4.3. Increasing Passenger Load Factor

Airline passenger traffic sustained growth at just above 6% between 2010 and 2015, despite years of weak global GDP growth. Airlines have been able to increase productivity through increasing passenger load factor combined with high aircraft utilisation.

Source: ICAO & IATA
4.4. Declining Storage Rates

Storage rates have been steadily decreasing since the peak in 2009. While storage rates are not an exact measure of lease rates and lease demand, they are a useful indicator of the overall strength of the airline industry.

% of Western Built Commercial Aircraft in Storage

Source: IBA

5. Record Aircraft Order Backlog

With continued passenger growth, changing technologies and long lead times on new aircraft, airlines need to plan their future fleet requirements years in advance. With the growth of low cost carriers (LCCs), increasing air travel in the emerging markets and China, the introduction of new fuel efficient aircraft and aging fleets in the mature markets of Europe and America, the demand for new aircraft has never been so strong.

As of December 31, 2015 Boeing and Airbus had a combined unfilled order backlog of 12,626 aircraft. This record number of orders based on 2015 delivery numbers equates to just over 9 year of production. Although this is down from the peak of 9.2 years in 2012, the total number of aircraft in the backlog has increased. Production over the same period has increased by 17.5% which has caused the backlog in years of production to stabilise.

Source: CAPA, Airbus and Boeing
5.1. Ageing Aircraft Fleets

Growth in demand for new aircraft is supported by the ageing worldwide aircraft fleet, particularly in the largest travel market of North America. Currently about ⅓ of North American aircraft are older than 20 years. The typical age for aircraft retirement is 25 years so replacements will start to increase over the coming years.

Record Aircraft Order Backlog

Despite lower than average growth rates in the established aviation markets of Europe and America, their requirement for new aircraft is still very strong. Currently 45% of the commercial aircraft order backlog belongs to Europe and America as they plan to replace their ageing fleets with new aircraft. Recently the airline industry in these mature markets has undergone consolidation and now focus has shifted to their fleet replacement needs.
5.2. Secure Industry
The aircraft leasing industry has shown incredible resilience to the prevailing market forces. Furthermore, aircraft leasing has consistently demonstrated resilience to the financial performance of the airline industry. Lessors remained profitable as the global airline industry posted losses of almost US$30 billion in 2008 and 2009.

Returns from aircraft leasing have consistently outperformed all market indices, significantly outperforming them between 2006 and 2015 as shown below.

5.3. Increasing Trend Towards Leasing
Since the 1980's, Aircraft leasing has continued to grow in popularity, accounting for more than ½ of today's commercial aircraft. It is expected that half of all commercial aircraft will be owned by lessors before the end of the decade. In 1981 less than 150 aircraft were owned by lessors. This number has grown to approximately 11,000 in 2014, a 60 fold increase. The number of leased aircraft is expected to double within 15 years.

Source: Boeing
6. Improving Lease Rates

Aircraft are valuable, mobile, long life assets. Aircraft lease rates declined in 2008/2009 but have recovered quickly. Some aircraft have already returned to pre 2008 levels. Lease rates are directly related to aircraft values and interest rates, so despite declining lease rates, yields have remained stable or have increased as a result of the low interest rate environment.

**Lease Rates for Constant Age Narrow Body Aircraft Per US$100,000 / 12mo LIBOR**

Source: IBA and Capital Aviation Research

**Lease Rates for Constant Age Wide Body Aircraft Per US$100,000 / 12mo LIBOR**

Source: IBA and Capital Aviation Research
7. Aircraft Leasing

Lessors gain access to aircraft through direct orders with manufacturers and subsequently enter into a lease agreement with an airline. Another common transaction is the “sale and leaseback” where leasing companies buy aircraft directly from airlines, and the airline leases the aircraft back from the lessor. This sale and leaseback can be done at any time whether prior to delivery, upon delivery or during the asset life cycle. This transfers capital back to the airline and residual value risks to the lessor.

Lease rates on new aircraft are largely determined by the aircraft purchase price, the cost of finance and the lease term. Rates on subsequent leases are influenced by market lease rates.

8. Aircraft Lease Agreement

Typically leases require lessees to provide a security deposit, pay monthly aircraft rental, pay monthly maintenance reserves or agree to return the aircraft in a pre-agreed condition. Lessees typically pay for aircraft insurance, the positioning and redelivery of the aircraft, maintain the aircraft in an airworthy state according to the relevant manufacturer and civil aviation recommendations and requirements, maintain maintenance records in English and make the aircraft and records available for inspections. The lessee in most cases is also responsible for expenses such as aircraft upgrades and modifications.

Operating lease agreements are complex contracts, defining what the lessee is required to report to the lessor, how the aircraft is maintained, insurance requirements, operational limitations and other responsibilities and covenants the airline operator must adhere to. Airlines operate in highly regulated environments and the lease agreements require strict adherence to civil aviation authorities.

Monitoring the lessee and the asset to ensure lease compliance is vital, thus protecting the asset and maximising its residual value. Typical lease terms include;
8.1. Lease Duration
Lease durations vary markedly, however a narrow body aircraft typically will be leased for 8 years from new and wide body aircraft will be leased for 12 years.

8.2. Security Deposits
Up front security deposits are paid by the lessee in the form of cash or a letter of credit. Security deposits are usually equal to three months rent or 2.5-3% of the aircraft value. These funds are available to the lessor in the event of a lessee default to reduce losses in redeploying the aircraft to a new airline.

Maintenance deposits are sometimes required to be paid by the lessee. The amount paid varies depending on the lessee and can be in excess of $1m or 1 year’s estimated maintenance expenses.

8.3. Lease Rental
Monthly lease rentals are paid in advance by the lessee. These monthly rentals are expressed as a percentage of the aircraft value. For example a 2014 Boeing 737-800 bought for $44m and leased for $380,000 per month is a lease factor of 0.86% per month or 10.36% per annum. Lease factors range from 0.75% - 1.5% per month. Lease factors are affected by lease duration, interest rates, aircraft type, tax liabilities, aircraft sale price, lessee credit quality, type of lease and aircraft depreciation.

8.4. Aircraft Maintenance
The lessee is responsible for the ongoing airworthiness, maintenance and the use of life limited parts according to the lease agreement. Maintenance payments are paid monthly to the lessor for disbursement according to actual aircraft utilisation or the aircraft is returned at the end of the lease in a pre-agreed maintenance condition.

Monthly maintenance payments are referred to as maintenance reserves. When the aircraft is to be returned in a pre-agreed condition, this is referred to as return condition.

8.5. Maintenance reserves
Maintenance reserves are calculated on a calendar, flight hour and flight cycle basis, according to the lease. Airlines pre-pay for future maintenance according to their monthly utilisation. The lessor then should have the funds available to cover any future maintenance events. A typical 737-800 Maintenance Reserve balance is shown on the diagram below.

8.6. Return Condition
Return condition is when the aircraft is to be returned in a pre-agreed condition. The lease agreement will stipulate what condition the lessee will return the aircraft. The lease agreement will also dictate what compensation is to be paid in lieu of maintenance not yet performed. A full life return condition means the lessee airline must return the aircraft with all components on the aircraft overhauled to new condition or replaced with new items, thus giving the aircraft full life. Any maintenance due during the period of the lease must be carried out by the lessee.
9. Financing Trends and Requirements

New banking leverage and liquidity requirements (Basel III) were enforced gradually from 2013. Basel III limits the adjusted leverage ratio independent of the quality of the asset. Basel III also limits Export Credit Agencies funding new aircraft deliveries. Traditionally ECAs were a back stop providing finance to only a small percentage of deals. Since the global financial crisis airlines and manufacturers have increasingly turned to ECAs for finance. Between 2009 and 2012 the US EX-IM Bank financed 28% of all new Boeing Aircraft. This was seen as anti-competitive and negative to the industry long term. ECA finance is now restricted through the Basel III Accord. As a result of the changes the US EX-IM Bank financed only 11% of Boeings 2015 deliveries.

We anticipate that $732 Bn will be required to fund new commercial deliveries over the next 5 years. Higher fees and equity requirements should further reduce ECA funding over the next few years. Lessors and the capital markets were quick to fill the gap left behind by the ECAs from 2013.

In 2014 the capital markets significantly increased their share from 14% (in 2013) to 28%. In 2015 the Capital Markets overtook the Banks as the largest provider of financing to the industry. This is expected to continue in 2016 as Capital Markets are predicted to fund 36% of new aircraft delivered.

Despite a reduction in the overall banking sectors participation in new aircraft delivery financing, Australian banks have increased their participation. This has added to the overall strength of the Banking sector as more geographically diverse range of Banks support the industry. All of the big 5 Australian banks provided significant debt in 2015, almost US$10 Bn in total or 8%. We anticipate the Australian Banks will continue to fund a significant percentage of the industries debt in 2016 and fund 7% of new aircraft deliveries.

9.1. Lessors and the Capital Market

Lessors have been playing an increasing role and are an integral part in funding airliners worldwide, as they gain market share. Approximately 1400 aircraft, worth USD $112 Bn will be delivered this year, with almost half purchased by lessors. Lessors are becoming increasingly innovative in sourcing finance to fund growing portfolios. As a result of the shifting market, more opportunities to invest in aircraft are being made available to a larger audience.

The capital market has been a successful and adaptive investor in Lessors and is key to funding future aircraft.

In 2013 more than USD $10 Bn of new and innovative funding was sourced and we estimate that at least an additional USD $10 BN in new funding will be required each year for the next few years.
9.2. Aircraft Financing and the Capital Market

Airlines have also been increasingly utilising the capital markets for sources of aircraft finance. The table below shows some recent lessor and airline US$ denominated transactions.

Recent Aircraft and Airline A.B.S. Transactions

| 1 | Capital Aviation CAAIF May-16 | 15 | British Airways 5 Yr Bond Sep-14 | 29 | Aircastle 5 Yr Bond Dec-13 |
| 2 | Air Lease Corp 7 Yr Apr-16 | 16 | BOC Aviation 6.5 Yr Bond Aug-14 | 30 | Air Lease 6 Yr Bond Nov-13 |
| 3 | Easy Jet 7 Yr Feb-16 | 17 | United EETC Jul-14 | 31 | Virgin Australia EETC Oct-13 |
| 4 | Malaysian Airlines 5 Yr Feb-16 | 18 | Fly Leasing 6 Yr Bond Jun-14 | 32 | ACG 3 Yr Bond Sep-13 |
| 5 | BOC Aviation 5 Yr Bond Mar-15 | 19 | Fly Leasing 7 Yr Bond Jun-14 | 33 | United EETC Aug-13 |
| 6 | British Airways 5 Yr Bond Nov-15 | 20 | Aercap 3 Yr Bond May-14 | 34 | Hawaiian EETC May-13 |
| 7 | British Airways 7 Yr Bond Nov-15 | 21 | Aercap 5 Yr Bond May-14 | 35 | US Airways EETC Apr-13 |
| 8 | Turkish Airlines 12 Yr EETC Mar-15 | 22 | Aercap 7 Yr Bond May-14 | 36 | BOC Aviation 10 Yr Bond Apr-13 |
| 9 | Latam Airlines 8 Yr EETC May-15 | 23 | Qantas 8 Yr Bond May-14 | 37 | American EETC Mar-13 |
| 10 | Latam Airlines 12 Yr EETC May-15 | 24 | BOC Aviation 5 Yr Bond Apr-14 | 38 | Air Lease 11 Yr Bond Mar-13 |
| 11 | American Airlines 12.5 Yr EETC Mar-15 | 25 | United EETC Mar-14 | 39 | BOC Aviation 10 Yr Bond Feb-13 |
| 12 | American Airlines 8.5 Yr EETC Mar-15 | 26 | Air Lease 6 Yr Bond Mar-14 | 40 | Aircastle 6 Yr Bond Nov-12 |
| 13 | Aercap 7 Yr Bond Sep-14 | 27 | Aircastle 7 Yr Bond Mar-14 | 41 | Continental EETC Sep-12 |
| 14 | Lufthansa 5 Yr Bond Sep-14 | 28 | Aircastle 4 Yr Bond Mar-14 | 42 | BOC Aviation 5 Yr Bond Sep-12 |

Source: Capital Aviation Research (US$ unless stated)

10. Generating Returns from Aircraft

**Monthly Cash Yield**

Lease rental income in excess of operating expenses and debt servicing provides a monthly return. Monthly lease payments are locked in for periods up to 16 years.

**Capital Gains**

Aircraft have a useful life of 20+ years but debt schedules outperform asset depreciation building in capital gains. These gains are realised on lease renewals, debt restructuring or aircraft disposal. Additionally, aircraft are paid off between 12-15 years. However, lease income can be generated for 25+ years.

**Asset Management**

Active trading of aircraft prior to lease expiry can realise future profits and increase returns and free capital for additional investments. Debt restructuring also can provide additional returns.

**Maintenance Reserves**

Contractual payments made in relation to aircraft maintenance reserves are held and often not required for scheduled maintenance 10 years in the future. Investing these funds in term deposits provides additional returns. Often aircraft are sold and maintenance reserve funds held for future maintenance is not subject to the sale contract providing immediate and often substantial profit.
11. Capital Aviation Environmental, Social & Governance (ESG)

Capital Aviation takes a Holistic approach to governance and investing which looks internally and externally at clients as well as counterparties.

With an in depth knowledge and experience of African aviation and first hand understanding of the challenges faced by the industry our investment approach to Africa is deeply rooted in our ESG policies and outcomes.

To find out more about our ESG or aircraft leasing investments, contact us at info@capitalaviation.net

There are many factors which lead us to believe now is an opportune time to enter the leasing market. These include:

- Increased aircraft production and deliveries
- Large aircraft order backlogs
- Changes to aircraft finance requirements and the finance markets
- Airlines increasing desire for aircraft leases
- Increasing world aircraft demand
- Increasing world aircraft load factors
- Increased demand in Asia for new/newer fuel efficient aircraft
- Other successful new aircraft lease companies entering
- The need to replace aging fleets in North America and Europe with new generation aircraft