

Eagle Airways

Advanced Negotiation Skills Case Study/Exercise

Eagle Airways Client Role brief

Eagle Airways - Client role brief

In this case study you will be playing the role of the CFO of an up-and-coming, cheap, “no frills” airline, based in Oman, which has seen tremendous growth over the last few years. Eagle Airways is 75% owned by Air Golf. In order to continue the expansion programme, Eagle Airways is seeking to acquire two more Boeing 767 aircraft.

Your main concern is that acquisition of these aircraft should not cause you a large, up-front cost, as your cash-flow situation is typical of a high-growth, investment phase: you are not very cash rich! You would prefer to finance the aircraft purchase through a loan or a credit facility although leasing is a possibility (and you would go for leasing if you were advised that it was more tax advantageous). Each aircraft costs \$125m brand new.

Having met with and eliminated DSC Bank and Bank of the Americas you are keen to press ahead and negotiate a deal with Bank Capricorn.

Based on the initial proposals from the three banks; Bank Capricorn’s terms were more favourable than the other two.

You need to finalise a deal today due having to attend a board meeting this evening, when you are expected to present the financing solution you have come up with to your senior colleagues.

You have already received a proposal from Bank Capricorn for a loan for the two aircraft for a total of US \$250,000,000, and you would like to go ahead with the general approach of this proposal. You are impressed by Bank Capricorn’s professionalism and their knowledge of the aircraft industry.

You could agree to their current terms however the board is expecting that you negotiate as a good a deal as possible as it will have a dramatic impact on the long term success for the company. You are keen to impress your senior colleagues at tonight’s meeting by announcing a very impressive financing structure for the purchase of the two aircraft that will secure your long term growth plans.

Specific areas where you would like to make improvements on the current proposed deal are:

- Increase term of loan to help with cash flow
- Reduce interest rate and fees to help with net profitability
- Agree a back loaded schedule to help with cash flow and growth of business
- Avoid having to pay Key Man insurance for CEO
- If possible not to have to go to parent company for LG
- Improve deposit rate on overnight funding (You have another bank that is aggressively bidding for this business and are happy not to include this in the overall deal if Bank Capricorn do not offer a competitive rate)

In order to improve the deal structure you can offer them your transport fleet, for which you would like to do a sale and leaseback arrangement. You currently have 50 company cars and you have a view that it would be a quick way of improving your cash flow position if you were to offer this piece of business to Bank Capricorn.

You would like to establish regular update sessions with your bank. As this year’s chairperson of an informal grouping of chief financial officers and chief procurement officers of 'Emerging Markets Airlines', you are very aware (from stories that you have heard) how much difference it can make if you regularly meet face-to-face with the firms who are providing you with financing.

Remember that you have to agree the deal today in order to present it to your senior management meeting this evening.

Failure to present a deal at tonight's board meeting would raise the issue of if you are the right person to manage the firm's finances, not a situation that you are prepared to accept.

On a personal note a Relationship Manager of the Bank Capricorn's Privilege Banking Services is keen to win your personal business. You are close to making a decision to go with them but are waiting to see the outcome of today's meeting.

Your Assignment

Your assignment is to craft your strategy so that you can successfully secure the deal today at the lowest possible cost to Eagle Airways.

Please prepare to welcome the Bank Capricorn Relationship Manager to your office.

Bank Capricorn Proposal to Eagle Airways

1. **Loan: US \$250,000,000**
2. **Interest rate: 3 month LIBOR + 65bp%**
3. **Term: 10 years**
4. **Arrangement fee: 75bp of deal value**
5. **All legal costs to be borne by borrower**
6. **Payment schedule: Level payments**
7. **Collateral : Letter of Guarantee required from parent company for full amount of loan**
8. **Key man insurance: US\$50,000 2bp of loan value (per annum for the life of the loan facility) for CEO who is regarded as critical to the on-going success of the business.**
9. **Treasury services: Guaranteed overnight deposit rate plus 2 bp on short term deposits**
10. **Insurance for both aircraft has to be in place before any loan draw down**

Payment Schedule: It is common industry practice for Banks to offer finance on an instalment basis. Naturally you would prefer a back loaded arrangement which would keep your initial monthly payments low whilst you are building the business. On the other hand, the advantage of delaying payments is offset by the fact that doing so would mean that your company cannot take immediate advantage of certain tax credits for investment projects. For budgeting purposes, your company would use a 5 percent discount rate for this project. There are three different payment options: "level" (in which regular instalments are made over the life of the loan), "front-loaded" (larger payments at the beginning of the loan than at the end), and "back-loaded" (smaller payments at the beginning). Your company applies the following factors when comparing the actual cost (in present value terms) of different price and payment packages:

Front-loaded:	91 percent of nominal price
Level payments:	86 percent of nominal price
Back-loaded	82 percent of nominal price

In short, you prefer a back-loaded loan structure. You would consider accelerating payments only if Bank capricorn agreed to a significant reduction in the interest rate.

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Bank Capricorn Role Brief

Eagle Airways – Bank Capricorn Brief

You are a relationship manager for Bank Capricorn working in the Corporate Banking department . Due to the Bank being new it has been a difficult year so far, and you have not sold as much new business as you would have liked. You are going to see a client in Muscat today, a firm called Eagle Airways , who have seen tremendous growth in recent years, thanks to their policy of providing cheap, “no frills” air travel.

You have previously met with the CFO of eagle Airways to discuss their requirements and have sent an initial proposal to them for the financing of two 767 aircraft, each of which costs \$125m to buy from Boeing.

You are aware that originally Eagle Airways wanted a lease facility but the loan structure proposed is a much more tax-efficient structure for the client (you may need to convince them of this).

Please see attached proposal document.

You believe that Eagle Airways are also talking to Bank of the Americas and DSC Bank about financing for these two aircraft, and you do not know at what stage the negotiations between Eagle Airways and Bank of the Americas/DSC Bank are at. However, you have heard on the grapevine that Bank of the Americas is extremely keen to get this piece of business from such an up-and-coming airline.

You are aware that the CFO of Eagle Airways is a high net worth individual who just happens to be a prospect of the Privilege Banking Services. So you do not want to alienate the client. It also just happens that the CFO is this year’s chairperson of an Emerging Markets group of chief financial officers and chief procurement officers, and you would like him to invite you to give a presentation to this group of people. If you can convince the CFO to let you do this, it will certainly make it easier to convince senior management at Bank Capricorn that you have done a good deal!

You are very keen to win this business as it would have a significant impact on your annual target. In order to enable you to reach a deal today you have met with the senior manager of the lending committee to discuss what financing options you have to win the business.

Lending Committee

The manager of the lending committee has expressed his concerns about the credit rating of Eagle Airways and does not want to be too aggressive on the pricing structure, however after much persuading he has agreed to the following.

He is prepared to sanction the loan of US \$250,000,000 if it is within the following parameters:

Loan Term	Interest rate:	Payment Schedule	Fee	Key Man Insurance	Treasury Services
10 years	3 month LIBOR + 65bp to min of + 50 bp	Front to min back loaded	75bp to min of 50bp	2 bp of deal value min 1.5 bp	+ 2 bp
15 years	LIBOR + 65BP to min + 55%	Front to min level loaded	75bp to min of 60bp	2 bp to min 1.75 bp	+1.75 bp
20 years	LIBOR + 65bp to min + 60bp	Min front loaded	75bp to min of 70bp	2 bp	+ 1bp

The senior lending manager has stressed how important it is that Key Man Insurance is put in place for this deal as they regard him critical to the on-going success of the firm.

If Eagle Airways is not prepared to agree to Key Man insurance then they will only approve the loan with a minimum interest rate of 3 month LIBOR + 85 bp on a 10 year loan.

Letter of Guarantee required from parent company for full value of loan facility. (Non-negotiable)

Having met with the senior manager of the lending department and having received his brief you have full authority to negotiate a deal within the parameters outlined.

However your manager is keen for you to negotiate as good a deal as possible.

Your Assignment

Your assignment is to craft your strategy so that you can successfully secure the deal within the parameters set by the lending department

Please prepare to meet with the CFO of Eagle Airways.

Bank Capricorn Proposal to Eagle Airways

1. **Loan: US \$250,000,000**
2. **Interest rate: 3 month LIBOR + 65bp**
3. **Maximum Term of loan: 10 years**
4. **Arrangement fee: 75bp of deal value**
5. **All legal costs to be borne by borrower**
6. **Payment schedule: Level payments**
7. **Collateral: Letter of Guarantee required from parent company for full amount of loan**
8. **Key man insurance: US\$50,000 2bp of loan value (per annum for the life of the loan facility) for CEO who is regarded as critical to the on-going success of the business.**
9. **Treasury services: Guaranteed overnight deposit rate plus 2 bp on short term deposits**
10. **Insurance for both aircraft has to be in place before any loan draw down**

Payment Schedule: It is common in this industry for Banks to offer loans on an instalments basis, though obviously you would prefer to be paid sooner rather than later. For planning and budgeting purposes, Bank Capricorn uses a 10 percent annual discount rate. There are three different payment options, "level" (in which the customer pays regular amounts over the life of the loan), "front-loaded" (in which the customer pays more at the beginning of the loan than at the end), and "back-loaded" (in which the customer pays less at the beginning than at the end). Bank Capricorn applies the following factors when calculating the present value of different price and payment packages:

Front-loaded:	83 percent of nominal price
Level payments:	76 percent of nominal price
Back-loaded:	68 percent of nominal price

In summary, you would prefer a front loaded loan structure as it would reduce your credit exposure and keep your lending department happy.