THE NORTHERN TERRITORY OF AUSTRALIA

Copy No. 1

CONFIDENTIAL

CABINET DECISION

NO. 1318

Submission No.: 1125

Title: PROPOSED GUARANTEES TO ASSIST NORTHERN AIRLINES TO FINANCE THE PURCHASE OF 3 METRO, 5 NOMAD AND 1 F27-500 AIRCRAFT

Cabinet -

a) approved in principle to negotiations proceeding for the granting of the requested guarantees subject broadly to the following terms and conditions :-

Security

1. Gross market value guarantees in accordance with details provided in the Submission of the estimated market values of aircraft to be given by the East-West Holding Company and its operating subsidiaries.

2. A first charge over the F27-500 aircraft.

3. A second charge (ranking behind the National Bank's ($750,000 first charge) over all the other assets (including uncalled capital) of Northern Airlines Limited and Northern Airlines (Operations) Pty. Limited and any future subsidiary.

Other Conditions

4. Lease payments, loan repayments and the contents of all documentation under the guaranteed arrangements will be on terms and conditions acceptable to the Government.

5. No further borrowings or off-balance sheet liabilities of a major nature are to be incurred or further security pledged without prior Government approval (say above $100,000 in any period of 12 months).

6. The current ratio (i.e. current assets :

(M.R. FINGER),
Secretary to Cabinet.

22 September, 1980.

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current liabilities) of the consolidated Northern Airlines Companies is not to be permitted to fall below 1 : 1 in 1980/81 and 1981/82 or 2 : 1 during the currency of the guarantees thereafter. Breach of this covenant for more than 30 days will constitute an event of default.

7. Quarterly financial statements of the Northern Airlines Companies are to be provided within sixty days (or ninety days in respect of the annual statements) of the close of each financial quarter.

8. Annual audited financial statements for East West Airlines will also be made available, plus annual cash and profit forecasts.

9. Other financial or associated information on Northern Airlines and East West activities will be made available on request, including specifically details of all inter-company transactions such as loans, charges for services, aircraft charters, asset sale or buy-back agreements, revenue sharing, etc.

10. No dividends will be paid, loans repaid or funds repatriated to shareholders in any way without prior Government approval.

11. Any asset transfers to Northern Airlines from East West companies not to be transacted at greater than current market prices, or from Northern to East West at less than current prices.

12. Guaranteed lessors or lender will be required to agree that in the event of default by the

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Secretary to Cabinet.

22 September, 1980.

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company in respect of its commitments and obligations under the terms of any of the guaranteed advances, action directly against the company will be withheld except with Government approval.

13. Adequate insurance cover arranged with insurance companies acceptable to the Government will be maintained at all times over all the comapny's assets and activities.

14. The Government's decision to give guarantees to Northern Airlines in this instance is a once only situation and there is no intention by the Government of further such involvement. However, it is noted that the company has asked that it be reserved the right to make application, without any commitment on the part of the Government; and

b) decided that the final detailed agreement on terms and conditions be referred back to Cabinet seeking approval for execution of the relevant documents.

(M.R. FINGER),
Secretary to Cabinet.
22 September, 1980.

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THE NORTHERN TERRITORY OF AUSTRALIA

Copy No: 1

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FOR CABINET **SUBMISSION No: 1125**

Title:	PROPOSED GUARANTEES TO ASSIST NORTHERN AIRLINES TO FINANCE THE PURCHASE OF THREE METRO, FIVE NOMAD AND ONE F27-500 AIRCRAFT.
Minister	Honourable Marshall B. Perron, Treasurer
Purpose:	To consider whether guarantees should be given for all or part of : . Leveraged leasing of three Metro aircraft . Leveraged leasing of five Nomad aircraft . A bank loan of $1.5m towards the purchase of the F27 aircraft for $2.5m.
Relation to existing policy:	Guarantees may be given under the Territory Development Act for support of industry within the Northern Territory. The proposal appears to fall within normal policy. Furthermore, the agreement with East West and Northern Airlines makes specific provision for support by Government guarantee in certain circumstances.
Timing/ legislative priority:	Early decision is required and recommended.
Announcement of decision, tabling, etc:	Public announcement is not recommended.
Acting required before announcement:	Nil
Staffing implications, numbers and costs, etc:	There are no Government staffing implications but the Company is an important employer in the Territory.
Total cost:	There is a contingent financial risk as shown in Appendix 1.

CONFIDENTIAL

Department/Authority ..... LAW .....

COMMENT ON CABINET SUBMISSION No.

TITLE: FINANCIAL GUARANTEES BY THE NORTHERN TERRITORY GOVERNMENT TO NORTHERN AIRLINES

COMMENTS:

There are no constitutional barriers to the proposal.

I make the following comments in respect of legal aspects of the proposal:-

1. Cabinet should consider whether it wishes to bind itself to a leverage lease arrangement at this early stage. There is a possibility that other financing mechanisms may be available and more appropriate;

2. It is not clear that the Government can give Guarantees only for the residue of an outstanding amount after the asset is sold up. This is not an insurmountable problem as it can probably be covered with appropriate documentation but Cabinet ought to be aware that the problem does exist;

3. The leases for the Nomads and F27s ought to be dealt with separately but at the same time there should be a cross collateralisation of the two loans;

4. The conditions stipulated in appendix 2 should be guidelines only;

5. I make no comment in respect of the financial mattersset out in the Submission.

SIGNED:

DESIGNATION: CROWN SOLICITOR

DATE: 12.9.80

A. B. CAUDELL, Government Printer of the Northern Territory

THE ISSUE

1. Northern Airlines, the operator of the Territory's regional airline, has made application for financial assistance by way of guarantees:-

(a) to support the leveraged leasing acquisition of five Nomad and three Metroliner aircraft, plus supporting spares.

(b) As security for a loan of $1.5 million from the National Bank, to help finance the purchase from East West Airlines of a second-hand F27-500 aircraft.

2. The issue before Cabinet is to decide whether all or any of the support requested is justifiable and should be approved.

BACKGROUND

3. An agreement has been drawn up to record the rights and responsibilities of the Northern Territory Government, East West Airlines and Northern Airlines in respect of the Northern Territory's regional airline. Clause 21 of that agreement provides for favourable consideration by the Government of a request for guarantees to support financial requirements associated with the airline, if otherwise there would be a significant adverse effect on East West or the regional airline. The application for assistance has been made in accordance with the Company's rights under that clause.

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4. It is planned that the Nomad and Metro aircraft will be acquired under "leveraged leasing" arrangements i.e. tri-partite agreements whereby a "debt party" and an "owner/lessor" provide the finance, purchase the assets and lease them to the lessee (in this case Northern Airlines).

5. Should the lessee default, the debt and lessor parties would take action to dispose of the aircraft. The Government guarantee is required in this instance to ensure that any residue then remaining on the lease payout figure is also cleared. Figures produced by the company (which are difficult to verify but should prove reasonably close based on experience during negotiations) suggest a total exposure under guarantees of just under $1.7 million during the first six months, and slightly over $1.3 million in the second six months (see Appendix 1). Thereafter the total sale value of the Nomads and Metros could be expected to exceed the lease payout figures. (But see Para 8 (i) (ii) and (iii)).

6. In the case of the F27 aircraft, purchase price is $2.5 million (considered a very reasonable price on evidence available). It is proposed to finance the purchase by means of a $1 million loan from East West and the proposed National Bank loan secured by a Government guarantee for $1.5 million.

7. Security offered for the guarantees consists of:-

- guarantees from the East West group of companies of the market values of the aircraft upon which the Government's risk exposure has been assessed. i.e. East West would be required to meet the difference between the prices listed in Appendix 1 and any lower prices received, should there be a shortfall on the lease payout figure.

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. a first charge over the F27 aircraft.

. a second charge (ranking after the National Bank's $750,000 first charge in respect of working capital advances) over all the other assets (including uncalled capital) of the Northern Airline companies and any future subsidiaries.

CONSIDERATION OF THE ISSUES

8. A consultant was engaged to work with Treasury officers on the complex issues surrounding this application. Careful consideration of all the evidence and supporting information has led to the following conclusions which must have a bearing upon Cabinet's judgement.

(i) Although evidence submitted suggested that the overall situation under the leveraged lease agreements would remove the Government's risk exposure after twelve months, in fact (as shown in Appendix 1) the Nomad aircraft situation would continue at risk throughout the eight-year life of the lease. Since there would be different parties involved in the two leveraged lease agreements, it is difficult to justify the lumping of the two together in assessing the overall risk.

(ii) The Company's projections of the Metro and F27 selling values are thought to be reasonable. However, Nomad valuations must be suspect since the second-hand market for these aircraft is a largely unknown factor.

(iii) Furthermore, the coastal surveillance contract for which the Nomads are required is initially for two years only. Should the contract not be renewed we could be faced with a forced sale very early in the life of the aircarft, along with a down-turn in the company's income.

(iv) Cash-flow projections presented by the company show surpluses of only about $300,000 in 1980/81 and $207,000 in 1981/82. Already adverse factors (such as late delivery of the Nomads, higher projected loan commitments etc) make even those surpluses doubtful. In other words, the Government's period of greatest exposure would coincide with a highly vulnerable liquidity situation on the part of the company.

(v) The proposed market value guarantees from East West in effect are unsecured obligations. Furthermore, the bulk of East West's assets are held by subsidiaries and the guarantees would have little value unless those subsidiaries were joined in the obligation.

9. In summary, the Government is being asked to assume a risk which is not a commercial proposition. However, the agreement mentioned above requires East West merely to demonstrate that refusal of Government guarantee support would adversely affect the operations of East West or Northern Airlines.

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Treasury officers and their consultant have concluded that those adverse effects have been properly demonstrated. Without the guarantees East West would have far greater pressures placed upon its liquidity, to the detriment of its operating ability. Northern Airlines, in meeting these obligations imposed by the agreement with the Government, requires finance which it appears would be impossible to obtain without the support of Government guarantees, or a vastly greater injection of funds by East West.

10. A decision by Cabinet, therefore, would seem to be a policy matter rather than one based entirely on commercial judgement. Should that decision be in favour then every effort ought to be made to minimise the risk to Government. The draft conditions set out in Appendix 2 have been drawn up with that objective.

11. The guarantees would be given under the Authority of the Territory Development Act, which requires that security must be sufficient to meet the contingent risk in full. Although not adequate for a normal commercial situation, it is considered that the security available as set out in paragraph 7 above meets that obligation.

OPTIONS

12. The principal options available in this instance are:-

(i) to approve the request in full.

(ii) to approve the request in part.

(iii) to reject the application.

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13. Options (i) and (ii) could involve some variation of or addition to the security proposals or the conditions suggested in Appendix 2, subject to final negotiations.

14. The viability of the Northern Airlines operations over the early life of the company appears to be fairly tenuous. Accordingly, to provide an opportunity to acquire the required aircraft with minimum adverse impact on the company, it is recommended that the guarantees be approved subject to the proposed conditions.

PUBLIC IMPACT

15. The arrangements for East West to establish Northern Airlines and take over the regional airline has attracted a lot of public attention and, as might be expected, criticism from some quarters. Similar criticism might be anticipated if publicity were given to a decision to assist by means of Government guarantees which, however, ought largely to be offset by the proposed offer of 49% of Northern Airlines shareholding to Territory residents.

16. Nevertheless, it has been the custom not to publicise individual cases of assistance to industry, except where requested by the recipient, and that policy should be adhered to in this instance. Accordingly, there is unlikely to be any real public re-action one way or the other.

FINANCIAL CONSIDERATIONS

17. This aspect has already been covered more or less in paragraphs 5 and 6. To summarise, the Government's risk exposure maximises at about $3.2 million in total, in the early stage of assistance. Security to cover that exposure is:-

First charge on F27 aircraft		$2.5 Million
Second charge over company assets		
	say -	$1.5 Million
		$4.0 Million

18. No doubt those security values should be fairly heavily discounted but they are supported further by the aircraft market value guarantees from East West. Nevertheless there is clearly a risk of some pay-out in respect of the Government's contingent liability in the early stages.

19. The situation in the longer term is more secure provided the company operates profitably. One of the proposed conditions requires a continuing stable current ratio i.e. current assets to current liabilities which should ensure that the position is constantly monitored.

EMPLOYMENT CONSIDERATIONS

20. The company is an important employer of labour and this is one of the justifications for considering the financial aid.

CO-ORDINATION

21. This submission has been put to the Department of Law and the Northern Territrory Development Corporation, whose comments are attached.

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PUBLICITY

22. As observed above, publicity is not recommended.

TIMING

23. Urgent Cabinet consideration of this submission is urged, to minimise further delays in financial arrangements for the purchase of aircraft.

RECOMMENDATION

24. It is recommended:-

(i) that Cabinet give approval in principle to negotiation proceeding for the granting of the requested guarantees, subject broadly to the terms and conditions listed in Appendix 2.

(ii) that the final detailed agreement on terms and conditions be referred back to Cabinet, seeking approval for execution of relevant documents.

Ian Isaworth
Acting for .....
MARSHALL B PERRON

APPENDIX 2

PROPOSED SECURITY AND CONDITIONS IN RESPECT OF GUARANTEES REQUESTED BY NORTHERN AIRLINES.

SECURITY

1. Gross market value guarantees in accordance with details in Appendix 1, to be given by the East West Holding Company and its operating subsidiaries.

2. A first charge over the F27-500 aircraft.

3. A second charge (ranking behind the National Bank's $750,000 first charge) over all the other assets (including uncalled capital) of Northern Airlines Limited and Northern Airlines (Operations) Pty. Limited and any future subsidiary.

OTHER CONDITIONS

1. Lease payments, loan repayments and the contents of all documentation under the guaranteed arrangements will be on terms and conditions acceptable to the Government.

2. No further borrowings or off-balance sheet liabilities of a major nature are to be incurred or further security pledged without prior Government approval (say above $100,000 in any period of 12 months).

4. The current ratio (i.e. current assets : current liabilities) of the consolidated Northern Airlines Companies is not to be permitted to fall below 1 : 1 in 1980/81 and 1981/82 or 2 : 1 during the currency of the guarantees thereafter. Breach of this covenant for more than 30 days will constitute an event of default.

5. Quarterly financial statements of the Northern Airlines Companies are to be provided within sixty days (or ninety days in respect of the annual statements) of the close of each financial quarter.

6. Annual audited financial statements for East West Airlines will also be made available, plus annual cash and profit forecasts.

7. Other financial or associated information on Northern Airlines and East West activities will be made available on request, including specifically details of all inter-company transactions such as loans, charges for services, aircraft charters, asset sale or buy-back agreements, revenue sharing, etc.

8. No dividends will be paid, loans repaid or funds repatriated to shareholders in any way without prior Government approval.

9. Any asset transfers to Northern Airlines from East West companies not to be transacted at greater than current market prices, or from Northern to Eastwest at less than current prices.

10. Guaranteed lessors or lender will be required to agree that in the event of default by the company in respect of its commitments and obligations under the terms of any of the guaranteed advances, action directly against the company will be with-held except with Government approval.

.../2

11. Adequate insurance cover arranged with insurance companies acceptable to the Government will be maintained at all times over all the company's assets and activities.

12. The Government's (possible) decision to give guarantees to Northern Airlines in this instance is a once only situation and there is no intention by the Government of further such involvement. However, note that the company has asked that it be reserved the right to make application, without any commitment on the part of the Government.

APPENDIX 1

Estimated market values of Aircraft

Metro No. 1 (Cost $1,411,034 - spares up to $350,000)

END OF HALF YEAR NO. (6 mthly period)	LEASE PAYOUT	AIRCRAFT VALUE	SPARES VALUE	TOTAL	RISK EXPOSURE
1	1,745,185	1,247,972	324,450	1,572,422	172,763
2	1,599,019	1,232,474	297,052	1,529,526	69,493
3	1,296,121	1,214,411	267,718	1,482,129	-186,008
4	1,218,636	1,193,649	236,357	1,430,006	-211,370
5	1,135,867	1,170,048	202,873	1,372,921	-237,054
6	1,056,620	1,143,462	167,167	1,310,629	-254,009
7	975,613	1,113,739	129,137	1,242,876	-267,263
8	896,366	1,080,720	88,674	1,169,394	-273,028
9	817,120	1,044,241	45,667	1,089,908	-272,788
10	739,634	1,004,129	-	1,004,129	-264,495
11	660,388	960,204	-	960,204	-299,816
12	581,141	912,280	-	912,280	-331,139
13	503,656	860,162	-	860,162	-356,506
14	440,259	803,648	-	803,648	-363,389

Metro No. 2 (Cost $1,418,644 - spares up to $50,000)

END OF HALF YEAR NO.	LEASE PAYOUT	AIRCRAFT VALUE	SPARES VALUE	TOTAL	RISK EXPOSURE
1	1,455,426	1,255,476	46,350	1,301,826	53,600
2	1,333,529	1,239,860	42,436	1,282,296	51,233
3	1,080,922	1,221,666	38,245	1,259,811	-178,889
4	1,016,302	1,200,758	33,765	1,234,523	-218,221
5	947,275	1,176,995	28,982	1,205,977	-258,702
6	881,186	1,150,231	23,881	1,174,112	-292,926
7	813,629	1,120,314	18,448	1,138,762	-325,133
8	747,540	1,087,083	12,668	1,099,751	-352,211
9	681,451	1,050,372	6,524	1,056,896	-375,445
10	616,830	1,010,009	-	1,010,009	-393,179
11	550,742	965,813	-	965,813	-415,071
12	484,653	917,597	-	917,597	-432,944
13	420,032	865,163	-	865,163	-445,131
14	367,161	808,309	-	808,309	-441,148

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Metro No. 3

Cost $1,542,810 - Spares up to $300,000

END OF HALF YEAR NO.	LEASE PAYOUT	AIRCRAFT VALUE	SPARES VALUE	TOTAL	RISK EXPOSURE
1	1,826,225	1,337,933	278,100	1,656,003	170,222
2	1,673,271	1,360,392	254,616	1,615,008	58,263
3	2,356,308	1,340,047	229,473	1,569,520	-213,212
4	1,275,225	1,316,750	202,592	1,519,342	-244,117
5	1,188,612	1,290,350	173,891	1,464,241	-275,629
6	1,105,686	1,260,686	143,286	1,403,972	298,286
7	1,020,917	1,227,591	110,689	1,338,280	-317,363
8	937,990	1,190,894	76,006	1,266,900	-328,910
9	855,064	1,150,413	39,143	1,189,556	-334,492
10	773,980	1,105,959	-	1,105,959	-331,979
11	691,054	1,057,337	-	1,057,337	-366,283
12	608,127	1,004,342	-	1,004,342	396,215
13	527,044	1,004,342	-	1,004,342	-477,298
14	460,703	884,374	-	884,374	-423,671

Nomads (Five Aircraft)

Total cost $4,569,177 - Spares $300,000

END OF QRTR YEAR NO.	LEASE PAYOUT	AIRCRAFT VALUE	SPARES VALUE	TOTAL	RISK EXPOSURE
(3 mthly periods)					
1	4,966,561	3,523,290	290,700	3,813,990	1,152,571
2	4,917,869	3,472,238	280,908	3,753,146	1,164,723
3	4,820,485	3,415,851	270,607	3,686,458	1,134,027
4	4,771,793	3,353,950	259,784	3,613,734	1,158,059
5	4,090,109	3,286,351	248,418	3,534,769	555,340
6	3,797,958	3,212,847	236,494	3,449,341	348,597
7	3,603,191	3,133,304	223,994	3,357,298	245,893
8	3,457,116	3,047,463	210,899	3,258,362	198,754
9	3,359,732	2,955,140	197,190	3,152,330	207,402
10	3,213,656	2,856,125	182,849	3,038,974	164,682
11	3,067,582	2,750,203	167,855	2,918,058	149,524
12	2,921,506	2,637,152	152,171	2,789,323	132,183
13	2,775,431	2,516,742	135,829	2,652,571	122,860
14	2,629,355	2,388,742	118,753	2,507,495	121,860
15	2,483,280	2,252,911	100,940	2,353,851	129,429
16	2,312,859	2,109,000	82,367	2,191,367	121,222

Termination values during the first 12 months include full recapture of investment allowances.