



**To: DA42 customers, Diamond Authorized Service Centers,
Diamond Distributors**

Re: Thielert Situation Update

Over the past 10 days, Diamond senior management has been working diligently in an attempt to achieve a workable solution for DA42 and DA40 tdi owners on parts support and warranty. We had a face-to-face meeting with the insolvency administrator on Friday, May 9th, and several subsequent telephone conversations, the latest on Friday, May 16th.

Unfortunately, the results have not been positive, and we need to share with you what clearly is a very disappointing update.

Overall, we have the impression that the insolvency administrator is not able to nor interested in providing a path forward which makes current TAE engine operators and owners a priority. Instead, we are left with no choice but to conclude that their agenda is at odds with ours and yours, and that we will likely not get a workable solution from working with TAE and the administrator until after the end of preliminary insolvency, presumably in July.

Diamond proposal made

Over the past two weeks, Diamond management has put together and proposed to the insolvency administrator a plan we believed to be in our mutual interest. We have offered up several proposals, including the following:

- Purchase, at Diamond's expense, a sizeable inventory of LEP and other key service parts
- Purchase, at Diamond's expense, a supply of replacement 1.7 L and 2.0 L engines to get AOG aircraft flying again
- Pay for materials costs to overhaul returned core parts to keep the fleet flying, with TAE to pay for labor (which is covered through preliminary insolvency coverage by the German government, i.e., is no cost to them.)

Our clearly expressed goal has been to devise a plan which helps DA42 and DA40 tdi customers, paves a way for continued production of Diamond aircraft with TAE engines, and simultaneously enables TAE to continue operations and protect their market position as much as possible by doing their best to serve our joint customers.

Insolvency administrator actions and impression of lacking cooperation

Unfortunately, the insolvency administration has not accepted any part of our proposal. Instead, we have gained the impression, based on several actions taken, that the goal of



the administration is to maximize near-term cash flow from what they seem to view a 'captive' audience – i.e., operators of Diamond aircraft with TAE engines, whose only choice is to park an AOG aircraft or pay whatever price TAE may ask for parts. We have come to this conclusion based on the following actions:

- Release of LEP parts list with excessive prices. As you can see from the attached price list distributed on Thursday, May 15, it is the intention of the insolvency administrator to charge \$7,900 for a gear box 300 hr inspection, \$1,400 for the inspection of a clutch etc. Note that these are prices for *inspections*, not for new parts – a new gear box is listed at about \$16,000! Also note that the core prices will initially be charged on top of the list prices, and are to get credited after return of the core – i.e., they are not credits against the list price. The net effect of this additional cost, an increase in the replacement engine price, and refusal to honor the prepaid portion of the pro-rata engine change - is a creation of approximately \$65,000 in new cost over 1,000 hours of 1.7 L engine operation. When challenged by us in Friday's telephone conversation, we were told that from now on TAE had to operate as a viable business and the new prices reflected this. It is clear that this means one of two things. Either the TAE engine is not financially viable and TAE cannot survive, or the pricing has been deliberately escalated beyond reason to take advantage of the existing customer base to amass liquidity. Please draw your own conclusion. It is similar for the 2.0 l engine, with the 1200 hour mid-time mandatory inspection cost undefined to date. This effective more than tripling of operating costs fundamentally changes the economics of operating a TAE engine: whereas Diamond and its customers had made a commitment to the TAE engine based on a parts and replacement cost of about \$20-\$25 per hour, with this action, the parts cost is more than tripling. Of course this applies to *scheduled* maintenance only with unscheduled maintenance and repair also being charged to the customer at the same exorbitant prices.
- Lack of relevant spare parts stock and inability to commit to any timing for obtaining parts. We have pressed the administrator to provide us with a list of parts available for purchase – and have to unfortunately come to the conclusion, based on the administrators own statement, that there are currently very low levels of relevant parts inventory at Thielert. This effectively means that the insolvency administrator is asking customers for pre-payment for parts yet to be manufactured or procured, without any guarantee as to when these parts might become available. It also means that Diamond cannot acquire a meaningful parts inventory as we had hoped to ease the situation temporarily, while the insolvency process takes its course, as few relevant parts exist to be acquired. When questioned as to why we could not get a significant parts inventory when the insolvency administrator distributed a complete spare parts price list and if in fact these parts even existed, we were told that while



some existed, most needed to be produced. The price list was viewed as a “wish-list” with no implication that these parts would or could actually be delivered.

NOTE: We strongly advise that anyone ordering any parts or services from TAE get a written confirmation from the office of Dr. Kuebler, the insolvency administrator, confirming completeness of the order, suitable airworthiness certification, firm delivery date, confirmation of availability of all required materials and resources to produce the ordered parts, return of any customer owned parts sent for repair/inspection, and cash credit (vs credit on account) of any cores returned to TAE.

- Rescinding of any guarantees. As stated in an e-mail to customers on Thursday, May 15, the insolvency administrator communicated to the field that it “is necessary to discontinue all the guarantees which have been given to customers as well as any terms of payment forthwith”, effectively requiring advance payment for all parts, as well as requiring customers to pay for and arrange for their own shipping. This advance payment is expected based upon a mere price list, without any guarantees to when any parts might be delivered – effectively asking customers to pre-fund the operations of an insolvent entity.
- Offer of new engines. Diamond had intended to acquire a batch of new engines to support existing customers. TAE has offered a limited number of engines to Diamond, however without warranty or assurance of further support. We offered two options. One, to supply new engines with sufficient spare parts (additional cost) to support operation to 1000 hrs. , and two, full payment to an escrow account which would release payment upon assured continuation of support. Both proposals were rejected by the insolvency administrator.

We have been advised that under German law, the government is covering TAE’s payroll during the first three months of the preliminary insolvency, which could run as long as July. After that point, the company will need to have other funds to continue operating – or might be forced into an asset sale, the assets including the plant, manufacturing processes and intellectual property – including the design and data for the TAE engine and its parts.

Unless the stance taken by the insolvency administrator changes, we fear that there will be few if any parts available at reasonable, non-abusive terms, during preliminary insolvency.

Warranty situation

As you know, Thielert is the sole warranty provider for the Thielert engine in the DA42 aircraft. We understand that despite this clear legal situation, many DA42 customers are asking if and to what extent Diamond might support them by assuming some part of the



cost they expected to be covered by Thielert under Thielert's warranty. Under German insolvency law, Thielert cannot preferentially treat any creditor and therefore cannot currently honor its debts, including warranty obligations - i.e. all warranty beneficiaries are part of the creditor pool, which may receive partial compensation at the conclusion of the insolvency. Diamond senior management is evaluating what action the company can take. We are well aware that Thielert's default on its obligation is hurting our customers and ourselves. We, however, cannot blindly assume a major liability without understanding what the financial implications may be: we need to be deliberate to protect Diamond's financial strength, to ensure our company will be there to support you in the long term.

We also are limited in our ability to make financial projections on supporting our customers, as no fair pricing is available for the parts, and parts themselves are not available. We cannot responsibly pay funds into an insolvent entity, without guarantees of getting valuable parts in return, within reasonable times and at reasonable prices.

We are painfully aware that this is a very difficult situation – effectively, Diamond and its customers are victims to actions beyond our control. The TAE insolvency was not foreseeable from our perspective: TAE was a respected, publicly traded company with significant customers including Cirrus, Cessna, General Atomics and others.

Future production

Obviously, this situation also impacts our future production of DA42 aircraft with TAE engines. We entered into our conversations with the insolvency administrator reaffirming our interest in resuming production as soon as possible, provided a reliable supply of engines and parts could be reestablished, and warranty would be supported. Unfortunately, given the handling of the situation to date, we are less confident that production can be resumed in the near term. The priority now is to manage the best possible support of aircraft in the field. Resumption of production will proceed only when we are assured of a steady supply of engines, adequate parts support, as well as a reliable assurance that aircraft delivered will have financially sound warranty coverage by Thielert or its successors.

Long term plans – Austro Engine

As some of you may have read in the aviation press, Austro Engines (AEG) is developing its own heavy fuel/diesel engine. Diamond has contractual long-term agreements with AEG. We have flown the engine on the DA40, the DA42, and a DA50 prototype. Certification of the engine in Europe, under EASA rules, is expected later this summer. Certification of new DA40s and DA42s with the Austro engine is expected under EASA rules (i.e., for the European market) late in 2008, with FAA validation to follow asap.



It is our intent to offer retrofit kits for all DA42's, which would replace the current TAE power plant with a 170hp AEG engine, when such a retrofit kit is certified. Although we expect such a retrofit to result in significant performance increase, we do not have any specific performance data, nor schedule or pricing information for such a retrofit, at this time. In consideration of the current situation we will make every effort to offer special price and schedule consideration to current DA42 customers that opt for an AEG retrofit kit.

How you can help

We are requesting all Diamond owners to provide us with status information of their aircraft. We are still missing this information for a number of customers, and will be following up with you to obtain it. It is critical for us to know as well as possible when aircraft are coming due for inspections, so we can make the case for parts, and be able to project the financial implications of any financial support we might offer our DA42 owners in the future.

In closing, please let us assure you that the TAE situation has the highest attention from everybody in Diamond's senior management. We are doing our best to work in this difficult situation, and can only ask that you understand that while we would like to do more, to get you engines and parts faster, we can only impress the importance and priority of providing AOG parts in a timely manner to TAE and the insolvency administrator.

We continue to have serious discussions with the insolvency administrator and other concerned parties to find a better solution than outlined above. We encourage you to weigh in by contacting the insolvency administrator and TAE directly, to impress upon them the importance of looking after the existing TAE customers, and not to just exploit them as a captive, short-term cash source.

The people in charge at the insolvency administration are Dr. Kuebler, managing partner at the firm, and Dr. Brune, the attorney in charge of day-to-day issues on the TAE case. You can reach them via phone at +49 (351) 31 50 50 (ask for Dr. Brune) or via e-mail at dresden@kuebler-gbr.de; their English-language web site is www.kuebler-gbr.de/e. To reach TAE, you can call them at +49 (37204) 696-0. You can also e-mail them by filling out a form on their web site, at <http://web.thielert.com>, under the section 'Contact'.

We have also contacted all concerned airworthiness authorities (including the FAA) to assist in finding a solution.

We sincerely appreciate your cooperation and patience – as well as the understanding calls we have received from some of our customers.

Diamond Aircraft Industries Inc.