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# EDITED TRANSCRIPT

AER - Q3 2013 AerCap Holdings N.V. Earnings Conference Call

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## OVERVIEW:

AER reported that 3Q13 total revenue was \$279m, reported net income was \$83.6m and reported EPS was \$0.74.



## CORPORATE PARTICIPANTS

**Peter Wortel** *AerCap Holdings N.V. - VP of IR*

**Aengus Kelly** *AerCap Holdings N.V. - CEO and Executive Director*

**Keith Helming** *AerCap Holdings N.V. - CFO*

## CONFERENCE CALL PARTICIPANTS

**John Godyn** *Morgan Stanley - Analyst*

**Michael Linenberg** *Deutsche Bank - Analyst*

**Jason Arnold** *RBC Capital Markets - Analyst*

**Gary Liebowitz** *Wells Fargo Securities - Analyst*

**Ryan Zacharia** *Jacobs Asset Management - Analyst*

**Helane Becker** *Cowen and Company - Analyst*

## PRESENTATION

### Operator

Welcome to AerCap Holdings 2013 third-quarter results conference call. At this time, all participants are in a listen-only mode. The call is being webcast and an audio version of the call will be available on the Company's website. This call is also being recorded for replay purposes.

I now hand over the call to Peter Wortel, Head of Investor Relations. Please go ahead.

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**Peter Wortel** - *AerCap Holdings N.V. - VP of IR*

Thank you very much. Good day, everyone, and welcome to the 2013 third-quarter results conference call. With me today in New York are Aengus Kelly, AerCap's CEO, and Keith Helming, AerCap's CFO.

Before we begin today's call, I would like to mention that AerCap will also be hosting an Investor and Analyst Day today at the New York Palace to review 2014 and beyond. You can find the information for this on the website. The presentation will commence at 11.30 a.m. and the doors are open from 11 a.m. onwards.

I also want to remind you that some statements made during this conference call that are not historical facts may be forward-looking statements. Forward-looking statements involve risks and uncertainties that may cause actual results or events to differ materially from those expressed or implied in such statements. In addition, this conference call contains time-sensitive information that reflects management's best judgment only as of the date of the last call. AerCap does not undertake any ongoing obligation, other than that imposed by law, to publicly update or revise any forward-looking statements to reflect future events, information, or circumstances that arise after this call.

For further information concerning issues that could materially affect performance related to forward-looking statements can be found in AerCap's earnings release dated November 4, 2013. A copy of the earnings release and conference call presentation are available on our website at AerCap.com. This call is open to the public and is being webcast simultaneously at AerCap.com and will be archived for replay.

I'll now turn the call over to Aengus Kelly.

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**Aengus Kelly** - *AerCap Holdings N.V. - CEO and Executive Director*

Thank you, Peter. Good morning to everyone in the US, and good afternoon to those of you in the Middle East and Europe. Thank you for joining us today for our third-quarter earnings call.

I am very pleased to report that the third quarter of 2013 was another record quarter, with earnings per share of \$0.79 and \$1.98 for the first nine months. Very importantly, these record earnings are being generated with a relatively low risk portfolio that is one of the youngest in the industry, and is also 90% concentrated in the most liquid aircraft types in the world.

This demonstrates that a disciplined asset manager in this industry can consistently generate industry-leading returns if it rigorously applies the core strategies of AerCap, which are firstly, a very active receivables management policy. Our receivables are running at an all-time low of \$6 million. That's less than 48 hours.

Two -- active portfolio management. AerCap has sold almost 270 aircraft with an average age of 13 years at a \$320 million gain in the last six years. And over the course of the last 24 months alone, we have contracted \$5 billion of growth through the American, LatAm and Singapore transactions.

Three -- you must have a long-term liability structure. Most of AerCap's debt matures close to the end of this decade. And finally, a hedged book, which, of course, AerCap has.

These strategies have led to the industry-leading ROE of 15% for the third quarter. Our utilization rate is running at 99%, and we have placed nearly all of the 2014 aircraft. Only eight are left to place, which, for a platform like AerCap that buys, sells or leases an aircraft every three days, is a very manageable task. The capabilities of the AerCap platform, as well as the long-term nature of our current leases and contracted purchases, will continue to drive stable future profits and cash flows.

Now, turning to market opportunities, we continue to see plenty of growth opportunities. The key, however, is to be disciplined, and ensure that we only deploy our shareholders' money when the risk/reward ratio is in balance. However, as we are one of the most active portfolio managers in the world -- if not the most active, having sold almost 270 aircraft at a \$320 million gain -- we know the value of what we are buying. So, when we see the right opportunity, we will be aggressive.

The fact that we have sold so many aircraft at a gain should give our shareholders confidence that, firstly, AerCap's book values are conservative, as it is not possible to cherry-pick 270 aircraft. And secondly, when we buy, we pay the right price. If we feel the risk/reward ratio investing in new aircraft is not in balance, we will return capital to our shareholders. Since we went public, we have returned 30% of our net income to our shareholders.

Now, I'm as concerned as any shareholder with the potential for capital misallocation between investing in aircraft and returning capital to our shareholders. I think the gains I just referenced are evidence of our disciplined approach to investing in aircraft. I am confident that if we continue to adhere to our core strategies, we can continue to generate industry-leading profitability and return substantial amounts of capital to our shareholders, while investing in modern fuel-efficient aircraft.

Turning to the leasing market, we have noticed, over the course of the last 12 months, an uptick in the level of placement activity in Europe, the world's largest leasing market. As I have mentioned on prior calls, we continue to see a hardening of the Airbus A320 market, and we could certainly place more of these if we had them available. The 737-800 and the A321 continue to be in high demand, and the 319 is stable.

Receivables are at all-time lows, as I mentioned -- less than 48 hours. We did have one repossession in early September, and the aircraft was repossessed in 72 hours with no credit loss, and has already been put through the maintenance shop and delivered to the next lessee. This is another example of the efficiency of the AerCap platform. Looking ahead to what remains of 2013 and into 2014, we expect to see further opportunities for fleet expansion, and again, to stress we are extremely focused on capital allocation, and will only invest if the acquisition is accretive to our shareholders.

On that note, I will hand the call over to Keith, who will go through the financials before we open up for the question-and-answer session. Thank you.

**Keith Helming** - *AerCap Holdings N.V. - CFO*

Thanks, Gus. Good morning, everyone. I'll start on page 4 of the presentation.

Our reported net income for the third-quarter 2013 was \$83.6 million. And adjusted net income, which excludes the various items listed, was \$89.4 million, a 44% increase over the third quarter of 2012. For the first nine months of 2013, reported net income was \$226.8 million, and adjusted net income was \$224.5 million.

Page 5 -- reported earnings per share were \$0.74 in third-quarter 2013. Adjusted earnings per share were \$0.79 during the same period, an increase of 63% over third quarter of 2012. For the first nine months of 2013, reported earnings per share were \$2.00, and adjusted earnings per share were \$1.98. The average shares outstanding in the third quarter was \$113.4 million, which is about 15 million shares lower than the same period in 2012 as a result of the shares we repurchased in 2012.

Page 6 -- total revenue in third-quarter 2013 was \$279 million, up 4% over 2012. The increase was driven primarily by higher gain on the sale of aircraft and other revenues, which related primarily to cash recoveries on bankruptcy claims from previous lessee defaults. The small decrease in basic rents from the prior-year was driven primarily by the sale of our oldest aircraft portfolio, ALS, which is partially offset by new aircraft purchases.

Page 7 -- net interest margin, our net spread, was \$175 million in the third quarter. The annualized margin as a percent to average lease assets was 8.75%. The small decrease in net spread was also driven primarily by the sale of the ALS portfolio, partially offset by the purchases of new aircraft.

Page 8 -- the impact from sales in the third quarter of 2013 was a pretax gain of \$10.7 million, and was \$32.2 million in the first nine months of 2013. In the first nine months of the year, we sold two A330s, nine 737-800s, one 737-400, and one MD-11 aircraft. The average age of our aircraft portfolio is 5.4 years.

Page 9 -- leasing expenses were \$5.5 million for the third quarter compared to \$23.3 million in the same period of 2012. The decrease in leasing expenses was driven primarily by a lower impact from defaults and restructurings. SG&A for third quarter of 2013 was \$23.4 million. Our tax rate for third-quarter 2013 was 8.5% and is expected to be the same for the full year.

Page 10 -- AerCap's unrestricted cash balance at the end of the third quarter was \$318 million, and our total cash balance, including restricted cash, was \$593 million. Operating cash flows were \$198 million for the third quarter. Operating cash flows for the first nine months of 2013 was \$494 million.

Page 11 -- at the end of third-quarter 2013, AerCap's debt balance was \$6.2 billion, and our debt to equity ratio was 2.6-to-1. Our book equity is nearly \$2.4 billion, and the average cost of our debt for the third quarter of 2013 was 3.9%.

Now, page 12, with regard to the 2013 financial outlook, currently expected aircraft purchases are \$1.7 billion. Basic lease rents for the full-year 2013 is expected to decrease by approximately 3% as a result of the ALS portfolio sale. The maintenance contribution to income is expected to be minimal, and the pretax gain from committed aircraft sales in 2013 is now expected to be approximately \$40 million. And the average cost of debt in 2013 will be around 4%, and the blended tax rate, as mentioned, 8.5%.

With regard to 2014, page 13 -- as of now, the committed aircraft purchases are \$600 million, but is expected to grow. Basic lease rents for the full-year 2014 are expected to increase by approximately 7%. The maintenance contribution, again, will be minimal in 2014. Pretax gain from committed aircraft sales is currently at \$10 million. Average cost of debt will be, again, around 4%, and the tax rate around 8%.

So, those are the financial highlights for the third quarter. So, I'll turn it back over to Gus.



**Aengus Kelly** - *AerCap Holdings N.V. - CEO and Executive Director*

Okay, operator, if you could open up the Q&A session, please.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions). John Godyn, Morgan Stanley.

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**John Godyn** - *Morgan Stanley - Analyst*

Thanks for taking my question. First, Gus, I was hoping that you could just elaborate on credit risk by geography, what you're seeing out there in the customer base.

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**Aengus Kelly** - *AerCap Holdings N.V. - CEO and Executive Director*

Well, I think if you look at our results, you'll see that the credit position of the AerCap portfolio is extremely strong right now. We see the North American market being extremely robust. The European market is getting materially better. There's always pockets of weakness in various places. Of course, India still has some issues, but we have no aircraft left there, apart from two with Air India, which is the state at the end of the day.

So, overall, things are reasonably benign. I mean, we are very active when it comes to receivables management, with only \$6 million of receivables left and 1% of lease revenue. But I think more generally the point is that AerCap's receivables history has been that our total credit costs, going through -- the last six years, going through \$148 fuel, going through the financial crisis, have been less than 100 basis points of lease revenue on an annualized basis. So, the credit costs and the receivables management policy here at AerCap is very, very active.

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**John Godyn** - *Morgan Stanley - Analyst*

Okay. That's very helpful. And we've recently seen some announcements out of the OEs that confirm rate increases, that I think the market was sort of looking for, but now we finally have confirmation of it. We've also got some new technology around the corner, and that's a topic that you've spoken about in the past. But with some of these events not only now confirmed but closer to us in the timeline, I was hoping that you could just update your thoughts big-picture on how you see the situation with the OEs playing out, particularly with new technology? And whether the market, you think, can sustain these higher rate increases, as we look out a few years? Thanks.

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**Aengus Kelly** - *AerCap Holdings N.V. - CEO and Executive Director*

Well, when it comes to the OEMs, I wouldn't really pay much attention to their announcements. I'd pay a lot more attention to what they actually deliver. There's a precedent of announcing one thing and delivering another. So, that's the key. And you have to look back -- step away and look at the bigger picture of the industry. Ultimately, you have two suppliers in this industry. You have about eight leasing companies that matter, and then you have 600-plus airlines.

On the supply side, therefore, you have a duopoly that ultimately act rationally. If they feel that their customer base cannot absorb the level of aircraft that have been ordered, the historic precedent has always shown that they will work with their customers and defer canceled orders. What they have never done in the past is cannibalize their own customer base by putting enough aircraft into the market to put them into bankruptcy. That has never happened. So, this is not like shipping where you have 60 shipyards just trying to cover variable costs, and cranking out ships despite -- no matter what the market demand is.



So on the OEMs, I think they will ultimately act rationally. The much bigger issue is, did you buy right? I mean, look, if you overpay for the airplanes, you're going to be in trouble. What I would say about AerCap -- I can't comment on any others -- is, look at our track record of our ability to monetize gains on airplanes we have bought consistently. And in all the big transactions we've done recently, we have printed substantial gains in the sale of some of the airplanes in those deals. And, as I referenced, we have sold 270 airplanes at a gain of over \$300 million.

That's really the only evidence that a shareholder should look at, is to say, can they -- if you're worried about book values, can the Company consistently sell at or above book values? That's the key message. And that really demonstrates how the Company operates and its approach to investing. If you overpay, you're going to get into trouble sooner or later. It doesn't matter what the OEMs are doing.

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**John Godyn** - *Morgan Stanley - Analyst*

Great, thanks a lot.

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**Operator**

Michael Linenberg, Deutsche Bank.

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**Michael Linenberg** - *Deutsche Bank - Analyst*

I want to go back to the comment, Keith, you talked about 2014 committed purchases. You said look at that \$600 million, but it's expected to be more than that. When we think about the appetite and the capacity of the Company, is 2013, the \$1.7 billion, is that a pretty good guide? Or does that represent just a year where you were a little bit higher than normal? How can we think about that and the upside?

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**Keith Helming** - *AerCap Holdings N.V. - CFO*

Sure. I mean when we went into 2013, I don't recall exactly what the level was, but committed purchases were well below \$1.7 billion. So, we obviously committed to a lot during the year. So I think 2013 is a good representation of what 2014 could be. Yes.

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**Michael Linenberg** - *Deutsche Bank - Analyst*

Okay, very good. And then my second question, I want to go back to some of the more difficult jurisdictions out there. Gus, you mentioned India. You have two airplanes with Air India. It's essentially a sovereign credit. That said, I know Air India out there, I believe, they have an RFP for a sizable number of 737s. And some of the things that we're hearing is that there's not a lot of takers.

And so the question is, well, one, we haven't seen the dust settle on this. But two, does this send a message out to other jurisdictions, or call it rogue nations, who don't protect the investors, that it would be that much more difficult to finance their assets going forward. I mean, what's the potential message out of this? And did these airplanes ultimately get picked up?

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**Aengus Kelly** - *AerCap Holdings N.V. - CEO and Executive Director*

Well, let me start with Air India. They had an extraordinarily competitive 787 campaign at the start of this year, where there was a tremendous amount of activity. And Air India, ultimately, is an airline that will get financed. Because, as you rightly point out, it is a sovereign credit. We have never had a single overdue balance from Air India in doing business with them for 20-plus years. So, Air India is separate.

Then, of course, you have other airlines in India. Now, Kingfisher is one where we were involved. We took our airplanes. We had six in there. We had them all out within a matter of weeks in late 2011. We had them all out over two years ago, and we had them out in a couple of weeks. You



know? So, the same is true in Mexico. We had our six airplanes out in 24 hours. Others had to wait an extended period of time to get them out of both of those airlines.

We are very active. I can only speak to AerCap's experience -- there has never been an airplane we couldn't get out within 60 days. The most difficult jurisdiction we've ever faced is the United States. That is the hardest jurisdiction to operate in, in a bankruptcy. If you have some of the challenged airplanes in the US major, that's where the biggest losses are always incurred. The situation in Kingfisher was, of course, disappointing; I understand that. But we have demonstrated our ability to cope in these jurisdictions.

The airplane that I referenced we pulled out earlier this quarter was out of a former Soviet Republic. People might look at it and say that must be a challenge, but it was done, as I said, within 72 hours. And then the airplane was back and it was gone through the maintenance shop and released straightaway. So, I think your message about India in general, we would certainly do business in India, but it's got to be on terms where you know that you can move quickly if things go wrong.

You know, Mike, when it comes to managing receivables, it's the loss-given default that you look at and say, right; based on my experience, my collateral package, the asset, what do I think I could lose in a default? And do I have enough collateral against that? That's how we certainly look at our Kingfisher exposure -- rather than the probability of default, look at the loss-given default. And make sure, then, that you're disciplined with yourself in managing that loss-given default, that if you ever get near that, that you're repossessing the airplanes quickly. So, we would be careful, of course, in how we structure a transaction, but we would certainly go back into India, no problem.

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**Michael Linenberg** - *Deutsche Bank - Analyst*

Okay, very good. Thank you for that.

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**Operator**

Jason Arnold, RBC Capital Markets.

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**Jason Arnold** - *RBC Capital Markets - Analyst*

I was just wondering if you could speak in a bit more detail about the opportunities you're seeing in the North American markets?

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**Aengus Kelly** - *AerCap Holdings N.V. - CEO and Executive Director*

I mean, the North American market is somewhere where we were very focused on a few years ago. And we felt that the consolidation was going to lead to a much more robust market. And hence, we moved a lot of material into North America -- not just the big American deal, but we did a lot more there. And now, of course, you know, look -- the North American airlines, particularly the majors, are generating extremely healthy levels of profitability and cash flow. I think it's evidenced by Delta's entry into the S&P 500; the first time an airline has done that in a very long time.

So, the North American market now, if we were to try and go in, is a much tougher proposition. You know, the time to try and get in there was probably a couple of years ago, when we went in. You've got to wonder if you can make the return on equity that your shareholders deserve if you're going to go into the North American market now, because it's so robust. We'd love to do a lot more here, obviously, but with the state of the EETC market and the level of profitability that these majors are generating, it's much tougher.

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**Jason Arnold** - *RBC Capital Markets - Analyst*

Great. Thanks for the color. Appreciate it.



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**Aengus Kelly** - *AerCap Holdings N.V. - CEO and Executive Director*

Welcome.

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**Operator**

Gary Liebowitz, Wells Fargo Securities.

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**Gary Liebowitz** - *Wells Fargo Securities - Analyst*

Gus, with the first of the new LatAm aircraft starting to deliver next year, can you give us an update on the financing strategy for those planes, what's being considered right now?

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**Aengus Kelly** - *AerCap Holdings N.V. - CEO and Executive Director*

You know, for the 787 on lease to LatAm, there's an awful lot of inbound calls, Gary, to do those deals. I think our strategy, our preferred strategy, internally, would be to use it as part of a portfolio financing. Where you have, in this instance, the most in-demand airplane in production next year with one of the top credits in the world, I think we will look to get some synergistic benefit out of that and finance it as a portfolio, either in the capital markets or in the bank market.

Keith?

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**Keith Helming** - *AerCap Holdings N.V. - CFO*

No, I agree with that. I think that's exactly right.

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**Gary Liebowitz** - *Wells Fargo Securities - Analyst*

Okay. Also, can you comment on this quarter's leasing expenses or net maintenance expenses overall? It seemed like leasing expenses were as low as they've been in a very long time; yet next year, your guidance assumes no net contribution from maintenance. Does this \$5 million figure go back to the usual quarterly \$10 million to \$15 million going forward?

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**Keith Helming** - *AerCap Holdings N.V. - CFO*

Yes, this quarter, Gary, was unusually low. I mean, first of all, just the year-over-year comparison, there were effectively very limited amounts of costs relating to defaults and restructuring versus last year. The biggest decrease was associated with that. But the \$5.5 million did not include any lessor contributions. It didn't include a lot of the normal transition costs. Again, these are costs that are not evenly distributed quarter-to-quarter. So, \$5.5 million is low. You'll see in our guidance the outlook that we'll go through today in the Investor Day discussion -- that the annual rate will be around the \$60 million - \$65 million level going forward.

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**Gary Liebowitz** - *Wells Fargo Securities - Analyst*

Okay, great. And just one last clarification. I hate to go back to this, but on the guidance for 7% basic lease rent growth, does that assume only the \$600 million that's committed? Because you've talked about maybe doing two or three times that much. Does that 7% reflect the \$600 million only?





**Keith Helming** - *AerCap Holdings N.V. - CFO*

It only includes the \$600 million -- the piece that's committed so far, yes.

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**Gary Liebowitz** - *Wells Fargo Securities - Analyst*

Okay. Thank you very much.

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**Operator**

Ryan Zacharia, Jacobs Asset Management.

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**Ryan Zacharia** - *Jacobs Asset Management - Analyst*

Thanks for taking the question. Just on the personnel expense this quarter, there was a big kind of sequential end year-over-year rise. Just trying to understand what drove that.

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**Keith Helming** - *AerCap Holdings N.V. - CFO*

Again, we had some additional costs relating to some specific bonus programs that was a catch-up for the full year. The annual rate that you should see again for SG&A should be around the \$21 million to \$22 million level on a quarterly basis.

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**Ryan Zacharia** - *Jacobs Asset Management - Analyst*

Okay, thanks. That's the only question I have.

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**Operator**

Helane Becker, Cowen and Company.

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**Helane Becker** - *Cowen and Company - Analyst*

Thanks for the time. Just one question. On the 747 freighter, did you say whether you disposed of it or parted it out? Or what was the disposition of that?

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**Aengus Kelly** - *AerCap Holdings N.V. - CEO and Executive Director*

They've both been released Helane.

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**Helane Becker** - *Cowen and Company - Analyst*

Oh, okay. Fine. Are you happy with that freighter market these days?

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**Aengus Kelly** - *AerCap Holdings N.V. - CEO and Executive Director*

You know, the freight market's a tough spot. We sold a freighter last year. We've never been big in the freight business. We acquired these as part of a bigger portfolio when we bought the Genesis Company a few years back. But you know it's such a tiny percent of our overall net assets at less than 1%, it's not really a material amount. But the freight market is in a tough spot. There's no getting away from it.

**Helene Becker** - *Cowen and Company - Analyst*

Okay, thank you. See you later.

**Aengus Kelly** - *AerCap Holdings N.V. - CEO and Executive Director*

Okay. No problem.

**Operator**

As there are no further questions, I'd like to hand the conference back over to Peter Wortel.

**Peter Wortel** - *AerCap Holdings N.V. - VP of IR*

Thank you very much. We hope to see you today at the New York Palace, if you're able to come. If you have more questions, please shoot me an email or give me a call. You can find my details on the website. Thanks very much.

**Aengus Kelly** - *AerCap Holdings N.V. - CEO and Executive Director*

Thank you all.

**Keith Helming** - *AerCap Holdings N.V. - CFO*

Thank you.

**Operator**

That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.

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