Company Name: AerCap Holdings
Company Ticker: AER US
Date: 2019-11-08
Event Description: Q3 2019 Earnings Call

Market Cap: 8384.00826575
Current PX: 61.375
YTD Change($): 21.775
YTD Change(%): 54.987

Bloomberg Estimates - EPS
Current Quarter: 1.864
Current Year: 7.84
Bloomberg Estimates - Sales
Current Quarter: 1232
Current Year: 4930

Q3 2019 Earnings Call

Company Participants

- Joseph McGinley, Head of Investor Relations
- Aengus Kelly, Chief Executive Officer
- Peter Juhas, Chief Financial Officer

Other Participants

- Moshe Orenbuch, Analyst
- Drew Campbell, Analyst
- Helane Becker, Analyst
- Ross Harvey, Analyst
- Catherine O'Brien, Analyst
- Scott Valentin, Analyst
- Koosh Patel, Analyst

Presentation

Operator

Good day, and welcome to the AerCap's Third Quarter 2019 Financial Results Call. Today's conference is being recorded and a transcript will be available following the call on the company's website.

At this time, I would like to turn the conference over to Joseph McGinley, Head of Investor Relations. Please go ahead, sir.

Joseph McGinley, Head of Investor Relations

Thank you, operator, and hello everyone. Welcome to our third quarter 2019 conference call. With me today is our Chief Executive Officer, Aengus Kelly; and our Chief Financial Officer, Pete Juhas.

Before we begin today's call, I would like to remind you that some statements made during this conference call, which 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. AerCap undertakes no 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.

Further information concerning issues that could materially affect performance can be found in AerCap's earnings release dated November 8th, 2019. A copy of our 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.

We will shortly run through our earnings presentation and will allow time at the end for Q&A. As a reminder, I would ask that analysts limit themselves to one question and one follow-up.

I will now turn the call over to Aengus Kelly.

Aengus Kelly, Chief Executive Officer

Thank you, Joe, and good morning, everyone. Thank you for joining us for our third quarter earnings call. I'm pleased to report another quarter of strong earnings. During the third quarter, AerCap generated $2.01 of earnings per share and net income of $270 million. It is of course, the platform of AerCap and its people that underpins our success.

During the quarter, the AerCap team executed 108 aircraft transactions, made about 72 lease agreements, 16 aircraft purchases and 20 aircraft sales. Furthermore, 23 of these transactions were for wide-body aircraft. On the purchases side, we took delivery of nine A320neos, four 787-9, two E2s and an A350 900. These aircraft remain the most in-demand variance of their types, which helps us to place them further and further out into the future. The key to AerCap's purchasing and portfolio strategy is to buy aircraft that our customers want, not whatever Boeing and Airbus want to sell.

With regard to the MAX, we did not take any deliveries in Q3. Boeing continues to work with the civil aviation authorities to ensure the MAXs safe return to service, and Boeing continues to assume that they will obtain regulatory approval in the fourth quarter of this year. Ultimately, though, the FAA and other regulatory authorities will determine the timing, and we may see variations by jurisdiction. As a reminder, we have taken delivery of only five MAX aircraft to-date, and we do not expect to receive any for the remainder of this year.

On the sales side, we continue to be active sellers of mid-life and older assets. During the quarter, we sold 19 owned aircraft at an average age of 14 years, and achieved a gain on sale of 8%. However, much more importantly, what this gain equates to is a premium of almost 30% to the book equity associated with these aircraft. And this is approximately the premium to book equity that AerCap has been earning on aircraft sales for the last 13 years. These sales have resulted in a further reduction in the average age of our portfolio to 6.2 years from 6.6 a year ago, and our average remaining lease term is now 7.5 years, up from 7.1, 12 months ago. Next Monday, I will go into much more detail at our Capital Markets Day on why we believe AerCap's portfolio strategy over the course of the last 13 years has consistently created the best fleet in the industry, and today is no exception.

On demand, the utilization rate in the quarter for AerCap was 99.8%, as demand for our fleet remains high. IATA data shows that RPKs grew 4.5% through the first nine months of this year to September 30. While these levels are lower than prior years, we believe this growth rate has been impacted by supply-side issues. During the summer, thousands of flights were cancelled due to both the MAX grounding and importantly A320neo delays.

In summary, this was another strong quarter for AerCap with EPS of 12% year-on-year. Our consistent growth in earnings and book value per share is the result of our people, processes, procedures, and a relentless focus on execution.

With that I will hand it over to Pete, before we head to Q&A.

Peter Juhas, Chief Financial Officer

Thanks, Gus. Good morning, everyone. AerCap produced a very strong performance in the third quarter. We had earnings per share of $2.01, a net income of $270 million. We were upgraded to BBB flat by S&P in October and placed on positive outlook by Moody's in August. So we continue to have a positive ratings trajectory. Our utilization rate was very high, as Gus mentioned at 99.8% for the third quarter, and we completed 108 aircraft transactions in the quarter, that included purchases of 16 new tech aircraft during the quarter and sales of 19 of our older and midlife aircraft. Our average lease assets increased by $2.4 billion year-over-year, and our average main lease term is now 7.5 years, one of the longest of any major lessor.

Our book value per share increased by 13% over the past year to $69.24, as of September 30th. We've continued with our share repurchase program. In the third quarter, we bought 2 million shares for $104 million. So far this year we've bought 9.1 million shares for a total of $438 million. So all together, it's a very strong quarter that reflects our consistent operating performance, power of the AerCap platform and our disciplined approach to managing our assets and allocating our capital. We're also announcing today, a new $200 million share repurchase program that will run through March of next year.

Turning to slide 5, our EPS increased by 12% year-over-year to $2.01 for the third quarter. This increase was driven by higher lease rents, resulting from higher average assets in 2019 compared to 2018, as well as to a higher gain on sale of aircraft during the quarter.

On slide 6, our total revenues for the quarter were $1,194 million, an increase from $1,167 million last year, primarily driven by the increase in our average lease assets. Our basic lease rents increased to $1,067 million for the third quarter, while maintenance revenues at $73 million were lower in 2019 due to lower maintenance revenue recognized, as a result of lease terminations. Gains on sale were higher based on the higher volume on the composition of aircraft sales in the quarter and other income was flat year-over-year.

On slide 7, our net interest margin was $758 million for the third quarter. The increase over last year was due to growth in our basic lease rents, driven by higher average lease assets. Our average cost of debt for the third quarter was 3.9% before debt issuance costs and fees of around 30 basis points. Including those costs and fees, it was 4.2% for the third quarter with a slight increase from 2018, driven primarily by the roll off of fair value of debt related to purchase accounting.

Our net spread was 8% for the third quarter, and our net spread less depreciation was 3.5%, up from 3.3% last year. Our net spread less depreciation was higher than normal in the third quarter because we had lower maintenance rights amortization expense this quarter than we would normally see.

The average age of our fleet decreased from 6.6 years to 6.2 years over the past year. We achieved this through a combination of purchases of new tech aircraft and sales of older current technology aircraft. The average age of our new tech aircraft, which represent 55% of our fleet today is 2.2 years, while the average age of our current tech fleet is around 11.1 years. So effectively in the third quarter of 2019, we generated higher returns on a better positioned portfolio, the lower average age, a higher proportion of new tech assets, and a longer average remaining lease term.

Turning to slide 8, our net gain on sales was $40.5 million for the third quarter. We sold 19 of our owned aircraft, including 40 narrow bodies and 5 wide-bodies with an average age of 14 years for a total of $561 million. And as Gus mentioned, our gain on sales margin was around 8% for the quarter. Turning to aircraft purchases in the third quarter, we took delivery of 16 new aircraft for CapEx of around $1.3 billion.

On the next slide, our SG&A expenses were around $65 million for the third quarter about the same as last year. This includes all stock compensation expense and is around 5.4% of revenues, which shows the efficiency of our platform. Our maintenance rights expense was $14 million for the quarter, down from $34 million in 2018. This was primarily driven by the lower maintenance rights asset balance as that asset continues to roll off, and it's also impacted by the level of maintenance activity.

Our other leasing expenses were $30 million for the quarter, a decrease from $51 million last year, and this was due to lower expenses related to lease terminations compared to the prior year period. The asset impairments in the third quarter related primarily to lease terminations and were largely offset by maintenance revenue recognized upon termination.

On slide 10, we continue to maintain a very strong liquidity position. As of September 30th, we had available liquidity of $9.1 billion, which includes our cash, our revolvers, our other undrawn facilities, and our contracted sales. In October, we amended and extended our main revolving credit facility. We kept the size of the facility at $4 billion and extend the maturity until 2024. Our total cash sources of $12.2 billion are twice our cash needs over the next 12 months, which amounts to excess cash coverage of just over $6 billion, and we'll talk more about our approach to liquidity on Monday.

Finally, our shareholders equity at the end of September was $9.175 billion and our book value per share was $69.24 compared to $61.24 last September. That's a 13% increase over the past 12 months. And through our operating performance and capital allocation strategy, we can continue to generate strong growth in book value per share year-after-year.

So in summary, we had another very strong quarter. Our EPS was up 12%; our utilization rate was high; our fleet continues to grow with the addition of new tech aircraft. We're placed far out into the future, and we continue to sell used aircraft at attractive prices.

We ended the quarter with a strong level of liquidity and through our operating performance and capital allocation strategy, we continue to generate strong double-digit growth in book value. And we've continued to maintain our positive ratings trajectory with the upgrade from S&P in October and the positive outlook from Moody's in August.

And with that, now I will turn it over for Q&A.

Questions And Answers

Operator

Thank you, sir. (Operator Instructions) We'll now take our first question over the phone from Moshe Orenbuch from Credit Suisse. Please go ahead. Your line is open.

Moshe Orenbuch, Analyst

Great. Thanks. I guess, first from a high level perspective, I mean, given that you've seen some increase in industry M&A, with one of your competitors being acquired relatively recently. Any thoughts about whether that presents opportunities in some respects for AerCap in the coming months?

Aengus Kelly, Chief Executive Officer

Moshe, I think it demonstrates once again the big discrepancy between where aircraft trade in what we would call the private market, i.e. not in the public equity markets, where a very, very small minority of aircraft leasing occurs i.e. ourselves and Air Lease now being the only two listed companies. But in the private market, where there is huge amounts of capital in this industry and tremendous interest in the business.

What we have seen is that for the course of the last five years, AerCap has pretty much sold 2.5 times the entire size of Aircastle, and we've done it at a premium to book of 130%. And because we're selling airplanes at an 8% gross margin, this business is lever three to one, that's how you get your 30% premium is what we have been consistently selling our assets out in the secondary market. And of course, then where appropriate and applicable, we've been using those proceeds to buy up our own shares at about 84%, 85%. So -- so long as that arbitrage continues to exist, we will exploit it.

Moshe Orenbuch, Analyst

Right. And you've actually done a really, really strong job with respect to that. My second question is just a little more -- little more basic, I mean your spread less depreciation was strong. Could you talk a little bit, I mean, because now you're getting probably closer to where the fleet getting younger, it has less of an impact on the yield, maybe the run-off of some of the debt costs and the lower interest rate environment. Can you talk about that sustainability of that 3.5% as we go forward?

Peter Juhas, Chief Financial Officer

Yeah. Well, Moshe, so we do expect to sustain that above 3%. But I think I'll cover that on Monday in the Capital Markets Day when we have more time to go through all the dynamics there.

Moshe Orenbuch, Analyst

Okay. Thank you, Peter.

Operator

(Operator Instructions) We'll now take our next question from Jamie Baker from JP Morgan. Please go ahead. Your line is open.

Drew Campbell, Analyst

Good morning, guys. This is Drew Campbell [ph] on behalf of Jamie Baker. Just a quick on from me. With a growing focus on ESG, can you just touch on what kind of discussions you may be having with customers to alleviate this -- their concerns and how this may impact your long-term strategy going forward?

Aengus Kelly, Chief Executive Officer

Sorry, I couldn't quite hear the question, would you mind repeating it?

Drew Campbell, Analyst

Yeah. Just with the growing focus on ESG, can you just touch on what kind of discussions you could be having with the customers to alleviate these concerns? And how this could potentially impact your long-term strategy going forward?

Aengus Kelly, Chief Executive Officer

Sure. Well, clearly on the environmental side, we've done a tremendous amount to reduce the carbon footprint and fuel burn of our fleet. We have spent more money than anyone in the world on acquiring new technology assets. We spent $23 billion in the last five years buying the most advanced fuel-efficient airplanes that there are in the market.

And so we continue to have those discussions with our customers. So we're doing as much as we can. However, it has to be said of course, when you're an airline, margins are thin. It's a large-scale business with relatively thin margins. And while many of our customers are doing all they can to reduce the fuel burn that they have by the same token, they also have an obligation to their shareholders as well. And so there is still strong demand for current technology assets -- good variance of current technology assets, which would be the 320, the 737, the 777, and the A330.

Drew Campbell, Analyst

Got it. Thank you.

Operator

We'll now take our next question from Helane Becker from Cowen. Please go ahead. Your line is open.

Helane Becker, Analyst

Hello.

Aengus Kelly, Chief Executive Officer

Hello, Helane.

Helane Becker, Analyst

Hello?

Peter Juhas, Chief Financial Officer

Yeah. We can hear you.

Helane Becker, Analyst

Hello? Oh, yes. Okay, sorry about that. So here's my question. I have actually two questions. My first question is, and I don't mean to be stupid and I apologize. But when you talk about the gains that you report and the fact that you had an 8% gain on the sold aircraft, is that a gain after -- Is that a pure gain on your cost or is that a gain after writing assets down? How -- I don't understand how to think about that like the difference between the two, you know, what I mean [ph] or guess?

Aengus Kelly, Chief Executive Officer

Helane, our gain is simply the carrying value of our assets before any charges, write-downs or anything like that and what we're selling at a premium. So if we sell -- we have an asset on our books for $100 unlike other leasing companies have taken large impairments because they bought the wrong assets, AerCap never has. So the only impairments we've ever taken --

Helane Becker, Analyst

Okay.

Aengus Kelly, Chief Executive Officer

(multiple speakers) as Pete just announced was to do with -- small amounts to do with lease terminations, where you're offsetting maintenance reserves. But the large-scale impairments --

Helane Becker, Analyst

Okay.

Aengus Kelly, Chief Executive Officer

That have occurred to some other leasing companies has never ever happened at AerCap, and we only report unadjusted GAAP numbers. We don't give you any other metric except what money we actually make and what's available to distribute to shareholders. And so when we give you a number, if we say we sell an airplane at an 8% margin, it was on the books for 100 million, that means we sold it at 108 million. However, because the equity component is 25 million, we're levered 3 to 1, so in our 100, 25 is equity. We're actually selling at a premium to our equity component of over 130%. So over the last 13 years, 14 years, AerCap has consistently sold 800 plus airplanes at a margin of 130% approximately to its book equity.

Helane Becker, Analyst

Okay. That's very helpful. Thank you very much. I appreciate that. And then just on my other question. There seems to have been a decline in the number of Chinese leasing companies that we've been seeing. And I'm kind of wondering if you guys are seeing that as well. Are you seeing fewer competitors when you're out there competing for business? Are you noticing that?

Aengus Kelly, Chief Executive Officer

Helane, it's fair to say that over the course of the last eight years, nine years, there was an influx of start-up capital into this sector. Much of this did come from China and that capital is particularly focused on chasing new airplanes, either through the sale leaseback markets, through buying airplanes of other lessors, such as ourselves or in some rare, in a small minority of cases ordering from Airbus and Boeing.

Now, what we have seen, and we have observed over the course of the last 12 odd months is a reduction in the appetite that particularly Chinese lessors have. I think that's due to a combination of factors, many of them are owned by banks, where dollar funding is maybe slightly more challenging. Furthermore, some of them will have paid some significant premiums to get their hands on those assets. Those assets are now maturing. The leases that they bought them on, the leases are expiring, and they're having to place these airplanes themselves. And few of them have a platform capable of leasing aircraft. And so I think we have -- well, I know we have seen at least a couple of these lessors start to sell off parts of their portfolio. However, there are still some of course, that are very competitive in the market, but there is certainly a reduction.

Helane Becker, Analyst

Okay. Thank you very much. I appreciate that, and well, see you, Monday.

Aengus Kelly, Chief Executive Officer

No problem.

Operator

We'll now take our next question from Ross Harvey from Davy. Please go ahead. Your line is open.

Ross Harvey, Analyst

Hi. Good morning, guys. Congrats on the good quarter. I'm going to leave more of the strategic questions to Monday, but on the housekeeping side I'm just wondering for Pete, what should we think about in terms of baseline maintenance rights, amortization expenses, and SG&A in the coming quarters?

Peter Juhas, Chief Financial Officer

Well, Ross, I'll cover all that stuff on Monday as well. But I mean basically, it's been running at about lately $65 million or so, SG&A. That -- it probably could go up slightly from that, but it's going to be around that area, $65 to $70 million. And then on the maintenance rights amortization, it was low this quarter at only $14 million. Typically, that would be more like $20 million, $25 million or so, maybe $30 million, but probably $25 million is a good number.

Ross Harvey, Analyst

See you on Monday.

Peter Juhas, Chief Financial Officer

Thanks.

Operator

We'll now take our next question from Catherine O'Brien from Goldman Sachs. Please go ahead. Your line is open.

Catherine O'Brien, Analyst

Good Morning, everyone. Thanks for the time. So a bit of a follow-up to Moshe and Helane's question earlier. You're seeing -- I guess, there has been this continuing discussion over the past couple of quarters that new entrant competition has decreased or those in the market has gotten a little bit more rational perhaps. Have we gotten to the point, where you think there are more attractive opportunities for M&A or really does buying back your own shares, is that still the most accretive option to grow earnings? Thanks.

Aengus Kelly, Chief Executive Officer

Well, Catherine, as I said, look, if we are consistently able to sell our own airplanes at 130% of book and buy ourselves back at 85 odd, that's a fairly big arbitrage. So that's highly attractive. But throughout the cycle, you have to be nimble and recognize opportunity, where it comes from. We have obviously bought more airplanes than anyone in the world over the last five years. We've paid down more debt than anyone in the world. We've given back more money to our shareholders than anyone in the world.

And over the last 15 years, we've done more M&A than anyone in the world. And so what you need to be is nimble to which alternative creates the best risk reward for your shareholders over the medium to long term. And if that's M&A well and good, as we've done a lot of it, but if it isn't, it isn't. And you just got to see what are the opportunities are, we will talk a bit more about this on Monday, as well though.

Catherine O'Brien, Analyst

That's great. And then maybe one of your competitors noted last night that Boeing is providing financial assistance to some of their lessees impacted by the grounding of the MAX, in some cases helping them pay their monthly leases. Are your lessees also receiving financial assistance from Boeing? Thanks.

Aengus Kelly, Chief Executive Officer

It varies by customer and the needs of each customer what is happening with Boeing, and there's a wide array of discussions going on at the moment. And they are very much, I would say, in the first innings of those discussions. There is a fair bit of wood to chop.

Catherine O'Brien, Analyst

Got it. If I could just sneak maybe one quick modeling one in. Any update on the 6.60 to 6.80 EPS outlook for this year ex-gains?

Peter Juhas, Chief Financial Officer

No, we'll be -- I'll be providing a new update for this year and for next year on Monday.

Catherine O'Brien, Analyst

Okay, great. Looking forward to it. Thank you.

Peter Juhas, Chief Financial Officer

Thanks.

Operator

We will now take our next question from Scott Valentin from Compass Point. Please go ahead. Your line is open.

Scott Valentin, Analyst

Yeah. Thanks for taking my question. Just Gus, you mentioned the 737 MAX, the timing of the return is up to the regulators. But when it does come back, do you expect there to be a glut of aircraft? Do you think it might depress given the increase in supply of aircraft narrow bodies particularly, might depress again on sale margins for a little bit until -- till the market clears?

Aengus Kelly, Chief Executive Officer

I don't, I think -- look everybody knows this airplane will come back. It's planned into the schedules for some point in the new year, certainly there will be differences by jurisdiction. But ultimately, the airlines are expecting the airplanes they have to get back in the year and for deliveries to resume. The pace at which they resume remains to be seen. Will Boeing be able to deliver at the rate they've indicated? Perhaps, perhaps not. But I do think that the process will stretch out over time and that the customers are assuming these airplanes are coming. So I don't see these aircraft leading to a glut in supply in the market.

Scott Valentin, Analyst

Okay. Thanks. Just a follow-up also. Airbus is having their own issues at the Homburg plant. I was just wondering how you think about CapEx, and if there's delays do you step into the secondary market, and maybe do sale leaseback transactions or do you just let it work through the system? And you said you can buy back stock and do other things with the capital?

Aengus Kelly, Chief Executive Officer

We would never ever go out and buy airplanes for the sake of growth, ever. We'll only ever spending our shareholders money if it makes a sensible long-term return for our shareholders. If we do not receive airplanes from Boeing and Airbus as scheduled, it will be enact of gross stupidity to go into the market to buy overpriced sale leasebacks in order to satisfy our quarterly growth targets. And this company will never do that. And what we'll do is look at what are the best possible alternatives available for us with the capital that is not being used that could be buybacks, it could be just waiting for the airplanes to come, but never under any circumstances we'll be going into the market to buy sub-optimal or overpriced assets on the spur the moment because you're not getting deliveries from Boeing and Airbus.

Scott Valentin, Analyst

Okay. Thanks. I appreciate the response.

Aengus Kelly, Chief Executive Officer

Thank you.

Operator

Our next question comes from Koosh Patel from Deutsche Bank. Please go ahead. Your line is open.

Koosh Patel, Analyst

Hi, guys. I just had one aircraft types. Now that the Airbus A220s has continued to gain some traction with airlines, how do you guys think about how that asset might fit into the AerCap portfolio? And maybe more broadly speaking, is that the right asset for a public lessor portfolio?

Aengus Kelly, Chief Executive Officer

Look, I think the -- now that the A220 has been -- it was obviously on the Bombardier. The big concern everybody had was -- was Bombardier, a viable entity stand-alone that was highly questionable, the fear, the manufacturer would survive. So everyone was extremely reluctant to purchase that airplane because if the OEM failed, then the value of the asset would tank.

Now that Airbus have us -- certainly that issue is long gone, and it has the Airbus muscle behind us. I think the long-term success of the airplane will probably be the next variant. If there is a new family of Airbus airplanes or if this airplane is modified to have more commonality with the 320 family itself.

Koosh Patel, Analyst

Great. Thanks a lot guys.

Operator

Ladies and gentlemen, this concludes today's question-and-answer session. Mr. Kelly, I would like to turn the conference back to yourself for any additional or closing remarks.

Aengus Kelly, Chief Executive Officer

Thank you very much. Look, in closing, we produced another very strong quarter of earnings and profits. This is achieved through a very proactive risk management policy and a disciplined approach to portfolio management, but above all a relentless focus on execution in all parts of the business. As you all know, we'll be hosting the 2019 Capital Markets Day next Monday in New York at the St. Regis hotel, and we hope, we'll see as many of you as possible there on Monday. Thank you very much everyone.

Operator

Ladies and gentlemen, this concludes today's call. Thank you for your participation. You may now disconnect.