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AER - Q1 2014 AerCap Holdings N.V. Earnings Conference Call

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OVERVIEW:

AER reported 1Q14 total revenue of \$265m, reported net income of \$54.7m and reported EPS of \$0.48.



CORPORATE PARTICIPANTS

Peter Wortel *AerCap Holdings NV - VP, IR*

Aengus Kelly *AerCap Holdings NV - CEO*

Keith Helming *AerCap Holdings NV - CFO*

CONFERENCE CALL PARTICIPANTS

Gary Liebowitz *Wells Fargo Securities - Analyst*

Arren Cyganovich *Evercore Partners - Analyst*

Richa Talwar *Deutsche Bank - Analyst*

Scott Valentin *FBR & Co. - Analyst*

Ryan Zacharia *Jacobs Asset Management - Analyst*

PRESENTATION

Operator

Welcome to AerCap Holdings first-quarter results conference call. At this time, all participants are in listen-only mode. This 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 will now hand the call over Peter Wortel, Head of Investor Relations.

Peter Wortel - *AerCap Holdings NV - VP, IR*

Thank you very much and good day, everyone. Welcome to our 2014 first-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 in addition to this earnings call, AerCap will also host a group presentation for analysts and investors today at the New York Palace hotel in the Spellman room starting at 11:30 AM. Doors will open at 11 AM. This presentation will not be webcast.

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. Further information concerning issues that could materially affect performance related to forward-looking statements can be found in AerCap's earnings release dated May 6, 2014.

A copy of the earnings release and conference call presentation are available on our website, AerCap.com. This call is open to the public and is being webcast simultaneously at AerCap.com and will be archived for replay.

I will now turn the call over to Aengus Kelly. Please go ahead.



Aengus Kelly - *AerCap Holdings NV - CEO*

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 first-quarter earnings call.

Following on the record year of 2013, we got off to a good start in 2014 with net income of \$80 million and adjusted EPS increased 17% to \$0.70. In April, we further optimized our portfolio by closing the sale of the \$750 million Genesis securitization. This resulted in the sale of 37 aircraft with an average age of 13 years. This takes the total number of aircraft that AerCap has sold to 313 aircraft, also with an average age of 13 years.

We remain on track to complete our industry-transforming transaction with ILFC, which will see AerCap become the largest independent aircraft lessor in the coming weeks. Our endeavor, disciplined approach, and strict adherence to four core strategic principles continue to be the foundations of our success.

Firstly, the way we actively manage credit risk. Our receivables balance was \$8 million at quarter end. Secondly, continuous portfolio management, as evidenced most recently by the sale of the Genesis portfolio.

Thirdly, our adherence to a long-term, stable liability structure, which matches our long-term assets and draws on highly diversified funding sources around the world. And fourthly, the manner in which we hedge our interest rate exposure through a combination of interest rate caps, fixed rate debt, and swaps.

I just referenced our groundbreaking transaction with ILFC and can tell you that the required anti-trust approvals have been received. In the meantime, dedicated teams from both AerCap and ILFC, led by our COO, have been working tirelessly on the integration process since the beginning of this year and we are on track to meet the milestones that we have set ourselves.

While this deal is transformational in terms of size, we will maintain our discipline and will continue to follow the core principles that I just mentioned, which are deeply embedded in AerCap's DNA and which put AerCap in a position to do this deal in the first place.

Our portfolio continues to perform well with 99% utilization. The results of the first quarter demonstrate that we are in a position of strength when it comes to delivering on our immediate priorities post completion of the ILFC deal. Our current portfolio has an average remaining lease term of 6.5 years and we have already contracted all of our future deliveries with an average lease term of 12 years.

Turning to the airline industry, we have observed a solid start to 2014, with Europe outperforming other regions in terms of traffic growth. Lease rates and demand for the core aircraft of the global fleet remain good, those types being the 320, the 737, the 330, and 777 families. Demand is good for these aircraft and post completion of the transaction, over 85% of our portfolio by value will be in these types. Our combined forward order book consists of the most in-demand new technology aircraft, such as Airbus 350s, 320neos, Boeing 787s, and Embraer E2s, and are very attractive in terms of pricing and delivery slots.

We have always told you that we will continually optimize the portfolio. Going forward, we expect to sell approximately \$1 billion of aircraft per annum to accomplish this objective.

We believe that this is very achievable given that AerCap on a standalone basis has annually executed this level of sales. Evidence of this is the fact that we just sold a \$750 million Genesis securitization. This transaction reduces the average age of our fleet to five years and, as I mentioned earlier, with the execution of this deal we've now sold over 300 aircraft.

AerCap's financial resources, along with our access to the global financing markets, helped us raise almost \$3 billion in the first quarter. This includes a new \$2.75 billion, four-year unsecured credit facility which will replace ILFC's \$2.3 billion facility. In total, we have now put in place almost \$4 billion of liquidity related to the ILFC deal. This is following on from the \$6 billion we raised in 2013.

Our conservative approach to funding and leverage allied to our strong track record of executing landmark deals provide AerCap shareholders with stable, long-term, high-quality profits and cash flows. As I have previously stated, the correct allocation of capital is always at the forefront of our minds. Both acquisitions and disposals of aircraft must result in an appropriate risk/reward balance for our shareholders.

To close, and most importantly, I would like to thank the entire AerCap and ILFC team for their tireless efforts over the course of the last five months without which this transaction could never happen. On that note, I will hand the call over to Keith before we open up to the Q&A.

Keith Helming - *AerCap Holdings NV - CFO*

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

Our reported net income for the first quarter of 2014 was \$54.7 million. Adjusted net income, which excludes the various items listed, was \$79.9 million, which is an 18% increase over the first quarter of 2013.

On page 5, reported earnings per share were \$0.48 in first quarter 2014. Adjusted earnings per share were \$0.70 during the same period. The average shares outstanding during the first quarter of 2014 was \$113.6 million.

Page 6, total revenue in first quarter 2014 was \$265 million, an increase of 8% over the first quarter 2013. The increase in total revenue was driven primarily by higher basic lease rents.

Page 7, net interest margin or net spread was \$177 million in the first quarter 2014, which is a 16% increase over the first quarter of 2013. The annualized margin as a percent to average lease assets was 8.7%.

Page 8, the impact from sales in the first quarter 2014 was a pretax gain of \$9.8 million and during first quarter 2014 we sold one A330 from our own portfolio.

Page 9, leasing expenses were \$12.8 million and SG&A was \$23.1 million in first quarter. Also in first quarter of 2014, we incurred \$21.5 million of expense relating to the ILFC transaction. The tax rate for the first quarter 2014 was 8.5%.

Page 10, AerCap's unrestricted cash balance at the end of the first quarter was \$320 million and our total cash balance, including restricted cash, was \$587 million. Operating cash flows were \$159 million for the first quarter of 2014.

And page 11, at the end of first quarter 2014, AerCap's debt balance was \$6.2 billion and our debt to equity ratio was 2.5 to 1. Our book equity is at \$2.5 billion and the average cost of our debt in the first quarter was 3.9%.

So those are the key financial highlights for the first quarter and then I would like to now open it up for Q&A.

Peter Wortel - *AerCap Holdings NV - VP, IR*

Operator, can you start the Q&A, please?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Gary Liebowitz, Wells Fargo Securities.



Gary Liebowitz - Wells Fargo Securities - Analyst

Thank you, operator. Good morning, gentlemen. Can you guys just confirm there wasn't anything in the release or the slides that the post-ILFC earnings guidance hasn't changed, nor has the AerCap standalone guidance, excluding the GFL transaction, any changes there?

Keith Helming - AerCap Holdings NV - CFO

Are you referring to the combined company, Gary?

Gary Liebowitz - Wells Fargo Securities - Analyst

Well, yes. I guess the combined company is the more important question.

Keith Helming - AerCap Holdings NV - CFO

The combined company, the \$1 billion of after-tax profit I think still is a good proxy. We still have -- we have to finalize acquisition accounting. Obviously the finalization of that won't be complete until the actual closing date, which obviously is going to be impacted by the share price, trading value of the debt, and conclusion with our auditors and other advisors. So again that proxy is still the best.

Gary Liebowitz - Wells Fargo Securities - Analyst

Okay. Now that you have all of the approvals, when would that accounting be done and when would we see what the pro forma financial statements would look like?

Keith Helming - AerCap Holdings NV - CFO

The first reporting for the combined company will be for the second quarter and that will occur in the April -- excuse me, the August time frame.

Gary Liebowitz - Wells Fargo Securities - Analyst

Then just last one. On the GFL sale, can you just go over what the accounting might look like in the second quarter? Was there a gain or loss on that? And also, maybe talk more about the structure of that transaction because you will still be managing the fleet.

Keith Helming - AerCap Holdings NV - CFO

The sale was an outright sale, so we sold the equity interest in all of the aircraft. The financial impact for the second quarter will be essentially breakeven. Going forward, for at least a year or more, we will be getting servicing fees off the portfolio so it's going to be relatively simple accounting going forward.

Gary Liebowitz - Wells Fargo Securities - Analyst

Okay, thanks. I will get back in the queue.



Operator

Arren Cyganovich, Evercore.

Arren Cyganovich - *Evercore Partners - Analyst*

Thanks. I guess back to the GFL sale, can you provide any details about whether or not there were any gains or losses relative to the book value of the aircraft that you are holding on the balance sheet?

Aengus Kelly - *AerCap Holdings NV - CEO*

No, there aren't any. This was a portfolio of 13 years of age. The aircraft were aged between eight and 23 years of age and they've been sold at book. We will, of course, earn fees going forward from the servicing in addition to that, but in effect we will recycle all the capital associated with that -- with those airplanes, the retained earnings.

Arren Cyganovich - *Evercore Partners - Analyst*

Thanks. Then, I guess with that comment, the recycled capital was this mainly just a way of helping to deleverage ahead of the deal? Was it the primary or would this have happened regardless of the ILFC transaction?

Aengus Kelly - *AerCap Holdings NV - CEO*

This would've happened regardless. This is part of our ongoing portfolio management. As you know, we have a strong track record of managing the portfolio to ensure that our stakeholders, be it creditors or shareholders, always face the best quality collateral.

Arren Cyganovich - *Evercore Partners - Analyst*

Then lastly, what are your top priorities post closing, which I would assume would be -- the timing would be relatively soon now that you got the regulatory approvals. What are your top priorities with ILFC once you have it completed?

Aengus Kelly - *AerCap Holdings NV - CEO*

Subject to the closing, the top priority is the management team has all been signed up. The senior management team is all in place. All contracts are signed, that's number one. Number two is the funding of the transaction. And as I mentioned on the call, we have already raised \$4 billion in relation to the transaction.

Number three is the re-domicile of the assets out of the United States into Ireland. That process is well underway. And number four is the IT systems.

Arren Cyganovich - *Evercore Partners - Analyst*

Great, thank you.

Operator

Mike Linenberg, Deutsche Bank.

Richa Talwar - *Deutsche Bank - Analyst*

It's actually Richa filling in for Mike. First, although it was relatively modest, we did notice that your overall portfolio utilization dipped a bit. I think it was by 60 basis points from the end of last quarter. Can you tell us what drove that?

Aengus Kelly - *AerCap Holdings NV - CEO*

Well, we went to 98.8% I think utilization and, frankly, that's just a function of airplanes transitioning. It depends how many are transitioning in any given quarter. It's a de minimis amount. We are still running at 99% utilization, which is full employment really for a leasing company.

Richa Talwar - *Deutsche Bank - Analyst*

Okay, great. Then sort of a big picture one. I realize that now with the pending ILFC transaction the order book you are getting you presumably don't need to worry about growth prospects for some time. But if you did want to pursue incremental, one-off type sale-leaseback type deals, it seems like every other day we're hearing about another entity, whether it be in Singapore, Japan, China, investing in the space.

And I was curious is that making it difficult to earn decent returns by effectively bidding up the price of aircraft, or do you still see ample opportunity to allocate capital and earn good returns?

Aengus Kelly - *AerCap Holdings NV - CEO*

I think I look to our track record and I mention it in each earnings call. The correct allocation of capital is at the forefront of our minds all the time. We will only deploy our shareholders' money if we believe that the risk/reward balance is in our favor.

And we have demonstrated consistently, be it with the American Airlines transaction, the LatAm transaction, or indeed the ILFC transaction, that we have the capability to do that. With the scale and size of the platform post-closing, we will have unrivaled access to airlines around the world. The new companies that you refer to, they are generally what I will call the retail buyers from someone like us as the wholesaler.

Richa Talwar - *Deutsche Bank - Analyst*

Okay, helpful. Thank you.

Operator

Scott Valentin, FBR Capital.

Scott Valentin - *FBR & Co. - Analyst*

Good morning and thank you for taking my question. Just with regard to what's going on in Russia, just two questions. One, can you quantify any exposure you have in the region?

And two, are you seeing any impact on travel? You mentioned Europe was strong still, but wondering if you have seen more recently any impact given what is happening there.



Aengus Kelly - *AerCap Holdings NV - CEO*

No, we see no impact on traffic. Our largest exposure in Russia is to Aeroflot, the state airline. We have never, ever had a late payment from Aeroflot and, quite frankly, if we had more customers like Aeroflot, we would be pretty happy.

The overall exposure to Russia is less than 10%. You have to bear in mind, of course, that Russia is such an enormous country in terms of landmass, the largest in the world, that it must have aircraft. It no longer has its own indigenous industrial base to produce airplanes, apart from of course the small regional jets, but it is reliant on Western-built technology aircraft. And we don't see any impact so far from the events in the Ukraine.

Scott Valentin - *FBR & Co. - Analyst*

Okay. Then just another question on China. Given the potential slow down there and ILFC's exposure in Asia, any signs there at all of weakness you are seeing in talking to lessees?

Aengus Kelly - *AerCap Holdings NV - CEO*

You see our receivables balance there, which is the best indicator. Bear in mind, we are not an equity investor here; we are effectively a debt provider, but we have seen no uptick in receivables out of China at all.

Scott Valentin - *FBR & Co. - Analyst*

Okay. All right, thanks very much.

Operator

(Operator Instructions) Ryan Zacharia, JAM Equity Partners.

Ryan Zacharia - *Jacobs Asset Management - Analyst*

Thanks for taking the question. Just with respect to GFL, is it fair to think about those planes as being encumbered by your financials. We would say \$450 million. The bonds outstanding is about \$500 million, but either way there's basically \$250 to \$300 million of capital that's going to be released as a result of this transaction.

Keith Helming - *AerCap Holdings NV - CFO*

It's not going to be as high as \$300 million, but you're right in terms of it's around \$230 million, \$240 million, something like that.

Ryan Zacharia - *Jacobs Asset Management - Analyst*

So that capital could be re-levered up to kind of a more optimal 3x versus the 2x that had existed inside of the securitization. Is that a fair way of thinking about it? You can buy more than \$750 million of planes now with this capital?

Keith Helming - *AerCap Holdings NV - CFO*

Correct, if you levered it up, yes.



Ryan Zacharia - *Jacobs Asset Management - Analyst*

Okay, thanks.

Operator

Thank you. We have no further questions at this time.

Aengus Kelly - *AerCap Holdings NV - CEO*

Operator, thank you very much and thank you all for dialing into the call. We hope to see as many of you as possible at the Palace later this morning.

Operator

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

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