

Power-by-the-Hour

Hello and welcome to our new Investor Education section. The idea of these videos is to explain topical issues that arise from time to time in no more than a couple of minutes.

Today I'll spend a few minutes explaining the impact of Power-by-the-hour lease contracts, why we entered into them, as well as the impact on our revenues and cash flows.

So, what are Power-by-the-hour contracts?

Whilst the vast majority of leases that AerCap enters into are fixed rate from the outset, during the Covid years, we offered a small selection of variable contracts where payments were based on the monthly utilization of the aircraft called "Power-by-the-hour", or "PBH". After this initial PBH period, these leases would then revert to fixed rate rentals for the remainder of the contract.

These contracts have always been a part of the toolkit. It's just that their usage increased significantly during Covid, peaking at around 140 contracts or approximately 10%.

The reason for their popularity was that the government restrictions at the time meant travel corridors around the world were constantly re-opening and closing due to those restrictions. So, even though airlines were confident in the long-term usage of the aircraft, the short-term was likely to be more variable.

It was attractive to AerCap also, as it meant we protected the back-end lease rates rather than locking in low rates for longer.

In practice, this worked very well for both AerCap and the airlines as utilization climbed steadily, reflecting the profitable deployment opportunities for the airlines and valuable income to AerCap.

Now, to the accounting.

When any lease has a variable element, the total lease revenues are averaged over the entire contract in what's known as "straight line rental".

As you'll see from the worked example below, we have assumed a five-year lease with the first year of the contract calculated on a PBH basis, reverting to a fixed rental thereafter of \$1 million per year. And for this one, we've assumed no utilization of the aircraft in that first year.

Scenario 1

In this example, we imagine a 5-year lease, with the first year structured as Power-by-the-hour, reverting to a fixed rent of \$1 million per annum thereafter. We assume the aircraft is not utilized in year one.

Cash	YR1	YR2	YR3	YR4	YR5	TOTAL
Total Cash Receipts	0	\$1000k	\$1000k	\$1000k	\$1000k	\$4000k

Accounting	YR1	YR2	YR3	YR4	YR5	TOTAL
Straight Line Rental Accounting Revenue	\$800k	\$800k	\$800k	\$800k	\$800k	\$4000k

On a cash basis, we would collect nothing in year one, rising to \$1 million thereafter. But from an accounting perspective, we would average the total contract revenue over five years of \$4 million, therefore recognizing \$800,000 per annum.

Now, in our second example below, let's assume the aircraft is actually utilized 65% of that time in the first year. In that case, we would have collected \$650,000 in cash, which is recognized in the year that it's collected, on top of the \$800,000 of straight-line rentals.

That means accounting revenue for year one would be \$1.45 million, reducing to \$800,000 in years 2 to 5. Cash receipts, however, would increase from \$650,000 in year 1 to \$1 million a year in the subsequent years.

Scenario 2

In this example, we imagine the same 5-year lease, with the first year structured as Power-by-the-hour, reverting to a fixed rent of \$1 million per annum thereafter. This time, we assume the aircraft is utilized 65% of the time in year one.

Cash	YR1	YR2	YR3	YR4	YR5	TOTAL
As above	0	\$1000k	\$1000k	\$1000k	\$1000k	\$4000k
PBH usage	\$650k	0	0	0	0	\$650k
Total Cash Receipts	\$650k	\$1000k	\$1000k	\$1000k	\$1000k	\$4650k

Accounting	YR1	YR2	YR3	YR4	YR5	TOTAL
Straight Line Rental Accounting Revenue	\$800k	\$800k	\$800k	\$800k	\$800k	\$4000k
PBH usage	\$650k	0	0	0	0	\$650k
Straight Line Rental Accounting Revenue	\$1450k	\$800k	\$800k	\$800k	\$800k	\$4600k

So, tying this back to AerCap, we referenced the PBH headwind in our guidance for 2024. This is because many of the contracts are reverting to their fixed rate rentals in the fourth quarter of 2023, and not a change in economics.

The cash collections from those contracts are actually expected to increase in 2024, as a result of moving them to fully fixed rate payments.

So, I hope you found this useful, and I look forward to adding more content in the year ahead.