Managing Credit Risk in Aircraft Leasing

Hello and welcome to our 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.

In today's video, we'll explore in more detail how credit costs are managed by aircraft leasing companies.

As any equity investor in an airline will know, the airline industry can be highly cyclical in nature. This is because of the small barriers to entry, the large swings in demand, and the low marginal cost of filling seats on aircraft that aren't full.

So naturally, when investors look at aircraft leasing, where all of our customers are airlines, they will assume that airline exposure must be the biggest risk posed to the lessor business model.

The reality, however, is that credit costs are not a major driver of financial performance for well-run lessors.

We put this down to three things.

1. **Having the right lease structures in place from the outset,**
2. **Having the right assets on lease,**
3. **Having the right attitude to collections.**

With the first one, lessors typically operate with long-term, fixed-rate lease contracts. For example, new aircraft are almost always placed on twelve-year leases. This structure provides stable, predictable, and contractual cash flows, with no right of negotiation in the interim. These leases will include various protections, including maintenance reserves, security deposits, return conditions, and much much more. For more on Maintenance Reserves, please see our earlier video on the topic.

The second is about having the right assets in place.

In this industry, it is always better to have a great aircraft on lease to a poorer credit, than to have a poorer aircraft on lease to a great credit. The reason? Assets' values are much more stable that airline credits.

A320neos, for example, lease for the same rate in the U.S., Japan and Australia, and supply is very well managed by the OEMs. Airline credits on the other hand, are much more volatile and harder to predict. If a poorer credit gets into difficulty, it's much easier to remarket an in-demand aircraft, and also creates a bigger opportunity cost for the airline returning it.

For AerCap, this means focusing on new technology aircraft, like the Airbus A320neo and A350s, as well as the Boeing 737MAX and 787s. These aircraft have large userbases, high backlogs liquid pricing and strong aftermarket support.

Lastly is the attitude to collections.

There is little point having a well-written lease without adequate monitoring and protection. This involves constant focus on timely cash collections, regular oversight of the technical conditions of the aircraft, and an open dialogue with your customers. This is best seen through the days' receivable averaging only 4-5 days for AerCap, compared to 40-60 days for Truck and Equipment lessors.

In addition, having a well-diversified customer base, both by geography and by airline, is also important from a risk management perspective. It helps us to avoid overexposure to any single airline lessee or region. Today, AerCap has over 300 customers from over 80 countries globally, allowing for great industry insight into weakness as well as demand.

So, in summary, while credit risk is something we take seriously at AerCap, when it's managed well it is not a major driver of business performance, averaging only 1% of lease revenues over the long term.

I hope you enjoyed this window into credit management, and I look forward to sharing more content with you in the months ahead.