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AER - Q2 2013 AerCap Holdings N.V. Earnings Conference Call

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OVERVIEW:

AER reported 1H13 reported net income of $143.1m or $1.26 per share, adjusted net income of $135.1m or $1.19 per share. 2Q13 revenue was $247m, reported net income was $75.7m or $0.67 per share, and adjusted net income was $67.1m or $0.59 per share.

CORPORATE PARTICIPANTS

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

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

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Richa Talwar *Deutsche Bank - Analyst*

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John Godyn *Morgan Stanley - Analyst*

Scott Valentin *FBR & Co. - Analyst*

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PRESENTATION

Operator

Welcome to AerCap Holdings 2013 second-quarter results conference call. (Operator Instructions). This call is being webcast, and an audio version of the call will be available on the Company's website. The call is also being recorded for replay purposes.

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

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

Thank you very much, operator. Good day, everyone. Welcome to the 2013 second-quarter results conference call.

With me here in Amsterdam today are Aengus Kelly, AerCap's CEO; and Keith Helming, AerCap's CFO. In today's call we will discuss our second-quarter earnings for 2013. Before I read the disclaimer language, I would also like to point out that we will not be hosting a lunch for analysts and investors in New York today.

Before we begin, I want to remind you that some statements made during this conference call that are not historical fact 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 August 6, 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 will now turn the call over to Aengus Kelly.

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 second-quarter earnings call.

I am very pleased to report that the key strategic decisions taken and executed by AerCap over recent years have culminated in AerCap reporting record half-year earnings of $1.19 per share for the first half of 2013 and $0.59 per share for the second quarter. Our record earnings per share and industry leading profitability have been driven by a core set of principles which we have rigorously followed. It is the combination of highly disciplined aircraft acquisitions and disposals as well as a long-term, stable liability structure that has enabled us to return $420 million to our shareholders; obtain an investment-grade credit rating; and generate these record earnings. These industry leading results and credit standing could not have been realized without the capabilities of the AerCap platform and its ability to actively manage our aircraft portfolio and liabilities.

Key transactions that have placed AerCap in the position it is in today include the sale of AeroTurbine; the timing and scale of the American Airlines and LATAM transactions; the sale of ALS; and the repurchase of 25% of the Company's outstanding shares at a 40% discount to today's share price and an almost 50% discount to book value per share. The most recent transaction is, of course, the LATAM deal. This demonstrated, like the American Airlines and Singapore Airlines deals, that patience and discipline will yield extremely attractive and large-scale growth opportunities.

So, look, the key benefits of the LATAM deal are, firstly, it provides us with the most in-demand, new technology widebody aircraft in the market on long-term lease to one of the strongest credits in the industry. Secondly, the deliveries occur over the next 48 months as opposed to post-2020, which is on average where the OEMs will offer a delivery stream to the lessors. Thirdly, it enhances our growth pipeline and drives very significant earnings accretion without the drag of large pre-delivery payments and substantial placement risk.

We have always said to you that attractive growth opportunities are out there in this industry, but you have to work hard, you have to be patient, you have to be disciplined to find them. And as we have referenced before, the reason they are out there is that the record orders that were placed in 2010 and 2011 are starting to deliver towards the end of this year and onwards. Because of that, over the course of the last 20 months alone we have contracted to purchase 72 new aircraft without any speculative orders at an appraised value of approximately $5 billion.

During the same timeframe we have sold over $2.1 billion of aircraft with an average age of 11 years. This reflects our portfolio management strategy of continually working the balance sheet; turning the equity related to the older aircraft or high concentration of credits into cash; and then reinvesting it into new technology assets, as well as returning substantial amounts of capital to our shareholders.

As I mentioned, we bought back $420 million worth of shares in the same timeframe at a very significant discount to book equity. And all this was done while AerCap maintained its investment-grade rating. We are the only aircraft leasing Company in the world to have an investment-grade rating without the benefit of a large parent.

Now, crucially, from a shareholder standpoint we have demonstrated that these purchases are materially in the money, as evidenced by the fact that out of the 72 aircraft we have contracted to purchase, 12 have already been sold at substantial gains. Most recently in the second quarter we sold 8 737-800s to Guggenheim. Not only did this deal generate attractive return on our investment, but it also helps to manage our exposure to American.

Going forward, this deal will generate significant management fees, as AerCap will continue to service the portfolio and share in the profits. As you can see, the deal generated almost $0.10 per share and day-one profits; and in addition, it will generate over $0.20 of earnings through management fees and profit participation over the remaining term.

Now turning to the shareholders, I am as concerned as any shareholder with the potential for misallocation of capital in this industry, between investing in aircraft and returning capital to the shareholders. I believe that the gains I just referenced are evidence of AerCap's disciplined approach to investing in aircraft. And similarly, when we saw the opportunity to return substantial amounts of capital to the shareholders by the share buyback program, we clearly made the right choice with regard to allocation of capital.

However, misallocation of capital in our business is also critical when it comes to selling aircraft. You may have aircraft today that generate attractive returns but could possibly in the future be a drag on earnings or credit exposure. Again, AerCap has shown extreme discipline in this area, as evidenced by the sale of the ALS portfolio of 50 mid-life aircraft, and very recently, the 8 American aircraft.

In total we have now sold more than 260 owned and managed aircraft at an average age of 13.2 years. On the owned aircraft sales we have realized a gain of $310 million, which averages out to about $1.7 million per aircraft. This is the most concrete indicator our shareholders and all capital providers can have with regard to the robust nature of the carrying value of AerCap's book equity.

This active portfolio management strategy, coupled with the long-term, stable financing structure, enables us to convert our book equity into cash, return a substantial amount of capital to our shareholders, and reinvest in the most in-demand aircraft in the world. I am confident that if we continue to adhere to our core principles, we can continue to generate industry-leading profitability and return a substantial amount of capital to our shareholders while investing in the most modern, fuel-efficient aircraft.

Turning to the operations, in terms of activities during the quarter, we executed 81 aircraft transactions, including the sale of 15 aircraft. That's more than one aircraft transaction every working day. The average lease term for new aircraft signed during the first half of 2013 was 166 months, and the average lease term for used aircraft was 58 months. These long-term leases will underpin AerCap's future profits.

Turning to lease rates, we continue to see stability for the A319s. A recent public data point of this was Spirit's decision to extend 14 A319s. We are, of course, aware of other private data that is similar to this.

On the 320 and especially the A321, we see further firming of the lease rates. The same applies to the A330, especially the 330-300. And the Boeing 737-800 continues to be in great demand. We have a relentless focus on receivables at AerCap, and our outstandings continue to trend at or near all-time lows.

Looking ahead to what remains of 2013 and into 2014, we expect to see opportunities for further fleet expansion comparable to what we have done with LATAM, American, and Singapore Airlines; but 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 before we open up to Q&A.

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

Great. Thanks very much, Gus. Good morning.

I will start on Page 4 of the presentation. Our reported net income for the second quarter 2013 was $75.1 million. Adjusted net income, which excludes the various items listed, was $67.1 million, a 13% increase over the second quarter of 2012. For the first half of 2013 reported net income was $143.1 million and adjusted net income was $135.1 million.

Page 5 -- reported earnings per share were $0.67 in the second quarter 2013. Adjusted earnings per share were $0.59 during the same period, an increase of 37% over the second quarter of 2012.

For the first half of 2013 reported earnings per share were $1.26 and adjusted earnings per share were $1.19. The average shares outstanding during the first half of 2013 were 113.4 million, which is approximately 26 million shares lower than the same period in 2012 as a result of the shares repurchased in 2012.

Page 6 -- total revenue in second quarter 2013 was $247 million. The small decrease from prior year was driven primarily by lower basic lease rents as a result of the sale of the ALS portfolio, the proceeds of which are being reinvested in future growth of new technology aircraft. This decrease in basic lease rents was partially offset by a higher gain on the sale of aircraft.

Page 7 -- net interest margin or net spread was $160 million in second quarter 2013. The annualized margin as a percent to average lease assets was 8.5%. The decrease in net spread was driven primarily by the sale of older aircraft, including the ALS portfolio, partially offset by purchases of new aircraft.

Page 8 -- the impact from sales in second quarter 2013 was a pretax gain of $10.5 million and was $21.5 million in the first half of 2013. In the first half of 2013 we sold one A330; 9 737-800s; and 1 MD-11 aircraft. The average age of our aircraft portfolio is 5.3 years.

Page 9 -- leasing expenses were $10.3 million for second quarter 2013 versus $17.9 million in the same period of 2012. The decrease in leasing expenses was driven primarily from a lower impact from defaults and restructurings. SG&A for the second quarter 2013 was $24.1 million. The increase in SG&A was driven primarily from one-off project-related fees. Our tax rate for second quarter 2013 was 8.5% and is expected to be the same for the full year of 2013.

Page 10 -- AerCap's free and unrestricted cash balance at the end of second quarter 2013 was $157 million, and our total cash balance including restructured cash was $474 million. Operating cash flows were $147 million for the second quarter.

The decrease in the cash balance for second quarter 2012 was driven primarily by the use of $257 million for share repurchases in the second half of 2012; a temporary decrease of approximately $100 million from funding several aircraft initially with cash; and $42 million repayment in 2013 of our most expensive debt. As of now, the temporary decrease is gone, and our free cash balance is now approximately $250 million.

Page 11 -- at the end of second quarter 2013, AerCap's debt balance was $6 billion and our debt-to-equity ratio was 2.6 to 1.0. Our book equity is $2.3 billion and the average cost of our debt in the second quarter was 3.9%.

Page 12 -- with regard to our full-year 2013 financial outlook, currently expected aircraft purchases are $1.7 billion. The maintenance contribution to income is expected to be minimal in 2013. And the pretax gain from committed aircraft sales is now expected to be approximately $30 million. The average cost of debt is expected to be approximately 4%; and the tax rate for 2013, as I mentioned, is 8.5%.

Those are the second-quarter 2013 financial highlights. So I would like to now open it up to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Michael Linenberg, Deutsche Bank.

Richa Talwar - *Deutsche Bank - Analyst*

This is actually Richa Talwar filling in for Mike. My first question this just on what you said, Gus, regarding opportunities currently in the market. I was wondering if you could tell us from a geographical perspective where you are seeing a lot of opportunity and how you expect your portfolio to shift in terms of geographical exposure going forward.

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

The opportunities are pretty much global, to be honest with you. Our portfolio, as you know, has trended more towards the North American market due to some of the transactions we've done recently, as we see that being probably the most stable market out there.

But of course, there are pockets of demand all over the world. And I think you will probably see our portfolio trend in increasing share into the Americas -- North and South America, obviously, with the LATAM deal; and then a reduction coming out of the European market; with the Asian market still making up around a third to 40% of it.

Richa Talwar - *Deutsche Bank - Analyst*

Okay, great. And then on your comments regarding allocating capital, can you refresh us on your views regarding a dividend, and why you think share repurchases are a better venue for returning capital to shareholders?

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

Well, first of all, when it comes to allocating capital, when we look at spending money, it's got to be accretive to the shareholders. So if I can buy aircraft that are going to generate a return that I need, and they are modern, fuel-efficient airplanes, that is obviously the core of the business, and we will do that.

To the extent that we don't see those, then we will return capital to the shareholders, as we have done in the past. The fact that we were able to purchase the shares at such a large discount made it fairly obvious to us that that was the correct way to go, rather than paying a special dividend for $400 million-plus when we were able to buy back the shares at a 40% discount to where they are trading today.

Richa Talwar - *Deutsche Bank - Analyst*

Okay, great. That's it for me. Thank you.

Operator

Gary Liebowitz, Wells Fargo Securities.

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

Gus, are you seeing anything with your customers that would suggest that the third-quarter utilization rate should be meaningfully different from second quarter?

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

No, I mean, Gary, we're almost halfway through the third quarter. It is always trending around the same levels, the high 90s. A portfolio of our size will always have aircraft in transition, given that we're moving so many airplanes. So you will always have 1% or 2% of downtime, naturally, in the book. But no, we don't see anything that wouldn't be -- it should be just in line with normal.

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

Okay, thanks. And for Keith -- Keith, your slide on the 2013 financial outlook did mention basic rents. That line item is usually there. Do you have an outlook for the top line?

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

I will get back to you on that one, Gary.

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

Okay. And then just one last one. Keith, you cited -- I think it was $2.9 billion of purchase commitments beyond 2013. Do you happen to have what the 2014 and 2015 numbers are?

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

We will lay that out for you guys as well.

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

Thank you very much.

Operator

John Godyn, Morgan Stanley.

John Godyn - *Morgan Stanley - Analyst*

Gus, first of all, just hoping you could talk about the return profile on sale leaseback transactions and how it compares to your normal targets or your existing weighted average ROE.

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

Well, I guess there's two sale leaseback markets, to be fair, John. There is the weekly bake-off that everybody shows up for, and you have 20 people bidding for one aircraft with Air France, or Air Berlin, or Garuda, whoever it is. And that is not where we play, as you know. That is a highly commoditized business.

However, where we go into the sale leaseback market is in much bigger size, where there is little to no competition -- American, LATAM, Singapore. They were all bilateral deals. They weren't competed transactions because we are bringing unique things to the table.

In American, obviously, we did it on the eve of the bankruptcy. No one else had the firepower at the time to do it. In the case of LATAM, given the fact that we are the most active aircraft trader in the world by probably quite a distance, along with GECAS, when we buy something, we know the value of it. So when we bought those A330s -- we have sold more A330s than anybody in the world. Absent Airbus. So we knew the value of what we were buying. And nobody else really understood the market as well as we did. So we could figure out how to do a very large-scale transaction with LATAM. And because you are bringing to bear the key skills of the platform, it's something that isn't a commoditized air bake-off like the daily -- the weekly sale leaseback bids for one or two airplanes. You do generate returns that are materially higher than the run rate of the business. When we invest extra capital it has to be at a very high level of returns. In order to -- for us not to allocate capital to the shareholders.

John Godyn - *Morgan Stanley - Analyst*

Okay. And I think in the past you have talked about at least a 15% return hurdle. Just to put your comments in --

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

That's correct.

John Godyn - *Morgan Stanley - Analyst*

Okay, that's helpful. When we think about --

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

As I started to say, that is an after-tax number.

John Godyn - *Morgan Stanley - Analyst*

Yes, got it.

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

That's not an operating or pretax; that is the hard after-tax number.

John Godyn - *Morgan Stanley - Analyst*

Okay. And we think about the fleet profile going forward, historically and I think currently, too, you still have a good concentration of A320 family aircraft. You talked about how the lease rates there are firming. But with the NEO around the corner, I think there is some risk in that part of the portfolio.

On the other hand, you've done a tremendous job managing around that risk. Can you just help us think about how you think about the A320 family concentration on a go-forward basis?

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

Well, the thing about the A320 is, look, it is the biggest seller in the world. It is the definition of the ubiquitous aircraft with the amount of users it has. So there's no issue placing it.

But actually, just to correct one thing, our single biggest exposure between what we have on order and what is on the books is the 737-800. And of course, over the term of the last 18 months, 2 years, we have materially reduced the exposure to the 320 family.

But the 320 is still an airplane that you can place all day long. There's no problem placing it. So given that, it's all about your carrying value. Are you carrying -- you know that this airplane can be leased, no problem. It is like a 737; you can move it. It is a question of the price.

Now, if you are carrying it on the books and you have overpaid for it, then you are in trouble. If you haven't, and we've demonstrated, I think, to you on numerous occasions, most recently with the ALS transaction, where we sold a big portfolio of predominantly A320s, the 50-aircraft deal we did almost at book value. And so we monetized all the profits that were associated with that vehicle. There were several hundred million dollars of retained earnings monetized. So I think, John, that is the best indicator I can give you. It all comes back in this business -- did you buy the stuff right? If you overpaid for it, sooner or later you are going to get done.

And on the 320s, for us, we have demonstrated time and again that we have bought them right. And that is the key.

So on 320s, we would buy 320s today. No problem, John. We look at 320s all the time. We bid on them, but they have to be at the price where we would find them attractive and where the price that we are buying them at takes account of, as you rightly point out, the NEO coming down the road, the MAX coming later on. But it's all about the price.

And I think it's also worth noting though, John, that we haven't speculatively ordered an A320 since 2005. That is 8 years ago.

So your real issues on the 320s would be spec orders that you placed in 2010, at the top of the market before the NEO was announced; and they are delivering in 2013, 2014, 2015. That is when it is likely that you are in a poor position versus the aircraft price. Whereas AerCap, as I said, we haven't ordered an A320 speculatively since 2005, which is 8 years ago.

John Godyn - *Morgan Stanley - Analyst*

That is very helpful. I was looking at Slide 18, when it said it was the highest percent. But you're right; with the future order book, the 737 certainly continues to gain. But a similar question -- I was hoping to get your perspective on the A330. Just as we look out and we see a lot of new widebodies beginning to be delivered, your thoughts there would be helpful.

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

Sure, certainly. If you go back to the history of the 330, originally you had the 767 as the clear market leader, almost a monopoly on the market for small widebody airplanes. Then the 330 came along in the 90s. It took Airbus a few years to get it really up and running; get the best engines on it; find the right price point.

But then it dislodged the 767. And the 787 was built to compete with the 330, to take that part of the market back. And the reason it was developed was it is so hard to recapture market share, and the idea was to start the proliferation of a 330 customer base.

So the 330 customer base doubled between the launch of the 787 and today -- it actually doubled in size. So once you have that huge customer base, you know that you can move the airplanes. Again, it comes back to the purchase price. You can always move them.

So the 330 is, for the minute, the only small widebody airplane out there. The 767, there's a lot of them in operation, but they are on their last leases. They are being parted out, et cetera.

So the 330 is a very placeable airplane, but you have to be cognizant, again, as you rightly point out, that as you go forward, if you were ordering these things in that timeframe of 2010, 2011, when all the orders were coming in and you are taking delivery in 2015, you are probably going to have some issues with the price point.

But again, our orders came a long way before that. And I think the best data point I can give you on our 330s is you can see the gains we booked on the sales of the recent 330s we've bought. We have been booking double-digit million gains. That is the best indicator I can give you.

John Godyn - *Morgan Stanley - Analyst*

So just to summarize, on the A320 and the A330, is it fair to say that the punchline is you feel like the values that those aircraft are recorded on your books are very favorable versus current market prices? Is that a fair way to think about the situation?

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

I think so. I think the issue on the 320s; or 330s; or 737s, for that matter, would be if you ordered them at the peak years of 2010, 2011, before the new technology was on the horizon and you are taking delivery and 2013, 2014, 2015, you've probably got some issues. But the best indication I can give you, rather than me just saying this, look at the hard results. Look at the results of our trading. No one has sold as many airplanes as us -- we've sold 330s, 320s, 737s. And it's a $310 million gain on all the aircraft we've sold over the last several years.

John Godyn - *Morgan Stanley - Analyst*

Very helpful. Thanks a lot.

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

You are very welcome.

Operator

Scott Valentin, FBR Capital Markets.

Scott Valentin - *FBR & Co. - Analyst*

Just Keith, starting with SG&A, you mentioned it was around $24 million. There were some one-off projects in there. Do you know what the amount of those one-offs were? Just trying to get an idea what core estimate should be going forward.

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

Yes, it's about $3 million, and it's relating to various funding projects. So going forward, the quarterly run rate of $21 million is what you should expect.

Scott Valentin - *FBR & Co. - Analyst*

Okay, all right. And then big picture, we've seen long-term rates rise. You guys run a pretty matched book. Your guidance for the year is still 4% cost of funds. Just wondering what you're seeing in terms of funding costs, and maybe what you're seeing -- do you expect lease rates to rise to maintain that margin? Or do you think there could be a squeeze?

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

Well, the lease rates are a function of interest rates. If you look at our leases, particularly for the new airplanes, they will adjust as interest rates adjust. So for example, if you say a base lease rental is $300,000, it will move up or down for $20,000 for each 1% shift in, say, the 10-year treasury. So it will match exactly that.

So the lease rates historically have always been made ultimately a function of interest rates. So that has been the core tenet of the business, and we don't see any evidence over the course of effectively 20 years that that is changing.

Scott Valentin - *FBR & Co. - Analyst*

Okay. And then one final question. The $417 million you have scheduled for delivery in the second half of 2013, is that pretty evenly spaced over the last two quarters? Or will one quarter have more than another?

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

It is pretty evenly spaced.

Scott Valentin - *FBR & Co. - Analyst*

Okay. All right, thanks very much.

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

You're welcome.

Operator

(Operator Instructions). Glenn Engel, Bank of America.

Glenn Engel - *BofA Merrill Lynch - Analyst*

Net margins have been drifting down for you, and I guess for the industry -- not hugely, but still drifting down over the last year or two. Is that going to start stabilizing and turn around? Or as you continue to take newer planes, does that keep pressure on that number?

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

Yes, the reason that the net spread percentage has decreased over the last year or so is because we sold a lot of the older aircraft, which has a slightly higher effective yield, if you will.

You can actually look on Page 14 of the presentation in the supplemental information. At the very bottom we normalize the net interest margin excluding the sale of the ALS portfolio. So you can see that outside of the sale of those assets, the older assets, that the margin is relatively constant. And that is where you should expect to see it going forward now for a while.

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

Just to add on that, Glenn, this goes back to my point about discipline and capital allocation. We could have, of course, held on to the ALS portfolio. And we just printed record EPS numbers. If we held onto it, they would even be higher.

But it is the disciplined area of saying, we have this portfolio of mid-life airplanes. We want to monetize the retained earnings associated with it and reinvest it in the future of the business, which are the 350s, the 787s, the NEOs, things like the LATAM deal, the American deal.

And that takes discipline to do that. And making sure that you're not just looking at the short term or the next quarter, but you're looking at the long-term future of the business. And so we've managed to keep the average age of the portfolio constant or slightly decreasing as well as generating record earnings.

Glenn Engel - *BofA Merrill Lynch - Analyst*

The second question, more on the widebody side, the A330 has been your mainstay. Are you looking at -- the 787's seem interesting. And two, it seems like your competitors now, who generally were just focused on narrowbodies, seem to be much more focused on the widebodies, catching up to your strategy. Is that starting to make it a much more competitive market for you?

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

Again, if you want to show up for the weekly bake-off for the 330 or 777, yes, sure, you will get you a boost to your P&L in the short term, because the lease rentals will be high. But if you have overpaid for the asset, in the long run it's going to come back to bite you.

We have not approached the market in that fashion, as you know. We believe there is plenty of opportunity out there. If you work hard and you are disciplined, those opportunities will show up, like the LATAM deal, where it wasn't a competed transaction; and like the Singapore Airlines transaction we did on the 330s. But there's no doubt that if you are chasing a bit of yield in your P&L, and you're out there in the weekly bake-offs, yes, it's questionable if you will have the long-term returns that justify the risks you are taking.

Glenn Engel - *BofA Merrill Lynch - Analyst*

And 787s?

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

787s and A350s are going to be the future. This no doubt about it. We believe the 787 will be a fantastic airplane, as will the 350. And we are certainly focused on that aircraft type; as you've seen, we've done our first deal on the 787 by the LATAM transaction. And we will certainly look to do more.

Glenn Engel - *BofA Merrill Lynch - Analyst*

Thank you.

Operator

Ryan Zacharia, JAM.

Ryan Zacharia - *Jacobs Asset Management - Analyst*

Thanks for taking the question. Just a couple. The project-related fees, what were those associated with? And should we expect those to run off on a go-forward basis?

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

Yes, again, these were one-off type projects. They are funding-related projects, and going forward, starting next quarter, you should not see this level of expense. Again, the quarterly run rate for SG&A should be around $21 million.

Ryan Zacharia - *Jacobs Asset Management - Analyst*

Okay. And then just as it relates to depreciation, I was a little surprised to see the jump, about 7% sequentially. There was only like a 3% increase in the average flight equipment. Was there anything going on there atypical, or is this the new run rate?

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

No, if you look at the depreciation as a percentage of the average lease assets, it should be around 4.3%. I think last quarter it was 4.2%. So that's more or less what the run rate should be going forward.

Ryan Zacharia - *Jacobs Asset Management - Analyst*

Okay. And the incremental $10 million of gains that you've guided to -- that's all going to come in Q3?

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

It is a Q3 transaction, correct.

Ryan Zacharia - *Jacobs Asset Management - Analyst*

Okay. Thanks a lot, guys.

Operator

Arren Cyganovich, Evercore.

Arren Cyganovich - *Evercore Partners - Analyst*

Just thinking about your asset strategy of selling aircraft, particularly when you have higher concentrations. Absolutely understand what you're doing there, and the gains are positive near-term, but it is somewhat dilutive longer-term unless you are reinvesting those fairly quickly.

So is it a reflection of the fact that you have a high amount of confidence in reinvesting those, say, $300 million of cash you are getting back from those assets, just to make investors feel that a little bit better about earnings growth going forward? It's great to have the near-term benefit, and it shows you have a good strategy and you're buying the assets at a good cost. Just want to have some comfort in your longer-term outlook.

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

Well, from our standpoint we do believe there's ample opportunity out there, as I've said before. And we've shown you time and again that we do reinvest the money. If you look at the sale of ALS, the sale of AeroTurbine, both generated very substantial amounts of capital; and both were reinvested, be it in returning capital to the shareholders or things like the American deal, the LATAM transaction. As I said, we have contracted 72 aircraft purchases in the last 20 months alone without a single speculative order from the OEMs.

So there is tremendous opportunity out there. If you step back and look at the industry, there's two suppliers. There's about 8 or 9 leasing companies in the world that matter. And there are 800 airlines out there. There's plenty of opportunity. And the airlines will always need us. They will always need capital providers.

And the dynamic of the industry hasn't really changed that much over the last 15 years, where you have a very small group of large, global lessors with a global platform. And I don't see that changing.

Also, from our standpoint, it's about making sure that you're not just worried about the next quarter. That's why we sell some of the aircraft, the mid-life airplanes -- you're not focused on maximizing the earnings just for the next quarter. You want to reduce the credit exposure of certain very heavy credits, also.

And so we stick to our discipline of doing that. And that discipline has generated record earnings in the first half of this year. So I don't see any reason to change that.

Arren Cyganovich - *Evercore Partners - Analyst*

Thanks. That's helpful. And then lastly, on the funding cost side, you have interest rate caps in place; I think you have around $1.5 billion maturing in the second half of this year. Are those going to be replaced with similar instruments? And is there going to be any impact in terms of the cost of your funding from that? I know the guidance shouldn't, but I am just curious as to what to expect from hedging.

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

It shouldn't. The caps are running -- the largest portion of the caps will be running off this year and next year. And again, the aircraft that they are supporting -- it will be going on new leases, and we will be putting in new interest rate protection, if you will. Likely fixed-rate debt or something like that.

Arren Cyganovich - *Evercore Partners - Analyst*

Okay. So it's more of a fixed-rate debt funding rather than the --

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

Trying to put in as much fixed-rate debt as -- but it's a combination of both at this point.

Arren Cyganovich - *Evercore Partners - Analyst*

Got you. Okay. Thank you.

Operator

Isaac Husseini, Barclays.

Isaac Husseini - *Barclays Capital - Analyst*

Had a question on the cash, the temporary reduction of $100 million. Just wondering if you can give us some color on the decision, why the decision was made to fund those planes temporarily with cash.

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

Yes, we had several funding transactions going on. So we wanted to put some of these aircraft in those funding transactions, and those weren't effectively completed until post-second quarter. So we had the cash available to temporarily put -- to fund these aircraft, so we did so.

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

And these deliveries happened in the last few days of the quarter.

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

Yes, exactly.

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

So they happened on the 28, 29 June, hence why they were cash funded.

Isaac Husseini - *Barclays Capital - Analyst*

That is helpful. And then I think if I'm not mistaken, you provided ROE targets at some point. Maybe it was during your Investor Day for 2013. Is this something you could provide an update post-LATAM?

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

We can. I think the ROE at this stage for 2013 is expected to be around the 12% level.

Isaac Husseini - *Barclays Capital - Analyst*

Okay. Thank you.

Operator

[Varino Yancankeep, Seaforth Group.]

Varino Yancankeep - *Seaforth Group - Analyst*

A little bit of a similar question to the one just asked. In terms of cash balances, you closed the quarter with $157 million, which to the best of my knowledge is one of the lowest levels in recent memory. Is there a number there that you are comfortable with, or a matrix that you are following in order to manage your cash holding? And maybe can you refresh us as your source of liquidity in addition from internally-generated cash flow?

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

Yes, first of all, the $150 million cash balance at the end of the second quarter has now been increased by $100 million. So we're back up to the $250 million level.

We also have 4 aircraft that are yet funded in cash, which will be debt funded shortly, so that will generate some more cash as well. We also have, as you will recall, an unsecured evolver of $290 million, which we use as backup liquidity, as well. So although the cash balance is down from prior quarters, our liquidity remains very, very strong.

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

It's a very robust liquidity position. If you add in the cash position today plus the unfunded aircraft, plus the undrawn revolver at and below debt equity ratio, there is substantial liquidity available if the right opportunity arises.

Varino Yancankeep - *Seaforth Group - Analyst*

My second question is at the end of 2002, the average lease tenure of your portfolio was 6.9 years. Do you have it updated as of June 30 of this year?

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

Yes, it should be in the press release.

Varino Yancankeep - *Seaforth Group - Analyst*

I didn't see it. That's my bad.

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

It is 6.6 years at the end of the second quarter 2013.

Varino Yancankeep - *Seaforth Group - Analyst*

And if I look at the numbers on Page 20, where they show the average terms of new versus used aircraft, I'm just wondering, it seems like directionally that the average tenure of the new leases is lengthening versus 2012 and average tenure for the user group is actually shortening. It is just a coincidence based on a transaction you have been involved, or this is a general industry trend?

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

The used aircraft lease -- if you look back over the last several years, you will see they always trend in and around the 5 years. Give or take, they are always around 5 years, either side of it.

What happened in FY 2012, why there was a 6-month increase on average, which is a bit, given the number of airplanes we move, was that there was a number of aircraft that were used that were placed on extremely long-term leases, which was unusual. That's what drove it up.

In terms of the 166 months, a lot of that is driven by some of the recent transactions we've done on the sale leaseback side, particularly with American Airlines. But again, the norm for the new airplanes historically has been around the 12-year mark.

Varino Yancankeep - *Seaforth Group - Analyst*

Thank you very much.

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

You're welcome.

Operator

John Godyn, Morgan Stanley.

John Godyn - *Morgan Stanley - Analyst*

Keith, I think I heard you say that 12% ROE this year. Is that an after-tax ROE? And does it include the gains on sale that we've seen year to date?

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

It is an after-tax ROE. Is probably slightly north of the 12%, but it would include the gains, yes.

John Godyn - *Morgan Stanley - Analyst*

Okay, that is helpful. Thanks. And Gus, if I could just ask a follow-up on some of the line of questioning we heard today, given your size and scale, you've done a great job being nimble operating in the secondary market for aircraft and growing. But is there a size or scale at which point the market -- the illiquidity of the market becomes a challenge for you? And maybe it does make sense to supplement the growth profile with a manufacturer order that might benefit from economies of scale or volume in the sense that a larger order will get you a better price? Can you put your scale in context with how big you could be in the future before we might see a shift in strategy?

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

We would order -- to be honest, John, if the deal was the right we would order tomorrow. And we're always talking to the OEMs. We're always looking at proposals from the OEMs in large scale.

The thing with a leasing company and the OEMs is -- we used to be owned by an OEM, so we know how they think. When GPA -- we were the largest customer of both OEMs. And the reality is as a leasing company, to get a very attractive deal off them, you need to be there when you are saying aircraft deliveries exceed aircraft orders during a year. That typically means that you are in a tough market, and you need to have a balance sheet that can enable you to order in that type of market.

Now, clearly, since 2010 we haven't been in that situation at all; it's been quite the opposite. The OEMs haven't needed the lessors because their core customer base, the airlines, have been filling up their order book.

Now, if we see that change, if we see that some of these record orders start to get deferred, I can assure you that we are always talking to the OEMs. And if we see the right deal and size, we will do it. To be honest, we're here to make money for the shareholders. That is why we're here. We are not here to be big or beautiful.

But having said that, I know that given the dynamics of this business, air traffic is going to grow. If we are sitting here in 10 years' time, the one thing I know about this business is that the number of people who fly, the number of ASKs -- available seat kilometers per annum will have doubled.

That is due to the emerging markets, some growth in the developed markets, et cetera. But that has been the historical trend -- every 10 years it doubles. So you know that is a given.

You also know that your customer base is, for the most part, not investment grade and will always stay the same due to the relatively low barriers of entry in the airline business. And over the last 20 years there hasn't been more than 8 or 9 leasing companies who really matter.

So there is plenty of opportunity out there given those dynamics to grow the business, be it in the sale leaseback market or be it with the OEMs. And we have ordered in scale with the OEMs as well in the past, but we try to do it when we feel they need us more than we need them.

John Godyn - *Morgan Stanley - Analyst*

Great. Thanks a lot.

Operator

As we have no further questions at this point of time, I would now like to turn the call back to your host today for any additional or closing remarks.

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

Thank you, operator. Well, thank you all very much for joining us today for the earnings call. And we look forward to talking with you again in 3 months' time for the third-quarter results. Good afternoon.

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

Thanks, everyone.

Operator

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