

Company Name: AerCap Holdings
Company Ticker: AER US
Date: 2020-11-10
Event Description: Q3 2020 Earnings Call

Market Cap: 4401.74257936
Current PX: 33.9449996948
YTD Change(\$): -27.5250003052
YTD Change(%): -44.778

Bloomberg Estimates - EPS
Current Quarter: 1.075
Current Year: 6.601
Bloomberg Estimates - Sales
Current Quarter: 1093.667
Current Year: 4627

Q3 2020 Earnings Call

Company Participants

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

Other Participants

- Helane Becker
- Jamie Baker
- Ross Harvey
- Koosh Patel
- Catherine O'Brien
- Ronald J. Epstein
- Moshe Orenbuch

Presentation

Operator

Good day and welcome to the AerCap Third Quarter 2020 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. Mr. Joseph McGinley, Head Investor Relations. Please go ahead, sir.

Joseph McGinley, Head of Investor Relations

Thank you Operator, and hello everyone. Welcome to our third quarter 2020 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 10th, 2020. 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. 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.

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Aengus Kelly, Chief Executive Officer and Executive Director

Good morning everyone and thank you for joining us today for our third quarter earnings call. There are four key points that we would like to address on today's call:

First, while there are still many challenges facing the aviation industry, we have seen a significant increase in air travel and in our cash flows from the lows of April. The positive developments announced yesterday regarding the near-term availability of a vaccine should provide a further boost to the industry.

Second, throughout the pandemic, AerCap has taken numerous proactive steps to manage through this environment including executing over \$12 billion of liquidity initiatives which resulted in the company ending the quarter with our strongest ever liquidity position. Third, Covid-19 is accelerating the pre-pandemic trend of airlines moving into new technology aircraft, of which AerCap is the world's largest owner. And Fourth, we are confident that as the recovery continues there will be ample attractive opportunities for AerCap to deploy its capital.

In March and April, there was widespread concern about whether air travel had permanently changed. Similar concerns prevailed immediately after 9/11 and during the depths of the financial crisis. In those cases, we heard the same extremely bearish predictions regarding the imminent demise of air travel. But after each of these events, air travel recovered, and it is recovering today.

Over the summer, we saw rapid and significant increases in air travel all over the world in a relatively short period of time. In Europe, the number of flights increased from 2,000 a day in April to almost 19,000 a day by the end-August. In the U.S., traffic increased from a low of 87,000 passengers a day in April to almost 800,000 a day by early July, and last month there were over 1 million passengers in a single day. And in China, they are now back to 100% of pre-pandemic domestic demand. All of these rebounds occurred in less than four months. So it is evident from these numbers that once they are allowed to fly, millions of people will quickly get back on board an airplane.

As we look around the world today, we see the airline industry at various stages of recovery depending on the region.

In the U.S. and Europe, we are currently between 35% and 45% of pre-pandemic flight levels. This is a significant recovery from the April lows, but there has been a pause in the recovery recently due to the resurgence of Covid-19 infections and the imposition of new quarantine periods. Yet, in China in October, 600 million people travelled by air, road and rail during Golden Week. And, in Latin America, passenger numbers continue to increase steadily.

The one region of the world where we have not seen a material increase in passenger numbers is South East Asia due to the significant restrictions on international travel that are still in place in these countries.

We have also seen a stabilization in the financial condition of many airlines. Buoyed by government support, significant funding in the capital markets, and the ability to reduce costs, airlines have significantly extended their cash runway. Since the coronavirus outbreak, we have seen an extraordinary response from governments around the world to support their airlines. This includes almost \$200 billion of direct assistance in the form of loans, payroll support and other initiatives, as well as billions more of indirect support provided by many countries. Governments around the world recognise that airlines are a critical part of the global infrastructure and country specific economies.

Airlines have also raised a record amount of funding from banks and the capital markets. The U.S. airlines alone have successfully raised over \$40 billion since March. These factors, combined with the rise in passenger traffic and the reduction of their expenses, will enable the vast majority of the world's airlines to navigate through this crisis.

We at AerCap have experienced the improved conditions as well in the form of a significant increase in our cash collections and a marked slowdown in rent deferral requests.

So, where do we go from here in terms of the airline industry's recovery. In our view, the key metric that we are using to gauge the industry's health is the point at which airlines are able to cover their cash operating costs. With today's low fuel prices and the cost reduction programs that airlines around the world have implemented, we believe that airlines' cash operating costs can be covered at around 60% of 2019 traffic levels. In contrast, AerCap does not need to see anything like the levels of airline profitability we witnessed in 2019 or otherwise over the last five years for our

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company to be successful. This is an important differentiator between leading lessors like AerCap and the airlines.

In order to make progress towards the traffic levels at which the industry becomes profitable, there will be two key drivers. These are the standardisation of pre-departure testing as well as a successful vaccine. On both of these fronts, very significant progress is being made, particularly with regards to the vaccine.

The very positive news yesterday from Pfizer on the 90% effectiveness of their vaccine in preventing Covid-19 infections will give travellers much greater confidence in booking flights, which will be a major positive for our airline customers. And on the testing side, there are various initiatives underway at airports around the world to support this goal that avoid placing pressure on existing national testing systems. Key among these is the European Union's recently introduced traffic light system, which all EU countries have signed up to. Once implemented, this will standardize measures across the continent and will either remove or significantly reduce quarantine periods, thereby removing the uncertainty that is currently constraining passenger travel.

Hong Kong and Singapore have also reached a preliminary agreement to establish an "air travel bubble" to reopen borders between the Asian financial hubs that will exempt travellers from current quarantine requirements. These systems may take several months to be fully implemented, just as it took time after 9/11 for governments to agree on new security protocols, but it is an important step, and it will get done. The same is true in the U.S., where progress is being made on the implementation of rapid testing capabilities at airports such as San Francisco and Dallas. Another example of this from October was when Hawaii dropped its 14-day quarantine requirement, provided the passenger had a negative test within 72 hours of departure.

Progress is also being made on both sides of the Atlantic to reopen the North Atlantic market, which is the most important long-haul market in the world by far. Governments have spent far too much on their airlines not to make sure their most valuable routes reopen. We expect that the measures taken to facilitate the re-opening of these North Atlantic routes will likely serve as a template for other lucrative long-haul routes. As I said at the beginning, we believe that once consumers know for certain that they can fly, they will fly.

Turning to AerCap, as I referenced earlier, our relentless focus on cash collection continues. We have collected significantly more cash month after month over the five months since April. This is evidenced by the improvement in our Q3 operating cash flow which was up by more than 70% versus Q2. Of course, there are individual airlines that present challenges, but the vast majority of our customers continue to pay us every month.

We have also seen a significant reduction in the number of new deferral requests. Our deferral balance itself increased by \$56 million in the third quarter compared to a \$288 million increase during the second quarter.

Our placement activity also picked up in the quarter and, whilst we are not at the levels we saw in prior years, we continue to place our aircraft. Coming into this crisis, one of AerCap's advantages was that we had been significantly extending our average remaining lease term through the sales of older equipment and the purchase of new technology aircraft on long-term leases. As a result, only 7% of our leases are scheduled to come off lease in the next two years.

In addition, of the 933 aircraft in our fleet, only 42 are on lease to airlines involved in a Chapter 11 style process, this includes Norwegian Airlines. We expect these airlines to emerge from Chapter 11 and to keep the vast majority of our aircraft on acceptable terms as they are predominantly new technology aircraft. This is evidenced by the fact that, even now, many of these aircraft continue to be operated by the airlines every week.

It is worth noting that just because an aircraft is on lease to an airline in Chapter 11, or subject to a restructuring discussion, it does not mean that it won't be leased again. Any aircraft that we do take back would of course be leased to other airlines on long-term leases. These are long-lived assets that will generate cash well into the future. Please bear in mind that the AerCap platform has leased over 1,000 aircraft in the last 5 years. This is what we do.

On the balance sheet side, we continue to actively manage our capex and debt maturities, leaving us with a record level of liquidity. As I noted previously, AerCap has already executed over \$12 billion of liquidity initiatives in 2020. Our ratio of cash sources to cash uses for the next 12 months is currently 2.9 to 1, the highest level we have ever had.

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Turning to the asset side of the balance sheet, as we mentioned on the Q2 call, we felt it was important to take a detailed and conservative review of all of our aircraft in light of current events and changing outlooks.

As you can see from the slide, our fleet consists of 62% new technology aircraft, being A320NEO, Boeing 787, Airbus A350 and the Boeing MAX, 29% current technology narrow-bodies A320 and Boeing 737 and 9% current technology wide-bodies being Airbus A330 and Boeing 777.

Our new technology aircraft are the most in-demand models in the world and will form the backbone of the world fleet for the next 25 years. AerCap has more of these aircraft than any other airline or leasing company in the world. By comparison, only 12% of the global in-service passenger fleet was comprised of new technology aircraft at the beginning of the year. We expect to see solid demand for current technology narrow-bodies well into the future. One of the reasons for this is the late entry into service of the new technology narrow-body aircraft. Indeed, it can be said that the MAX has yet to enter service and the ramp-up of A320 NEO production was much slower than anticipated due to its production problems. Based on the OEMs own production forecasts, new technology narrow-bodies will not make up the majority of the global narrow-body fleet until well into the next decade.

In contrast on the wide-body side, the Boeing 787 entered into service almost a decade ago in 2011. The Boeing 787 was followed in quick succession by the Airbus A350, the Airbus A330NEO, the Boeing 777X and the Boeing 747-8. This represented an unprecedented replacement wave of so many widebody variants in such a short period of time.

In response to this, beginning 6 years ago, AerCap implemented a deliberate portfolio strategy of reducing the number of current technology wide-body aircraft in our portfolio. We did this because we could see that over the course of the next decade airlines would increasingly replace these types of aircraft with new technology versions that are more fuel-efficient and environmentally friendly. Covid- 19 is accelerating this trend.

When you see a trend where airlines begin to move out of a particular aircraft type, you need to get ahead of it and reduce your exposure to that asset type, especially the younger versions. We have been highlighting this to you for several years. In 2014, we had 33% of our fleet in current technology wide-body aircraft. Through our focussed portfolio strategy since then we have reduced these aircraft types to only 9% of our portfolio today.

Looking back on the last six years, where we sold almost 600 aircraft generating consistent and significant gains on sale we could see that our aircraft were prudently valued on our balance sheet, and reflected our conservative approach to asset valuation and thoughtful approach to asset selection. This gave us significant headroom coming into the crisis.

Given the impact of COVID-19, and airlines' accelerating the move out of current technology wide- body aircraft, we felt it would be prudent to update all of our assumptions. In Q3, we reviewed each aircraft line by line, with a critical eye to ensuring that our assumptions were reflective not only of conditions today but importantly the conditions we believe are likely to prevail for the remaining useful life of each aircraft. As a result of this comprehensive review of our entire fleet, we have taken an impairment of \$915 million that is focused primarily on current technology wide-bodies.

Now, switching to the future. You may have heard the saying about the aircraft leasing industry: when times are good the airlines need our airplanes, and when times are tough the airlines need our financing. I can tell you that, over my 20+ years in the industry, financing has been a much more profitable activity for leasing companies. Based on our experience of prior downturns and the conversations I am having with our airline partners around the world, I am confident there will be significant opportunities for AerCap to deploy capital attractively as the industry recovers. Importantly, we are in the fortunate position to have the financial wherewithal to do so.

As airlines emerge from Covid-19, we expect that their main priorities will be to restore their balance sheets and unwind themselves from government involvement. This means they will need to focus on repaying debt rather than directing capital towards new aircraft purchases. Prior to this year, there were still airlines whose strategy was to own their entire fleet. That strategy has proved itself to be redundant. We have already heard from a number of airlines that going forward they plan to rely more on leasing.

When you look back over AerCap's history of capital deployment you will see that our strategy has been consistent for

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decades, it is simply the opportunity set that has changed each year. At different points in the cycle, we have been involved in large-scale M&A, sale-leasebacks, share repurchases and debt reduction in order to generate value for our shareholders.

Take the sale-leaseback market as an example: during the financial crisis, we completed 2 of the largest sale-leasebacks ever done. However, as that market segment became more competitive, we found more attractive ways to deploy our capital. Over the next few years as the industry recovers and airlines focus on repairing their balance sheets, we expect to see significant sale-leaseback opportunities, in particular as the OEM production rates start to ramp up again.

Given the broad impact of Covid-19 on sectors outside of aviation, I believe that the “tourist” capital that came into the sector in recent years will exit and find other avenues elsewhere to be deployed. This may create opportunities for leading aircraft lessors like AerCap.

Moving forward, with a strong balance sheet, record levels of liquidity, and airlines that are motivated to lease aircraft, we believe that AerCap is well-positioned to come out stronger from this crisis. Pete will now take you through the financials.

Peter Juhas, Chief Financial Officer

Thanks Gus. Good morning everyone. In the third quarter, AerCap had a net loss of \$850 million dollars, or \$6.66 per share.

This included a number of special non-cash items, including a write-off of \$915 million dollars related to flight equipment, a write-off of \$58 million related to goodwill, and \$128 million of mark-to-market movement on our Norwegian shares. We also recorded a \$43 million dollar loss on debt extinguishment related to the repayment of near-term debt maturities, which will be offset by lower interest expense in future quarters. Excluding these special items, our net income for the third quarter was \$158 million dollars and our earnings per share was \$1.24.

Our total revenues for the third quarter were \$1,027 million dollars, compared to \$1,194 million dollars last year. Basic lease rents were lower due to lease restructurings, aircraft transitions and the impact of airline bankruptcies during the quarter. This includes the impact of cash accounting, which was around \$100 million dollars for the quarter. We have placed all of our lessees that are currently in bankruptcy proceedings and other restructurings, or where we otherwise believe that the rent isn't probable of collection, on cash accounting, which is where we only recognize payments that we receive during the quarter as revenue. Our maintenance rents were \$91 million dollars in the third quarter, which was a little higher than last year due to lease terminations.

In terms of aircraft sales, during the third quarter we sold 7 of our owned aircraft for a total of \$63 million dollars. The average age of the aircraft we sold was 19 years old. Our net gain on sales for the quarter was \$7 million dollars, which was lower than last year primarily due to the lower volume of sales in the quarter. Our other income was \$31 million dollars for the third quarter, mainly due to higher interest income.

Along with the recovery in passenger traffic, we saw a significant increase in our cash collections during the third quarter. Our operating cash flow for the quarter was \$541 million dollars, which was a 76% increase from the second quarter. As Gus mentioned, during the third quarter we saw a slowing of new deferral activity. Our deferral balance was \$485 million dollars as of September 30th, which is around 10% of annual lease revenues, compared to a balance of \$429 million as of June 30th. So the increase in deferrals was only \$56 million dollars during the third quarter, and the vast majority of our airline customers continue to pay us every month. Our cash collection rate was around 80% for the third quarter. That is, the rent we collected during the quarter, compared to what we normally would have collected under our leases. If we exclude rent deferrals from that number, the cash collection rate was around 90%.

Each quarter, we review our aircraft for potential impairments. This involves forecasting, on a plane-by-plane basis, the expected cash flows for the remaining useful life of each aircraft and comparing those to our carrying value for that aircraft.

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In order to do this analysis, we update our expected lease rents as well as our other cash flow assumptions for each aircraft. This involves not just an assessment of lease rents today, but looking at the entire future life of each aircraft and forecasting what the lease rents will be for future leases. The assumptions that we used reflected our current estimates of the impact of Covid-19 on aircraft demand, both now and in the future.

As a result of this review, we took an impairment charge of \$915 million dollars in the third quarter, which related predominantly to our Airbus A330 and Boeing 777 current technology widebodies. These aircraft types together now represent less than 10% of our total fleet.

Our impairment of these aircraft is based on our view that the lease rates for these aircraft types will be lower in future years, as we're seeing an increased number of airlines transitioning out of current technology widebodies and into new technology aircraft such as Boeing 787s and Airbus A350s. Therefore, we decided it was appropriate to lower our assumptions for the future cash flows associated with our Airbus A330 and Boeing 777 aircraft. We've always taken a proactive approach to looking at our fleet values, and that's why we think it's prudent to take this action today.

We had minimal impairments on our current technology narrowbody aircraft, which make up 29% of our fleet, and we had no impairments on our new technology aircraft, which make up 62% of our fleet, as we believe there will continue to be strong demand for these aircraft types in the future, and they'll continue to form the backbone of the global fleet. And having completed this comprehensive review of all of our aircraft, going forward we don't expect to see further meaningful impairment of any aircraft types in our fleet.

We continue to see the benefits of having strong global access to funding. Since the beginning of April, we've raised \$6.5 billion dollars of new funding, both unsecured and secured. We've seen strong demand from the capital markets and from banks and other funding sources. The average cost of the debt we've raised this year is around 3.9%, which is in line with our overall average cost of debt of 4.0%. And we've used a substantial portion of the proceeds of these offerings to retire close to \$4.0 billion dollars of debt maturing over the next couple of years.

Working with the OEMs, we've reduced our capex for 2020 and 2021 by almost \$6 billion dollars, which is a 65% reduction from where we started the year. We currently expect to have around \$300 million dollars of capex for the fourth quarter and around \$1.8 billion dollars in 2021. Overall, we've rescheduled deliveries of over 90 aircraft from 2020 and 2021 into later years, generally 2-3 years later than the original delivery date. On our second quarter earnings call, we announced that we had cancelled orders for 15 Boeing 737 MAX aircraft. In addition to these, we cancelled orders for 9 more MAX aircraft during the third quarter. We currently have 71 MAXes remaining on order.

As a result of the liquidity actions we've taken and the improvement in our cash flows, we ended the third quarter with a record liquidity position. Our total sources of liquidity were \$11.2 billion dollars, which gives us a next 12 months' sources-to-uses ratio of 2.9x, the highest it's ever been. Our excess cash coverage is also a record \$7.4 billion dollars.

We continue to maintain a very strong balance sheet. Our leverage ratio is currently 2.67 to 1, which remains below our target ratio of 2.7 to 1. Our secured debt percentage continues to remain low, at 24% of total assets. And we have \$26 billion dollars' worth of unencumbered flight equipment, which can be used for additional financing in the future. Going forward, we'll continue to maintain a very strong liquidity position. We believe that's the prudent thing to do in the current environment. We'll continue to run at a higher liquidity level of at least 1.5x sources-to-uses coverage until things normalize.

Our strong liquidity position and prudent liquidity management have been recognized by the rating agencies. During the third quarter, both Moody's and Fitch reaffirmed our investment grade ratings and in their commentary, they highlighted our strong liquidity and the actions we've taken to enhance it, as well as the strength of our operating platform. So, since the start of the pandemic, all three rating agencies have affirmed our investment grade ratings.

This of course continues to be a very challenging time for the aviation industry, but with our strong balance sheet, our record liquidity, and our unmatched operating platform, as well as the actions we've taken this quarter, we remain well-positioned to continue to weather this storm and to take advantage of the opportunities that will arise as the recovery continues.

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And with that, operator, you can open up the call for Q&A.

Questions And Answers

Operator

(Question And Answer)

Operator

Thank you. (Operator Instructions) We will move on to our first question from Helane Becker of Cowen. Please go ahead. Your line is open.

Helane Becker

Thanks very much, operator. Hi everybody, and thank you very much for your time this morning. Just a couple of questions. I know that you look at the values of the aircraft. Can you just talk me through how you came to those numbers for the majority of aircraft that you wrote down? Is it just the discounted cash flows that came along?

Peter Juhas, Chief Financial Officer

Sure, Helane. So when we do our impairment test, we're looking at the long-term cash flows associated with each aircraft. And so we're projecting -- you look at the lease rents that they're on today, you look at the future lease rents that we expect for those aircraft, maintenance rents, all cash flows related to it. And so you're evaluating those and comparing those to the book value. And basically if you have a shortfall there and your expectations, then you write it down to the discounted value. And really what we saw with the A330s and 777s was airlines increasingly exiting those types of aircraft and we expect that, that will have an impact on their lease rents in the future.

Helane Becker

Okay. And then I don't know about the Norwegian investment. I think you have somebody from the company on the board and it looks like they're going to have some trouble getting through the winter. And I was just kind of wondering how you're thinking about that and if you're thinking about taking your aircraft back there?

Aengus Kelly, Chief Executive Officer and Executive Director

Let me talk about the aircraft first and we have already leased two of the airplanes we have with Norwegian, two 787s and they're under lease contracts with a new carrier and the remaining 787s we are marketing at the moment as well, as these are new technology, widebodies, the most in-demand, we will get those leased, Helane.

Helane Becker

Okay. Alright. Thanks very much team.

Peter Juhas, Chief Financial Officer

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Sure.

Operator

We will now move on to our next question from Jamie Baker of JP Morgan. Please go ahead. Your line is open.

Jamie Baker

Hey, good afternoon, everybody. Gus, could you hazard a guess when you think the leasing industry crosses that 50% threshold of the global fleet and also, I agree with you that we're going to see greater use of leases as airlines try to variabalize their cost structures, recognizing that's not an actual English word, but you get the point. I suspect that CFOs are also going to gravitate towards shorter duration. Do you agree with that? And how does that change your business if duration declines by, several years?

Aengus Kelly, Chief Executive Officer and Executive Director

Turning to the first question Jamie, the pace at which operating leasing will hit 50%, the velocity has increased. There was no doubt in my mind that as airlines come out of this crisis that their number one focus will be deleveraging their balance sheets, particularly those who have taken on government involvement. As government involvement will of course handicap their strategic capability and at self-interest level, of course, their own ability to enumerate themselves. So that's definitely the curve we saw that after the financial crisis with all the banks, I do not see airlines sending billions of dollars to Boeing and Airbus. I just don't see it. What they will do, because what we are seeing is an acceleration of the move into new technology airplane, particularly on the wide-body side. So we will see an increased use of leasing there. How quickly we'll get to 50%? Could be -- I would say Jamie we will see it in the next three years, or the next 36 months we will see that. Because airlines also realized the massive value that leasing produces in terms of optionality for an airline's fleet management strategies. So, and around the world airlines that used to predominantly own almost all their fleet, without question will use more leasing. I think that's -- that will definitely occur.

Jamie Baker

And on lease duration?

Aengus Kelly, Chief Executive Officer and Executive Director

On the lease duration, that will be a negotiated one Jamie. Of course, it will depend on the bargaining position of both counterparties. The lessors will push no doubt for the longest term and lessee will want the shortest term. I think that'll just be a question of the varying leverage of the two parties.

Jamie Baker

That's great. And second question and it's a bit of a follow-up to Helane's question. You decided to leave aircraft at Norwegian, but when we -- going forward, let me see how to ask is I mean, are you -- How are you handling stress at this point? Are you inclined to pull out aircraft earlier? Has the playbook changed with the pickup in flights as you look at some of these airlines, particularly in the eastern part of the world? I mean, basically, are you more courageous now, given what you're seeing in the market?

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Aengus Kelly, Chief Executive Officer and Executive Director

Jamie, the approach hasn't changed. As you were going through April, May, June, it was very difficult to find a home for airplanes at that point. So if you could store them, keep them on an operating certificates, have the storage cost taken care of, the maintenance cost taking care of associated with the airplane it made more sense provided the airline was still operating to leave the aircraft there. And then as you found homes to take them out, we have taken -- we've already signed up two 787s out of Norwegian to a new customer and we are marketing the balance of them as well.

Jamie Baker

Okay. That's helpful. Thank you, Gus. Take care.

Aengus Kelly, Chief Executive Officer and Executive Director

Pleasure.

Operator

We will now move on to our next question from Ross Harvey of Davy. Please go ahead. Your line is open.

Ross Harvey

Thanks. Good afternoon, Pete, Gus and Joseph. My questions on the impairment charge. I'm just wondering can you give us a sense as much as you can of the gale of future lease reductions or remaining useful life change that go with the impairment in this quarter and whether they were applied to all the 777s and 330s and maybe Pete as well. You alluded to this but more broadly I wanted to clarify, did the review suggest to you that there may be impairments over the next six to twelve months on the current tech narrowbodies or new tech widebodies or was there a very sufficient margin of safety there? Thanks.

Peter Juhas, Chief Financial Officer

Sure. Thanks Ross. So well first off, we looked at all of the aircraft in our fleet on a plane by plane basis. So it was a comprehensive review. It wasn't just the A330s and 777s, it was every plane that we looked at. And as I said, we look at the cash flows for each of those aircrafts, we stress those cash flows given the current environment, given lease rents today, as well as what we expect the impact of the COVID-19 pandemic to be on lease rents in the future. And so, as you would expect, that results in lower lease rents today and for most aircraft types, almost all, you see a recovery in the future. For those A330s and 777s, we believe that there's a permanent reduction there and that's what we reflected. But there are a lot of other assumptions that go into it as well as you mentioned including useful lives, downtime on aircraft, maintenance, and reconfiguration cost, all of those things. And so really it's the combination of all of those that go into it, when you come up with this analysis.

Now, I guess turning to the second part of your question in terms of the rest of our fleet. So, those A330s and 777s are 9% of the fleet. When we look at other areas of our fleet, take current tech narrowbodies, those are 29% of our fleet. We expect to see solid demand for these aircraft well into the future. And as Gus mentioned, current tech narrowbodies won't be overtaken by new tech aircraft until well into the next decade. As for new tech aircraft, which make up to 62% of the fleet, these are aircrafts that airlines are transitioning into. They're the most in-demand aircraft types. They'll form the backbone of the global fleet for the next 25 years. So really, as I said in my prepared remarks, looking out today, we don't see any more meaningful impairments in any parts of our fleet.

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Date: 2020-11-10
Event Description: Q3 2020 Earnings Call

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YTD Change(\$): -27.5250003052
YTD Change(%): -44.778

Bloomberg Estimates - EPS
Current Quarter: 1.075
Current Year: 6.601
Bloomberg Estimates - Sales
Current Quarter: 1093.667
Current Year: 4627

Ross Harvey

Great. And one quick follow-up if I may. The expected 12-month operating cash flow now is \$2.2 billion, kind of averages about \$570 million a quarter, which is kind of broadly in line with what Q3 was. I'm just wondering, does that include or not any material easing in the receivables balance? And if so, have you baked in any additional deferrals and that's it for me. Thanks.

Peter Juhas, Chief Financial Officer

Well, we've taken into account what we expect in terms of deferrals. I mentioned last quarter that we expect that I expected the deferral balance to grow over time to around \$700 million to \$800 million. As I look out today, I think it probably will peak at a lower level than that so we have reflected those in there, Ross, in that \$2.2 billion of next 12 months operating cash flow. And really, what that represents is just that's our estimate over the next 12 months of what happens. Obviously you saw that we had a significant improvement in cash flow the past quarter up 76% we expect to continue to see a gradual increase in cash flows continuing over the course of the next year.

Ross Harvey

Thanks, Pete.

Peter Juhas, Chief Financial Officer

Sure.

Operator

We will now move on to our next question from Koosh Patel of Deutsche Bank. Please go ahead. Your line is open.

Koosh Patel

Hey, good morning, guys. You commented that over the last several years you've seen a lot of capital investments from what you refer to as tourist capital and you see some of that pulling back and creating opportunities in the market, potentially for acquisitions and what not. How do you see that playing out? Do you see that in the form of large-scale M&A or more in this, by way of asset portfolios or individual opportunities, which may come along?

Aengus Kelly, Chief Executive Officer and Executive Director

I think it's fair to say that those people who have come into the sector looking for yield over the last five-years or six-years, and thought this was a spread business. And they didn't need a full-scale operating platform to run the business have found that, that is not a valid assumption and that you most definitely do need a global platform to run this business. So we have already seen many of them take the decision, we are not going to build a full scale operating platform and in fact, it's too late for that. So what I believe, we will continue to see from those type of participants that they won't deploy further capital into the sector. So I think they'll be further fretted, there'll be less new capital coming into the sector than was the case over the last five years. And on the other side, I believe that we will have a greater demand for the aircraft leasing product. So that's how I would see it take shape.

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Koosh Patel

Great. And then you mentioned that there's 42 aircraft on lease to airlines involved in chapter 11 like processes in your portfolio. I just wanted to, could you clarify how many of those aircraft are new technology widebodies and I guess what can you tell us about what you're seeing in the marketing environment for those aircraft right now?

Aengus Kelly, Chief Executive Officer and Executive Director

Most of those aircraft are new technology widebody airplanes. And as I said, they include our Norwegian ones. What we are seeing is that even though the airlines are in chapter 11 or an equivalent thereof. They continue to operate the airplanes, which means they have an obligation to pay us as well for the operation of those assets. We would expect as I said in my prepared comments that those airlines will continue to lease the majority of those aircraft on acceptable terms.

Koosh Patel

Okay, great. Thanks a lot guys.

Aengus Kelly, Chief Executive Officer and Executive Director

Pleasure.

Operator

We will have move on to our next question from Catherine O'Brien of Goldman Sachs. Please go ahead. Your line is open.

Catherine O'Brien

Hi, good morning, everyone. Thank you very much for the time. Maybe just a quick one on the sale leaseback opportunity. Do you feel that we've reached the point where it's okay for you to start moving forward with some of these transactions? You've a good sense of what airlines are capitalized well enough to continue making payments, or is rising cases making you take a little bit of a further pause. Just wondering what would lead to us seeing some transaction announcement from you guys? Thanks.

Aengus Kelly, Chief Executive Officer and Executive Director

There have been a very limited number of sale lease backs executed over the course of the last few months. Some of them have been in the public arena. And of course, we look at those. Now, what I do expect however is that as production and delivery ramps up from the OEMs the demand for sale lease backs will become much more urgent and I believe the leverage dynamic will be more in our favor. Right now, we have all-time lows of deliveries from Boeing and Airbus. Boeing isn't delivering anything really except a handful of widebodies a month and Airbus' own production is significantly down. So Catherine, I think that as we go into the New Year and the OEMs start to deliver more aircraft, there will be a more pressing demand for the sale-leaseback product.

Catherine O'Brien

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That makes a lot of sense. Thanks for your color. And then maybe just two quick follow-ups potentially both for Pete. Is the reason you expect deferrals to peak lower than your prior expectations. Is that because repayments have come in better, and then apologies just one more on Norwegian but should we be expecting any further headwinds to financials as you remove the remaining aircraft or is everything already on cash accounting so that the impact of Norwegians is already fully accounted for? Thanks so much for the time.

Peter Juhas, Chief Financial Officer

Yes. Sure. So, on the first one Catherine the --it's really because we've seen less deferral activity, we've seen a slowdown in that as you saw in the second quarter the increase there was only \$59 million, so it was much less than what we saw during the second quarter. So that's really given that trajectory that's why I think that the peak is likely to be below that \$700 million to \$800 million that I mentioned in the second quarter. In terms of Norwegian, so we do have shares in Norwegian and perpetual securities that are on the balance sheet, we've also got an offsetting provision for those -- against those. And so, we don't expect to see a net impact from Norwegian going forward, a negative net impact.

Catherine O'Brien

Okay. Very clear. Thank you.

Peter Juhas, Chief Financial Officer

Sure.

Operator

We will now move on to our next question from Ron Epstein of Bank of America. Please go ahead. Your line is now open.

Ronald J. Epstein

Yes. Hey, good morning, guys. Just a couple of small things. During the quarter -- last quarter, you guys mentioned that 15% of your revenue or you had a number of lessors on cash accounting. How did that compare to this quarter?

Peter Juhas, Chief Financial Officer

It was about the same Ron, again 15%.

Ronald J. Epstein

Okay, great.

Peter Juhas, Chief Financial Officer

So, not really many additions to what we had from last quarter.

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Ronald J. Epstein

Okay, great. And then maybe another question on the product front. Does the narrowbody shift towards the A320 family away from the 737 family given Airbus' market share pick up? Does that play quite well for you given your fleet and what you're planning for the future?

Aengus Kelly, Chief Executive Officer and Executive Director

Well, it does Ron because we saw it a long time before anyone else and that's why we're the biggest lessor in the world of A320neos. And we could see that coming, like we also saw on the current technology widebodies, because Ron we are the biggest in the world. We get more information than anyone, we see trends before anyone else sees them. And we could see that, that was happening on the A320neo, the A321neo and we could see it on the 777 family and the 330 family.

Ronald J. Epstein

Now in your view, do you think Boeing has to do something to counter the A321neo XLR?

Aengus Kelly, Chief Executive Officer and Executive Director

You know, the way it works in the aircraft market, is that the Boeing 737 MAX 10 can do a lot of the missions that the A321XLR does. Not everybody wants to fly a narrowbody from Dublin to Miami, it's a long way to go in a narrowbody tube. So Boeing could say to themselves, you know what we just going to concede that niche end of the market and yes, we have an airplane that's less capable. But by reducing the cost of the aircraft, we can make it a very competitive airplane, which is exactly what Airbus did with the A320 for many years against the 737NG. When the NG had a superior operating performance, but the Airbus airplane was good enough that with a slight price reduction below the competitor airplane, it was a competitive aircraft.

Ronald J. Epstein

Got you. And if I may, just one last question. On a typical 777-300ER, middle-aged, how much do you think the residual value has been impacted because of what's going on in the market on top of the pandemic?

Aengus Kelly, Chief Executive Officer and Executive Director

Well, look Ron, it's hard to say specific numbers, but we saw six years ago, again, because we see more data than anybody else in the world. We see more of what airlines are doing and that's why we acted so much on it over the course for the last six years, reducing the fleet from a third of the fleet to 9% and that wasn't done by balance sheet growth. In fact, the value of our assets stayed constant or shrank slightly. So what I would say to you is that it's very much case by case, but we have our own view of it and we have acted accordingly with our own airplanes.

Ronald J. Epstein

Okay. Great. Thank you.

Operator

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We will now take our next question from Moshe Orenbuch of Credit Suisse. Please go ahead. Your line is open.

Moshe Orenbuch

Great. Thanks. Gus both you and Pete talked about this kind of you being comfortable with the level of the charges that you took in terms of valuing the portfolio. So I guess, number one is can you talk a little bit about the discussions you had with the rating agencies around that? And then second part of that question is, does -- at what point does it now make sense for you to be able to go more on offense then defense?

Peter Juhas, Chief Financial Officer

Sure. Thanks so much. So yes, we've discussed those with the rating agencies and previewed them with them. I mean from the rating agencies perspective, they're main focus in this regard has been on where our leverage ratio is if we take an impairment. And so as you see we've done this comprehensive review on the fleet, don't see anything else out there and having done that we're at 2.67 to 1. So that's below our target ratio of 2.7 to 1. It's in line with or below where all the rating agencies want us to be in terms of our leverage ratio. So I think you know from that standpoint, I think that should be fine. I don't expect any negative reaction as a result of that, Gus, do you want to comment on offense?

Aengus Kelly, Chief Executive Officer and Executive Director

And look as we said, the company is in the strongest liquidity position it has ever been in. We do believe that there will be ample opportunity as we get to the other side of this crisis. And the focus of airlines as I mentioned in my prepared comments will be to de-lever the balance sheet and in particular unwind themselves from government debt. Also, I believe there will be fewer competitors for us. I think the tourist capital that came into the sector as I said, that believed it was a spread business. They are leaving the sector. So I do think that there will be ample opportunity. And if you look at our track record over the course of the last 10 years, we've engaged in the largest sale leasebacks ever done, the largest M&A ever done, the largest ordering, the largest buybacks ever done. And so, we're always looking at the alternatives that are there to maximize the value of the business for our shareholders. Thank you.

Moshe Orenbuch

Got it. Thanks. Pete just a quick follow-up on the cash flow question. Given that we now expect the deferral balance to kind of peak at a lower level. Are there other things I mean, in other words, your forecast out 12 months is really kind of the current -- the Q3 cash flow kind of annualized. What are the other puts and takes or could it be better than that \$2.2 billion?

Peter Juhas, Chief Financial Officer

It could be better, I mean, as we look out at it Moshe, we are projecting as I said a gradual recovery and a gradual recovery of air travel generally, as you know, the winter tends to be weaker for airlines. So we'll have to see what happens over the next couple quarters there. But, we're also seeing some positive developments in terms of pre-departure testing protocols, coordination among governments around quarantine periods, and then obviously, we'll have to see what happens in terms of the vaccine development. So really those are all of different variables that factor into that. We haven't -- I would say we haven't been aggressive about in our view on assuming a rapid recovery there in terms of cash flows.

Moshe Orenbuch

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Thanks very much.

Peter Juhas, Chief Financial Officer

Sure.

Operator

It appears there are no further questions at this time, I'd like to hand the conference back to Mr. Aengus Kelly, CEO of AerCap.

Aengus Kelly, Chief Executive Officer and Executive Director

Thank you all for joining us today. To sum up the four key points, I hope you will take away are: One, we are witnessing a significant increase in air travel and in our cash flows from the lows of April. Two, AerCap has a strong balance sheet and the strongest liquidity position we've ever had. Three, COVID-19 is accelerating the pre-pandemic trend of airlines moving into new technology aircraft, and AerCap is the largest owner of new technology aircraft in the world. Four, we are confident that as the recovery continues, there will be ample attractive opportunities for AerCap to deploy our capital. Thank you all for your time. We look forward to talking to you in three months' time.

Operator

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

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