

Edgar Filing: AIRLEASE LTD - Form 10-Q

AIRLEASE LTD  
Form 10-Q  
November 07, 2002

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549-1004

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2002

Commission file number 1-9259

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

\_\_\_\_\_  
(Exact name of registrant as specified in its charter)

California

94-3008908

\_\_\_\_\_  
(State of Organization)

\_\_\_\_\_  
(I.R.S. Employer Identification No.)

555 California Street, 4th floor, San Francisco, CA.

94104

\_\_\_\_\_  
(Address of principal executive offices)

\_\_\_\_\_  
(Zip Code)

(415) 765-1814

\_\_\_\_\_  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

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### PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

#### BALANCE SHEETS

(IN THOUSANDS EXCEPT UNIT DATA)	SEPTEMBER 30, 2002 (UNAUDITED)	DECEMBER 31, 2001
<hr/>		
ASSETS		
Cash and cash equivalents	\$ 2,574	\$ 9,432
Finance leases - net	6,524	6,949

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Operating leases - net	13,190	14,218
Aircraft held for lease	8,700	21,326
Notes receivable	0	544
Prepaid expenses and other assets	66	60
	<hr/>	<hr/>
Total assets	\$ 31,054	\$ 52,529
	=====	=====
LIABILITIES AND PARTNERS' EQUITY		
LIABILITIES		
Distribution payable to partners	\$ 233	\$ 7,521
Deferred income	0	509
Accounts payable and accrued liabilities	967	602
Taxes payable	91	223
Long-term notes payable	3,065	3,389
	<hr/>	<hr/>
Total liabilities	4,356	12,244
	<hr/>	<hr/>
COMMITMENTS AND CONTINGENCIES		
PARTNERS' EQUITY		
Limited partners (4,625,000 units outstanding)	26,431	39,883
General partner	267	402
	<hr/>	<hr/>
Total partners' equity	26,698	40,285
	<hr/>	<hr/>
Total liabilities and partners' equity	\$ 31,054	\$ 52,529
	=====	=====

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AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

STATEMENTS OF OPERATIONS

(UNAUDITED; IN THOUSANDS EXCEPT PER UNIT AMOUNTS)	THREE MONTHS ENDED SEPTEMBER 30, 2002	2001	NINE MONTHS END SEPTEMBER 30, 2002
------------------------------------------------------	---------------------------------------------	------	------------------------------------------

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REVENUES

Finance lease income	\$ 75	\$ 1,149	\$ 230	\$ 3
Operating lease rentals	750	270	2,250	
Other income	8	9	45	
	-	-	--	
Total revenues	833	1,428	2,525	4

EXPENSES

Interest	60	132	175	
Depreciation	856	160	2,568	
Management fee - general partner	94	139	287	
Investor reporting	92	87	289	
General and administrative	110	36	194	
Tax on gross income	42	139	127	
Aircraft maintenance and refurbishing	26	0	91	
Impairment charges on aircraft	11,086	0	11,086	
Bad debt expense	34	0	34	
	--	-	--	
Total expenses	12,400	693	14,851	2

Net (Loss)/Income	\$ (11,567)	\$ 735	\$ (12,326)	\$ 2
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Net (Loss)/Income Allocated To:

General Partner	\$ (116)	\$ 7	\$ (123)	\$
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Limited Partners	\$ (11,451)	\$ 728	\$ (12,203)	\$ 2
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Net (Loss)/Income Per Limited Partnership Unit	\$ (2.48)	\$ 0.16	\$ (2.64)	\$
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NINE MONTHS E  
SEPTEMBER 30

(UNAUDITED; IN THOUSANDS)

2002

CASH FLOWS FROM OPERATING ACTIVITIES

Net (Loss)/Income	\$ (12,326)	\$
Adjustments to reconcile net (loss)/income to net cash provided by operating activities:		
Depreciation	2,568	
Increase in accounts payable and accrued liabilities	365	
Decrease in taxes payable	(132)	
Decrease/(Increase) in prepaid expenses and other assets	(6)	
Increase in accounts receivable	0	
Bad debt Expense	34	
Impairment charges on aircraft	11,086	
Net cash provided by operating activities	<u>1,589</u>	

CASH FLOWS FROM INVESTING ACTIVITIES

Rental receipts in excess of earned finance lease income	425	
Net cash provided by investing activities	<u>425</u>	

CASH FLOWS FROM FINANCING ACTIVITIES

Repayments under lines of credit, net	0	
Repayment of long-term notes payable	(324)	
Distributions paid to partners	(8,548)	
Net cash used by financing activities	<u>(8,872)</u>	

Decrease in cash and cash equivalents	(6,858)	
Cash and cash equivalents at beginning of period	9,432	

Cash and cash equivalents at end of period	\$ 2,574	\$
	=====	=====

ADDITIONAL INFORMATION

Interest paid	\$ 134	\$
	=====	=====

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AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

## NOTES TO FINANCIAL STATEMENTS

### SIGNIFICANT ACCOUNTING POLICIES

**BASIS OF PRESENTATION** - The accompanying unaudited condensed financial statements reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of the Partnership, necessary to fairly state the results for the interim periods. The results of operations for such interim periods are not necessarily indicative of results of operations for a full year. The December 31, 2001 balance sheet included herein is derived from the audited financial statements included in the Partnership's Annual Report and incorporated by reference in the Form 10-K for the year ended December 31, 2001, but does not include all disclosures required by generally accepted accounting principles. The statements should be read in conjunction with the Organization and Significant Accounting Policies and other notes to financial statements included in the Partnership's Annual Report for the year ended December 31, 2001.

**CASH EQUIVALENTS** - The Partnership considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

**FINANCE LEASES** - Lease agreements, under which the Partnership recovers substantially all its investment from the minimum lease payments are accounted for as finance leases. At lease commencement, the partnership records the lease receivable, estimated residual value of the leased aircraft, and unearned lease income. The original unearned income is equal to the receivable plus the residual value less the cost of the aircraft (including the acquisition fee paid to an affiliate of the general partner). The remaining unearned income is recognized as revenue over the lease term so as to approximate a level rate of return on the investment.

**OPERATING LEASES** - Leases that do not meet the criteria for finance leases are accounted for as operating leases. The Partnership's undivided interests in aircraft subject to operating leases are recorded at carrying value of the aircraft at lease inception. Aircraft are depreciated over the related lease terms, generally five to nine years on a straight-line basis to an estimated salvage value, or over their estimated useful lives for aircraft held for lease, on a straight-line basis to an estimated salvage value.

**LONG LIVED ASSETS IMPAIRMENT** - The Partnership accounts for the impairment of its long-lived assets in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144 "ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS". SFAS requires that an impairment loss be recognized in an amount equal to the difference between the carrying value and the fair value if the carrying value of an asset is not recoverable based on the estimated undiscounted future cash flows. In the third quarter of 2002, the three off-lease MD-81 aircraft were considered impaired as defined by SFAS No. 144 as a result of the Partnership's continued inability to lease these aircraft. The Partnership recorded an impairment charge of \$3,695,000 per aircraft. The new book value per aircraft after the impairment charge is \$2,900,000. The fair values of the aircraft were determined by discounting the estimated future cash flows.

**NET INCOME/(LOSS) PER LIMITED PARTNERSHIP UNIT** - Net Income/(loss) Per Limited Partnership Unit is computed by dividing the net income allocated to the Limited Partners by the weighted average units outstanding (4,625,000).

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

LIQUIDITY AND CAPITAL RESOURCES

The Partnership presently has one long-term debt facility. At September 30, 2002, the 7.4% non-recourse note collateralized by one aircraft leased to FedEx had an outstanding balance of \$3.1 million. The facility matures in April 2006.

At September 30, 2002, long-term borrowings of \$3.1 million represented 2.9% of the original cost of the aircraft presently owned by the Partnership, including capital expenditures for upgrades. The terms of the Limited Partnership Agreement permit debt to be at a level not exceeding 50% of such cost.

Cash distributions paid in the first nine months of 2002 were \$1.83 per limited partnership unit, representing the regular first and second quarter 2002 distributions of \$0.11 per unit each, the regular 2001 fourth-quarter cash distribution of \$0.11 per unit, and a special distribution of \$1.50 per unit as a result of the sale of one MD-82 aircraft in December 2001.

In September 2002, the Partnership declared a third-quarter 2002 cash distribution of \$0.05 per unit totaling \$233,586 payable on November 15, 2002 to unitholders of record on October 4, 2002. As a result of this distribution and the first and second quarter 2002 distributions, and the Partnership loss for the first nine-months period of 2002, Partnership equity declined to \$26.7 million at September 30, 2002 from \$40.3 million at December 31, 2001, and limited partner equity per unit declined to \$5.71. The 2002 third quarter cash distribution constitutes a return of capital. The 2001 third-quarter cash distribution was \$0.30 per unit.

RESULTS OF OPERATIONS

The Partnership reported a loss of \$11,567,000 in the third quarter ended September 30, 2002, compared with last year's third quarter earnings of \$735,000. Revenues for the 2002 third quarter were \$833,000, compared with last year's third quarter revenues of \$1,428,000.

Net loss for the first nine months of 2002 was \$12,326,000, compared with a net income of \$2,404,000 for the first nine months of 2001. Revenues for the nine-month period were \$2,525,000, compared with \$4,468,000 for the first nine months of 2001.

The revenue reductions are primarily due to the expiration of the lease with US Airways for five aircraft in the fourth quarter of 2001, three of which remain off-lease; the sale of one aircraft in December 2001; and the scheduled decline in finance lease income in 2002 associated with the aircraft leased to FedEx.

The decline in earnings results from an increase in expenses, primarily due to aircraft impairment charges and an increase in depreciation expense, and from

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the reduced revenues.

Expenses for the first nine months of 2002 were \$14,851,000, an increase of \$12,787,000 from \$2,064,000 for the comparable 2001 period. The increase in expenses is primarily due to aircraft impairment charges in the third quarter of 2002 of \$11,086,000, as the three off-lease aircraft were marked to market, and to depreciation expense of \$2,568,000 for the first nine months of 2002 compared to depreciation expense of \$305,000 for the comparable 2001 period. The 2002 depreciation expense related to aircraft subject to operating leases and to aircraft available for lease. Also, a note receivable from US Airways recorded on the Partnership's books for \$34,000 (net of discount and deferred income) was written off as bad debt expense. The note was written off due to the uncertainty of its collection in light of US Airways' recent bankruptcy filing. Interest

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expense was lower in the first nine months of 2002 as a result of the reduction in the Partnership's debt balances. Management fees and taxes were lower due to a smaller asset base and lower revenues.

### PORTFOLIO MATTERS

At September 30, 2002, the Partnership's portfolio consisted of six Stage-III commercial aircraft. Two are leased to CSI Aviation Services, Inc., one to FedEx, and three are off lease.

The leases of the two aircraft leased to CSI expired October 1, 2002. CSI and the Partnership entered into a new agreement extending the leases for another five months through March 1, 2003, at a reduced rent. In the 4th quarter of 2002, the Partnership expects to incur on these two aircraft, maintenance and refurbishing expenses of approximately \$219,000.

In the third quarter of 2002, impairment charges were recorded on each of the three off-lease aircraft. As a result of the Partnership's continued inability to lease these aircraft, they were considered impaired as defined by the Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". The book value per aircraft after the impairment charge is \$2,900,000.

In June 2002, the Partnership commenced litigation against U.S. Airways seeking to recover damages for U.S. Airways' failure to return the three aircraft leased to U.S. Airways following lease expiration on September 30, 2001 and to pay rent due on the aircraft. U.S. Airways has since filed for bankruptcy. The outcome of the litigation and bankruptcy are both uncertain and there can be no assurance as to the amount or timing of any final settlement or award resulting from the litigation.

### OUTLOOK

The market conditions for aircraft leasing continue to be weak, as the supply of aircraft exceeds demand. Consequently, the Partnership continues to experience significant competitive pressure in marketing the three aircraft currently off lease, and management is not able to predict when these aircraft may be leased again or the terms of any such future leasing.

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF

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1995:

The Partnership has included in this quarterly report certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 concerning the Partnership's business, operations and financial condition. The words or phrases "can be", "may affect", "may depend", "expect", "believe", "anticipate", "intend", "will", "estimate", "project" and similar words and phrases are intended to identify such forward-looking statements. Such forward-looking statements are subject to various known and unknown risks and uncertainties and the Partnership cautions you that any forward-looking information provided by or on behalf of the Partnership is not a guarantee of future performance. Actual results could differ materially from those anticipated in such forward-looking statements due to a number of factors, some of which are beyond the Partnership's control, in addition to those discussed in the Partnership's other press releases and public filings, including (i) changes in the aircraft or aircraft leasing market, (ii) economic downturn in the airline industry, (iii) default by lessees under leases causing the Partnership to incur unanticipated expenses or not to receive rental income as and when expected, (iv) the impact of the events of September 11, 2001 on the aircraft or aircraft leasing market and on the airline industry, (v) changes in interest rates and (vi) legislative or regulatory changes that adversely affect the value of aircraft. All such forward-looking statements are current only as of the date on which such statements were made. The Partnership does not undertake any obligation to publicly update any forward-looking statement to reflect events or circumstances after the date on which any such statement is made or to reflect the occurrence of unanticipated events.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The General Partner believes there has been no material change in the Partnership's exposure to market risk from that discussed in the Partnership's Annual Report on Form 10-K for the year ended December 31, 2001.

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### ITEM 4. CONTROLS AND PROCEDURES

(a) The Chief Executive Officer and the Chief Financial Officer of the General Partner of the Partnership, after evaluating the effectiveness of the Partnership's disclosure controls and procedures as of a date within 90 days before the filing date of this quarterly report, have concluded that the Partnership's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Partnership in this quarterly report is accumulated and communicated to the Partnership's management to allow timely decisions regarding required disclosure.

(b) No significant changes were made in the Partnership's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

## PART II - OTHER INFORMATION

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

Exhibits:

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- (a) 10.57 Lease Supplement Number Two dated October 9, 2002, among Wachovia Bank, National Association, as successor to First Union National Bank, not in its individual capacity but solely as Trustee, the Partnership and CSI Aviation Services, Inc.
- 99.1 Certification of Chief Executive Officer
- 99.2 Certification of Chief Financial Officer
- (b) On August 28, 2002, the Partnership filed a report on Form 8-K dated August 26, 2002, disclosing under Item 5 the expected delisting of the Partnership's limited partnership units by the New York Stock Exchange and the commencement of trading on the OTC Bulletin Board on September 9, 2002.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

By: Airlease Management Services, Inc.  
General Partner

NOVEMBER 7, 2002

\_\_\_\_\_  
Date

By: /s/ DAVID B. GEBLER

\_\_\_\_\_  
David B. Gebler  
Chairman, Chief Executive Officer  
and President

NOVEMBER 7, 2002

\_\_\_\_\_  
Date

By: /s/ ROBERT A. KEYES

\_\_\_\_\_  
Robert A. Keyes  
Chief Financial Officer

CERTIFICATIONS

I, David B. Gebler, Chairman, Chief Executive Officer and President of Airlease Management Services, Inc., the General Partner of Airlease Ltd., A California Limited Partnership, certify that:

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1. I have reviewed this quarterly report on Form 10-Q of Airlease Ltd., A California Limited Partnership;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 7, 2002

/s/ DAVID B. GEBLER

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David B. Gebler

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Chairman, Chief Executive  
Officer and President

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I, Robert A. Keyes, Chief Financial Officer of Airlease Management Services, Inc., the General Partner of Airlease Ltd., A California Limited Partnership, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Airlease Ltd., A California Limited Partnership;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the

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registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 7, 2002

/s/ ROBERT A. KEYES

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Robert A. Keyes  
Chief Financial Officer

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### EXHIBIT INDEX

Exhibit Number	Description
10.57	Lease Supplement Number Two dated October 9, 2002, among Wachovia Bank, National Association, as successor to First Union National Bank, not in its individual capacity but solely as Trustee, the Partnership and CSI Aviation Services, Inc.
99.1	Certification of Chief Executive Officer
99.2	Certification of Chief Financial Officer

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