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# EDITED TRANSCRIPT

FLY - FLY Leasing Ltd at Deutsche Bank Aircraft Finance and Leasing Conference

EVENT DATE/TIME: SEPTEMBER 04, 2019 / 8:00PM GMT



## CORPORATE PARTICIPANTS

**Colm Barrington** *Fly Leasing Limited - CEO & Director*

## CONFERENCE CALL PARTICIPANTS

**Douglas William Runte** *Deutsche Bank AG, Research Division - MD and Head of Aircraft Debt Research*

## PRESENTATION

**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

Get going. Yes. Sorry to miss Doug, but he's got a call of nature. I understand. Good afternoon, everybody. I'm Colm Barrington, the CEO of FLY Leasing, which I'm trying to.

(technical difficulty)

Which I'm going to introduce to you. Here's FLY at a glance. I think as I mentioned last year, we were the smallest of the public leasing companies of the 4 New York Stock Exchange listed public leasing companies. But I said, I think we are small but beautiful. But in the last year, we've grown a little. And -- but I think we're no less beautiful. In fact, I think we are significantly better company than we were even a year ago.

As of the end of June, FLY had a fleet of 98 aircraft. A relatively young fleet with an average age of 7.4 years. And on relatively long term, leases averaging a weighted average lease term of 5.3 years. So as I'll show you in the next slide, quite an attractive portfolio. We also have a very diversified lessees, 40 airlines, 21 countries. I think that makes us just over 2 aircraft per lessee, which I think makes us even more diversified than the last speaker. We have about a 29 aircraft pipeline of A320 family, NEO family aircraft, A320s and A321neos, and of which 21 are on committed leases to airlines within the AirAsia Group, long term 12-year leases, and we take first delivery of those 21 aircraft in the fourth quarter this year with 9 more in 2020, 9 more in '21 and the final 3 in '22. And we've exercised 8 of 18 options we have for A320neo family aircraft for deliveries in '20 and '21. Those aircraft are not yet leased but we have a pretty good idea in our heads where they're all going.

We also have a very conservative financing strategy with 4.7 year average life and it's mainly secured financing. So that probably will be not a great interest to several of you guys and girls in the room because we are primarily a secured -- financing is primarily secured. Unlike most other -- all other public leasing companies, many other companies, we are externally managed. We are managed by BBAM, which is, as you know, the third-largest aircraft lease manager of the world. BBAM manages over 500 aircraft for clients of Nomura in Japan, for private equity group called Incline Aviation Capital for securitization 3 ABSs, ECAF Horizon 1, Horizon 2 and for FLY. So we are managed by BBAM, which has a population of over 150 staff based in 9 offices around the world. It's been in business for over 30 years and has all the expertise required to provide a really good platform. And providing FLY with a broad range of expertise, which a company of our size with 98 aircraft couldn't otherwise afford. I can deal with a little bit of the benefits of the BBAM relationship a little later.

I've got 17% of FLY is owned by BBAM shareholders. So we have quite a commonality of interest between ourselves and BBAM. And I think importantly, we have been trading at a reasonably good discount to our book value of \$24.28 a share at the end of last quarter. So we're trading today at around \$21 a share, so I think we represent reasonably good value.

Here's our fleet. It's basically 40% Airbus and 60% Boeing. As you can see, mainly the popular narrowbodies, the A320 Family and the Boeing 737 next-generation family. We have 2 Boeing 737 MAXs that we acquired on a sale and leaseback transaction involving grouped aircraft a few years ago. But we have no direct relationship with Boeing on those aircraft.

We've grown our portfolio from \$3 billion to \$3.4 billion over the last 12 months. And growing our total fleet from 85 to 98 aircraft. As I mentioned earlier, relatively young fleet of 7.4 years and a relatively long-term lease -- leases of 5.3 years.



You probably see this by various -- from various other presenters earlier in the today. So I come with the ends, so probably old information. But as you, our market is still very, very robust. IATA is showing about 5% annual growth rate for traffic this year, good airline profits, but most importantly for the aircraft leasing industry, there's a continuing strong demand for leased aircraft driven by that growth in traffic, by record load factors -- this is amazing, I mean load factors amount in the mid-'80s globally, which is pretty unique. So planes are being filled and airlines want more planes because they are getting very good load factors. And of course, that's helped also by the manufacturer backlog, not just the MAX obviously but delays in some of the Airbus products as well. So we're finding very strong demand for leased aircraft and just as good for us is a very strong demand for sales of aircraft in the secondary market, both driven by ABS transactions and by a strong interest from other buyers of aircraft.

Our strategy is based on 4 principles. Basically, disciplined acquisitions. We do not acquire aircraft, order aircraft for future delivery from the manufacturers. We think it's a risky strategy of company of our size, it's interesting to hear the last speaker support that strategy. So we do not by some manufacturers on a speculative order basis. We have been very rigorous in our pricing so we haven't followed the market down to the lease rate factors as well as [Herb] mentioned in the last few years of 0.5%, 0.6% per month and we just don't -- can't make money. We don't think anybody can make money at those lease rate factors.

So we have been very disciplined in our acquisitions because our view that if you buy the right aircraft at the right price, it will survive no matter what happens in the industry. If you have a popular aircraft that you bought well, you will do well regardless of industry conditions. I think that's proven to be the case over the last many years.

We have very conservative financing, mainly secured financing, mainly long dated and amortizing. So it amortizes as our aircraft depreciates, and we don't have major balloons of financing to refinance, which could hit a company at a bad time in the industry. So we have been quite conservative in our financing. We continue a very active fleet management policy of trying to buy the best aircraft and then moving aircraft down the -- we're great believers in velocity through the balance sheet, keeping the aircraft moving and availing of sales opportunities as they arise. And finally, real focus on share -- enhancing shareholder value. We're not rushing out to become investment grade or to do other things, we think it's more important for us to enhance shareholder value because you enhance shareholder value, then all the other parties, your capital structure will do well, also.

We have been delivering very good results. This is our second quarter highlights. We've produced just net income nearly \$62 million. We have adjusted EPS of \$0.192 -- \$1.92, and adjusted ROE of \$0.33 and a book value of \$24.28. That book value has grown very rapid. It's grown 16% in the last year from just over \$20 to \$24.28. And that's really been based on 2 things. One is -- well, 3 things. One is pretty good leasing income and good returns from our leased aircraft. Secondly, we've been repurchasing shares below book value. In the year-to-date, we purchased 2 million shares representing about 6% of our -- of our total outstanding shares at more than 30% discount to market -- to book value. In the meanwhile, we've been selling aircraft at significantly above book value. Moving onto the next slide, you'll see that since 1995 -- since 2015, we have sold 95 aircraft from our portfolio. Gross proceeds about \$2.4 billion and an aggregate 8% premium to net book value. So we've consistently sold aircraft from our portfolio at a significant premium to book value. Meanwhile, the company's stock has been trading at a significant discount to book value, so we don't quite see the connection. We have 14 more aircraft contracted to sale this year and those aircraft are all contracted to -- are delivering as I speak.

Last year, we did a major acquisition when we entered into a transaction with AirAsia. And this is done by BBAM, with FLY, with Incline Aviation Capital, their private equity group and Nomura. It was total \$7 billion deal, which we couldn't have done on our own and not many leasing companies could have done on their own, but because of BBAM's relationship with 3 clients, including FLY, we were able to pull off this \$7 billion deal, which has made a significant positive impact on FLY. That increased our leverage to something over 4x, 4:1 at the end of last year, but we've reduced that now down to just over 3:1 at the end of June, and we will be reducing it further during the course of this quarter. So I think we will be below 3x by the end of this quarter. So that's been quite a positive transaction for FLY. And that's been enhanced by further 2 deals done by BBAM, which many of you in the room are probably aware of. These are the Horizon ABS transactions, to which FLY has sold some aircraft. And those have been very positive transactions, both for investors, for BBAM and for FLY and has given us another conduit for sales of our aircraft, helping us generate profits, reduce our exposure to the AirAsia Group and to reduce our leverage.

So we are actively targeting further acquisitions. We have 6 aircraft more contracted in 2019. As I mentioned earlier, the pipeline of 21 new A320, 21 NEOs. These are all leased on attractive terms to airlines within the AirAsia Group, and then we have 8 NEO options, which we've exercised.



With strong liquidity, with long-date financing, lots of cash, long debt maturities and we have no significant debt maturities until one of our unsecured facilities was due in quarter 4 2021. So overall, we believe that FLY represents a very strong value proposition. We have given guidance of \$70-plus-million Q3 pretax income. We are growing our book value per share, that \$70 million should translate into close to \$2 additional growth in book value per share this quarter. We've got committed growth pipeline of the 21 -- committed A321s committed on lease and A320neos and 21 NEOs committed on lease plus the 8 options. We have significant buying power with the cash and unsecured assets we currently have. And shares are trading at a very significant discount to book value despite the recent run in our shares, which today are trading at about \$21 a share as compared to the book value of \$24.28 at the end of June, which will be give or take \$26 at the end of September. Our shares are still trading at a discount to book value, and we think FLY represents a very good value proposition, so...

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## QUESTIONS AND ANSWERS

**Douglas William Runte** - *Deutsche Bank AG, Research Division - MD and Head of Aircraft Debt Research*

Great. With that, let's maybe open up for some questions. Maybe I'll start with one. Over the past 2 years, you guys have done -- taken a number of steps to transition the portfolio to younger assets, transition out of some of the more niche assets and it's really shown up in your stock price, right? And you delivered on deleveraging target ahead of time. So when you think about priorities, what's the next greatest priority for FLY at this moment?

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**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

Well, I think the next greatest priority will be digest the pipeline, which we've committed to. As I mentioned, we've reduced our exposure to AirAsia Group airlines, now well less than 20% today to the 5 airlines within the AirAsia Group, it's not just a single airline but 5 airlines within the umbrella of the AirAsia Group. So we've reduced our exposure, we've reduced our leverage. So now we'll be taking on the new pipeline of aircraft so we -- that obviously is our priority in the short term, but we do want to add additional growth to that and we want to continue our sales program. So if we can generate gains from selling aircraft -- and we set our own targets; sale gain has to be significant multiple of the annual income that, that aircraft is producing for us to want to sell us. But some -- under GAAP, you can sometimes have aircraft that aren't producing great returns under GAAP, but which on a cash flow basis for an ABS buyer are very attractive. So we will continue to look at opportunities like that. So taking on the new portfolio and continue to generate gains from some of the existing aircraft, containing -- keeping our leverage down and keeping our exposure down.

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**Douglas William Runte** - *Deutsche Bank AG, Research Division - MD and Head of Aircraft Debt Research*

And then just on the top of the growth, as you mentioned, there's not many that could have pulled off this transaction besides that you did with AirAsia, the \$7 billion transaction. So what are some of the biggest takeaways from that transaction that you can speak to? And is this a strategy that you may consider pursuing in the future as well for growth with your partners at BBAM?

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**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

Well, answering the second part first, yes. If we could produce more AirAsia-type transactions, we would certainly find it very attractive. I suppose the takeaways are that, as you say is with a deal, that you take the existing few aircraft, which we bought last year, 32 into FLY and another 40-something into other BBAM partners. That was something which very few airlines -- aircraft leasing companies could have done on their own, but which because of the BBAM group of clients, it was possible for us. So that was -- obviously, that was very significant. And then taking on the orders for another 50-odd-committed A320neos, A321neos that was another 50 A320s or give or take \$2.5 billion, \$3 billion. So that was again a commitment, which would be difficult for a lot of the aircraft leasing companies, particularly those with significant order books of their own already to take on, but because we didn't have that commitment to an order book and because we were able to share that deal with other BBAM customers, BBAM clients, we were able to do that.



**Douglas William Runte** - *Deutsche Bank AG, Research Division - MD and Head of Aircraft Debt Research*

Okay. Let's open up to the floor, are there any questions for (inaudible)?

**Unidentified Analyst**

As a former GPA executive, you've seen a lot of interesting things in this industry over the years, and I realize that the MAX, it's only a small part of your fleet. But with that airplane grounded and for the time that it has been grounded, at what point is there within the contract with the airline lessee, I don't know if it's a material adverse change clause, is there at some point -- of some duration of time with the airline lessee, because right now they're current, airlines that have the airplanes even though they're not flying and they have to make the payments, can they come back to you and say, all right, this airplane, it's a broken airplane, it's been a long time, we have to stop paying and then they're not in default. Can you talk about that because I'm sure you've seen some really interesting contracts written over the years?

**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

I have, and I'm very happy to say, this is a very good contract from lessor's point of view. We acquired these 2 aircraft, the 2 MAXs, as part of the multi-aircraft deal -- we had some A320s in transaction multi-aircraft, sale and leaseback transaction with Lion Air and some net, net, net, net, lease. So we get paid regardless. Lion Air did come to us after the grounding and said, look, hey, things have been tough, they had a crash too, so life was a bit difficult, so we did actually defer some several months payments, which they have since repaid in full. So we're actually totally up to today's payments and the relationship remains very good with them.

But again, I think it will be interesting to see what happens. My understanding is the manufacturer is offering airline's credits as compensation, and I think airlines need cash rather than credits, particularly some of the more difficult credit such as we've heard about. Cash I think would be helpful.

**Unidentified Analyst**

Congratulations on a great year. I wanted to follow up and make sure I got a pretty good sense on the number of aircraft that you have under lease over the next few quarters, you did say you'll be selling 14 in the second half of 2019. Is that correct?

**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

That's correct. So the 98 figure that I quoted was our current fleet as of the end of June, when we have 14 contracted sales, so that 98 will go to 84. And then we have contracted to buy I think 4 of the 6 contracted buying this year -- I think 4 still to deliver, 3 or 4 I think are still to deliver. So it will go back up from 84 to 88, provided we find no further aircraft between now and the end of the year.

**Unidentified Analyst**

Sure. And on that same basis, could you roll it forward roughly a year and maybe 2 as to where you see the size of the fleet?

**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

Well, we don't have any -- other than the 9 -- well, between now and the end of 2020, we have 10 A320neo -- A320/21neos contracted and leased to AirAsia Group Airlines. And of the 8 options, which we've exercised, 4 will be in 2020. So that will be 14 additional NEOs in that -- between now and the end of the 2020. But we're in the market actively every day. So we can expect maybe another dozen, good 15 aircraft to be added to that during the period.

We have no sales contracted beyond the January 1, 2020, as of point in time. But we're always looking for sales, and we'll take opportunities as they arise.

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**Douglas William Runte** - *Deutsche Bank AG, Research Division - MD and Head of Aircraft Debt Research*

Maybe I'll ask another one. When I look at the composition of your portfolio, I noticed there's very few widebodies. So maybe you could just talk to us a little bit about what's your investment philosophy or what has been your investment philosophy towards widebodies in your portfolio?

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**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

Yes. Well, I think one of our strategic points I made earlier was that we want to have disciplined acquisitions. And our belief is that from an aircraft operating leasing company, you are best off in the widely used aircraft types. And for us, that is the A320 family, the Boeing 737 family. And keeping those relatively young, to the most attractive modern types. We used to have classic A737s and we got rid of them all. We currently have 42 next-generation 737s, and we'll be getting rid of those over the next few years as well. So keeping our fleet young, we'll keep moving on from those.

But I have this personal -- my own little rule, what I call the 55/500 rule. And I like to ensure that before an operation lessor gets into an aircraft type, there should be 50 customers with 500 either in service or on order for it to be a safe asset for aircraft lessor to buy. That's a general rule. It could be 40/400. But I'd like to sort of set that sort of general parameter. That's being a good yardstick to start from. Mike?

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**Unidentified Analyst**

Quick follow up. I know you bring up the discount to book value, Colm, it is a pretty meaningful discount but I do believe the share price is probably been one of the best performers in this space. And even when we look up against airlines and other aviation companies, it's actually done quite well. How do you and the Board sort of think about constantly buying back stock and yet given the size of your market cap, knowing that, that will undermine potential liquidity, it will add volatility to the share price. Obviously, I think from -- as you think through the math and you look at where the stock's trading, where your book value is, it's a very compelling proposition. But at some point, there may not be much stock left. And I guess to take it with the final step, if you're going to continue to buy almost into perpetuity, I want to be the guy holding that last share. There's obviously a trade-off there, so how do you think about it at the Board level, this compelling value arbitration exercise and yet maintaining the liquidity of your shares so that investors can move in and out relatively easily?

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**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

Yes. I think I remember making this argument to a shareholder once that we didn't want to buy in too many -- he was telling me to buy shares, buy shares, and I said we don't want to buy too many because there won't be enough liquidity in the stock. He says to me, Colm, you're a micro stock already, so just live with it.

I think our overriding criteria though is that we do not want to put money into repurchasing shares that might inhibit us from doing something significant to grow the company. So buying -- having a \$50 million share repurchase program, which we currently have, we don't think inhibits us from making a major acquisition if something comes along. And obviously, the higher you can get your share price, if you do an acquisition, maybe you can use some shares to help that acquisition, as we actually did with the AirAsia transaction. We sold 3 million shares as part of the transaction. And we sold them at \$15 a share, which may seem a bit dumb now, but in fact the whole value of that transaction has much more than compensated for selling those shares at a price, which was actually a bit above market value at the time but at discount to book.

In terms of buying back shares, it was no brainer when we were trading above 50% to book. It becomes a bit of a brainer. Now we've got to think about it, and in fact we're having a call next Tuesday, as I recall, to decide what we do next. So we'll be prudent on it. But certainly the overriding criteria is, don't spend more money that might stop you doing something significant to develop the company. Doug?

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**Douglas William Runte** - *Deutsche Bank AG, Research Division - MD and Head of Aircraft Debt Research*

I'll try a question from this side. So we've heard different lessors, and the manufacturers did give different assessments of the airline credit environment globally. So as you look at your airline counterparties, how do you view the credit quality today versus, say, 12 to 24 months ago? And what direction do you think it's going 12 to 24 months from now?

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**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

Well, we have been either reasonably smart or very lucky in the last 2 years in that we haven't had any significant bankruptcy. We had Air Berlin and we were lucky there. We had 2 aircraft in Air Berlin and A330, 200, which we were really worried about, for which we actually found a new lessee for within a week. And we had a very new A321, which we didn't worry about, but it took us 4 months to take to market. So you don't know but since then the only other default we've had was (inaudible) and we had 3 relatively young 737-800 next-gens with Air -- with (inaudible). We moved 2 of them within a week to a new lessee in India. And the third needed some maintenance both in the airframe and engines and went into the shop and will be out now I think next month and we have a few people circled for that. We haven't signed up anyone until we have a precise delivery date.

So things have actually been quite good -- sorry, we had -- then we had the issue obviously with HNA Airlines, like everybody else does. We think the airlines are doing reasonably well but parent as you know has its issues so -- and we're sticking with them because we think that's going to work out in the long run. But on that, we've been I'd say either smart or lucky. And so overall, the last 12, 18 months has been pretty good for us. And people I think over exaggerate maybe some of the airline issues when -- I know some people have problems in Brazil and those aircraft moved on. Some people have problems with WOW, but these are relatively small airlines, very small proportion of the global fleet. So WOW and Azul -- or Azur or Azul, whatever it is, which we weren't in fortunately, they weren't a significant impact.

If anything happened to one of the larger airlines, the airlines with 170 aircrafts for example, it might have more significant impact. But let's see. Those are very good aircraft, very young aircraft, and so I presume would be picked up pretty quickly by other people. For example, if anything happened, I could imagine Ryanair would love have the short-haul operation and (inaudible) really love to have the long-haul operation. So I mean those are 2 candidates I see could pick the thing up immediately and make sense of it.

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**Unidentified Analyst**

Would the company ever consider, perhaps in tandem, buying an airline with an order book as well as getting order book.

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**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

I don't want an order book. And I definitely don't want an airline.

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**Unidentified Analyst**

You just kind of alluded to 170 airplane airline, an interesting number to pick out of the...

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**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

I may be wrong about a few.

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**Unidentified Analyst**

Well, you're not right.

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**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

Again, it's a big bite, it's a big cherry that's what to bite. But I could imagine it would be interesting to buying other airlines and picking up (inaudible) operation.

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**Douglas William Runte** - *Deutsche Bank AG, Research Division - MD and Head of Aircraft Debt Research*

Maybe I'll ask one more. When you look at some of the gain on trading margin that you guys have seen this year in excess of 10%, which is a little above the historical averages, can you talk about some of the dynamics that are driving that and what your views on the sustainability of something in that range over the longer term is? Or whether you think that's a shorter-term phenomenon?

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**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

Yes. I think one of these factors is that, as you know, ABS transactions are evaluated on cash and aircraft are very good cash producing assets both in terms of rent -- well, security deposits up to the rent, so the maintenance accruals. So you take all those things into an account, for an ABS, it can recognize all of that cash day one, ABS makes a lot of sense. For a company such as ours that has report to under GAAP, it doesn't make so much sense. We don't book the maintenance accruals.

If for example we change leases and we have a bunch of maintenance accruals, and the aircraft goes from one lessee to another, we have to book those maintenance accruals as income the day the old lease ends and then have effectively give them back to the next lessee as a lease incentive under the second lease. And that means that we'd actually don't make any money on that second lease. We've taken it all in the maintenance -- in the end of lease income at the end of the first lease. So that aircraft is no longer very profitable to us, but the cash flow is still coming out for the next lessee and -- for the ABS transaction and they can make good sense out of it. So there are a lot of reasons why we can sell it at a premium and make -- still make sense for the ABS buyer.

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**Douglas William Runte** - *Deutsche Bank AG, Research Division - MD and Head of Aircraft Debt Research*

Okay. Well, perfect. I think with that we're right on time. So thanks a lot, Colm.

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**Colm Barrington** - *Fly Leasing Limited - CEO & Director*

Thanks, Doug.

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