Airline Economics Conference

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Who cares?

Why is financial reporting relevant for investing in aviation?

- Financial Reporting
  - is one of the most basic elements of internal control/governance infrastructure for finance
  - serves a dual purpose of (a) signalling and (b) controlling
  - is used extensively in decision making (credit and other risk assessment) and in monitoring performance (financial covenants, MAC clauses etc) forecasting and projections
  - often relied upon for determination of taxes and other matters e.g. executive compensation
- Aviation finance is a multi billion dollar business – annually. There are more investors and potential investors using published/reported financial information to make their initial investment decisions and monitor their subsequent performance.
- Now more than ever before more leasing companies publishing financial information – not all of it under (i) same reporting framework (IFRS vs US-GAAP vs PRC-GAAP vs HKG-GAAP) or (ii) using same accounting policies.
- It is therefore important to understand this information, be able to compare and contrast it, and more importantly understand what it does or does not purport to do.

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Whats important?

- Critical accounting policies, estimates and judgements
- Those most likely to have significant impact on results of operations, financial position, disclosures and that may require subjective and complex estimates and adjustments
- Which GAAP
- Reviewed disclosures by top lessors to identify most recurring/referred to matters:
  - Flight equipment held for lease (and sale)
  - Impairment charges
  - Maintenance
  - Intangibles
  - Revenue
  - Future accounting standards/developments

Why its important? Which gaap

- Evolution of IFRS has been a success
- 120 countries permit or require its use
- US:
  - continues to be major source of funding for the sector
  - is “home” for some of largest lessors

- Therefore an understanding of US-GAAP and differences to IFRS is necessary

- Despite efforts to converge and conform existing and new standards, differences continue to exist and evolve
- Devil is in the detail, but key areas that differences arise includes:
  - Depreciation
  - Impairment
  - Income Taxes

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Why its important? Flight equipment

Held for use or for sale?

- requires disclosure of managements intentions – sensitive.
- if held for sale (i) write down (but not up) the value of asset, (ii) stop depreciating but continue to recognise income.
- impact on accounting gain recognised vs commercial/economic decision to sell.

Why its important? Flight Equipment

- **Hold for Use**
  - Generally largest, most significant asset on balance sheet

Key Considerations	
Initial Recognition	First cost (rebates, grants), capitalised interest (on PDPs and other)
Subsequent Expenditure	Capitalise vs expense
Depreciation	Is an allocation of cost – not representative of value
	Key Estimates and judgements: - residual value - useful economic life
	Component or not?
	Method – s/ling reducing balance, others

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Why its important? Impairment

- Not required to mark and market
- GAAP difference

US-GAAP x 2 step approach

- Step 1 Compare gross/undiscounted cashflows to asset, if cashflows exceed the no impairment
- Step 2 If cashflows less than carrying value impairment measured is difference to fair

IFRS

- Single Step compares carrying value to higher of fair value (less costs to sell) and value in use

- Key Considerations
  - What cashflows to include/exclude – base rental, maintenance in/out flows, residual values
  - Discount rate to be applied
  - Assumptions – re-lease rates, downtime,
  - Lease encumbered values

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Why its important? Intangibles

- What are they?
  - the value of contractual rights/obligations under leases to receive aircraft in a better condition than that when required.
  - Initial reluctance/hesitation to accept “revised” application of GAAP as advocated by regulators due to perceived inconsistencies with commercial reality.
  - Arise primarily in connection with purchase of aircraft on lease, from other lessors/investors. Do not apply to OEM purchases in PLBs of aircraft not previously on lease.

- Key Considerations
  - “EOL” vs “MR” leases
  - Basis for allocating cost – input from experts
  - Subsequent accounting
  - + deferral and amortisation
  - + interaction with impairment
  - Tax consequences/treatmen

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Why its important? Consolidation

- Increasing importance due to:

  - JVs/Sidecars

  - ABS

- Key Considerations

  - Both frameworks require power/control and exposure to returns/risks

  - % of equity/E-Note held is important

  - Board representation

  - Servicer rights can be important, kick-out rights
  - Often a combination of some or all of above – it does depends !

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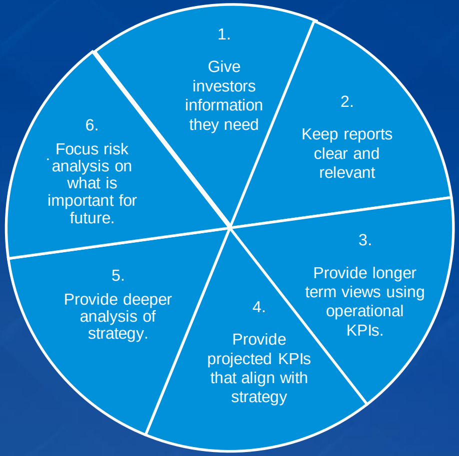
Room for improvement?

- Results of KPMG's analysis of 250+ larger listed companies globally

- Contribution to debate to help improved communications between companies and their shareholders.

- Equally valid for public and for private companies

- Key findings/observations



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What is next?

- IFRS – 16 Leases
  - Bigger impact for lessees than lessors
  - Requires lessees to bring all leases on balance sheet using common methodology

Balance sheet

Asset
= 'Right-of-use' of underlying asset

Liability
= Obligation to make lease payments

P&L

Lease expense
Depreciation

+ Interest

= Front-loaded total lease expense

- Commercial and other considerations
  - Buy v lease
  - Lease duration
  - Variable rentals – PBH
  - FX risk management
  - Others

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