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Chairman  
International Accounting Standards Board  
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Chairman  
Financial Accounting Standards Board  
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## **ILFC Lease Accounting Exposure Draft Comment Letter**

Dear Mr. Hoogervost and Mr. Golden:

Founded in 1973, International Lease Finance Corporation (“ILFC”) is a global market leader in the leasing and remarketing of commercial aircraft. With nearly 1,000 owned and managed aircraft and commitments to purchase approximately 340 new high-demand, fuel-efficient aircraft, ILFC is the world’s largest and oldest independent aircraft lessor. ILFC has approximately 200 customers in more than 80 countries and additionally provides part-out and engine leasing services through its subsidiary, AeroTurbine. During 2012, ILFC generated revenues of approximately \$4.5 billion. ILFC operates from offices in Los Angeles, Amsterdam, Beijing, Dublin, Miami, Seattle, and Singapore. Since 1990, ILFC has been a wholly owned subsidiary of American International Group, Inc. (AIG). Finally, ILFC is an SEC registrant with more than \$23 billion in debt outstanding as of June 30, 2013, which is held by a large and diverse group of investors and lenders.

ILFC has been closely following the FASB and IASB (the “Boards”) joint leasing project and appreciates this opportunity to comment on the proposed lease accounting exposure draft issued by the Boards in May 2013 (“ED”). As ILFC’s primary business is commercial aircraft leasing, the implementation of the ED would have a profound impact on how ILFC accounts for and

reports its financial data and on the financial information relied on by the users of its financial statements.

We appreciate the Boards' efforts in attempting to improve lease accounting. As acknowledged in the ED, we understand the driving force behind the joint lease project is the view that "the existing accounting models for leases...do not require lessees to recognize assets and liabilities arising from operating leases [on lessee balance sheets]." We also understand that while attempting to address the accounting for operating leases by lessees, the Boards have concluded that "retaining the existing lease accounting models for lessors would be inconsistent with the proposed approach to lessee accounting and would result in additional complexity in financial reporting." Therefore, the desire for consistency is driving the Boards to change the lessor accounting model.

**We do not agree that the proposed changes to the lessor accounting model in the ED will improve transparency and reduce complexity.**

We believe that the changes proposed in the ED for lessors will meaningfully reduce transparency in our financial statements; result in reported financial results that are not representative of the economics of our transactions; introduce significantly more subjectivity in deriving our financial results, which will diminish comparability between lessors and present greater opportunities for earnings manipulation; and significantly increase complexity and cost for preparers and users of financial statements. Our views on the ED are shared by the users of our financial statements, including fixed income and equity analysts, rating agencies, investors and lenders. We have enclosed a report on the ED published by an equity analyst that covers some of the sector.

Although we understand the Boards' desire for consistency, we do not agree that an inconsistent lessee/lessor accounting model will increase complexity. In fact, inconsistency in accounting between counterparties to the same transaction already exists in GAAP and IFRS and has not previously presented challenges to users of financial statements. These differences are well understood by the financial statement users and are appropriate. Examples of inconsistencies include the classification and accounting for debt securities, rules for gain and loss contingencies, and the fair value option for financial instruments, among others. Furthermore, we believe symmetry between lessor and lessee accounting is not necessary. The lessor and lessee sides of a transaction are by their nature different. Lessee accounting, where the leased asset is not owned or has been substantively purchased by the lessee, is fundamentally concerned with the recognition and measurement of the rights and obligations in a lease contract and the allocation of the cost of that arrangement. Lessor accounting, where the lessor is the owner of the asset, is concerned with the measurement of the lessor's investment and how income on that investment should be recognized. Furthermore, the lessor/owner is exposed to the risks and rewards of owning the asset, which the lessee is not. Given these fundamental differences between the two parties' positions, it is more critical to ensure the accounting followed by each party provides accurate, transparent and appropriate financial information that is useful to the users of the financial statements, instead of forcing consistency at the expense of meaningful financial information.

For the reasons articulated in this letter, we urge the Boards not to change the current lessor accounting model as it is well understood, appropriate and provides sufficient transparency to the users of our financial statements. The proposed rules in the ED will diminish the transparency of our financial information and will require us to provide non-GAAP measures that mimic the existing accounting rules. As previously mentioned, these views are shared by the users of our financial statements and our peers. Further, the implementation and ongoing compliance with the proposed rules will be costly and extensive.

### **The ED will meaningfully reduce the transparency of our financial statements**

It is critical for the users of our financial statements to understand the amount of rental revenue earned during the period separate from the cost of our asset (i.e. depreciation expense). We believe the replacement of these line items, in a Type A lease, with interest income will diminish the value and usefulness of our financial information. Further, the proposed rules require that interest income is recognized in a manner similar to an amortizing mortgage loan, which will result in most of the interest income recognized within the first half of the lease term. That recognition pattern is not a true and fair representation of the economics of our leasing transactions.

The current lessor model provides an adequate and appropriate recognition and measurement model for aircraft operating leases. Under the current model, rental revenue, which is recognized on a straight-line basis, is an important line item to the users of our financial statements as it serves as a proxy for our rental collections and in measuring the returns on our assets. Depreciation expense is an equally important measure as it provides the users of our financial statements with the cost of our capital expenditures. Replacing these two line items with interest income and residual asset accretion will diminish the financial statement user's ability to use the income statement as a source of information to assess the financial performance and profitability of the business. Because our financial statement users find the current lessor model useful, the proposed changes will require companies such as ours to develop non-GAAP financial measures that mimic the current accounting.

The following is an illustration of how the ED will diminish the usefulness of our financial information as it relates to leases of long-lived assets such as aircraft.

#### ***Example A (Type A Lease compared to current operating lease model)***

Key assumptions:

- New aircraft with a 25 year life on lease for 12 years
- Residual value at end of the lease term equal to \$60 million
- Purchase price of approximately \$100 million
- Fair value is \$112 million at lease commencement

Year	Type A Lease (\$ in thousands)				Current Operating Lease Model (\$ in thousands)		
	Day 1 Gain	Interest Income	Residual Accretion	Total Income	Rental Revenue	Depreciation*	Total Income
1	\$10,619	\$10,847	\$1,848	\$23,314	\$14,880	\$(3,410)	\$11,470
2		10,364	2,070	12,434	14,880	(3,410)	11,470
3		9,823	2,318	12,141	14,880	(3,410)	11,470
4		9,217	2,596	11,813	14,880	(3,410)	11,470
5		8,539	2,908	11,447	14,880	(3,410)	11,470
6		7,779	3,257	11,036	14,880	(3,410)	11,470
7		6,928	3,648	10,576	14,880	(3,410)	11,470
8		5,975	4,085	10,060	14,880	(3,410)	11,470
9		4,908	4,575	9,483	14,880	(3,410)	11,470
10		3,713	5,124	8,837	14,880	(3,410)	11,470
11		2,376	5,739	8,115	14,880	(3,410)	11,470
12		877	6,428	7,305	14,880	(3,410)	11,470
	\$10,619	\$81,346	\$44,596	\$136,561	\$178,560	\$(40,920)	\$137,640

\*Assumes 25 yr. life and residual value 15% of original cost

Pursuant to the ED, a lessor such as ILFC will be reporting day 1 gains/losses, interest income and residual accretion amounts in its income statement. These are useless financial data of little or no meaning to the users of our financial statements as they provide no insight in the actual performance and profitability of the business. As further explained below, the pattern of revenue recognition under the ED is inconsistent and a poor reflection of the economics of the lease.

We also understand that some users would like additional information on the residual value of our assets. We believe this information can be appropriately addressed with enhanced disclosures, including quantitative information about the assumed end of useful life residual values by asset type. These enhanced disclosures do not require a makeover of the recognition and measurement model for operating lessors.

### **The ED fails to properly distinguish between different leasing activities and creates financial information that does not reflect the lease economics**

We believe that a key conceptual flaw in the ED is the assumption that all leases that fall within the scope of Type A leases are financing transactions. Based on that assumption, the ED attempts to implement a single recognition and measurement model to a broad population of leases that are substantively different. This population includes finance leases that facilitate the purchase or sale of an asset, and leases that provide the lessee with the right to use the asset for a finite period of time, during which the aircraft owner continues to retain the risks and rewards of ownership. In our industry, airlines lease aircraft to enjoy fleet flexibility and to eliminate the residual value ownership risk. Any recognition and measurement model must recognize and distinguish between the different leasing activities to properly represent the economics of the transactions.

The current lessor accounting model appropriately distinguishes between these two types of leasing activities. Leases that are financing the sale of assets are accounted for as finance leases. In these transactions, the lessor is effectively the seller and the lessee is the purchaser. From an accounting perspective, the leased asset is appropriately derecognized, a lease receivable representing the sale financing is recognized and any gain or loss on sale is recorded. Beyond that point, the lessor / seller's principal revenue is interest income recognized on the sale financing. On the other hand, with respect to leases that involve the lease of the asset for a finite period of time with the lessor retaining the risks and rewards of ownership, the leased asset appropriately remains on the lessor's balance sheet, no gain or loss on sale is recognized, as this transaction is not a sale, rental revenue is recognized as earned, and the leased asset is depreciated over its life. We do not believe it is appropriate to record gains or losses on sale for the latter population of lease transactions as these transactions do not involve a sale of an asset. The risks and rewards of ownership have not transferred to the lessee to trigger sale treatment. Therefore, we believe that the current lessor accounting presents a model that appropriately distinguishes between the different types of leasing activities and provides a true and faithful representation of the economics of the leasing transactions.

We also do not understand the Boards' rationale for differentiating property leases from leases of other long-lived assets such as aircraft, as they share common characteristics. Under the ED, leases on property are treated as Type B leases, while most leases of other long-lived assets such as aircraft are treated as Type A leases. In the case of aircraft leasing, aircraft are long-lived assets with useful lives as long as 25 to 35 years. Typically, the term of the first lease on a new aircraft can range from 8 to 12 years, with each follow-on lease having a term ranging from 3 to 6 years. The term of the lease typically gets shorter as the aircraft ages. An aircraft may be leased to as many as 3 to 5 or more airlines over its life. The vast majority of ILFC's leases provide the lessee airline with the right to use the aircraft during the lease term in exchange for making monthly or quarterly rent payments. While the lessee is responsible for the maintenance of the aircraft during the lease term, ILFC's retains the risks and rewards of ownership. Any appreciation or depreciation in the value of the aircraft during its life is to ILFC's benefit or detriment. If the Boards proceed with the proposed lessor accounting model, then we believe that aircraft leases should be accounted for as Type B leases as they share common characteristics to property leases. We believe the recognition and measurement model provided for Type B leases will provide an appropriate model for leases of long-lived assets that are not financing transactions.

The ED will result in financial information that is not a true and fair representation of the economics of our leasing transactions. In the case of our leases, we believe the proposed rules will distort the economic reality of our transactions in the following areas:

- Recognition of day 1 gains / losses
- Recognition of interest income on the lease receivable
- Impact of early termination of leases
- Recognition of residual asset accretion

We do not believe it is appropriate to recognize a gain or loss at the commencement of a lease for two reasons: (i) operating lease transactions generally do not represent aircraft sales, and (ii) the gain or loss is determined using highly subjective measures that are not based on observable data points. Treating the lease as a sale will distort the substance of the transaction.

Further, the combination of accelerated revenue recognition and events such as early lease terminations, which are common in our industry, are likely to result in significant income statement volatility that does not reflect the economics of the lease or the leased asset. Under the proposed ED, when a lessee terminates a lease before its expiry date, an impairment loss related to the lease receivable will almost always be recognized due to the lease receivable amortization pattern and the impairment methodology proposed in the ED. An impairment loss may result even when the underlying asset is not impaired, and when all contractual lease cash flows to date have been collected, as provided in the example below.

***Example B (Early Termination Event):***

Key assumptions:

- New aircraft with a 25 year life on lease for 12 years
- Purchase price equal to \$100 million
- Residual value at end of the lease term equal to \$60 million
- Third party appraised value (fair value) of \$112 million at lease commencement
- Additional assumptions
  - lessee terminates its lease early at the end of year 5
  - Estimated aircraft sales price at the year 5 early termination date is approximately \$83 million
  - All contractual cash flows have been paid as agreed

As a result, the lessor will recognize the following pattern and timing of earnings:

<b>Type A Lease Income</b> (\$ in thousands)					
<b>Year</b>	<b>Day 1 Gain</b>	<b>Interest Income</b>	<b>Residual Accretion</b>	<b>Impairment</b>	<b>Total Income</b>
1	\$ 10,619	\$10,847	\$1,848		\$23,314
2		10,364	2,070		12,434
3		9,823	2,318		12,141
4		9,217	2,596		11,813
5		8,539	2,908	(15,948)	(4,501)
	\$ 10,619	\$48,790	\$ 11,740	\$(15,948)	\$55,201

As illustrated by this example, the ED will require a lessor to front-load the recognition of its earnings under a lease through a combination of a day 1 gain and accelerated interest income recognition. Following an event such as an early termination of the lease, the lessor will be required to reverse in the form of an asset impairment some of its previously recognized earnings to “true-up” the income statement to what has actually been earned under the lease. This

earnings pattern is neither consistent with how rent is earned pursuant to a lease nor does it provide useful information to users of our financial statements. A lessor earns a certain amount of rent each month commensurate with the lessee's use of the asset. With respect to this illustration, under the existing accounting rules, the lessor would have recognized rental revenue for the period through the early termination in a manner consistent with the lease. There would not have been any accelerated revenue recognition that would require reversal. This further illustrates why the current lessor accounting model provides a recognition and measurement model more consistent with the substance of the leasing transaction and is more meaningful to the users of our financial statements.

**The ED significantly increases subjectivity in determining our financial results and reduces comparability between lessors and presents greater opportunities for earnings manipulation**

In the proposed accounting for Type A leases, the *rate implicit in the lease*, and the gain or loss recognized at lease commencement will be based on the estimate of asset fair value. Using fair value estimates in almost all of our leases will meaningfully increase the amount of judgment necessary to account for Type A leasing transactions. These judgments will be necessary in an industry where asset fair values have limited observable and verifiable data points, and where there is no single industry-wide accepted valuation methodology employed by all major market participants. As a result, lessor accounting results are likely to differ, potentially by significant amounts, from other market participants, and will increase the opportunity for earnings manipulation.

It is important to recognize that aircraft are Level 3 assets, as there are limited observable data on aircraft valuations or related cash flows. In ILFC's case, the aircraft fair value estimate will be determined by us based on internal projections of future cash flows over the remaining life of the aircraft, while other market participants may rely on third party appraiser information or other valuation methods. Given the long dated nature of an aircraft and irrespective of the valuation method selected, significant assumptions and judgments must be provided to determine fair value.

It is common that valuations between market participants can meaningfully differ. For example, a 2002 vintage Boeing 777-300 is valued at \$44 million by one appraiser, while another appraiser believes the value is \$66 million. Another example is a 2001 vintage A340-300, valued by one appraiser at \$14 million, while a second appraiser values the same aircraft at \$24 million. Given these divergent views of value and their potential impact on the recognition of lease commencement date gains, ILFC's expects lessor financial statements will lack comparability. Furthermore, financial statement users do not find the gain recognition at lease commencement useful and some have noted that this treatment will distort the income statements of aircraft lessors. As a result, financial statement users will disregard the income statement produced under the ED, and will focus their analyses on the cash flow statement or other non-GAAP performance indicators.

The following is an example of how the increased use of judgment can reduce comparability and reliability in lessor financial information.

**Example C (Day 1 Gain):**

Key assumptions:

- New aircraft with a 25 year life on lease for 12 years
- Purchase price of approximately \$100 million
- Residual value at end of the lease term equal to \$60 million
- Potential fair values of the aircraft at lease commencement
  - Purchase price of \$100 million
  - Third party appraised value of \$112 million
  - Discounted cash flow model value of \$122 million

		<b>Type A Lease Income</b> (\$ thousands)		
		<i>Fair Value Equal to Purchase Price</i>	<i>FV Equal to \$112 Million</i>	<i>Fair Value Equal to \$122 million</i>
<i>Implicit Rate</i>		<i>13.5%</i>	<i>11.4%</i>	<i>10.0%</i>
<b>Year</b>				
1	\$13,430	\$23,314	\$30,527	Includes day 1 gain of \$18,472
2	13,223	12,434	11,761	
3	12,985	12,141	11,435	
4	12,714	11,813	11,075	
5	12,404	11,447	10,678	
6	12,050	11,036	10,239	
7	11,645	10,576	9,755	
8	11,181	10,060	9,220	
9	10,652	9,483	8,629	
10	10,046	8,837	7,976	
11	9,354	8,115	7,255	
12	8,563	7,305	6,459	
<b>Total</b>	<b>\$138,247</b>	<b>\$136,561</b>	<b>\$135,009</b>	

Depending on the fair value methodology selected in the example above, the income statement results will be different. Further, lessors are likely to recognize a gain or loss at the commencement of each lease, as the proposed recognition method is not limited to the first lease on an aircraft.

The subjectivity afforded by the ED in determining how the amount of a day 1 gain or loss is recognized increases the susceptibility to earnings manipulation. That risk cannot be mitigated by increased disclosure. From the perspective of the users of our financial statements, the recognition of a day 1 gain or loss derived from non-observable data is neither useful nor does it increase transparency into a lessor's financial performance. Accordingly, we do not believe the application of the proposed rules for Type A leases to lessor leasing transactions will result in an improvement in financial reporting, but will reduce transparency and comparability.

### **Increased Operational Costs with No Benefit**

Operating lessors of long lived assets will incur substantial implementation, transition and ongoing compliance costs, including periodic reassessments if changes to the lease term or lease payments are required. If the ED is finalized in its current form, lessors will be required to invest in additional personnel, implement new accounting systems and develop new processes to address the requirements of the proposed Type A lease model. The costs of implementation and ongoing compliance will be further exacerbated by the significant number of lessor subsidiary entities that act as both the lessor and the lessee in a leasing arrangement. These entities generally require separately audited financial statements in jurisdictions around the world, and the cost of complying with the proposed leasing standard will be cost prohibitive.

Financial statement users have expressed a view that the proposed lease standard will not provide useful financial information, and therefore we question whether the significant proposed changes to lessor accounting have met the cost versus benefit requirements for a new accounting standard. Users of financial statements have many financial data requirements, and in our view, the recognition and measurement system in the proposed model for Type A leases is not the best method of meeting those requirements.

### **Alternative Approach to Lessor Accounting**

As the above discussion indicates, we do not support the lease accounting project in its current form and we are concerned that a number of the proposed accounting provisions will have a detrimental impact on lessor accounting and financial statement reporting. Users of lessor financial statements have confirmed this view. We urge the Boards' to retain the existing lessor accounting model in lieu of the proposed lessor accounting changes in the ED, which should ensure that the users of our financial information are receiving useful, reliable and comparable information.

If the Boards ultimately decide to include lessor accounting in the new lease accounting standard, we would suggest two potential alternatives. The first alternative approach to lessor accounting would retain the differences in lease classification, but that the basis of the classification test would be whether the lessee has substantively purchased the asset and obtained substantially all of the risks and benefits of the underlying asset. This alternative accounting could be achieved by a simple modification to the current accounting guidance rather than a significant change to lessor accounting. The Boards could consider basing this approach on whether substantially all risks and rewards have been transferred, similar to the guidance contained in ASC 840 and IAS 17. Leases that do not transfer substantial risks and rewards of ownership could be accounted for in a manner similar to that proposed for Type B leases.

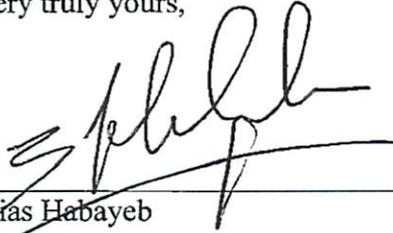
A second alternative for the Boards to consider is the expansion of the scope of Type B leases to include leases of long-lived assets (and not just property) that are not financing the sale of the asset. This would ensure consistency in accounting for long-lived assets such as property and aircraft.

We strongly urge the Boards to seriously consider feedback it is receiving from ILFC, other operating lessors and the users of our financial statements. The Boards should assess whether any proposed changes are consistent with that feedback, especially that from the user

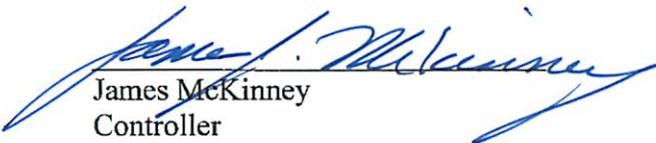
community, as the accounting rules are meant to ensure we are providing transparent and appropriate information to financial statement users. Any changes should be meaningful and result in an improvement in the quality of financial information, and the related costs of implementing the new standard should be measured by the level of improvement achieved. Forcing consistency between lessors and lessees is not appropriate when the net result is a decrease in transparency, reliability and comparability of financial information. We believe that would be a disservice to the user community.

We have responded to certain questions raised by the Boards that are important to us from a lessor perspective and are included in the Appendix to this letter. Thank you for this opportunity to present ILFC's views.

Very truly yours,



Elias Habayeb  
Chief Financial Officer  
International Lease Finance Corporation



James McKinney  
Controller  
International Lease Finance Corporation

## APPENDIX

### RESPONSES TO QUESTIONS ON PROPOSED ASU

#### **Question 1: Identifying a Lease**

This revised Exposure Draft defines a lease as a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. An entity would determine whether a contract contains a lease by assessing whether:

1. Fulfillment of the contract depends on the use of an identified asset.
2. The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.

Do you agree with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

#### *Response*

We agree with the definition of a lease as proposed in the ED.

#### **Question 2: Lessee Accounting**

Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

#### *Response*

ILFC elected to not respond to this question.

#### **Question 3: Lessor Accounting**

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

#### *Response*

We believe that any lessor accounting model needs to distinguish between different types of leasing activities. However, we do not believe the distinction should be based on the extent of the consumption of the asset. The determination of whether a significant or insignificant portion of the economic benefits embedded in the underlying asset are consumed is a subjective determination that would lead to inconsistent application and could also result in leased assets being reclassified between Type A and Type B categories. We do not believe it improves transparency in to our financial performance.

We believe it is more appropriate to differentiate the accounting model based on the economic substance of the leasing transaction. The population of leases covers a broad spectrum of transactions including finance leases that facilitate the purchase or sale of an asset, and leases that provide the lessee with the right to use the asset for a finite period of time, during which the aircraft owner continues to retain the risks and rewards of ownership. Any recognition and measurement model must recognize and distinguish between the different leasing activities to properly represent the economics of the transactions.

The current lessor accounting model appropriately distinguishes between these two types of leasing activities. For finance leases, the lessor is effectively the seller and the lessee is the purchaser. From an accounting perspective, the leased asset is appropriately derecognized, a lease receivable representing the sale financing is recognized and any gain or loss on sale is recorded. Beyond that point, the lessor / seller's principal revenue is interest income recognized on the sale financing. On the other hand, with respect to leases that involve the lease of the asset for a finite period of time with the lessor retaining the risks and rewards of ownership, the leased asset appropriately remains on the lessor's balance sheet, no gain or loss on sale is recognized as this transaction is not a sale, rental revenue is recognized as earned and the leased asset is depreciated over its life. We do not believe it is appropriate to record gains or losses on sale for the latter population of lease transactions as these transactions do not involve a sale of an asset. The risks and rewards of ownership have not transferred to the lessee to trigger sale treatment. Additionally, the recognition of a finance receivable and related interest income for these leases will reduce transparency and will not present an accurate picture of the economics of the transaction.

We urge the Boards' to retain the existing lessor accounting model in lieu of the proposed lessor accounting changes in the ED, which ensures that the users of our financial information are receiving useful, reliable and comparable information.

If the Boards ultimately decide to include lessor accounting in the new lease accounting standard, we would suggest two potential alternatives. The first alternative approach to lessor accounting would retain the differences in lease classification, but the basis of the classification test would be whether the lessee has substantively purchased the asset and obtained substantially all of the risks and benefits of the underlying asset. This alternative accounting could be achieved by a simple modification to the current accounting guidance rather than a significant change to lessor accounting. The Boards could consider basing this approach on whether substantially all risks and rewards have been transferred, similar to the guidance contained in ASC 840 and IAS 17. Leases that do not transfer substantial risks and rewards of ownership could be accounted for in a manner similar to that proposed for Type B leases.

A second alternative for the Boards to consider is the expansion of the scope of Type B leases to include leases of long-lived assets (and not just property) that are not financing the sale of the asset. This would ensure consistency in accounting for long-lived assets such as property and aircraft.

#### **Question 4: Classification of Leases**

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

#### *Response*

As explained above, we do not agree that the accounting for leases should be based upon whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset. As a result, almost all leases for lessors and lessees of long-lived assets will be considered Type A financing type leases. As previously stated, leasing covers a broad spectrum of transactions ranging from leases that are truly financing transactions that facilitate the purchase or sale of an asset, to leases that provide the lessee with the right to use the asset for a finite period of time. Any lease recognition and measurement model must recognize and distinguish between the different leasing activities to properly represent the economics of the transactions.

We also do not understand the Boards' rationale for differentiating property leases from leases of other long-lived assets such as aircraft, as they share common characteristics. Under the ED, leases on property are treated as Type B leases, while most leases of other long-lived assets such as aircraft are treated as Type A leases. In the case of aircraft leasing, aircraft are long-lived assets with useful lives as long as 25 to 35 years. Typically, the term of the first lease on a new aircraft can range from 8 to 12 years, with each follow-on lease having a term ranging from 3 to 6 years. The term of the lease typically gets shorter as the aircraft ages. An aircraft may be leased to as many as 3 to 5 or more airlines over its life. The vast majority of ILFC's leases provide the lessee airline with the right to use the aircraft during the lease term in exchange for making monthly or quarterly rent payments. While the lessee is responsible for the maintenance of the aircraft during the lease term, ILFC's retains the risks and rewards of ownership. Any appreciation or depreciation in the value of the aircraft during its life is to ILFC's benefit or detriment. If the Boards proceed with the proposed lessor accounting model, then we believe that aircraft leases should be accounted for as Type B leases as they share common characteristics to property leases. We believe the recognition and measurement model provided for Type B leases will provide an appropriate model for leases of long-lived assets that are not financing transactions.

However, we urge the Boards' to retain the existing lessor accounting model in lieu of the proposed lessor accounting changes in the ED, which ensures that the users of our financial information are receiving useful, reliable and comparable information. This is a view consistent with the feedback we have received from the users of our financial statements.

### **Question 5: Lease Term**

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

#### *Response*

We do not agree with the Boards' proposal that lease assets and liabilities should be re-measured when there are significant changes arising from the lease term since the last reporting period. Options to extend or terminate a lease do not give rise to contractual rights and obligations until the options are exercised or until the contingent events occur. As a result, lessors and lessees should not recognize assets and liabilities until the exercise of the options or the occurrence of the contingent events. In our view the Boards have not supported the requirement for the inclusion of lease options assets and liabilities in recognized lease assets or liabilities. If the Boards conclude that lease options should be included in the measurement of lease assets and liabilities and periodically reassessed, then we believe the reassessment should only be carried out when a material change to the contract has occurred.

We question whether the costs and benefits associated with the reassessment requirements included in the proposal have been considered. ILFC will need to invest significant personnel, process and system resources to meet the reassessment requirement. Furthermore, it is not clear that the proposed requirement will provide useful information to financial statement users. We recommend that the Boards use input from roundtable discussions and comment letters and give appropriate consideration to the costs and benefits of this proposal.

We do not believe the terms "contractual, entity and market based factors" are well defined in the proposed guidance and that they may be misunderstood if not further clarified in the ED. If this proposed language was intended to be similar to the lease term analysis under existing accounting standards, then we suggest that existing lease term assessment language be retained.

### **Question 6: Variable Lease Payments**

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

#### *Response*

If variable lease payments are included in the measure of the residual value asset, then lessor financial statement comparability will be compromised, and the subsequent revenue recognized will distort lease performance by relying on significant subjective judgments.

The ED proposes that a lessor include variable lease payments in its measurement of the residual asset if the lessor reflects an expectation of those variable lease payments in determining the rate the lessor charges the lessee ("Variable Lease Provisions"). Subsequent accounting requires that

the lessor de-recognize a portion of the residual value each period and recognize a corresponding lease expense based on a relatively complex methodology.

The proposed Variable Lease Provisions accounting will compromise the comparability of lessor financial statements, as ILFC expects there will be significant diversity in the application of the proposed accounting. From a practical perspective, lessors use many different methods to evaluate the economics of a lease transaction, and may elect to include or exclude variable lease payments in those assessments. For those lessors that do not include variable rents in their pricing models, other revenue recognition guidance will be applied, while for those that include variable lease payments, the proposed ED accounting model will apply. These two accounting models will result in significantly different accounting results, and will therefore compromise lessor financial statement comparability.

In addition, the proposed Variable Lease Provisions will distort lease performance by relying on significant subjective judgments. Operating lessors of long lived assets include variable lease payment provisions in many leases, and for ILFC a majority of its lease contains these provisions. In the aviation sector, these payments relate to the usage of the leased aircraft components (engines, aircraft, landing gear, etc.), whereby the lessor is required to contribute to future qualified maintenance events generally up to the amount of cumulative variable payments received. Lessor contribution amounts can be significant given the high cost of aircraft maintenance. Because lease terms related to new aircraft may be as long as 10 or more years, projecting the amount and timing of variable lease cash inflows and outflows over this extended period of time will involve significant judgment. When the expected timing of a large lessor contribution is different than the actual timing (from one accounting period to another), the accounting implications could be significant and could distort lessor financial statements.

Based on the factors described above, ILFC does not support the proposed accounting approach for Variable Lease Provisions, and believes the Boards should eliminate these provisions from the final standard. We recommend the existing revenue recognition guidance be applied to the Variable Lease Provisions. This approach will reduce the potential for diversity in practice and will increase comparability of lessor financial statements.

### **Question 7: Transition**

Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?

Are there any additional transition issues the Boards should consider? If yes, what are they and why?

### *Response*

To assist users in understanding trend and other lease information, ILFC believes the most comparable current and historical financial data should be presented in its financial statements. A full retrospective implementation achieves this objective but will involve relatively high costs,

including personnel, operational and accounting system resources needed for compliance. If a full retrospective implementation method is selected by the Boards, lessors should be provided adequate time for implementation so that they may properly account for lease contracts during the time between issuance of the new standard and the year in which the new standard must be adopted. When determining the amount of time to be provided for implementation, ILFC recommends the Boards specifically consider the Securities and Exchange Commission (“SEC”) Regulation S-K, Item 301, which requires five years of selected financial data. This SEC requirement will require additional time to comply with the adoption method selected.

### **Question 8: Disclosure**

Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

#### *Response*

We understand that some users would like additional information on the residual value of our assets. We believe this information can be appropriately addressed with enhanced disclosures, including quantitative disclosures about the assumed end of useful life residual values by asset type. These enhanced disclosures do not require a makeover of the recognition and measurement model for operating lessors.

### **Question 9: Nonpublic Entities (FASB Only)**

To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities:

1. To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.
2. To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

Will these specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for users of their financial statements? If not, what changes do you propose and why?

#### *Response*

ILFC elected to not respond to this question.

### **Question 10: (FASB Only)**

Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases (for example, to require the lease to be accounted for based

on the economic substance of the lease rather than the legally enforceable terms and conditions)? If not, what different recognition and measurement requirements do you propose and why?

*Response*

We believe this is a reasonable decision as the prior guidance was difficult to implement.

**Question 11: (FASB Only)**

Do you agree that it is not necessary to provide additional disclosures (beyond those required by Topic 850) for related party leases? If not, what additional disclosure requirements would you propose and why?

*Response*

We believe this is a reasonable decision.

**Question 12: Consequential Amendments to IAS 40 (IASB Only)**

Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

*Response*

ILFC elected to not respond to this question.

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## Lessor Accounting: Return of the Hobgoblin?

### Making Financials More Opaque, Inconsistent, and Manipulable

Sector Rating: Commercial Aerospace, Overweight

Company Name	Rating	Price	FY EPS		FY P/E	
		08/22/13	2013E	2014E	2013	2014
<b>Commercial Aerospace</b>						
▲ AerCap Holdings N.V. (AER)	1	\$18.20	\$2.35	\$2.37	7.7X	7.7X
Air Lease Corp. (AL)	2	26.51	1.69	2.18	15.7X	12.2X
Aircastle Ltd. (AYR)	1	17.05	1.25	1.53	13.6X	11.1X
Fly Leasing Ltd (FLY)	2	13.36	1.28	1.14	10.4X	11.7X

Source: Company data and Wells Fargo Securities, LLC estimates 1= Outperform, 2 = Market Perform, 3 = Underperform, V = Volatile,  
▲ = Company is on the Priority Stock List NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful

- Summary.** In our view, the latest changes proposed by the FASB and IASB accounting boards to *lessor* accounting are impediments for any investor or creditor who relies on published financial statements for clear, consistent, and comparable company analysis. We suggest that users of aircraft lessor financial statements consider making their opinion known during the Boards' open comment period. We understand the Boards want to hear more from the *users* of financial statements, not just their preparers.
- Return of the Hobgoblin?** In the Boards' quest to have *lessees* recognize assets that are currently off-balance sheet (a noble goal, in our view), they have insisted – for the sake of “consistency” – on a complete rewrite of *lessors'* accounting rules, even though current lessor accounting practices are adequate, in our view. When something similar was last attempted in 2010, we wrote: “This brings to mind Emerson’s ‘a foolish consistency is the hobgoblin of little minds.’”
- Key Balance Sheet Change.** For nearly all aircraft leases, lessors would de-recognize airplanes from their balance sheets, and replace them with the present values of lease receivables and residual assets. There are assumptions inherent in these accruals, the most dubious one being the asset’s projected residual value. We still are wondering what is wrong with the current practice of recording airplanes at cost less accumulated depreciation.
- P&L Distortions.** Under this “right-of-use” model, there are several new P&L distortions, including: (1) “Day 1” profit recognition if the aircraft’s fair value exceeds carrying value; (2) declining annual profits *even when economic terms are unchanged from year to year*; and (3) lower *total* profit over the life of the lease, but with far greater volatility. The basic concept of “lease rental revenue” is replaced by interest income and “residual accretion.” The P&L effects are so profound that analysts may re-focus their attention to the cash flow statement.
- EPS Manipulation.** Between this “Day 1” profit recognition, residual value assumptions, and other changes, we believe opportunities for lessors to manipulate earnings will become more pervasive under the proposed standard.
- One Kind Word.** Perhaps the one positive to emerge from this proposal is the focus on residual values – where much of the lessors’ risks reside. However, we believe this could be more effectively addressed by requiring additional footnote disclosure, not by fundamentally reconstructing the balance sheet.

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Please see page 6 for rating definitions, important disclosures and required analyst certifications  
All estimates/forecasts are as of 08/22/13 unless otherwise stated.

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Together we'll go far



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**Acknowledgments.** The discussion below draws from the following resources:

*A New Lease Accounting Proposal: FASB Stars in "Groundhog Day"* (The Analyst's Accounting Observer, July 30, 2013);

*Leases: Final Approach or Go-around?* (KPMG, June 2013) and related presentation; and  
*Revised Exposure Draft – Leases* (FASB/IFRS, 2013).

**Summary.** We won't mince words: In our view, the latest changes proposed by the FASB and IASB accounting boards to *lessor* accounting are impediments for any investor or creditor who relies on published financial statements for clear, consistent, and comparable analysis of aircraft leasing companies. The changes proposed in the Exposure Draft (ED) would replace a straight-forward presentation (aircraft on the balance sheet; lease rentals and depreciation on the P&L) with an unnecessarily complex one (lease receivables and residual assets on the balance sheet; interest income and "residual accretion" on the P&L).

Our primary issue with the proposed accounting changes is simple: they do nothing to enhance the usability of financial statements for the purpose of making investment decisions. In fact, it is manifestly clear to us that just the opposite is true – comparability and transparency would be degraded in what appears to be an effort to satisfy accounting academics, *not* the actual users of these reports.

Beyond merely usability, there are other issues with this proposal including: (1) there appears to be increased opportunities for earnings manipulation; (2) earnings volatility likely would increase, but with a downward bias – both of which are harmful to valuations, in our view; and (3) implementation could consume financial and managerial resources at the expense of other more productive, value-enhancing initiatives.

The most frustrating part of this proposal is that is *completely unnecessary*, in our opinion. We understand why the Boards want to have airlines capitalize revenue-generating assets instead keeping them off-balance sheet. However, there is no reason clear to us that *lessors* need to be included in these radical changes. We are unaware of investors who believe the current reporting rules for *lessors* are inadequate. As far as we can tell, the radical changes proposed for lessors is simply for *consistency* with the lessee side, and is NOT driven by an organized advocacy effort by equity and debt investors.

We suggest that users of aircraft lessor financial statements consider making their opinion known during the Boards' open comment period (through September 13). We understand the Boards want to hear more from the users of financial statements, not just their preparers. To date, most of the comments received (and posted online) by FASB have been from lessees/preparers and academic-types, not investors. To submit a comment, simply e-mail [director@fasb.org](mailto:director@fasb.org) and include the phrase "Lease Accounting ED" in the subject line.

This brief report is *not* intended to be a comprehensive review of the ED, but rather an introduction to its core elements, the balance sheet / P&L effects, and why we think investors would be worse off if it is implemented. If adopted, the ED will become effective in 2017, with retroactive effectiveness in 2016.

*While this report discusses the ED's impact on aircraft lessors, these standards will apply to lessors of most equipment and vehicles.*

**Lessor Accounting: Return of the Hobgoblin?****“Highlights” of the Lease Accounting ED**

The best way to show how this new standard would apply to *most* aircraft operating leases is with an example. The slides that follow are courtesy of KPMG’s Dublin office; the opinions expressed are our own, *not* KPMG’s.

**Table 1. Lease Example Assumptions**

Lease Term	5 years
Useful life of leased asset	10 years
Estimated future residual value at end of year 5	75,000
Present value of estimated future residual	44,719
Fair value of leased asset	230,000
Carrying amount of leased asset	200,000
Rate lessor charges Lessee	10.896%
Annual payments in arrears	50,000
Present value of lease payments	185,281

Source: KPMG

Notice immediately what is happening here: the present values of the lease stream (\$50,000/year for five years @ 10.896%, or \$185,281) and the residual value (\$75,000 after five years @ 10.896%, or \$44,719) must be calculated to establish the “lease receivable” and “residual asset,” respectively. These two asset accounts would replace what is currently disclosed as “flight equipment subject to operating leases (net of accumulated depreciation).” Today, we understand how *all* lessors book the asset: at cost (including some capitalized items such as interest expense and improvements), less depreciation. Under the new proposal, we would enter a world of varying discount rates and residual assumptions – in our view, inherently impairing the comparability of financial statements.

But the fun is just beginning! The sum of the discounted lease receivable (\$185,281) and residual asset (\$44,719) is \$230,000, which exceeds the \$200,000 carrying value (i.e., cost) of the plane. Therefore, this discounting exercise has created a \$30,000 “profit” embedded in the aircraft. The next step for the lessor would be to allocate this “profit” between the lease receivable and the residual asset:

**Table 2. Allocating the “Profit”**

Total profit in the asset:			
Fair value of asset:	230,000		
Carrying value of asset:	(200,000)		
Total profit:	30,000	A	
■ Allocated to receivable:			
– PV of lease payments:	185,281	B	
– Fair value of asset:	230,000	C	
– Portion in receivable:	24,167	D (A x B/C)	
■ Allocated to residual asset:			
– Total profit	30,000	A	
– Amount in receivable	(24,167)	D	
– Portion deferred	5,833	A – D	

Source: KPMG

In this example, \$24,167 of the “profit” is allocated to the lease receivable asset and \$5,833 to the residual asset. And now for one of the craziest accounting requirements we have ever seen: ***That \$24,167 “profit” is recognized IMMEDIATELY.***

Let’s allow that sink in for a moment, shall we?

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The new rules would *mandate* lessors recognize earnings on Day 1 based on *estimates* of residual values. We are unaware of any other accounting rule that allows for such accelerated profit recognition (admittedly, we are not accounting professionals). The mandate appears to counter the fundamental principle of conservatism.

One major problem here is that projections of future aircraft values are extremely subjective. For that matter, appraisals of aircraft *current* values are highly subjective! Lessors can maximize near-term profits simply by selecting a residual value at the high end of the range of possibilities. Also, with this new “tool” for earnings management, a lessor can combine aggressive residual value assumptions with a high volume of new lease placements to “maximize” results. We also suspect the discount rate could be adjusted (i.e., lowered) to increase the aircraft’s fair value, thereby increasing this Day 1 “profit.”

The following chart summarizes the balance sheet and P&L effects of this new accounting treatment:

**Table 3. Balance Sheet and P&L Effects**

Period	Statement of financial position				Profit or loss			
	Lease receivable	Gross residual asset	Deferred profit	Net residual asset	Day 1 gain	Interest income	Residual accretion	Net income
0	185,281	44,719	(5,833)	38,886	24,167	-	-	24,167
1	155,469	49,591	(5,833)	43,758	-	20,187	4,872	25,059
2	122,408	54,994	(5,833)	49,161	-	16,940	5,403	22,343
3	85,745	60,986	(5,833)	55,153	-	13,337	5,992	19,329
4	45,087	67,631	(5,833)	61,798	-	9,342	6,645	15,987
5	-	75,000	(5,833)	69,167	-	4,913	7,368	12,281
				<b>Total</b>	<b>24,167</b>	<b>64,719</b>	<b>30,281</b>	<b>119,167</b>

Source: KPMG

On the balance sheet, we see the “Period 0” establishment of the lease receivable and residual asset; the reported residual asset would be reported net of the deferred “profit” calculated earlier. As rents are collected, a portion is allocated to amortizing the receivable and a portion (calculated by multiplying the receivable by the discount rate) is allocated to interest income. The residual asset balance accretes over time to the expected residual value at the end of the lease.

The net P&L effects are, shall we say, *curious*. The first thing we notice is that \$24,167 Day 1 “profit” which seems out of place for the reasons described above. Second, due to the discounting math, the amount of reported interest income declines sharply every year. The third thing we notice is that *total* profit realized over the lease (\$119,167) is less than the amount recognized under current accounting (\$250,000 lease rents – \$125,000 depreciation = \$125,000 profit). The difference (\$5,833) is that portion of the up-front “profit” allocated to the residual asset that is trapped on the balance sheet until the asset is sold or re-leased.

So, to summarize the overall P&L impact:

- (1) earnings are far more **volatile**;
- (2) earnings have a strong **downward bias**; and
- (3) earnings, **in total, are lower**.

None of these effects are particularly positive for aircraft lessor valuations, but that is *not* our objection.

Rather, it is that reported earnings *no longer reflect economic reality*. In the example above, the lessor’s cash flows are identical every period, but reported earnings are highly variable. The differences between a lessor’s cash flows and reported income would be greatly exacerbated under the new standard, in our view. Therefore, the new rules could reorient investor focus on the cash flow statement rather than the income statement, which would be muddled by Day 1 “profit” + interest on lease receivables + discount on residual assets (for what we simply call “rent” today). We do not consider this progress.

**Impact on Financial Analysis.** Each quarter we publish a comprehensive review of the operating performance of six aircraft lessors. Under the proposed ED, nearly every operating metric computation – including lease yield, net margin, SG&A efficiency, and return on equity – would lose relevance. This is because the ED disaggregates straight-forward accounts such as basic lease revenue and flight equipment into multiple – though *less* informative – components that are driven by discount rates and highly-subjective estimates such as residual values. Based on our current understanding of the ED, any industry-wide apples-to-apples comparisons of lessor operating performance would be compromised.

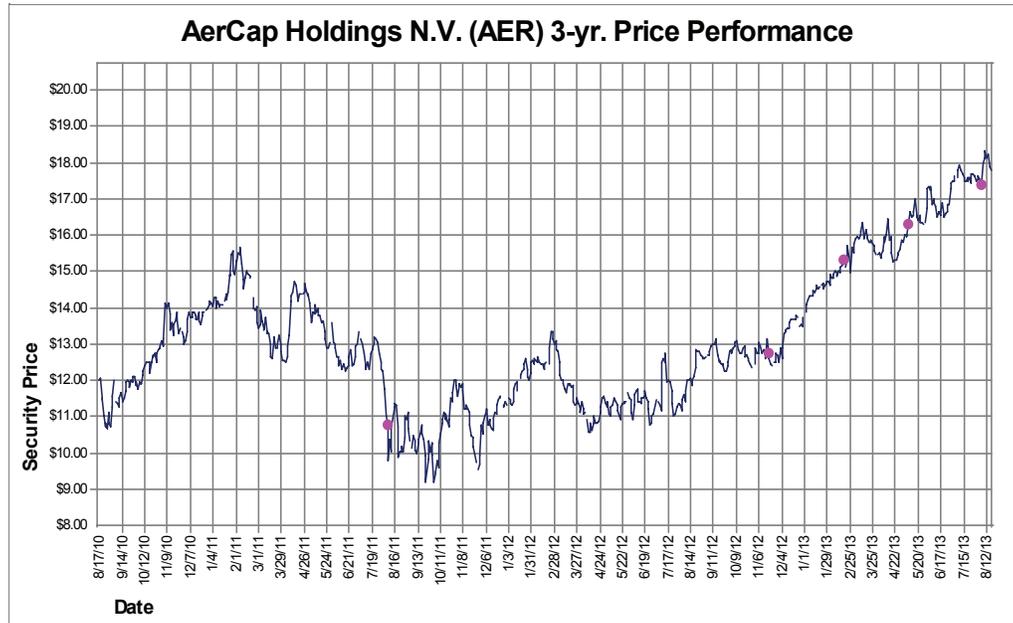
**Lessor Accounting: Return of the Hobgoblin?**

**One Kind Word.** We will give FASB/IASB credit for requiring additional information about lessors' residual value assumptions. After all, aircraft lessors are in effect compensated for assuming residual value risk. However, in our view the chosen approach is needlessly complicated – i.e. presenting a discounted balance on the balance sheet itself. Rather, we believe the same end could be more effectively achieved by requiring additional footnote disclosures, perhaps in the 10-Q/10-K section that discusses the asset impairment determination process.

**Aircraft Lessor Comp Sheet**

<b>Valuation Comps</b>				
	Aug 22, 2013			
	AerCap Holdings	Air Lease Corp.	Aircastle	FLY Leasing
<b>Ticker</b>	<b>AER</b>	<b>AL</b>	<b>AYR</b>	<b>FLY</b>
Rating	1	2	1	2
IPO Date	11/20/06	4/18/11	8/7/06	9/27/07
<b>Share price</b>	<b>\$18.21</b>	<b>\$26.49</b>	<b>\$17.06</b>	<b>\$13.36</b>
52-week high	\$18.41	\$31.00	\$18.12	\$17.37
52-week low	\$12.09	\$20.00	\$10.91	\$11.06
Avg. volume (000)	337	510	404	563
Market cap (\$MM)	2,045	2,644	1,340	515
Ent. Value (\$MM)	7,912	7,636	4,406	2,233
2013E GAAP P/E	7.8x	15.7x	13.6x	10.4x
2014E GAAP P/E	7.7x	12.1x	11.1x	11.7x
2013E Pretax P/E	7.1x	10.1x	12.1x	9.1x
2014E Pretax P/E	7.1x	7.8x	10.0x	10.2x
2013E ROE (pre-tax)	13.3%	11.4%	6.8%	8.1%
2014E ROE (pre-tax)	11.4%	13.8%	8.0%	7.4%
Current Dividend Yield	0.0%	0.4%	3.9%	6.6%
<b>GAAP Price/Book*</b>	<b>0.91x</b>	<b>1.12x</b>	<b>0.79x</b>	<b>0.73x</b>
Aircraft:				
Owned	227	174	158	103
Commitments (net)	33	346	3	3
Average age (years)	5.3	3.5	10.8	9.4
Note: 1=Outperform; 2=Market Perform				
P/B and aircraft data are as of the latest actual balance sheet date.				
*FLY P/B adjusted for pro forma effects of July 2013 equity issuance.				
Source: Wells Fargo Securities, LLC estimates, company data, and Bloomberg.				

## Required Disclosures



	Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
	8/17/2010		Liebowitz			
	8/17/2010	NA	1	17.00	19.00	12.01
●	8/5/2011	10.99	1	15.00	16.00	10.77
●	11/16/2012	13.15	1	16.00	17.00	12.76
●	2/16/2013	15.32	1	18.50	19.50	15.32
●	5/7/2013	16.31	1	19.00	20.00	16.31
●	8/6/2013	17.41	1	20.50	21.50	17.41

Source: Wells Fargo Securities, LLC estimates and Reuters data

### Symbol Key

- ▼ Rating Downgrade
- ▲ Rating Upgrade
- Valuation Range Change
- ◆ Initiation, Resumption, Drop or Suspend
- Analyst Change
- Split Adjustment

### Rating Code Key

- 1 Outperform/Buy
- 2 Market Perform/Hold
- 3 Underperform/Sell
- SR Suspended
- NR Not Rated
- NE No Estimate

## Lessor Accounting: Return of the Hobgoblin?



	Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
□	4/19/2011		IPO at \$26.50			
	5/31/2011		Liebowitz			
◆	5/31/2011	28.43	2	28.00	29.00	28.50
●	8/12/2011	21.30	2	23.00	24.00	22.56
●	3/12/2012	24.40	2	24.00	25.00	24.29
●	7/3/2012	19.41	2	22.00	23.00	19.63
●	2/28/2013	27.17	2	26.00	27.00	27.17
●	5/9/2013	30.58	2	28.00	29.00	30.58
●	8/8/2013	27.30	2	29.00	30.00	27.30

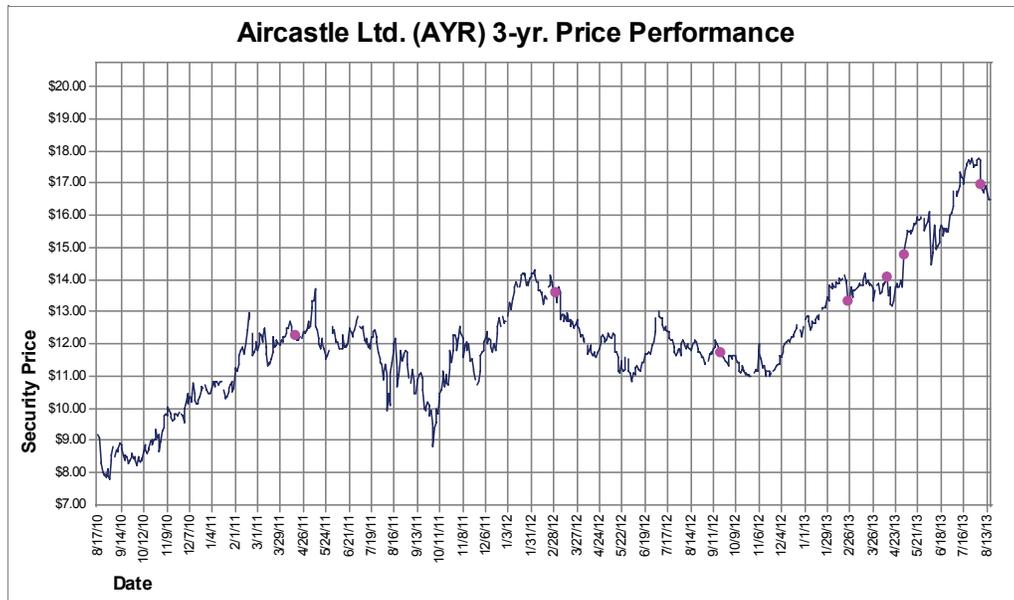
Source: Wells Fargo Securities, LLC estimates and Reuters data

**Symbol Key**

- ▼ Rating Downgrade
- ▲ Rating Upgrade
- Valuation Range Change
- ◆ Initiation, Resumption, Drop or Suspend
- Analyst Change
- Split Adjustment

**Rating Code Key**

- 1 Outperform/Buy
- 2 Market Perform/Hold
- 3 Underperform/Sell
- SR Suspended
- NR Not Rated
- NE No Estimate



	Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
	8/17/2010		Liebowitz			
	8/17/2010	NA	1	14.00	15.00	9.18
●	4/15/2011	12.21	1	15.00	16.00	12.28
●	2/29/2012	13.61	1	15.50	16.50	13.61
●	9/19/2012	11.77	1	14.00	15.00	11.77
●	2/22/2013	13.99	1	15.00	16.00	13.36
●	4/11/2013	14.05	1	16.00	16.50	14.09
●	5/2/2013	14.77	1	17.00	17.50	14.77
●	8/6/2013	16.98	1	19.50	20.00	16.98

Source: Wells Fargo Securities, LLC estimates and Reuters data

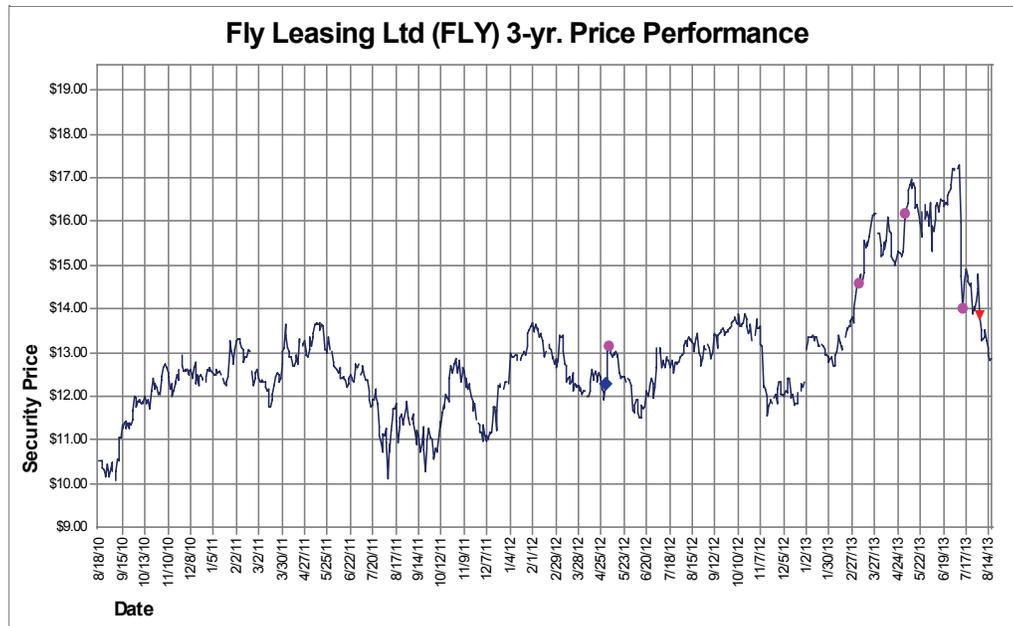
**Symbol Key**

- ▼ Rating Downgrade
- ▲ Rating Upgrade
- Valuation Range Change

- ◆ Initiation, Resumption, Drop or Suspend
- Analyst Change
- Split Adjustment

**Rating Code Key**

- 1 Outperform/Buy
- 2 Market Perform/Hold
- 3 Underperform/Sell
- SR Suspended
- NR Not Rated
- NE No Estimate

**Lessor Accounting: Return of the Hobgoblin?**

	Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
	5/1/2012		Liebowitz			
◆	5/1/2012	11.92	1	13.50	14.50	12.29
●	5/4/2012	13.02	1	14.50	15.50	13.15
●	3/7/2013	14.67	1	16.00	16.50	14.60
●	5/3/2013	16.16	1	18.00	18.50	16.18
●	7/12/2013	14.75	1	16.25	16.75	14.00
▼●	8/2/2013	14.80	2	15.00	15.50	13.83

Source: Wells Fargo Securities, LLC estimates and Reuters data

**Symbol Key**

▼ Rating Downgrade

▲ Rating Upgrade

● Valuation Range Change

◆ Initiation, Resumption, Drop or Suspend

■ Analyst Change

□ Split Adjustment

**Rating Code Key**

1 Outperform/Buy

2 Market Perform/Hold

3 Underperform/Sell

SR Suspended

NR Not Rated

NE No Estimate

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**3=Underperform:** The stock appears overvalued, and we believe the stock's total return will be below the market over the next 12 months. SELL

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**O=Overweight:** Industry expected to outperform the relevant broad market benchmark over the next 12 months.

**M=Market Weight:** Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

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**As of: August 22, 2013**

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