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AIRLEASE LTD
Form 10QSB
August 13, 2003

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

Form 10-QSB

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

For the Quarterly Period Ended June 30, 2003

Commission file number 1-9259

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

(Exact name of small business issuer as specified in its charter)

California

94-3008908

(State of Organization)

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

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

94104

(Address of principal executive offices)

(Zip Code)

(415) 765-1814

(Issuer's telephone number, including area code)

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

I N D E X

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

BALANCE SHEETS

(IN THOUSANDS EXCEPT UNIT DATA)	JUNE 30, 2003 (UNAUDITED)	DECEMBER 31, 2002*
<hr/>		
ASSETS		
Cash and cash equivalents	\$ 2,837	\$ 2,569
Finance leases - net	5,419	5,939
Operating leases - net	8,726	12,753
Aircraft held for lease		3,600
8,500		
Prepaid expenses and other assets	39	50
	-----	-----
Total assets	\$20,621	\$29,811
	=====	=====
LIABILITIES AND PARTNERS' EQUITY		
LIABILITIES		
Distribution payable to partners	\$ 234	\$ 234

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Accounts payable and accrued liabilities	245	345
Maintenance reserves	1,118	748
Taxes payable	0	0
Long-term notes payable	2,381	2,729
	<hr/>	<hr/>
Total liabilities	3,978	4,056
	<hr/>	<hr/>
COMMITMENTS AND CONTINGENCIES		
PARTNERS' EQUITY		
Limited partners (4,625,000 units outstanding)	16,477	25,498
General partner (46,717 units outstanding)	166	257
	<hr/>	<hr/>
Total partners' equity	16,643	25,755
	<hr/>	<hr/>
Total liabilities and partners' equity	\$20,621	\$29,811
	=====	=====

See accompanying notes to the condensed financial statements

* The amounts are derived from the December 31, 2002, audited financial statements

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AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

STATEMENTS OF OPERATIONS

(UNAUDITED; IN THOUSANDS EXCEPT PER UNIT AMOUNTS)	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2003	2002	2003	2002
REVENUES				
Finance lease income	\$ 63	\$ 75	\$ 132	\$ 155
Operating lease rentals	360	750	760	1,500
Other income	10	8	17	37
	<hr/>	<hr/>	<hr/>	<hr/>
Total revenues	433	833	909	1,692
	<hr/>	<hr/>	<hr/>	<hr/>

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EXPENSES

Interest	48	60	101	115
Depreciation	637	856	1,275	1,712
Management fee - general partner	65	96	132	193
Investor reporting	86	86	171	197
General and administrative	35	55	64	84
Tax on gross income	30	42	59	85
Impairment charge on aircraft	7,652	0	7,652	0
Aircraft maintenance and refurbishing	66	(26)	99	65
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total expenses	8,619	1,170	9,553	2,451
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net Loss	\$ (8,186)	\$ (337)	\$ (8,644)	\$ (759)
	=====	=====	=====	=====
Net Loss Allocated To:				
General Partner	\$ (82)	\$ (4)	\$ (86)	\$ (8)
	=====	=====	=====	=====
Limited Partners	\$ (8,104)	\$ (333)	\$ (8,558)	\$ (751)
	=====	=====	=====	=====
Net Loss Per Limited Partnership Unit	\$ (1.75)	\$ (0.07)	\$ (1.85)	\$ (0.16)
	=====	=====	=====	=====

See accompanying notes to the condensed financials statements

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AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

STATEMENTS OF CASH FLOWS

(UNAUDITED; IN THOUSANDS)	SIX MONTHS ENDED	
	2003	2002
	JUNE 30,	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (8,644)	\$ (758)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Impairment charge on aircraft	7,652	0

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Depreciation	1,275	1,712
Decrease in accounts payable and accrued liabilities	(100)	(321)
Increase in maintenance reserves	370	444
Increase/(decrease) in taxes payable	0	(139)
Decrease/(increase) in prepaid expenses and other assets	11	(26)
	564	912
CASH FLOWS FROM INVESTING ACTIVITIES		
Rental receipts in excess of finance lease income	520	500
	520	500
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of long-term notes payable	(348)	(324)
Distributions paid to partners	(468)	(8,035)
	(817)	(8,359)
Increase/(decrease) in cash and cash equivalents	268	(6,947)
Cash and cash equivalents at beginning of period	2,569	9,432
	\$ 2,837	\$ 2,485
	=====	=====
ADDITIONAL INFORMATION		
Interest paid	\$ 104	\$ 128
	=====	=====

See accompanying notes to the condensed financials statements

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

NOTES CONDENSED TO FINANCIAL STATEMENTS

SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION - The accompanying unaudited condensed financial statements of Airlease Ltd., A California Limited Partnership (the Partnership)

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reflect all adjustments (consisting only of normal recurring adjustments) that are, in the opinion of the Partnership, necessary to fairly state the results for the interim periods. The results of operations for such interim periods are not necessarily indicative of results of operations for a full year. The December 31, 2002, balance sheet included herein is derived from the audited financial statements included in the Partnership's Annual Report and incorporated by reference in the Form 10-K for the year ended December 31, 2002. The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-QSB and Article 10 of Regulation S-X. Accordingly, they do not include all disclosures required by accounting principles generally accepted in the United States for complete financial statements. The statements should be read in conjunction with the Organization and Significant Accounting Policies and other notes to financial statements included in the Partnership's Annual Report for the year ended December 31, 2002.

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

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

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

MAINTENANCE RESERVES - On certain operating leases the Partnership requires the lessees to pay aircraft maintenance reserves. The reserves will be applied toward the aircraft's future maintenance requirements. Reserves are collected for engines, airframe, and other aircraft components. The amount of the reserves is based on flight hours.

LONG LIVED ASSETS IMPAIRMENT - The Partnership accounts for its long-lived assets, including Operating Leases and Aircraft Held for Lease, in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144 "ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS".

SFAS No. 144, was issued in October 2001 and addresses how and when to measure impairment on long-lived assets and how to account for long-lived assets that an entity plans to dispose of either through sale, abandonment, exchange, or distribution to owners. Under SFAS No. 144, an impairment loss is recognized in an amount equal to the difference between the carrying value and the fair value if the carrying value of an asset is not recoverable based on undiscounted future cash flows.

On July 7, 2003, the Board of Directors of the General Partner of the Partnership approved a plan to sell the three off-lease MD-81 aircraft. The Partnership signed a purchase agreement with OLSF, LLC ("OLSF") to sell the three aircraft in intervals of 120 days, with the first aircraft being delivered

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on August 12, 2003. The purchase price per aircraft is \$1,200,000. As a result of the contractual sale of the aircraft being lower than its book value, the

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aircraft were written-down in the second quarter of 2003. The amount of the write-down per aircraft of \$1,500,000 was equal to the difference between the carrying book value of \$2,700,000 and the sale amount of \$1,200,000.

In the second quarter of 2003, management prepared an impairment evaluation on the two MD-82 aircraft currently on lease to CSI Aviation Services, Inc. on month-to-month basis. The evaluation indicated that the aircraft were impaired as defined by SFAS No. 144, and an impairment charge of \$1,576,000 per aircraft was recorded. The new book value per aircraft after the impairment charge is \$4,363,000. The fair values of these two MD-82 aircraft were determined by discounting the estimated future cash flows from leasing activities.

In addition, the two aircraft on lease to CSI are leased on a month-to-month basis. Management is not able to predict when these leases will terminate, or, if they are terminated, when the aircraft may be leased again. If the leases with CSI were to terminate, management's best estimate is that the Partnership would be able to recover the net book value through a combination of lease rentals and sales proceeds over the life of the aircraft, however, if the Partnership's assumptions regarding renewal lease rates and terms are not realized, the Partnership could record additional impairment charges with respect to these aircraft.

NET LOSS PER LIMITED PARTNERSHIP UNIT - Net loss per limited partnership unit is computed by dividing the net loss allocated to the Limited Partners by the weighted average limited partner units outstanding (4,625,000).

RECLASSIFICATION - Certain reclassifications have been made to the prior year's financial statements to conform to the current year's presentation.

CASH DISTRIBUTIONS - In June 2003, the Partnership declared a second-quarter 2003 cash distribution of \$0.05 per unit totaling approximately \$234,000 payable on August 15, 2003 to unitholders of record on June 30, 2003. As a result of this distribution and the first-quarter 2003 distribution, and the Partnership loss in the first and second quarters of 2003, Partnership equity declined to \$16.6 million at June 30, 2003 from \$25.8 million at December 31, 2002, and limited partner equity per unit declined to \$3.56 from \$5.51. The 2003 second-quarter cash distribution constitutes a return of capital. The 2002 second-quarter cash distribution was \$0.11 per unit.

The cash distributions paid in the first six months of 2003 totaled \$468,000, or \$0.10 per limited partnership unit, representing the regular fourth quarter 2002, and the first quarter 2003, distributions.

SUBSEQUENT EVENT - On August 12, 2003, the Partnership entered into an agreement with OLSF, LLC to sell the three off-lease MD-81 aircraft in intervals of 120 days. The first aircraft was sold and delivered on August 12, 2003. Subject to satisfaction of customary closing conditions, the second aircraft is to be sold and delivered 120 days thereafter, and the third aircraft is to be sold and delivered 120 days after the sale and delivery of the second aircraft, unless OLSF exercises an option to purchase either aircraft prior to that date or OLSF and the Partnership mutually agree to a different date. The purchase price per aircraft is \$1,200,000, which is equal to the carrying book value for the aircraft after giving effect to the impairment charges. The obligations of OLSF

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to purchase the aircraft are guaranteed by GA Telesis Turbine Technologies, LLC.

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

LIQUIDITY AND CAPITAL RESOURCES

The Partnership presently has one long-term debt facility. At June 30, 2003, the 7.4% non-recourse note collateralized by one aircraft leased to FedEx corporation ("Fed Ex"), had an outstanding balance of \$2.4 million. This outstanding balance is 2.25% of the original cost of the aircraft presently owned by the Partnership, including capital expenditures for upgrades. The terms of the Limited Partnership Agreement permit debt to be at a level not exceeding 50% of such cost. The lease and debt facility mature in April 2006.

In June 2003, the Partnership declared a second-quarter 2003 cash distribution of \$0.05 per unit totaling approximately \$234,000 payable on August 15, 2003 to unitholders of record on June 30, 2003. As a result of this distribution and the first-quarter 2003 distribution, and the Partnership loss in the first and second quarters of 2003, Partnership equity declined to \$16.6 million at June 30, 2003 from \$25.8 million at December 31, 2002, and limited partner equity per unit declined to \$3.57 from \$5.51. The 2003 second-quarter cash distribution constitutes a return of capital. The 2002 second-quarter cash distribution was \$0.11 per unit.

The cash distributions paid in the first six months of 2003 totaled \$468,000, or \$0.10 per limited partnership unit, representing the regular fourth quarter 2002, and first quarter 2003, distributions.

PORTFOLIO MATTERS

At June 30, 2003, the Partnership's portfolio consisted of six Stage-III commercial aircraft. Two were leased to CSI, one was leased to FedEx, and three were off-lease.

The leases of the two aircraft leased to CSI were due to expire on March 1, 2003. CSI and the Partnership entered into a new agreement extending the leases on a month-to-month basis at a monthly rate of \$60,000 per aircraft. The Partnership continues to actively search for new potential lessees for these two aircraft.

The lease for a 727-200 FH aircraft to FedEx is scheduled to terminate in 2006.

RESULTS OF OPERATIONS

The Partnership reported a loss of \$8,186,000 in the second quarter ended June 30, 2003, compared with last year's second quarter loss of \$337,000. Revenues for the 2003 second quarter were \$433,000, compared with last year's second quarter revenues of \$833,000. Net loss for the first six months of 2003 was \$8,644,000, compared with a net loss of \$758,000 for the first six months of 2002. Revenues for the six-month period of 2003 were \$909,000, compared with \$1,692,000 for the first six months of 2002.

The decline in earnings in the first half of 2003 results primarily from an

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increase in expenses, primarily due to aircraft impairment charges, and from the reduced revenues.

The revenue reductions are primarily due to lower operating lease rental income associated with the two aircraft on lease to CSI Aviation Services, Inc. ("CSI"), and the scheduled decline in finance lease income in 2003 associated with the aircraft leased to FedEx. The lease terms for the CSI leases were extended in the fourth quarter of 2002 and again in the first quarter of 2003, each time at a reduced monthly rental rate that reflects current market conditions. The FedEx aircraft lease had a scheduled decline in finance lease income of \$23,000 in the first six months of 2003 as compared with the first six months of 2002.

Expenses for the first six months of 2003 were \$9,553,000, an increase of \$7,102,000 from \$2,451,000 for the comparable 2002 period. The increase in expenses is primarily due to aircraft impairment charges in the second quarter of 2003 of \$7,652,000. During the 2003 second quarter, the General Partner evaluated the carrying values of the three off-lease aircraft and the two

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aircraft on lease to CSI under SFAS No. 144 and determined that these five aircraft were impaired. Accordingly, the carrying values were adjusted to estimated fair values. The increase in expenses was partially offset by lower interest expense in the first six months of 2003 as a result of the reduction in the Partnership's debt balances, and by lower management fees and taxes due to a smaller asset base and lower revenues.

SUBSEQUENT EVENT:

On August 12, 2003, the Partnership entered into an agreement with OLSF, LLC to sell the three off-lease MD-81 aircraft in intervals of 120 days. The first aircraft was sold and delivered on August 12, 2003. Subject to satisfaction of customary closing conditions, the second aircraft is to be sold and delivered 120 days thereafter, and the third aircraft is to be sold and delivered 120 days after the sale and delivery of the second aircraft, unless OLSF exercises an option to purchase either aircraft prior to that date or OLSF and the Partnership mutually agree to a different date. The purchase price per aircraft is \$1,200,000, which is equal to the carrying book value for the aircraft after giving effect to the impairment charges. The obligations of OLSF to purchase the aircraft are guaranteed by GA Telesis Turbine Technologies, LLC.

OUTLOOK

The market conditions for aircraft leasing continue to be weak, as the supply of aircraft exceeds demand.

The two aircraft on lease to CSI are leased on a month-to-month basis. Management is not able to predict when these leases will terminate, or, if they are terminated, when the aircraft may be leased again. If the leases with CSI were to terminate, management's best estimate is that the Partnership would be able to recover net book value through a combination of lease rentals and sales proceeds; however, if the Partnership's assumptions regarding renewal lease rates and terms are not realized, the Partnership could record additional impairment charges with respect to these aircraft.

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SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995:

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

ITEM 3. CONTROLS AND PROCEDURES

(a) The Chief Executive Officer and the Chief Financial Officer of the General Partner of the Partnership, after evaluating the effectiveness of the Partnership's disclosure controls and procedures as of the end of the period covered by this quarter report, have concluded that the Partnership's disclosure of the controls and procedures are effective to ensure that information required to be disclosed by the Partnership in this quarterly report is accumulated and

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communicated to the Partnership's management to allow timely decisions regarding required disclosure.

(b) No change was made in the Partnership's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Partnership's internal control over financial reporting.

PART II - OTHER INFORMATION

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

(a) Exhibits:

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

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- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

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

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

By: Airlease Management Services, Inc.
General Partner

AUGUST 13, 2003

Date

By: _____

David B. Gebler
Chairman, Chief Executive Officer
and President

AUGUST 13, 2003

Date

By: _____

Robert A. Keyes
Chief Financial Officer

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EXHIBIT INDEX

Exhibit Number Description

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- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
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