BEHIND THE NUMBERS
Quality of Earnings Analysis

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Air Lease Corp (AL)

Update on 3/22 results and 10-Q review

We are maintaining our earnings quality coverage of AL at 4+ (Acceptable) and maintaining Top Buy rating

For an explanation of the EQ Review Rating scale, please refer to the end of this report.

Summary

Air Lease's non-GAAP EPS of $1.76 in 1Q22 beat forecasts by 37 cents and it beat on revenues by $46 million. It recovered some of the Russian planes, but AL concluded it would not recover the remaining planes and wrote off the rest of the fleet there. All planes from Ukraine are accounted for at this point:

- Writing off Russian planes was a pre-tax charge of $802.4 million, which AL added back to adjusted earnings. The company also adds back income taxes for adjusted EPS. We can see that as a one-time event and it primarily lowered book value by $5.37 (at the low end of our forecast) from 4Q21 to $55.93, but had no impact on the adjusted EPS.

- When the planes were written off, the customers forfeited their security deposits and maintenance reserves of $59.6 million. That was booked into revenue and likely had little if any cost associated with it. That added 52 cents to EPS. That was not adjusted out of non-GAAP EPS and it will not repeat. We're not giving AL credit for beating on EPS or revenue based on this event.

- Stock compensation was a $2.5 million credit for 1Q22 or 2 cents of GAAP EPS vs. a $5.4 million expense in 1Q21 or a 4-cent headwind. The credit arose due to reducing forecasts of how many awards would be exercised with the stock price down. Adjusted EPS adds back stock compensation so this did not impact the reported $1.76 EPS figure.

- Losing the Russian planes means about $18 million of quarterly lease revenue will vanish too. AL weighs that against the realized revenue from the deposits and noted that many of these planes only had 1-2 years of lease time left. It did not come up on the call, but

we believe the rent was paid for at least January. Because AL recognized all the security deposits into income during 1Q, that won't repeat and the $18 million will be missing going forward. The company did note that six planes scheduled for delivery to Russia in early 2022 were placed with airlines in America and Europe, which offsets some of that.

That's the bad news that hit for 1Q22. There were some positives going forward too:

- The lost Russian planes are insured. There is no timing for it but eventually, it seems likely AL will get some settlements in this area that will flow to the bottom line. We would adjust it out of income as one-time, but it would boost book value again.

- AL guided to $750 million in aircraft sales for 2022 in the 10-Q. There were none in 1Q22 and they are expected to occur largely in 3Q and 4Q. We have been talking that with Covid and delays from Boeing and Airbus, this source of revenue and earnings has largely disappeared at AL for 2020 and started to return in 2021 but with only $138 million in sales. This should be lumpy, but could help bolster EPS. In 4Q21, this was $24 million in revenues and added as much as 21 cents to EPS.

- Covid deferred rent continues to decline at $190.4 million at the end of 1Q22 from $203.2 million at the end of 4Q22. That is accretive to revenue and is like earning 104% of scheduled rent – current due payments + delayed payments.

- AL has fixed-rate debt for 95% of its financing, but leases have interest rate escalators. Those are now working toward AL's benefit for higher earnings and revenues as rates increase.

- The delays from Airbus and Boeing may start to create an opportunity for AL. Many orders were canceled and airline customers took back their deposits. AL believes some of those orders are not fully completed due to a lack of parts. AL sees potential for those planes to be completed over 12-18 months and offered for sale by Airbus and Boeing. That could accelerate the rate of new planes coming in to AL.

Explanation of EQ Rating Scale

6- (Exceptionally Strong)- Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises

5 (Strong)- Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.

4 (Acceptable)- Indicates the company may have exhibited a minor “red flag”, but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement

3 (Minor Concern)- Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.

2 (Weak) Indicates the company’s recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.

1 (Strong Concern)- Indicates that the company’s recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely

In addition to the numerical rating, the EQ Review Rating also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into upcoming quarters. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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