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AIRLEASE LTD
Form 10QSB
May 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 March 31, 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

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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) | March 31, 2003 (Unaudited) | December 31, 2002 * |
|--|----------------------------------|------------------------|
| <hr/> | | |
| ASSETS | | |
| Cash and cash equivalents | \$ 2,542 | \$ 2,569 |
| Finance leases - net | 6,007 | 5,939 |
| Operating leases - net | 12,315 | 12,753 |
| Aircraft held for lease | | 8,300 |
| 8,500 | | |
| Prepaid expenses and other assets | 48 | 50 |
| Total assets | \$ 29,212 | \$ 29,811 |
| | ===== | ===== |
| LIABILITIES AND PARTNERS' EQUITY | | |
| LIABILITIES | | |
| Distribution payable to partners | \$ 234 | \$ 234 |
| Accounts payable and accrued liabilities | 259 | 345 |
| Maintenance reserves | 898 | 748 |
| Taxes payable | 29 | 0 |
| Long-term notes payable | 2,729 | 2,729 |
| Total liabilities | 4,149 | 4,056 |
| | ===== | ===== |
| COMMITMENTS AND CONTINGENCIES | | |
| PARTNERS' EQUITY | | |
| Limited partners (4,625,000 units outstanding) | 24,812 | 25,497 |
| General partner (46,717 units outstanding) | 251 | 258 |

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| | | |
|--|-----------|-----------|
| Total partners' equity | 25,063 | 25,755 |
| Total liabilities and partners' equity | \$ 29,212 | \$ 29,811 |

See accompanying notes to the 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 March 31, | |
|--|---------------------------------|--------------|
| | 2003 | 2002 |
| REVENUES | | |
| Finance lease income | \$ 69 | \$ 80 |
| Operating lease rentals | 400 | 750 |
| Other income | 7 | 29 |
| Total revenues | <u>476</u> | <u>859</u> |
| EXPENSES | | |
| Interest | 53 | 54 |
| Depreciation | 638 | 856 |
| Management fee - general partner | 67 | 97 |
| Investor reporting | 85 | 112 |
| General and administrative | 29 | 29 |
| Aircraft maintenance and refurbishing | 33 | 91 |
| Tax on gross income | 29 | 42 |
| Total expenses | <u>934</u> | <u>1,281</u> |
| Net loss | \$ (458) | \$ (422) |
| Net loss Allocated To: | | |
| General Partner | \$ (4) | \$ (4) |
| Limited Partners | \$ (454) | \$ (418) |
| Net loss per limited partnership unit | \$ (0.10) | \$ (0.09) |

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See accompanying notes to the financials statements

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AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

STATEMENTS OF CASH FLOWS

| (Unaudited; in thousands) | Three Months Ended March 31, | |
|--|---------------------------------|----------|
| | 2003 | 2002 |
| <hr/> | | |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net loss | \$ (458) | \$ (422) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation | 638 | 856 |
| Decrease in accounts payable and accrued liabilities | (87) | (464) |
| Increase in maintenance reserves | 150 | 308 |
| Increase/(decrease) in taxes payable | 29 | (166) |
| Decrease in prepaid expenses and other assets | 3 | 3 |
| | <hr/> | <hr/> |
| Net cash provided by operating activities | 275 | 115 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Decrease in operating lease rents receivable | 0 | 177 |
| Earned finance lease in excess of rental receipts | (68) | (80) |
| | <hr/> | <hr/> |
| Net cash (used in)/provided by investing activities | (68) | 97 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Distributions paid to partners | (234) | (7,521) |
| | <hr/> | <hr/> |
| Net cash and cash equivalents used in financing activities | (234) | (7,521) |
| Decrease in cash and cash equivalents | (27) | (7,309) |
| Cash and cash equivalents at beginning of period | 2,569 | 9,432 |
| | <hr/> | <hr/> |
| Cash at end of period | \$ 2,542 | \$ 2,123 |
| | ===== | ===== |
| ADDITIONAL INFORMATION | | |
| Interest paid | \$ 2 | \$ 1 |
| | ===== | ===== |

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See accompanying notes to the financials statements

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AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

NOTES TO FINANCIAL STATEMENTS

SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION - The accompanying unaudited condensed financial statements of Airlease Ltd., A California Limited Partnership (the Partnership) 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, but does not include all disclosures required by generally accepted accounting principles. 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. 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

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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 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 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.

The market conditions for aircraft leasing continue to be weak, as the supply of aircraft exceeds demand. Consequently, the Partnership continues to experience significant competitive pressure in leasing the three aircraft currently off lease, and management is not able to predict when the aircraft may be leased again or the terms of any such future leasing. Nevertheless, management has prepared an impairment evaluation in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" and does not believe an impairment charge is required as of March 31, 2003, because the anticipated future cash flows from leasing and ultimately selling the aircraft are expected to exceed net book value. Further,

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given the difficulties the Partnership has encountered in marketing the aircraft for lease, management may in the future conclude that it is in the Partnership's best interest to sell the aircraft. However, no formal plan of disposal has been recommended to or approved by the Board of Directors. Based on current market conditions, if the aircraft are sold, it is likely that the sale proceeds would be less than book value and that the Partnership would suffer a loss on sale.

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 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 an impairment charge 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.

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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 March 31, 2003, the 7.4% non-recourse note collateralized by one aircraft leased to FedEx corporation ("FedEx" had an outstanding balance of \$2.7 million. The facility matures in April 2006.

At March 31, 2003, long-term borrowings of \$2.7 million represented 2.6% 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 cash distribution paid in the first three months of 2003 was \$0.05 per limited partnership unit, representing the regular fourth quarter 2002 distribution.

In March 2003, the Partnership declared a first-quarter 2003 cash distribution of \$0.05 per unit totaling approximately \$234,000 payable on May 15, 2003 to unitholders of record on March 31, 2003. As a result of this distribution, and the Partnership loss for the first quarter of 2003, Partnership equity declined to \$25.1 million at March 31, 2003 from \$25.8 million at December 31, 2002, and limited partner equity per unit declined to \$5.36 from \$5.51. The 2003 first quarter cash distribution constitutes a return of capital. The 2002 first-quarter cash distribution was \$0.11 per unit.

RESULTS OF OPERATIONS

The Partnership reported a loss of \$458,000 in the first quarter ended March 31, 2003, compared with last year's first quarter loss of \$422,000. Revenues for the first quarter of 2003 were \$476,000, compared with last year's first quarter revenues of \$859,000.

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"), as the leases were extended in the fourth quarter of 2002 at a reduced monthly rental rate that reflects current market conditions; and the scheduled decline in finance lease income in 2003 associated with the aircraft leased to FedEx.

Expenses for the first three months of 2003 were \$934,000, a decrease of \$347,000 from \$1,281,000 for the comparable 2002 period. The decrease in expenses is primarily due to lower depreciation expenses as a result of a smaller depreciable base associated with the three off-lease aircraft. The depreciable base of the three off-lease aircraft was reduced in the third quarter of 2002 as a result of an impairment charge of approximately \$11.1 million that reduced the value of the aircraft. In addition, management fees and taxes were lower due to a smaller asset base and lower revenues.

PORTFOLIO MATTERS

At March 31, 2003, the Partnership's portfolio consisted of six Stage-III commercial aircraft. Two are leased to CSI, one to FedEx, and three are 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.

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The Partnership also leases a 727-200 FH aircraft to FedEx. This lease is scheduled to terminate in 2006.

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OUTLOOK

The market conditions for aircraft leasing continue to be weak, as the supply of aircraft exceeds demand. Consequently, the Partnership continues to experience significant competitive pressure in leasing the three aircraft currently off lease, and management is not able to predict when the aircraft may be leased again or the terms of any such future leasing. Nevertheless, management has prepared an impairment evaluation in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" and does not believe an impairment charge is required as of March 31, 2003, because the anticipated future cash flows from leasing and ultimately selling the aircraft are expected to exceed net book value. Further, given the difficulties the Partnership has encountered in marketing the aircraft for lease, management may in the future conclude that it is in the Partnership's best interest to sell the aircraft. However, no formal plan of disposal has been recommended to or approved by the Board of Directors. Based on current market conditions, if the aircraft are sold, it is likely that the sale proceeds would be less than book value and that the Partnership would suffer a loss on sale.

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 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 an impairment charge with respect to these aircraft.

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

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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 a date within 90 days before the filing date of this quarterly 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 communicated to the Partnership's management to allow timely decisions regarding required disclosure.

(b) No significant changes were made in the Partnership's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

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PART II - OTHER INFORMATION

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

Exhibits:

(a) 10.57 Lease Supplement Number Three dated April 9, 2003, among Wachovia Bank, National Association, as successor to First Union National Bank, not in its individual capacity but solely as Trustee, the Partnership and CSI Aviation Services, Inc.

99.1 Certification of Chief Executive Officer

99.2 Certification of Chief Financial Officer

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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

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May 12, 2003
Date

By: /s/ DAVID B. GEBLER

David B. Gebler
Chairman, Chief Executive Officer
and President

May 12, 2003
Date

By: /s/ ROBERT A. KEYES

Robert A. Keyes
Chief Financial Officer

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CERTIFICATIONS

I, David B. Gebler, Chairman, Chief Executive Officer and President of Airlease Management Services, Inc., the General Partner of Airlease Ltd., A California Limited Partnership, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Airlease Ltd., A California Limited Partnership;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this quarterly report;
4. The issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the issuer and have:
 - a) Designed such disclosure controls and procedures to ensure that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) Evaluated the effectiveness of the issuer's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) Presented in this quarterly report our conclusions about the

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effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The issuer's other certifying officers and I have disclosed, based on our most recent evaluation, to the issuer's auditors and the audit committee of issuer's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and
6. The issuer's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 12, 2003

/s/ DAVID B. GEBLER

David B. Gebler
Chairman, Chief Executive Officer and
President

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I, Robert A. Keyes, Chief Financial Officer of Airlease Management Services, Inc., the General Partner of Airlease Ltd., A California Limited Partnership, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Airlease Ltd., A California Limited Partnership;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this quarterly report;
4. The issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

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- a) Designed such disclosure controls and procedures to ensure that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) Evaluated the effectiveness of the issuer's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The issuer's other certifying officers and I have disclosed, based on our most recent evaluation, to the issuer's auditors and the audit committee of issuer's board of directors (or persons performing the equivalent functions):
- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and
6. The issuer's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 12, 2003

/s/ ROBERT A. KEYES

Robert A. Keyes
Chief Financial Officer

EXHIBIT INDEX

| Exhibit Number | Description |
|----------------|--|
| 10.57 | Lease Supplement Number Three dated April 9, 2003, among Wachovia Bank, National Association, as successor to First Union National Bank, not in its individual capacity but solely as Trustee, the Partnership and CSI Aviation Services, Inc. |

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- 99.1 Certification of Chief Executive Officer
- 99.2 Certification of Chief Financial Officer