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AIRLEASE LTD
Form 10-Q
July 30, 2002

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

Form 10-Q

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

For the Quarterly Period Ended June 30, 2002

Commission file number 1-9259

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

(Exact name of registrant 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

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No []

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

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AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

BALANCE SHEETS

| (In thousands except unit data) | June 30, 2002 (Unaudited) | December 31, 2001 |
|-----------------------------------|---------------------------------|----------------------|
| <hr/> | | |
| ASSETS | | |
| Cash and cash equivalents | \$ 2,485 | \$ 9,432 |
| Finance leases - net | 6,449 | 6,949 |
| Operating leases - net | 13,533 | 14,218 |
| Aircraft held for lease | 20,299 | 21,326 |
| Notes receivable | 544 | 544 |
| Prepaid expenses and other assets | 85 | 60 |
| | <hr/> | <hr/> |
| Total assets | \$43,395 | \$52,529 |
| | ===== | ===== |

LIABILITIES AND PARTNERS' EQUITY

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LIABILITIES

| | | |
|--|-------------------|-------------------|
| Distribution payable to partners | \$ 514 | \$ 7,521 |
| Deferred income | 509 | 509 |
| Accounts payable and accrued liabilities | 725 | 602 |
| Taxes Payable | 84 | 223 |
| Long-term notes payable | 3,065 | 3,389 |
| | <u> </u> | <u> </u> |
| Total liabilities | 4,897 | 12,244 |
| | <u> </u> | <u> </u> |

COMMITMENTS AND CONTINGENCIES

PARTNERS' EQUITY

| | | |
|--|-------------------|-------------------|
| Limited partners (4,625,000 units outstanding) | 38,113 | 39,882 |
| General partner | 385 | 403 |
| | <u> </u> | <u> </u> |
| Total partners' equity | 38,498 | 40,285 |
| | <u> </u> | <u> </u> |
| Total liabilities and partners' equity | \$43,395 | \$52,529 |
| | <u> </u> | <u> </u> |

See NOTES TO CONDENSED FINANCIAL STATEMENTS

AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

STATEMENTS OF OPERATIONS

| (Unaudited; in thousands except per unit amounts) | Three Months Ended | | Six Months Ended | |
|--|--------------------|-------------------|-------------------|-------------------|
| | June 30, | | June 30, | |
| | 2002 | 2001 | 2002 | 2001 |
| <hr/> | | | | |
| REVENUES | | | | |
| Finance lease income | \$ 75 | \$1,235 | \$ 155 | \$2,771 |
| Operating lease rentals | 750 | 246 | 1,500 | 246 |
| Other income | 8 | 9 | 37 | 23 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total revenues | 833 | 1,490 | 1,692 | 3,040 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

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EXPENSES

| | | | | |
|--|-----------|---------|-----------|---------|
| Interest | 60 | 149 | 115 | 323 |
| Depreciation | 856 | 145 | 1,712 | 145 |
| Management fee - general partner | 96 | 142 | 193 | 288 |
| Investor reporting | 86 | 87 | 197 | 193 |
| General and administrative | 55 | 37 | 84 | 53 |
| Tax on gross income | 23 | 184 | 65 | 369 |
| Aircraft maintenance and refurbishing | (6) | 0 | 85 | 0 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Total expenses | 1,170 | 744 | 2,451 | 1,371 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Net (Loss)/Income | \$ (337) | \$ 746 | \$ (758) | \$1,669 |
| | ===== | ===== | ===== | ===== |
| Net (Loss)/Income Allocated To: | | | | |
| General Partner | \$ (3) | \$ 7 | \$ (8) | \$ 17 |
| | ===== | ===== | ===== | ===== |
| Limited Partners | \$ (333) | \$ 739 | \$ (751) | \$1,652 |
| | ===== | ===== | ===== | ===== |
| Net (Loss)/Income Per Limited Partnership Unit | \$ (0.07) | \$ 0.16 | \$ (0.16) | \$ 0.36 |
| | ===== | ===== | ===== | ===== |

See NOTES TO CONDENSED FINANCIAL STATEMENTS

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AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

STATEMENTS OF CASH FLOWS

| | | |
|---------------------------|------------------|------|
| | Six Months Ended | |
| | June 30, | |
| (Unaudited; in thousands) | 2002 | 2001 |

CASH FLOWS FROM OPERATING ACTIVITIES

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| | | |
|--|----------|----------|
| Net (Loss)/Income | \$ (758) | \$ 1,669 |
| Adjustments to reconcile net (loss)/income to net cash provided by operating activities: | | |
| Depreciation | 1,712 | 145 |
| Increase in accounts payable and accrued liabilities | 123 | 334 |
| Decrease in taxes payable | (139) | (136) |
| Decrease/(Increase) in prepaid expenses and other assets | (26) | 57 |
| Increase in accounts receivable | 0 | (90) |
| | <hr/> | <hr/> |
| Net cash provided by operating activities | 912 | 1,979 |
| | <hr/> | <hr/> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Rental receipts in excess of earned finance lease income | 500 | 4,522 |
| | <hr/> | <hr/> |
| Net cash provided by investing activities | 500 | 4,522 |
| | <hr/> | <hr/> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Repayments under lines of credit, net | 0 | (1,765) |
| Repayment of long-term notes payable | (324) | (791) |
| Distributions paid to partners | (8,035) | (3,877) |
| | <hr/> | <hr/> |
| Net cash used by financing activities | (8,359) | (6,433) |
| | <hr/> | <hr/> |
| Increase (decrease) in cash and cash equivalents | (6,947) | 68 |
| Cash and cash equivalents at beginning of period | 9,432 | 17 |
| | <hr/> | <hr/> |
| Cash and cash equivalents at end of period | \$ 2,485 | \$ 85 |
| | ===== | ===== |
| ADDITIONAL INFORMATION | | |
| Interest paid | \$ 1 | \$ 310 |
| | ===== | ===== |

See NOTES TO CONDENSED FINANCIAL STATEMENTS

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NOTES TO FINANCIAL STATEMENTS

SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION - The accompanying unaudited condensed financial statements reflect all adjustments (consisting only of normal recurring adjustments) which 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, 2001 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, 2001, 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, 2001.

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.

NET INCOME PER LIMITED PARTNERSHIP UNIT - Net Income Per Limited Partnership Unit is computed by dividing the net income allocated to the Limited Partners by the weighted average units outstanding (4,625,000).

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AIRLEASE LTD., A CALIFORNIA LIMITED PARTNERSHIP

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

LIQUIDITY AND CAPITAL RESOURCES

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The Partnership presently has one long-term debt facility. At June 30, 2002, the 7.4% non-recourse note collateralized by one aircraft leased to FedEx had an outstanding balance of \$3.1 million. The facility matures in April 2006.

At June 30, 2002, long-term borrowings of \$3.1 million represented 2.9% 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.

Cash distributions paid in the first six months of 2002 were \$1.72 per limited partnership unit, representing the regular first-quarter 2002 distribution of \$0.11 per unit, the regular 2001 fourth-quarter cash distribution of \$0.11 per unit, and a special distribution of \$1.50 per unit as a result of the sale of one MD-82 aircraft in December 2001.

In June 2002, the Partnership declared a second-quarter 2002 cash distribution of \$0.11 per unit totaling \$513,889 payable on August 15, 2002 to unitholders of record on June 28, 2002. As a result of this distribution and the first-quarter 2001 distribution, and the Partnership loss for the first six months of 2002, Partnership equity declined to \$38.5 million at June 30, 2002 from \$40.3 million at December 31, 2001, and limited partner equity per unit declined to \$8.24. The second quarter cash distribution constitutes a return of capital. The 2001 second-quarter cash distribution was \$0.38 per unit.

RESULTS OF OPERATIONS

The Partnership reported a loss of \$337,000 in the second quarter ended June 30, 2002, compared with last year's second quarter earnings of \$746,000. Revenues for the 2002 second-quarter were \$833,000, compared with last year's second quarter revenues of \$1,490,000. Net loss for the first six months of 2002 was \$758,000, compared with a net income of \$1,669,000 for the first six months of 2001. Revenues for the six-month period were \$1,692,000, compared with \$3,040,000 for the first six months of 2001.

The revenue reductions are primarily due to the expiration of the lease with US Airways for five aircraft in the fourth quarter of 2001, three of which remain off lease; the sale of one aircraft in December 2001; and the scheduled decline in finance lease income in 2002 associated with the aircraft leased to FedEx. The decline in earnings results from the reduced revenues, together with an increase in expenses primarily due to an increase in depreciation expense.

Expenses for the first six months of 2002 were \$2,451,000, an increase of \$1,080,000 from \$1,371,000 for the comparable 2001 period. The increase in expenses is primarily due to depreciation expense of \$1,712,000 for the first six months of 2002 related to aircraft subject to operating leases and to aircraft available for lease. Depreciation expense in the first half of 2001 was \$145,000. The increase in expenses due to depreciation expense was partially offset by lower interest expense in the first six months of 2002 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.

PORTFOLIO MATTERS

At June 30, 2002, the Partnership's portfolio consisted of six Stage-III commercial aircraft. Two are leased to CSI Aviation Services, Inc., one to

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FedEx, and three are off lease.

In June 2002, the Partnership commenced litigation against US Airways seeking to recover damages for US Airways' failure to return three MD-82 aircraft leased to US Airways following lease expiration on September 30, 2001 and to pay rent due on the aircraft. The lawsuit was filed in California court by First Union National Bank, as trustee for the Partnership, the beneficial owner of the aircraft. The Partnership commenced the litigation after negotiations with US Airways failed to result in return of the aircraft.

In the lawsuit, the Partnership asserts that US Airways breached its obligations under the lease by failing to return the three aircraft by the date specified in the lease and in the condition prescribed by the lease, and by failing to pay rent due on the aircraft. The Partnership is seeking damages from US Airways including past due rent, rent that may accrue after the filing of the lawsuit, and the cost of restoring the aircraft to the condition prescribed by the lease.

OUTLOOK

The market conditions for aircraft leasing declined in 2001 in particular after September 11, 2001 and during the first half of 2002, when reduction in air-traffic demand, caused the supply of aircraft to exceed demand. While there are signs of increases in air traffic from September 2001 levels, which could lead to increased demand, it is widely believed that it will take time before the industry recovers fully. Consequently, the Partnership continues to experience significant competitive pressure in marketing the three aircraft currently off lease, and management is not able to predict when these aircraft may be leased again or the terms of any such future leasing.

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 other press releases and public filings, 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 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.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The General Partner believes there has been no material change in the Partnership's exposure to market risk from that discussed in the Partnership's Annual Report on Form 10-K for the year ended December 31, 2001.

PART II. OTHER INFORMATION

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(b) On June 25, 2002, the Partnership filed a report on Form 8-k dated June 25, 2002, disclosing under Item 5 the commencement of litigation against US Airways seeking to recover damages for US Airways' failure to return three MD-82 aircraft leased to US Airways in the condition prescribed in the lease following lease expiration on September 30, 2001 and to pay rent due on the aircraft.

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

July 30, 2002

Date

By: /s/ DAVID B. GEBLER

David B. Gebler
Chairman, Chief Executive Officer
and President

July 30, 2002

By: /s/ ROBERT A. KEYES

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Date

Robert A. Keyes
Chief Financial Officer