

WILLIS LEASE FINANCE CORP

Form 10-Q

May 06, 2014

[Table of Contents](#)

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 10-Q**

(Mark One)

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

For the Quarterly Period Ended March 31, 2014

OR

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

Commission File Number: 001-15369

---

# WILLIS LEASE FINANCE CORPORATION

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of incorporation or organization)

**68-0070656**  
(IRS Employer Identification No.)

**773 San Marin Drive, Suite 2215, Novato, CA**  
(Address of principal executive offices)

**94998**  
(Zip Code)

Registrant's telephone number, including area code **(415) 408-4700**

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Title of Each Class
Common Stock, \$0.01 par value per share

Outstanding at May 1, 2014
8,431,708



Table of Contents

**WILLIS LEASE FINANCE CORPORATION  
AND SUBSIDIARIES**

**INDEX**

**PART I. FINANCIAL INFORMATION**

<b><u>Item 1. Consolidated Financial Statements (Unaudited)</u></b>	3
<u>Consolidated Balance Sheets as of March 31, 2014 and December 31, 2013</u>	3
<u>Consolidated Statements of Income for the three months ended March 31, 2014 and 2013</u>	4
<u>Consolidated Statements of Comprehensive Income for the three months ended March 31, 2014 and 2013</u>	5
<u>Consolidated Statements of Shareholders' Equity for the three months ended March 31, 2014 and 2013</u>	6
<u>Consolidated Statements of Cash Flows for the three months ended March 31, 2014 and 2013</u>	7
<u>Notes to Unaudited Consolidated Financial Statements</u>	8
<b><u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	16
<b><u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u></b>	20
<b><u>Item 4. Controls and Procedures</u></b>	21
<b><u>PART II. OTHER INFORMATION</u></b>	22
<b><u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	22
<b><u>Item 5. Other Information</u></b>	22
<b><u>Item 6. Exhibits</u></b>	22

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements (Unaudited)****WILLIS LEASE FINANCE CORPORATION  
AND SUBSIDIARIES****Consolidated Balance Sheets****(In thousands, except share data, unaudited)**

	March 31, 2014	December 31, 2013
<b>ASSETS</b>		
Cash and cash equivalents	\$ 15,631	\$ 12,801
Restricted cash	53,375	50,794
Equipment held for operating lease, less accumulated depreciation of \$267,347 and \$257,806 at March 31, 2014 and December 31, 2013, respectively	1,022,462	1,033,022
Equipment held for sale	30,376	32,491
Operating lease related receivable, net of allowances of \$298 and \$296 at March 31, 2014 and December 31, 2013, respectively	13,650	13,286
Inventory	3,257	3,280
Investments	23,790	23,485
Property, equipment & furnishings, less accumulated depreciation of \$8,786 and \$8,666 at March 31, 2014 and December 31, 2013, respectively	4,920	4,950
Intangible assets, net	1,338	1,396
Equipment purchase deposits	1,969	1,369
Other assets	21,849	22,355
<b>Total assets</b>	<b>\$ 1,192,617</b>	<b>\$ 1,199,229</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
Accounts payable and accrued expenses	\$ 18,917	\$ 16,283
Deferred income taxes	88,924	86,685
Notes payable	767,108	787,614
Maintenance reserves	79,751	77,335
Security deposits	16,318	15,158
Unearned lease revenue	4,042	3,549
<b>Total liabilities</b>	<b>975,060</b>	<b>986,624</b>
<b>Shareholders' equity:</b>		
Common stock (\$0.01 par value, 20,000,000 shares authorized; 8,447,438 and 8,399,739 shares issued and outstanding at March 31, 2014 and December 31, 2013, respectively)	84	84
Paid-in capital in excess of par	45,441	44,741
Retained earnings	171,786	167,455
Accumulated other comprehensive income, net of income tax expense of \$46 and \$174 at March 31, 2014 and December 31, 2013, respectively	246	325
<b>Total shareholders' equity</b>	<b>217,557</b>	<b>212,605</b>

Edgar Filing: WILLIS LEASE FINANCE CORP - Form 10-Q

Total liabilities and shareholders' equity	\$	1,192,617	\$	1,199,229
--	----	-----------	----	-----------

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents**WILLIS LEASE FINANCE CORPORATION****AND SUBSIDIARIES****Consolidated Statements of Income****(In thousands, except per share data, unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>REVENUE</b>		
Lease rent revenue	\$ 26,900	\$ 24,487
Maintenance reserve revenue	14,030	9,229
Gain on sale of leased equipment	309	686
Other revenue	1,761	902
Total revenue	43,000	35,304
<b>EXPENSES</b>		
Depreciation and amortization expense	15,710	13,610
Write-down of equipment	295	
General and administrative	9,685	8,269
Technical expense	1,520	1,674
Net finance costs	9,359	9,227
Total expenses	36,569	32,780
Earnings from operations	6,431	2,524
Earnings from joint ventures	305	93
Income before income taxes	6,736	2,617
Income tax expense	(2,405)	(1,007)
Net income	\$ 4,331	\$ 1,610
Basic earnings per common share:	\$ 0.55	\$ 0.20
Diluted earnings per common share:	\$ 0.53	\$ 0.19
Average common shares outstanding	7,914	8,033
Diluted average common shares outstanding	8,129	8,273

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents**WILLIS LEASE FINANCE CORPORATION****AND SUBSIDIARIES****Consolidated Statements of Comprehensive Income****(In thousands, unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Net income	\$ 4,331	\$ 1,610
Other comprehensive income (loss):		
Derivative instruments		
Unrealized gain on derivative instruments		9
Reclassification adjustment for (gains) losses included in net income	(125)	366
Net gain (loss) recognized in other comprehensive income (loss)	(125)	375
Tax benefit (expense) related to items of other comprehensive income	46	(137)
Other comprehensive income (loss)	(79)	238
Total comprehensive income	\$ 4,252	\$ 1,848

See accompanying notes to the unaudited consolidated financial statements.



Table of Contents

**WILLIS LEASE FINANCE CORPORATION  
AND SUBSIDIARIES**

**Consolidated Statements of Shareholders' Equity**

**Three Months Ended March 31, 2014 and 2013**

**(In thousands, unaudited)**

	Issued and Outstanding Shares of Common Stock	Common Stock	Paid-in Capital in Excess of par	Accumulated Other Comprehensive Income/(Loss)	Retained Earnings	Total Shareholders' Equity
Balances at December 31, 2012	8,716	\$ 87	\$ 47,785	\$ (1,230)	\$ 152,911	\$ 199,553
Net income					1,610	1,610
Unrealized gain from derivative instruments, net of tax expense of \$137				238		238
Shares repurchased	(25)		(358)			(358)
Shares issued under stock compensation plans	20		230			230
Cancellation of restricted stock units in satisfaction of withholding tax	(18)		(263)			(263)
Stock-based compensation, net of forfeitures			783			783
Balances at March 31, 2013	8,693	\$ 87	\$ 48,177	\$ (992)	\$ 154,521	\$ 201,793
Balances at December 31, 2013	8,400	\$ 84	\$ 44,741	\$ 325	\$ 167,455	\$ 212,605
Net income					4,331	4,331
Unrealized loss from derivative instruments, net of tax benefit of \$46				(79)		(79)
Shares issued under stock compensation plans	63	1	211			212
Cancellation of restricted stock units in satisfaction of withholding tax	(16)	(1)	(269)			(270)
Stock-based compensation, net of forfeitures			758			758
Balances at March 31, 2014	8,447	\$ 84	\$ 45,441	\$ 246	\$ 171,786	\$ 217,557

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

**WILLIS LEASE FINANCE CORPORATION  
AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows**

(In thousands, unaudited)

	Three Months Ended March 31,	
	2014	2013
<b>Cash flows from operating activities:</b>		
Net income	\$ 4,331	\$ 1,610
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	15,710	13,610
Write-down of equipment	295	
Stock-based compensation expenses	758	783
Amortization of deferred costs	1,036	1,049
Amortization of interest rate derivative cost	(125)	(96)
Allowances and provisions	2	(52)
Gain on sale of leased equipment	(309)	(686)
Income from joint ventures, net of distributions	(305)	(93)
Deferred income taxes	2,405	1,007
Changes in assets and liabilities:		
Receivables	(366)	3,041
Other assets	(501)	6
Inventory	(350)	
Accounts payable and accrued expenses	1,734	144
Restricted cash	(8,068)	(5,695)
Maintenance reserves	2,416	3,679
Security deposits	(357)	(186)
Unearned lease revenue	493	430
Net cash provided by operating activities	18,799	18,551
<b>Cash flows from investing activities:</b>		
Proceeds from sale of equipment (net of selling expenses)	5,688	3,166
Restricted cash for investing activities	5,487	(2,207)
Capital contribution to joint ventures		(6,146)
Purchase of equipment held for operating lease and for sale	(7,915)	(79,576)
Purchase of property, equipment and furnishings	(156)	(31)
Net cash provided by (used in) investing activities	3,104	(84,794)
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of notes payable	5,000	69,000
Debt issuance cost	(27)	(570)
Interest bearing security deposits	1,518	3,035
Proceeds from shares issued under stock compensation plans	212	230
Cancellation of restricted stock units in satisfaction of withholding tax	(270)	(263)
Repurchase of common stock		(358)
Principal payments on notes payable	(25,506)	(8,853)
Net cash (used in) provided by financing activities	(19,073)	62,221
Increase/(Decrease) in cash and cash equivalents	2,830	(4,022)
Cash and cash equivalents at beginning of period	12,801	5,379
Cash and cash equivalents at end of period	\$ 15,631	\$ 1,357
Supplemental disclosures of cash flow information:		

Edgar Filing: WILLIS LEASE FINANCE CORP - Form 10-Q

Net cash paid for:

Interest	\$	8,811	\$	8,140
Income Taxes	\$	55	\$	

Supplemental disclosures of non-cash investing activities:

During the three months ended March 31, 2014, and 2013, a liability of \$802 and \$767, respectively, was incurred but not paid in connection with our purchase of aircraft and engines.

During the three months ended March 31, 2014 and 2013, engines and equipment totaling \$10,924 and \$2,141, respectively, were transferred from Held for Operating Lease to Held for Sale but not settled.

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

**Notes to Unaudited Consolidated Financial Statements**

**1. Summary of Significant Accounting Policies**

*(a) Basis of Presentation:* Our unaudited consolidated financial statements include the accounts of Willis Lease Finance Corporation and its subsidiaries ( we or the Company ) and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission for reporting on Form 10-Q. Pursuant to such rules and regulations, certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The accompanying unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto, together with Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal and recurring adjustments) necessary to present fairly our financial position as of March 31, 2014 and December 31, 2013, and the results of our operations for the three months ended March 31, 2014 and 2013, and our cash flows for the three months ended March 31, 2014 and 2013. The results of operations and cash flows for the period ended March 31, 2014 are not necessarily indicative of the results of operations or cash flows which may be reported for the remainder of 2014.

*(b) Fair Value Measurements:*

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs, to the extent possible. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

**Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis**

As of March 31, 2014 and December 31, 2013, we held no interest rate swaps. As of March 31, 2013, we measured the fair value of our interest rate swaps of \$100.0 million (notional amount) based on Level 2 inputs, due to the usage of inputs that can be corroborated by observable market data. The Company estimates the fair value of derivative instruments using a discounted cash flow technique and at March 31, 2013 used creditworthiness inputs that corroborate observable market data evaluating the Company's and counterparties' risk of non-performance. The interest rate swap agreements as of March 31, 2013 had a net liability fair value of \$1.2 million. For the three months ended March 31, 2014 and March 31, 2013, (\$0.1 million) and \$0.4 million, respectively, were realized as net finance costs on the Consolidated Statements of Income.

**Assets Measured and Recorded at Fair Value on a Nonrecurring Basis**

We determine the fair value of long-lived assets held and used, such as Equipment held for operating lease and Equipment held for sale, by reference to independent appraisals, quoted market prices (e.g. an offer to purchase) and other factors. An impairment charge is recorded when the carrying value of the asset exceeds its fair value.

Table of Contents

The following table shows by level, within the fair value hierarchy, the Company's assets measured at fair value on a nonrecurring basis as of March 31, 2014 and 2013, and the gains (losses) recorded during the three months ended March 31, 2014 and 2013 on those assets:

	Assets at Fair Value					Total Losses Three Months Ended March 31,				
	Total	March 31, 2014		Level 3 (in thousands)	Total	March 31, 2013		Level 3	2014	2013
		Level 1	Level 2			Level 1	Level 2			(in thousands)
Inventory	\$ 3,257	\$	\$	\$ 3,257	\$	\$	\$	\$	(295)	\$
Equipment held for sale	30,376		19,844	10,532	23,996		23,966	30		
Total	\$ 33,633	\$	\$ 19,844	\$ 13,789	\$ 23,996	\$	\$ 23,966	\$ 30	\$ (295)	\$

At March 31, 2014, the Company used Level 2 inputs and, due to a portion of the valuations requiring management judgment due to the absence of quoted market prices, Level 3 inputs to measure the fair value of certain assets that were held as inventory not consigned to third parties. The fair values of the assets categorized as Level 3 were based on management's estimate considering projected future sales proceeds at March 31, 2014 and March 31, 2013. An impairment charge is recorded when the carrying value of the asset exceeds its fair value. An asset write-down of \$0.3 million was recorded in the three months ended March 31, 2014 based upon a comparison of the asset net book value with the net proceeds expected from part sales arising from part-out of an engine. No asset write-down was recorded in the three months ended March 31, 2013.

## 2. Management Estimates

These consolidated financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States.

The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to residual values, estimated asset lives, impairments and bad debts. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Management believes that the accounting policies on revenue recognition, maintenance reserves and expenditures, useful life of equipment, asset residual values, asset impairment and allowance for doubtful accounts are critical to the results of operations.

If the useful lives or residual values are lower than those estimated by us, upon sale of the asset a loss may be realized. Significant management judgment is required in the forecasting of future operating results, which are used in the preparation of projected undiscounted cash-flows and should different conditions prevail, material impairment write-downs may occur.

**3. Commitments, Contingencies, Guarantees and Indemnities**

Our principal offices are located in Novato, California. We occupy space in Novato under a lease that covers approximately 20,534 square feet of office space and expires September 30, 2018. The remaining lease rental commitment is approximately \$2.4 million. Equipment leasing, financing, sales and general administrative activities are conducted from the Novato location. We sub-lease office and warehouse space for our operations in San Diego, California. This lease expires October 31, 2014, and the remaining lease commitment is approximately \$88,000. We lease office and warehouse space in Shanghai, China. The office lease expires December 31, 2014 and the warehouse lease expires July 31, 2017 and the remaining lease commitments are approximately \$49,000 and \$24,000, respectively. We lease office space in London, United Kingdom. The lease expires December 21, 2015 and the remaining lease commitment is approximately \$131,000. We lease office space in Blagnac, France. The lease expires December 31, 2014 and the remaining lease commitment is approximately \$15,000. We lease office space in Dublin, Ireland. The lease expires May 15, 2017 and the remaining lease commitment is approximately \$37,000. We lease office and warehouse space in Boynton Beach, Florida. The lease expires October 29, 2019 and the remaining lease commitment is approximately \$1.3 million.

We have made purchase commitments to secure the purchase of three engines and one aircraft and related equipment for a gross purchase price of \$36.2 million, for delivery in 2014. As of March 31, 2014, non-refundable deposits paid related to these purchase commitments were \$2.0 million. In October 2006, we entered into an agreement with CFM International ( CFM ) to purchase new spare aircraft engines. The agreement specifies that, subject to availability, we may purchase up to a total of 45 CFM56-7B and CFM56-5B spare engines over a five year period, with options to acquire up to



Table of Contents

an additional 30 engines. Our outstanding purchase order with CFM for one engine represents deferral of engine deliveries originally scheduled for 2009 and are included in our commitments to purchase in 2014.

**4. Investments**

On May 25, 2011, we entered into an agreement with Mitsui & Co., Ltd. to participate in a joint venture formed as a Dublin-based Irish limited company Willis Mitsui & Company Engine Support Limited ( WMES ) for the purpose of acquiring and leasing jet engines. Each partner holds a fifty percent interest in the joint venture. The initial capital contribution by the Company for its investment in WMES was \$8.0 million. The Company provided the initial lease portfolio by transferring 7 engines to the joint venture in June 2011. In addition, the Company made \$1.0 million, \$5.6 million and \$11.2 million capital contributions to WMES in the years ended December 31, 2011, 2012 and 2013, respectively, for the purchase of 17 engines from third parties, increasing the number of engines in the lease portfolio to 26. The Company made no capital contributions to WMES in the three months ended March 31, 2014. The \$25.8 million of capital contributions has been partially offset by \$3.6 million, resulting in a net investment of \$22.2 million, which has increased to \$23.8 million as a result of the Company's share of WMES reported earnings to date. The \$3.6 million reduction in investment represents 50% of the \$7.2 million gain related to the sale by the Company of the 7 engines to WMES.

WMES has a loan agreement with JA Mitsui Leasing, Ltd. which provides a credit facility of up to \$180.0 million to support the funding of future engine acquisitions. Funds available under the loan agreement have been extended through March 31, 2014. WMES has also established separate credit facilities totaling \$62.0 million to fund the purchase of engines. Our investment in the joint venture is \$23.8 million and \$23.5 million as of March 31, 2014 and December 31, 2013, respectively.

Three Months Ended March 31, 2014	(in thousands)
Investment in WMES joint venture as of December 31, 2013	\$ 23,485
Capital contribution	
Earnings from joint venture	305
Distribution	
Investment in WMES joint venture as of March 31, 2014	\$ 23,790

**5. Long Term Debt**

At March 31, 2014, notes payable consists of loans totaling \$767.1 million, payable over periods of approximately 6 months to 8 years with interest rates varying between approximately 2.4% and 5.5%.

At March 31, 2014, we had a \$450.0 million revolving credit facility to finance the acquisition of aircraft engines for lease as well as for general working capital purposes. We closed on this facility on November 18, 2011 and the proceeds of the facility, net of \$3.3 million in debt issuance costs, was used to pay off the balance remaining from our prior revolving facility. On June 18, 2013, we increased this revolving credit facility to \$450.0 million from \$430.0 million. As of March 31, 2014 and December 31, 2013, \$101.0 million and \$88.0 million was available under this facility, respectively. The revolving credit facility ends in November 2016. Based on the Company's debt to equity ratio of 3.87, as calculated under the terms of the revolving credit facility at December 31 2013, the interest rate on this facility is LIBOR plus 3.00% as of March 31, 2014. Under the revolving credit facility, all subsidiaries except WEST II and WOLF jointly and severally guarantee payment and performance of the

terms of the loan agreement. The guarantee would be triggered by a default under the agreement.

On September 17, 2012, we closed an asset-backed securitization ( ABS ) through a newly-created, bankruptcy-remote, Delaware statutory trust, Willis Engine Securitization Trust II, or WEST II , of which the Company is the sole beneficiary. WEST II issued and sold \$390 million aggregate principal amount of Class 2012-A Term Notes (the Notes ) and received \$384.9 million in net proceeds. We used these funds, net of transaction expenses and swap termination costs, in combination with our revolving credit facility to pay off the prior WEST notes totaling \$435.9 million. At closing, 22 engines were pledged as collateral from WEST to the Company 's revolving credit facility, which provided the remaining funds to pay off the WEST notes.

The assets and liabilities of WEST II will remain on the Company 's balance sheet. The current portfolio of 71 commercial jet aircraft engines and leases thereof secures the obligations of WEST II under the ABS. The Notes have no fixed amortization and are payable solely from revenue received by WEST II from the engines and the engine leases, after payment of certain expenses of WEST II. The Notes bear interest at a fixed rate of 5.50% per annum. The Notes may be accelerated upon the occurrence of certain events, including the failure to pay interest for five business days after the due date

Table of Contents

thereof. The Notes are expected to be paid 10 years from the issuance date by September 17, 2022. The legal final maturity of the Notes is September 15, 2037.

In connection with the transactions described above, effective September 17, 2012, the Company entered into a Servicing Agreement and Administrative Agency Agreement with WEST II to provide certain engine, lease management and reporting functions for WEST II in return for fees based on a percentage of collected lease revenues and asset sales. Because WEST II is consolidated for financial statement reporting purposes, all fees eliminate upon consolidation.

At March 31, 2014 and December 31, 2013, \$366.1 million and \$370.6 million of WEST II term notes were outstanding, respectively. The assets of WEST II are not available to satisfy our obligations or any of our affiliates other than the obligations specific to WEST II. WEST II is consolidated for financial statement presentation purposes. WEST II's ability to make distributions and pay dividends to the Company is subject to the prior payments of its debt and other obligations and WEST II's maintenance of adequate reserves and capital. Under WEST II, cash is collected in a restricted account, which is used to service the debt and any remaining amounts, after debt service and defined expenses, are distributed to the Company. Additionally, a portion of maintenance reserve payments and all lease security deposits are accumulated in restricted accounts and are available to fund future maintenance events and to secure lease payments, respectively. Cash from maintenance reserve payments are held in the restricted cash account equal to the maintenance obligations projected for the subsequent six months, and are subject to a minimum balance of \$9.0 million.

On September 18, 2013, we completed the acquisition of the fifty percent membership interest held by the other joint venture partner in WOLF, with the transaction being accounted for as an asset acquisition. As a result of the transaction, we now own one hundred percent of WOLF and it is consolidated for financial statement presentation purposes. The WOLF assets and liabilities and the results of operations have been included in the accompanying consolidated financial statements as of the acquisition date, September 18, 2013. Two term notes with an original principal amount of \$36.0 million, with a current balance outstanding of \$27.8 million as of March 31, 2014, are included in Notes payable. The two term notes are non-recourse to the Company, have a maturity date of May 28, 2017 and interest is payable at one-month LIBOR plus 4.0%.

The assets of WOLF are not available to satisfy our obligations or any of our affiliates other than the obligations specific to WOLF. WOLF's ability to make distributions to the Company is subject to the prior payments of all of its debt and other obligations. Under WOLF, cash related to parts sales and leasing of engine assets is collected in a restricted account and used to pay certain operating expenses, service the debt, and upon full debt repayment are distributed to the Company.

On January 10, 2014, we extended the term of an existing loan that was scheduled to mature on January 11, 2014. The loan has a term of 4 years with a maturity date of January 11, 2018. Interest is payable at one-month LIBOR plus 2.25% and principal and interest is paid quarterly. The loan is secured by three engines. The balance outstanding on this loan is \$15.5 million and \$15.8 million as of March 31, 2014 and December 31, 2013, respectively.

On September 28, 2012, we closed on a loan for a five year term totaling \$8.7 million. Interest is payable at a fixed rate of 5.50% and principal and interest is paid quarterly. The loan is secured by one engine. The funds were used to purchase the engine secured under the loan. The balance outstanding on this loan is \$8.1 million and \$8.2 million as of March 31, 2014 and December 31, 2013, respectively.

## Edgar Filing: WILLIS LEASE FINANCE CORP - Form 10-Q

On September 30, 2011, we closed on a loan for a three year term totaling \$4.0 million. Interest is payable at a fixed rate of 3.94% and principal and interest is paid monthly. The loan is secured by our corporate aircraft. The funds were used to refinance the loan for our corporate aircraft. The balance outstanding on this loan is \$0.7 million and \$1.0 million as of March 31, 2014 and December 31, 2013, respectively.

At March 31, 2014 and 2013, one-month LIBOR was 0.15% and 0.20%, respectively.

The following is a summary of the aggregate maturities of notes payable at March 31, 2014:

Year	(in thousands)
2014	\$ 20,062
2015	34,307
2016 (includes \$349.0 million outstanding on revolving credit facility)	376,589
2017	38,746
2018	33,804
Thereafter	263,600
	\$ 767,108

Table of Contents**6. Derivative Instruments**

We periodically hold interest rate derivative instruments to mitigate exposure to changes in interest rates, in particular one-month LIBOR, with \$392.3 million and \$392.0 million of our borrowings at March 31, 2014 and December 31, 2013, respectively, at variable rates. As a matter of policy, we do not use derivatives for speculative purposes. We currently have no interest rate swap agreements in place. During 2013 we were a party to one interest rate swap agreement with a notional outstanding amount of \$100.0 million with a fixed rate of 2.10%. The swap agreement expired in November 2013. The remaining effective portion of these hedges at the swap expiration date is being amortized into earnings over the term of the underlying borrowings. We recorded a \$0.1 million benefit to net finance costs during each of the three month periods ended March 31, 2014 and March 31, 2013.

The Company estimates the fair value of derivative instruments using a discounted cash flow technique and uses creditworthiness inputs that can be corroborated by observable market data evaluating the Company's and counterparties' risk of non-performance. Valuation of the derivative instruments requires certain assumptions for underlying variables and the use of different assumptions would result in a different valuation. We apply hedge accounting and account for the change in fair value of our cash flow hedges through other comprehensive income for all derivative instruments.

**Earnings Effects of Derivative Instruments on the Consolidated Statements of Income**

The following table provides information about the income effects of our cash flow hedging relationships for the three months ended March 31, 2014 and 2013:

Derivatives in Cash Flow Hedging Relationships	Location of (Gain) Loss Recognized on Derivatives in the Statements of Income	Amount of (Gain) Loss Recognized on Derivatives in the Statements of Income Three Months Ended March 31,	
		2014	2013
		(in thousands)	
Interest rate contracts	Interest expense	\$ (125)	\$ 366
Total		\$ (125)	\$ 366

Our derivatives are designated in a cash flow hedging relationship with the effective portion of the change in fair value of the derivative reported in the cash flow hedges subaccount of accumulated other comprehensive income.

Table of Contents**Effect of Derivative Instruments on Cash Flow Hedging**

The following tables provide additional information about the financial statement effects related to our cash flow hedges for the three months ended March 31, 2014 and 2013:

Derivatives in Cash Flow Hedging Relationships	Amount of Gain Recognized in OCI on Derivatives (Effective Portion)			Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		
	Three Months Ended March 31,		2013		Three Months Ended March 31,		2013
	2014	(in thousands)			2014	(in thousands)	
Interest rate contracts*	\$	\$	472	Interest expense	\$	125	\$ (366)
Total	\$	\$	472	Total	\$	125	\$ (366)

\* These amounts are shown net of \$0 and \$0.5 million of interest payments reclassified to the income statement during the three months ended March 31, 2014 and 2013, respectively.

The effective portion of the change in fair value on a derivative instrument designated as a cash flow hedge is reported as a component of accumulated other comprehensive income and is reclassified into earnings in the period during which the transaction being hedged affects earnings or it is probable that the forecasted transaction will not occur. The ineffective portion of the hedges is recorded in earnings in the current period. However, these are highly effective hedges and no significant ineffectiveness occurred in either period presented.

**Counterparty Credit Risk**

The Company evaluates the creditworthiness of the counterparties under its hedging agreements. The swap counterparty for the interest rate swap in place during the first eleven months of 2013 was a large financial institution in the United States that possessed an investment grade credit rating. Based on this rating, the Company believes that the counterparty was creditworthy and that their continuing performance under the hedging agreement was probable, and had not required the counterparty to provide collateral or other security to the Company.

**7. Stock-Based Compensation Plans**

Our 2007 Stock Incentive Plan (the 2007 Plan) was adopted on May 24, 2007. Under this 2007 Plan, a total of 2,000,000 shares are authorized for stock based compensation in the form of either restricted stock or stock options. There have been 1,784,946 shares of restricted stock awarded to date. The fair value of the restricted stock awards equaled the stock price at the date of grants. The following table summarizes restricted stock activity during the years ended December 31, 2012, December 31, 2013 and the three months ended March 31, 2014:

	<b>Shares</b>
Restricted stock at December 31, 2011	651,294
Granted in 2012 (vesting over 4 years)	283,000
Granted in 2012 (vesting on first anniversary from date of issuance)	28,040
Cancelled in 2012	(8,988)
Vested in 2012	(270,692)
Restricted stock at December 31, 2012	682,654
Granted in 2013 (vesting over 4 years)	130,000
Granted in 2013 (vesting on first anniversary from date of issuance)	21,408
Cancelled in 2013	(60,110)
Vested in 2013	(258,822)
Restricted stock at December 31, 2013	515,130
Granted in 2014 (vesting on first anniversary from date of issuance)	35,000
Vested in 2014	(39,000)
Restricted Stock at March 31, 2014	511,130

Table of Contents

All cancelled shares have reverted to the share reserve and are available for issuance at a later date, in accordance with the 2007 Plan.

Our accounting policy is to recognize the associated expense of such awards on a straight-line basis over the vesting period. Approximately \$0.8 million in stock compensation expense was recorded in each of the three month periods ended March 31, 2014 and March 31, 2013. The stock compensation expense related to the restricted stock awards will be recognized over the average remaining vesting period of 1.9 years and totals \$5.0 million at March 31, 2014 compared to 2.3 years and totaling \$5.8 million at March 31, 2013.

At March 31, 2014, the intrinsic value of unvested restricted stock awards issued through March 31, 2014 is \$10.5 million. At March 31, 2013, the intrinsic value of unvested restricted stock awards issued through March 31, 2013 was \$9.7 million. The 2007 Plan terminates on May 24, 2017.

In the three months ended March 31, 2014, 21,842 options under the 1996 Stock Options/Stock Issuance Plan (the 1996 Plan) were exercised. As of March 31, 2014, there are 53,595 stock options remaining under the 1996 Plan which have an intrinsic value of \$0.6 million. In the three months ended March 31, 2013, 12,375 options under the 1996 Plan were exercised and 6,500 options were cancelled.

**8. Income Taxes**

Income tax expense for the three months ended March 31, 2014 and 2013 was \$2.4 million and \$1.0 million, respectively. The effective tax rate for the three months ended March 31, 2014 and 2013 was 35.7% and 38.5%, respectively. The Company records tax expense or benefit for unusual or infrequent items discretely in the period in which they occur. Our tax rate is subject to change based on changes in the mix of assets leased to domestic and foreign lessees, the proportions of revenue generated within and outside of California, the amount of executive compensation exceeding \$1.0 million as defined in IRS code 162(m) and numerous other factors, including changes in tax law.

**9. Fair Value of Financial Instruments**

The carrying amount reported in the consolidated balance sheets for cash and cash equivalents, restricted cash, operating lease related receivable and accounts payable approximates fair value because of the immediate or short-term maturity of these financial instruments.

The carrying amount of the Company's outstanding balance on its Notes Payable as of March 31, 2014 and December 31, 2013 was estimated to have a fair value of approximately \$779.1 million and \$798.8 million, respectively, based on the fair value of estimated future payments calculated using the prevailing interest rates at each period end. There have been no changes in our valuation technique during the three months ended March 31, 2014. The fair value of the Company's notes payable at March 31, 2014 would be categorized as Level 3 of the fair value hierarchy. The carrying value of the Company's outstanding balance on its notes payable was \$767.1 million as of March 31, 2014 and \$787.6 million as of December 31, 2013.



**10. Operating Segments**

The Company operates in two business segments: (i) Leasing and Related Operations which involves acquiring and leasing, primarily pursuant to operating leases, commercial aircraft, aircraft engines and other aircraft equipment and the selective purchase and resale of commercial aircraft engines and other aircraft equipment and (ii) Spare Parts Sales which involves the purchase and resale of after-market engine and airframe parts, whole engines, engine modules and portable aircraft components and leasing of engines destined for disassembly and sale of parts.

The Company evaluates the performance of each of the segments based on profit or loss after general and administrative expenses and inter-company allocation of interest expense. While the Company believes there are synergies between the two business segments, the segments are managed separately because each requires different business strategies.

Table of Contents

The following tables present a summary of the operating segments (amounts in thousands):

For the three months ended March 31, 2014	Leasing and Related Operations		Spare Parts Sales	Total
<b>Revenue:</b>				
Lease rent revenue	\$	26,900	\$	26,900
Maintenance reserve revenue		14,030		14,030
Spare parts sales			79	79
Gain on sale of leased equipment		309		309
Other revenue		967	715	1,682
<b>Total revenue</b>		<b>42,206</b>	<b>794</b>	<b>43,000</b>
<b>Expenses:</b>				
Depreciation and amortization expense		15,638	72	15,710
General and administrative		9,021	664	9,685
Net finance costs		9,359		9,359
Other expense		1,815		1,815
<b>Total expenses</b>		<b>35,833</b>	<b>736</b>	<b>36,569</b>
Earnings from operations	\$	6,373	\$	58 \$
<b>Total assets as of March 31, 2014</b>	<b>\$</b>	<b>1,185,812</b>	<b>\$</b>	<b>6,805 \$</b>
<b>Total assets as of December 31, 2013</b>	<b>\$</b>	<b>1,194,800</b>	<b>\$</b>	<b>4,429 \$</b>

The Spare Parts Sales segment began operation during the fourth quarter of 2013. No activity occurred in this segment during the three months ended March 31, 2013.

**11. Subsequent Events**

Management has reviewed and evaluated subsequent events through the date that the financial statements were issued.

Table of Contents

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Overview**

Our core business is acquiring and leasing, primarily pursuant to operating leases, commercial aircraft engines and related aircraft equipment; and the selective purchase and sale of commercial aircraft engines (collectively "equipment"). In 2013, the Company launched a new, wholly-owned subsidiary, Willis Aeronautical Services, Inc. ("WASI"). WASI primarily engages in selling aircraft engine parts and materials through the acquisition or consignment of aircraft and engines from third parties.

**Critical Accounting Policies and Estimates**

There have been no material changes to our critical accounting policies and estimates from the information provided in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates included in our 2013 Form 10-K.

**Results of Operations**

*Three months ended March 31, 2014, compared to the three months ended March 31, 2013:*

*Lease Rent Revenue.* Lease rent revenue for the three months ended March 31, 2014 increased 9.9% to \$26.9 million from \$24.5 million for the comparable period in 2013. This increase was primarily due to higher utilization rates in the first quarter of 2014 and an increase in the average size of the lease portfolio during the quarter, which translated into a higher amount of equipment on lease. The aggregate of net book value of lease equipment at March 31, 2014 and 2013 was \$1,022.5 million and \$1,019.3 million, respectively, an increase of 0.3%. The average utilization for the three months ended March 31, 2014 and 2013 was 87% and 84%, respectively. At March 31, 2014 and 2013, respectively, approximately 84% and 82% of equipment held for lease by book value was on-lease.

During the three months ended March 31, 2014, we added \$8.0 million of equipment and capitalized costs to the lease portfolio. During the three months ended March 31, 2013, we added \$78.7 million of equipment and capitalized costs to the lease portfolio.

*Maintenance Reserve Revenue.* Our maintenance reserve revenue for the three months ended March 31, 2014 increased 52.2% to \$14.0 million from \$9.2 million for the comparable period in 2013. The increase was due to higher maintenance reserve revenues recognized related to the termination of long term leases in the three months ended March 31, 2014 than in the year ago period.

## Edgar Filing: WILLIS LEASE FINANCE CORP - Form 10-Q

*Gain on Sale of Leased Equipment.* During the three months ended March 31, 2014, we sold two engines and other related equipment generating a net gain of \$0.3 million. During the three months ended March 31, 2013, we sold seven engines and other related equipment generating a net gain of \$0.7 million.

*Other Revenue.* Our other revenue consists primarily of management fee income, lease administration fees as well as net spare parts sales and third party consignment commissions earned by our WASI subsidiary. Other revenue increased to \$1.8 million from \$0.9 million for the comparable period in 2013 primarily due to an increase in fees earned related to engines managed on behalf of third parties which increased in number from the year ago period and revenue resulting from commissions on third party spare parts sales.

*Depreciation and Amortization Expense.* Depreciation and amortization expense increased 15.4% to \$15.7 million for the three months ended March 31, 2014 from \$13.6 million in the comparable period in 2013, due to growth in the lease portfolio and changes in estimates of useful lives and residual values on certain older engine types that occurred in 2013 but did not affect the first quarter of 2013. As of July 1, 2013, we adjusted the depreciation for certain older engine types. It is our policy to review estimates regularly to reflect the cost of equipment over the useful life of these engines. The 2013 change in depreciation estimate resulted in a \$2.1 million increase in depreciation for the three months ended March 31, 2014. The net effect of the 2013 change in depreciation estimate is a reduction in net income of \$1.4 million or \$0.17 in diluted earnings per share for the three months ended March 31, 2014 over what net income would have otherwise been had the change in depreciation estimate not been made.

*Write-down of Equipment.* A write-down of equipment totaling \$0.3 million was recorded in the three months ended March 31, 2014 due to a management decision to consign an engine for part out and sale, in which the assets net book value exceeds the estimated proceeds from part-out. There was no write-down of equipment recorded in the three months ended March 31, 2013.

Table of Contents

*General and Administrative Expenses.* General and administrative expenses increased 17.1% to \$9.7 million for the three months ended March 31, 2014, from \$8.3 million in the comparable period in 2013, due primarily to increases in consulting and accounting fees (\$0.5 million), salary expense (\$0.3 million) and travel and entertainment expense (\$0.3 million).

*Technical Expense.* Technical expenses consist of the cost of engine repairs, engine thrust rental fees, outsourced technical support services, engine storage and freight costs. These expenses decreased 9.2% to \$1.5 million for the three months ended March 31, 2014, from \$1.7 million in the comparable period in 2013 due mainly to decreases in technical support service expenses (\$0.2 million) and engine freight expenses (\$0.2 million), which was partially offset by an increase in engine maintenance costs (\$0.3 million).

*Net finance costs.* Net finance costs increased 1.4% to \$9.4 million for the three months ended March 31, 2014, from \$9.2 million net finance costs in the comparable period in 2013, due primarily to an increase in the average debt outstanding which was partially offset by lower average one-month LIBOR in the first quarter of 2014. Notes payable balance at March 31, 2014 and 2013, was \$767.1 million and \$757.1 million, respectively, an increase of 1.3%. As of March 31, 2014, \$392.3 million of our debt is tied to one-month U.S. dollar LIBOR which decreased from an average of 0.20% for the three months ended March 31, 2013 to an average of 0.15% for the three months ended March 31, 2014 (average of month-end rates). As of March 31, 2014 and 2013, one-month LIBOR was 0.15% and 0.20%, respectively.

To mitigate exposure to interest rate changes, we periodically enter into interest rate swap agreements. As of March 31, 2013, one swap agreement had a notional outstanding amount of \$100.0 million with a remaining term of eight months and a fixed rate of 2.10%. This interest rate swap agreement matured in November 2013. In the three months ended March 31, 2013, \$0.4 million was realized on the statement of income as an increase in interest expense as a result of this swap. No swap agreements existed during the three months ended March 31, 2014.

*Income Tax Expense.* Income tax expense for the three months ended March 31, 2014 and 2013 was \$2.4 million and \$1.0 million, respectively. The effective tax rate for the three months ended March 31, 2014 and 2013 was 35.7% and 38.5%, respectively. The Company records tax expense or benefit for unusual or infrequent items discretely in the period in which they occur. Our tax rate is subject to change based on changes in the mix of assets leased to domestic and foreign lessees, the proportions of revenue generated within and outside of California, the amount of executive compensation exceeding \$1.0 million as defined in IRS code 162(m) and numerous other factors, including changes in tax law.

**Recent Accounting Pronouncements**

In July 2013, the FASB issued Accounting Standards Update ( ASU ) 2013-11, Income Taxes - Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists which is part of Accounting Standards Codification ( ASC ) 740: Income Taxes. The new guidance requires an entity to present an unrecognized tax benefit and an NOL carryforward, a similar tax loss, or a tax credit carryforward on a net basis as part of a deferred tax asset, unless the unrecognized tax benefit is not available to reduce the deferred tax asset component or would not be utilized for that purpose, then a liability would be recognized. We adopted this ASU as of January 1, 2014. The adoption of this ASU did not have a material impact on our Consolidated Financial Statements.

**Liquidity and Capital Resources**

We finance our growth through borrowings secured by our equipment lease portfolio. Cash of approximately \$5.0 million and \$69.0 million in the three-month periods ended March 31, 2014 and 2013, respectively, was derived from this activity. In these same time periods, \$25.5 million and \$8.9 million, respectively, was used to pay down related debt. Cash flow from operating activities was \$18.8 million and \$18.6 million in the three-month periods ended March 31, 2014 and 2013, respectively.

At March 31, 2014, \$8.8 million in cash and cash equivalents and restricted cash were held in foreign subsidiaries. We do not intend to repatriate the funds held in foreign subsidiaries to the United States. In the event that we decide to repatriate these funds to the United States, we would be required to accrue and pay taxes upon the repatriation.

Our primary use of funds is for the purchase of equipment for lease. Purchases of equipment (including capitalized costs) totaled \$7.9 million and \$79.6 million for the three-month periods ended March 31, 2014 and 2013, respectively.

Cash flows from operations are driven significantly by payments made under our lease agreements, which comprise lease revenue, security deposits and maintenance reserves, and are offset by net finance costs and general and administrative costs. Note that cash received from maintenance reserve arrangements for some of our engines on lease are restricted per our WEST II debt agreement. Cash from WEST II engine maintenance reserve payments, that can be used to fund future

Table of Contents

maintenance events, are held in the restricted cash account equal to the maintenance obligations projected for the subsequent six months, and are subject to a minimum balance of \$9.0 million. The lease revenue stream, in the short-term, is at fixed rates while a portion of our debt is at variable rates. If interest rates increase, it is unlikely we could increase lease rates in the short term and this would cause a reduction in our earnings and operating cash flows. Revenue and maintenance reserves are also affected by the amount of equipment off lease. Approximately 84%, by book value, of our assets were on-lease at March 31, 2014 compared to 82% at March 31, 2013. The average utilization rate was 87% and 84% for the three month periods ended March 31, 2014 and March 31, 2013, respectively. If there is any increase in off-lease rates or deterioration in lease rates that are not offset by reductions in interest rates, there will be a negative impact on earnings and cash flows from operations.

At March 31, 2014, Notes Payable consists of loans totaling \$767.1 million, payable over periods of approximately 6 months to 8 years with interest rates varying between approximately 2.4% and 5.5%.

At March 31, 2014, we had a \$450.0 million revolving credit facility to finance the acquisition of aircraft engines for lease as well as for general working capital purposes. As of March 31, 2014 and December 31, 2013, \$101.0 million and \$88.0 million was available under this facility, respectively. The revolving credit facility ends in November 2016. Based on the Company's debt to equity ratio of 3.87 as calculated under the terms of the revolving credit facility at December 31, 2013, the interest rate on this facility is LIBOR plus 3.00% as of March 31, 2014. Under the revolving credit facility, all subsidiaries except WEST II and WOLF jointly and severally guarantee payment and performance of the terms of the loan agreement. The guarantee would be triggered by a default under the agreement.

On September 17, 2012, we closed an asset-backed securitization ( ABS ) through a newly-created, bankruptcy-remote, Delaware statutory trust, Willis Engine Securitization Trust II, or WEST II , of which the Company is the sole beneficiary. WEST II issued and sold \$390 million aggregate principal amount of Class 2012-A Term Notes (the Notes ) and received \$384.9 million in net proceeds. We used these funds, net of transaction expenses and swap termination costs, in combination with our revolving credit facility to pay off the prior WEST notes totaling \$435.9 million. At closing, 22 engines were pledged as collateral from WEST to the Company's revolving credit facility, which provided the remaining funds to pay off the WEST notes.

The assets and liabilities of WEST II will remain on the Company's balance sheet. The current portfolio of 71 commercial jet aircraft engines and leases thereof secures the obligations of WEST II under the ABS. The Notes have no fixed amortization and are payable solely from revenue received by WEST II from the engines and the engine leases, after payment of certain expenses of WEST II. The Notes bear interest at a fixed rate of 5.50% per annum. The Notes may be accelerated upon the occurrence of certain events, including the failure to pay interest for five business days after the due date thereof. The Notes are expected to be paid 10 years from the issuance date by September 17, 2022. The legal final maturity of the Notes is September 15, 2037.

In connection with the transactions described above, effective September 17, 2012, the Company entered into a Servicing Agreement and Administrative Agency Agreement with WEST II to provide certain engine, lease management and reporting functions for WEST II in return for fees based on a percentage of collected lease revenues and asset sales. Because WEST II is consolidated for financial statement reporting purposes, all fees eliminate upon consolidation.

At March 31, 2014 and December 31, 2013, \$366.1 million and \$370.6 million of WEST II term notes were outstanding, respectively. The assets of WEST II are not available to satisfy our obligations or any of our affiliates other than the obligations specific to WEST II. WEST II is consolidated for financial statement presentation purposes. WEST II's ability to make distributions and pay dividends to the Company is subject to the prior payments of its debt and other obligations and WEST II's maintenance of adequate reserves and capital. Under WEST II, cash is

## Edgar Filing: WILLIS LEASE FINANCE CORP - Form 10-Q

collected in a restricted account, which is used to service the debt and any remaining amounts, after debt service and defined expenses, are distributed to the Company. Additionally, a portion of maintenance reserve payments and all lease security deposits are accumulated in restricted accounts and are available to fund future maintenance events and to secure lease payments, respectively. Cash from maintenance reserve payments are held in the restricted cash account equal to the maintenance obligations projected for the subsequent six months, and are subject to a minimum balance of \$9.0 million.

On September 18, 2013, we completed the acquisition of the fifty percent membership interest held by the other joint venture partner in WOLF, with the transaction being accounted for as an asset acquisition. With this acquisition, WOLF is consolidated for financial statement presentation purposes. Two term notes with an original principal amount of \$36.0 million, with a current balance outstanding of \$27.8 million and \$30.0 million as of March 31, 2013 and December 31, 2013, respectively, are included in Notes payable. The two term notes are non-recourse, have a maturity date of May 28, 2017 and interest is payable at one-month LIBOR plus 4.0%.



Table of Contents

The assets of WOLF are not available to satisfy our obligations or any of our affiliates other than the obligations specific to WOLF. WOLF's ability to make distributions to the Company is subject to the prior payments of all of its debt and other obligations. Under WOLF, cash related to parts sales and leasing of engine assets is collected in a restricted account and used to pay certain operating expenses, service the debt, and upon full debt repayment are distributed to the Company.

On January 10, 2014, we extended the term of an existing loan that was scheduled to mature on January 11, 2014. The loan has a term of 4 years with a maturity date of January 11, 2018. Interest is payable at one-month LIBOR plus 2.25% and principal and interest is paid quarterly. The loan is secured by three engines. The balance outstanding on this loan is \$15.5 million and \$15.8 million as of March 31, 2014 and December 31, 2013, respectively.

On September 28, 2012, we closed on a loan for a five year term totaling \$8.7 million. Interest is payable monthly at a fixed rate of 5.50% and principal is paid quarterly. The loan is secured by one engine. The funds were used to purchase the engine secured under the loan. The balance outstanding on this loan is \$8.1 million and \$8.2 million as of March 31, 2014 and December 31, 2013, respectively.

On September 30, 2011, we closed on a loan for a three year term totaling \$4.0 million. Interest is payable at a fixed rate of 3.94% and principal and interest is paid monthly. The loan is secured by our corporate aircraft. The funds were used to refinance the loan for our corporate aircraft. The balance outstanding on this loan is \$0.7 million and \$1.0 million as of March 31, 2014 and December 31, 2013, respectively.

As of March 31, 2014 and 2013, one-month LIBOR was 0.15% and 0.20%, respectively.

Virtually all of the above debt is subject to our ongoing compliance with the covenants of each financing, including debt/equity ratios, minimum tangible net worth and minimum interest coverage ratios, and other eligibility criteria including customer and geographic concentration restrictions. In addition, under these facilities, we can typically borrow 70% to 83% of an engine's net book value and approximately 70% of spare parts net book value. Therefore we must have other available funds for the balance of the purchase price of any new equipment to be purchased or we will not be permitted to draw on these facilities. The facilities are also cross-defaulted against other facilities. If we do not comply with the covenants or eligibility requirements, we may not be permitted to borrow additional funds and accelerated payments may become necessary. Additionally, much of the above debt is secured by engines to the extent that engines are sold, repayment of that portion of the debt could be required.

At March 31, 2014, we are in compliance with the covenants specified in the revolving credit facility Credit Agreement, including the Interest Coverage Ratio requirement of at least 2.50 to 1.00, and the Total Leverage Ratio requirement to remain below 4.75 to 1.00. At March 31, 2014, the Company's calculated Minimum Consolidated Tangible Net Worth exceeded the minimum required amount of \$199.3 million. As defined in the revolving credit facility Credit Agreement, the Interest Coverage Ratio is the ratio of Earnings before Interest, Taxes, Depreciation and Amortization and other one-time charges (EBITDA) to Consolidated Interest Expense and the Total Leverage Ratio is the ratio of Total Indebtedness to Tangible Net Worth. At March 31, 2014, we are in compliance with the covenants specified in the WEST II indenture and servicing agreement.

Approximately \$25.5 million of our debt is repayable during the next 12 months. Such repayments consist of scheduled installments due under term loans. Repayments are funded by the use of unrestricted cash reserves and from cash flows from ongoing operations. The table below

## Edgar Filing: WILLIS LEASE FINANCE CORP - Form 10-Q

summarizes our contractual commitments at March 31, 2014:

	Payment due by period (in thousands)				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long-term debt obligations	\$ 767,108	\$ 25,545	\$ 411,519	\$ 72,470	\$ 257,574
Interest payments under long-term debt obligations	163,908	32,692	57,823	31,768	41,625
Operating lease obligations	4,217	1,139	1,788	1,290	
Purchase obligations	34,227	34,227			
<b>Total</b>	<b>\$ 969,460</b>	<b>\$ 93,603</b>	<b>\$ 471,130</b>	<b>\$ 105,528</b>	<b>\$ 299,199</b>

We have estimated the interest payments due under long-term debt by applying the interest rates applicable at March 31, 2014 to the remaining debt, adjusted for the estimated debt repayments identified in the table above. Actual interest payments made will vary due to changes in the rates for one-month LIBOR.

Table of Contents

We have made purchase commitments to secure the purchase of three engines and one aircraft and related equipment for a gross purchase price of \$36.2 million, for delivery in 2014. As of March 31, 2014, non-refundable deposits paid related to these purchase commitments were \$2.0 million. In October 2006, we entered into an agreement with CFM International (CFM) to purchase new spare aircraft engines. The agreement specifies that, subject to availability, we may purchase up to a total of 45 CFM56-7B and CFM56-5B spare engines over a five year period, with options to acquire up to an additional 30 engines. Our outstanding purchase order with CFM for one engine represents deferral of engine deliveries originally scheduled for 2009 and are included in our commitments to purchase in 2014.

We occupy space in Novato under a lease that covers approximately 20,534 square feet of office space and expires September 30, 2018. The remaining lease rental commitment is approximately \$2.4 million. Equipment leasing, financing, sales and general administrative activities are conducted from the Novato location. We sub-lease office and warehouse space for our operations in San Diego, California. This lease expires October 31, 2014, and the remaining lease commitment is approximately \$88,000. We lease office and warehouse space in Shanghai, China. The office lease expires December 31, 2014 and the warehouse lease expires July 31, 2017 and the remaining lease commitments are approximately \$49,000 and \$24,000, respectively. We lease office space in London, United Kingdom. The lease expires December 21, 2015 and the remaining lease commitment is approximately \$131,000. We lease office space in Blagnac, France. The lease expires December 31, 2014 and the remaining lease commitment is approximately \$15,000. We lease office space in Dublin, Ireland. The lease expires May 15, 2017 and the remaining lease commitment is approximately \$37,000. We lease office and warehouse space in Boynton Beach, Florida. The lease expires October 29, 2019 and the remaining lease commitment is approximately \$1.3 million.

We believe our equity base, internally generated funds and existing debt facilities are sufficient to maintain our level of operations for the next twelve months. A decline in the level of internally generated funds, such as could result if the amount of equipment off-lease increases or there is a decrease in availability under our existing debt facilities, would impair our ability to sustain our level of operations. We are discussing additions to our capital base with our commercial and investment banks. If we are not able to access additional capital, our ability to continue to grow our asset base consistent with historical trends will be impaired and our future growth limited to that which can be funded from internally generated capital.

**Management of Interest Rate Exposure**

At March 31, 2014, \$392.3 million of our borrowings were on a variable rate basis at various interest rates tied to one-month LIBOR. Our equipment leases are generally structured at fixed rental rates for specified terms. Increases in interest rates could narrow or result in a negative spread, between the rental revenue we realize under our leases and the interest rate that we pay under our borrowings. We periodically enter into interest rate derivative instruments to mitigate our exposure to interest rate risk and not to speculate or trade in these derivative products. We currently have no interest rate swap agreements in place.

We record derivative instruments at fair value as either an asset or liability. We use derivative instruments (primarily interest rate swaps) to manage the risk of interest rate fluctuation. Hedge accounting is only applied where specific criteria have been met and it is practicable to do so. In order to apply hedge accounting, the transaction must be designated as a hedge and the hedge relationship must be highly effective. The hedging instrument's effectiveness is assessed utilizing regression analysis at the inception of the hedge and on at least a quarterly basis throughout its life. All of the transactions that we have designated as hedges are accounted for as cash flow hedges. The effective portion of the gain or loss on a derivative instrument designated as a cash flow hedge is reported as a component of other comprehensive income and is reclassified into earnings in the period during which the transaction being hedged affects earnings. The ineffective portion of these hedges flows through earnings in the current period. The hedge accounting for these derivative instrument arrangements (decreased) / increased net finance costs by (\$0.1 million) and \$0.4 million for the three months ended March 31, 2014 and March 31, 2013, respectively. This incremental cost for the swaps effective for hedge accounting was included in net finance costs for the respective periods. For further information see Note 6 to the unaudited consolidated financial statements.

For any interest rate swaps that we enter into, we will be exposed to risk in the event of non-performance of the interest rate hedge counter-parties. We anticipate that we may hedge additional amounts of our floating rate debt in the future.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Our primary market risk exposure is that of interest rate risk. A change in the LIBOR rates would affect our cost of borrowing. Increases in interest rates, which may cause us to raise the implicit rates charged to our customers, could result in a reduction in demand for our leases. Alternatively, we may price our leases based on market rates so as to keep the fleet on-lease and suffer a decrease in our operating margin due to interest costs that we are unable to pass on to our customers. As of March 31, 2014, \$392.3 million of our outstanding debt is variable rate debt. We estimate that for every one percent increase

Table of Contents

or decrease in interest rates on our variable rate debt (net of derivative instruments), annual interest expense would increase or decrease \$3.9 million (in 2013, \$2.4 million per annum).

We previously hedged a portion of our borrowings from time to time, effectively fixing the rate of these borrowings. This hedging activity helps protect us against reduced margins on longer term fixed rate leases. In November 2013, the last of our interest rate swap agreements matured. For any interest rate swaps entered into, we will be exposed to risk in the event of non-performance of the interest rate hedge counter-parties. We anticipate that we may hedge additional amounts of our floating rate debt in the future.

We are also exposed to currency devaluation risk. During the three months ended March 31, 2014, 86% of our total lease revenues came from non-United States domiciled lessees. All of our leases require payment in U.S. dollars. If these lessees' currency devalues against the U.S. dollar, the lessees could potentially encounter difficulty in making their lease payments.

No customer accounted for more than 10% of total lease rent revenue during the three months ended March 31, 2014 and March 31, 2013.

**Item 4. Controls and Procedures**

(a) *Evaluation of disclosure controls and procedures.* Based on management's evaluation (with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO)), as of the end of the period covered by this report, our CEO and CFO have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), are effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

**Inherent Limitations on Controls**

Management, including the CEO and CFO, does not expect that our disclosure controls and procedures will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.

(b) *Changes in internal control over financial reporting.* There has been no change in our internal control over financial reporting during our fiscal quarter ended March 31, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



Table of Contents

**PART II OTHER INFORMATION**

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(a) *None.*

(b) *None.*

(c) *Issuer Purchases of Equity Securities.* On September 27, 2012, the Company announced that its Board of Directors has authorized a plan to repurchase up to \$100.0 million of its common stock over the next 5 years. This plan extends the previous plan authorized on December 8, 2009, and increases the number of shares authorized for repurchase to up to \$100.0 million.

No common stock repurchases under our authorized plan occurred during the three months ended March 31, 2014. The approximate value of shares that may yet be purchased under the plans as of March 31, 2014 is \$83.3 million.

**Item 5. Other Information**

As disclosed in our 2013 Annual Report on Form 10-K, we are in settlement discussions with the SEC with respect to an administrative proceeding concerning certain instances in which we and three of our current officers failed to timely file public reports of the officers' stock ownership. The settlements have not been finalized and discussions with the SEC remain ongoing. We do not expect this matter to materially impact our business or operations.

**Item 6. Exhibits**

(a) *Exhibits.*

**EXHIBITS**

**Description**

## Edgar Filing: WILLIS LEASE FINANCE CORP - Form 10-Q

### Exhibit Number

- 3.1 Certificate of Incorporation, dated March 12, 1998, as amended by the Certificate of Amendment of Certificate of Incorporation, dated May 6, 1998 (incorporated by reference to Exhibit 3.1 to our report on Form 10-K filed on March 31, 2009).
- 3.2 Bylaws, dated April 18, 2001 as amended by (1) Amendment to Bylaws, dated November 13, 2001, (2) Amendment to Bylaws, dated December 16, 2008, and (3) Amendment to Bylaws, dated September 28, 2010 (incorporated by reference to Exhibit 3.2 to our report on Form 10-Q filed on November 8, 2010).
- 4.1 Specimen of Series A Cumulative Redeemable Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to Form S-1 Registration Statement Amendment No. 2 filed on January 27, 2006).
- 4.2 Form of Certificate of Designations of the Registrant with respect to the Series A Cumulative Redeemable Preferred Stock (incorporated by reference to Exhibit 4.2 to Form S-1 Registration Statement Amendment No. 2 filed on January 27, 2006).
- 4.3 Form of Amendment No. 1 to Certificate of Designations of the Registrant with respect to the Series A Cumulative Redeemable Preferred Stock (incorporated by reference to Exhibit 4.3 to our report on Form 10-K filed on March 31, 2009).
- 4.4 Rights Agreement dated as of September 24, 1999, by and between Willis Lease Finance Corporation and American Stock Transfer and Trust Company, as Rights Agent (incorporated by reference to Exhibit 4.1 to Form 8-K filed on October 4, 1999).
- 4.5 First Amendment to Rights Agreement dated as of November 30, 2000 by and between Willis Lease Finance Corporation and American Stock Transfer and Trust Company, as Rights Agent (incorporated by reference to Exhibit 10.1 to our report on Form 8-K filed on December 15, 2000).
- 4.6 Second Amendment to Rights Agreement dated as of December 15, 2005, by and between Willis Lease Finance Corporation and American Stock Transfer and Trust Company, as Rights Agent (incorporated by reference to Exhibit 4.5 to our report on Form 10-K filed on March 31, 2009).
- 4.7 Third Amendment to Rights Agreement dated as of September 30, 2008, by and between Willis Lease Finance Corporation and American Stock Transfer and Trust Company, as Rights Agent (incorporated by reference to Exhibit 4.6 to our report on Form 10-K filed on March 31, 2009).
- 4.8 Form of Certificate of Designations of the Registrant with respect to the Series I Junior Participating Preferred Stock (formerly known as Series A Junior Participating Preferred Stock ) (incorporated by reference to Exhibit 4.7 to our report on Form 10-K filed on March 31, 2009).
- 4.9 Form of Amendment No. 1 to Certificate of Designations of the Registrant with respect to Series I Junior Participating Preferred Stock (incorporated by reference to Exhibit 4.8 to our report on Form 10-K filed on March 31, 2009).



## Edgar Filing: WILLIS LEASE FINANCE CORP - Form 10-Q

### Table of Contents

- 10.1 Form of Indemnification Agreement entered into between the Registrant and its directors and officers (incorporated by reference to Exhibit 10.1 to Form 8-K filed on October 1, 2010).
- 10.2 1996 Stock Option/Stock Issuance Plan, as amended and restated as of March 1, 2003 (incorporated by reference to Exhibit 99.1 to Form S-8 filed on September 26, 2003).
- 10.3 2007 Stock Incentive Plan (incorporated by reference to the Registrant's Proxy Statement for 2007 Annual Meeting of Stockholders filed on April 30, 2007).
- 10.4 Amended and Restated Employment Agreement between the Registrant and Charles F. Willis IV dated as of December 1, 2008 (incorporated by reference to Exhibit 10.1 to Form 8-K filed on December 22, 2008).
- 10.5 Employment Agreement between the Registrant and Donald A. Nunemaker dated November 21, 2000 (incorporated by reference to Exhibit 10.3 to our report on Form 10-K filed on April 2, 2001).
- 10.6 Amendment to Employment Agreement between Registrant and Donald A. Nunemaker dated December 31, 2008 (incorporated by reference to Exhibit 10.6 to our report on Form 10-Q filed on May 9, 2011).
- 10.7 Employment Agreement between the Registrant and Thomas C. Nord dated September 19, 2005 (incorporated by reference to Exhibit 10.1 to Form 8-K filed on September 23, 2005).
- 10.8 Amendment to Employment Agreement between Registrant and Thomas C. Nord dated December 31, 2008 (incorporated by reference to Exhibit 10.8 to our report on Form 10-Q filed on May 9, 2011).
- 10.9 Employment Agreement between the Registrant and Bradley S. Forsyth dated February 20, 2007 (incorporated by reference to Exhibit 10.2 to Form 8-K filed on February 21, 2007).
- 10.10 Amendment to Employment Agreement between Registrant and Bradley S. Forsyth dated December 31, 2008 (incorporated by reference to Exhibit 10.10 to our report on Form 10-Q filed on May 9, 2011).
- 10.11 Loan and Aircraft Security Agreement dated September 30, 2012 between Banc of America Leasing & Capital, LLC and Willis Lease Finance Corporation (incorporated by reference to Exhibit 10.12 to our report on Form 10-Q filed on November 9, 2011).
- 10.12 Limited Liability Company Agreement of WOLF A340 LLC, dated as of December 8, 2005, between Oasis International Leasing (USA), Inc. and the Registrant (incorporated by reference to Exhibit 10.49 to Form S-1 Registration Statement Amendment No. 1 filed on January 9, 2006).
- 10.13\* Amended and Restated Credit Agreement, dated as of November 18, 2011, among Willis Lease Finance Corporation, Union Bank, N.A., as administrative agent and security agent, and certain lenders and financial institutions named therein (incorporated by reference to Exhibit 10.31 to our report on Form 10-K filed on March 13, 2011).
- 10.14\* Indenture dated as of September 14, 2012 among Willis Engine Securitization Trust II, Deutsche Bank Trust Company Americas, as trustee, the Registrant and Crédit Agricole Corporate and Investment Bank (incorporated by reference to Exhibit 10.14 to our report on Form 10-Q filed on November 9, 2012).
- 10.15\* Security Trust Agreement dated as of September 14, 2012 by and among Willis Engine Securitization Trust II, Willis Engine Securitization (Ireland) Limited, the Engine Trusts listed on Schedule V thereto, each of the additional grantors referred to therein and from time to time made a party thereto and Deutsche Bank Trust Company Americas, as trustee (incorporated by reference to Exhibit 10.15 to our report on Form 10-Q filed on November 9, 2012).
- 10.16\* Note Purchase Agreement dated as of September 6, 2012 by and among Willis Engine Securitization Trust II, the Registrant, Credit Agricole Securities (USA) Inc. and Goldman, Sachs & Co. (incorporated by reference to Exhibit 10.16 to our report on Form 10-Q filed on November 9, 2012).
- 10.17\* Servicing Agreement dated as of September 17, 2012 between Willis Engine Securitization Trust II, the Registrant and the entities listed on Appendix A thereto (incorporated by reference to Exhibit 10.17 to our report on Form 10-Q filed on November 9, 2012).
- 10.18\* Administrative Agency Agreement dated as of September 17, 2012 among Willis Engine Securitization Trust II, the Registrant, Deutsche Bank Trust Company Americas, as trustee, and the entities listed on Appendix A thereto (incorporated by reference to Exhibit 10.18 to our report on Form 10-Q filed on November 9, 2012).
- 10.19\* Asset Transfer and Liquidation Agreement dated as of September 14, 2012 between the Registrant and Willis Engine Securitization Trust (incorporated by reference to Exhibit 10.19 to our report on Form 10-Q filed on November 9, 2012)..
- 10.20\* Acquisition Transfer Agreement dated as of September 14, 2012 among the Registrant, Willis Engine Securitization Trust II, Facility Engine Acquisition LLC, WEST Engine Acquisition LLC, and WEST Engine Funding LLC (incorporated by reference to Exhibit 10.20 to our report on Form 10-Q filed on November 9, 2012).
- 10.21 Transition Agreement dated as of December 21, 2012 between Registrant and Thomas C. Nord (incorporated by reference to Exhibit 21.1 to our report on Form 10-K filed on March 18, 2013).
- 11.1 Statement re Computation of Per Share Earnings.
- 21.1 Subsidiaries of the Registrant.
- 31.1

Edgar Filing: WILLIS LEASE FINANCE CORP - Form 10-Q

Certification of Charles F. Willis, IV, pursuant to Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Table of Contents

- 31.2 Certification of Bradley S. Forsyth, pursuant to Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 The following materials from the Company's report on Form 10-Q for the quarter ended March 31, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Shareholder's Equity and Comprehensive Income, (iv) the Consolidated Statements of Cash Flows, and (v) Notes to Unaudited Consolidated Financial Statements.

---

\* Portions of these exhibits have been omitted pursuant to a request for confidential treatment and the redacted material has been filed separately with the Commission.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: May 6, 2014

Willis Lease Finance Corporation

By: **/s/ Bradley S. Forsyth**  
Bradley S. Forsyth  
Senior Vice President  
Chief Financial Officer  
*(Principal Accounting Officer)*