

WILLIS LEASE FINANCE CORP  
Form 10-Q  
August 12, 2008  
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 June 30, 2008**

**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.)

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

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 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	Outstanding at August 11, 2008
Common Stock, \$0.01 Par Value	8,690,242

---

Table of Contents

**WILLIS LEASE FINANCE CORPORATION  
AND SUBSIDIARIES**

**INDEX**

**PART I. FINANCIAL INFORMATION**

**Item 1. Consolidated Financial Statements (Unaudited)** 3

Consolidated Balance Sheets as of June 30, 2008 and December 31, 2007 3

Consolidated Statements of Income for the Three and Six months ended June 30, 2008 and 2007 4

Consolidated Statements of Shareholders' Equity and Comprehensive Income for the Six months ended June 30, 2008 and 2007 5

Consolidated Statements of Cash Flows for the Six months ended June 30, 2008 and 2007 6

Notes to Consolidated Financial Statements 7

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations** 11

**Item 3. Quantitative and Qualitative Disclosures About Market Risk** 17

**Item 4. Controls and Procedures** 17

**PART II. OTHER INFORMATION** 18

**Item 5. Exhibits** 18

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)**

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 1,576	\$ 7,234
Restricted cash	64,198	64,960
Equipment held for operating lease, less accumulated depreciation of \$140,724 and \$134,815 at June 30, 2008 and December 31, 2007, respectively	786,791	744,827
Equipment held for sale	9,079	5,006
Operating lease related receivable, net of allowances of \$77 and \$62 at June 30, 2008 and December 31, 2007, respectively	6,895	5,550
Investments	10,458	10,327
Assets under derivative instruments	467	12
Property, equipment & furnishings, less accumulated depreciation of \$2,499 and \$2,463 at June 30, 2008 and December 31, 2007, respectively	7,424	6,771
Other assets	33,692	23,903
<b>Total assets</b>	<b>\$ 920,580</b>	<b>\$ 868,590</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>Liabilities:</b>		
Accounts payable and accrued expenses	\$ 11,286	\$ 11,825
Liabilities under derivative instruments	7,029	7,709
Deferred income taxes	53,578	46,632
Notes payable, net of discount of \$4,240 and \$1,594 at June 30, 2008 and December 31, 2007, respectively	598,968	567,108
Maintenance reserves	52,811	49,481
Security deposits	6,407	5,890
Unearned lease revenue	4,131	5,293
<b>Total liabilities</b>	<b>734,210</b>	<b>693,938</b>
<b>Shareholders equity:</b>		
Preferred stock (\$0.01 par value, 5,000,000 shares authorized; 3,475,000 shares issued and outstanding at June 30, 2008 and December 31, 2007, respectively)	31,915	31,915
Common stock (\$0.01 par value, 20,000,000 shares authorized; 8,682,496 and 8,433,224 shares issued and outstanding at June 30, 2008 and December 31, 2007, respectively)	87	84
Accumulated other comprehensive loss, net of income tax of \$3,470 and \$3,892 at June 30, 2008 and December 31, 2007, respectively	(6,030)	(6,749)
Paid-in capital in excess of par	56,745	55,712
Retained earnings	103,653	93,690

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

Total shareholders' equity		186,370		174,652
Total liabilities and shareholders' equity	\$	920,580	\$	868,590

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 share data, unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
<b>REVENUE</b>				
Lease rent revenue	\$ 26,216	\$ 21,354	\$ 51,038	\$ 40,750
Maintenance reserve revenue	9,515	8,250	15,802	15,528
Gain on sale of leased equipment	1,261	1,239	1,261	1,300
Other income	248	124	1,382	505
Total revenue	37,240	30,967	69,483	58,083
<b>EXPENSES</b>				
Depreciation expense	9,085	7,946	17,725	14,389
Write-down of equipment	1,811	2,142	1,811	2,142
General and administrative	7,275	5,872	13,553	11,769
Net finance costs:				
Interest expense	9,584	9,218	19,361	17,999
Interest income	(439)	(909)	(1,063)	(1,759)
Total net finance costs	9,145	8,309	18,298	16,240
Total expenses	27,316	24,269	51,387	44,540
Earnings from operations	9,924	6,698	18,096	13,543
Earnings from joint venture	200	205	382	292
Income before income taxes	10,124	6,903	18,478	13,835
Income tax expense	(3,702)	(2,509)	(6,951)	(5,036)
Net income	\$ 6,422	\$ 4,394	\$ 11,527	\$ 8,799
Preferred stock dividends paid and accumulated-Series A	782	782	1,564	1,564
Net income attributable to common shareholders	\$ 5,640	\$ 3,612	\$ 9,963	\$ 7,235
Basic earnings per common share:	\$ 0.69	\$ 0.44	\$ 1.21	\$ 0.90
Diluted earnings per common share:	\$ 0.64	\$ 0.42	\$ 1.14	\$ 0.84
Average common shares outstanding	8,225	8,118	8,208	8,066
Diluted average common shares outstanding	8,754	8,636	8,764	8,589

See accompanying notes to the unaudited consolidated financial statements.



Table of Contents

**WILLIS LEASE FINANCE CORPORATION  
AND SUBSIDIARIES**

**Consolidated Statements of Shareholders' Equity and Comprehensive Income**

**Six months Ended June 30, 2008 and 2007**

**(In thousands, unaudited)**

	Preferred Stock	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, 2006	\$ 31,915	8,010	\$ 80	\$ 53,820	\$ (967)	\$ 79,154	\$ 164,002
Net income						8,799	8,799
Unrealized gain from derivative instruments, net of tax expenses of \$716					1,240		1,240
Total comprehensive income							10,039
Preferred stock dividends paid						(1,564)	(1,564)
Shares issued under stock compensation plans		132	1	895			896
Stock-based compensation expenses				254			254
Balances at June 30, 2007	\$ 31,915	8,142	\$ 81	\$ 54,969	\$ 273	\$ 86,389	\$ 173,627
Balances at December 31, 2007	\$ 31,915	8,433	\$ 84	\$ 55,712	\$ (6,749)	\$ 93,690	\$ 174,652
Net income						11,527	11,527
Unrealized gain from derivative instruments, net of tax expenses of \$415					719		719
Total comprehensive income							12,246
Preferred stock dividends paid						(1,564)	(1,564)
		249	3	278			281



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

Shares issued under stock compensation plans								
Stock-based compensation expense				714				714
Tax benefit on disqualified dispositions of shares				41				41
Balances at June 30, 2008	\$ 31,915	8,682	\$ 87	\$ 56,745	(6,030)	\$ 103,653	\$	186,370

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)

	Six months ended June 30,	
	2008	2007
<b>Cash flows from operating activities:</b>		
Net income	\$ 11,527	\$ 8,799
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	17,725	14,389
Write-down of equipment	1,811	2,142
Amortization of deferred costs	2,211	1,563
Amortization of loan discount	242	202
Allowances and provisions	15	(19)
Stock-based compensation expenses	714	254
Gain on sale of leased equipment	(1,261)	(1,300)
Earnings from joint venture	(382)	(292)
Changes in assets and liabilities:		
Receivables	(1,359)	1,172
Other assets	(2,828)	(376)
Accounts payable and accrued expenses	(4,173)	(7,737)
Deferred income taxes	6,537	5,036
Restricted cash	(9,778)	(15,875)
Maintenance reserves	3,331	5,187
Security deposits	517	301
Unearned lease revenue	(1,163)	2,071
Net cash provided by operating activities	23,686	15,517
<b>Cash flows from investing activities:</b>		
Proceeds from sale of equipment held for operating lease (net of selling expenses)	19,990	7,926
Restricted cash for investing activities	10,539	11,209
Proceeds from principal payment of notes receivable		12
Distributions from joint venture	250	595
Purchase of equipment held for operating lease	(86,473)	(61,703)
Purchase of property, equipment and furnishings	(936)	(15)
Net cash used in investing activities	(56,630)	(41,976)
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of notes payable	322,852	49,568
Distributions to preferred stockholders	(1,564)	(1,564)
Debt issuance cost	(3,090)	
Proceeds from shares issued under stock compensation plans	322	896
Principal payments on notes payable	(291,234)	(19,854)
Net cash provided by financing activities	27,286	29,046
(Decrease)/increase in cash and cash equivalents	(5,658)	2,587
Cash and cash equivalents at beginning of period	7,234	387
Cash and cash equivalents at end of period	\$ 1,576	\$ 2,974
Supplemental disclosures of cash flow information:		
Net cash paid for:		
Interest	\$ 17,763	\$ 17,116

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

Income Taxes	\$	722	\$	44
--------------	----	-----	----	----

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

**Notes to 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, 2007.

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 June 30, 2008, and December 31, 2007, and the results of our operations for the three and six month periods ended June 30, 2008 and 2007, and our cash flows for the six months ended June 30, 2008 and 2007. The results of operations and cash flows for the period ended June 30, 2008 are not necessarily indicative of the results of operations or cash flows which may be reported for the remainder of 2008.

Management considers the operations of our company to operate in one reportable segment. Certain reclassifications have been made to the prior year presentation to conform to current year presentation.

*(b) Fair Value Measurements:* In September 2006, the Financial Accounting Standards Board (FASB) issued Financial Accounting Standards Statement No. 157, Fair Value Measurements ( SFAS 157 ). SFAS 157 establishes a framework for measuring fair value under GAAP and expands disclosures about fair value measurements. In February 2008, the FASB issued FASB Staff Position No. SFAS 157-2, Effective Date of FASB Statement No. 157 , which provides a one year deferral of the effective date of SFAS 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Effective January 1, 2008, we adopted the provisions of SFAS 157 with respect to our financial assets and liabilities. We have applied SFAS 157 to our recording of derivative instruments at fair value as either an asset or liability, and have deferred adoption for non-recurring fair value measurements, principally impairment of equipment.

Fair value is defined under SFAS 157 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 under FAS 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. We utilize the market approach to measure fair value for our financial assets and liabilities. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The standard

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

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.

We measure the fair value of our notional interest rate swaps of \$304.0 million based on Level 3 inputs as defined by SFAS 157. The company estimates the fair value of derivative instruments using a discounted cash flow technique. Fair value may depend on the credit rating and risk attaching to the counterparties of the derivative contracts. We have interest rate swap agreements which have a cumulative liability net fair value of \$6.6 million and \$7.7 million as of June 30, 2008 and December 31, 2007, respectively. The change in fair value (net of income tax expense of \$0.4 million) of \$0.7 million, net of \$2.1 million realized through the income statement as interest expense, was recorded in the Consolidated Statements of Shareholders' Equity and Comprehensive Income as an unrealized gain from derivative instruments for the six months ended June 30, 2008.

Table of Contents

In February 2007, the FASB issued Financial Accounting Standards (FAS) Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of Measurement FASB Statement No. 115 ( SFAS 159 ). Under this pronouncement, companies may elect to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reporting earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. However, SFAS 159 specifically includes financial assets and financial liabilities recognized under leases (as defined in FAS No. 13, Accounting for Leases), as among those items not eligible for the fair value measurement option except contingent obligations for cancelled leases and guarantees of third-party lease obligations. Effective January 1, 2008, we adopted SFAS 159 and did not elect fair value measurement for any financial instruments or other items.

**2. Management Estimates**

These 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 its estimates, including those related to residual values, estimated asset lives, bad debts, income taxes, contingencies and litigation. Beginning April 1, 2007 and again on April 1, 2008, we adjusted the depreciation for certain older engine types within the portfolio. We base our estimate 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.

Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets , requires that long-lived assets and certain identifiable intangibles to be held and used by an entity be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, and long-lived assets and certain identifiable intangibles to be disposed of generally be reported at the lower of carrying amount or fair value less cost to sell. For the quarter ending June 30, 2008, we recorded a write-down of \$1.0 million related to two engines in which the net book value exceeded the expected net proceeds to be received through part sales arising from consignment and recorded a further \$0.8 million related to 4 aircraft and 2 engines for which we believe contractual return conditions are likely not to be met by the lessee.

Management believes that the accounting policies on useful life of equipment, residual values and asset impairment are critical to the results of operations. If the useful lives or residual values are lower than those estimated by us, upon sale of an 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 18,375 square feet of office space and expires February 28, 2015. The remaining lease rental commitment is approximately \$3.4 million. Equipment leasing,

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

financing, sales and general administrative activities are conducted from the Novato location. We also sub-lease approximately 3,100 square feet of office and warehouse space for our operations at San Diego, California. This lease expires October 31, 2008, and the remaining lease commitment is approximately \$48,000. We also lease office space in Shanghai, China. The lease expires December 31, 2008 and the remaining lease commitment is approximately \$25,000.

We have paid deposits to secure the purchase, during the remainder of 2008 and 2009, of 31 engines and 3 helicopters for a gross purchase price of \$293.1 million, for delivery from July 2008 to December 2009. As of June 30, 2008, non-refundable deposits paid related to this purchase commitment were \$18.0 million. In October 2006, we entered into an agreement with CFM International ( CFM ) to purchase up to \$540 million of 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 the next five years, with options to acquire up to an additional 30 engines. Our 2008 and 2009 purchase orders have been accepted by CFM and are included in our commitments to purchase.

Table of Contents**4. Investments**

In July 1999, we entered into an agreement to participate in a joint venture formed as a limited company Sichuan Snecma Aero-engine Maintenance Co. Ltd. ( Sichuan Snecma ) for the purpose of providing airlines in the Asia Pacific area with modern maintenance, leased engines and spare parts. Sichuan Snecma focuses on providing maintenance services for CFM56 series engines and is located in Chengdu, China. Our investment of \$1.48 million initially represented a 7% interest in the joint venture, for which we account using the cost accounting method. In 2005, we elected not to make a capital call agreed to by the other investors, Air China International Company and Snecma Services (France). When this \$10.9 million capital call was funded in April 2006, our investment in the joint venture was diluted to a 4.6% interest.

We hold a fifty percent membership interest in a joint venture, WOLF A340, LLC, a Delaware limited liability company, ( WOLF ). On December 30, 2005, WOLF completed the purchase of two Airbus A340-313 aircraft from Boeing Aircraft Holding Company for a purchase price of \$96 million. The purchase was funded by four term notes with one financial institution totaling \$76.8 million, with interest payable at LIBOR plus 1.0% to 2.5% and maturing in 2013. These aircraft are currently on lease to Emirates until 2013. Our investment in the joint venture is \$9.0 million as of June 30, 2008.

**Six months Ending June 30, 2008 (in thousands)**

Investment in WOLF A340, LLC as of December 31, 2007	\$	8,847
Earnings from joint venture		382
Distribution		(250)
Investment in WOLF A340, LLC as of June 30, 2008	\$	8,979

**5. Long Term Debt**

At June 30, 2008, notes payable consists of loans totaling \$599.0 million (net of discount of \$4.2 million), payable over periods of two months to 15 years with interest rates varying between approximately 3.7% and 8.5% (excluding the effect of our interest rate derivative instruments). At June 30, 2008, we had revolving and warehouse credit facilities totaling approximately \$489.0 million with \$298.5 million in funds available to us. Our significant debt instruments are discussed below.

At June 30, 2008, we had a \$289.0 million revolving credit facility to finance the acquisition of aircraft engines for lease as well as for general working capital purposes. As of June 30, 2008, \$129.5 million was available under this facility. The revolving facility was amended on June 7, 2007, and the revolving period ends in June 2009 with a final maturity in June 2010. The interest rate on this facility at June 30, 2008 was LIBOR plus 1.75%. Under the revolving credit facility, all subsidiaries except WEST Engine Funding LLC jointly and severally guarantee payment and performance of the terms of the loan agreement. The maximum guarantee is \$289.0 million plus any accrued and unpaid interest, fees or reimbursements but is limited at any given time to the sum of the principal outstanding plus accrued interest and fees. The guarantee would be triggered by a default under the agreement.

At June 30, 2008, we had \$386.2 million of WEST term notes and \$31.0 million of WEST warehouse notes outstanding. The term notes are divided into \$155.1 million Series 2005-A1 notes, \$22.8 million Series 2005-B1 notes and \$208.3 million Series 2008-A1 notes. At June 30, 2008, interest on the Series 2005-A1 notes is one-month LIBOR plus a margin of 1.25%. At June 30, 2008, interest on the Series 2005-B1 notes



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

is one-month LIBOR plus a margin of 3.00% and a supplemental margin of 3.00%, for a total margin of 6.00%. At June 30, 2008, interest on the Series 2008-A1 notes is one-month LIBOR plus a margin of 1.50%.

The sale of \$212.4 million of Series 2008-A1 notes and \$20.3 million of Series 2008-B1 notes closed on March 28, 2008. At the closing, WEST agreed to acquire 11 engines from us directly. As a result of the transfer of engines from us to WEST, we no longer have access to these engines and they are managed to repay the note holders of WEST and for us as the equity holder of WEST. These transactions did not change the book value of the engines in the consolidated financial statements. We used these funds net of a \$2.9 million discount on the Series 2008-A1 notes to pay off the balance remaining of the Series 2005-A2 and B2 notes of \$164.1 million, pay off \$62.0 million of our indebtedness related to the transfer of 11 engines from us to WEST, pay transaction expenses of approximately \$3.2 million and received cash of approximately \$0.5 million for general corporate purposes. Interest on the Series 2008-A1 and B1 notes is one-month LIBOR plus a margin of 1.50% and 3.50%, respectively. The Series 2008-A1 term notes expected maturity is March 2021 and the Series 2008-B1 term notes expected maturity is March 2023.

Table of Contents

From March 28, 2008 to June 30, 2008, our investment banker, acting as our agent to sell the notes, was the holder of \$20.3 million of the Series 2008-B1 notes. On June 30, 2008, we secured a \$20 million senior term loan and used the loan proceeds to re-purchase the Series 2008-B1 from our investment banker. The Series 2008-B1 notes were pledged as collateral for the \$20 million senior term loan. The loan is for a term of two years with maturity on July 1, 2010 and is structured as a bullet loan with no amortization with all amounts due at maturity. The interest rate for the term loan is one month LIBOR plus 3.50%. Our investment banker will continue to market the Series 2008-B1 notes and in the event the Series 2008-B1 notes are placed with an investor within the next two years, the term loan will be repaid with the proceeds from the sale of the Series 2008-B1 notes.

On December 13, 2007, we closed on a new \$200.0 million warehouse facility within WEST, consisting of \$175.0 million of Series 2007-A2 notes and \$25.0 million of Series 2007-B2 notes. At June 30, 2008, \$169.0 million was available under these warehouse notes. The 2007 series warehouse notes allow for borrowings during a three-year term, after which it is expected that they will be converted to term notes of WEST. Interest on the Series 2007-A2 notes and B2 notes is one-month LIBOR plus a margin of 1.25% and 2.75%, respectively. The facility has a committed amount of \$200.0 million. The Series 2007-A2 notes mature approximately December 2020 and the Series 2007-B2 notes mature approximately December 2022.

Following the sale of two Bell 412 EP helicopters on May 8, 2008, we repaid the Export Development Canada credit facility in the amount of \$13.6 million.

The assets of WEST, WEST Engine Funding and any associated Owner Trust are not available to satisfy the obligations of ours or any of our affiliates. WEST is consolidated for financial statement presentation purposes.

At June 30, 2008 and 2007, one-month LIBOR was 2.46% and 5.32%, respectively.

The following is a summary of the aggregate maturities of notes payable on June 30, 2008 (dollars in thousands):

**Year Ending December 31,**

2008	\$	17,445
2009		33,900
2010 (includes \$159.5 million outstanding on revolving credit facility and \$20 million for senior term loan)		213,409
2011		38,906
2012		33,607
2013 and thereafter		265,942
	\$	603,209

**6. Derivative Instruments**

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

We hold a number of interest rate derivative instruments to mitigate exposure to changes in interest rates, in particular one-month LIBOR, as virtually all of our borrowings are at variable rates. In addition, WEST is required under its credit agreement to hedge a portion of its borrowings. At June 30, 2008, we were a party to interest rate swap agreements with notional outstanding amounts of \$304.0 million, remaining terms of between seven and forty-four months and fixed rates of between 3.46% and 5.05%. The net fair value of these swaps at June 30, 2008 was negative \$6.6 million, and represented the estimated amount we would pay if we terminated the swaps.

The company estimates the fair value of derivative instruments using a discounted cash flow technique. Valuation of the derivative instruments requires certain assumptions for underlying variables and the use of different assumptions would result in a different valuation. Management believes it has applied assumptions consistently during the period and has not changed its method of valuation during the period.

Based on the estimated forward rate of LIBOR at June 30, 2008, we anticipate that net finance costs will be increased by approximately \$5.3 million for the 12 months ending June 30, 2009 due to the interest rate derivative contracts currently in place.

Table of Contents

**7. Stock-Based Compensation Plan**

Our 2007 Stock Incentive Plan (the Plan) was adopted on May 24, 2007. Under this Plan, a total of 2,000,000 shares are authorized for stock based compensation in the form of either restricted stock or stock options. Two types of restricted stock were granted in 2007: 239,952 shares vesting over 4 years and 15,452 shares vesting on the first anniversary date from date of issuance. In the first quarter of 2008, 179,190 shares of restricted stock were granted that will vest over 4 years. In the second quarter of 2008, 16,192 shares of restricted stock were granted that will vest on the first anniversary date from date of issuance. Our accounting policy is to recognize the grant date fair value net of expected forfeitures of such awards as an expense on a straight-line basis over the vesting period. The fair value of the awards equaled the stock price at the date of grants. Approximately \$714,000 in stock compensation expense was recorded in the six months ended June 30, 2008. The stock compensation expense related to the 2007 and 2008 restricted stock awards that will be recognized in future periods total \$4.7 million. The Plan terminates on May 24, 2017.

In the six months ended June 30, 2008, 45,465 options under the 1996 Stock Options/Stock Issuance Plan were exercised with a total intrinsic value at exercise date of approximately \$342,000. There are 1,317,846 stock options remaining under the 1996 Stock Options/Stock Issuance Plan which have an intrinsic value of \$5.1 million.

**8. Related Party and Similar Transactions**

Gavarnie Holding, LLC, a Delaware Limited Liability Company ( Gavarnie ) owned by Charles F. Willis, IV, purchased the stock of Aloha Island Air, Inc., a Delaware Corporation, ( Island Air ) from Aloha AirGroup, Inc. ( Aloha ) on May 11, 2004. Mr. Willis is the President, CEO and Chairman of our Board of Directors and owns approximately 33% of our common stock as of June 30, 2008. Island Air leases four DeHaviland DHC-8-100 aircraft and two spare engines from us, under non-cancelable leases and scheduled payments in accordance with the leases will generate lease revenue of approximately \$1.2 million in 2008 and \$0.3 million in 2009. In 2006, in response to a fare war commenced by a competitor, Island Air requested a reduction in lease rent payments by a deferral of 5 months lease rent totaling \$260,000 which was approved by our Board of Directors. Further rent deferrals were approved by the Board of Directors in 2007 through September 2007, totaling \$816,000. All deferrals were accounted for as a reduction in lease revenue in the applicable period. After taking into account the deferred amounts, Island Air remains current on all obligations. Our leases with Island Air are currently being restructured and amended. During the difficult period in Hawaii involving uneconomic fares being charged by a competitor, Island Air, in an effort to conserve cash, deferred maintenance on engines leased by the Company. Due to concern regarding Island Air's ability to meet lease return conditions and after reviewing the current maintenance status and condition of the leased assets, the Company recorded a reduction in the carrying value of these assets of \$0.8 million in the second quarter. After this write down, the aircraft and engines on lease to Island Air have a net book value of \$6.9 million at June 30, 2008.

We entered into a Consignment Agreement dated May 26, 2006, with J.T. Power LLC ( J.T. Power ), an entity whose majority shareholder, Austin Willis, is the son of our President and Chief Executive Officer, and directly and indirectly, a shareholder of ours. On January 22, 2008, we entered into a Consignment Agreement with J.T. Power in which they are responsible to market and sell parts from the teardown of three engines with a book value of \$4.2 million. During the six months ended June 30, 2008, sales of consigned parts under these agreements were \$0.9 million. The book value for the parts consigned to J.T. Power as of June 30, 2008 was \$3.7 million. On July 27, 2006, we entered into an Aircraft Engine Agency Agreement with J.T. Power, LLC, in which we will, on a non-exclusive basis, provide engine lease opportunities with respect to available spare engines at J.T. Power. J.T. Power will pay us a fee based on a percentage of the rent collected by J.T. Power for the duration of the lease including renewals thereof. We earned revenue of \$33,000 during the six months ended June 30, 2008 and paid no commissions under this program.

**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").

**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 2007 Form 10-K.

**Results of Operations**

*Three months ended June 30, 2008, compared to the three months ended June 30, 2007:*

*Lease Rent Revenue.* Lease rent revenue for the quarter ended June 30, 2008 increased 22.8% to \$26.2 million from \$21.4 million for the comparable period in 2007. This increase primarily reflects growth in the size of the lease portfolio which translated into a higher amount of equipment on lease. The aggregate of net book value of lease equipment at June 30, 2008 and 2007, was \$786.8 million and \$647.6 million, respectively, an increase of 21.5%. The average utilization for the quarter ended June 30, 2008 was 96%, the same rate for the comparable period in the prior year. At June 30, 2008 and 2007, approximately 96% and 94% respectively of equipment held for lease by book value were on-lease.

During the quarter ended June 30, 2008, we added \$44.1 million of equipment and capitalized costs to the lease portfolio. During the quarter ended June 30, 2007, we added \$29.8 million of equipment and capitalized costs to the lease portfolio.

Table of Contents

*Maintenance Reserve Revenue.* Our maintenance reserve revenue for the quarter ended June 30, 2008, increased 15.3% to \$9.5 million from \$8.3 million for the comparable period in 2007. This increase primarily reflects growth in the size of the lease portfolio which translated into a higher amount of equipment on lease.

*Gain on Sale of Leased Equipment.* During the quarter ended June 30, 2008, we sold two helicopters and other related equipment generating a net gain of \$1.3 million. During the quarter ended June 30, 2007, we sold one engine and other related equipment generating a net gain of \$1.2 million.

*Other Income.* Our other income consists primarily of management fee income and lease administration fees. During the quarter ended June 30, 2008, we received fees related to the brokering of an engine for lease on behalf of an airline.

*Depreciation Expense.* Depreciation expense increased 14.3% to \$9.1 million for the quarter ended June 30, 2008 from the comparable period in 2007, due to increased lease portfolio value and changes in estimates of useful life and residual values on certain older engine types.

*Write-down of Equipment.* Write-down of equipment to their estimated fair values totaled \$1.8 million for the quarter ended June 30, 2008 compared to \$2.1 million in the year ago period. In the quarter, management decided to consign seven engines for part out and sale. Of the seven engines, the net book value for two engines exceeded the expected net proceeds to be received through part sales arising from consignment, resulting in a write-down of \$1.0 million in the quarter. We also recorded a write-down of \$0.8 million in the quarter ended June 30, 2008 for aircraft and engines that are leased to Island Air, a related party, after reviewing the current maintenance status and condition of these leased assets. During the quarter ended June 30, 2007, we recorded a write-down of equipment of \$2.1 million due to management's decision to consign four engines for part out and sale.

*General and Administrative Expenses.* General and administrative expenses increased 23.9% to \$7.3 million for the quarter ended June 30, 2008, from the comparable period in 2007, mainly due to increased personnel related costs and selling expenses as well as increased legal and accounting fees.

*Net finance costs.* Net finance costs include interest expense and interest income. Interest expense increased 4.0% to \$9.6 million for the quarter ended June 30, 2008, from the comparable period in 2007, due to an increase in average debt outstanding for the quarter ended June 30, 2008, from the comparable period in 2007, which was partially offset by a decrease in interest rates. Notes payable balance at June 30, 2008 and 2007, was \$599.0 million and \$495.2 million, respectively, an increase of 21.0%. At June 30, 2008 and 2007, one-month LIBOR was 2.46% and 5.32%, respectively. Interest income decreased 51.7% to \$0.4 million for the quarter ended June 30, 2008, from the comparable period in 2007, due to a decrease in restricted cash balances and interest rates.

*Income Taxes.* Income tax expense for the quarters ended June 30, 2008 and 2007, was \$3.7 million and \$2.5 million, respectively. The effective tax rate for the quarters ended June 30, 2008 and 2007, was 36.6% and 36.3%, respectively.

*Six months ended June 30, 2008, compared to the six months ended June 30, 2007:*

*Lease Rent Revenue.* Lease rent revenue for the six months ended June 30, 2008 increased 25.2% to \$51.0 million from \$40.8 million for the comparable period in 2007. This increase primarily reflects growth in the size of the lease portfolio which translated into a higher amount of equipment on lease as well as higher utilization of lease assets. The aggregate of net book value of lease equipment at June 30, 2008 and 2007, was \$786.8 million and \$647.6 million, respectively, an increase of 21.5%. The average utilization for the six months ended June 30, 2008 was 96% compared to 94% in the prior year. At June 30, 2008 and 2007, approximately 96% and 94% respectively of equipment held for lease by book value were on-lease.

During the six months ended June 30, 2008, we added \$80.4 million of equipment and capitalized costs to the lease portfolio. During the six months ended June 30, 2007, we added \$64.2 million of equipment and capitalized costs to the lease portfolio.

*Maintenance Reserve Revenue.* Our maintenance reserve revenue for the six months ended June 30, 2008, increased 1.8% to \$15.8 million from \$15.5 million for the comparable period in 2007. This increase primarily reflects growth in the size of the lease portfolio which translated into a higher amount of equipment on lease. This increase was partially offset by the termination of 6 long term leases in the six months ended June 30, 2008 compared with the termination of 9 long term leases in the year ago period.

*Gain on Sale of Leased Equipment.* During the six months ended June 30, 2008, we sold two helicopters and other related equipment generating a net gain of \$1.3 million. During the six months ended June 30, 2007, we sold two engines and other related equipment generating a net gain of \$1.3 million.

*Other Income.* Our other income consists primarily of management fee income and lease administration fees. Other income for the six months ended June 30, 2008 increased 174% or \$0.9 million to \$1.4 million from \$0.5 million for the comparable period in 2007. The increase was due to the settlement of a claim in the first quarter of 2008 for \$975,000 to resolve a litigation arising from a lessee default.

*Depreciation Expense.* Depreciation expense increased 23.2% to \$17.7 million for the six months ended June 30, 2008 from the comparable period in 2007, due to increased lease portfolio value and changes in estimates of useful life and residual values on certain older engine types.





Table of Contents

*Write-down of Equipment.* Write-down of equipment to their estimated fair values totaled \$1.8 million for the six months ended June 30, 2008 compared to \$2.1 million in the year ago period. In the second quarter of 2008, management decided to consign seven engines for part out and sale. Of the seven engines, the net book value for two engines exceeded the expected net proceeds to be received through part sales arising from consignment, resulting in a write-down of \$1.0 million. We also recorded a write-down of \$0.8 million in the second quarter of 2008 for aircraft and engines that are leased to Island Air, a related party, after reviewing the current maintenance status and condition of these leased assets. During the six months ended June 30, 2007, we recorded a write-down of equipment of \$2.1 million due to management's decision in the second quarter of 2007 to consign four engines for part out and sale.

*General and Administrative Expenses.* General and administrative expenses increased 15.2% to \$13.6 million for the six months ended June 30, 2008, from the comparable period in 2007, mainly due to increased personnel related costs and selling expenses which were partially offset by lower technical services costs.

*Net finance costs.* Net finance costs include interest expense and interest income. Interest expense increased 7.6% to \$19.4 million for the six months ended June 30, 2008, from the comparable period in 2007, due to an increase in average debt outstanding for the six months ended June 30, 2008, from the comparable period in 2007, which was partially offset by a decrease in interest rates. Notes payable balance at June 30, 2008 and 2007, was \$599.0 million and \$495.2 million, respectively, an increase of 21.0%. At June 30, 2008 and 2007, one-month LIBOR was 2.46% and 5.32%, respectively. Interest income decreased 39.6% to \$1.1 million for the six months ended June 30, 2008, from the comparable period in 2007, due to a decrease in restricted cash balances and interest rates.

*Income Taxes.* Income tax expense for the six months ended June 30, 2008 and 2007, was \$7.0 million and \$5.0 million, respectively. The effective tax rate for the six months ended June 30, 2008 and 2007 was 37.6% and 36.4%, respectively. The change in effective tax rate was due primarily to a decrease in the estimated amount of benefit obtained under the Extraterritorial Income Exclusion as a percentage of pretax income in 2008 compared to 2007.

Table of Contents

**Recent Accounting Pronouncements**

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*, which modifies the accounting for business acquisitions. SFAS No. 141R requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction and establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed in a business combination. Certain provisions of this standard will, among other things, impact the determination of acquisition-date fair value of consideration paid in a business combination (including contingent consideration); exclude transaction costs from acquisition accounting; and change accounting practices for acquired contingencies, acquisition-related restructuring costs, in-process research and development, indemnification assets, and tax benefits. SFAS No. 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company presently does not expect the adoption of SFAS No. 141R to have an effect on its financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, an amendment of ARB No. 51, which establishes new standards governing the accounting for and reporting of noncontrolling interests in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for financial statements issued for the fiscal year beginning on or after December 15, 2008, and interim periods within those fiscal years. The Company presently does not expect the adoption of SFAS No. 160 to have an effect on its financial statements.

In March 2008, the FASB issued Statement No. 161, *Disclosures about Derivatives Instruments and Hedging Activities* ( SFAS 161 ), an amendment of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* ( SFAS 133 ). SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures stating how and why an entity uses derivative instruments; how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations; and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS 161 requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS 161 also encourages but does not require comparative disclosures for earlier periods at initial adoptions. We are currently evaluating the impact that the adoption of SFAS 161 will have on our financial statements.

**Liquidity and Capital Resources**

Historically, we have financed our growth through borrowings secured by our equipment lease portfolio. Cash of approximately \$322.9 million and \$49.6 million, in the six-month periods ended June 30, 2008 and 2007, respectively, was derived from this activity. In these same time periods \$291.2 million and \$19.9 million, respectively, was used to pay down related debt. Cash flow from operating activities provided \$23.7 million and \$15.5 million in the six-month periods ended June 30, 2008 and 2007, respectively. Cash flow from the release of restricted cash provided \$10.5 million and \$11.2 million in the six month-periods ended June 30, 2008 and 2007, respectively, which is available to fund future equipment purchases.

Our primary use of funds is for the purchase of equipment for lease. Purchases of equipment (including capitalized costs) totaled \$86.5 million and \$61.7 million for the six-month periods ended June 30, 2008 and 2007, respectively.

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

Cash flows from operations are driven significantly by payments made under our lease agreements, which comprise lease revenue and maintenance reserves, and are offset by general and administrative expenses and interest expense. Note that cash received from reserves arrangements for some of our engines on lease are restricted per our debt arrangements. The lease revenue stream, in the short-term, is at fixed rates while virtually all 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. Revenue and maintenance reserves are also affected by the amount of equipment off lease. Approximately 96%, by book value, of our assets were on-lease at June 30, 2008, compared to approximately 94% at June 30, 2007, and the average utilization rate for the six-month period ended June 30, 2008, was 96% compared to 94% in the prior year. 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 June 30, 2008, notes payable consists of loans totaling \$599.0 million payable over periods of two months to 15 years with interest rates varying between approximately 3.7% and 8.5% (excluding the effect of our interest rate derivative instruments). The significant facilities are described below.

Table of Contents

At June 30, 2008, we had a \$289.0 million revolving credit facility to finance the acquisition of aircraft engines for lease as well as for general working capital purposes. As of June 30, 2008, \$129.5 million was available under this facility. The revolving facility was amended on June 7, 2007, and the revolving period ends in June 2009 with a final maturity in June 2010. The interest rate on this facility at June 30, 2008 was LIBOR plus 1.75%. Under the revolving credit facility, all subsidiaries except WEST Engine Funding LLC jointly and severally guarantee payment and performance of the terms of the loan agreement. The maximum guarantee is \$289.0 million plus any accrued and unpaid interest, fees or reimbursements but is limited at any given time to the sum of the principal outstanding plus accrued interest and fees. The guarantee would be triggered by a default under the agreement.

At June 30, 2008, we had \$386.2 million of WEST term notes and \$31.0 million of WEST warehouse notes outstanding. The term notes are divided into \$155.1 million Series 2005-A1 notes, \$22.8 million Series 2005-B1 notes and \$208.3 million Series 2008-A1 notes. At June 30, 2008, interest on the Series 2005-A1 notes is one-month LIBOR plus a margin of 1.25%. At June 30, 2008, interest on the Series 2005-B1 notes is one-month LIBOR plus a margin of 3.00% and a supplemental margin of 3.00%, for a total margin of 6.00%. At June 30, 2008, interest on the Series 2008-A1 notes is one-month LIBOR plus a margin of 1.50%.

The sale of \$212.4 million of Series 2008-A1 notes and \$20.3 million of Series 2008-B1 notes closed on March 28, 2008. At the closing, WEST agreed to acquire 11 engines from us directly. As a result of the transfer of engines from us to WEST, we no longer have access to these engines and they are managed to repay the note holders of WEST and for us as the equity holder of WEST. These transactions did not change the book value of the engines in the consolidated financial statements. We used these funds net of a \$2.9 million discount on the Series 2008-A1 notes to pay off the balance remaining of the Series 2005-A2 and B2 notes of \$164.1 million, pay off \$62.0 million of our indebtedness related to the transfer of 11 engines from us to WEST, pay transaction expenses of approximately \$3.2 million and received cash of approximately \$0.5 million for general corporate purposes. Interest on the Series 2008-A1 and B1 notes is one-month LIBOR plus a margin of 1.50% and 3.50%, respectively. The Series 2008-A1 term notes expected maturity is March 2021 and the Series 2008-B1 term notes expected maturity is March 2023.

From March 28, 2008 to June 30, 2008, our investment banker, acting as our agent to sell the notes, was the holder of \$20.3 million of the Series 2008-B1 notes. On June 30, 2008, we secured a \$20 million senior term loan and used the loan proceeds to re-purchase the Series 2008-B1 from our investment banker. The Series 2008-B1 notes were pledged as collateral for the \$20 million senior term loan. The loan is for a term of two years with maturity on July 1, 2010 and is structured as a bullet loan with no amortization with all amounts due at maturity. The interest rate for the term loan is one month LIBOR plus 3.50%. Our investment banker will continue to market the Series 2008-B1 notes and in the event the Series 2008-B1 notes are placed with an investor within the next two years, the term loan will be repaid with the proceeds from the sale of the Series 2008-B1 notes.

On December 13, 2007, we closed on a new \$200.0 million warehouse facility within WEST, consisting of \$175.0 million of Series 2007-A2 notes and \$25.0 million of Series 2007-B2 notes. At June 30, 2008, \$169.0 million was available under these warehouse notes. The 2007 series warehouse notes allow for borrowings during a three-year term, after which it is expected that they will be converted to term notes of WEST. Interest on the Series 2007-A2 notes and B2 notes is one-month LIBOR plus a margin of 1.25% and 2.75%, respectively. The facility has a committed amount of \$200.0 million. The Series 2007-A2 notes mature approximately December 2020 and the Series 2007-B2 notes mature approximately December 2022.

Following the sale of two Bell 412 EP helicopters on May 8, 2008, we repaid the Export Development Canada credit facility in the amount of \$13.6 million.

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

The assets of WEST, WEST Engine Funding and any associated Owner Trust are not available to satisfy the obligations of ours or any of our affiliates. WEST is consolidated for financial statement presentation purposes.

At June 30, 2008 and December 31, 2007, we had warehouse and revolving credit facilities totaling approximately \$489.0 million and \$660.4 million, respectively. At June 30, 2008, and December 31, 2007, respectively, approximately \$298.5 million and \$300.0 million were available under these combined facilities. Included in the \$298.5 million available at June 30, 2008 is \$129.5 million available under the revolving credit facility that ends in June 2009, with a final maturity in June 2010.

At June 30, 2008 and December 31, 2007, one-month LIBOR was 2.46% and 4.60%, respectively.

Table of Contents

Approximately \$596.7 million of the above debt is subject to our continuing to comply 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, we can typically borrow 70% to 83% of an engine purchase and 50% to 85% of an aircraft or spare parts purchase under these facilities. We must have other funds available 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. 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, debt is secured by engines on lease to customers and to the extent that engines are returned from lease early or are sold, repayment of that portion of the debt could be accelerated. We were in compliance with all covenants at June 30, 2008.

Approximately \$34.4 million of our debt is repayable during the next year. Such repayments consist of scheduled installments due under term loans. The table below summarizes our contractual commitments at June 30, 2008.

	Total	Payment due by period			
		Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long-term debt obligations	\$ 603,209	\$ 34,393	\$ 247,318	\$ 72,360	\$ 249,138
Interest payments under long - term debt obligations	125,593	24,656	37,223	23,353	40,361
Operating lease obligations	3,460	541	975	1,036	908
Purchase obligations	293,101	235,764	57,337		
Total	\$ 1,025,363	\$ 295,354	\$ 342,853	\$ 96,749	\$ 290,407

We have commitments to purchase, during the remainder of 2008 and 2009, 31 engines and 3 helicopters for a gross purchase price of \$293.1 million, for delivery from July 2008 to December 2009. As at June 30, 2008, non-refundable deposits paid related to this purchase commitment were \$18.0 million.

We believe our equity base, internally generated funds and existing debt facilities are sufficient to maintain our level of operations through 2008. A decline in the level of internally generated funds, such as could result if off-lease rates increase 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 June 30, 2008, \$602.7 million of our borrowings are on a variable rate basis 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 eliminate the spread, 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.

To mitigate exposure to interest rate changes, we have entered into interest rate swap agreements, which have notional outstanding amounts of \$304.0 million, with remaining terms of between seven and forty-four months and fixed rates of between 3.46% and 5.05%.

The net cash settlements on these derivative instrument arrangements increased expense by \$2.1 million for the six month period ended June 30, 2008 and reduced expense by \$1.2 million for the six month period ended June 30, 2007. This incremental cost for the swaps effective for hedge accounting was included in interest expense for the six month period ended June 30, 2008. For further information see Note 6 to the consolidated financial statements. We will be exposed to risk in the event of non-performance of the interest rate derivative instrument counter-parties. We plan to hedge additional amounts of floating rate debt during the remainder of 2008.

#### **Related Party and Similar Transactions**

Gavarnie Holding, LLC, a Delaware Limited Liability Company ( Gavarnie ) owned by Charles F. Willis, IV, purchased the stock of Aloha Island Air, Inc., a Delaware Corporation, ( Island Air ) from Aloha AirGroup, Inc. ( Aloha ) on May 11, 2004. Mr. Willis is the President, CEO and Chairman of our Board of Directors and owns approximately 33% of our common stock as of June 30, 2008. Island Air leases four DeHaviland DHC-8-100 aircraft and two spare engines from

Table of Contents

us, under non-cancelable leases and scheduled payments in accordance with the leases will generate lease revenue of approximately \$1.2 million in 2008 and \$0.3 million in 2009. In 2006, in response to a fare war commenced by a competitor, Island Air requested a reduction in lease rent payments by a deferral of 5 months lease rent totaling \$260,000 which was approved by our Board of Directors. Further rent deferrals were approved by the Board of Directors in 2007 through September 2007, totaling \$816,000. All deferrals were accounted for as a reduction in lease revenue in the applicable period. After taking into account the deferred amounts, Island Air remains current on all obligations. Our leases with Island Air are currently being restructured and amended. During the difficult period in Hawaii involving uneconomic fares being charged by a competitor, Island Air, in an effort to conserve cash, deferred maintenance on engines leased by the Company. Due to concern regarding Island Air's ability to meet lease return conditions and after reviewing the current maintenance status and condition of the leased assets, the Company recorded a reduction in the carrying value of these assets of \$0.8 million in the second quarter. After this write down, the aircraft and engines on lease to Island Air have a net book value of \$6.9 million at June 30, 2008.

We entered into a Consignment Agreement dated May 26, 2006, with J.T. Power LLC ( J.T. Power ), an entity whose majority shareholder, Austin Willis, is the son of our President and Chief Executive Officer, and directly and indirectly, a shareholder of ours. On January 22, 2008, we entered into a Consignment Agreement with J.T. Power in which they are responsible to market and sell parts from the teardown of three engines with a book value of \$4.2 million. During the six months ended June 30, 2008, sales of consigned parts under these agreements were \$0.9 million. The book value for the parts consigned to J.T. Power as of June 30, 2008 was \$3.7 million. On July 27, 2006, we entered into an Aircraft Engine Agency Agreement with J.T. Power, LLC, in which we will, on a non-exclusive basis, provide engine lease opportunities with respect to available spare engines at J.T. Power. J.T. Power will pay us a fee based on a percentage of the rent collected by J.T. Power for the duration of the lease including renewals thereof. We earned revenue of \$33,000 during the six months ended June 30, 2008 and paid no commissions under this program.

**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 to us, 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. Approximately \$602.7 million or virtually all of our outstanding debt is variable rate debt. We estimate that for every one percent increase or decrease in interest rates on our variable rate debt (net of derivative instruments), annual interest expense would increase or decrease \$3.0 million (in 2007, \$2.7 million per annum).

We hedge a portion of our borrowings, effectively fixing the rate of these borrowings. This hedging activity helps protect us against getting squeezed by longer term fixed rate leases. Based on the implied forward rates for 1-month LIBOR, we expect interest expenses will be increased by approximately \$5.2 million for the year ending December 31, 2008, as a result of our hedges. Such hedging activities may limit our ability to participate in the benefits of any decrease in interest rates, but may also protect us from increases in interest rates. Furthermore, since lease rates tend to vary with interest rate levels, it is possible that we can adjust lease rates for the effect of change in interest rates at the termination of leases. Other financial assets and liabilities are at fixed rates.

We are also exposed to currency devaluation risk. During the six-month period ended June 30, 2008, 80% of our total lease revenues came from non-United States domiciled lessees. All of our leases require payment in US dollars. If these lessees' currency devalues against the US dollar, the lessees could potentially encounter difficulty in making their lease payments.

**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.

Table of Contents

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 June 30, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

**Item 5. Exhibits**

(a) Exhibits

**EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
3.1	Certificate of Incorporation, dated March 12, 1998 together with Certificate of Amendment of Certificate of Incorporation, dated May 6, 1998 (incorporated by reference to Exhibits 4.01 and 4.02 on Form 8-K filed on June 23, 1998, SEC File No. 000-28774).
3.2	Bylaws, dated April 18, 2001 (incorporated by reference to Exhibit 3.2 on Form 10-K filed on March 31, 2005).
3.3	Amendment to Bylaws, dated November 13, 2001 (incorporated by reference to Exhibit 3.3 on Form 10-K filed on March 31, 2005).
4.1	Specimen of Series A Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 on 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 Preferred Stock (incorporated by reference to Exhibit 4.2 on Form S-1 Registration Statement Amendment No. 2 filed on January 27, 2006).
10.1	Form of Indemnification Agreement entered into between the Company and its directors and officers (incorporated by reference to Exhibit 10.3 to Registration Statement No. 333-5126-LA filed on June 21, 1996).
10.4	Our 1996 Stock Option/Stock Issuance Plan, as amended and restated as of March 1, 2003 (incorporated by reference to Exhibit 99.1 of our Form S-8 filed on September 26, 2003).
10.5	Employment Agreement between the Company and Charles F. Willis IV dated November 7, 2000 (incorporated by reference to Exhibit 10.2 of our report on Form 10-K for the year ended December 31, 2000).
10.6	

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

- Employment Agreement between the Company and Donald A. Nunemaker dated November 21, 2000 (incorporated by reference to Exhibit 10.3 of our report on Form 10-K for the year ended December 31, 2000).
- 10.8 Employment Agreement between the Company and Thomas C. Nord dated September 19, 2005 (incorporated by reference to Exhibit 10.1 to our report on Form 8-K filed on September 23, 2005).
- 10.12 Eighth Amendment to the Note Purchase Agreement, dated as of May 3, 2002, by and among the Company, WLFC Funding Corporation and Variable Funding Capital Corporation (incorporated by reference to Exhibit 10.24 to our report on Form 10-Q for the quarter ended June 30, 2002).
- 10.13 Class A Note Purchase Agreement among Willis Engine Funding LLC, the Company, Sheffield Receivables Corporation and Barclay's Bank PLC dated as of September 12, 2002 (incorporated by reference to Exhibit 10.29 to our report on Form 10-Q for the quarter ended September 30, 2002).
- 10.14 Class B Note Purchase Agreement among Willis Engine Funding LLC, the Company, Fortis Bank (Nederland) N.V., and Barclay's Bank PLC dated as of September 12, 2002 (incorporated by reference to Exhibit 10.30 to our report on Form 10-Q for the quarter ended September 30, 2002).
- 10.29\* Amended and Restated Credit Agreement, dated as of June 29, 2004 among Willis Lease Finance Corporation, and Certain Banking Institutions Named Herein with National City Bank and Fortis Bank (Nederland) N.V. (incorporated by reference to Exhibit 10.39 of our Form 10-Q for the quarter ended June 30, 2004).
- 10.30 First Amendment to Amended and Restated Credit Agreement dated as of September 24, 2004 among the Company, National City Bank, Fortis Bank (Nederland) N.V. and CDC Finance CDC IXIS (incorporated by reference to Exhibit 10.41 of our Form 10-Q for the quarter ended September 30, 2004).
- 10.32 Loan and Aircraft Security Agreement dated October 29, 2004 between Fleet Capital Corporation and Willis Lease Finance Corporation (incorporated by reference to Exhibit 10.42 of our report in Form 10-K for the year ended December 31, 2004).

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

### Table of Contents

- 10.34 Amendment No. 1 to Loan and Aircraft Security Agreement dated as of December 9, 2004 between Fleet Capital Corporation and Willis Lease Finance Corporation (incorporated by reference to Exhibit 10.44 of our report in Form 10-K for the year ended December 31, 2004).
- 10.37\* Asset Transfer Agreement, dated as of August 9, 2005, among the Company, Willis Engine Securitization Trust, and WEST Engine Funding LLC (incorporated by reference to Exhibit 10.34 of our report in Form 10-Q filed on November 29, 2005).
- 10.38 Series A1 Note Purchase Agreement, dated as of July 28, 2005, among the Company, Willis Engine Securitization Trust, UBS Securities LLC and UBS Limited (incorporated by reference to Exhibit 10.35 of our report in Form 10-Q filed on November 29, 2005).
- 10.39 Series 2005 B1 Note Purchase Agreement, dated as of August 9, 2005, among the Company, Willis Engine Securitization Trust, Fortis Capital and HSH Nordbank AG (incorporated by reference to Exhibit 10.36 of our report in Form 10-Q filed on November 29, 2005).
- 10.40\* Series A2 Note Purchase Agreement, dated as of August 9, 2005, among the Company, Willis Engine Securitization Trust, Fortis Capital and HSH Nordbank AG (incorporated by reference to Exhibit 10.37 of our report in Form 10-Q filed on November 29, 2005).
- 10.41\* Series B2 Note Purchase Agreement, dated as of August 9, 2005 among the Company, Willis Engine Securitization Trust, Fortis Capital and HSH Nordbank AG (incorporated by reference to Exhibit 10.38 of our report in Form 10-Q filed on November 29, 2005).
- 10.42\* Indenture, dated August 9, 2005, by and between Willis Engine Securitization Trust and Deutsche Bank Trust Company Americas (incorporated by reference to Exhibit 10.39 of our report in Form 10-Q filed on November 29, 2005).
- 10.43 Series A1 Indenture Supplement, dated August 9, 2005, by and between Willis Engine Securitization Trust and Deutsche Bank Trust Company Americas (incorporated by reference to Exhibit 10.40 of our report in Form 10-Q filed on November 29, 2005).
- 10.44 Series B1 Indenture Supplement, dated August 9, 2005, by and between Willis Engine Securitization Trust and Deutsche Bank Trust Company Americas (incorporated by reference to Exhibit 10.41 of our report in Form 10-Q filed on November 29, 2005).
- 10.45\* Series A2 Indenture Supplement, dated August 9, 2005, by and between Willis Engine Securitization Trust and Deutsche Bank Trust Company Americas (incorporated by reference to Exhibit 10.42 of our report in Form 10-Q filed on November 29, 2005).
- 10.46\* Series B2 Indenture Supplement, dated August 9, 2005, by and between Willis Engine Securitization Trust and Deutsche Bank Trust Company Americas (incorporated by reference to Exhibit 10.43 of our report in Form 10-Q filed on November 29, 2005).
- 10.47 Servicing Agreement, dated as of August 9, 2005, among the Company, Willis Engine Securitization Trust, WEST Engine Funding and 59 engine owning trusts named therein (incorporated by reference to Exhibit 10.44 of our report in Form 10-Q filed on November 29, 2005).
- 10.48 Administrative Agency Agreement, dated as of August 9, 2005, among the Company, Willis Engine Securitization Trust, WEST Engine Funding and 59 engine owning trusts named therein (incorporated by reference to Exhibit 10.45 of our report in Form 10-Q filed on November 29, 2005).
- 10.49 Limited Liability Company Agreement of WOLF A340 LLC, dated as of December 8, 2005, between Oasis International Leasing (USA), Inc. and the Company (incorporated by reference to Exhibit 10.49 on Form S-1 Registration Statement Amendment No. 1 filed on January 9, 2006).
- 10.50 Sale and Purchase Agreement (139), dated as of December 9, 2005, between Boeing Aircraft Holding Company and WOLF A340 LLC (incorporated by reference to Exhibit 10.50 on Form S-1 Registration Statement Amendment No. 1 filed on January 9, 2006).
- 10.51 Sale and Purchase Agreement (149), dated as of December 9, 2005, between Boeing Aircraft Holding Company and WOLF A340 LLC (incorporated by reference to Exhibit 10.51 on Form S-1 Registration Statement Amendment No. 1 filed on January 9, 2006).
- 10.52\* Second Amended and Restated Credit Agreement, dated as of June 30, 2006 among Willis Lease Finance Corporation, and Certain Banking Institutions named therein with National City Bank and Fortis Bank (Nederland) N.V. (incorporated by reference to Exhibit 10.52 of our report in Form 10-Q filed on August 14, 2006).
- 10.54 Employment Agreement between the Company and Lee G. Beaumont dated February 20, 2007 (incorporated by reference to Exhibit 10.1 of our report on Form 8-K filed on February 21, 2007).
- 10.55 Employment Agreement between the Company and Bradley S. Forsyth February 20, 2007 (incorporated by reference to Exhibit 10.2 of our report on Form 8-K filed on February 21, 2007).
- 10.56 Stock Purchase Agreement dated as of December 8, 2006 between FlightTechnics LLC as the Seller and the Company as the Buyer (incorporated by reference to our report on Form 10-K filed on April 2, 2007).
- 10.57 2007 Stock Incentive Plan (incorporated by reference to our Proxy statement for 2007 Annual Meeting of Stockholders filed on April 30, 2007).



Table of Contents

10.58	Second Amendment to Second Amended and Restated Credit Agreement, dated as of June 7, 2007 among Willis Lease Finance Corporation, National City Bank and Certain Banking Institutions (incorporated by reference to Exhibit 10.58 to our report on Form 10-Q filed on August 13, 2007).
10.59	Series 2007-A2 Note Purchase and Loan Agreement dated as of December 13, 2007, among Willis Engine Securitization Trust, Willis Lease Finance Corporation and the initial Series 2007-A2 Holders (incorporated by reference to Exhibit 10.59 to our report on Form 10-K filed on March 31, 2008).
10.60	Series 2007-B2 Note Purchase and Loan Agreement dated as of December 13, 2007 among Willis Engine Securitization Trust, Willis Lease Finance Corporation and the initial Series 2007-B2 Holders (incorporated by reference to Exhibit 10.60 to our report on Form 10-K filed on March 31, 2008).
11.1	Statement re Computation of Per Share Earnings
14.1	Code of Ethics (incorporated by reference to our report on Form 10-K filed on March 31, 2006).
21.1	Subsidiaries of the Company (incorporated by reference to Exhibit 21.1 on Form S-1 Registration Statement filed on December 20, 2005).
31.1	Certification of Charles F. Willis, IV, pursuant to Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
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.

---

\* 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: August 12, 2008

Willis Lease Finance Corporation

By:

**/s/ Bradley S. Forsyth**

Bradley S. Forsyth  
Senior Vice President  
Chief Financial Officer  
*(Principal Accounting Officer)*