PRESCIENCE POINT
CAPITAL MANAGEMENT

AerSale Corporation

NASDAQ: ASLE

PRICE TARGET: $47

Prescience Point reiterates its Strong Buy recommendation and price target of $47 on AerSale Corporation ("ASLE" or the "Company"), a leading provider of aftermarket aircraft services and equipment, following ASLE's positive Q3 2021 earnings report. Despite the delay of key catalysts related to AerAware to early next year, the Company is still on track to generate a run-rate of around $2.00 of adjusted EPS, on a fully-diluted basis, by the end of FY 2022.

DATE OF REPORT	11/17/2021
SHARE PRICE	$17.76
52-WK HI / LOW	$9.41 / $24.20
AVG DAILY VOL	201.6K
FULLY-DILUTED MARKET CAP	$1,081.9M

Last Tuesday, AerSale Corporation ("ASLE" or "the Company") reported its Q3 2021 earnings. Although the near-term catalysts detailed in our prior report did not unfold as anticipated, we believe the earnings report was very positive as it confirmed or strengthened most of the key points of our long-term thesis. Because of this, we are even more confident in our investment in ASLE today than we were prior to the earnings release.

As we will detail in this report, although the catalysts related to AerAware have been pushed back to early next year, this "bad news" is far outweighed, in our view, by the Company providing confirmation during its Q3 earnings call that <u>receiving both FAA approval and a large initial order from its launch customer are a near certainty.</u> Additionally, although Q3 earnings fell below our expectations, this earnings miss was attributable to the inherent lumpiness of the Company's revenue from asset sales, rather than a deterioration in business fundamentals. Finally, based on the information provided in the Q3 earnings report, FY 2022 is shaping up to be a banner year for ASLE. In FY 2022, we project that the Company's run-rate adjusted EPS will more than double and reach around $2.00, on a fully-diluted basis, driven by continued growth in the core business and an initial 250 unit order for AerAware from United Airlines.

For the above reasons, we believe the recent pullback in ASLE is wholly unjustified, and as such, <u>we have not sold a single share or warrant since the release of our initial report and have been adding shares to our position in the Company since the earnings release.</u> We reiterate our Strong Buy recommendation and price target of $47, and we continue to believe that ASLE shares will eventually exceed $100 over the long-term.

FAA Approval Of AerAware Was Confirmed To Be A Near Certainty

One of the most significant and positive developments from the Q3 earnings call, which the market has seemingly overlooked, was ASLE management's comments that FAA approval of the AerAware STC for the Boeing 737 is a near certainty and that it is simply a matter of 'when' and not 'if' approval will be received:

> ASLE Management: Due to the complexity of the technology and in part due to labor constraints with our partners, the pacing item for completion of our AerAware STC continues to be software verification and validation, with expected completion before the end of February 2022. Final FAA approval should be granted shortly thereafter.
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> After three sets of initial flight testing with the FAA, **we have been verbally reassured by the FAA that our system is certifiable.** Consequently, although we're disappointed with the length of time this has taken, this is not unusual for the approval of ground breaking advanced technology. **We're highly confident it's not a matter of if rather it's only a matter of when we will receive an AerAware STC.**

We believe management's confirmation that FAA certification for AerAware is a virtual lock is a far more significant development than the delay in potential FAA approval to early next year. Although we are disappointed that the timeline for FAA approval has been pushed back, in the grand scheme of things, this has little impact on the long-term outlook for AerAware.

If AerAware is eventually approved in Q2 of next year, as management claims it is certain to be, then the Company will still be first-to-market with the only viable wearable HUD solution for the commercial airline market. Comparable HUD solutions are still several years away from hitting the market, which means that ASLE will have this huge opportunity all to itself for the foreseeable future.

A Large Initial Order For AerAware Upon FAA Approval Was Also Confirmed To Be Highly Likely

For the past several quarters, ASLE management has repeatedly indicated that it expects to receive a large order for AerAware from a major domestic airline upon receipt of FAA approval. During its Q3 earnings call, ASLE management confirmed this once again, and actually went one step further by predicting that an initial order for AerAware would be for around 250 units:

> Sellside Analyst: Okay. The other question was just on the initial orders that you might receive on the back of that [FAA] certification. Do you have a sense for how big that might be based on your conversations with the customer?

> ASLE Management: We've heard multiple times that because the FAA will require airlines to have half of its fleet with the AerAware system installed before they'll be able to use the AerAware system, that it would be half of the – that it would be a minimum of half of the existing fleet of 737 aircraft. That would be both 737 NG and 737 Max because we're working on both.
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> And a 250 aircraft order would not seem to be unreasonable. That's some number that's been bandied about already. We don't have any specifics on that as I've mentioned previously. Our conversation has been primarily with one of our -- with our potential launch customer, but we have had discussions with other airlines as well. But if our -- if the customer we've been talking to gives us a launch order. I would imagine that it would be in the 250 aircraft range.

As detailed in our prior report, due to the highly attractive unit economics of AerAware, just one large order for AerAware will be transformative for ASLE's financial performance. Assuming that the Company is able fulfill the entire 250 unit order over a 12-month timeframe, we project that this initial order, by itself, would contribute an additional $0.80 of EPS, resulting in an almost doubling of the Company's annual earnings.

PP-Estimated EPS Contribution from Initial AerAware Order

($ in millions, except unit and per share amounts)	
# of Units Delivered	250
(*) Average Selling Price	$0.4
Revenue Contribution	$100.0
Gross Profit Contribution	$65.0
% Margin	*65.0%*
Less: Incremental SG&A Expenses	($3.0)
Net Income b/f Taxes	$62.0
Less: Taxes	($13.0)
Net Income b/f Taxes	$49.0
(÷) Fully-Diluted Shares Outstanding [1]	60.9
PP-Estimated EPS Contribution From AerAware	**$0.80**

Source: Prescience Point estimates, sell-side reports, and public comments by ASLE management.
(1) Includes 17.25m public warrants and 0.718m private warrants.

We believe that ASLE's launch customer – whom we believe to be United Airlines based on flight data from FlightAware.com of the Company's AerAware test plane – will eventually have to order almost 600 AerAware units for a couple reasons. First, United currently owns 384 737s and will add more than 200 737s over the next two or three years, which will increase the total amount of 737s in its fleet to almost 600.

Second, an individual who is familiar with the FAA approval process for AerAware told us that, in addition to requiring that an operator equip half of the fleet of a specific aircraft type with AerAware before it can use the product, the FAA will also require that an operator must eventually equip its entire fleet of a specific aircraft type with AerAware. According to this individual, the reason for this requirement is that the FAA does not want pilots operating planes of a specific aircraft type that have different equipment, which could lead to potential safety issues:

> Airline Industry Professional: You have to equip your whole fleet of that type [with AerAware], and have at least half of that fleet have it installed before they will let you use it. I don't think the FAA is gonna let an airline, unless they can somehow segregate the airplanes out and say 'well this airplane has AerAware and they'll only fly over here and this one won't' because otherwise you have a non-standard fleet. And you know, airlines are made to train pilots for their standard fleet, so what's your standard?...the entire pilot fleet has to have training on that modified aircraft and the FAA is saying 'fine, you can do all that, but then your entire fleet now has to be homogenous.'

Multiple, Additional STCs Are Currently In Process For AerAware

During its Q3 earnings call, ASLE management disclosed that it is currently working on multiple, additional STCs for AerAware beyond the Boeing 737 and is in the process of engineering the integration of the product into the Airbus A318, A319, A320 and A321:

> ASLE Management: We are also installing this system into AerSale own Boeing 737-700 NG. Concurrent with the Boeing 737 NG platform we're engineering the integration of the AerAware system into the Airbus A318, 19, 20 and 21 family of aircraft.

This a very encouraging news, not only because these STCs will greatly expand the addressable market for AerAware, but also because it appears to mean that Elbit, who is providing the hardware for the AerAware system, is committed to working exclusively with ASLE and will not seek out other partners for different commercial aircraft types.

ASLE Is Projecting A Significant Rebound In Financial Performance In Q4 2021, Showing That Q3 2021 Was A Temporary Blip

ASLE's revised full-year guidance for adjusted EBITDA fell short of our expectations due to lower-than-expected results in Q3 2021. In our prior report, we projected that the Company would generate around $30m of adjusted in EBITDA in Q3. This proved to be off the mark as actual adjusted EBITDA in Q3 amounted to $13.9m.

To be frank, we are not concerned by the large shortfall in the Company's Q3 results. The reason being that this shortfall was not due to any deterioration in the fundamentals of the business. This is clearly illustrated by the fact that the Company is projecting a strong rebound in financial performance in Q4 2021. Based on the midpoint of ASLE's revised full-year adjusted EBITDA guidance of $85m and the $60.7m of adjusted EBITDA it generated through the first three quarters of FY 2021, the Company is projecting that it will generate almost $25m of adjusted EBITDA in Q4 2021.

So, why were Q3 results so much lower than we projected? As discussed in our prior report, one of the main drivers of the Company's strong growth in FY 2021 has been the ongoing sale of its fleet of converted Boeing 757 cargo planes. The timing of when the Company recognizes revenue from asset sales can be very lumpy, which can create large fluctuations in performance from quarter-to-quarter. This is what happened in Q3 as the Company sold just 3 757 cargo planes, which fell far short of our projection that the Company had sold at least 6 of these planes during the quarter.

If the Company was having trouble finding buyers for its 757s, then the lower-than-expected asset sales in Q3 would be cause for concern, but this is not the case. As disclosed by ASLE management during its Q3 earnings call, the Company already has 21 of the 24 757s in its fleet under contract or LOI, so all of these assets should be monetized over the next few quarters:

> ASLE Management: Sure we have of the 24 [757s] actually 26, we parted out two airframes…Of the remaining 24 aircraft with engines, we have under contract or LOI, 22 of those aircraft…We have 21, I'm sorry of those aircraft

The Core Business Is Poised To Further Accelerate In FY 2022

ASLE is one of the only companies in the airline industry that has actually managed to grow its business and generate record earnings in the midst of the pandemic. The midpoint of the Company's full-year adjusted EBITDA guidance of $85.0m, which does not include any contributions from AerAware, is $33.1m or 63.9% higher than the $51.9m of adjusted EBITDA it reported in FY 2020, and is $28.1m or 49.4% higher than the $56.9m of adjusted EBITDA it reported prior to the pandemic in FY 2019.

As lucrative as FY 2021 was, we expect the Company's core business to grow at an even faster pace in FY 2022 due to several major tailwinds. To begin with, in FY 2022, the Company will greatly benefit from the monetization of its remaining fleet of 757s. Based on the 5 757s that ASLE sold in Q2 2021 and Q3 2021 combined, along with our projection that an additional 6 757s will be sold in Q4 2021, we project that the Company will still have 13, or more than half, of its fleet of 757s remaining. Given that ASLE already has all but 3 of its remaining 757s under contract or LOI, we expect that all 13 of these remaining planes will be monetized during the year.

Additionally, during its Q3 earnings call, ASLE management disclosed that it is starting to see an increase in the number of aircraft available for sale at attractive prices:

> ASLE Management: I previously described the acquisition market as an incoming tide and the tide continues to come in. We're not in a flood state yet but we are seeing incrementally almost every week, or aircraft that are becoming available at pricing that starts to work for us. Now why is that? Is it because or aircraft are actually hitting the market or it's because aircraft have now been on the market for a year and a half and haven't moved and pricing is becoming more realistic to what the real market is.

> I think it's the latter. I think that more aircraft are becoming realistically priced because they're not moving in this market. So, incrementally, gradually, we continue to see more aircraft coming onto the market. We're bidding on and that we're starting to win.

If this trend continues, as management believes it will, then the Company's used aircraft purchases should pick-up significantly in FY 2022. These aircraft purchases should then, in turn, fuel further growth in the Company's core business as these assets are monetized via leasing, whole asset sales and the sale of USM parts.

Finally, the Company should also benefit from the continued recovery in domestic and international airline traffic. According to a recent Reuters article, international travel demand is expected to double next year and reach 44% of pre-pandemic levels, while domestic travel is expected to increase 20% next year and reach 93% of pre-pandemic levels. This increase in airline traffic should result in a significant increase in demand for the Company's products and services.

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