

Aircastle LTD  
Form 10-Q  
November 07, 2012  
Table of Contents

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

---

FORM 10-Q

---

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

For the quarterly period ended September 30, 2012  
or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File number 001-32959

---

AIRCASTLE LIMITED  
(Exact name of registrant as specified in its charter)

---

Bermuda 98-0444035  
(State or other jurisdiction of (IRS Employer  
incorporation or organization) Identification No.)

c/o Aircastle Advisor LLC 06902  
300 First Stamford Place, 5<sup>th</sup> Floor, Stamford, CT  
(Address of principal executive offices) (Zip Code)  
Registrant's telephone number, including area code (203) 504-1020

---

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

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

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

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

As of October 31, 2012, there were 69,743,929 outstanding shares of the registrant's common shares, par value \$0.01 per share.



Table of Contents

Aircastle Limited and Subsidiaries  
 Form 10-Q  
 Table of Contents

	Page No.
	<u>PART I. – FINANCIAL INFORMATION</u>
Item 1.	<u>Financial Statements</u>
	<u>Consolidated Balance Sheets as of December 31, 2011 and September 30, 2012</u> 3
	<u>Consolidated Statements of Operations for the three and nine months ended September 30, 2011 and 2012</u> 4
	<u>Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2011 and 2012</u> 5
	<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and 2012</u> 6
	<u>Notes to Unaudited Consolidated Financial Statements</u> 7
Item 2.	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> 25
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u> 53
Item 4.	<u>Controls and Procedures</u> 55
	<u>PART II. – OTHER INFORMATION</u>
Item 1.	<u>Legal Proceedings</u> 56
Item 1A.	<u>Risk Factors</u> 56
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 56
Item 3.	<u>Defaults Upon Senior Securities</u> 56
Item 4.	<u>Mine Safety Disclosures</u> 56
Item 5.	<u>Other Information</u> 56
Item 6.	<u>Exhibits</u> 57
	<u>SIGNATURE</u> 58

Table of Contents

## PART I. — FINANCIAL INFORMATION

## Item 1. Financial Statements

## Aircastle Limited and Subsidiaries

## Consolidated Balance Sheets

(Dollars in thousands, except share data)

	December 31, 2011	September 30, 2012 (Unaudited)
<b>ASSETS</b>		
Cash and cash equivalents	\$295,522	\$223,959
Accounts receivable	3,646	7,796
Restricted cash and cash equivalents	247,452	109,375
Restricted liquidity facility collateral	110,000	107,000
Flight equipment held for lease, net of accumulated depreciation of \$981,932 and \$1,228,052	4,387,986	4,532,445
Net investment in finance leases	—	121,533
Aircraft purchase deposits and progress payments	89,806	4,802
Other assets	90,047	162,042
<b>Total assets</b>	<b>\$5,224,459</b>	<b>\$5,268,952</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Borrowings from secured financings (including borrowings of ACS Ireland VIEs of \$295,952 and \$217,541, respectively)	\$2,535,759	\$1,828,883
Borrowings from unsecured financings	450,757	1,250,671
Accounts payable, accrued expenses and other liabilities	105,432	108,954
Lease rentals received in advance	46,105	51,666
Liquidity facility	110,000	107,000
Security deposits	83,037	87,216
Maintenance payments	347,122	372,555
Fair value of derivative liabilities	141,639	67,950
<b>Total liabilities</b>	<b>3,819,851</b>	<b>3,874,895</b>
<b>Commitments and Contingencies</b>		
<b>SHAREHOLDERS' EQUITY</b>		
Preference shares, \$.01 par value, 50,000,000 shares authorized, no shares issued and outstanding	—	—
Common shares, \$.01 par value, 250,000,000 shares authorized, 72,258,472 shares issued and outstanding at December 31, 2011; and 69,743,929 shares issued and outstanding at September 30, 2012	723	697
Additional paid-in capital	1,400,090	1,373,033
Retained earnings	191,476	162,397
Accumulated other comprehensive loss	(187,681)	(142,070)
<b>Total shareholders' equity</b>	<b>1,404,608</b>	<b>1,394,057</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$5,224,459</b>	<b>\$5,268,952</b>
The accompanying notes are an integral part of these unaudited consolidated financial statements.		



Table of Contents

Aircastle Limited and Subsidiaries  
Consolidated Statements of Operations  
(Dollars in thousands, except per share amounts)  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
<b>Revenues:</b>				
Lease rental revenue	\$ 145,890	\$ 159,547	\$ 430,361	\$ 465,413
Amortization of lease premiums, discounts and lease incentives	(4,709	) (6,838	) (10,841	) (6,392
Maintenance revenue	—	10,944	25,006	37,126
Total lease rentals	141,181	163,653	444,526	496,147
Other revenue	326	9,213	3,733	13,815
Total revenues	141,507	172,866	448,259	509,962
<b>Expenses:</b>				
Depreciation	60,132	68,413	178,299	200,024
Interest, net	48,872	54,101	150,384	167,203
Selling, general and administrative (including non-cash share based payment expense of \$1,619 and \$1,128 for the three months ended, and \$4,692 and \$3,233 for the nine months ended September 30, 2011 and 2012, respectively)	12,200	11,907	36,309	36,616
Impairment of Aircraft	1,236	78,676	6,436	88,787
Maintenance and other costs	4,045	3,926	10,944	11,943
Total expenses	126,485	217,023	382,372	504,573
<b>Other income (expense):</b>				
Gain on sale of flight equipment	8,997	11	28,958	3,062
Other	(117	) —	(153	) 604
Total other income (expense)	8,880	11	28,805	3,666
Income (loss) from continuing operations before income taxes	23,902	(44,146	) 94,692	9,055
Income tax provision	1,237	1,701	6,041	5,976
Net income (loss)	\$22,665	\$(45,847	) \$88,651	\$3,079
<b>Earnings (loss) per common share — Basic:</b>				
Net income (loss) per share	\$0.31	\$(0.65	) \$1.15	\$0.04
<b>Earnings (loss) per common share — Diluted:</b>				
Net income (loss) per share	\$0.31	\$(0.65	) \$1.15	\$0.04
Dividends declared per share	\$0.125	\$0.150	\$0.350	\$0.450

The accompanying notes are an integral part of these unaudited consolidated financial statements.



Table of Contents

## Aircastle Limited and Subsidiaries

## Consolidated Statements of Comprehensive Income (Loss)

(Dollars in thousands)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2011	2012	2011	2012
Net income (loss)	\$22,665	\$(45,847 )	\$88,651	\$3,079
Other comprehensive income, net of tax:				
Net change in fair value of derivatives, net of tax expense of \$48 and \$37 for the three months ended, and \$576 and \$465 for the nine months ended September 30, 2011 and 2012, respectively	(2,967 )	1,426	21,079	23,708
Net derivative loss reclassified into earnings	5,717	8,966	13,943	21,903
Other comprehensive income	2,750	10,392	35,022	45,611
Total comprehensive income (loss)	\$25,415	\$(35,455 )	\$123,673	\$48,690

The accompanying notes are an integral part of these unaudited consolidated financial statements.



Table of Contents

Aircastle Limited and Subsidiaries  
Consolidated Statements of Cash Flows  
(Dollars in thousands)  
(Unaudited)

	Nine Months Ended September 30,	
	2011	2012
Cash flows from operating activities:		
Net income	\$88,651	\$3,079
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	178,299	200,024
Amortization of deferred financing costs	12,394	10,082
Amortization of net lease discounts and lease incentives	10,841	6,392
Deferred income taxes	3,854	3,609
Non-cash share based payment expense	4,692	3,233
Cash flow hedges reclassified into earnings	13,943	21,903
Ineffective portion of cash flow hedges	(716	) 1,840
Security deposits and maintenance payments included in earnings	(25,262	) (36,312 )
Gain on sale of flight equipment	(28,958	) (3,062 )
Impairment of aircraft	6,436	88,787
Other	654	1,820
Changes in certain assets and liabilities:		
Accounts receivable	(1,629	) (9,180 )
Restricted cash and cash equivalents related to operating activities	6,035	—
Other assets	(3,098	) (3,278 )
Accounts payable, accrued expenses and other liabilities	(7,446	) 14,071
Lease rentals received in advance	(3,517	) 2,948
Net cash provided by operating activities	255,173	305,956
Cash flows from investing activities:		
Acquisition and improvement of flight equipment and lease incentives	(409,421	) (450,962 )
Proceeds from sale of flight equipment	318,547	54,439
Restricted cash and cash equivalents related to sale of flight equipment	—	35,762
Aircraft purchase deposits and progress payments	(96,939	) (25,155 )
Net investment in finance leases	—	(91,500 )
Collections on finance leases	—	2,041
Purchase of debt investment	—	(43,626 )
Principal repayments on debt investment	—	3,245
Other	(35	) (544 )
Net cash used in investing activities	(187,848	) (516,300 )
Cash flows from financing activities:		
Repurchase of shares	(91,402	) (30,692 )
Proceeds from term debt financings	388,894	877,100
Securitization and term debt financing repayments	(317,504	) (783,976 )
Deferred financing costs	(18,175	) (17,794 )
Restricted secured liquidity facility collateral	(36,000	) 3,000
Secured liquidity facility collateral	36,000	(3,000 )
Restricted cash and cash equivalents related to financing activities	(10,556	) 102,315
Security deposits received	17,088	11,400
Security deposits returned	(7,764	) (3,217 )

Edgar Filing: Aircastle LTD - Form 10-Q

Maintenance payments received	89,184	103,527
Maintenance payments returned	(65,608 )	(36,967 )
Payments for terminated cash flow hedges	—	(50,757 )
Dividends paid	(25,185 )	(32,158 )
Net cash (used in) provided by financing activities	(41,028 )	138,781
Net increase (decrease) in cash and cash equivalents	26,297	(71,563 )
Cash and cash equivalents at beginning of period	239,957	295,522
Cash and cash equivalents at end of period	\$266,254	\$223,959
Supplemental disclosures of cash flow information:		
Cash paid for interest, net of capitalized interest	\$130,923	\$114,538
Cash paid for income taxes	\$1,612	\$1,765
Supplemental disclosures of non-cash investing activities:		
Purchase deposits, advance lease rentals and security deposits assumed in asset acquisitions	\$267	\$18,988
Security deposits, maintenance liabilities and other liabilities settled in sale of flight equipment	\$11,066	\$7,817
Supplemental disclosures of non-cash financing activities:		
Security deposits converted to advance lease rentals	\$627	\$356
The accompanying notes are an integral part of these unaudited consolidated financial statements.		

Table of Contents

Aircastle Limited and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

September 30, 2012

Note 1. Summary of Significant Accounting Policies

Organization and Basis of Presentation

Aircastle Limited (“Aircastle,” the “Company,” “we,” “us” or “our”) is a Bermuda exempted company that was incorporated on October 29, 2004 under the provisions of Section 14 of the Companies Act of 1981 of Bermuda. Aircastle’s business is investing in aviation assets, including leasing, managing and selling commercial jet aircraft to airlines throughout the world and investing in aircraft related debt investments.

Aircastle is a holding company that conducts its business through subsidiaries. Aircastle directly or indirectly owns all of the outstanding common shares of its subsidiaries. The consolidated financial statements presented are prepared in accordance with U.S. generally accepted accounting principles (“US GAAP”). We operate in a single segment.

The accompanying consolidated financial statements are unaudited and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) for interim financial reporting and, in our opinion, reflect all adjustments, including normal recurring items, which are necessary to present fairly the results for interim periods. Operating results for the periods presented are not necessarily indicative of the results that may be expected for the entire year. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with US GAAP have been omitted in accordance with the rules and regulations of the SEC; however, we believe that the disclosures are adequate to make information presented not misleading. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011.

For the year ended December 31, 2011, we revised the presentation in our consolidated statements of cash flows to reflect the net change in restricted cash and cash equivalents from security deposits and maintenance payments as financing activities. For the nine months ended September 30, 2011, our consolidated statements of cash flows reflected the net change in restricted cash and cash equivalents from security deposits and maintenance payments as cash flows from operating activities. Therefore, the amounts included for the nine months ended September 30, 2011 have been reclassified to conform to the current period presentation.

The Company’s management has reviewed and evaluated all events or transactions for potential recognition and/or disclosure since the balance sheet date of September 30, 2012 through the date on which the consolidated financial statements included in this Form 10-Q were issued.

Principles of Consolidation

The consolidated financial statements include the accounts of Aircastle and all of its subsidiaries. Aircastle consolidates eight Variable Interest Entities (“VIEs”) of which Aircastle is the primary beneficiary. All intercompany transactions and balances have been eliminated in consolidation.

We consolidate VIEs in which we have determined that we are the primary beneficiary. We use judgment when deciding (a) whether an entity is subject to consolidation as a VIE, (b) who the variable interest holders are, (c) the potential expected losses and residual returns of the variable interest holders, and (d) which variable interest holder is the primary beneficiary. When determining which enterprise is the primary beneficiary, we consider (1) the entity’s purpose and design, (2) which variable interest holder has the power to direct the activities that most significantly impact the entity’s economic performance, and (3) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. When certain events occur, we reconsider whether we are the primary beneficiary of VIEs. We do not reconsider whether we are a primary beneficiary solely because of operating losses incurred by an entity.

Effective January 1, 2012, the Company adopted Financial Accounting Standards Board (the “FASB”) Accounting Standards Update (“ASU”) ASU 2011-04 (“ASU 2011-04”), Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs, to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with US GAAP and IFRS. The amendments in this update change the wording used to describe the requirements in US GAAP for measuring fair value

7

---

Table of Contents

Aircastle Limited and Subsidiaries  
Notes to Unaudited Consolidated Financial Statements  
(Dollars in thousands, except per share amounts)  
September 30, 2012

and for disclosing information about fair value measurements which include (1) those that clarify the FASB's intent about the application of existing fair value measurement and disclosure requirements, and (2) those that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurement. ASU 2011-04 is effective for interim and annual reporting periods beginning after December 15, 2011. The adoption of ASU 2011-04 did not have a material impact on the Company's consolidated financial statements. Also effective January 1, 2012, the Company adopted ASU 2011-12 ("ASU 2011-12") Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. This ASU defers the ASU 2011-05 requirement that companies present reclassification adjustments for each component of accumulated other comprehensive income ("AOCI") in both net income and other comprehensive income ("OCI") on the face of the financial statements. During the deferral period, there is no requirement to separately present or disclose the reclassification adjustments into net income. The FASB expects to complete a project to reconsider the presentation requirement for reclassification adjustments in 2012. The deferral allows the FASB time to further research the matter. ASU 2011-12 is effective for interim and annual reporting periods beginning after December 15, 2011 and should be applied retrospectively. The adoption of ASU 2011-12 did not have a material impact on the Company's consolidated financial statements.

**Risk and Uncertainties**

In the normal course of business, Aircastle encounters several significant types of economic risk including credit, market, aviation industry and capital market risks. Credit risk is the risk of a lessee's inability or unwillingness to make contractually required payments and to fulfill its other contractual obligations. Market risk reflects the change in the value of derivatives and financings due to changes in interest rate spreads or other market factors, including the value of collateral underlying derivatives and financings. Aviation industry risk is the risk of a downturn in the commercial aviation industry which could adversely impact a lessee's ability to make payments, increase the risk of unscheduled lease terminations and depress lease rates and the value of the Company's aircraft. Capital market risk is the risk that the Company is unable to obtain capital at reasonable rates to fund the growth of our business or to refinance existing debt facilities.

**Use of Estimates**

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. While Aircastle believes that the estimates and related assumptions used in the preparation of the consolidated financial statements are appropriate, actual results could differ from those estimates.

**Investment in Finance Leases**

If a lease meets specific criteria at the inception of a new lease or at any lease modification date, we recognize the lease as a Net investment in finance lease on our Consolidated Balance Sheets. The net investment in finance leases consists of lease receivables, less the unearned income, plus the estimated unguaranteed residual value of the leased flight equipment at the lease end date. The unearned income is recognized as Other revenue in our Consolidated Statements of Income over the lease term in a manner that produces a constant rate of return on the Net investment in finance lease.

Collectability of finance leases is evaluated periodically on an individual customer level. The evaluation of the collectability of the finance leases considers the credit of the lessee and the value of the underlying aircraft.

Recent Unadopted Accounting Pronouncements

In August 2010, the FASB issued an exposure draft, “Leases” (the “Lease ED”), which would replace the existing guidance in the Accounting Standards Codification (“ASC”) 840 (“ASC 840”), Leases. In June 2012, the FASB decided that leases would be classified as either leases of property or leases of assets other than property. Leases of property will

8

---

Table of Contents

Aircastle Limited and Subsidiaries  
 Notes to Unaudited Consolidated Financial Statements  
 (Dollars in thousands, except per share amounts)  
 September 30, 2012

continue to use operating lease accounting. Leases of other than property would use the receivable residual approach. Under the receivable residual approach, a lease receivable would be recognized for the lessor's right to receive lease payments, a portion of the carrying amount of the underlying asset would be allocated between the right of use granted to the lessee and the lessor's residual value and profit or loss would only be recognized at commencement if it is reasonably assured. The FASB completed all of its deliberations and decided to re-expose the Lease ED in the first quarter of 2013. We anticipate that the final standard may have an effective date no earlier than 2016. When and if the proposed guidance becomes effective, it may have a significant impact on the Company's consolidated financial statements. Although we believe the presentation of our financial statements, and those of our lessees could change, we do not believe the accounting pronouncement will change the fundamental economic reasons for which the airlines lease aircraft. Therefore, we do not believe it will have a material impact on our business.

#### Note 2. Fair Value Measurements

Fair value measurements and disclosures require the use of valuation techniques to measure fair value that maximize the use of observable inputs and minimize use of unobservable inputs. These inputs are prioritized as follows:

• Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.

• Level 2: Inputs other than quoted prices included within Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities or market corroborated inputs.

• Level 3: Unobservable inputs for which there is little or no market data and which require us to develop our own assumptions about how market participants price the asset or liability.

The valuation techniques that may be used to measure fair value are as follows:

• The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

• The income approach uses valuation techniques to convert future amounts to a single present amount based on current market expectation about those future amounts.

• The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost).

The following tables set forth our financial assets and liabilities as of December 31, 2011 and September 30, 2012 that we measured at fair value on a recurring basis by level within the fair value hierarchy. Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to their fair value measurement.

	Fair Value as of December 31, 2011	Fair Value Measurements at December 31, 2011 Using Fair Value Hierarchy			
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique
Assets:					
Cash and cash equivalents	\$295,522	\$295,522	\$—	\$—	Market
Restricted cash and cash equivalents	247,452	247,452	—	—	Market
Total	\$542,974	\$542,974	\$—	\$—	

Edgar Filing: Aircastle LTD - Form 10-Q

Liabilities:

Derivative liabilities	\$ 141,639	\$—	\$ 85,410	\$ 56,229	Income
------------------------	------------	-----	-----------	-----------	--------

9

---



Table of Contents

Aircastle Limited and Subsidiaries  
Notes to Unaudited Consolidated Financial Statements  
(Dollars in thousands, except per share amounts)  
September 30, 2012

	Fair Value as of September 30, 2012	Fair Value Measurements at September 30, 2012 Using Fair Value Hierarchy			
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique
Assets:					
Cash and cash equivalents	\$223,959	\$223,959	\$—	\$—	Market
Restricted cash and cash equivalents	109,375	109,375	—	—	Market
Total	\$333,334	\$333,334	\$—	\$—	

## Liabilities:

Derivative liabilities	\$67,950	\$—	\$67,950	\$—	Income
------------------------	----------	-----	----------	-----	--------

Our cash and cash equivalents, along with our restricted cash and cash equivalents balances, consist largely of money market securities that are considered to be highly liquid and easily tradable. These securities are valued using inputs observable in active markets for identical securities and are therefore classified as Level 1 within our fair value hierarchy. Our interest rate derivatives included in Level 2 consist of United States dollar-denominated interest rate derivatives, and their fair values are determined by applying standard modeling techniques under the income approach to relevant market interest rates (cash rates, futures rates, swap rates) in effect at the period close to determine appropriate reset and discount rates and incorporates an assessment of the risk of non-performance by the interest rate derivative counterparty in valuing derivative assets and an evaluation of the Company's credit risk in valuing derivative liabilities.

On April 4, 2012, the interest rate derivatives included in Level 3 were terminated when the related hedged debt was repaid with proceeds from the Senior Notes due 2017 and the Senior Notes due 2020 (See Note 6. Securitizations and Term Debt Financings — Unsecured Debt Financings below).

The following tables reflect the activity for the classes of our assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2011 and 2012, respectively:

	Derivative Liabilities	
	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Balance at beginning of period	\$(54,526 )	\$(55,181 )
Total gains/(losses), net:		
Included in other income (expense)	(117 )	(359 )
Included in interest expense	(35 )	(74 )
Included in other comprehensive income	(5,367 )	(4,431 )
Balance at end of period	\$(60,045 )	\$(60,045 )



Table of Contents

Aircastle Limited and Subsidiaries  
 Notes to Unaudited Consolidated Financial Statements  
 (Dollars in thousands, except per share amounts)  
 September 30, 2012

	Derivative Liabilities	
	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012
Balance at beginning of period	\$—	\$(56,229 )
Total gains/(losses), net:		
Included in other income (expense)	—	599
Included in interest expense	—	73
Included in other comprehensive income	—	4,800
Settlements	—	50,757
Balance at end of period	\$—	\$—

For the three and nine months ended September 30, 2011, we had no transfers into or out of Level 3 and we had no purchases, issuances, sales or settlements of Level 3 items. For the three and nine months ended September 30, 2012, we had no transfers into or out of Level 3; however in 2012 we did terminate all Level 3 interest rate derivatives.

We measure the fair value of certain assets and liabilities on a non-recurring basis, when US GAAP requires the application of fair value, including events or changes in circumstances that indicate that the carrying amounts of assets may not be recoverable. Assets subject to these measurements include aircraft. We record aircraft at fair value when we determine the carrying value may not be recoverable. Fair value measurements for aircraft impaired are based on an income approach that uses Level 3 inputs, which include our assumptions and appraisal data as to future cash proceeds from leasing and selling aircraft.

In the three months ended June 30, 2011, we recognized an impairment of \$5,200 related to a Boeing Model 737-400 aircraft triggered by the early termination of the lease and the change to estimated future cash flows. During the third quarter of 2011, we recorded an additional impairment of \$1,236 related to this aircraft triggered by our decision to sell the aircraft, whereupon we adjusted the net book value of the aircraft to the estimated disposition value. During the three months ended June 30, 2011, we recorded \$2,267 of maintenance revenue and reversed \$878 of lease incentive accruals related to the former lessee of this aircraft.

During the second quarter of 2012, we impaired two aircraft, one Boeing Model 757-200 aircraft that we sold for less than its net book value and one Boeing Model 767-300ER aircraft which was returned to us following its scheduled lease expiration and which failed its recoverability assessment. For these two aircraft, we recorded impairment charges of \$10,111, and we recorded \$2,447 of maintenance revenue for the three months ended June 30, 2012.

As more fully described in our Annual Report on Form 10-K for the year ended December 31, 2011, we perform a recoverability assessment of all aircraft in our fleet, on an aircraft-by-aircraft basis, at least annually. We performed this recoverability assessment during the third quarter of 2012. Management develops the assumptions used in the recoverability assessment based on current and future expectations of the global demand for a particular aircraft type and historical experience in the aircraft leasing market and aviation industry, as well as information received from third party industry sources. The factors considered in estimating the undiscounted cash flows are impacted by changes in future periods due to changes in contracted lease rates, residual values, economic conditions, technology, airline demand for a particular aircraft type and other factors. In particular, many of our assumptions were driven primarily by weak market demand for older technology narrow- and wide-body model aircraft caused by slowing global economic growth rates, declining business confidence levels and higher fuel prices. In the case of Boeing 737 "Classic" aircraft, production rate increases by both Boeing and Airbus for newer generation narrowbody aircraft, coupled with slowing demand growth, is enabling more rapid replacement of earlier generation aircraft. Storage levels

for these aircraft types have increased during the last twelve months. While we believe that the estimates and related assumptions used in the recoverability assessment are appropriate, actual results could differ from those estimates.

Table of Contents

Aircastle Limited and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

September 30, 2012

Following completion of the recoverability analysis, we took the following actions:

We determined that the cash flows expected to be generated by certain of our aircraft did not support our carrying values and therefore these aircraft did not pass our recoverability assessment. As a result, we impaired four Boeing Model 767-300ER aircraft, eight Boeing 737 "Classic" aircraft, and one Airbus Model A310-300F freighter aircraft and recorded aggregate impairment charges of \$67,370 to write these aircraft down to current market values. For some of these aircraft we also shortened the expected lives and/or reduced the residual values.

For seven other aircraft that passed the recoverability assessment, we took the following steps:

Shortened the expected lives of one Airbus A330-300 aircraft, five Boeing Model 767-300ER aircraft and one McDonnell Douglas MD-11SF aircraft, primarily to reflect the specific maintenance schedule that we expect for the airframe and related engines. With weaker expected market demand for these aircraft, we believe significant further investments in these aircraft would not be justified, so we adjusted the remaining lives of these aircraft to end prior to the next expected major maintenance event and/or

In the case of Boeing Model 767-300ER aircraft, reduced the residual value to reflect our current estimates. Again, due to market conditions and the change in expected retirement rates for aircraft with similar engines and other components, we determined that scrap values were likely to fall below our previous residual expectations.

During the third quarter of 2012, we elected not to invest in engine performance restoration maintenance visits for two Airbus Model A320-200 "Classic" aircraft with older technology engines and instead agreed with the lessee to terminate the leases prior to scheduled expiry and pursue part-out sales. Following agreement with our customer to terminate the leases, these aircraft failed the recoverability assessment and we recorded impairment charges of \$11,306 and we recorded \$10,159 of maintenance revenue and reversed \$1,157 of lease incentives for the three months ended September 30, 2012, for these two aircraft.

Reducing the expected lives or anticipated residual values for aircraft in our fleet will accelerate the future depreciation on these aircraft, which will be partly offset by reduced depreciation on aircraft that we impaired. As described above, these changes in depreciation going forward will affect 22 aircraft. For these 22 aircraft, our depreciation expense will increase by approximately \$838 in the fourth quarter of 2012, as compared to the three months ended September 30, 2012. We estimate an annual increase in depreciation for these 22 aircraft for the year ended December 31, 2013, of approximately \$1,442 for these aircraft, although future depreciation is expected to decrease as these aircraft reach the end of their holding periods.

Other than the aircraft discussed above, management believes that the net book value of each aircraft is currently supported by the estimated future undiscounted cash flows expected to be generated by that aircraft, and accordingly, no other aircraft were impaired as a consequence of this recoverability assessment. In addition our lessees may face financial difficulties and return aircraft to us prior to the contractual lease expiry dates. As a result, our cash flow assumptions may change and future impairment charges may be required.

Our financial instruments, other than cash, consist principally of cash equivalents, restricted cash and cash equivalents, accounts receivable, accounts payable, amounts borrowed under financings and interest rate derivatives. The fair value of cash, cash equivalents, restricted cash and cash equivalents, accounts receivable and accounts payable approximates the carrying value of these financial instruments because of their short-term nature. The fair values of our securitizations which contain third party credit enhancements are estimated using a discounted cash flow analysis, based on our current incremental borrowing rates of borrowing arrangements that do not contain third party credit enhancements. The fair values of our ECA term financings and bank financings are estimated using a discounted cash flow analysis, based on our current incremental borrowing rates for similar types of borrowing

arrangements. The fair value of our Senior Notes is estimated using quoted market prices.

Table of Contents

Aircastle Limited and Subsidiaries  
 Notes to Unaudited Consolidated Financial Statements  
 (Dollars in thousands, except per share amounts)  
 September 30, 2012

The carrying amounts and fair values of our financial instruments at December 31, 2011 and September 30, 2012 are as follows:

	December 31, 2011		September 30, 2012	
	Carrying Amount of Asset (Liability)	Fair Value of Asset (Liability)	Carrying Amount of Asset (Liability)	Fair Value of Asset (Liability)
Securitizations and term debt financings	\$(1,873,652 )	\$(1,681,023 )	\$(1,130,965 )	\$(999,160 )
ECA term financings	(536,107 )	(524,373 )	(581,823 )	(603,439 )
Bank financings	(126,000 )	(126,000 )	(116,095 )	(120,154 )
Senior Notes	(450,757 )	(482,625 )	(1,250,671 )	(1,390,675 )

All of our financial instruments are classified as Level 2 with the exception of our Senior Notes, which are classified as Level 1.

### Note 3. Lease Rental Revenues and Flight Equipment Held for Lease

Minimum future annual lease rentals contracted to be received under our existing operating leases of flight equipment at September 30, 2012 were as follows:

Year Ending December 31,	Amount
Remainder of 2012	\$152,159
2013	569,476
2014	477,385
2015	417,623
2016	356,038
2017	246,324
Thereafter	485,645
Total	\$2,704,650

Geographic concentration of lease rental revenue earned from flight equipment held for lease was as follows:

Region	Three Months Ended September 30,				Nine Months Ended September 30,			
	2011		2012		2011		2012	
Europe	44	%	37	%	45	%	40	%
Asia and Pacific	25	%	33	%	24	%	30	%
North America	12	%	12	%	13	%	12	%
Latin America	7	%	7	%	8	%	7	%
Middle East and Africa	12	%	11	%	10	%	11	%
Total	100	%	100	%	100	%	100	%

The classification of regions in the tables above and in the table and discussion below is determined based on the principal location of the lessee of each aircraft.

For the three months ended September 30, 2011, one customer accounted for 10% of lease rental revenue and three additional customers accounted for a combined 19% of lease rental revenue. No other customer accounted for more than 5% of lease rental revenue. For the three months ended September 30, 2012, one customer accounted for 9% of lease rental revenue and four additional customers accounted for a combined 24% of lease rental revenue. No other

customer accounted for more than 5% of lease rental revenue.



Table of Contents

Aircastle Limited and Subsidiaries  
 Notes to Unaudited Consolidated Financial Statements  
 (Dollars in thousands, except per share amounts)  
 September 30, 2012

For the nine months ended September 30, 2011, one customer accounted for 11% of lease rental revenue and three additional customers accounted for a combined 18% of lease rental revenue. No other customer accounted for more than 5% of lease rental revenue. For the nine months ended September 30, 2012, one customer accounted for 10% of lease rental revenue and four additional customers accounted for a combined 25% of lease rental revenue. No other customer accounted for more than 5% of lease rental revenue.

The following table sets forth revenue attributable to individual countries representing at least 10% of total revenue (including maintenance revenue) based on each lessee's principal place of business:

Country	Three Months Ended September 30, 2011			2012		
	Revenue	Percent of Total Revenue	Number of Lessees	Revenue	Percent of Total Revenue	Number of Lessees
China	\$18,431	13 %	4	\$19,303	11 %	4
United States	14,844	10 %	4	17,685	10 %	6
Russia <sup>(1)</sup>	—	— %	—	17,472	10 %	8

(1) Total revenue attributable to Russia was less than 10% for the three months ended September 30, 2011.

Country	Nine Months Ended September 30, 2011			2012		
	Revenue	Percent of Total Revenue	Number of Lessees	Revenue	Percent of Total Revenue	Number of Lessees
United States	\$48,261	11 %	4	\$61,366	12 %	6
China	50,832	11 %	5	56,160	11 %	4
Russia <sup>(1)</sup>	—	— %	—	50,280	10 %	8

(1) Total revenue attributable to Russia was less than 10% for the nine months ended September 30, 2011.

Geographic concentration of net book value of flight equipment (includes net book value of flight equipment held for lease and net investment in finance leases) was as follows:

Region	December 31, 2011			September 30, 2012		
	Number of Aircraft	Net Book Value %		Number of Aircraft	Net Book Value %	
Europe	66	41 %		70	37 %	
Asia and Pacific	39	28 %		49	33 %	
North America	16	9 %		18	11 %	
Latin America	10	6 %		11	6 %	
Middle East and Africa	9	15 %		8	13 %	
Off-lease	4	(1) 1 %		1	(2) — %	
Total	144	100 %		157	100 %	

(1)

Edgar Filing: Aircastle LTD - Form 10-Q

Includes two Boeing Model 747-400 aircraft being converted from passenger to freighter configuration, one of these aircraft was delivered to a customer in North America in January 2012 and one was delivered to a customer in North America in April 2012; one Airbus Model A320-200 aircraft which was delivered to a customer in Europe in March, 2012, and one Boeing Model 737-400 aircraft which was sold in January 2012.

(2) One Boeing Model 767-300ER aircraft that we are marketing for lease or sale.

Table of Contents

Aircastle Limited and Subsidiaries  
 Notes to Unaudited Consolidated Financial Statements  
 (Dollars in thousands, except per share amounts)  
 September 30, 2012

The following table sets forth net book value of flight equipment (includes net book value of flight equipment held for lease and net investment in finance leases) attributable to individual countries representing at least 10% of net book value of flight equipment based on each lessee's principal place of business as of:

Country	December 31, 2011			September 30, 2012		
	Net Book Value	Net Book Value %	Number of Lessees	Net Book Value	Net Book Value %	Number of Lessees
China	\$526,008	12 %	4	\$521,715	11 %	4
Russia <sup>(1)</sup>	453,695	10 %	8	—	— %	—
United States <sup>(2)</sup>	—	— %	—	492,530	11 %	5

(1) The net book value of flight equipment attributable to Russia was less than 10% as of September 30, 2012.

(2) The net book value of flight equipment attributable to the United States was less than 10% as of December 31, 2011.

At December 31, 2011 and September 30, 2012, the amounts of lease incentive liabilities recorded in maintenance payments on the consolidated balance sheets were \$28,412 and \$20,189, respectively.

#### Note 4. Net Investment in Finance Leases

At September 30, 2012, our net investment in finance leases represents six aircraft leased to a customer in Germany and three aircraft leased to a customer in the United States. The net book value of the three aircraft leased to a customer in the United States was transferred from flight equipment held for lease to net investment in finance leases on our consolidated balance sheet during the third quarter of 2012. The following table lists the components of our net investment in finance leases at September 30, 2012:

	Amount
Total lease payments to be received	\$134,519
Less: Unearned income	(78,110 )
Estimated residual values of leased flight equipment (unguaranteed)	65,124
Net investment in finance leases	\$121,533

At September 30, 2012, minimum future lease payments on finance leases are as follows:

	Amount
Year Ending December 31,	
Remainder of 2012	\$5,730
2013	22,070
2014	21,390
2015	21,390
2016	21,390
2017	20,948
Thereafter	21,601
Total	\$134,519



Table of Contents

Aircastle Limited and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

September 30, 2012

Note 5. Variable Interest Entities

Aircastle consolidates eight VIEs of which it is the primary beneficiary. The operating activities of these VIEs are limited to acquiring, owning, leasing, maintaining, operating and, under certain circumstances, selling the 21 aircraft discussed below.

Securitizations and Term Financing

In connection with Securitization No. 1, two of our subsidiaries, ACS Aircraft Finance Ireland plc (“ACS Ireland”) and ACS Aircraft Finance Bermuda Limited (“ACS Bermuda”) issued Class A-1 notes, and each has fully and unconditionally guaranteed the other’s obligations under the notes. In connection with Securitization No. 2, two of our subsidiaries, ACS Aircraft Finance Ireland 2 Limited (“ACS Ireland 2”) and ACS 2007-1 Limited (“ACS Bermuda 2”) issued Class A-1 notes and each has fully and unconditionally guaranteed the other’s obligations under the notes. ACS Bermuda and ACS Bermuda 2 are collectively referred to as the “ACS Bermuda Group.”

Aircastle is the primary beneficiary of ACS Ireland and ACS Ireland 2 (collectively, the “ACS Ireland VIEs”), as we have both the power to direct the activities of the VIEs that most significantly impact the economic performance of such VIEs and we bear the significant risk of loss and participate in gains through Class E-1 Securities. Although Aircastle has not guaranteed the ACS Ireland VIEs debt, Aircastle wholly owns the ACS Bermuda Group which has fully and unconditionally guaranteed the ACS Ireland VIEs obligations. The activity that most significantly impacts the economic performance is the leasing of aircraft. Aircastle Advisor (Ireland) Limited (Aircastle’s wholly owned subsidiary) is the remarketing servicer and is responsible for the leasing of the aircraft. An Irish charitable trust owns 95% of the common shares of the ACS Ireland VIEs. The Irish charitable trust’s risk is limited to its annual dividend of \$2 per VIE. At September 30, 2012, the assets of the two VIEs include 12 aircraft transferred into the VIEs at historical cost basis in connection with Securitization No. 1 and Securitization No. 2.

The combined assets of the ACS Ireland VIEs as of September 30, 2012 are \$353,600. The combined liabilities of the ACS Ireland VIEs, net of \$72,068 Class E-1 Securities held by the Company, which is eliminated in consolidation, as of September 30, 2012 are \$327,127.

ECA Term Financings

Aircastle, through various subsidiaries, each of which is owned by a charitable trust (such entities, collectively the “Air Knight VIEs”), entered into ten different twelve-year term loans, which are supported by guarantees from Compagnie Francaise d’ Assurance pour le Commerce Exterieur, (“COFACE”), the French government sponsored export credit agency (“ECA”). These loans provided for the financing for ten new Airbus Model A330-200 aircraft. In June 2011, we repaid one of these loans from the proceeds of the sale of the related aircraft. At September 30, 2012, Aircastle had nine outstanding term loans with guarantees from COFACE. We refer to these COFACE-supported financings as “ECA Term Financings.”

Aircastle is the primary beneficiary of the Air Knight VIEs, as we have the power to direct the activities of the VIEs that most significantly impact the economic performance of such VIEs and we bear the significant risk of loss and participate in gains through a finance lease. The activity that most significantly impacts the economic performance is the leasing of aircraft of which our wholly owned subsidiary is the servicer and is responsible for managing the relevant aircraft. There is a cross collateralization guarantee between the Air Knight VIEs. In addition, Aircastle guarantees the debt of the Air Knight VIEs.

The only assets that the Air Knight VIEs have on their books are financing leases that are eliminated in the consolidated financial statements and deferred financing costs. The related aircraft, with a net book value as of September 30, 2012 were \$739,689, are included in our flight equipment held for lease. The consolidated debt outstanding of the Air Knight VIEs as of September 30, 2012 is \$581,823.



Table of Contents

Aircastle Limited and Subsidiaries  
 Notes to Unaudited Consolidated Financial Statements  
 (Dollars in thousands, except per share amounts)  
 September 30, 2012

## Note 6. Secured and Unsecured Debt Financings

The outstanding amounts of our secured and unsecured term debt financings were as follows:

Debt Obligation	At December	At September 30, 2012		Final Stated Maturity <sup>(2)</sup>
	31, 2011	Outstanding Borrowings	Interest Rate <sup>(1)</sup>	
Secured Debt Financings:				
Securitization No. 1	\$387,124	\$323,266	0.49%	06/20/31
Securitization No. 2	891,452	807,699	0.54%	06/14/37
Term Financing No. 1	595,076	—	—%	N/A
ECA Term Financings	536,107	581,823	2.65% to 3.96%	12/03/21 to 04/03/24
Bank Financings	126,000	116,095	4.22% to 4.57%	09/15/15 to 10/26/17
Total secured debt financings	2,535,759	1,828,883		
Unsecured Debt Financings:				
Senior Notes due 2017	—	500,000	6.75%	04/15/17
Senior Notes due 2018	450,757	450,671	9.75%	08/01/18
Senior Notes due 2020	—	300,000	7.625%	04/15/20
2010 Revolving Credit Facility	—	—	N/A	09/28/13
Total unsecured debt financings	450,757	1,250,671		
Total secured and unsecured debt financings	\$2,986,516	\$3,079,554		

(1) Reflects floating rate in effect at the applicable reset date plus the margin except for the ECA Term Financings, Bank Financings and the Senior Notes due 2017, 2018 and 2020, which are fixed rate.

(2) For Securitization No. 1 and Securitization No. 2, all cash flows available after expenses and interest is applied to debt amortization.

The following securitizations include liquidity facility commitments described in the table below:

Facility	Liquidity Facility Provider	Available Liquidity			Interest Rate on any Advances
		December 31, 2011	September 30, 2012	Unused Fee	
Securitization No. 1	Crédit Agricole Corporate and Investment Bank	\$42,000	\$42,000	0.45%	1M Libor + 1.00
Securitization No. 2	HSH Nordbank AG	66,859	65,000	0.50%	1M Libor + 0.75

## Senior Notes due 2017 and Senior Notes due 2020

In April 2012, we closed an offering of \$500,000 aggregate principal amount of 6.75% Senior Notes due 2017 (the “Senior Notes due 2017”) and \$300,000 aggregate principal amount of 7.625% Senior Notes due 2020 (the “Senior Notes due 2020”). We used the net proceeds of the private placement to repay outstanding indebtedness under our Term Financing No. 1 and the termination of the associated interest rate derivatives, and for general corporate purposes, including the purchase of aviation assets.

As of September 30, 2012, we are in compliance with all applicable covenants in all of our financings.



Table of Contents

Aircastle Limited and Subsidiaries  
 Notes to Unaudited Consolidated Financial Statements  
 (Dollars in thousands, except per share amounts)  
 September 30, 2012

## Note 7. Dividends

The following table sets forth the quarterly dividends declared by our board of directors for the periods covered in this report:

Declaration Date	Dividend per Common Share	Aggregate Dividend Amount	Record Date	Payment Date
December 6, 2010	\$0.100	\$7,964	December 31, 2010	January 14, 2011
March 8, 2011	\$0.100	\$7,857	March 31, 2011	April 15, 2011
June 27, 2011	\$0.125	\$9,364	July 7, 2011	July 15, 2011
September 14, 2011	\$0.125	\$9,035	September 30, 2011	October 14, 2011
November 7, 2011	\$0.150	\$10,839	November 30, 2011	December 15, 2011
February 17, 2012	\$0.150	\$10,865	February 29, 2012	March 15, 2012
May 2, 2012	\$0.150	\$10,847	May 31, 2012	June 15, 2012
August 1, 2012	\$0.150	\$10,464	August 31, 2012	September 14, 2012

## Note 8. Shareholders' Equity and Share Based Payment

On May 24, 2012, the Company's Board of Directors authorized the repurchase of up to \$50,000 of the Company's common shares. Under the program, the Company may purchase its common shares from time to time in the open market or in privately negotiated transactions. The amount and timing of the purchases will depend on a number of factors, including the price and availability of the Company's common shares, trading volume and general market conditions. The Company may also from time to time establish a trading plan under Rule 10b5-1 of the Securities Exchange Act of 1934 (the "Exchange Act") to facilitate purchases of its common shares under this authorization. Through September 30, 2012, we repurchased 2,500,002 shares from Fortress Investment Group and certain of its affiliates at a total cost of \$28,500 under the repurchase program and we paid no commissions on this transaction. On November 5, 2012, the Company's Board of Directors authorized an increase in the Company's share repurchase program by up to an additional \$28,500 of its common shares, bringing the total back up to \$50,000 of its common shares in the aggregate.

## Note 9. Earnings Per Share

We include all common shares granted under our incentive compensation plan which remain unvested ("restricted common shares") and contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid ("participating securities"), in the number of shares outstanding in our basic earnings per share calculations using the two-class method. We use the more dilutive of the two-class method or the treasury stock method to calculate diluted earnings per share. All of our restricted common shares are currently participating securities.

Under the two-class method, earnings per common share are computed by dividing the sum of distributed earnings allocated to common shareholders and undistributed earnings allocated to common shareholders by the weighted average number of common shares outstanding for the period. In applying the two-class method, distributed and undistributed earnings are allocated to both common shares and restricted common shares based on the total weighted average shares outstanding during the period as follows:

Table of Contents

Aircastle Limited and Subsidiaries  
Notes to Unaudited Consolidated Financial Statements  
(Dollars in thousands, except per share amounts)  
September 30, 2012

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
Weighted-average shares:				
Common shares outstanding	72,950,361	70,349,265	75,791,005	71,248,765
Restricted common shares	970,559	571,326	965,655	596,749
Total weighted-average shares	73,920,920	70,920,591	76,756,660	71,845,514
Percentage of weighted-average shares:				
Common shares outstanding	98.69	% 99.19	% 98.74	% 99.17
Restricted common shares	1.31	% 0.81	% 1.26	% 0.83
Total	100.00	% 100.00	% 100.00	% 100.00

For the three months ended September 30, 2012, the treasury stock method was used in calculating diluted earnings per share as it resulted in a more dilutive earnings per share amount.

The calculations of both basic and diluted earnings per share are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
Earnings (loss) per share – Basic:				
Net income (loss)	\$22,665	\$(45,847 )	\$88,651	\$3,079
Less: Distributed and undistributed earnings allocated to restricted common shares (a)	(298 )	369	(1,115 )	(25 )
Earnings (loss) available to common shareholders – Basic	\$22,367	\$(45,478 )	\$87,536	\$3,054
Weighted-average common shares outstanding – Basic	72,950,361	70,349,265	75,791,005	71,248,765
Earnings (loss) per common share – Basic	\$0.31	\$(0.65 )	\$1.15	\$0.04
Earnings (loss) per share – Diluted:				
Net income (loss)	\$22,665	\$(45,847 )	\$88,651	\$3,079
Less: Distributed and undistributed earnings allocated to restricted common shares(a)	(298 )	369	(1,115 )	(25 )
Earnings (loss) available to common shareholders – Diluted	\$22,367	\$(45,478 )	\$87,536	\$3,054
Weighted-average common shares outstanding – Basic	72,950,361	70,349,265	75,791,005	71,248,765
Effect of dilutive shares	—	(b) —	(b) —	(b) —
Weighted-average common shares outstanding – Diluted	72,950,361	70,349,265	75,791,005	71,248,765
Earnings (loss) per common share – Diluted	\$0.31	\$(0.65 )	\$1.15	\$0.04

(a)

Edgar Filing: Aircastle LTD - Form 10-Q

For the three months ended September 30, 2011 and 2012, distributed and undistributed earnings to restricted shares is 1.31% and 0.81%, respectively, of net income. For the nine months ended September 30, 2011 and 2012, distributed and undistributed earnings to restricted share is 1.26% and 0.83%, respectively. The amount of restricted share forfeitures for all periods present is immaterial to the allocation of distributed and undistributed earnings.

(b) For the three and nine months ended September 30, 2011 and 2012, we have no dilutive shares.

Table of Contents

Aircastle Limited and Subsidiaries  
 Notes to Unaudited Consolidated Financial Statements  
 (Dollars in thousands, except per share amounts)  
 September 30, 2012

## Note 10. Income Taxes

Income taxes have been provided for based upon the tax laws and rates in countries in which our operations are conducted and income is earned. The Company received an assurance from the Bermuda Minister of Finance that it would be exempted from local income, withholding and capital gains taxes until March 2035. Consequently, the provision for income taxes recorded relates to income earned by certain subsidiaries of the Company which are located in, or earn income in, jurisdictions that impose income taxes, primarily the United States and Ireland. The sources of income (loss) from continuing operations before income taxes for the three and nine months ended September 30, 2011 and 2012 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
U.S. operations	\$372	\$572	\$1,195	\$1,253
Non-U.S. operations	23,530	(44,718 )	93,497	7,802
Total	\$23,902	\$(44,146 )	\$94,692	\$9,055

All of our aircraft-owning subsidiaries that are recognized as corporations for U.S. tax purposes are non-U.S. corporations. These non-U.S. subsidiaries generally earn income from sources outside the United States and typically are not subject to U.S. federal, state or local income taxes unless they operate within the U.S., in which case they may be subject to federal, state and local income taxes. We also have a U.S. based subsidiary which provides management services to our non-U.S. subsidiaries and is subject to U.S. federal, state and local income taxes.

The consolidated income tax expense for the three and nine months ended September 30, 2011 and 2012 was determined based upon estimates of the Company's consolidated effective income tax rates for the years ending December 31, 2011 and 2012, respectively.

The Company's effective tax rates for the three and nine months ended September 30, 2011 were 5.2% and 6.4%, respectively, compared to (3.9)% and 66.0% for the three and nine months ended September 30, 2012, respectively. Movements in the effective tax rates are due primarily to changes in the proportion of the Company's earnings in taxable and non-tax jurisdictions. Because the geographic mix of pre-tax profits and losses in interim periods may not be reflective of full year results, this distorts our interim period effective tax rate. Additionally, the three and nine months ended September 30, 2012 includes a discrete item in the amount of \$78,676 related to the impairment of aircraft.

Differences between statutory income tax rates and our effective income tax rates applied to pre-tax income consisted of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
Notional U.S. federal income tax expense (benefit) at the statutory rate	\$8,365	\$(15,451 )	\$33,142	\$3,169
U.S. state and local income tax, net	20	37	68	86
Non-U.S. operations:				
Bermuda	(3,597 )	20,203	(19,832 )	9,439
Ireland	(1,246 )	(2,101 )	(4,167 )	(3,776 )
Other	(2,097 )	(1,051 )	(3,740 )	(3,109 )
Non-deductible expenses in the U.S.	18	71	806	183

Edgar Filing: Aircastle LTD - Form 10-Q

Other	(226	) (7	) (236	) (16	)
Income tax provision (benefit)	\$1,237	\$1,701	\$6,041	\$5,976	

20

---

Table of Contents

Aircastle Limited and Subsidiaries  
 Notes to Unaudited Consolidated Financial Statements  
 (Dollars in thousands, except per share amounts)  
 September 30, 2012

## Note 11. Interest, Net

The following table shows the components of interest, net:

	Three Months Ended		Nine Months Ended	
	September 30, 2011	2012	September 30, 2011	2012
Interest on borrowings, net settlements on interest rate derivatives, and other liabilities <sup>(a)</sup>	\$42,066	\$41,373	\$129,757	\$135,140
Hedge ineffectiveness (gains) losses	(118 )	1,474	(716 )	1,840
Amortization of interest rate derivatives related to deferred losses <sup>(b)</sup>	5,717	8,966	13,943	21,903
Amortization of deferred financing fees <sup>(c)</sup>	2,977	2,391	12,394	10,082
Interest Expense	50,642	54,204	155,378	168,965
Less interest income	(95 )	(103 )	(355 )	(447 )
Less capitalized interest	(1,675 )	—	(4,639 )	(1,315 )
Interest, net	\$48,872	\$54,101	\$150,384	\$167,203

(a) For the nine months ended September 30, 2011, includes the loan termination fee of \$3,196 related to an aircraft sold in June, 2011.

(b) For the three months ended September 30, 2011, includes accelerated amortization of deferred hedge losses in the amount of \$1,704 related to an aircraft sold in September 2011. For the nine months ended September 30, 2011, includes accelerated amortization of deferred hedge losses in the amount of \$3,543 related to two aircraft sold in 2011.

(c) For the nine months ended September 30, 2011, includes the write-off of deferred financing fees of \$2,456 related to an aircraft sold in June, 2011. For the nine months ended September 30, 2012, includes the write-off of deferred financing fees of \$2,914 related to the pay-off of Term Financing No. 1.

## Note 12. Commitments and Contingencies

At September 30, 2012, we had commitments to acquire three aircraft in the fourth quarter of 2012 for \$168,100. We no longer have any commitments to convert passenger aircraft to cargo aircraft.

## Note 13. Derivatives

The objective of our hedging policy is to adopt a risk averse position with respect to changes in interest rates. Accordingly, we have entered into a number of interest rate derivatives to hedge the current and expected future interest rate payments on our variable rate debt. Interest rate derivatives are agreements in which a series of interest rate cash flows are exchanged with a third party over a prescribed period. The notional amount on an interest rate derivative is not exchanged. Our interest rate derivatives typically provide that we make fixed rate payments and receive floating rate payments to convert our floating rate borrowings to fixed rate obligations to better match the largely fixed rate cash flows from our investments in flight equipment.

We held the following interest rate derivatives as of September 30, 2012:

Table of Contents

Aircastle Limited and Subsidiaries  
 Notes to Unaudited Consolidated Financial Statements  
 (Dollars in thousands, except per share amounts)  
 September 30, 2012

Hedged Item	Derivative Liabilities			Future Maximum Notional Amount	Floating Rate	Fixed Rate	Balance Sheet Location	Fair Value
	Current Notional Amount	Effective Date	Maturity Date					
Interest rate derivatives designated as cash flow hedges:								
Securitization No. 1	\$343,972	Jun-06	Jun-16	\$343,972	1M LIBOR + 0.27%	5.78%	Fair value of derivative liabilities	\$54,526
Securitization No. 2	611,530	Jun-12	Jun-17	611,530	1M LIBOR	1.26% to 1.28%	Fair value of derivative liabilities	13,424
Total interest rate derivatives designated as cash flow hedges	\$955,502			\$955,502				\$67,950

Four interest rate derivatives hedging Securitization No. 2 matured on June 8, 2012. The two interest rate derivatives hedging Term Financing No. 1 were terminated on April 4, 2012 resulting in a net deferred loss of \$50,429 which is being amortized into interest expense using the interest rate method.

The weighted average interest pay rates of these derivatives at December 31, 2011 and September 30, 2012 were 5.03% and 2.89%, respectively.

For the nine months ended September 30, 2012, the amount of loss reclassified from accumulated other comprehensive income ("OCI") into interest expense related to net interest settlements on active interest rate derivatives was \$40,569. The amount of loss expected to be reclassified from OCI into interest expense over the next 12 months related to net interest settlements on active interest rate derivatives is \$21,290.

Our interest rate derivatives involve counterparty credit risk. As of September 30, 2012, our interest rate derivatives are held with the following counterparties: JP Morgan Chase Bank NA, Citibank Canada NA, and Wells Fargo Bank NA. All of our counterparties or guarantors of these counterparties are considered investment grade (senior unsecured ratings of Baa2 or above) by Moody's Investors Service. All are also considered investment grade (long-term foreign issuer ratings of A- or above) by Standard and Poor's. We do not anticipate that any of these counterparties will fail to meet their obligations.

In addition to the derivative liability above, another component of the fair value of our interest rate derivatives is accrued interest. As of September 30, 2012, accrued interest payable included in accounts payable, accrued expenses, and other liabilities on our consolidated balance sheet was \$1,080 related to interest rate derivatives designated as cash flow hedges.

Following is the effect of interest rate derivatives on the statement of financial performance for the nine months ended September 30, 2012:

Derivatives in ASC 815	Effective Portion		Ineffective Portion		
	Amount of Gain or (Loss)	Location of Gain or (Loss)	Amount of Gain or (Loss)	Location of Gain or (Loss)	Amount of Gain or (Loss)

Edgar Filing: Aircastle LTD - Form 10-Q

Cash Flow Hedging Relationships	Recognized in OCI on Derivative (a)	Reclassified from Accumulated OCI into Income	Reclassified from Accumulated OCI into Income (b)	Recognized in Income on Derivative	Recognized in Income on Derivative (c)
Interest rate derivatives	\$(16,059)	Interest expense	\$(61,670)	Interest expense	\$(3,754)

This represents the change in fair market value of our interest rate derivatives since year end, net of taxes, offset by (a) the amount of actual cash paid related to the net settlements of the interest rate derivatives for each of the nine months ended September 30, 2012.

(b) This represents the amount of actual cash paid, net of taxes, related to the net settlements of the interest rate derivatives for each of the nine months ended September 30, 2012 plus any effective amortization of net deferred interest rate derivative losses.

(c) This represents both realized and unrealized ineffectiveness incurred during the nine months ended September 30, 2012.



Table of Contents

Aircastle Limited and Subsidiaries  
Notes to Unaudited Consolidated Financial Statements  
(Dollars in thousands, except per share amounts)  
September 30, 2012

Derivatives Not Designated as Hedging Instruments under ASC 815	Location of Gain or (Loss) Recognized in Income On Derivative Other income (expense)	Amount of Gain or (Loss) Recognized in Income on Derivative \$ 599
--	--	--

## Interest rate derivatives

On an ongoing basis, terminated interest rate derivative notionals are evaluated against debt forecasts. To the extent that interest payments are deemed remote to occur, deferred gains or losses are accelerated into interest expense as applicable.

For the nine months ended September 30, 2012, the amount of deferred net loss reclassified from OCI into interest expense related to our terminated interest rate derivatives was \$21,903. The amount of deferred net loss expected to be reclassified from OCI into interest expense over the next 12 months related to our terminated interest rate derivatives is \$31,095 of which \$17,887 relates to Term Financing No. 1 interest rate derivatives terminated in 2012, \$4,094 relates to Term Financing No. 1 derivatives terminated in 2008, \$8,559 relates to ECA Term Financings for New A330 Aircraft and \$555 relates to other financings.

The following table summarizes amounts charged directly to the consolidated statement of income for the three and nine months ended September 30, 2011 and 2012, respectively, related to our interest rate derivatives:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
Interest Expense:				
Hedge ineffectiveness (gains) losses	\$(118 )	\$1,474	\$(716 )	\$1,840
Amortization:				
Accelerated amortization of deferred losses <sup>(a)</sup>	1,704	—	3,551	—
Amortization of deferred losses	4,013	8,966	10,392	21,903
Total Amortization	5,717	8,966	13,943	21,903
Total charged to interest expense	\$5,599	\$10,440	\$13,227	\$23,743

## Other Income (Expense):

Mark to market (losses) gains on undesignated interest rate derivatives	\$(117 )	\$—	\$(733 )	\$599
Total charged to other income (expense)	\$(117 )	\$—	\$(733 )	\$599

For the three months ended September 30, 2011, includes accelerated amortization of deferred hedge losses in the amount of \$1,704 related to an aircraft sold in September 2011. For the nine months ended September 30, 2011, <sup>(a)</sup> includes accelerated amortization of deferred hedge losses in the amount of \$3,543 related to two aircraft sold in 2011.

## Note 14. Other Assets

The following table describes the principal components of other assets on our consolidated balance sheet as of:

	December 31, 2011	September 30, 2012
Debt investments <sup>(1)</sup>	\$ —	\$ 42,667
Deferred debt issuance costs, net of amortization of \$55,173 and \$52,174, respectively	35,960	43,586
Deferred federal income tax asset	22,036	23,826

Edgar Filing: Aircastle LTD - Form 10-Q

Lease incentives and lease premiums, net of amortization of \$19,294 and \$23,858, respectively	20,490	45,313
Other assets	11,561	6,650
Total other assets	\$ 90,047	\$ 162,042

Represents a loan we acquired in March 2012 that is secured by a commercial jet aircraft. The loan matures in May (1)2013. The loan is classified as available for sale and the fair value was determined using the income approach with unobservable inputs.

23

---

Table of Contents

Aircastle Limited and Subsidiaries  
 Notes to Unaudited Consolidated Financial Statements  
 (Dollars in thousands, except per share amounts)  
 September 30, 2012

Note 15. Accounts Payable, Accrued Expenses and Other Liabilities

The following table describes the principal components of accounts payable, accrued expenses and other liabilities recorded on our consolidated balance sheet as of:

	December 31, 2011	September 30, 2012
Accounts payable and accrued expenses	\$ 34,931	\$ 20,883
Deferred federal income tax liability	40,410	46,825
Accrued interest payable	27,849	40,326
Lease discounts, net of amortization of \$30,830 and \$30,761 respectively	2,242	920
Total accounts payable, accrued expenses and other liabilities	\$ 105,432	\$ 108,954

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This management's discussion and analysis of financial condition and results of operations contains forward-looking statements that involve risks, uncertainties and assumptions. You should read the following discussion in conjunction with our historical consolidated financial statements and the notes thereto appearing elsewhere in this report. The results of operations for the periods reflected herein are not necessarily indicative of results that may be expected for future periods, and our actual results may differ materially from those discussed in the forward-looking statements as a result of various factors, including but not limited to those described under "Risk Factors" and included in our Annual Report on Form 10-K for the year ended December 31, 2011 filed with the Securities and Exchange Commission (the "SEC"). Please see "Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995" for a discussion of the uncertainties, risks and assumptions associated with these statements. Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, or US GAAP, and, unless otherwise indicated, the other financial information contained in this report has also been prepared in accordance with US GAAP. Unless otherwise indicated, all references to "dollars" and "\$" in this report are to, and all monetary amounts in this report are presented in, U.S. dollars.

Certain items in this Quarterly Report on Form 10-Q (this "report"), and other information we provide from time to time, may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 including, but not necessarily limited to, statements relating to our ability to acquire, sell, lease or finance aircraft, raise capital, pay dividends, and increase revenues, earnings, EBITDA and Adjusted Net Income and the global aviation industry and aircraft leasing sector. Words such as "anticipates," "expects," "intends," "plans," "projects," "believes," "may," "will," "would," "could," "should," "seeks," "estimates" and variations on these words and similar expressions intended to identify such forward-looking statements. These statements are based on management's current expectations and beliefs and are subject to a number of factors that could lead to actual results materially different from those described in the forward-looking statements; Aircastle can give no assurance that its expectations will be attained. Accordingly, you should not place undue reliance on any forward-looking statements contained in this report. Factors that could have a material adverse effect on our operations and future prospects or that could cause actual results to differ materially from Aircastle expectations include, but are not limited to, significant capital markets disruption and volatility and the significant contraction in the availability of bank financing, which may adversely affect our continued ability to obtain additional capital to finance new investments or our working capital needs; volatility in the value of our aircraft; general economic conditions and business conditions affecting demand for aircraft and lease rates; our continued ability to obtain favorable tax treatment in Bermuda, Ireland and other jurisdictions; our ability to pay dividends; high or volatile fuel prices, lack of access to capital, reduced load factors and/or reduced yields, operational disruptions caused by political unrest in North Africa, the Middle East or elsewhere, uncertainties in the Eurozone arising from the sovereign debt crisis and other factors affecting the creditworthiness of our airline customers and their ability to continue to perform their obligations under our leases; termination payments on our interest rate hedges; and other risks detailed from time to time in Aircastle's filings with the SEC, including as previously disclosed in Aircastle's 2011 Annual Report on Form 10-K, and elsewhere in this report. In addition, new risks and uncertainties emerge from time to time, and it is not possible for Aircastle to predict or assess the impact of every factor that may cause its actual results to differ from those contained in any forward-looking statements. Such forward-looking statements speak only as of the date of this report. Aircastle Limited expressly disclaims any obligation to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in its expectations with regard thereto or change in events, conditions or circumstances on which any statement is based.

WEBSITE AND ACCESS TO COMPANY'S REPORTS

The Company's Internet website can be found at [www.aircastle.com](http://www.aircastle.com). Our annual reports on Forms 10-K, quarterly reports on Forms 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act") are available free of charge through our website under "Investors — SEC Filings" as soon as reasonably practicable after they are electronically filed

with, or furnished to, the SEC.

Statements and information concerning our status as a Passive Foreign Investment Company (“PFIC”) for U.S. taxpayers are also available free of charge through our website under “Investors — SEC Filings”.

Our Corporate Governance Guidelines, Code of Business Conduct and Ethics, and board of directors committee charters (including the charters of the Audit Committee, Compensation Committee, and Nominating and Corporate Governance Committee) are available free of charge through our website under “Investors — Corporate Governance”. In addition, our

25

---

## Table of Contents

Code of Ethics for the Chief Executive and Senior Financial Officers, which applies to our Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer, Treasurer and Controller, is available in print, free of charge, to any shareholder upon request to Investor Relations, Aircastle Limited, c/o Aircastle Advisor LLC, 300 First Stamford Place, 5th Floor, Stamford, Connecticut 06902.

The information on the Company's website is not part of, or incorporated by reference, into this report, or any other report we file with, or furnish to, the SEC.

## OVERVIEW

We acquire, lease, and sell high-utility commercial jet aircraft. High-utility aircraft are generally modern and operationally efficient jets with many operators and have long useful lives. As of September 30, 2012, our portfolio consisted of 157 aircraft leased to 68 lessees located in 36 countries. Our aircraft fleet is managed by an experienced team based in the United States, Ireland and Singapore. Typically, our aircraft are subject to net leases whereby the lessee is generally responsible for maintaining the aircraft and paying operational, maintenance and insurance costs, although in a majority of cases, we are obligated to pay a portion of specified maintenance or modification costs. From time to time, we also make investments in other aviation assets, including debt investments secured by commercial jet aircraft. Our revenues and income (loss) from continuing operations for the three and nine months ended September 30, 2012 were \$172.9 million and \$(45.8) million, \$510.0 million and \$3.1 million, respectively. The commercial jet aircraft market has grown 41% over the past 10 years. Increasing global economic activity together with a proliferation of air travel in emerging economies has driven the long-term growth in the commercial jet aircraft market. At the same time, the share of the world's commercial jet aircraft owned by leasing companies has expanded to 40% as compared to 25% ten years ago. However, aircraft trading volumes during 2012 have been low and the availability of equity and debt capital remains somewhat limited for the type of aircraft investments we are currently pursuing.

In spite of these near-term challenges, we plan to grow our business and profits over the long-term by continuing to employ the following elements of our fundamental business strategy:

Investing in additional commercial jet aircraft and other aviation assets when attractively priced opportunities and cost effective financing are available. We believe the large and growing aircraft market, together with ongoing fleet replacements, will provide significant acquisition opportunities. We regularly evaluate potential aircraft acquisitions and expect to continue our investment program through additional passenger and cargo aircraft purchases when attractively priced opportunities and cost effective financing are available.

Maintaining efficient access to financing from multiple sources. We have financed our aircraft acquisitions using various long-term debt structures obtained through several different markets to obtain cost effective financing. In this regard, we believe having corporate credit ratings from Standard & Poor's and Moody's enables us to access a broader pool of capital than many of our peers. Indeed, we believe the contraction in traditional aviation bank debt lending capacity upon which many of our peers and airline customers depend will enhance our competitiveness and ability to source attractive investment opportunities. This, in turn, will allow us to grow our business and profits.

Leveraging our efficient operating platform and strong operating track record. We believe our team's capabilities in the global aircraft leasing market place us in a favorable position to explore new income-generating activities and we intend to continue to focus our efforts in areas where we believe we have competitive advantages and on transactions that offer attractive risk/return profiles after taking into consideration available financing options.

Reinvesting a portion of the cash flows generated by our business in additional aviation assets and/or our own debt and equity securities. Aircraft have finite useful lives, but typically provide reliable cash flows. Our strategy is to reinvest a portion of our cash flows from operations and asset sales in our business to grow our asset base and earnings bases.

Selling assets when attractive opportunities arise and for portfolio management purposes. We pursue asset sales as opportunities over the course of the business cycle with the aim of realizing profits and reinvesting proceeds where more accretive investments are available. We also use asset sales for portfolio management purposes such as reducing lessee specific concentrations and lowering residual value exposures to certain aircraft types.



## Table of Contents

For the first nine months of 2012, air traffic data demonstrated improvement in the passenger markets while the air cargo markets shrank. According to the International Air Transport Association, global passenger traffic increased by 5.7% while air cargo traffic, measured in freight ton kilometers, decreased 1.9% as compared to the same period in 2011. There are significant regional variations and airlines operating primarily in areas with slower economic growth, such as Europe, or with political instability, such as North Africa and the Middle East, may see more modest growth. While both passenger and air cargo growth rates are vulnerable to slowing economic growth and uncertain business conditions in the near term, over the long-term, we believe the market will be driven, to a large extent, by expansion of emerging market economies and rising levels of per capita air travel in those markets.

We intend to pay quarterly dividends to our shareholders based on the company's sustainable earnings levels; however, our ability to pay quarterly dividends will depend upon many factors, including those as previously disclosed in Aircastle's 2011 Annual Report on Form 10-K. On February 17, 2012, our board of directors declared a regular quarterly dividend of \$0.15 per common share, or an aggregate of \$10.9 million, for the three months ended March 31, 2012, which was paid on March 15, 2012 to holders of record on February 29, 2012. On May 2, 2012, our board of directors declared a regular quarterly dividend of \$0.15 per common share, or an aggregate of \$10.8 million, for the three months ended June 30, 2012, which was paid on June 15, 2012 to holders of record on May 31, 2012. On August 1, 2012, our board of directors declared a regular quarterly dividend of \$0.15 per common share, or an aggregate of \$10.5 million, for the three months ended September 30, 2012, which was paid on September 15, 2012 to holders of record on August 31, 2012. This dividend may not be indicative of the amount of any future dividends. On November 5, 2012, our board of directors declared a regular quarterly dividend of \$0.165 per common share for the three months ended December 31, 2012, which will be paid on December 14, 2012 to holders of record on November 30, 2012.

## Revenues

Our revenues are comprised primarily of operating lease rentals on flight equipment held for lease, revenue from retained maintenance payments related to lease expirations, lease termination payments, lease incentive amortization and interest recognized from finance leases.

Typically, our aircraft are subject to net operating leases whereby the lessee pays lease rentals and is generally responsible for maintaining the aircraft and paying operational, maintenance and insurance costs, although in a majority of cases we are obligated to pay a portion of specified maintenance or modification costs. Our aircraft lease agreements generally provide for the periodic payment of a fixed amount of rent over the life of the lease and the amount of the contracted rent will depend upon the type, age, specification and condition of the aircraft and market conditions at the time the lease is committed. The amount of rent we receive will depend on a number of factors, including the credit-worthiness of our lessees and the occurrence of delinquencies, restructurings and defaults. Our lease rental revenues are also affected by the extent to which aircraft are off-lease and our ability to remarket aircraft that are nearing the end of their leases in order to minimize their off-lease time. Our success in re-leasing aircraft is affected by market conditions relating to our aircraft and by general industry conditions and trends. An increase in the percentage of off-lease aircraft or a reduction in lease rates upon remarketing would negatively impact our revenues. Under an operating lease, the lessee will be responsible for performing maintenance on the relevant aircraft and will typically be required to make payments to us for heavy maintenance, overhaul or replacement of certain high-value components of the aircraft. These maintenance payments are based on hours or cycles of utilization or on calendar time, depending upon the component, and would be made either monthly in arrears or at the end of the lease term. For maintenance payments made monthly in arrears during a lease term, we will typically be required to reimburse all or a portion of these payments to the lessee upon their completion of the relevant heavy maintenance, overhaul or parts replacement. We record maintenance payments paid by the lessee during a lease as accrued maintenance liabilities in recognition of our obligation in the lease to refund such payments, and therefore we do not recognize maintenance revenue during the lease. Maintenance revenue recognition would occur at the end of a lease, when we are able to determine the amount, if any, by which reserve payments received exceed the amount we are required under the lease to reimburse to the lessee for heavy maintenance, overhaul or parts replacement. The amount of maintenance revenue we recognize in any reporting period is inherently volatile and is dependent upon a number of factors, including the



timing of lease expiries, including scheduled and unscheduled expiries, the timing of maintenance events and the utilization of the aircraft by the lessee.

Many of our leases contain provisions which may require us to pay a portion of the lessee's costs for heavy maintenance, overhaul or replacement of certain high-value components. We account for these expected payments as lease incentives, which are amortized as a reduction of revenue over the life of the lease. We estimate the amount of our portion for such costs, typically for the first major maintenance event for the airframe, engines, landing gear and auxiliary power units,

Table of Contents

expected to be paid to the lessee based on assumed utilization of the related aircraft by the lessee, the anticipated cost of the maintenance event and the estimated amounts the lessee is responsible to pay.

This estimated lease incentive is not recognized as a lease incentive liability at the inception of the lease. We recognize the lease incentive as a reduction of lease revenue on a straight-line basis over the life of the lease, with the offset being recorded as a lease incentive liability which is included in maintenance payments on the balance sheet. The payment to the lessee for the lease incentive liability is first recorded against the lease incentive liability and any excess above the lease incentive liability is recorded as a prepaid lease incentive asset which is included in other assets on the balance sheet and continues to amortize over the remaining life of the lease.

2012 Lease Expirations and Lease Placements

At the beginning of 2012, we had 17 aircraft with scheduled lease expirations in 2012 and we leased, extended or sold, or committed to lease, extend or sell, 14 of these aircraft, and we have a letter of intent to lease one aircraft, leaving us with two such aircraft that we are marketing for lease or sale in 2012. We are also marketing two Boeing Model 747-400 converted freighter aircraft for lease or sale in 2012. One of these aircraft was returned to us in October 2012 by Southern Air Inc. ("Southern"), which filed for bankruptcy protection in the third quarter of 2012. Southern continues to operate a second Boeing Model 747-400 converted freighter, and we expect this aircraft will be returned to us in the fourth quarter of 2012.

The four aircraft we are currently marketing for lease or sale in 2012 represented 2.5% of our total net book value of flight equipment held for lease (includes net book value of flight equipment held for lease and net investment in finance leases) at September 30, 2012.

In addition:

We have a commitment to lease one Boeing Model 747-400 converted freighter aircraft which we expect to return to us from another customer under a mutually agreed early termination arrangement in the fourth quarter of 2012.

We entered into lease extension agreements for two Boeing Model 737-700 aircraft which were returned to us earlier in 2012 and placed on short-term leases.

We agreed to an early termination of the lease for one Airbus Model A330-200 aircraft and have a commitment to lease the aircraft to another customer. We expect this transition to occur in the fourth quarter of 2012. We collected an early termination fee of \$6.9 million under that agreement, \$3.9 million of which we recorded as other revenue in the third quarter of 2012 and the remainder of which we expect to be recorded as other revenue in the fourth quarter of 2012.

We agreed to an early termination of the leases for two 1991-vintage Airbus Model A320-200 aircraft in the fourth quarter of 2012, and we expect to sell these aircraft for part-out. We recorded impairment charges of \$11.3 million and maintenance revenue of \$10.2 million in the third quarter of 2012 in connection with that agreement.

2013-2016 Lease Expirations and Lease Placements

Taking into account lease and sale commitments, we currently have the following number of aircraft with lease expirations scheduled in the period 2013-2016 representing the percentage of our net book value of flight equipment held for lease at September 30, 2012 specified below:

2013: 18 aircraft, representing 6%;

2014: 33 aircraft, representing 15%;

2015: 18 aircraft, representing 7%; and

2016: 24 aircraft, representing 12%.

## Table of Contents

### Operating Expenses

Operating expenses are comprised of depreciation of flight equipment held for lease, interest expense, selling, general and administrative expenses, aircraft impairment charges and maintenance and other costs. Because our operating lease terms generally require the lessee to pay for operating, maintenance and insurance costs, our portion of maintenance and other costs relating to aircraft reflected in our statement of income primarily relates to expenses for unscheduled lease terminations.

### Income Tax Provision

We have obtained an assurance from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act 1966 that, in the event that any legislation is enacted in Bermuda imposing any tax computed on profits or income, or computed on any capital asset, gain or appreciation or any tax in the nature of estate duty or inheritance tax, such tax shall not, until March 2035, be applicable to us or to any of our operations or to our shares, debentures or other obligations except insofar as such tax applies to persons ordinarily resident in Bermuda or to any taxes payable by us in respect of real property owned or leased by us in Bermuda. Consequently, the provision for income taxes recorded relates to income earned by certain subsidiaries of the Company which are located in, or earn income in, jurisdictions that impose income taxes, primarily Ireland and the United States.

All of our aircraft-owning subsidiaries that are recognized as corporations for U.S. tax purposes are non-U.S. corporations. These non-U.S. subsidiaries generally earn income from sources outside the United States and typically are not subject to U.S. federal, state or local income taxes unless they operate within the U.S., in which case they may be subject to federal, state and local income taxes. We also have a U.S. based subsidiary which provides management services to our non-U.S. subsidiaries and is subject to U.S. federal, state and local income taxes. In addition, those subsidiaries that are resident in Ireland are subject to Irish tax.

### Acquisitions and Disposals

Thus far in 2012, we invested \$563.3 million in the following 18 aircraft acquisitions:

- Two Airbus A330 family aircraft.
- One Airbus Model A320-200.
- Eight Boeing Model 737-800s.
- One Boeing Model 747-400 converted freighter.
- Six Boeing Model 767-300ERs.

We also have commitments to acquire three aircraft during the balance of 2012.

During the first nine months of 2012, we sold the following aircraft:

- Two Boeing Model 737 classics.
- One Boeing Model 757-200.
- One Boeing Model 767-300ER aircraft which was subject to an insurance settlement following an incident in late 2011.

In addition, we began the part-out sale of a Boeing Model 747-400 passenger configured aircraft, a process we expect to complete in the fourth quarter of 2012. As mentioned above, we also expect to sell two 1991-vintage Airbus Model A320-200 aircraft for part-out following an agreed early lease termination.

During the first nine months of 2012, the aggregate sales price for the aircraft we sold during 2012 was \$54.4 million, which resulted in a net gain on the sale of flight equipment of \$3.1 million. We repaid debt associated with these aircraft in the amount of \$32.6 million.

Table of Contents

The following table sets forth certain information with respect to the aircraft owned by us as of September 30, 2012:  
AIRCATTLE AIRCRAFT INFORMATION (dollars in millions)

	Owned Aircraft as of September 30, 2012 <sup>(1)</sup>	
Flight Equipment	\$4,654	
Unencumbered Flight Equipment	2,010	
Number of Aircraft	157	
Number of Unencumbered Aircraft	70	
Number of Lessees	68	
Number of Countries	36	
Weighted Average Age – Passenger (years) <sup>(2)</sup>	11.0	
Weighted Average Age – Freighter (years) <sup>(2)</sup>	10.9	
Weighted Average Age – Combined (years) <sup>(2)</sup>	11.0	
Weighted Average Remaining Passenger Lease Term (years) <sup>(3)</sup>	4.5	
Weighted Average Remaining Cargo Lease Term (years) <sup>(3)</sup>	5.7	
Weighted Average Remaining Combined Lease Term (years) <sup>(3)</sup>	4.9	
Weighted Average Fleet Utilization during the three months ended September 30, 2012 <sup>(4)</sup>	99	%
Weighted Average Fleet Utilization during the nine months ended September 30, 2012 <sup>(4)</sup>	99	%
Portfolio Yield for the three months ended September 30, 2012 <sup>(5)</sup>	14	%
Portfolio Yield for the nine months ended September 30, 2012 <sup>(5)</sup>	14	%

(1) Calculated using net book value of flight equipment held for lease and net investment in finance leases as of September 30, 2012.

(2) Weighted average age (years) by net book value.

(3) Weighted average remaining lease term (years) by net book value.

(4) Aircraft on-lease days as a percent of total days in period weighted by net book value, excluding aircraft in freighter conversion.

(5) Lease rental revenue for the period as a percent of the average net book value of flight equipment held for lease for the period; quarterly information is annualized.

Our owned aircraft portfolio as of September 30, 2012 is listed in Exhibit 99.1 to this report.

Table of Contents

## PORTFOLIO DIVERSIFICATION

	Owned Aircraft as of September 30, 2012		
	Number of Aircraft	% of Net Book Value	
Aircraft Type			
Passenger:			
Narrowbody	93	37	%
Midbody	36	29	%
Widebody	2	4	%
Total Passenger	131	70	%
Freighter	26	30	%
Total	157	100	%
Manufacturer			
Boeing	101	57	%
Airbus	56	43	%
Total	157	100	%
Regional Diversification			
Europe	70	37	%
Asia and Pacific	49	33	%
North America	18	11	%
Latin America	11	6	%
Middle East and Africa	8	13	%
Off-lease <sup>(1)</sup>	1	—	%
Total	157	100	%

(1) One Boeing Model 767-300ER aircraft that we are marketing for lease or sale.

Table of Contents

Our largest customer represents less than 8% of the net book value of flight equipment held for lease (includes net book value of flight equipment held for lease and net investment in finance leases) at September 30, 2012. Our top 15 customers for aircraft we owned at September 30, 2012, representing 72 aircraft and 59% of the net book value of flight equipment held for lease, are as follows:

Percent of Net Book Value	Customer	Country	Number of Aircraft
Greater than 6% per customer	South African Airways	South Africa	4
	Hainan Airlines Company	China	9
3% to 6% per customer	Emirates	United Arab Emirates	2
	US Airways	USA	11
	Martinair <sup>(1)</sup>	Netherlands	5
	SriLankan Airlines	Sri Lanka	5
	Airbridge Cargo <sup>(2)</sup>	Russia	2
	Jet Airways	India	6
	GOL <sup>(3)</sup>	Brazil	7
Less than 3% per customer	Iberia Airlines	Spain	6
	Asiana Airlines	South Korea	2
	Cathay Pacific	Hong Kong	1
	KLM <sup>(1)</sup>	Netherlands	1
	China Eastern Airlines <sup>(4)</sup>	China	6
	Orenburg Airlines	Russia	4

(1) Martinair is a wholly owned subsidiary of KLM. If combined with KLM and two other affiliated customers, that represents 9% of flight equipment held for lease.

(2) Guaranteed by Volga-Dnepr.

(3) GOL has guaranteed the obligations of an affiliate, VRG Linhas Aereas.

(4) Does not include the aircraft leased by Shanghai Airlines and China Cargo Airlines, which are wholly owned subsidiaries of China Eastern Airlines. Although China Eastern Airlines does not guarantee the obligations of these subsidiaries under their relevant leases, if combined, the three customers represent 5% of flight equipment held for lease.

## Finance

Historically, our debt financing arrangements typically have been secured by aircraft and related operating leases, and in the case of our securitizations and pooled aircraft term financings, the financing parties have limited recourse to Aircastle Limited. While such financings have historically been available on reasonable terms given the loan to value profile we have pursued, current market conditions continue to limit the availability of both debt and equity capital. Though financing market conditions have recovered recently and we expect them to continue to improve in time, current market conditions remain difficult with respect to financing mid-age, current technology aircraft. In April 2012, we closed an offering of \$500.0 million aggregate principal amount of 6.75% Senior Notes due 2017 (the "Senior Notes due 2017") and \$300.0 million aggregate principal amount of 7.625% Senior Notes due 2020 (the "Senior Notes due 2020"). We used the net proceeds of the private placement to repay outstanding indebtedness under our Term Financing No. 1 and the termination of the associated interest rate derivatives, and for general corporate purposes, including the purchase of aviation assets. During the near-term, we intend to focus our efforts on investment opportunities that are attractive on an unleveraged basis, that tap commercial financial capacity where it is accessible on reasonable terms or for which debt financing that benefits from government guarantees either from the ECAs or from EXIM is available.

We intend to fund new investments through cash on hand, cash flows from operations and potentially through medium- to longer-term financings on a secured or unsecured basis. We may repay all or a portion of such borrowings from time to time with the net proceeds from subsequent long-term debt financings, additional equity offerings or cash generated from operations and asset sales. Therefore, our ability to execute our business strategy, particularly the acquisition of additional commercial jet aircraft or other aviation assets, depends to a significant degree on our ability to obtain additional debt and equity capital on terms we deem attractive.

Table of Contents

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources — Secured Debt Financings.”

## RESULTS OF OPERATIONS

Comparison of the three months ended September 30, 2011 to the three months ended September 30, 2012:

	Three Months Ended September 30,	
	2011	2012
	(Dollars in thousands)	
Revenues:		
Lease rental revenue	\$145,890	\$159,547
Amortization of net lease premiums, discounts and lease incentives	(4,709 )	(6,838 )
Maintenance revenue	—	10,944
Total lease rentals	141,181	163,653
Other revenue	326	9,213
Total revenues	141,507	172,866
Expenses:		
Depreciation	60,132	68,413
Interest, net	48,872	54,101
Selling, general and administrative	12,200	11,907
Impairment of aircraft	1,236	78,676
Maintenance and other costs	4,045	3,926
Total operating expenses	126,485	217,023
Other income (expense):		
Gain on sale of flight equipment	8,997	11
Other income (expense)	(117 )	—
Total other income (expense)	8,880	11
Income (loss) from continuing operations before income taxes	23,902	(44,146 )
Income tax provision	1,237	1,701
Net income (loss)	\$22,665	\$(45,847 )

## Revenues:

Total revenues increased by 22.2%, or \$31.4 million for the three months ended September 30, 2012 as compared to the three months ended September 30, 2011, primarily as a result of the following:

Lease rental revenue. The increase in lease rental revenue of \$13.7 million for the three months ended September 30, 2012 as compared to the same period in 2011 was primarily the result of:

• \$30.0 million of revenue reflecting the full quarter impact of 13 aircraft purchased in 2011 and 12 aircraft purchased in 2012.

This increase was offset partially by a decrease in lease rental revenue of:

• \$5.9 million due to aircraft sales and disposals;

• \$5.9 million from the effect of lease terminations and other changes; and

• \$4.6 million due to lease extensions and transitions at lower rentals.



Table of Contents

Amortization of net lease premiums, discounts and lease incentives.

	Three Months Ended September 30,	
	2011	2012
	(Dollars in thousands)	
Amortization of lease discounts	\$612	\$323
Amortization of lease premiums	(646 )	(1,270 )
Amortization of lease incentives	(4,675 )	(5,891 )
Amortization of net lease premiums, discounts and lease incentives	\$(4,709)	\$(6,838)

As more fully described above under “Revenues”, lease incentives represent our estimated portion of the lessee’s cost for heavy maintenance, overhaul or replacement of certain high-value components which is amortized over the life of the related lease. As we enter into new leases, the amortization of lease incentives generally increases and, conversely, if a related lease terminates, the related unused lease incentive liability will reduce the amortization of lease incentives. The increase in amortization of lease premiums of \$0.6 million for the three months ended September 30, 2012 as compared to the same period in 2011 primarily resulted from additional amortization on six aircraft purchased during the first half of 2012 and three aircraft purchased during the second half of 2011. The increase in amortization of lease incentives of \$1.2 million was primarily attributable to aircraft transitions.

Maintenance revenue.

	Three Months Ended September 30,			
	2011		2012	
	Dollars (in thousands)	Number of Leases	Dollars (in thousands)	Number of Leases
Unscheduled lease terminations	\$—	—	\$10,258	2
Scheduled lease terminations	—	—	686	1
Maintenance revenue	\$—	—	\$10,944	3

Unscheduled lease terminations. For the three months ended September 30, 2011, we did not record any maintenance revenue from unscheduled lease terminations as we did not have any terminations. Comparatively, for the same period in 2012, we recorded maintenance revenue totaling \$10.3 million from unscheduled lease terminations primarily associated with two aircraft to be returned in the fourth quarter of 2012 resulting from early termination agreements in the third quarter of 2012.

Scheduled lease terminations. For the three months ended September 30, 2011, we did not record any maintenance revenue from scheduled lease terminations as we did not have any terminations. Comparatively, for the same period in 2012, we recorded maintenance revenue totaling \$0.7 million, primarily associated with one scheduled lease termination.

Other revenue. For the three months ended September 30, 2011, other revenue was \$0.3 million. For the three months ended September 30, 2012, other revenue was \$9.2 million which was primarily due to \$1.3 million of interest on our debt investments, \$3.5 million of interest recognized from finance leases and \$3.9 million recognized in additional fees paid by a lessee in connection with the early termination of one lease.

Operating Expenses:

Total operating expenses increased by 71.6%, or \$90.5 million for the three months ended September 30, 2012 as compared to the three months ended September 30, 2011 primarily as a result of the following:

Depreciation expense increased by 13.8%, or \$8.3 million for the three months ended September 30, 2012 over the same period in 2011. The net increase is primarily the result of:

\$9.3 million increase in depreciation for aircraft acquired; and

\$0.5 million increase in depreciation for capitalized aircraft improvements.



Table of Contents

These increases were offset partially by:

• \$2.7 million decrease in depreciation for aircraft disposals.

Interest, net consisted of the following:

	Three Months Ended September 30,	
	2011	2012
	(Dollars in thousands)	
Interest on borrowings, net settlements on interest rate derivatives, and other liabilities	\$42,066	\$41,373
Hedge ineffectiveness gains	(118 )	1,474
Amortization of interest rate derivatives related to deferred losses	5,717	8,966
Amortization of deferred financing fees and notes discount	2,977	2,391
Interest Expense	50,642	54,204
Less interest income	(95 )	(103 )
Less capitalized interest	(1,675 )	—
Interest, net	\$48,872	\$54,101

Interest, net increased by \$5.2 million, or 10.7%, over the three months ended September 30, 2011. The net increase is primarily a result of:

• a \$3.2 million increase in amortization of deferred losses which includes \$4.5 million of additional amortization as a result of the payoff of Term Financing No. 1 in April, 2012;

• a \$1.6 million increase in measured hedge ineffectiveness due to changes in our debt forecast; and

• a \$1.7 million decrease in capitalized interest.

These increases were offset partially by:

• a \$0.7 million decrease in interest expense on our borrowings due to a lower weighted average interest rate (5.3% for the three months ended September 30, 2012 as compared to 6.0% for the three months ended September 30, 2011), due to lower interest expense on our Securitization No. 2 financing; and

• a \$0.6 million decrease in amortization of deferred financing fees.

Selling, general and administrative expenses for the three months ended September 30, 2012 decreased slightly over the same period in 2011. Non-cash share based expense was \$1.6 million and \$1.1 million for the three months ended September 30, 2011 and 2012, respectively.

Impairment of aircraft was \$78.7 million for the three months ended September 30, 2012 related to eight Boeing Model 737-300 / -400 aircraft, four Boeing Model 767-300ER aircraft, one Airbus Model A310-300F aircraft and two Airbus Model A320-200 aircraft, all of which did not pass their recoverability assessments. See "Summary of Impairments" below for a detailed discussion of the related impairment charges for these aircraft. During the three months ended September 30, 2011, we recorded impairment of \$1.2 million related to a Boeing Model 737-400 aircraft which we repossessed following termination of the lease agreement in the second quarter of 2011.

Other income (expense):

Total other income for the three months ended September 30, 2012 was \$11 thousand as compared to \$8.9 million for the same period in 2011. The decrease is a result of a \$9.0 million decrease due to the gain on the sale of aircraft recorded in the three months ended September 30, 2011 as compared to the same period in 2012.

Table of Contents

## Income Tax Provision

Our provision for income taxes for the three months ended September 30, 2011 and 2012 was \$1.2 million and \$1.7 million, respectively. Income taxes have been provided based on the applicable tax laws and rates of those countries in which operations are conducted and income is earned, primarily Ireland and the United States. The increase in our income tax provision of approximately \$0.5 million for the three months ended September 30, 2012 as compared to the same period in 2011 was primarily attributable to an increase in operating income subject to tax in the U.S. and Ireland, and treating the \$78.7 million Bermuda asset impairment of aircraft as a discrete item.

All of our aircraft-owning subsidiaries that are recognized as corporations for U.S. tax purposes are non-U.S. corporations. These non-U.S. subsidiaries generally earn income from sources outside the United States and typically are not subject to U.S. federal, state or local income taxes, unless they operate within the U.S., in which case they may be subject to federal, state and local income taxes. We also have a U.S.-based subsidiary which provides management services to our non-U.S. subsidiaries and is subject to U.S. federal, state and local income taxes. In addition, those subsidiaries that are resident in Ireland are subject to Irish tax.

The Company received an assurance from the Bermuda Minister of Finance that it would be exempted from local income, withholding and capital gains taxes until March 2035. Consequently, the provision for income taxes recorded relates to income earned by certain subsidiaries of the Company which are located in, or earn income in, jurisdictions that impose income taxes, primarily the United States and Ireland.

## Other comprehensive income (loss):

	Three Months Ended September 30,	
	2011	2012
	(Dollars in thousands)	
Net income (loss)	\$22,665	\$(45,847)
Net change in fair value of derivatives, net of tax expense of \$48 and \$37, respectively	(2,967)	1,426
Derivative loss reclassified into earnings	5,717	8,966
Total comprehensive income (loss)	\$25,415	\$(35,455)

Other comprehensive loss was \$35.5 million for the three months ended September 30, 2012, a decrease of \$60.9 million from the \$25.4 million of other comprehensive income for the three months ended September 30, 2011. Other comprehensive income for the three months ended September 30, 2012 primarily consisted of:

\$45.8 million of net loss;

\$1.4 million gain from a change in fair value of interest rate derivatives, net of taxes which is due primarily to net settlements for the three months ended September 30, 2012 partially offset by a slight downward shift in the one-month LIBOR forward curve; and

\$9.0 million of amortization of deferred net losses reclassified into earnings related to terminated interest rate derivatives.

Other comprehensive income for the three months ended September 30, 2011 primarily consisted of:

\$22.7 million of net income;

a \$3.0 million loss from a change in fair value of interest rate derivatives, net of taxes which is due primarily to a downward shift in the 1 Month LIBOR forward curve offset by net settlements for the three months ended September 30, 2011; and

\$5.7 million of amortization of deferred net losses reclassified into earnings related to terminated interest rate derivatives.



Table of Contents

## RESULTS OF OPERATIONS

Comparison of the nine months ended September 30, 2011 to the nine months ended September 30, 2012:

	Nine Months Ended September 30,	
	2011	2012
	(Dollars in thousands)	
Revenues:		
Lease rental revenue	\$430,361	\$465,413
Amortization of net lease premiums, discounts and lease incentives	(10,841 )	(6,392 )
Maintenance revenue	25,006	37,126
Total lease rentals	444,526	496,147
Other revenue	3,733	13,815
Total revenues	448,259	509,962
Expenses:		
Depreciation	178,299	200,024
Interest, net	150,384	167,203
Selling, general and administrative	36,309	36,616
Impairment of aircraft	6,436	88,787
Maintenance and other costs	10,944	11,943
Total operating expenses	382,372	504,573
Other income (expense):		
Gain on sale of flight equipment	28,958	3,062
Other income (expense)	(153 )	604
Total other income (expense)	28,805	3,666
Income from continuing operations before income taxes	94,692	9,055
Income tax provision	6,041	5,976
Net income	\$88,651	\$3,079

## Revenues:

Total revenues increased by 13.8%, or \$61.7 million for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011, primarily as a result of the following:

Lease rental revenue. The increase in lease rental revenue of \$35.1 million for the nine months ended September 30, 2012 as compared to the same period in 2011 was primarily the result of:

\$81.7 million of revenue reflecting the full year impact of 19 aircraft purchased in 2011 and 12 aircraft purchased in 2012.

This increase was offset partially by a decrease in lease rental revenue of:

\$23.4 million due to aircraft sales and disposals;

\$8.4 million from the effect of lease terminations and other changes; and

- \$14.8 million due to lease extensions and transitions at lower rentals.

Table of Contents

Amortization of net lease premiums, discounts and lease incentives.

	Nine Months Ended September 30,	
	2011	2012
	(Dollars in thousands)	
Amortization of lease discounts	\$1,806	\$1,360
Amortization of lease premiums	(799 )	(3,184 )
Amortization of lease incentives	(11,848 )	(4,568 )
Amortization of net lease premiums, discounts and lease incentives	\$(10,841 )	\$(6,392)

As more fully described above under “Revenues”, lease incentives represent our estimated portion of the lessee’s cost for heavy maintenance, overhaul or replacement of certain high-value components which is amortized over the life of the related lease. As we enter into new leases, the amortization of lease incentives generally increases and conversely if a related lease terminates, the related unused lease incentive liability will reduce the amortization of lease incentives. The increase in amortization of lease premiums of \$2.4 million for the nine months ended September 30, 2012 as compared to the same period in 2011 primarily resulted from additional amortization on six aircraft purchased during the first half of 2012 and three aircraft purchased during the second half of 2011. The decrease in amortization of lease incentives of \$7.3 million resulted from six unscheduled lease terminations and three scheduled lease terminations in the nine months ended September 30, 2012.

Maintenance revenue.

	Nine Months Ended September 30,			
	2011		2012	
	Dollars (in thousands)	Number of Leases	Dollars (in thousands)	Number of Leases
Unscheduled lease terminations	\$15,257	6	\$25,069	6
Scheduled lease terminations	9,749	5	12,057	5
Maintenance revenue	\$25,006	11	\$37,126	11

Unscheduled lease terminations. For the nine months ended September 30, 2011, we recorded maintenance revenue in the amount of \$15.3 million from unscheduled lease terminations associated with six aircraft returned in 2011.

Comparatively, for the same period in 2012, we recorded maintenance revenue totaling \$25.1 million from unscheduled lease terminations associated with four aircraft returned in 2012 and two aircraft to be returned in the fourth quarter of 2012 resulting from an early termination agreement in the third quarter of 2012.

Scheduled lease terminations. For the nine months ended September 30, 2011, we recorded maintenance revenue from scheduled lease terminations totaling \$9.7 million associated with five scheduled lease terminations. Comparatively, for the same period in 2012, we recorded maintenance revenue totaling \$12.1 million associated with five scheduled lease terminations.

Other revenue. For the nine months ended September 30, 2011, other revenue was \$3.7 million which was primarily due to additional fees paid by lessees in connection with early termination of four leases. For the nine months ended September 30, 2012, other revenue was \$13.8 million which was primarily due to \$2.6 million of interest on our debt investments, \$4.5 million of interest recognized from finance leases and approximately \$6.7 million recognized in additional fees paid by lessees in connection with the early termination of nine leases.

Operating Expenses:

Total operating expenses increased by 32.0%, or \$122.2 million for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011 primarily as a result of the following:





Table of Contents

Depreciation expense increased by 12.1%, or \$21.7 million for the nine months ended September 30, 2012 over the same period in 2011. The net increase is primarily the result of:

\$25.6 million increase in depreciation for aircraft acquired; and  
 \$3.8 million increase in depreciation for capitalized aircraft improvements.

These increases were offset partially by:

a \$9.3 million decrease in depreciation for aircraft disposals.

Interest, net consisted of the following:

	Nine Months Ended September 30,	
	2011	2012
	(Dollars in thousands)	
Interest on borrowings, net settlements on interest rate derivatives, and other liabilities	\$129,757	\$135,140
Hedge ineffectiveness (gains) losses	(716 )	1,840
Amortization of interest rate derivatives related to deferred losses	13,943	21,903
Amortization of deferred financing fees and notes discount	12,394	10,082
Interest Expense	155,378	168,965
Less interest income	(355 )	(447 )
Less capitalized interest	(4,639 )	(1,315 )
Interest, net	\$150,384	\$167,203

Interest, net increased by \$16.8 million, or 11.2%, over the nine months ended September 30, 2011. The net increase is primarily a result of:

a \$5.4 million increase in interest expense on our borrowings primarily due to a higher weighted average debt balance (\$3.08 billion for the nine months ended September 30, 2012 as compared to \$2.76 billion for the nine months ended September 30, 2011), such increase resulting from the closing of two additional unsecured debt financings during the second quarter of 2012;

a \$8.0 million increase in amortization of deferred losses which includes \$8.9 million of additional amortization as a result of the repayment of Term Financing No. 1 in April, 2012;

a \$2.6 million increase resulting from changes in measured hedge ineffectiveness due to changes in our debt forecast;  
 and

a \$3.3 million decrease in capitalized interest.

These increases were offset partially by:

a \$2.3 million decrease in amortization of deferred financing fees due to lower amortization from Securitization No. 1 and Securitization No. 2, offset by a write-off of fees of \$2.9 million as a result of the repayment of Term Financing No. 1.

Selling, general and administrative expenses for the nine months ended September 30, 2012 increased slightly over the same period in 2011. Non-cash share based expense was \$4.7 million and \$3.2 million for the nine months ended September 30, 2011 and 2012, respectively.

Impairment of aircraft was \$88.8 million for the nine months ended September 30, 2012 related to eight Boeing Model 737-300 / -400 aircraft, one Boeing Model 757-200 aircraft and five Boeing Model 767-300ER aircraft, one Airbus Model A310-300F aircraft and two Airbus Model A320-200 aircraft, all of which did not pass their recoverability assessments. See "Summary of Impairments" below for a detailed discussion of the related impairment charges for these aircraft. During the nine months ended September 30, 2011, we recorded impairment of \$6.4 million related to a Boeing Model 737-400 aircraft which we repossessed following termination of the lease agreement in the second quarter of 2011.

Table of Contents

Maintenance and other costs were \$11.9 million for the nine months ended September 30, 2012, an increase of \$1.0 million over the same period in 2011. The net increase is primarily due to an increase in aircraft maintenance and other transitions costs primarily relating to unscheduled lease terminations for four aircraft returned to us in the second quarter of 2012.

## Other income (expense):

Total other income for the nine months ended September 30, 2012 was \$3.7 million as compared to \$28.8 million for the same period in 2011. The decrease is a result of a \$25.9 million decrease due to the gain on the sale of aircraft recorded in the nine months ended September 30, 2011 as compared to the same period in 2012.

## Income Tax Provision

Our provision for income taxes for the nine months ended September 30, 2011 and 2012 was \$6.0 million and \$6.0 million, respectively. Income taxes have been provided based on the applicable tax laws and rates of those countries in which operations are conducted and income is earned, primarily Ireland and the United States. The tax provision remained relatively constant for the nine months ended September 30, 2012 as compared to the same period in 2011, primarily attributable to an increase in operating income subject to tax in the U.S. and Ireland and treating the \$78.7 million Bermuda asset impairment of aircraft as a discrete item.

All of our aircraft-owning subsidiaries that are recognized as corporations for U.S. tax purposes are non-U.S. corporations. These non-U.S. subsidiaries generally earn income from sources outside the United States and typically are not subject to U.S. federal, state or local income taxes, unless they operate within the U.S., in which case they may be subject to federal, state and local income taxes. We also have a U.S.-based subsidiary which provides management services to our non-U.S. subsidiaries and is subject to U.S. federal, state and local income taxes. In addition, those subsidiaries that are resident in Ireland are subject to Irish tax.

The Company received an assurance from the Bermuda Minister of Finance that it would be exempted from local income, withholding and capital gains taxes until March 2035. Consequently, the provision for income taxes recorded relates to income earned by certain subsidiaries of the Company which are located in, or earn income in, jurisdictions that impose income taxes, primarily the United States and Ireland.

## Other comprehensive income:

	Nine Months Ended September 30,	
	2011	2012
	(Dollars in thousands)	
Net income	\$88,651	\$3,079
Net change in fair value of derivatives, net of tax expense of \$576 and \$465, respectively	21,079	23,708
Derivative loss reclassified into earnings	13,943	21,903
Total comprehensive income	\$123,673	\$48,690

Other comprehensive income was \$48.7 million for the nine months ended September 30, 2012, a decrease of \$75.0 million from the \$123.7 million of other comprehensive income for the nine months ended September 30, 2011. Other comprehensive income for the nine months ended September 30, 2012 primarily consisted of:

\$3.1 million of net income;

\$23.7 million gain from a change in fair value of interest rate derivatives, net of taxes which is due primarily to net settlements for the nine months ended September 30, 2012 partially offset by a slight downward shift in the one-month LIBOR forward curve; and

\$21.9 million of amortization of deferred net losses reclassified into earnings related to terminated interest rate derivatives.

Table of Contents

Other comprehensive income for the nine months ended September 30, 2011 primarily consisted of:

\$88.7 million of net income;

\$21.1 million gain from a change in fair value of interest rate derivatives, net of taxes which is due primarily to net settlements for the nine months ended September 30, 2011 partially offset by a downward shift in the 1 Month LIBOR curve; and

\$13.9 million of amortization of deferred net losses reclassified into earnings related to terminated interest rate derivatives.

For the nine months ended September 30, 2012, the amount of deferred net loss reclassified from OCI into interest expense related to our terminated interest rate derivatives was \$21.9 million. The amount of deferred net loss expected to be reclassified from OCI into interest expense over the next 12 months related to our terminated interest rate derivatives is \$31.1 million. See “Liquidity and Capital Resources — Hedging” below for more information on deferred net losses as related to terminated interest rate derivatives.

Summary of impairments and Recoverability Assessment

2012 Recoverability Assessment. As more fully described in our Annual Report on Form 10-K for the year ended December 31, 2011, we perform a recoverability assessment of all aircraft in our fleet, on an aircraft-by-aircraft basis, at least annually. We performed this recoverability assessment during the third quarter of 2012. Management develops the assumptions used in the recoverability assessment based on current and future expectations of the global demand for a particular aircraft type and historical experience in the aircraft leasing market and aviation industry, as well as information received from third party industry sources. The factors considered in estimating the undiscounted cash flows are impacted by changes in future periods due to changes in contracted lease rates, residual values, economic conditions, technology, airline demand for a particular aircraft type and other factors. In particular, many of our assumptions were driven primarily by weak market demand for older technology narrow- and wide-body model aircraft caused by slowing global economic growth rates, declining business confidence levels and higher fuel prices. In the case of Boeing 737 “Classic” aircraft, production rate increases by both Boeing and Airbus for newer generation narrowbody aircraft, coupled with slowing demand growth, is enabling more rapid replacement of earlier generation aircraft. Storage levels for these aircraft types have increased during the last twelve months. While we believe that the estimates and related assumptions used in the recoverability assessment are appropriate, actual results could differ from those estimates.

Following completion of the recoverability analysis, we took the following actions:

We determined that the cash flows expected to be generated certain of our aircraft did not support our carrying values and therefore did not pass our recoverability assessment. As a result, we impaired four Boeing Model 767-300ER aircraft, eight Boeing 737 “Classic” aircraft, and one Airbus Model A310-300F freighter aircraft and recorded aggregate impairment charges of \$67.4 million to write these aircraft down to current market values. For these 13 aircraft, the aggregate net book value as of June 30, 2012 was \$158.4 million. For some of these aircraft we also shortened the expected lives and/or reduced the residual values.

For seven other aircraft that passed the recoverability assessment, we took the following steps:

Shortened the expected lives of one Airbus A330-300 aircraft, five Boeing Model 767-300ER aircraft and one McDonnell Douglas MD-11SF aircraft, primarily to reflect the specific maintenance schedule that we expect for the airframe and related engines. With weaker expected market demand for these aircraft, we believe significant further investments in these aircraft would not be justified, so we adjusted the remaining lives of these aircraft to end prior to the next expected major maintenance event and/or

In the case of Boeing Model 767-300ER aircraft, reduced the residual value to reflect our current estimates. Again, due to market conditions and the change in expected retirement rates for aircraft with similar engines and other components, we determined that scrap values were likely to fall below our previous residual expectations.



Table of Contents

Other Impairments in Q3:2012. During the third quarter of 2012, we elected not to invest in engine performance restoration maintenance visits for two Airbus Model A320-200 "Classic" aircraft with older technology engines and instead agreed with the lessee to terminate the leases prior to scheduled expiry and pursue part-out sales. Following agreement with our customer to terminate the leases, these aircraft failed the recoverability assessment and we recorded impairment charges of \$11.3 million and we recorded \$10.2 million of maintenance revenue and reversed \$1.2 million of lease incentives for the three months ended September 30, 2012, for these two aircraft.

Reducing the expected lives or anticipated residual values for aircraft in our fleet will accelerate the future depreciation on these aircraft, which will be partly offset by reduced depreciation on aircraft that we impaired. As described above, these changes in depreciation going forward will affect 22 aircraft. For these 22 aircraft, our depreciation expense will increase by approximately \$0.8 million in the fourth quarter of 2012, as compared to the three months ended September 30, 2012. We estimate an annual increase in depreciation for these 22 aircraft for the year ended December 31, 2013, of approximately \$1.4 million for these aircraft, although future depreciation is expected to decrease as these aircraft reach the end of their holding periods.

Other than the aircraft discussed above, management believes that the net book value of each aircraft is currently supported by the estimated future undiscounted cash flows expected to be generated by that aircraft, and accordingly, no other aircraft were impaired as a consequence of this recoverability assessment. In addition our lessees may face financial difficulties and return aircraft to us prior to the contractual lease expiry dates. As a result, our cash flow assumptions may change and future impairment charges may be required.

At September 30, 2012, we had a total of 13 aircraft with a total net book value of \$329.3 million (accounting for 7.3% of the total net book value of our flight equipment held for lease) that we consider more susceptible to failing our recoverability assessment. The recoverability in the value of these aircraft is more sensitive to changes in contractual cash flows, future cash flow estimates and aircraft residual or scrap values. These aircraft fall into the categories as shown in the table below:

Aircraft Type	Number of Aircraft	Percent of Net Book Value
Narrowbody	5	2.1%
Midbody	5	2.3%
Freighters	3	2.9%

**RECENT UNADOPTED ACCOUNTING PRONOUNCEMENTS**

In August 2010, the Financial Accounting Standards Board (the "FASB") issued an exposure draft, "Leases" (the "Lease ED"), which would replace the existing guidance in the Accounting Standards Codification ("ASC") 840 ("ASC 840"), Leases. In June 2012, the FASB decided that leases would be classified as either leases of property or leases of assets other than property. Leases of property will continue to use operating lease accounting. Leases of other than property would use the receivable residual approach. Under the receivable residual approach, a lease receivable would be recognized for the lessor's right to receive lease payments, a portion of the carrying amount of the underlying asset would be allocated between the right of use granted to the lessee and the lessor's residual value and profit or loss would only be recognized at commencement if it is reasonably assured. The FASB completed all of its deliberations and decided to re-expose the Lease ED in the first quarter of 2013. We anticipate that the final standard may have an effective date no earlier than 2016. When and if the proposed guidance becomes effective, it may have a significant impact on the Company's consolidated financial statements. Although we believe the presentation of our financial statements, and those of our lessees could change, we do not believe the accounting pronouncement will change the fundamental economic reasons for which the airlines lease aircraft. Therefore, we do not believe it will have a material impact on our business.

**LIQUIDITY AND CAPITAL RESOURCES**

Our primary sources of liquidity currently are cash on hand, cash generated by our aircraft leasing operations, loans secured by new aircraft we acquire and unsecured borrowings. Our business is very capital intensive, requiring

significant investments in order to expand our fleet during periods of growth and investments in maintenance and improvements on our existing portfolio. Our business also generates a significant amount of cash from operations, primarily from lease rentals and maintenance collections. These sources have historically provided liquidity for these investments and for other uses, including the payment of dividends to our shareholders. In the past, we have also met our liquidity and capital resource

Table of Contents

needs by utilizing several sources, including:

- lines of credit, our securitizations, term financings, secured borrowings supported by export credit agencies for new aircraft acquisitions and bank financings secured by aircraft purchases;
- unsecured indebtedness, including an unsecured revolving credit facility and unsecured senior notes;
- public offerings of common shares; and
- asset sales.

Going forward, we expect to continue to seek liquidity from these sources subject to pricing and conditions that we consider satisfactory. In addition, we have a \$50.0 million senior unsecured revolving credit facility with Citigroup Global Markets Inc., which has a three-year term scheduled to expire in September 2013; we have not yet drawn down on this facility.

In April 2012, we closed an offering of \$500.0 million aggregate principal amount of Senior Notes due 2017 and \$300.0 million aggregate principal amount of Senior Notes due 2020. Both the Senior Notes due 2017 and the Senior Notes due 2020 were priced at par. We used the net proceeds of the private placement to repay outstanding indebtedness under our Term Financing No. 1 and the termination of the associated interest rate derivatives, and for general corporate purposes, including the purchase of aviation assets.

Under the terms of Securitization No. 2, effective June 8, 2012 all cash flows available after expenses and interest will be applied to debt amortization. We expect that debt amortization payments, excluding repayments from asset sales, over the next twelve months will be approximately \$130.0 million, excluding debt repayments from asset sales of \$3.1 million, compared to \$71.2 million, excluding debt repayments from asset sales of \$37.6 million, made over the twelve months ended September 30, 2012. Further, for this financing, we recently entered into a forward starting interest rate derivative arrangement to hedge approximately 75% of the expected future debt balance beginning in June 2012 at an average swap rate of 1.27%, which is approximately 400 basis points lower than the interest rate derivative which expired in June 2012.

While the financing structures for our securitizations and certain of our term financings include liquidity facilities, these liquidity facilities are primarily designed to provide short-term liquidity to enable the financing vehicles to remain current on interest payments during periods when the relevant entities incur substantial unanticipated expenditures. Because these facilities have priority in the payment waterfall and therefore must be repaid quickly, and because we do not anticipate being required to draw on these facilities to cover operating expenses, we do not view these liquidity facilities as an important source of liquidity for us.

As of September 30, 2012, we are in compliance with all applicable covenants in our financings.

We believe that cash on hand, funds generated from operations, maintenance payments received from lessees, and proceeds from any future contracted aircraft sales will be sufficient to satisfy our liquidity and capital resource needs over the next twelve months. Our liquidity and capital resource needs include required principal and interest payments under our long-term debt facilities, expected capital expenditures, lessee maintenance payment draws and lease incentive payments over the next twelve months.

## Cash Flows

	Nine Months Ended September 30,	
	2011	2012
	(Dollars in thousands)	
Net cash flow provided by operating activities	\$255,173	\$305,956
Net cash flow used in investing activities	(187,848 )	(516,300 )
Net cash flow (used in) provided by financing activities	(41,028 )	138,781

Table of Contents

Operating Activities:

Cash flow from operations was \$255.2 million and \$306.0 million for the nine months ended September 30, 2011 and September 30, 2012, respectively. The increase in cash flow from operations of approximately \$50.8 million for the nine months ended September 30, 2012 versus the same period in 2011 was primarily a result of:

- \$41.5 million increase in cash from lease rentals;  
and
- \$7.8 million increase in cash from other working capital.

This increase was offset partially by:

\$2.8 million increase in cash paid for SG&A and maintenance expenses.

Investing Activities:

Cash used in investing activities was \$187.8 million and \$516.3 million for the nine months ended September 30, 2011 and September 30, 2012, respectively. The increase in cash flow used in investing activities of \$328.5 million for the nine months ended September 30, 2012 versus the same period in 2011, was primarily a result of:

- \$41.5 million increase in the acquisition and improvement of flight equipment;
- \$264.1 million decrease in the proceeds from the sale of flight equipment;
- \$89.5 increase in the net investment of finance leases in 2012; and
- \$40.4 million net increase for the purchase of a debt investment in 2012.

These increases were offset partially by:

- \$71.8 million decrease in aircraft purchase deposits under our Airbus A330 Agreement; and
- \$35.8 million increase in restricted cash and cash equivalents related to the sale of flight equipment.

Financing Activities:

Cash used in financing activities was \$41.0 million for the nine months ended September 30, 2011 as compared to cash provided by financing activities of \$138.8 million for the nine months ended September 30, 2012. The net increase in cash flow provided by financing activities of \$179.8 million for the nine months ended September 30, 2012 versus the same period in 2011 was a result of:

- \$488.2 million of higher borrowings from the proceeds of the issuance of Senior Notes due 2017 and Senior Notes due 2020 and an additional borrowing under an ECA supported loan for the financing of an Airbus Model A330-200 aircraft in 2012 as compared to five ECA supported loan borrowings for the financing of five Airbus Model A330-200 aircraft in 2011;
- \$112.9 million higher restricted cash and cash equivalents related to security deposits and maintenance payments;
- \$60.7 million lower repurchases of our common shares as a result of the share buy-back program in 2011;
- \$43.0 million of higher maintenance deposits received net of maintenance deposits returned; and
- \$1.1 million of lower security deposits received net of security deposits returned.

The inflows were offset partially by:

- \$466.5 million of higher financing repayments on our securitizations and term debt financings as the result of the pay-off of Term Financing No. 1 in 2012 as compared to the pay-off of one ECA supported loan in 2011;
- \$50.7 million of payments for terminated cash flows hedges in 2012; and
- \$7.0 million in higher dividends paid.



Table of Contents

## Debt Obligations

The following table provides a summary of our secured and unsecured debt financings at September 30, 2012:

Debt Obligation	Collateral	Outstanding Borrowing	Number of Aircraft	Interest Rate <sup>(1)</sup>	Final Stated Maturity <sup>(2)</sup>
(Dollars in thousands)					
Secured Debt Financings:					
Securitization No. 1	Interests in aircraft leases, beneficial interests in aircraft owning/leasing entities and related interests	\$ 323,266	31	0.49%	06/20/31
Securitization No. 2	Interests in aircraft leases, beneficial interests in aircraft owning/leasing entities and related interests	807,699	44	0.54%	06/14/37
ECA Term Financings	Interests in aircraft, aircraft leases, beneficial interests in aircraft owning/leasing entities and related interests	581,823	9	2.65% to 3.96%	12/03/21 to 04/03/24
Bank Financings	Interests in aircraft, aircraft leases, beneficial interests in aircraft owning/leasing entities and related interests	116,095	3	4.22% to 4.57%	09/15/15 to 10/26/17
Total secured debt financings		1,828,883			
Unsecured Debt Financings:					
Senior Notes due 2017	None	500,000	—	6.75%	04/15/17
Senior Notes due 2018	None	450,671	—	9.75%	08/01/18
Senior Notes due 2020	None	300,000	—	7.625%	04/15/20
2010 Revolving Credit Facility	None	—	—	N/A	09/28/13
Total unsecured debt financings		1,250,671			
Total secured and unsecured debt financings		\$3,079,554			

(1) Reflects floating rate in effect at the most recent applicable reset date plus the margin, except for the ECA Term Financings, Bank Financings and the Senior Notes due 2017, 2018 and 2020, which are fixed rate.

(2) Effective June 2011 for Securitization No. 1, all cash flows available after expenses and interest is applied to debt amortization. Effective June 2012 for Securitization No. 2, all cash flows available after expenses and interest is applied to debt amortization.

The following securitizations and term debt financing structures include liquidity facility commitments described in the table below:

Facility	Liquidity Facility Provider	Available Liquidity			Interest Rate on any Advances
		December 31, 2011	September 30, 2012	Unused Fee	
(Dollars in thousands)					
Securitization No. 1	Crédit Agricole Corporate and Investment Bank	\$42,000	\$42,000	0.45%	1M Libor + 1.00

Edgar Filing: Aircastle LTD - Form 10-Q

Securitization No. 2	HSH Nordbank AG	66,859	65,000	0.50%	1M Libor + 0.75
----------------------	-----------------	--------	--------	-------	-----------------

Senior Notes due 2017 and Senior Notes due 2020

In April 2012, we closed an offering of \$500.0 million aggregate principal amount of Senior Notes due 2017 and \$300.0 million aggregate principal amount of Senior Notes due 2020. Both the Senior Notes due 2017 and the Senior Notes due 2020 were priced at par. We used the net proceeds of the private placement to repay outstanding indebtedness under our Term Financing No. 1 and the termination of the associated interest rate derivative, and for general corporate purposes, including the purchase of aviation assets.

Table of Contents

## Contractual Obligations

Our contractual obligations consist of principal and interest payments on variable and fixed rate liabilities, interest payments on interest rate derivatives, other aircraft acquisition and conversion agreements and rent payments pursuant to our office leases. Total contractual obligations increased from \$3.75 billion at December 31, 2011 to approximately \$4.10 billion at September 30, 2012 due primarily to:

- an increase in borrowings as a result of the closing of our Senior Notes due 2017 and 2020 and an ECA loan for the purchase of a New A330 aircraft in April, 2012 ; and
- an increase in the commitment for office leases as a result of a ten-year lease extension for the office space in Stamford, Connecticut signed in January 2012.

These increases were partially offset by:

- the payoff of Term Financing No. 1 in April, 2012; and
- principal and interest payments made under our securitizations, and our ECA term financings.

The following table presents our actual contractual obligations and their payment due dates as of September 30, 2012.

Contractual Obligations	Payments Due By Period as of September 30, 2012				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
	(Dollars in thousands)				
Principal payments:					
Senior Notes due 2017	\$ 500,000	\$—	\$—	\$ 500,000	\$—
Senior Notes due 2018	450,000	—	—	—	450,000
Senior Notes due 2020	300,000	—	—	—	300,000
Securitization No. 1 <sup>(1)</sup>	323,266	58,156	116,253	99,539	49,318
Securitization No. 2 <sup>(2)</sup>	807,699	133,111	274,103	239,965	160,520
ECA Term Financings <sup>(3)</sup>	581,823	46,573	98,039	104,949	332,262
Bank Financings <sup>(4)</sup>	116,095	13,499	32,471	18,458	51,667
Total principal payments	3,078,883	251,339	520,866	962,911	1,343,767
Interest payments:					
Interest payments on debt obligations <sup>(5)</sup>	767,593	132,236	250,245	236,812	148,300
Interest payments on interest rate derivatives <sup>(6)</sup>	77,327	23,532	39,490	14,305	—
Total interest payments	844,920	155,768	289,735	251,117	148,300
Office leases <sup>(7)</sup>	9,218	1,089	2,262	1,785	4,082
Purchase obligations <sup>(8)</sup>	168,100	168,100	—	—	—
Total	\$4,101,121	\$576,296	\$812,863	\$1,215,813	\$1,496,149

(1) Estimated principal payments for this non-recourse financing are based on excess cash flows available from forecasted lease rentals, net maintenance funding and proceeds from asset dispositions after the payment of forecasted operating expenses and interest payments, including interest payments on existing interest rate derivative agreements and policy provider fees.

(2) Estimated principal payments for this non-recourse financing are based on excess cash flows available from forecasted lease rentals, net maintenance funding and proceeds from asset dispositions after the payment of forecasted operating expenses and interest payments, including interest payments on existing interest rate derivative agreements and policy provider fees.

(3) Includes scheduled principal payments based upon fixed rate, 12-year, fully amortizing loans.

(4) Includes principal payments based upon individual loan amortization schedules.

- (5) Future interest payments on variable rate, LIBOR-based debt obligations are estimated using the interest rate in effect at September 30, 2012.
- (6) Future interest payments on derivative financial instruments are estimated using the spread between the floating interest rates and the fixed interest rates in effect at September 30, 2012.
- (7) Represents contractual payment obligations for our office leases in Stamford, Connecticut; Dublin, Ireland and Singapore.
- (8) At September 30, 2012, we had commitments to acquire three aircraft.

## Table of Contents

### Capital Expenditures

We make capital expenditures from time to time in connection with improvements made to our aircraft. These expenditures include the cost of major overhauls necessary to place an aircraft in service and modifications made at the request of lessees. For the nine months ended September 30, 2011 and 2012, we incurred a total of \$34.7 million and \$34.7 million, respectively, of capital expenditures (including lease incentives) related to the acquisition and improvement of aircraft.

As of September 30, 2012, the weighted average age (by net book value) of our aircraft was approximately 11.0 years. In general, the costs of operating an aircraft, including maintenance expenditures, increase with the age of the aircraft. Under our leases, the lessee is primarily responsible for maintaining the aircraft. We may incur additional maintenance and modification costs in the future in the event we are required to remarket an aircraft or a lessee fails to meet its maintenance obligations under the lease agreement. At September 30, 2012, we had \$372.6 million of maintenance reserves as a liability on our balance sheet. These maintenance reserves are paid by the lessee to provide for future maintenance events. Provided a lessee performs scheduled maintenance of the aircraft, we are required to reimburse the lessee for scheduled maintenance payments. In certain cases, we are also required to make lessor contributions, in excess of amounts a lessee may have paid, towards the costs of maintenance events performed by or on behalf of the lessee. For the nine months ended September 30, 2012, we received \$103.5 million of maintenance payments and returned \$37.0 million of maintenance payments.

Actual maintenance payments to us by lessees in the future may be less than projected as a result of a number of factors, including defaults by the lessees. Maintenance reserves may not cover the entire amount of actual maintenance expenses incurred and, where these expenses are not otherwise covered by the lessees, there can be no assurance that our operational cash flow and maintenance reserves will be sufficient to fund maintenance requirements, particularly as our aircraft age.

### Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements as of September 30, 2012.

### Foreign Currency Risk and Foreign Operations

At September 30, 2012, all of our leases are payable to us in U.S. dollars. However, we incur Euro- and Singapore dollar-denominated expenses in connection with our subsidiary in Ireland and branch office in Singapore. For the nine months ended September 30, 2012, expenses, such as payroll and office costs, denominated in currencies other than the U.S. dollar aggregated approximately \$7.6 million in U.S. dollar equivalents and represented approximately 20.8% of total selling, general and administrative expenses. Our international operations are a significant component of our business strategy and permit us to more effectively source new aircraft, service the aircraft we own and maintain contact with our lessees. Therefore, it is likely that our international operations and our exposure to foreign currency risk will increase over time. Although we have not yet entered into foreign currency hedges because our exposure to date has not been significant, if our foreign currency exposure increases we may enter into hedging transactions in the future to mitigate this risk. For the nine months ended September 30, 2011 and 2012, we incurred insignificant net gains and losses on foreign currency transactions.

### Hedging

The objective of our hedging policy is to adopt a risk averse position with respect to changes in interest rates. Accordingly, we have entered into a number of interest rate derivatives to hedge the current and expected future interest rate payments on our variable rate debt. Interest rate derivatives are agreements in which a series of interest rate cash flows are exchanged with a third party over a prescribed period. The notional amount on an interest rate derivative is not exchanged. Our interest rate derivatives typically provide that we make fixed rate payments and receive floating rate payments to convert our floating rate borrowings to fixed rate obligations to better match the largely fixed rate cash flows from our investments in flight equipment.



Table of Contents

We held the following interest rate derivatives as of September 30, 2012:

Hedged Item	Derivative Liabilities			Future Maximum Notional Amount	Floating Rate	Fixed Rate	Balance Sheet Location	Fair Value
	Current Notional Amount	Effective Date	Maturity Date					
(Dollars in thousands)								
Interest rate derivatives designated as cash flow hedges:								
Securitization No. 1	\$343,972	Jun-06	Jun-16	\$343,972	1M LIBOR + 0.27%	5.78%	Fair value of derivative liabilities	\$54,526
Securitization No. 2	611,530	Jun-12	Jun-17	611,530	1M LIBOR	1.26% to 1.28%	Fair value of derivative liabilities	13,424
Total interest rate derivatives designated as cash flow hedges	\$955,502			\$955,502				\$67,950

Four interest rate derivatives hedging Securitization No. 2 matured on June 8, 2012. The two interest rate derivatives hedging Term Financing No. 1 were terminated on April 4, 2012 resulting in a net deferred loss of \$50.4 million which is being amortized into interest expense using the interest rate method.

The weighted average interest pay rates of these derivatives at December 31, 2011 and September 30, 2012 were 5.03%, and 2.89%, respectively.

For the nine months ended September 30, 2012, the amount of loss reclassified from accumulated other comprehensive income ("OCI") into interest expense related to net interest settlements on active interest rate derivatives was \$40.6 million. The amount of loss expected to be reclassified from OCI into interest expense over the next 12 months related to net interest settlements on active interest rate derivatives is \$21.3 million.

Our interest rate derivatives involve counterparty credit risk. As of September 30, 2012, our interest rate derivatives are held with the following counterparties: JP Morgan Chase Bank NA, Citibank Canada NA, and Wells Fargo Bank NA. All of our counterparties or guarantors of these counterparties are considered investment grade (senior unsecured ratings of Baa2 or above) by Moody's Investors Service. All are also considered investment grade (long-term foreign issuer ratings of A- or above) by Standard and Poor's. We do not anticipate that any of these counterparties will fail to meet their obligations.

In addition to the derivative liability above, another component of the fair value of our interest rate derivatives is accrued interest. As of September 30, 2012, accrued interest payable included in accounts payable, accrued expenses, and other liabilities on our consolidated balance sheet was \$1.1 million related to interest rate derivatives designated as cash flow hedges.

Historically, the Company acquired its aircraft using short-term credit facilities and equity. The short-term credit facilities were refinanced by securitizations or term debt facilities secured by groups of aircraft. The Company completed two securitizations and two term financings during the period 2006 through 2008. The Company entered into interest rate derivatives to hedge interest payments on variable rate debt for acquired aircraft as well as aircraft that it expected to acquire within certain future periods. In conjunction with its financing strategy, the Company used

interest rate derivatives for periods ranging from 5 to 10 years to fix the interest rates on the variable rate debt that it incurred to acquire aircraft in anticipation of the expected securitization or term debt re-financings.

At the time of each re-financing, the initial interest rate derivatives were terminated and new interest rate derivatives were executed as required by each specific debt financing. At the time of each interest rate derivative termination, certain interest rate derivatives were in a gain position and others were in a loss position. Since the hedged interest payments for the variable rate debt associated with each terminated interest rate derivative were probable of occurring, the gain or loss was deferred in accumulated other comprehensive income (loss) and is being amortized into interest expense over the relevant period for each interest rate derivative.

On an ongoing basis, terminated interest rate derivative notionals are evaluated against debt forecasts. To the extent that interest payments are deemed remote to occur, deferred gains or losses are accelerated into interest expense as applicable.



Table of Contents

The following table summarizes the deferred (gains) and losses and related amortization into interest expense for our terminated interest rate derivative contracts for the nine months ended September 30, 2011 and 2012:

Hedged Item	Original Maximum Notional Amount	Effective Date	Maturity Date	Fixed Rate %	Termination Date	Deferred (Gain) or Loss Upon Termination	Amount of Deferred (Gain) or Loss		Amount of Deferred (Gain) or Loss Expected to be Amortized over the Next Twelve Months	
							Unamortized Deferred (Gain) or Loss at September 30, 2012	Amortized (including Accelerated Amortization) into Interest Expense for the Nine Months Ended September 30, 2011		
(Dollars in Thousands)										
Securitization No. 2	500,000	Mar-06	Mar-11	5.07	Jun-07	\$ (2,687 )	\$ —	\$ (122 )	\$ —	\$ —
Securitization No. 2	200,000	Jan-07	Aug-12	5.06	Jun-07	(1,850 )	—	(251 )	(190 )	—
Securitization No. 2	410,000	Feb-07	Apr-17	5.14	Jun-07	(3,119 )	(1,050 )	(264 )	(259 )	(309 )
Term Financing No. 1	150,000	Jul-07	Dec-17	5.14	Mar-08	15,281	6,403	1,347	1,303	1,531
Term Financing No. 1	440,000	Jun-07	Feb-13	4.88	Partial – Mar-08 Full – Jun-08	26,281	1,546	3,927	3,609	1,546
Term Financing No. 1	248,000	Aug-07	May-13	5.33	Jun-08	9,888	1,017	1,228	1,053	1,017
Term Financing No. 1 <sup>(1)</sup>	710,068	Jun-08	May-13	4.04	De-designated – Mar-12 Terminated – April-12	19,026	10,104	—	8,922	10,104
Term Financing No. 1 <sup>(1)</sup>	491,718	May-13	May-15	5.31	De-designated – Mar-12 Terminated – April-12	31,403	31,403	—	—	7,783
Senior Notes due 2018	360,000	Jan-08	Feb-19	5.16	Partial – Jun-08 Full – Oct-08	23,077	8,296	1,058	546	864
ECA Term Financing for New A330 Aircraft	231,000	Apr-10	Oct-15	5.17	Partial – Jun-08 Full – Dec-08	15,310	6,562	1,791	2,632	2,803
ECA Term Financing for	238,000	Jan-11	Apr-16	5.23	Dec-08	19,430	11,081	3,525	2,843	3,541

New A330 Aircraft ECA Term Financing for New A330 Aircraft	238,000	Jul-11	Sep-16	5.27	Dec-08	17,254	7,597	1,704	1,444	2,215
Total						\$169,294	\$82,959	\$13,943	\$21,903	\$31,095

(1) On April 4, 2012, upon the repayment of Term Financing No. 1, both interest rate derivatives were terminated resulting in a net deferred loss of \$50,429 which is being amortized into interest expense using the interest rate method. The mark-to-market adjustment for the period from date of de-designation through the termination date was charged to other income (expense) on our consolidated statement of income.

For the nine months ended September 30, 2012, the amount of deferred net loss reclassified from OCI into interest expense related to our terminated interest rate derivatives was \$21.9 million. The amount of deferred net loss expected to be reclassified from OCI into interest expense over the next 12 months related to our terminated interest rate derivatives is \$31.1 million of which \$17.9 million relates to Term Financing No. 1 interest rate derivatives terminated in April 2012, \$4.1 million relates to Term Financing No. 1 interest rate derivatives terminated in 2008, \$8.6 million relates to ECA Term Financings for New A330 Aircraft and \$0.6 million relates to other financings.

Table of Contents

The following table summarizes amounts charged directly to the consolidated statement of income for the three and nine months ended September 30, 2011 and 2012, respectively, related to our interest rate derivatives:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
	(Dollars in thousands)			
Interest Expense:				
Hedge ineffectiveness (gains) losses	\$(118 )	\$1,474	\$(716 )	\$1,840
Amortization:	1,704	—	3,551	—
Amortization of deferred losses	4,013	8,966	10,392	21,903
Total Amortization	5,717	8,966	13,943	21,903
Total charged to interest expense	\$5,599	\$10,440	\$13,227	\$23,743
Other Income (Expense):				
Mark to market(losses) gains on undesignated interest rate derivatives	\$(117 )	\$—	\$(733 )	\$599
Total charged to other income (expense)	\$(117 )	\$—	\$(733 )	\$599

**Management's Use of EBITDA and Adjusted EBITDA**

We define EBITDA as income (loss) from continuing operations before income taxes, interest expense, and depreciation and amortization. We use EBITDA to assess our consolidated financial and operating performance, and we believe this non-US GAAP measure is helpful in identifying trends in our performance.

This measure provides an assessment of controllable expenses and affords management the ability to make decisions which are expected to facilitate meeting current financial goals as well as achieving optimal financial performance. It provides an indicator for management to determine if adjustments to current spending decisions are needed.

EBITDA provides us with a measure of operating performance because it assists us in comparing our operating performance on a consistent basis as it removes the impact of our capital structure (primarily interest charges on our outstanding debt) and asset base (primarily depreciation and amortization) from our operating results. Accordingly, this metric measures our financial performance based on operational factors that management can impact in the short-term, namely the cost structure, or expenses, of the organization. EBITDA is one of the metrics used by senior management and the board of directors to review the consolidated financial performance of our business.

We define Adjusted EBITDA as EBITDA (as defined above) further adjusted to give effect to adjustments required in calculating covenant ratios and compliance as that term is defined in the indenture governing our senior unsecured notes. Adjusted EBITDA is a material component of these covenants.

The table below shows the reconciliation of net income to EBITDA and Adjusted EBITDA for the three and nine months ended September 30, 2011 and 2012, respectively.

Table of Contents

	Three Months Ended		Nine Months Ended	
	September 30, 2011	2012	September 30, 2011	2012
	(Dollars in thousands)			
Net income (loss)	\$22,665	\$(45,847 )	\$88,651	\$3,079
Depreciation	60,132	68,413	178,299	200,024
Amortization of net lease discounts and lease incentives	4,709	6,838	10,841	6,392
Interest, net	48,872	54,101	150,384	167,203
Income tax provision	1,237	1,701	6,041	5,976
EBITDA	\$137,615	\$85,206	\$434,216	\$382,674
Adjustments:				
Impairment of aircraft	1,236	78,676	6,436	88,787
Non-cash share based payment expense	1,619	1,128	4,692	3,233
Loss (gain) on mark to market of interest rate derivative contracts	117	—	733	(599 )
Contract termination expense	—	1,248	—	1,248
Adjusted EBITDA	\$140,587	\$166,258	\$446,077	\$475,343

## Management's Use of Adjusted Net Income ("ANI")

Beginning with our report for the quarter ended March 31, 2012, management, to be more consistent with reporting practices of peer aircraft leasing companies, has revised the calculation of ANI to no longer exclude gains (losses) on sales of assets, and to exclude non-cash share based payment expense in the calculation of ANI. Beginning with our quarterly report for the quarter ended June 30, 2012, we also excluded Term Financing No. 1 hedge loss amortization charges which will be reported in Interest, net on our consolidated statement of income from the calculation of ANI. The calculation of ANI for the three and nine months ended September 30, 2011 has been revised to be comparable with the current period presentation.

Management believes that ANI when viewed in conjunction with the Company's results under US GAAP and the below reconciliation, provides useful information about operating and period-over-period performance, and provides additional information that is useful for evaluating the underlying operating performance of our business without regard to periodic reporting elements related to interest rate derivative accounting.

The table below shows the reconciliation of net income to ANI for the three and nine months ended September 30, 2011 and 2012, respectively.

	Three Months Ended		Nine Months Ended	
	September 30, 2011	2012	September 30, 2011	2012
	(Dollars in thousands)			
Net income (loss)	\$22,665	\$(45,847 )	\$88,651	\$3,079
Ineffective portion and termination of hedges <sup>(1)</sup>	1,586	1,474	2,835	1,840
Mark to market of interest rate derivative contracts <sup>(2)</sup>	117	—	733	(599 )
Loan termination payment <sup>(1)</sup>	—	—	3,196	—
Write-off of deferred financing fees <sup>(1)</sup>	—	—	2,456	2,914
Stock compensation expense <sup>(3)</sup>	1,619	1,128	4,692	3,233
Term Financing No. 1 hedge loss amortization charges <sup>(1)</sup>	—	4,506	—	8,922
Contract termination expense	—	1,248	—	1,248
Adjusted net income (loss)	\$25,987	\$(37,491 )	\$102,563	\$20,637

(1)Included in Interest, net.

(2)Included in Other income (expense).

(3)Included in Selling, general and administrative expenses.



Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
Weighted-average shares:				
Common shares outstanding	72,950,361	70,349,265	75,791,005	71,248,765
Restricted common shares	970,559	571,326	965,655	596,749
Total weighted-average shares	73,920,920	70,920,591	76,756,660	71,845,514
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
Percentage of weighted-average shares:				
Common shares outstanding	98.69	% 99.19	% 98.74	% 99.17
Restricted common shares	1.31	% 0.81	% 1.26	% 0.83
Total	100.00	% 100.00	% 100.00	% 100.00
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
Weighted-average common shares outstanding – Basic	72,950,361	70,349,265	75,791,005	71,248,765
Effect of dilutive shares	—	—	—	—
Weighted-average common shares outstanding - Diluted (b)	72,950,361	70,349,265	75,791,005	71,248,765
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
Adjusted net income allocation:				
Adjusted net income (loss)	\$25,987	\$(37,491 )	\$102,563	\$20,637
Less: Distributed and undistributed earnings allocated to restricted common shares <sup>(a)</sup>	(341 )	302	(1,290 )	(171 )
Adjusted net income allocable to common shares – Basic and Diluted	\$25,646	\$(37,189 )	\$101,273	\$20,466
Adjusted net income (loss) per common share – Basic and Diluted	\$0.35	\$(0.53 )	\$1.34	\$0.29

For the three months ended September 30, 2011 and 2012, distributed and undistributed earnings to restricted shares is 1.31% and 0.81%, respectively, of net income. For the nine months ended September 30, 2011 and 2012, (a) distributed and undistributed earnings to restricted shares is 1.26% and 0.83%, respectively, of net income. The amount of restricted share forfeitures for all periods present is immaterial to the allocation of distributed and undistributed earnings.

(b) For the three and nine months ended September 30, 2011 and for the nine months ended September 30, 2012, we have no dilutive shares.

#### Limitations of EBITDA, Adjusted EBITDA and ANI

An investor or potential investor may find EBITDA, Adjusted EBITDA and ANI important measures in evaluating our performance, results of operations and financial position. We use these non-US GAAP measures to supplement our US GAAP results in order to provide a more complete understanding of the factors and trends affecting our business.

EBITDA, Adjusted EBITDA and ANI have limitations as analytical tools and should not be viewed in isolation or as substitutes for US GAAP measures of earnings. Material limitations in making the adjustments to our earnings to

calculate EBITDA, Adjusted EBITDA and ANI, and using these non-US GAAP measures as compared to US GAAP net income, income from continuing operations and cash flows provided by or used in operations, include: depreciation and amortization, though not directly affecting our current cash position, represent the wear and tear and/or reduction in value of our aircraft, which affects the aircraft's availability for use and may be indicative of future needs for capital expenditures;

Table of Contents

the cash portion of income tax (benefit) provision generally represents charges (gains), which may significantly affect our financial results;

elements of our interest rate derivative accounting may be used to evaluate the effectiveness of our hedging policy; and

non-cash share based payment expense;

hedge loss amortization charges related to Term Financing No. 1; and

adjustments required in calculating covenant ratios and compliance as that term is defined in the indenture governing our senior unsecured notes.

EBITDA, Adjusted EBITDA and ANI are not alternatives to net income, income from operations or cash flows provided by or used in operations as calculated and presented in accordance with US GAAP. You should not rely on these non-US GAAP measures as a substitute for any such US GAAP financial measure. We strongly urge you to review the reconciliations to US GAAP net income, along with our consolidated financial statements included elsewhere in this report. We also strongly urge you to not rely on any single financial measure to evaluate our business. In addition, because EBITDA, Adjusted EBITDA and ANI are not measures of financial performance under US GAAP and are susceptible to varying calculations, EBITDA, Adjusted EBITDA and ANI as presented in this report, may differ from and may not be comparable to, similarly titled measures used by other companies.



Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Interest rate risk is the exposure to loss resulting from changes in the level of interest rates and the spread between different interest rates. These risks are highly sensitive to many factors, including U.S. monetary and tax policies, U.S. and international economic factors and other factors beyond our control. We are exposed to changes in the level of interest rates and to changes in the relationship or spread between interest rates. Our primary interest rate exposures relate to our lease agreements, floating rate debt obligations and interest rate derivatives. Rent payments under our aircraft lease agreements typically do not vary during the term of the lease according to changes in interest rates. However, our borrowing agreements generally require payments based on a variable interest rate index, such as LIBOR. Therefore, to the extent our borrowing costs are not fixed, increases in interest rates may reduce our net income by increasing the cost of our debt without any corresponding increase in rents or cash flow from our securities. Changes in interest rates may also impact our net book value as our interest rate derivatives are periodically marked-to-market through shareholders' equity. Generally, we are exposed to loss on our fixed pay interest rate derivatives to the extent interest rates decrease below their contractual fixed rate.

The relationship between spreads on derivative instruments may vary from time to time, resulting in a net aggregate book value increase or decrease. Changes in the general level of interest rates can also affect our ability to acquire new investments and our ability to realize gains from the settlement of such assets.

Sensitivity Analysis

The following discussion about the potential effects of changes in interest rates is based on a sensitivity analysis, which models the effects of hypothetical interest rate shifts on our financial condition and results of operations. We changed our interest rate risk disclosure to an alternative that provides a more meaningful analysis of our interest rate risk. Although we believe a sensitivity analysis provides the most meaningful analysis permitted by the rules and regulations of the SEC, it is constrained by several factors, including the necessity to conduct the analysis based on a single point in time and by the inability to include the extraordinarily complex market reactions that normally would arise from the market shifts modeled. Although the following results of a sensitivity analysis for changes in interest rates may have some limited use as a benchmark, they should not be viewed as a forecast. This forward-looking disclosure also is selective in nature and addresses only the potential interest expense impacts on our financial instruments and, in particular, does not address the mark-to-market impact on our interest rate derivatives. It also does not include a variety of other potential factors that could affect our business as a result of changes in interest rates. As of September 30, 2012, a hypothetical 100-basis point increase/decrease in our variable interest rate on our borrowings would result in an interest expense increase/decrease of \$1.5 million and \$0.5 million, respectively, net of amounts received from our interest rate derivatives, over the next twelve months.

Table of Contents

Item 4. Controls and Procedures

Management's Evaluation of Disclosure Controls and Procedures

The term "disclosure controls and procedures" is defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. This term refers to the controls and procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") as appropriate, to allow timely decisions regarding required disclosure. An evaluation was performed under the supervision and with the participation of the Company's management, including the CEO and CFO, of the effectiveness of the Company's disclosure controls and procedures as of September 30, 2012. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective as of September 30, 2012.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

## PART II. — OTHER INFORMATION

## Item 1. Legal Proceedings

The Company is not a party to any material legal or adverse regulatory proceedings.

## Item 1A. Risk Factors

There have been no material changes to the disclosure related to the risk factors described in our Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2011.

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

## Issuer Purchases of Equity Securities

During the third quarter of 2012, we purchased our common shares as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(b)</sup>	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(b)</sup>
	(Dollars in thousands, except per share amounts)			
July	—	\$—	—	\$ 50,000
August	2,505,479	11.40 <sup>(a)</sup>	2,500,002	21,500
September	—	—	—	21,500
Total	2,505,479	\$11.40	2,500,002	\$ 21,500

(a) Our Compensation Committee approved the repurchase of 5,477 common shares pursuant to an irrevocable election made under the Amended and Restated Aircastle Limited 2005 Equity and Incentive Plan, in satisfaction of minimum tax withholding obligations associated with the vesting of restricted common shares during the third quarter of 2012.

(b) On May 24, 2012, the Company's Board of Directors authorized the repurchase of up to \$50 million of the Company's common shares. Under the program, the Company may purchase its common shares from time to time in the open market or in privately negotiated transactions. The amount and timing of the purchases will depend on a number of factors, including the price and availability of the Company's common shares, trading volume and general market conditions. The Company may also from time to time establish a trading plan under Rule 10b5-1 of the Exchange Act to facilitate purchases of its common shares under this authorization. Through September 30, 2012, we repurchased 2,500,002 shares from Fortress Investment Group and certain of its affiliates at a total cost of \$28.5 million under the repurchase program and we paid no commissions on this transaction. On November 5, 2012, the Company's Board of Directors authorized an increase in the Company's share repurchase program by up to an additional \$28.5 million of its common shares, bringing the total back up to \$50.0 million of its common shares in the aggregate.

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 5. Other Information

None.



Table of Contents

Item 6.	Exhibits
Exhibit No.	Description of Exhibit
3.1	Memorandum of Association (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1 (Amendment No. 2) (No. 333-134669) filed on July 25, 2006).
3.2	Bye-laws (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (Amendment No. 2) (No. 333-134669) filed on July 25, 2006).
4.1	Specimen Share Certificate (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 (Amendment No. 2) (No. 333-134669) filed on July 25, 2006).
4.2	Indenture, dated as of July 30, 2010, by and among Aircastle Limited and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K filed with the SEC on August 4, 2010).
4.3	First Supplemental Indenture, dated as of December 9, 2011, by and among Aircastle Limited and Wells Fargo Bank, National Association as trustee (incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K filed with the SEC on December 12, 2011).
4.4	Indenture, dated as of April 4, 2012, by and among Aircastle Limited and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K filed with the SEC on April 4, 2012).
10.1	Share Purchase Agreement, dated August 7, 2012, between Aircastle Limited and the sellers therein (incorporated by reference to Exhibit 1.2 to the Company's current report on Form 8-K filed with the SEC on August 13, 2012).
10.2	Registration Rights Letter Agreement dated August 10, 2012, between Aircastle Limited and Ontario Teachers' Pension Plan Board (incorporated by reference to Exhibit 1.3 of the Company's current report on Form 8-K filed with the SEC on August 13, 2012).
31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.1	Owned Aircraft Portfolio at September 30, 2012
101	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets as of December 31, 2011 and September 30, 2012, (ii) Consolidated Statements of Income for the three and nine months ended September 30, 2011 and 2012, (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2011 and 2012, (iv) Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and 2012, and (v) Notes to Unaudited Consolidated Financial Statements

r Filed herewith.

Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Exchange Act and otherwise are not subject to liability under those sections.

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: November 7, 2012

AIRCASTLE LIMITED

(Registrant)

By: /s/ Aaron Dahlke  
Aaron Dahlke  
Chief Accounting Officer and Authorized Officer