Aircastle LTD
Form 10-Q
September 20, 2006
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURTIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2006

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURTIES 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 incorporation or organization)	(IRS Employer Identification No.)
300 First Stamford Place, 5th Floor, Stamford, CT	06902
(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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of ‘‘accelerated filer and large accelerated filer’’ in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

Number of shares outstanding as of September 15, 2006: 51,511,754 common shares, par value $0.01 per share.

Aircastle Limited and Subsidiaries

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Part I. – Financial Information

Item 1. Financial Statements

Aircastle Limited and Subsidiaries
Consolidated Balance Sheets
(Dollars in thousands, except share data)

	December 31, 2005	June 30, 2006 (unaudited)
ASSETS		
Cash and cash equivalents	$ 79,943	$ 90,976
Accounts receivable	3,115	6,229
Debt securities, available for sale	26,907	120,034
Restricted cash and cash equivalents	40,652	111,407
Flight equipment held for sale	54,917	—
Flight equipment held for lease, net of accumulated depreciation of $14,685 and $36,037	746,124	1,120,452
Leasehold improvements, furnishings and equipment, net of accumulated depreciation of $165 and $450	1,529	1,890
Fair value of derivative assets	3,608	11,555
Aircraft purchase deposits	3,465	32,987
Other assets	7,272	23,063
Total assets	$ 967,532	$ 1,518,593
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Borrowings under credit facilities	$ 490,588	$ 262,435
Borrowings from securitization	—	560,000
Accounts payable, accrued expenses and other liabilities	12,038	27,116
Payable to affiliates	105	—
Lease rentals received in advance	6,241	8,887
Repurchase agreements	8,665	84,444
Security deposits and maintenance payments	37,089	74,620
Fair value of derivative liabilities	1,870	—
Total liabilities	556,596	1,017,502
Commitments and contingencies - Note 11		
SHAREHOLDERS' EQUITY		
Common shares, $.01 par value, 100,000,000 shares authorized, 40,000,000 shares issued and outstanding at December 31, 2005; and 44,685,200 shares issued and outstanding at June 30, 2006	400	447
Additional paid-in capital	400,009	445,349
(Accumulated deficit) retained earnings	(1,237)	14,994
Accumulated other comprehensive income	11,764	40,301
Total shareholders' equity	410,936	501,091
Total liabilities and shareholders' equity	$ 967,532	$ 1,518,593

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2006	2005	2006
Revenues				
Lease rentals	$ 4,335	$ 39,627	$ 6,197	$ 70,998
Interest income	957	2,460	1,282	4,101
Total revenues	5,292	42,087	7,479	75,099
Expenses				
Depreciation	2,000	11,848	3,462	21,763
Interest (net of interest income of $177 and $1,742 for the three months ended and $204 and $2,805 for the six months ended June 30, 2005 and 2006, respectively)	1,300	13,164	1,613	20,881
Selling, general and administrative (including non-cash share based payment expense of $82 and $5,393 for the three months ended and $91 and $6,685 for six months ended June 30, 2005 and 2006, respectively)	2,299	10,086	3,847	16,040
Other expenses	485	276	554	917
Total expenses	6,084	35,374	9,476	59,601
Income (loss) from continuing operations before income taxes	(792)	6,713	(1,997)	15,498
Income tax provision	84	1,663	253	2,667
Income (loss) from continuing operations	(876)	5,050	(2,250)	12,831
Earnings from discontinued operations, net of income taxes	—	—	—	3,399
Net income (loss)	$ (876)	$ 5,050	$ (2,250)	$ 16,230
Basic earnings (loss) per share:				
Income (loss) from continuing operations	$ (.02)	$ .12	$ (.06)	$ .30
Earnings from discontinued operations, net of income taxes	—	—	—	.08
Net income (loss) per share	$ (.02)	$ .12	$ (.06)	$ .38
Diluted earnings (loss) per share:				
Income (loss) from continuing operations	$ (.02)	$ .11	$ (.06)	$ .30
Earnings from discontinued operations, net of income taxes	—	—	—	.08
Net income (loss) per share	$ (.02)	$ .11	$ (.06)	$ .38

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

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

	Six Months Ended June 30, 2005	Six Months Ended June 30, 2006
Cash flows from operating activities		
Net (loss) income	$ (2,250)	$ 16,230
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities (inclusive of amounts related to discontinued operations):		
Depreciation	3,462	21,763
Amortization	1,094	1,893
Deferred income taxes	49	805
Accretion of purchase discount on debt securities	(297)	(382)
Non-cash share based payment expense	91	6,685
Cash flow hedges reclassified into earnings	—	(172)
Ineffective portion of cash flow hedges	—	(858)
Gain on the sale of flight equipment held for sale	—	(2,240)
Changes in certain assets and liabilities:		
Accounts receivable	(628)	(3,114)
Restricted cash and cash equivalents	(7,565)	(54,613)
Other assets	32	(804)
Accounts payable, accrued expenses and other liabilities	1,988	916
Payable to affiliates	182	(172)
Lease rentals received in advance	534	2,646
Security deposits and maintenance payments	2,564	37,531
Net cash (used in) provided by operating activities	(744)	26,114
Cash flows from investing activities		
Acquisition and improvement of flight equipment	(118,752)	(385,433)
Disposition of flight equipment held for sale	—	57,157
Purchase of debt securities	(22,981)	(92,726)
Leasehold improvements, furnishings and equipment	(452)	(602)
Deposits on aircraft purchases	(2,080)	(29,522)
Principal repayments on debt securities	—	3,589
Proceeds from sale of debt securities	3,294	—
Net cash used in investing activities	(140,971)	(447,537)
Cash flows from financing activities		
Issuance of common shares	—	38,702
Proceeds from securitization	—	560,000
Credit facility borrowings	104,471	294,730
Credit facility repayments	—	(522,883)
Deferred financing costs	(1,850)	(13,872)
Proceeds from repurchase agreements	6,352	75,978
Proceeds from terminated cash flow hedges	—	16,142
Restricted cash from terminated cash flow hedges	—	(16,142)

Principal repayment on repurchase agreements	(3,313)	(199)
Capital contributions	75,733	—
Net cash provided by financing activities	181,393	432,456
Net increase in cash and cash equivalents	39,678	11,033
Cash and cash equivalents at beginning of period	—	79,943
Cash and cash equivalents at end of period	$ 39,678	$ 90,976
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	$ 23	$ 19,570
Cash paid during the period for income taxes	$ —	$ 591

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

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

Note 1. Summary of Significant Accounting Policies

Organization and Basis of Presentation

Aircastle Limited, formerly Aircastle Investment Limited, (''Aircastle'', the ''Company'', ''we'', or ''our'') is a Bermuda exempted company that was incorporated on October 29, 2004 by Fortress Investment Group LLC and certain of its affiliates (together, the ''Fortress Shareholders'' or ''Fortress'') under the provisions of Section 14 of the Companies Act of 1981 of Bermuda. On August 11, 2006, we closed the sale of 10,454,535 common shares of Aircastle at $23.00 per share in an initial public offering (the ''initial public offering'').

Aircastle is a holding company that conducts its business through its subsidiaries. Aircastle owns directly or indirectly substantially all of the outstanding common shares of its subsidiaries. Aircastle consolidates a Variable Interest Entity (''VIE'') in accordance with the Financial Accounting Standards Board (''FASB'') Interpretation No. 46, Consolidation of Variable Interest Entities (''FIN 46'') of which Aircastle is the primary beneficiary. The consolidated financial statements include the accounts of Aircastle and all of its subsidiaries. All significant intercompany transactions and balances have been eliminated.

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 financial statements prepared in accordance with U.S. generally accepted accounting principles (''GAAP'') have been omitted in accordance with the rules and regulations of the SEC. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Registration Statement on Form S-1 (File No. 333-134669), as such registration statement became effective on August 7, 2006, and all of our other filings filed with the SEC from August 7, 2006 through the current date pursuant to the Securities Exchange Act of 1934.

Recent Accounting Pronouncements

In July 2006, FASB issued FASB Interpretation No. 48, ‘‘Accounting for Uncertainty in Income Taxes’’ (‘‘FIN 48’’), which clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with FASB No. 109, ‘‘Accounting for Income Taxes.’’ FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact, if any, of applying the guidance provided by FIN 48.

Note 2. Fair Value of Financial Instruments

Our financial instruments, other than cash, consist principally of cash equivalents, restricted cash and cash equivalents, accounts receivable, debt securities, accounts payable, amounts borrowed under credit facilities, repurchase agreements and cash flow hedges. 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. Borrowings under our credit facilities, securitization and repurchase agreements bear floating rates of interest which reset monthly or quarterly to a market benchmark rate plus a credit spread. We believe that, for similar

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

financial instruments with comparable credit risks, the effective rate of these agreements approximates market rates at the balance sheet dates. Accordingly, the carrying amounts of these agreements are believed to approximate their fair values. The fair value of our debt securities and cash flow hedges is generally determined by reference to broker quotations.

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 at June 30, 2006 are as follows:

Year Ending December 31,	Amount
Remainder of 2006	$ 86,036
2007	150,277
2008	129,219
2009	100,499
2010	76,127
2011	63,298
Thereafter	49,699

$ 655,155

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

	Three Months Ended June 30,		Six Months Ended June 30,	
Region	2005	2006	2005	2006
Europe	51%	45%	51%	42%
Asia	49%	22%	49%	24%
North America	—	27%	—	28%
Latin America	—	4%	—	5%
Africa	—	2%	—	1%
	100%	100%	100%	100%

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

In the three months ended June 30, 2005, five customers accounted for all lease rental revenue. In the three months ended June 30, 2006 four customers accounted for 45% of lease rental revenue. No other customers accounted for more than 4% of lease rental revenue.

In the six months ended June 30, 2005, five customers accounted for all lease rental revenue In the six months ended June 30, 2006, five customers accounted for 53% of lease rental revenue. No other customers accounted for more than 4% of lease rental revenue.

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Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
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Geographic concentration of net book value of flight equipment held for lease was as follows:

	December 31, 2005		June 30, 2006	
Region	Number of Aircraft	Net Book Value %	Number of Aircraft	Net Book Value %
Europe	16	40%	27	48%
Asia	9	26%	9	17%
North America	4	29%	9	25%
Latin America	3	5%	4	6%
Africa	—	—	2	4%

	32	100%	51	100%

At December 31, 2005 and June 30, 2006, lease acquisition costs included in other assets were $775 and $795, respectively. At December 31, 2005 and June 30, 2006, prepaid lease incentive costs included in other assets were $453 and $443, respectively.

Note 4. Discontinued Operations and Flight Equipment Held for Sale

As of December 31, 2005, one of our aircraft was classified as flight equipment held for sale. During the six months ended June 30, 2006, we completed the sale of this aircraft. In accordance with the credit facility associated with this aircraft, the proceeds from the sale were deposited into a restricted cash account. A portion of the proceeds was withdrawn from the restricted cash account and used to repay $36,666 of debt related to the aircraft plus accrued interest. The remaining balance was transferred from restricted cash in April 2006.

Earnings from discontinued operations for the six months ended June 30, 2006, related solely to the aircraft held for sale, were as follows:

Earnings from discontinued operations	
Lease rentals	$ 2,135
Gain on disposition	2,240
Interest expense	(528)
Earnings before income tax provision	3,847
Income tax provision	(448)
Earnings from discontinued operations	$ 3,399

Note 5. Debt Securities

As of December 31, 2005 and June 30, 2006, all of our debt securities were corporate obligations and were classified as available-for-sale. The aggregate fair value of these debt securities at June 30, 2006 was $120,034. These debt obligations are interests in pools of loans and are collateralized by interests in commercial aircraft of which $3,957 are investment grade, $93,791 are senior subordinated instruments within their pools and $22,286 are subordinate to other debt related to such aircraft. All of our debt securities had unrealized gain positions relative to their net book values, which aggregated to $9,900 and $13,508 at December 31, 2005 and June 30, 2006, respectively.

Three of our debt securities, with a fair value of $100,698 at June 30, 2006 have stated maturities in 2010. Our other three debt securities with an aggregate fair value of $19,336 have remaining terms to stated maturity in excess of 10 years after June 30, 2006. All of our debt securities provide for the periodic payment of both principal and interest and are subject to prepayment and/or acceleration depending on certain events, including sale of underlying collateral aircraft and events of default. Therefore, the actual maturity of our debt securities may be less than the stated maturities.

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Aircastle Limited and Subsidiaries

Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)

Note 6. Securitization and Borrowings under Credit Facilities

On June 15, 2006, we completed our first securitization, a $560,000 transaction comprising of 40 aircraft, which we refer to as Securitization No. 1. 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''), which we refer to together with their subsidiaries as the ''ACS Group,'' issued $560,000 of Class A-1 notes, or the ''notes,'' to a newly formed trust, the ACS 2006-1 Pass Through Trust, or the ''trust.'' The trust simultaneously issued a single class of Class G-1 pass through trust certificates, or the ''certificates,'' representing undivided fractional interests in the notes. Payments on the notes will be passed through to holders of the certificates. The notes are secured by ownership interests in aircraft-owning subsidiaries of ACS Bermuda and ACS Ireland and the aircraft leases, cash, rights under service agreements and any other assets they may hold. Each of ACS Bermuda and ACS Ireland has fully and unconditionally guaranteed the other's obligations under the notes. However, the notes are neither obligations of nor guaranteed by Aircastle Limited.

The ACS Group used the proceeds from the sale of the notes to acquire 40 aircraft from us and we paid for certain expenses incurred in connection with the certificates offering of $12,776. We used a portion of the proceeds of Securitization No. 1 to return $36,932 to Fortress in exchange for the cancellation of 3,693,200 of our common shares and to repay amounts owed on Credit Facility No. 1 and Credit Facility No. 2, as defined below. The notes provide for monthly payments of interest at a floating rate of one-month LIBOR plus 0.27%, which at June 30, 2006 was 5.47%, and scheduled payments of principal. Financial Guaranty Insurance Company, issued a financial guaranty insurance policy to support the payment of interest when due on the certificates and the payment, on the final distribution date, of the outstanding principal amount of the certificates. The certificates are rated Aaa and AAA by Moody's Investor Service and Standard & Poor's rating services, respectively. We have entered into a series of interest rate hedging contracts intended to hedge the interest rate exposure associated with issuing floating-rate obligations backed by primarily fixed-rate lease assets. These contracts, together with the guarantee premium, the spread referenced above and other costs of trust administration, result in a fixed rate cost of 6.60% per annum, after the amortization of issuance fees and expenses

ACS Ireland, which had total assets of $179,292 at June 30, 2006, is a VIE which we consolidate. At June 30, 2006, the outstanding principal amount of ACS Ireland's notes was $108,089.

On February 28, 2006, we entered into a $500,000 revolving credit facility with a group of banks, as lenders, to finance the acquisition of aircraft and related improvements which we refer to as Credit Facility No. 2. The borrowing base is equal to 85% of the net book value of the aircraft. Borrowings under this credit facility incur interest at the one-month LIBOR rate plus 1.25%. Additionally, we are subject to a 0.25% fee on any unused portion of the total committed facility. Credit Facility No. 2 requires the monthly payment of interest and principal, to the extent of 85% of any decrease in the net book value of the assets. Prior to the initial public offering, Credit Facility No. 2 limited our ability to pay dividends. After the initial public offering, Credit Facility No. 2 has no restrictions on the amount of dividends we can pay, provided that we are not in default. Additionally, we are required under Credit Facility No. 2 to maintain a net worth determined in conformity with GAAP of no less than $500,000. Effective June 15, 2006, Credit Facility No. 2 was amended to increase the maximum committed amount to $750,000 and to extend the maturity to November 15, 2007. As of June 30, 2006, we had borrowed $143,298 under Credit Facility No. 2.

On February 24, 2006, the revolving period of our $600,000 credit facility, which we refer to as Credit Facility No. 1, was extended to April 28, 2006 and the maximum amount of this credit facility was reduced to $525,000. The other terms of Credit Facility No. 1 remained the same. Monthly payments of interest only continued through repayment of Credit Facility No. 1. At June 30, 2006, $45,918 remained outstanding on Credit Facility No. 1; it was repaid in full on August 4, 2006.

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

In October 2005, the Company entered into a credit facility for $109,998 with a bank to finance the acquisition of three aircraft which we refer to as Credit Facility No. 3. On March 30, 2006, $36,666 of Credit Facility No. 3 was repaid using a portion of the proceeds from the disposition of flight equipment held for sale which had been financed under this facility. Credit Facility No. 3 was amended on July 18, 2006, to increase the maximum committed amount by approximately $25,116 and to extend the maturity date to March 31, 2007. The increase in the maximum committed amount was reduced by $25,116 with the closing of the initial public offering. On or prior to maturity, we intend to refinance Credit Facility No. 3 with long-term financing. However, we can give no assurances the Company will be able to obtain this financing.

Note 7. Repurchase Agreements

We entered into repurchase agreements to fund a portion of the purchase price of certain of our debt investments. At December 31, 2005 and June 30, 2006, the repurchase agreements are secured by liens on the debt investments with a fair value of $11,107 and $104,563, respectively. The repurchase agreements are substantially all with parties other than those from whom we originally purchased the debt investments. At June 30, 2006, the repurchase agreements are scheduled to mature through June 2007. Upon maturity, we intend to refinance the repurchase agreements on similar terms and conditions. However, there is no assurance the Company will be able to refinance the repurchase agreements. The weighted average interest rate of these repurchase agreements at June 30, 2006 was 5.65%.

Note 8. Shareholders' Equity, Share Based Payments and Earnings (Loss) Per Share

In January 2006, the board of directors (the ''Board'') and the Fortress Shareholders adopted the Aircastle Investment Limited 2005 Equity and Incentive Plan, and the Board and the Shareholders approved an amendment to and restatement thereof on July 20, 2006 (as so amended and restated, the ''2005 Plan''). The purpose of the 2005 Plan is to provide additional incentive to selected management employees. The 2005 Plan provides that the Company may grant (a) share options, (b) share appreciation rights, (c) awards of restricted shares, deferred shares, performance shares, unrestricted shares or other share-based awards, or (d) any combination of the foregoing. Four million shares were reserved under the 2005 Plan, increasing by 100,000 each year beginning in 2007 through and including 2016. The 2005 Plan provides that grantees of restricted shares will have all of the rights of shareholders, including the right to receive dividends, other than the right to sell, transfer, assign or otherwise dispose of the shares until the lapse of the restricted period.

In February and March of 2006, the Board ratified the initial grants under the 2005 Plan of 347,500 restricted shares in the first half of 2005 and 25,000 restricted shares on July 5, 2005 which were provided for in certain employment contracts, and approved new grants of 412,500 restricted shares. Generally, the restricted shares vest over five year periods, based on continued service and are being expensed on a straight line basis over the requisite service period of the awards. The terms of the grants provide for accelerated vesting under certain circumstances, including termination without cause following a change of control. The grants also impose lock-up restrictions on restricted shares from the date of grant through 120 days after the date of any initial public offering, and provide for certain further restrictions and notice periods thereafter.

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

A summary of the fair value of nonvested shares for the six months ended June 30, 2006 is as follows:

Nonvested Shares	Shares (in 000's)	Weighted Average Grant Date Fair Value	Fair Value of Nonvested Shares at Grant Date
Nonvested at January 1, 2006	372.5	$ 8.50	$ 3,166
Granted	412.5	22.00	9,075
Vested	(71.0)	14.92	(1,059)
Forfeited	—	—	—
Nonvested at June 30, 2006	714.0	$ 15.66	$ 11,182

The fair value of the restricted shares granted in 2006 was determined based on a retrospective estimate of the offering range per share from the anticipated initial public offering. We anticipate that the current requisite service periods will be obtained for employees with awards. The total unrecognized compensation cost as of June 30, 2006 in the amount of $9,471 is expected to be recognized over a weighted average period of four years.

During the six months ended June 30, 2005, 297,500 restricted shares of the initial grants of 347,500 shares were granted at a fair value of $8.50. The fair value of the restricted shares granted in 2005 was determined based on a retrospective valuation performed by an unrelated valuation specialist. The valuation relied on observed equity investments made by the Shareholders, adjusted to reflect the lack of marketability of the shares granted to employees.

Aircastle is required to present both basic and diluted earnings (loss) per share (‘‘EPS’’). Basic EPS is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during each period. The weighted average shares outstanding exclude our unvested shares for purposes of Basic EPS. Diluted EPS is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period while also giving effect to all potentially dilutive common shares that were outstanding during the period based on the treasury stock method. For the three and six months ended June 30, 2005, based on the treasury stock method, we had 5,696 and 68,998, respectively, anti-dilutive common share equivalents resulting from restricted shares. There were no anti-dilutive common shares for the three and six months ended June 30, 2006.

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

The calculations of both basic and diluted earnings (loss) per share for the three months and six months ended June 30, 2005 and 2006 are as follows:

	Three Months Ended June 30, 2005	Three Months Ended June 30, 2006	Six Months Ended June 30, 2005	Six Months Ended June 30, 2006
Numerator				
Income (loss) from continuing operations	$ (876)	$ 5,050	$ (2,250)	$ 12,831
Earnings from discontinued operations, net of income taxes	—	—	—	3,399
Net income (loss) per share	$ (876)	$ 5,050	$ (2,250)	$ 16,230
Denominator				
Denominator for basic earnings per share	40,000,000	43,922,711	40,000,000	42,610,193
Effect of dilutive restricted shares	(a)	204,556	(a)	245,298
Denominator for diluted earnings per share	40,000,000	44,127,267	40,000,000	42,855,491
Basic earnings (loss) per share:				
Income (loss) from continuing operations	$ (0.02)	$ 0.12	$ (0.06)	$ 0.30
Earnings from discontinued operations, net of income taxes	—	—	—	0.08
Net income (loss) per share	$ (0.02)	$ 0.12	$ (0.06)	$ 0.38
Diluted earnings (loss) per share:				
Income (loss) from continuing operations	$ (0.02)	$ 0.11	$ (0.06)	$ 0.30
Earnings from discontinued operations, net of income taxes	—	—	—	0.08
Net income (loss) per share	$ (0.02)	$ 0.11	$ (0.06)	$ 0.38

(a) Anti-dilutive

Note 9. Income Taxes

Income taxes have been provided 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 2016. 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 (loss) income from continuing operations before income taxes for the three and six months ended June 30, 2005 and 2006 are as follows:

	Three Months Ended June 30, 2005	Three Months Ended June 30, 2006	Six Months Ended June 30, 2005	Six Months Ended June 30, 2006
Bermuda	$ (930)	$ 216	$ (2,236)	$ 4,322
Non-Bermuda	138	6,497	239	11,176

Total	$ (792)	$ 6,713	$ (1,997)	$ 15,498

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The components of the income tax provision from continuing operations for the three and six months ended June 30, 2005 and 2006 consist of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2006	2005	2006
Current	$ 99	$ 1,139	$ 204	$ 1,988
Deferred	(15)	524	49	679
Total	$ 84	$ 1,663	$ 253	$ 2,667

Significant components of the Company's deferred tax assets and liabilities at December 31, 2005 and June 30, 2006 consist of the following:

	December 31, 2005	June 30, 2006
Deferred tax assets:		
Non-cash share based payments	$ 152	$ 589
Net operating loss carry forwards	49	362
Other	6	5
Total deferred tax assets	207	956
Deferred tax liabilities		
Accelerated depreciation	(333)	(1,508)
U.S.federal withholding tax on unremitted earnings	(207)	(460)
Total deferred tax liabilities	(540)	(1,968)
Net deferred tax liabilities	$ (333)	$ (1,012)

The Company had approximately $390 of net operating loss carry forwards available at December 31, 2005 to offset future taxable income in Ireland. Deferred tax assets and liabilities are included in other assets and accounts payable and accrued liabilities, respectively, in the accompanying consolidated balance sheets.

We do not expect to incur income taxes on future distributions of undistributed earnings of non-U.S. subsidiaries and, accordingly, no deferred income taxes have been provided for the distribution of such earnings. Withholding taxes have been provided on unremitted earnings of our U.S. subsidiary.

Note 10. Comprehensive Income (Loss)

Comprehensive income (loss) includes net income (loss) and the changes in the fair value of derivatives, reclassification into earnings of amounts previously deferred relating to our derivative financial instruments and the change in unrealized appreciation on debt securities.

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Comprehensive income for the three months and six months ended June 30, 2005 and 2006 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2006	2005	2006
Net income (loss)	$ (876)	$ 5,050	$ (2,250)	$ 16,230
Change in fair value of derivatives	4,943	13,235	7,776	24,930
Change in unrealized (depreciation) appreciation of debt securities	(19)	(158)	58	3,607
Comprehensive income (loss)	$ 4,048	$ 18,127	$ 5,584	$ 44,767

Note 11. Commitments and Contingencies

At June 30, 2006, Aircastle had letters of intent to acquire 12 aircraft for an estimated purchase price of $334,675. The Company completed the acquisition of these aircraft during the third quarter of 2006. The purchase price of the aircraft under these letters of intent is subject to variable price provisions that typically reduce the final purchase price if the actual closing occurs beyond an initially agreed upon date.

Note 12. Related Party Transactions

At June 30, 2006, we had entered into a letter of intent to acquire an aircraft, from an affiliate of one of the Fortress Shareholders. The purchase price of the aircraft was $11,063. This transaction was completed in the third quarter of 2006.

Aircastle employees participate in various benefit plans sponsored by Fortress including a voluntary savings plan (‘‘401(k) Plan’’) and other health and benefit plans. For the three and six months ended June 30, 2005 and 2006, Aircastle incurred $51, $84, $109 and $202, respectively, for its costs under the health and benefit plans. In addition, during the six months ended June 30, 2006, Aircastle remitted $179 in annual contributions for the 2005 plan year for our employees' participation in the 401(k) Plan sponsored by Fortress.

In addition, Fortress requires Aircastle to reimburse it for costs of services which it has incurred on behalf of Aircastle. These expenses are charged to Aircastle at cost and are included in selling, general and administrative expenses in the consolidated statement of operations. For the three and six months ended June 30, 2006, no such costs were incurred. For the three and six months ended June 30, 2005, such costs were $23 and $197, respectively, and were primarily for professional fees.

For the three and six months ended June 30, 2006, Aircastle paid $356 and $519, respectively, for legal fees related to the establishment and financing activities of our Bermuda subsidiaries. Additionally, Aircastle paid $10 and $95, respectively, for Bermuda corporate services related to our Bermuda companies to a law firm and a corporate secretarial services provider, respectively, affiliated with a Bermuda resident director serving on certain of our subsidiary boards. The Bermuda resident director serves as an outside director of these subsidiaries.

Note 13. Derivatives

On March 10, 2006, we designated an interest rate swap which we had entered into on February 2, 2006 as a hedge of the future variable rate interest payments on the repurchase agreements for debt securities we purchased during the quarter. The interest rate swap has an initial notional principal amount of $74,000, which decreases periodically based on estimated projected principal payments on the debt securities. The interest rate swap, which matures on July 1, 2010, provides for the semi-annual payment of a fixed rate of 5.02% and the monthly receipt of the one-month LIBOR rate on the notional amount.

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On March 21, 2006, we entered into a series of interest rate forward contracts to hedge the variable interest rate payments on debt we expect to incur to finance aircraft acquisitions over the next year. The last forward contract matures in March 2011. The notional amounts of the forward contracts in that series started at $100,000 with respect to the March 2006 forward contract and increase to a maximum of $500,000 with respect to the September 2006 forward contract. The terms of the forward contracts provide for a comparison of, on average, a fixed rate of 5.07% per annum and of one month LIBOR. The aggregate market value of the forward contracts at June 30, 2006 was a receivable of $9,163. The interest rate forward contracts are treated as cash flow hedges for accounting purposes with fair value adjustments recorded as a component of other comprehensive income in our balance sheet.

On June 1, 2006, we entered into a series of forward contracts to hedge the variable interest rate payments on the notes issued in connection with Securitization No. 1. The last forward contract matures in June 2016. The notional amounts of the initial forward contracts in that series start at $560,000 with respect to the July 2006 forward contract and decrease monthly based on the projected principal payments on the certificates. The terms of the forward contracts provide for a comparison of, on average, a fixed rate of 5.78% per annum and of one-month LIBOR plus 0.27%. The aggregate market value of the forward contracts at June 30, 2006 was a receivable of $1,374. The interest rate forward contracts are treated as cash flow hedges for accounting purposes with fair value adjustments recorded as a component of other comprehensive income on our balance sheet.

Note 14. Segment Reporting

We have two reportable segments: Aircraft Leasing and Debt Investments. We present our segment information on a contribution margin basis consistent with the information that our chief executive officer (the Chief Operating Decision Maker or ''CODM'') reviews in assessing segment performance and allocating resources. Contribution margin includes revenue, depreciation, interest expense and other expenses that are directly connected to our business segments. We believe contribution margin is an appropriate measure of performance because it reflects the marginal profitability of our business segments excluding overhead.

Aircraft Leasing

The Aircraft Leasing segment consists of amounts earned from our commercial aircraft leasing operations. All of our aircraft are subject to net operating leases whereby the lessee is generally responsible for maintaining the aircraft and paying all operational and insurance costs. In many of our leases we are obligated to bear a portion of maintenance costs or costs associated with modifications required by manufacturers or regulators. We retain the benefit, and bear the risk, of re-leasing and the residual value of the aircraft upon expiration or early termination of the lease.

Debt Investments

The Debt Investments segment consists of amounts earned from our investments in debt securities secured by commercial jet aircraft including enhanced equipment trust certificates, or EETCs, and other forms of collateralized debt.

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Information on reportable segments for the three months ended June 30, 2005 and 2006 is as follows:

	Three Months Ended June 30, 2005			Three Months Ended June 30, 2006		
	Aircraft Leasing	Debt Investments	Total	Aircraft Leasing	Debt Investments	Total
Revenues						
Lease rentals	$ 4,335	$ —	$ 4,335	$ 39,627	$ —	$ 39,627
Interest income	—	957	957	—	2,460	2,460
Total revenues	4,335	957	5,292	39,627	2,460	42,087
Expenses						
Depreciation	1,972	—	1,972	11,721	—	11,721
Interest	1,476	1	1,477	13,608	1,059	14,667
Other expenses	485	—	485	275	—	275
Total expenses	3,933	1	3,934	25,604	1,059	26,663
Contribution margin	$ 402	$ 956	$ 1,358	$ 14,023	$ 1,401	$ 15,424

Information on reportable segments for the six months ended June 30, 2005 and 2006 is as follows:

	Six Months Ended June 30, 2005			Six Months Ended June 30, 2006		
	Aircraft Leasing	Debt Investments	Total	Aircraft Leasing	Debt Investments	Total
Revenues						