Aircastle LTD
Form 10-Q
October 31, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2013

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 (State or other jurisdiction of incorporation or organization)	98-0444035 (IRS Employer Identification No.)
c/o Aircastle Advisor LLC 300 First Stamford Place, 5th Floor, Stamford, CT (Address of principal executive offices)	06902 (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 þ 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 þ 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	þ	Accelerated filer	¨
Non-accelerated filer	o (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 þ

As of October 28, 2013, there were 80,776,975 outstanding shares of the registrant’s common shares, par value $0.01 per share.

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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, 2012	September 30, 2013 (Unaudited)
ASSETS		
Cash and cash equivalents	$618,217	$238,150
Accounts receivable	5,625	5,127
Restricted cash and cash equivalents	111,942	191,843
Restricted liquidity facility collateral	107,000	107,000
Flight equipment held for lease, net of accumulated depreciation of $1,305,064 and $1,424,057	4,662,661	4,938,113
Net investment in finance leases	119,951	148,005
Other assets	186,764	177,242
Total assets	$5,812,160	$5,805,480
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Borrowings from secured financings (including borrowings of ACS Ireland VIEs of $207,926 and $168,107, respectively)	$1,848,034	$1,581,118
Borrowings from unsecured financings	1,750,642	1,750,556
Accounts payable, accrued expenses and other liabilities	108,593	134,892
Lease rentals received in advance	53,189	48,379
Liquidity facility	107,000	107,000
Security deposits	87,707	110,410
Maintenance payments	379,391	428,615
Fair value of derivative liabilities	61,978	44,307
Total liabilities	4,396,534	4,205,277
Commitments and Contingencies		
SHAREHOLDERS' EQUITY		
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, 68,639,729 shares issued and outstanding at December 31, 2012; and 80,776,975 shares issued and outstanding at September 30, 2013	686	808
Additional paid-in capital	1,360,555	1,560,509
Retained earnings	180,675	126,140
Accumulated other comprehensive loss	(126,290)	(87,254)
Total shareholders' equity	1,415,626	1,600,203
Total liabilities and shareholders' equity	$5,812,160	$5,805,480

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 September 30,		Nine Months Ended September 30,	
	2012	2013	2012	2013
Revenues:				
Lease rental revenue	$159,547	$161,148	$465,413	$475,656
Finance lease revenue	3,518	4,122	4,474	12,120
Amortization of lease premiums, discounts and lease incentives	(6,838)	(9,737)	(6,392)	(25,527)
Maintenance revenue	10,944	12,932	37,126	42,983
Total lease revenue	167,171	168,465	500,621	505,232
Other revenue	5,695	1,625	9,341	11,425
Total revenues	172,866	170,090	509,962	516,657
Operating expenses:				
Depreciation	68,413	70,469	200,024	212,448
Interest, net	54,101	57,843	167,203	183,651
Selling, general and administrative (including non-cash share based payment expense of $1,128 and $1,067 for the three months ended, and $3,233 and $2,931 for the nine months ended September 30, 2012 and 2013, respectively)	11,907	12,830	36,616	39,297
Impairment of Aircraft	78,676	106,136	88,787	112,335
Maintenance and other costs	3,926	1,914	11,943	11,464
Total expenses	217,023	249,192	504,573	559,195
Other income:				
Gain on sale of flight equipment	11	3,092	3,062	25,601
Other	—	855	604	5,016
Total other income	11	3,947	3,666	30,617
Income (loss) from continuing operations before income taxes	(44,146)	(75,155)	9,055	(11,921)
Income tax provision (benefit)	1,701	(597)	5,976	6,719
Net income (loss)	$(45,847)	$(74,558)	$3,079	$(18,640)
Earnings (loss) per common share — Basic:				
Net income (loss) per share	$(0.65)	$(0.95)	$0.04	$(0.26)
Earnings (loss) per common share — Diluted:				
Net income (loss) per share	$(0.65)	$(0.95)	$0.04	$(0.26)
Dividends declared per share	$0.15	$0.165	$0.45	$0.495

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

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Aircastle Limited and Subsidiaries
Consolidated Statements of Comprehensive Income (Loss)
(Dollars in thousands)
(Unaudited)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2013
Net income (loss)	$(45,847)	$(74,558)	$3,079	$(18,640)
Other comprehensive income, net of tax:				
Net change in fair value of derivatives, net of tax expense of $37 and $78 for the three months ended and $465 and $389 for the nine months ended, September 30, 2012 and 2013, respectively	1,426	1,798	23,708	13,751
Net derivative loss reclassified into earnings	8,966	7,300	21,903	25,285
Other comprehensive income	10,392	9,098	45,611	39,036
Total comprehensive income (loss)	$(35,455)	$(65,460)	$48,690	$20,396

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)

	Nine Months Ended September 30, 2012	2013
Cash flows from operating activities:		
Net income (loss)	$3,079	$(18,640)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	200,024	212,448
Amortization of deferred financing costs	10,082	11,757
Amortization of net lease discounts and lease incentives	6,392	25,527
Deferred income taxes	3,609	3,419
Non-cash share based payment expense	3,233	2,931
Cash flow hedges reclassified into earnings	21,903	25,285
Ineffective portion of cash flow hedges	1,840	197
Security deposits and maintenance payments included in earnings	(36,312)	(32,047)
Gain on sale of flight equipment	(3,062)	(25,601)
Impairment of aircraft	88,787	112,335
Other	1,820	(4,481)
Changes in certain assets and liabilities:		
Accounts receivable	(9,180)	1,588
Other assets	(3,278)	1,155
Accounts payable, accrued expenses and other liabilities	14,071	7,978
Lease rentals received in advance	2,948	(4,538)
Net cash provided by operating activities	305,956	319,313
Cash flows from investing activities:		
Acquisition and improvement of flight equipment and lease incentives	(450,962)	(837,183)
Proceeds from sale of flight equipment	54,439	285,199
Restricted cash and cash equivalents related to sale of flight equipment	35,762	(2,200)
Aircraft purchase deposits and progress payments	(25,155)	(5,655)
Net investment in finance leases	(91,500)	(11,595)
Collections on finance leases	2,041	6,658
Purchase of debt investment	(43,626)	—
Principal repayments on debt investment	3,245	42,001
Other	(544)	(852)
Net cash used in investing activities	(516,300)	(523,627)
Cash flows from financing activities:		
Issuance of shares net of repurchases	(30,692)	197,478
Proceeds from notes and term debt financings	877,100	78,230
Securitization and term debt financing repayments	(783,976)	(430,482)
Deferred financing costs	(17,794)	(2,910)
Restricted secured liquidity facility collateral	3,000	—
Secured liquidity facility collateral	(3,000)	—
Restricted cash and cash equivalents related to financing activities	102,315	(77,701)
Security deposits received	11,400	19,545
Security deposits returned	(3,217)	(3,890)
Maintenance payments received	103,527	134,758

Maintenance payments returned	(36,967)	(54,886)
Payments for terminated cash flow hedges	(50,757)	—
Dividends paid	(32,158)	(35,895)
Net cash (used in) provided by financing activities	138,781	(175,753)
Net increase (decrease) in cash and cash equivalents	(71,563)	(380,067)
Cash and cash equivalents at beginning of period	295,522	618,217
Cash and cash equivalents at end of period	$223,959	$238,150
Supplemental disclosures of cash flow information:		
Cash paid for interest, net of capitalized interest	$114,538	$136,799
Cash paid for income taxes	$1,765	$701
Supplemental disclosures of non-cash investing activities:		
Purchase deposits, advance lease rentals, security deposits and maintenance payments assumed in asset acquisitions	$18,988	$46,232
Term debt financings assumed in asset acquisitions	$—	$84,721
Advance lease rentals, security deposits, and maintenance payments settled in sale of flight equipment	$7,817	$41,659

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)
September 30, 2013

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 o 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, 2012.

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, 2013 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, 2013, the Company adopted Financial Accounting Standards Board (the "FASB") Accounting Standards Update ("ASU") 2013-02 (“ASU 2013-02”) Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This ASU requires that companies present reclassification adjustments for each component of accumulated other comprehensive income (“AOCI”) either on the face of the financial statements or in the notes, provided that all required information is presented in a single location. ASU 2013-02 is effective for interim and annual reporting periods beginning after December 15, 2012 and should be applied prospectively. The adoption of ASU 2013-02 did not have a material impact on the Company's consolidated financial statements.

Effective January 1, 2013, the Company adopted ASU 2011-11 (“ASU 2011-11”) Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities. This ASU requires that companies disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on its financial position. ASU 2011-11 is effective for interim and annual reporting periods beginning on or after January 1, 2013 and should be applied retrospectively for all

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2013

periods presented on the balance sheet. The adoption of ASU 2011-11 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.

Proposed Accounting Pronouncements
In May 2013, the FASB issued re-exposure draft, “Leases” (the “Lease Re-ED”), which would replace the existing guidance in the Accounting Standards Codification (“ASC”) 840 (“ASC 840”), Leases. The FASB decided that leases would be classified as either leases of real property (Type B) or leases of assets other than real property (Type A). Leases of real property will continue to use operating lease accounting. Leases of other than real 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 comment period for the Lease Re-ED ended on September 13, 2013. We anticipate that the final standard may have an effective date no earlier than 2017. 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.

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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, 2012 and September 30, 2013 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 Measurements at December 31, 2012 Using Fair Value Hierarchy			
	Fair Value as of December 31, 2012	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	$618,217	$618,217	$—	$—	Market
Restricted cash and cash equivalents	111,942	111,942	—	—	Market
Debt investments	40,388	—	—	40,388	Income
Total	$770,547	$730,159	$—	$40,388	
Liabilities:					
Derivative liabilities	$61,978	$—	$61,978	$—	Income

		Fair Value Measurements at September 30, 2013 Using Fair Value Hierarchy			
	Fair Value as of September 30, 2013	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	$238,150	$238,150	$—	$—	Market
Restricted cash and cash equivalents	191,843	191,843	—	—	Market
Total	$429,993	$429,993	$—	$—	
Liabilities:					
Derivative liabilities	$44,307	$—	$44,307	$—	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.

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
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September 30, 2013

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, 2012 and 2013, respectively:

	Assets			
	Debt Investments			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2013	2012	2013
Balance at beginning of period	$—	$—	$—	$40,388
Total gains/(losses), net:				
Included in other revenue	—	—	—	1,613
Settlements	—	—	—	(42,001)
Balance at end of period	$—	$—		