

Aircastle LTD
Form 10-Q
May 04, 2011

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 March 31, 2011
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
AIRCATTLE 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 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 Smaller reporting company
(Do not check if a 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 April 29, 2011, there were 76,955,758 outstanding shares of the registrant's common shares, par value \$0.01 per share.

Aircastle Limited and Subsidiaries
Form 10-Q
Table of Contents

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
<u>Consolidated Balance Sheets as of December 31, 2010 and March 31, 2011</u>	3
<u>Consolidated Statements of Income for the three months ended March 31, 2010 and 2011</u>	4
<u>Consolidated Statements of Cash Flows for the three months ended March 31, 2010 and 2011</u>	5
<u>Notes to Unaudited Consolidated Financial Statements</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	46
<u>Item 4. Controls and Procedures</u>	46
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	48
<u>Item 1A. Risk Factors</u>	48
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	48
<u>Item 6. Exhibits</u>	48
<u>SIGNATURE</u>	50
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	
<u>EX-99.1</u>	

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, 2010	March 31, 2011 (Unaudited)
ASSETS		
Cash and cash equivalents	\$ 239,957	\$ 240,275
Accounts receivable	1,815	1,447
Restricted cash and cash equivalents	191,052	191,361
Restricted liquidity facility collateral	75,000	71,000
Flight equipment held for lease, net of accumulated depreciation of \$785,490 and \$835,642	4,065,780	4,120,309
Aircraft purchase deposits and progress payments	219,898	186,009
Other assets	65,557	72,300
Total assets	\$ 4,859,059	\$ 4,882,701
LIABILITIES AND SHAREHOLDERS EQUITY LIABILITIES		
Borrowings from secured and unsecured financings (including borrowings of ACS Ireland VIEs of \$314,877 and \$310,573, respectively)	\$ 2,707,958	\$ 2,748,906
Accounts payable, accrued expenses and other liabilities	76,470	63,847
Dividends payable	7,964	7,857
Lease rentals received in advance	43,790	38,955
Liquidity facility	75,000	71,000
Security deposits	83,241	82,391
Maintenance payments	342,333	327,994
Fair value of derivative liabilities	179,585	155,363
Total liabilities	3,516,341	3,496,313
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, 79,640,285 shares issued and outstanding at December 31, 2010; and 78,568,761 shares issued and outstanding at March 31, 2011	796	783
Additional paid-in capital	1,485,841	1,468,401
Retained earnings	104,301	139,121
Accumulated other comprehensive loss	(248,220)	(221,917)

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Total shareholders' equity	1,342,718	1,386,388
Total liabilities and shareholders' equity	\$ 4,859,059	\$ 4,882,701

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

3

Table of Contents

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

	Three Months Ended	
	March 31,	
	2010	2011
Revenues:		
Lease rental revenue	\$ 130,122	\$ 141,116
Amortization of net lease discounts and lease incentives	(4,845)	(3,102)
Maintenance revenue	5,254	16,844
Total lease rentals	130,531	154,858
Other revenue	30	3,056
Total revenues	130,561	157,914
Expenses:		
Depreciation	54,145	59,591
Interest, net	40,959	45,619
Selling, general and administrative (including non-cash share based payment expense of \$1,782, and \$1,895, respectively)	11,673	12,531
Maintenance and other costs	2,200	3,530
Total expenses	108,977	121,271
Other income (expense):		
Gain on sale of flight equipment		9,662
Other	(370)	(359)
Total other income (expense)	(370)	9,303
Income from continuing operations before income taxes	21,214	45,946
Income tax provision	2,335	3,269
Net income	\$ 18,879	\$ 42,677
Earnings per common share Basic	\$ 0.24	\$ 0.54
Earnings per common share Diluted	\$ 0.24	\$ 0.54
Dividends declared per share	\$ 0.10	\$ 0.10

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

4

Table of Contents

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

	Three Months Ended	
	March 31,	
	2010	2011
Cash flows from operating activities:		
Net income	\$ 18,879	\$ 42,677
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	54,145	59,591
Amortization of deferred financing costs	2,804	3,528
Amortization of net lease discounts and lease incentives	4,845	3,102
Deferred income taxes	1,234	1,853
Non-cash share based payment expense	1,782	1,895
Cash flow hedges reclassified into earnings	2,304	2,835
Ineffective portion of cash flow hedges	866	(475)
Security deposits and maintenance payments included in earnings	(267)	(18,534)
Gain on sale of flight equipment		(9,662)
Other	370	(57)
Changes in certain assets and liabilities:		
Accounts receivable	(346)	1,288
Restricted cash and cash equivalents	(22,185)	(309)
Other assets	(946)	(731)
Accounts payable, accrued expenses and other liabilities	(9,309)	(17,416)
Lease rentals received in advance	(2,464)	(5,381)
Net cash provided by operating activities	51,712	64,204
Cash flows from investing activities:		
Acquisition and improvement of flight equipment and lease incentives	(10,136)	(110,410)
Proceeds from sale of flight equipment		75,200
Aircraft purchase deposits and progress payments	(39,551)	(36,630)
Net cash used in investing activities	(49,687)	(71,840)
Cash flows from financing activities:		
Repurchase of shares	(926)	(16,367)
Proceeds from term debt financings		157,161
Securitization and term debt financing repayments	(37,929)	(116,340)
Deferred financing costs	(106)	(7,346)
Restricted secured liquidity facility collateral	1,000	4,000
Secured liquidity facility collateral	(1,000)	(4,000)
Security deposits received	2,413	7,009
Security deposits returned	(3,868)	(5,312)
Maintenance payments received	31,186	27,487

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Maintenance payments returned	(5,906)	(30,374)
Dividends paid	(7,955)	(7,964)
Net cash (used in) provided by financing activities	(23,091)	7,954
Net increase (decrease) in cash and cash equivalents	(21,066)	318
Cash and cash equivalents at beginning of period	142,666	239,957
Cash and cash equivalents at end of period	\$ 121,600	\$ 240,275
Supplemental disclosures of cash flow information:		
Cash paid for interest, net of capitalized interest	\$ 35,114	\$ 46,919
Cash paid for income taxes	\$ 2,429	\$ 1,004
Supplemental disclosures of non-cash financing activities:		
Advance lease rentals converted to maintenance reserves	\$ 1,750	\$
Security deposits converted to advance lease rentals	\$	\$ 546

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)

March 31, 2011

Note 1. Summary of Significant Accounting Policies

Organization

Aircastle Limited (Aircastle, the Company, we, us 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. 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.

Basis of Presentation

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, 2010.

The Company's management has reviewed and evaluated all events or transactions for potential recognition and/or disclosure since the balance sheet date of March 31, 2011 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.

Recent Accounting Pronouncements

In August 2010, the Financial Accounting Standards Board (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. Under the Lease ED, a lessor would be required to adopt a right-of-use model where the lessor

Table of Contents

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

March 31, 2011

would apply one of two approaches to each lease based on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset. For the lessor, the right-of-use model records a right to receive lease payment (lease receivable) and a lease liability, for the obligation to permit the lessee to use the underlying asset. The final Lease ED is expected to be issued in the second half of 2011. Before issuing the final document, the FASB intends to expose for public comment the proposed amendments to the FASB ASC (as required by the FASB's Rules of Procedure). A final standard may have an effective date no earlier than 2014. 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:

Market approach Uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

Income approach Uses valuation techniques to convert future amounts to a single present amount based on current market expectation about those future amounts.

Cost approach 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, 2010 and March 31, 2011 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.

Table of Contents

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
March 31, 2011

	Fair Value as of December 31, 2010	Fair Value Measurements at December 31, 2010 Using Fair Value Hierarchy			Valuation Technique
		Level 1	Level 2	Level 3	
Assets:					
Cash and cash equivalents	\$239,957	\$ 239,957	\$	\$	Market
Restricted cash and cash equivalents	191,052	191,052			Market
Derivative assets	374		374		Income
Total	\$431,383	\$ 431,009	\$ 374	\$	
Liabilities:					
Derivative liabilities	\$179,585	\$	\$ 124,404	\$ 55,181	Income

	Fair Value as of March 31, 2011	Fair Value Measurements at March 31, 2011 Using Fair Value Hierarchy			Valuation Technique
		Level 1	Level 2	Level 3	
Assets:					
Cash and cash equivalents	\$240,275	\$ 240,275	\$	\$	Market
Restricted cash and cash equivalents	191,361	191,361			Market
Derivative assets	137		137		Income
Total	\$431,773	\$ 431,636	\$ 137	\$	
Liabilities:					
Derivative liabilities	\$155,363	\$	\$ 106,599	\$ 48,764	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.

Our interest rate derivatives included in Level 3 consist of United States dollar denominated interest rate swaps on Term Financing No. 1 with a guaranteed notional balance. The guaranteed notional balance has an upper notional band that matches the hedged debt and a lower notional band. The notional balance is guaranteed to match the hedged

debt balance if the debt balance decreases within the upper and lower notional band. During the year ended December 31, 2010, the notional balance was adjusted to match the debt balance of Term Financing No. 1 as a result of various changes to Term Financing No. 1 including supplemental principal payments and debt payoff related to an aircraft sale. The fair value of the interest rate derivative is determined based on the adjusted upper notional band using cash flows discounted at the relevant market interest rates in effect at the period close. It 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. The range of the guaranteed notional between the upper and lower band represents an option that may not be exercised independently of the debt notional and is therefore valued based on unobservable market inputs.

Table of Contents

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

March 31, 2011

The following table reflects 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 months ended March 31, 2010 and 2011:

	Liabilities Derivative Liabilities
Balance as of December 31, 2009	\$ (38,907)
Total gains/(losses), net:	
Included in other income (expense)	(139)
Included in interest expense	(51)
Included in other comprehensive income	(5,943)
Balance as of March 31, 2010	\$ (45,040)
	Liabilities Derivative Liabilities
Balance as of December 31, 2010	\$ (55,181)
Total gains/(losses), net:	
Included in other income (expense)	(122)
Included in interest expense	6
Included in other comprehensive income	6,533
Balance as of March 31, 2011	\$ (48,764)

For the three months ended March 31, 2010 and 2011, we had no transfers into or out of Level 3 and we had no purchases, issuances, sales or settlements of Level 3 items.

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.

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 term debt financings are estimated using a discounted cash flow analysis, based on our current incremental borrowing rates for similar types of borrowing arrangements.

The carrying amounts and fair values of our financial instruments at December 31, 2010 and March 31, 2011 are as follows:

December 31, 2010

March 31, 2011

	Carrying Amount of Asset (Liability)	Fair Value of Asset (Liability)	Carrying Amount of Asset (Liability)	Fair Value of Asset (Liability)
Securitizedizations and term debt financings	\$ (2,056,012)	\$ (1,829,277)	\$ (1,984,507)	\$ (1,779,493)
ECA term financings	(267,311)	(273,203)	(408,181)	(414,908)
A330 PDP Facility	(88,487)	(88,487)	(59,943)	(59,943)
2010-1 Notes	(296,148)	(328,500)	(296,275)	(335,250)
	9			

Table of Contents

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

March 31, 2011

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 March 31, 2011 were as follows:

Year Ending December 31,	Amount
Remainder of 2011	\$ 417,384
2012	499,490
2013	397,377
2014	311,206
2015	261,210
2016	231,381
Thereafter	373,168
Total	\$ 2,491,216

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

Region	Three Months Ended	
	March 31,	
	2010	2011
Europe	45%	46%
Asia	20%	24%
North America	16%	13%
Latin America	9%	9%
Middle East and Africa	10%	8%
Total	100%	100%

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

For the three months ended March 31, 2010, one customer accounted for 11% of lease rental revenue and two additional customers accounted for a combined 14% of lease rental revenue. No other customer accounted for more than 5% of lease rental revenue.

For the three months ended March 31, 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.

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

Three Months Ended March 31,	
2010	2011
Number	