Aircastle LTD
Form 10-Q
November 03, 2015

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, 2015

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 30, 2015, there were 81,187,495 outstanding shares of the registrant’s common shares, par value $0.01 per share.

Aircastle Limited and Subsidiaries
Form 10-Q
Table of Contents

PART I. — FINANCIAL INFORMATION
Item 1. Financial Statements
Aircastle Limited and Subsidiaries
Consolidated Balance Sheets
(Dollars in thousands, except share data)

	September 30, 2015 (Unaudited)	December 31, 2014
ASSETS		
Cash and cash equivalents	$149,041	$169,656
Accounts receivable	3,046	3,334
Restricted cash and cash equivalents	84,258	98,884
Restricted liquidity facility collateral	65,000	65,000
Flight equipment held for lease, net of accumulated depreciation of $1,403,443 and $1,294,063, respectively	5,885,807	5,579,718
Net investment in finance leases	120,882	106,651
Unconsolidated equity method investment	49,131	46,453
Other assets	131,231	105,450
Total assets	$6,488,396	$6,175,146
LIABILITIES AND SHAREHOLDERS’ EQUITY		
LIABILITIES		
Borrowings from secured financings, net of debt issuance costs	$1,277,361	$1,373,131
Borrowings from unsecured financings, net of debt issuance costs	2,717,859	2,371,456
Accounts payable, accrued expenses and other liabilities	154,209	140,863
Lease rentals received in advance	60,447	53,216
Liquidity facility	65,000	65,000
Security deposits	114,594	117,689
Maintenance payments	338,515	333,456
Total liabilities	4,727,985	4,454,811
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, 81,181,495 shares issued and outstanding at September 30, 2015; and 80,983,249 shares issued and outstanding at December 31, 2014	812	810
Additional paid-in capital	1,567,692	1,565,180
Retained earnings	210,310	192,805
Accumulated other comprehensive loss	(18,403)	(38,460)
Total shareholders’ equity	1,760,411	1,720,335
Total liabilities and shareholders’ equity	$6,488,396	$6,175,146

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues:				
Lease rental revenue	$188,038	$178,886	$550,023	$536,452
Finance lease revenue	1,868	1,463	5,352	9,347
Amortization of lease premiums, discounts and lease incentives	(2,113)	(1,075)	(10,288)	(7,252)
Maintenance revenue	15,726	(4,189)	55,148	35,035
Total lease revenue	203,519	175,085	600,235	573,582
Other revenue	8,555	2,511	10,700	6,763
Total revenues	212,074	177,596	610,935	580,345
Operating expenses:				
Depreciation	85,324	75,519	237,538	225,230
Interest, net	60,381	56,794	184,063	181,551
Selling, general and administrative (including non-cash share based payment expense of $1,424 and $949 for the three months ended and $3,981 and $3,167 for the nine months ended September 30, 2015 and 2014, respectively)	14,032	13,817	42,663	41,818
Impairment of Aircraft	78,403	20,436	102,358	67,005
Maintenance and other costs	2,520	713	9,126	5,222
Total expenses	240,660	167,279	575,748	520,826
Other income (expense):				
Gain on sale of flight equipment	15,679	11,390	43,034	13,384
Loss on extinguishment of debt	—	—	—	(36,570)
Other	70	1	341	758
Total other income (expense)	15,749	11,391	43,375	(22,428)
Income (loss) from continuing operations before income taxes	(12,837)	21,708	78,562	37,091
Income tax provision	2,709	3,484	12,037	10,925
Earnings of unconsolidated equity method investment, net of tax	1,557	927	4,563	1,898
Net income (loss)	$(13,989)	$19,151	$71,088	$28,064
Earnings (loss) per common share — Basic:				
Net income (loss) per share	$(0.17)	$0.24	$0.88	$0.35
Earnings (loss) per common share — Diluted:				
Net income (loss) per share	$(0.17)	$0.24	$0.88	$0.35
Dividends declared per share	$0.22	$0.20	$0.66	$0.60

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

4

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income (loss)	$(13,989)	$19,151	$71,088	$28,064
Other comprehensive income, net of tax:				
Net change in fair value of derivatives, net of tax expense of $3 and $21 for the three months ended and tax expense of $26 and $825 for the nine months ended September 30, 2015 and 2014, respectively	272	1,643	708	2,025
Net derivative loss reclassified into earnings	5,006	8,549	19,349	26,730
Other comprehensive income	5,278	10,192	20,057	28,755
Total comprehensive income (loss)	$(8,711)	$29,343	$91,145	$56,819

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

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

	Nine Months Ended September 30, 2015	2014
Cash flows from operating activities:		
Net income	$71,088	$28,064
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	237,538	225,230
Amortization of deferred financing costs	11,211	10,493
Amortization of net lease discounts and lease incentives	10,288	7,252
Deferred income taxes	(1,455)	(2,623)
Non-cash share based payment expense	3,981	3,167
Cash flow hedges reclassified into earnings	19,349	26,730
Security deposits and maintenance payments included in earnings	(20,645)	(38,257)
Gain on sale of flight equipment	(43,034)	(13,384)
Loss on extinguishment of debt	—	36,570
Impairment of aircraft	102,358	67,005
Other	269	(2,278)
Changes in certain assets and liabilities:		
Accounts receivable	253	(1,603)
Other assets	(4,382)	(1,691)
Accounts payable, accrued expenses and other liabilities	14,085	17,138
Lease rentals received in advance	7,566	4,162
Net cash provided by operating activities	408,470	365,975
Cash flows from investing activities:		
Acquisition and improvement of flight equipment and lease incentives	(1,034,578)	(939,651)
Proceeds from sale of flight equipment	343,020	563,882
Restricted cash and cash equivalents related to sale of flight equipment	—	(24,606)
Aircraft purchase deposits and progress payments	(4,421)	1,315
Net investment in finance leases	(24,000)	(14,258)
Collections on finance leases	6,768	8,096
Unconsolidated equity method investment and associated costs	—	(8,592)
Distributions from unconsolidated equity method investment in excess of earnings	—	997
Other	(260)	(466)
Net cash used in investing activities	(713,471)	(413,283)
Cash flows from financing activities:		
Issuance of shares net of repurchases	(1,960)	(2,092)
Proceeds from secured and unsecured debt financings	800,000	803,200
Repayments of secured and unsecured debt financings	(548,359)	(895,459)
Debt extinguishment costs	—	(32,835)
Deferred financing costs	(12,185)	(15,843)
Restricted liquidity facility collateral	—	42,000
Liquidity facility	—	(42,000)
Restricted cash and cash equivalents related to financing activities	14,626	32,987
Security deposits and maintenance payments received	114,644	131,136
Security deposits and maintenance payments returned	(28,797)	(72,030)

Payments for terminated cash flow hedges	—	(33,427)
Dividends paid	(53,583)	(48,604)
Net cash provided by (used in) financing activities	284,386	(132,967)
Net increase (decrease) in cash and cash equivalents	(20,615)	(180,275)
Cash and cash equivalents at beginning of period	169,656	654,613
Cash and cash equivalents at end of period	$149,041	$474,338
Supplemental disclosures of cash flow information:		
Cash paid for interest	$129,696	$135,880
Cash paid for income taxes	$9,665	$4,382
Supplemental disclosures of non-cash investing activities:		
Purchase deposits, advance lease rentals, security deposits and maintenance payments assumed in asset acquisitions	$8,461	$20,837
Term debt financings assumed in asset acquisitions	$—	$39,061
Advance lease rentals, security deposits, and maintenance payments settled in sale of flight equipment	$77,624	$65,831

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

6

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2015

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 acquiring, leasing, managing and selling high utility commercial jet aircraft. 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 one 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, 2014.

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, 2015 through the date on which the consolidated financial statements included in this Form 10-Q were issued.

Effective July 1, 2015, the Company adopted Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") 2015-03, Interest - Imputation of Interest (Subtopic 835-30) Simplifying the Presentation of Debt Issuance Costs, which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the associated debt liability. The guidance in the new standard is limited to the presentation of debt issuance costs and does not affect the recognition and measurement of debt issuance costs. The standard is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The new guidance is applied on a retrospective basis. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

Principles of Consolidation

The consolidated financial statements include the accounts of Aircastle and all of its subsidiaries. Aircastle consolidates seven 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.

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.

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2015

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. In March 2014, the FASB decided that the accounting for leases by lessors would basically remain unchanged from the concepts existing in current ASC 840 accounting. In addition, the FASB decided that a lessor should be precluded from recognizing selling profit and revenue at lease commencement for any sales-type or direct finance lease that does not transfer control of the underlying asset to the lessee. This requirement aligns the notion of what constitutes a sale in the lessor accounting guidance with that in the forthcoming revenue recognition standard, which evaluates whether a sale has occurred from the customer’s perspective. We anticipate that the final standard may have an effective date no earlier than 2018. We believe that when and if the proposed guidance becomes effective, it will not have a material impact on the Company’s consolidated financial statements.

On May 28, 2014, the FASB and the International Accounting Standards Board (the “IASB”) (collectively, the Boards), jointly issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). Lease contracts within the scope of ASC 840, Leases, are specifically excluded from ASU No. 2014-09. The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. The standard is effective for public entities beginning after December 15, 2017. The standard allows for either “full retrospective” adoption, meaning the standard is applied to all of the periods presented, or “modified retrospective” adoption, meaning the standard is applied only to the most current period presented in the financial statements. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures. The Company is currently evaluating the impact of the ASU on its consolidated financial statements and related disclosures.

On August 27, 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements - Going Concern (Subtopic 205-40). The standard requires management of public companies to evaluate whether there is substantial doubt about the entity’s ability to continue as a going concern and, if so, disclose that fact. Management should evaluate whether there are conditions or events, considered in the aggregate, that raises substantial doubt about the entity’s ability to continue as a going concern within one year after the date that the financial statements are issued (or available to be issued, when applicable). The standard is effective for annual periods ending after December 15, 2016 and interim periods thereafter, and early adoption is permitted. We do not believe the standard will have a material impact on our consolidated financial statements and related disclosures when adopted.

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).

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2015

The following tables set forth our financial assets and liabilities as of September 30, 2015 and December 31, 2014 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 September 30, 2015 Using Fair Value Hierarchy			
	Fair Value as of September 30, 2015	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	$149,041	$149,041	$—	$—	Market
Restricted cash and cash equivalents	84,258	84,258	—	—	Market
Total	$233,299	$233,299	$—	$—	
Liabilities:					
Derivative liabilities	$2,433	$—	$2,433	$—	Income

		Fair Value Measurements at December 31, 2014 Using Fair Value Hierarchy			
	Fair Value as of December 31, 2014	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	$169,656	$169,656	$—	$—	Market
Restricted cash and cash equivalents	98,884	98,884	—	—	Market
Total	$268,540	$268,540	$—	$—	
Liabilities:					
Derivative liabilities	$2,879	$—	$2,879	$—	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.
For the three and nine months ended September 30, 2015 and 2014, we had no transfers into or out of Level 3.
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 our investment in an unconsolidated joint venture and

aircraft. We account for our investment in an unconsolidated joint venture under the equity method of accounting and record impairment when its fair value is less than its carrying value. We record aircraft at fair value when we determine the carrying value may not be recoverable. Fair value measurements for aircraft in impairment tests are based on an income approach which uses Level 3 inputs, which include the Company’s assumptions and appraisal data as to future cash proceeds from leasing and selling aircraft.

Aircraft Valuation

Annual Fleet-Wide Review

We perform our annual fleet-wide recoverability assessment during the third quarter of each year. This recoverability assessment is a comparison of the carrying value of each aircraft to its undiscounted expected future cash flows. We develop the assumptions used in the recoverability assessment, including those relating to current and future demand for each aircraft type, based on management's experience in the aircraft leasing industry, as well as information received from third party sources. Estimates of the undiscounted cash flows for each aircraft type are impacted by changes in contracted and future expected lease rates, residual values, expected scrap values, economic conditions and other factors.

In our 2015 assessment, we reduced forecasted future cash flows for our six Boeing 747-400 converted freighter aircraft not subject to sales agreements, all of which are more than twenty years old. Our new forecast reflects the persisting glut of supply in the air cargo market resulting from weak growth in demand combined with the growth in capacity arising from new production air freighters and higher belly capacity in latest generation wide-body passenger aircraft. In addition to these market-wide impacts, our older freighters were affected specifically by the imposition of age limits in certain countries and by lower utilization levels.

As a result, we determined that each of our older converted freighter aircraft was on its last lease, and we reduced our residual value assumptions for these aircraft and expect to scrap them following lease expiry. During the third quarter of 2015, we therefore impaired four of these aircraft, which had an aggregate net book value as of August 31, 2015 of $115,888, writing down their book values by a total of $34,575, with a fair value date of September 1, 2015. For one of these aircraft, we recorded maintenance revenue of $5,858, as we no longer plan to reinvest these funds.

In the 2014 assessment, we determined that the cash flows expected to be generated by two of our McDonnell Douglas MD-11 freighter aircraft did not support their carrying values. As a result, during the third quarter of 2014, we impaired these two aircraft, which had an aggregate net book value as of June 30, 2014 of $53,777, writing down their book values by a total of $19,515. We also shortened their expected lives from 25 to 21 years and reduced their residual values.

Other Impairments

In September 2015, Malaysian Airline System (“MAS”) informed us that it was effectively rejecting the lease on our Boeing 777-200ER aircraft as part of its restructuring. This aircraft, which was manufactured in 1998, is the only one of its type in our fleet and the only aircraft we had on lease to MAS. We repossessed it in October 2015. We reduced the carrying value of this aircraft to our best estimate of scrap value. While we haven’t made a decision to dispose of the aircraft, this write-down was driven by weak overall demand tor older widebody aircraft, an increase in the supply of competing aircraft and the difficulty of recovering high redeployment costs given the proliferation of aircraft age limits across the world. This write-down resulted in an impairment of $37,770, partially offset by $1,200 of other revenue from a letter of credit we drew following the lease rejection.

Also in September 2015, we modified the lease agreement with respect to one Airbus A321-200 aircraft. We elected not to reinvest in certain major maintenance events during the lease term, and the lessee agreed to release its rights to certain maintenance payments. As a result, we recorded an impairment of $6,058 and maintenance revenue of $7,109 for this aircraft.

In the second quarter of 2015, we impaired two McDonnell Douglas MD-11 freighter aircraft and one Boeing 737-800 aircraft and recorded impairment charges totaling $23,955 and maintenance revenue of $18,234.

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2015

During the nine months ended September 30, 2014, we impaired three Boeing 747-400 converted freighter aircraft and one Boeing 737-400 aircraft and recorded impairment charges totaling $46,570. For these aircraft, we recorded maintenance revenue of $24,262 and other revenue of $137 and reversed lease incentives of $3,626.
Other than the aircraft discussed above, management believes that the net book value of each of our 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. However, if our estimates or assumptions change, we may revise our cash flow assumptions and record future impairment charges. While we believe that the estimates and related assumptions used in the recoverability assessment are appropriate, actual results could differ from those estimates.

Financial Instruments

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 value of our Securitization No. 2, which contains a third party credit enhancement, is 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.
The carrying amounts and fair values of our financial instruments at September 30, 2015 and December 31, 2014 are as follows:

	September 30, 2015		December 31, 2014	
	Carrying Amount of Asset (Liability)	Fair Value of Asset (Liability)	Carrying Amount of Asset (Liability)	Fair Value of Asset (Liability)
Securitization No. 2	$(229,969)	$(226,385)	$(391,680)	$(376,752)
Credit Facilities	(50,000)	(50,000)	(200,000)	(200,000)
ECA term financings	(415,988)	(441,218)	(449,886)	(471,918)
Bank financings	(653,486)	(674,706)	(554,888)	(560,285)
Senior Notes	(2,700,000)	(2,820,988)	(2,200,000)	(2,300,615)

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

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2015

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, 2015 were as follows:

Year Ending December 31,	Amount
Remainder of 2015	$182,038
2016	701,166
2017	614,693
2018	535,419
2019	469,377
Thereafter	1,531,375
Total	$4,034,068

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
Region	2015		2014		2015		2014	
Asia and Pacific	43	%	39	%	42	%	40	%
Europe	28	%	29	%	28	%	29	%
South America	16	%	13	%	15	%	12	%
Middle East and Africa	9	%	9	%	9	%	9	%
North America	4	%	10	%	6	%	10	%
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, 2015, our two largest customers each accounted for more than 5% of lease rental revenue for a combined 12%. No other customer accounted for more than 5% of lease rental revenue. For the three months ended September 30, 2014, our four largest customers each accounted for more than 5% of lease rental revenue for a combined 24%. No other customer accounted for more than 5% of lease rental revenue.

For the nine months ended September 30, 2015, our three largest customers each accounted for more than 5% of lease rental revenue for a combined 17%. No other customer accounted for more than 5% of lease rental revenue. For the nine months ended September 30, 2014, our three largest customers each accounted for more than 5% of lease rental revenue for a combined 17%. No other customer accounted for more than 5% of lease rental revenue.

For the three and nine months ended September 30, 2015 and 2014, respectively, no country represented at least 10% of total revenue based on each lessee’s principal place of business.

12

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2015

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	September 30, 2015 Number of Aircraft		September 30, 2015 Net Book Value %		December 31, 2014 Number of Aircraft		December 31, 2014 Net Book Value %	
Asia and Pacific	54		42	%	46		40	%
Europe	66		27	%	65		29	%
South America	18		17	%	13		14	%
Middle East and Africa	6		9	%	6		10	%
North America	15		5	%	17		7	%
Off-lease	1	(1)	—	%	1	(2)	—	%
Total	160		100	%	148		100	%

____

(1) Consists of one Boeing 777-200ER aircraft, which we are marketing for lease or sale.
(2) Consisted of one Airbus A320-200 aircraft, which was subject to a commitment to lease and was delivered to our customer in February 2015.

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:

Region	September 30, 2015 Net Book Value	Net Book Value %		Number of Lessees	December 31, 2014 Net Book Value	Net Book Value %		Number of Lessees
Indonesia	$637,810	11	%	3	$—	—	%	—

At September 30, 2015 and December 31, 2014, the amounts of lease incentive liabilities recorded in maintenance payments on the consolidated balance sheets were $27,500 and $22,833, respectively.

Note 4. Net Investment in Finance Leases

At September 30, 2015, our net investment in finance leases represents six aircraft leased to two customers in the United States, one aircraft leased to a customer in Canada, and one aircraft leased to a customer in Germany. The following table lists the components of our net investment in finance leases at September 30, 2015:

	Amount	
Total lease payments to be received	$93,976	
Less: Unearned income	(37,227	)
Estimated residual values of leased flight equipment (unguaranteed)	64,133	
Net investment in finance leases	$120,882	

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2015

At September 30, 2015, minimum future lease payments on finance leases are as follows:

Year Ending December 31,	Amount
Remainder of 2015	$3,842
2016	15,365
2017	14,843
2018	9,715
2019	9,695
Thereafter	40,516
Total	$93,976

Note 5. Unconsolidated Equity Method Investment

On December 19, 2013, the Company and an affiliate of Ontario Teachers' Pension Plan ("Teachers'") formed a joint venture (the "JV"), in which we hold a 30% equity interest, to invest in leased aircraft. Teachers' holds 9.7% of our outstanding common shares.

The Company recorded a $6,270 guarantee liability, which is reflected in Maintenance payments on the balance sheet and a $5,400 guarantee liability, which is reflected in Security deposits on the balance sheet.

Investment in joint venture at December 31, 2014	$46,453
Investment in joint venture	2,994
Earnings from joint venture, net of tax	4,563
Distributions	(4,879)
Investment in joint venture at September 30, 2015	$49,131

Note 6. Variable Interest Entities

Aircastle consolidates seven 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 12 aircraft discussed below.

Securitization

Aircastle is the primary beneficiary of ACS Ireland 2, as we have both the power to direct the activities of the VIE that most significantly impacts the economic performance of such VIE 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 2 debt, Aircastle wholly owns ACS Bermuda 2, which has fully and unconditionally guaranteed the ACS Ireland 2 VIE 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 ACS Ireland 2. The Irish charitable trust's risk is limited to its annual dividend of $2. At September 30, 2015, the assets of ACS Ireland 2 include four aircraft transferred into the VIE at historical cost basis in connection with Securitization No. 2.

The assets of the ACS Ireland 2, net of intercompany receivables, as of September 30, 2015 are $88,771. The liabilities of the ACS Ireland 2, net of $40,351 Class E-1 Securities held by the Company and intercompany payables, which are eliminated in consolidation, as of September 30, 2015 are $64,787.

14

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2015

ECA Term Financings

Aircastle, through various subsidiaries, each of which is owned by a charitable trust (such entities, collectively the “Air Knight VIEs”), has entered into eight 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”). 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. The related aircraft, with a net book value as of September 30, 2015 of $625,680 were included in our flight equipment held for lease. The consolidated debt outstanding, net of debt issuance costs, of the Air Knight VIEs as of September 30, 2015 is $401,339.

Note 7. Secured and Unsecured Debt Financings

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

	At September 30, 2015				At December 31, 2014
Debt Obligation	Outstanding Borrowings	Number of Aircraft	Interest Rate[1]	Final Stated Maturity[2]	Outstanding Borrowings
Secured Debt Financings:					
Securitization No. 2	$229,969	30	0.51%	06/14/37	$391,680
ECA Term Financings	415,988	8	3.02% to 3.96%	12/3/21 to 11/30/24	449,886
Bank Financings	653,486	13	1.21% to 5.09%	10/26/17 to 01/19/26	554,888
Less: Debt Issuance Costs	(22,082)	—			(23,323)
Total secured debt financings, net of debt issuance costs	1,277,361	51			1,373,131
Unsecured Debt Financings:					
Senior Notes due 2017	500,000		6.75%	04/15/17	500,000
Senior Notes due 2018	400,000		4.625%	12/05/18	400,000
Senior Notes due 2019	500,000		6.250%	12/01/19	500,000
Senior Notes due 2020	300,000		7.625%	04/15/20	300,000
Senior Notes due 2021	500,000		5.125%	03/15/21	500,000
Senior Notes due 2022	500,000		5.50%	02/15/22	—
Revolving Credit Facility	50,000		2.44%	05/13/19	200,000
Less: Debt Issuance Costs	(32,141)				(28,544)

Total unsecured debt financings, net of debt issuance costs	2,717,859	2,371,456
Total secured and unsecured debt financings, net of debt issuance costs	$3,995,220	$3,744,587

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2015

(1) Reflects the floating rate in effect at the applicable reset date plus the margin for Securitization No. 2, five of our Bank Financings, and our Revolving Credit Facility. All other financings have a fixed rate.
(2) For Securitization No. 2, all cash flows available after expenses and interest are applied to debt amortization.

The following Securitization includes a liquidity facility commitment described in the table below:

Facility	Liquidity Facility Provider	Available Liquidity September 30, 2015	Available Liquidity December 31, 2014	Unused Fee	Interest Rate on any Advances
Securitization No. 2	HSH Nordbank AG	$ 65,000	$ 65,000	0.50%	1M Libor + 0.75

Secured Debt Financings:

ECA Term Financings

As described in Note 6 - Variable Interest Entities, we refer to our COFACE-supported financings as “ECA Term Financings.” In addition, Aircastle has guaranteed the repayment of the ECA Term Financings. The borrowings under these financings at September 30, 2015 have a weighted average rate of interest of 3.57%.

Bank Financings

In May 2015, we entered into two floating rate loans with The Bank of Tokyo-Mitsubishi UFJ, Ltd. and Development Bank of Japan Inc. These loans, which total $150,000, are secured by two A330-300 aircraft that we acquired in the fourth quarter of 2014.

Our Bank Financings contain, among other customary provisions, a $500,000 minimum net worth covenant and, in some cases, a cross-default to other financings with the same lender. In addition, Aircastle has guaranteed the repayment of the Bank Financings. The borrowings under these financings at September 30, 2015 have a weighted average fixed rate of interest of 3.15%.

Unsecured Debt Financings:

Senior Notes due 2022

On January 15, 2015, Aircastle issued $500,000 aggregate principal amount of Senior Notes due 2022 (the "2022 Senior Notes") at par. The 2022 Senior Notes will mature on February 15, 2022 and bear interest at the rate of 5.50% per annum, payable semi-annually on February 15 and August 15 of each year, commencing on August 15, 2015. Interest accrues on the 2022 Senior Notes from January 15, 2015.

We may redeem the Senior Notes due 2022 at any time at a redemption price equal to (a) 100% of the principal amount of the notes redeemed, plus accrued and unpaid interest thereon to, but not including, the redemption date and (b) the sum of the present values of the remaining scheduled payments of principal and interest on the notes from the redemption date through the maturity date of the notes (computed using a discount rate equal to the Treasury Rate (as defined in the indenture governing the notes) as of such redemption date plus 50 basis points). In addition, on or before February 15, 2018, we may redeem up to 35% of the aggregate principal amount of the notes issued under the indenture at a redemption price equal to 105.50% plus accrued and unpaid interest thereon to, but not including, the redemption date, with the net proceeds of certain equity offerings. If the Company undergoes a change of control, it must offer to repurchase the Senior Notes due 2022 at 101% of the principal amount, plus accrued and unpaid interest. The Senior Notes due 2022 are not guaranteed by any of the Company's subsidiaries or any third party.

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2015

Revolving Credit Facility

On January 26, 2015, we increased the size of our Revolving Credit Facility from $450,000 to $600,000. On May 13, 2015, we extended the maturity of our Revolving Credit Facility to May 13, 2019. At September 30, 2015, we had $50,000 drawn on the facility.

As of September 30, 2015, we are in compliance with all applicable covenants in all of our financings.

Note 8. 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
August 4, 2015	$0.220	$17,860	August 31, 2015	September 15, 2015
May 4, 2015	$0.220	$17,863	May 29, 2015	June 15, 2015
February 17, 2015	$0.220	$17,860	March 6, 2015	March 13, 2015
October 31, 2014	$0.220	$17,817	November 28, 2014	December 15, 2014
July 28, 2014	$0.200	$16,201	August 29, 2014	September 12, 2014
May 5, 2014	$0.200	$16,202	May 30, 2014	June 13, 2014
February 21, 2014	$0.200	$16,201	March 7, 2014	March 14, 2014

Note 9. Earnings (Loss) 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. All of our restricted common shares are currently participating securities.
Under the two-class method, earnings per common share is 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. Because the holders of the participating restricted common shares were not contractually required to share in the Company’s losses, in applying the two-class method to compute the basic and diluted net loss per common share, no allocation to restricted common shares was made for the three months ended September 30, 2015.

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2015

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Weighted average shares:				
Common shares outstanding	80,566,400	80,389,996	80,565,754	80,389,131
Restricted common shares	645,427	600,581	604,179	581,932
Total weighted average shares	81,211,827	80,990,577	81,169,933	80,971,063
Percentage of weighted average shares:				
Common shares outstanding	99.21 %	99.26 %	99.26 %	99.28 %
Restricted common shares	0.79 %	0.74 %	0.74 %	0.72 %
Total	100.00 %	100.00 %	100.00 %	100.00 %

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Earnings (loss) per share – Basic:				
Net income (loss)	$(13,989)	$19,151	$71,088	$28,064
Less: Distributed and undistributed earnings allocated to restricted common shares[a]	—	(142)	(529)	(202)
Earnings (loss) available to common shareholders – Basic	$(13,989)	$19,009	$70,559	$27,862
Weighted average common shares outstanding – Basic	80,566,400	80,389,996	80,565,754	80,389,131
Earnings (loss) per common share – Basic	$(0.17)	$0.24	$0.88	$0.35
Earnings (loss) per share – Diluted:				
Net income (loss)	$(13,989)	$19,151	$71,088	$28,064
Less: Distributed and undistributed earnings allocated to restricted common shares[a]	—	(142)	(529)	(202)
Earnings (loss) available to common shareholders – Diluted	$(13,989)	$19,009	$70,559	$27,862
Weighted average common shares outstanding – Basic	80,566,400	80,389,996	80,565,754	80,389,131
Effect of dilutive shares[b]	—	—	—	—
Weighted average common shares outstanding – Diluted	80,566,400	80,389,996	80,565,754	80,389,131
Earnings (loss) per common share – Diluted	$(0.17)	$0.24	$0.88	$0.35

(a)

For the three months ended September 30, 2014, distributed and undistributed earnings to restricted shares is 0.74% of net income. For the nine months ended September 30, 2015 and 2014, distributed and undistributed earnings to restricted shares is 0.74% and 0.72% of net income, 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, 2015 and 2014, we had no dilutive shares.

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2015

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 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, Singapore and the United States.

The sources of income (loss) from continuing operations before income taxes and earnings of unconsolidated equity method investment for the three and nine months ended September 30, 2015 and 2014 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
U.S. operations	$597	$772	$1,817	$2,293
Non-U.S. operations	(13,434)	20,936	76,745	34,798
Total	$(12,837)	$21,708	$78,562	$37,091

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. The aircraft owning subsidiaries resident in Ireland, Mauritius and Singapore are subject to tax in those respective jurisdictions.

We 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. We also have Ireland and Singapore based subsidiaries which provide management services to our non-U.S. subsidiaries and are subject to tax in those respective jurisdictions.

The consolidated income tax expense for the three and nine months ended September 30, 2015 and 2014 was determined based upon estimates of the Company’s consolidated effective income tax rates for the years ending December 31, 2015 and 2014, respectively.

The Company’s effective tax rate for the three and nine months ended September 30, 2015 was 21.1% and 15.3% respectively, compared to 16.0% and 29.5% for the three and nine months ended September 30, 2014, respectively. Movements in the effective tax rates are generally caused by changes in the proportion of the Company’s pre-tax earnings in taxable and non-tax jurisdictions. For the three and nine months ended September 30, 2015, the interim period effective tax rate reflects impairments of $78,403 and $102,358, respectively, which resulted in a higher effective tax rate. For the nine months ended September 30, 2014, the interim period effective tax rate reflects the loss on extinguishment of debt in the amount of $36,570 related to Bermuda operations, which was treated as a discrete item with no tax benefit.

Aircastle Limited and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
September 30, 2015

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,	
	2015	2014	2015	2014
Notional U.S. federal income tax expense (benefit) at the statutory rate	$(4,493)	$7,598	$27,497	$12,982
U.S. state and local income tax, net	57	57	167	176
Non-U.S. operations:				
Bermuda	6,696	215	(9,199)	6,455
Ireland	2,500	(2,411)	(407)	(3,163)
Singapore	(1,385)	(1,418)	(4,116)	(3,895)
Other	(860)	(692)	(2,439)	(2,061)
Non-deductible expenses in the U.S.	205	146	566	464
Other	(11)	(11)	(32)	(33)
Income tax provision	$2,709	$3,484	$12,037	$10,925

Note 11. Interest, Net

The following table shows the components of interest, net:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Interest on borrowings, net settlements on interest rate derivatives, and other liabilities	$51,428	$44,820	$153,076	$144,677
Hedge ineffectiveness losses	215	(4)	509	55
Amortization of interest rate derivatives related to deferred losses	5,006	8,549	19,349	