Aircastle LTD
Form 10-Q
August 04, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 30, 2011

or

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

For the transition period from __________ to __________

Commission File number 001-32959

AIRCASTLE LIMITED

(Exact name of registrant as specified in its charter)

Bermuda	**98-0444035**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*
c/o Aircastle Advisor LLC 300 First Stamford Place, 5th Floor, Stamford, CT	**06902**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code **(203) 504-1020**

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

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 o

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 o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of July 29, 2011, there were 74,915,769 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, 2010	June 30, 2011 (Unaudited)
ASSETS		
Cash and cash equivalents	$ 239,957	$ 184,017
Accounts receivable	1,815	2,665
Restricted cash and cash equivalents	191,052	185,245
Restricted liquidity facility collateral	75,000	112,000
Flight equipment held for lease, net of accumulated depreciation of $785,490 and $891,810	4,065,780	4,099,641
Aircraft purchase deposits and progress payments	219,898	188,599
Other assets	65,557	74,529
Total assets	$ 4,859,059	$ 4,846,696
LIABILITIES AND SHAREHOLDERS EQUITY		
LIABILITIES		
Borrowings from secured and unsecured financings (including borrowings of ACS Ireland VIEs of $314,877 and $306,040, respectively)	$ 2,707,958	$ 2,685,632
Accounts payable, accrued expenses and other liabilities	76,470	80,899
Dividends payable	7,964	9,364
Lease rentals received in advance	43,790	39,066
Liquidity facility	75,000	112,000
Security deposits	83,241	78,959
Maintenance payments	342,333	320,696
Fair value of derivative liabilities	179,585	154,655
Total liabilities	3,516,341	3,481,271
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 74,915,769 shares issued and outstanding at June 30, 2011	796	749
Additional paid-in capital	1,485,841	1,427,558
Retained earnings	104,301	153,066
Accumulated other comprehensive loss	(248,220)	(215,948)

Total shareholders equity	1,342,718	1,365,425
Total liabilities and shareholders equity	$ 4,859,059	$ 4,846,696

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

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Aircastle Limited and Subsidiaries

Consolidated Statements of Income
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2011	Six Months Ended June 30, 2010	Six Months Ended June 30, 2011
Revenues:				
Lease rental revenue	$ 128,133	$ 143,355	$ 258,255	$ 284,471
Amortization of net lease discounts and lease incentives	(4,909)	(3,030)	(9,754)	(6,132)
Maintenance revenue	6,836	8,162	12,090	25,006
Total lease rentals	130,060	148,487	260,591	303,345
Other revenue	124	351	154	3,407
Total revenues	130,184	148,838	260,745	306,752
Expenses:				
Depreciation	54,424	58,576	108,569	118,167
Interest, net	40,166	55,893	81,125	101,512
Selling, general and administrative (including non-cash share based payment expense of $1,929 and $1,178 for the three months ended, and $3,711 and $3,073 for the six months ended, June 30, 2010 and 2011, respectively)	11,036	11,578	22,709	24,109
Impairment of aircraft		5,200		5,200
Maintenance and other costs	3,437	3,369	5,637	6,899
Total expenses	109,063	134,616	218,040	255,887
Other income (expense):				
Gain (loss) on sale of flight equipment	(1,291)	10,299	(1,291)	19,961
Other	(176)	323	(546)	(36)
Total other income (expense)	(1,467)	10,622	(1,837)	19,925
Income from continuing operations before income taxes	19,654	24,844	40,868	70,790
Income tax provision	1,515	1,535	3,850	4,804
Net income	$ 18,139	$ 23,309	$ 37,018	$ 65,986

Earnings per common share	Basic	$	0.23	$	0.30	$	0.46	$	0.84
Earnings per common share	Diluted	$	0.23	$	0.30	$	0.46	$	0.84
Dividends declared per share		$	0.10	$	0.125	$	0.20	$	0.225

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

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Aircastle Limited and Subsidiaries

Consolidated Statements of Cash Flows
(Dollars in thousands)
(Unaudited)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2011
Cash flows from operating activities:		
Net income	$ 37,018	$ 65,986
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	108,569	118,167
Amortization of deferred financing costs	5,760	9,417
Amortization of net lease discounts and lease incentives	9,754	6,132
Deferred income taxes	2,537	2,712
Non-cash share based payment expense	3,711	3,073
Cash flow hedges reclassified into earnings	4,074	8,226
Ineffective portion of cash flow hedges	1,769	(598)
Security deposits and maintenance payments included in earnings	(9,978)	(25,282)
(Gain) loss on sale of flight equipment	1,291	(19,961)
Impairment of aircraft		5,200
Other	546	566
Changes in certain assets and liabilities:		
Accounts receivable	(662)	(1,366)
Restricted cash and cash equivalents	12,436	5,807
Other assets	655	(1,276)
Accounts payable, accrued expenses and other liabilities	(5,445)	(11,861)
Lease rentals received in advance	(1,343)	(5,231)
Net cash provided by operating activities	170,692	159,711
Cash flows from investing activities:		
Acquisition and improvement of flight equipment and lease incentives	(55,353)	(196,132)
Proceeds from sale of flight equipment	17,707	151,577
Restricted cash and cash equivalents related to sale of flight equipment	(17,707)	
Aircraft purchase deposits and progress payments, net of aircraft sale deposits	(74,666)	(76,897)
Other	(16)	(10)
Net cash used in investing activities	(130,035)	(121,462)
Cash flows from financing activities:		
Repurchase of shares	(1,663)	(61,403)
Proceeds from term debt financings	57,089	230,333
Securitization and term debt financing repayments	(88,341)	(252,912)
Deferred financing costs	(2,023)	(11,253)
Restricted secured liquidity facility collateral	2,000	(37,000)

Secured liquidity facility collateral	(2,000)	37,000
Security deposits received	3,917	10,317
Security deposits returned	(8,760)	(7,764)
Maintenance payments received	57,762	57,571
Maintenance payments returned	(35,702)	(43,257)
Dividends paid	(15,906)	(15,821)
Net cash used in financing activities	(33,627)	(94,189)
Net increase (decrease) in cash and cash equivalents	7,030	(55,940)
Cash and cash equivalents at beginning of period	142,666	239,957
Cash and cash equivalents at end of period	$ 149,696	$ 184,017
Supplemental disclosures of cash flow information:		
Cash paid for interest, net of capitalized interest	$ 70,216	$ 83,754
Cash paid for income taxes	$ 2,595	$ 1,525
Supplemental disclosures of non-cash investing activities:		
Security deposits, maintenance liabilities and other liabilities settled in sale of flight equipment	$	$ 9,566
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

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

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 would apply one of two approaches to each lease based on whether the lessor

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retains exposure to significant risks or benefits associated with the underlying asset. In July 2011, the FASB tentatively decided on a new model for lessor accounting that would require a single approach for all leases, with a few exceptions. Under the new model, 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. Even though the FASB has not completed all of its deliberations, the decisions made to date were sufficiently different from those published in the Lease ED to warrant re-exposure of the revised proposal. The FASB intends to complete its deliberations during the third quarter of 2011 with a view to publishing a revised proposed leases standard shortly thereafter. A final standard may have an effective date no earlier than 2015. 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.

In May 2011, the FASB issued ASU 2011-04 (ASU 2011-04), *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs*, to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRS. The amendments in this update change the wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements which include (1) those that clarify the FASB s intent about the application of existing fair value measurement and disclosure requirements, and (2) those that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurement. ASU 2011-04 is effective for interim and annual reporting periods beginning after December 15, 2011. The adoption of ASU 2011-04 will not have a material impact on the Company s consolidated financial statements.

In June 2011, the FASB issued Accounting Standards Update (ASU) 2011-05 (ASU 2011-05), *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, which gives the option to present the total of comprehensive income either in a single continuous statement of comprehensive net income or in two separate but consecutive statements. In either option, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. If a two statement approach is used, the statement of other comprehensive income should immediately follow the statement of net income. This update eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders equity. It also requires the presentation on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. ASU 2011-05 is effective for interim and annual reporting periods beginning after December 15, 2011 and should be applied retrospectively. The adoption of ASU 2011-05 will not have a material impact on the Company s consolidated financial statements.

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:

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 June 30, 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.

	Fair Value as of December 31, 2010	Fair Value Measurements at December 31, 2010 Using Fair Value Hierarchy			
		Level 1	Level 2	Level 3	Valuation Technique
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 June 30, 2011	Fair Value Measurements at June 30, 2011 Using Fair Value Hierarchy			
		Level 1	Level 2	Level 3	Valuation Technique
Assets:					
Cash and cash equivalents	$ 184,017	$ 184,017	$	$	Market
Restricted cash and cash equivalents	185,245	185,245			Market
Total	$ 369,262	$ 369,262	$	$	
Liabilities:					
Derivative liabilities	$ 154,655	$	$ 100,129	$ 54,526	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

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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.

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 six months ended June 30, 2010 and 2011:

	Three Months Ended June 30, 2010	Six Months Ended June 30, 2010
	Derivative Liabilities	
Balance at beginning of period	$ (45,040)	$ (38,907)
Total gains/(losses), net:		
Included in other income (expense)	(136)	(275)
Included in interest expense	(71)	(122)
Included in other comprehensive income	(14,169)	(20,112)
Balance at end of period	$ (59,416)	$ (59,416)

	Three Months Ended June 30, 2011	Six Months Ended June 30, 2011
	Derivative Liabilities	
Balance at beginning of period	$ (48,764)	$ (55,181)
Total gains/(losses), net:		
Included in other income (expense)		