

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

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FORM 10-Q

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

For the quarterly period ended September 30, 2013

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File number 001-32959

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AIRCASTLE LIMITED  
(Exact name of registrant as specified in its charter)

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|  |  |
|--|--|
| Bermuda<br>(State or other jurisdiction of<br>incorporation or organization) | 98-0444035<br>(IRS Employer<br>Identification No.) |
|--|--|

|  |                     |
|--|---------------------|
| c/o Aircastle Advisor LLC<br>300 First Stamford Place, 5 <sup>th</sup> Floor, Stamford, CT<br>(Address of principal executive offices) | 06902<br>(Zip Code) |
| Registrant's telephone number, including area code   | (203) 504-1020      |

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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 | <input type="checkbox"/>  | Accelerated filer         | <input checked="" type="checkbox"/> |
| Non-accelerated filer   | <input checked="" type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company | <input type="checkbox"/>            |

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

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

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## PART I. — FINANCIAL INFORMATION

## Item 1. Financial Statements

## Aircastle Limited and Subsidiaries

## Consolidated Balance Sheets

(Dollars in thousands, except share data)

|  | December 31,<br>2012 | September 30,<br>2013<br>(Unaudited) |
|--|----------------------|--------------------------------------|
| <b>ASSETS</b>  |                      |                                      |
| Cash and cash equivalents  | \$618,217            | \$238,150                            |
| Accounts receivable  | 5,625                | 5,127                                |
| Restricted cash and cash equivalents   | 111,942              | 191,843                              |
| Restricted liquidity facility collateral   | 107,000              | 107,000                              |
| Flight equipment held for lease, net of accumulated depreciation of \$1,305,064 and \$1,424,057  | 4,662,661            | 4,938,113                            |
| Net investment in finance leases   | 119,951              | 148,005                              |
| Other assets   | 186,764              | 177,242                              |
| Total assets   | \$5,812,160          | \$5,805,480                          |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                      |                                      |
| <b>LIABILITIES</b>   |                      |                                      |
| Borrowings from secured financings (including borrowings of ACS Ireland VIEs of \$207,926 and \$168,107, respectively)   | \$1,848,034          | \$1,581,118                          |
| Borrowings from unsecured financings   | 1,750,642            | 1,750,556                            |
| Accounts payable, accrued expenses and other liabilities   | 108,593              | 134,892                              |
| Lease rentals received in advance  | 53,189               | 48,379                               |
| Liquidity facility   | 107,000              | 107,000                              |
| Security deposits  | 87,707               | 110,410                              |
| Maintenance payments   | 379,391              | 428,615                              |
| Fair value of derivative liabilities   | 61,978               | 44,307                               |
| Total liabilities  | 4,396,534            | 4,205,277                            |
| Commitments and Contingencies  |                      |                                      |
| <b>SHAREHOLDERS' EQUITY</b>  |                      |                                      |
| Preference shares, \$.01 par value, 50,000,000 shares authorized, no shares issued and outstanding   |                      |                                      |
| Common shares, \$.01 par value, 250,000,000 shares authorized, 68,639,729 shares issued and outstanding at December 31, 2012; and 80,776,975 shares issued and outstanding at September 30, 2013 | 686                  | 808                                  |
| Additional paid-in capital   | 1,360,555            | 1,560,509                            |
| Retained earnings  | 180,675              | 126,140                              |
| Accumulated other comprehensive loss   | (126,290)            | (87,254)                             |
| Total shareholders' equity   | 1,415,626            | 1,600,203                            |
| Total liabilities and shareholders' equity   | \$5,812,160          | \$5,805,480                          |

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



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

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

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



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## Aircastle Limited and Subsidiaries

## Consolidated Statements of Comprehensive Income (Loss)

(Dollars in thousands)

(Unaudited)

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

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



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

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

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

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

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

Note 1. Summary of Significant Accounting Policies

Organization and Basis of Presentation

Aircastle Limited (“Aircastle,” the “Company,” “we,” “us” or “our”) is a Bermuda exempted company that was incorporated on October 29, 2004 under the provisions of Section 14 of the Companies Act of 1981 of Bermuda. Aircastle’s business is investing in aviation assets, including leasing, managing and selling commercial jet aircraft to airlines throughout the world and investing in aircraft related debt investments.

Aircastle is a holding company that conducts its business through subsidiaries. Aircastle directly or indirectly owns all of the outstanding common shares of its subsidiaries. The consolidated financial statements presented are prepared in accordance with U.S. generally accepted accounting principles (“US GAAP”). We operate in a single segment.

The accompanying consolidated financial statements are unaudited and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) for interim financial reporting and, in our opinion, reflect all adjustments, including normal recurring items, which are necessary to present fairly the results for interim periods. Operating results for the periods presented are not necessarily indicative of the results that may be expected for the entire year. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with US GAAP have been omitted in accordance with the rules and regulations of the SEC; however, we believe that the disclosures are adequate to make information presented not misleading. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

The Company’s management has reviewed and evaluated all events or transactions for potential recognition and/or disclosure since the balance sheet date of September 30, 2013 through the date on which the consolidated financial statements included in this Form 10-Q were issued.

Principles of Consolidation

The consolidated financial statements include the accounts of Aircastle and all of its subsidiaries. Aircastle consolidates eight Variable Interest Entities (“VIEs”) of which Aircastle is the primary beneficiary. All intercompany transactions and balances have been eliminated in consolidation.

We consolidate VIEs in which we have determined that we are the primary beneficiary. We use judgment when deciding (a) whether an entity is subject to consolidation as a VIE, (b) who the variable interest holders are, (c) the potential expected losses and residual returns of the variable interest holders, and (d) which variable interest holder is the primary beneficiary. When determining which enterprise is the primary beneficiary, we consider (1) the entity’s purpose and design, (2) which variable interest holder has the power to direct the activities that most significantly impact the entity’s economic performance, and (3) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. When certain events occur, we reconsider whether we are the primary beneficiary of VIEs. We do not reconsider whether we are a primary beneficiary solely because of operating losses incurred by an entity.

Effective January 1, 2013, the Company adopted Financial Accounting Standards Board (the “FASB”) Accounting Standards Update (“ASU”) 2013-02 (“ASU 2013-02”) Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This ASU requires that companies present reclassification adjustments for each component of accumulated other comprehensive income (“AOCI”) either on the face of the financial statements or in the notes, provided that all required information is presented in a single location. ASU 2013-02 is effective for interim and annual reporting periods beginning after December 15, 2012 and should be applied prospectively. The adoption of ASU 2013-02 did not have a material impact on the Company’s consolidated financial statements.

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

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(Dollars in thousands, except per share amounts)  
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periods presented on the balance sheet. The adoption of ASU 2011-11 did not have a material impact on the Company's consolidated financial statements.

### Risk and Uncertainties

In the normal course of business, Aircastle encounters several significant types of economic risk including credit, market, aviation industry and capital market risks. Credit risk is the risk of a lessee's inability or unwillingness to make contractually required payments and to fulfill its other contractual obligations. Market risk reflects the change in the value of derivatives and financings due to changes in interest rate spreads or other market factors, including the value of collateral underlying derivatives and financings. Aviation industry risk is the risk of a downturn in the commercial aviation industry which could adversely impact a lessee's ability to make payments, increase the risk of unscheduled lease terminations and depress lease rates and the value of the Company's aircraft. Capital market risk is the risk that the Company is unable to obtain capital at reasonable rates to fund the growth of our business or to refinance existing debt facilities.

### Use of Estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. While Aircastle believes that the estimates and related assumptions used in the preparation of the consolidated financial statements are appropriate, actual results could differ from those estimates.

### Proposed Accounting Pronouncements

In May 2013, the FASB issued re-exposure draft, "Leases" (the "Lease Re-ED"), which would replace the existing guidance in the Accounting Standards Codification ("ASC") 840 ("ASC 840"), Leases. The FASB decided that leases would be classified as either leases of real property (Type B) or leases of assets other than real property (Type A). Leases of real property will continue to use operating lease accounting. Leases of other than real property would use the receivable residual approach. Under the receivable residual approach, a lease receivable would be recognized for the lessor's right to receive lease payments, a portion of the carrying amount of the underlying asset would be allocated between the right of use granted to the lessee and the lessor's residual value and profit or loss would only be recognized at commencement if it is reasonably assured. The comment period for the Lease Re-ED ended on September 13, 2013. We anticipate that the final standard may have an effective date no earlier than 2017. When and if the proposed guidance becomes effective, it may have a significant impact on the Company's consolidated financial statements. Although we believe the presentation of our financial statements, and those of our lessees could change, we do not believe the accounting pronouncement will change the fundamental economic reasons for which the airlines lease aircraft. Therefore, we do not believe it will have a material impact on our business.

### Note 2. Fair Value Measurements

Fair value measurements and disclosures require the use of valuation techniques to measure fair value that maximize the use of observable inputs and minimize use of unobservable inputs. These inputs are prioritized as follows:

- Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities or market corroborated inputs.
- Level 3: Unobservable inputs for which there is little or no market data and which require us to develop our own assumptions about how market participants price the asset or liability.



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The valuation techniques that may be used to measure fair value are as follows:

• The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

• The income approach uses valuation techniques to convert future amounts to a single present amount based on current market expectation about those future amounts.

• The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost).

The following tables set forth our financial assets and liabilities as of December 31, 2012 and September 30, 2013 that we measured at fair value on a recurring basis by level within the fair value hierarchy. Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to their fair value measurement.

|                                      | Fair Value as of December 31, 2012  | Fair Value Measurements at December 31, 2012 Using Fair Value Hierarchy  |   |   |  | Valuation Technique |
|--------------------------------------|-------------------------------------|--|---|---|--|---------------------|
|                                      |                                     | Quoted Prices In Active Markets for Identical Assets (Level 1)           | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |  |                     |
| <b>Assets:</b>                       |                                     |  |   |   |  |                     |
| Cash and cash equivalents            | \$618,217                           | \$618,217  | \$—   | \$—                                       |  | Market              |
| Restricted cash and cash equivalents | 111,942                             | 111,942  | —   | —   |  | Market              |
| Debt investments                     | 40,388                              | —  | —   | 40,388                                    |  | Income              |
| <b>Total</b>                         | <b>\$770,547</b>                    | <b>\$730,159</b>   | <b>\$—</b>                                    | <b>\$40,388</b>                           |  |                     |
| <b>Liabilities:</b>                  |                                     |  |   |   |  |                     |
| Derivative liabilities               | \$61,978                            | \$—  | \$61,978                                      | \$—                                       |  | Income              |
|                                      | Fair Value as of September 30, 2013 | Fair Value Measurements at September 30, 2013 Using Fair Value Hierarchy |   |   |  | Valuation Technique |
|                                      |                                     | Quoted Prices In Active Markets for Identical Assets (Level 1)           | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |  |                     |
| <b>Assets:</b>                       |                                     |  |   |   |  |                     |
| Cash and cash equivalents            | \$238,150                           | \$238,150  | \$—   | \$—                                       |  | Market              |
| Restricted cash and cash equivalents | 191,843                             | 191,843  | —   | —   |  | Market              |
| <b>Total</b>                         | <b>\$429,993</b>                    | <b>\$429,993</b>   | <b>\$—</b>                                    | <b>\$—</b>                                |  |                     |
| <b>Liabilities:</b>                  |                                     |  |   |   |  |                     |
| Derivative liabilities               | \$44,307                            | \$—  | \$44,307                                      | \$—                                       |  | Income              |

Our cash and cash equivalents, along with our restricted cash and cash equivalents balances, consist largely of money market securities that are considered to be highly liquid and easily tradable. These securities are valued using inputs observable in active markets for identical securities and are therefore classified as Level 1 within our fair value hierarchy. Our interest rate derivatives included in Level 2 consist of United States dollar-denominated interest rate derivatives, and their fair values are determined by applying standard modeling techniques under the income approach to relevant market interest rates (cash rates, futures rates, swap rates) in effect at the period close to determine appropriate reset and discount rates and incorporates an assessment of the risk of non-performance by the interest rate derivative counterparty in valuing derivative assets and an evaluation of the Company's credit risk in valuing derivative liabilities.



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 (Dollars in thousands, except per share amounts)  
 September 30, 2013

The following tables reflect the activity for the classes of our assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2012 and 2013, respectively:

|  | Assets                 |      |                   |           |
|--|------------------------|------|-------------------|-----------|
|  | Debt Investments       |      |                   |           |
|  | Three Months Ended     |      | Nine Months Ended |           |
|  | September 30,          |      | September 30,     |           |
|  | 2012                   | 2013 | 2012              | 2013      |
| Balance at beginning of period         | \$—                    | \$—  | \$—               | \$40,388  |
| Total gains/(losses), net:             |                        |      |                   |           |
| Included in other revenue              | —                      | —    | —                 | 1,613     |
| Settlements                            | —                      | —    | —                 | (42,001 ) |
| Balance at end of period               | \$—                    | \$—  | \$—               | \$—       |
|  |                        |      |                   |           |
|  | Liabilities            |      |                   |           |
|  | Derivative Liabilities |      |                   |           |
|  | Three Months Ended     |      | Nine Months Ended |           |
|  | September 30,          |      | September 30,     |           |
|  | 2012                   | 2013 | 2012              | 2013      |
| Balance at beginning of period         | \$—                    | \$—  | \$(56,229)        | \$—       |
| Total gains/(losses), net:             |                        |      |                   |           |
| Included in other income (expense)     | —                      | —    | 599               | —         |
| Included in interest expense           | —                      | —    | 73                | —         |
| Included in other comprehensive income | —                      | —    | 4,800             | —         |
| Settlements                            | —                      | —    | 50,757            | —         |
| Balance at end of period               | \$—                    | \$—  | \$—               | \$—       |

For the three and nine months ended September 30, 2012, we had no transfers into or out of Level 3; however we did terminate all Level 3 interest rate derivatives during the second quarter of 2012. For the three and nine months ended September 30, 2013, we had no transfers into or out of Level 3; however we did settle the debt investment during the first quarter of 2013.

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. Fair value measurements for aircraft impaired are based on an income approach that uses Level 3 inputs, which include our assumptions and appraisal data as to future cash proceeds from leasing and selling aircraft.

Aircraft Valuation

We perform our annual fleet-wide recoverability assessment during the third quarter of each year. This recoverability assessment, as more fully described in our Annual Report on Form 10-K for the year ended December 31, 2012, 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.

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Following completion of the recoverability analysis during the third quarter of 2013, we determined the cash flows expected to be generated by several of our aircraft did not support carrying values. As a result, as noted below, we impaired seven aircraft with an aggregate net book value as of June 30, 2013 that was \$318,854, writing down their book values by a total of \$97,592. For some of these aircraft we also shortened the expected lives and/or reduced the residual values. More specifically, we wrote down the values on:

- Six Boeing Model 747-400 converted freighter aircraft manufactured between 1990 and 1994 and recorded impairment charges total \$88,647; and
- One Boeing Model 737-700 aircraft manufactured in 1999 and recorded an impairment charge of \$8,945.

During the third quarter of 2013, we elected not to invest in engine performance restoration maintenance visits for one Boeing Model 767-300ER aircraft and instead agreed with the lessee to terminate the lease prior to scheduled expiry and pursue a part-out sale. We recorded impairment charges of \$8,544 and we recorded maintenance revenue of \$12,056 and other revenue of \$875 from an early termination payment for the three months ended September 30, 2013, for this aircraft.

In addition, for two McDonnell Douglas MD-11F freighter aircraft manufactured in 1997 that passed the recoverability assessment, we shortened the expected lives from 35 years to 25 years from production date. For changes we made to our aircraft, our total depreciation expense will decrease by approximately \$900 in the fourth quarter of 2013, as compared to the three months ended June 30, 2013. We estimate a decrease in depreciation expense for changes we made to our aircraft for the year ended December 31, 2014 of approximately \$4,600. In this year's assessment, we lowered our assumptions for the freighter aircraft noted above to reflect the cumulative effect of increasing supply in the wake of stagnating demand over the past three years. More specifically, higher production levels for new, large freighter aircraft together with increased belly freight capacity from the latest generation of wide-body passenger aircraft have resulted in a glut of large freighter aircraft. At the same time, air freight demand has not increased due to modest economic growth rates in certain key economies and structural changes in the freight market (e.g., the evolution of smaller, smarter and lighter electronic devices and modal shifts). The combined effect of these developments has depressed lease rates and driven more converted freighter aircraft into storage, particularly over the past year.

In addition to the changes noted above, we reduced projected rental levels for Boeing Model 737-700 aircraft to reflect lower demand for this smaller variant of the Boeing 737 "New Generation" family, as lower fare airline business models drive demand for shorter-haul operations to larger models having similar trip costs.

Other than the aircraft discussed above, management believes that the net book value of each 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, our lessees may face financial difficulties and return aircraft to us prior to the contractual lease expiry dates which may change our cash flow assumptions and require 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.

During the first quarter of 2013, we impaired two aircraft, one Airbus A319-100 aircraft and one Boeing 767-300ER aircraft, each of which was returned to us early by the respective lessee. The decision was made to sell these aircraft

and the net book value of each was written down to the expected sale price. For these two aircraft, we recorded impairment charges totaling \$6,199 and recorded maintenance revenue of \$9,019 and other revenue of \$876 during the nine months ended September 30, 2013.

During the third quarter of 2012, following our recoverability assessment of the aircraft in our fleet at that time, we impaired four Boeing Model 767-300ER aircraft, eight Boeing 737 “Classic” aircraft, and one Airbus Model A310-300F freighter aircraft and recorded aggregate impairment charges of \$67,370 to write these aircraft down to current market values. Also during the third quarter of 2012, we elected not to invest in engine performance restoration maintenance visits for two Airbus Model A320-200 “Classic” aircraft with older technology engines and instead agreed with the lessee to terminate

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the leases prior to scheduled expiry and pursue part-out sales. Following agreement with our customer to terminate the leases, these aircraft failed the recoverability assessment and we recorded impairment charges of \$11,306 and we recorded \$10,159 of maintenance revenue and reversed \$1,157 of lease incentives for the three months ended September 30, 2012, for these two aircraft.

During the second quarter of 2012, we impaired two aircraft, one Boeing Model 757-200 aircraft that we sold for less than its net book value and one Boeing Model 767-300ER aircraft which was returned to us following its scheduled lease expiration and which failed its recoverability assessment. For these two aircraft, we recorded impairment charges of \$10,111, and we recorded \$2,447 of maintenance revenue during the three months ended June 30, 2012.

#### 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 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 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 December 31, 2012 and September 30, 2013 are as follows:

|  | December 31, 2012                    |                                 | September 30, 2013                   |                                 |
|--|--------------------------------------|---------------------------------|--------------------------------------|---------------------------------|
|  | Carrying Amount of Asset (Liability) | Fair Value of Asset (Liability) | Carrying Amount of Asset (Liability) | Fair Value of Asset (Liability) |
| Securitizations and term debt financings | \$(1,082,368 )                       | \$(962,960 )                    | \$(892,272 )                         | \$(831,391 )                    |
| ECA term financings                      | (652,916 )                           | (671,966 )                      | (504,419 )                           | (522,478 )                      |
| Bank financings                          | (112,750 )                           | (116,272 )                      | (184,427 )                           | (189,094 )                      |
| Senior Notes                             | (1,750,642 )                         | (1,905,565 )                    | (1,750,556 )                         | (1,899,575 )                    |

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

#### 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, 2013 were as follows:

| Year Ending December 31, | Amount    |
|--------------------------|-----------|
| Remainder of 2013        | \$166,891 |
| 2014                     | 620,543   |
| 2015                     | 554,155   |
| 2016                     | 483,676   |
| 2017                     | 354,261   |
| Thereafter               | 998,948   |

Total

\$3,178,474

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

| Region                 | Three Months<br>Ended September<br>30, |       |   | Nine Months<br>Ended September<br>30, |       |   |
|------------------------|--|-------|---|---------------------------------------|-------|---|
|                        | 2012                                   | 2013  |   | 2012                                  | 2013  |   |
| Europe                 | 37                                     | % 33  | % | 40                                    | % 33  | % |
| Asia and Pacific       | 33                                     | % 38  | % | 30                                    | % 38  | % |
| North America          | 12                                     | % 10  | % | 12                                    | % 9   | % |
| South America          | 7                                      | % 9   | % | 7                                     | % 9   | % |
| Middle East and Africa | 11                                     | % 10  | % | 11                                    | % 11  | % |
| 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, 2012, one customer accounted for 9% of lease rental revenue and four additional customers accounted for a combined 24% of lease rental revenue. No other customer accounted for more than 5% of lease rental revenue. For the three months ended September 30, 2013, one customer accounted for 8% of lease rental revenue and three additional customers accounted for a combined 16% of lease rental revenue. No other customer accounted for more than 5% of lease rental revenue.

For the nine months ended September 30, 2012, one customer accounted for 10% of lease rental revenue and four additional customers accounted for a combined 25% of lease rental revenue. No other customer accounted for more than 5% of lease rental revenue. For the nine months ended September 30, 2013, one customer accounted for 8% of lease rental revenue and three additional customers accounted for a combined 17% 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 (including maintenance revenue) based on each lessee's principal place of business:

| Country                       | Three Months Ended September 30, |                                |                         |         |                                |                         |
|-------------------------------|----------------------------------|--------------------------------|-------------------------|---------|--------------------------------|-------------------------|
|                               | 2012                             |                                |                         | 2013    |                                |                         |
|                               | Revenue                          | Percent of<br>Total<br>Revenue | Number<br>of<br>Lessees | Revenue | Percent of<br>Total<br>Revenue | Number<br>of<br>Lessees |
| China <sup>(1)</sup>          | \$19,303                         | 11                             | % 4                     | \$—     | —                              | % —                     |
| United States <sup>(1)</sup>  | 17,685                           | 10                             | % 6                     | —       | —                              | % —                     |
| Russia <sup>(1)</sup>         | 17,472                           | 10                             | % 8                     | —       | —                              | % —                     |
| United Kingdom <sup>(2)</sup> | —                                | —                              | % —                     | 16,293  | 10                             | % 2                     |

(1) Total revenue was less than 10% for the three months ended September 30, 2013.

(2) Total revenue includes \$12,056 of maintenance revenue and \$875 of other revenue related to an agreed upon lease termination prior to delivery date.

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| Country                      | Nine Months Ended September 30,<br>2012 |                                |                         | 2013     |                                |                         |
|------------------------------|---|--------------------------------|-------------------------|----------|--------------------------------|-------------------------|
|                              | Revenue                                 | Percent of<br>Total<br>Revenue | Number<br>of<br>Lessees | Revenue  | Percent of<br>Total<br>Revenue | Number<br>of<br>Lessees |
| China                        | \$56,160                                | 11 %                           | 4                       | \$49,148 | 10 %                           | 4                       |
| United States <sup>(1)</sup> | 61,366                                  | 12 %                           | 6                       | —        | — %                            | —                       |
| Russia <sup>(1)</sup>        | 50,280                                  | 10 %                           | 8                       | —        | — %                            | —                       |

(1) Total revenue was less than 10% for the nine months ended September 30, 2013.

Geographic concentration of net book value of flight equipment (includes net book value of flight equipment held for lease, net investment in finance leases and flight equipment held for sale) was as follows:

| Region                 | December 31, 2012        |                     |  | September 30, 2013       |                     |  |
|------------------------|--------------------------|---------------------|--|--------------------------|---------------------|--|
|                        | Number<br>of<br>Aircraft | Net Book<br>Value % |  | Number<br>of<br>Aircraft | Net Book<br>Value % |  |
| Europe                 | 68                       | 35 %                |  | 67                       | 33 %                |  |
| Asia and Pacific       | 50                       | 34 %                |  | 52                       | 38 %                |  |
| North America          | 17                       | 10 %                |  | 21                       | 11 %                |  |
| South America          | 14                       | 8 %                 |  | 14                       | 7 %                 |  |
| Middle East and Africa | 8                        | 12 %                |  | 7                        | 11 %                |  |
| Off-lease              | 2                        | (1) 1 %             |  | —                        | — %                 |  |
| Total                  | 159                      | 100 %               |  | 161                      | 100 %               |  |

(1) Includes one Boeing 767-300ER that was sold in the first quarter of 2013 and one Boeing 747-400BDSF aircraft which was delivered to a lessee in the second quarter of 2013.

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:

| Country              | December 31, 2012 |                     |                      | September 30, 2013 |                     |                      |
|----------------------|-------------------|---------------------|----------------------|--------------------|---------------------|----------------------|
|                      | Net Book<br>Value | Net Book<br>Value % | Number of<br>Lessees | Net Book<br>Value  | Net Book<br>Value % | Number of<br>Lessees |
| China <sup>(1)</sup> | \$515,194         | 11 %                | 4                    | \$—                | — %                 | —                    |

(1) The net book value of flight equipment was less than 10% as of September 30, 2013.

At December 31, 2012 and September 30, 2013, the amounts of lease incentive liabilities recorded in maintenance payments on the consolidated balance sheets were \$15,587 and \$25,265, respectively.





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## Note 4. Net Investment in Finance Leases

At September 30, 2013, our net investment in finance leases represents six aircraft leased to a customer in Germany, four aircraft leased to two customers in the United States and one aircraft leased to a customer in Canada. The following table lists the components of our net investment in finance leases at September 30, 2013:

|   | Amount    |
|---|-----------|
| Total lease payments to be received                                 | \$144,341 |
| Less: Unearned income   | (66,795 ) |
| Estimated residual values of leased flight equipment (unguaranteed) | 70,459    |
| Net investment in finance leases                                    | \$148,005 |

At September 30, 2013, minimum future lease payments on finance leases are as follows:

|                          | Amount    |
|--------------------------|-----------|
| Year Ending December 31, |           |
| Remainder of 2013        | \$7,129   |
| 2014                     | 27,042    |
| 2015                     | 27,042    |
| 2016                     | 27,042    |
| 2017                     | 26,127    |
| Thereafter               | 29,959    |
| Total                    | \$144,341 |

## Note 5. Variable Interest Entities

Aircastle consolidates eight 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 17 aircraft discussed below.

## Securitizations

In connection with Securitization No. 1, two of our subsidiaries, ACS Aircraft Finance Ireland plc (“ACS Ireland”) and ACS Aircraft Finance Bermuda Limited (“ACS Bermuda”) issued Class A-1 notes, and each has fully and unconditionally guaranteed the other’s obligations under the notes. In connection with Securitization No. 2, two of our subsidiaries, ACS Aircraft Finance Ireland 2 Limited (“ACS Ireland 2”) and ACS 2007-1 Limited (“ACS Bermuda 2”) issued Class A-1 notes and each has fully and unconditionally guaranteed the other’s obligations under the notes. ACS Bermuda and ACS Bermuda 2 are collectively referred to as the “ACS Bermuda Group.”

Aircastle is the primary beneficiary of ACS Ireland and ACS Ireland 2 (collectively, the “ACS Ireland VIEs”), as we have both 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 Class E-1 Securities. Although Aircastle has not guaranteed the ACS Ireland VIEs debt, Aircastle wholly owns the ACS Bermuda Group which has fully and unconditionally guaranteed the ACS Ireland VIEs 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 the ACS Ireland VIEs. The Irish charitable trust’s risk is limited to its annual dividend of \$2 per VIE. At September 30, 2013, the assets of the two VIEs include 10 aircraft transferred into the VIEs at historical cost basis in connection with Securitization No. 1 and Securitization No. 2.



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The combined assets of the ACS Ireland VIEs as of September 30, 2013 are \$322,269. The combined liabilities of the ACS Ireland VIEs, net of \$72,068 Class E-1 Securities held by the Company, which is eliminated in consolidation, as of September 30, 2013 are \$267,810.

**ECA Term Financings**

Aircastle, through various subsidiaries, each of which is owned by a charitable trust (such entities, collectively the “Air Knight VIEs”), entered into eleven different twelve-year term loans, which are supported by guarantees from Compagnie Francaise d’ Assurance pour le Commerce Extérieur, (“COFACE”), the French government sponsored export credit agency (“ECA”). These loans provided for the financing for eleven new Airbus Model A330-200 aircraft. In June 2011, we repaid one of these loans from the proceeds of the sale of the related aircraft. In June 2013, we repaid two of these loans from the proceeds of the sale of the related aircraft. We sold an additional aircraft in June 2013, and we posted cash, which is reflected in restricted cash and cash equivalents on the consolidated balance sheet, as collateral for the related term loan until we pay-off the loan or substitute an aircraft. At September 30, 2013, Aircastle had eight outstanding term loans with guarantees from COFACE. 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 and deferred financing costs. The related aircraft, with a net book value as of September 30, 2013 of \$580,361 were included in our flight equipment held for lease. The related assets also include restricted cash and cash equivalents of \$70,771. The consolidated debt outstanding of the Air Knight VIEs as of September 30, 2013 is \$504,419.

**Note 6. Secured and Unsecured Debt Financings**

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

| Debt Obligation                   | At December            | At 9/30/2013           | Interest Rate <sup>(1)</sup> | Final Stated Maturity <sup>(2)</sup> |
|-----------------------------------|------------------------|------------------------|------------------------------|--------------------------------------|
|                                   | 31, 2012               |                        |                              |                                      |
|                                   | Outstanding Borrowings | Outstanding Borrowings |                              |                                      |
| <b>Secured Debt Financings:</b>   |                        |                        |                              |                                      |
| Securitization No. 1              | \$309,505              | \$239,221              | 0.45%                        | 06/20/31                             |
| Securitization No. 2              | 772,863                | 653,051                | 0.49%                        | 06/14/37                             |
| ECA Term Financings               | 652,916                | 504,419                | 3.02% to 3.96%               | 12/3/21 to 11/30/24                  |
| Bank Financings                   | 112,750                | 184,427                | 1.08% to 4.57%               | 09/15/15 to 02/13/20                 |
| Total secured debt financings     | 1,848,034              | 1,581,118              |                              |                                      |
| <b>Unsecured Debt Financings:</b> |                        |                        |                              |                                      |
| Senior Notes due 2017             | 500,000                | 500,000                | 6.75%                        | 04/15/17                             |
| Senior Notes due 2018             | 450,642                | 450,556                | 9.75%                        | 08/01/18                             |

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|   |             |             |        |          |
|---|-------------|-------------|--------|----------|
| Senior Notes due 2019                       | 500,000     | 500,000     | 6.250% | 12/01/19 |
| Senior Notes due 2020                       | 300,000     | 300,000     | 7.625% | 04/15/20 |
| 2013 Revolving Credit Facility              | —           | —           | N/A    | 08/02/16 |
| Total unsecured debt financings             | 1,750,642   | 1,750,556   |        |          |
| Total secured and unsecured debt financings | \$3,598,676 | \$3,331,674 |        |          |

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

The following securitizations include liquidity facility commitments described in the table below:

| Facility             | Liquidity Facility Provider                      | Available Liquidity  |                       |               | Interest Rate<br>on any Advances |
|----------------------|--|----------------------|-----------------------|---------------|----------------------------------|
|                      |  | December 31,<br>2012 | September 30,<br>2013 | Unused<br>Fee |                                  |
| Securitization No. 1 | Crédit Agricole Corporate and<br>Investment Bank | \$42,000             | \$ 42,000             | 0.45%         | 1M Libor + 1.00                  |
| Securitization No. 2 | HSH Nordbank AG                                  | 65,000               | 65,000                | 0.50%         | 1M Libor + 0.75                  |

#### ECA Term Financings

In June 2013, we repaid in full the outstanding principal balances on two of our ECA term financings in the total amount of \$111,693, plus accrued interest, interest rate derivative breakage fees of \$2,954, and accrued interest on the terminated interest rate derivatives. During the second quarter of 2013, we wrote off \$3,825 of deferred financing fees which is reflected in interest expense on the consolidated statement of income. We sold an additional aircraft in June 2013, and we posted cash, which is reflected in restricted cash and cash equivalents on the consolidated balance sheet, as collateral for the related term loan until we pay-off the loan or substitute an aircraft.

In August 2013, one of our subsidiaries issued a fixed rate ECA bond with a face value of \$78,230 which is supported by a guarantee from COFACE and the proceeds were utilized to repay an interim floating rate bank financing that was drawn in connection with the acquisition of one Airbus Model A330-200 aircraft in 2012. The bond has a fixed coupon rate of 3.488% and a final maturity of November 30, 2024.

#### Bank Financings

In May 2013, we assumed three floating rate loans and one fixed rate loan totaling \$91,797 in connection with the acquisition of two Airbus Model A320-200 aircraft and two Boeing Model 737-800 aircraft. During the quarter, we amended two of the floating rate loans to a fixed rate of 2.58% for the remaining debt term. At September 30, 2013, these four loans had a weighted average interest rate of 2.36% and mature in 2018 and 2020.

We include these loan facilities in "Bank Financings". Aircastle Limited has guaranteed the repayment of these Bank Financings.

#### 2013 Revolving Credit Facility

In early August 2013, we amended and restructured our existing \$150,000 revolving credit facility (the "2012 Revolving Credit Facility") with a new unsecured revolving credit facility (the "2013 Revolving Credit Facility"). The

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2013 Revolving Credit Facility was initially sized at \$335,000 and can be increased to a maximum of \$400,000. The 2013 Revolving Credit Facility has a term of 3 years and is scheduled to expire in August 2016.

As of September 30, 2013, we are in compliance with all applicable covenants in all of our financings.

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## Note 7. 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<br>per Common<br>Share | Aggregate<br>Dividend<br>Amount | Record Date       | Payment Date       |
|-------------------|---------------------------------|---------------------------------|-------------------|--------------------|
| February 17, 2012 | \$0.150                         | \$10,865                        | February 29, 2012 | March 15, 2012     |
| May 2, 2012       | \$0.150                         | \$10,847                        | May 31, 2012      | June 15, 2012      |
| August 1, 2012    | \$0.150                         | \$10,464                        | August 31, 2012   | September 14, 2012 |
| November 5, 2012  | \$0.165                         | \$11,493                        | November 30, 2012 | December 14, 2012  |
| February 18, 2013 | \$0.165                         | \$11,268                        | March 4, 2013     | March 15, 2013     |
| May 1, 2013       | \$0.165                         | \$11,297                        | May 31, 2013      | June 14, 2013      |
| August 2, 2013    | \$0.165                         | \$13,330                        | August 30, 2013   | September 13, 2013 |

## Note 8. Shareholders' Equity

During January 2013, we repurchased 679,292 common shares at an aggregate cost of \$8,579 including commissions. The remaining dollar value of common shares that may be purchased under the repurchase program approved by the Company's Board of Directors on November 5, 2012 is \$30,000.

In July 2013, we issued 12,320,000 of our common shares, par value US\$0.01, at a price of \$17.00 per share to an affiliate of Marubeni Corporation, a Japanese corporation (the "Investor"). In June 2013, we also entered into a Shareholder Agreement with the Investor, which became effective in July 2013 upon the closing of the issuance.

## Note 9. Earnings 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 basic and diluted net loss per common share, no allocation to restricted common shares was made for the three months ended September 30, 2012 and 2013 and the nine months ended September 30, 2013.



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|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2012                                | 2013       | 2012                               | 2013       |
| Weighted-average shares:               |                                     |            |                                    |            |
| Common shares outstanding              | 70,349,265                          | 78,544,380 | 71,248,765                         | 71,462,264 |
| Restricted common shares               | 571,326                             | 669,489    | 596,749                            | 562,612    |
| Total weighted-average shares          | 70,920,591                          | 79,213,869 | 71,845,514                         | 72,024,876 |
| Percentage of weighted-average shares: |                                     |            |                                    |            |
| Common shares outstanding              | 99.19                               | % 99.15    | % 99.17                            | % 99.22    |
| Restricted common shares               | 0.81                                | % 0.85     | % 0.83                             | % 0.78     |
| 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<br>September 30, |             | Nine Months Ended<br>September 30, |             |
|--|-------------------------------------|-------------|------------------------------------|-------------|
|  | 2012                                | 2013        | 2012                               | 2013        |
| Earnings (loss) per share – Basic:   |                                     |             |                                    |             |
| Net income (loss)  | \$(45,847 )                         | \$(74,558 ) | \$3,079                            | \$(18,640 ) |
| Less: Distributed and undistributed earnings allocated to restricted common shares (a) | —                                   | —           | (25 )                              | —           |
| Earnings (loss) available to common shareholders – Basic                               | \$(45,847 )                         | \$(74,558 ) | \$3,054                            | \$(18,640 ) |
| Weighted-average common shares outstanding – Basic                                     | 70,349,265                          | 78,544,380  | 71,248,765                         | 71,462,264  |
| Earnings (loss) per common share – Basic   | \$(0.65 )                           | \$(0.95 )   | \$0.04                             | \$(0.26 )   |
| Earnings (loss) per share – Diluted:   |                                     |             |                                    |             |
| Net income (loss)  | \$(45,847 )                         | \$(74,558 ) | \$3,079                            | \$(18,640 ) |
| Less: Distributed and undistributed earnings allocated to restricted common shares(a)  | —                                   | —           | (25 )                              | —           |
| Earnings (loss) available to common shareholders – Diluted                             | \$(45,847 )                         | \$(74,558 ) | \$3,054                            | \$(18,640 ) |
| Weighted-average common shares outstanding – Basic                                     | 70,349,265                          | 78,544,380  | 71,248,765                         | 71,462,264  |
| Effect of dilutive shares <sup>(b)</sup>   | —                                   | —           | —                                  | —           |
| Weighted-average common shares outstanding – Diluted                                   | 70,349,265                          | 78,544,380  | 71,248,765                         | 71,462,264  |
| Earnings (loss) per common share – Diluted   | \$(0.65 )                           | \$(0.95 )   | \$0.04                             | \$(0.26 )   |

For the nine months ended September 30, 2012, distributed and undistributed earnings to restricted shares is 0.83% (a) of net income. 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, 2012 and 2013, we had no dilutive shares.

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 recorded relates to income earned by certain subsidiaries of the Company which are located in, or earn income in, jurisdictions that impose income taxes, primarily the United States and Ireland.

The sources of income (loss) from continuing operations before income taxes for the three and nine months ended September 30, 2012 and 2013 were as follows:

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|                     | Three Months Ended |             | Nine Months Ended |             |
|---------------------|--------------------|-------------|-------------------|-------------|
|                     | September 30,      |             | September 30,     |             |
|                     | 2012               | 2013        | 2012              | 2013        |
| U.S. operations     | \$572              | \$488       | \$1,253           | \$1,684     |
| Non-U.S. operations | (44,718 )          | (75,643 )   | 7,802             | (13,605 )   |
| Total               | \$(44,146 )        | \$(75,155 ) | \$9,055           | \$(11,921 ) |

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. We also 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. The consolidated income tax expense (benefit) for the three and nine months ended September 30, 2012 and 2013 was determined based upon estimates of the Company's consolidated effective income tax rates for the years ending December 31, 2012 and 2013, respectively.

The Company's effective tax rate for the three and nine months ended September 30, 2012 was (3.9)% and 66.0%, respectively, compared to 0.8% and (56.4)%, respectively, for the three and nine months ended September 30, 2013. 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, 2012 and 2013, the interim period effective tax rate reflects the portfolio impairment of aircraft in the amount of \$78,676 and \$97,592, respectively, which was treated as a discrete item.

Differences between statutory income tax rates and our effective income tax rates applied to pre-tax income consisted of the following:

|  | Three Months Ended |             | Nine Months Ended |            |
|--|--------------------|-------------|-------------------|------------|
|  | September 30,      |             | September 30,     |            |
|  | 2012               | 2013        | 2012              | 2013       |
| Notional U.S. federal income tax expense (benefit) at the statutory rate | \$(15,451 )        | \$(26,305 ) | \$3,169           | \$(4,173 ) |
| U.S. state and local income tax, net                                     | 37                 | 39          | 86                | 125        |
| Non-U.S. operations:   |                    |             |                   |            |
| Bermuda  | 20,203             | 26,613      | 9,439             | 13,748     |
| Ireland  | (2,101 )           | (53 )       | (3,776 )          | (544 )     |
| Other  | (1,051 )           | (990 )      | (3,109 )          | (2,719 )   |
| Non-deductible expenses in the U.S.                                      | 71                 | 107         | 183               | 306        |
| Other  | (7 )               | (8 )        | (16 )             | (24 )      |
| Income tax provision (benefit)   | \$1,701            | \$(597 )    | \$5,976           | \$6,719    |

## Note 11. Interest, Net

The following table shows the components of interest, net:

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|  | Three Months Ended |          | Nine Months Ended |           |
|--|--------------------|----------|-------------------|-----------|
|  | September 30,      |          | September 30,     |           |
|  | 2012               | 2013     | 2012              | 2013      |
| Interest on borrowings, net settlements on interest rate derivatives, and other liabilities <sup>(1)</sup> | \$41,373           | \$47,682 | \$135,140         | \$147,096 |
| Hedge ineffectiveness (gains) losses   | 1,474              | 93       | 1,840             | 197       |
| Amortization of interest rate derivatives related to deferred losses                                       | 8,966              | 7,300    | 21,903            | 25,285    |
| Amortization of deferred financing fees <sup>(2)</sup>   | 2,391              | 2,976    | 10,082            | 11,757    |
| Interest Expense   | 54,204             | 58,051   | 168,965           | 184,335   |
| Less interest income   | (103               | ) (208   | ) (447            | ) (684    |
| Less capitalized interest  | —                  | —        | (1,315            | ) —       |
| Interest, net  | \$54,101           | \$57,843 | \$167,203         | \$183,651 |

(1) For the nine months ended September 30, 2013, includes the loan termination fee of \$2,954 related to two ECA aircraft sold in June 2013.

(2) For the nine months ended September 30, 2012, includes the write-off of deferred financings fees of \$2,914 related to the repayment of Term Financing No. 1. For the nine months ended September 30, 2013, includes the write-off of deferred financings fees of \$3,975 related to the repayment of two ECA Financings.

#### Note 12. Commitments and Contingencies

At September 30, 2013, we had commitments to acquire five aircraft during the remainder of 2013 for \$256,320.

#### Note 13. Derivatives

The objective of our hedging policy is to adopt a risk averse position with respect to changes in interest rates. Accordingly, we have entered into a number of interest rate derivatives to hedge the current and expected future interest rate payments on our variable rate debt. Interest rate derivatives are agreements in which a series of interest rate cash flows are exchanged with a third party over a prescribed period. The notional amount on an interest rate derivative is not exchanged. Our interest rate derivatives typically provide that we make fixed rate payments and receive floating rate payments to convert our floating rate borrowings to fixed rate obligations to better match the largely fixed rate cash flows from our investments in flight equipment.

We held the following interest rate derivatives as of September 30, 2013:

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| Hedged Item   | Derivative Liabilities        |                   |                  | Future<br>Maximum<br>Notional<br>Amount | Floating<br>Rate    | Fixed<br>Rate        | Balance Sheet<br>Location                  | Fair<br>Value |
|---|-------------------------------|-------------------|------------------|---|---------------------|----------------------|--|---------------|
|   | Current<br>Notional<br>Amount | Effective<br>Date | Maturity<br>Date |   |                     |                      |  |               |
| Interest rate<br>derivatives designated<br>as cash flow hedges:             |                               |                   |                  |   |                     |                      |  |               |
| Securitization No. 1  | \$222,487                     | Jun-06            | Jun-16           | \$222,487                               | 1M LIBOR<br>+ 0.27% | 5.78%                | Fair value of<br>derivative<br>liabilities | \$27,122      |
| Securitization No. 2  | 499,338                       | Jun-12            | Jun-17           | 499,338                                 | 1M LIBOR            | to<br>1.26%<br>1.28% | Fair value of<br>derivative<br>liabilities | 6,510         |
| Total interest rate<br>derivatives designated<br>as cash flow hedges        | \$721,825                     |                   |                  | \$721,825                               |                     |                      |  | \$33,632      |
| Interest rate<br>derivatives not<br>designated as cash<br>flow hedges:      |                               |                   |                  |   |                     |                      |  |               |
| Securitization No. 1  | 87,575                        | Jun-06            | Jun-16           | 87,575                                  | 1M LIBOR<br>+ 0.27% | 5.78%                | Fair value of<br>derivative<br>liabilities | 10,675        |
| Total interest rate<br>derivatives not<br>designated as cash<br>flow hedges | 87,575                        |                   |                  | 87,575                                  |                     |                      |  | 10,675        |
| Total interest rate<br>derivative liabilities                               | \$809,400                     |                   |                  | \$809,400                               |                     |                      |  | \$44,307      |

The weighted average interest pay rates of these derivatives at December 31, 2012 and September 30, 2013 were 2.91% and 3%, respectively.

For the nine months ended September 30, 2013, the amount of loss reclassified from accumulated other comprehensive income ("OCI") into interest expense related to net interest settlements on active interest rate derivatives was \$13,717. The amount of loss expected to be reclassified from OCI into interest expense over the next 12 months related to net interest settlements on active interest rate derivatives is \$16,077.

Our interest rate derivatives involve counterparty credit risk. As of September 30, 2013, our interest rate derivatives are held with the following counterparties: JP Morgan Chase Bank NA, Citibank Canada NA, and Wells Fargo Bank NA. All of our counterparties or guarantors of these counterparties are considered investment grade (senior unsecured

ratings of Baa2 or above) by Moody's Investors Service. All are also considered investment grade (long-term foreign issuer ratings of A- or above) by Standard and Poor's. We do not anticipate that any of these counterparties will fail to meet their obligations.

In addition to the derivative liability above, another component of the fair value of our interest rate derivatives is accrued interest. As of September 30, 2013, accrued interest payable included in accounts payable, accrued expenses, and other liabilities on our consolidated balance sheet was \$827 related to interest rate derivatives designated as cash flow hedges and \$194 related to interest rate derivatives not designated as cash flow hedges.

Following is the effect of interest rate derivatives on the statement of financial performance for the nine months ended September 30, 2013:

| Effective Portion  |   |  | Ineffective Portion   |   |  |
|--|---|--|---|---|--|
| Derivatives in<br>ASC 815<br>Cash Flow<br>Hedging<br>Relationships | Amount of<br>Gain or (Loss)<br>Recognized in<br>OCI on<br>Derivative<br>(a) | Location of<br>Gain or (Loss)<br>Reclassified<br>from<br>Accumulated<br>OCI into<br>Income | Amount of<br>Gain or (Loss)<br>Reclassified from<br>Accumulated<br>OCI into<br>Income (b) | Location of<br>Gain or (Loss)<br>Recognized in<br>Income on<br>Derivative | Amount of<br>Gain or (Loss)<br>Recognized in<br>Income on<br>Derivative<br>(c) |
| Interest rate derivatives  | \$403   | Interest expense   | \$(38,633)  | Interest expense  | \$(203)  |

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This represents the change in fair market value of our interest rate derivatives since year end, net of taxes, offset by (a) the amount of actual cash paid related to the net settlements of the interest rate derivatives for the nine months ended September 30, 2013.

This represents the amount of actual cash paid, net of taxes, related to the net settlements of the interest rate (b) derivatives for the nine months ended September 30, 2013 plus any effective amortization of net deferred interest rate derivative losses.

(c) This represents both realized and unrealized ineffectiveness incurred during the nine months ended September 30, 2013.

| Derivatives Not Designated as Hedging Instruments under ASC<br>815 | Location of Gain<br>or (Loss)<br>Recognized in Income<br>On Derivative<br>Other income (expense) | Amount of Gain<br>or (Loss)<br>Recognized in Income on<br>Derivative<br>\$ 3,727 |
|--|--|--|
| Interest rate derivatives  |  |  |

On an ongoing basis, terminated swap notionals are evaluated against debt forecasts. To the extent that interest payments are deemed remote to occur, deferred gains or losses are accelerated into interest expense as applicable. For the nine months ended September 30, 2013, the amount of deferred net loss (including \$2,027 of accelerated amortization driven by aircraft sales in 2013) reclassified from OCI into interest expense related to our terminated interest rate derivatives was \$24,117. The amount of deferred net loss expected to be reclassified from OCI into interest expense over the next 12 months related to our terminated interest rate derivatives is \$24,603 of which \$15,908 relates to Term Financing No. 1 interest rate derivatives terminated in 2012, \$1,336 relates to Term Financing No. 1 derivatives terminated in 2008, \$6,030 relates to ECA Term Financings for New A330 Aircraft and \$1,329 relates to other financings.

For the nine months ended September 30, 2013, the amount of effective deferred loss reclassified from OCI into interest expense related to our undesignated active interest rate derivative was \$1,168. The amount of effective deferred loss expected to be reclassified from OCI into interest expense over the next 12 months related to our undesignated active interest rate derivative under our Securitization No. 1 is \$1,678.

The following table summarizes amounts charged directly to the consolidated statement of income for the three and nine months ended September 30, 2012 and 2013, respectively, related to our interest rate derivatives:

|   | Three Months<br>Ended September<br>30, |         | Nine Months Ended<br>September 30, |          |
|---|--|---------|------------------------------------|----------|
|   | 2012                                   | 2013    | 2012                               | 2013     |
| Interest expense:   |  |         |                                    |          |
| Hedge ineffectiveness losses                                | \$1,474                                | \$93    | \$1,840                            | \$197    |
| Amortization:   |  |         |                                    |          |
| Accelerated amortization of deferred losses <sup>(1)</sup>  | —                                      | (2 )    | —                                  | 2,025    |
| Amortization of loss of designated interest rate derivative | —                                      | 423     | —                                  | 1,168    |
| Amortization of deferred losses                             | 8,966                                  | 6,879   | 21,903                             | 22,092   |
| Total Amortization  | 8,966                                  | 7,300   | 21,903                             | 25,285   |
| Total charged to interest expense                           | \$10,440                               | \$7,393 | \$23,743                           | \$25,482 |

Other income:

|  |     |       |       |         |
|--|-----|-------|-------|---------|
| Mark to market gains on undesignated interest rate derivatives | \$— | \$855 | \$599 | \$3,727 |
| Total charged to other income                                  | \$— | \$855 | \$599 | \$3,727 |

(1) For the nine months ended September 30, 2013, represents accelerated amortization of deferred hedge losses related to two aircraft sold in June 2013.



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## Note 14. Other Assets

The following table describes the principal components of other assets on our consolidated balance sheet as of:

|   | December 31,<br>2012 | September 30,<br>2013 |
|---|----------------------|-----------------------|
| Debt investments  | \$ 40,388            | \$ —                  |
| Deferred debt issuance costs, net of amortization of \$54,146 and \$58,802, respectively        | 55,087               | 47,103                |
| Deferred federal income tax asset   | 22,207               | 26,414                |
| Lease incentives and lease premiums, net of amortization of \$26,902 and \$36,787, respectively | 62,822               | 84,860                |
| Flight equipment held for sale  | —                    | 300                   |
| Other assets  | 6,260                | 18,565                |
| Total other assets  | \$ 186,764           | \$ 177,242            |

## Note 15. Accounts Payable, Accrued Expenses and Other Liabilities

The following table describes the principal components of accounts payable, accrued expenses and other liabilities recorded on our consolidated balance sheet as of:

|  | December 31,<br>2012 | September 30,<br>2013 |
|--|----------------------|-----------------------|
| Accounts payable and accrued expenses                                    | \$ 21,507            | \$ 22,014             |
| Deferred federal income tax liability                                    | 48,217               | 56,231                |
| Accrued interest payable   | 38,273               | 48,638                |
| Lease discounts, net of amortization of \$7,328 and \$5,528 respectively | 596                  | 8,009                 |
| Total accounts payable, accrued expenses and other liabilities           | \$ 108,593           | \$ 134,892            |

## Note 16. Accumulated Other Comprehensive Loss

The following table describes the principal components of accumulated other comprehensive loss recorded on our consolidated balance sheet as of:

|   | Three Months<br>Ended<br>September 30,<br>2013 | Nine Months<br>Ended<br>September 30,<br>2013 |
|---|--|---|
| Changes in accumulated other comprehensive loss by component <sup>(a)</sup>   |  |   |
| Beginning balance   | \$(96,352 )                                    | \$(126,290 )                                  |
| Amount recognized in other comprehensive loss on derivatives, net of tax benefit of \$43 and tax expense of \$21, respectively  | (2,556 )                                       | 403   |
| Amounts reclassified from accumulated other comprehensive loss into income, net of tax expense of \$121 and \$368, respectively | 11,654   | 38,633  |
| Net current period other comprehensive income   | 9,098  | 39,036  |
| Ending balance  | \$(87,254 )                                    | \$(87,254 )                                   |

(a) All amounts are net of tax. Amounts in parentheses indicate debits.

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| Reclassifications from accumulated other comprehensive loss <sup>(a)</sup>   | Three Months<br>Ended<br>September 30,<br>2013 | Nine Months<br>Ended<br>September 30,<br>2013 |
|--|--|---|
| Losses on cash flow hedges   |  |   |
| Amount of effective amortization of net deferred interest rate derivative losses <sup>(b)</sup>                                      | \$7,300  | \$25,285                                      |
| Effective amount of net settlements of interest rate derivatives, net of tax expense of \$121 and \$368, respectively <sup>(b)</sup> | 4,354  | 13,348  |
| Amount of loss reclassified from accumulated other comprehensive loss into income <sup>(c)</sup>                                     | \$11,654                                       | \$38,633                                      |

(a) All amounts are net of tax.

(b) Included in interest expense.

(c) This represents the effective amounts of actual cash paid related to the net settlements of the interest rate derivatives plus any effective amortization of net deferred interest rate derivative losses (see Note 13. - Derivatives).

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This management's discussion and analysis of financial condition and results of operations contains forward-looking statements that involve risks, uncertainties and assumptions. You should read the following discussion in conjunction with our historical consolidated financial statements and the notes thereto appearing elsewhere in this report. The results of operations for the periods reflected herein are not necessarily indicative of results that may be expected for future periods, and our actual results may differ materially from those discussed in the forward-looking statements as a result of various factors, including but not limited to those described under "Risk Factors" and included in our Annual Report on Form 10-K for the year ended December 31, 2012 filed with the Securities and Exchange Commission (the "SEC"). Please see "Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995" for a discussion of the uncertainties, risks and assumptions associated with these statements. Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, or US GAAP, and, unless otherwise indicated, the other financial information contained in this report has also been prepared in accordance with US GAAP. Unless otherwise indicated, all references to "dollars" and "\$" in this report are to, and all monetary amounts in this report are presented in, U.S. dollars.

Certain items in this Quarterly Report on Form 10-Q (this "report"), and other information we provide from time to time, may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 including, but not necessarily limited to, statements relating to our ability to acquire, sell, lease or finance aircraft, raise capital, pay dividends, and increase revenues, earnings, EBITDA, Adjusted EBITDA and Adjusted Net Income and the global aviation industry and aircraft leasing sector. Words such as "anticipates," "expects," "intends," "plans," "projects," "believes," "may," "will," "would," "could," "should," "seeks," "estimates" and variations on these words and similar expressions are intended to identify such forward-looking statements. These statements are based on management's current expectations and beliefs and are subject to a number of factors that could lead to actual results materially different from those described in the forward-looking statements; Aircastle can give no assurance that its expectations will be attained. Accordingly, you should not place undue reliance on any forward-looking statements contained in this report. Factors that could have a material adverse effect on our operations and future prospects or that could cause actual results to differ materially from Aircastle expectations include, but are not limited to, capital markets disruption or volatility which could adversely affect our continued ability to obtain additional capital to finance new investments or our working capital needs; government fiscal or tax policies, general economic and business conditions or other factors affecting demand for aircraft or aircraft values and lease rates; our continued ability to obtain favorable tax treatment in Bermuda, Ireland and other jurisdictions; our ability to pay dividends; high or volatile fuel prices, lack of access to capital, reduced load factors and/or reduced yields, operational disruptions caused by political unrest in North Africa, the Middle East or elsewhere, and other factors affecting the creditworthiness of our airline customers and their ability to continue to perform their obligations under our leases; termination payments on our interest rate hedges; and other risks detailed from time to time in Aircastle's filings with the SEC, including as previously disclosed in Aircastle's 2012 Annual Report on Form 10-K, and elsewhere in this report. In addition, new risks and uncertainties emerge from time to time, and it is not possible for Aircastle to predict or assess the impact of every factor that may cause its actual results to differ from those contained in any forward-looking statements. Such forward-looking statements speak only as of the date of this report. Aircastle Limited expressly disclaims any obligation to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in its expectations with regard thereto or change in events, conditions or circumstances on which any statement is based.

### WEBSITE AND ACCESS TO COMPANY'S REPORTS

The Company's Internet website can be found at [www.aircastle.com](http://www.aircastle.com). Our annual reports on Forms 10-K, quarterly reports on Forms 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act") are available free of charge through our website under "Investors — SEC Filings" as soon as reasonably practicable after they are electronically filed with, or furnished to, the SEC.

Statements and information concerning our status as a Passive Foreign Investment Company ("PFIC") for U.S. taxpayers are also available free of charge through our website under "Investors — SEC Filings".

Our Corporate Governance Guidelines, Code of Business Conduct and Ethics, and board of directors committee charters (including the charters of the Audit Committee, Compensation Committee, and Nominating and Corporate Governance Committee) are available free of charge through our website under “Investors — Corporate Governance”. In addition, our

Code of Ethics for the Chief Executive and Senior Financial Officers, which applies to our Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer, Treasurer and Controller, is available in print, free of charge, to any shareholder upon request to Investor Relations, Aircastle Limited, c/o Aircastle Advisor LLC, 300 First Stamford Place, 5th Floor, Stamford, Connecticut 06902.

The information on the Company’s website is not part of, or incorporated by reference, into this report, or any other report we file with, or furnish to, the SEC.

## OVERVIEW

We acquire, lease, and sell high-utility commercial jet aircraft. High-utility aircraft are generally modern, operationally efficient jets with many operators and long useful lives. As of September 30, 2013, our portfolio consisted of 161 aircraft leased to 68 lessees located in 37 countries. Our aircraft fleet is managed by an experienced team based in the United States, Ireland and Singapore. Typically, our aircraft are subject to net leases whereby the lessee is generally responsible for maintaining the aircraft and paying operational, maintenance and insurance costs, although in a majority of cases, we are obligated to pay a portion of specified maintenance or modification costs. From time to time, we also make investments in other aviation assets, including debt investments secured by commercial jet aircraft. Our revenues and net losses for the

three and nine months ended September 30, 2013 were \$170.1 million and \$74.6 million, and \$516.7 million and \$18.6 million, respectively.

The commercial jet aircraft market has grown 41% over the past 10 years and, in response, production levels for new aircraft by Boeing and Airbus have increased significantly during this time. For the first nine months of 2013, air traffic data demonstrated improvement in passenger travel levels while the air cargo traffic continued to stagnate. According to the International Air Transport Association, global passenger traffic increased by 5.0% while air cargo traffic, measured in freight ton kilometers, increased 0.5% as compared to the same period in 2012. Increasing global GDP levels together with a proliferation of passenger air travel in emerging economies has driven the long-term growth in the commercial passenger jet aircraft market. On the other hand, the air cargo market has been sluggish since 2011, reflecting very low levels of world trade growth during this time in addition to shifts away from air freight to other transportation modes.

The share of the world's commercial jet aircraft owned by leasing companies has expanded to 40% as compared to 25% ten years ago. The growing share of the world's aircraft fleet owned by aircraft lessors reflects more efficient and plentiful access to capital enjoyed by leasing companies in general, together with increased investment opportunities set resulting from higher new aircraft production levels. However, competition for aircraft investments, particularly for certain models such as newer, narrow-body aircraft, has increased over the past two years with the entrance of several new players as well as increased activity from many existing lessors.

The overall financing environment has improved over the past two to three years and aircraft owners have generally benefited from the low interest rate environment. Particularly strong conditions in the debt capital markets have provided select borrowers with access to such markets attractively priced, flexible financing that gives them a competitive advantage over airlines and lessors that lack similar access. Moreover, traditional asset-based financing for aircraft from banks remains limited, particularly for older aircraft.

We plan to grow our business and profits over the long-term by continuing to employ the following elements of our fundamental business strategy:

Investing in additional commercial jet aircraft and other aviation assets when attractively priced opportunities and cost effective financing are available. We believe the large and growing aircraft market, together with ongoing fleet replacements, will provide significant acquisition opportunities. We regularly evaluate potential aircraft acquisitions and expect to continue our investment program through additional purchases when attractively priced opportunities and cost effective financing are available.

Pursue a disciplined, "value oriented" investment strategy. In our view, the relative values of different aircraft investments change over time. As a consequence, we maintain a "value oriented" investment strategy to seek out the best risk-adjusted return opportunities across the commercial jet market. To this end, we carefully evaluate investments across different aircraft models, ages, lessees and acquisition sources and re-evaluate these choices periodically as market conditions and relative investment values change. In this respect, we believe the financing flexibility offered through unsecured debt enables our value oriented strategy and provides us with a competitive advance for many investment opportunities.

Maintaining efficient access to financing from multiple sources. We finance our aircraft acquisitions using various long-term debt structures obtained through several different markets to obtain cost effective financing. In this regard, we believe having corporate credit ratings from major ratings agencies enables us to access a broader pool of capital than many of our peers, enhancing our competitiveness and ability to source attractive investment opportunities. This, in turn, will allow us to grow our business and profits.

Leveraging our efficient operating platform and strong operating track record. We believe our team's capabilities in the global aircraft leasing market place us in a favorable position to source and manage new income-generating activities. We intend to continue to focus our efforts in areas where we believe we have competitive advantages, both with respect to new direct investments as well as ventures with strategic business partners.

Reinvesting a portion of the cash flows generated by our business in additional aviation assets and/or our own debt and equity securities. Aircraft have finite useful lives, but typically provide reliable cash flows. Our strategy is to reinvest a portion of our cash flows from operations and asset sales in our business to grow our asset base and earnings bases.

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Selling assets when attractive opportunities arise and for portfolio management purposes. We pursue asset sales as opportunities over the course of the business cycle with the aim of realizing profits and reinvesting

proceeds where more accretive investments are available. We also use asset sales for portfolio management purposes such as reducing lessee specific concentrations and lowering residual value exposures to certain aircraft types and also to exit from an investment when a sale or part-out would provide the greatest expected cash flow for us.

We intend to pay quarterly dividends to our shareholders based on the company's sustainable earnings levels.

However our ability to pay quarterly dividends will depend upon many factors, including those as previously disclosed in Aircastle's 2012 Annual Report on Form 10-K. On August 2, 2013, our board of directors declared a regular quarterly dividend of \$0.165 per common share, or an aggregate of \$13.3 million for the three months ended September 30, 2013, which was paid on September 13, 2013 to holders of record on August 30, 2013. These dividends may not be indicative of the amount of any future dividends.

## Revenues

Our revenues are comprised primarily of operating lease rentals on flight equipment held for lease, revenue from retained maintenance payments related to lease expirations, lease termination payments, lease incentive amortization and interest recognized from finance leases.

Typically, our aircraft are subject to net operating leases whereby the lessee pays lease rentals and is generally responsible for maintaining the aircraft and paying operational, maintenance and insurance costs, although in a majority of cases we are obligated to pay a portion of specified maintenance or modification costs. Our aircraft lease agreements generally provide for the periodic payment of a fixed amount of rent over the life of the lease and the amount of the contracted rent will depend upon the type, age, specification and condition of the aircraft and market conditions at the time the lease is committed. The amount of rent we receive will depend on a number of factors, including the credit-worthiness of our lessees and the occurrence of delinquencies, restructurings and defaults. Our lease rental revenues are also affected by the extent to which aircraft are off-lease and our ability to remarket aircraft that are nearing the end of their leases in order to minimize their off-lease time. Our success in re-leasing aircraft is affected by market conditions relating to our aircraft and by general industry conditions and trends. An increase in the percentage of off-lease aircraft or a reduction in lease rates upon remarketing would negatively impact our revenues. Under an operating lease, the lessee will be responsible for performing maintenance on the relevant aircraft and will typically be required to make payments to us for heavy maintenance, overhaul or replacement of certain high-value components of the aircraft. These maintenance payments are based on hours or cycles of utilization or on calendar time, depending upon the component, and would be made either monthly in arrears or at the end of the lease term. For maintenance payments made monthly in arrears during a lease term, we will typically be required to reimburse all or a portion of these payments to the lessee upon their completion of the relevant heavy maintenance, overhaul or parts replacement. We record maintenance payments paid by the lessee during a lease as accrued maintenance liabilities in recognition of our obligation in the lease to refund such payments, and therefore we do not recognize maintenance revenue during the lease. Maintenance revenue recognition would occur at the end of a lease, when we are able to determine the amount, if any, by which reserve payments received exceed the amount we are required under the lease to reimburse to the lessee for heavy maintenance,

overhaul or parts replacement. The amount of maintenance revenue we recognize in any reporting period is inherently volatile and is dependent upon a number of factors, including the timing of lease expiries, including scheduled and unscheduled expiries, the timing of maintenance events and the utilization of the aircraft by the lessee.

Many of our leases contain provisions which may require us to pay a portion of the lessee's costs for heavy maintenance, overhaul or replacement of certain high-value components. We account for these expected payments as lease incentives, which are amortized as a reduction of revenue over the life of the lease. We estimate the amount of our portion for such costs, typically for the first major maintenance event for the airframe, engines, landing gear and auxiliary power units, expected to be paid to the lessee based on assumed utilization of the related aircraft by the lessee, the anticipated cost of the maintenance event and the estimated amounts the lessee is responsible to pay.

This estimated lease incentive is not recognized as a lease incentive liability at the inception of the lease. We recognize the lease incentive as a reduction of lease revenue on a straight-line basis over the life of the lease, with the offset being recorded as a lease incentive liability which is included in maintenance payments on the balance sheet.

The payment to the lessee for the lease incentive liability is first recorded against the lease incentive liability and any excess above the lease incentive liability is recorded as a prepaid lease incentive asset which is included in other assets



on the balance sheet and continues to amortize over the remaining life of the lease.

When we acquire a leased aircraft, determining the fair value of the attached lease requires us to make assumptions regarding the current fair value of that lease. In doing so, we estimate a range of current lease rates of like aircraft in order to determine if the relevant lease is within a fair value range. If the lease rental is below or above the range of current lease rates, we present value the estimated amount below or above the fair value range over the remaining term of the lease. The resulting lease discount or premium is recorded as a liability or asset and is amortized into lease rental income over the remaining term of the lease.

#### 2013 Lease Expirations and Lease Placements

We started the year with 19 aircraft having scheduled lease expirations in 2013 and we have leased, extended or sold 17 of these aircraft. We expect to sell or use for internal purposes the two remaining aircraft which represent less than 1% of our total net book value of flight equipment (including flight equipment held for lease and net investment in finance leases) at September 30, 2013. In the first half of 2013, we also leased or sold seven aircraft that were off-lease earlier in the year.

#### 2014 Lease Expirations and Lease Placements

We reported as of June 30, 2013 that 37 aircraft in our fleet had scheduled lease expirations in 2014. We have leased, extended or sold 15 of these aircraft, and we added one new scheduled lease expiration in 2014. The remaining 23 aircraft now having scheduled lease expiration in 2014 represent 9% of our total net book value of flight equipment (including flight equipment held for lease and net investment in finance leases) at September 30, 2013. We are remarketing the remaining 23 aircraft for sale or lease and we expect to sell ten of these aircraft, representing 2% of such net book value, for part-out.

#### 2015-2018 Lease Expirations and Lease Placements

Taking into account lease and sale commitments, we currently have the following number of aircraft with lease expirations scheduled in the period 2015-2018 representing the percentage of our net book value of flight equipment (including flight equipment held for lease and net investment in finance leases) at September 30, 2013 specified below:

- 2015: 21 aircraft, representing 7%;
- 2016: 25 aircraft, representing 10%;
- 2017: 32 aircraft, representing 23%; and
- 2018: 19 aircraft, representing 13%.

### Operating Expenses

Operating expenses are comprised of depreciation of flight equipment held for lease, interest expense, selling, general and administrative expenses, aircraft impairment charges and maintenance and other costs. Because our operating lease terms generally require the lessee to pay for operating, maintenance and insurance costs, our portion of maintenance and other costs relating to aircraft reflected in our statement of income primarily relates to expenses for unscheduled lease terminations.

### Income Tax Provision

We have obtained an assurance from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act 1966 that, in the event that any legislation is enacted in Bermuda imposing any tax computed on profits or income, or computed on any capital asset, gain or appreciation or any tax in the nature of estate duty or inheritance tax, such tax shall not, until March 2035, be applicable to us or to any of our operations or to our shares, debentures or other obligations except insofar as such tax applies to persons ordinarily resident in Bermuda or to any taxes payable by us in respect of real property owned or leased by us in Bermuda. Consequently, the provision for income taxes recorded relates to income earned by certain subsidiaries of the Company which are located in, or earn income in, jurisdictions that impose income taxes, primarily Ireland and the United States.

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. We also 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. In addition, those subsidiaries that are resident in Ireland are subject to Irish tax.

### Acquisitions and Sales

Thus far in 2013, we invested in 17 aircraft for \$976.0 million as follows:

- seven aircraft for \$659.7 million with ages of less than five years;
- seven aircraft for \$264.4 million between five and ten years in age;
- two aircraft for \$40.1 million between ten and fifteen years in age; and
- one aircraft for \$11.8 million with an age of over fifteen years.

As of September 30, 2013, we had commitments to acquire five aircraft for \$256.3 million. Since September 30, 2013, we made additional commitments to acquire three aircraft for \$223.0 million, for total commitments of \$479.3 million.

During the first nine months of 2013, the aggregate sales price for flight equipment sold was \$285.2 million, which resulted in a net gain of \$25.6 million. We repaid debt associated with this flight equipment in the amount of \$154.7 million.

The following table sets forth certain information with respect to the aircraft owned by us as of September 30, 2013:

## AIRCATTLE AIRCRAFT INFORMATION (dollars in millions)

|  | Owned<br>Aircraft as of<br>September 30,<br>2013 <sup>(1)</sup> |   |
|--|---|---|
| Flight Equipment   | \$5,086   |   |
| Unencumbered Flight Equipment  | \$2,712   |   |
| Number of Aircraft   | 161   |   |
| Number of Unencumbered Aircraft  | 80  |   |
| Number of Lessees  | 68  |   |
| Number of Countries  | 37  |   |
| Weighted Average Age – Passenger (years) <sup>(2)</sup>  | 9.2   |   |
| Weighted Average Age – Freighter (years) <sup>(2)</sup>  | 12.9  |   |
| Weighted Average Age – Combined (years) <sup>(2)</sup>   | 10.0  |   |
| Weighted Average Remaining Passenger Lease Term (years) <sup>(3)</sup>                             | 5.4   |   |
| Weighted Average Remaining Freighter Lease Term (years) <sup>(3)</sup>                             | 4.0   |   |
| Weighted Average Remaining Combined Lease Term (years) <sup>(3)</sup>                              | 5.1   |   |
| Weighted Average Fleet Utilization during the three months ended September 30, 2013 <sup>(4)</sup> | 100   | % |
| Weighted Average Fleet Utilization during the nine months ended September 30, 2013 <sup>(4)</sup>  | 98  | % |
| Portfolio Yield for the three months ended September 30, 2013 <sup>(5)</sup>                       | 13.7  | % |
| Portfolio Yield for the nine months ended September 30, 2013 <sup>(5)</sup>                        | 13.5  | % |

(1) Calculated using net book value of flight equipment held for lease and net investment in finance leases at period end.

(2) Weighted average age (years) by net book value.

(3) Weighted average remaining lease term (years) by net book value.

(4) Aircraft on-lease days as a percent of total days in period weighted by net book value.

(5) Lease rental revenue for the period as a percent of the average net book value of flight equipment held for lease for the period; quarterly information is annualized.

Our owned aircraft portfolio as of September 30, 2013 is listed in Exhibit 99.1 to this report.



## PORTFOLIO DIVERSIFICATION

|                          | Owned Aircraft as of<br>September 30, 2013 |  |   |
|--------------------------|--|--|---|
|                          | Number of<br>Aircraft                      | % of Net<br>Book<br>Value <sup>(1)</sup> |   |
| Aircraft Type            |  |  |   |
| Passenger:               |  |  |   |
| Narrowbody               | 97   | 36                                       | % |
| Midbody                  | 38   | 35                                       | % |
| Widebody                 | 4  | 9  | % |
| Total Passenger          | 139  | 80                                       | % |
| Freighter                | 22   | 20                                       | % |
| Total                    | 161  | 100                                      | % |
| Manufacturer             |  |  |   |
| Boeing                   | 96   | 52                                       | % |
| Airbus                   | 60   | 45                                       | % |
| Embraer                  | 5  | 3  | % |
| Total                    | 161  | 100                                      | % |
| Regional Diversification |  |  |   |
| Europe                   | 67   | 33                                       | % |
| Asia and Pacific         | 52   | 38                                       | % |
| North America            | 21   | 11                                       | % |
| South America            | 14   | 7  | % |
| Middle East and Africa   | 7  | 11                                       | % |
| Total                    | 161  | 100                                      | % |

(1) Calculated using net book value of flight equipment held for lease and net investment in finance leases at period end.

Our largest customer represents less than 7% of the net book value of flight equipment held for lease (includes net book value of flight equipment held for lease and net investment in finance leases) at September 30, 2013. Our top 15 customers for aircraft we owned at September 30, 2013, representing 60 aircraft and 56% of the net book value of flight equipment held for lease, are as follows:

| Percent of Net Book Value    | Customer                       | Country              | Number of Aircraft |
|------------------------------|--------------------------------|----------------------|--------------------|
| Greater than 6% per customer | Garuda                         | Indonesia            | 5                  |
|                              | South African Airways          | South Africa         | 4                  |
| 3% to 6% per customer        | Emirates                       | United Arab Emirates | 2                  |
|                              | US Airways                     | USA                  | 11                 |
|                              | Virgin Australia               | Australia            | 2                  |
|                              | SriLankan Airlines             | Sri Lanka            | 5                  |
|                              | AirBridge Cargo <sup>(1)</sup> | Russia               | 2                  |
|                              | Singapore Airlines             | Singapore            | 2                  |
|                              | Thai Airways                   | Thailand             | 1                  |
| Less than 3% per customer    | Martinair <sup>(2)</sup>       | Netherlands          | 4                  |
|                              | Jet Airways                    | India                | 6                  |
|                              | Azul                           | Brazil               | 5                  |
|                              | GOL <sup>(3)</sup>             | Brazil               | 7                  |
|                              | Air Canada                     | Canada               | 2                  |
|                              | Asiana Airlines                | South Korea          | 2                  |

(1) Guaranteed by Volga-Dnepr Airlines.

(2) Martinair is a wholly owned subsidiary of KLM. If combined with KLM and two other affiliated customers, represents 7% of flight equipment held for lease.

(3) GOL has guaranteed the obligations of an affiliate, VRG Linhas Aereas.

#### Finance

We intend to fund new investments through cash on hand, cash flows from operations and potentially through medium- to longer-term financings on a secured or unsecured basis. We may repay all or a portion of such borrowings from time to time with the net proceeds from subsequent long-term debt financings, additional equity offerings or cash generated from operations and asset sales. Therefore, our ability to execute our business strategy, particularly the acquisition of additional commercial jet aircraft or other aviation assets, depends to a significant degree on our ability to obtain additional debt and equity capital on terms we deem attractive.

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources.”

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## RESULTS OF OPERATIONS

Comparison of the three months ended September 30, 2012 to the three months ended September 30, 2013:

|  | Three Months Ended<br>September 30, |             |
|--|-------------------------------------|-------------|
|  | 2012                                | 2013        |
|  | (Dollars in thousands)              |             |
| Revenues:  |                                     |             |
| Lease rental revenue   | \$ 159,547                          | \$ 161,148  |
| Finance lease revenue  | 3,518                               | 4,122       |
| Amortization of net lease premiums, discounts and lease incentives | (6,838 )                            | (9,737 )    |
| Maintenance revenue  | 10,944                              | 12,932      |
| Total lease revenue  | 167,171                             | 168,465     |
| Other revenue  | 5,695                               | 1,625       |
| Total revenues   | 172,866                             | 170,090     |
| Operating expenses:  |                                     |             |
| Depreciation   | 68,413                              | 70,469      |
| Interest, net  | 54,101                              | 57,843      |
| Selling, general and administrative                                | 11,907                              | 12,830      |
| Impairment of aircraft   | 78,676                              | 106,136     |
| Maintenance and other costs  | 3,926                               | 1,914       |
| Total operating expenses   | 217,023                             | 249,192     |
| Other income:  |                                     |             |
| Gain on sale of flight equipment                                   | 11                                  | 3,092       |
| Other  | —                                   | 855         |
| Total other income   | 11                                  | 3,947       |
| Income (loss) from continuing operations before income taxes       | (44,146 )                           | (75,155 )   |
| Income tax provision   | 1,701                               | (597 )      |
| Net income (loss)  | \$(45,847 )                         | \$(74,558 ) |

## Revenues:

Total revenues decreased by 1.6%, or \$2.8 million for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012, primarily as a result of the following:

Lease rental revenue. The increase in lease rental revenue of \$1.6 million for the three months ended September 30, 2013 as compared to the same period in 2012 was primarily the result of:

\$24.6 million of revenue reflecting the full quarter impact of 10 aircraft purchased in 2012 and 16 aircraft purchased in 2013; and

\$3.2 million due to lease extensions and transitions.

This increase was offset partially by a decrease in lease rental revenue of:

\$15.2 million due to aircraft sales; and

\$11.1 million from the effect of lease terminations and other changes.

Finance lease revenue: For the three months ended September 30, 2013, \$4.1 million of interest income from finance leases was recognized as compared to \$3.5 million of interest income from finance leases recorded for the same period in 2012.

Amortization of net lease premiums, discounts and lease incentives.

|  | Three Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|
|  | 2012                                | 2013      |
|  | (Dollars in<br>thousands)           |           |
| Amortization of lease incentives                                   | \$(5,891)                           | \$(7,886) |
| Amortization of lease premiums                                     | (1,270)                             | (2,347)   |
| Amortization of lease discounts                                    | 323                                 | 496       |
| Amortization of net lease premiums, discounts and lease incentives | \$(6,838)                           | \$(9,737) |

As more fully described above under “Revenues”, lease incentives represent our estimated portion of the lessee’s cost for heavy maintenance, overhaul or replacement of certain high-value components which is amortized over the life of the related lease. As we enter into new leases, the amortization of lease incentives generally increases and, conversely, if a related lease terminates, the related unused lease incentive liability will reduce the amortization of lease incentives. The increase in amortization of lease incentives of \$2.0 million was primarily attributable to the reversal of lease incentive amortization in the second quarter of 2012 related to seven unscheduled lease transitions and two scheduled lease transitions. This resulted in lower amortization of lease incentives for the three months ended September 30, 2012 as compared to the same period in 2013.

As more fully described above under “Revenues”, lease premiums represent the present value of the amount above current lease rates for acquired aircraft with attached leases. The increase in amortization of lease premiums of \$1.1 million for the three months ended September 30, 2013 as compared to the same period in 2012 primarily resulted from additional amortization on 11 aircraft purchased after the end of the third quarter of 2012.

Maintenance revenue.

|                                | Three Months Ended September 30, |                     |                           |                     |
|--------------------------------|----------------------------------|---------------------|---------------------------|---------------------|
|                                | 2012                             |                     | 2013                      |                     |
|                                | Dollars<br>(in<br>thousands)     | Number of<br>Leases | Dollars<br>(in thousands) | Number of<br>Leases |
| Unscheduled lease terminations | \$10,258                         | 2                   | \$12,056                  | 1                   |
| Scheduled lease terminations   | 686                              | 1                   | 876                       | 2                   |
| Maintenance revenue            | \$10,944                         | 3                   | \$12,932                  | 3                   |

Unscheduled lease terminations. For the three months ended September 30, 2012, we recorded maintenance revenue from unscheduled lease terminations of \$10.3 million primarily associated with two aircraft returned in the fourth quarter of 2012. Comparatively, for the same period in 2013, we recorded maintenance revenue totaling \$12.1 million from unscheduled lease terminations primarily associated with one aircraft returned in the third quarter of 2013 resulting from an early termination agreement with the lessee.

Scheduled lease terminations. For the three months ended September 30, 2012, we recorded maintenance revenue from scheduled lease terminations of \$0.7 million primarily associated with one scheduled lease termination.

Comparatively, for the same period in 2013, we recorded \$0.9 million, primarily associated with maintenance revenue from two scheduled lease terminations.

Other revenue. For the three months ended September 30, 2012, other revenue was \$5.7 million which was primarily comprised of \$1.3 million of interest on our debt investments and \$3.9 million recognized in additional fees paid by a lessee in connection with the early termination of one lease. For the three months ended September 30, 2013, other revenue was \$1.6 million which represents additional fees paid by one lessee in connection with the early termination of one lease.

Operating expenses:



Total operating expenses increased \$32.2 million for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012, primarily as a result of the following:

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Depreciation expense increased by 3.0%, or \$2.1 million for the three months ended September 30, 2013 as compared to the same period in 2012. The net increase is primarily the result of :

- \$7.9 million increase in depreciation for aircraft acquired; and
- \$1.8 million increase due to changes in asset lives and residual values.

This increase was partially offset by:

- \$6.7 million decrease in depreciation for aircraft sales; and
- a \$1.0 million decrease due to capitalized aircraft improvements being fully depreciated.

Interest, net consisted of the following:

|   | Three Months Ended<br>September 30, |          |
|---|-------------------------------------|----------|
|   | 2012                                | 2013     |
|   | (Dollars in thousands)              |          |
| Interest on borrowings, net settlements on interest rate derivatives, and other liabilities | \$41,373                            | \$47,682 |
| Hedge ineffectiveness losses (gains)  | 1,474                               | 93       |
| Amortization of interest rate derivatives related to deferred losses                        | 8,966                               | 7,300    |
| Amortization of deferred financing fees and notes discount                                  | 2,391                               | 2,976    |
| Interest Expense  | 54,204                              | 58,051   |
| Less interest income  | (103 )                              | (208 )   |
| Less capitalized interest   | —                                   | —        |
| Interest, net   | \$54,101                            | \$57,843 |

Interest, net increased by \$3.7 million, or 6.9%, over the three months ended September 30, 2012. The net increase is primarily a result of:

- a \$6.3 million increase in interest expense on our borrowings driven by increased volume on our debt outstanding of \$3.4 million (\$3.36 billion for the three months ended September 30, 2013 as compared to \$3.11 billion for the three months ended September 30, 2012), and higher weighted average interest rate of 2.9 million (5.6% for the three months ended September 30, 2013 as compared to 5.3% for the three months ended September 30, 2012).

This increase was partially offset by:

- \$1.4 million decrease in hedge ineffectiveness resulting from changes in our debt forecast; and
- \$1.7 million decrease in amortization of deferred losses which came to full term in January 2013.

Selling, general and administrative expenses for the three months ended September 30, 2013 increased slightly over the same period in 2012. Non-cash share based expense was \$1.1 million and \$1.1 million for the three months ended September 30, 2012 and 2013, respectively.

Impairment of Aircraft was \$106.1 million for the three months ended September 30, 2013 related to six Boeing Model 747-400BCF/SF aircraft and one Boeing Model 737-700 aircraft, all of which did not pass their recoverability assessments. (See "Summary of Impairments and Recoverability Assessment" below for a detailed discussion of the related impairment charges for these aircraft.) During the three months ended September 30, 2012, we recorded impairment of \$78.7 million related to eight Boeing Model 737-300/ -400 aircraft, four Boeing Model 767-300ER aircraft, one Airbus Model A310-300F aircraft and two Airbus Model A320-200 aircraft, all of which did not pass their recoverability assessments.

## Other income:

Total other income for the three months ended September 30, 2013 was \$3.9 million as compared to \$11 thousand for the same period in 2012. The increase was due to a \$3.1 million increase on gain on sale of flight equipment and a \$0.9 million increase related to the mark to market value of an undesignated interest rate derivative.

## Income tax provision

Our provision for income taxes for the three months ended September 30, 2012 and 2013 was \$1.7 million and \$(0.6) million, respectively. Income taxes have been provided based on the applicable tax laws and rates of those countries in which operations are conducted and income is earned, primarily Ireland and the United States. The decrease in our income tax provision of approximately \$2.3 million for the three months ended September 30, 2013 as compared to the same period in 2012 was primarily attributable to a decrease in operating income subject to tax in the U.S. and Ireland as a result of treating the \$97.6 million portfolio impairment of aircraft as a discrete item.

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. We also 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. In addition, those subsidiaries that are resident in Ireland are subject to Irish tax.

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 recorded relates to income earned by certain subsidiaries of the Company which are located in, or earn income in, jurisdictions that impose income taxes, primarily the United States and Ireland.

## Other comprehensive loss:

|  | Three Months Ended<br>September 30, |             |
|--|-------------------------------------|-------------|
|  | 2012                                | 2013        |
|  | (Dollars in thousands)              |             |
| Net loss   | \$ (45,847)                         | \$ (74,558) |
| Net change in fair value of derivatives, net of tax expense of \$37 and \$78, respectively | 1,426                               | 1,798       |
| Derivative loss reclassified into earnings   | 8,966                               | 7,300       |
| Total comprehensive loss   | \$ (35,455)                         | \$ (65,460) |

Other comprehensive loss was \$65.5 million for the three months ended September 30, 2013, an increase of \$30.0 million from the \$35.5 million of other comprehensive loss for the three months ended September 30, 2012. Other comprehensive income for the three months ended September 30, 2013 primarily consisted of:

\$74.6 million of net loss;

\$1.8 million gain from a change in fair value of interest rate derivatives, net of taxes which is due primarily to net settlements for the three months ended September 30, 2013 partially offset by a slight loss due to a downward shift in the one-month LIBOR forward curve; and

\$7.3 million of amortization of deferred net losses reclassified into earnings related to terminated interest rate derivatives.

Other comprehensive loss for the three months ended September 30, 2012 primarily consisted of:

\$45.8 million of net loss;

a \$1.4 million gain from a change in fair value of interest rate derivatives, net of taxes which is due primarily to net settlements for the three months ended September 30, 2012, partially offset by a slight loss due to a downward shift in the one-month LIBOR forward curve; and  
 \$9.0 million of amortization of deferred net losses reclassified into earnings related to terminated interest rate derivatives.

## RESULTS OF OPERATIONS

Comparison of the nine months ended September 30, 2012 to the nine months ended September 30, 2013:

|  | Nine Months Ended<br>September 30, |             |
|--|------------------------------------|-------------|
|  | 2012                               | 2013        |
|  | (Dollars in thousands)             |             |
| Revenues:  |                                    |             |
| Lease rental revenue   | \$465,413                          | \$475,656   |
| Finance lease revenue  | 4,474                              | 12,120      |
| Amortization of net lease premiums, discounts and lease incentives | (6,392 )                           | (25,527 )   |
| Maintenance revenue  | 37,126                             | 42,983      |
| Total lease revenue  | 500,621                            | 505,232     |
| Other revenue  | 9,341                              | 11,425      |
| Total revenues   | 509,962                            | 516,657     |
| Operating expenses:  |                                    |             |
| Depreciation   | 200,024                            | 212,448     |
| Interest, net  | 167,203                            | 183,651     |
| Selling, general and administrative                                | 36,616                             | 39,297      |
| Impairment of aircraft   | 88,787                             | 112,335     |
| Maintenance and other costs  | 11,943                             | 11,464      |
| Total operating expenses   | 504,573                            | 559,195     |
| Other income:  |                                    |             |
| Gain on sale of flight equipment                                   | 3,062                              | 25,601      |
| Other  | 604                                | 5,016       |
| Total other income   | 3,666                              | 30,617      |
| Income (loss) from continuing operations before income taxes       | 9,055                              | (11,921 )   |
| Income tax provision   | 5,976                              | 6,719       |
| Net income (loss)  | \$3,079                            | \$(18,640 ) |

## Revenues:

Total revenues increased by 1.3%, or \$6.7 million for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012, primarily as a result of the following:

Lease rental revenue. The increase in lease rental revenue of \$10.2 million for the nine months ended September 30, 2013 as compared to the same period in 2012 was primarily the result of:

\$69.5 million of revenue reflecting the full quarter impact of 17 aircraft purchased in 2012 and 16 aircraft purchased in 2013; and

\$14.4 million due to lease extensions and transitions.

This increase was offset partially by a decrease in lease rental revenue of:

\$38.4 million from the effect of lease terminations and other changes; and

\$35.3 million due to aircraft sales.



Finance lease revenue: For the nine months ended September 30, 2013, \$12.1 million of interest income from finance leases was recognized as compared to \$4.5 million of interest income from finance leases recorded for the same period in 2012.

Amortization of net lease premiums, discounts and lease incentives.

|  | Nine Months Ended<br>September 30, |            |
|--|------------------------------------|------------|
|  | 2012                               | 2013       |
|  | (Dollars in thousands)             |            |
| Amortization of lease incentives                                   | \$(4,568)                          | \$(20,072) |
| Amortization of lease premiums                                     | (3,184 )                           | (6,473 )   |
| Amortization of lease discounts                                    | 1,360                              | 1,018      |
| Amortization of net lease premiums, discounts and lease incentives | \$(6,392)                          | \$(25,527) |

As more fully described above under “Revenues”, lease incentives represent our estimated portion of the lessee’s cost for heavy maintenance, overhaul or replacement of certain high-value components which is amortized over the life of the related lease. As we enter into new leases, the amortization of lease incentives generally increases and, conversely, if a related lease terminates, the related unused lease incentive liability will reduce the amortization of lease incentives. The increase in amortization of lease incentives of \$15.5 million was primarily attributable to the reversal of \$14.7 million of lease incentive amortization in the nine months ended September 30, 2012 related to eight unscheduled lease transitions and three scheduled lease transitions, resulting in lower amortization of lease incentives for the nine months ended September 30, 2012 as compared to the same period in 2013.

As more fully described above under “Revenues”, lease premiums represent the present value of the amount above current lease rates for acquired aircraft with attached leases. The increase in amortization of lease premiums of \$3.3 million for the nine months ended September 30, 2013 as compared to the same period in 2012 primarily resulted from additional amortization on 11 aircraft purchased after the end of the third quarter of 2012.

Maintenance revenue.

|                                | Nine Months Ended September 30, |                     |                           |                     |
|--------------------------------|---------------------------------|---------------------|---------------------------|---------------------|
|                                | 2012                            |                     | 2013                      |                     |
|                                | Dollars<br>(in<br>thousands)    | Number of<br>Leases | Dollars<br>(in thousands) | Number of<br>Leases |
| Unscheduled lease terminations | \$25,069                        | 6                   | \$32,051                  | 8                   |
| Scheduled lease terminations   | 12,057                          | 5                   | 10,932                    | 6                   |
| Maintenance revenue            | \$37,126                        | 11                  | \$42,983                  | 14                  |

Unscheduled lease terminations. For the nine months ended September 30, 2012, we recorded maintenance revenue from unscheduled lease terminations of \$25.1 million primarily associated with four aircraft returned in 2012 and two aircraft returned in the fourth quarter of 2012 resulting from an early termination agreement in the third quarter of 2012. Comparatively, for the same period in 2013, we recorded maintenance revenue totaling \$32.1 million from unscheduled lease terminations primarily associated with eight aircraft returned in the first half of 2013 resulting from early termination agreements with those lessees.

Scheduled lease terminations. For the nine months ended September 30, 2012, we recorded maintenance revenue from scheduled lease terminations of \$12.1 million associated with five scheduled lease terminations. Comparatively, for the same period in 2013, we recorded \$10.9 million, associated with maintenance revenue from six scheduled lease terminations.

Other revenue. For the nine months ended September 30, 2012, other revenue was \$9.3 million primarily comprised of \$6.7 million of additional fees paid by lessees in connection with early termination of nine leases and \$2.6 million of interest on our debt investments. For the nine months ended September 30, 2013, other revenue was \$11.4 million which was comprised of \$1.7 million of interest on our debt investments and \$9.6 million recognized in additional fees paid by six lessees in connection with the early termination of eight leases.



## Operating expenses:

Total operating expenses increased by 10.8%, or \$54.6 million for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012, primarily as a result of the following:

Depreciation expense increased by 6.2%, or \$12.4 million for the nine months ended September 30, 2013 as compared to the same period in 2012. The net increase is primarily the result of:

- a \$20.4 million increase in depreciation for aircraft acquired; and
- a \$7.3 million increase due to changes to asset lives and residual values.

This increase was offset by:

- a \$13.1 million decrease in depreciation for aircraft sales; and
- a \$2.6 million decrease due to capitalized aircraft improvements being fully depreciated.

Interest, net consisted of the following:

|   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2012                               | 2013       |
|   | (Dollars in thousands)             |            |
| Interest on borrowings, net settlements on interest rate derivatives, and other liabilities | \$ 135,140                         | \$ 147,096 |
| Hedge ineffectiveness losses  | 1,840                              | 197        |
| Amortization of interest rate derivatives related to deferred losses                        | 21,903                             | 25,285     |
| Amortization of deferred financing fees and notes discount                                  | 10,082                             | 11,757     |
| Interest Expense  | 168,965                            | 184,335    |
| Less interest income  | (447 )                             | (684 )     |
| Less capitalized interest   | (1,315 )                           | —          |
| Interest, net   | \$ 167,203                         | \$ 183,651 |

Interest, net increased by \$16.4 million, or 9.8%, over the nine months ended September 30, 2012. The net increase is primarily a result of:

a \$12.0 million increase in interest expense on our borrowings driven by driven by loan breakage fees of \$3.0 million in connection with the early repayment of two ECA Loans and the impact of higher weighted average debt outstanding (\$3.47 billion for the nine months ended September 30, 2013 as compared to \$3.08 billion for the nine months ended September 30, 2012) of \$17.6 million, partially offset by the effect of lower interest rates during the same period in the prior year of \$8.6 million;

a \$3.4 million increase in amortization of deferred losses primarily due to deferred swap loss amortization related to the repayment of Term Financing No. 1 in April 2012 and the repayment of two ECA loans in June 2013; and

a \$1.7 million increase in amortization of deferred financing fees primarily due to the write-off of fees related to the early repayment of two ECA loans in June 2013.

These increases were partially offset by:

a \$1.6 million decrease resulting from changes in measured hedge ineffectiveness due to changes in our debt forecast; and

a \$1.3 million decrease in capitalized interest reflecting the final aircraft delivery from our A330 program in April 2012.

Selling, general and administrative expenses for the nine months ended September 30, 2013 increased by \$2.7 million over the same period in 2012. Non-cash share based expense was \$3.2 million and \$2.9 million for the nine months ended September 30, 2012 and 2013, respectively.



Impairment of aircraft was \$112.3 million for the nine months ended September 30, 2013 related to six Boeing Model 747-400BCF/SF aircraft and one Boeing Model 737-700 aircraft, all of which did not pass their recoverability assessments, and one Boeing Model 767-300ER aircraft and one Airbus A319-100 aircraft, each of which was returned to us early by the respective lessee. (See "Summary of Impairments and Recoverability Assessment" below for a detailed discussion of the related impairment charges for these aircraft.) During the nine months ended September 30, 2012, we recorded impairment of \$88.8 million related to eight Boeing Model 737-300/ -400 aircraft, four Boeing Model 767-300ER aircraft, one Boeing Model 757-200 aircraft, five Boeing Model 767-300ER aircraft, one Airbus Model A310-300F aircraft and two Airbus Model A320-200 aircraft, all of which did not pass their recoverability assessments.

Other income:

Total other income for the nine months ended September 30, 2013 was \$30.6 million as compared to \$3.7 million for the same period in 2012. The increase was due to a \$22.5 million increase on gain on sale of flight equipment and a \$3.1 million increase related to the mark to market value of an undesignated interest rate derivative.

Income tax provision

Our provision for income taxes for the nine months ended September 30, 2012 and 2013 was \$6.0 million and \$6.7 million, respectively. Income taxes have been provided based on the applicable tax laws and rates of those countries in which operations are conducted and income is earned, primarily Ireland and the United States. The increase in our income tax provision of approximately \$0.7 million for the nine months ended September 30, 2013 as compared to the same period in 2012 was primarily attributable to an increase in operating income subject to tax in the U.S. and Ireland and the tax effect of treating the \$97.6 million portfolio impairment of aircraft as a discrete item.

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. We also 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. In addition, those subsidiaries that are resident in Ireland are subject to Irish tax.

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 recorded relates to income earned by certain subsidiaries of the Company which are located in, or earn income in, jurisdictions that impose income taxes, primarily the United States and Ireland.

Other comprehensive income:

|  | Nine Months Ended<br>September 30, |            |
|--|------------------------------------|------------|
|  | 2012                               | 2013       |
|  | (Dollars in thousands)             |            |
| Net income (loss)  | \$3,079                            | \$(18,640) |
| Net change in fair value of derivatives, net of tax expense of \$465 and \$389, respectively | 23,708                             | 13,751     |
| Derivative loss reclassified into earnings   | 21,903                             | 25,285     |
| Total comprehensive income   | \$48,690                           | \$20,396   |

Other comprehensive income was \$20.4 million for the nine months ended September 30, 2013, an decrease of \$28.3 million from the \$48.7 million of other comprehensive income for the nine months ended September 30, 2012. Other comprehensive income for the nine months ended September 30, 2013 primarily consisted of:

\$(18.6) million of net loss;

\$13.8 million gain from a change in fair value of interest rate derivatives, net of taxes which is due primarily to net settlements for the nine months ended September 30, 2013 partially offset by a slight loss due to a downward shift in

the one-month LIBOR forward curve; and

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\$25.3 million of amortization of deferred net losses reclassified into earnings related to terminated interest rate derivatives.

Other comprehensive income for the nine months ended September 30, 2012 primarily consisted of:

\$3.1 million of net income;

a \$23.7 million gain from a change in fair value of interest rate derivatives, net of taxes which is due primarily to net settlements for the nine months ended September 30, 2012 partially offset by a slight loss due to a downward shift in the one-month LIBOR forward curve; and

\$21.9 million of amortization of deferred net losses reclassified into earnings related to terminated interest rate derivatives.

#### Summary of Impairments and Recoverability Assessment

We perform our annual fleet-wide recoverability assessment during the third quarter of each year. This recoverability assessment, as more fully described in our Annual Report on Form 10-K for the year ended December 31, 2012, 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.

Following completion of the recoverability analysis during the third quarter of 2013, we determined the cash flows expected to be generated by several of our aircraft did not support carrying values. As a result, as noted below, we impaired seven aircraft with an aggregate net book value as of June 30, 2013 that was \$318.9 million, writing down their book values by a total of \$97.6 million. For some of these aircraft we also shortened the expected lives and/or reduced the residual values. More specifically, we wrote down the values on:

Six Boeing Model 747-400 converted freighter aircraft manufactured between 1990 and 1994 and recorded impairment charges total \$88.6 million; and

One Boeing Model 737-700 aircraft manufactured in 1999 and recorded an impairment charge of \$8.9 million.

During the third quarter of 2013, we elected not to invest in engine performance restoration maintenance visits for one Boeing Model 767-300ER aircraft and instead agreed with the lessee to terminate the lease prior to scheduled expiry and pursue a part-out sale. We recorded impairment charges of \$8.5 million and we recorded maintenance revenue of \$12.1 million and other revenue of \$0.9 million from an early termination payment for the three months ended September 30, 2013, for this aircraft.

In addition, for two McDonnell Douglas MD-11F freighter aircraft manufactured in 1997 that passed the recoverability assessment, we shortened the expected lives from 35 years to 25 years from production date. For changes we made to our aircraft, our total depreciation expense will decrease by approximately \$0.9 million in the fourth quarter of 2013, as compared to the three months ended June 30, 2013. We estimate a decrease in depreciation expense for changes we made to our aircraft for the year ended December 31, 2014 of approximately \$4.6 million. In this year's assessment, we lowered our assumptions for the freighter aircraft noted above to reflect the cumulative effect of increasing supply in the wake of stagnating demand over the past three years. More specifically, higher production levels for new, large freighter aircraft together with increased belly freight capacity from the latest generation of wide-body passenger aircraft have resulted in a glut of large freighter aircraft. At the same time, air freight demand has not increased due to modest economic growth rates in certain key economies and structural changes in the freight market (e.g., the evolution of smaller, smarter and lighter electronic devices and modal shifts). The combined effect of these developments has depressed lease rates and driven more converted freighter aircraft into storage, particularly over the past year.

In addition to the changes noted above, we reduced projected rental levels for Boeing Model 737-700 aircraft to reflect lower demand for this smaller variant of the Boeing 737 "New Generation" family, as lower fare airline business models drive demand for shorter-haul operations to larger models having similar trip costs.

Other than the aircraft discussed above, management believes that the net book value of each 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, our lessees may face financial difficulties and return aircraft to us prior to the contractual lease expiry dates which may change our cash flow assumptions and require 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.

At September 30, 2013, we had a total of 11 aircraft with a total net book value of \$208.7 million (accounting for 4.1% of the total net book value of our flight equipment held for lease) that we consider more susceptible to failing our recoverability assessment. The recoverability in the value of these aircraft is more sensitive to changes in contractual cash flows, future cash flow estimates and aircraft residual or scrap values. These aircraft fall into the categories as shown in the table below:

| Aircraft Type | Number of Aircraft | Percent of Net Book Value |
|---------------|--------------------|---------------------------|
| Narrowbody    | 5                  | 1.3%                      |
| Midbody       | 3                  | 1.0%                      |
| Freighters    | 3                  | 1.8%                      |

#### RECENT UNADOPTED ACCOUNTING PRONOUNCEMENTS

None

#### PROPOSED ACCOUNTING PRONOUNCEMENTS

In May 2013, the Financial Accounting Standards Board (the "FASB") issued re-exposure draft, "Leases" (the "Lease Re-ED"), which would replace the existing guidance in the Accounting Standards Codification ("ASC") 840 ("ASC 840"), Leases. The FASB decided that leases would be classified as either leases of real property (Type B) or leases of assets other than real property (Type A). Leases of real property will continue to use operating lease accounting. Leases of other than real property would use the receivable residual approach. Under the receivable residual approach, a lease receivable would be recognized for the lessor's right to receive lease payments, a portion of the carrying amount of the underlying asset would be allocated between the right of use granted to the lessee and the lessor's residual value and profit or loss would only be recognized at commencement if it is reasonably assured. The comment period for the Lease Re-ED ended on September 13, 2013. We anticipate that the final standard may have an effective date no earlier than 2017. When and if the proposed guidance becomes effective, it may have a significant impact on the Company's consolidated financial statements. Although we believe the presentation of our financial statements, and those of our lessees could change, we do not believe the accounting pronouncement will change the fundamental economic reasons for which the airlines lease aircraft. Therefore, we do not believe it will have a material impact on our business.

#### LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity currently are cash on hand, cash generated by our aircraft leasing operations, loans secured by new aircraft we acquire and unsecured borrowings. Our business is very capital intensive, requiring significant investments in order to expand our fleet during periods of growth and investments in maintenance and improvements on our existing portfolio. Our business also generates a significant amount of cash from operations, primarily from lease rentals and maintenance collections. These sources have historically provided liquidity for these investments and for other uses, including the payment of dividends to our shareholders. In the past, we have also met our liquidity and capital resource needs by utilizing several sources, including:

- lines of credit, our securitizations, term financings, secured borrowings supported by export credit agencies for new aircraft acquisitions and bank financings secured by aircraft purchases;
- unsecured indebtedness, including an unsecured revolving credit facility and unsecured senior notes;
- sales of common shares; and

asset sales.

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In July 2013, we issued 12,320,000 of our common shares, par value US\$0.01, at a price of \$17.00 per share to an affiliate of Marubeni Corporation, a Japanese corporation (the "Investor") for \$209.4 million. In June 2013, we also entered into a Shareholder Agreement with the Investor, which became effective in July 2013 upon the closing of the issuance.

In early August 2013, we amended and restructured our existing \$150.0 million 2012 revolving credit facility (the "2012 Revolving Credit Facility") with a new unsecured revolving credit facility (the "2013 Revolving Credit Facility"). The 2013 Revolving Credit Facility was initially sized at \$335.0 million and can be increased to a maximum of \$400.0 million. The 2013 Revolving Credit Facility has a term of three and is scheduled to expire in August 2016.

While the financing structures for our securitizations include liquidity facilities, these liquidity facilities are primarily designed to provide short-term liquidity to enable the financing vehicles to remain current on interest payments during periods when the relevant entities incur substantial unanticipated expenditures. Because these facilities have priority in the payment waterfall and therefore must be repaid quickly, and because we do not anticipate being required to draw on these facilities to cover operating expenses, we do not view these liquidity facilities as an important source of liquidity for us.

As of September 30, 2013, we are in compliance with all applicable covenants in our financings.

We believe that cash on hand, payments received from lessees and other funds generated from operations, borrowings under our 2013 Revolving Credit Facility and other borrowings and proceeds from future aircraft sales will be sufficient to satisfy our liquidity and capital resource needs over the next twelve months. Our liquidity and capital resource needs include payments due under our aircraft purchase obligations, required principal and interest payments under our long-term debt facilities, expected capital expenditures, lessee maintenance payment reimbursements and lease incentive payments over the next twelve months.

#### Cash Flows

|  | Nine Months Ended<br>September 30, |            |
|--|------------------------------------|------------|
|  | 2012                               | 2013       |
|  | (Dollars in thousands)             |            |
| Net cash flow provided by operating activities           | \$305,956                          | \$319,313  |
| Net cash flow used in investing activities               | (516,300 )                         | (523,627 ) |
| Net cash flow (used in) provided by financing activities | 138,781                            | (175,753 ) |

#### Operating Activities:

Cash flow from operations was \$306.0 million and \$319.3 million for the nine months ended September 30, 2012 and September 30, 2013, respectively. The increase in cash flow from operations of approximately \$13.4 million for the nine months ended September 30, 2013 versus the same period in 2012 was primarily a result of:

- \$12.9 million increase in cash from maintenance revenue;
- \$9.1 million increase in cash from working capital;
- \$7.6 million increase in cash from finance leases; and
- \$1.1 million decrease in cash paid for taxes.

These inflows were offset partially by:

- \$22.3 million increase in cash paid for interest.





Investing Activities:

Cash used in investing activities was \$516.3 million and \$523.6 million for the nine months ended September 30, 2012 and September 30, 2013, respectively. The increase in cash flow used in investing activities of \$7.3 million for the nine months ended September 30, 2013 versus the same period in 2012, was primarily a result of:

- a \$230.8 million increase in the proceeds from the sale of flight equipment;
- a \$84.5 million decrease in the net investment in finance leases;
- a \$43.6 million decrease in purchase of debt investments;
- a \$38.8 million increase in principal repayments on debt investments; and
- a \$19.5 million decrease in aircraft purchase deposits and progress payments.

These inflows were offset partially by:

- a \$386.2 million increase in the acquisition and improvement of flight equipment; and
- a \$38.0 million decrease in restricted cash and cash equivalents related to sale of flight equipment.

Financing Activities:

Cash provided by financing activities was \$138.8 million for the nine months ended September 30, 2012 as compared to cash used in financing activities of \$175.8 million for the nine months ended September 30, 2013. The net increase in cash flow used in financing activities of \$314.5 million for the nine months ended September 30, 2013 versus the same period in 2012 was a result of:

- a \$798.9 million decrease in proceeds from notes and debt financings;
- a \$180.0 million decrease in restricted cash and cash equivalents related to security deposits and maintenance payments; and
- a \$3.7 million increase in dividends.

The increases were offset partially by:

- a \$353.5 million decrease in securitization and term debt repayments primarily due to the repayment of \$583.1 million for Term Financing No. 1 in April 2012;
- a \$228.2 million increase in issuances of common shares, net of repurchased shares;
- a \$50.8 million decrease in payments for terminated cash flow hedges;
- a \$14.9 million decrease in deferred financing costs;
- a \$13.3 million increase in maintenance deposits received net of maintenance deposits returned; and
- a \$7.5 million increase in security deposits received net of security deposits returned.

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Debt Obligations

The following table provides a summary of our secured and unsecured debt financings at September 30, 2013:

| Debt Obligation                             | Collateral   | Outstanding Borrowing | Number of Aircraft | Interest Rate <sup>(1)</sup> | Final Stated Maturity <sup>(2)</sup> |
|---|--|-----------------------|--------------------|------------------------------|--------------------------------------|
| (Dollars in thousands)                      |  |                       |                    |                              |                                      |
| Secured Debt Financings:                    |  |                       |                    |                              |                                      |
| Securitization No. 1                        | Interests in aircraft leases, beneficial interests in aircraft owning/leasing entities and related interests           | \$239,221             | 26                 | 0.45%                        | 06/20/31                             |
| Securitization No. 2                        | Interests in aircraft leases, beneficial interests in aircraft owning/leasing entities and related interests           | 653,051               | 41                 | 0.49%                        | 06/14/37                             |
| ECA Term Financings                         | Interests in aircraft, aircraft leases, beneficial interests in aircraft owning/leasing entities and related interests | 504,419               | 7                  | 3.02% to 3.96%               | 12/3/21 to 11/30/24                  |
| Bank Financings                             | Interests in aircraft, aircraft leases, beneficial interests in aircraft owning/leasing entities and related interests | 184,427               | 7                  | 1.08% to 4.57%               | 09/15/15 to 02/13/20                 |
| Total secured debt financings               |  | 1,581,118             |                    |                              |                                      |
| Unsecured Debt Financings:                  |  |                       |                    |                              |                                      |
| Senior Notes due 2017                       | None   | 500,000               | —                  | 6.75%                        | 04/15/17                             |
| Senior Notes due 2018                       | None   | 450,556               | —                  | 9.75%                        | 08/01/18                             |
| Senior Notes due 2019                       | None   | 500,000               | —                  | 6.25%                        | 12/01/19                             |
| Senior Notes due 2020                       | None   | 300,000               | —                  | 7.625%                       | 04/15/20                             |
| 2012 Revolving Credit Facility              | None   | —                     | —                  | N/A                          | 08/02/16                             |
| Total unsecured debt financings             |  | 1,750,556             |                    |                              |                                      |
| Total secured and unsecured debt financings |  | \$3,331,674           |                    |                              |                                      |

(1) Reflects the floating rate in effect at the applicable reset date plus the margin for Securitization No. 1, Securitization No. 2 and one of our Bank Financings. All other financings have a fixed rate.

(2) For Securitizations No. 1 and No. 2, all cash flows available after expenses and interest are applied to debt amortization.

The following securitizations include liquidity facility commitments described in the table below:

| Facility               | Liquidity Facility Provider                   | Available Liquidity |                    | Unused Fee | Interest Rate on any Advances |
|------------------------|---|---------------------|--------------------|------------|-------------------------------|
|                        |   | December 31, 2012   | September 30, 2013 |            |                               |
| (Dollars in thousands) |   |                     |                    |            |                               |
| Securitization No. 1   | Crédit Agricole Corporate and Investment Bank | \$42,000            | \$42,000           | 0.45%      | 1M Libor + 1.00               |
| Securitization No. 2   | HSH Nordbank AG                               | 65,000              | 65,000             | 0.50%      | 1M Libor + 0.75               |

ECA Term Financings

In June 2013, we repaid in full the outstanding principal balances on two of our ECA term financings in the total amount of \$111.7 million, plus accrued interest, interest rate derivative breakage fees of \$3.0 million, and accrued interest on the terminated interest rate derivatives. During the second quarter of 2013, we wrote off \$3.8 million of deferred financing fees which is reflected in interest expense on the consolidated statement of income. We sold an additional aircraft in June 2013, and we posted cash, which is reflected in restricted cash and cash equivalents on the consolidated balance sheet, as collateral for the related term loan until we pay-off the loan or substitute an aircraft.

In August 2013, one of our subsidiaries issued a fixed rate ECA bond with a face value of \$78.2 million which is supported by a guarantee from COFACE and the proceeds were utilized to repay an interim floating rate bank financing that was drawn in connection with the acquisition of one Airbus Model A330-200 aircraft in 2012. The bond has a fixed coupon rate of 3.488% and a final maturity of November 30, 2024.

#### Bank Financings

In May 2013, we assumed three floating rate loans and one fixed rate loan totaling \$91.8 million in connection with the acquisition of two Airbus Model A320-200 aircraft and two Boeing Model 737-800 aircraft. During the quarter, we amended two of the floating rate loans to a fixed rate of 2.58% for the remaining debt term. At September 30, 2013, these four loans had a weighted average interest rate of 2.36% and mature in 2018 and 2020.

We include these loan facilities in "Bank Financings". Aircastle Limited has guaranteed the repayment of these Bank Financings.

#### 2013 Revolving Credit Facility

In early August 2013, we amended and restructured our existing \$150.0 million 2012 Revolving Credit Facility") with the 2013 Revolving Credit Facility. The 2013 Revolving Credit Facility was initially sized at \$335.0 million and can be increased to a maximum of \$400.0 million. The 2013 Revolving Credit Facility has a term of three and is scheduled to expire in August 2016.

As of September 30, 2013, we are in compliance with all applicable covenants in all of our financings.

#### Contractual Obligations

Our contractual obligations consist of principal and interest payments on variable and fixed rate liabilities, interest payments on interest rate derivatives, other aircraft acquisition and conversion agreements and rent payments pursuant to our office leases. Total contractual obligations decreased from \$4.64 billion at December 31, 2012 to approximately \$4.51 billion at September 30, 2013 due primarily to:

- an increase in purchase obligations for three aircraft to be acquired during the remainder of 2013; and
- an increase in the amount of bank financings for the purchase of four aircraft in May 2013.

This increase was partially offset by principal and interest payments made under our securitizations, ECA term financings and our Bank financings and the pay-off of two ECA term financings in June 2013.

The following table presents our actual contractual obligations and their payment due dates as of September 30, 2013.

| Contractual Obligations                                       | Payments Due By Period as of September 30, 2013 |                     |           |             |                      |
|---|---|---------------------|-----------|-------------|----------------------|
|   | Total   | Less than<br>1 year | 1-3 years | 3-5 years   | More than<br>5 years |
|   | (Dollars in thousands)                          |                     |           |             |                      |
| Principal payments:   |   |                     |           |             |                      |
| Senior Notes due 2017   | \$ 500,000                                      | \$—                 | \$—       | \$ 500,000  | \$—                  |
| Senior Notes due 2018   | 450,000   | —                   | —         | 450,000     | —                    |
| Senior Notes due 2019   | 500,000   | —                   | —         | —           | 500,000              |
| Senior Notes due 2020   | 300,000   | —                   | —         | —           | 300,000              |
| Securitization No. 1 <sup>(1)</sup>                           | 239,221   | 60,263              | 102,045   | 66,172      | 10,741               |
| Securitization No. 2 <sup>(1)</sup>                           | 653,051   | 177,840             | 254,147   | 221,064     | —                    |
| ECA Term Financings <sup>(2)</sup>                            | 504,419   | 43,436              | 91,597    | 98,304      | 271,082              |
| Bank Financings <sup>(3)</sup>                                | 190,887   | 22,558              | 49,344    | 87,333      | 31,652               |
| Total principal payments                                      | 3,337,578                                       | 304,097             | 497,133   | 1,422,873   | 1,113,475            |
| Interest payments:  |   |                     |           |             |                      |
| Interest payments on debt obligations <sup>(4)</sup>          | 850,190   | 160,646             | 310,490   | 259,506     | 119,548              |
| Interest payments on interest rate derivatives <sup>(5)</sup> | 54,619  | 21,135              | 32,316    | 1,168       | —                    |
| Total interest payments                                       | 904,809   | 181,781             | 342,806   | 260,674     | 119,548              |
| Office leases <sup>(6)</sup>                                  | 8,122   | 1,124               | 2,184     | 1,479       | 3,335                |
| Purchase obligations <sup>(7)</sup>                           | 256,320   | 256,320             | —         | —           | —                    |
| Total   | \$4,506,829                                     | \$743,322           | \$842,123 | \$1,685,026 | \$1,236,358          |

Estimated principal payments for these non-recourse financings are based on excess cash flows available from forecasted lease rentals, net maintenance funding and proceeds from asset dispositions after the payment of

(1) forecasted operating expenses and interest payments, including interest payments on existing interest rate derivative agreements and policy provider fees.

(2) Includes scheduled principal payments based upon eight fixed rate, 12-year, fully amortizing loans and one floating rate loan.

(3) Includes principal payments based upon individual loan amortization schedules.

(4) Future interest payments on variable rate, LIBOR-based debt obligations are estimated using the interest rate in effect at September 30, 2013.

(5) Future interest payments on derivative financial instruments are estimated using the spread between the floating interest rates and the fixed interest rates in effect at September 30, 2013.

(6) Represents contractual payment obligations for our office leases in Stamford, Connecticut; Dublin, Ireland and Singapore.

(7) At September 30, 2013, we had commitments to acquire five aircraft. Since September 30, 2013, we made additional commitments to acquire three aircraft for \$223.0 million, for total commitments of \$479.3 million.

#### Capital Expenditures

We make capital expenditures from time to time in connection with improvements made to our aircraft. These expenditures include the cost of major overhauls necessary to place an aircraft in service and modifications made at the request of lessees. For the nine months ended September 30, 2012 and 2013, we incurred a total of \$34.7 million and \$22.3 million, respectively, of capital expenditures (including lease incentives) related to the acquisition and improvement of aircraft.

As of September 30, 2013, the weighted average age (by net book value) of our aircraft was approximately 10.0 years. In general, the costs of operating an aircraft, including maintenance expenditures, increase with the age of the aircraft. Under our leases, the lessee is primarily responsible for maintaining the aircraft. We may incur additional maintenance and modification costs in the future in the event we are required to remarket an aircraft or a lessee fails to meet its maintenance obligations under the lease agreement. At September 30, 2013, we had a \$428.6 million maintenance payment liability on our balance sheet, which is a \$49.2 million increase from December 31, 2012. The increase consisted of net maintenance cash inflows of \$39.5 million and an increase in lease incentive liabilities of \$9.7 million. These maintenance reserves are paid by the lessee to provide for future maintenance events. Provided a lessee performs scheduled maintenance of the aircraft, we are required to reimburse the lessee for scheduled maintenance payments. In certain cases, we are also required to make lessor contributions, in excess of amounts a lessee may have paid, towards the costs of maintenance events performed by or on behalf of the lessee.

Actual maintenance payments to us by lessees in the future may be less than projected as a result of a number of factors, including defaults by the lessees. Maintenance reserves may not cover the entire amount of actual maintenance expenses incurred and, where these expenses are not otherwise covered by the lessees, there can be no assurance that our operational cash flow and maintenance reserves will be sufficient to fund maintenance requirements, particularly as our aircraft age.

#### Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements as of September 30, 2013.

#### Foreign Currency Risk and Foreign Operations

At September 30, 2013, all of our leases are payable to us in U.S. dollars. However, we incur Euro- and Singapore dollar-denominated expenses in connection with our subsidiaries in Ireland and Singapore. For the nine months ended September 30, 2013, expenses, such as payroll and office costs, denominated in currencies other than the U.S. dollar aggregated approximately \$9.8 million in U.S. dollar equivalents and represented approximately 25% of total selling, general and administrative expenses. Our international operations are a significant component of our business strategy and permit us to more effectively source new aircraft, service the aircraft we own and maintain contact with our lessees. Therefore, it is likely that our international operations and our exposure to foreign currency risk will increase over time. Although we have not yet entered into foreign currency hedges because our exposure to date has not been significant, if our foreign currency exposure increases we may enter into hedging transactions in the future to mitigate this risk. For the nine months ended September 30, 2012 and 2013, we incurred insignificant net gains and losses on foreign currency transactions.

#### Hedging

The objective of our hedging policy is to adopt a risk averse position with respect to changes in interest rates. Accordingly, we have entered into a number of interest rate derivatives to hedge the current and expected future interest rate payments on our variable rate debt. Interest rate derivatives are agreements in which a series of interest rate cash flows are exchanged with a third party over a prescribed period. The notional amount on an interest rate derivative is not exchanged. Our interest rate derivatives typically provide that we make fixed rate payments and receive floating rate payments to convert our floating rate borrowings to fixed rate obligations to better match the largely fixed rate cash flows from our investments in flight equipment.

We held the following interest rate derivatives as of September 30, 2013:

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| Hedged Item   | Derivative Liabilities        |                   |                  | Future<br>Maximum<br>Notional<br>Amount | Floating<br>Rate    | Fixed<br>Rate        | Balance Sheet<br>Location                  | Fair<br>Value |
|---|-------------------------------|-------------------|------------------|---|---------------------|----------------------|--|---------------|
|   | Current<br>Notional<br>Amount | Effective<br>Date | Maturity<br>Date |   |                     |                      |  |               |
| (Dollars in thousands)  |                               |                   |                  |   |                     |                      |  |               |
| Interest rate derivatives designated as cash flow hedges:                   |                               |                   |                  |   |                     |                      |  |               |
| Securitization No. 1  | \$222,487                     | Jun-06            | Jun-16           | \$222,487                               | 1M LIBOR<br>+ 0.27% | 5.78%                | Fair value of<br>derivative<br>liabilities | \$27,122      |
| Securitization No. 2  | 499,338                       | Jun-12            | Jun-17           | 499,338                                 | 1M LIBOR            | 1.26%<br>to<br>1.28% | Fair value of<br>derivative<br>liabilities | 6,510         |
| Total interest rate<br>derivatives designated<br>as cash flow hedges        | \$721,825                     |                   |                  | \$721,825                               |                     |                      |  | \$33,632      |
| Interest rate derivatives not designated as cash flow hedges:               |                               |                   |                  |   |                     |                      |  |               |
| Securitization No. 1  | 87,575                        | Jun-06            | Jun-16           | 87,575                                  | 1M LIBOR<br>+ 0.27% | 5.78%                | Fair value of<br>derivative<br>liabilities | 10,675        |
| Total interest rate<br>derivatives not<br>designated as cash<br>flow hedges | 87,575                        |                   |                  | 87,575                                  |                     |                      |  | 10,675        |
| Total interest rate<br>derivative liabilities                               | \$809,400                     |                   |                  | \$809,400                               |                     |                      |  | \$44,307      |

The weighted average interest pay rates of these derivatives at December 31, 2012 and September 30, 2013 were 2.91%, and 3.00%, respectively.

For the nine months ended September 30, 2013, the amount of loss reclassified from accumulated other comprehensive income (“OCI”) into interest expense related to net interest settlements on active interest rate derivatives was \$13.7 million. The amount of loss expected to be reclassified from OCI into interest expense over the next 12 months related to net interest settlements on active interest rate derivatives is \$16.1 million.

Our interest rate derivatives involve counterparty credit risk. As of September 30, 2013, our interest rate derivatives are held with the following counterparties: JP Morgan Chase Bank NA, Citibank Canada NA, and Wells Fargo Bank NA. All of our counterparties or guarantors of these counterparties are considered investment grade (senior unsecured ratings of Baa2 or above) by Moody’s Investors Service. All are also considered investment grade (long-term foreign issuer ratings of A- or above) by Standard and Poor’s. We do not anticipate that any of these counterparties will fail to meet their obligations.

In addition to the derivative liability above, another component of the fair value of our interest rate derivatives is accrued interest. As of September 30, 2013, accrued interest payable included in accounts payable, accrued expenses, and other liabilities on our consolidated balance sheet was \$0.8 million related to interest rate derivatives designated



as cash flow hedges and \$0.2 million related to interest rate derivatives not designated as cash flow hedges.

On an ongoing basis, terminated interest rate derivative notionals are evaluated against debt forecasts. To the extent that interest payments are deemed remote to occur, deferred gains or losses are accelerated into interest expense as applicable.

The following table summarizes the deferred (gains) and losses and related amortization into interest expense for our terminated interest rate derivative contracts for the nine months ended September 30, 2012 and 2013:

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| Hedged Item                                       | Original<br>Maximum<br>Notional<br>Amount | Effective<br>Date | Maturity<br>Date | Fixed<br>Rate<br>% | Termination<br>Date                                   | Deferred<br>(Gain) or<br>Loss Upon<br>Termination | Unamortized<br>Deferred<br>(Gain) or<br>Loss at<br>September<br>30,<br>2013 | Amount of<br>Deferred<br>(Gain) or<br>Loss<br>Amortized<br>(including<br>Accelerated<br>Amortization)<br>into Interest<br>Expense for<br>the Nine<br>Months<br>Ended<br>September 30,<br>2012 | 2013   | Amount of<br>Deferred<br>(Gain) or<br>Loss<br>Expected<br>to be<br>Amortized<br>over the<br>Next<br>Twelve<br>Months |
|---|---|-------------------|------------------|--------------------|---|---|---|---|--------|--|
| (Dollars in Thousands)                            |   |                   |                  |                    |   |   |   |   |        |  |
| Securitization<br>No. 2                           | 200,000                                   | Jan-07            | Aug-12           | 5.06               | Jun-07  | (1,850 )  | —   | (190 )  | —      | —  |
| Securitization<br>No. 2                           | 410,000                                   | Feb-07            | Apr-17           | 5.14               | Jun-07  | (3,119 )  | (739 )  | (259 )  | (230 ) | (266 )   |
| Term<br>Financing<br>No. 1                        | 150,000                                   | Jul-07            | Dec-17           | 5.14               | Mar-08  | 15,281  | 4,872   | 1,303   | 1,093  | 1,336  |
| Term<br>Financing<br>No. 1                        | 440,000                                   | Jun-07            | Feb-13           | 4.88               | Partial – Mar-08<br>Full – Jun-08                     | 26,281  | —   | 3,609   | 384    | —  |
| Term<br>Financing<br>No. 1                        | 248,000                                   | Aug-07            | May-13           | 5.33               | Jun-08  | 9,888   | —   | 1,053   | 721    | —  |
| Term<br>Financing<br>No. 1 <sup>(1)</sup>         | 710,068                                   | Jun-08            | May-13           | 4.04               | De-designated –<br>Mar-12<br>Terminated –<br>April-12 | 19,026  | —   | 8,922   | 5,695  | —  |
| Term<br>Financing<br>No. 1 <sup>(1)</sup>         | 491,718                                   | May-13            | May-15           | 5.31               | De-designated –<br>Mar-12<br>Terminated –<br>April-12 | 31,403  | 23,619  | —   | 7,783  | 15,908   |
| Senior Notes<br>due 2018                          | 360,000                                   | Jan-08            | Feb-19           | 5.16               | Partial – Jun-08<br>Full – Oct-08                     | 23,077  | 7,431   | 546   | 765    | 1,595  |
| ECA Term<br>Financing for<br>New A330<br>Aircraft | 231,000                                   | Apr-10            | Oct-15           | 5.17               | Partial – Jun-08<br>Full – Dec-08                     | 15,310  | 1,961   | 2,632   | 3,631  | 752  |
| ECA Term<br>Financing for<br>New A330<br>Aircraft | 238,000                                   | Jan-11            | Apr-16           | 5.23               | Dec-08  | 19,430  | 7,542   | 2,843   | 2,629  | 3,247  |
| ECA Term<br>Financing for<br>New A330             | 238,000                                   | Jul-11            | Sep-16           | 5.27               | Dec-08  | 17,254  | 5,383   | 1,444   | 1,645  | 2,031  |

|          |            |           |           |           |           |
|----------|------------|-----------|-----------|-----------|-----------|
| Aircraft |            |           |           |           |           |
| Total    | \$ 171,981 | \$ 50,069 | \$ 21,903 | \$ 24,116 | \$ 24,603 |

On April 4, 2012, upon the repayment of Term Financing No. 1, both interest rate derivatives were terminated (1) resulting in a net deferred loss of \$50,429 which is being amortized into interest expense using the interest rate method.

For the nine months ended September 30, 2013, the amount of deferred net loss (including \$2.0 million of accelerated amortization driven by aircraft sales in 2013) reclassified from OCI into interest expense related to our terminated interest rate derivatives was \$24.1 million. The amount of deferred net loss expected to be reclassified from OCI into interest expense over the next 12 months related to our terminated interest rate derivatives is \$24.6 million of which \$15.9 million relates to Term Financing No. 1 interest rate derivatives terminated in April 2012, \$1.3 million relates to Term Financing No. 1 interest rate derivatives terminated in 2008, \$6.0 million relates to ECA Term Financings for New A330 Aircraft and \$1.3 million relates to other financings.

For the nine months ended September 30, 2013, the amount of effective deferred loss reclassified from OCI into interest expense related to our undesignated active interest rate derivative was \$1.2 million. The amount of effective deferred loss expected to be reclassified from OCI into interest expense over the next 12 months related to our undesignated active interest rate derivative under our Securitization No. 1 is \$1.7 million.

The following table summarizes amounts charged directly to the consolidated statement of income for the three and nine months ended September 30, 2012 and 2013, respectively, related to our interest rate derivatives:

|  | Three Months<br>Ended September<br>30, |          | Nine Months Ended<br>September 30, |           |
|--|--|----------|------------------------------------|-----------|
|  | 2012                                   | 2013     | 2012                               | 2013      |
|  | (Dollars in thousands)                 |          |                                    |           |
| Interest expense:  |  |          |                                    |           |
| Hedge ineffectiveness losses                                   | \$ 1,474                               | \$ 93    | \$ 1,840                           | \$ 197    |
| Amortization:  |  |          |                                    |           |
| Accelerated amortization of deferred losses <sup>(1)</sup>     | —                                      | (2 )     | —                                  | 2,025     |
| Amortization of loss of designated interest rate derivative    | —                                      | 423      | —                                  | 1,168     |
| Amortization of deferred losses                                | 8,966                                  | 6,879    | 21,903                             | 22,092    |
| Total Amortization   | 8,966                                  | 7,300    | 21,903                             | 25,285    |
| Total charged to interest expense                              | \$ 10,440                              | \$ 7,393 | \$ 23,743                          | \$ 25,482 |
| Other income:  |  |          |                                    |           |
| Mark to market gains on undesignated interest rate derivatives | \$ —                                   | \$ 855   | \$ 599                             | \$ 3,727  |
| Total charged to other income                                  | \$ —                                   | \$ 855   | \$ 599                             | \$ 3,727  |

(1) For the three and six months ended June 30, 2013, represents accelerated amortization of deferred hedge losses related to two aircraft sold in June 2013.

#### Management's Use of EBITDA and Adjusted EBITDA

We define EBITDA as income (loss) from continuing operations before income taxes, interest expense, and depreciation and amortization. We use EBITDA to assess our consolidated financial and operating performance, and we believe this non-US GAAP measure is helpful in identifying trends in our performance.

This measure provides an assessment of controllable expenses and affords management the ability to make decisions which are expected to facilitate meeting current financial goals as well as achieving optimal financial performance. It provides an indicator for management to determine if adjustments to current spending decisions are needed.

EBITDA provides us with a measure of operating performance because it assists us in comparing our operating performance on a consistent basis as it removes the impact of our capital structure (primarily interest charges on our outstanding debt) and asset base (primarily depreciation and amortization) from our operating results. Accordingly, this metric measures our financial performance based on operational factors that management can impact in the short-term, namely the cost structure, or expenses, of the organization. EBITDA is one of the metrics used by senior management and the board of directors to review the consolidated financial performance of our business.

We define Adjusted EBITDA as EBITDA (as defined above) further adjusted to give effect to adjustments required in calculating covenant ratios and compliance as that term is defined in the indenture governing our senior unsecured notes. Adjusted EBITDA is a material component of these covenants.

The table below shows the reconciliation of net income (loss) to EBITDA and Adjusted EBITDA for the three and nine months ended September 30, 2012 and 2013, respectively.

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|  | Three Months Ended     |             | Nine Months Ended |             |
|--|------------------------|-------------|-------------------|-------------|
|  | September 30,          |             | September 30,     |             |
|  | 2012                   | 2013        | 2012              | 2013        |
|  | (Dollars in thousands) |             |                   |             |
| Net income (loss)  | \$(45,847 )            | \$(74,558 ) | \$3,079           | \$(18,640 ) |
| Depreciation   | 68,413                 | 70,469      | 200,024           | 212,448     |
| Amortization of net lease discounts and lease incentives     | 6,838                  | 9,737       | 6,392             | 25,527      |
| Interest, net  | 54,101                 | 57,843      | 167,203           | 183,651     |
| Income tax provision   | 1,701                  | (597 )      | 5,976             | 6,719       |
| EBITDA   | \$85,206               | \$62,894    | \$382,674         | \$409,705   |
| Adjustments:   |                        |             |                   |             |
| Impairment of aircraft                                       | 78,676                 | 106,136     | 88,787            | 112,335     |
| Non-cash share based payment expense                         | 1,128                  | 1,067       | 3,233             | 2,931       |
| Gain on mark to market of interest rate derivative contracts | —                      | (855 )      | (599 )            | (3,727 )    |
| Contract termination expense                                 | 1,248                  | —           | 1,248             | —           |
| Adjusted EBITDA  | \$166,258              | \$169,242   | \$475,343         | \$521,244   |

Management's Use of Adjusted Net Income ("ANI")

Beginning with our report for the quarter ended March 31, 2012, management, to be more consistent with reporting practices of peer aircraft leasing companies, has revised the calculation of ANI to no longer exclude gains (losses) on sales of assets, and to exclude non-cash share based payment expense in the calculation of ANI. Beginning with our quarterly report for the quarter ended June 30, 2012, we also excluded Term Financing No. 1 hedge loss amortization charges which will be reported in Interest, net on our consolidated statement of income from the calculation of ANI. The calculation of ANI for the three and nine months ended September 30, 2012 has been revised to be comparable with the current period presentation.

Management believes that ANI, when viewed in conjunction with the Company's results under US GAAP and the below reconciliation, provides useful information about operating and period-over-period performance, and provides additional information that is useful for evaluating the underlying operating performance of our business without regard to periodic reporting elements related to interest rate derivative accounting and gains or losses related to flight equipment and debt investments.

Under the two-class method, adjusted net income (loss) per common share is computed by dividing the sum of distributed adjusted net income (loss) allocated to common shareholders and undistributed adjusted net income (loss) 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 adjusted net income (loss) is 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 basic and diluted adjusted net loss per common share, no allocation to restricted common shares was made for the three months ended September 30, 2012 and 2013.

The table below shows the reconciliation of net income (loss) to ANI for the three and nine months ended September 30, 2012 and 2013, respectively.

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|   | Three Months Ended<br>September 30, |             | Nine Months Ended<br>September 30, |             |
|---|-------------------------------------|-------------|------------------------------------|-------------|
|   | 2012                                | 2013        | 2012                               | 2013        |
|   | (Dollars in thousands)              |             |                                    |             |
| Net income (loss)   | \$(45,847 )                         | \$(74,558 ) | \$3,079                            | \$(18,640 ) |
| Loan termination fee <sup>(1)</sup>   | —                                   | —           | —                                  | 2,954       |
| Ineffective portion and termination of hedges <sup>(1)</sup>                | 1,474                               | 91          | 1,840                              | 2,222       |
| Gain on mark to market of interest rate derivative contracts <sup>(2)</sup> | —                                   | (855 )      | (599 )                             | (3,727 )    |
| Write-off of deferred financing fees <sup>(1)</sup>                         | —                                   | 150         | 2,914                              | 3,975       |
| Stock compensation expense <sup>(3)</sup>                                   | 1,128                               | 1,067       | 3,233                              | 2,931       |
| Term Financing No. 1 hedge loss amortization charges <sup>(1)</sup>         | 4,506                               | 4,591       | 8,922                              | 13,478      |
| Securitization No. 1 hedge loss amortization charges <sup>(1)</sup>         | —                                   | 423         | —                                  | 1,168       |
| Contract termination expense  | 1,248                               | —           | 1,248                              | —           |
| Adjusted net income (loss)  | \$(37,491 )                         | \$(69,091 ) | \$20,637                           | \$4,361     |

(1)Included in Interest, net.

(2)Included in Other income (expense).

(3)Included in Selling, general and administrative expenses.

|   | Three Months Ended<br>September 30,              |             | Nine Months Ended<br>September 30, |            |
|---|--|-------------|------------------------------------|------------|
|   | 2012   | 2013        | 2012                               | 2013       |
| Weighted-average shares:  |  |             |                                    |            |
| Common shares outstanding   | 70,349,265                                       | 78,544,380  | 71,248,765                         | 71,462,264 |
| Restricted common shares  | 571,326  | 669,489     | 596,749                            | 562,612    |
| Total weighted-average shares   | 70,920,591                                       | 79,213,869  | 71,845,514                         | 72,024,876 |
|   | Three Months Ended<br>September 30,              |             | Nine Months Ended<br>September 30, |            |
|   | 2012   | 2013        | 2012                               | 2013       |
| Percentage of weighted-average shares:  |  |             |                                    |            |
| Common shares outstanding   | 99.19 %  | 99.15 %     | 99.17 %                            | 99.22 %    |
| Restricted common shares  | 0.81 %   | 0.85 %      | 0.83 %                             | 0.78 %     |
| Total   | 100.00 %   | 100.00 %    | 100.00 %                           | 100.00 %   |
|   | Three Months Ended<br>September 30,              |             | Nine Months Ended<br>September 30, |            |
|   | 2012   | 2013        | 2012                               | 2013       |
| Weighted-average common shares outstanding – Basic  | 70,349,265                                       | 78,544,380  | 71,248,765                         | 71,462,264 |
| Effect of dilutive shares   | —  | —           | —                                  | —          |
| Weighted-average common shares outstanding - Diluted <sup>(b)</sup>                               | 70,349,265                                       | 78,544,380  | 71,248,765                         | 71,462,264 |
|   | Three Months Ended<br>September 30,              |             | Nine Months Ended<br>September 30, |            |
|   | 2012   | 2013        | 2012                               | 2013       |
|   | (Dollars in thousands, except per share amounts) |             |                                    |            |
| Adjusted net income (loss) allocation:  |  |             |                                    |            |
| Adjusted net income (loss)  | \$(37,491 )                                      | \$(69,091 ) | \$20,637                           | \$4,361    |
| Less: Distributed and undistributed earnings allocated to restricted common shares <sup>(a)</sup> | —  | —           | (171 )                             | (34 )      |
| Adjusted net income (loss) allocable to common shares – Basic and Diluted                         | \$(37,491 )                                      | \$(69,091 ) | \$20,466                           | \$4,327    |

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|   |          |   |          |   |         |         |
|---|----------|---|----------|---|---------|---------|
| Adjusted net income (loss) per common share – Basic and Diluted | \$ (0.53 | ) | \$ (0.88 | ) | \$ 0.29 | \$ 0.06 |
|---|----------|---|----------|---|---------|---------|

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For the nine months ended September 30, 2012, distributed and undistributed earnings to restricted shares is 0.83% (a) of net income. 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, 2012 and 2013, we had no dilutive shares.

#### Limitations of EBITDA, Adjusted EBITDA and ANI

An investor or potential investor may find EBITDA, Adjusted EBITDA and ANI important measures in evaluating our performance, results of operations and financial position. We use these non-US GAAP measures to supplement our US GAAP results in order to provide a more complete understanding of the factors and trends affecting our business.

EBITDA, Adjusted EBITDA and ANI have limitations as analytical tools and should not be viewed in isolation or as substitutes for US GAAP measures of earnings. Material limitations in making the adjustments to our earnings to calculate EBITDA, Adjusted EBITDA and ANI, and using these non-US GAAP measures as compared to US GAAP net income, income from continuing operations and cash flows provided by or used in operations, include: depreciation and amortization, though not directly affecting our current cash position, represent the wear and tear and/or reduction in value of our aircraft, which affects the aircraft's availability for use and may be indicative of future needs for capital expenditures; the cash portion of income tax (benefit) provision generally represents charges (gains), which may significantly affect our financial results; elements of our interest rate derivative accounting may be used to evaluate the effectiveness of our hedging policy; hedge loss amortization charges related to Term Financing No. 1; and adjustments required in calculating covenant ratios and compliance as that term is defined in the indenture governing our senior unsecured notes.

EBITDA, Adjusted EBITDA and ANI are not alternatives to net income, income from operations or cash flows provided by or used in operations as calculated and presented in accordance with US GAAP. You should not rely on these non-US GAAP measures as a substitute for any such US GAAP financial measure. We strongly urge you to review the reconciliations to US GAAP net income, along with our consolidated financial statements included elsewhere in this report. We also strongly urge you to not rely on any single financial measure to evaluate our business. In addition, because EBITDA, Adjusted EBITDA and ANI are not measures of financial performance under US GAAP and are susceptible to varying calculations, EBITDA, Adjusted EBITDA and ANI as presented in this report, may differ from and may not be comparable to, similarly titled measures used by other companies.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### Interest Rate Risk

Interest rate risk is the exposure to loss resulting from changes in the level of interest rates and the spread between different interest rates. These risks are highly sensitive to many factors, including U.S. monetary and tax policies, U.S. and international economic factors and other factors beyond our control. We are exposed to changes in the level of interest rates and to changes in the relationship or spread between interest rates. Our primary interest rate exposures relate to our lease agreements, floating rate debt obligations and interest rate derivatives. Rent payments under our aircraft lease agreements typically do not vary during the term of the lease according to changes in interest rates. However, our borrowing agreements generally require payments based on a variable interest rate index, such as LIBOR. Therefore, to the extent our borrowing costs are not fixed, increases in interest rates may reduce our net income by increasing the cost of our debt without any corresponding increase in rents or cash flow from our securities. Changes in interest rates may also impact our net book value as our interest rate derivatives are periodically marked-to-market through shareholders' equity. Generally, we are exposed to loss on our fixed pay interest rate derivatives to the extent interest rates decrease below their contractual fixed rate.



The relationship between spreads on derivative instruments may vary from time to time, resulting in a net aggregate book value increase or decrease. Changes in the general level of interest rates can also affect our ability to acquire new investments and our ability to realize gains from the settlement of such assets.

#### Sensitivity Analysis

The following discussion about the potential effects of changes in interest rates is based on a sensitivity analysis, which models the effects of hypothetical interest rate shifts on our financial condition and results of operations. Although we believe a sensitivity analysis provides the most meaningful analysis permitted by the rules and regulations of the SEC, it is constrained by several factors, including the necessity to conduct the analysis based on a single point in time and by the inability to include the extraordinarily complex market reactions that normally would arise from the market shifts modeled. Although the following results of a sensitivity analysis for changes in interest rates may have some limited use as a benchmark, they should not be viewed as a forecast. This forward-looking disclosure also is selective in nature and addresses only the potential interest expense impacts on our financial instruments and, in particular, does not address the mark-to-market impact on our interest rate derivatives. It also does not include a variety of other potential factors that could affect our business as a result of changes in interest rates. As of September 30, 2013, a hypothetical 100-basis point increase/decrease in our variable interest rate on our borrowings would result in an interest expense increase/decrease of \$0.6 million and \$0.2 million, respectively, net of amounts received from our interest rate derivatives, over the next twelve months.

Item 4. Controls and Procedures

Management's Evaluation of Disclosure Controls and Procedures

The term "disclosure controls and procedures" is defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. This term refers to the controls and procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") as appropriate, to allow timely decisions regarding required disclosure. An evaluation was performed under the supervision and with the participation of the Company's management, including the CEO and CFO, of the effectiveness of the Company's disclosure controls and procedures as of September 30, 2013. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective as of September 30, 2013.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2013 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. — OTHER INFORMATION

Item 1. Legal Proceedings

The Company is not a party to any material legal or adverse regulatory proceedings.

Item 1A. Risk Factors

There have been no material changes to the disclosure related to the risk factors described in our Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2012.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

During the third quarter of 2013, we purchased our common shares as follows:

| Period   | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(a)</sup> | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(a)</sup> |
|--|----------------------------------|------------------------------|---|---|
| (Dollars in thousands, except per share amounts) |                                  |                              |   |   |
| July   | —                                | \$—                          | —   | \$ 30,000   |
| August   | 1,820                            | (b) 16.51                    | —   | 30,000  |
| September  | —                                | —                            | —   | 30,000  |
| Total  | 1,820                            | \$ 16.51                     | —   | \$ 30,000   |

(a) The remaining dollar value of common shares that may be purchased under the repurchase program approved by the Company's Board of Directors on November 5, 2012 is \$30,000.

Our Compensation Committee approved the repurchase of common shares pursuant to an irrevocable election made under the Amended and Restated Aircastle Limited 2005 Equity and Incentive Plan, in satisfaction of (b) minimum tax withholding obligations associated with the vesting of restricted common shares during the third quarter of 2013.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

| Item 6. Exhibits |   |
|------------------|---|
| Exhibit No.      | Description of Exhibit  |
| 2.1              | Transaction Agreement dated as of June 6, 2013, by and between Marubeni Corporation and Aircastle Limited (incorporated by reference to Exhibit 2.1 to the Company's current report on Form 8-K filed with the SEC on June 6, 2013).  |
| 3.1              | Memorandum of Association (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1 (Amendment No. 2) (No. 333-134669) filed on July 25, 2006).   |
| 3.2              | Bye-laws (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (Amendment No. 2) (No. 333-134669) filed on July 25, 2006).  |
| 4.1              | Specimen Share Certificate (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 (Amendment No. 2) (No. 333-134669) filed on July 25, 2006).  |
| 4.2              | Indenture, dated as of July 30, 2010, by and among Aircastle Limited and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K filed with the SEC on August 4, 2010).  |
| 4.3              | First Supplemental Indenture, dated as of December 9, 2011, by and among Aircastle Limited and Wells Fargo Bank, National Association as trustee (incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K filed with the SEC on December 12, 2011).  |
| 4.4              | Indenture, dated as of April 4, 2012, by and among Aircastle Limited and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K filed with the SEC on April 4, 2012).   |
| 4.5              | Indenture, dated as of November 30, 2012, by and among Aircastle Limited and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K filed with the SEC on November 30, 2012).   |
| 4.6              | Shareholder Agreement dated as of June 6, 2013, by and between Aircastle Limited and Marubeni Corporation (incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K filed with the SEC on June 6, 2013).  |
| 10.1             | Amended and Restated Credit Agreement, dated as of August 2, 2013, by and among Aircastle Limited, the several lenders from time to time parties thereto, and Citibank N.A., in its capacity as agent for the lenders. *  |
| 31.1             | Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002 *  |
| 31.2             | Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002 *  |
| 32.1             | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *   |
| 32.2             | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *   |
| 99.1             | Owned Aircraft Portfolio at September 30, 2013 *  |
| 101              | The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2013 formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets as of December 31, 2012 and September 30, 2013, (ii) Consolidated Statements of Income for the three and nine months ended September 30, 2012 and 2013, (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2012 and 2013, (iv) Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2013, and (v) Notes to Unaudited Consolidated Financial Statements r |

\* Filed herewith.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: October 31, 2013

AIRCASTLE LIMITED

(Registrant)

By: /s/ Aaron Dahlke

Aaron Dahlke

Chief Accounting Officer and Authorized Officer