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Aircastle LTD

Form 10-Q

November 01, 2018

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 xbrli:shares ayr:Lessee xbrli:pure

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2018  
or

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

For the transition period from to

Commission File number 001-32959

**AIRCASTLE LIMITED**

(Exact name of registrant as specified in its charter)

**Bermuda**  
(State or other jurisdiction of  
incorporation or organization)

**98-0444035**  
(IRS Employer  
Identification No.)

**c/o Aircastle Advisor LLC**  
**201 Tresser Boulevard, Suite 400, Stamford, CT 06901**  
(Address of principal executive offices) (Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of October 30, 2018, there were 76,227,375 outstanding shares of the registrant's common shares, par value \$0.01 per share.

**Aircastle Limited and Subsidiaries**  
**Form 10-Q**  
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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)**

	<b>September 30, 2018</b>	<b>December 31, 2017</b>
	<b>(Unaudited)</b>	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 593,922	\$ 211,922
Restricted cash and cash equivalents	16,275	21,935
Accounts receivable	27,365	12,815
Flight equipment held for lease, net of accumulated depreciation of \$1,212,799 and \$1,125,594, respectively	6,321,622	6,188,469
Net investment in finance and sales-type leases	517,221	545,750
Unconsolidated equity method investments	82,146	76,982
Other assets	172,718	141,210
Total assets	\$ 7,731,269	\$ 7,199,083
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Borrowings from secured financings, net of debt issuance costs and discounts	\$ 717,305	\$ 849,874
Borrowings from unsecured financings, net of debt issuance costs and discounts	3,938,568	3,463,732
Accounts payable, accrued expenses and other liabilities	149,583	140,221
Lease rentals received in advance	81,594	57,630
Security deposits	131,000	130,628
Maintenance payments	754,522	649,434
Total liabilities	5,772,572	5,291,519
Commitments and Contingencies		
<b>SHAREHOLDERS' EQUITY</b>		
Preference shares, \$0.01 par value, 50,000,000 shares authorized, no shares issued and outstanding	—	—
Common shares, \$0.01 par value, 250,000,000 shares authorized, 77,179,863 shares issued and outstanding at September 30, 2018; and 78,707,963 shares issued and outstanding at December 31, 2017	772	787
Additional paid-in capital	1,500,030	1,527,796
Retained earnings	458,362	380,331
Accumulated other comprehensive loss	(467)	(1,350)
Total shareholders' equity	1,958,697	1,907,564
Total liabilities and shareholders' equity	\$ 7,731,269	\$ 7,199,083

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

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
<b>Revenues:</b>				
Lease rental revenue	\$182,043	\$171,687	\$538,012	\$551,371
Finance and sales-type lease revenue	8,793	6,412	27,103	16,363
Amortization of lease premiums, discounts and incentives	(4,044 )	(2,388 )	(10,706 )	(8,780 )
Maintenance revenue	—	14,507	11,991	55,738
Total lease revenue	186,792	190,218	566,400	614,692
Gain on sale of flight equipment	2,954	21,642	28,586	35,926
Other revenue	1,083	1,193	2,799	4,526
Total revenues	190,829	213,053	597,785	655,144
<b>Operating expenses:</b>				
Depreciation	78,059	70,018	229,242	227,446
Interest, net	57,131	60,636	171,637	185,376
Selling, general and administrative (including non-cash share-based payment expense of \$2,798 and \$2,506 for the three months ended and \$8,252 and \$10,636 for the nine months ended September 30, 2018 and 2017, respectively)	18,306	17,137	54,724	55,491
Impairment of flight equipment	—	—	—	80,430
Maintenance and other costs	2,179	2,572	4,728	7,846
Total operating expenses	155,675	150,363	460,331	556,589
Total other income (expense)	368	(360 )	4,443	(3,069 )
Income from continuing operations before income taxes and earnings of unconsolidated equity method investments	35,522	62,330	141,897	95,486
Income tax provision	1,236	6,195	3,524	8,536
Earnings of unconsolidated equity method investments, net of tax	2,046	1,296	5,709	5,804
Net income	\$36,332	\$57,431	\$144,082	\$92,754
Earnings per common share — Basic:				
Net income per share	\$0.47	\$0.73	\$1.84	\$1.18
Earnings per common share — Diluted:				
Net income per share	\$0.46	\$0.73	\$1.83	\$1.18
Dividends declared per share	\$0.28	\$0.26	\$0.84	\$0.78

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



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

	<b>Three Months Ended September 30, 2018</b>		<b>Nine Months Ended September 30, 2018</b>	
	<b>2017</b>	<b>2018</b>	<b>2017</b>	<b>2018</b>
Net income	\$36,332	\$57,431	\$144,082	\$92,754
Other comprehensive income, net of tax:				
Net derivative loss reclassified into earnings	288	569	883	1,725
Other comprehensive income	288	569	883	1,725
Total comprehensive income	\$36,620	\$58,000	\$144,965	\$94,479

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

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

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 144,082	\$ 92,754
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	229,242	227,446
Amortization of deferred financing costs	10,802	15,860
Amortization of lease premiums, discounts and incentives	10,706	8,780
Deferred income taxes	3,850	(1,369 )
Non-cash share-based payment expense	8,252	10,636
Cash flow hedges reclassified into earnings	883	1,725
Security deposits and maintenance payments included in earnings	821	(17,147 )
Gain on sale of flight equipment	(28,586 )	(35,926 )
Impairment of flight equipment	—	80,430
Other	(11,377 )	2,078
Changes in certain assets and liabilities:		
Accounts receivable	(9,731 )	415
Other assets	1,541	(6,980 )
Accounts payable, accrued expenses and other liabilities	6,476	17,648
Lease rentals received in advance	26,336	(2,892 )
Net cash and restricted cash provided by operating activities	393,297	393,458
<b>Cash flows from investing activities:</b>		
Acquisition and improvement of flight equipment	(626,022 )	(353,492 )
Proceeds from sale of flight equipment	276,165	764,984
Net investment in finance and sales-type leases	(15,783 )	(246,871 )
Collections on finance and sales-type leases	22,645	23,673
Aircraft purchase deposits and progress payments, net of returned deposits and aircraft sales deposits	(9,544 )	(14,068 )
Other	3,880	(405 )
Net cash and restricted cash (used in) provided by investing activities	(348,659 )	173,821
<b>Cash flows from financing activities:</b>		
Repurchase of shares	(36,955 )	(4,862 )
Proceeds from secured and unsecured debt financings	873,902	500,000
Repayments of secured and unsecured debt financings	(535,808 )	(852,451 )
Deferred financing costs	(6,628 )	(8,540 )
Security deposits and maintenance payments received	155,567	138,813
Security deposits and maintenance payments returned	(52,513 )	(104,475 )
Dividends paid	(65,863 )	(61,396 )
Net cash and restricted cash provided by (used in) financing activities	331,702	(392,911 )
<b>Net increase in cash and restricted cash:</b>	<b>376,340</b>	<b>174,368</b>
Cash and restricted cash at beginning of period	233,857	508,817
Cash and restricted cash at end of period	\$ 610,197	\$ 683,185



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

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
<b>Reconciliation to Consolidated Balance Sheets:</b>		
Cash and cash equivalents	\$593,922	\$662,649
Restricted cash and cash equivalents	16,275	20,536
Unrestricted and restricted cash and cash equivalents	\$610,197	\$683,185
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid for interest, net of capitalized interest	\$144,844	\$156,428
Cash paid for income taxes	\$5,971	\$3,622
<b>Supplemental disclosures of non-cash investing activities:</b>		
Advance lease rentals, security deposits, maintenance payments, other liabilities and other assets assumed in asset acquisitions	\$13,909	\$133,389
Advance lease rentals, security deposits, maintenance payments, other liabilities and other assets settled in sale of flight equipment	\$59,577	\$22,542
Transfers from flight equipment held for lease to Net investment in finance and sales-type leases and Other assets	\$40,198	\$154,213

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

**Aircastle Limited and Subsidiaries**  
**Notes to Unaudited Consolidated Financial Statements**  
**(Dollars in thousands, except per share amounts)**  
**September 30, 2018**

**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 acquiring, leasing, managing and selling commercial jet aircraft.

Aircastle is a holding company that conducts its business through subsidiaries. Aircastle directly or indirectly owns all of the outstanding common shares of its subsidiaries. The consolidated financial statements presented are prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”). The Company manages, analyzes and reports on its business and results of operations on the basis of one operating segment: leasing, financing, selling and managing commercial flight equipment. Our Chief Executive Officer is the chief operating decision maker.

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 U.S. 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, 2017.

As part of the Company’s adoption of Financial Accounting Standards Board (“FASB”) Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, we have reclassified Gain on sale of flight equipment from Other income (expense) to Revenues on our Consolidated Statements of Income for the three and nine months ended September 30, 2018. We believe this better reflects the sale of flight equipment as part of our ordinary activities and conforms our presentation to those of our publicly traded peers. The presentation for the three and nine months ended September 30, 2017, has also been reclassified to conform to the current period presentation:

	<b>Three Months Ended September 30, 2017</b>	<b>Nine Months Ended September 30, 2017</b>
Total revenues as previously reported	\$ 191,411	\$ 619,218
Gain on sale of flight equipment	21,642	35,926
Total revenues	\$ 213,053	\$ 655,144

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, 2018, through the date on which the consolidated financial statements included in this Form 10-Q were issued.

Effective January 1, 2018, the Company adopted FASB ASU No. 2016-15, *Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments*. The standard clarifies how entities should classify certain cash receipts and cash payments on the statement of cash flows. The guidance also clarifies how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. The update is applied using a retrospective transition method to each period presented. The standard did not have a material impact on our consolidated financial statements and related disclosures.

Effective January 1, 2018, the Company adopted FASB ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* and related updates, as noted above. Lease contracts within the scope of Accounting Standards Codification (“ASC”) 840, *Leases*, are specifically excluded from ASU No. 2014-09. The standard’s core principle is

that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. The update is applied using the modified retrospective approach. The standard did not have a material impact on our consolidated financial statements and related disclosures.

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**Aircastle Limited and Subsidiaries**  
**Notes to Unaudited Consolidated Financial Statements**  
**(Dollars in thousands, except per share amounts)**  
**September 30, 2018**

Effective January 1, 2018, the Company adopted FASB ASU No. 2017-09, *Compensation-Stock Compensation (Topic 718), Scope of Modification Accounting*. The standard clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. Entities will apply the modification accounting guidance if the value, vesting conditions or classification of the award changes. In addition, when applicable, disclosure is required to indicate that compensation expense has not changed. The update is applied using a prospective transition method to each period presented. The standard did not have a material impact on our consolidated financial statements and related disclosures.

**Principles of Consolidation**

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

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

**Use of Estimates**

The preparation of financial statements in conformity with U.S. 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.

**Recent Accounting Pronouncements**

On February 25, 2016, the FASB issued ASC 842, *Leases* (“ASC 842”) which, together with all subsequent amendments, replaced the existing guidance in ASC 840, *Leases* (“ASC 840”). The accounting for leases by lessors basically remained unchanged from the concepts that existed in ASC 840 accounting. The FASB decided that lessors would be precluded from recognizing selling profit and revenue at lease commencement for any sales-type or direct finance lease that does not transfer control of the underlying asset to the lessee. This requirement aligns the notion of what constitutes a sale in the lessor accounting guidance with that in the revenue recognition standard, which evaluates whether a sale has occurred from the customer’s perspective.

The most significant among the changes in ASC 842 is the recognition of right-of-use assets and lease liabilities by lessees for those leases classified as operating leases under current U.S. GAAP, existing at, or entered into after, January 1, 2019. The standard will be effective for reporting periods beginning after December 15, 2018. We plan to adopt the standard on its required effective date of January 1, 2019, using the required “modified retrospective” approach and the available practical expedients. We have evaluated the impact of ASC 842 and have determined the standard will not have a material impact on our consolidated financial statements and related disclosures. We do not believe that the adoption of the standard will significantly impact our existing or potential lessees' economic decisions to lease aircraft.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments*. The standard affects entities holding financial assets and net investment in leases that are not accounted for at fair value through net income. The amendments affect loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. The standard is applied on

a modified retrospective approach. The standard is effective for annual periods beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted as early as the fiscal years beginning after December 15, 2018, including

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**Aircastle Limited and Subsidiaries**  
**Notes to Unaudited Consolidated Financial Statements**  
**(Dollars in thousands, except per share amounts)**  
**September 30, 2018**

interim periods within those fiscal years. We are in the process of determining the impact the standard will have on our consolidated financial statements and related disclosures.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820), Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement*. The standard modifies certain disclosure requirements for fair value measurements as part of its disclosure framework project. The standard is effective for annual periods beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted. We are in the process of determining the impact the standard will have on our related disclosures.

In August 2018, the FASB issued ASU No. 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40), Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract*. The standard requires a customer in a cloud computing arrangement that is a service contract to follow the internal-use-software guidance in ASC 350-40 to determine which implementation costs to capitalize as assets or expense as incurred. The standard is effective for annual periods beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period. We are in the process of determining the impact the standard will have on our consolidated financial statements and related disclosures.

**Note 2. Fair Value Measurements**

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

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

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

- The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
- The income approach uses valuation techniques to convert future amounts to a single present amount based on current market expectation about those future amounts.
- The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost).

The following tables set forth our financial assets as of September 30, 2018 and December 31, 2017 that we measured at fair value on a recurring basis by level within the fair value hierarchy. Assets measured at fair value are classified in their entirety based on the lowest level of input that is significant to their fair value measurement.

**Aircastle Limited and Subsidiaries**  
**Notes to Unaudited Consolidated Financial Statements**  
(Dollars in thousands, except per share amounts)  
**September 30, 2018**

	Fair Value Measurements at September 30, 2018 Using Fair Value Hierarchy				
	Fair Value as of September 30, 2018	in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique
<b>Assets:</b>					
Cash and cash equivalents	\$ 593,922	\$593,922	\$ —	\$ —	Market
Restricted cash and cash equivalents	16,275	16,275	—	—	Market
Derivative assets	7,696	—	7,696	—	Market
Total	\$ 617,893	\$ 610,197	\$ 7,696	\$ —	
	Fair Value Measurements at December 31, 2017 Using Fair Value Hierarchy				
	Fair Value as of December 31, 2017	in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique
<b>Assets:</b>					
Cash and cash equivalents	\$ 211,922	\$211,922	\$ —	\$ —	Market
Restricted cash and cash equivalents	21,935	21,935	—	—	Market
Derivative assets	3,254	—	3,254	—	Market
Total	\$ 237,111	\$ 233,857	\$ 3,254	\$ —	

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 derivative assets included in Level 2 consist of United States dollar-denominated interest rate caps, and the fair value is based on market comparisons for similar instruments. We also considered the credit rating and risk of the counterparty providing the interest rate cap based on quantitative and qualitative factors.

For the three and nine months ended September 30, 2018 and the year ended December 31, 2017, we had no transfers into or out of Level 3.

We measure the fair value of certain assets and liabilities on a non-recurring basis, when U.S. GAAP requires the application of fair value, including events or changes in circumstances that indicate that the carrying amounts of assets may not be recoverable. Assets subject to these measurements include our investments in unconsolidated joint ventures and aircraft. We account for our investments in unconsolidated joint ventures under the equity method of accounting and record impairment when its fair value is less than its carrying value. We record aircraft at fair value when we determine the carrying value may not be recoverable. Fair value measurements for aircraft in impairment tests are based on an income approach which uses Level 3 inputs, which include the Company's assumptions and appraisal data as to future cash proceeds from leasing and selling aircraft.

#### **Aircraft Valuation**

##### *Annual Recoverability Assessment*

We completed our annual recoverability assessment of our aircraft in the second quarter this year. We also performed aircraft-specific analyses where there were changes in circumstances, such as approaching lease expirations. No impairments were recorded as a result of our annual recoverability assessment.



**Aircastle Limited and Subsidiaries**  
**Notes to Unaudited Consolidated Financial Statements**  
**(Dollars in thousands, except per share amounts)**  
**September 30, 2018**

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

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 aircraft were impaired as a consequence of our annual recoverability assessment. However, if our estimates or assumptions change, we may revise our cash flow assumptions and record future impairment charges. While we believe that the estimates and related assumptions used in the annual recoverability assessment are appropriate, actual results could differ from those estimates.

**Financial Instruments**

Our financial instruments, other than cash, consist principally of cash equivalents, restricted cash and cash equivalents, accounts receivable, accounts payable, amounts borrowed under financings and interest rate derivatives. The fair value of cash, cash equivalents, restricted cash and cash equivalents, accounts receivable and accounts payable approximates the carrying value of these financial instruments because of their short-term nature.

The fair value of our senior notes is estimated using quoted market prices. The fair values of all our other financings are estimated using a discounted cash flow analysis, based on our current incremental borrowing rates for similar types of borrowing arrangements.

The carrying amounts and fair values of our financial instruments at September 30, 2018 and December 31, 2017 were as follows:

	September 30, 2018		December 31, 2017	
	Carrying Amount of Liability	Fair Value of Liability	Carrying Amount of Liability	Fair Value of Liability
Credit Facilities	\$ —	\$ —	\$ 175,000	\$ 175,000
Unsecured Term Loan	120,000	120,000	120,000	120,000
ECA Financings	198,809	198,395	227,491	232,030
Bank Financings	528,317	529,373	634,898	634,132
Senior Notes	3,850,000	3,923,812	3,200,000	3,367,245

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, 2018 were as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
Remainder of 2018	\$ 186,005
2019	693,418
2020	592,246
2021	480,666
2022	395,624
Thereafter	767,833
Total	\$ 3,115,792



**Aircastle Limited and Subsidiaries**  
**Notes to Unaudited Consolidated Financial Statements**  
**(Dollars in thousands, except per share amounts)**  
**September 30, 2018**

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

<b>Region</b>	<b>Three Months Ended September 30, 2018</b>		<b>Nine Months Ended September 30, 2017</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Asia and Pacific	34 %	35 %	35 %	38 %
Europe	27 %	24 %	28 %	23 %
Middle East and Africa	11 %	12 %	11 %	12 %
North America	11 %	9 %	9 %	8 %
South America	17 %	20 %	17 %	19 %
Total	100 %	100 %	100 %	100 %

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

The following table shows the number of lessees with lease rental revenue of at least 5% of total lease rental revenue and their combined total percentage of lease rental revenue for the periods indicated:

	<b>Three Months Ended September 30, 2018</b>		<b>2017</b>		<b>Nine Months Ended September 30, 2018</b>		<b>2017</b>	
	<b>Number of Lessees</b>	<b>Combined % of Lease Rental Revenue</b>	<b>Number of Lessees</b>	<b>Combined % of Lease Rental Revenue</b>	<b>Number of Lessees</b>	<b>Combined % of Lease Rental Revenue</b>	<b>Number of Lessees</b>	<b>Combined % of Lease Rental Revenue</b>
Largest lessees by lease rental revenue	3	19%	4	25%	3	19%	4	24%

At September 30, 2018 and December 31, 2017, no country represented at least 10% of total revenue based on each counterparty's principal place of business.

Geographic concentration of net book value of flight equipment (including flight equipment held for lease and net investment in finance and sales-type leases, or "net book value") was as follows:

<b>Region</b>	<b>September 30, 2018</b>		<b>December 31, 2017</b>	
	<b>Number of Aircraft</b>	<b>Net Book Value %</b>	<b>Number of Aircraft</b>	<b>Net Book Value %</b>
Asia and Pacific	65	32 %	59	30 %
Europe	89	30 %	92	32 %
Middle East and Africa	17	9 %	15	9 %
North America	37	11 %	32	10 %
South America	26	18 %	25	19 %
Off-lease	—	— %	1 <sup>(1)</sup>	— %
Total	234	100 %	224	100 %

(1) Consisted of one Airbus A321-200 aircraft, which was delivered on lease to a customer in the second quarter of 2018.

At September 30, 2018 and December 31, 2017, no country represented at least 10% of net book value of flight equipment based on each lessee's principal place of business.

At September 30, 2018 and December 31, 2017, the amounts of lease incentive liabilities recorded in maintenance payments on our Consolidated Balance Sheets were \$14,586 and \$11,496, respectively.



**Aircastle Limited and Subsidiaries**  
**Notes to Unaudited Consolidated Financial Statements**  
(Dollars in thousands, except per share amounts)  
**September 30, 2018**

**Note 4. Net Investment in Finance and Sales-Type Leases**

At September 30, 2018, our net investment in finance and sales-type leases consisted of 30 aircraft. The following table lists the components of our net investment in finance and sales-type leases at September 30, 2018:

	<b>Amount</b>
Total lease payments to be received	\$280,498
Less: Unearned income	(139,490 )
Estimated residual values of leased flight equipment (unguaranteed)	376,213
 Net investment in finance and sales-type leases	 \$517,221

At September 30, 2018, minimum future lease payments on finance and sales-type leases are as follows:

<b><u>Year Ending December 31,</u></b>	<b>Amount</b>
Remainder of 2018	\$16,770
2019	66,285
2020	63,840
2021	53,057
2022	42,460
Thereafter	38,086
Total lease payments to be received	\$280,498

**Note 5. Unconsolidated Equity Method Investments**

We have joint ventures with an affiliate of Ontario Teachers' Pension Plan ("Teachers'") and with the leasing arm of the Industrial Bank of Japan, Limited ("IBJL").

At September 30, 2018, the net book value of both joint ventures' twelve aircraft was approximately \$621,000.

	<b>Amount</b>
Investment in joint ventures at December 31, 2017	\$76,982
Investment in joint ventures	355
Earnings from joint ventures, net of tax	5,709
Distributions	(900 )
Investment in joint ventures at September 30, 2018	\$82,146

The Company has recorded in its Consolidated Balance Sheet a \$13,200 guarantee liability in Maintenance payments and a \$5,100 guarantee liability in Security deposits representing its share of the respective exposures.

**Note 6. Variable Interest Entities**

Aircastle consolidates four 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 six aircraft discussed below.

*ECA Financings*

Aircastle, through various subsidiaries, each of which is owned by a charitable trust (such entities, collectively the "Air Knight VIEs"), has entered into six different twelve-year term loans, which are supported by guarantees from Compagnie



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Française d'Assurance pour le Commerce Extérieur, (“COFACE”), the French government sponsored export credit agency (“ECA”). We refer to these COFACE-supported financings as “ECA Financings.”

Aircastle is the primary beneficiary of the Air Knight VIEs, as we have the power to direct the activities of the VIEs that most significantly impact the economic performance of such VIEs and we bear the significant risk of loss and participate in gains through a finance lease. The activity that most significantly impacts the economic performance is the leasing of aircraft of which our wholly owned subsidiary is the servicer and is responsible for managing the relevant aircraft. There is a cross collateralization guarantee between the Air Knight VIEs. In addition, Aircastle guarantees the debt of the Air Knight VIEs.

The only assets that the Air Knight VIEs have on their books are financing leases that are eliminated in the consolidated financial statements. The related aircraft, with a net book value as of September 30, 2018 of \$399,301, were included in our flight equipment held for lease. The consolidated debt outstanding, net of debt issuance costs, of the Air Knight VIEs as of September 30, 2018 is \$194,687.

**Note 7. Secured and Unsecured Debt Financings**

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

	At September 30, 2018				At December 31, 2017
<u>Debt Obligation</u>	Outstanding Borrowings	Number of Aircraft	Interest Rate	Final Stated Maturity	Outstanding Borrowings
<b>Secured Debt Financings:</b>					
ECA Financings <sup>(1)</sup>	\$ 198,809	6	3.02% to 3.96%	12/03/21 to 11/30/24	\$ 227,491
Bank Financings <sup>(2)</sup>	528,317	21	2.22% to 5.03%	12/12/18 to 01/19/26	634,898
Less: Debt issuance costs and discounts	(9,821 )	—			(12,515 )
Total secured debt financings, net of debt issuance costs and discounts	717,305	27			849,874
<b>Unsecured Debt Financings:</b>					
Senior Notes due 2018	400,000		4.625%	12/15/18	400,000
Senior Notes due 2019	500,000		6.25%	12/01/19	500,000
Senior Notes due 2020	300,000		7.625%	04/15/20	300,000
Senior Notes due 2021	500,000		5.125%	03/15/21	500,000
Senior Notes due 2022	500,000		5.50%	02/15/22	500,000
Senior 5.00% Notes due 2023	500,000		5.00%	04/01/23	500,000
Senior 4.40% Notes due 2023	650,000		4.40%	09/25/23	—
Senior Notes due 2024	500,000		4.125%	05/01/24	500,000
Unsecured Term Loan	120,000		4.337%	04/28/19	120,000
Revolving Credit Facilities	—		—%	11/21/19 to 06/27/22	175,000
Less: Debt issuance costs and discounts	(31,432 )				(31,268 )
Total unsecured debt financings, net of debt issuance costs and discounts	3,938,568				3,463,732
Total secured and unsecured debt financings, net of debt issuance costs and discounts	\$ 4,655,873				\$ 4,313,606

(1) The borrowings under these financings at September 30, 2018 have a weighted-average rate of interest of 3.58%.

(2) The borrowings under these financings at September 30, 2018 have a weighted-average fixed rate of interest of 4.37%.



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**Unsecured Debt Financings:**

*Senior 4.40% Notes due 2023*

On September 25, 2018, Aircastle issued \$650,000 aggregate principal amount of Senior Notes due 2023 (the “Senior 4.40% Notes due 2023”) at an issue price of 99.831%. The Senior 4.40% Notes due 2023 will mature on September 25, 2023 and bear interest at the rate of 4.40% per annum, payable semi-annually on March 25 and September 25 of each year, commencing on March 25, 2019. Interest accrues on the Senior 4.40% Notes due 2023 from September 25, 2018.

Prior to August 25, 2023, we may redeem all or part of the aggregate principal amount of the Senior 4.40% Notes due 2023 at any time at a redemption price equal to the greater of (a) 100% of the principal amount of the notes redeemed, plus accrued and unpaid interest thereon to, but not including, the redemption date and (b) the sum of the present values of 100% of the principal amount of the notes redeemed and the remaining scheduled payments of interest on the notes from the redemption date through August 25, 2023 (computed using a discount rate equal to the Treasury Rate (as defined in the indenture governing the Senior 4.40% Notes due 2023) as of such redemption date plus 0.25%). In addition, on or after August 25, 2023, we may redeem all or part of the aggregate principal amount of the Senior 4.40% Notes due 2023 at a redemption price equal to 100%, plus accrued and unpaid interest thereon to, but not including, the redemption date. If the Company undergoes a change of control (as defined in the indenture governing the Senior 4.40% Notes due 2023) and, as a result of the change of control, the rating of the Senior 4.40% Notes due 2023 is downgraded to below an investment grade rating by certain rating agencies in the manner specified in the indenture governing the Senior 4.40% Notes due 2023, it must offer to repurchase the Senior 4.40% Notes due 2023 at 101% of the principal amount, plus accrued and unpaid interest to, but not including, the purchase date. The Senior 4.40% Notes due 2023 are not guaranteed by any of the Company's subsidiaries or any third-party.

The net proceeds from the issuance were used to repay amounts drawn under our existing revolving credit facility and for general corporate purposes.

*Revolving Credit Facility*

On June 27, 2018, we entered into an amendment that increased the size of one of our unsecured revolving facilities from \$675,000 to \$800,000, extended its maturity by more than two years to June 2022 and decreased the interest rate from LIBOR plus 2.25% to LIBOR plus 1.50%. At September 30, 2018, we had no amounts outstanding under our revolving credit facilities and had \$935,000 available.

As of September 30, 2018, we were in compliance with all applicable covenants in our financings.

**Note 8. Shareholders' Equity and Share-Based Payment**

During the nine months ended September 30, 2018, the Company issued 291,876 restricted common shares and issued 336,826 performance share units (“PSUs”). These awards were made under the Aircastle Limited Amended and Restated 2014 Omnibus Incentive Plan.

During the nine months ended September 30, 2018, the Company incurred share-based compensation expense of \$4,085 related to restricted common shares and \$4,167 related to PSUs, which included an adjustment related to a retirement and transition agreement entered into with the Company's Chief Commercial Officer.

As of September 30, 2018, there was \$5,974 of unrecognized compensation cost related to unvested restricted common share-based payments and \$7,599 of unrecognized compensation cost related to unvested PSU share-based payments that are expected to be recognized over a weighted-average remaining period of 1.76 years.

During the nine months ended September 30, 2018, we repurchased 1,702,811 common shares at an aggregate cost of \$34,461, including commissions. At September 30, 2018, the remaining dollar value of shares that may be repurchased under the repurchase program approved by our Board of Directors on February 9, 2016 is \$61,427.

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**Note 9. Dividends**

The following table sets forth the quarterly dividends declared by our Board of Directors for the periods covered in this report:

<u>Declaration Date</u>	<u>Dividend per Common Share</u>	<u>Aggregate Dividend Amount</u>	<u>Record Date</u>	<u>Payment Date</u>
August 3, 2018	\$ 0.28	\$ 21,870	August 31, 2018	September 14, 2018
May 1, 2018	\$ 0.28	\$ 21,908	May 31, 2018	June 15, 2018
February 9, 2018	\$ 0.28	\$ 22,085	February 28, 2018	March 15, 2018
October 31, 2017	\$ 0.28	\$ 22,039	November 30, 2017	December 15, 2017
August 4, 2017	\$ 0.26	\$ 20,464	August 31, 2017	September 15, 2017

**Note 10. 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. Our PSUs are contingently issuable shares which are included in our diluted earnings per share calculations which do not include voting or dividend rights.

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.

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
<b>Weighted-average shares:</b>				
Common shares outstanding	77,599,803	78,237,199	77,956,159	78,197,091
Restricted common shares	488,771	569,617	472,999	569,453
Total weighted-average shares	78,088,574	78,806,816	78,429,158	78,766,544

**Percentage of weighted-average shares:**

Common shares outstanding	99.37	% 99.28	% 99.40	% 99.28	%
Restricted common shares	0.63	% 0.72	% 0.60	% 0.72	%
Total percentage of weighted-average shares	100.00	% 100.00	% 100.00	% 100.00	%

**Aircastle Limited and Subsidiaries**  
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The calculations of both basic and diluted earnings per share are as follows:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
<b>Earnings per share – Basic:</b>				
Net income	\$ 36,332	\$ 57,431	\$ 144,082	\$ 92,754
Less: Distributed and undistributed earnings allocated to restricted common shares <sup>(1)</sup>	(227 )	(415 )	(869 )	(671 )
Earnings available to common shareholders – Basic	\$ 36,105	\$ 57,016	\$ 143,213	\$ 92,083
Weighted-average common shares outstanding – Basic	77,599,803	78,237,199	77,956,159	78,197,091
Earnings per common share – Basic	\$ 0.47	\$ 0.73	\$ 1.84	\$ 1.18
<b>Earnings per share – Diluted:</b>				
Net income	\$ 36,332	\$ 57,431	\$ 144,082	\$ 92,754
Less: Distributed and undistributed earnings allocated to restricted common shares <sup>(1)</sup>	(227 )	(415 )	(869 )	(671 )
Earnings available to common shareholders – Diluted	\$ 36,105	\$ 57,016	\$ 143,213	\$ 92,083
Weighted-average common shares outstanding – Basic	77,599,803	78,237,199	77,956,159	78,197,091
Effect of dilutive shares <sup>(2)</sup>	295,671	137,810	287,136	169,053
Weighted-average common shares outstanding – Diluted	77,895,474	78,375,009	78,243,295	78,366,144
Earnings per common share – Diluted	\$ 0.46	\$ 0.73	\$ 1.83	\$ 1.18

For the three months ended September 30, 2018 and 2017, distributed and undistributed earnings to restricted shares were 0.63% and 0.72%, respectively, of (1) net income. For the nine months ended September 30, 2018 and 2017, distributed and undistributed earnings to restricted shares were 0.60% and 0.72%, respectively, of net income. The amount of restricted share forfeitures for all periods presented are immaterial to the allocation of distributed and undistributed earnings.

(2) For all periods presented, dilutive shares represented contingently issuable shares.

**Note 11. Income Taxes**

Income taxes have been provided based on the tax laws and rates in countries in which our operations are conducted and income is earned. The Company received an assurance from the Bermuda Minister of Finance that it would be exempted from local income, withholding and capital gains taxes until March 2035. Consequently, the provision for income taxes relates to income earned by certain subsidiaries of the Company which are located in, or earn income in, jurisdictions that impose income taxes, primarily Ireland and the United States.

The sources of income from continuing operations before income taxes and earnings of our unconsolidated equity method investments for the three and nine months ended September 30, 2018 and 2017 were as follows:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
U.S. operations	\$ 3,033	\$ 531	\$ 4,504	\$ 2,029
Non-U.S. operations	32,489	61,799	137,393	93,457
Income from continuing operations before income taxes and earnings of unconsolidated equity method investments	\$ 35,522	\$ 62,330	\$ 141,897	\$ 95,486

Our aircraft-owning subsidiaries that are recognized as corporations for U.S. tax purposes are primarily non-U.S. corporations. These subsidiaries generally earn income from sources outside the United States and typically are not subject to U.S. federal, state or local income taxes. The aircraft owning subsidiaries resident in Ireland, Mauritius and the U.S. are subject to tax in those respective jurisdictions.

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We have a U.S. based subsidiary which provides management services to our subsidiaries and is subject to U.S. federal, state and local income taxes. We also have Ireland and Singapore based subsidiaries which provide management services to our non-U.S. subsidiaries and are subject to tax in those respective jurisdictions.

The consolidated income tax expense for the three and nine months ended September 30, 2018 and 2017 was determined based upon estimates of the Company's consolidated effective income tax rates for the years ending December 31, 2018 and 2017, respectively.

The Company's effective tax rate ("ETR") for the three and nine months ended September 30, 2018 was 3.5% and 2.5%, respectively, compared to 9.9% and 8.9%, respectively, for the three and nine months ended September 30, 2017. The first quarter of 2018 included a \$2,779 tax benefit related to the Singapore rate reduction from 10% to 8%, which was treated as a discrete item. Excluding this tax benefit, the ETR would have been 4.5% for the nine months ended September 30, 2018. The pre-tax earnings for the nine months ended September 30, 2017 included impairment charges of approximately \$80,430 in a non-taxable jurisdiction. Movements in the ETR are generally caused by changes in the proportion of the Company's pre-tax earnings in taxable and non-tax jurisdictions.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Notional U.S. federal income tax expense at the statutory rate	\$7,459	\$21,815	\$29,798	\$33,420
U.S. state and local income tax, net	188	33	291	122
Non-U.S. operations:				
Bermuda	(5,501 )	(12,260 )	(19,896 )	(10,632 )
Ireland	(100 )	(315 )	(1,228 )	(569 )
Singapore	(2 )	(1,518 )	(2,826 )	(9,107 )
Other low tax jurisdictions	(835 )	(1,450 )	(2,478 )	(4,377 )
Non-deductible expenses in the U.S.	27	(104 )	(137 )	(298 )
Other	—	(6 )	—	(23 )
Income tax provision	\$1,236	\$6,195	\$3,524	\$8,536

**Note 12. Interest, Net**

The following table shows the components of interest, net:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest on borrowings and other liabilities <sup>(1)</sup>	\$53,683	\$54,527	\$161,640	\$170,225
Amortization of deferred losses related to interest rate derivatives	288	569	883	1,725
Amortization of deferred financing fees and debt discount <sup>(2)</sup>	3,760	6,735	10,802	15,860
Interest expense	57,731	61,831	173,325	187,810
Less: Interest income	(365 )	(1,061 )	(1,355 )	(2,089 )
Less: Capitalized interest	(235 )	(134 )	(333 )	(345 )
Interest, net	\$57,131	\$60,636	\$171,637	\$185,376





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Includes a loan termination gain of \$838 related to the prepayment of debt on one aircraft during both the three and nine months ended September 30, 2018.

(1) Includes \$1,070 and \$2,058 in loan termination fees related to the prepayment of debt on one and four aircraft during the three and nine months ended September 30, 2017, respectively.

Includes \$300 in deferred financing fees written off related to the prepayment of debt on one aircraft during both the three and nine months ended September 30, 2018. Includes \$3,019 and \$4,005 in deferred financing fees written off related to the prepayment of debt on four and seven aircraft during the three and nine months ended September 30, 2017, respectively.

**Note 13. Commitments and Contingencies**

At September 30, 2018, we had commitments to acquire 43 aircraft for \$1,736,127, including 25 Embraer E-Jet E2 aircraft.

Commitments, including \$117,135 of remaining progress payments, contractual price escalations and other adjustments for these aircraft, at September 30, 2018, net of amounts already paid, are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
Remainder of 2018	\$ 683,297
2019	263,560
2020	404,023
2021	385,247
2022	—
Thereafter	—
Total	\$ 1,736,127

As of October 30, 2018, we had commitments to acquire 38 aircraft for \$1,502,577.

**Note 14. Other Assets**

The following table describes the principal components of other assets on our Consolidated Balance Sheets as of:

	<b>September 30, 2018</b>	<b>December 31, 2017</b>
Deferred income tax asset	\$ 1,124	\$ 497
Lease incentives and lease premiums, net of amortization of \$43,934 and \$41,246, respectively	85,815	74,515
Flight equipment held for sale	364	707
Aircraft purchase deposits and progress payments	36,448	23,704
Fair value of interest rate cap	7,696	3,254
Note receivable <sup>(1)</sup>	5,485	10,000
Other assets	35,786	28,533
Total other assets	\$ 172,718	\$ 141,210

(1) Related to the sale of aircraft during the year ended December 31, 2017.

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**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 Sheets as of:

	September 30, 2018	December 31, 2017
Accounts payable and accrued expenses	\$ 45,279	\$ 50,948
Deferred income tax liability	40,954	36,547
Accrued interest payable	54,399	38,129
Lease discounts, net of amortization of \$42,108 and \$36,111, respectively	8,951	14,597
Total accounts payable, accrued expenses and other liabilities	\$ 149,583	\$ 140,221

**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, 2017 filed with the Securities and Exchange Commission (the “SEC”). Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP, and, unless otherwise indicated, the other financial information contained in this report has also been prepared in accordance with U.S. 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.

All statements included or incorporated by reference in this Quarterly Report on Form 10-Q (this “report”), other than characterizations of historical fact, are forward-looking statements within the meaning of the federal securities laws, including the Private Securities Litigation Reform Act of 1995. Examples of forward-looking statements include, but are 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 our historical performance and that of our subsidiaries and on our current plans, estimates and expectations 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 such forward-looking statements which are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated as of the date of this report. These risks or uncertainties include, but are not limited to, those described from time to time in Aircastle’s filings with the SEC and previously disclosed under “Risk Factors” in Part I - Item 1A of Aircastle’s 2017 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 expressly disclaims any obligation to revise or update publicly any forward-looking statement to reflect future events or circumstances.

**WEBSITE AND ACCESS TO THE 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 — Financial Information — 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 — PFIC Information.”

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, 201 Tresser Boulevard, Suite 400, Stamford, Connecticut 06901.

The information on the Company’s Internet 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**

Aircastle acquires, leases, and sells commercial jet aircraft to airlines throughout the world. As of September 30, 2018, we owned and managed on behalf of our joint ventures 246 aircraft leased to 85 lessees located in 46 countries. Our aircraft are managed by an experienced team based in the United States, Ireland and Singapore. Our aircraft are subject to net leases whereby the lessee is generally responsible for maintaining the aircraft and paying operational, maintenance and insurance costs. In many cases we are, however, obligated to pay a specified portion of maintenance or modification costs. As of September 30, 2018, the net book value (including flight equipment held for lease and net investment in finance and sales-type leases, or “net book value”) was \$6.84 billion compared to \$6.73 billion at December 31, 2017. Our revenues and net income for the three and nine months ended September 30, 2018 were \$190.8 million and \$597.8 million, and \$36.3 million and \$144.1 million, respectively.

Growth in commercial air traffic is broadly correlated with world economic activity. In recent years, commercial air traffic growth has expanded at a rate 1.5 to 2 times that of global GDP growth. The expansion of air travel has driven an increase in the world aircraft fleet. There are approximately 21,000 commercial mainline passenger and freighter aircraft in current operation worldwide. This fleet is expected to continue expanding at three to four percent average annual rate over the next twenty years. Aircraft leasing companies own approximately 42% of the world’s commercial jet aircraft.

2018 continues to show strong growth in air traffic. According to the International Air Transport Association, during the first eight months of 2018, global passenger traffic increased 6.8% compared to the same period in 2017. Demand for air travel varies by region. Emerging market economies have generally been experiencing greater increases in air traffic, driven by rising levels of per capita income leading to an increased propensity to fly. Mature markets, such as North America and Western Europe, have been growing more slowly in tandem with their economies. Air traffic growth is also being driven by the proliferation of low cost carriers, which have stimulated demand through lower prices. The outlook for airlines operating in areas with political instability or weakening economies is more uncertain. On balance, we believe air travel will increase over time and, as a result, we expect demand for modern aircraft will continue to remain strong over the long-term.

Notwithstanding the sector’s long-term growth, the aviation market is subject to economic variability due to changes in macroeconomic variables, such as fuel price levels and foreign exchange rates. The aviation industry is also susceptible to external shocks, such as regional conflicts and terrorist events. Mitigating this risk is the portability of the assets, allowing aircraft to be redeployed to locations where there is demand.

Fuel prices and interest rates have had a substantial effect on our industry. After dropping to a low of \$36 per barrel in December 2015, the price of fuel has risen to an average of \$68 per barrel during 2018. While still below historic highs, rising fuel prices are impacting airline profitability. The prolonged low interest rate environment and the strong overall performance of the aircraft financing sector attracted significant new capital, increasing competition for new investments. Interest rates have started to rise in the U.S., with Federal Reserve guidance suggesting multiple rate hikes in the Federal Funds rate going forward.



Capital availability for aircraft has varied over time, and we consider this variability to be a basic characteristic of our business. If pursued properly, this represents an important source of investment opportunity. Strong U.S. debt capital market conditions benefit borrowers by permitting access to financing at historic lows. Commercial bank debt also continues to play a critical role for aircraft finance. Export credit agency availability, however, has been curtailed due to political issues, both in the U.S. and in Europe. While financial market conditions remain attractive, geopolitical issues may increase capital costs and limit availability going forward.

We believe capital market developments should generate attractive additional investment and trading opportunities for which we are well placed to capitalize given our access to different financing sources, our limited capital commitments and our reputation as a reliable trading partner. During 2018, we achieved an investment grade credit rating from Moody's, Standard & Poor's and Fitch. We believe being an investment grade issuer will reduce our borrowing costs and enable more reliable access to debt capital throughout the business cycle.

Our business approach is differentiated from those of other large leasing companies. Our investment strategy is to seek out the best risk-adjusted return opportunities across the commercial jet market, so the nature and volume of assets we buy will vary with market conditions. We plan to grow our business and profits over the long-term while maintaining a countercyclical orientation and a conservative, flexible capital structure. We prefer to have capital resources available to capture investment opportunities that arise in the context of changing market circumstances. As such, we limit large, long-term capital commitments and are therefore less reliant on orders for new aircraft from aircraft manufacturers as a source of new investments than many of our competitors.

Our business strategy entails the following elements:

***Pursuing a disciplined and differentiated investment strategy.*** In our view, the relative values of different aircraft change over time. We continually evaluate investments across different aircraft models, ages, lessees and acquisition sources and re-evaluate these choices as market conditions and relative investment values change. We believe our team's experience with a wide range of asset types and the financing flexibility offered through unsecured debt provides us with a competitive advantage. We view orders from equipment manufacturers to be part of our investment opportunity set, but choose to keep our long term capital commitments limited.

***Originating investments from many different sources across the globe.*** Our strategy is to seek out worthwhile investments by leveraging our team's wide range of contacts. We utilize a multi-channel approach to sourcing acquisitions and have purchased aircraft from a large number of airlines, lessors, original equipment manufacturers, lenders and other aircraft owners. Since our formation in 2004, we have acquired aircraft from 93 different sellers.

***Selling assets when attractive opportunities arise.*** We sell assets with the aim of realizing profits and reinvesting proceeds. We also use asset sales for portfolio management purposes, such as reducing lessee specific concentrations and lowering residual value exposures to certain aircraft types. Since our formation, we have sold aircraft to 64 buyers.

***Maintaining efficient access to capital from a wide set of sources and leveraging our recent investment grade credit rating.*** We believe the aircraft investment market is influenced by the business cycle. Our strategy is to increase our purchase activity when prices are low and to emphasize asset sales when prices are high. To implement this approach, we believe it is important to maintain access to a wide variety of financing sources. During 2018, we achieved our objective of improving our corporate credit ratings to an investment grade level by maintaining strong portfolio and capital structure metrics while achieving a critical size through accretive growth. We believe our improved credit rating will not only reduce our borrowing costs, but also facilitate more reliable access to both unsecured and secured debt capital throughout the business cycle.

***Leveraging our strategic relationships.*** We intend to capture the benefits provided through the extensive global contacts and relationships maintained by Marubeni, which is our biggest shareholder and one of the largest Japanese trading companies. Marubeni has enabled greater access to Japanese-based financing and helped source and develop our joint venture with the leasing arm of the Industrial Bank of Japan, Limited ("IBJL").

***Capturing the value of our efficient operating platform and strong operating track record.*** We believe our team's capabilities in the global aircraft leasing market places 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, including new direct investments as well as ventures with strategic business partners.

*Intending to pay quarterly dividends to our shareholders based on the Company's sustainable earnings levels.*  
Aircastle has paid dividends each quarter since our initial public offering in 2006. On August 3, 2018, our Board

of Directors declared a regular quarterly dividend of \$0.28 per common share, or an aggregate of \$21.9 million for the three months ended September 30, 2018, which was paid on September 14, 2018 to holders of record on August 31, 2018. These dividends may not be indicative of the amount of any future dividends. Our ability to pay quarterly dividends will depend upon many factors, including those as described in Item 1A. "Risk Factors" and elsewhere in our 2017 Annual Report on Form 10-K.

### **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, interest recognized from finance and sales-type leases and gains from aircraft sales.

Typically, our aircraft are subject to net leases whereby the lessee pays lease rentals and is generally responsible for maintaining the aircraft and paying operational, maintenance and insurance costs arising during the term of the lease. 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 creditworthiness of our lessees and the occurrence of 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.

During 2018, we have experienced a trend of increasing accounts receivable, particularly involving one of our largest customers, Avianca Brazil. Our team is an experienced asset manager and actively manages collections, potential restructurings, repossession and re-leasing of aircraft. We have ten desirable 2014-15 vintage Airbus A320-200 aircraft and one 2014 vintage A330-200 aircraft on lease with Avianca Brazil. During 2018, we have been in ongoing discussions with the airline regarding collections and as of October 30, 2018, outstanding amounts were within our



security package. For mo

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re information regarding risks associated with our lessees see Item 1A. "Risk Factors - Risks Related to Our Lessees" in our 2017 Annual Report on Form 10-K.

#### **2018 Lease Expirations and Lease Placements**

At September 30, 2018, all aircraft with leases expiring in 2018 have been placed or sold. During October 2018, one aircraft accounting for less than 1% of our net book value was returned by its lessee and is now off-lease. We are currently marketing this aircraft for lease or sale.

#### **2019-2022 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 2019-2022, representing the percentage of our net book value of flight equipment (including flight equipment held for lease and net investment in finance and sales-type leases) at September 30, 2018, specified below:

2019: 11 aircraft, representing 3%;

2020: 29 aircraft, representing 9%;

2021: 26 aircraft, representing 11%; and

2022: 28 aircraft, representing 10%.

#### **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 obtained an assurance from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act 1966 that, in the event 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 the United States and Ireland.

Our aircraft-owning subsidiaries that are recognized as corporations for U.S. tax purposes are primarily non-U.S. corporations. These subsidiaries generally earn income from sources outside the United States and typically are not subject to U.S. federal, state or local income taxes. The aircraft owning subsidiaries resident in Ireland, Mauritius and the U.S. are subject to tax in those respective jurisdictions.

We have a U.S. based subsidiary which provides management services to our subsidiaries and is subject to U.S. federal, state and local income taxes. We also have Ireland and Singapore based subsidiaries which provide management services to our non-U.S. subsidiaries and are subject to tax in those respective jurisdictions.

#### **Acquisitions and Sales**

During the first nine months of 2018, we acquired 21 aircraft for \$674.8 million. At September 30, 2018, we had commitments to acquire 43 additional aircraft for \$1.74 billion, including the acquisition of 25 new E-Jet E2 aircraft from Embraer, with delivery beginning in December 2019. Of this amount, approximately \$683.3 million represents commitments for the remainder of 2018. As of October 30, 2018, we have commitments to acquire 38 aircraft for \$1.50 billion.

During the first nine months of 2018, we sold eleven aircraft for net proceeds of \$276.2 million, which resulted in a net gain of \$28.6 million. As of October 30, 2018, we have sold one aircraft.

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The following table sets forth certain information with respect to the aircraft owned by us as of September 30, 2018:  
**AIRCATTLE AIRCRAFT INFORMATION (dollars in millions)**

	As of September 30, 2018 <sup>(1)</sup>	As of September 30, 2017 <sup>(1)</sup>	
<b><u>Owned Aircraft</u></b>			
Net Book Value of Flight Equipment	\$ 6,839	\$ 5,979	
Net Book Value of Unencumbered Flight Equipment	\$ 5,606	\$ 4,572	
Number of Aircraft	234	192	
Number of Unencumbered Aircraft	207	163	
Number of Lessees	85	71	
Number of Countries	46	38	
Weighted Average Age (years) <sup>(2)</sup>	9.6	8.7	
Weighted Average Remaining Lease Term (years) <sup>(2)</sup>	4.5	4.7	
Weighted Average Fleet Utilization during the three months ended September 30, 2018 and 2017 <sup>(3)</sup>	100.0	%	100.0 %
Weighted Average Fleet Utilization during the nine months ended September 30, 2018 and 2017 <sup>(3)</sup>	99.6	%	99.2 %
Portfolio Yield for the three months ended September 30, 2018 and 2017 <sup>(4)</sup>	11.8	%	12.3 %
Portfolio Yield for the nine months ended September 30, 2018 and 2017 <sup>(4)</sup>	11.6	%	12.3 %
<b><u>Managed Aircraft on behalf of Joint Ventures</u></b>			
Net Book Value of Flight Equipment	\$ 621	\$ 661	
Number of Aircraft	12	13	

(1) Calculated using net book value at period end.

(2) Weighted by net book value.

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

(4) Lease rental revenue, interest income and cash collections on our net investment in finance and sales-type leases for the period as a percent of the average net book value for the period; quarterly information is annualized.

Our owned aircraft portfolio as of September 30, 2018 is listed in Exhibit 99.1 to this report.

**PORTFOLIO DIVERSIFICATION**

	Owned Aircraft as of September 30, 2018			Owned Aircraft as of September 30, 2017		
	Number of Aircraft	% of Net Book Value <sup>(1)</sup>	%	Number of Aircraft	% of Net Book Value <sup>(1)</sup>	%
<b>Aircraft Type</b>						
Passenger:						
Narrow-body	203	69	%	159	60	%
Wide-body	27	27	%	28	34	%
Total Passenger	230	96	%	187	94	%
Freighter	4	4	%	5	6	%
<b>Total</b>	<b>234</b>	<b>100</b>	<b>%</b>	<b>192</b>	<b>100</b>	<b>%</b>
<b>Manufacturer</b>						
Airbus	142	57	%	108	53	%
Boeing	87	41	%	79	45	%
Embraer	5	2	%	5	2	%
<b>Total</b>	<b>234</b>	<b>100</b>	<b>%</b>	<b>192</b>	<b>100</b>	<b>%</b>
<b>Regional Diversification</b>						
Asia and Pacific	65	32	%	54	31	%
Europe	89	30	%	67	28	%
Middle East and Africa	17	9	%	13	9	%
North America	37	11	%	34	11	%
South America	26	18	%	24	21	%
<b>Total</b>	<b>234</b>	<b>100</b>	<b>%</b>	<b>192</b>	<b>100</b>	<b>%</b>

(1) Calculated using net book value at period end.

Our largest single customer represents approximately 7% of the net book value at September 30, 2018. Our top fifteen customers for aircraft we owned at September 30, 2018, representing 116 aircraft and 55% of the net book value, are as follows:

Percent of Net Book Value	Customer	Country	Number of Aircraft
Greater than 6% per customer	Avianca Brazil	Brazil	11
3% to 6% per customer	TAP Portugal <sup>(1)</sup>	Portugal	8
	LATAM	Chile	3
	Lion Air	Indonesia	10
	South African Airways	South Africa	4
	easyJet	United Kingdom	20
	Iberia	Spain	13
	IndiGo	India	8
	Aerolineas Argentinas	Argentina	5
	Interjet	Mexico	11
Less than 3% per customer	AirBridgeCargo <sup>(2)</sup>	Russia	2
	American Airlines	United States	6
	AirAsia X	Malaysia	2
	Jeju Air	South Korea	6
	Jet Airways	India	7
	Total top fifteen customers		116
	All other customers		118
	Total all customers		234

(1) Combined with an affiliate.

(2) Guaranteed by Volga-Dnepr Airlines. We have one additional aircraft on lease with an affiliate.

## Finance

We believe that cash on hand, payments received from lessees and other funds generated from operations, secured borrowings for aircraft, borrowings under our revolving credit facilities 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. 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 “Liquidity and Capital Resources” below.

**RESULTS OF OPERATIONS***Comparison of the three months ended September 30, 2018 to the three months ended September 30, 2017:*

	<b>Three Months Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>
	<b><u>(Dollars in thousands)</u></b>	
Revenues:		
Lease rental revenue	\$ 182,043	\$ 171,687
Finance and sales-type lease revenue	8,793	6,412
Amortization of lease premiums, discounts and incentives	(4,044 )	(2,388 )
Maintenance revenue	—	14,507
Total lease revenue	186,792	190,218
Gain on sale of flight equipment	2,954	21,642
Other revenue	1,083	1,193
Total revenues	190,829	213,053
Operating expenses:		
Depreciation	78,059	70,018
Interest, net	57,131	60,636
Selling, general and administrative	18,306	17,137
Maintenance and other costs	2,179	2,572
Total operating expenses	155,675	150,363
Total other income (expense)	368	(360 )
Income from continuing operations before income taxes and earnings of unconsolidated equity method investments	35,522	62,330
Income tax provision	1,236	6,195
Earnings of unconsolidated equity method investments, net of tax	2,046	1,296
Net income	\$ 36,332	\$ 57,431

**Revenues**

*Total revenues* decreased by \$22.2 million for the three months ended September 30, 2018 as compared to the three months ended September 30, 2017.

*Lease rental revenue.* The increase in lease rental revenue of \$10.4 million for the three months ended September 30, 2018, as compared to the same period in 2017, was primarily the result of a \$39.7 million increase in revenue, reflecting the partial period impact of twenty aircraft purchased in 2018 and the full period impact due to the acquisition of 40 aircraft since July 1, 2017. This increase was partially offset by:

- \$16.9 million decrease due to the sale of 29 aircraft since September 30, 2017; and
- \$12.4 million decrease due to lease extensions, amendments, transitions and other changes.

*Finance and sales-type lease revenue.* For the three months ended September 30, 2018, \$8.8 million of interest income from finance and sales-type leases was recognized, as compared to \$6.4 million of interest income from finance and sales-type leases recorded for the same period in 2017, due to the addition of fourteen aircraft, partially offset by the sale of five aircraft, since July 1, 2017.

*Amortization of net lease premiums, discounts and lease incentives* consisted of the following:

	<b>Three Months Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>
	<b><u>(Dollars in thousands)</u></b>	
Amortization of lease incentives	\$(2,910)	\$(1,810)
Amortization of lease premiums	(3,137 )	(2,266 )
Amortization of lease discounts	2,003	1,688

Amortization of lease premiums, discounts and incentives \$ (4,044) \$ (2,388)

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 are 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 \$1.1 million for the three months ended September 30, 2018, as compared to the same period in 2017, was primarily attributable to the transition of aircraft and changes in estimates of existing lease incentives for certain aircraft.

*Maintenance revenue.* For the three months ended September 30, 2018, we recorded no maintenance revenue. For the same period in 2017, we recorded \$14.5 million of maintenance revenue due to the transition of one narrow-body and one wide-body aircraft.

*Gain on sale of flight equipment* decreased by \$18.7 million to \$3.0 million for the three months ended September 30, 2018, as compared to gains of \$21.6 million for the same period in 2017. During the third quarter of 2018, we sold three aircraft as compared to fifteen aircraft sold during the third quarter of 2017.

#### ***Operating expenses***

*Total operating expenses* increased by \$5.3 million for the three months ended September 30, 2018, as compared to the three months ended September 30, 2017.

*Depreciation expense* increased by \$8.0 million for the three months ended September 30, 2018 as compared to the same period in 2017. The increase is primarily the result of higher depreciation of:

\$15.7 million due to the effect of 60 aircraft acquired since July 1, 2017; and

\$0.6 million due to changes in asset lives, residual values and other changes.

These increases were partially offset by a decrease of \$8.4 million in depreciation due to 29 aircraft sold.

*Interest, net* consisted of the following:

	<b>Three Months Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>
	<b><u>(Dollars in thousands)</u></b>	
Interest on borrowings and other liabilities <sup>(1)</sup>	\$53,683	\$54,527
Amortization of deferred losses related to interest rate derivatives	288	569
Amortization of deferred financing fees and debt discount <sup>(2)</sup>	3,760	6,735
Interest expense	57,731	61,831
Less: Interest income	(365 )	(1,061 )
Less: Capitalized interest	(235 )	(134 )
Interest, net	\$57,131	\$60,636

(1) Includes a loan termination gain of \$0.8 million related to the prepayment of debt on one aircraft during the three months ended September 30, 2018. Includes \$1.1 million in loan termination fees related to the prepayment of debt on one aircraft during the three months ended September 30, 2017.



(2) Includes \$0.3 million in deferred financing fees written off related to the prepayment of debt on one aircraft during the three months ended September 30, 2018. Includes \$3.0 million in deferred financing fees written off related to the prepayment of debt on four aircraft during the three months ended September 30, 2017.

Interest, net decreased by \$3.5 million as compared to the three months ended September 30, 2017. This decrease was primarily the result of lower amortization of deferred financing fees of \$3.0 million as the result of aircraft sales in the prior year.

***Other income (expense)***

*Total other income (expense)* increased by \$0.7 million for the three months ended September 30, 2018 as compared to the three months ended September 30, 2017, primarily attributable to mark-to-market on our interest rate caps.

***Income tax provision***

Our *provision for income taxes* for the three months ended September 30, 2018 and 2017 was \$1.2 million and \$6.2 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 \$5.0 million for the three months ended September 30, 2018, as compared to the same period in 2017, was primarily attributable to changes in operating income subject to tax in Ireland, the United States and other jurisdictions.

Our aircraft-owning subsidiaries that are recognized as corporations for U.S. tax purposes are primarily non-U.S. corporations. These subsidiaries generally earn income from sources outside the United States and typically are not subject to U.S. federal, state or local income taxes. The aircraft owning subsidiaries resident in Ireland, Mauritius and the U.S. are subject to tax in those respective jurisdictions.

We have a U.S. based subsidiary which provides management services to our subsidiaries and is subject to U.S. federal, state and local income taxes. We also have Ireland and Singapore based subsidiaries which provide management services to our non-U.S. subsidiaries and are subject to tax in those respective jurisdictions.

The 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***

*Other comprehensive income* consisted of the following:

	<b>Three Months Ended September 30, 2018      2017</b>	
	<b><u>(Dollars in thousands)</u></b>	
Net income	\$36,332	\$57,431
Derivative loss reclassified into earnings	288	569
Total comprehensive income	\$36,620	\$58,000

*Other comprehensive income* decreased by \$21.4 million for the three months ended September 30, 2018, due to decreases of \$21.1 million in net income and \$0.3 million in 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, 2018 to the nine months ended September 30, 2017:*

	<b>Nine Months Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>
	<b>(Dollars in thousands)</b>	
Revenues:		
Lease rental revenue	\$ 538,012	\$ 551,371
Finance and sales-type lease revenue	27,103	16,363
Amortization of lease premiums, discounts and incentives	(10,706 )	(8,780 )
Maintenance revenue	11,991	55,738
Total lease revenue	566,400	614,692
Gain on sale of flight equipment	28,586	35,926
Other revenue	2,799	4,526
Total revenues	597,785	655,144
Operating expenses:		
Depreciation	229,242	227,446
Interest, net	171,637	185,376
Selling, general and administrative	54,724	55,491
Impairment of flight equipment	—	80,430
Maintenance and other costs	4,728	7,846
Total operating expenses	460,331	556,589
Total other income (expense)	4,443	(3,069 )
Income from continuing operations before income taxes and earnings of unconsolidated equity method investments	141,897	95,486
Income tax provision	3,524	8,536
Earnings of unconsolidated equity method investments, net of tax	5,709	5,804
Net income	\$ 144,082	\$ 92,754

**Revenues**

*Total revenues* decreased by \$57.4 million for the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017.

*Lease rental revenue.* The decrease in lease rental revenue of \$13.4 million for the nine months ended September 30, 2018 as compared to the same period in 2017 was primarily the result of decreases in revenue of:

\$78.9 million due to the sale of 42 aircraft since September 30, 2017; and

\$40.9 million due to lease extensions, amendments, transitions and other changes.

These decreases were offset by a \$106.5 million increase in revenue, reflecting the partial period impact of twenty aircraft purchased in 2018 and the full period impact due to the acquisition of 47 aircraft since January 1, 2017.

*Finance and sales-type lease revenue.* For the nine months ended September 30, 2018, \$27.1 million of interest income from finance and sales-type leases was recognized as compared to \$16.4 million for the same period in 2017 due to the addition of 22 aircraft, partially offset by the sale of six aircraft, since January 1, 2017.

*Amortization of net lease premiums, discounts and lease incentives* consisted of the following:

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
	<b><u>(Dollars in thousands)</u></b>	
Amortization of lease incentives	\$(8,516 )	\$(7,124)
Amortization of lease premiums	(8,188 )	(7,935 )
Amortization of lease discounts	5,998	6,279

Amortization of lease premiums, discounts and incentives \$(10,706) \$(8,780)

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 \$1.4 million for the nine months ended September 30, 2018, as compared to the same period in 2017, was primarily attributable to the transition of aircraft and changes in estimates of existing lease incentives for certain aircraft, partially offset by aircraft sales.

*Maintenance revenue.* For the nine months ended September 30, 2018, we recorded \$12.0 million of maintenance revenue, primarily due to the transition of one freighter aircraft. For the same period in 2017, we recorded \$55.7 million of maintenance revenue primarily due to the transition of four narrow-body, four wide-body and one freighter aircraft.

*Gain on sale of flight equipment* decreased by \$7.3 million to \$28.6 million for the nine months ended September 30, 2018, as compared to gains of \$35.9 million for the same period in 2017. During the nine months ended September 30, 2018, we sold eleven aircraft as compared to the sale of 29 aircraft during the same period in 2017.

#### ***Operating expenses***

*Total operating expenses* decreased by \$96.3 million for the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017.

*Depreciation expense* increased by \$1.8 million for the nine months ended September 30, 2018 as compared to the same period in 2017. The increase is primarily the result of higher depreciation of:

\$42.1 million due to the effect of 67 aircraft acquired since January 1, 2017; and

\$2.9 million due to changes in asset lives, residual values and other changes.

These increases were partially offset by a decrease of \$43.6 million in depreciation due to 42 aircraft sold.

*Interest, net* consisted of the following:

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
	<b><u>(Dollars in thousands)</u></b>	
Interest on borrowings and other liabilities <sup>(1)</sup>	\$161,640	\$170,225
Amortization of deferred losses related to interest rate derivatives	883	1,725
Amortization of deferred financing fees and debt discount <sup>(2)</sup>	10,802	15,860
Interest expense	173,325	187,810
Less: Interest income	(1,355 )	(2,089 )
Less: Capitalized interest	(333 )	(345 )
Interest, net	\$171,637	\$185,376

(1) Includes a loan termination gain of \$0.8 million related to the prepayment of debt on one aircraft during the nine months ended September 30, 2018. Includes \$2.1 million in loan termination fees related to the prepayment of debt on four aircraft during the nine months ended September 30, 2017.

(2) Includes \$0.3 million in deferred financing fees written off related to the prepayment of debt on one aircraft during the nine months ended September 30, 2018. Includes \$4.0 million in deferred financing fees written off related to the prepayment of debt on seven aircraft during the nine months ended September 30, 2017.

Interest, net decreased by \$13.7 million as compared to the nine months ended September 30, 2017. This decrease was primarily the result of lower interest on our borrowings of \$8.6 million due to lower weighted average debt outstanding and lower amortization of deferred financing fees of \$5.1 million as the result of aircraft sales in the prior year.

*Selling, general and administrative expenses* for the nine months ended September 30, 2018 decreased \$0.8 million compared to the same period in 2017. During the nine months ended September 30, 2017, we had \$5.1 million of separation and disability compensation expense related to our former Chief Executive Officer under the terms of his employment and share-based award agreements. This decrease was partially offset by an increase in recurring personnel costs during the nine months ended September 30, 2018.

*Impairment of Aircraft* for the nine months ended September 30, 2018 decreased \$80.4 million compared to the same period in 2017. We had no impairments during the nine months ended September 30, 2018. During the nine months ended September 30, 2017, we entered into agreements to sell two Boeing 747-400 production freighter aircraft at the end of their respective leases and one older Boeing 747-400 converted freighter aircraft to its lessee, resulting in impairment charges totaling \$79.2 million.

*Maintenance and other costs* were \$4.7 million for the nine months ended September 30, 2018, a decrease of \$3.1 million compared to the same period in 2017. The net decrease is primarily attributable to lower maintenance costs related to terminations and transitions for the nine months ended September 30, 2018 versus the same period in 2017.

***Other income (expense)***

*Total other income (expense)* increased by \$7.5 million for the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017, primarily attributable to mark-to-market on our interest rate caps.

***Income tax provision***

Our *income tax provision* for the nine months ended September 30, 2018 and 2017 was \$3.5 million and \$8.5 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 \$5.0 million for the nine months ended September 30, 2018, as compared to the same period in 2017, was primarily attributable to changes in operating income subject to tax in Ireland, the United States and other jurisdictions, including the recording of the discrete item of \$2.8 million tax benefit related to the Singapore rate reduction from 10% to 8%. Pre-tax earnings for the nine months ended September 30, 2017 included transactional impairment charges of approximately \$80.4 million in a non-taxable jurisdiction.

Our aircraft-owning subsidiaries that are recognized as corporations for U.S. tax purposes are primarily non-U.S. corporations. These subsidiaries generally earn income from sources outside the United States and typically are not subject to U.S. federal, state or local income taxes. The aircraft owning subsidiaries resident in Ireland, Mauritius and the U.S. are subject to tax in those respective jurisdictions.

We have a U.S. based subsidiary which provides management services to our subsidiaries and is subject to U.S. federal, state and local income taxes. We also have Ireland and Singapore based subsidiaries which provide management services to our non-U.S. subsidiaries and are subject to tax in those respective jurisdictions.

The 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***

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
	<b><u>(Dollars in</u></b>	
	<b><u>thousands)</u></b>	
Net income	\$ 144,082	\$ 92,754
Derivative loss reclassified into earnings	883	1,725
Total comprehensive income	\$ 144,965	\$ 94,479

*Other comprehensive income* increased by \$50.5 million for the nine months ended September 30, 2018, as a result of a \$51.3 million increase in net income, partially offset by a decrease of \$0.8 million in amortization of deferred net losses reclassified into earnings related to terminated interest rate derivatives.

***Summary of Recoverability Assessment******Annual Recoverability Assessment***

We completed our annual recoverability assessment of our aircraft in the second quarter this year. We also performed aircraft-specific analyses where there were changes in circumstances, such as approaching lease expirations. No impairments were recorded as a result of our annual recoverability assessment.

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

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 aircraft were impaired as a consequence of our annual recoverability assessment. However, if our estimates or assumptions change, we may revise our cash flow assumptions and record future impairment charges. While we believe that the estimates and related assumptions used in the annual recoverability assessment are appropriate, actual results could differ from those estimates.

***Aircraft Monitoring List***

At September 30, 2018, no aircraft were on our monitoring list. We monitor our fleet for aircraft that are more susceptible to failing our recoverability assessments within one year due to their sensitivity to changes in contractual cash flows, future cash flow estimates and aircraft residual or scrap values.

**RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS**

See Note 1 - "Summary of Significant Accounting Policies – Organization and Basis of Presentation" in the Notes to Unaudited Consolidated Financial Statements above.

**RECENTLY UNADOPTED ACCOUNTING PRONOUNCEMENTS**

See Note 1 - "Summary of Significant Accounting Policies – Recent Accounting Pronouncements" in the Notes to Unaudited Consolidated Financial Statements above.

**LIQUIDITY AND CAPITAL RESOURCES**

Our business is very capital intensive, requiring significant investments in order to expand our fleet and to maintain and improve our existing portfolio. Our operations generate a significant amount of cash, primarily from lease rentals and maintenance collections. We have also met our liquidity and capital resource needs by utilizing several sources over time, including:

- unsecured indebtedness, including our current unsecured revolving credit facilities, term loan and senior notes;
- various forms of borrowing secured by our aircraft, including bank term facilities, limited recourse securitization financings, and ECA-backed financings for new aircraft acquisitions;
- asset sales; and
- sales of common shares.

Going forward, we expect to continue to seek liquidity from these sources and other sources, subject to pricing and conditions we consider satisfactory.

During the first nine months of 2018, we met our liquidity and capital resource needs with \$393.3 million of cash flow from operations, \$650.0 million in gross proceeds from the issuance of our Senior 4.40% Notes due 2023 and \$276.2 million of cash from aircraft sales.

As of September 30, 2018, the weighted-average maturity of our secured and unsecured debt financings was 3.2 years and we were in compliance with all applicable covenants.

We believe that cash on hand, payments received from lessees and other funds generated from operations, secured borrowings for aircraft, borrowings under our revolving credit facilities 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**

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
	<b>(Dollars in thousands)</b>	
Net cash flow provided by operating activities	\$393,297	\$393,458
Net cash flow (used in) provided by investing activities	(348,659 )	173,821
Net cash flow provided by (used in) financing activities	331,702	(392,911 )

*Operating Activities:*

Cash flow provided by operations was \$393.3 million and \$393.5 million for the nine months ended September 30, 2018 and 2017, respectively. The decrease in cash flow provided by operations of \$0.2 million for the nine months ended September 30, 2018 versus the same period in 2017 was primarily a result of:

- a \$28.5 million decrease in cash received from maintenance revenue; and
- a \$15.6 million decrease in cash from working capital.

These inflows were offset by:

- a \$26.6 million increase in cash from lease rentals, net of finance and sales-type leases;
- an \$11.6 million decrease in cash paid for interest; and
- a \$3.1 million decrease in cash paid for maintenance expense.

*Investing Activities:*

Cash flow used in investing activities was \$348.7 million for the nine months ended September 30, 2018 as compared to cash flow provided by investing activities of \$173.8 million for the nine months ended September 30, 2017. The net increase in cash flow used in investing activities of \$522.5 million for the nine months ended September 30, 2018 versus the same period in 2017 was primarily a result of:

- a \$488.8 million decrease in aircraft proceeds from the sale of flight equipment; and
- a \$42.0 million net increase in the acquisition and improvement of flight equipment and net investments in finance and sales-type leases.

*Financing Activities:*

Cash flow provided by financing activities was \$331.7 million for the nine months ended September 30, 2018 as compared to cash flow used in financing activities of \$392.9 million for the nine months ended September 30, 2017. The net increase in cash flow provided by financing activities of \$724.6 million for the nine months ended September 30, 2018 versus the same period in 2017 was primarily a result of:

- a \$373.9 million increase in proceeds from secured and unsecured financings;
- a \$316.6 million decrease in securitization and term debt financing repayments;
- a \$68.7 million decrease in maintenance payments and security deposits returned, net of receipts; and
- a \$1.9 million decrease in deferred financing costs.

These inflows were offset by:

- a \$32.1 million increase in shares repurchased; and
- a \$4.5 million increase in dividends paid.

## Debt Obligations

For complete information on our debt obligations, please refer to Note 7 - “Secured and Unsecured Debt Financings” in the Notes to Unaudited Consolidated Financial Statements above.

## Contractual Obligations

Our contractual obligations consist of principal and interest payments on debt, other aircraft acquisition agreements and rent payments related to our office leases. Total contractual obligations increased to \$7.24 billion at September 30, 2018 from \$6.61 billion at December 31, 2017, due primarily to an increase in aircraft purchase obligations, partially offset by debt amortization.

The following table presents our actual contractual obligations and their payment due dates as of September 30, 2018:

<u>Contractual Obligations</u>	<b>Payments Due by Period as of September 30, 2018</b>				
	<b>Total</b>	<b>1 year or less</b>	<b>2-3 years</b>	<b>4-5 years</b>	<b>More than 5 years</b>
	<b>(Dollars in thousands)</b>				
Principal payments:					
Senior Notes due 2018 - 2024	\$ 3,850,000	\$ 400,000	\$ 1,300,000	\$ 1,650,000	\$ 500,000
Unsecured Term Loan	120,000	120,000	—	—	—
Revolving Credit Facilities	—	—	—	—	—
ECA Financings	198,809	39,449	83,231	66,105	10,024
Bank Financings	528,317	68,590	95,793	267,506	96,428
Total principal payments	4,697,126	628,039	1,479,024	1,983,611	606,452
Interest payments on debt obligations <sup>(1)</sup>	786,886	234,923	331,000	193,384	27,579
Office leases <sup>(2)</sup>	17,661	2,583	3,428	3,361	8,289
Purchase obligations <sup>(3)</sup>	1,736,127	878,830	857,297	—	—
<b>Total</b>	<b>\$ 7,237,800</b>	<b>\$ 1,744,375</b>	<b>\$ 2,670,749</b>	<b>\$ 2,180,356</b>	<b>\$ 642,320</b>

(1) Future interest payments on variable rate, LIBOR-based debt obligations are estimated using the interest rate in effect at September 30, 2018.

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

At September 30, 2018, we had commitments to acquire 43 aircraft for \$1.74 billion, including 25 new E-Jet E2 aircraft from Embraer S.A. These amounts include estimates for pre-delivery deposits, contractual price escalation and other adjustments. As of October 30, 2018, we have commitments to acquire 38 aircraft for \$1.50 billion.

## Capital Expenditures

From time to time, we make capital expenditures to maintain or improve 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, 2018 and 2017, we incurred a total of \$7.7 million and \$24.4 million, respectively, of capital expenditures (including lease incentives) related to the improvement of aircraft.

As of September 30, 2018, the weighted average age by net book value of our aircraft was approximately 9.6 years. In general, the costs of operating an aircraft, including maintenance expenditures, increase with the age of the aircraft. Our lease agreements call for the lessee to be 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. 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. See Item 1A. “Risk Factors - Risks Related to Our Business - Risks related to our leases - If lessees are unable to fund their maintenance obligations on our aircraft, we may incur increased costs at the conclusion of the applicable lease” in our 2017 Annual Report on Form 10-K.

#### **Off-Balance Sheet Arrangements**

We entered into two joint venture arrangements in order to help expand our base of new business opportunities. None of these joint ventures qualifies for consolidated accounting treatment. The assets and liabilities of these entities are not included in our Consolidated Balance Sheets and we record our net investment under the equity method of accounting. See Note 5 - “Unconsolidated Equity Method Investments” in the Notes to Unaudited Consolidated Financial Statements above.

We hold a 30% equity interest in our Lancaster joint venture and a 25% equity interest in our IBJ Air joint venture. At September 30, 2018, the net book value of our two joint ventures’ twelve aircraft was approximately \$621 million.

#### **Foreign Currency Risk and Foreign Operations**

At September 30, 2018, 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, 2018, expenses, such as payroll and office costs, denominated in currencies other than the U.S. dollar aggregated approximately \$11.7 million in U.S. dollar equivalents and represented approximately 21% 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, our international operations and our exposure to foreign currency risk will likely 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, 2018 and 2017, we incurred insignificant net gains and losses on foreign currency transactions.

#### **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-U.S. 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 to EBITDA and Adjusted EBITDA for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	<u>(Dollars in thousands)</u>			
Net income	\$36,332	\$57,431	\$144,082	\$92,754
Depreciation	78,059	70,018	229,242	227,446
Amortization of lease premiums, discounts and incentives	4,044	2,388	10,706	8,780
Interest, net	57,131	60,636	171,637	185,376
Income tax provision	1,236	6,195	3,524	8,536
EBITDA	176,802	196,668	559,191	522,892
Adjustments:				
Impairment of flight equipment	—	—	—	80,430
Non-cash share-based payment expense	2,798	2,506	8,252	10,636
(Gain) loss on mark-to-market of interest rate derivative contracts	(367 )	361	(4,442 )	3,073
Adjusted EBITDA	\$179,233	\$199,535	\$563,001	\$617,031

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

Management believes that ANI, when viewed in conjunction with the Company's results under U.S. GAAP and the below reconciliation, provides useful information about operating and period-over-period performance and 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, changes related to refinancing activity and non-cash share-based payment expense.

The table below shows the reconciliation of net income to ANI for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	<u>(Dollars in thousands)</u>			
Net income	\$36,332	\$57,431	\$144,082	\$92,754
Loan termination (gain) fee <sup>(1)</sup>	(838 )	1,070	(838 )	2,058
(Gain) loss on mark-to-market of interest rate derivative contracts <sup>(2)</sup>	(367 )	361	(4,442 )	3,073
Write-off of deferred financing fees <sup>(1)</sup>	300	3,019	300	4,005
Non-cash share-based payment expense <sup>(3)</sup>	2,798	2,506	8,252	10,636
Adjusted net income	\$38,225	\$64,387	\$147,354	\$112,526

(1) Included in Interest, net.

(2) Included in Other income (expense).

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
<b>Weighted-average shares:</b>				
Common shares outstanding	77,599,803	78,237,199	77,956,159	78,197,091
Restricted common shares	488,771	569,617	472,999	569,453
Total weighted-average shares	78,088,574	78,806,816	78,429,158	78,766,544

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
<b><u>Percentage of weighted-average shares:</u></b>				
Common shares outstanding	99.37 %	99.28 %	99.40 %	99.28 %
Restricted common shares <sup>(1)</sup>	0.63 %	0.72 %	0.60 %	0.72 %
Total percentage of weighted-average shares	100.00 %	100.00 %	100.00 %	100.00 %
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Weighted-average common shares outstanding – Basic	77,599,803	78,237,199	77,956,159	78,197,091
Effect of dilutive shares <sup>(2)</sup>	295,671	137,810	287,136	169,053
Weighted average common shares outstanding – Diluted	77,895,474	78,375,009	78,243,295	78,366,144
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	<b><u>(Dollars in thousands, except per share amounts)</u></b>			
<b><u>Adjusted net income allocation:</u></b>				
Adjusted net income	\$38,225	\$64,387	\$147,354	\$112,526
Less: Distributed and undistributed earnings allocated to restricted common shares <sup>(2)</sup>	(239 )	(465 )	(889 )	(814 )
Adjusted net income allocable to common shares – Basic and Diluted	\$37,986	\$63,922	\$146,465	\$111,712
Adjusted net income per common share – Basic	\$0.49	\$0.82	\$1.88	\$1.43
Adjusted net income per common share – Diluted	\$0.49	\$0.82	\$1.87	\$1.43

For the three months ended September 30, 2018 and 2017, distributed and undistributed earnings to restricted shares were 0.63% and 0.72%, respectively, of (1) net income. For the nine months ended September 30, 2018 and 2017, distributed and undistributed earnings to restricted shares were 0.60% and 0.72%, respectively, of net income. The amount of restricted share forfeitures for all periods presented is immaterial to the allocation of distributed and undistributed earnings.

(2) For all periods presented, dilutive shares represent contingently issuable 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-U.S. GAAP measures to supplement our U.S. 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 U.S. GAAP measures of earnings (loss). Material limitations in making the adjustments to our earnings (loss) to calculate EBITDA, Adjusted EBITDA and ANI, and using these non-U.S. GAAP measures as compared to U.S. GAAP net income (loss), income (loss) 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; 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 (loss), income (loss) from operations or cash flows provided by or used in operations as calculated and presented in accordance with U.S. GAAP. You should not rely on these non-U.S. GAAP measures as a substitute for any such U.S. GAAP financial measure. We strongly urge you to review the reconciliations to U.S. GAAP net income (loss), 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 U.S. 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 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. A hypothetical 100-basis point increase/decrease in our variable interest rates would increase/decrease the minimum contracted rentals on our portfolio as of September 30, 2018 by \$3.7 million and \$3.7 million, respectively, over the next twelve months. As of September 30, 2018, a hypothetical 100-basis point increase/decrease in our variable interest rate on our borrowings would result in an interest expense increase/decrease of \$2.6 million and \$4.2 million, respectively, net of amounts received from our interest rate derivatives, over the next twelve months. In September 2016, we purchased an interest rate cap to hedge a portion of our floating rate interest exposure. The interest rate cap is set at 2% and has a current notional balance of \$380.0 million and reduces over time to \$215.0 million. The cap matures in September 2021.

#### **ITEM 4. CONTROLS AND PROCEDURES**

##### **Management's Evaluation of Disclosure Controls and Procedures**

The term "disclosure controls and procedures" is defined in Exchange Act Rules 13a-15(e) and 15d-15(e). 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, 2018. 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, 2018.

##### **Changes in Internal Control over Financial Reporting**

There were no changes in the Company's internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f), that occurred during the quarter ended September 30, 2018 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, 2017.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****Issuer Purchases of Equity Securities**

In February 2016, our Board of Directors authorized the repurchase of \$100.0 million of the Company's common shares. During the third quarter of 2018, we purchased our common shares as follows:

<u>Period</u>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs<sup>(1)</sup></b>	<b>Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(1)</sup></b>
(Dollars in thousands, except per share amounts)				
July 1 through July 31	58,030	\$ 20.23	58,030	\$ 82,222
August 1 through August 31	75,828	20.96	75,828	80,632
September 1 through September 30	930,317	20.64	930,317	61,427
Total	1,064,175	\$ 20.64	1,064,175	\$ 61,427

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We repurchased an additional 952,488 common shares at a total cost of \$19.2 million, including commissions, during October 2018. Under our current (1) repurchase program, we have repurchased an aggregate of 2,872,873 common shares at an aggregate cost of \$57.8 million, including commissions. The remaining dollar value of common shares that may be repurchased under the program is \$42.2 million.

**ITEM 3.DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4.MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5.OTHER INFORMATION**

None.



**ITEM 6. EXHIBITS**

Exhibit No.	<u>Description of Exhibit</u>
3.1	<u>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).</u>
3.2	<u>Amended Bye-laws, dated May 18, 2018. *</u>
4.1	<u>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).</u>
4.2	<u>Indenture, dated as of April 4, 2012, by and between 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 on April 5, 2012).</u>
4.3	<u>Indenture, dated as of November 30, 2012, by and between 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).</u>
4.4	<u>Amended and Restated Shareholder Agreement, dated as of February 18, 2015, by and between Aircastle Limited and Marubeni Corporation (incorporated by reference to Exhibit 4.8 to the Company's Quarterly Report on Form 10-Q filed on May 6, 2015).</u>
4.5	<u>Amendment No. 1 to the Amended and Restated Shareholder Agreement, dated as of September 23, 2016, by and among Aircastle Limited, Marubeni Corporation, and Marubeni Aviation Holding Coöperatief U.A. (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on September 26, 2016).</u>
4.6	<u>Indenture, dated as of December 5, 2013, by and between Aircastle Limited and Wells Fargo Bank, National Association, as trustee Citigroup Global Markets, Inc., Goldman, Sachs &amp; Co., J.P. Morgan Securities LLC and RBC Capital Markets, LLC (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on December 6, 2013).</u>
4.7	<u>First Supplemental Indenture, dated as of December 5, 2013, by and between Aircastle Limited and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on December 6, 2013).</u>
4.8	<u>Second Supplemental Indenture, dated as of March 26, 2014, by and between 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 on March 26, 2014).</u>
4.9	<u>Third Supplemental Indenture, dated as of January 15, 2015, by and between 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 on January 15, 2015).</u>
4.10	<u>Fourth Supplemental Indenture, dated as of March 24, 2016, by and between 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 on March 24, 2016).</u>

- 4.11 Fifth Supplemental Indenture, dated as of March 20, 2017, by and between 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 on March 20, 2017).
- 4.12 Sixth Supplemental Indenture, dated as of September 25, 2018, between 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 on September 25, 2018).
- 10.1 Amendment No. 6 to Purchase Agreement COM0270-15, dated as of June 29, 2018, by and between Aircastle Holding Corporation and Embrarer S.A. \*Ø
- 10.2 Retirement and Transition Agreement, dated September 17, 2018, for Michael L. Kriedberg (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 19, 2018).
- 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, 2018. \*

**Exhibit No.**

**Description of Exhibit**

101 The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017; (ii) Consolidated Statements of Income for the three and nine months ended September 30, 2018 and 2017; (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2018 and 2017; (iv) Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017; and (v) Notes to Unaudited Consolidated Financial Statements. \*

\* Filed herewith.

Ø Portions of this exhibit have been omitted pursuant to a request for confidential treatment.

**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: November 1, 2018

**AIRCASTLE LIMITED**

(Registrant)

By: /s/ James C. Connelly

James C. Connelly

Chief Accounting Officer and Authorized Officer