

Babcock & Brown Air LTD
Form 20-F
March 10, 2009

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 20-F**

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) or (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

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

For the fiscal year ended December 31, 2008

OR

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

OR

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

Commission file number 001-33701

BABCOCK & BROWN AIR LIMITED

(Exact name of Registrant as specified in its charter)

Bermuda

(Jurisdiction of incorporation or organization)

West Pier

Dun Laoghaire

County Dublin, Ireland

(Address of principal executive office)

Mina Kim, Telephone number: +353 1 231 1900, Facsimile number: +353 1 231 1901

(Name, Telephone, Email and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class

Name of each exchange on which registered

American Depositary Shares
Common Shares, par value of \$0.001 per share

New York Stock Exchange
New York Stock Exchange*

* Not for trading,
but only in
connection with
the registration
of American
Depositary
Shares
representing

these shares,
pursuant to the
requirements of
the Securities
and Exchange
Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

32,488,911 Common Shares, par value of \$0.001 per share.

100 Manager Shares, par value of \$0.001 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

If this report is an annual or transition report, indicate by check mark, if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes No

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP

International Financial Reporting Standards as issued
by the International Accounting Standards Board

Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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PRELIMINARY NOTE

This Annual Report should be read in conjunction with the consolidated financial statements and accompanying notes included in this report.

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP) and are presented in U.S. Dollars. These statements and discussion below contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, objectives, expectations and intentions and other statements contained in this Annual Report that are not historical facts, as well as statements identified by words such as expects, anticipates, intends, plans, believes, seeks, estimates, or words of similar meaning. Such statements address future events and conditions concerning matters such as, but not limited to, our earnings, cash flow, liquidity and capital resources, compliance with debt and other restrictive covenants, interest rates and dividends. These statements are based on current beliefs or expectations and are inherently subject to significant uncertainties and changes in circumstances, many of which are beyond our control. Actual results may differ materially from these expectations due to changes in political, economic, business, competitive, market and regulatory factors. We believe that these factors include, but are not limited to the those described under Item 3 Risk Factors and elsewhere in this Annual Report.

We undertake no obligation to update these forward looking statements to reflect events, developments or circumstances after the date of this document, a change in our views or expectations, or to reflect the occurrence of future events.

Unless the context requires otherwise, when used in this Annual Report, (1) the terms B&B Air, Company, we, our and us refer to Babcock & Brown Air Limited and its subsidiaries; (2) the term B&B Air Funding refers to our subsidiary, Babcock & Brown Air Funding I Limited; (3) the term B&B Air Acquisition refers to our subsidiary, Babcock & Brown Air Acquisition I Limited; (4) all references to our shares refer to our common shares held in the form of American Depositary Shares, or ADSs; (5) the terms Predecessor and JET-i refer to JET-i Leasing LLC, the predecessor company of B&B Air; (6) the terms B&B and Babcock & Brown refer to Babcock & Brown Limited, an Australian company, and its subsidiaries; (7) the terms BBAM and the Servicer refer to Babcock & Brown Aircraft Management LLC and Babcock & Brown Aircraft Management (Europe) Limited, collectively; and (8) the term Manager refers to Babcock & Brown Air Management Co. Limited, the Company's manager.

Unless indicated otherwise, all percentages and weighted average characteristics of the aircraft in our portfolio have been calculated using net book values as of December 31, 2008.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

B&B Air is a global lessor of modern, fuel-efficient commercial jet aircraft. Our aircraft are leased under long-term to medium-term contracts to a diverse group of airlines throughout the world. On October 2, 2007, we (i) completed our initial public offering (IPO) and issued 18,695,650 common shares in the form of ADSs at a public offering price of \$23 per share; (ii) completed a private placement of 14,907,800 ADSs (Private Placement , and together with the IPO, Offerings) and (iii) issued \$853.0 million of aircraft lease-backed notes (the Notes) at an offering price of 99.71282%, or \$850.6 million, as part of a securitization transaction (the Securitization) through our subsidiary, B&B Air Funding. Using proceeds of the Offerings and the Notes, we acquired our initial portfolio of 47 commercial jet aircraft (Initial Portfolio). We retained \$120.8 million of the proceeds for the acquisition of additional aircraft.

On November 7, 2007, our subsidiary, B&B Air Acquisition, entered into a revolving credit facility (the Aircraft Acquisition Facility) that provides for up to \$1.2 billion of financing for additional aircraft including a \$96.0 million equity tranche from B&B Air.

As of December 31, 2008, we had acquired 17 additional aircraft using the Aircraft Acquisition Facility and had sold two aircraft from the Initial Portfolio. We owned 62 aircraft as of December 31, 2008.

Selected Financial Data.

The following selected financial data is derived from our and our Predecessor s consolidated financial statements, prepared in conformity with U.S. GAAP, and should be read in conjunction with Item 5 Operating and Financial Review and Prospects and our and our Predecessor s audited consolidated financial statements and related notes thereto included at Item 18 Financial Statements in this Annual Report. The selected financial data presented below are: (i) our operating results for the year ended December 31, 2008; (ii) our operating results for the period from May 3, 2007 (our incorporation date) to December 31, 2007; (iii) our Predecessor s operating results for the years ended December 31, 2007 and December 31, 2006; and (iv) our Predecessor s operating results for period from November 22, 2005 (commencement of operations) to December 31, 2005.

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	(Dollars in thousands, except share data)				
	Babcock & Brown Air Limited		JET-i Leasing LLC (Predecessor Company)		
	For the year ended December 31, 2008	For the period from May 3, 2007 (incorporation date) to December 31, 2007	For the years ended December 31, 2007 2006		For the period from November 22, 2005 (commencement of operations) to December 31, 2005
Revenues					
Operating lease revenue	\$ 218,940	\$ 26,042	\$ 107,620	\$ 56,566	\$ 550
Finance lease income	2,446	2,365	7,477	1,668	
Gain on sale of aircraft	11,437				
Interest and other income	3,315	4,927	5,940	3,115	65
Total revenues	236,138	33,334	121,037	61,349	615
Expenses					
Depreciation	74,161	8,573	34,548	17,976	156
Interest expense	81,689	14,628	61,541	33,840	487
Interest expense related party			11,585	6,390	288
Selling, general and administrative	20,989	4,866	4,588	3,321	331
Maintenance and other costs	4,307	165	2,415	1,379	145
Mark-to-market of non-hedge derivatives			(5,898)	5,898	
Debt extinguishment costs			9,165		
Hedging costs related to interest rate swap option		1,725	5,423		
Swap breakage costs			12,500		
Total expenses	181,146	29,957	135,867	68,804	1,407
Net income (loss) before provision for income taxes	54,992	3,377	(14,830)	(7,455)	(792)
Provision for income taxes	6,867	1,032	466	17	
Net income (loss)	\$ 48,125	\$ 2,345	\$ (15,296)	\$ (7,472)	\$ (792)
Earnings per share:					

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Basic and diluted	\$	1.44	\$	0.19
Pro forma			\$	0.07

Basic and diluted earnings per share is calculated: (1) for 2008 by dividing net income by the weighted average number of shares outstanding for the year and (2) for 2007 by dividing net income for the period from May 3, 2007, the date the Company was incorporated, to December 31, 2007 by the weighted average number of shares outstanding from October 2, 2007 to December 31, 2007. The Company has presented pro forma earnings per share for the period ended December 31, 2007 as if its initial public offering had occurred on May 3, 2007 (incorporation date).

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(Dollars in thousands, except share)

	Babcock & Brown Air Limited		JET-i Leasing LLC (Predecessor Company)		
	As of December 31, 2008	As of December 31, 2007	2007	As of December 31, 2006 2005	
Balance sheet data:					
Total assets	\$ 2,086,174	\$ 1,589,226	\$5,249	\$1,010,875	\$83,496
Total liabilities	1,696,761	1,098,724	2,766	983,175	57,615
Capital stock	499,914	504,546			
Total shareholders' equity/ members' capital	389,413	490,502	2,483	27,700	25,881
Number of shares	32,488,911	33,603,450			

Risk Factors

The risks discussed below could materially and adversely affect our business, prospects, financial condition, results of operations, cash flows and ability to pay dividends and cause the trading price of our shares to decline. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially and adversely affect our business, prospects, financial condition, results of operations, cash flows and ability to pay dividends.

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Risks Related to Our Business

Changes in economic conditions could adversely affect our business.

Our business and results of operations are significantly affected by general economic, capital markets, credit and industry conditions. The stress experienced by global capital markets that began in the second half of 2007 continued and substantially increased during 2008 and is continuing into 2009. In particular, the substantial losses experienced by the global banking industry have led to an increase in the cost and deterioration in the availability of capital. Numerous governments have sought to establish programs to support the banking industry in order to encourage lending and to mitigate against a sustained recessionary environment. Nevertheless, continued concerns over the availability and cost of credit, declining business and consumer confidence and increased unemployment have precipitated an economic recession, resulting in expectations for reduced global economic growth.

A continued decline in global economic activity and the resulting volatility in the capital markets could adversely affect our financial condition and results of operations. For example, numerous airlines across the world have recently become insolvent due to high oil prices during the first half of 2008, reduced travel demand and a lack of investor support. As a result, we repossessed five aircraft from two lessees in 2008, and we have been required to bear unforeseen maintenance expenses, additional remarketing expenses and lost revenues. The economic downturn and the impairment of credit markets have also resulted in a decline in aircraft values and lease rates. A protracted economic downturn could exacerbate these adverse conditions. The current dislocation in the credit markets may make it difficult for us to refinance our Notes or amounts outstanding under the Aircraft Acquisition Facility on our anticipated schedule or on terms which we find acceptable. In addition, since our IPO in October 2007, the price of our common stock has declined significantly, which could limit our ability to raise additional equity capital.

The recent changes in demand and supply of aircraft could depress lease rates and the value of our aircraft portfolio.

The economic downturn and the slowdown in air travel have contributed to a decrease in the demand for aircraft, while a number of recent airline bankruptcies, as well as financial challenges potentially facing other airlines, may result in an increase in the supply of aircraft. In addition, several large portfolios of leased aircraft are available for sale. For example, it has been reported that American International Group intends to sell International Lease Finance Corporation (ILFC), its aircraft leasing business, which is the largest aircraft lessor in the world, measured by portfolio value. This shift in supply/demand dynamics may lead to a decrease in aircraft lease rates and values. A decrease in lease rates could adversely affect our lease revenues in future periods as our current leases terminate or to the extent that airlines default on their leases. A decrease in aircraft values would adversely affect the value of the aircraft in our portfolio. An adverse decline in the value of our aircraft could end the availability period under the Aircraft Acquisition Facility and prevent us from making additional borrowings and require us to begin making principal payments.

We will need additional capital to finance our growth, and we may not be able to obtain it on acceptable terms, or at all, which may limit our ability to grow and compete in the aviation market.

We will require additional financing to expand our business through the acquisition of additional aircraft and other aviation assets. We plan to finance acquisitions through borrowings under our Aircraft Acquisition Facility or other debt facilities or additional equity and debt offerings. Our ability to execute our business strategy to acquire additional assets depends to a significant degree on our ability to access debt and equity capital markets. Continuing turmoil in the financial markets has significantly impacted most classes of lending and has caused banks and financial institutions to decrease the amount of capital available for lending and has significantly increased the risk premium of such borrowings.

Our access to capital markets also will depend on a number of other factors, such as our historical and expected performance, compliance with the terms of our debt agreements, industry and market trends and

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the relative attractiveness of alternative investments. Current market conditions have exerted significant downward pressure on the price of our common shares, which could impact our ability to raise capital through the issuance of additional equity-related securities. The terms of our Aircraft Acquisition Facility and the Securitization restrict our ability to incur additional debt. The agent for our Aircraft Acquisition Facility has the right to approve funding requests in its sole discretion. If the agent refuses to provide financing for an acquisition, we may be unable to secure alternative financing for the proposed acquisition. If we are unable to raise additional funds or obtain capital on acceptable terms, we may have to delay, modify or abandon some or all of our growth strategies.

Unforeseen difficulties and costs associated with the acquisition of our aircraft portfolio and other aviation assets could reduce or prevent our future growth and profitability.

Our growth strategy contemplates future acquisitions and leasing of additional commercial aircraft and other aviation assets. Our ability to acquire additional aircraft requires the availability of financing for the acquisition. Even if financing were available, the market for commercial aircraft is cyclical, and we may encounter difficulties in acquiring aircraft on favorable terms or at all which could reduce our acquisition opportunities or cause us to pay higher prices. A significant increase in market interest rates would make it more difficult for us to make accretive acquisitions that would increase our distributable cash flows. Any acquisition of aircraft or other aviation assets may not be profitable to us after the acquisition of such asset and may not generate sufficient cash flow to justify our investment. In addition, our acquisition growth strategy exposes us to risks that may harm our business, financial condition, results of operations and cash flows, including risks that we may:

- impair our liquidity by using a significant portion of our available cash or borrowing capacity to finance acquisitions;
- significantly increase our interest expense and financial leverage to the extent we incur additional debt to finance acquisitions;
- incur or assume unanticipated liabilities, losses or costs associated with the aircraft or other aviation assets that we acquire;
- incur other significant charges, including asset impairment or restructuring charges; or
- be unable to maintain our ability to pay regular dividends to our shareholders.

Unlike new aircraft, existing aircraft typically do not carry warranties as to their condition (although certain manufacturer warranties may still be effective and assignable when the aircraft is purchased). Although we may inspect an existing aircraft and its documented maintenance, usage, lease and other records prior to acquisition, such an inspection normally would not provide us with as much knowledge of an aircraft's condition as we would have if it had been built for us. Repairs and maintenance costs for existing aircraft are difficult to predict and generally increase as aircraft age and may have been adversely affected by prior use. These costs could decrease our cash flow and reduce our liquidity and our ability to pay regular dividends to our shareholders.

Risk Related to Our Financial Information

We have limited independent operating history upon which to assess our prospects or ability to pay dividends to our shareholders.

On October 2, 2007, we completed our IPO, Private Placement and Securitization, entered into a purchase agreement for the acquisition of our Initial Portfolio, and commenced independent operations. We completed our first full year of operations on December 31, 2008. As a result, we are a recently organized company with limited independent operating history, and our prospects and ability to pay dividends must be considered in light of the risks, expenses and difficulties frequently encountered when any new business is formed. Our limited independent operating history will make it difficult for shareholders to assess the quality of our management and our ability to operate profitably and pay dividends to our shareholders. We cannot assure you that we will be able to implement our business strategies, that any of our strategies will be achieved or that we will be able to operate profitably and pay regular dividends to our shareholders.

Risks Related to Our Dividend

We may not be able to pay or maintain dividends on our shares.

Although we have paid a dividend each quarter since our IPO, we reduced our quarterly dividend to \$0.20 per share for the fourth quarter of 2008, compared to \$0.50 per share in prior quarters. There are a number of factors that could

affect our ability to pay future dividends including, but not limited to, the following:

- lack of availability of cash to pay dividends due to changes in our operating cash flow, capital expenditure requirements, working capital requirements and other cash needs;
- restrictions imposed by our financing arrangements, including under the Notes, our Aircraft Acquisition Facility and any indebtedness incurred in the future to refinance our existing debt or to expand our aircraft portfolio;
- our inability to make acquisitions of additional aircraft that are accretive to cash flow;
- application of funds to make and finance acquisitions of aircraft and other aviation assets;
- reduced levels of demand for, or value of, our aircraft;
- increased supply of aircraft;
- obsolescence of aircraft in our portfolio;
- lower lease rates on new aircraft and re-leased aircraft;
- delays in re-leasing our aircraft after the expiration or early termination of existing leases;
- impaired financial condition and liquidity of our lessees;
- deterioration of economic conditions in the commercial aviation industry generally;
- poor performance by our Manager, BBAM and their affiliates and other service providers and our limited rights to terminate them;
- unexpected or increased maintenance, operating or other expenses or changes in the timing thereof;
- a decision by our board of directors to cease distributing a portion of our cash flow available for distribution;
- changes in Irish tax law, the tax treaty between the United States and Ireland (the Irish Treaty) or our ability to claim the benefits of such treaty;
- cash reserves established by our board of directors; and
- restrictions under Bermuda law on the amount of dividends that we may pay.

Risks Related to Our Indebtedness

We will not be able to borrow under the Aircraft Acquisition Facility after the end of the availability period.

We currently depend on the Aircraft Acquisition Facility to fund acquisitions of new aircraft. The availability period for borrowings under the Aircraft Acquisition Facility is expected to end on November 6, 2009. However, certain events, including a servicer replacement event under the servicing agreement for the Aircraft Acquisition Facility, could result in the earlier termination of the availability period. A servicer

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replacement event includes the following, some of which also constitute events of default under the Aircraft Acquisition Facility:

Babcock & Brown ceases to hold at least 5% of the issued and outstanding shares of B&B Air;

Babcock & Brown ceases to hold at least 51% of the capital stock of BBAM;

BBAM fails to deliver the audited financial statements of Babcock & Brown Limited to the agent and lenders in the Aircraft Acquisition Facility within 120 days of fiscal year end or the unaudited or audited financial statements for each semi-annual period within 90 days, and in each case such failure to deliver the required financial statements continues for 30 days after written notice from the agent;

Any Babcock & Brown Limited annual or quarterly financial statement required to be delivered as described above contains a going-concern or similar qualification;

The insolvency of BBAM or any significant subsidiary of BBAM; and

A BBAM default on recourse debt over \$25 million.

The occurrence of any of these events would immediately end the availability period for the Aircraft Acquisition Facility and accelerate the date on which we are required to apply all of the available cash flow from the aircraft owned by B&B Air Acquisition to repay amounts due under the Aircraft Acquisition Facility. In addition, on the occurrence of a servicer replacement event, B&B Air Acquisition (with the consent of the agent) or the agent on the direction of 2/3 of the Tranche A and Tranche B lenders combined may terminate the service agreement.

An event of default under the Aircraft Acquisition Facility would be triggered if Babcock & Brown ceases to hold at least 5% of the issued and outstanding shares of B&B Air and at least 51% of the capital stock of BBAM. As of December 31, 2008, Babcock & Brown holds 14.7% of our outstanding ADSs. As of December 31, 2008, B&B Air Acquisition was not in default under the Notes.

Babcock & Brown has announced a restructuring of its corporate debt facilities which requires it to sell all of its assets over the next two to three years. Although no definitive transaction has been announced, we expect Babcock & Brown to sell all of its aviation related assets, including BBAM and the common shares of B&B Air owned by them, either of which could result in an event of default under the Aircraft Acquisition Facility.

If any event of default occurs (other than B&B Air Acquisition or any of its subsidiaries becoming the subject of insolvency proceedings), the agent, on the request of 2/3 of the Tranche A and Tranche B lenders combined may demand immediate repayment of all outstanding borrowings under the Aircraft Acquisition Facility. After the occurrence of certain bankruptcy and insolvency related events of default, or any acceleration of the amounts due under the Aircraft Acquisition Facility after the occurrence of any event of default, all cash generated by B&B Air Acquisition will be used to repay amounts due under the facility and will not be available to us.

Even prior to the end of the availability period, the agent for our Aircraft Acquisition Facility has the right to approve funding requests in its sole discretion. If they refuse to provide financing for an acquisition, we may be unable to secure alternative financing for the proposed acquisition.

We may not be able to refinance the Notes or the Aircraft Acquisition Facility on favorable terms or at all, which may require us to seek more costly or dilutive financing for our investments or to liquidate assets.

We currently intend to refinance the Notes and the Aircraft Acquisition Facility prior to the dates on which we are required to apply all of the available cash flow from our aircraft portfolio to repay the principal thereon. This date is August 2012 for the Notes and is expected to be the earlier of the date six months after 90% of the total amount of the facility under the Aircraft Acquisition Facility (the Facility Amount) is

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utilized and November 6, 2009, except in certain circumstances which could accelerate this date. (See above *We will not be able to borrow under the Aircraft Acquisition Facility after the end of the availability period.*) Refinancing may be difficult in the current environment, and we bear the risk that we will not be able to refinance our existing indebtedness on favorable terms or at all. The inability to refinance our indebtedness may require us to seek more costly or dilutive financing for our aircraft or to liquidate assets. If we are not able to refinance our indebtedness before being required to apply all of the available cash flow from our portfolio to repay the principal thereon and, as a result, excess cash available for dividends from our subsidiaries is eliminated, then our ability to continue paying dividends to our shareholders will be adversely affected if we have not developed sufficient additional sources of cash flow to replace the cash flows that will be applied to such principal amortization.

We are subject to risks related to our indebtedness that may limit our operational flexibility and our ability to pay dividends on our shares.

The terms of the Notes and the terms of the Aircraft Acquisition Facility subject us to certain risks and operational restrictions, including:

- all the aircraft and related leases in our portfolio secure debt obligations, the terms of which restrict our ability to sell aircraft and require us to use proceeds from sales of aircraft, in part, to repay amounts outstanding under those notes;

- we are required to dedicate a significant portion of our cash flow from operations to debt service payments, thereby reducing the amount of our cash flow available to pay dividends, fund working capital, make capital expenditures and satisfy other needs;

- restrictions on our subsidiaries' ability to distribute excess cash flow to us under certain circumstances;

- lessee, geographical and other concentration requirements limit our flexibility in leasing our aircraft;

- requirements to obtain the consent of third parties including lenders, the financial guaranty policy provider for the Securitization, whom we refer to as the policy provider, and rating agency confirmations for certain actions; and

- restrictions on our subsidiaries' ability to incur additional debt, create liens on assets, sell assets, make freighter conversions and make certain investments or capital expenditures.

The restrictions described above may impair our ability to operate and to compete effectively with our competitors. Similar restrictions may be contained in the terms of future financings that we may enter into to finance our growth.

We are a holding company and currently rely on our subsidiaries, B&B Air Funding and B&B Air Acquisition, and their subsidiaries, the owners of the aircraft in our portfolio, to provide us with funds necessary to meet our financial obligations and pay dividends, and our subsidiaries are significantly restricted from making funds available to us.

We are a holding company and our principal asset is the equity interest we hold in our subsidiaries, which own, through their subsidiaries, the aircraft in our portfolio. As a result, we depend on dividends and other payments from B&B Air Funding, B&B Air Acquisition and from any other subsidiaries through which we may conduct operations in the future, to generate the funds necessary to meet our financial obligations and to pay dividends on our shares.

B&B Air Funding and B&B Air Acquisition are legally distinct from us and are significantly restricted from paying dividends or otherwise making funds available to us pursuant to the agreements governing their financing arrangements. Any other subsidiaries through which we may conduct operations in the future will also be legally distinct from us and may be similarly restricted from paying dividends or otherwise making funds available to us under certain conditions. Our subsidiaries will generally be required to service their debt obligations before making distributions to us, thereby reducing the amount of our cash flow available to pay dividends, fund working capital, make capital expenditures and satisfy other needs.

Our subsidiaries may be required in certain circumstances to apply funds to the repayment of their indebtedness.

Commencing August 2012, B&B Air Funding will be required to apply all of its available cash flow after payment of certain expenses to repay the principal of the Notes. If B&B Air Funding's debt service coverage ratio (as defined in the indenture for the Securitization) is less than 1.80 on any two consecutive monthly payment dates occurring between July 2010 and July 2012, B&B Air Funding will be required to apply all of its available cash flow to repay the principal of the Notes. B&B Air Acquisition will be required to apply all of its available cash flow to repay the principal under its Aircraft Acquisition Facility on the earlier of the date six months after 90% of the Facility Amount

is utilized or November 6, 2009 (or earlier under certain circumstances). Failure to maintain a monthly interest coverage ratio of at least 1.1 to 1 and a rolling three month interest coverage ratio of at least 1.25 to 1 would be an event of default under the Aircraft Acquisition Facility and would result in termination of the availability period and all outstanding principal amounts would become due immediately. If our subsidiaries have not refinanced their indebtedness prior to being required to apply all available cash flow to repay the principal amount of the debt, then the cash flow from the aircraft in our portfolio will not be available to us to pay dividends or to finance acquisitions of additional aircraft.

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Our subsidiaries are subject to interest rate risk, which could impair their ability to make distributions to us and our ability to pay dividends to you.

The Notes and the Aircraft Acquisition Facility have floating interest rates, creating the risk of an increase in interest rates and the risk that cash flow may be insufficient to make scheduled interest payments if interest rates were to increase. To limit this risk, our subsidiaries have entered into interest rate swaps with one or more counterparties. If any counterparty were to default on its obligations, then a mismatch in the floating rate interest obligations and fixed rate lease payments may arise, which could impair our subsidiaries' ability to make distributions to us, which would, in turn, adversely affect our ability to meet our financial obligations and pay dividends to our shareholders. If any of our hedging arrangements were terminated early, we could be obligated to make a material payment to our counterparty.

Risks Related to Our Relationship with Babcock & Brown

We are wholly dependent on B&B, primarily through BBAM, to manage our business and to service our aircraft portfolio.

B&B manages our business and all of our affairs. Therefore, our success or failure wholly depends on the skill and care with which B&B performs its services under our management and servicing agreements. We depend on the diligence, skill and network of business contacts of our Manager and our Servicer. Our Manager manages our company and is responsible for our day-to-day operations. Our Servicer is responsible for arranging the leasing of our fleet, acquiring and disposing our aircraft, marketing our aircraft for lease and re-lease, collecting rents and other payments from the lessees of our aircraft, monitoring maintenance, insurance and other obligations under our leases and enforcing our rights against lessees. Our continued success depends on the continued service of key employees of our Manager and our Servicer. The departure of any key employee of our Manager or our Servicer, or of a significant number of professionals of our Manager or our Servicer, could have a material adverse effect on our performance. As described in the risk factors below, if our board of directors is not satisfied with the performance of B&B under these agreements, we may not be able to terminate B&B and would have to continue to rely on B&B notwithstanding our board's dissatisfaction with the management and aircraft lease services being provided to us.

Financial conditions at Babcock & Brown could adversely affect our business.

There are significant concerns about the financial performance and viability of Babcock & Brown, whose subsidiaries (primarily BBAM) manage our business, service our portfolio of aircraft and perform many services for us pursuant to multiple management and servicing agreements. Babcock & Brown has announced a restructuring of its corporate debt facilities which requires it to sell all of its assets over the next two to three years. It has also announced that the publicly traded Australian entity, Babcock & Brown Limited, may be delisted from the Australian Stock Exchange and may be placed into administration if it is unable to restructure its subordinated notes which are listed on the Australian and New Zealand stock exchanges. These subordinated notes are subordinated to the corporate debt facilities which were recently restructured.

Although no definitive transaction has been announced, we expect Babcock & Brown to sell all of its aviation-related assets and businesses, including its rights under our servicing and management agreements with them, the legal entities which are party to those agreement (including BBAM) and the common shares of B&B Air owned by them. A sale of BBAM by Babcock & Brown would create uncertainty about our management and servicing arrangements. We cannot assure you that a new owner of BBAM would dedicate comparable resources to BBAM as Babcock & Brown, and the quality of the services that BBAM has provided to us could deteriorate. If Babcock & Brown cannot sell its aviation assets quickly, there is no assurance that it will continue to dedicate resources to BBAM or continue its operations.

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Some of our agreements with Babcock & Brown, as well as the agreements governing the Notes and the Aircraft Acquisition Facility, contain provisions that are linked to the financial performance and ownership of Babcock & Brown and BBAM.

These provisions include the following with respect to the Aircraft Acquisition Facility:

Babcock & Brown ceases to hold at least 5% of the issued and outstanding shares of B&B Air;

Babcock & Brown ceases to hold at least 51% of the capital stock of BBAM;

BBAM fails to deliver the audited financial statements of Babcock & Brown Limited to the agent and lenders in the Aircraft Acquisition Facility within 120 days of fiscal year end or the unaudited or audited financial statements for each semi-annual period within 90 days, and in each case such failure to deliver the required financial statements continues for 30 days after written notice from the agent;

Any Babcock & Brown Limited annual or quarterly financial statement required to be delivered as described above contains a going-concern or similar qualification in the audit opinion;

The insolvency of BBAM or any significant subsidiary of BBAM; and

BBAM default on recourse debt over \$25 million.

The occurrence of any of these events would immediately end the availability period for the Aircraft Acquisition Facility and accelerate the date on which we are required to apply all of the available cash flow from the aircraft owned by B&B Air Acquisition to repay amounts due under the Aircraft Acquisition Facility. An event of default under the Aircraft Acquisition Facility would also be triggered if Babcock & Brown ceases to hold at least 5% of the issued and outstanding shares of B&B Air and at least 51% of the capital stock of BBAM. If any event of default occurs (other than B&B Air Acquisition or any of its subsidiaries becoming the subject of insolvency proceedings), the agent, on the request of 2/3 of the Tranche A and Tranche B lenders combined may demand immediate repayment of all outstanding borrowings under the Aircraft Acquisition Facility. After the occurrence of certain bankruptcy and insolvency related events of default, or any acceleration of the amounts due under the Aircraft Acquisition Facility after the occurrence of any event of default, all cash generated by B&B Air Acquisition will be used to repay amounts due under the facility and will not be available to us. Each of these events is beyond our control and could have a materially adverse effect on our business. See the Risk Factor, *We will not be able to borrow under the Aircraft Acquisition Facility after the end of the availability period* above.

In addition, under the servicing agreement related to the Notes, a servicer termination event is triggered if Babcock & Brown International Pty Ltd (BBIPL) ceases to own at least 50.1% of the voting equity or economic interest in BBAM or on the bankruptcy or insolvency of BBIPL or BBAM. Babcock & Brown has announced that an administration proceeding in respect of Babcock & Brown Limited will not impact the solvency of BBIPL, which is the primary operating company in the Babcock & Brown group and the borrower under the recently restructured corporate debt facilities.

B&B has conflicts of interest with us and their limited contractual or other duties will not restrict them from favoring their own business interests to our detriment.

Conflicts of interest will arise between us and B&B, as the manager of our business and the Servicer for our aircraft, with respect to our operations and business opportunities. These conflicts will arise because BBAM acquires, manages and remarkets for lease or sale aircraft for us and for other entities, including entities in which B&B has an economic interest. We may compete directly with such other managed entities for investment opportunities. For example, BBAM performs aircraft acquisition, disposal and management services pursuant to a joint marketing agreement between B&B and Nomura Babcock & Brown Co., Ltd, which we refer to as NBB. BBAM has arranged a significant number of aircraft acquisitions and dispositions pursuant to the NBB arrangement. We expect that BBAM will continue to arrange acquisition and disposition opportunities with NBB and that we may compete with NBB for such opportunities. A

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conflict of interest will arise if B&B identifies an aircraft acquisition opportunity that would meet our investment objectives as well as those of NBB or any other entity managed by B&B. We do not have any exclusive right to participate in aircraft acquisition opportunities originated or identified by B&B. Under our agreements with B&B, our Manager has agreed to act in the best interests of our shareholders. However, neither BBAM nor any other B&B affiliate will be restricted from pursuing, or offering to a third party, including NBB or any other party managed by, or otherwise affiliated or associated with, B&B, any investment or disposal opportunity or will be required to establish any investment protocol in relation to prioritization of any investment or disposal opportunity. In addition, we have purchased and are likely to purchase in the future additional aircraft beyond the Initial Portfolio from entities in which B&B has an ownership interest. Although such purchases have been and will continue to be required to be approved by our independent directors, the pricing and other terms of these transactions may be less advantageous to us than if they had been the result of transactions among unaffiliated third parties.

Under our servicing agreements with BBAM, if a conflict of interest arises as to our aircraft and other aircraft managed by BBAM, BBAM must perform the services in good faith, and, to the extent that our aircraft or other aircraft managed by BBAM have substantially similar objectively identifiable characteristics that are relevant for purposes of the particular services to be performed, BBAM has agreed not to discriminate among our aircraft or between any of our aircraft and any other managed aircraft on an unreasonable basis. Nevertheless, despite these contractual undertakings, BBAM as Servicer may favor its own interests and the interests of other managed entities over our interests. Conflicts may arise when our aircraft are leased to entities that also lease other aircraft managed by BBAM and decisions affecting some aircraft may have an adverse impact on others. For example, when a lessee in financial distress seeks to return some of its aircraft, BBAM may be required to decide which aircraft to accept for return and may favor its or another managed entity's interest over ours. Conflicts also may arise, for example, when our aircraft are being marketed for re-lease or sale at a time when other aircraft managed by BBAM are being similarly marketed.

Under the terms of our servicing agreements, we are not entitled to be informed of all conflicts of interest involving BBAM and are limited in our right to replace BBAM because of conflicts of interest. Any replacement Servicer may not provide the same quality of service or may not afford us terms as favorable as the terms currently offered by BBAM. If BBAM, as the Servicer, makes a decision that is adverse to our interests, our business, financial condition, results of operations and cash flows could suffer. See Even if we are dissatisfied with B&B's performance, there are only limited circumstances under which we will be able to terminate the servicing agreements and we may not terminate the servicing agreement for our Initial Portfolio without the prior written consent of the policy provider.

Even if we are dissatisfied with B&B's performance, there are only limited circumstances under which we are able to terminate our management and servicing agreements and we may not terminate the servicing agreement for our Initial Portfolio without the prior written consent of the policy provider.

The management agreement provides for a 25-year term and is subject to termination only under the following limited circumstances:

- at least 75% of our independent directors and holders of 75% or more of all of our outstanding common shares (measured by vote) determine by resolution that there has been unsatisfactory performance by our Manager that is materially detrimental to us;
- our Manager materially breaches the management agreement and fails to remedy such breach within 90 days of receiving written notice from us requiring it to do so, or such breach results in liability to us and is attributable to our Manager's gross negligence, fraud or dishonesty, or willful misconduct in respect of the obligation to apply the standard of care;
- any license, permit or authorization held by the Manager which is necessary for it to perform the services and duties under the management agreement is materially breached, suspended or revoked, or

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otherwise made subject to conditions which, in the reasonable opinion of our board of directors, would prevent the Manager from performing the services and the situation is not remedied within 90 days;
our Manager becomes subject to bankruptcy or insolvency proceedings that are not discharged within 75 days, unless our Manager is withdrawn and replaced within 90 days of the initiation of such bankruptcy or insolvency proceedings with an affiliate or associate of B&B that is able to make correctly the representations and warranties set out in the management agreement;
B&B in aggregate ceases to hold (directly or indirectly) more than 50% of the issued share capital of our Manager;
or
an order is made for the winding up of our Manager, unless our Manager is withdrawn and replaced within 15 days with an affiliate or associate of B&B that is able to make correctly the representations and warranties set out in the management agreement.

Even though our shareholders (with the concurrence of 75% of our independent directors) have the right under the management agreement to terminate our Manager, it may not be possible for them to exercise this right in view of the number of common shares held by B&B, its affiliates and funds managed by its affiliates. B&B, its affiliates and such funds own approximately 25% of our outstanding common shares, and termination of our management agreement requires the vote of holders of 75% of our outstanding common shares.

We have the right to terminate the servicing agreement for our Initial Portfolio (with the prior written consent of the policy provider) and the policy provider has the independent right to terminate the agreement (without our consent) in the following limited circumstances:

BBAM ceases to be at least majority-owned directly or indirectly by B&B;

BBAM fails in any material respect to perform any material services under the servicing agreements in accordance with the standard of care or the conflicts standard in a manner that is materially adverse to us and our applicable subsidiaries taken as a whole;

specified B&B entities (including BBAM) become subject to bankruptcy or insolvency proceedings;

with respect to the servicing agreement for our Initial Portfolio, we have insufficient funds for the payment of interest on the notes for a period of at least 60 days;

at least 15% of the number of aircraft assets in the Initial Portfolio remain off-lease but reasonably available for re-lease for a period of at least three months following specified events set forth in the trust indenture;

without limiting BBAM's rights under the security trust agreement, BBAM takes any steps for the purpose of processing the appointment of an administrative receiver or the making of any administrative order or for instituting a bankruptcy, reorganization, arrangement, insolvency, winding up, liquidation, composition or any similar proceeding under the laws of any jurisdiction with respect to any jurisdiction with respect to B&B Air Funding, and any of its subsidiaries, or any of the aircraft assets;

we cease to own all of the aircraft in our Initial Portfolio;

BBAM withdraws from servicing a specified number of our aircraft in the Initial Portfolio for specified periods of time due to conflicts of interest; or

BBAM ceases to be actively involved in the aircraft leasing business.

If the servicing agreement for our Initial Portfolio is terminated by us or the policy provider and another servicer is engaged to service our Initial Portfolio, we will no longer be entitled to a credit against fees due under the management agreement for servicing fees paid with respect to our Initial Portfolio and our expenses would increase substantially. Although this will be a disincentive for us to terminate the servicing

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agreement for our Initial Portfolio, it is not likely to be a factor in a decision by the policy provider to exercise its independent ability to terminate the agreement.

Our management and servicing agreements limit our remedies against BBAM for unsatisfactory performance and provide certain termination rights to the policy provider.

Under our management and servicing agreements with B&B, in many cases we may not have the right to recover damages from BBAM for unsatisfactory performance. Moreover, we have agreed to indemnify our Manager, BBAM and their affiliates for broad categories of losses arising out of the performance of services, unless they are finally adjudicated to have been caused directly by our Manager's or BBAM's gross negligence, fraud, deceit or willful misconduct in respect of its obligation to apply its standard of care or, in the case of the servicing agreement for our Initial Portfolio, conflicts of interest standard in the performance of its services. In addition, because of our substantial dependence on B&B, our board of directors may be reluctant to initiate litigation against B&B to enforce contractual rights under our management and servicing agreements.

Under certain circumstances the provider of the financial guaranty insurance policy with respect to the Notes has the right to terminate BBAM as the Servicer for our Initial Portfolio without our consent and may terminate BBAM at a time which may be disadvantageous to us.

Our Manager may terminate the management agreement if we breach the management agreement and that breach is not remedied within 90 days of notice.

Our Manager may terminate the management agreement if we fail to make any payment due under the management agreement to our Manager within 15 days after the same becomes due or we materially breach the agreement and that breach is not remedied within 90 days of notice from our Manager, whether or not we have found a replacement manager. If our Manager terminates the management agreement, we may not be able to find a new manager or hire internal management with similar expertise to provide the same or equivalent services on acceptable terms, or at all. If we are unable to do so quickly, our operations are likely to experience a disruption, our financial results could be adversely affected, and the market price of our shares may decline. Further, if the management agreement is terminated, we and, where applicable, our subsidiaries will be required to promptly change our names to remove any references to Babcock & Brown.

BBAM may resign as Servicer under our servicing agreements under certain circumstances, which would significantly impair our ability to re-lease or sell aircraft and service our leases.

BBAM may resign under one or more of our servicing agreements under certain circumstances if it reasonably determines that directions given, or services required, would, if carried out, be unlawful under applicable law, be likely to lead to an investigation by any governmental authority of BBAM or its affiliates, expose BBAM to liabilities for which, in BBAM's good faith opinion, adequate bond or indemnity has not been provided or place BBAM in a conflict of interest with respect to which, in BBAM's good faith opinion, BBAM could not continue to perform its obligations under the servicing agreement with respect to all serviced aircraft or any affected aircraft, as the case may be (but with respect to the foregoing circumstance, BBAM may resign only with respect to the affected aircraft).

Whether or not it resigns, BBAM is not required to take any action of the foregoing kind. BBAM may also resign if it becomes subject to taxes for which we do not indemnify it. BBAM's decision to resign would significantly impair our ability to re-lease or sell aircraft and service our leases.

The terms of our agreements with B&B were negotiated without independent assessment on our behalf, and these terms may be less advantageous to us than if they had been the result of transactions among unaffiliated third parties.

We have entered into various agreements with B&B that effect the transactions relating to our formation, our IPO, the Securitization and the application of the proceeds from our IPO and the Securitization to acquire our Initial Portfolio, and our ongoing operations and business. Although the pricing and other terms

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of these agreements were reviewed by our directors, they were determined by B&B in the overall context of our IPO and the related transactions. As a result, provisions of these agreements may be less favorable to us than they might have been had they been the result of arm's-length transactions among unaffiliated third parties.

Risks Relating to Our Aircraft Portfolio

The variability of supply and demand for aircraft and other aviation assets could depress lease rates and the value of our leased assets, which would have an adverse effect on our financial results and growth prospects and on our ability to meet our debt obligations and pay dividends.

The aviation leasing and sales industry has experienced periods of aircraft oversupply and undersupply. The oversupply of a specific type of aircraft or other aviation asset in the market is likely to depress lease rates for, and the value of, that type of asset. The supply and demand for aircraft is affected by various cyclical and non-cyclical factors that are not under our control, including:

- passenger air travel and air cargo demand;
- geopolitical and other events, including war, acts of terrorism, outbreaks of epidemic diseases and natural disasters;
- operating costs, availability of jet fuel and general economic conditions affecting our lessees' operations;
- governmental regulation, including new airworthiness directives;
- interest rates;
- airline restructurings and bankruptcies;
- cancellations of orders for aircraft;
- delays in delivery by manufacturers;
- availability and cost of credit;
- manufacturer production levels and technological innovation;
- retirement and obsolescence of aircraft models;
- manufacturers merging or exiting the industry or ceasing to produce aircraft or engine types;
- accuracy of estimates relating to future supply and demand made by manufacturers and lessees;
- reintroduction into service of aircraft or engines previously in storage; and
- airport and air traffic control infrastructure constraints.

These factors may produce sharp decreases in asset values and achievable lease rates, which would have an impact on our cost of acquiring aircraft or other aviation assets, may result in lease defaults and could delay or prevent the aircraft or other aviation assets from being re-leased or re-leased on favorable terms, or, if desired, sold on favorable terms.

Factors that increase the risk of decline in aircraft value and achievable lease rates could have an adverse effect on our financial results and growth prospects and on our ability to meet our debt obligations and to pay dividends.

In addition to factors linked to the aviation industry generally, other factors that may affect the value and achievable lease rates of our aircraft and other aviation assets include:

- the particular maintenance, damage and operating history of the airframes and engines;

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the number of operators using that type of aircraft or engine;
whether an aircraft or other aviation asset is subject to a lease and, if so, whether the lease terms are favorable to the lessor;
the age of our aircraft and other aviation assets;
airworthiness directives and service bulletins;
aircraft noise and emission standards;
any tax, customs, regulatory and other legal requirements that must be satisfied when an aircraft is purchased, sold or re-leased;
compatibility of our aircraft configurations or specifications with other aircraft owned by operators of that type; and
decreases in the creditworthiness of our lessees.

Any decrease in the values of and achievable lease rates for commercial aircraft or other aviation assets that may result from the above factors or other unanticipated factors may have a material adverse effect on our financial results and growth prospects and our ability to meet our debt obligations and to pay dividends.

The advent of superior aircraft technology could cause our existing aircraft portfolio to become outdated and therefore less desirable, which could adversely affect our financial results and growth prospects and our ability to compete in the marketplace.

As manufacturers introduce technological innovations and new types of aircraft, including the Boeing 787 and the Airbus A350 and potential replacement types for the Boeing 737 and Airbus A320 families of aircraft, certain aircraft in our existing aircraft portfolio may become less desirable to potential lessees. In addition, although all of the aircraft in our portfolio are Stage 3 noise-compliant, the imposition of more stringent noise or emissions standards may make certain of our aircraft less desirable in the marketplace. Any of these risks could adversely affect our ability to lease or sell our aircraft on favorable terms or at all or our ability to charge rental amounts that we would otherwise seek to charge.

Our operational costs will increase as our aircraft age, which will adversely affect the amounts available to pay dividends.

As of December 31, 2008, the weighted average age of the aircraft in our portfolio was 6.4 years. In general, the cost of delivering an aircraft under a re-lease, including maintenance and modification expenditures, increases with the age of the aircraft. The costs of converting an aging passenger aircraft to a cargo aircraft are also substantial. The incurrence of these greater expenses as our fleet ages could adversely affect our ability to pay dividends.

The concentration of aircraft types in our portfolio could harm our business and financial results should any difficulties specific to these particular types of aircraft occur.

As of December 31, 2008, our portfolio contains a mix of aircraft types including Airbus A319 aircraft, A320 aircraft, A330 aircraft, Boeing 737 aircraft, Boeing 747 aircraft, Boeing 757 aircraft, Boeing 767 aircraft and Boeing 777 aircraft. 86% of our aircraft are single-aisle, narrow-body aircraft, measured by net book value. If any of these aircraft types (or other types that we acquire in the future) should encounter technical or other difficulties, such affected aircraft types may be subject to grounding or diminution in value and we may be unable to lease such affected aircraft types on favorable terms or at all. The inability to lease the affected aircraft types may reduce our revenues and net income to the extent the affected aircraft types comprise a significant percentage of our aircraft portfolio.

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We operate in a highly competitive market for investment opportunities in aircraft and other aviation assets.

The leasing and remarketing of commercial jet aircraft is highly competitive. As the exclusive Servicer of our aircraft, BBAM competes in leasing, re-leasing and selling our aircraft with other aircraft leasing companies, including GE Commercial Aviation Services (GECAS), ILFC, AerCap, Aircastle, Aviation Capital Group, AWAS, Boeing Capital, CIT Aerospace, Genesis Lease Limited, Macquarie Aircraft Leasing, RBS Aviation Capital and BOC Aviation (formerly Singapore Aircraft Leasing Enterprise). We also may encounter competition from other entities that selectively compete with us, including:

- airlines;
- aircraft manufacturers;
- financial institutions (including those seeking to dispose of repossessed aircraft at distressed prices);
- aircraft brokers;
- special purpose vehicles formed for the purpose of acquiring, leasing and selling aircraft; and
- public and private partnerships, investors and funds, including private equity and hedge funds.

Competition for a leasing transaction is based principally upon lease rates, delivery dates, lease terms, reputation, management expertise, aircraft condition, specifications and configuration and the availability of the types of aircraft necessary to meet the needs of the customer. Some of our competitors have significantly greater resources than we have. In addition, some competing aircraft lessors have a lower overall cost of capital and may provide financial services, maintenance services or other inducements to potential lessees that we cannot provide. Given the financial condition of the airline industry, many airlines have reduced their capacity by eliminating select types of aircraft from their fleets. This has resulted in an increase in available aircraft of these types, a decrease in rental rates for these aircraft and a decrease in market values of these aircraft.

Competition in the purchase and sale of used aircraft is based principally on the availability of used aircraft, price, the terms of the lease to which an aircraft is subject and the creditworthiness of the lessee. When we decide to dispose of an aircraft, BBAM, as our Servicer, will arrange the disposition pursuant to the terms of the servicing agreement for that aircraft. In doing so, BBAM will compete with the aircraft leasing companies listed above, as well as with the other types of entities described above and other investors.

If demand for leased aircraft does not increase, we may not be able to expand our business.

Over the past 20 years, the world's airlines have leased a growing proportion of their aircraft. Our growth strategy contemplates future acquisitions and leasing of additional commercial aircraft and other aviation assets. If, however, the aggregate demand for leased aircraft does not expand, then we may be unable to implement our growth strategy through aircraft acquisitions. Failure to expand our aircraft portfolio would impair our ability to sustain our revenues or support our expected dividend payments.

Depreciation expenses and impairment charges could have a material adverse effect on our financial condition and results of operations.

Our aircraft have finite economic lives, their values depreciate in the ordinary course over time and their ability to generate earnings and cash flow for our business declines over time. If depreciated aircraft are not replaced with newer aircraft, our ability to generate earnings and cash to pay dividends will be reduced. In addition, we depreciate our aircraft for accounting purposes on a straight-line basis to the aircraft's estimated residual value over its estimated useful life. If we dispose of an aircraft for a price that is less than its depreciated value, then we would be required to recognize a loss that would reduce our net income during the period of the disposition and reduce our total assets and shareholders' equity.

In addition, aircraft in our portfolio and any other aircraft and other aviation assets that we acquire in the future are expected to be under operating leases that are subject to periodic review for impairment for

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accounting purposes. We believe the carrying value of the aircraft in our portfolio is currently recoverable through the cash flows expected to result from their use and eventual disposition. However, if these expected cash flows are adversely affected by factors including credit deterioration of a lessee, declines in rental rates, other market conditions and residual values, then we may be required to recognize material impairment charges that would reduce our net earnings or increase our net losses. Under U.S. GAAP, once an impairment results in a reduction to the carrying value of an asset, the carrying value of such asset cannot thereafter be increased.

Aircraft liens could impair our ability to repossess, re-lease or resell the aircraft.

In the normal course of business, liens that secure the payment of airport fees and taxes, custom duties, air navigation charges, landing charges, crew wages, repairers charges, salvage or other obligations are likely, depending on the laws of the jurisdictions where aircraft operate, to attach to the aircraft (or, if applicable, to the engines separately). The liens may secure substantial sums that may, in certain jurisdictions or for limited types of liens (particularly fleet liens), exceed the value of any particular aircraft to which the liens have attached. Until they are discharged, the liens described above could impair our ability to repossess, re-lease or resell our aircraft.

If our lessees fail to fulfill their financial obligations, liens may attach to our aircraft. In some jurisdictions, aircraft liens or separate engine liens may give the holder thereof the right to detain or, in limited cases, sell or cause the forfeiture of the aircraft (or, if applicable, the engines separately). We cannot assure you that the lessees will comply with their obligations under the leases to discharge liens arising during the terms of the leases. We may, in some cases, find it necessary to pay the claims secured by such liens in order to repossess the aircraft or obtain the aircraft or engines from a creditor thereof. These payments would be a required expense for us and would reduce our net income and our cash flows.

We cannot assure you that all lessees will comply with the registration requirements in the jurisdiction where they operate.

All of our aircraft are required to be registered at all times with appropriate governmental authorities. Generally, in jurisdictions outside the United States, failure by a lessee to maintain the registration of a leased aircraft would be a default under the applicable lease, entitling us to exercise our rights and remedies thereunder. If an aircraft were to be operated without a valid registration, the lessee operator or, in some cases, the owner or lessor might be subject to penalties, which could constitute or result in a lien being placed on such aircraft. Failure to comply with registration requirements also could have other adverse effects, including inability to operate the aircraft and loss of insurance. We cannot assure you that all lessees will comply with these requirements.

Government regulations could require substantial expenditures, reduce our profitability and limit our growth.

Certain aspects of our business are subject to regulation and require the oversight and regulation by state, federal and foreign governmental authorities. Aircraft are subject to regulations imposed by aviation authorities regarding aircraft maintenance and airworthiness. Laws affecting the airworthiness of aircraft generally are designed to ensure that all aircraft and related equipment are continuously maintained in proper condition to enable safe operation of the aircraft. Aircraft manufacturers also may issue their own recommendations. Airworthiness directives and similar requirements typically set forth particular special maintenance actions or modifications to certain aircraft types or models that the owners or operators of aircraft must implement.

Each lessee generally is responsible for complying with airworthiness directives with respect to its aircraft and is required to maintain the aircraft's airworthiness. To the extent that a lessee fails to comply with airworthiness directives required to maintain its certificate of airworthiness or other manufacturer requirements in respect of an aircraft or if the aircraft is not currently subject to a lease, we may have to bear the cost of such compliance. Under many leases, we have agreed to share with our lessees the cost of obligations under airworthiness directives (or similar requirements). These expenditures can be substantial,

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and, to the extent we are required to pay them, our cash flow and ability to pay dividends could be substantially adversely affected.

In addition to these expenditures, which may be substantial, significant new requirements with respect to noise standards, emission standards and other aspects of our aircraft or their operation could cause our costs to increase and could cause the value of our aircraft portfolio to decrease. Other governmental regulations relating to noise and emissions levels may be imposed not only by the jurisdictions in which the aircraft are registered, possibly as part of the airworthiness requirements, but also by other jurisdictions where the aircraft operate. In addition, most countries aviation laws require aircraft to be maintained under an approved maintenance program having defined procedures and intervals for inspection, maintenance and repair. To the extent that our aircraft are off-lease or a lessee defaults in effecting such compliance, we are required to comply with such requirements at our expense.

Risks Relating to Our Leases

We will need to re-lease or sell aircraft as leases expire to continue to generate sufficient funds to meet our debt obligations, finance our growth and operations and pay dividends. We may not be able to re-lease or sell aircraft on favorable terms, or at all.

Our business strategy entails the need to re-lease aircraft as our current leases expire to generate sufficient revenues to meet our debt obligations, finance our growth and operations and pay dividends to our shareholders. The ability to re-lease aircraft depends on general market and competitive conditions. Some of our competitors may have greater access to financial resources and, as a result of restrictions on us contained in the terms of our indebtedness, may have greater operational flexibility. If we are not able to re-lease an aircraft or to do so on favorable terms, we may be required to attempt to sell the aircraft to provide funds for debt service or operating expenses. Our ability to re-lease or sell aircraft on favorable terms or without significant off-lease time could be adversely affected by depressed conditions in the airline and aircraft industries, airline bankruptcies, the effects of terrorism and war, the sale of other aircraft by financial institutions or other factors.

We rely on our lessees' continuing performance of their lease obligations.

We operate as a supplier to airlines and are indirectly impacted by the risks facing airlines today. Our success depends upon the financial strength of our lessees, our ability to assess the credit risk of our lessees and the ability of lessees to perform their contractual obligations to us. The ability of each lessee to perform its obligations under its lease will depend primarily on the lessee's financial condition and cash flow, which may be affected by factors beyond our control, including:

- competition;
- fare levels;
- air cargo rates;
- passenger air travel and air cargo demand;
- geopolitical and other events, including war, acts of terrorism, outbreaks of epidemic diseases and natural disasters;
- operating costs, availability and cost of jet fuel and general economic conditions affecting our lessees' operations;
- labor difficulties;
- economic conditions and currency fluctuations in the countries and regions in which the lessee operates; and
- governmental regulation of, or affecting, the air transportation business.

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Given the size of our portfolio, we expect that some lessees from time to time, will be slow in making or will fail to make their payments in full under the leases. A delayed, missed or reduced rental payment from a lessee decreases our revenues and cash flow and may adversely affect our ability to make payments on our indebtedness and pay dividends to shareholders. We may experience increased delinquencies, particularly if economic conditions continue to deteriorate. In addition, the demand for aircraft generally diminishes as they age, and the creditworthiness of the lessees of older aircraft is generally lower than the creditworthiness of the lessees of newer aircraft. In addition, many airlines are exposed to currency risk due to the fact that they earn revenues in their local currencies and certain of their liabilities and expenses are denominated in U.S. dollars, including lease payments to us. Some lessees encountering financial difficulties may seek a reduction in their lease rates or other concessions such as a decrease in their contribution toward maintenance obligations. We are typically not in possession of any aircraft while the aircraft are on lease to the lessees. Consequently, our ability to determine the condition of the aircraft or whether the lessees are properly maintaining the aircraft is limited to periodic inspections that we perform or that are performed on our behalf by third-party service providers or aircraft inspectors. A lessee's failure to meet its maintenance obligations under a lease could:

- result in a grounding of the aircraft;
- cause us to incur costs in restoring the aircraft to an acceptable maintenance condition to re-lease the aircraft;
- adversely affect lease terms in the re-lease of the aircraft; and
- adversely affect the value of the aircraft.

We cannot assure you that, in the event that a lessee defaults under a lease, any security deposit paid or letter of credit provided by the lessee will be sufficient to cover the lessee's outstanding or unpaid lease obligations and required maintenance expenses or be sufficient to discharge liens that may have attached to our aircraft.

If our lessees encounter financial difficulties and we decide to restructure our leases with those lessees, this could result in less favorable leases, significant reductions in our cash flows and adversely affect our ability to meet our debt obligations and pay dividends on our shares.

We may restructure a lease when a lessee is late in making payments, fails to make required payments or has otherwise advised us that it expects to default in making required payments. Restructuring may involve anything from a simple rescheduling of payments to the termination of a lease without receiving all or any of the past-due amounts. The terms and conditions of possible lease restructurings could result in significant reductions of rental payments, which would have an adverse impact on our cash flow available for distribution and reduced dividends to shareholders. We may receive more requests for restructuring if current economic conditions continue to deteriorate or do not improve.

Lease defaults could result in significant expenses and loss of revenues.

During 2008, we repossessed five of our aircraft following lessee default. Repossession, re-registration and flight and export permissions after a lessee default typically result in greater costs than those incurred when an aircraft is returned at the end of a lease. These costs include legal expenses that could be significant, particularly if the lessee is contesting the proceedings or is in bankruptcy. Delays resulting from repossession proceedings also would increase the period of time during which an aircraft or other aviation asset does not generate rental revenue. In addition, we may incur substantial maintenance, refurbishment or repair costs that a defaulting lessee has failed to pay and that are necessary to put the aircraft in a condition suitable for re-lease or sale, and we may need to pay off liens, taxes and governmental charges on the aircraft or other aviation asset to obtain clear possession and to remarket the asset effectively.

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If we repossess an aircraft or other aviation asset, we will not necessarily be able to export or deregister and profitably redeploy the asset. For instance, where a lessee or other operator flies only domestic routes in the jurisdiction in which an aircraft is registered, repossession may be more difficult, especially if the jurisdiction permits the lessee or the other operator to resist deregistration. Significant costs may also be incurred in retrieving or recreating aircraft records required for registration of the aircraft and obtaining a certificate of airworthiness for the aircraft or engine.

Our lessees' failure to fund their maintenance requirements on our aircraft could significantly harm our revenues, cash flows and ability to pay dividends.

The standards of maintenance observed by our lessees and the condition of aircraft at the time of sale or lease may affect the values and rental rates of our aircraft. Under each of our leases, the lessee is primarily responsible for maintaining the aircraft and complying with all governmental requirements applicable to the lessee and to the aircraft, including operational, maintenance, and registration requirements and airworthiness directives. A lessee's failure to perform required maintenance during the term of a lease could result in a diminution in the value of an aircraft, an inability to lease the aircraft at favorable rates or at all, or a potential grounding of the aircraft, and would likely require us to incur maintenance and modification costs upon the expiration or earlier termination of the lease to restore the aircraft to an acceptable condition prior to sale or re-leasing.

Failure to pay certain potential additional operating costs could result in the grounding of our aircraft and prevent the re-lease, sale or other use of our aircraft, which would negatively affect our business, financial condition and results of operations.

As in the case of maintenance costs, we may incur other operational costs upon a lessee default or where the terms of the lease require us to pay a portion of those costs. Such costs, which can be substantial, include:

- the costs of casualty, liability, war and political risk insurance and the liability costs or losses when insurance coverage has not been or cannot be obtained as required or is insufficient in amount or scope;
- the costs of licensing, exporting or importing an aircraft, costs of storing and operating an aircraft, airport taxes, customs duties, air navigation charges, landing fees and similar governmental or quasi-governmental impositions; and
- penalties and costs associated with the failure of lessees to keep the aircraft registered under all appropriate local requirements or obtain required governmental licenses, consents and approvals.

The failure to pay some of these costs can result in liens on the aircraft or a loss of insurance. Any of these events could result in the grounding of the aircraft and prevent the re-lease, sale or other use of the aircraft until the problem is cured.

Our lessees may have inadequate insurance coverage or fail to fulfill their respective indemnity obligations, which could result in us not being covered for claims asserted against us and may negatively affect our business, financial condition and results of operations.

Although we do not expect to control the operation of our leased aircraft, our ownership of the aircraft could give rise, in some jurisdictions, to strict liability for losses resulting from their operation. Our lessees are required to indemnify us for, and insure against, liabilities arising out of the use and operation of the aircraft, including third-party claims for death or injury to persons and damage to property for which we may be deemed liable. Lessees are also required to maintain public liability, property damage and hull all risks and hull war risks insurance on the aircraft at agreed upon levels. However, they are not generally required to maintain political risk insurance. There may be circumstances under which it would be desirable for us to maintain top-up and/or political risk coverage at our expense, which would add to our operating expenses.

Following the terrorist attacks of September 11, 2001, aviation insurers significantly reduced the amount of insurance coverage available to airlines for liability to persons other than employees or passengers for

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claims resulting from acts of terrorism, war or similar events. At the same time, they significantly increased the premiums for such third-party war risk and terrorism liability insurance and coverage in general. As a result, the amount of such third-party war risk and terrorism liability insurance that is available at any time may be below the amount required under the initial leases and required by the market in general.

We cannot assure you that the insurance maintained by our lessees will be sufficient to cover all types of claims that may be asserted against us. Any inadequate insurance coverage or default by lessees in fulfilling their indemnification or insurance obligations, as well as the lack of available insurance, could reduce the proceeds upon an event of loss and could subject us to uninsured liabilities, either of which could adversely affect our business, financial condition and results of operations.

Failure to obtain certain required licenses, consents and approvals could negatively affect our ability to re-lease or sell aircraft, which would negatively affect our business, financial condition and results of operations.

Aircraft leases often require specific licenses, consents or approvals. These include consents from governmental or regulatory authorities for certain payments under the leases and for the import, re-export or deregistration of the aircraft. Subsequent changes in applicable law or administrative practice may increase or otherwise modify these requirements. In addition, a governmental consent, once given, might be withdrawn. Furthermore, consents needed in connection with future re-leasing or sale of an aircraft may not be forthcoming. Any of these events could adversely affect our ability to re-lease or sell aircraft, which would negatively affect our business, financial condition and results of operations.

Some of our leases provide the lessees with early termination rights.

As of December 31, 2008, five of the leases in our portfolio provide the lessees with early termination rights. We also could enter into leases in the future that provide lessees with early termination rights. If any lease is terminated early at a time when we could not re-lease the aircraft at rates at least as favorable to us as the terminated lease, our results of operations and ability to pay dividends could be adversely affected.

Risks associated with the concentration of our lessees in certain geographical regions could harm our business.

In addition to global economic conditions, our business is exposed to local economic and political conditions that can influence the performance of lessees located in a particular region. The effect of these conditions on payments to us will be more or less pronounced, depending on the concentration of lessees in the region with adverse conditions.

European concentration. Revenues from 20 lessees based in Europe accounted for 47% of our total revenues in 2008. Commercial airlines in Europe face, and can be expected to continue to face, increased competitive pressures, in part as a result of the deregulation of the airline industry by the European Union and the development of low-cost carriers. European countries generally have relatively strict environmental regulations and traffic constraints that can restrict operational flexibility and decrease aircraft productivity, which could significantly increase aircraft operating costs.

Asian concentration. Revenues from 7 lessees based in Asia (including India) accounted for 22% of our total revenues in 2008, and lease rental revenues from 2 lessees based in India accounted for 12% of total revenues. There are significant obstacles to the Indian airline industry's development, including poor aviation infrastructure, continuing losses from operations due to overcapacity and other factors, continuing government control and regulation over the industry. If this control and regulation persists or expands, the Indian airline industry likely would experience a significant decrease in growth or restrictions on future growth.

North American concentration. Revenues from 5 lessees based in North America accounted for 20% of our total revenues in 2008. During the past 15 years a number of North American passenger airlines filed Chapter 11 bankruptcy proceedings and several major U.S. airlines ceased operations altogether. High labor costs, high fuel costs, the strength of labor unions in collective bargaining negotiations, the

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war and prolonged conflict in Iraq and the September 11, 2001 terrorist attacks in the United States have imposed additional financial burdens on most U.S. airlines.

South and Central American concentration. Revenues from 3 lessees based in South and Central America accounted for 11% of our total revenues in 2008. While lessees throughout the world are affected by exchange rate fluctuations as a result of the mismatch of U.S. dollar exposure between their operating expenses and revenues, airlines in South and Central America are particularly sensitive to this risk because of the history of currency devaluations in this region. Any strengthening of the U.S. dollar against the local currency could negatively impact the profitability of these airlines and their ability to meet their lease obligations to us. These risks are exacerbated by the potential for South and Central American currencies to be devalued by governments as they have been periodically during the last four decades.

The risks associated with the geographical concentration of our lessees may become exacerbated as our aircraft are re-leased to lessees or subleased to sublessees in other regions or as we acquire additional aircraft.

In addition to the geographic concentrations described above, we also have significant exposure to risks associated with conducting business in emerging markets. Emerging markets have developing economies that are vulnerable to business and political disturbances, such as significant economic instability, interest and exchange rate fluctuations, civil unrest, government instability, and the nationalization or expropriation of private assets. The occurrence of any of these events in markets served by our lessees and the resulting instability may adversely affect our ownership interest in aircraft or the ability of lessees which operate in these markets to meet their lease obligations and these lessees may be more likely to default than lessees that operate in developed economies.

Risks Related to the Aviation Industry

The passenger aviation industry is historically cyclical and a significant downturn in the industry would adversely impact our lessee's ability to make payments to us, which would adversely affect our financial results and growth prospects.

Our ability to achieve our primary business objectives of growing our lease portfolio and increasing distributable cash flow per share depend on the financial condition and growth of the commercial airline industry, which is inherently cyclical. The years 2001 through 2004 were characterized by falling demand and rising costs. This industry downturn was exacerbated by the terrorist attacks on September 11, 2001, prolonged military action in Iraq and Afghanistan, rising fuel prices, SARS and avian influenza. As a result, the global airline industry experienced significant financial losses. Many airlines, including some of our lessees, announced or implemented reductions in capacity, service and workforce. Additionally, many airlines sought protection under bankruptcy laws. The airline bankruptcies and the reduction in demand led to the grounding of significant numbers of aircraft and engines and the negotiation of reductions in lease rental rates, which depressed aircraft and engine market values.

The current decline in global economic activity is negatively impacting airlines. Airlines are again reducing capacity, service and workforce. The duration of this downturn and the potential long-term impact of these events on the aviation industry is unclear.

The risks affecting our airline customers are generally beyond our control, but because they have a significant impact on our customers they affect us as well. The risk factors that follow describe risks that affect the commercial airline industry generally and therefore have an impact on our business, financial condition and results of operations. Our ability to succeed depends on the financial strength of our customers and their ability to manage these risks. To the extent that our customers are adversely affected by these risk factors, we may experience:

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downward pressure on demand for the aircraft in our fleet and reduced market lease rates and lease margins; a higher incidence of lessee defaults, lease restructurings, repossessions and airline bankruptcies and restructurings, resulting in lower lease margins due to maintenance and legal and other costs associated with the repossession, as well as lost revenue for the time the aircraft are off lease and possibly lower lease rates from the new lessees; an inability to lease aircraft on commercially acceptable terms, resulting in lower lease margins due to such aircraft not earning revenue and resulting in storage, insurance and maintenance costs; and a loss if our aircraft is damaged or destroyed by an event specifically excluded from an insurance policy, such as dirty bombs, bio-hazardous materials and electromagnetic pulsing.

Airline reorganizations could impair our lessees' ability to comply with their lease payment obligations to us.

In recent years, several U.S. airlines have sought to reorganize (and, in certain instances, have completed reorganization) under Chapter 11, and numerous other airlines have filed for similar protection under their local laws. Bankruptcies have led to the grounding of significant numbers of aircraft, rejections of leases and negotiated reductions in aircraft lease rentals, with the effect of depressing aircraft market values. We repossessed five aircraft from two lessors in 2008 as a result of their insolvency. Additional reorganizations or liquidations by airlines under applicable bankruptcy or reorganization laws or further rejection or abandonment of aircraft by airlines in bankruptcy proceedings may depress aircraft values and aircraft lease rates. Additional grounded aircraft and lower market values would adversely affect our ability to sell certain of our aircraft or re-lease other aircraft at favorable rates.

High fuel prices can adversely affect the profitability of the airline industry and our lessees' ability to meet their lease payment obligations to us.

Fuel costs represent a major expense to companies operating within the airline industry, and fuel prices fluctuate widely depending primarily on international market conditions, geopolitical and environmental events and currency exchange rates. Fuel prices increased in 2008 to record highs, with the price of crude oil reaching more than \$145 per barrel in July 2008 before falling to \$32 per barrel in December 2008. Many airlines entered into hedging arrangements which locked in fuel at significant prices. As a consequence, some airlines were not in a position to benefit from a fall in fuel prices during the latter part of 2008, and a number of them will realize significant losses from these hedging positions. Although fuel prices have decreased from their highs in 2008, they will continue to have a significant impact on airline profitability. Due to the competitive nature of the airline industry, airlines may not be able to pass on increases in fuel prices to their customers by increasing fares. If they pass on the higher costs, it may adversely affect demand for air travel, which would reduce revenues to our customers. In addition, airlines may not be able to manage this risk by appropriately hedging their exposure to fuel price fluctuations. If fuel prices return to historically high levels, they are likely to cause our lessees to incur higher costs or experience reduced revenues.

Consequently, increases in fuel prices may:

- affect our lessees' ability to make rental and other lease payments;
- result in lease restructurings and aircraft and engine repossessions;
- increase our costs of servicing and marketing aircraft;
- impair our ability to re-lease the aircraft and other aviation assets or re-lease or otherwise dispose of the assets on a timely basis at favorable rates; and
- reduce the proceeds received for the aircraft or other aviation assets upon any disposition.

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The effects of various environmental regulations may negatively affect the airline industry. This may cause lessees to default on their lease payment obligations to us.

Governmental regulations regarding aircraft and engine noise and emissions levels apply based on where the relevant aircraft is registered and operated. For example, jurisdictions throughout the world have adopted noise regulations which require all aircraft to comply with noise level standards. In addition to the current requirements, the United States and the International Civil Aviation Organization, or ICAO, have adopted a new, more stringent set of standards for noise levels which applies to engines manufactured or certified on or after January 1, 2006. Currently, U.S. regulations would not require any phase-out of aircraft that qualify with the older standards applicable to engines manufactured or certified prior to January 1, 2006, but the European Union has established a framework for the imposition of operating limitations on aircraft that do not comply with the new standards. These regulations could limit the economic life of the aircraft and engines, reduce their value, limit our ability to lease or sell the non-compliant aircraft and engines or, if engine modifications are permitted, require us to make significant additional investments in the aircraft and engines to make them compliant.

In addition to more stringent noise restrictions, the United States and other jurisdictions are beginning to impose more stringent limits on nitrogen oxide, carbon monoxide and carbon dioxide emissions from engines, consistent with current ICAO standards. These limits generally apply only to engines manufactured after 1999. Certain of the aircraft engines owned by us were manufactured after 1999. Because aircraft engines are replaced from time to time in the usual course, it is likely that the number of such engines may increase over time. Concerns over global warming could result in more stringent limitations on the operation of aircraft powered by older, non-compliant engines.

European countries generally have relatively strict environmental regulations that can restrict operational flexibility and decrease aircraft productivity. The European Parliament has confirmed that aviation is to be included in the European Union's Emissions Trading Scheme starting from 2012. This inclusion could possibly distort the European air transport market leading to higher ticket prices and ultimately a reduction in the number of airline passengers. As an answer to these concerns, European airlines have established the Committee for Environmentally Friendly Aviation to promote the positive environmental performance of airlines. The United Kingdom has doubled its air passenger duties, effective February 1, 2007, in recognition of the environmental costs of air travel. Similar measures may be implemented in other jurisdictions as a result of environmental concerns.

Compliance with current or future regulations, taxes or duties imposed to deal with environmental concerns could cause the lessees to incur higher costs and to generate lower net revenues, resulting in an adverse impact on their financial conditions. Consequently, such compliance may affect the lessees' ability to make rental and other lease payments and reduce the value received for the aircraft upon any disposition, which could have an adverse effect on our ability to pay the interest on and principal of the notes in full or on a timely basis.

The effects of terrorist attacks and geopolitical conditions may negatively affect the airline industry. This may cause our lessees to default on their lease payment obligations to us.

As a result of the September 11, 2001 terrorist attacks in the United States and subsequent terrorist attacks abroad, airports have increased security restrictions, airline costs for aircraft insurance and security measures have increased and airlines have faced increased difficulties in acquiring war risk and other insurance at reasonable costs. Terrorist attacks and geopolitical conditions have harmed the airline industry, and concerns about geopolitical conditions and further terrorist attacks could harm airlines in the future as a result of various factors, including:

- higher costs to airlines because of increased security measures;
- the inconvenience of additional security measures;

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the price and availability of jet fuel and the cost and practicability of obtaining fuel hedges under current market conditions; and

significantly higher costs of aircraft insurance coverage for claims caused by acts of war, terrorism, sabotage, hijacking and other similar perils, and the extent to which such insurance has been or will continue to be available.

Future terrorist attacks, war or armed hostilities, or the fear of such events, may further increase airline costs, depress air travel demand, cause certain aviation insurance to become available only at significantly increased premiums or not be available at all and could have a further adverse impact on the airline industry and on the financial condition and liquidity of our lessees, aircraft values and rental rates, all of which could adversely affect our financial results, growth prospects and ability to pay dividends.

The effects of war or armed hostilities may negatively affect the airline industry. This may cause lessees to default on their lease payment obligations to us.

War or armed hostilities in the Middle East, North Korea, or elsewhere, or the fear of such events, could reasonably be expected to further exacerbate many of the problems experienced by the aviation industry as a result of the terrorist attacks on September 11, 2001. The situation in Iraq continues to be uncertain and tension over Iran's nuclear program continues, and either or both may lead to further instability in the region. Potential problems include increased security restrictions on air travel in the United States and elsewhere, increased airline costs for, and restricted availability of, aircraft insurance and fuel, enhanced security measures, a decline in passenger demand for air travel, increased difficulties in acquiring war risk and other insurance at reasonable costs, and additional lessee restructurings.

The effects of pandemic diseases may negatively affect the airline industry. This may cause our lessees to default on their lease payment obligations to us.

The 2003 outbreak of SARS was linked to air travel early in its development and had a severe adverse impact on the aviation industry, which was evidenced by a sharp reduction in passenger bookings, cancellation of many flights and employee layoffs. In addition, since 2003, there have been several outbreaks of avian influenza, or the bird flu, beginning in Asia and, most recently, spreading to certain parts of Africa and Europe. Additional outbreaks of SARS or other pandemic diseases, or the fear of such events, could provoke responses, including government-imposed travel restrictions, which could negatively affect passenger demand for air travel and the financial condition of the aviation industry.

We depend on aircraft and engine manufacturers' success in remaining financially stable and producing aircraft.

The supply of aircraft, which we purchase and lease, is dominated by two airframe manufacturers, Boeing and Airbus, and a limited number of engine manufacturers. We therefore depend on these manufacturers' success in remaining financially stable and producing aircraft and related components which meet airlines' demands and providing customer support. Further, competition between the manufacturers for market share is escalating and may cause instances of deep discounting for certain aircraft types and may have a negative impact on our competitive pricing when we sell or lease aircraft. Should the manufacturers fail to respond appropriately to changes in the market environment or fail to fulfill their contractual obligations, we may experience:

an inability to acquire aircraft and related components on terms that will allow us to lease those aircraft and related components to customers at our anticipated profit levels, resulting in lower growth rates or a contraction in our fleet;

poor customer support from the manufacturers of aircraft and components resulting in reduced demand for a particular manufacturer's product, creating downward pressure on demand for those aircraft and components in our fleet and reduced market lease rates for those aircraft; and

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reduction in our competitiveness due to deep discounting by the manufacturers, which may lead to reduced market lease rates and may adversely affect the value of our portfolio and our ability to remarket or sell some of the aircraft in our fleet.

Risks Related to the Ownership of Our Shares

We have anti-takeover provisions in our bye-laws that may discourage a change of control.

Our bye-laws contain provisions that could make it more difficult for a third party to acquire us without the consent of our board of directors. These include:

- provisions that permit us to require any competitor of BBAM that acquires beneficial ownership of more than 15% of our common shares either to tender for all of our remaining common shares for no less than their fair market value, or sell such number of common shares to us or to third parties as would reduce its beneficial ownership to less than 15%, in either case within 90 days of our request to so tender or sell;
- provisions that reduce the vote of each common share held by a competitor of BBAM that beneficially owns 15% or more, but less than 50%, of our common shares to three-tenths of one vote per share on all matters upon which shareholders may vote;
- provisions that permit our board of directors to determine the powers, preferences and rights of any preference shares we may issue and to issue any such preference shares without shareholder approval;
- advance notice requirements by shareholders for director nominations and actions to be taken at annual meetings; and
- no provision for cumulative voting in the election of directors, such that all the directors standing for election may be elected by our shareholders by a plurality of votes cast at a duly convened annual general meeting, the quorum for which is two or more persons present in person or by proxy at the start of the meeting and representing in excess of 25% of all votes attaching to all shares in issue entitling the holder to vote at the meeting.

These provisions may make it difficult and expensive for a third party to pursue a tender offer, change in control or takeover attempt that is opposed by our management and/or our board of directors. Public shareholders who might desire to participate in these types of transactions may not have an opportunity to do so. These anti-takeover provisions could substantially impede the ability of public shareholders to benefit from a change in control of our company or change our board of directors and, as a result, may adversely affect the market price of our shares and your ability to realize any potential change of control premium.

We are a Bermuda company that is managed and controlled in Ireland. It may be difficult for you to enforce judgments against us or against our directors and executive officers.

We were incorporated under the laws of Bermuda and are managed and controlled in Ireland. Our business is based outside the United States and a majority of our directors and officers reside outside the United States and a majority of our assets and some or all of the assets of such persons are located outside the United States. As a result, it may be difficult or impossible to effect service of process within the United States upon us or those persons, or to recover against us or them on judgments of U.S. courts, including judgments predicated upon the civil liability provisions of the U.S. federal securities laws. Further, no claim may be brought in Bermuda or Ireland against us or our directors and officers in the first instance for violation of U.S. federal securities laws because these laws have no extraterritorial application under Bermuda or Irish law and do not have force of law in Bermuda or Ireland. However, a Bermuda or Irish court may impose civil liability, including the possibility of monetary damages, on us or our directors and officers if the facts alleged in a complaint constitute or give rise to a cause of action under Bermuda or Irish law. There is doubt as to whether the courts of Bermuda or Ireland would enforce judgments of U.S. courts obtained in actions against us or our directors and officers, as well as the experts named herein, predicated

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upon the civil liability provisions of the U.S. federal securities laws, or entertain actions brought in Bermuda or Ireland against us or such persons predicated solely upon U.S. federal securities laws. Further, there is no treaty in effect between the United States and Bermuda or Ireland providing for the enforcement of judgments of U.S. courts in civil and commercial matters, and there are grounds upon which Bermuda or Irish courts may decline to enforce the judgments of U.S. courts. Some remedies available under the laws of U.S. jurisdictions, including some remedies available under the U.S. federal securities laws, may not be allowed in Bermuda or Irish courts as contrary to public policy in Bermuda or Ireland. Because judgments of U.S. courts are not automatically enforceable in Bermuda or Ireland, it may be difficult for you to recover against us or our directors and officers based upon such judgments.

As a shareholder of our company, you may have greater difficulties in protecting your interests than as a shareholder of a U.S. corporation.

The Companies Act 1981 of Bermuda, as amended, which we refer to as the Companies Act, applies to our company and differs in material respects from laws generally applicable to U.S. corporations and their shareholders. Taken together with the provisions of our bye-laws, some of these differences may result in your having greater difficulties in protecting your interests as a shareholder of our company than you would have as a shareholder of a U.S. corporation. This affects, among other things, the circumstances under which transactions involving an interested director are voidable, whether an interested director can be held accountable for any benefit realized in a transaction with our company, what approvals are required for business combinations by our company with a large shareholder or a wholly-owned subsidiary, what rights you may have as a shareholder to enforce specified provisions of the Companies Act or our bye-laws, and the circumstances under which we may indemnify our directors and officers.

Risks Related to Taxation

We may face increased tax costs.

We and our subsidiaries could face increased tax costs for various reasons, including our failure to qualify for treaty benefits under the Irish Treaty, the maintenance of a permanent establishment within the United States, or the deduction of withholding taxes from rent payments. Any increase in our tax costs, directly or indirectly, would adversely affect our net income and would decrease cash available for distribution to our shareholders.

In addition, because Ireland does not have tax treaties with all jurisdictions, we may find it necessary to establish subsidiaries in other jurisdictions to lease or sublease aircraft to customers in those jurisdictions. Such subsidiaries may be subject to taxation in the jurisdictions in which they are organized, which would reduce our net income and have an adverse impact on our cash flow available for distribution to our shareholders.

The tax rate applicable to us would be higher than we expect if we were considered not to be carrying on a trade in Ireland for the purposes of Irish law.

We expect to be subject to Irish corporation tax on our net trading income at the rate of 12.5%. Under Irish tax law, non-trading income is taxed at the rate of 25% and capital gains are taxed at the rate of 20%. We intend to carry on sufficient activity in Ireland, directly through our board of directors and indirectly through the services of our Manager, BBAM and our servicer, so as to be treated as carrying on a trade in Ireland for the purposes of Irish tax law. If we or any of our Irish tax-resident subsidiaries were considered not to be carrying on a trade in Ireland, we or they may be subject to additional Irish tax liabilities. The application of a higher tax rate (25% instead of 12.5%) on taxable income could decrease cash available for distribution to our shareholders. In addition, we cannot assure you that the 12.5% tax rate applicable to trading income, the 20% tax rate applicable to capital gains or the 25% tax rate applicable to non-trading income will not be changed in the future.

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ITEM 4. INFORMATION ON THE COMPANY

We are Babcock & Brown Air Limited, a Bermuda exempted company incorporated on May 3, 2007 under the provisions of Section 14 of the Companies Act 1981 of Bermuda. Our registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda. Although we are organized under the laws of Bermuda, we are resident in Ireland for Irish tax purposes and thus are subject to Irish corporation tax on our income in the same way, and to the same extent, as if we were organized under the laws of Ireland. Our principal executive offices are located at West Pier, Dun Laoghaire, County Dublin, Ireland. Our telephone number at that address is +353 1 231-1900. Our agent for service of process in the United States is Puglisi & Associates located at 850 Library Avenue, Suite 204, Newark, Delaware 19711.

We are a global lessor of modern, fuel-efficient commercial jet aircraft. Our aircraft are leased under long-term to medium-term contracts to a diverse group of airlines throughout the world. On October 2, 2007, we (1) completed our IPO and issued 18,695,650 ADSs at a public offering price of \$23.00 per share, (2) issued 14,907,800 ADSs in a private placement for a price of \$23.00 per share, (3) issued \$853.0 million of aircraft lease-backed notes as part of the Securitization, and (4) used the net proceeds of the IPO, the private placement and the Securitization to finance the acquisition of our Initial Portfolio of 47 commercial aircraft. We currently have two significant subsidiaries: B&B Air Funding and B&B Air Acquisition. Both of these subsidiaries are organized under the laws of Bermuda and are tax resident in Ireland. We own 100% of B&B Air Funding's Class A common stock. For purposes of the Securitization, a charitable trust holds the Class B common stock of B&B Air Funding, having limited voting rights and representing less than 0.001% of the economic interest in B&B Air Funding. B&B Air Funding holds interest in 45 of the 47 aircraft in our Initial Portfolio directly or through its wholly-owned subsidiaries. B&B Air Funding sold the remaining two aircraft from the Initial Portfolio in September and October 2008.

On November 7, 2007, our wholly owned subsidiary, B&B Air Acquisition, entered into the Aircraft Acquisition Facility which provides for up to \$1.2 billion of financing for additional aircraft, including a \$96.0 million equity tranche from B&B Air. As of December 31, 2008, B&B Air Acquisition holds interest in 17 aircraft acquired, directly or through its wholly-owned subsidiaries.

As of December 31, 2008, our portfolio consisted of 62 aircraft.

Our Relationship With BBAM

BBAM is a leading commercial jet aircraft servicer. BBAM and its affiliates assist us in acquiring and leasing additional aircraft, manage our day-to-day operations and affairs and act as Servicer for our portfolio of aircraft and related leases.

We engage BBAM and its affiliates as Manager of our company and Servicer for our aircraft portfolio under long-term management and servicing agreements. Pursuant to these agreements our Manager manages our company under the direction of its chief executive officer and chief financial officer, who are exclusively dedicated to our business. BBAM acts as our Servicer and, in addition to arranging for the leasing of our fleet, assists our Manager in acquiring and disposing of our aircraft, markets our aircraft for lease and release, collects rents and other payments from the lessees of our aircraft, monitors maintenance, insurance and other obligations under our leases and enforces our rights against lessees. BBAM is among the largest aircraft leasing company in the world, as measured by the number of owned and managed aircraft in its portfolio. As of December 31, 2008, BBAM has re-marketed more than 300 aircraft. BBAM has also been a financial advisor to airlines worldwide and has been an active participant in the Asian aircraft leasing market since 1989. We believe BBAM's position in the industry and relationships throughout the world allows us to manage our portfolio effectively, acquire and lease additional aircraft, access high-growth emerging markets and remarket our aircraft when leases expire.

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There are significant concerns about the financial performance and viability of BBAM's corporate parent. Babcock & Brown has announced a restructuring of its corporate debt facilities which requires it to sell all of its assets over the next two to three years. It has also announced that the publicly traded Australian entity, Babcock & Brown Limited, may be delisted from the Australian Stock Exchange and may be placed into administration if it is unable to restructure its subordinated notes which are listed on the Australian and New Zealand stock exchanges. These subordinated notes are subordinated to the corporate debt facilities which were recently restructured.

Although no definitive transaction has been announced, we expect Babcock & Brown to sell all of its aviation related assets and businesses, including its rights under our servicing and management agreements with them, the legal entities which are party to these agreements including BBAM, and the common shares of B&B Air owned by them. A sale of BBAM by Babcock & Brown would create uncertainty about our management and servicing arrangements. We cannot assure you that a new owner of BBAM would dedicate comparable resources to BBAM as Babcock & Brown, and the quality of the services that BBAM has provided to us could deteriorate. If Babcock & Brown cannot sell its aviation assets quickly, there is no assurance that they will continue to dedicate resources to BBAM or continue its operations.

Some of our agreements with Babcock & Brown, as well as the agreements governing the Notes and the Aircraft Acquisition Facility, contain provisions that are linked to the financial performance and ownership of Babcock & Brown and BBAM.

These provisions include the following with respect to the Aircraft Acquisition Facility:

Babcock & Brown ceases to hold at least 5% of the issued and outstanding shares of B&B Air;

Babcock & Brown ceases to hold at least 51% of the capital stock of BBAM;

BBAM fails to deliver the audited financial statements of Babcock & Brown Limited to the agent and lenders in the Aircraft Acquisition Facility within 120 days of fiscal year end or the unaudited or audited financial statements for each semi-annual period within 90 days, and in each case such failure to deliver the required financial statements continues for 30 days after written notice from the agent;

Any Babcock & Brown Limited annual or quarterly financial statement required to be delivered as described above contains a going-concern or similar qualification;

The insolvency of BBAM or any significant subsidiary of BBAM; and

A BBAM default on recourse debt over \$25 million.

The occurrence of any of these events would immediately end the availability period for the Aircraft Acquisition Facility and accelerate the date on which we are required to apply all of the available cash flow from the aircraft owned by B&B Air Acquisition to repay amounts due under the Aircraft Acquisition Facility. An event of default under the Aircraft Acquisition Facility would also be triggered if Babcock & Brown ceases to hold at least 5% of the issued and outstanding shares of B&B Air and at least 51% of the capital stock of BBAM. As of December 31, 2008, B&B holds 14.7% of our outstanding ADSs. If any event of default occurs (other than B&B Air Acquisition or any of its subsidiaries becoming the subject of insolvency proceedings), the agent, on the request of 2/3 of the Tranche A and Tranche B lenders combined may demand immediate payment of all outstanding borrowings under the Aircraft Acquisition Facility. After the occurrence of certain bankruptcy and insolvency related events of default, or any acceleration of the amounts due under the Aircraft Acquisition Facility after the occurrence of any event of default, all cash generated by B&B Air Acquisition will be used to repay amounts due under the facility and will not be available to us. Each of these events is beyond our control and could have a materially adverse effect on our business. See the Risk Factor, *We will not be able to borrow under the Aircraft Acquisition Facility after the end of the availability period* above.

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In addition, under the servicing agreement related to the Notes, a servicer termination event is triggered if Babcock & Brown International Pty Ltd (BBIPL) ceases to own at least 50.1% of the voting equity or economic interest in BBAM or on the bankruptcy or insolvency of BBIPL or BBAM. Babcock & Brown has announced that an administration proceeding in respect of Babcock & Brown Limited will not impact the solvency of BBIPL, which is the primary operating company in the Babcock & Brown group and the borrower under the recently restructured corporate debt facilities.

Our Aircraft Portfolio

As of December 31, 2008, our aircraft portfolio consisted of 62 commercial jet aircraft with 58 narrow-body passenger aircraft (including two freighters) and four wide-body passenger aircraft. In September and October 2008, we sold two aircraft from our Initial Portfolio to a third party.

As of December 31, 2008, we had 34 Boeing aircraft and 28 Airbus aircraft in our fleet. The aircraft in our portfolio were manufactured between 1989 and 2008 and have a weighted average age of 6.4 years as of December 31, 2008. We estimate that the useful life of our aircraft is generally 25 years from the date of manufacture, except in the case of a converted freighter in which case remaining useful life is determined based on the date of conversion and can extend beyond 25 years.

The following table presents the aircraft in our portfolio as of December 31, 2008:

Lessee Name	Aircraft Type	Airframe Type	Date of Manufacture
1 Aeroflot-don	B737-500	Narrowbody	1992
2 Aeroflot-don	B737-500	Narrowbody	1992
3 Aeromexico	B737-700	Narrowbody	2005
4 Aeromexico	B737-700	Narrowbody	2005
5 Aigle Azur	A320-200	Narrowbody	1998
6 Air Berlin	B737-800	Narrowbody	1999
7 Air China	B737-800	Narrowbody	2006
8 Atlant-Soyuz	B737-800	Narrowbody	2000
9 CCM	A320-200	Narrowbody	1995
10 CCM	A320-200	Narrowbody	1995
11 Chang An Airlines	B737-800	Narrowbody	2006
12 China Southern	B757-200	Narrowbody	1999
13 China Southern	B757-200	Narrowbody	1999
14 Clickair	A320-200	Narrowbody	2007
15 Clickair	A320-200	Narrowbody	2007
16 Donbassaero	A320-200	Narrowbody	1997
17 Donbassaero	A320-200	Narrowbody	1997
18 easyJet	A319-100	Narrowbody	2007
19 Ethiopian Airlines	B757-200	Narrowbody	1997
20 Ethiopian Airlines	B757-200	Narrowbody	1998
21 Hainan Airlines	A319-100	Narrowbody	2006
22 Icelandair	B757-200	Narrowbody	2000
23 Icelandair	B757-200	Narrowbody	2000
24 Icelandair	B757-200SF ⁽¹⁾	Narrowbody	1990
25 Kingfisher Airlines	A320-200	Narrowbody	2005
26 Kingfisher Airlines	A320-200	Narrowbody	2006
27 KLM	B777-200ER	Widebody	2004
28 LTU	A330-200	Widebody	2001
29 Mexicana	A320-200	Narrowbody	1995
30 Norwegian Air	B737-800	Narrowbody	2001

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				Date of Manufacture
Lessee Name	Aircraft Type	Airframe Type		
31 Omni Air International	B757-200	Narrowbody		1989
32 Sky Airlines	B737-800	Narrowbody		2007
33 SpiceJet Limited	B737-800	Narrowbody		2006
34 SpiceJet Limited	B737-800	Narrowbody		2006
35 SpiceJet Limited	B737-800	Narrowbody		2006
36 SpiceJet Limited	B737-900ER	Narrowbody		2007
37 SpiceJet Limited	B737-900ER	Narrowbody		2008
38 Sunwing Airlines	B737-800	Narrowbody		2006
39 Swiss International	A320-200	Narrowbody		1995
40 Swiss International	A320-200	Narrowbody		1995
41 Swiss International	A320-200	Narrowbody		1995
42				