

Babcock & Brown Air LTD  
Form 20-F  
March 31, 2008

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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, 2007

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)

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	New York Stock Exchange Common
Shares, par value of \$0.001 per share	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.

33,603,450 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.

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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 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 generally accepted accounting principles in the United States (“U.S. 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. 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 global political, economic, business, competitive, market and regulatory factors. We believe that these factors include, but are not limited to, those described under Item 3 “Risk Factors” and elsewhere in this Annual Report.

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.

All percentages and weighted average characteristics of the aircraft in our portfolio have been calculated using appraised values as of December 31, 2007.

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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

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 B&B Air Funding. Using the net proceeds of the Offerings and the Notes, less expenses related to the IPO, the private placement and the Securitization, and the retention of a cash balance of \$120.8 million for the acquisition of additional aircraft, we acquired our initial portfolio of 47 commercial jet aircraft (“Initial Portfolio”). In connection with the Securitization, B&B Air Funding also entered into a liquidity facility that provides B&B Air Funding and its subsidiaries of up to \$60 million of revolving credit capacity (“Liquidity Facility”). On November 7, 2007, 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.

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 consolidated financial data presented below are our operating results for the period from May 3, 2007 (our incorporation date) to December 31, 2007 and our Predecessor’s operating results for the period from November 22, 2005 (commencement of operations) to December 31, 2005 and the years ended December 31, 2006 and December 31, 2007. We are a Bermuda exempted company incorporated on May 3, 2007 under the provisions of Section 14 of the Companies Act 1981 of Bermuda.

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(Dollars in thousands, except share data) Babcock & Brown Air Limited JET-i Leasing LLC (Predecessor Company) For the period from May 3, 2007 (incorporation date) to December 31, 2007

For the years ended December 31, For the period from November 22, 2005 (commencement of operations) to

December 31, 2005	2007	2006	Revenues	Operating lease revenue	\$ 26,042	\$ 107,620
\$ 56,566	\$ 550	Finance lease income	2,365	7,477	1,668	—
3,115	65	Other revenues	—	750	—	—
		Depreciation	8,573	34,548	17,976	156
33,840	487	Interest expense – related party	—	11,585	6,390	288
4,866	4,588	3,321	331	Maintenance and other costs	165	2,415
		—	(5,898)	5,898	—	—
		1,725	5,423	—	—	—
29,957	135,867	68,804	1,407	Net income (loss) before provision for income taxes	3,377	(14,830)
(7,455)	(792)	Provision for income taxes	1,032	466	17	—
\$ (15,296)	\$ (7,472)	\$ (792)	Earnings per share:	Basic and diluted	\$ 0.19	—
—	Pro forma \$ 0.07	—	—	—	—	—

Basic and diluted earnings per share is calculated by dividing net income by the weighted average number of shares outstanding for the period from October 2, 2007 to December 31, 2007 over the period from May 3, 2007, the date the Company was incorporated, 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, 2007	As of December 31,	2007	2006	2005	Balance sheet data:			Total assets	
\$ 1,589,226	\$ 5,249	\$ 1,010,875	\$ 83,496	Total liabilities	1,098,724	2,766	983,175	57,615	
Capital stock	504,546	—	—	Total shareholders' equity/ member's capital	490,502	2,483	27,700		
25,881	Number of shares	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.

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, our Private Placement, the Securitization, entered into a purchase agreement for the acquisition of our Initial Portfolio, and we commenced independent operations. 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. The historical financial information included in this report reflects our financial condition, results of operations and cash flows from the date we were incorporated, May 3, 2007 up to December 31, 2007, and therefore may not be a reliable indicator of our future financial performance or ability to pay dividends. 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 Policy

We may not be able to pay or maintain dividends on our shares. The failure to do so would adversely affect the trading price of our shares.

There are a number of factors that could affect our ability to pay 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;
- 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;

supply of aircraft;

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- increased

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aircraft;	• obsolescence of
lower lease rates on new aircraft and re-leased aircraft;	•
re-leasing our aircraft after the expiration or early termination of existing leases;	• delays in
financial condition and liquidity of our lessees;	• impaired
economic conditions in the commercial aviation industry generally;	• deterioration of
performance by our Manager, BBAM and their affiliates and other service providers and our limited rights to terminate them;	• poor
increased maintenance, operating or other expenses or changes in the timing thereof;	• unexpected or
our board of directors to modify or revoke its policy to distribute a portion of our cash flow available for distribution;	• a decision by
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;	• restrictions
tax law, the tax treaty between the United States and Ireland (the “Irish Treaty”) or our ability to claim the benefits of such treaty;	• changes in Irish
• cash reserves established by our board of directors; and	• restrictions
under Bermuda law on the amount of dividends that we may pay.	

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.

We own aircraft through subsidiaries, and our rights to our aircraft are structurally subordinated to the rights of the creditors of those subsidiaries.

Our rights to the aircraft beneficially owned by B&B Air Funding, B&B Air Acquisition and by our other affiliates and subsidiaries are structurally subordinated to the rights of the creditors of B&B Air Funding and B&B Air Acquisition. This means that the creditors of B&B Air Funding and B&B Air Acquisition and of our other affiliates

and subsidiaries will be paid from their assets before we would have any claims to those assets.

#### Other Risks Related to Our Business

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. Financing may not be available to us or may be available to us only on terms

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that are not favorable. Turmoil in US financial markets initiated during mid-2007 by losses related to sub-prime lending and gradually spreading to global financing markets and impacting most classes of lending 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. The terms of our Aircraft Acquisition Facility and the Securitization restrict our ability to incur additional debt. In addition, the terms of any other future indebtedness may restrict our ability to incur additional debt. The agent for our Aircraft Acquisition Facility has the right to make funding decisions 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. 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. There is currently high market demand for certain aircraft, 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:

- fail to realize anticipated benefits, such as new customer relationships or cash flow enhancements;
- 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.

Risks Related to Our Indebtedness

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 the earlier of the date six months after 90% of the total amount of the facility (including the \$96.0 million of equity tranche from us) under the Aircraft Acquisition Facility (the "Facility Amount") is utilized and November 6, 2009. We bear the risk that we will not be able to refinance our existing indebtedness on favorable terms or at all. The inability

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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.

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 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 to 1.00 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 commencing on the earlier of the date six months after 90% of the Facility Amount is utilized or November 6, 2009. 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.

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 or

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other interest rate hedging arrangements with one or more counterparties. Although the initial counterparties to such hedging arrangements have credit ratings of A1/A+ and AA1/AA, respectively, we may not continue to be able to enter into hedging arrangements with counterparties with similar credit ratings. 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.

## Risks Related to Our Relationship with Babcock & Brown

We are wholly dependent on B&B 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.

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 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

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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 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 expected to be held by B&B, its affiliates and funds managed by its affiliates. B&B, its affiliates and such funds own approximately 30% of our outstanding common shares, and termination of our management agreement requires the vote of holders of 75% of our outstanding common shares.

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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 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 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 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

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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 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;

availability of jet fuel and general economic conditions affecting our lessees' operations;  
regulation, including new airworthiness directives;  
restructurings and bankruptcies;

- operating costs,
- governmental
- interest rates;
  - airline

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orders for aircraft;	• cancellations of
delivery by manufacturers;	• delays in
cost of credit;	• availability and
production levels and technological innovation;	• manufacturer
obsolescence of aircraft models;	• retirement and
merging or exiting the industry or ceasing to produce aircraft or engine types;	• manufacturers
estimates relating to future supply and demand made by manufacturers and lessees;	• accuracy of
into service of aircraft or engines previously in storage; and	• reintroduction
traffic control infrastructure constraints.	• airport and air

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 affect 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:

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



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.

Some of the aircraft in our portfolio have been damaged and subsequently repaired.

As of December 31, 2007, at least one of the aircraft in our portfolio has been damaged. Even though this aircraft has been repaired, we may not be able to resell or re-lease such aircraft on terms as favorable as those for an aircraft that has not been damaged.

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

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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, 2007, the weighted average age of the aircraft in our portfolio was 5.8 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, 2007, our portfolio contains a mix of aircraft types including Airbus A319 aircraft, A320 aircraft, Boeing 737 aircraft, Boeing 757 aircraft and Boeing 767 aircraft. 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. In addition, the abandonment or rejection of the lease of any of the types listed above of aircraft by one or more carriers in reorganization proceedings under Chapter 11 of the U.S. Bankruptcy Code or comparable statutes in non-U.S. jurisdictions may diminish the value of such aircraft and will subject us to re-leasing risks.

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), International Lease Finance Corporation (ILFC), AerCap, Aircraftle, 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.

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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. According to data from Ascend, the proportion of the global fleet under operating lease has increased from 17% in 1990 to 30% in 2006. 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 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.

Our subsidiaries in many cases have owned the aircraft prior to our acquisition of those subsidiaries and may have unknown contingent liabilities that we may be required to fund.

There is a risk that our subsidiaries, many of which have owned the aircraft in our portfolio prior to our acquisition of such subsidiaries, could have material contingent liabilities that are unknown to us and that were incurred by third parties from operating and leasing the aircraft in our portfolio or for other reasons.

The aircraft sellers, from whom we acquired our Initial Portfolio, have made representations and warranties relating to:

- the existence of a valid and final transfer of the beneficial interests of entities that hold the aircraft or entities that hold the

beneficial interests of any such entities and that are sold to us by each of the aircraft sellers;

aircraft-owning subsidiaries to the applicable aircraft; and

additional liabilities of our aircraft-owning subsidiaries or liens on the aircraft other than disclosed to us.

- the title of our
- the lack of

These representations and warranties are subject to time limits. If a liability arises and we are called on to pay it but are not able to recover any amount from the sellers for such liability, our liquidity could decrease significantly and we may be unable to pay dividends to our shareholders.

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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, 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.

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### 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;

air travel and air cargo demand;

and other events, including war, acts of terrorism, outbreaks of epidemic diseases and natural disasters;

availability and cost of jet fuel and general economic conditions affecting our lessees' operations;

difficulties;

• economic conditions and currency fluctuations in the countries and regions in which the lessee operates; and

regulation of, or affecting, the air transportation business.

- 
- fare levels;
- air cargo rates;
  - passenger
- geopolitical
- operating costs,
- labor
- governmental

Some of our lessees may experience payment difficulties. 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 delinquencies, particularly if economic conditions 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.



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;

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lease terms in the re-lease of the aircraft; and

- adversely affect

the value of the aircraft.

- adversely affect

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.

Because some airlines are in a weak financial condition and suffer liquidity problems, we may have trouble collecting lease payments on a timely basis or at all, which would adversely affect our revenues and cash flows and may adversely affect our ability to meet our debt obligations and pay dividends.

Some airlines are in a weak financial condition and suffer liquidity problems, and this is likely to be the case in the future with other airlines. Four of our lessees, United Airlines, US Airways, ATA Airlines and the predecessor of SpiceJet, were recently in bankruptcy or insolvency proceedings. 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. Given the size of our portfolio, we expect that some lessees from time to time, and possibly in the near future, will be slow in making or will fail to make their payments in full under the leases. 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. A delayed, missed or reduced rental payment from a lessee would reduce our revenues and may adversely affect our ability to make payments on our debt obligations, including the Notes and the Aircraft Acquisition Facility, and pay dividends on our shares. While we may experience some level of delinquency under our leases, default levels may increase over time, particularly as our aircraft portfolio ages and if economic conditions deteriorate.

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 be required to 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.

Because many of our lessees operate in emerging markets, we are indirectly subject to many of the economic and political risks associated with competing in such markets.

Emerging markets are countries which 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. As of December 31, 2007, our portfolio includes 22 aircraft leased to lessees that are domiciled in emerging markets.

We may be required to purchase repossession insurance if BBAM re-leases any of our aircraft to lessees located in certain jurisdictions.

Under the servicing agreement for our Initial Portfolio, BBAM has broad discretion to re-lease aircraft to lessees around the world, subject to concentration limits and other restrictions contained in the Notes and Aircraft Acquisition Facility. If an aircraft is leased to a lessee in certain specified jurisdictions (including, among others, Belarus, Bhutan, Kazakhstan and Mongolia), B&B Funding may be required to purchase insurance to ensure its ability to repossess the aircraft. If BBAM re-leases any of the aircraft to lessees in these jurisdictions, expenses may increase due to the need to purchase repossession insurance.

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

If we are unable to agree upon acceptable terms for a lease restructuring, then we have the right to repossess aircraft and to exercise other remedies upon a lessee default. However, 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.

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.

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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 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, 2007, four 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.

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.

All percentages below are for the period from October 2, 2007 to December 31, 2007.

concentration. Revenues from 14 lessees based in Europe accounted for 33% of our total revenues for the period ended December 31, 2007. Commercial airlines in Europe face, and can be

European

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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.

expected to

concentration. Revenues from 7 lessees based in Asia (including India) accounted for 25% of our total revenues for the period ended December 31, 2007, and lease rental revenues from 2 lessees based in India accounted for 8% 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.

Asian

American concentration. Revenues from 5 lessees based in North America accounted for 22% of our total revenues for the period ended December 31, 2007. 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 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.

North

Central American concentration. Revenues from 4 lessees based in South and Central America accounted for 20% of our total revenues for the period ended December 31, 2007. 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.

South and

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.



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### 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.

The passenger aviation industry 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.

Although many of the world's airlines are currently experiencing improved financial performance, there may be a recession developing in the United States economy which could trigger a slowdown or recession in other economies. Although the potential impact of these events on the aviation industry is unclear, an industry downturn is likely to occur again in the future. Such a downturn would likely place already financially weakened lessees under further duress, once again exerting downward pressure on lease rates. As in the previous downturn, the grounding of undesirable older aircraft would also play a role in depressing aircraft values.

A deterioration in the financial condition of the commercial airline industry would have an adverse impact on our ability to lease our aircraft, sustain our revenues and pay dividends.

The financial condition of the commercial airline industry is of particular importance to us because we lease most of our aircraft to commercial airline customers. 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. The risks affecting our airline customers are generally out of 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. These risks are generally not within our control. 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:

- 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, reposessions 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. Historically, airlines involved in reorganizations have undertaken substantial fare discounting to maintain cash flows and to encourage continued customer loyalty. This fare discounting has led to lower yields for all airlines, including certain of our lessees. The bankruptcies have led to the

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grounding of significant numbers of aircraft, rejections of leases and negotiated reductions in aircraft lease rentals, with the effect of depressing aircraft market values.

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.

As high fuel prices continue to affect the profitability of the airline industry, our lessees might not be able 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. In addition, natural disasters can significantly affect fuel availability and prices. For example, in August and September 2005, Hurricanes Katrina and Rita inflicted widespread damage along the Gulf Coast of the United States, causing significant disruptions to oil production, refinery operations and pipeline capacity in the region and to oil production in the Gulf of Mexico. These disruptions resulted in decreased fuel availability and higher fuel prices.

Fuel prices remain at historically high levels. The continuing high cost of fuel will likely have a material adverse 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 remain at historically high levels or increase further, they are likely to cause our lessees to incur higher costs or experience reduced revenues. Consequently, these conditions may:

lessees' ability to make rental and other lease payments;

- affect our

restructurings and aircraft and engine repossessions;

- result in lease

costs of servicing and marketing aircraft;

- increase 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

- impair our

proceeds received for the aircraft or other aviation assets upon any disposition.

- reduce the

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

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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;
- 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.

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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
- 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;

requirements by shareholders for director nominations and actions to be taken at annual meetings; and

- advance notice

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• 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, a majority of our directors and officers, and some of the experts named in this Annual Report, 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 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.

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### 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.

## 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 and our wholly-owned subsidiaries were 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 were formed at the direction of Babcock & Brown to acquire our Initial Portfolio from affiliates of Babcock & Brown and to develop an independent aircraft leasing business. 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. Forty-four of the aircraft in the Initial Portfolio were acquired from JET-i and its subsidiaries and the remaining three aircraft from companies managed by Babcock & Brown.

We currently have two significant subsidiaries: B&B Air Funding and B&B Air Acquisition. B&B Air Funding is organized under the laws of Bermuda and is 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 the aircraft in our Initial Portfolio directly or through its wholly-owned subsidiaries.

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B&B Air Acquisition, our wholly-owned subsidiary, is organized under the laws of Bermuda and is tax resident in Ireland. B&B Air Acquisition holds interest in the seven aircraft we acquired in November and December 2007 and the five aircraft acquired in 2008 (through March 31, 2008), directly or through its wholly-owned subsidiaries.

Our aircraft are leased to a diverse group of airlines throughout the world. Our strategy is to grow our portfolio through accretive acquisitions of aircraft and other aviation assets and to increase our distributable cash flows, while paying regular quarterly dividends to our shareholders.

## Our Relationship With Babcock & Brown

B&B is a global investment and advisory firm whose aircraft management division, BBAM, is one of the world's leading commercial jet aircraft lessors. Affiliates of B&B 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 affiliates of B&B 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. As of March 31, 2008, B&B holds 14% of our outstanding shares.

B&B has over 25 years of experience in the aircraft industry. BBAM is among the five largest aircraft leasing company in the world, as measured by the number of owned and managed aircraft in its portfolio. As of December 31, 2007, BBAM managed over 270 aircraft valued at over \$7 billion and has leased aircraft to more than 140 airlines worldwide. B&B 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 B&B'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.

## Aircraft Portfolio

Our

As of December 31, 2007, our aircraft portfolio consisted of 52 commercial jet aircraft including 51 narrow-body passenger aircraft, which includes a freighter and one wide-body passenger aircraft. Forty-five of these aircraft comprise our Initial Portfolio and are owned through B&B Air Funding and its subsidiaries. The remaining seven aircraft in our portfolio are owned by B&B Air Acquisition and its subsidiaries. Two aircraft from the Initial Portfolio are excluded because they were delivered to us in February 2008. These two aircraft are:

B737-800 (narrowbody) manufactured in 1999 on lease to Air Berlin, and

1. One

A320-200 (narrowbody) manufactured in 1998 on lease to Aigle Azur.

2. One

As of December 31, 2007, we had 27 Boeing aircraft and 25 Airbus aircraft in our fleet. The aircraft in our portfolio were manufactured between 1989 and 2007 and have a weighted average age of 5.8 years. We estimate that the useful life of our passenger aircraft is approximately 25 to 30 years, including, in the case of an aircraft originally

manufactured as a passenger aircraft and later converted to freighter configuration, 15 to 20 years as a passenger aircraft and an additional 10 to 20 years as a freighter aircraft following the accomplishment of such conversion.

The

following table presents the aircraft in our portfolio as of December 31, 2007:

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Lessee Name	Equipment Type	Airframe Type	Date of
Manufacture Aircraft owned by B&B Air Acquisition and its subsidiaries:			
1 Clickair	A320-200	Narrowbody	2007
2 Icelandair	B757-200	Narrowbody	2000
3 SpiceJet Limited	B737-900ER	Narrowbody	2007
4 US Airways	A319-100	Narrowbody	2000
5 US Airways	A319-100	Narrowbody	2000
6 US Airways	A319-100	Narrowbody	2000
Aircraft owned by B&B Air Funding and its subsidiaries:			
8 Aeroflot-don	B737-500	Narrowbody	1992
9 Aeroflot-don	B737-500	Narrowbody	1992
10 Aeromexico	B737-700	Narrowbody	2005
11 Aeromexico	B737-700	Narrowbody	2005
12 Air China	B737-800	Narrowbody	2006
13 Air Europa	B737-800	Narrowbody	2001
14 ATA Airlines	B757-200	Narrowbody	1996
15 ATA Airlines	B757-200	Narrowbody	1997
16 ATA Airlines	B757-200	Narrowbody	1998
17 ATA Airlines	B757-200	Narrowbody	1998
18 CCM	A320-200	Narrowbody	1995
19 CCM	A320-200	Narrowbody	1995
20 Chang'An Airlines	B737-800	Narrowbody	2006
21 China Southern	B757-200	Narrowbody	1999
22 China Southern	B757-200	Narrowbody	1999
23 easyJet	A319-100	Narrowbody	2007
24 First Choice Airways	B757-200	Narrowbody	1999
25 First Choice Airways	B757-200	Narrowbody	1999
26 Hainan Airlines	A319-100	Narrowbody	2006
27 Kingfisher Airlines	A320-200	Narrowbody	2005
28 Kingfisher Airlines	A320-200	Narrowbody	2006
29 Mexicana	A320-200	Narrowbody	1995
30 Omni Air International	B757-200	Narrowbody	1989
31 SpiceJet Limited	B737-800	Narrowbody	2006
32 SpiceJet Limited	B737-800	Narrowbody	2006
33 SpiceJet Limited	B737-800	Narrowbody	2006
34 Sunwing Airlines	B737-800	Narrowbody	2006
35 Swiss Int'l	A320-200	Narrowbody	1995
36 Swiss Int'l	A320-200	Narrowbody	1995
37 Swiss Int'l	A320-200	Narrowbody	1995
38 Swiss Int'l	A320-200	Narrowbody	1995
39 Swiss Int'l	A320-200	Narrowbody	1996
40 TACA	A320-200	Narrowbody	1997
41 TACA	A320-200	Narrowbody	1997
42 Tiger Airways	A320-200	Narrowbody	2006
43 Titan Airways(1)	B737-300	Narrowbody	1991
44 Transavia Airlines	B737-700	Narrowbody	2001
45 Travel Service Airlines	B737-800	Narrowbody	1999
46 TUI	B767-300ER	Widebody	1997

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Lessee Name	Equipment Type	Airframe Type	Date of
Manufacture 47	Virgin America	A320-200 Narrowbody	2005 48
	Virgin America	A320-200 Narrowbody	
2006 49	Volaris Airlines	A319-100 Narrowbody	1999 50
	Volaris Airlines	A319-100 Narrowbody	
2000 51	Volaris Airlines	A319-100 Narrowbody	2007 52
	XL Airways	B737-800 Narrowbody	2000
			(1)

Freighter.

The following table summarizes the composition of our portfolio by manufacturer and aircraft type as of December 31, 2007:

Aircraft Type	Number of	Aircraft Manufacturer								
Aircraft Boeing	B737-300QC	1	B737-500	2	B737-700	3	B737-800	9	B737-900ER	1
B757-200	10	B767-300ER	1	Total	27	Airbus	A319-100	9	A320-200	16
Total	52								Total	25

We believe the high utility and young age of these aircraft ensure a long remaining useful life and increase our ability to redeploy aircraft at attractive lease rates.



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The following table presents the composition of our aircraft portfolio based on age, as of December 31, 2007:

		Year of Manufacture														Number of						
Aircraft	1989	1	1990	—	1991	1	1992	2	1993	—	1994	—	1995	7	1996	2	1997	4	1998	2		
	1999	6	2000	7	2001	2	2002	—	2003	—	2004	—	2005	4	2006	10	2007	4	Total	52		

Approximately 80.4% of the aircraft in our portfolio are members of the narrow-body Airbus 320 and next generation Boeing 737 aircraft families, both of which enjoy high worldwide demand due to their fuel-efficient design, relatively low maintenance costs, and an increase in customer demand for point-to-point destination service. These aircraft are based on more routes around the world than any other airframe and thus have the largest installed base. As a result, we believe they are easier and more cost-efficient to lease and market than wide-body jets or other specialized types of aircraft.

The following table presents the composition of our portfolio based on airframe type:

		Airframe Type		Number of			
Aircraft	Narrow-body(1)	51	Wide-body	1	Total	52	
							(1)

Includes one freighter.

We have assumed the rights and obligations under a sale agreement entered into by our Predecessor, to sell one of the aircraft in our Initial Portfolio, a Boeing 757-200, upon expiration of the lease thereof in 2010.

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## Our Leases

## Lease Terms

All of our aircraft are subject to leases under which lessees are responsible for most operational and insurance costs, and 43 of the 52 leases in our portfolio are subject to fixed rental rates. Our portfolio is diversified across 29 different airlines in 16 countries, in both developed and emerging markets. Our leases, which are scheduled to expire between 2008 and 2021 and have a weighted average remaining lease term of 6.3 years, are expected to provide us with a stable source of revenues and cash flows.

The following table presents the scheduled lease maturity of the aircraft in our portfolio as of December 31, 2007:

Airframe Type	Year of Lease Expiration	Narrow(1)	Wide	Total	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021					
4	—	4	2011	5	1	6	2012	10	—	10	2013	2	—	2	2014	2	—	2	2015	8	—		
8	2016	4	—	4	2017	2	—	2	2018	3	—	3	2019	—	—	—	2020	—	—	—	2021	4	—
4	Total	51	1	52																			

(1)

Includes one freighter in 2012.

Under our leases, the lessees agree to lease the aircraft for a fixed term, although in some cases the lessees have termination rights or extension rights. As of December 31, 2007, four of the leases in our portfolio provide the lessees with early termination rights and under 21 of the leases the lessee has the option to extend the term of the lease.

During 2007, we received all of our revenue in U.S. dollars and paid substantially all of our expenses in U.S. dollars. We have recently entered into a lease agreement pursuant to which we receive part of the lease payments in euros. We have engaged in a foreign currency hedging transaction related to this lease.

Most lease rentals are payable monthly in advance, but some lease rentals are payable quarterly. Of our leases, 43 have fixed rental rates and nine have floating rental rates based on six-month LIBOR. We generally enter into leases with fixed rental rates, except in situations where a lessee expresses a preference for a lease with a floating rental rate. In addition, because most of our debt will bear floating rates of interest, we intend to manage interest-rate payment risk by entering into interest-rate swaps pursuant to which we will make fixed-rate interest payments on the swap and receive floating-rate payments on our leases. All leases are on a ‘net’ basis with the lessee generally responsible for all operating expenses, which customarily include maintenance, fuel, crews, airport and navigation charges, taxes, licenses, aircraft registration and insurance premiums.

Most of our leases generally provide that the lessee’s payment obligations are absolute and unconditional under any and all circumstances. Lessees are generally required to make payment without deduction on account of any amounts that we may owe the lessee or any claims that the lessee may have against us.

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Most of our leases also require lessees to gross up lease payments where they are subject to withholdings and other taxes, although there are some exceptions to this requirement, including withholdings that arise out of transfers of the aircraft to or by us or due to our corporate structure. In addition, changes in law may result in the imposition of withholding and other taxes and charges that are not reimbursable by the lessee under the lease or that cannot be reimbursed under applicable law. Furthermore, lessees may fail to reimburse us even when obligated under the lease to do so. Our leases also require lessees to indemnify us for certain other tax liabilities relating to the leases and the aircraft, including, in most cases, value added tax and stamp duties.

The cost of an aircraft typically is not fully recovered over the term of the initial lease. We therefore retain the benefit and assume the risk that we will not be able to recover our investment in the aircraft upon expiration or early termination of the lease and of the ultimate residual value. Operating leases allow airlines greater fleet and financial flexibility than outright ownership because of the relatively shorter-term nature of operating leases, the relatively small initial capital outlay necessary to obtain use of the aircraft and the significant reduction in aircraft residual value risk.

**Security Deposits and Letters of Credit.** 40 of our leases provide for cash security deposits and/or letters of credit which may be drawn down in the event that a lessee defaults under any of these leases. These security deposits and/or letters of credit may mitigate losses we may incur while attempting to re-lease the aircraft. Under certain circumstances, the lessee may be required to obtain guarantees or other financial support from an acceptable financial institution or other third parties.

**Maintenance Obligations.** Under our leases, the lessee is generally responsible for normal maintenance and repairs, airframe and engine overhauls, obtaining consents and approvals and compliance with return conditions of aircraft on lease. In connection with the lease of a used aircraft we sometimes agree to contribute specific additional amounts to the cost of certain major overhauls or modifications, which usually reflect the usage of the aircraft prior to the commencement of the lease. In many cases, we also agree to share with our lessees the cost of compliance with airworthiness directives.

Our portfolio includes 30 leases pursuant to which we collect maintenance reserve payments that are determined based on passage of time or usage of the aircraft measured by hours flown or cycles operated. Under these leases, we are obligated to make reimbursements to the lessee for expenses incurred for certain planned major maintenance, up to a maximum amount that is typically determined based on maintenance reserves paid by the lessee. Certain leases also require us to make maintenance contributions for costs associated with certain major maintenance events in excess of any maintenance reserve payments. Major maintenance includes heavy airframe, off-wing engine, landing gear and auxiliary power unit overhauls and replacements of engine life limited parts. We are not obligated to make maintenance contributions under leases at any time that a lessee default is continuing. Twenty-two of our leases provide for a lease-end adjustment payment based on the usage of the aircraft during the lease term and its condition upon return. Most such payments are likely to be made by the lessee to us, although payments may be required to be made by us to the lessee.

**Compliance with Laws.** The lessee is responsible for compliance with all applicable laws and regulations with respect to the aircraft. We generally require our lessees to comply with the standards of either the U.S. Federal Aviation Administration or its non-U.S. equivalent. We often require a deposit as security for the lessee's performance of obligations under the lease and the condition of the aircraft upon return.

**General.** Each aircraft generally must remain in the possession of the applicable lessee and any sublessees of the aircraft generally must be approved by the lessor unless, in some leases, certain conditions are met. Under most of our

leases, the lessees may enter into charter or “wet lease” arrangements in respect of the aircraft (i.e., a lease with crew and services provided by the lessor under the lease), provided the lessee does not part with operational control of the aircraft. Under some of our leases, the lessee is permitted to enter into subleases with specified operators or types of operators without the lessor’s consent, provided certain conditions are met. We are aware that five of the aircraft are currently subject to subleases. Our leases also generally permit the lessees to subject the equipment or components to removal or replacement and, in certain cases, to pooling arrangements (temporary borrowing of equipment), without the lessor’s consent but subject to conditions and criteria set forth in the applicable lease. Under our leases, the lessee may deliver possession of the aircraft, engines and other

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equipment or components to the relevant manufacturer for testing or similar purposes, or to a third party for service, maintenance, repair or other work required or permitted under the lease.

Some foreign countries have currency and exchange laws regulating the international transfer of currencies. When necessary, we will require as a condition to any foreign transaction, that the lessee or purchaser in a foreign country obtain the necessary approvals of the appropriate government agency, finance ministry or central bank for the remittance of all funds contractually owed in U.S. dollars. We attempt to minimize our currency and exchange risks by negotiating most of our aircraft leases and all of our sales transactions in U.S. dollars. The terms of the Securitization will permit B&B Air Funding to have up to 5% of its leases denominated in euros. During 2007, we received all of our revenue in U.S. dollars and paid substantially all of our expenses in U.S. dollars. We have recently entered into a lease agreement pursuant to which we receive part of the lease payments in euros. We have engaged in a foreign currency hedging transaction related to this lease.

**Lease Restructurings.** During the term of a lease, a lessee's business circumstances may change to the point where it is economically sensible for us to consider restructuring the terms of the lease. Restructurings may involve the voluntary termination of leases prior to contracted lease expiration, the arrangement of subleases from the primary lessee to another airline, the rescheduling of lease payments, the forgiveness and/or reduction of lease obligations and the extension of the lease terms.

**Aircraft Repossessions.** If a restructuring is not possible, we may seek to terminate the lease and gain possession of the aircraft for remarketing. Although the majority of repossessions are accomplished through negotiation, if we cannot obtain the lessee's cooperation we would have to take legal action in the appropriate jurisdiction. This legal process could delay the ultimate return of the aircraft. In addition, in connection with the repossession of an aircraft, we may be required to pay outstanding mechanic's, airport, navigation and other liens on the repossessed aircraft. These charges could relate to other aircraft that we do not own but were operated by the lessee. In contested repossessions, we likely would incur substantial additional costs for maintenance, refurbishment and remarketing of the aircraft.

## Lease Management and Remarketing

We outsource our lease management and aircraft remarketing activities to BBAM. Pursuant to our servicing agreements with BBAM, BBAM provides us with most services related to leasing our fleet, including marketing aircraft for lease and re-lease or sale, 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. All our leases that expired in 2007 have been re-leased. Four leases expire in 2008. Three of these leases have been re-leased or extended. We have entered into a letter of intent with a potential lessee to enter into a new lease at the end of the current lease term for the fourth lease. We may have additional remarketings in 2008 if any leases are terminated prior to their scheduled expiry dates.

From time to time, we may decide to dispose of our leased aircraft at or before the expiration of their leases.

## Competition

The leasing and remarketing of commercial jet aircraft is highly competitive. See the risk factor "We operate in a highly competitive market for investment opportunities in aircraft and other aviation assets."

## Insurance

We require our lessees to carry those types of insurance which are customary in the air transportation industry. These include aircraft all-risk hull covering the aircraft and its engines, spares insurance and hull war and allied perils insurance covering risks such as hijacking, terrorism, confiscation, expropriation, seizure and nationalization to the extent normally available in the international market. Coverage under aircraft hull insurance policies generally is subject to standard deductible levels in respect of partial damage to the aircraft, in some instances and under certain circumstances the lessee has the right to self-insure some or all of the risk. The lessee is required to pay all deductibles, and also would be responsible for payment of amounts self-insured.

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We also carry comprehensive liability insurance, including war and allied perils coverage, provisions for bodily injury, property damage, passenger liability, cargo liability and such other provisions reasonably necessary in commercial passenger and cargo airline operations. Coverage under liability policies generally is not subject to deductibles except as to baggage and cargo that are standard in the airline industry.

In general, we are named as an additional insured and loss payee on the hull and hull war policy for the sum of the stipulated loss value or agreed value of the aircraft and our own contingent coverage in place is at least equal to the appraised value of the aircraft. In cases where the servicer believes that the agreed value stated in the lease is not sufficient, the servicer will purchase additional total loss only coverage for the deficiency and as additional insured on the liability policies carried by our lessees.

The Servicer will obtain certificates of insurance from the lessees' insurance brokers to evidence the existence of such insurance. These certificates of insurance generally include, in addition to the information above, (i) a breach of warranty endorsement so that, subject to certain standard exceptions, our interests are not prejudiced by any act or omission of the lessee, (ii) confirmation that the liability insurance is primary and not contributory, (iii) agreement that insurers waive rights of subrogation against us and (iv) in respect to all policies, notice of cancellation or material change 30 days in respect of most policies but war and allied perils insurance policies customarily provide seven days advance written notice for cancellation and may be subject to lesser notice under certain market conditions.

As a result of the terrorist attacks on September 11, 2001, the insurance market unilaterally terminated war risk liability coverage for a short period of time. When it became available again, the insurance market imposed a sub limit on each operator's policy for third-party war risk liability, which is currently between \$50 million and \$150 million on the customary war-risk liability endorsement available in the London market. U.S., Canadian and certain other non-European Community-based airlines have government war-risk insurance programs available in which they currently participate.

Although we currently require each lessee to purchase third party war risk liability in amounts greater than such sublimits, or obtain an indemnity from their government, the market or applicable governments may discontinue to make such excess coverage available for premiums that are acceptable to carriers. As a result, it is possible that we may be required to permit lessees to operate with considerably less third-party war risk liability coverage than currently carried, which could have a material adverse effect on the financial condition of our lessees and on us in the event of an uncovered claim.

In late 2005, the international aviation insurance market unilaterally introduced exclusions for physical damage to aircraft hulls caused by dirty bombs, bio-hazardous materials, electromagnetic pulsing and similar causes of loss in addition to the existing exclusion for the detonation of a nuclear device. It is possible that the same exclusions may be introduced into liability policies, but there is no time frame as to implementation.

In addition to the coverage maintained by our lessees, we maintain contingent liability insurance and contingent hull insurance with respect to our aircraft. Such contingent insurance is intended to provide coverage in the event that the insurance maintained by any of our lessees should not be available for our benefit as required pursuant to the terms of the contract. Consistent with industry practice, our insurance policies are subject to commercially reasonable deductibles or self-retention amounts.

We cannot assure you that we have adequately insured against all risks, that lessees will at all times comply with their obligations to maintain insurance, that any particular claim will be paid, or that we will be able to procure adequate insurance coverage at commercially reasonable rates in the future.

Government Regulation

The air transportation industry is highly regulated. Because we do not operate aircraft, we generally are not directly subject to most of these laws. However, our lessees are subject to extensive regulation under the laws of the jurisdiction in which they are registered or under which they operate. These laws govern, among other things, the registration, operation, maintenance and condition of our aircraft. See the risk factor, “We cannot assure you that all lessees will comply with the registration requirements in the jurisdiction where they operate.”



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Most of our aircraft are registered in the jurisdictions in which the lessees of our aircraft are certified as air operators. As a result, our aircraft are subject to the airworthiness and other standards imposed by these jurisdictions. See the risk factor, “Government regulations could require substantial expenditures, reduce our profitability and limit our growth.”

Properties

We have no physical facilities. Our executive offices are located on our Manager’s premises in Dublin, Ireland, and we reimburse our Manager for the cost of those facilities pursuant to the management agreement.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

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## ITEM 5. OPERATING

## AND FINANCIAL REVIEW AND PROSPECTS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this Annual Report. The consolidated financial statements for the period from May 3, 2007 (incorporation date) to December 31, 2007 have been prepared in accordance with U.S. GAAP and are presented in U.S. dollars. The discussion below contains forward-looking statements that are based upon our current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from these expectations due to changes in global, regional or local political, economic, business, competitive, market, regulatory and other factors, many of which are beyond our control. See “Preliminary note” and Item 3 “Risk factors.”

## Overview

We are a company formed by Babcock & Brown to acquire and lease commercial jet aircraft and other aviation assets. Our aircraft are leased under long-term to medium-term contracts to a diverse group of airlines throughout the world. Our strategy is to grow our portfolio through accretive acquisitions of aircraft and other aviation assets and to increase our distributable cash flows, while paying regular quarterly dividends to our shareholders.

On October 2, 2007, we completed our IPO and Private Placement and received gross proceeds totaling approximately \$772.9 million. Of this amount, approximately \$454.2 million was received in cash from the Offerings, and approximately \$321.4 million was received in the form of interest-bearing notes receivable from certain private investors who participated in the private placement. Net underwriting fees and other offering costs totaling \$26.4 million were incurred in connection with our IPO. In consideration for arranging the transactions associated with the Offerings, certain private placement investors agreed to pay B&B Air an aggregate of \$3.0 million for certain offering costs.

On October 2, 2007, our subsidiary, B&B Air Funding also completed the issuance of \$853.0 million in Notes at an offering price of 99.71282%, or \$850.6 million, as part of the Securitization.

Using the net proceeds of the IPO, the Private Placement and the Securitization, less expenses related to the IPO, the Private Placement and the Securitization, and the retention of a cash balance of \$120.8 million for the acquisition of additional aircraft, we acquired our Initial Portfolio of 47 commercial jet aircraft for a total base purchase price of \$1,451.0 million. As of December 31, 2007, 45 of the 47 aircraft comprising our Initial Portfolio have been delivered. The remaining two aircraft were delivered in February 2008.

The final purchase price for Initial Portfolio was \$1,443.1 million, which represents the following adjustments to the base purchase price:

	– Less (i)
\$12.5 million for the amount of rents received by the sellers from October 2, 2007 through the date of delivery of the aircraft and (ii) \$0.2 million of other amounts;	
	– Plus \$4.8 million of
investment earnings.	

As title of each aircraft owned by our Predecessor was transferred to the Company, a prorated portion of the notes receivable from certain participants in the private placement, together with any accrued interest, was required to be paid to the Company. As of December 31, 2007, \$319.5 million had been repaid on these notes and \$1.8 million

remained outstanding. In January 2008, the outstanding balance of the notes was fully repaid.

The acquisition of aircraft included in our Initial Portfolio was accounted for at the historical cost of our Predecessor. In addition, we have through our wholly-owned subsidiary, B&B Air Acquisition, acquired and taken delivery of seven aircraft in November and December 2007 and five additional aircraft in 2008 through March 31, 2008 using borrowings under our Aircraft Acquisition Facility.

#### Critical Accounting Policies and Estimates

B&B Air and JET-i have prepared their consolidated financial statements in accordance with U.S. GAAP, which requires the use of estimates and assumptions that affect the amounts reported in the consolidated

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financial statements and accompanying notes. The use of estimates is or could be a significant factor affecting the reported carrying values of flight equipment, investments, deferred assets, accruals and reserves. We utilize third party appraisers and industry valuation professionals, where possible, to support estimates, particularly with respect to flight equipment. Despite our best efforts to accurately estimate such amounts, actual results could differ from those estimates. The following is a discussion of the accounting policies that involve a high degree of judgment and the methods of their application.

### Rental Revenue

Rental revenue from flight equipment under operating leases is recorded on a straight-line basis over the term of the lease. Rental revenue from finance leases is recognized on the interest method to produce a level yield over the life of the finance lease. Rentals received but unearned under the lease agreements are recorded in "Rentals received in advance" on the Consolidated Balance Sheet until earned. In certain cases, leases may provide for additional rentals based on usage which is recorded as revenue as it is earned under the terms of the lease. The usage is calculated based on passage of time or on hourly usage or cycles operated, depending on the lease agreement. Usage is typically reported monthly by the lessee and is non-refundable. Other leases provide for a lease-end adjustment payment by us or the lessee based on usage of the aircraft and its condition upon return. Lease-end adjustment payments received are included in rental revenue of flight equipment. Lease-end adjustment payments made are capitalized in "Flight equipment under operating leases, net" when they relate to planned major maintenance activities or expensed when they relate to minor maintenance activities.

Rent receivables represent unpaid, current lease obligations of lessees under existing lease contracts. No revenues are recognized, and no receivable is recorded, from a lessee when collectibility is not reasonably assured. Estimating whether collectibility is reasonably assured requires some level of subjectivity and judgment as it is based primarily on the extent to which amounts outstanding exceed the value of security held, the financial strength and condition of the lessee and the current economic conditions of the lessee's operating environment. When collectibility of rental payments is not certain, revenue is recognized when cash payments are received. Collectibility is evaluated based on factors such as the lessee's credit rating, payment performance, financial condition and requests for modifications of lease terms and conditions as well as security received from the lessee in the form of guarantees and/or letters of credit.

There were no allowances for doubtful accounts required at December 31, 2007.

### Flight Equipment Under Operating Leases, Net

Flight equipment under operating lease previously owned by our Predecessor and comprising part of our Initial Portfolio is recorded at our Predecessor's cost upon delivery to us, including costs required to transfer the aircraft. Other aircraft are recorded at its acquisition cost. Flight equipment under operating lease is depreciated on a straight-line basis over its remaining useful life to estimated residual value. Useful life is based on 25 years from the date of manufacture. Estimated residual values are generally estimated to be approximately 15% of original manufacturer's price of aircraft when new. We may make exceptions to this policy on a case by case basis when, in our judgment, the residual value calculated pursuant to this policy does not appear to reflect current expectations of residual values. Examples of such situations would include, but are not limited to:

- flight equipment where original manufacturer's prices are not relevant due to plane modifications and conversions; and
- flight

equipment which is out of production and may have a shorter useful life due to obsolescence.

Estimated residual values and useful lives of flight equipment are reviewed and adjusted if appropriate at each reporting period.

We apply Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (“SFAS No. 144”), which addresses financial accounting and reporting for impaired flight equipment and flight equipment that we intend to and reasonably expect to sell within a twelve-month period. In accordance with SFAS No. 144, we evaluate flight equipment for impairment

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where circumstances indicate that the carrying amounts of such assets may not be recoverable. The review for recoverability has a level of subjectivity and requires the use of our judgment in the assessment of the estimated future cash flows associated with the use of an asset and its eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, we assess whether the fair values of the flight equipment exceed the carrying value and an impairment loss is required. The impairment loss is measured as the excess of the carrying amount of the impaired asset over its fair value. Fair value reflects the present value of cash expected to be received from the aircraft in the future, including its expected residual value discounted at a rate commensurate with the associated risk. The estimation of these future cash flows is subjective and requires the use of estimates. Future cash flows are assumed to occur under the current market conditions and assume adequate time for a sale between a willing buyer and a willing seller. Expected future lease rates are based on all relevant information available, including the existing lease, current contracted rates for similar aircraft, appraisal data and industry trends. Residual value assumptions generally reflect an aircraft's booked residual, except where more recent industry information indicates a different value is appropriate. The preparation of these impairment analyses requires the use of assumptions and estimates, including the level of future rents, the residual value of the flight equipment to be realized upon sale at some date in the future, estimated downtime between re-leasing events and the amount of re-leasing costs.

At the time of aircraft acquisition, an evaluation is made whether the lease acquired with the aircraft is at fair market value. Lease premium relates to leases acquired that are determined to be above market value; lease discounts relate to leases acquired that are determined to be below fair market value. Lease premiums are capitalized into other assets and lease discounts are reserved in other liabilities and both are amortized on a straight-line basis to rent revenue over the lease term.

## Investment in Direct Finance Leases

In accordance with Statement of Financial Accounting Standards No. 13, Accounting for Leases, we have recorded certain leases as investment in direct finance leases, which consists of lease receivables, plus the estimated residual value of the equipment on lease termination date less unearned income. The determination of residual values is subjective and requires the use of estimates. Residual values are determined based on estimated market values at the end of lease received from appraisers. Lease receivables represent the total rent to be received over the term of the lease reduced by rent already collected. Initial unearned income is the amount by which the original sum of the lease receivable and the estimated residual value exceeds the original cost of the leased equipment. Unearned income is amortized to finance lease income over the lease term in a manner that produces a constant rate of return on the net investment in the lease.

## Derivative Financial Instruments

We use derivative financial instruments to manage exposure to interest rate risks. Derivatives are accounted for in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities ("SFAS No. 133"), as amended. All derivatives are recognized on the balance sheet at their fair value. SFAS No. 144 provides special hedge accounting provisions, which permit the change in the fair value of the item being hedged to be recognized into earnings in the same period and in the same income statement line as the change in the fair value of the derivative instrument. On the date that the Company enters into a derivative contract, the Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking each hedge transaction. Derivate instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Cash flow hedges are accounted for by recording the fair value of the

derivate instrument on the balance sheet as either a freestanding asset or liability. Changes in the fair value of an effective cash flow hedge are recorded in accumulated other comprehensive income (loss), net of tax until earnings are affected by the variability of cash flows of the hedged transaction.

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Any derivative gains and losses that are not effective in hedging the variability of expected cash flows of the hedged item are recognized directly into income. Changes in the fair value of derivative financial instruments that do not qualify for hedge treatment under SFAS No. 133 are recorded in income.

At the hedge's inception and at least quarterly thereafter, a formal assessment is performed to determine whether changes in cash flows of the derivative instrument have been highly effective in offsetting changes in the cash flows of the hedged items and whether they are expected to be highly effective in the future. If it is determined a derivative instrument has not been or will not continue to be highly effective as a hedge, hedge accounting is discontinued. When this occurs, unrecognized gains and losses recorded on hedged assets and liabilities are amortized over the remaining life of the hedged item beginning no later than when hedge accounting ceases.

## Security Deposits and Maintenance Payment Liabilities

In the normal course of leasing aircraft to third parties under certain lease agreements, we receive cash or a letter of credit as security for contractual obligations and maintenance payments to be applied against the future maintenance of aircraft. Our aircraft are typically subject to triple-net leases under which the lessee is responsible for maintenance, insurance and taxes. Amounts collected from lessees for future maintenance of the aircraft are recorded as maintenance payment liabilities. Maintenance payment liabilities are attributable to specific aircraft. Upon occurrence of qualified maintenance events, funds are disbursed and the liability is relieved. In some leases the lessor may be obligated to contribute to maintenance related expenses on an aircraft during the term of the lease. In other instances, the lessee or lessor may be obligated to make a payment to the counterparty at the end of lease based on a computation stipulated in the lease agreement. The calculation is based on the utilization and condition of the airframe, engines and other major life-limited components as determined at lease termination. We may also incur maintenance expenses on off-lease aircraft. Scheduled major maintenance or overhaul activities and costs for certain high-value components that are paid by us will be capitalized and depreciated over the estimated useful life of such maintenance or component. Amounts paid by us for maintenance, repairs and re-leasing of aircraft that do not extend the useful life of flight equipment are expensed as incurred.

Maintenance payment liability balances at the end of a lease or any amount received as part of a redelivery adjustment are recorded as operating lease revenue at lease termination. When flight equipment is sold, maintenance payment liabilities which are not specifically assigned to the buyer are released from the balance sheet as part of the disposition gain or loss.

## Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be reliably measured. Where amounts do not meet these recognition criteria, they are deferred and recognized in the period in which the recognition criteria are met.

- Operating lease revenue. We receive lease revenues from flight equipment under operating leases. Rental income from aircraft rents is recognized on a straight-line basis over the respective lease terms. Contingent rents are recognized as revenue when they are earned. Revenue is not recognized when collection is not reasonably assured.

- Finance lease income. Revenue from direct finance leases is recognized on the interest method to produce a level yield over the life of the finance lease. Expected unguaranteed residual values of leased assets are based on our assessment of residual values and independent appraisals of the values of leased assets remaining at expiration of a lease term.



## Operating Results

Management's discussion and analysis of operating results presented below pertain to: (i) the consolidated statement of operations of B&B Air for the period from May 3, 2007 (incorporation date) to December 31, 2007; (ii) the consolidated statement of operations of JET-i for the year ended December 31, 2006 and for the period from November 22, 2005 (commencement of operations) to December 31, 2005; and (iii) the consolidated statement of operations of JET-i for the years ended December 31, 2007 and 2006.

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The historical financial and operating results of JET-i for the years ended December 31, 2007 and 2006 discussed below are not intended to be indicative of what results B&B Air would have had if we had acquired, maintained and operated the aircraft owned by JET-i in the periods presented below as B&B Air's debt and equity structure and management agreements differ significantly from those of JET-i's.

Consolidated Statement of Operations of B&B Air for the period from May 3, 2007 (incorporation date) to December 31, 2007 ('Period')

							For the period from
May 3, 2007							
(incorporation date)							
to December 31, 2007	(Dollars in thousands)	Revenues	Operating lease revenue	\$ 26,042	Finance lease		
income	2,365	Interest income	4,927	Total revenues	33,334	Expenses	Depreciation
expense	14,628	Hedging costs related to interest rate swap option	1,725	Selling, general and administrative	4,866	Maintenance and other costs	165
		Total expenses	29,957	Net income before provision for income taxes	3,377	Provision for income taxes	1,032
		Net income	\$ 2,345				

As of December 31, 2007, we had received delivery of 45 aircraft of the 47 aircraft comprising our Initial Portfolio. In addition, through our subsidiary B&B Air Acquisition, we acquired an additional seven aircraft in November and December 2007.

Rental revenues received from operating leases are recognized on a straight-line basis over the respective lease terms. For the Period, we recorded no end of lease payments into income. Lease discounts and premiums amortized into lease revenue during the Period totaled \$0.2 million and \$37,000, respectively.

As of December 31, 2007, we had 4 aircraft under finance leases. We recorded \$2.4 million in finance lease income during the Period.

During the Period, we recorded interest earned on our cash balances totaling \$4.9 million.

We depreciate our flight equipment under operating leases on a straight-line basis over its remaining estimated useful life to estimated salvage value. Depreciation expense during the Period for the 45 aircraft from our Initial Portfolio was \$8.0 million, and for aircraft owned by B&B Air Acquisition and its subsidiaries was \$0.6 million.

Our subsidiary, B&B Air Funding, issued Notes on October 2, 2007 that bear interest at the prevailing one-month LIBOR plus 0.67%. Interest expense incurred during the Period totaled \$12.1 million for the Notes.

B&B Air Funding has also entered into a revolving credit facility under which advances bear interest at the one-month LIBOR plus 1.20%. A commitment fee of 0.40% is due based on the unused portion of the Liquidity Facility. Commitment fees of \$0.1 million were incurred on the undrawn portion of the Liquidity Facility during the Period.

To finance the acquisition of aircraft, B&B Air Acquisition entered into a senior secured revolving Aircraft Acquisition Facility. Borrowings under the Aircraft Acquisition Facility bear interest at a rate of



