



24-Hour trading  
and support  
**24/7**



# TheStreet.com

Transportation

[Return to Article](#)

## Headwinds Threaten Aircastle's Dividend

Nicholas Yulico

03/18/08 - 01:10 PM EDT

**Aircastle's** SAYR lofty 20% dividend yield looks enticing on first glance. But with global aviation demand weakening and the aircraft financing markets under pressure, the aircraft-leasing company may be forced to cut its dividend this year or next.

Aircastle makes its money by buying planes and leasing them to passenger and freight carriers such as **US Airways**LCC and Sterling Airlines, its two largest customers.

The company's rapid growth in recent years was fueled by an acquisition binge that was financed through cheap long-term debt secured in the asset-backed securities market, which is now virtually shut down.

Aircastle's management said in its February earnings call that it is having trouble finding new planes to purchase since debt costs remain high but sellers are not yet cutting prices on planes.

The difficult plane purchasing market is hurting Aircastle's growth prospects. As well, the company is facing near-term cash flow pressures from a perfect storm of weakening airplane lease rates, ballooning oil prices that may force airlines to ground their planes, and margin calls on the firm's interest rate swaps.

Amid these headwinds, Aircastle has been paying out more dividends than it receives in net income. The extraordinary 20% dividend yield today means investors are either betting on a possible dividend cut or substantial hits to book value, because stocks rarely trade at such high yields.

Aircastle's stock has already plunged about 60% in the past six months to around \$14, a discount to its recent stated book value of \$16.50. The stock's dismal performance is a black eye for alternative asset manager **Fortress Investment Group**FIG, which owns a substantial stake in Aircastle and took it public in 2006.

The company sits as yet another dog in Fortress' "castle" line of businesses, which also include real estate investment firms **Newcastle Investment**NCT and Eurocastle Investment, a public company traded on the Amsterdam exchange. All four companies are trading at 52-week lows.

Aircastle and Fortress did not respond to requests for comment.

Somewhat surprisingly, not one Wall Street analyst rates Aircastle a sell. Skeptics say that is because no one wants to upset Fortress, which pays hefty trading and investment banking fees to the major banks.

FBR analyst John Stilmar, who rates the stock "market perform," says Aircastle's shares have been hit too hard by the broader credit crunch.

"Any company that has to re-access the capital markets as part of near-term [business strategy](#) is continuing to be penalized," says Stilmar, who thinks Aircastle shares are worth \$23 and will trade higher once credit risk premiums lower across the financial industry. (He says the stock has shown a strong correlation to corporate credit default swaps for large global banks.)

One major issue looming at Aircastle is that \$900 million related to recent plane purchases still sits as debt outstanding on its credit facilities, which need to be paid off by year's end.

Last year, Aircastle would have tapped the asset-backed securities market to fund this debt on a cheap long-term basis. But today, the ABS market is shut down amid the fallout from existing asset-backed securities paper tied to soured residential and commercial mortgage loans.

Aircastle says it expects to secure a term loan in the second quarter to swap out of some of this debt. Analysts project the company will be able to extend the credit facilities before the end of the year.

In both cases, interest costs on the new debt are sure to rise, eating away at profits. Aircastle also is facing near-term margin calls as interest rates fall because the firm over-hedged through the use of interest-rate swaps.

Stilmar believes Aircastle will increase its dividend from \$2.80 currently to \$3 per share by 2009. He projects that earnings per share will total \$1.81 in 2008 and \$1.89 in 2009, compared with \$1.89 in 2007.

The numbers show that Aircastle continues to pay dividends that are higher than net income. The company argues investors should add back depreciation -- a non-cash charge -- when evaluating its dividend coverage. But even taking into account that depreciation, Aircastle is setting aside very little capital in what is a capital-intensive [business](#).

Most analysts have been cutting Aircastle's earnings estimates based on the slowing growth prospects from this difficult acquisition market. But Wall Street has overlooked the risk of Aircastle re-leasing planes or dealing with existing airline carriers starting to ground planes because of weaker demand and high oil prices.

These situations may play out over the next year, putting the company's dividend in jeopardy, a [similar issue](#) faced by fellow aircraft-leasing outfit **Babcock & Brown AirFLY**.

Stilmar does grant that an eventual \$3 per share dividend at Aircastle "could be in jeopardy if asset values become impaired," as he wrote in a recent research note.

Les Weal, head of valuation services as aviation consultant Ascend Worldwide, says 2007 marked the peak point for valuations of planes.

He says wide-body planes -- which generally carry cargo or passengers for long-haul travel -- are faring better than narrow-body planes. Part of the issue is that carriers such as **DeltaDAL**, **UnitedUAUA** and **AMR Corp.**'s AMR American Airlines are seeing strong long-haul demand but are reining in shorter-haul trips, he says.

This is bad news for Aircastle, since narrow-body planes make up 50% of the company's owned aircraft by book value.

"Our view is that on the narrow-body side, it probably takes two years to get to a bottom (in valuations) before it turns," Weal says, pointing to a similar two-year plane depreciation period after Sept. 11, 2001.

Besides falling plane values, another issue looming for Aircastle and other [leasing](#) firms is if airlines begin falling behind on maintenance reserve payments. Airlines reimburse leasing firms for maintenance costs.

If oil prices hit continue climbing, then more airlines may be pressured to keep aircraft on the ground or fall behind on maintenance reserve payments, even though neither issue is prevalent today, Weal says.

Perhaps a sign of things to come, Delta said Tuesday that it will reduce U.S. plane capacity by an additional 5% by parking 15 to 20 mainline aircraft and 20 to 25 regional jets.

## THE STREET PREMIUM SERVICES

From the action-oriented investing ideas of *Action Alerts PLUS* by Jim Cramer to the expert technical trading strategies of Helene Meisler's *Top Stocks*, TheStreet.com offers a range of premium services to help boost your portfolio's performance. [View now.](#)

## EXPERT ADVISORS ALERTS DELIVERED TO YOUR INBOX

*Action Alerts PLUS*: Cramer's personal portfolio, emails before he acts.  
*RealMoney*: 45+ experts share their top investing ideas and analysis.  
*Stocks Under \$10*: Alerts identify undervalued stocks with profit potential.

## FREE NEWSLETTERS

Get an edge on the market with the help of free email newsletters like Jim Cramer's *Daily Booyah!*. Learn about the day's major market events, companies that sizzled or fizzled and lots more that can help you make more profitable investing decisions. [Sign up.](#)

## REALMONEY SILVER

Cover all your investing bases. This popular premium service gives you access to *Action Alerts PLUS*, *Stocks Under \$10*, *RealMoney*, *Value Investor* and *Earnings Calls* — all in 1 easy-to-use interface at 1 deeply-discounted price. [Learn more.](#)

### Sponsored Links

#### Project Management

100% Online. Project Management certificate from Villanova. Free info. [www.VillanovaU.com](http://www.VillanovaU.com)

#### Sell More, Earn More.







Learn Proven Tools & Techniques From an Accredited Univ. ? Online! [www.USanFranOnline.com](http://www.USanFranOnline.com)

#### What's Your Credit Score?

View All 3 Credit Scores and Credit Reports Online Now. See it for \$0. [FreeCreditReportsInstantly.com](http://FreeCreditReportsInstantly.com)

[Buy a link here](#)

### BROKERAGE PARTNERS

 Fidelity Investments	 100 FREE TRADES E*TRADE Securities LLC E*TRADE FINANCIAL
 Zecco.com	 100 FREE TRADES E*TRADE Securities LLC E*TRADE FINANCIAL
 Fidelity Investments	 INTRODUCING \$8.95 ONLINE TRADES. LEARN MORE ▶ Charles Schwab

© 1996-2008 TheStreet.com, Inc. All rights reserved.

TheStreet.com's enterprise databases running Oracle are professionally monitored and managed by [Pythian Remote DBA](#).

Quotes delayed at least 20 minutes for all exchanges. Market Data provided by [Interactive Data](#). Company fundamental data provided by Hemscott. Earnings and ratings provided by Zacks. Mutual fund data provided by Valueline. ETF data provided by Lipper. [Terms & Conditions](#). Powered and implemented by [Interactive Data Managed Solutions](#).

TheStreet.com Ratings updates stock ratings daily. However, if no rating change occurs, the data on this page does not update. The data does update after 90 days if no rating change occurs within that time period.

IDC calculates the Market Cap for the basic symbol to include common shares only. Year-to-date mutual fund returns are calculated on a monthly basis by Value Line and posted mid-month.

\*Oil Data in Market Overview is Brent Crude Pricing