

AEROCENTURY CORP
Form 10-Q
May 11, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

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

For the transition period from _____ to _____

Commission File Number: 001-13387

AeroCentury Corp.
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of Incorporation or Organization)

94-3263974
(I.R.S. Employer Identification No.)

1440 Chapin Avenue, Suite 310
Burlingame, California 94010
(Address of Principal Executive Offices)

(650) 340-1888
(Registrant's Telephone Number Including Area Code)

None
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required submit and post such files).

Yes No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: As of May 11, 2012 the issuer had 1,606,557 shares of common stock, par value \$0.001 per share, issued, of which 63,300 are held as treasury stock.

PART I
FINANCIAL INFORMATION

Forward-Looking Statements

This Quarterly Report on Form 10-Q includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended ("the Exchange Act"). All statements in this Report other than statements of historical fact are "forward-looking statements" for purposes of these provisions, including any statements of plans and objectives for future operations and any statements of assumptions underlying any of the foregoing. Statements that include the use of terminology such as "may," "will," "expects," "plans," "anticipates," "estimates," "potential," or "continue," or the negative thereof, or other comparable terminology are forward-looking statements. Forward-looking statements include: (i) Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources," the Company's statements that the Company will be in compliance with all of its Credit Facility covenants in 2012; and that the Company will have adequate cash flow to fund operational needs and payments required under its Credit Facility; (ii) in Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Outlook," the Company's statements that the trend of lower on-lease utilization rates, longer lead times for remarketing returned aircraft, and lower rental rates is expected to continue to affect the Company's operating lease revenue in the remainder of 2012; that there is likely to be a significant decrease in the pool of customers requiring aircraft and that the Company's portfolio growth will continue to be slow; that the Company has incurred the majority of the maintenance costs necessary to prepare certain off-lease assets returned in 2010 and 2011 for re-lease to new customers; that the Company will be in compliance with all of its Credit Facility covenants through the end of 2012; and that the Company does not believe that its lessee deferral agreements represent a trend that will result in additional deferral agreements in 2012; and (iii) in Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Factors that May Affect Future Results," that the Company will have sufficient funds to make any payment that arises due to any collateral base limitations; that the Company will continue to be in compliance with all of its Credit Facility covenants; that the availability under the Credit Facility will be sufficient to fund projected acquisitions through the end of 2012; that most of the Company's growth will be outside the United States; that the Company has the industry experience and technical resources necessary to effectively manage new aircraft types and engines; that there are effective mitigating factors against undue compensation-incented risk-taking by JMC; that the costs of complying with environmental regulations will not have a material adverse effect on the Company; that the Company has sufficient cyber-security measures in place; and that the Company has sufficient replacement mechanisms in the event of a cyber-attack. These forward-looking statements involve risks and uncertainties, and it is important to note that the Company's actual results could differ materially from those projected or assumed in such forward-looking statements. Among the factors that could cause actual results to differ materially are the factors detailed under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations — Factors That May Affect Future Results," including the impact of the current economic downturn or future financial crises, particularly in Europe, on the Company's customer base of regional air carriers; the continued availability of financing for acquisitions; the compliance of the Company's lessees with obligations under their respective leases; risks related to use of debt financing for acquisitions; the Company's success in finding appropriate assets to acquire with such financing; deviations from the assumption that future major maintenance expenses will be relatively evenly spaced over the entire portfolio; and future trends and results which cannot be predicted with certainty. The cautionary statements made in this Report should be read as being applicable to all related forward-looking statements wherever they appear herein. All forward-looking statements and risk factors included in this document are made as of the date hereof, based on information available to the Company as of the date hereof, and the Company assumes no obligation to update any forward-looking statement or risk factor. You should consult the risk factors listed from time to time in the Company's filings with the Securities and Exchange Commission.

Item 1. Financial Statements.

AeroCentury Corp.
Condensed Balance Sheets
(Unaudited)

| ASSETS | March 31, 2012 | December 31, 2011 |
|--|-----------------------|-----------------------|
| Assets: | | |
| Cash and cash equivalents | \$ 1,702,500 | \$ 995,500 |
| Accounts receivable, including deferred rent of \$1,822,600 and \$1,923,300, net of allowance for doubtful accounts of \$1,924,400 at March 31, 2012 and December 31, 2011 | 3,504,400 | 2,936,100 |
| Finance lease receivable | 1,228,800 | 1,271,400 |
| Aircraft and aircraft engines held for lease, net of accumulated depreciation of \$50,422,000 and \$48,935,200 at March 31, 2012 and December 31, 2011, respectively | 131,257,300 | 124,245,000 |
| Prepaid expenses and other | 2,488,700 | 1,378,000 |
| Total assets | \$ 140,181,700 | \$ 130,826,000 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities: | | |
| Accounts payable and accrued expenses | \$ 442,100 | \$ 368,100 |
| Notes payable and accrued interest | 72,196,900 | 65,672,700 |
| Maintenance reserves and accrued maintenance costs | 6,426,200 | 5,814,700 |
| Security deposits | 5,665,600 | 5,607,300 |
| Unearned revenues | 723,400 | 558,200 |
| Deferred income taxes | 12,688,000 | 12,094,400 |
| Taxes payable | 24,300 | 20,400 |
| Total liabilities | 98,166,500 | 90,135,800 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, \$0.001 par value, 2,000,000 shares authorized, no shares issued and outstanding | - | - |
| Common stock, \$0.001 par value, 10,000,000 shares authorized, 1,606,557 shares issued and outstanding | 1,600 | 1,600 |
| Paid-in capital | 14,780,100 | 14,780,100 |
| Retained earnings | 27,737,600 | 26,412,600 |
| Treasury stock at cost, 63,300 shares | (504,100) | (504,100) |
| Total stockholders' equity | 42,015,200 | 40,690,200 |

| | | |
|--|----------------|----------------|
| Total liabilities and stockholders' equity | \$ 140,181,700 | \$ 130,826,000 |
|--|----------------|----------------|

The accompanying notes are an integral part of these statements.

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AeroCentury Corp.
Condensed Statements of Operations
(Unaudited)

| | For the Three Months Ended March 31, | |
|---|---|---------------|
| | 2012 | 2011 |
| Revenues and other income: | | |
| Operating lease revenue, net | \$5,906,900 | \$4,204,400 |
| Maintenance reserves revenue, net | 849,800 | 540,500 |
| Other income | 26,600 | 149,600 |
| | 6,783,300 | 4,894,500 |
| Expenses: | | |
| Depreciation | 1,486,800 | 1,238,800 |
| Interest | 1,071,900 | 967,100 |
| Management fees | 986,700 | 945,300 |
| Maintenance | 754,500 | 4,568,100 |
| Professional fees, general and administrative and other | 311,300 | 325,100 |
| Insurance | 132,700 | 266,100 |
| Other taxes | 22,600 | 22,600 |
| | 4,766,500 | 8,333,100 |
| Income/(loss) before income tax provision | 2,016,800 | (3,438,600) |
| Income tax provision/(benefit) | 691,800 | (1,159,800) |
| Net income/(loss) | \$1,325,000 | \$(2,278,800) |
| Earnings/(loss) per share: | | |
| Basic | \$0.86 | \$(1.48) |
| Diluted | \$0.85 | \$(1.48) |
| Weighted average shares used in earnings/(loss) per share computations: | | |
| Basic | 1,543,257 | 1,543,257 |
| Diluted | 1,550,756 | 1,543,257 |

The accompanying notes are an integral part of these statements.

AeroCentury Corp.
Condensed Statements of Cash Flows
(Unaudited)

| | For the Three Months Ended March 31, | |
|--|--|--------------|
| | 2012 | 2011 |
| Net cash provided by/(used in) operating activities | \$3,621,100 | \$(539,800) |
| Investing activity - | | |
| Purchases of aircraft and aircraft engines | (8,209,100) | (312,200) |
| Net cash used in investing activity | (8,209,100) | (312,200) |
| Financing activities: | | |
| Borrowings under Credit Facility | 7,400,000 | - |
| Repayments of Credit Facility | (500,000) | - |
| Debt issuance costs | (1,605,000) | - |
| Repayments of Subordinated Notes | - | (800,000) |
| Net cash provided by/(used in) financing activities | 5,295,000 | (800,000) |
| Net increase/(decrease) in cash and cash equivalents | 707,000 | (1,652,000) |
| Cash and cash equivalents, beginning of period | 995,500 | 1,949,400 |
| Cash and cash equivalents, end of period | \$1,702,500 | \$297,400 |

During the three months ended March 31, 2012 and 2011, the Company paid interest totaling \$1,136,000 and \$792,200 respectively. The Company paid no income taxes during the three months ended March 31, 2012 and 2011.

The accompanying notes are an integral part of these statements.

AeroCentury Corp.
Notes to Financial Statements (Unaudited)
March 31, 2012

1. Organization and Summary of Significant Accounting Policies

(a) The Company and Basis of Presentation

AeroCentury Corp. (the “Company”), a Delaware corporation incorporated in 1997, acquires used regional aircraft and engines for lease to foreign and domestic regional carriers.

The condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

For further information, refer to the financial statements and footnotes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2011.

(b) Use of Estimates

The Company’s financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable for making judgments that are not readily apparent from other sources.

The most significant estimates with regard to these financial statements are the residual values of the aircraft, the useful lives of the aircraft, the amount and timing of cash flow associated with each aircraft that are used to evaluate whether assets are impaired, accrued maintenance costs, the estimated fair value of financial instruments, accounting for income taxes, and the amounts recorded as allowances for doubtful accounts.

(c) Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs, to the extent possible. The fair value hierarchy under GAAP is based on three levels of inputs.

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be

corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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AeroCentury Corp.
Notes to Financial Statements (Unaudited)
March 31, 2012

1. Organization and Summary of Significant Accounting Policies (continued)

(c) Fair Value Measurements (continued)

Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis

The following table shows by level, within the fair value hierarchy, the Company's assets at fair value:

| | March 31, 2012 | | | | December 31, 2011 | | | |
|--|--------------------|--------------------|------------|------------|-------------------|------------------|------------|------------|
| | Total | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 |
| Money market funds included in cash and cash equivalents | \$1,336,500 | \$1,336,500 | \$- | \$- | \$736,000 | \$736,000 | \$- | \$- |
| Total | \$1,336,500 | \$1,336,500 | \$- | \$- | \$736,000 | \$736,000 | \$- | \$- |

As of March 31, 2012 and December 31, 2011, there were no liabilities required to be measured and recorded at fair value on a recurring basis.

Assets Measured and Recorded at Fair Value on a Nonrecurring Basis

The Company determines fair value of long-lived assets held and used, such as aircraft and aircraft engines held for lease, by reference to independent appraisals, quoted market prices (e.g., offers to purchase) and other factors. An impairment charge is recorded when the Company believes that the carrying value of an asset will not be recovered through future net cash flows and that the carrying value exceeds its fair value. During the three-month periods ended March 31, 2012 and 2011, there was no recorded write-down of long-lived assets.

Fair Value of Other Financial Instruments

The Company's financial instruments, other than cash and cash equivalents, consist principally of accounts receivable, accounts payable and amounts borrowed under the Credit Facility. The fair value of accounts receivable and accounts payable approximates the carrying value of these financial instruments because of their short-term nature.

Borrowings under the Company's Credit Facility bear floating rates of interest that reset periodically to a market benchmark rate plus a credit margin. The Company believes the effective interest rate of this debt agreement approximates current market rates for such indebtedness at the balance sheet date, which were estimated by calculation of the present value of future repayment obligations using estimates of borrowing rates that would be available to the Company for such an instrument.

AeroCentury Corp.
Notes to Financial Statements (Unaudited)
March 31, 2012

1. Organization and Summary of Significant Accounting Policies (continued)

(d) Finance Leases

The lease for one of the Company's aircraft contains a purchase option for the lessee for an amount substantially below the estimated residual value of the asset at the date for purchase under such option. Consequently, the Company considers the purchase option to be a "bargain purchase option" and has classified such lease as a finance lease for financial accounting purposes. The Company also had a second aircraft subject to a finance lease that terminated in June 2011 in connection with the disposal of the asset. The Company does not include the value, purchase price or accumulated depreciation of finance lease assets on its balance sheet. Instead, for any finance lease, the discounted present value of (i) future minimum lease payments (including the bargain purchase option) and (ii) any residual value not subject to a bargain purchase option are reported as a finance lease receivable. Rental revenue and depreciation expense are not recognized on finance leases. Rather, the Company accrues interest on the balance of the finance lease receivable based on the interest rate inherent in the lease. The Company's results for the quarters ended March 31, 2012 and 2011 included \$23,400 and \$144,300, respectively, of interest earned on finance leases recorded as other income.

2. Aircraft and Aircraft Engines Held for Lease

At March 31, 2012 and December 31, 2011, the Company's aircraft and aircraft engines, which were on lease or held for lease, consisted of the following.

| Model | March 31, 2012 | | | December 31, 2011 | | |
|----------------------------------|----------------|---------------------|---|-------------------|---------------------|---|
| | Number owned | % of net book value | | Number owned | % of net book value | |
| Bombardier Dash-8-300 | 9 | 28 | % | 8 | 23 | % |
| Fokker 100 | 7 | 26 | % | 7 | 28 | % |
| Fokker 50 | 14 | 17 | % | 14 | 18 | % |
| General Electric CF34-8E5 engine | 3 | 8 | % | 3 | 8 | % |
| Bombardier Dash-8-Q400 | 1 | 8 | % | 1 | 8 | % |
| Saab 340B | 6 | 6 | % | 6 | 6 | % |
| Saab 340B Plus | 2 | 3 | % | 2 | 4 | % |
| deHavilland DHC-8-100 | 2 | 3 | % | 2 | 4 | % |
| deHavilland DHC-6 | 1 | 1 | % | 1 | 1 | % |
| Saab 340A | 1 | - | | 1 | - | |

Net book value at March 31, 2012 and December 31, 2011 excludes the Company's Saab 340A aircraft, which is subject to a finance lease. As discussed in Note 7, in May 2012, a purchase agreement was executed to sell one of the Company's deHavilland DHC-8-100 aircraft.

During the three months ended March 31, 2012, the Company purchased a deHavilland Dash-8-Q314 aircraft on lease to a new customer in Asia, with a lease term expiring in January 2018.

During the three months ended March 31, 2012, the Company extended the lease for one of its deHavilland DHC-8-100 aircraft for three months.

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AeroCentury Corp.
Notes to Financial Statements (Unaudited)
March 31, 2012

2. Aircraft and Aircraft Engines Held for Lease (continued)

At March 31, 2012, the Company had an allowance for doubtful accounts totaling \$1,924,400 related to one customer for the amounts owed in excess of payments received and the security deposits held by the Company. In early 2012, the Company and the customer signed a memorandum of understanding regarding the arrearages owed to the Company. The memorandum of understanding specifies that the customer will pay \$1,270,000 of the arrearages over three years, with the balance forgiven upon receipt of all payments due under the agreement. Since collectability of this receivable is not reasonably assured, the Company will record these payments as revenue on a cash basis when received.

At March 31, 2012, four of the Company's assets, comprised of three Fokker 100 aircraft and one Saab 340B aircraft, were off lease. As discussed in Note 7, a second Saab 340B aircraft was returned to the Company at lease expiration in April 2012 and one of the Fokker 100 aircraft was delivered to an existing customer in May 2012. The Company is seeking re-lease opportunities for the other off-lease aircraft.

As discussed in Note 7, the lessee for four of the Company's aircraft declared bankruptcy in April 2012 and the aircraft have been returned to the Company. The Company is analyzing the anticipated effects of the bankruptcy on the Company's results for the second quarter of 2012 and subsequent periods.

In March 2012, the Company executed a letter of intent for the lease of the Saab 340B aircraft that was off lease at March 31, 2012. That customer has the option to lease three of the Company's other Saab 340B aircraft which, as discussed above, were returned during the second quarter of 2012.

3. Maintenance and Accrued Costs

Maintenance costs under the Company's triple net operating leases are generally the responsibility of the lessees. Most of the Company's leases require payment of maintenance reserves, which are based upon lessee-reported usage and billed monthly, and are intended to accumulate funds that are expected to cover most or all of the cost of the lessees' performance of certain maintenance obligations under the leases. Some of these payments for maintenance reserves are refundable, and some are non-refundable.

Refundable maintenance reserves received by the Company are accounted for as a liability, which is reduced when maintenance work is performed during the lease and reimbursement to the lessee is paid. Maintenance reserves that are refundable to the lessee are refunded after all return conditions specified in the lease and, in some cases, any other payments due under the lease are satisfied. Any refundable reserves retained by the Company to satisfy return conditions are recorded as revenue when the aircraft is returned.

Non-refundable maintenance reserves are recorded as maintenance reserves revenue (assuming cash is received or collections are reasonably assured).

The timing difference between recording maintenance reserves revenue as usage occurs and recording maintenance expense as maintenance is performed can have material effects on the volatility of reported earnings.

AeroCentury Corp.
Notes to Financial Statements (Unaudited)
March 31, 2012

3.Maintenance and Accrued Costs (continued)

The accompanying balance sheets reflect refundable maintenance payments billed to lessees based on usage and accrued maintenance costs as liabilities for maintenance reserves. At March 31, 2012 and December 31, 2011, the Company's maintenance reserves and accruals consisted of the following:

| | March 31, 2012 | December 31, 2011 |
|---------------------------------|-------------------|-------------------------|
| Refundable maintenance reserves | \$5,440,700 | \$4,801,300 |
| Accrued maintenance costs | 985,500 | 1,013,400 |
| | \$6,426,200 | \$5,814,700 |

Additions to and deductions from the Company's accrued maintenance costs during the three months ended March 31, 2012 and 2011 for aircraft maintenance were as follows:

| | For Three Months Ended March 31, | |
|---|-------------------------------------|-------------|
| | 2012 | 2011 |
| Balance, beginning of period | \$1,013,400 | \$2,446,800 |
| Additions: | | |
| Charged to expense | 754,800 | 4,592,500 |
| Reversals of previously accrued maintenance costs | (300) | (24,400) |
| Total maintenance expense | 754,500 | 4,568,100 |
| Capital equipment | 46,000 | 207,400 |
| Accrued claims related to refundable maintenance reserves | 292,300 | 8,700 |
| Prepaid maintenance | 122,500 | (407,900) |
| Total additions | 1,215,300 | 4,376,300 |
| Deductions: | | |
| Payments | 1,026,200 | 3,940,700 |
| Other | 217,000 | - |
| Total deductions | 1,243,200 | 3,940,700 |
| Net (decrease)/increase in accrued maintenance costs | (27,900) | 435,600 |
| Balance, end of period | \$985,500 | \$2,882,400 |

AeroCentury Corp.
Notes to Financial Statements (Unaudited)
March 31, 2012

4. Notes Payable and Accrued Interest

At March 31, 2012 and December 31, 2011, the Company's notes payable and accrued interest consisted of the following:

| | March 31, 2012 | December 31, 2011 |
|----------------------------------|-------------------|-------------------------|
| Credit Facility principal | \$72,100,000 | \$65,200,000 |
| Credit Facility accrued interest | 96,900 | 472,700 |
| | \$72,196,900 | \$65,672,700 |

In March 2012, the Company's \$90 million credit facility provided by a syndicate of banks (the "Credit Facility") was extended for one year, to April 29, 2013, on terms similar to the original agreement. The Credit Facility is secured by all of the assets of the Company, including its aircraft and engine portfolio.

Although the unused amount of the Credit Facility was \$17,900,000 and \$24,800,000 as of March 31, 2012 and December 31, 2011, respectively, the amount available was limited to \$10,904,600 and \$17,388,300, respectively, because of exclusions of certain assets from the collateral base.

The weighted average interest rate on the Credit Facility was 4.00% and 4.17% at March 31, 2012 and December 31, 2011, respectively.

The Company's subordinated notes ("Subordinated Notes") were fully repaid in December 2011. The Subordinated Notes purchasers hold warrants to purchase up to 81,224 shares of the Company's common stock at an exercise price of \$8.75 per share. The warrants are exercisable through December 31, 2015.

5. Computation of Earnings/(Loss) Per Share

Basic and diluted earnings/(loss) per share are calculated as follows:

| | For the Three Months Ended March 31, | |
|---|--|---------------|
| | 2012 | 2011 |
| Net income/(loss) | \$1,325,000 | \$(2,278,800) |
| Weighted average shares outstanding for the period | 1,543,257 | 1,543,257 |
| Dilutive effect of warrants | 7,499 | - |
| Weighted average diluted shares used in calculation of diluted earnings/(loss) per share | 1,550,756 | 1,543,257 |

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| | | |
|-----------------------------------|--------|-----------|
| Basic earnings/(loss) per share | \$0.86 | \$(1.48) |
| Diluted earnings/(loss) per share | \$0.85 | \$(1.48) |

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AeroCentury Corp.
Notes to Financial Statements (Unaudited)
March 31, 2012

5. Computation of Earnings/(Loss) Per Share (continued)

Basic earnings/(loss) per common share is computed using net income/(loss) and the weighted average number of common shares outstanding during the period. Diluted earnings per common share are computed using net income and the weighted average number of common shares outstanding, assuming dilution. Weighted average common shares outstanding, assuming dilution, includes potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include the assumed exercise of warrants using the treasury stock method. For the three months ended March 31, 2011, the potential dilutive effect of outstanding warrants was 42,828 shares. However, the effect of these potentially outstanding shares was not included in the calculation of diluted loss per share for the current period because the effect would have been anti-dilutive.

6. Related Party Transactions

The Company's portfolio of leased aircraft assets is managed and administered under the terms of a management agreement with JetFleet Management Corp. ("JMC"), which is an integrated aircraft management, marketing and financing business and a subsidiary of JetFleet Holding Corp. ("JHC"). Certain officers of the Company are also officers of JHC and JMC and hold significant ownership positions in both JHC and the Company. Under the Management Agreement, JMC receives a monthly management fee based on the net asset value of the assets under management. JMC also receives an acquisition fee for locating assets for the Company, provided that the aggregate purchase price, including chargeable acquisition costs and any acquisition fee, does not exceed the fair market value of the asset based on appraisal, and may receive a remarketing fee in connection with the sale or re-lease of the Company's assets. The Company recorded management fees of \$986,700 and \$945,300 during the quarters ended March 31, 2012 and 2011, respectively. The Company paid acquisition fees totaling \$290,000 to JMC during the quarter ended March 31, 2012, which were included in the cost basis of the asset purchased. The Company paid no remarketing fees to JMC during the quarter ended March 31, 2012. The Company paid no acquisition or remarketing fees to JMC during the quarter ended March 31, 2011.

In August 2009, the Company entered into an agreement with Lee G. Beaumont in which Mr. Beaumont assigned to the Company his rights to purchase certain aircraft engines from an unrelated third party seller. In January 2012, Mr. Beaumont became a "related person" with respect to the Company due to his acquisition on the open market of shares representing over 5% of the Company's Common Stock. During the quarters ended March 31, 2012 and 2011, the Company made no payments to Mr. Beaumont. A balance of \$66,700 is payable in the third quarter of 2012.

In connection with its Subordinated Notes financing entered into 2007 and 2008, the Company issued warrants to purchase up to 81,224 shares of the Company's common stock. The warrants became exercisable on December 30, 2011, and the shares issuable upon exercise of the warrants constitute over 5% of the common stock of the Company. As a result, the Subordinated Notes purchasers became "related persons" with respect to the Company. During the three months ended March 31, 2012 and 2011, the Company made interest payments totaling \$0 and \$89,900 to the Subordinated Notes purchasers.

AeroCentury Corp.
Notes to Financial Statements (Unaudited)
March 31, 2012

7. Subsequent Events

In April 2012, one of the Company's Saab 340B aircraft was returned to the Company at lease expiration, pursuant to the return conditions of the lease.

In April 2012, the Company and one of its customers in the Caribbean signed a lease for one of the Company's off-lease Fokker 100 aircraft. The aircraft was delivered in May 2012 and is subject to a 36-month lease.

In April 2012, the lessee for four of the Company's Saab 340B aircraft, three of which were to be returned to the Company at lease end in the second quarter of 2012, declared bankruptcy. The four aircraft have been returned to the Company, and the Company is analyzing the anticipated effects of the bankruptcy on the Company's results for the second quarter of 2012 and subsequent periods.

In April 2012, the Company agreed to sell one of its deHavilland DHC-8-100 aircraft upon its return from its current lessee, which the Company expects to occur in the second quarter of 2012. As of March 31, 2012, the aircraft had a net book value of \$1,675,100 and the Company expects to record a gain on sale.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with the Company's Form 10-K for the year ended December 31, 2011 and the unaudited financial statements and related notes that appear elsewhere in this report.

Critical Accounting Policies, Judgments and Estimates

The Company's discussion and analysis of its financial condition and results of operations are based upon the financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities at the date of the financial statements. In the event that actual results differ from these estimates or the Company adjusts these estimates in future periods, the Company's operating results and financial position could be materially affected. The Company's significant accounting policies are described in Notes 1 and 3 to the financial statements. The Company believes that the most critical accounting policies include the following: Aircraft Capitalization and Depreciation; Impairment of Long-lived Assets; Maintenance Reserves and Accrued Costs; Accounting for Income Taxes; and Revenue Recognition, Accounts Receivable and Allowance for Doubtful Accounts.

Results of Operations

Quarter ended March 31, 2012 compared to the quarter ended March 31, 2011

The Company's net income increased by \$3,603,800 in the quarter ended March 31, 2012 compared to the same period in 2011, due primarily to increased operating lease revenue and maintenance reserves revenue and decreased expenses for maintenance, general and administrative and insurance, the aggregate effect of which was partially offset by increased depreciation and interest expense.

Operating lease revenue increased by \$1,702,500 in the quarter ended March 31, 2012 compared to the same period in 2011 primarily because of: (i) a \$996,500 increase related to aircraft that were on lease in the 2012 quarter but off lease for all or part of the 2011 quarter; (ii) a \$487,800 increase related to aircraft that were acquired and leased during the fourth quarter of 2011 and first quarter of 2012; and (iii) a \$239,200 increase related to assets that were on lease in the 2012 and 2011 quarters but were subject to bad debt allowances for all or part of the 2011 quarter. The effects of these increases were partially offset by a decrease of \$347,300 related to aircraft that were off lease for all or part of the first quarter of 2012, were sold during 2011, or were re-leased at lower rates.

Maintenance reserves revenue increased by \$309,300 in the first quarter of 2012 compared to the same quarter of 2011, primarily as a result of revenue from assets that were on lease in the 2012 period, but off lease or subject to bad debt allowances in the 2011 period. The effects of such increases were partially offset by lower reserves rates applicable to some of the Company's assets in the 2012 quarter, compared to the 2011 quarter, and by the effect of asset sales during 2011.

Depreciation expense increased by \$248,000 in the quarter ended March 31, 2012 compared to the quarter ended March 31, 2011, primarily due to aircraft purchased in late 2011 and the first quarter of 2012, the effect of which was partially offset by changes in estimated residual values, which the Company analyzes and adjusts periodically based on third party appraisals.

Interest expense increased by \$104,800 in the quarter ended March 31, 2012 compared to the quarter ended March 31, 2011, primarily as a result of a higher fee amortization related to the Company's Credit Facility which was extended for one year in March 2012, and a higher average Credit Facility balance in 2012. The effects of these increases were partially offset by the decrease in 2012 in interest expense and fee amortization related to the Company's Subordinated Notes, which were fully repaid in December 2011.

The Company's maintenance expense decreased by \$3,813,600 in the quarter ended March 31, 2012 compared to the same period in 2011, primarily as a result of a \$3,523,400 decrease in maintenance performed on off-lease aircraft, as well as a \$269,000 decrease in maintenance performed by lessees using non-refundable reserves.

During the quarters ended March 31, 2012 and 2011, \$495,100 and \$4,119,700, respectively, of the Company's maintenance expense for off-lease aircraft and maintenance performed by lessees were funded by non-refundable maintenance reserves that had been recorded as revenue when earned.

Insurance expense for off-lease aircraft decreased by \$133,400 in the quarter ended March 31, 2012 compared to the quarter ended March 31, 2011, primarily due to aircraft that were on lease in the 2012 period but off lease in the 2011 period.

Liquidity and Capital Resources

The Company is currently financing its assets primarily through debt financing and excess cash flows.

(a) Credit Facility

In March 2012, the Company's \$90 million Credit Facility provided by a syndicate of banks was extended for one year, to April 29, 2013, on terms similar to the original agreement. The Credit Facility is secured by all of the assets of the Company, including its aircraft and engine portfolio.

During the three months ended March 30, 2012, the Company borrowed \$7,400,000 and repaid \$500,000 of the outstanding principal under the Credit Facility.

As of March 31, 2012 and December 31, 2011, the Company was in compliance with all covenants under the Credit Facility agreement. Although the Company believes it will continue to be in compliance with all of the Credit Facility covenants in 2012, there can be no assurance of such compliance. Any default under the Credit Facility, if not waived by the lenders, could result in foreclosure upon any or all of the existing assets of the Company.

As of May 11, 2012, the Company had an outstanding balance of \$70,700,000 under the Credit Facility. Although the unused amount of the Credit Facility is currently \$19,300,000, exclusion of certain assets from the collateral base has decreased the available credit to \$11,988,000.

The Company's interest expense will generally increase and decrease with prevailing interest rates. The Company has the ability to enter into interest rate swaps to economically hedge against interest rate increases in its floating rate debt under the Credit Facility and has done so in the past.

(b) Cash flow

The Company's primary sources of cash are (i) operating lease revenue and (ii) maintenance reserves billed monthly to lessees based on aircraft usage. Cash collected by the Company for maintenance reserves is not required by the leases to be segregated and is included in cash and cash equivalents on the Company's balance sheets.

The Company's primary uses of cash are for maintenance expense, management fees, professional fees, insurance, purchase of aircraft and engines and Credit Facility interest payments. The amount of interest paid by the Company depends on the outstanding balance of its Credit Facility, which carries a floating interest rate as well as an interest rate margin, and is therefore also dependent on changes in prevailing interest rates.

The timing and amount of the Company's payments for maintenance vary, depending on the timing of lessee-performed maintenance that is eligible for reimbursement, the aggregate amount of such claims and the timing and amount of maintenance incurred in connection with preparation of off-lease assets for re-lease to new customers. The Company's maintenance payments constitute a large portion of its cash needs, and the Company may from time to time borrow additional funds under the Credit Facility to provide funding for such payments.

Management believes that the Company will have adequate cash flow to meet its ongoing operational needs, including required repayments under the Credit Facility, based upon its estimates of future revenues and expenditures, which include assumptions regarding (i) revenues for assets to be re-leased, (ii) required debt payments, (iii) interest rates, (iv) the cost and anticipated timing of maintenance to be performed and (v) timely use of proceeds of unused debt capacity toward additional acquisitions of income producing assets.

Although the Company believes that the assumptions it has made in forecasting its cash flow are reasonable in light of experience, actual results could deviate from such assumptions. Among the more significant factors that could have an impact on the accuracy of cash flow assumptions are (i) lessee non-performance or non-compliance with lease obligations, (ii) inability to locate new lessees for returned equipment within a reasonable remarketing period, or at a rent level consistent with projected rental rates for the asset, (iii) lessee performance of maintenance, and payment of related maintenance claims, earlier than anticipated, (iv) inability to locate and acquire a sufficient volume of additional assets at prices that will produce acceptable net returns, (v) an increase in interest rates and (vi) any one or a combination of the above factors that causes the Company to violate covenants of the Credit Facility agreement, which may in turn require repayment of some or all of the amounts outstanding under the Credit Facility.

(i) Operating activities

The Company's cash flow from operations increased by \$4,160,900 in the quarter ended March 31, 2012 compared to the same period in 2011. As discussed below, the change in cash flow was primarily a result of an increase in payments received for rent and a decrease in expenditures for maintenance, the effects of which were partially offset by an increase in expenditures for interest and Credit Facility fees.

Payments for operating lease revenue

Several assets that were on lease in the first three months of 2012 were off lease for all or part of the same period in 2011. In addition, the Company purchased three aircraft in late 2011 and early 2012. As a result, payments received from lessees for rent increased by \$1,952,700 in the three-month period of 2012 compared to the same period in 2011.

The Company currently is receiving no lease revenue for its off-lease assets, comprised of two Fokker 100 and six Saab 340-B aircraft, two of which were returned at lease expiration in March 2011 and April 2012 and four of which were returned in the second quarter of 2012 after the lessee declared bankruptcy.

Payments for maintenance

Payments for maintenance decreased by \$2,663,400 in the three months ended March 31, 2012 compared to the same period in 2011 as a result of a decrease in maintenance on off-lease aircraft. The amount of payments for maintenance in future periods will depend on the amount and timing of maintenance paid as reimbursement to lessees for maintenance reserves claims, which are dependent upon utilization and required maintenance intervals, and maintenance paid for off-lease assets.

(ii) Investing activities

During the first quarter of 2012, the Company used cash of \$8,209,100 for the purchase of an aircraft, for equipment installed on an aircraft, and for acquisition costs related to two aircraft purchased in November 2011.

During the first quarter of 2011, the Company used cash of \$312,200 for the purchase of equipment that was installed on several aircraft and for acquisition costs related to an aircraft purchased in December 2010.

(iii) Financing activities

The Company borrowed \$7,400,000 and \$0 under the Credit Facility during the quarters ended March 31, 2012 and 2011, respectively. The Company repaid \$500,000 and \$800,000 of its total outstanding debt in the quarters ended March 31, 2012 and 2011, respectively. Such payments were funded by excess cash flow. During the quarter ended March 31, 2012, the Company paid \$1,605,000 of fees related to the extension of the Company's Credit Facility. Such fees will be amortized over the remaining term of the Credit Facility.

Outlook

(a) General

The recent global downturn resulted in a significant reduction in airline passenger volume and, in reaction to that, a reduction in the number of aircraft and aircraft engines needed for operation by carriers in nearly all geographic areas, especially Europe. The slow recovery from this downturn and the current European financial crisis have created a challenging environment for the Company in three respects:

- The global economic situation has increased the possibility of an unanticipated lessee default, particularly by the Company's less-established carriers. A lessee's default and the unscheduled return of an asset to the Company for remarketing could result not only in reduced operating lease revenue but also in unanticipated, unrecoverable expenses arising from the lessee's default on its maintenance and return condition obligations. The Company monitors the performance of all of its customers and continues to note indications of weakened financial conditions and operating results for the majority of its customers.
- The reduction in demand for aircraft and aircraft engines has increased the possibility that the Company's current lessees will choose to return leased assets at lease expiration rather than renew the existing leases, notwithstanding that any such lessee may incur significant expenses to satisfy return conditions. Due to decreased demand for aircraft capacity, it is likely that the Company will experience lower on-lease utilization rates and longer lead times for remarketing of returned assets, as well as lower rental rates for remarketed assets, as was the case with several lease extensions and re-leases in 2011. This trend is expected to continue to affect the Company's operating revenue for the remainder of 2012.
- Finally, the downturn also has created fewer opportunities for acquisitions for the Company. The Company's customers are generally carriers needing additional aircraft to expand their route systems or increase frequencies. In the current environment of reduced demand for air travel and consequently reduced capacity by carriers, there is likely to be a significant decrease in the pool of such customers requiring aircraft. Therefore, it is possible that the Company's portfolio growth will continue to be slow, as fewer carriers seek to expand their fleets.

(b) Remarketing Efforts

(i) Assets currently off lease

As of May 11, 2012, the Company is seeking release opportunities for the following of its assets that are off lease:

- Two Fokker 100 aircraft, which were returned to the Company prior to lease expiration in 2010; and
- Six Saab 340B aircraft, two of which were returned at lease expiration in March 2011 and April 2012 and four of which were returned in April and May 2012 after the lessee declared bankruptcy. The Company has a signed letter of intent and a deposit for the lease of one of the aircraft with a customer that has the option to lease three of the other aircraft.

The Company has incurred significant maintenance expenses in order to prepare its off-lease assets for lease to new customers. Although the Company believes it has incurred the majority of such expenses for the aircraft returned to the Company in 2010 and 2011, it is possible that additional maintenance expenses will be incurred when new customers are identified for these assets. The amount of such maintenance could exceed the amount of reserves previously collected for the assets. As discussed above, four of the Company's Saab 340B aircraft were returned during

the second quarter of 2012 after the customer declared bankruptcy. The Company is analyzing the anticipated effects of the bankruptcy on the Company's results for the second quarter of 2012 and subsequent periods.

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(ii) Upcoming lease expirations

Unless they are renewed, leases for four of the Company's assets will expire in the remainder of 2012.

(c) Credit Facility

The Company believes that the availability under the Credit Facility should be sufficient to fund its anticipated asset acquisitions through the end of 2012. The term of the current Credit Facility will expire in April 2013, and the Company anticipates that it will need to negotiate an extension or a replacement of the Credit Facility by that date.

Although the Company believes it will be in compliance with the covenants of the Credit Facility in 2012, as discussed below in "Factors that May Affect Future Results – Credit Facility Obligations," there can be no assurance of such compliance. Any default under the Credit Facility, if not waived by the lenders, could result in foreclosure upon any or all of the existing assets of the Company.

(d) Deferral Agreements

Beginning in 2009, the Company granted deferral of certain overdue and/or future rental or reserves payment obligations pursuant to agreements with certain customers that had experienced financial difficulties. The Company currently has no deferral agreement balances outstanding. One of the Company's customers, with which the Company previously had a deferral agreement, has made timely payments to the Company since August 2011 following a change in management. At March 31, 2012, the Company had an allowance for doubtful accounts in the amount of \$1,924,400 for the amounts owed by that customer in excess of the security deposits held by the Company. In January 2012, the Company and that customer signed a memorandum of understanding regarding the arrearages owed to the Company. The memorandum of understanding calls for 50% of the arrearages to be paid over time, with the remaining balance to be forgiven by the Company only if the required payments under the agreement contemplated by the memorandum are made.

Although beginning in 2009 the Company agreed with several lessees to defer certain payments, based on its evaluation of its current customers, the Company does not anticipate any trend developing that will result in additional deferral agreements in 2012.

Factors that May Affect Future Results

Credit Facility Obligations. The total amount of borrowing under the Credit Facility is limited to a percentage of the collateral base, and assets that come off lease and remain off-lease for a period of time may reduce the collateral base. Past due lease payments may also affect an asset's eligibility for inclusion in the collateral base, and the Credit Facility agreement places certain limits on the use of deferral agreements to mitigate such arrearages for purposes of inclusion of the subject asset in the collateral base. The Company believes it will have sufficient cash funds to make any required principal repayment that arises due to any such collateral base limitations. Although the Company believes, based in part on certain assumptions discussed below, that it will continue to be in compliance with the covenants of the Credit Facility, there can be no assurance that the Company's assumptions will be correct, and if not, the Company will need to seek further waivers from its lenders. Any default under the Credit Facility, if not waived by the lenders, could result in foreclosure upon any or all of the existing assets of the Company.

The Company's beliefs regarding compliance with its Credit Facility covenants are based on certain assumptions regarding the timing of the incurrence of maintenance expense, remarketing of off-lease assets within the time period anticipated by the Company, certain lease renewals, interest rate levels, the Company's profitability, lessee defaults or bankruptcies, and certain other matters that the Company deems reasonable in light of its experience in the industry (See "Liquidity and Capital Resources – Cash flow," above). There can be no assurance that the Company's assumptions will prove to be correct. If the assumptions are incorrect (for example, if the Company's off-lease aircraft are not re-leased in the time period currently anticipated by the Company as described in "Outlook – (c) Credit Facility") and the Company has not obtained an applicable waiver or amendment of applicable covenants from its lenders to mitigate the situation, the Company may have to sell a significant portion of its portfolio in order to avoid or cure a default under the Credit Facility agreement.

Risks of Debt Financing. The Company's use of debt as the primary form of acquisition financing subjects the Company to increased risks associated with leveraging. Indebtedness owed under the Credit Facility carries a higher cost of capital relative to equity financing, resulting in relatively higher expense and reduced free cash flow. The Company's assets secure its debt financing. In addition to payment obligations, the Credit Facility also requires the Company to comply with certain financial covenants, including a requirement of positive earnings and compliance with interest coverage ratios and required net worth. Any default under the Credit Facility, if not waived by the lenders, could result in foreclosure upon any or all of the existing assets of the Company. In addition, the term of the current Credit Facility will expire in April 2013, and the Company will need to negotiate an extension or a replacement of the Credit Facility by that date, and there can be no assurance of any such extension or replacement.

General Economic Conditions and Lowered Demand for Travel. The Company's business is dependent upon general economic conditions and the strength of the travel and transportation industry. The industry is continuing to experience financial difficulty and contraction due to the protracted downturn in the global economy. Passenger volume has fallen significantly for carriers, and the loss of revenue has affected many carriers' financial condition. The ongoing credit crisis has made it difficult or impossible for many regional carriers to find the additional debt financing on which they have traditionally relied. The confluence of these economic factors increases the likelihood of failures among the Company's customers. The spread of a disease epidemic, the threat or execution of a terrorist attack against aviation, a worsening financial/bank crisis in Europe, a natural event that interrupts air traffic (such as the 2010 Iceland volcano eruption), political crises or other events that cause a prolonged spike in fuel prices, or other like events could exacerbate an already weakened condition and lead to widespread failures in the air carrier industry. If lessees experience financial difficulties and are unable to meet lease obligations, this will, in turn, negatively affect the Company's financial performance.

During the current period of economic contraction, many airlines have reduced capacity in response to lower passenger loads, and as a result, there has been reduced demand for aircraft and aircraft engines and a corresponding decrease in market lease rental rates and aircraft values for many aircraft types. This reduced market value could

affect the Company's results if the market value of an asset or assets in the Company's portfolio falls below carrying value, and the Company determines that a write-down of the value on its balance sheet is appropriate. Furthermore, if older, expiring leases are replaced with leases at decreased lease rates, the lease revenue from the Company's existing portfolio is likely to decline, with the magnitude of the decline dependent on the length of the downturn and the depth of the decline in market rents.

Economic downturns can affect certain regions of the world more than others. As the Company's portfolio is not entirely globally diversified, a localized downturn in one of the key regions in which the Company leases assets could have a significant adverse impact on the Company. Currently, 34%, 24%, 20% and 12% of the Company's lease revenue comes from the European, Caribbean, Asian and African regions, respectively, with six, two, four and two lessees, respectively. Therefore, Europe is currently the most significant market to the Company and a regional downturn that affects the financial health of European regional carriers could have a material adverse effect on the Company's financial results. In that respect, the current European financial crisis and its potential impact on the European economy is a substantial area of concern for the Company.

Over the last few years, several of the Company's customers have experienced financial difficulties arising from a combination of the weakened air carrier market and their own unique financial circumstances and have requested and been granted deferral of certain overdue and/or future rental or reserve payment obligations. It is possible that the Company may enter into additional deferral agreements if the current weakened air carrier environment continues. When a customer requests a deferral of lease obligations, the Company evaluates the lessee's financial plan, the likelihood that the lessee can remain a viable carrier, and whether the deferral will be repaid according to the agreed schedule. If the Company feels that there is a risk that deferred obligations will not be repaid, the Company records the rent and reserve payments from the applicable lessee on a cash basis. If the Company makes a judgment that the lessee is likely to meet its deferred obligations, the Company continues to record the deferred rental and reserve payments as revenue in the periods in which they accrue. It is possible that a lessee that the Company judges to be likely to repay its deferred obligations could experience a worsening financial condition. In that circumstance, the Company may determine that full repayment of the deferred obligations is no longer likely, in which case the Company would record a bad debt expense or reduction of income. This could have a material effect on the Company's financial results in the period that such bad debt expense or income reduction is recorded.

Availability of Financing. The Company believes that the availability of financing under the Credit Facility will be sufficient to fund projected acquisitions through the end of 2012. The Credit Facility term was recently extended for one year to April 2013. The Company will either need to negotiate a longer-term facility with the current syndicate of lenders or a replacement group within the coming year, or seek another short-term extension of the current Credit Facility on its existing terms. In the longer term, however, the Company's continued growth will depend on its ability to obtain capital, either through debt or equity financings. The financial markets have experienced significant setbacks that have made access to capital more costly and difficult. As a result, commercial lending origination has dramatically decreased, and asset-based debt financing remains difficult to obtain. There is no assurance that the Company will succeed in finding additional funding, and if such financing is found, it may be on terms less favorable than the Company's current debt financings.

Ownership Risks. Nearly all of the Company's portfolio is leased under operating leases. The term of a lease is typically less than the entire anticipated remaining useful life of the leased asset. The Company's ability to recover its purchase investment in an asset subject to such a lease is dependent upon the Company's ability to profitably re-lease or sell the asset after the expiration of the initial lease term. Some of the factors that have an impact on the Company's ability to re-lease or sell the asset include worldwide economic conditions, general aircraft market conditions, regulatory changes that may make an asset's use more expensive or preclude use unless the asset is modified, changes in the supply or cost of aircraft equipment and technological developments that cause the asset to become obsolete. If the Company is unable to remarket its assets on favorable terms when the leases for such assets expire, the Company's business, financial condition, cash flow, ability to service debt and results of operations could be adversely affected.

In addition, a successful investment in an asset subject to a lease depends in part upon having the asset returned by the lessee in the condition as required under the lease. Each lease typically obligates a customer to return an asset to the Company in a specified condition, which generally requires it be returned in equal or better condition than at delivery to the lessee. If the lessee becomes insolvent during the term of its lease and the Company has to repossess the asset from the lessee, it is unlikely that the lessee will have the financial ability to meet these return obligations and it is likely that the Company would be required to expend funds in excess of the maintenance reserves collected to return the asset to a remarketable condition.

Several of the Company's leases do not require payment of monthly maintenance reserves, which serve as the lessee's advance payment for its future repair and maintenance obligations. If repossession due to lessee default occurs under such a lease, the Company will be left with the expense for the costs of unperformed repair and maintenance under the applicable lease and the Company may incur an unanticipated expense in order to re-lease the asset.

Furthermore, the occurrence of unexpected adverse changes that impact the Company's estimates of expected cash flows generated from an asset may result in an asset impairment charge against the Company's earnings. The Company periodically reviews long-term assets for impairment, in particular, when events or changes in circumstances indicate the carrying value of an asset may not be recoverable. An impairment loss is recognized when the carrying amount of an asset is estimated to be not recoverable and exceeds its fair value. The Company may be required to recognize asset impairment charges in the future as a result of a prolonged weak economic environment, challenging market conditions in the airline industry or events related to particular lessees, assets or asset types.

Lessee Credit Risk. The Company carefully evaluates the credit risk of each customer and attempts to obtain a third party guaranty, letters of credit or other credit enhancements, if it deems them necessary in addition to customary security deposits. There can be no assurance, however, that such enhancements will be available, or that, if obtained, will fully protect the Company from losses resulting from a lessee default or bankruptcy.

If a lessee that is a certified U.S. airline were in default under a lease and sought protection under Chapter 11 of the United States Bankruptcy Code, Section 1110 of the Bankruptcy Code would automatically prevent the Company from exercising any remedies against such lessee for a period of 60 days. After the 60-day period had passed, the lessee would have to agree to perform the lease obligations and cure any defaults, or the Company would have the right to repossess the equipment. This procedure under the Bankruptcy Code has been subject to significant litigation, however, and it is possible that the Company's enforcement rights may be further adversely affected by a declaration of bankruptcy by a defaulting lessee.

Most of the Company's current and expected growth is expected outside of the United States, and non-U.S. lessees are not subject to U.S. bankruptcy laws, although there may be debtor protection similar to U.S. bankruptcy laws available in some jurisdictions. In any event, collection and enforcement may be more difficult and complicated in foreign countries.

Since 2009, the Company has seen indications of a weakening in both the financial condition and operating results of the majority of its customers, and several of the Company's customers have experienced financial difficulties. The Company closely monitors the performance of all of its lessees. If any of the Company's current or future lessees becomes unable to meet their lease obligations, the Company's future results could be materially and adversely impacted.

Concentration of Lessees and Aircraft Type. For the month ended April 30, 2012, based on monthly operating lease revenue and interest income from finance leases, the Company's three largest customers were located in Antigua, Germany and Norway and accounted for a total of approximately 39% of the Company's monthly lease revenue. A lease default by or collection problem with one or a combination of any of these significant customers could have a disproportionate negative impact on the Company's financial results and collateral base under the Credit Facility, and, therefore, the Company's operating results are especially sensitive to any negative developments with respect to these customers in terms of lease compliance or collection. Such concentration of lessee credit risk decreases as the Company leases additional assets to new lessees.

As of April 30, 2012, the Company owned seven Fokker 100, nine Bombardier Dash-8-300 and fourteen Fokker 50 aircraft, making these three aircraft types the dominant types in the portfolio and representing 26%, 28% and 17%, respectively, of net book value. As a result, a change in the desirability and availability of any of these types of aircraft, which would in turn affect valuations of such aircraft, would have a disproportionately significant impact on the Company's portfolio value. Such aircraft type concentration will diminish if the Company acquires additional assets of other types. Conversely, acquisition of these types of aircraft will increase the Company's risks related to its concentration of those aircraft types.

Risks Related to Regional Air Carriers. The Company's continued focus on its customer base of regional air carriers subjects the Company to additional risks. Some of the lessees in the regional air carrier market are companies that are start-up, low-capital, and/or low-margin operators. Often, the success of such carriers depends on contractual arrangements with major trunk carriers or franchises from governmental agencies that provide subsidies for operating essential air routes, both of which may be subject to termination or cancellation with short notice periods.

Leasing Risks. The Company's successful negotiation of lease extensions, re-leases and sales is critical to achieving its financial objectives and involves a number of risks. Demand for lease or purchase of the assets depends on the economic condition of the airline industry, which is, in turn, sensitive to general economic conditions. The ability to

re-lease equipment at acceptable rates may depend on the demand and market values at the time of remarketing. The Company acquires used aircraft equipment. The market for used aircraft equipment has been cyclical, and generally reflects economic conditions and the strength of the travel and transportation industry. The demand for and value of many types of used aircraft in the recent past has been depressed by such factors as airline financial difficulties, increased fuel costs, the number of new aircraft on order and the number of aircraft coming off lease. Values may also increase for certain aircraft types that become desirable based on market conditions and changing airline capacity. If the Company were to purchase an aircraft during a period of increasing values, it would in turn need to lease such aircraft at a corresponding higher lease rate to compensate for its higher purchase price.

Investment in New Aircraft Types and Engines. The Company intends to continue to focus solely on regional aircraft and engines. Although the Company has traditionally invested in a limited number of types of turboprop aircraft and engines, the Company has also acquired several Fokker 100 regional jet aircraft and regional jet aircraft engines, and may continue to seek acquisition opportunities for new types and models of regional jet and turboprop aircraft and engines used in the Company's targeted customer base of regional air carriers. Acquisition of aircraft types and engines not previously acquired by the Company entails greater ownership risk due to the Company's lack of experience managing those aircraft and engine types. The Company believes, however, that the overall industry experience of JMC's personnel and its technical resources should permit the Company to effectively manage such new aircraft types and engines. Further, the broadening of the asset types in the aircraft portfolio may have a benefit of diversifying the Company's portfolio (see "Factors That May Affect Future Results – Concentration of Lessees and Aircraft Type," above).

Engine Leasing Risk. The Company currently has three engines in its portfolio, making up 8% of the Company's total aircraft and aircraft engines net book value. The Company may from time to time lease one or more of these engines under industry standard short-term engine leases, which place the risk of an engine failure not caused by lessee negligence or foreign object damage upon the lessor. It is not economically practicable for an engine lessor to insure against that risk. If an engine failure occurs and is not covered by a manufacturer's warranty or caused by circumstances that the lessee is required to cover, the Company's investment in the engine could be a significant loss.

Interest Rate Risk. The Credit Facility carries a floating interest rate based upon short-term interest rate indices. Lease rates typically, but not always, move over time with interest rates, but market demand and numerous other asset-specific factors also affect lease rates. Because the Company's typical lease rates are fixed at the origination of leases, interest rate changes during the term of a lease have no effect on existing lease rental payments. Therefore, if interest rates rise significantly and there is relatively little lease origination by the Company following such rate increases, the Company could experience decreased net income as additional interest expense outpaces revenue growth. Further, even if significant lease origination occurs following such rate increases, other contemporaneous aircraft market forces may result in lower or flat rental rates, thereby decreasing net income.

International Risks. The Company leases assets primarily in overseas markets. Leases with foreign lessees, however, may present different risks than those with domestic lessees.

Foreign laws, regulations and judicial procedures may be more or less protective of lessor rights than those that apply in the United States. The Company could experience collection or repossession problems related to the enforcement of its lease agreements under foreign local laws and remedies in foreign jurisdictions. The protections potentially offered by Section 1110 of the Bankruptcy Code do not apply to non-U.S. carriers, and applicable local law may not offer similar protections. Certain countries do not have a central registration or recording system with which to locally establish the Company's interest in equipment and related leases. This could make it more difficult for the Company to recover an aircraft in the event of a default by a foreign lessee.

A lease with a foreign lessee is subject to risks related to the economy of the country or region in which such lessee is located, which may be weaker than the U.S. economy. An economic downturn in a particular country or region may impact a foreign lessee's ability to make lease payments, even if the U.S. and other foreign economies remain stable.

In addition, foreign lessees are subject to risks related to currency conversion fluctuations. Although the Company's current leases are all payable in U.S. dollars, the Company may agree in the future to leases that permit payment in foreign currency, which would subject such lease revenue to monetary risk due to currency fluctuations. In addition, if the Company undertakes certain obligations under a lease to contribute to a repair or improvement and if the work is performed in a foreign jurisdiction and paid for in foreign currency, currency fluctuations causing a weaker dollar between the time such agreement is made and the time payment for the work is made may result in an unanticipated increase in U.S. dollar-denominated cost for the Company.

Even with U.S. dollar-denominated lease payment provisions, the Company could still be affected by a devaluation of the lessee's local currency that would make it more difficult for a lessee to meet its U.S. dollar-denominated payments, increasing the risk of default of that lessee, particularly if its revenue is primarily derived in the local currency.

Foreign lessees that operate internationally may also face restrictions on repatriating foreign revenue to their home country. This could create a cash flow crisis for an otherwise profitable carrier, affecting its ability to meet its lease obligations.

Finally, ownership of a leased asset operating in a foreign country and/or by a foreign carrier may subject the Company to additional tax liabilities that are not present with aircraft operated in the United States. Depending on the jurisdiction, laws governing such tax liabilities may be complex, not well formed or not uniformly enforced. In such jurisdictions, the Company may decide to take an uncertain tax position based on the best advice of the local tax experts it engages, which position may be challenged by the taxing authority. If the taxing authority later assesses a liability, the Company may be required to pay penalties and interest on the assessed amount, which penalties and interest would not give rise to a corresponding foreign tax credit on the Company's U.S. tax return.

Reliance on JMC. All management of the Company is performed by JMC under a Management Agreement between the Company and JMC, which is in the fifteenth year of a 20-year term and provides for an asset-based management fee. JMC is not a fiduciary to the Company or its stockholders. The Company's Board of Directors (the "Board") has ultimate control and supervisory responsibility over all aspects of the Company and owes fiduciary duties to the Company and its stockholders. The Board has no control over the internal operations of JMC, but the Board does have the ability and responsibility to manage the Company's relationship with JMC and the performance of JMC's obligations to the Company under the Management Agreement, as it would have for any third party service provider to the Company. While JMC may not owe any fiduciary duties to the Company by virtue of the Management Agreement, all of the officers of JMC are also officers of the Company, and in that capacity owe fiduciary duties to the Company and its stockholders. In addition, certain officers of the Company hold significant ownership positions in the Company and JHC, the parent company of JMC.

The Management Agreement may be terminated if JMC defaults on its obligations to the Company. However, the agreement provides for liquidated damages in the event of its wrongful termination by the Company. Certain directors of the Company are also directors of JMC and, as discussed above, the officers of the Company are also officers of JMC and certain officers hold significant ownership positions in both the Company and JHC, the holding company for JMC. Consequently, the directors and officers of JMC may have a conflict of interest in the event of a dispute between the Company and JMC. Although the Company has taken steps to prevent conflicts of interest arising from such dual roles, such conflicts may still occur.

JMC has acted as the management company for two other aircraft portfolio owners, JetFleet III, which raised approximately \$13,000,000 in bond issuance proceeds, and AeroCentury IV, Inc. ("AeroCentury IV"), which raised approximately \$5,000,000 in bond issuance proceeds. In the first quarter of 2002, AeroCentury IV defaulted on certain bond obligations. In June 2002, the indenture trustee for AeroCentury IV's bondholders repossessed AeroCentury IV's assets and took over management of AeroCentury IV's remaining assets. JetFleet III defaulted on its bond obligation of \$11,076,400 in May 2004. The indenture trustee for JetFleet III bondholders repossessed JetFleet III's unsold assets in late May 2004.

Management Fee Structure. All decisions regarding acquisitions and disposal of aircraft from the Company's portfolio are made by JMC. JMC is paid a management fee based on the net asset value of the Company's portfolio. It may also receive a one-time asset acquisition fee upon purchase of an asset by the Company, and a one-time remarketing fee in connection with the sale or re-lease of an asset. Optimization of the results of the Company depends on timing of the acquisition, lease yield on the acquired assets, and re-lease or sale of its portfolio assets. Under the current management fee structure, a larger volume of acquisitions generates acquisition fees and also increases the periodic management fee by increasing the size of the aircraft portfolio. Since the Company's current business strategy involves continued growth of its portfolio and a "buy and hold" strategy, a compensation structure that results in greater compensation with an increased portfolio size is not inherently inconsistent with that strategy. The compensation structure does, nonetheless, create a situation where a decision by JMC for the Company to forego an asset transaction deemed to be an unacceptable business risk due to the lessee or the aircraft type is in conflict with JMC's own pecuniary interest. As a result, the compensation structure could act to incent greater risk-taking by JMC in asset acquisition decision-making. All acquisition decisions by JMC on behalf of the Company, however, currently require Credit Facility lender approval of the asset acquired and the lessee in order to be included in the Credit Facility collateral base, and the Company has established objective target guidelines for yields on acquired assets. Further, the Company's Board, including a majority of the outside independent directors, must approve any acquisition that involves a new asset type. While the Company currently believes the foregoing are effective mitigating factors against undue compensation-incented risk-taking by JMC, there is no assurance that such mechanisms can entirely and effectively eliminate such risk.

Government Regulation. There are a number of areas in which government regulation may result in costs to the Company. These include aircraft registration, safety requirements, required equipment modifications and aircraft noise requirements. Although it is contemplated that the burden and cost of complying with such requirements will fall primarily upon lessees of equipment, there can be no assurance that the cost will not fall on the Company. Furthermore, future government regulations could cause the value of any non-complying equipment owned by the Company to decline substantially.

Competition. The aircraft leasing industry is highly competitive. The Company competes with aircraft manufacturers, distributors, airlines and other operators, equipment managers, leasing companies, equipment leasing programs, financial institutions and other parties engaged in leasing, managing or remarketing aircraft, many of which have significantly greater financial resources. Nevertheless, the Company believes that it is competitive because of JMC's experience and operational efficiency in identifying and obtaining financing for the transaction types desired by regional air carriers. This market segment, which is characterized by transaction sizes of less than \$10 million and in many cases privately-held customers without well-established third party credit ratings, is not well served by the

Company's larger competitors. JMC has developed a reputation as a global participant in this segment of the market, and the Company believes that JMC's reputation benefits the Company. There is, however, no assurance that competition from larger aircraft leasing companies will not increase significantly or that JMC's reputation will continue to be strong in this market segment.

Casualties, Insurance Coverage. The Company, as owner of transportation equipment, may be named in a suit claiming damages for injuries or damage to property caused by its assets. As a triple-net lessor, the Company is generally protected against such claims, since the lessee would be responsible for, insure against and indemnify the Company for such claims. The Company defines an "operating lease" as a lease with a term that is less than the useful life of the asset. A "triple net operating lease" is an operating lease under which, in addition to monthly rental payments, the lessee is generally responsible for the taxes, insurance and maintenance and repair of the aircraft arising from the use and operation of the aircraft during the term of the lease. Although the United States Aviation Act may provide some protection with respect to the Company's aircraft assets, it is unclear to what extent such statutory protection would be available to the Company with respect to most of the Company's assets, which are operated in foreign countries where such provisions of the United States Aviation Act may not apply.

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The Company's leases generally require a lessee to insure against likely risks of loss or damage to the leased asset, and liability to passengers and third parties pursuant to industry standard insurance policies and require lessees to provide insurance certificates documenting the policy periods and coverage amounts. The Company tracks receipt of the certificates and calendars their expiration dates. Prior to the expiration of an insurance certificate, if a replacement certificate has not been received, the Company reminds the lessee of its obligation to provide current insurance certificates.

Despite these requirements and procedures, there may be certain cases where the loss is not entirely covered by the lessee or its insurance. The possibility of such an event is remote, but any such uninsured loss with respect to the equipment or insured loss for which insurance proceeds are inadequate might result in a loss of invested capital in and any profits anticipated from, such equipment, as well as a potential claim directly against the Company.

Compliance With Future Environmental Regulations. Compliance with future environmental regulations may harm the Company's business. Many aspects of aircraft operations are subject to increasingly stringent environmental regulations, and growing concerns about climate change may result in the imposition by the U.S and foreign governments of additional regulation of carbon emissions, aimed at either requiring adoption of technology to reduce the amount of carbon emissions or putting in place a fee or tax system on carbon emitters. It is likely that any such regulation will be directed at the Company's customers, as operators of aircraft, or at the Company, as owners of aircraft. Under the Company's triple-net arrangements, the Company would likely shift responsibility for compliance to its lessees, but there might be some costs of regulation that the Company could not shift and would itself have to bear. Although it is not expected that the costs of complying with current environmental regulations will have a material adverse effect on the Company's financial position, results of operations, or cash flows, no assurance can be given that the costs of complying with environmental regulations adopted in the future will not have such an effect.

Cyber-Security Risks. The Company believes that it has sufficient cyber-security measures in place commensurate with the risks to the Company of a successful cyber-attack or breach of security. The Company's main vulnerability to a cyber-attack would be interruption of the Company's email communications internally and with third parties, and loss of document sharing between the Company's offices and remote workers. Such an attack could temporarily impede the efficiency of the Company's operations; however, the Company believes that sufficient replacement mechanisms exist in the event of such an interruption that there would not be a material adverse financial impact on the Company's business.

Warrant Issuance. As part of the Subordinated Notes financing, warrants were issued to the holders of Subordinated Notes to purchase up to 81,224 shares of the Company's common stock that are currently exercisable and represent approximately 5% of the post-exercise fully diluted capitalization of the Company. The exercise price under the warrants is \$8.75 per share. If the warrants to purchase shares are exercised at a time when the exercise price is less than the fair market value of the Company's common stock, there will be dilution to the existing holders of common stock. This dilution of the Company's common stock could depress its trading price.

Possible Volatility of Stock Price. The market price of the Company's common stock may be subject to fluctuations following developments relating to the Company's operating results, changes in general conditions in the economy, the financial markets, the airline industry, changes in accounting principles or tax laws applicable to the Company or its lessees, or other developments affecting the Company, its customers or its competitors, or arising from other investor sentiment unknown to the Company. Because the Company has a relatively small capitalization of approximately 1.5 million shares outstanding, there is a correspondingly limited amount of trading and float of the Company's shares. Consequently, the Company's stock price is more sensitive to a single large trade or a small number of simultaneous trades along the same trend than a company with larger capitalization and higher trading volume and float.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

This report does not include information described under Item 3 of Form 10-Q pursuant to the rules of the Securities and Exchange Commission that permit “smaller reporting companies” to omit such information.

Item 4. Controls and Procedures.

CEO and CFO Certifications. Attached as exhibits to this Quarterly Report on Form 10-Q (the “Report”) are certifications of the Company’s Chief Executive Officer (the “CEO”) and the Company’s Chief Financial Officer (the “CFO”), which are required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (the “Section 302 Certifications”). This section of the Report includes information concerning the evaluation of disclosure controls and procedures referred to in the Section 302 Certifications and this should be read in conjunction with the Section 302 Certifications for a more complete understanding of the topics presented.

Evaluation of the Company’s Disclosure Controls and Procedures. Disclosure controls and procedures (“Disclosure Controls”) are controls and other procedures that are designed to ensure that information required to be disclosed in the Company’s reports filed under the Securities Exchange Act of 1934, such as this Report, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and that such information is accumulated and communicated to the Company’s management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

The Company’s management, with the participation of the CEO and CFO, evaluated the effectiveness of the design and operation of the Company’s Disclosure Controls and concluded that the Company’s Disclosure Controls were effective as of March 31, 2012.

Changes in Internal Control Over Financial Reporting. No change in the Company’s internal control over financial reporting occurred during the fiscal quarter ended March 31, 2012 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II
OTHER INFORMATION

Item 6.Exhibits

| Exhibit Number | Description |
|-------------------|---|
| 10.1 | Second Loan Modification Agreement dated as of March 8, 2012, incorporated by reference to Exhibit 10.1 to the current report on Form 8-K filed with the Securities and Exchange Commission on March 12, 2012 SEC File No. 001-13387, Film No. 12683059 |
| 31.1 | Certification of Neal D. Crispin, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Toni M. Perazzo, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1* | Certification of Neal D. Crispin, Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2* | Certification of Toni M. Perazzo, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Schema Document |
| 101.CAL | XBRL Calculation Linkbase Document |
| 101.LAB | XBRL Label Linkbase Document |
| 101.PRE | XBRL Presentation Linkbase Document |

* These certificates are furnished to, but shall not be deemed to be filed with, the Securities and Exchange Commission.

SIGNATURES

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

AEROCENTURY CORP.

Date: May 11, 2012

By: /s/ Toni M. Perazzo
Name: Toni M. Perazzo
T i t l e : S e n i o r V i c e
President-Finance and
Chief Financial Officer

