

Edgar Filing: AEROCENTURY CORP - Form 10-Q

AEROCENTURY CORP  
Form 10-Q  
May 15, 2018  
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, 2018

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 94-3263974  
(State or Other Jurisdiction of Incorporation or Organization) (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

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):

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

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

The number of shares of the Registrant's Common Stock outstanding as of May 15, 2018 was 1,416,699.

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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 these statements: (i) in Item 1, "Notes to Financial Statements," that the Company does not expect to adopt ASU 2016-02 early, and expects to elect practical expedients in connection with its adoption; that the Company believes the outcome of any existing or known threatened proceedings, even if determined adversely, should not have a material adverse effect on the Company's business, financial condition, liquidity or results of operations; that the Company intends to hold a special meeting of the Company's shareholders to approve the issuance of Common Stock in connection with the merger with JetFleet Holding Corp. ("JHC"), that if the Company's shareholders approve the issuance of Common Stock in connection with the merger with JHC, the merger is anticipated to be consummated in the second quarter of 2018 or shortly thereafter; (ii) in Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources," that based on its current projections, the Company believes that it will be in compliance with all of its Credit Facility covenants at future calculation dates; and that the Company will have adequate cash flow to meet its ongoing operational needs, including any required repayments under the Credit Facility; (iii) in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations – Outlook," that the Company intends to hold a special meeting of the Company's stockholders in order to approve the issuance of AeroCentury Common Stock in connection with the merger; that the combination of the management function performed by JMC and the portfolio held by the Company will be accretive to the Company and will create shareholder value for the shareholders of the combined post-merger company; that the Company will incur certain non-recurring, non-tax deductible merger expenses in the periods leading up to the merger, and immediately following, as well as having to record, for accounting purposes, a settlement loss at the time of consummation of the merger; that the trend toward downward pressure on lease rates, resulting in lower margins, and fewer acquisition opportunities for the Company will continue for the short- to medium-term, until yields on alternative investments return to a more normal historical range; and that certain out-of-production aircraft owned by the Company may remain off lease for a significant period of time; (iv) in Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Factors that May Affect Future Results," that the Company believes it will continue to be in compliance with all of the covenants under its debt agreements; that the Company intends to acquire JHC; that the Company will incur significant additional expenses, including legal and third party consulting fees, which will be payable whether or not the Merger eventually occurs; that the Company will be required to record a substantial portion of the consideration paid for JHC as a settlement loss if the merger is consummated; that the Company believes that waivers or modifications of certain covenants from its Credit Facility lenders for post-merger periods obtained from the Credit Facility lenders are sufficient to avoid a default under such Credit Facility financial covenants; that the Company will have sufficient cash funds to make any required principal repayment that arises due to any Credit Facility borrowing limitations; that the Company typically acquires used aircraft; that the Company does not anticipate any worsening of the financial condition of its overall customer base, but believes that there may be further shakeouts of weaker carriers in economically troubled regions; that most of the Company's expected growth is outside of North America; that the Company intends to continue to focus solely on regional aircraft; that the Company's overall industry expertise may permit the Company to effectively manage new aircraft types; that effective mitigating factors exist against undue compensation-incented risk-taking by JMC and that the risk of such would be largely mitigated after the merger of JHC with ACY; that the burden and cost of complying with government regulatory requirements will fall primarily upon lessees of equipment; that the costs of complying with environmental regulations will not have a material adverse effect on the Company; that the Company's main

vulnerability would be interruption to email communication, internally and with third parties, loss of customer and lease archives, and loss of document sharing between the Company's offices and remote workers; that sufficient replacement mechanisms exist such that there would not be a material adverse financial impact on the Company's business; and that while the Company believes that it has sufficient cyber-security measures and backup mechanisms in place commensurate with the risks to the Company of a successful cyber-attack or breach of its data security, its resources and technical sophistication may not be adequate to prevent all types of cyber-attacks.

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 lack of any unexpected lessee defaults or insolvency; the continued availability of financing for acquisitions under the Credit Facility; the Company's success in finding appropriate assets to acquire with such financing; a deterioration of the market or appraised values of aircraft assets owned by the Company; an unanticipated surge in interest rates; compliance by the Company's lessees with obligations under their respective leases; no sudden current economic downturn or unanticipated future financial crises; deviations from the assumption that future major maintenance expenses will be relatively evenly spaced over the entire portfolio; large unanticipated maintenance expenses; the failure of the JHC acquisition to be consummated as a result of the failure of conditions precedent or otherwise; the Company's inability to perform the management services previously performed by JMC at a cost less than the fees that would otherwise be payable pursuant to the management agreement; the Company's inability to raise capital on attractive terms, or at all, and limited trading volume in the Company's stock; and future trends and results that 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 Consolidated Balance Sheets  
(Unaudited)

## ASSETS

	March 31, 2018	December 31, 2017
Assets:		
Cash and cash equivalents	\$4,793,100	\$8,657,800
Accounts receivable, including deferred rent of \$592,100 and \$707,300 at March 31, 2018 and December 31, 2017, respectively	3,159,000	3,825,100
Finance leases receivable	22,893,400	23,561,000
Aircraft and aircraft engines held for lease, net of accumulated depreciation of \$35,068,600 and \$33,234,200 at March 31, 2018 and December 31, 2017, respectively	188,858,000	195,098,200
Assets held for sale	4,821,800	4,966,500
Prepaid expenses and other	1,662,600	301,300
Total assets	\$226,187,900	\$236,409,900
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accounts payable and accrued expenses	\$820,100	\$645,200
Notes payable and accrued interest, net of unamortized debt issuance costs of \$1,817,200 and \$2,216,000 at March 31, 2018 and December 31, 2017, respectively	133,768,100	145,598,200
Maintenance reserves	27,113,600	26,942,800
Accrued maintenance costs	294,300	1,275,300
Security deposits	2,968,800	3,147,900
Unearned revenues	4,398,600	2,447,500
Deferred income taxes	8,583,900	8,533,700
Income taxes payable	556,500	452,600
Total liabilities	178,503,900	189,043,200
Commitments and contingencies (Note 5)		
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, 1,629,999 shares issued, 1,416,699 shares outstanding	1,600	1,600
Paid-in capital	14,780,100	14,780,100
Retained earnings	35,939,100	35,621,800
	50,720,800	50,403,500
Treasury stock at cost, 213,300 shares	(3,036,800 )	(3,036,800 )
Total stockholders' equity	47,684,000	47,366,700
Total liabilities and stockholders' equity	\$226,187,900	\$236,409,900

The accompanying notes are an integral part of these statements.

AeroCentury Corp.  
Condensed Consolidated Statements of Operations  
(Unaudited)

	For the Three Months Ended March 31,	
	2018	2017
Revenues and other income:		
Operating lease revenue, net	\$6,462,900	\$7,316,900
Finance lease revenue	379,000	325,400
Net (loss)/gain on disposal of assets	(8,200 )	13,900
Net gain on sales-type finance leases	-	297,400
Other income	1,051,400	200
	7,885,100	7,953,800
Expenses:		
Depreciation	2,941,900	2,936,100
Interest	2,254,100	1,610,300
Management fees	1,446,800	1,506,800
Professional fees, general and administrative and other	577,400	506,100
Maintenance	91,200	256,100
Insurance	79,700	73,200
Other taxes	22,600	22,600
	7,413,700	6,911,200
Income before income tax provision	471,400	1,042,600
Income tax provision	154,100	401,100
Net income	\$317,300	\$641,500
Earnings per share:		
Basic	\$0.22	\$0.41
Diluted	\$0.22	\$0.41
Weighted average shares used in earnings per share computations:		
Basic	1,416,699	1,550,032
Diluted	1,416,699	1,550,032

The accompanying notes are an integral part of these statements.

AeroCentury Corp.  
Condensed Consolidated Statements of Cash Flows  
(Unaudited)

	For the Three Months Ended March 31,	
	2018	2017
Net cash provided by operating activities	\$4,552,000	\$4,258,100
Investing activities:		
Proceeds from sale of aircraft and aircraft engines held for lease, net of re-sale fees	3,195,000	570,100
Proceeds from sale of assets held for sale, net of re-sale fees	1,683,500	16,200
Investment in direct financing leases	-	(7,354,100)
Investment in aircraft parts and acquisition costs	(1,236,000 )	(62,800 )
Net cash provided by/(used in) investing activities	3,642,500	(6,830,600)
Financing activities:		
Issuance of notes payable – Credit Facility	-	7,000,000
Repayment of notes payable – Credit Facility	(11,000,000)	(2,800,000)
Repayment of notes payable – special purpose financing	(1,059,200 )	(1,013,300)
Net cash (used in)/provided by financing activities	(12,059,200)	3,186,700
Net (decrease)/increase in cash and cash equivalents	(3,864,700 )	614,200
Cash and cash equivalents, beginning of period	8,657,800	2,194,400
Cash and cash equivalents, end of period	\$4,793,100	\$2,808,600

During the three months ended March 31, 2018 and 2017, the Company paid interest totaling \$2,055,100 and \$1,402,600, respectively. The Company paid no income taxes during the three months ended March 31, 2018 or 2017.

The accompanying notes are an integral part of these statements.

AeroCentury Corp.  
Notes to Condensed Consolidated Financial Statements (Unaudited)  
March 31, 2018

1. Organization and Summary of Significant Accounting Policies

(a) The Company and Basis of Presentation

AeroCentury Corp., a Delaware corporation incorporated in 1997, typically acquires used regional aircraft and engines for lease to foreign and domestic regional carriers.

In August 2016, AeroCentury Corp. formed two wholly-owned subsidiaries, ACY 19002 Limited ("ACY 19002") and ACY 19003 Limited ("ACY 19003") for the purpose of acquiring aircraft using a combination of cash and financing ("SPE Financing") separate from the parent's credit facility. Financial information for AeroCentury Corp., ACY 19002 and ACY 19003 (collectively, the "Company") is presented on a consolidated basis 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 GAAP 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, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. All intercompany balances and transactions have been eliminated in consolidation.

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, 2017.

(b) Use of Estimates

The Company's condensed consolidated financial statements have been prepared in accordance with GAAP. The preparation of consolidated 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 consolidated 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 condensed consolidated financial statements are the residual values and useful lives of the Company's long-lived assets, the amount and timing of future cash flows associated with each asset that are used to evaluate whether assets are impaired, accrued maintenance costs, 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.

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

The carrying amount of the Company's money market funds included in cash and cash equivalents was \$3,153,300 and \$6,151,900 at March 31, 2018 and December 31, 2017, respectively. The fair value of the Company's money market funds is categorized as Level 1 under the GAAP fair value hierarchy.

As of March 31, 2018 and December 31, 2017, there were no liabilities that were 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 and assets held for sale, 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 asset's carrying value exceeds its fair value. The Company recorded no impairment charges on its aircraft held for lease or sale during the three months ended March 31, 2018 and 2017.

Fair Value of Other Financial Instruments

The Company's financial instruments, other than cash and cash equivalents, consist principally of finance leases receivable, amounts borrowed under its credit facility (the "Credit Facility") and notes payable under special purpose financing. The fair value of accounts receivable, finance leases receivable, accounts payable and the Company's maintenance reserves and accrued maintenance costs approximates the carrying value of these financial instruments because of their short-term maturities.

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 under the Credit Facility approximates current market rates for such indebtedness at the balance sheet date, and therefore that the outstanding principal and accrued interest of \$123,111,100 and \$134,278,900 at March 31, 2018 and December 31, 2017, respectively, approximate their fair values on such dates. The fair value of the Company's outstanding balance of its Credit Facility would be categorized as Level 3 under the GAAP fair value hierarchy.

The amounts payable under the Company's SPE financing are payable through the fourth quarter of 2020 and bear a fixed rate of interest, as described in Note 4(b) to the condensed consolidated financial statements. The Company believes that the effective interest rate under the special purpose financing approximates current market rates for such indebtedness at the balance sheet date, and therefore that the outstanding principal and accrued interest of \$12,474,200 and \$13,535,300 approximates their fair value at March 31, 2018 and December 31, 2017, respectively. Such fair value would be categorized as Level 3 under the GAAP fair value hierarchy.

(d) Finance Leases

As of March 31, 2018, the Company had six aircraft subject to sales-type finance leases and three aircraft subject to direct financing leases. All nine leases contain lessee bargain purchase options at prices substantially below the subject assets' estimated residual values at the exercise date for the options. Consequently, the Company has classified each of these nine leases as finance leases for financial accounting purposes. For such finance leases, the Company reports 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 as a finance lease receivable on its balance sheet and accrues interest on the balance of the finance lease receivable based on the interest rate inherent in the applicable lease over the term of the lease. For each of the six sales-type finance leases, the Company recognized as a gain or loss the amount equal to (i) the net investment in the sales-type finance lease plus any initial direct costs and lease incentives less (ii) the net book value of the subject aircraft at inception of the applicable lease.

The Company recognized revenue from interest earned on finance leases in the amount of \$379,000 and \$325,400 in the three months ended March 31, 2018 and 2017, respectively.

(e) Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09 that created the new Topic 606 ("Topic 606") in the Accounting Standards Codification ("ASC"). Topic 606 also included numerous conforming additions and amendments to other Topics within the ASC. Topic 606 established new rules that affect the amount and timing of revenue recognition for contracts with customers, but does not affect lease accounting and reporting. As such, adoption of these provisions will not affect the Company's lease revenues. On August 12, 2015, the FASB deferred the effective date of the provisions included in Topic 606 to years commencing after December 15, 2017, although early adoption was permitted for the year ended December 31, 2017. As such, the Company has adopted Topic 606 as of January 1, 2018. Adoption may be reflected using either a full retrospective method, applying the standard to all periods presented, or a simplified method that does not recast prior periods but does disclose the effect of the adoption on the current period consolidated financial statements. Since most of the Company's revenues arise from its lease contracts, which are not affected by the new standard, and since the Company's revenue recognition for other sources of revenue is generally the same as it was under previous accounting standards, adoption of Topic 606 in the current year, using the modified retrospective approach, has had no effect on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) ("ASU 2016-02"). ASU 2016-02 is effective for public companies for years beginning after December 15, 2018, although early adoption is permitted. ASU 2016-02 substantially modifies lessee accounting for leases, requiring that lessees recognize lease assets and liabilities for leases extending beyond one year. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement.

The new standard requires a lessor to classify leases as sales-type, finance, or operating. A lease will be treated as sales-type if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing. If the lessor does not convey risks and rewards or control, an operating lease results. A modified retrospective transition approach is required for lessors for sales-type, finance, and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available.

The Company is reviewing those agreements under which it is the lessor and is evaluating the impact of the adoption of ASU 2016-02 on its consolidated financial statements and related disclosures. The Company does not expect to adopt ASU 2016-02 early, and expects to elect practical expedients in connection with its adoption, including not re-evaluating lease classification or capitalized initial direct costs on existing leases.

The Company is not a lessee under any agreements that would be considered leases under ASU 2016-02, and so would be unaffected with respect to its adoption with respect to lessee accounting.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805) ("ASU 2017-01"). ASU 2017-01 is effective for public companies for years beginning after December 15, 2017, although early adoption is permitted. ASU 2017-01 clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The Company has early adopted ASU 2017-01 effective beginning the first quarter ended March 31, 2017 and has determined that none of its acquired assets qualifies as a business, such that no gain, loss or adjustment to the carrying value of assets was required in connection with such adoption.

In January 2017, the FASB issued ASU 2017-04, Intangibles -- Goodwill and Other (Topic 350) ("ASU 2017-04"), which provides for simplification of the test for goodwill impairment. Under the revised standard, "step 2" of the test under the previous standard is eliminated and (i) the fair value of the reporting unit is compared to its carrying value, with (ii) an impairment charge up to the amount of goodwill recognized for the excess of carrying value over fair value (considering the income tax effects of deductible goodwill, if applicable). The new provisions are required to be

adopted for fiscal years beginning after December 15, 2019, although the Company has elected to early adopt the new provisions beginning with its quarter ended March 31, 2017. Adoption of ASU 2017-04 has had no effect on the financial results or position of the Company.

In December of 2017, the United States enacted the Tax Cuts and Jobs Act of 2017 (the "Tax Act"), which had numerous effects on US corporate taxation, including reducing the federal corporate tax rate to 21%, substantially modifying the U.S. taxation of international investments and transactions, and repeals the alternative minimum tax. Earlier this year, the SEC issued Staff Accounting Bulletin 118 ("SAB 118"), which clarifies that companies should account for the effects of the change in tax law as the results are determinable or reasonably estimable, continuing to account for items for which no reasonable estimate under the new law can be made under the provisions of the law as it existed before enactment of the Tax Act, and that companies would report any provisional amounts as soon as a reasonable estimate is available. Under SAB 118, in no event should the period during which the effects of the law change are being analyzed but have not been completed exceed one year from enactment (the "measurement period"), the fourth quarter of 2018. The Company has provided all estimates of the effects of the Tax Act that it has determined in its financial statements and expects that any further analysis will be completed within the measurement period.

## 2. Finance Leases Receivable

At March 31, 2018 and December 31, 2017, the net investment included in finance leases and direct financing leases receivable were as follows:

	March 31, 2018	December 31, 2017
Gross minimum lease payments receivable	\$26,027,700	\$27,074,400
Less unearned interest	(3,134,300 )	(3,513,400 )
Finance leases receivable	\$22,893,400	\$23,561,000

As of March 31, 2018, minimum future payments receivable under finance leases were as follows:

Years ending	
Remainder of 2018	\$5,215,500
2019	7,087,600
2020	5,036,600
2021	5,381,000
2022	3,307,000
	\$26,027,700

## 3. Aircraft and Aircraft Engines Held for Lease or Sale

## (a) Assets Held for Lease

At March 31, 2018 and December 31, 2017, the Company's aircraft and aircraft engines held for lease consisted of the following:

	March 31, 2018		December 31, 2017	
	% of net book value		% of net book value	
Type	Number	Owned	Number	Owned
Regional jet aircraft	13	83 %	13	82 %
Turboprop aircraft	8	16 %	10	17 %
Engines	1	1 %	1	1 %

During the first quarter of 2018, the Company recorded \$1,050,000 in other income resulting from cash received from the previous lessee of three aircraft that were returned to the Company during 2017. Such payments were for unpaid maintenance reserves, as well as amounts due pursuant to the return conditions of the applicable leases. The Company did not accrue unpaid reserves or return condition amounts at the time of lease termination based on management's evaluation of the creditworthiness of the lessee. Therefore, the Company is accounting for payments as they are received and recorded the amount in other income.

During the first quarter of 2018, the Company made deposits of \$1,236,000 for two aircraft that it intends to acquire during the second quarter. In addition to its investment in direct financing leases discussed in Note 2, during the first quarter of 2017, the Company used \$62,800 for equipment to be installed on an aircraft and for acquisition costs related to aircraft acquired in 2016.

During the first quarter of 2018, the Company sold two of its aircraft held for lease and recorded a net loss of \$8,200.

Six turboprop aircraft, representing 11% of the net book value of the Company's aircraft and engines held for lease, were off lease at March 31, 2018.

As of March 31, 2018, minimum future lease revenue payments receivable under noncancelable operating leases were as follows:

Years ending	
Remainder of 2018	\$ 18,515,500
2019	24,641,300
2020	23,003,000
2021	15,901,600
2022	13,944,000
Thereafter	29,447,500
	\$ 125,452,900

(b) Assets Held for Sale

Assets held for sale at March 31, 2018 consist of turboprop airframe parts from two aircraft.

During the first quarter of 2018, the Company received \$931,800 in cash and accrued \$10,600 in receivables for parts sales. These amounts were accounted for as follows: \$779,700 reduced accounts receivable for parts sales accrued in 2017, \$144,600 reduced the carrying value of the parts, and \$18,100 was recorded as gains in excess of the carrying value of the parts. During the first quarter of 2017, the Company received \$16,200 from the sale of parts, of which \$2,300 reduced the carrying value of the parts and \$13,900 was recorded as a gain.

## 4. Notes Payable and Accrued Interest

At March 31, 2018 and December 31, 2017, the Company's notes payable and accrued interest consisted of the following:

	March 31, 2018	December 31, 2017
Credit Facility:		
Principal	\$ 123,000,000	\$ 134,000,000
Unamortized debt issuance costs	(1,817,200 )	(2,216,000 )
Accrued interest	111,100	278,900
Special purpose financing:		
Principal	12,452,600	13,511,900
Accrued interest	21,600	23,400
	\$ 133,768,100	\$ 145,598,200

## (a) Credit facility

The Company's \$170 million Credit Facility is provided by a syndicate of banks and is secured by all of the assets of the Company, including its aircraft and engine portfolio. The Credit Facility, which expires on May 31, 2019, can be expanded to a maximum of \$180 million. The Company was in compliance with all covenants under the Credit Facility at March 31, 2018 and December 31, 2017.

The unused amount of the Credit Facility was \$47,000,000 and \$36,000,000 as of March 31, 2018 and December 31, 2017, respectively.

The weighted average interest rate on the Credit Facility was 5.30% and 5.21% at March 31, 2018 and December 31, 2017, respectively.

## (b) SPE Financing

In August 2016, the Company acquired two regional jet aircraft using cash and financing separate from its Credit Facility. The separate SPE Financing resulted in note obligations of \$9,805,600 and \$9,804,300, which are being paid from a portion of the rent payments on the related aircraft leases through October 3, 2020 and November 7, 2020, respectively, and which bear interest at the rate of 4.455% per annum. The borrower under each note obligation is the special purpose entity that owns each aircraft. The notes are collateralized by the aircraft and are recourse only to the special purpose entity borrower and its aircraft asset, subject to standard exceptions for this type of financing. Payments due under the notes consist of quarterly principal and interest. The combined balance of the notes payable and accrued interest on these notes at March 31, 2018 and December 31, 2017 was \$12,474,200 and \$13,535,300, respectively.

## 5. Contingencies

In the ordinary conduct of the Company's business, the Company is subject to lawsuits, arbitrations and administrative proceedings from time to time. The Company believes that the outcome of any existing or known threatened proceedings, even if determined adversely, should not have a material adverse effect on the Company's business, financial condition, liquidity or results of operations.

## 6. Computation of Earnings Per Share

Basic and diluted earnings per share are calculated as follows:

	For the Three Months Ended March 31,	
	2018	2017
Net income	\$317,300	\$641,500
Weighted average shares outstanding for the period	1,416,699	1,550,032
Basic earnings per share	\$0.22	\$0.41
Diluted earnings per share	\$0.22	\$0.41

Basic earnings per common share is computed using net income 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, include potentially dilutive common shares outstanding during the period.

## 7. Related Party Transactions

The Company's portfolio of leased aircraft assets is managed and administered under the terms of a management agreement (the "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. Acquisition fees are included in the cost basis of the asset purchased. JMC may receive a remarketing fee in connection with the re-lease or sale of the Company's assets. Remarketing fees are amortized over the applicable lease term or included in the gain or loss on sale.

Fees incurred during the three months ended March 31, 2018 and 2017 were as follows:

	For the Three Months Ended March 31,	
	2018	2017
Management fees	\$1,446,800	\$1,506,800
Acquisition fees	-	220,500
Remarketing fees	-	51,100

In August 2009, the Company entered into an agreement (the "Assignment 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 open market acquisitions of shares representing over 5% of the Company's common stock. In March 2017, the Company exchanged one of its engines for 150,000 shares of common stock of the Company held by Mr. Beaumont. The Company recorded no gain or loss related to the exchange.



## 8. Acquisition of Management Company

In October 2017, the Company and JHC entered into an Agreement and Plan of Merger (the "Merger Agreement") for the acquisition of JHC by the Company in a reverse triangular merger ("Merger") for consideration of \$3.5 million in cash and 129,286 shares of common stock of the Company, subject to adjustment as provided in the Merger Agreement. The Company submitted an application to the State of California Department of Business Oversight (the "DBO") for a permit ("Permit") to issue securities to JHC's shareholders in the Merger, which Permit was issued on February 22, 2018 after a hearing with the DBO. JHC has received the requisite consent of its shareholders to the Merger. The Company intends to hold a special meeting of the Company's shareholders in order to approve the Merger and the issuance of AeroCentury Common Stock in connection with the Merger as required under the applicable listing rules of the NYSE American exchange on which AeroCentury's common stock is traded. Approval of the Merger is not required under Delaware or California corporate law, or under the Merger Agreement. If the AeroCentury shareholders approve the issuance of AeroCentury Common Stock, the Merger is anticipated to be consummated in the second quarter of 2018 or shortly thereafter, but there can be no assurance that such closing will occur, or that it will occur in the anticipated time frame.

During the quarter ended March 31, 2018, the Company accrued \$200,000 of expenses related to the proposed Merger transaction. Such expenses are included in professional fees, general and administrative and other in the Company's consolidated statements of operations.

## 9. Subsequent Events

Subsequent to the execution of the Merger Agreement for the acquisition of JHC, JHC agreed to forebear on its right to receive certain fees otherwise owed by the Company to JHC pursuant to the Management Agreement for all periods after March 31, 2018 and until August 15, 2018, provided that the Company will still be required to reimburse JetFleet for certain expenses as required under the Management Agreement. If the Merger Agreement is terminated on or before August 15, 2018 or the Merger otherwise does not close by August 15, 2018, this forbearance will end and the Company will be obligated to pay all such fees that JHC agreed to forebear. If the Merger closes on or before August 15, 2018, this forbearance will be deemed to be a permanent waiver of such fees and the Company will not be required to pay such fees to JHC.

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, 2017 and the unaudited financial statements and related notes that appear elsewhere in this report.

AeroCentury provides leasing and finance services to regional airlines worldwide. The Company is principally engaged in providing leasing services of mid-life regional aircraft to carriers, including operating leases and finance leases. In addition to leasing activities, the Company sells aircraft from its operating lease portfolio to third parties, including other leasing companies, financial services companies, and airlines. Its operating performance is driven by the growth of its aircraft portfolio, the terms of its leases, the interest rate of its debt, as well as asset sales.

During the first three months of 2018, the Company sold two aircraft for cash. The Company ended the period with a total of twenty-one aircraft and one engine held for lease, with a net book value of approximately \$189 million. This represents a 3% decrease compared to the net book value at December 31, 2017, as a result of two asset sales during the first quarter of 2018 as well as depreciation on its remaining assets held for lease. The Company also owns nine aircraft subject to finance leases, three of which were acquired in 2017.

The Company has a globally diversified customer base of ten airlines in eight countries. Average portfolio utilization was approximately 90% during the first three months of 2018 compared with approximately 96% during the same period in 2017. The decrease was due to asset sales during 2017 and 2018, as well as the return of several aircraft at lease end in 2017.

In July 2017, the Company expanded its revolving \$150 million credit facility to \$170 million. The unused amount of the Credit Facility was \$47,000,000 as of March 31, 2018. The weighted average interest rate on the Credit Facility was 5.30% at March 31, 2018.

Total revenues and other income for the quarter ended March 31, 2018 decreased by \$0.1 million compared to the first quarter of 2017, primarily as a result of decreased operating lease revenues and decreased gains from asset dispositions, the effects of which were significantly offset by increased other income.

Net income for the quarter ended March 31, 2018 was \$0.3 million, compared to net income of \$0.6 million in the same period of 2017, resulting in basic and diluted earnings per share of \$0.22 and \$0.41 respectively. Pre-tax profit margin for the quarter ended March 31, 2018 was 6% compared to 13% for the first quarter of 2017. The first quarter of 2018 included \$200,000 of expenses incurred in connection with the proposed acquisition of JHC by the Company.

## Fleet Summary

Portfolio metrics of the Company's aircraft held for lease as of March 31, 2018 and December 31, 2017 were as follows.

	March 31, 2018	December 31, 2017
Number of aircraft and engines held for lease	22	24
Weighted average fleet age	11.5 years	11.4 years
Weighted average remaining lease term	57 months	58 months
Aggregate fleet net book value	\$188,858,000	\$195,098,200
		For the Three Months Ended March 31, 2018 2017
Average portfolio utilization	90%	96%

The following table sets forth the net book value and percentage of the net book value, by type, of the Company's assets that were held for lease at March 31, 2018 and December 31, 2017.

Type	March 31, 2018	December 31, 2017
	% of net book value	% of net book value
Turboprop aircraft:		
Bombardier Dash-8-400	2 7 %	2 7 %
Bombardier Dash-8-300	3 6 %	3 6 %
Saab 340B Plus	2 2 %	4 3 %
Saab 340B	1 1 %	1 1 %
Regional jet aircraft:		
Canadair 900 (*)	5 39 %	5 38 %
Embraer 175	3 16 %	3 16 %
Canadair 1000	2 15 %	2 15 %
Canadair 700	3 13 %	3 13 %
Engines:		
Pratt & Whitney 150A	1 1 %	1 1 %

(\*) December 31, 2017 includes a Canadair 705 that was converted to a Canadair 900 in 2018.

At March 31, 2018 and December 31, 2017, the Company also had nine aircraft subject to finance leases.



The following table sets forth the net book value and percentage of the net book value of the Company's assets that were held for lease at March 31, 2018 and December 31, 2017 in the indicated regions:

Region	March 31, 2018		December 31, 2017	
	Net book value	% of net book value	Net book value	% of net book value
Europe	\$90,544,500	48 %	\$92,108,500	47 %
North America	71,324,400	38 %	72,270,700	37 %
Asia	5,968,300	3 %	6,082,100	3 %
Off lease	21,020,800	11 %	24,636,900	13 %
	\$188,858,000	100 %	\$195,098,200	100 %

For the quarter ended March 31, 2018, approximately 32%, 30%, and 22% of the Company's operating lease revenue was derived from customers in Slovenia, the United States and Spain, respectively. Operating lease revenue does not include interest income from the Company's finance leases. The following table sets forth geographic information about the Company's operating lease revenue for leased aircraft and aircraft equipment, grouped by domicile of the lessee:

Region	For the Three Months Ended March 31, 2018		2017	
	Number of lessors	% of operating lease revenue	Number of lessors	% of operating lease revenue
Europe	3	56 %	4	53 %
North America	4	39 %	4	24 %
Africa	-	-	1	15 %
Asia	1	5 %	1	4 %
Australia	-	-	1	4 %

For the quarter ended March 31, 2018, approximately 70% and 30% of the Company's finance lease revenue was derived from customers in Africa and Europe, respectively.

## Results of Operations

The Company recorded net income of \$0.3 million for the quarter ended March 31, 2018.

Operating lease revenue decreased 12% to \$6.5 million in the first quarter of 2018 from \$7.3 million in the first quarter of 2017, primarily due to (i) the loss of revenue from assets that were on lease during the 2017 quarter, but off lease in 2018 and (ii) the loss of revenue from aircraft that were sold during 2017. Such decreases were partially offset by revenue from assets purchased in mid-2017.

Average portfolio utilization decreased to approximately 90% during the first quarter of 2018 from approximately 96% during the first quarter of 2017. The decrease was due to asset sales during late 2017 and 2018, as well as the return of several aircraft at lease end in 2017.

During the first quarter of 2018, the Company sold two aircraft and recorded a net loss of \$8,200. During the first quarter of 2017, the Company exchanged one of its spare engines for 150,000 shares of the Company's common stock held by a stockholder. The Company recorded no gain or loss related to the exchange.

During the first quarter of 2017, the Company recorded a gain of \$297,400 related to the sale of an aircraft pursuant to a sales-type finance lease.

During the first quarter of 2018, the Company recorded \$1.1 million in other income resulting from cash received from the previous lessee of three aircraft that were returned to the Company during 2017. Such payments were for unpaid maintenance reserves, as well as amounts due pursuant to the return conditions of the applicable leases. The Company did not accrue unpaid reserves or return condition amounts at the time of lease termination based on management's evaluation of the creditworthiness of the lessee. Therefore, the Company is accounting for payments as they are received and recorded the amount in other income.

The Company added no equipment to its portfolio during the first quarter of 2018. During the first quarter of 2017, the Company acquired three aircraft and entered into direct financing leases for such aircraft.

The average net book value of assets held for lease during the first quarters of 2018 and 2017 was approximately \$190.4 million and \$188.7 million, respectively. Management fees, which are based on the net book value of the Company's aircraft and engines as well as finance lease receivable balances, were 4% lower for the first quarter of 2018 as compared to the same period of 2017, as a result of asset sales in late 2017 and 2018, the effect of which was only partially offset by the effect of aircraft acquired in 2017.

The Company's interest expense increased by 40% to \$2.3 million in the first quarter of 2018 from \$1.6 million in the same period of 2017, primarily as a result of both a higher average debt balance and a higher average interest rate in the 2018 period.

Professional fees, general and administrative and other expenses in the 2018 period included \$200,000 incurred in connection with the proposed acquisition of JHC.

## Liquidity and Capital Resources

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

### (a) Credit Facility

The Company has a \$170 million Credit Facility, as described in Note 4(a) to the Company's condensed consolidated financial statements in Item 1 of this Quarterly Report on Form 10-Q. The Company was in compliance with all covenants at March 31, 2018 and December 31, 2017.

Based on its current projections, the Company believes that it will be in compliance with all of its Credit Facility covenants at future calculation dates. Although the Company believes that the assumptions it has made in forecasting its compliance with the Credit Facility covenants are reasonable in light of experience, actual results could deviate from such assumptions and there can be no assurance that the Company's beliefs will prove to be correct. Among the more significant factors that could have an impact on the accuracy of the Company's covenant compliance forecasts are (i) unanticipated decreases in the market value of the Company's assets, or in the rental rates deemed achievable for such assets that cause the Company to record an impairment charge against earnings, (ii) lessee non-compliance with lease obligations, (iii) inability to locate new lessees for returned equipment within a reasonable remarketing period, or at a rent level consistent with projected rates, (iv) inability to locate and acquire a sufficient volume of additional assets at prices that will produce acceptable net returns, (v) increases in interest rates, or (vi) inability to timely dispose of off-lease assets at prices commensurate with their market value.

Although the Company believes it will continue to be in compliance with all of the Credit Facility covenants, there can be no assurance of such compliance and, in the event of any non-compliance, the Company would need to seek waivers or amendment of applicable covenants from its lenders if such compliance failure is not timely cured. Any default under the Credit Facility, if not cured in the time permitted under the facility or waived by the lenders, could result in the Company's inability to borrow any further amounts under the Credit Facility, the acceleration of the Company's obligation to repay amounts borrowed under the Credit Facility, or foreclosure upon any or all of the assets of the Company.

(b) Special purpose financings

In August 2016, the Company acquired, using wholly-owned special purpose entities, two regional jet aircraft, using cash and third-party financing separate from its Credit Facility, as described in Note 4(b) to the Company's condensed consolidated financial statements in Item 1 of this Quarterly Report on Form 10-Q.

(c) Cash flow

The Company's primary sources of cash are payments due under the Company's operating and finance leases, maintenance reserves, which are billed monthly to lessees based on asset usage, and proceeds from the sale of aircraft and engines.

The Company's primary uses of cash are for (i) purchase of assets, (ii) Credit Facility and special purpose financing interest and principal payments, (iii) maintenance expense and reimbursement to lessees from collected maintenance reserves, (iv) management fees, and (v) professional fees, including legal, accounting and directors' fees costs.

The Company's payments for maintenance consist of reimbursements to lessees for eligible maintenance costs under their leases and maintenance incurred directly by the Company for preparation of off-lease assets for re-lease to new customers. The timing and amount of such payments may vary widely between quarterly and annual periods, as the required maintenance events can vary greatly in magnitude and cost, and the performance of the required maintenance events by the lessee or the Company, as applicable, are not regularly scheduled calendar events and do not occur at uniform intervals throughout any calendar period. The Company's maintenance payments typically 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 fees paid by the Company are relatively predictable because they are based on the net asset value of the Company's portfolio and finance lease receivable balances. Because of this, the risk of increased costs for employee salaries and benefits, worldwide travel related to the management of the Company's aircraft portfolio, office rent, outside technical experts and other overhead expenses is entirely placed on JMC.

The amount of interest paid by the Company depends primarily 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. Interest related to the Company's special purpose financings is payable at a fixed rate.

Management believes that the Company will have adequate cash flow to meet its ongoing operational needs, including any 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) cost and anticipated timing of maintenance to be performed, (iii) required debt payments, (iv) timely use of proceeds of unused debt capacity for additional acquisitions of income producing assets and (v) interest rates. 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. As discussed above, in "Liquidity and Capital Resources – (a) Credit Facility," there are a number of factors that may cause actual results to deviate from such forecasts.

(i) Operating activities

The Company's cash flow from operations increased by \$0.3 million in the first quarter of 2018 compared to the same period in 2017. As discussed below, the increase in cash flow was primarily a result of increases in payments received for other income and operating lease revenue, as well as a decrease in payments for management fees. This positive effect was partially offset by increases in payments for interest and maintenance and a decrease in payments received for security deposits.



(A) Payments for other income

During the first quarter of 2018, the Company recorded \$1.1 million in other income resulting from cash received from the previous lessee of three aircraft that were returned to the Company during 2017. Such payments were for unpaid maintenance reserves, as well as amounts due pursuant to the return conditions of the applicable leases. The Company did not accrue unpaid reserves or return condition amounts at the time of lease termination based on management's evaluation of the creditworthiness of the lessee. Therefore, the Company is accounting for payments as they are received and recorded the amount in other income.

(B) Payments for operating lease revenue

Rent receipts from lessees increased by \$0.6 million in the first quarter of 2018 compared to the same period in 2017, primarily due to higher rent from assets purchased and leased to customers during 2017.

As of the date of this filing, the Company is receiving no lease revenue for six aircraft held for lease that are off lease. The total book value of these assets is \$20.9 million, representing 11% of the Company's total assets held for lease.

(C) Payments for management fees

Payments for management fees decreased by \$0.5 million in the first quarter of 2018 compared to the same period in 2017, primarily as a result of a difference in the timing of payments from year to year.

(D) Payments for interest

Payments for interest increased by \$0.7 million in the first quarter of 2018 compared to the first quarter of 2017 as a result of a higher average debt balance and higher rates during the 2018 period.

(E) Payments for maintenance

Although maintenance expense was lower in the first quarter of 2018 than in the same period in 2017, payments for maintenance increased by \$0.6 million in the 2018 period compared to the 2017 period as a result of a difference in the timing of the payments.

(F) Payments for security deposits

Net security deposits received by the Company decreased by \$0.5 million in the first quarter of 2018 compared to the same period in 2017, primarily as a result of lease deposits received in connection with aircraft purchased by the Company and leased pursuant to direct financing leases during the 2017 period. The Company received no such amounts in the 2018 period.

(ii) Investing activities

During the first quarters of 2018 and 2017, the Company received net cash of \$4.9 million and \$0.6 million, respectively, from the sale of assets. During the first quarter of 2018, the Company used cash of \$1.2 million for deposits on two aircraft that it intends to acquire during the second quarter. During the first quarter of 2017, the Company used cash of \$7.4 million for acquisitions of aircraft leased pursuant to direct financing leases.

(iii) Financing activities

The Company made no borrowings under the Credit Facility during the first quarter of 2018. During the first quarter of 2017, the Company borrowed an additional \$7.0 million under the Credit Facility. In the first quarters of 2018 and 2017, the Company repaid \$11.0 million and \$2.8 million, respectively, of its total outstanding debt under the Credit Facility. Such repayments were funded by excess cash flow and the sale of assets. During the first quarters of 2018 and 2017, the Company's special purpose entities repaid \$1.1 million and \$1.0 million, respectively, of principal.

## Outlook

The Company has identified three factors that may affect the Company's growth and operating results:

- The Company entered into an Agreement and Plan of Merger to acquire JHC on October 26, 2017. There are several conditions to the closing of the Merger between the Company and JHC, most of which are out of the control of the Company. On February 22, 2018, the State of California Department of Business Oversight ("DBO") held a hearing regarding the Merger pursuant to Section 25142 of the California Corporations Code, to determine whether the terms and conditions of the issuance of AeroCentury's shares of Common Stock in the Merger to JHC's shareholders are fair. Following the hearing, a permit was issued by the DBO, which will allow the issuance of the Company's common stock in the Merger transaction to be exempt from federal securities registration under Section 3(a)(10) of the Securities Act. The Company has received the consent of JHC's shareholders to the Merger. The Company intends to hold a special meeting of the Company's stockholders in order to approve the issuance of AeroCentury Common Stock in connection with the Merger as required under the applicable listing rules of the NYSE American exchange on which AeroCentury's common stock is traded. Approval of the Merger is not required under Delaware or California corporate law. If the AeroCentury shareholders approve the issuance of AeroCentury Common Stock, the Merger is anticipated to be consummated in the second quarter of 2018 or shortly thereafter, but there can be no assurance that such closing will occur, or that it will occur in the anticipated time frame.

The Company believes that the combination of the management function performed by JMC and the portfolio held by the Company will be accretive to the Company and will create shareholder value for the shareholders of the combined post-Merger company, but such accretion may not be realized until after transaction and integration costs in connection with the Merger have been incurred. The Company, however, will incur certain non-recurring, non-tax deductible Merger expenses in the periods leading up to the Merger, and immediately following, as well as having to record, for accounting purposes, a settlement loss at the time of consummation of the Merger, which could negatively affect the Company's results for those periods.

- Increased production of aircraft types in the Company's market niche has resulted in some manufacturers offering competitive pricing for new aircraft to regional aircraft customers. In addition, notwithstanding recent interest rate increases in the U.S., competition for assets in the Company's market niche of worldwide regional aircraft has continued to increase. Some of the Company's newer competitors are funded by investment banks and private equity firms seeking higher yields on investment assets than are currently available from traditional income investment types. The increased competition has resulted in higher acquisition prices for many of the aircraft types that the Company has targeted to buy and, at the same time, continues to put downward pressure on lease rates, resulting in lower margins and, therefore, fewer acceptable acquisition opportunities for the Company. The Company anticipates this trend will continue for the short- to medium-term, until yields on alternative investments return to a more normal historical range.

- The Company has not identified re-lease or sale customers for six turboprop aircraft that are currently off lease. The Company is analyzing the amount and timing of maintenance required to remarket these assets, the amount of which may differ significantly if the assets are sold rather than re-leased. These aircraft are older types that are no longer in production, so it is not unusual that market demand for them is weak and, therefore, they may remain off lease for significant periods of time.

## 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. For a discussion of Critical Accounting Policies, Judgments and Estimates, refer to Note 1 to the Company's financial statements in Item 1 of this Quarterly Report on Form 10-Q.

## Factors that May Affect Future Results

**Noncompliance with Debt Financial Covenants.** The Company's use of debt as the primary form of acquisition financing subjects the Company to increased risks associated with leverage. In addition to payment obligations, the Company's debt agreements include financial covenants, including some requiring the Company to have positive earnings, meet minimum net worth standards and be in compliance with certain other financial ratios.

Although the Company believes it will continue to be in compliance with all of the covenants under its debt agreements, there can be no assurance of such compliance, and in the event of any non-compliance, the Company would need to seek further waivers or amendments of applicable covenants from its lenders if such compliance failure is not timely cured. Any default under a debt agreement, if not cured in the time permitted or waived by the respective lender, could result in the Company's inability to borrow under the Credit Facility, the acceleration of the Company's debt obligations, or the foreclosure upon any or all of the assets of the Company.

**Consummation of Merger May Subject the Company to Additional Risks.** In October 2017, the Company announced its agreement to acquire JHC, the parent of the Company's management company, JMC, by way of a reverse triangular merger. There can be no assurance that the Merger will be consummated as there are numerous closing conditions that must be satisfied, some of which are out of the control of the Company. The entry into the Agreement and Plan of Merger subjects the Company to additional risks, including the following:

- **Merger Expenses.** In addition to legal, accounting and financial advisory fees incurred prior to the execution of the Agreement and Plan of Merger, in order to consummate the Merger, the Company will need to incur significant additional expenses, including legal and third party consulting fees, which will be payable whether or not the Merger eventually occurs.
- **Settlement Loss Effect on Covenant Compliance.** The Company believes that if the acquisition by merger of JHC is consummated, it will record a settlement loss related to its existing obligations under the management agreement with JMC on the closing date of the Merger in an amount equal to a substantial portion of the purchase consideration to be paid in the Merger. The amount of the loss cannot be ascertained exactly until the Merger closes, as it depends on several variables, including final adjustments to the agreed purchase price and the quoted market price of AeroCentury Common Stock on the Merger closing date. In December 2017, the Company obtained the consent of the Credit Facility lenders to the Merger, and modifications to the Credit Facility for post-Merger periods to prevent certain expense items arising from the Merger causing a default under the Credit Facility agreement covenants. The modifications impose a limit on the amount of settlement loss and merger costs that will be disregarded for covenant purposes, but the Company believes that they are sufficient to avoid these from causing a default under the Credit Facility financial covenants.
- **Assumption of Expenses Covered under Management Agreement.** Under the Management Agreement, the Company pays a management fee to JMC based upon the book value of the Company's aircraft assets, an acquisition fee for each asset purchased by the Company, and a remarketing/re-lease fee for each sale or re-lease transaction entered into with

respect to the Company's aircraft. In return, JMC provides the Company with comprehensive management services, under which JMC has full responsibility for payment of all employee salaries and benefits, outside technical services, worldwide travel needed to promote the Company's business, office space, utilities, IT and communications, furniture and fixtures, and other general administrative and overhead costs. Under the Management Agreement, if the fees collected are not enough to cover JMC's expenses in managing the Company's portfolio, such losses are borne entirely by JMC. If the Merger is consummated, then the obligation to pay JMC management fees will cease, but the costs previously borne by JMC in managing the Company's assets will be borne by the Company and will not be limited, as is the case with the Management Agreement in place.

- AeroCentury's management will become internalized. If the Merger is consummated, JHC will become a wholly-owned subsidiary of the Company and sole responsibility for management of the combined company will fall upon its management. If the Company is dissatisfied with management services following consummation of the Merger, the Company would have to address the shortcomings internally, and if they cannot be resolved with the existing management and personnel, the Company may be required to reorganize its management structure and replace personnel or seek new third party management services, either of which could result in the Company incurring significant expense and use of resources.

- Assumption of JHC Liabilities. By acquiring JHC in a reverse triangular merger, JHC will become a wholly-owned subsidiary of the Company. To the extent that JHC or any of its subsidiaries have liabilities, these will become liabilities of the Company on a consolidated basis. While the Merger Agreement provides for limited indemnification by JHC shareholders for certain liabilities of JHC or its subsidiaries that arise from pre-Merger occurrences, and the Company has performed due diligence reviews of the liabilities of JHC and its subsidiaries, the indemnification is limited to the consideration paid by the Company to JHC.

Availability of Financing. The Company's continued growth will depend on its ability to continue to obtain capital, either through debt or equity financings. One of the current primary limiters on the Company's ability to draw under the current credit facility is the covenant limitation on the Company's maximum debt to equity ratio. Under the current terms, even if the credit facility limit were increased, in order to utilize the higher limit, the Company would need to source additional equity capital in order to remain in compliance with the debt to equity ratio covenant to utilize the higher limit. Thus, the Company would need to raise additional equity capital to accompany any increase in the current credit facility, or, in the alternative, would need to refinance its credit facility debt with a new lender with more favorable financial covenants not limited by the Company's current equity capitalization. One of the motivations for the Company to acquire JHC was to remove the outside management structure of the Company which was believed to be an impediment to attracting capital sources. Even if the Merger is consummated, there can be no assurance that the Company will obtain such additional equity capital in the future or that it will be successful in obtaining more favorable credit facility financing, as a successful capital raising transaction depends on many factors, some of which are outside the Company's control.

**Credit Facility Debt Limitations.** The amount available to be borrowed under the Credit Facility is limited by asset-specific advance rates. Lease arrearages or off-lease periods for a particular asset that is collateral under the Credit Facility may reduce the loan advance rate permitted with respect to that asset and, therefore, reduce the permitted borrowing under the facility. Amounts subject to payment deferral agreements also reduce the amount of permitted borrowing. The Company believes it will have sufficient cash funds to make any required principal repayment that arises due to any such borrowing limitations.

**Ownership Risks.** The Company's leases typically are for a period shorter than the entire, anticipated, remaining useful life of the leased assets. As a result, the Company's recovery of its investment and realization of its expected yield in such a leased asset is dependent upon the Company's ability to profitably re-lease or sell the asset following the expiration of the lease. This ability is affected by worldwide economic conditions, general aircraft market conditions, regulatory changes, changes in the supply or cost of aircraft equipment, and technological developments that may 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 financial condition, cash flow, ability to service debt, and results of operations could be adversely affected.

The Company typically 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, airline consolidations, the number of new aircraft on order, an excess supply of newly manufactured aircraft or used aircraft coming off lease, as well as introduction of new aircraft models and types that may be more technologically advanced, more fuel efficient and/or less costly to maintain and operate. Values may also increase or decrease for certain aircraft types that become more or less desirable based on market conditions and changing airline capacity. Because the Company's ability to borrow under its credit facility is subject to a covenant setting forth an upper limit on the ratio of (i) the outstanding debt under the facility to (ii) the appraised value of the collateral base of aircraft assets securing the credit facility, a significant drop in the appraised market value of the portfolio could require the Company to make a substantial prepayment of outstanding principal under the credit facility in order to avoid a default under the credit facility.

In addition, a successful investment in an asset subject to an operating lease depends in part upon having the asset returned by the lessee in the condition as required under the lease. Each operating lease obligates a customer to return an asset to the Company in a specified condition, generally in a condition that will allow the aircraft to be readily re-leased to a new lessee, and/or pay an economic settlement for redelivery that is not in compliance with such specified conditions. The Company strives to ensure this result through onsite management during the return process. However, if the lessee were to become insolvent during the term of its lease and the Company had to repossess the asset, it is unlikely that the lessee would have the financial ability to meet these return obligations. In addition, if the lessee filed for bankruptcy and rejected the aircraft lease, the lessee would be required to return the aircraft but would be relieved from further lease obligations, including return conditions specified in the lease. In either case, it is likely that the Company would be required to expend funds in excess of any maintenance reserves collected to return the asset to a remarketable condition.

Several of the Company's leases with financially strong lessees 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 or bankruptcy occurred under such a lease, the Company would be left with the costs of unperformed repair and maintenance under the applicable lease and the Company would likely incur an unanticipated expense in order to re-lease or sell the asset.

Furthermore, the occurrence of unexpected adverse changes that impact the Company's estimates of expected cash flows generated from an asset could result in an asset impairment charge against the Company's earnings. The Company periodically reviews long-term assets for impairment, particularly when events or changes in circumstances indicate the carrying value of an asset may not be recoverable. An impairment charge is recorded when the carrying

amount of an asset is estimated to be not recoverable and exceeds its fair value. The Company recorded impairment charges for some of its aircraft in 2016 and 2017, and may be required to record asset impairment charges in the future as a result of a prolonged weak economic environment, challenging market conditions in the airline industry, events related to particular lessees, assets or asset types or other factors affecting the value of aircraft or engines.

**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 lease origination, interest rate changes during the lease term 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.

**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. However, this procedure under the Bankruptcy Code has been subject to significant litigation, and it is possible that the Company's enforcement rights would be further adversely affected by a bankruptcy filing by a defaulting lessee.

Lessees located in low-growth or no-growth areas of the world carry heightened risk of an unanticipated lessee default. The Company has had customers that have experienced significant financial difficulties, become insolvent, or have entered bankruptcy proceedings. An insolvency or bankruptcy of a customer usually results in a total loss of the receivables from that customer, as well as the Company incurring additional costs in order to repossess and, in some cases, repair the aircraft. The Company closely monitors the performance of all of its lessees and its risk exposure to any lessee that may be facing financial difficulties, in order to guide decisions with respect to such lessee that would mitigate losses in the event the lessee is unable to meet or rejects its lease obligations. There can be no assurance that additional customers will not become insolvent or file for bankruptcy or that the Company will be able to mitigate any of the resultant losses.

It is possible that the Company may enter into deferral agreements for overdue lessee obligations. 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. The Company may elect to record the deferred rent and reserves payments from the lessee on a cash basis, which could have a material effect on the Company's financial results in the applicable periods. Deferral agreements with lessees also reduce the Company's borrowing capacity under its Credit Facility.

**Concentration of Lessees and Aircraft Type.** For the month ended March 31, 2018, the Company's four largest customers accounted for a total of approximately 84% of the Company's monthly operating 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 borrowing 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. In addition, if the Company's revenues become overly concentrated in a small number of lessees, the Company could fail to comply with certain financial covenants in its Credit Facility related to customer concentration. In the event of any non-compliance that is not cured in the time permitted under the Credit Facility, the Company would need to seek waivers or amendment of the applicable covenants if such compliance failure is not timely cured. Any default under the Credit Facility, if not cured in the time permitted under the Credit Facility or waived by the lenders, could result in foreclosure upon any or all of the assets of the Company.

The Company's aircraft portfolio is currently focused on a small number of aircraft types and models compared to the variety of aircraft used in the commercial air carrier market. A change in the desirability and availability of any of the particular types and models of aircraft owned by the Company could affect valuations and future rental revenues of such aircraft, and would have a disproportionately significant impact on the Company's portfolio value. Such aircraft type concentration would diminish if the Company acquires assets of other types. Conversely, acquisition of additional aircraft of types currently owned by the Company will increase the Company's risks related to its concentration of those aircraft types.



**Competition.** The aircraft leasing industry is highly competitive. The Company competes with aircraft manufacturers, distributors, airlines and aircraft 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. Competition in the Company's market niche of regional aircraft, however, has increased significantly recently as a result of new entrants to the acquisition and leasing market and consolidation of certain competitors. As competition increases, it has and will likely continue to create upward pressure on acquisition prices for many of the aircraft types that the Company has targeted to buy and, at the same time, create downward pressure on lease rates, resulting in lower margins for the Company and, therefore, fewer acceptable acquisition opportunities for the Company.

**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. Many regional airlines rely heavily or even exclusively on a code-share or other contractual relationship with a major carrier for revenue, and can face financial difficulty or failure if the major carrier terminates the relationship or if the major carrier files for bankruptcy or becomes insolvent. Some regional carriers may depend on contractual arrangements with industrial customers such as mining or oil companies, or franchises from governmental agencies that provide subsidies for operating essential air routes, which may be subject to termination or cancellation on short notice. Furthermore, many lessees in the regional air carrier market are start-up, low-capital, and/or low-margin operators. A current concern for regional air carriers is the supply of qualified pilots. Due to recently imposed FAA regulations requiring a higher minimum number of hours to qualify as a commercial passenger pilot, many regional airlines have had difficulty meeting their business plans for expansion. This could in turn affect demand for aircraft and the Company's business.

General Economic Conditions and Lowered Demand for Travel. While the United States economy has seen substantial improvement since its most recent global recession, not all global regions are experiencing growth, and some remain in recession. The Company does not anticipate any worsening of the financial condition of its overall customer base, but believes that there may be further shakeouts of weaker carriers in economically troubled regions.

A growing concern arises from the fact that much of the recent growth in demand for regional aircraft in developing countries has arisen from mining or other resource extraction operations by Chinese enterprises in these countries. A future, sustained major downturn in the Chinese domestic economy that reduces demand for imported raw materials could have a significant negative impact on the demand for business and regional aircraft in these developing countries, including in some of the markets in which the Company does, or seeks to do, business.

Furthermore, any further upheavals due to instability in Europe due to newly imposed U.S. sanctions against Russia, and the Russian and European reaction to such sanctions could have a negative impact on intra-European carriers with which the Company does business. Also, Brexit and any further departures from the European Union ("EU") could threaten "open-sky" policies under which EU based carriers operate freely within the EU. Losing open-sky flight rights could have a significant negative impact on the health of the Company's European lessees and, as a result, the financial performance and condition of the Company.

If international conflicts erupt into military hostilities, heightened visa requirements make international travel more difficult, or terrorist attacks involving aircraft or airports occur, or a major flu outbreak occurs, passengers may avoid air travel altogether, and global air travel worldwide could be significantly affected. This would have an adverse impact on many of the Company's customers.

Airline reductions in capacity in response to lower passenger loads can result in reduced demand for aircraft and aircraft engines and a corresponding decrease in market lease rental rates and aircraft values. 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. The Company's significant sources of operating lease revenue by region are summarized in Item 7 - Fleet Summary, above.

**International Risks.** The Company leases assets in overseas markets. Leases with foreign lessees, however, may present different risks than those with domestic lessees. Most of the Company's expected growth is outside of North America.

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.

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.

Even with U.S. dollar-denominated lease payment provisions, the Company could still be affected by a devaluation of the lessee's local currency and a stronger U.S. dollar 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. Foreign lessees may also face restrictions on payment of obligations to foreign vendors, including the Company, which may affect their ability to timely meet lease obligations to the Company.

Foreign 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. Certain countries do not have a central registration or recording system which can be used to locally record 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. In any event, collection and enforcement may be more difficult and complicated in foreign countries.

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.

**Investment in New Aircraft Types.** The Company intends to continue to focus solely on regional aircraft. Although the Company invested in a limited number of turboprop aircraft types in the past, the Company has also acquired several regional jet aircraft types, which now comprise a larger percentage of the Company's portfolio based on number of aircraft and net book value. The Company may continue to seek acquisition opportunities for new types and models of aircraft used in the Company's targeted customer base of regional air carriers. Acquisition of aircraft types not previously acquired by the Company entails greater ownership risk due to the Company's lack of experience managing those assets. The Company believes, however, that its overall industry expertise may permit the Company to effectively manage such new aircraft types. 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).

**Reliance on JMC.** All management of the Company is currently performed by JMC under a Management Agreement between the Company and JMC that expires in August of 2025 and provides for an asset-based management fee. JMC is not a fiduciary of 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, an officer of the Company holds significant ownership positions in the Company and JHC, the parent company of JMC, and JHC is the Company's largest shareholder. Therefore, the economic interests of the Company should be aligned with the interests of JHC and JMC, and JMC should have substantial incentive to make financial decisions as the management company for the Company that are in the best interests of the Company.

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. A director of the Company is also a director of JMC and, as discussed above, the officers of the Company are also officers of JMC, and one such officer holds significant ownership positions in both the Company and JHC, the holding company for JMC. Consequently, the director 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.

There can be no assurance that the proposed Merger with JHC, the parent of JMC, will be consummated. If the Merger is consummated, the Company would have control over JMC's operations and it is expected that the foregoing risks would be largely mitigated. However, operating costs previously borne by JMC in managing the Company's assets would be borne by the Company, and there can be no assurance that such costs will be less than the fees previously paid to JMC.

**Management Fee Structure.** All decisions regarding acquisitions and disposal of aircraft from the Company's portfolio are currently 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, with the intention to buy and hold assets until the appropriate time to sell them, a compensation structure that results in greater compensation with an increased portfolio size is consistent 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 short-term pecuniary interest. As a result, the compensation structure could act to incent greater risk-taking by JMC in asset acquisition decision-making. However, because JMC's sole business and source of revenue arises from and is expected to continue arising from acting as the management company for the Company, the long-term financial health and viability of the Company are important to JMC's own long-term health and viability. Therefore, in assessing risk-taking in the Company's acquisition transactions, JMC's and the Company's motivations are closely aligned, as JMC is incented to make asset acquisitions that are expected to contribute to the long-term viability of the Company. In addition, the Company has established objective target guidelines for yields on acquired assets and 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 can be no assurance that such mechanisms can entirely and effectively eliminate such risk.

If the Merger is consummated, the management fee would be internalized and it is expected that the foregoing risks would be largely mitigated.

**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, maximum aircraft age, and aircraft noise requirements. Although it is contemplated that the burden and cost of complying with such requirements will fall primarily upon lessees, 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.

**Casualties, Insurance Coverage.** The Company, as an 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. A "triple net lease" is a 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 its assets that are operated in foreign countries where such provisions of the United States Aviation Act may not apply.

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 to avoid a default under the lease.

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 lease 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 its main vulnerability to a cyber-attack would be interruption of the Company's email communications internally and with third parties, loss of customer and lease archives, 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 and backup mechanisms exist in the event of such an interruption such that there would not be a material adverse financial impact on the Company's business. A cyber-hacker could also gain access to and release proprietary information of the Company, its customers, suppliers and employees stored on the Company's data network. Such a breach could harm the Company's reputation and result in competitive disadvantages, litigation, lost revenues, additional costs, or liability to third parties. While 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 its data security, its resources and technical sophistication may not be adequate to prevent all types of cyber-attacks.

**Possible Volatility of Stock Price.** The market price of the Company's common stock is 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 1.4 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 305 of Regulation S-K 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, 2018.

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, 2018 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
31.1	Certification of Michael G. Magnusson, 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 Michael G. Magnusson, 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
101.DEF	XBRL Definition 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 15, 2018 By: /s/ Toni M. Perazzo

Name: Toni M. Perazzo

Title: Senior Vice President-Finance and  
Chief Financial Officer