AEROCENTURY CORP
Form 10-Q
November 13, 2001
19

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-QSB

(Mark One)
[X] Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended September 30, 2001

[ ] Transition Report Under 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.
(Name of small business issuer 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)	(Zip Code)

Issuer's telephone number, including area code: (650) 340-1888

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered
Common Stock, $0.001 par value	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Check whether the Issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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 X No
----- -----

As of November 13, 2001 the Issuer has 1,606,557 Shares of Common Stock outstanding, of which 63,300 are held as Treasury Stock.

Transitional Small Business Disclosure Format (check one): Yes No __X__
----- -

Part I. Financial Information

Item 1. Financial Statements

AeroCentury Corp.
Consolidated Balance Sheet

ASSETS

	September 30, 2001
Assets:	
Cash and cash equivalents	$ 2,044,420
Deposits	7,405,320
Accounts receivable	446,140
Aircraft and aircraft engines on operating leases, net of accumulated depreciation of $15,014,270	58,285,610
Note receivable	80,910
Prepaid expenses and other	581,470
Total assets	$ 68,843,870

LIABILITIES AND SHAREHOLDERS' EQUITY

Liabilities:	
Accounts payable and accrued expenses	$ 788,480
Notes payable and accrued interest	37,659,640
Maintenance reserves and accrued costs	6,423,050
Security deposits	1,689,770
Prepaid rent	309,830
Deferred taxes	3,266,010
Total liabilities	50,136,780
Shareholders' equity:	
Preferred stock, $.001 par value, 2,000,000 shares authorized, no shares issued and outstanding	-
Common stock, $.001 par value, 3,000,000 shares authorized, 1,606,557 shares issued	1,610
Paid in capital	13,821,200
Retained earnings	5,388,350
	19,211,160
Treasury stock at cost, 63,300 shares	(504,070
Total shareholders' equity	18,707,090
Total liabilities and shareholders' equity	$ 68,843,870

The accompanying notes are an integral part of this statement.

AeroCentury Corp.
Consolidated Statements of Income

	For the Nine Months Ended September 30,		For the Three Septemb
	2001	2000	2001
Revenues:			
Rent income	$ 7,787,150	$ 8,065,660	$ 2,455,720
Other income	667,450	304,220	423,110
	8,454,600	8,369,880	2,878,830
Expenses:			
Management fees	1,329,720	1,262,650	438,910
Depreciation	2,100,960	1,961,510	705,560
Interest	2,234,490	2,470,200	662,970
Maintenance	143,330	110,000	155,460
Professional fees and general and administrative	327,700	345,620	113,800
	6,136,200	6,149,980	2,076,700
Income before taxes	2,318,400	2,219,900	802,130
Tax provision	773,980	773,020	271,850
Net income	$ 1,544,420	$ 1,446,880	$ 530,280
Weighted average common shares outstanding	1,543,257	1,543,257	1,543,257
Basic earnings per share	$ 1.00	$ 0.94	$ 0.34

The accompanying notes are an integral part of these statements.

AeroCentury Corp.
Consolidated Statements of Cash Flows

	For the Nine Months Ended	
	2001	
Net cash provided by operating activities	$ 2,649,830	$
Investing activity –		
Purchase of aircraft and aircraft engines	(275,380)	
Net cash used by investing activities	(275,380)	
Financing activities:		
Issuance of notes payable	-	
Repayment of notes payable	(3,514,500)	
Net cash (used)/provided by financing activities	(3,514,500)	
Net (decrease)/increase in cash and cash equivalents	(1,140,050)	
Cash and cash equivalents, beginning of period	3,184,470	
Cash and cash equivalents, end of period	$ 2,044,420	$

The accompanying notes are an integral part of these statements.

AeroCentury Corp.
Notes to Consolidated Financial Statements
September 30, 2001

1. Organization and Summary of Significant Accounting Policies

(a) Basis of Presentation

AeroCentury Corp. ("AeroCentury") was incorporated in the state of Delaware on February 28, 1997. AeroCentury was formed solely for the purpose of acquiring JetFleet Aircraft, L.P. and JetFleet Aircraft II, L.P., partnerships formed under California law for the purpose of investing in leased aircraft equipment, (collectively, the "Partnerships") in a statutory merger (the

"Consolidation"), which was effective January 1, 1998. AeroCentury is continuing in the aircraft leasing business in which the Partnerships engaged and is using leveraged financing to acquire additional aircraft assets on lease.

During November 1999 and August 2000, AeroCentury Corp. formed two wholly-owned subsidiaries, AeroCentury Investments LLC ("AeroCentury LLC") and AeroCentury Investments II LLC ("AeroCentury II LLC"), respectively, for the purpose of acquiring aircraft using a combination of cash and bank financing separate from AeroCentury Corp.'s revolving credit facility. Financial information for AeroCentury, AeroCentury LLC and AeroCentury II LLC (collectively, the "Company") is presented on a consolidated basis. All intercompany balances and transactions have been eliminated in consolidation.

Certain amounts previously reported have been reclassified to conform to the current year presentation. These reclassifications do not affect previously reported net income or shareholders' equity.

(b) Capitalization

On April 17, 1998, in connection with the adoption of a shareholder rights plan, the Company filed a Certificate of Designation, designating the rights, preferences and privileges of a new Series A Preferred Stock. Pursuant to the plan, the Company issued rights to its shareholders of record as of April 23, 1998, entitling each shareholder to the right to purchase one one-hundredth of a share of Series A Preferred Stock for each share of Common Stock held by the shareholder. Such rights are exercisable only under certain circumstances concerning a proposed acquisition or merger of the Company.

On October 23, 1998, the Company's Board of Directors adopted a stock repurchase plan, granting management the authority to purchase up to 100,000 shares of the Company's common stock, in privately negotiated transactions or on the market, at such price and on such terms and conditions deemed satisfactory to management. The Company has purchased 63,300 shares in total and has not purchased any shares since 1999.

As discussed above, AeroCentury is the sole member and manager of AeroCentury LLC and AeroCentury II LLC.

(c) Cash and Cash Equivalents/Deposits

The Company considers highly liquid investments readily convertible into known amounts of cash, with original maturities of 90 days or less, as cash equivalents. Deposits represent cash balances held related to maintenance reserves and security deposits and generally are subject to withdrawal restrictions.

At September 30, 2001, the Company held security deposits of $1,689,770, refundable maintenance reserves received from lessees of $3,488,890 and non-refundable maintenance reserves of $2,226,660.

AeroCentury Corp.
Notes to Consolidated Financial Statements
September 30, 2001

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

(c) Cash and Cash Equivalents/Deposits (continued)

The Company's leases are typically structured so that if any event of default occurs under the lease, the Company may apply all or a portion of the lessee's security deposit to cure such default. If such an application of the security deposit is made, the lessee typically is required to replenish and maintain the full amount of the deposit during the remaining term of the lease. All of the security deposits currently held by the Company are refundable to the lessee at the end of the lease.

Maintenance reserves which are refundable to the lessee at the end of the lease may be retained by the Company if such amounts are necessary to meet the return conditions specified in the lease and, in some cases, to satisfy any other payments due under the lease.

Non-refundable maintenance reserves held by the Company are accounted for as a liability until the aircraft has been returned at the end of the lease, at which time the Company evaluates the adequacy of the remaining reserves in light of maintenance to be performed as a result of hours flown. At that time, any excess is recorded as income. When an aircraft is sold, any excess non-refundable maintenance reserves are recorded as income.

(d) Aircraft and Aircraft Engines On Operating Leases

The Company's interests in aircraft and aircraft engines are recorded at cost, which includes acquisition costs. Depreciation is computed using the straight-line method over the aircraft's estimated economic life (generally assumed to be twelve years), to an estimated residual value. The depreciable base of the assets acquired by the Company in the Consolidation was equal to the net book value of the assets at December 31, 1997.

(e) Impairment of Long-lived Assets

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-lived Assets and Long-lived Assets to Be Disposed Of," assets are reviewed for impairment whenever events or changes in circumstances indicate that the book value of the asset may not be recoverable. Periodically, the Company reviews its long-lived assets for impairment based on estimated future nondiscounted cash flows attributable to the assets. In the event such cash flows are not expected to be sufficient to recover the recorded value of the assets, the assets are written down to their estimated realizable value.

(f) Loan Commitment and Related Fees

To the extent that the Company is required to pay loan commitment fees and legal fees in order to secure debt, such fees are amortized over the life of the related loan.

(g) Maintenance Reserves and Accrued Costs

Maintenance costs under the Company's triple net leases are generally the responsibility of the lessees. Maintenance reserves and accrued costs in the accompanying balance sheet include refundable and non-refundable maintenance payments received from lessees. The Company periodically reviews maintenance reserves for adequacy in light of the number of hours flown, airworthiness directives issued by the manufacturer or government authority, and the return conditions specified in the lease. As a result of such review, when it is probable that the Company has incurred costs for maintenance in excess of amounts received from lessees, the Company accrues its share of costs for work to be performed as a result of hours flown. At September 30, 2001, the Company had accrued costs of approximately $518,000 related to three of its aircraft.

AeroCentury Corp.
Notes to Consolidated Financial Statements
September 30, 2001

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

(h) Income Taxes

The Company follows the liability method of accounting for income taxes as required by the provisions of SFAS No. 109, Accounting for Income Taxes. Under the liability method, deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The effect on deferred taxes of a change in the tax rates is recognized in income in the period that includes the enactment date.

(i) Revenue Recognition

Revenue from leasing of aircraft assets is recognized as operating lease revenue on a straight-line basis over the terms of the applicable lease agreements.

(j) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect certain reported amounts, disclosures and contingent assets and liabilities. Accordingly, actual results could differ from those estimates.

(k) Comprehensive Income

The Company does not have any comprehensive income other than the revenue and expense items included in the consolidated statements of income. As a result, comprehensive income equals net income for the three months and nine months ended September 30, 2001 and 2000.

(l) Recent Accounting Pronouncements

SFAS No. 137, which amended the effective date of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, was issued in June 1999. The Company adopted SFAS No. 133 on January 1, 2001. This statement establishes accounting and reporting standards requiring that all derivative instruments are recorded on the balance sheet as either an asset or a liability, measured at fair value. The statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met and such hedge accounting treatment is elected. Because the Company does not hold any derivatives as defined in SFAS No. 133, the adoption of SFAS No. 133 did not have a material effect on its results of operations or financial position.

In December 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements ("SAB 101"). SAB 101, as amended, summarizes certain of the SEC's views in applying generally accepted accounting principles to revenue recognition in financial statements. SAB 101 was adopted by the Company in 2000. The adoption of the provisions of SAB 101 did not have a material effect on the Company's results of operations or financial position.

AeroCentury Corp.
Notes to Consolidated Financial Statements
September 30, 2001

2. Aircraft and Aircraft Engines On Operating Leases

At September 30, 2001, the Company owned three deHavilland DHC-8s, two deHavilland DHC-7s, three deHavilland DHC-6s, one Fairchild Metro III, three Shorts SD 3-60, six Fokker 50s, two Saab 340As and 26 turboprop engines, one of which is held in inventory as a spare and is not subject to a lease or to depreciation. The Company did not acquire any aircraft during the first nine months of 2001, but did capitalize a total of $275,380 of equipment added to three aircraft. As discussed in Note 7, one of the Company's Shorts SD 3-60 aircraft was sold during October 2001.

In 2001, the Company and the lessee of two of the Company's DHC-6 aircraft agreed to the terms pertaining to the early termination of the leases for the two aircraft. Under the agreement, the lessee paid all rent and reserves through the return dates in April 2001, and performed certain maintenance procedures prior to such return. At the same time, the Company reversed the $66,000 allowance against a portion of the receivables it had recorded at December 31, 2000. Both aircraft have been re-leased to a regional airline. Prior to delivery of the aircraft, however, the Company incurred approximately $7,000 of maintenance work in addition to estimates accrued during 2000. In addition, the Company capitalized approximately $36,000 of equipment added to the aircraft.

The lease for one of the Company's two DHC-7 aircraft was extended from September 30, 2000 to the date of completion of its pre-return inspection in July 2001. The Company is currently seeking re-lease or sale opportunities for both DHC-7 aircraft.

At the time of purchase, one of the Company's Shorts SD 3-60 aircraft was subject to a 48-month lease, expiring in March 2002, with a British regional airline. The original lease, entered into in 1998, did not require that the lessee pay maintenance reserves based on usage because, at the time, the lessee was considered creditworthy. Subsequently, the airline experienced financial difficulties and, on February 24, 2000, filed for reorganization. The lessee continued to operate the aircraft, and, under the reorganization plan, the lessee agreed to continue leasing the Company's aircraft on a month-to-month basis, at the same rent. Upon its return to the Company during the fourth quarter of 2000, the Company was able to inspect the aircraft in order to identify its maintenance requirements and estimate the funds needed to complete such maintenance. Based on this inspection, the Company accrued $521,000 of maintenance costs in 2000, related to hours flown prior to the reorganization filing, which the Company did not anticipate receiving from the lessee or from the reorganization administrator. During the second quarter of 2001, the Company received approximately $9,300 of rent which had not been paid by the lessee during the fourth quarter of 2000 and which the Company had not accrued. In addition, the reorganization administrator paid approximately $210,000 for maintenance work on the aircraft. Therefore, the Company reversed $210,000 of the maintenance accrual made during 2000. During the second quarter, the aircraft was re-leased to a new lessee. In connection with the delivery of the aircraft to the new lessee, the Company capitalized approximately $239,000 of equipment added to the aircraft and incurred approximately $166,000 of unanticipated maintenance expenses. In addition, based on its periodic review of the adequacy of maintenance reserves, the Company accrued an additional $50,000

of maintenance expense for the aircraft. Therefore, at September 30, 2001, the reserve balance for this aircraft was $361,000. However, during October 2001, the Company and the lessee agreed to the early termination of the lease and the aircraft was sold to a third party. At that time, the previously accrued maintenance expense was reversed.

The leases for the Company's other two Shorts SD 3-60 aircraft were extended from March 31, 2001 to their pre-return inspection completion. The inspections were completed and the aircraft were returned during May. One of the aircraft has been re-leased to a regional operator in Haiti. The Company is currently seeking re-lease or sale opportunities for the second aircraft.

AeroCentury Corp.
Notes to Consolidated Financial Statements
September 30, 2001

2. Aircraft and Aircraft Engines On Operating Leases (continued)

The lease for one of the Company's Fokker 50 aircraft has been extended from June 30, 2001 to December 31, 2001.

The lessee of twenty-four of the Company's leased engines has exercised its option to extend the lease for an additional two-year term, through April 30, 2004.

In June 2001, one of the Company's deHavilland DHC-8 aircraft sustained significant damage while landing. During the third quarter of 2001, the Company received net insurance proceeds of $350,000, which represented the amount in excess of the cost of repairs to the aircraft. The insurance proceeds are included in other income.

3. Note Receivable

At September 30, 2001, the Company's note receivable consists of a loan to one of the Company's long-standing lessees in connection with a manufacturer-required inspection of the aircraft and repair of certain components. The Company and the lessee agreed to a cost sharing arrangement whereby a portion of the cost was funded by maintenance reserves previously paid by the lessee and the remaining cost was allocated to the Company and the lessee. The Company recorded a note receivable for the lessee's portion, net of interest to be received at a rate of 5%, which will be repaid through increased rent during the remainder of the lease term, which expires on April 30, 2003.

4. Notes Payable and Accrued Interest

On June 28, 2000, the Company signed an agreement for a revolving credit facility totaling $50 million. The new facility, which expires on June 28, 2003, bears interest, at the Company's option, at either (i) prime or (ii) LIBOR plus a margin ranging from 200 to 250 basis points, depending on certain financial ratios. The Company's assets, excluding those of AeroCentury LLC and AeroCentury II LLC, serve as collateral under the facility and, in accordance with the credit agreement, the Company must maintain compliance with certain financial covenants. As of September 30, 2001, the Company was in compliance with all such covenants. As of September 30, 2001, $27,225,000 was outstanding under the credit facility, and interest of $14,130 was accrued, using a combination of prime and LIBOR rates. As discussed in "Outlook", below, the Company made a repayment on its revolving credit facility in the amount of

$300,000 during October 2001 because of certain collateral borrowing base limitations and may be required to make additional monthly repayments.

As discussed in Note 1, during November 1999 the Company acquired two aircraft using cash and bank financing separate from its credit facility. The financing consisted of a note in the amount of $9,061,000, due February 15, 2002, which bears fixed interest at 8.04%. Payments due under the note consist of monthly principal and interest and a balloon principal payment due on the maturity date. The balance of the note payable at September 30, 2001 was $7,280,950. A similar financing was concluded in September 2000, consisting of a note in the amount of $3,575,000, due April 18, 2003, which bears fixed interest at 8.36% for the acquisition of one aircraft. Payments due under the note consist of monthly principal and interest and a balloon principal payment due on the maturity date. The balance of the note payable at September 30, 2001 was $3,130,840 and interest of $8,720 was accrued. As of September 30, 2001, the Company was in compliance with all covenants of the loan agreements pertaining to the financing of these three aircraft.

AeroCentury Corp.
Notes to Consolidated Financial Statements
September 30, 2001

5. Income Taxes

The items comprising income tax expense are as follows:

	For the Nine Months E
	2001
Current tax provision:	
Federal	$ 97,670
State	8,280
Foreign	118,750
Current tax provision	224,700
Deferred tax provision/(benefit):	
Federal	563,960
State	(14,680)
Deferred tax provision	549,280
Total provision for income taxes	$ 773,980

Total income tax expense differs from the amount that would be provided by applying the statutory federal income tax rate to pretax earnings as illustrated below:

	For the Nine Months E
	2001
Income tax expense at	

statutory federal income tax rate	$ 788,250
State taxes net of federal benefit	20,880
Tax refunds	(15,470)
Other	(19,680)
Total income tax expense	$ 773,980

Temporary differences and carryforwards that gave rise to a significant portion of deferred tax assets and liabilities as of September 30, 2001 are as follows:

Deferred tax assets:	
Organizational costs	$ 19,270
Maintenance reserves	618,420
Prepaid rent	108,130
Deferred maintenance	332,580
Other	2,360
Deferred tax assets	1,080,760
Deferred tax liabilities:	
Depreciation on aircraft and engines	(4,064,610)
Other	(282,160)
Net deferred tax liabilities	$ (3,266,010)

AeroCentury Corp.
Notes to Consolidated Financial Statements
September 30, 2001

5. Income Taxes (continued)

No valuation allowance is deemed necessary, as the Company anticipates generating adequate future taxable income to realize the benefits of all deferred tax assets on the balance sheet.

6. Related Party Transactions

Since the Company has no employees, the Company's portfolio of leased aircraft assets is managed and administered under the terms of a management agreement with JetFleet Management Corp. ("JMC"). Under this agreement, JMC receives a monthly management fee based on the net asset value of the assets under management. JMC may also receive an acquisition fee for locating assets for the Company, provided that the aggregate purchase price including chargeable acquisition costs and any acquisition fee does not exceed the fair market value of the asset based on appraisal, and a remarketing fee in connection with the sale or re-lease of the Company's assets. The management fees, acquisition fees and remarketing fees may not exceed the customary and usual fees that would be paid to an unaffiliated party for such services. The Company recorded management fees of $1,329,720 and $1,262,650 during the nine months ended September 30, 2001 and 2000, respectively, and $438,910 and $435,930 during the quarters ended September 30, 2001 and 2000, respectively. Because the Company did not acquire any aircraft during the first nine months of 2001, no acquisition fees were paid to JMC. During the same period of 2000, the Company accrued a total of $371,300 in acquisition fees, which are included in the capitalized cost of the aircraft. No remarketing fees were paid to JMC during the first nine months of 2001 or 2000.

Certain employees of JMC participate in an employee stock incentive plan which grants options to purchase shares of the Company held by JHC. As of September 30, 2001, 28,833 such options had been exercised.

7. Subsequent Events

During October 2001, the Company and the lessee for one of the Company's Shorts SD 3-60 aircraft agreed to an early termination of the lease which requires that the lessee pay all amounts due through the return date, as well as a termination payment. Upon its return from the lessee, the aircraft was sold. The total of the sales proceeds and the maintenance reserves retained by the Company approximated book value.

Item 2. Management's Discussion and Analysis or Plan of Operation.

Forward-Looking Statements

Certain statements contained in this report and, in particular, the discussion regarding the Company's beliefs, plans, objectives, expectations and intentions contained in this "Item 2 -- Management's Discussion and Analysis or Plan of Operation" section (particularly the "Outlook" section hereof) regarding: the use, application and replenishment of lessee security deposits; the adequacy of the Company's cash flow to meet interest rate increases under its revolving credit facility; the early initiation of remarketing efforts helping to reduce off-lease time for the assets; the adequacy of the Company's cash flow to meet ongoing operational needs; the Company's ability to fund repayments under the credit facility in the event off-lease aircraft are not remarketed; the Company's ability to remain in compliance with credit facility covenants if off-lease aircraft are remarketed; the anticipated increased demand for shorter-term leases; the Company's need to change credit line covenants to take advantage of such demand; the expected time of a decision by lenders on such covenant changes; the Company's expectations regarding rent income and earnings for the fourth quarter of 2001; the impact of rent concessions, rent collection problems and aircraft value reductions on fourth quarter results; the Company's intention to repay a portion of the revolving loans from proceeds of subsequent debt or equity financings; the attractiveness of overseas markets; JMC's competitiveness due to its experience and operational efficiency in financing transaction types desired by regional air carriers; the acquisition by lessees of additional war risk coverage before new policy limitations take effect; and the Company's ability to obtain third party guaranties, letters of credit or other credit enhancements from future lessees; are forward-looking statements. While the Company believes that such statements are accurate, they are dependent upon general economic conditions, particularly those that affect the demand for regional aircraft and engines and the financial status of the Company's primary customers, regional passenger airlines; the lack of any further disruptions to the air travel industry similar to that which occurred on September 11, 2001; the success of the Company's remarketing efforts with respect to aircraft that are returned upon expiration or termination of leases; the Company's ability to remain in compliance with the terms of its credit facility agreement; the financial performance of the Company's lessees and their compliance with rental, maintenance and return conditions under their respective leases; the

availability of suitable aircraft acquisition transactions in the regional aircraft market; and future trends and results which cannot be predicted with certainty. The Company's actual results could differ materially from those discussed in such forward-looking statements. The cautionary statements made in this Report should be read as being applicable to all related forward-looking statements wherever they appear in this Report. Factors that could cause or contribute to such differences also include those discussed below in the section entitled "Factors that May Affect Future Results."

Results of Operations

Revenues

The Company had revenues of $8,454,600 and $8,369,880 and net income of $1,544,420 and $1,446,880 for the nine months ended September 30, 2001 and 2000, respectively, and revenues of $2,878,830 and $2,969,660 and net income of $530,280 and $488,360 for the quarters ended September 30, 2001 and 2000, respectively.

Rent income is approximately $279,000 lower in the nine month period of 2001 versus 2000 primarily due to the decrease in rent from assets sold during the fourth quarter of 2000 and assets which came off-lease during the second quarter of 2001, which effect was only partially offset by the purchases of additional aircraft on lease during the latter half of 2000. These transactions had the same effect on the comparison of the three month periods for both years, resulting in lower rent income of approximately $393,000 in 2001.

Due to the net insurance proceeds received as a result of damage to one of the Company's deHavilland DHC-8 aircraft, other income is higher by approximately $363,000 and $303,000 for the nine and three month periods of 2001 versus 2000.

Expense Items

Management fees were approximately $67,000 and $3,000 higher in the nine month and three month periods, respectively, of 2001 versus 2000 because of the aircraft acquisitions during the latter half of 2000, net of the aircraft sold during 2000. Such acquisitions had a similar effect on depreciation, which was approximately $139,000 and $26,000 higher in the nine month and three month periods, respectively, in 2001 versus 2000. Interest expense was approximately $236,000 and $270,000 lower in the nine month and three month periods of 2001 versus 2000 because of lower interest rates and a lower average principal balance during 2001.

Maintenance expense was approximately $33,000 and $45,000 higher during the nine month and three month periods of 2001 as a result of work performed to ready the Company's off-lease aircraft for re-lease to new customers. Professional fees and general and administrative expenses were lower by approximately $18,000 in the nine month period of 2001 versus 2000 primarily because of lower legal and accounting and other expenses, the effect of which was partially offset by higher insurance expense for off-lease aircraft. Professional fees and general and administrative expenses were approximately $42,000 higher in the three month period of 2001 because of higher legal and insurance expense.

The Company's effective tax rates in the nine month and three month periods ended September 30, 2001 were approximately 33% and 34%, respectively, versus 35% and 34% for the same periods of 2000. The Company's tax rate is subject to changes in the mix of domestic and foreign leased assets, the proportions of

revenue generated within and outside of California and numerous other factors, including changes in tax laws.

Liquidity and Capital Resources

The Company is currently financing its assets primarily through credit facility borrowings and excess cash flow. On June 28, 2000, the Company signed an agreement for a revolving credit facility totaling $50 million. The new facility, which expires on June 28, 2003, bears interest, at the Company's option, at either (i) prime or (ii) LIBOR plus a margin ranging from 200 to 250 basis points, depending on certain financial ratios. The Company's assets, excluding those of AeroCentury LLC and AeroCentury II LLC, serve as collateral under the facility and, in accordance with the credit agreement, the Company must maintain compliance with certain financial covenants. As of September 30, 2001, the Company was in compliance with all such covenants. As of September 30, 2001, $27,225,000 was outstanding under the credit facility, and interest of $14,130 was accrued, using a combination of prime and LIBOR rates. Because of the collateral limitations discussed below in "Outlook", approximately $225,000 of the unused portion of the credit facility was available for borrowing at September 30, 2001.

The majority of the Company's borrowings continue to be financed using one-month LIBOR rates, which have decreased since the Company began financing pursuant to such rates during June 1999. The Company believes it has adequate cash flow to meet any increases in interest rates applicable to its credit facility obligations.

The primary source of the Company's acquisition financing is the credit facility, which carries a floating interest rate. Therefore, the Company's interest expense will generally move up or down with the prevailing interest rates, as the Company has not entered into any interest rate hedges.

Because aircraft owners seeking financing generally can obtain financing through either leasing transactions or traditional secured debt financings, prevailing interest rates are a significant factor in determining market lease rates, and market lease rates generally move up or down with prevailing interest rates, assuming supply and demand of the desired equipment remains constant. However, because lease rates for the Company's assets typically are fixed under existing leases, the Company typically does not experience any positive or negative impact in revenue from changes in market lease rates due to interest rate changes until such leases have terminated.

During November 1999, the Company acquired two aircraft using cash and bank financing separate from its credit facility. The financing consists of a note in the amount of $9,061,000, due February 15, 2002, which bears fixed interest at 8.04%. Payments due under the note consist of monthly principal and interest and a balloon principal payment due on the maturity date.

A similar financing was concluded in September 2000, consisting of a note in the amount of $3,575,000, due April 18, 2003, which bears fixed interest at 8.36% for the acquisition of one aircraft. Payments due under the note consist of monthly principal and interest and a balloon principal payment due on the maturity date.

The Company's primary source of revenue is lease rentals collected from lessees of its aircraft assets. It is the Company's policy to monitor each lessee's needs in periods before leases are due to expire. If it appears that a lessee will not be renewing its lease, the Company immediately initiates marketing efforts to locate a potential new lessee or purchaser for the aircraft. This procedure helps the Company reduce the time that an asset will be "off-lease". The Company's aircraft are subject to leases with varying expiration dates between November 2001 and June 2004. Given the varying lease terms and

expiration dates for the aircraft in the Company's portfolio, management believes that the Company will have adequate cash flow to meet its on-going operational needs. See "Outlook", below, for a discussion of factors which may affect the Company's cash flow.

The Company's cash flow from operations for the nine months ended September 30, 2001 versus 2000 decreased by approximately $1,016,000. The decrease from year to year was due to the effect of the change in accounts payable and accrued expenses, maintenance reserves and accrued costs, security deposits, and prepaid rent, and a net decrease in deferred taxes. The effect of these changes was only partially offset by an increase in net income, and the positive effect of the change in deposits, accounts receivable, notes receivable, prepaid expenses and other assets, and accrued interest on notes payable during 2001 versus 2000.

Specifically, the Company's cash flow from operations for the nine months ended September 30, 2001 consisted of net income of $1,544,420 and adjustments consisting primarily of depreciation of $2,100,960, an increase in deposits of $541,750, a decrease in accounts receivable of $125,020, decreases in accounts payable and accrued expenses and security deposits of $1,096,860 and $124,030, respectively, an increase in maintenance reserves and accrued costs of $112,850 and a net increase in deferred taxes of $549,290.

Specifically, the Company's cash flow from operations for the nine months ended September 30, 2000 consisted of net income of $1,446,880 and adjustments consisting primarily of depreciation of $1,961,510, increases in deposits, accounts receivable, and prepaid expenses and other assets of $1,993,540, $668,400 and $232,450, respectively, increases in accounts payable and accrued expenses, maintenance reserves and accrued costs, security deposits, prepaid rent, and a net increase in deferred taxes of $472,820, $1,888,350, $85,630, $118,020 and $754,400, respectively, and a decrease of $167,040 in accrued interest on notes payable.

The decrease in cash flow provided by financing activities from year to year was a result of principal repayments on the Company's indebtedness, which, during 2000, were more than offset by borrowings used to finance aircraft purchases. The only cash flow used for investing activities during the first nine months of 2001 was for equipment added to aircraft already owned by the Company, as compared to the first nine months of 2000, when the Company purchased three aircraft.

Outlook

Under the provisions of the Company's revolving credit facility, when an aircraft that is part of the collateral base securing the credit facility is off-lease or coming off-lease within a certain period of time, there is a reduction in the amount of the collateral base, which affects the amount that can be outstanding under the credit facility. Although the Company has recently re-leased an aircraft, extended the lease on a pool of engines pursuant to an option and sold an aircraft, the aircraft which are off lease or will come off lease by December 31, 2001 (five as of October 31, 2001) precluded the Company from utilizing almost all of the $23 million of unused credit on its facility at September 30, 2001. The eventual re-lease or sale of these aircraft will be required in order for the Company to utilize the remaining credit facility as well as to remain in compliance with its credit facility covenants. The Company made a repayment on its revolving credit facility in the amount of $300,000 during October 2001. If all the aircraft that are currently off lease or due to be returned to the Company upon termination of leases during 2001 remain unleased, the Company will be required to make additional monthly repayments totaling $550,000 through December 2001. The Company anticipates having sufficient cash flow to fund such repayments if this scenario were to occur.

If, however, the Company is able to re-lease some or all of such aircraft before

year end, and there are no other unanticipated negative events with respect to other aircraft currently on lease, the Company should be able to remain in compliance with its covenants and have sufficient collateral to permit additional borrowings. The amount of such borrowings would be dependent upon the net book value of the re-leased assets.

The Company believes that the events of September 11, 2001 in the United States have created increased demand for shorter term leases. As a result, the Company has approached the agent bank for the Company's revolving credit facility to discuss changes to certain financial covenants contained in the loan agreement. The Company believes such changes will be necessary to enable it to continue to take advantage of business opportunities in the current industry environment. In particular, the ability to have assets on short-term leases included in the collateral base could be a significant factor in the Company's ability to acquire additional assets in the near- and medium-term. The Company anticipates a decision from its lenders during the fourth quarter of 2001.

While the Company has previously used special purpose asset-based financing for the acquisition of three aircraft and may have such financing available again in the future, the revolving credit facility is currently the Company's only funding source for new acquisitions because the Company does not have sufficient cash flow to fund the equity portion of a special purpose financing. Therefore, the Company's management is making remarketing of off-lease aircraft the primary focus of its efforts in the balance of 2001 and 2002 in order to resolve the credit facility limitations discussed above.

A balloon principal payment in connection with the special purpose financing of two aircraft is due at the time the leases expire during the first quarter of 2002. Funding the payment or extending the financing will be dependent on the Company's ability to sell or re-lease the aircraft which serve as collateral.

Because of the loss of revenue from assets sold during the fourth quarter of 2000, which has been only partially offset by acquisitions made during the latter half of 2000, and because of the lease terminations and expirations discussed above, it is likely that rent income for the fourth quarter of 2001 will be substantially lower than in 2000. In addition, while the Company leases primarily to regional airlines that operate outside the U.S., management recognizes that some customers may be adversely impacted by the September 11, 2001 terrorist attacks in the U.S. Several of the Company's lessees have approached the Company to discuss revised payment terms in light of these events. Also, the Company is reviewing its asset valuations in light of the worldwide economic downturn. Fourth quarter results could be negatively affected by rental reduction concessions, rent collections and possible reductions in aircraft values. Although management has begun assessing the impact of these factors on the Company, it is too early to determine the extent of any such impact.

Factors that May Affect Future Results

General Economic Conditions; Recent Events. The Company's business is dependent upon general economic conditions and the strength of the travel and transportation industry. The industry appeared to be experiencing the beginnings of a cyclical downturn early in the third quarter, and this downturn was exacerbated greatly by the terrorist attacks of September 11, 2001 and their aftermath. As a result, there has been a severe reduction in air travel, and less revenue and less demand for aircraft capacity by the major air carriers, particularly those that serve U.S. markets.

The Company's lessees and targeted potential lessees have been primarily outside the U.S. It is not clear how long this downturn will last and whether and to what extent it will have an effect on the non-U.S. regional carriers that are the Company's primary lessees, and the consequent overall impact on the

Company's results. It is possible that in certain instances, current economic circumstances may favor the Company, in that planned aircraft replacements for the Company's leased aircraft by its lessees may be cancelled or postponed, resulting in greater likelihood of renewals by existing lessees. Further, demand for more economically operated turboprop aircraft (which make up most of the Company's portfolio), relative to the more expensive new regional jets, may increase (see "Leasing Risks," below).

At this time, it appears that large, international carriers have been most affected by these adverse events. To the extent that the Company's regional lessees depend on passenger traffic from the international carriers, they may also be adversely affected. Those regional carriers that are less dependent on the major carriers, however, may be less affected. Nevertheless, since regional carriers are not as well-capitalized as major air carriers, the downturn may result in the increased possibility of an economic failure of one or more of the Company's lessees. The combined effect of all or any decreased air travel, further weakening of the industry as a result of subsequent threats of attacks similar to the September 11 events, an increase in the price of jet fuel due to fears of hostilities in the Middle East and increased costs and reduced operations by air carriers due to new security directives, depending on their scope and duration, could have a material adverse impact on the Company's lessees and thus the Company's results. Further, if there is substantial excess capacity for regional air carriers, the supply of regional aircraft may become out of balance with demand. If this were to occur, the Company's off-lease periods for its aircraft may significantly increase, and the value of its portfolio of aircraft could be adversely impacted.

One anticipated result of the economic situation is that lessees are likely to desire shorter-term leases which will give those lessees more short-term flexibility to deal with the current downturn. The Company's ability to enter into such short-term leases is somewhat limited by credit facility covenants that govern to what extent aircraft on short-term leases can be added to the collateral base that determines how much the Company can draw under the credit facility (see "Credit Facility Availability," below). The Company is currently working with its lenders to modify such covenants to give the Company more flexibility to offer short-term leases to its lessees without a negative impact on the credit facility covenants. There can be no assurance that the Company will be successful in obtaining its desired amendments to the credit facility agreement with its lenders.

Risks of Debt Financing. The Company's use of acquisition financing under its revolving credit facility subjects the Company to increased risks of leveraging. The revolving loans are secured by the Company's existing assets as well as the assets acquired with each financing. Any default under the revolving credit facility could result in foreclosure upon not only the asset acquired using such financing, but also the existing assets of the Company securing the revolving loan.

In order to achieve optimal benefit from the revolving credit facility, the Company intends to repay a portion of the revolving loans from proceeds of subsequent term debt or equity financings. Such replacement financing would likely provide the Company with more favorable long-term repayment terms and also would permit the Company to make further borrowings under the revolving credit facility equal to the amount of revolving debt refinanced. There can be no assurance that the Company will be able to obtain the necessary amount of replacement term debt or equity financing on favorable terms so as to permit multiple draws on the revolving credit facility.

All of the Company's current credit facility indebtedness carries a floating interest rate based upon either the lender's prime rate or a floating LIBOR rate. If the applicable index rate increases, and the Company has not entered into a mitigating hedge transaction, then the Company's payment obligations

under the credit facility would increase and could result in lower net revenues for the Company. As discussed above, however, the Company may also have available to it financing separate from its credit facility, which financing has carried a fixed rate of interest in the past.

Credit Facility Availability and Repayments Based on Collateral Base. As discussed above, in "Outlook" the Company's ability to draw on its $50 million credit facility is dependent upon the status of its collateral base. If a significant portion of the collateral base is off-lease for an extended period of time (see "Ownership Risks" below), this may affect the amount the Company can borrow under its credit line. Since the Company currently does not have additional, immediately available sources of acquisition funding, the ability to draw fully on its credit facility will be a critical factor to enable the Company to continue its asset and revenue growth. Further, as discussed above in "Outlook", if the five aircraft which are off lease or will come off lease by December 31, 2001 remain either unsold or off-lease, the Company will be required to make monthly principal repayments totaling $550,000 through December 2001. While the Company has sufficient cash to make such repayments through December 31, 2001, if the aircraft remain unleased or unsold through that date, and the Company has not obtained a waiver or amendment of such covenants from its lenders by that time, the Company may have to sell a significant portion of its portfolio in order to maintain compliance with the covenants, or, if that is not possible, default on its credit facility.

Leasing Risks. The Company's successful negotiation of lease extensions, re-leases and sales may be critical to its ability to achieve its financial objectives, and involves a number of risks. Demand for lease or purchase of the assets depends on the economic condition of the airline industry which is, in turn, sensitive to general economic conditions. Ability to remarket equipment at acceptable rates may depend on the demand and market values at the time of remarketing. The Company anticipates that the bulk of the equipment it acquires will be used aircraft equipment. The market for used aircraft is cyclical, and generally, but not always, reflects economic conditions and the strength of the travel and transportation industry, which is currently experiencing a severe downturn. The demand for and value of many types of older aircraft in the recent past have been depressed by such factors as airline financial difficulties, increased fuel costs, the number of new aircraft on order and the number of older aircraft coming off-lease. The Company's expected concentration in a limited number of airframe and aircraft engine types (generally, turboprop equipment) subjects the Company to economic risks if those airframe or engine types should decline in value. If "regional jets" were to be used on short routes previously served by turboprops, even though regional jets are more expensive to operate than turboprops, the demand for turboprops could be decreased. This could result in lower lease rates and values for the Company's existing turboprop aircraft.

Reliance on JMC. All management of the Company is performed by JMC under a management agreement which is in its fourth year of a 20-year term and provides for an asset-based management fee. JMC is not a fiduciary to the Company or its stockholders. The Board of Directors, however, has ultimate control and supervisory responsibility over all aspects of the Company and owes fiduciary duties to the Company and its stockholders. In addition, while JMC may not owe any fiduciary duties to the Company by virtue of the management agreement, the officers of JMC are also officers of the Company, and in that capacity owe fiduciary duties to the Company and the stockholders by virtue of holding such offices with the Company.

The management agreement may be terminated upon a default in the obligations of JMC to the Company, and provides for liquidated damages in the event of a wrongful termination of the agreement by the Company. All of the officers of JMC are also officers of the Company, and certain directors of the Company are also directors of JMC. Consequently, the directors and officers of JMC may have a

conflict of interest in the event of a dispute over obligations 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.

Ownership Risks. Most of the Company's portfolio is leased under operating leases, where the terms of the leases do not take up the entire useful life of an asset. The Company's ability to recover its purchase investment in an asset subject to an operating lease is dependent upon the Company's ability to profitably re-lease or sell the asset after the expiration of the initial lease term. Some of the factors that have an impact on the Company's ability to re-lease or sell include worldwide economic conditions, general aircraft market conditions, regulatory changes that may make an asset's use more expensive or preclude use unless the asset is modified, changes in the supply or cost of aircraft equipment and technological developments which cause the asset to become obsolete. 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 serviceable condition as required under the lease. If the Company is unable to remarket its aircraft equipment on favorable terms when the operating lease for such equipment expires, the Company's business, financial condition, cash flow, ability to service debt and results of operation could be adversely affected.

Lessee Credit Risk. If a lessee defaults upon its obligations under a lease, the Company may be limited in its ability to enforce remedies. Most of the Company's lessees are small regional passenger airlines, which may be even more sensitive to airline industry market conditions than the major airlines. As a result, the Company's inability to collect rent under a significant lease or to repossess equipment in the event of a default by a lessee could have a material adverse effect on the Company's revenue. If a lessee that is a certified U.S. airline is in default under the lease and seeks protection under Chapter 11 of the United States Bankruptcy Code, under Section 1110 of the Bankruptcy Code, the Company would be automatically prevented from exercising any remedies for a period of 60 days. By the end of the 60-day period, the lessee must agree to perform the obligations and cure any defaults, or the Company would have the right to repossess the equipment. This procedure under the Bankruptcy Code has been subject to significant recent litigation, however, and it is possible that the Company's enforcement rights may still be further adversely affected by a declaration of bankruptcy by a defaulting lessee.

International Risks. The Company has focused recently on leases in overseas markets, which are currently dynamic and which the Company believes present attractive opportunities. Leases with foreign lessees, however, may present somewhat different credit risks than those with domestic lessees.

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

Leases with foreign lessees are subject to risks related to the economy of the country or region in which such lessee is located, even if the U.S. economy remains strong. On the other hand, a foreign economy may remain strong even though the U.S. economy does not. A foreign economic downturn may impact a foreign lessee's ability to make lease payments, even though the U.S. and other economies remain stable. Furthermore, 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 dollar-denominated lease payment provisions, the Company could still be affected by a devaluation of the lessee's local currency which would make it more difficult for a lessee to meet its dollar-denominated lease payments, increasing the risk of default of that lessee, particularly if that carrier's revenue is primarily derived in the local currency.

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

Competition. The aircraft leasing industry is highly competitive. The Company competes with aircraft manufacturers, distributors, airlines and other operators, equipment managers, leasing companies, equipment leasing programs, financial institutions and other parties engaged in leasing, managing or remarketing aircraft, many of which have significantly greater financial resources and more experience than the Company. The Company, however, believes that it is competitive because of JMC's experience and operational efficiency in financing the transaction types desired by regional air carriers. This market segment, which is characterized by transaction sizes of less than $10 million and lessee credits that are strong, but generally unrated and more speculative than the major air carriers, is not well served by the Company's larger competitors in the aircraft industry. JMC has developed a reputation as a global participant in this segment of the market, and the Company believes this will benefit the Company. There is no assurance that the lack of significant competition from the larger aircraft leasing companies will continue or that the reputation of JMC will continue to be strong in this market segment and benefit the Company.

Casualties, Insurance Coverage. The Company, as owner of transportation equipment, could be held liable for injuries or damage to property caused by its assets. Though some protection may be provided by the United States Aviation Act with respect to its aircraft assets, it is not clear to what extent such statutory protection would be available to the Company and such act may not apply to aircraft operated in foreign countries. Though the Company may carry insurance or require a lessee to insure against a risk, some risks of loss may not be insurable. An uninsured loss with respect to the equipment or an insured loss, for which insurance proceeds are inadequate, would result in a possible loss of invested capital in and any profits anticipated from such equipment.

As a result of the terrorist attacks of September 11, 2001, certain insurance carriers have instituted a new $50 million limitation on war risk liability coverage. To the extent that the $50 million coverage is not sufficient to comply with lease obligations, the Company will require that its lessees acquire additional insurance, to bring coverage up to the required limits. To date, the Company believes that all of its lessees who have received notices of the new limitation have either obtained the additional coverage required or will do so before the limitation takes effect. If the additional insurance or government indemnity is not acquired in time, then the Company may ground any aircraft until it is adequately insured.

Risks Related to Regional Air Carriers. Because the Company has concentrated its existing leases and intends to concentrate on leases to regional air carriers, it is subject to certain risks. First, some of the lessees in the regional air carrier market are companies that are start-up, low capital, low margin

operations. Often, the success of such carriers is dependent upon arrangements with major trunk carriers, which may be subject to termination or cancellation by such major carrier. Leasing transactions with these types of lessees result in a generally higher lease rate on aircraft, but may entail higher risk of default or lessee bankruptcy. The Company evaluates the credit risk of each lessee carefully, and attempts to obtain a third party guaranty, letters of credit or other credit enhancement, if it deems them necessary. There is no assurance, however, that such enhancements will be available or that even if obtained will fully protect the Company from losses resulting from a lessee default or bankruptcy. Second, a significant area of growth of this market is in areas outside of the United States, where collection and enforcement are often more difficult and complicated than in the United States.

Possible Volatility of Stock Price. The market price of the Company's common stock could be subject to fluctuations in response to operating results of the Company, 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, some of which may be unrelated to the Company's performance. Also, because the Company has a relatively small capitalization of approximately 1.5 million shares, there is a correspondingly limited amount of trading of the shares. Consequently, a single or small number of trades could result in a market fluctuation not related to any business or financial development relating to the Company.

SIGNATURES

In accordance with the requirements of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AEROCENTURY CORP.
(Registrant)

By: /s/ Neal D. Crispin

Neal D. Crispin
Title: President

Date: November 13, 2001

/s/ Toni M. Perazzo

Toni M. Perazzo
Title: Senior Vice President - Finance
Chief Financial Officer and Secretary
(Principal Financial and Accounting Officer)

Date: November 13, 2001