

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

June 30, 2021

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

For the transition period from _____ to _____

Commission File Number:

001-13387

AeroCentury Corp

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

94-3263974

(I.R.S. Employer Identification No.)

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

(650) 340-1888

(Registrant's Telephone Number Including Area Code)

None

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
<u>Common Stock</u>	<u>ACY</u>	<u>NYSE American</u>

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 every Interactive Data File required to be submitted 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 to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting

company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

<u>Large accelerated filer</u>	Accelerated filer	<input type="checkbox"/>
<u>Non-accelerated filer</u>	Smaller reporting company	<input checked="" type="checkbox"/>
	Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 August 23, 2021 was 1,545,884.

As used in this report, unless the context indicates otherwise, “AeroCentury” refers to AeroCentury Corp. and the “Company” refers to AeroCentury together with its consolidated subsidiaries.

Forward-Looking Statements

As used in this report, unless the context indicates otherwise, “AeroCentury” refers to AeroCentury Corp. and the “Company” refers to AeroCentury together with its consolidated subsidiaries.

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 the Company’s plans and objectives for future operations, the Company’s future financial or economic performance (including known or anticipated trends), and the assumptions underlying or related to 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 in this report include statements about the following matters, although this list is not exhaustive:

- the expected timing of the hearing for approval of the Bankruptcy Court of the Plan Sponsor Agreement and the plan for the Company’s exit from the bankruptcy process;
- the Company’s anticipated plan for exit from bankruptcy, including the proposed terms of the equity financing with a plan sponsor on the terms set forth in the proposed Plan Sponsor Agreement;
- the expected terms and conditions of the Plan Sponsor Agreement to become effective upon the Bankruptcy Court’s approval, including the terms of the equity investment by the proposed plan sponsor;
- the resolution of the Drake Indebtedness (as defined below) through sale of collateral assets securing such indebtedness within the bankruptcy process, and the expected timing of the closings of the sales and full satisfaction of the Drake Indebtedness;
- the sufficiency of available cash required to fund the Company’s bankruptcy proceeding along with its other ongoing operational costs;
- the possibility that the Company’s operations may be expanded into, or refocused upon, new lines of business, which lines of businesses may be complementary to, or entirely unrelated to the Company’s legacy aircraft leasing business;
- the expectation that the consummation of the Plan Sponsor Agreement and Chapter 11 exit plan will result in satisfaction of the holders of senior claims and interests, such as secured indebtedness, and reinstatement of the outstanding common stock;

- the Company’s use of the PPP Loan proceeds and the potential forgiveness of principal due under such loans;
- the availability and use of debt or equity financing to fund the restart of the Company’s aircraft leasing business upon exit from bankruptcy, expand the existing business line, or expand into new business lines;
- the impact of certain industry trends, and in particular those that relate to the COVID pandemic, on the Company and its performance;
- the ability of the Company and its customers to comply with applicable government and regulatory requirements in the numerous jurisdictions in which the Company and its customers operate;
- the Company’s cyber vulnerabilities and the anticipated effects on the Company if a cybersecurity threat or incident were to materialize;
- general economic, market, political and regulatory conditions, including anticipated changes in these conditions and the impact of such changes on customer demand and other facets of the Company’s business; and
- the impact of any of the foregoing on the prevailing market price and trading volume of the Company’s common stock.

All of the Company’s forward-looking statements involve risks and uncertainties that could cause the Company’s actual results to differ materially from those projected or assumed by such forward-looking statements. Among others, the factors that could cause such differences include: the Company’s ability to complete its obligations under the Stalking Horse Agreement and thereby resolve its Drake Indebtedness; the Company’s ability to obtain the Bankruptcy Court approvals for motions necessary for the Company to execute its reorganization plan; the ongoing effects on the airline industry and global economy of the COVID-19 pandemic or any other public health emergencies; the impact on the industry from a terrorist attack involving air travel; the ability of the Company to raise debt or equity financing when needed on acceptable terms and in desired amounts, or at all; the Company’s ability to execute its reorganization plan successfully if approved; any economic downturn or other financial crisis; any inability to compete effectively with the Company’s better capitalized competitors; limited trading volume in the Company’s stock; and the other factors detailed under “Factors That May Affect Future Results and Liquidity” in Item 2 of this report. In addition, the Company operates in a competitive and evolving industry in which new risks emerge from time to time, and it is not possible for the Company to predict all of the risks it may face, nor can it assess the impact of all factors on its business or the extent to which any factor or combination of factors could cause actual results to differ from expectations. As a result of these and other potential risks and uncertainties, the Company’s forward-looking statements should not be relied on or viewed as predictions of future events.

This cautionary statement should be read as qualifying all forward-looking statements included in this report, wherever they appear. All forward-looking statements and descriptions of risks included in this report are made as of the date hereof based on information available to the Company as of the date hereof, and except as required by applicable law, the Company assumes no obligation to update any such forward-looking statement or risk for any reason. You should, however, consult the risks and other disclosures described in the reports the Company files from time to time with the United States Securities and Exchange Commission (“SEC”) after the date of this report for updated information.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

AeroCentury Corp.
(Debtor-In-Possession)
Condensed Consolidated Balance Sheets
(Unaudited)

	June 30, 2021	December 31, 2020
ASSETS		
Assets:		
Cash and cash equivalents	<u>\$2,709,300</u>	<u>\$2,408,700</u>
Accounts receivable	<u>108,100</u>	<u>256,600</u>
Finance leases receivable, net of allowance for doubtful accounts of \$ <u>1,190,000</u> and \$ <u>1,503,000</u> at June 30, 2021 and December 31, 2020, respectively	<u>700,000</u>	<u>2,547,000</u>
Aircraft held for lease, net of accumulated depreciation of \$ <u>21,001,300</u>	<u>-</u>	<u>45,763,100</u>
Property, equipment and furnishings, net of accumulated depreciation of \$ <u>13,800</u> and \$ <u>16,400</u> at June 30, 2021 and December 31, 2020, respectively	<u>10,200</u>	<u>14,900</u>
Office lease right of use, net of accumulated amortization of \$ <u>60,600</u> and \$ <u>27,400</u> at June 30, 2021 and December 31, 2020, respectively	<u>109,200</u>	<u>142,400</u>
Deferred tax asset	<u>4,300</u>	<u>1,150,900</u>
Taxes receivable	<u>1,234,500</u>	<u>-</u>
Prepaid expenses and other assets	<u>367,800</u>	<u>255,300</u>
Assets held for sale	<u>53,409,400</u>	<u>40,838,900</u>
Total assets	<u>\$58,652,800</u>	<u>\$93,377,800</u>
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Liabilities:		
Accounts payable and accrued expenses	<u>\$735,700</u>	<u>\$367,700</u>
Accrued payroll	<u>241,000</u>	<u>190,100</u>
Notes payable and accrued interest, net of unamortized debt issuance costs of \$ <u>780,900</u>	<u>-</u>	<u>88,793,200</u>
Derivative termination liability	<u>-</u>	<u>3,075,300</u>
Lease liability	<u>137,300</u>	<u>172,000</u>

Maintenance reserves	-	2,000,600
Accrued maintenance costs	19,500	46,100
Security deposits	-	716,000
Unearned revenues	-	1,027,400
Income taxes payable	3,700	900
Total liabilities not subject to compromise	1,137,200	96,389,300
Liabilities subject to compromise	80,277,600	-
Liabilities held for sale	3,460,400	14,604,800
Total liabilities	84,875,200	110,994,100
Commitments and contingencies (Note 10)		
Stockholders' deficit:		
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, 1,545,884 shares outstanding at June 30, 2021 and December 31, 2020	1,800	1,800
Paid-in capital	16,782,800	16,782,800
Accumulated deficit	(39,969,700)	(31,361,600)
Accumulated other comprehensive loss	(-)	(2,000)
	(23,185,100)	(14,579,000)
Treasury stock at cost, 213,332 shares at June 30, 2021 and December 31, 2020	(3,037,300)	(3,037,300)
Total stockholders' deficit	(26,222,400)	(17,616,300)
Total liabilities and stockholders' deficit	\$58,652,800	\$93,377,800

The accompanying notes are an integral part of these condensed consolidated financial statements.

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AeroCentury Corp.
(Debtor-In-Possession)
Condensed Consolidated Statements of Operations
(Unaudited)

	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
	2021	2020	2021	2020
Revenues and other income:				
Operating lease revenue	\$4,207,600	\$9,146,700	\$1,470,300	\$4,378,500

Net (loss)/gain on disposal of assets	((((
	<u>194,900</u>	<u>11,100</u>	<u>6,800</u>	<u>13,100</u>
Finance lease revenue	-	<u>56,300</u>	-	-
Other income/(loss)	<u>2,200</u>	<u>23,200</u>	<u>3,600</u>	-
other income	<u>4,014,900</u>	<u>9,168,700</u>	<u>1,480,700</u>	<u>4,391,600</u>
Expenses:				
Impairment in value of aircraft	<u>\$4,204,400</u>	<u>16,381,500</u>	<u>2,264,000</u>	<u>9,726,600</u>
Interest	<u>1,916,600</u>	<u>10,472,500</u>	<u>1,900</u>	<u>4,459,500</u>
Professional fees, general and administrative and other	<u>1,714,900</u>	<u>2,998,500</u>	<u>119,600</u>	<u>2,148,200</u>
Depreciation	<u>1,165,800</u>	<u>4,172,800</u>	<u>466,600</u>	<u>2,002,400</u>
Bad debt expense	<u>1,147,000</u>	<u>1,170,000</u>	<u>326,000</u>	-
Salaries and employee benefits	<u>993,100</u>	<u>1,034,700</u>	<u>486,700</u>	<u>517,700</u>
Reorganization costs	<u>952,800</u>	-	<u>952,800</u>	-
Insurance	<u>464,100</u>	<u>411,400</u>	<u>216,300</u>	<u>224,600</u>
PPP Loan forgiveness	(<u>279,200</u>)	-	(<u>279,200</u>)	-
Maintenance	<u>239,500</u>	<u>168,400</u>	<u>94,500</u>	<u>88,200</u>
Other taxes	<u>51,100</u>	<u>51,100</u>	<u>25,600</u>	<u>25,600</u>
loss from operating	<u>12,570,100</u>	<u>36,860,900</u>	<u>4,674,800</u>	<u>19,192,800</u>
Loss before income tax provision/(benefit)	(<u>8,555,200</u>)	(<u>27,692,200</u>)	(<u>3,194,100</u>)	(<u>14,801,200</u>)
Income tax provision/(benefit)	(<u>52,900</u>)	(<u>3,996,100</u>)	(<u>3,700</u>)	(<u>1,283,500</u>)
Net loss	(<u>\$8,608,100</u>)	(<u>\$23,696,100</u>)	(<u>\$3,197,800</u>)	(<u>\$13,517,700</u>)
Loss per share:				
Basic	(<u>\$5.57</u>)	(<u>\$15.33</u>)	(<u>\$2.07</u>)	(<u>\$8.74</u>)
Diluted	(<u>\$5.57</u>)	(<u>\$15.33</u>)	(<u>\$2.07</u>)	(<u>\$8.74</u>)
Weighted average shares used in loss per share computations:				
Basic	<u>1,545,884</u>	<u>1,545,884</u>	<u>1,545,884</u>	<u>1,545,884</u>
Diluted	<u>1,545,884</u>	<u>1,545,884</u>	<u>1,545,884</u>	<u>1,545,884</u>

The accompanying notes are an integral part of these condensed consolidated financial statements.

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AeroCentury Corp.
(Debtor-In-Possession)
Condensed Consolidated Statements of Comprehensive Loss
(Unaudited)

	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
	2021	2020	2021	2020
Net loss	(<u>\$8,608,100</u>)	(<u>\$23,696,100</u>)	(<u>\$3,197,800</u>)	(<u>\$13,517,700</u>)
Other comprehensive income/(loss):				

Unrealized losses on derivative instruments	-	575,000	(-	-
Reclassification of net unrealized losses on derivative instruments to interest expense	2,600	1,557,200	-	-	238,900
Tax expense related to items of other comprehensive loss	600	211,000	(-	51,300
Other comprehensive income	2,000	771,200	-	-	187,600
Total comprehensive loss	\$8,606,100	\$22,924,900	(\$3,197,800	\$13,330,100

The accompanying notes are an integral part of these condensed consolidated financial statements.

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AeroCentury Corp.
(Debtor-In-Possession)
Condensed Consolidated Statements of Stockholders' Equity/(Deficit)
For the Three Months and Six Months Ended June 30, 2020 and June 30, 2021
(Unaudited)

	Number of Common Stock Shares Outstanding	Common Stock	Paid-in Capital	Retained Earnings/ (Deficit)	Treasury Stock	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2019	1,545,884	\$ 1,800	\$ 16,782,800	\$ 10,882,100	\$ 3,037,300	\$ 1,370,800	\$ 23,258,600
Net loss	-	-	-	10,178,400	-	-	10,178,400
Accumulated other comprehensive income	-	-	-	-	-	583,700	583,700
Balance, March 31, 2020	1,545,884	1,800	16,782,800	703,700	3,037,300	787,100	13,663,900
Net loss	-	-	-	13,517,700	-	-	13,517,700
Accumulated other comprehensive income	-	-	-	-	-	187,600	187,600
Balance, June 30, 2020	1,545,884	\$ 1,800	\$ 16,782,800	\$ 12,814,000	\$ 3,037,300	\$ 599,500	\$ 333,800
Balance, December 31, 2020	1,545,884	\$ 1,800	\$ 16,782,800	\$ 31,361,600	\$ 3,037,300	\$ 2,000	\$ 17,616,300
Net loss	-	-	-	5,410,300	-	-	5,410,300
Accumulated other comprehensive income	-	-	-	-	-	2,000	2,000
Balance, March 31, 2021	1,545,884	1,800	16,782,800	36,771,900	3,037,300	\$ -	\$ 23,024,600
Net loss	-	-	-	3,197,800	-	-	3,197,800
Balance, June 30, 2021	1,545,884	\$ 1,800	\$ 16,782,800	\$ 39,969,700	\$ 3,037,300	\$ -	\$ 26,222,400

The accompanying notes are an integral part of these condensed consolidated financial statements.

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	AeroCentury Corp. (Debtor-In-Possession) Condensed Consolidated Statements of Cash Flows (Unaudited)	
	For the Six Months Ended June 30,	
	2021	2020
Net cash provided by/(used in) operating activities	\$ 561,300	\$ 1,104,600
Investing activity-		
Proceeds from sale of aircraft and Part-out Assets held for sale, net of re-sale fees	11,796,100	3,167,500
Net cash provided by investing activity	11,796,100	3,167,500
Financing activities:		
Repayment of notes payable – MUFG Credit Facility and Drake Indebtedness	(14,210,700)	(1,165,000)
Repayment of notes payable – Nord Loans	(703,100)	(1,334,700)
Issuance of notes payable – PPP Loan	170,000	276,400
Debt issuance costs	(5,200)	(1,707,000)
Net cash used in financing activities	(14,749,000)	(3,930,300)
Net decrease in cash, cash equivalents and restricted cash	(2,391,600)	(1,867,400)
Cash, cash equivalents and restricted cash, beginning of period	5,100,900	3,427,100
Cash, cash equivalents and restricted cash, end of period	\$ 2,709,300	\$ 1,559,700

The components of cash and cash equivalents and restricted cash at the end of each of the periods presented consisted of:

	June 30,	
	2021	2020
Cash and cash equivalents	\$ 2,709,300	\$ 1,531,300
Restricted cash	-	28,400
Total cash, cash equivalents and restricted cash shown in the statement of cash flows	\$ 2,709,300	\$ 1,559,700

During the six months ended June 30, 2021 and 2020, the Company paid interest totaling \$186,500 and \$2,792,200, respectively. During the six months ended June 30, 2021, the Company paid income taxes totaling \$4,000 and received a Federal tax refund of \$23,100. During the six months ended June 30, 2020, the Company paid income taxes totaling \$222,900.

The accompanying notes are an integral part of these condensed consolidated financial statements.

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June 30, 2021

1. Organization and Summary of Significant Accounting Policies

(a) The Company and Basis of Presentation

AeroCentury Corp. (“AeroCentury”) is a Delaware corporation incorporated in 1997. AeroCentury together with its consolidated subsidiaries is referred to as the “Company.”

In August 2016, AeroCentury 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 third-party financing (“UK LLC SPE Financing” or “special-purpose financing”) separate from AeroCentury’s credit facility (the “MUFG Credit Facility”). The UK LLC SPE Financing was repaid in full in February 2019 as part of a refinancing involving new non-recourse term loans totaling approximately \$44.3 million (“Nord Loans”) made to ACY 19002, ACY 19003, and two other newly formed special-purpose subsidiaries of AeroCentury, ACY SN 15129 LLC (“ACY 15129”) and ACY E-175 LLC (“ACY E-175”), which were formed for the purpose of refinancing four of the Company’s aircraft using the Nord Loans. See Note 4(b) for more information about the Nord Loans. As discussed in Note 3(a), the Company sold its membership interest in ACY E-175 in March 2021.

Financial information for AeroCentury and its consolidated subsidiaries 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 8 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 and six-month periods ended June 30, 2021 are not necessarily indicative of the results that may be expected for the year ending December 31, 2021 or for any other period. All intercompany balances and transactions have been eliminated in consolidation.

As discussed below, on March 29, 2021 (the “Petition Date”), AeroCentury and certain of its subsidiaries in the U.S. (collectively, the “Debtors” and the “Debtors-in-Possession”) filed voluntary petitions for relief (collectively, the “Petitions”) under Chapter 11 of Title 11 (“Chapter 11”) of the U.S. Bankruptcy Code (the “Bankruptcy Code”) in the U.S. Bankruptcy Court for the District of Delaware (the “Bankruptcy Court”). The Chapter 11 cases (the “Chapter 11 Case”) are being jointly administered under the caption *In re: AeroCentury Corp., et al., Case No. 21-10636*.

Effective on the Petition Date, the Company applied accounting standards applicable to reorganizations, Accounting Standards Codification 852 – *Reorganizations*, in preparing the accompanying condensed consolidated financial statements, which requires the financial statements, for periods subsequent to the commencement of the Chapter 11 Cases, to distinguish transactions and events that are directly associated with the reorganization from the ongoing operations of the business. Accordingly, obligations of the Debtors incurred prior to the Petition Date (“Pre-petition”) that may be impacted by the Chapter 11 Cases have been classified as liabilities subject to compromise in the accompanying unaudited condensed consolidated balance sheet as of June 30, 2021. These liabilities are reported at the amounts the Company anticipates will be allowed by the Bankruptcy Court, even if they may be settled for lesser amounts. See Note 8, “Liabilities Subject to Compromise,” for additional information.

(b) Company Indebtedness

As discussed in Note 4, on October 30, 2020, the lenders (“MUFG Lenders”) under the Company’s previous term loan facility (the “MUFG Loan”) sold the MUFG Loan and the \$3.1 million obligation of the Company from termination of the two swaps (the “MUFG Swaps”) related to the MUFG Loan to Drake Asset Management Jersey Limited (“Drake”), and the Company and Drake entered into an amendment of the loan (as amended, the “Drake Loan Agreement”) under which, among other things, the cash component of interest due for March 2020 and thereafter for the term of the loan was capitalized.

The Drake Loan Agreement had a stated maturity date of March 31, 2021 and is secured by a lien on substantially all of the Company’s assets but the collection of debt under, and the exercise of rights or remedies pursuant to, the Drake Loan Agreement were stayed due to the Company’s Chapter 11 filing, as discussed below in Note 1(e), “Automatic Stay.”

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(c) Voluntary Petitions for Bankruptcy

In connection with the impending maturity of the Company’s indebtedness owed to Drake (“Drake Indebtedness”) and the continuing economic

impact from COVID-19, on March 29, 2021, the Debtors filed the Petitions under Chapter 11 in the Bankruptcy Court. The Chapter 11 Cases are being jointly administered under the caption *In re: AeroCentury Corp., et al., Case No. 21-10636*.

The Bankruptcy Court approved motions filed by the Debtors that were designed primarily to mitigate the impact of the Chapter 11 Cases on the Company's operations, customers and employees. Pursuant to orders entered by the Bankruptcy Court, the Debtors are authorized to conduct their business activities in the ordinary course, and among other things and subject to the terms and conditions of such orders: (i) pay employees' wages and related obligations; (ii) pay certain taxes; (iii) continue to maintain certain customer programs; (iv) maintain their insurance program; (v) use cash collateral on an interim basis; and (vi) continue their cash management system.

On April 22, 2021, the Bankruptcy Court entered an order authorizing and approving the funding of the Company's Chapter 11 Cases on a final basis. This final order authorizes the Company's continued access to funding for its business operations and restructuring process, to the extent that such funding is available. On the same date, the Bankruptcy Court entered an order authorizing and approving marketing and sale procedures with respect to the sale of some or all of the Company's assets. The Company's court-supervised sale process required any bids for its assets to be submitted by 5:00 p.m. on May 17, 2021. No third-party qualified bids were received for the Company's assets in the Court-approved marketing and sale process, so the proposed auction for assets was not conducted, and the sale of the Drake Collateral to Drake under the terms of an Asset Purchase Agreement ("Stalking Horse Agreement") with Drake was approved by the Bankruptcy Court and is pending. The Company, with Drake's consent, has sold certain assets that are not collateral for the Drake Indebtedness, including one aircraft that was collateral for a sales-type finance lease and certain aircraft parts that were subject to a consignment arrangement. Pursuant to the Bankruptcy Court's cash collateral order, the Company retained the proceeds for its operating expenses.

On August 9, 2021, the Company identified Mr. Yucheng Hu ("Lead Investor") as the lead investor for a group ("Plan Sponsor Group") of individual investors with whom the Company is negotiating definitive equity investment agreements ("Plan Sponsor Agreements") in connection with the recapitalization of the Company. On August 16, 2021, the Company filed the form of the Plan Sponsor Agreement and related documents and a hearing is scheduled for August 31, 2021, where the court will hear the motion to approve the Plan Sponsor Agreements. If the Plan Sponsor Agreement is approved by the court, it is anticipated the equity investment provided for in the Plan Sponsor Agreement will close before the end of September. A summary of the Plan Sponsor Agreement is set forth below in Note 13(b) to the Company's financial statement contained herein. The full text of the forms of Plan Sponsor Agreements and related documents were made public by the Company in its Report on Form 8-K filed with the Securities and Exchange Commission on August 17, 2021, available on the SEC's EDGAR system at:

<https://www.sec.gov/Archives/edgar/data/0001036848/000165495421009126/a8kPSAfiled.htm>

(d) Debtors-In-Possession

The Debtors are currently operating as debtors-in-possession under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code and orders of the Bankruptcy Court. In general, as debtors-in-possession under the Bankruptcy Code, the Debtors are authorized to continue to operate as an ongoing business but may not engage in transactions outside the ordinary course of business without the prior approval of the Bankruptcy Court.

(e) Automatic Stay

Subject to certain specific exceptions under the Bankruptcy Code, the Petitions automatically stayed most judicial or administrative actions against the Debtors and efforts by creditors to collect on or otherwise exercise rights or remedies with respect to Pre-petition obligations of the Debtors. Absent an order from the Bankruptcy Court, substantially all of the Debtors' Pre-petition liabilities are subject to settlement under the Bankruptcy Code.

(f) Borrowing Capacity and Availability

At June 30, 2021, the Company had no borrowing capacity or availability under the Drake Loan Agreement. The filing of the Chapter 11 Cases constituted a default, termination events and/or amortization event with respect to the Drake Indebtedness. As discussed in Note 3(a), in March 2021, the Company sold its ownership interest in ACY E-175 to Drake, and Drake assumed ACY E-175's indebtedness under its Nord Loan.

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(g) Going Concern

▶ At June 30, 2021, the Company had total book assets of approximately \$58.7 million and total liabilities of \$84.9 million, resulting in a negative book equity of \$26.2 million. The largest portion, \$80.1 million, of the Company's debt is owed to Drake Asset Management Jersey Limited ◀

("Drake") and was payable with accrued interest on March 31, 2021.

The Company did not have the resources to meet its obligations to repay the Drake debt when due on March 31, 2021, which is a principal reason for its decision to file for protection under Chapter 11 of the Bankruptcy Code. The Company anticipates that it will receive the additional funding to continue its operations through the closing of the equity investment provided for under the Plan Sponsor Agreement. Although the Company has agreed to the terms of a Plan Sponsor Agreement and anticipates a closing of the recapitalization pursuant to the Plan Sponsor Agreement, the exit plan and the Plan Sponsor Agreement must be approved by the Bankruptcy Court, and there are several conditions precedent to be satisfied for consummation of the equity investment by the Plan Sponsor. Thus, there is still substantial doubt about the Company's ability to continue as a going concern. The Company has suffered recurring losses from operations, is in default of its debt obligations under the Drake Indebtedness, and has a net capital deficiency. The Company's poor financial position, including its poor short-term liquidity given the maturity of the Drake Indebtedness, the amount of liability under the Drake Indebtedness in relation to the fair value of the Company's assets and the uncertainty of generating sufficient funds over the year after publication of its financial statements to continue operations have led the Company to conclude that there is substantial doubt about its ability to continue as a going concern.

The accompanying condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern and contemplate the realization of assets and the satisfaction of liabilities in the normal course of business. The Company's ability to continue as a going concern is contingent upon its ability to successfully implement a plan of reorganization, among other factors, and the realization of assets and the satisfaction of liabilities are subject to uncertainty. Further, any plan of reorganization could materially change the amounts of assets and liabilities reported in the accompanying condensed consolidated financial statements. The condensed consolidated financial statements presented in this Quarterly Report on Form 10-Q have been prepared on a going concern basis and do not include any adjustments that might arise as a result of uncertainties about the Company's ability to continue as a going concern or as a consequence of its Chapter 11 filing.

(h) Impact of COVID-19

In March 2020, the World Health Organization ("WHO") declared the novel strain of coronavirus ("COVID-19") a pandemic, and COVID-19 has continued to have wide-ranging impacts as the virus spreads globally (the "COVID-19 Pandemic"). The ongoing COVID-19 Pandemic has had an overwhelming effect on all forms of transportation globally, but most acutely for the airline industry. The combined effect of fear of infection during air travel and international and domestic travel restrictions has caused a dramatic decrease in passenger loads in all areas of the world, not just in those countries with active clusters of COVID-19, but in airline ticket net bookings (i.e. bookings made less bookings canceled) of flights as well. This has led to significant cash flow issues for airlines, including some of the Company's customers. The Company provided one of its customers, which leases two regional turboprop aircraft, lease payment reductions totaling approximately \$0.3 million in the second and fourth quarters of 2020 as well as \$0.4 million in the first quarter of 2021 and the customer paid the reduced amounts.

In addition, two other customers, each of which leases an aircraft subject to a sales-type lease, failed to make scheduled lease payments totaling approximately \$1.0 million in 2020. The Company sold one of the aircraft to the customer during the second quarter of 2021. The Company has agreed to sell the second aircraft to the customer that leases it and expects the sale to occur in the fourth quarter of 2021. As discussed in Note 2, the Company recorded bad debt allowances of \$821,000 and \$326,000 in the first and second quarters of 2021, respectively, related to the two sales-type finance leases.

The impact of the COVID-19 Pandemic has also led the Company to determine that there is uncertainty related to rent, interest and debt payments such that, as disclosed in Notes 4 and 5, the Company de-designated its interest rate swaps as hedges in March 2020 since the payments related to the swaps were deemed not probable to occur. Additionally, in December 2020, the Company determined that it was probable that certain future cash flows under its interest rate swaps would not occur, and the Company consequently reclassified accumulated other comprehensive income ("AOCI") associated with such cash flows into interest expense. As discussed in Note 5, one of the Company's interest rate swaps was terminated in March 2020, two swaps had maturities in the fourth quarter of 2020 and were terminated when the associated assets were sold and the related debt was paid off and three swaps had maturities in 2025, but were sold in March 2021 as part of the Company's sale of its membership interest in ACY E-175. As a result, the Company is no longer party to any interest rate swaps.

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(i) 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 condensed 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 current value of the Company's assets held for sale, 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, the assumptions used to value the Company's derivative instruments, the valuation of the right of use asset and related lease liability associated with the Company's office, and the amounts recorded as allowances for doubtful accounts.

(j) Comprehensive Income/(Loss)

▶ The Company accounts for former interest rate cash flow hedges by reclassifying accumulated other comprehensive income into earnings in the periods in which the expected transactions occur or when it is probable that the hedged transactions will no longer occur, and are included in interest expense.

(k) Finance Leases

▶ As of June 30, 2021, the Company had one sales-type lease secured by an aircraft. The lease contains a lessee bargain purchase option at a price substantially below the subject asset's estimated residual value at the exercise date for the option. Consequently, the Company classified the lease as a finance lease for financial accounting purposes. For such finance lease, 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. During the second quarter of 2021, the Company recorded a bad debt allowance of \$326,000 related to the sales-type finance lease as a result of its July 2021 agreement to sell the aircraft to the customer.

(l) Taxes

▶ As part of the process of preparing the Company's condensed consolidated financial statements, management estimates income taxes in each of the jurisdictions in which the Company operates. This process involves estimating the Company's current tax exposure under the most recent tax laws and assessing temporary differences resulting from differing treatment of items for tax and GAAP purposes. These differences result in deferred tax assets and liabilities, which are included in the balance sheet. In assessing the valuation of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income or availability to carryback the losses to taxable income during periods in which those temporary differences become deductible. The Company considered several factors when analyzing the need for a valuation allowance including the Company's current three-year cumulative loss through December 31, 2020, the impacts of the COVID-19 Pandemic on the worldwide airline industry and the Company's recent filing for protection under Chapter 11 of the Bankruptcy Code. Significant management judgment is required in determining the Company's future taxable income for purposes of assessing the Company's ability to realize any benefit from its deferred taxes. Based on its analysis, the Company has concluded that a valuation allowance is necessary for its U.S. deferred tax assets not supported by either future taxable income or availability of future reversals of existing taxable temporary differences and has recorded a valuation allowance of \$575,000 and \$1,701,100 for the three months and six months ended June 30, 2021, respectively. Additionally, the Company has concluded that based on its analysis, some of its foreign net operating loss carrybacks are not expected to be realized based on limitations on the utilization of its foreign net operating losses, and therefore recorded a foreign tax expense of \$0 and \$54,300 for the reduced tax refund for the three months and six months ended June 30, 2021, respectively.

The Company accrues non-income-based sales, use, value added and franchise taxes as other tax expense in the condensed consolidated statement of operations.

(m) Revenue Recognition, Accounts Receivable and Allowance for Doubtful Accounts

▶ Revenue from leasing of aircraft assets pursuant to operating leases is recognized on a straight-line basis over the terms of the applicable lease agreements. Deferred payments are recorded as accrued rent when the cash rent received is lower than the straight-line revenue recognized. Such receivables decrease over the term of the applicable leases. Interest income is recognized on finance leases based on the interest rate implicit in the lease and the outstanding balance of the lease receivable.

In instances where collectability is not reasonably assured, the Company recognizes revenue as cash payments are received. The Company estimates and charges to income a provision for bad debts based on its experience with each specific customer, the amount and length of payment arrearages, and its analysis of the lessee’s overall financial condition. If the financial condition of any of the Company’s customers deteriorates, it could result in actual losses exceeding any estimated allowances.

The Company had an allowance for doubtful accounts of \$1,190,000 and \$1,503,000 at June 30, 2021 and December 31, 2020, respectively.

(n) Interest Rate Hedging

▶ During the first quarter of 2019, the Company entered into certain derivative instruments to mitigate its exposure to variable interest rates under the Nord Loan debt and a portion of the MUFG Indebtedness. Hedge accounting is applied to such a transaction only if specific criteria have been met, the transaction is deemed to be “highly effective” and the transaction has been designated as a hedge at its inception. Under hedge accounting treatment, generally, the effects of derivative transactions are recorded in earnings for the period in which the hedge transaction affects earnings. A change in value of a hedging instrument is reported as a component of other comprehensive income/(loss) and is reclassified into earnings in the period in which the transaction being hedged affects earnings.

If at any time after designation of a cash flow hedge, such as those entered into by the Company, it is no longer probable that the forecasted cash flows will occur, hedge accounting is no longer permitted and a hedge is “de-designated.” After de-designation, if it is still considered reasonably possible that the forecasted cash flows will occur, the amount previously recognized in other comprehensive income/(loss) will continue to be reversed as the forecasted transactions affect earnings. However, if after de-designation it is probable that the forecasted transactions will not occur, amounts deferred in accumulated other comprehensive income/(loss) will be recognized in earnings immediately.

As noted in Note 5, in October 2019 the Company became aware that, as a result of certain defaults under its MUFG Credit Facility, certain of the forecasted transactions related to its MUFG Credit Facility interest rate swaps were no longer probable of occurring and, hence, those swaps were de-designated from hedge accounting at that time. The two swaps related to the MUFG Credit Facility were terminated in March 2020 and the Company incurred a \$3.1 million obligation in connection with such termination, payment of which was due no later than the March 31, 2021 maturity of the Drake Indebtedness. As a result of the forecasted transaction being not probable to occur, accumulated other comprehensive loss of \$1,167,700 related to the MUFG Swaps was recognized as interest expense in the first quarter of 2020.

In March 2020, the Company determined that the future hedged interest payments related to its five remaining Nord Loan interest rate hedges (the “Nord Swaps”) were no longer probable of occurring, and consequently de-designated all five swaps from hedge accounting. Additionally, in December 2020, the Company determined that the interest cash flows that were associated with its three remaining swaps were probable of not occurring after February 2021.

(o) Out-Of-Period Adjustment

During the three months ended June 30, 2021, the Company recorded an immaterial out-of-period adjustment related to a lease modification to correct an overstatement of operating lease revenues and understatement of unearned revenues of \$318,300 for the three months and as of March 31, 2021. The out-of-period adjustment resulted in a \$318,300 reduction of operating lease revenues for the three months ended June 30, 2021. There was no impact on the six months ended June 30, 2021.

(p) Recent Accounting Pronouncements

▶ ASU 2016-13 ◀

The FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326)*, in June 2016 (“ASU 2016-13”). ASU 2016-13 provides that financial assets measured at amortized cost are to be presented as a net amount, reflecting a reduction for a valuation allowance to present the amount expected to be collected (the “current expected credit loss” model of reporting). As such, expected credit losses will be reflected in the carrying value of assets and losses will be recognized before they become probable, as is required under the Company’s present accounting practice. In the case of assets held as available for sale, the amount of the valuation allowance will be limited to an amount that reflects the marketable value of the debt instrument. This amendment to GAAP is effective in the first quarter of 2023 for calendar-year SEC filers that are smaller reporting companies as of the one-time determination date. Early adoption is permitted beginning in 2019. The Company plans to adopt the new guidance on January 1, 2023, and has not determined the impact of this adoption on its consolidated financial statements.

In December 2019, the FASB issued ASU 2019-12, *Income Taxes (Topic 740)*, to simplify the accounting for income taxes. The new guidance removes certain exceptions for recognizing deferred taxes for investments, performing intra-period allocation and calculating income taxes in interim periods. It also adds guidance to reduce complexity in certain areas, including recognizing deferred taxes for tax goodwill and allocating taxes to members of a consolidated group. This guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. The Company’s adoption of ASU 2019-12 did not have a material impact on its consolidated financial statements.

FASB Staff Guidance on Effects of COVID-19

In April 2020, the FASB staff provided some relief from the unprecedented effect of the COVID-19 Pandemic. Under this guidance, lessors may elect to treat lease concessions due to COVID-19 as if they arose from enforceable rights and obligations that existed in the lease contract, with the consequent effect that the concessions would not be treated as a lease modification which could require reclassification and remeasurement of the lease and to either recognize income during the deferral period or to treat deferred rent as variable rent during the period. Other guidance released in April 2020 provided that when hedge accounting is discontinued and it is probable that the forecasted transaction that had been hedged will occur beyond two months after its originally expected date as a result of the effects of COVID-19, the reporting entity may still defer recognizing related AOCI immediately and should defer recognition of such amounts until the forecasted transactions actually occur. The Company has elected to treat certain lease concessions to lessees as if they arose from rights initially in the lease contracts and so did not give rise to modifications of the leases, and to treat deferrals as variable rent during the period of the deferral, reducing income during such period.

2. Aircraft Lease Assets

The Company’s leases are normally “triple net leases” under which the lessee is obligated to bear all costs, including tax, maintenance and insurance, on the leased assets during the term of the lease. In most cases, the lessee is obligated to provide a security deposit or letter of credit to secure its performance obligations under the lease, and in some cases, is required to pay maintenance reserves based on utilization of the aircraft, which reserves are available for qualified maintenance costs during the lease term and may or may not be refundable at the end of the lease. Typically, the leases also contain minimum return conditions, as well as an economic adjustment payable by the lessee (and in some instances by the lessor) for amounts by which the various aircraft or engine components are worse or better than a targeted condition set forth in the lease. Some leases contain renewal or purchase options, although the Company’s sales-type leases contain a bargain purchase option at lease end which the Company expects the lessees to exercise or require that the lessee purchase the aircraft at lease-end for a specified price.

Because all of the Company’s leases transfer use and possession of the asset to the lessee and contain no other substantial undertakings by the Company, the Company has concluded that all of its lease contracts qualify for lease accounting. Certain lessee payments of what would otherwise be lessor costs (such as insurance and property taxes) are excluded from both revenue and expense.

The Company evaluates the expected return on its leased assets by considering both the rents receivable over the lease term, any expected additional consideration at lease end, and the residual value of the asset at the end of the lease. In some cases, the Company depreciates the asset to the expected residual value because it expects to sell the asset at lease end; in other cases, it may expect to re-lease the asset to the same or another lessee and the depreciation term and related residual value will differ from the initial lease term and initial residual value. Residual value is estimated by considering future estimates provided by independent appraisers, although it may be adjusted by the Company based on expected return conditions or location, specific lessee considerations, or other market information.

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Three of the Company’s operating lease assets are subject to manufacturer residual value guarantees totaling approximately \$13.7 million at the end of their lease terms in the second quarter of 2027. The Company considers the best market for re-leasing and/or selling its assets at the end of its leases, although it does not expect to retain ownership of the assets under sales-type leases given the lessees’ bargain purchase options or required purchase.

(a) Assets Held for Lease

During the second quarter of 2021, with the exception of one aircraft that is collateral for a sales-type lease receivable, the Company reclassified all of its aircraft to held for sale as a result of a sale order ("Sale Order") approved by the Bankruptcy Court. At December 31, 2020, the Company’s aircraft held for lease consisted of the following:

Type	Number owned	% of net book value
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Regional jet aircraft	4	67	%
Turboprop aircraft	2	33	%

Type	Cost	Accumulated depreciation	Impairment losses	Net
Aircraft under operating leases	<u>\$74,397,700</u>	<u>(\$21,001,300)</u>	<u>(\$7,633,300)</u>	<u>\$45,763,100</u>

(b) Sales-Type and Finance Leases

The Company had two sales-type leases, which were substantially modified in January 2020 to reduce the amount of monthly payments and purchase option amounts due under the leases. Although the modifications would ordinarily have given rise to income or loss resulting from the changed term of the agreements, the lessee's poor compliance with the lease terms led the Company to value the sales-type leases at the fair value of the collateral and, as such, the modifications did not give rise to any effect on income other than that related to the collateral value of the financed aircraft. As a result of payment delinquencies by the two customers, the Company recorded bad debt allowances of \$1,170,000 and \$333,000 during the first and second quarters of 2020, respectively. During the first quarter of 2021, the Company recorded a bad debt allowance of \$821,000 related to one of the two sales-type finance leases as a result of its May 2021 agreement to sell the aircraft to the customer, which occurred in May 2021. During the second quarter of 2021, the Company recorded a bad debt allowance of \$326,000 related to the second sales-type finance lease as a result of its July 2021 agreement to sell the aircraft to the customer. The Company expects this sale to occur in the fourth quarter of 2021. The lease remains treated as a sales-type lease.

At June 30, 2021 and December 31, 2020, the net investment included in sales-type leases and direct financing leases receivable were as follows:

	June 30, 2021	December 31, 2020
Gross minimum lease payments receivable	<u>\$1,900,000</u>	<u>\$4,138,000</u>
Less unearned interest	<u>10,000</u> ()	<u>88,000</u> ()
Allowance for doubtful accounts	<u>1,190,000</u> ()	<u>1,503,000</u> ()
Difference between minimum lease payments receivable and collateral value of leases	-	-
Finance leases receivable	<u>\$700,000</u>	<u>\$2,547,000</u>

As of June 30, 2021, minimum future payments receivable under the remaining finance lease was as follows:

Years ending December 31

2021	<u>\$1,100,000</u>
2022	<u>600,000</u>
2023	<u>200,000</u>
	<u>\$1,900,000</u>

The remaining weighted average lease term of the Company's assets under sales-type and finance leases was 18 months and 25 months at June 30, 2021 and December 31, 2020, respectively.

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The following is a roll forward of the Company's finance lease receivable allowance for doubtful accounts from December 31, 2020 to June 30, 2021:

Balance, December 31, 2020	<u>\$1,503,000</u>
Additions charged to expense	<u>1,147,000</u>
Deductions upon sale of aircraft	<u>()</u>

	1,460,000)
Balance, June 30, 2021	<u>\$1,190,000</u>

3. Assets and Liabilities Held for Sale

The Company’s assets and liabilities classified as held for sale are required to be recorded at the lower of the carrying value or fair value less cost to sell. During the second quarter of 2021, with the exception of one aircraft that is collateral for a sales-type lease receivable, the Company reclassified all of its aircraft to held for sale as a result of the Sale Order approved by the Bankruptcy Court.

In May 2021, the Company agreed to sell most of the remaining inventory of two aircraft that were being sold in parts (“Part-out Assets”) for \$290,000, and recorded an impairment loss of \$1,940,400 in the first quarter of 2021. During the second quarter of 2021, the Company received \$345,400 in cash related to the Part-out Assets. This amount was accounted for as follows: \$44,300 reduced accounts receivable for parts sales accrued in the first quarter of 2021; \$294,300 reduced the carrying value of the parts; and \$6,800 was recorded as gains in excess of the carrying value of the parts. During the second quarter of 2020, the Company received \$112,000 in cash and accrued \$30,100 in receivables for parts sales. These amounts were accounted for as follows: \$77,300 reduced accounts receivable for parts sales accrued in the first quarter of 2020; \$43,700 reduced the carrying value of the parts; and \$21,100 was recorded as gains in excess of the carrying value of the parts.

The table below sets for the assets and liabilities that were classified as held for sale at June 30, 2021 and December 31, 2020:

	June 30, 2021	December 31, 2020
Cash and cash equivalents	\$-	\$345,900
Restricted cash	-	2,346,300
Aircraft and Part-out Assets	53,409,400	38,146,700
Notes payable and accrued interest, net of unamortized debt issuance costs of \$313,400	-	(13,836,900)
Derivative liability	-	(767,900)
Maintenance reserves	2,028,000	(-)
Security deposits	466,000	(-)
Unearned revenue	966,400	(-)

As of June 30, 2021, minimum future lease revenue payments receivable under non-cancelable operating leases were as follows:

Years ending December 31

2021 (six months)	\$3,858,100
2022	7,368,300
2023	7,368,300
2024	5,892,000
2025	2,992,200
Thereafter	2,886,000
	<u>\$30,364,900</u>

The remaining weighted average lease term of the Company’s assets under operating leases was 40 months and 29 months at June 30, 2021 and December 31, 2020, respectively.

4. Notes Payable and Accrued Interest

At June 30, 2021 and December 31, 2020, the Company’s notes payable and accrued interest consisted of the following. The Drake Indebtedness and PPP Loan (discussed in Note 4(c)) are included in liabilities subject to compromise at June 30, 2021 in the accompanying condensed consolidated balance sheet.

	June 30, 2021	December 31, 2020
Drake Indebtedness, subject to compromise at June 30, 2021:		
Principal	\$79,936,800	\$88,557,000
Unamortized debt issuance costs	-	(780,900)
Accrued interest	124,100	739,000
PPP Loan, subject to compromise at June 30, 2021:		
Principal	170,000	276,400
Accrued interest	600	1,700
	<u>\$80,231,500</u>	<u>\$88,793,200</u>
Nord Loans held for sale:		
Principal	\$-	\$14,091,300
Unamortized debt issuance costs	-	(313,400)
Accrued interest	-	59,000
	<u>\$-</u>	<u>\$13,836,900</u>

(a) Drake Indebtedness

On October 30, 2020, the MUFG Lenders under the Company’s MUFG Loan sold the MUFG Loan and the \$3.1 million obligation of the Company from termination of the MUFG Swaps to Drake, and the Company and Drake entered into the Drake Loan Agreement under which, among other things, the cash component of interest due for March 2020 and thereafter for the term of the loan will be capitalized.

The Drake Indebtedness is secured by a first priority lien held by Drake, which lien is documented in an amended and restated mortgage and security agreement assigned to Drake, on all of the Company’s assets, including the Company’s entire aircraft portfolio, other than one aircraft leased to a Kenyan lessee and certain Part-out Assets. The Drake Indebtedness had a stated maturity date of March 31, 2021, but collection of debt under, and the exercise of rights or remedies pursuant to, the Drake Loan Agreement were stayed due to the Company’s Chapter 11 filing, as discussed in Note 1(e), “Automatic Stay.” The Company has entered into the Stalking Horse Agreement with Drake for the sale of certain of the aircraft assets securing the Drake Indebtedness (the “Drake Collateral”), which has been approved by the Bankruptcy Court as the best and/or highest offer for the Drake Collateral. The Company is proceeding with transfer of title to the Drake Collateral pursuant to the Stalking Horse Agreement. Upon consummation of such transfers of title to Drake pursuant to the Stalking Horse Agreement, the Company’s obligations to Drake under the Drake Indebtedness will be deemed fully satisfied.

(b) Nord Loans

On February 8, 2019, the Company, through four wholly-owned subsidiary limited liability companies (“LLC Borrowers”), entered into a term loan agreement with NordDeutsche Landesbank Girozentrale, New York Branch (“Nord”) that provided for six separate term loans (“Nord Loans”) with an aggregate principal amount of \$44.3 million. Each of the Nord Loans was secured by a first priority security interest in a specific aircraft (“Nord Loan Collateral Aircraft”) owned by an LLC Borrower, the lease for such aircraft, and a pledge by the Company of its membership interest in each of the LLC Borrowers, pursuant to a Security Agreement among the LLC Borrowers and a security trustee, and certain pledge agreements.

The interest rates payable under the Nord Loans varied by aircraft and were based on a fixed margin above either 30-day or 3-month LIBOR. The maturity of each Nord Loan varied by aircraft, with the first Nord Loan maturing in October 2020 and the last Nord Loan maturing in May 2025. The debt under the Nord Loans was expected to be fully amortized by rental payments received by the LLC Borrowers from the lessees of the Nord Loan Collateral Aircraft during the terms of their respective leases and remarketing proceeds.

The Nord Loans included covenants that imposed various restrictions and obligations on the LLC Borrowers, including covenants that required the LLC Borrowers to obtain Nord consent before they could take certain specified actions, and certain events of default. The Company was in compliance with all covenants under the Nord Loans at December 31, 2020.

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One of the Nord Loan Collateral Aircraft was sold in 2019 and two Nord Loan Collateral Aircraft were sold in 2020. The excess proceeds from the 2020 sales were held as restricted cash by ACY E-175. The restricted cash, the three aircraft held by ACY E-175 and ACY E-175's Nord Loans and derivative liability were classified as held for sale at December 31, 2020. During March 2021, the Company sold its interest in ACY E-175 and was released from any remaining guarantee obligations under the Nord Loan and interest swap obligations of the special-purpose subsidiary.

(c) Paycheck Protection Program Loans

On May 20, 2020, JetFleet Management Corp. (the "PPP Borrower"), an indirect subsidiary of AeroCentury Corp., was granted a loan (the "PPP Loan") from American Express National Bank in the aggregate amount of \$276,353, pursuant to the Paycheck Protection Program (the "PPP") under Division A, Title I of the CARES Act, which was enacted March 27, 2020. The PPP Loan, which was in the form of a Note dated May 18, 2020 issued by the PPP Borrower, was forgiven during the second quarter of 2021 and the Company recorded \$279,200 of loan forgiveness as a negative expense in its condensed consolidated statement of operations.

In February 2021, the Company was granted a second PPP Loan ("Second PPP Loan") (collectively, with the initial PPP Loan, the "PPP Loans") in the aggregate amount of \$170,002. The Second PPP Loan, in the form of a Note dated February 11, 2021, matures on February 11, 2026 and bears interest at a rate of 1.00% per annum, payable in monthly payments commencing 30 days after the Small Business Administration has made its final determination that any part of the loan will not be forgiven.

The applications for the PPP Loans required the Company to certify in good faith that the current economic uncertainty made the loan request necessary to support the ongoing operations of the Company. This certification further required the Company to take into account its current business activity and its ability to access other sources of liquidity sufficient to support ongoing operations in a manner that is not significantly detrimental to the business. The receipt of these funds, and the forgiveness of the loans attendant to these funds, is dependent on the Company having initially qualified for the loans and qualifying for the forgiveness of such loans based on its future adherence to the forgiveness criteria.

The Second PPP Loan may be prepaid by the PPP Borrower at any time prior to maturity with no prepayment penalties. Funds from the PPP Loans may only be used for payroll costs and any payments of certain covered interest, lease and utility payments. The Company intends to use the entire PPP Loans for qualifying expenses. Under the terms of the PPP, certain amounts of the Second PPP Loan may be forgiven if they are used for qualifying expenses as described in the CARES Act. Although the Company expects that all or a significant portion of the Second PPP Loan will be forgiven, no assurance can be provided that the Company will obtain such forgiveness.

▶ 5. Derivative Instruments ◀

In the first quarter of 2019, the Company entered into eight fixed pay/receive variable interest rate swaps. The Company entered into the interest rate swaps in order to reduce its exposure to the risk of increased interest rates.

The Company estimates the fair value of derivative instruments using a discounted cash flow technique and uses creditworthiness inputs that corroborate observable market data evaluating the Company's and counterparties' risk of non-performance. Valuation of the derivative instruments requires certain assumptions for underlying variables and the use of different assumptions would result in a different valuation. Management believes it has applied assumptions consistently during the period.

The Company designated seven of its interest rate swaps as cash flow hedges upon entering into the swaps. Changes in the fair value of the hedged swaps were included in other comprehensive income/(loss), which amounts are reclassified into earnings in the period in which the transaction being hedged affected earnings (i.e., with future settlements of the interest rate swaps). One of the interest rate swaps was not eligible under its terms for hedge treatment and was terminated in 2019 when the associated asset was sold and the related debt was paid off. Changes in fair value of non-hedge derivatives are reflected in earnings in the periods in which they occur.

(a) MUFG Swaps

The two interest rate swaps entered into by AeroCentury (the "MUFG Swaps") were intended to protect against the exposure to interest rate increases on \$50 million of the Company's MUFG Credit Facility debt prior to its sale to Drake during the fourth quarter of 2020. The MUFG Swaps had notional amounts totaling \$50 million and were to extend through the maturity of the MUFG Credit Facility in February 2023. Under the ISDA agreement for these interest rate swaps, defaults under the MUFG Credit Facility gave the swap counterparty the right to terminate the interest rate swaps with any breakage costs being the liability of the Company.

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In October 2019, the Company determined that it was no longer probable that forecasted cash flows for its two interest rate swaps with a nominal value of \$50 million would occur as scheduled as a result of the Company’s defaults under the MUFG Credit Facility. Therefore, those swaps were no longer subject to hedge accounting and changes in fair market value thereafter were recognized in earnings as they occurred. As a result of the forecasted transaction being not probable to occur, accumulated other comprehensive loss of \$1,167,700 related to the MUFG Swaps was recognized as interest expense in the first quarter of 2020. The two swaps related to the MUFG Credit Facility were terminated in March 2020 and the Company incurred a \$3.1 million obligation, recorded as interest expense and derivative termination liability, in connection with such termination, payment of which was due no later than the March 31, 2021 maturity of the Drake Indebtedness.

(b) Nord Swaps

With respect to the interest rate swaps entered into by the LLC Borrowers (“the Nord Swaps”), the swaps were deemed necessary so that the anticipated cash flows of such entities, which arise entirely from the lease rents for the aircraft owned by such entities, would be sufficient to make the required Nord Loan principal and interest payments, thereby preventing default so long as the lessees met their lease rent payment obligations.

The Nord Swaps were entered into by the LLC Borrowers and provided for reduced notional amounts that mirrored the amortization under the Nord Loans entered into by the LLC Borrowers, effectively converting each of the related Nord Loans from a variable to a fixed interest rate, ranging from 5.38% to 6.30%. Each of Nord Swaps extended for the duration of the corresponding Nord Loan. Two of the swaps had maturities in the four quarter of 2020 and were terminated when the associated assets were sold and the related debt was paid off. The other three Nord Swaps had maturities in 2025, but were sold in March 2021 as part of the Company’s sale of its membership interest in ACY E-175.

As discussed in Note 4, in March 2020, the Company determined that the future hedged interest payments related to its Nord Swaps were no longer probable of occurring, as a result of lease payment defaults for the aircraft owned by ACY 19002 and ACY 19003 and conversations with the lessee for the three aircraft owned by ACY E-175 regarding likely rent concessions, and consequently de-designated all five Nord Swaps as hedges because the lease payments that were used to service the Nord Loans associated with the Nord Swaps were no longer probable to occur. As a result of de-designation, future changes in market value were recognized in ordinary income and AOCI was reclassified to ordinary income as the forecasted transactions occurred. In December 2020, the Company determined that the payments after February 2021 for the three remaining Nord Swaps were probable not to occur as a result of the Company’s agreement to sell its interest in ACY E-175 during the first quarter of 2021. Accumulated other comprehensive income of \$2,600 and \$48,100 related to the Nord Swaps was recognized as an expense in the first quarters of 2021 and 2020, respectively.

The Company has reflected the following amounts in its net loss:

	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
	2021	2020	2021	2020
Change in value of undesignated interest rate swaps	\$48,700	\$1,990,400	\$-	\$82,200
Reclassification from other comprehensive income to interest expense	2,600	389,500	-	238,800
Reclassification from other comprehensive income to interest expense – forecasted transaction probable not to occur	-	1,167,700	-	-
Included in interest expense	\$46,100	\$3,547,600	\$-	\$321,000

The following amount was included in other comprehensive income/(loss), before tax:

Loss on derivative instruments deferred into other comprehensive income/(loss)	\$-	\$575,000	\$-	\$-
Reclassification from other comprehensive income to interest expense	2,600	389,500	-	238,800
Reclassification from other comprehensive income to interest expense – forecasted transaction probable not to occur	-	1,167,700	-	-
Change in accumulated other comprehensive income	\$2,600	\$982,200	\$-	\$238,800

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6. Lease Right of Use Asset and Liability

The Company was a lessee under a lease of the office space it occupies in Burlingame, California, which expired in June 2020. The lease also provided for two, successive one-year lease extension options for amounts that were substantially below the market rent for the property. The lease provided for monthly rental payments according to a fixed schedule of increasing rent payments. As a result of the below-market extension options, the Company determined that it was reasonably certain that it would extend the lease and, therefore, included such extended term in its calculation of the right of use asset (“ROU Asset”) and lease liability recognized in connection with the lease.

In addition to a fixed monthly payment schedule, the office lease also included an obligation for the Company to make future variable payments for certain common areas and building operating and lessor costs, which have been and will be recognized as expense in the periods in which they are incurred. As a direct pass-through of applicable expense, such costs were not allocated as a component of the lease.

Effective January 1, 2020, the Company reduced both the size of the office space leased and the amount of rent payable in the future. As such, the Company recognized a reduction in both the capitalized amount related to the surrendered office space and a proportionate amount of the liability associated with its future lease obligations. In January 2020, the Company recorded a loss of \$160,000 related to the reduction in its ROU Asset, net of the reduction in its operating lease liability.

In March 2020, the Company elected not to exercise the extension options for its office lease. The lease liability associated with the office lease was calculated at March 31, 2020 and December 31, 2019 by discounting the fixed, minimum lease payments over the remaining lease term, including the below-market extension periods, at a discount rate of 7.25%, which represents the Company’s estimate of the incremental borrowing rate for a collateralized loan for the type of underlying asset that was the subject of the office lease at the time the lease liability was evaluated. As a result of non-exercise of its extension option, the Company reduced the lease liability to reflect only the three remaining rent payments in the second quarter of 2020.

In July 2020, the lease for the Company’s office lease was extended for one month to July 31, 2020 at a rate of \$10,000. The Company signed a lease for a smaller office suite in the same building effective August 1, 2020. The lease provides for a term of 30 months expiring on January 31, 2023, at a monthly base rate of approximately \$7,400, with no rent due during the first six months. The Company recognized an ROU Asset and lease liability of \$169,800, both of which were non-cash items and are not reflected in the condensed consolidated statement of cash flows. No cash was paid at the inception of the lease, and a discount rate of 3% was used, based on the interest rates available on secured commercial real estate loans available at the time. At June 30, 2021, the weighted average discount rate was 3% and the weighted average remaining lease term was 22 months.

The Company estimates that the maturities of operating lease base rent of its office space were as follows as of June 30, 2021:

	June 30, 2021
2021 (six months)	<u>\$44,300</u>
2022	<u>88,700</u>
2023	<u>7,400</u>
	<u>140,400</u>
Discount	<u>(3,100)</u>
Lease liability	<u>\$137,300</u>

During the quarter ended June 30, 2021, the Company recognized amortization, finance costs and other expense related to the office lease as follows:

Fixed rental expense during the quarter	<u>\$17,800</u>
Variable lease expense	<u>4,500</u>
Total lease expense during the quarter	<u>\$22,300</u>

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7. 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 Company estimates the fair value of derivative instruments using a discounted cash flow technique and has used creditworthiness inputs that corroborate observable market data evaluating the Company’s and counterparties’ risk of non-performance.

The Company had no interest rate swaps as of June 30, 2021 or during the quarter then ended. As of December 31, 2020, the Company measured the fair value of its interest rate swaps of \$14,091,300 (notional amount) based on Level 2 inputs, due to the usage of inputs that can be corroborated by observable market data. The interest rate swaps had a net fair value liability of \$767,900 as of December 31, 2020. In the year ended December 31, 2020, \$1,979,800 was realized through the income statement as an increase in interest expense.

The following table shows, by level within the fair value hierarchy, the Company’s assets and liabilities at fair value on a recurring basis as of June 30, 2021 and December 31, 2020:

	June 30, 2021				December 31, 2020			
	Total	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3
Derivatives	\$-	-	\$-	-	(<u>\$767,900</u>)	\$-	(<u>\$767,900</u>)	\$-
Total	\$-	\$-	\$-	\$-	(<u>\$767,900</u>)	\$-	(<u>\$767,900</u>)	\$-

There were no transfers into or out of Level 3 during the six months ended June 30, 2021 or 2020.

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 these and other assets held for sale, by reference to independent appraisals, quoted market prices (e.g., offers to purchase) and other factors. The independent appraisals utilized the market approach which uses recent sales of comparable assets, making appropriate adjustments to reflect differences between them and the subject property being analyzed. Certain assumptions are used in the management’s estimate of the fair value of aircraft including the adjustments made to comparable assets, identifying market data of similar assets, and estimating cost to sell. These are considered Level 3 within the fair value hierarchy. 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. During the second quarter of 2021, the Company recorded impairment losses totaling \$2,264,000 on five assets held for sale, based on appraised values or expected sales proceeds, which had an aggregate fair value of \$29,333,100. During the second quarter of 2020, the Company recorded impairment losses totaling \$6,706,600 for two of its aircraft held for lease, which were written down to their estimated sales prices, less cost of sale.

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The following table shows, by level within the fair value hierarchy, the Company’s assets at fair value on a nonrecurring basis as of June 30,

2021 and December 31, 2020:

	Assets Written Down to Fair Value								Total Losses	
	June 30, 2021				December 31, 2020				For the Six Months Ended	
	Total	Level			Total	Level			June 30,	
	1	2	3	1	2	3	2021	2020		
Assets held for lease	\$-	\$-	\$-	\$-	\$32,650,000	\$-	\$-	\$32,650,000	\$-	\$6,706,600
Assets held for sale	53,409,400	-	-	53,409,400	38,041,600	-	-	38,041,600	4,204,400	9,674,900
Total	\$53,409,400	\$-	\$-	\$53,409,400	\$70,691,600	\$-	\$-	\$70,691,600	\$4,204,400	\$16,381,500

There were no transfers into or out of Level 3 during the six months ended June 30, 2021 or 2020.

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 the Drake Indebtedness, notes payable under special-purpose financing, its derivative termination liability and its derivative instruments. The fair value of accounts 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 maturity. The fair value of finance lease receivables approximates the carrying value as discussed in Note 1(k). The fair value of the Company’s derivative instruments is discussed in Note 5 and in this note above in “Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis.”

The Drake Indebtedness bears floating rates of interest that reset periodically to a market benchmark rate plus a credit margin. The Company believes the effective interest rate of the Drake Indebtedness approximates current market rates, and therefore that the outstanding principal and accrued interest of \$80,060,900 at June 30, 2021 approximates its fair values on such date. The fair value of the Company’s outstanding balance of its Drake Indebtedness is categorized as a Level 3 input under the GAAP fair value hierarchy. Pursuant to rules related to its bankruptcy filing, the Company reported the liability of the Drake Indebtedness as subject to compromise at the amount expected to be allowed.

The Company believes the effective interest rate under the Nord Loans approximated current market rates for such indebtedness at the dates of the condensed consolidated balance sheets, and therefore that the outstanding principal and accrued interest of \$0 and \$14,150,300 approximate their fair values at June 30, 2021 and December 31, 2020, respectively. Such fair value is categorized as a Level 3 input under the GAAP fair value hierarchy.

As discussed in Note 2(b), as a result of payment delinquencies by the Company’s two customers of aircraft subject to sales-type finance leases, the Company recorded bad debt allowances of \$821,000 and \$326,000 during the first and second quarters of 2021, respectively. The aircraft securing one of the sales-type finance leases was sold to the lessee during the second quarter. The finance lease receivable for the Company’s remaining finance lease is valued at the cash flow from the expected sale during the fourth quarter of 2021.

There were no transfers in or out of assets or liabilities measured at fair value under Level 3 during the three months or nine months ended June 30, 2021 or 2020.

8. Liabilities Subject to Compromise

The accompanying unaudited condensed consolidated balance sheet as of June 30, 2021 includes amounts classified as liabilities subject to compromise, which represents Pre-petition liabilities the Company anticipates will be allowed as claims in the Chapter 11 Cases. These amounts represent the Company’s current estimate of known or potential obligations to be resolved in connection with the Chapter 11 Cases and may differ from actual settlement amounts. The Company will continue to evaluate these liabilities throughout the Chapter 11 process and adjust amounts as necessary. Such adjustments could be material and will be recorded in reorganization items, net in the accompanying unaudited condensed statements of operations.

The following table summarizes liabilities subject to compromise at June 30, 2021:

Accrued maintenance costs	\$46,100
Drake Indebtedness:	
Principal	76,861,500
Accrued interest	124,100
PPP Loan:	
Principal	170,000
Accrued interest	600
Derivative termination liability	3,075,300
	<u>\$80,277,600</u>

9. Reorganization Items, Net

The Debtors have incurred and will continue to incur costs associated with the reorganization, including professional and consulting fees. Charges associated with the Chapter 11 Cases are recorded as reorganization items in the Company's condensed consolidated statements of operations. For the three months ended June 30, 2021, the Company incurred \$952,800 of such expenses, all of which was comprised of professional fees. The Company paid \$453,700 during the three months ended June 30, 2021 and \$499,100 is recorded in accrued liabilities in the accompanying unaudited condensed consolidated balance sheet as of June 30, 2021.

10. Commitments and Contingencies

In the ordinary course of the Company's business, the Company may be 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.

11. Income Taxes

The Company recorded income tax expense of \$3,600 in the second quarter of 2021, or negative 0.11% of pre-tax loss, compared to \$1.3 million income tax benefit, or 8.67% of pre-tax loss in the second quarter of 2020. The difference in the effective federal income tax rate from the normal statutory rate in the second quarter of 2021 was primarily related to the recording of a valuation allowance of \$575,000 for the second quarter of 2021 on U.S. deferred tax assets.

The Company recorded an income tax expense of \$52,800 for the six months ended June 30, 2021, or negative 0.62% of pre-tax loss, compared to a \$4.0 million income tax benefit, or 14.4% of pre-tax loss, for the six months ended June 30, 2020. The difference in the effective federal income tax rate from the normal statutory rate was primarily related to the recording of a valuation allowance of \$1.7 million for the six months ended June 30, 2021 on U.S. deferred tax assets not supported by either future taxable income or availability of future reversals of existing taxable temporary differences, partially offset by deferred foreign tax assets that are supported by existing temporary differences.

In assessing the valuation of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income or availability to carryback the losses to taxable income during periods in which those temporary differences become deductible. The Company considered several factors when analyzing the need for a valuation allowance including the Company's current five-year cumulative loss through June 30, 2021, the impacts of the COVID-19 Pandemic on the worldwide airline industry and the Company's recent filing for protection under Chapter 11 of the Bankruptcy Code. Based on this analysis, the Company has concluded that a valuation allowance is necessary for its U.S. deferred tax assets not supported by either future taxable income or availability of future reversals of existing taxable temporary differences and has recorded a valuation allowance of \$575,000 and \$1.7 million for the three months and six months ended June 30, 2021, respectively. Additionally, the Company has concluded that based on its analysis, some of its foreign net operating loss carrybacks are not expected to be realized based on limitations on the utilization of its foreign net operating losses, and therefore has recorded a foreign tax expense of \$0 and \$54,300 for the reduced tax refund for the three months and six months ended June 30, 2021, respectively. The tax treatment of the bankruptcy is dependent on the interpretation and the application of the Stalking Horse Agreement and the Sale Order. Depending on the final resolution of these matters and the occurrence or nonoccurrence of certain future events, there may be a future tax liability associated with the disposition of the aircraft pursuant to the Stalking Horse Agreement.

12. Condensed Combined Debtor-in-Possession Financial Information

The following financial statements represent the unaudited condensed combined financial statements of the Debtors. The results of the non-debtor entities are not included in these financial statements. Intercompany transactions among the Debtors have been eliminated in the following financial statements. Intercompany transactions among the Debtor and non-debtor entities have not been eliminated in the following financial statements.

The Debtors
Condensed Combined Balance Sheet
June 30, 2021
(Unaudited)

Assets:	
Cash and cash equivalents	\$2,224,500
Accounts receivable	91,900
Due from non-debtor affiliates	351,500
Finance leases receivable, net of allowance for doubtful accounts of \$1,190,000	700,000
Assets held for sale	53,409,400
Property, equipment and furnishings, net of accumulated depreciation of \$13,800	10,200
Office lease right of use, net of accumulated amortization of \$43,900	109,200
Investment in non-debtor subsidiaries	3,716,700
Prepaid expenses and other assets	367,900
Total assets	<u>\$60,981,300</u>
Liabilities:	
Accounts payable	\$655,700
Payable to non-debtor subsidiaries	2,425,600
Accrued payroll	225,300
Lease liability	137,300
Maintenance reserves	2,028,000
Security deposits	466,000
Accrued maintenance costs	19,500
Unearned revenues	966,400
Taxes payable	2,300
Total liabilities not subject to compromise	<u>6,926,100</u>
Liabilities subject to compromise	<u>80,277,600</u>
Total liabilities	<u>87,203,700</u>
Total stockholders' deficit attributable to the Debtors	<u>(26,222,400)</u>
Total liabilities and stockholders' deficit	<u>\$60,981,300</u>

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The Debtors
Condensed Combined Statements of Operations
(Unaudited)

For the Six For the Three

	Months Ended June 30, 2021	Months Ended June 30, 2021
Revenues and other income:		
Operating lease revenue	\$3,457,600	\$1,470,300
Net (loss)/gain on disposal of assets	2,463,700	6,800
Other (loss)/income	1,400	3,100
	<u>992,500</u>	<u>1,480,200</u>
Expenses:		
Impairment in value of aircraft	4,204,400	2,264,000
Professional fees, general and administrative and other	1,900,700	268,300
Interest	1,845,800	1,100
Depreciation	1,165,800	466,600
Bad debt expense	1,147,000	326,000
Reorganization costs	952,800	952,800
Salaries and employee benefits	910,200	445,900
Insurance	464,100	216,300
PPP Loan forgiveness	279,200	279,200
Maintenance	239,500	94,500
Other taxes	51,100	25,600
	<u>12,602,200</u>	<u>4,781,900</u>
Loss before income taxes and equity in earnings of non-debtor entities	11,609,700	3,301,700
Income tax provision	52,900	3,700
Equity in earnings of non-debtor entities	3,054,500	107,600
Net loss	<u>\$8,608,100</u>	<u>\$3,197,800</u>

The Debtors
Condensed Combined Statements of Cash Flows
For the Six Months Ended June 30, 2021
(Unaudited)

Net cash provided by operating activities	<u>\$745,900</u>
Investing activity-	
Proceeds from sale of aircraft and aircraft engines held for sale, net of re-sale fees	<u>13,591,400</u>
Net cash provided by investing activity	
Financing activities:	
Repayment of notes payable – MUFG Credit Facility and Drake Indebtedness	(<u>14,210,700</u>)
Issuance of notes payable – PPP Loan	<u>170,000</u>
Net cash used in financing activities	(<u>14,040,700</u>)
Net increase in cash, cash equivalents and restricted cash	<u>296,600</u>
Cash, cash equivalents and restricted cash, beginning of period	<u>1,927,900</u>
Cash, cash equivalents and restricted cash, end of period	<u>\$2,224,500</u>

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▶ **13. Subsequent Events** ◀

(a) Sale of assets

In August 2021, the Company sold one on-lease regional jet aircraft, three off-lease regional jet aircraft and one off-lease turboprop aircraft to Drake. Pursuant to the Stalking Horse Agreement, the sales resulted in the full satisfaction and cancellation of \$40,001,900 of the Drake Indebtedness.

(b) Plan Sponsor Agreements

On August 16, 2021, the Company entered into a Plan Sponsor Agreement with a group of investors led by Mr. Yucheng Hu with respect to the terms of an \$11 million equity investment in the Company (“Plan Sponsor Agreement”), which is subject to approval of the Bankruptcy Court. If court approval is received, following a scheduled August 31, 2021 hearing, the Company anticipates closing of the equity investment on a date in mid to late September 2021 (the “Effective Date”). The principal terms of the Plan Sponsor Agreement are below:

- **Plan Sponsor Equity Investment.** The Plan Sponsor Agreement provides for the issuance by AeroCentury Corp. of 2,857,143 of Common Stock (“New ACY Shares”) at a purchase price equal to \$ 3.85 per share, for an aggregate purchase price of US\$11 million. The New ACY Shares issuance would result in post-issuance pro forma ownership percentages of the AeroCentury common stock of (a) 64.89% held by the Plan Sponsor, and (b) 35.11% held by existing shareholders of AeroCentury on the Effective Date (the “Legacy ACY Shareholders”).
- **Refundability of the Deposit.** In the event the purchase of the New ACY Shares does not close as a result of Plan Sponsor’s failure to comply with the terms of Plan Sponsor Agreement, the Deposit will be forfeited to AeroCentury. In the event the purchase of the New ACY Shares does not close as a result of Debtors’ failure to comply with the terms of the Plan Sponsor Agreement or the failure of the conditions precedent set forth in the Plan Sponsor Agreement, the Deposit will be refunded to Plan Sponsor. If Bankruptcy Court or any regulatory authority having the authority to block the consummation of the purchase of the New ACY Shares do not approve of the purchase of the New ACY Shares, the Deposit will be refunded to Plan Sponsor.
- **Breakup Fee.** If the Bankruptcy Court accepts and approves an exit financing transaction for AeroCentury with a party other than the Plan Sponsor (an “Alternative Transaction”) then AeroCentury shall pay Plan Sponsor, upon the closing of such Alternative Transaction, in addition to the return of the Deposit, a breakup fee equal to US\$ 1,000,000.
- **New Capital Structure for JetFleet Holding Corp. (“JHC”).** On the Effective Date, the following transactions relating to JHC equity ownership shall be executed:
 - Cancellation of ACY Equity in JHC. All outstanding stock of JetFleet Holding Corp. (“JHC”) currently held 100% by its parent, AeroCentury, shall be canceled.
 - JHC Common Stock Issuance to Plan Sponsor and JHC Management. Plan Sponsor shall acquire 35,000 shares of common stock of JHC, and certain employees of JHC (“JHC Management”) who will be appointed to continue the legacy aircraft leasing business of AeroCentury through JHC shall acquire 65,000 shares of common stock of JHC. All shares of common stock of JHC will be purchased at a price of \$ 1 per share.
 - JHC Series A Preferred Stock Issuance to AeroCentury Corp. AeroCentury will use \$ 2

million of its proceeds from the Plan Sponsor’s purchase of New ACY Shares to purchase new JHC Series A Preferred Stock from JHC. The JHC Series A Preferred Stock shall carry a dividend rate of

7.5%

per annum, shall be non-convertible and non-transferable, shall be redeemable by JHC at any time, but shall only be redeemable by AeroCentury after 7 years. The JHC Series A Preferred Stockholders shall in the aggregate constitute 51% of the voting equity of JHC, voting as a single class together with the outstanding JHC Common Stock.

- Distribution of Trust Interest in JHC Series B to Legacy ACY Shareholders. A trust (“Legacy Trust”) will be established for the benefit of the Legacy ACY Shareholders, and JHC will issue new JHC Series B Preferred Stock to the Legacy Trust. The JHC Series B Preferred Stock issued to the Legacy Trust will have an aggregate liquidation preference of \$

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, non-convertible, non-transferable, non-voting, will not pay a dividend, and will contain a mandatory, redeemable provision. The JHC Series B Preferred Stock will be redeemable for an aggregate amount equal to (i)

\$1,000,000, if the JHC Series B Preferred Stock is redeemed after the first fiscal year for which JHC reports positive EBITDA for the preceding 12-month period, or (ii) \$0.001 per share, if the JHC Series B Preferred Stock is redeemed prior the first fiscal year for which JHC reports positive EBITDA for the preceding 12-month period

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- **Cash Distribution to Legacy ACY Shareholders.** As soon as practicable following the Effective Date, AeroCentury will make a cash dividend distribution to the Legacy ACY Shareholders in the aggregate amount of US\$ 1,000,000, funded from the purchase price paid by Plan Sponsor for the New ACY Shares.
- **Board Make-up Following Sponsor Investment.** Following the Effective Date, AeroCentury will have a Board of Directors initially consisting of five (5) members, which will consist of (i) three directors designated by Yucheng Hu (the “Lead Investor”) and (ii) two directors to be mutually agreed upon by the Lead Investor and the current incumbent Board of Directors.

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

The following discussion and analysis should be read together with the Company’s annual report on Form 10-K for the fiscal year ended December 31, 2020 and the audited consolidated financial statements and notes included therein (collectively, the “2020 Annual Report”), as well as the Company’s unaudited condensed consolidated financial statements and the related notes included in this report. Pursuant to Instruction 2 to paragraph (b) of Item 303 of Regulation S-K promulgated by the SEC, in preparing this discussion and analysis, the Company has presumed that readers have access to and have read the disclosure under the same heading contained in the 2020 Annual Report. This discussion and analysis contains forward-looking statements. Please see the cautionary note regarding these statements at the beginning of this report.

Overview

The Company has historically provided leasing and finance services to regional airlines worldwide and has been principally engaged in leasing mid-life regional aircraft to customers worldwide under operating leases and finance leases. In addition to leasing activities, the Company has also sold 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 composition of its aircraft portfolio, the terms of its leases, and the interest rate of its debt, as well as asset sales. As discussed below, the Company has entered into a definitive agreement with an investment sponsor for a plan of reorganization to exit the Chapter 11 Cases and provide \$11 million in equity financing to the Company. It is possible that a sponsor may only be willing to invest in the Company if the Company’s operations are broadened to include and focus on new lines of business other than the aircraft leasing business.

The COVID-19 Pandemic has led to significant cash flow issues for many lessors. Some of the Company’s lessees were unable to timely meet their obligations under their lease obligations with the Company during 2020 and in the quarter ended June 30, 2021. This in turn has caused

those lessees to make requests for lease payment concessions and/or deferrals from the Company, which in turn impacted the Company’s cash flow. The onset of the COVID-19 Pandemic substantially impeded the Company’s ability to regain compliance with its debt covenants under its credit facility with lenders led by agent bank MUFG Union Bank (the “MUFG Lenders”), which credit facility was in default prior to the COVID-19 Pandemic due to the failure of the Company’s largest customer, a European regional carrier.

In October 2020, the Company’s MUFG indebtedness, which consisted of \$87.9 million loan indebtedness to the MUFG Lenders, including deferred interest, and approximately \$3.1 million owed to MUFG Bank, Ltd for termination of interest rate swaps entered into with respect to the Drake Indebtedness (collectively, the “MUFG Indebtedness”) was sold to Drake Asset Management Jersey Limited (“Drake”).

In March 2021, the Company’s special purpose financing debt owed to Nord LB related to three of the Company’s assets was repaid in full as a result of dispositions of the three aircraft over the course of the last two years. In March 2021, the Company sold its membership interest in ACY E-175 LLC (“ACY E-175”), and the buyer assumed the remaining debt owed to Nord LB.

On March 29, 2021, AeroCentury and two of its subsidiaries, JetFleet Holding Corp. and JetFleet Management Corp. (“the Debtors”) filed a voluntary petition for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the District of Delaware on March 29, 2021. After the bankruptcy filing, the Company has continued to operate its businesses in the ordinary course as “debtors-in-possession” under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code. The Bankruptcy Court has granted the Company’s motions designed primarily to minimize the effect of bankruptcy on the Company’s operations, customers and employees and make it possible for the Company to continue existing operations without interruption during the pendency of the Chapter 11 Cases.

The Bankruptcy Court also approved the conduct of a process to market and sell the Company’s assets as part of the Chapter 11 proceeding in order to permit the Company to satisfy the Company’s obligations to its creditors, including its sole secured creditor, Drake. The Company entered into a Stalking Horse Agreement with Drake for the sale of certain of the aircraft assets securing the Drake Indebtedness (the “Drake Collateral”), which was approved by the Bankruptcy Court as the best and/or highest offer for the Drake Collateral. Upon consummation of the transfers of title of the Drake Collateral to Drake or their nominees, the Company’s obligations to Drake under the Drake Indebtedness will be deemed fully satisfied.

Finally, during the first quarter of 2021, the Company entered into negotiations for the sale of an aircraft securing a sales-type finance lease receivable to the customer and recorded a bad debt allowance of \$821,000. The Company entered into an agreement to sell such aircraft to the current lessee in May of 2021 for a purchase price of \$700,000, subject to Bankruptcy Court approval, and the sale occurred in the second quarter of 2021. In June 2021, the Company entered into an agreement to sell a second aircraft securing a sales-type finance lease receivable to the customer and recorded a bad debt allowance of \$326,000. The Company expects the sale to occur in the fourth quarter of 2021. In addition, in May 2021, the Company agreed to sell most of the Part-out Assets for \$290,000, and recorded an impairment loss of \$1,940,400 in the first quarter of 2021. The sale occurred during the second quarter of 2021.

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Average portfolio utilization was 81% and 91% during the second quarters of 2021 and 2020, respectively. The year-to-year decrease was due to aircraft sales during 2020 and 2021 and aircraft that were on lease in in the 2020 period, but off lease in the 2021 period.

Net loss for the second quarters of 2021 and 2020 was \$3.2 million and \$13.5 million, respectively, resulting in basic and diluted loss per share of \$(2.07) and \$(8.74), respectively. Pre-tax profit margin (which the Company calculates as its (loss)/income before income tax (benefit)/provision as a percentage of its revenues and other income) was (181%) and (308%) in the second quarters of 2021 and 2020, respectively.

The Company ended the second quarter of 2021 with a total of ten aircraft and an inventory of spare parts held for sale, with a net book value of approximately \$53 million. In addition to the assets held for sale at quarter-end, the Company held one aircraft subject to a finance lease.

Fleet Summary

(a) Assets Held for Lease

Key portfolio metrics of the Company’s aircraft held for lease as of June 30, 2021 and December 31, 2020 were as follows:

	June 30, 2021	December 31, 2020
Number of aircraft and engines held for lease	-	6

Weighted average fleet age	-	14.4 years
Weighted average remaining lease term	-	29 months
Aggregate fleet net book value	-	\$ 45,763,100

	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
	2021	2020	2021	2020
Average portfolio utilization	84%	88%	81%	91%

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 June 30, 2021 and December 31, 2020:

Type	June 30, 2021		December 31, 2020	
	Number owned	% of net book value	Number owned	% of net book value
Regional jet aircraft:				
Canadair 700	-	-	3	38%
Canadair 900	-	-	1	29%
Turboprop aircraft:				
Bombardier Dash-8-400	-	-	2	33%
Bombardier Dash-8-300	-	-	-	-

The Company did not purchase any aircraft during the quarter ended June 30, 2021. As a result of its Chapter 11 filing in March 2021 and a sale order approved by the Bankruptcy Court during the second quarter, the Company reclassified all of its aircraft, comprised of seven regional jet aircraft and three turboprop aircraft, from held for lease to held for sale.

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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 June 30, 2021 and December 31, 2020 in the indicated regions (based on the domicile of the lessee):

Region	June 30, 2021		December 31, 2020	
	Net book value	% of net book value	Net book value	% of net book value
North America	\$ -	-	\$ 30,433,100	67%
Europe and United Kingdom	-	-	15,330,000	33%
Off lease	-	-	-	-
	\$ -	-	\$ 45,763,100	100%

For the three months ended June 30, 2021, approximately 43%, 40% and 17% of the Company's operating lease revenue was derived from customers in Croatia, Canada and the United States, 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 Six Months Ended June 30,				For the Three Months Ended June 30,			
	2021		2020		2021		2020	
	Number of lessees	% of operating lease revenue	Number of lessees	% of operating lease revenue	Number of lessees	% of operating lease revenue	Number of lessees	% of operating lease revenue
Europe and United Kingdom	1	23%	3	45%	1	43%	3	42%
North America	3	77%	3	55%	2	57%	3	58%

At June 30, 2021 and December 31, 2020, the Company also had one and two finance lease receivables collateralized by aircraft, respectively. The Company did not record any finance lease revenue during the quarter ended June 30, 2021.

(b) Assets Held for Sale

Assets held for sale at June 30, 2021 consisted of ten aircraft and engine parts from a turboprop aircraft. As a result of its Chapter 11 filing in March 2021 and a sale order approved by the Bankruptcy Court during the second quarter, the Company reclassified all of its aircraft, comprised of seven regional jet aircraft and three turboprop aircraft, from held for lease to held for sale.

In May 2021, the Company sold most of the Part-out Assets for \$290,000, for which the Company recorded an impairment loss of \$1,940,400 in the first quarter of 2021.

Results of Operations*(a) Quarter ended June 30, 2021 compared to the quarter ended June 30, 2020**(i) Revenues and Other Income*

Revenues and other income decreased by 66% to \$1.5 million in the second quarter of 2021 from \$4.4 million in the second quarter of 2020. The decrease was primarily a result of a 66% decrease in operating lease revenues to \$1.5 million in the second quarter of 2021 from \$4.4 million in the second quarter of 2020 as a result of reduced rent income from the sale of aircraft during the fourth quarter of 2020 and first quarter of 2021 and reduced rent for three assets in the 2021 quarter as a result of lease extensions and related rent reductions, the effects of which were partially offset by reduced rent for two assets in the 2020 period as a result of lease amendments related to the COVID-19 Pandemic.

[Table of Contents](#)*(ii) Expenses*

Total expenses decreased by 76% to \$4.7 million in the second quarter of 2021 from \$19.2 million in the second quarter of 2020. The decrease was primarily a result of decreases in asset impairment losses, interest expense, professional fees and general and administrative expenses and depreciation, the effects of which were partially offset by increases in reorganization costs and bad debt expense. Expenses in the second quarter of 2021 also included (\$0.3) million of Paycheck Protection Program (“PPP”) Loan forgiveness.

During the second quarter of 2021, the Company recorded impairment charges totaling \$2.3 million on five assets held for sale, based on appraised values or expected sales proceeds. During the second quarter of 2020, the Company recorded impairment charges of (i) \$6.7 million on two assets held for lease, based on estimated future cash flow, (ii) \$2.9 million on three assets held for sale, based on appraised values and (iii) \$0.1 million on a fourth asset held for sale, based on expected net sales proceeds.

The Company’s interest expense decreased by 100% to \$1,900 in the second quarter of 2021 from \$4.5 million in the second quarter of 2020, as a result of the Company’s Chapter 11 filing in late March 2021, after which the Company did not accrue interest on the Drake Indebtedness. The second quarter of 2020 included a \$1.5 million write-off of a portion of the Company’s unamortized debt issuance costs related to the MUFG Credit Facility.

Professional fees, general and administrative and other expenses decreased 94% to \$0.1 million in the second quarter of 2021 from \$2.1 million in the second quarter of 2020. The 2020 period included legal fees related to the May 2020 MUFG Indebtedness amendment and litigation brought by an activist shareholder, consulting fees related to the May 2020 MUFG Indebtedness amendment and increased amortization related to the Company’s office lease right of use.

Depreciation expense decreased 77% to \$0.5 million in the second quarter of 2021 from \$2.0 million in the second quarter of 2020, primarily as a result of the reclassification of aircraft from held for lease to held for sale during the fourth quarter of 2020 and second quarter of 2021, as well as a decrease in depreciation for two aircraft that were written down to their estimated sale values during the second quarter of 2020 and were sold during the fourth quarter.

During the second quarter of 2021, the Company recorded \$1.0 million of reorganization costs as a result of its March 29, 2021 Chapter 11 filing.

Based on an agreement to sell an aircraft that secures a sales-type finance lease receivable, the Company recorded bad debt expense totaling \$0.3 million during the second quarter of 2021. The Company recorded no such expense during the second quarter of 2020.

The Company had a tax expense of \$3,600 in the second quarter of 2021 compared to tax benefit of \$1.3 million in the second quarter of 2020. The effective tax rate for the second quarter of 2021 was a negative 0.11% tax expense compared to a 8.67% tax benefit for the second quarter of

2020. The difference in the effective income tax rate from the normal statutory rate in the second quarter of 2021 was primarily related to the recording of a valuation allowance in the current period on the Company's U.S. deferred tax assets. In assessing the valuation of deferred tax assets, the Company considered whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income or availability to carryback the losses to taxable income during periods in which those temporary differences become deductible. The Company considered several factors when analyzing the need for a valuation allowance, including the Company's current five-year cumulative loss through June 30, 2021, the impacts of the COVID-19 Pandemic on the worldwide airline industry and the Company's recent filing for protection under Chapter 11 of the Bankruptcy Code. Based on this analysis, the Company concluded that a valuation allowance is necessary for the Company's net U.S. deferred tax assets not supported by either future taxable income or availability of future reversals of existing taxable temporary differences and has recorded a valuation allowance of \$575,000 in the second quarter of 2021 compared to a valuation allowance of \$3.1 million in the second quarter of 2020.

(b) Six months ended June 30, 2021 compared to the six months ended June 30, 2020

(i) Revenues and Other Income

Revenues and other income decreased by 56% to \$4.0 million in the first six months of 2021 from \$9.2 million in the same period of 2020. The decrease was primarily a result of a 54% decrease in operating lease revenues to \$4.2 million in the first six months of 2021 from \$9.1 million in the same period of 2020 as a result of reduced rent income from the sale of aircraft during the fourth quarter of 2020 and first quarter of 2021 and reduced rent for three assets in the 2021 quarter as a result of lease extensions and related rent reductions.

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(ii) Expenses

Total expenses decreased by 66% to \$12.6 million in the first six months of 2021 from \$36.9 million in the same period of 2020. The decrease was primarily a result of decreases in asset impairment losses, interest expense, professional fees and general and administrative expenses and depreciation, the effects of which were partially offset by an increase in reorganization costs. Expenses in the first six months of 2021 also included (\$0.3) million of PPP Loan forgiveness.

During the first six months of 2021, the Company recorded impairment charges totaling \$4.2 million on seven assets held for sale, based on appraised values or expected sales proceeds. During the six months ended June 30, 2020, the Company recorded impairment charges of (i) \$6.7 million on two assets held for lease, based on estimated future cash flow and (ii) \$9.7 million on five assets held for sale, based on appraised values or expected sales proceeds.

The Company's interest expense decreased by 82% to \$1.9 million in the first six months of 2021 from \$10.5 million in the same period of 2020, as a result of the Company's Chapter 11 filing in late March 2021, after which the Company did not accrue interest on the Drake Indebtedness. The second quarter of 2020 included \$2.0 million of valuation charges related to the Company's interest rate swaps and a \$2.0 million write-off of a portion of the Company unamortized debt issuance costs related to the MUFG Credit Facility.

Professional fees, general and administrative and other expenses decreased 43% to \$1.7 million in the first six months of 2021 from \$3.0 million in the first six months of 2020, primarily as a result of decreases in legal fees related to the May 2020 MUFG Indebtedness amendment and litigation brought by an activist shareholder, consulting fees related to the May 2020 MUFG Indebtedness amendment and amortization related to the Company's office lease right of use.

Depreciation expense decreased 72% to \$1.2 million in the six months ended June 30, 2021 from \$4.2 million in the six months ended June 30, 2020 primarily as a result of the reclassification of aircraft from held for lease to held for sale during the fourth quarter of 2020 and second quarter of 2021, as well as a decrease in depreciation for two aircraft that were written down to their estimated sale values during the second quarter of 2020 and were sold during the fourth quarter.

During the first six months of 2021, the Company recorded \$1.0 million of reorganization costs as a result of its March 29, 2021 Chapter 11 filing.

The Company had a tax expense of \$52,800 for the six months ended June 30, 2021 compared to tax benefit of \$4.0 million for the six months ended June 30, 2020. The effective tax rate for the six months ended June 30, 2021 was a negative 0.62% tax expense compared to a 14.4% tax benefit for the six months ended June 30, 2020. The difference in the effective income tax rate from the normal statutory rate for the six months ended June 30, 2021 was primarily related to the recording of a valuation allowance in the current period on the Company's U.S. deferred tax assets. In assessing the valuation of deferred tax assets, the Company considered whether it is more likely than not that some portion or all of the

deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income or availability to carryback the losses to taxable income during periods in which those temporary differences become deductible. The Company considered several factors when analyzing the need for a valuation allowance, including the Company's current five-year cumulative loss through June 30, 2021, the impacts of the COVID-19 Pandemic on the worldwide airline industry and the Company's recent filing for protection under Chapter 11 of the Bankruptcy Code. Based on this analysis, the Company concluded that a valuation allowance is necessary for the Company's net U.S. deferred tax assets not supported by either future taxable income or availability of future reversals of existing taxable temporary differences and has recorded a valuation allowance of \$1.7 million for the six months ended June 30, 2021 compared to a valuation allowance of \$3.2 million for the six months ended June 30, 2020. Additionally, the Company has concluded that based on its analysis, some of its foreign net operating loss carrybacks are not expected to be realized based on limitations on the utilization of its foreign net operating losses, and therefore recorded a foreign tax expense of \$54,300 for the reduced tax refund for the six months ended June 30, 2021.

Liquidity and Capital Resources

At June 30, 2021, the Company had total book assets of approximately \$58.7 million and total liabilities of \$84.9 million, resulting in a negative book equity of \$26.2 million. The largest portion, \$80.1 million, of the Company's debt is owed to Drake. The maturity date of the Drake Indebtedness was March 31, 2021.

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The Company did not have the resources to meet its obligations to repay the Drake Indebtedness when due on March 31, 2021, which is a principal reason for its decision to file for protection under Chapter 11 of the Bankruptcy Code on March 29, 2021, as discussed in Note 1(c). The Company requires additional funding to continue its operations and has not identified a source for such funding to date. Although the Company is seeking to secure additional funding and has entered into a Plan Sponsor Agreement with a proposed equity investor as part of its plan for exit from Bankruptcy, the agreement must be approved by the Bankruptcy Court and there are terms and conditions precedent to the equity investment that must be fulfilled by the Company prior to consummation of the investment. Therefore, the Company cannot conclude that it is probable that succeed in doing so in order to mitigate the conditions that led to substantial doubt about the Company's ability to continue as a going concern. The Company's poor financial position, including the amount of liability under the Drake Indebtedness in relation to the fair value of the Company's remaining assets and the uncertainty of generating sufficient revenue to continue operations have led the Company to conclude that there is substantial doubt about its ability to continue as a going concern.

The accompanying condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern and contemplate the realization of assets and the satisfaction of liabilities in the normal course of business. The Company's ability to continue as a going concern is contingent upon its ability to successfully implement a plan of reorganization, among other factors, and the realization of assets and the satisfaction of liabilities are subject to uncertainty. Further, any plan of reorganization could materially change the amounts of assets and liabilities reported in the accompanying condensed consolidated financial statements. The condensed consolidated financial statements presented in this Quarterly Report on Form 10-Q have been prepared on a going concern basis and do not include any adjustments that might arise as a result of uncertainties about the Company's ability to continue as a going concern or as a consequence of its Chapter 11 filing.

(a) MUFG Credit Facility and Drake Indebtedness

On October 30, 2020, Drake purchased all of the indebtedness of the Company under the MUFG Loan, totaling approximately \$87.9 million as well as all of the Company's indebtedness to MUFG Bank, Ltd. of approximately \$3.1 million for termination of interest rate swaps entered into with respect to such MUFG Loan Agreement indebtedness. The purchase and sale were consented to by the Company pursuant to a Consent and Release Agreement of Borrower Parties, entered into by the Company and its subsidiaries.

On the same day, the Company entered into an Amendment No. 1 to the MUFG Loan Agreement ("Amendment No. 1") with Drake and UMB Bank, N.A., the replacement Administrative Agent under the MUFG Loan Agreement, to amend the MUFG Loan Agreement to: (i) defer the cash component of any monthly interest payments due under the MUFG Loan Agreement, commencing with the payments due for March 2020, and capitalize and add such deferred interest to the principal balance of the indebtedness until such time as the indebtedness is repaid; (ii) require lender approval for any material changes in lease terms with respect to the collateral; and (iii) delete certain financial reporting requirements and change required frequency of certain other surviving reporting requirements. The indebtedness continues to be secured by a first priority lien on all of the Company's assets, including the Company's aircraft portfolio.

The Company and Drake have entered into an Asset Purchase Agreement ("Stalking Horse Agreement") for the sale of the Drake Collateral, subject to better and higher offers. The Stalking Horse Agreement was entered into in conjunction with the filing by the Company of the Chapter 11 Cases. No other third-party bids were received for the Company's assets in the Court-approved marketing and sale process, so the proposed auction ("Auction Sale") for assets was not conducted. Since approval of the Stalking Horse Agreement, the Company and Drake have

consummated the transfer of a significant portion of the Drake Collateral on the terms set forth in the Stalking Horse Agreement and expect the remaining Drake Collateral held by the Company to be completed by the end of September 2021. Upon the final transfer of assets, the Company's indebtedness to Drake will be deemed fully satisfied.

Following is a summary of the principal terms and conditions of the Stalking Horse Agreement:

- *Assets Covered.* The Stalking Horse Agreement covers the Drake Collateral, consisting of ten aircraft assets and related leases ("Assumed Leases") over which Drake holds a first priority lien that secures the Drake Indebtedness.
- *Purchase Price.* The aggregate consideration for the purchase of the Drake Collateral is an amount equal to the amount of the outstanding secured obligations.
- *Sale Order Approval Required.* The mutual obligations for the purchase and sale of the Drake Collateral are subject to the entry of an order by the Bankruptcy Court authorizing the purchase transaction as the best and highest offer available with respect to such assets.
- *Excluded Assets.* Certain assets are not being sold to Drake pursuant to the Stalking Horse Agreement ("Excluded Assets"), including two aircraft being sold to Kenyan lessees under sales-type finance leases, and certain aircraft and an engine that are being parted out under consignment arrangements, which Excluded Assets remain free and clear of Drake claims, if and when the sale of the Drake Collateral pursuant to the Stalking Horse Agreement or to another higher and better offer is consummated. Subsequent to entering into the Stalking Horse Agreement, the Company sold one aircraft that had been collateral for a sales-type finance lease receivable and certain spare parts subject to consignment to the consignee, and pursuant to the terms of the cash collateral order of the Bankruptcy Court, the Company has retained the cash proceeds from such sales.

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- *Economic Closing Date Allocation.* Lease revenue received with respect to the Drake Collateral is allocated based on a February 1, 2021 economic closing date (the "ECD"). Any lease revenue received by the Company for periods prior to the ECD is the property of the Company. Any lease revenue received that relates to any period after the ECD ("Post-ECD Proceeds") is held by the Company for the benefit of Drake and remitted to Drake pursuant to terms of the cash collateral order entered into in connection with the Company's Chapter 11 Case.
- *Assumed Liabilities.* Drake is to assume liability for (a) any amounts required to be paid by the Company pursuant to section 365 of the Bankruptcy Code in connection with the assumption and assignment of the Assumed Leases; (b) all costs of obtaining necessary consents to assignment of the Assumed Leases (to the extent not assignable pursuant to contract or applicable law); (c) all of the legal fees payable to lessees under the Assumed Leases incurred in connection with legal review and negotiation of the lease novation or assignment documents for the Assumed Leases, and 50% of the Company's legal fees for such legal review and negotiation; (d) sales, use, documentary, transfer, property, bulk, stamp, ad valorem or similar tax imposed on the assignment and transfer of the Drake Collateral, and any related penalties, or interest incurred; (e) reimbursements payable to a lessee upon completion of specific qualified maintenance projects, as defined and specified under any Assumed Lease; and (f) any unsatisfied liabilities with respect to certain programs that the Company maintains in connection with its leasing business in respect of the Assumed Leases.
- *Release of Secured Lender Claims on Company Assets.* On the date that the transfer of title to all Drake Collateral has been completed, the Drake Indebtedness will be deemed satisfied in full and canceled, and Drake will release any claims it may otherwise have in: (a) any cash held in the Company's bank accounts that are not Post-ECD Proceeds; (b) any proceeds received by the Company under any consignment contract with respect to Excluded Assets; (c) all assets of the Company other than the Drake Collateral; and (d) any proceeds of sale or other funds received in respect of the foregoing items listed in (a)-(c).

(b) Special-purpose Financing and Nord Loans

On February 8, 2019, the Company, through four wholly-owned subsidiary limited liability companies ("LLC Borrowers"), entered into a term loan agreement NordDeutsche Landesbank Girozentrale, New York Branch ("Nord") that provided for six separate term loans ("Nord Loans") with an aggregate principal amount of \$44.3 million. Each of the Nord Loans was secured by a first priority security interest in a specific aircraft ("Nord Loan Collateral Aircraft") owned by an LLC Borrower, the lease for such aircraft, and a pledge by the Company of its membership interest in each of the LLC Borrowers, pursuant to a Security Agreement among the LLC Borrowers and a security trustee, and certain pledge agreements.

The interest rates payable under the Nord Loans varied by aircraft, and were based on a fixed margin above either 30-day or 3-month LIBOR.

The maturity of each Nord Loan varied by aircraft, with the first Nord Loan maturing in October 2020 and the last Nord Loan maturing in May 2025. The debt under the Nord Loans was expected to be fully amortized by rental payments received by the LLC Borrowers from the lessees of the Nord Loan Collateral Aircraft during the terms of their respective leases and remarketing proceeds.

One of the Nord Loan Collateral Aircraft was sold in 2019 and two Nord Loan Collateral Aircraft were sold in 2020. The excess proceeds from the 2020 sales were held as restricted cash by ACY E-175. The restricted cash, the three aircraft held by ACY E-175 and ACY E-175's Nord Loans and derivative liability were classified as held for sale at December 31, 2020. During March 2021, the Company sold its interest in ACY E-175 and was released from any remaining guarantee obligations under the Nord Loan and interest swap obligations of the special-purpose subsidiary.

(c) Paycheck Protection Program Loans

On May 20, 2020, JetFleet Management Corp. (the "PPP Borrower"), an indirect subsidiary of AeroCentury Corp., was granted a loan (the "PPP Loan") from American Express National Bank in the aggregate amount of \$276,353, pursuant to the PPP under Division A, Title I of the CARES Act, which was enacted March 27, 2020. The PPP Loan, which was in the form of a Note dated May 18, 2020 issued by the PPP Borrower, was forgiven during the second quarter of 2021 and the Company recorded \$279,200 of loan forgiveness as a reduction in expense.

In February 2021, the Company was granted a second PPP Loan ("Second PPP Loan") (collectively, with the initial PPP Loan, the "PPP Loans") in the aggregate amount of \$170,002. The Second PPP Loan, in the form of a Note dated February 11, 2021, matures on February 11, 2026 and bears interest at a rate of 1.00% per annum, payable in monthly payments commencing 30 days after the Small Business Administration has made its final determination that any part of the loan will not be forgiven.

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The applications for the PPP Loans required the Company to certify in good faith that the current economic uncertainty made the loan request necessary to support the ongoing operations of the Company. This certification further required the Company to take into account its current business activity and its ability to access other sources of liquidity sufficient to support ongoing operations in a manner that is not significantly detrimental to the business. The receipt of these funds, and the forgiveness of the loans attendant to these funds, is dependent on the Company having initially qualified for the loans and qualifying for the forgiveness of such loans based on its future adherence to the forgiveness criteria.

The Second PPP Loan may be prepaid by the PPP Borrower at any time prior to maturity with no prepayment penalties. Funds from the PPP Loans may only be used for payroll costs and any payments of certain covered interest, lease and utility payments. The Company intends to use the entire PPP Loans for qualifying expenses. Under the terms of the PPP, certain amounts of the Second PPP Loan may be forgiven if they are used for qualifying expenses as described in the CARES Act. Although the Company expects that all or a significant portion of the Second PPP Loan will be forgiven, no assurance can be provided that the Company will obtain such forgiveness.

(d) Cash Flow

The Company's primary sources of cash from operations 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) salaries, employee benefits and general and administrative expenses, (ii) professional fees and legal expenses with respect to the Company's Chapter 11 Cases and restructuring and recapitalization effort; (iii) maintenance expense and (iv) reimbursement to lessees from collected maintenance reserves. The Company's cash flow is subject to a cash collateral order issued by the Bankruptcy Court.

During 2019, the Company engaged B. Riley Securities, Inc. as an investment banking advisor to help (i) negotiate with the Company's stakeholders and formulate and analyze the Company's various strategic financial alternatives with respect to its plan of reorganization and (ii) locate and negotiate with potential lenders, investors or transaction partners who would play a role in recapitalization of the Company.

The Company's ability to develop and obtain approval for its plan of reorganization is subject to a variety of factors, as discussed under *Factors that May Affect Future Results and Liquidity – Risks Related to Chapter 11 Case*.

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.

Though the Company's maintenance payments typically constitute a large portion of its cash outflow, this is not likely to be the case in the near term. One of the Company's lessees that pays maintenance reserves has agreed with the Company that if the Company is unable or unwilling to repay its maintenance reimbursement obligations to the lessee, the reimbursement obligation will be offset against the lessee's monthly rental obligations to the Company until such maintenance reimbursement obligations are repaid in full. The one lessee that pays maintenance reserves under its sales-type lease is currently in arrearage under the lease and will not be eligible to submit maintenance reserve claims until it has cured its arrearages. When and if the sale of the Company's aircraft portfolio pursuant to the Stalking Horse Agreement, or any successor agreement, is consummated, any existing reimbursement obligations under the Company's leases sold at such sale will be assumed by the asset buyer.

Actual results could deviate substantially from the assumptions management has made in forecasting the Company's future cash flow. As discussed in *Liquidity and Capital Resources – (a) MUFG Credit Facility and Drake Indebtedness* and in *Outlook and Factors that May Affect Future Results and Liquidity*, there are a number of factors that may cause actual results to deviate from these forecasts. If these assumptions prove to be incorrect and the Company's cash requirements exceed its cash flow, the Company would need to pursue additional sources of financing to satisfy these requirements, which may not be available when needed, on acceptable terms or at all. See *Factors that May Affect Future Results and Liquidity* for more information about financing risks and limitations.

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(i) Operating activities

The Company's cash flow from operations increased by \$1.7 million in the first six months of 2021 compared to the first six months of 2020. As discussed below, the increase in cash flow was primarily a result of decreases in payments made for interest and maintenance, the effects of which were partially offset by decreases in payments received for rent and maintenance reserves.

(A) Payments for interest

Payments made for interest decreased by \$2.6 million in the first six months of 2021 compared to the same period of 2020 as a result of the deferral of the interest due on the Company's Drake Indebtedness in the 2021 period.

(B) Payments for maintenance

Payments made for maintenance decreased by \$0.3 million in the first six months of 2021 compared to the first six months of 2020 as a result of maintenance performed by the Company on an off-lease aircraft that was sold during the 2020 period.

(C) Payments for rent

Receipts from lessees for rent decreased by \$1.5 million in the first six months of 2021 compared to the same period of 2020, primarily due to rent concessions granted to one of the Company's customers beginning in the fourth quarter of 2020 and decreased revenue from an asset that was on lease during the 2020 period but off lease in 2021.

(D) Payments for maintenance reserves

Receipts from lessees for maintenance reserves decreased by \$0.2 million in the first six months of 2021 compared to the same period of 2020, primarily due to reduced usage of the aircraft for which the Company collects maintenance reserves and decreased maintenance reserves from an aircraft that was on lease during the 2020 period but off lease in 2021.

(ii) Investing activities

The Company did not acquire any aircraft during the first six months of 2021 or 2020. During the same periods, the Company received net cash of \$11.8 million and \$3.2 million, respectively, from asset sales.

(iii) Financing activities

During the first six months of 2021 and 2020, the Company borrowed \$2.5 million and \$1.1 million, respectively, in the form of paid-in-kind interest that was added to the outstanding principal balance under the MUFG Indebtedness and Drake Indebtedness. During the same periods, the Company repaid \$14.2 and \$1.2 million, respectively, of its total outstanding debt under the Drake Indebtedness and MUFG Indebtedness,

respectively. Such repayments were funded by the sale of assets and, in the 2021 period, rent and reserves received and used to pay down the Drake Indebtedness. During the first six months of 2021 and 2020, the Company's special-purpose entities repaid \$0.7 million and \$1.3 million, respectively, of the Nord Loans. During the first six months of 2021 and 2020, the Company paid approximately \$5,000 and \$1.7 million, respectively, for debt issuance and amendment fees.

(iv) Off balance sheet arrangements

The Company has no material off -balance sheet arrangements.

Critical Accounting Policies, Judgments and Estimates

The Company's discussion and analysis of its financial condition and results of operations are based upon the condensed consolidated financial statements included in this report, 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 or during the applicable reporting period. 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 further discussion of Critical Accounting Policies, Judgments and Estimates, refer to Note 1 to the Company's condensed consolidated financial statements in this report and the Company's consolidated financial statements in the 2020 Annual Report.

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Outlook

Bankruptcy Process. The Company filed for protection under Chapter 11 of Title 11 of the U.S. Code on March 29, 2021, in the U.S. Bankruptcy Court for the District of Delaware, (Case No. 21-10636). Immediately prior to the filing, the Company completed the sale of its ACY E-175 LLC subsidiary, thereby resolving \$13.4 million in financing debt that was remaining due under the Nord Loans, and also generated \$2.1 million in cash proceeds for the Company.

The Court approved the conduct of a proposed auction of the Company's assets to generate proceeds to be applied to the satisfaction of the Drake Indebtedness. No third-party qualified bids were received for the Company's assets in the Court-approved marketing and sale process, so the proposed auction for assets was not conducted. The Company and Drake, with the Bankruptcy Court's approval, are proceeding with the sale of the Drake Collateral pursuant to the terms of the Stalking Horse Agreement, and the Company expects the remaining Drake Collateral held by the Company to be completed by the end of September 2021. Upon the final transfer of assets, the Company's indebtedness to Drake will be deemed fully satisfied. Due to the economic closing date provision under the Stalking Horse Agreement that provides that all revenue on the Drake Collateral received for periods after February 1, 2021 be remitted to Drake, the Company currently has minimal cash-generating assets, and its cash on hand upon the conclusion of the Chapter 11 Cases, will consist mainly of any unused proceeds from its sale of Part-Out Assets or other aircraft assets that are not Drake Collateral.

Based on the Company's current projections, the Company anticipates that the Company's current cash position should be sufficient to fund the Company through a planned exit from its bankruptcy process sometime in the third quarter of 2021, assuming no significant unexpected expenses are incurred during the bankruptcy process. The Company has entered into a Plan Sponsor Agreement with a plan sponsor to provide capital to fund the Company's exit from Chapter 11 and fund the Company's operations, including funding a restart of the Company's legacy aircraft leasing business, and potential other additional lines of business it may enter into upon exit from bankruptcy. Once the Company has exited from Chapter 11, the Company's operations may be expanded into, or refocused upon, new lines of business, which lines of businesses may be complementary to, or entirely unrelated to the Company's legacy aircraft leasing business. The Court has scheduled a hearing on August 31, 2021 to hear a motion by the Company for approval of the Plan Sponsor Agreement. If the Sponsor Agreement is approved, the Company anticipates that the date (the "Effective Date") of the Company's exit from Chapter 11 and the Plan Sponsor equity investment funding will be in mid to late September.

The principal terms of the Plan Sponsor Agreement are below:

- **Plan Sponsor Equity Investment.** The Plan Sponsor Agreement provides for the issuance by AeroCentury Corp. of 2,857,143 of Common Stock ("New ACY Shares") at a purchase price equal to \$3.85 per share, for an aggregate purchase price of \$11 million. The New ACY Shares issuance would result in post-issuance pro forma ownership percentages of the AeroCentury common stock of (a) 64.89% held by the Plan Sponsor, and (b) 35.11% held by existing shareholders of AeroCentury on the Effective Date (the "Legacy ACY Shareholders").

- **Refundability of the Deposit.** In the event the purchase of the New ACY Shares does not close as a result of Plan Sponsor’s failure to comply with the terms of Plan Sponsor Agreement, the Deposit will be forfeited to AeroCentury. In the event the purchase of the New ACY Shares does not close as a result of Debtors’ failure to comply with the terms of the Plan Sponsor Agreement or the failure of the conditions precedent set forth in the Plan Sponsor Agreement, the Deposit will be refunded to Plan Sponsor. If Bankruptcy Court or any regulatory authority having the authority to block the consummation of the purchase of the New ACY Shares do not approve of the purchase of the New ACY Shares, the Deposit will be refunded to Plan Sponsor.
- **Breakup Fee.** If the Bankruptcy Court accepts and approves an exit financing transaction for AeroCentury with a party other than the Plan Sponsor (an “Alternative Transaction”) then AeroCentury shall pay Plan Sponsor, upon the closing of such Alternative Transaction, in addition to the return of the Deposit, a breakup fee equal to \$1,000,000.
- **New Capital Structure for JetFleet Holding Corp. (“JHC”).** On the Effective Date, the following transactions relating to JHC equity ownership shall be executed:
 - Cancellation of ACY Equity in JHC. All outstanding stock of JetFleet Holding Corp. (“JHC”) currently held 100% by its parent, AeroCentury, shall be canceled.
 - JHC Common Stock Issuance to Plan Sponsor and JHC Management. Plan Sponsor shall acquire 35,000 shares of common stock of JHC, and certain employees of JHC (“JHC Management”) who will be appointed to continue the legacy aircraft leasing business of AeroCentury through JHC shall acquire 65,000 shares of common stock of JHC. All shares of common stock of JHC will be purchased at a price of \$1 per share.
 - JHC Series A Preferred Stock Issuance to AeroCentury Corp. AeroCentury will use \$2 million of its proceeds from the Plan Sponsor’s purchase of New ACY Shares to purchase new JHC Series A Preferred Stock from JHC. The JHC Series A Preferred Stock shall carry a dividend rate of 7.5% per annum, shall be non-convertible and non-transferable, shall be redeemable by JHC at any time, but shall only be redeemable by AeroCentury after 7 years. The JHC Series A Preferred Stockholders shall in the aggregate constitute 51% of the voting equity of JHC, voting as a single class together with the outstanding JHC Common Stock.
 - Distribution of Trust Interest in JHC Series B to Legacy ACY Shareholders. A trust (“Legacy Trust”) will be established for the benefit of the Legacy ACY Shareholders, and JHC will issue new JHC Series B Preferred Stock to the Legacy Trust. The JHC Series B Preferred Stock issued to the Legacy Trust will have an aggregate liquidation preference of \$1, non-convertible, non-transferable, non-voting, will not pay a dividend, and will contain a mandatory, redeemable provision. The JHC Series B Preferred Stock will be redeemable for an aggregate amount equal to (i) \$1,000,000, if the JHC Series B Preferred Stock is redeemed after the first fiscal year for which JHC reports positive EBITDA for the preceding 12-month period, or (ii) \$0.001 per share, if the JHC Series B Preferred Stock is redeemed prior the first fiscal year for which JHC reports positive EBITDA for the preceding 12-month period.

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- **Cash Distribution to Legacy ACY Shareholders.** As soon as practicable following the Effective Date, AeroCentury will make a cash dividend distribution to the Legacy ACY Shareholders in the aggregate amount of \$1,000,000, funded from the purchase price paid by Plan Sponsor for the New ACY Shares.
- **Board Make-up Following Sponsor Investment.** Following the Effective Date, AeroCentury will have a Board of Directors initially consisting of five (5) members, which will consist of (i) three directors designated by Yucheng Hu (the “Lead Investor”) and (ii) two directors to be mutually agreed upon by the Lead Investor and the current incumbent Board of Directors.

The full text of the executed Plan Sponsor Agreement is publicly available on the Company’s Exhibit 99.1 to the Company’s Report on Form 8-K, filed on August 17, 2021, available on the SEC’s EDGAR website at:

<https://www.sec.gov/Archives/edgar/data/0001036848/000165495421009126/exh991plansponsoragreemen.htm>

Factors that May Affect Future Results and Liquidity

The Company’s business, financial condition, results of operations, liquidity, prospects and reputation could be affected by a number of factors. In addition to matters discussed elsewhere in this discussion, the Company believes the following are the most significant factors that may impact the Company; however, additional or other factors not presently known to the Company or that management presently deems immaterial could also impact the Company and its performance and liquidity.

- ***Risks related to the Chapter 11 Cases***

Chapter 11 Effect on Common Stock Value. As previously disclosed, on March 29, 2021, the AeroCentury and two of its subsidiaries filed voluntary petitions under Chapter 11 of the Bankruptcy Code in the Bankruptcy Court, thereby commencing the Chapter 11 Case. The price of the Company's common stock has been volatile following the commencement of the Chapter 11 Cases and the Company's common stock may decrease in value or become worthless. Accordingly, any trading in the Company's common stock during the pendency of the Company's Chapter 11 Cases is highly speculative and poses substantial risks to purchasers of the Company's common stock. Although the Company has entered into a Plan Sponsor Agreement, which is the linchpin of its proposed Chapter 11 exit plan, the exit plan and Plan Sponsor Agreement are subject to the approval of the bankruptcy court. While the consummation of the Plan Sponsor Agreement and Chapter 11 exit plan will result in satisfaction of the holders of senior claims and interests, such as secured indebtedness, and reinstatement of the outstanding common stock, there is no assurance that the Company will be able to consummate its exit. If the Court fails to approve the Plan Sponsor Agreement, the Company would likely transition to a liquidating plan. Under a liquidating plan, the Company will likely cease operations and liquidate and distribute any remaining assets toward satisfaction of the Company's creditors. In such event, a court-appointed trustee would be appointed or elected to liquidate the Company's assets for distribution to creditors in accordance with the priorities established by the Bankruptcy Code. Holders of the Company's common stock could lose all or a significant part of their entire investment if the Company executes a liquidation plan.

Impact of Chapter 11 on Business Strategy. For the duration of the Chapter 11 Cases, the Company's operations and ability to execute its business strategy will be subject to the risks and uncertainties associated with bankruptcy. These risks include:

- the ability to obtain Bankruptcy Court approval with respect to motions filed in the Chapter 11 Cases from time to time;
- the ability to comply with and operate under the requirements and constraints of the Bankruptcy Code and under any cash management, adequate protection, or other orders entered by the Bankruptcy Court from time to time;
- the ability to fund operations from cash on hand;
- the ability to negotiate and consummate a Chapter 11 reorganization plan; and
- the ability to develop, fund, and execute a business plan in the aircraft leasing business or another potential line of business into which the Company may expand.

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These risks and uncertainties could affect the Company's business and operations in various ways. For example, negative events or publicity associated with the Chapter 11 Cases could adversely affect the Company's relationships with its suppliers, customers and employees. In particular, critical vendors, suppliers, and/or customers may determine not to do business with the Company due to the Chapter 11 Cases and the Company may not be successful in securing alternative sources or relationships. Also, transactions outside the ordinary course of business are subject to the prior approval of the Bankruptcy Court, which may limit the Company's ability to respond timely to certain events or take advantage of opportunities. Because of the risks and uncertainties associated with the Chapter 11 Cases, the Company cannot predict or quantify the ultimate impact that events occurring during the Chapter 11 process may have on the Company's business, financial condition and results of operations.

Adverse Impact of Chapter 11 Cases on Business and Human Resources. While the Chapter 11 Cases continue, the Company's management will be required to spend a significant amount of time and effort focusing on the Chapter 11 Cases. This diversion of attention may materially adversely affect the conduct of the Company's business, and, as a result, the Company's financial condition and results of operations, particularly if the Chapter 11 Cases become protracted. During the Chapter 11 Cases, the Company's employees will face considerable distraction and uncertainty and the Company may experience increased levels of employee attrition. A loss of key personnel or material erosion of employee morale could have a materially adverse effect on the Company's ability to meet customer expectations, thereby adversely affecting its business and results of operations. The failure to retain or attract members of the Company's management team and other key personnel could impair its ability to execute its strategy and implement operational initiatives and the Company's reorganization plan, thereby having a material adverse effect on its financial condition and results of operations.

Change in Capital Structure or Business Focus Upon Bankruptcy Exit. The Company's post-bankruptcy capital structure will change significantly pursuant to the reorganization plan ("Reorganization Plan") that requires Bankruptcy Court approval. Under the agreements with the Plan Sponsor, the Plan Sponsor will be issued new equity securities in return for an \$11 million cash investment. The issuance of these new shares will result in a change in control of the Company as well as a significant ownership dilution of existing stockholder. Though the proposed Plan provides a continuing equity interest by current stockholders in ACY, such current stockholders would end up holding shares representing only 35% of the recapitalized Company following consummation of the Plan Sponsor Agreement. Furthermore, once the Plan Sponsor obtains control of the Company, it may decide to expand, and devote significant focus, into new currently unidentified lines of business in addition to, or

in replacement of the Company's current line of business in the regional aircraft leasing space. If that occurs, the value of the Company's common stock would in turn depend upon the success or failure of that new line of business.

Plan Assumptions May Prove Inaccurate. Any Chapter 11 Reorganization Plan that the Company may implement will affect both its capital structure and the ownership, structure and operation of its business and will likely reflect assumptions and analyses based on its experience and perception of historical trends, current conditions and expected future developments, as well as other factors that the Company considers appropriate under the circumstances. Whether actual future results and developments will be consistent with management's expectations and assumptions depends on a number of factors, including but not limited to (i) the Company's ability to substantially change its capital structure; (ii) the overall strength and stability of general economic conditions, both in the U.S. and in global markets, and (iii) the Company's success in formulating and executing a profitable business plan in the regional aircraft line of business and/or other potential lines of business that the Company may enter into in the future. The failure of any of these factors could materially adversely affect the successful reorganization of the Company's businesses.

In addition, any Reorganization Plan will likely rely upon financial projections, including with respect to revenues, consolidated adjusted EBITDA, capital expenditures, debt service and cash flow. Financial forecasts are necessarily speculative, and it is likely that one or more of the assumptions and estimates that are the basis of these financial forecasts will not be accurate. In the Company's case, the forecasts will be even more speculative than normal, because they may involve fundamental changes in the nature of the Company's capital structure. Additionally, the impact of the COVID-19 Pandemic on the aviation and travel industry in general, and on the Company, make it even more challenging than usual to develop business forecasts. Accordingly, the Company expects that its actual financial condition and results of operations will differ, perhaps materially, from what is anticipated. Consequently, there can be no assurance that the results or developments contemplated by any Reorganization Plan will occur or, even if they do occur, that they will have the anticipated effects on the Company's businesses or operations. The failure of any such results or developments to materialize as anticipated could materially adversely affect the successful execution of any Reorganization Plan. If the Company were to engage in a new line of business following the reorganization, any projections, assumptions or plans relating to the Company's future operations that were based upon the assumed continuation of the Company's aircraft leasing business would become irrelevant.

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Non-dischargeable Claims. The Bankruptcy Code provides that the confirmation of a debtor's Reorganization Plan by the Bankruptcy Court discharges a debtor from substantially all debts arising prior to confirmation. With few exceptions, all claims that arose prior to confirmation of the Reorganization Plan (i) would be subject to compromise and/or treatment under the Reorganization Plan and (ii) would be discharged in accordance with the Bankruptcy Code and the terms of the Reorganization Plan. Any claims not ultimately discharged through the Company's Chapter 11 Reorganization Plan could be asserted against the reorganized entities and may have an adverse effect on the Company's financial condition and results of operations on a post-reorganization basis.

Protracted Chapter 11 Cases Adverse to Business. A long period of operations under Bankruptcy Court protection could have a material adverse effect on the Company's business, financial condition, results of operations, and liquidity. So long as the Chapter 11 Cases continue, senior management will be required to spend a significant amount of time and effort dealing with the reorganization instead of focusing exclusively on business operations. A prolonged period of operating under Bankruptcy Court protection also may make it more difficult to retain management and other key personnel necessary to the success of the Company's business. In addition, the longer the Chapter 11 Cases continue, the more likely it is that customers and suppliers will lose confidence in the Company's ability to reorganize its business successfully and will seek to establish alternative commercial relationships.

So long as the Chapter 11 Cases continue, the Company will be required to incur substantial costs for professional fees and other expenses associated with the administration of the Chapter 11 Cases, including potentially the cost of litigation. In general, litigation can be expensive and time consuming to bring or defend against. Such litigation could result in settlements or damages that could significantly affect the Company's financial results. It is also possible that certain parties will commence litigation with respect to the treatment of their claims under a Reorganization Plan. It is not possible to predict the potential litigation that the Company may become party to, nor the final resolution of such litigation. The impact of any such litigation on the Company's business and financial stability, however, could be material. Should the Chapter 11 Cases be protracted, the Company may also need to seek new financing to fund operations. If the Company is unable to obtain such financing on favorable terms or at all, the chances of confirming a Reorganization Plan may be seriously jeopardized and the likelihood that we will instead be required to liquidate the Company's assets may increase. If the Company is able to obtain such financing, it may be on unfavorable terms, and may be conditioned upon changes in the line of business in which the Company is engaged.

No Assurance of Closing of Plan Sponsor Investment. The Company has entered into a Plan Sponsor Agreement which would be effective upon approval of the Bankruptcy Court and the Company's exiting the Chapter 11 Cases. The Plan Sponsor Agreement and the funding of the capital investment from the Plan Sponsor set forth thereunder is subject to numerous conditions that must be satisfied on or before closing. There is no

assurance that the Company will be able to comply with all of the requisite conditions precedent. If the Company is unable to consummate the Plan Sponsor Agreement due to inability to meet the closing conditions for the Plan Sponsor's investment, the Company may not have sufficient time or resources to locate or negotiate with an alternative source of exit financing and would be forced to cease operations and liquidate and distribute any remaining assets toward satisfaction of the Company's creditors.

Impact of Further Equity Financings on Existing Stockholders and Market Price. The Plan Sponsor Agreement provides for the issuance of 2,857,143 shares of Common Stock to the Plan Sponsor at a price of \$3.85, which is lower than the market price for the shares as of the date of this filing. The issuance of the new shares to the Plan Sponsor will result in the current stockholders' percentage interest in the Common Stock of the Company decreasing to 35%. In order to raise additional working capital to expand the Company's existing business line, or expand into new business lines, the Company may in the future issue additional shares of its common stock or other securities convertible into or exchangeable for its common stock at prices that are lower than the prices quoted on the NYSE American Stock Exchange at the time of issuance. These issuances could dilute existing stockholders. And investors acquiring shares or other securities in the future could have rights superior to existing stockholders.

Sales of a substantial number of shares of the Company's common stock, whether in a private placement or in the public markets, or the perception that such sales could occur, could depress the market price of the Company's common stock and impair the Company's ability to raise capital through the sale of additional equity securities. The Company cannot predict the effect that future sales of its common stock would have on the market price of its common stock.

Court-ordered Restrictions on Trading Common Stock. In connection with the Chapter 11 Cases, the Bankruptcy Court entered an order that, among other things, imposes certain trading restrictions on holders of greater than 4.9% of the Company's common stock. The restrictions in this order are intended to preserve certain of the Company's tax attributes, including tax losses and carryforwards. There can be no assurance that the existing restrictions will remain in place or that additional or modified trading restrictions will not be implemented with respect to the Company's common stock, nor can there be any assurance of the Company's ability to use its tax attributes.

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- ***Leasing Industry and Aviation Related Risks***

Impact of COVID-19 Pandemic. The ongoing COVID-19 Pandemic has had an overwhelming adverse effect on the Company, as it has had on all forms of transportation globally, but most acutely for the airline industry. The combined effect of fear of infection during air travel, quarantines, and shifting international and domestic travel restrictions has caused a dramatic decrease in passenger loads in all areas of the world, not just in those countries with active clusters of COVID-19. This has led to significant cash flow issues for airlines, including some of the Company's customers, and some airlines have been unable to timely meet their obligations under their lease obligations with the Company. Any significant nonpayment or late payment of lease payments by a significant lessee or combination of lessees could in turn impose limits on the Company's ability to fund its ongoing operations. Furthermore, for the duration of the pandemic and a period of financial recovery thereafter, sale transactions and financing availability could be curtailed entirely or delayed while the industry returns to financial stability, which could impact the Company's ability to implement any restart of its leasing business following its potential exit from its Chapter 11 Cases.

General Economic Conditions and Lowered Demand for Travel. Because of the international nature of the Company's business, a downturn in the health of the global economy could have a negative impact on the Company's financial results, as demand for air travel generally decreases during slow or no-growth periods, and thus demand by airlines for aircraft capacity is also decreased. As discussed above, the COVID-19 Pandemic has caused significant disruptions to the global supply chain, the stock market and consumer and business-to-business commerce, resulting in continued global economic uncertainty and the effects of which may endure well beyond the current pandemic's ultimate life cycle and result in low or negative growth in future periods. According to current reports, scheduled airline flights have been significantly reduced. While lower demand for air travel may actually lead to business opportunities as airlines turn to smaller aircraft to right-size capacity, it also presents potential challenges for the Company as it may impact the values of aircraft in the Company's portfolio, lower market rents for aircraft that are being offered for lease by the Company, cause Company customers to be unable to meet their lease obligations, or reduce demand by airlines that would be potential customers for additional or replacement regional aircraft offered by the Company. Further, while the increasing availability of vaccines and various treatments for COVID-19 are expected to have an overall positive impact on business conditions including travel, there remain uncertainties as to the logistics and the overall efficacy of any treatment program, including with regard to new strains or variants of the virus.

A downturn in the Chinese domestic or export economy that reduces demand for imported raw materials, such as further economic volatility or future periods of economic slowdown associated with the COVID-19 Pandemic, could have a significant negative longer-term impact on the demand for business and regional aircraft in developing countries, including in some of the markets in which the Company seeks to do business.

Furthermore, instability arising from new U.S. sanctions or trade wars against U.S. trading partners, and the global reaction to such sanctions, or due to other factors, could have a negative impact on the Company's customers located in regions affected by such sanctions.

Also, the withdrawal of the United Kingdom ("UK") from the European Union, known as "Brexit," could threaten "open-sky" policies under which UK-based carriers operate throughout the European Union, and European Union-based carriers operate between the UK and other European Union countries. 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, terrorist attacks involving aircraft or airports occur, or if another major flu or new pandemic occurs, air travel could be severely affected. Any such occurrence 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 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.

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, they will fully protect the Company from losses resulting from a lessee default or bankruptcy.

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If a U.S. lessee defaults under a lease and seeks protection under Chapter 11 of the 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 in the event of a bankruptcy filing by a defaulting lessee.

Lessees located in low-growth or no-growth areas of the world carry heightened risk of lessee default. A customer's insolvency or bankruptcy usually results in the Company's total loss of the receivables from that customer, as well as additional costs in order to repossess and, in some cases, repair the aircraft leased by the customer. 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 in an attempt to mitigate losses in the event the lessee is unable to meet or rejects its lease obligations. There can be no assurance, however, that additional customers will not become insolvent, file for bankruptcy or otherwise fail to perform their lease obligations, 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 is likely to 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.

Lack of Portfolio Diversification. Because of the diminished size of the Company's portfolio relative to its historical size, the Company's current portfolio lacks diversification and any default by a lessee would have a significant impact on the Company's financial results. Once the sale of the Drake Collateral pursuant to the Stalking Horse Agreement is consummated, the Company's portfolio of leased aircraft will consist of one, or possibly no aircraft, and a small group of engine part assets. This risk of non-diversification is likely to last for a considerable time through and after the Company's exit from its Chapter 11 Cases as it may take a number of years for the Company, if and when it is able to continue its aircraft leasing business, to rebuild its portfolio to a size that reflects diversification in terms of lessees and geographic location.

Concentration of Aircraft Type. The Company's aircraft portfolio is likely to remain focused on a small number of aircraft types and models relative to the variety of aircraft used in the commercial air carrier market, most of these types are used extensively by regional airlines. 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. In addition, the Company is dependent on the third-party companies that manufacture and provide service for the aircraft types in the Company's portfolio. The

Company has no control over these companies, and they could decide to curtail or discontinue production of or service for these aircraft types at any time or significantly increase their costs, which could negatively impact the Company's prospects and performance. These effects would diminish if the Company acquires assets of other types. Conversely, acquisition of additional aircraft of the 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 other leasing companies, banks, financial institutions, private equity firms, aircraft leasing syndicates, aircraft manufacturers, distributors, airlines and aircraft operators, equipment managers, equipment leasing programs and other parties engaged in leasing, managing or remarketing aircraft. Many of these competitors have longer operating histories, more experience, larger customer bases, more expansive brand recognition, deeper market penetration and significantly greater financial resources.

Prior to the COVID Pandemic, competition was intense as competitors who have traditionally neglected the regional air carrier market began to focus on this market. The industry also experienced a number of consolidations of smaller leasing companies, creating a handful of very large companies operating in this market, as well as new entrants to the market. The entry of traditional large aircraft lessors into the regional aircraft niche, particularly those with greater access to capital than the Company, led to fewer acquisition opportunities for the Company and lower lease yields to the Company, as well as fewer renewals of existing leases or new leases of existing aircraft.

The current COVID Pandemic has disrupted the airline industry and many of its competitors, as many airline customers have grounded aircraft and are seeking rent holidays or terminating leases, and in the absence of such lessor accommodations are defaulting on lease obligations. Many of the Company's aircraft leasing competitors have left the market, been acquired, or, like the Company, are shedding assets in order to raise cash to resolve debt non-compliance. In the near and medium term, those lessors with substantial cash reserves and/or available acquisition financing for speedy closings will have opportunities for profitable transactions and will have a significant competitive advantage in the market that the Company cannot currently match unless and until it obtains readily drawable acquisition financing.

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Risks Related to Regional Air Carriers. The Company's continued focus on its customer base of regional air carriers subjects the Company to certain 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 or fails to perform under the relationship or 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 regulations of the U.S. Federal Aviation Administration 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 the aircraft types in the Company's portfolio and the Company's business, performance and liquidity.

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

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 or less stable 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 strong and stable.

The Company is subject to certain risks related to currency conversion fluctuations. The Company currently has one customer with rent obligations payable in Euros, and the Company may, from time to time, agree to additional leases that permit payment in foreign currency, which would subject such lease revenue to monetary risk due to currency exchange rate fluctuations. During the periods covered by this report, the Company considers the estimated effect on its revenues of foreign currency exchange rate fluctuations to be immaterial; however, the impact of these fluctuations may increase in future periods if additional rent obligations become payable in foreign currencies.

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

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. Any such challenge could result in increased tax obligations in these jurisdictions going forward or assessments of liability by the taxing authority, in which case the Company may be required to pay penalties and interest on the assessed amount that would not give rise to a corresponding foreign tax credit on the Company's U.S. tax returns.

Significant changes in U.S. trade policy that materially impact U.S. trade, including terminating, renegotiating or otherwise modifying U.S. trade agreements with countries in various regions and imposing tariffs on certain goods imported into the United States could have a financial impact on the Company. Such changes in U.S. trade policy could trigger retaliatory actions by affected countries, including China, resulting in "trade wars" with these countries. These trade wars could generally increase the cost of aircraft, aircraft and engine components and other goods regularly imported by the Company's customers, thereby increasing costs of operations for its air carrier customers that are located in the affected countries. The increased costs could materially and adversely impact the financial health of affected air carriers, which in turn could have a negative impact on the Company's business opportunities, and if the Company's lessees are significantly affected, could have a direct impact on the Company's financial results. Furthermore, the Company often incurs maintenance or repair expenses not covered by lessees in foreign countries, which expenses could increase if such countries are affected by such a trade war.

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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 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. Declines in the value of the Company's aircraft and any resulting decline in market demand for these aircraft could materially adversely affect the Company's revenues, performance and liquidity.

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 a lessee becomes insolvent during the term of its lease and the Company has to repossess the asset, it is unlikely that the lessee would have the financial ability to meet these return obligations. In addition, if a lessee files for bankruptcy and rejects 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 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 need to pay the costs of unperformed repair and maintenance under the applicable lease and 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 flow 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 as recently as the first quarter of 2021 and may be required to record asset impairment charges in the future as a result of the sale of the Drake Collateral pursuant to the Stalking Horse Agreement, the impact of COVID-19 on the aviation industry, 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.

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. Additionally, even if lessees are responsible for the costs of complying with these requirements, changes to the requirements to make them more stringent or otherwise increase these costs could negatively impact the Company's customers' businesses, which could result in nonperformance under their lease agreements or decreased demand for the Company's aircraft. Furthermore, future government regulations could cause the value of any noncomplying equipment owned by the Company to decline substantially. Moreover, any failure by the Company to comply with the government regulations applicable to it could result in sanctions, fines or other penalties, which could harm the Company's reputation and performance.

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Casualties and 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, because 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 additional 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 the provisions of this law 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 has adopted measures designed to ensure these insurance policies continue to be maintained, including tracking receipt of the insurance certificates, calendaring their expiration dates, and reminding lessees of their obligations to maintain such insurance and provide current insurance certificates to the Company if a replacement certificate is not timely received prior to the expiration of an existing certificate.

Despite these requirements and procedures, there may be certain cases where losses or liabilities are not entirely covered by the lessee or its insurance. Although the Company believes the possibility of such an event is remote, any such uninsured loss or liability, or insured loss or liability for which insurance proceeds are inadequate, might result in a loss of invested capital in and any profits anticipated from the applicable aircraft, as well as potential claims directly against the Company.

Compliance with Environmental Regulations. Compliance with 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, including requirements to adopt technology to reduce the amount of carbon emissions or imposing a fee or tax system on carbon emitters. Any such regulation could be directed at the Company's customers, as operators of aircraft, at the Company, as an owner of aircraft, and/or on the manufacturers of aircraft. Under the Company's triple-net lease arrangements, the Company would likely try to shift responsibility for compliance to its lessees; however, it may not be able to do so due to competitive or other market factors, and there might be some compliance costs that the Company could not pass through to its customers 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 liquidity, there is no assurance that the costs of complying with environmental regulations as amended or adopted in the future will not have such an effect.

Cybersecurity Risks. The Company believes that its main vulnerabilities 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 to date the Company has not experienced a material cyber-attack and the Company believes that it has sufficient cybersecurity 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 or adequately respond to and mitigate all types of cyber-attacks.

- **Risks Related to the Company's Common Stock**

Listing Compliance Deficiency Notice from NYSE American. On September 11, 2020, the Company received a deficiency letter from NYSE American Stock Exchange ("NYSE American") notifying that the Company was not in compliance with the continued listing standards as set forth in Section 1003(a)(i) – (iii) of the NYSE American Company Guide (the "Company Guide"). The noncompliance arose from the Company's financial statement showing a stockholders' equity deficiency as of June 30, 2020 combined with net losses for the most recent fiscal years ended December 31, 2018 and December 31, 2019.

The Company Guide requires a minimum stockholders' equity of \$2.0 million or more if it has reported losses from continuing operations and/or net losses in two of its three most recent fiscal years; Stockholders' equity of \$4.0 million or more if it has reported losses from continuing operations and/or net losses in three of its four most recent fiscal years (Section 1003(a)(ii)); and Stockholders' equity of \$6.0 million or more if it has reported losses from continuing operations and/or net losses in its five most recent fiscal years (Section 1003(a)(iii)). Currently, the Company is required to meet the \$4.0 million threshold.

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The letter had no immediate effect on the listing of the Company's common stock on the NYSE American and the Company's common stock will continue to trade on the NYSE American while the Company takes measures to regain compliance with the continued listing standards. As required by Company Guide, the Company has submitted a detailed plan of compliance to the NYSE American, advising the NYSE American of the actions the Company has taken, or plans to take, that would bring it into compliance with the continued listing standards within 18 months of receipt of the Deficiency Letter and must periodically report on its progress or any deviation from its plan.

If the Company fails to return to compliance by the end of that eighteen-month period, the NYSE American exchange could de-list the Company's common stock. If that occurs, liquidity of common stock held by the shareholders of the Company could be significantly impacted, as any trading in the Company's securities would no longer be executed over the NYSE American Exchange but would have to be transacted through over-the-counter exchanges or pink sheets. This could depress the Company's market price substantially. De-listing may also make further equity financing of the Company more difficult by eliminating as potential investors those who are seeking liquidity in their investment.

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 or 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, including changes in investor perception on competitor's stock prices and operating results, or arising from other investor sentiment unknown to the Company. The Chapter 11 Cases may also contribute significantly to market price volatility of the Company's common stock due to investors' perceptions of the Company's equity value in light of the Chapter 11 Cases and speculation on the impact of the plan of reorganization that will be proposed and the Bankruptcy Court's decision on such plan. Because the Company has a relatively small capitalization of approximately 1.55 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. This stock price and trading volume volatility could limit the Company's ability to use its capital stock to raise capital, if and when needed or desired, or as consideration for other types of transactions, including strategic collaborations, investments or acquisitions. Any such limitation could negatively affect the Company's performance, growth prospects and liquidity.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Disclosure under this item has been omitted pursuant to the rules of the SEC that permit smaller reporting companies to omit such information.

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Item 4. Controls and Procedures.

CEO and CFO Certifications. Attached as exhibits to this 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 Item 4 includes information concerning the evaluation of disclosure controls and procedures referred to in the Section 302 Certifications and 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 or submitted under the Exchange Act, such as this report, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC 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 Company’s Disclosure Controls as of June 30, 2021. Based on this evaluation, the CEO and CFO concluded that the Company’s Disclosure Controls were not effective as of June 30, 2021 due to the material weakness described below.

Inherent Limitations of Disclosure Controls and Internal Control. In designing its Disclosure Controls and Internal Control, the Company’s management recognizes that any controls and procedures, no matter how well-designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of the Company’s controls and procedures must reflect the fact that there are resource constraints, and management necessarily applies its judgment in evaluating the benefits of possible controls and procedures relative to their costs. Because of these inherent limitations, the Company’s Disclosure Controls and Internal Control may not prevent or detect all instances of fraud, misstatements or other control issues. In addition, projections of any evaluation of the effectiveness of disclosure or internal controls to future periods are subject to risks, including, among others, that controls may become inadequate because of changes in conditions or that compliance with policies or procedures may deteriorate.

The Company previously identified a material weakness in its internal control over financial reporting (“Internal Control”) relating to its tax review control for complex transactions. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company’s annual or interim financial statements will not be prevented or detected on a timely basis. Management is in the process of enhancing its tax review control related to unusual transactions the Company may encounter, but that control has not operated for a sufficient time to determine if the control is effective as of June 30, 2021.

Changes in Internal Control. No change in the Company’s Internal Control occurred during the fiscal quarter ended June 30, 2021 that has materially affected, or is reasonably likely to materially affect, the Company’s Internal Control.

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PART II – OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Under the Drake Loan Agreement, the Company is not permitted to pay dividends on any shares of its capital stock without the consent of Drake.

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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 Harold M. Lyons, 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 Harold M. Lyons, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
10.1	Plan Sponsor Agreement between AeroCentury Corp., JetFleet Management Corp., JetFleet Holding Corp., and Yucheng Hu.

[Hao Yang, Jing Li, Yeh Ching, Yu Wang, TongTong Ma, Qiang Zhang, Yanhua Li, and Yiyi Huang \(collectively, the “Plan Sponsor”\)](#)

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 SEC.

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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: August 23, 2021

By: /s/ Harold M. Lyons
 Name: Harold M. Lyons
 Title: Senior Vice President-Finance and
 Chief Financial Officer