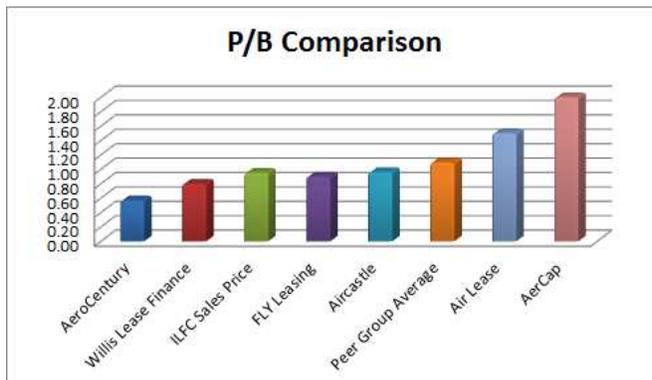


Can AeroCentury's Share Price Catch Up to Its Book Value?

Neutral

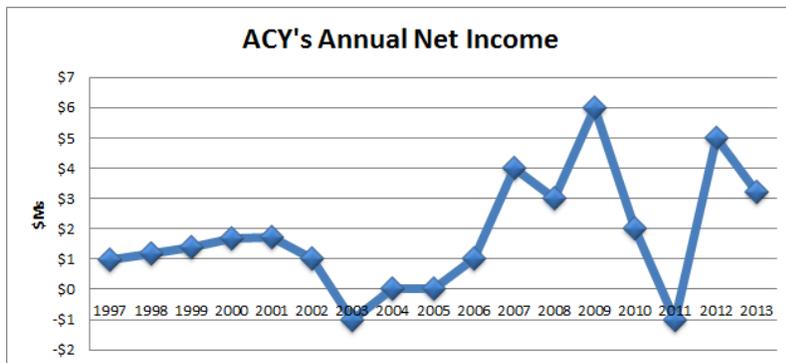
We have considered investing in AeroCentury (ACY), an aircraft leasing company because Russ Murdock of Seabreeze Capital Management amassed a 15.7% stake in the company. We liked that it enjoyed jet-powered revenue and profit growth from 2003 to 2009 but its financial results stagnated since then. We like that AeroCentury's shares are trading at a 43% discount to its book value. However, we do not like the lack of liquidity (3-month average daily volume of 2,723 shares traded) and its projected revenue and EPS declines in Q4 2013 and FY 2014. On one hand, we liked that AIG sold its ILFC aircraft-leasing subsidiary to AerCap (AER) for \$3B in cash and 46% of the newly combined AerCap/ILFC enterprise. We see the ILFC sale as paving the way for consolidation in the aircraft leasing business and we liked that the 0.95X book value AIG realized from selling ILFC is higher than the 0.57X that ACY is trading at. We like that AeroCentury's principal executives and stockholders are each over 65 years old and may want to retire and cash out their stakes in the company, which may help shareholders realized value in AeroCentury. On the other hand, AeroCentury has a poison pill that may decrease the likelihood of a potential deal.



Source: Morningstar Direct

AeroCentury's Corporate Overview

AeroCentury is an independent aircraft leasing company that focuses on foreign regional carriers. AeroCentury generally targets used regional aircraft and engines with purchase prices between \$3 million and \$10 million, and lease terms less than five years. JetFleet Management, an integrated aircraft management, marketing and financing company, manages the assets under an agreement with AeroCentury. Certain officers of AeroCentury are also officers of AeroCentury and hold significant ownership positions in both JetFleet Management and AeroCentury.



Source: Morningstar Direct

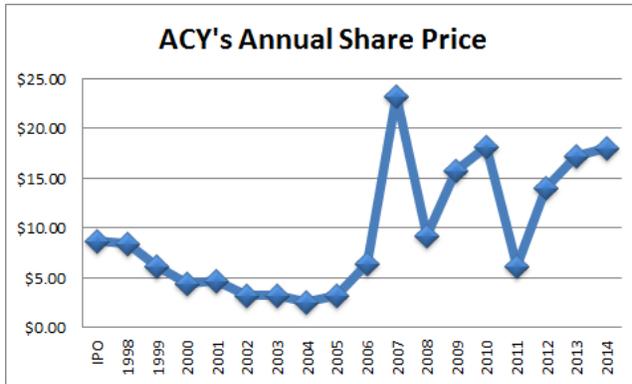
Large Shareholders of AeroCentury:

- Neal Crispin (Chairman of the Board and President) and his wife Toni Perazzo (Senior Vice President of Finance) (332K shares, 20.44% of AeroCentury)
- Seabreeze Capital Management (242K shares, 15.7% of AeroCentury)
- Lee Beaumont (91.95K shares, 5.7% of AeroCentury)
- Whitebox Advisors, LLC (81K shares, 5% of AeroCentury)

Risks to AeroCentury include the following:

- Increased competition from other aircraft leasing companies or financial institutions in its regional aircraft leasing market segment.
- Slowdowns in the worldwide economy reducing the demand for aircraft and air travel.
- Continued high prices for oil and jet fuel
- Its four largest customers account for nearly 50% of its lease revenue as of FY 2012 and loss of any of these customers will have a negative impact on its revenues and profits.
- Four of its customers have declared bankruptcy over the past two years and the company could see additional potential bankruptcies in future years.

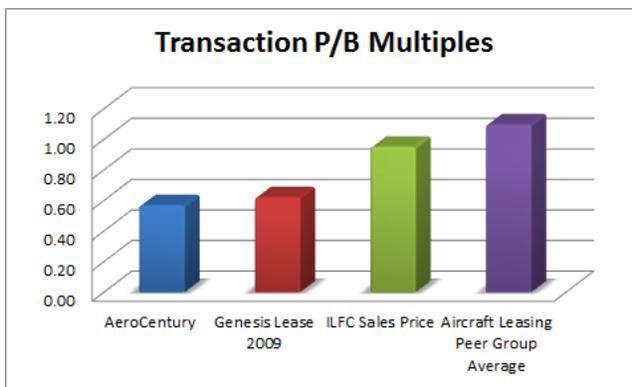
Although its share price is 43% below its book value, AeroCentury's stock is not for the faint of heart. AeroCentury went public in 1998 at \$8.75 per share and it steadily sagged to a low of \$2.05 in August 2004. It then reached a high of \$26.67 in January 2008, sunk to \$3.15 in March 2009, climbed to \$25 in May 2010, dropped to a low of \$5.30 in November 2011, recovered to \$22.30 in August 2013 and shed 19% since then to close at \$18.07 on March 12.



Source: Morningstar Direct

Industry Overview:

The good news for AeroCentury is that there are not many aircraft leasing companies worldwide, maybe a dozen or two dozen. AeroCentury occupies a narrow niche in that it focuses on regional airlines and is one of the few companies worldwide that specialize in this segment. However, the only aircraft-leasing firm that generated significant growth in Q3 2013 was Steven Udvar-Házy's Air Lease Corporation (AL). At least AerCap reduced competition in this segment by acquiring ILFC from AIG for \$7B. AeroCentury has a poison pill, which will not help the odds of a takeover. Speculators may consider buying AeroCentury because its two most senior executives may want to cash out and retire from the company. However, given that AerCap paid 0.62X book value for Genesis Lease in 2009 and is paying 0.95X book value for ILFC, there can be no guarantee that a buyer will acquire AeroCentury at our fair target value of 1X book value.



Source: Morningstar Direct

In conclusion, we rate AeroCentury as a Neutral. We like that it is trading at a discount to its book value and it enjoys significant institutional/insider ownership. However, we are concerned that its revenues and profits have peaked in the near term as it registered a big decline in Q4 2013 and will continue to decline in FY 2014. We disagree with the [International Air Transport Association's thesis](#) that 2014 will be the most profitable year ever as we see global macroeconomic headwinds that may potentially sap demand for air travel. Furthermore, the

only company in the aircraft leasing industry that has shown significant growth this year is Air Lease. Four of AeroCentury's customers have declared bankruptcy in the last two years. AeroCentury's management expects the company to experience lower on-lease utilization rates and longer lead times for remarketing of returned assets, as well as lower rental rates for remarketed assets, as was the case with several lease extensions and re-leases since 2011. We expect this trend to continue to affect AeroCentury's operating revenue for the remainder of 2013 and 2014. For these reasons, we assigned a neutral rating to it.

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Disclosure: Analyst covering ACY does not have a position in it

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