AEROCENTURY CORP
Form 10QSB
November 13, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-QSB

(Mark One)
x Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2006

o Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ____________ to ____________

Commission File Number: **001-13387**

AeroCentury Corp.
(Exact name of small business issuer as specified in its charter)

Delaware	**94-3263974**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1440 Chapin Avenue, Suite 310
Burlingame, California 94010
(Address of principal executive offices)

(650) 340-1888
(Issuer's telephone number)

None
(Former name, former address and former fiscal year, if changed since last report)

Check whether the Issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of November 13, 2006 the Issuer had 1,606,557 Shares of Common Stock, par value $0.001 per share, issued, of which 63,300 are held as Treasury Stock.

Transitional Small Business Disclosure Format (check one):
Yes o No x

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PART I
FINANCIAL INFORMATION

Forward-Looking Statements

This Quarterly Report on Form 10-QSB includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (“the Exchange Act”). All statements in this Report other than statements of historical fact are "forward looking statements" for purposes of these provisions, including any statements of plans and objectives for future operations and any statements of assumptions underlying any of the foregoing. Statements that include the use of terminology such as "may," "will," "expects," "plans," "anticipates," "estimates," "potential," or "continue," or the negative thereof, or other comparable terminology are forward-looking statements. Forward-looking statements include: (i) in Item 1 "Financial Statements, Note 1" the statement regarding the Company's belief that its current tax positions are highly certain and that implementation of FASB Interpretation No. 48 will not have any material effect on its tax accounts, balances or provisions; and the Company’s belief that SAB 108 will have a material impact on the Company’s results of operations but will not have a material impact on the Company’s financial position (ii) in Item 1 “Financial Statements, Note 5” the statement that future taxable income will likely be sufficient to realize the tax benefits of all the deferred tax assets on the balance sheet; (iii) in Item 2 "Management's Discussion and Analysis or Plan of Operation -- Liquidity and Capital Resources," statements regarding the Company's belief that it continue to be in compliance with all covenants of its credit facility; and that it will have adequate cash flow to meet its ongoing operational needs; (iv) in Item 2 "Management's Discussion and Analysis or Plan of Operation -- Outlook," statements regarding the Company's belief that the lease for an aircraft that expires in November 2006 will be extended; and that the Company’s adoption of a new method for accounting of planned major maintenance will lead to a greater fluctuation in quarterly earnings; and (v) in Item 2 "Management's Discussion and Analysis or Plan of Operation -- Factors that May Affect Future Results,” statements regarding the Company's belief that it will be able to meet its short term cash flow needs; that it will have sufficient cash to fund any required repayments under its credit facility caused by borrowing base limitations as a result of assets scheduled to come off lease in the near term; that it will have sufficient funds to pay increased Sarbanes-Oxley compliance costs; that it will acquire primarily used aircraft and expect to concentrate in a limited number of airframe and aircraft engine types; that overseas markets present business opportunities; that the Company is competitive because of JMC's experience and operational efficiency and will benefit because of JMC's reputation in the marketplace.

These forward-looking statements involve risks and uncertainties, and it is important to note that the Company's actual results could differ materially from those projected or assumed in such forward-looking statements. Among the factors that could cause actual results to differ materially are the factors detailed under the heading "Management's Discussion and Analysis or Plan of Operation -- Factors That May Affect Future Results," including the compliance of the Company's lessees with obligations under their respective leases; risks related to use of debt financing for acquisitions; the Company’s success in finding additional financing and appropriate assets to acquire with such financing; general economic conditions, particularly those that affect the air travel industry; unanticipated sharp increases in interest rates; further disruptions to the air travel industry due to terrorist attacks; and future trends and results which cannot be predicted with certainty. The cautionary statements made in this Report should be read as being applicable to all related forward-looking statements wherever they appear herein. All forward-looking statements and risk factors included in this document are made as of the date hereof, based on information available to the Company as of the date hereof, and the Company assumes no obligation to update any forward-looking statement or risk factor. You should consult the risk factors listed from time to time in the Company's filings with the Securities and Exchange Commission.

AeroCentury Corp.
Condensed Consolidated Balance Sheet
Unaudited

ASSETS

		September 30, 2006
Assets:		
Cash and cash equivalents	$	3,245,260
Accounts receivable		947,140
Aircraft and aircraft engine held for lease, net of accumulated depreciation of $20,767,730		90,044,570
Prepaid expenses and other		730,610
Total assets	$	94,967,580

LIABILITIES AND STOCKHOLDERS' EQUITY

Liabilities:		
Accounts payable and accrued expenses	$	896,810
Notes payable and accrued interest		54,813,300
Maintenance reserves and accrued costs		13,995,480
Security deposits		4,092,860
Prepaid rent		515,710
Deferred taxes		1,243,130
Taxes payable		10,490
Total liabilities		75,567,780
Stockholders' equity:		
Preferred stock, $0.001 par value, 2,000,000 shares authorized, no shares issued and outstanding		-
Common stock, $0.001 par value, 3,000,000 shares authorized, 1,606,557 shares issued and outstanding		1,610
Paid in capital		13,821,200
Retained earnings		6,081,060
		19,903,870
Treasury stock at cost, 63,300 shares		(504,070)
Total stockholders' equity		19,399,800
	$	94,967,580

The accompanying notes are an integral part of these statements.

AeroCentury Corp.
Condensed Consolidated Statements of Operations
Unaudited

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2006	2005	2006	2005
Revenues and other income:				
Operating lease revenue	$ 11,454,940	$ 8,216,510	$ 3,920,000	$ 2,956,410
Gain/(loss) on sale of aircraft	408,840	(59,550)	-	-
Other income	2,400,700	94,600	9,510	130
	14,264,480	8,251,560	3,929,510	2,956,540
Expenses:				
Depreciation	3,708,520	2,935,430	1,247,560	1,030,030
Interest	3,687,380	2,456,860	1,271,750	877,000
Management fees	2,061,720	1,705,960	678,460	594,470
Maintenance	3,554,920	219,870	221,600	169,440
Professional fees and general and administrative	413,450	405,420	124,690	129,500
Insurance	183,000	242,140	53,760	75,160
Bad debt expense	48,820	88,110	-	-
Provision for impairment in value of aircraft	-	12,180	-	-
	13,657,810	8,065,970	3,597,820	2,875,600
Income before taxes	606,670	185,590	331,690	80,940
Tax provision	196,970	47,770	112,580	28,840
Net income	$ 409,700	$ 137,820	$ 219,110	$ 52,100
Weighted average common shares outstanding	1,543,257	1,543,257	1,543,257	1,543,257
Basic and diluted earnings per share	$ 0.27	$ 0.09	$ 0.14	$ 0.03

The accompanying notes are an integral part of these statements.

AeroCentury Corp.
Condensed Consolidated Statements of Cash Flows
Unaudited

	For the Nine Months Ended September 30, 2006	2005
Net cash provided by operating activities	$ 6,007,910	$ 3,240,390
Investing activities:		
Payments received on note receivable	-	210,080
Proceeds from disposal of assets	1,434,770	7,900,130
Purchase of aircraft	(1,015,760)	(14,488,870)
Net cash provided/(used) by investing activities	419,010	(6,378,660)
Financing activities:		
Issuance of notes payable	1,650,000	10,941,000
Repayment of notes payable	(5,450,570)	(8,800,690)
Net cash (used)/provided by financing activities	(3,800,570)	2,140,310
Net increase/(decrease) in cash and cash equivalents	2,626,350	(997,960)
Cash and cash equivalents, beginning of period	618,910	2,403,630
Cash and cash equivalents, end of period	$ 3,245,260	$ 1,405,670

During the nine months ended September 30, 2006 and 2005, the Company paid interest totaling $3,454,330 and $2,492,450, respectively, and income taxes totaling $48,800 and $1,780,380, respectively.

The accompanying notes are an integral part of these statements.

AeroCentury Corp.
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2006

1. Organization and Summary of Significant Accounting Policies

(a) Basis of Presentation

AeroCentury Corp. (“AeroCentury”), a Delaware corporation, uses leveraged financing to acquire leased aircraft assets. The Company (as defined below) purchases used regional aircraft on lease to foreign and domestic regional carriers. Financial information for AeroCentury and its wholly-owned subsidiaries, AeroCentury Investments V LLC (“AeroCentury V LLC”) and AeroCentury Investments VI LLC (“AeroCentury VI LLC”) (collectively, the “Company”), is presented on a consolidated basis. All intercompany balances and transactions have been eliminated in consolidation.

(b) Cash and Cash Equivalents/Deposits

The Company considers highly liquid investments readily convertible into known amounts of cash, with original maturities of 90 days or less from the date of acquisition, as cash equivalents.

(c) Aircraft and Aircraft Engine Held For Lease and Held for Sale

The Company’s interests in aircraft and aircraft engines are recorded at cost, which includes acquisition costs. The Company purchases only used aircraft. It is the Company’s policy to hold aircraft for approximately twelve years unless market conditions necessitate earlier disposition. Depreciation is computed using the straight-line method over the twelve year period to an estimated residual value based on appraisal. Decreases in the market value of aircraft could not only affect the current value, but could also affect the assumed residual value. The Company periodically obtains a residual value appraisal for its assets and, historically, has not written down any estimated residuals. The Company’s aircraft which are held for sale are not subject to depreciation.

(d) Impairment of Long-lived Assets

The Company periodically reviews its portfolio of assets for impairment in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-lived Assets." Such review necessitates estimates of current market values, re-lease rents, residual values and component values. The estimates are based on currently available market data and are subject to fluctuation from time to time. The Company initiates its review periodically, whenever events or changes in circumstances indicate that the carrying amount of a long-lived asset may not be recoverable. Recoverability of an asset is measured by comparison of its carrying amount to the expected future undiscounted cash flows (without interest charges) that the asset is expected to generate. Any impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair market value. Significant management judgment is required in the forecasting of future operating results which are used in the preparation of projected undiscounted cash flows and, should different conditions prevail, material write downs may occur.

AeroCentury Corp.
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2006

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

(e) Loan Commitment and Related Fees

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

(f) Maintenance Reserves and Accrued Costs

Maintenance costs under the Company's triple net leases are generally the responsibility of the lessees. The accompanying consolidated balance sheet reflects liabilities for maintenance reserves and accrued costs, which include refundable and non-refundable maintenance payments received from lessees based on usage. At September 30, 2006, the Company's maintenance reserves and accruals consisted of the following:

Refundable maintenance reserves	$ 1,634,880
Non-refundable maintenance reserves	8,454,510
Accrued costs	3,906,090
	$ 13,995,480

Maintenance reserves received by the Company are accounted for as a liability, which is reduced when maintenance work is performed during the lease. Maintenance reserves which are refundable to the lessee are refunded after all return conditions specified in the lease and, in some cases, any other payments due under the lease, are satisfied. Any refundable reserves retained by the Company to satisfy return conditions are reclassified to the Company's own maintenance payable account at lease end. Maintenance reserves which are non-refundable to the lessee are recorded as income at lease end. If an aircraft is returned early, any collected reserves are reclassified to the Company's own maintenance payable account.

The Company periodically reviews its maintenance reserves and maintenance accruals for adequacy in light of the number of hours flown, airworthiness directives issued by the manufacturer or government authority, and the return conditions specified in the lease, as well as the condition of the aircraft upon return or inspection. As a result of such review, when it is probable that the Company has incurred costs for maintenance in excess of amounts accrued, the Company records an expense for the additional work to be performed. Such costs include maintenance such as engine and propeller overhauls, structural inspections and work to comply with airworthiness directives.

When an aircraft is sold, any remaining accrual is reversed and included in the Company's gain or loss on sale calculation. During the nine months ended September 30, 2006 and 2005, $378,770 and $282,030, respectively, of excess accruals were so included.

AeroCentury Corp.
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2006

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

(f) Maintenance Reserves and Accrued Costs (continued)

Additions to and deductions from the Company's accruals during the nine months ended September 30, 2006 and 2005 for maintenance work were as follows:

	For the Nine Months Ended September 30,			
		2006		2005
Additions:				
Charged to expense	$	3,175,220	$	196,800
Charged to other -				
Reclassification of reserves collected from lessees to the Company's own liability account		359,450		40,050
		3,534,670		236,850
Deductions:				
Paid for previously accrued maintenance		2,588,390		316,570
Reversals of over-accrued maintenance		11,850		760
Included in gain/(loss) on sale of aircraft and aircraft engines		378,770		282,030
		2,979,010		599,360
Net increase/(decrease) in accrued maintenance costs, in excess of amounts received under the leases		555,660		(362,510)
Balance, beginning of period		3,350,430		2,296,520
Balance, end of period	$	3,906,090	$	1,934,010

(g) Security deposits

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

(h) Income Taxes

As part of the process of preparing the Company's consolidated financial statements, management is required to estimate 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 accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the consolidated balance sheet. Management must also assess the likelihood that the Company's deferred tax assets will be recovered from future taxable income, and, to the extent management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized, the Company must establish a valuation allowance. To the extent the Company establishes a valuation allowance

AeroCentury Corp.
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2006

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

(h) Income Taxes (continued)

or changes the allowance in a period, the Company reflects the corresponding increase or decrease within the tax provision in the consolidated statement of operations.

(i) Revenue Recognition and Allowance for Doubtful Accounts

Revenue from leasing of aircraft assets is recognized as operating lease revenue on a straight-line basis over the terms of the applicable lease agreements. The Company estimates and charges to income a provision for bad debts based on its experience in the business and with each specific customer, the level of past due accounts, and its analysis of the lessees' overall financial condition. If the financial condition of the Company's customers deteriorates, it could result in actual losses exceeding any estimated allowances.

(j) Use of Estimates

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

The most significant estimates with regard to these financial statements are the residual values of the aircraft, the useful lives of the aircraft, the amount and timing of cash flow associated with each aircraft that are used to evaluate impairment, if any, accrued maintenance costs in excess of amounts received from lessees, the amounts recorded as bad debt allowances and accounting for income taxes.

(k) Comprehensive Income

The Company does not have any comprehensive income other than the revenue and expense items included in the consolidated statements of operations. As a result, comprehensive income equals net income for the three months and nine months ended September 30, 2006 and 2005.

(l) Recent Accounting Pronouncements

SFAS 153, *Exchanges of Nonmonetary Assets,* addresses the measurement of exchanges of nonmonetary assets. It eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of SFAS 153 are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS 153 had no effect on the Company's consolidated financial condition or results of operations.

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AeroCentury Corp.
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2006

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

(l) Recent Accounting Pronouncements (continued)

In March 2005, the FASB issued interpretation FIN No. 47, *Accounting for Conditional Asset Retirement Obligations* ("FIN 47"). FIN 47 clarifies that the term *conditional asset retirement obligation* as used in SFAS 143, *Accounting for Asset Retirement Obligations*, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 is applicable to fiscal years ending after December 15, 2005. The adoption of FIN 47 had no material effect on the Company's consolidated financial condition or results of operations.

SFAS 123(R), *Share-based Payment*, requires compensation cost relating to share-based payment transactions be recognized in financial statements. SFAS 123(R) is effective for small business issuers as of the beginning of the first interim or annual reporting period that began after December 15, 2005, supercedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and replaces SFAS No. 123, *Accounting for Stock-based Compensation*. The pro-forma disclosure previously permitted under SFAS No. 123 is no longer an acceptable alternative to recognition of expenses in the financial statements. The adoption of SFAS 123(R) had no effect on the Company's consolidated financial condition or results of operations.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement 109*. Interpretation No. 48 is effective for fiscal years beginning after December 15, 2006. Interpretation No. 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that a company has taken or expects to take on a tax return (including a decision whether to file or not to file a return in a particular jurisdiction). Under the Interpretation, the financial statements will reflect expected future tax consequences of such positions presuming the taxing authorities' full knowledge of the position and all relevant facts, but without considering time values. The Company is required to implement Interpretation No. 48 in the year beginning January 1, 2007; however, the Company believes that its current tax positions are highly certain and therefore that such implementation will not have any material affect on its tax accounts, balances or provisions.

FASB Staff Position AUG AIR-1, *Accounting for Planned Major Maintenance Activities* ("FSP AUG AIR-1"), was posted on September 8, 2006 and prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities in annual and interim financial reporting periods. FSP AUG AIR-1 must be applied to the first fiscal year beginning after December 15, 2006. The Company is evaluating the impact of adoption of FSP AUG AIR-1 on its consolidated financial statements.

On September 13, 2006, the SEC staff issued Staff Accounting Bulletin ("SAB") No. 108 (SAB Topic 1N), "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," which outlines the approach it believes registrants should use to quantify the misstatement of current year financial statements that results from misstatements of prior year financial statements. Implementing the approach outlined in SAB 108 may require the Company to make significant adjustments in its 2006 annual financial statements. The SAB will change practice by requiring registrants to use a combination of two approaches, the "rollover" approach, which quantifies a misstatement based on the amount of the error originating in the current year income statement and the "iron curtain" approach, which quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year. The SAB requires registrants to adjust their financial statements if the new approach results in a conclusion that an error is material. SAB 108 is effective for fiscal years ending after

November 15, 2006. The Company is required to adopt SAB 108 in the year ending December 31, 2006. Management believes the impact of adopting SAB 108 will have a material impact on results of operations but will not have a material impact on the Company's financial position.

AeroCentury Corp.
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2006

2. Aircraft and Aircraft Engine Held for Lease

At September 30, 2006, the Company owned eleven deHavilland DHC-8s, three deHavilland DHC-6s, fourteen Fokker 50s, two Saab 340As, three Saab 340Bs and one turboprop engine which are held for lease. At September 30, 2006, all of the Company's aircraft were on lease. The Company's spare turboprop engine was leased in November 2006.

3. Notes Payable and Accrued Interest

(a) Credit facility

In November 2005, the Company's $50 million credit facility was renewed through October 31, 2007. In connection with the renewal, certain financial covenants were modified, including the applicable margin which is added to the index rate for each of the Company's outstanding loans under the credit facility. The margin, which is determined by certain financial ratios, was revised from a range of 275 to 375 basis points to a range of 275 to 325 basis points. In May 2006, a participant was added to the Company's credit facility and the amount of the facility was increased to $55 million. During the first nine months of 2006, the Company repaid $3 million of the outstanding principal under its credit facility. As a result of maintenance expense in connection with preparing one of the Company's aircraft for lease in the second quarter, on June 30, 2006, the Company was out of compliance with a financial ratio covenant which is based on net income. The Company obtained a waiver from its banks regarding that covenant for the quarter then ended. As of September 30, 2006, the Company was in compliance with all covenants under its credit facility agreement, $46,996,000 was outstanding under the credit facility, and interest of $655,260 was accrued.

(b) Special purpose financing

In September 2000, a special purpose subsidiary acquired a deHavilland DHC-8 aircraft using cash and bank financing separate from its credit facility. The financing resulted in a note obligation in the amount of $3,575,000, due April 15, 2006, which bore interest at the rate of one-month LIBOR plus 3%. The note was collateralized by the aircraft and was non-recourse to the Company. Payments due under the note consisted of monthly principal and interest and a balloon principal payment due on the maturity date. The financing also provided for a six month remarketing period at the expiration or early termination of the lease. This note obligation was refinanced in April 2006, using bank financing from another lender, and the subsidiary was dissolved. The aircraft was transferred to AeroCentury VI LLC, a newly formed special purpose limited liability company, which borrowed $1,650,000, due October 15, 2009. The note bears interest at an adjustable rate of one-month LIBOR plus 3%. The note is collateralized by the aircraft and the Company's interest in AeroCentury VI LLC and is non-recourse to the Company. Payments due under the note consist of monthly principal and interest through April 20, 2009, interest only from April 20, 2009 until the maturity date, and a balloon principal payment due on the maturity date. If the aircraft lease agreement is terminated on April 15, 2008 pursuant to a lessee early termination option, the note will be due October 15, 2008, and the interest only period will be from April 20, 2008 through October 15, 2008. During the first nine months of 2006, these two special purpose subsidiaries repaid $1,785,530 of principal. The balance of the note payable at September 30, 2006 was $1,495,360 and interest of $3,810 was accrued. As of September 30, 2006, the Company was in compliance with all covenants of this note obligation.

AeroCentury Corp.
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2006

3. Notes Payable and Accrued Interest (continued)

(b) Special purpose financing (continued)

In November 2005, the Company refinanced two DHC-8 aircraft that had been part of the collateral base for its credit facility. The financing, by a bank separate from its credit facility, was provided to a newly formed special purpose subsidiary, AeroCentury V LLC, to which the aircraft were transferred. The financing resulted in a note obligation in the amount of $6,400,000, due November 10, 2008, which bears interest at the rate 7.87%. The note is collateralized by the aircraft and is non-recourse to the Company. Payments due under the note consist of monthly principal and interest through April 22, 2008, interest only from April 22, 2008 until the maturity date, and a balloon principal payment due on the maturity date. During the first nine months of 2006, AeroCentury V LLC repaid $665,040 of principal. The balance of the note payable at September 30, 2006 was $5,651,750 and interest of $11,120 was accrued. As of September 30, 2006, the Company was in compliance with all covenants of this note obligation.

4. Stockholder Rights Plan

On April 8, 1998, the Company's Board of Directors adopted a stockholder rights plan granting a dividend of one stock purchase right for each share of the Company's common stock outstanding as of April 23, 1998. The rights become exercisable only upon the occurrence of certain events specified in the plan, including the acquisition of 15% of the Company's outstanding common stock by a person or group. Each right entitles the holder to purchase one one-hundredth of a share of Series A Preferred Stock of the Company at an exercise price of $66.00 per one-one-hundredth of a share. Each right entitles the holder, other than an "acquiring person," to acquire shares of the Company's common stock at a 50% discount to the then prevailing market price. The Company's Board of Directors may redeem outstanding rights at a price of $0.01 per right.

5. Income Taxes

The items comprising income tax expense are as follows:

	For the Nine Months Ended September 30,	
	2006	2005
Current tax provision:		
Federal	$ -	$ 175,390
State	11,140	1,630
Current tax provision	11,140	177,020
Deferred tax provision/(benefit):		
Federal	202,540	