

Research Report – Update

Investors should consider this report as only a single factor in making their investment decision.

AeroCentury Corp.

Rating: Speculative Buy

Howard Halpern

ACY \$14.05 – (AMEX)

September 4, 2007

	FY (12/05)A	FY (12/06) A	FY (12/07) E	FY (12/08) E
Total revenue (millions)	\$13.50	\$18.32**	\$20.66	\$20.95
Earnings per share (diluted)	\$0.13	\$0.53	\$1.37	\$1.37

52-Week range	\$24.50 – \$4.77	Fiscal year ends:	December
Shares outstanding <small>a/o 08/13/07</small>	1.61 million	Rent income/shares (ttm)	\$10.49
Approximate float	1.19 million	Price/Sales (ttm)	1.3X
Market Capitalization	\$23 million	Price/Sales (2008)E	1.1X
Book value/share	\$18.30	Price/Earnings (ttm)	10.6X
Price/Book	0.8X	Price/Earnings (2008)E	10.3X

* Includes \$1.748 million gain on disposal of assets ** Includes \$2.387 million gain from non-refundable maintenance reserves

AeroCentury Corp., is engaged in the business of ownership, management, leasing and acquisition of aircraft. The primary focus is on used commercial turboprop aircraft equipment for lease to foreign and domestic regional air carriers.

Key investment considerations:

We are maintaining our Speculative Buy rating on the shares of AeroCentury (AMEX: ACY) and reiterating our twelve-month price target of \$18.90 per share. Our price target is based on our total revenue and earnings per share estimates over the next four quarters and a relative analysis of price to sales and earnings for the rental and leasing industry.

On August 8, 2007, ACY reported second quarter 2007 total revenue of \$5.000 million versus \$4.628 million. Net income for the quarter was \$0.463 million or \$0.29 per diluted share versus a net loss of \$0.207 million or (\$0.13) per share in the same period last year. As a reminder, during the first quarter of 2007, the Company adopted FASB Staff Position AUG AIR-1. As a result, Management believes that reported net income may be subject to greater fluctuations from quarter-to-quarter as compared to historic results.

On April 17, 2007, the Company and its lenders reached an agreement to extend its credit facility to March 31, 2010, as well as increase the borrowing capacity to \$80 million from \$55 million. Also, the Company issued \$10 million of subordinated notes that have an interest rate of 16% per year.

Based on first half results, current operating trends, and adoption of AUG AIR-1, we are adjusting our forecast for 2007, to total revenue of \$20.66 million and net income of \$2.167 million or \$1.37 per diluted share. Our prior forecast called for total revenue of \$20.327 million and net income of \$1.709 million or \$1.11 per diluted share.

We are adjusting our forecasts for 2008. We are estimating total revenue of \$20.950 million and net income of \$2.200 million or \$1.37 per diluted share. Our prior forecast called for total revenue of \$20.895 million and net income of \$1.770 million or \$1.15 per diluted share. Investors need to be aware that this estimate may change substantially, as we continue to gauge the impact of AUG AIR-1.

**Please view our disclaimer located on page 13.*

The Company

AeroCentury Corp. (AMEX: ACY), based in Burlingame, California, was formed in 1997. ACY is engaged in the business of ownership, management, leasing, and acquisition of turboprop aircraft and engines. The primary focus is on used commercial turboprop aircraft equipment for lease to foreign and domestic regional air carriers.

The Company's mission is to increase stockholder value by acquiring aircraft assets and managing those assets in order to provide a return on investment through lease revenue and the eventual sale of the asset. Management believes it can achieve the Company's mission by reinvesting cash flow, as well as successfully executing on asset selection, lessee selection, and obtaining acquisition financing.

Of note, as of June 30, 2007, all but two of the Company's 38 aircraft were on lease. Also, one turboprop engine was owned and held for lease. Also, at the end of the second quarter of 2007, two of the Company's Saab 340A aircraft were off lease. These two aircraft came off lease as a result of the Company agreeing to their early return (the leases were set to expire in May and July 2008). Also, ACY filed a complaint against the lessee since it may incur significant unreimbursed expenses in order to prepare the aircraft for re-lease or resale (the magnitude of which is unknown at the present time). Management is seeking re-lease or sale opportunities for these aircraft.

As a reminder, beginning in Q1 2007, the Company adopted AUG AIR-1; therefore, it discontinued the accrue-in-advance method of accounting for planned major maintenance. The Company's adoption of AUG AIR-1 requires the accrual of non-refundable maintenance reserves as income and performance of maintenance work as an expense. Management believes that reported net income may be subject to greater fluctuations from quarter-to-quarter as compared to historic results.

Recent Developments

During the second quarter of 2007: AeroCentury announced the following:

- It purchased two Fokker 100 aircraft from an affiliate of Pembroke Group Ltd. Subsequently, the existing leases were assumed by a new customer, Dutch Antilles Express B.V. The airline based in Curacao, Netherlands Antilles, provides regularly scheduled daily domestic service throughout the Netherlands Antilles, as well as other Caribbean and Latin American destinations. The leases do not expire until January 2012; and
- It extended the leases for six Fokker 50 aircraft for three years.

Recent Financials

On August 8, 2007, AeroCentury reported second quarter 2007 total revenue of \$5.000 million versus \$4.628 million in the same period last year. Investors should be cognizant that both periods reflect the adoption of AUG AIR-1, Accounting for Planned Major Maintenance Activities (the period last year was restated to conform to current period results).

Operating lease revenue (rent income) improved to \$4.152 million versus \$3.834 million in the second quarter of 2006. The positive change in operating lease revenue versus the same period last year was primarily due to aircraft purchased in the fourth quarter of 2006, rent increases for several of the Company's aircraft and revenue from several aircraft which had been off lease during the first half of 2006. Mitigating the operating lease revenue increase was aircraft off lease for part of 2007.

Maintenance reserves income is a new revenue line item that resulted from the adoption of AUG AIR-1. On a year-over-year basis, it increased to \$0.847 million from \$0.756 million in the second quarter of 2006. The increase resulted from a higher level of aircraft usage by the Company's lessees, on which the amount of reserves income was based, as well as the acquisition of two aircraft in June 2007. Investors need to be aware that these

are the only four data points for this line item and as the 2007 quarters unfold we will get corresponding numbers for the same periods in 2006. **To reiterate, Management believes that this revenue line item is likely to make overall results more volatile.**

ACY reported that depreciation, management fees, G&A, insurance expenses, and bad debt for the second quarter of 2007 increased by approximately \$0.157 million versus the same period last year (which was restated for the adoption of AUG AIR-1). The increase was primarily due to higher depreciation and general and administrative expenses. Depreciation increased by approximately \$0.098 million, primarily due to the purchase of aircraft in the fourth quarter of 2006 and second quarter of 2007, which was mitigated by the sale of aircraft in the second quarter of 2006. G&A expenses increased by approximately \$0.061 million resulting from higher accounting fees, legal expense incurred in connection with the early termination of two of the Company's aircraft leases, as well as director fees. Management fees, insurance expenses, and bad debt costs were essentially flat on a year-over-year basis.

Maintenance expenses decreased by approximately \$0.944 million in the quarter compared to the same period last year. According to the 10-Q filing, the decrease was due to lower expense for maintenance claims submitted by lessees and lower expenses incurred for off-lease aircraft in 2007.

Net income for quarter was \$0.463 million or \$0.29 per diluted share versus a net loss of \$0.207 million or (\$0.13) per share in the second quarter of 2006.

Investors should note that the Company's effective tax rate was 34% versus 27% tax benefit in the same period last year. The change was primarily the result of a change in effective state tax rates resulting from the decrease in the number of aircraft leased to domestic carriers.

In comparison, Taglich Brothers' estimates called for total revenue of \$5.050 million and net income of \$0.080 million or \$0.05 per diluted share. Actual results differed from our estimates primarily due to the new revenue line item (Maintenance reserves income).

Balance Sheet as of June 30, 2007

The Company provided the following balance sheet data:

- Total assets were \$108.314 million versus \$98.505 million at December 31, 2006 (2006 full year not yet restated for SAB 108 and AUG AIR-1);
- Total liabilities were \$78.92 million versus \$78.157 million at December 31, 2006 (2006 full year not yet restated for SAB 108 and AUG AIR-1); and
- Shareholders' equity stood at \$29.394 million versus \$20.348 million at December 31, 2006 (2006 full year not yet restated for SAB 108 and AUG AIR-1).

Investors should note that the current period numbers above reflect the adoption of SAB 108 and AUG AIR-1; however, the Company has not yet restated its full year balance sheet to reflect the adoption of those two accounting rules.

The Company ended the second quarter of 2007 with cash and cash equivalents of \$2.558 million versus \$3.384 million at December 31, 2006. Total outstanding notes payable and accrued interest increased to \$62.944 million versus \$57.907 million at the end of fiscal 2006.

On April 17, 2007, an agreement was reached to increase the Company's \$55 million senior revolving credit to \$80 million and the maturity date was extended to March 31, 2010. Also, the potential exists to increase the maximum amount available under the revolving credit facility to \$110 million. The applicable margin will range between 275 to 325 basis points above LIBOR based on certain financial ratios. During the first half of 2007, the Company repaid \$13.0 million of the outstanding principal under its credit facility. At the end of the second

quarter of 2007, \$48.896 million was outstanding under the credit facility. As of June 30, 2007, according to the Company's 10-Q filing, the Company was in compliance with all covenants under its credit facility.

Also during April 2007, the ACY entered into a Securities Purchase Agreement (SPA), which allowed for the issuance of 16% senior unsecured subordinated notes, with an aggregate principal amount of up to \$28 million. The subordinated notes will be due December 30, 2011. As of April 17, 2007 (the closing date), \$10 million of the notes were sold at 99% of the face amount. Any notes issued for the remaining \$18 million will be sold at 99% of the face amount, at subsequent closings expected to occur on or before June 30, 2008. As of June 30, 2007, the carrying amount of the notes was approximately \$7.622 million (outstanding principal amount of \$10 million less unamortized debt discount of approximately \$2.378 million), as well as accrued interest payable of approximately \$0.133 million. According to the second quarter 10-Q, the Company was in compliance with all covenants under the SPA.

Investors should be aware that during November 2005, the Company refinanced two DHC-8 aircraft that were part of its credit facility collateral base, using bank financing separate from its credit facility. The aircraft were transferred to AeroCentury V LLC, a special purpose LLC, which borrowed \$6.4 million at a fixed interest rate of 7.87% and is due November 10, 2008. The note is collateralized by the aircraft of this new non-recourse subsidiary (which means that if a default were to occur it would not impact ACY's base business). Repayments of this financing consists of monthly principal and interest payments through April 22, 2008, interest only from April 22, 2008 until the maturity date, and a balloon principal payment due at maturity. According to the second quarter 2007 10-Q filing, the balance of the note payable at June 30, 2007 was \$4.995 million and ACY was in compliance with all covenants related to this obligation.

In April 2006, the Company refinanced a note obligation for an aircraft previously owned by AeroCentury II LLC, using bank financing from another lender. The aircraft was transferred to AeroCentury VI LLC, a special purpose LLC, which borrowed \$1.650 million 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. 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. According to the second quarter 2007 10-Q filing, the balance of the note payable at June 30, 2007 was \$1.269 million and ACY was in compliance with all covenants related to this obligation.

Management believes that the Company will have adequate cash flow to meet its ongoing operational needs, including required repayments under its credit facility and obligation under its recently issued subordinated notes. Their belief is based on each advance on its credit facility being able to fund a portion of a new acquisition of an asset subject to a lease with the lease revenue expected to be greater than the incremental increase in required for interest payments arising from the advance. However, future growth is likely to depend on the availability of such additional financing for acquisitions of leased assets.

Competitive Environment

The Company targets regional commercial aircraft operators that are seeking to lease aircraft under an operating lease. The competition in this market, which is primarily based on price and lease terms, comes from companies that offer financing, including leasing companies, banks and other financial institutions, and aircraft leasing partnerships. The large participants in the aircraft leasing industry include International Lease Finance Corp., a subsidiary of American International Group (NYSE: AIG), the CIT Group (NYSE: CIT), GE Capital Aviation Services, a subsidiary of General Electric Commercial Finance, and Willis Lease Finance Corp. (NasdaqGM: WLFC).

Impacting the leasing of aircraft for all industry participants had been relatively low interest rates, which caused lease rates to decline upon the releasing of an aircraft. Since mid-2004, interest rates have trended higher as reflected by seventeen 25 basis points increases in interest rates, by the Federal Reserve. However, that came to

an end in August 2006, when the Federal Reserve stopped its consecutive streak of interest rate hikes. Only time will tell whether the Federal Reserve will resume its previous 25 basis point increases in interest rates.

Also, articles in Aircraft Value News (during April and May 2007) offered the following insights:

- Lease rentals of Fokker 100 aircraft had previously been languishing but began to improve because of the absence of alternative equipment. Rents that were around \$50,000 to \$70,000 per month have increased to approximately \$80,000 to \$90,000 per month; and
- The market for turboprop aircraft has undergone a rapid change, as it is no longer seen as the poor relative of the overall market. Turboprop aircraft is once again viewed as the mainstay of many fleets, offering a cost effective solution for price sensitive travelers and for operations to smaller airports. There are some 7,500 turboprops in service, production of new aircraft are only about 100 per year.

According to the Travel Industry Association of America (TIA), after years of little travel volume growth combined with significantly lower travel spending, 2005 was the year of recovery the industry has been awaiting. It was the first year since 2000 that all travel industry sectors experience increased demand. The TIA is reporting that overall traveler spending by domestic and international visitors increased by 7.1% to \$699.9 billion in 2006, versus \$653.8 billion in 2005. The TIA is estimating that number should increase by approximately 4.9% in 2007 to \$733.9 billion and by another 4.0% in 2008 to \$762.9 billion.

Outlook and Projections

Given results for the first six months of 2007, a review of the second quarter 10-Q filing, and second look at the potential impact of AUG AIR-1, we are revising our forecast for 2007 based on the belief that the Company should be able to maintain a consistent operating trend for the next twelve months (investors should note that individual quarters may vary significantly due to the adoption of AUG AIR-1).

As a reminder, beginning in Q1 2007, the Company adopted AUG AIR-1; therefore, it discontinued the accrue-in-advance method of accounting for planned major maintenance. AUG AIR-1 requires the accrual of maintenance work in connection with the release of maintenance reserves to be reflected as an expense when maintenance is actually performed. Management believes that reported net income maybe subject to greater fluctuations from quarter-to-quarter, as compared to historic results.

Supporting our projections for 2007 and 2008 should be a combination of approximately thirty-eight aircraft and one aircraft engine within its portfolio (as of June 30, 2007). In January 2007, ACY and the lessee of the Company's two Saab 340A aircraft, which have leases expiring in May and July 2008, began discussing the early return of the aircraft based on the lessee's anticipated financial difficulties. In March 2007, the company agreed to the return of the two Saab 340A aircraft, and began negotiating a termination settlement with the lessee. During the second quarter of 2007 those aircraft were returned. ACY began to seek re-lease or sale opportunities for these aircraft. Several aircraft leases are scheduled to expire in 2007 and Management anticipates that all but one of them will be renewed. The one that may not be renewed will be returned at lease end and re-marketed for re-lease. In general, investors should be aware that if any of the leases are not renewed, the Company may be required to make principal repayments under its credit facility due to collateral base covenant restrictions. However, Management believes it will be able to remain in compliance with the terms of its credit facility and subordinated notes.

We are forecasting for 2007, total revenue of \$20.066 million and net income of \$2.167 million or \$1.37 per diluted share. Our prior expectation was for total revenue of \$20.327 million and net income of \$1.709 million or \$1.11 per diluted share. It is important to note that our total revenue estimate for 2007 primarily consists of rent income and maintenance reserves income, as we are not forecasting any unusual events (sale of aircraft) that might also impact total top line results. Our bottom line expectations increased, due to our view that maintenance expense will be approximately \$0.574 million lower than we had previously anticipated. Our expectations for this line item changed based on first half results.

Our bottom line estimate includes the following:

- Interest expense of \$5.746 million versus \$4.954 million reported in 2006. The increase is primarily the result of the \$10 million subordinated debt issued on April 17, 2007;
- SG&A expenses, which includes insurance, of \$0.903 million versus \$0.796 million reported in 2006;
- Management fees and depreciation of \$7.805 million versus \$7.580 million reported in 2006;
- Maintenance, impairment, and bad debt expenses of \$2.342 million versus \$2.956 million as reported in 2006 prior to the adoption of AUG AIR-1; and
- A tax rate of 36.60% versus 36.63% reported in 2006.

We are adjusting our forecasts for 2008. We are estimating total revenue of \$20.950 million and net income of \$2.200 million or \$1.37 per diluted share. Our prior preliminary forecast called for total revenue of \$20.895 million and net income of \$1.770 million or \$1.15 per diluted share. We anticipate operating expenses to increase to \$17.645 million from our 2007 estimate of \$16.796 million.

Investors should be aware that if additional purchases of aircraft are made (from the expanded credit facility and/or subordinated notes) and the Company is able to re-lease aircraft on a consistent basis, revenues could exceed our expectations for 2007 and 2008. Of particular note, during November 2005, the Company created a non-recourse special purpose subsidiary that refinanced two DHC-8 aircraft, which had been part of the collateral base for its credit facility. A separate bank at a fixed interest rate of 7.87% provided the \$6.4 million financing. Also, the Company's increased credit facility and subordinated notes provide additional capital to make acquisitions.

In general, the specific timing of when aircraft(s) will be returned to the Company remains unclear; however, until an aircraft is returned, rent will be paid by the lessor even if the lease term has expired. In order to obtain re-lease agreements, Management continues to focus its efforts on marketing. In addition, two aircraft were returned during the second quarter of 2007.

Of note, due to the extremely low share count (1.601 million – which includes the dilutive effect of warrants in the amount of 0.058 million) a \$0.100 million change in net income equals approximately a change of \$0.06 per diluted share.

Risks

FASB Staff Position AUG AIR-1

The Company discontinued the accrue-in-advance method of accounting for planned major maintenance beginning on January 1, 2007. Under the accrue-in-advance method of accounting, the collection of non-refundable maintenance reserves for planned major maintenance and disbursements from reserves to lessees to pay for maintenance performed was reflected only on the Company's balance sheet. AUG AIR-1 allows major maintenance activities to be accounted for in one of three ways: 1) the built-in overhaul method, 2) the deferral method, or 3) the direct expensing method. Management evaluated the impact of the adoption of this new staff position and determined that, going forward, it will use the direct expensing method, under which actual costs incurred are expensed directly. This requires the accrual of non-refundable maintenance reserves from the Company's lessees for planned major maintenance to be reflected as income and performance of maintenance work in connection with the re-lease of maintenance reserves to be reflected as an expense (when maintenance is actually performed). Since the total amount of maintenance reserves accrued in any given period usually exceeds the amount of maintenance expense, it is likely that the Company's net income under the new accounting method will be higher than it would have been under the previous method. **In addition, because the net effect of income from maintenance reserves and maintenance expense in any given period will vary, it is likely that the new accounting method will result in uneven effects on the Company's results of operations.**

SEC Accounting Bulletin (SAB) 108

On September 13, 2006, the SEC staff issued SAB #108 "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements". SAB #108 is effective for fiscal years ending after November 15, 2006. In the course of evaluating balance sheet amounts, Management under SAB #108, identified the following adjustments as of January 1, 2006, as a result of:

- Non-refundable maintenance reserves received at the time four aircraft were purchased in 1999, which should have been treated as a tax basis reduction rather than a liability for maintenance reserves, a net decrease to the Company's deferred tax liability in the amount of \$0.269 million;
- Funds received from the seller when the Company purchased an aircraft in 2004, which should have been treated as a reduction in the purchase price rather than as a liability for maintenance reserves and incorrect tax treatment of a portion of maintenance reserves as non-refundable instead of refundable, a decrease of \$0.288 million to both the cost basis of the Company's aircraft and maintenance reserves and accrued costs, a decrease of \$0.034 million in accumulated depreciation, an increase of \$0.012 million in accounts receivable, and an increase of \$0.015 million in deferred tax liabilities;
- Reversal of tax liabilities due to a lower anticipated state tax rate than was provided for at the time of the Company's incorporation, a decrease of \$0.137 million to deferred tax liabilities; and
- Incorrect treatment of interest related to maintenance reserves for one aircraft as additional reserves rather than income, a decrease of \$0.103 million to refundable maintenance reserves.

These amounts were recorded in immaterial amounts prior to 2006; however, using the dual evaluation approach prescribed by SAB 108, correction of the above amounts would be material to current year earnings. These adjustments resulted in a net addition to retained earnings in the amount of \$0.541 million.

Credit Facility

At June 30, 2007, \$48.896 million was outstanding under the Company's \$80 million credit facility, which expires on March 31, 2010. This means that Management has the ability to increase its aircraft portfolio. As of June 30, 2007, according to the Company's 10-Q, it was in compliance with all covenants related to this obligation.

Special Purpose Financing

The Company owns one deHavilland DHC-8 aircraft that is held in a special purpose subsidiary entity and financed by a lender separate from the credit facility. A balloon principal payment was due during April 2006. The obligation was refinanced and the \$1.650 million is now due October 15, 2009. The note bears interest at an adjustable rate of one-month LIBOR plus 3%.

During November 2005, the Company refinanced two DHC-8 aircraft using bank financing separate from its credit facility. The aircraft were transferred to a special purpose LLC, which borrowed \$6.4 million, due November 10, 2008. The note is collateralized by the aircraft. Payments consist of monthly principal and interest through April 22, 2008, and interest only from April 22, 2008 until the maturity date, when a balloon principal payment is due.

In general, the availability of special purpose financing in the future will depend on: 1) the availability of funds to be used for the equity portion of the financing; 2) the type of asset being financed; 3) the creditworthiness of the underlying lessee; and 4) continued compliance with certain of the Company's credit facility covenants.

Debt Financing

During April 2007, the Company entered into a Securities Purchase Agreement (SPA), which allows for the issuance of 16% senior unsecured subordinated notes, with an aggregate principal amount of up to \$28 million. The subordinated notes will be due December 30, 2011. Under the SPA, the note purchasers will also be issued

warrants to purchase up to 171,473 shares of the common stock at an exercise price of \$8.75 (subject to registration rights pursuant to an Investor's Registration Rights Agreement).

The Company uses its revolving credit facility, subordinated debt, and special purpose financing to acquire aircraft in order to lease it to a customer. If a customer is unable to make its lease payments, AeroCentury may not have the ability to repay the debt secured by the aircraft acquired, which means that title to the aircraft would likely be lost in a foreclosure proceeding. It should be noted that money drawn under the credit facility is secured by the Company's existing assets, as well as the assets acquired with each financing. A reduction in the number of aircraft in AeroCentury's portfolio would negatively impact operations.

Competitive Environment

The Company competes for customers, who generally are regional commercial aircraft operators that are seeking to lease aircraft under an operating lease, with other leasing companies, banks, financial institutions, and aircraft leasing partnerships. The competitive environment may increase if competitors who have traditionally neglected the regional air carrier market begin to focus on that market. In general, competition is largely based on price and lease terms, as well as the entry of new competitors into the market. In addition, those companies with greater access to capital markets could mean fewer acquisition opportunities for ACY and/or lease terms less favorable to the Company on new acquisitions, as well as renewals of existing leases or new leases of existing aircraft.

Shares Outstanding

ACY has a limited number of shares outstanding; therefore, any change in the top-line could dramatically impact bottom-line results. Based on the current fully diluted shares outstanding, a \$0.1 million change in net income would result in an approximate \$0.06 per share change in earnings per share.

Customer Concentration

The Company's 2006 10-K filing, stated that its six largest customers are located in Belgium, Taiwan, the Caribbean, Norway, the United States, and Sweden, account for approximately 14%, 12%, 12%, 11%, 11%, and 10%, respectively, of the Company's monthly lease revenue.

The Company's 2007 second quarter 10-Q filing, stated that its four largest customers are located in the Netherlands Antilles, Sweden, Belgium and Taiwan, account for approximately 13%, 12%, 12%, and 10% respectively, of the Company's monthly lease revenue. Concentration of credit risk with respect to lease receivables will diminish in the future only if the Company is able to lease additional assets or re-lease assets currently on lease to significant customers to new customers.

Economic Factors

The Company's business is dependent on the strength of the Travel and Transportation Industries and on the general level of global economic activity. A July 2007 economic forecast by the Mortgage Bankers Association (is a national association representing the real estate finance industry) calls for Gross Domestic Product (GDP) to grow at an annual rate of approximately 2.1% in 2007. The Federal Reserve has maintained interest rate stability as it has not raised or lowered the Federal Funds rate at its August, September, October, and December 2006 meetings, as well as January, February, March, May, June, and August 2007 meetings. However, on August 18, 2007, it did lower the rate charged to banks borrowing from the Discount Window to 5.75% from 6.25%, this may portend a change when the Federal Reserve Open Market Committee meets on September 18th to decide on the direction of interest rates. If the economic growth were to stall or slow due to unforeseen events (such as hurricanes and terror attacks) it would likely impact the Travel and Aviation Industries, which in turn could negatively impact the Company's operations.

Interest Rates

If interest rates were to increase sharply, the Company's near-term operations would likely be negatively impacted in terms of the borrowing required to finance the purchase of assets (i.e. aircraft, engines, etc.). Higher lease rates would over the long-term mitigate the impact of a rapid rise in interest rates. The opposite could occur if interest rates were to fall rapidly.

Leasing

Crucial to the Company's ability to regain profitability and grow revenues is its ability to successfully negotiate lease extensions and re-lease/remarket aircraft. However, factors that may negatively impact the Company's leasing operations include: 1) demand for leasing aircraft and/or the sale of an aircraft; 2) acceptable rates that an aircraft can be leased for; and 3) the cyclical nature of the Air Transportation and Travel Industries.

Reliance on JetFleet Management

AeroCentury relies on JetFleet Management Corp (JMC) to perform management functions under a management agreement. Currently, the agreement is in its ninth year of a 20-year term. Under this agreement, the Company pays an asset-based management fee to JMC.

JMC is not a fiduciary to the Company or its stockholders. The Board of Directors, however, has ultimate control and supervisory responsibility over all aspects of the Company and owes fiduciary duties to the Company and its stockholders. It is important to note that the officers of JMC are also officers of the Company; therefore, if a dispute over obligations between the Company and JMC occurs, a conflict of interests may exist.

Insurance

The Company 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. Additionally, the Company should have some protection through the United States Aviation Act with respect to its aircraft assets. The Company may carry insurance or require a lessee to insure against a risk, there may be certain cases where the loss is not entirely covered by the lessee or its insurance.

International Risks

The Company has focused on leases in overseas markets, which may present somewhat different risks than those with domestic lessees. Foreign laws, regulations and judicial procedures may be more or less protective of lessor rights than those which apply in the United States. Also, the Company could experience collection or repossession problems related to the enforcement of its lease agreements under foreign local laws and the remedies in foreign jurisdictions.

Miscellaneous

The Company's financial results and equity values are subject to other risks and uncertainties known and unknown, including but not limited to competition, operations, financial markets, regulatory risk, and/or other events. These risks may cause actual results to differ from expected results.

Trading Volume

An equity specific concern relates to liquidity. Based on our calculations, average daily-volume for 2004 decreased to 1,261 from 2,660 shares in 2003. Average daily-volume for 2005 increased to 10,992 shares traded a day. During 2006, average daily-volume decreased to 3,494 shares traded a day. However, during the first seven months of 2007, average daily volume surged to 50,813 shares traded per day. On a relative basis, volume for this equity is very small. Investors need to be aware that by nature, an equity that lacks liquidity can have significant price volatility.

Conclusion

We are maintaining our Speculative Buy rating on the shares of AeroCentury (AMEX: ACY) and reiterating our twelve-month price target of \$18.90 per share.

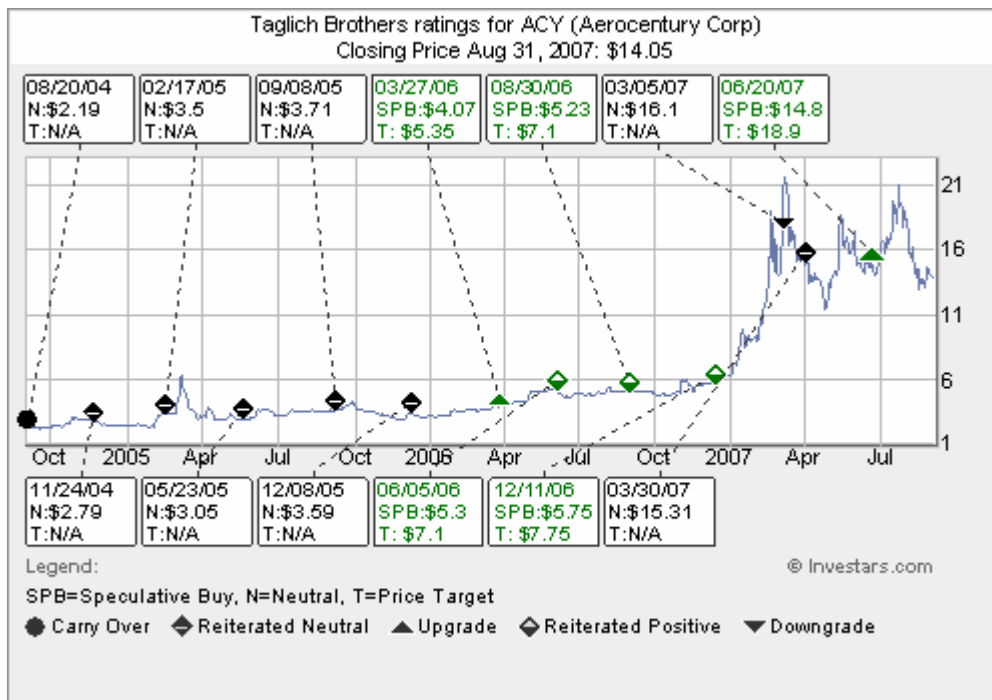
Beginning in Q1 2007, the Company adopted AUG AIR-1; therefore, it discontinued the accrue-in-advance method of accounting for planned major maintenance. The Company's adoption of AUG AIR-1 requires the accrual of non-refundable maintenance reserves as income and performance of maintenance work as an expense. Management believes that reported net income may be subject to greater fluctuations from quarter-to-quarter as compared to historic results.

Our price target is based on our total revenue and earnings per share estimates over the next four quarters and a relative analysis of price to sales and earnings for the rental and leasing industry (see valuation model below).

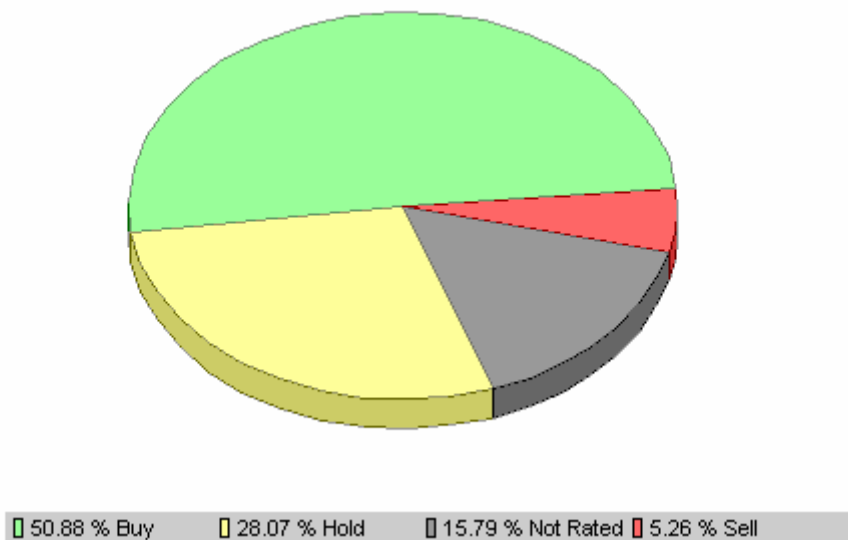
Our price target is derived using the following valuation models discounted by approximately 30% to account for Company specific and microcap risks:

- A 2.3X price to revenue multiple, which is the trailing twelve month multiple (as of August 31, 2007) for the Rental & Leasing Industry according to reuters.com, applied to our operating lease revenue (rent income) per share estimate of \$10.63 for 2007 the next four quarters (09/07 to 06/08); and
- A 27.5X price to earnings multiple, which is the trailing twelve month multiple (as of August 31, 2007) for the Rental & Leasing Industry according to reuters.com, applied to our earnings per share estimate of \$1.15 for the next four quarters (09/07 to 06/08).

AeroCentury Inc.



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months		
Rating	#	%
Buy	1	3.23%
Hold	0	0
Sell	0	0
Not Rated	0	0

Meaning of Ratings

Buy

We believe the Company is undervalued relative to its market and peers. We believe its risk reward ratio strongly advocates purchase of the stock relative to other stocks in the marketplace. Remember, with all equities there is always downside risk.

Speculative Buy

We believe that the long run prospects of the Company are positive. We believe its risk reward ratio advocates purchase of the stock. We feel the investment risk is higher than our typical “buy” recommendation. In the short run, the stock may be subject to high volatility and continue to trade at a discount to its market.

Neutral

We will remain neutral pending certain developments.

Underperform

We believe that the Company may be fairly valued based on its current status. Upside potential is limited relative to investment risk.

Sell

We believe that the Company is significantly overvalued based on its current status. The future of the Company's operations may be questionable and there is an extreme level of investment risk relative to reward.

Some notable Risks within the Microcap Market

Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.

From time to time our analysts may choose to withhold or suspend a rating on a company. We continue to publish informational reports on such companies; however, they have no ratings or price targets. In general, we will not rate any company that has too much business or financial uncertainty for our analysts to form an investment conclusion, or that is currently in the process of being acquired.

Public Companies mentioned in this report:

American International Group	(NYSE: AIG)
CIT Group	(NYSE: CIT)
Tyco Inc.	(NYSE: TYC)

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I, Howard Halpern, the research analyst of this report, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers; and that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this report.

AeroCentury Inc.
Consolidated Balance Sheets
(in thousands)

	Dec. '04 Year End*	Dec. '05 Year End*	Dec. '06 Year End*	Mar. '07 1st Qtr End	Jun. '07 2nd Qtr End
ASSETS					
Current assets:					
Cash & Equivalents	\$ 2,404	\$ 619	\$ 3,384	\$ 3,131	\$ 2,558
Accounts Receivable	6,455	1,128	864	758	973
Note receivable	295	-	-	-	-
Prepaid Expense & Other	410	1,036	582	886	1,461
Total current assets	9,563	2,783	4,830	4,775	4,992
Aircraft & engines, net of depreciation	72,621	93,763	93,675	90,788	103,358
Total assets	\$ 83,932	\$ 96,547	\$ 98,505	\$ 95,564	\$ 108,350
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Accounts Payable and accrued expenses	\$ 868	\$ 1,175	\$ 351	\$ 452	\$ 855
Notes Payable and accrued interest	48,990	58,337	57,907	54,553	62,944
Maintenance deposits and accrued costs	10,293	13,368	14,111	3,837	4,692
Security deposits	1,775	3,125	4,187	4,079	4,784
Prepaid rent	405	447	474	542	700
Unearned income	3	-	-	-	-
Income Taxes Payable	1,704	48	-	142	156
Total current liabilities	64,037	76,499	77,030	63,604	74,132
Long-Term debt-net of current	-	-	-	-	-
Deferred Income Taxes	1,098	1,057	1,127	4,585	4,788
Total Liabilities	65,134	77,557	78,157	68,189	78,920
Stockholders' equity:					
Common stock, par value \$0.01; authorized 10,000,000 shares;					
	2	2	2	2	2
Paid-in capital	13,821	13,821	13,821	13,821	15,378
Retained earnings	5,478	5,671	7,029	14,056	14,519
Accumulated deficit	-	-	-	-	-
Treasury Stock, at cost	(504)	(504)	(504)	(504)	(504)
Total stockholders' equity	18,797	18,990	20,348	27,374	29,394
Total liabilities and stockholders' equity	\$ 83,932	\$ 96,547	\$ 98,505	\$ 95,564	\$ 108,314
SHARES OUT	1,607	1,607	1,607	1,607	1,607

*Not yet restated for SAB 108 and AUG AIR-1

AeroCentury Inc.
Annual Income Statement
For the Years Ended December 31,
(in thousands)

	FY2004A *	FY2005A	FY2006A	FY2007E	FY2008E
Revenues:					
Rent Income	\$ 8,996	\$ 11,387	\$ 15,509	\$ 16,734	\$ 17,450
Maintenance reserves income	-	-	-	3,324	3,500
Gain(loss) on disposal of assets	1,748	(48)	409	-	-
Other Income	160	2,161	2,404	8	-
Total Revenues	<u>10,904</u>	<u>13,499</u>	<u>18,322</u>	<u>20,066</u>	<u>20,950</u>
Expenses:					
Management Fees	1,988	2,340	2,750	2,757	2,855
Depreciation	3,555	4,031	4,980	5,048	5,170
Interest	2,421	3,485	4,954	5,746	6,550
SG&A	887	826	796	903	970
Maintenance	847	2,299	3,504	2,326	2,100
Provision for impairment in value of aircraft and Bad Debt Expense	803	180	49	16	-
Total Expenses	<u>10,501</u>	<u>13,160</u>	<u>17,032</u>	<u>16,796</u>	<u>17,645</u>
Operating Income	<u>403</u>	<u>339</u>	<u>1,290</u>	<u>3,271</u>	<u>3,305</u>
<i>Operating Margin</i>	3.70%	2.51%	7.04%	16.30%	15.78%
Taxes(Benefit)	137	146	472	1,104	1,105
<i>Tax Rate</i>	33.90%	43.10%	36.63%	33.75%	33.43%
Net Income	<u>\$ 266</u>	<u>\$ 193</u>	<u>\$ 817</u>	<u>\$ 2,167</u>	<u>\$ 2,200</u>
EPS-fully diluted includes insurance settlement	<u>\$ 0.17</u>	<u>\$ 0.13</u>	<u>\$ 0.53</u>	<u>\$ 1.37</u>	<u>\$ 1.37</u>
Avg Shares Out-fully diluted	<u>1,543</u>	<u>1,543</u>	<u>1,543</u>	<u>1,587</u>	<u>1,601</u>
Margin Analysis					
Gross Profit	8,916	11,160	15,572	17,309	18,095
GPM	81.8%	82.7%	85.0%	86.3%	86.4%
NI/Rev	2.4%	1.4%	4.5%	10.8%	10.5%
NI/Rent Income	3.0%	1.7%	5.3%	13.0%	12.6%
Total Exp/Rev	96.3%	97.5%	93.0%	83.7%	84.2%
As Per Cent of Rent Income					
Expenses:					
Management Fees	22.10%	20.55%	17.73%	16.48%	16.36%
Depreciation	39.51%	35.40%	32.11%	30.17%	29.63%
Interest	26.91%	30.60%	31.95%	34.34%	37.54%
SG&A	9.86%	7.26%	5.13%	5.40%	5.56%
Total Expenses	116.73%	115.57%	109.82%	100.37%	101.12%
Percent Change Year/Year					
Rent Income	2.61%	26.58%	36.20%	7.90%	4.28%

*Excluding unusual charges for maintenance, bad debt, legal fees, and impairment of leased aircraft, as well as a gain from the disposal of assets, we estimate a net loss of approximately \$0.077 million or (\$0.05) per share.

AeroCentury Inc.
Quarterly Income Statement
For the Year Ended December 31, 2006
(in thousands)

	(3/06)Q1A**	(6/06)Q2A**	(9/06)Q3A	(12/06)Q4A	FY2006A
Revenues:					
Rent Income	\$ 3,701	\$ 3,834	\$ 3,920	\$ 4,054	\$ 15,509
Maintenance reserves income	792	\$ 756			
Gain(loss) on disposal of assets	-	34		-	409
Other Income	(9)	4	10	4	2,404
Total Revenues	<u>4,484</u>	<u>4,628</u>	<u>3,930</u>	<u>4,058</u>	<u>18,322</u>
Expenses:					
Management Fees	1,155	683	678	688	2,750
Depreciation	1,164	1,160	1,248	1,271	4,980
Interest	696	1,251	1,272	1,267	4,954
SG&A	244	174	178	199	796
Maintenance	1,092	1,644	222	(51)	3,504
Provision for impairment in value of aircraft and bad debt expense	49	-	-	-	49
Total Expenses	<u>4,401</u>	<u>4,913</u>	<u>3,598</u>	<u>3,374</u>	<u>17,032</u>
Operating Income	<u>83</u>	<u>(285)</u>	<u>332</u>	<u>683</u>	<u>1,290</u>
<i>Operating Margin</i>	1.84%	-6.16%	8.44%	16.83%	7.04%
Taxes(Benefit)	31	(78)	113	275	472
<i>Tax Rate</i>	37.64%	27.39%	33.94%	40.32%	36.63%
Net Income	<u>\$ 52</u>	<u>\$ (207)</u>	<u>\$ 219</u>	<u>\$ 408</u>	<u>\$ 817</u>
EPS-fully diluted	<u>\$ 0.03</u>	<u>\$ (0.13)</u>	<u>\$ 0.14</u>	<u>\$ 0.26</u>	<u>\$ 0.53</u>
Avg Shares Out-fully diluted	<u>1,543</u>	<u>1,543</u>	<u>1,543</u>	<u>1,543</u>	<u>1,543</u>

** As restated for adoption of SAB 108 and AUG AIR-1. Quarterly results will change as the Company reports results over the course of the next two quarter of 2007.

AeroCentury Inc.
Quarterly Income Statement
For the Year Ended December 31, 2007
(in thousands)

	<u>(3/07)Q1A</u>	<u>(6/07)Q2A</u>	<u>(9/07)Q3E</u>	<u>(12/07)Q4E</u>	<u>FY2007E</u>
Revenues:					
Rent Income	\$ 4,207	\$ 4,152	\$ 4,175	\$ 4,200	\$ 16,734
Maintenance reserves income	827	847	825	825	3,324
Gain(loss) on disposal of assets	-	-	-	-	-
Other Income	<u>7</u>	<u>1</u>	<u>-</u>	<u>-</u>	<u>8</u>
Total Revenues	5,042	5,000	5,000	5,025	20,066
Expenses:					
Management Fees	683	684	690	700	2,757
Depreciation	1,235	1,258	1,275	1,280	5,048
Interest	1,222	1,424	1,525	1,575	5,746
SG&A	195	233	235	240	903
Maintenance	<u>225</u>	<u>701</u>	<u>700</u>	<u>700</u>	<u>2,326</u>
Total Expenses	3,576	4,299	4,425	4,495	16,796
Operating Income	<u>1,465</u>	<u>700</u>	<u>575</u>	<u>530</u>	<u>3,271</u>
<i>Operating Margin</i>	29.07%	14.01%	11.50%	10.55%	16.30%
Taxes(Benefit)	<u>492</u>	<u>237</u>	<u>195</u>	<u>180</u>	<u>1,104</u>
<i>Tax Rate</i>	33.55%	33.86%	33.91%	33.96%	33.75%
Net Income	<u>\$ 974</u>	<u>\$ 463</u>	<u>\$ 380</u>	<u>\$ 350</u>	<u>\$ 2,167</u>
EPS-fully diluted	<u>\$ 0.63</u>	<u>\$ 0.29</u>	<u>\$ 0.24</u>	<u>\$ 0.22</u>	<u>\$ 1.37</u>
Avg Shares Out-fully diluted	<u>1,543</u>	<u>1,601</u>	<u>1,601</u>	<u>1,601</u>	<u>1,587</u>
Margin Analysis					
Gross Profit	4,358	4,316	4,310	4,325	17,309
GPM	86.4%	86.3%	86.2%	86.1%	86.3%
NI/Rev	19.3%	9.3%	7.6%	7.0%	10.8%
NI/Rent Income	23.1%	11.2%	9.1%	8.3%	13.0%
Total Exp/Rev	70.9%	86.0%	88.5%	89.5%	83.7%
As Per Cent of Rent Income					
Expenses:					
Management Fees	16.24%	16.47%	16.53%	16.67%	16.48%
Depreciation	29.35%	30.31%	30.54%	30.48%	30.17%
Interest	29.04%	34.30%	36.53%	37.50%	34.34%
SG&A	4.64%	5.61%	5.63%	5.71%	5.40%
Total Expenses	85.01%	103.56%	105.99%	107.02%	100.37%
Percent Change Year/Year					
Rent Income	13.67%	8.29%	6.51%	3.60%	7.90%

AeroCentury Inc.
Quarterly Income Statement
For the Year Ended December 31, 2008
(in thousands)

	(3/08)Q1E	(6/08)Q2E	(9/08)Q3E	(12/08)Q4E	FY2008E
Revenues:					
Rent Income	\$ 4,300	\$ 4,350	\$ 4,375	\$ 4,425	\$ 17,450
Maintenance reserves income	875	875	875	875	3,500
Gain(loss) on disposal of assets	-	-	-	-	-
Other Income	-	-	-	-	-
Total Revenues	<u>5,175</u>	<u>5,225</u>	<u>5,250</u>	<u>5,300</u>	<u>20,950</u>
Expenses:					
Management Fees	705	710	715	725	2,855
Depreciation	1,285	1,290	1,295	1,300	5,170
Interest	1,600	1,625	1,650	1,675	6,550
SG&A	235	240	245	250	970
Maintenance	<u>525</u>	<u>525</u>	<u>525</u>	<u>525</u>	<u>2,100</u>
Total Expenses	<u>4,350</u>	<u>4,390</u>	<u>4,430</u>	<u>4,475</u>	<u>17,645</u>
Operating Income	<u>825</u>	<u>835</u>	<u>820</u>	<u>825</u>	<u>3,305</u>
<i>Operating Margin</i>	15.94%	15.98%	15.62%	15.57%	15.78%
Taxes(Benefit)	<u>275</u>	<u>280</u>	<u>275</u>	<u>275</u>	<u>1,105</u>
<i>Tax Rate</i>	33.33%	33.53%	33.54%	33.33%	33.43%
Net Income	<u>\$ 550</u>	<u>\$ 555</u>	<u>\$ 545</u>	<u>\$ 550</u>	<u>\$ 2,200</u>
EPS-fully diluted	<u>\$ 0.34</u>	<u>\$ 0.35</u>	<u>\$ 0.34</u>	<u>\$ 0.34</u>	<u>\$ 1.37</u>
Avg Shares Out-fully diluted	<u>1,601</u>	<u>1,601</u>	<u>1,601</u>	<u>1,601</u>	<u>1,601</u>
Margin Analysis					
Gross Profit	4,470	4,515	4,535	4,575	18,095
GPM	86.4%	86.4%	86.4%	86.3%	86.4%
NI/Rev	10.6%	10.6%	10.4%	10.4%	10.5%
NI/Rent Income	12.8%	12.8%	12.5%	12.4%	12.6%
Total Exp/Rev	84.1%	84.0%	84.4%	84.4%	84.2%
As Per Cent of Rent Income					
Expenses:					
Management Fees	16.40%	16.32%	16.34%	16.38%	16.36%
Depreciation	29.88%	29.66%	29.60%	29.38%	29.63%
Interest	37.21%	37.36%	37.71%	37.85%	37.54%
SG&A	5.47%	5.52%	5.60%	5.65%	5.56%
Total Expenses	101.16%	100.92%	101.26%	101.13%	101.12%
Percent Change Year/Year					
Rent Income	2.21%	4.77%	4.79%	5.36%	4.28%