AEROCENTURY CORP
Form 10-K
March 12, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

(Mark One)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2014

o 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	94-3263974
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

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

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

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.001 per share	NYSE MKT Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No x

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files).
Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o
Non-accelerated filer o Smaller reporting company x

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates (based upon the closing price as of June 30, 2014) was $15,332,400.

The number of shares of the Registrant's Common Stock outstanding as of March 12, 2015 was 1,543,257.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Annual Report on Form 10-K incorporates information by reference from the Registrant's Proxy Statement for its 2015 Annual Meeting of Stockholders. Except as expressly incorporated by reference, the Registrant's Proxy Statement shall not be deemed to be a part of this Annual Report on Form 10-K.

PART I
FINANCIAL INFORMATION

Forward Looking Statements

This Annual Report on Form 10-K 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 these statements: (i) in Part I, Item 1, “Business of the Company,” that the Company can purchase assets at an appropriate price and maintain an acceptable overall on-lease rate for the Company’s assets; and that it is able and willing to enter into transactions with a wider range of lessees than would be possible for traditional, large lending institutions and leasing companies; (ii) in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources” that the Company will be in compliance with all of its credit facility covenants at future calculation dates; and that the Company will have adequate cash flow to meet its ongoing operational needs, including any required repayments under the Credit Facility due to borrowing base limitations; (iii) in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Outlook,” that the Company could experience a delay in remarketing its off-lease assets; that the customers under several of the leases that expire in 2015 will choose to return the assets; that three of the Company’s aircraft will be returned at lease-end in 2015 after meeting the return conditions of the leases; that the leases for the remaining four aircraft will be extended; and that the Company will be in compliance with all of its Credit Facility covenants at future calculation dates; that available borrowings under the Credit Facility will be sufficient to meet its continuing obligations and, if it is expanded to the maximum of $180 million, to fund anticipated acquisitions; (v) in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Factors that May Affect Future Results,” that the Company will be in compliance with all of its credit facility covenants at future calculation dates; that the Company will have sufficient cash funds to make any required principal repayment that arises due to borrowing base limitations; that most of the Company’s growth will be outside North America; that the overall industry experience of JMC’s personnel and its technical resources should permit the Company to effectively manage new aircraft types and engines; that effective mitigating factors exist against undue compensation-incented risk-taking by JMC; that the burden and cost of complying with regulatory requirements will fall primarily upon lessees of equipment or the Company as owner of the equipment; that the costs of complying with environmental regulations will not have a material adverse effect on the Company; that the Company has sufficient cyber-security measures in place; that its main vulnerability would be interruption to email communication, loss of archives and loss of document sharing; and that sufficient replacement mechanisms exist such that there would not be a material adverse financial impact on the Company’s business.

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 of Financial Condition and Results of Operations — Factors That May Affect Future Results," including the lack of any unexpected lessee defaults or insolvency; a deterioration of the market values of aircraft types owned by the Company; compliance by the Company's lessees with obligations under their respective leases; no sudden current economic downturn or unanticipated future financial crises; the continued availability of financing for acquisitions under the Credit Facility; the Company’s success in finding appropriate assets to acquire with such financing; deviations from the assumption that future major maintenance expenses will be relatively evenly spaced over the entire portfolio; 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.

Item 1.Business.

Business of the Company

AeroCentury Corp., a Delaware corporation incorporated in 1997 (the “Company”), typically acquires used regional aircraft and aircraft engines for lease to regional carriers worldwide.

The business of the Company is managed by JetFleet Management Corp. ("JMC"), pursuant to a management agreement (the “Management Agreement”) with JMC. JMC is an integrated aircraft management, marketing and financing business and a subsidiary of JetFleet Holding Corp. ("JHC"). Certain officers of the Company are also officers of JHC and JMC and hold significant ownership positions in both JHC and the Company.

Since its formation, the Company has been engaged in the business of investing in used regional aircraft equipment leased to foreign and domestic regional air carriers. The Company’s principal business objective 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, eventually, sale proceeds. The Company strives to achieve its business objective by reinvesting cash flow and using short-term and long-term debt and/or equity financing.

The Company’s success in achieving its objective depends in large part on its success in three areas: asset selection, lessee selection and obtaining financing for acquisition of aircraft and engines.

The Company typically acquires assets in one of three ways. The Company may purchase an asset already subject to a lease and assume the rights and obligations of the seller, as lessor under the existing lease. Additionally, the Company may purchase an asset from an air carrier and lease it back to the air carrier. Finally, the Company may purchase an asset from a seller and then immediately enter into a new lease for the aircraft with a third party lessee. In this last case, the Company typically does not purchase an asset unless a potential lessee has been identified and has committed to lease the asset. Occasionally, the Company may also acquire an asset for which it does not have a potential lessee.

Although the Company has generally targeted used regional aircraft and engines with purchase prices between $3 million and $10 million, and lease terms of less than five years, in 2013 and 2014, the Company acquired six regional jets and a new ATR 42-600 aircraft with purchase prices and lease terms exceeding those of previously-acquired aircraft. In determining assets for acquisition, the Company evaluates, among other things, the type of asset, its current price and projected future value, its versatility or specialized uses, the current and projected availability of and demand for that asset, and the type and number of future potential lessees. Because JMC has extensive experience in purchasing, leasing and selling used regional aircraft and engines, the Company believes it can purchase these assets at an appropriate price and maintain an acceptable overall on-lease rate for the Company’s assets.

In order to improve the remarketability of an aircraft after expiration of a lease, the Company’s leases generally contain provisions that require lessees to return the aircraft in a condition that allows the Company to expediently re-lease or sell the aircraft, or pay sufficient amounts based on usage under the lease to cover any maintenance or overhaul of the aircraft required to bring the aircraft to such a state.

When considering whether to enter into transactions with a lessee, the Company generally reviews the lessee’s creditworthiness, growth prospects, financial status and backing; the experience of its management; and the impact of legal and regulatory matters in the lessee's market, all of which are weighed in determining the lease terms offered to the lessee. In addition, it is the Company’s policy to monitor the lessee’s business and financial performance closely throughout the term of the lease, and, if requested, provide assistance drawn from the experience of the Company’s management in many areas of the air carrier industry. Because of its “hands-on” approach to portfolio management, the Company believes it is able and willing to enter into transactions with a wider range of lessees than would be possible for traditional, large lending institutions and leasing companies.

The Company has funded its asset acquisitions primarily through debt financing supplemented by free cash flow. The Company’s primary source of debt financing has been a secured credit facility. The Company's current credit facility ("Credit Facility") is provided by a syndicate of banks, with MUFG Union Bank, N.A. as agent, and in May 2014, the term was extended to May 31, 2019.

Working Capital Needs

The Company’s portfolio of assets has historically generated revenues that have exceeded the Company’s cash expenses, which consist mainly of management fees, maintenance costs, principal and interest payments on debt, professional fees, and insurance premiums.

The management fees paid by the Company to JMC are based upon the size of the Company’s asset pool. Maintenance costs for off-lease aircraft are recognized as expenses as incurred, while reimbursement of lessee maintenance costs from previously collected maintenance reserves reduce the Company's maintenance reserves liability. Interest expense is dependent on both the balance of the Company’s indebtedness and applicable interest rates. Professional fees are paid to third parties for expenses not covered by JMC under the Management Agreement. Insurance expense includes amounts paid for directors and officers insurance, as well as product liability insurance and aircraft hull insurance for periods when an aircraft is off lease.

So long as the Company succeeds in keeping the majority of its assets on lease and interest rates do not rise significantly and rapidly, the Company’s cash flow should continue to be sufficient to cover its expenses and provide excess cash flow. If the Company incurs unusually large maintenance costs or reimbursements for maintenance in any given period, the Company expects it will have sufficient cash flow or borrowing availability under its credit facility to fund such maintenance.

Competition

The Company competes with other leasing companies, banks, financial institutions, and aircraft leasing partnerships for customers that generally are regional commercial aircraft operators seeking to lease aircraft under operating leases. Competition has increased as competitors who have traditionally neglected the regional air carrier market have begun to focus on that market. Because competition is largely based on price and lease terms, the entry of new competitors into the market, and/or the entry of traditional large aircraft lessors into the regional aircraft niche, particularly those with greater access to capital markets than the Company, could lead to fewer acquisition opportunities for the Company and/or lease terms less favorable to the Company on acquisitions, as well as fewer renewals of existing leases or new leases of existing aircraft, all of which could lead to lower revenues, profitability and cash flow for the Company.

The Company, however, believes that it has a competitive advantage due to its experience and operational efficiency in financing the transaction sizes that are desired by many in the regional air carrier market. Management believes that the Company also continues to have a competitive advantage because JMC has developed a presence as a global participant in the regional aircraft leasing market.

Dependence on Significant Customers

For the year ended December 31, 2014, the Company’s four largest customers accounted for 20%, 18%, 14% and 11% of lease revenue. For the year ended December 31, 2013, the Company’s four largest customers accounted for 23%, 19%, 11% and 10% of lease revenue. Concentration of credit risk with respect to lease receivables will diminish in the future only if the Company is able to re-lease assets currently on lease to significant customers to new customers and/or acquire assets for lease to new customers.

Environmental Matters

Neither compliance with federal, state and local provisions regulating discharge of greenhouse gas emissions (including carbon dioxide (CO_2)) in the environment and/or aircraft noise regulations, nor remedial agreements or other actions relating to the environment, has had, or is expected to have, a material effect on the Company's capital expenditures, financial condition, results of operations or competitive position.

Employees

Under the Company's Management Agreement with JMC, JMC is responsible for all administration and management of the Company. Consequently, the Company does not have any employees.

Available Information

The headquarters of AeroCentury Corp. is located at 1440 Chapin Avenue, Suite 310, Burlingame, California 94010. The main telephone number is (650) 340-1888. The Company's website is located at: http://www.aerocentury.com.

The Company is subject to the reporting requirements of the Securities Exchange Act (the "Exchange Act"). Therefore, the Company files periodic reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). Copies of these materials, filed by us with the SEC, are available free of charge on our website at www.aerocentury.com through the Investor Relations link (SEC Filings). The public may read and copy any materials the Company files with the SEC at the SEC's Public Reference Room of the SEC at 100 F Street N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site (http://www.sec.gov) that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC.

Item 1A.Risk Factors.

Smaller reporting companies are not required to provide this information.

Item 1B.Unresolved Staff Comments.

None.

Item 2.Properties.

As of December 31, 2014, the Company did not own or lease any real property, plant or materially important physical properties. The Company maintains its principal office at 1440 Chapin Avenue, Suite 310, Burlingame, California 94010. However, since the Company has no employees and the Company's portfolio of leased aircraft assets is managed and administered under the terms of the Management Agreement with JMC, all office facilities are provided by JMC.

For information regarding the aircraft and aircraft engines owned by the Company, refer to Note 3 to the Company's financial statements in Item 8 of this Annual Report on Form 10-K.

Item 3.Legal Proceedings.

The Company from time to time engages in ordinary course litigation relating to lease collection matters against defaulting lessees and mechanic's lien claims by vendors hired by lessees. None of the current litigation, if resolved adverse to the Company, is anticipated to have a material adverse effect on the Company's financial condition or results of operations.

Item 4.Mine Safety Disclosures.

Not applicable.

PART II

Item 5.Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The shares of the Company’s Common Stock are traded on the NYSE MKT exchange ("NYSE MKT") under the symbol “ACY.”

Market Information

The Company’s Common Stock has been traded on the NYSE MKT since January 16, 1998. The following table sets forth the high and low sales prices reported on the NYSE MKT for the Company’s Common Stock for the periods indicated:

Period	High	Low
Fiscal year ended December 31, 2014:		
Fourth Quarter	$11.82	$8.05
Third Quarter	16.40	10.90
Second Quarter	18.90	15.25
First Quarter	19.00	15.03
Fiscal year ended December 31, 2013:		
Fourth Quarter	20.60	14.65
Third Quarter	22.30	19.10
Second Quarter	21.50	17.53
First Quarter	18.31	14.20

On March 10, 2015, the closing sale price of the Company’s Common Stock on the NYSE MKT exchange was $13.50 per share.

Number of Security Holders

According to the Company’s transfer agent, the Company had approximately 1,400 stockholders of record as of March 10, 2015. Because brokers and other institutions on behalf of beneficial stockholders hold many of the Company’s shares of Common Stock, the Company is unable to estimate the total number of beneficial stockholders represented by those record holders.

Dividends

No dividends have been declared or paid to date. The Company has no plans at this time to declare or pay dividends, and intends to re-invest any earnings into the acquisition of additional revenue-generating aircraft equipment.

The terms of the Credit Facility prohibit the Company from declaring or paying dividends on its Common Stock, except for cash dividends in an aggregate annual amount not to exceed 50% of the Company's net income in the immediately preceding fiscal year so long as immediately prior to and immediately following such dividend the Company is not in default under the Credit Facility.

Stockholder Rights Plan

For information regarding the Company's stockholder rights plan, refer to Note 8 to the Company's financial statements in Item 8 of this Annual Report on Form 10-K.

Item 6.Selected Financial Data.

This report does not include information described under Item 301 of Regulation S-K pursuant to the rules of the SEC that permit “smaller reporting companies” to omit such information.

Item 7.Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Overview

The Company owns regional aircraft and engines, which are typically leased to customers under triple net leases with terms that are less than the useful life of the assets. A “triple net operating lease” is an operating 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. The acquisition of such equipment is generally made using debt financing. The Company’s profitability and cash flow are dependent in large part upon its ability to acquire equipment, obtain and maintain favorable lease rates on such equipment, and re-lease or sell equipment that comes off lease. The Company is subject to the credit risk of its lessees, both as to collection of rental payments and as to performance by lessees of their obligations to maintain the equipment. Since lease rates for assets in the Company’s portfolio generally decline as assets age, the Company’s ability to maintain and grow revenue and earnings is primarily dependent upon the Company’s ability to acquire and lease additional assets.

The Company’s primary uses of cash are for purchases of aircraft and engines, maintenance, debt service payments, management fees, insurance and professional fees.

The Company's most significant non-cash expenses include aircraft and engine depreciation, amortization of costs associated with the Company’s indebtedness, which is included in interest expense, and, in some years, impairment provisions, which are affected by significant estimates.

Critical Accounting Policies, Judgments and Estimates

The Company’s discussion and analysis of its financial condition and results of operations are based upon its financial statements, 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. 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 discussion of Critical Accounting Policies, Judgments and Estimates, refer to Note 1 to the Company’s financial statements in Item 8 of this Annual Report on Form 10-K.

For a discussion of the Company’s accounting policies regarding maintenance reserves, refer to Note 4 to the Company’s financial statements in Item 8 of this Annual Report on Form 10-K. For a discussion of the Company's change in method of accounting for certain maintenance reserves and lessor maintenance obligations and its application to prior periods, refer to Note 2 to the Company's financial statements in Item 8 of this Annual Report on Form 10-K.

Results of Operations

The Company recorded a net loss of $11.3 million in 2014 compared to net income of $8.3 million in 2013, primarily as a result of recording impairment charges totaling $18.2 million for its seven Fokker 100 aircraft, as well as impairment charges of $0.5 million for three of its Fokker 50 aircraft in 2014. There were no recorded impairment charges of long-lived assets during 2013.

Operating lease revenue increased 17% from $18.8 million in 2013 to $21.9 million in 2014, primarily as a result of assets purchased during 2013 and 2014. The effect of these increases was partially offset by the effect of assets that were on lease in the 2013 period but off lease in the 2014 period and asset sales during 2013 and 2014.

Maintenance reserves revenue decreased 77% from $14.9 million in 2013 to $3.4 million in 2014. The amount recorded in 2013 period was comprised of $6.5 million, which was received from the prior lessee of two of the Company's aircraft when the leases were assigned to a new lessee in 2012 and recognized as maintenance reserves revenue upon termination of those leases in the first quarter of 2013, and $8.4 million from maintenance reserves retained at lease end for five other aircraft. The amount recorded in 2014 period includes approximately $1.7 million of maintenance reserves retained at lease end for one aircraft and approximately $1.7 million of maintenance reserves retained when six aircraft were returned to the Company prior to lease expiration.

During 2014, the Company recorded $3.1 million of net gains on the sale of nine aircraft and an aircraft engine, as compared to 2013, when the Company recorded $3.8 million in net gains from the sale of five aircraft and an engine, as well as the disposal of a spare engine.

During 2014, the Company recorded $0.1 million of other income from retention of a non-refundable security deposit when a potential buyer of one of the Company's aircraft did not complete the planned purchase. During 2013, the Company recorded $0.5 million of other income from security deposits retained upon early termination of two leases following the lessee's bankruptcy.

During 2014 and 2013, the Company added equipment to its lease portfolio of approximately $81.0 million and $24.7 million, respectively. The Company sold equipment with book values of approximately $14.5 million and $8.7 million million during 2014 and 2013, respectively. As a result of the timing of these asset acquisitions and sales, as well as changes in residual value assumptions from year to year, depreciation decreased by 1% in 2014 over the previous year. Management fees, which are based on the net asset value of the Company's aircraft and engines, increased by 12% in 2014 as compared to 2013. Due to a waiver by JMC of its fourth quarter management fees of approximately $1.2 million, management fees incurred by the Company were less by that amount than they would have been without such waiver.

The average net book value of assets held for lease during 2014 and 2013 was approximately $171.7 million and $143.3 million, respectively, representing an increase of 20%. The average portfolio utilization during 2014 and 2013 was 82% and 76%, respectively.

The Company's maintenance expense increased by 7% from $7.0 million in 2013 to $7.5 million in 2014, primarily as a result of an increase in maintenance performed by the Company on off-lease aircraft.

The Company's interest expense increased by 26% from $4.1 million in 2013 to $5.1 million in 2014, primarily as a result of a higher average Credit Facility balance.

The Company's professional fees, general and administrative and other expenses increased by 46% from $1.2 million in 2013 to $1.7 million in 2014, primarily as a result of expenses incurred in connection with the return of six aircraft and two engines by one of the Company's customers when it ceased operations in 2014.

The Company's other taxes expense increased by $0.4 million in 2014 compared to 2013 as a result of the accrual of goods and service tax related to four of the Company's aircraft that are leased to a customer in Papua New Guinea.

Liquidity and Capital Resources

The Company is currently financing its assets primarily through debt financing and excess cash flows.

(a)Credit Facility

In May 2014, the Company's $130 million Credit Facility was increased to $180 million and extended through May 31, 2019. The Credit Facility is provided by a syndicate of banks and is secured by all of the assets of the Company, including its aircraft and engine portfolio.

In November 2013, the Company obtained a waiver of compliance with a lessee concentration covenant under its Credit Facility agreement at the September 30, 2013 and December 31, 2013 calculation dates. The Company was in compliance with all covenants other than the waived covenant under the Credit Facility agreement at December 31, 2013.

Although the Company previously had letters of intent for the lease of five of its Fokker 100 aircraft, the prospective lessees decided not to lease the aircraft during the second quarter of 2014. Therefore, at June 30, 2014, the Company reevaluated the recoverability of the net book value of these assets and consequently obtained current market value appraisals, which resulted in aircraft impairment charges totaling $6.8 million being recorded for these aircraft during the second quarter of 2014. As a result of the impairment charges, the Company was out of compliance with a profitability covenant at June 30, 2014. In August 2014, the Company and the Credit Facility banks agreed to an amendment to the profitability covenant which cured the June 30, 2014 non-compliance.

During the third quarter of 2014, based on management's assessment of the market for Fokker 100 aircraft and the estimated costs associated with preparing the Company's five off-lease Fokker 100 aircraft for re-lease, the Company recorded additional impairment charges of $8.5 million for these aircraft to write them down to their estimated liquidation values. The Company also recorded impairment charges of $0.3 million for an off-lease Fokker 50 aircraft and reclassified these six aircraft as held for sale. The Company sold the Fokker 50 aircraft in March 2015. The Company also recorded an impairment charge of $2.9 million, based on the appraised market values, for its two other Fokker 100 aircraft that were leased in September and October 2014.

As a result of the third quarter impairment charges, the Company was out of compliance with the profitability, interest coverage and debt service coverage covenants of its Credit Facility at September 30, 2014. In November 2014, the Company and the Credit Facility banks agreed to an amendment to the Credit Facility that: cured the September 30, 2014 non-compliance; revised the compliance requirements through September 30, 2015; decreased the amount of the Credit Facility to $150 million due to the departure of two participant lenders; and decreased the maximum amount to which the Credit Facility can be expanded from $200 million to $180 million. The Company was in compliance with all covenants at December 31, 2014.

Based on its current projections, the Company believes that it will be in compliance with all of its Credit Facility covenants at future calculation dates. Although the Company believes that the assumptions it has made in forecasting its compliance with the Credit Facility covenants are reasonable in light of experience, actual results could deviate from such assumptions and there can be no assurance the Company's beliefs will prove to be correct. Among the more significant factors that could have an impact on the accuracy of the Company's covenant compliance forecasts are (i) unanticipated decreases in the market value of the Company's assets, or in the rental rates deemed achievable for such assets that cause the Company to record an impairment charge against earnings; (ii) lessee non-compliance with lease obligations, (iii) inability to locate new lessees for returned equipment within a reasonable remarketing period, or at a rent level consistent with projected rates, (iv) inability to locate and acquire a sufficient volume of additional assets at prices that will produce acceptable net returns, (v) increases in interest rates, or (vi) inability to timely dispose of off-lease assets at prices commensurate with their market value.

Although the Company believes it will continue to be in compliance with all of the Credit Facility covenants, there can be no assurance of such compliance and, in the event of any non-compliance, the Company will need to seek further waivers or amendment of applicable covenants from its lenders if such compliance failure is not timely cured. Any default under the Credit Facility, if not cured in the time permitted under the facility or waived by the lenders, could result in foreclosure upon any or all of the assets of the Company.

For additional information regarding the Company’s Credit Facility, refer to Note 7 to the Company’s financial statements in Item 1 of this Annual Report on Form 10-K.

(b)Cash flow

The Company’s primary sources of cash are (i) rent payments due under the Company’s operating and finance leases, (ii) maintenance reserves billed monthly to lessees based on asset usage, and (iii) proceeds from the sale of aircraft and engines.

The Company’s primary uses of cash are for purchase of assets, maintenance expense and reimbursement to lessees from collected maintenance reserves, management fees, professional fees, insurance, and Credit Facility fees, interest and principal payments. The amount of interest paid by the Company depends on the outstanding balance of its Credit Facility, which carries a floating interest rate as well as an interest rate margin, and is therefore also dependent on changes in prevailing interest rates.

The timing and amount of the Company’s payments for maintenance vary, depending on the timing of lessee-performed maintenance that is eligible for reimbursement, the aggregate amount of such claims and the timing and amount of maintenance incurred in connection with preparation of off-lease assets for re-lease to new customers. The Company’s maintenance payments typically constitute a large portion of its cash needs, and the Company may from time to time borrow additional funds under the Credit Facility to provide funding for such payments.

Management believes that the Company will have adequate cash flow to meet its ongoing operational needs, including any required repayments under the Credit Facility due to borrowing base limitations, based upon its estimates of future revenues and expenditures, which include assumptions regarding (i) revenues for assets to be re-leased, (ii) the cost and anticipated timing of maintenance to be performed, (iii) required debt payments, (iv) timely use of proceeds of unused debt capacity toward additional acquisitions of income producing assets and (v) interest rates. There can be no assurance, however, that the Company's beliefs will prove to be correct.

Although the Company believes that the assumptions it has made in forecasting its cash flow are reasonable in light of experience, actual results could deviate from such assumptions. As discussed above, in “Liquidity and Capital Resources – (a) Credit Facility” above, there are a number of factors that may cause actual results to deviate from such forecasts.

(i)Operating activities

The Company’s cash flow from operations decreased by $1.6 million in 2014 compared to 2013. As discussed below, the change in cash flow was primarily a result of a decrease in payments received for maintenance reserves and increases in payments for maintenance, interest, management fees and professional fees and general and administrative expenses, the effects of which were partially offset by an increase in payments received for operating lease revenue and a decrease in payments for aircraft insurance.

Payments for operating lease revenue and maintenance reserves

Rent receipts from lessees increased by $2.9 million in 2014 compared to 2013, primarily due to rent from assets purchased during late 2013 and early 2014. Receipts from lessees for maintenance reserves decreased by $1.8 million in 2014 compared to 2013, primarily as a result of asset sales and returns, as well as lower utilization of some assets for which the Company collects maintenance reserves. In addition, the Company does not collect maintenance reserves for most of the aircraft it acquired in 2013 and 2014.

As of the date of this filing, the Company is receiving no lease revenue for six aircraft and five engines that are off lease, with a total book value of $22.3 million, representing 12% of the Company's total assets held for lease. One of the off-lease engines is being held as a spare and used in connection with required maintenance on the Company’s Fokker 100 aircraft. In addition, five off-lease Fokker 100 aircraft, with a total book value of $5.0 million, are being held for sale and not lease.

Payments for maintenance

Payments for maintenance increased by $0.7 million in 2014 compared to 2013, primarily as a result of an increase in maintenance costs for off-lease aircraft. The amount of payments for maintenance in future periods will depend on the amount and timing of maintenance paid as reimbursement to lessees for maintenance reserves claims, which are dependent upon utilization and required maintenance intervals, as well as maintenance paid for off-lease assets.

Payment for interest

Payments for interest increased by $1.1 million in 2014 compared to 2013 as a result of a higher Credit Facility balance.

Payments for management fees

Although JMC waived its management fees of approximately $1.2 million for the fourth quarter of 2014, payments for management fees increased by $0.4 million in 2014 compared to 2013 as a result of asset purchases in 2013 and 2014. No assurance can be given that JMC will waive any management fees in the future.

Payment for professional fees, general and administrative and other expenses and aircraft insurance

Payments for professional fees, general and administrative and other expenses increased by $0.6 million in 2014 compared to 2013 primarily as a result of expenses incurred in connection with the early return of six aircraft and two engines by one of the Company's customers in 2014 period when it ceased operations. Payments for aircraft insurance decreased by $0.7 million in 2014 compared to 2013 primarily as a result of a difference in the timing of premium payments that are made on a semi-annual basis.

(ii)Investing activities

During 2014 and 2013, the Company received cash of $16.2 million and $10.9 million, respectively, from the sale of assets. During the same time periods, the Company used cash of $74.5 million and $25.0 million, respectively, for purchases and capital improvement of aircraft.

(iii)Financing activities

The Company borrowed $71.1 million and $19.0 million under the Credit Facility during 2014 and 2013, respectively. In these same time periods, the Company repaid $15.2 million and $9.3 million, respectively, of its total outstanding debt under the Credit Facility. Such repayments were funded by excess cash flow and the sale of assets. During 2014 and 2013, the Company paid $3.0 million and $2.1 million of fees, respectively, in connection with the extension and administration of the Company's Credit Facility, as well as the waiver obtained from the banks during the fourth quarter of 2014. Such fees are being amortized over the term of the Credit Facility.

Outlook

(a)General

While in certain areas of the world the air carrier industry is now beginning to experience growth after a period of contraction following the global downturn of recent years, other areas of the world continue to experience slow recovery and failures of weaker air carrier competitors that were unable to survive the aftermath of the global downturn. Overall, the Company continues to experience a reduction in the number of aircraft and aircraft engines needed for operation by carriers in nearly all geographic areas, especially in Western Europe, as compared to periods before the global downturn.

The Company has identified three areas that could challenge the Company's growth and operating results by negatively affecting its collateral base and, therefore, its ability to access sources of financing:

• The Company could experience (i) a delay in remarketing its off-lease assets, as well as (ii) lower rental rates for assets that are remarketed. The Company expects that the customers for several of the leases that expire in 2015 and after will choose to return the assets rather than renew the leases, notwithstanding that any such customer may incur significant expenses to satisfy return conditions.

• Lessees that are located in low- or no- growth areas of the world carry heightened risk of an unanticipated lessee default. A lessee's default and the unscheduled return of an asset to the Company for remarketing could result not only in reduced operating lease revenue but also in unanticipated, unrecoverable expenses arising from the lessee's default on its maintenance and return condition obligations. The Company monitors the performance of all of its customers and has noted that several of the Company's customers continue to experience weakened operating results and have not yet achieved financial stability.

• Competition in the Company's market niche has increased recently as a result of new entrants to the acquisition and leasing market. The increased competition has put downward pressure on lease rates, resulting in lower margins.

(b)Operating Segments

The Company operates in one business segment, the leasing of regional aircraft to foreign and domestic regional airlines, and therefore does not present separate segment information for lines of business.

At February 28, 2015, the dominant types of aircraft in the Company's portfolio of assets held for lease were as follows:

Model	Number owned	% of net book value	
Bombardier Dash-8-300	8	17	%
Bombardier CRJ-700	3	16	%
Bombardier CRJ-900	2	16	%
Bombardier Dash-8-Q400	3	13	%

For the month ended February 28, 2015, the Company's sources of operating lease revenue were from the following regions:

Region	Number of lessees	% of operating lease revenue	
Europe	3	29	%
North America	2	22	%
Africa	2	17	%
Asia	3	14	%
Central and South America	1	9	%
Australia	1	9	%

(c)Remarketing Efforts

At December 31, 2014, five Fokker 100 aircraft and one Fokker 50 aircraft were classified as held for sale. In March 2015, the Company sold the Fokker 50 aircraft. The Company is seeking sales opportunities for the Fokker 100 aircraft.

The Company is seeking remarketing opportunities for six aircraft and five engines that are held for lease. The Company is considering selling some or all of these assets. The Company is analyzing the amount and timing of maintenance required to remarket the assets, the amount of which may differ significantly if the assets are sold rather than re-leased.

The leases for seven of the Company's aircraft will expire during the first half of 2015. The Company believes that three of the aircraft will be returned at lease-end in 2015 after meeting the return conditions of the leases, and the Company believes that the leases for the remaining four aircraft will be extended.

(d)Credit Facility

In August 2014 and November 2014, the Company and the Credit Facility banks agreed to amendments to the Credit Facility, which cured non-compliance with certain of the covenants under the Credit Facility at June 30, 2014 and September 30, 2014. The November 2014 amendment also revised the compliance requirements through September 30, 2015, decreased the amount of the Credit Facility to $150 million due to the departure of two participant lenders, and decreased the maximum amount to which the Credit Facility can be expanded from $200 million to $180 million.

The unused amount of the Credit Facility was $16,600,000 as of March 12, 2015. Based on its current projections, the Company believes that it will be in compliance with all of its Credit Facility covenants at future calculation dates. The Company also believes that available borrowings under the Credit Facility will be sufficient to meet its continuing obligations and, if it is expanded to the maximum of $180 million, to fund anticipated acquisitions. However, there can be no assurance the Company's beliefs will prove to be correct.

Factors that May Affect Future Results

Noncompliance with Credit Facility Financial Covenants. The Company's use of debt as the primary form of acquisition financing subjects the Company to increased risks associated with leverage. In addition to payment obligations, the Credit Facility agreement includes financial covenants, including some requiring the Company to have positive earnings, meet minimum net worth standards and be in compliance with certain other financial ratios.

As discussed above in "Outlook – Credit Facility," the Company was out of compliance with a number of covenants under its Credit Facility at June 30, 2014 and September 30, 2014. The Credit Facility was amended in August 2014 to cure the June 30, 2014 non-compliance and in November 2014 to cure the September 30, 2014 non-compliance, revise certain compliance requirements and decrease the amount of the Credit Facility from $180 million to $150 million. The November amendment also reduced the amount to which the Credit Facility can be expanded from $200 million to $180 million.

Although the Company believes it will continue to be in compliance with all of the Credit Facility covenants, there can be no assurance of such compliance, and in the event of any non-compliance, the Company will need to seek further waivers or amendment of applicable covenants from its lenders if such compliance failure is not timely cured. Any default under the Credit Facility, if not cured in the time permitted under the facility or waived by the lenders, could result in foreclosure upon any or all of the assets of the Company.

Ownership Risks. The Company's leases typically are for a period shorter than the entire, anticipated, remaining useful life of the leased assets. The Company's ability to recover its investment in an asset subject to such a lease is dependent upon the Company's ability to profitably re-lease or sell the asset after the expiration of the lease term. This ability is dependent on worldwide economic conditions, general aircraft market conditions, regulatory changes that may make an asset's use more expensive or preclude use due to the age of the aircraft or unless the asset is modified, changes in the supply or cost of aircraft equipment and technological developments that 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 Company typically acquires used aircraft equipment. 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, the number of new aircraft on order and the number of 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.

In addition, a successful investment in an asset subject to a lease depends in part upon having the asset returned by the lessee in the condition as required under the lease. Each lease typically obligates a customer to return an asset to the Company in a specified condition, which generally requires it be returned in equal or better condition than at delivery to the lessee. If the lessee were to become insolvent during the term of its lease and the Company had to repossess the asset, it is unlikely that the lessee would have the financial ability to meet these return obligations and 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. If the lessee filed for bankruptcy and rejected 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 that case, it is also 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 be left with the costs of unperformed repair and maintenance under the applicable lease and the Company 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 flows generated from an asset could result in an asset impairment charge against the Company's earnings. The Company periodically reviews long-term assets for impairment, in particular, 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 for some of its aircraft in 2014 and may be required to record asset impairment charges in the future as a result of a 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.

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

If a lessee that is a certified U.S. airline were in default under a lease and sought protection under Chapter 11 of the United States 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 by a bankruptcy filing by a defaulting lessee.

Several of the Company’s customers have experienced significant financial difficulties, become insolvent, or have been declared or have filed for bankruptcy. An insolvency or bankruptcy of a customer usually results in a total loss of those receivables. 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 that would mitigate losses in the event the lessee is unable to meet or rejects its lease obligations. There can be no assurance that additional customers will not become insolvent or file for bankruptcy or that the Company will be able to mitigate any of the resultant losses.

Risks Related to Regional Air Carriers. The Company’s continued focus on its customer base of regional air carriers subjects the Company to additional risks. Some of the lessees in the regional air carrier market are companies that are start-up, low-capital, and/or low-margin operators. Often, the success of such carriers depends on contractual arrangements with major trunk carriers or franchises from governmental agencies that provide subsidies for operating essential air routes, both of which may be subject to termination or cancellation on short notice. Regional carriers, even if financially strong, that are affiliated with an established major carrier can also be swept into bankruptcy if the major carrier files for bankruptcy or becomes insolvent. Four of the Company's regional air carrier customers filed for bankruptcy in 2012 and 2013, and a Thai regional carrier that leased six aircraft and two engines from the Company ceased operations in May of 2014.

Credit Facility Debt Limitations. The amount available to be borrowed under the Credit Facility is limited by the asset-specific advance rates. Lessee arrearages or asset off-lease periods may reduce the advance rate for the related assets and, therefore, the permitted borrowing under the facility. Amounts subject to payment deferral agreements also reduce the amount of permitted borrowing. The Company believes it will have sufficient cash funds to make any required principal repayment that arises due to any such borrowing limitations.

Availability of Financing. The Company’s continued growth will depend on its ability to continue to obtain capital, either through debt or equity financings. There can be no assurance that the Company will succeed in obtaining capital in the future at terms favorable to the Company.

General Economic Conditions and Lowered Demand for Travel. The Company’s business is dependent upon general economic conditions and the strength of the travel and transportation industry. The industry is continuing to experience financial difficulty due to the slow recovery in the global economy. The spread of a disease epidemic, the threat or execution of a terrorist attack against aviation, a worsening financial/bank crisis in Europe, a natural event that interrupts air traffic, military conflict, political crises or other events that cause a prolonged spike in fuel prices, or other like events could exacerbate an already weakened condition and lead to widespread failures in the air carrier industry. If lessees experience financial difficulties and are unable to meet lease obligations, this will, in turn, negatively affect the Company’s financial performance.

Airline reductions in capacity in response to lower passenger loads have resulted in reduced demand for aircraft and aircraft engines and a corresponding decrease in market lease rental rates and aircraft values for many aircraft types. 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 on its balance sheet 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.

Economic downturns can affect certain regions of the world more than others. As the Company’s portfolio is not entirely globally diversified, a localized downturn in one of the key regions in which the Company leases assets could have a significant adverse impact on the Company. The Company’s significant sources of operating lease revenue by region are summarized in “Outlook - Operating Segments,” above.

In past years, several of the Company's customers have experienced financial difficulties arising from a combination of the weakened air carrier market and their own unique financial circumstances and have requested and been granted deferral of certain overdue and/or future rental or maintenance reserve payment obligations. It is possible that the Company may enter into additional deferral agreements if the current weakened air carrier environment continues. 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 will be repaid according to the agreed schedule. The Company may elect to record the deferred rent and reserve payments from the lessee on a cash basis, which could have a material effect on the Company's financial results in the applicable periods. Deferral agreements with lessees also reduce the Company's borrowing capacity under its Credit Facility.

International Risks. The Company leases assets in overseas markets. Leases with foreign lessees, however, may present different risks than those with domestic lessees. Most of the Company's expected growth is outside of North America.

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 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 stable.

Foreign lessees are subject to risks related to currency conversion fluctuations. Although the Company's current leases are all payable in U.S. dollars, the Company may agree in the future to leases that permit payment in foreign currency, which would subject such lease revenue to monetary risk due to currency fluctuations. In addition, if the Company undertakes certain obligations under a lease to contribute to a repair or improvement and if the work is performed in a foreign jurisdiction and paid for in foreign currency, currency fluctuations resulting in a weaker dollar between the time such agreement is made and the time payment for the work is made may result in an unanticipated increase in U.S. dollar-denominated cost for the Company.

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

Finally, 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. If the taxing authority later assesses a liability, the Company may be required to pay penalties and interest on the assessed amount, which penalties and interest would not give rise to a corresponding foreign tax credit on the Company's U.S. tax return.

Concentration of Lessees and Aircraft Type. For the month ended February 28, 2015, the Company's four largest customers accounted for a total of approximately 54% of the Company's monthly lease revenue. A lease default by or collection problem with one or a combination of any of these significant customers could have a disproportionate negative impact on the Company's financial results and borrowing base under the Credit Facility, and, therefore, the Company's operating results are especially sensitive to any negative developments with respect to these customers in terms of lease compliance or collection. In addition, if the Company's revenues become overly concentrated in a small number of lessees, the Company could fail to comply with certain financial covenants in its Credit Facility related to customer concentration. In the event of any such failure to be in compliance, the Company will need to seek waivers or amendment of the applicable covenants from its lenders if such compliance failure is not timely cured. Any default under the Credit Facility, if not cured in the time permitted under the Credit Facility or waived by the lenders, could result in foreclosure upon any or all of the assets of the Company.

The dominant types of aircraft in the Company's portfolio are summarized in "Outlook - Operating Segments," above. A change in the desirability and availability of any of these types of aircraft, which would in turn affect valuations of such aircraft, would have a disproportionately significant impact on the Company's portfolio value. Such aircraft type concentration would diminish if the Company acquires assets of other types. Conversely, acquisition of these types of aircraft will increase the Company's risks related to its concentration of those aircraft types.

Investment in New Aircraft Types and Engines. The Company intends to continue to focus solely on regional aircraft and engines. Although the Company has traditionally invested in a limited number of types of turboprop aircraft and engines, the Company has also acquired several types of regional jet aircraft and regional jet aircraft engines, and may continue to seek acquisition opportunities for new types and models of aircraft and engines used in the Company's targeted customer base of regional air carriers. Acquisition of aircraft types and engines not previously acquired by the Company entails greater ownership risk due to the Company's lack of experience managing those assets. The Company believes, however, that the overall industry experience of JMC's personnel and its technical resources should permit the Company to effectively manage such new aircraft types and engines. Further, the broadening of the asset types in the aircraft portfolio may have a benefit of diversifying the Company's portfolio (see "Factors That May Affect Future Results – Concentration of Lessees and Aircraft Type," above).

Engine Leasing Risk. The Company currently has five engines in its portfolio, making up 5% of the Company's total net book value of aircraft and aircraft engines held for lease. The Company may from time to time lease one or more of these engines under industry standard short-term engine leases, which place the risk of an engine failure not caused by lessee negligence or foreign object damage upon the lessor. It is not economically practicable for an engine lessor to insure against that risk. If an engine failure occurs and is not covered by a manufacturer's warranty or is not otherwise caused by circumstances that the lessee is required to cover, the Company's investment in the engine could be a significant loss or the Company might incur a significant maintenance expense.

Interest Rate Risk. The Credit Facility carries a floating interest rate based upon short-term interest rate indices. Lease rates typically, but not always, move over time with interest rates, but market demand and numerous other asset-specific factors also affect lease rates. Because the Company's typical lease rates are fixed at lease origination, interest rate changes during the lease term have no effect on existing lease rental payments. Therefore, if interest rates rise significantly and there is relatively little lease origination by the Company following such rate increases, the Company could experience decreased net income as additional interest expense outpaces revenue growth. Further, even if significant lease origination occurs following such rate increases, other contemporaneous aircraft market forces may result in lower or flat rental rates, thereby decreasing net income.

Reliance on JMC. All management of the Company is performed by JMC under the twenty-year Management Agreement between the Company and JMC that expires in April of 2018 and provides for an asset-based management fee. JMC is not a fiduciary of the Company or its stockholders. The Company's Board of Directors (the "Board") has ultimate control and supervisory responsibility over all aspects of the Company and owes fiduciary duties to the

Company and its stockholders. The Board has no control over the internal operations of JMC, but the Board does have the ability and responsibility to manage the Company's relationship with JMC and the performance of JMC's obligations to the Company under the Management Agreement, as it would have for any third party service provider to the Company. While JMC may not owe any fiduciary duties to the Company by virtue of the Management Agreement, all of the officers of JMC are also officers of the Company, and in that capacity owe fiduciary duties to the Company and its stockholders. In addition, certain officers of the Company hold significant ownership positions in the Company and JHC, the parent company of JMC.

The Management Agreement may be terminated if JMC defaults on its obligations to the Company. However, the agreement provides for liquidated damages in the event of its wrongful termination by the Company. Certain directors of the Company are also directors of JMC and, as discussed above, the officers of the Company are also officers of JMC and certain officers hold significant ownership positions in both the Company and JHC, the holding company for JMC. Consequently, the directors and officers of JMC may have a conflict of interest in the event of a dispute between the Company and JMC. Although the Company has taken steps to prevent conflicts of interest arising from such dual roles, such conflicts may still occur.

Management Fee Structure. All decisions regarding acquisitions and disposal of aircraft from the Company's portfolio are made by JMC. JMC is paid a management fee based on the net asset value of the Company's portfolio. It may also receive a one-time asset acquisition fee upon purchase of an asset by the Company, and a one-time remarketing fee in connection with the sale or re-lease of an asset. Optimization of the results of the Company depends on timing of the acquisition, lease yield on the acquired assets, and re-lease or sale of its portfolio assets. Under the current management fee structure, a larger volume of acquisitions generates acquisition fees and also increases the periodic management fee by increasing the size of the aircraft portfolio. Since the Company's current business strategy involves continued growth of its portfolio and a "buy and hold" strategy, a compensation structure that results in greater compensation with an increased portfolio size is consistent with that strategy. The compensation structure does, nonetheless, create a situation where a decision by JMC for the Company to forego an asset transaction deemed to be an unacceptable business risk due to the lessee or the aircraft type is in conflict with JMC's own pecuniary interest. As a result, the compensation structure could act to incent greater risk-taking by JMC in asset acquisition decision-making. The Company has established objective target guidelines for yields on acquired assets. Further, the Company's Board, including a majority of the outside independent directors, must approve any acquisition that involves a new asset type. While the Company currently believes the foregoing are effective mitigating factors against undue compensation-incented risk-taking by JMC, there is no assurance that such mechanisms can entirely and effectively eliminate such risk.

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 of equipment, there can be no assurance that the cost will not fall on the Company. Furthermore, future government regulations could cause the value of any non-complying equipment owned by the Company to decline substantially.

Competition. The aircraft leasing industry is highly competitive. The Company competes with aircraft manufacturers, distributors, airlines and aircraft operators, equipment managers, leasing companies, equipment leasing programs, financial institutions and other parties engaged in leasing, managing or remarketing aircraft, many of which have significantly greater financial resources. Nevertheless, the Company believes that it is competitive because of JMC's experience and operational efficiency in identifying and obtaining financing for the transaction types desired by regional air carriers. This market segment, which in many cases involves customers that are private companies without well-established third party credit ratings, is not well served by the Company's larger competitors. JMC has developed a reputation as a global participant in this segment of the market, and the Company believes that JMC's reputation benefits the Company. There is, however, no assurance that competition from larger aircraft leasing companies will not increase significantly or that JMC's reputation will continue to be strong in this market segment.

Casualties, Insurance Coverage. The Company, as 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, since 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 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 such provisions of the United States Aviation Act 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 tracks receipt of the certificates and calendars their expiration dates. Prior to the expiration of an insurance certificate, if a replacement certificate has not been received, the Company reminds the lessee of its obligation to provide current insurance certificates to avoid a default under the lease.

Despite these requirements and procedures, there may be certain cases where the loss is not entirely covered by the lessee or its insurance. The possibility of such an event is remote, but any such uninsured loss with respect to the equipment or insured loss for which insurance proceeds are inadequate might result in a loss of invested capital in and any profits anticipated from, such equipment, as well as a potential claim directly against the Company.

Compliance with Future Environmental Regulations. Compliance with future 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, aimed at either requiring adoption of technology to reduce the amount of carbon emissions or putting in place a fee or tax system on carbon emitters. It is likely that any such regulation will be directed at the Company’s customers, as operators of aircraft, or at the Company, as owners of aircraft. Under the Company’s triple-net lease arrangements, the Company would likely shift responsibility for compliance to its lessees, but there might be some costs of regulation that the Company could not shift 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 cash flows, no assurance can be given that the costs of complying with environmental regulations adopted in the future will not have such an effect.

Christopher J. Klein
10,000

3 yrs.

5,000

10,000

15,000

Mark Hausberg
4,000

3 yrs.

2,000

4,000

6,000

(1) Performance share awards were granted for the January 1, 2005 December 31, 2007 performance period. These figures represent the number of shares that will be awarded upon attainment of the average consolidated return on equity and cumulative increase in diluted earnings per share targets for the performance period 2005-2007.

The number of shares of common stock to be delivered for the performance period 2005-2007 is based on the level of achievement of specified operating goals of the Company and its consolidated subsidiaries during the performance period. The target number of shares will be earned if 100% of the targeted average consolidated return on equity and cumulative diluted earnings per share are achieved and an additional amount of shares will be paid if the targeted goals are exceeded, but the maximum number of shares paid will not exceed 150% of the

target amount. The threshold amount will be earned at the achievement of approximately 90% of the targeted average consolidated return on equity and cumulative diluted earnings per share. In addition, cash dividend equivalents will be paid, but only to the extent that the performance goals are achieved.

Retirement Plans

The following table sets forth the highest estimated annual retirement benefits payable to persons in the specified compensation and years of service classifications upon retirement at normal retirement date, assuming election of an annuity for the life of the employee only, under the plans of the Company under which executive officers of the Company would be entitled to benefits:

Pension Plan Table

	Estimated Annual Retirement Benefits for Representative Years of Credited Service					
Remuneration	**10**	**15**	**20**	**25**	**30**	**35**
$ 500,000	$ 87,500	$131,250	$156,250	$187,500	$ 225,000	$ 262,500
600,000	105,000	157,500	187,500	225,000	270,000	315,000
700,000	122,500	183,750	218,750	262,500	315,000	367,500
800,000	140,000	210,000	250,000	300,000	360,000	420,000
900,000	157,500	236,250	281,250	337,500	405,000	472,500
1,000,000	175,000	262,500	312,500	375,000	450,000	525,000
1,100,000	192,500	288,750	343,750	412,500	495,000	577,500
1,200,000	210,000	315,000	375,000	450,000	540,000	630,000
1,300,000	227,500	341,250	406,250	487,500	585,000	682,500
1,400,000	245,000	367,500	437,500	525,000	630,000	735,000
1,600,000	280,000	420,000	500,000	600,000	720,000	840,000
1,800,000	315,000	472,500	562,500	675,000	810,000	945,000
2,000,000	350,000	525,000	625,000	750,000	900,000	1,050,000
2,200,000	385,000	577,500	687,500	825,000	990,000	1,155,000
2,400,000	420,000	630,000	750,000	900,000	1,080,000	1,260,000
2,600,000	455,000	682,500	812,500	975,000	1,170,000	1,365,000

The estimated retirement benefits in the preceding table include any offset for Social Security benefits. The compensation covered by the plans that provide retirement benefits to executive officers generally includes the categories of Salary and Bonus from the Summary Compensation Table shown above on page 13, averaged over the five highest consecutive years. The years of service of Messrs. Wesley, Omtvedt, Roche, Hausberg and Klein are 20, 15, 23, 11 and 2, respectively. Mr. Roche, who joined our employ in 1988, has a special retirement arrangement which credits him with service since 1981 in order to recognize that he devoted full time to our legal affairs from 1981 through 1988 while with an outside law firm.

Supplemental Plan. All of the executive officers named in the Summary Compensation Table on page 13 participate in the Supplemental Plan. Messrs. Wesley, Omtvedt, Roche and Hausberg are accruing benefits after 1995 solely under the Supplemental Plan rather than the Company s tax qualified Retirement Plan. The Supplemental Plan provides that certain senior officers of Fortune Brands, Inc. will receive an annual benefit equal to 52-1/2% of average compensation during the five highest-paid consecutive years of employment if designated by the Compensation and Stock Option Committee to receive this benefit. Messrs. Wesley, Omtvedt, Roche and Hausberg are entitled to this retirement benefit. This 52-1/2% benefit is reduced by 1-1/2% of such average compensation for each year that the officer retires prior to age 65 unless he has completed 35 years of service. The benefit is also reduced by benefits under the Fortune Brands Pension Plan and the retirement plans of our subsidiaries and any prior employer.

The Supplemental Plan also pays the difference between the benefits payable under our tax qualified Retirement Plan and the amount that would have been paid if the Internal Revenue Code did not have a limit on the amount of annual benefits that may be paid from a tax qualified Retirement Plan. The current Internal Revenue Code limit is the lesser of $170,000 or the employee s average annual compensation during the three

highest-paid consecutive years of employment. The Internal Revenue Code also provides that benefits under tax qualified plans cannot be based on compensation in excess of a certain limit, currently $210,000. The Supplemental Plan provides the difference between the amount paid under our tax qualified plans and the amount that would have been paid if the limit on compensation were not included therein. In calculating benefits, no credit is given for service in excess of 35 years.

Agreement with Mr. Wesley. Mr. Wesley has an agreement that his average annual compensation under the Supplemental Plan will be determined using his three highest-paid consecutive calendar years of employment rather than five. If Mr. Wesley becomes disabled or dies prior to normal retirement age of 65, his employment is terminated for reasons other than cause, or Mr. Wesley terminates his employment for good reason (as defined in the agreement), Mr. Wesley s compensation at the date of his retirement will be deemed to have continued until his normal retirement age for purposes of calculating this retirement benefit.

Change in Control Agreements. We have agreements with Messrs. Wesley, Omtvedt, Roche, Hausberg and Klein to provide each of them with benefits if they are terminated following a change in control of Fortune Brands, Inc. Each agreement states that if, subsequent to a change in control, (1) Fortune Brands, Inc. terminates the officer s employment for a reason other than disability or cause, or (2) the officer decides to terminate his employment for good reason (as defined in the agreement), the officer will receive:

(i) three years of base salary, three times the amount of his annual incentive compensation award and defined contribution plan allocation (and the supplemental profit-sharing allocation under the Supplemental Plan);

(ii) three additional years of service and earnings credit under our retirement plans and agreements; and

(iii) three additional years of coverage under our life, health, accident, disability and other employee plans.

If the special excise tax under Section 280G of the Internal Revenue Code applies, the agreements provide that we will restore amounts lost by the executive officer. The Company has established a rabbi trust with a bank for the purpose of paying such amounts. The executive officer would also be entitled to retain his split-dollar life insurance policy in order to provide his death benefit, but any insurance proceeds after death in excess of the death benefit will be returned to the Company. Any amounts payable under these change in control agreements are reduced by amounts payable under the severance agreements referred to below.

Severance Agreements. We have agreements with Messrs. Wesley, Omtvedt, Roche, Hausberg and Klein, to provide each of them with severance benefits without regard to a change in control if Fortune Brands, Inc. terminates their employment for reasons other than disability or cause or if they terminate their employment for good reason (as defined in the agreement). The severance agreements provide the same benefits as those described above for a termination of employment following a change in control except that the multiplier is three in the case of Mr. Wesley and two in the case of Messrs. Omtvedt, Roche, Hausberg and Klein.

Report of the Compensation and Stock Option Committee on Executive Compensation

The Company s executive compensation program (the Program) assists the Company in attracting, motivating and retaining executives that it needs in order to maximize its return to stockholders.

Toward that end, the Program provides:

(i) competitive levels of salary and total compensation;

(ii) annual incentive compensation that varies with the financial performance of the Company and its various operating companies; and

(iii) long-term incentive compensation to reward long-term financial performance.

The Company provides levels of total compensation for executive officers that are competitive with compensation for executives with comparable responsibilities in corporations of similar size. The Compensation and Stock Option Committee (the Committee) derives the competitive information from a variety of sources, including surveys of compensation conducted by Hewitt Associates and Towers Perrin. Most of the companies in

the survey group are in the S&P 500 and some are in the Peer Group Index described on pages 22 and 23. The Committee relies on a broad array of companies for comparative analysis of executive compensation because it believes that the Company s competitors for executive talent are more varied than the Peer Group. The Committee believes that the companies in the survey group provide a good basis for comparison. In reviewing competitive information, the Committee compares the performance of the Company with the performance of companies in the survey group. The Committee also solicits compensation information and advice from Hewitt Associates, the Committee s outside consultant.

The Program consists of three basic elements base salaries, annual incentive bonuses and long-term incentives. The Program provides the flexibility to reward executives based on their individual performance and company performance. The Company designs the long-term incentive plans covering its executive officers to ensure that the level of incentive compensation changes to reflect the profitability of the Company and the performance of the Company s common stock.

Committee Responsibilities

Under the Company s By-laws and the Committee Charter, the Committee has the following responsibilities: (i) reviews and approves compensation and goals for the Chief Executive Officer and evaluates his or her performance; (ii) approves the salaries of Vice Presidents and more senior officers; (iii) selects annual corporate performance measures and determines bonuses under the Annual Executive Incentive Compensation Plan; (iv) grants awards under the Company s 1999 and 2003 Long-Term Incentive Plans, which in 2004 consisted of stock options and performance share awards; (v) reviews the design of the incentive plans and recommends changes deemed appropriate to the Board of Directors; and (vi) assesses the competitiveness and effectiveness of all compensation programs.

Each element of the Program is described in the report below, including a discussion of the specific actions taken by the Committee for 2004 concerning the Chief Executive Officer and other executive officers.

Base Salaries

In determining salary adjustments for the Chief Executive Officer and other executive officers, the Committee sought to maintain salary levels that are competitive with the survey group. The salary increase for the Chief Executive Officer for 2004 was 4.0%, which placed the Chief Executive Officer in the second quartile (the fourth quartile being the highest) of the survey group. The average salary increase for executive officers during 2004 was 3.9%. The average salary increase for the survey group was 3.7%. The salary levels of the Company s executive officers, other than the Chief Executive Officer, were within the third quartile of the survey group.

Annual Incentive Bonuses

The Company s Annual Executive Incentive Compensation Plan, which was approved by stockholders in 2002, covers officers holding the office of Vice President and above. In January, 2004 the Committee established an incentive bonus fund for the year equal to 2.5% of adjusted net income (defined as the Company s income from continuing operations). The Company determined net income in accordance with generally accepted accounting principles, as reflected in the audited consolidated statement of income for 2004. The net income is then adjusted by the Company s independent accountants to:

(i) eliminate restructuring charges or credits;

(ii) eliminate other nonrecurring charges or credits, as disclosed in the audited financial statements and notes;

(iii) include the results of operations for such year from businesses classified as discontinued operations prior to the disposition dates; and

(iv) to the extent not adjusted pursuant to the above items, eliminate gains or losses resulting from the sale, disposal or writedown of intangible assets, land or buildings, charges for impaired assets, businesses, securities resulting from the sale of businesses and the sale of financial instruments.

The Committee also established a maximum percentage of the incentive bonus fund that could be awarded to each executive officer. These maximum percentages are: 20% to Mr. Wesley, 7.5% to Messrs. Omtvedt, Roche, Klein and Hausberg and 2.5% to the other executive officers.

Although the incentive bonus fund and the percentage of the fund allocated to each executive officer determine the maximum amount that can be paid individually and in the aggregate, the Committee s practice has been to approve incentive bonus awards based on target bonus levels set for each executive officer and pre-established earnings per share growth targets. Specifically, in order to allocate the incentive bonus fund among the executives, the Committee established a competitive target level for the annual bonuses equal to 90% of salary for Mr. Wesley and 40 55% of salary for all other executive officers. The Company determines the actual bonus awards based on the Company s earnings per share performance, ranging from 0 200% of the target bonus amount. The Committee has the authority to reduce, or increase, the incentive bonus award below or above the executive s target bonus level as adjusted for Company performance. But in no event can an executive officer s incentive bonus award exceed the maximum percentage of the incentive bonus fund allotted to the officer.

The Committee determined award payments to Mr. Wesley and the executive officers based on actual earnings per share growth as compared to earnings per share growth targets set at the beginning of 2004. The Committee approved payments of 156.8% of the target award with one exception. The total amount of the incentive bonuses paid to eligible officers for 2004 was 31.3% of the total authorized incentive fund.

Long-Term Incentives

Under the Company s 1999 and 2003 Long-Term Incentive Plans, the Committee can grant to key employees of the Company and its subsidiaries a variety of long-term incentives, including nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock, performance awards, dividend equivalents and other stock-based incentives. During 2004, the Committee granted incentive stock options and nonqualified stock options to executive officers of the Company. Performance share awards and dividend equivalents were also granted for the 2005 2007 performance period.

The Committee intends that stock options and performance awards serve as a significant portion of the executives total compensation package. They are granted in consideration of present and anticipated performance, as well as past performance. The stock options and performance awards offer the executive officers significant long-term incentives to increase their efforts on behalf of the Company and its subsidiaries, to focus managerial efforts on enhancing stockholder value and to align the interests of the executives with the stockholders.

The Committee s compensation philosophy is to have long-term incentives that pay more for superior performance and less if performance does not achieve that level. The Committee, in determining stock option and performance award grants to the individual executive officers, considered the award levels granted to similarly-compensated executives in the survey group and information presented by the Committee s outside consultant. The Committee also compared the performance of the companies in the survey group to the performance of the Company. The Committee believes that it is desirable to set a competitive percentile target as compared to the survey group in order to reward executive officers for strong performance and to increase their efforts on behalf of the Company, its subsidiaries and its stockholders. Grants were designed so that stock options comprise the greatest portion of the long-term incentive grant (ranging from 63% to 76% of the total long-term incentive grant for individual executive officers). Performance awards comprise the remainder.

During 2004 the Committee granted incentive and nonqualified stock options. The options have an exercise price equal to the fair market value of the stock on the date of grant. The options become exercisable in three annual installments beginning one year after the grant date, and expire 10 years after the grant date. Executive officers will realize benefits from stock options only if the market value of the Company s common stock increases.

The Committee also granted performance share awards for the 2005 2007 performance period that are contingent upon the Company and its subsidiaries achieving specified average return on equity and cumulative diluted earnings per share targets over the performance period. The target number of shares of the Company s common stock will be earned if 100% of the targeted consolidated return on equity and cumulative diluted earnings per share are achieved. An additional amount of shares will be paid if the targeted goals are exceeded, but the maximum number of shares paid will not exceed 150% of the target amount. The Company will not pay

performance share awards unless approximately 90% of the targeted consolidated return on equity and cumulative diluted earnings per share are achieved. In that event, 50% of the target number of shares will be earned. Recipients of performance awards will receive cash dividend equivalents at the time of payment equal to the cash dividends that would have been paid on the shares had the recipient owned the shares during the performance period. The executive officers have the option to receive their performance share award in cash if they have met the Company s stock ownership guidelines. The Company s stock ownership guidelines are:

Chairman and Chief Executive Officer	4 times salary;
Senior Vice Presidents and First-Tier Chief Executive Officers	2 times salary; and
Vice Presidents	1 times salary.

The performance share award grant when aggregated with the 2004 stock option grant to the individual executive officers placed them in the fourth quartile of the survey group. Mr. Wesley s long-term incentive grant placed him within the third quartile of the survey group.

Tax Treatment

The Internal Revenue Code limits the allowable tax deduction that may be taken by the Company for compensation paid to the Chief Executive Officer and the other highest paid executive officers required to be named in the Summary Compensation Table on page 13. The limit is $1 million per executive per year, although compensation payable solely based on performance goals is excluded from the limitation. All compensation of executive officers is fully tax deductible by the Company with the exception of $1,089,009, primarily due to employee grantor trust funding. Employee grantor trusts were established to provide retirement benefits in lieu of allowing participation in the Company s tax-qualified pension plan. These trusts have been approved by stockholders. The Committee intends that the annual incentive bonus, stock options and performance awards qualify as performance-based compensation so that these awards may qualify for the exclusion from the $1 million limit.

Compensation Consultant and Process

The Committee has retained Hewitt Associates as the Committee s consultant. The consultant regularly meets with the Committee and is included during executive sessions without the presence of Company management. In 2004, the consultant gave a presentation on executive compensation to the entire Board of Directors during executive session. Hewitt Associates is separately retained by the Company for pension plan and other employee benefits administration and consulting.

Compensation and Stock Option Committee

Gordon R. Lohman, Chairman
Patricia O. Ewers
Eugene A. Renna
J. Christopher Reyes

February 21, 2005

FORTUNE BRANDS, INC. STOCK PRICE PERFORMANCE
(With Dividend Reinvestment)

Peer Group Index

The Peer Group is composed of the following publicly traded companies in industry segments corresponding to the Company s current four core businesses:

Spirits and Wine: Allied Domecq PLC, Brown-Forman Corporation, Constellation Brands, Inc. (formerly Canadaigua Brands, Inc.) and Diageo PLC (formerly Guinness PLC);

Home and Hardware: Armstrong World Industries, Inc., The Black & Decker Corporation, Masco Corporation, Newell Rubbermaid Inc. (formerly Newell Co.) and The Stanley Works;

Office: Avery Dennison Corporation, General Binding Corporation, Mead Westvaco (formerly, The Mead Corporation), and The Standard Register Company; and

Golf and Leisure: Brunswick Corporation, Callaway Golf Company, Huffy Corporation, K2, Inc. and Reebok International Ltd.

Moore Wallace, Inc., which was formerly included in the Office segment, has been removed because it was acquired by R.R. Donnelley & Sons Company.

The weighted average total return of the entire Peer Group, for each year, is calculated in the following manner:

(1) the total return of each Peer Group member is calculated by dividing the change in market value of a share of its common stock, assuming periodic dividend reinvestment, by the cumulative value of a share of its common stock at the beginning of the year;

(2) each Peer Group member s total return is then weighted within its industry segment based on its market capitalization at the beginning of the year, relative to the market capitalization of the entire segment, and the sum of such weighted returns results in a weighted average total return for that segment; and

(3) each segment s weighted average total return is then weighted based on the percentage of sales, excluding excise taxes, of that segment of the Company for the year, as compared with total Company sales, excluding excise taxes, and the sum of such weighted returns results in a weighted average total return for the entire Peer Group.

The Peer Group Index reflects the weighted average total return for the entire Peer Group calculated for the five year period, starting with a base of $100.

Report of the Audit Committee

The Audit Committee of the Board of Directors (the Audit Committee) is composed of four directors that are independent as defined under the New York Stock Exchange Listing Standards and Rule 10A-3 of the Exchange Act. The Audit Committee has a written charter that has been approved by the Board of Directors. A copy of the Audit Committee Charter is available on the Company s website at *http://www.fortunebrands.com*. The Audit Committee has appointed (subject to stockholder ratification) the Company s independent auditors.

Management has the responsibility for the Company s financial statements and overall financial reporting process, including the Company s systems of internal controls. The independent auditor has the responsibility to conduct an independent audit in accordance with generally accepted auditing standards and to issue an opinion thereon. The Audit Committee s responsibility is to monitor and oversee these processes.

In this context, the Audit Committee has reviewed and discussed the audited financial statements and the Company s quarterly and annual reports to the SEC with management and the independent auditor. Management has confirmed to the Audit Committee that the Company s financial statements were prepared in accordance with generally accepted accounting principles. The Audit Committee has met with the independent auditor and discussed matters required to be discussed by SAS No. 61 (Communication with Audit Committees). The independent auditor has provided an unqualified opinion regarding the Company s financial statements for the year ended December 31, 2004 and management s assessment of internal controls over financial reporting and the effectiveness of those controls as of December 31, 2004.

The Company s independent auditor has also provided to the Audit Committee the written disclosures and letter required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committee), and the Audit Committee has discussed with the independent auditor that firm s independence. The Audit Committee has also reviewed non-audit services provided by the independent auditor and has considered the compatibility of these services with maintaining the auditor s independence.

Based upon the review and discussions with management and the independent auditor, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2004 for filing with the SEC.

Audit Committee

David M. Thomas, Chairman
Pierre E. Leroy
J. Christopher Reyes
Anne M. Tatlock

February 21, 2005

The Report of the Compensation and Stock Option Committee on Executive Compensation, the Fortune Brands, Inc. Stock Price Performance graph, and the Report of the Audit Committee shall not be deemed to be soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Exchange Act or to the liabilities of Section 18 of the Exchange Act. In addition, they shall not be deemed incorporated by reference by any statement that incorporates this Proxy Statement by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates this information by reference.

Fees of Independent Registered Public Accounting Firm

The independent auditor of the Company during the year ended December 31, 2004 was PricewaterhouseCoopers LLP. All PricewaterhouseCoopers LLP services were approved in advance by the Audit Committee. The aggregate fees billed by PricewaterhouseCoopers LLP during the years 2004 and 2003 are set forth in the table below:

Type of Fee	Fiscal Year Ended December 31, 2004	2003
Audit Fees (1)	$ 6,189,000	$ 3,528,000
Audit Related Fees (2)	770,000	1,263,000

Type of Fee	Fiscal Year Ended December 31,	
Tax Fees (3)	835,000	1,581,000
All Other Fees (4)	102,000	301,000

(1) Aggregate fees billed by PricewaterhouseCoopers LLP in connection with the audit of the Company s annual financial statements and the review of the Company s financial information included in its SEC Form 10-Q filings, the review of management s assessment of internal controls and the assessment of the effectiveness of the Company s internal controls.

(2) Audit-related services included assistance with due diligence activities and accounting advice on proposed acquisitions, audits of employee benefit plans, evaluation of the new internal control certification requirements, and for 2003 only, assistance in the development of a program to document the Company s internal controls.

(3) Tax fees represented services which included domestic and international tax compliance, tax planning and expatriate tax services.

(4) All Other Fees, for 2004, represented services that include the audit of our pharmacy benefits contract and the lease of office space in the UK. All Other Fees for 2003 represented services that include the sale of an automated tool to assist management in the evaluation of access controls and consulting services relating to data archiving.

Approval of Audit and Non-Audit Services

The Audit Committee has adopted the following policies and procedures for the pre-approval of all audit and permissible non-audit services provided by our independent auditor. The Audit Committee annually reviews the audit and non-audit services to be performed by the independent auditor during the upcoming year. The Audit Committee considers, among other things, whether the provision of specific non-audit services is permissible under existing law and whether it is consistent with maintaining the auditor s independence. The Audit Committee then approves the audit services and any permissible non-audit services it deems appropriate for the upcoming year. The Audit Committee s pre-approval of non-audit services is specific as to the services to be provided and includes pre-set spending limits. The provision of any additional non-audit services during the year, or the provision of services in excess of pre-set spending limits, must be pre-approved by either the Audit Committee or by the Chairman of the Audit Committee, who has been delegated authority to pre-approve such services on behalf of the Audit Committee. Any pre-approvals granted by the Chairman of the Audit Committee must be reported to the full Audit Committee at its next regularly scheduled meeting. All of the fees described above under audit fees, audit-related fees, tax fees and all other fees for 2004 were pre-approved by the Audit Committee pursuant to its pre-approval policies and procedures.

Item 2

RATIFICATION OF APPOINTMENT OF
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee has appointed PricewaterhouseCoopers LLP as our independent registered public accounting firm for 2005. The Audit Committee and the Board of Directors recommend that you ratify this appointment. In line with this recommendation, the Board of Directors intends to introduce the following resolution at the Annual Meeting (designated as Item 2):

RESOLVED, that the appointment of PricewaterhouseCoopers LLP as the independent registered public accounting firm for this Company for the year 2005 is ratified.

A member of PricewaterhouseCoopers LLP will attend the Annual Meeting to make a statement if he or she desires, and respond to appropriate questions that may be asked by stockholders.

The Board of Directors recommends that you vote FOR Item 2.

Item 3

APPROVAL OF THE 2005 NON-EMPLOYEE DIRECTOR STOCK PLAN

On April 25, 2000, the Company s stockholders approved the Stock Plan for Non-employee Directors which annually granted shares of common stock to each non-employee director of the Company. The plan expired on December 31, 2004. A new stock plan for non-employee directors (the 2005 Non-Employee Director Stock Plan) is now being proposed for your approval. The 2005 Non-Employee Director Stock Plan is similar to the Company s old plan. Our Board of Directors believes that the 2005 Non-Employee Director Stock Plan will aid the Company in continuing to attract and retain non-employee directors of exceptional ability by supplementing their cash fees and further aligning their interests with those of the stockholders by increasing their proprietary interest in the Company. Many large corporations provide stock-based plans to non-employee directors and the 2005 Non-Employee Director Stock Plan will continue to keep the Company in conformity with this practice. Our Board of Directors believes that the proposed terms of the Plan permit the Company to maintain its competitive position.

Subject to your approval, the 2005 Non-Employee Director Stock Plan will be effective for the years 2005 through 2009. Under the Plan, each non-employee director will receive a designated number of shares, as determined by the Nominating and Corporate Governance Committee (the Committee) from time to time, for each year in which he or she serves as a non-employee director. Initially, each non-employee director will receive 700 shares. The share grant will follow the Annual Meeting of Stockholders. The shares will be delivered after the Annual Meeting and will be in addition to, not in place of, the annual cash fee and cash fees for service on committees.

The 2005 Non-Employee Director Stock Plan will be administered by the Committee. The Committee will have discretion to award interim or partial grants to directors to reflect partial years of service for directors who are elected or appointed to the Board of Directors after the most recent Annual Meeting. However, the Committee does not otherwise have discretion with respect to the amount of or the terms of any individual grant.

The maximum number of shares that may be issued in the aggregate to non-employee directors under the 2005 Non-Employee Director Stock Plan is 150,000. These shares may consist of authorized but unissued or treasury shares. The number of shares of common stock which a non-employee director may receive per year and the aggregate number of shares which may be issued to non-employee directors under the 2005 Non-Employee Director Stock Plan are subject to adjustment for stock splits, stock dividends and similar events. The 2005 Non-Employee Director Stock Plan also includes a provision that did not exist in the previous plan, which allows non-employee directors to elect to receive their annual compensation, including the annual, chairperson, committee membership and committee attendance fees, in Company stock rather than cash. This election must be made in

the period prior to the quarter in which such fees are paid, subject to the Company s general policies with respect to quiet periods and investment elections during quiet periods. Although a total of 75,000 shares was authorized for issuance under the old plan, we believe that a greater number of authorized shares are preferable to provide for the provision that allows directors to receive their cash compensation in stock and to provide for grants to additional non-employee directors who might be elected to the Board.

Like the predecessor plan that expired on December 31, 2004, the 2005 Non-Employee Director Stock Plan permits a non-employee director to elect to defer receipt of shares of common stock until a specified date or until the occurrence of a specified event in the future. During the period that receipt of any such shares is deferred, dividends that would have been paid are also deferred and will accrue interest quarterly from the dates such dividends would have been paid at a rate equal to the average quarterly United States Treasury bill rate and be delivered to the non-employee director, with the deferred shares, on the specified date or upon the death, disability or separation from service of the non-employee director. Upon the occurrence of a Change in Control, as defined below, any shares of common stock which a non-employee director has elected to defer and any accrued and unpaid dividends (and accrued interest) will be delivered to such non-employee director.

A change in control is defined in the 2005 Non-Employee Director Stock Plan as follows:

- the acquisition by a person or group of beneficial ownership of more than 50% of the outstanding stock of the Company, measured by vote or by value;

- the acquisition by a person or group that acquires, within a 12-month period, 35% or more of the total voting power of the outstanding stock of the Company;

- a majority of our current Board of Directors, or their successor directors, are replaced during any 12-month period;

a sale of a substantial portion of the Company s assets (40% or more of the total value) within a 12-month period, unless the recipient of the assets is (i) a subsidiary of the Company, (ii) Company stockholder(s) owning 50% or more of the total value or voting power of the Company, or (iii) an entity at least 50% owned by such Company stockholder(s) described in (ii); provided, however, that the assets are not distributed to a Company shareholder in exchange for Company stock.

The Board of Directors retains the right to amend or terminate the 2005 Non-Employee Director Stock Plan, subject to compliance with Section 16 of the Exchange Act and, subject to stockholder approval, as required under applicable law.

Under current federal income tax laws, a non-employee director will realize taxable income, and the Company will be entitled to a tax deduction, when the shares of common stock are delivered to the non-employee director in an amount equal to the fair market value of the shares on the date of grant.

Accordingly, we recommend that you approve adoption of the 2005 Non-Employee Director Stock Plan. The 2005 Non-Employee Director Stock Plan is set forth in full in Exhibit A, and the description of the 2005 Non-Employee Director Stock Plan, which appears above, is qualified in its entirety by reference to the full text.

The resolution (designated as Item 3) to approve the 2005 Non-Employee Director Stock Plan is as follows:

RESOLVED, that the Fortune Brands, Inc. 2005 Non-Employee Director Stock Plan submitted to this Annual Meeting and shown in Exhibit A of the Proxy Statement is approved.

The Board of Directors recommends that you vote FOR Item 3.

EQUITY COMPENSATION PLAN INFORMATION

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	12,416,720	$50.45	7,126,664
Equity compensation plans not approved by security holders	0	N/A	0
Total	12,416,720	$50.45	7,126,664[(1)]

(1) 6,991,664 shares remain available for issuance under the Company s 2003 Long-Term Incentive Plan, which allows for grants of stock options, performance stock awards, restricted stock awards and other stock-based awards. 135,000 shares remain available for issuance under the 2002 Non-Employee Directors stock option plan, which provides for grants of stock options.

CERTAIN INFORMATION REGARDING SECURITY HOLDINGS

We have listed below the beneficial ownership of common stock of Fortune Brands, Inc. by (a) each director, (b) the executive officers of the Company listed on page 13, and (c) directors and executive officers of the Company as a group on February 4, 2005. The table is based on information we received from the nominees, other directors and executive officers, our Corporate Employee Benefits Committee, and the Trustee of our defined contribution plan. Unless otherwise indicated, the business address of each of the Company s directors and executive officers is the same as the Company s address:

Name	Amount and Nature of Beneficial Ownership (1)(2)(3)	Percent of Class
Patricia O. Ewers	22,564	*
Mark Hausberg	161,512	*
Thomas C. Hays	325,815	*
Christopher J. Klein	29,273	*
Pierre E. Leroy	4,608	*
Gordon R. Lohman	21,717	*
Craig P. Omtvedt	171,528	*
Eugene A. Renna	17,515	*
J. Christopher Reyes	10,242	*
Mark A. Roche	222,827	*
Anne M. Tatlock	25,999	*
David M. Thomas	14,775	*
Norman H. Wesley	697,448	*
Peter M. Wilson	22,922	*
Directors and executive officers as a group (15 persons)[4]	1,780,869	1.22%

* Less than 1%

(1) To the best of our knowledge, each nominee and Class II and III director and executive officer who is not a director has sole voting and investment power with respect to shares shown above, other than with respect to the shares listed in Notes (3) and (4) below that may be acquired upon exercise of options, and except as follows: Mr. Hays shares voting and investment power as a co-trustee of various family trusts with respect to 5,907 shares, he has no voting and investment power for 4,000 shares, but for which his wife is the beneficiary. With respect to all 9,907 shares he disclaims beneficial ownership.

(2) Includes the following number of shares attributable to Company contributions under the Company s Retirement Savings Plan (RSP):

	Number of Shares
Mark Hausberg	1,149
Thomas C. Hays	1,134
Craig P. Omtvedt	1,342
Mark A. Roche	3,821

Also includes the number of shares attributable to employee contributions under the RSP as follows:

	Number of Shares
Mark Hausberg	0

	Number of Shares
Thomas C. Hays	2,922
Craig P. Omtvedt	1,160
Mark A. Roche	1,664

The Trustee of the RSP has agreed to vote the shares it holds in the Trust in accordance with instructions received from members of the RSP and shares as to which instructions are not received are voted by the Trustee proportionally in the same manner as shares as to which the Trustee has received instructions. The number shown in the table above includes 13,192 shares of common stock held on February 4, 2005 by the Trustee of the RSP (including certain of those referred to above) which number is equivalent as of that date to the undivided proportionate beneficial interests of the directors and executive officers of the Company in all such shares.

(3) Includes the following number of shares with respect to which the following directors and executive officers have the right to acquire beneficial ownership within 60 days of the date of this table:

	Number of Shares
Patricia O. Ewers	17,000
Mark Hausberg	137,639
Thomas C. Hays	260,500
Christopher J. Klein	20,000
Pierre E. Leroy	3,958
Gordon R. Lohman	20,217
Craig P. Omtvedt	123,691
Eugene A. Renna	7,500
J. Christopher Reyes	6,042
Mark A. Roche	173,767
Anne M. Tatlock	20,217
David M. Thomas	11,875
Norman H. Wesley	571,195
Peter M. Wilson	17,000

(4) Includes 1,419,501 shares of which the directors and executive officers as a group had the right to acquire beneficial ownership pursuant to the exercise on or before April 4, 2005 of options granted by the Company. Inclusion of such shares does not constitute an admission by any nominee, director or executive officer that he or she is the beneficial owner of such shares.

To the best of the Company s knowledge, directors and executive officers did not own any shares of $2.67 Convertible Preferred stock of Fortune Brands, Inc.

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SUBMISSION OF STOCKHOLDER PROPOSALS AND NOMINATIONS

What governs stockholder proposals and nominations?

Our Restated Certificate of Incorporation contains procedures for stockholder nomination of directors. Our By-laws contain procedures for other stockholder proposals to be presented before annual stockholder meetings.

Who can make a nomination?

According to our Restated Certificate of Incorporation, any record owner of stock entitled to be voted generally in the election of directors may nominate one or more persons for election as a director at a stockholders meeting at least 120 days prior to the Annual Meeting.

How do I go about making a nomination?

If you are a record owner of stock and you wish to make a nomination, you must notify the Secretary, in writing, of your intent to make a nomination. Written notice must be submitted 120 days before the Annual Meeting, that is, by December 26, 2005 for the 2006 Annual Meeting (assuming the 2006 Annual Meeting is held on April 25, 2006), and it must include:

the names and addresses of you and any other stockholder who intends to appear in person or by proxy to make the nomination, and the name and address of the person(s) to be nominated;

a description of all arrangements or understandings between you and each nominee and any other person(s) (naming them) pursuant to which the nomination is to be made;

any other information regarding each of your proposed nominees that would be included in a proxy statement; and

the consent of each nominee to serve if elected.

Who can make a proposal?

According to the By-laws, a proposal or other business to be considered at the Annual Meeting of Stockholders can be made by a person who is a stockholder of record.

How do I go about making a proposal?

If you are a record owner of stock and you wish to make a proposal, you must notify the Secretary, in writing, of your intent. You must give your written notice 120 days before the Annual Meeting, that is, by December 26, 2005 for the 2006 Annual Meeting (assuming the 2006 Annual Meeting is held on April 25, 2006), and it must include:

a brief description of the business to be brought before the meeting, the reasons for conducting the business and any material interest that you or the beneficial owners, if any, on whose behalf you are making the proposal may have in the business;

your name and address, and the names and addresses of the beneficial owners, if any, on whose behalf you are making the proposal, as they appear on our books; and

the class and number of shares of our stock that are owned beneficially and of record by you and the beneficial owners.

The By-laws also provide that stockholders who wish to have a proposal included in the Company s Proxy Statement must comply with the applicable requirements of the Exchange Act, as well as its rules and regulations. Such stockholders also have the benefit of the rights provided by Rule 14a-8 of the Exchange Act. In order to be eligible under Rule 14a-8 for inclusion in the Company s Proxy Statement and accompanying proxy at the next Annual Meeting of Stockholders currently scheduled to be held on April 25, 2006, stockholder proposals must be received by the Company on or before November 17, 2005.

A copy of the Restated Certificate of Incorporation and By-law provisions is available upon written request to Mr. Mark A. Roche, Senior Vice President, General Counsel and Secretary, Fortune Brands, Inc., 300 Tower Parkway, Lincolnshire, Illinois 60069. The person presiding at the meeting is authorized to determine if a proposed matter is properly before the meeting or if a nomination is properly made.

MISCELLANEOUS

A copy of the Company s Annual Report on Form 10-K as filed with the SEC for its last fiscal year, including any financial statements and financial statement schedules to the Form 10-K, will be made available to stockholders without charge, upon written request to Mr. Mark A. Roche, Senior Vice President, General Counsel and Secretary, Fortune Brands, Inc., 300 Tower Parkway, Lincolnshire, Illinois 60069. The Company will furnish any exhibits to Form 10-K to each stockholder requesting them upon payment of a fee of $.10 per page to cover their cost.

Our Board of Directors is soliciting this proxy. The Company will bear the expense of soliciting proxies for this meeting, including mailing costs. In addition to mailing copies of this material to stockholders, we will request that persons who hold stock in their names or custody, or in the names of nominees, for the benefit of others, to forward copies of these materials to the beneficial owners of our stock, and to request the authority to execute the proxies. In order to assure that there is sufficient representation at the meeting, our officers and regular employees may solicit proxies by telephone, facsimile, or in person. In addition, we have retained Morrow & Co., Inc., 445 Park Avenue, New York, New York 10022, to aid in soliciting proxies for a fee, estimated at $12,500, plus reasonable out-of-pocket expenses. Our total expenses will depend upon the volume of shares represented by the proxies received *promptly* in response to the Notice of Meeting and Proxy Statement.

Stockholders who do not intend to be present at the meeting are urged to send in their proxies without delay or vote their proxies by telephone or through the Internet. Prompt response is helpful, and your cooperation will be appreciated.

Multiple Stockholders Having the Same Address

If you and other residents at your mailing address own shares of common stock in street name, your broker or bank may have sent you a notice that your household will receive only one Annual Report and Proxy Statement for each company in which you hold stock through that broker or bank. This practice, known as householding, is designed to reduce our printing and postage costs. If you did not respond that you did not want to participate in householding, the broker or bank will assume that you have consented, and will send one copy of our Annual Report and Proxy Statement to your address. You may revoke your consent to householding at any time by sending your name, the name of your brokerage firm, and your account number to ADP, Householding Department, 51 Mercedes Way, Edgewood, New York 11717. The revocation of your consent to householding will be effective 30 days following its receipt. In any event, if you did not receive an individual copy of this Proxy Statement or our Annual Report, or if you wish to receive individual copies of our Proxy Statements and Annual Reports for future meetings, we will send a copy to you if you call Alvin Santiago, Manager of Shareholder Services, at (847) 484-4538, or write him at Fortune Brands, Inc., 300 Tower Parkway, Lincolnshire, Illinois 60069.

If you and other residents at your mailing address are registered stockholders and you receive more than one copy of the Annual Report and Proxy Statement, but you wish to receive only one copy, you must request, in writing, that the Company eliminate these duplicate mailings. To request the elimination of duplicate copies, please write to The Bank of New York, Shareholder Relations Department, P. O. Box 11258, Church Street Station, New York, New York 10286.

Other Matters

The Company knows of no other matters to be submitted to the stockholders at the meeting. If any other matters properly come before the meeting, people named in the enclosed proxy will vote the shares they represent in accordance with the recommendation of the Board of Directors.

March 14, 2005

EXHIBIT A

FORTUNE BRANDS, INC.

2005 NON-EMPLOYEE DIRECTOR STOCK PLAN

1. Purpose of Plan

The purpose of the Fortune Brands, Inc. 2005 Non-Employee Director Stock Plan (the Plan) is to enable Fortune Brands, Inc. (Fortune Brands) to provide its non-employee directors (as defined below) with shares of common stock of Fortune Brands (Common Stock) and to attract and retain non-employee directors of exceptional ability and further align their interests with those of the other stockholders of Fortune Brands by increasing their proprietary interests in Fortune Brands.

2. Administration of Plan

The Plan shall be administered by the Nominating and Corporate Governance Committee (the Committee) of the Board of Directors of Fortune Brands. The Committee shall have the power and authority to administer, construe and interpret the Plan, to make rules for carrying it out and to make changes in such rules.

3. Participation

All non-employee directors shall participate in the Plan. The term non-employee director means a member of the Board of Directors of Fortune Brands who, at the time of performance of the services relevant to payment under the Plan, is not an employee of Fortune Brands or any subsidiary.

4. Annual Payment of Shares of Common Stock

(a) Subject to all the terms and conditions of the Plan, each non-employee director shall receive such number of shares of Common Stock per year for services as a non-employee director during such year, as determined from time to time by the Committee, which number shall initially be set at 700. To be entitled to receive such shares with respect to any year, a non-employee director must be serving as such immediately following the Annual Meeting of stockholders of Fortune Brands held during such year; provided, however, that the Committee in its discretion may award interim or partial grants to eligible directors to reflect partial years of service by eligible directors who are elected or appointed to the Board of Directors after the most recent Annual Meeting. Certificates representing such shares shall be delivered to such non-employee director after such Annual Meeting.

(b) A non-employee director may elect to defer receipt of shares of Common Stock under this Section 4. The election shall be irrevocable and must (i) be made in writing to the Secretary of Fortune Brands before November 1 immediately preceding the year in which the non-employee director becomes entitled to receive shares of Common Stock, and (ii) specify the future date or dates on which the shares of Common Stock are to be distributed, or specify that distribution of the shares of Common Stock will be upon the death, disability, or separation from service of the non-employee director, in a manner consistent with Section 409A of the Internal Revenue Code of 1986, as amended (the Code). Upon the distribution date or event, certificates representing the shares of Common Stock that have been deferred pursuant to this Section 4(b) shall be delivered to the non-employee director, or, in the case of that individual s death, to his or her beneficiary, together with an amount representing the dividends on such shares that would have been paid prior to such distribution date or event if receipt of such shares had not been deferred (unpaid dividends), together with interest on such unpaid dividends, calculated at a rate equal to the average quarterly United States Treasury bill rate and accrued quarterly from the respective dates such dividends would have been paid. The obligation of Fortune Brands to make payment of any deferred shares of Common Stock or any unpaid dividends (and interest) as provided in this Section 4(b) is not required to be funded.

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(c) An election by a non-employee director pursuant to Section 4(b) to defer receipt of any shares of Common Stock shall confer no rights upon such non-employee director, as a stockholder of the Company or otherwise, with respect to such shares, but shall confer only the right to receive such shares and unpaid dividends (and interest) as and when provided in Section 4(b).

(d) Notwithstanding anything to the contrary in Section 4(b) or 4(c), in the event a non-employee director has elected to defer receipt of shares of Common Stock pursuant to Section 4(b) and in the event of such person s death prior to receipt, such shares and any unpaid dividends (and interest) provided for in Section 4(b) shall be promptly paid to the beneficiary or beneficiaries designated by such person in writing to the Secretary of Fortune Brands or, if no beneficiary has been so designated, to such person s estate.

(c) Notwithstanding anything to the contrary in Section 4(b) or 4(c), in the event a non-employee director has elected to defer receipt of shares of Common Stock pursuant to Section 4(b) and in the event of a Change in Control (as defined in this Section 4(e)), such shares and any unpaid dividends (and interest) provided for in Section 4(b) shall be promptly paid to such non-employee director. A Change in Control means the first to occur of any of the following events, but only to the extent such event is a change in control for purposes of Section 409A of the Code:

i. *Change in ownership of Fortune Brands*. A change in the ownership of Fortune Brands is deemed to occur on the date that any one person, or more than one person acting as a group (as described in paragraph (iv)), acquires ownership of stock of Fortune Brands that, together with stock held by such person or group, constitutes more than 50 percent of the total fair market value or total voting power of the stock of Fortune Brands. However, if any one person or more than one person acting as a group, is considered to own more than 50 percent of the total fair market value or total voting power of the stock of Fortune Brands, the acquisition of additional stock by the same person or persons is not considered to cause a change in the ownership of the corporation. An increase in the percentage of stock owned by any one person, or persons acting as a group, as a result of a transaction in which Fortune Brands acquires its stock in exchange for property will be treated as an acquisition of stock for purposes of this section. This section applies only when there is a transfer or issuance of stock of Fortune Brands and the stock remains outstanding after the transaction.

ii. *Change in effective control of Fortune Brands*. Change in the effective control of Fortune Brands occurs on the date that either (A) any one person, or more than one person acting as a group (as described in paragraph (iv)), acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) ownership of stock of Fortune Brands possessing 35 percent or more of the total voting power of the stock of Fortune Brands; or (B) a majority of members of the Board is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the members of the Board prior to the date of the appointment or election. If any one person, or more than one person acting as a group, is considered to effectively control Fortune Brands, the acquisition of additional control of Fortune Brands by the same person or persons is not considered to cause a change in the effective control of Fortune Brands.

iii. *Sale of a substantial portion of Fortune Brands assets*. A change in the ownership of a substantial portion of Fortune Brands assets occurs on the date that any one person or persons acting as a group acquire (or have acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) assets from Fortune Brands that have a total gross fair market value equal to or more than 40 percent of the total gross fair market value of all of the assets of Fortune Brands immediately prior to such acquisition or acquisitions. For this purpose, gross fair market value means the value of the assets of Fortune Brands, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets. A transfer of assets to an entity that is controlled by the shareholders of Fortune Brands immediately after the transfer, or a transfer of assets by Fortune Brands to any of the following, are not considered to be a change in the ownership of a substantial portion of Fortune Brands assets for purposes of this

paragraph: (A) a shareholder of Fortune Brands (immediately before the asset transfer) in exchange for or with respect to its stock; (B) an entity, 50 percent or more of the total value or voting power of which is owned, directly or indirectly, by Fortune Brands; (C) a person, or more than one person acting as a group, that owns, directly or indirectly, 50 percent or more of the total value or voting power of all the outstanding stock of Fortune Brands; or (D) an entity, at least 50 percent of the total value or voting power of which is owned, directly or indirectly, by a person described in paragraph (C). For purposes of this paragraph (iii) and except as otherwise provided, a person s status is determined immediately after the transfer of the assets. For example, a transfer to a corporation in which Fortune Brands has no ownership interest before the transaction, but which is a majority-owned subsidiary of Fortune Brands after the transaction is not treated as a change in the ownership of the assets of Fortune Brands.

iv. Persons will not be considered to be acting as a group solely because they purchase or own stock of Fortune Brands at the same time, or as a result of the same public offering. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with Fortune Brands. If a person, including an entity, owns stock in Fortune Brands and another corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar transaction with Fortune Brands, such shareholder is considered to be acting as a group with other shareholders of the other corporation only with respect to their ownership interest in that corporation prior to the transaction.

(f) The right to receive shares of Common Stock, the receipt of which has been deferred by a non-employee director pursuant to Section 4(b) shall not be transferable by such non-employee director otherwise than by will or the laws of descent and distribution or pursuant to a qualified domestic relations order as defined in the Code, as amended. The shares issued pursuant to this Section 4 shall be in addition to any other fees to which a non-employee director may be entitled.

5. Election to Receive Fees in Common Stock

(a) The Company generally pays certain fees, including, but not limited to, an annual retainer, meeting fees and chairperson fees, to non-employee directors in cash. Each non-employee director shall have the right to elect, at any time, subject to Fortune Brands general policies with respect to quiet periods and investment elections during such quiet periods, to receive payment of all such fees in shares of Common Stock of Fortune Brands, and shall have the right, at any time, to reverse such an election, by filing with the Committee, or such person as the Committee shall designate, a Payment Election Form, as attached hereto as Annex A. Any election to receive fees in shares of Common Stock, or any reversal of such an election, will become effective three months after the date the Payment Election Form is filed with Fortune Brands.

(b) If an election is made pursuant to Section 5(a) of the Plan then, after the election becomes effective, Fortune Brands shall pay any amounts due to the non-employee director that are subject to the election in whole shares of Common Stock, except that the value of any fractional share shall be paid in cash. The number of shares of Common Stock to be issued to the non-employee director shall be equal to a fraction, the numerator of which is the amount to be paid to the non-employee director and the denominator of which is the average of the high and low prices of the Common Stock on the national exchange on which the stock is listed on the last day of trading that immediately precedes the date of issue. To eliminate any fractional shares, to the extent the fraction is not equal to a whole number, it shall be rounded down to the next whole number, which shall be subtracted from the amount to be paid to the non-employee director and the difference shall be paid to the non-employee director in cash.

6. Taxes

Fortune Brands shall have the power and the right to deduct or withhold, or require a non-employee director to remit to Fortune Brands, a cash amount sufficient to satisfy federal, state, and local taxes, required by law or regulation to be withheld with respect to any distribution or other taxable event arising under the Plan. Any taxes that are required to be withheld upon delivery of shares of Common Stock issued pursuant to the Plan to a non-employee director shall be paid to Fortune Brands in cash by such non-employee director unless deducted and withheld from any cash fees payable by Fortune Brands to such non-employee director or paid by such non-employee director in shares of Common Stock in an exempt transaction under Section 16 of the Securities Exchange Act of 1934 (the Exchange Act).

7. Limitations and Conditions

(a) The total number of shares of Common Stock that may be issued to non-employee directors under the Plan is 150,000. Such total number of shares may consist, in whole or in part, of authorized but unissued shares or shares held in Fortune Brands treasury. The foregoing number may be increased or decreased by the events set forth in Section 8 below.

(b) Prior to each issuance to a non-employee director of shares of Common Stock pursuant to the Plan, such non-employee director must make representations satisfactory to the Committee to the effect that such shares are to be held for investment purposes and not with a view to or for resale or distribution except in compliance with the Securities Act of 1933, as amended (the Securities Act), and must give a written undertaking to Fortune Brands in form and substance satisfactory to the Committee that he or she will not publicly offer or sell or otherwise distribute such shares other than (i) in the manner and to the extent permitted by Rule 144 promulgated by the Securities and Exchange Commission under the Securities Act, (ii) pursuant to any other exemption from the registration provisions of the Securities Act or (iii) pursuant to an effective registration statement thereunder.

(c) Nothing contained herein shall be deemed to create the right in any non-employee director to remain a member of the Board of Directors of Fortune Brands, to be nominated for reelection or to be reelected as such or, after ceasing to be such a member, to receive any shares of Common Stock under the Plan to which he or she is not already entitled with respect to any year.

8. Stock Adjustments

In the event of any merger, consolidation, stock or other non-cash dividend, extraordinary cash dividend, split-up, spin-off, combination or exchange of shares, reorganization or recapitalization or change in capitalization, or any other similar corporate event, the Committee may make such adjustments in (i) the aggregate number of shares of Common Stock that may be issued under the Plan as set forth in Section 7(a), (ii) the number of shares issued to a non-employee director with respect to any year as set forth in Section 4(a), and (iii) the kind of shares that may be issued under the Plan, as the Committee shall deem appropriate in the circumstances. The determination by the Committee as to the terms of any of the foregoing adjustments shall be conclusive and binding.

9. Amendment and Termination

(a) The Board of Directors of Fortune Brands shall have the power to amend or terminate the Plan at any time, subject to stockholder approval requirements under applicable laws; provided, however, that, to be effective, any amendment of the Plan shall comply with the requirements of the rules and regulations promulgated under Section 16(b) of the Exchange Act to the extent necessary so that the receipt of shares of Common Stock by a non-employee director under the Plan shall be exempt from such Section 16(b).

(b) Subject to any prior termination of the Plan by the Board of Directors of Fortune Brands, shares of Common Stock shall be issuable under the Plan only with respect to the calendar years 2005 through 2009 inclusive.

10. Miscellaneous

(a) Indemnification. Each person who is or has been a member of the Board of Directors of Fortune Brands will be indemnified and held harmless by Fortune Brands against and from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by that person in connection with or resulting from any claim, action, suit, or proceeding to which that person may be a party or in which that person may be involved by reason of any action taken or failure to act under the Plan and against and from any and all amounts paid by that person in a settlement approved by Fortune Brands, or paid by that person in satisfaction of any judgment in any such action, suit, or proceeding against that person, provided he or she gives Fortune Brands an opportunity, at its own expense, to handle and defend the action, suit or proceeding before that person undertakes to handle and defend it. The foregoing right of indemnification will not be exclusive of any other rights of indemnification to which an individual may be otherwise entitled, or any power that Fortune Brands may have to indemnify him or her or hold him or her harmless, to the fullest extent permitted under Delaware law.

(b) Gender and Number. Except where otherwise indicated by the context, any masculine term used herein will also include the feminine; the plural will include the singular and the singular will include the plural.

(c) Severability. If any provision of the Plan is held illegal or invalid for any reason, the illegality or invalidity will not affect the remaining parts of the Plan, and the Plan will be construed and enforced as if the illegal or invalid provision had not been included.

(d) Requirements of Law. The issuance of payments under the Plan will be subject to all applicable laws, rules, and regulations, and to any approvals required by any governmental agencies or national securities exchanges.

(e) Unfunded Status of the Plan. The Plan is intended to constitute an unfunded plan. With respect to any payments not yet made to a non-employee director by Fortune Brands, nothing contained herein will give any rights to a non-employee director that are greater than those of a general creditor of Fortune Brands.

Governing Law. The Plan will be construed in accordance with and governed by the laws of the State of Delaware, determined without regard to its conflict of law rules.

11. Effective Date

The Plan shall be subject to and effective upon its approval by the stockholders of Fortune Brands.

Annex A

FORTUNE BRANDS, INC.

2005 NON-EMPLOYEE DIRECTOR STOCK PLAN

PAYMENT ELECTION FORM

As of ________________ , 20_, the individual whose name appears below, who is a non-employee director of Fortune Brands, Inc. (Fortune Brands), executes this election (the Payment Election Form) with respect to fees payable to him or her described in section 5(a) of the Fortune Brands, Inc. 2005 Non-Employee Director Stock Plan (the Plan). Any term capitalized herein but not defined will have the meaning set forth in the Plan.

In accordance with the terms of the Plan and to the extent permitted by the Plan, the non-employee director hereby elects to receive all fees described in section 5(a) of the Plan payable to him or her, in their entirety, in the following form:

____ Common Stock

OR

____ Cash

This election will become effective three months after the date this Payment Election Form is filed with Fortune Brands. This Payment Election Form will, upon becoming effective, supersede any prior Payment Election Form filed by the non-employee director. If no Payment Election Form is filed by the non-employee director, or if a Payment Election Form is internally inconsistent or conflicts with a concurrent Payment Election Form, payment under the Plan will be made to the non-employee director in cash, except as otherwise specified in the Plan.

IN WITNESS WHEREOF, the non-employee director has duly executed this Payment Election Form as of the date first written above.

____
Non-Employee Director s Signature

____
Non-Employee Director s Name (please print)

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C/O BANK OF NEW YORK
CHURCH STREET STATION
P.O. BOX 11002
NEW YORK, NY 10286-1002

VOTE BY INTERNET - www.proxyvote.com

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

VOTE BY PHONE - 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the meeting date. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign, and date your proxy card and return it in the postage-paid envelope we have provided or return it to Fortune Brands, Inc., c/o ADP, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS: FTNBR1

KEEP THIS PORTION FOR YOUR RECORDS

DETACH AND RETURN THIS PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

FORTUNE BRANDS, INC.

THE BOARD OF DIRECTORS RECOMMENDS VOTES <u>FOR</u> ITEMS 1, 2 AND 3:

Vote on Directors

		For All	Withhold All	For All Except	
1. Election of Directors. Nominees:	01) Thomas C. Hays 02) Pierre E. Leroy 03) Gordon R. Lohman 04) J. Christopher Reyes	¡	¡	¡	To withhold authority to vote for any individual nominee, mark For All Except and write the nominee s name on the line below. ______

Vote on Proposals	**For**	**Against**	**Abstain**
2. Ratify the appointment of PricewaterhouseCoopers LLP as independent registered public accounting firm for 2005.	¡	¡	¡
3. Approve the 2005 Non-Employee Director Stock Plan.	¡	¡	¡

Please Sign, Date and Return the Proxy Promptly Using the Enclosed Envelope.

Note: Please sign as your name appears. If shares are held by joint tenants, both should sign. When signing as attorney, executor, administrator, trustee or guardian, please give your full title as such. If a corporation, please sign in full corporate name by authorized officer. If a partnership, please sign in full partnership name by authorized person.

For address changes and/or comments, please check this box and write them on the back where indicated. ¡

Please indicate if you plan to attend this meeting ¡ ¡

Yes No

Signature [PLEASE SIGN WITHIN BOX] Date Signature (Joint Owners) Date

Website available 24 hours a day, 7 days a week

ELECTRONIC DELIVERY

Reduce paper mailed to your home and help lower Fortune Brands printing and postage costs!

Fortune Brands is pleased to offer the convenience of viewing Proxy Statements, Annual Reports to Stockholders and related materials on-line. With your consent, we can stop sending paper copies of these documents beginning next year and until you notify us otherwise.

To participate, follow the easy directions on the right. You will receive notification when the materials are available for review.

ACT NOW...IT S FAST & EASY
Just follow these 4 easy steps:

Log onto the Internet at www.icsdelivery.com/fo

Enter your Social Security or Tax I.D. Number (as printed on your check or statement)

Enter your e-mail address

Enter a PIN number of your choice which will be used for electronic voting

Reminder: Electronic Voting is also available.

You may vote by telephone or over the Internet.
Voting electronically is quick, easy, and also saves the company money.

Just follow the instructions on your Proxy Card.

FORTUNE BRANDS, INC.

PROXY SOLICITED BY THE BOARD OF DIRECTORS

The undersigned stockholder appoints N.H. WESLEY, C.P. OMTVEDT, and M.A. ROCHE (and any other person chosen by Messrs. Wesley, Omtvedt or Roche) proxies, to vote at the Annual Meeting (including adjournments) of stockholders of Fortune Brands, Inc. to be held April 26, 2005 at the Hilton Northbrook, 2855 North Milwaukee Avenue, Northbrook, IL at 1:30 P.M., for the election of nominees, Thomas C. Hays, Pierre E. Leroy, Gordon R.

Lohman and J. Christopher Reyes, as Class I directors (item 1), on items 2 and 3 referred to on the reverse side and described in the Proxy Statement, and on any other business which shall properly come before the meeting, with all powers the stockholder would possess if personally present. A majority of the proxies (or, if only one, then that one) or their substitutes acting at the meeting may exercise all powers hereby conferred.

This proxy when properly executed will be voted in the manner directed by the stockholder. Unless the stockholder indicates otherwise, the proxies will vote FOR the election of the nominees to the Board of Directors (item 1) and FOR items 2 and 3.

If you participate in the Fortune Brands Stock Fund under a retirement savings trust, your signature on the reverse side will be a direction to the trustee to vote as instructed.

FORTUNE BRANDS, INC.
P.O. BOX 11010
NEW YORK, N.Y. 10203-0010

Address Changes/Comments:

(If you noted any Comments above, please mark corresponding box on other side.)

(Continued And To Be Signed On Other Side.)

PLEASE EXECUTE AND RETURN YOUR PROXY PROMPTLY

ILY: Times New Roman">

(i) Recognize non-refundable maintenance reserves as liabilities for deposits against future maintenance reimbursements of maintenance reserves received in the normal course of ongoing leases;
(ii) Recognize reimbursements from such collected reserves as disbursements against the liability when claims are submitted for payment against previously collected maintenance reserves;
(iii) Reflect as liabilities non-refundable reserves received by the prior lessor upon acquisition of an aircraft, which are claimable by the lessee when maintenance is performed;
(iv) Recognize as income non-refundable reserves not refunded to lessees upon termination of the lease and return of the aircraft to the Company in accordance with all lease return requirements; and
(v) Record lessor maintenance obligations as liabilities upon acquisition of an aircraft subject to a lease under which the Company assumes the prior lessor's obligation to pay a portion of a first-time maintenance event.

In management's judgment, the change to this accounting method is preferable in that it will provide the user of the Company's financial statements a better understanding of the underlying business terms of the Company's leasing transactions and provide additional clarity with respect to the Company's sources of income, its non-refundable reserve obligations, and its lessor maintenance obligations. The Company has applied the change in method of accounting for maintenance reserves and lessor maintenance obligations to all prior periods presented within the financial statements in accordance with accounting principles relating to accounting changes. The change in accounting principle resulted in a cumulative net decrease of $8,088,200 in stockholders' equity as of January 1, 2013.

AeroCentury Corp.
Notes to Financial Statements
December 31, 2014

2.Change in Accounting Principle (continued)

The effects on the Company's balance sheet at December 31, 2013 as a result of the retroactive application of the change in accounting principle in accordance with ASC 250 were as follows:

	December 31, 2013		
	As reported previously	As adjusted	Effect of change
Cash and cash equivalents	$2,112,700	$2,112,700	$-
Accounts receivable, net	3,313,700	3,303,800	(9,900)
Finance leases receivable	1,895,200	1,895,200	-
Aircraft and aircraft engines held for lease, net	152,375,200	152,954,600	579,400
Assets held for sale	735,000	735,000	-
Prepaid expenses and other	3,633,000	3,633,000	-
Total assets	$164,064,800	$164,634,300	$569,500
Accounts payable and accrued expenses	$1,175,300	$1,202,700	$27,400
Notes payable and accrued interest	77,527,300	77,527,300	-
Maintenance reserves and accrued maintenance costs	13,254,100	18,283,900	5,029,800
Security deposits	6,265,000	6,265,000	-
Unearned revenues	646,700	646,700	-
Deferred income taxes	16,099,700	14,573,800	(1,525,900)
Total liabilities	114,968,100	118,499,400	3,531,300
Preferred stock	-	-	-
Common stock	1,600	1,600	-
Paid-in capital	14,780,100	14,780,100	-
Retained earnings	34,819,100	31,857,300	(2,961,800)
Treasury stock	(504,100)	(504,100)	-
Total stockholders' equity	49,096,700	46,134,900	(2,961,800)
Total liabilities and stockholders' equity	$164,064,800	$164,634,300	$569,500

AeroCentury Corp.
Notes to Financial Statements
December 31, 2014

2.Change in Accounting Principle (continued)

The effects on the Company's statement of operations for the year ended December 31, 2013 as a result of the retroactive application of the change in accounting principle in accordance with ASC 250 were as follows:

	For the Year Ended December 31, 2013		
	As reported previously	As adjusted	Effect of change
Operating lease revenue, net	$18,794,200	$18,794,200	$-
Maintenance reserves income, net	8,878,300	14,910,400	6,032,100
Gain on disposal of assets and other income	4,527,000	4,527,000	-
	32,199,500	38,231,600	6,032,100
Maintenance	8,765,000	6,962,400	(1,802,600)
Depreciation	7,312,500	7,363,100	50,600
Management fees	4,352,400	4,369,300	16,900
Interest	4,075,000	4,075,000	-
Professional fees, general and administrative and other	1,532,100	1,532,100	-
Insurance	1,166,400	1,166,400	-
Other taxes	90,200	90,200	-
	27,293,600	25,558,500	(1,735,100)
Income before taxes	4,905,900	12,673,100	7,767,200
Tax provision	1,688,400	4,329,200	2,640,800
Net income	$3,217,500	$8,343,900	$5,126,400
Earnings per share:			
Basic	$2.08	$5.41	$3.33
Diluted	$2.03	$5.26	$3.23

AeroCentury Corp.
Notes to Financial Statements
December 31, 2014

2.Change in Accounting Principle (continued)

The effects on the Company's statement of cash flows for the year ended December 31, 2013 as a result of the retroactive application of the change in accounting principle in accordance with ASC 250 were as follows:

	For the Year Ended December 31, 2013		
	As reported previously	As adjusted	Effect of change
Operating activities:			
Net income	$ 3,217,500	$ 8,343,900	$ 5,126,400
Adjustments to reconcile net income to net cash provided by operating activities:			
Net gain on disposal of assets	(3,808,200)	(3,808,200)	-
Depreciation	7,312,500	7,363,100	50,600
Non-cash interest	1,113,600	1,113,600	-
Deferred income taxes	1,680,500	4,321,300	2,640,800
Changes in operating assets and liabilities:			
Accounts receivable	(106,000)	(96,100)	9,900
Finance lease receivable	246,000	246,000	-
Income taxes receivable	2,000	2,000	-
Prepaid expenses and other	(772,400)	(772,400)	-
Accounts payable and accrued expenses	(40,300)	(23,400)	16,900
Accrued interest on notes payable	(38,400)	(38,400)	-
Maintenance reserves and accrued costs	(1,284,200)	(9,128,800)	(7,844,600)
Security deposits	(525,200)	(525,200)	-
Unearned revenue	(105,700)	(105,700)	-
Income taxes payable	(19,100)	(19,100)	-
Net cash provided by operating activities	6,872,600	6,872,600	-
Investing activities:			
Proceeds from sale of aircraft and aircraft engines held for lease, net of re-sale fees	10,018,700	10,018,700	-
Proceeds from sale of assets held for sale, net of re-sale fees	945,100	945,100	-
Purchases of aircraft and aircraft engines	(24,965,500)	(24,965,500)	-
Net cash used in investing activities	(14,001,700)	(14,001,700)	-
Financing activities:			
Borrowings under Credit Facility	19,000,000	19,000,000	-
Repayments of Credit Facility	(9,300,000)	(9,300,000)	-
Debt issuance costs	(2,055,000)	(2,055,000)	-
Net cash provided by financing activities	7,645,000	7,645,000	-
Net increase in cash and cash equivalents	515,900	515,900	-
Cash and cash equivalents, beginning of year	1,596,800	1,596,800	-
Cash and cash equivalents, end of year	$ 2,112,700	$ 2,112,700	$ -

AeroCentury Corp.
Notes to Financial Statements
December 31, 2014

3.Aircraft and Aircraft Engines Held for Lease or Sale

(a)Assets Held for Lease

At December 31, 2014 and December 31, 2013, the Company's aircraft and aircraft engines, which were on lease or held for lease, consisted of the following:

	December 31, 2014			December 31, 2013		
	Number	% of net		Number	% of net	
Model	owned	book value		owned	book value	
Bombardier Dash-8-300	8	17	%	9	23	%
Bombardier CRJ-700	3	16	%	-	-	
Bombardier CRJ-900	2	16	%	-	-	
Bombardier Dash-8-Q400	3	13	%	3	17	%
ATR 42-600	1	9	%	-	-	
Bombardier CRJ-705	1	9	%	1	12	%
Saab 340B Plus	6	7	%	6	8	%
Fokker 50	6	5	%	10	10	%
General Electric CF34-8E5 engine	2	4	%	3	6	%
Fokker 100	2	3	%	7	19	%
Saab 340B	1	1	%	4	4	%
Tay 650-15 engine	1	-		1	1	%
General Electric CT7-9B engine	2	-		2	-	
Saab 340A	-	-		1	-	

Assets subject to finance leases are not included in the net book value of assets held for lease. Therefore, the Company's single Saab 340A aircraft and two General Electric CT7-9B engines, which were subject to finance leases in 2013, are not included in the net book value calculation as of December 31, 2013.

During 2014, based on appraised values, the Company recorded impairment charges on assets held for lease totaling $2,906,400 and $217,800 on two Fokker 100 and two Fokker 50 aircraft, respectively.

During 2014 and 2013, the Company used cash of $74,529,000 and $24,965,500, respectively, for the purchase and capital improvement of aircraft and engines.

During 2014, the Company recorded net gains totaling $3,147,200 from the sale of three Fokker 50 aircraft, five Saab 340B aircraft, one Bombardier Dash-8-300 aircraft and one General Electric CF34-8E5 engine. During 2013, the Company recorded net gains totaling $4,504,200 from the sale of three Fokker 50 aircraft, a deHavilland DHC-8-100 aircraft, a deHavilland DHC-6 aircraft and a General Electric CT7-9B engine. The Company also leased an engine pursuant to a finance lease in 2013 and recorded a gain of $73,300. In addition, the Company recorded a loss of $769,300 in 2013 on the disposal of a Tay 650-15 engine, which was replaced by one of the Company's spare engines.

During 2014, the Company extended the leases for nine of its assets and leased two assets that had been off lease at December 31, 2013.

In May 2014, six Saab 340B Plus aircraft and two General Electric CT7-9B engines were returned by a customer when it ceased operations. Two of the aircraft have been re-leased.

AeroCentury Corp.
Notes to Financial Statements
December 31, 2014

3.Aircraft and Aircraft Engines Held for Lease or Sale (continued)

(a)Assets Held for Lease (continued)

Ten of the Company's assets that are held for lease were off lease at December 31, 2014, representing 10% of the net book value of the Company's aircraft and engines held for lease. Such assets were comprised of four Saab 340B Plus aircraft, one Saab 340B aircraft, and five engines.

(b)Assets Held for Sale

Assets held for sale include two Saab 340B airframes, which are being sold in parts, as well as five Fokker 100 aircraft and a Fokker 50 aircraft.

During 2014 and 2013, the Company received $312,100 and $945,100, respectively, from the sale of parts belonging to the two airframes, which proceeds reduced their carrying value.

During 2014, the Company recorded impairment charges totaling $15,278,900 and $333,400 related to five Fokker 100 aircraft and one Fokker 50 aircraft, respectively. At December 31, 2014, five of the Fokker 100 aircraft and one of the Fokker 50 aircraft were classified as held for sale on the Company's balance sheet. As discussed in Note 13, the Company sold the Fokker 50 aircraft in March 2015.

4.Maintenance Reserves and Accrued Maintenance Costs

Maintenance costs under the Company's triple net leases are generally the responsibility of the lessees. Most of the Company's leases require payment of maintenance reserves, which are based upon lessee-reported usage and billed monthly, and are intended to accumulate and be applied by the Company toward reimbursement of most or all of the cost of the lessees' performance of certain maintenance obligations under the leases. Maintenance reserves are characterized as either refundable or non-refundable depending on their disposition at lease-end. The Company retains non-refundable maintenance reserves at lease-end, even if the lessee has met all of its obligations under the lease, including any return conditions applicable to the leased asset, while refundable reserves are returned to the lessee under such circumstances.

The liabilities for maintenance reserves in the accompanying balance sheets include both refundable and non-refundable maintenance reserves payments billed to and received from lessees. These amounts are paid out as related maintenance is performed and, in the case of refundable reserves, at the end of the lease. Such payments reduce the associated maintenance reserve liability. Any reserves retained by the Company at lease end are recorded as revenue at that time.

Accrued maintenance costs include (i) maintenance for work performed for off-lease aircraft, which is not related to the release of reserves received from lessees and (ii) lessor maintenance obligations assumed upon acquisition of aircraft subject to a lease with such provisions. Maintenance costs are expensed as incurred.

AeroCentury Corp.
Notes to Financial Statements
December 31, 2014

5.Operating Segments

The Company operates in one business segment, the leasing of regional aircraft to foreign and domestic regional airlines, and therefore does not present separate segment information for lines of business.

Approximately 18% and 0% of the Company's operating lease revenue was derived from lessees domiciled in the United States during 2014 and 2013, respectively. All revenues relating to aircraft leased and operated internationally are denominated and payable in U.S. dollars.

The tables below set forth geographic information about the Company's operating lease revenue for leased aircraft and aircraft equipment, grouped by domicile of the lessee:

	For the Years Ended December 31,	
Operating Lease Revenue	2014	2013
North America	$6,423,700	$1,542,000
Africa	5,183,600	5,454,700
Central and South America	3,533,300	4,233,000
Asia	3,460,400	4,149,000
Europe and United Kingdom	2,952,300	3,415,500
Australia	360,000	-
	$21,913,300	$18,794,200

	December 31,	
Net Book Value of Aircraft and Aircraft Engines Held for Lease	2014	2013
North America	$65,423,400	$17,779,000
Europe and United Kingdom	43,468,700	20,384,700
Africa	28,858,200	29,951,800
Off lease	17,106,000	34,446,300
Asia	16,588,900	31,068,800
Central and South America	10,146,100	19,324,000
Australia	5,171,300	-
	$186,762,600	$152,954,600

6.Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash deposits and receivables. The Company places its deposits with financial institutions and other creditworthy issuers and limits the amount of credit exposure to any one party.

For the year ended December 31, 2014 the Company had four significant customers, which accounted for 20%, 18%, 14% and 11%, respectively, of lease revenue. For the year ended December 31, 2013 the Company had four significant customers, which accounted for 23%, 19%, 11% and 10%, respectively, of lease revenue.

At December 31, 2014, the Company had receivables from two customers totaling $1,130,000, representing 56% of the Company's total receivables. The two customers paid the amounts owed in full in early 2015.

AeroCentury Corp.
Notes to Financial Statements
December 31, 2013

6.Concentration of Credit Risk (continued)

At December 31, 2013, the Company had receivables from two customers totaling $1,231,500, representing 40% of the Company's total receivables, all of which was paid in 2014.

As of December 31, 2014, minimum future lease revenue payments receivable under noncancelable leases were as follows:

Years ending	
2015	$ 22,938,700
2016	21,300,400
2017	17,937,600
2018	13,719,200
2019	12,860,000
Thereafter	37,596,300
	$ 126,352,200

7.Notes Payable and Accrued Interest

At December 31, 2014 and December 31, 2013, the Company's notes payable and accrued interest consisted of the following:

	December 31, 2014	December 31, 2013
Credit Facility principal	$ 133,400,000	$ 77,500,000
Credit Facility accrued interest	190,600	27,300
	$ 133,590,600	$ 77,527,300

The Company's Credit Facility is provided by a syndicate of banks and is secured by all of the assets of the Company, including its aircraft and engine portfolio.

In November 2013, the Company obtained a waiver of compliance with a customer concentration covenant under its Credit Facility at the September 30, 2013 and December 31, 2013 calculation dates. The Company was in compliance with all covenants other than the waived covenant under the Credit Facility agreement at December 31, 2013.

During May 2014, the Company's Credit Facility was increased from $130 million to $180 million and extended through May 31, 2019.

The Company was out of compliance with a profitability covenant at June 30, 2014, primarily as a result of the Company recording aircraft impairment charges on aircraft totaling $6,800,000 during the quarter then ended. In August 2014, the Company and the Credit Facility banks agreed to an amendment to the profitability covenant, which cured the June 30, 2014 non-compliance.

AeroCentury Corp.
Notes to Financial Statements
December 31, 2014

7.Notes Payable and Accrued Interest (continued)

The Company was out of compliance with the profitability, interest coverage and debt service coverage covenants at September 30, 2014, resulting primarily from the Company recording additional aircraft impairment charges on aircraft totaling $11,718,700 during the third quarter of 2014. In November 2014, the Company and the Credit Facility banks agreed to an amendment to the Credit Facility, which cured the September 30, 2014 non-compliance, revised the compliance requirements through September 30, 2015, decreased the amount of the Credit Facility to $150 million due to the departure of two participant lenders, and decreased the maximum amount to which the Credit Facility can be expanded from $200 million to $180 million.

The unused amount of the Credit Facility was $16,600,000 and $52,500,000 as of December 31, 2014 and December 31, 2013, respectively.

The weighted average interest rate on the Credit Facility was 3.58% and 3.94% at December 31, 2014 and December 31, 2013, respectively.

8.Stockholder Rights Plan

In December 2009, 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 December 18, 2009 and the Company entered into a rights agreement dated December 1, 2009 in connection therewith. The rights become exercisable only upon the occurrence of certain events specified in the rights agreement, including the acquisition of 15% of the Company's outstanding common stock by a person or group in certain circumstances. Each right allows the holder, other than an "acquiring person," to purchase one one-hundredth of a share (a unit) of Series A Preferred Stock at an initial purchase price of $97.00 under circumstances described in the rights agreement. The purchase price, the number of units of preferred stock and the type of securities issuable upon exercise of the rights are subject to adjustment. The rights expire at the close of business December 1, 2019 unless earlier redeemed or exchanged. Until a right is exercised, the holder thereof, as such, has no rights as a stockholder of the Company, including the right to vote or to receive dividends.

9. Income Taxes

The items comprising the income tax provision are as follows:

	For the Years Ended December 31, 2014	2013 (As adjusted)
Current tax provision:		
Federal	$ -	$ -
State	800	800
Foreign	-	7,100
Current tax provision	800	7,900

Deferred tax (benefit)/provision:				
Federal		(5,854,400)		4,478,800
State		(98,200)		1,100
Decrease in valuation allowance		-		(158,600)
Deferred tax (benefit)/provision		(5,952,600)		4,321,300
Total income tax (benefit)/provision	$	(5,951,800)	$	4,329,200

AeroCentury Corp.
Notes to Financial Statements
December 31, 2014

9. Income Taxes (continued)

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

	For the Years Ended December 31,	
	2014	2013 (As adjusted)
Income tax (benefit)/provision at statutory federal income tax rate	$(5,863,600)	$4,308,900
State tax (benefit)/provision, net of federal benefit	(97,500)	19,400
Prior year withholding tax adjustment	-	174,600
Decrease in valuation allowance	-	(158,600)
Other	9,300	(15,100)
Total income tax (benefit)/provision	$(5,951,800)	$4,329,200

Temporary differences and carry-forwards that give rise to a significant portion of deferred tax assets and liabilities as of December 31, 2014 and 2013 were as follows:

	December 31,	
	2014	2013 (As adjusted)
Deferred tax assets:		
Maintenance reserves	$2,138,900	$1,813,900
Foreign tax credit carryover	-	1,210,900
Alternative minimum tax credit	10,800	100,800
Bad debt allowance and other	961,100	490,100
Deferred tax assets	3,110,800	3,615,700
Deferred tax liabilities:		
Accumulated depreciation on aircraft and aircraft engines	(10,450,000)	(17,540,000)
Minimum lease payments receivable	-	(649,500)
Deferred income	(1,282,100)	-
Net deferred tax liabilities	$(8,621,300)	$(14,573,800)

All foreign tax credit carryovers were used to offset federal tax expense in 2014. The foreign tax credit carryovers are expected to expire between 2016 and 2022. A significant portion of the alternative minimum tax credit was used to offset federal tax expense in the current year. The remaining alternative minimum tax credit will be available to offset federal tax expense in excess of the alternative minimum tax in future years and does not expire.

At December 31, 2014 and December 31, 2013, the Company had no material uncertain tax positions.

The Company accounts for interest related to uncertain tax positions as interest expense, and for income tax penalties as tax expense.

All of the Company's tax years remain open to examination other than as barred in the various jurisdictions by statutes of limitation.

AeroCentury Corp.
Notes to Financial Statements
December 31, 2014

10.Computation of Earnings Per Share

Basic and diluted earnings per share are calculated as follows:

	For the Years Ended December 31, 2014	2013 (As adjusted)
Net (loss)/income	$(11,294,000)	$8,343,900
Weighted average shares outstanding for the period	1,543,257	1,543,257
Dilutive effect of warrants	-	43,779
Weighted average diluted shares used in calculation of diluted (loss)/earnings per share	1,543,257	1,587,036
Basic (loss)/earnings per share	$(7.32)	$5.41
Diluted (loss)/earnings per share	$(7.32)	$5.26

Basic earnings per common share is computed using net income and the weighted average number of common shares outstanding during the period. Diluted earnings per common share are computed using net income and the weighted average number of common shares outstanding, assuming dilution. Weighted average common shares outstanding, assuming dilution, include potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include the assumed exercise of warrants using the treasury stock method. For the year ended December 31, 2014, warrants for 81,224 shares were not included in the calculation of diluted loss per share because the effect would have been anti-dilutive.

11. Related Party Transactions

The Company's portfolio of leased aircraft assets is managed and administered under the terms of a management agreement with JetFleet Management Corp. ("JMC"), which is an integrated aircraft management, marketing and financing business and a subsidiary of JetFleet Holding Corp. ("JHC"). Certain officers of the Company are also officers of JHC and JMC and hold significant ownership positions in both JHC and the Company.

Under the management agreement, JMC receives a monthly management fee based on the net asset value of the assets under management. Such fee, totaling approximately $1,200,000, was waived by JMC for the fourth quarter of 2014. JMC also receives an acquisition fee for locating assets for the Company. Acquisition fees are included in the cost basis of the asset purchased. JMC may receive a remarketing fee in connection with the re-lease or sale of the Company's assets. Remarketing fees are amortized over the applicable lease term or included in the gain or loss on sale.

Fees incurred during 2014 and 2013 were as follows:

	For the Years Ended December 31, 2014	2013

Management fees, net of approximately $1,200,000 of fees waived by JMC in 2014	$3,864,900	$4,369,300
Acquisition fees	2,100,000	799,000
Remarketing fees	64,000	589,300

12. Warrants

As part of a previous subordinated debt financing, which was fully repaid in December 2011, the Company issued warrants to purchase up to 81,224 shares of the Company's common stock that are currently exercisable (and expire on December 31, 2015) and represent approximately 5% of the post-exercise fully diluted capitalization of the Company. The exercise price of the warrants is $8.75 per share.

13.Subsequent Events

In March 2015, the Company sold a Fokker 50 aircraft that had been classified as held for sale at December 31, 2014 and recorded a gain of approximately $475,000.

Item 9.Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

None.

Item 9A.Controls and Procedures.

CEO and CFO Certifications. Attached as exhibits to this Annual Report on Form 10-K (the “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 section of the Report includes information concerning the evaluation of disclosure controls and procedures referred to in the Section 302 Certifications and this 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 under the Securities Exchange Act of 1934 (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 Securities and Exchange Commission (“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 design and operation of the Company’s Disclosure Controls and concluded that the Company’s Disclosure Controls were effective as of December 31, 2014.

Management’s Annual Report on the Company’s Internal Control Over Financial Reporting. Internal control over financial reporting (“Internal Control”) is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes policies and procedures that (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on the financial statements. The Company’s management is responsible for establishing and maintaining adequate Internal Control. Management evaluated the Company’s Internal Control based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework (1992) and concluded that the Company’s Internal Control was effective as of December 31, 2014. This report does not include an attestation report on Internal Control by the Company’s independent registered public accounting firm since the Company is a smaller reporting company under the rules of the SEC.

Changes in Internal Control Over Financial Reporting. No change in Internal Control occurred during the fiscal quarter ended December 31, 2014 that has materially affected, or is reasonably likely to materially affect, the Company’s Internal Control.

Item 9B.Other Information.

None.

PART III

Item 10.Directors, Executive Officers and Corporate Governance.

The information required by this item is included under (i) "Proposal 1: Election of Directors" as it relates to members of the Company's Board of Directors, including the Company's Audit Committee and the Company's Audit Committee financial experts, any changes to procedures by which security holders may recommend nominees to the Company's Board of Directors, (ii) "Information Regarding the Company's Directors and Officers" as it relates to the Company's executive officers, and (iii) "Section 16(a) Beneficial Ownership Reporting Compliance" as it relates to information concerning Section 16(a) beneficial ownership reporting compliance, in the Company's definitive proxy statement ("Proxy Statement"), to be filed in connection with the Company's 2015 Annual Meeting of Stockholders, and is incorporated herein by reference.

The Company has adopted a code of business conduct and ethics, or code of conduct. The code of conduct qualifies as a "code of ethics" within the meaning of Section 406 of the Sarbanes-Oxley Act of 2002 and the rules promulgated thereunder. A copy of the code of conduct is available on the Company's website at http://www.aerocentury.com or upon written request to the Investor Relations Department, 1440 Chapin Avenue, Suite 310, Burlingame, California 94010. To the extent required by law, any amendments to, or waivers from, any provision of the code will be promptly disclosed publicly. To the extent permitted by such requirements, the Company intends to make such public disclosure on its website in accordance with SEC rules.

Item 11. Executive Compensation.

Incorporated by reference to the section of the Proxy Statement entitled "Information Regarding the Company's Directors and Officers — Employee Compensation."

Item 12.Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Incorporated by reference to the section of the Proxy Statement entitled "Security Ownership of Certain Beneficial Owners and Management."

Item 13.Certain Relationships and Related Transactions, and Director Independence.

Incorporated by reference to the section of the Proxy Statement entitled "Related Party Transactions."

Item 14.Principal Accountant Fees and Services.

Incorporated by reference to the section of the Proxy Statement entitled "Information Regarding Auditors – Audit Fees."

PART IV

Item 15.Exhibits.

(b)Exhibits

Exhibit Number	Description
10.19	Second Amended and Restated Loan and Security Agreement, between the Company and MUFG Union Bank, N.A., as agent and lender ("Union"), and the other lenders under its credit facility, California Bank and Trust, First Bank, Umpqua Bank, U.S. Bank National Association, and Cathay Bank (collectively, the "Participants"), incorporated by reference to Exhibit 10.19 to the Quarterly Report on Form 10-Q of the Company, filed with the Securities and Exchange Commission ("SEC") on August 13, 2014
10.20	Modification and Limited Waiver to Second Amended and Restated Loan and Security Agreement between Union, the Participants and the Company, dated as of August 26, 2014, incorporated by reference to Exhibit 10.1 to the Report on Form 8-K of the Company, filed with the SEC on September 2, 2014
10.21	Second Modification Agreement between Union, Participants and the Company, dated as of November 13, 2014, incorporated by reference to Exhibit 10.21 to the Report on Form 10-Q of the Company, filed with the SEC on November 14, 2014
10.22	Form of Aircraft Sale Agreement (SN 15128) between the Company and Adria Airways d.d., dated December 5, 2014
10.23	Form of Aircraft Sale Agreement (SN15129) between the Company and Adria Airways d.d., dated December 5, 2014
31.1	Certification of Neal D. Crispin, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Toni M. Perazzo, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Neal D. Crispin, Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Toni M. Perazzo, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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 Securities and Exchange Commission.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AEROCENTURY CORP.

By

Toni M. Perazzo
Senior Vice President-Finance and
Chief Financial Officer

DateMarch 12, 2015

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Neal D. Crispin and Toni M. Perazzo, and each of them, his or her attorneys-in-fact, each with the power of substitution, for him or her in any and all capacities, to sign any amendments to this Report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his or her substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated.

Signature	Title	Dated
---------------------- Neal D. Crispin	Director, President and Chairman of the Board of Directors of the Registrant (Principal Executive Officer)	March 12, 2015
---------------------- Toni M. Perazzo	Director, Senior Vice President-Finance and Secretary of the Registrant (Principal Financial and Accounting Officer)	March 12, 2015
---------------------- Roy E. Hahn	Director	March 12, 2015
---------------------- Thomas W. Orr	Director	March 12, 2015
---------------------- Evan M. Wallach	Director	March 12, 2015
----------------------	Director	March 12, 2015

David P. Wilson