

Air Transport Services Group, Inc.

Form 10-Q

August 10, 2009

[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For Quarterly Period Ended June 30, 2009

Commission File Number 000-50368

(Exact name of registrant as specified in its charter)

Delaware
(State of incorporation

or organization)

145 Hunter Drive

26-1631624
(IRS Employer

Identification No.)

Edgar Filing: Air Transport Services Group, Inc. - Form 10-Q

Wilmington, Ohio 45177

(Address of Principal Executive Office)

(937) 382-5591

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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 definitions of large accelerated filer, large accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer (do not check if a smaller reporting company) Smaller reporting company

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

As of August 10, 2009, Air Transport Services Group, Inc. had outstanding 63,493,234 shares of common stock, par value \$.01.

Table of Contents

AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES

Form 10-Q

Table of Contents

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	
<u>Condensed Consolidated Statements of Earnings</u>	4
<u>Condensed Consolidated Balance Sheets</u>	5
<u>Condensed Consolidated Statements of Cash Flows</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	34
Item 4. <u>Controls and Procedures</u>	34
<u>PART II. OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	35
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	36
Item 5. <u>Other Information</u>	37
Item 6. <u>Exhibits</u>	38
<u>SIGNATURES</u>	39

Table of Contents

FORWARD LOOKING STATEMENTS

Statements contained in this quarterly report on Form 10-Q that are not historical facts are considered forward-looking statements (as that term is defined in the Private Securities Litigation Reform Act of 1995). Words such as projects, believes, anticipates, will, estimates, plans, expects, intends and similar words and expressions are intended to identify forward-looking statements. These forward-looking statements are based on expectations, estimates and projections as of the date of this filing, and involve risks and uncertainties that are inherently difficult to predict. Actual results may differ materially from those expressed in the forward-looking statements for any number of reasons, including those described in this report and in our 2008 Annual Report filed on Form 10-K with the Securities and Exchange Commission.

Filings with the Securities and Exchange Commission

The Securities and Exchange Commission maintains an Internet site that contains reports, proxy and information statements and other information regarding Air Transport Services Group, Inc. at www.sec.gov. Additionally, our filings with the Securities and Exchange Commission, including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports, are available free of charge from our website at www.atsginc.com as soon as reasonably practicable after filing with the SEC.

Table of Contents**PART 1. FINANCIAL INFORMATION****Item 1. Financial Statements****AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS**

(In thousands, except per share data)

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
REVENUES	\$ 235,107	\$ 394,860	\$ 515,659	\$ 776,916
OPERATING EXPENSES				
Salaries, wages and benefits	119,592	149,011	257,048	307,768
Fuel	35,615	151,280	75,264	271,172
Depreciation and amortization	21,153	22,928	42,876	44,170
Maintenance, materials and repairs	15,487	27,964	35,697	54,108
Landing and ramp	5,558	7,534	17,407	21,571
Travel	4,649	8,111	10,519	16,064
Rent	2,625	3,430	6,211	6,876
Insurance	3,011	2,748	6,050	5,524
Other operating expenses	8,507	13,803	20,443	26,032
	216,197	386,809	471,515	753,285
INTEREST EXPENSE	(7,166)	(8,697)	(14,812)	(19,072)
INTEREST INCOME	129	517	307	1,519
INCOME (LOSS) BEFORE INCOME TAXES	11,873	(129)	29,639	6,078
INCOME TAXES	(3,766)	(397)	(10,435)	(2,817)
NET EARNINGS (LOSS)	\$ 8,107	\$ (526)	\$ 19,204	\$ 3,261
EARNINGS (LOSS) PER SHARE				
Basic	\$ 0.13	\$ (0.01)	\$ 0.31	\$ 0.05
Diluted	\$ 0.13	\$ (0.01)	\$ 0.31	\$ 0.05
WEIGHTED AVERAGE SHARES				
Basic	62,685	62,460	62,662	62,438
Diluted	63,011	62,460	62,906	62,667

See notes to condensed consolidated financial statements.

Table of Contents**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except share data)

	June 30, 2009	December 31, 2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 112,064	\$ 116,114
Marketable securities - available-for-sale		26
Accounts receivable, net of allowance of \$506 in 2009 \$469 in 2008	18,690	24,495
Due from DHL	58,639	63,362
Inventory	7,611	11,259
Prepaid supplies and other	8,122	11,151
Deferred income taxes	20,171	20,172
Aircraft and engines held for sale	32,901	2,353
TOTAL CURRENT ASSETS	258,198	248,932
Property and equipment, net	627,768	671,552
Other assets	23,265	25,281
Deferred income taxes	14,973	54,807
Intangibles	10,557	11,000
Goodwill	89,777	89,777
TOTAL ASSETS	\$ 1,024,538	\$ 1,101,349
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 30,625	\$ 36,618
Accrued salaries, wages and benefits	40,259	63,500
Accrued severance and retention	45,301	67,846
Accrued expenses	15,161	13,772
Current portion of debt obligations	62,774	61,858
Unearned revenue	9,232	14,813
TOTAL CURRENT LIABILITIES	203,352	258,407
Long-term obligations	380,225	450,628
Post-retirement liabilities	269,886	294,881
Other liabilities	17,163	17,041
Commitments and contingencies (Note H)		
STOCKHOLDERS EQUITY:		
Preferred stock, 20,000,000 shares authorized, including 75,000 Series A Junior Participating Preferred Stock		
Common stock, par value \$0.01 per share; 75,000,000 shares authorized; 63,493,234 and 63,247,312 shares issued and outstanding in 2009 and 2008, respectively	635	632
Additional paid-in capital	490,349	460,155
Accumulated deficit	(226,330)	(245,534)
Accumulated other comprehensive loss	(110,742)	(134,861)
TOTAL STOCKHOLDERS EQUITY	153,912	80,392

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 1,024,538	\$ 1,101,349
---	--------------	--------------

See notes to condensed consolidated financial statements.

Table of Contents**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

	Six Months Ended June 30	
	2009	2008
OPERATING ACTIVITIES:		
Net earnings	\$ 19,204	\$ 3,261
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	42,876	44,170
Pension and post-retirement amortization	17,035	3,491
Deferred income taxes	9,323	2,510
Amortization of stock-based compensation	710	1,202
Gains on asset disposition, net of impairments	(2,099)	(819)
Changes in assets and liabilities:		
Accounts receivable	10,528	18,011
Inventory and prepaid supplies	5,653	1,502
Accounts payable	(6,133)	(11,000)
Unearned revenue	(6,609)	8,180
Accrued expenses, salaries, wages and benefits and other liabilities	(43,812)	(9,728)
Post-retirement liabilities	(6,300)	8,517
Other	3,315	3,711
NET CASH PROVIDED BY OPERATING ACTIVITIES	43,691	73,008
INVESTING ACTIVITIES:		
Capital expenditures	(31,364)	(53,959)
Proceeds from the sale of property and equipment	6,808	6,469
Proceeds from redemptions of marketable securities	26	48,389
Long-term deposits		(9,000)
Acquisition of CHI		(3,840)
NET CASH (USED IN) INVESTING ACTIVITIES	(24,530)	(11,941)
FINANCING ACTIVITIES:		
Principal payments on borrowings	(23,211)	(57,668)
Proceeds from borrowings		20,000
NET CASH (USED IN) FINANCING ACTIVITIES	(23,211)	(37,668)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(4,050)	23,399
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	116,114	59,271
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 112,064	\$ 82,670
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid, net of amount capitalized	\$ 13,509	\$ 17,873
Income taxes paid	\$ 1,922	\$

SUPPLEMENTAL NON-CASH INFORMATION:

Accrued aircraft modification expenditures	\$ 2,204	\$ 6,166
--	----------	----------

See notes to condensed consolidated financial statements.

Table of Contents

AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2009

NOTE A SUMMARY OF FINANCIAL STATEMENT PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

The interim period consolidated financial statements of Air Transport Services Group, Inc. and its subsidiaries (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America and rules and regulations of the Securities and Exchange Commission for interim financial information. Accordingly, they do not include all of the information, footnotes and disclosures required by generally accepted accounting principles for complete financial statements and are unaudited. The results of operations and cash flows for any interim periods are not necessarily indicative of results that may be reported for the full year. The December 31, 2008 financial amounts are extracted from the annual audited financial statements.

The Company evaluated subsequent events through the date the financial statements were issued and filed with the Securities and Exchange Commission, which was August 10, 2009. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

Nature of Operations

The Company includes three independently certificated airlines through its wholly-owned subsidiaries. Its airline subsidiaries are ABX Air, Inc. (ABX), Capital Cargo International Airlines, Inc. (CCIA), and Air Transport International, LLC (ATI). The airlines primarily operate as cargo airlines within the U.S. The Company's operations include a wholly-owned aircraft leasing business, Cargo Aircraft Management, Inc. (CAM). CAM leases aircraft to each of the Company's airlines as well as to non-affiliated airlines.

DHL, an international, integrated delivery company, is the Company's largest customer, accounting for 63% of the Company's revenues in the second quarter of 2009. Under an aircraft, crew, maintenance and insurance agreement (ACMI agreement) and a Hub Services agreement, ABX provides airlift, package handling, and other cargo-related services to DHL Express (USA), Inc. and DHL Network Operations (USA), Inc. (collectively, DHL). Through its airline subsidiaries, the Company provides airlift to other customers typically through ACMI agreements. At June 30, 2009, ABX had 12 Boeing 767-200 freighter aircraft in service that were not under the DHL ACMI agreement, while CCIA and ATI had 16 aircraft and 18 aircraft in revenue service, respectively. CCIA and ATI each have contracts to provide airlift to BAX Global, Inc. (BAX) under ACMI agreements. BAX provides freight transportation and supply chain management services, specializing in the heavy freight market for business-to-business shipping. ATI also provides passenger transportation, primarily to the U.S. military, using its McDonnell Douglas DC-8 combi aircraft, which are certified to carry passengers as well as cargo on the main deck.

In addition to its airline operations and aircraft leasing services, the Company (i) sells aircraft parts and provides aircraft and equipment maintenance services; (ii) operates three sorting facilities for the U.S. Postal Service (USPS); and (iii) and provides specialized services for aircraft fuel management and freight logistics.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Estimates and assumptions are used to record allowances for uncollectible amounts, self-insurance reserves, spare parts inventory, depreciation and impairments of property, equipment, goodwill and intangibles, labor contract settlements, post-retirement obligations, income taxes, contingencies and litigation. Changes in these estimates and assumptions may have a material impact on the consolidated financial statements.

Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions are eliminated.

Table of Contents

Cash and Cash Equivalents

The Company classifies short-term, highly liquid investments with maturities of three months or less at the time of purchase as cash and cash equivalents. These investments are recorded at cost, which approximates fair value. Substantially all deposits of the Company's cash are held in accounts that exceed federally insured limits. The Company deposits cash in common financial institutions which are financially sound.

Inventory

The Company's inventory is comprised primarily of expendable spare parts and supplies used for internal consumption. These items are generally charged to expense when issued for use. The Company values aircraft spare parts inventory at weighted-average cost and maintains a related obsolescence reserve. The Company records an obsolescence reserve on a base stock of inventory for each fleet type. Inventory amortization for the obsolescence reserve corresponds to the expected life of each fleet type. Additionally, the Company monitors the usage rates of inventory parts and segregates parts that are technologically outdated or no longer used in its fleet types. Slow moving and segregated items are actively marketed and written down to their estimated net realizable values based on market conditions.

Management analyzes the inventory reserve for reasonableness at the end of each calendar quarter. That analysis includes consideration of the expected fleet life, amounts expected to be on hand at the end of a fleet life, and recent events and conditions that may impact the usability or value of inventory. Events or conditions that may impact the expected life, usability or net realizable value of inventory include additional aircraft maintenance directives from the Federal Aviation Administration, changes in Department of Transportation regulations, new environmental laws and technological advances.

Marketable Securities

Marketable securities classified as available-for-sale are recorded at their estimated fair market values, and any unrealized gains and losses are included in accumulated other comprehensive income or loss within stockholders' equity, net of tax. Interest on marketable securities is included in interest income. Realized gains and losses of any securities sold are based on the specific identification method.

Goodwill and Intangible Assets

In accordance with Statement of Financial Accounting Standard (SFAS) No. 142, Accounting for Goodwill and Other Intangible Assets (SFAS 142), the Company assesses, during the fourth quarter of each year, whether acquired goodwill is impaired. Additional impairment assessments may be performed on an interim basis if the Company finds it necessary. Finite-lived intangible assets are amortized over their estimated useful economic lives and are periodically reviewed for impairment. Indefinite-lived intangible assets are not amortized but are assessed for impairment annually in the fourth quarter.

Property and Equipment

Property and equipment are stated at cost, net of any impairment recorded, in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144). The cost and accumulated depreciation of disposed property and equipment are removed from the accounts with any related gain or loss reflected in earnings from operations.

Depreciation of property and equipment is provided on a straight-line basis over the lesser of the asset's useful life or lease term. Depreciable lives are as follows:

Aircraft and flight equipment	5 to 20 years
Package handling and ground support equipment	5 to 10 years
Vehicles and other equipment	3 to 8 years

The Company periodically evaluates the useful lives, salvage values and fair values of property and equipment. Acceleration of depreciation expense or the recording of significant impairment losses could result from changes in the estimated useful lives of assets due to a number of reasons, such as an assessment done quarterly to determine if excess capacity exists in the air or ground networks, or changes in regulations governing the use of aircraft.

Table of Contents

Long-lived assets are reviewed for impairment when circumstances indicate the carrying value of an asset may not be recoverable. For assets that are to be held and used, impairment is recognized when the estimated undiscounted cash flows associated with the asset or group of assets is less than the carrying value. If impairment exists, an adjustment is made to write the asset down to its fair value, and a loss is recorded as the difference between the carrying value and fair value. Fair values are determined considering quoted market values, discounted cash flows or internal and external appraisals, as applicable. Assets to be disposed of are carried at the lower of carrying value or fair value less the cost to sell.

The airlines' General Electric CF6 engines that power the Boeing 767 aircraft are maintained under power by the hour agreements with engine maintenance providers. Under the power by the hour agreements, the engines are maintained by the service providers for a fixed fee per flight hour; accordingly, the cost of engine maintenance is generally expensed as flight hours occur. Maintenance for the airlines' other aircraft engines are typically contracted to service providers on a time and material basis. The Company's accounting policy for major airframe and engine maintenance varies by subsidiary. ATI, CCIA and CAM capitalize the cost of major maintenance and amortize the costs over the useful life of the overhaul. ABX expenses the cost of airframe and engine overhauls as incurred.

Capitalized Interest

Interest costs incurred while aircraft are being modified are capitalized as an additional cost of the aircraft until the date the asset is placed in service. Capitalized interest was \$0.4 million and \$0.6 million for the quarters ended June 30, 2009 and 2008, respectively and \$1.0 million and \$1.9 million for the six month period ended June 30, 2009 and 2008 respectively.

Exit Activities

The Company accounts for the costs associated with exit activities in accordance with SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. One-time, involuntary employee termination benefits are generally expensed when the Company communicates the benefit arrangement to the employee and requires no significant future services, other than a minimum retention period, for the employee to earn the termination benefits. Liabilities for contract termination costs associated with exit activities are recognized in the period incurred and measured initially at fair value. Pension obligations are accounted for in accordance with SFAS No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, in the event that a significant number of employees are terminated or a pension plan is suspended.

Income Taxes

Income taxes have been computed using the asset and liability method, under which deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. Deferred taxes are measured using provisions of currently enacted tax laws. A valuation allowance against net deferred tax assets is recorded when it is more likely than not that such assets will not be fully realized. Tax credits are accounted for as a reduction of income taxes in the year in which the credit originates.

Under FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48), the Company recognizes the impact of a tax position taken on a tax return, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. An uncertain income tax provision is not recognized if it has a less than a 50% likelihood of being sustained. The Company recognizes interest and penalties accrued related to uncertain tax positions in operating expense.

Comprehensive Income

Comprehensive income (loss) includes net earnings or loss and other comprehensive income or loss. Other comprehensive income or loss results from changes in the Company's pension liability, unrealized gains and losses on available-for-sale marketable securities and gains and losses associated with interest rate hedging instruments.

Fair Value Information

Assets or liabilities that are required to be measured at fair value are reported using the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

Table of Contents

Revenue Recognition

Revenues from DHL are determined based on expenses incurred during a period under the two commercial agreements with DHL and are recognized when the related services are performed. Except for the amendments described below, expenses incurred under these agreements are generally subject to a base mark-up of 1.75%, which is recognized in the period the expenses are incurred. Certain costs, the most significant of which include fuel, interest on the promissory note due to DHL, rent and ramp and landing fees incurred under the two commercial agreements are reimbursed and included in revenues without mark-up.

Both agreements also allow the Company to earn incremental mark-up above the base 1.75% mark-up (up to 1.60% under the ACMI agreement, and 2.10% under the Hub Services agreement) as determined from the achievement of certain cost-related and service goals outlined in the two commercial agreements. The agreements stipulate the setting of quarterly and annual cost-related goals and annual service goals expressly specified in each of the two agreements. The Company measures quarterly goals and records incremental revenues in the quarter in which earned. Historically, at the end of each fiscal year, the Company measures the achievement of annual goals and records any incremental revenues earned by achieving the annual goals during the fourth quarter.

ABX and DHL amended the ACMI agreement and the Hub Services agreement to set the base mark-up and incremental mark-up to specific amounts for the first and second quarters of 2009. Under these revenue amendments, annual goals were not set for 2009, nor was a quarterly cost goal. Instead, the agreed revenue for the first and second quarters of 2009 includes amounts to replace the incremental revenues. In 2008, ABX and DHL executed a severance and retention agreement (S&R agreement) which specifies employee severance, retention and other benefits that DHL reimburses ABX for payment to its employees that are displaced in conjunction with DHL's U.S. restructuring plan. DHL reimburses ABX for the cost of employee severance, retention, productivity bonuses and vacation benefits paid in accordance with the agreement. The Company's revenues for the first and second quarters of 2009 includes reimbursement for expenses incurred under the commercial agreements, the incremental revenues set by the revenue amendments and reimbursement for employee severance, retention and other benefit costs incurred during the quarter.

ACMI revenues from customers other than DHL are typically recognized based on hours flown or the amount of aircraft and crew resources provided during a reporting period. Charter service revenues are recognized on scheduled and non-scheduled flights when the specific flight has been completed. Aircraft parts and fuel sales are recognized when the parts and fuel are delivered. Revenues earned and expenses incurred in providing aircraft-related maintenance repair services or technical maintenance services are recognized in the period in which the services are completed and delivered to the customer. Revenues derived from transporting freight and sorting parcels are recognized upon delivery of shipments and completion of service.

New Accounting Pronouncements

In December 2008, the Financial Accounting Standards Board (FASB) affirmed FSP No. FAS 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets (FSP FAS 132(R)-1). FSP FAS 132(R)-1 requires additional disclosures about assets held in an employer's defined benefit pension or other postretirement plan, primarily related to categories and fair value measurements of plan assets. FSP FAS 132(R)-1 is effective for the Company as of December 31, 2009. Because FSP FAS 132(R)-1 applies only to financial statement disclosures, the adoption will not have a material effect on the Company's consolidated financial statements.

In June 2009, the FASB issued SFAS No. 166 Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140 (SFAS 166). SFAS 166 improves the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. SFAS 166 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. The Company is evaluating the impact the adoption of SFAS 166 will have on its consolidated financial statements.

Table of Contents

In June 2009, the FASB issued SFAS No. 167 Amendments to FASB Interpretation No. 46(R) (SFAS 167). SFAS 167 improves financial reporting by enterprises involved with variable interest entities and to address (1) the effects on certain provisions of FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities , as a result of the elimination of the qualifying special-purpose entity concept in SFAS 166 and (2) constituent concerns about the application of certain key provisions of Interpretation 46(R), including those in which the accounting and disclosures under the Interpretation do not always provide timely and useful information about an enterprise's involvement in a variable interest entity. SFAS 167 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. The Company is evaluating the impact the adoption of SFAS 167 will have on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168 The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162 . The FASB Accounting Standards Codification (Codification) will be the single source of authoritative nongovernmental U.S. generally accepted accounting principles (GAAP). Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. SFAS 168 is effective for interim and annual periods ending after September 15, 2009. All existing accounting standards are superseded as described in SFAS 168. All other accounting literature not included in the Codification is nonauthoritative. The Codification is not expected to have a significant impact on the Company's consolidated financial statements.

NOTE B SIGNIFICANT CUSTOMERS

DHL

Pursuant to its 2008 restructuring plans, DHL discontinued intra-U.S. domestic pickup and delivery services in January 2009. DHL now provides only international services to and from the U.S. In January 2009, the regional sorting hubs staffed by ABX were closed, the sort operations in Wilmington, Ohio were downsized to process only international shipments and all of ABX's remaining 32 DC-9 aircraft were terminated from the DHL ACMI agreement. In March 2009, DHL gave ABX notice to remove five Pratt & Whitney powered Boeing 767 aircraft having a net book value of approximately \$24.0 million, from the DHL network. Further, on April 17, 2009 DHL announced that it planned to relocate its package sorting and aircraft hub operations from the DHL Air Park in Wilmington, Ohio to the Cincinnati/Northern Kentucky International Airport in Hebron, Kentucky (CVG). On May 12, 2009, DHL notified ABX that DHL will not be renewing the Hub Services agreement when its term expires on August 15, 2009. On July 24, 2009, sort operations in Wilmington were terminated and the sorting and hub operations were transferred to CVG. ABX is assisting DHL with the transition from Wilmington to CVG and will provide sort staffing for the CVG operations through August 2009.

Revenues from the Hub Services agreement were \$37.0 million and \$98.8 million for the second quarter and first six months of 2009 respectively. Pre-tax earnings from the Hub Services agreement were \$2.0 million, or 17% of consolidated pre-tax earnings, for the second quarter of 2009 and \$6.6 million, or 22% of consolidated pre-tax earnings, for the first six months of 2009. In conjunction with the transfer of the aircraft hub operations to CVG in July 2009, ABX is no longer providing aircraft fuel for its aircraft that remain in the DHL network. Revenues from fuel were \$11.6 million and \$26.7 million for the second quarter and first six months of 2009 respectively. ABX did not earn a mark-up on fuel used within the DHL network.

Through June 30, 2009, ABX has terminated the employment of approximately 8,000 people since DHL's restructuring began in mid-2008. During the second quarter and first six months of 2009, hours paid to employees declined approximately 72% and 66% respectively, compared to the corresponding periods of 2008, primarily due to DHL's restructuring plans. Employees receive severance, retention and other benefits under the S&R agreement executed between ABX and DHL. The S&R agreement specifies employee severance, retention and other benefits that DHL will pay to ABX in conjunction with its U.S. restructuring plan. The same agreement includes provisions to pay ABX for crewmember benefits if ABX and the collective bargaining unit for the crewmembers can reach an agreement in regards to the use of those funds for severance, pension funding or other issues arising from DHL's U.S. restructuring plan.

Table of Contents

ABX currently remains the primary provider of airlift capacity for DHL's U.S. based international delivery network through its fleet of Boeing 767 aircraft. In addition to Boeing 767 aircraft provided under the primary ACMI agreement, ABX is also supplying DHL with five Boeing 767 standard freighters under supplemental, short-term, ACMI arrangements. In June 2009, ABX and DHL entered into a lease option agreement for four ABX Boeing 767 standard freighter aircraft under 64.5 month lease terms, commencing August 15, 2010. Additionally, ABX and DHL are discussing long-term leases for eight to ten of ABX's Boeing 767 aircraft as they are converted to standard freighter configuration.

On August 7, 2009, DHL notified ABX that DHL will not be renewing the ACMI agreement when its initial term expires on August 15, 2010. DHL has expressed its interest to contract with the Company for aircraft dry lease and aircraft operations under competitive, commercial terms after the current ACMI agreement expires in 2010. DHL's decision to terminate the ACMI agreement in 2010, adds impetus to management's strategy of modifying ABX's non-standard Boeing 767 aircraft into standard freighter configuration. Interest in efficient, reliable Boeing 767 aircraft remains strong. As the modified Boeing 767 aircraft become available for service, management anticipates that some portion of them will be leased to other airlines, while some may be operated by an ATSG airline. Management will make the decision to redeploy each modified aircraft either into airline operations or into leasing arrangements, depending on which alternative will generate the higher return on capital.

The Company's balance sheets included the following balances related to revenue transactions with DHL (in thousands):

	June 30, 2009	December 31, 2008
Assets (Liabilities):		
Accounts receivable	\$ 58,639	\$ 63,362
Aircraft put to DHL	31,293	393
Accounts payable	(189)	(392)
Accrued severance and retention	(45,301)	(67,846)
Unearned revenue	(6,535)	(8,749)
Net asset (liability)	\$ 37,907	\$ (13,232)

Aircraft for sale as of June 30, 2009 includes approximately \$31.3 million for aircraft that ABX has put to DHL but for which the sale has not been completed. Under the terms of the ACMI agreement, the aircraft were valued by an independent aircraft appraiser and put to DHL at the lower of fair market value or net book value. DHL has subsequently asserted that the aircraft have a fair market value of only \$22.7 million. If DHL continues its assertion, ABX may initiate the resolution process prescribed in the ACMI agreement.

Through June 30, 2009, ABX has paid terminating employees approximately \$15.1 million for accrued vacation benefits since DHL's restructuring began in mid-2008. DHL is obligated to reimburse ABX for the amounts it paid to its terminating employees for their accrued vacation benefits. In March 2009, after auditing ABX's payments to terminating employees for vacation, DHL paid ABX \$3.2 million for invoices specifically for 2008 vacation reimbursement. As of June 30, 2009, accounts receivable includes approximately \$7.1 million due from DHL for the reimbursement of accrued vacation benefits that ABX paid as employees were terminated in the first quarter of 2009. In late May 2009, DHL expressed to the Company that it believes it may not be obligated to reimburse ABX for any of the vacation benefits. The Company's financial results do not reflect the recognition of \$4.8 million for reimbursement that is due to ABX for vacation payments made in the second quarter of 2009 because the revenue recognition requirements under U.S. generally accepted accounting principles (GAAP) were not met. After reevaluating DHL's contractual obligations, management believes that ABX will fully recover the \$7.1 million paid in the first quarter of 2009 and expects to recognize the reimbursement for the second quarter payments after reimbursement from DHL becomes assured through further discussions or legal action, if necessary.

Revenues from contracted services performed for DHL were approximately 63% and 71% of the Company's total revenues for the three months ended June 30, 2009 and 2008, respectively, and 65% and 73% of consolidated revenues for the six month periods ended June 30, 2009 and 2008, respectively.

As specified in the two commercial agreements with DHL, ABX is advanced funds on the first business day of each week for the costs budgeted to be incurred for the upcoming week. Unearned revenue reflects the portion of a scheduled payment from DHL that relates to revenues earned in the next quarter. Accounts receivable is primarily from the revenues earned under the commercial agreements. Accounts payable is interest payable on the promissory note.

Table of Contents**BAX Global**

A substantial portion of the Company's revenues, cash flows and liquidity are also dependent on BAX. Revenues from services performed for BAX were approximately 17% and 16% of the Company's total revenues for the three months ended June 30, 2009 and 2008, respectively, and 15% of consolidated revenues for the six month periods ended June 30, 2009 and 2008, respectively. Under its agreement with BAX, CHI has the right to be the exclusive provider of main deck freighter lift in the BAX U.S. network through December 31, 2011.

The Company's balance sheets include the following balances related to revenue transactions with BAX (in thousands):

	June 30, 2009	December 31, 2008
Assets (Liabilities):		
Accounts receivable	\$ 2,619	\$ 2,101
Accounts payable	(509)	(1,529)
Net asset	\$ 2,110	\$ 572

NOTE C WIND-DOWN COSTS

As a result of DHL's U.S. restructuring plan, the Company has incurred costs to reduce the scope of its operations. Under the S&R agreement between DHL and ABX, the severance and retention benefits provided to employees are refunded to ABX by DHL after payments are made by ABX. Wind-down expenses are reflected in the DHL segment. All expenses related to employee severance and retention benefits are included in salaries, wages, and benefits. The wind-down expenses incurred through June 30, 2009 are summarized below (in thousands):

	Severance Benefits	Retention Benefits	Total
Accrued costs at December 31, 2008	\$ 28,920	\$ 38,926	\$ 67,846
Costs incurred	33,636	24,836	58,472
Costs paid	(45,119)	(35,898)	(81,017)
Accrued costs at June 30, 2009	\$ 17,437	\$ 27,864	\$ 45,301

Future wind-down costs are expected to include additional severance benefits as more ABX employees are terminated, as well as the cost to terminate aircraft maintenance contracts. In April 2009, ABX and DHL amended the S&R agreement to provide for additional retention bonuses for covered employees who remain employed through August 31, 2009. As a result of DHL's restructuring plans for the U.S., the Company estimates the total employee severance and retention benefits that it will pay and for which DHL is obligated to reimburse, will exceed \$200 million. The actual cost will depend on the size and timing of DHL business reductions. In addition to severance and retention benefits, ABX paid terminated employees \$11.9 million for accrued vacation benefits during the first six months of 2009. The Company estimates that it will pay \$5.8 million more for accrued vacation benefits as employees terminate. At this time, it is not reasonably possible to estimate other wind-down costs.

Table of Contents**NOTE D FAIR VALUE MEASUREMENTS**

The Company's money market funds, short-term available-for-sale securities and derivative financial instruments are reported on the Company's consolidated balance sheet at fair values based on market values from identical or comparable transactions. The fair value of the Company's short-term available-for-sale securities are based on quoted prices in active markets for identical assets (Level 1). The fair value of the Company's derivative financial instruments is based on observable inputs (Level 2) from comparable market transactions. The use of significant unobservable inputs (Level 3) was not necessary in determining the fair value of the Company's financial assets and liabilities.

The following table reflects assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2009 (in thousands):

	Fair Value Measurement Using			Total
	Level 1	Level 2	Level 3	
Assets				
Cash equivalents - money market	\$ 23,903	\$	\$	\$ 23,903
Liabilities				
Interest rate swap	\$	\$ (3,297)	\$	\$ (3,297)

SFAS No. 157, Fair Value Measurements (SFAS 157) establishes three levels of input that may be used to measure fair value:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include items where the determination of fair value requires significant management judgment or estimation.

The carrying amounts for accounts receivable, accounts payable and accrued liabilities approximate fair value. As a result of higher market interest rates compared to the stated interest rates of the Company's fixed and variable rate debt obligations, the fair value of the Company's debt obligations was approximately \$91.0 million less than the carrying value, which was \$443.0 million at June 30, 2009.

NOTE E INCOME TAXES

The provision for income taxes for interim periods is based on management's best estimate of the effective income tax rate expected to be applicable for the current year, plus any adjustments arising from changes in the estimated amount of taxable income related to prior periods. Income taxes recorded through June 30, 2009 have been estimated utilizing a 37.5% rate based on year-to-date income and projected results for the full year, excluding discrete items. The final effective tax rate to be applied to 2009 will depend on the actual amount of pre-tax book income generated by the Company for the full year.

The Company files income tax returns in the U.S. federal jurisdiction and various state and local jurisdictions. The Internal Revenue Service (IRS) recently completed the examinations of CHI and ABX for the tax years through December 31, 2006. The CHI examination also covered the 2007 tax year. The examinations resulted in no changes to taxable income. These returns continue to be subject to examination by the IRS to the extent of net operating loss carryovers, and fully subject to examination by other jurisdictional authorities. The 2007 ABX tax return remains open to examination in all relevant taxing jurisdictions.

The Company reduced deferred tax assets for net operating loss carry forwards by \$16.8 million in 2009 to reflect the tax effect associated with the extinguishment of debt (See Note G).

Table of Contents**NOTE F PROPERTY AND EQUIPMENT**

At June 30, 2009, the Company's subsidiaries operated 67 aircraft, consisting of 35 Boeing 767, two Boeing 757, 14 Boeing 727, and 16 McDonnell Douglas DC-8 aircraft. During the first six months of 2009, CAM leased four aircraft with a cost of \$79.4 million and accumulated depreciation of \$3.9 million to external customers. The aircraft are recorded in aircraft and flight equipment.

Property and equipment, to be held and used, consisted of the following (in thousands):

	June 30, 2009	December 31, 2008
Aircraft and flight equipment	\$ 806,762	\$ 899,315
Support equipment	51,149	50,823
Vehicles and other equipment	1,830	1,832
Leasehold improvements	1,255	1,272
	860,996	953,242
Accumulated depreciation	(233,228)	(281,690)
Property and equipment, net	\$ 627,768	\$ 671,552

Property and equipment includes \$59.1 million of property held under capital leases as of June 30, 2009 and \$55.0 million as of December 31, 2008. Accumulated depreciation and amortization includes \$21.6 million as of June 30, 2009 and \$17.5 million as of December 31, 2008 for property held under capital leases.

Aircraft and Engines Held For Sale

In December 2008, ABX received notice from DHL that ABX's remaining 32 DC-9 aircraft would not be needed in the DHL network after January 2009. Accordingly, in January 2009, these aircraft were removed from service. During 2009, ABX put to DHL the 32 DC-9 aircraft that were removed from service under the ACMI agreement. In March 2009, DHL gave ABX notice to remove five Pratt & Whitney powered Boeing 767 aircraft from the DHL network. ABX put these Boeing 767 aircraft to DHL in the second quarter of 2009, pursuant to the put option included in the ACMI agreement.

At June 30, 2009, ABX held spare engines and aircraft that had been removed from DHL service. At June 30, 2009, \$31.3 million of the \$32.9 million balance reflects Boeing 767 and McDonnell Douglas DC-9 aircraft that were put to DHL, but for which the sales have yet to be completed pending agreement on the sales price (see Note B). The remaining aircraft and engines held for sale are being marketed to parts dealers and private operators or are being used for spare parts. Gains or losses from the sale of aircraft and spare engines are recorded in other operating expenses on the statement of operations.

Table of Contents**NOTE G DEBT OBLIGATIONS**

Long-term obligations consisted of the following (in thousands):

	June 30, 2009	December 31, 2008
Unsubordinated term loan	\$ 211,375	\$ 222,500
Revolving credit facility	18,500	18,500
Aircraft loans	103,407	106,928
Capital lease obligations-Boeing 767	47,498	52,864
Capital lease obligations-Boeing 727	15,584	18,648
Promissory note due to DHL, unsecured	46,000	92,276
Other capital leases	635	770
Total long-term obligations	442,999	512,486
Less: current portion	(62,774)	(61,858)
Total long-term obligations, net	\$ 380,225	\$ 450,628

The Company entered into a Credit Agreement with a consortium of lenders on December 31, 2007 that provides for a \$75.0 million revolving credit facility and an unsubordinated term loan through December 2012. The unsubordinated term loan and the revolving credit facility are collateralized by substantially all the aircraft, property and equipment owned by the Company that are not collateralized under aircraft loans or capital leases. Under the Credit Agreement, interest rates are adjusted quarterly based on the Company's earnings before interest and taxes and on prevailing LIBOR or prime rates. At June 30, 2009, the unsubordinated term loan bears a variable interest rate of LIBOR (90-day) plus 2.63% (3.23% at June 30, 2009). The agreement provides for the issuance of letters of credit on the Company's behalf. As of June 30, 2009, the unused revolving credit facility totaled \$39.5 million, net of draws of \$18.5 million and outstanding letters of credit of \$17.0 million. The revolving credit facility at June 30, 2009 carried an interest rate of LIBOR (30-day) plus 2.63% (2.95% at June 30, 2009).

In January, 2008, DHL made a demand for payment in full of the unsecured promissory note. In its demand, DHL asserted that the acquisition by the Company of Cargo Holding International, Inc (CHI) and the related financing transaction, which closed on December 31, 2007, constituted a change of control under the terms of the promissory note. On March 16, 2009, the Company and DHL reached a binding agreement to amend the promissory note. On May 8, 2009, the promissory note was formally amended. DHL agreed it would relinquish its claim that the Company's acquisition of CHI and the related financing transaction, constituted a change of control. The Company agreed to pay DHL \$15.0 million of the principal balance, while DHL agreed to extinguish an additional \$46.3 million of principal balance. In March 2009, the Company recorded the extinguishment of \$46.3 million as a capital transaction due to ABX's relationship with DHL stemming from ABX's separation from Airborne, Inc. in August 2003. Net of the income tax effects, paid in capital increased by \$29.5 million due to the extinguishment. Based on the anticipated principal payment in 2009, the Company's balance sheet as of June 30, 2009, reflects the \$15.0 million as a current liability. The due date for the remaining \$31.0 million remains unchanged - August 2028. Until that time, the promissory note continues to bear interest at a rate of 5% per annum and DHL will continue to reimburse ABX the interest expense from the note at least through 2012.

The aircraft loans are collateralized by seven aircraft, and fully amortize by 2018 with interest rates ranging from 6.74% to 7.36% per annum payable monthly. The capital lease obligations for five Boeing 767 aircraft consist of two different leases, both expiring in 2011 with options to extend into 2017. The capital lease payments for three of the five aircraft include quarterly principal and variable interest of LIBOR (90-day) plus 2.50% (3.31% at June 30, 2009). The capital lease for the other two Boeing 767 aircraft carries a fixed implicit interest rate of 8.55%. Capital lease obligations for seven Boeing 727 aircraft carry a fixed implicit rate of 6.50% and expire between 2010 and 2012. At the termination of the leases, the Company is subject to normal aircraft return provisions for maintenance of the aircraft.

In June 2009, ABX entered into a Lease Assumption and Option Agreement with DHL pursuant to which DHL has (i) assumed financial responsibility for the capital leases associated with five Boeing 767 aircraft that ABX is currently operating on behalf of DHL under the ACMI agreement; and (ii) the option to lease up to four Boeing 767-200 freighter aircraft from ABX. ABX agreed that, upon DHL's request, it will continue operating the five Boeing 767 aircraft under the ACMI agreement. ABX also granted DHL a credit of \$2.5 million as prepaid rent toward each of the four lease option aircraft, conditioned upon extinguishment or assignment of the capital leases to DHL. DHL has until February 15, 2010 to exercise its lease option for one or more of the aircraft. If DHL foregoes its lease option with respect to one or more aircraft, ABX will be required to pay to DHL \$2.5 million for each option that was not exercised. As of June 30, 2009, the Company's balance

Edgar Filing: Air Transport Services Group, Inc. - Form 10-Q

sheet reflected approximately \$47.5 million of debt obligations and \$20.9 million of net book value related to five Boeing 767 capital lease aircraft.

Table of Contents

In July 2009, the lease agreements for three of the five Boeing 767 capital lease aircraft were settled and terminated with the lessor. Accordingly, the Company will record the debt extinguishment, remove the related aircraft book values and record the prepaid rent liability during the third quarter of 2009 as a capital transaction.

Under the Credit Agreement, the Company is subject to expenses, covenants and warranties that are usual and customary. The Credit Agreement contains covenants including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness, and the level of annual capital expenditures. The Credit Agreement stipulates events of default, including unspecified events that may have material adverse effects on the Company. If a lender within the Credit Agreement declares a material adverse event (MAE), availability under the revolving credit facility will be reduced by that lender's portion of the facility. Further, the Credit Agreement provides that if lenders having more than half of the outstanding dollar amount of the commitments assert that an MAE exists at the time the Company attempts to borrow under the Credit Facility, the lenders can assert that an event of default exists under the Credit Agreement and require the lead bank to exercise its remedies. If an event of default occurs, the Company may be forced to repay, renegotiate or replace the Credit Agreement. The conditions of the Credit Agreement and the aircraft loans cross-default. The Company is currently in compliance with the financial covenants specified in the Credit Agreement.

NOTE H COMMITMENTS AND CONTINGENCIES

Leases

The Company leases airport facilities and certain operating equipment under long-term operating lease agreements. ABX leases portions of the DHL Air Park, the term of which expires at the end of the transition period that follows the termination of the ACMI agreement.

Commitments

On September 15, 2008, CAM entered into an agreement with Israel Aerospace Industries Ltd. (IAI) for the conversion of up to fourteen Boeing 767-200 passenger door freighters to a standard freighter configuration. The conversion primarily consists of the installation of a standard cargo door and loading system. At June 30, 2009, the Company owned two Boeing 767 aircraft that were in modification from passenger door freighter to standard freighter configuration. The Company added a third aircraft into the modification process in July 2009. The Company anticipates costs of approximately \$19.6 million to complete the modification of these aircraft. If CAM were to cancel the conversion program as of June 30, 2009, it would owe IAI, in addition to payments for aircraft currently undergoing modification, approximately \$3.9 million for non-recurring engineering costs and approximately \$4.9 million associated with additional conversion part kits which have been ordered.

Additionally, the Company is committed to purchase another Boeing 767 for approximately \$23.0 million after the aircraft is completely modified to freighter configuration in 2009.

Guarantees and Indemnifications

Certain operating leases and agreements of the Company contain indemnification obligations to the lessor, or one or more other parties that are considered ordinary and customary (e.g. use, tax and environmental indemnifications), the terms of which range in duration and are often limited. Such indemnification obligations may continue after expiration of the respective lease or agreement.

Department of Transportation (DOT) Continuing Fitness Review

ABX filed a notice of substantial change with the DOT arising from its separation from Airborne, Inc. In connection with the filing, which was initially made in mid-July of 2003 and updated in April of 2005 and again in September of 2007, the DOT will determine whether ABX continues to be a U.S. citizen and fit, willing and able to engage in air transportation of cargo.

Under U.S. laws and DOT precedents, non-U.S. citizens may not own more than 25% of voting equity or have actual control of a U.S. certificated air carrier. The DOT may determine that DHL actually controls ABX as a result of its commercial arrangements (in particular, the ACMI agreement and Hub Services agreement) with DHL. If the DOT determines that ABX is controlled by DHL, the DOT could require amendments or modifications of the ACMI and/or other agreements between ABX and DHL. If ABX were unable to modify such agreements to the satisfaction of the DOT, the DOT could seek to suspend, modify or revoke ABX's air carrier certificates and/or authorities, and this would materially and adversely affect the business.

The DOT has yet to specify the procedures it intends to use in processing ABX's filing.

Table of Contents**Alleged Violations of Immigration Laws**

ABX reported in January of 2005 that it was cooperating fully with an investigation by the U.S. Department of Justice (DOJ) with respect to Garcia Labor Co., Inc., (Garcia) a temporary employment agency based in Morristown, Tennessee, and ABX's use of contract employees that were being supplied to it by Garcia. The investigation concerns the immigration status of the Garcia employees assigned to ABX.

ABX terminated its contract with Garcia in February of 2005 and replaced the Garcia employees.

In October of 2005, the DOJ notified ABX that ABX and a few Company employees in its human resources department, in addition to Garcia, were targets of a criminal investigation. ABX cooperated fully with the investigation. In June of 2006, a non-senior management employee of the Company entered a plea to a misdemeanor related to this matter. In July of 2006, a federal grand jury indictment was unsealed charging two Garcia companies, the president of Garcia and two of their corporate officers with numerous counts involving the violation of federal immigration laws. The Garcia defendants subsequently entered guilty pleas in U.S. district court and were sentenced in February and March of 2007. No proceedings have been initiated against ABX by the DOJ. While ABX believes it has adequately reserved for potential losses stemming from the investigation, it is possible that, in the event proceedings were initiated against ABX that resulted in an adverse finding, ABX could be subjected to a financial penalty that is materially greater than the amount it has accrued and restrictions on its ability to engage in business with agencies of the U.S. Government.

On December 31, 2008, a former ABX employee filed a complaint against ABX, a total of four current and former executives and managers of ABX, Garcia Labor Company of Ohio, and three former executives of the Garcia Labor companies, in the U.S. District Court for the Southern District of Ohio. The case was filed as a putative class action against the defendants, and asserts violations of the Racketeer Influenced and Corrupt Practices Act (RICO). The complaint, which seeks damages in an unspecified amount, alleges that the defendants engaged in a scheme to hire illegal immigrant workers to depress the wages paid to hourly wage employees during the period from December 1999 to January 2005. On January 23, 2009, ABX and the four current and former executives and managers of ABX filed an answer denying the allegations contained in the complaint. On July 24, 2009, ABX and the current and former executives of ABX filed a motion to dismiss the complaint; which motion is currently pending.

The complaint is similar to a prior complaint filed by another former employee in April 2007. The prior complaint was subsequently dismissed without prejudice at the plaintiff's request on November 3, 2008.

Other

In addition to the foregoing matters, the Company is also currently a party to legal proceedings in various federal and state jurisdictions arising out of the operation of their business. The amount of alleged liability, if any, from these proceedings cannot be determined with certainty; however, the Company believes that their ultimate liability, if any, arising from the pending legal proceedings, as well as from asserted legal claims and known potential legal claims which are probable of assertion, taking into account established accruals for estimated liabilities, should not be material to the Company's financial condition or results of operations.

Employees Under Collective Bargaining Agreements

As of June 30, 2009, all of the flight crewmembers of ABX, ATI and CCIA were covered under collective bargaining agreements, which are summarized in the following table:

Airline	Labor Agreement Unit	Date Contract Became Amendable	Percentage of Company's Employees
ABX	International Brotherhood of Teamsters	July 31, 2006	9.7%
ATI	International Brotherhood of Teamsters	May 1, 2004	4.9%
CCIA	Airline Pilots Association	March 31, 2004	3.7%

Table of Contents**NOTE I COMPONENTS OF NET PERIODIC BENEFIT COST**

ABX sponsors a qualified defined benefit pension plan for its flight crewmembers and a qualified defined benefit pension plan for certain of its other employees that meet minimum eligibility requirements. ABX also sponsors non-qualified defined benefit pension plans for certain employees. These non-qualified plans are unfunded. ABX also sponsors a post-retirement healthcare plan, which is unfunded.

The accounting and valuation for these post-retirement obligations are determined by prescribed accounting and actuarial methods that consider a number of assumptions and estimates. The selection of appropriate assumptions and estimates is significant due to the long time period over which benefits will be accrued and paid. The long-term nature of these benefit payouts increases the sensitivity of certain estimates on our post-retirement costs. The Company's net periodic benefit cost for its qualified defined benefit pension and post-retirement healthcare plans are as follows (in thousands):

	Three Months Ended June 30				Six Months Ended June 30			
	Pension Plans		Post-retirement Healthcare Plan		Pension Plans		Post-retirement Healthcare Plan	
	2009	2008	2009	2008	2009	2008	2009	2008
Service cost	\$ 3,470	\$ 8,328	\$ 153	\$ 467	\$ 6,940	\$ 16,656	\$ 306	\$ 934
Interest cost	9,434	9,631	10	466	18,868	19,262	20	932
Expected return on plan assets	(7,104)	(9,092)			(14,209)	(18,184)		
Curtailment loss	1,827				1,827			
Amortization of prior service cost	619	1,247			1,238	2,494		
Amortization of net loss	7,912	480		18	15,824	960		36
Net periodic benefit cost	\$ 16,158	\$ 10,594	\$ 163	\$ 951	\$ 30,488	\$ 21,188	\$ 326	\$ 1,902

In June 2009, after revaluing pension assets and liabilities due to employee terminations, the Company reduced pension liabilities by \$16.9 million to reflect curtailment of benefits and changes in actuarial assumptions and assets since the previous revaluation on December 31, 2008. The Company revoked its previously announced decision to freeze benefits of ABX's largest defined benefit pension plan for non-pilots. Employees within the plan continue to earn retirement benefits without interruption. During the three and six month periods ended June 30, 2009, the Company paid \$10.5 and \$21.4 million of contributions to its defined benefit pension plans, respectively. The Company presently anticipates contributing at least \$27.2 million to fund its pension plans during the remainder of 2009 for a total of \$48.6 million.

Table of Contents**NOTE J DERIVATIVE INSTRUMENTS**

To reduce the effects of fluctuating LIBOR-based interest rates on interest payments that stem from its variable rate outstanding debt, the Company entered into interest rate swaps having combined notional values of \$135.0 million in January 2008. The notional values step downward in conjunction with the underlying debt through December 31, 2012. Under the interest rate swap agreements, the Company will pay a fixed rate of 3.105% and receive a floating rate that resets quarterly based on LIBOR. For the outstanding notional value, the Company expects that the amounts received from the floating leg of the interest rate swap will offset fluctuating payments for interest expense because interest rates for its outstanding debt and the interest rate swap are both based on LIBOR and reset quarterly. The Company accounts for the interest rate swaps as cash flow hedges.

The liability for outstanding derivatives is recorded in other liabilities and in accrued expenses. The table below provides information about the Company's interest rate swaps at June 30, 2009 (in thousands):

Expiration Date	Notional Amount	Stated Interest Rate	Market Value (Liability)
12/31/2012	\$ 80,750	3.105%	\$ (2,079)
12/31/2012	47,500	3.105%	(1,218)

To reduce its exposure to rising interest rates on anticipated aircraft financing transactions, during the first quarter of 2006, the Company entered into five forward treasury lock agreements (treasury locks) with settlement dates near the forecasted execution dates of the anticipated financing transactions. The Company anticipated aircraft financing under fixed interest rate loans based on the interest rates of ten-year U.S. Treasury Notes. The values of the treasury locks were based on the ten-year U.S. Treasury interest rates, effectively offsetting the effect of changing interest rates on the anticipated loan transactions. The final remaining treasury lock was with a major U.S. financial institution and settled in cash in July 2007. In accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, the Company accounted for the treasury locks as cash flow hedges. The treasury locks were evaluated and deemed to be highly effective as hedges at inception and upon expiration. The Company recorded unrealized gains or losses resulting from the changes in fair value in the consolidated balance sheets under accumulated other comprehensive income in stockholders' equity. These gains and losses are recognized into earnings over the terms of the loan transactions.

At June 30, 2009, accumulated other comprehensive loss included unrecognized losses of \$1.8 million net of tax for derivative instruments.

Table of Contents**NOTE K COMPREHENSIVE INCOME AND PAID IN CAPITAL**

Comprehensive income includes the following transactions for the three and six month periods ended June 30, 2009 and 2008 (in thousands):

	Three Months Ended June 30			Six Months Ended June 30		
	Before Tax	Income Tax (Expense) Benefit	Net of Tax	Before Tax	Income Tax (Expense) Benefit	Net of Tax
2009						
Net income			\$ 8,107			\$ 19,204
Other comprehensive income:						
Actuarial gain for pension liabilities	\$ 18,695	\$ (6,786)	11,909	\$ 18,695	\$ (6,786)	11,909
Unrealized gain on marketable securities					20	20
Unrealized gain on hedge derivatives	1,966	(714)	1,252	2,160	(784)	1,376
Reclassifications to net income:						
Hedging gain realized in net income	(29)	11	(18)	(58)	21	(37)
Pension actuarial loss	7,912	(2,872)	5,040	15,824	(5,744)	10,080
Post-retirement actuarial loss	(13)	5	(8)	(27)	10	(17)
Pension prior service cost	619	(225)	394	1,238	(450)	788
Total other comprehensive income	\$ 29,150	\$ (10,581)	18,569	\$ 37,832	\$ (13,713)	24,119
Comprehensive income			\$ 26,676			\$ 43,323
2008						
Net income (loss)			\$ (526)			\$ 3,261
Other comprehensive income:						
Unrealized gain (loss) on marketable securities	\$ 18	\$ (7)	11	\$ 7	\$ (3)	4
Unrealized gain on hedge derivatives	4,499	(1,633)	2,866	4,375	(1,588)	2,787
Reclassifications to net income:						
Hedging gain realized in net income	(31)	11	(20)	(62)	22	(40)
Pension actuarial loss	480	(174)	306	961	(348)	613
Post-retirement actuarial loss	18	(7)	11	36	(13)	23
Pension prior service cost	1,247	(453)	794	2,494	(905)	1,589
Total other comprehensive income	\$ 6,231	\$ (2,263)	3,968	\$ 7,811	\$ (2,835)	4,976
Comprehensive income			\$ 3,442			\$ 8,237

Paid in capital includes the following transactions for the three and six month periods ended June 30, 2009 (in thousands):

	Three Months Ended June 30			Six Months Ended June 30		
	Before Tax	Income Tax (Expense) Benefit	Net of Tax	Before Tax	Income Tax (Expense) Benefit	Net of Tax
2009						
Beginning balance	\$ 489,948	\$	\$ 489,948	\$ 460,155	\$	\$ 460,155
Grant of restricted stock	(2)		(2)	(2)		(2)
Issuance of common shares	12		12	9		9
Amortization of stock awards and restricted stock	391		391	710		710
Debt extinguishment (see Note G)				46,276	(16,799)	29,477

Edgar Filing: Air Transport Services Group, Inc. - Form 10-Q

Ending balance	\$ 490,349	\$	\$ 490,349	\$ 507,148	\$ (16,799)	\$ 490,349
----------------	------------	----	------------	------------	-------------	------------

Table of Contents**NOTE L STOCK-BASED COMPENSATION**

The Company's Board of Directors has granted stock incentive awards to certain employees and board members pursuant to a long-term incentive plan which was approved by the Company's stockholders in May 2005. Employees have been awarded non-vested stock units with performance conditions, non-vested stock units with market conditions and non-vested restricted stock. The restrictions on the non-vested restricted stock awards lapse at the end of a specified service period, which is approximately three years from the date of grant. Restrictions could lapse sooner upon a business combination, death, disability or after an employee qualifies for retirement. The non-vested stock units will be converted into a number of shares of Company stock depending on performance and market conditions at the end of a specified service period, lasting approximately three years. The performance condition awards will be converted into a number of shares of Company stock depending on the Company's average return on equity during the service period. Similarly, the market condition awards will be converted into a number of shares depending on the appreciation of the Company's stock compared to the NASDAQ Transportation Index. Board members were granted time-based awards with approximately a six-month vesting period, which will settle when the board member ceases to be a director of the Company. The Company expects to settle all of the stock unit awards by issuing new shares of stock. The table below summarizes award activity.

	Six Months Ended June 30, 2009		Six Months Ended June 30, 2008	
	Target number of shares	Weighted average grant date value	Target number of shares	Weighted average grant date value
Outstanding at beginning of period	1,667,100	\$ 4.24	748,700	\$ 7.64
Granted	295,200	0.93	1,353,800	2.95
Converted	(60,974)	6.63	(62,150)	7.79
Cancelled	(109,426)	6.15	(62,150)	9.91
Outstanding at end of period	1,791,900	\$ 3.50	1,978,200	\$ 4.36
Vested	161,200	\$ 5.23	161,200	\$ 5.23

For the six month periods ended June 30, 2009 and 2008, the Company recorded expense of \$0.7 million and \$1.3 million, respectively, for stock incentive awards. At June 30, 2009, there was \$1.6 million of unrecognized expense related to the stock incentive awards that is expected to be recognized over a weighted-average period of 1.1 years. As of June 30, 2009, 1,791,900 awards were outstanding. None of the awards were convertible, and none of the outstanding shares of restricted stock had vested as of June 30, 2009. These awards could result in a maximum number of 2,155,650 additional outstanding shares of the Company's common stock depending on service, performance and market results through December 31, 2011.

NOTE M EARNINGS PER SHARE

The calculation of basic and diluted earnings per common share follows (in thousands, except per share amounts):

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Net income (loss) applicable to common stockholders	\$ 8,107	\$ (526)	\$ 19,204	\$ 3,261
Weighted-average shares outstanding for basic earnings per share	62,685	62,460	62,662	62,438
Common equivalent shares:				
Effect of stock-based compensation awards	326		244	229
Weighted-average shares outstanding assuming dilution	63,011	62,460	62,906	62,667

Edgar Filing: Air Transport Services Group, Inc. - Form 10-Q

Basic earnings per share	\$ 0.13	\$ (0.01)	\$ 0.31	\$ 0.05
Diluted earnings per share	\$ 0.13	\$ (0.01)	\$ 0.31	\$ 0.05

The number of equivalent shares that were not included in weighted average shares outstanding assuming dilution, because their effect would have been anti-dilutive, is approximately 350,000 shares at June 30, 2009 and 770,000 at June 30, 2008.

Table of Contents**NOTE N SEGMENT INFORMATION**

The Company operates in three reportable segments, as described below. The DHL segment consists of the air cargo transportation, logistics and package handling services provided to DHL under the ACMI and Hub Services agreements. The DHL segment earnings include interest expense that is reimbursed under the DHL agreement. The ACMI Services segment consists of the ACMI and charter services that the Company provides outside of the ACMI agreement with DHL. The CAM segment consists of the Company's aircraft leasing operations, and its segment earnings includes an allocation of interest expense based on aircraft values. The Company's other activities, which include contracts with the USPS, aircraft parts sales and maintenance services, fuel management and logistics services, do not constitute reportable segments and are combined in All other with interest income, unallocated interest expense and inter-segment profit eliminations. Inter-segment revenues are valued at arms-length, market rates. Cash, cash equivalents, marketable securities and deferred tax assets are reflected in Assets. All other below (in thousands):

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Total revenues:				
DHL	\$ 138,901	\$ 280,335	\$ 321,775	\$ 561,152
ACMI Services	84,634	106,711	170,668	200,004
CAM	14,652	11,621	27,669	21,713
All other	12,996	9,404	23,998	17,953
Eliminate Inter-segment revenues	(16,076)	(13,211)	(28,451)	(23,906)
Total	\$ 235,107	\$ 394,860	\$ 515,659	\$ 776,916
Customer revenues				
DHL	\$ 138,901	\$ 280,335	\$ 321,775	\$ 561,152
ACMI Services	84,390	106,711	170,424	200,004
CAM	2,420		4,476	
All other	9,396	7,814	18,984	15,760
Total	\$ 235,107	\$ 394,860	\$ 515,659	\$ 776,916
Depreciation and amortization expense:				
DHL	\$ 6,954	\$ 10,490	\$ 15,550	\$ 20,705
ACMI Services	8,615	8,471	16,749	16,604
CAM	5,331	3,761	10,128	6,467
All other	253	206	449	394
Total	\$ 21,153	\$ 22,928	\$ 42,876	\$ 44,170
Segment earnings (loss):				
DHL	\$ 5,741	\$ 1,085	\$ 18,422	\$ 5,046
ACMI Services	558	(773)	2,428	316
CAM	5,831	4,847	10,581	9,166
All other	(257)	(5,288)	(1,792)	(8,450)
Total	\$ 11,873	\$ (129)	\$ 29,639	\$ 6,078
Assets:				
		June 30, 2009	December 31, 2008	

Edgar Filing: Air Transport Services Group, Inc. - Form 10-Q

DHL	\$ 268,716	\$ 310,818
ACMI Services	276,346	297,300
CAM	287,090	259,321
All other	192,386	233,910
 Total	 \$ 1,024,538	 \$ 1,101,349

Interest income of \$0.1 million and \$0.3 million is included in All other pre-tax earnings for the three and six month periods ended June 30, 2009, respectively, as compared to \$0.5 million and \$1.5 million for the three and six month periods ended June 30, 2008, respectively. Interest expense of \$1.9 million and \$4.3 million for the three and six month periods ended June 30, 2009, respectively, as compared to \$2.6 million and \$5.2 million for the three and six month periods ended June 30, 2008, respectively, is reimbursed through the commercial agreements with DHL and included in the DHL segment earnings above. The remaining interest is included in the All other category.

Table of Contents

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

The following Management's Discussion and Analysis has been prepared with reference to the historical financial condition and results of operations of Air Transport Services Group, Inc. and its subsidiaries. Air Transport Services Group, Inc. and its subsidiaries may hereinafter individually and collectively be referred to as the Company, we, our or us from time to time. The following discussion and analysis describes the principal factors affecting the results of operations, financial condition, cash flows, liquidity and capital resources. It should be read in conjunction with the accompanying unaudited financial statements and the related notes contained in this report and our Annual Report on Form 10-K for the year ended December 31, 2008.

BACKGROUND

Air Transport Services Group, Inc. (ATSG) is a holding company whose principal subsidiaries include three independently certificated airlines, ABX Air, Inc. (ABX), Capital Cargo International Airlines, Inc. (CCIA) and Air Transport International, LLC (ATI) and an aircraft leasing company, Cargo Aircraft Management, Inc. (CAM). When the context requires, we may also use the terms Company and ATSG in this report to refer to the business of ATSG and its subsidiaries on a consolidated basis. The Company has three reportable segments: DHL, ACMI Services, and CAM. Each of these is described below.

DHL

ABX currently has two commercial agreements with DHL Express (USA), Inc. and DHL Network Operations (USA), Inc. (collectively, DHL). Under an aircraft, crew, maintenance and insurance agreement (ACMI agreement) and a Hub Services agreement, ABX provides airlift, package handling, and other cargo related services to DHL. Revenues from these services accounted for approximately 59% and 62% of the Company's revenues for the three and six month periods ended June 30, 2009. In 2008, DHL began to restructure its U.S. operations, which significantly impacted ABX's operations. The Hub Services agreement will be expiring on August 15, 2009. Additionally, on August 7, 2009, DHL notified ABX that it will not be renewing the ACMI agreement when its initial term expires on August 15, 2010, although DHL has expressed an interest in contracting with the Company for airlift services under competitive commercial terms to be provided upon the expiration of the ACMI agreement.

ACMI Services

Through its airline subsidiaries, the Company provides airlift to other airlines, freight forwarders and the U.S. military, typically through ACMI agreements. CCIA and ATI each have contracts to provide airlift to BAX Global, Inc. (BAX) under ACMI agreements. BAX provides freight transportation and supply chain management services, specializing in the heavy freight market for business-to-business shipping. ATI also provides passenger transportation primarily to the U.S. military using its DC-8 combi aircraft that are certified to carry passengers as well as cargo on the main flight deck.

The airlines serve a variety of customers in the air cargo industry by flying in North America, South America, Central America, Europe and Asia. At June 30, 2009, ABX operated 12 Boeing 767-200 freighter aircraft that were not under the DHL ACMI agreement, while CCIA and ATI operated 16 aircraft and 18 aircraft, respectively. Customers are usually charged based on the number of block hours flown, and typical agreements specify a minimum number of block hours to be charged monthly. ACMI Services also includes revenues from block space agreements, in which customers contract for specific amounts of space on certain flights. In these agreements, customers are typically charged by the weight carried on the aircraft during a flight, or based on the number of aircraft load positions purchased. ACMI Services includes revenues from supplemental airlift provided to DHL under additional, short-term ACMI arrangements.

CAM

The Company offers aircraft leasing through its CAM subsidiary. Aircraft leases normally cover a term of several years. In a typical leasing agreement, customers pay rent and a maintenance deposit on a monthly basis. CAM had 39 aircraft that were under lease at the quarter ended June 30, 2009, 35 of them to ABX, ATI and CCIA.

Other Activities

Through separate subsidiaries, the Company sells aircraft parts and provides aircraft maintenance and modification services to other airlines. The Company also operates three U.S. Postal Service (USPS) sorting facilities. The Company also provides equipment leasing and maintenance, as well as specialized services for aircraft fuel management and freight logistics. These other business activities do not constitute reportable segments. Other activities include general and administrative expenses not associated with the DHL commercial agreements, including an allocation of ABX's overhead expenses, starting January 1, 2008.

Table of Contents**SEGMENT RESULTS AND OUTLOOK****DHL Segment**

Pursuant to its 2008 restructuring plans, DHL discontinued intra-U.S. domestic pickup and delivery services in January 2009. DHL now provides only international services to and from the U.S. In January 2009, the regional sorting hubs staffed by ABX were closed, the sort operations in Wilmington, Ohio were downsized to process only international shipments and all of ABX's DC-9 aircraft were terminated from the DHL ACMI agreement. In March 2009, DHL gave ABX notice to remove five Pratt & Whitney powered Boeing 767 aircraft having a net book value of approximately \$24.0 million, from the DHL network. Further, on April 17, 2009, DHL announced that it planned to relocate its package sorting and aircraft hub operations from the DHL Air Park in Wilmington, Ohio to the Cincinnati/Northern Kentucky International Airport in Hebron, Kentucky (CVG). On May 12, 2009, DHL notified ABX that DHL will not renew the Hub Services agreement when its term expires on August 15, 2009. On July 24, 2009, sort operations in Wilmington were terminated and the sorting and hub operations were transferred to CVG. ABX is assisting DHL with the transition from Wilmington to CVG and will provide staffing for the CVG operations through August 2009. ABX estimates it will terminate approximately 1,000 employees after the DHL transition to CVG is complete in the third quarter.

Revenues from the Hub Services agreement were \$37.0 million and \$98.8 million for the second quarter and first six months of 2009; respectively. Pre-tax earnings from the Hub Services agreement were \$2.0 million, or 17% of consolidated pre-tax earnings, for the second quarter of 2009 and \$6.6 million, or 22% of consolidated pre-tax earnings, for the first six months of 2009. In conjunction with the transfer of the aircraft hub operations to CVG in July 2009, ABX is no longer providing aircraft fuel for its aircraft that remain in the DHL network. Revenues from fuel were \$11.6 million and \$26.7 million for the second quarter and first six months of 2009, respectively. ABX did not earn a mark-up on fuel used within the DHL network.

ABX currently remains the primary provider of airlift capacity for DHL's U.S. based international delivery network through its fleet of Boeing 767 aircraft. In addition to Boeing 767 aircraft provided under the primary ACMI agreement, ABX is also supplying DHL with five Boeing 767 standard freighters under supplemental, short-term, ACMI arrangements. In June 2009, ABX and DHL entered into a lease option agreement for four ABX Boeing 767 standard freighter aircraft under 64.5 month lease terms, commencing August 15, 2010. Additionally, ABX and DHL are discussing long-term leases for eight to ten of ABX's Boeing 767 aircraft as they are converted to standard freighter configuration.

On August 7, 2009, DHL notified ABX that DHL will not renew the ACMI agreement when its initial term expires on August 15, 2010. DHL has expressed its interest to contract with the Company for aircraft dry lease and aircraft operations under competitive, commercial terms after the current ACMI agreement expires in 2010. DHL's decision to terminate the ACMI agreement in 2010, adds impetus to management's strategy of modifying ABX's Boeing 767 aircraft into standard freighter configuration. Interest in efficient, reliable Boeing 767 aircraft remains strong. As the modified Boeing 767 aircraft become available for service, management anticipates that some portion of them will be leased to other airlines, while some may be operated by an ATSG airline. Management will make the decision to redeploy each modified aircraft either into airline operations or into leasing arrangements, depending on which alternative will generate the higher return on capital.

The ACMI agreement grants ABX certain rights to put to DHL any aircraft that is removed from service. The Company can sell such aircraft to DHL at the lesser of fair market value or net book value. The decision to put aircraft to DHL depends on a number of factors, including the anticipated number of aircraft to be removed, the type of aircraft removed, the demand for cargo airlift and the market value for aircraft. Provisions of the ACMI agreement stipulate that if ABX's stand-alone equity is less than or equal to \$100 million at the time of the put to DHL, any amount by which fair market value is less than net book value would be applied to the promissory note owed to DHL. However, if ABX's stand-alone equity is greater than \$100 million, as it is at this time, any amount by which the fair market value is less than net book value would be recorded as an impairment charge. For purposes of applying the \$100 million stockholders' equity threshold, stockholders' equity will be calculated after including the effect of any charges caused by the removal of aircraft.

The S&R agreement includes provisions to pay ABX for crewmember benefits if ABX and the collective bargaining unit for the crewmembers can reach an agreement in regards to the use of those funds for severance, retention and/or other issues arising from DHL's U.S. restructuring plan. ABX continues to negotiate with the collective bargaining unit.

Table of Contents

Through June 30, 2009, ABX has terminated the employment of approximately 8,000 people since DHL's restructuring began in mid-2008. During the second quarter and first six months of 2009, hours paid to employees declined approximately 72% and 66%, respectively, compared to the corresponding periods of 2008, primarily due to DHL's restructuring plans. Employees receive severance, retention and other benefits under a severance and retention agreement (S&R agreement) executed between ABX and DHL. The S&R agreement specifies employee severance, retention and other benefits that DHL will pay to ABX in conjunction with its U.S. restructuring plan.

Our pre-tax earnings from the DHL segment increased by \$4.7 million and \$13.4 million in the second quarter and for the first six months of 2009 compared to the corresponding periods of 2008. Our pre-tax earnings from the DHL segment includes approximately \$5.7 million and \$11.2 million of mark-up above our cost for the second quarter and for the first six month of 2009 compared to approximately \$3.6 million and \$7.5 million of mark-up above our costs for the corresponding periods of 2008. Our pre-tax earnings from the DHL segment for the first six months of 2009 also includes \$7.1 million for the reimbursement of employee vacation benefits that ABX paid to terminated employees. ABX is reimbursed employee severance, retention, vacation and other benefits under the S&R agreement that ABX and DHL executed in 2008 to facilitate the restructuring and wind-down of DHL's U.S. operations. The comparison of our 2009 pre-tax earnings to 2008 is positively impacted by a charge recorded in the second quarter of 2008 to reserve \$2.2 million of DHL revenues related to a dispute over arbitration expenses. This matter was resolved favorably later in 2008.

The increase in incremental revenues in 2009 reflects amendments to our ACMI and Hub services agreement with DHL. ABX and DHL amended the pricing provisions of the ACMI and Hub Services agreements (revenue amendments) which effectively fixed ABX's pre-tax earnings for the DHL agreements for the first and second quarters of 2009. Prior to the revenue amendments, expenses incurred under the commercial agreements were generally marked-up by 1.75% and included in revenues. Both agreements also allowed ABX to earn incremental revenues calculated on mark-ups above the 1.75% base mark-up (up to an additional 1.60% under the ACMI agreement and an additional 2.10% under the Hub Services agreement) from the achievement of certain cost-related and service goals specified in the two agreements. Under the revenue amendments, annual goals were not set for 2009, nor was a quarterly cost goal. Instead, the agreed revenue for the first and second quarters of 2009 includes amounts to replace these incremental revenues. The Company's revenues for the first and second quarters of 2009 include reimbursement for all expenses incurred under the commercial agreements, as well as, all of the incremental revenues set by the revenue amendments. ABX and DHL are currently discussing revenue mark-up revenue arrangements for the third quarter of 2009 and through the remaining term of the ACMI agreement which expires in August 2010.

The S&R agreement specifies employee severance, retention and other benefits that DHL reimburses to ABX for payments to its employees that are affected by DHL's U.S. restructuring plan. ABX revenues and expenses for the second quarter and first six months of 2009 include \$28.7 million and \$58.5 million for severance and retention benefits incurred under the S&R agreement. Additionally, under the S&R agreement, DHL is required to reimburse ABX for employee vacation benefits that ABX pays to terminated employees.

Through June 30, 2009, ABX has paid terminating employees approximately \$15.1 million for accrued vacation benefits since DHL's restructuring began in mid-2008. DHL is obligated to reimburse ABX for the amounts it paid to its terminating employees for their accrued vacation benefits. In March 2009, after auditing ABX's payments to terminating employees for vacation, DHL paid ABX \$3.2 million for invoices specifically for 2008 vacation reimbursement. As of June 30, 2009, accounts receivable includes approximately \$7.1 million due from DHL for the reimbursement of accrued vacation benefits that ABX paid as employees were terminated in the first quarter of 2009. In late May 2009, DHL expressed to the Company that it believes it may not be obligated to reimburse ABX for any of the vacation benefits. The Company's financial results do not reflect the recognition of \$4.8 million for reimbursement that is due to ABX for vacation payments made in the second quarter of 2009 because the revenue recognition requirements under U.S. generally accepted accounting principles (GAAP) were not met. After reevaluating DHL's contractual obligations, management believes that ABX will fully recover the \$7.1 million paid in the first quarter of 2009 and expects to recognize the reimbursement for the second quarter payments after reimbursement from DHL becomes assured through further discussions or legal action, if necessary.

ACMI Services

ACMI Services revenues, excluding reimbursed expenses, were \$67.7 million and \$137.7 million for the second quarter and first six months of 2009, decreasing 1% and increasing 5% compared to the corresponding periods of 2008. Block hours increased 9% and 8% for the second quarter and first six months of 2009, respectively. At June 30, 2009, ACMI Services included 46 in-service aircraft, five more than in March 2008. The increase in revenues trailed increased block hours due to lower fuel prices for those ACMI and charter contracts that include fuel. ACMI Services results included revenues of \$6.1 million from Boeing 767 freighter aircraft that ABX supplied to DHL during the first six months of 2009 under short-term supplemental agreements.

Table of Contents

Increased block hours contributed to improved pre-tax earnings. Pre-tax earnings for the ACMI Services segment increased \$1.2 million and \$2.0 million for the second quarter and first six months of 2009 as compared to the corresponding 2008 periods. Our 2009 results for ACMI Services were negatively impacted by lower than expected cargo volumes for a transatlantic scheduled service ABX commenced in January 2009. Additionally, the cost of ABX flight crews were high during 2009 due to scheduling changes caused when senior DC-9 flight crew members were retrained for the Boeing 767. ABX, which expenses aircraft maintenance as its incurred, completed four scheduled maintenance checks during the first six months of 2009, compared to two during the same period in 2008. During the second quarter of 2008, ATI and CCIA incurred approximately \$1.1 million of expenses (excluding inter-company lease charges of \$1.4 million from CAM) while completing the FAA certification process to add aircraft types to their respective operating certificates. ATI added the Boeing 767 to its operating certificate while CCIA added the Boeing 757.

CAM Segment

Segment earnings for CAM were \$5.8 million and \$10.6 million for the second quarter and first six months of 2009 compared to \$4.8 million and \$9.2 million for the corresponding 2008 periods. CAM has placed ten aircraft under lease since March 2008, four of them to external customers. CAM's results reflect an allocation of interest expense based on prevailing interest rates and the carrying value of its operating assets. CAM's three and six month period ended June 30, 2009 revenues include \$12.2 million and \$23.2 million for the leasing of aircraft to ATI, CCIA and ABX. During the first six months of 2009, CAM leased three additional aircraft to ATSG airlines. During the second quarter of 2009 CAM leased two additional Boeing 767 aircraft to external customers. At June 30, 2009, CAM had 35 cargo aircraft that were under lease to subsidiaries of the Company and four aircraft under lease to an external customer.

In February 2009, CAM finalized a lease agreement to provide Boeing 767 aircraft to a Miami, Florida based operator. The lease agreement, which is for two aircraft, is expected to begin in the fourth quarter of 2009 and includes the option to lease up to three more Boeing 767 aircraft. In the second quarter of 2009, CAM began to lease a Boeing 767 to a Canadian carrier under a three-year term and its sole passenger aircraft under a 20 month term.

CAM has an agreement with Israel Aerospace Industries Ltd. (IAI) for the conversion of up to 14 non-standard Boeing 767 aircraft to full freighter configuration. Two Boeing 767 aircraft were undergoing freighter modification as of June 30, 2009, and a third aircraft began modification during July 2009. We expect CAM to add more Boeing 767 aircraft to its fleet over the next two years. ATSG plans to modify up to 11 Boeing 767 aircraft that are currently under contract to DHL under the ACMI agreement to a standard freighter configuration as the aircraft are removed from the DHL network. The conversion primarily consists of the installation of a standard cargo door and loading system replacing the passenger door and loading system currently in the aircraft.

Other Activities

Revenues from all other activities increased \$3.6 million and \$6.0 million in the second quarter and first six months of 2009 compared to the corresponding 2008 periods. Increased revenues were primarily a result of an increase in aircraft parts sales and maintenance services when compared to 2008. Most of this increase was from the inter-company aircraft part sales and maintenance services within the ATSG companies. Pre-tax earnings from all other activities were \$2.1 million and \$2.8 million in the second quarter and first six months of 2009 compared to a \$2.5 million loss and a \$2.0 million loss in the corresponding 2008 periods. Improved earnings reflected the sale of surplus aircraft and aircraft parts in 2009. Additionally, our pre-tax loss for the second quarter of 2008 included a one-time charge of \$2.5 million stemming from an arbitration ruling in 2008. Internal sales and earnings were eliminated from the consolidated results.

In May 2009, the aircraft maintenance and engineering business operations of ABX were transferred to a newly formed ATSG subsidiary, Airborne Maintenance and Engineering Services, Inc. (AMES). Organizing the aircraft maintenance and engineering capabilities separately from ABX will facilitate a cost structure and marketing organization which can better compete in the aircraft maintenance industry. AMES operates as a Federal Aviation Administration (FAA) certificated 145 repair station, utilizing the Wilmington, Ohio facilities including hangars and a component shop leased by ABX from DHL. ABX is AMES's primary customer at this time. AMES leverages the Company's existing engineering skills and technical experience to perform airframe maintenance, component repairs, part sales, line maintenance and avionics modifications for other ATSG airlines as well as external customers.

Table of Contents

A summary of our revenues and segment earnings is shown below (in thousands):

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Revenues:				
DHL				
ACMI				
Reimbursed Expenses	\$ 78,289	\$ 209,535	\$ 176,499	\$ 408,114
Mark-ups	3,616	2,486	7,232	5,012
Reimbursable wind-down payments	19,992		39,204	
Total ACMI	101,897	212,021	222,935	413,126
Hub Services				
Reimbursed Expenses	23,725	69,422	61,975	147,753
Mark-ups	1,994	1,097	3,989	2,478
Reimbursable wind-down payments	11,285		32,876	
Total Hub Services	37,004	70,519	98,840	150,231
Reimbursement reserve		(2,205)		(2,205)
Total DHL	138,901	280,335	321,775	561,152
ACMI Services				
Charter and ACMI	67,888	68,142	137,809	131,257
Other Reimbursable	16,746	38,569	32,859	68,747
Total ACMI Services	84,634	106,711	170,668	200,004
CAM	14,652	11,621	27,669	21,713
Other Activities	12,996	9,404	23,998	17,953
Total Revenues	251,183	408,071	544,110	800,822
Eliminate internal revenues	(16,076)	(13,211)	(28,451)	(23,906)
Customer Revenues	\$ 235,107	\$ 394,860	\$ 515,659	\$ 776,916
Pre-tax Earnings:				
DHL				
ACMI				
ACMI	\$ 3,741	\$ 864	\$ 11,847	\$ 3,395
Hub Services	2,000	221	6,575	1,651
Total DHL	5,741	1,085	18,422	5,046
ACMI Services	558	(773)	2,428	316
CAM	5,831	4,847	10,581	9,166
Other Activities	2,093	(2,452)	2,799	(2,022)
Net non-reimbursed interest income (expense)	(2,350)	(2,836)	(4,591)	(6,428)
Total Pre-tax Earnings	\$ 11,873	\$ (129)	\$ 29,639	\$ 6,078

Note: DHL revenues for 2009 reflect amendments to the ACMI and Hub Services agreements and the adoption of a Severance and Retention agreement between ABX and DHL. The purpose of these changes was to facilitate the wind-down and restructuring of DHL's U.S. operations. The wind-down revenues include revenues to manage the termination of employees and support the scale-down of DHL's U.S. operations.

Table of Contents

RESULTS OF OPERATIONS

Net earnings increased \$8.6 million and \$15.9 million for the second quarter and first six months of 2009 compared to the corresponding periods of 2008. Net earnings improved on increased mark-up revenues from ABX's DHL agreements. Due to contractual amendments stemming from DHL's restructuring plans, revenues for the first and second quarter of 2009 included additional amounts in lieu of annual incremental revenues that ABX historically recorded only in the fourth quarter of each year. Additionally, 2009 revenues included additional amounts specified by the S&R agreement to facilitate the wind-down of DHL's U.S. network. Operating results for the second quarter of 2008 included one-time charges totaling \$4.7 million stemming from an arbitration ruling in July 2008. Net earnings for the second quarter and first six months of 2009 also improved due to lower interest expense, additional aircraft under lease to external customers, and increased block hours for ACMI Services compared to the corresponding periods of 2008.

Salaries, wages and benefits expense decreased 20% and 17% during the three and six month periods ended June 30, 2008, respectively, compared to the corresponding periods of 2008. Due primarily to the DHL restructuring, ABX headcount declined approximately 68% as of June 30, 2009 compared to June 30, 2008.

Fuel expense decreased \$115.7 million and \$195.9 million during the three and six month periods ended June 30, 2009, respectively, compared to the corresponding periods of 2008. The decrease reflects the reduction in aircraft in service for DHL. In addition, the average price of aviation fuel decreased significantly compared to the second quarter of 2008. The average price of a gallon of aviation fuel decreased 55% in the second quarter of 2009 compared to the second quarter of 2008.

Maintenance, materials and repairs decreased \$12.5 million and \$18.4 million during the three and six month periods ended June 30, 2009, respectively, compared to the corresponding periods of 2008. The decrease is a result of DHL's removal of aircraft from service in conjunction with its U.S. restructuring plans.

Depreciation and amortization expense decreased \$1.8 million and \$1.3 million during the three and six month periods ended June 30, 2009, respectively, compared to the corresponding periods of 2008. Depreciation expense decreased due to the removal of the ABX DC-9 fleet since DHL's restructuring announcement in May 2008. The depreciation expense for 2009 reflects the addition of two Boeing 757 aircraft and three Boeing 767 aircraft that the Company has placed in service since March 2008.

Landing and ramp expense, which includes the cost of deicing chemicals, decreased \$2.0 million and \$4.2 million during the three and six month periods ended June 30, 2009, respectively, compared to the corresponding periods of 2008. The decrease is a result of DHL's removal of aircraft from service in conjunction with its U.S. restructuring plans.

Travel expense decreased \$3.5 million and \$5.5 million during the three and six month periods ended June 30, 2009, respectively, compared to the corresponding periods of 2008. The decrease is a result of DHL's removal of aircraft from service, and the resulting decline in required flight crew travel, in conjunction with its U.S. restructuring plans.

Insurance increased \$0.3 million and \$0.5 million during the three and six month periods ended June 30, 2009, respectively, compared to the corresponding periods of 2008. The increase is a result of placing additional freighter aircraft into service since March 2008.

Other operating expenses include professional fees, utilities, costs of parts sold to non-DHL customers and packaging supplies. Other operating expenses decreased \$5.3 million and \$5.6 million during the three and six month periods ended June 30, 2009, respectively, compared to the corresponding periods of 2008. During the second quarter of 2008, the Company recorded a charge of \$2.5 million for professional fees stemming from an arbitration matter. DHL's removal of aircraft from service in conjunction with its U.S. restructuring plans in 2009 also resulted in lower expenses.

Interest expense decreased \$1.5 million and \$4.3 million during the three and six month periods ended June 30, 2009, respectively, compared to the corresponding periods of 2008. The decline in interest expense reflects the reduction in the Company's debt since December 2007. Additionally, interest rates on the Company's variable interest debt declined. The variable interest rate on the unsubordinated term loan decreased from 5.4% in the second quarter of 2008 to 3.2% for the second quarter of 2009.

Interest income decreased \$0.4 million and \$1.2 million during the three and six month periods ended June 30, 2009, respectively, compared to the corresponding periods of 2008 due to lower short-term interest rates on our cash and cash equivalents.

Table of Contents

Our effective tax rate for the three and six month periods ended June 30, 2009 was 31.7% and 35.2%, respectively, compared to (308.2%) and 46.3% for the corresponding periods in 2008. Income taxes recorded through June 30, 2009 have been estimated based on year-to-date income and projected results for the full year, excluding discrete items. Our effective tax rate declined in the first half of 2009 compared to 2008 due to the effect of non-deductible items on the higher amounts of earnings in 2009. Our tax expense for the first half of 2009 includes \$1.5 million currently payable for U.S. alternative minimum tax primarily related to the extinguishment of \$46.3 million of debt in March 2009. The Company recorded a deferred tax benefit in the second quarter of 2009 related to the recognition of a previously unrecognized tax position under FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48). The effective settlement of this item resulted in a deferred tax benefit of \$0.7 million. No additional changes to the FIN 48 unrecognized tax benefits are anticipated in the next twelve months.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES***Commitments***

Through CAM, we have contracted with aircraft maintenance and modification provider, IAI, to convert some of our Boeing 767 aircraft from passenger door loading systems to standard freighter configuration. The Company had two Boeing 767 aircraft in the modification process from passenger to a standard freighter configuration as of June 30, 2009 and a third non-standard aircraft began modification during July 2009. Based on the most current projections, we expect to place two of these aircraft into service during the third quarter of 2009 and one in the fourth quarter of 2009 as modifications are completed. We have the rights to convert up to eleven more Boeing 767 aircraft at IAI. We plan to finance the cost of modifying aircraft with existing cash, cash generated from aircraft sold to DHL under existing put options and cash generated from operations during the modification period. If CAM were to cancel the conversion program as of June 30, 2009, it would owe IAI, in addition to payments for aircraft currently undergoing modification, approximately \$3.9 million for non-recurring engineering costs and approximately \$4.9 million associated with additional conversion part kits which have been ordered. Additionally, the Company is committed to purchase another Boeing 767 for approximately \$23.0 million after the aircraft is completely modified to freighter configuration, which we anticipate in 2009.

On March 16, 2009, ABX and DHL reached a binding agreement to amend the unsecured DHL promissory note. On May 8, 2009 the DHL promissory note was formally amended. The Company agreed to pay DHL \$15.0 million of the principal balance, while DHL agreed to extinguish an additional \$46.3 million of principal balance. We expect to pay the \$15 million from the proceeds of aircraft puts. Accordingly the Company's balance sheet as of June 30, 2009 reflects \$15.0 million of the promissory note as a current liability. The due date for the remaining \$31.0 million remains unchanged, August 2028. Until that time, the promissory note continues to bear interest at a rate of 5% per annum and DHL will continue to reimburse ABX the interest expense from the note at least through 2012.

ABX has an agreement with DHL to provide employee severance benefits, retention payments and vacation payouts to ABX employees that are affected by DHL's restructuring plans. The agreement calls for DHL to reimburse ABX after ABX makes the related benefit payments. During the third quarter of 2009, we expect to make significant payments for employee severance, retention and vacation payouts. Scheduled payments for employee severance, including medical coverage, retention and vacation are projected to total \$52.2 million during the third quarter of 2009.

We plan to contribute at least \$26.8 million to our qualified pension plans during the second half of 2009, and make total contributions to our qualified defined benefit pension plans of \$46.2 million for 2009.

Cash flows

Net cash generated from operating activities was \$43.7 million for the first six months of 2009 compared to \$73.0 million in the first six months of 2008. The decrease in operating cash flows were primarily driven by the liquidation of vendor payables and payments for employee wages, severance and benefits. As ABX's operations for DHL were scaled back, cash in-flows from the operations declined.

Capital spending levels are primarily a result of aircraft acquisitions and related freighter modification costs. Cash payments for capital expenditures were \$31.4 million in the first six months of 2009 compared to \$54.0 million in the first six months of 2008. Capital expenditures in the first six months of 2009 included aircraft and cargo modification costs for three aircraft while capital expenditures in the first six months of 2008 included aircraft and cargo modification costs for eight aircraft. We estimate the total level of capital spending for all of 2009 will be approximately \$109 million compared to \$112 million in 2008.

Table of Contents

Liquidity and Capital Resources

At June 30, 2009, the Company had approximately \$112.1 million of cash balances. The Company had \$39.5 million of unused credit facility, net of draws of \$18.5 million and outstanding letters of credit of \$17.0 million, through a syndicated Credit Agreement that expires in December 2012.

As of June 30, 2009, DHL owes the Company \$58.6 million. Additionally, ABX has \$31.3 million of aircraft that are in the process of being sold to DHL. Conversely, the Company has significant liabilities and commitments stemming from the wind-down of DHL's operations including employee severance, retention and benefits. DHL is currently disputing some of the amounts it owes to ABX for the reimbursement of vacation payout and the sale price of the aircraft (see Note B). If there is a significant delay in receipts from DHL, or a substantial reduction in the amounts that DHL ultimately pays, the Company's cash balances could decline. If this occurs, the Company could elect to reduce capital spending by deferring the freighter modification of 767 aircraft.

In June 2009, the Company and DHL executed a Lease Assumption and Option Agreement related to Boeing 767 aircraft leases. DHL has the option to lease from ABX up to four Boeing 767 aircraft under 64.5 month lease terms, commencing August 15, 2010. DHL assumed all of ABX's financial obligations for five other Boeing 767 aircraft under capital leases, retroactive to January 31, 2009. In return, ABX granted DHL a credit of \$10.0 million as prepaid rent toward the four aircraft leases, conditioned upon extinguishment or assignment of the capital leases to DHL. DHL has until February 15, 2010 to exercise the lease option on each aircraft. If DHL does not exercise its lease option for an aircraft, ABX will pay DHL \$2.5 million of the prepaid rent credit.

Through its Credit Agreement, the Company has a syndicated, unsubordinated term loan and a revolving credit facility that are collateralized by substantially all the aircraft, property and equipment owned by the Company that are not separately collateralized under aircraft loans or capital leases. The lenders currently consist of 16 U.S. based banks. Under the Credit Agreement, the Company is subject to expenses, covenants and warranties that are usual and customary. The Credit Agreement contains covenants including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness, and the level of annual capital expenditures. The Credit Agreement stipulates events of default including unspecified events that may have material adverse effects on the Company. The conditions of the Credit Agreement and the aircraft loans cross-default.

The implementation by DHL of its U.S. restructuring plan, turmoil in the global financial markets and the crisis in the U.S. credit market could affect the Company's access to liquidity. If a lender within the Credit Agreement declares a material adverse event (MAE), availability under the revolving credit facility will be reduced by that lender's portion of the facility. Further, the Credit Agreement provides that if lenders having more than half of the outstanding dollar amount of the commitments assert that an MAE exists at the time the borrowers attempt to borrow under the Credit Facility, they can assert that an event of default exists under the Credit Agreement and require the lead bank to exercise its remedies. If an event of default occurs, the Company may be forced to repay, renegotiate or replace the Credit Agreement. Given the current credit crisis and DHL's U.S. restructuring plan, the interest rates and other costs of a renegotiated or new facility, assuming the Company could obtain a new facility, would be more expensive and may require more rapid amortization of principal than under the terms of the current Credit Agreement. The Company is in compliance with the financial covenants specified in the Credit Agreement.

Table of Contents**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as certain disclosures included elsewhere in this report, are based upon our consolidated 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 us to select appropriate accounting policies and make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingencies. In certain cases, there are alternative policies or estimation techniques which could be selected. On an ongoing basis, we evaluate our selection of policies and the estimation techniques we use, including those related to revenue recognition, post-retirement liabilities, bad debts, self-insurance reserves, accruals for labor contract settlements, valuation of spare parts inventory, useful lives, salvage values and impairment of property and equipment, income taxes, contingencies and litigation. We base our estimates on historical experience, current conditions and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources, as well as for identifying and assessing our accounting treatment with respect to commitments and contingencies. Actual results may differ from these estimates under different assumptions or conditions. We believe the following significant and critical accounting policies involve the more significant judgments and estimates used in preparing the consolidated financial statements.

Revenue Recognition

Through September 30, 2008, revenues from DHL were determined based on expenses incurred during a period under the two commercial agreements with DHL and were recognized when the related services are performed. Expenses incurred under these agreements were generally subject to a base mark-up of 1.75%, which is recognized in the period the expenses are incurred. Certain costs, the most significant of which include fuel, interest on the promissory note due to DHL, rent and ramp and landing fees incurred under the two commercial agreements are reimbursed and included in revenues without mark-up.

Both agreements also allow ABX to earn incremental mark-up above the base 1.75% mark-up (up to 1.60% under the ACMI agreement, and 2.10% under the Hub Services agreement) as determined from the achievement of certain cost-related and service goals outlined in the two commercial agreements. The agreements stipulate the setting of quarterly and annual cost-related goals and annual service goals expressly specified in each of the two agreements. We measure quarterly goals and record incremental revenues in the quarter in which earned. Historically, at the end of each fiscal year, we measure the achievement of annual goals and record any incremental revenues earned by achieving the annual goals during the fourth quarter.

ABX and DHL amended the ACMI agreement and the Hub Services agreement to set the base mark-up and incremental mark-up to specific amounts for the first and second quarters of 2009. Under these revenue amendments, annual goals were not set for 2009, nor was a quarterly cost goal established. Instead, the agreed revenue for the first and second quarter of 2009 includes fixed amounts to replace these incremental revenues. In 2008, ABX and DHL executed a severance and retention agreement (S&R agreement) which specifies employee severance, retention and other benefits that DHL reimburses ABX for payment to its employees that are affected by DHL's U.S. restructuring plan. DHL reimburses ABX for the cost of employee severance, retention, productivity bonuses and vacation benefits paid in accordance with the agreement. The Company's revenues for the first and second quarter of 2009 includes reimbursement for expenses incurred under the commercial agreements, the incremental revenues set by the revenue amendments and reimbursement for employee severance, retention and other benefits incurred during the quarters for employees terminated as a result of DHL's restructuring plan.

ACMI revenues with customers other than DHL are typically recognized based on hours flown or the amount of aircraft and crew resources provided during a reporting period. Charter service revenues are recognized on scheduled and non-scheduled flights when the specific flight has been completed. Aircraft parts and fuel sales are recognized when the parts and fuel are delivered. Revenues earned and expenses incurred in providing aircraft-related maintenance repair services or technical maintenance services are recognized in the period in which the services are completed and delivered to the customer. Revenues derived from transporting freight and sorting parcels are recognized upon delivery of shipments and completion of service.

Goodwill and Intangible Assets

In accordance with Statement of Financial Accounting Standard (SFAS) No. 142, Accounting for Goodwill and Other Intangible Assets, we will assess on an annual basis whether goodwill acquired in the acquisition of CHI is impaired. Additional impairment assessments may be performed on an interim basis if we find it necessary. Finite-lived intangible assets are amortized over their estimated useful economic lives and are periodically reviewed for impairment. Indefinite-lived intangible assets are not amortized but are assessed for impairment annually.

Table of Contents

Depreciation

Depreciation of property and equipment is provided on a straight-line basis over the lesser of the asset's useful life or lease term. We periodically evaluate the estimated service lives and residual values used to depreciate our property and equipment. The acceleration of depreciation expense or the recording of significant impairment losses could result from changes in the estimated useful lives of our assets. We may change the estimated useful lives due to a number of reasons, such as the existence of excess capacity in our air system or ground networks or changes in regulations grounding or limiting the use of aircraft.

Self-Insurance

We self-insure certain claims relating to workers compensation, aircraft, automobile, general liability and employee healthcare. We record a liability for reported claims and an estimate for incurred claims that have not yet been reported. Accruals for these claims are estimated utilizing historical paid claims data, recent claims trends and, in the case of employee healthcare and workers compensation, an independent actuarial evaluation. Changes in claim severity and frequency could result in actual claims being materially different than the costs provided for in our results of operations. We maintain excess claim coverage with common insurance carriers to mitigate our exposure to large claim losses.

Contingencies

We are involved in legal matters that have a degree of uncertainty associated with them. We continually assess the likely outcomes of these matters and the adequacy of amounts, if any, provided for these matters. There can be no assurance that the ultimate outcome of these matters will not differ materially from our assessment of them. There also can be no assurance that we know all matters that may be brought against us at any point in time.

Income Taxes

We account for income taxes under the provisions of SFAS No. 109, Accounting for Income Taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Fluctuations in the actual outcome of expected future tax consequences could materially impact the Company's financial position or its results of operations.

The Company has significant deferred tax assets including net operating loss carryforwards (NOL CFs) for federal income tax purposes which begin to expire in 2023. Based upon projections of taxable income, we determined that it was more likely than not that all the net deferred tax assets, including the NOL CF's will be realized prior to their expiration. Accordingly, we do not have an allowance against deferred tax assets at this time.

We recognize the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position.

Post-retirement Obligations

ABX sponsors qualified defined benefit plans for its pilots and other eligible employees. ABX also sponsors unfunded post-retirement healthcare plans for its flight crewmembers and non-flight crewmember employees. ABX also sponsors unfunded excess plans for certain employees in a non-qualified plan, which includes its executive management, that provide benefits in addition to amounts permitted to be paid under provisions of the tax law to participants in its qualified plans.

The accounting and valuation for these post-retirement obligations are determined by prescribed accounting and actuarial methods that consider a number of assumptions and estimates. The selection of appropriate assumptions and estimates is significant due to the long time period over which benefits will be accrued and paid. The long-term nature of these benefit payouts increases the sensitivity of certain estimates on our post-retirement costs. In actuarially valuing our pension obligations and determining related expense amounts, assumptions we consider most sensitive are discount rates, expected long-term investment returns on plan assets and future salary increases. Additionally, other assumptions concerning retirement ages, mortality and employee turnover also affect the valuations. For our post-retirement healthcare plans, consideration of future medical cost trend rates is a critical assumption in valuing these obligations. Actual results and future changes in these assumptions could result in future costs significantly higher than those recorded in our results of operations.

Table of Contents

Exit Activities

We account for the costs associated with exit activities in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. One-time, involuntary employee termination benefits are generally expensed when the Company communicates the benefit arrangement to the employee that it will no longer require the services of the employee beyond a minimum retention period. Liabilities for contract termination costs associated with exit activities are recognized in the period incurred and measured initially at fair value. Pension obligations are accounted for in accordance with SFAS No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits* in the event that the expected working life of employees is significantly reduced due to terminations or a pension plan is suspended.

Recent Accounting Pronouncements

See Note A to our Financial Statements for a discussion of new accounting pronouncements

Item 3. Quantitative and Qualitative Disclosures about Market Risk

In the ordinary course of our business, we are exposed to market risk for changes in the price of jet fuel; however, this risk is largely mitigated by reimbursement through the DHL ACMI agreement and charter agreements with other customers. We face financial exposure to changes in interest rates. Variable interest rate debt exposes us to differences in future cash flows resulting from changes in market interest rates. This risk was partially mitigated since a portion of our interest expense for the debt with variable rate risk was marked up and charged to DHL under our ACMI agreement. To reduce the exposure to rising interest rates, we entered into interest rate swaps in January 2008 and forward treasury lock agreements (*treasury locks*) during 2006. See Note J for discussion of our accounting treatment for these hedging transactions.

No significant changes have occurred to the market risks we face since we disclosed information about those risks in item 7A of the Company's 2008 Annual Report on Form 10-K filed for the year ended December 31, 2008.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

As of June 30, 2009, the Company carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the *Exchange Act*)). Based upon the evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that their disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports filed or submitted by it under the Exchange Act is recorded, processed, summarized and reported within time periods specified in the Securities and Exchange Commission rules and forms.

(b) Changes in Internal Controls

There were no changes in internal control over financial reporting during the most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Department of Transportation (DOT) Continuing Fitness Review

ABX filed a notice of substantial change with the DOT arising from its separation from Airborne, Inc. In connection with the filing, which was initially made in mid-July of 2003 and updated in April of 2005 and again in September of 2007, the DOT will determine whether ABX continues to be a U.S. citizen and fit, willing and able to engage in air transportation of cargo.

Under U.S. laws and DOT precedents, non-U.S. citizens may not own more than 25% of voting equity, or have actual control of, a U.S. certificated air carrier. The DOT may determine that DHL actually controls ABX as a result of its commercial arrangements (in particular, the ACMI agreement and Hub Services agreement) with DHL. If the DOT determines that ABX is controlled by DHL, the DOT could require amendments or modifications of the ACMI and/or other agreements between ABX and DHL. If ABX were unable to modify such agreements to the satisfaction of the DOT, the DOT could seek to suspend, modify or revoke ABX's air carrier certificates and/or authorities, and this would materially and adversely affect the business.

The DOT has yet to specify the procedures it intends to use in processing ABX's filing.

Alleged Violations of Immigration Laws

ABX reported in January of 2005 that it was cooperating fully with an investigation by the U.S. Department of Justice (DOJ) with respect to Garcia Labor Co., Inc., (Garcia) a temporary employment agency based in Morristown, Tennessee, and ABX's use of contract employees that were being supplied to it by Garcia. The investigation concerns the immigration status of the Garcia employees assigned to ABX.

ABX terminated its contract with Garcia in February of 2005 and replaced the Garcia employees.

In October of 2005, the DOJ notified ABX that ABX and a few Company employees in its human resources department, in addition to Garcia, were targets of a criminal investigation. ABX cooperated fully with the investigation. In June of 2006, a non-senior management employee of the Company entered a plea to a misdemeanor related to this matter. In July of 2006, a federal grand jury indictment was unsealed charging two Garcia companies, the president of Garcia and two of their corporate officers with numerous counts involving the violation of federal immigration laws. The Garcia defendants subsequently entered guilty pleas in U.S. district court and were sentenced in February and March of 2007. No proceedings have been initiated against ABX by the DOJ. See Note H to the accompanying consolidated financial statements of this report for additional information.

On December 31, 2008, a former ABX employee filed a complaint against ABX, a total of four current and former executives and managers of ABX, Garcia Labor Company of Ohio, and three former executives of the Garcia Labor companies, in the U.S. District Court for the Southern District of Ohio. The case was filed as a putative class action against the defendants, and asserts violations of the Racketeer Influenced and Corrupt Practices Act (RICO). The complaint, which seeks damages in an unspecified amount, alleges that the defendants engaged in a scheme to hire illegal immigrant workers to depress the wages paid to hourly wage employees during the period from December 1999 to January 2005. On January 23, 2009, ABX and the four current and former executives and managers of ABX filed an answer denying the allegations contained in the complaint. On July 24, 2009, ABX and the current and former executives of ABX filed a motion to dismiss the complaint; which motion is currently pending.

The complaint is similar to a prior complaint filed by another former employee in April 2007. The prior complaint was subsequently dismissed without prejudice at the plaintiff's request on November 3, 2008.

Other

In addition to the foregoing matters, we are also currently a party to legal proceedings in various federal and state jurisdictions arising out of the operation of our business. The amount of alleged liability, if any, from these proceedings cannot be determined with certainty; however, we believe that our ultimate liability, if any, arising from the pending legal proceedings, as well as from asserted legal claims and known potential legal claims which are probable of assertion, taking into account established accruals for estimated liabilities, should not be material to our financial condition or results of operations.

Table of Contents**Item 1A. Risk Factors**

The Company faces risk factors that could adversely affect our financial condition and results of operations. Many of these risks are disclosed in item 1A of the Company's 2008 Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 23, 2009.

Additional significant risks have been identified below. There are additional risks that are currently unknown to us or that we currently consider immaterial or unlikely, which could also adversely affect the Company.

The wind-down of ABX's services for DHL may negatively impact the Company's liquidity and operating results.

As of June 30, 2009, DHL owes the Company \$58.6 million. Additionally, ABX has \$31.3 million of aircraft that are in the process of being sold to DHL pursuant to the put provisions under the ACMI agreement. Conversely, the Company has significant liabilities and commitments stemming from the wind-down of DHL's operations including employee severance retention and benefits. DHL is currently disputing some of the amounts it owes to ABX for the reimbursement of vacation payouts and the sale price of aircraft. If there is a significant delay in receipts from DHL, or a substantial reduction in the amounts that DHL pays, the Company's cash balances could decline. If this occurs, the Company could elect to reduce capital spending by deferring the freighter modification of Boeing 767 aircraft. Operating results may be negatively impacted if the Company were to take a charge to reduce amounts due from DHL or to lower the value of aircraft held for sale.

The ability to use net operating loss carryforwards to offset future taxable income for U.S. federal income tax purposes may be further limited.

Limitations imposed on the ability to use net operating losses (NOLs) to offset future taxable income could cause U.S. federal income taxes to be paid earlier than otherwise would be paid if such limitations were not in effect and could cause such NOLs to expire unused, in each case reducing or eliminating the benefit of such NOLs. Similar rules and limitations may apply for state income tax purposes.

In general, under Section 382 of the Internal Revenue Code of 1986, as amended (the Code), a corporation that undergoes an ownership change is subject to limitations on its ability to utilize its pre-change NOLs to offset future taxable income. In general, an ownership change occurs if the aggregate stock ownership of certain stockholders increases by more than 50 percentage points over such stockholders' lowest percentage ownership during the testing period (generally three years). During the second quarter of 2009, the Company experienced significant ownership changes. If the Company continues to experience more ownership changes, we may face limitations on our ability to use NOLs to offset future taxable income.

Item 4. Submission of Matters to a Vote of Security Holders

On May 12, 2009, the Company held an annual meeting of its shareholders. At the meeting, shareholders voted to elect Jeffrey J. Vorholt and Joseph C. Hete to serve as Directors of the Company for a term of three years, voted to grant discretionary authority to the Company's Board of Directors to amend the Company's Certificate of Incorporation to effect a reverse stock split in a specific ratio ranging from 1-for-2 to 1-for-5, as selected by the Company's Board of Directors, voted to adopt an amendment to the Company's Amended and Restated 2005 Long-Term Incentive plan to increase from 3,000,000 to 6,000,000 the number of shares available for issuance under the Plan, and ratified the appointment of Deloitte and Touche LLP as the independent registered public accounting firm of the Company for fiscal year 2009.

	Votes		Broker Non-Vote	
	Received	Withheld		
Election of Directors				
Jeffrey J. Vorholt	49,592,901	3,090,802		
Joseph C. Hete	49,356,464	3,327,239		
	Votes Cast			
Proposal	For	Against	Abstain	
Effect a reverse stock split	49,977,634	2,594,100	111,968	1
Adopt amendment to Long-Term Incentive Plan	23,405,956	3,694,129	145,933	25,437,685
Ratify independent auditors	51,632,204	897,159	154,339	1

Table of Contents

Item 5. Other Information

Air Transport Services Group, Inc.'s wholly owned subsidiary, ABX Air, Inc. ("ABX"), is party to an ACMI Service Agreement (the "ACMI agreement") with DHL Network Operations (USA), Inc. ("DHL"). On August 7, 2009, DHL notified ABX that it will not be renewing the ACMI agreement when its initial term expires on August 15, 2010, although DHL has expressed an interest in contracting with the Company for airlift services under competitive commercial terms to be provided upon the expiration of the ACMI agreement.

Under the ACMI agreement, ABX provides air cargo transportation services to DHL on a cost-plus basis. The expenses incurred under the agreement are generally marked-up by 1.75% (the base mark-up) and included in revenues, although ABX also has the opportunity to earn an additional 1.60% incremental markup over and above the base mark-up from the achievement of certain cost-related and service goals specified in the agreement. Notwithstanding the foregoing, the revenue formula under ACMI agreement was amended, starting in the fourth quarter of 2008, to more appropriately compensate ABX for the aircraft assets and level of services required to support DHL's reduced level of domestic operations resulting from the implementation of its U.S. restructuring plan. The new formula provides for quarterly markup payments to ABX through the second quarter of 2009 for fixed dollar amounts, rather than as a percentage of costs incurred. Fuel, rent, interest on a promissory note to DHL, and ramp and landing fees incurred under the ACMI agreement are the most significant cost items reimbursed without mark-up.

ABX is also a party to several other agreements with DHL and its affiliates, including that certain (i) Hub and Line-Haul Services Agreement with DHL Express (USA), Inc. ("DHL Express"), dated August 15, 2003 (the "Hub Services agreement"); (ii) Severance and Retention Agreement with DPWN Holdings (USA), Inc. ("DPWN Holdings"), dated August 15, 2008 (the "S&R agreement"); and (iii) Wilmington Air Park Sublease with DHL Express, dated August 15, 2003 (the "Sublease"). Under the Hub Services agreement, which will terminate on August 15, 2009, ABX provides staff to conduct package handling, package sorting and airport facilities and equipment maintenance services for DHL Express on a cost-plus basis. Under the S&R agreement, DPWN Holdings reimburses ABX for severance, retention and other benefits that ABX pays to its employees that have or will be displaced in conjunction with DHL's U.S. restructuring plan. Under the Sublease, ABX subleases office and hangar space from DHL at DHL Air Park in Wilmington, Ohio, the term of which will expire at the end of a transition period following the termination of the ACMI agreement. Copies of the Hub Services Agreement, together with amendments, the S&R agreement and the Sublease have been filed with the SEC.

The Audit Committee of the Board of Directors has approved the services rendered by our independent registered public accounting firm during the period covered by this Form 10-Q filing.

Table of Contents

Item 6. Exhibits

The following exhibits are filed as part of, or are incorporated in, the Quarterly Report on Form 10-Q:

Exhibit No.	Description of Exhibit
10.1	Second Amendment, dated January 30, 2009, to Escrow Agreement among Air Transport Services Group, Inc., ABX Air, Inc., each of the significant shareholders listed on the Schedule of Significant Shareholders attached thereto, and Wells Fargo Bank, NA, as escrow agent, incorporated by reference to the Company's 8-K filed February 5, 2009.
10.2	Second Amendment, dated November 9, 2008, to the ACMI Service Agreement, by and between DHL Network Operations (USA), Inc. and ABX Air, Inc., dated August 15, 2003, incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange commission on May 11, 2009.
10.3	Third Amendment, dated November 9, 2008, to the Hub and Line-Haul Services Agreement, by and between DHL Express (USA), Inc. and ABX Air, Inc., dated August 15, 2003, incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange commission on May 11, 2009.
10.4	Letter Agreement, dated April 16, 2009, Concerning Base and Incremental Markup for the Second Quarter of 2009 under the ACMI Service Agreement, by and between DHL Network Operations (USA), Inc. and ABX Air, Inc., dated August 15, 2003, filed herewith.
10.5	Letter Agreement, dated April 16, 2009, Concerning Base and Incremental Markup for the Second Quarter of 2009 under the Hub and Line-Haul Services Agreement, by and between DHL Express (USA), Inc. and ABX Air, Inc., dated August 15, 2003, filed herewith.
10.6	Amended and Restated First Non-Negotiable Promissory Note between ABX Air, Inc., as maker, and DHL Express (USA), Inc., as holder, dated May 8, 2009, filed herewith.
10.7	Guaranty by Air Transport Services Group, Inc. in favor of DHL Express (USA), Inc., dated May 8, 2009, filed herewith.
10.8	Lease Assumption and Option Agreement between DHL Network Operations (USA), Inc. and ABX Air, Inc., dated May 29, 2009, filed herewith.
31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized:

AIR TRANSPORT SERVICES GROUP, INC.,

a Delaware Corporation

Registrant

/s/ JOSEPH C. HETE
Joseph C. Hete
Chief Executive Officer

Date: August 10, 2009

/s/ QUINT O. TURNER
Quint O. Turner
Chief Financial Officer

Date: August 10, 2009