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

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**FORM 10-Q**

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

**For Quarterly Period Ended September 30, 2009**

**Commission File Number 000-50368**



**(Exact name of registrant as specified in its charter)**

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**Delaware**  
**(State of incorporation**  
**or organization)**

**26-1631624**  
**(IRS Employer**  
**Identification No.)**

**145 Hunter Drive**  
**Wilmington, Ohio 45177**  
**(Address of Principal Executive Office)**

**(937) 382-5591**  
**(Registrant's telephone number, including area code)**

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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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  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 November 12, 2009, Air Transport Services Group, Inc. had outstanding 63,460,734 shares of common stock, par value \$.01.

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**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**

**Form 10-Q**

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## **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](http://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](http://www.atsginc.com) as soon as reasonably practicable after filing with the SEC.

**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 September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
REVENUES	\$174,202	\$239,686	\$572,973	\$684,722
OPERATING EXPENSES				
Salaries, wages and benefits	74,127	98,614	257,191	283,892
Fuel	27,068	54,504	75,560	139,529
Depreciation and amortization	19,954	24,282	62,354	68,378
Maintenance, materials and repairs	15,217	20,674	48,513	65,932
Landing and ramp	5,828	6,603	22,790	26,754
Travel	5,524	7,201	15,888	22,870
Rent	2,629	2,355	7,025	7,080
Insurance	2,731	2,663	8,306	6,998
Other operating expenses	10,315	10,053	26,967	28,565
	<u>163,393</u>	<u>226,949</u>	<u>524,594</u>	<u>649,998</u>
INTEREST EXPENSE	(6,236)	(8,609)	(21,048)	(27,681)
INTEREST INCOME	74	511	381	2,030
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	4,647	4,639	27,712	9,073
INCOME TAXES	<u>(1,792)</u>	<u>(531)</u>	<u>(9,822)</u>	<u>(2,749)</u>
EARNINGS FROM CONTINUING OPERATIONS	2,855	4,108	17,890	6,324
EARNINGS FROM DISCONTINUED OPERATIONS NET OF TAX	882	857	5,051	1,902
NET EARNINGS	<u>\$ 3,737</u>	<u>\$ 4,965</u>	<u>\$ 22,941</u>	<u>\$ 8,226</u>
EARNINGS PER SHARE - Basic				
Continuing operations	\$ 0.05	\$ 0.07	\$ 0.29	\$ 0.10
Discontinued operations	0.01	0.01	0.08	0.03
NET EARNINGS PER SHARE	<u>\$ 0.06</u>	<u>\$ 0.08</u>	<u>\$ 0.37</u>	<u>\$ 0.13</u>
EARNINGS PER SHARE - Diluted				
Continuing operations	\$ 0.05	\$ 0.07	\$ 0.28	\$ 0.10
Discontinued operations	0.01	0.01	0.08	0.03
NET EARNINGS PER SHARE	<u>\$ 0.06</u>	<u>\$ 0.08</u>	<u>\$ 0.36</u>	<u>\$ 0.13</u>
WEIGHTED AVERAGE SHARES				
Basic	<u>62,685</u>	<u>62,508</u>	<u>62,670</u>	<u>62,462</u>
Diluted	<u>63,731</u>	<u>62,631</u>	<u>63,181</u>	<u>62,655</u>

See notes to condensed consolidated financial statements.

**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share data)

	<u>September 30,</u> <u>2009</u>	<u>December 31,</u> <u>2008</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 89,699	\$ 116,114
Marketable securities - available-for-sale	—	26
Accounts receivable, net of allowance of \$1,205 in 2009 and \$469 in 2008	22,239	24,495
Due from DHL	72,832	63,362
Inventory	6,523	11,259
Prepaid supplies and other	8,900	11,151
Deferred income taxes	20,171	20,172
Aircraft and engines held for sale	32,521	2,353
<b>TOTAL CURRENT ASSETS</b>	<u>252,885</u>	<u>248,932</u>
Property and equipment, net	614,433	671,552
Other assets	22,225	25,281
Deferred income taxes	1,040	54,807
Intangibles	10,335	11,000
Goodwill	89,777	89,777
<b>TOTAL ASSETS</b>	<u>\$ 990,695</u>	<u>\$1,101,349</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 32,825	\$ 36,618
Accrued salaries, wages and benefits	37,605	63,500
Accrued severance and retention	13,718	67,846
Accrued expenses	20,628	13,772
Current portion of debt obligations	55,487	61,858
Unearned revenue	17,251	14,813
<b>TOTAL CURRENT LIABILITIES</b>	<u>177,514</u>	<u>258,407</u>
Long-term debt obligations	350,463	450,628
Post-retirement liabilities	239,292	294,881
Other liabilities	44,321	17,041
Commitments and contingencies (Note I)		
<b>STOCKHOLDERS' EQUITY:</b>		
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; 63,460,734 and 63,247,312 shares issued and outstanding in 2009 and 2008, respectively	635	632
Additional paid-in capital	495,551	460,155
Accumulated deficit	(222,593)	(245,534)
Accumulated other comprehensive loss	(94,488)	(134,861)
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<u>179,105</u>	<u>80,392</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<u>\$ 990,695</u>	<u>\$1,101,349</u>

See notes to condensed consolidated financial statements.

**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	Nine Months Ended September 30	
	2009	2008
<b>OPERATING ACTIVITIES:</b>		
Net earnings from continuing operations	\$ 17,890	\$ 6,324
Net earnings from discontinued operations	5,051	1,902
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	62,978	68,665
Pension and post-retirement amortization	24,650	5,237
Deferred income taxes	10,418	3,492
Amortization of stock-based compensation	1,013	1,810
Gains on asset disposition, net of impairments	(2,077)	(563)
Changes in assets and liabilities:		
Accounts receivable	(3,837)	26,006
Inventory and prepaid supplies	5,531	4,687
Accounts payable	(3,754)	(1,125)
Unearned revenue	(8,744)	(63)
Accrued expenses, salaries, wages and benefits and other liabilities	(44,600)	(6,176)
Post-retirement liabilities	(18,846)	(477)
Other	3,854	4,584
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>49,527</u>	<u>114,303</u>
<b>INVESTING ACTIVITIES:</b>		
Capital expenditures	(49,908)	(96,623)
Proceeds from the sale of property and equipment	7,044	10,572
Proceeds from redemptions of marketable securities	26	49,499
Acquisition of CHI	—	(3,840)
Other	—	(1,510)
NET CASH (USED IN) INVESTING ACTIVITIES	<u>(42,838)</u>	<u>(41,902)</u>
<b>FINANCING ACTIVITIES:</b>		
Principal payments on borrowings	(33,104)	(110,938)
Proceeds from borrowings	—	38,500
NET CASH (USED IN) FINANCING ACTIVITIES	<u>(33,104)</u>	<u>(72,438)</u>
NET (DECREASE) IN CASH AND CASH EQUIVALENTS	(26,415)	(37)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>116,114</u>	<u>59,271</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 89,699</u>	<u>\$ 59,234</u>
<b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>		
Interest paid, net of amount capitalized	<u>\$ 18,396</u>	<u>\$ 24,521</u>
Income taxes paid	<u>\$ 2,085</u>	<u>\$ —</u>
<b>SUPPLEMENTAL NON-CASH INFORMATION:</b>		
Accrued aircraft modification expenditures	<u>\$ 2,025</u>	<u>\$ 542</u>

See notes to condensed consolidated financial statements.

**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**September 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 November 12, 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.

ABX provides airlift including aircraft flight crews and maintenance to DHL Network Operations (USA), Inc. under an aircraft, crew, maintenance and insurance agreement (“ACMI agreement”). Under a Hub Services agreement, ABX provided package handling, sorting and other cargo-related services to DHL Express (USA), Inc. through August 2009 (DHL Network Operations (USA), Inc. and DHL Express (USA), Inc. are collectively referred to as “DHL”). DHL, an international, integrated delivery company, is the Company’s largest customer, accounting for 46% of the Company’s revenues from continuing operations in the third quarter of 2009.

Through its airline subsidiaries, the Company provides airlift to other customers typically through ACMI agreements. At September 30, 2009, ABX had 13 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, (ii) provides aircraft and equipment maintenance services; (iii) operates three mail sorting facilities for the U.S. Postal Service (“USPS”); and (iv) 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, for workers compensation claims and employee medical costs, 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.

## AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued) September 30, 2009

#### *Consolidation*

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

#### *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 the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") topic 350-20 "Intangibles – Goodwill and Other", 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.



## AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued) September 30, 2009

#### *Property and Equipment*

Property and equipment are stated at cost, net of any impairment recorded, in accordance with FASB ASC topic 360-10 “Property, Plant and Equipment”. 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.

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 \$0.3 million and \$0.7 million for the quarters ended September 30, 2009 and 2008, respectively and \$1.3 million and \$2.6 million for the nine month period ended September 30, 2009 and 2008 respectively.

#### *Discontinued Operations*

In accordance with the guidance of FASB ASC topic 205-20 “Presentation of Financial Statements,” a business component whose operations are discontinued is reported as discontinued operations if the cash flows of the component have been eliminated from the ongoing operations of the Company, and the Company will no longer have any significant continuing involvement in the business component. The results of discontinued operations are aggregated and presented separately in the consolidated statement of operations. FASB ASC topic 205-20 requires the reclassification of amounts presented for prior years to reflect their classification as discontinued operations.

#### *Exit Activities*

The Company accounts for the costs associated with exit activities in accordance with FASB ASC topic 420-10 “Exit or Disposal Cost Obligations.” 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 FASB ASC topic 715-30 “Compensation – Retirement Benefits” in the event that a significant number of employees are terminated or a pension plan is suspended.

**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**September 30, 2009**

***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 ASC topic 740-10 "Income Taxes," 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.

***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 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 measured the achievement of annual goals and recorded 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, second and third 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, second and third 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, second and third quarters of 2009 includes reimbursement for certain 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 or technical 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 services.

## AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued) September 30, 2009

#### *New Accounting Pronouncements*

In June 2009, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 168 “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162” which establishes the FASB Accounting Standards Codification (“the Codification” or “ASC”) as the official single source of authoritative U.S. generally accepted accounting principles (“GAAP”). The Codification reorganizes GAAP into related topics and subtopics, providing authoritative literature related to a particular topic in one place. The Codification is not intended to change GAAP, but changes the way GAAP is organized and presented. Going forward, the FASB will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead it will issue Accounting Standards Updates (“ASU”) which will serve to update the Codification, provide background information about the guidance and provide the basis for conclusions on the changes to the Codification. The Codification is effective for the Company for the financial statements issued for interim and annual periods ending after September 15, 2009. Except for the disclosure requirements, the adoption of this statement did not have an impact on the determination or reporting of the Company’s consolidated financial statements.

In December 2008, FASB affirmed FSP No. FAS 132(R)-1, “Employers’ Disclosures about Postretirement Benefit Plan Assets” (FASB ASC 715, “Compensation – Retirement Benefits”). FSP No. 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 No. FAS 132(R)-1 is effective for the Company as of December 31, 2009. Because this Staff Position 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”). This statement is not yet reflected in the FASB ASC. 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.

In June 2009, the FASB issued SFAS No. 167 “Amendments to FASB Interpretation No. 46(R)” (“SFAS 167”). This statement is not yet reflected in the FASB ASC. 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) 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.

## AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued) September 30, 2009

#### 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. A summarized chronology of DHL's restructuring actions in 2009 and their effects on ABX's operations follows:

- 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.
- On March 16, 2009, DHL agreed to restructure an unsecured promissory note and assume financial responsibility for capital leases for five Boeing 767 aircraft guaranteed by DHL. The promissory note was subsequently amended in May 2009 and a Lease Assumption and Option Agreement was executed in June 2009.
- 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 would not be renewing the Hub Services agreement when its term expired on August 15, 2009.
- On July 24, 2009, sort operations in Wilmington ceased and the sorting and hub operations were transferred to CVG. ABX assisted DHL with the transition to CVG by providing temporary staffing for the CVG operations through early September 2009. Revenues from the Hub Services agreement were \$54.4 million and \$145.0 million for the third quarter and first nine months of 2009, respectively. Pre-tax earnings from the Hub Services agreement were \$1.4 million, or 23% of consolidated pre-tax earnings, for the third quarter of 2009 and \$8.0 million, or 22% of consolidated pre-tax earnings, for the first nine months of 2009.
- In conjunction with the transfer of the hub operations to CVG in July 2009, DHL assumed management of fueling services for its network previously provided by ABX. ABX ceased providing aircraft fuel and related services for its aircraft that remain in the DHL network. Revenues from fuel were \$2.3 million and \$28.5 million for the third quarter and first nine months of 2009, respectively. ABX did not earn a mark-up on fuel used within the DHL network. The Hub Services operations and the aircraft fueling operations are now reported as discontinued operations.
- On August 7, 2009, DHL notified ABX that DHL would not be renewing the ACMI agreement when its initial term expires on August 15, 2010. Revenues from the ACMI agreement were \$69.8 million and \$273.7 million for the third quarter and first nine months of 2009, respectively. Pre-tax earnings from the ACMI agreement were \$1.9 million, or 32% of consolidated pre-tax earnings, for the third quarter of 2009 and \$13.8 million, or 39% of consolidated pre-tax earnings, for the first nine months of 2009.

DHL continues to express interest in the Company's Boeing 767 aircraft. 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 six Boeing 767 standard freighters under supplemental, short-term, ACMI arrangements. In June 2009, ABX and DHL executed a lease option agreement for four ABX Boeing 767 standard freighter aircraft under 64.5 month lease terms, each commencing August 15, 2010. DHL has expressed 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. The companies are currently negotiating aircraft leases and airline services agreements that the ATSG subsidiaries may provide to DHL after the ACMI agreement terminates.

Through September 30, 2009, ABX has terminated approximately 8,600 employee positions since DHL's restructuring began in mid-2008. 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 regard to the use of those funds for severance, pension funding or other issues arising from DHL's U.S. restructuring plan. On November 6, 2009, the Company and negotiators for the ABX pilots' union reached a tentative agreement which is being submitted to the ABX pilots' union members for ratification at large.

**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**September 30, 2009**

As a result of DHL's U.S. restructuring plans ABX is incurring significant termination and wind-down costs. Such costs include severance, vacation payments, medical coverage and workers compensation claims to former employees. Such costs are reimbursable to ABX under the provisions of its agreements with DHL. DHL and ABX have an ongoing process to verify that ABX's costs are subject to reimbursement. To the extent that DHL has not reimbursed ABX's cost, ABX reflects the amount due from DHL as a receivable. If ABX and DHL cannot agree on reimbursement of disputed amounts, arbitration or legal proceedings can result.

Through September 30, 2009, ABX has paid terminating employees approximately \$18.4 million for accrued vacation benefits since DHL's restructuring began in mid-2008. DHL is obligated to reimburse ABX for the amounts 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 September 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 and \$3.3 million for reimbursement due to ABX for vacation payments made in the second and third quarters of 2009 because the revenue recognition requirements under 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. A resolution and final recognition of vacation reimbursement is ancillary at this time to broader negotiations between ATSG and DHL for aircraft dry leases and airline service agreements noted above.

Aircraft and engines for sale as of September 30, 2009 include approximately \$31.3 million for aircraft that ABX has put to DHL under provision of the ACMI agreement. The sale of these aircraft 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. ABX and DHL management are addressing the value difference through continued discussions. However, if DHL continues its assertion, ABX may initiate the resolution process prescribed in the ACMI agreement.

As specified in the ACMI agreement 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 includes 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. The Company's balance sheets included the following balances related to revenue transactions with DHL (in thousands):

	<u>September 30, 2009</u>	<u>December 31, 2008</u>
<b>Assets (Liabilities):</b>		
Accounts receivable	\$ 72,832	\$ 63,362
Aircraft put to DHL	31,293	393
Accounts payable	(771)	(392)
Accrued severance and retention	(13,414)	(67,846)
Unearned revenue	(3,446)	(8,749)
Net asset (liability)	<u>\$ 86,494</u>	<u>\$ (13,232)</u>

Continuing revenues from contracted services performed for DHL were approximately 46% and 49% of the Company's consolidated revenues from continuing operations for the three months ended September 30, 2009 and 2008, respectively, and 51% of consolidated revenues from continuing operations for both the nine month periods ended September 30, 2009 and 2008.

**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**September 30, 2009**

***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 24% and 26% of the Company's total revenues from continuing operations for the three months ended September 30, 2009 and 2008, respectively, and 20% and 26% of consolidated revenues for the nine month periods ended September 30, 2009 and 2008, respectively. Under their agreements with BAX, ATI and CCIA have the right to be the exclusive providers 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):

	<u>September 30, 2009</u>	<u>December 31, 2008</u>
<b>Assets (Liabilities):</b>		
Accounts receivable	\$ 2,882	\$ 2,101
Accounts payable	—	(1,529)
Net asset	<u>\$ 2,882</u>	<u>\$ 572</u>

**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 and discontinued operations. The wind-down expenses incurred through September 30, 2009 are summarized below (in thousands):

	<u>Severance Benefits</u>	<u>Retention Benefits</u>	<u>Total</u>
Accrued costs at December 31, 2008	\$ 28,920	\$ 38,926	\$ 67,846
Costs incurred	46,188	29,068	75,256
Costs paid	(61,905)	(67,479)	(129,384)
Accrued costs at September 30, 2009	<u>\$ 13,203</u>	<u>\$ 515</u>	<u>\$ 13,718</u>

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 and other contracts. 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 \$210 million. The actual cost will depend on the extent and timing of DHL business reductions and whether ABX is successful at replacing the DHL ACMI agreement with other service contracts. In addition to severance and retention benefits, ABX paid terminated employees \$18.4 million for accrued vacation benefits during the first nine months of 2009. The Company estimates that it may pay \$2.6 million more for accrued vacation benefits as employees terminate. At this time, it is not reasonably possible to estimate other wind-down costs.

**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**September 30, 2009**

**NOTE D—DISCONTINUED OPERATIONS**

On July 24, 2009, DHL ceased the sort operations in Wilmington and transferred the hub operations to CVG. ABX assisted DHL with the transition from Wilmington to CVG by providing temporary staffing for the CVG operations through early September 2009. In conjunction with the transfer of the aircraft hub operations to CVG in July 2009, DHL assumed management of fueling services for its network previously provided by ABX. ABX ceased providing aircraft fuel and related services for its aircraft that remain in the DHL network. ABX's Hub Services operations and the aircraft fueling operations, which previously had been reported in the DHL segment, are reported as discontinued operations beginning with ATSG's report on form 10-Q for the third quarter of 2009.

ABX sponsors defined benefit plans for retirees that include the former employees of the hub operation. Additionally, ABX is self insured for medical coverage and injured workers compensation. Provisions for the cost of employee injuries have been significant in 2009 as a result of ceasing sort operations in Wilmington and record unemployment levels. Besides cash outflows, the Company may incur expenses in the future related to pension obligations, reserves for medical expenses and wage loss for former employees. Provisions for workers compensation claims were estimated utilizing historical paid claims data, recent trends and an independent actuarial evaluation. Changes in claim severity and frequency could result in actual claims being materially different than the amounts reserved. Carrying amounts of significant assets and liabilities of the discontinued operations are below (in thousands):

	<u>September 30,</u> <u>2009</u>	<u>December 31,</u> <u>2008</u>
<b>Assets</b>		
Receivable due from DHL	\$ 42,670	\$ 29,872
Other current assets	—	121
<b>Total Assets</b>	<u>\$ 42,670</u>	<u>\$ 29,993</u>
<b>Liabilities</b>		
Accounts payable	\$ 51	\$ 2,332
Employee compensation and benefits	56,773	63,172
Post-retirement	34,377	45,928
<b>Total Liabilities</b>	<u>\$ 91,201</u>	<u>\$ 111,432</u>

The revenues and pre-tax earnings of the discontinued operations are below (in thousands):

	<u>Three months ended</u> <u>September 30</u>		<u>Nine months ended</u> <u>September 30</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Revenue	\$56,673	\$163,409	\$173,561	\$495,289
Pre-tax earnings	\$ 1,390	\$ 1,349	\$ 7,964	\$ 2,993

**NOTE E—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 are 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 September 30, 2009 (in thousands):

	<u>Fair Value Measurement Using</u>			<u>Total</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
<b>Assets</b>				
Cash equivalents - money market	\$2,367	\$ —	\$ —	\$ 2,367
<b>Liabilities</b>				
Interest rate swap	\$ —	\$(4,281)	\$ —	\$(4,281)

## AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued) September 30, 2009

FASB ASC topic 820-10 “Fair Value Measurements and Disclosures” 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 \$53.8 million less than the carrying value, which was \$405.9 million at September 30, 2009.

#### NOTE F—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 September 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 Cargo Holdings International, Inc. and ABX for the tax years through December 31, 2006. The Cargo Holdings International, Inc. 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 and 2008 ABX tax returns remain open to examination in all relevant taxing jurisdictions.

The Company reduced deferred tax assets for net operating loss carry forwards by \$19.5 million in 2009 to reflect the tax effect associated with the extinguishment of debt (see Note H).

#### NOTE G—PROPERTY AND EQUIPMENT

At September 30, 2009, the Company’s subsidiaries operated 63 aircraft, consisting of 31 Boeing 767, two Boeing 757, 14 Boeing 727, and 16 McDonnell Douglas DC-8 aircraft. During the first nine months of 2009, CAM leased three aircraft with a cost of \$66.7 million and accumulated depreciation of \$4.8 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):

	September 30, 2009	December 31, 2008
Aircraft and flight equipment	\$ 796,889	\$ 899,315
Support equipment	51,546	50,823
Vehicles and other equipment	1,847	1,832
Leasehold improvements	1,255	1,272
	<u>851,537</u>	<u>953,242</u>
Accumulated depreciation	(237,104)	(281,690)
Property and equipment, net	<u>\$ 614,433</u>	<u>\$ 671,552</u>

Property and equipment includes \$39.3 million of property held under capital leases as of September 30, 2009 and \$55.0 million as of December 31, 2008. Accumulated depreciation and amortization includes \$14.1 million as of September 30, 2009 and \$17.5 million as of December 31, 2008 for property held under capital leases.



**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**September 30, 2009**

In October 2009, the Company purchased another Boeing 767-200 freighter for approximately \$17.8 million to complete a commitment it made in 2007 when the Company acquired Cargo Holdings International, Inc.

The ACMI agreement grants ABX certain rights to put to DHL any aircraft that is removed from service prior to the expiration of the ACMI. 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.

***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 September 30, 2009, ABX held spare engines and aircraft that had been removed from DHL service. At September 30, 2009, \$31.3 million of the \$32.5 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 earnings.

**NOTE H—DEBT OBLIGATIONS**

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

	September 30, 2009	December 31, 2008
Unsubordinated term loan	\$ 205,812	\$ 222,500
Revolving credit facility	18,500	18,500
Aircraft loans	101,600	106,928
Capital lease obligations-Boeing 767	19,457	52,864
Capital lease obligations-Boeing 727	14,014	18,648
Promissory note due to DHL, unsecured	46,000	92,276
Other capital leases	567	770
Total long-term obligations	405,950	512,486
Less: current portion	(55,487)	(61,858)
Total long-term obligations, net	<u>\$ 350,463</u>	<u>\$ 450,628</u>

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 September 30, 2009, the unsubordinated term loan bears a variable interest rate of LIBOR (90-day) plus 2.63% (2.92% at September 30, 2009). The agreement provides for the issuance of letters of credit on the Company's behalf. As of September 30, 2009, the unused revolving credit facility totaled \$41.7 million, net of draws of \$18.5 million and outstanding letters of credit of \$14.8 million. The revolving credit facility at September 30, 2009 carried an interest rate of LIBOR (30-day) plus 2.63% (2.88% at September 30, 2009).

## AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued) September 30, 2009

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 two Boeing 767 aircraft expire in 2011 with options to extend into 2017. The capital lease payments for the two Boeing 767 aircraft carry 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 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 Holdings 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 September 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.

In June 2009, ABX executed 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 granted DHL a credit of \$2.5 million as prepaid rent toward each of the four lease option aircraft. 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 up to \$10 million, \$2.5 million for each option that is not exercised, which amount will be offset against expiration costs under the ACMI agreement.

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 recorded a debt extinguishment of \$27.2 million as a capital transaction and increased paid-in capital by \$4.9 million, net of income taxes. The increase in paid in capital reflects the removal of aircraft having a net book value of \$12.6 million, the recognition of the \$10.0 million liability for future rent credits granted to DHL, and the settlement of recent lease payments and expenses of \$3.0 million, as well as the extinguishment of the debt. As of September 30, 2009, the Company’s balance sheet reflected approximately \$19.5 million of debt obligations and \$8.3 million of net book value related to two Boeing 767 capital lease aircraft guaranteed by DHL. The Company anticipates it will record the debt extinguishment and remove the related aircraft book values as a capital transaction when the leases are terminated or assigned to DHL.

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 Agreement, 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.

**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**September 30, 2009**

**NOTE I—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 upon the expiration, or 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 September 30, 2009, the Company owned three Boeing 767 aircraft that were in modification from passenger door freighter to standard freighter configuration. The Company anticipates costs of approximately \$16.3 million to complete the modification of these aircraft. If CAM were to cancel the conversion program as of September 30, 2009, it would owe IAI, in addition to payments for aircraft currently undergoing modification, approximately \$2.6 million for non-recurring engineering costs and approximately \$7.8 million associated with additional conversion part kits which have been ordered.

***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) 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. 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’s 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.

## AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued) September 30, 2009

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.

#### ***Proposed FAA Civil Penalty***

In September 2009, ABX received a letter from the FAA alleging that it had failed to comply with an FAA Airworthiness Directive involving its Boeing 767 aircraft and proposing a monetary settlement. ABX will be scheduling a meeting with the FAA to discuss this matter, as permitted by FAA procedures. The Company believes it has adequately reserved for this matter.

#### ***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 September 30, 2009, the flight crewmembers of ABX, ATI and CCIA were represented by labor unions listed below:

<u>Airline</u>	<u>Labor Agreement Unit</u>	<u>Percentage of Company's Employees</u>
ABX	International Brotherhood of Teamsters	11.9%
ATI	International Brotherhood of Teamsters	7.9%
CCIA	Airline Pilots Association	5.7%

However, on November 4, 2009, the flight crewmembers of ATI elected the Airline Pilots Association as their collective bargaining representative in replacement of the International Brotherhood of Teamsters.

**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**September 30, 2009**

**NOTE J—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 costs for its qualified defined benefit pension and post-retirement healthcare plans for both continuing and discontinued operations are as follows (in thousands):

	<b>Three Months Ended September 30</b>				<b>Nine Months Ended September 30</b>			
	<b>Pension Plans</b>		<b>Post-retirement Healthcare Plan</b>		<b>Pension Plans</b>		<b>Post-retirement Healthcare Plan</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Service cost	\$ 3,372	\$ 8,327	\$ 163	\$ 467	\$ 10,312	\$ 24,982	\$ 489	\$ 1,401
Interest cost	9,415	9,631	427	466	28,278	28,892	1,281	1,398
Expected return on plan assets	(7,389)	(9,092)	—	—	(21,598)	(27,275)	—	—
Curtailement loss	1,365	—	—	—	3,192	—	—	—
Amortization of prior service cost	486	1,247	—	—	1,724	3,741	—	—
Amortization of net loss	7,142	481	—	18	22,966	1,442	—	54
<b>Net periodic benefit cost</b>	<b>\$14,391</b>	<b>\$10,594</b>	<b>\$ 590</b>	<b>\$ 951</b>	<b>\$ 44,874</b>	<b>\$ 31,782</b>	<b>\$1,770</b>	<b>\$2,853</b>

After revaluing pension assets and liabilities due to employee terminations, the Company reduced pension liabilities by \$34.6 million to reflect curtailment of benefits and changes in actuarial assumptions and assets since the previous revaluations 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 nine month periods ended September 30, 2009, the Company paid \$19.7 and \$41.1 million of contributions to its defined benefit pension plans, respectively. The Company presently anticipates contributing at least \$4.2 million to fund its qualified defined benefit pension plans during the remainder of 2009.

**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**September 30, 2009**

**NOTE K—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 September 30, 2009 (in thousands):

<u>Expiration Date</u>	<u>Notional Amount</u>	<u>Stated Interest Rate</u>	<u>Market Value (Liability)</u>
12/31/2012	\$78,625	3.105%	\$ (2,689)
12/31/2012	46,250	3.105%	(1,592)

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 September 30, 2009, accumulated other comprehensive loss included unrecognized losses of \$2.4 million net of tax for derivative instruments.

**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**September 30, 2009**

**NOTE L—COMPREHENSIVE INCOME AND PAID-IN CAPITAL**

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

	Three Months Ended September 30			Nine Months Ended September 30		
	Before Tax	Income Tax (Expense) Benefit	Net of Tax	Before Tax	Income Tax (Expense) Benefit	Net of Tax
<b>2009</b>						
Net income			\$ 3,737			\$22,941
Other comprehensive income:						
Actuarial gain for pension liabilities	\$ 18,914	\$ (6,866)	12,048	\$37,609	\$ (13,652)	23,957
Unrealized gain on marketable securities	—	—	—	—	20	20
Unrealized gain on hedge derivatives	(984)	357	(627)	1,176	(427)	749
Reclassifications to net income:						
Hedging gain realized in net income	(28)	10	(18)	(86)	31	(55)
Pension actuarial loss	7,142	(2,592)	4,550	22,966	(8,337)	14,629
Post-retirement actuarial loss	(14)	5	(9)	(40)	15	(25)
Pension prior service cost	486	(177)	309	1,724	(626)	1,098
Total other comprehensive income	<u>\$ 25,516</u>	<u>\$ (9,263)</u>	<u>16,253</u>	<u>\$63,349</u>	<u>\$ (22,976)</u>	<u>40,373</u>
Comprehensive income			<u>\$ 19,990</u>			<u>\$63,314</u>
<b>2008</b>						
Net income			\$ 4,965			\$ 8,226
Other comprehensive income:						
Unrealized gain on marketable securities	\$ 14	\$ (5)	9	\$ 22	\$ (8)	14
Unrealized gain (loss) on hedge derivatives	(1,087)	394	(693)	3,288	(1,194)	2,094
Reclassifications to net income:						
Hedging gain realized in net income	(30)	12	(18)	(92)	34	(58)
Pension actuarial loss	481	(198)	283	1,442	(547)	895
Post-retirement actuarial loss	18	(10)	8	54	(23)	31
Pension prior service cost	1,247	(513)	734	3,741	(1,418)	2,323
Total other comprehensive income	<u>\$ 643</u>	<u>\$ (320)</u>	<u>323</u>	<u>\$ 8,455</u>	<u>\$ (3,156)</u>	<u>5,299</u>
Comprehensive income			<u>\$ 5,288</u>			<u>\$13,525</u>

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

	Three Months Ended September 30			Nine Months Ended September 30		
	Before Tax	Income Tax (Expense) Benefit	Net of Tax	Before Tax	Income Tax (Expense) Benefit	Net of Tax
<b>2009</b>						
Beginning balance	\$490,349	\$ —	\$490,349	\$460,155	\$ —	\$460,155
Grant of restricted stock	—	—	—	(2)	—	(2)
Issuance of common shares	—	—	—	9	—	9
Amortization of stock awards and restricted stock	304	—	304	1,013	—	1,013
Debt extinguishment transactions (see Note H)	7,642	(2,744)	4,898	53,918	(19,542)	34,376
Ending balance	<u>\$498,295</u>	<u>\$ (2,744)</u>	<u>\$495,551</u>	<u>\$515,093</u>	<u>\$ (19,542)</u>	<u>\$495,551</u>

**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**September 30, 2009**

**NOTE M—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.

	Nine Months Ended September 30, 2009		Nine Months Ended September 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	(131,950)	6.21
Cancelled	(174,426)	4.98	(62,150)	9.91
Outstanding at end of period	<u>1,726,900</u>	<u>\$ 3.52</u>	<u>1,908,400</u>	<u>\$ 4.34</u>
Vested	161,200	\$ 5.23	151,400	\$ 3.80

For the nine month periods ended September 30, 2009 and 2008, the Company recorded expense of \$1.0 million and \$1.9 million, respectively, for stock incentive awards. At September 30, 2009, there was \$1.2 million of unrecognized expense related to the stock incentive awards that is expected to be recognized over a weighted-average period of 0.8 years. As of September 30, 2009, 1,726,900 awards were outstanding. None of the awards were convertible, and none of the outstanding shares of restricted stock had vested as of September 30, 2009. These awards could result in a maximum number of 2,074,400 additional outstanding shares of the Company's common stock depending on service, performance and market results through December 31, 2011.

**NOTE N—EARNINGS PER SHARE**

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Net income from continuing operations	\$ 2,855	\$ 4,108	\$ 17,890	\$ 6,324
Weighted-average shares outstanding for basic earnings per share	62,685	62,508	62,670	62,462
Common equivalent shares:				
Effect of stock-based compensation awards	1,046	123	511	193
Weighted-average shares outstanding assuming dilution	<u>63,731</u>	<u>62,631</u>	<u>63,181</u>	<u>62,655</u>
Basic earnings per share from continuing operations	\$ 0.05	\$ 0.07	\$ 0.29	\$ 0.10
Diluted earnings per share from continuing operations	<u>\$ 0.05</u>	<u>\$ 0.07</u>	<u>\$ 0.28</u>	<u>\$ 0.10</u>

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 14,000 shares at September 30, 2009 and 2,573,000 at September 30, 2008.



**AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**September 30, 2009**

**NOTE O—SEGMENT INFORMATION**

The Company operates in three reportable segments, as described below. The DHL segment consists of the air cargo transportation services provided to DHL under the ACMI agreement. 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. The Company's segment information for continuing operations is presented below (in thousands):

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Total revenues:</b>				
DHL	\$ 69,801	\$ 112,806	\$ 273,695	\$ 340,950
ACMI Services	90,491	116,876	261,159	316,880
CAM	16,046	11,964	43,715	33,677
All other	17,838	15,708	42,829	34,789
Eliminate Inter-segment revenues	(19,974)	(17,668)	(48,425)	(41,574)
<b>Total</b>	<b>\$ 174,202</b>	<b>\$ 239,686</b>	<b>\$ 572,973</b>	<b>\$ 684,722</b>
<b>Customer revenues</b>				
DHL	\$ 69,801	\$ 112,806	\$ 273,695	\$ 340,950
ACMI Services	90,446	110,570	260,870	308,381
CAM	3,159	602	7,636	602
All other	10,796	15,708	30,772	34,789
<b>Total</b>	<b>\$ 174,202</b>	<b>\$ 239,686</b>	<b>\$ 572,973</b>	<b>\$ 684,722</b>
<b>Depreciation and amortization expense:</b>				
DHL	\$ 5,161	\$ 9,962	\$ 20,236	\$ 30,592
ACMI Services	8,809	9,578	25,558	26,183
CAM	5,734	4,530	15,862	10,996
All other	250	212	698	607
<b>Total</b>	<b>\$ 19,954</b>	<b>\$ 24,282</b>	<b>\$ 62,354</b>	<b>\$ 68,378</b>
<b>Segment earnings (loss):</b>				
DHL	\$ 1,929	\$ 2,326	\$ 13,776	\$ 5,728
ACMI Services	(926)	879	1,502	1,195
CAM	6,115	4,038	16,696	13,204
All other	(2,471)	(2,604)	(4,262)	(11,054)
<b>Total from continuing operations</b>	<b>\$ 4,647</b>	<b>\$ 4,639</b>	<b>\$ 27,712</b>	<b>\$ 9,073</b>

	September 30, 2009	December 31, 2008
<b>Assets:</b>		
DHL	\$ 207,139	\$ 280,825
ACMI Services	276,562	297,300
CAM	304,711	259,321
Discontinued operations	42,670	29,993
All other	159,613	233,910
<b>Total</b>	<b>\$ 990,695</b>	<b>\$1,101,349</b>

## **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 which are discussed below.

### ***DHL***

In 2008, DHL began to restructure its U.S. operations, which significantly impacted ABX's operations. 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. Under a Hub Services agreement, ABX provided, package handling, and other cargo related services to DHL Express (USA), Inc. The Hub Services agreement expired on August 15, 2009 and the results of these operations are now reported as discontinued operations. ABX currently has an aircraft, crew, maintenance and insurance agreement ("ACMI agreement") with DHL Network Operations (USA), Inc. ("DHL") to provide airlift in the U.S. 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, however, DHL has expressed interest in contracting with the Company separately for aircraft leases and airline services under competitive commercial terms upon the expiration of the ACMI agreement.

A summarized chronology of DHL's restructuring actions in 2009 and their effects on ABX's operations follows:

- 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.
- On March 16, 2009, DHL agreed to restructure an unsecured promissory note and assume financial responsibility for the capital leases associated with five Boeing 767 aircraft guaranteed by DHL. The promissory note was subsequently amended in May 2009 and a Lease Assumption and Option Agreement was executed in June 2009.
- 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 would not be renewing the Hub Services agreement when its term expired on August 15, 2009.
- On July 24, 2009, sort operations in Wilmington ceased and the sorting and hub operations were transferred to CVG. ABX assisted DHL with the transition to CVG by providing temporary staffing for the CVG operations through early September 2009. Revenues from the Hub Services agreement were \$54.4 million and \$145.0 million for the third quarter and first nine months of 2009, respectively. Pre-tax earnings from the Hub Services agreement were \$1.4 million, or 23% of consolidated pre-tax earnings, for the third quarter of 2009 and \$8.0 million, or 22% of consolidated pre-tax earnings, for the first nine months of 2009.
- In conjunction with the transfer of the hub operations to CVG in July 2009, DHL assumed management of fueling services for its U.S. network previously provided by ABX. ABX ceased providing aircraft fuel and related services for its aircraft that remain in the DHL network. Revenues from fuel were \$2.3 million and \$28.5 million for the third quarter and first nine months of 2009, respectively. ABX did not earn a mark-up on fuel used within the DHL network. The Hub Services operations and the aircraft fueling operations are now reported as discontinued operations.

- On August 7, 2009, DHL notified ABX that DHL would not be renewing the ACMI agreement when its initial term expires on August 15, 2010. Revenues from the ACMI agreement were \$69.8 million and \$273.7 million for the third quarter and first nine months of 2009, respectively. Pre-tax earnings from the ACMI agreement were \$1.9 million, or 32% of consolidated pre-tax earnings, for the third quarter of 2009 and \$13.8 million, or 39% of consolidated pre-tax earnings, for the first nine months of 2009.

DHL continues to express interest in the Company's Boeing 767 aircraft. 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 six Boeing 767 standard freighters under supplemental, short-term, ACMI arrangements. In June 2009, ABX and DHL executed a lease option agreement, in which DHL may lease up to four ABX Boeing 767 standard freighter aircraft under 64.5 month lease terms, commencing August 15, 2010. DHL has expressed interest to contract with the Company for aircraft dry lease and airline services under competitive, commercial terms after the current ACMI agreement expires. ATSG and its subsidiaries are currently discussing with DHL long-term leases for eight to ten other Boeing 767 aircraft as they are converted to standard freighter configuration

ABX has been negotiating with designated representatives of ABX's pilots' union on amendments to their collective bargaining agreement ("CBA"). On November 6, 2009, the Company and negotiators for the ABX pilots' union reached a tentative agreement which is being submitted to the ABX pilots' union members for ratification at large. ABX is seeking to achieve lower wages and benefits and more favorable work rules so that it may effectively compete in the ACMI air cargo markets with lower cost carriers. If ABX can secure a more competitive cost structure, it may be able to obtain contracts to provide crews and other airline services to DHL. The amended CBA, if ratified, is effective only if ABX wins contracts to provide crews and airline services to DHL after the current ACMI terminates. If ABX is unsuccessful at achieving a more competitive CBA in the near future, or winning airline service contracts with DHL, management will consider other business alternatives. Those alternatives may include reducing or discontinuing ABX's ACMI operations and pursuing more opportunities to place aircraft under leasing arrangements.

In September 2008, ATSG's CAM subsidiary entered into an agreement with Israel Aerospace Industries Ltd. ("IAI") for the conversion of up to 14 Boeing 767-200 aircraft to full freighter configuration. The decision by DHL to terminate the ACMI agreement 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 from DHL and other carriers. 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.

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. Through September 30, 2009, ABX has terminated approximately 8,600 employee positions since DHL's people since DHL's restructuring began in mid-2008. Employees receive severance, retention and other benefits under the S&R agreement executed between ABX and DHL. The S&R agreement includes provisions to pay ABX for crewmember benefits if ABX and its pilots' union 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. The tentative agreement reached on November 6, 2009, includes an allocation of the funds, which will be distributed accordingly if the tentative agreement is ratified by the pilots union membership.

Our pre-tax earnings from the ACMI agreement decreased by \$0.4 million in the third quarter and increased by \$8.0 million for the first nine months of 2009 compared to the corresponding periods of 2008. Our pre-tax earnings from the ACMI agreement includes approximately \$1.8 million and \$9.0 million of mark-up above our cost incurred under the ACMI agreement for the third quarter and for the first nine months of 2009 compared to approximately \$2.3 million and \$7.3 million of mark-up above our costs for the corresponding periods of 2008.

Our pre-tax earnings from the ACMI agreement for the first nine months of 2009 also includes \$4.5 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 difference between our 2009 and 2008 pre-tax earnings is impacted by charges recorded in the second and third quarters of 2008 to reserve \$2.9 million of DHL revenues related to a dispute over arbitration expenses. This matter was resolved favorably later in 2008.

Our pre-tax earnings from discontinued DHL operations increased by \$5.0 million for the first nine months of 2009 compared to the corresponding periods of 2008. Our pre-tax earnings from the discontinued DHL operations for the first nine months of 2009 includes \$2.6 million for the reimbursement of employee vacation benefits that ABX paid to terminated employees under the S&R agreement.

The increase in incremental revenues in 2009 reflects amendments to our ACMI and Hub services agreements 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 from the DHL agreements for the first, second and third 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, second and third 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 fourth quarter of 2009 and through the remaining term of the ACMI agreement.

### *ACMI Services*

Through its three airline subsidiaries, the Company provides airlift to other airlines, freight forwarders and the U.S. military, typically through ACMI agreements. The airlines serve a variety of customers in the air cargo industry by flying in North America, South America, Central America, Europe and Asia. 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. At September 30, 2009, ACMI Services included 47 in-service aircraft, three more than in September 2008. ABX operated 13 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 revenues, excluding directly reimbursed fuel expenses, were \$70.3 million and \$208.1 million for the third quarter and first nine months of 2009, decreasing 12% and 1%, respectively, compared to the corresponding periods of 2008. Block hours increased 12% and 8% for the third quarter and first nine months of 2009, respectively, reflecting additional Boeing 767 and Boeing 757 aircraft placed into service since mid 2008. The decline in revenues is due to the lower cost of aviation fuel for those ACMI, block space and charter contracts that include fuel in their price. The price per gallon of aviation fuel in 2009 declined approximately 50% compared to 2008. Excluding those contracts that include fuel, revenues per block hour declined 4% and remained unchanged for the third quarter and first nine months of 2009, respectively, compared to the corresponding 2008 periods. ACMI Services results included revenues of \$5.6 million from Boeing 767 freighter aircraft that ABX supplied to DHL during the first nine months of 2009 under short-term supplemental agreements.

Pre-tax earnings for the ACMI Services segment decreased \$1.8 million and increased \$0.3 million for the third quarter and first nine 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 Boeing 767 transatlantic scheduled service which 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. High levels of sick occurrences among crew members in the third quarter of 2009 resulted in higher pay premiums for unscheduled pilots who flew open routes. Additionally, pre-tax earnings were negatively impacted by the timing of scheduled maintenance checks. ABX, which expenses aircraft maintenance as it is incurred, completed six scheduled maintenance checks during the first nine months of 2009, compared to three maintenance checks during the same period in 2008.

### ***CAM Segment***

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 41 aircraft that were under lease as of September 30, 2009, 38 of them to ABX, ATI and CCIA.

Pre-tax segment earnings for CAM were \$6.1 million and \$16.7 million for the third quarter and first nine months of 2009 compared to \$4.0 million and \$13.2 million for the corresponding 2008 periods. The increase in pre-tax earnings reflects six additional aircraft that CAM has placed in service since September 2008. CAM's results reflect an allocation of interest expense based on prevailing interest rates and the carrying value of its operating assets. CAM's revenues for the three and nine month period ended September 30, 2009 include \$12.9 million and \$36.1 million for the leasing of aircraft to ATI, CCIA and ABX. During the first nine months of 2009, CAM leased four additional aircraft to ATSG airlines.

In February 2009, CAM finalized a lease agreement to provide two Boeing 767 aircraft to a Miami, Florida based operator. The lease agreement is expected to begin in the fourth quarter of 2009 and includes the option to lease up to three additional Boeing 767 aircraft.

CAM has contracted with IAI for the conversion of up to 14 non-standard Boeing 767 aircraft to full freighter configuration. 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. Three Boeing 767 aircraft were undergoing freighter modification as of September 30, 2009. ATSG plans to modify up to 10 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 ACMI contract. In October 2009, CAM purchased another Boeing 767-200 freighter for approximately \$17.8 million, completing a purchase commitment made in 2007 when the Company acquired Cargo Holdings International, Inc.

### ***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 facility 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.

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 facilitates 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.

Revenues from all other activities increased \$2.1 million and \$8.0 million in the third quarter and first nine months of 2009 compared to the corresponding 2008 periods. Increased revenues were primarily a result of an increase in aircraft and facility maintenance services when compared to 2008. Pre-tax earnings from all other activities were \$0.1 million and \$2.9 million during the third quarter and first nine months of 2009 compared to a \$0.2 million loss and a \$2.2 million loss in the corresponding 2008 periods. Improved pre-tax earnings for the third quarter of 2009 compared to the third quarter of 2008 were driven by higher maintenance and postal revenues. These improvements were partially offset by an increase in the proportion of overhead cost that the Company does not recover through its DHL ACMI and Hub services agreements, the latter of which expired on August 15, 2009 offset. Improved earnings for the first nine months of 2009 reflected increased sales of surplus aircraft and aircraft parts compared to 2008. Additionally, our pre-tax loss for the 2008 year 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.

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Revenues:</b>				
<b>DHL</b>				
ACMI				
Reimbursed Expenses	\$ 58,293	\$110,948	\$215,749	\$335,403
Mark-ups	1,800	2,322	9,033	7,334
Reimbursable wind-down payments	9,708	—	48,913	—
Total ACMI	69,801	113,270	273,695	342,737
Reimbursement reserve	—	(464)	—	(1,787)
<b>Total DHL</b>	<b>69,801</b>	<b>112,806</b>	<b>273,695</b>	<b>340,950</b>
<b>ACMI Services</b>				
Charter and ACMI	70,296	79,434	208,105	210,691
Other Reimbursable	20,195	37,442	53,054	106,189
<b>Total ACMI Services</b>	<b>90,491</b>	<b>116,876</b>	<b>261,159</b>	<b>316,880</b>
<b>CAM</b>	<b>16,046</b>	<b>11,964</b>	<b>43,715</b>	<b>33,677</b>
<b>Other Activities</b>	<b>17,838</b>	<b>15,708</b>	<b>42,829</b>	<b>34,789</b>
<b>Total Revenues</b>	<b>194,176</b>	<b>257,354</b>	<b>621,398</b>	<b>726,296</b>
Eliminate internal revenues	(19,974)	(17,668)	(48,425)	(41,574)
<b>Customer Revenues</b>	<b><u>\$174,202</u></b>	<b><u>\$239,686</u></b>	<b><u>\$572,973</u></b>	<b><u>\$684,722</u></b>
<b>Pre-tax Earnings:</b>				
<b>DHL</b>	\$ 1,929	\$ 2,326	\$ 13,776	\$ 5,728
<b>ACMI Services</b>	(926)	879	1,502	1,195
<b>CAM</b>	6,115	4,038	16,696	13,204
<b>Other Activities</b>	140	(219)	2,939	(2,242)
<b>Net non-reimbursed interest income (expense)</b>	<b>(2,611)</b>	<b>(2,385)</b>	<b>(7,201)</b>	<b>(8,812)</b>
<b>Total Pre-tax Earnings</b>	<b><u>\$ 4,647</u></b>	<b><u>\$ 4,639</u></b>	<b><u>\$ 27,712</u></b>	<b><u>\$ 9,073</u></b>

*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.*

## **RESULTS OF OPERATIONS**

Net earnings from continued operations decreased \$1.3 million for the third quarter of 2009 compared to the corresponding period of 2008. For the third quarter of 2009, improved earnings generated by CAM from aircraft leases of \$2.1 million was offset by losses from ACMI services and increased absorption of overhead costs that the Company did not recover through its DHL agreements.

Net earnings from continued operations improved \$11.6 million for the first nine months of 2009 compared to the corresponding period of 2008. Improved earnings included increased revenues from the DHL ACMI agreement. Due to contractual amendments stemming from DHL's restructuring plans, revenues for the first nine months 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 included revenues specified by the S&R agreement to facilitate the wind-down of DHL's U.S. network. By comparison, operating results from continued operations for the first nine months of 2008 included one-time charges totaling \$3.8 million stemming from an arbitration ruling in July 2008. During 2009, improved CAM earnings of \$3.5 million, lower non reimbursed interest expense of \$1.6 million and gains from the sale of surplus aircraft of \$2.2 million were offset by higher income tax expenses of \$7.1 million and increased non reimbursed overhead cost compared to the first nine months of 2008.

Salaries, wages and benefits expense decreased 25% and 9% during the three and nine month periods ended September 30, 2009, respectively, compared to the corresponding periods of 2008. Due primarily to the DHL restructuring, headcount declined approximately 75% as of September 30, 2009 compared to September 30, 2008.

Fuel expense decreased \$27.4 million and \$64.0 million during the three and nine month periods ended September 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 third quarter of 2008. The average price of a gallon of aviation fuel decreased 50% in the third quarter of 2009 compared to the third quarter of 2008.

Maintenance, materials and repairs decreased \$5.5 million and \$17.4 million during the three and nine month periods ended September 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 \$4.3 million and \$6.0 million during the three and nine month periods ended September 30, 2009, respectively, compared to the corresponding periods of 2008. Depreciation expense decreased due to the removal of the ABX DC-9 fleet and eight Boeing 767 aircraft since DHL's restructuring announcement in May 2008. The depreciation expense for 2009 reflects the addition of one Boeing 757 aircraft and four Boeing 767 aircraft that the Company has placed in service since September 2008.

Landing and ramp expense, which includes the cost of deicing chemicals, decreased \$0.8 million and \$4.0 million during the three and nine month periods ended September 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 \$1.7 million and \$7.0 million during the three and nine month periods ended September 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 \$0.1 million and \$1.3 million during the three and nine month periods ended September 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, and the cost of parts sold to non-DHL customers. Other operating expenses increased \$0.3 million and decreased \$1.6 million during the three and nine month periods ended September 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 \$2.4 million and \$6.6 million during the three and nine month periods ended September 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 and lower interest rates. Interest rates on the Company's variable interest, unsubordinated term loan decreased from 6.8% in the third quarter of 2008 to 2.9% for the third quarter of 2009.

Interest income decreased \$0.4 million and \$1.6 million during the three and nine month periods ended September 30, 2009, respectively, compared to the corresponding periods of 2008 due to lower short-term interest rates on our cash and cash equivalents and a decrease in the cash and cash equivalents balance.

The effective tax rate for the three and nine month periods ended September 30, 2009 was 38.1% and 35.7%, respectively, compared to 17.1% and 31.8% for the corresponding periods in 2008. Income taxes recorded through September 30, 2009 have been estimated based on year-to-date income and projected results for the full year, excluding discrete items. The effective tax rate increased in 2009 compared to 2008 and 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 lower effective tax rate for 2008 included a \$1.3 million benefit recorded in the third quarter of 2008 due to the completion of an IRS examination. The Company recorded a deferred tax benefit in the second quarter of 2009 related to the recognition of a previously unrecognized tax position under the Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”) topic 740-10 “Income Taxes.” The effective settlement of this item resulted in a deferred tax benefit of \$0.7 million. No additional changes to the unrecognized tax benefits are anticipated in the next twelve months.

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

### ***Commitments***

Through CAM, we have contracted with an 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 three Boeing 767 aircraft in the modification process from passenger to a standard freighter configuration as of September 30, 2009. Based on the most current projections, we expect to place two of these aircraft into service during the fourth quarter of 2009 and one in the first quarter of 2010 as modifications are completed. We have the right to convert up to ten 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 September 30, 2009, it would owe IAI, in addition to payments for aircraft currently undergoing modification, approximately \$2.6 million for non-recurring engineering costs and approximately \$7.8 million associated with additional conversion part kits which have been ordered. In October 2009, CAM purchased a Boeing 767-200 freighter aircraft for approximately \$17.8 million using the Company’s cash, completing a purchase commitment made in 2007 when the Company acquired Cargo Holdings International, Inc.

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 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.

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. 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, which amount will be offset from termination costs upon the expiration of the ACMI agreement.

We plan to contribute at least \$4.2 million to our qualified pension plans during the fourth quarter of 2009, and make total contributions to our qualified defined benefit pension plans of \$43.1 million for 2009.



### *Cash flows*

Net cash generated from operating activities was \$49.5 million for the first nine months of 2009 compared to \$114.3 million in the first nine months of 2008. The decrease in operating cash flows was 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 modification costs. Cash payments for capital expenditures were \$49.9 million in the first nine months of 2009 compared to \$96.6 million in the first nine months of 2008. Capital expenditures in the first nine months of 2009 included aircraft and cargo modification costs for six aircraft, while capital expenditures in the first nine months of 2008 included aircraft and cargo modification costs for nine aircraft. We estimate the total level of capital spending for all of 2009 will be approximately \$104 million compared to \$112 million in 2008.

### *Liquidity and Capital Resources*

At September 30, 2009, the Company had approximately \$89.7 million of cash balances. The Company had \$41.7 million of unused credit facility, net of draws of \$18.5 million and outstanding letters of credit of \$14.8 million, through a syndicated Credit Agreement that expires in December 2012.

As of September 30, 2009, DHL owes the Company \$72.8 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 payouts, certain accruals and the sale price of aircraft (see Note B). If ABX and DHL cannot agree on payments, arbitration or legal proceedings could result. 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.

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 a material adverse effect 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 and the prevailing tight credit markets 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.

## **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*

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 were performed. Except for the amendments described below, expenses incurred under these agreements are generally subject to a base mark-up of 1.75%, which was recognized in the period the expenses were incurred. Certain costs, the most significant of which include interest on the promissory note due to DHL, rent, 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 measured the achievement of annual goals and recorded 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, second and third 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, second and third 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. The Company’s revenues for the first, second and third quarters of 2009 includes reimbursement for certain 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 or technical 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 the Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”) topic 350-20 “Intangibles – Goodwill and Other”, we will assess on an annual basis whether goodwill acquired in the acquisition of Cargo Holdings International, Inc. 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.

### *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 FASB ASC topic 740-10 "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.

### *Discontinued Operations*

In accordance with the guidance of FASB ASC topic 205-20 “Presentation of Financial Statements”, a business component whose operations are discontinued is reported as discontinued operations if the cash flows of the component have been eliminated from the ongoing operations of the Company and the Company will no longer have any significant continuing involvement in the business component. The results of discontinued operations are aggregated and presented separately in the consolidated statement of operations. FASB ASC topic 205-20 requires the reclassification of amounts presented for prior years to reflect their classification as discontinued operations.

### *Exit Activities*

We account for the costs associated with exit activities in accordance with FASB ASC topic 420-10 “Exit or Disposal Cost Obligations”. 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 FASB ASC topic 715-30 “Compensation – Retirement 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 ACMI and charter agreements with our 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 is 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 K 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 September 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.

## 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) 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. 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 I 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.

#### *Proposed FAA Civil Penalty*

In September 2009, ABX received a letter from the FAA alleging that it had failed to comply with an FAA Airworthiness Directive involving its Boeing 767 aircraft and proposing a monetary settlement. ABX will be scheduling a meeting with the FAA to discuss this matter, as permitted by FAA procedures. The Company believes it has adequately reserved for this matter.

## *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.

### **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 September 30, 2009, DHL owes the Company \$72.8 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, certain accruals 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.

*Growth of aircraft leasing revenues and operating results from potential aircraft leasing arrangements may be less than planned.*

ATSG is currently negotiating long term Boeing 767 aircraft lease arrangements with DHL and other potential customers. ATSG may not be successful at winning new lease arrangements. Contracted lease rates may be less than currently expected. There may be long delays in the time between when an aircraft modification is complete and when a lease for it begins.

*ABX's may lose air cargo customers.*

ABX has been negotiating with designated representatives of ABX's pilots' union on amendments to the collective bargaining agreement ("CBA"). On November 6, 2009, the Company and negotiators for the ABX pilots' union reached a tentative agreement which is being submitted to the ABX pilots' union members for ratification at large. ABX is seeking to achieve lower wages and benefits and more favorable work rules so that it may independently compete in the ACMI air cargo markets with lower cost carriers. ABX is also negotiating with DHL under competitive conditions to provide it with crews and other airline services. In conjunction with its restructuring, downsizing and wage concessions, if ABX is unsuccessful at achieving a more competitive CBA in the near future, ABX will be at competitive disadvantage for winning a service contract with DHL and other potential customers. Further, if ABX is unsuccessful at achieving a more competitive CBA and winning a long term service contract with DHL, ABX will likely incur additional job losses, reductions in revenues and lower cash in flows in the future.

Management believes that the proposed changes to the CBA, if ratified, will improve ABX's ability to compete in air cargo markets. Even if the proposal is ratified, there are no assurances that ABX will be able to compete profitably in the highly competitive air cargo markets. Continued cost pressures and potential excess capacity in the air cargo markets could negatively impact ABX's future operating results.

*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). The Company has at times 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 5. Other Information

Air Transport Services Group, Inc.'s wholly owned subsidiary, ABX Air, Inc. ("ABX Air"), is a party to an ACMI Service Agreement with DHL Network Operations (USA), Inc. ("ACMI Agreement") and was also a party to a recently expired Hub and Line-Haul Services Agreement with DHL Express (USA), Inc. ("Hub Services Agreement"), both of which are dated August 15, 2003. (DHL Network Operations (USA), Inc. and DHL Express (USA), Inc. will hereinafter individually and collectively be referred to as "DHL" from time to time.).

Under the ACMI Agreement, ABX Air provides air cargo transportation services to DHL on a cost plus basis. Under the Hub Services Agreement, which expired on August 15, 2009, ABX Air provided staff to conduct package handling, package sorting and airport facilities and equipment maintenance services for DHL, also on a cost plus basis. Historically, the expenses incurred under these Agreements were generally marked-up by 1.75% (the base mark-up) and included in revenues. Both Agreements also allowed ABX Air to earn incremental mark-up 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. Fuel, rent, interest on the promissory note to DHL, and ramp and landing fees incurred under the ACMI agreement were the most significant cost items reimbursed without mark-up.

In November 2008, DHL and ABX Air amended the ACMI Agreement and the Hub Services Agreement to provide for specific base and incremental mark-up amounts for the fourth quarter of 2008 and the first quarter of 2009. The parties further agreed to make commercially reasonable efforts to agree upon alternative compensation arrangements under the Agreements for subsequent quarters, as well as to an allocation of overhead costs attributable to ABX Air's revenues from sources other than DHL, at least sixty days prior to the first day of each quarter. The purpose of the amendment was to more appropriately compensate ABX Air 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.

Thereafter, in April 2009, the parties agreed to specific base and incremental markup amounts under each of the Agreements and to an overhead allocation for the second quarter of 2009.

Most recently, on November 11, 2009, the parties agreed to specific base and incremental markup amounts and to an overhead allocation under each of the Agreements for the third quarter of 2009. For the third quarter of 2009, DHL will pay ABX Air \$1.8 million in markups under the ACMI Agreement and \$1.3 million in markups under the Hub Services Agreement. In addition, ABX Air's total overhead allocation to DHL for the third quarter was fixed at \$800,000. Notwithstanding the foregoing, the parties further agreed that, in the event that DHL and/or one or more of its affiliates and ABX Air and/or one or more of its affiliates subsequently consummate transaction documentation with respect to the lease and operation of Boeing 767 aircraft after the termination or expiration of the ACMI Agreement, the markup under the ACMI Agreement for the third quarter of 2009 will be increased to \$2.8 million and the total overhead allocation to DHL for the third quarter of 2009 will be increased to \$1.0 million.

On November 12, 2009, DHL and ABX Air amended the Hub Services Agreement to provide that, notwithstanding the expiration of the Agreement during the third quarter of 2009, the parties will reconcile any changes with respect to ABX Air's workers' compensation reserves for the fourth quarter of 2009.

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.



**Item 6. Exhibits**

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

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
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, incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange commission on August 10, 2009.
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, incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange commission on August 10, 2009.
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, incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange commission on August 10, 2009.
10.7	Guaranty by Air Transport Services Group, Inc. in favor of DHL Express (USA), Inc., dated May 8, 2009, incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange commission on August 10, 2009.
10.8	Lease Assumption and Option Agreement between DHL Network Operations (USA), Inc. and ABX Air, Inc., dated May 29, 2009, incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange commission on August 10, 2009.
10.9	Letter Agreement, dated November 9, 2009, Concerning Base and Incremental Markup for the Third 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.
10.10	Letter Agreement, dated November 9, 2009, Concerning Base and Incremental Markup for the Third 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.
10.11	Fourth Amendment, dated November 11, 2009, to the Hub and Line-Haul Services Agreement, by and between DHL Express (USA), Inc., as successor in interest to Airborne, Inc. ("Groundco") and ABX Air, Inc. ("Airco"), dated August 15, 2003, 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.

## 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

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**Joseph C. Hete**  
Chief Executive Officer

Date: November 12, 2009

/s/ QUINT O. TURNER

---

**Quint O. Turner**  
Chief Financial Officer

Date: November 12, 2009

November 9, 2009

**VIA FACSIMILE TO (954) 888-7310  
& DHL EXPRESS**

DHL Network Operations (USA), Inc.  
1200 South Pine Island Road  
Plantation, Florida 33324  
Attention: Jon E. Olin – EVP, General Counsel & Secretary

Re: Base and Incremental Markup for the Third Quarter of 2009 under the ACMI Service Agreement, by and between DHL Network Operations (USA), Inc., as successor in interest to Airborne, Inc. (“Groundco”) and ABX Air, Inc. (“Airco”), dated August 15, 2003, as amended on April 27, 2004 and November 9, 2009 (the “ACMI Agreement”).

Dear Jon:

Unless otherwise defined herein, all capitalized terms used herein shall have the meanings ascribed thereto in the ACMI Agreement.

In accordance with paragraph (c) of the Second Amendment to the ACMI Agreement, dated November 9, 2008, Groundco and Airco hereby agree as follows:

(a) The Base Markup, quarterly cost component and quarterly portion of the annual cost and service components of the Incremental Markup to be paid to Airco in exchange for the services provided by Airco to Groundco under the ACMI Agreement during the third quarter of 2009 shall total \$1,800,000, consisting of the following:

\$735,163	Base Markup for third quarter of 2009
\$275,613	Quarterly cost component of Incremental Markup for third quarter of 2009
\$358,545	Quarterly portion of annual cost component of Incremental Markup for 2009
\$ 88,179	Quarterly portion of annual service component of Incremental Markup for 2009

DHL shall pay to ABX such amounts, to the extent that such amounts have yet to be paid, no later than November 16, 2009, in accordance with the terms of the ACMI Agreement.

(b) Notwithstanding paragraph (a) above, in the event that ABX Air and/or one or more of its affiliates and DHL and/or one or more of its affiliates subsequently consummate transaction documentation with respect to the lease and operation of Boeing

Jon E. Olin  
November 9, 2009  
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767 aircraft, then the total amount set forth in paragraph (a) above shall be increased to \$2,750,000, consisting of the following, which amount will be paid by DHL to ABX within fourteen (14) days from the date of the consummation of such documentation:

\$1,387,100 Base Markup for third quarter of 2009  
\$ 520,025 Quarterly cost component of Incremental Markup for third quarter of 2009  
\$ 676,500 Quarterly portion of annual cost component of Incremental Markup for 2009  
\$ 166,375 Quarterly portion of annual service component of Incremental Markup for 2009

(c) Groundco and Aircor further agree that the allocation of overhead costs attributable to Aircor's provision of (i) Third Party Services under the ACMI Agreement, and (ii) Ancillary Services under the Hub and Line-Haul Services Agreement, by and between DHL Express (USA), Inc., as successor in interest to Airborne, Inc., and Aircor, dated August 15, 2003, as amended from time to time, shall not exceed \$800,000 in total for the third quarter of 2009. Notwithstanding the foregoing sentence, in the event that ABX Air and/or one or more of its affiliates and DHL and/or one or more of its affiliates subsequently consummate transaction documentation with respect to the lease and operation of Boeing 767 aircraft after the termination or expiration of the ACMI Agreement, then the overhead costs attributable to Aircor's provision of such Third Party Services and Ancillary Services shall not exceed \$1,000,000 in total for the third quarter of 2009, and ABX will reimburse DHL for any additional overhead allocation resulting therefrom within fourteen (14) days from the date of the consummation of such documentation.

Except to the extent provided herein, the terms and conditions of the ACMI Agreement shall remain in full force and effect until August 15, 2010, when the Agreement will expire by its own terms.

Please acknowledge Groundco's acceptance of the foregoing by having an authorized representative of DHL Network Operations (USA), Inc. sign and date both counterparts of this letter in the space provided below and returning one counterpart to me for my records.

Sincerely,

ABX Air, Inc.

/s/ W. Joseph Payne

W. Joseph Payne

Vice President

General Counsel & Secretary

Jon E. Olin  
November 9, 2009  
3 of 3

ACCEPTED AND AGREED:

DHL Network Operations (USA), Inc.

/s/ Jon E. Olin

By: Jon E. Olin

Its: SVP

Date: November 11, 2009

November 9, 2009

**VIA FACSIMILE TO (954) 888-7310  
& DHL EXPRESS**

DHL Network Operations (USA), Inc.  
1200 South Pine Island Road  
Plantation, Florida 33324  
Attention: Jon E. Olin – EVP, General Counsel & Secretary

Re: Base and Incremental Markup for the Third Quarter of 2009 under the Hub and Line-Haul Services Agreement, by and between DHL Express (USA), Inc., as successor in interest to Airborne, Inc. (“Groundco”) and ABX Air, Inc. (“Airco”), dated August 15, 2003, as amended on April 27, 2004, August 8, 2005 and November 9, 2008 (the “Hub Services Agreement”).

Dear Jon:

Unless otherwise defined herein, all capitalized terms used herein shall have the meanings ascribed thereto in the Hub Services Agreement.

In accordance with paragraph (c) of the Third Amendment of the Hub Services Agreement, dated November 9, 2008, Groundco and Airco hereby agree as follows:

(a) The Base Markup, quarterly cost component and quarterly portion of the annual cost and service components of the Incremental Markup to be paid to Airco in exchange for the services provided by Airco to Groundco under the Hub Services Agreement during the third quarter of 2009 through the date of its expiration on August 15, 2009, shall total \$1,330,000, consisting of the following:

\$741,608	Base Markup for third quarter of 2009
\$100,016	Quarterly cost component of Incremental Markup for third quarter of 2009
\$150,024	Quarterly portion of annual cost component of Incremental Markup for 2009
\$338,352	Quarterly portion of annual service component of Incremental Markup for 2009

DHL shall pay to ABX such amounts, to the extent that such amounts have yet to be paid, no later than November 16, 2009, in accordance with the terms of the Hub Services Agreement.

Jon E. Olin  
November 9, 2009  
2 of 2

(b) Groundco and Airco further agree that the allocation of overhead costs attributable to Airco's provision of (i) Ancillary Services under the Hub Services Agreement, and (ii) Third Party Services under the ACMI Service Agreement, by and between DHL Network Operations (USA), Inc., as successor in interest to Airborne, Inc. and Airco, dated August 15, 2003, as amended from time to time, shall not exceed \$800,000 in total for the third quarter of 2009. Notwithstanding the foregoing sentence, in the event that ABX Air and/or one or more of its affiliates and DHL and/or one or more of its affiliates subsequently consummate transaction documentation with respect to the lease and operation of Boeing 767 aircraft after the termination or expiration of the ACMI Agreement, then the overhead costs attributable to Airco's provision of such Third Party Services and Ancillary Services shall not exceed \$1,000,000 in total for the third quarter of 2009, and ABX will reimburse DHL for any additional overhead allocation resulting therefrom within fourteen (14) days from the date of the consummation of such documentation.

Please acknowledge Groundco's acceptance of the foregoing by having an authorized representative of DHL Express (USA), Inc., sign and date both counterparts of this letter in the space provided below and returning one counterpart to me for my records.

Nothing in this letter agreement shall be deemed a renewal, novation, or amendment of the Hub Services Agreement, which expired by its own terms on August 15, 2009, and so remains expired.

Sincerely,

ABX Air, Inc.

/s/ W. Joseph Payne  
\_\_\_\_\_  
W. Joseph Payne  
Vice President  
General Counsel & Secretary

ACCEPTED AND AGREED:

DHL Express (USA), Inc.

/s/ Jon E. Olin

By: Jon E. Olin

Its: SVP

Date: November 11, 2009

November 11, 2009

**VIA FACSIMILE TO (954) 888-7310  
& DHL EXPRESS**

DHL Express (USA), Inc.  
1200 South Pine Island Road  
Plantation, Florida 33324  
Attention: Jon E. Olin – EVP, General Counsel & Secretary

Re: Fourth Amendment to the Hub and Line-Haul Services Agreement, by and between DHL Express (USA), Inc., as successor in interest to Airborne, Inc. (“Groundco”) and ABX Air, Inc. (“Airco”), dated August 15, 2003, as previously amended on April 27, 2004, August 8, 2005 and November 9, 2008 (the “Hub Services Agreement”).

Dear Jon:

This letter is intended to confirm the agreement between Groundco and Airco to amend the Hub Services Agreement in order to accommodate the requirements of each other.

Unless otherwise defined herein, all capitalized terms used herein shall have the meanings ascribed thereto in the Hub Services Agreement.

The Hub Services Agreement is hereby amended, modified and/or confirmed as follows:

(a) Airco and Groundco agree that, notwithstanding the expiration of the Hub Services Agreement on August 15, 2009, Airco shall, in accordance with Section 5.12(a) of the Hub Services Agreement, submit to Groundco a statement of costs incurred through the fourth quarter of 2009, solely with respect to workers’ compensation reserves. Thereupon, any Reconciliation Payment owing to either party for the fourth quarter with respect to workers’ compensation reserves, shall be determined in accordance with Section 5.12(a) of the Hub Services Agreement.

Nothing in this letter shall be deemed an agreement by DHL to any workers compensation reserve amount or the amount of any workers compensation expense of Airco for any period.

Except to the extent specifically provided herein, nothing in this letter of amendment shall be deemed to renew, novate, amend, extend the term of, or provide any rights or impose any obligations on any party hereto or any of their respective affiliates pursuant to, the Hub Services Agreement, which expired by its own terms on August 15, 2009.



Jon E. Olin  
November 11, 2009  
2 of 2

Please acknowledge Groundco's acceptance of the foregoing by having an authorized representative of DHL Express (USA), Inc. sign and date this letter of amendment in the space provided below and returning one counterpart to me for my records.

Sincerely,

ABX Air, Inc.

/s/ W. Joseph Payne  
W. Joseph Payne  
Vice President  
General Counsel & Secretary

ACCEPTED AND AGREED: (as amended)

DHL Express (USA), Inc.

/s/ Jon E. Olin

By: Jon E. Olin

Its: SVP

Date: November 12, 2009



CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Quint O. Turner, certify that:

1. I have reviewed this report on Form 10-Q of Air Transport Services Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2009

/s/ QUINT O. TURNER

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Quint O. Turner  
Chief Financial Officer



