

Air Transport Services Group, Inc.  
Form 10-Q  
August 07, 2015

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

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FORM 10-Q  
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended June 30, 2015  
Commission file number 000-50368

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(Exact name of registrant as specified in its charter)

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|                                                      |                                      |
|------------------------------------------------------|--------------------------------------|
| Delaware                                             | 26-1631624                           |
| (State of Incorporation)                             | (I.R.S. Employer Identification No.) |
| 145 Hunter Drive, Wilmington, OH 45177               |                                      |
| (Address of principal executive offices)             |                                      |
| 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 x NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO o

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

|                                                                       |                             |
|-----------------------------------------------------------------------|-----------------------------|
| Large accelerated filer o                                             | Accelerated filer x         |
| Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO x  
As of August 7, 2015, 64,860,351 shares of the registrant's common stock, par value \$0.01, were outstanding.

AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES  
FORM 10-Q  
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**FILINGS WITH THE SECURITIES AND EXCHANGE COMMISSION**

The financial information, including the financial statements, included in the Quarterly Report on Form 10-Q should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, filed with the Securities and Exchange Commission on March 9, 2015.

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.

**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 2014 Annual Report filed on Form 10-K with the Securities and Exchange Commission.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

|                                                         | Three Months Ended |           | Six Months Ended |           |
|---------------------------------------------------------|--------------------|-----------|------------------|-----------|
|                                                         | June 30,           |           | June 30,         |           |
|                                                         | 2015               | 2014      | 2015             | 2014      |
| REVENUES                                                | \$148,353          | \$149,618 | \$295,378        | \$293,211 |
| OPERATING EXPENSES                                      |                    |           |                  |           |
| Salaries, wages and benefits                            | 42,036             | 40,895    | 85,715           | 83,960    |
| Fuel                                                    | 12,275             | 14,014    | 23,053           | 26,274    |
| Maintenance, materials and repairs                      | 23,993             | 23,168    | 46,686           | 48,047    |
| Depreciation and amortization                           | 31,400             | 27,142    | 60,393           | 52,121    |
| Travel                                                  | 4,342              | 4,419     | 8,765            | 8,992     |
| Rent                                                    | 2,447              | 6,924     | 6,654            | 14,234    |
| Landing and ramp                                        | 2,166              | 2,576     | 4,874            | 5,314     |
| Insurance                                               | 546                | 1,573     | 1,804            | 2,778     |
| Other operating expenses                                | 9,354              | 10,790    | 20,111           | 19,538    |
|                                                         | 128,559            | 131,501   | 258,055          | 261,258   |
| OPERATING INCOME                                        | 19,794             | 18,117    | 37,323           | 31,953    |
| OTHER INCOME (EXPENSE)                                  |                    |           |                  |           |
| Interest income                                         | 24                 | 24        | 46               | 43        |
| Net gain (loss) on derivative instruments               | 264                | 31        | 251              | 330       |
| Interest expense                                        | (2,839)            | (3,481)   | (5,904)          | (7,304)   |
|                                                         | (2,551)            | (3,426)   | (5,607)          | (6,931)   |
| EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES | 17,243             | 14,691    | 31,716           | 25,022    |
| INCOME TAX EXPENSE                                      | (6,673)            | (5,393)   | (12,251)         | (9,202)   |
| EARNINGS FROM CONTINUING OPERATIONS                     | 10,570             | 9,298     | 19,465           | 15,820    |
| EARNINGS FROM DISCONTINUED OPERATIONS, NET OF TAXES     | 214                | 211       | 428              | 422       |
| NET EARNINGS                                            | \$10,784           | \$9,509   | \$19,893         | \$16,242  |
| BASIC EARNINGS PER SHARE                                |                    |           |                  |           |
| Continuing operations                                   | \$0.16             | \$0.14    | \$0.30           | \$0.25    |
| Discontinued operations                                 | 0.01               | 0.01      | 0.01             | —         |
| TOTAL BASIC EARNINGS PER SHARE                          | \$0.17             | \$0.15    | \$0.31           | \$0.25    |
| DILUTED EARNINGS PER SHARE                              |                    |           |                  |           |
| Continuing operations                                   | \$0.16             | \$0.14    | \$0.30           | \$0.24    |
| Discontinued operations                                 | —                  | 0.01      | —                | 0.01      |
| TOTAL DILUTED EARNINGS PER SHARE                        | \$0.16             | \$0.15    | \$0.30           | \$0.25    |
| WEIGHTED AVERAGE SHARES                                 |                    |           |                  |           |
| Basic                                                   | 64,541             | 64,285    | 64,498           | 64,217    |
| Diluted                                                 | 65,471             | 65,207    | 65,404           | 65,174    |

See notes to condensed consolidated financial statements.

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AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES  
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (In thousands)

|                                        | Three Months Ended |         | Six Months Ended |          |
|----------------------------------------|--------------------|---------|------------------|----------|
|                                        | June 30,           |         | June 30,         |          |
|                                        | 2015               | 2014    | 2015             | 2014     |
| NET EARNINGS                           | \$10,784           | \$9,509 | \$19,893         | \$16,242 |
| OTHER COMPREHENSIVE INCOME (LOSS):     |                    |         |                  |          |
| Defined benefit pension                | 1,142              | —       | 2,284            | (1 )     |
| Defined benefit post-retirement        | (40 )              | (504 )  | (80 )            | (1,008 ) |
| Interest rate derivatives              | 2                  | (7 )    | (4 )             | (14 )    |
| Foreign currency translation           | 144                | —       | (296 )           | —        |
| TOTAL COMPREHENSIVE INCOME, net of tax | \$12,032           | \$8,998 | \$21,797         | \$15,219 |

See notes to condensed consolidated financial statements.

AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES  
 UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

|                                                                                                                                                                | June 30,<br>2015   | December 31,<br>2014 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|----------------------|
| <b>ASSETS</b>                                                                                                                                                  |                    |                      |
| <b>CURRENT ASSETS:</b>                                                                                                                                         |                    |                      |
| Cash and cash equivalents                                                                                                                                      | \$22,182           | \$30,560             |
| Accounts receivable, net of allowance of \$315 in 2015 and \$812 in 2014                                                                                       | 36,663             | 43,513               |
| Inventory                                                                                                                                                      | 10,709             | 10,665               |
| Prepaid supplies and other                                                                                                                                     | 10,583             | 12,613               |
| Deferred income taxes                                                                                                                                          | 19,770             | 19,770               |
| <b>TOTAL CURRENT ASSETS</b>                                                                                                                                    | <b>99,907</b>      | <b>117,121</b>       |
| Property and equipment, net                                                                                                                                    | 859,482            | 847,268              |
| Other assets                                                                                                                                                   | 26,904             | 28,230               |
| Goodwill and acquired intangibles                                                                                                                              | 38,870             | 39,010               |
| <b>TOTAL ASSETS</b>                                                                                                                                            | <b>\$1,025,163</b> | <b>\$1,031,629</b>   |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                                    |                    |                      |
| <b>CURRENT LIABILITIES:</b>                                                                                                                                    |                    |                      |
| Accounts payable                                                                                                                                               | \$39,316           | \$40,608             |
| Accrued salaries, wages and benefits                                                                                                                           | 20,485             | 25,633               |
| Accrued expenses                                                                                                                                               | 8,022              | 8,201                |
| Current portion of debt obligations                                                                                                                            | 24,672             | 24,344               |
| Unearned revenue                                                                                                                                               | 12,812             | 12,914               |
| <b>TOTAL CURRENT LIABILITIES</b>                                                                                                                               | <b>105,307</b>     | <b>111,700</b>       |
| Long term debt                                                                                                                                                 | 290,781            | 319,750              |
| Post-retirement obligations                                                                                                                                    | 86,102             | 92,050               |
| Other liabilities                                                                                                                                              | 59,266             | 57,647               |
| Deferred income taxes                                                                                                                                          | 115,985            | 102,993              |
| <b>TOTAL LIABILITIES</b>                                                                                                                                       | <b>657,441</b>     | <b>684,140</b>       |
| Commitments and contingencies (Note G)                                                                                                                         |                    |                      |
| <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; 64,987,351 and 64,854,950 shares issued and outstanding in 2015 and 2014, respectively | 650                | 649                  |
| Additional paid-in capital                                                                                                                                     | 525,104            | 526,669              |
| Accumulated deficit                                                                                                                                            | (77,060)           | (96,953)             |
| Accumulated other comprehensive loss                                                                                                                           | (80,972)           | (82,876)             |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>                                                                                                                              | <b>367,722</b>     | <b>347,489</b>       |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                              | <b>\$1,025,163</b> | <b>\$1,031,629</b>   |

See notes to condensed consolidated financial statements.

AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES  
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

|                                                                                     | Six Months Ended |                  |
|-------------------------------------------------------------------------------------|------------------|------------------|
|                                                                                     | June 30,         |                  |
|                                                                                     | 2015             | 2014             |
| <b>OPERATING ACTIVITIES:</b>                                                        |                  |                  |
| Net earnings from continuing operations                                             | \$19,465         | \$15,820         |
| Net loss from discontinued operations                                               | 428              | 422              |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                  |                  |
| Depreciation and amortization                                                       | 60,393           | 52,121           |
| Reclassification of pension and post-retirement balance                             | 3,460            | (1,585 )         |
| Deferred income taxes                                                               | 11,940           | 9,047            |
| Amortization of stock-based compensation                                            | 1,645            | 1,286            |
| Amortization of DHL promissory note                                                 | (1,550 )         | (3,100 )         |
| Net gain on derivative instruments                                                  | (251 )           | (330 )           |
| Changes in assets and liabilities:                                                  |                  |                  |
| Accounts receivable                                                                 | 6,977            | (4,619 )         |
| Inventory and prepaid supplies                                                      | 1,082            | (3,713 )         |
| Accounts payable                                                                    | 2,738            | (976 )           |
| Unearned revenue                                                                    | 2,354            | (2,334 )         |
| Accrued expenses, salaries, wages, benefits and other liabilities                   | (5,963 )         | 96               |
| Pension and post-retirement                                                         | (5,948 )         | (4,660 )         |
| Other                                                                               | (184 )           | (2,041 )         |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                    | <b>96,586</b>    | <b>55,434</b>    |
| <b>INVESTING ACTIVITIES:</b>                                                        |                  |                  |
| Capital expenditures                                                                | (76,308 )        | (23,508 )        |
| Proceeds from property and equipment                                                | 1,030            | 1,404            |
| Investment in nonconsolidated affiliate                                             | —                | (15,000 )        |
| <b>NET CASH (USED IN) INVESTING ACTIVITIES</b>                                      | <b>(75,278 )</b> | <b>(37,104 )</b> |
| <b>FINANCING ACTIVITIES:</b>                                                        |                  |                  |
| Principal payments on long term obligations                                         | (47,091 )        | (44,285 )        |
| Proceeds from borrowings                                                            | 20,000           | 15,000           |
| Purchase of common stock                                                            | (2,595 )         | —                |
| Funding for hangar construction                                                     | —                | 3,019            |
| <b>NET CASH (USED IN) FINANCING ACTIVITIES</b>                                      | <b>(29,686 )</b> | <b>(26,266 )</b> |
| <b>NET (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                                  | <b>(8,378 )</b>  | <b>(7,936 )</b>  |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>                               | <b>30,560</b>    | <b>31,699</b>    |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>                                   | <b>\$22,182</b>  | <b>\$23,763</b>  |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>                                          |                  |                  |
| Interest paid, net of amount capitalized                                            | \$5,646          | \$7,118          |
| Federal alternative minimum and state income taxes paid                             | \$501            | \$565            |
| <b>SUPPLEMENTAL NON-CASH INFORMATION:</b>                                           |                  |                  |
| Debt extinguished                                                                   | \$1,550          | \$3,100          |
| Accrued capital expenditures                                                        | \$3,618          | \$1,184          |

See notes to condensed consolidated financial statements.





AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE A—SUMMARY OF FINANCIAL STATEMENT PREPARATION AND SIGNIFICANT ACCOUNTING  
POLICIES

Nature of Operations

Air Transport Services Group, Inc. is a holding company whose principal subsidiaries include an aircraft leasing company and two independently certificated airlines. The Company provides airline operations, aircraft leases, aircraft maintenance and other support services primarily to the cargo transportation and package delivery industries. Through the Company's subsidiaries, it offers a range of complementary services to delivery companies, freight forwarders, airlines and government customers.

The airlines, ABX Air, Inc. ("ABX") and Air Transport International, Inc. ("ATI"), each have the authority, through their separate U.S. Department of Transportation ("DOT") and Federal Aviation Administration ("FAA") certificates, to transport cargo worldwide. The Company's leasing subsidiary, Cargo Aircraft Management, Inc. ("CAM"), leases aircraft to each of the Company's airlines as well as to non-affiliated airlines and other lessees.

The Company provides aircraft and airline operations to its customers, typically under contracts providing for a combination of aircraft, crews, maintenance and insurance ("ACMI") services. The Company serves a base of concentrated customers who have a diverse line of international cargo traffic. DHL Network Operations (USA), Inc. and its affiliates, "DHL," is the Company's largest customer. ATI provides passenger transportation, primarily to the U.S. Military, using "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 sells aircraft parts, provides aircraft and equipment maintenance services, and operates mail sorting facilities for the U.S. Postal Service ("USPS").

Basis of Presentation

The accompanying unaudited condensed interim consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America and such principles are applied on a basis consistent with information reflected in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014 filed with the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations promulgated by the SEC related to interim financial statements. In the opinion of management, the accompanying financial statements contain all adjustments, including normal recurring adjustments, necessary for the fair presentation of the Company's results of operations and financial position for the periods presented. Due to seasonal fluctuations, among other factors common to the airline industry, the results of operations for the periods presented are not necessarily indicative of the results of operations to be expected for the entire year or any interim period. The preparation of consolidated financial statements requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements. The accounting estimates reflect the best judgment of management, but actual results could differ materially.

The accompanying condensed consolidated financial statements include the accounts of Air Transport Services Group, Inc. and its wholly-owned subsidiaries. Investments in an affiliate in which the Company has significant influence but does not exercise control are accounted for using the equity method of accounting. Using the equity method, the Company's share of the nonconsolidated affiliate's income or loss is recognized in the consolidated statement of earnings and cumulative post-acquisition changes in the investment are adjusted against the carrying amount of the investment. Inter-company balances and transactions are eliminated.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"). ASU 2014-09 is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty



of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017 with earlier adoption permitted for reporting periods beginning after December 15, 2016. The Company is currently evaluating the methods of adoption allowed by the new standard and the effect the standard is expected to have on the Company's consolidated financial position, results of operations or cash flows and related disclosures.

In April 2015, the FASB issued ASU 2015-03, "Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs" ("ASU 2015-03"). ASU 2015-03 requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying value of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by ASU 2015-03. The amendments in ASU 2015-03 are effective retrospectively for fiscal years, and interim periods within those years, beginning after December 15, 2015. Early adoption is permitted. The Company does not expect the impact of adopting ASU 2015-03 to be material to the Company's financial statements and related disclosures.

#### NOTE B—SIGNIFICANT CUSTOMERS

##### DHL

The Company's largest customer is DHL. The Company has had long-term contracts with DHL since August 2003. Commencing March 31, 2010, the Company and DHL executed commercial agreements under which DHL leases Boeing 767 freighter aircraft from CAM and ABX operates those aircraft under a separate crew, maintenance and insurance ("CMI") agreement. The initial term of the CMI agreement was five years, ending March 31, 2015 while the terms of the aircraft leases were seven years. Effective April 1, 2015, the Company and DHL amended and restated the CMI agreement ("restated CMI agreement") under which ABX continues to operate Boeing 767 aircraft for DHL through March of 2019 and the Boeing 767 aircraft lease terms were extended through March of 2019. Pricing for services provided through the restated CMI agreement is based on pre-defined fees scaled for the number of aircraft hours flown, aircraft scheduled and flight crews provided to DHL for its U.S. network. During the second quarter of 2015, CAM leased 16 Boeing 767 aircraft to DHL and ABX operated them under the restated CMI agreement for DHL's network.

The Company has other agreements to provide additional air cargo transportation services to DHL. During the second quarter of 2015, ATI operated four CAM-owned Boeing 757 aircraft for DHL's network through ACMI agreements in which the Company provides the aircraft, crews, maintenance and insurance under a single contract. Additionally, ATI operated a Boeing 757 aircraft, supplied by DHL, for DHL's network. Revenues generated from the ACMI agreements are typically based on hours flown during the period. The Company also provides maintenance services to DHL for ground equipment, such as power units and air starts under separate agreements.

Revenues from continuing operations performed for DHL were approximately 48% and 50% of the Company's consolidated revenues from continuing operations for the three and six month periods ended June 30, 2015, respectively, compared to 57% and 57% for the corresponding periods of 2014. The Company's balance sheets include accounts receivable with DHL of \$9.0 million and \$12.2 million as of June 30, 2015 and December 31, 2014, respectively.

##### U.S. Military

A substantial portion of the Company's revenues are also derived from the U.S. Military. The U.S. Military awards flights to U.S. certificated airlines through annual contracts and through temporary "expansion" routes. Revenues from services performed for the U.S. Military were approximately 18% and 17% of the Company's total revenues from continuing operations for the three and six month periods ended June 30, 2015, respectively, compared to 17% and 16% for the corresponding periods of 2014. The Company's balance sheets included accounts receivable with the U.S. Military of \$5.3 million and \$6.0 million as of June 30, 2015 and December 31, 2014, respectively.

**NOTE C—GOODWILL, ACQUIRED INTANGIBLES AND EQUITY INVESTMENTS**

The Company has one reporting unit that has goodwill, CAM. The carrying amounts of goodwill are as follows (in thousands):

|                                        | CAM      | Total    |
|----------------------------------------|----------|----------|
| Carrying value as of December 31, 2014 | \$34,395 | \$34,395 |
| Carrying value as of June 30, 2015     | \$34,395 | \$34,395 |

The Company's intangible assets relate to the ACMI Services segment and are as follows (in thousands):

|                                        | Customer Relationships | Airline Certificates | Total   |
|----------------------------------------|------------------------|----------------------|---------|
| Carrying value as of December 31, 2014 | \$1,615                | \$3,000              | \$4,615 |
| Amortization                           | (140                   | ) —                  | (140    |
| Carrying value as of June 30, 2015     | \$1,475                | \$3,000              | \$4,475 |

The customer relationship intangible amortizes through 2020. The airline certificates have an indefinite life and therefore are not amortized.

In January 2014, the Company acquired a 25 percent equity interest in West Atlantic AB of Gothenburg, Sweden ("West"). West, through its two airlines, Atlantic Airlines Ltd. and West Air Sweden AB, operates a fleet of approximately 40 aircraft primarily in Europe. West operates its aircraft on behalf of European regional mail carriers and express logistics providers. The airlines operate a combined fleet of British Aerospace ATPs, Bombardier CRJ-200-PFs, Boeing 737 and Boeing 767 aircraft.

The Company has significant influence, but does not exercise control, over West. Accordingly, the investment in West is accounted for using the equity method of accounting and was initially recognized at cost. The Company's carrying value of West was \$12.9 million and \$13.8 million at June 30, 2015 and December 31, 2014, respectively, including \$5.5 million of excess purchase price over the Company's proportional fair value of West's net assets in January of 2014. The carrying value is reflected in "Other Assets" in the Company's consolidated balance sheets.

**NOTE D—FAIR VALUE MEASUREMENTS**

The Company's money market funds and interest rate swaps are reported on the Company's consolidated balance sheets at fair values based on market values from identical or comparable transactions. The fair value of the Company's money market funds and interest rate swaps 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 (in thousands):

| As of June 30, 2015           | Fair Value Measurement Using |          |         | Total    |
|-------------------------------|------------------------------|----------|---------|----------|
|                               | Level 1                      | Level 2  | Level 3 |          |
| <b>Assets</b>                 |                              |          |         |          |
| Cash equivalents—money market | \$20                         | \$5,505  | \$—     | \$5,525  |
| Total Assets                  | \$20                         | \$5,505  | \$—     | \$5,525  |
| <b>Liabilities</b>            |                              |          |         |          |
| Interest rate swap            | \$—                          | \$(1,169 | ) \$—   | \$(1,169 |
| Total Liabilities             | \$—                          | \$(1,169 | ) \$—   | \$(1,169 |

| As of December 31, 2014       | Fair Value Measurement Using |           |         | Total     |
|-------------------------------|------------------------------|-----------|---------|-----------|
|                               | Level 1                      | Level 2   | Level 3 |           |
| <b>Assets</b>                 |                              |           |         |           |
| Cash equivalents—money market | \$20                         | \$2,306   | \$—     | \$2,326   |
| Total Assets                  | \$20                         | \$2,306   | \$—     | \$2,326   |
| <b>Liabilities</b>            |                              |           |         |           |
| Interest rate swap            | \$—                          | \$(1,419) | ) \$—   | \$(1,419) |
| Total Liabilities             | \$—                          | \$(1,419) | ) \$—   | \$(1,419) |

As a result of lower 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, based on Level 2 observable inputs, was approximately \$0.3 million less than the carrying value, which was \$315.5 million at June 30, 2015. As of December 31, 2014, the fair value of the Company's debt obligations was approximately \$2.5 million more than the carrying value, which was \$344.1 million. The non-financial assets, including goodwill, intangible assets and property and equipment are measured at fair value on a non-recurring basis.

#### NOTE E—PROPERTY AND EQUIPMENT

The Company's property and equipment consists primarily of cargo aircraft, aircraft engines and flight equipment. Property and equipment, to be held and used, is summarized as follows (in thousands):

|                                                         | June 30,<br>2015 | December 31,<br>2014 |
|---------------------------------------------------------|------------------|----------------------|
| Flight equipment                                        | \$1,335,943      | \$1,285,966          |
| Ground equipment                                        | 33,735           | 33,677               |
| Leasehold improvements, facilities and office equipment | 25,152           | 25,180               |
| Aircraft modifications and projects in progress         | 21,043           | 18,612               |
|                                                         | 1,415,873        | 1,363,435            |
| Accumulated depreciation                                | (556,391)        | ) (516,167)          |
| Property and equipment, net                             | \$859,482        | \$847,268            |

CAM owned aircraft with a carrying value of \$370.2 million and \$289.5 million that were under leases to external customers as of June 30, 2015 and December 31, 2014, respectively.

The carrying value of Boeing 727 and DC-8 freighter aircraft and engines available for sale totaled \$0.4 million and \$0.7 million as of June 30, 2015 and December 31, 2014, respectively.

## NOTE F—DEBT OBLIGATIONS

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

|                                       | June 30,<br>2015 | December 31,<br>2014 |
|---------------------------------------|------------------|----------------------|
| Unsubordinated term loan              | \$108,750        | \$116,250            |
| Revolving credit facility             | 165,000          | 180,000              |
| Aircraft loans                        | 41,703           | 46,294               |
| Promissory note due to DHL, unsecured | —                | 1,550                |
| Total long term obligations           | 315,453          | 344,094              |
| Less: current portion                 | (24,672          | ) (24,344            |
| Total long term obligations, net      | \$290,781        | \$319,750            |

The Company executed a syndicated credit agreement ("Senior Credit Agreement") in May 2011 which includes an unsubordinated term loan and a revolving credit facility. On May 8, 2015, the Company executed an amendment to the Senior Credit Agreement (the "Fifth Credit Amendment"). The Fifth Credit Amendment extended the maturity of the term loan and revolving credit facility to May 5, 2020, increased the capacity of the Revolving credit facility by \$50.0 million to \$325.0 million, increased the permitted additional indebtedness by \$50.0 million to \$150.0 million, and retained the accordion feature whereby the Company can draw up to an additional \$50.0 million subject to the lenders' consent. Under the amended terms of the Senior Credit Agreement, the Company is required to maintain collateral coverage equal to 150% of the outstanding balances of the term loan and the maximum capacity of revolving credit facility or 175% of the outstanding balance of the term loan and the total funded revolving credit facility, whichever is less. The minimum collateral coverage which must be maintained is 50% of the outstanding balance of the term loan plus the revolving credit facility commitment which was \$325.0 million as of May 8, 2015. Each year, through May 6, 2019, the Company may request a one year extension of the final maturity date, subject to the lenders' consent.

Under the terms of the Senior Credit Agreement, interest rates are adjusted quarterly based on the Company's earnings before interest, taxes, depreciation and amortization expenses ("EBITDA"), its outstanding debt level and prevailing LIBOR or prime rates. At the Company's current debt-to-EBITDA ratio, the LIBOR based financing for the unsubordinated term loan and revolving credit facility bear a variable interest rate of 1.94% and 1.94%, respectively. The Credit Amendment did not affect the EBITDA based pricing or covenants of the Senior Credit Agreement. The Senior Credit Agreement provides for the issuance of letters of credit on the Company's behalf. As of June 30, 2015, the unused revolving credit facility totaled \$150.9 million, net of draws of \$165.0 million and outstanding letters of credit of \$9.1 million.

The aircraft loans are collateralized by six aircraft, and amortize monthly with a balloon payment of approximately 20% with maturities between 2016 and early 2018. Interest rates range from 6.74% to 7.36% per annum payable monthly.

The Senior Credit Agreement is collateralized by certain of the Company's Boeing 767 and 757 aircraft that are not collateralized under aircraft loans. The Senior Credit Agreement contains covenants including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness, as well as a total debt to EBITDA ratio and a fixed charge coverage ratio. The Senior Credit Agreement stipulates events of default, including unspecified events that may have material adverse effects on the Company. If an event of default occurs, the Company may be forced to repay, renegotiate or replace the Senior Credit Agreement. The Senior Credit Agreement limits the amount of dividends the Company can pay and the amount of common stock it can repurchase to \$50.0 million during any calendar year, provided the Company's total debt to EBITDA ratio is under 2.5 times, after giving effect to the dividend or repurchase.

## NOTE G—COMMITMENTS AND CONTINGENCIES

## Lease Commitments

The Company leases portions of the air park in Wilmington, Ohio, under long-term lease agreements with a regional port authority. The leased facilities include corporate offices, 310,000 square feet of maintenance hangars and a 100,000 square foot component repair shop at the air park. ABX also has the non-exclusive right to use the airport, which includes one active runway, taxi ways and ramp space. Additionally, the Company leases certain equipment and airport facilities, office space and maintenance facilities at locations outside of the airpark in Wilmington.

## Guarantees and Indemnifications

Certain leases and agreements of the Company contain guarantees and indemnification obligations to the lessor, or one or more other parties that are considered reasonable 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.

## Brussels Noise Ordinance

The Brussels Instituut voor Milieubeheer ("BIM"), a governmental authority in the Brussels-Capital Region of Belgium that oversees the enforcement of environmental matters, imposed four separate administrative penalties on ABX in the approximate aggregate amount of €0.4 million (\$0.4 million) for numerous alleged violations of an ordinance limiting the noise caused by aircraft overflying the Brussels-Capital Region (which is located near the Brussels Airport) during the period from May 2009 through December 2010. ABX has exhausted its appeals with respect to all four of the administrative penalties.

The ordinance in question is controversial for the reason that it was adopted by the Brussels-Capital Region and is more restrictive than the noise limitations in effect in the Flemish Region, which is where the Brussels Airport is located. Numerous airlines have been levied fines under the ordinance, which is currently the subject of several court cases pending before the Belgian courts, including with respect to demands for payment. The Brussels government has suspended issuing demands for payment of the penalties pending the outcome of the litigation. ABX has yet to receive a demand for payment of the penalties.

## Other

In addition to the foregoing matters, we are also currently a party to legal proceedings, including FAA enforcement actions, in various federal and state jurisdictions arising out of the operation of the Company's business. The amount of alleged liability, if any, from these proceedings cannot be determined with certainty; however, we believe that the Company's 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.

## Employees Under Collective Bargaining Agreements

As of June 30, 2015, the flight crewmember employees of ABX and ATI were represented by the labor unions listed below:

| Airline | Labor Agreement Unit                   | Percentage of the Company's Employees |
|---------|----------------------------------------|---------------------------------------|
| ABX     | International Brotherhood of Teamsters | 11.4%                                 |
| ATI     | Air Line Pilots Association            | 5.8%                                  |



## NOTE H—PENSION AND OTHER POST-RETIREMENT BENEFIT PLANS

## Defined Benefit and Post-retirement Healthcare Plans

ABX sponsors a qualified defined benefit pension plan for ABX crewmembers and a qualified defined benefit pension plan for a major portion of its other ABX employees that meet minimum eligibility requirements. ABX also sponsors non-qualified defined benefit pension plans for certain employees. These non-qualified plans are unfunded.

Employees are no longer accruing benefits under any of the defined benefit pension plans. ABX also sponsors a post-retirement healthcare plan for its ABX employees, which is unfunded. Benefits for covered individuals terminate upon reaching age 65 under the post-retirement healthcare 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 of our post-retirement costs. The assumptions considered most sensitive in actuarially valuing ABX's pension obligations and determining related expense amounts are discount rates and expected long term investment returns on plan assets. Additionally, other assumptions concerning retirement ages, mortality and employee turnover also affect the valuations. Actual results and future changes in these assumptions could result in future costs significantly higher than those recorded in our results of operations. The Company's net periodic benefit costs for its defined benefit pension plans and post-retirement healthcare plans for both continuing and discontinued operations are as follows (in thousands):

|                                    | Three Months Ended June 30, |            |                                 |          | Six Months Ended June 30, |            |                                 |            |
|------------------------------------|-----------------------------|------------|---------------------------------|----------|---------------------------|------------|---------------------------------|------------|
|                                    | Pension Plans               |            | Post-Retirement Healthcare Plan |          | Pension Plans             |            | Post-Retirement Healthcare Plan |            |
|                                    | 2015                        | 2014       | 2015                            | 2014     | 2015                      | 2014       | 2015                            | 2014       |
| Service cost                       | \$—                         | \$—        | \$44                            | \$60     | \$—                       | \$—        | \$88                            | \$120      |
| Interest cost                      | 8,646                       | 9,879      | 48                              | 71       | 17,292                    | 19,758     | 96                              | 142        |
| Expected return on plan assets     | (11,020 )                   | (11,528 )  | —                               | —        | (22,040 )                 | (23,056 )  | —                               | —          |
| Amortization of prior service cost | —                           | —          | (136 )                          | (872 )   | —                         | —          | (272 )                          | (1,744 )   |
| Amortization of net (gain) loss    | 1,793                       | —          | 73                              | 80       | 3,586                     | (1 )       | 146                             | 160        |
| Net periodic benefit cost (gain)   | \$(581 )                    | \$(1,649 ) | \$29                            | \$(661 ) | \$(1,162 )                | \$(3,299 ) | \$58                            | \$(1,322 ) |

During the three and six month periods ended June 30, 2015, the Company contributed \$0.3 million and \$0.9 million to the pension plans. The Company expects to contribute an additional \$5.6 million during the remainder of 2015.

## NOTE I—INCOME TAXES

The provision for income taxes for interim periods is based on management's best estimate of the effective income tax rate expected to be applicable for the current year, plus any adjustments arising from changes in the estimated amount of taxable income related to prior periods. Income taxes recorded through June 30, 2015 have been estimated utilizing a 38.6% rate based upon year-to-date income and projected results for the full year. The final effective tax rate applied to 2015 will depend on the actual amount of pre-tax book income generated by the Company for the full year.

The Company has operating loss carryforwards for U.S. federal income tax purposes. Management expects to utilize the loss carryforwards to offset federal income tax liabilities in the future. Due to the Company's deferred tax assets, including its loss carryforwards, management does not expect to pay federal income taxes until 2017 or later. The Company may, however, be required to pay alternative minimum taxes and certain state and local income taxes before then.

## NOTE J—DERIVATIVE INSTRUMENTS

The Company's Senior Credit Agreement requires the Company to maintain derivative instruments for protection from fluctuating interest rates, for at least fifty percent of the outstanding balance of term loan. Accordingly, the Company entered into interest rate swaps, which are described in the table below (in thousands):

| Expiration Date | Stated Interest Rate | June 30, 2015   |                          | December 31, 2014 |                          |
|-----------------|----------------------|-----------------|--------------------------|-------------------|--------------------------|
|                 |                      | Notional Amount | Market Value (Liability) | Notional Amount   | Market Value (Liability) |
| May 9, 2016     | 2.020                | % 54,375        | (713 )                   | 58,125            | (1,071 )                 |
| June 30, 2017   | 1.183                | % 54,375        | (456 )                   | 58,125            | (348 )                   |

The outstanding interest rate swaps are not designated as hedges for accounting purposes. The effects of future fluctuations in LIBOR interest rates on derivatives held by the Company will result in the recording of unrealized gains and losses into the statement of operations. The Company recorded unrealized gain on derivatives of \$0.3 million and \$0.3 million for the six month periods ending June 30, 2015 and 2014, respectively. The liability for outstanding derivatives is recorded in other liabilities and in accrued expenses.

## NOTE K—ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated other comprehensive income (loss) includes the following items by components for the three and six month periods ending June 30, 2015 and 2014 (in thousands):

|                                                                            | Defined Benefit Pension | Defined Benefit Post-Retirement | Gains and Losses on Derivative | Foreign Currency Translation | Total     |
|----------------------------------------------------------------------------|-------------------------|---------------------------------|--------------------------------|------------------------------|-----------|
| Balance as of March 31, 2014                                               | (31,073 )               | 741                             | 2                              | —                            | (30,330 ) |
| Amounts reclassified from accumulated other comprehensive income:          |                         |                                 |                                |                              |           |
| Actuarial costs (reclassified to salaries, wages and benefits)             | —                       | 80                              | —                              | —                            | 80        |
| Negative prior service cost (reclassified to salaries, wages and benefits) | —                       | (872 )                          | —                              | —                            | (872 )    |
| Hedging gain (reclassified to interest expense)                            | —                       | —                               | (11 )                          | —                            | (11 )     |
| Income Tax (Expense) or Benefit                                            | —                       | 288                             | 4                              | —                            | 292       |
| Other comprehensive income (loss), net of tax                              | —                       | (504 )                          | (7 )                           | —                            | (511 )    |
| Balance as of June 30, 2014                                                | (31,073 )               | 237                             | (5 )                           | —                            | (30,841 ) |
| Balance as of December 31, 2013                                            | (31,072 )               | 1,245                           | 9                              | —                            | (29,818 ) |
| Amounts reclassified from accumulated other comprehensive income:          |                         |                                 |                                |                              |           |
| Actuarial costs (reclassified to salaries, wages and benefits)             | (1 )                    | 160                             | —                              | —                            | 159       |
| Negative prior service cost (reclassified to salaries, wages and benefits) | —                       | (1,744 )                        | —                              | —                            | (1,744 )  |
| Hedging gain (reclassified to interest expense)                            | —                       | —                               | (22 )                          | —                            | (22 )     |
| Income Tax (Expense) or Benefit                                            | —                       | 576                             | 8                              | —                            | 584       |
| Other comprehensive income (loss), net of tax                              | (1 )                    | (1,008 )                        | (14 )                          | —                            | (1,023 )  |
| Balance as of June 30, 2014                                                | (31,073 )               | 237                             | (5 )                           | —                            | (30,841 ) |

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|                                                                            | Defined<br>Benefit<br>Pension | Defined Benefit<br>Post-Retirement | Gains and<br>Losses on<br>Derivative | Foreign<br>Currency<br>Translation | Total     |
|----------------------------------------------------------------------------|-------------------------------|------------------------------------|--------------------------------------|------------------------------------|-----------|
| Balance as of March 31, 2015                                               | (80,049 )                     | (670 )                             | (2 )                                 | (1,499 )                           | (82,220 ) |
| Other comprehensive income (loss) before reclassifications:                |                               |                                    |                                      |                                    |           |
| Foreign currency translation adjustment                                    | —                             | —                                  | —                                    | 224                                | 224       |
| Amounts reclassified from accumulated other comprehensive income:          |                               |                                    |                                      |                                    |           |
| Actuarial costs (reclassified to salaries, wages and benefits)             | 1,793                         | 73                                 | —                                    | —                                  | 1,866     |
| Negative prior service cost (reclassified to salaries, wages and benefits) | —                             | (136 )                             | —                                    | —                                  | (136 )    |
| Hedging gain (reclassified to interest expense)                            | —                             | —                                  | (41 )                                | —                                  | (41 )     |
| Income Tax (Expense) or Benefit                                            | (651 )                        | 23                                 | 43                                   | (80 )                              | (665 )    |
| Other comprehensive income (loss), net of tax                              | 1,142                         | (40 )                              | 2                                    | 144                                | 1,248     |
| Balance as of June 30, 2015                                                | (78,907 )                     | (710 )                             | —                                    | (1,355 )                           | (80,972 ) |
| Balance as of December 31, 2014                                            | (81,191 )                     | (630 )                             | 4                                    | (1,059 )                           | (82,876 ) |
| Other comprehensive income (loss) before reclassifications:                |                               |                                    |                                      |                                    |           |
| Foreign currency translation adjustment                                    | —                             | —                                  | —                                    | (453 )                             | (453 )    |
| Amounts reclassified from accumulated other comprehensive income:          |                               |                                    |                                      |                                    |           |
| Actuarial costs (reclassified to salaries, wages and benefits)             | 3,586                         | 146                                | —                                    | —                                  | 3,732     |
| Negative prior service cost (reclassified to salaries, wages and benefits) | —                             | (272 )                             | —                                    | —                                  | (272 )    |
| Hedging gain (reclassified to interest expense)                            | —                             | —                                  | (50 )                                | —                                  | (50 )     |
| Income Tax (Expense) or Benefit                                            | (1,302 )                      | 46                                 | 46                                   | 157                                | (1,053 )  |
| Other comprehensive income (loss), net of tax                              | 2,284                         | (80 )                              | (4 )                                 | (296 )                             | 1,904     |
| Balance as of June 30, 2015                                                | (78,907 )                     | (710 )                             | —                                    | (1,355 )                           | (80,972 ) |

## NOTE L—STOCK-BASED COMPENSATION

The Company's Board of Directors has granted stock incentive awards to certain employees and board members pursuant to a long term incentive plan which was approved by the Company's stockholders. 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 typically 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 based on the Company's average return on invested capital 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 vesting periods of approximately a six or twelve months. The Company expects to settle all of the stock unit awards by issuing new shares of stock. The table below summarizes award activity.

|                                    | Six Months Ended |                                        |                  |                                        |
|------------------------------------|------------------|----------------------------------------|------------------|----------------------------------------|
|                                    | June 30, 2015    |                                        | June 30, 2014    |                                        |
|                                    | Number of Awards | Weighted average grant-date fair value | Number of Awards | Weighted average grant-date fair value |
| Outstanding at beginning of period | 1,406,550        | \$6.21                                 | 1,477,762        | \$5.83                                 |
| Granted                            | 390,200          | 9.61                                   | 467,567          | 7.52                                   |
| Converted                          | (263,791 )       | 6.42                                   | (186,179 )       | 7.50                                   |
| Expired                            | (1,600 )         | 10.11                                  | (4,300 )         | 7.64                                   |
| Forfeited                          | —                | —                                      | (17,800 )        | 6.26                                   |
| Outstanding at end of period       | 1,531,359        | \$7.04                                 | 1,737,050        | \$6.10                                 |
| Vested                             | 329,059          | \$5.61                                 | 415,550          | \$5.28                                 |

The average grant-date fair value of each performance condition award, non-vested restricted stock award and time-based award granted by the Company in 2015 was \$9.22, the fair value of the Company's stock on the date of grant. The average grant-date fair value of each market condition award granted in 2015 was \$10.99. The market condition awards were valued using a Monte Carlo simulation technique, a risk-free interest rate of 0.9% and a volatility of 41.5% based on volatility over three years using daily stock prices.

For the six month periods ended June 30, 2015 and 2014, the Company recorded expense of \$1.6 million and \$1.3 million, respectively, for stock incentive awards. At June 30, 2015, there was \$4.4 million of unrecognized expense related to the stock incentive awards that is expected to be recognized over a weighted-average period of 1.5 years. As of June 30, 2015, none of the awards were convertible, 329,059 units of the Board members time-based awards had vested and none of the outstanding shares of the restricted stock had vested. These awards could result in a maximum number of 1,837,409 additional outstanding shares of the Company's common stock depending on service, performance and market results through December 31, 2017.

## NOTE M—EARNINGS PER SHARE

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

|                                                                  | Three Months Ending |         | Six Months Ending |          |
|------------------------------------------------------------------|---------------------|---------|-------------------|----------|
|                                                                  | June 30,<br>2015    | 2014    | June 30,<br>2015  | 2014     |
| Earnings from continuing operations                              | \$10,570            | \$9,298 | \$19,465          | \$15,820 |
| Weighted-average shares outstanding for basic earnings per share | 64,541              | 64,285  | 64,498            | 64,217   |
| Common equivalent shares:                                        |                     |         |                   |          |
| Effect of stock-based compensation awards                        | 930                 | 922     | 906               | 957      |
| Weighted-average shares outstanding assuming dilution            | 65,471              | 65,207  | 65,404            | 65,174   |
| Basic earnings per share from continuing operations              | \$0.16              | \$0.14  | \$0.30            | \$0.25   |
| Diluted earnings per share from continuing operations            | \$0.16              | \$0.14  | \$0.30            | \$0.24   |

The number of equivalent shares that were not included in weighted average shares outstanding assuming dilution, because their effect would have been anti-dilutive, was none and 13,000 at June 30, 2015 and 2014, respectively.

## NOTE N—SEGMENT INFORMATION

The Company operates in two reportable segments. The CAM segment consists of the Company's aircraft leasing operations and its segment earnings includes an allocation of interest expense. The ACMI Services segment consists of the Company's airline operations, including the CMI agreement with DHL as well as ACMI and charter service agreements that the Company has with other customers. Due to the similarities among the Company's airline operations, the airline operations are aggregated into a single reportable segment, ACMI Services. The Company's other activities, which include contracts with the USPS, the sale of aircraft parts and maintenance services, facility and ground equipment maintenance services and management services for workers' compensation do not constitute reportable segments and are combined in "All other" with inter-segment profit eliminations. Inter-segment revenues are valued at arms-length, market rates. Cash, cash equivalents and deferred tax assets are reflected in Assets - All other below. The Company's segment information from continuing operations is presented below (in thousands):

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|                                                                     | Three Months Ending |            | Six Months Ending |              |
|---------------------------------------------------------------------|---------------------|------------|-------------------|--------------|
|                                                                     | June 30,            |            | June 30,          |              |
|                                                                     | 2015                | 2014       | 2015              | 2014         |
| Total revenues:                                                     |                     |            |                   |              |
| CAM                                                                 | \$45,632            | \$40,590   | \$88,486          | \$81,225     |
| ACMI Services                                                       | 103,892             | 111,304    | 209,360           | 219,900      |
| All other                                                           | 32,179              | 36,493     | 67,785            | 63,301       |
| Eliminate inter-segment revenues                                    | (33,350)            | ) (38,769) | ) (70,253)        | ) (71,215)   |
| Total                                                               | \$148,353           | \$149,618  | \$295,378         | \$293,211    |
| Customer revenues:                                                  |                     |            |                   |              |
| CAM                                                                 | \$24,660            | \$17,839   | \$44,541          | \$36,253     |
| ACMI Services                                                       | 103,892             | 111,304    | 209,360           | 219,900      |
| All other                                                           | 19,801              | 20,475     | 41,477            | 37,058       |
| Total                                                               | \$148,353           | \$149,618  | \$295,378         | \$293,211    |
| Depreciation and amortization expense:                              |                     |            |                   |              |
| CAM                                                                 | \$22,356            | \$20,328   | \$43,266          | \$38,673     |
| ACMI Services                                                       | 9,027               | 7,191      | 17,118            | 14,026       |
| All other                                                           | 17                  | (377)      | ) 9               | (578)        |
| Total                                                               | \$31,400            | \$27,142   | \$60,393          | \$52,121     |
| Segment earnings (loss):                                            |                     |            |                   |              |
| CAM                                                                 | \$14,441            | \$10,667   | \$28,879          | \$25,107     |
| ACMI Services                                                       | 1,126               | 309        | (1,445)           | ) (6,737)    |
| All other                                                           | 1,840               | 4,108      | 4,916             | 7,125        |
| Net unallocated interest expense                                    | (428)               | ) (424)    | ) (885)           | ) (803)      |
| Net gain on derivative instruments                                  | 264                 | 31         | 251               | 330          |
| Pre-tax earnings from continuing operations                         | \$17,243            | \$14,691   | \$31,716          | \$25,022     |
| The Company's assets are presented below by segment (in thousands): |                     |            | June 30,          | December 31, |
|                                                                     |                     |            | 2015              | 2014         |
| Assets:                                                             |                     |            |                   |              |
| CAM                                                                 |                     |            | \$785,686         | \$801,195    |
| ACMI Services                                                       |                     |            | 140,372           | 135,109      |
| All other                                                           |                     |            | \$99,105          | \$95,325     |
| Total                                                               |                     |            | \$1,025,163       | \$1,031,629  |

Interest expense allocated to CAM was \$2.4 million and \$5.0 million for the three and six month periods ending June 30, 2015, respectively, compared to \$3.0 million and \$6.3 million for the corresponding periods of 2014, respectively.

## 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 condensed consolidated financial statements and the related notes prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") contained in this report and our Annual Report on Form 10-K for the year ended December 31, 2014.

### INTRODUCTION

The Company leases aircraft, provides air cargo lift and performs aircraft maintenance and other support services primarily to the air cargo transportation and package delivery industries. Through the Company's subsidiaries, we offer a range of complementary services to delivery companies, freight forwarders, airlines and government customers. The Company's principal subsidiaries include two independently certificated airlines, ABX Air, Inc. ("ABX") and Air Transport International, Inc. ("ATI"), and an aircraft leasing company, Cargo Aircraft Management, Inc. ("CAM").

The Company has two reportable segments: CAM, which leases Boeing 767 and Boeing 757 aircraft and aircraft engines, and ACMI Services, which primarily includes the cargo transportation operations of the Company's two airlines. The ACMI Services segment provides airline operations to its customers, typically under contracts providing for a combination of aircraft, crews, maintenance and insurance ("ACMI"). The Company's other business operations, which primarily provide support services to the transportation industry, include aircraft maintenance, aircraft parts sales, ground equipment leasing and mail handling services. These operations do not constitute reportable segments due to their size.

The Company's largest customer is DHL Network Operations (USA), Inc. and its affiliates ("DHL"). The Company has had long-term contracts with DHL since August 2003. Commencing March 31, 2010, the Company and DHL executed commercial agreements under which DHL leased thirteen Boeing 767 freighter aircraft from CAM and ABX operate those aircraft under a separate crew, maintenance and insurance ("CMI") agreement. The initial term of the CMI agreement was five years while the terms of the aircraft leases were seven years.

### UPDATE

#### DHL agreements

In 2015, the Company and DHL amended and restated the CMI agreement ("restated CMI agreement"). As a result, effective April 1, 2015, the existing monthly aircraft lease rates for the thirteen Boeing 767-200 freighter aircraft declined approximately 5%, DHL agreed to lease an additional two Boeing 767 aircraft were previously supporting DHL under short-term operating arrangements, and all Boeing 767 aircraft lease terms with DHL were extended through March 2019. Under the restated CMI agreement, ABX continues to operate and maintain the aircraft through March 2019. Additionally, during June 2015, DHL began a long-term lease for a sixteenth Boeing 767 aircraft from CAM which ABX operates for DHL under the restated CMI agreement.

Similar to the previous agreement, pricing for services provided under the restated CMI agreement is based on pre-defined fees scaled for the number of aircraft hours flown, aircraft scheduled and flight crews provided to DHL for its network. Under the new pricing structure of the restated CMI agreement, ABX assumes responsibility for the cost of complying with FAA airworthiness directives, the cost of Boeing 767 airframe maintenance and certain engine maintenance events for the DHL-leased aircraft that it operates. While the Company's operating results will be negatively impacted by provisions of the restated CMI agreement, we project that the reduced earnings from the CMI operations for DHL will be offset through additional aircraft lease revenues, international ACMI opportunities, cost controls and aircraft maintenance growth.

DHL accounted for 50% of the Company's consolidated revenues for the first six months of 2015 compared with 57% of the Company's consolidated revenues in the corresponding period in 2014. During the second quarter ended June 30, 2015, ABX operated 16 CAM-owned Boeing 767 aircraft leased to DHL under long-term leases primarily in





DHL's U.S network under the restated CMI agreement. Additionally, ATI operated four CAM-owned and one DHL-supplied Boeing 757 freighter aircraft in DHL's U.S. network.

#### Fleet Summary 2015

At June 30, 2015, the Company's combined operating fleet of owned freighter aircraft consisted of 36 Boeing 767-200 aircraft, 10 Boeing 767-300 aircraft, four Boeing 757-200 aircraft and four Boeing 757 "combi" aircraft. The Boeing 757 combi aircraft are capable of simultaneously carrying passengers and cargo containers on the main flight deck.

Aircraft fleet activity during the first six months of 2015 is summarized below:

- Two DHL-owned Boeing 767-200 aircraft, previously leased by ABX for operation in DHL's network, were returned to DHL.
- CAM placed one Boeing 767-300 freighter aircraft with an external customer in February 2015 under a multi-year lease.
- In February 2015, CAM purchased the Boeing 767-300 freighter aircraft that ABX was leasing from an external lessor and began to lease it to ABX.
- ABX returned three Boeing 767-200 freighters to CAM, two of which were leased to external lessors in April 2015 with the third being staged for another external lease.
- During the second quarter, CAM began to lease three Boeing 767-300 aircraft, which are operated by ABX, directly to DHL under multi-year leases.
- ATI began to operate a Boeing 757 freighter that DHL leases from a third party.
- An external lessee returned a Boeing 767-200 to CAM and that aircraft is now being prepped for releasing.
- CAM purchased one Boeing 767-300 passenger aircraft in June, which is currently being modified to standard freighter configuration.

The Company's cargo aircraft fleet is summarized below as of June 30, 2015 (\$'s in thousands):

|                                                      | ACMI<br>Services | CAM | Total     |
|------------------------------------------------------|------------------|-----|-----------|
| In-service aircraft                                  |                  |     |           |
| Aircraft owned                                       |                  |     |           |
| Boeing 767-200                                       | 11               | 23  | 34        |
| Boeing 767-300                                       | 4                | 6   | 10        |
| Boeing 757-200                                       | 4                | —   | 4         |
| Boeing 757-200 Combi                                 | 4                | —   | 4         |
| Total                                                | 23               | 29  | 52        |
| Carrying value                                       |                  |     | \$740,347 |
| Operating lease                                      |                  |     |           |
| Boeing 757-200                                       | 1                | —   | 1         |
| Total                                                | 1                | —   | 1         |
| Other aircraft                                       |                  |     |           |
| Owned Boeing 767-200s available or staging for lease | —                | 2   | 2         |
| Owned Boeing 767-300 under modification              | —                | 1   | 1         |

As of June 30, 2015, ACMI Services leased 23 of its in-service aircraft internally from CAM. As of June 30, 2015, 13 of CAM's 23 leased Boeing 767-200 aircraft shown above and three of the six Boeing 767-300 aircraft, were leased to DHL and operated by ABX. CAM leased the other ten Boeing 767-200 and three Boeing 767-300 aircraft to external airlines.

The table above does not reflect CAM's only Boeing 767-200 passenger aircraft. This aircraft was under lease to an external airline. In July 2015, CAM purchased another Boeing 767-300 passenger aircraft with the intent of modifying it to a freighter aircraft. Also in July, upon the expiration of external customer leases, CAM received two Boeing 767-200 freighters. The aircraft are being prepped for operation by other airlines.

## RESULTS OF OPERATIONS

### Summary

External customer revenues from continuing operations decreased by \$1.3 million to \$148.4 million and increased by \$2.2 million to \$295.4 million for the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014. Increased external customer revenues from CAM were offset by lower revenues from ACMI services during the three and six month periods ended June 30, 2015, and by lower aircraft maintenance revenues during the three months ended June 30, 2015, compared to the corresponding periods of 2014. Since March 31, 2014, and June 30, 2014, six and two of our aircraft, respectively, have been removed from ACMI services through June 30, 2015 and leased by CAM to external customers.

The consolidated net earnings from continuing operations were \$10.6 million and \$19.5 million for the three and six month periods ended June 30, 2015, respectively, compared to \$9.3 million and \$15.8 million for the corresponding periods of 2014. The pre-tax earnings from continuing operations were \$17.2 million and \$31.7 million for the three and six month periods ended June 30, 2015, respectively, compared to \$14.7 million and \$25.0 million for the corresponding periods of 2014. Pre-tax earnings from continuing operations for 2015 improved compared to 2014, due primarily to better aircraft fleet utilization.

A summary of our revenues and pre-tax earnings from continuing operations is shown below (in thousands):

|                                                     | Three Months Ending |           | Six Months Ending |           |
|-----------------------------------------------------|---------------------|-----------|-------------------|-----------|
|                                                     | June 30,            |           | June 30,          |           |
|                                                     | 2015                | 2014      | 2015              | 2014      |
| Revenues from Continuing Operations:                |                     |           |                   |           |
| CAM                                                 | \$45,632            | \$40,590  | \$88,486          | \$81,225  |
| ACMI Services                                       |                     |           |                   |           |
| Airline services                                    | 97,897              | 100,288   | 195,592           | 199,805   |
| Reimbursable                                        | 5,995               | 11,016    | 13,768            | 20,095    |
| Total ACMI Services                                 | 103,892             | 111,304   | 209,360           | 219,900   |
| Other Activities                                    | 32,179              | 36,493    | 67,785            | 63,301    |
| Total Revenues                                      | 181,703             | 188,387   | 365,631           | 364,426   |
| Eliminate internal revenues                         | (33,350)            | (38,769)  | (70,253)          | (71,215)  |
| Customer Revenues                                   | \$148,353           | \$149,618 | \$295,378         | \$293,211 |
| Pre-Tax Earnings (Loss) from Continuing Operations: |                     |           |                   |           |
| CAM, inclusive of interest expense                  | \$14,441            | \$10,667  | \$28,879          | \$25,107  |
| ACMI Services                                       | 1,126               | 309       | (1,445)           | (6,737)   |
| Other Activities                                    | 1,840               | 4,108     | 4,916             | 7,125     |
| Net unallocated interest expense                    | (428)               | (424)     | (885)             | (803)     |
| Net gain on derivative instruments                  | 264                 | 31        | 251               | 330       |
| Pre-Tax Earnings from Continuing Operations         | 17,243              | 14,691    | 31,716            | 25,022    |
| Less: Net (gain) on derivative instruments          | (264)               | (31)      | (251)             | (330)     |
| Adjusted Pre-Tax Earnings                           | \$16,979            | \$14,660  | \$31,465          | \$24,692  |

Reimbursable revenues shown above include revenues related to fuel, landing fees, navigation fees, aircraft rent and certain other operating costs that are directly reimbursed to the airlines by their customers. Effective April 1, 2015, the cost of engine and airframe maintenance for all CAM-owned aircraft operated for DHL are the responsibility of the airlines, including Boeing 767-200 maintenance costs previously reimbursed directly by DHL. For all periods



presented above, airline service revenues include compensation for maintenance provided by the airlines on aircraft operated for DHL. Reimbursable revenues declined for the three and six month periods ending June 30, 2015 compared to the corresponding periods of 2014 due to lower fuel prices and the return of four DHL-owned Boeing 767-200 aircraft.

Adjusted pre-tax earnings, a non-GAAP measure, is pre-tax earnings excluding interest rate derivative gains and losses. Management uses adjusted pre-tax earnings to compare the performance of core operating results between periods. Adjusted pre-tax earnings should not be considered in isolation or as a substitute for analysis of the Company's results as reported under GAAP.

#### CAM Segment

Through CAM, we offer aircraft leasing and related services to external customers and also lease aircraft internally to the Company's airlines. Aircraft leases normally cover a term of five to seven years. In a typical leasing agreement, customers pay rent and maintenance deposits on a monthly basis.

As of June 30, 2015, CAM had a fleet of 54 freighter aircraft in service condition, 23 of them leased internally to the Company's airlines, 29 leased to external customers, one that was being staged for lease and one that was available for lease.

CAM's revenues grew \$5.0 million and \$7.3 million during the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014, primarily as a result of additional aircraft leases to external customers. As of June 30, 2015 and 2014, CAM had 29 and 21 aircraft under lease to external customers, respectively. Revenues from external customers totaled \$24.7 million and \$44.5 million for the three and six month periods ended June 30, 2015, respectively, compared to \$17.8 million and \$36.3 million for the corresponding periods of 2014. CAM's revenues from the Company's airlines totaled \$21.0 million and \$43.9 million during the three and six month periods ended June 30, 2015, respectively, compared to \$22.8 million and \$45.0 million for the corresponding periods in 2014.

In the first quarter of 2015, CAM placed a recently converted Boeing 767-300 aircraft under a long-term lease with an external customer. During the second quarter of 2015, CAM placed five Boeing 767 aircraft that had previously been operated by ATSG airlines with external customers under long-term leases. These included three Boeing 767-300 aircraft leased to DHL, two in April and one in June 2015, and two Boeing 767-200 aircraft placed with external airlines in April 2015.

CAM's pre-tax earnings, inclusive of an interest expense allocation, grew by \$3.8 million in each of the three and six month periods ended June 30, 2015 to \$14.4 million and \$28.9 million, respectively, compared to the corresponding 2014 periods. The improved earnings reflect the additional external lease revenues offset by depreciation expense for three additional cargo aircraft that have been added to CAM's operating fleet since June of 2014. Also, CAM incurred additional expenses to place and support the larger fleet of aircraft. Administrative expenses included international legal counsel, aircraft records review and other professional services.

#### ACMI Services Segment

The ACMI Services segment performs airline operations for its customers under contracts providing for a combination of aircraft, crews, maintenance and insurance. Under ACMI agreements, customers are usually responsible for supplying the necessary aviation fuel and cargo handling services and reimbursing our airline for other operating expenses such as landing fees, ramp expenses, and fuel procured directly by the airline. Aircraft charter agreements, including those for the U.S. Military, usually require the airline to provide full service, including fuel and other operating expenses for a fixed, all-inclusive price. As of June 30, 2015, ACMI Services included 40 in-service aircraft, including 23 leased internally from CAM, one DHL-supplied aircraft operated by ATI and 16 CAM-owned freighter aircraft which are under lease to DHL and operated by ABX under the CMI agreement.

Revenues from ACMI Services were \$103.9 million and \$209.4 million for the three and six month periods ending June 30, 2015, respectively, compared to \$111.3 million and \$219.9 million for the corresponding periods of 2014. Airline services revenues from external customers, which do not include revenues for the reimbursement of fuel and certain operating expenses, decreased \$2.4 million and \$4.2 million for the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014. Revenue decreased due to a fewer number of aircraft operated by our airlines. Since June 30, 2014 the combined freighter fleet operated by our airlines decreased



by five aircraft through June 30, 2015, reflecting fewer aircraft operated for DHL. While we operated fewer routes for DHL, billable block hours for customers other than DHL increased 13% and 10% during the three and six month periods ended June 30, 2015, respectively, compared with the corresponding periods in 2014. Total billable block hours declined 6% for both the three and six month periods ended June 30, 2015, respectively, compared with the corresponding periods in 2014, reflecting the fewer number of aircraft in service.

ACMI Services incurred pre-tax earnings of \$1.1 million and pre-tax losses of \$1.4 million during the three and six month periods ended June 30, 2015, respectively, compared to pre-tax earnings of \$0.3 million and pre-tax losses of \$6.7 million for the corresponding periods of 2014. Earnings improved in 2015 compared to 2014 due to better fleet utilization and reduced airline personnel expenses. Since mid-2014, our airlines returned underutilized aircraft to CAM and reduced operating expenses. CAM subsequently leased those aircraft to external customers. Expenses for aircraft engine maintenance decreased during 2015 compared to 2014 due to fewer block hours flown. The decline in engine maintenance expense was partially offset by additional costs for airframe checks. Both the number of aircraft maintenance events, such as airframe checks and unscheduled engine repairs, and the work scope of such events can vary among periods.

We expect the recent operational improvements in ACMI Services to continue during 2015. However, due to higher pension expense as actuarially determined, aircraft maintenance schedules and the new pricing structure under the restated CMI, we expect this segment to generate a pre-tax loss for the full year in 2015. We expect the expense for scheduled airframe maintenance checks to increase by \$3 million during the second half of 2015 compared to the first half of 2015 due to the timing of scheduled maintenance. Under the new pricing structure of the restated CMI agreement, ABX assumed responsibility, effective April 1, 2015, for the cost of complying with FAA airworthiness directives, the cost of Boeing 767 airframe maintenance and certain engine maintenance events for the aircraft leased to DHL that it operates. Achieving profitability in the ACMI Services segment will depend on new revenue opportunities for airline services, the number of aircraft we operate, crewmember productivity, the cost of employee benefits and other factors. Our airlines may return underutilized aircraft to CAM for lease to external customers after considering a number of factors, including the duration of the customer commitment, the underlying credit quality of the customer and market pricing for each opportunity. The ACMI Services segment has two aircraft that are underutilized at this time.

#### Other Activities

We sell aircraft parts and provide aircraft maintenance and modification services primarily through the Company's aircraft maintenance and repair business, Airborne Maintenance and Engineering Services, Inc. ("AMES"). We also provide services to the U.S. Postal Service ("USPS") which mainly consists of sorting services at five USPS facilities. Additionally, we lease and maintain ground support equipment and provide facility maintenance services. Other activities also include the management of workers' compensation claims under an agreement with DHL and gains from the reduction in employee post-retirement obligations.

External customer revenues from all other activities were \$19.8 million and \$41.5 million for the three and six month periods ended June 30, 2015, respectively, compared to \$20.5 million and \$37.1 million for the corresponding periods in 2014. Revenues from aircraft maintenance for external customers decreased by \$2.1 million during the second quarter of 2015 compared to 2014, but increased by \$1.5 million for the first six months of 2015 compared to 2014. Revenues from aircraft maintenance can vary among periods due to the timing of scheduled maintenance events and the completion level of work during a period. Revenues from our services for the USPS increased \$1.2 million and \$2.1 million during the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014 reflecting higher contractual costs and mail volumes at the facilities we operate.

The pre-tax earnings from other activities were \$1.8 million and \$4.9 million for the three and six month periods ended June 30, 2015, respectively, compared to \$4.1 million and \$7.1 million for the corresponding periods in 2014. Lower earnings from our maintenance operations and lower gains from the reduction of employee benefit obligations were partially offset by improved USPS operations during the three and six month periods ended June 30, 2015 and 2014, respectively.

The Company has been providing mail sorting services to the USPS since September 2004. The contracts for the five facilities we service have been extended from their original expiration dates in 2014 and are currently scheduled



to expire in September 2015. We currently expect these five contracts to be extended 18 months through March 2017, although it is possible that some or all of these facilities may not be renewed.

#### Discontinued Operations

Pre-tax gains related to the former sorting operations were \$0.7 million for both of the first six months of 2015 and 2014. The results of discontinued operations primarily reflect the effects of defined benefit pension plans for former employees that supported sort operations under a hub services agreement with DHL.

#### Expenses from Continuing Operations

Salaries, wages and benefits expense increased \$1.1 million and \$1.8 million during the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014 primarily due to higher pension expense offset by a reduction in the number of airline employees. Pension expense for continuing operations increased \$1.1 million and \$2.1 million for the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014, due to a lower interest rate on pension plan obligations at the beginning of 2015.

While the number of airline employees declined, the number of employees for maintenance and other support services increased compared to the previous year.

Fuel expense decreased by \$1.7 million and \$3.2 million during the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014. Fuel expense reflects the cost of fuel to operate U.S. Military charters, reimbursable fuel billed to DHL and fuel used to position aircraft for service and for maintenance purposes. The cost of fuel declined due to lower prices for aviation fuel. The average price per gallon of fuel decreased about 18% and 17% for the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014.

Maintenance, materials and repairs expense increased by \$0.8 million and decreased by \$1.4 million during the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014. Expenses for aircraft engine maintenance decreased during the first six months of 2015 compared to 2014 due to fewer block hours flown. The decline in expenses for engines maintenance were offset by additional costs for airframe checks and costs incurred by CAM to prepare aircraft for external lease. Aircraft maintenance expenses can vary among periods due to the number of scheduled airframe maintenance checks, unscheduled maintenance events and the scope of the maintenance tasks required during a period.

Depreciation and amortization expense increased \$4.3 million and \$8.3 million during the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014. The increase in depreciation expense reflects incremental depreciation expense for additional aircraft engines and three Boeing 767 aircraft added to the in-service fleet since mid 2014.

Travel expense decreased by \$0.1 million and \$0.2 million during the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014, reflecting lower block hours flown and the lower level of airline headcount during 2015 compared to 2014.

Rent expense decreased by \$4.5 million and \$7.6 million during the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014. Rent expense decreased primarily due to the purchase of two Boeing 767-300 aircraft in September of 2014 and the return of four Boeing 767-200 aircraft which were previously leased from external providers during the first half of 2014.

Landing and ramp expense, which includes the cost of deicing chemicals, decreased by \$0.4 million during the three and six month periods ended June 30, 2015 compared to the corresponding periods of 2014. Landing and ramp fees can vary based on the flight schedules and the airports that are used in a period.

Insurance expense decreased by \$1.0 million during both the three and six month periods ended June 30, 2015 compared to the corresponding periods of 2014. Insurance expense decreased due to fewer aircraft in ACMI operations during 2015 compared to 2014.

Other operating expenses decreased by \$1.4 million and increased by \$0.6 million during the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014. Other operating expenses include professional fees, navigational services, employee training, utilities, the cost of parts sold to customers and gains on the disposition of equipment. Other operating expenses increased during the first six months of 2015 due to





additional costs of handling the mail we process for the USPS compared to 2014. Additionally, other operating expenses decreased during the second quarter of 2015 due to fewer parts sold to aircraft maintenance customers and larger gains from the disposition of equipment.

Interest expense decreased by \$0.6 million and \$1.4 million during the three and six month periods ended June 30, 2015, respectively, compared to the corresponding periods of 2014. Interest expense decreased due to a lower average debt level and lower interest rates on the Company's outstanding loans during the first quarter of 2015 compared to 2014.

The Company recorded pre-tax gains on derivatives of \$0.3 million during both the three and six month periods ended June 30, 2015 compared to less than \$0.1 million and \$0.3 million during the corresponding periods of 2014, reflecting the impact of fluctuating market interest rates.

The provision for income taxes for interim periods is based on management's best estimate of the effective income tax rate expected to be applicable for the current year, plus any adjustments arising from changes in the estimated amount of taxable income related to prior periods. Income taxes recorded through June 30, 2015 have been estimated utilizing a 38.6% rate based upon year-to-date income and projected results for the full year. The final effective tax rate applied to 2015 will depend on the actual amount of pre-tax book income generated by the Company for the full year. The effective tax rate from continuing operations for the three and six month periods ended June 30, 2014 was 36.7% and 36.8%, respectively, based on projections of taxable income and tax deductions at that time. The effective tax rate increased during the first three months of 2015 compared to the corresponding period of 2014, because we expect proportionally more earnings to occur in the U.S. during 2015.

As of December 31, 2014, the Company had operating loss carryforwards for U.S. federal income tax purposes of approximately \$94.7 million, which will begin to expire in 2024 if not utilized before then. We expect to utilize the loss carryforwards to offset federal income tax liabilities in the future. As a result, we do not expect to pay federal income taxes until 2017 or later. The Company may, however, be required to pay alternative minimum taxes and certain state and local income taxes before then. The Company's taxable income earned from international flights is primarily sourced to the United States under international aviation agreements and treaties. If we begin to operate in countries without such agreements, the Company could incur additional foreign income taxes.

## FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

### Cash Flows

Net cash generated from operating activities totaled \$96.6 million and \$55.4 million for the first six months of 2015 and 2014, respectively. Improved cash flows generated from operating activities was driven by faster customer payments since the first quarter of 2014, and reflects additional aircraft leases and the timing of customer aircraft maintenance projects, both of which are typically paid faster than revenues related to ACMI services. Cash outlays for pension contributions for the first six months of 2015 were \$0.9 million compared to \$1.0 million for the corresponding period of 2014.

Capital spending levels were primarily the result of aircraft modification costs and the acquisition of passenger aircraft for freighter modification. Cash payments for capital expenditures were \$76.3 million and \$23.5 million for the first six months of 2015 and 2014, respectively. Capital expenditures in 2015 included the acquisition of two Boeing 767-300 aircraft and next generation navigation and communication modifications. Capital expenditures during 2015 for required heavy maintenance were \$31.0 million, and \$14.5 million for other equipment, including purchases of aircraft engines and rotables. Our capital expenditures in the first six months of 2014 included \$6.7 million for required heavy maintenance, \$5.3 million for construction of the new aircraft hangar, \$6.6 million for next generation navigation and communication modifications and \$4.9 million for other equipment, including the purchases of aircraft engines and rotables. During the first quarter of 2014, we made an investment in West Atlantic AB for \$15 million. Net cash used for financing activities was \$29.7 million for the first six months of 2015 compared to \$26.3 million of cash used in the corresponding period of 2014. During the first six months of 2015, we drew \$20.0 million from the revolving credit facility under the Senior Credit Agreement to fund capital spending and we made debt principal payments of \$47.1 million. During the first six months of 2014, we drew \$15.0 million from the revolving credit facility to fund the investment in West Atlantic AB and capital spending, and we made debt principal payments of \$44.3 million. During May and June of 2015, we used \$2.6 million to buy 244,869 shares of the Company's common

stock in the

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open market as part of a share repurchase plan authorized in 2014 by the Board of Directors to repurchase up to \$50 million of the Company's common stock. Additionally, \$1.6 million and \$3.1 million of the principal balance of the DHL promissory note was extinguished during the first six months of 2015 and 2014, respectively, pursuant to the CMI agreement with DHL.

#### Commitments

We recently purchased (one each in June and July 2015) two Boeing 767-300 passenger aircraft to convert to standard cargo freighters and expect to purchase another Boeing 767-300 passenger aircraft in early 2016 for freighter conversion. The freighter modification process for two of the aircraft is expected to be completed in 2015, while the third is scheduled to be completed in the second quarter of 2016. We estimate that capital expenditures for 2015 will total \$150 million for aircraft purchases, engine purchases, aircraft modification costs, airframe and engine maintenance and other expenditures. Capital spending for any future period will be impacted by aircraft acquisitions, maintenance and modification processes. We expect to finance the remaining 2015 capital expenditures from current cash balances, future operating cash flow and the Senior Credit Agreement.

#### Liquidity

The Company has a Senior Credit Agreement with a consortium of banks that includes an unsubordinated term loan of \$108.8 million and a revolving credit facility from which the Company has drawn \$165.0 million, net of repayments as of June 30, 2015. On May 8, 2015, the Company executed the fifth amendment to the Senior Credit Agreement (the "Fifth Credit Amendment"). The Fifth Credit Amendment increased the capacity of the revolving credit facility by \$50.0 million to \$325.0 million, increased the permitted additional indebtedness by \$50.0 million to \$150.0 million, and retained the accordion feature whereby the Company can draw up to an additional \$50.0 million subject to the lenders' consent. The Senior Credit Agreement is collateralized by the Company's fleet of Boeing 767 and 757 aircraft that are not collateralized under aircraft loans. Under the amended terms of the Senior Credit Agreement, the Company is required to maintain collateral coverage equal to 150% of the outstanding balances of the term loan and the maximum capacity of the revolving credit facility or 175% of the outstanding balance of the term loan and the total funded revolving credit facility, whichever is less. The minimum collateral coverage which must be maintained is 50% of the outstanding balance of the term loan plus the revolving credit facility commitment of \$325 million. Beginning on May 5, 2016, and each year thereafter through May 6, 2019, the Company may request a one year extension of the final maturity date, subject to the lenders' consent.

Under the Senior Credit Agreement, the Company is subject to covenants and warranties that are usual and customary, including among other things, limitations on certain additional indebtedness, guarantees of indebtedness, as well as a total debt to EBITDA ratio and a fixed charge coverage ratio. The Senior Credit Agreement stipulates events of default including unspecified events that may have a material adverse effect on the Company. If an event of default occurs, the Company may be forced to repay, renegotiate or replace the Senior Credit Agreement.

Additional debt or lower EBITDA may result in higher interest rates. Under the Senior Credit Agreement, interest rates are adjusted quarterly based on the prevailing LIBOR or prime rates and a ratio of the Company's outstanding debt level to EBITDA (earnings before interest, taxes, depreciation and amortization expenses). At the Company's current debt-to-EBITDA ratio, the unsubordinated term loan and the revolving credit facility both bear a variable interest rate of 1.94%.

At June 30, 2015, the Company had \$22.2 million of cash balances. The Company had \$150.9 million available under the revolving credit facility, net of outstanding letters of credit, which totaled \$9.1 million. As specified under the terms of ABX's CMI agreement with DHL, the unsecured note payable to DHL extinguished without payment at March 31, 2015. We believe that the Company's current cash balances and forecasted cash flows provided from its operating agreements, combined with its Senior Credit Agreement, will be sufficient to fund operations, scheduled debt payments, required pension funding and planned capital expenditures for at least the next 12 months.

#### Off-Balance Sheet Arrangements

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities ("SPEs"), which would have been established for the purpose of facilitating off-balance sheet arrangements or other



contractually narrow or limited purposes. As of June 30, 2015, we were not involved in any material unconsolidated SPE transactions.

Certain of our operating leases and agreements contain indemnification obligations to the lessor or one or more other parties that are considered usual 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 the expiration of the respective lease or agreement. No amounts have been recognized in our financial statements for the underlying fair value of guarantees and indemnifications.

#### 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 disclosures 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, 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. Those factors 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.

There have been no material changes to our critical accounting policies and estimates from the information provided in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Policies and Estimates" included in our Annual Report on Form 10-K for the year ended December 31, 2014.

For information regarding recently issued accounting pronouncements and the expected impact on our annual statements, see Note A "SUMMARY OF FINANCIAL STATEMENT PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES" in the accompanying notes to Condensed Consolidated Financial Statements included in Part II, Item 1 of this Form 10-Q.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk for changes in interest rates and changes in the price of jet fuel. The risk associated with jet fuel, however, is largely mitigated by reimbursement through the agreements with our customers. No significant changes have occurred to the market risks the Company faces since information about those risks were disclosed in Item 7A of the Company's 2014 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 9, 2015.

### ITEM 4. CONTROLS AND PROCEDURES

#### (a) Evaluation of Disclosure Controls and Procedures

As of June 30, 2015, 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 the Company's 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 and is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

#### (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

#### Brussels Noise Ordinance

The Brussels Instituut voor Milieubeheer ("BIM"), a governmental authority in the Brussels-Capital Region of Belgium that oversees the enforcement of environmental matters, imposed four separate administrative penalties on ABX in the approximate aggregate amount of €0.4 million (\$0.4 million) for numerous alleged violations of an ordinance limiting the noise caused by aircraft overflying the Brussels-Capital Region (which is located near the Brussels Airport) during the period from May 2009 through December 2010. ABX has exhausted its appeals with respect to all four of the administrative penalties.

The ordinance in question is controversial for the reason that it was adopted by the Brussels-Capital Region and is more restrictive than the noise limitations in effect in the Flemish Region, which is where the Brussels Airport is located. Numerous airlines have been levied fines under the ordinance, which is currently the subject of several court cases pending before the Belgian courts, including with respect to demands for payment. The Brussels government has suspended issuing demands for payment of the penalties pending the outcome of the litigation. ABX has yet to receive a demand for payment of the penalties.

#### Other

In addition to the foregoing matters, we are also currently a party to legal proceedings, including FAA enforcement actions, in various federal and state jurisdictions arising out of the operation of the Company's business. The amount of alleged liability, if any, from these proceedings cannot be determined with certainty; however, we believe that the Company's 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 risks that could adversely affect its condition or results of operations. Many of these risks are disclosed in Item 1A of the Company's 2014 Annual Report on form 10-K, filed with the Securities and Exchange Commission on March 9, 2015. Other risks that are currently unknown to management or are currently considered immaterial or unlikely, could also adversely affect the Company.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On August 5, 2014, the Board of Directors authorized the Company to repurchase up to \$50.0 million of outstanding common stock. The Board's authorization does not require the Company to repurchase a specific number of shares and the Board may terminate the repurchase program at any time. Repurchases may be made from from time to time on the open market or in privately negotiated transactions. All of the repurchases done by the Company during the second quarter of 2015 were on the open market. There is no expiration date for the repurchase program. The following table summarizes the Company's repurchases of its common stock during the second quarter of 2015:

| Period                             | Total Number of Shares Purchased | Average Price paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Program | Maximum Dollar Value of Shares That May Yet Be Purchased Under the Program |
|------------------------------------|----------------------------------|------------------------------|------------------------------------------------------------------------|----------------------------------------------------------------------------|
| May 1, 2015 through May 31, 2015   | 40,000                           | \$ 10.71                     | 40,000                                                                 | \$49,571,564                                                               |
| June 1, 2015 through June 30, 2015 | 204,869                          | \$ 10.58                     | 204,869                                                                | \$47,404,575                                                               |
| Total for the quarter              | 244,869                          | \$ 10.60                     | 244,869                                                                | \$47,404,575                                                               |

## ITEM 6. EXHIBITS

The following exhibits are filed with or incorporated by reference into this report.

- |      |                                                                                                                                                                                                                                                                                                                                                          |
|------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1 | Amended and Restated Air Transportation Services Agreement between DHL Network Operations (USA), Inc., ABX Air, Inc. and Cargo Aircraft Management, Inc., dated January 14, 2015. Those portions of the Agreement marked with an [*] have been omitted pursuant to a request for confidential treatment and have been filed separately with the SEC. (1) |
| 10.2 | Fifth Amendment to Credit Agreement, dated May 8, 2015, by and among Cargo Aircraft Management, Inc., as Borrower, Air Transport Services Group, Inc., each of the Guarantors party thereto, each of the financial institutions party thereto as "Lenders" and SunTrust Bank, in its capacity as Administrative Agent, filed herewith.                   |
| 10.3 | Description of Compensation Arrangements for Non-Employee Directors, 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.                                                                                                                                                                                                                  |

|         |                                                        |
|---------|--------------------------------------------------------|
| 101.INS | XBRL Instance Document                                 |
| 101.SCH | XBRL Taxonomy Extension Schema Document                |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB | XBRL Taxonomy Extension Labels Linkbase Document       |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

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Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 8, 2015, as amended by the Company's Quarterly Report on Form 10-Q/A filed with the Securities and Exchange Commission on August 7, 2015.

SIGNATURES

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

AIR TRANSPORT SERVICES GROUP, INC.,  
a Delaware Corporation  
Registrant

/S/ JOSEPH C. HETE  
Joseph C. Hete  
Chief Executive Officer (Principal Executive Officer)

Date: August 7, 2015

/S/ QUINT O. TURNER  
Quint O. Turner  
Chief Financial Officer (Principal Financial Officer  
and Principal Accounting Officer)

Date: August 7, 2015