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MERCURY AIR GROUP INC
Form 10-Q
February 13, 2001

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended December 31, 2000.

Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 For the Transition period from _____ to _____

Commission File No. 1-7134

MERCURY AIR GROUP, INC.

(Exact name of registrant as specified in its charter)

New York ----- (State or other jurisdiction of incorporation or organization)	11-1800515 ----- (I.R.S. Employer Identification Number)
5456 McConnell Avenue, Los Angeles, CA ----- (Address of principal executive offices)	90066 ----- (Zip Code)

(310) 827-2737

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES No

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.

Title -----	Number of Shares Outstanding As of February 9, 2001 -----
Common Stock, \$.01 Par Value	6,531,305

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

ASSETS	DECEMBER 31, 2000 -----
CURRENT ASSETS:	
Cash and cash equivalents	\$ 3,438,000
Trade accounts receivable, net of allowance for doubtful accounts of \$2,975,000 at 12/31/00 and \$2,550,000 at 6/30/00 (Note 7)	61,453,000
Notes receivable - current portion	1,000,000
Inventories, principally aviation fuel	4,680,000
Prepaid expenses and other current assets	2,392,000

Total current assets	72,963,000
PROPERTY, EQUIPMENT AND LEASEHOLDS (Note 3), net of accumulated depreciation and amortization of \$48,317,000 at 12/31/00 and \$43,792,000 at 6/30/00	74,162,000
NOTES RECEIVABLE	1,967,000
OTHER ASSETS (Notes 3 and 6)	10,905,000

	\$ 159,997,000 =====
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable	\$ 37,530,000
Accrued expenses and other current liabilities	8,829,000
Income tax payable	1,408,000
Current portion of long-term debt	6,220,000

Total current liabilities	53,987,000
LONG-TERM DEBT (Note 9)	49,088,000
DEFERRED INCOME TAXES	120,000
SENIOR SUBORDINATED NOTE	22,937,000
COMMITMENTS AND CONTINGENCIES (Note 7)	
STOCKHOLDERS' EQUITY (Note 4):	
Preferred Stock - \$.01 par value; authorized 3,000,000 shares; no shares outstanding	
Common Stock - \$.01 par value; authorized 18,000,000 shares; outstanding 6,531,305 shares at 12/31/00; outstanding 6,472,955 shares at 6/30/00	65,000
Additional paid-in capital	21,200,000
Retained earnings	13,361,000
Cumulative translation adjustment	(228,000)
Notes receivable from sale of stock	(533,000)

Total stockholders' equity	33,865,000

	\$ 159,997,000 =====

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See accompanying notes to consolidated financial statements.

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

	SIX MONTHS ENDED DECEMBER 31,		THREE D
	2000	1999	2000
Sales and Revenues:			
Sales	\$ 199,131,000	\$ 115,286,000	\$ 109,455,000
Service revenues	49,196,000	42,887,000	26,071,000
	248,327,000	158,173,000	135,526,000
Costs and Expenses:			
Cost of sales	180,069,000	100,289,000	99,259,000
Operating expenses	48,432,000	39,995,000	25,629,000
	228,501,000	140,284,000	124,888,000
Gross Margin (Excluding depreciation and amortization)	19,826,000	17,889,000	10,638,000
Expenses (Income):			
Selling, general and administrative	4,156,000	3,672,000	2,124,000
Provision for bad debts	1,899,000	928,000	1,100,000
Depreciation and amortization	5,142,000	4,762,000	2,583,000
Interest expense	3,879,000	2,796,000	1,929,000
Interest income	(66,000)	(106,000)	(20,000)
	15,010,000	12,052,000	7,716,000
Income Before Provision for Income Taxes	4,816,000	5,837,000	2,922,000
Provision for Income Taxes	1,878,000	2,276,000	1,140,000
Net Income Before Extraordinary Item	2,938,000	3,561,000	1,782,000
Extraordinary Item less applicable income taxes of \$625,000 and \$0	--	(979,000)	--
Net Income	\$ 2,938,000	\$ 2,582,000	\$ 1,782,000
Net Income Per Common Share (Note 5):			
Basic:			
Before extraordinary item	\$ 0.45	\$ 0.54	\$ 0.45
Extraordinary item	--	(0.15)	--
Net income	\$ 0.45	\$ 0.39	\$ 0.45

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Diluted:				
Before extraordinary item	\$	0.44	\$	0.46
Extraordinary item		--		(0.12)
		-----		-----
Net income	\$	0.44	\$	0.34
		-----		-----

See accompanying notes to consolidated financial statements.

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	SIX MONTHS ENDED DECEMBER	
	2000	1999
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 2,938,000	\$
Non-cash component of extraordinary charge		
Adjustments to derive cash flow from		
Operating activities:		
Bad debt expense	1,899,000	
Depreciation and amortization	5,142,000	
Deferred income taxes	10,000	
Amortization of officers' loans	20,000	
Amortization of senior subordinated note discount	93,000	
Changes in operating assets and liabilities:		
Trade accounts receivable	(15,032,000)	(15,032,000)
Inventories	(1,252,000)	(1,252,000)
Prepaid expenses and other current assets	568,000	568,000
Accounts payable	11,419,000	11,419,000
Income taxes payable	1,408,000	1,408,000
Accrued expenses and other current liabilities	2,738,000	2,738,000
	-----	-----
Net cash provided by operating activities	9,951,000	9,951,000
CASH FLOWS FROM INVESTING ACTIVITIES:		
Reduction in restricted cash		
(Increase) Decrease in notes receivable	(2,103,000)	(2,103,000)
Decrease (Addition) to other assets	839,000	839,000
Acquisition of businesses	(10,400,000)	(10,400,000)
Additions to property, equipment and leaseholds	(3,268,000)	(3,268,000)
	-----	-----
Net cash used in investing activities	(14,932,000)	(14,932,000)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term debt	11,969,000	11,969,000
Reduction of long-term debt	(5,955,000)	(5,955,000)
Reduction of note receivable from sale of stock	75,000	75,000
Reduction of convertible subordinated debentures		
Repurchase of common stock		
Proceeds from senior subordinated note		

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Proceeds from issuance of common stock	187,000	
	-----	-----
Net cash provided by (used in) investing activities	6,276,000	-----
	-----	-----
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,295,000	(
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	2,143,000	
	-----	-----
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 3,438,000	\$
	=====	=====
CASH PAID DURING THE PERIOD:		
Interest	\$ 3,816,000	\$
Income taxes (refunded)	\$ (715,000)	\$
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Conversion of 318 debentures into 43,590 shares of common stock		\$

See accompanying notes to consolidated financial statements.

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2000
(Unaudited)

NOTE 1 - BASIS OF PRESENTATION:

The accompanying unaudited financial statements reflect all adjustments (consisting of normal, recurring accruals only) which are necessary to fairly present the results for the interim periods. Such financial statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X and therefore do not include all the information or footnotes necessary for a complete presentation. They should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended June 30, 2000 and the notes thereto. The results of operations for the six months ended December 31, 2000 are not necessarily indicative of results for the full year.

NEW ACCOUNTING PRONOUNCEMENTS:

On July 1, 2000, the Company adopted Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities," which establishes accounting and reporting standards for derivative instruments and for hedging activities. The statement requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. The cumulative effect of adoption at July 1, 2000 was insignificant. At December 31, 2000, there were no outstanding derivative contracts.

In December 1999, the Securities and Exchange Commission released Staff Accounting Bulletin No. 101 ("SAB 101"), which provided the staff's views in

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applying generally accepted accounting principles to selected revenue issues. SAB 101, as amended, is required to be implemented by the Company during the quarter ended June 30, 2001. The Company does not believe that the impact of implementing SAB 101 will be material.

NOTE 2 - INCOME TAXES:

Income taxes have been computed based on the estimated annual effective income tax rate for the respective years.

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NOTE 3 - ACQUISITIONS:

On September 1, 2000, the Company acquired certain assets of an FBO located in Birmingham, Alabama, from Raytheon Aircraft Services, Inc. (RAS) for \$6.6 million in cash, which was funded under the Company's acquisition line. The acquisition was accounted for under the purchase method of accounting. Included in the acquisition are tangible refueling assets utilized in the FBO business, leasehold and leasehold improvements and a sublease for the entire duration of the master lease. The consideration of \$6.6 million has been allocated to Property, Equipment and Leaseholds. The consideration included a deposit of \$1.5 million which was classified in Other Assets at June 30, 2000.

In July 2000, the Company purchased hangars, buildings and leaseholds at its Tulsa, Oklahoma FBO and paid \$3.8 million cash which was borrowed from its acquisition line.

NOTE 4 - STOCKHOLDINGS' EQUITY:

During the six month period ended December 31, 2000, 58,350 common shares were issued from the exercise of options, the proceeds from which were \$187,000. In addition, options to purchase 86,275 common shares were repurchased by the Company in September 2000 at a cost of \$428,000 and charged to expense.

NOTE 5- EARNINGS PER SHARE:

Basic income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted income per share is computed by dividing net income by the weighted average number of common shares and common stock equivalents. Common stock equivalents include stock options, warrants and shares resulting from the assumed conversion of subordinated debentures, when dilutive.

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		Six Months Ended		
		December 31, 2000	December 31, 1999	December 31,
		-----		-----
		Diluted	Basic	Diluted

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Weighted average number of common shares outstanding during the period	6,516,000	6,516,000	6,652,000	6,652,000	6,531,000	6
Common stock equivalents resulting from the assumed exercise of stock options and warrants	173,000		373,000		151,000	
Common shares resulting from the assumed conversion of debentures	46,000	--	1,126,000	--	46,000	
Weighted average number of common and common equivalent shares outstanding during the period	6,735,000	6,516,000	8,151,000	6,652,000	6,728,000	6
Net income before extraordinary item	\$2,938,000	\$2,938,000	\$3,561,000	\$3,561,000	\$1,782,000	\$1
Interest expense, net of tax, on convertible debenture	12,000	--	179,000	--	6,000	
Adjusted income before extraordinary item	2,950,000	2,938,000	3,740,000	3,561,000	1,788,000	1
Extraordinary item	--	--	(979,000)	(979,000)	--	
Adjusted income	\$2,950,000	\$2,938,000	\$2,761,000	\$2,582,000	\$1,788,000	\$1
Common and common share equivalents	6,735,000	6,516,000	8,151,000	6,652,000	6,728,000	6
Earnings per share:						
Before extraordinary item	\$ 0.44	\$ 0.45	\$ 0.46	\$ 0.54	\$ 0.27	\$
Extraordinary item	--	--	(0.12)	(0.15)	--	
Net income	\$ 0.44	\$ 0.45	\$ 0.34	\$ 0.39	\$ 0.27	\$

NOTE 6 - OTHER ASSETS:

Other Assets include \$1.0 million related to an investment made by the Company on September 1, 2000 for a 49% interest in a start-up cargo company. The investment will be accounted for using the equity method of accounting.

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NOTE 7- LITIGATION:

In connection with the Chapter 7 bankruptcy filing for Western Pacific

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Airlines, Inc., ("WPAI"), the Company received a letter, dated August 25, 1999, from the bankruptcy trustee's attorneys making a formal demand for recovery of alleged preference payments of approximately \$11.4 million. This amount represents cash received for payment of fuel sales during the 90 days prior to WPAI's initial bankruptcy filing. The Company also received notice of a claim by the trustee for \$1.1 million against Compass Bank for payments made pursuant to a loan between Compass and WPAI, which the Company guaranteed. The trustee filed suit in the United States District Court for the District of Colorado on October 1, 1999. In December 2000, the Company agreed to a settlement of all claims with the Trustee, subject to the Bankruptcy courts approval. The settlement consists of ten quarterly payments of \$175,000, with the unpaid balance secured by a letter of credit. Payments are expected to begin upon approval of the settlement by the bankruptcy court. The Company has recorded a charge to bad debt expense equal to the present value of the payments, \$1.6 million. During the quarter, this was partially offset by approximately \$900,000 in bad debt recoveries from a former customer.

In November 1999, Mr. Perez, formerly the President of RPA, filed a lawsuit alleging violations of his employment contract between the Company, RPA and Mr. Perez asserting, among other things, constructive termination. The Company subsequently filed a suit seeking declaratory relief regarding the employment contract. The suit was then amended to seek damages against Mr. Perez. The Company filed a motion with the United States District Court for the Southern District of New York (New York City) to dismiss Mr. Perez's claim against the Company. On January 31, 2001 the court ruled in the Company's favor and dismissed all of Mr. Perez's claims against the Company. The Company has remaining claims against Mr. Perez, which are expected to go forward in February, 2001. Mr. Perez filed a mirror case in the State Court of Florida (Miami Dade County), which the Company expects to be dismissed.

NOTE 8 - SEGMENT REPORTING:

The Company operates and reports it's activities through five principal units: 1) Fuel Sales and Services, 2) Fixed Based Operations, 3) Cargo Operations, 4) Government Contract Services, and 5) RPA.

(Dollars in Thousands)	Fuel Sales and Services	Fixed Base Operations	Cargo Operations	Government Contract Services
QUARTER ENDED DECEMBER 31, 2000				
Revenues	\$ 91,760	\$ 26,445	\$ 8,669	\$ 7,220
Gross Margin	2,511	4,065	2,349	1,525
Depreciation and Amortization	187	1,303	805	212
Capital Expenditures	42	1,063	1,263	11
Segment Assets	58,883	39,331	34,598	20,557

(Dollars in Thousands)	Fuel Sales and Services	Fixed Base Operations	Cargo Operations	Government Contract Services
------------------------	----------------------------	--------------------------	---------------------	------------------------------------

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QUARTER ENDED DECEMBER 31, 1999

Revenues	\$ 50,107	\$ 17,692	\$ 9,031	\$ 5,885
Gross Margin	2,078	2,737	3,356	1,197
Depreciation and Amortization	211	1,112	812	208
Capital Expenditures	63	5,261	163	40
Segment Assets	54,979	27,517	31,542	17,948

SIX MONTHS ENDED DECEMBER 31, 2000

Revenues	\$164,905	\$ 50,335	\$ 15,728	\$ 14,520
Gross Margin	4,534	7,810	4,071	3,061
Depreciation and Amortization	373	2,584	1,606	428
Capital Expenditures	79	12,300	1,332	(43)
Segment Assets	58,883	39,331	34,598	20,557

SIX MONTHS ENDED DECEMBER 31, 1999

Revenues	\$ 93,080	\$ 32,874	\$ 17,350	\$ 12,928
Gross Margin	4,326	5,448	6,310	2,658
Depreciation and Amortization	377	2,110	1,725	436
Capital Expenditures	63	6,896	510	48
Segment Assets	54,979	27,517	31,542	17,948

Gross margin is used as the measure of profit and loss for segment reporting purposes as it is viewed by key decision makers as the principal operating indicator in measuring segment profitability. The key decision makers also view bad debt expense as an important measure of profit and loss. The predominant component of bad debt expense relates to Fuel Sales and Services. Bad debt expense for Fuel Sales and Services was approximately \$999,000 and \$469,000 in the quarter ended December 31, 2000 and December 31, 1999 respectively; total bad debt expense was \$1,100,000 and \$569,000 in the quarter ending December 2000 and December 1999, respectively. For the six months ended December 31, 2000 and December 31, 1999, bad debt expense for Fuel Sales and Services was approximately \$1,699,000 and \$728,000, respectively: total bad debt expense was \$1,899,000 and \$928,000, respectively.

NOTE 9 - LONG-TERM DEBT:

During the six months ended December 31, 2000, the Company borrowed \$11,969,000 under its acquisition line to fund, 1) the Birmingham, Alabama FBO acquisition in September 2000 (\$6.6 million), 2) the Tulsa, Oklahoma, FBO acquisition in July 2000 (\$3.8 million) and 3) a hangar project in Bedford, Massachusetts (\$1.6 million). Additionally, the Company paid down \$4.5 million of its acquisition line debt.

NOTE 10 - COMPREHENSIVE INCOME:

For the periods presented, adjustments to derive comprehensive income from net income were insignificant.

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RESULTS OF OPERATIONS- COMPARISON OF THE THREE MONTHS ENDED DECEMBER 31, 2000 AND DECEMBER 31, 1999 AND COMPARISON OF THE SIX MONTHS ENDED DECEMBER 31, 2000 AND DECEMBER 31, 1999.

The following tables set forth, for the periods indicated, the revenues and gross margin for each of the Company's five operating units, as well as selected other financial statement date.

(\$ in millions)	Six Months Ended December 31,				Three Months Ended December 31,	
	2000		1999		2000	
	Amount	% of Total Revenues	Amount	% of Total Revenues	Amount	% of Total Revenues
Revenues:						
Fuel sales and services	\$ 164.9	66.4%	\$ 93.1	58.8%	\$ 91.8	67.2%
FBOs	50.4	20.4	32.9	20.8	26.4	19.1%
Cargo operations	15.7	6.3	17.4	11.0	8.7	6.4%
Government contract services	14.5	5.8	12.9	8.2	7.2	5.3%
RPA	2.8	1.1	1.9	1.2	1.4	1.0%
Total Revenue	\$ 248.3	100.0%	\$ 158.2	100.0%	\$ 135.5	100.0%
	Amount	% of Unit Revenues	Amount	% of Unit Revenues	Amount	% of Unit Revenues
Gross Margin (1):						
Fuel sales and services	\$ 4.5	2.7%	\$ 4.3	4.6%	\$ 2.5	2.2%
FBOs	7.8	15.5	5.4	16.6	4.1	15.1%
Cargo operations	4.1	25.9	6.3	36.4	2.3	27.1%
Government contract services	3.0	21.1	2.7	20.6	1.5	21.1%
RPA	0.4	12.3	(0.8)	(43.9)	0.2	13.3%
Total Gross Margin	\$ 19.8	8.0%	\$ 17.9	11.3%	\$ 10.6	7.8%
	Amount	% of Total Revenues	Amount	% of Total Revenues	Amount	% of Total Revenues
Selling, general and administrative	\$ 4.2	1.7%	\$ 3.7	2.3%	\$ 2.1	1.5%
Provision for bad debts	1.9	0.8	0.9	0.6	1.1	0.8%
Depreciation and amortization	5.1	2.1	4.8	3.0	2.6	1.9%
Interest expense and other	3.8	1.4	2.7	1.7	1.9	1.4%
Income before income taxes	4.8	1.9	5.8	3.7	2.9	2.1%
Provision for income taxes	1.9	0.8	2.3	1.4	1.1	0.8%

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Net income before	-----	-----	-----	-----	-----	-----
extraordinary item	2.9	1.2	3.6	2.3	1.8	1
Extraordinary item	--	--	(1.0)	(0.6)	--	--
Net income	-----	-----	-----	-----	-----	-----
	\$ 2.9	1.2%	\$ 2.6	1.6%	\$ 1.8	1
	=====	=====	=====	=====	=====	=====

(1) Gross margin as used here and throughout Management's Discussion excludes depreciation and amortization and selling, general and administrative expense.

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THREE MONTHS ENDED DECEMBER 31, 2000 COMPARED TO DECEMBER 31, 1999.

Revenue increased by 62.2% to \$135.5 million in the current quarter from \$83.5 million a year ago primarily due to an increase in both the price and volume of fuel sold. Gross margin increased 21.7% to \$10.6 million in the current period from \$8.8 million a year ago primarily due to an increase in gross margins from the FBOs and from RPA compared to a year ago.

Revenues from fuel sales and services represented 67.7% of total revenues in the current period compared to 60.0% of total revenues a year ago. Revenues from fuel sales and services increased 83.1% to \$91.8 million from \$50.1 million last year. The increase in revenues from fuel sales and services was due to an increase of 33.2% in the volume of fuel sold and an increase of approximately 37% in the price of fuel. Gross margin from fuel sales and service increased by 20.8% to \$2.5 million in the current period from \$2.1 million last year due to the volume increase resulting from a significant new customer added in September 2000.

Revenues from FBOs increased by 49.5% in the current period to \$26.4 million from \$17.7 million a year ago primarily due to the addition of FBOs in Fort Wayne, Birmingham, Tulsa, Charleston and John's Island during or subsequent to the December 1999 quarter and higher fuel prices in the period. Gross margin increased 48.5% in the current period to \$4.1 million from \$2.7 million last year. The increase was primarily attributable to increased fuel volume and higher per gallon margins at existing locations and to contributions made from the new locations.

Revenues from cargo operations in the current quarter decreased 4.0% to \$8.7 million from \$9.0 million a year ago. This decrease was due to a reduction in space brokerage revenues, primarily due to the bankruptcy of Tower Air in the third quarter of fiscal 2000. Gross margin from cargo operations in the current quarter decreased 30.0% to \$2.3 million from \$3.4 million in the year ago period primarily due to lower space brokerage revenue and higher cargo handling costs.

Revenues from government contract services increased 22.7% in the current period to \$7.2 million from \$5.9 million in the year ago period. The increase in revenues from government contract services was due primarily to new contracts added in the past twelve months and higher revenue from the base housing maintenance contract in Yokota, Japan. Partially offsetting this were two refueling contract losses and lower revenue from Weather Data based on a lower number of contracts during the last twelve months. Gross margin increased by 27.4% to \$1.5 million in the current period from \$1.2 million last year due to higher revenues.

Revenues from RPA increased by 75.1% in the current period to \$1.4 million from

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\$0.8 million a year ago due to higher contract license fees. As a result of the increased revenues, gross margin increased to \$0.2 million in the current period compared to a loss of \$0.6 million a year ago.

Selling, general and administrative expenses increased 16.3% to \$2.1 million from \$1.8 million in the prior year's quarter due primarily to higher professional fees.

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Provision for bad debts increased to \$1.1 million from \$0.6 million in the year ago quarter due to higher sales in the current period and greater credit exposure due to significantly higher fuel prices which has created a greater risk of potential bad debts related to certain airline accounts. A portion of the current quarter increase is also attributable to the Western Pacific legal settlement. (See Note 7 to the accompanying financial statements.)

Depreciation and amortization expense increased 7.4% to \$2.6 million from \$2.4 million primarily due to FBO acquisitions made during the past twelve months and various capital expenditures.

Interest expense increased 24.9% to \$1.9 million from \$1.5 million due to higher interest rates and higher average outstanding borrowings in the current period.

Income tax expense approximated 39.0% of pre-tax income in each period reflecting the expected effective annual income tax rate.

SIX MONTHS ENDED DECEMBER 31, 2000 COMPARED TO DECEMBER 31, 1999.

Revenues increased 57.0% to \$248.3 million from \$158.2 million in the prior year due to a significant increase in the volume and price of fuel sold. Gross margin increased 10.8% to \$19.8 million from \$17.9 million a year ago primarily due to an increase in gross margin from FBOs and RPA which were partially offset by lower gross margins from cargo operations.

Revenues from fuel sales and services represented 66.4% of total revenues in the current period compared to 58.8% of total revenue a year ago. Revenues from fuel sales and services increased 77.2% to \$164.9 million from \$93.1 million last year. The increase in revenues from fuel sales and services was due to an increase of 43% in the price of fuel and an increase of 23.9% in the volume of fuel sold. Gross margin from fuel sales and services increased 4.8% in the current period to \$4.5 million from \$4.3 million a year ago. The increase in gross margin from fuel sales and services was due to higher margins on increased volume of fuel sold, partially offset by higher expenses. In September 2000, the Company added a significant new customer which accounted for the volume increase.

Revenue from FBOs increased 53.1% to \$50.4 million from \$32.9 million a year ago due to higher fuel prices and the acquisition of FBOs in Tulsa and Fort Wayne in fiscal 2000 and Birmingham in September 2000. Gross margin increased 43.4% to \$7.8 million from \$5.4 million in the year ago period due primarily to the new locations and higher fuel volumes and margins from existing locations.

Revenues from cargo operations decreased 9.3% to \$15.7 million from \$17.4 million a year ago. The decrease was principally due to a reduction in space brokerage revenues, primarily due to the Tower Air bankruptcy which occurred during the third quarter of fiscal 2000. Gross margin from cargo operations decreased 35.5% to \$4.1 million from \$6.3 million in the year ago period primarily due to lower space brokerage revenue and higher cargo handling costs.

Revenues from government contract services increased 12.3% to \$14.5 million from \$12.9 million in the year ago period. The increase in revenues from government contract services was primarily due to the addition of new contracts during the last twelve months and higher revenue from the Yokota, Japan contract. Partially offsetting this were two refueling contracts lost and lower Weather Data revenue based on a lower number of contracts in the last twelve months. Gross margin from government contract services in the current period increased 15.2% to \$3.0 million from \$2.7 million last year due to higher revenues.

Revenues from RPA increased by 46.3% in the current period to \$2.8 million from \$1.9 million a year ago due to increased contract license fees. As a result of the revenue increase, gross margin increased to \$0.4 million in the current period compared to a loss of \$0.8 million a year ago.

Selling general and administrative expenses in the current period increased 13.2% to \$4.2 million from \$3.7 million in the year ago period. The increase was primarily due to higher professional fees.

Provision for bad debts increased 104.6% in the current period to \$1.9 million from \$0.9 million in the year ago period due to significantly higher sales in the current period and greater credit exposure due to significantly higher fuel prices. A portion of the current bad debt provision is attributable to the Western Pacific legal settlement. (See Note 7 to the accompanying financial statements.)

Depreciation and amortization expense increased 8.0% to \$5.1 million from \$4.8 million a year ago. The increase is primarily related to the FBO acquisitions and various capital expenditures during the past year.

Interest expense increased 38.7% in the current six months to \$3.9 million from \$2.8 million a year ago due to higher interest rates and higher average outstanding borrowings.

Income tax expense approximated 39.0% of pretax income in both periods reflecting the expected effective annual tax rate.

The extraordinary item of \$979,000 in the year ago period consisted of charges associated with the redemption of the company's 7 3/4% convertible subordinated debentures in September 1999. The charge includes a \$780,000 redemption premium plus write off of capitalized fees of \$824,000, less a tax benefit of \$625,000.

LIQUIDITY AND CAPITAL RESOURCES:

Mercury has historically financed its operations primarily through operating cash flow, bank debt and various public and private placements of bonds and subordinated debt. Mercury's cash balance at December 31, 2000 was \$3.4 million

Net cash provided by operating activities was \$10.0 million during the six month period ended December 31, 2000. During this period, the primary sources were net income and depreciation and amortization totalling \$8.2 million and an increase in accounts payable of \$11.4 million. The primary use of cash was an increase in accounts receivable of \$15.0 million. Accounts receivable at December 31, 2000 increased to \$61.5

million from \$48.3 million at June 30, 2000 due to significantly higher sales in the current six month period. Days sales outstanding were approximately 41 at December 31, 2000 compared to approximately 52 at June 30, 2000.

Net cash used in investing activities was \$14.9 million during the current six month period. The primary use of cash from investing activities included additions to property, equipment and leaseholds of \$3.3 million, acquisition of businesses of \$10.4 million and an increase in notes receivable of \$2.1 million.

Net cash provided by financing activities was \$6.3 million during the current six month period. The primary use of cash from financing activities in the current six month period was the reduction in long-term debt of \$6.0 million. The primary source of cash from financing activities was proceeds from long-term debt of \$12.0 million.

The Company's Senior Secured bank credit facility consists of a \$35 million Revolver, a term loan with an outstanding balance of \$17.6 million at December 31, 2000 and an acquisition facility with an outstanding balance of \$17.4 million at December 31, 2000. At December 31, 2000, there was \$2.5 million outstanding under the Revolver and approximately \$17.5 million in outstanding letters of credit. Principal installments are due quarterly on the term loan over a five year period ending in March 2004. Balances owed under the Revolver and acquisition facility are due in March 2004. The agreement contains provisions that require the maintenance of certain financial ratios including minimum tangible net worth (as defined), minimum profitability levels, maximum leverage and minimum debt service coverage and quick ratios and limitations on annual capital expenditures. Additionally, the Company is prohibited from paying dividends in excess of \$400,000 per year.

On September 10, 1999, the Company issued a \$24 million Senior Subordinate Note due in September 2006 with detachable warrants to purchase 503,126 shares of Company's common stock exercisable at \$6.50 per share for seven years. The Note agreement contains covenants that, among other matters, limit senior indebtedness, the disposition of assets and unfunded capital expenditures. The covenants also include a ratio test for interest coverage, leverage, fixed charge coverage and debt service.

In the event that fuel prices increase significantly for an extended period of time, the Company's liquidity could be adversely affected unless the Company is able to increase vendor credit or increase lending limits under its revolving credit facility. The company believes, however its revolver and vendor credit should provide it with sufficient liquidity in the event of a major temporary surge in oil prices.

From June 1999 to June 30, 2000 per gallon fuel costs rose approximately 67%. During the current fiscal year fuel prices have remained high. Significantly higher fuel prices for an extended period of time have a negative impact on the aviation industry as it increases the airlines operating expenses. Smaller, less well capitalized airlines may be more seriously impacted. The provision in the current six month period was \$1.9 million compared to \$0.9 million a year ago. The increase in the general bad debt reserve resulted from significantly higher fuel prices during the current fiscal year which have created a greater risk of loss due to potential bad debts related to certain airline accounts. Future periods may continue to be impacted by higher reserve requirements related to potential bankruptcies. In December 2000, National Airlines, a significant

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fuel customer of the Company's, filed for Chapter 11 Bankruptcy protection. The Company's receivable from National is secured by certain of National's assets and the Company keeps National's credit line at or under \$1.0 million. Mercury is continuing to provide fuel to National on a post petition basis under the auspices of the Bankruptcy Court.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.

There has been no material change during the six months ended December 31, 2000 from the disclosures regarding market risk presented in the Company's Annual Report on Form 10-K for the year ended June 30, 2000.

FORWARD-LOOKING STATEMENTS

Statements contained in this Quarterly Report on Form 10-Q which are not historical facts are forward-looking statements. In addition, Mercury, from time-to-time, makes forward-looking statements concerning its expected future operations and performance and other developments. Such forward-looking statements are necessarily estimates reflecting Mercury's best judgment based upon current information and involve a number of risks and uncertainties, and there can be no assurance that other factors will not affect the accuracy of such forward-looking statements. While it is impossible to identify all such factors, factors which could cause actual results to differ materially from those estimated by Mercury include, but are not limited to, risks associated with acquisitions, the financial condition of customers, non-renewal of contracts, government regulation, as well as operating risks, general conditions in the economy and capital markets, and other factors which may be identified from time-to-time in Mercury's Securities and Exchange Commission filings and other public announcements.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In connection with the Chapter 7 bankruptcy filing for Western Pacific Airlines, Inc., ("WPAI"), the Company received a letter, dated August 25, 1999, from the bankruptcy trustee's attorneys making a formal demand for recovery of alleged preference payments of approximately \$11.4 million. This amount represents cash received for payment of fuel sales during the 90 days prior to WPAI's initial bankruptcy filing. The Company also received notice of a claim by the trustee for \$1.1 million against Compass Bank for payments made pursuant to a loan between Compass and WPAI, which the Company guaranteed. The trustee filed suit in the United States District Court for the District of Colorado on October 1, 1999. In December 2000, the Company agreed to a settlement of all claims with the Trustee, subject to the Bankruptcy courts approval. The settlement consists of ten quarterly payments of \$175,000, with the unpaid balance secured by a letter of credit. Payments are expected to begin upon approval of the settlement by the bankruptcy court. The Company has recorded a charge to bad debt expense equal to the present value of the payments, \$1.6 million. During the quarter, this was partially offset by approximately \$900,000 in bad debt recoveries from a former customer.

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In November 1999, Mr. Perez, formerly the President of RPA, filed a lawsuit alleging violations of his employment contract between the Company, RPA and Mr. Perez asserting, among other things, constructive termination. The

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Company subsequently filed a suit seeking declaratory relief regarding the employment contract. The suit was then amended to seek damages against Mr. Perez. The Company filed a motion with the United States District Court for the Southern District of New York (New York City) to dismiss Mr. Perez's claim against the Company. On January 31, 2001 the court ruled in the Company's favor and dismissed all of Mr. Perez's claims against the Company. The Company has remaining claims against Mr. Perez, which are expected to go forward in February, 2001. Mr. Perez filed a mirror case in the State Court of Florida (Miami Dade County), which the Company expects to be dismissed.

Item 2. Change in Securities

None

Item 3. Default Upon Senior Securities

None

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

On December 14, 2000, the Company held its annual meeting of Shareholders.

All of the Company's directors were re-elected at the meeting by the following votes:

Name	For	Against	Abstain Broker Non-Vote
----	---	-----	-----
Dr. Philip Fagan, Jr.	5,336,161	312,727	-0-
Joseph A. Czyzyk	5,336,161	312,727	-0-
Frederick H. Kopko	5,336,161	312,727	-0-
Harold T. Bowling	5,335,705	313,183	-0-
Robert L. List	5,336,161	312,727	-0-

The annual meeting of Shareholders was adjourned until January 9, 2001 for the purpose of adopting the proposal that would change the Company's state of incorporation from New York to Delaware. On January 9, 2001, the proposal was adopted at meeting by the following votes:

For	Against	Abstain Broker Non-Vote
---	-----	-----
4,470,586	415,954	27,736

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

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Mercury Air Group, Inc.
Registrant

/s/ JOSEPH CZYZYK

Joseph Czyzyk
Chief Executive Officer

/s/ RANDY AJER

Randy Ajer
Principal Financial and Accounting Officer

February 09, 2001

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Item 6 (a) Exhibits and Exhibit List
(b) Reports on Form 8-K

(a)

Exhibit
No.

Description

3.1	Restated Certificate of Incorporation.(4)
3.2	Form of Amendment to Restated Certificate of Incorporation creating the Series A 8% Convertible Cumulative Redeemable Preferred Stock.(4)
3.3	Form of Amendment to Restated Certificate of Incorporation declaring the Separation Date for the Series A 8% Convertible Redeemable Preferred Stock.(5)
3.4	Bylaws of the Company.(4)
3.5	Amendment to Bylaws of the Company.(10)
3.6	Amendment to Bylaws of the Company adopted on December 3, 1998.(19)
3.7	Amendment to Bylaws of the Company adopted on August 22, 2000.(23)
4.1	Form of Indenture between Mercury Air Group, Inc. and IBJ Schroder Bank & Trust Company.(11)
4.2	Negotiable Promissory Note, dated as of June 21, 1996, from Mercury Air Group, Inc. to Raytheon Aircraft Services, Inc.(13)
4.3	Legend Agreement, dated as of August 29, 1996 between Mercury Air Group, Inc. and Raytheon Aircraft Services, Inc.(13)
4.4	Loan Agreement between California Economic Development Financing Authority and Mercury Air Group, Inc. relating to \$19,000,000 California Economic Development Financing Authority Variable Rate Demand Airport Facilities Revenue Bonds, Series 1998 (Mercury Air Group, Inc. Project) dated as of April 1, 1998.(3)
4.5	Securities Purchase Agreement dated September 10, 1999 by and among Mercury Air Group, Inc. and J.H. Whitney Mezzanine Fund, L.P.(20)
4.6	Amendment No. 1 dated as of September 30, 2000 by and between J.H. Whitney Mezzanine Fund, L.P. and Mercury Air Group, Inc. to the Securities Purchase Agreement.
10.1	Employment Agreement dated December 10, 1993 between the Company and Seymour Kahn.(8) *

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- 10.2 Stock Purchase Agreement between the Company, SK Acquisition, Inc., Randolph E. Ajer, Kevin J. Walsh, Grant Murray and Joseph Czyzyk.(2)*
- 10.3 Company's 1990 Long-Term Incentive Plan.(6)*
- 10.4 Company's 1990 Directors Stock Option Plan.(1)*
- 10.5 Lease for 6851 West Imperial Highway, Los Angeles, California.(4)
- 10.6 Memorandum Dated September 15, 1997 regarding Summary of Officer Life Insurance Policies with Benefits Payable to Officers or Their Designated Beneficiaries.(15)*
- 10.7 Memorandum dated September 15, 1995 regarding Summary of Bonus Plans for Seymour Kahn, Joseph Czyzyk and Randolph E. Ajer.(10)*
- 10.8 Memorandum dated September 15, 1995 regarding Summary of Bonus Plans for Kevin Walsh and William Silva.(10)*
- 10.9 The Company's 401(k) Plan consisting of LCI Actuaries, Inc. Regional Prototype Defined Contribution Plan and Trust and Adoption Agreement.(7)*

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Exhibit
No.

Description

- | ----- | ----- |
|-------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.10 | Non-Qualified Stock Option Agreement by and between the Company and Seymour Kahn dated January 21, 1993.(7)* |
| 10.11 | Stock Purchase Agreement among the Company, SK Acquisition, Inc. and William L. Silva dated as of August 9, 1993.(8)* |
| 10.12 | Stock Exchange Agreement dated as of November 15, 1994 between Joseph Czyzyk and the Company.(9)* |
| 10.13 | Employment Agreement dated November 15, 1994 between the Company and Joseph Czyzyk.(16) |
| 10.14 | Non-Qualified Stock Option Agreement dated August 24, 1995, by and between S.K. Acquisition and Mercury Air Group, Inc.(12)* |
| 10.15 | Non-Qualified Stock Option Agreement dated March 21, 1996, by and between Frederick H. Kopko and Mercury Air Group, Inc.(12)* |
| 10.16 | Credit Agreement by and among Sanwa Bank California, Mellon Bank, N.A., The First National Bank of Boston and Mercury Air Group, Inc. dated March 14, 1997.(14) |
| 10.17 | First Amendment to Credit Agreement and Related Loan Documents dated as of November 1997, by and among Sanwa Bank California, Mellon Bank, N.A., BankBoston, N.A. and Mercury Air Group, Inc.(16) |
| 10.18 | First Amendment of 1998 to Credit Agreement and Other Loan Documents dated as of April 1, 1998, by and among Sanwa Bank California, Mellon Bank, N.A., BankBoston, N.A. and Mercury Air Group, Inc.(3) |
| 10.19 | Second Amendment of 1998 to Credit Agreement and Other Loan Documents dated as of April 1998, by and between Sanwa Bank California, Mellon Bank, N.A., BankBoston, N.A. and Mercury Air Group, Inc.(16) |
| 10.20 | Third Amendment of 1998 to Credit Agreement and Other Loan Documents dated as of August 31, 1998, by and between Sanwa Bank California, Mellon Bank, N.A., BankBoston, N.A. and Mercury Air Group, Inc.(16) |
| 10.21 | Reimbursement Agreement dated as of April 1, 1998, by and among Sanwa Bank California, Mellon Bank, N.A., BankBoston, N.A. and Mercury Air Group, Inc.(3) |
| 10.22 | First Amendment to Reimbursement Agreement and Other L/C Documents as of August 31, 1998, by and between Sanwa Bank California, Mellon Bank, N.A., BankBoston, N.A. and Mercury Air Group, Inc.(16) |
| 10.23 | Fourth Amendment of 1998 to Credit Agreement and Other Loan Documents by and between Sanwa Bank California, Mellon Bank, N.A., BankBoston, N.A. and Mercury Air Group, Inc. dated September 15, 1998.(17) |
| 10.24 | Second Amendment to Reimbursement Agreement and Other L/C Documents by and between Sanwa Bank California, Mellon Bank, N.A., BankBoston, N.A. and Mercury Air Group, Inc. dated September 15, 1998.(17) |
| 10.25 | Company's 1998 Long-Term Incentive Plan.(18)* |

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- 10.26 Company's 1998 Directors Stock Option Plan.(18)*
- 10.27 Amendment to Employment Agreement by and between Mercury Air Group, Inc. and Joseph A. Czyzyk dated October 15, 1998.(19)*
- 10.28 Amendment No. 2 to Employment Agreement by and between Mercury Air Group, Inc. and Joseph A. Czyzyk dated April 12, 1999.(19)*
- 10.29 First Amendment of 1999 to Credit Agreement and Other Loan Documents dated as of December 31, 1998 by and between Sanwa Bank California, Mellon Bank, N.A. and BankBoston, N.A. and Mercury Air Group, Inc.(19)

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Exhibit
No.

Description

- | Exhibit No. | Description |
|-------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.30 | Third Amendment to Reimbursement Agreement and Other L/C Documents dated as of December 31, 1998 by and between Sanwa Bank California, Mellon Bank, N.A., BankBoston, N.A. and Mercury Air Group, Inc.(19) |
| 10.31 | Revolving Credit and Term Loan Agreement dated as of March 2, 1999 by and among Mercury Air Group, Inc., The Banks listed on Schedule 1 thereto, and The Fleet National Bank f/k/a BankBoston, N.A., as Agent.(19) |
| 10.32 | First Amendment to Revolving Credit and Term Loan Agreement dated as of September 10, 1999.(22) |
| 10.33 | Second Amendment to Revolving Credit and Term Loan Agreement dated as of March 31, 2000.(22) |
| 10.34 | Third Amendment, Waiver and Consent to Revolving Credit and Term Loan Agreement dated as of August 11, 2000.(22) |
| 10.35 | The Company's 401(k) Plan consisting of CNA Trust Corporation. Regional Prototype Defined Contribution Plan and Trust and Adoption Agreement.(22)* |
| 10.36 | Amendment No. 3 to Employment Agreement by and between Mercury Air Group, Inc. and Joseph A. Czyzyk dated September 11, 2000.(23)* |
| 10.37 | Employment Agreement dated July 31, 2000 between the Company and Dr. Philip J. Fagan.(23)* |
| 10.38 | Fourth Amendment to Revolving Credit and Term Loan Agreement dated as of November 14, 2000. |
| 10.39 | Amendment No. 1 to Mercury Air Group, Inc. 1998 Long-Term Incentive Option Plan as of August 22, 2000.* |
| 10.40 | Amendment No. 1 to Mercury Air Group, Inc. 1998 Directors Stock Option Plan as of August 22, 2000.* |
| 99.1 | Partnership Agreement dated as of July 27, 2000 of FK Partners by and among Philip J. Fagan, M.D., Frederick H. Kopko, Jr., and Joseph A. Czyzyk.(21) |

* Denotes managements contract or compensation plan or arrangement.

- (1) Such document was previously filed as Appendix A to the Company's Proxy Statement for the December 10, 1993 Annual Meeting of Shareholders and is incorporated herein by reference.
- (2) Such document was previously filed as an Exhibit to the Company's Current Report on Form 8-K dated December 6, 1989 and is incorporated herein by reference.
- (3) All such documents were previously filed as Exhibits to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1998 and are incorporated herein by reference.

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- (4) All such documents were previously filed as Exhibits to the Company's Registration Statement No. 33-39044 on Form S-2 and are incorporated herein by reference.
- (5) Such document was previously filed as an Exhibit to the Company's Quarterly

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Report on Form 10-Q for the quarter ended March 31, 1992 and is incorporated herein by reference.

- (6) Such document was previously filed as Appendix A to the Company's Proxy Statement for the December 2, 1992 Annual Meeting of Shareholders.
- (7) All such documents were previously filed as Exhibits to the Company's Annual Report on Form 10-K for the year ended June 30, 1993 and are incorporated herein by reference.
- (8) All such documents were previously filed as Exhibits to the Company's Annual Report on Form 10-K for the year ended June 30, 1994 and are incorporated herein by reference.
- (9) Such document was previously filed as an Exhibit to the Company's Current Report on Form 8-K dated November 15, 1994 and is incorporated herein by reference.
- (10) All such documents were previously filed as Exhibits to the Company's Annual Report on Form 10-K for the year ended June 30, 1995 and are incorporated herein by reference.
- (11) All such documents were previously filed as Exhibits to the Company's Registration Statement No. 33-65085 on Form S-1 and are incorporated herein by reference.
- (12) All such documents were previously filed as Exhibits to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1996 and are incorporated herein by reference.
- (13) All such documents were previously filed as Exhibits to the Company's Report on Form 8-K filed September 13, 1996 and are incorporated herein by reference.
- (14) Such document was previously filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997 and is incorporated herein by reference.
- (15) Such document was previously filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended June 30, 1997 and is incorporated herein by reference.
- (16) All such documents were previously filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended June 30, 1998 and is incorporated herein by reference.
- (17) Such document was previously filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 1998 and is incorporated herein by reference.

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- (18) Such document was previously filed as Appendix A to the Company's Proxy Statement for the December 3, 1998 Annual Meeting of Shareholders and incorporated herein by reference.
 - (19) All such documents were previously filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1999 and incorporated herein by reference.
 - (20) All such documents were previously filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended June 30, 1999 and is incorporated herein by reference.
 - (21) Such document was previously filed as an Exhibit to the Company's current Report on Form 8-K on August 11, 2000 and is incorporated herein by reference.
 - (22) All such documents were previously filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended June 30, 2000 and is incorporated herein by reference.
 - (23) All such documents were previously filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000 and incorporated herein by reference.
- (b) Reports on Form 8-K:

None