ABX AIR INC
Form 10-K
March 16, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006

Commission file number 000-50368

ABX AIR, INC.

(Exact name of registrant as specified in its charter)

Delaware	**91-1091619**
(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)

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

Common Stock, Par Value $.01 per share

(Title of class)

Name of each exchange on which registered: NASDAQ Stock Market, Inc.

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

Title of class: None

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES ¨ NO x

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, as of the last business day of the registrant s most recently completed second fiscal quarter: $349,358,619.

As of March 16, 2007, 58,683,500 shares of the registrant s common stock, par value $0.01, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Stockholders scheduled to be held May 9, 2007 are incorporated by reference into Part III.

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FORWARD LOOKING STATEMENTS

Statements contained in this annual report on Form 10-K, including Management s Discussion and Analysis of Financial Condition and Results of Operations, in Item 7, 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 simi 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 Risk Factors starting on page 8 and Outlook starting on page 16.

Filings with the Securities and Exchange Commission

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

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ABX AIR, INC. AND SUBSIDIARIES

2006 FORM 10-K ANNUAL REPORT

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PART I

ITEM 1. BUSINESS

Background

ABX Air, Inc. (ABX or the Company) is a cargo airline providing transportation through a fleet of Boeing 767, McDonnell Douglas DC-9 (DC-9) and McDonnell Douglas DC-8 (DC-8) aircraft. We complement our air transport capabilities with package handling and warehousing services. We employ approximately 6,100 full-time employees and 3,600 part-time employees. We operate primarily in the United States but have the authority to fly worldwide. Our headquarters, principal airline hub and largest package sorting operations are located in Wilmington, Ohio.

ABX was formed as a Delaware corporation in 1980. Between 1980 and August 2003, ABX was an affiliate of Airborne, Inc. (Airborne), a publicly traded, integrated delivery service provider. On August 15, 2003, ABX was separated from Airborne in conjunction with a merger agreement between Airborne and DHL Holdings (USA), Inc., (DHL) a wholly-owned subsidiary of DHL Worldwide Express, B.V. The merger agreement required Airborne to separate its air operations from its ground operations with the air operations being retained by ABX. ABX became an independent publicly traded company, and Airborne was subsequently merged into DHL.

DHL is our largest customer, constituting substantially all of our revenues in recent years. We manage a network of eighteen hubs for DHL, providing package sorting and handling. We process shipments ranging from individual letters to shipper-packaged pallets of electronic equipment, retail catalogs, movies and pharmaceuticals. Using our aircraft, we assist DHL in providing domestic express delivery services for cargo typically requiring next day delivery. We also offer ACMI (aircraft, crew, maintenance and insurance) and full service charters to freight forwarders, airlines and other major shippers. Additionally, we operate three sorting facilities for the United States Postal Service (USPS). We sell aircraft parts, provide maintenance and repair services for airframes and aircraft components and conduct flight-training services for customers. We operate in two reportable segments: DHL and Non-DHL ACMI/Charters. (Financial information about our reportable segments is presented in Note N to the accompanying consolidated financial statements.)

Business with DHL

ABX and DHL operate under two commercial agreements. The aircraft, crew, maintenance and insurance agreement (ACMI agreement) and a hub services agreement (Hub Services agreement) became effective August 16, 2003, in conjunction with Airborne merging with DHL. Under these agreements, we provide services to DHL on a cost-plus basis. We assist DHL in providing domestic express and deferred delivery services to its customers. DHL s express delivery services include its Next Day Service and DHL 2nd Day Service. Next Day Service packages are primarily transported by our fleet of aircraft and sorted through our nightly hub operations. 2nd Day and DHL s other deferred delivery services, which include DHL@Home and DHL Ground Service, are primarily transported by contracted trucks and sorted through our Wilmington daytime sort and regional hub operations.

We operate and maintain DHL s primary U.S. hub facility located in Wilmington, Ohio. The Wilmington facility handles approximately one million pieces during nightly sort operations each weekday. In addition to the sort facility in Wilmington, we operate seventeen regional hubs on behalf of DHL. These regional hub facilities primarily sort shipments originating and having a destination within approximately 250 miles. We also conduct daytime sort operations in Wilmington that process deferred delivery shipments. The day sort generally receives shipments through a combination of aircraft and trucks originating from regional hubs, DHL station facilities or customer sites. The night sort and day sort operations at Wilmington handle approximately 50% of the total system-wide shipment weight, while the regional hubs handle the remaining 50%.

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The seventeen regional hubs are located near Atlanta, Georgia; Baton Rouge, Louisiana; Chehalis, Washington; Kansas City, Missouri; Denver, Colorado; Erie, Pennsylvania; Fresno, California; Memphis, Tennessee; Minneapolis, Minnesota; Orlando, Florida; Phoenix, Arizona; Providence, Rhode Island; Roanoke, Virginia; Salt Lake City, Utah; Riverside, California; South Bend, Indiana; and Waco, Texas.

ACMI Agreement

Air cargo transportation services are provided to DHL under the ACMI agreement on a cost-plus pricing structure. Costs incurred under the ACMI agreement are generally marked-up 1.75% and recorded in revenues. Certain costs which are reimbursed by DHL, the most significant of which include fuel, rent, interest on a promissory note to DHL, ramp fees and landing fees incurred under the ACMI agreement, are recorded in revenues without mark-up. By achieving certain cost-related and service goals specified in the agreement, the mark-up can increase from a base of 1.75% up to approximately 3.35%.

The initial term of the ACMI agreement expires August 15, 2010 and automatically renews for an additional three years unless a one-year notice of non-renewal is given. DHL may terminate the ACMI agreement if, after a cure period, ABX is not in compliance with applicable performance standards specified in the agreement. The agreement allows DHL to reduce the air routes that we fly or to remove aircraft from service. For any aircraft removed from service during the term of the ACMI agreement, the agreement allows us to put the aircraft to DHL, requiring DHL to buy such aircraft from us at the lesser of book value or fair market value. If our stockholders equity is less than or equal to $100 million at the time of sale, any amount by which the appraised fair market value is less than net book value would be applied to a promissory note we owe to DHL. However, if our stockholders equity is greater than $100 million, as it is at this time, any amount by which fair market value is less than net book value would be recorded as an operating charge. For purposes of applying the $100 million stockholders equity threshold, ABX s stockholders equity will be calculated after including the effect of any charges caused by the removal of aircraft.

Hub Services Agreement

Under the Hub Services agreement, we provide staff to conduct package sorting, warehousing, and logistics services, as well as airport, facilities and equipment maintenance services for DHL. Costs incurred under the agreements are generally marked-up 1.75% and included in revenues. By achieving certain cost and service goals specified in the agreement, the mark-up can increase from a base of 1.75% up to approximately 3.85%.

The Hub Services agreement currently expires on August 15, 2007 and thereafter automatically renews for periods of one year each unless a ninety-day notice of non-renewal is given. DHL may terminate the Hub Services agreement if, after a cure period, ABX is not in compliance with applicable performance standards specified in the agreement. DHL may also terminate the Hub Services agreement if the ACMI agreement has been terminated. The agreement allows DHL to terminate specific services after giving at least sixty days of advance notice.

DHL has reduced the scope of services provided by ABX in the last year. Since the second quarter of 2006, DHL has directly managed the truck line-haul network previously managed by ABX. On January 1, 2007, the Company transferred the operations of a regional hub in Allentown, Pennsylvania, from ABX s management to its own management. In February 2007, DHL notified us of its plan to take over management of the regional hub operation in Riverside, California in June 2007.

ACMI and Charter Services for Customers other than DHL

We also have aircraft that are not under contract to DHL. We deploy these aircraft to provide ACMI services and fly charters for customers other than DHL. A typical ACMI contract requires ABX to supply, at a specific rate per block hour, the aircraft, crew, maintenance and insurance for specified cargo operations, while the customer is responsible for substantially all other aircraft operating expenses, including fuel, landing fees, parking fees and ground and cargo handling expenses. Charter agreements usually require ABX to provide full service, including fuel and other operating expenses in addition to aircraft, crew, maintenance and insurance for a fixed, all-inclusive price. Under our ACMI and charter arrangements, we have exclusive operating control of our aircraft, and our customers must typically obtain any government authorizations and permits required to service the designated routes.

Other Products and Services

U.S. Postal Service

During the third quarter of 2006, ABX was awarded contracts to manage USPS mail sort centers in Dallas, Texas and Memphis, Tennessee. Each of these facilities began operations in September 2006. ABX was also awarded a renewal of a USPS sort center in Indianapolis, Indiana that we have operated since 2004. Under each of these contracts, we are compensated at a firm price for fixed costs and an additional amount based on the volume of mail handled at each sort center. Each of the contracts has a four-year term with extensions at the discretion of the USPS.

Airport-to-Airport Transportation of Freight on a Space-Available Basis

Our ACMI agreement with DHL allows us, subject to certain limitations described in the ACMI agreement, to sell any aircraft space that DHL does not use to other customers. On the routes we operate for DHL, we sell airport-to-airport transportation services to freight forwarders and to the USPS.

Aircraft Maintenance and Modification Services

We operate a Federal Aviation Administration (FAA) certified 145 repair station. We can leverage the repair station facilities (including hangars and a component shop, which we lease) and our engineering capabilities to perform airframe and component maintenance and repair services for other airlines and maintenance repair organizations. We have developed technical expertise related to aircraft modifications as a result of our long history in aviation. We own many Supplemental Type Certificates (STCs). An STC is granted by the FAA and represents an ownership right, similar to an intellectual property right, which authorizes the alteration of an airframe, engine or component. We market our capabilities by identifying aviation-related maintenance and modification opportunities and attempting to match them to our capabilities.

Our marketable capabilities include the installation of terrain awareness warning systems (TAWS), terminal collision avoidance systems (TCAS), reduced vertical separation minima (RVSM) and flat panel displays for Boeing 757 and Boeing 767 cockpits. The flat panel display updates aircraft avionics equipment and reduces maintenance costs by combining multiple display units into a single instrumentation panel. We perform heavy maintenance and airframe overhauls on DC-9 and Boeing 767 aircraft and line maintenance on DC-8, DC-9, Boeing 747 and Boeing 767 aircraft. We refurbish in-house approximately 60% of the airframe components for DC-8 and DC-9 aircraft and the wheels and brakes for DC-8, DC-9 and Boeing 767 aircraft types. We can also perform intermediate repairs on the engines for DC-8 aircraft and the engines and auxiliary power units for DC-9 aircraft. Additionally, we update aircraft manuals for customers in conjunction with the modification of aircraft from passenger to cargo configuration.

Aircraft Parts Sales and Brokerage

Our wholly-owned subsidiary, ABX Material Services, Inc., which holds a certificate relating to free trade zone rights, is an ASA (Aviation Suppliers Association) 100 Certified reseller and broker of aircraft parts. We carry an inventory of DC-8, DC-9 and Boeing 767 spare parts and also maintain inventory on consignment from original equipment manufacturers, resellers, lessors and other airlines. Our customers include the commercial air cargo industry, passenger airlines, aircraft manufacturers and contract maintenance companies serving the commercial aviation industry, as well as other resellers.

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Flight Crew Training

We are FAA-certificated to offer training to customers and rent usage of our flight simulators for outside training programs. We train flight crewmembers in-house utilizing our own classroom instructors and facilities. We own four flight simulators, including one Boeing 767, one DC-8 and two DC-9 flight simulators. Our Boeing 767 and one of our DC-9 flight simulators are level C certified, which allows us to qualify flight crewmembers under FAA requirements without performing check flights in an aircraft. Our DC-8 and the other DC-9 flight simulator are level B certified, which allows us to qualify flight crewmembers by performing a minimum number of flights in an aircraft.

Airline Operations

Aircraft

We currently utilize pre-owned Boeing 767, McDonnell Douglas DC-8 and McDonnell Douglas DC-9 aircraft. Once acquired, aircraft are modified for use in our cargo operation. As of December 31, 2006, our in-service fleet consisted of 99 aircraft, including 33 Boeing 767 aircraft, five DC-8 aircraft, and 61 DC-9 aircraft.

The majority of our aircraft are not equipped with standard cargo doors, but instead utilize the former passenger doors for the loading and unloading of freight. This reduced the cost of modifying the aircraft from passenger to cargo configuration but limits the size of the freight that can be carried onboard the aircraft and necessitates the use of specialized containers and loading equipment. The absence of a cargo door may also negatively impact the market value of the aircraft.

On December 31, 2006, we had nine Boeing 767 aircraft that were converted from passenger aircraft to a standard cargo door configuration. We are currently committed to add eight more of these Boeing 767 freighters to our fleet by the end of the first quarter of 2008. The timing of acquisitions and modification payments are described on page 30 of this report. We also have four DC-8 aircraft that are equipped with an activated standard cargo door.

Flight Operations and Control

Our flight operations, including aircraft dispatching, flight tracking and crew scheduling, are planned and controlled by ABX personnel from the DHL Air Park in Wilmington, Ohio. We staff aircraft dispatching and flight tracking 24 hours per day, 7 days per week. Our flight operations office at the DHL Air Park also coordinates the technical support necessary for our flights to operate into other airports. Because our flight operations can be hindered by inclement weather, we use sophisticated landing systems and other equipment that is intended to minimize the effect that weather may have on our flight operations. All of our Boeing 767 aircraft are equipped for Category III landings. This allows our crews to land under weather conditions with runway visibility of only 600 feet at airports with Category III Instrument Landing Systems. All of our DC-8 and DC-9 aircraft are equipped for Category II landings which enable landing with runway visibility of only 1,200 feet.

Maintenance

Our operations are regulated by the FAA for aircraft safety and maintenance. We are certificated as an FAA repair station to perform maintenance on DC-8, DC-9 and Boeing 767 aircraft and their related avionics and accessories. Our maintenance and engineering personnel coordinate all routine and non-routine maintenance requirements. Our maintenance programs include tracking the maintenance status of each aircraft, consulting with manufacturers and suppliers about procedures to correct irregularities and training ABX maintenance personnel on the requirements of our FAA-approved maintenance program. We conduct nearly all of our own maintenance training. Performing a majority of the aircraft maintenance ourselves reduces costs, minimizes the out-of-service time for aircraft and achieves a higher level of reliability.

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We perform airframe heavy maintenance and modification on our DC-9 and Boeing 767 aircraft. We perform routine inspections and airframe maintenance, including Airworthiness Directives and Service Bulletin compliance on all of our aircraft. Additionally, we contract with a maintenance repair organization to perform the passenger-to freighter cargo conversions on our Boeing 767 airframes. We contract with maintenance repair organizations to perform heavy airframe maintenance on our DC-8 and Boeing 767 airframes. We also contract with maintenance repair organizations for the performance of heavy maintenance on our aircraft engines. We own a supply of spare aircraft engines, auxiliary power units, aircraft parts and consumable items. The number of spare items we maintain is based on the size of the fleet of each aircraft and engine type we operate and the reliability history of the item types.

Due to the nature of ABX s business, our aircraft experience relatively low utilization. For this reason, we have elected to schedule and perform heavy maintenance on our aircraft on a calendar basis as opposed to an hourly use basis. This results in ABX s aircraft undergoing inspections and maintenance on a more frequent basis, thereby improving mechanical reliability, lowering costs and, ultimately, improving service to our customers.

Insurance

We are required by the Department of Transportation (DOT) to carry liability insurance on each of our aircraft. Each of our aircraft leases, loans and the ACMI agreement also require us to carry such insurance. We currently maintain public liability and property damage insurance, aircraft hull and liability insurance and war risk insurance for each of the aircraft in our fleet in amounts consistent with industry standards.

Employees

As of December 31, 2006, there were approximately 9,700 ABX employees, including 6,100 full-time employees and 3,600 part-time employees. We employ approximately 650 flight crewmembers, 1,350 aircraft maintenance technicians and flight support personnel, 3,660 sort employees at the DHL Air Park, 2,450 sort employees at the seventeen regional hubs and postal centers, 500 employees for airport and hub maintenance, 610 employees for warehousing and logistics and 470 employees for administrative functions. We also use contracted labor during business peaks, particularly during the fourth calendar quarter.

We perform employee background checks for a five or ten-year period prior to employment, depending on the job, and, in fact, conduct a more in-depth pre-employment screening than is mandated by FAA regulations. In addition, management personnel who are directly involved in the supervision of flight operations, training, maintenance and aircraft inspection must meet experience standards prescribed by FAA regulations. All of our employees are subject to pre-employment drug and alcohol testing, and employees holding certain positions are subject to subsequent random testing. Our flight crewmembers are our only group of unionized employees.

Labor Agreements

The International Brotherhood of Teamsters (IBT) is the duly designated and authorized representative of ABX s flight crewmembers under the Railway Labor Act (RLA), as amended. The flight crewmembers contract became amendable as of July 31, 2006 and is currently under negotiation. Under the RLA, labor agreements do not expire, so the existing contract remains in effect throughout any negotiation process. If required, mediation under the RLA is conducted by the National Mediation Board, which has the sole discretion as to how long mediation can last and when it will end. In addition to direct negotiations and mediation, the RLA includes a provision for potential arbitration of unresolved issues and a 30-day cooling-off period before either party can resort to self-help.

Training

ABX flight crewmembers are required to be licensed in accordance with Federal Aviation Regulation (FAR) Part 121, with specific ratings for the aircraft type to be flown, and to be medically certified as

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physically fit to fly aircraft. Licenses and medical certifications are subject to recurrent requirements as set forth in the FARs to include recurrent training and minimum amounts of recent flying experience.

The FAA mandates initial and recurrent training for most flight, maintenance and engineering personnel. Mechanics and quality control inspectors must also be licensed and qualified for specific aircraft. We pay for all of the recurrent training required for our flight crewmembers and provide training for our ground service and maintenance personnel. Our training programs have received all required FAA approvals.

Industry

The scheduled delivery industry is dominated by integrated, door-to-door carriers including DHL, the USPS, FedEx Corporation and United Parcel Service, Inc. Although the volume of our DHL business is being impacted by competition among integrated carriers, we do not usually compete directly with these integrated carriers; instead, we compete for domestic cargo volume principally with other cargo airlines and passenger airlines which have substantial belly cargo capacity. Other cargo airlines include Astar Air Cargo, Inc. (Astar), World Air Holdings, Inc., Atlas Air, Inc., Evergreen International, Inc. and Kitty Hawk, Inc. The industry is highly competitive. At least two other cargo airlines have an ACMI agreement with DHL. The primary competitive factors in our industry are price, geographic coverage, flight frequency, reliability and capacity.

Cargo volumes within the U.S. are highly dependent on the economic conditions and the level of commercial activity. Generally, time-critical delivery needs, such as just-in-time inventory management, increase the demand for air cargo delivery. Historically, ABX and the cargo industry have experienced higher volumes during the fourth calendar quarter of each year.

Intellectual Property

We own a small number of U.S. patents that are important to our business operations and have nominal commercial value. We also own approximately 160 STCs issued by the FAA. We use these STCs mainly in support of our own fleet; however, we have marketed certain STCs to other airlines.

Information Systems

We have invested significant management and financial resources in the development of information systems to facilitate cargo, flight and maintenance operations. We utilize our systems to maintain records about the maintenance status and history of each major aircraft component, as required by FAA regulations. Using our systems, we track and control inventories and costs associated with each maintenance task, including the personnel performing those tasks. In addition, our flight operations system coordinates flight schedules and crew schedules. We have developed and procured systems to track flight time, flight crewmember duty and flight hours and crewmember training status.

Regulation

Our air carrier operations are generally regulated by the DOT and the FAA. Our operations must comply with numerous security and environmental laws, ordinances and regulations. In addition, we must also comply with various other federal, state, local and foreign authorities.

Environment

Under current federal, state and local environmental laws, ordinances and regulations, a current or previous owner or operator of real property may be liable for the costs of removal or clean-up of hazardous or toxic substances on, under, or in such property. Such laws often impose liability whether or not the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances. In addition, the presence of

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contamination from hazardous or toxic substances, or the failure to properly clean up such contaminated property, may adversely affect the ability of the owner of the property to use such property as collateral for a loan or to sell such property. Environmental laws also may impose restrictions on the manner in which a property may be used or transferred or in which businesses may be operated and may impose remediation or compliance costs. Under the DHL sublease, ABX and DHL are required to defend, indemnify and hold each other harmless from and against certain environmental claims associated with DHL Air Park.

We are subject to the regulations of the U.S. Environmental Protection Agency and state and local governments regarding air quality and other matters. In part, because of the highly industrialized nature of many of the locations at which we operate, there can be no assurance that we have discovered all environmental contamination for which we may be responsible.

Our aircraft currently meet all known requirements for engine emission levels. However, under the Clean Air Act, individual states or the U.S. Environmental Protection Agency may adopt regulations requiring reduction in emissions for one or more localities based on the measured air quality at such localities. Such regulations may seek to limit or restrict emissions by restricting the use of emission-producing ground service equipment or aircraft auxiliary power units. There can be no assurance that, if such regulations are adopted in the future or changes in existing laws or regulations are promulgated, such laws or rules would not have a material adverse effect on our financial condition or results of operations.

The federal government generally regulates aircraft engine noise at its source. However, local airport operators may, under certain circumstances, regulate airport operations based on aircraft noise considerations. The Airport Noise and Capacity Act of 1990 provides that, in the case of Stage 3 aircraft (all of our operating aircraft satisfy Stage 3 noise compliance requirements), an airport operator must obtain the carriers consent to or the government s approval of the rule prior to its adoption. We believe the operation of our aircraft either complies with or is exempt from compliance with currently applicable local airport rules. However, some airport authorities are considering adopting local noise regulations, and, to the extent more stringent aircraft operating regulations are adopted on a widespread basis, we may be required to spend substantial funds, make schedule changes or take other actions to comply with such local rules.

The U.S. government, working through the International Civil Aviation Organization, has in the past adopted more stringent aircraft engine emissions regulations with regard to newly certificated engines and aircraft noise regulations applicable to newly certificated aircraft. Although these rules will not apply to any of ABX s existing aircraft, additional rules could be adopted in the future that would either apply these more stringent noise and emissions standards to aircraft already in operation or require that some portion of the fleet be converted over time to comply with these new standards.

Department of Transportation

Although a majority of the economic regulation of domestic air transportation has been eliminated, the DOT maintains authority over certain aspects of domestic air transportation, such as requiring a minimum level of insurance and the requirement that a person be fit to hold a certificate to engage in air transportation. In addition, the DOT continues to regulate many aspects of international aviation, including the award of international routes. The DOT has issued to ABX a Domestic All-Cargo Air Service Certificate for air cargo transportation between all points within the U.S., the District of Columbia, Puerto Rico, and the U.S. Virgin Islands, and a Certificate of Public Convenience and Necessity (Route 377) to engage in scheduled foreign air cargo transportation between the U.S. and Canada. Prior to issuing such certificates, the DOT examines a company s managerial competence, financial resources and plans, compliance, disposition and citizenship in order to determine whether the carrier is fit, willing and able to engage in the transportation services it has proposed to undertake. By maintaining these certificates, ABX is vested with authority from the U.S. government to conduct all-cargo charter operations worldwide.

The DOT has the authority to impose civil penalties, or to modify, suspend or revoke our certificates for cause, including failure to comply with federal law or DOT regulations. A corporation holding either of such certificates must qualify as a U.S. citizen, which requires that (1) it be organized under the laws of the U.S. or a state, territory or possession thereof, (2) that its president and at least two-thirds of its Board of Directors and other managing officers be U.S. citizens, (3) that not more than 25% of its voting interest be owned or controlled by non-U.S. citizens, and (4) that it not otherwise be subject to foreign control. Neither certificate confers proprietary rights on the holder, and the DOT may impose conditions or restrictions on such certificates. We believe we possess all necessary DOT-issued certificates and authorities to conduct our current operations and continue to qualify as a U.S. citizen.

Federal Aviation Administration

The FAA regulates aircraft safety and flight operations generally, including equipment, ground facilities, maintenance, flight dispatch, training, communications, the carriage of hazardous materials and other matters affecting air safety. The FAA issues operating certificates and operations specifications to carriers that possess the technical competence to conduct air carrier operations. In addition, the FAA issues certificates of airworthiness to each aircraft that meets the requirements for aircraft design and maintenance. ABX believes it holds all airworthiness and other FAA certificates and authorities required for the conduct of its business and the operation of its aircraft, although the FAA has the power to suspend, modify or revoke such certificates for cause, or to impose civil penalties for any failure to comply with federal law and FAA regulations.

The FAA has the authority to issue maintenance directives and other mandatory orders relating to, among other things, the inspection and maintenance of aircraft and the replacement of aircraft structures, components and parts, based on the age of the aircraft and other factors. For example, the FAA has required ABX to perform inspections of its DC-9, DC-8 and Boeing 767 aircraft to determine if certain of the aircraft structures and components meet all aircraft certification requirements. If the FAA were to determine that the aircraft structures or components are not adequate, it could order operators to take certain actions, including but not limited to, grounding aircraft, reducing cargo loads, strengthening any structure or component shown to be inadequate, or making other modifications to the aircraft. New mandatory directives could also be issued requiring ABX to inspect and replace aircraft components based on their age or condition. As a matter of routine, the FAA issues airworthiness directives applicable to the aircraft operated by us, and ABX complies, sometimes at considerable cost, as part of our aircraft maintenance program.

The FAA is proposing legislation that would permit the adoption of rules that would limit the number of daily airline operations to control airport and air traffic control congestion. The FAA would seek to do so by permitting airport rates and charges to be set at levels reflecting the scarcity of airspace and airside capacity. With this new authority, the FAA or airport operators may in the future seek to impose limits on the number of arrivals and departures and, were they to do so, ABX may incur higher airport fees and charges as a result. Currently, ABX has all of the necessary airport operator permission to operate at each of the airports we serve.

Transportation Security Administration

The Transportation Security Administration (TSA), an administration within the Department of Homeland Security, is responsible for the screening of passengers, baggage and cargo and the security of aircraft and airports. ABX complies with all applicable aircraft and cargo security requirements. TSA is currently considering the adoption of additional cargo security-related rules that, if adopted as proposed, could impose additional burdens on ABX, which could have an impact on our ability to efficiently process cargo or otherwise increase costs. In addition, we may be required to reimburse the TSA for the cost of security services it may provide to ABX in the future.

Other Regulations

We believe our current operations are substantially in compliance with the numerous regulations to which our business is subject; however, various regulatory authorities have jurisdiction over significant aspects of our business, and it is possible that new laws or regulations or changes in existing laws or regulations or the interpretations thereof could have a material adverse effect on operations. In addition to the above, other laws and regulations to which we are subject, and the agencies responsible for compliance with such laws and regulations, include the following:

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ABX s labor relations are generally regulated under the Railway Labor Act, which vests in the National Mediation Board certain regulatory powers with respect to disputes between airlines and labor unions arising under collective bargaining agreements;

The Federal Communications Commission regulates ABX s use of radio facilities pursuant to the Federal Communications Act of 1934, as amended;

U.S. Customs and Border Protection inspects cargo imported from ABX s international operations;

ABX must comply with U.S. Citizenship and Immigration Services regulations regarding the citizenship of its employees;

U.S. Customs and Border Protection inspects animals, plants and produce imported from ABX s international destinations; and

ABX must comply with wage, work conditions and other regulations of the Department of Labor regarding its employees.

Security and Safety

Security

We have instituted various security procedures to comply with FAA and TSA regulations and comply with the directives outlined in the federal Domestic Security Integration Program. DHL customers are required to inform us in writing of the nature and composition of any freight which is classified as Dangerous Goods by the DOT. In addition, we conduct background checks of our employees, restrict access to our aircraft, inspect our aircraft for suspicious persons or cargo, and inspect all dangerous goods. Notwithstanding these procedures, ABX could unknowingly transport contraband or undeclared hazardous materials for customers, which could result in fines and penalties and possible damage to our aircraft.

Safety and Inspections

Management is committed to the safe operation of our aircraft. In compliance with FAA regulations, our aircraft are subject to various levels of scheduled maintenance or checks and periodically go through phased overhauls. In addition, a comprehensive internal review and evaluation program is in place and active. Our aircraft maintenance efforts are monitored closely by the FAA. We also conduct extensive safety checks on a regular basis.

ITEM 1A. RISK FACTORS

The risks described below could adversely affect our financial condition or results of operations. The risks below are not the only risks that ABX faces. Additional risks that are currently unknown to us or that we currently consider immaterial or unlikely could also adversely affect ABX.

We rely on DHL for substantially all of our revenue and the majority of our operating cash flows. DHL could reduce the scope of service provided by ABX.

DHL has placed increasing pressure on its vendors and services providers, including ABX, to reduce costs, improve productivity and stem its operating losses in the U.S. DHL competes in the U.S. against FedEx Corporation and United Parcel Services, Inc., each of which has significant resources, market penetration and brand recognition. ABX may experience declines in its revenues and operating cash flows if volume reductions are experienced by DHL.

DHL can, after a contractual advance-notice period, reduce the scope of services that ABX provides under the ACMI or Hub Services agreements. For example, DHL can reduce the number of aircraft or the number of routes that we fly, or DHL can transfer the management of any or all of the hubs that we operate. Since 2003, DHL has assumed administration of charters for tertiary markets that ABX previously contracted from other airlines, transferred the international gateway operations from ABX, removed 28 ABX aircraft from service under the ACMI agreement, transferred the management of the line-haul network and transferred the management of the Allentown, Pennsylvania regional hub from ABX. Additionally, in February 2007, DHL notified ABX that it intends to assume management of the Riverside, California regional hub in June of 2007.

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The term of the Hub Services agreement expires on August 15, 2007. The term will automatically renew for an additional year unless either party gives notice of termination on or before May 17, 2007. Termination of the Hub Services agreement would adversely impact our business, resulting in a significant decline in our revenues and earnings. As a condition to renewal, DHL may seek to negotiate new terms, possibly creating greater risk/reward opportunities related to the Company s performance and cost controls or a reduction in the scope of services ABX provides to DHL.

We have a credit facility and other debt agreements that subjects ABX to covenants and stipulates events of default. The removal of services from the ACMI or Hub Services agreement could trigger a covenant violation or result in a condition of default that could limit our use of the credit arrangements.

Certain terms of the ACMI agreement and Hub Services agreement with DHL may adversely affect ABX s operating results.

Under the ACMI agreement and Hub Services agreement, if we do not meet certain performance standards, after a cure period, DHL may terminate the ACMI agreement and Hub Services agreement prior to the end of their respective terms. A recurring work slowdown or strike by one or more groups of employees, such as our mechanics, sorters or flight crews, could adversely impact our operating performance. These events could result in reductions by DHL to the scope of services we provide under the DHL agreements, leading to the termination of those agreements.

Although the ACMI agreement and Hub Services agreement with DHL are structured as cost-plus arrangements, the costs for which we can be reimbursed are subject to certain limitations. For instance, labor rate increases are capped at predetermined levels and certain other costs are non-reimbursable. DHL can dispute whether expenses we have incurred are reimbursable under the agreements. The agreements give DHL the right to audit our expenses. Further, the agreements stipulate dispute and arbitration procedures. If labor costs sharply increase or we incur excessive non-reimbursable costs, there can be no assurance that the revenues from these agreements will generate sufficient income to recover our costs.

For the purposes of internal reporting, ABX does not allocate overhead costs that are reimbursed by DHL to its non-DHL activities. The provisions of the commercial agreements with DHL do not require an allocation of overhead until such time as ABX derives more than 10% of its total revenue from non-DHL business activities. The 10% threshold may be reached through a combination of decreased DHL revenues and increased non-DHL revenues. After the 10% threshold is reached, a portion of our overhead expenses may be allocated to non-DHL activities and not subject to reimbursement under the DHL agreements.

The ACMI agreement with DHL may limit our ability to provide services to third parties.

The ACMI agreement limits our ability to use the aircraft designated for use under the ACMI agreement to perform services for parties other than DHL by permitting such use only if (1) it does not interfere in any material respect with ABX s performance of ACMI services for DHL, (2) ABX does not solicit DHL s customers in competition with DHL, (3) it does not involve ABX providing air cargo transportation services to major integrated international air express delivery companies with annual revenues in excess of $5 billion (other than the USPS or any affiliate of DHL) and (4) an ABX event of default shall not have occurred and be continuing.

ABX is dependent upon the economic conditions in the U.S.

An economic downturn in the U.S. is likely to adversely affect demand for delivery services offered by DHL, in particular expedited services shipped via aircraft. During an economic slowdown, customers generally use ground-based delivery services instead of more expensive air delivery services. A prolonged economic slowdown may increase the likelihood that DHL would reduce the scope of services we provide under the ACMI

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agreement. Although the cost of jet fuel does not directly affect our net earnings, increased prices of jet fuel could also reduce the demand for air delivery services from DHL or our other ACMI customers.

ABX has made a significant investment in Boeing 767 aircraft.

We are adding eight Boeing 767 aircraft to the ABX in-service fleet through 2008. This is in addition to four Boeing 767 aircraft that we added to our non-DHL ACMI operations in 2006. Our future operating results and financial condition will depend on our ability to successfully deploy these aircraft in operations that provide a positive return on our investment. Our success will depend, in part, on our ability to obtain and operate additional cargo volumes with customers other than DHL. To deploy our growing non-DHL fleet, we are pursuing international opportunities, including flights in Asia. Deploying aircraft in new international markets may pose additional risk, regulatory requirements and costs.

These eight aircraft will be converted from passenger configurations to standard freight configuration. We plan to finance the purchase price and the cost of modifying the aircraft with existing cash and contractor-provided financing during the modification period. Upon completion of the modification, we anticipate financing some aircraft through a syndication process being arranged by our lead bank. Currently, only the financing for one aircraft is committed, but we expect to finalize borrowing arrangements in 2007 and 2008 as needed. Our future operating results will be affected by the interest rates, limits and other terms and conditions of the new borrowings or leases. See page 30 for further discussion of these aircraft.

We may need to reduce the carrying value of our assets.

We own a significant amount of aircraft, aircraft parts and related equipment. Additionally, our balance sheet reflects assets for income tax carryforwards and other deferred tax assets. The removal of aircraft from service could require the Company to evaluate the recoverability of the carrying value of those aircraft in accordance with Statements of Financial Accounting Standard (SFAS) No. 144 and result in an impairment charge. At the Company s current level of stockholders equity, the removal of additional aircraft from the DHL ACMI agreement could result in impairment charges for aircraft if their fair market values are less than their carrying values.

If we incur operating losses or our estimates of expected future earnings indicate a decline, it may be necessary to reassess the need for a valuation allowance for some or all of the Company s net deferred tax assets.

If insurance coverage becomes unavailable, it would adversely affect our ability to operate.

The U.S. government has been offering war risk insurance to U.S. airlines at rates below the commercial insurance market. The U.S. government has committed to offer war risk insurance to airlines through August 31, 2007, after which it may be necessary to procure war risk insurance in the commercial market. The war risk insurance available to airlines in the commercial market may be more limited in coverage and/or may not be available on commercially reasonable terms.

Although we believe that our insurance coverage is adequate, there can be no assurance that the amount of such coverage will not be changed upon renewal or that we will not be forced to bear substantial losses from accidents. Substantial claims resulting from an accident could have a material adverse effect on our financial condition and could affect our ability to obtain insurance in the future.

Penalties, fines, and sanctions levied by governmental agencies or the costs of complying with government regulations could negatively affect our results of operations.

Our operations are subject to complex aviation, transportation, environmental, labor, employment and other laws and regulations. These laws and regulations generally require us to maintain and comply with a wide variety of certificates, permits, licenses and other approvals. Our inability to maintain required certificates, permits or licenses, or to comply with applicable laws, ordinances or regulations could result in substantial fines or, in the case of DOT and FAA requirements, possible suspension or revocation of our authority to conduct our operations.

All aircraft in our in-service fleet of 99 aircraft were manufactured prior to 1990. The average ages of our Boeing 767, DC-8 and DC-9 aircraft are approximately 23, 38 and 36 years, respectively. Manufacturer Service Bulletins and the FAA Airworthiness Directives issued under its Aging Aircraft program cause aircraft operators of such aged aircraft to be subject to extensive aircraft examinations and require such aircraft to undergo structural inspections and modifications to address problems of corrosion and structural fatigue at specified times. Airworthiness Directives have been issued that require inspections and both major and minor modifications to such aircraft. It is possible that additional Service Bulletins or Airworthiness Directives applicable to the types of aircraft or engines included in our fleet could be issued in the future. The cost of compliance with Airworthiness Directives and of following Service Bulletins cannot currently be reasonably estimated but could be substantial.

ABX and a few employees in our Human Resources Department are the targets of a criminal investigation by the U.S. Department of Justice (DOJ) regarding whether we violated U.S. immigration laws in respect of our use of contract employees being supplied to us by Garcia Labor Co., Inc., a temporary employment agency. While ABX believes that it has not engaged in any wrongdoing, the investigation could result in proceedings being initiated against the Company. In the event proceedings were initiated against ABX that resulted in an adverse finding, ABX could be subjected to a financial penalty that is materially greater than the amount we have accrued and restrictions on our ability to engage in business with agencies of the U.S. Government.

Our operations are geographically concentrated.

Our aircraft repair station, headquarters, and principal site of hub services are located in Wilmington, Ohio. If these facilities were damaged or our access to these facilities was limited, for example, due to security concerns, severe weather or natural disaster, our operations and financial conditions could be adversely affected.

Failure to maintain ABX s operating certificates and authorities would adversely affect our business.

We have the necessary authority to conduct flight operations within the U.S. and maintain a Domestic All-Cargo Air Service Certificate for our domestic services, a Certificate of Public Convenience and Necessity for Route 377 for our Canada service, and an Air Carrier Operating Certificate issued to ABX by the FAA. The continued effectiveness of such authority is subject to our compliance with applicable statutes and DOT, FAA and TSA rules and regulations, including any new rules and regulations that may be adopted in the future.

Under U.S. laws and DOT precedents, non-U.S. citizens may not own more than 25% of, or have actual control of, a U.S. certificated air carrier. The separation of ABX from Airborne required us to file a notice of a substantial change with the DOT. In connection with the filing, the DOT will determine whether ABX continues to be fit, willing and able to engage in air transportation of cargo and a U.S. citizen. The DOT may determine that DHL actually controls ABX as a result of the commercial arrangements (in particular, the ACMI agreement and the Hub Services agreement) between ABX and DHL. If the DOT determined that ABX was controlled by DHL, the DOT could bring an enforcement action against ABX to revoke its certificates. The DOT could take action requiring ABX to show cause that it is a U.S. citizen and that it is fit, willing and able to engage in air transportation of cargo, or requiring amendments or modifications of the ACMI agreement, the Hub Services agreement or the other transaction documents. If we were unable to modify such agreements to the satisfaction of the DOT, the DOT may seek to suspend, modify or revoke our air carrier certificates and/or authorities.

The loss of our authorities, including in the situation described above, would materially and adversely affect our operations and would effectively eliminate our ability to operate the air services.

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Employees may decide to institute labor agreements.

We rely on a diverse group of employees, including sorters, mechanics and pilots. Today, only the pilots are organized under a labor agreement, which became amendable July 31, 2006 and is currently under negotiation. Operations could be interrupted and business could be adversely affected if no agreement is reached with the pilots or if other employee groups choose to organize with a union.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

We lease our corporate offices, 210,000 square feet of maintenance hangars and a 100,000-square-foot component repair shop from DHL. These facilities are located at the DHL Air Park in Wilmington, Ohio. We also have the non-exclusive right to use the airport which includes two runways, taxi ways, and ramp space comprising approximately 300 paved acres. The term of the lease runs concurrently with the term of the ACMI agreement with DHL. We believe our existing facilities are adequate to meet our current and reasonably foreseeable future needs.

The following table contains detailed information about our in-service aircraft fleet.

Aircraft Type	Number of Aircraft as of Dec. 31, 2006	Year of Manufacture	Gross Payload (Lbs.)	Still Air Range (Nautical Miles)
DC-8-61	1	1969	40,000-83,000	2,200-3,800
DC-8-63F (2)	4	1967-1972	40,000-97,000	2,600-4,300
DC-9-31	12	1967-1971	26,000-36,000	550-1,100
DC-9-32	12	1967-1972	26,000-36,000	550-1,100
DC-9-32F (1)	3	1967-1968	26,000-36,000	550-1,100
DC-9-33F (1)	5	1968-1970	26,000-38,000	500-1,100
DC-9-41	29	1969-1978	26,000-38,000	500-1,100
767-205	1	1984	67,000-91,000	1,800-4,400
767-231	4	1983	67,000-91,000	1,800-4,400
767-232SF (2)	4	1983	67,000-91,000	1,800-4,400
767-281	19	1983-1988	67,000-91,000	1,800-3,000
767-281SF (2)	5	1985-1987	67,000-91,000	1,800-3,000
Total	99			

(1) These aircraft were manufactured with a cargo door for transporting freight. The cargo doors are currently deactivated.
(2) These passenger aircraft are configured for standard cargo containers, including activated cargo doors.

ITEM 3. LEGAL PROCEEDINGS

Department of Transportation (DOT) Continuing Fitness Review

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

Under U.S. laws and DOT precedents, non-U.S. citizens may not own more than 25% of, or have actual control of, a U.S. certificated air carrier. The DOT may determine that DHL actually controls ABX as a result of

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its commercial arrangements (in particular, the ACMI agreement and Hub Services agreement) with DHL. If the DOT determines that ABX is controlled by DHL, the DOT could require amendments or modifications of the ACMI and/or other agreements between ABX and DHL. If ABX were unable to modify such agreements to the satisfaction of the DOT, the DOT could seek to suspend, modify or revoke ABX s air carrier certificates and/or authorities, and this would materially and adversely affect the business.

The DOT has yet to specify the procedures it intends to use in processing ABX s filing. We believe the DOT should find that ABX is controlled by U.S. citizens and continues to be fit, willing and able to engage in air transportation of cargo.

ALPA Lawsuit

On August 25, 2003, ABX intervened in a lawsuit filed in the U.S. District Court for the Southern District of New York by DHL Holdings and DHL Worldwide Express, Inc. (DHL Worldwide) against the Air Line Pilots Association (ALPA), seeking a declaratory judgment that neither DHL entity is required to arbitrate a grievance filed by ALPA. ALPA represents the pilot group at Astar. The grievance seeks to require DHL Holdings to direct its subsidiary, Airborne, Inc., now DHL Network Operations (USA), Inc., to cease implementing its ACMI agreement with ABX on the grounds that DHL Worldwide is a legal successor to Astar. ALPA similarly filed a counterclaim requesting injunctive relief that includes having DHL s freight currently being flown by ABX transferred to Astar.

The proceedings were stayed on September 5, 2003, pending the National Labor Relations Board s (NLRB) processing of several unfair labor practice charges ABX filed against ALPA on the grounds that ALPA s grievance and counterclaim to compel arbitration violates the National Labor Relations Act. In March 2004, the NLRB prosecuted ALPA on the unfair labor practice charges. On July 2, 2004, an Administrative Law Judge (ALJ) for the NLRB issued a decision finding that ALPA s grievance and counterclaim violated the secondary boycott provisions of the National Labor Relations Act, and recommended that the NLRB order ALPA to withdraw both actions. ALPA appealed the ALJ s finding to the full NLRB, which subsequently affirmed the ALJ s decision in its own decision and order dated August 27, 2005.

On September 14, 2005, ALPA filed a petition for review with the U.S. Court of Appeals for the Ninth Circuit and that Court subsequently granted ABX s motion to intervene in the case. The parties have filed briefs in the matter, and we are currently waiting for the court to set a date for oral argument. We believe that the NLRB s decision will be sustained on appeal and that ALPA s grievance and counterclaim will be denied.

Alleged Violations of Immigration Laws

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

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

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

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Other

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

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of 2006.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Common Stock

Our common stock became publicly traded on the OTC Bulletin Board under the symbol ABXA.OB on August 15, 2003 and on the NASDAQ under the symbol ABXA on May 9, 2005. The following table shows the range of high and low prices per share of our common stock for the periods indicated as quoted on the OTC Bulletin Board and the NASDAQ. Over-the-counter market prices reflect inter-dealer prices without retail mark-up, mark-down or commission.

2006 Quarter Ended:	**Low**	**High**
December 31, 2006	$ 5.12	$ 6.94
September 30, 2006	$ 4.94	$ 6.07
June 30, 2006	$ 5.73	$ 7.11
March 31, 2006	$ 6.48	$ 8.50

2005 Quarter Ended:	**Low**	**High**
December 31, 2005	$ 6.89	$ 8.50
September 30, 2005	$ 7.84	$ 9.19
June 30, 2005	$ 7.08	$ 8.55
March 31, 2005	$ 6.90	$ 8.90

On March 14, 2007, there were 2,156 stockholders of record of ABX common stock. The closing price of ABX common stock was $7.12 on March 15, 2007.

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Performance Graph

The graph below compares the cumulative total stockholder return on a $100 investment in the Company s common stock with the cumulative total return of a $100 investment in the NASDAQ Stock Market and the cumulative total return of a $100 investment in the NASDAQ Transportation Index for the period beginning on August 18, 2003, the date on which the Company s shares first began trading publicly, and ending on December 31, 2006.

	8/18/2003	12/31/2003	12/31/2004	12/31/2005	12/31/2006
ABX Air, Inc.	100.00	277.42	573.55	506.45	447.10
NASDAQ Transportation Index	100.00	104.11	133.24	137.77	154.32
NASDAQ Composite Index	100.00	110.63	119.93	122.57	135.15

Dividends

We are restricted from paying dividends on our common stock in excess of $1.0 million during any calendar year under the provisions of our promissory note due to DHL and our credit facility agreement. No cash dividends have been paid or declared.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

Comparability of financial data among years is affected by ABX s separation from Airborne on August 15, 2003. The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and the notes thereto and the information contained in Item 7 of Part II, Management s Discussion and Analysis of Financial Condition and Results of Operations.

The selected consolidated financial data and the consolidated operations data below are derived from ABX s audited consolidated financial statements.

	As of and for the Years Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands, except per share data)				
OPERATING RESULTS:					
Revenues (1)	$ 1,260,361	$ 1,464,390	$ 1,202,509	$ 1,160,959	$ 1,173,735
Operating expenses (2)	1,217,576	1,425,627	1,157,511	1,720,125	1,125,200
Net interest expense	6,772	8,451	8,025	16,379	25,866
Earnings (loss) before income taxes	36,013	30,312	36,973	(575,545)	22,669
Income tax benefit (expense) (3)	54,041			128,644	(9,383)
Net earnings (loss) (2)	$ 90,054	$ 30,312	$ 36,973	$ (446,901)	$ 13,286
EARNINGS (LOSS) PER SHARE					
Basic	$ 1.55	$ 0.52	$ 0.63	$ (8.52)	$ 0.25
Diluted	$ 1.54	$ 0.52	$ 0.63	$ (8.52)	$ 0.23
WEIGHTED AVERAGE SHARES:					
Basic	58,270	58,270	58,270	52,474	52,107
Diluted	58,403	58,475	58,270	52,474	58,521
SELECTED CONSOLIDATED FINANCIAL DATA:					
Unrestricted and restricted cash	$ 63,219	$ 69,473	$ 38,749	$ 65,741	$ 33
Deferred income taxes (3)	101,715				
Property and equipment, net	458,638	381,645	351,646	312,803	1,089,485
Total assets	679,798	516,043	472,923	413,106	1,174,008
Advances from parent					474,608
Post-retirement liabilities (4)	224,376	89,319	79,770	66,825	67,858
Capital lease obligations	73,551	80,908	88,861	96,193	37,825
Long-term debt	125,126	92,276	92,949	92,949	76,318
Stockholders equity	$ 120,210	$ 113,079	$ 87,949	$ 58,666	$ 232,322

(1) Prior to August 16, 2003, revenues were calculated as pre-tax net expenses plus two percent. See revenue recognition policy on page 26 of this report.

(2) Operating expenses for 2003 include an impairment charge of $600.9 million recorded in conjunction with ABX s separation from Airborne, Inc. A tax benefit of $134.8 million occurred primarily as a result of recording the impairment charge.

(3) In the fourth quarter of 2006, an income tax benefit was recognized to completely reverse the valuation allowance on ABX s deferred tax assets. See Note G to the accompanying consolidated financial statements.

(4) Post-retirement liabilities for 2006 reflect the adoption of SFAS No. 158. See Note J to the accompanying consolidated financial statements.

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ITEM 7. 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 ABX Air, Inc. and its subsidiaries (ABX) and should be read in conjunction with the Risk Factors on page 8 of this report, our historical financial statements, and the related notes contained in this report.

INTRODUCTION

ABX operates an in-service fleet of 99 aircraft as of December 31, 2006 and employs approximately 6,100 full-time employees and 3,600 part-time employees. DHL is our largest customer, accounting for over 96% of our revenues. We are DHL s primary provider for air cargo transportation and for package handling and warehousing services within the U.S. ABX provides staffing, management and maintenance services for DHL s primary hub in Wilmington, Ohio and seventeen regional hubs throughout the U.S. In addition to DHL, we provide air cargo and aircraft maintenance related services to customers other than DHL. We currently operate three sorting facilities for the U.S. Postal Service (USPS).

We assess our performance and operate in two reportable segments:

DHL: We have two commercial agreements with DHL: an aircraft, crew, maintenance and insurance agreement (ACMI agreement) and a hub services agreement (Hub Services agreement). Under the ACMI agreement, ABX provides air cargo transportation to DHL on a cost-plus pricing structure. Under the Hub Services agreement, ABX provides staff to conduct package handling, package sorting, warehousing, and facilities and equipment maintenance services for DHL, also on a cost-plus pricing structure. Costs incurred under these agreements are generally marked-up by 1.75% and included in revenues. Both agreements also allow ABX to earn incremental mark-up above the base 1.75% mark-up (up to an additional 1.60% under the ACMI agreement and an additional 2.10% under the Hub Services agreement) from the achievement of certain cost-related and service goals specified in the two agreements. Fuel, rent, interest on the promissory note to DHL, and ramp and landing fees incurred under the ACMI agreement are the most significant cost items reimbursed without mark-up.

Unless we are notified of non-renewal, ACMI agreement automatically renews for a period of three years in August 2010, and the Hub Services agreement automatically renews for additional one year periods beginning in August 2007. However, DHL can terminate specific ACMI aircraft, delete or modify the air routes we operate under the ACMI agreement and increase or reduce the scope of services we provide under the Hub Services agreement before their respective renewal dates.

Non-DHL ACMI/Charters: We offer ACMI (aircraft, crew, maintenance and insurance) and full service charters to freight forwarders, airlines and other shippers. We usually charge customers based on the number of block hours flown, and typical agreements specify a minimum number of block hours to be charged monthly.

Our other activities, which include contracts with the USPS and aircraft parts sales and maintenance services, do not constitute reportable segments.

Summary of 2006 and Outlook

DHL Agreements

Our earnings from the DHL agreements were $22.5 million, up from $21.3 million in 2005, despite lower DHL revenues. Our DHL revenues declined 15% in 2006 compared to 2005 due to reductions in the services we provide to DHL. As a result, our earnings on base mark-ups declined. This decline, however, was more than offset by improved incremental mark-ups for achieving annual service level targets. During 2006, DHL had agreed to additional incentives for our 2006 performance, beyond the existing contractual incentives, in the event we achieved very significant cost reductions under our commercial agreements. We did not achieve these incentives.

We deployed two additional standard freighter Boeing 767 aircraft under the ACMI agreement in 2006. These aircraft generate approximately $4.1 million in annual reimbursable depreciation expense under the ACMI.

In 2004, DHL started to change its network plan to reduce overlapping flights among its airlift providers. To complete its network plan, DHL released 21 specific aircraft (eleven DC-9s and ten DC-8s) from dedicated service for DHL in August 2006. Several of these aircraft had previously been placed in back-up status since September of 2005, when DHL consolidated its hub operations from Cincinnati into its main, ABX-managed hub in Wilmington, Ohio, eliminating redundant air routes within the network. The August 2006 reduction of 21 aircraft brings the total number of aircraft released from service under the ACMI agreement since November 2004 to 28 (fourteen DC-8s and fourteen DC-9s). DHL will continue to fully fund depreciation for eight of the DC-9s that were removed through their remaining depreciable lives in August 2010. The net book value of these eight aircraft was approximately $4.1 million. We will use the engines on these eight DC-9 aircraft to support the remaining 59 DC-9 aircraft that ABX has in service to DHL.

The removal of aircraft from service to DHL required us to evaluate the recoverability of the carrying value of those aircraft removed from the ACMI agreement. In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. We recorded an impairment charge of $0.3 million in 2006 for the excess of the carrying value of the aircraft over their fair value less cost to sell. The charge is reflected under the ACMI expenses but is not reimbursed by DHL.

Under the ACMI agreement with DHL, ABX had the option to put each of the other ten DC-8 and three DC-9 aircraft released in 2006 to DHL at the lower of their fair value or net book value. After having the aircraft appraised, management decided not to exercise the put provisions on these aircraft. Instead, ABX is marketing the aircraft to part dealers and private operations, using the aircraft for spare parts or, in some cases, operating the aircraft as back-ups or for other customers.

DHL has made reductions in the scope of hub services we provide. In May 2006, DHL took over responsibility for the over-the-road truck line-haul network we previously managed for DHL. Effective April 1, 2006, ABX did not earn any mark-up on line-haul expenses during the second quarter 2006 transitional period, and effective May 1, 2006, ABX no longer recorded revenues or expenses associated with over-the-road trucks. As a result, line-haul services revenue declined approximately $214.5 million and earnings were reduced by approximately $2.7 million during 2006 compared to 2005. Effective January 1, 2007, we no longer operate or manage DHL s Allentown hub facility. The Allentown hub comprised approximately $16.7 million of ABX s revenues and approximately $0.4 million of net earnings during 2006. We were notified in February 2007 that DHL would take over the management of the Riverside, California operation effective June 2007. During 2006, the Riverside hub contributed $11.7 million in revenues and approximately $0.3 million in pre-tax earnings, less than 1% of the Company s total revenue and pre-tax earnings.

Our level of business depends substantially on DHL s ability to compete in the U.S. where FedEx Corporation and United Parcel Service, Inc., have significant resources, market penetration and brand recognition. Our future operating results for this segment will depend, in part, on DHL s sourcing preferences for providing these services. Although we have not begun discussions with DHL, at this time we expect to renew the Hub Services agreement under terms similar to the existing terms.

Non-DHL ACMI/Charters

During 2006, we deployed four Boeing 767 aircraft in our non-DHL ACMI/charter operations, replacing two freighter aircraft that were subsequently redeployed into the DHL network. We achieved strong utilization rates as we deployed two Boeing 767 aircraft during the fourth quarter peak cargo season. As a result, our charter revenues increased 76% to $24.4 million, and pre-tax earnings increased to $3.7 million in 2006, compared to pre-tax earnings of $1.1 million in 2005. These four aircraft are the first of twelve aircraft we committed ABX to purchase from Delta Air Lines, Inc. (Delta).

Based on the most current projections, we are planning to deploy eight more former Delta aircraft through 2008. Our intention is to modify all of the aircraft to an industry standard freighter configuration and deploy them in ACMI/charter operations. (The timing of acquisitions and modification payments are described on page 30 of this filing.) We contracted with an aircraft maintenance provider to modify these aircraft from passenger to freighter configurations. We believe the fuel efficiency, cubic capacity, payload and operating cost of the Boeing 767 make it a desirable freighter aircraft in the domestic, Atlantic and other medium-range international air cargo markets (less than 3,000 nautical miles). While some of these former Delta aircraft may be contracted to DHL after the modifications are complete, interest from non-DHL customers is currently strong, particularly from cargo markets outside of the U.S.

In addition to these Boeing 767 aircraft, we have one DC-8 aircraft in standard cargo configuration and two DC-9 aircraft in non-standard cargo configuration that are available for service.

Our future results from the Charter segment will depend on several factors, including how quickly we can place Boeing 767 aircraft into service after the modifications are completed, the level of aircraft utilization, and the revenue rates we are able to negotiate in the cargo markets. We expect to have lower utilization in 2007 compared to the high utilization levels we achieved in the fourth quarter of 2006. Additionally, because our policy is to expense maintenance costs as they are incurred, our results will fluctuate due to the timing of scheduled heavy maintenance procedures.

Diversification

In recent years, we have attempted to diversify our customer base and service offerings. Our investment in Boeing 767 aircraft is a key component of our strategy to diversify our sources of revenues and earnings. During 2006 and 2005, our non-DHL revenues, including non-DHL ACMI/charters, USPS contracts and aircraft maintenance services, increased approximately 42% and 27%, respectively, compared to the immediately preceding year. Excluding interest income, pre-tax earnings from non-DHL sources were $8.4 million in 2006 compared to $6.5 million in 2005.

Our strategy also includes expanding the services we provide to the USPS. During the third quarter of 2006, ABX was awarded contracts to manage USPS mail sort centers in Dallas, Texas and Memphis, Tennessee. Each of these facilities began operations in September 2006. ABX was also awarded a renewal of a USPS sort center in Indianapolis, Indiana that we have operated since 2004. Under each of these contracts, we are compensated at a firm price for fixed costs and an additional amount based on the volume of mail handled at each sort center. Each of the contracts has a four-year term with extensions at the discretion of the USPS. In December 2006, we operated a temporary, seasonal flight for the USPS and a sorting facility. In addition to adding air cargo capacity and USPS facilities, we have also marketed our technical expertise, aircraft maintenance services and training to other airlines.

Our non-DHL business activities typically earn operating margins relative to revenues that are higher than the margin on our DHL business. Our margin relative to revenues on the DHL agreements is predicated on large business volumes and reflects long-term agreements backed by a financially strong international company. The non-DHL opportunities typically involve single sales or short-term service arrangements across many different customers. These opportunities have different economic and risk profiles that often dictate a higher sales price and expected return than our DHL business. We expect that revenues and earnings from non-DHL business could vary widely among quarters, due to the capacity of our facilities, availability of aircraft, and the timing of our non-DHL customers demand for services. Our direct costs to develop, market and offer services to non-DHL customers are not reimbursed by DHL.

RESULTS OF OPERATIONS

2006 compared to 2005

Net earnings increased $59.7 million to $90.1 million for 2006 compared to $30.3 million in 2005, including a $54.0 million income tax benefit recorded in 2006. Pre-tax net earnings increased $5.7 million primarily due to achieving a higher level of incremental mark-up under the DHL Hub Services agreement in 2006 compared to 2005[1] and an increase in non-DHL charter/ACMI earnings. Our incremental mark-up from hub services increased $2.3 million, the incremental mark-up from the DHL ACMI agreement increased by $0.4 million, and our earnings from non-DHL charter operations increased by $2.6 million. Base earnings[2] from the DHL agreements declined $1.5 million during 2006 compared to 2005 and our earnings from all other activities declined $0.8 million. These declines were offset by an increase in net non-DHL interest income of $2.7 million.

DHL

While our revenues from DHL declined 15.3% during 2006, reflecting DHL s decision to take over the management of the line-haul trucking operation during the year, our 2006 earnings from the DHL segment increased $1.1 million to $22.5 million. Earnings for achieving cost-related and service goals increased $2.7 million to $10.5 million for 2006.

The increase in our 2006 DHL earnings and in the annual cost-related and service mark-up is primarily due to higher achievement of incentives within the Hub Services agreement. Mark-ups of $2.1 million from the *annual* service-related goals under the Hub Services agreement were recognized for 2006 while none were recognized in 2005. The improvement in incremental hub services revenues primarily reflects operational issues we experienced in 2005 during the Wilmington hub consolidation, the relocation of two smaller hubs and other changes that were made by DHL to their network in 2005. In an effort to share responsibility and demonstrate our commitment to DHL, we agreed to forego approximately $0.9 million of 2005 annual service incentive revenue that was otherwise earned under the agreement.

Our base earnings for 2006 declined $1.5 million to $12.0 million compared to $13.5 million for 2005. The decline is principally because DHL assumed management of its line-haul trucking operations from ABX Air in May 2006. Full-year results from those operations were $1.6 million in pre-tax earnings in 2006, and $4.3 million in pre-tax earnings in 2005, including fuel surcharge.

During the fourth quarters of 2006 and 2005, we recognized $4.1 million and $4.0 million, respectively, or approximately 100%, of the maximum available incremental mark-up from the *annual cost-related* goal under the ACMI agreement. Also, during the fourth quarter of 2006, we recognized revenue from the *annual service* goal in the ACMI agreement of $1.2 million, or 100% of the maximum available. During the fourth quarter of 2005, we recognized revenue from the *annual service* goal in the ACMI agreement of $0.7 million, or 60% of the maximum available.

Non-DHL ACMI/Charters

Our revenues from non-DHL ACMI/charter services were $24.4 million in 2006 compared to $13.9 million in 2005. Contributing to the higher revenues in 2006 was high utilization of the Boeing 767 freighter aircraft we operated for customers other than DHL. Early in 2005, we reached an agreement with DHL to

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1 The two agreements with DHL allow ABX to earn additional incremental mark-up for meeting certain quarterly cost-related goals, annual cost-related goals and annual service goals. The maximum incremental mark-up available from the quarterly cost goals is approximately 0.54% of cost eligible for mark-up under each agreement, except during the last six months of 2005, when the incremental mark-up under the Hub Services agreement for cost-related goals was approximately 1.04%. The maximum incremental mark-up available from the annual service goals is 0.25% of costs subject to mark-up under the ACMI agreement and 0.75% of costs eligible for mark-up under the Hub Services agreement. The maximum incremental mark-up available from the annual cost-related goals is approximately 0.81% of costs subject to mark-up under the ACMI agreement and approximately 0.81% of costs eligible for mark-up under the Hub Services agreement. Incremental mark-ups earned on the annual goals are only recognized in the fourth quarter.

2 Base earnings from DHL agreements are the segment s pre-tax earnings excluding revenues from incremental mark-ups.

temporarily defer two Boeing 767 freighter aircraft from DHL service and instead deploy the aircraft in our non-DHL charter operations for a twelve-month period. As a result, during the twelve months, the depreciation, maintenance and other operating costs associated with the aircraft were borne by ABX and not reimbursed by DHL under the ACMI agreement. By mid-2006, we deployed two newly modified Boeing 767 cargo aircraft into our non-DHL charter business, allowing us to return the two 767s previously deferred to service for DHL. By the end of 2006, we had deployed two additional newly modified Boeing 767 aircraft into service for our non-DHL charter operations, bringing the total to four. Our earnings from non-DHL ACMI/charter were $3.7 million in 2006 compared to $1.1 million in 2005. Our non-DHL charter earnings in the first half of 2005 were hampered by low utilization and higher fixed costs while we transitioned the 767 freighters into non-DHL service.

Other Activities

Other, non-DHL revenues increased $3.9 million to $24.1 million in 2006 compared to $20.2 million for 2005, while earnings declined $0.8 million to $4.7 million. In September 2006, ABX began managing two USPS sorting facilities in Dallas and Memphis to go along with a third USPS facility in Indianapolis that ABX has operated since September 2004. Fourth quarter 2006 pre-tax earnings for ABX s other non-DHL operations were affected by start-up losses from the two added USPS sorting facilities.

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A summary of our revenues, expenses and pre-tax earnings is shown below (in thousands):

	Year Ended December 31,		
	2006	2005	2004
Revenues:			
DHL Contracts			
ACMI			
Base mark-up	$ 466,967	$ 480,322	$ 475,826
Incremental mark-up - cost goals	6,303	6,319	6,341
Incremental mark-up - service goals	1,148	708	935
Total ACMI	474,418	487,349	483,102
Hub Services			
Base mark-up	400,336	605,094	440,602
Incremental mark-up - cost goals	951	753	3,917
Incremental mark-up - service goals	2,064		3,248
Total Hub Services	403,351	605,847	447,767
Other Reimbursable	334,101	337,151	244,935
Total DHL	1,211,870	1,430,347	1,175,804
Charters	24,440	13,864	16,673
Other Activities	24,051	20,179	10,032
Total Revenues	$ 1,260,361	$ 1,464,390	$ 1,202,509
Expenses:			
DHL Contracts			
ACMI	$ 459,926	$ 472,283	$ 467,642
Hub Services	395,391	599,591	433,024
Other Reimbursable	334,101	337,151	244,935
Total DHL	1,189,418	1,409,025	1,145,601
Charters	20,736	12,726	14,147
Other Activities	19,356	14,786	5,788
Total Expenses	$ 1,229,510	$ 1,436,537	$ 1,165,536
Pre-tax earnings:			
DHL Contracts			
ACMI	$ 14,492	$ 15,066	$ 15,460
Hub Services	7,960	6,256	14,743
Other Reimbursable			
Total DHL	22,452	21,322	30,203
Charters	3,704	1,138	2,526
Other Activities	4,695	5,393	4,244
Interest income and other	5,162	2,459	
Total pre-tax earnings	$ 36,013	$ 30,312	$ 36,973

For the purposes of internal reporting, the Company does not allocate overhead costs that are reimbursed by DHL to its non-DHL activities. The provisions of the commercial agreements with DHL do not require an allocation of overhead until such time as ABX derives more than 10% of its total revenue from non-DHL business activities.

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Operating Expenses

Our expenses are driven by operational variables including the number of aircraft hours flown, the volume and size of packages handled for DHL, the services that DHL requests (such as electronic package scanning) and the number of instances in which a package is handled during the sort and transportation process. Pounds processed reflects the weight of a package at multiple times as it moves through the network. The design of the DHL air and ground network, which includes routing standards and transportation determinations, is generally communicated to us by DHL.

	2006	2005	Increase (Decrease)
Pounds processed for DHL (millions)	2,817	2,834	(1%)
Labor hours (thousands)	21,976	20,702	6%
Aircraft block hours flown	107,396	121,508	(12%)

Labor hours increased in 2006 compared to 2005 due primarily to higher levels of staffing to operate DHL s main hub in Wilmington, Oho and DHL s network of regional hubs. Labor hours increased as a result of DHL s hub integration project in September 2005. At that time, DHL consolidated its Cincinnati, Ohio hub, which was not operated by ABX, with its Wilmington hub, which we operate. Aircraft block hours flown for DHL declined 14% in 2006 compared to 2005, reflecting the lower level of flying since the September 2005 hub consolidation, which eliminated redundant routes within the DHL air network. Aircraft block hours flown for non-DHL customers increased 67% in 2006 compared to 2005 reflecting the deployment of two Boeing 767 aircraft in mid 2005 and two more Boeing 767 aircraft in 2006.

Salaries, wages and benefits expense increased 4.1% during 2006 compared to 2005 due to increased staffing to operate the main hub in Wilmington, Ohio and additional resources to service the network of regional hubs located outside of Ohio after DHL s hub integration project in September 2005. The increase reflects higher healthcare costs and increases in our defined benefit pension plan expense.

Purchased line-haul and yard management expenses decreased $224.1 million, or 71.7%, during 2006 compared to 2005. The decrease is primarily a result of DHL assuming management of its line-haul trucking operations from ABX in May 2006. ABX Air s expenses from those line-haul management operations were approximately $81.5 million in 2006, compared with $293.3 million in 2005.

Fuel expense increased 2.0% in 2006 compared to 2005. The increases were driven by higher market prices for aviation fuel. The average aviation fuel price was $2.14 and $1.85 per gallon in 2006 and 2005, respectively. Our aviation fuel consumption declined to 130 million gallons in 2006 from 142 million gallons of aviation fuel in 2005, due to the flight reductions made by DHL. We do not hedge fuel prices or purchase fuel derivatives. The volatility of fuel prices are effectively assumed by DHL and other customers through ACMI agreements.

Maintenance, materials and repairs expense decreased 10.4% in 2006 compared to 2005. Our aircraft engine maintenance expenses have declined in conjunction with the lower level of flight hours for DHL since the September 2005 hub consolidation. Our policy is to expense these maintenance costs as they are incurred. Accordingly, our aircraft maintenance expenses fluctuate from period to period due to the timing of scheduled heavy maintenance work for aircraft. During 2006, we processed 54 heavy maintenance checks compared to 67 checks in 2005.

Depreciation and amortization expense increased $4.5 million in 2006 compared to 2005. The increase is primarily a result of four additional Boeing 767 aircraft that we placed in service in 2006. Our depreciation expense for 2007 will be impacted by the timing of the additional Boeing 767s that we anticipate placing into service. At this time, we estimate that depreciation and amortization expense will approximate $49.7 million in 2007.

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Landing and ramp expense decreased by 20.4% during 2006 compared to 2005. The reduction reflects lower deicing costs due to a milder winter in 2006 and a lower level of landing fees as a result of scheduled flight reductions in conjunction with the DHL hub consolidation in September 2005.

Rent expense increased $2.2 million during 2006 compared to 2005, due to equipment rentals in support of the consolidated Wilmington hub and expanded regional hubs since September 2005 and additional building rentals to support the United States Postal Service centers.

Other operating expenses include pilot travel, professional fees, insurance, utilities, and packaging supplies. Other operating expenses decreased by $4.0 million in 2006 compared to 2005. During the third quarter of 2005, our expenses included significant costs associated with DHL s hub integration project and bad debt expenses associated with airline bankruptcy filings.

Interest Income and Expense

Our interest expense increased by $0.7 million in 2006 compared to 2005. The increase in interest expense in 2006 is a result of the Boeing 767 aircraft we financed in 2006. Interest income increased by $2.4 million in 2006 compared to 2005 due to holding a higher level of marketable securities, cash and cash equivalent balances compared to 2005 and by achieving higher yields.

Income Tax

In the fourth quarter of 2006, we recorded an income tax benefit to completely reverse the remaining valuation allowance on ABX s deferred tax assets. The valuation allowance had originally been placed on income tax carryforwards and other deferred tax assets since ABX s separation from Airborne, Inc. in August 2003. The allowance was originally recorded due to a significant operating loss at that time and uncertainty in ABX s future earnings prospects. ABX s former parent, Airborne, Inc., which had been our predominant source of business for over twenty years, was acquired by DHL in 2003.

Since that time, ABX has generated annual pre-tax earnings in each of the last three years while diversifying its business. ABX has diversified its revenues and earnings, growing non-Airborne/DHL revenues from $16.6 million in 2002 to $48.5 million for 2006. Our projections of taxable income and a successful implementation of diversification strategies, combined with a three-year record of profitable results, indicate it is more likely than not that all the deferred tax assets will be realized prior to their expiration. As a result, the asset valuation allowance that had been placed on income tax carryforwards and other deferred tax assets was completely reversed.

As of December 31, 2006, ABX had operating loss carryforwards for U.S. federal income tax purposes of approximately $143.9 million, which will begin to expire in 2022. We expect to utilize the loss carryforwards to offset federal income tax liabilities ABX will generate in the future. As a result, we do not expect to pay federal income taxes for at least the next two years. ABX may, however, be required to pay alternative minimum taxes and certain state and local income taxes before then. In 2007, we expect to record a deferred income tax expense at an effective rate of approximately 38% of pre-tax earnings.

ABX did not record a tax expense in 2005 because deferred tax expense was offset by a reduction in the valuation allowance for net deferred tax assets.

2005 compared to 2004

Net earnings declined $6.7 million to $30.3 million for 2005 compared to $37.0 million in 2004. The decline in our net earnings was primarily due to achieving a lower level of incremental mark-up under the DHL Hub Services agreement in 2005 compared to 2004[3]. Our incremental mark-up from hub services declined $6.4 million and base earnings from the DHL agreements declined $2.2 million during 2005 compared to 2004. Additionally, our incremental mark-up earnings from the DHL ACMI agreement declined by $0.3 million, and our earnings from non-DHL charter operations declined by $1.4 million. These declines were partially offset by non-DHL interest income of $2.4 million and improved earnings on all other activities of $1.2 million.

DHL

While our revenues from DHL increased 21.6% during 2005, reflecting increased activity to support the growth of DHL s ground delivery services and the expansion of DHL s ground network compared to 2004, our 2005 earnings from the DHL segment declined $8.9 million to $21.3 million. Earnings for achieving cost-related and service goals declined $6.7 million to $7.8 for 2005. The decline in our 2005 DHL earnings and in the annual cost-related and service mark-up was primarily due to lower achievement of incentives within the Hub Services agreement. No mark-ups from the *annual* cost-related or service-related goals under the Hub Services agreement were recognized for 2005 compared to $5.9 million that were recognized in 2004. The decline in incremental hub services revenues primarily reflected the operational issues we experienced during the Wilmington hub consolidation, the relocation of two other hubs and other changes that were made by DHL in 2005 to their network. In an effort to share responsibility and demonstrate our commitment to DHL, we agreed to forego approximately $0.9 million of annual service incentive revenue that was otherwise earned under the agreement.

Our base earnings[4] for 2005 declined $2.2 million to $13.5 million compared to $15.7 million for 2004. Our base earnings for 2005 were negatively impacted by $1.9 million of credits we granted to DHL stemming from cost overruns incurred as a result of the hub consolidation in September 2005. We agreed to grant these credits in recognition of the operational difficulties and higher than anticipated cost associated with DHL s hub network changes in 2005. The decline in base earnings also reflected the temporary reduction in the base mark-up during the second half of 2005 and increases in operating expenses that were not reimbursed by DHL. These include employee stock compensation and costs related to legal matters. (Legal matters are discussed on page 13.)

During the fourth quarters of 2005 and 2004, we recognized $4.0 million, or approximately 100%, of the maximum available incremental mark-up from the *annual cost -related* goal under the ACMI agreement. Also, during the fourth quarter of 2005, we recognized revenue from the *annual service* goal in the ACMI agreement of $0.7 million, or 60.0% of the maximum available. During the fourth quarter of 2004, we recognized revenue from the *annual service* goal in the ACMI agreement of $0.9 million, or 80.0% of the maximum available.

Non-DHL ACMI/Charters

Our revenues from non-DHL ACMI/charter services were $13.9 million in 2005 compared to $16.7 million in 2004, which included $4.5 million of revenues related to the temporary network that was not contracted

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3 The two agreements with DHL allow ABX to earn additional incremental mark-up for meeting certain quarterly cost-related goals, annual cost-related goals and annual service goals. The maximum incremental mark-up available from the quarterly cost goals is approximately 0.54% of cost eligible for mark-up under each agreement, except during the last six months of 2005, when the incremental mark-up under the Hub Services agreement for cost-related goals was approximately 1.04%. The maximum incremental mark-up available from the annual service goals is 0.25% of costs subject to mark-up under the ACMI agreement and 0.