GULFSTREAM INTERNATIONAL GROUP INC
Form 10-Q
August 23, 2010

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

FORM 10-Q

(Mark One)
þ QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2010

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
For the transition period from _________ to _________

Commission file number 001-33884

GULFSTREAM INTERNATIONAL GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware	20-3973956
(State or other jurisdiction of incorporation or organization)	(IRS Employee Identification No.)

3201 Griffin Road, 4th Floor, Fort Lauderdale, Florida 33312
(Address of principal executive offices)

(954) 985-1500
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	Smaller reporting company þ

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

Number of outstanding shares of the registrant's par value $0.01 common stock, as of August 20, 2010: 3,693,631.

Gulfstream International Group, Inc.
Quarterly Report on Form 10-Q

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Cautionary Statement Concerning Forward-Looking Statements

Our representatives and we may from time to time make written or oral statements that are "forward-looking," including statements contained in this Quarterly Report on Form 10-Q and other filings with the Securities and Exchange Commission, reports to our stockholders and news releases. All statements that express expectations, estimates, forecasts or projections are forward-looking statements within the meaning of the Act. In addition, other written or oral statements which constitute forward-looking statements may be made by us or on our behalf. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," "projects," "forecasts," "may," "should," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions which are difficult to predict. These risks may relate to, without limitation:

- the need to immediately raise additional capital to support our current operations;
- our business strategy;
- our value proposition;
- the market opportunity for our services, including expected demand for our services;
- information regarding the replacement, deployment, acquisition and financing of certain numbers and types of aircraft, and projected expenses associated therewith;
- costs of compliance with FAA regulations, Department of Homeland Security regulations and other rules and acts of Congress;
- the ability to pass taxes, fuel costs, inflation, and various expenses to our customers;
- certain projected financial obligations;
- our estimates regarding our capital requirements;
- any of our other plans, objectives, expectations and intentions contained in this report that are not historical facts;
- changing external competitive, business, budgeting, fuel supply, weather or economic conditions;
- changes in our relationships with employees or code share partners;
- availability and cost of funds for financing new aircraft and our ability to profitably manage our existing fleet;
- adverse reaction and publicity that might result from any accidents;
- the impact of current or future laws and government investigations and regulations affecting the airline industry and our operations;
- additional terrorist attacks; and
- consumer unwillingness to incur greater costs for flights.

Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in or suggested by such forward-looking statements. We undertake no obligation to publicly revise these forward-looking statements to reflect events or circumstances that arise after the date hereof. Readers should carefully review the factors described herein and in other documents we file from time to time with the Securities and Exchange Commission, including our Quarterly Reports on Form 10-Q, Annual Reports on Form 10-K, and any Current Reports on Form 8-K filed by us.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GULFSTREAM INTERNATIONAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands)

	As of	
Assets	December 31, 2009	June 30, 2010 (Unaudited)
Current Assets		
Cash and cash equivalents	$2,260	$1,108
Accounts receivable, net	3,426	3,670
Expendable parts and fuel	1,210	1,400
Prepaid expenses	1,135	1,102
Total Current Assets	8,031	7,280
Property and Equipment		
Flight equipment	3,809	3,848
Other property and equipment	1,546	1,545
Less accumulated depreciation	(2,658)	(3,003)
Total Property and Equipment	2,697	2,390
Intangible assets, net	2,837	2,706
Other assets	1,213	1,184
Total Assets	$14,778	$13,560
Liabilities and Stockholders' Deficit		
Current Liabilities		
Accounts payable and accrued expenses	$12,694	$11,447
Accounts payable - restructured, current portion	2,606	2,544
Notes payable	3,864	5,760
Engine return liability, current portion	1,168	1,221
Warrant liability	-	2,621
Air traffic liability	1,391	966
Deferred tuition revenue	929	511
Total Current Liabilities	22,652	25,070
Long Term Liabilities		
Accounts payable, restructured, net of current portion	426	131
Long-term debt, net of current portion	-	468
Warrant liability	2,639	321
Total Liabilities	25,717	25,990
Stockholders' Deficit		

Preferred stock	-	668
Common stock	36	37
Additional paid-in capital	14,236	14,855
Common stock warrants	61	61
Accumulated deficit	(25,272)	(28,051)
Total Stockholders' Deficit	(10,939)	(12,430)
Total Liabilities & Stockholders' Deficit	$ 14,778	$ 13,560

The accompanying notes are an integral part of these consolidated financial statements.

GULFSTREAM INTERNATIONAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands)
(Unaudited)

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2010	Six Months Ended June 30, 2009	Six Months Ended June 30, 2010
Operating Revenues				
Passenger revenue	$16,235	$16,040	$33,767	$30,771
Academy, charter and other revenue	7,464	8,239	13,508	15,562
Total Operating Revenues	23,699	24,279	47,275	46,333
Operating Expenses				
Flight operations	3,762	4,036	6,827	7,956
Aircraft fuel	3,321	4,381	6,782	8,257
Maintenance	5,505	5,186	10,975	9,993
Passenger and traffic service	5,033	6,192	9,860	11,880
Aircraft rent	1,577	1,449	3,223	2,896
Promotion and sales	1,293	1,210	2,596	2,339
General and administrative	1,931	2,178	3,628	4,026
Depreciation and amortization	293	306	580	613
Total Operating Expenses	22,715	24,938	44,471	47,960
Operating profit (loss)	984	(659)	2,804	(1,627)
Non-operating (expense) income				
Interest expense	(561)	(705)	(1,145)	(1,273)
Interest income	-	1	7	1
Gain on modification of debt	-	-	-	194
Other (expense) income	(49)	(13)	(114)	(74)
Total non-operating (expense) income	(610)	(717)	(1,252)	(1,152)
Profit (loss) before income tax provision (benefit)	374	(1,376)	1,552	(2,779)
Income tax provision (benefit)	(1,859)	-	(1,411)	-
Net profit (loss)	$2,233	$(1,376)	$2,963	$(2,779)
Net profit (loss) per share:				
Basic	0.75	$(0.37)	$1.00	$(0.76)
Diluted	0.63	$(0.37)	$0.82	$(0.76)
Shares used in calculating net income (loss) per share:				
Basic	2,959	3,694	2,959	3,671
Diluted	3,293	3,694	3,293	3,671

The accompanying notes are an integral part of these consolidated financial statements.

GULFSTREAM INTERNATIONAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2010
Cash flows from operating activities:		
Net income (loss)	$2,963	$(2,779)
Adjustment to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	580	609
Amortization of deferred finance costs	659	699
Gain on the modification of senior debentures	-	(194)
Deferred income tax provision (benefit)	(1,406)	-
Loss on fuel hedge contracts	314	-
Changes in fair market value of derivative warrants	125	89
Stock-based compensation	66	36
Provision for bad debts	7	-
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	159	(244)
Decrease (increase) in expendable parts and fuel	(71)	(190)
Decrease (increase) in prepaid expense	(165)	33
Decrease (increase) in other assets	25	(98)
Increase (decrease) in accounts payable and accrued expenses	(1,369)	(576)
Increase (decrease) in accounts payable - restructured	(389)	(357)
Increase (decrease) in deferred revenue	(24)	(843)
Increase (decrease) in engine return liability	(1,692)	53
Net cash provided by (used in) operating activities	(218)	(3,762)
Cash flows from (used in) investing activities:		
Acquisition of property and equipment	(434)	(172)
Disposal of equipment	-	9
Net cash provided by (used in) investing activities	(434)	(163)
Cash flows from (used in) financing activities:		
Proceeds from borrowings		1,500
Repayments of debt	(900)	(125)
Proceeds from issuance of common stock	-	289
Proceeds from issuance of preferred stock	-	1,109
Net cash provided by (used in) financing activities	(900)	2,773
Net increase (decrease) in cash and cash equivalents	(1,552)	(1,152)
Cash, beginning of period	3,215	2,260
Cash, end of period	$1,663	$1,108

The accompanying notes are an integral part of these consolidated financial statements.

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GULFSTREAM INTERNATIONAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

	Six Months Ended June 30,	
	2009	2010
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$244	$196
Cash paid during the period for income taxes	$-	$-

Supplemental disclosure of non-cash investing and financing activities:

1) Upon issuance of preferred stock, certain common stockholders (See note 6) were granted rights to convert their shares and warrants to preferred stock and warrants. As of June 30, 2010, 101,000 shares of common were converted to 142,000 preferred shares. The warrant rights associated with the common stock issuance in January, 2010 were also exchanged for the warrant rights associated with the preferred stock offering.

2) Warrants valued at $266,000 and a note payable in the amount of $50,000 were issued in conjunction with the issuance of Senior Secured Debt during the quarter. The fair market valuation of the warrants combined with the face value of the notes were recorded as deferred finance costs and the warrants and notes payable were recorded as current liabilities.

3) Warrants valued at $150,000 were issued in conjunction with the issuance of convertible preferred and common stock during the six months ended June 30, 2010. The fair market valuation of the warrants combined with the face value of the notes were recorded as deferred finance costs and the warrants and notes payable were recorded as current liabilities.

The accompanying notes are an integral part of these consolidated financial statements.

GULFSTREAM INTERNATIONAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Six Months Ended June 30, 2009 and 2010
(Unaudited)

(1) Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial reporting and the instructions to Form 10-Q and, therefore, reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. These interim consolidated financial statements should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. The results of operations for the interim periods are not necessarily indicative of the results for the entire fiscal year.

Gulfstream International Group, Inc. was incorporated in Delaware in December 2005 as Gulfstream Acquisition Group, Inc., and changed its name to Gulfstream International Group, Inc. in June 2007. We were formed for the purpose of acquiring Gulfstream International Airlines, Inc. ("Gulfstream"), a wholly-owned subsidiary of G-Air Holdings Corp., Inc., and Gulfstream Training Academy, Inc. ("Academy"), collectively referred to as the "Company". References to "the Company," "we," "our," and "us," refer to Gulfstream International Group, Inc. and either or both of Gulfstream or the Academy.

Gulfstream Air Charter, Inc. ("GAC"), a related company, operates charter flights between Miami and Havana. GAC is licensed by the Office of Foreign Assets Control of the U. S. Department of the Treasury as a carrier and travel service provider for charter air transportation between designated U. S. and Cuban airports. Pursuant to a services agreement between Gulfstream and GAC dated August 8, 2003 and amended on March 14, 2006, Gulfstream may provide use of its aircraft, flight crews, the Gulfstream name, insurance, and service personnel, including passenger, ground handling, security, and administrative. Gulfstream also maintains the financial records for GAC. Pursuant to the March 14, 2006 amended agreement, Gulfstream receives 75% of the operating profit generated by GAC's Cuban charter operation. Since January 1, 2008, we have consolidated the results of the Cuba charter business as a variable interest entity pursuant to the requirements of Accounting Standards Codification ("ASC") 810-10.

(2) New Pronouncements

In February 2010, the Financial Accounting Standards Board ("FASB") issued amended guidance to require an SEC filer to evaluate subsequent events through the date the financial statements are filed with the SEC. The amended guidance adds the definitions of an SEC filer and revised financial statements and no longer requires that an SEC filer disclose the date through which subsequent events have been reviewed. It also removes the definition of a public entity. The adoption of the new guidance did not have an impact on the Company's disclosures, consolidated financial position, results of operations and cash flows.

In January 2010, the FASB issued authoritative guidance to require additional disclosures about the different classes of assets and liabilities measured at fair value, the valuation techniques and inputs used, the activity in Level 3 fair value measurements and the transfers between Levels 1, 2, and 3. The disclosure requirements are related to recurring and nonrecurring fair value measurements. This new guidance relates only to disclosures and therefore, had no impact on the Company's consolidated financial position, results of operations and cash flows.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 167, "Amendments to FASB Interpretation No. 46(R)" ("SFAS No. 167"). As of December 31, 2009, SFAS No. 167 had been codified under

Accounting Standard Update ("ASU") 2009-17. SFAS No. 167 amends FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" (FIN 46(R)) to require an enterprise to qualitatively assess the determination of the primary beneficiary of a variable interest entity ("VIE") based on whether the entity (1) has the power to direct the activities of a VIE that most significantly impact the entity's economic performance and (2) has the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. Also, SFAS No. 167 requires an ongoing reconsideration of the primary beneficiary, and amends the events that trigger a reassessment of whether an entity is a VIE. Enhanced disclosures are also required to provide information about an enterprise's involvement in a VIE. The standard was effective for the Company beginning in the first quarter of 2010. The adoption of the new standard did not have an impact on our consolidated financial position, results of operations and cash flows.

(3) Earnings Per Share

Basic net income (loss) per share is computed by dividing net income by the weighted average number of common shares outstanding during the period presented. Diluted net income (loss) per share reflects the potential dilution that could occur from common stock issuable through stock based compensation including stock options, restricted stock awards, warrants and other convertible securities, as well as warrants issued by Gulfstream.

The computation of per share earnings / losses for the three and six-month periods ended June 30, 2009 and 2010 is as follows and includes the effect of warrants issued by Gulfstream International Airlines, Inc. ("Airline Subsidiary"), a subsidiary of the Company and convertible debt issued by the Company:

	Three months Ended June 30,		Six months Ended June 30,	
	2009	2010	2009	2010
Net income (loss)	$2,233,000	$(1,376,000)	$2,963,000	$(2,779,000)
Effect of assumed interest on convertible debt	26,000	-	53,000	-
Effect of Airline Subsidiary warrants	(192,000)	-	(310,000)	-
Net income (loss) — diluted	$2,067,000	$(1,376,000)	$2,706,000	$(2,779,000)
Weighted average of shares outstanding — basic	2,959,600	3,694,000	2,959,600	3,671,000
Weighted average of shares outstanding — diluted	3,292,933	3,694,000	3,292,933	3,671,000
Earnings (loss) per common share:				
Basic	$0.75	$(0.37)	$1.00	$(0.76)
Diluted	$0.63	$(0.37)	$0.82	$(0.76)

The effect on net income of the Airline Subsidiary warrants is calculated in accordance with ASC 260-10-45-11A as follows:

	2009	2010	2009	2010
Earnings Per Share of Airline Subsidiary:				
Net income (loss)	$1,191,000	$(381,000)	$3,322,000	$(968,000)
Add: Airline Subsidiary's portion of consolidated tax benefit (provision)	923,000	-	85,000	-
Adjusted net income (loss)	2,114,000	(381,000)	3,407,000	(968,000)
Basic weighted average shares	19,575,000	19,575,000	19,575,000	19,575,000
Dilutive effect of warrants	1,957,000	- (1)	1,957,000	- (1)
Diluted weighted average shares	21,532,000	19,575,000	21,532,000	19,575,000
Earnings per common share:				
Basic	$0.11	$(0.02)	$0.17	$(0.05)
Diluted	$0.10	$(0.02)	$0.16	$(0.05)
Effect on Net Income of Airline Subsidiary Warrants:				
Proportionate share of Airline Subsidiary income included in:				
basic earnings per share (2)	$2,114,000	$(381,000)	3,407,000	$(968,000)

diluted earnings per share (3)	1,922,000	(381,000)	3,097,000	(968,000)
Difference	$192,000	$-	$310,000	$-

(1) — For the three and six months ended June 30, 2010, there were 1,958,000 warrants that have been excluded from the weighted average shares outstanding because the effect on earnings (loss) per share would have been anti-dilutive.
(2) — Calculated as the number of outstanding shares times basic earnings per share
(3) — Calculated as the number of outstanding shares times diluted earnings per share

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(4) Segment Results

The Company has two reportable segments: the airline and charter operation and the flight academy. The accounting policies of the business segments are the same and are described in Note (1) to the financial statements included in the Company's Form 10-K for the year ended December 31, 2009 as filed with the Securities and Exchange Commission. Although the reportable segments are business units that offer different services and are managed separately, their activities are highly integrated.

Virtually all of the Company's consolidated capital expenditures, depreciation and amortization, and interest expense are attributable to the Airline and Charter business segment.

Financial information for the three and six-month periods ended June 30, 2009 and 2010 by business segment is as follows (in thousands):

Three months ended June 30, 2010	Airline and Charter	Academy	Parent	Intercompany Eliminations	Total
Operating revenues	$23,934	$446	$-	$ (101)	$24,279
Operating expenses	24,308	421	310	(101)	$24,938
Loss from operations	$(374)	$25	$(310)	$ -	$(659)
Net income (loss)	$(416)	$30	$(990)	$ -	$(1,376)
Depreciation and amortization	$303	$3	$-	$ -	$306
Interest expense	43	-	662	-	705
Interest income	(1)	-	-	-	(1)
Gain on modification of debt	-	-	-	-	-
Income tax provision	-	-	-	-	-
Capital expenditures	93	-	-	-	93
Total assets	6,813	1,993	17,333	(12,579)	13,560

Three months ended June 30, 2009	Airline and Charter	Academy	Parent	Intercompany Eliminations	Total
Operating revenues	$23,493	$489	$-	$ (283)	$23,699
Operating expenses	22,284	546	168	(283)	$22,715
Loss from operations	$1,209	$(57)	$(168)	$ -	$984
Net income (loss)	$1,114	$(43)	$1,162	$ -	$2,233
Depreciation and amortization	$290	$3	$-	$ -	$293
Interest expense	94	1	466	-	561
Interest income	(5)	-	-	-	(5)
Income tax provision (benefit)	-	-	(1,859)		(1,859)
Capital expenditures	246	-	-	-	246
Total assets	13,595	2,792	15,178	(12,580)	18,985

Six months ended June 30, 2010	Airline and Charter	Academy	Parent	Intercompany Eliminations	Total
Operating revenues	$45,672	$886	$-	$ (225)	$46,333
Operating expenses	46,595	942	648	(225)	$47,960
Loss from operations	$(923)	$(56)	$(648)	$ -	$(1,627)
Net income (loss)	$(990)	$(39)	$(1,750)	$ -	$(2,779)
Depreciation and amortization	$607	$6	$-	$ -	$613
Interest expense	86	-	1,187	-	1,273
Interest income	(1)	-	-	-	(1)
Gain on modification of debt	-	-	194	-	194
Income tax provision	-	-	-		-
Capital expenditures	172	-	-	-	172
Total assets	6,813	1,993	17,333	(12,579)	13,560

Six months ended June 30, 2009	Airline and Charter	Academy	Parent	Intercompany Eliminations	Total
Operating revenues	$46,952	$868	$-	$ (545)	$47,275
Operating expenses	43,565	1,106	345	(545)	$44,471
Loss from operations	$3,387	$(238)	$(345)	$ -	$2,804
Net income (loss)	$3,214	$(204)	$(47)	$ -	$2,963
Depreciation and amortization	$574	$6	$-	$ -	$580
Interest expense	179	1	965	-	1,145
Interest income	2	-	-	-	2
Income tax provision (benefit)	-	-	(1,411)		(1,411)
Capital expenditures	434	-	-	-	434
Total assets	13,595	2,792	15,178	(12,580)	18,985

(5) Changes in Stockholders' Equity and Comprehensive Income

A summary of the changes in equity for the six months ended June 30, 2010 and 2009 is provided below:

Six months ended June 30, 2010	Common Stock Number of Shares	Common Stock Amount	Additional Paid-in Capital	Common Stock Warrants	Accum. Other Comp. Loss	Preferred Stock	Retained Earnings (Deficit)	Total
Balance January 1, 2010	3,561	$ 36	$ 14,236	$ 61	$ -	$ -	$ (25,272)	$ (10,939)
Net income (loss)							$ (2,779)	(2,779)
Issuance of common stock net of placement costs	234	2	287					289
Issuance of preferred stock net of placement costs			427			549		976
Conversion of common stock to preferred stock	(101)	(1)	(118)			119		-
Cash dividend declared			(13)					(13)
Share based compensation			36					36
Balance June 30, 2010	3,694	$ 37	$ 14,855	$ 61	$ -	$ 668	$ (28,051)	$ (12,430)

Six months ended June 30, 2009	Common Stock Number of Shares	Common Stock Amount	Additional Paid-in Capital	Common Stock Warrants	Accum. Other Comp. Loss	Preferred Stock	Retained Earnings (Deficit)	Total
Balance January 1, 2009	2,960	$ 30	$ 13,088	$ 252	$ (314)	$ -	$ (17,721)	$ (4,665)
Net income (loss)							2,963	2,963
Change in fair value of fuel hedge contracts					314			314
Share based compensation			65					65
Balance June 30, 2009	2,960	$ 30	$ 13,153	$ 252	$- $ -	$ -	$ (14,758)	$ (1,323)

(6) Capital and Liquidity-Related Transactions

Issuance of $1.5 million of Subordinated Notes

On October 7, 2009, the Company issued a subordinated note to Gulfstream Funding II, LLC ("GF II") for $1.5 million that matured on January 15, 2010 and bore interest at 12%. On January 15, 2010, the Company and GF II agreed to enter into one or more definitive agreements to extend the maturity date of the note and to provide for the conversion of the outstanding principal amount of the note and all accrued and unpaid interest thereon (collectively, the "Debt") into preferred stock of the Company at current market prices. Upon the execution of such agreements by the Company and GF II, the Company will file a Current Report on Form 8-K disclosing the transaction and including such agreements as exhibits. In addition, GF II waived any event of default, which would have occurred due to the Company's failure to repay the Debt on the maturity date.

Sale of Units of Common Stock and Warrants

On January 29, 2010, the Company consummated the closing under a Unit Purchase Agreement with seven accredited investors (the "Investors") pursuant to which the Company sold to the Investors units of its securities (the "Units") consisting of (i) one share of common stock of the Company, par value $0.01 per share (the "Common Stock"); and (ii) warrants to purchase three-quarters of a share of Common Stock (the "Warrants"), at a per Unit purchase price of $1.40 for aggregate gross proceeds of $327,300. Upon completion of the closing, the Company sold to the Investors an aggregate of 233,786 shares of Common Stock and Warrants to purchase an aggregate of 175,339 shares of Common Stock.

In connection with the closing of the offering, the Company paid/issued the placement agent (i) cash commissions in the amount of 9% of the total purchase price received by the Company in the closing; (ii) a non-accountable expense allowance equal to 2% of the total purchase price received by the Company in the closing; and (iii) Warrants to purchase 18,703 shares of Common Stock, which represents 8% of the aggregate amount of shares sold as part of the Units in the closing.

Forbearance Agreement with Raytheon Aircraft Credit Corporation

On February 11, 2010, Gulfstream received a notice of default (the "Default Notice") from Raytheon Aircraft Credit Corporation ("RACC"), Gulfstream's principal aircraft lessor, pursuant to which RACC notified Gulfstream that it was in default of the payment of certain obligations under Airliner Operating Lease Agreements, each dated August 7, 2003, and amended on August 2, 2005, and March 15, 2006 (the "Lease Agreements"), by and between Gulfstream and RACC, pursuant to which Gulfstream currently leases from RACC twenty-one (21) Beech 1900D aircraft. The default resulted from Gulfstream's failure to make its scheduled lease payments for the month of February 2010. Accordingly, RACC demanded that Gulfstream make such payments on or before February 19, 2010. The failure to make such payment would have given RACC the right to terminate the Lease Agreements, thereby prohibiting Gulfstream from using the leased aircraft. Also pursuant to the Default Notice, RACC claimed that Gulfstream is in default in certain other payments under a separate agreement dated as of December 19, 2008 by and between Gulfstream and RACC (the "December Agreement"), which defaults are also considered to be defaults under the Lease Agreements. RACC indicated in the Default Notice that if Gulfstream made the required payments under the Lease Agreements by February 19, 2010, it was prepared to discuss the manner in which the Company can cure or otherwise address the December Agreement defaults.

On February 19, 2010, Gulfstream made the required payment to RACC, which allowed it to continue operating the aircraft covered by the Lease Agreements. In addition, on February 19, 2010, RACC advised Gulfstream that it would forebear from exercising any of its rights under the December Agreement or the Lease Agreements, provided that Gulfstream remains current in payment of future lease payments and provides RACC by April 20, 2010 with a mutually acceptable debt and financial restructuring plan that provides for a feasible basis to enable Gulfstream to continue to meet its ongoing financial obligations under the Lease Agreement and commence to repay restructured amounts due under the December Agreement, which presently amount to approximately $3 million. Gulfstream provided to RACC on April 20, 2010 the required financial restructuring plan. We continue to be engaged in related restructuring discussions with Pratt & Whitney Canada with respect to approximately $2.5 million of past-due creditor obligations.

On May 14, 2010, we entered into a lease amendment and forbearance agreement with RACC. Under the terms of such agreement, RACC agreed that until the earliest of (i) December 6, 2010, (ii) an event of default by us under the agreement, (iii) a material adverse change in our current business, or (iv) a bankruptcy event (the "Forbearance Termination Date), RACC agreed not to terminate the leases for the aircraft covered by the Lease Agreement, and agreed to extend the term of the leases through December 6, 2010. We agreed to pay on a current basis all monthly rental payments due under each of the leases on or before the 6th day of each month between May and November 2010, and we and RACC agreed that certain missed lease payments aggregating $1.1 million would be paid in full on the Forbearance Termination Date. We also agreed with RACC that our opportunity to purchase all of the 21 aircraft currently leased from RACC would be extended to a date which shall be at any time on or before the expiration of the Forbearance Termination Date and, if we successfully purchase and pay for such aircraft on a timely basis, that RACC would grant us concessions in connection with certain of the obligations currently due to it.

Issuance of $1.0 million of Senior Secured Notes and Warrants

On February 26, 2010, the Company completed a $1,000,000 debt financing pursuant to purchase agreements for senior secured notes and warrants with accredited investors and/or qualified institutional purchasers (the “Investors”) pursuant to which the Company sold to the Investors (i) 12% Senior Secured Notes due December 31, 2010 in an aggregate principal amount of $1,000,000 (the “Notes”); and (ii) warrants, exercisable at $1.22 per share (the “Exercise Price”) (subject to customary anti-dilution adjustments) and expiring February 28, 2015 (the “Warrants”), to purchase an aggregate of 409,827 of shares of the Company’s common stock (the “Common Stock”). The number of Warrants issued to each Investor was determined by dividing (a) 50% of the principal amount of the Notes purchased by the Investors, by (b) the Exercise Price of the Warrants. However, the shares of Common Stock issuable upon exercise of the Warrants (the “Warrant Shares”) would represent 100% of the original $1,000,000 principal amount of the Notes if the Notes were not paid in full by the Company by June 30, 2010. The Notes were not paid by June 30, 2010 and accordingly, the Warrant Shares increased from 409,827 to 819,654 on this date.

In connection with the closing of the offering, the Company issued to Taglich Brothers, Inc. ("TBI"), as placement agent, (i) a $50,000 Note (identical to the investors' Notes) and a Warrant to purchase 20,491 Warrant Shares, which represents 5% of the total principal amount of the Notes and Warrants sold in the Offering; and (ii) a separate Warrant to purchase 40,982 shares of Common Stock, which represents 10% of the number of Warrant Shares issuable to Investors under the Warrants.

Forbearance Agreement with Shelter Island Opportunity Fund and Amendment to Debenture

In August 2008, the Company obtained an original $5,100,000 debt financing with Shelter Island Opportunity Fund LLC ("Shelter Island") pursuant to a securities purchase agreement (the "Shelter Island Agreement") and a secured original issue discount debenture due August 31, 2011 (the "Debenture") of which $3,659,000 was outstanding as of February 26, 2010. As part of such financing, the Company granted Shelter Island a first priority lien and security interest on all of the assets and properties of the Company and its subsidiaries, issued certain warrants to Shelter Island and granted Shelter Island a right to "put" the warrants to the Company for $3,000,000. In December 2009 and January 2010, Shelter Island agreed to defer the December and January interest payments under the Debenture.

On February 26, 2010, the Company and Shelter Island entered into a Forbearance Agreement and Amendment to Debenture (the "Forbearance Agreement") which reduced the Company's potential liability under the put option from $3,000,000 to $1,050,000 and rescheduled certain principal and interest payments under the Debenture to reduce near-term liquidity requirements.

Under the terms of the Forbearance Agreement, Shelter Island agreed to forbear from exercising its rights and remedies under the Shelter Island Agreement until the occurrence of (a) the failure by the Company to comply with the terms, covenants and agreements of the Forbearance Agreement; and (b) the occurrence of any event of default under the Debenture or the Shelter Island Agreement (collectively, a "Termination Event"). One of the covenants to be performed by the Company under the Forbearance Agreement is the obligation of the Company to raise an additional $1.5 million of debt or equity financing by March 26, 2010, subsequently changed to March 31, 2010, or otherwise satisfy Shelter Island that the Company has adequate liquidity and working capital. Shelter Island confirmed on March 31, 2010 that the Company complied with this covenant based primarily on the first closing under a Series A Convertible Preferred Stock Purchase Agreement described below under the heading, Sale of up to $2.5 million of Convertible Preferred Stock and Warrants.

Pursuant to the Forbearance Agreement the parties amended the Debenture, as follows (i) the Company shall pay interest on the outstanding principal amount monthly in cash, commencing March 31, 2010; (ii) the Company shall pay monthly installments on the outstanding principal amount commencing April 30, 2010 and on the last trading day of each month thereafter until the August 31, 2011 maturity date of the Debenture; and (iii) the Company may prepay all or any portion of the outstanding principal amount of the Debenture together with a premium equal to 5% of outstanding principal amount being prepaid; provided that, if such prepayment is made in 2011, there shall be no premium applicable. The Company, each of its subsidiaries and Shelter Island also entered into an Omnibus Amendment to the Guaranty Agreements pursuant to which, without limitation, the parties agreed to amend the existing guarantees to include the repayment of the Shelter Island Note.

As indicated above, Shelter Island currently holds a first priority lien and security interest on all of the assets of the Company and its subsidiaries. Under the terms of the Intercreditor Agreement, Shelter Island agreed to subordinate its first priority lien on the accounts receivable of the Company and its subsidiaries and the proceeds thereof, to the lien granted to the Investors under the Security Agreement with TBI to the extent of the deferred principal and accrued interest under the Notes. Shelter Island retained its first priority security interest in all of the other assets and properties of the Company and its subsidiaries.

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As contemplated in the original warrant to purchase Common Stock issued to Shelter Island on August 31, 2008 (the “Original Warrant”), on February 26, 2010 the Company divided the Original Warrant into (a) a warrant in the form of the Original Warrant initially exercisable into 70,000 shares of Common Stock (the “Put Warrant”); and (b) a warrant in the form of the Original Warrant (the “Remaining Warrant”, and together with the Put Warrant, the "Divided Warrants") such that the aggregate number of shares of Common Stock of Company that are initially exercisable under the Divided Warrants (inclusive of the 70,000 Shares of Common Stock initially issuable under the Put Warrant) shall equal, in the aggregate, 15% of the fully-diluted shares of Company Common Stock issued and outstanding immediately following consummation of the transactions contemplated under the Forbearance Agreement and the TBI Purchase Agreement, after giving pro-forma effect to the conversion into Common Stock of all Company convertible securities and the exercise of all Company granted options and warrants, including the Warrants issued to the Investors. As a result of consummation of the above transactions with Shelter Island and the TBI Investors, the aggregate number of shares issuable upon conversion of the Divided Warrant is 914,189 shares of Company Common Stock.

The Company and Shelter Island also entered into an Amendment to the Put Option Agreement (the “Put Option Amendment”) dated as of August 31, 2008 under which, among other things, the exercise price applicable for all the put shares under the put option was reduced from $3,000,000 to $1,050,000, or $15.00 per share.

As consideration for its financial accommodations, the Company paid Shelter Island an additional $250,000 as a forbearance fee, by delivering a $250,000 promissory note (the “Shelter Island Note”) due on the earlier of (i) August 31, 2011, and (ii) the date the Debenture is permitted or required to be paid in accordance with its terms. The Shelter Island Note accrues interest at a rate of 9% per annum and is payable in cash on a monthly basis beginning on February 26, 2011.

The Company recognized a gain of $194,000 as a result of the debt modification.

For the quarters ended March 31, 2010 and June 30, 2010, we were in violation of the covenant to maintain minimum quarterly EBITDA pursuant to the Debenture issued to Shelter Island. The lender granted a one-time waiver with respect to non-compliance with this financial covenant on May 12, 2010 for the quarter ended March 31, 2010. On August 23, 2010 the lender granted a waiver with respect to non-compliance with this financial covenant for the quarter ended June 30, 2010.

Sale of up to $2.5 million of Convertible Preferred Stock and Warrants

On March 31, 2010, Gulfstream International Group, Inc. consummated the first closing under a Series A Convertible Preferred Stock Purchase Agreement (the “Purchase Agreement”) with 17 accredited investors (the “Investors”) pursuant to which the Company sold to the Investors (i) an aggregate of 118,500 shares of Series A Convertible Preferred Stock, par value $0.001 and stated value $10.00 per share (the “Preferred Shares”), convertible into 1,185,000 shares of common stock of the Company, par value $0.01 per share (the “Common Stock”); and (ii) 5-year warrants to purchase an aggregate of 592,500 shares of Common Stock (the “Warrants”), representing 50% of the number of shares of Common Stock issuable upon conversion of the Preferred Shares, for aggregate gross proceeds of $1,043,000 (the “Offering”). The Warrants expire on March 31, 2013 and are exercisable into shares of Common Stock at an exercise price equal to $1.75 per share, subject to adjustment as set forth in the Warrants.

Pursuant to the Certificate of Designation, Preferences and Rights of the Series A Convertible Preferred Stock of the Company which was filed with the State of Delaware on March 31, 2010 (the “Certificate of Designation”), each Preferred Share is convertible into 10 shares of Common Stock. In addition, the Preferred Shares pay an annual dividend at the rate of 12% per annum, payable quarterly, on the last business day of each December, March, June and September (each a “Dividend Payment Date”), payable on each Dividend Payment Date as follows: (i) 60% of each quarterly dividend (based on an annual rate of 7% per annum) shall be payable in cash, and (ii) 40% of each quarterly dividend (based on an annual rate of 5% per annum) shall be payable either in cash, or at the sole option of the Company, in additional shares of Common Stock, calculated for such purposes by dividing the amount of the quarterly dividend then payable by 100% of the market price of the Common Stock on such Dividend Payment Date. Unless previously converted into Common Stock, all Preferred Shares outstanding on the earlier to occur of (a) the date on which the average of the market prices of the Common Stock for any 20 consecutive trading days shall be $2.00 or higher, or (b) 5 years from the Preferred Shares issuance date, shall be automatically converted into Common Stock at the Conversion Price then in effect.

In addition, on March 31, 2010, 4 of the 7 purchasers of the Company's units consisting of one share of Common Stock (the "Shares"), and warrants to purchase three-quarters of a share of Common Stock (the "Prior Warrants") which was consummated on January 29, 2010 (the "Prior Offering") and described above under the heading, Sale of Units of Common Stock and Warrants, entered into a letter agreement with the Company (the "Exchange Agreement") pursuant to which such purchasers agreed to exchange their Shares and Prior Warrants for Preferred Shares and Warrants, under the same terms and conditions applicable to Investors in the Offering. Such purchasers also agreed that the Company shall have no further obligations or liabilities in connection with the transaction documents executed and delivered with respect to the Prior Offering, including, without limitation, the Unit Purchase Agreement, the Registration Rights Agreement and the Prior Warrant, each dated as of January 29, 2010, and each of which are terminated in any and all respects.

On May 27, 2010, the Company completed the sale of an additional 20,300 shares of Series A Convertible Preferred Stock resulting in gross proceeds of $203,000. This financing supplemented the first closing on March 31, 2010 with the same terms as described above.

On March 31, 2010, the Company and the Investors entered into a Registration Rights Agreement under which the Company is obligated to file a registration statement (the "Registration Statement") with the Securities and Exchange Commission (the "SEC") registering the shares of Common Stock issuable upon conversion of the Preferred Shares and upon exercise of the Warrants for resale by the Investors on or prior to April 30, 2010 (the "Filing Date"), which has been extended to June 30, 2010 by agreement with the Investors. We continue to be in discussions with the investors for a further extension of this Filing Date. In the event we are unable to reach an agreement with the investors, we may be subject to liquidation damages up to a maximum of $125,000. In addition, the Company agreed to use its best efforts to cause the SEC to declare the Registration Statement effective by the earlier of (i) 150 days following the Filing Date; and (ii) 180 days following the Filing Date if the SEC conducts a full review of the Registration Statement.

In connection with the both the March 31, and May 27, 2010 closings of the Offering, the Company paid/issued the placement agent (i) cash commissions in the amount of 9% of the total purchase price received by the Company; (ii) a non-accountable expense allowance equal to 2% of the total purchase price received by the Company; and (iii) Warrants to purchase 137,060 shares of Common Stock, which represents 11% of the total purchase price received by the Company in both closings.

Reset Provisions

The Company's warrant and convertible preferred stock agreements include reset provisions, in the event that the Company subsequently issues new common stock or other financial instruments with exercise or conversion prices that are lower than the existing warrant exercise or preferred stock conversion prices. The reset provision would result in the issuance of additional common shares to the existing holders of warrants and convertible preferred shares.

(7) Liquidity and Going Concern

For the past four quarters, we have experienced significant demand deterioration in our revenue environment, which, combined with rising fuel costs, has resulted in greater than anticipated losses and pressure on our liquidity outlook. As a result, it was necessary to attract new capital beginning in the fourth quarter of 2009, and to continue actively seeking short-term financing to meet near-term liquidity requirements and to provide sufficient time to significantly increase the equity capital base to support both long-term growth opportunities, as well as the purchase of twenty-one (21) aircraft leased from Raytheon Aircraft Credit Corporation.

These near-term financing transactions and restructuring efforts are essential due to our current liquidity position, as well as several additional factors, including a highly seasonal business, the ongoing risk posed by a relatively weak economy, the potential for continued volatility in the price of jet fuel, and scheduled payments of debt and restructured creditor obligations over the next two years.

In response to its immediate need for additional working capital, the Company has been actively seeking financing. On August 23, 2010, the Company's board of directors approved the terms of an agreement in principle with a third party lending source for approximately $2.5 to $3.0 million in financing and expects that definitive agreements will be executed and the initial funding of $1.5 million in the form of senior secured debt will be consummated on or before August 31, 2010. However, there can be no assurance that such financing will be consummated or that our efforts to improve liquidity and obtain near-term or longer-term growth-oriented equity financing will be completed successfully in the near term, if at all. If we are unable to consummate the anticipated $1.5 million portion of the debt financing within the time frame expected, we may be unable to fund continued operations or meet our financial obligations. In such event, the Company may be required to seek statutory and judicial protection from its creditors.

Our financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Our ability to continue as a going concern is substantially dependent on the successful completion of the financing efforts referred to above. Our interim condensed financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts nor to the amounts and classification of liabilities that may be necessary should we be unable to continue as a going concern.

(8) Subsequent Events

On May 7, 2009, the Federal Aviation Administration (the "FAA") notified the Company that it was seeking a proposed civil penalty of $1,310,000 against the Company for alleged non-compliance with respect to certain record keeping requirements, and regulatory requirements relating to the use of certain replacement parts. On July 13, 2010, we entered into a settlement agreement with the FAA pursuant to which we agreed to pay a civil penalty in the amount of $550,000 to resolve the FAA enforcement action, payable in twenty equal quarterly installments of $27,500 commencing on October 31, 2010 through July 30, 2015, represented by our issuance of a non-interest bearing promissory note to the FAA in the principal amount of $550,000. This settlement has been recognized as of June 30, 2010.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

WE URGE YOU TO READ THE FOLLOWING DISCUSSION IN CONJUNCTION WITH OUR CONSOLIDATED FINANCIAL STATEMENTS AND THE NOTES THERETO BEGINNING ON PAGE F-1. THIS DISCUSSION MAY CONTAIN FORWARD-LOOKING STATEMENTS THAT INVOLVE SUBSTANTIAL RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS, PERFORMANCE OR ACHIEVEMENTS COULD DIFFER MATERIALLY FROM THOSE EXPRESSED OR IMPLIED BY THE FORWARD-LOOKING STATEMENTS AS A RESULT OF A NUMBER OF FACTORS, INCLUDING BUT NOT LIMITED TO THE RISKS AND UNCERTAINTIES DISCUSSED UNDER THE HEADING “RISK FACTORS” IN OUR FORM 10-K FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON APRIL 15, 2010 AND IN OUR OTHER FILINGS WITH THE SECURITIES AND EXCHANGE COMMISSION. IN ADDITION, SEE “CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS” SET FORTH IN THIS REPORT.

Overview

We operate a scheduled airline, scheduled and on-demand charter services, and a flight training academy for commercial pilots.

Our most significant market opportunity relates to the fact that we currently operate in and have targeted future expansion in unserved and underserved short haul markets, which is a growing opportunity for two principal reasons. Many smaller markets are being abandoned by major carriers, as they shift their focus increasingly to international markets and away from domestic markets and hubs. In addition, many smaller markets are also being abandoned by regional airlines, as they continue to gravitate toward larger jet aircraft in the 70-100 seat range, and away from smaller markets that utilize turboprop aircraft. As a result, we continue to seek opportunities to grow in the expanding number of smaller underserved or unserved markets that are suitable for our fleet of small-capacity aircraft.

Our most significant challenges relate to:

- our need to immediately secure capital to improve liquidity, fund our current operations, fund growth opportunities, and acquire our fleet of twenty-one (21) leased aircraft;
- volatility in the price of aircraft fuel;
- weakened economic environment; and
- rationalizing cost-effective maintenance resources, as the average age of our aircraft fleet increases.

Current Developments

For the past four quarters, we have experienced significant demand deterioration in our revenue environment, which, combined with rising fuel costs, has resulted in greater than anticipated losses and pressure on our liquidity outlook. As a result, it was necessary to attract new capital beginning in the fourth quarter of 2009, and to continue actively seeking short-term financing to meet near-term liquidity requirements and to provide sufficient time to significantly increase the equity capital base to support both long-term growth opportunities, as well as the purchase of twenty-one (21) aircraft leased from Raytheon Aircraft Credit Corporation.

These near-term financing transactions and restructuring efforts, which are described in detail below in Management’s Discussion and Analysis of Financial Condition and Results of Operations, Liquidity and Capital Resources, are essential due to our current liquidity position, as well as several additional factors, including a highly seasonal business, the ongoing risk posed by a relatively weak economy, the potential for continued volatility in the price of jet fuel, and scheduled payments of debt and restructured creditor obligations over the next two years.

In response to its immediate need for additional working capital, the Company has been actively seeking financing. On August 23, 2010, the Company's board of directors approved the terms of an agreement in principle with a third party lending source for approximately \$2.5 to \$3.0 million in financing and expects that definitive agreements will be executed and the initial funding of \$1.5 million in the form of senior secured debt will be consummated on or before August 31, 2010. However, there can be no assurance that such financing will be consummated or that our efforts to improve liquidity and obtain near-term or longer-term growth-oriented equity financing will be completed successfully in the near term, if at all. If we are unable to consummate the anticipated \$1.5 million portion of the debt financing within the time frame expected, we may be unable to fund continued operations or meet our financial obligations. In such event, the Company may be required to seek statutory and judicial protection from its creditors.

Results of Operations

Comparative Results for the Three-Month and Six-Month Periods Ended June 30, 2009 and 2010

The following table sets forth our financial results for the three months ended June 30, 2009 and 2010:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2009	2010	% Change	2009	2010	% Change
	(In thousands except EPS)			(In thousands except EPS)		
Revenue						
Airline passenger revenue	$16,235	$16,040	-1.2 %	$		