Air Transport Services Group, Inc.
Form 10-Q
August 05, 2014

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

FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2014
Commission file number 000-50368

(Exact name of registrant as specified in its charter)

Delaware	26-1631624
(State of Incorporation)	(I.R.S. Employer Identification No.)

145 Hunter Drive, Wilmington, OH 45177
(Address of principal executive offices)
937-382-5591
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO x
As of August 5, 2014, 64,939,895 shares of the registrant's common stock, par value $0.01, were outstanding.

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

The financial information, including the financial statements, included on this Quarterly Report on Form 10-Q should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, filed with the Securities and Exchange Commission on March 10, 2014.

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

FORWARD LOOKING STATEMENTS

Statements contained in this Quarterly Report on Form 10-Q that are not historical facts are considered forward-looking statements (as that term is defined in the Private Securities Litigation Reform Act of 1995). Words such as "projects," "believes," "anticipates," "will," "estimates," "plans," "expects," "intends" and similar words and expressio intended to identify forward-looking statements. These forward-looking statements are based on expectations, estimates and projections as of the date of this filing, and involve risks and uncertainties that are inherently difficult to predict. Actual results may differ materially from those expressed in the forward-looking statements for any number of reasons, including those described in this report and in our 2013 Annual Report filed on Form 10-K with the Securities and Exchange Commission.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
REVENUES	$149,618	$138,904	$293,211	$282,183
OPERATING EXPENSES				
Salaries, wages and benefits	40,895	41,964	83,960	85,273
Maintenance, materials and repairs	23,168	25,005	48,047	47,139
Depreciation and amortization	27,142	21,765	52,121	42,685
Fuel	14,014	12,440	26,274	26,801
Rent	6,924	6,791	14,234	13,570
Travel	4,419	4,772	8,992	9,499
Landing and ramp	2,576	1,972	5,314	6,037
Insurance	1,573	1,396	2,778	2,907
Other operating expenses	10,790	8,630	19,538	17,690
	131,501	124,735	261,258	251,601
OPERATING INCOME	18,117	14,169	31,953	30,582
OTHER INCOME (EXPENSE)				
Interest income	24	18	43	39
Interest expense	(3,481)	(3,554)	(7,304)	(6,686)
Net gain on derivative instruments	31	452	330	742
	(3,426)	(3,084)	(6,931)	(5,905)
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	14,691	11,085	25,022	24,677
INCOME TAX EXPENSE	(5,393)	(4,170)	(9,202)	(9,261)
EARNINGS FROM CONTINUING OPERATIONS	9,298	6,915	15,820	15,416
EARNINGS (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAXES	211	(1)	422	(2)
NET EARNINGS	$9,509	$6,914	$16,242	$15,414
BASIC EARNINGS PER SHARE				
Continuing operations	$0.14	$0.11	$0.25	$0.24
Discontinued operations	0.01	—	—	—
TOTAL BASIC EARNINGS PER SHARE	$0.15	$0.11	$0.25	$0.24
DILUTED EARNINGS PER SHARE				
Continuing operations	$0.14	$0.11	$0.24	$0.24
Discontinued operations	0.01	—	0.01	—
TOTAL DILUTED EARNINGS PER SHARE	$0.15	$0.11	$0.25	$0.24
WEIGHTED AVERAGE SHARES				
Basic	64,285	64,050	64,217	63,931
Diluted	65,207	64,859	65,174	64,692

See notes to condensed consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
NET EARNINGS	$9,509	$6,914	$16,242	$15,414
OTHER COMPREHENSIVE INCOME (LOSS):				
Defined Benefit Pension	—	1,958	(1)	3,916
Defined Benefit Post-Retirement	(504)	(834)	(1,008)	(1,668)
Gains and Losses on Derivatives	(7)	(8)	(14)	(16)
TOTAL COMPREHENSIVE INCOME, net of tax	$8,998	$8,030	$15,219	$17,646

See notes to condensed consolidated financial statements.

AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	June 30, 2014	December 31, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$23,763	$31,699
Accounts receivable, net of allowance of $863 in 2014 and $717 in 2013	57,126	52,247
Inventory	9,777	9,050
Prepaid supplies and other	12,810	9,730
Deferred income taxes	13,957	13,957
Aircraft and engines held for sale	1,015	2,995
TOTAL CURRENT ASSETS	118,448	119,678
Property and equipment, net	809,810	838,172
Other assets	38,214	21,143
Pension assets, net of obligations	18,862	14,855
Intangibles	4,755	4,896
Goodwill	34,395	34,395
TOTAL ASSETS	$1,024,484	$1,033,139
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$33,971	$34,818
Accrued salaries, wages and benefits	21,061	23,163
Accrued expenses	10,121	9,695
Current portion of debt obligations	24,027	23,721
Unearned revenue	9,487	8,733
TOTAL CURRENT LIABILITIES	98,667	100,130
Long term debt	328,103	360,794
Post-retirement obligations	29,985	30,638
Other liabilities	64,134	62,740
Deferred income taxes	118,335	109,869
TOTAL LIABILITIES	639,224	664,171
Commitments and contingencies (Note G)		
STOCKHOLDERS' EQUITY:		
Preferred stock, 20,000,000 shares authorized, including 75,000 Series A Junior Participating Preferred Stock	—	—
Common stock, par value $0.01 per share; 75,000,000 shares authorized; 64,939,895 and 64,618,305 shares issued and outstanding in 2014 and 2013, respectively	649	646
Additional paid-in capital	526,023	524,953
Accumulated deficit	(110,571)	(126,813)
Accumulated other comprehensive loss	(30,841)	(29,818)
TOTAL STOCKHOLDERS' EQUITY	385,260	368,968
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$1,024,484	$1,033,139

See notes to condensed consolidated financial statements.

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

	Six Months Ended June 30,	
	2014	2013
OPERATING ACTIVITIES:		
Net earnings from continuing operations	$15,820	$15,416
Net earnings (loss) from discontinued operations	422	(2)
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	52,121	42,685
Pension and post-retirement	(1,585)	3,530
Deferred income taxes	9,047	9,111
Amortization of stock-based compensation	1,286	1,275
Amortization of DHL promissory note	(3,100)	(3,100)
Net gain on derivative instruments	(330)	(742)
Changes in assets and liabilities:		
Accounts receivable	(4,619)	4,023
Inventory and prepaid supplies	(3,713)	1,689
Accounts payable	(976)	(2,243)
Unearned revenue	(2,334)	(3,079)
Accrued expenses, salaries, wages, benefits and other liabilities	96	(2,964)
Pension and post-retirement assets	(4,660)	(15,239)
Other	(2,041)	(2,329)
NET CASH PROVIDED BY OPERATING ACTIVITIES	55,434	48,031
INVESTING ACTIVITIES:		
Capital expenditures	(23,508)	(72,841)
Proceeds from property and equipment	1,404	1,310
Investment in nonconsolidated affiliate	(15,000)	—
NET CASH (USED IN) INVESTING ACTIVITIES	(37,104)	(71,531)
FINANCING ACTIVITIES:		
Principal payments on long term obligations	(44,285)	(32,625)
Proceeds from borrowings	15,000	60,000
Reimbursement of hanger construction costs	3,019	1,615
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(26,266)	28,990
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(7,936)	5,490
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	31,699	15,442
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$23,763	$20,932
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid, net of amount capitalized	$7,118	$6,417
Federal alternative minimum and state income taxes paid	$565	$666
SUPPLEMENTAL NON-CASH INFORMATION:		
Debt extinguished	$3,100	$3,100
Accrued capital expenditures	$1,184	$9,947

See notes to condensed consolidated financial statements.

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

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

Nature of Operations

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

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

The Company provides aircraft and airline operations to its customers, typically under contracts providing for aircraft or a combination of aircraft, crews, maintenance and insurance ("ACMI") services. The Company serves a base of concentrated customers who have a diverse line of international cargo traffic. DHL Network Operations (USA), Inc. and its affiliates, “DHL,” is the Company's largest customer. ATI provides passenger transportation, primarily to the U.S. Military, using "combi" aircraft, which are certified to carry passengers as well as cargo on the main deck.

In addition to its airline operations and aircraft leasing services, the Company sells aircraft parts, provides aircraft and equipment maintenance services, and operates mail sorting facilities for the U.S. Postal Service (“USPS”).

Basis of Presentation

The accompanying condensed consolidated financial statements include the accounts of Air Transport Services Group, Inc. and its wholly-owned subsidiaries. Inter-company balances and transactions have been eliminated. The financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP").

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Estimates and assumptions are used to record allowances for uncollectible amounts, self-insurance reserves, spare parts inventory, depreciation and impairments of property, equipment, goodwill and intangibles, post-retirement obligations, income taxes, contingencies and litigation. Changes in estimates and assumptions may have a material impact on the consolidated financial statements.

Investment in Nonconsolidated Affiliate

In January 2014, the Company acquired a 25 percent equity interest in West Atlantic AB of Gothenburg, Sweden ("West") for $15 million. West, through its two airlines, Atlantic Airlines Ltd. and West Air Sweden AB, operates a fleet of approximately 40 aircraft and is Europe’s largest regional cargo aircraft operator. West operates its aircraft on behalf of European regional mail carriers and express logistics providers. The airlines operate a combined fleet of British Aerospace ATPs, Bombardier CRJ-200-PFs, and Boeing 737 aircraft. In addition, Atlantic Airlines Ltd. is in the process of adding the Boeing 767 aircraft to its operating capability.

The Company has significant influence, but does not exercise control, over West. Accordingly, the investment in West is accounted for using the equity method of accounting and is initially recognized at cost. The Company’s share of West’s income or loss is recognized in the consolidated statement of earnings and cumulative post-acquisition changes in the investment are adjusted against the carrying amount of the investment. The Company’s carrying value of West is reflected in “Other Assets” in the Company’s consolidated balance sheets.

Cash and Cash Equivalents

The Company classifies short-term, highly liquid investments with maturities of three months or less at the time of purchase as cash and cash equivalents. These investments, consisting of money market funds, are recorded at cost, which approximates fair value. Substantially all deposits of the Company’s cash are held in accounts that exceed federally insured limits. The Company deposits cash in common financial institutions which management believes are financially sound.

Accounts Receivable and Allowance for Uncollectible Accounts

The Company's accounts receivable is primarily due from its significant customers (see Note B), other airlines, the USPS and freight forwarders. The Company performs a quarterly evaluation of the accounts receivable and the allowance for uncollectible accounts by reviewing specific customers' recent payment history, growth prospects, financial condition and other factors that may impact a customer's ability to pay. The Company establishes an allowance for uncollectible accounts for probable losses due to a customer's potential inability or unwillingness to make contractual payments. Account balances are written off against the allowance when the Company ceases collection efforts.

Inventory

The Company’s inventory is comprised primarily of expendable aircraft parts and supplies used for aircraft maintenance. Inventory is generally charged to expense when issued for use on a Company aircraft. The Company values its inventory of aircraft parts and supplies at weighted-average cost and maintains a related obsolescence reserve. The Company records an obsolescence reserve on a base stock of inventory for each fleet type. The amortization of base stock for the obsolescence reserve corresponds to the expected life of each fleet type. Additionally, the Company monitors the usage rates of inventory parts and segregates parts that are technologically outdated or no longer used in its fleet types. Slow moving and segregated items are actively marketed and written down to their estimated net realizable values based on market conditions.

Management analyzes the inventory reserve for reasonableness at the end of each quarter. That analysis includes consideration of the expected fleet life, amounts expected to be on hand at the end of a fleet life, and recent events and conditions that may impact the usability or value of inventory. Events or conditions that may impact the expected life, usability or net realizable value of inventory include additional aircraft maintenance directives from the FAA, changes in DOT regulations, new environmental laws and technological advances.

Goodwill and Intangible Assets

The Company assesses, during the fourth quarter of each year, the carrying value of goodwill. Finite-lived intangible assets are amortized over their estimated useful economic lives. The Company also conducts impairment assessments of goodwill, indefinite-lived intangible assets and finite-lived intangible assets whenever events or changes in circumstance indicate an impairment may have occurred.

Property and Equipment

Property and equipment held for use is stated at cost, net of any impairment recorded. The cost and accumulated depreciation of disposed property and equipment are removed from the accounts with any related gain or loss reflected in earnings from operations.

Depreciation of property and equipment is provided on a straight-line basis over the lesser of the asset’s useful life or lease term. Depreciable lives are summarized as follows:

Boeing 767 and 757 aircraft and flight equipment	10 to 20 years
Support equipment	5 to 10 years
Vehicles and other equipment	3 to 8 years

The Company periodically evaluates the useful lives, salvage values and fair values of property and equipment. Acceleration of depreciation expense or the recording of significant impairment losses could result from changes in

the estimated useful lives of assets due to a number of reasons, such as excess aircraft capacity or changes in regulations governing the use of aircraft.

Aircraft and other long-lived assets are tested for impairment when circumstances indicate the carrying value of the assets may not be recoverable. To conduct impairment testing, the Company groups assets and liabilities at the lowest level for which identifiable cash flows are largely independent of cash flows of other assets and liabilities. For assets that are to be held and used, impairment is recognized when the estimated undiscounted cash flows associated with the asset group is less than the carrying value. If impairment exists, an adjustment is made to write the assets down to fair value, and a loss is recorded as the difference between the carrying value and fair value. Fair values are determined considering quoted market values, discounted cash flows or internal and external appraisals, as applicable. For assets held for sale, impairment is recognized when the fair value less the cost to sell the asset is less than the carrying value.

The Company's accounting policy for major airframe and engine maintenance varies by subsidiary and aircraft type. The costs for ABX's Boeing 767-200 airframe maintenance, which is the majority of the Company's aircraft fleet, are expensed as they are incurred. The costs of major airframe maintenance for the Company's other aircraft are capitalized and amortized over the useful life of the overhaul. The Company's General Electric CF6 engines that power the Boeing 767-200 aircraft are maintained under "power by the hour" agreements with an engine maintenance provider. Under the power by the hour agreements, the engines are maintained by the service provider for a fixed fee per flight hour; accordingly, the cost of engine maintenance is generally expensed as flight hours occur. Maintenance for the airlines' other aircraft engines, including those on the Boeing 767-300 and Boeing 757 aircraft, are typically contracted to service providers on a time and material basis and the costs of those engine overhauls are capitalized and amortized over the useful life of the overhaul.

Under certain leases, the Company is required to make periodic payments to the lessor for future maintenance events such as engine overhauls and major airframe maintenance. These payments are recorded as deposits until drawn for qualifying maintenance costs. The maintenance costs are expensed or capitalized in accordance with the airline's accounting policy for major airframe and engine maintenance. The Company evaluates at the balance sheet date, whether it is probable that an amount on deposit will be returned by the lessor to reimburse the costs of the maintenance activities. When an amount on deposit is less than probable of being returned, it is recognized as additional maintenance expense.

Capitalized Interest

Interest costs incurred during construction of facilities and while aircraft are being modified are capitalized as an additional cost of the aircraft until the date the asset is placed in service. Capitalized interest was $0.1 million and $0.1 million for the three and six month periods ending June 30, 2014, respectively, compared to $0.3 million and $1.0 million for the corresponding periods of 2013.

Self-Insurance

The Company is self-insured for certain workers' compensation, employee healthcare, automobile, aircraft, and general liability claims. The Company maintains excess claim coverage with common insurance carriers to mitigate its exposure to large claim losses. The Company records a liability for reported claims and an estimate for incurred claims that have not yet been reported. Accruals for these claims are estimated utilizing historical paid claims data and recent claims trends. Other liabilities included $28.0 million and $28.3 million at June 30, 2014 and December 31, 2013, respectively, for self-insured reserves. Changes in claim severity and frequency could result in actual claims being materially different than the costs accrued.

Pension and Post-Retirement Benefits

The costs of benefits provided by defined benefits pension and post-retirement health care plans are recorded in the period the employees provide service. Costs adjustments for plan amendments are amortized over the expected working life or the life expectancy of plan participants. The funded status of the Company's plans is measured as the difference between the fair value of plan assets and the accumulated benefit obligations to plan participants. The overfunded or underfunded status of a plan is recorded as an asset or liability. The funded status is ordinarily measured annually at year end.

Income Taxes

Income taxes have been computed using the asset and liability method, under which deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. Deferred taxes are measured using provisions of currently enacted tax laws. A valuation allowance against net deferred tax assets is recorded when it is more likely than not that such assets will not be fully realized. Tax credits are accounted for as a reduction of income taxes in the year in which the credit originates.

The Company recognizes the benefit of a tax position taken on a tax return, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. An uncertain income tax benefit is not recognized if it has a less than a 50% likelihood of being sustained. The Company recognizes interest and penalties accrued related to uncertain tax positions in operating expense.

Comprehensive Income

Comprehensive income includes net earnings and other comprehensive income or loss. Other comprehensive income or loss results from certain changes in the Company's liabilities for pension and other post-retirement benefits and gains and losses associated with interest rate hedging instruments.

Fair Value Information

Assets or liabilities that are required to be measured at fair value are reported using the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC Topic 820-10 Fair Value Measurements and Disclosures establishes three levels of input that may be used to measure fair value:

- Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include items where the determination of fair value requires significant management judgment or estimation.

Revenue Recognition

Revenues generated from airline service agreements are typically recognized based on hours flown or the amount of aircraft and crew resources provided during a reporting period. Certain agreements include provisions for incentive payments based upon on-time reliability. These incentives are typically measured on a monthly basis and recorded to revenue in the corresponding month earned. Revenues for operating expenses that are reimbursed through customer agreements, including consumption of aircraft fuel, are generally recognized as the costs are incurred. Revenues from charter service agreements are recognized on scheduled and non-scheduled flights when the specific flight has been completed. Aircraft lease revenues are recognized as operating lease revenues on a straight-line basis over the term of the applicable lease agreements. Revenues from the sale of aircraft parts and engines are recognized when the parts are delivered. Revenues earned and expenses incurred in providing aircraft-related maintenance, repair or technical services are recognized in the period in which the services are completed and delivered to the customer. Revenues derived from sorting parcels are recognized in the reporting period in which the services are performed.

New Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." The objective of the update is to change the requirements for reporting discontinued operations in Subtopic 205-20. It is effective in the first quarter of 2015, and the impact to the consolidated financial statements is not expected to be material.

In May 2014, FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). ASU 2014-09 is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016 and early adoption is not permitted. The Company is currently evaluating the methods of adoption allowed by the new standard and the effect the standard is expected to have on our consolidated financial position, results of operations or cash flows and related disclosures.

NOTE B—SIGNIFICANT CUSTOMERS

DHL

The Company's largest customer is DHL Network Operations (USA), Inc. and its affiliates ("DHL"). The Company has had long term contracts with DHL since August 2003. Revenues from continuing operations performed for DHL were approximately 57% and 57% of the Company's consolidated revenues from continuing operations for the three and six month periods ended June 30, 2014, respectively, compared to 56% and 54% for the corresponding periods of 2013. The Company’s balance sheets include accounts receivable with DHL of $32.4 million and $24.1 million as of June 30, 2014 and December 31, 2013, respectively.

The Company leases Boeing 767 aircraft to DHL under both long-term and short-term lease agreements. Under a separate crew, maintenance and insurance (“CMI”) agreement, the Company operates Boeing 767 aircraft that DHL leases from the Company and Boeing 767 aircraft that DHL owns. Pricing for services provided through the CMI agreement is based on pre-defined fees, scaled for the number of aircraft operated and the number of flight crews provided to DHL for its U.S. network. The Company provides DHL with scheduled maintenance services for aircraft that DHL leases or owns. The Company also provides Boeing 767 and Boeing 757 air cargo transportation services for DHL through additional ACMI agreements in which the Company provides the aircraft, crews, maintenance and insurance under a single contract. Revenues generated from the ACMI agreements are typically based on hours flown. The Company also provides ground equipment, such as power units, air starts and related maintenance services to DHL under separate agreements.

U.S. Military

A substantial portion of the Company's revenues are also derived from the U.S. Military. The U.S. Military awards flights to U.S. certificated airlines through annual contracts and through temporary "expansion" routes. Revenues from services performed for the U.S. Military were approximately 17% and 16% of the Company's total revenues from continuing operations for the three and six month periods ended June 30, 2014, respectively, compared to 16% and 17% for the corresponding periods of 2013. The Company's balance sheets included accounts receivable with the U.S. Military of $6.1 million and $4.8 million as of June 30, 2014 and December 31, 2013, respectively.

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NOTE C—GOODWILL AND OTHER INTANGIBLES

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

	CAM	Total
Carrying value as of December 31, 2013	$34,395	$34,395
Carrying value as of June 30, 2014	$34,395	$34,395

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

	Customer Relationships	Airline Certificates	Total
Carrying value as of December 31, 2013	$1,896	$3,000	$4,896
Amortization	(141)	—	(141)
Carrying value as of June 30, 2014	$1,755	$3,000	$4,755

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

NOTE D—FAIR VALUE MEASUREMENTS

The Company's money market funds and interest rate swaps are reported on the Company's consolidated balance sheets at fair values based on market values from identical or comparable transactions. The fair value of the Company's money market funds and interest rate swaps are based on observable inputs (Level 2) from comparable market transactions. The use of significant unobservable inputs (Level 3) was not necessary in determining the fair value of the Company's financial assets and liabilities.

The following table reflects assets and liabilities that are measured at fair value on a recurring basis (in thousands):

As of June 30, 2014	Fair Value Measurement Using			Total
	Level 1	Level 2	Level 3	
Assets				
Cash equivalents—money market	$20	$4,310	$—	$4,330
Total Assets	$20	$4,310	$—	$4,330
Liabilities				
Interest rate swap	$—	$(2,185)	$—	$(2,185)
Total Liabilities	$—	$(2,185)	$—	$(2,185)
As of December 31, 2013	Fair Value Measurement Using			Total
	Level 1	Level 2	Level 3	
Assets				
Cash equivalents—money market	$20	$301	$—	$321
Total Assets	$20	$301	$—	$321
Liabilities				
Interest rate swap	$—	$(2,515)	$—	$(2,515)
Total Liabilities	$—	$(2,515)	$—	$(2,515)

As a result of lower market interest rates compared to the stated interest rates of the Company's fixed and variable rate debt obligations, the fair value of the Company's debt obligations, based on Level 2 observable inputs, was

approximately $1.0 million less than the carrying value, which was $352.1 million at June 30, 2014. As of December 31, 2013, the fair value of the Company's debt obligations was approximately $6.3 million more than the carrying value, which was $384.5 million. The non-financial assets, including goodwill, intangible assets and property and equipment are measured at fair value on a non-recurring basis.

NOTE E—PROPERTY AND EQUIPMENT

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

	June 30, 2014	December 31, 2013
Aircraft and flight equipment	$1,247,913	$1,236,225
Support equipment	49,733	51,179
Vehicles and other equipment	1,759	1,771
Leasehold improvements	1,143	1,154
	1,300,548	1,290,329
Accumulated depreciation	(490,738)	(452,157)
Property and equipment, net	$809,810	$838,172

CAM owned aircraft with a carrying value of $254.0 million and $250.9 million that were under leases to external customers as of June 30, 2014 and December 31, 2013, respectively.

The carrying value of Boeing 727 and DC-8 freighter aircraft and engines available for sale totaled $1.0 million and $3.0 million as of June 30, 2014 and December 31, 2013, respectively.

NOTE F—DEBT OBLIGATIONS

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

	June 30, 2014	December 31, 2013
Unsubordinated term loan	$123,750	$131,250
Revolving credit facility	173,000	190,500
Aircraft loans	50,730	55,015
Promissory note due to DHL, unsecured	4,650	7,750
Total long term obligations	352,130	384,515
Less: current portion	(24,027)	(23,721)
Total long term obligations, net	$328,103	$360,794

The Company executed a syndicated credit agreement ("Senior Credit Agreement") in May 2011 which includes an unsubordinated term loan and a revolving credit facility. On May 6, 2014, the Company executed an amendment to the Senior Credit Agreement (the "Third Credit Amendment"). The Third Credit Amendment extends the maturity of the term loan and revolving credit facility to May 6, 2019, provides for annual, one year extension options, provides for an accordion feature whereby the Company can draw up to an additional $50.0 million subject to the lenders' consent, reduces the EBITDA-based pricing, eases requirements for stock dividends and stock buybacks and reduces the collateral requirements. The Senior Credit Agreement is collateralized by the Company's fleet of Boeing 767 and 757 aircraft that are not collateralized under the aircraft loans. Under the amended terms of the Senior Credit Agreement, the Company is required to maintain collateral coverage equal to 150% of the outstanding balances of the term loan and the maximum capacity of revolving credit facility or 175% of the outstanding balance of the term loan and the total funded revolving credit facility, whichever is less. The minimum collateral coverage which must be maintained is 50% of the outstanding balance of the term loan plus the revolving credit facility commitment of $275.0 million. The Third

Credit Amendment does not change the repayment terms of the Senior Credit Agreement. Beginning May 6, 2015, and each year thereafter through May 6, 2019, the Company may request a one year extension of the final maturity date, subject to the lenders' consent.
Under the terms of the Senior Credit Agreement, interest rates are adjusted quarterly based on the Company's earnings before interest, taxes, depreciation and amortization expenses ("EBITDA"), its outstanding debt level and prevailing LIBOR or prime rates. At the Company's current debt-to-EBITDA ratio, the LIBOR based financing for the unsubordinated term loan and revolving credit facility bear a variable interest rate of 2.15% and 2.15%, respectively. The Third Credit Amendment reduced the EBITDA-based pricing but did not affect the covenants of the Senior Credit Agreement other than the collateral covenant. The Senior Credit Agreement provides for the issuance of letters of credit on the Company's behalf. As of June 30, 2014, the unused revolving credit facility totaled $91.8 million, net of draws of $173.0 million and outstanding letters of credit of $10.2 million.
The aircraft loans are collateralized by six aircraft, and amortize monthly with a balloon payment of approximately 20% with maturities between 2016 and early 2018. Interest rates range from 6.74% to 7.36% per annum payable monthly.
The promissory note payable to DHL becomes due in August 2028 as a balloon payment, unless it is extinguished sooner under the terms of the CMI agreement. Beginning April 1, 2010 and extending through the term of the CMI agreement, the balance of the note is amortized ratably without cash payment in exchange for services provided and, thus, is expected to be completely amortized by April 2015. The promissory note bears interest at a rate of 5% per annum, and DHL reimburses ABX the interest expense from the note through the term of the CMI agreement.
The Senior Credit Agreement is collateralized by certain of the Company's Boeing 767 and 757 aircraft that are not collateralized under aircraft loans. The Senior Credit Agreement contains covenants including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness, as well as a total debt to EBITDA ratio and a fixed charge coverage ratio. The Senior Credit Agreement stipulates events of default, including unspecified events that may have material adverse effects on the Company. If an event of default occurs, the Company may be forced to repay, renegotiate or replace the Senior Credit Agreement. The Senior Credit Agreement limits the amount of dividends the Company can pay and the amount of common stock it can repurchase to $50.0 million during any calendar year, provided the Company's total debt to EBITDA ratio is under 2.5 times, after giving effect to the dividend or repurchase. Under the provisions of its promissory note due to DHL, the Company is required to prepay the DHL note in the amount of $0.20 for each dollar of dividend distributed to its stockholders. The same prepayment stipulation applies to stock repurchases.

NOTE G—COMMITMENTS AND CONTINGENCIES

Lease Commitments

The Company leases six Boeing 767 aircraft, airport facilities, office space, maintenance facilities and certain equipment under operating leases. In December 2012, the Company entered into agreements with the Clinton County Port Authority ("CCPA") to construct and lease an aircraft hangar in Wilmington, Ohio, adjacent to the existing aircraft maintenance facility currently leased by the Company. The Company acts as construction agent for the CCPA and began construction of the 100,000 square foot aircraft hangar in 2013. Construction was primarily completed by the end of June 2014. While the current facility houses aircraft as large as the Boeing 767, the new hangar provides the capability of servicing aircraft as large as a Boeing 747 and a Boeing 777. The hangar is anticipated to cost approximately $15.7 million and The CCPA is financing the construction of the hangar primarily through a State of Ohio bond program and a State of Ohio loan on incremental taxes. The costs incurred to build the hangar are included in "Property and equipment" and the construction amounts that are reimbursed through the State of Ohio and the CCPA are included in "Other liabilities" on the Company's balance sheet. The Company began to make lease payments for the hangar directly to the trustee for the State of Ohio beginning in 2014.

Guarantees and Indemnifications

Certain leases and agreements of the Company contain guarantees and indemnification obligations to the lessor, or one or more other parties that are considered reasonable and customary (e.g. use, tax and environmental

indemnifications), the terms of which range in duration and are often limited. Such indemnification obligations may continue after expiration of the respective lease or agreement.

Brussels Noise Ordinance

The Brussels Instituut voor Milieubeheer ("BIM"), a governmental authority in the Brussels-Capital Region of Belgium that oversees the enforcement of environmental matters, imposed four separate administrative penalties on ABX in the approximate aggregate amount of €0.4 million ($0.5 million) for numerous alleged violations of an ordinance limiting the noise caused by aircraft overflying the Brussels-Capital Region (which is located near the Brussels Airport) during the period from May 2009 through December 2010. ABX has exhausted its appeals with respect to all four of the administrative penalties.

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

Other

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

Employees Under Collective Bargaining Agreements

As of June 30, 2014, the flight crewmember employees of ABX and ATI were represented by the labor unions listed below:

Airline	Labor Agreement Unit	Percentage of the Company's Employees
ABX	International Brotherhood of Teamsters	14.5%
ATI	Air Line Pilots Association	5.9%

NOTE H—PENSION AND OTHER POST-RETIREMENT BENEFIT PLANS

Defined Benefit and Post-retirement Healthcare Plans

ABX sponsors a qualified defined benefit pension plan for ABX crewmembers and a qualified defined benefit pension plan for a major portion of its other ABX employees that meet minimum eligibility requirements. ABX also sponsors non-qualified defined benefit pension plans for certain employees. These non-qualified plans are unfunded. Employees are no longer accruing benefits under any of the defined benefit pension plans. ABX also sponsors a post-retirement healthcare plan for its ABX employees, which is unfunded.

The accounting and valuation for these post-retirement obligations are determined by prescribed accounting and actuarial methods that consider a number of assumptions and estimates. The selection of appropriate assumptions and estimates is significant due to the long time period over which benefits will be accrued and paid. The long term nature of these benefit payouts increases the sensitivity of certain estimates of our post-retirement costs. The assumptions considered most sensitive in actuarially valuing ABX's pension obligations and determining related expense amounts are discount rates and expected long term investment returns on plan assets. Additionally, other assumptions concerning retirement ages, mortality and employee turnover also affect the valuations. Actual results and future changes in these assumptions could result in future costs significantly higher than those recorded in our results of operations. The Company's net periodic benefit costs for its defined benefit pension plans and post-retirement healthcare plans for both continuing and discontinued operations are as follows (in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	Pension Plans		Post-Retirement Healthcare Plan		Pension Plans		Post-Retirement Healthcare Plan	
	2014	2013	2014	2013	2014	2013	2014	2013
Service cost	$—	$—	$60	$69	$—	$—	$120	$138
Interest cost	9,879	8,989	71	66	19,758	17,978	142	132
Expected return on plan assets	(11,528)	(11,498)	—	—	(23,056)	(22,996)	—	—
Amortization of prior service cost	—	—	(872)	(1,413)	—	—	(1,744)	(2,826)
Amortization of net (gain) loss	—	3,074	80	104	(1)	6,148	160	208
Net periodic benefit cost	$(1,649)	$565	$(661)	$(1,174)	$(3,299)	$1,130	$(1,322)	$(2,348)

During the three and six month periods ended June 30, 2014, the Company contributed $0.3 million and $1.0 million to the pension plans. The Company expects to contribute and additional $5.3 million during the remainder of 2014.

NOTE I—INCOME TAXES

The provision for income taxes for interim periods is based on management's best estimate of the effective income tax rate expected to be applicable for the current year, plus any adjustments arising from changes in the estimated amount of taxable income related to prior periods. Income taxes recorded through June 30, 2014 have been estimated utilizing a 36.7% rate based upon year-to-date income and projected results for the full year. The final effective tax rate applied to 2014 will depend on the actual amount of pre-tax book income generated by the Company for the full year.

The Company has operating loss carryforwards for U.S. federal income tax purposes. Management expects to utilize the loss carryforwards to offset federal income tax liabilities in the future. Due to the Company's deferred tax assets, including its loss carryforwards, management does not expect to pay federal income taxes until 2016 or later. The Company may, however, be required to pay alternative minimum taxes and certain state and local income taxes before then.

NOTE J—DERIVATIVE INSTRUMENTS

The Company's Senior Credit Agreement requires the Company to maintain derivative instruments for protection from fluctuating interest rates, for at least fifty percent of the outstanding balance of term loan. As a result, the Company entered into an interest rate swap in July of 2011 having an initial notional value of $75.0 million and a forward start date of December 31, 2011. Under this swap, the Company pays a fixed rate of 2.02% and receives a floating rate that resets quarterly based on LIBOR. In addition to the interest rate swap above, the Company entered into an interest rate swap in June of 2013 having an initial notional value of $65.6 million and a forward start date of December 31, 2013. Under this swap, the Company will pay a fixed rate of 1.1825% and receive a floating rate that resets monthly based on LIBOR.

The outstanding interest rate swaps are not designated as hedges for accounting purposes. The effects of future fluctuations in LIBOR interest rates on derivatives held by the Company will result in the recording of unrealized gains and losses into the statement of operations. The Company did not record any unrealized gain on derivatives for the

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second quarter of 2014 and recorded unrealized gains of $0.3 million for the six month periods ending June 30, 2014 to reflect the interest rate swaps at market value. Comparably, the Company recorded unrealized gains on derivatives of $0.5 million and $0.7 million for the three and six month periods ending June 30, 2013, respectively. The liability for outstanding derivatives is recorded in other liabilities and in accrued expenses. The table below provides information about the Company's interest rate swaps (in thousands):

		June 30, 2014		December 31, 2013	
Expiration Date	Stated Interest Rate	Notional Amount	Market Value (Liability)	Notional Amount	Market Value (Liability)
May 9, 2016	2.020%	61,875	(1,590)	65,625	(1,988)
June 30, 2017	1.183%	61,875	(595)	65,625	(527)

NOTE K—ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated other comprehensive income (loss) includes the following items by components for the three and six month periods ended June 30, 2014 and 2013 (in thousands):

	Defined Benefit Pension	Defined Benefit Post-Retirement	Gains and Losses on Derivative	Total
Balance as of March 31, 2013	(119,644)	3,443	30	(116,171)
Amounts reclassified from accumulated other comprehensive income:				
Actuarial costs (reclassified to salaries, wages and benefits)	3,074	104	—	3,178
Negative prior service cost (reclassified to salaries, wages and benefits)	—	(1,413)	—	(1,413)
Hedging gain (reclassified to interest expense)	—	—	(13)	(13)
Income Tax (Expense) or Benefit	(1,116)	475	5	(636)
Other comprehensive income (loss), net of tax	1,958	(834)	(8)	1,116
Balance as of June 30, 2013	(117,686)	2,609	22	(115,055)
Balance as of December 31, 2012	(121,602)	4,277	38	(117,287)
Amounts reclassified from accumulated other comprehensive income				
Actuarial costs (reclassified to salaries, wages and benefits)	6,148	208	—	6,356
Negative prior service cost (reclassified to salaries, wages and benefits)	—	(2,826)	—	(2,826)
Hedging gain (reclassified to interest expense)	—	—	(26)	(26)
Income Tax (Expense) or Benefit	(2,232)	950	10	(1,272)
Other comprehensive income (loss), net of tax	3,916	(1,668)	(16)	2,232
Balance as of June 30, 2013	(117,686)	2,609	22	(115,055)

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

NOTE L—STOCK-BASED COMPENSATION

The Company's Board of Directors has granted stock incentive awards to certain employees and board members pursuant to a long term incentive plan which was approved by the Company's stockholders in May 2005. Employees have been awarded non-vested stock units with performance conditions, non-vested stock units with market conditions and non-vested restricted stock. The restrictions on the non-vested restricted stock awards lapse at the end of a specified service period, which is typically approximately three years from the date of grant. Restrictions could lapse sooner upon a business combination, death, disability or after an employee qualifies for retirement. The non-vested stock units will be converted into a number of shares of Company stock depending on performance and market conditions at the end of a specified service period, lasting approximately three years. The performance condition awards will be converted into a number of shares of Company stock based on the Company's average return on invested capital during the service period. Similarly, the market condition awards will be converted into a number of shares depending on the appreciation of the Company's stock compared to the NASDAQ Transportation Index. Board members were granted time-based awards with vesting periods of approximately six or twelve months. The Company expects to settle all of the stock unit awards by issuing new shares of stock. The table below summarizes award activity.

	Six Months Ended June 30, 2014		June 30, 2013	
	Number of Awards	Weighted average grant-date fair value	Number of Awards	Weighted average grant-date fair value
Outstanding at beginning of period	1,477,762	$5.83	1,463,272	$5.97
Granted	467,567	7.52	627,488	5.73
Converted	(186,179)	7.50	(392,748)	4.87
Expired	(4,300)	7.64	—	—
Forfeited	(17,800)	6.26	(7,200)	6.82
Outstanding at end of period	1,737,050	$6.10	1,690,812	$6.13
Vested	415,550	$5.28	441,812	$4.90

The average grant-date fair value of each performance condition award, non-vested restricted stock award and time-based award granted by the Company in 2014 was $7.44, the fair value of the Company's stock on the date of grant. The average grant-date fair value of each market condition award granted in 2014 was $7.83. The market condition awards were valued using a Monte Carlo simulation technique, a risk-free interest rate of 0.8% and a volatility of 48.9% based on volatility over three years using daily stock prices.

For the six month periods ended June 30, 2014 and 2013, the Company recorded expense of $1.3 million and $1.3 million, respectively, for stock incentive awards. At June 30, 2014, there was $4.2 million of unrecognized expense related to the stock incentive awards that is expected to be recognized over a weighted-average period of 1.5 years. As of June 30, 2014, none of the awards were convertible, 415,550 units of the Board members' time-based awards had vested and none of the outstanding shares of the restricted stock had vested. These awards could result in a maximum number of 2,071,000 additional outstanding shares of the Company's common stock depending on service, performance and market results through December 31, 2016.

NOTE M—EARNINGS PER SHARE

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

	Three Months Ending June 30,		Six Months Ending June 30,	
	2014	2013	2014	2013
Earnings from continuing operations	$9,298	$6,915	$15,820	$15,416
Weighted-average shares outstanding for basic earnings per share	64,285	64,050	64,217	63,931
Common equivalent shares:				
Effect of stock-based compensation awards	922	809	957	761
Weighted-average shares outstanding assuming dilution				