

Air Transport Services Group, Inc.
Form 10-Q
November 03, 2010
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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 Quarterly Period Ended September 30, 2010

Commission File Number 000-50368

(Exact name of registrant as specified in its charter)

Delaware
(State of incorporation

or organization)

26-1631624
(IRS Employer

Identification No.)

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145 Hunter Drive

Wilmington, Ohio 45177

(Address of Principal Executive Office)

(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 No

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 No

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 definitions of large accelerated filer, non-accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer (do not check if a smaller reporting company) Smaller reporting company

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

As of November 3, 2010, Air Transport Services Group, Inc. had outstanding 63,775,766 shares of common stock, par value \$.01.

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AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES

Form 10-Q

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FORWARD LOOKING STATEMENTS

Statements contained in this quarterly report on Form 10-Q that are not historical facts are considered forward-looking statements (as that term is defined in the Private Securities Litigation Reform Act of 1995). Words such as projects, believes, anticipates, will, estimates, plans, expects, intends and similar words and expressions are intended to identify forward-looking statements. These forward-looking statements are based on expectations, estimates and projections as of the date of this filing, and involve risks and uncertainties that are inherently difficult to predict. Actual results may differ materially from those expressed in the forward-looking statements for any number of reasons, including those described in this report and in our 2009 Annual Report filed on Form 10-K with the Securities and Exchange Commission.

Filings with the Securities and Exchange Commission

The Securities and Exchange Commission maintains an Internet site that contains reports, proxy and information statements and other information regarding 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.

Table of Contents**PART 1. 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 September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2010 | 2009 | 2010 | 2009 |
| REVENUES | \$ 167,726 | \$ 174,202 | \$ 488,781 | \$ 572,973 |
| OPERATING EXPENSES | | | | |
| Salaries, wages and benefits | 41,074 | 74,127 | 129,830 | 257,191 |
| Fuel | 33,745 | 27,068 | 98,203 | 75,560 |
| Depreciation and amortization | 22,758 | 19,954 | 65,310 | 62,354 |
| Maintenance, materials and repairs | 22,446 | 15,217 | 57,355 | 48,513 |
| Landing and ramp | 5,419 | 5,828 | 17,830 | 22,790 |
| Travel | 5,667 | 5,524 | 16,383 | 15,888 |
| Rent | 4,881 | 2,629 | 12,257 | 7,025 |
| Insurance | 2,130 | 2,731 | 7,122 | 8,306 |
| Other operating expenses | 8,378 | 10,315 | 26,956 | 26,967 |
| | 146,498 | 163,393 | 431,246 | 524,594 |
| INTEREST EXPENSE | (4,641) | (6,236) | (14,424) | (21,048) |
| INTEREST INCOME | 83 | 74 | 241 | 381 |
| EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES | 16,670 | 4,647 | 43,352 | 27,712 |
| INCOME TAX EXPENSE | (5,282) | (1,792) | (15,299) | (9,822) |
| EARNINGS FROM CONTINUING OPERATIONS | 11,388 | 2,855 | 28,053 | 17,890 |
| EARNINGS (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX | (230) | 882 | (58) | 5,051 |
| NET EARNINGS | \$ 11,158 | \$ 3,737 | \$ 27,995 | \$ 22,941 |
| EARNINGS PER SHARE - Basic | | | | |
| Continuing operations | \$ 0.18 | \$ 0.05 | \$ 0.45 | \$ 0.29 |
| Discontinued operations | | 0.01 | | 0.08 |
| NET EARNINGS PER SHARE | \$ 0.18 | \$ 0.06 | \$ 0.45 | \$ 0.37 |
| EARNINGS (LOSS) PER SHARE - Diluted | | | | |
| Continuing operations | \$ 0.18 | \$ 0.05 | \$ 0.44 | \$ 0.28 |

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| | | | | |
|--|----------------|----------------|----------------|----------------|
| Discontinued operations | (0.01) | 0.01 | | 0.08 |
| NET EARNINGS PER SHARE | \$ 0.17 | \$ 0.06 | \$ 0.44 | \$ 0.36 |
| WEIGHTED AVERAGE SHARES OUTSTANDING | | | | |
| Basic | 62,811 | 62,685 | 62,805 | 62,670 |
| Diluted | 64,202 | 63,731 | 64,076 | 63,181 |

See notes to unaudited condensed consolidated financial statements.

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

| | September 30, 2010 | December 31, 2009 |
|--|-----------------------|----------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 44,465 | \$ 83,229 |
| Accounts receivable, net of allowance of \$1,378 in 2010 and \$1,288 in 2009 | 37,331 | 87,708 |
| Inventory | 5,769 | 5,226 |
| Prepaid supplies and other | 10,480 | 7,093 |
| Deferred income taxes | 31,597 | 31,597 |
| Aircraft and engines held for sale | | 30,634 |
| TOTAL CURRENT ASSETS | 129,642 | 245,487 |
| Property and equipment, net | 660,988 | 636,089 |
| Other assets | 28,463 | 21,307 |
| Intangibles | 9,472 | 10,113 |
| Goodwill | 89,777 | 89,777 |
| TOTAL ASSETS | \$ 918,342 | \$ 1,002,773 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 37,329 | \$ 38,174 |
| Accrued salaries, wages and benefits | 23,651 | 44,077 |
| Accrued severance and retention | 1,039 | 18,959 |
| Accrued expenses | 15,367 | 16,429 |
| Current portion of debt obligations | 36,112 | 51,737 |
| Unearned revenue | 14,335 | 15,340 |
| TOTAL CURRENT LIABILITIES | 127,833 | 184,716 |
| Long-term debt obligations | 277,031 | 325,690 |
| Post-retirement liabilities | 97,292 | 152,297 |
| Other liabilities | 54,863 | 44,044 |
| Deferred income taxes | 64,172 | 50,044 |
| Commitments and contingencies (Note I) | | |
| 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; 63,775,766 and 63,416,564 shares issued and outstanding in 2010 and 2009, respectively | 638 | 634 |
| Additional paid-in capital | 513,898 | 502,822 |
| Accumulated deficit | (183,090) | (211,085) |
| Accumulated other comprehensive loss | (34,295) | (46,389) |

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| | | |
|--|------------|--------------|
| TOTAL STOCKHOLDERS EQUITY | 297,151 | 245,982 |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | \$ 918,342 | \$ 1,002,773 |

See notes to unaudited condensed consolidated financial statements.

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

| | Nine Months Ended September 30, | |
|---|--|------------------|
| | 2010 | 2009 |
| OPERATING ACTIVITIES: | | |
| Net earnings from continuing operations | \$ 28,053 | \$ 17,890 |
| Net earnings from discontinued operations | (58) | 5,051 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 65,310 | 62,978 |
| Pension and post-retirement amortization | (1,144) | 24,650 |
| Deferred income taxes | 14,864 | 10,418 |
| Amortization of stock-based compensation | 1,230 | 1,013 |
| Amortization of DHL promissory note | (3,100) | |
| Gains on asset disposition, net of impairments | (8) | (2,077) |
| Changes in assets and liabilities: | | |
| Accounts receivable | 40,080 | (3,837) |
| Inventory and prepaid supplies | (2,730) | 5,531 |
| Accounts payable | (311) | (3,754) |
| Unearned revenue | 11,966 | (8,744) |
| Accrued expenses, salaries, wages and benefits and other liabilities | (40,895) | (44,600) |
| Post-retirement liabilities | (33,020) | (18,846) |
| Other | 1,427 | 3,854 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 81,664 | 49,527 |
| INVESTING ACTIVITIES: | | |
| Capital expenditures | (90,741) | (49,908) |
| Proceeds from the sale of property and equipment | 31,497 | 7,044 |
| Proceeds from redemptions of marketable securities | | 26 |
| NET CASH (USED IN) INVESTING ACTIVITIES | (59,244) | (42,838) |
| FINANCING ACTIVITIES: | | |
| Principal payments on borrowings | (61,184) | (33,104) |
| NET CASH (USED IN) FINANCING ACTIVITIES | (61,184) | (33,104) |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (38,764) | (26,415) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 83,229 | 116,114 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 44,465 | \$ 89,699 |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Interest paid, net of amount capitalized | \$ 12,591 | \$ 18,396 |

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| | | |
|---|----------|----------|
| Income taxes paid | \$ 367 | \$ 2,085 |
| SUPPLEMENTAL NON-CASH INFORMATION: | | |
| Accrued capital expenditures | \$ 1,215 | \$ 2,025 |

See notes to unaudited condensed consolidated financial statements.

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AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

NOTE A SUMMARY OF FINANCIAL STATEMENT PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

The interim period consolidated financial statements of Air Transport Services Group, Inc. and its subsidiaries (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America and rules and regulations of the Securities and Exchange Commission for interim financial information. Accordingly, they do not include all of the information, footnotes and disclosures required by generally accepted accounting principles for complete financial statements and are unaudited. The results of operations and cash flows for any interim periods are not necessarily indicative of results that may be reported for the full year. The December 31, 2009 financial amounts are extracted from the annual audited financial statements.

The Company evaluated subsequent events through the date the financial statements were issued and filed with the Securities and Exchange Commission. In the opinion of management, all adjustments and disclosures considered necessary for a fair presentation have been included.

Nature of Operations

Air Transport Services Group, Inc. is a holding company whose principal subsidiaries include an aircraft leasing company, Cargo Aircraft Management, Inc. (CAM) and three independently certificated airlines, ABX Air, Inc. (ABX), Capital Cargo International Airlines, Inc. (CCIA) and Air Transport International, LLC (ATI). CAM leases aircraft to each of the Company's airlines as well as to non-affiliated airlines.

Since August 16, 2003, the Company, through ABX, has had long term contracts with DHL Network Operations (USA), Inc. and DHL Express (USA), Inc. which are collectively referred to as DHL. DHL, an international, integrated delivery company, is the Company's largest customer. In March 2010, the Company and DHL executed new follow-on agreements effective March 31, 2010. Under the new agreements, DHL committed to lease 13 Boeing 767 freighter aircraft from CAM and ABX has been contracted to operate those aircraft for DHL under a separate crew, maintenance and insurance (CMI) agreement. Prior to the new, follow-on agreements, ABX provided aircraft, flight crews and maintenance to DHL under an aircraft, crew, maintenance and insurance agreement (ACMI).

Through its airline subsidiaries, the Company provides aircraft, flight crews and airline operations to its customers. CCIA and ATI each have contracts to provide airlift to BAX Global, Inc. (BAX/Schenker), the Company's second largest customer. BAX/Schenker provides freight transportation and supply chain management services, specializing in the heavy freight market for business-to-business shipping. ATI also provides passenger transportation, primarily to the U.S. military, using its McDonnell Douglas DC-8 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, operates three mail sorting facilities for the U.S. Postal Service (USPS), and provides specialized services for aircraft fuel management and freight logistics.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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, labor contract settlements, post-retirement obligations, income taxes, contingencies and litigation. Changes in estimates and assumptions may have a material impact on the consolidated financial statements.

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Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions are eliminated.

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 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.

Inventory

The Company's inventory is comprised primarily of expendable spare parts and supplies used for internal consumption. These items are generally charged to expense when issued for use. The Company values aircraft spare parts inventory for internal consumption 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. Inventory amortization 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 calendar 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 Federal Aviation Administration, changes in Department of Transportation regulations, new environmental laws and technological advances. Provisions for inventory obsolescence are recorded to maintenance expense.

Goodwill and Intangible Assets

In accordance with the Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 350 *Intangibles Goodwill and Other*, the Company assesses, during the fourth quarter of each year, the carrying value of goodwill and indefinite-lived intangible assets. Impairment assessments may be performed on an interim basis if the Company finds it necessary. Finite-lived intangible assets are amortized over their estimated useful economic lives and are periodically reviewed for impairment, in accordance with FASB ASC 360 *Property, Plant and Equipment*.

Property and Equipment

Property and equipment are stated at cost, net of any impairment recorded, in accordance with FASB ASC Topic 360-10 *Property, Plant and Equipment*. 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 as follows:

| | |
|---|---------------|
| Aircraft and flight equipment | 3 to 20 years |
| Package handling and ground 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 an assessment done quarterly to determine if excess capacity exists in the customer air networks, or changes in regulations governing the use of aircraft.

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Long-lived assets are reviewed for impairment when circumstances indicate the carrying value of an asset may not be recoverable. For assets that are to be held and used, impairment is recognized when the estimated undiscounted cash flows associated with the asset or group of assets is less than the carrying value. If impairment exists, an adjustment is made to write the asset down to its 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. Assets to be disposed of are carried at the lower of carrying value or fair value less the cost to sell.

The airlines' 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, these CF6 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 are typically contracted to service providers on a time and material basis. The accounting policy for major airframe and engine maintenance, other than the CF6 engines, varies by airline subsidiary. ATI and CCIA capitalize the cost of major maintenance and amortize the costs over the useful life of the overhaul. ABX expenses the cost of airframe and engine overhauls as incurred.

Capitalized Interest

Interest costs incurred 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 \$0.3 million for the quarters ended September 30, 2010 and 2009, respectively, and \$1.3 million for the nine month periods ended September 30, 2010 and 2009.

Discontinued Operations

In accordance with the guidance of FASB ASC Topic 205-20 *Presentation of Financial Statements*, a business component whose operations are discontinued is reported as discontinued operations if the cash flows of the component have been eliminated from the ongoing operations of the Company, and the Company will no longer have any significant continuing involvement in the business component. The results of discontinued operations are aggregated and presented separately in the consolidated statement of operations. FASB ASC Topic 205-20 requires the reclassification of amounts presented for prior years to reflect their classification as discontinued operations.

Exit Activities

The Company accounts for the costs associated with exit activities in accordance with FASB ASC Topic 420-10 *Exit or Disposal Cost Obligations*. One-time, involuntary employee termination benefits are generally expensed when the Company communicates the benefit arrangement to the employee and requires no significant future services, other than a minimum retention period, for the employee to earn the termination benefits. Liabilities for contract termination costs associated with exit activities are recognized in the period incurred and measured initially at fair value. Pension obligations are accounted for in accordance with FASB ASC Topic 715-30 *Compensation - Retirement Benefits* in the event that a significant number of employees are terminated or a pension plan is suspended.

Self-Insurance

The Company is self-insured for certain claims relating to workers' compensation, aircraft, automobile, general liability and employee healthcare. 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, recent claims trends and, in the case of employee healthcare and workers' compensation, an independent actuarial evaluation. Other liabilities included \$39.6 million and \$41.3 million at September 30, 2010 and December 31, 2009, respectively, for self-insurance reserves. Changes in claim severity and frequency could result in actual claims being materially different than the costs reserved.

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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.

Under FASB ASC Topic 740-10 *Income Taxes*, the Company recognizes the impact 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 provision 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 (loss) includes net earnings or loss and other comprehensive income or loss. Other comprehensive income or loss results from changes in the Company's pension liability 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.

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 from charter service agreements are recognized on scheduled and non-scheduled flights when the specific flight has been completed. Aircraft parts and fuel sales are recognized when the parts and fuel 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 transporting freight and sorting parcels are recognized upon delivery of shipments and completion of services. Aircraft lease revenues are recognized as operating lease revenue on a straight-line basis over the term of the applicable lease agreements.

Revenues from the former DHL ACMI agreement were generally determined based on expenses incurred during a period plus mark-ups and were recognized when the related services were performed. ABX and DHL amended the ACMI agreement to set mark-ups to specific quarterly amounts for 2009 and the first quarter of 2010. In 2008, ABX and DHL executed a severance and retention agreement (S&R agreement) which specified employee severance, retention and other benefits that DHL reimbursed to ABX for payment to its employees that were affected in conjunction with DHL's U.S. restructuring plan. DHL was obligated to reimburse ABX for the cost of employee severance, retention, productivity bonuses and vacation benefits paid in accordance with the agreement. The Company's revenues for 2009 and the first quarter of 2010 included reimbursement for expenses incurred under the DHL ACMI agreement, the incremental mark-up revenues set by the DHL ACMI amendments and reimbursement for employee severance, retention, vacation and other benefit costs incurred during the period.

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In July 2010, the FASB issued an Accounting Standards Update No. 2010-20, Receivables, Disclosure about the Credit Quality of Financing Receivables and Allowances for Credit Losses. The new guidance will require additional disclosures about the nature of credit risk in a company's portfolio of financing receivables, how risk is analyzed and assessed in arriving at the allowance for credit losses and the reasons for changes in the allowance for credit losses. The new guidance will be effective in fiscal years beginning on or after December 15, 2010 and is not expected to have material impact the Company's financial statements.

NOTE B SIGNIFICANT CUSTOMERS

In March 2010, the Company and DHL terminated the DHL ACMI agreement and executed new follow-on agreements effective March 31, 2010. Under the new agreements, DHL will lease 13 Boeing 767 freighter aircraft from CAM while ABX operates those aircraft for DHL under a separate CMI agreement. The CMI agreement is not based on a cost-plus pricing arrangement, but instead pricing is based on a pre-defined fee, scaled for the number of aircraft operated and the number of crews provided to DHL for its U.S. network. The initial term of the CMI agreement is five years, while the term of the aircraft leases are seven years. Under the CMI agreement, ABX contracted with Airborne Maintenance and Engineering Services, Inc. (AMES), a wholly-owned subsidiary of the Company, to provide scheduled maintenance for the 13 Boeing 767 aircraft for at least the first three years of the CMI agreement.

As of September 30, 2010, CAM had leased 11 of the 13 Boeing 767-200 freighter aircraft to DHL. Until CAM completes the aircraft modification process for the remaining two aircraft committed to DHL, ABX will provide bridging aircraft to DHL under short term, month-to-month arrangements with economic terms similar to the leases for the 13 aircraft. CAM is projected to provide the twelfth and thirteenth Boeing 767-200 aircraft to DHL by July 2011.

The S&R agreement with DHL was terminated effective April 1, 2010. In conjunction with the termination of the ACMI agreement and the S&R agreement, ABX and DHL entered into a termination agreement which addressed several open issues between the parties. Under the termination agreement, in May 2010, DHL paid ABX the aircraft carrying value of \$29.7 million to complete the sale of aircraft that ABX previously put to DHL under provisions of the ACMI agreement. DHL reimbursed ABX for \$11.2 million of accrued vacation payments which is in addition to \$3.2 million previously reimbursed by DHL. The Company's financial results for 2010 reflect the recognition of \$4.1 million of revenue in the first quarter of 2010 for vacation payments which DHL reimbursed to ABX and were not previously recognized in revenues. As previously agreed, ABX paid DHL \$15.0 million toward the balance of the promissory note with DHL during May 2010. Beginning April 1, 2010 and extending through the term of the DHL CMI agreement, the balance of the note with DHL is extinguished ratably without payment.

The Company's balance sheets included the following balances related to transactions with DHL (in thousands):

| | September 30, 2010 | December 31, 2009 |
|---|-----------------------|----------------------|
| Assets (Liabilities): | | |
| Accounts receivable | \$ 13,904 | \$ 62,672 |
| Other assets (non current amounts due from DHL) | 8,229 | |
| Aircraft put to DHL | | 29,656 |
| Accounts payable | (531) | (265) |
| Unearned revenue (current) | (10,698) | (12,880) |
| Other liabilities (unearned revenue) | (12,971) | |
| Principal portion of note to DHL | (27,900) | (46,000) |
| Net asset (liability) | \$ (29,967) | \$ 33,183 |

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Continuing revenues from leases to and contracted services performed for DHL were approximately 33% and 46% of the Company's consolidated revenues from continuing operations for the three months ended September 30, 2010 and 2009, respectively, and 35% and 51% of total revenues from continuing operations for the nine month period ended September 30, 2010 and 2009, respectively.

A substantial portion of the Company's revenues are derived from providing services to BAX/Schenker and the U.S. Military. Revenues from services performed for BAX/Schenker were approximately 29% and 24% of the Company's total revenues from continuing operations for the three months ended September 30, 2010 and 2009, respectively, and 29% and 20% of total revenues from continuing operations for the nine month period ended September 30, 2010 and 2009, respectively. Under their agreements with BAX/Schenker, ATI and CCIA have the right to be the exclusive providers of main deck freighter lift in the BAX/Schenker U.S. network through December 31, 2011. Revenues from services performed for the U.S. Military were approximately 14% and 10% of the Company's total revenues from continuing operations for the three months ended September 30, 2010 and 2009, respectively, and 14% and 10% of total revenues from continuing operations for the nine month period ended September 30, 2010 and 2009, respectively.

NOTE C WIND-DOWN COSTS

As a result of DHL's U.S restructuring plan that was initiated in 2008, the Company has incurred costs to reduce the scope of its operations. Wind-down expenses are reflected in the ACMI Services segment and discontinued operations. The wind-down activity during 2010 is summarized below (in thousands):

| | Severance Benefits | Retention Benefits | Total |
|-------------------------------------|-------------------------------|-------------------------------|--------------|
| Accrued costs at December 31, 2009 | \$ 18,776 | \$ 183 | \$ 18,959 |
| Costs incurred | (114) | 240 | 126 |
| Costs paid | (18,043) | (3) | (18,046) |
| Accrued costs at September 30, 2010 | \$ 619 | \$ 420 | \$ 1,039 |

Wind-down costs estimated to be incurred during the remainder of 2010 are not expected to be significant.

NOTE D DISCONTINUED OPERATIONS

Under a hub services agreement, ABX provided package handling, sorting and other cargo-related services to DHL through August 2009. On July 24, 2009, DHL ceased the sort operations in Wilmington, Ohio and transferred the hub operations to the Cincinnati/Northern Kentucky International Airport (CVG). ABX assisted DHL with the transition from Wilmington to CVG by providing temporary staffing for the CVG operations through early September 2009. In conjunction with the transfer of the aircraft hub operations to CVG in July 2009, DHL assumed management of fueling services for its network previously provided by ABX. ABX ceased providing aircraft fuel and related services for its aircraft that remain in the DHL network. ABX's hub services operations and the aircraft fueling operations are reported as discontinued operations for all periods presented.

ABX sponsors defined benefit plans for retirees that include the former employees of the hub operation. Additionally, ABX is self-insured for medical coverage and workers' compensation. The Company may incur expenses and cash outlays in the future related to pension obligations, reserves for medical expenses and wage loss for former employees. Carrying amounts of significant assets and liabilities of the discontinued operations are below (in thousands):

| | September 30, 2010 | December 31, 2009 |
|-------------------------|-------------------------------|------------------------------|
| Assets | | |
| Receivable due from DHL | \$ | \$ 21,587 |
| Other assets | 8,229 | |

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| | | | | |
|------------------------------------|----|--------|----|--------|
| Total Assets | \$ | 8,229 | \$ | 21,587 |
| Liabilities | | | | |
| Accounts payable | \$ | | \$ | 3 |
| Employee compensation and benefits | | 43,381 | | 48,280 |
| Post-retirement | | 21,069 | | 25,420 |
| Total Liabilities | \$ | 64,450 | \$ | 73,703 |

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The revenues and pre-tax earnings of the discontinued operations are below (in thousands):

| | Three months ended September 30, 2010 | | Nine months ended September 30, 2009 | |
|-------------------------|--|-----------|---|------------|
| Revenue | 11 | \$ 56,673 | 95 | \$ 173,561 |
| Pre-tax earnings (loss) | \$ (362) | \$ 1,390 | \$ (93) | \$ 7,964 |

NOTE E FAIR VALUE MEASUREMENTS

The Company's money market funds and derivative financial instruments are reported on the Company's consolidated balance sheet at fair values based on market values from identical or comparable transactions. The fair value of the Company's money market funds and derivative financial instruments are based on observable inputs (Level 2) from comparable market transactions. The use of quoted prices in active markets for identical assets (Level 1) and 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):

| | Fair Value Measurement Using | | | Total |
|---------------------------------|------------------------------|------------|---------|------------|
| | Level 1 | Level 2 | Level 3 | |
| September 30, 2010 | | | | |
| Assets | | | | |
| Cash equivalents - money market | \$ | \$ 25,867 | \$ | \$ 25,867 |
| Total Assets | \$ | \$ 25,867 | \$ | \$ 25,867 |
| Liabilities | | | | |
| Interest rate swap | \$ | \$ (5,521) | \$ | \$ (5,521) |
| Total Liabilities | \$ | \$ (5,521) | \$ | \$ (5,521) |
| December 31, 2009 | | | | |
| Assets | | | | |
| Cash equivalents - money market | \$ | \$ 63,831 | \$ | \$ 63,831 |
| Total Assets | \$ | \$ 63,831 | \$ | \$ 63,831 |
| Liabilities | | | | |
| Interest rate swap | \$ | \$ (3,715) | \$ | \$ (3,715) |
| Total Liabilities | \$ | \$ (3,715) | \$ | \$ (3,715) |

The carrying amounts for accounts receivable, accounts payable and accrued liabilities approximate fair value. As a result of higher 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 was approximately \$9.6 million less than the carrying value, which was \$313.1 million at September 30, 2010.

NOTE F INCOME TAXES

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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 September 30, 2010 have been estimated utilizing a 37.4% rate based on year-to-date income and projected results for the full year, excluding discrete items. The final effective tax rate to be applied to 2010 will depend on the actual amount of pre-tax book income generated by the Company for the full year.

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The Company files income tax returns in the U.S. federal jurisdiction and various state, local and international jurisdictions. Prior to 2008, ABX and Cargo Holdings International, Inc. (CHI) filed separate consolidated federal tax returns with their respective wholly-owned subsidiaries. The consolidated federal tax returns for the years 2003 through 2006 for ABX and the years 2001 through 2007 for CHI remain open to federal examination by the Internal Revenue Service (IRS) only to the extent of net operating loss carryforwards carried over from or utilized in those years. Effective in 2008, the Company began to file federal tax returns under the new common parent of the consolidated group that includes ABX, CHI and all the wholly-owned subsidiaries. The IRS is currently examining the 2008 federal tax return. All returns related to the new consolidated group remain open to examination by the IRS. State and local returns filed for 2004 through 2009 are generally also open to examination by their respective jurisdictions. As of September 30, 2010, the Company does not have any unrecognized tax positions.

The Company reduced deferred tax assets for post retirement benefits by \$8.0 million in 2010 to reflect the tax effect associated with the changes to the crewmembers post retirement health care benefit plan (see Note J).

During 2010, the Company reduced deferred tax liabilities that had been recorded in 2009 for the partial extinguishment of the promissory note payable to DHL. The Company reduced the deferred tax liabilities and increased paid-in capital by \$9.9 million in 2010 to reflect the original issue discount associated with the extinguished amount of the promissory note. The extinguishment of the promissory note negotiated in 2009 was recorded as a capital transaction due to the related party nature of ABX's relationship with DHL stemming from ABX's separation from Airborne in August 2003.

NOTE G PROPERTY AND EQUIPMENT

At September 30, 2010, the Company's subsidiaries owned or leased under capital leases, 62 aircraft in serviceable condition, consisting of 16 Boeing 767-200 aircraft leased to external customers, two Boeing 757, 12 Boeing 727, 15 McDonnell Douglas DC-8 and 17 Boeing 767-200 aircraft operated by the Company's airlines. As of September 30, 2010, the Company had one aircraft, a Boeing 767-300, with a cost of \$10.2 million undergoing modification to standard freighter configuration. Additionally, at September 30, 2010, the Company had four other Boeing 767-200 and two Boeing 767-300 aircraft which were scheduled to enter into the freighter modification. Property and equipment, to be held and used, consisted of the following (in thousands):

| | September 30, 2010 | December 31, 2009 |
|-------------------------------|-----------------------|----------------------|
| Aircraft and flight equipment | \$ 915,169 | \$ 842,235 |
| Support equipment | 52,603 | 51,903 |
| Vehicles and other equipment | 1,583 | 1,883 |
| Leasehold improvements | 1,277 | 1,255 |
| | 970,632 | 897,276 |
| Accumulated depreciation | (309,644) | (261,187) |
| Property and equipment, net | \$ 660,988 | \$ 636,089 |

Aircraft and flight equipment includes \$22.4 million of property held under capital leases as of September 30, 2010 and \$25.0 million as of December 31, 2009. Accumulated depreciation and amortization includes \$12.6 million as of September 30, 2010 and \$9.2 million as of December 31, 2009 for property held under capital leases. CAM owned aircraft with a carrying value of \$269.7 million and \$61.0 million that were under leases to external customers as of September 30, 2010 and December 31, 2009, respectively.

At September 30, 2010, ACMI Services had three DC-8 airframes whose engines and rotables were being used for other aircraft in the Company's fleets. The spare airframes can be reactivated as needed. The combined carrying value of the idle DC-8 aircraft was \$1.1 million at September 30, 2010.

Aircraft and Engines Held For Sale

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The DHL ACMI agreement granted ABX certain rights to put to DHL any aircraft that was removed from service prior to the expiration of the ACMI. In May 2010, DHL paid the Company \$29.7 million for the carrying value of the five Boeing 767 non-standard freighter aircraft and the 26 DC-9 aircraft previously put to DHL. In conjunction with the termination of the DHL ACMI agreement, effective March 31, 2010, ABX no longer has the right to put aircraft to DHL.

Gains or losses from the sale of aircraft and spare engines are recorded in other operating expenses on the statement of earnings.

Table of Contents**NOTE H DEBT OBLIGATIONS**

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

| | September 30, 2010 | December 31, 2009 |
|---|-----------------------|----------------------|
| Unsubordinated term loan | \$ 183,563 | \$ 200,250 |
| Revolving credit facility | | 18,500 |
| Aircraft loans | 94,047 | 99,759 |
| Capital lease obligations-Boeing 727 | 7,353 | 12,421 |
| Promissory note due to DHL, unsecured | 27,900 | 46,000 |
| Other capital leases | 280 | 497 |
| Total long-term obligations | 313,143 | 377,427 |
| Less: current portion | (36,112) | (51,737) |
| Total long-term obligations, net | \$ 277,031 | \$ 325,690 |

The Company has a credit agreement with a consortium of lenders that provides for a \$75.0 million revolving credit facility and an unsubordinated term loan through December 2012 (Credit Agreement). The unsubordinated term loan and the revolving credit facility are collateralized by substantially all the aircraft, property and equipment owned by the Company that are not collateralized under aircraft loans or capital leases. Under the Credit Agreement, interest rates are adjusted quarterly based on the Company's earnings before interest and taxes and on prevailing LIBOR or prime rates. At September 30, 2010, the unsubordinated term loan bears a variable interest rate of LIBOR (90-day) plus 2.63% (2.92% at September 30, 2010). The Credit Agreement provides for the issuance of letters of credit on the Company's behalf. As of September 30, 2010, the unused revolving credit facility totaled \$60.1 million, net of outstanding letters of credit of \$14.9 million.

The aircraft loans are collateralized by seven aircraft, and fully amortize by 2018 with interest rates ranging from 6.74% to 7.36% per annum, payable monthly. Capital lease obligations for six Boeing 727 aircraft carry a fixed implicit rate of 6.50% and expire between 2010 and 2012.

The promissory note due to DHL becomes due in August 2028 as a balloon payment. Until that time, the promissory note continues to bear interest at a rate of 5% per annum, and DHL will continue to reimburse ABX the interest expense from the note through the term of the DHL CMI agreement. Beginning April 1, 2010 and extending through the term of the DHL CMI agreement, the balance of the note is amortized ratably without payment as revenue, in exchange for services provided and thus is expected to be completely amortized by April 2015.

Under the Credit Agreement, the Company is subject to expenses, covenants and warranties that are usual and customary. The Credit Agreement contains covenants including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness, and the level of annual capital expenditures. The Credit Agreement stipulates events of default, including unspecified events that may have material adverse effects on the Company. If a lender within the Credit Agreement declares a material adverse event (MAE), availability under the revolving credit facility will be reduced by that lender's portion of the facility. Further, the Credit Agreement provides that if lenders having more than half of the outstanding dollar amount of the commitments assert that an MAE exists at the time the Company attempts to borrow under the Credit Agreement, the lenders can assert that an event of default exists under the Credit Agreement and require the lead bank to exercise its remedies. If an event of default occurs, the Company may be forced to repay, renegotiate or replace the Credit Agreement. The conditions of the Credit Agreement and the aircraft loans cross-default. The Company is currently in compliance with the financial covenants specified in the Credit Agreement. The Company is restricted from paying dividends on its common stock in excess of \$50.0 million during any calendar year under the provisions of the Credit Agreement.

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NOTE I COMMITMENTS AND CONTINGENCIES

Leases

The Company leases portions of the air park in Wilmington, Ohio under a lease agreement with a regional port authority, the term of which expires in May of 2019.

Commitments

In September 2008, CAM entered into an agreement with Israel Aerospace Industries Ltd. (IAI) for the conversion of up to fourteen Boeing 767-200 passenger door freighters to a standard freighter configuration. The conversion primarily consists of the installation of a standard cargo door and loading system. Through September 30, 2010, eight such aircraft have completed the modification process. If CAM were to cancel the conversion program as of September 30, 2010, it would owe IAI, in addition to payments for aircraft currently undergoing modification, approximately \$8.0 million associated with additional conversion part kits which have been ordered.

In May 2010, CAM entered into a purchase agreement for three passenger-configured Boeing 767-300 ER aircraft, each equipped with General Electric CF6-80C2-B6 engines. On August 6, 2010, CAM entered into an agreement with M&B Conversions Limited and IAI for the conversion by IAI of the three Boeing 767-300 series passenger aircraft to a full freighter configuration. The agreement includes an option to convert up to seven additional Boeing 767-300 series passenger aircraft during the 10-year term of the agreement. The Company plans to modify the aircraft into standard freighter configurations. If CAM were to cancel the conversion program as of September 30, 2010, it would owe IAI approximately \$2.3 million associated with additional conversion part kits which have been ordered.

In October 2010, CAM entered an agreement with Precision Conversions, LLC (Precision) for the design, engineering and certification of a Boeing 757 combi aircraft variant. The Boeing 757 combi variant to be developed by Precision will incorporate 10 full cargo pallet positions along with passenger seating for up to 58 occupants. CAM is committed to convert at least two Boeing 757 aircraft with Precision.

Guarantees and Indemnifications

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

Department of Transportation (DOT) Continuing Fitness Review

ABX filed a notice of substantial change with the DOT arising from its separation from Airborne, Inc., in August 2003. The filing was initially made in mid-July of 2003 and thereafter updated in April of 2005, September of 2007, December of 2007 and March of 2010 with respect to subsequent events relevant to the DOT's analysis, including the reorganization of ABX under a holding company structure and the acquisition of Cargo Holdings International, Inc. The DOT will determine whether ABX continues to be a U.S. citizen and fit, willing and able to engage in air transportation of cargo. In the event the DOT were to identify any concerns and ABX was unable to address those concerns to the satisfaction of the DOT, the DOT could seek to suspend, modify or revoke ABX's air carrier certificate and other authorizations, and this would materially and adversely affect the business.

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Civil Action Alleging Violations of Immigration Laws

On December 31, 2008, a former ABX employee filed a complaint against ABX, a total of four current and former executives and managers of ABX (the other ABX defendants), Garcia Labor Company of Ohio, and three former executives of the Garcia Labor companies, in the U.S. District Court for the Southern District of Ohio. The case was filed as a putative class action against the defendants, and asserts violations of the Racketeer Influenced and Corrupt Practices Act (RICO). The complaint, which was later amended to include a second former employee plaintiff, seeks damages in an unspecified amount and alleges that the defendants engaged in a scheme to hire illegal immigrant workers to depress the wages paid to hourly wage employees during the period from December 1999 to January 2005. On March 18, 2010, the Court issued a decision in response to a motion filed by ABX and the other ABX defendants, dismissing three of the five claims constituting the basis of plaintiffs' complaint. Most recently, the Court issued a decision on October 7, 2010, permitting the plaintiffs to amend their complaint for the purpose of reinstating one of their dismissed claims. On October 26, 2010, ABX and the other ABX defendants filed an answer denying the allegations contained in plaintiffs' second amended complaint.

The complaint is similar to a prior complaint filed by another former employee in April 2007. The prior complaint was subsequently dismissed without prejudice at the plaintiff's request on November 3, 2008.

FAA Enforcement Actions

The Company's airline operations are subject to complex aviation and transportation laws and regulations that are continually enforced by the DOT and FAA. The Company's airlines receive letters of investigation (LOIs) from the FAA from time to time in the ordinary course of business. The LOIs generally provide that some action of the airline may have been contrary to the FAA's regulations. The airlines respond to the LOIs and if the response is not satisfactory to the FAA, it can seek to impose a civil penalty for the alleged violations. Airlines are entitled to a hearing before an Administrative Law Judge or a Federal District Court Judge, depending on the amount of the penalty being sought, before any penalty order is deemed final.

The FAA issued LOIs to CCIA arising from a focused inspection of that airline's operations during the fourth quarter of 2009 which could result in the FAA seeking monetary penalties against CCIA. ABX also received an LOI from the FAA alleging that ABX failed to comply with an FAA Airworthiness Directive involving its Boeing 767 aircraft and proposing a monetary settlement. The Company believes it has adequately reserved for those monetary penalties being proposed by the FAA, although it is possible that the FAA may propose additional penalties exceeding the amounts currently reserved.

Other

In addition to the foregoing matters, the Company is also currently a party to legal proceedings in various federal and state jurisdictions arising out of the operation of their business. The amount of alleged liability, if any, from these proceedings cannot be determined with certainty; however, the Company believes that their 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 the Company's financial condition or results of operations.

Employees Subject to Collective Bargaining Agreements

As of September 30, 2010, the flight crewmembers of ABX, ATI and CCIA were represented by the labor unions listed below:

| Airline | Labor Agreement Unit | Contract Amendable Date | Percentage of the Company's Employees |
|----------------|--|--------------------------------|--|
| ABX | International Brotherhood of Teamsters | 12/31/2014 | 11.8% |
| ATI | Airline Pilots Association | 5/1/2004 | 10.4% |
| CCIA | Airline Pilots Association | 7/31/2013 | 6.3% |

Table of Contents**NOTE J COMPONENTS OF NET PERIODIC BENEFIT COST**

ABX sponsors a qualified defined benefit pension plan for its flight crewmembers and a qualified defined benefit pension plan for certain of its other employees that meet minimum eligibility requirements. ABX also sponsors non-qualified defined benefit pension plans for certain employees. These non-qualified plans are unfunded. ABX also sponsors a post-retirement healthcare plan, 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 on our post-retirement costs. The Company's net periodic benefit costs for its qualified defined benefit pension and post-retirement healthcare plans for both continuing and discontinued operations are as follows (in thousands):

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|------------------------------------|----------------------------------|-----------|---------------------------------|--------|---------------------------------|-----------|---------------------------------|----------|
| | Pension Plans | | Post-retirement Healthcare Plan | | Pension Plans | | Post-retirement Healthcare Plan | |
| | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 |
| Service cost | \$ | \$ 3,372 | \$ 59 | \$ 163 | \$ 2,286 | \$ 10,312 | \$ 280 | \$ 489 |
| Interest cost | 9,169 | 9,415 | 146 | 427 | 27,508 | 28,278 | 654 | 1,281 |
| Expected return on plan assets | (8,900) | (7,389) | | | (26,700) | (21,598) | | |
| Curtailement loss | | 1,365 | | | | 3,192 | | |
| Amortization of prior service cost | | 486 | (1,250) | | | 1,724 | (2,917) | |
| Amortization of net loss | 517 | 7,142 | 104 | | 1,551 | 22,966 | 259 | |
| Net periodic benefit cost | \$ 786 | \$ 14,391 | \$ (941) | \$ 590 | \$ 4,645 | \$ 44,874 | \$ (1,724) | \$ 1,770 |

During 2009, the Company amended each defined benefit pension plan to freeze the accrual of additional benefits. These freezes took effect on December 31, 2009 and April 1, 2010. During 2010, the Company modified the post-retirement health care plan for crewmembers of ABX. Instead of a life-time benefit, benefits for covered individuals will terminate upon reaching age 65 under the modified post-retirement health care plan. As a result, the Company's liabilities for post-retirement healthcare benefits declined by \$22.0 million and other accumulated comprehensive loss, net of tax effects of \$8.0 million, decreased by \$14.0 million.

During the three and nine month periods ended September 30, 2010, the Company paid \$5.9 million and \$36.4 million of contributions to its defined benefit pension plans, respectively.

NOTE K DERIVATIVE INSTRUMENTS

To reduce the effects of fluctuating LIBOR-based interest rates on interest payments that stem from its variable rate outstanding debt, the Company entered into interest rate swaps having combined original notional values of \$135.0 million in January 2008. The notional values step downward in conjunction with the underlying debt through December 31, 2012. Under the interest rate swap agreements, the Company will pay a fixed rate of 3.105% and receive a floating rate that resets quarterly based on LIBOR. For the outstanding notional value, the Company expects that the amounts received from the floating leg of the interest rate swap will offset fluctuating payments for interest expense because interest rates for its outstanding debt and the interest rate swap are both based on LIBOR and reset quarterly. The Company accounts for the interest rate swaps as cash flow hedges. There is no ineffective portion of the derivatives.

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):

| | |
|-----------------------|----------------------|
| September 30, 2010 | December 31, 2009 |
|-----------------------|----------------------|

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| Expiration Date | Stated Interest Rate | Notional Amount | Market Value (Liability) | Notional Amount | Market Value (Liability) |
|-----------------|----------------------------|--------------------|--------------------------------|--------------------|--------------------------------|
| 12/31/2012 | 3.105% | \$ 70,125 | \$ (3,477) | \$ 76,500 | \$ (2,336) |
| 12/31/2012 | 3.105% | 41,250 | (2,044) | 45,000 | (1,379) |

At September 30, 2010, accumulated other comprehensive loss included unrecognized losses of \$3.3 million, net of income tax, for derivative instruments.

Table of Contents**NOTE L. COMPREHENSIVE INCOME**

Comprehensive income includes the following transactions for the three and nine month periods ended September 30, 2010 and 2009 (in thousands):

| | Three Months Ended September 30, Income | | | Nine Months Ended September 30, Income | | |
|---|--|-----------------------------|---------------|---|-----------------------------|---------------|
| | Before Tax | Tax (Expense) Benefit | Net of Tax | Before Tax | Tax (Expense) Benefit | Net of Tax |
| 2010 | | | | | | |
| Net earnings | | | \$ 11,158 | | | \$ 27,995 |
| Other comprehensive income: | | | | | | |
| Post-retirement liabilities negative prior service cost | \$ | \$ | | \$ 22,014 | \$ (7,991) | 14,023 |
| Unrealized loss on hedge derivatives | (477) | 173 | (304) | (1,806) | 656 | (1,150) |
| Reclassifications to net income: | | | | | | |
| Hedging gain realized in net income | (26) | 9 | (17) | (80) | 29 | (51) |
| Pension actuarial loss | 517 | (188) | 329 | 1,551 | (564) | 987 |
| Post-retirement actuarial loss | 92 | (32) | 60 | 222 | (79) | 143 |
| Post-retirement negative prior service cost | (1,250) | 454 | (796) | (2,917) | 1,059 | (1,858) |
| Total other comprehensive income (loss) | \$ (1,144) | \$ 416 | (728) | \$ 18,984 | \$ (6,890) | 12,094 |
| Comprehensive income | | | \$ 10,430 | | | \$ 40,089 |
| 2009 | | | | | | |
| Net earnings | | | \$ 3,737 | | | \$ 22,941 |
| Other comprehensive income: | | | | | | |
| Actuarial gain for pension liabilities | \$ 18,914 | \$ (6,866) | 12,048 | \$ 37,609 | \$ (13,652) | 23,957 |
| Unrealized gain on marketable securities | | | | | 20 | 20 |
| Unrealized gain on hedge derivatives | (984) | 357 | (627) | 1,176 | (427) | 749 |
| Reclassifications to net income: | | | | | | |
| Hedging gain realized in net income | (28) | 10 | (18) | (86) | 31 | (55) |
| Pension actuarial loss | 7,142 | (2,592) | 4,550 | 22,966 | (8,337) | 14,629 |
| Post-retirement actuarial gain | (14) | 5 | (9) | (40) | 15 | (25) |
| Pension prior service cost | 486 | (177) | 309 | 1,724 | (626) | 1,098 |
| Total other comprehensive income | \$ 25,516 | \$ (9,263) | 16,253 | \$ 63,349 | \$ (22,976) | 40,373 |
| Comprehensive income | | | \$ 19,990 | | | \$ 63,314 |

Table of Contents**NOTE M 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 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 equity or investment capital, depending on the form of award, 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 approximately a six-month vesting period, which will settle when the board member ceases to be a director of the Company. The Company expects to settle all of the stock unit awards by issuing new shares of stock. The table below summarizes award activity.

| | Nine Months Ended September 30, 2010 | | Nine Months Ended September 30, 2009 | |
|------------------------------------|---|--|---|--|
| | Target number of shares | Weighted average grant date value | Target number of shares | Weighted average grant date value |
| Outstanding at beginning of period | 1,505,550 | \$ 3.07 | 1,667,100 | \$ 4.24 |
| Granted | 804,400 | 4.37 | 295,200 | 0.93 |
| Converted | (27,539) | 9.20 | (60,974) | 6.63 |
| Cancelled | (104,611) | 5.33 | (174,426) | 4.98 |
| Outstanding at end of period | 2,177,800 | \$ 3.37 | 1,726,900 | \$ 3.52 |
| Vested | 326,400 | \$ 3.71 | 161,200 | \$ 5.23 |

The grant-date fair value of each performance condition award, non-vested restricted stock award and time-based award granted by the Company in 2010 was \$4.00, the value of the Company's stock on the grant date. The grant-date fair value for each market condition award granted in 2010 was \$5.60. The market condition awards were valued using a Monte Carlo simulation technique, a risk-free interest rate of 1.74%, a term of 36 months, and a volatility of 125.3% based on historical volatility over three years using daily stock prices.

For the nine month periods ended September 30, 2010 and 2009, the Company recorded expense of \$1.2 million and \$1.0 million, respectively, for stock incentive awards. At September 30, 2010, there was \$2.9 million of unrecognized expense related to the stock incentive awards that is expected to be recognized over a weighted-average period of 1.6 years. None of the awards were convertible, and none of the outstanding shares of restricted stock had vested as of September 30, 2010. These awards could result in a maximum number of 2,621,100 additional outstanding shares of the Company's common stock depending on service, performance and market results through December 31, 2012.

Table of Contents**NOTE N EARNINGS PER SHARE**

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2010 | 2009 | 2010 | 2009 |
| Net earnings from continuing operations | \$ 11,388 | \$ 2,855 | \$ 28,053 | \$ 17,890 |
| Weighted average shares outstanding for basic earnings per share | 62,811 | 62,685 | 62,805 | 62,670 |
| Common equivalent shares: | | | | |
| Effect of stock-based compensation awards | 1,391 | 1,046 | 1,271 | 511 |
| Weighted average shares outstanding assuming dilution | 64,202 | 63,731 | 64,076 | 63,181 |
| Basic earnings per share from continuing operations | \$ 0.18 | \$ 0.05 | \$ 0.45 | \$ 0.29 |
| Diluted earnings per share from continuing operations | \$ 0.18 | \$ 0.05 | \$ 0.44 | \$ 0.28 |

The number of equivalent shares that were not included in weighted average shares outstanding assuming dilution, because their effect would have been anti-dilutive, was zero at September 30, 2010 and approximately 14,000 at September 30, 2009.

Table of Contents**NOTE O SEGMENT INFORMATION**

The Company operates in two reportable segments, as described below. The CAM segment consists of the Company's aircraft leasing operations and its segment earnings includes an allocation of interest expense based on aircraft values. The ACMI Services segment consists of the Company's airline operations including the CMI, the ACMI and charter service agreements that the Company provides to customers. The Company's other activities, which include contracts with the USPS, the sale of aircraft parts and maintenance services, management services for workers compensation, logistics services and fuel management, do not constitute reportable segments and are combined in All other with inter-segment profit eliminations. Inter-segment revenues are valued at arms-length, market rates. Cash, cash equivalents and deferred tax assets are reflected in Assets All other below. Beginning in the second quarter of 2010, the Company and DHL terminated the DHL ACMI agreement and executed new follow-on agreements. Due to the similarities among the Company's airline operations, including the new airline service agreement with DHL, the airline operations have been aggregated into a single reportable segment. The segment information has been updated to retrospectively reflect the aggregation of the formerly reported DHL segment with the ACMI Services segment. The Company's segment information for continuing operations is presented below (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|-------------------|-------------------|-------------------|
| | September 30, | | September 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| Total revenues: | | | | |
| CAM Leasing | \$ 28,559 | \$ 16,046 | \$ 71,176 | \$ 43,715 |
| ACMI Services | 142,717 | 160,292 | 428,244 | 534,854 |
| All other | 23,040 | 17,838 | 63,188 | 42,829 |
| Eliminate Inter-segment revenues | (26,590) | (19,974) | (73,827) | (48,425) |
| Total | \$ 167,726 | \$ 174,202 | \$ 488,781 | \$ 572,973 |
| Customer revenues | | | | |
| CAM Leasing | \$ 14,384 | \$ 3,159 | \$ 28,735 | \$ 7,636 |
| ACMI Services | 142,586 | 160,247 | 427,995 | 534,565 |
| All other | 10,756 | 10,796 | 32,051 | 30,772 |
| Total | \$ 167,726 | \$ 174,202 | \$ 488,781 | \$ 572,973 |
| Depreciation and amortization expense: | | | | |
| CAM Leasing | \$ 11,515 | \$ 5,734 | \$ 28,669 | \$ 15,862 |
| ACMI Services | 11,197 | 13,970 | 36,365 | 45,794 |
| All other | 46 | 250 | 276 | 698 |
| Total | \$ 22,758 | \$ 19,954 | \$ 65,310 | \$ 62,354 |
| Segment earnings: | | | | |
| CAM Leasing | \$ 11,991 | \$ 6,115 | \$ 28,282 | \$ 16,696 |
| ACMI Services | 3,448 | 1,003 | 14,918 | 15,278 |
| Net unallocated interest expense | (1,893) | (2,611) | (5,448) | (7,201) |
| All other | 3,124 | 140 | 5,600 | 2,939 |
| Total pretax earnings from continuing operations | \$ 16,670 | \$ 4,647 | \$ 43,352 | \$ 27,712 |

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| | September 30, 2010 | December 31, 2009 |
|-------------------------|-----------------------|----------------------|
| Assets: | | |
| CAM Leasing | \$ 538,092 | \$ 351,172 |
| ACMI Services | 264,540 | 482,976 |
| Discontinued operations | 8,229 | 21,587 |
| All other | 107,481 | 147,038 |
| Total | \$ 918,342 | \$ 1,002,773 |

CAM Leasing's interest expense was \$2.3 million and \$7.2 million for the three and nine month periods ending September 30, 2010, respectively, compared to \$2.3 million and \$7.9 million for the corresponding periods of 2009.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis has been prepared with reference to the historical financial condition and results of operations of Air Transport Services Group, Inc. and its subsidiaries. Air Transport Services Group, Inc. and its subsidiaries may hereinafter individually and collectively be referred to as the Company, we, our or us from time to time. The following discussion and analysis describes the principal factors affecting the results of operations, financial condition, cash flows, liquidity and capital resources. It should be read in conjunction with the accompanying unaudited financial statements and the related notes contained in this report and our Annual Report on Form 10-K for the year ended December 31, 2009.

BACKGROUND

Air Transport Services Group, Inc. (ATSG) is a holding company whose principal subsidiaries include an aircraft leasing company, Cargo Aircraft Management, Inc. (CAM) and three independently certificated airlines, ABX Air, Inc. (ABX), Capital Cargo International Airlines, Inc. (CCIA), and Air Transport International, LLC (ATI). When the context requires, we may also use the terms Company and ATSG in this report to refer to the business of ATSG and its subsidiaries on a consolidated basis.

The Company, through ABX, has had long term contracts with DHL Network Operations (USA), Inc. and its affiliates, which are collectively referred to as DHL, since August 16, 2003. DHL, an international, integrated delivery company, is the Company's largest customer. In March 2010, the Company and DHL executed new follow-on agreements, effective March 31, 2010. The new agreements separate CAM's lease of freighter aircraft to DHL from the maintenance and operation of those aircraft on behalf of DHL. DHL committed to lease 13 Boeing 767 freighter aircraft from CAM and ABX has been contracted to operate those aircraft for DHL under a separate crew, maintenance and insurance (CMI) agreement. The CMI agreement is not based on a cost-plus pricing arrangement, but instead pricing is based on a pre-defined fee, scaled for the number of aircraft operated and the number of flight crews provided to DHL for its U.S. network. The initial term of the CMI agreement is five years, while the term of the aircraft leases are seven years, with early termination provisions. Until CAM completes the aircraft modification process for the 13 aircraft committed to DHL, ABX will operate its own Boeing 767 aircraft as bridging aircraft for DHL under short term, month-to-month arrangements under economic terms similar to those under the lease agreements for the 13 aircraft. Prior to the new, follow-on agreements, ABX provided flight crews, maintenance and aircraft to DHL under an aircraft, crew, maintenance and insurance agreement (DHL ACMI agreement) which compensated ABX on a cost-plus mark-up basis.

The new follow-on agreements with DHL commenced March 31, 2010. Due to the similarities among the Company's airline operations, including the new airline service agreement with DHL, the airline operations have been combined into a single reportable segment. The segment information has been updated to retrospectively reflect the aggregation of the former DHL segment with the ACMI Services segment.

Table of Contents**SEGMENTS**

The Company has two reportable segments: CAM Leasing and ACMI Services which are discussed below. A summary of our revenues and segment earnings from continuing operations is shown below (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-------------------|------------------------------------|-------------------|
| | 2010 | 2009 | 2010 | 2009 |
| Revenues: | | | | |
| CAM Leasing | \$ 28,559 | \$ 16,046 | \$ 71,176 | \$ 43,715 |
| ACMI Services | | | | |
| Airline services | 102,366 | 127,349 | 325,826 | 425,205 |
| Reimbursable expenses | 40,351 | 32,943 | 102,418 | 109,649 |
| Total ACMI Services | 142,717 | 160,292 | 428,244 | 534,854 |
| Other Activities | 23,040 | 17,838 | 63,188 | 42,829 |
| Total Revenues | 194,316 | 194,176 | 562,608 | 621,398 |
| Eliminate internal revenues | (26,590) | (19,974) | (73,827) | (48,425) |
| Customer Revenues | \$ 167,726 | \$ 174,202 | \$ 488,781 | \$ 572,973 |
| Pre-tax Earnings from Continuing Operations: | | | | |
| CAM, inclusive of interest expense | \$ 11,991 | \$ 6,115 | \$ 28,282 | \$ 16,696 |
| ACMI Services | 3,448 | 1,003 | 14,918 | 15,278 |
| Other Activities | 3,124 | 140 | 5,600 | 2,939 |
| Net, unallocated interest expense | (1,893) | (2,611) | (5,448) | (7,201) |
| Total Pre-tax Earnings | \$ 16,670 | \$ 4,647 | \$ 43,352 | \$ 27,712 |

CAM Leasing

Since September 30, 2009, CAM has completed the modification of eight Boeing 767-200 aircraft into standard cargo configuration and acquired eight other Boeing 767-200 aircraft in standard cargo configuration from ABX. CAM had 56 aircraft that were under lease as of September 30, 2010, 40 of them to ABX, ATI and CCIA.

CAM's revenues for the third quarter and first nine months of 2010 included \$14.4 million and \$28.7 million, respectively, for the leasing of aircraft and related services to external customers, compared to \$3.2 million and \$7.6 million for the corresponding periods in 2009. In April 2010, as part of the follow-on agreements with DHL, CAM placed seven Boeing 767-200 aircraft under lease with DHL. By the end of the third quarter of 2010, CAM leased four more Boeing 767-200 aircraft to DHL. At this time, CAM does not have all 13 Boeing 767 freighter aircraft available for lease to DHL. Accordingly, ABX is operating its aircraft for DHL under short term, month-to-month bridging arrangements with economic terms similar to the leases for the 13 aircraft until CAM completes the aircraft modification process in 2011 for the remaining two Boeing 767-200 aircraft committed to DHL. In addition to the eleven leases with DHL in 2010, CAM placed two Boeing 767-200 aircraft under lease to a Florida based operator in February 2010 and in July 2010, bringing the total number of external aircraft leases to 16.

Pre-tax segment earnings from CAM were \$12.0 million and \$28.3 million for the third quarter and first nine months of 2010, respectively, compared to \$6.1 million and \$16.7 million for the corresponding periods of 2009. The increase in pre-tax earnings reflects sixteen additional aircraft that CAM has placed in service since September 30, 2009. CAM's results reflect an allocation of overhead expenses and interest expense based on the Company's external interest rates and the carrying value of its operating assets. CAM's interest expense was \$2.3 million and \$7.2 million for the third quarter and first nine months of 2010, respectively, compared to \$2.3 million and \$7.9 million for the corresponding periods of 2009.

Table of Contents**ACMI Services**

Through its three airline subsidiaries, the Company provides airlift to other airlines, freight forwarders and the U.S. Military. In addition to DHL, BAX Global, Inc. (BAX/Schenker) is a significant customer with airline operating agreements with CCIA and ATI. At September 30, 2010, ACMI Services included 45 in-service aircraft which the Company owned or operated under capital leases. Additionally, ACMI Services included the operation of eleven freighter aircraft by ABX for DHL under the CMI agreement during the third quarter of 2010. During the third quarter of 2010, ATI leased its third Boeing 767-200 cargo aircraft while CCIA redeployed two of its leased Boeing 727 aircraft that had been temporarily unassigned. ABX returned one of its leased Boeing 767-200 s to CAM, who released the aircraft to an external customer under a seven year agreement.

ACMI Services revenues were \$142.7 million and \$428.2 million during the third quarter and first nine months of 2010, respectively, declining \$17.6 million and \$106.6 million for the corresponding periods in 2009. Revenues generated from DHL s U.S. network declined \$33.2 million and \$155.7 million compared to the third quarter and first nine months of 2009, when those revenues included the reimbursement of employee severance and retention benefits, the reimbursement of aircraft depreciation expense and compensation for a larger U.S. network capacity from DHL. Under a severance and retention agreement (S&R agreement) which was terminated on March 31, 2010, DHL was obligated to reimburse ABX for the cost of employee severance, retention, productivity bonuses and vacation benefits paid in accordance with the agreement. The reduction in revenues includes a reduction in the reimbursement of severance and retention benefits since 2009 when ABX experienced significant employee terminations. The decline in DHL revenues was partially offset by increased block hours flown for customers in Europe, Asia Pacific and the Caribbean. Block hours increased 6% and 8% to 23,108 hours and 67,268 hours during the third quarter and first nine months of 2010 compared to 2009. ACMI Services revenues also included additional crews that ABX added during the third quarter of 2010 to prepare for additional customer aircraft operations scheduled to begin in October of 2010. ACMI Services results included revenues of \$2.3 million and \$10.4 million from bridging aircraft that ABX supplied to DHL during the third quarter and first nine months of 2010, respectively, compared to \$3.8 million and \$8.2 million for aircraft supplied to DHL under short-term supplemental agreements during the corresponding periods in 2009.

The pre-tax earnings for ACMI Services were \$3.4 million for the third quarter of 2010, compared to pre-tax earnings of \$1.0 million during the same period of 2009. Higher pre-tax earnings reflect improved profits from ABX s transatlantic operation for TNT Airways SA and increased block hours. In January 2010, ABX terminated a scheduled transatlantic service and replaced that block space agreement with a conventional ACMI agreement which contributed positively to the segment s earnings during 2010. These improvements were partially offset by increased crew training costs, lower performance incentive revenues and higher aircraft maintenance expenses among the ATSG airlines during the third quarter of 2010. Maintenance expense not specifically reimbursed under contractual provisions increased approximately \$3.3 million during the third quarter of 2010 compared to the same period of 2009. Non-reimbursed maintenance expenses increased due to premature engine and component failures as well as extra planned maintenance tasks with the intent of improving aircraft performance for future periods. Management expects the Boeing 727 and Boeing 757 aircraft to perform more reliably over the coming months as a result of the additional maintenance tasks performed during the third quarter of 2010. The costs of training flight crews increased in the third quarter of 2010 as CCIA redeployed two Boeing 727 aircraft that were temporarily unassigned and ATI added a third Boeing 767 aircraft and prepared to add a DC-8 for BAX/Schenker in the fourth quarter of 2010.

The pre-tax earnings for ACMI Services were \$14.9 million for first nine months of 2010, compared to pre-tax earnings of \$15.3 million during the corresponding period of 2009. Lower pre-tax earnings for 2010 reflect the changes in the DHL contractual arrangements, higher aircraft maintenance costs in the third quarter and increased operating expenses for the BAX/Schenker network, offset by the improved results from ABX s transatlantic operation. Pretax earnings for the first nine months of 2010 included \$3.5 million related to vacation earned as a result of the S&R agreement with DHL compared to \$4.5 million in the first nine months of 2009. (The S&R agreement was terminated in March 2010.) CCIA s Boeing 727 aircraft scheduled in the BAX/Schenker network have been assigned to operate on a greater number of multi-stop routes than during 2009, which negatively impacted reliability and increased the costs of operating those aircraft.

Beginning in November 2010, ABX expects to begin leasing a Boeing 767-300 aircraft from an external lessor for a 45 month period. ABX has an ACMI agreement to operate the aircraft for DHL on a transatlantic flight beginning in November 2010. Also in November 2010, ABX began to operate one of its Boeing 767-200 aircraft in Asia under an agreement with Japan Airlines International Co., Ltd. and DHL. Additionally, during October 2010, ABX began to operate one additional Boeing 767 aircraft that is owned by DHL. DHL has requested ABX to operate two additional DHL-owned Boeing 767-200 aircraft beginning in the first quarter of 2011 and we anticipate that DHL will request ABX to operate a fourth DHL-owned Boeing 767-200 aircraft in 2011. Each DHL-owned aircraft will generate a pre-negotiated monthly service fee.

Table of Contents*Aircraft Fleet*

The Company's aircraft fleet is summarized below as of September 30, 2010 (\$ in thousands).

| | ACMI Services | CAM Leasing (External) | Total |
|--|------------------|------------------------------|------------|
| In-service aircraft | | | |
| Aircraft owned or under capital lease | | | |
| Boeing 767-200 | 16 | 17 | 33 |
| Boeing 757 | 2 | | 2 |
| Boeing 727 | 12 | | 12 |
| DC-8 | 15 | | 15 |
| Total | 45 | 17 | 62 |
| Carrying value | | | \$ 572,992 |
| Operating lease | | | |
| Boeing 727 | 1 | | 1 |
| Aircraft in freighter modification | | | |
| Boeing 767-300 | | 1 | 1 |
| Carrying value | | | \$ 10,177 |
| Idle aircraft (not scheduled for revenue) | | | |
| Aircraft owned or under capital lease | | | |
| DC-8 | 3 | | 3 |
| Boeing 767-200 | | 4 | 4 |
| Boeing 767-300 | | 2 | 2 |
| Carrying value | | | \$ 28,268 |

At September 30, 2010, ACMI Services had three DC-8 airframes whose engines and rotables were being used for other aircraft in the Company's fleets. The spare airframes can be reactivated as needed. At September 30, 2010, CAM has four Boeing 767-200 aircraft and two Boeing 767-300 aircraft that were not in service, but are scheduled to enter the freighter modification process.

Table of Contents**Other Activities**

Through separate subsidiaries, the Company sells aircraft parts and provides aircraft maintenance and modification services to other airlines. The Company also operates three U.S. Postal Service (USPS) sorting facilities. The Company provides equipment leasing and facility maintenance, as well as specialized services for aircraft fuel management and freight logistics. Other activities also include the management of workers compensation claims under an agreement with DHL and gains from the reduction to employee post retirement obligations. These other business activities do not constitute reportable segments. Prior to April 1, 2010, other activities included an allocation of ABX 's overhead expenses that could not be charged to DHL under the former cost-plus agreements. In September and October of 2010, the USPS renewed the Company 's operating agreements for each of the three sorting facilities. The renewed agreements were extended through September and October 2012 at substantially the same terms.

External customer revenues from all other activities remained even and increased \$1.3 million in the third quarter and first nine months of 2010, respectively, compared to the corresponding periods in 2009. Increased revenues were primarily a result of an increase in aircraft and facility maintenance services when compared to 2009.

The pre-tax earnings from all other activities were \$3.1 million and \$5.6 million for the third quarter and first nine months of 2010, respectively, compared to \$0.1 million and \$2.9 million for the corresponding periods of 2009. The increase in pre-tax earnings of \$3.0 million for the third quarter of 2010 reflects increased revenues from aircraft maintenance and modification services, gains from the reduction to employee post retirement obligations and lower overhead costs compared to the third quarter of 2009. Pre-tax earnings for the first nine months of 2010 increased by \$2.7 million compared to the corresponding 2009 period, which included additional gains from the sale of spare aircraft and engines which were not as significant in 2010.

Discontinued Operations

Pre-tax results from discontinued DHL operations were a \$0.4 million loss and a \$0.1 million loss during the third quarter and first nine months of 2010, respectively, compared to earnings of \$1.4 million and \$8.0 million for the corresponding periods of 2009. The declines reflect the discontinuance of sorting operations for DHL in the third quarter of 2009. Pre-tax earnings from the discontinued DHL operations for the third quarter and first nine months of 2009 were \$1.4 million and \$5.4 million, respectively, from contractual cost mark-ups. Pre-tax earnings for the first quarter of 2009 included \$2.6 million for the reimbursement from DHL of employee vacation benefits that ABX paid to terminated employees under the S&R agreement. During 2010, ABX has provided certain transitional services to DHL which are expected to cease before the end of 2010. Pre-tax earnings from the discontinued DHL operations for the first nine months of 2010 included \$0.6 million from the reimbursement from DHL of employee vacation benefits. The costs of discontinued operations for the first nine months of 2010 also included pension expenses for former employees that supported the sorting operations and medical costs in excess of initially estimated accruals for former employees under severance benefit plans or COBRA.

RESULTS OF OPERATIONS

Consolidated net earnings from continuing operations increased \$8.5 million and \$10.2 million for the third quarter and first nine months of 2010, respectively, compared to the corresponding periods of 2009. Improved earnings were driven by CAM Leasing. CAM Leasing 's pre-tax earnings increased by \$5.9 million and \$11.6 million during the third quarter and first nine months of 2010, respectively, compared to the corresponding 2009 periods, reflecting the lease of thirteen additional Boeing 767 aircraft to external lessees since September 2009, including eleven aircraft leases initiated with DHL since March 2010. Pre-tax earnings from ACMI Services improved by \$2.4 million for the third quarter of 2010 and declined by \$0.4 million for the first nine months of 2010, respectively, compared to the corresponding periods of 2009. The increased ACMI Services results for the third quarter were a result of additional block hours and the improvement of ABX 's transatlantic operation for TNT Airways S.A. which was restructured as a conventional ACMI agreement in early 2010. The decline in ACMI Services for the first nine months of 2010 compared to 2009, reflects the shift of revenues to CAM for DHL aircraft leases starting April 1, 2010, higher aircraft maintenance expenses and a reduction of \$1.0 million in earnings for the first quarter of 2010 from the S&R agreement, offset by the improved profitability of the transatlantic operations.

Salaries, wages and benefits expense decreased 45% and 50% during the three and nine month periods ended September 30, 2010, respectively, compared to the corresponding periods of 2009. During the first quarter of 2009, this expense line included significant amounts for employee severance and retention benefits. Due primarily to the DHL restructuring, headcount, excluding headcount associated with discontinued operations, declined approximately 21% as of September 30, 2010 compared to March 31, 2009.

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Fuel expense increased \$6.7 million and \$22.6 million during the three and nine month periods ended September 30, 2010, respectively, compared to the corresponding periods of 2009. The increase reflects the increase in the average price of aviation fuel compared to the third quarter and first nine months of 2009. The average price of a gallon of aviation fuel increased 28% and 35% in the third quarter and first nine months of 2010, respectively, compared to the corresponding periods of 2009.

Maintenance, materials and repairs increased \$7.2 million and \$8.8 million during the three and nine month periods ended September 30, 2010, respectively, compared to the corresponding periods of 2009. The increase in maintenance expense included an increase in aircraft C-check expenses during 2010 compared to 2009 of \$4.1 million and \$5.8 million for the three and nine month periods ended September 30, 2010, respectively. These C-check expenses were reimbursed to ABX by DHL under the CMI and former ACMI agreements. The increase in maintenance expenses for the third quarter of 2010 also includes additional aircraft maintenance procedures by CCIA with the intent of improving the recent on-time reliability level of the Boeing 727 and Boeing 757 aircraft. The increase in maintenance expenses also reflects the increased cost to support the growth in block hours flown since the corresponding periods of 2009 and the higher maintenance cost for Boeing 727 aircraft operating in the BAX/Schenker network. CCIA's Boeing 727 aircraft scheduled in the BAX/Schenker network have been assigned to operate on a greater number of multi-stop routes compared to 2009, which negatively impacted reliability and increased the costs of operating those aircraft.

Depreciation and amortization expense increased \$2.8 million and \$3.0 million during the three and nine month periods ended September 30, 2010, respectively, compared to the corresponding periods of 2009. Depreciation expense increased primarily due to the deployment of eight modified Boeing 767-200 aircraft since September of 2009.

Landing and ramp expense, which includes the cost of deicing chemicals, decreased \$0.4 million and \$5.0 million during the three and nine month periods ended September 30, 2010, respectively, compared to the corresponding periods of 2009. The decrease is a result of DHL's removal of aircraft from service in conjunction with its U.S. restructuring plan during the first quarter of 2009.

Travel expense increased \$0.1 million and \$0.5 million during the three and nine month periods ended September 30, 2010, respectively, compared to the corresponding periods of 2009. The increase is a result of additional crew training and increased block hours, particularly in the Europe and Asia-Pacific regions.

Rent expense from continuing operations increased \$2.3 million and \$5.2 million during the three and nine month periods ended September 30, 2010, respectively, compared to the corresponding periods of 2009. The increase reflects a change in the allocation of expense for the Wilmington, Ohio facility due to the closure of the sorting operations in July 2009, and an increase in the rental rates for the Wilmington facility in conjunction with a new lease agreement for the facility executed with a regional port authority in May 2010.

Insurance expense decreased \$0.6 million and \$1.2 million during the three and nine month periods ended September 30, 2010, respectively, compared to the corresponding periods of 2009. The decline in insurance expense primarily reflects the transition to a Company-insured employee medical coverage plan from a third party insurance plan for certain employee groups. Company insured medical expenses are recorded in salaries, wages and benefits.

Other operating expenses include professional fees, utilities, the cost of parts sold to customers and gains from the sale of aircraft and spare engines. Other operating expenses decreased \$1.9 million for the third quarter of 2010 compared to the third quarter of 2009 due to a lower volume of parts sales and a lower level of external professional fees incurred since 2009 to support the DHL wind-down. For the nine month periods ended September 30, 2010 and 2009, respectively, other operating expenses remained unchanged. The declines in cost of parts sold and professional fees incurred during 2010 were offset by declines in gains from the sale and disposal of spare equipment compared to the 2009 periods.

Interest expense decreased \$1.6 million and \$6.6 million during the three and nine month periods ended September 30, 2010, respectively, compared to the corresponding periods of 2009. The decline in interest expense reflects the reduction in the Company's debt since March 2009 and lower interest rates. Interest rates on the Company's variable interest, unsubordinated term loan decreased from 4.2% in the first quarter of 2009 to 2.9% for the third quarter of 2010, while interest bearing debt decreased \$92.8 million since September 30, 2009.

Interest income remained even and decreased \$0.1 million during the three and nine month periods ended September 30, 2010, respectively, compared to the corresponding periods of 2009 due to lower short-term interest rates on our cash and cash equivalents.

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The effective tax rate for continuing operations for the three and nine month periods ended September 30, 2010 was 31.7% and 35.3%, respectively, compared to 38.6% and 35.4% for the corresponding periods in 2009. The effective tax rate for the three months ended September 30, 2010 was reduced by the recording of a deferred tax benefit related to a previously unrecognized tax position under the Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 740-10 Income Taxes. The expiration of the statute of limitations for this item resulted in a deferred tax benefit of \$0.4 million in the third quarter of 2010. Income taxes recorded through September 30, 2010 have been estimated based on year-to-date income and projected results for the full year, excluding discrete items. The effective tax rate for 2010 is projected to be approximately 35.9%.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES
Cash flows

Net cash generated from operating activities was \$81.7 million for the first nine months of 2010 compared to \$49.5 million in the first nine months of 2009. The increase in operating cash flows was primarily driven by the collection of receivables due from DHL.

In conjunction with the termination of the former operating agreements, DHL settled the open amounts that were payable to ABX. In April 2010, DHL reimbursed ABX for \$11.2 million of accrued vacation payments which ABX had previously paid to terminated employees. Additionally, in May 2010, DHL paid ABX its carrying value of \$29.7 million to complete the sale of aircraft that ABX previously put to DHL under provisions of the DHL ACMI agreement. We contributed \$36.4 million to our pension plans in the first nine months of 2010, including \$25.0 million contributed to the ABX flight crew member pension trust in conjunction with amending the ABX pilot collective bargaining agreement. We plan to contribute \$0.1 million more to ABX's qualified defined benefit pension plans during the remainder of 2010.

Capital spending levels are primarily a result of aircraft modification costs for Boeing 767 aircraft. Cash payments for capital expenditures were \$90.7 million in the first nine months of 2010 compared to \$49.9 million in the first nine months of 2009. Capital expenditures in 2010 included acquisition and cargo modification costs for eight aircraft compared to six aircraft during the first nine months of 2009. Our capital expenditures for 2010 included \$65.2 million for aircraft modifications and acquisitions, \$22.0 million for required heavy maintenance and \$3.5 million for other equipment costs. We estimate the total level of capital spending for all of 2010 will be approximately \$114 million compared to \$101 million in 2009. Our estimated 2010 capital spending has been increased from \$102 million projected in our 2009 Form 10-K to reflect the Company's acquisition and partial freighter conversion of three Boeing 767-300 aircraft. Actual capital spending for any future period will be impacted by progress in the aircraft modification process.

During the first nine months of 2010, the Company made principal payments of \$61.2 million, including \$18.5 million to pay down the outstanding balance of the revolving credit facility and \$15.0 million to DHL toward the balance of the promissory note with DHL, as previously agreed.

Commitments

In September 2008, CAM contracted with an aircraft maintenance and modification provider, IAI, to convert up to 14 Boeing 767-200 aircraft from passenger door loading systems to a standard freighter configuration. Through September 30, 2010, eight such aircraft have been converted. CAM has the right to convert up to six more Boeing 767-200 aircraft at IAI. If CAM were to cancel the conversion program as of September 30, 2010, it would owe IAI, approximately \$8.0 million associated with additional conversion part kits which have been ordered.

In May 2010, CAM entered into a purchase agreement for three passenger-configured Boeing 767-300 ER aircraft, each equipped with General Electric CF6-80C2-B6 engines. We plan to modify these aircraft into standard freighter configuration. On August 6, 2010, CAM entered into an agreement with M&B Conversions Limited and IAI for the conversion by IAI of the three Boeing 767-300 passenger aircraft. The agreement includes an option to convert up to seven additional Boeing 767-300 series passenger aircraft during the 10-year term of the agreement. When converted into standard freighters, the Boeing 767-300's are expected to have a range of approximately 3,255 nautical miles, and a maximum payload of approximately 120,000 pounds. If CAM were to cancel the conversion program as of September 30, 2010, it would owe IAI approximately \$2.3 million associated with additional conversion part kits which have been ordered.

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In October 2010, CAM entered an agreement with Precision Conversions, LLC (Precision) for the design, engineering and certification of a Boeing 757 combi aircraft variant. The Boeing 757 combi variant to be developed by Precision will incorporate 10 full cargo pallet positions along with passenger seating for up to 58 occupants. The Boeing 757 combi is intended to strategically position CAM to provide next-generation combi aircraft to complement and eventually replace, the four DC-8 combi aircraft CAM currently leases to ATI. CAM is committed to convert at least two Boeing 757 aircraft.

We estimate that over the next 15 month period ending December 31, 2011, capital expenditures for aircraft acquisitions and modifications could total \$160 million to \$190 million to complete six Boeing 767-200 aircraft, three Boeing 767-300 aircraft and two or three Boeing 757 aircraft. Actual capital spending for any future period will be impacted by the number of aircraft we decide to modify and the progress in the aircraft modification process. We expect to finance the aircraft purchases and modifications from current cash balances, future operating cash flow and existing credit facilities.

Liquidity and Capital Resources

At September 30, 2010, the Company had approximately \$44.5 million of cash balances. The Company had \$60.1 million of unused credit facility, net of outstanding letters of credit of \$14.9 million, through a syndicated Credit Agreement that expires in December 2012. As of September 30, 2010, DHL owes the Company \$13.9 million. Additionally, DHL is scheduled make two separate prepayments of \$11.4 million in March of 2011 and 2012. Beginning April 1, 2010 and extending through the term of the DHL CMI agreement, the \$27.9 million balance of the unsecured note payable to DHL is extinguished ratably without payment. We believe that the Company's current cash balances and forecasted cash flows provided from its operating agreements, combined with its credit facility, will be sufficient to fund operations, scheduled debt payments, required pension funding and planned capital expenditures.

Table of Contents**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as certain disclosures included elsewhere in this report, are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to select appropriate accounting policies and make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingencies. In certain cases, there are alternative policies or estimation techniques which could be selected. On an ongoing basis, we evaluate our selection of policies and the estimation techniques we use, including those related to revenue recognition, post-retirement liabilities, bad debts, self-insurance reserves, accruals for labor contract settlements, valuation of spare parts inventory, useful lives, salvage values and impairment of property and equipment, income taxes, contingencies and litigation. We base our estimates on historical experience, current conditions and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources, as well as for identifying and assessing our accounting treatment with respect to commitments and contingencies. Actual results may differ from these estimates under different assumptions or conditions. We believe the following significant and critical accounting policies involve the more significant judgments and estimates used in preparing the consolidated financial statements.

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 from charter service agreements are recognized on scheduled and non-scheduled flights when the specific flight has been completed. Aircraft parts and fuel sales are recognized when the parts and fuel 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 transporting freight and sorting parcels are recognized upon delivery of shipments and completion of services. Aircraft lease revenues are recognized as operating lease revenue on a straight-line basis over the term of the applicable lease agreements.

The Company's revenues for 2009 and the first quarter of 2010 included reimbursement for expenses incurred under the former DHL ACMI agreement, the incremental mark-up revenues set by the DHL ACMI amendments and reimbursement for employee severance, retention, vacation and other benefit costs incurred during the period. Revenues from the former DHL ACMI agreement were generally determined based on expenses incurred during a period plus mark-ups and were recognized when the related services were performed. ABX and DHL amended the ACMI agreement to set mark-ups to specific quarterly amounts for 2009 and the first quarter of 2010. In 2008, ABX and DHL executed a severance and retention agreement ("S&R agreement") which specified employee severance, retention and other benefits that DHL reimbursed to ABX for payment to its employees that were affected in conjunction with DHL's U.S. restructuring plan. DHL was obligated to reimburse ABX for the cost of employee severance, retention, productivity bonuses and vacation benefits paid in accordance with the agreement.

Goodwill and Intangible Assets

In accordance with the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") Topic 350-20 *Intangibles Goodwill and Other*, we will assess on an annual basis whether goodwill is impaired. Additional impairment assessments may be performed on an interim basis if we find it necessary. Finite-lived intangible assets are amortized over their estimated useful economic lives and are periodically reviewed for impairment. Indefinite-lived intangible assets are not amortized but are assessed for impairment annually.

Depreciation

Depreciation of property and equipment is provided on a straight-line basis over the lesser of the asset's useful life or lease term. We periodically evaluate the estimated service lives and residual values used to depreciate our property and equipment. The acceleration of depreciation expense or the recording of significant impairment losses could result from changes in the estimated useful lives of our assets. We may change the estimated useful lives due to a number of reasons, such as the existence of excess capacity in our customers' air networks or changes in regulations grounding or limiting the use of aircraft.

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Self-Insurance

We self-insure certain claims related to workers compensation, aircraft, automobile, general liability and employee healthcare. We record 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, recent claims trends and, in the case of employee healthcare and workers compensation, an independent actuarial evaluation. Changes in claim severity and frequency could result in actual claims being materially different than the costs provided for in our results of operations. We maintain excess claim coverage with common insurance carriers to mitigate our exposure to large claim losses.

Contingencies

We are involved in legal matters that have a degree of uncertainty associated with them. We continually assess the likely outcomes of these matters and the adequacy of amounts, if any, provided for these matters. There can be no assurance that the ultimate outcome of these matters will not differ materially from our assessment of them. There also can be no assurance that we know all matters that may be brought against us at any point in time.

Income Taxes

We account for income taxes under the provisions of FASB ASC Topic 740-10 *Income Taxes*. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Fluctuations in the actual outcome of expected future tax consequences could materially impact the Company's financial position or its results of operations.

The Company has significant deferred tax assets including net operating loss carryforwards (NOL CFs) for federal income tax purposes which begin to expire in 2024. Based upon projections of taxable income, we determined that it was more likely than not that all the net deferred tax assets, including the NOL CF s will be realized prior to their expiration. Accordingly, we do not have an allowance against deferred tax assets related to federal income taxes at this time.

We recognize the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position.

Post-retirement Obligations

ABX sponsors qualified defined benefit plans for its pilots and other eligible employees. ABX also sponsors unfunded post-retirement healthcare plans for its flight crewmembers and non-flight crewmember employees. ABX also sponsors unfunded excess plans for certain employees in a non-qualified plan, which includes its executive management, that provide benefits in addition to amounts permitted to be paid under provisions of the tax law to participants in its qualified plans. The Company amended each defined benefit pension plan to freeze the accrual of additional benefits.

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 on our post-retirement costs. In actuarially valuing our pension obligations and determining related expense amounts, assumptions we consider most sensitive are discount rates and expected long-term investment returns on plan assets. Additionally, other assumptions concerning retirement ages, and mortality also affect the valuations. For our post-retirement healthcare plans, consideration of future medical cost trend rates is a critical assumption in valuing these obligations. Actual results and future changes in these assumptions could result in future costs significantly higher than those recorded in our results of operations.

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Discontinued Operations

In accordance with the guidance of FASB ASC Topic 205-20 *Presentation of Financial Statements*, a business component whose operations are discontinued is reported as discontinued operations if the cash flows of the component have been eliminated from the ongoing operations of the Company and the Company will no longer have any significant continuing involvement in the business component. The results of discontinued operations are aggregated and presented separately in the consolidated statement of operations. FASB ASC Topic 205-20 requires the reclassification of amounts presented for prior years to reflect their classification as discontinued operations.

Exit Activities

We account for the costs associated with exit activities in accordance with FASB ASC Topic 420-10 *Exit or Disposal Cost Obligations*. One-time, involuntary employee termination benefits are generally expensed when the Company communicates the benefit arrangement to the employee that it will no longer require the services of the employee beyond a minimum retention period. Liabilities for contract termination costs associated with exit activities are recognized in the period incurred and measured initially at fair value. Pension obligations are accounted for in accordance with FASB ASC Topic 715-30 *Compensation - Retirement Benefits* in the event that the expected working life of employees is significantly reduced due to terminations or a pension plan is suspended.

Recent Accounting Pronouncements

See Note A to our Financial Statements for a discussion of new accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company is exposed to market risk for changes in interest rates and changes in the price of jet fuel. The risk associated with jet fuel, however, is largely mitigated by reimbursement through the agreements with our customers. To reduce the exposure to rising interest rates, we entered into interest rate swaps in January 2008. See Note K of the accompanying financial statements for discussion of our accounting treatment for these hedging transactions.

No significant changes have occurred to the market risks we face since we disclosed information about those risks in item 7A of the Company's 2009 Annual Report on Form 10-K filed for the year ended December 31, 2009.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

As of September 30, 2010, the Company carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based upon the evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that their disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports filed or submitted by it under the Exchange Act is recorded, processed, summarized and reported within time periods specified in the Securities and Exchange Commission rules and forms.

(b) Changes in Internal Controls

There were no changes in internal control over financial reporting during the most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Department of Transportation (DOT) Continuing Fitness Review

ABX filed a notice of substantial change with the DOT arising from its separation from Airborne, Inc., in August of 2003. The filing was initially made in mid-July of 2003 and thereafter updated in April of 2005, September of 2007, December of 2007 and March of 2010 with respect to subsequent events relevant to the DOT's analysis, including the reorganization of ABX under a holding company structure and the acquisition of Cargo Holdings International, Inc. The DOT will determine whether ABX continues to be a U.S. citizen and fit, willing and able to engage in air transportation of cargo. In the event the DOT were to identify any concerns and ABX was unable to address those concerns to the satisfaction of the DOT, the DOT could seek to suspend, modify or revoke ABX's carrier certificate and other authorizations, and this would materially and adversely affect the business.

Civil Action Alleging Violations of Immigration Laws

On December 31, 2008, a former ABX employee filed a complaint against ABX, a total of four current and former executives and managers of ABX (the other ABX defendants), Garcia Labor Company of Ohio, and three former executives of the Garcia Labor companies, in the U.S. District Court for the Southern District of Ohio. The case was filed as a putative class action against the defendants, and asserts violations of the Racketeer Influenced and Corrupt Practices Act (RICO). The complaint, which was later amended to include a second former employee plaintiff, seeks damages in an unspecified amount and alleges that the defendants engaged in a scheme to hire illegal immigrant workers to depress the wages paid to hourly wage employees during the period from December 1999 to January 2005. On March 18, 2010, the Court issued a decision in response to a motion filed by ABX and the other ABX defendants, dismissing three of the five claims constituting the basis of Plaintiffs' complaint. Most recently, the Court issued a decision on October 7, 2010, permitting the plaintiffs to amend their complaint for the purpose of reinstating one of their dismissed claims. On October 26, 2010, ABX and the other ABX defendants filed an answer denying the allegations contained in plaintiffs' second amended complaint.

The complaint is similar to a prior complaint filed by another former employee in April 2007. The prior complaint was subsequently dismissed without prejudice at the plaintiff's request on November 3, 2008.

FAA Enforcement Actions

The Company's airline operations are subject to complex aviation and transportation laws and regulations that are continually enforced by the DOT and FAA. The Company's airlines receive letters of investigation (LOIs) from the FAA from time to time in the ordinary course of business. The LOIs generally provide that some action of the airline may have been contrary to the FAA's regulations. The airlines respond to the LOIs and if the response is not satisfactory to the FAA, it can seek to impose a civil penalty for the alleged violations. Airlines are entitled to a hearing before an Administrative Law Judge or a Federal District Court Judge, depending on the amount of the penalty being sought, before any penalty order is deemed final.

The FAA issued LOIs to CCIA arising from a focused inspection of that airline's operations during the fourth quarter of 2009 which could result in the FAA seeking monetary penalties against CCIA. ABX received an LOI from the FAA alleging that ABX failed to comply with an FAA Airworthiness Directive involving its Boeing 767 aircraft and proposing a monetary settlement. The Company believes it has adequately reserved for those monetary penalties being proposed by the FAA, although it is possible that the FAA may propose additional penalties exceeding the amounts currently reserved.

Environmental Matters

The Ohio Environmental Protection Agency (OEPA) is contemplating a proceeding against DHL, in its capacity as the former owner of Wilmington Air Park (ILN), and ABX, in its capacity as the permit holder for the stormwater treatment system at ILN, arising from the unauthorized discharge of stormwater from ILN on or about May 7, 2008, and seeking a monetary penalty in the amount of \$210,000. DHL has agreed to indemnify ABX for this matter under the terms of the Mutual Termination Agreement and Release, dated March 29, 2010, among DPWN Holdings (USA), Inc., DHL Network Operations (USA), Inc., DHL Express (USA), Inc., Air Transport Services Group, Inc. and ABX

Air, Inc. DHL is currently holding discussions with the OEPA regarding this matter.

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Other

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

Item 1A. Risk Factors

The Company faces risk factors that could adversely affect our financial condition and results of operations. Many of these risks are disclosed in item 1A of the Company's 2009 Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 31, 2010. Additional significant risks have been identified below.

Future results may be impacted by the on-time performance of the Company's aircraft operations.

ABX's CMI agreement with DHL, which became effective March 31, 2010, contains penalties if ABX's monthly on-time performance is below a certain level. If ABX's on-time reliability falls below a certain level for an extended period of time, DHL may declare a default under the CMI agreement. CCIA's and ATI's ACMI agreements with BAX/Schenker contain similar provisions.

Under provisions of the CMI and lease agreements with DHL, DHL can terminate the CMI or lease agreements subject to early termination provisions.

DHL may terminate the CMI agreement for convenience at any time during the initial five-year term (other than the first six-months thereof) on the date that it ceases operating or causing to be operated the aircraft on air routes for which the origin and destination are within the United States, subject to providing six months notice and paying to ABX a termination fee. DHL may terminate one or more of the aircraft leases for convenience at any time after the first 24 months of the respective terms thereof, upon providing six months notice and paying to CAM a lump sum amount equal to six months rent. DHL may also terminate one or more aircraft leases at any time after the first 54 months of the term of the CMI agreement, in the event that DHL desires to transfer operational control of such aircraft, but is restricted from doing so by the terms of the collective bargaining agreement between ABX and its pilots' union providing that members of the pilots' union have the right to follow the aircraft to another operator, subject to providing six months notice and paying to CAM a lump sum amount equal to two months rent.

Proposed rules from the U.S. Federal Aviation Administration would increase the Company's costs of flight operations and could reduce customers' utilization of airfreight.

In September 2010, the FAA proposed new rules for Flightcrew Member Duty and Rest Requirements (FMDRR). If implemented, the new rules would require a pilot to have nine hours for the opportunity to rest before reporting to flight duty and place other restrictions on the number of duty hours in particular time periods. If enacted, these rules could have a significant impact on ATSG airlines' costs of operation. The airlines would attempt to pass such additional costs onto their customers in the form of price increases. Customers, as a result, may seek to reduce the utilization of aircraft in favor of less expensive transportation alternatives. The ATSG airlines are each studying the proposed rules and evaluating the effect that the rules could have on their flight resources and costs.

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Item 5. Other Information

On October 17, 2010, CAM entered into a letter agreement with Precision Conversions LLC pursuant to which Precision Conversions LLC will begin performing the design, engineering and certification work associated with the conversion of Boeing 757-200 series aircraft from a passenger to a combination passenger and freighter configuration. The letter agreement contemplates that the parties will seek to enter into a definitive agreement associated with the work on or before December 1, 2010, pursuant to which CAM will convert no less than three such aircraft to a combination passenger and freighter configuration, including an option for a fourth such aircraft. In the event that CAM terminates the letter agreement or if the parties do not come to terms on a definitive agreement, then CAM will be obligated to contract with Precision Conversions LLC for the conversion of two Boeing 757-200 series aircraft to a standard cargo configuration.

The Boeing 757-200 series combination passenger and freighter conversion will incorporate 10 full cargo pallet positions along with passenger seating for up to 58 occupants. The conversion is intended to strategically position CAM to provide next-generation combination passenger and freighter aircraft to complement and eventually replace the four DC-8 combination passenger and freighter aircraft that CAM currently leases to ATI. CAM paid an initial retainer to Precision to begin the design and engineering work, all or a portion of which would be credited against the cost to convert the aircraft to a combi configuration or, alternatively, to a standard freighter configuration. The conversion cost of the Boeing 757 aircraft is expected to range from \$7.0 million to \$9.0 million per combi aircraft or, alternatively, \$5.0 million per standard freighter aircraft.

Table of Contents**Item 6. Exhibits**

The following exhibits are filed as part of, or are incorporated in, the Quarterly Report on Form 10-Q:

| Exhibit No. | Description of Exhibit |
|--------------------|--|
| 10.1 | Air Transportation Services Agreement between DHL Network Operations (USA), Inc. and ABX Air, Inc, dated March 29, 2010. ⁽¹⁾ |
| 10.2 | Mutual Termination Agreement and Release, made among DPWN Holdings (USA), Inc., DHL Network Operations (USA), Inc., DHL Express (USA), Inc., Air Transport Services Group, Inc., and ABX Air, Inc., dated March 29, 2010. ⁽¹⁾ |
| 10.3 | Second Amendment to Lease Assumption and Option Agreement and Exercise of Lease Option, between DHL Network Operations (USA), Inc. and ABX Air, Inc., dated March 29, 2010. ⁽¹⁾ |
| 10.4 | Form of Time-Based Restricted Stock Award Agreement under Air Transport Services Group, Inc. 2005 Amended and Restated Long-Term Incentive Plan. ⁽²⁾ |
| 10.5 | Form of Performance-Based Stock Unit Award Agreement under Air Transport Services Group, Inc. 2005 Amended and Restated Long-Term Incentive Plan. ⁽²⁾ |
| 10.6 | Form of Restricted Stock Unit Award Agreement under Air Transport Services Group, Inc. 2005 Amended and Restated Long-Term Incentive Plan. ⁽²⁾ |
| 10.7 | Aircraft Sale Agreements relating to three used Boeing 767-338ER aircraft between Cargo Aircraft Management, Inc. and Qantas Airways Limited. ⁽³⁾ |
| 10.8 | Lease Agreement (Wilmington Airpark) between Clinton County Port Authority and Air Transport Services Group, Inc., dated June 2, 2010. ⁽⁴⁾ |
| 10.9 | Air Transport Services Group, Inc. Executive Incentive Compensation Plan, last modified July 30, 2010. ⁽⁴⁾ |
| 10.10 | Conversion Agreement dated August 3, 2010, between Cargo Aircraft Management, Inc., M&B Conversions Limited and Israel Aerospace Industries Ltd., filed herewith. Those portions of the Agreement marked with an [*] have been omitted pursuant to a request for confidential treatment and have been filed separately with the SEC. |
| 31.1 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith. |
| 31.2 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith. |
| 32.1 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith. |
| 32.2 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith. |

⁽¹⁾ Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 10, 2010. Those portions of the Agreement marked with an [*] have been omitted pursuant to a request for confidential treatment and have been filed separately with the SEC.

⁽²⁾ Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 10, 2010.

⁽³⁾ Incorporated by reference to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 21, 2010. Those portions of the Agreement marked with an [*] have been omitted pursuant to a request for confidential treatment and have been filed separately with the SEC.

⁽⁴⁾ Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 4, 2010.

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SIGNATURES

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

AIR TRANSPORT SERVICES GROUP, INC.,

a Delaware Corporation

Registrant

/s/ JOSEPH C. HETE
Joseph C. Hete
Chief Executive Officer

Date: November 3, 2010

/s/ QUINT O. TURNER
Quint O. Turner
Chief Financial Officer

Date: November 3, 2010