Air Transport Services Group, Inc.
Form 10-Q
November 06, 2013

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

FORM 10-Q
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2013
Commission file number 000-50368

(Exact name of registrant as specified in its charter)

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO x
As of November 6, 2013, 64,666,881 shares of the registrant's common stock, par value $0.01, were outstanding.

AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES
FORM 10-Q
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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 i 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 2012 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.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
REVENUES	$140,877	$153,826	$423,060	$452,886
OPERATING EXPENSES				
Salaries, wages and benefits	41,498	44,153	126,771	135,827
Fuel	11,356	12,038	38,157	39,962
Maintenance, materials and repairs	24,644	26,751	71,783	75,135
Depreciation and amortization	23,392	21,057	66,077	62,871
Travel	4,409	5,618	13,908	17,162
Rent	6,958	6,745	20,528	18,719
Landing and ramp	2,227	3,877	8,264	11,823
Insurance	1,559	1,944	4,466	5,780
Other operating expenses	8,224	9,348	25,914	27,908
	124,267	131,531	375,868	395,187
OPERATING INCOME	16,610	22,295	47,192	57,699
OTHER INCOME (EXPENSE)				
Interest income	17	38	56	104
Interest expense	(3,814)	(3,668)	(10,500)	(10,886)
Net gain (loss) on derivative instruments	(317)	294	425	956
	(4,114)	(3,336)	(10,019)	(9,826)
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	12,496	18,959	37,173	47,873
INCOME TAX EXPENSE	(4,697)	(7,403)	(13,958)	(18,436)
EARNINGS FROM CONTINUING OPERATIONS	7,799	11,556	23,215	29,437
LOSS FROM DISCONTINUED OPERATIONS, NET OF TAXES	—	(186)	(2)	(576)
NET EARNINGS	$7,799	$11,370	$23,213	$28,861
BASIC EARNINGS PER SHARE				
Continuing operations	$0.12	$0.18	$0.36	$0.46
Discontinued operations	—	—	—	(0.01)
TOTAL BASIC EARNINGS PER SHARE	$0.12	$0.18	$0.36	$0.45
DILUTED EARNINGS PER SHARE				
Continuing operations	$0.12	$0.18	$0.36	$0.46
Discontinued operations	—	—	—	(0.01)
TOTAL DILUTED EARNINGS PER SHARE	$0.12	$0.18	$0.36	$0.45
WEIGHTED AVERAGE SHARES				
Basic	64,052	63,456	63,972	63,439
Diluted	65,036	64,667	64,807	64,478

See notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
NET EARNINGS	$7,799	$11,370	$23,213	$28,861
OTHER COMPREHENSIVE INCOME (LOSS):				
Defined Benefit Pension	1,958	1,682	5,874	5,047
Defined Benefit Post-Retirement	(834)	(806)	(2,502)	(2,419)
Gains and Losses on Derivatives	(7)	(9)	(23)	(27)
TOTAL OTHER COMPREHENSIVE INCOME	1,117	867	$3,349	$2,601
TOTAL COMPREHENSIVE INCOME	$8,916	$12,237	$26,562	$31,462

See notes to unaudited condensed consolidated financial statements.

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

	September 30, 2013	December 31, 2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$16,864	$15,442
Accounts receivable, net of allowance of $543 in 2013 and $749 in 2012	45,680	47,858
Inventory	8,952	9,430
Prepaid supplies and other	11,075	8,855
Deferred income taxes	19,154	19,154
Aircraft and engines held for sale	2,491	3,360
TOTAL CURRENT ASSETS	104,216	104,099
Property and equipment, net	848,550	818,924
Other assets	21,427	20,462
Intangibles	4,958	5,146
Goodwill	86,980	86,980
TOTAL ASSETS	$1,066,131	$1,035,611
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$32,988	$36,521
Accrued salaries, wages and benefits	22,936	22,917
Accrued expenses	8,258	8,502
Current portion of debt obligations	23,572	21,265
Unearned revenue	9,771	10,311
TOTAL CURRENT LIABILITIES	97,525	99,516
Long term debt obligations	368,331	343,216
Post-retirement liabilities	149,326	185,097
Other liabilities	61,592	62,104
Deferred income taxes	62,066	46,422
TOTAL LIABILITIES	738,840	736,355
Commitments and contingencies (Note G)		
STOCKHOLDERS' EQUITY:		
Preferred stock, 20,000,000 shares authorized, including 75,000 Series A Junior Participating Preferred Stock	—	—
Common stock, par value $0.01 per share; 75,000,000 shares authorized; 64,672,632 and 64,130,056 shares issued and outstanding in 2013 and 2012, respectively	647	641
Additional paid-in capital	524,554	523,087
Accumulated deficit	(83,972)	(107,185)
Accumulated other comprehensive loss	(113,938)	(117,287)
TOTAL STOCKHOLDERS' EQUITY	327,291	299,256
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$1,066,131	$1,035,611

See notes to unaudited condensed consolidated financial statements.

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

	Nine Months Ended September 30, 2013	2012
OPERATING ACTIVITIES:		
Net earnings from continuing operations	$23,215	$29,437
Net loss from discontinued operations	(2)	(576)
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	66,077	62,871
Pension and post-retirement	5,295	4,172
Deferred income taxes	13,736	17,682
Amortization of stock-based compensation	2,123	2,668
Amortization of DHL promissory note	(4,650)	(4,650)
Net gain on derivative instruments	(425)	(956)
Changes in assets and liabilities:		
Accounts receivable	2,183	2,618
Inventory and prepaid supplies	(2,516)	(2,509)
Accounts payable	(157)	(4,811)
Unearned revenue	(5,676)	4,002
Accrued expenses, salaries, wages, benefits and other liabilities	1,520	3,811
Pension and post-retirement liabilities	(35,771)	(24,689)
Other	(3,439)	(2,106)
NET CASH PROVIDED BY OPERATING ACTIVITIES	61,513	86,964
INVESTING ACTIVITIES:		
Capital expenditures	(96,766)	(108,339)
Proceeds from property and equipment	1,337	3,484
NET CASH (USED IN) INVESTING ACTIVITIES	(95,429)	(104,855)
FINANCING ACTIVITIES:		
Principal payments on long term obligations	(47,928)	(9,399)
Proceeds from bank borrowings	80,000	25,000
Reimbursement of hangar construction costs	3,266	—
NET CASH PROVIDED BY FINANCING ACTIVITIES	35,338	15,601
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,422	(2,290)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	15,442	30,503
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$16,864	$28,213
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid, net of amount capitalized	$9,976	$9,240
Federal alternative minimum and state income taxes paid	$1,014	$272
SUPPLEMENTAL NON-CASH INFORMATION:		
Debt extinguished	$4,650	$4,650
Accrued capital expenditures	$1,394	$15,390

See notes to unaudited condensed consolidated financial statements.

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

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

Nature of Operations

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

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

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

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

Basis of Presentation

The accompanying unaudited condensed financial statements include the accounts of Air Transport Services Group, Inc. and its wholly-owned subsidiaries. Inter-company balances and transactions have been eliminated. The financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission for Form 10-Q. Accordingly, the accompanying financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the audited financial statements of the Company and notes thereto included in the annual report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2012.

In the opinion of management, the accompanying financial statements contain all adjustments, including normal recurring adjustments, necessary for the fair presentation of the Company’s results of operations and financial position for the periods presented.

Use of Estimates

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

Cash and Cash Equivalents

The Company classifies short-term, highly liquid investments with maturities of three months or less at the time of purchase as cash and cash equivalents. These investments, consisting of money market funds, are recorded at cost,

which approximates fair value. Substantially all deposits of the Company's cash are held in accounts that exceed federally insured limits. The Company deposits cash in common financial institutions which management believes are financially sound.

Accounts Receivable and Allowance for Uncollectible Accounts

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

Inventory

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

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

Goodwill and Intangible Assets

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

Property and Equipment

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

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

DC-8 combi aircraft and flight equipment	Less than 1 year
Boeing 767 and 757 aircraft and flight equipment	10 to 20 years
Support equipment	5 to 10 years
Vehicles and other equipment	3 to 8 years

The Company periodically evaluates the useful lives, salvage values and fair values of property and equipment. Acceleration of depreciation expense or the recording of significant impairment losses could result from changes in the estimated useful lives of assets due to a number of reasons, such as excess aircraft capacity or changes in regulations governing the use of aircraft.

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

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

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

Capitalized Interest

Interest costs incurred 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 none and $0.7 million for the quarters ended September 30, 2013 and 2012, respectively and $1.0 million and $2.0 million for the nine month periods ended September 30, 2013 and 2012, respectively.

Discontinued Operations

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 statements of operations.

The Company's results of discontinued operations consist primarily of pension expenses and other benefits for former employees previously associated with ABX's former freight sorting and aircraft fueling services provided to DHL. ABX is self-insured for medical coverage and workers’ compensation, and may incur expenses and cash outlays in the future related to pension obligations, reserves for medical expenses and wage loss for former employees.

Exit Activities

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.

Self-Insurance

The Company is self-insured for certain workers' compensation, employee healthcare, automobile, aircraft, and general liability claims. The Company maintains excess claim coverage with common insurance carriers to mitigate its exposure to large claim losses. The Company records a liability for reported claims and an estimate for incurred claims that have not yet been reported. Accruals for these claims are estimated utilizing historical paid claims data and recent claims trends. Other liabilities included $30.7 million and $31.6 million at September 30, 2013 and December 31, 2012, respectively, for self-insured reserves. Changes in claim severity and frequency could result in actual claims being materially different than the costs accrued.

Income Taxes

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

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

Comprehensive Income

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

Fair Value Information

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

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

Revenue Recognition

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

NOTE B—SIGNIFICANT CUSTOMERS

DHL

The Company has had long term contracts with DHL since August 2003. Revenues from continuing operations performed for DHL were approximately 55% and 55% of the Company's consolidated revenues from continuing operations for the three and nine month periods ended September 30, 2013, respectively, compared to 55% and 53% for the corresponding periods of 2012. The Company's balance sheets include accounts receivable with DHL of $22.2 million and $18.3 million as of September 30, 2013 and December 31, 2012, respectively.

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

U.S. Military

A substantial portion of the Company's revenues are also derived from the U.S. Military. The U.S. Military awards flights to U.S. certificated airlines through annual contracts and through temporary "expansion" routes. Revenues from services performed for the U.S. Military were approximately 17% and 17% of the Company's total revenues from continuing operations for the three and nine month periods ending September 30, 2013, respectively, compared to 15% and 16% for the corresponding periods of 2012. The Company's balance sheets included accounts receivable with the U.S. Military of $4.2 million and $4.2 million as of September 30, 2013 and December 31, 2012, respectively.

NOTE C—GOODWILL AND OTHER INTANGIBLES

The Company has two reporting units that have goodwill, ATI (a component of the ACMI Services segment) and CAM. The carrying amounts of goodwill by reportable segment, are as follows (in thousands):

	ACMI Services	CAM	Total
Carrying value as of December 31, 2012	$52,585	$34,395	$86,980
Carrying value as of September 30, 2013	$52,585	$34,395	$86,980

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

	Customer Relationships	Airline Certificates	Total
Carrying value as of December 31, 2012	$2,146	$3,000	$5,146
Amortization	(188)	—	(188)
Carrying value as of September 30, 2013	$1,958	$3,000	$4,958

The customer relationship intangible amortizes over eight more years. The airline certificates have an indefinite life and therefore are not amortized.

NOTE D—FAIR VALUE MEASUREMENTS

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

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

As of September 30, 2013	Fair Value Measurement Using			Total
	Level 1	Level 2	Level 3	
Assets				
Cash equivalents—money market	$20	$3,797	$—	$3,817
Total Assets	$20	$3,797	$—	$3,817
Liabilities				
Interest rate swaps	$—	$(2,721)	$—	$(2,721)
Total Liabilities	$—	$(2,721)	$—	$(2,721)
As of December 31, 2012	Fair Value Measurement Using			Total
	Level 1	Level 2	Level 3	
Assets				
Cash equivalents—money market	$18	$339	$—	$357
Total Assets	$18	$339	$—	$357
Liabilities				
Interest rate swaps	$—	$(3,146)	$—	$(3,146)
Total Liabilities	$—	$(3,146)	$—	$(3,146)

As a result of lower market interest rates for the aircraft loans compared to the stated interest rates of the Company’s fixed rate debt obligations, the fair value of the Company’s debt obligations, based on Level 2 observable inputs, was approximately $2.8 million more than the carrying value, which was $391.9 million at September 30, 2013. The non-financial assets, including goodwill, intangible assets and property and equipment are measured at fair value on a non-recurring basis.

NOTE E—PROPERTY AND EQUIPMENT

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

	September 30, 2013	December 31, 2012
Aircraft and flight equipment	$1,232,284	$1,148,781
Support equipment	51,179	52,209
Vehicles and other equipment	1,706	1,597
Leasehold improvements	1,091	814
	1,286,260	1,203,401
Accumulated depreciation	(437,710)	(384,477)
Property and equipment, net	$848,550	$818,924

CAM owned aircraft with a carrying value of $254.4 million and $273.4 million that were under leases to external customers as of September 30, 2013 and December 31, 2012, respectively.

The carrying value of Boeing 727 and DC-8 freighter aircraft and engines available for sale totaled $2.5 million and $3.4 million as of September 30, 2013 and December 31, 2012, respectively.

NOTE F—DEBT OBLIGATIONS

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

	September 30, 2013	December 31, 2012
Unsubordinated term loan	$135,000	$144,375
Revolving credit facility	190,500	143,000
Aircraft loans	57,103	63,156
Promissory note due to DHL, unsecured	9,300	13,950
Total long term obligations	391,903	364,481
Less: current portion	(23,572)	(21,265)
Total long term obligations, net	$368,331	$343,216

The Company executed a syndicated credit agreement ("Senior Credit Agreement") in May 2011 which includes an unsubordinated term loan and a revolving credit facility. In July 2012, the Company executed the first amendment to the Senior Credit Agreement (“Credit Amendment”). The Credit Amendment increased the amount available under the revolving credit facility by $50.0 million to $225.0 million, extended the maturity of the term loan and revolving credit facility to July 20, 2017, and provided for an accordion feature whereby the Company could draw up to an additional $50.0 million, subject to the lenders' consent. The Senior Credit Agreement provides for the issuance of letters of credit on the Company's behalf. In October 2013, the lenders agreed to make the accordion funds of $50.0 million available to the Company, increasing the capacity of the revolving credit facility to $275.0 million. At this time, the unused revolving credit facility totals $74.1 million, net of draws of $190.5 million and outstanding letters of credit of $10.4 million.

Under the terms of the Senior Credit Agreement, interest rates are adjusted no more than quarterly based on the Company's earnings before interest, taxes, depreciation and amortization expenses ("EBITDA"), its outstanding debt level and prevailing LIBOR or prime rates. At the Company's current debt-to-EBITDA ratio, the LIBOR based financing for the unsubordinated term loan and revolving credit facility bear a variable interest rate of 2.555% and 2.555%, respectively. The Credit Amendment did not affect the EBITDA based pricing or covenants of the Senior Credit Agreement.

The aircraft loans are collateralized by six aircraft, and amortize monthly with a balloon payment of approximately 20% with maturities between 2016 and early 2018. Interest rates range from 6.74% to 7.36% per annum payable monthly.
The promissory note payable to DHL becomes due in August 2028 as a balloon payment, unless it is extinguished sooner under the terms of the CMI agreement. Beginning April 1, 2010 and extending through the term of the CMI agreement, the balance of the note is amortized ratably without cash payment in exchange for services provided and, thus, is expected to be completely amortized by April 2015. The promissory note bears interest at a rate of 5% per annum, and DHL reimburses ABX the interest expense from the note through the term of the CMI agreement.
The Senior Credit Agreement is collateralized by certain of the Company's Boeing 767 and 757 aircraft that are not collateralized under aircraft loans. Under the terms of the Senior Credit Agreement, the Company is required to maintain collateral coverage equal to 150% of the outstanding balance of the term loan and total capacity of the revolving credit facility. The Senior Credit Agreement contains covenants including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness, as well as a total debt to EBITDA ratio and a fixed charge coverage ratio. The Senior Credit Agreement stipulates events of default, including unspecified events that may have material adverse effects on the Company. If an event of default occurs, the Company may be forced to repay, renegotiate or replace the Senior Credit Agreement. The Company is currently in compliance with the financial covenants specified in the Senior Credit Agreement. The Senior Credit Agreement limits the amount of dividends the Company can pay and the amount of common stock it can repurchase to $50.0 million during any calendar year, provided the Company's total debt to EBITDA ratio is under two times, after giving effect to the dividend or repurchase. Under the provisions of its promissory note due to DHL, the Company is required to prepay the DHL note in the amount of $0.20 for each dollar of dividend distributed to its stockholders. The same prepayment stipulation applies to stock repurchases.

NOTE G—COMMITMENTS AND CONTINGENCIES

Lease Commitments

The Company leases six Boeing 767 aircraft, airport facilities, office space, maintenance facilities and certain equipment under operating leases. In December 2012, the Company entered into agreements with the Clinton County Port Authority ("CCPA") to construct and lease an aircraft hangar in Wilmington, Ohio, adjacent to the existing aircraft maintenance facility currently leased by the Company. The Company is acting as the construction agent for the CCPA and began construction of the 100,000 square foot aircraft hangar in January 2013. While the current facility houses aircraft as large as the Boeing 767, the new hangar will provide the capability of servicing aircraft as large as a Boeing 747-400 and a Boeing 777. The hangar is anticipated to cost approximately $15.7 million and is expected to take 14 to 16 months to complete. The CCPA is financing the construction of the hangar primarily through a State of Ohio bond program and a State of Ohio loan on incremental taxes. The costs incurred to build the hangar are included in "Property and equipment" and the amounts reimbursed through the State of Ohio and the CCPA are included in "Other liabilities" on the Company's balance sheet. The Company will begin to make lease payments for the hangar directly to the trustee for the State of Ohio beginning in 2014.

Guarantees and Indemnifications

Certain leases and agreements of the Company contain guarantees and indemnification obligations to the lessor, or one or more other parties that are considered reasonable and customary (e.g. use, tax and environmental indemnifications), the terms of which range in duration and are often limited. Such indemnification obligations may continue after expiration of the respective lease or agreement.

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, 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.

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On December 2, 2011, the plaintiffs agreed to settle this matter in exchange for the payment by ABX to plaintiffs and the putative class members of a monetary amount, which amount management believes to be less than it would have cost to defend the case at trial. The final settlement was approved by the Court on July 9, 2013 and following a 30-day appeal period during which no objections were received, the settlement funds were paid to the class administrator for distribution in accordance with the terms of the settlement agreement.

Brussels Noise Ordinance

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

The ordinance in question is controversial for the reason that it was adopted by the Brussels-Capital Region and is more restrictive than the noise limitations in effect in the Flemish Region, which is where the Brussels Airport is located. The ordinance is the subject of several court cases currently pending in the Belgian courts and numerous airlines have been levied fines thereunder.

Other

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

Employees Under Collective Bargaining Agreements

As of September 30, 2013, the flight crewmember employees of ABX and ATI were represented by the labor unions listed below:

Airline	Labor Agreement Unit	Percentage of the Company’s Employees
ABX	International Brotherhood of Teamsters	14.6%
ATI	Airline Pilots Association	8.9%

NOTE H—PENSION AND OTHER POST-RETIREMENT BENEFIT PLANS

Defined Benefit and Post-retirement Healthcare Plans

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

The accounting and valuation for these post-retirement obligations are determined by prescribed accounting and actuarial methods that consider a number of assumptions and estimates. The selection of appropriate assumptions and estimates is significant due to the long time period over which benefits will be accrued and paid. The long term nature of these benefit payouts increases the sensitivity of certain estimates of our post-retirement costs. The assumptions considered most sensitive in actuarially valuing ABX’s pension obligations and determining related expense amounts are discount rates and expected long term investment returns on plan assets. Additionally, other assumptions concerning retirement ages, mortality and employee turnover also affect the valuations. Actual results and future changes in these assumptions could result in future costs significantly higher than those recorded in our results of operations. The Company's net periodic benefit costs for its qualified defined benefit pension plans 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	
	2013	2012	2013	2012	2013	2012	2013	2012
Service cost	$—	$—	$69	$67	$—	$—	$207	$201
Interest cost	8,989	9,272	66	95	26,967	27,816	198	285
Expected return on plan assets	(11,498)	(9,970)	—	—	(34,494)	(29,910)	—	—
Amortization of prior service cost	—	—	(1,413)	(1,388)	—	—	(4,239)	(4,164)
Amortization of net (gain) loss	3,074	2,670	104	108	9,222	8,010	312	324
Net periodic benefit cost (benefit)	$565	$1,972	$(1,174)	$(1,118)	$1,695	$5,916	$(3,522)	$(3,354)

During the three and nine month periods ended September 30, 2013, the Company contributed $17.9 million and $27.6 million to the pension plans. The Company does not expect to make additional contributes to the pension plans during the remainder of 2013.

NOTE I—INCOME TAXES

The provision for income taxes for interim periods is based on management's best estimate of the effective income tax rate expected to be applicable for the current year, plus any adjustments arising from changes in the estimated amount of taxable income related to prior periods. Income taxes recorded through September 30, 2013 have been estimated utilizing a 37.5% rate based upon year-to-date income and projected results for the full year. The final effective tax rate applied to 2013 will depend on the actual amount of pre-tax book income generated by the Company for the full year.

The Company has operating loss carryforwards for U.S. federal income tax purposes. Management expects to utilize the loss carryforwards to offset federal income tax liabilities in the future. Due to the Company's deferred tax assets, including its loss carryforwards, management does not expect to pay federal income taxes through 2015 or later. The Company may, however, be required to pay alternative minimum taxes and certain state and local income taxes before then.

NOTE J—DERIVATIVE INSTRUMENTS

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

The outstanding interest rate swaps are not designated as hedges for accounting purposes. The effects of future fluctuations in LIBOR interest rates on derivatives held by the Company will result in the recording of unrealized gains and losses into the statement of earnings. For the quarter ended September 30, 2013, the Company recorded an unrealized loss on derivatives of $0.3 million to reflect the interest rate swaps at market value. 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, 2013		December 31, 2012	
Expiration Date	Stated Interest Rate	Notional Amount	Market Value (Liability)	Notional Amount	Market Value (Liability)
May 9, 2016	2.0200%	$67,500	$(2,203)	$72,188	$(3,146)
June 30, 2017	1.1825%	65,625	(518)	—	—

NOTE K—ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated other comprehensive income (loss) includes the following items by components for the three and nine month periods ended September 30, 2013 and 2012 (in thousands):

	Defined Benefit Pension	Defined Benefit Post-Retirement	Gains and Losses on Derivative	Total
Balance as of June 30, 2012	$(107,262)	$ 5,892		