Air Transport Services Group, Inc.
Form 10-K
March 23, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2008

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)

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

Common Stock, Par Value $.01 per share

Preferred Stock Purchase Rights

(Title of class)

Name of each exchange on which registered: NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

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

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 ¨	Accelerated filer x
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 Act). YES ¨ NO x

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, as of the last business day of the registrant s most recently completed second fiscal quarter: $62,415,500. As of March 23, 2009, 63,247,312 shares of the registrant s common stock, par value $0.01, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Stockholders scheduled to be held May 12, 2009 are incorporated by reference into Part III.

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FORWARD LOOKING STATEMENTS

Statements contained in this annual report on Form 10-K, including Management s Discussion and Analysis of Financial Condition and Results of Operations, in Item 7, that are not historical facts are considered forward-looking statements (as that term is defined in the Private Securities Litigation Reform Act of 1995). Words such as projects, believes, anticipates, will, estimates, plans, expects, intends and simi expressions are intended to identify forward-looking statements. These forward-looking statements are based on expectations, estimates and projections as of the date of this filing, and involve risks and uncertainties that are inherently difficult to predict. Actual results may differ materially from those expressed in the forward-looking statements for any number of reasons, including those described in Risk Factors starting on page 9 and Outlook starting on page 22.

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.

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AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES

2008 FORM 10-K ANNUAL REPORT

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PART I

ITEM 1. BUSINESS

General Business Development

Air Transport Services Group Inc. (ATSG) is a holding company whose principal subsidiaries include three independently operated and U.S certificated airlines and an aircraft leasing company. The three airlines, ABX Air, Inc. (ABX), Capital Cargo International Airlines, Inc. (CCIA), and Air Transport International, LLC (ATI), primarily transport cargo within the United States and include operations in Europe, Central America, South America, and Asia. ATSG s leasing subsidiary, Cargo Aircraft Management, Inc. (CAM), leases aircraft to ATSG s airlines and to external customers. (When the context requires, we may use the terms Company and ATSG in this report to refer to the business of ATSG and its subsidiaries on a consolidated basis.)

ABX was incorporated in 1980 and is based in Wilmington, Ohio. ABX provides air cargo transportation through a fleet of Boeing 767 aircraft. ABX complements its air transport capabilities with package handling services. Between 1980 and August 2003, ABX was an affiliate of Airborne, Inc. (Airborne), a publicly traded, integrated delivery service provider. On August 15, 2003, ABX was separated from Airborne in conjunction with the acquisition of Airborne by an indirect wholly owned subsidiary of DHL Worldwide Express, B.V. The merger agreement required Airborne to separate its air operations from its ground operations with the air operations being retained by ABX. At that time, ABX became an independent publicly traded company. Airborne was subsequently merged into DHL.

On December 31, 2007, ABX was reorganized, forming a holding company structure incorporated in Delaware. ABX became a wholly owned subsidiary of ATSG and all of the common shares of ABX, which were then publicly traded, were converted into shares of ATSG. The Company s shares are publicly traded on the NASDAQ Stock Market under the symbol ATSG.

Immediately after ABX became a wholly owned subsidiary of the Company, the Company completed the acquisition of Orlando, Florida based Cargo Holdings International, Inc. (CHI), at that time the privately-owned parent company of CAM, CCIA and ATI. The Company acquired all of the outstanding stock, stock options and warrants of CHI for a combination of cash, shares of the Company, and debt repayment. The overall transaction value was approximately $340 million. ATSG financed the deal partially through a $270 million unsubordinated term loan.

CCIA obtained its airline operating certificate in 1996 and currently operates Boeing 727 and 757 aircraft, primarily providing air freight transportation for BAX Global, Inc. (BAX). ATI, based in Little Rock, Arkansas, began operations in 1979 and was an affiliate of BAX prior to 2006. ATI operates Boeing 767 aircraft and McDonnell Douglas DC-8 aircraft, also for BAX, and provides airlift to the U.S. military through the Air Mobility Command. The acquisition of CHI also includes the operations of CAM and LGSTX Services, Inc. These CHI companies provide aircraft leasing, fuel management, specialized transportation management and air charter brokerage services.

Description of Business

During 2008, the Company operated three reportable segments, DHL, ACMI Services, and CAM. The Company s other business operations include aircraft maintenance and modification services, aircraft part sales, equipment leasing and maintenance, mail handling for the U.S. Postal Service (USPS), specialized services for aircraft fuel management and freight logistics. These other business operations do not constitute reportable segments. Financial information about our segments and geographical revenues is presented in Note Q to the accompanying consolidated financial statements.

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Business with DHL

ABX operates primarily under two commercial agreements with DHL; the aircraft, crew, maintenance and insurance agreement with DHL Network Operations (USA), Inc. (ACMI agreement) and the hub services agreement (Hub Services agreement) with DHL Express (USA), Inc., both of which became effective August 16, 2003, in conjunction with the acquisition of Airborne (DHL Network Operations (USA), Inc. and DHL Express (USA), Inc. are individually and collectively referred to herein as DHL). Since August 2003, DHL has served as ABX s largest customer, constituting a significant portion of ABX s revenues in recent years. Revenues from DHL operations accounted for 72% of the Company s consolidated 2008 revenues. Under these agreements, ABX and DHL generally operate under a cost-plus pricing structure.

ABX provides the airlift for DHL s express and deferred delivery services using its aircraft. ABX has also managed a U.S. network of hubs for DHL, including DHL s primary U.S. sorting facility, which is located in the air park in Wilmington, Ohio. ABX staffed the network, providing package sorting and handling at as many as 19 hubs for DHL. Under the Hub Services agreement, ABX provides staff to conduct package sorting, as well as airport, facilities and equipment maintenance services for DHL.

The ACMI agreement and Hub Services agreement each allow DHL to reduce the scope of services that ABX provides. This includes, for example, the reduction in air routes that ABX flies, the removal of aircraft from service and the termination of hub management services. Since 2004, DHL has from time to time reduced the scope of services provided by ABX, and in 2008, DHL announced a restructuring plan to focus exclusively on handling international freight destined to or from the U.S. By January 31, 2009, DHL had ceased to service intra-U.S. shipments (shipments having both an origin and destination within the U.S.). DHL s announcement of a U.S. restructuring plan and its withdrawal from the intra-U.S. market has had, and will continue to have, an impact on the Company s operations. Between DHL s restructuring announcement in May 2008 and February 2009, ABX removed 47 McDonnell Douglas DC-9 aircraft from DHL service, closed all regional sorting hubs, downsized the Wilmington, Ohio sort operations and terminated over 4,800 employees.

At this time, ABX continues to provide airlift and package sorting for DHL s international delivery services through ABX s Boeing 767 aircraft and personnel at the Wilmington, Ohio night sort operations. ABX provides these services to DHL under the preexisting ACMI and Hub Services agreements, as amended in November 2008. DHL has indicated that their network will continue to utilize some ABX Boeing 767 aircraft and sorting operations in Wilmington to support its international services at least through September 2009. Management cannot reasonably predict the types or level of ABX services that DHL will utilize on a longer term basis.

The ACMI agreement automatically renews for a period of three years in August 2010, unless at least a one year notice of non-renewal is given. The Hub Services agreement renewed in August 2008 and automatically renews for additional periods of one year each, unless at least 90 days notice of non-renewal is given. Renewal of these agreements is uncertain. DHL continues to plan its long term operational strategy for the U.S. and is evaluating various alternatives, some of which may involve utilizing airlift or services from ABX. (See Item 7 of this report for additional information about the effects of the DHL restructuring plan.)

Business with BAX

CCIA and ATI each have contracts to provide airlift to BAX under ACMI agreements. BAX provides freight transportation and supply chain management services, specializing in the heavy freight market for business-to-business shipping. Revenues from BAX operations accounted for 14% of the Company s consolidated 2008 revenues. During 2008, CCIA operated twelve Boeing 727s for the BAX network. ATI operated nine McDonnell Douglas DC-8s as part of the BAX network. The BAX central hub is located in Toledo, Ohio. CHI has the exclusive right to supply all main deck freighter airlift in BAX s U.S. domestic network through December 31, 2011.

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ACMI Services

The Company, through its three airlines, provides airlift to freight forwarders, other airlines and other customers, typically under ACMI and charter contracts. A typical ACMI contract requires the ATSG airline to supply, at a specific rate per block hour, the aircraft, crew, maintenance and insurance for specified cargo operations, while the customer is responsible for substantially all other aircraft operating expenses, including fuel, landing fees, parking fees and ground and cargo handling expenses. Charter agreements usually require the airline to provide full service, including fuel and other operating expenses, in addition to aircraft, crew, maintenance and insurance for a fixed, all-inclusive price. The Company also provides air cargo transportation under block space agreements. These agreements include multiple customers contracting for space on specific routes. The customers are typically charged based upon the weight carried. Under the Company s ACMI, charter arrangements and block space agreements, it has exclusive operating control of its aircraft, and its customers must typically obtain any government authorizations and permits required to service the designated routes. The Company reports its business from ACMI, charter and space available contracts, including the services it provides for BAX, in the ACMI Services segment.

Other Products and Services

U.S. Postal Service

During the third quarter of 2006, ABX s subsidiary, ABX Cargo Services, Inc. (ACS), was awarded contracts to manage USPS mail sort centers in Dallas, Texas and Memphis, Tennessee. In 2006, ACS was also awarded a renewal of a USPS sort center in Indianapolis, Indiana that it has operated since 2004. Under each of these contracts, ACS is compensated at a firm price for fixed costs and an additional amount based on the volume of mail handled at each sort center. Each of the contracts has a four-year term with extensions at the discretion of the USPS.

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

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

Aircraft Maintenance and Modification Services

ABX operates a Federal Aviation Administration (FAA) certificated 145 repair station. ABX leverages the repair station facilities (including hangars and a component shop leased from DHL) and its engineering capabilities to perform airframe and component maintenance and repair services for other airlines and maintenance repair organizations. ABX has developed technical expertise related to aircraft modifications as a result of its long history in aviation. ABX owns many Supplemental Type Certificates (STCs). An STC is granted by the FAA and represents an ownership right, similar to an intellectual property right, which authorizes the alteration of an airframe, engine or component. ABX markets its capabilities by identifying aviation-related maintenance and modification opportunities and matching them to its capabilities.

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

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Aircraft Parts Sales and Brokerage

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

Flight Crew Training

ABX and CCIA are FAA-certificated to offer training to customers and rent usage of its flight simulators for outside training programs. ATSG owns six flight simulators, including one Boeing 767, one DC-8, two Boeing 727 and two DC-9 flight simulators. The Company s Boeing 767, one of its Boeing 727 and one of its DC-9 flight simulators are level C certified and one of its Boeing 727 flight simulators is level D certified. The level C and D flight simulators allow the Company to qualify flight crewmembers under FAA requirements without performing check flights in an aircraft. The DC-8 and the other DC-9 flight simulators are level B certified, which allows the Company to qualify flight crewmembers by performing a minimum number of flights in an aircraft.

Airline Operations

Flight Operations and Control

Airline flight operations, including aircraft dispatching, flight tracking and crew scheduling, are planned and controlled by personnel within each airline. ABX staffs aircraft dispatching and flight tracking 24 hours per day, 7 days per week from the DHL Air Park in Wilmington, Ohio. CCIA flight operations, including flight tracking and crew scheduling, are controlled by on-duty personnel in CCIA s operations center in Orlando, Florida, and the same functions for ATI are controlled from ATI s operations center in Little Rock, Arkansas.

Maintenance

Our airlines operations are regulated by the FAA for aircraft safety and maintenance. Each airline performs routine inspections and airframe maintenance, including Airworthiness Directive and Service Bulletin compliance on all of their aircraft. The airlines maintenance and engineering personnel coordinate routine and non-routine maintenance requirements. Each airline s maintenance program includes tracking the maintenance status of each aircraft, consulting with manufacturers and suppliers about procedures to correct irregularities and training maintenance personnel on the requirements of its FAA-approved maintenance program. ATI and CCIA contract with maintenance repair organizations (MROs) to perform heavy airframe maintenance on airframes and engines. ABX, as a certificated FAA repair station, can perform maintenance on DC-8, DC-9, and Boeing 767 aircraft and their related avionics and accessories. ABX accomplishes heavy maintenance on Boeing 767 airframes in-house as well as through outside MROs. ABX contracts with MROs for the performance of heavy maintenance on its aircraft engines. Each airline owns a supply of spare aircraft engines, auxiliary power units, aircraft parts and consumable items. The number of spare items maintained is based on the fleet size, engine type operated and the reliability history of the item types.

Insurance

Our airline subsidiaries are required by the Department of Transportation (DOT) to carry liability insurance on each of their aircraft. Their aircraft leases, loan agreements and the ACMI agreements also require them to carry such insurance. The Company currently maintains public liability and property damage insurance, and our airline subsidiaries currently maintain aircraft hull and liability insurance and war risk insurance for their respective aircraft fleets in amounts consistent with industry standards.

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Employees

As of December 31, 2008, ATSG and its subsidiaries had approximately 5,620 employees, including 3,830 full-time employees and 1,790 part-time employees. ATSG employs approximately 855 flight crewmembers, 1,195 aircraft maintenance technicians and flight support personnel, 1,635 sort employees at the Wilmington facility, 1,110 sort employees at the regional hubs and postal centers, 425 employees for airport and hub maintenance, 20 employees for warehousing and logistics and 380 employees for administrative functions.

On December 31, 2007, the Company had approximately 10,150 employees. The decline in the number of employees from 2007 to 2008 is primarily due to the DHL restructuring plan and reduced shipment volumes. The Company is making additional headcount reductions in 2009.

Labor Agreements

The Company s flight crewmembers are unionized employees. The table below summarizes the representation of the Company s flight crewmembers at December 31, 2008.

Airline	Labor Agreement Unit	Date Contract Became Amendable	Approximate Number of Employees Represented
ABX	International Brotherhood of Teamsters	7/31/2006	575
ATI	International Brotherhood of Teamsters	5/1/2004	165
CCIA	Airline Pilots Association	3/31/2004	115

Under the Railway Labor Act (RLA), as amended, the labor agreements do not expire, so the existing contract remains in effect throughout any negotiation process. If required, mediation under the RLA is conducted by the National Mediation Board, which has the sole discretion as to how long mediation can last and when it will end. In addition to direct negotiations and mediation, the RLA includes a provision for potential arbitration of unresolved issues and a 30-day cooling-off period before either party can resort to self-help, including, but not limited to, work stoppage.

Training

Our airline subsidiaries flight crewmembers are required to be licensed in accordance with Federal Aviation Regulation (FAR) Part 121, with specific ratings for the aircraft type to be flown, and to be medically certified as physically fit to fly aircraft. Licenses and medical certifications are subject to recurrent requirements as set forth in the FARs to include recurrent training and minimum amounts of recent flying experience.

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

Industry

The primary competitive factors in the air cargo industry are price, fuel efficiency, geographic coverage, flight frequency, reliability and capacity. Our airline subsidiaries compete for domestic cargo volume principally with other cargo airlines and passenger airlines which have substantial belly cargo capacity. Other cargo airlines include Astar Air Cargo, Inc. (Astar), World Air Holdings, Inc., Atlas Air Worldwide Holdings, Inc., and Evergreen International, Inc. The industry is highly competitive.

Cargo volumes within the U.S. are highly dependent on the economic conditions and the level of commercial activity. Generally, time-critical delivery needs, such as just-in-time inventory management, increase the demand for air cargo delivery, while higher costs of jet fuel generally reduces the demand for air delivery services within the U.S. When jet fuel prices increase, shippers will consider using ground transportation within the U.S. if the delivery time allows. Historically, the cargo industry has experienced higher volumes during the fourth calendar quarter of each year.

The scheduled delivery industry is dominated by integrated, door-to-door carriers including DHL, the USPS, FedEx Corporation, BAX and United Parcel Service, Inc. Although the volume of our business is impacted by competition among these integrated carriers, we do not usually compete directly with these integrated carriers.

Intellectual Property

ABX owns a small number of U.S. patents that are important to its business operations and have nominal commercial value. It also owns approximately 160 STCs issued by the FAA. ABX uses these STCs mainly in support of its own fleet; however, it has marketed certain STCs to other airlines.

Information Systems

The Company has invested significant management and financial resources in the development of information systems to facilitate cargo, flight and maintenance operations. The Company utilizes its systems to maintain records about the maintenance status and history of each major aircraft component, as required by FAA regulations. Using its systems, the Company tracks and controls inventories and costs associated with each maintenance task, including the personnel performing those tasks. In addition, the Company s flight operations systems coordinate flight schedules and crew schedules. It has developed and procured systems to track flight time, flight crewmember duty and flight hours and crewmember training status.

Regulation

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

Environment

Under current federal, state and local environmental laws, ordinances and regulations, a current or previous owner or operator of real property may be liable for the costs of removal or clean-up of hazardous or toxic substances on, under, or in such property. Such laws often impose liability whether or not the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances. In addition, the presence of contamination from hazardous or toxic substances, or the failure to properly clean up such contaminated property, may adversely affect the ability of the owner of the property to use such property as collateral for a loan or to sell such property. Environmental laws also may impose restrictions on the manner in which a property may be used or transferred or in which businesses may be operated and may impose remediation or compliance costs. Under its air park sublease with DHL, ABX and DHL are required to defend, indemnify and hold each other harmless from and against certain environmental claims associated with the DHL Air Park in Wilmington, Ohio.

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

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

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

Department of Transportation

The DOT maintains authority over certain aspects of domestic air transportation, such as requiring a minimum level of insurance and the requirement that a person be fit to hold a certificate to engage in air transportation. In addition, the DOT continues to regulate many aspects of international aviation, including the award of international routes. The DOT has issued to ABX, CCIA and ATI separately Domestic All-Cargo Air Service Certificates for air cargo transportation between all points within the U.S., the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Additionally, the DOT has issued ABX a Certificate of Public Convenience and Necessity authorizing it to engage in scheduled foreign air transportation of cargo and mail between the U.S. and over 88 foreign countries. Prior to issuing such certificates, and periodically thereafter, the DOT examines a company s managerial competence, financial resources and plans, compliance, disposition and citizenship in order to determine whether the carrier is fit, willing and able to engage in the transportation services it has proposed to undertake. By maintaining these certificates, the Company, through its airline subsidiaries, can conduct all-cargo charter operations worldwide.

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

Federal Aviation Administration

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

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

The FAA has amended policies regarding the proper application of airport rates and charges imposed on air carriers. The amended policy provides greater flexibility to airport operators to impose charges that would allow for the imposition of congestion fees rather than uniform airport fees. If airports in the U.S. seek to use the flexibility offered by this new policy, it could have an impact on the cost of conducting our flight operations. The FAA has also adopted regulations applicable at John F. Kennedy International Airport, Newark International Airport and O Hare International Airport, to which one or more of our air carrier subsidiaries operate, that limit the number of operations that may be conducted per hour. We must obtain in advance from the FAA the hourly operating authorizations necessary to conduct our operations at these three airports. While we have been successful in doing so in the past, there can be no assurance that we will be able to obtain the necessary airport operating authorizations in the future in which case the failure to do so could have a material adverse effect on our financial condition or results of operations. Nor can there be any assurance that operations limitations will not be imposed at other airports to which any of our airline subsidiaries operate.

Transportation Security Administration

The Transportation Security Administration (TSA), an administration within the Department of Homeland Security, is responsible for the screening of passengers, baggage and cargo and the security of aircraft and airports. Our airline subsidiaries comply with all applicable aircraft and cargo security requirements. TSA has adopted new cargo security-related rules that, have imposed additional burdens on our airlines, [describe the nature of the additional cargo screening burden]. In addition, we may be required to reimburse the TSA for the cost of security services it may provide to the Company s airlines subsidiaries in the future.

Other Regulations

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

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

- The Federal Communications Commission regulates our airline subsidiaries use of radio facilities pursuant to the Federal Communications Act of 1934, as amended;

- U.S. Customs and Border Protection inspects cargo imported from our subsidiaries international operations;

- Our airlines must comply with U.S. Citizenship and Immigration Services regulations regarding the citizenship of our employees;

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The Company and its subsidiaries must comply with wage, work conditions and other regulations of the Department of Labor regarding our employees.

Security and Safety

Security

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

Safety and Inspections

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

ITEM 1A. RISK FACTORS

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

The economic conditions in the U.S. and throughout the globe have impacted and may continue to impact the Company s operating results, financial condition and access to liquidity.

A continued global economic downturn could further reduce the demand for delivery services offered by DHL, BAX and other delivery businesses, in particular expedited services shipped via aircraft. During an economic slowdown, customers generally prefer to use ground-based delivery services instead of more expensive air delivery services. Additionally, if the price of aviation fuel rises, the demand for air delivery services is likely to decline further. The current economic slowdown could negatively affect our growth prospects and financial projections more severely than we have projected.

DHL s U.S. restructuring combined with a tight credit market could impact the Company s access to liquidity.

DHL s U.S. restructuring announcement, the turmoil in the global financial markets and the crisis in the U.S. credit market could affect the Company s access to liquidity. Certain lenders have questioned whether DHL s decision to restructure its U.S. business constitutes a material adverse event (MAE) under provisions of the Credit Agreement and aircraft loans (see Note J to the accompanying consolidated financial statements). If a lender within the Credit Agreement declares an MAE, availability under the revolving credit facility will be reduced by the 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 borrower attempts to borrow under the Credit Agreement, they can assert an event of default exists under the Credit Agreement and require the agent to exercise its remedies. If an event of default occurs, the Company may be forced to repay, renegotiate or replace the Credit Agreement. Given the current credit crisis and announcement by DHL of its U.S. restructuring plan, the interest rates and other costs of a renegotiated or new facility, if one can be obtained, would likely be more expensive and may require more rapid amortization of principal than under the terms of the current Credit Agreement.

The Company could violate debt covenants.

The Company s Credit Agreement and aircraft loans contain covenants including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness, and the level of annual capital expenditures. The Credit Agreement and loans stipulate events of default including unspecified events that may have material adverse effects on the Company. DHL s restructuring may trigger an event of default. Such a default could increase the Company s cost of borrowings, accelerate contractual repayment of debt and limit the Company s ability to modify and redeploy Boeing 767 aircraft.

The Company may need to fund its employee pension plans faster than management expects.

The turmoil in the global financial markets has negatively affected the Company s funded pension plans. Based on existing laws, the increase in the unfunded status could increase the contributions which ABX is expected to make into the plans in 2009 and in subsequent years, or become subject to penalty. Additionally, since DHL s restructuring announcement in May 2008, the Pension Benefit Guaranty Corporation (PBGC), a governmental agency that insures pension plan benefits in the U.S., has made several inquiries of management regarding the plans status, and as to DHL s intentions with respect to providing additional plan funding. The Company has approached DHL to request that DHL make additional contributions to strengthen the funded status of the plans; those discussions are ongoing and the outcome uncertain. The PBGC has broad authority over pension funding and could compel ABX to terminate and settle the plans, which could accelerate pension funding requirements.

The Company s financial condition will be affected by the degree it recovers contract termination cost from DHL.

DHL s U.S. restructuring plan presents additional risk and uncertainties to the Company s future financial condition and operating results. ABX is incurring significant termination and restructuring costs. Such costs include aircraft, equipment and property lease termination costs, maintenance agreement termination costs, severance benefits, pension and retiree medical funding, deferred tax reserves and asset impairments. The Company s liquidity and financial condition will depend on ABX s contractual termination rights and management s ability to negotiate cash funding from DHL to cover the cash needed to terminate and wind-down the air network and the ground-based operations. Failure to reach an agreement regarding contractual termination rights, including aircraft under capital leases and pension funding, could result in arbitration or legal proceedings.

If ABX is not successful at recovering sufficient termination funds from DHL, the Company may need additional sources of liquidity. In the absence of such sources, the Company may seek to sell assets to raise liquidity or the Company may seek relief of its obligations.

The Company relies on DHL for a substantial portion of its revenue and operating cash flows.

DHL has indicated that their network will continue to utilize some ABX Boeing 767 aircraft and Wilmington sorting operations to support its international services at least through September 2009. ABX and DHL management continue to discuss DHL s longer term airlift and sorting requirements. However, we cannot reasonably predict the scope or level of ABX services that DHL will utilize, if any.

The term of the Hub Services agreement will automatically renew for an additional year unless either party gives notice of termination on or before May 17, 2009. Further, the term of the ACMI agreement will automatically renew for an additional three years, unless either party gives notice of termination on or before August 15, 2009. As a condition to renewal, DHL may seek to negotiate new terms, possibly creating greater risk/reward opportunities related to ABX s performance and cost controls or a reduction in the scope of services ABX provides to DHL.

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

Under the ACMI agreement and Hub Services agreement, if ABX does not meet certain performance standards, after a cure period, DHL may terminate the ACMI agreement and Hub Services agreement prior to the end of their respective terms. A recurring work slowdown or strike by one or more groups of employees, such as ABX s mechanics, sorters or flight crews, could adversely impact our operating performance, leading to the termination of those agreements.

Although the ACMI agreement and Hub Services agreement with DHL are structured as cost-plus arrangements, the costs for which ABX can be reimbursed are subject to certain limitations. DHL can dispute whether expenses ABX has incurred are reimbursable under the agreements. The agreements give DHL, within reason, certain rights to audit ABX s expenses. Further, the agreements stipulate dispute and arbitration procedures. If ABX incurs excessive non-reimbursable costs, there can be no assurance that the revenues from these agreements will generate sufficient income for ABX to recover its costs.

The Company s financial condition will depend on its ability to diversify its customer base and restructure ABX s costs.

The Company is accelerating and expanding its efforts to diversify its revenue streams and develop new business opportunities in the wake of DHL s restructuring of its U.S. operations. Those opportunities may require additional investments to complete standard freighter modification for a number of its Boeing 767 aircraft, and will include expanded aircraft maintenance and repair operations, aircraft dry leasing, ACMI contracts outside of the domestic U.S. market and additional mail sorting and mail transport contracts with the USPS. New business opportunities each involve separate risks, management expertise and cash requirements. The number of new opportunities may be limited.

Additionally, management anticipates that significant restructuring, downsizing and wage concessions will be required to position ABX to competitively pursue new business development. These reductions include the costs of flight crews and aircraft maintenance. If ABX is unable to achieve sufficient cost reductions, new business development and revenue diversity will be limited. The timing of cost reductions must coincide with new business opportunities or ABX may not be able to make competitive bids on new business.

ABX s cost structure may be affected by its lease with DHL at the Wilmington, Ohio, air park. ABX could lose its lease at the air park. The term of the lease coincides with the ACMI agreement. Other facilities, if suitable for ABX s operations, may be more expensive and less convenient to customers and employees.

The Company will need sufficient liquidity as it attempts to quickly transition its resources to other customers and services. This includes capital to modify some of its Boeing 767 aircraft with passenger door loading systems to standard freight configuration and redeploy them for other potential customers.

The Company continues to make significant investments in Boeing 767 aircraft which may affect the Company s operating results and financial condition.

The Company, through its subsidiaries, is planning to add Boeing 767 standard freighter aircraft to service through 2011. Our future operating results and financial condition will depend in part on our subsidiaries ability to successfully deploy these aircraft in operations that provide a positive return on investment. Our success will depend, in part, on their ability to obtain and operate additional cargo volumes with customers other than DHL and BAX. Certain of our subsidiaries are pursuing international opportunities, including flights in Asia, Central America, South America and Europe. Deploying aircraft in new international markets may pose additional risks, regulatory requirements and costs. The Company s future operating results will be affected by the interest rates, limits and other terms and conditions of the borrowing agreements.

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The Company will need DHL to release Boeing 767 aircraft from the ACMI agreement so that the aircraft can be redeployed for other customers.

The Company s aircraft may experience service interruptions.

In June 2008, one of ABX s Boeing 767 aircraft experienced a fire prior to engine start. The incident is currently under investigation by the National Transportation Safety Board, which has jurisdiction over such matters. The cause of the fire is unknown at this time. The resulting investigation could reveal an issue with the aircraft that may be applicable to all other Boeing 767s that the Company has in its fleets. This could require significant repairs or alterations on the remaining aircraft in the fleet, which could temporarily delay flights the Company could perform, adversely affecting the revenue streams.

We may need to reduce the carrying value of the Company s assets.

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

As a result of acquiring CHI, we have recorded significant amounts of goodwill and acquisition-related intangibles, which will be tested periodically for impairment at least annually. If we are unable to achieve the projected levels of operating results and these assets are impaired, it may be necessary to record a non-cash charge to earnings.

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

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

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

The costs of complying with government regulations could negatively affect our results of operations.

All aircraft in the Company s airline subsidiaries in-service fleets were manufactured prior to 1990. Manufacturer Service Bulletins and the FAA Airworthiness Directives issued under its Aging Aircraft program cause operators of such aged aircraft to be subject to extensive aircraft examinations and require such aircraft to undergo structural inspections and modifications to address problems of corrosion and structural fatigue at specified times. Airworthiness Directives have been issued that require inspections and both major and minor modifications to such aircraft. The FAA is currently considering the issuance of an airworthiness directive that would require the replacement of the aft pressure bulkhead on Boeing 767-200 aircraft based on a certain number of landing cycles. If such an Airworthiness Directive is issued, all of the Boeing 767s within the Company will be affected over approximately a seven year period. The cost of compliance is estimated to be $1.0 million per aircraft.

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

Failure to maintain the operating certificates and authorities of ABX, ATI and CCIA would adversely affect our business.

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

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

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

Employees may decide to institute labor agreements.

The Company s subsidiaries rely on a diverse group of employees, including sorters, mechanics and pilots. Today, only flight crewmembers are organized under labor agreements. Operations could be interrupted and business could be adversely affected if no agreements are reached with the pilots or if other employee groups choose to organize with a union.

Reporting of financial results could be delayed.

Disagreements between ABX and DHL over the cost reimbursement provisions of the commercial agreements or arbitration rulings could delay future financial filings with the Securities and Exchange Commission and the Company s lenders. The Company s failure to file financial reports timely could adversely impact compliance with the Company s credit facility.

ATSG common stock may be delisted from NASDAQ.

The Company s stock has been trading near or below $1.00 since DHL announced its plans on May 28, 2008. The Company received notice from NASDAQ indicating that the minimum bid price of the stock has been below $1.00 for 30 consecutive trading days. The stock must trade above $1.00 for at least 10 consecutive business days before September 18, 2009 or the stock will be delisted from NASDAQ. Alternatively, NASDAQ may permit the Company to transfer its common stock from the NASDAQ Global Market to the NASDAQ Capital Market if it satisfies the requirements for initial inclusion other than the minimum bid price requirement.

If its application for transfer is approved, the Company would have an additional 180 calendar days to comply with the minimum bid price requirement in order to remain on the NASDAQ Capital Market. Delisting of ATSG stock may reduce the market for the stock and further adversely affect its stock price.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

ATSG and ABX lease their corporate offices, 210,000 square feet of maintenance hangars and a 100,000-square-foot component repair shop from DHL. These facilities are located at the DHL Air Park in Wilmington, Ohio. ABX also has the non-exclusive right to use the airport which includes two runways, taxi ways, and ramp space comprising approximately 300 paved acres. The term of the lease runs concurrently with the term of the ACMI agreement with DHL, which automatically renews for three years in August 2010 unless a one-year notice of non-renewal is given. We believe our existing facilities are adequate to meet our current and reasonably foreseeable future needs.

Aircraft

Our airline subsidiaries currently utilize pre-owned Boeing 767, Boeing 757, Boeing 727 and McDonnell Douglas DC-8 aircraft. Once acquired, aircraft are modified for use in our cargo operation. As of December 31, 2008, the combined in-service fleet consisted of 103 aircraft, including 40 Boeing 767 aircraft, 1 Boeing 757 aircraft, 14 Boeing 727 aircraft, 32 DC-9 aircraft and 16 DC-8 aircraft. In January 2009, DHL removed all of the ABX DC-9 aircraft from the ACMI agreement.

Twenty-three of ABX s Boeing 767 aircraft are not equipped with standard cargo doors, but instead utilize the former passenger doors for the loading and unloading of freight. This reduced the cost of modifying the aircraft from passenger to freighter configuration but limits the size of the freight that can be carried onboard the aircraft and necessitates the use of specialized containers and loading equipment. The absence of a cargo door may also negatively impact the market value of the aircraft.

The tables below show our subsidiaries aircraft fleets and the certificates under which they operate.

ABX Air, Inc. in-service fleet

Aircraft Type	Number of Aircraft as of Mar. 23, 2009	Year of Manufacture	Gross Payload (Lbs.)	Still Air Range (Nautical Miles)
767-200 PC (1)	23	1983-1985	67,000-91,000	1,800-4,400
767-200 SF (2)	16	1982-1987	67,000-91,000	1,800-4,400
Total	39			

Air Transport International, LLC in-service fleet

Aircraft Type	Number of Aircraft as of Mar. 23, 2009	Year of Manufacture	Gross Payload (Lbs.)	Still Air Range (Nautical Miles)
DC-8-F	12	1967-1969	96,000-108,800	1,800-4,400
DC-8-CF (3)	4	1968-1970	80,000-85,000	1,800-4,400
767-200SF	2	1985	98,000	2,200-6,000
Total	18			

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Capital Cargo International Airlines, Inc. in-service fleet

Aircraft Type	Number of Aircraft as of Mar. 23, 2009	Year of Manufacture	Gross Payload (Lbs.)	Still Air Range (Nautical Miles)
727-200SF	14	1973-1981	52,300-61,000	1,200-2,100
757-200SF	2	1984-1986	48,000-68,000	2,700-4,000
Total	16			

CAM

CAM has the following aircraft under lease to outside customers or being marketed for long-term lease:

Aircraft Type	Number of Aircraft as of Mar. 23, 2009	Year of Manufacture
767-200SF	3	1984-1985
767-200ER (4)	1	1985
Total	4	

Additionally, CAM has one Boeing 767 aircraft currently undergoing modification to standard freighter configuration.

(1) These aircraft were manufactured without a large main deck cargo door for transporting freight. This total includes five Boeing 767 aircraft that are under capital leases.
(2) These aircraft are configured for standard cargo containers, including large standard main deck cargo doors.
(3) These aircraft are configured as combi aircraft capable of carrying passenger and cargo containers on the main flight deck.
(4) Passenger configured aircraft.

Because our airline subsidiaries flight operations can be hindered by inclement weather, sophisticated landing systems and other equipment are utilized to minimize the effect that weather may have on their flight operations. For example, ABX s Boeing 767 aircraft are equipped for Category III landings. This allows their crews to land under weather conditions with runway visibility of only 600 feet at airports with Category III Instrument Landing Systems.

ITEM 3. LEGAL PROCEEDI