

ABX AIR INC
Form 10-Q
August 14, 2007
Table of Contents

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For Quarter Ended June 30, 2007

Commission File Number 000-50368

ABX AIR, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State of incorporation
or organization)

145 Hunter Drive

Wilmington, Ohio 45177

(Address of Principal Executive Office)

(937) 382-5591

(Registrant's telephone number, including area code)

91-1091619
(IRS Employer
Identification No.)

Edgar Filing: ABX AIR INC - Form 10-Q

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definitions of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of August 9, 2007, ABX Air, Inc. had outstanding 58,678,437 shares of common stock, par value \$.01.

Table of Contents

ABX AIR, INC. AND SUBSIDIARIES

Form 10-Q

Table of Contents

	Page
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
<u>Condensed Consolidated Statements of Earnings</u>	2
<u>Condensed Consolidated Balance Sheets</u>	3
<u>Condensed Consolidated Statements of Cash Flows</u>	4
<u>Notes to Condensed Consolidated Financial Statements</u>	5
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	23
Item 4. <u>Controls and Procedures</u>	23
PART II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	24
Item 1A. <u>Risk Factors</u>	24
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	24
Item 5. <u>Other Information</u>	25
Item 6. <u>Exhibits</u>	25
<u>SIGNATURES</u>	26

Table of Contents

FORWARD LOOKING STATEMENTS

Statements contained in this quarterly report on Form 10-Q that are not historical facts are considered forward-looking statements (as that term is defined in the Private Securities Litigation Reform Act of 1995). Words such as projects, believes, anticipates, will, estimates, plans, expects, intends and similar words and expressions are intended to identify forward-looking statements. These forward-looking statements are based on expectations, estimates and projections as of the date of this filing, and involve risks and uncertainties that are inherently difficult to predict. Actual results may differ materially from those expressed in the forward-looking statements for any number of reasons, including those described in this report and in our 2006 Annual Report filed on Form 10-K/A with the Securities and Exchange Commission.

Filings with the Securities and Exchange Commission

Our filings with the Securities and Exchange Commission, including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, are available free of charge from our website at www.ABXAir.com as soon as reasonably practicable after filing with the SEC.

Table of Contents**PART 1. FINANCIAL INFORMATION****Item 1. Financial Statements****ABX AIR, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS**

(In thousands, except share data)

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
REVENUES	\$ 281,297	\$ 303,578	\$ 569,359	\$ 672,743
OPERATING EXPENSES				
Salaries, wages and benefits	151,114	152,592	309,039	317,357
Fuel	61,398	69,714	120,351	131,052
Maintenance, materials and repairs	22,673	23,211	45,545	55,849
Depreciation and amortization	12,837	11,350	24,780	22,353
Landing and ramp	4,377	4,516	14,178	12,122
Rent	2,195	2,280	4,713	4,710
Purchased line-haul and yard management	1,546	18,955	3,217	84,449
Other operating expenses	15,640	12,910	29,232	27,019
	271,780	295,528	551,055	654,911
INTEREST EXPENSE	(3,403)	(2,733)	(6,566)	(5,566)
INTEREST INCOME	1,191	1,142	2,449	2,286
INCOME BEFORE INCOME TAXES	7,305	6,459	14,187	14,552
INCOME TAXES	(2,760)		(5,375)	
NET EARNINGS	\$ 4,545	\$ 6,459	\$ 8,812	\$ 14,552
EARNINGS PER SHARE				
Basic	\$ 0.08	\$ 0.11	\$ 0.15	\$ 0.25
Diluted	\$ 0.08	\$ 0.11	\$ 0.15	\$ 0.25
WEIGHTED AVERAGE SHARES				
Basic	58,282	58,270	58,282	58,270
Diluted	58,635	58,567	58,612	58,481

See notes to condensed consolidated financial statements.

Table of Contents

ABX AIR, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	June 30, 2007	December 31, 2006
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 38,684	\$ 63,219
Marketable securities available-for-sale	20,450	15,374
Accounts receivable, net of allowance of \$516 in 2007 and 2006	12,543	10,365
Inventory	13,434	13,907
Prepaid supplies and other	5,266	6,395
Deferred income taxes	14,691	14,691
Aircraft and engines held for sale	1,971	2,219
TOTAL CURRENT ASSETS	107,039	126,170
Other assets	14,377	7,966
Deferred income taxes	78,082	87,024
Property and equipment, net	507,923	458,638
TOTAL ASSETS	\$ 707,421	\$ 679,798
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 44,721	\$ 65,313
Salaries, wages and benefits	50,650	53,173
Accrued expenses	10,283	10,298
Current portion of long-term obligations	13,684	11,413
Unearned revenue	10,474	4,081
TOTAL CURRENT LIABILITIES	129,812	144,278
Long-term obligations	215,957	189,118
Post-retirement liabilities	224,943	222,587
Other liabilities	3,931	3,605
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; 58,678,437 and 58,539,300 shares issued and outstanding in 2007 and 2006, respectively	587	585
Additional paid-in capital	432,410	431,071
Accumulated deficit	(200,318)	(207,836)
Accumulated other comprehensive loss	(99,901)	(103,610)
TOTAL STOCKHOLDERS EQUITY	132,778	120,210
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 707,421	\$ 679,798

See notes to condensed consolidated financial statements.

Table of Contents**ABX AIR, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

	Six Months Ended June 30	
	2007	(As restated, see Note N) 2006
OPERATING ACTIVITIES:		
Net earnings	\$ 8,812	\$ 14,552
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	24,780	22,353
Pension and post-retirement amortization	5,708	
Deferred income taxes	5,375	
Stock-based compensation	1,341	783
Other	(100)	
Changes in assets and liabilities:		
Accounts receivable	(2,178)	10,376
Inventory and prepaid supplies	575	(89)
Accounts payable	(2,755)	(18,065)
Unearned revenue	6,592	2,428
Accrued expenses, salaries, wages and benefits and other liabilities	(2,411)	(1,179)
Post-retirement liabilities	2,356	14,781
Other	376	626
NET CASH PROVIDED BY OPERATING ACTIVITIES	48,471	46,566
INVESTING ACTIVITIES:		
Capital expenditures	(92,032)	(53,933)
Proceeds from the sale of property and equipment	538	
Restricted deposits of interest-bearing funds	(10,017)	
Proceeds from redemptions of marketable securities	7,705	8,500
Purchases of marketable securities	(8,291)	(8,857)
NET CASH USED IN INVESTING ACTIVITIES	(102,097)	(54,290)
FINANCING ACTIVITIES:		
Principal payments on long-term obligations	(5,890)	(4,222)
Proceeds from borrowings on long-term obligations	35,000	707
Financing fees	(19)	
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	29,091	(3,515)
NET DECREASE IN CASH	(24,535)	(11,239)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	63,219	69,473
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 38,684	\$ 58,234
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid, net of amount capitalized	\$ 5,882	\$ 5,334
Income taxes paid	\$	\$

SUPPLEMENTAL NON-CASH INFORMATION:

Accrued aircraft modification expenditures	\$ 15,692	\$ 10,208
--	-----------	-----------

See notes to condensed consolidated financial statements.

Table of Contents

ABX AIR, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2007

NOTE A SUMMARY OF FINANCIAL STATEMENT PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

The interim period consolidated financial statements of ABX Air, Inc. and its subsidiaries (ABX or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America and rules and regulations of the Securities and Exchange Commission for interim financial information. Accordingly, they do not include all of the information, footnotes and disclosures required by generally accepted accounting principles for complete financial statements and are unaudited. The results of operations and cash flows for any interim periods are not necessarily indicative of results that may be reported for the full year. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The December 31, 2006 financial amounts are extracted from the annual audited financial statements. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions between the Company and its subsidiaries are eliminated upon consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Estimates and assumptions are used to record allowances for uncollectible amounts, self-insurance reserves, spare parts inventory, depreciation and impairments of property and equipment, labor contract settlements, post-retirement obligations, income taxes, contingencies and litigation. Changes in these estimates and assumptions may have a material impact on the consolidated financial statements.

Consolidation

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

Revenue Recognition

The Company derives approximately 93% of its revenues from an aircraft, crew, maintenance and insurance agreement (ACMI agreement) and a hub services agreement (Hub Services agreement) with DHL Express (USA), Inc. (DHL). Revenues from DHL are determined based on the expenses incurred during a period and recognized when the related services are performed. Expenses incurred under these agreements are generally subject to a base mark-up of 1.75%, which is recognized in the period the expenses are incurred. Certain costs, the most significant of which include fuel, interest on a promissory note due to DHL, airport rent, ramp and landing fees, incurred under the two commercial agreements are reimbursed and included in revenues without mark-up. Beginning April 1, 2006, no mark-up was recorded on the over-the-road truck line-haul network while those operations were transitioned to DHL. Beginning May 1, 2006, the Company no longer operated the line-haul network for DHL.

Both agreements also allow the Company to earn incremental mark-up above the base 1.75% mark-up (up to 1.60% under the ACMI agreement and 2.10% under the Hub Services agreement), as determined from the achievement of certain cost-related and service goals outlined in the two commercial agreements. The agreements stipulate the setting of quarterly and annual cost-related goals and annual service goals specified in each of the two agreements. At the end of each quarter, the Company measures the achievement of quarterly goals and records any incremental revenues earned by achieving the goals during the quarter. In a similar way, the Company measures annual goals and records incremental revenues at the end of its fiscal year.

The Company derives a portion of its revenues from customers other than DHL. Charter segment revenues are recognized on scheduled and non-scheduled flights when the specific flight has been completed. Aircraft parts and fuel sales are recognized when the parts and fuel are delivered. Revenues earned and expenses incurred in providing aircraft-related maintenance, repair and technical services are recognized in the period in which the services are completed and delivered to the customer. Revenues derived from transporting freight and sorting parcels are recognized upon delivery of shipments and completion of service.

Table of Contents

Cash and Cash Equivalents

The Company classifies short-term, highly liquid investments with maturities of three months or less at the time of purchase as cash and cash equivalents. These investments are recorded at cost, which approximates fair value.

Inventory

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

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

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 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.

Comprehensive Income (Loss)

Comprehensive income includes net income and other comprehensive income or loss. Other comprehensive income or loss results from changes in the Company's pension liability, unrealized gains and losses on available-for-sale marketable securities and gains and losses associated with interest rate hedging instruments.

Marketable Securities

Marketable securities classified as available-for-sale are recorded at their estimated fair market values and any unrealized gains and losses are included in accumulated other comprehensive income or loss within stockholders' equity. Interest on marketable securities is included in interest income. Realized gains and losses of any securities sold are based on the specific identification method.

Property and Equipment

Property and equipment are 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.

The Company periodically evaluates, when events or circumstances require, the useful lives, salvage values and fair values of property and equipment. The acceleration of depreciation expense or the recording of significant impairment losses could result from changes in the estimated useful lives of assets due to a number of reasons, such as an assessment done quarterly to determine if excess capacity exists in the air or ground networks or changes in regulations governing the use of aircraft.

Long-lived assets are reviewed for impairment when circumstances indicate the carrying value of an asset may not be recoverable. For assets that are to be held and used, impairment is recognized when the estimated undiscounted cash flows associated with the asset or group of assets are less than their carrying value. If an impairment exists, an adjustment is made to write the asset down to its fair value, and a loss is recorded as the difference between the carrying value and fair value. Fair values are determined based on quoted market values, discounted cash flows or internal and external appraisals, as applicable. Assets held for sale or disposition are carried at the lower of carrying value or fair value less the cost to sell and have been classified as aircraft and engines held for sale.

Table of Contents

The cost of modifying passenger aircraft to freighter aircraft configuration is capitalized as incurred. Interest costs incurred while aircraft are being modified are capitalized as an additional cost of the aircraft until the date the asset is placed in service. Capitalized interest was \$0.9 million and \$0.4 million for the six months ended June 30, 2007 and 2006, respectively.

The cost of major airframe and engine overhauls on the Company's in-service fleet, as well as routine maintenance and repairs, are charged to expense as incurred.

Unearned Revenue

As specified in the two commercial agreements with DHL, the Company is advanced funds on each Monday for the costs budgeted to be incurred for the upcoming week. Unearned revenue reflects those funds that the Company has received in advance of incurring the associated cost to perform under the commercial agreements. Unearned revenue also includes advance payments from customers other than DHL.

Stock-Based Payments

The Company measures the cost of services received in exchange for stock-based awards using the grant-date fair value of the award. The cost of the awards is recognized over the period during which service is required to be provided. Restricted stock awards granted to employees vest over a service period. The restrictions on the non-vested restricted stock awards lapse at the end of a specified service period, which is approximately three years from the date of grant. Restrictions could lapse sooner upon a business combination, death, disability or after an employee qualifies for retirement.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 157, Fair Value Measurements, (SFAS 157) which defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. SFAS 157 will be effective for the Company's fiscal year beginning January 1, 2008. The Company has not yet evaluated the impact that SFAS 157 will have on its financial statements and related disclosures.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS 115, (SFAS 159) which allows for the option to measure financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. Other than marketable securities and derivative instruments already measured at fair value, the Company does not presently have any financial assets or liabilities that it would elect to measure at fair value, and, therefore, the Company expects this standard will have no impact on its financial statements. SFAS 159 will be effective for the Company's fiscal year beginning January 1, 2008.

NOTE B TRANSACTIONS WITH DHL

The Company's revenues, cash flows and liquidity resources are highly dependent on DHL. Substantially all of the Company's revenues are derived through contracted services provided to DHL. Revenues from contracted services performed for DHL were \$258.9 million and \$294.8 million for the three month periods ended June 30, 2007 and 2006, respectively, and \$531.8 million and \$655.7 million for the six month periods ended June 30, 2007 and 2006, respectively.

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

	June 30, 2007	December 31, 2006
Assets (Liabilities):		
Accounts receivable	\$ 2,022	\$ 2,680
Accounts payable	(379)	(392)
Unearned revenue	(7,623)	(2,607)
Net liability	\$ (5,980)	\$ (319)

Edgar Filing: ABX AIR INC - Form 10-Q

The ACMI agreement has a term of seven years, expiring in August 2010 and automatically renews for an additional three years unless a one-year notice of non-renewal is given. The Hub Services agreement had an amended term of four years, expiring in August 2007, with automatic annual renewals, unless a ninety-day notice of non-renewal is given. The agreement automatically renewed in 2007 for a one-year period.

Table of Contents**NOTE C MARKETABLE SECURITIES**

The marketable securities held by the Company consist of debt securities, which are classified as available-for-sale. Marketable securities of approximately \$1.0 million and \$5.4 million as of June 30, 2007 and December 31, 2006, respectively, have an expected life of over one year and are included in other assets within the Company's consolidated balance sheets. Expected maturities may differ from contractual maturities because the issuers of certain securities may have the right to prepay the obligations without prepayment penalties.

The following is a summary of the Company's marketable securities (in thousands):

	Estimated Fair Market Value	
	June 30, 2007	December 31, 2006
Obligations of U.S. Government Agencies	\$ 7,600	\$ 9,480
Obligations of U.S. corporations	13,838	11,336
Total marketable securities	\$ 21,438	\$ 20,816

NOTE D INCOME TAXES

The Company implemented the provisions of FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48) as of January 1, 2007. This Interpretation requires financial statement recognition of the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. As required by FIN 48, the cumulative effect of applying the provisions of the interpretation has been recorded as a \$1.3 million charge to the retained earnings balance as of January 1, 2007. This amount represents the full value of the Company's unrecognized tax benefits at January 1, 2007 and June 30, 2007 and, if recognized, would favorably impact the effective tax rate for the period of recognition. No changes to the unrecognized tax benefits are anticipated in the next twelve months.

The Company files income tax returns in the U.S. federal jurisdiction and various state and local jurisdictions. The returns may be subject to examination by the Internal Revenue Service (IRS) and other jurisdictional authorities for years ending December 31, 2003 through 2006. All federal income tax returns of the Company's former parent, Airborne, Inc., are closed through 2000. Returns filed for calendar years 2001, 2002, and the short period ended August 15, 2003 are still subject to examination by the IRS and state jurisdictions. As part of the separation agreement between the Company and Airborne, Inc., all tax liabilities resulting from returns prior to the August 15, 2003 separation date are the responsibility of Airborne, Inc. or its successors. Any adjustments to these returns could potentially increase or decrease deferred tax assets and liabilities carried over from the separation. The Company's 2003 U.S. federal income tax return was examined during 2006, and no changes were issued as a result of the examination.

The Company recognizes interest and penalties accrued related to uncertain tax positions in operating expense. As of January 1, 2007, no liability was recorded for interest or penalties related to income tax contingences. Income tax interest and penalty expense for prior years were minimal.

The Company's effective tax rate for the second quarter and first six months of 2007 was approximately 38.0%. In the first six months of 2006, income tax expense was offset by reductions in the tax valuation allowance.

Table of Contents**NOTE E PROPERTY AND EQUIPMENT**

At June 30, 2007, the Company's operating fleet consisted of 101 aircraft, including 36 Boeing 767, 61 McDonnell Douglas DC-9 and four McDonnell Douglas DC-8 aircraft.

Property and equipment, to be held and used, consisted of the following (in thousands):

	June 30, 2007	December 31, 2006
Aircraft and flight equipment	\$ 757,396	\$ 685,652
Support equipment	49,099	48,602
Vehicles and other equipment	1,708	1,725
Leasehold improvements	969	849
	809,172	736,828
Accumulated depreciation	(301,249)	(278,190)
Property and equipment, net	\$ 507,923	\$ 458,638

Property and equipment included \$36.9 million of property held under capitalized leases as of June 30, 2007 and December 31, 2006. Accumulated depreciation included \$10.0 million as of June 30, 2007 and \$8.6 million as of December 31, 2006 for capital leases.

NOTE F LONG TERM OBLIGATIONS

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

	June 30, 2007	December 31, 2006
Promissory note due to DHL	\$ 92,276	\$ 92,276
Capital lease obligations	68,865	73,551
Aircraft loans	68,500	34,704
Total long-term obligations	229,641	200,531
Less: current portion	(13,684)	(11,413)
Total long-term obligations, net	\$ 215,957	\$ 189,118

The unsecured promissory note is due in 2028 and bears interest at 5.00% per annum payable semi-annually. Interest on the promissory note is reimbursable under the ACMI agreement without mark-up. The capital lease obligations are primarily for five Boeing 767 aircraft and consist of two different leases, both expiring in 2011 with options to extend into 2017. The capital lease terms for three of the five aircraft include quarterly principal payments and variable interest of LIBOR plus 2.50% (7.86% at June 30, 2007). The capital lease for the other two Boeing 767 aircraft is at an imputed interest rate of 8.55%. At the termination of the leases, the Company is subject to normal aircraft return provisions for maintenance of the aircraft. As of June 30, 2007, the aircraft loans are collateralized by four financed aircraft, are due in 2016 and 2017 and bear interest at rates from 6.88% to 7.07% per annum payable monthly.

The Company has a \$45.0 million credit facility through a syndicated Credit Agreement that expires in December 2008. Borrowings under the agreement are collateralized by substantially all of the Company's assets, and bear interest equal to the prime rate or a short term LIBOR (a one-, two- or three-month LIBOR at the Company's discretion) plus 2.25%. The agreement contains an accordion feature to increase the borrowings to a total of \$50.0 million if the Company needs additional borrowing capacity. The agreement provides for the issuance of letters of credit on the Company's behalf. As of June 30, 2007, the unused credit facility totaled \$35.2 million, net of outstanding letters of credit of \$9.8 million. There were no borrowings outstanding under the Credit Agreement as of June 30, 2007.

Edgar Filing: ABX AIR INC - Form 10-Q

Under the Credit Agreement, the Company is subject to other expenses, covenants and warranties that are usual and customary. The agreement stipulates events of default and contains covenants including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness, level of cash dividends, and certain other transactions as defined in the agreement. The Company is in compliance with the terms of the credit agreement.

Table of Contents

NOTE G COMMITMENTS AND CONTINGENCIES

Leases

The Company leases airport facilities and certain operating equipment under various long-term operating lease agreements. The Company subleases portions of the DHL Air Park from DHL. The term of the lease expires at the end of the transition period that follows termination of the ACMI agreement. The annual rent payable by the Company under the lease is approximately \$2.0 million and is reimbursable by DHL without mark-up.

Commitments

The Company has purchase commitments to acquire one additional Boeing 767 aircraft in 2007. Based on the most current projections, the Company is planning to complete the modification of five aircraft by the end of 2007 and complete the modification of two aircraft in 2008. The Company has contracted with an aircraft maintenance and modification provider to convert aircraft from passenger to standard freighter configuration. The estimated costs of the remaining aircraft purchase commitments and the anticipated costs to complete the modifications approximate \$74.5 million. The Company projects cash payments for aircraft purchases and modifications will be \$76.5 million in 2007 and \$14.0 million in 2008.

The Company anticipates that it may execute aircraft loans for four more of the aircraft as they are modified. One loan of approximately \$17.5 million was executed in July 2007. These aircraft loans are expected to occur through a syndication process being arranged by the Company's lead bank.

Guarantees and Indemnifications

Certain operating leases and agreements of the Company contain indemnification obligations to the lessor, service provider or vendor that are considered ordinary and customary (e.g. use, tax, environmental and employee 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.

Legal Proceedings

Alleged Violations of Immigration Laws

The Company reported in January of 2005 that it was cooperating fully with an investigation by the U.S. Department of Justice (DOJ) with respect to Garcia Labor Co., Inc. (Garcia), a temporary employment agency based in Morristown, Tennessee, and ABX Air's use of contract employees that were being supplied to it by Garcia. The investigation concerns the immigration status of the Garcia employees assigned to the Company.

The Company terminated its contract with Garcia in February of 2005 and replaced the Garcia employees.

In October of 2005, the DOJ notified the Company that the Company and a few Company employees in its human resources department, in addition to Garcia, were targets of a criminal investigation. The Company cooperated fully with the investigation. In June of 2006, a non-senior management employee of the Company entered a plea to a misdemeanor related to this matter. In July of 2006, a federal grand jury indictment was unsealed, charging two Garcia companies, the president of Garcia and two of their corporate officers with numerous counts involving the violation of federal immigration laws. The Garcia defendants subsequently entered guilty pleas in U.S. district court in October of 2006 and were sentenced in February and March of 2007. No proceedings have been initiated against the Company by the DOJ. The Company believes it has adequately reserved for potential losses stemming from the investigation. In the event proceedings were initiated against the Company that resulted in an adverse finding, the Company could be subjected to a financial penalty that is materially greater than the amount we have accrued and restrictions on our ability to engage in business with agencies of the U.S. Government.

Other

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

material to our financial condition or results of operations.

Table of Contents

NOTE H COMPONENTS OF NET PERIODIC BENEFIT COST

The Company sponsors a qualified defined benefit pension plan for its flight crewmembers and a qualified defined benefit pension plan for its other employees that meet minimum eligibility requirements. The Company also sponsors non-qualified defined benefit pension plans for certain employees. These non-qualified plans are unfunded. The Company sponsors a post-retirement healthcare plan which is unfunded.

The accounting and valuation for these post-retirement obligations are determined by prescribed accounting and actuarial methods that consider a number of assumptions and estimates. The selection of appropriate assumptions and estimates is significant due to the long time period over which benefits will be accrued and paid. The long-term nature of these benefit payouts increases the sensitivity of certain estimates on our post-retirement costs.

The Company's net periodic benefit cost for its qualified defined benefit pensions and post-retirement healthcare plans are as follows (in thousands):

	Three Months Ended June 30				Six Months Ended June 30			
	Pension Plans		Post-retirement Healthcare Plan		Pension Plans		Post-retirement Healthcare Plan	
	2007	2006	2007	2006	2007	2006	2007	2006
Service cost	\$ 8,924	\$ 9,540	\$ 546	\$ 602	\$ 17,848	\$ 19,080	\$ 1,092	\$ 1,204
Interest cost	8,351	7,505	495	480	16,702	15,010	990	960
Expected return on plan assets	(7,950)	(6,305)			(15,900)	(12,610)		
Amortization of prior service cost	1,205	1,052			2,410	2,104		
Amortization of net loss	1,491	2,638	158	268	2,982	5,276	316	536
Net periodic benefit cost	\$ 12,021	\$ 14,430	\$ 1,199	\$ 1,350	\$ 24,042	\$ 28,860	\$ 2,398	\$ 2,700

During the three and six month periods ended June 30, 2007, the Company paid \$9.0 million and \$18.2 million of contributions to its defined benefit pension plans, respectively. The Company presently anticipates contributing an additional \$26.8 million to fund its pension plans during the remainder of 2007 for a total of \$45.0 million.

NOTE I STOCK-BASED COMPENSATION

The Company's Board of Directors has granted stock incentive awards to certain employees and board members pursuant to a long-term incentive plan which was approved by the Company's stockholders in May 2005. Employees have been awarded non-vested stock units with performance conditions, non-vested stock units with market conditions and non-vested restricted stock. Board members were granted time-based awards. Restricted stock and time-based awards vest over a specified service period. The non-vested stock units will be converted at the end of a specified service period into a number of shares of Company stock depending on performance and market conditions. The Company expects to settle all of the stock unit awards by issuing new shares of stock. The table below summarizes award activity.

	Six Months Ended June 30, 2007		Six Months Ended June 30, 2006	
	Number of shares	Weighted average grant date value	Number of shares	Weighted average grant date value
Outstanding at beginning of period	597,000	\$ 7.38	264,600	\$ 8.33
Granted	319,100	8.13	332,400	6.61
Exercised	16,200	7.35		
Cancelled				
Outstanding at end of period	899,900	\$ 7.65	597,000	\$ 7.37

Edgar Filing: ABX AIR INC - Form 10-Q

Vested

65,800 \$ 7.42 25,600 \$ 8.20

The grant-date fair value of each performance condition award, non-vested restricted stock award and time-based award granted by the Company in 2007 was \$7.83, the value of the Company's stock on the date of grant. The grant-date fair value of each market condition award granted in 2007 was \$9.20. The market condition awards were valued using a Monte Carlo simulation technique, a risk-free interest rate of 4.67%, a term of 36 months, and a volatility of 44.1% based on historical volatility over three years using daily stock prices.

Table of Contents

For the six month periods ended June 30, 2007 and 2006, the Company recorded expense of \$1.3 million and \$0.7 million, respectively, for stock incentive awards. At June 30, 2007, there was \$3.2 million of unrecognized expense related to the stock incentive awards that is expected to be recognized over a weighted-average period of 1.4 years. As of June 30, 2007, awards totaling 916,100 had been granted and 899,900 awards were outstanding. None of the awards were convertible, and none of the outstanding shares of restricted stock had vested as of June 30, 2007. These awards could result in a maximum number of 1,108,600 additional outstanding shares of the Company's common stock depending on service, performance and market results through December 31, 2009.

NOTE J DERIVATIVE INSTRUMENTS

To reduce its exposure to rising interest rates on anticipated aircraft financing transactions, the Company entered into forward treasury lock agreements (treasury locks) during the first quarter of 2006. Under the anticipated financing transactions, the Company would finance aircraft under fixed interest rate loans based on the interest rates of ten-year U.S. Treasury Notes. The treasury lock was with a major U.S. financial institution and settled in cash in July 2007, near the forecasted execution date of the anticipated financing transaction. The value of the remaining treasury lock was based on the ten-year U. S. Treasury interest rates, effectively offsetting the effect of changing interest rates on the anticipated loan transaction.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, the Company accounts for the treasury lock as a cash flow hedge. The treasury lock was evaluated and deemed to be highly effective as a hedge at its inception and at June 30, 2007. The Company records unrealized gain or losses resulting from the changes in fair value in the consolidated balance sheets under accumulated other comprehensive income in stockholders' equity. These gains and losses are recognized into earnings over the terms of the forecasted loan transactions. At June 30, 2007, any amount of hedge ineffectiveness was not material.

The table below provides information about ABX's remaining treasury lock instrument at June 30, 2007 (in thousands):

Expire	Notional Amount	Stated Interest Rate	Market Value
2007	\$ 12,000	4.75%	\$ 296

NOTE K COMPREHENSIVE INCOME

Comprehensive income includes the following transactions for the six months ended June 30, 2007 and 2006 (in thousands):

	Three Months Ended June 30			Six Months Ended June 30		
	Before Tax	Income Tax (Expense) Benefit	Net of Tax	Before Tax	Income Tax (Expense) Benefit	Net of Tax
2007						
Net income			\$ 4,545			\$ 8,812
Other comprehensive income:						
Unrealized gain (loss) on marketable securities	\$ (20)	\$ 8	(12)	\$ (8)	\$ 3	(5)
Unrealized gain on hedge derivatives	421	(160)	261	329	(125)	204
Reclassifications to net income:						
Hedging gain realized in net income	(22)	8	(14)	(47)	18	(29)
Pension actuarial loss	1,490	(566)	924	2,981	(1,133)	1,848
Post-retirement actuarial loss	159	(60)	99	317	(120)	197
Pension prior service cost	1,204	(457)	747	2,409	(915)	1,494
Total other comprehensive income	\$ 3,232	\$ (1,227)	2,005	\$ 5,981	\$ (2,272)	3,709
Comprehensive income			\$ 6,550			\$ 12,521
2006						
Net income			\$ 6,459			\$ 14,522

Edgar Filing: ABX AIR INC - Form 10-Q

Other comprehensive income:					
Unrealized loss on marketable securities	\$ (17)	\$	(17)	\$ (20)	\$ (20)
Unrealized gain on hedge derivatives	1,214		1,214	2,027	2,027
Total other comprehensive income	\$ 1,197	\$	1,197	\$ 2,007	\$ 2,007
Comprehensive income			\$ 7,656		\$ 16,529

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

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

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
Net income applicable to common stockholders	\$ 4,545	\$ 6,459	\$ 8,812	\$ 14,552
Weighted-average shares outstanding for basic earnings per share	58,282	58,270	58,282	58,270
Common equivalent shares:				
Effect of stock-based compensation awards	353	297	330	211
Weighted-average shares outstanding assuming dilution	58,635	58,567	58,612	58,481
Basic earnings per share	\$ 0.08	\$ 0.11	\$ 0.15	\$ 0.25
Diluted earnings per share	\$ 0.08	\$ 0.11	\$ 0.15	\$ 0.25

NOTE M SEGMENT INFORMATION

The Company operates in two reportable segments. The air cargo transportation, logistics and package handling services provided to DHL under the ACMI and Hub Services agreements are aggregated below as DHL (see Note A). The ACMI and charter services that the Company provides outside of the ACMI agreement with DHL are referred to as Charters below. The Company's other activities, which include contracts with the U.S. Postal Service and aircraft parts sales and maintenance services, do not constitute a reportable segment and are combined in All other with interest income. Cash, cash equivalents, marketable securities and deferred tax assets are reflected in Assets All other below (in thousands):

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
Revenues:				
DHL	\$ 258,880	\$ 294,849	\$ 531,833	\$ 655,661
Charters	14,162	5,401	21,207	9,251
All other	8,255	3,328	16,319	7,831
Total	\$ 281,297	\$ 303,578	\$ 569,359	\$ 672,743
Depreciation and amortization expense:				
DHL	\$ 10,472	\$ 10,498	\$ 20,845	\$ 20,416
Charters	2,176	803	3,561	1,844
All other	189	49	374	93
Total	\$ 12,837	\$ 11,350	\$ 24,780	\$ 22,353
Pre-tax earnings:				
DHL	\$ 3,406	\$ 3,641	\$ 7,220	\$ 8,892
Charters	2,215	704	3,205	946
All other	1,684	2,114	3,762	4,714
Total	\$ 7,305	\$ 6,459	\$ 14,187	\$ 14,552

Edgar Filing: ABX AIR INC - Form 10-Q

	June 30, 2007	December 31, 2006
Assets:		
DHL	\$ 341,170	\$ 358,211
Charters	195,239	126,682
All other	171,012	194,905
Total	\$ 707,421	\$ 679,798

The Company does not allocate overhead costs that are reimbursed by DHL to its non-DHL activities. The provisions of the commercial agreements with DHL do not require an allocation of overhead until such time as ABX derives more than 10% of its total revenue from non-DHL business activities.

Table of Contents**NOTE N RESTATEMENT OF PREVIOUSLY ISSUED FINANCIAL STATEMENTS**

Subsequent to the issuance of the Company's original Form 10-Q for the six months ended June 30, 2006, the Company's management determined that the unaudited condensed consolidated statement of cash flows for the six month period ended June 30, 2006 did not properly classify certain payments made for capital expenditures as investing activities. Rather, such payments were reflected as operating activities. This misclassification resulted in an understatement of cash flows provided by operating activities and an equal understatement of cash flows used by investing activities. As a result, the condensed consolidated statement of cash flows for the six month period ended June 30, 2006 has been restated to correct this error. This restatement does not impact the Company's previously reported condensed consolidated balance sheets, statements of earnings, comprehensive income, or changes in stockholders' equity.

The following table sets forth the effects of the restatement on certain line items within the Company's previously reported statements of cash flows (in thousands):

	Six months ended June 30, 2006		
	Previously reported	Adjustments	Restated
Changes in accounts payable	\$ (28,627)	\$ 10,562	\$ (18,065)
Net cash provided by operating activities	36,004	10,562	46,566
Capital expenditures	(43,371)	(10,562)	(53,933)
Net cash used in investing activities	(43,728)	(10,562)	(54,290)

Table of Contents

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

The following Management's Discussion and Analysis has been prepared with reference to the historical financial condition and results of operations of ABX Air, Inc. and its subsidiaries (ABX). The following discussion and analysis describes the principal factors affecting the results of operations, financial condition, cash flows, liquidity and capital resources. It should be read in conjunction with the accompanying unaudited financial statements and the related notes contained in this report and our Annual Report on Form 10-K/A for the year ended December 31, 2006.

BACKGROUND

ABX is an independent airline that provides cargo transportation and package sorting and handling services. We operate an in-service fleet of 101 aircraft as of June 30, 2007. DHL Express (USA), Inc. (DHL) is our largest customer. Our principal airline hub and largest package sorting operations are located in Wilmington, Ohio, and we operate sixteen regional hubs for DHL.

We assess our performance and operate in two reportable segments:

DHL: ABX provides services to DHL under two commercial agreements: an aircraft, crew, maintenance and insurance agreement (ACMI agreement) and a hub services agreement (Hub Services agreement). Under the ACMI agreement, ABX provides air cargo transportation to DHL on a cost-plus pricing structure. Under the Hub Services agreement, ABX provides staff to conduct package handling, package sorting, warehousing, and logistics services, as well as airport facilities and equipment maintenance services for DHL, also on a cost-plus pricing structure. Costs incurred under these agreements are generally marked up by 1.75% and included in revenues. Both agreements also allow ABX to earn incremental mark-up above the base 1.75% mark-up from the achievement of certain cost-related and service goals specified in the two agreements. Fuel, rent, interest on the promissory note to DHL, and ramp and landing fees incurred under the ACMI agreement are the most significant cost items reimbursed without mark-up.

The ACMI agreement has a term of seven years, expiring in August 2010, and the Hub Services agreement had an amended term of four years, expiring in August 2007. The Hub Services agreement automatically renews in August 2007 for a one-year period. Under the agreements, DHL can terminate specific ACMI aircraft, add to, delete or modify the air routes we operate under the ACMI agreement and increase or reduce the scope of services we provide under the Hub Services agreement. Additionally, DHL can terminate the agreements if ABX does not comply with certain performance standards specified in the agreements.

Charter: We also offer ACMI (aircraft, crew, maintenance and insurance) and on-demand charter services to freight forwarders and other shippers. We usually charge customers based on the number of block hours flown, and typical agreements specify a minimum number of block hours to be charged monthly. At June 30, 2007, we had seven Boeing 767 aircraft in charter segment service. Based on the most current projections, we are expecting to deploy five more Boeing 767 aircraft in 2007 and two more in 2008.

Our other activities, which include contracts with the U.S. Postal Service (USPS) and aircraft parts sales and maintenance services, do not constitute reportable segments.

Table of Contents**RESULTS OF OPERATIONS**

Earnings in the second quarter of 2007 declined \$1.9 million compared to the second quarter of 2006, primarily due to \$2.8 million of incremental, deferred (non-cash) income tax expense. ABX began to record deferred income tax expense starting in 2007 and, accordingly, had no income tax expense for the second quarter of 2006. Pre-tax earnings in the second quarter of 2007 increased \$0.8 million compared to the second quarter of 2006. The improvement in pre-tax earnings primarily reflects increased charter segment results, partially offset by increased interest expense. Total revenues decreased \$22.3 million, or 7.3%, to \$281.3 million for the second quarter of 2007 compared to the second quarter of 2006. The decline was primarily due to the removal of DC-9 aircraft from DHL services in August 2006 and the transition of the line-haul trucking network to DHL in May 2006. Revenue during the second quarter of 2007 was positively impacted by increased non-DHL charter flight hours, additional aircraft maintenance services and two additional USPS sorting centers added in September of 2006.

For the first half of 2007, we had net earnings of \$8.8 million compared to net earnings of \$14.6 million for the first half of 2006. Earnings from the first half of 2007 include a provision for deferred income tax expense of \$5.4 million, compared with no such provision in 2006. Before taxes, first-half earnings declined \$0.4 million, or 2.5%, to \$14.2 million. Increased earnings from charter segment operations largely offset increased interest expense and declines in earnings from our DHL contracts. Total revenues decreased 15.4% to \$569.4 million compared to the first half of 2006. Lower revenues from DHL, which declined 18.9%, were partially offset by increased charter segment revenues, which grew 129.2% compared to the first half of 2006.

Our earnings from the DHL segment declined \$0.2 million and \$1.7 million in the second quarter and first half of 2007, respectively, compared to the corresponding 2006 periods. We earned \$1.3 million on revenues of \$82.8 million from management of DHL's line-haul trucking operations in the first half of 2006, prior to the transfer of those operations to DHL in May 2006. Under the two agreements with DHL, we have the potential to earn additional revenues from an incremental mark-up each quarter based on achieving certain cost-related goals. We earned \$0.5 million and \$0.7 million of incremental mark-up under the ACMI agreement during the second quarter of 2007 and 2006, respectively. No incremental mark-up was earned under the Hub Services agreement for the second quarter of 2007 or 2006. For the first half of 2007, we earned \$1.1 million under the ACMI agreement and no incremental mark-up under the Hub Services agreement compared to \$1.4 million and \$0.8 million of incremental mark-up under the ACMI and Hub Services agreements, respectively, in the first half of 2006. The incremental mark-up for ACMI decreased \$0.2 million and \$0.3 million during the second quarter and first half of 2007, respectively, compared to the corresponding 2006 periods. The incremental mark-up for the first half of 2007 under the ACMI agreement resulted from flying greater than budgeted aircraft hours during the periods, while incurring lower than budgeted aircraft maintenance expenses. The incremental mark-up under the Hub Services agreement decreased \$0.8 million during the first half of 2007 compared to 2006. ABX did not earn an incremental mark-up under the Hub Services agreement in the second quarter or first half of 2007 because our costs were higher than budgeted while shipment volumes handled during the periods were below anticipated levels.

No incremental mark-up contribution from the annual cost and service goals specified in the two agreements was included in our revenue for the second quarter or first half of 2007 and 2006. Any revenue earned through the achievement of annual goals is recorded in the fourth quarter.

During the second quarter and first half of 2007, our expenses for the DHL segment included approximately \$0.5 million and \$0.9 million for costs, allocations and administrative expenses that are not reimbursable under the two DHL agreements. Our expenses for DHL that are reimbursed without mark-up decreased \$27.0 million and \$34.7 million for the second quarter and first half of 2007, respectively, compared to the same 2006 periods. The reason for the majority of this decrease is the transition of the management of the line-haul trucking network to DHL in May 2006. During the period of transition in April 2006, all costs incurred by ABX to manage the network were recorded as reimbursable without mark-up.

Table of Contents

Charter segment revenues grew 162.2% over the second quarter of 2006 to \$14.2 million for the second quarter of 2007. For the first half of 2007, charter revenues grew 129.2% to \$21.2 million compared to the first half of 2006. The growth of our non-DHL charter revenues reflects the deployment of five additional Boeing 767 aircraft into service since June 2006, including two aircraft contracted to All Nippon Airways Co., Ltd. (ANA). The two-year agreement, with an option for annual renewals, began May 15, 2007. We are supporting ANA's cargo operations throughout the Asian market, including Japan, China and Thailand. As a result of the expanded operations, our earnings included \$2.2 million from charter operations for the second quarter of 2007 compared to \$0.7 million for the second quarter of 2006. For the first half of 2007 and 2006, earnings from charter segment operations were \$3.2 million and \$0.9 million, respectively.

We expect to deploy five additional Boeing 767 aircraft into the charter segment by the end of 2007, and two more in 2008 as the freighter modifications are completed. While customer demand for these aircraft is currently strong, our operating results could be impacted by the time difference between the redelivery of a modified aircraft to us and that aircraft's deployment into revenue service. We begin to incur depreciation expense for each additional aircraft when an aircraft is ready for service. Revenue generating service may begin some time later, however, depending on satisfaction of a number of conditions, including international regulations and laws, contract negotiations, establishing flight crews, and arranging resources for aircraft handling. New customer agreements typically involve start-up expenses including those for route authorities, over fly rights, travel and other activities, and may impact future operating results, particularly as we experience a surge in aircraft deployments. We may begin to incur interest expense from incremental aircraft loans before those aircraft reach normal utilization levels.

Other, non-DHL revenues increased to \$8.3 million in the second quarter of 2007 compared to \$3.3 million in the second quarter of 2006. For the first half of 2007 and 2006, other, non-DHL revenues increased to \$16.3 million compared to \$7.8 million. Increased revenues were a result of being awarded two USPS sort center contracts in the fall of 2006 and an increase in aircraft maintenance work compared to 2006. As a result, earnings from all other, non-DHL activities increased \$0.4 million and \$0.2 million during the second quarter and first half of 2007, respectively, compared to the corresponding periods in 2006. Aircraft maintenance revenues continue to fluctuate and depend on hangar availability that coincides with customer maintenance schedules.

Table of Contents

A summary of our earnings is shown below (in thousands):

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
Revenues:				
DHL				
ACMI				
Base mark-up	\$ 109,800	\$ 114,938	\$ 225,887	\$ 243,083
Incremental mark-up	489	683	1,137	1,431
Total ACMI	110,289	115,621	227,024	244,514
Hub Services				
Base mark-up	77,428	81,081	158,694	229,564
Incremental mark-up				792
Total Hub Services	77,428	81,081	158,694	230,356
Other Reimbursable	71,163	98,147	146,115	180,791
Total DHL	258,880	294,849	531,833	655,661
Charters	14,162	5,401	21,207	9,251
Other Activities	8,255	3,328	16,319	7,831
Total Revenues	\$ 281,297	\$ 303,578	\$ 569,359	\$ 672,743
Expenses:				
DHL				
ACMI				
Hub Services	\$ 108,133	\$ 113,163	\$ 222,432	\$ 239,217
Other Reimbursable	76,178	79,898	156,066	226,761
Total DHL	255,474	291,208	524,613	646,769
Charters	11,947	4,697	18,002	8,305
Other Activities	7,143	2,598	14,095	5,801
Total Expenses	\$ 274,564	\$ 298,503	\$ 556,710	\$ 660,875
Pre-tax Earnings:				
DHL				
ACMI				
Hub Services	\$ 2,156	\$ 2,458	\$ 4,592	\$ 5,297
Other Reimbursable	1,250	1,183	2,628	3,595
Total DHL	3,406	3,641	7,220	8,892
Charters	2,215	704	3,205	946
Other Activities	1,112	730	2,224	2,030
Interest Income and Other	572	1,384	1,538	2,684
Total Pre-tax Earnings	\$ 7,305	\$ 6,459	\$ 14,187	\$ 14,552

Note: We do not allocate overhead costs that are reimbursed by DHL to charter and other non-DHL business activities. The provisions of the commercial agreements with DHL do not require an allocation of overhead until such time as ABX derives more than 10% of its total revenue from non-DHL business activities.

Table of Contents

Salaries, wages and benefits expense decreased 1.0% and 2.6% during the second quarter and first half of 2007 as compared to the corresponding periods of 2006. The decrease reflects an approximately 4% decrease in part time and full time staffing levels compared to the second quarter of 2006 and includes transferring the Allentown, Pennsylvania hub operations to DHL in January 2007.

Fuel expense decreased 11.9% and 8.2% during the three and six month periods ended June 30, 2007, respectively, compared to the corresponding periods in 2006. The decrease was driven by lower consumption of aviation fuel. The average aviation fuel price was \$2.20 and \$2.25 per gallon in the second quarters of 2007 and 2006, respectively. Our consumption of aviation fuel during the second quarter and first half of 2007 declined compared to 2006 in conjunction with the removal of aircraft by DHL since the third quarter of 2006.

Maintenance, materials and repairs decreased 2.3% and 18.4% during the three and six month periods ended June 30, 2007, compared to the corresponding periods in 2006. The primary reason for the decrease was the timing of scheduled heavy maintenance work for aircraft. Our policy is to expense these maintenance costs as they are incurred. Accordingly, our aircraft maintenance expenses fluctuate from period to period due to the timing of scheduled heavy maintenance work for aircraft. During the first six months of 2007, we processed 25 heavy maintenance checks compared to 38 in the first six months of 2006.

Depreciation and amortization expense increased 13.1% and 10.9% during the three and six month periods ended June 30, 2007, respectively, compared to the corresponding periods in 2006. The increase is primarily a result of five additional Boeing 767 aircraft that we placed in service since June of 2006.

Landing and ramp expense, which includes the cost of deicing chemicals, decreased 3.1% during the second quarter of 2007 but increased 17.0% during the six month period ended June 30, 2007 compared to the corresponding periods in 2006. These expenses increased over the six month period due to the more difficult winter weather experienced during the first quarter of 2007 compared to the first quarter of 2006.

Purchased line-haul expense decreased 91.8% and 96.2% during the three and six month periods ended June 30, 2007, respectively, compared to the corresponding periods in 2006. The decrease is a result of DHL assuming management of its line-haul trucking operations from ABX in May 2006. Expenses from those line-haul management operations were approximately \$17.5 million and \$81.5 million during the three and six month periods ended June 30, 2006.

Other operating expenses include pilot travel, professional fees, insurance, utilities, cost of parts sold to non-DHL customers and packaging supplies. Other operating expenses increased by \$2.7 million and \$2.2 million in the second quarter and first half of 2007 compared to the corresponding periods in 2006. The increase is a result of travel and consulting fees to generate third party growth and explore business development, as well as costs to support aircraft modifications. Other operating expenses will be impacted in future quarters by professional fees to legal and financial advisors engaged to advise ABX and evaluate an indication of interest by another company to purchase all of the outstanding shares of ABX stock

Our interest expense for the second quarter of 2007 increased \$0.7 million to \$3.4 million compared to second quarter of 2006. Our interest expense for the first half of 2007 increased \$1.0 million to \$6.6 million compared to the first half of 2006. The increase in interest expense is a result of four Boeing 767 aircraft financed through June 30, 2007.

Interest income increased by less than \$0.1 million and by \$0.2 million during the second quarter and first half of 2007, respectively, compared to the corresponding periods of 2006 due to higher short-term interest rates on our cash, cash equivalents and marketable securities.

Our effective tax rate for the second quarter and first half of 2007 was approximately 38.0%. In the second quarter and first half of 2006, income tax expense was offset by reductions in the tax valuation allowance.

Table of Contents**FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES*****Commitments***

We have commitments to acquire one additional Boeing 767 aircraft and complete the modification of it and six additional aircraft. We have contracted with an aircraft maintenance and modification provider to convert aircraft from passenger to standard freighter configuration. Based on the most current projections, we expect to place five more Boeing 767s into service by the end of 2007 and two in 2008 as modifications are completed. The estimated costs of the remaining aircraft purchase commitments and the anticipated modification costs approximate \$74.5 million. We project cash payments for aircraft purchases and modifications will be \$76.5 million in 2007 and \$14.0 million in 2008. The status of the Boeing 767 freighter aircraft available outside the ACMI agreement with DHL is shown below:

	At June 30, 2007			
	In Service	In Modification	Future Deliveries	Total
Charter Segment Boeing 767 Freighter Aircraft	7	6	1	14

We plan to finance the cost of modifying the aircraft with existing cash and contractor-provided financing during the modification period. Upon completion of the modification, we anticipate four more aircraft will be financed through a syndication process being arranged by our lead bank, financing approximately \$54.3 million. Our future operating results will be affected by the interest rates and other terms and conditions of the new borrowings.

We estimate that contributions to our qualified defined benefit pension plans will be \$26.8 million for the remainder of 2007 and total \$45.0 million for the year. We estimate our total pension expense, which is primarily reimbursable under the two DHL agreements, will be \$24.1 million for the remainder of 2007 for all pension plans, totaling \$48.1 million for the year.

Cash flows

Net cash generated from operating activities was \$48.5 million for the first six months of 2007 compared to \$46.6 million in the first half of 2006.

Capital spending levels are primarily a result of aircraft acquisitions and related freighter modification costs. Cash payments for capital expenditures were \$92.0 million in the first six months of 2007 compared to \$53.9 million in the first six months of 2006. Our capital expenditures in the first six months of 2007 included the acquisitions of four Boeing 767 aircraft and cargo modification costs for eleven aircraft. In the first six months of 2006, our capital expenditures were primarily for the acquisition of five Boeing 767 aircraft, their cargo modification costs and modification costs for an aircraft purchased in 2005. We estimate the total level of capital spending for all of 2007 will be approximately \$170.7 million compared to \$99.6 million in 2006. This revised estimate, updated from our Form 10-Q for the quarter ended March 31, 2007, includes the additional aircraft we expect to purchase and begin to modify in 2007.

Liquidity and Capital Resources

As of June 30, 2007, we had approximately \$38.7 million of cash and cash equivalents and \$21.4 million of marketable securities. The Company has a \$45.0 million credit facility through a syndicated Credit Agreement that expires in December 2008. Borrowings under the agreement are collateralized by substantially all of the Company's assets. The agreement contains an accordion feature to increase the borrowings to a total of \$50.0 million if the Company needs additional borrowing capacity. The agreement provides for the issuance of letters of credit on the Company's behalf. As of June 30, 2007, the unused credit facility totaled \$35.2 million, net of outstanding letters of credit of \$9.8 million.

We believe our current cash balances and forecasted cash flows provided by commercial agreements with DHL and other customers, combined with our credit facility and anticipated financing for aircraft acquisitions, will be sufficient to fund our planned operations and capital expenditures for 2007.

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

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

Revenue Recognition

Revenues from DHL are recognized when the related services are performed. Expenses incurred under the commercial agreements with DHL are generally subject to a base mark-up of 1.75%, which is recognized in the period during which the expenses are incurred. Certain costs, the most significant of which include fuel costs, interest on the promissory note to DHL, airport rent, ramp and landing fees incurred for performance under the ACMI agreement, are reimbursed and included in revenues without mark-up.

In addition to a base mark-up of 1.75%, both the ACMI and Hub Services agreements provide for an incremental mark-up potential above the base 1.75%, based on our achievement of specified cost and service goals. The ACMI agreement provides for a maximum potential incremental mark-up of 1.60%, with 1.35% based on cost performance and 0.25% based on service performance. The Hub Services agreement provides for a maximum potential incremental mark-up of 2.10%, with 1.35% based on cost performance and 0.75% on service performance. Both contracts call for 40% of any incremental mark-up earned from cost performance to be recognized based on quarterly results, with 60% measured against annual results. Accordingly, a maximum mark-up of approximately 0.54% may be achieved based on quarterly results and recognized in our quarterly revenues. Up to a maximum mark-up of approximately 0.81% based on annual cost performance could be recognized during the fourth quarter, when full-year results are known. Incremental mark-up potential associated with the service goals (0.25% in the ACMI agreement and 0.75% in the Hub Services agreement) is measured annually and any revenues earned from their attainment would be recognized during the fourth quarter, when full year results are known. Management cannot predict to what degree the Company will be successful in achieving incremental mark-up.

The Company derives a portion of its revenues from customers other than DHL. Non-DHL ACMI/charter service revenues are recognized on scheduled and non-scheduled flights when the specific flight has been completed. Aircraft parts and fuel sales are recognized when the parts and fuel are delivered. Revenues earned and expenses incurred in providing aircraft-related maintenance repair services or technical maintenance services are recognized in the period in which the services are completed and delivered to the customer. Revenues derived from transporting freight and sorting parcels are recognized upon delivery of shipments and completion of service.

Depreciation

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

Self-Insurance

We self-insure certain claims relating to workers compensation, aircraft, automobile, general liability and employee healthcare. We record a liability for reported claims and an estimate for incurred claims that have not yet been reported. Accruals for these claims are estimated utilizing historical paid claims data, recent claims trends and, in the case of employee healthcare, an independent actuarial report. Changes in claim severity and frequency could result in actual claims being materially different than the amounts provided for in our results of operations.

Table of Contents

Contingencies

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

Income Taxes

We account for income taxes under the provisions of SFAS No. 109, Accounting for Income Taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the company's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in ABX's financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences could materially impact the company's financial position or its results of operations.

Post-retirement Obligations

We sponsor qualified defined benefit plans for our pilots and other eligible employees. We also sponsor unfunded post-retirement healthcare plans for our flight crewmembers and non-flight crewmember employees. We also sponsor unfunded excess plans for certain employees in a non-qualified plan which includes our executive management that provide benefits in addition to amounts permitted to be paid under provisions of the tax law to participants in our qualified plans.

The accounting and valuation for these post-retirement obligations are determined by prescribed accounting and actuarial methods that consider a number of assumptions and estimates. The selection of appropriate assumptions and estimates is significant due to the long time period over which benefits will be accrued and paid. The long-term nature of these benefit payouts increases the sensitivity of certain estimates on our post-retirement costs. In actuarially valuing our pension obligations and determining related expense amounts, assumptions we consider most sensitive are discount rates, expected long-term investment returns on plan assets and future salary increases. Additionally, other assumptions concerning retirement ages, mortality and employee turnover also affect the valuations. For our post-retirement healthcare plans, consideration of future medical cost trend rates is a critical assumption in valuing these obligations. Actual results and future changes in these assumptions could result in future costs significantly higher than those recorded in our results of operations.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, (SFAS 157) which defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. SFAS 157 will be effective for the Company's fiscal year beginning January 1, 2008. The Company has not yet evaluated the impact that SFAS 157 will have on its financial statements and related disclosures.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS 115, which allows for the option to measure financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. Other than marketable securities and derivative instruments already measured at fair value, the Company does not presently have any financial assets or liabilities that it would elect to measure at fair value, and therefore the Company expects this standard will have no impact on its financial statements. SFAS 159 will be effective for the Company's fiscal year beginning January 1, 2008.

Table of Contents**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We face financial exposure to changes in interest rates. ABX's variable interest rate debt exposes us to differences in future cash flows resulting from changes in market interest rates. This risk is largely mitigated, however, because our interest expense for the debt with variable rate risk is marked up and charged to DHL under the ACMI agreement. The debt issued at fixed interest rates is exposed to fluctuations in fair value resulting from changes in market interest rates. ABX has a portfolio of marketable securities consisting primarily of U.S. government agency obligations and U.S. corporation obligations. These securities are classified as available-for-sale and are consequently recorded at fair market value with unrealized gains or losses reported as a separate component of stockholders' equity. These financial instruments are denominated in U.S. dollars and are not held for the purpose of trading. Our market risk related to debt and marketable securities did not materially change since December 31, 2006 except for new fixed interest rate aircraft loans described in Note F.

To reduce ABX's exposure to rising interest rates on anticipated aircraft financing transactions, we entered into five forward treasury lock agreements (treasury locks) with a major U.S. financial institution during the first quarter of 2006. The value of the treasury locks were also based on the ten-year U.S. Treasury rates, effectively countering the effect of changing interest rates on the anticipated financing transactions. The last outstanding treasury lock was settled in cash in July 2007, near the forecasted execution date of the anticipated financing transaction. See Note J for a table of treasury lock values and discussion of our accounting treatment for these hedging transactions.

Item 4. Controls and Procedures**(a) Evaluation of Disclosure Controls and Procedures**

As of June 30, 2007, ABX carried out an evaluation, under the supervision and with the participation of the Company's management, of the effectiveness of the design and operation of ABX's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)). Based upon the evaluation, ABX's Chief Executive Officer and Chief Financial Officer concluded that ABX's disclosure controls and procedures were effective to ensure that information required to be disclosed by ABX in the reports filed or submitted by it under the Exchange Act is recorded, processed, summarized and reported within time periods specified in the Securities and Exchange Commission rules and forms.

(b) Changes in Internal Controls

During the preparation of the condensed consolidated cash flow statement for the six month period ended June 30, 2007, management detected a material weakness in the Company's controls to appropriately report cash paid for capital expenditures. This caused restatements of the Company's consolidated statement of cash flows for the year ended December 31, 2006 and the quarter ended March 31, 2007. For the second quarter of 2007, management implemented a revised process to ensure that capital expenditures are properly reflected in the statement of cash flows in accordance with SFAS No. 95, Statement of Cash Flows. Specifically, the Company has added additional oversight review controls, accounts payable roll-forward procedures and tie-out processes to appropriately report cash paid for capital expenditures. Accordingly, management believes this process has remediated the material weakness as of the end the six month period ended June 30, 2007.

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

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Alleged Violations of Immigration Laws

ABX reported in January of 2005 that it was cooperating fully with an investigation by the U.S. Department of Justice ("DOJ") with respect to Garcia Labor Co., Inc., ("Garcia") a temporary employment agency based in Morristown, Tennessee, and ABX's use of contract employees that were being supplied to it by Garcia. The investigation concerns the immigration status of the Garcia employees assigned to ABX.

ABX terminated its contract with Garcia in February of 2005 and replaced the Garcia employees.

In October of 2005, the DOJ notified ABX that ABX and a few Company employees in its human resources department, in addition to Garcia, were targets of a criminal investigation. ABX cooperated fully with the investigation. In June of 2006, a non senior management employee of the Company entered a plea to a misdemeanor related to this matter. In July of 2006, a federal grand jury indictment was unsealed charging two Garcia companies, the president of Garcia and two of their corporate officers with numerous counts involving the violation of federal immigration laws. The Garcia defendants subsequently entered guilty pleas in U.S. district court and were sentenced in February and March of 2007. No proceedings have been initiated against ABX by the DOJ. See Note G to the consolidated financial statements of this report for additional information.

Other

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

Item 1A. Risk Factors

On June 12, 2007, DHL announced that it had acquired a 49% minority equity interest and a 24.9% voting interest in ASTAR Air Cargo Holdings, LLC (ASTAR), ABX's main competitor in providing air cargo lift to DHL in the U.S., and had extended its ACMI contract with ASTAR through 2019. DHL further announced that Hans Hickler, CEO of DHL Express (USA), Inc., had joined ASTAR's Board of Directors. On June 26, 2007, ASTAR expressed an indication of interest in acquiring all of the outstanding stock of ABX. The ABX Board of Directors, after consulting with its financial and legal advisors, rejected the proposal, stating that it did not adequately reflect the long term value of ABX's business plan, and it did not compensate ABX shareholders for any synergies that could be garnered if ABX and ASTAR were combined. The trading price of ABX's stock may fluctuate due to market speculation about possible buyout offers or the absence of such buyout offers.

There have been no other material changes from the risk factors previously disclosed in item 1A of ABX's 2006 Annual Report on Form 10-K/A, filed with the Securities and Exchange Commission on March 16, 2007.

Item 4. Submission of Matters to a Vote of Security Holders

On May 9, 2007, the Company held an annual meeting of its shareholders. At the meeting, shareholders voted to elect James E. Bushman, Randy D. Rademacher and Frederick R. Reed to serve as Directors of the Company for a term of three years, ratified the appointment of Deloitte and Touche LLP as independent auditors for 2007, voted against a stockholder proposal to establish a pay-for-superior-performance standard in the Company's executive incentive compensation plan, and voted against a stockholder proposal to limit the benefits provided under the Company's supplemental executive retirement plan.

Edgar Filing: ABX AIR INC - Form 10-Q

Director	Votes	
	Received	Withheld
James E. Bushman	52,607,288	2,198,354
Randy D. Rademacher	53,490,957	1,314,685
Frederick R. Reed	53,524,112	1,281,530

Table of Contents

Proposal	Votes Cast		
	For	Against	Abstain
Ratify independent auditors	54,604,530	127,097	74,015
Establish a pay-for-superior-performance standard in executive incentive compensation plan	2,742,135	34,155,865	745,226
Limit the benefits provided under the supplemental executive retirement plan	8,174,193	28,732,921	736,112

Item 5. Other Information

The Audit Committee of the Board of Directors has approved the services rendered by our independent registered public accounting firm during the period covered by this Form 10-Q filing.

Item 6. Exhibits

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

Exhibit No.	Description of Exhibit
10	Aircraft Loan and Security Agreement and related promissory note, dated February 16, 2007, by and among ABX Air, Inc. and Chase Equipment Leasing, Inc. ⁽¹⁾
10.1	Aircraft Loan and Security Agreement and related promissory note, dated April 25, 2007, by and among ABX Air, Inc. and Chase Equipment Leasing, Inc., filed herewith.
31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

(1) Incorporated by reference to the Company's Quarterly Report on Form 10-Q, filed with the Securities and Exchange Commission on May 9, 2007.

Table of Contents

SIGNATURES

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

ABX AIR, INC.,
a Delaware Corporation
Registrant

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

Date: August 13, 2007

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

Date: August 13, 2007