

Air Transport Services Group, Inc.  
Form 10-Q  
November 02, 2018

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

FORM 10-Q

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

For the quarterly period ended September 30, 2018

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

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) (Zip Code)

937-382-5591  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO   
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES  NO   
As of November 2, 2018, 59,080,387 shares of the registrant's common stock, par value \$0.01, were outstanding.



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

The financial information, including the financial statements, included in the Quarterly Report on Form 10-Q should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, filed with the Securities and Exchange Commission on March 1, 2018.

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](http://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](http://www.atsginc.com) as soon as reasonably practicable after filing with the SEC.

#### FORWARD LOOKING STATEMENTS

Statements contained in this Quarterly report on Form 10-Q that are not historical facts are considered forward-looking statements (as that term is defined in the Private Securities Litigation Reform Act of 1995). Words such as “future,” “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “predicts,” “will,” “would,” “could,” “ca” similar terms 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 2017 Annual Report filed on Form 10-K with the Securities and Exchange Commission.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
REVENUES	\$204,919	\$254,101	\$611,566	\$745,229
OPERATING EXPENSES				
Salaries, wages and benefits	71,341	61,177	216,173	199,496
Depreciation and amortization	43,201	37,605	124,825	111,828
Maintenance, materials and repairs	33,469	33,100	107,152	100,970
Fuel	5,981	34,035	17,682	101,134
Contracted ground and aviation services	2,636	40,445	7,464	93,283
Travel	6,903	6,357	20,823	20,543
Landing and ramp	1,211	4,682	3,670	14,338
Rent	3,274	3,052	10,264	10,091
Insurance	1,696	1,234	4,473	3,451
Other operating expenses	8,380	7,962	20,672	24,588
	178,092	229,649	533,198	679,722
OPERATING INCOME	26,827	24,452	78,368	65,507
OTHER INCOME (EXPENSE)				
Interest income	67	37	144	85
Non-service component of retiree benefit costs	2,045	(5,529)	6,135	(5,883)
Net gain (loss) on financial instruments	17,895	(34,433)	28,707	(100,213)
Loss from non-consolidated affiliate	(2,647)	(945)	(7,600)	(945)
Interest expense	(5,608)	(4,351)	(16,336)	(11,658)
	11,752	(45,221)	11,050	(118,614)
EARNINGS (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	38,579	(20,769)	89,418	(53,107)
INCOME TAX EXPENSE	(5,646)	(7,460)	(16,339)	(19,244)
EARNINGS (LOSS) FROM CONTINUING OPERATIONS	32,933	(28,229)	73,079	(72,351)
EARNINGS (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAXES	170	(4,655)	536	(4,271)
NET EARNINGS (LOSS)	\$33,103	\$(32,884)	\$73,615	\$(76,622)
BASIC EARNINGS (LOSS) PER SHARE				
Continuing operations	\$0.56	\$(0.48)	\$1.24	\$(1.23)
Discontinued operations	—	(0.08)	0.01	(0.07)
TOTAL BASIC EARNINGS (LOSS) PER SHARE	\$0.56	\$(0.56)	\$1.25	\$(1.30)
DILUTED EARNINGS (LOSS) PER SHARE				
Continuing operations	\$0.24	\$(0.48)	\$0.71	\$(1.23)
Discontinued operations	—	(0.08)	0.01	(0.07)
TOTAL DILUTED EARNINGS (LOSS) PER SHARE	\$0.24	\$(0.56)	\$0.72	\$(1.30)
WEIGHTED AVERAGE SHARES				
Basic	58,739	58,733	58,773	58,965

Diluted	68,323	58,733	68,629	58,965
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See notes to condensed consolidated financial statements.

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

(In thousands)

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
NET EARNINGS (LOSS)	\$33,103	\$(32,884)	\$73,615	\$(76,622)
OTHER COMPREHENSIVE INCOME (LOSS):				
Defined Benefit Pension	687	5,763	2,061	8,232
Defined Benefit Post-Retirement	43	37	127	111
Foreign Currency Translation	22	(15)	(117)	121
TOTAL COMPREHENSIVE INCOME (LOSS), net of tax	\$33,855	\$(27,099)	\$75,686	\$(68,158)

See notes to condensed consolidated financial statements.

AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES  
 UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	September 30, 2018	December 31, 2017
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 43,462	\$ 32,699
Accounts receivable, net of allowance of \$1,014 in 2018 and \$2,445 in 2017	93,662	109,114
Inventory	24,412	22,169
Prepaid supplies and other	15,698	20,521
<b>TOTAL CURRENT ASSETS</b>	<b>177,234</b>	<b>184,503</b>
Property and equipment, net	1,226,500	1,159,962
Lease incentive	68,006	80,684
Goodwill and acquired intangibles	43,710	44,577
Convertible note hedges	—	53,683
Other assets	37,618	25,435
<b>TOTAL ASSETS</b>	<b>\$ 1,553,068</b>	<b>\$ 1,548,844</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 101,205	\$ 99,728
Accrued salaries, wages and benefits	31,416	40,127
Accrued expenses	11,387	10,455
Current portion of debt obligations	14,860	18,512
Unearned revenue	15,204	15,850
<b>TOTAL CURRENT LIABILITIES</b>	<b>174,072</b>	<b>184,672</b>
Long term debt	527,226	497,246
Convertible note obligations	—	54,359
Stock warrant obligations	186,093	211,136
Post-retirement obligations	29,355	61,355
Other liabilities	46,334	45,353
Deferred income taxes	119,289	99,444
<b>TOTAL LIABILITIES</b>	<b>1,082,369</b>	<b>1,153,565</b>
Commitments and contingencies (Note H)		
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, 20,000,000 shares authorized, including 75,000 Series A Junior Participating Preferred Stock	—	—
Common stock, par value \$0.01 per share; 110,000,000 shares authorized; 59,080,387 and 59,057,195 shares issued and outstanding in 2018 and 2017, respectively	591	591
Additional paid-in capital	470,676	471,456
Retained earnings (accumulated deficit)	60,381	(13,748 )
Accumulated other comprehensive loss	(60,949 )	(63,020 )
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>470,699</b>	<b>395,279</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 1,553,068</b>	<b>\$ 1,548,844</b>

See notes to condensed consolidated financial statements.



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

(In thousands)

	Nine Months Ended September 30	
	2018	2017
<b>OPERATING ACTIVITIES:</b>		
Net earnings (loss) from continuing operations	\$73,079	\$(72,351)
Net earnings (loss) from discontinued operations	536	(4,271 )
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	143,471	121,589
Pension and post-retirement	2,826	18,916
Deferred income taxes	15,972	15,986
Amortization of stock-based compensation	3,568	2,648
Net (gain) loss on financial instruments	(28,707 )	100,213
Changes in assets and liabilities:		
Accounts receivable	18,159	11,770
Inventory and prepaid supplies	477	(2,661 )
Accounts payable	1,097	11,698
Unearned revenue	(1,412 )	6,995
Accrued expenses, salaries, wages, benefits and other liabilities	(4,618 )	(7,357 )
Pension and post-retirement assets	(32,000 )	(10,658 )
Other	8,365	(1,244 )
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>200,813</b>	<b>191,273</b>
<b>INVESTING ACTIVITIES:</b>		
Capital expenditures	(214,025)	(218,759)
Proceeds from property and equipment	17,473	9
Acquisitions and investments in businesses	(8,285 )	(6,900 )
Redemption of long term deposits	—	9,975
<b>NET CASH (USED IN) INVESTING ACTIVITIES</b>	<b>(204,837)</b>	<b>(215,675)</b>
<b>FINANCING ACTIVITIES:</b>		
Principal payments on long term obligations	(39,889 )	(250,131)
Proceeds from borrowings	60,000	90,000
Proceeds from convertible notes	—	258,750
Payments for financing costs	(414 )	(6,469 )
Purchase convertible note hedges	—	(56,097 )
Proceeds from issuance of warrants	—	38,502
Purchase of common stock	(3,581 )	(11,184 )
Withholding taxes paid for conversion of employee stock awards	(1,329 )	(1,436 )
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>14,787</b>	<b>61,935</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>10,763</b>	<b>37,533</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b>32,699</b>	<b>16,358</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$43,462</b>	<b>\$53,891</b>
<b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>		
Interest paid, net of amount capitalized	\$9,087	\$11,229
Federal alternative minimum and state income taxes paid	\$1,212	\$1,285
<b>SUPPLEMENTAL NON-CASH INFORMATION:</b>		
Accrued capital expenditures	\$23,775	\$12,561

See notes to condensed consolidated financial statements.

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

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

Nature of Operations

Air Transport Services Group, Inc. is a holding company whose subsidiaries primarily operate within the airfreight and logistics industry. The Company leases aircraft and provides airline operations, ground services, aircraft modification and maintenance services and other support services. The Company's subsidiaries offer a range of complementary services to delivery companies, freight forwarders, airlines and government customers. The Company's leasing subsidiary, Cargo Aircraft Management, Inc. ("CAM"), leases aircraft to each of the Company's airlines as well as to non-affiliated airlines and other lessees. The airlines, ABX Air, Inc. ("ABX") and Air Transport International, Inc. ("ATI"), each have the authority, through their separate U.S. Department of Transportation ("DOT") and Federal Aviation Administration ("FAA") certificates, to transport cargo worldwide. The Company's airlines provide a combination of aircraft, crews, maintenance and insurance services for a customer's transportation network through "CMI" and "ACMI" agreements and through charter contracts in which aviation fuel is also included. ATI provides passenger transportation, primarily to the U.S. Military, using "combi" aircraft, which are certified to carry passengers as well as cargo on the main deck. Through its subsidiary Airborne Maintenance and Engineering Services, Inc. ("AMES"), the Company provides aircraft maintenance and modification services. In addition, the Company provides ground equipment maintenance and operates mail and package sorting facilities.

Basis of Presentation

The accompanying unaudited condensed interim consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America and such principles are applied on a basis consistent with the financial statements reflected in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations promulgated by the SEC related to interim financial statements. In the opinion of management, the accompanying financial statements contain all adjustments, including normal recurring adjustments, necessary for the fair presentation of the Company's results of operations and financial position for the periods presented. Due to seasonal fluctuations, among other factors common to the air cargo industry, the results of operations for the periods presented are not necessarily indicative of the results of operations to be expected for the entire year or any interim period. The preparation of consolidated financial statements requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements. The accounting estimates reflect the best judgment of management, but actual results could differ materially from those estimates.

The accompanying condensed consolidated financial statements include the accounts of Air Transport Services Group, Inc. and its wholly-owned subsidiaries. Investments in affiliates in which the Company has significant influence but does not exercise control are accounted for using the equity method of accounting. Using the equity method, the Company's share of the nonconsolidated affiliates' income or loss is recognized in the consolidated statement of earnings and cumulative post-acquisition changes in the investment are adjusted against the carrying amount of the investment. Inter-company balances and transactions are eliminated.

Accounting Standards Updates

Effective January 1, 2018 the Company adopted the Financial Accounting Standards Board's ("FASB") Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("Topic 606") which superseded previous revenue recognition guidance. Topic 606 is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. The Company's lease revenues within the scope of ASC 840, Leases, are specifically excluded from Topic 606.



The Company adopted the standard using a modified retrospective approach, under which financial statements are prepared under the revised guidance for the year of adoption, but not for prior years. Under this method, entities recognize a cumulative catch-up adjustment to the opening balance of retained earnings at the effective date for open contract performance at that time. The Company's adoption efforts included the identification of revenue within the scope of the standard, the evaluation of customer contracts in conjunction with new guidance and an assessment of the qualitative and quantitative impacts of the new standard on its financial statements. The evaluation included the application of each of the five steps identified in the Topic 606 revenue recognition model.

The Company determined that under Topic 606, it is an agent for aviation fuel and certain other costs reimbursed by customers under its ACMI and CMI contracts and for certain cargo handling services that it arranges for a customer. Under the new revenue standard, such reimbursed amounts are reported net of the corresponding expenses beginning in 2018. This application of Topic 606 did not have a material impact on the Company's reported earnings in any period. Additionally under Topic 606, the Company is required to record revenue over time, instead of at the time of completion, for certain customer contracts for airframe and modification services that do not have an alternative use and for which the Company has an enforceable right to payment during the service cycle. The Company adopted the provisions of this new standard using the modified retrospective method which requires the Company to record a one time adjustment to retained deficit for the cumulative effect that the standard has on open contracts at the time of adoption. Upon adoption of the new standard the Company accelerated \$3.6 million of revenue resulting in an immaterial adjustment to its January 1, 2018 retained deficit for open airframe and modification services contracts. In January 2017, the FASB issued ASU "Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment" ("ASU 2017-04"). This new standard eliminates Step 2 from the goodwill impairment test and requires an entity to perform its goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity recognizes an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. ASU 2017-04 is effective for any annual or interim goodwill impairment tests in the fiscal years beginning after December 15, 2019 and must be applied prospectively. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company adopted this new accounting guidance in January of 2018. The adoption did not have an impact on the Company's financial position, results of operations, or cash flows.

In March 2017, the FASB issued ASU "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost" (ASU 2017-07"). ASU 2017-07 requires an employer to report the service cost component of retiree benefits in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented separately from the service cost component and outside a subtotal of income from operations. The Company adopted ASU 2017-07 on January 1, 2018, retrospectively to all periods presented. As a result, retiree benefit plan interest expense, investment returns, settlements and other non-service cost components of retiree benefit expenses are excluded from the Company's operating income subtotal as reported in the Company's Consolidated Statement of Operations, but remain included in earnings before income taxes. Information about retiree benefit plans' interest expense, investment returns and other components of retiree benefit expenses can be found in Note I.

In February 2016, the FASB issued ASU "Leases (Topic 842)" ("ASU 2016-02"), which will require the recognition of right to-use-assets and lease liabilities for leases previously classified as operating leases by lessees. The standard will take effect for annual reporting periods beginning after December 15, 2018, including interim reporting periods. Early application will be permitted for all entities. In addition, the FASB has decided to require a lessee to apply a modified retrospective transition approach for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements (the date of initial application). The modified retrospective approach would not require any transition accounting for leases that expired before the date of initial application. The Company is currently evaluating the impact of the standard on its financial statements and disclosures.

In February 2018, the FASB issued ASU "Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income" ("ASU 2018-02"). ASU 2018-02 amends ASC 220, Income Statement — Reporting Comprehensive Income, to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from U.S. federal tax legislation known as the Tax Cuts and Jobs Act. In addition, under the ASU 2018-02, a Company will be required to provide certain disclosures regarding stranded tax effects. ASU 2018-02 is effective for years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the impact of the standard on its financial statements and disclosures.

In June 2018, the FASB issued ASU "Improvements to Non-employee Share-based Payment Accounting" ("ASU 2018-07"). ASU 2018-07 amends ASC 718, "Compensation - Stock Compensation" ("ASC 718"), to simplify the accounting for share-based payments granted to non-employees for goods and services. ASU 2018-07 supersedes ASC 505-50, "Equity-Based Payments to Non-employees" ("ASC 505-50"). ASU 2018-07 aligns much of the accounting for share-based payments granted to non-employees for goods and services with the accounting for share-based payments granted to employees. ASU 2018-07 is effective for years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. Companies will apply the new guidance to equity-classified non-employee awards for which a measurement date has not been established and liability-classified non-employee awards that have not been settled as of the date of adoption by recognizing a cumulative-effect adjustment to retained earnings as of the beginning of the annual period of adoption. The Company is currently evaluating the impact of the standard on its financial statements and disclosures.

#### NOTE B—SIGNIFICANT CUSTOMERS

##### DHL

The Company has had long term contracts with DHL Network Operations (USA), Inc. and its affiliates ("DHL") since August 2003. Revenues from aircraft leases and related services performed for DHL were approximately 27% and 27% of the Company's consolidated revenues from continuing operations for the three and nine month periods ending September 30, 2018, respectively, compared to 25% and 25% for the corresponding periods of 2017. Revenues excluding directly reimbursed expenses from continuing operations performed for DHL comprised approximately 32% and 31% of the Company's consolidated revenues from continuing operations for the three and nine month periods ending September 30, 2017. The Company's balance sheets include accounts receivable with DHL of \$12.3 million and \$15.7 million as of September 30, 2018 and December 31, 2017, respectively.

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

##### Amazon

The Company has been providing freighter aircraft and services for cargo handling and logistical support for Amazon.com Services, Inc. ("ASI"), successor to Amazon Fulfillment Services, Inc., a subsidiary of Amazon.com, Inc. ("Amazon") since September 2015. On March 8, 2016, the Company entered into an Air Transportation Services Agreement (the "ATSA") with ASI, pursuant to which CAM leases 20 Boeing 767 freighter aircraft to ASI, including 12 Boeing 767-200 freighter aircraft for a term of five years and eight Boeing 767-300 freighter aircraft for a term of seven years. The ATSA also provides for the operation of those aircraft by the Company's airline subsidiaries, and the management of ground services by the Company's subsidiary LGSTX Services Inc. ("LGSTX"). The ATSA became effective on April 1, 2016 and has a term of five years. CAM owns all 20 of the Boeing 767 aircraft that are leased and operated under the ATSA.



Revenues from continuing operations performed for Amazon comprised approximately 31% and 29% of the Company's consolidated revenues from continuing operations for the three and nine month periods ending September 30, 2018, respectively, compared to 45% and 42% for the corresponding periods of 2017. Revenues excluding directly reimbursed expenses from continuing operations performed for Amazon comprised approximately 27% and 27% of the Company's consolidated revenues from continuing operations for the three and nine month period ending September 30, 2017. The Company's balance sheets include accounts receivable with Amazon of \$37.3 million and \$44.2 million as of September 30, 2018 and December 31, 2017, respectively.

In conjunction with the execution of the ATSA, the Company and Amazon entered into an Investment Agreement and a Stockholders Agreement on March 8, 2016. The Investment Agreement calls for the Company to issue warrants in three tranches which will grant Amazon the right to acquire up to 19.9% of the Company's outstanding common shares as described below. The first tranche of warrants, issued upon the execution of the Investment Agreement and all of which are now fully vested, granted Amazon the right to purchase approximately 12.81 million ATSG common shares, with the first 7.69 million common shares vesting upon issuance on March 8, 2016, and the remaining 5.12 million common shares vesting as the Company delivered additional aircraft leased under the ATSA. The second tranche of warrants, which were issued and vested on March 8, 2018, grants Amazon the right to purchase approximately 1.59 million ATSG common shares. The third tranche of warrants will be issued and vest on September 8, 2020, and will grant Amazon the right to purchase such additional number of ATSG common shares as is necessary to bring Amazon's ownership to 19.9% of the Company's pre-transaction outstanding common shares measured on a GAAP-diluted basis, adjusted for share issuances and repurchases by the Company following the date of the Investment Agreement and after giving effect to the warrants granted. The exercise price of the warrants is \$9.73 per share, which represents the closing price of ATSG's common shares on February 9, 2016. Each of the three tranches of warrants are exercisable in accordance with its terms through March 8, 2021. The Company anticipates making available the common shares required for the underlying warrants through a combination of share repurchases and the issuance of additional shares.

The Company's accounting for the warrants has been determined in accordance with the financial reporting guidance for equity-based payments to non-employees and for financial instruments. The warrants issued to Amazon as of March 8, 2016, were recorded to stockholders equity, having a fair value of \$4.89 per share. At that time, the fair value of the 7.69 million vested warrants issued to Amazon was recorded as a lease incentive asset and is being amortized against revenues over the duration of the aircraft leases. On May 12, 2016, the Company's stockholders approved an amendment to the Certificate of Incorporation of the Company at the annual meeting of stockholders to increase the number of authorized common shares and to approve the warrants in full as required under the rules of the Nasdaq Global Select Market. The stockholders' approval enabled features of the warrants that required the vested warrants of the first tranche and the warrants of the second and third tranches to be classified as financial instruments as of May 12, 2016. Accordingly, the fair value of those warrants was measured and classified in liabilities on that date. Since May 12, 2016, 5.12 million additional warrants in the first tranche vested in conjunction with the execution of eight aircraft leases. As of September 30, 2018, the Company's liabilities reflected 14.83 million warrants having a fair value of \$12.55 per share. The re-measurements of the warrants to fair value resulted in non-operating gains before the effect of income taxes of \$17.3 million and \$25.0 million for the three and nine month periods ended September 30, 2018, respectively, compared to non-operating losses of \$35.0 million and \$100.6 million for the corresponding periods of 2017.

The Company's earnings in future periods will be impacted by the number of warrants granted, the re-measurements of warrant fair value, amortizations of the lease incentive asset and the related income tax effects. For income tax calculations, the value and timing of related tax deductions will differ from the guidance described above for financial reporting.



### U.S. Military

A substantial portion of the Company's revenues is also derived from the U.S. Military. The U.S. Military awards flights to U.S. certificated airlines through annual contracts and through temporary "expansion" routes. Revenues from services performed for the U.S. Military were approximately 9% and 10% of the Company's total revenues from continuing operations for the three and nine month periods ending September 30, 2018, respectively, compared to 7% and 7% for the corresponding periods of 2017. Revenues excluding directly reimbursed expenses from continuing operations performed for the U.S. Military comprised approximately 10% and 10% of the Company's consolidated revenues from continuing operations for the three and nine month periods ending September 30, 2017. The Company's balance sheets included accounts receivable with the U.S. Military of 4.0 million and 6.7 million as of September 30, 2018 and December 31, 2017, respectively.

### NOTE C—GOODWILL, INTANGIBLES AND EQUITY INVESTMENTS

The Company's assets for CAM and the MRO Services segments each include goodwill. An annual impairment test was performed for each, respectively, at December, 31, 2017 using industry market multiples and discounted cash flows utilizing a market-derived rate of return (level 3 fair value inputs). Goodwill was not impaired.

The carrying amounts of goodwill are as follows (in thousands):

	CAM	MRO Services	Total
Carrying value as of December 31, 2017	\$34,395	\$ 2,884	\$37,279
Carrying value as of September 30, 2018	\$34,395	\$ 2,884	\$37,279

The Company's acquired intangible assets are as follows (in thousands):

	Airline Certificates	Amortizing Intangibles	Total
Carrying value as of December 31, 2017	\$ 3,000	\$ 4,298	\$7,298
Amortization	—	(867 )	(867 )
Carrying value as of September 30, 2018	\$ 3,000	\$ 3,431	\$6,431

The airline certificates have an indefinite life and therefore are not amortized. The Company amortizes finite-lived intangibles assets, including customer relationship and STC intangibles, over 4 to 7 years.

Stock warrants issued to a lessee (see Note B) as an incentive are recorded as a lease incentive asset using their fair value at the time that the lessee has met its performance obligation and amortized against revenues over the duration of related aircraft leases. The Company's lease incentive granted to the lessee was as follows (in thousands):

	Lease Incentive
Carrying value as of December 31, 2017	\$80,684
Amortization	(12,678 )
Carrying value as of September 30, 2018	\$68,006

The lease incentive began to amortize in April 2016, with the commencement of certain aircraft leases over the duration of the related leases.

In January 2014, the Company acquired a 25 percent equity interest in West Atlantic AB of Gothenburg, Sweden ("West") and in December 2017, the Company entered into a preferred equity instrument. West, through its two airlines, Atlantic Airlines Ltd. and West Air Sweden AB, operates a fleet of aircraft on behalf of European regional mail carriers and express logistics providers. The airlines operate a combined fleet of British Aerospace ATPs, Bombardier CRJ-200-PFs, and Boeing 767 and 737 aircraft. West leases three Boeing 767 aircraft and two Boeing 737 from the Company. The Company's carrying value of West was \$6.6 million and \$7.1 million at September 30, 2018 and December 31,

2017, respectively, including \$5.5 million of excess purchase price over the Company's fair value of West's net assets in January of 2014. The Company's equity interest and the preferred equity instrument are reflected in "Other Assets" in the Company's consolidated balance sheets as of September 30, 2018 and December 31, 2017.

On August 3, 2017 the Company entered into a joint-venture agreement with Precision Aircraft Solutions, LLC, to develop a passenger-to-freighter conversion program for Airbus A321-200 aircraft. The Company anticipates approval of a supplemental type certificate from the FAA in 2019. The Company expects to make contributions equal to its 49% ownership percentage of the program's total costs over the next two years. The Company accounts for its investment in the joint venture under the equity method of accounting, in which the carrying value of the investment is reduced for the Company's share of the joint ventures operating losses. The carrying value of the joint venture, reflected in "Other Assets" in the Company's consolidated balance sheets, was \$6.3 million and \$5.6 million at September 30, 2018 and December 31, 2017.

#### NOTE D—FAIR VALUE MEASUREMENTS

The Company's money market funds and interest rate swaps are reported on the Company's consolidated balance sheets at fair values based on market values from identical or comparable transactions. The fair value of the Company's money market funds, stock warrant obligations, convertible note, convertible note hedges and interest rate swaps are based on observable inputs (Level 2) from comparable market transactions. The fair value of the stock warrant obligations were determined using a Black-Scholes pricing model which considers the Company's common stock price and various assumptions, such as the volatility of the Company's common stock, the expected dividend yield, and the risk-free interest rate. The fair value of the note conversion obligations and the convertible note hedges were estimated using a Black-Scholes pricing model and incorporate the terms and conditions of the underlying financial instruments. The valuations are, among other things, subject to changes in both the Company's credit worthiness and the counter-parties to the instruments as well as change in general market conditions. While the change in fair value of the note conversion obligations and the convertible note hedges are generally expected to move in opposite directions, the net change in any given period may be material.

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

As of September 30, 2018	Fair Value Measurement Using		Total
	Level 2	Level 3	
<b>Assets</b>			
Cash equivalents—money market	\$ 31,899	\$ —	—\$31,899
Interest rate swap	—5,555	—	5,555
Total Assets	\$ 37,454	\$ —	—\$37,454
<b>Liabilities</b>			
Stock warrant obligations	—(186,093 )	—	(186,093 )
Total Liabilities	\$ —(186,093)	\$ —	—\$(186,093)

As of December 31, 2017	Fair Value		Total
	Measurement Level	Using Level 2 Level 3	
<b>Assets</b>			
Cash equivalents—money market	\$1,326	\$	—\$1,326
Interest rate swap	—1,840	—	1,840
Convertible note hedges	—53,683	—	53,683
<b>Total Assets</b>	<b>\$—56,849</b>	<b>\$</b>	<b>—\$56,849</b>
<b>Liabilities</b>			
Note conversion obligations	—(54,359 )	—	(54,359 )
Stock warrant obligation	—(211,136 )	—	(211,136 )
<b>Total Liabilities</b>	<b>\$—(265,495 )</b>	<b>\$</b>	<b>—\$(265,495 )</b>

As a result of higher market interest rates compared to the stated interest rates of the Company's fixed rate debt obligations, the fair value of the Company's debt obligations, based on Level 2 observable inputs, was approximately \$7.5 million less than the carrying value, which was \$542.1 million at September 30, 2018. As of December 31, 2017, the fair value of the Company's debt obligations was approximately \$9.1 million more than the carrying value, which was \$515.8 million. The non-financial assets, including goodwill, intangible assets and property and equipment are measured at fair value on a non-recurring basis.

#### NOTE E—PROPERTY AND EQUIPMENT

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

	September 30, 2018	December 31, 2017
Flight equipment	\$ 1,927,864	\$ 1,801,808
Ground equipment	55,548	53,523
Leasehold improvements, facilities and office equipment	28,609	26,897
Aircraft modifications and projects in progress	152,202	121,760
	2,164,223	2,003,988
Accumulated depreciation	(937,723 )	(844,026 )
<b>Property and equipment, net</b>	<b>\$ 1,226,500</b>	<b>\$ 1,159,962</b>

CAM owned aircraft with a carrying value of \$733.6 million and \$697.4 million that were under leases to external customers as of September 30, 2018 and December 31, 2017, respectively.

The Company's accounting policy for major airframe and engine maintenance varies by subsidiary and aircraft type. The costs of airframe maintenance for Boeing 767-200 operated by ABX are expensed as they are incurred. The costs of major airframe maintenance for the Company's other aircraft are capitalized and amortized over the useful life of the overhaul. Many of the Company's General Electric CF6 engines that power the Boeing 767-200 aircraft are maintained under "power by the hour" and "power by the cycle" agreements with an engine maintenance provider. Further, in May 2017, the Company entered into similar maintenance agreements for certain General Electric CF6 engines that power many of the Company's Boeing 767-300 aircraft. Under these agreements, the engines are maintained by the service provider for a fixed fee per cycle and/or flight hour. As a result, the cost of maintenance for these engines is generally expensed as flights occur. During their term, these maintenance agreements contain provisions for a minimum level of flight activity. Maintenance for the airlines' other aircraft engines, including those powering Boeing 757 aircraft, are typically contracted to service providers on a time and material basis and the costs of those engine overhauls are capitalized and amortized over the useful life of the overhaul.

## NOTE F—DEBT OBLIGATIONS

Debt obligations consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Unsubordinated term loan	\$59,346	\$ 70,568
Revolving credit facility	280,000	245,000
Aircraft loans	—	3,640
Convertible debt	202,740	196,550
Total debt obligations	542,086	515,758
Less: current portion	(14,860 )	(18,512 )
Total long term obligations, net	\$527,226	\$ 497,246

The Company executed a syndicated credit agreement ("Senior Credit Agreement") in May 2011 which includes an unsubordinated term loan and a revolving credit facility which has a capacity of \$545.0 million. The Senior Credit Agreement expires May 30, 2023. Each year, through May 6, 2019, the Company may request a one year extension of the final maturity date, subject to the lenders' consent. The Senior Credit Agreement permits additional indebtedness of up to \$300.0 million for the convertible debt. The Senior Credit Agreement limits the amount of dividends the Company can pay and the amount of common stock it can repurchase to \$100.0 million during any calendar year, provided the Company's total secured debt to earnings before interest, taxes, depreciation and amortization expenses ("EBITDA") ratio is under 3.00 times, after giving effect to the dividend or repurchase. As of September 30, 2018, the unused revolving credit facility totaled \$254.9 million, net of draws of \$280.0 million and outstanding letters of credit of \$10.1 million. Additionally, the Senior Credit Agreement includes an accordion feature such that the Company can now draw up to an additional \$100.0 million subject to the lenders' consent.

The Senior Credit Agreement is collateralized by certain of the Company's Boeing 767 and 757 aircraft that are not collateralized under aircraft loans. Under the terms of the Senior Credit Agreement, the Company is required to maintain collateral coverage equal to 125% of the outstanding balance of the term loan and the maximum capacity of revolving credit facility or 150% of the outstanding balance of the term loan and the total funded revolving credit facility, whichever is less. The minimum collateral coverage which must be maintained is 50% of the outstanding balance of the term loan plus the revolving credit facility commitment which was \$545.0 million.

The balance of the unsubordinated term loan is net of debt issuance costs of \$0.7 million and \$0.7 million for the periods ending September 30, 2018 and December 31, 2017, respectively. Under the terms of the Senior Credit Agreement, interest rates are adjusted quarterly based on the Company's EBITDA, its outstanding debt level and prevailing LIBOR or prime rates. At the Company's current debt-to-EBITDA ratio, the LIBOR based financing for the unsubordinated term loan and revolving credit facility bear a variable interest rate of 3.75% and 3.75%, respectively. The aircraft loan was paid off by the Company in January 2018.

The Senior Credit Agreement contains covenants including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness, as well as a total debt to EBITDA ratio and a fixed charge coverage ratio. The Senior Credit Agreement stipulates events of default, including unspecified events that may have material adverse effects on the Company. If an event of default occurs, the Company may be forced to repay, renegotiate or replace the Senior Credit Agreement.

In September 2017, the Company issued \$258.8 million aggregate principal amount of 1.125% Convertible Senior Notes due 2024 ("Notes") in a private offering to qualified institutional buyers pursuant to Rule 144A under the Securities Act. The Notes bear interest at a rate of 1.125% per year payable semi-annually in arrears on April 15 and October 15 each year, beginning April 15, 2018. The Notes mature on October 15, 2024, unless repurchased or converted in accordance with their terms prior to such date. The Notes are unsecured indebtedness, subordinated to the Company's existing and future secured indebtedness and other liabilities, including trade payables. Conversion of the Notes can only occur upon satisfaction of certain conditions and during certain periods, beginning in any calendar quarter commencing after December 31, 2017 and thereafter, until the close of business on the second scheduled trading day



immediately preceding the maturity date. Upon the occurrence of certain fundamental changes, holders of the Notes can require the Company to repurchase their notes at the cash repurchase price equal to the principal amount of the notes, plus any accrued and unpaid interest.

The Notes may be settled in cash, the Company's common shares or a combination of cash and the Company's common shares, at the Company's election. The initial conversion rate is 31.3475 common shares per \$1,000 principal amount of Notes (equivalent to an initial conversion price of approximately \$31.90 per common share). If a "make-whole fundamental change" (as defined in the offering circular with the Notes) occurs, the Company will, in certain circumstances, increase the conversion rate for a specified period of time.

In conjunction with the Notes, the Company purchased convertible note hedges having the same number of the Company's common shares, 8.1 million shares, and same strike price of \$31.90, that underlie the Notes. The convertible note hedges are expected to reduce the potential equity dilution with respect to the Company's common stock, and/or offset any cash payments in excess of the principal amount due, as the case may be, upon conversion of the Notes. The Company's current intent and policy is to settle all Note conversions through a combination settlement which satisfies the principal amount of the Notes outstanding with cash. The Notes could have a dilutive effect on the computation of earnings per share in accordance with accounting principles to the extent that the average traded market price of the Company's common shares for a reporting period exceeds the conversion price.

The conversion feature of the Notes required bifurcation from the principal amount under the applicable accounting guidance. Settlement provisions of the Notes and the convertible note hedges required cash settlement of these instruments until the Company's shareholders increased the number of authorized shares of common stock to cover the full number of shares underlying the Notes. As a result, the conversion feature of the Notes and the convertible note hedges were initially accounted for as liabilities and assets, respectively, and marked to market at the end of each period. On May 10, 2018, the Company's shareholders increased the number of authorized shares of common stock to cover the full number of shares underlying the Notes. The Company reevaluated the Notes and convertible note hedges under the applicable accounting guidance including ASC 815, "Derivatives and Hedging," and determined that the instruments, which meet the definition of derivative and are indexed to the Company's own stock, should be classified in shareholder's equity. The fair value of the the conversion feature of the Notes and the convertible note hedges of \$51.3 million and \$50.6 million, respectively on May 10, 2018 were reclassified to paid-in capital.

The Notes issuance costs and discount are being amortized to interest expense through October 2024, using an effective interest rate of approximately 5.15%. The carrying value of the Company's Convertible debt is shown below:

	September 30, 2018	December 31, 2017
Principal value, Convertible Senior Notes, due 2024	258,750	258,750
Unamortized issuance costs	(6,028 )	(6,685 )
Unamortized discount	(49,982 )	(55,515 )
Convertible debt	202,740	196,550

In conjunction with the offering of the Notes, the Company also sold warrants to the convertible note hedge counterparties in separate, privately negotiated warrant transactions at a higher strike price and for the same number of the Company's common shares, subject to customary anti-dilution adjustments. The amount received for these warrants and recorded in paid-in capital on the Company's consolidated balance sheets was \$38.5 million. These warrants could result in 8.1 million additional shares of the Company's common stock, if the Company's traded market price exceeds the strike price which is \$41.35 per share and is subject to certain adjustments under the terms of the warrant transactions. The warrants could have a dilutive effect on the computation of earnings per share to the extent that the average traded market price of the Company's common shares for a reporting period exceeds the strike price.

## NOTE G—DERIVATIVE INSTRUMENTS

The Company's Senior Credit Agreement requires the Company to maintain derivative instruments for protection from fluctuating interest rates, for at least fifty percent of the outstanding balance of the term loan. Accordingly, the Company entered into interest rate swaps. The table below provides information about the Company's interest rate swaps (in thousands):

Expiration Date	Stated Interest Rate	September 30, 2018		December 31, 2017	
		Notional Amount	Market Value (Liability)	Notional Amount	Market Value (Liability)
May 5, 2021	1.090%	30,000	929	35,625	719
May 30, 2021	1.703%	30,000	606	35,625	240
March 31, 2022	1.900%	50,000	1,657	50,000	416
March 31, 2022	1.950%	75,000	2,363	75,000	465

The outstanding interest rate swaps are not designated as hedges for accounting purposes. The effects of future fluctuations in LIBOR interest rates on derivatives held by the Company will result in the recording of unrealized gains and losses into the statement of operations. The Company recorded pre-tax gains on derivatives of \$3.7 million and pre-tax losses of \$0.2 million for the nine month periods ending September 30, 2018 and 2017, respectively. The liability for outstanding derivatives is recorded in other liabilities and in accrued expenses.

The Company recorded a net loss before the effects of income taxes of \$0.1 million during the nine month periods ending September 30, 2018 for the revaluation of the convertible note hedges and the note conversion obligations to fair value before these instruments were reclassified to paid-in capital.

## NOTE H—COMMITMENTS AND CONTINGENCIES

## Lease Commitments

The Company leases portions of the air park in Wilmington, Ohio, under lease agreements with a regional port authority, the terms of which expire in May of 2019 and June of 2036 with options to extend the leases. The leased facilities include corporate offices, 310,000 square feet of maintenance hangars and a 100,000 square foot component repair shop at the air park. ABX also has the non-exclusive right to use the airport, which includes one active runway, taxi ways and ramp space. The Company also leases and operates a 311,500 square foot, two hangar aircraft maintenance complex in Tampa, Florida. Additionally, the Company leases certain equipment and airport facilities, office space, and maintenance facilities at other locations. As of September 30, 2018 and December 31, 2017, the Company did not lease any aircraft from lessors.

## Purchase Commitments

The Company has agreements with Israel Aerospace Industries Ltd. ("IAI") for the conversion of Boeing 767 passenger aircraft into a standard configured freighter aircraft. The conversions primarily consist of the installation of a standard cargo door and loading system. At September 30, 2018, the Company was committed to acquire and modify additional Boeing 767-300 passenger aircraft into standard freighter aircraft. In addition to six aircraft that were in the modification process at September 30, 2018, the Company is committed to induct one more aircraft into the freighter modification process through 2019, including commitments to purchase one more Boeing 767-300 passenger aircraft during the fourth quarter of 2018. As of September 30, 2018, the Company's commitments to complete the conversions of aircraft it owns or has the contracts to purchase totaled \$50.5 million. Additionally, the Company could incur a cancellation fee for part kits for any aircraft that is not inducted into conversion at IAI.

### Guarantees and Indemnifications

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

### Other

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

### Employees Under Collective Bargaining Agreements

As of September 30, 2018, the flight crewmember employees of ABX and ATI and flight attendant employees of ATI were represented by the labor unions listed below:

Airline Labor Agreement Unit	Percentage of the Company's Employees
ABX International Brotherhood of Teamsters	7.6%
ATI Air Line Pilots Association	7.5%
ATI Association of Flight Attendants	1.1%

### NOTE I—PENSION AND OTHER POST-RETIREMENT BENEFIT PLANS

#### Defined Benefit and Post-retirement Healthcare Plans

ABX sponsors a qualified defined benefit pension plan for ABX crewmembers and a qualified defined benefit pension plan for a major portion of its other ABX employees that meet minimum eligibility requirements. ABX also sponsors non-qualified defined benefit pension plans for certain employees. These non-qualified plans are unfunded.

Employees are no longer accruing benefits under any of the defined benefit pension plans. ABX also sponsors a post-retirement healthcare plan for its ABX employees, which is unfunded. Benefits for covered individuals terminate upon reaching age 65 under the post-retirement healthcare 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 of our post-retirement costs. The assumptions considered most sensitive in actuarially valuing ABX's pension obligations and determining related expense amounts are discount rates and expected long term investment returns on plan assets. Additionally, other assumptions concerning retirement ages, mortality and employee turnover also affect the valuations. Actual results and future changes in these assumptions could result in future costs significantly higher than those recorded in our results of operations.

ABX measures plan assets and benefit obligations as of December 31 of each year. Information regarding ABX's sponsored defined benefit pension plans and post-retirement healthcare plans follow below. The accumulated benefit obligation reflects pension benefit obligations based on the actual earnings and service to-date of current employees.



The Company's net periodic benefit costs for its defined benefit pension plans and post-retirement healthcare plans for both continuing and discontinued operations are as follows (in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	Pension Plans		Post-Retirement Healthcare Plan		Pension Plans		Post-Retirement Healthcare Plan	
	2018	2017	2018	2017	2018	2017	2018	2017
Service cost	\$—	\$—	\$ 30	\$ 39	\$—	\$—	\$ 90	\$ 117
Interest cost	7,284	8,396	32	36	21,852	25,946	96	108
Expected return on plan assets	(10,523 )	(10,520 )	—	—	(31,569 )	(32,379 )	—	—
Settlement charge	—	12,923	—	—	—	12,923	—	—
Amortization of prior service cost	—	—	—	(13 )	—	—	—	(39 )
Amortization of net (gain) loss	887	1,944	55	71	2,661	5,819	165	213
Net periodic benefit cost (income)	\$(2,352)	\$12,743	\$ 117	\$ 133	\$(7,056)	\$12,309	\$ 351	\$ 399

During the nine month period ending September 30, 2018, the Company contributed \$22.2 million to the pension plans. The Company expects to contribute an additional \$0.2 million during the remainder of 2018.

#### NOTE J—INCOME TAXES

The provision for income taxes for interim periods is based on management's best estimate of the effective income tax rate expected to be applicable for the current year, plus any adjustments arising from changes in the estimated amount of taxable income related to prior periods. Federal legislation known as the Tax Cuts and Jobs Acts ("Tax Act") was enacted on December 22, 2017. The Tax Act reduces the U.S. federal corporate tax rate from the previous rate of 35% to 21% effective January 1, 2018. The Tax Act also makes broad and complex changes to the U.S. tax code, including, but not limited to a one time tax on earnings of certain foreign subsidiaries, limitations of net operating loss carryforwards created in tax years beginning after December 31, 2017, bonus depreciation for full expensing of qualified property, and limitations on the deductibility of certain executive compensation. The Company will continue to refine the calculations as additional analysis is completed and the Company gains a more thorough understanding of the Tax Act, including the tax law related to the deductibility of purchased assets, state tax treatment, and amounts related to employee compensation.

Income tax expense recorded through September 30, 2018 utilized a projected annualized 24.4% rate applied to year-to-date income. Additionally, the Company recorded discrete tax items for the conversion of employee stock awards during the first quarter of 2018, resulting in an effective tax rate of 18.3%. The final effective tax rate applied to 2018 will depend on the actual amount of pre-tax book results by the Company for the full year, the additional conversions of employee stock awards, issuance of stock warrants and other items.

The Company has operating loss carryforwards for U.S. federal income tax purposes. Management expects to utilize the loss carryforwards to offset federal income tax liabilities in the future. Due to the Company's deferred tax assets, including its loss carryforwards, management does not expect to pay federal income taxes until 2023 or later. The Company may, however, be required to pay some federal tax due to loss carryforward usage limitations and certain state and local income taxes before then.

## NOTE K—ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated other comprehensive income (loss) includes the following items by components for the three and nine month periods ending September 30, 2018 and 2017 (in thousands):

	Defined Benefit Pension	Defined Benefit Post-Retirement	Foreign Currency Translation	Total
Balance as of June 30, 2017	(74,619)	(1,227 )	(1,341 )	(77,187)
Other comprehensive income (loss) before reclassifications:				
Actuarial loss for retiree liabilities	(5,821 )	—	—	(5,821 )
Foreign currency translation adjustment	—	—	(24 )	(24 )
Amounts reclassified from accumulated other comprehensive income:				
Pension settlement (reclassified to salaries, wages and benefits)	12,923	—	—	12,923
Actuarial costs (reclassified to non-service costs)	1,944	71	—	2,015
Negative prior service cost	—	(13 )	—	(13 )
Income Tax (Expense) or Benefit	(3,283 )	(21 )	9	(3,295 )
Other comprehensive income (loss), net of tax	5,763	37	(15 )	5,785
Balance as of September 30, 2017	(68,856)	(1,190 )	(1,356 )	(71,402)
	Defined Benefit Pension	Defined Benefit Post-Retirement	Foreign Currency Translation	Total
Balance as of December 31, 2016	(77,088)	(1,301 )	(1,477 )	(79,866)
Other comprehensive income (loss) before reclassifications:				
Actuarial loss for retiree liabilities	(5,821 )	—	—	(5,821 )
Foreign currency translation adjustment	—	—	186	186
Amounts reclassified from accumulated other comprehensive income:				
Pension settlement (reclassified to salaries, wages and benefits)	12,923	—	—	12,923
Actuarial costs (reclassified to non-service costs)	5,819	213	—	6,032
Negative prior service cost	—	(39 )	—	(39 )
Income Tax (Expense) or Benefit	(4,689 )	(63 )	(65 )	(4,817 )
Other comprehensive income (loss), net of tax	8,232	111	121	8,464
Balance as of September 30, 2017	(68,856)	(1,190 )	(1,356 )	(71,402)

	Defined Benefit Pension	Defined Benefit Post-Retirement	Foreign Currency Translation	Total
Balance as of June 30, 2018	(59,201)	(1,013 )	(1,487 )	(61,701)
Other comprehensive income (loss) before reclassifications:				
Foreign currency translation adjustment	—	—	33	33
Amounts reclassified from accumulated other comprehensive income:				
Actuarial costs (reclassified to non-service costs)	887	55	—	942
Income Tax (Expense) or Benefit	(200 )	(12 )	(11 )	(223 )
Other comprehensive income (loss), net of tax	687	43	22	752
Balance as of September 30, 2018	(58,514)	(970 )	(1,465 )	(60,949)

	Defined Benefit Pension	Defined Benefit Post-Retirement	Foreign Currency Translation	Total
Balance as of December 31, 2017	(60,575)	(1,097 )	(1,348 )	(63,020)
Other comprehensive income (loss) before reclassifications:				
Foreign currency translation adjustment	—	—	(178 )	(178 )
Amounts reclassified from accumulated other comprehensive income:				
Actuarial costs (reclassified to non-service costs)	2,661	165	—	2,826
Income Tax (Expense) or Benefit	(600 )	(38 )	61	(577 )
Other comprehensive income (loss), net of tax	2,061	127	(117 )	2,071
Balance as of September 30, 2018	(58,514)	(970 )	(1,465 )	(60,949)

## NOTE L—STOCK-BASED COMPENSATION

The Company's Board of Directors has granted stock incentive awards to certain employees and board members pursuant to a long term incentive plan which was approved by the Company's stockholders in May 2005 and in May 2015. Employees have been awarded non-vested stock units with performance conditions, non-vested stock units with market conditions and non-vested restricted stock. The restrictions on the non-vested restricted stock awards lapse at the end of a specified service period, which is typically three years from the date of grant. Restrictions could lapse sooner upon a business combination, death, disability or after an employee qualifies for retirement. The non-vested stock units will be converted into a number of shares of Company stock depending on performance and market conditions at the end of a specified service period, lasting approximately three years. The performance condition awards will be converted into a number of shares of Company stock based on the Company's average return on invested capital during the service period. Similarly, the market condition awards will be converted into a number of shares depending on the appreciation of the Company's stock compared to the NASDAQ Transportation Index. Board members were granted time-based awards with vesting periods of approximately six or twelve months. The Company expects to settle all of the stock unit awards by issuing new shares of stock. The table below summarizes award activity.

	Nine Months Ended			
	September 30, 2018		September 30, 2017	
	Number of Awards	Weighted average grant-date fair value	Number of Awards	Weighted average grant-date fair value
Outstanding at beginning of period	873,849	\$ 12.30	1,040,569	\$ 9.97
Granted	207,295	26.50	243,940	17.52
Converted	(96,616 )	10.89	(173,210 )	9.69
Expired	(500 )	28.38	—	—
Forfeited	(2,600 )	26.76	(3,800 )	13.66
Outstanding at end of period	981,428	\$ 15.39	1,107,499	\$ 11.66
Vested	326,928	\$ 7.18	324,599	\$ 6.39

The average grant-date fair value of each performance condition award, non-vested restricted stock award and time-based award granted by the Company in 2018 was \$25.15, the fair value of the Company's stock on the date of grant. The average grant-date fair value of each market condition award granted in 2018 was \$31.60. The market condition awards were valued using a Monte Carlo simulation technique, a risk-free interest rate of 2.4% and a volatility of 33.8% based on volatility over three years using daily stock prices.

For the nine month periods ending September 30, 2018 and 2017, the Company recorded expense of \$3.6 million and \$2.6 million, respectively, for stock incentive awards. At September 30, 2018, there was \$5.9 million of unrecognized expense related to the stock incentive awards that is expected to be recognized over a weighted-average period of 1.3 years. As of September 30, 2018, none of the awards were convertible, 326,928 units of the Board members time-based awards had vested and none of the outstanding shares of the restricted stock had vested. These awards could result in a maximum number of 1,216,478 additional outstanding shares of the Company's common stock depending on service, performance and market results through December 31, 2020.

## NOTE M—COMMON STOCK AND EARNINGS PER SHARE

## Earnings per Share

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

	Three Months Ending September 30,		Nine Months Ending September 30,	
	2018	2017	2018	2017
Numerator:				
Earnings (loss) from continuing operations - basic	\$32,933	\$(28,229)	\$73,079	\$(72,351)
Gain from stock warrants revaluation, net of tax	(16,801)	—	(24,274)	—
Earnings (loss) from continuing operations - diluted	\$16,132	\$(28,229)	\$48,805	\$(72,351)
Denominator:				
Weighted-average shares outstanding for basic earnings per share	58,739	58,733	58,773	58,965
Common equivalent shares:				
Effect of stock-based compensation awards and warrants	9,584	—	9,856	—
Weighted-average shares outstanding assuming dilution	68,323	58,733	68,629	58,965
Basic earnings per share from continuing operations	\$0.56	\$(0.48)	\$1.24	\$(1.23)
Diluted earnings per share from continuing operations	\$0.24	\$(0.48)	\$0.71	\$(1.23)

The determination of diluted earnings per share requires the exclusion of the fair value re-measurement of the stock warrants recorded as a liability (see Note B), if such warrants have a anti-dilutive effect on earnings per share. The dilutive effect of the weighted-average diluted shares outstanding is calculated using the treasury method for periods in which equivalent shares have a dilutive effect on earnings per share. Under this method, the number of diluted shares is determined by dividing the assumed proceeds of the warrants recorded as a liability by the average stock price during the period and comparing that amount with the number of corresponding warrants outstanding.

The underlying warrants recorded as a liability as of September 30, 2018 and 2017, could result in 14.8 million and 14.9 million additional shares of the Company's common stock if the warrants are settled by tendering cash, respectively.

The number of equivalent shares that were not included in weighted average shares outstanding assuming dilution, because their effect would have been anti-dilutive, were 9.9 million and 8.1 million for the three and nine month periods ended September 30, 2017, respectively.

## NOTE N—SEGMENT AND REVENUE INFORMATION

The Company operates in three reportable segments. The CAM segment consists of the Company's aircraft leasing operations and its segment earnings include an allocation of interest expense. The ACMI Services segment consists of the Company's airline operations, including CMI agreements as well as ACMI and charter service agreements that the Company has with its customers. The MRO Services segment provides airframe maintenance services, aircraft modifications and other maintenance services. The MRO Services became reportable during 2018 due to the size of its revenues. Prior periods presented below have been prepared by separating MRO Services from "All other" for comparative purposes. The Company's ground services and other activities, which include the mail and package sorting services, maintenance services for ground equipment, facilities and material handling equipment, the sales of aviation fuel and other services, are not large enough to constitute reportable segments and are combined in All other. Inter-segment revenues are valued at arms-length market rates. Cash and cash equivalents are reflected in Assets - All other below.

The Company's segment information for revenue from continuing operations is presented below (in thousands):

	Three Months Ending		Nine Months Ending	
	September 30, 2018	2017	September 30, 2018	2017
Total revenues:				
CAM	\$58,786	\$58,465	\$165,539	\$155,973
ACMI Services	116,224	146,943	355,204	436,391
MRO Services	46,879	39,928	145,125	146,602
All other	22,598	54,542	61,611	153,582
Eliminate inter-segment revenues	(39,568 )	(45,777 )	(115,913 )	(147,319 )
Total	\$204,919	\$254,101	\$611,566	\$745,229
Customer revenues:				
CAM	\$41,366	\$40,940	\$115,270	\$104,102
ACMI Services	116,209	146,938	355,172	436,386
MRO Services	27,227	13,916	87,236	70,492
All other	20,117	52,307	53,888	134,249
Total	\$204,919	\$254,101	\$611,566	\$745,229

The Company adopted Topic 606 for revenue recognition using a modified retrospective approach, under which financial statements are prepared under the revised guidance for the year of adoption, but not for prior years. The effects of Topic 606 on the Company's customer revenues are summarized below:

	For the three months ending			For the nine months ending		
	September 30, 2018			September 30, 2018		
	Revenue			Revenue		
	As Reported	Without Topic 606	Increase (decrease)	As Reported	Without Topic 606	Increase (decrease)
ACMI Services	\$116,209	\$163,866	\$(47,657 )	\$355,172	\$500,139	\$(144,967)
MRO Services	27,227	25,319	1,908	87,236	80,237	6,999
Other (ground services)	20,117	60,953	(40,836 )	53,888	191,820	(137,932 )

ACMI Services revenues are generated from airline service agreements and are typically based on hours flown, the amount of aircraft operated and crew resources provided during a month. ACMI Services revenues are recognized over time as flight hours are performed for the customer. Certain agreements include provisions for incentive payments

based upon on-time reliability. These incentives are measured on a monthly basis and recorded to revenue in the corresponding month earned. Under CMI agreements, the Company's airlines have an obligation to provide integrated services including flight crews, aircraft maintenance and insurance for the customer's cargo network. Under ACMI agreements, the Company's airlines are also obligated to provide aircraft. Under CMI and ACMI agreements, customers are generally responsible for aviation fuel, landing fees, navigation fees and certain other flight expenses. When functioning as the customers' agent for arranging such services, the Company records amounts reimbursable from the customer as revenues net of the related expenses as the costs are incurred. Under charter agreements the Company's airline is obligated to provide full services for one or more flights having specific origins and destinations. Under charter agreements, in which the Company's airline is responsible for fuel, airport fees and all flight services, the related costs are recorded in operating expenses. ACMI Services are invoiced monthly or more frequently. MRO Services revenues for customer contracts for airframe maintenance and aircraft modification services that do not have an alternative use and for which the Company has an enforceable right to payment are generally recognized over time based on the percentage of costs completed. Other MRO Services revenues for aircraft part sales, component repairs and line service are recognized at a point in time typically when the parts are delivered to the customer and the services are completed. For airframe maintenance, aircraft modifications and aircraft component repairs, contracts include assurance warranties that are not sold separately.

Effective January 1, 2018 the Company records revenues and estimated earnings for its airframe maintenance and aircraft modification contracts using the percentage-of-completion cost-to-cost method. For such services, the Company estimates the earnings on a contract as the difference between the expected revenue and estimated costs to complete a contract and recognizes revenues and earnings based on the proportion of costs incurred compared to the total estimated costs. The Company's estimates consider the timing and extent of the services, including the amount and rates of labor, materials and other resources required to perform the services. The Company recognizes adjustments in estimated earnings on a contract under the cumulative catch-up method in which the impact of the adjustment on estimated earnings of a contract is recognized in the period the adjustment is identified.

The Company's external customer revenues for providing mail and package sorting services and related equipment maintenance for the three and nine month periods ending September 30, 2018 were \$19.5 million and \$51.9 million, respectively, compared to \$51.7 million and \$132.7 million for the corresponding periods in 2017. During the three and nine month periods ended September 30, 2018, the Company netted \$40.8 million and \$137.9 million of customer reimbursable revenues against the related expenses when functioning as the customers' agent for arranging ground services, respectively. These revenues are reported in All other. The Company's external customer revenues from providing mail and package sorting services are recognized as the services are performed for the customer over time. Revenues from related equipment maintenance services are recognized over time and at a point in time depending on the nature of the customer contracts.

Revenue is not recognized until collectibility of customer payment is probable. For customers that are not a governmental agency or department, the Company generally receives partial payment in advance of services, otherwise customer balances are typically paid within 30 to 60 days of service. For the three and nine month periods ended September 30, 2018, the Company recognized \$4.8 million and \$8.8 million of non lease revenue that was reported in deferred revenue at the beginning of the respective period.

CAM's aircraft lease revenues are recognized as operating lease revenues on a straight-line basis over the term of the applicable lease agreements. Customer payments for leased aircraft and equipment are typically paid monthly in advance.

The Company's other segment information from continuing operations is presented below (in thousands):

	Three Months Ending		Nine Months Ending	
	September 30, 2018	2017	September 30, 2018	2017
Depreciation and amortization expense:				
CAM	\$31,590	\$26,829	\$91,055	\$77,383
ACMI Services	10,950	9,805	31,502	31,368
MRO Services	840	680	2,520	2,039
All other	(179 )	291	(252 )	1,038
Total	\$43,201	\$37,605	\$124,825	\$111,828
Segment earnings (loss):				
CAM	\$19,034	\$19,445	\$49,892	\$45,570
ACMI Services	61	300	4,993	(2,976 )
MRO Services	2,332	2,514	8,115	16,805
All other	3,139	1,432	8,469	5,295
Inter-segment earnings eliminated	(2,420 )	(3,285 )	(6,776 )	(10,105 )
Net unallocated interest expense	(860 )	(268 )	(2,517 )	(655 )
Net gain (loss) on financial instruments	17,895	(34,433 )	28,707	(100,213 )
Other non-service components of retiree benefit costs, net	2,045	(5,529 )	6,135	(5,883 )
Loss from non-consolidated affiliate	(2,647 )	(945 )	(7,600 )	(945 )
Pre-tax earnings from continuing operations	\$38,579	\$(20,769)	\$89,418	\$(53,107 )

Interest expense allocated to CAM was \$4.7 million and \$13.7 million for the three and nine month periods ending September 30, 2018, respectively, compared to \$4.0 million and \$10.9 million for the corresponding periods of 2017.

The Company's assets are presented below by segment (in thousands):

	September 30, 2018	December 31 2017
Assets:		
CAM	\$1,246,833	\$1,192,890
ACMI Services	180,382	189,379
MRO Services	96,277	87,177
All other	29,576	79,398
Total	\$1,553,068	\$1,548,844



#### NOTE O—SUBSEQUENT EVENT

On October 2, 2018, the Company announced that it has agreed to acquire Omni Air International LLC (Omni Air), a passenger ACMI and charter services airline with significant experience serving U.S. and allied foreign governments and commercial customers, for \$845 million, subject to customary adjustments. Omni Air's fleet includes seven Boeing 767-300ER, three 767-200ER and three 777-200ER passenger aircraft. The combination with Omni Air is anticipated to add over \$430 million in annualized revenues to the Company. The acquisition of Omni Air is expected to diversify ATSG's customer base, add significant presence in the growing government passenger services market, and broaden the Company's operating capabilities to include Boeing 777-200 extended range aircraft. The acquisition will position the Company to meet customers' global cargo needs with the longer-range 777 platform. The Company plans to fund the all-cash acquisition of Omni Air by expanding its existing Senior Credit Agreement. The acquisition is expected to close during the fourth quarter of 2018, subject to regulatory approvals and the satisfaction of customary closing conditions. In conjunction with the close of the acquisition, the Company will have significant fees and estimates that deal expenses for the fourth quarter of 2018 will be \$5.5 million in addition to financing fees.

#### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis has been prepared with reference to the historical financial condition and results of operations of Air Transport Services Group, Inc., and its subsidiaries. Air Transport Services Group, Inc. and its subsidiaries may hereinafter individually and collectively be referred to as "the Company", "we", "our" or "us" from time to time. The following discussion and analysis describes the principal factors affecting the results of operations, financial condition, cash flows, liquidity and capital resources. It should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and the related notes prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") contained in this report and our Annual Report on Form 10-K for the year ended December 31, 2017.

#### INTRODUCTION

The Company leases aircraft, provides air cargo transportation and performs aircraft maintenance and other support services primarily to the air cargo transportation and package delivery industries. Through the Company's subsidiaries, we offer a range of complementary services to delivery companies, freight forwarders, e-commerce operators, airlines and government customers. Our principal subsidiaries include ABX Air, Inc. ("ABX"), Air Transport International, Inc. ("ATI"), Cargo Aircraft Management, Inc. ("CAM") and Airborne Maintenance and Engineering Services, Inc. ("AMES"). ABX and ATI are two independently certificated airlines. CAM provides competitive aircraft lease rates by converting passenger aircraft into cargo freighters and offering them to customers under long-term leases. AMES provides aircraft maintenance and modification services.

We have three reportable segments: CAM, which leases Boeing 767, Boeing 757 and Boeing 737 aircraft and aircraft engines, ACMI Services, which primarily includes the air transportation operations of the two airlines, and MRO Services, which provides aircraft maintenance and modification services to customers. Our other business operations, which primarily provide support services to the transportation industry, include mail and package sorting services as well as related equipment maintenance services. These operations do not constitute reportable segments due to their size.

Our largest customers are DHL Network Operations (USA), Inc. and its affiliates ("DHL"), Amazon.com Services, Inc. ("ASI"), successor to Amazon Fulfillment Services, Inc., a subsidiary of Amazon.com, Inc. ("Amazon"), and the U.S. Military.

#### DHL

The Company has had long-term contracts with DHL since August 2003. DHL accounted for 27% of the Company's consolidated revenues for the first nine months of 2018, compared with 31% of the Company's consolidated revenues excluding directly reimbursed revenues in the corresponding period in 2017. As of September 30, 2018, the Company, through CAM, leased 16 Boeing 767 aircraft to DHL, 11 of which were being operated by the Company's airlines for DHL under a crew, maintenance and insurance agreement and five aircraft which are operated by a DHL-affiliated



airline in the Middle East. Additionally, ATI operated four CAM-owned Boeing 757 aircraft under other operating arrangements with DHL.

#### Amazon

The Company has been providing freighter aircraft, operating flight services and arranging cargo handling and logistical support for ASI since September 2015. On March 8, 2016, the Company entered into an Air Transportation Services Agreement (the "ATSA") with ASI pursuant to which CAM agreed to lease 20 Boeing 767 freighter aircraft to ASI, including 12 Boeing 767-200 freighter aircraft for a term of five years and eight Boeing 767-300 freighter aircraft for a term of seven years. CAM owns all of the Boeing 767 aircraft that are leased and operated under the ATSA. The ATSA became effective on April 1, 2016. Revenues from continuing operations performed for ASI comprised approximately 29% of the Company's consolidated revenues from continuing operations for the first nine months of 2018, compared with 27% of revenues, excluding directly reimbursed revenues, during the corresponding period in 2017.

In conjunction with the execution of the ATSA, the Company and Amazon entered into an Investment Agreement and a Stockholders Agreement on March 8, 2016. The Investment Agreement calls for the Company to issue warrants in three tranches which grant Amazon the right to acquire up to 19.9% of the Company's pre-transaction outstanding common shares measured on a GAAP-diluted basis, adjusted for share issuances and repurchases by the Company following the date of the Investment Agreement and after giving effect to the warrants granted. The exercise price of the warrants is \$9.73 per share, which represents the closing price of the Company's common shares on February 9, 2016. Each of the three tranches of warrants will be exercisable in accordance with its terms through March 8, 2021. Our accounting for the warrants issued to Amazon has been determined in accordance with the financial reporting guidance for equity-based payments to non-employees and for financial instruments. The fair value of the warrants issued or issuable to Amazon are recorded as a lease incentive asset and are amortized against revenues over the duration of the aircraft leases. The warrants are accounted for as financial instruments, and accordingly, the fair value of the outstanding warrants are measured and classified in liabilities at the end of each reporting period. The Company's earnings are impacted by the fair value re-measurement of warrants at the end of each period, lease incentive amortization and the related income tax effects. For income tax calculations, the value and timing of related tax deductions will differ from the guidance described above for financial reporting. For additional information about the accounting for the warrants, see Note B to the accompanying unaudited condensed consolidated financial statements.

The U.S. Military comprised 10% of the Company's consolidated revenues excluding directly reimbursed revenues during both the nine month periods ending September 30, 2018 and 2017, respectively. The Company's airlines contract their services to the Air Mobility Command ("AMC"), through the U.S. Transportation Command ("USTC"), both of which are organized under the U.S. Military.

#### Fleet Summary 2018

As of September 30, 2018, the combined operating fleet of owned freighter aircraft consisted of 34 Boeing 767-200 aircraft, 29 Boeing 767-300 aircraft, four Boeing 757-200 aircraft, four Boeing 757 "combi" aircraft and two Boeing 737-400 aircraft. The Boeing 757 combi aircraft are capable of simultaneously carrying passengers and cargo containers on the main flight deck. At September 30, 2018, the Company owned six Boeing 767-300 aircraft that were either already undergoing or awaiting induction into the freighter conversion process.

Aircraft fleet activity during the first nine months of 2018 is summarized below:

- CAM completed the modification of five Boeing 767-300 freighter aircraft purchased in the previous year and began to lease four of those aircraft under multi-year leases to external customers. CAM began to lease the fifth aircraft to ATI.
- CAM completed the modification of one 737-400 freighter aircraft purchased the previous year and entered into a multi-year lease with an external customer.
- ABX returned one Boeing 767-300 freighter aircraft to CAM. That aircraft was then leased to an external customer under a multi-year lease and is being operated by ABX.
- CAM sold one Boeing 767-300 freighter aircraft, which was under lease to an external customer, to that same external customer.



- CAM purchased five Boeing 767-300 passenger aircraft for the purpose of converting the aircraft into a standard freighter configuration.
- External lessees returned two Boeing 767-200 freighter aircraft to CAM. Both of these aircraft are being prepped for redeployment to other lessees.

	September 30, 2018			December 31, 2017		
	ACMI Services	CAM	Total	ACMI Services	CAM	Total
In-service aircraft						
Aircraft owned						
Boeing 767-200	7	27	34	7	29	36
Boeing 767-300	4	25	29	4	21	25
Boeing 757-200	4	—	4	4	—	4
Boeing 757-200 Combi	4	—	4	4	—	4
Boeing 737-400	—	2	2	—	1	1
Total	19	54	73	19	51	70
Other aircraft						
Owned Boeing 767-300 under modification	—	6	6	—	6	6
Owned Boeing 737-400 under modification	—	—	—	—	1	1
Owned Boeing 767 available or staging for lease	—	2	2	—	—	—

As of September 30, 2018, ABX and ATI were leasing 19 in-service aircraft internally from CAM for use in ACMI Services. As of September 30, 2018, four of CAM's 27 Boeing 767-200 aircraft and seven of the 25 Boeing 767-300 aircraft shown in the aircraft fleet table above were leased to DHL and operated by ABX. Additionally, 12 of CAM's 27 Boeing 767-200 aircraft and eight of CAM's 25 Boeing 767-300 aircraft were leased to ASI and operated by ABX or ATI. The other 11 Boeing 767-200 aircraft leased to external customers include five Boeing 767-200 aircraft leased to DHL and operated by a DHL-owned airline. One of the other 10 Boeing 767-300 aircraft leased to external customers was operated by ATI. The carrying values of the total in-service fleet as of September 30, 2018 and December 31, 2017 were \$982.2 million and \$955.2 million, respectively. The table above does not reflect one Boeing 767-200 passenger aircraft owned by CAM.

## RESULTS OF OPERATIONS

### Summary

External customer revenues from continuing operations decreased by \$49.2 million to \$204.9 million and decreased by \$133.7 million to \$611.6 million for the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. Effective January 1, 2018, the Company adopted Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("Topic 606"). As a result of adopting Topic 606 beginning January 1, 2018, the Company reported certain revenues net of related expenses that are directly reimbursed by customers. Corresponding 2017 revenues include such expense reimbursements. Excluding revenues directly reimbursed in 2017, customer revenues increased \$23.0 million, or 13% and \$53.9 million, or 10% during the three and nine month periods ended September 30, 2018, respectively, compared with the corresponding periods of 2017. External customer revenues increased primarily due to additional aircraft leases and expanded CMI services.

The consolidated net earnings from continuing operations were \$32.9 million and \$73.1 million for the three and nine month periods ended September 30, 2018, respectively, compared to net losses of \$28.2 million and \$72.4 million for the corresponding periods of 2017. The pre-tax earnings from continuing operations were \$38.6 million and \$89.4 million for the three and nine month periods ended September 30, 2018, respectively, compared to pre-tax losses of \$20.8 million and \$53.1 million for the corresponding periods of 2017. Earnings were affected by specific events and



certain adjustments that do not directly reflect our underlying operations among the years presented. Net earnings from continuing operations for 2018 benefited from a lower effective tax rate due to The Tax Cuts and Jobs Acts ("Tax Act") which was enacted on December 22, 2017. On a pre-tax basis, earnings included gains of \$17.9 million and \$28.7 million for the three and nine months ended September 30, 2018, respectively, for the re-measurement of financial instruments, including the warrant obligations granted to Amazon. This compares to pre-tax losses for re-measurement of such financial instruments of \$34.4 million and \$100.2 million for the corresponding periods of 2017. Pre-tax earnings were also reduced by \$4.2 million and \$12.7 million for the three and nine month periods ended September 30, 2018, respectively, for the amortization of lease incentives given to ASI in the form of warrants, compared to \$3.9 million and \$9.8 million for the corresponding periods of 2017. Additionally, pre-tax earnings from continuing operations included gains of \$2.0 million and \$6.1 million for the three and nine month periods ended September 30, 2018, respectively, for the non-service components of retiree benefit plans, compared to losses of \$5.5 million and \$5.9 million for the corresponding periods of 2017. Pre-tax earnings for the three and nine month periods ending September 30, 2018 included losses of \$2.6 million and \$7.6 million, respectively, for the Company's share of development costs for a new joint venture. After removing the effects of these items, adjusted pre-tax earnings from continuing operations, a non-GAAP measure (a definition and reconciliation of adjusted pre-tax earnings from continuing operations follows) increased \$1.5 million to \$25.5 million and \$11.2 million to \$74.9 million for the three and nine month periods ended September 30, 2018, respectively, compared to 2017. Results for the three and nine month periods ended September 30, 2018 included an additional pre-tax interest expense of \$2.1 million and \$6.2 million, respectively, for the amortization of convertible debt discount and issuance costs.

Adjusted pre-tax earnings from continuing operations for the first nine months of 2018 improved compared to 2017, driven primarily by additional aircraft lease revenues and the improved financial results of our airline operations. The pre-tax results included reduced earnings from MRO Services due to a mix of lower margin services compared to 2017. Adjusted pre-tax earnings from continuing operations for the three months ended September of 2018 improved compared to 2017, primarily due to increased support services for USPS facilities and ASI gateways. Adjusted pre-tax earnings from continuing operations for the three months ended September of 2018 reflects fewer spare engine leases, less engine maintenance services revenues and additional lease incentive amortization compared to 2017.

A summary of our revenues and pre-tax earnings and adjusted pre-tax earnings from continuing operations is shown below (in thousands):

	Three Months Ending		Nine Months Ending	
	September 30,		September 30,	
	2018	2017	2018	2017
Revenues from Continuing Operations:				
CAM				
Aircraft leasing and related services	\$63,012	\$62,351	178,217	165,733
Lease incentive amortization	(4,226 )	(3,886 )	(12,678 )	(9,760 )
Total CAM	58,786	58,465	165,539	155,973
ACMI Services	116,224	112,203	355,204	332,120
MRO Services	46,879	39,928	145,125	146,602
Other Activities	22,598	17,141	61,611	70,245
Total Revenues	244,487	227,737	727,479	704,940
Eliminate internal revenues	(39,568 )	(45,777 )	(115,913 )	(147,319 )
Customer Revenues - non reimbursed	\$204,919	\$181,960	\$611,566	\$557,621
Revenues for reimbursed expenses	—	72,141	—	187,608
Customer Revenues	\$204,919	\$254,101	\$611,566	\$745,229

Pre-Tax Earnings (Loss) from Continuing Operations:

CAM, inclusive of interest expense	\$19,034	\$19,445	49,892	45,570
ACMI Services	61	300	4,993	(2,976 )
MRO Services	2,332	2,514	8,115	16,805
Other Activities	3,139	1,432	8,469	5,295
Inter-segment earnings eliminated	(2,420 )	(3,285 )	(6,776 )	(10,105 )
Net unallocated interest expense	(860 )	(268 )	(2,517 )	(655 )
Net financial instrument re-measurement (loss) gain	17,895	(34,433 )	28,707	(100,213 )
Other non-service components of retiree benefit costs, net	2,045	(5,529 )	6,135	(5,883 )
Loss from non-consolidated affiliate	(2,647 )	(945 )	(7,600 )	(945 )
Pre-Tax Earnings (Loss) from Continuing Operations	38,579	(20,769 )	89,418	(53,107 )
Add other non-service components of retiree benefit costs, net	(2,045 )	5,529	(6,135 )	5,883
Add charges for non-consolidated affiliate	2,647	945	7,600	945
Add lease incentive amortization	4,226	3,886	12,678	9,760
Add net loss (gain) on financial instruments	(17,895 )	34,433	(28,707 )	100,213
Adjusted Pre-Tax Earnings from Continuing Operations	\$25,512	\$24,024	\$74,854	\$63,694

Adjusted pre-tax earnings from continuing operations, a non-GAAP measure, is pre-tax earnings excluding other non-service components of retiree benefit costs, gains and losses for the fair value re-measurement of financial instruments, lease incentive amortizations and the start-up costs of a non-consolidated joint venture. We exclude these items from adjusted pre-tax earnings because they are distinctly different in their predictability or not closely related to our on-going operating activities. Management uses adjusted pre-tax earnings to compare the performance of core operating results between periods. Presenting this measure provides investors with a comparative metric of fundamental operations while highlighting changes to certain items among periods. Adjusted pre-tax earnings should not be considered in isolation or as a substitute for analysis of the Company's results as reported under GAAP. Effective January 1, 2018, we adopted Topic 606 using a modified retrospective approach, under which financial statements are prepared under the revised guidance for the year of adoption, but not for prior years. We determined



that under Topic 606, the Company is an agent for aircraft fuel and certain other costs reimbursed under its ACMI and CMI contracts and for certain ground services that it arranges for ASI. Under the new standard, such reimbursed amounts are reported net of the corresponding expenses beginning in 2018. Revenues for the three and nine month periods ended September 30, 2017 included \$72.1 million and \$187.6 million for reimbursable revenues under its ACMI and CMI contracts and for directly reimbursed ground services, which, under the new standard, have been reported net of the related expenses in 2018.

#### CAM Segment

CAM offers aircraft leasing and related services to external customers and also leases aircraft internally to the Company's airlines. CAM acquires passenger aircraft and manages the modification of the aircraft into freighters. The follow-on aircraft leases normally cover a term of five to eight years.

As of September 30, 2018 and 2017, CAM had 54 and 47 aircraft under lease to external customers, respectively. CAM's revenues increased by \$0.3 million and \$9.6 million for the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. CAM's revenues from aircraft leases increased, while revenues for engine leases and engine maintenance services declined during the third quarter of 2018 compared to 2017. CAM's revenues, excluding customer lease incentive amortization, increased \$0.7 million and \$12.5 million during the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017, primarily as a result of new aircraft leases. Since October 1, 2017, CAM has added eight Boeing 767-300 freighter aircraft and two Boeing 737-400 freighter aircraft to its lease portfolio. Revenues from external customers totaled \$41.4 million and \$115.3 million for the three and nine month periods ended September 30, 2018, respectively, compared to \$40.9 million and \$104.1 million for the corresponding periods of 2017.

CAM's pre-tax earnings, inclusive of internally allocated interest expense, were \$19.0 million and \$49.9 million during the three and nine month periods ended September 30, 2018, respectively, compared to \$19.4 million and \$45.6 million during the corresponding periods of 2017. Pre-tax earnings for 2018 reflects additional external aircraft lease revenues. These additions were partially offset by increases in internally allocated interest expense of \$0.6 million and \$2.8 million for the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017 due to higher debt levels. The pre-tax earnings were also partially offset by the increased amortization of the ASI lease incentive of \$0.3 million and \$2.9 million for the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. Depreciation expense increased by \$4.8 million and \$13.7 million for the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017, due to the addition of six Boeing aircraft in the first nine months of 2018 compared to 2017. Pre-tax earnings during the third quarter of 2018 reflect fewer spare engine leases and less engine maintenance services revenues compared to 2017. Additionally, CAM's pre-tax earnings during the third quarter of 2018 was reduced due to the transition time of aircraft between lessees.

During the first nine months of 2018, CAM purchased five 767-300 passenger aircraft for freighter conversion. CAM also sold one Boeing 767-300 aircraft which had been under a long-term lease to an external customer. As of September 30, 2018, all five of the Boeing 767-300 passenger aircraft purchased in 2018 and one Boeing 767-300 passenger aircraft purchased during 2017 were being modified from passenger to freighter configuration.

CAM expects to complete the freighter modification of five of the six passenger aircraft which it owned at September 30, 2018 during the fourth quarter of 2018. CAM has customer commitments or letters of intent for three of these five aircraft. CAM's future operating results will depend on the timing and lease rates under which these aircraft are ultimately leased. CAM's operating results will depend on its continuing ability to convert passenger aircraft into freighters within planned costs and within the time frames required by customers.

#### ACMI Services Segment

The ACMI Services segment provides airline operations to its customers, typically under contracts providing for a combination of aircraft, crews, maintenance and insurance ("ACMI"). Our customers are usually responsible for supplying the necessary aviation fuel and cargo handling services and reimbursing our airline for other operating expenses such as landing fees, ramp expenses, certain aircraft maintenance expenses and fuel procured directly by the airline. Aircraft charter agreements, including those for the U.S. Military, usually require the airline to provide full service, including fuel and other operating expenses for a fixed, all-inclusive price. As of September 30, 2018, ACMI



Services included 51 in-service aircraft, including 19 leased internally from CAM, 11 CAM-owned freighter aircraft which are under lease to DHL and operated by ABX under the restated CMI agreement, 20 CAM-owned freighter aircraft which are under lease to ASI and operated by ATI and ABX under the ATSA and another CAM-owned freighter operated by ATI.

Total revenues from ACMI Services decreased \$30.7 million and \$81.2 million during the three and nine month periods ended September 30, 2018, respectively, to \$116.2 million and \$355.2 million compared to the corresponding periods of 2017. ACMI Services revenues for the three and nine month periods ended September 30, 2017 included \$34.7 million and \$104.3 million, respectively, for the reimbursement of fuel and certain operating expenses. Such revenues for 2018 are reported net of expenses after the adoption of Topic 606. Airline services revenues from external customers, which do not include revenues for the reimbursement of fuel and certain operating expenses, increased \$4.0 million and \$23.1 million for the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. Improved revenues were driven by additional aircraft operations for ASI and reflect a 2% and 6% increase in billable block hours for the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. As of September 30, 2018, ACMI Services included the operation of the same number of CAM-owned aircraft as of September 30, 2017. ACMI Services had pre-tax earnings of \$0.1 million and \$5.0 million during the three and nine month periods ended September 30, 2018, respectively, compared to pre-tax earnings of \$0.3 million and losses of \$3.0 million for the corresponding periods of 2017. Improved pre-tax results in 2018 compared to 2017 reflect higher revenues from increased block hours offset by the cost of additional employees and aircraft maintenance expenses to support the expanded operations. In March 2018, ATI began to implement a recently ratified amendment to the collective bargaining agreement with its crewmembers. The amendment resulted in increased wages for the ATI crewmembers beginning in the second quarter of 2018.

Effective January 1, 2018, we adopted ASU "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost ("ASU 2017-07"). As a result of adopting ASU 2017-07, the pre-tax earnings for ACMI Services do not include the other non-service components of retiree benefit costs.

ABX is negotiating with its flight crewmembers' collective bargaining unit. These negotiations could result in changes that may effect our productivity, employee compensation levels and the marketability of our services. Maintaining profitability in ACMI Services will depend on a number of factors, including customer flight schedules, crewmember productivity and pay, employee benefits, aircraft maintenance schedules and the number of aircraft we operate.

#### MRO Services Segment

MRO Services sells aircraft parts and provides aircraft maintenance and modification services through the AMES and Pemco World Air Services, Inc. ("Pemco"), subsidiaries. Total revenues from MRO Services increased \$7.0 million and decreased \$1.5 million for the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. External customer revenues for MRO Services increased \$13.3 million and \$16.7 million during the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. Revenues for 2018 reflect the change in accounting standards beginning in 2018 after the adoption of Topic 606 to recognize certain aircraft maintenance and modification services over time instead of upon completion. During 2017, revenues were recognized in large amounts upon completion and redelivery of an aircraft to the customer.

The pre-tax earnings from MRO Services decreased \$0.2 million and \$8.7 million during the three and nine month periods ended September 30, 2018 to \$2.3 million and \$8.1 million, respectively, compared to the corresponding periods of 2017. The decline in MRO Services profitability reflects a mix of more lower margin maintenance services revenues during 2018 and longer completion times. During the third quarter of 2018, the time to complete several complex maintenance projects took longer than expected, negatively impacting earnings.

#### Other Activities

We provide other support services to our ACMI Services customers and other airlines by leveraging our knowledge and capabilities developed for our own operations over the years. We provided mail and package sorting and logistical support to the U.S. Postal Service ("USPS") at five USPS facilities and, further, arrange similar services for certain



ASI gateway locations in the U.S. We provide maintenance for ground equipment, facilities and material handling equipment. We also resell aviation fuel in Ohio and provide flight training.

External customer revenues from all other activities were \$20.1 million and \$53.9 million during the three and nine month periods ended September 30, 2018, respectively, compared to \$52.3 million and \$134.2 million for the corresponding periods of 2017. Customer revenues for the three and nine month periods ended September 30, 2017 included \$37.4 million and \$83.3 million, respectively, for the reimbursement of certain ground services that it arranges for ASI which are being netted against expenses in 2018, after the adoption of Topic 606. Revenues from external customers, which do not include 2017 revenues for the reimbursement of certain ground services, increased \$5.2 million and increased \$3.0 million for the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. The increase in revenue compared to 2017 was driven by additional mail volumes, higher contractual rates and additional ground support services provided to ASI. During June of 2018, we began to provide cargo handling and related ground support services directly to ASI at one of its gateway locations.

The pre-tax earnings from other activities increased \$1.7 million and \$3.2 million during the three and nine month periods ended September 30, 2018 to \$3.1 million and \$8.5 million, respectively, compared to the corresponding periods of 2017. Additional earnings were a result of higher contractual rates and increased volumes at the USPS facilities, additional ASI services and improved results from an airline affiliate accounted for under the equity method. The contracts for five USPS facilities expired in September 2018 without renewal. Revenues from these USPS facilities were \$9.6 million and \$28.9 million during the three and nine month periods ended September 30, 2018, respectively,

#### Discontinued Operations

The financial results of discontinued operations primarily reflect benefits for former employees previously associated with ABX's former freight sorting and aircraft fueling services provided to DHL. Pre-tax results related to the former sorting operations were a \$0.7 million gain and a \$6.7 million loss for the first nine months of 2018 and 2017, respectively.

#### Expenses from Continuing Operations

Salaries, wages and benefits expense increased \$10.2 million and \$16.7 million during the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. Expenses for the three and nine month periods ended September 30, 2018, increased due to higher flight crew wages in conjunction with an amendment to the collective bargaining agreement with the ATI crewmembers, additional employees and additional aircraft maintenance technician time to support increased block hours and increased MRO services revenues.

Depreciation and amortization expense increased \$5.6 million and \$13.0 million during the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. The increase in depreciation expense reflects incremental depreciation for eight Boeing 767-300 aircraft and two Boeing 737-400 aircraft added to the operating fleet since October 1, 2017. We expect depreciation expense to increase during future periods in conjunction with our fleet expansion and capital spending plans.

Maintenance, materials and repairs expense increased by \$0.4 million and increased \$6.2 million during the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. The increase in expenses during 2018 compared to 2017 was due primarily to MRO Services for external customers. During 2018, MRO Services had an increased level of customer revenues and direct expenses compared to 2017. Additionally, during the third quarter of 2018, the airlines experienced a decline in engine maintenance incidents and costs. Aircraft maintenance and material expenses can vary among periods due to the number of maintenance events and the scope of airframe checks that are performed.

Fuel expense decreased by \$28.1 million and \$83.5 million during the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. In 2017, fuel expense included reimbursable fuel billed to DHL, ASI and other ACMI customers which is being netted against the revenue in 2018 after the adoption of Topic 606. The customer-reimbursed fuel for the three and nine month periods ended September 30, 2017 was \$30.4 million and \$90.2 million, respectively. Fuel expense includes the cost of fuel to operate U.S. Military charters as well as fuel used to position aircraft for service and for maintenance purposes. Fuel expense, excluding

customer reimbursed

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fuel increased \$2.3 million and \$6.7 million for the three and nine month periods ended September 30, 2018 compared to 2017 due to more block hours flown for military customers in the first nine months of 2018.

Contracted ground and aviation services expense includes navigational services, aircraft and cargo handling services and other airport services. Contracted ground and aviation services decreased \$37.8 million and \$85.8 million during the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. The decrease is primarily due to the netting of reimbursable revenues from certain ground services arranged for ASI against the expense in 2018 due to the adoption of Topic 606. The customer-reimbursed expenses in the three and nine month periods ended September 30, 2017 were \$38.2 million and \$86.9 million, respectively.

Landing and ramp expense, which includes the cost of deicing chemicals, decreased by \$3.5 million and \$10.7 million during the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. The decrease is primarily due to the netting of reimbursable revenues from landing and ramp fees billed to DHL, ASI and other ACMI customers against the expense in 2018 due to the adoption of Topic 606.

Other operating expenses increased by \$0.4 million and decreased \$3.9 million during the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. Other operating expenses include professional fees, employee training and utilities. The decline in other operating expenses for the first nine months of 2018 includes gains related to the sale of equipment, improved operating results of an airline affiliate accounted for under the equity method and lower expense for uncollectible customer accounts compared to the same periods of 2017.

Interest expense increased by \$1.3 million and \$4.7 million during the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. Interest expense increased due to a higher average debt level and interest rates on the Company's outstanding loans. Capitalized interest due to our fleet expansion was flat during the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017. Interest expense in the first nine months of 2018 was also impacted by the convertible notes issued in September 2017. The convertible notes have a principal value of \$258.8 million and bear interest at a cash coupon rate of 1.125%. At the time of issuance, the value of the conversion feature of the convertible notes was recorded as a debt discount and is being amortized along with debt issuance costs to interest expense over the seven year term of the convertible notes. The non-cash amortization of the debt discount and issuance costs was \$2.1 million and \$6.2 million during the three and nine month periods ended September 30, 2018, respectively, compared to the corresponding periods of 2017.

The Company recorded pre-tax net gains on financial instruments of \$17.9 million and \$28.7 million during the three and nine month periods ended September 30, 2018, respectively, compared to losses of \$34.4 million and \$100.2 million during the corresponding periods of 2017. The gains are primarily a result of re-measuring, as of September 30, 2018, the fair value of the stock warrants granted to Amazon. A decrease in the fair value of the warrant obligation since the previous re-measurement dates of June 30, 2018 and December 31, 2017, corresponded to a decrease in the traded price of the Company's shares and resulted in non-cash losses. The non-cash gains and losses resulting from quarterly re-measurements of the warrants may vary widely among quarters.

The provision for income taxes for interim periods is based on management's best estimate of the effective income tax rate expected to be applicable for the current year, plus any adjustments arising from changes in the estimated amount of taxable income related to prior periods. Income taxes recorded through September 30, 2018, have been estimated utilizing a 24.4% rate based upon year-to-date income and projected results for the full year. The recognition of discrete tax items, such as the conversion of employee stock awards, the issuance of stock warrants and other items have an impact on the effective tax rate during a period.

The effective tax rate from continuing operations for the three and nine month periods ended September 30, 2018, was 14.6% and 18.3%, respectively. These effective tax rates include deferred tax expense related to the warrant re-measurement loss at the end of the period. The effective tax rate before including the effects of the warrants was 23.8% and 23.9% for the three and nine month periods ended September 30, 2018, respectively. The effective tax rate before including the effects of the warrants for the three and nine month periods ended September 30, 2017 were 37.5% and 36.5%, respectively. The effective tax rate decreased for the first nine months of 2018 due to the enactment of the Tax Act in December 2017.





As of December 31, 2017, the Company had operating loss carryforwards for U.S. federal income tax purposes of approximately \$57.6 million which will begin to expire in 2031 if not utilized before then. We expect to utilize the loss carryforwards to offset federal income tax liabilities in the future. As a result, we do not expect to pay federal income taxes until 2023 or later. The Company may, however, be required to pay some federal tax due to loss carryforward usage limitations and certain state and local income taxes before then. The Company's taxable income earned from international flights are primarily sourced to the United States under international aviation agreements and treaties. When we operate in countries without such agreements, the Company could incur additional foreign income taxes.

## FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

### Cash Flows

Net cash generated from operating activities totaled \$200.8 million and \$191.3 million for the first nine months of 2018 and 2017, respectively. Improved cash flows generated from operating activities during the first nine months of 2018 were driven primarily by additional aircraft leases to customers, increased operating levels of the ACMI Services segment and customer collections. Cash outlays for pension contributions for the first nine months of 2018 were \$22.2 million compared to \$4.1 million for the corresponding period of 2017.

Capital spending levels were primarily the result of aircraft modification costs and the acquisition of aircraft for freighter modification. Cash payments for capital expenditures were \$214.0 million and \$218.8 million for the first nine months of 2018 and 2017, respectively. Capital expenditures in 2018 included \$149.2 million for the acquisition of five Boeing 767-300 aircraft and freighter modification costs; \$38.4 million for required heavy maintenance; and \$26.4 million for other equipment, including purchases of aircraft engines and rotables. Our capital expenditures during 2017 included \$159.4 million for the acquisition of five Boeing 767-300 aircraft and two Boeing 737-400 aircraft and freighter modification costs; \$36.2 million for required heavy maintenance; and \$23.2 million for other equipment, including purchases of aircraft engines and rotables.

During the first nine months of 2018 we contributed an additional \$8.3 million to a joint venture with Precision Aircraft Solutions, LLC, which is developing a passenger-to-freighter conversion program for Airbus A321-200 aircraft. During the first quarter of 2017 we paid \$6.9 million to complete our acquisition of Pemco World Air Services, Inc.

Net cash provided by financing activities was \$14.8 million for the first nine months of 2018 compared to \$61.9 million in 2017. During the first nine months of 2018, we drew \$60.0 million from the revolving credit facility under the Senior Credit Agreement to fund capital spending for aircraft acquisition and modifications. We made debt principal payments of \$39.9 million.

During the first quarter of 2018, we repurchased 157,000 shares of the Company's common stock pursuant to an authorized share repurchase plan for \$3.6 million, of which \$0.6 million was paid in the first quarter and \$3.0 million was paid in April 2018. The repurchase plan was amended by the Board again in February 2018 to increase the authorized share repurchase plan to up to \$150 million (less amounts previously repurchased).

### Commitments

On October 2, 2018, we announced that the Company has agreed to acquire Omni Air for \$845 million, subject to adjustments, as described in Note O in the accompanying financial statements. The Company plans to fund the all-cash acquisition of Omni Air by expanding its existing Senior Credit Agreement. The acquisition is expected to close during the fourth quarter of 2018, subject to regulatory approvals and the satisfaction of customary closing conditions. In conjunction with the close of the acquisition, the Company will have significant fees. We estimate that deal expenses for the fourth quarter of 2018 will be \$5.5 million in addition to financing fees.

We estimate that capital expenditures for 2018 will total \$280 million of which the majority will be related to aircraft purchases and freighter modifications. Actual capital spending for any future period will be impacted by aircraft acquisitions, maintenance, modification processes and the timing of large payments. We expect to finance the capital expenditures from current cash balances, future operating cash flow and the Senior Credit Agreement. The Company outsources a significant portion of the aircraft freighter modification process to a non-affiliated third party. The modification primarily consists of the installation of a standard cargo door and loading system. For additional information about the Company's aircraft modification obligations, see Note H of the accompanying financial

statements.

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Since August 3, 2017, the Company has been part of a joint-venture with Precision Aircraft Solutions, LLC, to develop a passenger-to-freighter conversion program for Airbus A321-200 aircraft. We anticipate approval of a supplemental type certificate from the FAA in 2019. We expect to make contributions equal to the Company's 49% ownership percentage of the program's total costs during 2018 and 2019.

#### Liquidity

The Company has a Senior Credit Agreement with a consortium of banks that includes an unsubordinated term loan of \$59.3 million, net of debt issuance costs, and a revolving credit facility from which the Company has drawn \$280.0 million, net of repayments, as of September 30, 2018. The revolving credit facility has a capacity of \$545.0 million, permitted additional indebtedness of \$300.0 million of which \$258.8 million has been utilized for the issuance of convertible notes, and an accordion feature whereby the Company can draw up to an additional \$100.0 million subject to the lenders' consent. The Senior Credit Agreement is collateralized by the Company's fleet of Boeing 767 and 757 freighter aircraft. Under the terms of the Senior Credit Agreement, the Company is required to maintain collateral coverage equal to 125% of the outstanding balances of the term loan and the maximum capacity of revolving credit facility or 150% of the outstanding balance of the term loan and the total funded revolving credit facility, whichever is less. The minimum collateral coverage which must be maintained is 50% of the outstanding balance of the term loan plus the revolving credit facility commitment which was \$545.0 million. Each year, through May 6, 2019, the Company may request a one year extension of the final maturity date, subject to the lenders' consent. Absent such future extensions, the maturity date is currently set to expire on May 30, 2023.

Under the Senior Credit Agreement, the Company is subject to covenants and warranties that are usual and customary including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness, as well as a total debt to EBITDA ratio and a fixed charge coverage ratio. The Senior Credit Agreement stipulates events of default including unspecified events that may have a material adverse effect on the Company. If an event of default occurs, the Company may be forced to repay, renegotiate or replace the Senior Credit Agreement.

Additional debt or lower EBITDA may result in higher interest rates. Under the Senior Credit Agreement, interest rates are adjusted quarterly based on the prevailing LIBOR or prime rates and a ratio of the Company's outstanding debt level to EBITDA (earnings before interest, taxes, depreciation and amortization expenses). At the Company's current debt-to-EBITDA ratio, the unsubordinated term loan and the revolving credit facility both bear a variable interest rate of 3.75%.

At September 30, 2018, the Company had \$43.5 million of cash balances. The Company had \$254.9 million available under the revolving credit facility, net of outstanding letters of credit, which totaled \$10.1 million. We believe that the Company's current cash balances and forecasted cash flows provided from its operating agreements, combined with its Senior Credit Agreement, which is being amended and restated in conjunction with the pending acquisition of Omni Air, will be sufficient to fund operations, capital spending, scheduled debt payments and required pension funding for at least the next 12 months.

#### Off-Balance Sheet Arrangements

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities ("SPEs"), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of September 30, 2018 and 2017, we were not involved in any material unconsolidated SPE transactions.

Certain of our operating leases and agreements contain indemnification obligations to the lessor or one or more other parties that are considered usual and customary (e.g. use, tax and environmental indemnifications), the terms of which range in duration and are often limited. Such indemnification obligations may continue after the expiration of the respective lease or agreement. No amounts have been recognized in our financial statements for the underlying fair value of guarantees and indemnifications.

## 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 disclosures of contingencies. In certain cases, there are alternative policies or estimation techniques which could be selected. On an ongoing basis, we evaluate our selection of policies and the estimation techniques we use, including those related to revenue recognition, post-retirement liabilities, bad debts, self-insurance reserves, valuation of spare parts inventory, useful lives, salvage values and impairment of property and equipment, income taxes, contingencies and litigation. The Company bases its estimates on historical experience, current conditions and on various other assumptions that are believed to be reasonable under the circumstances. Those factors 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.

For information regarding recently issued accounting pronouncements and the expected impact on our annual statements, see Note A "SUMMARY OF FINANCIAL STATEMENT PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES" in the accompanying notes to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk for changes in interest rates and changes in the price of jet fuel. The risk associated with jet fuel, however, is largely mitigated by reimbursement through the agreements with our customers. No changes have occurred to the market risks the Company faces since information about those risks were disclosed in item 7A of the Company's 2017 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 1, 2018.

## ITEM 4. CONTROLS AND PROCEDURES

### (a) Evaluation of Disclosure Controls and Procedures

As of September 30, 2018, the Company carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based upon the evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports filed or submitted by it under the Exchange Act is recorded, processed, summarized and reported within time periods specified in the Securities and Exchange Commission rules and forms and is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

### (b) Changes in Internal Controls

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

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

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

### ITEM 1A. RISK FACTORS

The Company faces risks that could adversely affect its condition or results of operations. Many of these risks are disclosed in Item 1A of the Company's 2017 Annual Report on form 10-K, filed with the Securities and Exchange Commission on March 1, 2018. The risk factors presented below update, and should be considered in addition to, the risk factors previously disclosed in Item 1A of the Company's 2017 Annual Report on Form 10-K. Other risks that are currently unknown to management or are currently considered immaterial or unlikely, could also adversely affect the Company.

On October 2, 2018, the Company announced that it has agreed to acquire Omni Air as described in this report. As a result, the Company faces additional risks and uncertainties associated with the pending acquisition, including, but not limited to, the possibility: (i) that one or more closing conditions to the acquisition, including certain regulatory approvals, may not be satisfied or waived, on a timely basis or otherwise, including that a governmental entity may prohibit, delay or refuse to grant approval for the consummation of the acquisition, or may require conditions, limitations or restrictions in connection with such approvals; (ii) the risk that the acquisition may not be completed on the terms or in the time frame expected by the Company, or at all; (iii) uncertainty of the expected financial performance of the combined company following completion of the acquisition; (iv) failure to realize the anticipated benefits of the acquisition; (v) difficulties and delays in achieving synergies of the combined company; (vi) the inability to retain key personnel subsequent to the acquisition; (vii) the occurrence of any event that could give rise to termination of the acquisition; (viii) changes in general economic and/or industry specific conditions that could adversely impact the acquisition; and (ix) actions by third parties, including government agencies that could adversely impact the acquisition.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On August 5, 2014, the Board of Directors authorized the Company to repurchase up to \$50.0 million of outstanding common stock. In May 2016, the Board amended the Company's common stock repurchase program increasing the amount that management may repurchase from \$50.0 million to \$100.0 million of outstanding common stock. In February 2018, the Board again amended the common stock repurchase program to increase the amount that management may repurchase to \$150 million (less amounts previously repurchased). The Board's authorization does not require the Company to repurchase a specific number of shares and the Board may terminate the repurchase program at any time. Repurchases may be made from time to time in the open market or in privately negotiated transactions. There is no expiration date for the repurchase program. There were no repurchases made during the third quarter of 2018. As of September 30, 2018, the Company has repurchased 6,592,349 shares and has a maximum dollar value of shares that may yet be purchased under the program of \$61.3 million.

### ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The following exhibits are filed with or incorporated by reference into this report.

Exhibit No. Description of Exhibit

Articles of Incorporation

- 3.1 Restated Certificate of Incorporation of Air Transport Services Group, Inc. (1)
- 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.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Labels Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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(1) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 8, 2018

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AIR TRANSPORT SERVICES GROUP, INC.,  
a Delaware Corporation  
Registrant

/S/ JOSEPH C. HETE  
Joseph C. Hete  
Chief Executive Officer (Principal Executive Officer)

Date: November 2, 2018

/S/ QUINT O. TURNER  
Quint O. Turner  
Chief Financial Officer (Principal Financial Officer  
and Principal Accounting Officer)

Date: November 2, 2018