ATLAS AIR WORLDWIDE HOLDINGS INC
Form 10-Q
August 07, 2008

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**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, DC 20549**

**FORM 10-Q**

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

**For the quarterly period ended June 30, 2008**

**OR**

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

**For the transition period from __________ to __________**

**0-25732**
**(Commission File Number)**
**Atlas Air Worldwide Holdings, Inc.**
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **13-4146982** |
| (State or other jurisdiction of incorporation) | (IRS Employer Identification No.) |
| **2000 Westchester Avenue, Purchase, New York** | **10577** |
| (Address of principal executive offices) | (Zip Code) |

**(914) 701-8000**
(Registrant s telephone number, including area code)
**Not Applicable**
(Former name, former address and former fiscal year, if changed since last report)

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 þ No o

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

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

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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes þ No o

**APPLICABLE ONLY TO CORPORATE ISSUERS:** As of June 30, 2008, there were 21,744,810 shares of the registrant s Common Stock outstanding.

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# PART I FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

**Atlas Air Worldwide Holdings, Inc.**
**Condensed Consolidated Balance Sheets**
*(in thousands, except share data)*
*(Unaudited)*

| | June 30, 2008 | December 31, 2007 |
|---|---|---|
| **Assets** | | |
| **Current Assets** | | |
| Cash and cash equivalents | $ 367,538 | $ 477,309 |
| Accounts receivable, net of allowance of $3,483 and $3,481, respectively | 137,548 | 134,014 |
| Prepaid maintenance | 61,306 | 72,250 |
| Deferred taxes | 26,712 | 35,053 |
| Prepaid expenses and other current assets | 30,768 | 24,693 |
| Total current assets | 623,872 | 743,319 |
| **Property and equipment** | | |
| Property and equipment, net | 841,512 | 594,872 |
| **Other Assets** | | |
| Deposits and other assets | 39,050 | 41,038 |
| Lease contracts and intangible assets, net | 37,042 | 37,961 |
| **Total Assets** | $ 1,541,476 | $ 1,417,190 |
| **Liabilities and Stockholders Equity** | | |
| **Current Liabilities** | | |
| Accounts payable | $ 25,587 | $ 29,600 |
| Accrued liabilities | 161,078 | 163,831 |
| Deferred gain | 152,836 | 151,742 |
| Current portion of long-term debt and capital leases | 30,332 | 28,444 |
| Total current liabilities | 369,833 | 373,617 |
| **Other Liabilities** | | |
| Long-term debt and capital leases | 457,097 | 365,619 |
| Deferred taxes | 16,115 | 21,570 |
| Other liabilities | 97,871 | 93,682 |
| Total other liabilities | 571,083 | 480,871 |
| Commitments and contingencies (Note 12) | | |
| Minority interest | 9,802 | 13,477 |
| **Stockholders Equity** | | |
| Preferred stock, $1 par value; 10,000,000 shares authorized; no shares issued | | |
| Common stock, $0.01 par value; 50,000,000 shares authorized; 21,912,851 and 21,796,484 shares issued, 21,744,810 and 21,636,250 shares outstanding (net | 219 | 218 |

| | | |
|---|---|---|
| of treasury stock), at June 30, 2008 and December 31, 2007, respectively | | |
| Additional paid-in-capital | 349,657 | 341,537 |
| Receivable from issuance of subsidiary stock | (39,543) | (77,065) |
| Treasury stock, at cost; 168,041 and 160,234 shares, respectively | (7,018) | (6,599) |
| Accumulated other comprehensive income | 1,860 | 1,750 |
| Retained earnings | 285,583 | 289,384 |
| Total stockholders equity | 590,758 | 549,225 |
| **Total Liabilities and Stockholders Equity** | $ 1,541,476 | $ 1,417,190 |

*See accompanying notes to the unaudited Condensed Consolidated Financial Statements.*

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**Atlas Air Worldwide Holdings, Inc.**
**Condensed Consolidated Statements of Operations**
*(in thousands, except per share data)*
*(Unaudited)*

| | For the Three Months Ended | | For the Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2008 | June 30, 2007 | June 30, 2008 | June 30, 2007 |
| **Operating Revenues** | $ 438,780 | $ 372,627 | $ 811,801 | $ 727,962 |
| **Operating Expenses** | | | | |
| Aircraft fuel | 207,031 | 122,123 | 351,522 | 234,434 |
| Salaries, wages and benefits | 52,845 | 61,438 | 111,748 | 123,188 |
| Maintenance, materials and repairs | 40,271 | 37,937 | 93,843 | 83,219 |
| Aircraft rent | 40,869 | 38,702 | 80,327 | 77,123 |
| Ground handling and airport fees | 19,096 | 18,385 | 37,622 | 35,706 |
| Landing fees and other rent | 20,213 | 18,288 | 38,930 | 36,018 |
| Depreciation and amortization | 12,817 | 10,062 | 21,183 | 19,637 |
| Gain on disposal of aircraft | (2,726) | (37) | (2,726) | (1,005) |
| Travel | 12,882 | 12,610 | 26,609 | 24,604 |
| Minority interest | (239) | | (3,675) | |
| Other | 22,169 | 21,883 | 45,466 | 46,312 |
| Total operating expenses | 425,228 | 341,391 | 800,849 | 679,236 |
| Operating income | 13,552 | 31,236 | 10,952 | 48,726 |
| **Non-operating Expenses** | | | | |
| Interest income | (3,118) | (3,838) | (8,476) | (7,259) |
| Interest expense | 11,709 | 11,274 | 23,092 | 22,522 |
| Capitalized interest | (2,274) | (1,121) | (4,049) | (1,963) |
| Other (income) expense, net | 607 | (271) | 139 | 92 |
| Total non-operating expenses | 6,924 | 6,044 | 10,706 | 13,392 |
| Income before income taxes | 6,628 | 25,192 | 246 | 35,334 |
| Income tax expense (benefit) | 5,098 | (17,993) | 4,047 | (14,048) |
| Net income (loss) | $ 1,530 | $ 43,185 | $ (3,801) | $ 49,382 |

Income (loss) per share:

| | | | | |
|---|---|---|---|---|
| Basic | $ 0.07 | $ 2.04 | $ (0.18) | $ 2.34 |
| Diluted | $ 0.07 | $ 2.01 | $ (0.18) | $ 2.30 |
| Weighted average shares: | | | | |
| Basic | 21,506 | 21,175 | 21,465 | 21,110 |
| Diluted | 21,656 | 21,452 | 21,465 | 21,393 |

*See accompanying notes to the unaudited Condensed Consolidated Financial Statements.*

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**Atlas Air Worldwide Holdings, Inc.**
**Condensed Consolidated Statements of Cash Flows**
*(in thousands)*
*(Unaudited)*

| | Six Months Ended June 30, 2008 | June 30, 2007 |
|---|---|---|
| **Cash Flows from Operating Activities:** | | |
| Net income (loss) | $ (3,801) | $ 49,382 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 21,183 | 19,637 |
| Accretion of debt discount | 3,632 | 3,519 |
| Amortization of operating lease discount | 919 | 918 |
| Provision for (release of) allowance for doubtful accounts | (502) | 555 |
| Gain on disposal of aircraft | (2,726) | (1,005) |
| Deferred taxes | 2,886 | (25,607) |
| Stock-based compensation expense | 3,758 | 4,108 |
| Minority interest | (3,675) | |
| Other, net | | 496 |
| Changes in operating assets and liabilities | 4,785 | (8,030) |
| Net cash provided by operating activities | 26,459 | 43,973 |
| **Cash Flows from Investing Activities:** | | |
| Capital expenditures | (274,424) | (30,400) |
| Proceeds from sale of aircraft | | 6,000 |
| Insurance proceeds | 5,900 | |
| Net cash used by investing activities | (268,524) | (24,400) |
| **Cash Flows from Financing Activities:** | | |
| Proceeds from loan | 107,259 | |
| Proceeds from stock option exercises | 3,162 | 4,050 |
| Purchase of treasury stock | (419) | (673) |
| Excess tax benefits from share-based compensation expense | 1,201 | 1,563 |
| Proceeds from issuance of subsidiary stock | 38,616 | 75,000 |
| Payments on debt | (17,525) | (18,842) |
| Net cash provided by financing activities | 132,294 | 61,098 |
| Net increase (decrease) in cash and cash equivalents | (109,771) | 80,671 |
| Cash and cash equivalents at the beginning of period | 477,309 | 231,807 |

| | | |
|---|---|---|
| Cash and cash equivalents at the end of period | $ 367,538 | $ 312,478 |

*See accompanying notes to the unaudited Condensed Consolidated Financial Statements.*

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**Atlas Air Worldwide Holdings, Inc.**
**Notes to Unaudited Condensed Consolidated Financial Statements**
**June 30, 2008**

## 1. Basis of Presentation

The accompanying interim Condensed Consolidated Financial Statements (the Financial Statements ) are unaudited and have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. As permitted by the rules and regulations of the Securities and Exchange Commission (the SEC ), the Financial Statements exclude certain footnote disclosures normally included in audited consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles ( GAAP ). In the opinion of management, the Financial Statements contain all adjustments, consisting of normal recurring items, necessary to fairly state the financial position of Atlas Air Worldwide Holdings, Inc. ( Holdings or AAWW ) and its consolidated subsidiaries as of June 30, 2008, the results of operations for the three and six months ended June 30, 2008 and 2007, and cash flows for the six months ended June 30, 2008 and 2007. The Financial Statements include the accounts of Holdings and its consolidated subsidiaries. All inter-company accounts and transactions have been eliminated. The year end balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP. The Financial Statements should be read in conjunction with the audited consolidated financial statements and the notes thereto for the fiscal year ended December 31, 2007 included in the Annual Report on Form 10-K of Holdings that was filed with the SEC on February 28, 2008 (the 2007 10-K ).

Holdings is the parent company of two principal operating subsidiaries, Atlas Air, Inc. ( Atlas ), which is wholly owned, and Polar Air Cargo Worldwide, Inc. ( Polar ), of which Holdings has a 51% economic interest and 75% voting interest. On June 28, 2007, Polar issued shares representing a 49% economic interest and a 25% voting interest to DHL Network Operations (USA), Inc. ( DHL ), a subsidiary of Deutsche Post AG ( DP ). Prior to that date, Polar was wholly owned by Holdings and was the parent company of Polar Air Cargo, Inc. ( Polar LLC ). Holdings, Atlas, Polar and Polar LLC are referred to collectively as the Company . The Company provides air cargo and related services throughout the world, serving Asia, the Middle East, Australia, Europe, South America, Africa and North America through: (i) contractual lease arrangements including contracts through which the Company leases an aircraft to a customer and provides value-added services including, crew, maintenance and insurance ( ACMI ); (ii) airport-to-airport scheduled air cargo service ( Scheduled Service ); (iii) military charter ( AMC Charter ); (iv) seasonal, commercial and ad-hoc charter services ( Commercial Charter ); and (v) dry leasing or sub-leasing of aircraft and engines ( Dry Leasing or Dry Lease ). The Company operates only Boeing 747 freighter aircraft.

The Company s quarterly results have in the past been subject to seasonal and other fluctuations and the operating results for any quarter are therefore not necessarily indicative of results that may be otherwise expected for the entire year.

Except for per share data, all dollar amounts are in thousands unless otherwise noted.

## 2. General

***DHL***

In March 2008, Atlas entered into a three year ACMI agreement and related agreements with Polar for two Boeing 747-400 aircraft, beginning on March 21, 2008. Polar entered into an interim blocked space agreement (the Interim BSA ) with DHL covering these two aircraft commencing on March 30, 2008 and expiring on October 27, 2008. In addition, on March 21, 2008, Polar and DHL amended and restated the original blocked space agreement entered into in June 2007 (the Amended BSA ) to include these two additional aircraft as part of that agreement beginning on the expiration of the Interim BSA. See Note 3 of the 2007 10-K for discussion of the blocked space agreement. Under the Interim BSA, Polar began express network flying ( Express Network ACMI ) on March 30, 2008 and the direct contribution for such flying is included as part of the ACMI reporting segment (see Note 4 for further discussion).

***Investments***

The Company holds a minority interest (49%) in a private company, which is accounted for under the equity method. The June 30, 2008 and December 31, 2007 aggregate carrying value of the investment was $5.8 million and $5.6 million, respectively, and was included within Deposits and other assets on the Condensed Consolidated Balance Sheets.

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Atlas has Dry Leased three owned aircraft to this company. The leases have terms that mature in the third quarter of 2009. The carrying value of these leased aircraft as of June 30, 2008 and December 31, 2007 was $165.8 million and $168.1 million, respectively. The related accumulated depreciation as of June 30, 2008 and December 31, 2007 was $18.9 million and $16.5 million, respectively. The leases provide for payment of rent and a provision for maintenance costs associated with the aircraft. Total rental income for the three aircraft was $10.8 million and $11.4 million for the three months ended June 30, 2008 and 2007, respectively, and $21.6 million and $22.8 million for the six months ended June 30, 2008 and 2007, respectively.

***Property and equipment, net***

Property and equipment, net consisted of the following at:

| | June 30, 2008 | December 31, 2007 |
|---|---|---|
| Flight equipment | $ 682,929 | $ 583,468 |
| Ground equipment | 24,057 | 23,040 |
| Purchase deposits for flight equipment | 232,230 | 75,026 |
| Less: accumulated depreciation | (97,704) | (86,662) |
| Property and equipment, net | $ 841,512 | $ 594,872 |

At June 30, 2008 and December 31, 2007, included in purchase deposits for flight equipment is capitalized interest of $9.2 million and $5.2 million, respectively.

On January 11, 2008, AAWW entered into an aircraft purchase agreement under which AAWW or its designee agreed to acquire two Boeing 747-400 aircraft. The acquisition of such aircraft was completed on May 6, 2008. The aircraft include one production Boeing 747-400 freighter, which entered service on June 12, 2008, and one passenger configured Boeing 747-400 aircraft that will be converted to freighter configuration and is expected to enter service in the third quarter of 2008. The purchase price for these aircraft was approximately $167.5 million, which includes conversion costs, of which $152.3 million has been paid. The remaining $15.2 million will be paid upon completion of the freighter conversion.

In February 2008, one of the Company s Boeing 747-200 aircraft (tail number N527MC) on a short-term ACMI lease to a customer was damaged due to improper shipper packaging of a load which damaged the hull. The plane landed safely but as a result of this incident the airframe was damaged beyond economic repair. Atlas negotiated a net $5.9 million cash-in-lieu-of-repair settlement with its insurance carriers and received the insurance proceeds in June 2008. The Company removed the engines and other certain high value rotable parts, which were transferred into rotable inventory. The remainder of the airframe is being sold for scrap metal. Since the settlement proceeds exceeded the net book value of the airframe after salvaging certain rotable parts, the Company recorded a gain of $2.7 million in the second quarter of 2008.

In March 2007, the Company sold aircraft tail number N536MC for $6.0 million and recorded a gain of approximately $1.0 million.

***Concentration of Credit Risk and Significant Customers***

United States Military Airlift Mobility Command ( AMC ) charters accounted for 25.5% and 25.6% of the Company s total revenues for the three months ended June 30, 2008 and 2007, respectively, and 25.3% and 29.1% for the six months ended June 30, 2008 and 2007, respectively. Accounts receivable from AMC were $19.6 million and $32.2 million at June 30, 2008 and December 31, 2007, respectively. The International Airline of United Arab Emirates ( Emirates ) accounted for 14.1% and 11.7% of the Company s total revenues for the three months ended June 30, 2008 and 2007, respectively, and 7.6% and 11.5% for the six months ended June 30, 2008 and 2007, respectively. Emirates accounted for 38.9% and 47.6% of the Company s ACMI revenues for the three months ended June 30, 2008 and 2007, respectively, and 40.1% and 47.7% for the six months ended June 30, 2008 and 2007, respectively. Accounts receivable from Emirates were $8.5 million and $13.4 million at June 30, 2008 and December 31, 2007, respectively. No other customer accounted for 10% or more of the Company s total operating revenues or accounts receivable during these periods.

***Debt Discount***

At June 30, 2008 and December 31, 2007, the Company had $71.8 million and $75.4 million, respectively, of unamortized discount related to fair market value adjustments recorded against debt upon application of fresh-start accounting.

***Recent Accounting Pronouncements***

In September 2006, the Financial Accounting Standards Board (the FASB ) issued Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* ( SFAS No. 157 ). SFAS No. 157 establishes a common definition for fair value to be applied to U.S. GAAP requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS No. 157 is effective for financial assets and financial liabilities for fiscal years beginning after November 15, 2007. Issued in February 2008, FASB Staff Position ( FSP ) 157-1 Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 ( FSP 157-1 ) removed leasing transactions accounted for under Statement 13 and related guidance from the scope of SFAS No. 157. FSP 157-2 Partial Deferral of the Effective Date of Statement 157 ( FSP 157-2 ), deferred the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008.

The implementation of SFAS No. 157 for financial assets and financial liabilities, effective January 1, 2008, did not have a material impact on the Company s consolidated financial position and results of operations. The Company is currently assessing the impact of SFAS No. 157 for non-financial assets and non-financial liabilities on its consolidated financial position and results of operations.

SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). SFAS No. 157 classifies the inputs used to measure fair value into the following hierarchy:

| | |
|---|---|
| Level 1 | Unadjusted quoted prices in active markets for identical assets or liabilities |
| Level 2 | Unadjusted quoted prices in active markets for similar assets or liabilities, or |
| | Unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or |
| | Inputs other than quoted prices that are observable for the asset or liability |
| Level 3 | Unobservable inputs for the asset or liability |

The Company endeavors to utilize the best available information in measuring fair value.

As of June 30, 2008, the Company did not have any financial assets or liabilities that were impacted by SFAS No. 157.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*, ( SFAS No. 159 ). SFAS No. 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The implementation of this standard did not have a material impact on the Company s consolidated financial position and results of operations.

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements ( SFAS No. 160 ). SFAS No. 160 establishes requirements for ownership interests in subsidiaries held by parties other than the Company (sometimes called minority interests ) be clearly identified, presented, and disclosed in the consolidated statement of financial position within equity, but separate from the parent s equity. All changes in the parent s ownership interests are required to be accounted for consistently as equity transactions and any non-controlling equity investments in unconsolidated subsidiaries must be measured initially at fair value. SFAS No. 160 is effective, on a prospective basis, for fiscal years beginning after December 15, 2008. However, presentation and disclosure requirements must be retrospectively applied to comparative financial statements. The

Company is currently assessing the impact of SFAS No. 160 on its consolidated financial position and results of operations.

In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 ( SFAS No. 161 ). SFAS No. 161 expands quarterly disclosure requirements in SFAS No. 133 about an entity s derivative instruments and hedging activities. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008. The Company is currently assessing the impact of SFAS No. 161 on its consolidated financial position and results of operations.

***Reclassifications***

Certain reclassifications have been made in the prior period s Condensed Consolidated Financial Statement amounts and related note disclosures to conform to the current period s presentation, primarily related to the classification of segments and commission income.

**3. Notes Payable**

On January 30, 2008, Atlas entered into a $270.3 million pre-delivery deposit payment ( PDP ) financing facility with Norddeutsche Landesbank Girozentrale (the PDP Financing Facility ), which is intended to fund a portion of Atlas PDP obligations in respect of the first five aircraft to be delivered to Atlas under its Boeing 747-8F purchase agreement with The Boeing Company ( Boeing ). These aircraft are scheduled for delivery between February and July 2010.

The facility is comprised of five separate tranches and is secured by certain of Atlas rights in and to the purchase agreement, but only to the extent related to the first five aircraft scheduled to be delivered thereunder. In the case of a continuing event of default by Atlas, the lenders will have certain rights to assume Atlas position and accept delivery of the related aircraft. Each tranche relating to each aircraft will become due on the earlier of (a) the date the aircraft is delivered or (b) up to nine months following the last day of the scheduled delivery month, depending on the cause of the delivery delay.

Funds available under the facility are subject to certain up-front and commitment fees, and funds drawn under the facility bear interest at Libor plus a margin. The facility is guaranteed by AAWW and is subject to typical and customary events of default. As of June 30, 2008, the Company had borrowed $107.3 million under the facility and has unused availability of $163.0 million.

**4. Segment Reporting**

The Company has five reportable segments: ACMI, Scheduled Service, AMC Charter, Commercial Charter and Dry Leasing. Each segment has different operating and economic characteristics which are separately reviewed by the Company s senior management.

The Company is pursuing growth in its Dry Leasing business. The increasing importance of this business has led senior management to classify Dry Leasing as a separate reportable segment and in the first quarter of 2008, the Company formed a wholly owned subsidiary, based in Ireland, for the purpose of Dry Leasing aircraft and engines. The Company currently Dry Leases three Boeing 747-400s to an affiliate in which the Company owns a minority (49%) interest. These aircraft are currently in the service of British Airways. In addition, the Company currently has one Boeing 747-200 aircraft Dry Leased to a cargo operator. Previously, the Company included Dry Lease revenue with Other Revenue and did not report the segment results separately.

In addition to reporting the Dry Lease segment separately, in the first quarter of 2008 the Company changed the principal economic performance metric it reports for each of its business segments. Previously, the Company used Fully Allocated Contribution ( FAC ) as its economic performance metric. FAC was computed by allocating all operating and non-operating costs to segments, and only taxes, post-emergence costs and related professional fees, gains on the sale of aircraft, and other unusual items were not allocated to segments. As part of the change, Management has adopted an economic performance metric that shows profitability of each segment after allocation of direct costs and ownership ( Direct Contribution ). Management believes that Direct Contribution is a better measurement of segment profitability. Direct costs and ownership include crew costs, maintenance, fuel, ground operations, sales costs, aircraft rent, interest expense related to aircraft debt and aircraft depreciation. Direct Contribution shows each segment s contribution to corporate fixed costs. Although corporate fixed costs are not allocated to each segment, the total corporate fixed costs are disclosed. Direct Contribution consists of income (loss) before taxes, excluding post-emergence costs and related professional fees, gains on the sale of aircraft, and unallocated fixed costs. Unallocated

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fixed costs include corporate overhead, non-aircraft depreciation, interest income, foreign exchange gains and losses and other non-operating costs.

Management allocates the direct costs of aircraft operation and ownership among the various segments based on the aircraft type and activity levels in each segment. Allocation methods are standard activity-based methods commonly used in the industry.

The ACMI segment provides aircraft, crew, maintenance and insurance services, whereby customers receive the use of an insured and maintained aircraft and crew in exchange for, in most cases, a guaranteed monthly level of operation at a predetermined rate for defined periods of time. The customer bears the commercial revenue risk and the obligation for other direct operating costs, including fuel. Beginning on March 30, 2008, Polar began Express Network ACMI flying with two aircraft for DHL. Under the terms of the Interim BSA, DHL is responsible for the commercial revenue risk (yields and cargo loads) and bears all of the direct costs of operation, including fuel, for these two aircraft. For segment reporting purposes all revenue derived from ACMI and related services provided to Polar for Express Network ACMI operations have been reclassified from Scheduled Service to the ACMI segment (see table below for reconciliation of revenue per the Financial Statements to revenue by segment). All costs associated with providing such services have also been reclassified for purposes of calculating Direct Contribution. Non-ACMI costs and an equal amount of revenue remain in the Scheduled Service segment.

The Scheduled Service segment provides airport-to-airport scheduled air freight and available on-forwarding services primarily to freight forwarding customers. The Company carries all of the commercial revenue risk (yields and cargo loads) and bears all of the direct costs of operation, including fuel. Distribution costs include direct sales costs through the Company s own sales force and through commissions paid to general sales agents. Commission rates typically range between 2.5% and 5% of commissionable revenue sold. Scheduled Service is highly seasonal, with peak demand coinciding with the retail holiday season, which traditionally begins in September and lasts through mid-December.

The AMC Charter segment provides full-planeload charter flights to the U.S. Military through the AMC. The AMC Charter business is similar to the Commercial Charter business in that the Company is responsible for the direct operating costs of the aircraft. However, in the case of AMC operations, the price of fuel consumed during AMC flights is fixed by the military. The contracted charter rates (per mile) and fuel prices (per gallon) are established and fixed by the AMC for twelve-month periods running from October to September of the next year. The Company receives reimbursement from the AMC each month if the price of fuel paid by the Company to vendors for AMC missions exceeds the fixed price; if the price of fuel paid by the Company is less than the fixed price, then the Company pays the difference to the AMC.

The Commercial Charter segment provides full-planeload airfreight capacity on one or multiple flights to freight forwarders, airlines and other air cargo customers. Charters are typically paid in advance and as with Scheduled Service, the Company bears the direct operating costs (except as otherwise defined in the charter contracts).

The Dry Leasing segment provides for the leasing of aircraft and engines to customers.

The following table sets forth revenues and Direct Contribution for the Company s five reportable business segments reconciled to operating income (loss) and income (loss) before income taxes as required by SFAS No. 131, *Disclosure about Segments of an Enterprise and Related Information,* for the stated periods:

| For the Three Months Ended | June 30, 2008 Revenue per Financial Statements | June 30, 2008 Express Network ACMI Revenue | June 30, 2008 Segment Revenue | June 30, 2007 Revenue per Financial Statements | June 30, 2007 Express Network ACMI Revenue | June 30, 2007 Segment Revenue |
|---|---|---|---|---|---|---|
| **Revenues:** | | | | | | |
| ACMI | $ 76,247 | $ 15,834 | $ 92,081 | $ 91,252 | $ | $ 91,252 |
| Scheduled Service | 213,423 | (15,834) | 197,589 | 144,245 | | 144,245 |
| AMC Charter | 111,756 | | 111,756 | 95,471 | | 95,471 |

| | | | | | |
|---|---|---|---|---|---|
| Commercial Charter | 24,370 | | 24,370 | 28,634 | 28,634 |
| Dry Leasing | 12,984 | | 12,984 | 13,025 | 13,025 |
| **Total operating revenues** | $ 438,780 | $ | $ 438 | | |