

ATLAS AIR WORLDWIDE HOLDINGS INC

Form 10-Q

May 05, 2016

Table of Contents

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, DC 20549**

**FORM 10-Q**

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

**For the quarterly period ended March 31, 2016**

**OR**

.. **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: 001-16545**

**Atlas Air Worldwide Holdings, Inc.**

**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction**

**13-4146982**  
**(IRS Employer**

**of incorporation)**

**Identification No.)**

**2000 Westchester Avenue, Purchase, New York**  
**(Address of principal executive offices)**

**10577**  
**(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)**

Edgar Filing: ATLAS AIR WORLDWIDE HOLDINGS INC - Form 10-Q

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

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

As of May 2, 2016, there were 24,811,018 shares of the registrant's Common Stock outstanding.

**Table of Contents****TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
Item 1.	<u>Financial Statements</u>
	<u>Consolidated Balance Sheets as of March 31, 2016 and December 31, 2015 (unaudited)</u> 3
	<u>Consolidated Statements of Operations for the Three Months ended March 31, 2016 and 2015 (unaudited)</u> 4
	<u>Consolidated Statements of Comprehensive Income for the Three Months ended March 31, 2016 and 2015 (unaudited)</u> 5
	<u>Consolidated Statements of Cash Flows for the Three Months ended March 31, 2016 and 2015 (unaudited)</u> 6
	<u>Consolidated Statements of Stockholders' Equity as of and for the Three Months ended March 31, 2016 and 2015 (unaudited)</u> 7
	<u>Notes to Unaudited Consolidated Financial Statements</u> 8
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 17
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 24
Item 4.	<u>Controls and Procedures</u> 25
<b><u>PART II. OTHER INFORMATION</u></b>	
Item 1.	<u>Legal Proceedings</u> 26
Item 1A.	<u>Risk Factors</u> 26
Item 6.	<u>Exhibits</u> 27
	<u>Signatures</u> 28
	<u>Exhibit Index</u> 29

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Atlas Air Worldwide Holdings, Inc.****Consolidated Balance Sheets***(in thousands, except share data)**(Unaudited)*

	<b>March 31, 2016</b>	<b>December 31, 2015</b>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 317,410	\$ 425,950
Short-term investments	3,990	5,098
Restricted cash	14,503	12,981
Accounts receivable, net of allowance of \$2,288 and \$1,247, respectively	134,677	164,308
Prepaid maintenance	5,621	6,052
Prepaid expenses and other current assets	44,937	37,548
<b>Total current assets</b>	<b>521,138</b>	<b>651,937</b>
<b>Property and Equipment</b>		
Flight equipment	3,709,611	3,687,248
Ground equipment	60,968	58,487
Less: accumulated depreciation	(472,389)	(450,217)
Purchase deposits for flight equipment	64,624	39,678
<b>Property and equipment, net</b>	<b>3,362,814</b>	<b>3,335,196</b>
<b>Other Assets</b>		
Long-term investments and accrued interest	34,089	37,604
Deposits and other assets	90,234	81,183
Intangible assets, net	56,380	58,483
<b>Total Assets</b>	<b>\$ 4,064,655</b>	<b>\$ 4,164,403</b>
<b>Liabilities and Equity</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 58,471	\$ 93,278
Accrued liabilities	294,570	293,138
Current portion of long-term debt	157,701	161,811
<b>Total current liabilities</b>	<b>510,742</b>	<b>548,227</b>

<b>Other Liabilities</b>		
Long-term debt	1,711,861	1,739,496
Deferred taxes	287,922	286,928
Other liabilities	98,400	135,569
<b>Total other liabilities</b>	<b>2,098,183</b>	<b>2,161,993</b>
<b>Commitments and contingencies</b>		
<b>Equity</b>		
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; 29,242,911 and 28,955,445 shares issued, 24,812,088 and 24,636,651, shares outstanding (net of treasury stock), as of March 31, 2016 and December 31, 2015, respectively		
	293	290
Additional paid-in-capital	630,151	625,244
Treasury stock, at cost; 4,430,823 and 4,318,794 shares, respectively	(175,956)	(171,844)
Accumulated other comprehensive loss	(5,785)	(6,063)
Retained earnings	1,007,027	1,006,556
<b>Total equity</b>	<b>1,455,730</b>	<b>1,454,183</b>
<b>Total Liabilities and Equity</b>	<b>\$ 4,064,655</b>	<b>\$ 4,164,403</b>

*See accompanying Notes to Unaudited Consolidated Financial Statements*

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

	<b>For the Three Months Ended</b>	
	<b>March 31, 2016</b>	<b>March 31, 2015</b>
<b>Operating Revenue</b>		
ACMI	\$ 182,740	\$ 189,047
Charter	202,303	220,138
Dry leasing	28,192	31,919
Other	5,380	3,741
<b>Total Operating Revenue</b>	<b>418,615</b>	<b>444,845</b>
<b>Operating Expenses</b>		
Salaries, wages and benefits	93,845	88,773
Aircraft fuel	63,220	78,115
Maintenance, materials and repairs	57,024	58,832
Aircraft rent	37,037	34,261
Depreciation and amortization	35,005	32,030
Travel	30,323	20,813
Navigation fees, landing fees and other rent	21,974	23,503
Passenger and ground handling services	20,879	19,963
Loss on disposal of aircraft		1,209
Special charge	6,631	(568)
Acquisition-related expenses	793	
Other	31,827	30,944
<b>Total Operating Expenses</b>	<b>398,558</b>	<b>387,875</b>
<b>Operating Income</b>	<b>20,057</b>	<b>56,970</b>
<b>Non-operating Expenses (Income)</b>		
Interest income	(1,604)	(4,488)
Interest expense	21,302	24,548
Capitalized interest	(357)	(26)
Loss on early extinguishment of debt	132	
Other expense (income), net	(240)	675
<b>Total Non-operating Expenses (Income)</b>	<b>19,233</b>	<b>20,709</b>
<b>Income before income taxes</b>	<b>824</b>	<b>36,261</b>

Income tax expense	353	7,029
<b>Net Income</b>	<b>\$ 471</b>	<b>\$ 29,232</b>
<b>Earnings per share:</b>		
Basic	\$ 0.02	\$ 1.18
Diluted	\$ 0.02	\$ 1.17
<b>Weighted average shares:</b>		
Basic	24,711	24,876
Diluted	24,846	25,070

*See accompanying Notes to Unaudited Consolidated Financial Statements*



Table of Contents

## Atlas Air Worldwide Holdings, Inc.

## Consolidated Statements of Comprehensive Income

*(in thousands)**(Unaudited)*

	<b>For the Three Months Ended</b>	
	<b>March 31, 2016</b>	<b>March 31, 2015</b>
<b>Net Income</b>	\$ 471	\$ 29,232
<b>Other comprehensive income (loss):</b>		
Interest rate derivatives:		
Reclassification to interest expense	454	650
Income tax expense	(176)	(248)
Foreign currency translation:		
Translation adjustment		(58)
Other comprehensive income	278	344
<b>Comprehensive Income</b>	<b>\$ 749</b>	<b>\$ 29,576</b>

*See accompanying Notes to Unaudited Consolidated Financial Statements*

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

	<b>For the Three Months Ended</b>	
	<b>March 31, 2016</b>	<b>March 31, 2015</b>
<b>Operating Activities:</b>		
Net Income	\$ 471	\$ 29,232
Adjustments to reconcile Net Income to net cash provided by operating activities:		
Depreciation and amortization	39,817	36,375
Accretion of debt securities discount	(332)	(1,902)
Provision for allowance for doubtful accounts	221	(174)
Special charge, net of cash payments	6,631	(568)
Loss on early extinguishment of debt	132	
Loss on disposal of aircraft		1,209
Deferred taxes	292	7,029
Stock-based compensation expense	5,455	5,285
Changes in:		
Accounts receivable	29,871	11,088
Prepaid expenses, current assets and other assets	(10,575)	(949)
Accounts payable and accrued liabilities	(52,544)	4,023
Net cash provided by operating activities	19,439	90,648
<b>Investing Activities:</b>		
Capital expenditures	(10,682)	(10,385)
Purchase deposits and payments for flight equipment	(84,230)	(14,925)
Changes in restricted cash	(1,522)	(747)
Proceeds from investments	4,955	1,202
Proceeds from disposal of aircraft		24,345
Net cash used for investing activities	(91,479)	(510)
<b>Financing Activities:</b>		
Proceeds from debt issuance	14,790	
Customer maintenance reserves received	3,547	4,129
Proceeds from stock option exercises		52
Purchase of treasury stock	(4,112)	(6,118)
Excess tax benefit from stock-based compensation expense	158	449
Payment of debt issuance costs	(217)	
Payments of debt	(50,666)	(50,845)
Net cash used for financing activities	(36,500)	(52,333)

Net increase (decrease) in cash and cash equivalents	(108,540)	37,805
Cash and cash equivalents at the beginning of period	425,950	298,601
Cash and cash equivalents at the end of period	\$ 317,410	\$ 336,406

**Non-cash Investing and Financing Activities:**

Acquisition of flight equipment included in Accounts payable and accrued liabilities	\$ 12,059	\$
--	-----------	----

*See accompanying Notes to Unaudited Consolidated Financial Statements*

Table of Contents

## Atlas Air Worldwide Holdings, Inc.

## Consolidated Statements of Stockholders Equity

*(in thousands, except share data)**(Unaudited)*

	Common Stock	Treasury Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders Equity	Total Equity
<b>Balance at December 31, 2014</b>	\$ 286	\$ (145,322)	\$ 573,133	\$ (9,572)	\$ 999,270	\$ 1,417,795	\$ 1,417,795
Net Income					29,232	29,232	29,232
Other comprehensive income				344		344	344
Stock option and restricted stock compensation			5,285			5,285	5,285
Purchase of 131,162 shares of treasury stock		(6,118)				(6,118)	(6,118)
Exercise of 1,900 employee stock options			52			52	52
Issuance of 324,406 shares of restricted stock	3		(3)				
Tax benefit (expense) on restricted stock and stock options			37			37	37
<b>Balance at March 31, 2015</b>	\$ 289	\$ (151,440)	\$ 578,504	\$ (9,228)	\$ 1,028,502	\$ 1,446,627	\$ 1,446,627

	Common Stock	Treasury Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders Equity	Total Equity
<b>Balance at December 31, 2015</b>	\$ 290	\$ (171,844)	\$ 625,244	\$ (6,063)	\$ 1,006,556	\$ 1,454,183	\$ 1,454,183
Net Income					471	471	471
Other comprehensive income				278		278	278
			5,455			5,455	5,455

Stock option and  
restricted stock  
compensation

Purchase of 112,029 shares of treasury stock		(4,112)		(4,112)	(4,112)
Issuance of 287,466 shares of restricted stock	3		(3)		
Tax benefit (expense) on restricted stock and stock options			(545)	(545)	(545)

**Balance at March 31,  
2016**

\$ 293    \$(175,956)    \$ 630,151    \$ (5,785)    \$ 1,007,027    \$ 1,455,730    \$ 1,455,730

*See accompanying Notes to Unaudited Consolidated Financial Statements*

**Table of Contents**

**Atlas Air Worldwide Holdings, Inc.**

**Notes to Unaudited Consolidated Financial Statements**

**March 31, 2016**

**1. Basis of Presentation**

Our consolidated financial statements include the accounts of the holding company, Atlas Air Worldwide Holdings, Inc. ( AAWW ) and its consolidated subsidiaries. AAWW is the parent company of its principal operating subsidiary, Atlas Air, Inc. ( Atlas ), and of Polar Air Cargo LLC ( Old Polar ). AAWW is also the parent company of several subsidiaries related to our dry leasing services (collectively referred to as Titan ). AAWW has a 51% equity interest and 75% voting interest in Polar Air Cargo Worldwide, Inc. ( Polar ). We record our share of Polar s results under the equity method of accounting.

The terms we, us, our, and the Company mean AAWW and all entities included in its consolidated financial statements.

We provide outsourced aircraft and aviation operating services throughout the world, serving Africa, Asia, Australia, Europe, the Middle East, North America and South America through: (i) contractual service arrangements, including those through which we provide aircraft to customers and value-added services, including crew, maintenance and insurance ( ACMI ), as well as those through which we provide crew, maintenance and insurance, but not the aircraft ( CMI ); (ii) cargo and passenger charter services ( Charter ); and (iii) dry leasing aircraft and engines ( Dry Leasing or Dry Lease ).

The accompanying unaudited consolidated financial statements and related notes (the Financial Statements ) have been prepared in accordance with the U.S. Securities and Exchange Commission (the SEC ) requirements for quarterly reports on Form 10-Q, and consequently exclude certain disclosures normally included in audited consolidated financial statements prepared in conformity with accounting principles generally accepted in the United States of America ( GAAP ). All significant intercompany accounts and transactions have been eliminated. The Financial Statements should be read in conjunction with the audited consolidated financial statements and the notes included in the AAWW Annual Report on Form 10-K for the year ended December 31, 2015, which includes additional disclosures and a summary of our significant accounting policies. The December 31, 2015 balance sheet data was derived from that Annual Report. In our opinion, the Financial Statements contain all adjustments, consisting of normal recurring items, necessary to fairly state the financial position of AAWW and its consolidated subsidiaries as of March 31, 2016, the results of operations for the three months ended March 31, 2016 and 2015, comprehensive income for the three months ended March 31, 2016 and 2015, cash flows for the three months ended March 31, 2016 and 2015, and shareholders equity as of and for the three months ended March 31, 2016 and 2015.

Our quarterly results are 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.

Certain reclassifications have been made to prior periods consolidated financial statement amounts and related note disclosures to conform to the current year s presentation.

**2. Recent Accounting Pronouncements**

In March 2016, the Financial Accounting Standards Board ( FASB ) amended its accounting guidance for share-based compensation. The amended guidance changes how companies account for certain aspects of share-based payment awards to employees, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. This amended guidance is effective as of the beginning of 2017. Early adoption is permitted. We are currently assessing the impact the amended guidance will have on our financial statements.

In February 2016, the FASB amended its accounting guidance for leases. The guidance requires a lessee to recognize assets and liabilities on the balance sheet arising from leases with terms greater than twelve months. While lessor accounting guidance is relatively unchanged,

**Table of Contents**

certain amendments were made to conform with changes made to lessee accounting and recently released revenue recognition guidance. The new guidance for leases will continue to classify them as either finance or operating, with classification affecting the pattern of expense and income recognition in the statement of operations. It also requires additional quantitative and qualitative disclosures about leasing arrangements. The amended guidance is effective as of the beginning of 2019. Early adoption is permitted. We are currently assessing the impact the amended guidance will have on our financial statements.

In May 2014, the FASB amended its accounting guidance for revenue recognition. The fundamental principles of the new guidance are that companies should recognize revenue in a manner that reflects the timing of the transfer of services to customers and consideration that a company expects to receive for the services provided. It also requires additional disclosures necessary for the financial statement users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB deferred the effective date by one year to the beginning of 2018. Early adoption is permitted, but not before the beginning of 2017. While we are still assessing the impact the amended guidance will have on our financial statements, we expect that revenue currently recognized based on flight departure will likely be recognized over time as the services are performed.

**3. Related Parties*****DHL Investment and Polar***

AAWW has a 51% equity interest and 75% voting interest in Polar. DHL Network Operations (USA), Inc. ( DHL ), a subsidiary of Deutsche Post AG ( DP ), holds a 49% equity interest and a 25% voting interest in Polar. Polar is a variable interest entity that we do not consolidate because we are not the primary beneficiary as the risks associated with the direct costs of operation are with DHL. Under a 20-year blocked space agreement (the BSA ), Polar provides air cargo capacity to DHL. Atlas has several agreements with Polar to provide ACMI, CMI, Dry Leasing, administrative, sales and ground support services to one another. We do not have any financial exposure to fund debt obligations or operating losses of Polar, except for any liquidated damages that we could incur under these agreements. The following table summarizes our transactions with Polar:

	<b>For the Three Months Ended</b>	
	<b>March 31, 2016</b>	<b>March 31, 2015</b>
<b>Revenue and Expenses:</b>		
Revenue from Polar	\$ 98,737	\$ 94,258
Ground handling and airport fees paid to Polar	\$ 223	\$ 797
	<b>March</b>	<b>December 31, 2015</b>
	<b>31, 2016</b>	
<b>Accounts receivable/payable as of:</b>		
Receivables from Polar	\$ 5,908	\$ 6,527
Payables to Polar	\$ 2,281	\$ 4,660
	<b>March</b>	<b>December 31,</b>
	<b>31, 2016</b>	<b>2015</b>
<b>Aggregate Carrying Value of Polar Investment as of:</b>		



Aggregate Carrying Value of Polar Investment	\$	4,870	\$	4,870
--	----	-------	----	-------

**GATS**

We hold a 50% interest in GATS GP (BVI) Ltd. ( GATS ), a joint venture with an unrelated third party. The purpose of the joint venture is to purchase rotatable parts and provide repair services for those parts, primarily for our 747-8F aircraft. The joint venture is a variable interest entity that we do not consolidate because we are not the primary beneficiary as we do not exercise financial control. As of March 31, 2016 and December 31, 2015, our investment in GATS was \$20.8 million and \$20.7 million, respectively, and our maximum exposure to losses from the entity is limited to our investment, which is comprised primarily of rotatable inventory parts. GATS does not have any third-party debt obligations. We had Accounts payable to GATS of \$2.5 million as of March 31, 2016 and \$2.3 million as of December 31, 2015.

**4. Southern Air Holdings Acquisition**

On January 15, 2016, we entered into an Agreement and Plan of Merger to acquire all the outstanding shares of Southern Air Holdings, Inc. ( Southern Air ) (the Southern Acquisition ). The Southern Acquisition was completed on April 7, 2016 for cash consideration of \$107.5 million, net of cash acquired, and is subject to working capital and other adjustments. Southern Air is the parent company of several subsidiaries, including Southern Air Inc. and Florida West

**Table of Contents**

International Airways, Inc. The Southern Acquisition provides us with immediate entry into 777 and 737 aircraft operating platforms, with the potential for developing additional business with existing and new customers of both companies. We believe the platforms provided by these aircraft will augment our ability to offer customers the broadest array of aircraft and operating services for domestic, regional and international applications. Southern Air currently flies five 777-200F and five 737-400F aircraft under CMI agreements for DHL.

For the three months ended March 31, 2016, we incurred Acquisition-related expenses of \$0.8 million, primarily related to professional fees and integration costs. Due to the timing of this acquisition, certain disclosures, including the preliminary allocation of the purchase price, are not presented as the valuation and accounting have not yet been completed.

**5. Special Charge**

During the first quarter of 2016, we classified four CF6-80 engines as held for sale, recognized an impairment loss of \$6.5 million and ceased depreciation on the engines. The carrying value of these CF6-80 engines was \$6.1 million and the carrying value of all CF6-80 engines held for sale was \$10.7 million at March 31, 2016, which was included within Prepaid expenses and other current assets in the consolidated balance sheets. The sales are expected to be completed during the second and third quarters of 2016.

**6. Accrued Liabilities**

Accrued liabilities consisted of the following as of:

	<b>March 31, 2016</b>	<b>December 31, 2015</b>
Customer maintenance reserves	\$ 70,501	\$ 70,252
Maintenance	64,492	52,070
U.S. class action settlement	35,000	35,000
Salaries, wages and benefits	31,494	51,649
Aircraft fuel	25,214	12,983
Deferred revenue	10,659	12,702
Other	57,210	58,482
Accrued liabilities	\$ 294,570	\$ 293,138

**7. Debt*****Term Loans***

In February 2016, we borrowed \$14.8 million related to the conversion of a 767-300BDSF aircraft under an eight-year term loan with a final payment of \$3.8 million due in February 2024 (the First 2016 Term Loan). The First 2016 Term Loan, which is secured by a mortgage against aircraft tail number N642GT, contains customary covenants and events of default and accrues interest at a fixed rate of 3.19%, with principal and interest payable monthly.

***Convertible Notes***

In June 2015, we issued \$224.5 million aggregate principal amount of convertible senior notes (the Convertible Notes ) in an underwritten public offering. The Convertible Notes are senior unsecured obligations and accrue interest payable semiannually on June 1 and December 1 of each year at a fixed rate of 2.25%. The Convertible Notes will mature on June 1, 2022, unless earlier converted or repurchased pursuant to their terms. Proceeds from the issuance of the Convertible Notes were used to refinance higher-rate debt related to five 747-400 freighter aircraft that had an average cash coupon of 8.1%. As of March 31, 2016, the remaining life of the Convertible Notes is 6.5 years and consisted of the following:

Liability component:	
Gross proceeds	\$ 224,500
Less: debt discount, net of amortization	(47,810)
Less: debt issuance cost, net of amortization	(4,656)
Net carrying amount	\$ 172,034
Equity component (1)	\$ 52,903

(1) Included in Additional paid-in capital on the consolidated balance sheet as of March 31, 2016.

**Table of Contents**

The following table presents the amount of interest expense recognized related to the Convertible Notes:

	<b>For the Three Months Ended March 31, 2016</b>	
Contractual interest coupon	\$	1,263
Amortization of debt discount		1,567
Amortization of debt issuance costs		167
Total interest expense recognized	\$	2,997

**8. Income Taxes**

Our effective income tax rates were 42.8% and 19.4% for the three months ended March 31, 2016 and March 31, 2015, respectively. The effective income tax rate for the three months ended March 31, 2016 differed from the U.S. federal statutory rate primarily due to nondeductible acquisition-related expenses incurred in connection with the acquisition of Southern Air. The effective rate for the three months ended March 31, 2015 differed from the U.S. federal statutory rate primarily due to an income tax benefit of \$4.0 million, net of reserves, related to extraterritorial income ( ETI ) from leasing certain of our aircraft. The effective rates for both periods also differed from the U.S. federal statutory rate due to the income tax impact of foreign operations taxed at different rates, our assertion to indefinitely reinvest the net earnings of certain foreign subsidiaries outside the U.S., U.S. state income taxes, the nondeductibility of certain expenses for tax purposes, adjustments to our liability for uncertain tax positions, and the relationship of these items to our projected operating results for the year. For interim accounting purposes, we recognize income taxes using an estimated annual effective tax rate.

**9. Financial Instruments**

Fair value is 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). Inputs used to measure fair value are classified in the following hierarchy:

- Level 1      Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2      Other inputs that are observable directly or indirectly, such as quoted prices in active markets for similar assets or liabilities, or inactive quoted prices for identical assets or liabilities in inactive markets;
- Level 3      Unobservable inputs reflecting assumptions about the inputs used in pricing the asset or liability.

We endeavor to utilize the best available information to measure fair value.

The carrying value of Cash and cash equivalents, Short-term investments and Restricted cash is based on cost, which approximates fair value.

Long-term investments consist of debt securities for which we have both the ability and the intent to hold until maturity. These investments are classified as held-to-maturity and reported at amortized cost. The fair value of our

Long-term investments is based on a discounted cash flow analysis using the contractual cash flows of the investments and a discount rate derived from unadjusted quoted interest rates for debt securities of comparable risk. Such debt securities represent investments in Pass-Through Trust Certificates ( PTCs ) related to enhanced equipment trust certificates ( EETCs ) issued by Atlas in 1998, 1999 and 2000.

The fair value of our term loans, notes guaranteed by the Export-Import Bank of the United States ( Ex-Im Bank ) and EETCs are based on a discounted cash flow analysis using current borrowing rates for instruments with similar terms.

The fair value of our Convertible Notes is based on unadjusted quoted market prices for these securities.

**Table of Contents**

The following table summarizes the carrying value, estimated fair value and classification of our financial instruments as of:

	<b>March 31, 2016</b>				
	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>					
Cash and cash equivalents	\$ 317,410	\$ 317,410	\$ 317,410	\$	\$
Short-term investments	3,990	3,990			3,990
Restricted cash	14,503	14,503	14,503		
Long-term investments and accrued interest	34,089	41,248			41,248
	\$ 369,992	\$ 377,151	\$ 331,913	\$	\$ 45,238
<b>Liabilities</b>					
Term loans	\$ 999,730	\$ 1,042,648	\$	\$	\$ 1,042,648
Ex-Im Bank guaranteed notes	671,717	711,185			711,185
EETCs	26,081	31,294			31,294
Convertible Notes	172,034	186,335	186,335		
	\$ 1,869,562	\$ 1,971,462	\$ 186,335	\$	\$ 1,785,127
<b>December 31, 2015</b>					
	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>					
Cash and cash equivalents	\$ 425,950	\$ 425,950	\$ 425,950	\$	\$
Short-term investments	5,098	5,098			5,098
Restricted cash	12,981	12,981	12,981		
Long-term investments and accrued interest	37,604	45,867			45,867
	\$ 481,633	\$ 489,896	\$ 438,931	\$	\$ 50,965
<b>Liabilities</b>					
Term loans	\$ 1,013,265	\$ 1,049,785	\$	\$	\$ 1,049,785
Ex-Im Bank guaranteed notes	689,720	715,890			715,890
EETCs	28,022	30,074			30,074
Convertible Notes	170,300	185,325	185,325		
	\$ 1,901,307	\$ 1,981,074	\$ 185,325	\$	\$ 1,795,749

The following table presents the carrying value, gross unrealized gain (loss) and fair value of our long-term investments and accrued interest by contractual maturity as of:

	March 31, 2016			December 31, 2015		
	Carrying Value	Gross Unrealized Gain (Loss)	Fair Value	Carrying Value	Gross Unrealized Gain (Loss)	Fair Value
<b>Debt securities</b>						
Due after one but within five years	\$ 34,089	\$ 7,159	\$ 41,248	\$ 37,604	\$ 8,263	\$ 45,867
<b>Total</b>	<b>\$ 34,089</b>	<b>\$ 7,159</b>	<b>\$ 41,248</b>	<b>\$ 37,604</b>	<b>\$ 8,263</b>	<b>\$ 45,867</b>

## 10. Segment Reporting

Our business is organized into three operating segments based on our service offerings: ACMI, Charter and Dry Leasing. All segments are directly or indirectly engaged in the business of air transportation services but have different commercial and economic characteristics. Each operating segment is separately reviewed by our chief operating decision maker to assess operating results and make resource allocation decisions. We do not aggregate our operating segments and, therefore, our operating segments are our reportable segments.

We use an economic performance metric ( Direct Contribution ) that shows the profitability of each segment after allocation of direct operating and ownership costs. Direct Contribution represents Income before income taxes excluding the following: Special charges, Acquisition-related expenses, nonrecurring items, Losses (gains) on the disposal of aircraft, Losses on early extinguishment of debt, Gains on investments and Unallocated income and expenses, net. Direct operating and ownership costs include crew costs, maintenance, fuel, ground operations, sales costs, aircraft rent, interest expense on the portion of debt used for financing aircraft, interest income on debt securities and aircraft depreciation. Unallocated income and expenses, net include corporate overhead, nonaircraft depreciation, noncash expenses and income, interest expense on the portion of debt used for general corporate purposes, interest income on nondebt securities, capitalized interest, foreign exchange gains and losses, other revenue and other non-operating costs.

---

**Table of Contents**

The following table sets forth Operating Revenue and Direct Contribution for our reportable segments reconciled to Operating Income and Income before Income Taxes:

	<b>For the Three Months Ended</b>	
	<b>March 31, 2016</b>	<b>March 31, 2015</b>
<b>Operating Revenue:</b>		
ACMI	\$ 182,740	\$ 189,047
Charter	202,303	220,138
Dry Leasing	28,192	31,919
Other	5,380	3,741