ABX AIR INC
Form DEFA14A
April 05, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No. __)

Filed by the Registrant x   Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

¨ Definitive Proxy Statement

x Definitive Additional Materials

¨ Soliciting Material Pursuant to §240.14a-12

ABX Air, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

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(2) Form, Schedule or Registration Statement No.:

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(3) Filing Party:

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(4) Date Filed:

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ABX Air 2004 Annual Report

Years of Growth

ABX Air was born on April 16, 1980, as Airborne Express, Inc., a subsidiary of Airborne Freight Corporation. During our first year of operation, we occupied what had been the Clinton County Air Force Base near Wilmington, Ohio. Airborne Express moved about 500,000 packages a month. Within ten years, we would be able to sort that many packages in a single night.

Our early fleet had an estimated 10 different types of planes. We soon retired many of the smaller ones in favor of DC-8, DC-9, and YS-11 aircraft. This streamlining of the fleet reduced costs while maintaining an optimum mix of payload arrangements.

In 1988, the company was renamed ABX Air, Inc. To support our rapid expansion, we began developing a hub and spoke system by opening our first regional hub in Allentown, Pa. Six more hubs were added in the next three years.

By ABX Air s 15th anniversary, more than 5,000 employees were working together to move an average of over a million packages in a 24-hour period. Meanwhile our fleet had grown to over 100 aircraft. In 1997, we retired the turboprop-driven YS-11s and took delivery of our first wide-bodied aircraft, the Boeing 767-200, introducing an even greater range and flexibility to our fleet. ABX Air was spun off in 2003 as an independent, publicly traded company as part of DHL s acquisition of Airborne.

The graph below charts the company s growth. Each containerrepresents an average of 100,000 packages moved per day. Each aircraft represents 10 planes owned by the company at the end of each year.

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ABX Air 2004 Annual Report

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ABX Air 2004 Annual Report

Dear Fellow Stockholders:

Last year I announced that ABX Air s focus for 2004 would be two-fold: maximizing our earnings under our contracts with DHL and enhancing those profits by expanding our revenue from non-DHL business.

I m pleased to report we were largely successful in both endeavors. By meeting cost and service goals during 2004, ABX Air earned a significant portion of the maximum incremental mark-ups available during the year under the aircraft, crew, maintenance, and insurance (ACMI) and hub services agreements with DHL. Meanwhile, we made strides in diversifying our revenue streams by increasing our level of non-DHL business from $11.6 million in 2003 to $26.7 million in 2004.

Performance

As a result of these successes, ABX Air realized annual revenue of $1.2 billion and net income of $37.0 million, or $0.63 per diluted share in 2004.

Our contracts with DHL accounted for $30.2 million, or 81.6 percent of our net earnings. Accordingly, supporting DHL s continued drive to strengthen and expand its share of the U.S. cargo market remains a priority. The volume of packages handled by ABX Air grew to a record 541 million pieces in 2004, a 14 percent increase over the previous year. We began operating seven additional regional sort hubs for DHL, bringing our total number of hub operations to 19.

Customers other than DHL accounted for 2.2 percent of ABX Air s total annual revenue in 2004, but the higher margins associated with this business accounted for $6.8 million, or 18.4 percent of our net earnings. Non-DHL revenue has continued to grow in each successive quarter since our separation from Airborne. While such income may vary due to changes in capacity and customer demand, this steady growth is a promising sign; and we will continue to nurture this segment of our business.

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ABX Air 2004 Annual Report

Experience Counts

As any leader can attest, you can t build a winning team overnight. Skills must be honed through experience. Our success during this first full year as a publicly traded company confirms my belief that, over the past 25 years, ABX Air has built a highly skilled, dedicated, and innovative team.

The U.S. Postal Service (USPS) recognized this depth of expertise by awarding ABX Air a greater share of business in 2004. We began managing the USPS terminal handling activities in Indianapolis, and we were contracted to manage an air network and provide logistical support to the USPS during the busy holiday season.

Meanwhile, our proven expertise in aircraft maintenance continues to drive sales. In 2004, we completed 18 major aircraft maintenance projects on customers DC-9s.

Time-Tested Values

ABX Air operates based on a common set of values held by the stakeholders in our success our employees, management, customers, stockholders, and community leaders. We value our people, quality, teamwork, safety, trust, and customer satisfaction.

These words are more than mere sentiment; they are principles that have given the company a history of responsible leadership, personal accountability, and commitment to a shared vision.

During 2004 we made significant efforts to evaluate and improve our internal controls over financial reporting. We have met the requirements of the Sarbanes-Oxley Act for 2004 and will remain vigilant in this area.

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ABX Air 2004 Annual Report

Our Board of Directors has put forth two stockholder proposals that, if passed, will strengthen corporate governance at ABX Air. The first would allow us to enlarge the board, thereby increasing the diversity of experience, skills, and talents. The second would permit the board to establish a long-term incentive program for the company s senior management and board. The plan would serve to better align the interests of management with yours, our stockholder.

A Strong Prospect for the Future

Despite the phased elimination of selected air routes planned for 2005, I remain cautiously optimistic about ABX Air s prospects for the coming year and beyond.

DHL earmarked over $300 million to expand the Wilmington facility, which we operate for them as their consolidated hub. This expansion lays the groundwork for future growth of the network.

As ABX Air marks its 25th anniversary this year, the importance of our role as a reliable ACMI carrier and cost-effective hub operator has never been greater. The same combination of outstanding service, experience, and cost-effectiveness that makes us a valued service provider to DHL also gives us the ability to further diversify our revenue base. Going forward, these are the building blocks for another 25 years of sound, profitable growth.

Joseph C. Hete
President & Chief Executive Officer

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2004

Commission file number 000-50368

ABX AIR, INC.

(Exact name of registrant as specified in its charter)

Delaware	**91-1091619**
(State of Incorporation)	**(I.R.S. Employer Identification No.)**

145 Hunter Drive, Wilmington, OH 45177

(Address of principal executive offices)

937-382-5591

(Registrant s telephone number, including area code)

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

Title of class: none

Name of each exchange on which registered: none

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

Common Stock, Par Value $.01 per share

(Title of class)

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).   YES x   NO ¨

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, as of the last business day of the registrant s most recently completed second fiscal quarter: $396,002,895.

As of March 16, 2005, 58,270,400 shares of the registrant s common stock, par value $0.01, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held May 5, 2005, are incorporated by reference into Part III.

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FORWARD LOOKING STATEMENTS

Statements contained in this annual report on Form 10-K, including Management s Discussion and Analysis of Financial Condition and Results of Operations, in Item 7, that are not historical facts are considered forward-looking statements (as that term is defined in the Private Securities Litigation Reform Act of 1995). Words such as projects, believes, anticipates, will, estimates, plans, expects, intends and similar wo 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 Challenges and Risks and Additional Risk Factors Associated with ABX s Business.

Filings with the Securities and Exchange Commission

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

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ABX AIR, INC. AND SUBSIDIARIES

2004 FORM 10-K ANNUAL REPORT

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PART I

ITEM 1. BUSINES S

Background

ABX Air, Inc. (ABX) is an airline that provides cargo transportation and, through a network of 19 hubs, provides package sorting, handling and line-haul services within the United States. We operate an in-service fleet of 115 aircraft as of December 31, 2004, and have the authority to fly worldwide. We primarily utilize our aircraft to provide express delivery services for cargo typically requiring next day delivery. We utilize contracted line-haul from third party trucking companies to transport deferred delivery cargo within our network. Deferred delivery cargo is scheduled for delivery at a specific time, but has longer services intervals than the express freight generally transported by our aircraft. We do not provide local pickup and delivery services to consumers. We also sell aircraft parts, provide maintenance and repair services for airframes and aircraft components and conduct flight-training services for customers. Additionally, we operate a sorting facility for the U.S. Postal Service. Our headquarters and the principal site of our airline hub and package sorting operation are located in Wilmington, Ohio. ABX is a Delaware corporation that was formed in 1980 and was formerly a wholly-owned subsidiary of Airborne, Inc. (Airborne). On August 15, 2003, DHL Worldwide Express, B.V., through its wholly-owned subsidiary, DHL Holdings (USA), Inc., (DHL Holdings) acquired the ground and related operations of Airborne and ABX was separated from Airborne, becoming an independent publicly traded company. On January 1, 2005, Airborne was merged into DHL Express (USA), Inc. (DHL Express). (Hereinafter, DHL Holdings, DHL Express and the former Airborne will sometimes be referred to individually and collectively as DHL .)

DHL remained our primary customer, accounting for approximately 98% of our revenues in 2004. We assist DHL in providing domestic express and deferred delivery services to its customers. DHL s express delivery services include its Next Day Services and DHL 2nd Day Service. Next Day Services are primarily transported by our fleet of aircraft and sorted through our nightly hub operations. Second Day Service packages and packages shipped using DHL s deferred delivery services, which include DHL@Home and DHL Ground Service, are primarily transported by contracted trucks and sorted through our Wilmington daytime sort and regional hub operations. Some of the packages for Second Day Service and for deferred delivery services may be transported on our aircraft.

Separation from Airborne

The merger agreement between Airborne and DHL required Airborne to separate its air operations from its ground operations with the air operations being retained by ABX. Immediately prior to the separation, certain assets and liabilities related to Airborne s ground operations were transferred out of ABX to Airborne.

The separation of ABX from Airborne occurred according to the terms and conditions of the separation agreement, which was included in our S-4 registration statement amended on July 11, 2003. In the separation:

- ABX transferred the stock membership interests of Wilmington Air Park, Inc. which owned an airport in Wilmington, Ohio, to Airborne;

ABX transferred certain assets, including material handling and sorting equipment, and certain liabilities related to Airborne s ground operations to Airborne;

ABX retained certain assets, including aircraft, flight simulators and related spare parts and retained certain liabilities related to Airborne s air and sort operations;

ABX s advances payable to Airborne of $457.3 million were cancelled;

ABX issued a promissory note to DHL in the amount of $92.9 million and

Effective August 16, 2003, ABX and Airborne entered into an aircraft, crew, maintenance and insurance agreement (ACMI agreement), a hub and line-haul services agreement (Hub Services agreement), a lease, an employee matters agreement, a tax sharing agreement and a transition services agreement.

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Commercial Agreements with DHL

After Airborne was merged into DHL, the commercial agreements were assumed by DHL Express. Under the ACMI agreement, we provide air cargo transportation to DHL on a cost plus pricing structure. We have complete and exclusive responsibility for the operation, maintenance and safety of the aircraft. Costs incurred under the ACMI agreement are generally marked-up 1.75% and recorded in revenues. Certain costs, the most significant of which include fuel, rent, interest on the promissory note to DHL, ramp fees and landing fees incurred under the ACMI agreement, are recorded in revenues without mark-up. By achieving certain cost-related and service goals specified in the agreement, the mark-up can increase from a base of 1.75%, up to approximately 3.35%.

The ACMI agreement has a term of seven years and automatically renews for an additional three years unless a one-year notice of non-renewal is given. DHL may terminate the ACMI agreement if, after a cure period, ABX is not in compliance with applicable performance standards specified in the agreement. The agreement allows DHL to reduce the air routes that we fly or remove aircraft from service. For any aircraft removed from service during the term of the ACMI agreement, the agreement allows us to put the aircraft to DHL, requiring DHL to buy such aircraft from us at book value or fair market value depending on our level of stockholders equity and the size of the promissory note to DHL at the time the put is executed.

Under the Hub Services agreement, we provide staff to conduct package sorting, warehousing, and line-haul logistics as well as airport, facilities and equipment maintenance services for DHL. Costs incurred under these agreements are generally marked-up 1.75% and included in revenues. By achieving certain cost and service goals specified in the agreement, the mark-up can increase from a base of 1.75%, up to approximately 3.85%.

The Hub Services agreement has a term of three years, with automatic one-year renewals unless a ninety-day notice of non-renewal is given. DHL may terminate the Hub Services agreement if, after a cure period, ABX is not in compliance with applicable performance standards specified in the agreement. DHL may also terminate the Hub Services agreement if the ACMI agreement has been terminated. The agreement allows DHL to terminate specific services at one or more of the hubs after giving us sixty days of advance notice.

Products and Services

We also provide cargo transportation and aircraft related services to customers other than DHL. Our revenues from customers other than DHL were approximately 2% of our total revenues in 2004 and 2003. Our strategy involves increasing the number of customers we serve and expanding our revenue base by leveraging our current assets and capabilities. Our services provided to non-DHL customers are described below.

ACMI and Charter Services

We can use our aircraft to provide ACMI services and fly on-demand charters for customers other than DHL. A typical ACMI contract requires ABX to supply, at a specific rate per block hour, the aircraft, crew, maintenance and insurance for specified cargo operations, while the customer is responsible for substantially all other aircraft operating expenses, including fuel, landing fees, parking fees and ground and cargo handling expenses. On-demand charter agreements usually require ABX to supply fuel and other operating expenses in addition to aircraft, crew, maintenance and insurance for a fixed, all inclusive price. Under our ACMI and charter arrangements, we have exclusive operating control of our aircraft and our customers must typically obtain any government authorizations and permits required to service the designated routes. This model allows customers to utilize our capabilities instead of committing to aircraft ownership. During 2004 and 2003, we flew approximately 4,260 and 1,910 block hours, respectively, for customers other than DHL.

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

Our ACMI agreement with DHL allows us, subject to certain limitations described in the ACMI agreement, to sell any aircraft space that DHL does not use to other customers. On the routes we operate for DHL, we sell airport-to-airport transportation services to freight forwarders and to the U.S. Postal Service.

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Aircraft Maintenance and Modification Services

We are a Federal Aviation Administration (FAA) certified repair station. We can leverage the repair station facilities (including hangars and a component shop which we lease) and our engineering capabilities to perform airframe and component maintenance and repair services for other airlines and maintenance repair organizations. We have developed technical expertise related to aircraft modifications as a result of our long history in aviation. We own many Supplemental Type Certificates (STCs). An STC is granted by the FAA and represents an ownership right, similar to an intellectual property right, which authorizes the alteration of an airframe, engine or component. Prior to our separation from Airborne, we did not actively sell these services. Since the separation, we have begun to market our capabilities. When we identify aviation-related maintenance and modification opportunities, we attempt to match them to our capabilities.

Our marketable capabilities include the implementation of terrain awareness warning systems (TAWS) and collision avoidance systems (TCAS) and heavy maintenance for McDonnell Douglas DC-9 (DC-9) aircraft. We have developed a turnkey approach for installing FAA certified Reduced Vertical Separation Minima (RVSM) equipment in DC-9 and McDonnell Douglas DC-8 (DC-8) aircraft and signed an exclusive distribution agreement to sell the related hardware. (RVSM is designed to reduce air traffic congestion by permitting aircraft to fly closer together vertically above certain altitudes.) We perform airframe overhauls on DC-9 aircraft and line maintenance on DC-8, DC-9 and Boeing 767 aircraft. We refurbish in-house, approximately 60% of the airframe components for our DC-8 and DC-9 aircraft and the wheels and brakes for our DC-8, DC-9 and Boeing 767 aircraft types. We can also perform intermediate repairs on the engines for DC-8 aircraft and the engines and auxiliary power units for DC-9 aircraft. Additionally, we update aircraft manuals for customers in conjunction with the modification of aircraft from passenger to cargo configuration.

Aircraft Parts Sales and Brokerage

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

Flight Crew Training

We are FAA certificated to offer training to customers and rent usage of our flight simulators for outside training programs. We train flight crewmembers in-house utilizing our own classroom instructors and facilities. We own four flight simulators, including one Boeing 767, one DC-8 and two DC-9 flight simulators. Our Boeing 767 and one of our DC-9 flight simulators are level C certified, which allows us to qualify flight crewmembers under FAA requirements without performing check flights in an aircraft. Our DC-8 and the other DC-9 flight simulator are level B certified which allows us to qualify flight crewmembers by performing a minimum number of flights in an aircraft.

HASP

We provide parcel-handling services for the U.S. Postal Service for its Hub and Spoke Program (HASP) near Indianapolis, Indiana under a two-year agreement that expires in September 2006.

Industry

We compete primarily in scheduled cargo transportation services, processing shipments ranging from individual letters to shipper-packaged pallets of electronic equipment, retail catalogs, movies and pharmaceuticals. Air cargo transportation services provide time definite delivery for time critical or priority

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shipments. Shippers generally try to use ground based delivery services when longer delivery times are permissible because the cost of truck transportation is usually substantially less than air transportation. The industry has been and is expected to remain highly competitive. The primary competitive factors in our industry are price, geographic coverage, flight frequency, reliability and capacity.

The scheduled cargo transportation industry is dominated by integrated, (door-to-door) carriers including the U.S. Postal Service, Federal Express Corporation (FedEx) and United Parcel Service, Inc. (UPS), who we usually do not compete with directly. We compete for domestic cargo volume principally with other cargo airlines and passenger airlines which have substantial belly cargo capacity. Other all-cargo airlines include Astar Air Cargo, Inc. (Astar), Atlas Air, Inc., Evergreen International, Inc. and Kitty Hawk, Inc. At least one of our ACMI competitors has an ACMI agreement with DHL.

Cargo volumes within the U.S. are highly dependent on the economic conditions and the level of commercial activity. We expect the market to grow as the U.S. economy grows. Continued emphasis among businesses for just-in-time inventory management and time critical delivery services increases the demand for air cargo delivery. Historically, ABX and our industry have experienced higher cargo volumes during the fourth calendar quarter of each year.

Airline Operations

Aircraft

We currently utilize pre-owned Boeing 767, DC-8 and DC-9 aircraft. Once acquired, aircraft are modified for use in our cargo operation. As of December 31, 2004, our in-service fleet consisted of 115 aircraft, including 26 Boeing 767 aircraft, 16 DC-8 aircraft, and 73 DC-9 aircraft. We own 110 of these aircraft and lease five Boeing 767s. The average ages of our Boeing 767, DC-8 and DC-9 aircraft are 21, 36 and 34 years, respectively.

With newer generation and more operationally efficient Boeing 767 aircraft, the less economical DC-8 aircraft can be placed into shorter lane segments, transferred to backup or charter operation roles, or removed from service. Future DC-8 aircraft retirements will be determined based on ACMI requirements, capacity requirements, charter service demand and the timing of placing future Boeing 767 aircraft into service.

The majority of our aircraft are not equipped with a standard cargo door, but instead utilize the former passenger door for the loading and unloading of freight. This reduces the cost of modifying the aircraft from passenger to cargo configuration, but limits the size of the freight that can be carried onboard the aircraft and necessitates the use of specialized containers and loading equipment. The absence of a cargo door also negatively impacts the market value of the aircraft. We currently have eight DC-8 aircraft that are equipped with an activated standard cargo door. At December 31, 2004, we have two Boeing 767 aircraft that were converted from passenger aircraft to a standard cargo door configuration. We also have eight DC-9 aircraft that are equipped with a standard cargo door, however, these doors are not currently activated. We are installing standard cargo doors on two Boeing 767 passenger aircraft and plan to install a standard cargo door on one Boeing 767 passenger aircraft that we are committed to purchase in July of 2005.

Flight Operations and Control

Our flight operations, including aircraft dispatching, flight tracking and crew scheduling, are planned and controlled by ABX personnel at the Wilmington Air Park, an airport located in Wilmington, Ohio. We staff aircraft dispatching and flight tracking 24 hours per day, 7 days per week. Our flight operations office at the Wilmington Air Park also coordinates the technical support necessary for our flights into other airports. Because our flight operations can be hindered by inclement weather, we use sophisticated landing systems and other equipment that are intended to minimize the effect that weather may have on our flight operations. All of our Boeing 767 aircraft are equipped for Category III landings. This allows our crews to land under weather

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conditions with runway visibility of only 600 feet at airports with Category III Instrument Landings Systems. All of our DC-8 and DC-9 aircraft are equipped for Category II landings which enable landing with runway visibility of only 1,200 feet.

Maintenance

Our operations are regulated by the FAA for aircraft safety and maintenance. We believe that maintaining a majority of our fleet of aircraft ourselves reduces maintenance costs, minimizes the out-of-service time for aircraft and achieves a higher level of reliability. We are certificated as an FAA repair station to perform maintenance on DC-8, DC-9 and Boeing 767 aircraft and their related avionics and accessories. Our maintenance and engineering personnel coordinate all routine and non-routine maintenance programs. Our maintenance programs include tracking the maintenance status of each aircraft, consulting with manufacturers and vendors about procedures to correct irregularities and training ABX maintenance personnel on the requirements of our FAA-approved maintenance program. We conduct nearly all of our own maintenance training.

We perform major airframe maintenance and modification on our DC-9 aircraft. We perform routine inspections and airframe maintenance, including Airworthiness Directives and Service Bulletin compliance on our DC-8, DC-9 and Boeing 767 aircraft. We contract with maintenance repair organizations to perform heavy maintenance on our DC-8 and Boeing 767 airframes. We also contract with maintenance repair organizations for the performance of heavy maintenance on our aircraft engines. We own a supply of spare aircraft engines, auxiliary power units, aircraft parts and consumable items. The number of spare items we maintain is based on the size of the fleet of each aircraft type we operate and the reliability history of the item types.

Due to the nature of ABX s business, our aircraft experience relatively low utilization. For this reason, we have elected to schedule and perform heavy maintenance on our aircraft on a calendar basis as opposed to an hourly use basis. This results in ABX s aircraft undergoing inspections and maintenance on a more frequent basis, thereby improving mechanical reliability, lowering costs and, ultimately, improving service to our customers.

Insurance

We are required by the Department of Transportation (DOT) to carry liability insurance on each of our aircraft. Each of our aircraft leases and the ACMI and Hub Services agreements also require us to carry such insurance. We currently maintain public liability and property damage insurance and aircraft hull and liability insurance for each of the aircraft in our fleet in amounts consistent with industry standards.

Sort and Line-haul Operations

We operate and maintain DHL s primary U.S. sort facility located in Wilmington, Ohio. The Wilmington facility currently has the capacity to handle approximately 1.3 million pieces during the primary 3.25 hour nightly sort operation. On average, approximately 948,000 pieces are sorted each weekday night at the sort center. In addition to the sort facility in Wilmington, we operate 18 regional hubs on behalf of DHL. These regional hub facilities primarily sort shipments originating and having a destination within approximately 250 miles. We also conduct a daytime sort operation in Wilmington that processes deferred delivery shipments. The day sort generally receives shipments through a combination of aircraft and trucks originating from regional hubs, Airborne station facilities or customer sites. The night sort and day sort operations at Wilmington handle approximately 60% of the total system-wide shipment weight, while the regional hubs handle the remaining 40%.

The eighteen regional hubs are located near Allentown, Pennsylvania; Atlanta, Georgia; Baton Rouge, Louisiana; Chehalis, Washington; Columbia, Missouri; Denver, Colorado; Erie, Pennsylvania; Fresno, California; Memphis, Tennessee; Minneapolis, Minnesota; Orlando, Florida; Phoenix, Arizona; Providence, Rhode Island; Roanoke, Virginia; Salt Lake City, Utah; San Bernardino, California; South Bend, Indiana; and Waco, Texas.

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Employees

As of December 31, 2004, there were approximately 7,600 ABX employees, including 4,000 full-time employees and 3,600 part-time employees. We employ approximately 740 flight crewmembers, 1,440 aircraft maintenance technicians and flight support personnel, 2,590 sort employees at the Wilmington Air Park, 1,545 sort employees at the eighteen regional hubs and HASP, 450 employees for airport and hub maintenance, 410 employees for warehousing and logistics and 425 employees for administrative functions. We also use contracted labor during business peaks, particularly during the fourth calendar quarter.

We perform employee background checks for a five or ten-year period prior to employment, depending on the job, and, in fact, conduct a more in-depth pre-employment screening than is mandated by FAA regulations. In addition, management personnel who are directly involved in the supervision of flight operations, training, maintenance and aircraft inspection, must meet experience standards prescribed by FAA regulations. All of our employees are subject to pre-employment drug and alcohol testing, and employees holding certain positions are subject to subsequent random testing. Our flight crewmembers are our only group of unionized employees.

Labor Agreements

The International Brotherhood of Teamsters (IBT) is the duly designated and authorized representative of ABX s flight crewmembers under the Railway Labor Act (RLA), as amended. The flight crewmembers contract becomes amendable as of July 31, 2006. Under the RLA, labor agreements do not expire, so the existing contract remains in effect throughout any negotiation process. If required, mediation under the RLA is conducted by the National Mediation Board, which has the sole discretion as to how long mediation can last and when it will end. In addition to direct negotiations and mediation, the RLA includes a provision for potential arbitration of unresolved issues and a 30 day cooling off period before either party can resort to self-help.

Training

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

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

Competitive Strengths

Our competitive strengths include our low cost structure, reputation for reliability and industry expertise. We believe we are well positioned to grow with DHL as it expands its business in the U.S. In addition, we are attempting to utilize our airlift capacities, technical knowledge in aircraft maintenance, as well as, our hub management expertise to enhance our revenues and earnings through opportunities beyond our agreements with DHL. Our strategy is based on our competitive strengths described below:

Commercial Agreements. The ACMI and Hub Services agreements with DHL provide us with a predictable and dependable source of revenues and cash. Regular cash flow streams afford us the financial flexibility to invest in ABX s service offerings in efforts to increase our customer base.

Experienced Management Team. We are led by an experienced management team, headed by Joseph C. Hete, who has over 20 years of experience in the air cargo industry. The other key members of the management team, including those responsible for its flight operations and maintenance, each have over 20 years of industry experience.

Competitive Cost Structure. We maintain a low cost structure through: (i) the acquisition of used aircraft, engines and spare parts, (ii) maintaining coordinated flight and maintenance operations in Wilmington, Ohio, and (iii) the in-sourcing of activities such as training, and routine engine repairs and aircraft maintenance.

Manageable Debt Servicing Requirements. We own 110 of the aircraft in our in-service fleet. Only five of the aircraft are financed through leases, and the associated interest expense is reimbursed with mark-up under the DHL ACMI agreement. Principal payments on our note payable to DHL are deferred until 2028, and the associated interest expense is reimbursed without mark-up under the ACMI agreement.

Established Reputation. We have an excellent reputation for reliability and service to our customers. ABX has established strong working relationships with regulators due to our historically successful safety and maintenance programs.

Our business strategy and industry are subject to various risks, some of which are described starting on page 30**.**

Intellectual Property

We own a small number of U.S. patents, that while essential for our business operations, are of nominal commercial value. We also own approximately 160 STCs issued by the FAA. We believe that our most marketable STC concerns Reduced Vertical Separation Minima for DC-9 aircraft, which is designed to reduce air traffic congestion by permitting aircraft to fly closer together vertically above certain altitudes. We believe that our intellectual property rights and licensing rights are adequate for our business.

Information Systems

We have invested significant management and financial resources in the development of information systems to facilitate cargo, flight and maintenance operations. We utilize our systems to maintain records about the maintenance status and history of each major aircraft component, as required by FAA regulations. Using our systems, we track and control inventories and costs associated with each maintenance task, including the personnel performing those tasks. In addition, our flight operations system coordinates flight schedules and crew schedules. We have developed and procured systems to track flight time, flight crewmember duty and flight hours and crewmember training status.

Regulation

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

Environment

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

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

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

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

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

Department of Transportation

Although a majority of the economic regulation of domestic air transportation has been eliminated, the DOT maintains authority over certain aspects of domestic air transportation, such as requiring a minimum level of insurance and the requirement that a person be fit to hold a certificate to engage in air transportation. In addition, the DOT continues to regulate many aspects of international aviation, including the award of international routes. The DOT has issued to ABX a Domestic All-Cargo Air Service Certificate for air cargo transportation between all points within the U.S., the District of Columbia, Puerto Rico, the U.S. Virgin Islands, and a Certificate of Public Convenience and Necessity (Route 377) to engage in scheduled foreign air cargo transportation between the U.S. and Canada. Prior to issuing such certificates, the DOT examines a company s managerial competence, financial resources and plans, compliance disposition and citizenship in order to determine whether the carrier is fit, willing and able to engage in the transportation services it has proposed to undertake. By maintaining these certificates, ABX is vested with authority from the U.S. Government to conduct all-cargo, charter operations worldwide.

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

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Federal Aviation Administration

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

The FAA has the authority to issue maintenance directives and other mandatory orders relating to, among other things, the inspection and maintenance of aircraft and the replacement of aircraft structures, components and parts, based on the age of the aircraft and other factors. For example, the FAA has required ABX to perform inspections of its DC-9, DC-8 and Boeing 767 aircraft to determine if certain of the aircraft structures and components meet all aircraft certification requirements. If the FAA were to determine that the aircraft structures or components are not adequate, it could order operators to take certain actions, including but not limited to, grounding aircraft, reducing cargo loads, strengthening any structure or component shown to be inadequate, or making other modifications to the aircraft. New mandatory directives could also be issued requiring ABX to inspect and replace aircraft components based on their age or condition.

Transportation Security Administration

The Transportation Security Administration (TSA), an administration within the Department of Homeland Security, is responsible for the screening of passengers, baggage and cargo and the security of aircraft and airports. ABX complies with all applicable aircraft and cargo security requirements. TSA is currently considering the adoption of additional cargo security related rules that, if adopted as proposed, could impose additional burdens on ABX, which could have an impact on our ability to efficiently process cargo or otherwise increase costs. In addition, we may be required to reimburse the TSA for the cost of security services it may provide to ABX in the future.

Other Regulations

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

ABX s labor relations are generally regulated under the Railway Labor Act, which vests in the National Mediation Board certain regulatory powers with respect to disputes between airlines and labor unions arising under collective bargaining agreements,

The Federal Communications Commission regulates ABX s use of radio facilities pursuant to the Federal Communications Act of 1934, as amended,

U.S. Customs and Border Protection inspects cargo imported from ABX s international operations, ABX must comply with U.S. Citizenship and Immigration Services regulations regarding the citizenship of its employees,

U.S. Customs and Border Protection inspects animals, plants and produce imported from ABX s international destinations, and

ABX must comply with wage, work conditions and other regulations of the Department of Labor regarding its employees.

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Security and Safety

Security

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

Safety and Inspections

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

ITEM 2. PROPERTIES

We lease our corporate offices, 210,000 square feet of maintenance hangars and a 100,000 square feet component repair shop from DHL. These facilities are located at DHL s airport in Wilmington, Ohio. We also have the non-exclusive right to use the airport which includes two runways, taxi ways, and ramp space comprising approximately 250 paved acres. The term of the lease runs concurrently with the term of the ACMI agreement with DHL. We believe our existing facilities are adequate to meet our current and reasonably foreseeable future needs.

The following table contains detailed information about our in-service aircraft fleet. We own 110 of these aircraft and lease five Boeing 767s. The table excludes two Boeing 767s purchased in 2003 and 2004 that, as of December 31, 2004, were undergoing modification from passenger to cargo configuration. Additionally, we are committed and purchasing one more Boeing 767 and modifying it to a cargo configuration during 2005.

Aircraft Type	Number of Aircraft as of December 31, 2004	Year of Manufacture	Gross Payload (Lbs.)	Still Air Range (Nautical Miles)
DC-8-61	4	1968-1969	40,000-83,000	2,200-3,800
DC-8-63	4	1968-1970	47,000-97,000	2,800-4,400
DC-8-63F	8	1967-1979	40,000-97,000	2,600-4,300

DC-9-14	1	1967	17,000-25,000	450-1,100
DC-9-15	1	1966	17,000-25,000	450-1,100
DC-9-31	18	1967-1971	26,000-36,000	550-1,100
DC-9-32	16	1967-1972	26,000-36,000	550-1,100
DC-9-32F (1)	3	1967-1968	26,000-36,000	550-1,100
DC-9-33F (1)	5	1968-1970	26,000-38,000	500-1,100
DC-9-41	29	1969-1978	26,000-38,000	500-1,100
767-205	1	1984	37,000-91,000	1,800-4,400
767-231	4	1983	37,000-91,000	1,800-4,400
767-281	19	1983-1988	67,000-91,000	1,800-3,000
767-281SF (2)	2	1985-1987	67,000-91,000	1,800-3,000
Total	115			

(1) These aircraft were manufactured with a cargo door for transporting freight. The cargo doors are currently deactivated.
(2) These passenger aircraft were modified to a cargo configuration, including cargo doors.

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ITEM 3. LEGAL PROCEEDINGS

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

DOT Continuing Fitness Review

We filed a notice of substantial change with the DOT arising from our separation from Airborne. In connection with our filing, which we made in mid-July of 2003, the DOT will determine whether we continue to be fit, willing and able to engage in air transportation of cargo and a U.S. citizen.

Under U.S. laws and DOT precedents, non-U.S. citizens may not own more than 25% of, or have actual control of, a U.S. air carrier. The DOT may determine that DHL actually controls ABX as a result of our commercial arrangements (in particular, the ACMI agreement and Hub Services agreement) with DHL. If the DOT determines that ABX is controlled by DHL, the DOT could require amendments or modifications of the ACMI and/or other agreements between ABX and DHL. If ABX were unable to modify such agreements to the satisfaction of the DOT, the DOT could seek to suspend, modify or revoke our air carrier certificates and/or authorities, and this would materially and adversely affect our business.

Certain DHL competitors, including FedEx and UPS challenged the citizenship status of Astar, formerly DHL Airways. DHL has entered into an ACMI agreement with Astar which accounts for a substantial portion of the business of Astar. FedEx and UPS alleged this relationship, among others, constituted control by DHL of Astar in violation of U.S. law. An Administrative Law Judge (ALJ) for the DOT reviewed the citizenship of Astar and issued a decision recommending to the DOT that it find that Astar is a U.S. citizen. On May 13, 2004, the DOT issued its decision finding that Astar is a U.S. citizen and making the ALJ s recommended decision the DOT s final decision. Neither FedEx nor UPS appealed the DOT s final decision.

The DOT issued a notice requesting comments on the procedures to be used in processing our filing, and several parties, including ABX, have provided comments. The DOT has yet to specify the procedures it intends to use. While Astar and ABX are different, and their respective relationships with DHL are distinguishable, the DOT s decision regarding Astar will likely serve as a precedent for the DOT s review of our filing.

We believe the DOT should find that ABX continues to be fit, willing and able to engage in air transportation of cargo and a U.S. citizen.

ALPA Lawsuit

On August 25, 2003 the Company intervened in a lawsuit filed in the U.S. District Court for the Southern District of New York by DHL Holdings and DHL Worldwide Express, Inc. (DHL Worldwide) against the Air Line Pilots Association (ALPA), seeking a declaratory judgment that neither DHL entity is required to arbitrate a grievance filed by ALPA. ALPA represents the pilot group at Astar. The grievance seeks to require DHL Holdings to direct its subsidiary, Airborne (now DHL Express) to cease implementing its ACMI agreement with ABX on the grounds that DHL Worldwide is a legal successor to Astar. ALPA similarly filed a counterclaim requesting injunctive relief that includes having Airborne s freight currently being flown by ABX transferred to Astar. The proceedings were stayed on September 5, 2003, pending the National Labor Relations Board s (NLRB) processing of several unfair labor practice charges the Company filed against ALPA on the grounds that ALPA s grievance and counterclaim to compel arbitration violates the National Labor Relations Act. In March 2004, the NLRB prosecuted ALPA on the unfair labor practice charges. On July 2, 2004, an ALJ for the NLRB issued a decision finding that ALPA s grievance and counterclaim violated the secondary boycott

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provisions of the National Labor Relations Act, and recommended that the NLRB order ALPA to withdraw both actions. ALPA has appealed the ALJ s finding to the full NLRB, which has yet to issue a decision. In the event the full NLRB were to sustain the decision of the ALJ, ALPA has the right to appeal the decision in federal court.

Management believes that the ALJ s decision will be sustained on appeal and that, regardless thereof, ALPA s claim to the work being performed by the Company is without merit and its grievance and counterclaim will be denied

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of 2004.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Common Stock

Our common stock became publicly traded in an over-the-counter market under the symbol ABXA.OB on August 15, 2003. The following table shows the range of high and low closing prices per share of our common stock for the periods indicated as quoted on the OTC Bulletin Board. Such over-the-counter market prices reflect inter-dealer prices, without retail mark-up, mark-down or commission.

2004 Quarter Ended:	**Low**	**High**
December 31, 2004	$ 6.52	$ 8.95
September 30, 2004	$ 5.77	$ 7.25
June 30, 2004	$ 3.60	$ 6.83
March 31, 2004	$ 4.28	$ 7.48
2003 Quarter Ended:	**Low**	**High**
December 31, 2003	$ 2.45	$ 4.33
September 30, 2003	$ 1.55	$ 2.73

On March 1, 2005, there were 16,648 stockholders of ABX common stock. The closing price of ABX common stock was $7.97 on March 15, 2005.

Dividends

We are restricted from paying dividends on our common stock in excess of $1.0 million during any calendar year under the provisions of our promissory note due to DHL. No cash dividends have been paid or declared.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

Comparability of financial data among years is affected by ABX s separation from Airborne on August 15, 2003. The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and the notes thereto and the information contained in Item 7 of Part II, Management s Discussion and Analysis of Financial Condition and Results of Operations.

ABX derived the selected consolidated balance sheet data as of December 31, 2004, 2003, 2002 and 2001 and the consolidated statements of operations data for each of the five years in the period ended December 31, 2004, from ABX s audited consolidated financial statements. The consolidated balance sheet data as of December 31, 2000, was derived from unaudited consolidated financial statements.

	As of and for the Years Ended December 31				
	2004	**2003**	**2002**	**2001**	**2000**
	(In thousands, except per share data)				
OPERATING RESULTS:					
Revenues	$ 1,202,509	$ 1,160,959	$ 1,173,735	$ 1,165,037	$ 1,168,237
Operating expenses (1)	1,157,511	1,720,125	1,125,200	1,121,543	1,124,922
Earnings (loss) from operations	44,998	(559,166)	48,535	43,494	43,315
Net interest expense	8,025	16,379	25,866	21,147	20,861
Earnings (loss) before income taxes and change in accounting	36,973	(575,545)	22,669	22,347	22,454
Income tax benefit (expense) (1)		128,644	(9,383)	(9,527)	(9,682)
Earnings (loss) before change in accounting	36,973	(446,901)	13,286	12,820	12,772
Cumulative effect of change in accounting, net of tax					14,206
Net earnings (loss) (1)	$ 36,973	$ (446,901)	$ 13,286	$ 12,820	$ 26,978
EARNINGS (LOSS) PER SHARE FROM CONTINUING OPERATIONS:					
Basic (2)	$ 0.63	$ (8.52)	$ 0.25	$ 0.25	$ 0.25
Diluted (2)	$ 0.63	$ (8.52)	$ 0.23	$ 0.22	$ 0.22
WEIGHTED AVERAGE SHARES:					
Basic	58,270	52,474	52,107	52,107	52,107
Diluted	58,270	52,474	58,521	58,521	58,521
SELECTED CONSOLIDATED FINANCIAL DATA:					
Unrestricted and restricted cash	$ 38,749	$ 65,741	$ 33	$ 33	$ 1,580
Property and equipment, net	351,646	312,803	1,089,485	1,137,912	1,201,879
Total assets	472,923	413,106	1,174,008	1,220,623	1,296,100
Advances from parent			474,608	547,431	764,486
Long-term debt	92,949	92,949	76,318	80,882	19,706
Capital lease obligations	88,861	96,193	37,825	39,754	
Stockholders equity	$ 87,949	$ 58,666	$ 232,322	$ 223,999	$ 211,895

(1) Operating expenses for 2003 include an impairment charge of $600.9 million recorded in conjunction with ABX s separation from Airborne, Inc. A tax benefit of $134.8 million primarily occurred as a result of recording the impairment charge. See Note A to the consolidated financial statements.

(2) For 2000, earnings per common share are shown exclusive of the cumulative effect of a change in accounting for major engine overhaul costs. Basic and diluted earnings per share inclusive of the change were $0.52 and $0.46, respectively.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management s Discussion and Analysis has been prepared with reference to the historical financial condition and results of operations of ABX Air, Inc. (ABX) and its subsidiaries and should be read in conjunction with our historical financial statements, the related notes contained in this report and the S-4 registration statement, as amended, filed by our former parent corporation, Airborne, Inc. (Airborne), on July 11, 2003.

INTRODUCTION

ABX operates a fleet of aircraft, providing air cargo transportation services primarily within the U.S. In December 2004, our in-service fleet of 115 aircraft consisted of 26 Boeing 767 aircraft, 16 McDonnell Douglas DC-8 (DC-8) aircraft and 73 McDonnell Douglas DC-9 (DC-9) aircraft. We complement our air transport capabilities with package handling, warehousing and line-haul logistic services. We also offer ACMI (aircraft, crew, maintenance and insurance) and on-demand charter services to freight forwarders and other major shippers. We employ approximately 4,000 full-time employees, 3,600 part-time employees and utilize temporary workers as needed. Airborne, now DHL Express (USA), Inc. (DHL Express), is our largest customer, constituting approximately 98% of our total revenues in 2004. ABX operates a single reportable segment that provides air cargo transport, line-haul logistics and package handling services to DHL Express. Our other activities, which include charter services, parts sales and aircraft maintenance services, do not constitute a reportable segment.

On August 15, 2003, ABX was separated from its former parent, Airborne, and became an independent, publicly-owned company. The separation of ABX from Airborne was a condition of the merger agreement between Airborne and DHL Worldwide Express, B.V., an integrated, global cargo carrier, competing with Federal Express Corporation and United Parcel Service, Inc. The merger agreement required Airborne to separate its air operations from its ground operations with the air operations being retained by ABX. Immediately prior to the separation, certain assets and liabilities related to Airborne s ground operations and airport were transferred out of ABX to Airborne. ABX was capitalized with $60.0 million of cash and a $92.9 million promissory note payable to Airborne. All inter-company advances, totaling $457.3 million, were cancelled. (A description of the separation is in Item 1 Business, of this Form 10-K Annual Report.) On January 1, 2005, Airborne was merged into DHL Express, a wholly owned subsidiary of DHL Holdings (USA), Inc. (DHL Holdings). (Hereinafter, DHL Holdings, DHL Express and Airborne will sometimes be referred to individually and collectively as DHL .)

Agreements with DHL

At the time of the separation, ABX and DHL entered into an aircraft, crew, maintenance and insurance agreement (ACMI agreement), and a hub and line-haul services agreement (Hub Services agreement). Under the ACMI agreement, ABX provides air cargo transportation to DHL on a cost plus pricing structure. Under the Hub Services agreement, ABX provides staff to conduct package handling, package sorting, warehousing, line-haul logistics services, as well as airport facilities and equipment maintenance services for DHL, also on a cost plus pricing structure. Costs incurred under these agreements are generally marked-up by 1.75% and included in revenues. Both agreements also allow the Company to earn incremental mark-up above the base 1.75% mark-up (up to an additional 1.60% under the ACMI agreement, and an additional 2.10% under the Hub Services agreement) from the achievement of certain cost-related and service goals specified in the two agreements. Fuel, rent, interest on the promissory note to DHL, and ramp and landing fees incurred under the ACMI agreement are the most significant cost items reimbursed without mark-up. The ACMI agreement and the Hub Services agreement have initial terms of seven and three years, respectively. However, DHL can terminate specific ACMI aircraft, add to, delete or modify the air routes we operate under the ACMI agreement and increase or reduce the scope of services we provide under the Hub services agreement. Additionally, DHL can terminate the agreements if ABX does not comply with certain performance standards specified in the agreements.

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Prior to the separation, we were Airborne s primary provider of air cargo transportation services within the U.S. and to Canada and Puerto Rico, as well as Airborne s primary provider of package handling, warehousing and line-haul logistics services. After the separation from Airborne, we have continued to be the primary provider for these same services to DHL.

Separation Impairment

The separation of ABX from Airborne, and the execution of the related commercial agreements collectively constituted an event which required us to evaluate the recoverability of the carrying value of long-term assets under Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Under SFAS No. 144, ABX was required to record an impairment charge for the excess of the carrying value of the long-lived asset group over its fair value. The fair value of ABX s aircraft was derived using a market approach by comparing recent sales of similar assets and adjusting these comparables for factors such as age and condition. The fair value of aircraft, aircraft-related spare parts inventory, maintenance tooling and equipment and other ABX fixed assets was derived utilizing a cost approach in which replacement cost was adjusted downward to reflect reduction in value due to physical depreciation and functional obsolescence. As a result of the fair value analysis, we recorded a pre-tax, non cash charge to write down assets and inventory by $600.9 million. The impairment charge resulted in a net deferred tax asset, which, under provisions of SFAS No. 109, Accounting for Income Taxes, was fully offset by a valuation allowance which was established due to the likelihood that future taxable earnings generated would not allow for the asset s full utilization. Due to the impairment charge, an income tax benefit of $134.8 million was provided, net of the valuation allowance of $81.0 million.

CHALLENGES AND RISKS

Our prospects for growth and financial security are primarily dependent on our relationship with DHL. We operate in a competitive market to provide ACMI and hub services to DHL. We are committed to providing the highest level of on-time services and productivity to DHL with a competitive, low cost structure. As a result of its merger with Airborne, DHL has integrated product offerings, sales, marketing, administrative and operating resources to eliminate duplicative costs. DHL continues to review its network costs and capacity, including excess air routes among its airlift suppliers. At the same time, DHL is expanding its ground network and adding regional sorting hubs. Our objective is to position ABX to grow with DHL as it expands its business in the U.S. As a result, our growth is heavily dependent on DHL s ability to expand its package volumes in the U.S. where FedEx and UPS have significant resources, market penetration and brand recognition.

ACMI

On November 3, 2004, DHL notified ABX of its plans to remove twenty-six specific aircraft from service during 2005. The information provided by DHL indicated that seven of the twenty-six aircraft (three DC-9s and four DC-8s) are targeted for removal in early 2005, and the remaining nineteen aircraft are to be removed by the end of 2005. The removal affects twenty-two scheduled air routes. DHL further indicated that the number of affected aircraft, the air routes and the timing of planned reductions are subject to change. The impact of DHL s airlift plan on our operating results, cash flows and financial condition will depend upon several factors that are uncertain. These factors include the timing of aircraft removals, the air routes that will be affected, the fair market value of the aircraft, the demand for cargo airlift and the future level of ABX equity. The potential impacts of DHL airlift plans on our future financial statements are described below.

Operating cash flows

The removal of aircraft from the ACMI agreement with DHL will reduce our cash flows from depreciation expense that is reimbursed by DHL. The current annual depreciation expense on the twenty-six aircraft planned

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for removal is approximately $2.7 million. In addition to the reduction in depreciation expense, the removal of aircraft will also result in lower flight crew, maintenance, and other expenses that are subject to mark-up under the ACMI agreement. The impact on cash flows for flight crew and maintenance expenses will be limited to the mark-up on such expenses (from a minimum of 1.75% to a maximum of 3.35%). When the twenty-six aircraft reduction is fully implemented, we project that the associated annual reduction in cash flows from operations will be in a range of $3.5 million to $4.2 million. While we expect to incur some severance costs that are not reimbursable by DHL, at this time we anticipate that those costs will not be significant.

Operating results

When the twenty-six aircraft reduction is fully implemented, we project that their removal will reduce our annual net earnings by $0.8 million to $1.5 million and our annual gross revenues by $86.0 million to $96.0 million. We project that depreciation, flight crew, maintenance, and other ACMI expenses that are subject to mark-up under the ACMI agreement will decline approximately $48.9 million with a corresponding decline in revenue of approximately $50.1 million after the twenty-six aircraft are removed. Our estimate of expenses and revenues also includes a decline for reductions in jet fuel and other expenses that are reimbursed without mark-up under the ACMI agreement. The annual gross revenue reduction includes approximately $45.5 million of revenues associated with jet fuel and other expenses that are reimbursed without mark-up under the ACMI agreement. Actual fuel amounts will depend significantly on the future price of jet fuel.

Aircraft dispositions and utilization

Pursuant to the terms of the ACMI agreement, we have certain rights to put to DHL any aircraft that is removed from service. We can sell such aircraft to DHL at the lesser of fair market value or net book value. We can foresee situations in which we may not sell an aircraft to DHL and instead retain or deploy the aircraft in other market opportunities such as part sales and charter operations.

Of the seven aircraft targeted for removal in early 2005, one DC-8 aircraft was removed from service at the end of December 2004 and is being decommissioned to use as parts in support of our fleet. Its carrying value approximates the total value of the usable parts. The six other aircraft are currently in service to DHL or utilized in our non-DHL ACMI and charter operations. We expect DHL to remove these aircraft from service in early 2005. One DC-8 may be decommissioned and used for parts to support our remaining fleet, one DC-9 will be sold to DHL for its carrying value, and two DC-9s and two DC-8s, will be retained by ABX. We may use the retained aircraft in our non-DHL ACMI and charter operations, sell the aircraft for the value of the usable parts or use the aircraft in lieu of freighter aircraft scheduled for service within the DHL network. The freighter aircraft could instead be utilized for our non-DHL ACMI and charter operations if we are successful at obtaining additional ACMI or charter contracts. We anticipate placing three additional Boeing 767 freighter aircraft into service under the ACMI agreement with DHL or in our non-DHL ACMI operations by the end of 2005. After all three Boeing 767s are in service, they are projected to generate approximately $5.6 million annually in depreciation expense. Depreciation and maintenance expenses will not be reimbursed by DHL for those aircraft not in service for DHL.

The decision to put additional aircraft to DHL as they are removed from service will depend on a number of factors including the anticipated number of aircraft to be removed, the type of aircraft removed, demand for cargo airlift and the market value for our aircraft. Management is currently assessing the number of other aircraft that it may want to sell to DHL. Accordingly, the amount of cash flow that might be generated from the exercise of the put provisions cannot be projected at this time.

Recoverability of aircraft carrying values

The removal of aircraft by DHL could result in losses if our aircraft carrying values are greater than fair market values. Losses could depend on several factors, including the appraised value of our aircraft, number of

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aircraft removed from service and the amount of our stockholders equity at the time that an aircraft is sold to DHL. Provisions of the ACMI agreement stipulate that if our stockholders equity is less than or equal to $100 million at the time of sale, any amount by which the appraised fair market value is less than net book value would be applied to a promissory note that we owe to DHL. However, if our stockholders equity is greater than $100 million, any amount by which fair market value is less than net book value would be recorded as an operating charge. For purposes of applying the $100 million stockholders equity threshold, ABX s stockholders equity will be calculated after including the effect of any charges caused by the removal of aircraft.

The expected future cash flows related to our aircraft support the carrying values reflected in our consolidated balance sheet at December 31, 2004.

Hub Services

On June 25, 2004, DHL announced plans to consolidate operations from its Northern Kentucky hub into a central U.S. hub at its Wilmington, Ohio facilities which we operate under the Hub Services agreement. The plan involves an estimated investment of approximately $300 million by DHL to expand facilities in Wilmington, including an additional 1.2 million square feet of sort space and 1.5 million square feet of ramp space. Additional automation and information technology infrastructure improvements are also likely. DHL began construction in August 2004 and plans to consolidate by the fourth quarter of 2005. The transition is expected to be completed in late 2005. The significant construction and operational changes that will occur as DHL completes consolidation may impact ABX s ability to achieve incremental mark-up under the Hub Services agreement. We expect to retain operation of the expanded Wilmington hub for DHL, however, at this time we cannot reasonably estimate the impact that the consolidation and DHL s investment will have on our operating results.

In 2004, DHL selected ABX to staff seven new regional sorting hubs across the U.S. The seven new hubs began operations in the last four months of 2004. These are in addition to the Wilmington hub and 11 regional hubs that we already operate for DHL. We estimate that we could earn base revenues of approximately $12.0 million to $15.0 million annually by staffing the seven new regional hubs, with potential to earn incremental mark-up.

Hiring the necessary work force levels at each hub and matching our labor levels to growing package volumes was a challenge in 2004. We expect this to remain an ongoing business challenge. Adequate work force levels and employee training are critical to our operating performance under the DHL agreements.

Non-DHL Business

Our diversification strategy includes selling ACMI/charter services and unused air cargo space to freight forwarders and shippers. Our strategy also includes marketing our technical expertise, aircraft maintenance services and training to other airlines. During 2004, ABX s non-DHL revenues doubled to $26.7 million while non-DHL earnings increased over 150% to $6.8 million. Repeating these growth rates will be a significant challenge in 2005. The air cargo markets remain intensely competitive due to excess capacity within the airline industry. Our aircraft maintenance revenues will depend on our ability to find customers and on the availability of our maintenance resources during a time period that corresponds to the customer s maintenance cycles. Many of our potential customers currently purchase air cargo and maintenance services from other providers. Our costs to develop, market and offer new services to non-DHL customers are not reimbursed by DHL.

See page 30 for additional discussion of our business risk.

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RESULTS OF OPERATIONS

2004 compared to 2003

Net earnings were $37.0 million for 2004 compared to a net loss of $446.9 million in 2003. Net earnings for 2004 increased $17.8 million compared to non GAAP earnings of $19.2 million for 2003, excluding the 2003 impairment charge and related tax benefits. Our net earnings increased compared to 2003 non-GAAP earnings due to additional incremental revenues earned under the DHL agreements, a reduction of income tax expense and growth in non-DHL business activities. These changes were partially offset by the lower base mark-up earned under the DHL contracts.

Incremental mark-ups: Earnings from incremental mark-ups for achieving service goals and certain cost-related goals increased $10.8 million to $14.4 million during 2004. The incremental mark-ups were applied to the expenses incurred during the entire twelve months of 2004. During 2003, incremental mark-ups for service goals and certain cost-related goals were applied to costs incurred only during the 138 days occurring after the separation from Airborne.

Income taxes: During 2003, ABX recognized a net income tax benefit of $128.6 million largely due to the impairment charge of $600.9 million. Excluding the tax benefit of the impairment charge, income tax expense was $6.1 million, in 2003. No income tax provision was recorded in 2004 due to ABX s net operating loss carryforwards.

Non-DHL earnings: Non DHL pretax earnings increased to $6.8 million in 2004 from pre-tax earnings of $3.1 million in 2003. Higher earnings were driven by increased ACMI, charter and aircraft maintenance services.

Base revenues: DHL revenues calculated from the base mark-up declined $2.8 million in 2004 compared to 2003. Prior to the August 15, 2003 separation, revenues from Airborne were calculated as the sum of pretax net expenses incurred plus 2.00%. Net expenses included all operating and interest expenses reduced by revenues recorded from our non-Airborne customers. Since the separation, our DHL base revenues are generally based on costs incurred plus a base mark-up of 1.75%, except for certain costs, including fuel, rent, interest on the promissory note to DHL and ramp and landing fees, that are recorded in revenues without mark-up. Our expenses, and accordingly our revenues for 2003, included depreciation expense related to the ground equipment that was transferred to Airborne in the separation. Additionally, depreciation expense and our revenues were lower in 2004 due to the effects of the impairment charge, which we recorded immediately after the separation from Airborne. Also, our expenses and revenues for the first 227 days of 2003 included Airborne packaging and labeling supplies, interest allocations and administrative cost allocations which we no longer record after the separation.

Our 2004 earnings from the DHL agreements was $30.2 million including revenue of $3.5 million from incremental mark-up for achieving quarterly cost-related goals during the year and $10.9 million for achieving annual cost-related and service goals. The two agreements with DHL allow ABX to earn additional incremental mark-up for meeting certain quarterly cost-related goals, annual cost-related goals and annual service goals. The maximum incremental mark-up available from the annual service goals is 0.25% of costs subject to mark-up under the ACMI agreement and 0.75% of costs eligible for mark-up under the Hub Services agreement. The maximum incremental mark-up available from the annual cost-related goals is approximately 0.81% of costs subject to mark-up under the ACMI agreement and approximately 0.81% of costs eligible for mark-up under the Hub Services agreement. Incremental mark-up earned on the annual goals is only recognized in the fourth quarter. During the fourth quarter of 2004, we recognized $4.0 million, or 100% of the maximum available incremental mark-up from the *annual cost-related* goal under the ACMI agreement, and $2.7 million, or 76% of the maximum *annual cost-related* goals under the Hub Services agreement. During the fourth quarter of 2004, ABX recognized revenue from the *annual service* goal in the ACMI agreement of $0.9 million, or

80% of the maximum available. Mark-up earned in the fourth quarter from the *annual service* goal under the Hub Services agreement totaled $3.3 million, or 100% of the maximum available under that contract.

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A summary of our 2004 earnings is shown below (in thousands).

	For the Year Ended December 31, 2004					
	DHL					
	ACMI	Hub Services	Other Reimbursable	Subtotal	Customers other than DHL	Total
Revenues:						
Base	$ 475,826	$ 440,602	$ 244,935	$ 1,161,363	$ 26,705	$ 1,188,068
Quarterly incremental mark-up	2,309	1,255		3,564		3,564
Annual incremental mark-up	4,967	5,910		10,877		10,877
Total revenues	483,102	447,767	244,935	1,175,804	26,705	1,202,509
Operating expenses	461,750	433,024	242,802	1,137,576	19,935	1,157,511
Interest expense, net	5,892		2,133	8,025		8,025
Total expense	467,642	433,024	244,935	1,145,601	19,935	1,165,536
Earnings	$ 15,460	$ 14,743	$	$ 30,203	$ 6,770	$ 36,973

Our earnings from customers other than DHL do not include an allocation of overhead expenses. Our agreements with DHL require that after our non-DHL revenues reach 10% of our total revenues, we must allocate a portion of our overhead expenses to the non-DHL business.

Revenues

Total revenues increased 3.6% for 2004 compared to 2003. Revenues from DHL increased 2.3% during 2004, reflecting increased activity to support the growth of DHL s ground delivery services and the expansion of DHL s ground network compared to last year. Revenues from DHL accounted for approximately 98% of our revenues for 2004 and 2003.

Non-DHL revenues increased $15.1 million to $26.7 million in 2004 compared to $11.6 million for 2003. The growth was driven by ACMI/charter services, aircraft part sales and maintenance services. Non-DHL ACMI and charter service revenues grew $11.0 million to $17.0 million during 2004 compared to 2003. Hours flown for ACMI and charters increased approximately 2,350 hours to approximately 4,260 hours in 2004 compared to 2003. ACMI and charter revenues and hours for 2004 include $4.5 million and 315 hours for a seasonal air network that we provided to the U.S. Postal Service during seven days in December of 2004. We did not operate such a network in 2003 for the U.S. Postal Service. Revenues from aircraft part sales and maintenance services grew 69% to $7.6 million during 2004, compared to 2003. Since our separation from Airborne, we have marketed our aircraft maintenance services to other airlines. As a result, we completed 18 major aircraft maintenance projects on customers DC-9s during 2004. We expect that revenues and earnings from aircraft maintenance services will vary widely among quarters, due to the capacity of our facilities and the timing of our non-DHL customers demand for maintenance services.

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Operating Expenses

Our operating expenses are impacted by the volume of packages handled for DHL and by the type of service we provide, such as air or ground delivery. Generally, higher piece volumes increase our expenses and positively impact revenues and earnings. The table below compares selected operating statistics for the years ended December 31.

	Year Ended December 31			Percentage Increase (Decrease)	
	2004	2003	2002	2004	2003
Pieces handled (millions)	541	475	456	14%	4%
Pounds processed (millions)	2,382	2,139	1,949	11%	10%
Pieces handled per labor hour paid	36.10	33.85	31.86	7%	6%
Gallons of aviation fuel consumed (millions)	148	148	153		(3)%
Average price per gallon of aviation fuel	$ 1.32	$ 1.00	$ 0.83	32%	20%

The increases in the number of pieces handled and pounds processed were a result of several factors, particularly the growth in DHL s ground delivery service, the expansion of DHL s ground network and the impact of one additional operating day in 2004. Pieces handled per labor hour improved 6.6% during 2004 compared to 2003, reflecting additional inter-hub shipments to accommodate the expansion of DHL s ground network and growth in ground delivery services.

Salaries, wages and benefits expense increased 6.1% during 2004 compared to 2003. The increase includes the impact of one additional payroll day in 2004 compared to 2003. The increase also reflects incentive compensation and salary inflation adjustments of 4.0% in our flight crew pay scale effective on August 1, 2003 and a flight crew salary adjustment of 2.0% effective on August 1, 2004. Total paid hours increased 6.9% in 2004 compared to 2003. The increase was driven by additional labor at the regional hubs necessary to support the expanded DHL ground network. We expect salaries, wages and benefits expense to increase in 2005 due to escalating wage and health care costs, increased expenses for our defined benefit retirement plans and increases in staffing to support DHL shipment growth.

Purchased line-haul expense increased $61.2 million or 35.6% during 2004 compared to 2003. The increase reflects growth in DHL s deferred delivery products that are generally transported via truck, as well as additional line-haul to accommodate more inter-hub shipments for DHL s ground network. During 2004, we added line-haul to support the expansion of DHL s ground network. In 2005, anticipated growth for deferred delivery services, additional routes for DHL, and stronger demand for over-the-road trucking is expected to increase our purchased line-haul expense.

Fuel expense increased 31.5% in 2004 compared to 2003. The increases were driven by higher market prices for aviation fuel. The average aviation fuel price was $1.32 and $1.00 per gallon in 2004 and 2003, respectively. We consumed 148 million gallons of aviation fuel in 2004 and 2003. We do not hedge fuel prices or purchase fuel derivatives. The risks of volatile fuel prices are effectively assumed by DHL through the ACMI agreement.

Maintenance, materials and repairs decreased 4.9% in 2004 compared to 2003, primarily due to reduced cost of expendable aircraft parts and lower contracted maintenance rates in 2004.

Depreciation and amortization expense decreased $61.7 million in 2004 compared to 2003. The primary reasons for the decline in expense are the transfer of approximately $183.8 million of depreciable assets to Airborne as part of the separation transaction, and the impairment charge recorded in 2003 which reduced depreciable assets by approximately $600.9 million. Additionally, at the time of our separation from Airborne, we reassessed the estimated useful lives of our aircraft. We estimate that reducing the useful lives of the aircraft increased depreciation expense approximately $4.9 million in 2004. Our future depreciation expense will be

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impacted by the timing and the number of aircraft that DHL may elect to remove from the ACMI agreement, as well as additional Boeing 767s that we anticipate placing into service under the agreement in 2005. Annualized depreciation and amortization expense for 2005, is difficult to predict due to the uncertainties related to DHL s plan to remove aircraft from service. At this time, we estimate that depreciation expense will approximate $39.0 million in 2005.

Landing and ramp expense decreased by 15.9% during 2004 compared to 2003. Effective with our separation from Airborne on August 15, 2003, certain ramp leases were transferred to DHL. Also, included in this category are deicing costs, which were higher in 2003 due to adverse winter weather in the first quarter. We expect landing and ramp expense will remain stable in 2005, however, changes in scheduled air routes for DHL or additional non-DHL charters can impact our landing and ramp expenses.

Rent expense decreased $2.8 million during 2004 compared to 2003 due to the transfer of facility lease agreements to Airborne in conjunction with the separation, including the majority of lease agreements for the regional hubs, warehouse facilities and airport locations. Our expenses during 2004 included $2.0 million of lease expense for facilities at the Wilmington Air Park. We expect rent expense to increase moderately in 2005.

Other operating expenses include pilot travel, professional fees, insurance, utilities and, prior to August 16, 2003, administrative allocations from Airborne and Airborne packaging and labeling supplies. Other operating expenses decreased by $24.8 million in 2004 compared to 2003 primarily due to approximately $26.6 million of Airborne packaging and labeling supplies which were recorded by ABX in 2003 while we were a subsidiary of Airborne. After the separation, packaging and labeling supplies are no longer expenses of ABX. We expect other operating expense to remain stable in 2005.

Interest Expense

Our interest expense decreased by $7.6 million in 2004 compared to 2003, due to interest allocations from Airborne that are no longer recorded by ABX since our separation from Airborne on August 15, 2003.

Income Tax

ABX did not record a tax provision in 2004 due to its net operating loss carryforwards and recorded a tax benefit in 2003 of $128.6 million. We fully reserved the net deferred tax assets as of December 31, 2004 and 2003.

2003 compared to 2002

For 2003, we had a net loss of $446.9 million, inclusive of the impairment charge of $600.9 million ($466.1 million, net of tax benefit). Excluding this charge, non-GAAP earnings for 2003 were $19.2 million compared to $13.3 million for 2002. Our operating results for 2003 reflect 138 days as a separate, independent business and 227 days as a subsidiary of Airborne. The separation from Airborne complicates the comparison of 2003 financial results to 2002. Since the separation, our DHL revenues are generally based on a mark-up of 1.75% of expenses, except for certain costs, the most significant of which are fuel, rent, interest on the promissory note to DHL, ramp and landing fees, that are recorded in revenue without mark-up. Prior to the August 15, 2003 separation, revenues from Airborne were calculated as the sum of pretax net expenses incurred plus 2.00%. Net expenses included all operating and interest expenses, including allocated expenses from Airborne, reduced by revenues recorded from our non-Airborne customers. Our expenses prior to August 15, 2003, included depreciation expense related to the ground equipment that was transferred to Airborne in the separation and administrative expense allocations from Airborne. Also complicating comparisons to 2002 financial information is the impairment charge, which we recorded in 2003 immediately after the separation from Airborne. As a result of the much lower adjusted basis of our remaining fixed assets, depreciation expense was significantly reduced compared to pre-separation periods.

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Revenues

Total revenues decreased 1.1% to $1.161 billion in 2003 compared to revenues of $1.174 billion in 2002. Revenues from Airborne and DHL decreased 0.6% to $ 1.149 billion in 2003 compared to $1.156 billion in 2002. The decrease in revenues is primarily due to lower reimbursable expenses, such as depreciation, incurred during 2003 compared to 2002 and the lower reimbursement rate earned from DHL during the last 138 days of 2003.

ACMI and charter service revenues from customers other than Airborne and DHL decreased to $6.0 million in 2003 compared to $14.3 million in 2002. The decrease was due primarily to the loss of a charter customer. Other revenues, consisting primarily of aircraft parts sales and revenue associated with performing aircraft-related maintenance for other carriers, increased to $5.6 million in 2003 compared to $3.3 million in 2002. The increase in other revenues was due to higher levels of aircraft parts sales as well as an increase in revenues associated with aircraft-related maintenance services.

Operating Expenses

Our operating expenses are impacted by the volume and type of packages handled. Generally, higher piece volumes increase our expenses and positively impact our revenues. The increases in pieces and pounds in 2003 compared to 2002 was due to Airborne s expansion of its ground based deferred delivery services. Labor productivity, measured by pieces handled per labor hour paid, and the operating cost efficiencies gained through our continued focus on improvement, had a positive impact on our ability to control costs during 2003.

Salaries, wages and benefits expense increased 4.6% in 2003, compared to 2002. The increases compared to 2002 were primarily the result of higher healthcare benefit costs and increases in our company-sponsored defined benefit pension plan expenses. The increases reflect inflationary salary adjustments as well as a 4.0% increase in our flight crew salary costs. Total hours paid decreased for 2003 as compared to 2002 by 2.0%, reflecting productivity improvements primarily by our employees who handled Airborne s shipments.

Purchased line-haul expense increased 14.5% in 2003 compared to 2002. The expense increases were primarily due to additional contracted truck line-haul to accommodate the growth in Airborne s deferred delivery services that are generally transported via truck due to the less time sensitive nature of the delivery. Piece counts of the Wilmington day sort, which processes much of the cargo for deferred delivery services, increased 23.1% in 2003 to 94.2 million

Fuel expense increased 16.3% in 2003 compared to 2002. The average aviation fuel price was $1.00 per gallon in 2003, compared to $0.83 per gallon in 2002. Aviation fuel consumption decreased 3.3% to 148.0 million gallons in 2003 compared to 153.0 million gallons in 2002. The decrease in consumption was primarily due to combining certain flight segments and the placement of three Boeing 767 aircraft in service since the third quarter of 2002, which allowed us to reduce our utilization of less fuel-efficient DC-8 aircraft.

Depreciation and amortization expense decreased 33.4% to $98,503 in 2003 compared to 2002. The decline is due to the lower depreciable base of property and equipment as a result of our August 15, 2003 separation from Airborne. In conjunction with the separation, we transferred property and equipment having a net book value of approximately $183.8 million to Airborne. Immediately after the separation, we recorded a SFAS No. 144 impairment charge, writing down depreciable assets remaining with ABX to their fair value (see Note A to the consolidated financial statements). In the process of recording the asset impairment and separation adjustments, depreciable aircraft asset lives were reassessed and adjustments were made to reflect management s assessment of appropriate useful lives based in part on the ACMI agreement with DHL**.** We estimate that reducing the useful lives of the aircraft increased depreciation expense approximately $1.8 million in 2003.

Maintenance, materials and repairs decreased 1.9% in 2003 compared to 2002 due primarily to performing fewer scheduled DC-8 heavy maintenance checks in 2003.

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Landing and ramp expense increased 5.0% in 2003 as compared to 2002. Included in this category are deicing costs, which were higher in 2003 due to adverse winter weather in the first quarter. These increases were offset by the transfer of ramp leases to DHL effective with our separation on August 15, 2003.

Rent expense decreased 18.6% in 2003 compared to 2002. Effective August 15, 2003, the majority of lease agreements, including the lease agreements for the regional hubs, warehouse facilities and most airport locations, were transferred to Airborne. Since August 16, 2003, our expenses do not include rent expense for lease agreements transferred to Airborne. However, our expenses since August 16, 2003, include a pro rata portion of $2.0 million of annual lease expense for space at the Wilmington Air Park.

Other operating expenses include pilot travel, professional fees, insurance, utilities and prior to August 16, 2003, allocations from Airborne (see Note C to the consolidated financial statements) and packaging and labeling supplies used by Airborne. Excluding the Airborne allocations, and packaging and labeling expenses, other operating expenses were $48.0 million in 2003 and 2002.

Interest Expense

Interest expense includes allocations from Airborne, interest on aircraft capital lease obligations of ABX, and since August 16, 2003, interest on the $92.9 million promissory note due to DHL. Our interest expense decreased 36.1% in 2003 compared to 2002. Interest expense is lower because for the last 138 days of 2003, we did not incur an interest allocation from Airborne. Airborne interest allocations were $8.6 million and $18.1 million in 2003 and 2002, respectively. Interest on the promissory note is reimbursed by DHL. The note bears interest of 5.0% per annum and principal payments can be deferred until 2028.

Income Taxes

The income tax benefit of $128.6 million for 2003 is primarily a result of a tax benefit of $220.3 million related to the impairment charge. The overall tax benefit was reduced by a valuation allowance of $81.0 million offsetting the net deferred tax asset created primarily as a result of the impairment charge. The effective income tax benefit rate was 22.4% in 2003 compared to an effective tax rate of 41.4% for 2002. The effective rate declined in 2003 due to the recording of the valuation allowance.

2003 Non-GAAP Earnings

For purposes of the above discussions on the results of operations, we have excluded the impairment charge of $600.9 million and its related tax benefit of $134.8 million from non-GAAP earnings. Non-GAAP earnings, which excludes the impairment charge, should not be considered a measure of financial performance under GAAP. We believe that excluding the impairment charge from our earnings is a significant component in understanding and assessing our financial performance. The impairment charge was triggered by our separation from Airborne, an event unlikely to recur. Excluding the impairment charge from our earnings is useful when comparing ABX s financial results to previous periods and current periods or forming expectations of future results. Non-GAAP earnings should not be considered in isolation or as an alternative to net income, cash flows generated by operations, or other financial statement data presented in the consolidated financial statements as an indicator of financial performance or liquidity.

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The table below presents a reconciliation of our non-GAAP measure to the most directly comparable GAAP measure for the year ended December 31, 2003 (in thousands):

GAAP net loss	$ (446,901)
Unusual items:	
Impairment charge	600,871
Tax benefit on impairment and separation	(134,738)
Non-GAAP earnings	$ 19,232
GAAP diluted loss per share	$ (8.52)
Effect of unusual items, net of tax	8.88
Effect of anti-dilutive equivalent shares	(0.03)
Non-GAAP diluted earnings per share	$ 0.33

Pension Plans

We sponsor qualified defined benefit plans for our eligible employees and pilots. We also sponsor unfunded excess plans for certain employees in non-qualified plans which include our executive management, that provide benefits in addition to amounts permitted to be paid under provisions of the tax law to participants in our qualified plans.

The accounting and valuation for these postretirement obligations are determined by prescribed accounting and actuarial methods that consider a number of assumptions and estimates. The selection of appropriate assumptions and estimates is significant due to the long time period over which benefits will be accrued and paid. The long-term nature of these benefit payouts increases the sensitivity of certain estimates on our postretirement costs. In actuarially valuing our pension obligations and determining related expense amounts, assumptions we consider most sensitive are discount rates, expected long-term investment returns on plan assets and future salary increases. Based on our actuary s calculations, we expect our 2005 expense for defined benefit plans to total $43.0 million. Under our agreements with DHL the actuarial expense of our pension plans are reimbursed with mark-up.

The plan assets related to our funded pension plans have experienced an actual investment return of 9.5% over the last ten years. Our actuarial valuation includes an assumed long-term rate of return on plan assets of 8%. Our assumed rate of return is based on a targeted long-term investment allocation of 60% equity securities and 40% fixed income securities. Actual allocation at December 31, 2004, was 60% equities and 40% fixed income. In evaluating our assumption regarding expected long-term investment returns on plan assets, we consider a number of factors including the historical plan returns in connection with the asset allocation policies. We use assistance from investment consultants hired to provide oversight of the actively managed investment. The selection of the expected return rate materially affects our pension costs. Based on our evaluation, we selected an expected rate of return of 8% in 2004 and continue to use this rate for valuation and determining pension expense for 2005. If we were to lower our long-term rate of return assumption by a hypothetical 100 basis points, expense in 2005 would be increased by approximately $3.7 million.

In selecting the interest rate to discount estimated future benefit payments that have been earned to date to their net present value (defined as the projected benefit obligation), we match the plan s benefit payment streams to high-quality bonds of similar maturities. The selection of the discount rate not only affects the reported funded status information as of December 31 (as shown in Note I to the consolidated financial statements), but also affects the succeeding year s pension expense. The discount rate selected for December 31, 2004, based on the method described above, was 5.85% compared to 6.25% at December 31, 2003. If we were to lower our discount rate by a hypothetical 50 basis points, pension expense in 2005 would increase by approximately $6.4 million.

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The assumed future increase in salaries and wages also is a significant estimate in determining pension costs. In selecting this assumption we consider our historical wage and pensionable earnings increases, future wage increase projections, our collective bargaining agreement with our pilots and inflation. We used annual salary increase assumptions of 4% to 4.5% depending on job classification and will use the same assumptions for 2005. For 2005, if we had used a salary increase assumption which was 100 basis points higher, pension costs would have increased by approximately $4.8 million.

We estimate that cash contributions to the defined benefit pension plans will total approximately $39.6 million in 2005. Funding for the contributions will be generated primarily from our operating agreements with DHL.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Operating Cash Flows

Operating cash flows were $57.2 million, $101.4 million and $177.7 million for 2004, 2003 and 2002, respectively. Our operating cash flows are primarily a function of aircraft depreciation expense reimbursed by DHL and the mark-up earned under our commercial agreements with DHL, offset by pension funding. The decline in operating cash flows compared to 2003 is primarily a result of lower reimbursed depreciation expense and increased amounts due from DHL at the end of 2004. At the end of 2004 we had a large receivable due from DHL primarily as a result of expanded DHL business activity during the fourth quarter 2004, which resulted in actual expenses exceeding funded expenses during the quarter.

We have budgeted to be reimbursed for approximately $78.9 million of depreciation and pension expense from DHL in 2005. We estimate that contributions to our defined benefit pension plans will be $39.6 million in 2005.

Capital Expenditures

Total capital expenditures were $73.7 million in 2004 compared to $88.5 million and $98.4 million in 2003 and 2002, respectively. Our capital expenditures in recent years have primarily been for the acquisition and modification of aircraft. We have continued our program to acquire and deploy Boeing 767 aircraft, which provide a higher level of operating efficiency than the DC-8 aircraft they replace. We acquired two Boeing 767 aircraft in 2004, three Boeing 767 aircraft in 2003, and two Boeing 767 aircraft in 2002. As of December 31, 2004, two Boeing 767s were undergoing modification to standard cargo door configuration. Other capital expenditures included a DC-9 flight simulator in 2003, facilities and package handling equipment (subsequent to the August 15, 2003 separation from Airborne, capital expenditures associated with facilities and package handling equipment were no longer our responsibility), computer equipment, as well as tooling and expenditures supporting the operation of the airport in Wilmington, Ohio**.** The level of capital spending for 2005 is anticipated to be approximately $58.0 million.

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Commitments

We have a commitment to acquire one additional Boeing 767 aircraft during 2005. The aircraft is committed to be modified to a standard freighter configuration from its original passenger configuration. Payments for the aircraft and the conversion of it and other recently purchased aircraft will approximate $44.0 million in 2005. There are currently no aircraft or aircraft-related commitments extending beyond 2005.

As of December 31, 2004, we had the following contractual obligations and commercial commitments (in thousands):

	Payments Due By Period				
Contractual Obligations	**Total**	**Less Than 1 Year**	**2-3 Years**	**4-5 Years**	**After 5 Years**
Long-term debt, excluding interest payments	$ 92,949				$ 92,949
Capital lease obligations	88,861	7,954	17,941	21,042	41,924
Operating leases	21,497	4,518	7,607	6,196	3,176
Unconditional purchase obligations	43,962	43,962			
Total contractual cash obligations	$ 247,269	$ 56,434	$ 25,548	$ 27,238	$ 138,049

The unconditional purchase obligations consist of commitments to acquire and modify aircraft. The long-term debt bears interest at 5.00% per annum, payable semi-annually. The table above does not include cash contributions for pension funding due to the absence of scheduled maturities. The timing of pension payments cannot be determined, except for amounts estimated to be paid in 2005 which are discussed above under Pension Plans.

As of December 31, 2004, approximately $10.0 million in various letters of credit were issued under our credit facility. We plan to renew these letters of credit through the credit facility when the letters expire in 2005.

Liquidity

At December 31, 2004, we had approximately $38.7 million of cash balances and $46.1 million due from DHL. We anticipate that our current cash balances, combined with forecasted cash flows provided by commercial agreements with DHL and growth in new business will be sufficient to fund our planned operations and capital expenditures for 2005 and beyond. If certain liquidity levels are not maintained, we will be able to request certain cash advances under the commercial agreements to supplement liquidity through December 31, 2005. Also, DHL guarantees our financing obligations for three Boeing 767 aircraft. The Company has a $45.0 million credit facility through a syndicated Credit Agreement that expires in March 2007. Borrowings under the agreement are collateralized by substantially all of the Company s assets. The agreement contains an accordion feature to increase the borrowings to a total of $50.0 million if the Company needs additional borrowing capacity. The agreement provides for the issuance of letters of credit on the Company s behalf. As of December 31, 2004, the unused credit facility totaled $35.0 million, net of outstanding letters of credit of $10.0 million.

The promissory note due to DHL limits cash dividends that we can pay to $1.0 million annually. We have not declared any cash dividends and intend to retain earnings to finance future growth and cash requirements.

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 December 31, 2004, we are not involved in any material unconsolidated SPE transactions.

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We adopted FASB Interpretation No. 45 (FIN 45), Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, effective January 1, 2003. The initial recognition and measurement provisions of FIN 45 apply prospectively to guarantees and indemnifications issued or modified after December 31, 2002. Our adoption of FIN 45 did not have any effect on our financial position or results of operations. No amounts have been recognized in our financial statements for the underlying fair value of guarantees and indemnifications. Certain of our operating leases and agreements contain indemnification obligations to the lessor or one or more other parties that are considered ordinary 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. The Company fully and unconditionally guarantees a senior note of DHL. The senior note issued by Airborne, bears interest at a rate of 7.35% and matures in September 2005. Subsequent to Airborne s merger, DHL paid down this note, such that the remaining amount outstanding is $6.9 million at December 31, 2004.

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

Revenue Recognition

Revenues from DHL are recognized when the related services are performed. Prior to August 16, 2003, revenues from Airborne were calculated as the sum of pretax net expenses incurred plus 2.0%. Prior to August 16, 2003, net expenses included all operating and interest expenses, including allocated expenses from Airborne, less revenues recorded from customers other than Airborne. Since August 16, 2003, revenues from DHL are determined based on the expenses incurred during a reporting period for the ACMI and Hub Services agreements. Expenses incurred under these agreements are generally subject to a base mark-up of 1.75%, which is recognized in the period during which the expenses are incurred. Certain costs, the most significant of which include fuel costs, interest on the promissory note to DHL, airport rent, ramp and landing fees incurred for performance under the ACMI agreement, are reimbursed and included in revenues without mark-up.

In addition to a base mark-up of 1.75%, both the ACMI and Hub Services agreements provide for an incremental mark-up potential above the base 1.75%, predicated on our achievement of specified cost-related and service goals. The ACMI agreement provides for a maximum potential incremental mark-up of 1.60%, with 1.35% based on cost-related goals and 0.25% based on service performance. The Hub Services agreement provides for a maximum potential incremental mark-up of 2.10%, with 1.35% based on cost-related goals and 0.75% based on service performance. Both contracts call for 40% of any incremental mark-up earned from cost-related goals to be recognized based on quarterly results, with 60% measured against annual results. Accordingly,

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a maximum incremental mark-up of approximately 0.54% may be achieved based on quarterly results and recognized in our quarterly revenues. Up to a maximum incremental mark-up of approximately 0.81% based on annual cost-related goals could be recognized during the fourth quarter, when full year results are known. Incremental mark-up potential associated with the service goals (0.25% in the ACMI agreement and 0.75% in the Hub Services agreement) is measured annually and any revenues earned from their attainment would be recognized during the fourth quarter, when full year results are known. Management cannot predict to what degree the Company will be successful in achieving incremental mark-up.

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

Depreciation

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

Self-Insurance

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

Contingencies

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

Postretirement Obligations

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

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NEW ACCOUNTING PRONOUNCEMENTS

See Note B to the consolidated financial statements for discussion of recent accounting pronouncements.

ADDITIONAL RISK FACTORS ASSOCIATED WITH ABX S BUSINESS

We rely on a single customer for substantially all of our revenue and operating cash flows.

We expect revenues from our ACMI agreement and Hub Services agreement with DHL to account for nearly all of our revenues and cash flows during 2005. If DHL experiences a decline in its business, our own business volume would experience a corresponding decline.

Our success is highly dependent upon the level of business activity and overall economic conditions in the U.S. An economic downturn in the U.S. is likely to adversely affect demand for delivery services offered by DHL, in particular expedited services shipped via aircraft. During an economic slowdown customers generally use ground based delivery services instead of more expensive air delivery services. A prolonged economic slowdown may increase the likelihood that DHL would reduce the scope of services we provide under the ACMI agreement.

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

The ACMI agreement is for an initial term of seven years, expiring August 2010, and thereafter automatically renews for an additional three year period, unless notice is given not less than one year prior to the renewal thereof. The Hub Services agreement is for an initial term of three years, expiring August 2006, and thereafter automatically renews for additional periods of one year each, until at least ninety days notice is given prior to the next annual renewal thereof. However, DHL may reduce the level of services such as line-haul logistics services, we provide under the ACMI and Hub Services agreements from time to time during their respective terms. In fact, as described in this filing, during November 2004, DHL notified us of their intent to remove twenty-six aircraft from service.

Under the ACMI agreement and Hub Services agreement, if we do not meet certain performance standards, after a cure period, DHL may terminate the ACMI agreement and Hub Services agreement prior to the end of their respective terms.

Although the ACMI agreement and Hub Services agreement with DHL are structured as cost plus arrangements, the costs for which we can be reimbursed are subject to certain limitations. For instance, labor rate increases are capped at predetermined levels and certain other costs are non-reimbursable. Accordingly, if labor costs sharply increase or we incur excessive non-reimbursable costs, there can be no assurance that the revenues from these agreements will generate sufficient income to recover our costs.

The ACMI agreement with DHL may limit our ability to provide services to third parties.

The ACMI agreement limits our ability to use the aircraft designated for use under the ACMI agreement to perform services for parties other than DHL by permitting such use only if (1) it does not interfere in any material respect with ABX s performance of ACMI services for DHL, (2) ABX does not solicit DHL s customers in competition with DHL, (3) it does not involve ABX providing air cargo transportation services to major integrated international air express delivery companies with annual revenues in excess of $5 billion (other than the U.S. Postal Service or any affiliate of DHL) and (4) an ABX event of default shall not have occurred and be continuing.

If insurance coverage becomes unavailable, it would adversely affect our ability to operate.

Following the terrorist attack of September 11, 2001, commercial insurance providers initially cancelled war risk liability insurance coverage and thereafter began offering such coverage on a more limited basis and at

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substantially higher rates. For this reason, the U.S. government has been and is continuing to offer war risk insurance to U.S. airlines at rates below the commercial insurance market. The U.S. government has committed to offer war risk insurance to airlines through August 31, 2005, after which it may be necessary to procure war risk insurance in the commercial market. The war risk insurance available to airlines in the commercial market may be more limited in coverage and/or may not be available on commercially reasonable terms.

Although we believe that our insurance coverage is adequate, there can be no assurance that the amount of such coverage will not be changed upon renewal or that we will not be forced to bear substantial losses from accidents. Substantial claims resulting from an accident could have a material adverse effect on our financial condition and could affect our ability to obtain insurance in the future.

Our inability to comply with, or the costs of complying with, government regulations could negatively affect our results of operations.

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

As of December 31, 2004, all aircraft in our in-service fleet of 115 aircraft were manufactured prior to 1990. Manufacturer Service Bulletins and the Federal Aviation Administration Airworthiness Directives issued under its Aging Aircraft program cause aircraft operators of such aged aircraft to be subject to extensive aircraft examinations and require such aircraft to undergo structural inspections and modifications to address problems of corrosion and structural fatigue at specified times. Airworthiness Directives have been issued that require inspections and both major and minor modifications to such aircraft. It is possible that additional Service Bulletins or Airworthiness Directives applicable to the types of aircraft or engines included in our fleet could be issued in the future. The cost of compliance with Airworthiness Directives and of following Service Bulletins cannot currently be reasonably estimated, but could be substantial.

Failure to maintain ABX s operating certificates and authorities would adversely affect our business.

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

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

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

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the ordinary course of our business, we are exposed to market risk for changes in the price of jet and diesel fuel, however, this risk is largely mitigated by reimbursement through the ACMI agreement.

We have interest rate risk as a result of debt obligations. As of December 31, 2004, $126.4 million of fixed interest rate exposure and $55.4 million of variable interest rate exposure were outstanding on debt arrangements.

Variable interest rate debt exposes us to differences in future cash flows resulting from changes in market interest rates. This risk is largely mitigated, however, because our interest expense for the debt with variable rate risk is marked up and charged to DHL under our ACMI agreement. Variable interest rate risk can be quantified by estimating the change in annual cash flows resulting from a hypothetical 20% increase in interest rates. A hypothetical 20% increase in interest rates would have resulted in an increase in interest expense of approximately $1.2 million for the year ended December 31, 2004.

The debt issued at fixed interest rates is exposed to fluctuations in fair value resulting from changes in market interest rates. Fixed interest rate risk can be quantified by estimating the increase in fair value of our long-term debt through a hypothetical 20% decrease in interest rates. As of December 31, 2004, a 20% decrease in interest rates would have increased the fair value of our fixed interest rate debt by approximately $7.1 million.

The Company did not have any derivative financial instruments at December 31, 2004.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to Consolidated Financial Statements

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of ABX Air, Inc.

Wilmington, Ohio

We have audited the accompanying consolidated balance sheets of ABX Air, Inc. and subsidiaries (the Company) as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2004. Our consolidated audits also included the financial statement schedule listed in the index of Item 15. These financial statements and the financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note A to the consolidated financial statements, in 2003 the Company changed its estimated useful lives of aircraft.

As discussed in Note A to the consolidated financial statements, the Company determined that the carrying value of its long-lived assets had been impaired during 2003. In accordance with Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the Company recorded an impairment charge of approximately $600.9 million for the year ended December 31, 2003.

As discussed in Note C, prior to August 16, 2003, the Company operated as a wholly-owned subsidiary of Airborne, Inc. Accordingly, the accompanying consolidated financial statements may not necessarily be representative of the results of operations that would have been attained if the Company would have operated as an unaffiliated entity. Certain expenses prior to August 16, 2003, represent allocations made from and applicable to Airborne, Inc. as a whole.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of ABX Air, Inc. and subsidiaries at December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of December 31, 2004, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 15, 2005, expressed an unqualified opinion on management s assessment of the effectiveness of the Company s internal control over financial reporting and an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ Deloitte & Touche LLP

Dayton, Ohio

March 15, 2005

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ABX AIR, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	December 31	
	2004	**2003**
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 38,749	$ 63,101
Restricted cash (Note B)		2,640
Accounts receivable, net of allowance of $244 and $269 in 2004 and 2003, respectively	54,677	5,482
Spare parts and fuel inventory	15,045	16,252
Prepaid supplies and other	2,550	2,511
TOTAL CURRENT ASSETS	111,021	89,986
Property and equipment, net (Note E)	351,646	312,803
Other assets	10,256	10,317
TOTAL ASSETS	**$ 472,923**	**$ 413,106**
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 62,635	$ 43,355
Salaries, wages and benefits	44,689	35,187
Accrued expenses	7,020	5,921
Current portion of postretirement liabilities (Note I)	12,706	9,044
Current portion of long-term obligations	7,954	7,332
Unearned revenue (Note C)	7,565	12,301
TOTAL CURRENT LIABILITIES	142,569	113,140
Long-term obligations (Note G)	173,856	181,810
Postretirement liabilities (Note I)	67,063	57,781
Other liabilities	1,486	1,709
Deferred income tax liabilities (Note F)		
Commitments and contingencies (Note H)		
STOCKHOLDERS EQUITY:		
Preferred stock, 20,000,000 shares authorized, including 75,000 Series A Junior Participating Preferred Stock		
Common stock, par value $0.01 per share; 75,000,000 shares authorized; 58,270,400 shares issued and outstanding;	583	583
Additional paid-in capital	428,637	428,637
Deficit	(328,202)	(365,175)
Accumulated other comprehensive loss (Note J)	(13,069)	(5,379)

TOTAL STOCKHOLDERS EQUITY	87,949	58,666
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	**$ 472,923**	**$ 413,106**

See notes to consolidated financial statements.

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ABX AIR, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Year Ended December 31		
	2004	**2003**	**2002**
REVENUES	$ 1,202,509	$ 1,160,959	$ 1,173,735
OPERATING EXPENSES:			
Salaries, wages and benefits	500,831	472,028	451,474
Purchased line-haul	233,367	172,126	150,281
Fuel	197,879	150,454	129,321
Maintenance, materials and repairs	108,425	114,032	116,254
Depreciation and amortization	36,817	98,503	147,993
Landing and ramp	23,040	27,385	26,082
Rent	6,993	9,748	11,982
Other operating expenses	50,159	74,978	91,813
Impairment charge (Note A)		600,871	
	1,157,511	1,720,125	1,125,200
INTEREST EXPENSE	(8,956)	(16,517)	(25,866)
INTEREST INCOME	931	138	
EARNINGS (LOSS) BEFORE INCOME TAXES	36,973	(575,545)	22,669
INCOME TAX BENEFIT (EXPENSE) (Note F)		128,644	(9,383)
NET EARNINGS (LOSS)	$ 36,973	$ (446,901)	$ 13,286
EARNINGS (LOSS) PER SHARE:			
Basic	$ 0.63	$ (8.52)	$ 0.25
Diluted	$ 0.63	$ (8.52)	$ 0.23
WEIGHTED AVERAGE SHARES (Note D):			
Basic	58,270	52,474	52,107
Diluted	58,270	52,474	58,521

See notes to consolidated financial statements.

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ABX AIR, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended December 31		
	2004	**2003**	**2002**
OPERATING ACTIVITIES:			
Net earnings (loss)	$ 36,973	$ (446,901)	$ 13,286
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:			
Impairment charge		600,871	
Deferred income taxes		(134,738)	11,063
Depreciation and amortization	36,817	98,503	147,993
Postretirement liabilities	5,307	(2,751)	(5,218)
Changes in assets and liabilities:			
Restricted cash	2,640	(2,640)	
Accounts receivable	(49,195)	(3,293)	1,227
Inventory and prepaid supplies	(899)	2,082	1,258
Accounts payable	19,280	(7,925)	(2,774)
Accrued expenses, salaries, wages and benefits and other liabilities	10,378	(14,720)	10,185
Unearned revenue	(4,736)	12,301	
Other	609	644	697
NET CASH PROVIDED BY OPERATING ACTIVITIES	57,174	101,433	177,717
INVESTING ACTIVITIES:			
Capital expenditures	(73,668)	(88,524)	(98,401)
NET CASH USED IN INVESTING ACTIVITIES	(73,668)	(88,524)	(98,401)
FINANCING ACTIVITIES:			
Principal payments on long-term obligations	(7,333)	(7,332)	(6,493)
Line of credit cost	(525)	(306)	
Proceeds from promissory note		89,021	
Distribution of promissory note proceeds to Airborne, Inc.		(29,021)	
Advances from Airborne, Inc.		(2,203)	(72,823)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(7,858)	50,159	(79,316)
NET INCREASE (DECREASE) IN CASH	(24,352)	63,068	
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	63,101	33	33
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 38,749	$ 63,101	$ 33
SUPPLEMENTAL CASH FLOW INFORMATION:			
Interest paid, net of amount capitalized (Note B)	$ 9,440	$ 13,665	$ 25,853

See notes to consolidated financial statements.

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ABX AIR, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(In thousands, except share data)

	Common Stock Number	Common Stock Amount	Additional Paid-in Capital	Retained (Deficit) Earnings	Accumulated Other Comprehensive Income (Loss)	Total
BALANCE AT DECEMBER 31, 2001	52,107,129	$ 521	$ 410	$ 223,784	$ (716)	$ 223,999
Comprehensive income:						
Net earnings				13,286		13,286
Other comprehensive loss, net of tax:						
Unrealized interest rate swap loss					(2,830)	(2,830)
Minimum pension liabilities					(2,133)	(2,133)
Total comprehensive income						$ 8,323
BALANCE AT DECEMBER 31, 2002	52,107,129	$ 521	$ 410	$ 237,070	$ (5,679)	$ 232,322
Separation from Airborne, Inc.:						
Dividend of certain assets and liabilities to Airborne, Inc. (Note A)				(155,344)		(155,344)
Cancellation of advances payable to Airborne, Inc. (Note A)			457,310			457,310
Distribution of promissory note proceeds to Airborne, Inc.			(29,021)			(29,021)
Issuance of shares to note holders of Airborne s Convertible Senior Notes (Note D)	6,163,271	62	(62)			
Comprehensive loss:						
Net loss				(446,901)		(446,901)
Other comprehensive income (loss), net of tax:						
Unrealized interest rate swap gain					2,204	2,204
Minimum pension liabilities					(1,904)	(1,904)
Total comprehensive loss						$ (446,601)
BALANCE AT DECEMBER 31, 2003	58,270,400	$ 583	$ 428,637	$ (365,175)	$ (5,379)	$ 58,666
Comprehensive income:						
Net earnings				36,973		36,973
Other comprehensive (loss):						
Minimum pension liabilities						

The Audit Committee shall have the sole authority to select, evaluate, appoint and replace the independent auditors (subject to shareholder ratification) and shall approve in advance all audit engagement fees and terms and all non-audit engagements with the independent auditors. The Audit Committee shall consult with management, but shall not delegate these responsibilities.

The Audit Committee shall have the authority, to the extent it deems necessary or appropriate, to retain special legal, accounting, or other consultants to advise the Audit Committee. The Company shall provide funding, as determined by the Audit Committee, for payment of compensation to the independent auditors and to any advisors employed by the Audit Committee. Any communications between the Audit Committee and legal counsel in the course of obtaining legal advice will be considered privileged communications of the Company, and the Audit Committee will take all necessary steps to preserve the privileged nature of those communications.

The Audit Committee may form and delegate authority to subcommittees, comprised of one or more members of the Committee, as necessary or appropriate. Each subcommittee shall have the full power and authority of the Audit Committee.

The Audit Committee may conduct or authorize investigations into any matter, within the Audit Committee s scope of responsibilities, brought to its attention.

MEETINGS

The Committee shall meet at least four times annually, or more frequently as circumstances dictate. The Audit Committee may hold special meetings upon the call of the Chair of the Committee. At Committee meetings, a majority of the total members will constitute a quorum. A member of the Audit Committee or a person designated by the Audit Committee shall keep minutes. The Committee shall regularly report to the Board on the Audit Committee s activities, and annually review and evaluate its own performance. The Committee shall review and assess the adequacy of this Charter annually and recommend any proposed changes to the Board for approval.

As part of its job to foster open communication, the Committee should meet at least annually with management, the manager of the internal audit function, and the independent auditors to discuss any matters that the Committee or each of these groups believe should be discussed privately.

In addition, the Committee, or at least its Chair, should meet with the independent auditors and management annually to review the Company s financial reports.

All members of the Board who are not members of the Committee may attend meetings of the Committee, but may not vote. The Committee may invite to its meetings any management or other personnel of the Company, or any third parties, as it deems appropriate in order to carry out its responsibilities.

RESPONSIBILITIES AND DUTIES

In carrying out its responsibilities, the Audit Committee believes its policies and procedures should remain flexible, in order to best react to changing conditions and ensure to the directors and shareholders that the corporate accounting and reporting practices of the Company are in accordance with all requirements.

The Audit Committee s duties and responsibilities are designated by the categories listed below:

1. Financial Statement and Disclosure Matters

- Review the regular internal reports to management prepared by the internal audit function and management s response.

- Review and discuss with management and the independent auditors the annual audited financial statements, including disclosures made in Management s Discussion and Analysis of Financial Condition and Results of Operations , and recommend to the Board whether the audited financial statements should be included in the Company s Form 10-K.

- Prepare annually a report for inclusion in the Company s proxy statement relating to its annual shareholders meeting. In that report, the Audit Committee will state whether it has: (i) reviewed and discussed the audited financial statements with management; (ii) discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61, as that statement may be modified or supplemented from time to time; and (iii) received from the independent auditors written disclosures and the letter required by Independence Standards Board Standard No. 1, as that standard may be modified or supplemented from time to time, and discussed with the independent auditors the independence of the independent auditors.

- Review and discuss with management and the independent auditors the Company s quarterly financial statements prior to the filing of its Form 10-Q, including the results of the independent auditors reviews of the quarterly financial statements.

- Discuss generally the Company s earnings press releases, including the use of pro forma or adjusted non-GAAP information, as well as financial information and earnings guidance provided to analysts and rating agencies to the extent required by applicable law or listing standards. The Committee need not discuss in advance each earnings release or each instance in which the Company may provide earnings guidance.

- Receive a disclosure from the Chief Executive Officer and Chief Financial Officer during their certification process for the 10-K and 10-Qs about (i) any significant deficiencies in design or operation of internal controls or material weaknesses therein and (ii) any fraud, whether or not material, involving management or other employees who have a significant role in the Company s internal controls.

- At least annually prior to the filing of the Audit Committee Report with the SEC (and more frequently if appropriate), review and discuss reports from the independent auditors on, among other things, certain:

- Critical accounting policies and practices to be used;

- Alternative treatments of financial information within generally accepted accounting principles;

- Other material written communications between the independent auditors and management, such as any management letter and the Company s response to such letter or schedule of unadjusted differences; and,

- Difficulties encountered in the course of the audit work, including any restrictions on the scope of activities or access to requested information, any significant disagreements with management, and communications between the audit team and the audit firm s office with respect to difficult auditing or accounting issues presented by the engagement.

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- Discuss with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61 relating to the conduct of the audit.

- Review and discuss with management and the independent auditors, at least annually, significant accounting and financial reporting issues, including complex or unusual transactions and judgments concerning significant estimates or significant changes in the Company s selection or application of accounting principles, and recent professional, accounting and regulatory pronouncements and initiatives, and understand their impact on the Company s financial statements.

- Review with management the Audit Committee s evaluation of the Company s internal control structure and procedures for financial reporting and review periodically, but in no event less frequently than quarterly, management s conclusions about the efficacy of such internal controls and procedures, including any significant deficiencies in or material noncompliance with such controls and procedures.

- Discuss with management the Company s major financial risk exposures and the steps management has taken to monitor and control such exposures, including the Company s risk assessment and risk management policies.

2. Authorization of the Company s Whistleblower Policy

- Establish procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters, and the confidential, anonymous submission by Company employees of concerns regarding questionable accounting or auditing matters.

- Treatment of Certain Complaints

- The protection of corporate whistleblowers shall be the responsibility of the Audit Committee.

- The Audit Committee shall protect anyone who comes forth with any information concerning any irregularities or fraudulent activity being performed. The Sarbanes-Oxley Act of 2002 expands the federal statute concerning retaliation against a witness to prohibit interference with the lawful employment or livelihood of a witness for providing information relating to the commission of a federal offense.

- The Audit Committee shall provide for employees of a public company who provide evidence of fraud. The Company may not fire, demote, suspend, threaten, harass, or otherwise discriminate against an employee because of the employee s involvement in a securities or fraud-related investigation involving the Company. Any employee who is adversely treated because of his or her whistleblowing activities may sue the Company within 90 days after the date of the discriminatory act for compensatory damages and attorney s fees. The employee must make a prima facie case showing that his or her whistleblowing activities were a contributing factor in the unfavorable personnel action alleged in the complaint, while the employer must show by clear and convincing evidence that it would have taken the same unfavorable personnel action in the absence of the whistleblowing behavior.

3. Oversight of the Company s Relationship with Independent Auditors

- The independent auditors shall report directly to the Audit Committee.

- Review and discuss the scope and plan of the independent audit.

- Review and appraise the audit efforts of the Company s independent auditors and internal auditing department.

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- Provide an open avenue of communication with the independent auditors.

- On an annual basis, review and discuss with the auditors all significant relationships the auditors have with the Company to determine the independence of the internal and independent auditors.

- Review the performance of the independent auditors and approve any proposed discharge of the independent auditors when circumstances warrant.

- Review with management and the independent auditors at the completion of the annual examination:

- The Company s annual financial statements and related footnotes;

- The independent audit of the financial statements and report thereon;

- Any significant changes required in the independent audit plan; and,

- Any serious difficulties or disputes with management encountered during the course of the audit.

- Review the internal audit function of the Company including the independence and authority of its reporting obligations, the proposed audit plans for the coming year, and the coordination of such plans with the independent auditors.

- Provide sufficient opportunity for the internal and independent auditors to meet with the members of the Audit Committee without members of management present. Among the items to be discussed in these meetings are the independent auditors evaluation of the Company s financial, accounting and internal controls.

- Receive and discuss a report from the independent auditors at least annually regarding:

- The independent auditors internal quality control procedures;

- Any material issues raised by the most recent quality control review, or peer review (if applicable), of the independent auditors, or by any inquiry or investigation by governmental professional authorities within the preceding five years respecting one or more independent audits carried out by the independent auditors;

- Any steps taken to deal with any such issues; and,

- All relationships between the independent auditors and the Company, in order to assess the independent auditors independence.

- Approve guidelines for the retention of the independent auditors for any non-audit services and determine procedures for the approval of audit and non-audit services in advance. In accordance with such procedures, the Audit Committee shall approve in advance any audit or non-audit services provided to the Company by the independent auditors, all as required by applicable law or listing standards. Preapproval authority may be delegated to one or more members of the Audit Committee.

- Evaluate the qualifications, performance and independence of the independent auditors, including whether the provision of non-audit services is compatible with maintaining the auditors independence, and taking into account the opinions of management and the Company s legal counsel. This shall include a review and discussion of the annual communication as to independence delivered by the independent auditors (Independence Standards Board Standard

No. 1 - Independence Discussions with Audit Committees). The Audit Committee shall present its conclusions to the Board and, if so determined by the Audit Committee, recommend that the Board

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take additional action to satisfy itself of the qualifications, performance and independence of the auditors.

- Recommend to the Board policies for the Company s hiring of employees or former employees of the independent auditors which guidelines shall meet the requirements of applicable law and listing standards.

- Ensure the rotation of the lead audit partner every five years and other audit partners every seven years, as well as consider whether there should be regular rotation of the audit firm itself.

4. Financial Reporting Processes

- In consultation with the independent auditors and the internal auditors, review the integrity of the Company s financial reporting processes, both internal and external.

- Review any differences in the independent auditors judgments relating to the interpretation of the Company s accounting principles as applied in its financial reporting.

- Review and approve, if appropriate, major changes to the Company s auditing and accounting principles and practices as suggested by the independent auditors, management, or the internal audit function.

- Review with the Chief Executive Officer, Chief Financial Officer, independent auditors, and the manager of the internal audit function the financial report before it is filed with the SEC or other regulators.

- Receive prior to each meeting, a summary of findings from completed internal audits and a progress report on the proposed internal audit plan, with explanations for any deviations from the original plan.

- Review the financial statements contained in the annual report to shareholders with management and the independent auditors to determine that the independent auditors are satisfied with the disclosure and content of the financial statements to be presented to the shareholders. Any changes in accounting principles, the effect of any regulatory and accounting initiatives, and off-balance sheet structures should be reviewed.

- Serve as an independent and objective party to monitor the Company s financial reporting process and internal control system.

5. Oversight of Audit and Risk Review (ARR)

The Audit Committee may contract for internal audit services as necessary to assess the adequacy and effectiveness of internal accounting controls, financial systems or financial statements, and the accuracy of management reporting and compliance with laws, regulations and Company policy. As used in this section or subsequent sections, the lead or coordinating auditor refers to the Company s internal auditor or, if such services are outsourced, to the auditor of the public accounting firm primarily responsible for the Company s internal audit functions.

- Review and discuss the appointment and replacement of the lead or coordinating auditor.

- Review and discuss the ARR findings that have been reported to management, management s responses, and the progress of the related corrective action plans.

- Review and evaluate the adequacy of the work performed by the lead or coordinating auditor and ARR function, and ensure that the ARR function is independent and has adequate resources to fulfill its duties, including implementation of the annual audit plan.

- Review any significant disagreement among management and the independent auditors or the internal audit function in connection with the preparation of the financial statements.

- Review with the independent auditors, the lead or coordinating auditor, and management the extent to which changes or improvements in financial or accounting practices, as approved by the Audit Committee, have been implemented.

- Inquire of management, the lead or coordinating auditor of the internal audit function, and the independent auditors about significant risks or exposures and assess the steps management has taken to minimize such risk to the Company.

- Consider, in consultation with the independent auditors and the lead or coordinating auditor of the internal audit function, the audit scope and plan of the internal auditors.

- Review with the lead or coordinating auditor of the internal audit function and the independent auditors the coordination of audit efforts to assure completeness of coverage, reduction of redundant efforts, and the effective use of audit resources.

- Consider and review with the independent auditors and the lead or coordinating auditor of the internal audit function:

- The adequacy of the Company s internal controls including computerized information, system controls, and security;

- Any related significant findings and recommendations of the independent auditors and internal auditors together with management s responses thereto;

- Any difficulties encountered in the course of their audits, including any restrictions on the scope of their work or access to required information;

- Any changes required in the planned scope of their audit plans; and,

- The Internal Audit Department Charter.

6. Compliance Oversight Responsibilities

- Review periodically with management and the independent auditors any correspondence with, or other action by, regulators or governmental agencies, any material legal affairs of the Company, and the Company s compliance with applicable law and listing standards.

- Review and discuss the report of the lead or coordinating auditor regarding the expenses of, the perquisites paid to, and the conflicts of interest, if any, of members of the Company s senior management.

- Review and discuss with management and the independent auditors any correspondence with, or the findings of any examinations by, regulatory agencies, published reports or auditor observations that raise significant issues regarding the Company s financial statements or accounting policies.

- Obtain regular updates from management and Company counsel regarding compliance matters and legal matters that may have a significant impact on the financial statements or the Company s compliance policies.

- Advise the Board with respect to policies and procedures regarding compliance with the Company s Code of Ethics including review of the process for communicating the Code of Ethics to Company personnel and for monitoring compliance.

- Review periodically the Code of Ethics and ensure that management has established a system to enforce this Code.

- Review activities, organizational structure, and qualifications of the internal audit function.

- Review, with the Company s counsel, any legal matter that could have a significant impact on the Company s financial statements, related Company compliance policies, and programs and reports received from regulators.

- Report Committee actions to the Board of Directors with such recommendations as the Committee may deem appropriate.

- Possess the power to conduct or authorize investigations into any matters within the Committee s scope of responsibilities. The Committee shall be empowered to retain independent counsel, accountants, or others to assist it in the conduct of any investigation.

- Perform such other functions as assigned by law, the Bylaws, or the Board of Directors.

- Ensure no improper influence by the Board of Directors or management in the conduct of internal or external audits.

ACNB CORPORATION
PROXY

ý **PLEASE MARK VOTES AS IN THIS EXAMPLE**

ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON MAY 9, 2006.

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS.

The undersigned hereby constitutes and appoints D. Richard Guise and Edgar S. Heberlig and each or either of them, proxies of the undersigned, with full power of substitution to vote all of the shares of ACNB Corporation that the undersigned shareholder(s) may be entitled to vote at the Annual Meeting of Shareholders to be held at the ACNB Corporation Operations Center, 100 V-Twin Drive, Gettysburg, Pennsylvania 17325, on Tuesday, May 9, 2006, at 1:00 p.m., prevailing time, and at any adjournment or postponement of the meeting, as indicated upon the matters referred to in the proxy statement, and upon any matters which may properly come before the Annual Meeting.

	For	Against	Abstain
1. TO FIX THE NUMBER OF DIRECTORS OF ACNB CORPORATION AT THIRTEEN (13).	o	o	o
2. TO FIX THE NUMBER OF CLASS 1 DIRECTORS AT FIVE (5).	o	o	o
3. TO FIX THE NUMBER OF CLASS 2 DIRECTORS AT FOUR (4).	o	o	o
4. TO FIX THE NUMBER OF CLASS 3 DIRECTORS AT FOUR (4).	o	o	o

	For	With-hold	For All Except
5. TO ELECT ONE (1) CLASS 1 DIRECTOR TO SERVE FOR A ONE-YEAR TERM. **Frank C. Russell, Jr.**	o	o	o
6. TO ELECT FOUR (4) CLASS 2 DIRECTORS TO SERVE FOR A THREE-YEAR TERM. **Wayne E. Lau** **Jennifer L. Weaver** **Alan J. Stock** **Harry L. Wheeler**	o	o	o

INSTRUCTION: To withhold authority to vote for any individual nominee, mark For All Except and strike the name above.

	For	Against	Abstain
7. TO RATIFY THE SELECTION OF BMC (BEARD MILLER COMPANY LLP) AS ACNB CORPORATION S INDEPENDENT AUDITORS FOR THE YEAR ENDING DECEMBER 31, 2006.	o	o	o

Please be sure to sign and date this Proxy in the box below. Date

The Board of Directors recommends a vote **FOR** all nominees listed above and **FOR** proposals 1, 2, 3, 4 and 7.

8. In their discretion, the proxyholders are authorized to vote upon such other matters as may properly come before the meeting and any adjournment or postponement of the meeting.

Stockholder sign above

Co-holder (if any) sign above

Detach above card, sign, date and mail in postage paid envelope provided.

ACNB CORPORATION

THIS PROXY, WHEN PROPERLY SIGNED AND DATED, WILL BE VOTED IN THE MANNER DIRECTED BY THE ABOVE-SIGNED SHAREHOLDER(S).

IF NO DIRECTION IS MADE, THIS PROXY WILL BE VOTED **FOR** ALL NOMINEES LISTED ABOVE AND **FOR** PROPOSALS 1, 2, 3, 4 and 7.

This Proxy must be dated, signed by the shareholder(s), and returned promptly to Registrar & Transfer Company in the enclosed envelope. When signing as Attorney, Executor, Administrator, Trustee or Guardian, please give full title. If more than one trustee, all should sign. If stock is held jointly, each owner should sign.

PLEASE ACT PROMPTLY.

SIGN, DATE AND MAIL YOUR PROXY CARD TODAY.

IF YOUR ADDRESS HAS CHANGED, PLEASE CORRECT THE ADDRESS IN THE SPACE PROVIDED BELOW AND RETURN THIS PORTION WITH THE PROXY IN THE ENVELOPE PROVIDED