EXELON CORP
Form 10-Q
November 07, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2013

or

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

Commission File Number	Name of Registrant; State of Incorporation; Address of Principal Executive Offices; and Telephone Number	IRS Employer Identification Number
1-16169	EXELON CORPORATION (a Pennsylvania corporation) 10 South Dearborn Street P.O. Box 805379 Chicago, Illinois 60680-5379 (312) 394-7398	23-2990190
333-85496	EXELON GENERATION COMPANY, LLC (a Pennsylvania limited liability company) 300 Exelon Way Kennett Square, Pennsylvania 19348-2473 (610) 765-5959	23-3064219
1-1839	COMMONWEALTH EDISON COMPANY	36-0938600

	(an Illinois corporation) 440 South LaSalle Street Chicago, Illinois 60605-1028 (312) 394-4321	
000-16844	PECO ENERGY COMPANY (a Pennsylvania corporation) P.O. Box 8699 2301 Market Street Philadelphia, Pennsylvania 19101-8699 (215) 841-4000	23-0970240
1-1910	BALTIMORE GAS AND ELECTRIC COMPANY (a Maryland corporation) 2 Center Plaza 110 West Fayette Street Baltimore, Maryland 21201-3708 (410) 234-5000	52-0280210

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).   Yes x   No ¨

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

	Large Accelerated Filer	**Accelerated Filer**	**Non-accelerated Filer**	**Smaller Reporting Company**
Exelon Corporation	x			
Exelon Generation Company, LLC			x	
Commonwealth Edison Company			x	
PECO Energy Company			x	
Baltimore Gas and Electric Company			x	

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

The number of shares outstanding of each registrant   s common stock as of September 30, 2013 was:

Exelon Corporation Common Stock, without par value	856,903,972
Exelon Generation Company, LLC	not applicable
Commonwealth Edison Company Common Stock, $12.50 par value	127,016,855

PECO Energy Company Common Stock, without par value	170,478,507
Baltimore Gas and Electric Company Common Stock, without par value	1,000

TABLE OF CONTENTS

GLOSSARY OF TERMS AND ABBREVIATIONS

Exelon Corporation and Related Entities	
Exelon	Exelon Corporation
Generation	Exelon Generation Company, LLC
ComEd	Commonwealth Edison Company
PECO	PECO Energy Company
BGE	Baltimore Gas and Electric Company
BSC	Exelon Business Services Company, LLC
Exelon Corporate	Exelon in its corporate capacity as a holding company
CENG	Constellation Energy Nuclear Group, LLC
Constellation	Constellation Energy Group, Inc.
Exelon Transmission Company	Exelon Transmission Company, LLC
Exelon Wind	Exelon Wind, LLC and Exelon Generation Acquisition Company, LLC
Ventures	Exelon Ventures Company, LLC
AmerGen	AmerGen Energy Company, LLC
BondCo	RSB BondCo LLC
PEC L.P.	PECO Energy Capital, L.P.
PECO Trust III	PECO Capital Trust III
PECO Trust IV	PECO Energy Capital Trust IV
PETT	PECO Energy Transition Trust
Registrants	Exelon, Generation, ComEd, PECO and BGE, collectively
Other Terms and Abbreviations	
Note " " of the Exelon 2012 Form 10-K	Reference to specific Combined Note to Consolidated Financial Statements within Exelon's 2012 Annual Report on Form 10-K
1998 restructuring settlement	PECO's 1998 settlement of its restructuring case mandated by the Competition Act
Act 11	Pennsylvania Act 11 of 2012
Act 129	Pennsylvania Act 129 of 2008
AEC	Alternative Energy Credit that is issued for each megawatt hour of generation from a qualified alternative energy source
AEPS	Pennsylvania Alternative Energy Portfolio Standards
AEPS Act	Pennsylvania Alternative Energy Portfolio Standards Act of 2004, as amended
AESO	Alberta Electric Systems Operator
AFUDC	Allowance for Funds Used During Construction
ALJ	Administrative Law Judge
AMI	Advanced Metering Infrastructure
ARC	Asset Retirement Cost
ARO	Asset Retirement Obligation
ARP	Title IV Acid Rain Program
ARRA of 2009	American Recovery and Reinvestment Act of 2009
Block contracts	Forward Purchase Energy Block Contracts
CAIR	Clean Air Interstate Rule
CAISO	California ISO
CAMR	Federal Clean Air Mercury Rule
CERCLA	Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended
CFL	Compact Fluorescent Light
Clean Air Act	Clean Air Act of 1963, as amended
Clean Water Act	Federal Water Pollution Control Amendments of 1972, as amended
Competition Act	Pennsylvania Electricity Generation Customer Choice and Competition Act of 1996

GLOSSARY OF TERMS AND ABBREVIATIONS

Other Terms and Abbreviations	
CPI	Consumer Price Index
CPUC	California Public Utilities Commission
CSAPR	Cross-State Air Pollution Rule
CTC	Competitive Transition Charge
DOE	United States Department of Energy
DOJ	United States Department of Justice
DSP	Default Service Provider
DSP Program	Default Service Provider Program
EDF	Electricite de France SA
EE&C	Energy Efficiency and Conservation/Demand Response
EGS	Electric Generation Supplier
EIMA	Energy Infrastructure Modernization Act (Illinois Senate Bill 1652 and Illinois House Bill 3036)
EPA	United States Environmental Protection Agency
ERCOT	Electric Reliability Council of Texas
ERISA	Employee Retirement Income Security Act of 1974, as amended
EROA	Expected Rate of Return on Assets
ESPP	Employee Stock Purchase Plan
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FRCC	Florida Reliability Coordinating Council
FTC	Federal Trade Commission
GAAP	Generally Accepted Accounting Principles in the United States
GHG	Greenhouse Gas
GRT	Gross Receipts Tax
GSA	Generation Supply Adjustment
GWh	Gigawatt hour
HAP	Hazardous air pollutants
Health Care Reform Acts	Patient Protection and Affordable Care Act and Health Care and Education Reconciliation Act of 2010
IBEW	International Brotherhood of Electrical Workers
ICC	Illinois Commerce Commission
ICE	Intercontinental Exchange
Illinois Act	Illinois Electric Service Customer Choice and Rate Relief Law of 1997
Illinois EPA	Illinois Environmental Protection Agency
Illinois Settlement Legislation	Legislation enacted in 2007 affecting electric utilities in Illinois
IPA	Illinois Power Agency
IRC	Internal Revenue Code
IRS	Internal Revenue Service
ISO	Independent System Operator
ISO-NE	ISO New England Inc.
ISO-NY	ISO New York
kV	Kilovolt
kW	Kilowatt
kWh	Kilowatt-hour
LIBOR	London Interbank Offered Rate
LILO	Lease-In, Lease-Out
LLRW	Low-Level Radioactive Waste
LTIP	Long-Term Incentive Plan
MATS	U.S. EPA Mercury and Air Toxics Rule

GLOSSARY OF TERMS AND ABBREVIATIONS

Other Terms and Abbreviations	
MBR	Market Based Rates Incentive
MDE	Maryland Department of the Environment
MDPSC	Maryland Public Service Commission
MGP	Manufactured Gas Plant
MISO	Midcontinent Independent System Operator, Inc.
mmcf	Million Cubic Feet
Moody's	Moody's Investor Service
MOPR	Minimum Offer Price Rule
MRV	Market-Related Value
MW	Megawatt
MWh	Megawatt hour
NAAQS	National Ambient Air Quality Standards
n.m.	not meaningful
NAV	Net Asset Value
NDT	Nuclear Decommissioning Trust
NEIL	Nuclear Electric Insurance Limited
NERC	North American Electric Reliability Corporation
NGS	Natural Gas Supplier
NJDEP	New Jersey Department of Environmental Protection
Non-Regulatory Agreements Units	Nuclear generating units or portions thereof whose decommissioning-related activities are not subject to contractual elimination under regulatory accounting
NOV	Notice of Violation
NPDES	National Pollutant Discharge Elimination System
NRC	Nuclear Regulatory Commission
NSPS	New Source Performance Standards
NWPA	Nuclear Waste Policy Act of 1982
NYMEX	New York Mercantile Exchange
OCI	Other Comprehensive Income
OIESO	Ontario Independent Electricity System Operator
OPEB	Other Postretirement Employee Benefits
PA DEP	Pennsylvania Department of Environmental Protection
PAPUC	Pennsylvania Public Utility Commission
PGC	Purchased Gas Cost Clause
PJM	PJM Interconnection, LLC
POLR	Provider of Last Resort
POR	Purchase of Receivables
PPA	Power Purchase Agreement
Price-Anderson Act	Price-Anderson Nuclear Industries Indemnity Act of 1957
PRP	Potentially Responsible Parties
PSEG	Public Service Enterprise Group Incorporated
PURTA	Pennsylvania Public Realty Tax Act
PV	Photovoltaic
RCRA	Resource Conservation and Recovery Act of 1976, as amended
REC	Renewable Energy Credit which is issued for each megawatt hour of generation from a qualified renewable energy source
Regulatory Agreement Units	Nuclear generating units whose decommissioning-related activities are subject to contractual elimination under regulatory accounting
RES	Retail Electric Suppliers
RFP	Request for Proposal
Rider	Reconcilable Surcharge Recovery Mechanism

GLOSSARY OF TERMS AND ABBREVIATIONS

Other Terms and Abbreviations

RGGI	Regional Greenhouse Gas Initiative
RMC	Risk Management Committee
RPM	PJM Reliability Pricing Model
RPS	Renewable Energy Portfolio Standards
RTEP	Regional Transmission Expansion Plan
RTO	Regional Transmission Organization
S&P	Standard & Poor's Ratings Services
SEC	United States Securities and Exchange Commission
Senate Bill 1	Maryland Senate Bill 1
SERC	SERC Reliability Corporation (formerly Southeast Electric Reliability Council)
SERP	Supplemental Employee Retirement Plan
SFC	Supplier Forward Contract
SGIG	Smart Grid Investment Grant
SGIP	Smart Grid Initiative Program
SILO	Sale-In, Lease-Out
SMP	Smart Meter Program
SMPIP	Smart Meter Procurement and Installation Plan
SNF	Spent Nuclear Fuel
SOS	Standard Offer Service
SPP	Southwest Power Pool
Tax Relief Act of 2010	Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010
TEG	Termoelectrica del Golfo
TEP	Termoelectrica Penoles
Upstream	Natural gas exploration and production activities
VIE	Variable Interest Entity
WECC	Western Electric Coordinating Council

FILING FORMAT

This combined Form 10-Q is being filed separately by the Registrants. Information contained herein relating to any individual Registrant is filed by such Registrant on its own behalf. No Registrant makes any representation as to information relating to any other Registrant.

FORWARD-LOOKING STATEMENTS

This Report contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, that are subject to risks and uncertainties. The factors that could cause actual results to differ materially from the forward-looking statements made by Exelon Corporation, Exelon Generation Company, LLC, Commonwealth Edison Company, PECO Energy Company and Baltimore Gas and Electric Company (Registrants) include those factors discussed herein, as well as the items discussed in (1) Exelon s 2012 Annual Report on Form 10-K in (a) ITEM 1A. Risk Factors, (b) ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and (c) ITEM 8. Financial Statements and Supplementary Data: Note 19; (2) this Quarterly Report on Form 10-Q in (a) Part II, Other Information, ITEM 1A. Risk Factors, (b) Part 1, Financial Information, ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations and (c) Part I, Financial Information, ITEM 1. Financial Statements: Note 18; and (3) other factors discussed in filings with the SEC by the Registrants. Readers are cautioned not to place undue reliance on these forward-looking statements, which apply only as of the date of this Report. None of the Registrants undertakes any obligation to publicly release any revision to its forward-looking statements to reflect events or circumstances after the date of this Report.

WHERE TO FIND MORE INFORMATION

The public may read and copy any reports or other information that the Registrants file with the SEC at the SEC s public reference room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. These documents are also available to the public from commercial document retrieval services, the website maintained by the SEC at www.sec.gov and the Registrants websites at www.exeloncorp.com. Information contained on the Registrants websites shall not be deemed incorporated into, or to be a part of, this Report.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

EXELON CORPORATION AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions, except per share data)	**2013**	**2012**	**2013**	**2012**
Operating revenues	$ 6,502	$ 6,579	$ 18,725	$ 17,235
Operating expenses				
Purchased power and fuel	2,743	3,026	8,143	7,398
Operating and maintenance	1,735	2,170	5,391	5,979
Depreciation and amortization	530	500	1,606	1,376
Taxes other than income	277	290	825	737
Total operating expenses	5,285	5,986	15,965	15,490
Equity in earnings (loss) of unconsolidated affiliates	37	10	7	(69)
Operating income	1,254	603	2,767	1,676
Other income and (deductions)				
Interest expense	(228)	(240)	(1,091)	(678)
Interest expense to affiliates, net	(6)	(6)	(19)	(19)
Other, net	155	101	311	253
Total other income and (deductions)	(79)	(145)	(799)	(444)
Income before income taxes	1,175	458	1,968	1,232
Income taxes	439	161	733	445
Net income	736	297	1,235	787
Net income (loss) attributable to noncontrolling interests, preferred security dividends and redemption and preference stock dividends	(2)	1	11	5
Net income attributable to common shareholders	738	296	1,224	782
Comprehensive income (loss), net of income taxes				
Net income	736	297	1,235	787
Other comprehensive income (loss), net of income taxes				
Pension and non-pension postretirement benefit plans:				
Prior service benefit reclassified to periodic benefit cost	1			1
Actuarial loss reclassified to periodic cost	49	44	151	126
Transition obligation reclassified to periodic cost				2
Pension and non-pension postretirement benefit plans valuation adjustment	(8)	(67)	69	(78)
Deferred compensation unit valuation adjustment			10	
Change in unrealized loss on cash flow hedges	(46)	(88)	(169)	(29)
Change in unrealized income on equity investments	16	17	51	23
Change in unrealized gain (loss) on foreign currency translation		2	(5)	
Change in unrealized loss on marketable securities			(1)	
Other comprehensive income (loss)	12	(92)	106	45
Comprehensive income	$ 748	$ 205	$ 1,341	$ 832

Average shares of common stock outstanding:				
Basic	857	854	856	804
Diluted	860	857	860	806
Earnings per average common share:				
Basic	$ 0.86	$ 0.35	$ 1.43	$ 0.97
Diluted	$ 0.86	$ 0.35	$ 1.42	$ 0.97
Dividends per common share	$ 0.31	$ 0.53	$ 1.15	$ 1.58

See the Combined Notes to Consolidated Financial Statements

EXELON CORPORATION AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In millions)	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Cash flows from operating activities		
Net income	$ 1,235	$ 787
Adjustments to reconcile net income to net cash flows provided by operating activities:		
Depreciation, amortization, depletion and accretion, including nuclear fuel and energy contract amortization	2,844	2,909
Impairment of assets held for sale		278
Deferred income taxes and amortization of investment tax credits	(164)	263
Net fair value changes related to derivatives	(229)	(377)
Net realized and unrealized gains on nuclear decommissioning trust fund investments	(95)	(142)
Other non-cash operating activities	738	1,235
Changes in assets and liabilities:		
Accounts receivable	54	228
Inventories	(103)	12
Accounts payable, accrued expenses and other current liabilities	(243)	(817)
Option premiums paid, net	(38)	(122)
Counterparty collateral (posted) received, net	(73)	408
Income taxes	863	465
Pension and non-pension postretirement benefit contributions	(360)	(131)
Other assets and liabilities	(35)	(422)
Net cash flows provided by operating activities	4,394	4,574
Cash flows from investing activities		
Capital expenditures	(3,887)	(4,162)
Proceeds from nuclear decommissioning trust fund sales	3,344	6,262
Investment in nuclear decommissioning trust funds	(3,518)	(6,422)
Cash and restricted cash acquired from Constellation		964
Proceeds from sale of long-lived assets	32	
Proceeds from sales of investments	20	26
Purchases of investments	(3)	(13)
Change in restricted cash	(23)	(38)
Other investing activities	65	41
Net cash flows used in investing activities	(3,970)	(3,342)
Cash flows from financing activities		
Payment of accounts receivable agreement	(210)	
Changes in short-term debt	205	(139)
Issuance of long-term debt	2,031	1,558
Retirement of long-term debt	(1,156)	(731)
Redemption of preferred securities	(93)	
Dividends paid on common stock	(981)	(1,226)
Dividends paid to former Constellation shareholders		(51)
Proceeds from employee stock plans	40	61
Other financing activities	(102)	(20)
Net cash flows used in financing activities	(266)	(548)

Increase in cash and cash equivalents	158		684
Cash and cash equivalents at beginning of period			
Total ACMI	116,735	128,893	
Hub Services			
Base mark-up	81,266	148,483	
Incremental mark-up		792	
Total Hub Services	81,266	149,275	
Other Reimbursable	74,952	82,644	
Total DHL	272,953	360,812	
Charters	7,045	3,850	
Other Activities	8,064	4,503	
Total Revenues	$ 288,062	$ 369,165	
Expenses:			
DHL Contracts			
ACMI	$ 114,299	$ 126,054	
Hub Services	79,888	146,863	
Other Reimbursable	74,952	82,644	
Total DHL	269,139	355,561	
Charters	6,055	3,608	
Other Activities	6,952	3,203	
Total Expenses	$ 282,146	$ 362,216	
Pre-tax Earnings:			
DHL Contracts			
ACMI	$ 2,436	$ 2,839	
Hub Services	1,378	2,412	
Other Reimbursable			
Total DHL	3,814	5,251	
Charters	990	242	
Other Activities	1,112	1,300	
Interest Income and Other	966	1,300	
Total Pre-tax Earnings	$ 6,882	$ 8,093	

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

Salaries, wages and benefits expense decreased 4% in the first quarter of 2007 as compared to the first quarter of 2006. The reduction reflects an approximately 6% decrease in part time and full time staffing levels compared to the first quarter of 2006 and includes transferring the Allentown, Pennsylvania hub operations to DHL in January 2007.

Table of Contents

Fuel expense decreased 4% in the first quarter of 2007 compared to the corresponding period in 2006. The decrease was driven by lower consumption of aviation fuel. The average aviation fuel price was $1.96 and $1.98 per gallon in the first quarters of 2007 and 2006, respectively. Our consumption of aviation fuel during the first quarter of 2007 declined compared to the first quarter of 2006 in conjunction with the removal of aircraft by DHL since the third quarter of 2006.

Maintenance, materials and repairs decreased 30% in the first quarter of 2007 compared to the corresponding quarter in 2006. The primary reason for the decrease was the timing of scheduled heavy maintenance work for aircraft. Our policy is to expense these maintenance costs as they are incurred. Accordingly, our aircraft maintenance expenses fluctuate from period to period due to the timing of scheduled heavy maintenance work for aircraft. During the first quarter of 2007, we processed eleven heavy maintenance checks compared to twenty-one in the corresponding period of 2006.

Depreciation and amortization expense increased 9% in the first quarter of 2007 compared to the corresponding quarter in 2006. The increase is primarily a result of five additional Boeing 767 aircraft that we placed in service since March of 2006. Our future depreciation expense will continue to be impacted by the additional Boeing 767 aircraft that we anticipate placing into service during 2007 and 2008.

Landing and ramp expense, which includes the cost of deicing chemicals, increased 29% in the first quarter of 2007 compared to the corresponding quarter in 2006. These expenses increased due to the more difficult winter weather experienced during first quarter of 2007 compared to the first quarter of 2006.

Rent expense increased $0.1 million in the first quarter of 2007 compared to the corresponding quarter of 2006 due to additional rentals for mail sorting centers we operate under contract with the USPS.

Purchased line-haul and yard management expense decreased $63.8 million, or 97%, in the first quarter of 2007 compared to the corresponding quarter in 2006. The decrease is a result of DHL assuming management of its line-haul trucking operations from ABX in May 2006. Expenses from those line-haul management operations were approximately $64.0 million during the first quarter of 2006.

Other operating expenses include pilot travel, professional fees, insurance, utilities, costs of parts sold to non-DHL customers and packaging supplies. Other operating expenses decreased by $0.5 million, or 4%, in the first quarter of 2007 compared to the corresponding quarter in 2006. The decrease is a result of lower professional fees and legal claims.

Our interest expense for the first quarter of 2007 increased $0.3 million compared to the first quarter of 2006. The increase in interest expense is a result of three Boeing 767 aircraft financed through March 31, 2007.

Interest income increased by $0.1 million in the first quarter of 2007 compared to the first quarter of 2006 due to higher short-term interest rates on our cash, cash equivalents, and marketable securities.

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

Table of Contents

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Aircraft commitments

Based on the most current projections, we have commitments to acquire one additional Boeing 767 aircraft and complete the modification of seven additional aircraft in 2007 and one in 2008. We have contracted with an aircraft maintenance and modification provider to convert aircraft from passenger to standard freighter configuration. The estimated cost of the remaining aircraft purchase commitments and the anticipated modification costs approximate $100.7 million, $92.6 million in the remainder of 2007 and $8.1 million in 2008. The status of the Boeing 767 freighter aircraft available outside the ACMI agreement with DHL is shown below:

	At March 31, 2007			
	In Service	In Modification	Future Deliveries	Total
Boeing 767 Freighter Aircraft	5	6	2	13

We plan to finance the cost of modifying the aircraft with existing cash and contractor-provided financing during the modification period. Upon completion of the modification, we anticipate three more aircraft will be financed through a syndication process being arranged by our lead bank, financing approximately $47.3 million. Our future operating results will be affected by the interest rates and other terms and conditions of the new borrowings.

We estimate that contributions to our qualified defined benefit pension plans will be $36.8 million for the remainder of 2007 and total $46.0 million for the year. We estimate our total pension expense, which is reimbursable under the two DHL agreements, will be $36.1 million for the remainder of 2007 for all pension plans, totaling $48.1 million for the year.

Cash flows

Net cash used for operating activities was $21.8 million for the first quarter of 2007 compared to net cash generated from operations of $7.1 million in the first quarter of 2006. During the first quarter of each year, we typically experience large payouts to vendors. Additionally, during the first quarter of 2007, our payments from DHL were lower due to a lower level of operating expenses. By comparison, during the first quarter of 2006, we collected a large receivable from DHL in addition to normal funding receipts.

Capital spending levels are primarily a result of aircraft acquisitions and related freighter modification costs. Cash payments for capital expenditures were $14.7 million in the first three months of 2007 compared to $13.0 million in the first three months of 2006. Our capital expenditures in the first three months of 2007 included the acquisitions of three Boeing 767 aircraft from Delta and cargo modification costs for three aircraft. In the first three months of 2006, our capital expenditures were primarily for the acquisition of three Boeing 767 aircraft and cargo modification cost for a fourth aircraft purchased in 2005. The total level of capital spending for all of 2007 is anticipated to be approximately $149.8 million compared to $89.0 million in 2006.

Liquidity and Capital Resources

As of March 31, 2007, we had approximately $37.4 million of cash balances and $20.2 million of marketable securities. The Company has a $45.0 million credit facility through a syndicated Credit Agreement that expires in December 2008. Borrowings under the agreement are collateralized by substantially all of the Company s assets. The agreement contains an accordion feature to increase the borrowings to a total of $50.0 million if the Company needs additional borrowing capacity. The agreement provides for the issuance of letters of credit on the Company s behalf. As of March 31, 2007, the unused credit facility totaled $35.2 million, net of outstanding letters of credit of $9.8 million.

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

Table of Contents

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

Revenue Recognition

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

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

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

Depreciation

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

Table of Contents

Self-Insurance

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

Contingencies

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

Income Taxes

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

Post-retirement Obligations

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

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

Recent Accounting Pronouncements

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

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

Table of Contents

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

We anticipate that ABX will execute financing transactions for three of the remaining aircraft it is committed to purchase and modify through 2008. The financing transactions are expected to be fixed interest rate aircraft loans based on ten-year U.S. Treasury Notes. To reduce ABX s exposure to rising interest rates before the financing transactions are executed, we entered into forward treasury lock agreements (treasury locks) during the first quarter of 2006. The value of the treasury locks are also based on the ten-year U.S. Treasury rates, effectively countering the effect of changing interest rates on the anticipated financing transactions. The treasury locks are with major U.S. financial institutions and will settle in cash at the time each expires. The outstanding treasury locks are timed to expire between May 2007 and July 2007, near the forecasted execution dates of the anticipated financing transactions. See Note J for a table of treasury lock values and discussion of our accounting treatment for these hedging transactions.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

As of March 31, 2007, ABX carried out an evaluation, under the supervision and with the participation of the Company s management, of the effectiveness of the design and operation of ABX s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)). Based upon the evaluation, ABX s Chief Executive Officer and Chief Financial Officer concluded that ABX s disclosure controls and procedures were effective to ensure that information required to be disclosed by ABX in the reports filed or submitted by it under the Exchange Act is recorded, processed, summarized and reported within time periods specified in the Securities and Exchange Commission rules and forms.

(b) Changes in Internal Controls

There were no significant changes in ABX s internal controls over financial reporting during the quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, ABX s internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

i. Department of Transportation (DOT) Continuing Fitness Review

ABX filed a notice of substantial change with the DOT arising from its separation from Airborne, Inc. In connection with the filing, which was initially made in mid-July of 2003 and updated in April of 2005, 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.

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. certificated air carrier. The DOT may determine that DHL actually controls ABX as a result of its 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 ABX s air carrier certificates and/or authorities, and this would materially and adversely affect the business.

The DOT has yet to specify the procedures it intends to use in processing ABX s filing. We believe the DOT should find that ABX is controlled by U.S. citizens and continues to be fit, willing and able to engage in air transportation of cargo.

ii. ALPA Lawsuit

On August 25, 2003, ABX 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, Inc., now DHL Network Operations (USA), Inc., 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 DHL 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 ABX 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 Administrative Law Judge (ALJ) for the NLRB issued a decision finding that ALPA s grievance and counterclaim violated the secondary boycott provisions of the National Labor Relations Act, and recommended that the NLRB order ALPA to withdraw both actions. ALPA appealed the ALJ s finding to the full NLRB, which subsequently affirmed the ALJ s decision in its own decision and order dated August 27, 2005.

On September 14, 2005, ALPA filed a petition for review with the U.S. Court of Appeals for the Ninth Circuit and that Court subsequently granted ABX s motion to intervene in the case. The parties have filed briefs in the matter, and we are currently waiting for the court to set a date for oral argument. We believe that the NLRB s decision will be sustained on appeal and that ALPA s grievance and counterclaim will be denied.

iii. Alleged Violations of Immigration Laws

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

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

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

25

Table of Contents

On April 13, 2007, a former ABX employee filed a complaint against ABX, a total of three current and former executives and managers of ABX, DHL, Garcia Labor Company, Garcia Labor Company of Ohio, and three former executives of the Garcia Labor companies, in the U.S. District Court for the Southern District of Ohio. The case was filed as a putative class action against the defendants, and asserts violations of the Racketeer Influenced and Corrupt Practices Act (RICO). The complaint, which seeks damages in an unspecified amount, alleges that the defendants engaged in a scheme to hire illegal immigrant workers to depress the wages paid to hourly wage employees during the period from December 1999 to January 2005. ABX is currently preparing to file an answer to the complaint. Management believes the claim is without merit.

iv. Other

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

Item1A. Risk Factors.

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

Item 5. Other Information.

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

Item 6. Exhibits.

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

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

Table of Contents

SIGNATURES

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

ABX AIR, INC.,

a Delaware Corporation

Registrant

/s/ JOSEPH C. HETE

Joseph C. Hete
Chief Executive Officer

Date: May 9, 2007

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

Date: May 9, 2007