COGNIZANT TECHNOLOGY SOLUTIONS CORP
Form 10-Q
November 07, 2008
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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, 2008

¨ **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the transition period from ______ to ______

Commission File Number 0-24429

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**13-3728359**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

Glenpointe Centre West

500 Frank W. Burr Blvd.

Teaneck, New Jersey	**07666**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code (201) 801-0233

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Indicate the number of shares outstanding of each of the issuer s class of common stock, as of November 3, 2008:

Class	**Number of Shares**
Class A Common Stock, par value $.01 per share	291,187,366

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (unaudited).

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME

(Unaudited)

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenues	$ 734,726	$ 558,837	$ 2,063,259	$ 1,535,621
Operating expenses:				
Cost of revenues (exclusive of depreciation and amortization expense shown separately below)	405,936	317,286	1,153,068	864,521
Selling, general and administrative expenses	166,685	126,551	482,643	356,514
Depreciation and amortization expense	19,474	13,870	53,544	39,183
Income from operations	142,631	101,130	374,004	275,403
Other income (expense), net:				
Interest income	5,344	7,917	16,428	21,038
Other income (expense), net	(14,777)	2,644	(11,308)	3,156
Total other income (expense), net	(9,433)	10,561	5,120	24,194
Income before provision for income taxes	133,198	111,691	379,124	299,597
Provision for income taxes	20,370	15,537	60,567	45,720
Net income	$ 112,828	$ 96,154	$ 318,557	$ 253,877
Basic earnings per share	$ 0.39	$ 0.33	$ 1.10	$ 0.88
Diluted earnings per share	$ 0.38	$ 0.32	$ 1.06	$ 0.83
Weighted average number of common shares outstanding Basic	291,341	289,559	289,740	287,823
Dilutive effect of shares issuable under stock-based compensation plans	8,464	15,005	9,656	16,236
Weighted average number of common shares outstanding Diluted	299,805	304,564	299,396	304,059
Comprehensive income:				
Net income	$ 112,828	$ 96,154	$ 318,557	$ 253,877
Foreign currency translation adjustments	(15,507)	2,678	(12,942)	4,976
Unrealized gain (loss) on available-for-sale securities, net	46		(3,790)	

Total comprehensive income	$ 97,367	$ 98,832	$ 301,825	$ 258,853

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Unaudited)

(in thousands, except par values)

	September 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 569,262	$ 339,845
Short-term investments	26,134	330,580
Trade accounts receivable, net of allowances of $13,094 and $6,339, respectively	528,621	382,960
Unbilled accounts receivable	71,329	53,496
Deferred income tax assets, net	50,989	75,470
Other current assets	74,873	59,828
Total current assets	1,321,208	1,242,179
Property and equipment, net of accumulated depreciation of $182,300 and $142,981, respectively	453,350	356,047
Long-term investments	162,134	
Goodwill	156,298	148,789
Intangible assets, net	44,855	45,565
Deferred income tax assets, net	38,242	11,949
Other assets	36,141	33,777
Total assets	$ 2,212,228	$ 1,838,306
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 45,753	$ 36,176
Deferred revenue	28,572	29,020
Accrued expenses and other current liabilities	271,573	275,488
Total current liabilities	345,898	340,684
Deferred income tax liabilities, net	8,033	15,145
Other noncurrent liabilities	15,268	14,267
Total liabilities	369,199	370,096
Commitments and Contingencies (See Note 5)		
Stockholders equity:		
Preferred stock, $.10 par value, 15,000 shares authorized, none issued		
Class A common stock, $.01 par value, 500,000 shares authorized, 291,184 and 288,012 shares issued and outstanding, at September 30, 2008 and December 31, 2007, respectively	2,912	2,880
Additional paid-in-capital	523,529	450,567
Retained earnings	1,318,117	999,560
Accumulated other comprehensive income (loss)	(1,529)	15,203
Total stockholders equity	1,843,029	1,468,210
Total liabilities and stockholders equity	$ 2,212,228	$ 1,838,306

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)

	For the Nine Months Ended September 30,	
	2008	2007
Cash flows from operating activities:		
Net income	$ 318,557	$ 253,877
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	53,544	39,183
Provision for doubtful accounts	7,776	3,132
Deferred income taxes	9,902	22,536
Stock-based compensation expense	32,957	26,105
Excess tax benefit on stock option exercises	(16,259)	(36,503)
Changes in assets and liabilities:		
Trade accounts receivable	(156,066)	(115,340)
Other current assets	(24,570)	(31,032)
Other assets	(5,334)	(9,438)
Accounts payable	14,123	3,337
Other current and noncurrent liabilities	2,162	38,567
Net cash provided by operating activities	236,792	194,424
Cash flows from investing activities:		
Purchases of property and equipment	(146,325)	(110,433)
Purchases of investments	(128,332)	(544,475)
Proceeds from maturity or sale of investments	262,160	415,657
Acquisitions, net of cash acquired	(20,956)	(11,955)
Net cash used in investing activities	(33,453)	(251,206)
Cash flows from financing activities:		
Proceeds from issued shares	48,813	47,822
Excess tax benefit on stock option exercises	16,259	36,503
Repurchases of common stock	(27,835)	
Cash flows provided by financing activities	37,237	84,325
Effect of currency translation on cash and cash equivalents	(11,159)	3,008
Increase in cash and cash equivalents	229,417	30,551
Cash and cash equivalents, beginning of year	339,845	265,937
Cash and cash equivalents, end of period	$ 569,262	$ 296,488

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(dollar amounts in thousands)

Note 1 Interim Condensed Consolidated Financial Statements

The terms Cognizant, we, our, us and Company refer to Cognizant Technology Solutions Corporation unless the context indicates otherwise have prepared the accompanying unaudited condensed consolidated financial statements included herein in accordance with generally accepted accounting principles in the United States of America and Article 10 of Regulation S-X under the Securities and Exchange Act of 1934, as amended. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements (and notes thereto) included in our Annual Report on Form 10-K for the year ended December 31, 2007. In our opinion, all adjustments considered necessary for a fair presentation of the accompanying unaudited condensed consolidated financial statements have been included, and all adjustments are of a normal and recurring nature. Operating results for the interim periods are not necessarily indicative of results that may be expected to occur for the entire year. Certain reclassifications have been made to prior year numbers to conform to the current year presentation.

Note 2 Acquisitions

In June 2008, we acquired substantially all the assets of Strategic Vision Consulting, Inc. (SVC), a U.S. based company specializing in IT consulting in the media and entertainment industry, for initial consideration of approximately $12,100 (including direct transaction costs) in cash and stock. The stock consideration consisted of 62,340 shares of Class A common stock valued at $2,206. Additional purchase price, not to exceed $14,000, payable in cash, is contingent on SVC achieving certain financial and operating targets during an earn-out period and will be recorded when the contingency is resolved. We completed this acquisition primarily to strengthen our service capabilities in the media and entertainment industry. We made a preliminary allocation of the purchase price to the tangible and intangible assets and liabilities acquired. The allocation is subject to revision upon completion of our appraisal of the assets acquired and liabilities assumed.

In March 2008, we entered into a business alliance with T-Systems Enterprise Solutions GmbH (T-Systems), a global IT services provider, to jointly go to market targeting select corporations with global delivery requirements for system integration services. As part of this alliance, we acquired T-Systems Indian subsidiary for approximately $11,900, net of cash acquired.

In November 2007, we acquired marketRx, Inc. (marketRx), a U.S.-based leading provider of data analytics and process outsourcing to global life sciences companies in the pharmaceutical, biotechnology and medical devices segments for initial net cash consideration of approximately $136,000 (net of cash acquired of $305 and including direct transaction costs). In addition, the purchase price also included the estimated fair value of unvested stock options assumed by us. We completed this acquisition to strengthen our life sciences industry expertise as well as our data analytics capabilities in order to leverage such capabilities across multiple industries. We made a preliminary allocation of the purchase price to the tangible and intangible assets and liabilities acquired. The allocation is subject to final revision upon completion of our appraisal in the fourth quarter of 2008 of the assets acquired and liabilities assumed. Any changes in the allocation are expected to be immaterial to the consolidated financial statements.

Note 3 Cash Equivalents and Short and Long-Term Investments

The following is a summary of short-term and long-term investments:

	September 30, 2008	December 31, 2007
Available-for-sale securities:		
Auction rate securities	$	$ 282,800
Other	9,689	1,638
Total available-for-sale securities	9,689	284,438

Time deposits		16,445		46,142
Total short-term investments	$	26,134	$	330,580
Long-term investments available-for-sale auction rate securities	$	162,134	$	

The carrying value of the time deposits approximated fair value as of September 30, 2008 and December 31, 2007. Realized gains or losses, if any, on these investments were insignificant for the periods presented.

Effective January 1, 2008, we adopted Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS No. 157). In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff

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Position No. FAS 157 2, Effective Date of FASB Statement No. 157 , which provides a one year deferral of the effective date of SFAS 157 for non financial assets and non financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Therefore, we adopted the provisions of SFAS No. 157 with respect to our financial assets and liabilities only. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under SFAS No. 157 as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS No. 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The adoption of SFAS No. 157 did not have a material impact on our consolidated results of operations and financial condition.

The following table summarizes our financial assets measured at fair value on a recurring basis in accordance with SFAS No. 157 as of September 30, 2008:

	Level 1	Level 2	Level 3	Total
Cash Equivalents:				
Money market funds	$ 291,275	$	$	$ 291,275
Agency discount notes and commercial paper		23,201		23,201
Investments:				
Available-for-sale securities - current				
Available-for-sale securities - non-current			162,134	162,134
Total	$ 291,275	$ 23,201	$ 162,134	$ 476,610

Level 3 assets consist of AAA-rated municipal bonds with an auction reset feature, referred to as auction rate securities, whose underlying assets are generally student loans which are substantially backed by the Federal Family Education Loan Program (FFELP). In February 2008, auctions began to fail for these securities and each auction since then, involving securities remaining in our portfolio as of September 30, 2008, has failed. As of September 30, 2008, our investment in auction rate securities was classified as a long-term investment. The classification of the auction rate securities as long term investments is due to continuing auction failures, the securities stated maturity of greater than one year and the Company s ability to hold such securities beyond one year. These investments are recorded at fair value. The following table provides a summary of changes in fair value of the Company s Level 3 financial assets for the following periods:

	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2008
Balance at the beginning of the period	$ 163,957	$
Transfers in: auction rate securities with failed auctions		176,325
Transfers out: redemptions of called securities	(1,900)	(7,800)

Unrealized gains / (losses) included in other accumulated comprehensive income		77		(6,391)
Balance at the end of the period	$	162,134	$	162,134

We estimated the fair value of these auction rate securities using a discounted cash flow analysis which considered the following key inputs: (i) the underlying structure of each security; (ii) the timing of expected future principal and interest payments; and (iii) discount rates that are believed to reflect current market conditions and the relevant risk associated with each security. We estimated that the fair market value of these securities at September 30, 2008 was $162,134. For the three and nine months ended September 30, 2008, respectively, we recorded an unrealized gain of $77 ($46, net of tax) and a net unrealized loss of $6,391 ($3,790, net of tax) in other comprehensive income reported in the accompanying unaudited condensed consolidated statement of operations and comprehensive income. We concluded that the unrealized losses are temporary based on the following: (i) we believe that the decline in market value is due to general market conditions; (ii) the auction rate securities continue to be of high credit quality and interest is paid when due; and (iii) we have the intent and ability to hold the auction rate securities until a recovery in market value

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occurs. The fair value of these auction rate securities could change significantly in the future and we may be required to record additional unrealized losses or an other than temporary impairment charge against net income if there are further reductions in fair value in future periods.

In October 2008, the FASB issued FSP FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP FAS 157-3), which addresses the application of SFAS 157 for illiquid financial instruments. The adoption of FSP FAS 157-3 did not change our valuation methodology or have an impact on our consolidated financial statements.

In addition to the debt securities noted above, we had approximately $16,457 of time deposits included in cash and cash equivalents and short-term investments as of September 30, 2008.

Below is a summary of our investments of available-for-sale securities in an unrealized loss position as of September 30, 2008:

	Number of Holdings	Market Value	Unrealized Loss
Investments in an unrealized loss position:			
Less than 12 months	34	$ 162,134	$ 6,391
12 months or longer			

As of December 31, 2007, we did not have any available-for-sale securities in an unrealized loss position. As of September 30, 2008 and December 31, 2007, none of our investments in time deposits were in an unrealized loss position.

In October 2008, we received an offer from one of our investment providers, to sell at par value our auction rate securities at any time during an exercise period from June 30, 2010 to July 2, 2012. The offer is non-transferable and expires on November 14, 2008. The acceptance of the offer will likely result in an adjustment to our operating results for the difference between the fair value of the offer, which will likely approximate the unrealized loss, and the unrealized loss on the auction rate securities held. We are in the process of evaluating the offer and its related impact on our consolidated financial statements.

Note 4 Income Taxes

Our Indian subsidiaries (collectively referred to as Cognizant India) are export-oriented companies, which, under the Indian Income Tax Act of 1961, are entitled to claim tax holidays for a period of ten consecutive years for each Software Technology Park (STP) with respect to export profits for each STP. Substantially all of the earnings of Cognizant India are attributable to export profits. The majority of our STPs in India are currently entitled to a 100% exemption from Indian income tax. In May 2008, the Indian government extended the tax holidays for STPs by one year from March 31, 2009 to March 31, 2010. In addition, we have located several new development centers in areas designated as Special Economic Zones (SEZ). Development centers operating in SEZs will be entitled to certain income tax incentives for periods up to 15 years. The incremental Indian taxes related to the taxable STPs, for which the income tax holiday has expired, have been incorporated into our effective income tax rate for 2008. The effective tax rate of 15.3% and 16.0% for the three months and nine months ended September 30, 2008 increased from 13.9% and 15.3% for the three and nine months ended September 30, 2007, respectively. The increase in the effective income tax is primarily attributed to a net benefit recorded during the second quarter of 2007 for the effective settlement of certain foreign income tax positions. Excluding discrete items, the effective rate for the nine months ended September 30, 2008 and 2007 was 16.1% and 16.4%, respectively. This decrease was primarily due to our overall growth, which resulted in a greater percentage of Cognizant India s revenues falling under the income tax holiday, growth in tax jurisdictions in Europe with lower income tax rates than the United States and net reductions in statutory income tax rates, primarily in Europe. The principal difference between the income tax rates for the 2008 and 2007 periods and the U.S. federal statutory rate is the effect of the Indian tax holiday and earnings taxed in countries that have lower rates than the United States.

During 2007, the Indian government passed tax legislation that, among other items, subjects Indian taxpayers to a Minimum Alternative Tax (MAT). The MAT may be credited against Indian income taxes due in future years. We have recorded a deferred income tax asset for taxes due under the MAT.

Note 5 Commitments and Contingencies

As of September 30, 2008, we had outstanding fixed capital commitments of approximately $73,252 related to our India development center expansion program.

We are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the outcome of such claims and legal actions, if decided adversely, is not expected to have a material adverse effect on our business, financial condition and results of operations. Additionally, many of our engagements involve projects that are critical to the operations of our customers business and provide benefits that are difficult to quantify. Any failure in a customer s computer system could result in a claim for substantial damages against us, regardless of our responsibility for such failure. Although we attempt to contractually limit our liability for damages arising from negligent acts, errors, mistakes, or omissions in rendering our software development and maintenance services, there can be no assurance that the limitations of liability set forth in our contracts will be enforceable in all instances or will otherwise protect us from liability for damages. Although we have general liability insurance coverage, including

coverage for errors or omissions, there can be no assurance that such coverage will continue to be available on reasonable terms or will be available in sufficient amounts to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim. The successful assertion of one or more large claims against us that exceed available insurance coverage or changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, would have a material adverse effect on our business, results of operations and financial condition.

Note 6 Segment Information

Our reportable segments are: Financial Services, which includes customers providing banking/transaction processing, capital markets and insurance services; Healthcare, which includes healthcare providers and payers as well as life sciences customers; Manufacturing/Retail/Logistics, which includes manufacturers, retailers, travel and other hospitality customers, as well as customers providing logistics services; and Other, which is an aggregation of industry segments which, individually, are less than 10% of consolidated revenues and segment operating profit. The Other reportable segment includes media and information services, communications and high technology operating segments. Our sales managers, account executives, account managers and project teams are aligned in accordance with the specific industries they serve.

Our chief operating decision maker evaluates the Company s performance and allocates resources based on segment revenues and operating profit. Segment operating profit is defined as income from operations before unallocated costs. Expenses included in segment operating profit consist principally of direct selling and delivery costs as well as a per seat charge for use of our IT development centers. Certain expenses, such as general and administrative, and a portion of depreciation and amortization, are not specifically allocated to specific segments as management does not believe it is practical to allocate such costs to individual segments because they are not directly attributable to any specific segment. Further, stock-based compensation expense and the related stock-based Indian fringe benefit tax are not allocated to individual segments in internal management reports used by the chief operating decision maker. Accordingly, these expenses are separately disclosed as unallocated and adjusted only against our total income from operations. Additionally, management has determined that it is not practical to allocate identifiable assets, by segment, since such assets are used interchangeably among the segments.

Revenues from external customers and segment operating profit, before unallocated expenses, for the Financial Services, Healthcare, Manufacturing/Retail/Logistics, and Other reportable segments for the three months and nine months ended September 30, 2008 and 2007, are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenues:				
Financial Services	$ 339,004	$ 260,673	$ 945,545	$ 717,911
Healthcare	174,183	130,414	498,335	359,080
Manufacturing/Retail/Logistics	115,395	86,452	319,752	233,449
Other	106,144	81,298	299,627	225,181
Total revenues	$ 734,726	$ 558,837	$ 2,063,259	$ 1,535,621
Segment Operating Profit:				
Financial Services	$ 113,981	$ 94,675	$ 327,162	$ 249,752
Healthcare	66,783	54,707	197,847	135,967
Manufacturing/Retail/Logistics	32,955	31,414	104,551	76,741
Other	33,885	29,215	103,216	80,801
Total segment operating profit	247,604	210,011	732,776	543,261
Less: unallocated costs(1)	104,973	108,881	358,772	267,858
Income from operations	$ 142,631	$ 101,130	$ 374,004	$ 275,403

(1) Includes $9,509 and $32,957 of stock-based compensation expense and $660 and $7,492 of stock-based Indian fringe benefit tax expense for the three months and nine months ended September 30, 2008, respectively, and $9,155 and $26,105 of stock-based compensation expense for the three months and nine months ended September 30, 2007, respectively.

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Geographic Area Information

Revenue and long-lived assets, by geographic area, are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenues[(1)]				
North America[(2)]	$ 577,109	$ 458,208	$ 1,627,226	$ 1,284,526
Europe[(3)]	145,028	94,197	405,188	234,686
Asia	12,589	6,432	30,845	16,409
Total	$ 734,726	$ 558,837	$ 2,063,259	$ 1,535,621

	As of September 30, 2008	As of December 31, 2007
Long-lived Assets[(4)]		
North America[(2)]	$ 11,207	$ 12,860
Europe	2,809	1,873
Asia[(5)]	439,334	341,314
Total	$ 453,350	$ 356,047

(1) Revenues are attributed to regions based upon customer location.
(2) Substantially all relates to operations in the United States.
(3) Includes revenue from operations in the United Kingdom of $88,621 and $59,869 and $245,794 and $150,194 for the three months and nine months ended September 30, 2008 and 2007, respectively.
(4) Long-lived assets include property and equipment, net of accumulated depreciation and amortization.
(5) Substantially all of these long-lived assets relate to our operations in India.

Note 7 Recent Accounting Pronouncements

Effective January 1, 2008, we adopted SFAS No. 157. In February 2008, the FASB issued FASB Staff Position No. FAS 157 2, Effective Date of FASB Statement No. 157 , which provides a one year deferral of the effective date of SFAS 157 for non financial assets and non financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Therefore, we adopted the provisions of SFAS No. 157 with respect to our financial assets and liabilities only. Refer to Note 3 Cash Equivalents and Short and Long-Term Investments for additional information regarding adoption of SFAS 157.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of FASB Statement No. 115 (SFAS No. 159), which is effective for our financial statements beginning January 1, 2008. SFAS No. 159 permits entities to measure eligible financial assets, financial liabilities and firm commitments at fair value, on an instrument-by-instrument basis, that are otherwise not permitted to be accounted for at fair value under other generally accepted accounting principles. The fair value measurement election is irrevocable and subsequent changes in fair value must be recorded in earnings. Effective January 1, 2008, we adopted SFAS No. 159 and have chosen not to elect the fair value option for any items that are not already required to be measured at fair value in accordance with accounting principles generally accepted in the United States.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations (SFAS No. 141(R)). This Statement replaces SFAS No. 141, Business Combinations. SFAS No. 141(R) establishes principles and requirements for how an acquiring company: recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to

enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141(R) further changes the accounting treatment for certain specific items, including: acquisition costs will be generally expensed as incurred; acquired contingent liabilities will be recorded at fair value at the acquisition date and subsequently measured at either the higher of such amount or the amount determined under existing guidance for non-acquired contingencies; in-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date; restructuring costs associated with a business combination will be generally expensed subsequent to the acquisition date; and changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense. SFAS No. 141(R) applies prospectively to our business combinations for which the acquisition date is on or after January 1, 2009.

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In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51 (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This statement is effective for periods beginning January 1, 2009. We are currently evaluating the potential impact that SFAS No. 160 will have on our consolidated financial statements.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.
Executive Summary

During the three and nine months ended September 30, 2008, our revenue increased to $734.7 million and $2,063.3 million compared to $558.8 million and $1,535.6 million during the three and nine months ended September 30, 2007. Net income increased to $112.8 million and $318.6 million, respectively, or $0.38 and $1.06 per diluted share, including stock-based compensation expense and stock-based Indian fringe benefit tax expense, net of tax, equal to $0.02 and $0.12 per diluted share, during the three months and nine months ended September 30, 2008. This is compared to net income of $96.2 million and $253.9 million, respectively, or $0.32 and $0.83 per diluted share, including stock-based compensation expense, net of tax, equal to $0.02 and $0.07 per diluted share, during the three months and nine months ended September 30, 2007. The key drivers of our revenue growth during the quarter ended September 30, 2008 were as follows:

- greater penetration of the European market, where we experienced revenue growth of 54% for the quarter as compared to the quarter ended September 30, 2007;

- strong performance across all our business segments, each of which had revenue growth equal to or greater than 30% for the quarter as compared to the quarter ended September 30, 2007, and each segment experienced solid sequential revenue growth from the quarter ended June 30, 2008, which was as follows: 7.9% for Financial Services; 5.9% for Healthcare; 8.0% for Manufacturing/Retail/Logistics and 6.3% for Other;

- expansion of our service offerings, which enabled us to cross-sell new services to our customers and meet the rapidly growing demand for complex large-scale outsourcing solutions;

- increased penetration at existing customers, including strategic customers; and

- continued expansion of the market for global delivery of IT services and business process outsourcing.

We saw a continued increase in demand from our customers for a broad range of IT solutions, particularly high performance web development initiatives and complex systems development engagements, testing, enterprise resource planning or ERP, infrastructure management, business process outsourcing and business intelligence. We finished the quarter with 551 active clients compared to 445 as of September 30, 2007 and increased the number of strategic clients by six during the quarter bringing the total number of our strategic clients to 124. We define a strategic client as one offering the potential to generate between $5 million and $50 million or more in annual revenues at maturity. Our top five and top ten customers accounted for approximately 19.0% and 29.7%, respectively, of our total revenues during the quarter ended September 30, 2008 as compared to approximately 23.6% and 34.2%, respectively, for the quarter ended September 30, 2007. As we continue to add new customers and increase our penetration at existing customers, we expect the percentage of revenues from our top five and top ten customers to continue to decline over time.

In Europe, we continue to experience solid growth. During the quarter ended September 30, 2008, our revenue from European customers increased by 54% to approximately $145.0 million compared to approximately $94.2 million in the quarter ended September 30, 2007. For the quarter ended September 30, 2008, revenue from Europe, excluding the UK, increased by approximately $22.1 million from approximately $34.3 million in the quarter ended September 30, 2007 to approximately $56.4 million. Europe will continue to be an area of heavy investment

for us for the remainder of the year and in 2009 as we see this region as a growth opportunity for the long term.

Our revenue growth is also attributed to increasing market acceptance of, and strong demand for, offshore IT software and services and business process outsourcing. Recent NASSCOM (India s National Association of Software and Service Companies) reports state that India s IT software and services and business process outsourcing sectors were an estimated $40.4 billion industry for the fiscal year ended March 31, 2008, with IT software and services exports and business process outsourcing exports growing 28% and 30%, respectively. The Indian IT software and services and business process outsourcing sectors are expected to grow to $50 billion during the 2009 fiscal year.

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Our Financial Services, Healthcare, Manufacturing/Retail/Logistics and Other business segments reported sequential revenue growth of 7.9%, 5.9%, 8.0% and 6.3%, respectively, from the quarter ended June 30, 2008. Contractions in the credit markets, increases in borrowing rates, a slowdown in the U.S. housing market, currency fluctuation and other factors have all led to increasingly volatile capital markets over the course of the year and the increasing likelihood of a recession that could negatively impact our clients and their ability to pay for services. In addition, we expect that the slowing economy may negatively impact growth across all of our business segments in the near term. This negative trend towards reduced spending is partially mitigated by the fact that we expect the slowing economy will encourage certain companies to utilize the on-site/offshore delivery model as a means to reduce overall IT costs. We have reduced our original hiring plans for 2008 in response to the lower than originally anticipated growth during 2008. Additionally, we intend to continue to closely monitor economic conditions, client spending and other factors and seek to take actions available to us to respond to changing conditions.

Our operating margin increased to approximately 19.4% for the quarter ended September 30, 2008 compared to 18.1% for the quarter ended September 30, 2007. Excluding stock-based compensation costs of approximately $9.5 million and stock-based Indian fringe benefit tax expense of $0.7 million, operating margin for the quarter ended September 30, 2008 was approximately 20.8%. This was above our historic targeted operating margin range, excluding stock-based compensation costs and stock-based Indian fringe benefit tax expense, of 19% to 20% of total revenues and was primarily due to the favorable impact of the depreciation of the Indian rupee versus the U.S. dollar and achieving operating efficiencies as a result of revenue growth outpacing our headcount growth partially offset by an increase in compensation costs. Historically, we have invested our profitability above the 19% to 20% operating margin level, which excludes stock-based compensation and stock-based Indian fringe benefit tax expense, back into our business, which we believe is a significant contributing factor to our strong revenue growth. This investment is primarily focused in the areas of: (i) hiring client partners and relationship personnel with specific industry experience or domain expertise; (ii) training our technical staff in a broader range of IT service offerings; (iii) strengthening our business analytic capabilities; (iv) strengthening and expanding our portfolio of services; (v) continuing to expand our geographic presence for both sales and delivery; and (vi) recognizing and rewarding exceptional performance by our employees. In addition, this investment includes maintaining a level of resources, trained in a broad range of service offerings, to be well positioned to respond to our customer requests to take on additional projects. For the year ending December 31, 2008, we expect to continue to invest amounts in excess of our historical targeted operating margin levels back into the business.

During 2007 and the first quarter of 2008, we experienced pressure on our cost structure due to the appreciation of the Indian rupee versus the U.S. dollar on a year-over-year basis. This is in addition to the continuing wage inflation, primarily in India, that we have experienced over the last several years. However, for the quarter ended September 30, 2008, the Indian rupee depreciated against the U.S. dollar, favorably impacting our operating margin by approximately 188 basis points or 1.88%. Each additional 1% change in the Indian rupee will have the effect of changing our operating margin by approximately 26 basis points or 0.26 percentage points. During the third quarter of 2008, approximately 29% of our global costs were denominated in the Indian rupee. During the remainder of 2008, we expect to continue to optimize the global utilization rates of our technical staff and control discretionary spending in response to the uncertain global economic environment. Accordingly, we believe this balanced approach will permit us to continue to maintain operating margins in our historic targeted operating margin range, which excludes stock compensation costs and stock-based Indian fringe benefit tax expense, of 19% to 20% of total revenues and permit us to continue to make the necessary investments to continue to grow the Company.

We finished the third quarter of 2008 with total headcount of approximately 59,500, an increase of approximately 10,600 over the total headcount at September 30, 2007. The increases in the number of our technical personnel and the related infrastructure costs, to meet the demand for our services, are the primary drivers of the increase in our operating expenses in 2008. Annualized turnover, including both voluntary and involuntary, was approximately 17.6% during the three months ended September 30, 2008. The majority of our turnover occurs in India. As a result, annualized attrition rates on-site at clients are below our global attrition rate. In addition, attrition is weighted towards the more junior members of our staff. We have experienced wage inflation in India, which may continue in the future; however, this has not had a material impact on our results of operations as Indian wages represented less than 20% of our total operating expenses for the three months ended September 30, 2008.

Our current India real estate development program now includes planned construction of approximately 4.3 million square feet of new space. The expanded program, which commenced during the quarter ended March 31, 2007, includes the expenditure of approximately $330 million on land acquisition, facilities construction and furnishings to build new state-of-the-art IT development centers in regions primarily designated as Special Economic Zones located in India. During 2008, we plan to spend approximately $225 million for capital expenditures, the majority of which relates to our India real estate development program.

At September 30, 2008, we had cash and cash equivalents and short-term investments of $595.4 million and working capital of $975.3 million. Accordingly, we do not anticipate any near-term liquidity issues.

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Critical Accounting Estimates and Risks

Management s discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements that have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the amounts reported for assets and liabilities, including the recoverability of tangible and intangible assets, disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. On an on-going basis, we evaluate our estimates. The most significant estimates relate to the recognition of revenue and profits based on the percentage of completion method of accounting for certain fixed-bid contracts, the allowance for doubtful accounts, income taxes, valuation of goodwill and other long-lived assets, valuation of short and long-term investments, assumptions used in valuing stock-based compensation arrangements, contingencies and litigation. We base our estimates on historical experience 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. The actual amounts may differ from the estimates used in the preparation of the accompanying unaudited condensed consolidated financial statements. Our significant accounting policies are described in Note 1 to the audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2007.

We believe the following critical accounting policies require a higher level of management judgments and estimates than others in preparing the consolidated financial statements:

Revenue Recognition. Revenues related to our highly complex information technology application development contracts that are fixed-priced contracts are recognized as the service is performed using the percentage of completion method of accounting. Under this method, total contract revenue during the term of an agreement is recognized on the basis of the percentage that each contract s total labor cost to date bears to the total expected labor cost (cost to cost method). This method is followed where reasonably dependable estimates of revenues and costs can be made. Management reviews total expected labor costs on an ongoing basis. Revisions to our estimates may result in increases or decreases to revenues and income and are reflected in the consolidated financial statements in the periods in which they are first identified. If our estimates indicate that a contract loss will be incurred, a loss provision is recorded in the period in which the loss first becomes probable and reasonably estimable. Contract losses are determined to be the amount by which the estimated costs of the contract exceed the estimated total revenues that will be generated by the contract and are included in cost of revenues in our unaudited condensed consolidated statements of operations. Contract losses for the 2008 and 2007 periods presented were immaterial.

Stock-Based Compensation. Under the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, Share-based Payment (SFAS No. 123R), stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Determining the fair value of stock-based awards at the grant date requires judgment, including estimating the expected term over which stock options will be outstanding before they are exercised, the expected volatility of our stock, the number of stock-based awards that are expected to be forfeited and the expected exercise proceeds for stock-based awards subject to the Indian fringe benefit tax. If actual results differ significantly from our estimates, stock-based compensation expense and our results of operations could be materially impacted.

Income Taxes. Determining the consolidated provision for income tax expense, deferred tax assets and liabilities and related valuation allowance, if any, involves judgment. As a global company, we are required to calculate and provide for income taxes in each of the jurisdictions where we operate. Changes in the geographic mix or estimated level of annual pre-tax income can also affect the overall effective income tax rate. Effective January 1, 2007, we adopted Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of SFAS No. 109 (FIN 48). The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement.

Tax exposures can involve complex issues and may require an extended period to resolve. Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest.

On an on-going basis, we evaluate whether a valuation allowance is needed to reduce our deferred tax assets to the amount that is more likely than not to be realized. While we have considered future taxable income and on-going prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we determine that we will be able to realize deferred tax assets in the future in excess of the net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made. Likewise, should we determine that we will not be able to realize all or part of the net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

Our Indian subsidiaries, collectively referred to as Cognizant India, are export-oriented companies, which, under the Indian Income Tax Act of 1961, are entitled to claim tax holidays for a period of ten consecutive years for each Software Technology Park (STP) with respect to export profits for each STP. Substantially all of the earnings of Cognizant India are attributable to export profits. The majority of our STPs in India are currently entitled to a 100% exemption from Indian income tax. In May 2008, the Indian government extended the tax holidays for STPs by one year from March 31, 2009 to March 31, 2010. The incremental Indian taxes related to the taxable STPs, for which the income tax holiday has expired, have been incorporated into our effective income tax rate for 2008. In anticipation of the complete phase out of the tax holidays in March 2010, we will continue to locate a portion of our new development centers in areas designated as Special Economic Zones (SEZ). Development centers operating in SEZs will be entitled to certain income tax incentives for periods up to 15 years. Under current Indian tax law, export profits after March 31, 2010 from our existing STPs will be fully taxable at the Indian statutory rate (33.99% as of September 30, 2008) in effect at such time. If the tax holidays relating to our Indian STPs are not extended or new tax incentives are not introduced that would effectively extend the income tax holiday benefits beyond March 31, 2010, we expect that our effective income tax rate would increase significantly beginning in calendar year 2010.

Short-term and Long-term Investments. As of September 30, 2008, we had $26.1 million and $162.1 million in short-term and long-term investments, respectively. We have historically invested these amounts in municipal debt securities with interest rates that reset through a Dutch auction process and in corporate notes and bonds, U.S. government agencies, bank time deposits and commercial paper meeting certain criteria. We classify our marketable and debt securities as available-for-sale at the time of purchase and evaluate such designation as of each balance sheet date. We evaluate our investments periodically for possible other-than-temporary impairment by reviewing factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and our ability and intent to hold the investment for a period of time, which may be sufficient for anticipated recovery of market value. An impairment charge would be recorded to the extent that the carrying value of our available-for-sale securities exceeds the fair market value of the securities and the decline in value is determined to be other-than-temporary.

Determining the fair value of our investment in auction rate securities with unobservable inputs that are supported by little or no market activity requires judgment, including determining the appropriate holding period and discount rate to be used in valuing such securities. We value our investment in auction rate securities using a discounted cash flow analysis which incorporates the following key inputs: (i) the underlying structure of each security; (ii) frequency and amounts of cash flows; (iii) expected holding period for the security; and (iv) discount rates that are believed to reflect current market conditions and the relevant risk associated with each security. In estimating the holding period, we considered the current developments in the auction rate market including: our ability to hold the securities for such period of time, recent calls of auction rate securities by issuers and the possible reestablishment of an active market for the auction rate securities that we hold. Based upon these factors, we used a holding period of five years for securities with a stated maturity beyond five years, which represents the period of time we anticipate will elapse before a liquidity event will occur. An increase or decrease in the holding period by two years would change the fair value of our investment in auction rate securities by approximately $2 million. We derive the discount rate by considering observable interest rate yields for bonds supported by student loans and pricing of new bond issuances, and adding an illiquidity premium to such rates. The illiquidity premium was estimated by management considering current market conditions, including very limited recent trading activity for auction rate securities. As of September 30, 2008, we used a weighted-average illiquidity premium of 350 basis points, up from 150 as of June 30, 2008. The increase in the illiquidity premium was precipitated by illiquidity issues in the overall credit and capital markets resulting from recent additional volatility and uncertainty in the credit and money markets. An increase or decrease to the illiquidity premium of 100 basis points would change the estimated fair value of our investment in auction rate securities by approximately $7 million. The increase in the illiquidity premium was mitigated by an increase in the cash flows resulting from an increase in the index rates on which our investments are benchmarked. The collapse of the market for auction rate securities occurred in the first quarter of 2008. However, we anticipate there will be ongoing developments in the market for the auction rate securities that we hold. Accordingly, our estimates of the expected holding period and illiquidity premium used in valuing such securities are reasonably likely to change in the short-term.

Allowance for Doubtful Accounts. We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The allowance for doubtful accounts is determined by evaluating the relative credit-worthiness of each customer, historical collections experience and other information, including the aging of the receivables. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Goodwill. We evaluate goodwill for impairment at least annually, or as circumstances warrant. When determining the fair value of our reporting units, we utilize various assumptions, including projections of future cash flows. Any adverse changes in key assumptions about our businesses and their prospects or an adverse change in market conditions may cause a change in the estimation of fair value and could result in an impairment charge. As of September 30, 2008, our goodwill balance was approximately $156.3 million.

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Long-Lived Assets. In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets , we review long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In general, we will recognize an impairment loss when the sum of undiscounted expected future cash flows is less than the carrying amount of such asset. The measurement for such an impairment loss is then based on the fair value of the asset. If such assets were determined to be impaired, it could have a material adverse effect on our business, results of operations and financial condition.

Risks. Most of our IT development centers, including a majority of our employees, are located in India. As a result, we may be subject to certain risks associated with international operations, including risks associated with foreign currency exchange rate fluctuations and risks associated with the application and imposition of protective legislation and regulations relating to import and export or otherwise resulting from foreign policy or the variability of foreign economic or political conditions. Additional risks associated with international operations include difficulties in enforcing intellectual property rights, limitations on immigration programs, the burdens of complying with a wide variety of foreign laws, potential geo-political and other risks associated with terrorist activities and local and cross border conflicts, potentially adverse tax consequences, tariffs, quotas and other barriers. We are also subject to risks associated with our overall compliance with Section 404 of the Sarbanes-Oxley Act of 2002. The inability of our management and our independent registered public accounting firm to provide us with an unqualified report as to the adequacy and effectiveness of our internal controls over financial reporting for future year ends could result in adverse consequences to us, including, but not limited to, a loss of investor confidence in the reliability of our financial statements, which could cause the market price of our stock to decline. See Part II, Item 1A. Risk Factors .

Results of Operations

Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007

The following table sets forth, for the periods indicated, certain financial data expressed for the three months ended September 30:

(Dollars in thousands)

)8	% of Revenues	2007	% of Revenues	Increase/ (Decrease)
,726	100.0%	$ 558,837	100.0%	$ 175,889
,936	55.2	317,286	56.8	88,650
,685	22.7	126,551	22.6	40,134
,474	2.7	13,870	2.5	5,604
,631	19.4%	101,130	18.1%	41,501
,433)		10,561		(19,994)

,370 15,537 4,833

Base Salary

The Company provides the named executive officers with a base salary to compensate ther
services rendered during the fiscal year. The Compensation Committee determines the bas
for the Chief Executive Officer and the other named executive officers, although the base s
for the latter are determined in consultation with the Chief Executive Officer. The Compen
Committee typically reviews the base salaries of the named executive officers sometime du
the first half of the year as part of the Company's performance review process, as well as i
event of a promotion or other change in job responsibilities. This review primarily takes in
account a compensation analysis, such as the Towers Watson analysis described above; an
internal review of the executive's compensation, both on an individual basis and relative to
executives; and the individual performance of the executive, as evaluated by the Chief Exe
Officer. The Compensation Committee intends to review the base salaries of the Company
named executive officers during the first half of 2014.

The base salaries paid to the named executive officers in 2013 are set forth in the "Salary"
of the "Summary Compensation Table" below.

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Short-Term Incentive Compensation

During 2013, the Company's executives, including the named executive officers, had the p
to earn incentive compensation under the Company’s Executive Incentive Compensation P
“EIC Plan”). The purpose of the EIC Plan is to incentivize executive management to achie
short-term corporate goals. Under the EIC Plan, participants are eligible to receive a cash b
utilizing a non-discretionary formula that establishes a bonus amount, expressed as a perce
of base salary, based upon the extent of achievement of performance measures that are pre
under the EIC Plan. The performance measures selected, and the relevant weight given to e
such performance measure, may vary by participant, provided that, unless otherwise deter
by the Compensation Committee, bonuses will be based on at least two performance meas
one of which will be net income from continuing operations. The other performance measu
that may be utilized under the EIC Plan, include revenue growth, return on capital, earning
share, shipment growth, increase in stock price, return on assets, service or strategic object
The cash-incentive bonus opportunity for each participant varies depending upon the posit
and ranges from 4% to 130% of the participant's base salary earned during the year. The
threshold, target and maximum bonus potentials for the named executive officers in 2013,
included the following:

Named Executive Officer	Threshold	Target	Maximum
Joseph C. Hete	4% of base salary	78% of base salary	130% of base s
Quint O. Turner	4% of base salary	60% of base salary	100% of base s
W. Joseph Payne	4% of base salary	60% of base salary	100% of base s
Richard F. Corrado	4% of base salary	60% of base salary	100% of base s

The Compensation Committee determines the performance measures, and the extent of the
achievement thereof, for the Chief Executive Officer. The Chief Executive Officer, in
consultation with the Compensation Committee, determines the performance measures, an
extent of the achievement thereof, for the other named executive officers.

For 2013, 80% of the named executive officers’ bonus opportunity was based upon the lev
achievement of net income from continuing operations and 20% of their bonus opportunity
based upon the level of achievement of strategic objectives (the "Strategic Objectives"). Th
Compensation Committee determined that Messrs. Hete, Turner, Payne and Corrado (i) ha
achieved any of the targets based on net income from continuing operations, and (ii) had
respectively achieved 84%, 83%, 93% and 80% of the targets associated with the strategic
objectives. The following table shows for each of the named executive officers (i) the
performance measures utilized; (ii) the relevant weight given to the performance measures
on net income from continuing operations and in the aggregate for the strategic objectives;
the potential bonus amounts, at threshold, target and maximum, for the achievement of the
performance measures based on net income from continuing operations, and in total for the
strategic objectives; and (iv) the actual cash incentive bonus achieved for the performance
measures under the EIC Plan for 2013:

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	Component of 2013 Bonus		Potential Bonus Attainment			Ac 201 Bo
			Minimum	Target	Maximum	
Joseph C. Hete						
Net Earnings From Continuing Operations	80.0	%	$17,120	$333,840	$ 556,400	$—
Strategic Objectives	20.0	%	4,280	83,460	139,100	116
Broaden Base of Interest/Investment in Company						
Customer Relations Matters						
Strategic Sales and Marketing Initiatives						
Financing Matters						
Strategic Business Initiatives						
Business Consolidation Matters						
Cost Reduction Matters						
Total						$1
Quint O. Turner						
Net Earnings From Continuing Operations	80.0	%	$9,680	$145,200	$ 242,000	$—
Strategic Objectives	20.0	%	2,420	36,300	60,500	50,
Broaden Base of Interest/Investment in Company						
Customer Relations Matters						
Financing Matters						
Strategic Business Initiatives						
Cost Reduction Matters						
Total						$50
W. Joseph Payne						
Net Earnings From Continuing Operations	80.0	%	$8,960	$134,400	$ 224,000	$—
Strategic Objectives	20.0	%	2,240	33,600	56,000	52,
Customer Relations Matters						
Strategic Business Initiatives						
Business Consolidation Matters						
Cost Reduction Matters						
Total						$52
Richard F. Corrado						
Net Earnings from Continuing Operations	80.0	%	$8,288	$124,320	$ 207,200	$—
Strategic Objectives	20.0	%	2,072	31,080	51,800	41,
Customer Relations Matters						
Strategic Sales and Marketing Initiatives						
Total						$4

The amounts paid to the named executive officers under the EIC Plan for 2013 are also set in the "Non-Equity Incentive Plan Compensation" column of the "Summary Compensation below.

Long-Term Incentive Compensation

The Company's executives, including the named executive officers, and senior managemer eligible to participate in the Company's omnibus long-term incentive plan entitled the Air Transport Services Group, Inc. Amended and Restated 2005 Long-Term Incentive Plan (th Plan"). The purpose of the LTI Plan is to foster and promote the long-term financial succes Company, to reward performance and to increase stockholder value by providing participa appropriate incentives and awards, to enable the Company to attract and retain the services outstanding individuals, to encourage stock ownership in the Company, and to align the in of management and directors with

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that of stockholders. The LTI Plan authorizes a wide range of equity awards, including sto
options, restricted stock awards, restricted stock units, stock awards, stock appreciation rig
performance-based awards payable in shares or cash and other forms of equity compensati
Since the approval of the LTI Plan, the Compensation Committee has granted restricted st
awards and performance-based stock unit awards to the Company's named executive offic
other executives and members of the senior management group on an annual basis under t
terms of the LTI Plan. The amount of the total long-term incentive grants to be received by
named executive officer is typically determined by multiplying the officer's base salary by
percentage, the latter of which depends on the position held. The percentage is 100% in th
of the Chief Executive Officer (Mr. Hete), and 80% in the case of the Chief Financial Offi
Turner), the Sr. Vice President, Corporate General Counsel & Secretary (Mr. Payne) and t
Chief Commercial Officer (Mr. Corrado). The restricted stock awards and performance-ba
stock unit awards are divided evenly, so that half of the long-term incentive compensation
delivered in restricted stock and half is delivered in performance-based stock units. The nu
of shares of restricted stock and performance-based stock units to be received is determine
dividing the value derived above by the closing stock price on the date of grant, provided,
however, that in order to ensure that adequate share reserves are maintained under the LTI
an assumed stock price of $3.00 per share will be used whenever the stock price is trading
that amount as of the date of grant. The Compensation Committee typically authorizes the
of awards at the close of the market on the third full trading day after the issuance of the
Company's earnings for the fourth quarter and year-end.

Restricted Stock Awards

Under the restricted stock award agreements, shares of stock are issued in the name of eac
participant employees, but are held in escrow until they fully vest. Ordinarily, the vesting p
is approximately 34 months from the date of grant. The employees may exercise any votin
associated with the restricted stock while in escrow, and any dividends paid on the restrict
are also held in escrow and paid once they are fully vested. The restrictions will be remove
the stock distributed to the employees if they are actively employed at the end of the vesti
period, but may be settled earlier or forfeited in certain limited circumstances under the te
the award agreements.

The number of shares of restricted stock that were granted to each of the named executive
during fiscal year 2013, all of which will vest at the end of the restriction period, are set fo
the "All Other Stock Awards: Number of Shares of Stock or Units" column of the "Grants
Plan-Based Awards Table" below.

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Performance-Based Stock Unit Awards

Under the performance-based stock unit award agreements, the performance units are conv
to an equal number of shares of common stock and paid out or forfeited, depending upon v
and the extent to which certain performance criteria are met during the performance period
performance period is ordinarily 36 months. The performance-based stock units consist of
types—stock performance units and return-on-invested-capital ("ROIC") units. The agreem
contain an equal number of stock performance units and ROIC units. The performance crit
the stock performance units are based upon the extent to which the appreciation in the Con
stock during the performance period equals or exceeds the total stockholder return perform
the NASDAQ Transportation Index during the same period. Each award agreement contai
following chart, setting forth when the stock performance awards are earned or forfeited:

If, on December 31, [. . . .], the Company's stock performance is . . .	You will rec following nu of shares of Company sto
Below the 40th percentile of the NASDAQ Transportation Index	—
At the 40th percentile of the NASDAQ Transportation Index (threshold Stock Performance Unit level) . . .	#
At the 50th percentile of the NASDAQ Transportation Index (target Stock Performance Unit level) . . .	#
At the 75th or higher percentile of the NASDAQ Transportation Index (maximum Stock Performance Unit Level) . . .	#

For performance outcomes between the 40th percentile and the 75th percentile levels, the ac
awards are interpolated.

The ROIC units are based upon how the Company's average return on invested capital dur
performance period compares to the levels specified under the award agreements. Each aw
agreement contains the following chart, setting forth when the ROIC awards are earned or
forfeited:

If, over the Performance Period, the Company's Average Return on Invested Capital is . . .	You will rec following nu of shares of Company sto
Less than 8%	—
8% ("threshold ROIC Unit level")...	#
10% ("target ROIC Unit level")...	#
12% or higher ("maximum ROIC Unit level")...	#

For performance outcomes between the 8% ROIC and 12% ROIC levels, the actual award
interpolated.

The performance-based stock units (both stock performance units and ROIC units) may be
earlier or forfeited in certain limited circumstances under the terms of the award agreemen

The number of performance-based stock units that were granted to each of the named exec
officers during fiscal year 2013, all or a portion of which may vest at the end of the perforn
period, depending upon and the extent to which the performance criteria are met during the

performance period, are set forth in the “Estimated Future Payouts Under Equity Incentive Awards" columns of the “Grants of Plan-Based Awards Table” below.

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Long-Term Incentive Compensation Grants for 2014

The Compensation Committee authorized the grant of awards under the LTI Plan for 2014
close of the market on the third full trading day after the issuance of the Company's earnin
the fourth quarter and year-ended December 31, 2013. On that date, which was March 10,
the named executive officers were granted the following awards:

	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)[1]			Equity Incentive Plan Award Market or Payout Value of Unearned Shares, Units or O Rights That Have Not Vestec		
	Restricted Stock	Return on Invested Capital Units	Stock Performance Units	Restricted Stock	Return on Invested Capital Units	Stock Perfo Units
Joseph C. Hete	37,000	18,500	18,500	$275,280	$137,640	$ 137
Quint O. Turner	16,700	8,350	8,350	124,248	62,124	62,12
W. Joseph Payne	15,400	7,700	7,700	114,576	57,288	57,28
Richard F. Corrado	15,100	7,550	7,550	112,344	56,172	56,17

(1) The amounts shown reflect the number of shares of restricted stock and performance-based stock units (consisting of an equal number of Return on Investe Capital Units and Stock Performance Units) that were granted to each of the name executive officers for fiscal year 2014 under the Company's LTI Plan. In addition, amounts shown for the performance-based stock units were computed based on the probable outcome of the performance conditions as of the grant date. The LTI Plan described in further detail above under the heading "Long-Term Incentive Compe The grants will vest on December 31, 2016.

(2) The amounts shown were calculated using a per share value of $7.44, the closing n price of our common stock on March 10, 2014. In addition, the amounts shown fo performance-based stock units were computed based on the probable outcome of t performance conditions as of the grant date. Assuming the highest level of outcom maximum value for both the Return on Invested Capital Units and the Stock Perfo Units would be: Hete ($206,460), Turner ($93,186), Payne ($85,932) and Corrado ($84,258).

Equity Compensation Plan Information

The following table sets forth, for the LTI Plan, the number of shares of common stock su
outstanding performance-based stock units and the number of shares remaining available f
future award grants, in each case, as of March 12, 2014.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants, and Rights	Number of S Remaining Available for Future Is Under Equit Compensati Plans (Excluding Securities R in the First Column)

Equity compensation plans approved by stockholders	2,213,679	N/A	1,475,105
Total	2,213,679	N/A	1,475,105

Stock Ownership Guidelines
To better align the interests of the Company's executives, including the named executive o
with the interests of stockholders, the Committee requires that certain executives, includin
named executive officers, maintain a minimum ownership interest in the Company. The an
of stock required to be owned and retained is based on the minimum number of shares tota
value as of the date of grant or purchase (including restricted stock granted under the LTI I
and a multiple of the executive's base salary, which multiple depends upon the position hel
Chief Executive Officer (Mr. Hete) is required to own and retain the minimum number of s
totaling in value as of the

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date of grant or purchase at least three times his base salary. The Chief Financial Officer (I
Turner); Senior Vice President, Corporate General Counsel and Secretary (Mr. Payne); an
Commercial Officer (Mr. Corrado) are each required to own and retain the minimum numl
shares totaling in value as of the date of grant or purchase at least two times their respectiv
salaries. The Company's executives, including the named executive officers, are expected
compliance with the ownership guidelines on or about the third anniversary of the date on
the executive was first elected to the position held.

Company-Sponsored Retirement and Benefit Plans

Retirement Plans

ATSG and its subsidiaries maintain several retirement plans for their executives, including
named executive officers, and other employees that are not covered by a collective bargai
agreement. These plans are designed to help the Company retain and attract employees for
positions. Among these, the named executive officers participate in one or more of the foll
plans: (i) the ABX Air Capital Accumulation Plan, which is both a defined contribution 40
plan (the "CAP 401(k) 5%") and a voluntary 401(k) salary deferral plan (the "CAP 401(k)
ABX Air Retirement Income Plan (the "RIP"), which is a defined benefit pension plan, (ii
ABX Air Profit Sharing Plan (the "PSP"), which is a defined contribution plan (no contrib
have been made to this plan for non-union employees or union employees since December
1999 and December 31, 2009, respectively), (iv) the ABX Supplemental Executive Retire
Plan (the "SERP"), a non-qualified and unfunded plan that provides for benefits in excess
statutory limits, and (v) the Air Transport Services Group, Inc. Nonqualified Deferred
Compensation Plan (the "DCP"), a non-qualified and unfunded plan that provides deferre
compensation in excess of statutory limits.

All eligible full and part-time non-union employees of ATSG, including the named execut
officers, who complete one year of service and work at least 1,000 hours during the year r
company contribution to the CAP 401(k) 5%. Under the CAP 401(k) 5%, employees that
completed three continuous years of employment with the Company and worked at least 1
hours each year, earn the right to receive benefits upon termination. Contributions are calc
as the product of 5% of eligible annual pay for each year of service, and the contributions
deposited in the CAP 401(k) 5%.

Similarly, all full and part-time non-union employees of ATSG, including the named exec
officers, are also eligible to participate in the CAP 401(k), which is a 401(k) plan that allo
voluntary deferrals of up to 75% of an employee's pay, subject to IRS income limits.

Messrs. Hete, Turner and Payne are eligible to receive benefits under the RIP. The RIP is
offset pension plan that works in step with the PSP. Under the RIP, all eligible full and par
non-union employees of ATSG that have completed five continuous years of employment
the Company, earn the right to receive benefits upon termination at the normal retirement
65 or reduced benefits upon early retirement on or after age 55, with 10 or more years of s
Retirement benefits are calculated as the product of 2% times the final average annual elig
for the first 25 years of service and 0.5% times the final average annual eligible pay for ea
after the first 25 years of service, less the actuarial equivalent of the PSP balance. The RIP
frozen on January 14, 2010, and, as such, no years of service or average monthly compens
have been credited to the participants since that date in determining the benefit available u
RIP.

Messrs. Hete, Turner and Payne are eligible to receive benefits under the SERP. The SER
provides an age 62 targeted benefit of 50% of a participant's Final Average Earnings (FA
25 or more years of service, which benefit is reduced by 4% a year for each year of servic

than 25 years. In addition, a participant may elect early retirement as early as age 55 provi
or she has at least 10 years of service with the Company. The benefit is reduced by 6% a y
early retirement before age 62. Participants become vested in the SERP after completing 5
of service with the Company. Prior to the date upon which the SERP was frozen, benefits
through the formula were offset by benefits from Social Security, the RIP, the PSP and the
401(k) 5%. The SERP was frozen on April 14, 2009. Accordingly, years of service used to
calculate the targeted benefit as well as FAEs were frozen as of that date.

Messrs. Turner, Payne and Corrado are eligible to receive benefits under the DCP. The DC
provides deferred compensation to a select group of management and highly compensated
employees (except for any person so employed

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under the terms of a collective bargaining agreement) in an amount equal to the retirement
contributions that cannot be made to the qualified plan in which the eligible employee part
due to IRS compensation limits. The annual contributions made on behalf of the named ex
officers participating under the DCP are dependent upon a number of factors, including the
and bonus paid to the named executive officer during the year, the terms of the qualified p
which he participates, and the annual IRS compensation limit (The annual contributions m
behalf of the named executive officers under the DCP for 2013 are set forth in footnote 4 t
"Summary Compensation Table" below.).

Benefit Plans

The core benefit package for the named executive officers and all other employees of the
Company includes health, dental, vision, short and long-term disability, group term life ins
accidental death and dismemberment ("AD&D") insurance, and certain post-retirement be
The core benefit package is designed to assist the Company in retaining and attracting emp
for key positions. The core benefit package for all of the employees of ATSG, including th
named executive officers, also includes business travel accident insurance. The named exe
officers participate in the Company's benefit plans on the same basis as all other Company
employees, except to the extent described under the heading "Retirement Plans" and "Pote
Payments upon Termination or Change in Control."

Change-in-Control Agreements

The Company has entered into change-in-control agreements with certain of its executives
including the named executive officers. Information regarding applicable payments under
agreements for the named executive officers is set forth under "Potential Payments Upon
Termination or Change in Control" below.

Financial Restatements

Certain bonuses and equity compensation received by the Chief Executive Officer and Chi
Financial Officer must be forfeited as required by applicable law, if the Company is requir
prepare an accounting restatement due to material non-compliance by the Company as a re
misconduct with any financial reporting requirements under the securities laws.

Tax and Accounting Implications

Deductibility of Executive Compensation

As part of its evaluation, the Compensation Committee reviews and considers the deductib
executive compensation under Section 162(m) of the Internal Revenue Code, which provid
the Company may not deduct compensation of more than $1,000,000 that is paid to certain
individuals. The Compensation Committee believes that the compensation paid under the
Company's incentive compensation plans is generally fully deductible for federal income t
purposes and, further, that all of the compensation earned in 2013 by the Company's execu
including the named executive officers, will be deductible.

Accounting for Stock-Based Compensation

The Company began accounting for stock-based payments in accordance with the requiren
FASB ASC Topic 718, beginning with the initial grant of awards under the Company's Ar
and Restated 2005 Long-Term Incentive Plan.

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Compensation Committee Report

This report will not be deemed to be incorporated by reference by any general statement incorporating this Proxy Statement into any filing of the Company with the SEC under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, e to the extent the Company specifically incorporates this information by reference and will deemed soliciting material or deemed filed under those Acts.

The Compensation Committee of the Board of Directors has reviewed and discussed the Company's Compensation Discussion and Analysis required by Item 402(b) of Regulation with management and, based on such review and discussion, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in the Company's definitive proxy statement on Schedule 14A for its 2014 Annual Meeting, which is incorporated by reference in the Company's Annual Report on Form 10 the fiscal year ended December 31, 2013, each as filed with the Securities and Exchange Commission.

Respectfully submitted,
The Compensation Committee
J. Christopher Teets, Chairman
James H. Carey
John D. Geary
Arthur J. Lichte
Jeffrey J. Vorholt

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Summary Compensation Table

The following table sets forth the total compensation earned by, including the stock award granted to, each of the named executive officers for the fiscal years ended December 31, 2013, December 31, 2012, and December 31, 2011.

Name and Principal Position	Year	Salary ($)	Stock Awards(1)	Non-Equity Incentive Plan Compensation(2)	Change in Pension Value and Non-qualified Deferred Compensation Earnings(3)	All Other Compensation(4	To
Joseph C. Hete	2013	$535,000	$551,208	$ 116,844	$ (353,334)	$ 17,654	$8
President &	2012	520,000	553,014	159,250	410,769	15,870	1,(
Chief Executive Officer	2011	470,000	746,730	256,150	637,259	14,842	2,
Quint O. Turner	2013	302,500	250,128	50,215	(165,635)	21,897	45
Chief Financial	2012	285,000	233,415	79,800	125,221	14,353	73
Officer	2011	265,000	358,968	119,250	195,941	14,038	95
W. Joseph Payne	2013	280,000	231,600	52,080	(68,746)	20,145	51
Senior VP Corp General	2012	266,500	221,445	71,289	49,534	14,237	62
Counsel & Secretary	2011	250,000	348,192	112,500	77,313	13,935	80
Richard F. Corrado	2013	259,077	214,230	41,440	—	37,984	55
Chief	2012	246,000	204,687	56,580	—	31,759	53
Commercial Officer	2011	240,000	183,192	108,000	—	91,400	62

(1) The amounts shown reflect the aggregate grant date fair value, in accordance with F ASC Topic 718, of restricted stock and performance-based stock units under the LT The amounts shown for the performance-based stock units were computed based on probable outcome of the performance conditions as of the grant date. Assuming the l level of outcome, the maximum value of the performance-based stock units in 2013 have been: Hete ($696,684), Turner ($316,224), Payne ($292,800) and Corrado ($27 Assuming the highest level of outcome, the maximum value of the performance-bas units in 2012 would have been: Hete ($699,468), Turner ($295,230), Payne ($280,0 Corrado ($258,894). Assuming the highest level of outcome, the maximum value of performance-based stock units in 2011 would have been: Hete ($870,533), Turner ($411,402), Payne ($397,713) and Corrado ($232,713). Assumptions used in the calc of these amounts are included in Note L to the Company's audited financial stateme the fiscal year ended December 31, 2013, included in the Company's Annual Report Form 10-K filed with the SEC on March 5, 2014. The LTI Plan is described in furth above under the heading "Long-Term Incentive Compensation."

(2) The amounts shown reflect the award of cash incentive compensation on March 21, March 22, 2013 and March 16, 2012, under the EIC Plan. The EIC Plan is described

further detail above under the heading "Short-Term Incentive Compensation."

(3) The amounts shown reflect the respective actuarial increases (decreases) in the prese value of the named executive officers' benefits under the RIP and the SERP, determi using interest rate and mortality rate assumptions consistent with those used in the Company's financial statements. The SERP provides an age 62 targeted benefit of 50 participant's Final Average Earnings (FAEs) at 25 years of service. For each year of below 25 years, a 4% per year reduction factor is applied. If a participant retires betw ages 55 and 62, an additional 6% per year reduction factor is applied. The targeted 5 benefit is offset by the RIP (before the PSP offset) or the actuarial equivalent of the employer contribution under the CAP 401(k) 5% and an estimated Social Security be based on the maximum amount. If a participant terminates prior to age 55, the SERP will be payable at age 55. If a participant does not have 5 years of service at terminat they are not eligible for a SERP benefit. The SERP benefit will be paid as a lump sur on RP 2000 annuitant mortality projected to 2018 and 5.55% interest. The decrease i as compared to 2012 for Messrs. Hete, Turner and Payne was primarily attributable t higher market discount rates in 2013. Mr. Corrado does not participate in the RIP or SERP.

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(4) The amounts shown reflect the value of contributions made by the Company to each named executive officers pursuant to the CAP 401(k) 5%, the value of contributions by the Company to each of the named executive under the DCP, the dollar value of l insurance premiums paid by the Company for the benefit of each of the named execu officers, relocation assistance paid by the Company, and commuting and temporary l expenses paid by the Company for each named executive officer, as follows:

(a) The amounts for Mr. Hete include contributions made by the Company pursuant to t 401(k) 5% ($12,750, $12,500 and $12,250 for 2013, 2012 and 2011, respectively) an dollar value of life insurance premiums paid by the Company ($4,904, $3,370 and $2 for 2013, 2012 and 2011, respectively).

(b) The amounts for Mr. Turner include contributions made by the Company pursuant to CAP 401(k) 5% ($12,750, $12,500 and $12,250 for 2013, 2012 and 2011, respective the DCP ($6,365 for 2013), and the value of life insurance premiums paid by the Co ($2,782, $1,853 and $1,788 for 2013, 2012 and 2011, respectively).

(c) The amounts for Mr. Payne include contributions made by the Company pursuant to CAP 401(k) 5% ($12,750, $12,500 and $12,250 for 2013, 2012 and 2011, respective the DCP ($4,814 for 2013), and the value of life insurance premiums paid by the Co ($2,580, $1,737 and $1,685 for 2013, 2012 and 2011, respectively).

(d) The amounts for Mr. Corrado include contributions made by the Company pursuant CAP 401(k) 5% ($12,750, $12,500 and $12,250 for 2013, 2012 and 2011, respective the DCP ($3,033 for 2013), the value of life insurance premiums paid by the Compa ($2,379, $1,594 and $1,555 for 2013, 2012 and 2011, respectively), relocation assist ($16,124 for 2011), commuting expenses ($4,761, $8,274 and $43,131 for 2013, 201 2011, respectively) and housing and other living expenses ($15,061, $9,391 and $18 2013, 2012 and 2011, respectively).

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Grants of Plan-Based Awards Table

The following table summarizes the grants of plan-based awards made to each of the name
executive officers during the fiscal year ended December 31, 2013.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards[1]			Estimated Future Payouts Under Equity Incentive Plan Awards[2]			All Other Stock Awards: Number of Shares of Stock or Units (#) [3]	Gr Da Va Sto Op Aw
		Threshold ($)	Target ($)	Maximum ($)	Threshold (#)	Target (#)	Maximum (#)		
Joseph C. Hete	3/4/2013*				16,660	23,800	35,700		$ 1
	3/4/2013**				16,660	23,800	35,700		12
	3/4/2013							47,600	25
	N/A	$21,400	$417,300	$695,500					
Quint O. Turner	3/4/2013*				7,560	10,800	16,200		73
	3/4/2013**				7,560	10,800	16,200		58
	3/4/2013							21,600	11
	N/A	12,100	181,500	302,500					
W. Joseph Payne	3/4/2013*				7,000	10,000	15,000		67
	3/4/2013**				7,000	10,000	15,000		54
	3/4/2013							20,000	10
	N/A	11,200	168,000	280,000					
Richard F. Corrado	3/4/2013*				6,475	9,250	13,875		62
	3/4/2013**				6,475	9,250	13,875		50
	3/4/2013							18,500	10
	N/A	10,360	155,400	259,000					

(1) The amounts shown reflect the threshold, target and maximum payment levels under EIC Plan. The EIC Plan is described in further detail above under the heading “Short Incentive Compensation.” There is no grant date for awards made under the EIC Pla actual payments were made on March 21, 2014 and are disclosed above under the “Non-Equity Incentive Plan Compensation” column of the “Summary Compensation

(2) The amounts shown reflect the threshold, target and maximum number of shares of Company stock that can be awarded to each of the named executive officers with res the grant of stock performance units and ROIC units made under the LTI Plan. The I

Plan is described in further detail above under the heading “Long-Term Incentive Compensation.” The stock performance units are identified with an "*" and the ROI are identified with an "**".

(3) The amounts shown reflect the number of shares of restricted stock that were awarde each of the named executive officers under the LTI Plan. The LTI Plan is described i further detail above under the heading “Long-Term Incentive Compensation.”

(4) The amounts shown reflect the aggregate grant date fair value, in accordance with F ASC Topic 718, of restricted stock and performance-based stock units under the LT This amount assumes the performance-based stock units were computed based on th probable outcome of the performance conditions as of the grant date. Assumptions u the calculation of these amounts are included in Note L to the Company’s audited fi statements for the fiscal year ended December 31, 2013, included in the Company’s Report on Form 10-K filed with the SEC on March 5, 2014. The LTI Plan is describ further detail above under the heading “Long-Term Incentive Compensation.”

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Outstanding Equity Awards at Fiscal Year-End Table
The following table sets forth information about outstanding equity awards held by the nar
executive officers as of December 31, 2013.

Name	Grant Date	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)(1)			Equity Incentive Plan Award Market or Payout Value of Unearned Shares, Units or O Rights That Have Not Veste		
		Restricted Stock	Return on Invested Capital Units	Stock Performance Units	Restricted Stock	Return on Invested Capital Units	Stoc Perf Unit
Joseph C. Hete	3/8/2012	46,200	23,100	34,650	$373,758	$186,879	$ 28
	3/4/2013	47,600	23,800	35,700	385,084	192,542	288,
Quint O. Turner	3/8/2012	19,500	9,750	14,625	157,755	78,878	118,
	3/4/2013	21,600	10,800	16,200	174,744	87,372	131,
W. Joseph Payne	3/8/2012	18,500	9,250	13,875	149,665	74,833	112,
	3/4/2013	20,000	10,000	15,000	161,800	80,900	121,
Richard F. Corrado	3/8/2012	17,100	8,550	12,825	138,339	69,170	103,
	3/4/2013	18,500	9,250	13,875	149,665	74,833	112,

(1) The amounts shown reflect the number of shares of restricted stock and performance stock units that were granted to each of the named executive officers for fiscal years and 2013 under the LTI Plan. The LTI Plan is described in further detail above unde heading "Long-Term Incentive Compensation." The grants made in fiscal years 201 2013 will vest on December 31, 2014, and December 31, 2015, respectively.

(2) The amounts shown were calculated using a per share value of $8.09, the closing ma price of our common stock on December 31, 2013. In addition, the amounts shown a that the stock performance units will be paid out at the maximum level for both the 2 and 2013 awards and the ROIC units will be paid out at the target level for both the 2 and 2013 awards, based on the Company's performance under the respective awards December 31, 2013.

Vested Equity Awards at Fiscal Year-End Table
The following table sets forth information about equity awards held by the named executiv
officers that vested on December 31, 2013.

Name	Number of Shares Acquired on Vesting (#)(1)			Value Realized on Vesting ($)		
	Restricted Stock	Return on Invested Capital Units	Stock Performance Units	Restricted Stock	Return on Invested Capital Units	Stoc Perfo Units

Joseph C. Hete	25,500	—	12,240	$206,295	$—	$78,
Quint O. Turner	10,800	—	5,184	87,372	—	33,0
W. Joseph Payne	10,200	—	4,896	82,518	—	31,2
Richard F. Corrado	10,200	—	4,896	82,518	—	31,2

(1) The amounts shown reflect the number of shares of restricted stock and performance stock units that were granted to each of the named executive officers for fiscal year 2 that vested on December 31, 2013, under the LTI Plan. The LTI Plan is described in detail above under the heading “Long-Term Incentive Compensation.”

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(2) The amounts shown were calculated using a per share value of $8.09 for the restricte stock, which was the closing market price of our common stock on the date of vestin December 31, 2013, and a per share value of $6.38 for the performance-based stock which was the closing market price of our common stock on the date that the stock v issued, March 3, 2014.

Pension Benefits Table

The table below shows the present value of accumulated benefits payable to each of the na executive officers, including the number of years of service credited to each of the named executive officers, under the RIP and the SERP, determined using interest rate and mortali assumptions consistent with those used in the Company's financial statements.

Name	Plan Name[1]	Number of Years Credited Service (#)	Present Va of Accum Benefit ($
Joseph C. Hete	Retirement Income Plan	29.3	$650,645
	Supplemental Executive Retirement Plan	25.0	3,327,804
Quint O. Turner	Retirement Income Plan	21.6	412,042
	Supplemental Executive Retirement Plan	20.8	408,828
W. Joseph Payne	Retirement Income Plan	14.7	300,921
	Supplemental Executive Retirement Plan	13.9	—
Richard F. Corrado[3]	Retirement Income Plan	N/A	—
	Supplemental Executive Retirement Plan	N/A	—

(1) The RIP and the SERP are described in further detail above under the heading, "Reti Plans."

(2) The valuation method and assumptions used to calculate the amounts shown are incl Note H to the Company's audited financial statements for the fiscal year ended December 31, 2013, included in the Company's Annual Report on Form 10-K filed SEC on March 5, 2014, and are based on the SERP in effect as of December 31, 201

(3) Mr. Corrado does not participate in the RIP or the SERP.

Potential Payments Upon Termination or Change in Control

Payments Made Upon Retirement

Certain of the named executive officers participated in the RIP and the SERP in 2013. The plans are discussed above under the heading "Retirement Plans" and the present value of accumulated benefits payable to each of the named executive officers under these plans is described above under the heading "Pension Benefits Table."

In addition, the restriction on any shares of restricted stock would be removed automaticall the stock distributed to the executive in conjunction with his retirement. Further, a pro-rata portion of the award of any performance-based stock units would be paid out to the execut the end of the performance period.

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Payments Made Upon Disability

Under the terms of ATSG's short-term disability plan, each of the named executive officer be entitled to receive 50% of his annual base salary (up to a maximum of $1,000 per week six-month period beginning 15 days from the date he first became disabled. In the event th named executive officer continued to be disabled for a period longer than six months, he w entitled to participate under the Company's long-term disability plan. Under ATSG's long disability plan, the named executive officer would be entitled to receive 66 2/3% of his an base salary (up to a maximum of $15,000 per month) during the period of disability. The payments would continue until the named executive officer died, ceased to have a disabilit reached his normal retirement age for purposes of receiving Social Security benefits. The definition of disability is the same as that used for the disability plans covering all full-tim non-union employees of ATSG. Namely, the named executive officer must be unable to pe the material and substantial duties of his occupation. Further, after 24 months, the named executive officer must be unable to perform the duties of any gainful occupation for which reasonably fitted by education, training or experience. The disability benefits would be red by any benefits payable under the Company's pension plans, social security, workers compensation or via subrogation against a third party.

In addition, the restriction on any shares of restricted stock would be removed automatical the stock distributed to the named executive officer in the event that he were to become di Further, a pro-rata portion of the award of any performance-based stock units would be pa to the named executive officer at the end of the performance period.

Payments Made Upon Death

In the event of the death of a named executive officer, his surviving spouse would receive amounts that have accrued and vested under the RIP and the SERP in the form of a 50% jo survivor benefit and his beneficiaries would receive those amounts that have accrued and v under the PSP, which benefit plans are discussed above in this Proxy Statement, including the headings "Summary Compensation Table" and "Pension Benefits." In addition, the na executive officer's beneficiaries would receive life insurance proceeds in the amount of 2 his annual base salary, rounded up to the next $10,000, up to a maximum of $1,500,000. F in the event the cause of death was attributable to an accident, the beneficiaries would rece additional 2 1/2 times the named executive officer's annual base salary, rounded up to the $10,000, up to a maximum of $1,500,000 over and above the life insurance benefit. Furthe event the cause of death was attributable to an accident while traveling on company busine beneficiaries would receive an additional 2 times annual base salary, rounded up to the ne $1,000, up to a maximum of $500,000 over and above the life insurance benefit and accide death benefit.

In addition, the restriction on any shares of restricted stock would be removed automatical the stock distributed to the name executive officer's beneficiaries in the event of his death. Further, a pro-rata portion of the award of any performance-based stock units would be pa to the named executive officer's beneficiaries at the end of the performance period.

Payments Upon Change In Control

The Company has entered into change-in-control agreements with certain of its executives including the named executive officers, as described below under the heading "Potential P Upon Termination or Change in Control Table." The purpose of the agreements is to assis retaining the executives and better enable them to function effectively without distraction i event that uncertainty as to the future control of the Company and/or a subsidiary should a the result of a merger proposal or acquisition attempt by third parties. The agreements pro

that, in the event of a change in control of the Company or the subsidiary that employs the
executive, the executive will have the right to remain employed, at not less than his respec
of compensation in effect as of the date of the change in control, for at least four years ther
A change in control is generally defined in the agreements as (i) the direct or indirect acqu
by any person of a greater than 50% ownership interest in or voting power over the Compa
the subsidiary of the Company that employs the executive, (ii) the direct or indirect acquis
any person, within any 12 month period, of a 30% or more ownership interest in or voting
over the Company or the subsidiary of the Company that employs the

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executive, (iii) a majority of the members of the Board are replaced during any 12 month p
by directors whose appointment or election is not endorsed by a majority of the members o
Board prior to the date of the appointment or election, or (iv) the acquisition by any person
within any 12 month period, of assets from the Company or the subsidiary of the Company
employs the executive that have a total gross fair market value equal to or more than 40%
total gross fair market value of all of the assets of the Company or the subsidiary, as applic
The agreements generally provide that, if an executive is terminated without "cause" (defi
willful and continued failure to perform duties after demand from the Board, or willful or g
misconduct) within four years after a change in control, the Company must pay the executi
addition to all accrued compensation, the equivalent of two years' (three years' in the case
Chief Executive Officer) salary and bonus. In addition, the executive is entitled to the
continuation of his group health insurance coverage and certain other benefits for the rema
the term of the agreement, reimbursement for outplacement services and, if a participant,
increased benefits under the SERP. The Company or subsidiary that employs the executive
required to provide the same additional compensation and benefits described above in the e
an executive officer resigns due to a material reduction by his employer in his salary, autho
duties or responsibilities or a material change in the geographic location of his employmen
The agreements require for the Company to make a tax gross-up payment to reimburse the
executive officer for any excise tax and associated income taxes on excess parachute paym
outlined under Section 280G and 4999 of the Internal Revenue Code. However, the Board
the recommendation of the Compensation Committee, adopted a policy in March 2014 wh
provides that the Company will no longer include tax gross-up payments in any change-in-
agreements that it enters into with its executives, including the named executive officers, i
future. In addition, the Compensation Committee has determined to undertake a review the
current change-in-control agreements that it has with its executives, including the named
executive officers, with the intent of securing amendments to those agreements by the end
year, that eliminates the tax gross-up provisions contained therein.
In the event of a change in control, the restrictions on any shares of restricted stock will la
the stock will be distributed. In addition, the performance objectives imposed on any
performance-based stock units will be deemed to have been met at the threshold level or a
higher level actually achieved as of the date of the change in control ("Accelerated Units")
executive will receive cash or stock (depending on the nature of the change in control) as i
performance period ended on the date of the change in control. The amount awarded with
to performance-based stock units will be determined by multiplying the Accelerated Units
number of whole months between the beginning of the performance period and the date of
change in control divided by the number of whole months in the performance period.

Potential Payments Upon Termination or Change in Control Table

The table below shows potential payments to each of the named executive officers upon (i
retirement, (ii) disability, (iii) death or (iv) termination upon a change in control of the Co
The amounts shown assume that a termination was effective as of December 31, 2013 and
estimates of the amounts that would be paid to the executives upon their termination in add
the base salary and bonus earned by the executives during 2013 and any applicable pensio
amounts payable to the executive officers described above under the headings "Pension Be
and "Pension Benefits Table." The actual amounts that would be paid can only be determi
actual time of an executive's termination.

Name	Type of Benefit	Retirement ($)	Disability ($)	Death ($)	Terminat Without

					for Good Reason After a Change i ($)
Joseph C. Hete	Long-Term Disability Payments(1)	—	180,000	—	—
	Life and Accidental Death Insurance Proceeds(2)	—	—	1,380,000	—
	Restricted Stock(3)	758,842	758,842	758,842	758,842
	Performance-Based Stock Units(4)	471,917	471,917	471,917	471,917

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	Severance Pay under Change-in-Control Agreement[5]	—	—	—	2,038,7
	Health Care Continuation Coverage[6]	22,592	—	—	98,306
	Premiums for Life, AD&D, Short-Term Disability and Long-Term Disability Insurance[7]	—	—	—	25,540
	Job Outplacement Services[8]	—	—	—	10,000
Quint O. Turner	Long-Term Disability Payments[1]	—	180,000	—	—
	Life and Accidental Death Insurance Proceeds[2]	—	—	780,000	—
	Restricted Stock[3]	—	332,499	332,499	332,49
	Performance-Based Stock Units[4]	—	204,273	204,273	204,27
	Severance Pay under Change-in-Control Agreement[5]	—	—	—	758,68
	Health Care Continuation Coverage[6]	—	—	—	98,306
	Premiums for Life, AD&D, Short-Term Disability and Long-Term Disability Insurance[7]	—	—	—	19,319
	Job Outplacement Services[8]	—	—	—	10,000
W. Joseph Payne	Long-Term Disability Payments[1]	—	180,000	—	—
	Life and Accidental Death Insurance Proceeds[2]	—	—	720,000	—
	Restricted Stock[3]	—	311,465	311,465	311,46
	Performance-Based Stock Units[4]	—	192,138	192,138	192,13
	Severance Pay under Change-in-Control Agreement[5]	—	—	—	716,41
	Health Care Continuation Coverage[6]	—	—	—	98,306
	Premiums for Life, AD&D, Short-Term Disability and Long-Term Disability Insurance[7]	—	—	—	18,697
	Job Outplacement Services[8]	—	—	—	10,000
Richard F. Corrado	Long-Term Disability Payments[1]	—	180,000	—	—
	Life and Accidental Death Insurance Proceeds[2]	—	—	700,000	—
	Restricted Stock[3]	—	288,004	288,004	288,00

Performance-Based Stock Units[4]	—	177,643	177,643	177,64
Severance Pay under Change-in-Control Agreement[5]	—	—	—	681,13
Health Care Continuation Coverage[6]	—	—	—	98,306
Premiums for Life, AD&D, Short-Term Disability and Long-Term Disability Insurance[7]	—	—	—	18,490
Job Outplacement Services[8]	—	—	—	10,000

(1) This amount represents the value of long-term disability payments for one year. Howe the executive officer would receive short-term disability benefits for the first six mont any disability, which in the case of the named executive officers would constitute 50% their base salary (up to a maximum of $1,000 per week).

(2) This amount assumes the cause of death was not attributable to an accident. The follo amounts would be paid to the named executive officers' beneficiaries in the event the of death was attributable to an accident: Hete ($2,760,000), Turner ($1,560,000), Pay ($1,440,000) and Corrado ($1,400,000). Further, the following amounts would be pai executive officers' beneficiaries in the event the cause of death was attributable to an while traveling on business: Hete ($3,260,000), Turner ($2,060,000), Payne ($1,940,0 and Corrado ($1,900,000).

(3) These amounts were calculated using a per share value of $8.09, the closing market p our common stock on December 31, 2013. Mr. Hete became eligible for early retirem of April 3, 2009.

(4) These amounts were calculated using a per share value of $8.09, the closing market p our common stock on December 31, 2013. In addition, the performance-based stock u awarded in 2012 and 2013 were valued at the maximum amount for the stock perform units and the target amount for the ROIC units. Mr. Hete became eligible for early ret as of April 3, 2009.

(5) This amount constitutes the equivalent of two years' (three years' in the case of Mr. H salary and bonus for the named executive officer as well as the cash value of contribu that the Company would have made on his behalf for a 3-year period under the CAP 4 5%.

(6) The amount contained in the "Retirement" column for Mr. Hete constitutes the cumul value of the portion of his retiree medical coverage that the Company would have pai behalf until he reaches age 65, and is merely intended as an estimate. Mr. Hete becam eligible for early retirement as of April 3, 2009. The amount contained in the "Termin Without Cause or for Good Reason Under an Employment Agreement or After a Cha Control" column reflects the value of COBRA continuation coverage for the 4-year te the change-in-control agreement and is merely intended as an estimate. Under the change-in-control agreement, the Company will pay the named executive officer's he insurance premiums for the remaining term of the agreement, provided that the execu elected COBRA continuation coverage, and at the end of such continuation coverage shall arrange for the executive to receive health benefits substantially similar to those the executive was receiving immediately prior to the termination of the coverage peri

(7) This amount constitutes the value of life, AD&D, short-term disability and long-term disability insurance premiums that the Company would have paid on the named execu officer's behalf for the 4-year term of the change-in-control agreement and is merely intended as an estimate.

(8) This constitutes the maximum amount that the Company will pay or reimburse to the executive officer for job outplacement services under the terms of the change-in-contr agreement.

Compensation Committee Interlocks and Insider Participation

No interlocking relationship exists between the members of the Company's Board of Direc Compensation Committee and the board of directors or compensation committee of any ot company, nor has any such interlocking relationship existed in the past. None of the memb the Compensation Committee are officers or employees, or former officers or employees, o Company or any of its subsidiaries.

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STOCK OWNERSHIP OF MANAGEMENT

The following table sets forth information as to the shares of common stock beneficially o
(or deemed to be beneficially owned pursuant to the rules of the SEC) by each director of t
Company and the named executive officers on March 12, 2014, and by all directors and ex
officers as a group:

Name	Common Stock of the Company Beneficially Owned(1)	Percent Comm Outstar
Directors(3)		
Richard A. Baudouin	—	*
James H. Carey	41,413	*
John D. Geary	13,000	*
Arthur J. Lichte	—	*
Randy D. Rademacher	25,000	*
J. Christopher Teets(4)	—	*
Jeffrey J. Vorholt(7)	90,000	*
Named Executive Officers(5)		
Joseph C. Hete, President and Chief Executive Officer(6)	783,967	1
Quint O. Turner, Chief Financial Officer	289,593	*
W. Joseph Payne, Senior Vice President, Corporate General Counsel & Secretary	191,463	*
Richard F. Corrado, Chief Commercial Officer	82,512	*
All Directors and Executive Officers as a Group (11 Persons)	1,516,948	2.3

* Less than 1% of common stock outstanding.

(1) Except as otherwise noted, none of the individuals shares with another person either or investment power as to the shares reported.

(2) Based on 64,850,537 shares outstanding (which includes 676,600 shares of restricte

(3) The stock ownership information for the directors does not include restricted stock u held by the following directors in the following amounts: Messrs. Baudouin (23,817 (106,829), Geary (101,829), Lichte (23,817), Rademacher (89,429), Teets (69,829) a Vorholt (101,829).

(4) The information for Mr. Teets does not include shares beneficially owned by Red M Capital Partners LLC (as described in footnote 1 on page 4 of this Proxy Statement). Mr. Teets, a Partner of Red Mountain Capital Partners LLC, disclaims beneficial ow of the shares of the Company beneficially owned by Red Mountain Capital Partners

(5) These amounts include the restricted shares held by Messrs. Hete (130,800), Turner (57,800), Payne (53,900) and Corrado (50,700), as to which the holder has sole votir no dispositive power.

(6) Mr. Hete also serves as a director.

(7) This amount includes 4,500 shares of common stock that are owned by Mr. Vorholt' spouse.

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PROPOSAL 2
RATIFICATION OF SELECTION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The firm of Deloitte & Touche LLP, an independent registered public accounting firm, exa
the financial statements of the Company for 2013 and has been selected by the Audit Com
of the Board to serve as the Company's independent registered public accounting firm for
We are asking the stockholders to ratify the Audit Committee's selection. In the event of a
negative vote on such ratification, the Audit Committee will reconsider its selection. Even
appointment is ratified, the Audit Committee, in its discretion, may direct the appointment
different independent registered public accounting firm at any time during the year if the A
Committee determines that such a change would be in the best interest of the Company an
stockholders.

Representatives of Deloitte & Touche LLP are expected to be present at the meeting to res
questions.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE FOR THE RATIFICATION OF THE SELECTION OF THE INDEPENDENT REGISTERED PUBL ACCOUNTING FIRM

Fees of the Independent Registered Public Accounting Firm

The aggregate fees billed to the Company for professional services by Deloitte & Touche
calendar years 2013 and 2012 are as follows:

	Year Ended December 31	
	2013	2012
Audit Fees	$870,468	$859,162
Audit-Related Fees	—	—
Tax Fees	—	—
All Other Fees	—	—
Total	$870,468	$859,162

Audit Fees

These are the aggregate fees billed for the audit of the Company's annual financial stateme
the fiscal years ended December 31, 2013 and December 31, 2012, the effectiveness of the
Company's internal controls as of December 31, 2013 and December 31, 2012, and for the
of the financial statements included in the Company's Quarterly Reports on Form 10-Q.

Audit-Related Fees

There were no fees billed for audited-related services for the fiscal years ended December
2013 and December 31, 2012.

Tax Fees

There were no fees billed for tax services for the fiscal years ended December 31, 2013 an
December 31, 2012.

All Other Fees

There were no fees billed for other services for the fiscal years ended December 31, 2013 a
December 31, 2012.

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Auditor Independence

In considering the nature of the services provided by Deloitte and Touche LLP, the Audit Committee determined that such services are compatible with the provision of independen services. The Audit Committee discussed these services with Deloitte and Touche LLP an Company's management to determine that they are permitted under the rules and regulatio concerning auditor independence promulgated by the SEC to implement the Sarbanes-Oxl of 2002, as well as the American Institute of Certified Public Accountants.

Pre-Approval Policy

All audit services for 2013 were pre-approved by the Audit Committee. The charter of the Committee provides for pre-approval of all audit and non-audit services performed by the Company's independent registered public accounting firm. Such pre-approval may be give of the Audit Committee's approval of the scope of the engagement of the independent regi public accounting firm or on an individual basis. The charter of the Audit Committee auth the Audit Committee to delegate to one or more of its members pre-approval authority wit respect to non-audit services, but the decision must be presented to the full Committee at t regularly scheduled Committee meeting.

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PROPOSAL 3

ADVISORY VOTE ON EXECUTIVE COMPENSATION

We are asking stockholders to approve an advisory resolution on the Company's executive compensation as reported in this Proxy Statement. The Compensation Committee and the I of Directors believes that the compensation policies and practices of the Company articula the "Compensation Discussion and Analysis" contained in this Proxy Statement are effecti achieving our goals and that the compensation of our named executive officers reported in Proxy Statement has contributed to the Company's success.

A significant portion of the compensation of our named executive officers is tied closely to performance of the Company, thus aligning our officers' interests with those of our stockho The annual cash bonus paid to our named executive officers under the Company's Executiv Incentive Compensation Plan is based in large part on the Company's net income from con operations, while the remainder is designed to incentivize and reward the achievement of s objectives that are more specifically targeted to the named executive officer. The restricted and performance-based stock unit awards made to the named executive officers under the Company's Amended and Restated 2005 Long-Term Incentive Plan, as described on page further align our executives' interests with our stockholders' interests.

As disclosed under "Stock Ownership Requirements" and "Stock Ownership of Managem of our named executive officers also owns shares of common stock of the Company, thus g each of them a direct, vested interest in long-term Company performance and stockholder Further, with the exception of change of control agreements, the Company does not mainta employment or severance agreements with any of the named executive officers. Each of th named executive officers is employed at will and is expected to perform in order to continu serving as a member of the executive team.

We urge stockholders to read the "Compensation Discussion and Analysis" beginning on p of this Proxy Statement, which describes in more detail how our executive compensation p and practices operate and are designed to achieve our compensation objectives, as well as t "Summary Compensation Table" and other related compensation tables and narrative, appe on pages 28 through 36, which provide detailed information on the compensation of our na executive officers. Included therein, under "Advisory Votes on Executive Compensation" 18, is additional information concerning the results of advisory votes on executive compen in recent years and actions taken by the Compensation Committee and the Board of Direct response thereto.

In accordance with provisions of the Securities Exchange Act of 1934 (the "Exchange Act are asking stockholders to approve the following advisory resolution at the 2014 Annual M of Stockholders:

RESOLVED, that the stockholders of Air Transport Services Group, Inc. (the "Company") approve, on an advisory basis, the compensation of the Company's named executive office disclosed in the Compensation Discussion and Analysis, the Summary Compensation Tabl the related compensation tables, notes and narrative in the Proxy Statement for the Compa 2014 Annual Meeting of Stockholders.

This advisory resolution, commonly referred to as a "say-on-pay" resolution, is non-bindin the Board of Directors. Although non-binding, the Compensation Committee and the Boar Directors will review and consider the voting results when making future decisions regardi executive compensation program.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT STOCKHOI VOTE FOR THE APPROVAL OF THE ADVISORY RESOLUTION ON EXECUTIVE COMPENSATION

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SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires that the directo certain officers of the Company, and persons who own more than ten percent of the Comp common stock, file reports of ownership and changes of ownership with the SEC. Officers directors and greater than ten percent stockholders are required by SEC regulations to furn Company with copies of all such forms they file.

Based solely on its review of the copies of such forms received by the Company, and the representations of the officers and directors of the Company regarding their compliance wi filing requirements, the Company believes that in 2013, all filing requirements applicable officers, directors and greater than ten percent beneficial owners were complied with, exce one Form 4 report covering one transaction for each of Messrs. Hete, Turner, Payne, Corra Manibusan, Starkovich, Templeton and Fedders, and one Form 5 report covering two trans for Mr. Manibusan, were not timely filed.

STOCKHOLDER PROPOSALS

Under the rules of the SEC, if you wish to include a proposal in the Company's proxy state for the 2015 Annual Meeting, it must be received by the Secretary of the Company at Air Transport Services Group, Inc., 145 Hunter Drive, Wilmington, Ohio 45177, no later than November 28, 2014.

Under the Company's Bylaws, proposals of stockholders intended to be presented at the 2 Annual Meeting outside of the proxy statement process must be received by the Secretary Company not less than 90 days nor more than 120 days prior to the anniversary of the prec year's annual meeting (May 8, 2014); provided, however, that in the event the date of the a meeting is advanced or delayed by more than 30 days from such anniversary date, notice b stockholder to be timely must be so delivered not earlier than the 120th day prior to such a meeting and not later than the close of business on the later of the 90th day prior to such an meeting or the 10th day following the day on which public announcement of the date of su meeting is first made. Any proposals received after such date will be considered untimely. written notice must satisfy certain requirements specified in the Company's Bylaws. A cop Bylaws will be sent to any stockholder upon written request to the Secretary of the Compa These requirements apply to any matter that a stockholder wishes to raise at the annual me other than pursuant to the procedures set forth in Rule 14a-8 under the Securities Exchange 1934.

ANNUAL REPORT ON FORM 10-K

If any person who was a beneficial owner of common stock of the Company on the record for the 2014 Annual Meeting desires copies of the Company's Annual Report on Form 10- copies will be furnished without charge upon request by writing or calling:

Air Transport Services Group, Inc.
145 Hunter Drive
Wilmington, Ohio 45177
Attn: Executive Assistant
Telephone: (937) 366-2296

We also make available free of charge the Company's Report on Form 10-K through our I website at http://www.atsginc.com.

IMPORTANT NOTICE REGARDING THE INTERNET AVAILABILITY OF PROXY MATERIALS FOR THE ANNUAL MEETING TO BE HELD ON MAY 8, 2014

This Proxy Statement is available at http://www.proxyvote.com.

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OTHER MATTERS

Management is not aware at this time that any other matters are to be presented for action a
meeting. If other matters come before the meeting, the persons named in the enclosed prox
will vote all proxies in accordance with their best judgment unless the stockholder has indi
on the proxy card that the shares represented thereby are not to be voted on such other mat

INCORPORATION BY REFERENCE

The SEC allows us to "incorporate by reference" into this Proxy Statement certain other do
that are filed with the SEC. The information incorporated by reference is considered to be
of this Proxy Statement. We are incorporating by reference the section titled "Executive O
from the Company's Annual Report on Form 10-K for the fiscal year ended December 31,

IT IS IMPORTANT THAT PROXIES BE RETURNED PROMPTLY AND THAT YOUI
SHARES BE REPRESENTED. STOCKHOLDERS ARE URGED TO VOTE BY USING
INTERNET, TELEPHONE OR BY FILLING IN, SIGNING AND RETURNING THE
ENCLOSED PROXY IN THE ENCLOSED ENVELOPE WHETHER OR NOT THEY PI
TO ATTEND THE MEETING.

By Order of the Board of Directors

/s/ W. Joseph Payne
W. JOSEPH PAYNE
Secretary

March 28, 2014
Wilmington, Ohio

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