Air Transport Services Group, Inc. SM

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JUNE 15, 2011

**STATEMENT OF
JOE HETE, CEO OF AIR TRANSPORT SERVICES GROUP, INC.
BEFORE THE
COMMITTEE OF OVERSIGHT AND GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES**

Good afternoon, Chairman Ross and members of the committee. I appreciate the opportunity to testify today and assist with identifying real solutions for the United States Postal Service (USPS). This hearing is a vital step toward averting the looming business liquidity crisis as the USPS is on the brink of insolvency due to continued losses in both mail volume and revenue.

My name is Joe Hete and I am the Chief Executive Officer for Air Transport Services Group, also known as ATSG, which is the parent company of ABX Air and four other wholly owned subsidiaries. It was only two short years ago that I testified before the Transportation and Infrastructure Committee about the devastating impact of DHL opting to pull out of the domestic market, and its potential impact on my company, its employees, and our community.

ABX Air, headquartered in Wilmington, Ohio, was part of a FORTUNE 1,000 organization with annual revenues exceeding $1.6 billion, with over 12,000 employees. On May 28, 2008, ABX Air was notified by DHL that it currently was in negotiations with UPS to take over DHL's air uplift for DHL Express U.S. domestic and international shipments within North America.

The news devastated the company and community.

On Nov. 10, 2008, with still no UPS deal and many people uncertain of what was next, DHL would again make an announcement that would accelerate the decline of what was ABX Air's business model. It announced it would pull out of the domestic market completely, effective January 30, 2009. All 15 regional hub locations across the United States would be closed and ABX Air would be forced to make a quick business model transition, including a mass reduction in force.

What was ABX Air declined to just under 1,000 employees.

While the USPS is not exactly in a similar situation, there are many parallels between the business challenges and threats of its current business environment and the last 36 months for ABX Air and its sister companies.

The USPS is an iconic institution and embodies reliability and service that the American people have grown to trust and expect when it comes to service and reliability. In its own right, it could be considered the first social network. Regrettably, the USPS had seen its market share decrease over a long period of time and volume has continued on a sharp decline.

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Several factors are outside the control of the USPS and are driving the decline—specifically technology that is continually evolving. In fiscal 2010, 170.6 billion pieces of mail were delivered, a drop of 6 billion pieces from the previous year. It is estimated that volume will continue to decline at the rate of 7% every year.

Not unlike to ABX Air, the USPS now is forced into an unfortunate position that will demand it to restructure its business model to ensure its long-term viability. The USPS has offered solutions that include:

1. "Exigent" rate increase of 5.6%—which was denied by the postal Regulatory Commission
2. Reduce mail delivery from 6 days to 5 days per week
3. To refund the overpayment of the Civil Service Retirement fund from payments of $5.5 billion to pre-fund retiree health benefits and $2.5 billion to federal government's workers' compensation insurance fund.
4. Flexibility to close postal and sorting locations that are underutilized.

While helpful, these solutions do not address one major factor that has the potential to significantly contribute to the long-term financial stability, which is to restructure its labor costs to match its current level of operations.

Beginning immediately after the May 2008 announcement, ABX Air began to explore plans for restructuring its workforce, based on what it then believed to be the go-forward plan for support for DHL. It engaged its employees—being transparent on what the changes in the business model would mean for all of those involved. ABX Air was able to make changes to much of its workforce, free from the encumbrances of an employee base represented by a union. Wages were reduced, pension plans were frozen and replaced with defined contribution plans, and paid time off reduced.

It was a sobering experience when it appeared all 12,000 ABX Air jobs would be eliminated because of the DHL announcement. However, ABX Air's flexible workforce relationships allowed us to go back to our customers and offer solutions to retain parts of the business.

The USPS has made attempts to restructure its workforce to match diminishing mail volumes. Using attrition and early retirement buyout options as its primary attempt to right-size its organization, a 16% reduction in upper-level management, and minimal closings of underutilized post offices and operations; it has yet to achieve the efficiencies it needs to survive.

The USPS' inability to reduce its workforce to match its operational needs due to legacy union contracts and no-layoff clauses restricts its potential to continue to be the most trusted government agency. It is a reputation that has been earned over a hundred of years of hard work and reliable service. Unmistakably, the USPS business model needs to change.

ATSG developed a comprehensive business strategy that segmented specific functions from ABX Air and created sister companies; to align its workforce and core lines of business with current market needs. In addition, it redesigned its infrastructure to be more competitive and adapt to the changing economic demands.

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Through these initiatives, we were able to position our company for job growth.
And we are growing:

- ABX Air now has 576 jobs, a 9% increase;
- AMES now has 523 jobs, a 53% increase;
- LGSTX now has 126 jobs, an 8% increase;

By identifying our strengths we developed the business lines that offered us the strongest chances of success. That success resulted in 239 jobs or 25% growth.

We succeeded. We are the anchor for the redevelopment and growth in our community.

USPS needs the authority to redevelop and implement its business strategy.

The USPS has offered solutions, including raising the price of the stamp, reducing delivery days, repaying of pension and the flexibility to close underutilized locations. However, none of these solutions fix the cost and productivity constraints that are imposed by the union contracts. The USPS is hindered in acting in the best interests of its "shareholders" – every American household that receives mail. Though the USPS has not used taxpayer funding, it is here today because it is in financial distress. The current union contracts are cost prohibitive and contribute to the severe financial losses. This should not go unaddressed. We had a union contract with our pilots but the financial viability of our company won out over perpetuating non-competitive labor agreements.

When you are able to adjust your workforce to the operational needs, infrastructure changes will naturally follow. The USPS needs the authority to close underutilized centers as a business decision that will attain savings that will affect the bottom line.

The political outcry for the USPS to mitigate financial losses needs to balance with the closures that need to happen in respective districts and acknowledge how difficult that will be.

Restructuring does not come without pain. I know this first hand. As previously noted, my company lost over 10,000 employees that I considered family members. I knew many of them by name, I knew their spouses, their children, and had worked closely with them for many years. They were not an employee number, they had names, they were neighbors, and I knew most of them on a personal level. It was difficult for everyone involved.

Restructuring is required when what you have been doing is no longer a viable plan and for the USPS it will take many forms. We need to give the USPS every opportunity to achieve its four business strategies:

- Strengthening the Business-to-Consumer Channel
- Improving Customer Experience
- Competing for Package Business
- Continuing to become a Leaner, Faster and Smarter organization

Keeping in mind these strategies, the USPS has made aggressive and targeted efforts to combat the economic recession and the digital revolution, but has constraints that won't allow it to restructure to the

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depth required to fulfill its four business strategies.

USPS solutions are bound by current legislation. These solutions affect the customer. Given the ability to realign the workforce and the infrastructure the USPS will be able to have a more sustainable business environment, and a majority of the changes would be invisible to its customers and not negatively affect service. The USPS' historic reliable service is its most coveted brand. It cannot afford to be jeopardized.

The USPS' financial state is not just a government problem any more—it may soon become a taxpayer issue.

There are dire consequences that have been identified by the USPS as it teeters on insolvency, and one is that in fiscal year 2012, the USPS may not be able to make its payroll. Your constituents are the shareholders of the USPS. Your action can help the USPS renegotiate legacy union contracts, which will enable them to restructure successfully and return to financial solvency.

Cost efficiencies are something that every business is looking to maximize. We have worked with the postal group in a myriad of capacities over the last 6 years. We have offered cost savings proposals that we have identified through observations of heavy labor costs and layers of network operations. Unfortunately, none of these proposals, with an aggregate benefit of hundreds of millions of dollars in cost savings, have come to fruition due to labor contract constraints.

Part of business strategy is to watch not only your competition but also your peers. You look to refine your strategy watching their every move and monitor successes and failures. Success is an intricate process that is compounded—but so is failure.

I have watched the USPS from afar, and they mirror many of our struggles over the last few years. However, unlike the USPS we had a nimble workforce that we could maneuver to build a better business model after a devastating loss of business. When the industry thought we were going to fail, our stock price was at its lowest point of 12 cents per share, stakeholders confidence was at an all-time low, and our employees were down, but not broken—we flourished. Today we are a thriving and growing company, and our stock has increased more than 50-fold.

I look forward to working with you to address these issues and find sound solutions that will keep the Postal Service as a viable part of our economy. I will be happy to answer any questions you might have.

Thank you.

Joseph C. Hete

Air Transport Services Group (ATSG)
CEO and President

Joseph C. Hete is the chairman, chief executive officer and president of Air Transport Services Group, Inc. (ATSG), a $660 million company that is a leading provider of air cargo transportation and related services to domestic and foreign air carriers and other companies. ATSG has five principal subsidiaries: ABX Air, Air Transport International (ATI), Capital Cargo Airlines International (CCIA), Airborne Maintenance & Engineering services (AMES), and Airborne Global Solutions (AGS). ATSG's subsidiaries serve over 50 countries and territories with operations that include 64 aircraft, and over 2,000 employees worldwide.

Hete is responsible for establishing the strategic planning for all the entities under the ATSG umbrella.

He is a 30-year veteran of ABX Air. Hete joined ABX Air as an Accounting Manager in September of 1980 and held positions as Treasurer, Director of Strategic Planning, and Director of Administration from 1981 to 1985. He was promoted to Senior Director of Administration in 1985, to Vice President of Administration in 1986 and to Senior Vice President of Administration in 1991. In early 1997, he was named Chief Operating Officer, and he was named President and COO in December of 1999. He became CEO in August of 2003. In December 2007, Air Transport Services Group, Inc. (ATSG) was formed from the reorganization of ABX Air for the purpose of creating a holding company structure; Hete was name chief executive officer and president. On December 31, 2007, ATSG completed the acquisition of Cargo Holdings International.

Prior to ABX Air, he held positions as General Accounting Supervisor and Staff Accountant at Anderson IBEC from 1977 to 1980.

Hete currently serves on the Economic Task Foce in Wilmington, Ohio, that focuses on the redevelopment of the local area, and was a former board member of the Air Transport Association (ATA). He has served his community as a Board member for organizations including: United Way, Clinton Memorial Hospital, Clinton County YMCA, Clinton County Foundation, Downtown Wilmington, Inc., and Wilmington City Schools Business Advisory Committee.

Hete earned his bachelors of science degree in Accounting from the University of Akron.

A native from just outside Akron, Ohio, Hete and his wife have four children and reside in Clarksville, Ohio.

NOTABLE

- Testified before the Transportation and Infrastructure Committee in the House of Representatives in September 2008.
- Testified before the Ohio House State Government and Elections; and the Senate Finance and Financial Institutions in August 2008.

Parent Company

ATSG
Air Transport Services Group, Inc.

Subsidiaries

ABX AIR

ATI
AIR TRANSPORT INTERNATIONAL, L.L.C.

CAPITAL CARGO
INTERNATIONAL AIRLINES

AIRBORNE
MAINTENANCE & ENGINEERING SERVICES

AIRBORNE
GLOBAL SOLUTIONS

CAM
CARGO AIRCRAFT MANAGEMENT

LGSTX
Services, Inc.

ABX Cargo Services