MERCURY AIR GROUP INC
Form 10-K
October 15, 2002

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

[X] Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the Fiscal Year ended June 30, 2002

[ ] 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: 1-7134 1)

MERCURY AIR GROUP, INC.
(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| DELAWARE<br>(State or Other Jurisdiction of Incorporation or Organization) | 11-1800515<br>(I.R.S. Employer Identification Number) |

5456 McConnell Avenue, Los Angeles, California 90066

(Address of Principal Executive Offices) (Zip Code)

Registrant s Telephone Number, Including Area Code: (310) 827-2737

Securities Registered Pursuant to Section 12(b) of the Act:

| Title of Each Class | Name of Each Exchange on Which Registered |
|---|---|
| Common Stock Par Value $.01 | American Stock Exchange<br>Pacific Stock Exchange |

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes [ ] No [X.]

As of September 19, 2002, 6,537,699 shares of the Registrant s Common Stock were outstanding. Of these shares, 2,647,883 shares were held by persons who may be deemed to be affiliates. The 3,889,816 shares held by non-affiliates as of September 19, 2002 had an aggregate market value (based on the closing price of these shares on the American Stock Exchange of $3.81 a share) of $14,820,198. As of September 19, 2002, there were no non-voting shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement which is to be distributed in connection with the Annual Meeting of Shareholders to be held on November 19, 2002 are incorporated by reference into Part III of this Form 10-K.

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PART I

ITEM 1. BUSINESS

Mercury Air Group, Inc., a Delaware Corporation, was organized in 1956 and provides a broad range of services to the aviation industry through four principal operating units: fixed base operations, cargo operations, fuels sales, and government contract services. Fixed base operations ( FBOs ) include fuel sales, into-plane services, ground support services, aircraft hangar and tie-down facilities and maintenance at certain locations for commercial, private, general aviation and military aircraft. Cargo operations consist of cargo handling, space logistics operations and general cargo sales agent services. Fuel sales include the sale of fuel and delivery of fuel primarily to domestic and international commercial airlines, business aviation and air freight airlines. Government contract services consist of aircraft refueling and fuel storage operations, base operating support (BOS) services, air terminal and ground handling services and weather observation and forecasting services performed principally for agencies of the United States Government. Additionally, the Company had a fifth operating unit, RPA Airline Automation Services, Inc. ( RPA ) which was sold on July 3, 2001 and is shown as a discontinued operation. As a result, RPA s current and historical operating results have been reclassified as a discontinued operation. As used in this Annual Report, the term Company or Mercury refers to Mercury Air Group, Inc. and, unless the context otherwise requires, its subsidiaries. The Company s principal executive offices are located at 5456 McConnell Avenue, Los Angeles, California 90066 and its telephone number is (310) 827-2737.

NARRATIVE DESCRIPTION OF THE BUSINESS

FIXED BASE OPERATIONS

Mercury currently provides Fixed Base Operations ( FBO ) services at 18 airports throughout the United States either directly through Mercury Air Group, Inc. or through its wholly owned subsidiary Mercury Air Centers, Inc. ( Air Centers ). At each FBO site, the Company: 1.) conducts retail aviation fuel sales and aircraft refueling operations which service principally corporate, private and fractional ownership aircraft and to some extent refueling operations to commercial aircraft, 2.) provides aircraft hangar rental and aircraft tie-down services, and 3.) at a few select FBO sites, provides aircraft maintenance. At each FBO site, the Company maintains administrative offices and provides office rent for its customers. The Company owns and leases refueling vehicles and maintains fuel storage tanks as required to support the fuels sales and into-plane fueling operations. During the year ended June 30, 2002, the Company sold 36,025,000 gallons through its aviation retail fuel sales operations. FBO s revenue for the year ended June 30, 2002 declined 5.1% from the 2001 fiscal year to $94.4 million, representing 24.6% of the Company s total revenue for the year. The FBO property and facilities are leased from the respective airport authorities.

In June 2002, the Company sold its FBO operations at Bedford, Massachusetts to Signature Flight Support Corp. for $15.5 million, resulting in a pre-tax gain of $9.0 million. During the fiscal year ended June 30, 2002, the Bedford FBO had retail aviation fuel sales volume of 2,939,000 gallons, or 8.2% of the Company s FBO retail sales volume for fiscal 2002. The net proceeds from this sale were used to reduce the outstanding principal of long-term debt.

The Company s FBO operations have grown through a combination of organic growth by facility enhancements and expansion and through the strategic acquisition of additional operating locations. In fiscal 2001, the Company acquired the assets of an FBO in Birmingham, Alabama at a cost of approximately $6.6 million, which was funded through the Company s existing senior credit facility. Also, the Company acquired the assets of an FBO located in Tulsa, Oklahoma for $6.2 million which was also funded through the Company s existing senior debt facility with payments in fiscal 2001 and fiscal 2000. In fiscal 2000, the Company acquired FBO operations located in Fort Wayne, Indiana, in South Carolina at the Charleston International Airport and at the John s Island Executive Airport.

In its continuing effort to improve the quality of service the Company provides through its FBO network, the Company is currently developing plans to: 1) build a new hangar at its Charleston, South Carolina FBO; 2) relocate and upgrade its FBO facilities at Los Angeles International Airport; 3) upgrade and expand its FBO operations in Santa Barbara, California; and 4.) convert an existing hangar at the Ontario International Airport to better accommodate private corporate aircraft. These projects are scheduled to begin in fiscal 2003 pending approval from the respective airport authorities and finalization of project funding.

The Company continuously assesses its FBO network to position the Company to provide high quality and value added service to its customers. The Company intends on continuing this practice with the assessment of strategic facility acquisitions or dispositions and to enhance its position in the market and through facility enhancements with the goal of upgrading and standardizing the level and quality of service throughout the Company s FBO network. These initiatives are undertaken with the intent of providing satisfactory return to all stakeholders and to the extent permissible under the Company s existing credit facilities.

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CARGO OPERATIONS

The Company s cargo operations are conducted through its wholly-owned subsidiary, Mercury Air Cargo, Inc. ( MAC ), which provides the following services: cargo handling, space logistics operations, and general cargo sales agent services. MAC s operations were adversely impacted in 2002 due to the tragic events of September 11, 2001 and due to the general decline in worldwide economic conditions. As a result, MAC s revenue for the year ended June 30, 2002 declined 10.3% from the 2001 fiscal year to $28.1 million, representing 7.3% of the Company s total revenue for the year. The revenue decline was due to both reduced volume and severe downward price pressures on the services MAC provides. These factors resulted in a decline in MAC s gross margin in 2002 to $1.4 million, a reduction of $4.7 million from 2001. In response, during the 4th quarter of 2002, MAC s management implemented cost reduction initiatives to improve the financial results, including across the board salary reductions. These cost reduction initiatives, along with improvement in the general air cargo business activity, resulted in improved financial results towards the end of fiscal 2002 and into early fiscal 2003. It is too early to determine whether these improved operational and financial results will continue into the remainder of the year.

Cargo Handling

MAC provides domestic and international air cargo handling, air mail handling and bonded warehousing. MAC is one of only 4 non-airline providers of contractual cargo containerization and palletization for domestic and international airlines and cargo airlines at the Los Angeles International Airport (LAX). In 2002, the Cargo Handling operations comprised 79% of MAC s revenue.

MAC handles cargo at LAX, William B. Hartsfield International Airport (ATL), Dorval International Airport (YUL), Mirabel International Airport (YMX) and Lester B. Pearson International Airport (YYZ). In February 2001, MAC entered into a ten-year lease for a 104,646 square foot warehouse and operations area at ATL. At that time, MAC closed down its former warehouse at ATL. In March 2002, MAC entered into a sub-lease agreement for its new warehouse facility at ATL with Lufthansa Handling. This sub-lease agreement allows MAC to continue to provide cargo handling at ATL utilizing Lufthansa Handling as a sub-contract service provider for the operations.

In April 1998, MAC completed the construction and commenced operation of a 174,000 square foot warehouse at LAX under a five-year lease which has subsequently been extended to expire in 2006. MAC is currently the largest independent cargo handling company at LAX. In mid-2002, MAC relocated its office headquarters to the LAX facility.

MAC competes in the cargo handling business based on the quality and timeliness of the service it provides along with a competitive pricing structure.

Space Logistics Operations

MAC brokers cargo space on transcontinental flights within the United States and on international flights to Europe, Asia, the Middle East, Australia, Mexico and Central and South America. Space logistics involves the contracting for bulk cargo space on airlines and selling that space to customers with shipping needs. MAC has an established network of shipping agents who assist in obtaining cargo for shipment on space purchased from airlines, and who facilitate the delivery and collection of freight charges for cargo shipped by MAC. In 2002, the space logistics revenue comprised 10% of MAC s revenue.

In April 2002, MAC entered into a one-year renewal of its contract with South African Airways ( SAA ) to purchase all of SAA s cargo capacity on its passenger flights from the United States to South Africa. MAC s one-year commitment for these routes is approximately $6.2 million. This allows MAC to effectively arrange and schedule cargo shipments and optimize the return to SAA and to its freight forwarders while providing a reasonable margin to MAC.

Unlike an air cargo airline which operates its own aircraft, MAC s space logistics business arranges for the purchase of cargo space on scheduled flights or supplemental flights at negotiated rates. MAC is thereby able to profit from the sale of air cargo space worldwide without the overhead cost of owning and operating an aircraft. In some instances, MAC has entered into fixed minimum commitments for cargo space resulting in exclusive or preferred rights to broker desirable cargo space profitably. Due to the large volume of cargo space contracted, MAC is able to secure air cargo space at rates lower than an individual freight forwarder could arrange. MAC is then able to pass on these lower rates to its customers and still realize a profit. MAC recognizes as revenue the difference between the rate charged to its customers for the space acquired and the cost of the air cargo space.

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General Sales Agent Services

MAC also serves as a general sales agent ( GSA ) directly through its subsidiaries, Hermes Aviation, Inc., Hermes Aviaciaon de Mexico, S.A. de C.V., and Aero Freightways, Inc. of Canada for airlines in the Far East, Canada, Mexico, Central and South America and in the United States. In this capacity, MAC sells the transportation of cargo on client airlines flights, using the client airlines own airway bills. MAC earns a commission from the airlines for selling their cargo space. In 2002, the GSA business revenue comprised 12% of MAC s total revenue. As with its space logistics business, the growth for MAC s GSA business is not constricted by requirements for physical facilities or by large capital commitments.

Mercury World Cargo

Using its part 135 cargo airline certificate, Mercury World Cargo is able to enter into interline agreements with other airlines worldwide. Using the Mercury World Cargo airway bill as the cargo transportation document and the other airlines air cargo capacity, Mercury World Cargo is able to provide a service for both freight forwarders and airlines. Effectively, Mercury World Cargo provides a secondary brand to airlines that prefer not to utilize their own brand for discounted freight. The fiscal year 2002 was the start-up year for this business.

FUEL SALES

The Company s fuel sales operations are handled through MercFuel, Inc. ( MercFuel ), a wholly owned subsidiary of the Company. The Company transferred all of its assets and business activities associated with its fuel sales operations to MercFuel in October 2000. MercFuel facilitates the management and distribution of aviation fuel serving as a reseller of aviation fuel for major oil companies, affording the oil companies access to certain customers without the credit risk or administrative costs associated with the management of these customer accounts. MercFuel competes based on the quality of its services by offering a combination of reliable and timely supply, competitive pricing and credit terms, and a real time analysis of the availability, quantity and pricing of fuel in airports and terminals throughout the world.

MercFuel s sales activities continue to provide a major revenue source for the Company, representing 60.7% of the Company s total revenue for the year ended June 30, 2002, a decrease from 66.6% of the Company s total revenue in 2001. Sales volume in 2002 was 287.7 million gallons, a decline of 21.7 million gallons or 7.0% from 2001. The decline in sales volume was partially due the tragic events of September 11, 2001.

| | Year Ended June 30, | | |
|---|---|---|---|
| | **2002** | **2001** | **2000** |
| | | (In millions) | |
| Fuel Revenue | $232.6 | $318.8 | $202.8 |
| Gallons Sold | 287.7 | 309.4 | 232.0 |

MercFuel is able to leverage its scale of operations to obtain credit terms and competitive pricing from its suppliers that may not be afforded to MercFuel s customers. Many of the major oil companies that provide fuel supply to MercFuel have limited infrastructure to support the small to medium sized and emerging carriers that comprise a large portion of MercFuel s customer base. This arrangement allows MercFuel to offer more competitive pricing and credit terms to its customers than they would be able to obtain directly from the major oil companies. With over 23 years of service in the aviation fuel reselling and distribution industry, MercFuel has established itself as a reliable and price competitive reseller which has resulted in the establishment of significant contracts with smaller and medium sized commercial carriers and business fleet managers. MercFuel s resale service provides an established distribution network for oil companies worldwide and provides them access to certain markets and customers which they do not directly serve. In addition, MercFuel provides the administrative support required in serving this customer base which would otherwise be required by the major oil companies and assumes the credit risk of supplying this customer base. MercFuel s experience in the aviation fuel reselling industry allows it to assess those risks in a more effective and efficient manner.

In many cases, the small to medium sized commercial carriers and business fleet managers are subject to securing aviation fuel supply on the spot market, resulting in high spot fuel prices. MercFuel provides a 24-hour single source coordinated distribution system on a national and international basis through its network of over 400 third party supply locations nationally and 1,000 international locations through which customers can purchase fuel. As a result of this integrated network, MercFuel is able to provide its customers with reliable and competitive fuel pricing from airport to airport enabling its customers to reduce their exposure to the volatile spot market.

Through its automated on-line system, MercFuel provides its customers with online pricing, fuel location and ordering information streamlining its customers   fuel purchase process and reducing their administrative costs associated with fuel logistics by providing a single source through which fuel procurement can be arranged and automatically released to the business jet customer.

MercFuel   s continued success in attracting and retaining its customer base is due, in part, to its willingness to extend credit on an unsecured basis to many of its customers. Otherwise, these customers would be required to prepay or post letters of credit with their suppliers. MercFuel recognized that active oversight and management of credit risk is essential to the Company   s success. The Company   s executive staff and MercFuel management meet regularly to assess and evaluate MercFuel   s credit exposure, in the aggregate and by individual customer. The Company   s credit committee is responsible for approving credit lines above certain pre-established amounts, and for setting and maintaining credit standards to ensure overall credit quality and optimize its credit portfolio.

MercFuel purchases aviation and other fuel at current market prices from several major oil companies and certain independent and state owned oil companies to meet the expected requirements of its customers. From time-to-time, MercFuel will commit to purchase a fixed volume of fuel, at a fixed price, over an established period of time to meet selected customers   purchase commitments at set locations. MercFuel   s payment terms generally range from 10 to 30 days, except for bulk purchases which are generally payable in shorter periods. MercFuel has agreements with certain suppliers under which MercFuel purchases a minimum amount of fuel each month at prices which approximate the market price. MercFuel also makes occasional spot purchases of fuel to take advantage of market differentials. To insure supply availability, MercFuel carries limited inventories at various locations. The amount of inventory held at any particular point in time varies depending on market conditions.

Outside of the United States, MercFuel does not maintain fuel inventory. MercFuel arranges to have fuel delivered directly to its customers aircraft in an into-plane arrangement. Domestically, fuels sales are made on either an into-plane basis where fuel is supplied directly into MercFuel   s customers   aircraft with fuel provided by MercFuel   s supplier or the fuel is delivered from MercFuel   s inventory. While inventory is maintained at multiple locations, inventory levels are maintained at minimum levels.

MercFuel purchases its fuel from suppliers worldwide at prices that are generally tied to market-based formulas. MercFuel is currently extended unsecured credit for its fuel purchases. If MercFuel   s relationship with any of these key suppliers terminates, MercFuel may not be able to obtain sufficient quantity on competitive terms to meet its customers   demands. MercFuel may encounter difficulty and/or delays in securing aviation fuel from alternative sources. In addition, financial or supply disruptions encountered by MercFuel   s suppliers could also limit the available of fuel supplied to MercFuel.

For the fiscal year ended June 30, 2002, MercFuel   s average cost of fuel was 77 cents per gallon, a decrease of 23 cents per gallon, or 23% from 2001. Although MercFuel believes that there are currently adequate aviation fuel supplies to meet its customers   needs, events outside of MercFuel   s control have in the past resulted in, and could in the future result in, spot shortages or rapid price changes. Although MercFuel has generally been able to pass through fuel price changes to its customers, extended periods of high fuel costs could adversely affect MercFuel   s ability to purchase fuel in sufficient quantities because of credit limits placed on MercFuel by its fuel suppliers.

GOVERNMENT CONTRACT SERVICES

Mercury conducts its government contract services through its wholly owned subsidiary, Maytag Aircraft Corporation (   Maytag   ), which is headquartered in Colorado Springs, Colorado. Maytag provides aircraft refueling, air terminal services, base operating support, and weather data services in 17 countries on four continents.

Aircraft Refueling

Maytag provides aircraft refueling and related services at 14 military bases in the United States, one in Greece, and one in Okinawa, Japan. Maytag   s refueling contracts generally have a term of four years, with expiration dates ranging from December 2002 to March 2006. Refueling contracts provide a firm-fixed price for specified services. Under the terms of its refueling contracts, Maytag supplies all necessary personnel and equipment to operate government-owned fuel storage facilities and provides 24-hour refueling services for a variety of military and contractor aircraft. All fuel handled in these operations is government owned. In connection with its government contract refueling business, Maytag owns, leases, and operates a fleet of refueling trucks and other support vehicles.

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Air Terminal Services

Maytag provides air terminal and ground handling services to the United States ( U.S. ) Government at 19 locations under seven contracts. Six contracts cover three U.S. military bases in Alaska, Japan, and Korea, and three international airports in Japan, Korea, and Kuwait. Maytag also has one contract servicing international airports in Latin America. Air terminal services contracts are generally for a base period of up to one year, with government options for multiple one-year extension periods. The expiration dates for Maytag s air terminal contracts range from March 2003 to September 2003. Maytag s multi-site Latin America air terminal contract has options to extend through September 2004. Air terminal contracts provide a firm-fixed price for specified services. Air terminal and ground handling services include the loading and unloading of passengers and cargo, transient alert, and flight planning services.

Base Operating Support Services

Maytag provides base operating support (BOS) services at Niagara Falls, NY, Westover, MA, Youngstown, OH and Willow Grove, PA Air Reserve Facilities and Patrick Air Force Base on a subcontracted basis. Under the terms of the subcontracts, Maytag provides, at a firm-fixed price, multi-function services, including fuel management, traffic management, airfield management, air terminal operations, vehicle operations and maintenance services, and meteorological services. Contract expirations range from March 2003 through October 2003, with one to three pre-priced one-year options. The Company believes the Government will exercise all options to extend the contracts.

Weather Data Services

Maytag provides weather observation and/or weather forecasting services at 17 locations within the United States pursuant to ten contracts with the United States Government and certain local governmental agencies. This includes one weather observation and forecasting contract and nine weather observation contracts. The Weather Data contracts provide firm fixed prices for specified services and are generally for a base period of one year, with multiple one-year options at the government s election. Weather Data s existing observation contracts were extended for a one year period ending September 30, 2002. The U.S. Air Force Academy observation and forecasting contract has options to extend through January 2005.

All of Maytag s government contracts are subject to competitive bidding. Refueling, air terminal, and weather forecasting contracts are generally awarded to the offeror with the proposal that represents the best value to the government. In a best value competition, the proposals are evaluated on the basis of price, past performance history of the offeror, and the merit of the technical proposal, creating a more subjective process. Weather observation contracts are generally awarded to the offeror with the lowest priced technically acceptable proposal.

Maytag s contracts are all subject to termination at the discretion of the United States Government, in whole or in part. Termination of a contract may occur if the United States Government determines that it is in its best interest to discontinue the contract, in which case closure costs will be paid to Maytag. Termination may also occur if Maytag defaults under a contract. Maytag has never experienced any such default termination.

RPA

On July 3, 2001, the Company sold substantially all of the assets of RPA (now Jupiter Airlines Automation Services, Inc.) for cash consideration of $3.6 million. The Company realized a loss of approximately $0.5 million on the sale of discontinued operations.

MAJOR CUSTOMERS AND FOREIGN CUSTOMERS

During fiscal 2002, EVA Airways Corporation accounted for approximately 13% of cargo operations revenue. Air Tran Airways and National Airlines, Inc. represented approximately 25% and 21% of MercFuel s revenue, respectively, and 15% and 13% of consolidated revenue, respectively, for fiscal 2002. During fiscal 2002, government contract services consisted entirely of revenues from agencies of the United States Government. No other customers accounted for over 10% of Mercury s consolidated revenue or 10% of revenues for any of the four reporting units.

The Company does business with a number of foreign airlines, principally in the sale of aviation fuels. For the most part, such sales are made within the United States and utilize the same assets and generally the same personnel as are utilized in the Company s domestic business. Revenues related to these foreign airlines amounted to approximately 18%, 18% and 25% of consolidated revenues for the years ended June 30, 2002, 2001 and 2000, respectively.

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In May 1999, Mercury entered into a fuel management contract with National Airlines, Inc., pursuant to which Mercury began selling fuel to National Airlines, Inc. and managing their fuel requirement at all National Airlines, Inc. locations. On December 6, 2000, National Airlines, Inc. filed for bankruptcy protection. Mercury continues to sell fuel to National Airlines, Inc. on a secured basis, under the auspices of the bankruptcy court.

SEASONAL NATURE OF BUSINESS

Mercury s commercial fuel sales, FBOs and aircraft support operations are seasonal in nature, being relatively stronger during the months of April through December in its fueling operations and FBOs than during the winter months due in part to weather conditions, and increased during summer months due in part to additional commercial and charter flights. MAC s cargo business is lower during the months of January and February and increases March through December. The cargo business is affected by the patterns of international trade. Operations at military facilities are not seasonal.

POTENTIAL LIABILITY AND INSURANCE

Mercury s business activities subject it to risk of significant potential liability under federal and state statutes, common law and contractual indemnification agreements. Mercury reviews the adequacy of its insurance on an on-going basis. Mercury believes it follows generally accepted standards for its lines of business with respect to the purchase of business insurance and risk management practices. The Company purchases airport liability and general and auto liability in amounts which the Company believes are adequate for the risks of its business.

COMPETITION

MercFuel competes with approximately five independent fuel suppliers, of which the largest is World Fuel Services Corporation. Additionally, the division competes with other aircraft support companies which maintain their own sources of aviation fuel. Many of MercFuel s competitors have greater financial, technical and marketing resources than Mercury. In addition, certain airlines provide cargo and fueling services comparable to those furnished by Mercury. At LAX Mercury competes with, in addition to the airlines, three fuel delivery providers and with three non-airline entities with respect to air cargo handling business. Generally, FBOs have a minimum of one competitor at each airport as well as national multi-location chains. Mercury has many principal competitors with respect to government contracting services including certain small disadvantaged businesses which receive a ten percent cost advantage with respect to certain bids and set asides of certain contracts. Recently the FBO market has seen the emergence of increased competition among several national FBO chains owned by major corporations whose total sales and financial resources exceed those of Mercury. Substantially all of Mercury s services are subject to competitive bidding. Mercury competes on the basis of price, quality of service, prior relationship with customers, and credit terms.

ENVIRONMENTAL MATTERS

Mercury must continuously comply with federal, state and local environmental statutes and regulations associated with its fuel storage tanks and fueling operations. These requirements include, among other things, tank and pipe testing for integrity and soil sampling for evidence of leaking and remediation of detected leaks and spills. Other than the $3.4 million spent during the 1999 fiscal year to comply with certain federal mandates regarding below ground fuel tanks, there have been no material capital expenditures nor has there been a material negative impact on Mercury s earnings or competitive position in performing such compliance and related remediation work. In late 1998, Mercury, and many other companies operating on Southern California airports received notice of potential violations of California Environmental Protection Agency Air Resources Board regulations. This notice alleged that such companies had violated the act by fueling airport service vehicles with Jet A fuel. Mercury immediately brought all of its operations into full compliance with all applicable regulations and has entered into a settlement agreement with the state of California. In addition, it has undertaken a review of federal and state regulations to ensure future compliance. The Company has agreed to provide certain environmental remediation on property formerly leased by the Company in Anaheim, California. The Company terminated operations on this leased property in fiscal 1987 at which time a closure letter was in effect. The Company has installed an approved remediation system at a cost of approximately $78,000 and expects to incur maintenance cost for a period of between six and 24 months of $4,500 per month. Mercury received notice from the EPA on August 9, 2001 that the EPA expected Mercury to provide secondary containment for mobile fuel trucks at its Fort Wayne, Indiana facility. Mercury is working with the EPA, trade association, and the Airport to resolve this issue. Mercury knows of no other basis for any notice of violation or cease and abatement proceeding by any governmental agency as a result of failure to comply with applicable environmental laws and regulations.

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EMPLOYEES

As of August 31, 2002, Mercury employed 1,558 full-time and 339 part-time persons in its following operating units: fuel sales, 40 full-time and one part-time person; corporate, 38 full-time and two part-time persons; cargo operations, 454 full-time and 47 part-time persons; FBOs 646 full-time and 46 part-time persons; and government services, 380 full-time and 243 part-time persons. Maytag has collective bargaining agreements which effect approximately 143 employees in its weather and base support operations. MAC has collective bargaining agreements which affect approximately 54 employees in its ground handling operations. Management believes that, in general, wages, hours, fringe benefits and other conditions of employment offered throughout Mercury s operations are at least equivalent to those found elsewhere in its industry and that its general relationships with its employees is satisfactory.

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ITEM 2. PROPERTIES.

Listed below are the significant properties leased or owned by Mercury as of June 30, 2002

| LOCATION | LEASED OR OWNED | ANNUAL RENTAL | EXPIRATION OF LEASE | ACTIVITY AT FACILITY | FACILITY DESCRIPTION |
|---|---|---|---|---|---|
| CORPORATE HEADQUARTERS | | | | | |
| 5456 McConnell Los Angeles, California (3) | Leased | $440,000 | December 2006 | Landlord, executive and support personnel offices | 22,500 sq.ft. building |
| MAYTAG OPERATIONS | | | | | |
| 6145 Lehman Drive, Suite 300 Colorado Springs, CO (1) | Owned | N/A | N/A | Landlord, executive and support personnel offices | 8,000 sq.ft. offices |
| HARTSFIELD ATLANTA INT L AIRPORT | | | | | |
| Cargo Building A South Cargo Area | Leased | $924,000 | December 2010 | Landlord, cargo handling warehouse with offices | 60,597 sq. ft. of cargo warehouse facility with 9,785 of office space on 2.4 acres of land |
| LOS ANGELES INT L AIRPORT | | | | | |
| 6851 W. Imperial Highway, Los Angeles, CA | Leased | $754,000 | December 2004 | Cargo hangar, with offices and executive offices rented to customers | 70,245 sq.ft. of offices and cargo warehouse facility on 5.4 acres |
| 6040 Avion Drive Los Angeles, CA | Leased | $2,242,000 | June 2006 | Cargo handling warehouse with offices | 207,000 sq.ft. offices and cargo warehouse facility |
| 7000 World Way West Los Angeles, CA | Leased | $295,000 | Month-to-month | Service and refueling of private aircraft | 2,000 sq.ft. of executive terminal on 1.93 acres |
| LESTER B. PEARSON INT L AIRPORT | | | | | |
| Concession 6 East Hurontario St. (2) | Leased | $121,800 | November 2010 | Cargo handling warehouse with offices | 5,447 sq. ft. office space and 48,360 sq. ft. of warehouse space |
| DORVAL INT L AIRPORT | | | | | |
| 800 Stuart Graham Blvd. South Dorval, Quebec (3) | Leased | $489,000 | November 2007 | Cargo handling warehouse with offices | 51,000 sq.ft. warehouse and 2,432 sq.ft. of office space |
| MIRABEL INT L AIRPORT | | | | | |
| 12005, Rue Cargo A-3, Suite 102 Mirabel, Quebec | Leased | $83,000 | November 2005 | Cargo handling warehouse with offices | 1,200 sq.ft. warehouse and 570 sq. ft. of office space |
| ONTARIO INT L AIRPORT | | | | | |
| 2161 East Avion Ontario, CA | Leased | $287,000 | April 2008 | Landlord, service and refueling of commercial and private | Offices and hangars on 14.4 acres |
| 2161 East Avion Ontario, CA | Leased | $11,020 | December 2005 | Aircraft parking | 24,000 sq. ft. of hanger space |

| | | | | | |
|---|---|---|---|---|---|
| 1150 South Vineyard Avenue Ontario, CA | Leased | $250,000 | Month-to-Month | Landlord, ramp, parking, office and hangar space | 32,400 sq. ft. of hangar, shop area and office space. Site, ramp and parking on 5.4 acres. |
| BAKERSFIELD AIRPORT | | | | | |
| 1550 Skyway Drive Bakersfield, CA (3) | Leased | $137,000 | May 2020 | Landlord, service and refueling of commercial and private Aircraft | Executive offices, terminal and hangars on 6.14 acres |
| BURBANK-GLENDALE-PASADENA AIRPORT | | | | | |
| 4301/4405/4407/4409/4411/4531 10660/10670/10700/10750 /10760/10800/10820 | Leased | $1,745,000 | April 2025 | Landlord, service and refueling of commercial and private aircraft | Offices hangars, and shop facilities on 27.65 acres |
| Sherman Way, Burbank, CA | | | | | |
| 4561 Empire Ave. Burbank, CA | Leased | $78,000 | December 2010 | Landlord, service and refueling of commercial and private Aircraft | 68,200 sq. ft. of ramp space |

| LOCATION | LEASED OR OWNED | ANNUAL RENTAL | EXPIRATION OF LEASE | ACTIVITY AT FACILITY | FACILITY DESCRIPTION |
|---|---|---|---|---|---|
| 6920 Vineland Ave. No. Hollywood, CA | Leased | $164,000 | Month to month | Landlord, service and refueling of commercial and private Aircraft | 5,200 sq. ft. of offices, hangars and shop facilities |
| CHARLESTON INTERNATIONAL AIRPORT | | | | | |
| 6060 S Aviation Wy. N. Charleston, SC | Leased | $161,160 | August 2007 | Terminal, office, and hangars | 148,000 sq. ft. of Offices, hangars and parking area |
| 6070 Perimeter. N. Charleston, SC | Leased | $11,680 | Month-to-month | Building and hanger space | Hangars, building, shop facilities and parking areas |
| Johns Island Airport 2700 Fort Trenholm Johns Island, SC | Leased | $26,130 | May 2004 | Terminal, office, and hanger space | consisting of 6.6 acres 285,200 sq. feet on 6.54 acres |
| SANTA BARBARA MUNICIPAL AIRPORT | | | | | |
| 404 Moffet Road Goleta, CA | Leased | $9,360 | Month-to-month | Landlord, service, maintenance, and refueling of commercial and private aircraft | 8 T-Hangar space totaling 28,413 sq. ft. |
| 404 Moffet Road Goleta, CA (Building 124 &126) | Leased | $56,000 | Month-to-month | Building space | 9,360 sq. ft of building space |
| 204 Moffett Place Goleta, CA Building 121 | Leased | $28,920 | Month-to-month | Building space and parking spaces | 10,370 sq. ft. office space and 10 parking spaces |
| 302 Moffet Place Goleta, CA | Leased | $39,580 | Month-to-month | Building space | 3,120 sq. ft office space |
| Building 122 327 Firestone Rd. Goleta, CA | Leased | $31,000 | June 2032 | Fuel Farm | |
| FRESNO YOSEMITE INT L AIRPORT | | | | | |
| 5045 E. Anderson Avenue Fresno, CA | Leased | $74,000 | April 2020 | Landlord, service and refueling of commercial and private aircraft aircraft | 8.47 acres |
| 5045 E. Anderson Avenue Fresno, CA | Leased | $67,000 | August 2006 | Terminal, office and hangar facility | Hangars and offices on 2.16 acres |
| 5045 E. Anderson Avenue Fresno, CA | Leased | $115,000 | May 2005 | Hangar and commercial office | 22,000 sq. ft. office space on 19.26 acres |

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|---|---|---|---|---|---|
| | | | | space | |
| WM. B. HARTSFIELD INT L AIRPORT<br>1200 Toffie Terrace<br>Atlanta, GA | Leased | $107,000 | Month-to-month | Landlord, service and refueling of commercial and private aircraft | 4,800 sq.ft. of offices and ramp area on 11.2 acres |
| DEKALB-PEACHTREE AIRPORT<br>1951 Airport Road<br>Atlanta, GA (3) | Leased | $238,000 | November 2006 | Landlord, service and refueling of commercial and private aircraft. | 164,288 sq.ft. of offices, hangars, and land on 24.89 acres |
| RENO CANNON INT L AIRPORT<br>655 So. Rock Blvd. Reno, NV | Building owned, land leased | $13,000 | June 2017 | Landlord, service and refueling of commercial, private and military aircraft | 33,000 sq.ft. of hangars and administrative building on 23.7 acres of land |
| 1500 Terminal Way<br>Reno, NV | Leased | $21,215 | August 2007 | Ground Support Equipment Service Bay | 1,247 sq. ft. of office space and 2,087 sq. ft. of warehouse |

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| LOCATION | LEASED OR OWNED | ANNUAL RENTAL | EXPIRATION OF LEASE | ACTIVITY AT FACILITY | FACILITY DESCRIPTION |
|---|---|---|---|---|---|
| ADDISON AIRPORT<br>4400 Glenn Curtiss Dr.<br>Dallas, TX (3) | Leased | $314,000 | September 2021 | Landlord, service and refueling of commercial and private aircraft | 49,472 sq. ft. of offices and hangars on 2.80 acres |
| 4400 Glenn Curtiss Dr.<br>Dallas, TX (3) | Leased | $52,000 | June 2022 | Landlord, service and refueling of commercial and private aircraft | 57,949 sq. ft. of offices and hangar space on 6.28 acres |
| 4400 Glenn Curtiss Dr.<br>Dallas, TX (3) | Leased | $8,000 | July 2021 | Landlord, service and refueling of commercial and private aircraft | 12,600 sq. ft. of offices and hangar space |
| 4400 Glenn Curtis Dr.<br>Dallas, TX (3) | Leased | $28,000 | Month-to-month | Fuel farm | |
| CORPUS CHRISTI<br>355 Pinson Drive<br>Corpus Christi, TX (3) | Leased | $19,000 | October 2009 | Landlord, service and refueling of commercial and private aircraft | 66,096 sq. ft. of offices and hangars on 6.69 acres |
| NASHVILLE INT L AIRPORT<br>635 Hangar Lane<br>Nashville, TN | Leased | $247,000 | June 2012 | Landlord, service and refueling of commercial and private aircraft | Office and hangars on 38.69 acres |
| JACKSON INT L AIRPORT<br>110 S. Hangar Drive<br>Jackson, MS (3) | Leased | $107,000 | February 2006 | Landlord, service and refueling of commercial and private aircraft | Office and hangars on 7 acres |
| TULSA INT L AIRPORT<br>7500 E. Apache<br>Hangar 1&2<br>Tulsa, OK | Leased | $73,000 | April 2019 | Landlord, service and refueling of commercial and private Aircraft | Office and hangars on 11.23 acres |
| 7500 E. Apache<br>Hangar 22 & 26<br>Tulsa, OK | Leased | $22,000 | April 2019 | Landlord, service and refueling of commercial and private Aircraft | Land consisting of 5.23 acres |
| 7500 E. Apache<br>Hangar 22 & 26<br>Tulsa, OK | Leased | $62,000 | June 2011 | Landlord, service and refueling of commercial and private Aircraft | Office and hangars on 5.23 acres |
| 7500 E. Apache<br>Hangar 18<br>Tulsa, OK | Leased | $11,000 | June 2016 | Landlord, service and refueling of commercial and private Aircraft | Hangar space on 6.18 acres |

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|---|---|---|---|---|---|
| FORT WAYNE AIRPORT<br>Fort Wayne-Allen County Airport Authority<br>Hangar 37,41, 41A Building 28 | Leased | $43,650 | December 2003 | Landlord, service and refueling of commercial and private Aircraft | Office, hangars, and ramp space on 172,734 sq. ft of land |
| Fort Wayne-Allen County Airport Authority<br>Hangar 40, 43 | Leased | $66,700 | December 2003 | Landlord, service and refueling of commercial and private Aircraft | 234,451 sq. ft. of office, hangar, parking and ramp space |
| Fort Wayne-Allen County Airport Authority<br>Hangar 42 | Leased | $54,900 | November 2004 | Landlord, service and refueling of commercial and private Aircraft | 49,500 sq. ft of hangar, ramp and parking space |
| Fort Wayne-Allen County Airport Authority<br>Hangar 45 | Leased | $40,400 | October 2016 | Landlord, service and refueling of commercial and private Aircraft | Aircraft hangar space consisting of 53,658 sq. ft. |
| Fort Wayne-Allen County Airport Authority<br>Hangar D | Leased | $8,600 | August 2003 | Landlord, service and refueling of commercial and private aircraft | Aircraft hangar space consisting of 4,000 sq. ft. |

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| LOCATION | LEASED OR OWNED | ANNUAL RENTAL | EXPIRATION OF LEASE | ACTIVITY AT FACILITY | FACILITY DESCRIPTION |
|---|---|---|---|---|---|
| Fort Wayne-Allen County Airport Authority T-Hangar | Leased | $2,100 | Month to month | Landlord, service and refueling of commercial and private aircraft | 2,500 sq. ft. of Aircraft hangar space |
| Fort Wayne-Allen County Airport Authority Parcel No. 1,2, & 3 | Leased | $21,400 | November 2004 | Landlord, service and refueling of commercial and private aircraft | 115,128 sq. ft. of space used for parking, ramp and hangar space |
| Fort Wayne-Allen County Airport Authority | Leased | $100 | December 2005 | Landlord, service and refueling of commercial and private aircraft | Fuel Farm Consisting of 57,000 sq. ft. |
| BIRMINGHAM AIRPORT | | | | | |
| Birmingham Airport Parcel 1-6&9 | Leased | $140,400 | August 2021 | Landlord, service and refueling of commercial and private aircraft | Office, hangar, storage, and ramp space on 29.30 acres |
| Parcel G | Leased | | August 2021 | Fuel Farm | |

(1) This property was purchased in May 1995 for $515,000 and is subject to a first mortgage to U.S. Bank in the sum of $298,000 at June 30, 2002 repayable with interest at 9% in equal monthly installments of approximately $4,450, the last payment due May 2010.

(2) Term date is subject to change upon completion of tenant improvements.(3) The leasehold interest is subject to security interest granted to Fleet National Bank f/k/a Bank Boston.

At most commercial airports where Mercury operates FBOs, Mercury maintains its own fuel storage capabilities. Effective January 1, 2000, Mercury has replaced, retrofit or closed most of its existing underground fuel storage facilities in order to comply with applicable federal regulations. See Business Environmental Matters and Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources. The following table summarizes Mercury s existing fuel storage facilities.

| Location | Approximate Capacity (gallons) |
|---|---|
| Los Angeles, California | 310,000(UG) |
| Bakersfield, California | 98,000(62,000 AG; 36,000 UG) |
| Burbank, California | (1) |
| Santa Barbara, California | 54,000 |
| Reno, Nevada | 47,000(AG) |
| Ontario, California | 88,000(UG) |
| Dallas, Texas | 57,000(UG)(2) |

| | |
|---|---|
| Corpus Christi, Texas | 25,000(AG) |
| Atlanta, Georgia (Hartsfield) | 49,000(AG) |
| Atlanta, Georgia (Peachtree) | 47,000(AG) |
| Fresno, California | 42,000(AG) |
| Nashville, Tennessee | 37,000(AG) |
| Charleston, South Carolina | 24,000(AG) |
| Jackson, Mississippi | 42,000(AG)(3) |
| Tulsa, Oklahoma | 126,000(UG) |
| Fort Wayne, Indiana | 170,000(AG) |
| John s Island, South Carolina | 18,000(UG) |
| Birmingham, Alabama | 195,500(AG) |

stributor the sums that it has paid to Eagle Eye in respect of those Defective Products that are not replaced or repaired within th