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MERCURY AIR GROUP INC
Form 10-Q/A
October 15, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A

(Mark One)

Amendment No. 2 to Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2001

Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 For the Transition period from _____ to _____

Commission File No. 1-7134

MERCURY AIR GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware	11-1800515
-----	-----
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

5456 McConnell Avenue, Los Angeles, CA	90066
-----	-----
(Address of principal executive offices)	(Zip Code)

(310) 827-2737

(Registrant's telephone number, including area code)

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 No

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.

Title	Number of Shares Outstanding As of November 9, 2001
-----	-----
Common Stock, \$0.01 Par Value	6,577,380

MERCURY AIR GROUP, INC.
INDEX TO FORM 10-Q/A
INTRODUCTORY NOTE

THE REGISTRANT IS FILING THIS FORM 10-Q/A TO GIVE EFFECT TO THE RESTATEMENT AS DISCUSSED IN NOTE 9 TO THE CONSOLIDATED FINANCIAL STATEMENTS. ONLY PART I, ITEMS 1 AND 2 OF THE ORIGINAL 10-Q FILING ARE BEING AMENDED AND RESTATED AS PART OF THIS 10-Q/A.

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PART 1- FINANCIALS INFORMATION

Item 1. Financial Statements

MERCURY AIR GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	(AS RESTATED, SEE ----- SEPTEMBER 30, 2001 -----)
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	\$ 875,000
Trade accounts receivable, net of allowance for doubtful accounts of \$2,097,000 at 9/30/01 and \$1,653,000 at 6/30/01	49,301,000
Inventories, principally aviation fuel	4,382,000
Prepaid expenses and other current assets	3,572,000
Net assets of discontinued operations (Note 2)	60,000

Total current assets	58,190,000
PROPERTY, EQUIPMENT AND LEASEHOLDS, net of accumulated depreciation and amortization of \$51,750,000 at 9/30/01 and \$50,811,000 at 6/30/01	72,386,000
Notes Receivable	1,923,000
OTHER ASSETS	8,926,000

	\$ 141,425,000 =====
 LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable	\$ 25,981,000
Accrued expenses and other current liabilities	6,139,000
Income tax payable	592,000
Current portion of long-term debt	7,296,000

Total current liabilities	40,008,000
LONG-TERM DEBT	42,062,000

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DEFERRED RENT	1,501,000
DEFERRED INCOME TAXES	392,000
SENIOR SUBORDINATED NOTE (Note 5)	23,077,000
COMMITMENTS AND CONTINGENCIES (Note 4)	
STOCKHOLDERS' EQUITY	
Preferred Stock - \$0.01 par value; authorized 3,000,000 shares; no shares outstanding	
Common Stock - \$ 0.01 par value; authorized 18,000,000 shares; outstanding 6,576,680 shares at 9/30/01 and 6/30/01	66,000
Additional paid-in capital	21,454,000
Retained earnings	13,626,000
Cumulative translation adjustment (Note 8)	(228,000)
Notes receivable from sale of stock	(533,000)
Total stockholders' equity	34,385,000
	<u>\$ 141,425,000</u>

See accompanying notes to consolidated financial statements

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

	(AS RESTATED, SEE NOTE 9)	
	THREE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
Sales and Revenues:		
Sales	\$ 80,443,000	\$ 89,676,000
Service revenues	23,309,000	21,719,000
	<u>103,752,000</u>	<u>111,395,000</u>
Costs and Expenses:		
Cost of sales	70,289,000	80,810,000
Operating expenses	25,739,000	21,728,000
	<u>96,028,000</u>	<u>102,538,000</u>
Gross Margin (Excluding depreciation and amortization)	<u>7,724,000</u>	<u>8,857,000</u>
Expenses (Income):		
Selling, general and administrative	1,960,000	2,032,000
Provision for bad debts	585,000	799,000
Depreciation and amortization	2,304,000	2,314,000

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Interest expense	1,526,000	1,928,000
Interest income	(17,000)	(30,000)
	-----	-----
	6,358,000	7,043,000
	-----	-----
Income from Continuing Operations Before Provision for Income Taxes	1,366,000	1,814,000
Provision for Income Taxes	533,000	707,000
	-----	-----
Income from Continuing Operations	833,000	1,107,000
(Loss) Income from Discontinued Operations net of income tax (benefit) charge of (\$27,000) in 2001 and \$31,000 in 2000	(42,000)	49,000
	-----	-----
Net Income	\$ 791,000	\$ 1,156,000
	=====	=====
Net Income Per Common Share (Note 6):		
Basic:		
From Continuing Operations	\$ 0.13	\$ 0.17
(Loss) Income from Discontinued Operations	(0.01)	0.01
	-----	-----
Net income	\$ 0.12	\$ 0.18
	=====	=====
Diluted:		
From Continuing Operations	\$ 0.12	\$ 0.16
(Loss) Income from Discontinued Operations	(0.01)	0.01
	-----	-----
Net income	\$ 0.11	\$ 0.17
	=====	=====

See accompanying notes to consolidated financial statements

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	(AS RESTATED, SEE NOTE 9)	
	THREE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 791,000	\$ 1,156,000
Less: (Loss) income from discontinued operations	(42,000)	49,000
	-----	-----
Income from continuing operations	833,000	1,107,000
Adjustments to derive cash flow from operating activities:		
Bad debt expense	585,000	799,000
Depreciation and amortization	2,304,000	2,314,000
Deferred income taxes	12,000	6,000
Deferred rent	147,000	169,000

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Compensation expense related to remeasurement of stock options	12,000	
Amortization of senior subordinated note discount	47,000	46,000
Changes in operating assets and liabilities:		
Trade and other accounts receivable	3,644,000	(14,092,000)
Inventories	(313,000)	(598,000)
Prepaid expenses and other current assets	(690,000)	859,000
Accounts payable	(5,687,000)	16,211,000
Income taxes payable	496,000	310,000
Accrued expenses and other current liabilities	(4,218,000)	(131,000)
	-----	-----
Net cash (used in) provided by operating activities	(2,828,000)	7,000,000
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
(Increase) decrease in other assets	(17,000)	416,000
Acquisition of businesses		(10,400,000)
Increases in Note Receivable	(413,000)	
Additions to property, equipment and leaseholds	(1,326,000)	(889,000)
	-----	-----
Net cash used in investing activities	(1,756,000)	(10,873,000)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term debt		11,440,000
Reduction of long-term debt	(2,663,000)	(7,212,000)
Reduction of note receivable from sale of stock		75,000
Proceeds from exercise of stock options		187,000
	-----	-----
Net cash (used in) provided by financing activities	(2,663,000)	4,490,000
	-----	-----
Net cash provided by (used in) discontinued operations	4,236,000	(71,000)
	-----	-----
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS FROM CONTINUING OPERATIONS	(7,247,000)	617,000
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	3,886,000	2,143,000
	-----	-----
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 875,000	\$ 2,689,000
	=====	=====
CASH PAID DURING THE PERIOD:		
Interest	\$ 1,498,000	\$ 1,611,000
Income taxes (refunded)		\$ (753,000)

See accompanying notes to consolidated financial statements

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2001

(Unaudited)

NOTE 1 -- GENERAL:

BUSINESS:

Mercury Air Group, Inc., a Delaware corporation, provides a broad range

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of services to the aviation industry through four principal operating units: fuel sales and services, cargo operations, fixed base operations and U.S. government contract 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. Cargo operations consist of cargo handling, space logistics operations and general cargo sales agent 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. 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 classified as a discontinued operation (see note 2).

MERCFUEL, INC:

On March 7, 2001, the Company announced its plan to create an independent publicly traded company, MercFuel, Inc. ("MercFuel"). MercFuel was organized in Delaware on October 27, 2000 as a wholly owned subsidiary of the Company. On January 1, 2001, the Company transferred to MercFuel, the assets and liabilities of its Fuel Sales division. On April 30, 2001, MercFuel agreed to sell 239,942 shares of common stock in a private placement at a per share price of \$4.35, the net proceeds of which were \$860,000. The sale will be consummated at such time as the Company's lenders consent to that offering. On May 15, 2001, the Company contributed \$4.0 million of equity to MercFuel in the form of cancellation of intercompany debt payable to the Company. On May 16, 2001 and amended twice thereafter, MercFuel filed a registration statement related to the proposed sale of 1,200,000 shares of common stock (excluding 180,000 shares to cover over-allotments and an option issued to the underwriter to purchase 120,000 shares, exercisable one year after the effective date of the offering at a price equal to 140% of the initial public offering price). There is no assurance the Company will complete the initial public offering, however, if the initial public offering is completed the Company will own at least 80.1% of MercFuel's outstanding common stock. The Company currently intends, subject to satisfactory resolution of certain conditions, to distribute (the "Distribution") all of the shares of MercFuel common stock that the Company owns to the Company's stockholders no earlier than six months after MercFuel's initial public offering. The distribution is subject to consent by the Company's senior and subordinated note holders.

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BASIS OF PRESENTATION:

The accompanying unaudited financial statements reflect all adjustments (consisting of normal, recurring accruals only) which are necessary to fairly present the results for the interim periods. Such financial statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X and therefore do not include all the information or footnotes necessary for a complete presentation. They should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended June 30, 2001 and the notes thereto. The results of operations for the three months ended September 30, 2001 are not necessarily indicative of results for the full year.

Certain reclassifications were made to the prior year and quarter statements to conform to the September 30, 2001 presentation.

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NEW ACCOUNTING PRONOUNCEMENTS:

In July 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations." SFAS No. 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interest method.

In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." The Company has elected to adopt SFAS No. 142 on July 1, 2002. SFAS No. 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairments of goodwill. SFAS. No. 142 also requires the Company to complete a transitional goodwill impairment test six months from the date of adoption. The Company has not yet determined what impact the adoption will have on its financial statements.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which supersedes FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." This new statement also supersedes certain aspects of APB Opinion No 30, "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," with regard to reporting the effects of a disposal of a segment of a business and will require expected future operating losses from discontinued operations to be reported in discontinued operations in the period incurred (rather than as of the measurement date as presently required by APB Opinion No 30). In addition, more dispositions may qualify for discontinued operations treatment. The provisions of this statement are required to be applied on July 1, 2002. The Company has not yet determined what effect this statement will have on its financial statements.

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NOTE 2 -- DISCONTINUED OPERATIONS:

On July 3, 2001, the Company completed the sale of its subsidiary, RPA Airline Automation Services, Inc. ("RPA"), which provides airline revenue accounting and management information software consisting of proprietary software programs which are marketed to foreign and domestic airlines. The Company has reclassified its consolidated financial statements to reflect the sale of RPA and to segregate the revenues, direct costs and expenses (excluding allocated costs), assets and liabilities, and cash flows of RPA. The net operating results, net assets and net cash flows of this business have been reported as "Discontinued Operations" in the accompanying consolidated financial statements.

	THREE MONTHS ENDED SEPTEMBER 30, 2000

Service revenues	\$1,406,000
Operating expense	1,244,000

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Gross margin	162,000

Other expense	82,000

Income before income taxes	80,000
Income tax	31,000

Net income	\$ 49,000
	=====

JUNE 30, 2001

Current assets	\$4,324,000
Total assets	5,292,000
Current and total liabilities	954,000
Net assets of discontinued operations	4,338,000

NOTE 3 -- INCOME TAXES:

Income taxes have been computed based on the estimated annual effective income tax rate for the respective periods.

NOTE 4 -- LITIGATION:

On March 16, 2001, the bankruptcy court approved a settlement related to preference payments received in connection with the Chapter 7 bankruptcy filing for Western Pacific Airlines, Inc., ("WPAI"). The settlement consists of ten quarterly payments of \$175,000, four of which have been made with the unpaid balance secured by a letter of credit. During the quarter ended December 31, 2000 the Company recorded a charge to bad debt expense equal to the present value of the payments, \$1.6 million. The outstanding balance on September 30, 2001 was approximately \$979,000.

In February 2001, the Company received notice of a complaint filed by the Chapter 7 Trustee for Tower Air in regard to a preference action. In July 2001, the Company settled this matter for \$1.0 million. In accordance with the terms of the settlement, the Company paid \$750,000 subsequent to June 30, 2001 and will pay the balance in ten monthly installments of \$25,000 each. As of September 30, 2001, the unpaid note balance was \$225,000 and is secured by a letter of credit.

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In April 2000, Mercury filed a collection action against AER Global Logistics ("AER") in the state of New York. AER filed a counterclaim for \$1.0 million alleging among other things, tortious interference with contract. Mercury believes that this claim is without merit, and accordingly, does not believe this matter will have a significant impact on its financial position or operating results.

On April 3, 2001 Mercury received notice of an action filed by Skylink Express, Inc. in the Superior Court of Justice Ontario, Canada against Excel Cargo, Inc. and others for damages to aircraft occurring in November 30, 1999 and January 10, 2000 at Mirabel International Airport Quebec for a total amount of \$2.5 million Canadian (\$1.65 million U.S.) plus interest and fees. Mercury

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does not believe the outcome of this claim will have a significant impact on its financial position or operating results.

In October 2001, Mercury received notice that the California Court of Appeals had rejected its appeal in the matter of Koye Fernandez v. Mercury Air Group, Inc. The case is currently on appeal to the California Supreme Court. Mercury does not believe the outcome of this claim will have a significant impact on its financial position or operating results.

The Company is also a defendant in certain litigation arising in the normal course of business. In the opinion of management, the ultimate resolution of such litigation will not have a significant effect on the financial statements.

NOTE 5 -- DEBT:

On September 10, 1999, the Company issued, in a private placement, a \$24.0 million senior Subordinated 12% Note ("the Note") due 2006 with detachable warrants to purchase 503,126 shares of the Company's common stock exercisable at \$6.50 per share for seven years. On November 16, 2001, the agreement was amended to reduce the exercise price to \$5.50 per share. The Note agreement contains covenants that, among other matters, limit senior indebtedness, the disposition of assets and unfunded capital expenditures. The covenants also included a ratio test for interest coverage, leverage, fixed charge coverage and debt service. On November 16, 2001 and effective September 30, 2001, the Company received a waiver pertaining to the interest coverage test and the agreement was amended by reducing the ongoing interest coverage test.

NOTE 6 -- EARNINGS PER SHARE:

Basic earnings per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares and potential common shares. Potential common shares include stock options and shares resulting from the assumed conversion of subordinated debentures, when dilutive.

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	Three Months Ended September 30, 2001		Three Months Ended September 30, 2000	
	Diluted	Basic	Diluted	Basic
Weighted average number of common Shares outstanding during the period	6,577,000	6,577,000	6,501,000	6,501,000
Common share equivalents resulting from the assumed exercise of stock options	163,000	--	205,000	
Common shares resulting from the assumed conversion of debentures	36,000	--	51,000	
	-----	-----	-----	-----
Weighted average number of common and common equivalent shares outstanding during the period	6,776,000	6,577,000	6,757,000	6,501,000
	=====	=====	=====	=====

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NOTE 7 -- SEGMENT REPORTING:

The Company operates and reports its activities through four principal units: 1) Fuel Sales, 2) Fixed Based Operations, 3) Cargo Operations and 4) Government Contract Services. Additionally, the Company had a fifth operating unit, RPA, which was sold on July 3, 2001. As a result, RPA's historical operating results have been reclassified as a discontinued operations. The segment data for the quarter ended September 30, 2000 included below has been restated to exclude amounts related to the RPA business unit.

	FUEL SALES -----	FIXED BASE OPERATIONS -----	CARGO OPERATIONS -----	GOVERNMENT CONTRACT SERVICES -----
(DOLLARS IN THOUSANDS)				
QUARTER ENDED SEPTEMBER 30, 2001				
Revenues	\$64,500	\$23,962	\$ 7,138	\$ 8,152
Gross Margin	1,946	3,464	287	2,027
Depreciation and Amortization	15	1,343	587	193
Capital Expenditures		1,225	97	
Segment Assets	26,870	44,430	35,400	22,143
QUARTER ENDED SEPTEMBER 30, 2000				
Revenues	\$73,146	\$23,890	\$ 7,059	\$ 7,300
Gross Margin	2,023	3,745	1,553	1,536
Depreciation and Amortization	15	1,281	632	216
Capital Expenditures	37	11,237	69	(54)
Segment Assets	36,505	33,784	33,307	19,243

Gross margin is used as the measure of profit and loss for segment reporting purposes as it is viewed by key decision makers as the principal operating indicator in measuring segment profitability. The key decision makers also view bad debt expense as an important measure of profit and loss. The predominant component of bad debt expense relates to Fuel Sales. Bad debt expense for Fuel Sales was approximately \$485,000 and \$699,000; total bad debt expense was \$585,000 and \$799,000 in the quarter ending September 2001 and September 2000, respectively.

NOTE 8 -- COMPREHENSIVE INCOME:

For the periods presented, adjustments to derive comprehensive income from net income were insignificant.

NOTE 9 -- RECLASSIFICATION AND RESTATEMENT OF FINANCIAL STATEMENTS

Subsequent to the issuance of its interim consolidated financial statements for the three months ended September 30, 2001, the Company corrected its accounting to properly record leasehold amortization expenses for the cargo operations, certain FBO operating expenses, compensation resulting from changes in stock option terms and sales tax adjustments. As a result, the accompanying consolidated financial statements for the three months ended September 30, 2001 have been restated from the amounts previously reported to properly reflect such expenses. The aggregate of all adjustments was an increase in net income of \$85,000 for the three months ended September 30, 2001.

In addition, the Company has reflected in the accompanying consolidated financial statements certain reclassifications associated with one of its cargo warehouse leases. These reclassifications resulted in an increase of property,

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equipment and leaseholds, with a corresponding increase of long-term deferred rent, as of September 30, 2001 and June 30, 2001, and a decrease of gross margin (excluding depreciation and amortization), with a corresponding decrease of depreciation and amortization expense, for the three months ended September 30, 2001 and 2000. The reclassifications had no effect on total stockholders' equity, net income (loss) or earnings (loss) per share for any period presented.

A summary of the significant effects of the restatement and reclassifications is as follows:

INCOME STATEMENT:

	For the Three Months Ended Se		
	2001		
	(In Thousands)		
	As Previously Reported	As Restated	As Previ Report
Gross Margin (Excluding Depreciation and Amortization)	\$ 7,746	\$ 7,724	\$ 9,0
Selling, General and Administration	\$ 1,948	\$ 1,960	\$ 2,0
Depreciation and Amortization	\$ 2,477	\$ 2,304	\$ 2,4
Income from Continuing Operations Before			
Provision for Income Taxes	\$ 1,227	\$ 1,366	\$ 1,8
Income from Continuing Operations	\$ 748	\$ 833	\$ 1,1
Net Income	\$ 706	\$ 791	\$ 1,1
Net Income Per Common Share:			
Basic:			
From Continuing Operations	\$ 0.11	\$ 0.13	\$ 0.
Net Income	\$ 0.11	\$ 0.12	\$ 0.
Diluted:			
From Continuing Operations	\$ 0.11	\$ 0.12	\$ 0.
Net Income	\$ 0.10	\$ 0.11	\$ 0.

BALANCE SHEET:

	As of September 30, 2001		As of
	(In Thousands)		(In
	As Previously Reported	As Reclassified	As Previou Reported
Property, Equipment, and Leaseholds, net	\$ 70,859	\$ 72,386	\$ 71,77
Total Assets	\$139,919	\$141,425	\$151,13
Total Current Liabilities	\$ 40,100	\$ 40,008	\$ 49,58
Deferred Rent -- Non current		\$ 1,501	
Total Liabilities	\$105,631	\$107,040	\$117,55
Total Stockholders' Equity	\$ 34,288	\$ 34,385	\$ 33,58

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ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following management's discussion and analysis of financial condition and results of operations gives effect to the restatement discussed in Note 9 to the consolidated financial statements.

Results of operations-comparison of the three months ended September 30, 2001 and September 30, 2000. The following tables set forth, for the periods indicated, the revenues and gross margin for each of the Company's four operating units, as well as selected other financial statement data.

	THREE MONTHS ENDED SEPTEMBER 30,			
	(\$ IN MILLIONS)			
	2001		2000	
	AMOUNT	% OF TOTAL REVENUES	AMOUNT	% OF TOTAL REVENUES
Revenues:				
Fuel Sales	\$ 64.5	62.1%	\$ 73.1	65.7%
FBOs	24.0	23.1	23.9	21.4
Cargo Operations	7.1	6.9	7.1	6.3
Government Contract Services	8.2	7.9	7.3	6.6
	-----	-----	-----	-----
Total Revenue	\$103.8	100.0%	\$111.4	100.0%
	=====	=====	=====	=====
		% of Unit		% of Unit
	Amount	Revenues	Amount	Revenues
	-----	-----	-----	-----
Gross Margin(1):				
Fuel Sales	\$ 1.9	3.0%	\$ 2.0	2.8%
FBOs	3.5	14.5	3.8	15.7
Cargo Operations	0.3	4.0	1.5	22.0
Government Contract Services	2.0	24.9	1.5	21.0
	-----	-----	-----	-----
Total Gross Margin	\$ 7.7	7.5%	\$ 8.8	8.0%
	=====	=====	=====	=====
		% of Total		% of Total
	Amount	Revenues	Amount	Revenues
	-----	-----	-----	-----
Selling, general and administrative	\$ 1.9	1.9%	\$ 2.0	1.8%
Provision for bad debts	0.6	0.6	0.8	0.7
Depreciation and amortization	2.3	2.2	2.3	2.1
Interest expense and other	1.5	1.5	1.9	1.7

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Income from continuing operations	-----	-----	-----	-----
before tax	1.4	1.3	1.8	1.6
Provision for income taxes	0.5	0.5	0.7	0.6
	-----	-----	-----	-----
Income from continuing operations	0.9	0.8	1.1	1.0
(Loss) income from discontinued operations	(0.1)	--	0.1	0.1
	-----	-----	-----	-----
Net Income	\$ 0.8	0.8%	\$ 1.2	1.0%
	=====	=====	=====	=====

- (1) Gross margin as used here and throughout Management's Discussion excludes depreciation and amortization and selling, general and administrative expense.

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THREE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO SEPTEMBER 30, 2000

Revenue decreased by 6.9% to \$103.8 million in the current period from \$111.4 million in the prior year due to lower fuel prices in the current period. Gross margin decreased 12.8% to \$ 7.7 million in the current period from \$8.8 million a year ago, primarily due to a decline in Cargo operations and higher operating costs.

Revenues from fuel sales represented 62.1% of total revenues in the current period compared to 65.7% of revenues a year ago. Revenues from fuel sales decreased 11.8% to \$64.5 million from \$73.1 million last year. The decrease from fuel sales was due to a decrease of 18% in the price of fuel sold, partially offset by an increase of 7.5% in volume sold. Gross margin from fuel sales was \$1.9 million in the current period compared with \$2.0 million last year primarily due to lower per gallon margins in the current period caused by a change in the customer mix. Following September 11th, for several days, the Company's operations were partially shutdown and sales were negligible as airlines were not flying. As a result, fuel volumes were lower by approximately 18% in September compared with the previous two months. Since that time volumes have returned closer to normal levels. Revenues and gross margin from fuel sales includes the activities of Mercury's contract fueling business.

Revenues from FBOs were \$24.0 million in the current period compared to \$23.9 million a year ago. Gross margin decreased 8.0% in the current period to \$3.5 million from \$3.8 million last year. The gross margin decrease was primarily caused by the impact the events of September 11th had on operations in the month of September with lower sales volume combined with fixed costs. In September, the volume of fuel sold was down approximately 28% compared to the first two months of the period. Since September, volumes have returned closer to normal levels. Additionally, revenues in the current period were favorably impacted by the addition of Birmingham in September 2000.

Revenues from cargo operations were \$7.1 million in both periods. Gross margin from cargo operations in the current period decreased 81.5% to \$0.3 million from \$1.5 million in the year ago period due to higher operating costs, primarily labor and lease costs, associated with cargo handling and general sales agency (GSA). The Company's operations in Atlanta were impacted by higher lease costs associated with a new facility and lower revenues primarily caused by the loss of an account which had represented approximately 30% of its revenues in the year ago period and none in the current period. Revenues from existing customers at the Company's LAX operations for both warehouse and GSA were lower compared to last year due to a softer marketplace while operating expenses rose. New GSA accounts were added during fiscal 2001 subsequent to September 2000 which offset

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lower revenues from existing customers, but operating expenses increased correspondingly. Revenues in September 2001 approximated revenues in the first two months of the quarter and have remained relatively constant since. The Cargo business has been impacted by a slowdown in worldwide cargo tonnage and shipments.

Revenues from government contract services increased 11.7% in the current period to \$8.2 million from \$7.3 million in the year ago period due to new contracts added in fiscal 2001 and in the current period, partially offset by lower weather observation and forecasting revenues from fewer contracts and the loss of the Yokota, Japan contract in September 2001 which provided \$1.8

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million or 25.0% of total revenues during the quarter ended September 30, 2000 and \$5.1 million or 17.6% of total revenues during fiscal year 2001. Gross margin from government contract services in the current period increased 32.0% to \$2.0 million from \$1.5 million last year due to higher revenues and higher margins.

Selling, general and administrative expenses in the current quarter decreased 3.5% to \$1.9 million from \$2.0 million in last year's quarter due to the cost of repurchasing certain options in the year ago period, partially offset by higher professional fees in the current period.

Provision for bad debts decreased 26.8% in the current period to \$0.6 million from \$0.8 million a year ago primarily due to lower sales in the current period.

Depreciation and amortization expense was \$2.3 million in the current period compared to \$2.3 million a year ago.

Interest expense decreased by 20.9% in the current period to \$1.5 million from \$1.9 million a year ago due lower interest rates.

Income tax expense approximated 39% of pre-tax income in both periods reflecting the expected effective annual tax rate.

Loss from discontinued operations was \$42,000 in the current period net of a tax benefit of \$27,000 and was related to the sale of property which was included in net assets of discontinued operations at June 30, 2001. Income from discontinued operations of \$49,000, net of income taxes of \$31,000, in the year ago period was related to RPA's operations.

LIQUIDITY AND CAPITAL RESOURCES:

The events of September 11, 2001 have had a significant impact on the aviation industry and, as a result, have impacted the Company's operations as well. In the first few days following September 11th, revenue from the Company's fuel sales, cargo and FBO operations were negligible. At this time, the Company's operations are returning to normal levels. In view of the uncertainty of the ultimate impact upon the aviation industry, the long-term impact to the Company's customers and operations cannot be determined at this time.

On March 7, 2001, the Company announced its plan to create an independent publicly traded company, MercFuel, Inc. MercFuel, Inc. was organized in Delaware on October 27, 2000 as a wholly owned subsidiary of the Company. On January 1, 2001, the Company transferred to MercFuel, Inc. the assets and liabilities of its Fuel Sales division. On April 30, 2001, MercFuel, Inc. agreed to sell 239,942 shares of common stock in a private placement at a per share price of \$4.35, the net proceeds of which are \$860,000. The sale will be consummated at such time as the Company's lenders consent to that offering. On May 15, 2001,

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the Company contributed \$4.0 million of equity to MercFuel, Inc. in the form of cancellation of intercompany debt payable to the Company. On May 16, 2001 and amended twice thereafter, MercFuel filed a registration statement related the proposed sale of 1,200,000 shares of common stock (along with an additional 180,000 shares to cover over-allotments and an option issued to the underwriter to purchase 120,000 shares, exercisable one year after the effective date of the offering at a price equal to 140% of the initial public offering price). There can be no assurance that the Company will be able to complete the

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initial public offering, however, if the offering is completed, the Company will own at least 80.1% of MercFuel's outstanding common stock. The Company currently intends, subject to satisfactory resolution of certain conditions, to distribute (the "Distribution") all of the shares of MercFuel common stock that the Company owns to the Company's stockholders no earlier than six months after MercFuel's initial public offering. The Distribution is subject to consent by the Company's senior and subordinated debt holders.

Mercury has historically financed its operations primarily through operating cash flow, bank debt and various public and private placements of bonds and subordinated debt. Mercury's cash balance at September 30, 2001 was \$875,000.

Net cash used in operating activities was \$2.8 million for the period ended September 30, 2001. During this period, the primary sources of net cash provided by operating activities was income from continuing operations plus depreciation and amortization totaling \$3.1 million and a decrease in accounts receivable of \$3.6 million. The primary use of cash from operating activities in this period was a decrease in accounts payable of \$5.7 million and a decrease in accrued expenses and other current liabilities of \$4.2 million.

Net cash used in investing activities was \$1.8 million during the current period primarily due to additions to property, equipment and leaseholds and notes receivables.

Net cash used in financing activities was \$2.7 million during the current period due to a reduction in long-term debt.

Net cash provided by Discontinued Operations was \$4.2 million in the current period primarily due to the sale of RPA on July 3, 2001.

The Company's senior secured bank credit facility consists of a \$35.0 million Revolver, a term loan with an outstanding balance of \$11.2 million at September 30, 2001 and an acquisition facility with an outstanding balance of \$17.4 million at September 30, 2001. At September 30, 2001, there was \$2.5 million outstanding under the Revolver. The agreement contains provisions that require the maintenance of certain financial ratios including minimum tangible net worth (as defined), minimum profitability levels, maximum leverage and minimum debt service coverage and quick ratios and limitations on annual capital expenditures. Additionally, the Company is prohibited from paying dividends in excess of \$400,000 per year. These facilities mature in March 2004. In connection with the proposed Distribution, the Company had executed term sheets with two financial institutions to replace its senior credit facility. These term sheets included a \$20.0 million revolving credit facility which would be entered into by MercFuel, Inc. and a \$60.0 million facility which would be entered into by the Company. These term sheets have expired due to various delays and it is uncertain at this time whether the lenders will agree to renew or replace these term sheets given the environment in the credit markets since September 11, 2001.

On September 10, 1999, the Company issued, in a private placement, a \$24.0

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million senior Subordinated 12% Note ("the Note") due 2006 with detachable warrants to purchase 503,126 shares of the Company's common stock exercisable at \$6.50 per share for seven years. On November 16, 2001, the Company agreed to reduce the exercise price to \$5.50 per share. The Note agreement contains covenants that, among other matters, limit senior indebtedness, the disposition of assets and unfunded capital expenditures. The covenants also included a ratio test

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for interest coverage, leverage, fixed charge coverage and debt service. On November 16, 2001 and effective September 30, 2001, the Company received a waiver pertaining to the interest coverage test and the agreement was amended by reducing the ongoing interest coverage test.

On September 26, 2001, the Company announced that it had agreed to enter into a financing arrangement to issue convertible subordinated debentures for a total amount of \$110.0 million discounted to \$71.9 million, with funding expected to occur in October 2001 of approximately \$25.0 million and the balance within one year. As of this date, the funding has not occurred and the Company believes that such funding will not occur.

On August 10, 2001, MercFuel, Inc. entered into an agreement with a provider of hardware and software applications ("System Provider"), for the development and exclusive license of an aviation fuel management system. The agreement requires MercFuel, Inc. to enter into a non-interest bearing note in the amount of \$750,000, payable in 24 equal monthly payments beginning in August 2002 (the present value of which is \$640,000, assuming an imputed interest rate of 8%). The note is convertible, at MercFuel's option, at any time after the Distribution into 125,000 shares of MercFuel common stock. MercFuel is also required to attempt to register the shares. In addition, if MercFuel does not complete an offering of its common shares by December 31, 2001, the agreement shall be terminated.

In the event that fuel prices increase significantly for an extended period of time, the Company's liquidity could be adversely affected unless the Company is able to increase vendor credit or increase lending limits under its revolving credit facility. The Company believes, however its revolver and vendor credit should provide it with sufficient liquidity in the event of a major temporary surge in oil prices.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Mercury Air Group, Inc.
Registrant

/s/ Joseph Czyzyk

Joseph Czyzyk
Chief Executive Officer

/s/ Robert Schlax

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Robert Schlax
Vice President Finance
(Principal Financial Officer)

Date: October 14, 2002

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I, Joseph Czyzyk certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Mercury Air Group, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

Date: October 14, 2002

/s/ JOSEPH CZYZYK

Joseph Czyzyk
Chief Executive Officer

I, Robert M. Schlax certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Mercury Air Group, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

Date: October 14, 2002

/s/ ROBERT M. SCHLAX

Robert M. Schlax
Vice President Finance
(Principal Financial Officer)