

MERCURY AIR GROUP INC

Form 10-Q

January 13, 2004

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UNITED STATES OF AMERICA
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2003

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
*(State or other jurisdiction of
incorporation or organization)*

11-1800515
*(I.R.S. Employer
Identification Number)*

5456 McConnell Avenue
Los Angeles, CA
(Address of principal executive offices)

90066
(Zip Code)

Registrant's telephone number, including area code:

(310) 827-2737

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 by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). 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 January 7, 2004 |
|--------------------------------|---|
| Common Stock, \$0.01 Par Value | 2,954,818 |

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| | September 30, 2003 | June 30, 2003 |
|--|-----------------------|-----------------------|
| | (Unaudited) | |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 3,490,000 | \$ 2,802,000 |
| Trade accounts receivable, net of allowance for doubtful accounts of \$2,448,000 at September 30, 2003 and \$2,006,000 at June 30, 2003 | 48,758,000 | 46,753,000 |
| Inventories, principally aviation fuel | 4,225,000 | 4,422,000 |
| Prepaid expenses and other current assets | 3,708,000 | 5,241,000 |
| Deferred income taxes | 1,125,000 | 901,000 |
| | <hr/> | <hr/> |
| Total current assets | 61,306,000 | 60,119,000 |
| PROPERTY, EQUIPMENT AND LEASEHOLDS, net of accumulated depreciation and amortization of \$62,058,000 at September 30, 2003 and \$61,061,000 at June 30, 2003 | 58,048,000 | 58,844,000 |
| NOTES RECEIVABLE, net of allowance for doubtful accounts of \$463,000 at September 30, 2003 and \$509,000 at June 30, 2003 | 1,509,000 | 1,815,000 |
| DEFERRED INCOME TAXES | 2,282,000 | 2,284,000 |
| GOODWILL | 4,389,000 | 4,389,000 |
| OTHER INTANGIBLE ASSETS, NET | 958,000 | 1,033,000 |
| OTHER ASSETS, NET | 4,205,000 | 4,471,000 |
| | <hr/> | <hr/> |
| TOTAL ASSETS | \$ 132,697,000 | \$ 132,955,000 |
| | <hr/> | <hr/> |
| LIABILITIES, MANDATORILY REDEEMABLE PREFERRED STOCK AND STOCKHOLDERS EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 34,534,000 | \$ 34,677,000 |
| Accrued expenses and other current liabilities | 11,095,000 | 10,162,000 |
| Current portion of long-term debt | 4,156,000 | 4,194,000 |
| | <hr/> | <hr/> |
| Total current liabilities | 49,785,000 | 49,033,000 |
| LONG-TERM DEBT | 24,771,000 | 25,501,000 |
| SENIOR SUBORDINATED NOTE | 23,489,000 | 23,445,000 |
| DEFERRED RENT | 1,728,000 | 1,885,000 |
| MINORITY INTEREST | 184,000 | 180,000 |
| | <hr/> | <hr/> |
| Total liabilities | 99,957,000 | 100,044,000 |
| COMMITMENTS AND CONTINGENCIES | | |
| MANDATORILY REDEEMABLE PREFERRED STOCK, Series A \$0.01 par value; 1,000,000 shares authorized; | 490,000 | 481,000 |

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462,627 shares outstanding at September 30 and June 30, 2003

STOCKHOLDERS EQUITY:

| | | |
|---|-----------------------------|-----------------------------|
| Preferred Stock \$0.01 par value; authorized 2,000,000 shares; no shares outstanding | | |
| Common Stock \$0.01 par value; authorized 18,000,000 shares; 3,298,418 and 3,293,568 shares outstanding at September 30 and June 30, 2003, respectively | 33,000 | 33,000 |
| Additional paid-in capital | 22,509,000 | 22,496,000 |
| Retained earnings | 13,716,000 | 14,018,000 |
| Accumulated other comprehensive loss | (78,000) | (86,000) |
| Notes receivable from officers | (3,930,000) | (4,031,000) |
| | <u> </u> | <u> </u> |
| Total stockholders equity | 32,250,000 | 32,430,000 |
| | <u> </u> | <u> </u> |
| Total liabilities, mandatorily redeemable preferred stock and stockholders equity | \$ 132,697,000 | \$ 132,955,000 |
| | <u> </u> | <u> </u> |

See accompanying notes to consolidated financial statements.

Table of Contents**MERCURY AIR GROUP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS**

| | Three Months Ended September 30, | |
|--|---|---------------------|
| | 2003 | 2002 |
| | (Unaudited) | |
| Sales and revenues: | | |
| Sales | \$ 78,576,000 | \$ 85,450,000 |
| Service revenues | 22,437,000 | 22,445,000 |
| | <u>101,013,000</u> | <u>107,895,000</u> |
| Costs and expenses: | | |
| Cost of sales | 68,986,000 | 76,034,000 |
| Operating expenses | 25,312,000 | 25,911,000 |
| | <u>94,298,000</u> | <u>101,945,000</u> |
| Gross margin (excluding depreciation and amortization) | <u>6,715,000</u> | <u>5,950,000</u> |
| Expenses (income): | | |
| Selling, general and administrative | 2,275,000 | 2,615,000 |
| Provision for bad debts | 383,000 | 352,000 |
| Depreciation and amortization | 2,171,000 | 2,051,000 |
| Interest expense | 2,594,000 | 1,384,000 |
| Write-off of deferred financing costs | | 500,000 |
| Interest income | (213,000) | (52,000) |
| | <u>7,210,000</u> | <u>6,850,000</u> |
| Loss before income tax benefit | (495,000) | (900,000) |
| Income tax benefit | (193,000) | (311,000) |
| Net loss | (302,000) | (589,000) |
| Accrued preferred stock dividends | (9,000) | |
| Net loss applicable to common stockholders | <u>\$ (311,000)</u> | <u>\$ (589,000)</u> |
| Net loss per common share: | | |
| Basic | <u>\$ (0.09)</u> | <u>\$ (0.18)</u> |
| Diluted | <u>\$ (0.09)</u> | <u>\$ (0.18)</u> |

See accompanying notes to consolidated financial statements.

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Three Months Ended September 30, | |
|--|-------------------------------------|--------------------|
| | 2003 | 2002 |
| | (Unaudited) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$ (302,000) | \$ (589,000) |
| Adjustments to derive cash flow from operating activities: | | |
| Bad debt expense | 383,000 | 352,000 |
| Depreciation and amortization | 2,171,000 | 2,051,000 |
| Deferred income taxes | (222,000) | 1,000 |
| Deferred rent | (157,000) | 147,000 |
| Compensation expense related to remeasurement of stock options | | 318,000 |
| Expense related to amortization of executive stock plan | 101,000 | 102,000 |
| Amortization of senior subordinated note discount | 44,000 | 49,000 |
| Loss on retirement of assets | | 41,000 |
| Minority interest | 4,000 | |
| Changes in operating assets and liabilities: | | |
| Trade and other accounts receivable | (2,388,000) | 562,000 |
| Inventories | 197,000 | (3,576,000) |
| Prepaid expenses and other current assets | 1,533,000 | (159,000) |
| Accounts payable | (143,000) | (2,756,000) |
| Accrued expenses and other current liabilities | 942,000 | (272,000) |
| | <u>2,163,000</u> | <u>(3,729,000)</u> |
| Net cash provided by (used in) operating activities | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Decrease in restricted cash | | 3,530,000 |
| Increase in other assets | 125,000 | (37,000) |
| Decrease in notes receivable | 306,000 | 80,000 |
| Proceeds from sale of property | | 35,000 |
| Additions to property, equipment and leaseholds | (1,160,000) | (610,000) |
| | <u>(729,000)</u> | <u>2,998,000</u> |
| Net cash provided by (used in) investing activities | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net reduction of debt instruments | (768,000) | (418,000) |
| Repurchase of common stock | | (370,000) |
| Proceeds from exercise of stock options | 14,000 | |
| | <u>(754,000)</u> | <u>(788,000)</u> |
| Net cash used in financing activities | | |
| Effect of exchange rate changes on cash | 8,000 | (39,000) |

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| | | |
|---|---------------------|---------------------|
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 688,000 | (1,558,000) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | <u>2,802,000</u> | <u>5,565,000</u> |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | <u>\$ 3,490,000</u> | <u>\$ 4,007,000</u> |
| CASH PAID DURING THE PERIOD FOR: | | |
| Interest | \$ 1,527,000 | \$ 1,286,000 |
| Income taxes | \$ 349,000 | \$ 4,539,000 |

See accompanying notes to consolidated financial statements.

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2003

(Unaudited)

Note 1 General

Business

Mercury Air Group, Inc. (the Company), a Delaware Corporation, was organized in 1956 and provides a broad range of services to the aviation industry through four principal operating units: Mercury Air Centers, Inc. (Air Centers), Mercury Air Cargo, Inc. (Air Cargo), MercFuel, Inc. (MercFuel) and Maytag Aircraft Corporation (Maytag), a provider of government contract services. The Air Centers operations consist of aviation fuel sales, commercial aircraft refueling operations (into-plane), aircraft ground support services, aircraft hangar services, secured aircraft parking (aircraft tie-down services) and aircraft maintenance at certain Air Center locations, known as Fixed Based Operations (FBOs), for commercial, private, general aviation and United States Government aircraft (collectively FBO services). Air Cargo's operations consist of cargo handling, the sale of cargo capacity on other airlines (Cargo Space Logistics), and general cargo sales agent services. MercFuel's operations consist of the sale and delivery of fuel, primarily aviation fuel, to domestic and international commercial airlines, corporate aviation and air freight airlines. Maytag's government contract services consist of the following services primarily for agencies of the United States Government: aircraft refueling and fuel storage operations, base operations support (BOS) services, air terminal and ground handling services and weather observation and forecasting services.

On October 28, 2003, the Company announced that it had entered into a definitive agreement, subject to the Company's stockholders approval, completion of due diligence, and regulatory agencies' approvals and consents, to sell 100% of the outstanding common stock of Air Centers to Allied Capital Corporation (Allied) for \$70 million, subject to adjustments (the FBO Sale). In accordance with the terms of the definitive agreement, as amended, closing of this transaction is to occur on January 16, 2004 but the closing date can be extended, at Allied's discretion, to April 16, 2004. The Company expects the closing of the FBO sale to occur during its third quarter of fiscal 2004.

Risks and Uncertainties

As of September 30, 2003, the \$24.0 million Senior Subordinated 12% Note (the Note) contained provisions that provided incentives for the Company to prepay the principal of the Note. If the entire principal of the Note was not prepaid by December 31, 2003, the Note holder would have been entitled to stock warrants equivalent to 5% of the Company's outstanding shares of common stock then outstanding, exercisable for nominal consideration. If the principal amount of the Note was in excess of \$12.0 million on December 31, 2003, the Note holder would have been entitled to receive stock warrants equivalent to an additional 5% of the number of shares of common stock outstanding at that date, exercisable for nominal consideration, along with an additional note with a principal amount of \$5.0 million. In addition, beginning January 2004 and continuing through June 2004, the interest rate was to increase by 1% per annum each month up to a maximum rate of 18%. Since December 30, 2002, the effective date of this amended Note, the Company expected that the Note would be outstanding for the full term of the Note and, therefore, accrued for the premium associated with the issuance of the additional consideration over the remaining term of the Note which was 36 months. However, on October 28, 2003, the Company announced that Allied had acquired the Note from the holder and had waived the provisions of the Note regarding the additional stock warrants, equivalent to 10% of the Company's outstanding common stock, that would have been issued on December 31, 2003, as well as the provision regarding the additional \$5.0 million note. In conjunction with the acquisition of the Note by Allied, the Company and Allied entered into a definitive agreement for Allied to purchase 100% of the outstanding common stock of Air Centers from the Company, subject to the Company's stockholders' approval, completion of due diligence and regulatory agency approvals. The purchase price for the Air Centers is \$70 million, subject to adjustment for working capital and for certain investments made by the Company. At

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

the close of the FBO Sale, \$8.3 million from the sale proceeds will be deposited into an escrow account pending the award of a new lease for the FBO located at Atlanta's Hartsfield International Airport. In accordance with the terms of the definitive agreement, as amended, the closing date for the FBO Sale is January 16, 2004 with Allied having the right to extend the closing date through April 16, 2004. The Company expects the FBO Sale to close during its third quarter of fiscal 2004.

On December 5, 2003, the Company and its lenders under the Senior Secured Credit Facility executed the Fifth Amendment to the Loan and Security Agreement and Forebearance Agreement (the Forebearance Agreement). Among other things, the Company requested the lenders and the lenders agreed to forebear from exercising their rights and remedies under the Senior Secured Credit Facility for the following events of default, as defined in the Loan and Security Agreement: (1) the Company's failure to deliver its annual audited financial statements for the fiscal year 2003 within the prescribed time-frame allowed; (2) the formation of a subsidiary, Mercury Air Center Long Beach, without the prior consent of the lenders; (3) the Company's failure to deliver supplemental schedules to the J. H. Whitney as required under the terms of the \$24 million Senior Secured 12% Note. The Forebearance Agreement states that the lenders agree, for a limited time, to forebear from exercising their rights and remedies under the Senior Secured Credit Facility with respect to the events of default noted above. The Company is currently in compliance with the terms and conditions of the Forebearance Agreement.

In April 2002, the Company received a notice from Los Angeles World Airports (LAWA) of a proposed rental increase for one of Air Cargo's warehouse facilities at LAX (the Avion Warehouse). In response to this notice, the Company submitted protests to the LAWA Staff and Board of Commissioners regarding the proposed increase on the basis that: (1) the Company had made a substantial investment in the warehouse facility and the proposed rental increase would greatly reduce the Company's ability to achieve an acceptable rate of return on the Company's investment to date; (2) if any increase is to be made, it should be determined based on the Company being the developer of the facility and not strictly a tenant; and (3) that the amount of the proposed increase is not justified given the general business environment of the air cargo handling operations. In response to the Company's protests to the proposed increase, in September 2002 the Company received a revised notice from LAWA of a reduced proposal for a rental increase for the Avion Warehouse. The LAWA Staff intend to present their recommended rental increase to the LAWA Board of Commissioners for approval in late January 2004. From June 18, 2003 through September 30, 2003, the accumulated amount of the retroactive rental increase is \$1,772,000, which will be partially offset by recoverable retroactive sublease rental income of \$742,000. The LAWA Staff has indicated that the retroactive portion of the rental increase would be payable by the Company in equal monthly installments over the remaining term of the lease agreement, which is scheduled to expire in June 2006. The proposed increase in the monthly rent, on a go-forward basis, is \$64,000, or 35%, of the existing monthly rent. As of September 30, 2003, the Company has accrued \$1,031,000 for the retroactive rental increase, which is net of the recoverable retroactive sublease rental income. Of this amount, \$113,000 was recorded in the first quarter of fiscal 2004.

Accounts receivable is comprised primarily of trade receivables from customers and is net of an allowance for doubtful accounts. The Company's credit risk is based in part on the following: 1) substantially all receivables are related to the aviation industry, 2) there is a concentration of credit risk as there are several customers who at any time have significant balances owed to the Company, and 3) significant balances are owed by certain customers that are not adequately capitalized. In addition, significantly higher fuel prices for extended periods of time may have a negative impact on the aviation industry as it substantially increases airlines' operating expenses. Smaller airlines with lower levels of capital may be more seriously impacted. The

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

Company assesses its credit portfolio on an ongoing basis and establishes allowances which it believes are adequate to absorb potential credit problems that can be reasonably anticipated.

The Company purchases fuel from a limited number of suppliers. If the Company's relationship with any of these key suppliers terminates, the Company may not be able to obtain a sufficient quantity of fuel on favorable terms or may experience difficulty in obtaining fuel from alternative suppliers. Furthermore, difficulties faced by these suppliers or fuel shortages or the inability to obtain fuel from alternate sources at acceptable prices and terms, could impair the Company's ability to sell fuel to its customers at competitive prices and terms.

Basis of Presentation

The accompanying unaudited financial statements of Mercury Air Group, Inc. and subsidiaries (the Company) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments consisting of normal recurring adjustments and accruals necessary for a fair presentation have been reflected in these financial statements. Operating results for the quarter are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2004 due to seasonal and other factors. In order to maintain consistency and comparability between periods presented, certain prior period amounts have been reclassified to conform to the current period presentation. The accompanying financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2003.

New Accounting Pronouncements

On April 30, 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. This standard amends and clarifies the accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. The provisions of this statement are generally effective for contracts entered into or modified after June 30, 2003. The Company does not expect this standard to have a material impact on the Company's consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46). This interpretation of Accounting Research Bulletin No. 51, Consolidated Financial Statements, addresses consolidation by business enterprises of variable interest entities. Under current practice, two enterprises generally have been included in consolidated financial statements because one enterprise controls the other through voting interests. FIN 46 defines the concept of variable interests and requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among the parties involved. This interpretation applies immediately to variable interest entities created after January 31, 2003. It applies in the first fiscal year or interim period beginning after December 15, 2003, to variable interest entities considered to be a special purpose entity (SPE) in which an enterprise holds a variable interest that it acquired before February 1, 2003. For non-SPE variable interest entities acquired before February 1, 2003, the interpretation must be adopted no later than the first interim or annual period ending after March 15, 2004. The interpretation may be applied prospectively with a cumulative-effect adjustment as of the date on which it is first applied or by restating previously issued financial statements for one or more years with a cumulative-effect adjustment as of the beginning of the first year restated. The Company is currently evaluating the potential impact of the adoption of FIN 46.

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In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, which establishes standards for the classification and measurement of certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires classification of financial instruments within its scope as a liability, including financial instruments issued in the form of shares that are mandatorily redeemable, because those financial instruments are deemed to be, in essence, obligations of the issuer. The Company does not expect that the adoption of this standard will have a material impact on its consolidated financial statements.

Note 2 Stock-Based Employee Compensation

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. The Company has elected to continue utilizing the intrinsic value method to account for stock-based compensation as allowed by SFAS No. 123, Accounting for Stock-Based Compensation.

SFAS No. 148 also amends the disclosure requirements of SFAS No. 123, to require disclosure in both interim and annual financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 is effective for the Company's fiscal year ended June 30, 2003 and for interim financial statements beginning January 1, 2003.

The Company has five stock option plans. As permitted under SFAS No. 123, the Company measures compensation expense related to employee stock options granted utilizing the intrinsic value method as prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations under the intrinsic value method. The following table illustrates the pro forma effect on the net loss if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation.

| | Three Months Ended September 30, | |
|--|-------------------------------------|--------------|
| | 2003 | 2002 |
| Net loss, as reported | \$ (302,000) | \$ (589,000) |
| Add stock-based employee compensation expense included in net loss, net of tax | 62,000 | 274,000 |
| Less total stock based employee compensation determined under the fair value based method for all awards, net of tax | (32,000) | (198,000) |
| Pro forma net loss | \$ (272,000) | \$ (513,000) |
| Basic net loss per share as reported | \$ (0.09) | \$ (0.18) |
| Basic net loss per share pro forma | \$ (0.08) | \$ (0.16) |
| Diluted net loss per share as reported | \$ (0.09) | \$ (0.18) |
| Diluted net loss per share pro forma | \$ (0.08) | \$ (0.16) |

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 May 1, 2002, Mercury received a Notice of Violation (NOV) for its Fort Wayne, Indiana facility alleging that Mercury's Spill Prevention, Control and Countermeasure Plan (the SPCC Plan) did not meet certain federal regulatory guidelines. Specifically, the Environmental Protection Agency (EPA) alleged

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

that Mercury's SPCC Plan failed to provide for proper parking, secondary containment, and proper drainage of its refueler trucks. Mercury entered into discussions with the EPA and responded to the NOV. On January 29, 2003, the Company was notified of some deficiencies in its latest SPCC Plan and requested that Mercury submit a written response to its allegations within 30 days. On March 14, 2003, Mercury received a NOV from the United States Environmental Protection Agency, Region 5 (EPA Region 5) alleging certain deficiencies in the SPCC Plan for its Fort Wayne, Indiana facility, submitted to the EPA Region 5 in November 2002. Mercury believes that it has resolved all deficiencies except for alleged deficiencies related to secondary containment for refueler trucks, and for its discrete fuel loading areas. Pursuant to an agreement detailed in a letter submitted to the EPA Region 5 on April 16, 2003, Mercury has been permitted to suspend modifications to its SPCC Plan regarding the installation of secondary containment for its refueler trucks, pending resolution of federal regulatory issues associated with secondary containment for such trucks. The EPA Region 5 has also extended national compliance with regulations related to discrete loading areas until August 17, 2004. In the opinion of management, the ultimate resolution of this matter is not expected to have a material effect on the Company's consolidated financial statements.

On April 16, 2003, the Plan Committee of Shuttle America Corp filed a Adversary Proceeding in the United States Bankruptcy Court, District of Connecticut alleging preferential transfers in the amount of \$995,000. The parties reached a settlement agreement, which provides that the Company will pay Shuttle America \$40,000. The settlement agreement is subject to approval of the Bankruptcy Court.

On November 26, 2003, Signature Flight Support Corporation filed a complaint against Mercury Air Centers, Inc. and Allied Capital Corporation alleging: (1) breach of contract and tortious Interference with contract against Allied; (2) interference with prospective economic advantage against Allied; and (3) unfair business practices against Mercury and Allied. The Company believes that the allegations are without merit and is in the process of preparing a response. The Company has agreed to indemnify Allied and its affiliates (including, without limitation, Air Centers after the closing of the FBO Sale), directors, officers, agents, employees and controlling persons from any liability, obligation, loss or expense to which Allied may become subject as a result of the complaint. In the opinion of management, the ultimate resolution of this complaint is not expected to have a material effect on the Company's consolidated financial statements.

On December 5, 2003, the Company terminated its Chief Operating Officer of Mercury Air Cargo. This former employee is claiming one year's salary, (approximately \$170,000), and other damages as a result of the termination. On December 31, 2003, he filed notice of demand for mediation.

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 material effect on its consolidated financial statements. Reference is made to the Company's Annual Report on Form 10-K for the period ended June 30, 2003 for additional Litigation Matters with respect to which no material developments have occurred in the current quarter.

Note 5 Debt

On December 30, 2002, the Company entered into a loan and security agreement, (the Facility), refinancing its senior secured credit facilities with Foothill Capital Corporation (Foothill), a division of Wells Fargo Bank, for a five-year term. In addition, the Company and J.H. Whitney Co. Mezzanine Fund entered into agreements revising the terms of the Note, which will mature on December 31, 2005. The funding under the Facility and the amendments to the Note were completed on December 31, 2002. On October 28, 2003, Allied acquired the Note from J. H. Whitney Co. Mezzanine Fund and waived certain provisions of the Note. See Note 10 Subsequent Event for a description of the Note and the modified terms associated with the Note.

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The Facility provides a total of up to \$42.5 million in revolving and term loans. The term loan is for an amount equal to \$12.5 million, while the revolving loan is for an amount not to exceed 85% of Eligible Accounts Receivable (as defined in the loan agreement), subject to certain limitations. The term loan is payable in \$1.0 million installments each April 1 and October 1, beginning April 1, 2003 and in \$0.5 million installments each July 1 and December 31, until paid in full. Amounts repaid under the term loan increase the maximum availability under the revolving loan. The Facility also provides for the issuance of certain letters of credit. The terms of the Facility requires that the Company maintain a minimum availability on the revolving line of credit of \$2.5 million. As of September 30, 2003, the Company had \$3.9 million of availability on the revolving line of credit. The amount of the available revolving credit line fluctuates on a daily basis dependent upon the amount of Eligible Receivables and the amount of letters of credit outstanding and the amount of outstanding cash borrowings against the revolving credit facility.

The Facility may be terminated on December 23, 2005, if the Note is not paid in full or refinanced, on terms acceptable to Foothill, prior to October 31, 2005. The Facility is collateralized by substantially all of the assets of the Company and its subsidiaries. The Facility contains provisions that require the maintenance of certain financial ratios including minimum EBITDA levels, minimum fixed charge coverage ratios, and maximum annual capital expenditure levels. In addition, under the Facility, the Company is prohibited from paying non-intercompany cash dividends.

While the Note is subordinate to the Facility, the loan and security agreement does allow for the prepayment of principal on both the Note and the Facility under certain conditions. Under the terms of the loan and security agreement, if certain conditions are met, the first \$15.0 million of principal prepayment is to be applied equally to the outstanding principal of the Facility's term loan and the Note. The next \$4.5 million of principal prepayment is to be applied entirely to the outstanding principal of the Note. The next principal prepayments will then either be applied equally to the outstanding principal of the Facility and to the Note or entirely to the outstanding principal of the Note, depending on certain conditions, until the entire \$24.0 million of the Note has been repaid in full.

Note 6 Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Net diluted income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares and potential common shares except for amounts that are antidilutive. Potential common shares include stock options and shares resulting from the assumed conversion of subordinated debentures, when dilutive.

| | Three Months Ended September 30, 2003 | | Three Months Ended September 30, 2002 | |
|--|--|-----------|--|-----------|
| | Diluted | Basic | Diluted | Basic |
| Weighted average number of common shares outstanding during the period | 3,298,418 | 3,298,418 | 3,231,500 | 3,231,500 |
| Common share equivalents resulting from the assumed exercise of stock options | | | | |
| Weighted average number of common and common equivalent shares outstanding during the period | 3,298,418 | 3,298,418 | 3,231,500 | 3,231,500 |

Note 7 Segment Reporting

The Company discloses segment information in accordance with SFAS No. 131, Disclosure About Segments of an Enterprise and Related Information, which requires companies to report selected segment information on a quarterly basis and to report certain entity-wide disclosures about products and services,

Table of Contents**MERCURY AIR GROUP, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

major customers and material countries in which the entity holds assets and reports revenues. The operating segments reported below are the segments of the Company for which operating results are evaluated regularly by management in deciding how to allocate resources and in assessing performance. Intersegment sales are not significant.

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.

| | Fuel Sales | Fixed Base Operations | Cargo Operations | Government Contract Services | Corporate or Unallocated | Total |
|---|------------|--------------------------|---------------------|------------------------------------|--------------------------------|-----------|
| (Dollars In Thousands) | | | | | | |
| Quarter Ended September 30, 2003 | | | | | | |
| Revenues | \$64,990 | \$22,533 | \$ 8,894 | \$ 5,826 | \$ (1,230) | \$101,013 |
| Gross margin | 1,426 | 3,204 | 773 | 1,312 | | 6,715 |
| Depreciation and amortization | 115 | 1,380 | 458 | 81 | 137 | 2,171 |
| Capital expenditures | 637 | 485 | 12 | 17 | 9 | 1,160 |
| Segment assets | 28,104 | 58,292 | 16,864 | 11,068 | 18,369 | 132,697 |
| Quarter Ended September 30, 2002 | | | | | | |
| Revenues | \$70,573 | \$23,826 | \$ 7,290 | \$ 6,206 | | \$107,895 |
| Gross margin | 1,620 | 2,973 | 404 | 953 | | 5,950 |
| Depreciation and amortization | 54 | 1,253 | 546 | 91 | 107 | 2,051 |
| Capital expenditures | | 524 | 65 | | 21 | 610 |
| Segment assets | 30,957 | 58,797 | 15,262 | 12,059 | 15,311 | 132,386 |

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 \$326,000 and \$293,000 for the quarters ended September 30, 2003 and 2002, respectively; total bad debt expense was \$383,000 and \$352,000 in the quarters ended September 2003 and 2002, respectively.

Note 8 Comprehensive Income

Comprehensive loss is summarized as follows:

| | Three Months Ended September 30, | |
|---|-------------------------------------|-------------|
| | 2003 | 2002 |
| Net loss | \$(302,000) | \$(589,000) |
| Foreign currency translation adjustment | 8,000 | (39,000) |
| Comprehensive loss | \$(294,000) | \$(628,000) |

Note 9 Related Party Transactions

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CFK Partners is a partnership consisting of three of the Company's directors, one of whom also serves as the Company's Chief Executive Officer and another who serves as Chairman of the Board. In addition, CFK Partners also owns approximately 28.4% of the Company's outstanding common stock and 24% of the combined common and preferred stock.

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

In January 2002, the Company sold the land and the office building which houses its corporate headquarters to CFK Realty Partners, LLC (CFK Realty) for \$4,200,000, consisting of \$2,800,000 in cash and a note receivable of \$1,400,000. The note accrues interest at 5% and contains provisions whereby CFK Realty can elect to extend the maturity date in one year increments through December 31, 2004. The note had an original maturity date of December 31, 2002. In early December 2003, the Company received notification from CFK Realty that it was exercising its right to extend the maturity date of the note for an additional one year period. Concurrently with the sale, the Company also entered into a ten-year lease of the property for a monthly rental amount of approximately \$37,000. CFK Realty financed the purchase of the building through a \$3.2 million loan. CFK Realty is included in the Company's consolidated financial statements included herein.

The Company and its Chairman (collectively, the Members) each own an equity interest in MercMed LLC (MercMed) of 64.94% and 35.06%, respectively. Accordingly, MercMed has been included in the Company's consolidated financial statements and the liability to the minority interest has also been reflected as of September 30, 2003. Minority Interest on the Company's consolidated balance sheet represents the minority member's equity in MercMed. MercMed was formed for the purpose of owning and operating an aircraft for the Members. In June 2003, the Members amended the MercMed Operating Agreement to amend each Member's ownership interest from 50% for each Member to the ownership percentages previously noted. On March 27, 2003, MercMed obtained new financing for the aircraft which is a 15-year loan with the interest rate being fixed for the initial 36-month period. At the end of the initial 36-month period, the interest rate will be reviewed and fixed at the then Federal Home Loan Bank's regular three-year interest rate plus 275 basis points. Each of the Members are guarantors of this note. Since the inception of the new loan and through September 30, 2003, MercMed is current on the payments due. The outstanding principal amount of the loan as of September 30, 2003 was \$691,000.

The Company uses the services of the legal firm McBreen and Kopko (the Firm) for various general corporate legal matters. Mr. Frederick H. Kopko, Jr., a partner of the Firm, is a member of the Company's Board of Directors and is a partner with CFK Partners, LLC. For the three month periods ended September 30, 2003 and 2002, the Company paid the Firm \$142,000 and \$134,000, respectively, for legal services rendered.

Note 10 Subsequent Events

On October 28, 2003, the Company announced that Allied had acquired the Company's \$24.0 million Senior Subordinated 12% Note from J. H. Whitney Co. Mezzanine Fund (the Whitney Note) and that the Company and Allied had entered into a definitive agreement, subject to stockholders' approval, completion of due diligence and regulatory agencies' approvals and consents, for Allied to acquire 100% of the outstanding stock of Mercury Air Centers, Inc. for \$70 million. The actual cash proceeds to be received by the Company is subject to the establishment of an escrow account of \$8.3 million associated with the month-to-month terms of the Air Centers' FBO located at the Atlanta Hartsfield International Airport, reimbursement for certain FBO capital investments made by the Company, minimum Air Centers working capital at closing and other customary terms and conditions. In accordance with the terms of the definitive agreement, as amended, the FBO Sale is to close on January 16, 2004 but the closing date can be extended, at Allied's discretion, to April 16, 2004. The Company expects this transaction to close during its third quarter of fiscal 2004.

The Whitney Note, as amended, included provisions whereby the Company, if any amount of the principal on the Whitney Note remained outstanding as of December 31, 2003, would issue warrants to the note holder to purchase 5% of the Company's outstanding common stock, exercisable for nominal consideration, and, if the amount of principal on the Whitney Note was greater than \$12.0 million as of December 31, 2003, would issue warrants to the note holder to purchase an additional 5% of the Company's outstanding common stock, exercisable for nominal consideration, along with an additional note in the original principal amount of \$5.0 million. In addition, the Whitney Note, as amended, also provided that beginning January

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MERCURY AIR GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

2004 and continuing through June 2004, the interest rate will increase by 1% per annum each month up to a maximum of 18% per annum. Allied, in the new promissory note issued in replacement of the Whitney Note (the Allied Note), has waived the penalty provisions that were included in the Whitney Note, however, beginning January 2004 and continuing through June 2004, the interest rate will increase by 1% per annum each month up to a maximum of 18% per annum.

On December 12, 2003, the Company entered into a settlement agreement (the Hambro Settlement) relating to litigation with J O Hambro Capital Management and certain of its affiliates and private clients (J O Hambro) whereby the Company issued three promissory notes for an aggregate principle amount of \$3,586,000 (the Hambro Notes) in exchange for the following: (1) the release of certain claims by J O Hambro; (2) the Company's agreement to dismiss litigation against J O Hambro; (3) the Company's agreement not to institute certain litigation against J O Hambro and certain other parties; (4) reimbursement of certain costs associated with the pending litigation and the defense of and preparation for anticipated litigation between the parties; and (5) the purchase of 343,600 shares of the Company's common stock in exchange for the Hambro Notes. The Hambro Notes: (1) are subordinated to the Senior Secured Credit Facility and to the Senior Subordinated Note; (2) are due on the earlier of (a) March 31, 2005, provided that if the Senior Secured Credit Facility matures on December 31, 2007 then such date shall be March 31, 2008 and (b) the ninetieth day following the payment in full of the Senior Secured Credit Facility and the termination of commitments for the Senior Secured Lender to provide financing under the Senior Secured Credit Facility; and (3) bear and accrue interest at the rate of 12% per annum commencing on December 31, 2003 but will increase to 16% per annum for any amount of unpaid principal after June 30, 2004. During the Company's second quarter of fiscal 2004, the Company will recognize expense of \$1.8 million, which represents the consideration paid to J O Hambro in excess of the market value of the shares at the time of the settlement.

At the close of the FBO Sale, the Company estimates gross sales proceeds of \$73.1 million. The Company intends to use these proceeds to: 1) prepay the outstanding principal amount on the Senior Secured Term Loan of \$10 million; 2) repay all outstanding cash advances on the Revolving Line of Credit; 3) pay all accrued interest, fees and expenses associated with the Senior Secured Credit Facility; 4) provide cash collateral for the outstanding Letters of Credit of approximately \$16.0 million; 5) prepay the outstanding principal amount on the Allied Note; 6) pay all accrued interest, fees and expenses associated with the Allied Note; 7) establish an escrow account for the FBO located at the Hartsfield Airport in the amount of \$8.3 million; 8) repay the outstanding principal amount due on the Hambro Note of \$3.6 million; 9) repay all accrued interest on the Hambro Note; and 10) pay all commissions, fees and expenses associated with the FBO Sale. After settlement of the all of the obligations noted above, the Company estimates that the FBO Sale will result in surplus cash proceeds of \$4.0 million, of which an estimated \$1.5 million will be required to settle the Company's current income tax obligation associated with the FBO Sale.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Results of Operations Comparison of the Three Months ended September 30, 2003 and September 30, 2002

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, | | | |
|---------------------------------------|----------------------------------|---------------------|-------------------|---------------------|
| | 2003 | | 2002 | |
| | Amount | % of Total Revenues | Amount | % of Total Revenues |
| (\$ in thousands) | | | | |
| Revenues: | | | | |
| Fuel Sales | \$ 64,990 | 64.3% | \$ 70,573 | 65.4% |
| FBOs | 22,533 | 22.3 | 23,826 | 22.1 |
| Cargo Operations | 8,894 | 8.8 | 7,290 | 6.8 |
| Government Contract Services | 5,826 | 5.8 | 6,206 | 5.7 |
| Intercompany Eliminations | (1,230) | (1.2) | 0 | 0 |
| Total Revenue | \$ 101,013 | 100.0% | \$ 107,895 | 100.0% |
| | | | | |
| | Amount | % of Unit Revenues | Amount | % of Unit Revenues |
| Gross Margin(1): | | | | |
| Fuel Sales | \$ 1,426 | 2.2% | \$ 1,620 | 2.3% |
| FBOs | 3,204 | 14.2 | 2,973 | 12.5 |
| Cargo Operations | 773 | 8.7 | 404 | 5.6 |
| Government Contract Services | 1,312 | 22.5 | 953 | 15.4 |
| Total Gross Margin | \$ 6,715 | 6.7% | \$ 5,950 | 5.5% |
| | | | | |
| | Amount | % of Total Revenues | Amount | % of Total Revenues |
| Selling, general and administrative | \$ 2,275 | 2.3% | \$ 2,615 | 2.4% |
| Provision for bad debts | 383 | 0.4 | 352 | 0.3 |
| Depreciation and amortization | 2,171 | 2.1 | 2,051 | 1.9 |
| Interest expense and other | 2,381 | 2.4 | 1,332 | 1.2 |
| Write off of deferred financing costs | 0 | 0 | 500 | 0.5 |
| Loss before tax | (495) | (0.5) | (900) | (0.8) |
| Income tax benefit | (193) | (0.2) | (311) | (0.3) |
| Net loss | \$ (302) | (0.3)% | \$ (589) | (0.5)% |

- (1) Gross margin as used here and throughout Management's Discussion includes certain selling, general and administrative costs which are charged directly to the operating units, but excludes depreciation and amortization expenses and selling, general and administrative expense.

Three Months Ended September 30, 2003 Compared to September 30, 2002

Revenue for the Company in the first quarter of fiscal 2004 was \$101,013 thousand, which decreased by 6.4% from revenue of \$107,895 thousand reported for the first quarter of fiscal 2003. The decrease in revenue is due to lower MercFuel revenue of \$5,583 thousand. Gross margin increased by 12.9% to \$6,715 thousand in the first quarter of fiscal 2004 from \$5,950 thousand reported in the first quarter of fiscal 2003. The increase in

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gross margin is due to improved performances at the Company's Air Centers, Air Cargo and Maytag Government Contract Services Operations segments.

MercFuel, the Company's fuel sales business, generated revenue of \$64,990 thousand in the current period, a decrease of \$5,583 thousand or 7.9% from last year's revenue of \$70,573 thousand. The decrease in revenue was primarily due to lower sales volume partially offset by higher average fuel sales prices. Fuel sales volume was 64.3 million gallons in the first quarter of fiscal 2004, a decrease of 15.8 million gallons from the same period of fiscal 2003 resulting in a reduction in sales revenue of \$13.9 million. The decline in sales volume is due to National Airlines, Inc. (National), a customer of MercFuel since May 1999, ceasing operations on November 6, 2002. Sales volume to National in the first quarter of fiscal 2003 was 20.9 million gallons, resulting in revenue of \$17.5 million. Excluding the sales volume to National from the sales volume in the first quarter of fiscal 2003, first quarter 2004 sales volume increased 5.2 million gallons, or 8.8% from last year. The average sales price in the first quarter of fiscal 2004 was \$1.01 per gallon, an increase of \$0.129 per gallon from the same period of last year resulting in revenue increasing due to higher average sales prices of \$8.3 million. The higher average sales price is due to higher worldwide petroleum prices. Revenues from the fuel sales business represented 64.3% of the Company's total revenue in the current period compared to 65.4% of revenue in the comparable prior year quarter. Gross margin from fuel sales was \$1,426 thousand in the current period compared with \$1,620 thousand in the same period last year, of which \$0.2 million was generated from sales to National. The decline in gross margin was primarily due to National ceasing operations. The average gross margin per gallon sold in the first quarter of fiscal year 2004 was \$0.0396 per gallon as compared to \$0.0347 for the same period last year.

The Company's Air Centers business segment had revenue of \$22,533 thousand in the first quarter of fiscal year 2004, a decrease of \$1,293 thousand or 5.4% from last year's first quarter revenue of \$23,826 thousand. The revenue decrease was mainly due to lower revenue of \$1.0 million in maintenance activities in the Air Center operations. The Air Centers' aviation fuel sales volume in the first quarter of fiscal 2004 was 7.8 million gallons with an average sales price of \$1.91 per gallon as compared to last year's first quarter sales volume of 8.8 million gallons with an average sales price of \$1.70 per gallon. The higher average sales price was mainly due to higher worldwide petroleum prices. Gross margin increased by \$231 thousand or 7.8% in the current period to \$3,204 thousand from \$2,973 thousand last year due to the Company's efforts to reduce operating expenses.

The Company's Air Cargo operations had revenue of \$8,894 thousand in the first quarter of fiscal 2004, an increase of \$1,604 thousand or 22% from the revenue of \$7,290 thousand in the first quarter of fiscal 2003. The increase in revenue is mainly due to improvements in cargo handling of \$0.5 million, cargo management of \$0.2 million and cargo marketing services of \$0.9 million. Gross margin from Air Cargo operation in the current period increased by \$369 thousand, or 91.3%, to \$773 thousand from \$404 thousand in the year ago period due to higher volume for cargo management and Mercury World Cargo operations resulting in higher gross margin of \$0.2 million and of \$0.2 million, respectively.

The Company's Government Contract Services segment had revenue of \$5,826 thousand in the first quarter of fiscal 2004, a decrease of \$380 thousand or 6.1% from revenue of \$6,206 thousand in the first quarter of fiscal 2003. The revenue decrease is primarily due to the decreased revenue from the Weather Data Services contracts in the amount of \$0.3 million and the loss of one refueling contract, which generated revenue of \$0.3 million last year. Gross margin in the current period increased by \$359 thousand or 37.7% to \$1,312 thousand from \$953 thousand last year due to higher margin on the Kuwait Air Terminal and the Patrick Base Operation contracts, which had a reserve for legal settlements of \$0.3 million in the first quarter of fiscal 2003.

Selling, general and administrative expenses in the current quarter decreased by \$340 thousand, or 13.0%, to \$2,275 thousand from \$2,615 thousand in last year's quarter primarily due to \$0.3 million associated with the extension of certain stock options and \$0.3 million associated with a reserve for legal settlements included in the first quarter of fiscal 2003.

Provision for bad debts was \$383 thousand in the current period, essentially unchanged from the same period last year.

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Depreciation and amortization expense was \$2,171 thousand in the current period compared to \$2,051 thousand a year ago.

Interest expense and other was \$2,381 thousand in the first quarter of fiscal 2004, an increase of \$1,049 thousand from the same period last year. The increase was primarily due to the accrual in the first quarter of fiscal 2004 of \$0.9 million for the premium relating to the senior subordinated note which would have been payable in the event the note was not prepaid prior to December 31, 2003. As noted in Note 10 Subsequent Events, on October 28, 2003, the Company announced that Allied had acquired the senior subordinated note from J.H. Whitney and waived many of the premiums that would have been due in the event that the note was not prepaid by December 31, 2003.

The Company wrote off capitalized financing costs in the first quarter of fiscal 2003 associated with the Company's debt restructuring in the amount of \$500 thousand.

The effective income tax rate in the first quarter of fiscal year 2004 was 39.0% compared to 34.5% in the same period last year. The lower effective income tax rate in the prior period is due to certain non-deductible expenses and a lower effective state income tax benefit rate.

Liquidity and Capital Resources

As of September 30, 2003, the Company's cash and cash equivalents were \$3.5 million, an increase of \$0.7 million as compared to a decrease of \$1.6 million during last year's first quarter.

Cash provided by operating activities for the three month period ended September 30, 2003 was \$2.2 million as compared to cash used for operating activities of \$3.7 million in the first quarter of fiscal 2003. The change in operating assets and liabilities resulted in an increase of \$0.1 as compared to a decrease of \$6.2 million in the first quarter of fiscal 2003 which reflects a payment of \$4.5 million for income taxes primarily due to the sale of the Bedford FBO late in fiscal 2002.

During the first three months of fiscal 2004, the Company used \$0.7 million in investing activities primarily due to additions to property, equipment and leaseholds of \$1.2 million, offset by a \$0.4 million reduction in notes receivable and other assets. This compared to cash provided from investing activities of \$3.0 million during the first quarter of fiscal 2003 resulting from the reduction in restricted cash of \$3.5 million established to pay for the estimated income tax obligation from the sale of the Bedford FBO partially offset by capital expenditures of \$0.6 million. The Company's financing activities resulted in a net cash outlay of \$0.8 million during the first quarter primarily associated with the scheduled repayment of debt, essentially unchanged from last year.

On December 30, 2002, the Company entered into a loan and security agreement with Foothill Capital Corporation (Foothill), now known as Wells Fargo Foothill, a division of Wells Fargo Bank (the Facility), refinancing its senior collateralized credit facilities for a five-year term, as agent for the lenders party thereto. In addition, the Company and J.H. Whitney Co. Mezzanine Fund entered into agreements amending the terms of the subordinated note (the Whitney Note), which will mature on December 31, 2005. The initial funding from the facility and the amendments to the subordinated note were completed on December 31, 2002.

The Company's senior secured credit facility (Facility) consists of up to \$42.5 million in revolving and term loans. The term loan is currently for an amount equal to \$11.0 million, while the revolving loan is for an amount not to exceed 85% of Eligible Accounts Receivable (as defined in the loan agreement), subject to certain limitations. The term loan is payable in \$1.0 million installments each April 1 and October 1, beginning April 1, 2003 and in \$0.5 million installments each July 1 and December 31, until paid in full. Amounts repaid under the term loan increase the maximum availability under the revolving loan. The Facility also provides for the issuance of certain letters of credit. The terms of the Facility require that the Company maintain a minimum availability on the revolving line of credit of \$2.5 million. As of September 30, 2003, the Company had \$3.9 million of availability on the revolving line of credit. The amount of available revolving credit line fluctuates on a daily basis dependent upon the amount of Eligible Receivables, the amount of letters of credit outstanding and the amount of outstanding cash borrowings against the revolving credit facility.

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The Facility may be terminated on December 23, 2005, if the Whitney Note is not paid in full or refinanced, on terms acceptable to Foothill, prior to October 31, 2005. The Facility is collateralized by substantially all of the assets of the Company and its subsidiaries. The Facility contains provisions that require the maintenance of certain financial ratios including minimum EBITDA levels, minimum fixed charge coverage ratios, and maximum annual capital expenditure levels. In addition, under the Facility, the Company is prohibited from paying non-intercompany cash dividends.

The amended Whitney Note is in the form of a \$24.0 million Senior Subordinated 12% Note (the Note) with detachable warrants to purchase 251,563 shares of the Company's common stock exercisable through September 9, 2006 at \$6.10 per share as adjusted for the one-for-two stock split in July 2003. The warrant exercise price was reduced from \$11.0 per share. The Note is collateralized by the Company's assets, subordinate to Foothill's interest. Warrants to purchase an additional 5% of the Company's common stock, exercisable for nominal consideration, will be issuable if the principal amount of the Note is not prepaid by December 31, 2003. Warrants to purchase a second 5% of the Company's common stock, exercisable for nominal consideration, along with an additional note in the original principal amount of \$5 million must also be issued if the outstanding principal amount of the Note is greater than \$12 million after December 31, 2003. However, on October 28, 2003 the Company announced that Allied had acquired the Note from Whitney and waived the provisions for the additional warrants equivalent to 10% of the Company's outstanding common stock and the additional \$5 million note. Beginning January 2004 and continuing through June 2004, the interest rate will increase by 1% per annum each month up to a maximum rate of 18%. The amended note contains similar covenants as the original Note, including covenants that, among other matters, limit senior indebtedness, the payment of dividends, and the disposition of assets. The revised covenants also include minimum EBITDA requirements and capital expenditure limitations.

On October 28, 2003, the Company also announced the FBO Sale, for which closing is, among other things, contingent on: 1) stockholder approval; 2) the completion of due diligence; and 3) regulatory agencies' approvals and consents. The proceeds from the FBO Sale are subject to the establishment of an escrow account in the amount of \$8.3 million to be distributed at the earlier of the award of a long term lease to Allied for the FBO at the Hartsfield Airport or in five equal annual installment payments starting at the first anniversary date of the close of the FBO Sale if the Air Centers' lease for the Hartsfield FBO is not terminated earlier, reimbursement for certain FBO capital expenditures made by the Company, minimum working capital amounts at closing and other customary terms and conditions. The Company has received consent for the FBO Sale from its Senior Lenders. In accordance with the terms of the definitive agreement, as amended, the FBO Sale is to close on January 16, 2004 but the closing date can be extended, at Allied's discretion, to April 16, 2004. The Company expects the FBO Sale to close in the Company's third quarter of fiscal 2004.

On December 5, 2003, the Company and its lenders under the Senior Secured Credit Facility executed the Fifth Amendment to the Loan and Security Agreement and Forebearance Agreement (the Forebearance Agreement). Among other things, the Company requested the lenders and the lenders agreed to forebear from exercising their rights and remedies under the Senior Secured Credit Facility for the following events of default, as defined in the Loan and Security Agreement: (1) the Company's failure to deliver its annual audited financial statements for the fiscal year 2003 within the prescribed time-frame allowed; (2) the formation of a subsidiary, Mercury Air Center - Long Beach, without the prior consent of the lenders; (3) the Company's failure to deliver supplemental schedules to the J. H. Whitney as required under the terms of the \$24 million Senior Secured 12% Note. The Forebearance Agreement states that the lenders agree, for a limited time, to forebear from exercising their rights and remedies under the Senior Secured Credit Facility with respect to the events of default noted above. The Company is currently in compliance with the terms and conditions of the Forebearance Agreement.

On December 12, 2003, the Company entered into a settlement agreement (the Hambro Settlement) relating to litigation with J O Hambro Capital Management and certain of its affiliates and private clients (J O Hambro) whereby the Company issued three promissory notes for an aggregate principle amount of \$3,586,000 (the Hambro Notes) in exchange for the following, among other things: (1) The release of certain claims by J O Hambro; (2) the Company's agreement to dismiss litigation against J O Hambro;

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(3) the Company's agreement not to institute certain litigation against J O Hambro and certain other parties; (4) reimbursement of certain costs associated with the pending litigation and the defense preparation for anticipated litigation between the parties; and (5) the purchase of 343,600 shares of the Company's common stock in exchange for the Hambro Notes. The Hambro Notes: 1) are subordinated to the Senior Secured Credit Facility and to the Senior Subordinated Note; 2) are due on the earlier of (a) March 31, 2006, provided that if the Senior Secured Credit Facility Matures on December 31, 2007 then such date shall be March 31, 2008 and (b) the ninetieth day following payment in full of the Senior Secured Credit Facility and the termination of commitments for the Senior Secured Lender to provide financing under the Senior Secured Credit Facility; and 3) bear and accrue interest at the rate of 12% per annum commencing on December 31, 2003 but will increase to 16% per annum for any amount of unpaid principal after June 30, 2004. During the second quarter of fiscal 2004, the Company will recognize as expense \$1.8 million, which represents the consideration paid to J.O. Hambro in excess of the market value of such shares at that time.

At the close of the FBO Sale, the Company estimates gross sales proceeds of \$73.1 million. The Company intends to use these proceeds to: 1) prepay the outstanding principal amount on the Senior Secured Term Loan of \$10 million; 2) repay all outstanding cash advances on the Revolving Line of Credit; 3) pay all accrued interest, fees and expenses associated with the Senior Secured Credit Facility; 4) provide cash collateral for the outstanding Letters of Credit of approximately \$16.0 million; 5) prepay the outstanding principal amount on the Allied Note; 6) pay all accrued interest, fees and expenses associated with the Allied Note; 7) establish an escrow account for the FBO at the Hartsfield Airport in the amount of \$8.3 million; 8) repay the outstanding principal amount due on the J. O. Hambro Note of \$3.6 million; 9) repay all accrued interest on the Hambro Notes; and 10) pay all commissions, fees and expenses associated with the sale transaction. After settlement of the all of the obligations noted above, the Company estimates that the transaction will result in surplus cash proceeds of approximately \$4.0 million, of which an estimated \$1.5 million will be required to settle the Company's current income tax obligation associated with the FBO Sale although the exact amount of the surplus cash proceeds will be dependent upon many factors including, but not limited to, the date of closing.

The Company is currently evaluating new credit facilities to support the Company's expansion of its remaining three business lines and to support the Company's Letters of Credit requirements thereby releasing the cash collateral of approximately \$16 million to be used for working capital requirements and general corporate purposes.

Critical Accounting Policies

Management's beliefs regarding critical accounting policies have not changed significantly from those discussed in Item 7 of the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2003.

Item 3. *Quantitative and Qualitative Disclosure About Market Risk*

There has been no material change during the quarter ended September 30, 2003 from the disclosures regarding market risk presented in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2003.

Item 4. *Controls and Procedures*

Evaluation of Disclosure Controls and Procedures

Based on evaluations as of September 30, 2003, our principal executive officer and principal financial officer, with the participation of our management team, have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC.

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Changes in Internal Controls

There were no significant changes in our internal controls or in other factors that could significantly affect these internal controls subsequent to the date of their most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Forward-Looking Statements

Statements contained in this Quarterly Report on Form 10-Q which are not historical facts are forward-looking statements. In addition, Mercury, from time-to-time, makes forward-looking statements concerning its expected future operations and performance and other developments. Such forward-looking statements are necessarily estimates reflecting Mercury's best judgment based upon current information and involve a number of risks and uncertainties, and there can be no assurance that other factors will not affect the accuracy of such forward-looking statements. While it is impossible to identify all such factors, factors which could cause actual results to differ materially from those estimated by Mercury include, but are not limited to, risks associated with acquisitions, the financial condition of customers, non-renewal of contracts, government regulation, as well as operating risks, general conditions in the economy and capital markets, and other factors which may be identified from time-to-time in Mercury's Securities and Exchange Commission filings and other public announcements.

PART II OTHER INFORMATION

Item 1. *Legal Proceedings*

On May 1, 2002, Mercury received a Notice of Violation (NOV) for its Fort Wayne, Indiana facility alleging that Mercury's Spill Prevention, Control and Countermeasure Plan (the SPCC Plan) did not meet certain federal regulatory guidelines. Specifically, the Environmental Protection Agency (EPA) alleged that Mercury's SPCC Plan failed to provide for proper parking, secondary containment, and proper drainage of its refueler trucks. Mercury entered into discussions with the EPA and responded to the NOV. On January 29, 2003, the Company was notified of some deficiencies in its latest SPCC Plan and requested that Mercury submit a written response to its allegations within 30 days. On March 14, 2003, Mercury received a NOV from the United States Environmental Protection Agency, Region 5 (EPA Region 5) alleging certain deficiencies in the SPCC for its Fort Wayne, Indiana facility, submitted to the EPA Region 5 in November 2002. Mercury believes that it has resolved all deficiencies except for alleged deficiencies related to secondary containment for refueler trucks for its discrete fuel loading areas. Pursuant to an agreement detailed in a letter submitted to the EPA Region 5 on April 16, 2003, Mercury has been permitted to suspend modifications to its SPCC Plan regarding the installation of secondary containment for its refueler trucks, pending resolution of federal regulatory issues associated with secondary containment for such trucks. The EPA Region 5 has also extended national compliance with regulations related to discrete loading areas until August 17, 2004. In the opinion of management, the ultimate resolution of this matter is not expected to have a material effect on the Company's consolidated financial statements.

On April 16, 2003, the Plan Committee of Shuttle America Corp filed a Adversary Proceeding in the United States Bankruptcy Court, District of Connecticut alleging preferential transfers in the amount of \$995,000. The parties reached a settlement agreement, which provides that the Company will pay Shuttle America \$40,000. The settlement agreement is subject to approval of the Bankruptcy Court.

On November 26, 2003, Signature Flight Support Corporation filed a complaint against Mercury Air Centers, Inc. and Allied Capital Corporation alleging: (1) breach of contract and tortious Interference with contract against Allied; (2) interference with prospective economic advantage against Allied; and (3) unfair business practices against Mercury and Allied. The Company believes that the allegations are without merit and is in the process of preparing a response. The Company has agreed to indemnify Allied and its affiliates (including, without limitation, Air Centers after the closing of the FBO Sale), directors, officers, agents, employees and controlling persons from any liability, obligation, loss or expense to which Allied may become

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subject as a result of the complaint. In the opinion of management, the ultimate resolution of this complaint is not expected to have a material effect on the Company's consolidated financial statements.

On December 5, 2003, the Company terminated its Chief Operating Officer of Mercury Air Cargo. This former employee is claiming one year's salary, (approximately \$170,000), and other damages as a result of the termination. On December 31, 2003, he filed notice of demand for mediation.

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 material effect on its consolidated financial statements. Reference is made to the Company's Annual Report on Form 10-K for the period ended June 30, 2003 for additional litigation matter with respect to which no material developments have occurred in the current quarter.

Item 2. *Change in Securities*

None

Item 3. *Default Upon Senior Securities*

None

Item 4. *Submission of Matters to a Vote of Security Holders*

None

Item 5. *Other Information*

None

Item 6. *Exhibits and Exhibit List*

(a) *Exhibits and Reports on Form 8-K:*

| Exhibit No. | Description |
|-------------|--|
| 2.1 | Agreement and Plan of Merger adopted January 9, 2001.(17) |
| 2.2 | Certificate of Merger.(17) |
| 2.3 | Stock Purchase Agreement Dated as of October 28, 2003. By and Among Allied Capital Corporation, Mercury Air Centers, Inc. and Mercury Air Group, Inc.(28) |
| 3.1 | Certificate of Incorporation.(17) |
| 3.2 | Amended and Restated Bylaws of Mercury Air Group, Inc. adopted December 7, 2002.(25) |
| 3.3 | Certificate of Designations of Series A 8% Cumulative Convertible Preferred Stock.(27) |
| 4.1 | Loan Agreement between California Economic Development Financing Authority and Mercury Air Group, Inc. relating to \$19,000,000 California Economic Development Financing Authority Variable Rate Demand Airport Facilities Revenue Bonds, Series 1998 (Mercury Air Group, Inc. Project) dated as of April 1, 1998.(2) |
| 4.2 | Securities Purchase Agreement dated September 10, 1999 by and among Mercury Air Group, Inc. and J.H. Whitney Mezzanine Fund, L.P.(12) |
| 4.3 | Amendment No. 1 dated as of September 30, 2000 by and between J.H. Whitney Mezzanine, L.P. and Mercury Air Group, Inc. to the Securities Agreement.(16) |
| 4.4 | Waiver and Consent Agreement dated as of December 29, 2000 among Mercury Air Group, Inc. and J.H. Whitney Mezzanine Fund, L.P.(17) |
| 4.5 | Waiver and Consent Agreement dated as of July 2, 2001 among Mercury Air Group, Inc. and J.H. Whitney Mezzanine Fund, L.P.(18) |

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| Exhibit No. | Description |
|----------------|--|
| 4.6 | Waiver Agreement dated as of September 25, 2001 among Mercury Air Group, Inc. and J.H. Whitney Mezzanine Fund, L.P.(18) |
| 4.7 | Amendment No. 2 dated as of September 30, 2001 by and between J.H. Whitney Mezzanine Fund, L.P. and Mercury Air Group, Inc. to the Securities Purchase Agreement.(19) |
| 4.8 | Waiver Agreement dated as of November 26, 2001 among Mercury Air Group, Inc. and J.H. Whitney Mezzanine, L.P.(21) |
| 4.9 | Waiver Agreement dated as of December 21, 2001 among Mercury Air Group, Inc. and J.H. Whitney Mezzanine, L.P.(21) |
| 4.10 | Waiver Agreement dated as of June 26, 2002 among Mercury Air Group, Inc. and J.H. Whitney Mezzanine, L.P.(24) |
| 4.11 | Amendment No. 3 to Securities Purchase Agreement by and between Mercury Air Group, Inc. and J.H. Whitney Mezzanine Fund, L.P. dated as of December 30, 2002.(26) |
| 4.12 | Amended and Restated J.H. Whitney Mezzanine Fund, L.P. Warrant dated September 10, 1999.(26) |
| 4.13 | Amended and Restated J.H. Whitney Mezzanine Fund, L.P. Senior Subordinated Promissory Note dated September 10, 1999.(26) |
| 4.14 | Security Agreement by and between Mercury Air Group, Inc. and each of its subsidiaries hereto as Obligors and J.H. Whitney Mezzanine Fund, L.P. as the Lenders, dated as of December 30, 2002.(26) |
| 4.15 | Subordination Agreement among J.H. Whitney Mezzanine Fund, L.P. Foothill Capital Corporation, as Agent and Mercury Air Group, Inc. and certain of its subsidiaries signatory thereto, dated as of December 30, 2002.(26) |
| 4.16 | Loan and Security Agreement by and among Foothill Capital Corporation and Mercury Air Group, Inc. and certain subsidiaries signatory thereto, dated as of December 30, 2002.(26) |
| 4.17 | First Amendment to Loan and Security Agreement by and among Foothill Capital Corporation and Mercury Air Group, Inc. and certain of its subsidiaries, dated March 12, 2003.(30) |
| 4.18 | Second Amendment to Loan and Security Agreement by and among Foothill Capital Corporation and Mercury Air Group, Inc. and certain of its subsidiaries, dated March 31, 2003.(30) |
| 4.19 | Third Amendment to Loan and Security Agreement by and among Foothill Capital Corporation and Mercury Air Group, Inc. and certain of its subsidiaries, dated July 16, 2003.(30) |
| 4.20 | Fourth Amendment to Loan and Security Agreement by and among Foothill Capital Corporation and Mercury Air Group, Inc. and certain of its subsidiaries, dated August 1, 2003.(30) |
| 4.21 | Amendment No. 4 to Securities Purchase Agreement by and between Mercury Air Group, Inc. and Allied Capital Corporation, as Assignee of J.H. Whitney Mezzanine Fund, L.P. dated as of October 28, 2003(28) |
| 4.22 | Assignment of Note dated as of October 28, 2003 between Allied Capital Corporation and J.H. Whitney Mezzanine Fund, L.P.(28) |
| 4.23 | Second Amended and Restated Allied Capital Corporation 12% Senior Subordinated Promissory Note dated September 10, 1999(28) |
| 4.24 | Second Amended and Restated Allied Capital Corporation Warrant dated October 28, 2003(28) |
| 4.25 | Securities Purchase Agreement dated as of October 28, 2003 by and among J.H. Whitney Mezzanine Fund, L.P. and J.H. Whitney Mezzanine Debt Fund, L.P., Allied Capital Corporation and Mercury Air Group, Inc.(28) |
| 4.26 | Second Amended and Restated J.H. Whitney Mezzanine Fund, L.P. Warrant dated October 28, 2003(28) |
| 10.1 | Mercury Air Group, Inc. s 1990 Long-Term Incentive Plan.(4)* |
| 10.2 | Mercury Air Group, Inc. s 1990 Directors Stock Option Plan.(1)* |

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| Exhibit No. | Description |
|----------------|--|
| 10.3 | Memorandum Dated September 15, 1997 regarding Summary of Officer Life Insurance Policies with Benefits Payable to Officers or Their Designated Beneficiaries.(8)* |
| 10.4 | Non-Qualified Stock Option Agreement dated March 21, 1996, by and between Frederick H. Kopko and Mercury Air Group, Inc.(6)* |
| 10.5 | Mercury Air Group, Inc. s 1998 Long-Term Incentive Plan.(10)* |
| 10.6 | Mercury Air Group, Inc. s 1998 Directors Stock Option Plan.(10)* |
| 10.7 | Revolving Credit and Term Loan Agreement dated as of March 2, 1999 by and among Mercury Air Group, Inc., The Banks listed on Schedule 1 thereto, and The Fleet National Bank f/k/a BankBoston, N.A., as Agent.(11) |
| 10.8 | First Amendment to Revolving Credit and Term Loan Agreement dated as of September 10, 1999.(14) |
| 10.9 | Second Amendment to Revolving Credit and Term Loan Agreement dated as of March 31, 2000.(14) |
| 10.10 | Third Amendment, Waiver and Consent to Revolving Credit and Term Loan Agreement dated as of August 11, 2000.(14) |
| 10.11 | The Company s 401(k) Plan consisting of CNA Trust Corporation. Regional Prototype Defined Contribution Plan and Trust and Adoption Agreement.(14)* |
| 10.12 | Employment Agreement dated July 31, 2000 between the Company and Dr. Philip J. Fagan.(15)* |
| 10.13 | Fourth Amendment to Revolving Credit and Term Loan Agreement dated as of November 14, 2000.(16) |
| 10.14 | Amendment No. 1 to Mercury Air Group, Inc. 1998 Long-Term Incentive Option Plan as of August 22, 2000.(16)* |
| 10.15 | Amendment No. 1 to Mercury Air Group, Inc. 1998 Directors Stock Option Plan as of August 22, 2000.(16)* |
| 10.16 | Limited Waiver letter Agreement to Revolving Credit and Term Loan Agreement dated as of September 21, 2001.(18) |
| 10.17 | Fifth Amendment to Revolving Credit and Term loan Agreement dated as of September 21, 2001.(18) |
| 10.18 | Limited Consent letter Agreement to Revolving Credit and Term Loan Agreement dated as of September 30, 2001.(19) |
| 10.20 | Limited waiver and Consent to Revolving Credit and Term Loan Agreement dated as of December 31, 2001.(21) |
| 10.21 | 2002 Management Stock Purchase Plan.(22) |
| 10.22 | Amended and Restated Employment Agreement dated May 22, 2002 between Mercury Air Group, Inc. and Joseph A. Czyzyk.(22)* |
| 10.23 | Employment Agreement dated May 22, 2002 between Mercury Air Group, Inc. and Wayne J. Lovett(22)* |
| 10.24 | Employment Agreement dated May 22, 2002 between Mercury Air Group, Inc. and John Enticknap(22)* |
| 10.25 | Employment Agreement dated May 22, 2002 between Mercury Air Group, Inc. and Mark Coleman(22)* |
| 10.26 | Employment Agreement dated May 22, 2002 between Mercury Air Group, Inc. and Steven S. Antonoff(22)* |
| 10.27 | Employment Agreement dated May 22, 2002 between Mercury Air Group, Inc. and Robert Schlax(22)* |

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| Exhibit No. | Description |
|----------------|--|
| 10.28 | Limited waiver and Consent to Revolving Credit and Term Loan Agreement dated as of June 27, 2002.(24) |
| 10.29 | Sale-Leaseback agreement made by and between CFK Realty Partners, LLC and Mercury Air Group, Inc. dated December 15, 2001.(24) |
| 10.30 | Amendment to Sale-Leaseback agreement made by and between CFK Realty Partners, LLC and Mercury Air Group, Inc.(24) |
| 10.31 | Promissory Note by CFK Partners, LLC in favor of Mercury Air Group, Inc.(24) |
| 10.32 | Limited Waiver and Consent to Revolving Credit and Term Loan Agreement dated as June 27, 2002.(24) |
| 10.33 | Amendment No. 1 to Amended and Restated Employment Agreement dated May 22, 2002 between Mercury Air Group, Inc. and Joseph A. Czyzyk.*(24) |
| 10.34 | Lease dated December 31, 2001 by and between CFK Realty Partners, LLC. and Mercury Air Group, Inc.(30) |
| 10.35 | Settlement Agreement dated December 12, 2003 by and among (i) J O Hambro Capital Management Group Limited, (ii) J O Hambro Capital Management Limited, (iii) American Opportunity Trust PLC, (iv) The Trident North Atlantic Fund, and (v) Mercury Air Group, Inc.(29) |
| 21.1 | Subsidiaries of Registrant.(30) |
| 31.1 | Section 302 Certification of Chief Executive Officer |
| 31.2 | Section 302 Certification of Chief Financial Officer |
| 32.1 | Section 906 Certification of Chief Executive Officer |
| 32.2 | Section 906 Certification of Chief Financial Officer |
| 99.1 | Partnership Agreement dated as of July 27, 2000 of CFK Partners by and among Philip J. Fagan, M.D., Frederick H. Kopko, Jr. and Joseph A. Czyzyk.(13) |

* Denotes managements contract or compensation plan or arrangement.

- (1) Such document was previously filed as Appendix A to the Company s Proxy Statement for the December 10, 1993 Annual Meeting of Stockholders and is incorporated herein by reference.
- (2) All such documents were previously filed as Exhibits to the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 1998 and are incorporated herein by reference.
- (3) All such documents were previously filed as Exhibits to the Company s Registration Statement No. 33-39044 on Form S-2 and are incorporated herein by reference.
- (4) Such document was previously filed as Appendix A to the Company s Proxy Statement for the December 2, 1992 Annual Meeting of Stockholders.
- (5) All such documents were previously filed as Exhibits to the Company s Registration Statement No. 33-65085 on Form S-1 and are incorporated herein by reference.
- (6) All such documents were previously filed as Exhibits to the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 1996 and are incorporated herein by reference.
- (7) All such documents were previously filed as Exhibits to the Company s Report on Form 8-K filed September 13, 1996 and are incorporated herein by reference.
- (8) Such document was previously filed as an Exhibit to the Company s Annual Report on Form 10-K for the year ended June 30, 1997 and is incorporated herein by reference.
- (9) All such documents were previously filed as an Exhibit to the Company s Annual Report on Form 10-K for the year ended June 30, 1998 and are incorporated herein by reference.
- (10) Such document was previously filed as Appendix A to the Company s Proxy Statement for the December 3, 1998 Annual Meeting of Stockholders and is incorporated herein by reference.

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- (11) All such documents were previously filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1999 and are incorporated herein by reference.
- (12) All such documents were previously filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended June 30, 1999 and are incorporated herein by reference.
- (13) Such document was previously filed as an Exhibit to the Company's current Report on Form 8-K on August 11, 2000 and is incorporated herein by reference.
- (14) All such documents were previously filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended June 30, 2000 and is incorporated herein by reference.
- (15) All such documents were previously filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000 and are incorporated herein by reference.
- (16) All such documents were previously filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2000 and are incorporated herein by reference.
- (17) All such documents were previously filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001 and are incorporated herein by reference.
- (18) All such documents were previously filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended June 30, 2001 and are incorporated herein by reference.
- (19) All such documents were previously filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 and are incorporated herein by reference.
- (20) Such document was previously filed as Appendix A to the Company's Proxy Statement for the November 7, 2001 Annual Meeting of Stockholders and is incorporated herein by reference.
- (21) All such documents were previously filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2001 and are incorporated herein by reference.
- (22) Such document was previously filed as an Exhibit to the Company's Current Report on Form 8-K on June 5, 2002 and is incorporated herein by reference.
- (23) Such document was previously filed as an Exhibit to the Company's Current Report on Form 8-K on July 11, 2002 and is incorporated herein by reference.
- (24) All such documents were previously filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended June 30, 2002 and are incorporated herein by reference.
- (25) Such document was previously filed as an Exhibit to the Company's Current Report on Form 8-K on December 7, 2002 and is incorporated herein by reference.
- (26) Such document was previously filed as an Exhibit to the Company's Current Report on Form 8-K on December 30, 2002 and is incorporated herein by reference.
- (27) All such documents were previously filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2003 and are incorporated herein by reference.
- (28) Such document was previously filed as an Exhibit to the Company's Current Report on Form 8-K on October 28, 2003 and is incorporated herein by reference.
- (29) Such document was previously filed as an Exhibit to the Company's Current Report on Form 8-K on December 12, 2003 and is incorporated herein by reference.

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(30) All such documents were previously filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended June 30, 2003 and are incorporated herein by reference.

(b) Reports on Form 8-K:

A Form 8-K was filed dated September 30, 2003 reporting on Item 5, Other Events and Regulation FD Disclosure as to preliminary operational results for the three and twelve-month periods ended June 30, 2003. An amended report on Form 8-K was filed on November 19, 2003, amending the previous 8-K to report the operational results on Item 12.

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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

Robert Schlax
Chief Financial Officer
(Principal Financial Officer)

Date: January 12, 2004