

MESA AIR GROUP INC
Form 10-K
December 14, 2005

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

Form 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended September 30, 2005
Commission File Number 0-15495

Mesa Air Group, Inc.

(Exact name of registrant as specified in its charter)

Nevada

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

85-0302351

*(I.R.S. Employer
Identification No.)*

410 North 44th Street, Suite 700,
Phoenix, Arizona
(Address of principal executive offices)

85008
(Zip Code)

Registrant's telephone number, including area code:
(602) 685-4000

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, No Par Value
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Act Rule 12b-2). Yes No

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of December 1, 2005: Common Stock, no par value: \$305.6 million.

On December 1, 2005, the Registrant had outstanding 29,086,346 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement for the 2006 annual meeting of stockholders

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2005 FORM 10-K REPORT
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This Form 10-K Report contains certain statements including, but not limited to, information regarding the replacement, deployment, and acquisition of certain numbers and types of aircraft, and projected expenses associated therewith; costs of compliance with Federal Aviation Administration regulations and other rules and acts of Congress; the passing of taxes, fuel costs, inflation, and various expenses to the consumer; the relocation of certain operations of Mesa; the resolution of litigation in a favorable manner and certain projected financial obligations. These statements, in addition to statements made in conjunction with the words expect, anticipate, intend, plan, believe, seek, estimate, and similar expressions, are forward-looking statements within the meaning of the Safe Harbor provision of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements relate to future events or the future financial performance of Mesa and only reflect management's expectations and estimates. The following is a list of factors, among others, that could cause actual results to differ materially from the forward-looking statements: changing business conditions in certain market segments and industries; changes in Mesa's code-sharing relationships; the inability of America West, Delta Air Lines, US Airways or United Airlines to pay their obligations under the code-share agreements; the inability of United Airlines to successfully restructure and emerge from bankruptcy; the ability of Delta Air Lines to reject our code-share agreements in bankruptcy; the inability to transition the planes we currently fly under our code-share agreement with US Airways without undue cost and expense; an increase in competition along the routes Mesa operates or plans to operate; material delays in completion by the manufacturer of the ordered and yet-to-be delivered aircraft; availability and cost of funds for financing new aircraft; changes in general economic conditions; changes in fuel price; changes in regional economic conditions; Mesa's relationship with employees and the terms of future collective bargaining agreements; the impact of current and future laws; additional terrorist attacks; Congressional investigations, and governmental regulations affecting the airline industry and Mesa's operations; bureaucratic delays; amendments to existing legislation; consumers unwilling to incur greater costs for flights; unfavorable resolution of negotiations with municipalities for the leasing of facilities; and risks associated with the outcome of litigation. One or more of these or other factors may cause Mesa's actual results to differ materially from any forward-looking statement. Mesa is not undertaking any obligation to update any forward-looking statements contained in this Form 10-K.

All references to we, our, us, or Mesa refer to Mesa Air Group, Inc. and its predecessors, direct and indirect subsidiaries and affiliates.

Item 1. Business**General**

Mesa Air Group, Inc. (Mesa or the Company) is a holding company whose principle subsidiaries operate as regional air carriers providing scheduled passenger and airfreight service. As of September 30, 2005, the Company served 176 cities in 43 states, the District of Columbia, Canada and Mexico and operated a fleet of 182 aircraft with approximately 1,100 daily departures.

Approximately 99% of our consolidated passenger revenues for the fiscal year ended September 30, 2005 were derived from operations associated with code-share agreements. Our subsidiaries have code-share agreements with America West Airlines, Inc. (America West), Midwest Airlines, Inc. (Midwest Airlines), United Airlines, Inc. (United Airlines or United) and US Airways, Inc. (US Airways). These code-share agreements allow use of the code-share partners' flight designator code to identify flights and fares in computer reservation systems, permit use of logos, service marks, aircraft paint schemes and uniforms similar to the code-share partner and provide coordinated schedules and joint advertising. The remaining passenger revenues are derived from our independent operations. On October 1, 2005, we commenced flight operations as Delta Connection under a code-share agreement with Delta Air Lines, Inc. (Delta).

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In addition to carrying passengers, we carry freight and express packages on our passenger flights and have interline small cargo freight agreements with many other carriers. We also have contracts with the U.S. Postal Service for carriage of mail to the cities we serve and occasionally operate charter flights when our aircraft are not otherwise used for scheduled service.

Our airline operations are conducted by the following airline subsidiaries:

Mesa Airlines, Inc. (Mesa Airlines), a Nevada corporation, operates regional jet and turboprop aircraft as America West Express under a code-share agreement with America West, primarily at America West's operations hubs located in Phoenix and Las Vegas; as US Airways Express under a code-share agreement with US Airways, primarily at US Airways' hubs on the East Coast; and as United Express under a code-share agreement with United Airlines, at various United hubs across the country.

Air Midwest, Inc. (Air Midwest), a Kansas corporation, operates Beechcraft 1900D 19-seat turboprop aircraft as US Airways Express under a code-share agreement with US Airways at certain US Airways' hubs on the East Coast as well as Kansas City. Air Midwest's flights in Kansas City code-share with both Midwest Airlines and US Airways. Air Midwest operates as America West Express in Phoenix. Air Midwest also operates as Mesa Airlines in Albuquerque, New Mexico and in select Essential Air Service (EAS) markets. The Albuquerque flights and certain EAS markets are Independent Operations and are not subject to a code-sharing agreement with a major carrier.

Freedom Airlines, Inc. (Freedom), a Nevada corporation, commenced flight operations using ERJ-145 50-seat regional jets as Delta Connection on October 1, 2005 under a code-share agreement with Delta primarily between Orlando, Florida and designated outlying cities. Freedom previously operated Beechcraft 1900D 19-seat turboprop aircraft and CRJ-700 and 900 regional jets pursuant to the Company's code-share agreement with America West.

Unless the context indicates otherwise, the terms Mesa, the Company, we, us, or our, refer to Mesa Air Group and its subsidiaries.

Corporate Structure

Mesa is a Nevada corporation with its principal executive office in Phoenix, Arizona.

In addition to operating the airline subsidiaries listed above, we also have the following other subsidiaries:

MPD, Inc., a Nevada corporation, doing business as Mesa Pilot Development and MPD, operates training programs for student pilots in conjunction with San Juan College in Farmington, New Mexico and Arizona State University in Tempe, Arizona.

Regional Aircraft Services, Inc., (RAS) a California corporation, performs aircraft component repair, certain overhaul services, and ground handling services, primarily to Mesa subsidiaries.

MAGI Insurance, Ltd., a Barbados, West Indies based captive insurance company, was established for the purpose of obtaining more favorable aircraft liability insurance rates.

Ritz Hotel Management Corp., a Nevada Corporation, was established to facilitate the Company's acquisition and management of a Phoenix area hotel property used for crew-in-training accommodations.

Mesa Air Group Airline Inventory Management, LLC (MAG-AIM), an Arizona Limited Liability Company, was established to purchase, distribute and manage Mesa's inventory of spare rotatable and expendable parts.

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The following table sets forth our aircraft fleet (owned and leased) in operation by aircraft type as of September 30, 2005:

	Canadair Regional Jet-200 (CRJ-200)	Canadair Regional Jet-700 (CRJ-700)	Canadair Regional Jet-900 (CRJ-900)	Embraer Regional Jet-145 (ERJ-145)	Beechcraft 1900D	DeHavilland Dash 8-200	Total
US Airways Express	23			36	14		73
America West Express	18		37		2	6	63
United Express	15	15				10	40
Mesa Airlines					6		6
Total	56	15	37	36	22	16	182

Code-Share Agreements

Our airline subsidiaries have agreements with America West, Delta, US Airways, United Airlines and Midwest Airlines to use those carriers' designation codes (commonly referred to as code-share agreements). These code-share agreements allow use of the code-share partner's flight designator code to identify flights and fares in computer reservation systems, permit use of logos, service marks, aircraft paint schemes and uniforms similar to the code-share partner's and provide coordinated schedules and joint advertising. Our passengers traveling on flights operated pursuant to code-share agreements receive mileage credits in the respective frequent flyer programs of our code-share partners, and credits in those programs can be used on flights operated by us.

The financial arrangement with our code-share partners involves either a revenue-guarantee or pro-rate arrangement. The America West (regional jet and Dash-8), Delta (regional jet), United (regional jet and Dash-8), and US Airways (regional jet) code-share agreements are revenue-guarantee code-share agreements. Under the terms of these code-share agreements, the major carrier controls marketing, scheduling, ticketing, pricing and seat inventories. We receive a guaranteed payment based upon a fixed minimum monthly amount plus amounts related to departures and block hours flown in addition to direct reimbursement of expenses such as fuel, landing fees and insurance. Among other advantages, revenue-guarantee arrangements reduce the Company's exposure to fluctuations in passenger traffic and fare levels, as well as fuel prices. The US Airways, Midwest Airlines and America West Beechcraft 1900D turboprop code-share agreements are pro-rate agreements, for which we receive an allocated portion of each passenger's fare and pay all of the costs of transporting the passenger.

The following table summarizes our available seat miles (ASMs) flown and revenue recognized under our code-share agreements for the years ended September 30, 2005 and 2004:

	Fiscal 2005				Fiscal 2004			
	ASMs		Passenger Revenue		ASMs		Passenger Revenue	
(In thousands)								
America West (Revenue-Guarantee)	4,360,713	50%	\$ 487,221	44%	2,983,969	42%	\$ 323,889	37%
US Airways (Revenue-Guarantee)	2,401,808	28%	316,072	29%	2,471,476	35%	304,290	35%

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United (Revenue-Guarantee)	1,748,466	20%	260,541	24%	1,269,454	18%	171,493	20%
US Airways (Pro-Rate)*	112,514	1%	25,101	2%	211,195	3%	47,177	5%
Mesa Airlines	71,257	1%	8,590	1%	94,269	1%	9,568	1%
America West (Pro-Rate)	20,991		5,025		21,372		4,558	1%
Frontier (Revenue-Guarantee)					55,949	1%	7,440	1%
Total	8,715,749		\$ 1,102,550		7,107,684		\$ 868,415	

* Amount includes the ASMs and Passenger Revenue associated with the Midwest Airlines (Pro-Rate) code-share agreement.

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America West Code-Sharing Agreement

Revenue-Guarantee

As of September 30, 2005, we operated 37 CRJ-900 (a 38th CRJ-900 entered service for America West in October), 18 CRJ-200, and six Dash-8 aircraft for America West under a revenue-guarantee code-share agreement. In exchange for providing flights and all other services under the agreement, we receive a fixed monthly minimum amount plus certain additional amounts based upon the number of flights flown and block hours performed during the month. America West also reimburses us for certain costs on an actual basis, including fuel costs, aircraft ownership and financing costs, landing fees, passenger liability and hull insurance, and aircraft property taxes, all as defined in the agreement. In addition, America West also provides, at no cost to Mesa, certain ground handling and customer service functions, as well as airport-related facilities and gates at America West hubs and cities where both carriers operate. We also receive a monthly payment from America West based on a percentage of revenue from flights that we operate under the code-share agreement. Under the amended code-share agreement, America West has the right to reduce the combined CRJ fleets utilized under the code-share agreement by one aircraft in any six-month period commencing in June 2006 (except during the calendar year 2007 in which 2 CRJ-200 can be eliminated in each six-month period). In addition, beginning in February 2007, America West may eliminate the Dash-8 aircraft upon 180 days prior written notice. The code-share agreement terminates on June 30, 2012 unless America West elects to extend the contract for two years or exercises options to increase fleet size. The code-share agreement is subject to termination prior to that date in various circumstances including:

If our flight completion factor or arrival performance in the Phoenix Hub falls below a specified percentage for a specified period of time, subject to notice and cure rights;

If either America West or we become insolvent, file for bankruptcy or fail to pay our debts as they become due, the non-defaulting party may terminate the agreement;

Failure by us or America West to perform the covenants, conditions or provisions of the code-sharing agreement, subject to 15 days notice and cure rights;

If we or America West fails to make a payment when due, subject to ten business days notice and cure rights; or

If we are required by the FAA or the U.S. Department of Transportation (DOT) to suspend operations and we have not resumed operations within three business days, except as a result of an emergency airworthiness directive from the FAA affecting all similarly equipped aircraft, America West may terminate the agreement.

On September 16, 2005, the merger of US Airways Group, Inc., the parent company of US Airways, Inc., and America West Holdings, the parent company of America West Airlines, Inc. was completed. The new US Airways Group will operate under a single brand name of US Airways through two principal operating subsidiaries, US Airways, Inc. and America West Airlines, Inc. We will continue to provide regional jet airline services for US Airways Group pursuant to our code-share agreement with America West Airlines.

Pro-Rate

Pursuant to a turboprop code-share agreement with America West, we operated two Beechcraft 1900D turboprop aircraft in the Phoenix hub under a pro-rate revenue-sharing arrangement as of September 30, 2005. We control scheduling, inventory and pricing. We are allocated a portion of each passenger's fare based on a standard industry formula and are required to pay all costs of transporting the passenger. The pro-rate agreement terminates on March 31, 2012 unless America West elects to extend the contract for successive one-year periods. The pro-rate agreement could also be terminated prior to the termination under similar circumstances as the revenue-guarantee agreement.

Table of Contents***US Airways Code-Sharing Agreements******Revenue-Guarantee***

As of September 30, 2005, we operated 23 CRJ-200 and 36 ERJ-145 aircraft for US Airways under a code-sharing agreement. As a result of US Airways' emergence from bankruptcy and their non-assumption of our code-share agreement, we began working with US Airways to provide for the orderly transition of these 59 jets to our United and Delta revenue-guarantee code-sharing arrangements. As of December 1, 2005, we had transitioned 32 of the 59 aircraft and operated 27 50-seat regional jets for US Airways under our code-sharing agreement. We expect to complete the transition of aircraft from US Airways to United in the first quarter of fiscal year 2006 and to Delta in the second quarter of fiscal year 2006. Under the jet code-share agreement, we provide US Airways Express service between US Airways hubs and cities designated by US Airways. In exchange for performing the flight services under the agreement, we receive from US Airways a fixed monthly minimum amount, plus certain additional amounts based upon the number of flights flown and block hours performed during the month. Additionally, certain costs incurred by us in performing the flight services are pass-through costs, whereby US Airways agrees to reimburse us for the actual amounts incurred for these items: insurance, property tax per aircraft, fuel and oil cost, catering cost and landing fees. We also receive a fixed profit margin based upon certain cost reimbursements under the agreement. In addition, US Airways also provides, at no cost to Mesa, certain ground handling and customer service functions, as well as, airport-related facilities and gates at US Airways hubs and cities.

Pro-Rate

Pursuant to a turboprop code-sharing agreement with US Airways, we operated 14 Beechcraft 1900D turboprop aircraft under a pro-rate revenue-sharing arrangement as of September 30, 2005. We control scheduling, inventory and pricing subject to US Airways' concurrence that such service does not adversely affect its other operations in the region. We are allocated a portion of each passenger's fare based on a standard industry formula and are required to pay all the costs of transporting the passenger. Additionally, we are required to pay certain franchise, marketing and reservation fees to US Airways.

US Airways may terminate the turboprop agreement at any time for cause upon not less than five days notice under any of the following conditions:

If we fail to utilize the aircraft as specified in the agreements.

If we fail to comply with the trademark license provisions of the agreement.

If we fail to perform the material terms, covenants or conditions of the code-sharing agreement.

Upon a change in our ownership or control without the written approval of US Airways.

The turboprop code-share agreement terminates in October 2006, provided, however, most of the turboprop flying hub markets can be terminated by US Airways for any reason upon 180 days prior advance written notice.

United Code-Sharing Agreement

As of September 30, 2005, we operated 15 CRJ-200, 15 CRJ-700 and 10 Dash-8 aircraft for United under a code-sharing arrangement. The code-share agreement provides that we can increase our fleet to 45 50-seat and 30 70-seat regional jet aircraft (15 of which would be replacements for 15 CRJ-200s). In exchange for performing the flight services under the agreement, we receive from United a fixed monthly minimum amount, plus certain additional amounts based upon the number of flights flown and block hours performed during the month. Additionally, certain costs incurred by us in performing the flight services are pass-through costs, whereby United agrees to reimburse us for the actual amounts incurred for these items: insurance, property tax per aircraft, fuel cost, oil cost, catering cost and landing fees. We also receive a profit margin based upon certain reimbursable costs under the agreement as well as our operational performance. The code-share agreement for (i) the ten Dash-8 aircraft terminates in July 2013 unless terminated by United by giving notice six months prior to April 30, 2010, (ii) the 15 50-seat CRJ-200s terminates no later

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than April 30, 2010, which can be accelerated up to two years at our discretion, (iii) the 15 70-seat regional jets (to be delivered upon the withdrawal of the 50-seat regional jets) terminates ten years from delivery date, but no later than October 31, 2018, and (iv) the remaining 15 70-seat regional jets terminates in three tranches between December 31, 2011 and December 31, 2013. The code-share agreement is subject to termination prior to these dates under various circumstances including:

If certain operational performance factors fall below a specified percentage for a specified time, subject to notice and cure rights;

Failure by us to perform the material covenants, agreements, terms or conditions of the code-share agreement or similar agreements with United, subject to thirty (30) days notice and cure rights; or

If either United or we become insolvent, file bankruptcy or fail to pay debts when due, the non-defaulting party may terminate the agreement.

Delta Code-Sharing Agreement

On October 1, 2005, we commenced flight operations for Delta under a code-sharing agreement. Flight operations for Delta are performed by our wholly-owned subsidiary, Freedom Airlines. The code-share agreement provides that we increase our fleet to 30 50-seat regional jet aircraft. In exchange for performing the flight services and our other obligations under the agreement, we receive from Delta monthly compensation made up of a fixed monthly amount, plus certain additional amounts based upon number of block hours flown and departures during the month. Additionally, certain costs incurred by Freedom are pass-through costs, whereby Delta agrees to reimburse us for the actual amounts incurred for these items: landing fees, hull insurance, passenger liability costs, fuel costs, catering costs and property taxes. Aircraft rent/ownership expenses are also considered a pass-through cost, but are limited to a specified amount for each type of aircraft. We are eligible to receive additional compensation based upon our completion rate and on-time arrival rate each month. Further, for each semi-annual period during the term of the agreement, we are eligible to receive additional compensation from Delta based upon performance. The fixed rates payable to us by Delta under the code-sharing agreement have been determined through the term of such agreement and are subject to annual revision.

The code-share agreement terminates on an aircraft-by-aircraft basis between 2017 and 2018. At the end of the term, Delta has the right to extend the agreement for additional one year successive terms on the same terms and conditions. Delta may terminate the code-sharing agreement at any time, with or without cause, upon twelve months prior written notice, provided such notice shall not be given prior to the earlier of (i) the sixth anniversary of the in-service date of the 30th aircraft added to the Delta Connection fleet by the Company, or (ii) November 2012. However, Delta has not yet assumed our code-share agreement in its bankruptcy proceedings and could choose to terminate this agreement at any time prior to its emergence from bankruptcy.

This agreement may be subject to early termination under various circumstances including:

If either Delta or we file for bankruptcy, reorganization or similar action or if either Delta or we make an assignment for benefit of creditors;

If either Delta or we commit a material breach of the code-share agreement, subject to 30 days notice and cure rights; or

Upon the occurrence of an event of force majeure that continues for a period of 30 or more consecutive days.

In addition, Delta may immediately terminate the code-share agreement upon the occurrence of one or more of the following events:

If there is a change of control of Freedom or Mesa;

If there is a merger involving Freedom or Mesa;

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If we fail to maintain a specified completion rate with respect to the flights we operate for Delta during a specified period; or

If our level of safety is not reasonably satisfactory to Delta.

Fleet Plans and Aircraft Manufacturer Relationships

Interim Financing of Aircraft

Upon delivery of an aircraft from the manufacturer it is our customary business practice to enter into an interim financing arrangement with the manufacturer until such time as permanent financing as an operating lease or debt can be arranged. Under interim financing arrangements, we take delivery and title of the aircraft prior to securing permanent financing and the acquisition of the aircraft is accounted for as a purchase with debt financing. Accordingly, we reflect the aircraft and debt under interim financing on our balance sheet during the interim financing period. The interim financing period can be for up to six months after delivery of the aircraft. This practice allows us to take delivery and begin operating aircraft quicker while arranging permanent financing, either as an operating lease or with debt, with an independent third party.

At September 30, 2005, we had \$54.6 million in notes payable to an aircraft manufacturer for two aircraft on interim financing. These interim financing agreements are six months in length and provide for monthly interest only payments at LIBOR plus three percent. The current interim financing agreement with the manufacturer provides for the Company to have a maximum of 15 aircraft on interim financing at a given time.

ERJ Program

In June 1999, we entered into an agreement with Empresa Brasileira de Aeronautica SA (Embraer) to acquire 36 Embraer ERJ-145 50-passenger regional jets. Mesa introduced the ERJ-145 aircraft into revenue service in the third quarter of fiscal 2000. As of September 30, 2005, we have taken delivery of all 36 ERJ-145s, which have been financed as operating leases with initial terms of 16.5 to 18 years. We also have options for 45 additional aircraft. In May 2005, our contract with Embraer was amended to extend the option exercise date to December 2005 for deliveries beginning in May 2007.

CRJ Program

In August 1996, we entered into an agreement (the 1996 BRAD Agreement) with Bombardier Regional Aircraft Division (BRAD) to acquire 32 CRJ-200 50-passenger regional jet aircraft. The 32 aircraft have been delivered and are currently under permanent financing as operating leases with initial terms ranging from 16.5 to 18.5 years. The Company has also entered into operating leases for 24 previously-operated CRJ-200s under both short and long-term leases.

In May 2001, we entered into a second agreement with BRAD (the 2001 BRAD Agreement) under which we committed to purchase a total of 15 CRJ-700s and 25 CRJ-900s. In January 2004, the Company exercised options to purchase 20 CRJ-900 aircraft (seven of which can be converted to CRJ-700 aircraft) reserved under the option provision of the 2001 BRAD Agreement. The transaction includes standard product support provisions, including training, preferred pricing on initial inventory provisioning, maintenance and technical publications. As of September 30, 2005, we have accepted delivery of 15 CRJ-700s and 37 CRJ-900 aircraft. The Company accepted its 38th CRJ-900 in October 2005. We also have firm orders for seven additional CRJ-900s (which can be converted to CRJ-700s). In addition to the firm orders, we have an option to acquire an additional 72 CRJ-700 or CRJ-900 regional jets that are exercisable through 2009 and 40 CRJ-700 and CRJ-900 regional jets that are exercisable in 2010 and beyond. In conjunction with the 2001 BRAD Agreement, we had \$15.0 million on deposit with BRAD, which was included with lease and equipment deposits at September 30, 2005.

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Beechcraft 1900D

As of September 30, 2005, we owned 35 Beechcraft 1900D aircraft and were operating 22 of these aircraft. During fiscal year 2005, the Company leased four of its Beechcraft 1900D aircraft to Gulfstream International Airlines (Gulfstream), a regional turboprop air carrier based in Ft. Lauderdale, Florida for a term of five years. In January 2005, we entered into an agreement to lease ten of our Beechcraft 1900D aircraft to Big Sky Transportation Co. (Big Sky), a regional turboprop carrier based in Billings, Montana. As of September 30, 2005, we had leased nine aircraft to Big Sky and leased the tenth aircraft to Big Sky in the first quarter of fiscal 2006 for a term of five years.

Dash-8

As of September 30, 2005, we operated 16 leased Dash-8 aircraft.

Marketing

Our flight schedules are structured to facilitate the connection of our passengers with the flights of our code-share partners at their hub airports and to maximize local and connecting service to other carriers.

Under the America West, Delta, US Airways and United revenue-guarantee code-share agreements, market selection, pricing and yield management functions are performed by our respective partners. The market selection process for our B1900 turboprop operations, outside the Essential Air Service program flights, includes an in-depth analysis on a route-by-route basis and is followed by a review and approval process in a joint effort with US Airways or America West, as the case may be, regarding the level of service and fares. We believe that this selection process enhances the likelihood of profitability in a given market.

Under our code-share agreements, the code-share partner coordinates advertising and public relations within their respective systems. In addition, our traffic is impacted by the major airline partners' advertising programs in regions outside those served by us, with the major partners' customers becoming our customers as a result of through fares. Under pro-rate code-share arrangements, our passengers also benefit from through fare ticketing with the major airline partners and greater accessibility to our flights on computer reservation systems and in the Official Airline Guide.

Our pro-rate agreements and independent flights are promoted through, and our revenues are generally believed to benefit from, listings in computer reservation systems, the Official Airline Guide and through direct contact with travel agencies and corporate travel departments. Our independent operations utilize SABRE, a computerized reservation system widely used by travel agents, corporate travel offices and other airlines. The reservation systems of our code-share partners are also utilized in each of our other operations through their respective code-share agreements. We also pay booking fees to owners of other computerized reservation systems based on the number of independent and pro-rate passengers booked by travel agents using such systems. We believe that we have good relationships with the travel agents serving our passengers.

Competition

The airline industry is highly competitive and volatile. Airlines compete in the areas of pricing, scheduling (frequency and timing of flights), on-time performance, type of equipment, cabin configuration, amenities provided to passengers, frequent flyer plans, and the automation of travel agent reservation systems. Further, because of the Airline Deregulation Act, airlines are currently free to set prices and establish new routes without the necessity of seeking governmental approval. At the same time, deregulation has allowed airlines to abandon unprofitable routes where the affected communities may be left without air service.

We believe that the Airline Deregulation Act facilitated our entry into scheduled air service markets and allows us to compete on the basis of service and fares, thus causing major carriers to seek out further contractual agreements with carriers like us as a way of expanding their respective networks. However, the Airline Deregulation Act makes the entry of other competitors possible, some of which may have substantial financial resources and experience, creating the potential for intense competition among regional air carriers in our markets.

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Fuel

Historically, we have not experienced problems with the availability of fuel, and believe that we will be able to obtain fuel in quantities sufficient to meet our existing and anticipated future requirements at competitive prices. Standard industry contracts generally do not provide protection against fuel price increases, nor do they ensure availability of supply. However, our revenue-guarantee code-share agreements with America West, United and US Airways (regional jet) allow fuel used in the performance of the agreements to be reimbursed by our code-share partner, thereby reducing our exposure to fuel price fluctuations. In fiscal 2005, approximately 95% of our fuel purchases was associated with our America West, United and US Airways (regional jet) code-share agreements. A substantial increase in the price of jet fuel, to the extent our fuel costs are not reimbursed, or the lack of adequate fuel supplies in the future, could have a material adverse effect on our business, financial condition, results of operations and liquidity.

Maintenance of Aircraft and Training

All mechanics and avionics specialists employed by us have the appropriate training and experience and hold the required licenses issued by the FAA. Using a combination of FAA-certified maintenance vendors and our own personnel and facilities, we maintain our aircraft on a scheduled and "as-needed" basis. We emphasize preventive maintenance and inspect our aircraft engines and airframes as required. We also maintain an inventory of spare parts specific to the aircraft types we fly. We provide periodic in-house and outside training for our maintenance and flight personnel and also take advantage of factory training programs that are offered when acquiring new aircraft.

Insurance

We carry types and amounts of insurance customary in the regional airline industry, including coverage for public liability, passenger liability, property damage, product liability, aircraft loss or damage, baggage and cargo liability and workers' compensation.

As a result of the terrorist attacks on September 11, 2001, aviation insurers have significantly reduced the maximum amount of insurance coverage available to commercial air carriers for war-risk (terrorism) coverage, while at the same time, significantly increasing the premiums for this coverage as well as for aviation insurance in general. Given the significant increase in insurance costs, the federal government is currently providing insurance assistance under the Air Transportation Safety and System Stabilization Act. In addition, the federal government has issued war-risk coverage to U.S. air carriers that is generally renewable for 60-day periods. However, the availability of aviation insurance is not guaranteed and our inability to obtain such coverage at affordable rates may result in the grounding of our aircraft. Insurance costs are reimbursed under the terms of our revenue-guarantee code-share agreements.

Employees

As of September 30, 2005, we employed approximately 4,600 employees. Approximately 2,600 of our employees are represented by various labor organizations. Our continued success is partly dependent on our ability to continue to attract and retain qualified personnel. Historically, we have had no difficulty attracting qualified personnel to meet our requirements.

Relations between air carriers and labor unions in the United States are governed by the Railway Labor Act or RLA. Under the RLA, collective bargaining agreements generally contain "amendable dates" rather than expiration dates, and the RLA requires that a carrier maintain the existing terms and conditions of employment following the amendable date through a multi-stage and usually lengthy series of bargaining processes overseen by the National Mediation Board. Mesa Airline's flight attendants are represented by the Association of Flight Attendants (AFA). Mesa Airline's contract with the AFA becomes amendable in June 2006. Our pilots are represented by the Air Line Pilot Association (ALPA). Our contract with ALPA becomes amendable in September 2007.

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Although not currently observing high turnover, pilot turnover at times is a significant issue among regional carriers when major carriers are hiring experienced commercial pilots away from regional carriers. The addition of aircraft, especially new aircraft types, can result in pilots upgrading between aircraft types and becoming unavailable for duty during the extensive training periods required. No assurances can be made that pilot turnover and unavailability will not be a significant problem in the future, particularly if major carriers expand their operations. Similarly, there can be no assurance that sufficient numbers of new pilots will be available to support any future growth.

No other Mesa subsidiaries are parties to any other collective bargaining agreement or union contracts.

Essential Air Service Program

The Essential Air Service (EAS) program administered by the DOT guarantees a minimum level of air service in certain communities, predicated on predetermined guidelines set forth by Congress. Based on these guidelines, the DOT subsidizes air service to communities that might not otherwise have air service. At September 30, 2005, we provided service to 24 such cities for an annualized subsidy of approximately \$19 million. EAS rates are normally set for two-year contract periods for each city. There is no guarantee that we will continue to receive subsidies for the cities we serve. The DOT may request competitive proposals from other airlines at the end of the contract period for EAS service to a particular city. Proposals, when requested, are evaluated on, among other things, level of service provided, subsidy requested, fitness of the applicant and comments from the communities served. If the funding under this program is terminated for any of the cities served by us, in all likelihood we would not continue to fly in these markets, and as a result, we would be forced to find alternative uses for the Beechcraft 1900D 19-seat turboprop aircraft affected.

Regulation

As an interstate air carrier, we are subject to the economic jurisdiction, regulation and continuing air carrier fitness requirements of the DOT. Such requirements include minimum levels of financial, managerial and regulatory fitness. The DOT is authorized to establish consumer protection regulations to prevent unfair methods of competition and deceptive practices, to prohibit certain pricing practices, to inspect a carrier's books, properties and records, and to mandate conditions of carriage. The DOT also has the power to bring proceedings for the enforcement of air carrier economic regulations, including the assessment of civil penalties, and to seek criminal sanctions.

We are subject to the jurisdiction of the FAA with respect to our aircraft maintenance and operations, including equipment, ground facilities, dispatch, communication, training, weather observation, flight personnel and other matters affecting air safety. To ensure compliance with its regulations, the FAA requires airlines to obtain an operating certificate, which is subject to suspension or revocation for cause, and provides for regular inspections.

We are subject to various federal and local laws and regulations pertaining to other issues of environmental protocol. We believe we are in compliance with all governmental laws and regulations regarding environmental protection.

We are also subject to the jurisdiction of the Federal Communications Commission with respect to the use of our radio facilities and the United States Postal Service with respect to carriage of United States mail.

Local governments in certain markets have adopted regulations governing various aspects of aircraft operations, including noise abatement and curfews.

Available Information

We maintain a website where additional information concerning our business can be found. The address of that website is www.mesa-air.com. We make available free of charge on our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports, as soon as reasonably practicable after we electronically file or furnish such materials to the SEC.

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The following risk factors, in addition to the information discussed elsewhere herein, should be carefully considered in evaluating us and our business:

Risks Related to Our Business

We are dependent on our agreements with our code-share partners.

We depend on relationships created by our code-share agreements. We derive a significant portion of our consolidated passenger revenues from our revenue guarantee code-share agreements with America West, United Airlines, and US Airways. Our code-share partners have certain rights to cancel the applicable code-share agreement upon the occurrence of certain events or the giving of appropriate notice, subject to certain conditions. No assurance can be given that one or more of our code-share partners will not serve notice at a later date of their intention to cancel our code-sharing agreement, forcing us to stop selling those routes with the applicable partner's code and potentially reducing our traffic and revenue.

Our code-share agreement with America West allows America West, subject to certain restrictions, to reduce the combined CRJ fleets utilized under the code-share agreement by one aircraft in any six-month period commencing in June 2006 (except during the calendar year 2007 in which 2 CRJ-200 can be eliminated in each six-month period). In addition, beginning in February 2007, America West may eliminate the Dash-8 aircraft upon 180 days prior written notice. America West has used this provision to reduce the number of aircraft covered by the code-share agreement and there can be no assurance that, commencing in January 2007, they will not continue to further reduce the number of covered aircraft.

In addition, because a majority of our operating revenues are currently generated under revenue-guarantee code-share agreements, if any one of them is terminated, our operating revenues and net income could be materially adversely affected unless we are able to enter into satisfactory substitute arrangements or, alternatively, fly under our own flight designator code, including obtaining the airport facilities and gates necessary to do so. For the year ended September 30, 2005, our America West code-share agreement accounted for 44% of our consolidated passenger revenues, our US Airways code-share agreement accounted for 31% of our consolidated passenger revenues and our United code-share agreement accounted for 24% of our consolidated passenger revenues. Following the transition of the 59 aircraft previously operated at US Airways, we currently anticipate that our America West code-share agreement will account for approximately 40% of our consolidated passenger revenues, our Delta code-share agreement will account for approximately 20% of our consolidated passenger revenues and our United code-share agreement will account for approximately 35% of our consolidated passenger revenues. Any material modification to, or termination of, our code-share agreements with any of these partners could have a material adverse effect on our financial condition, the results of our operations and the price of our common stock. Should America West, Delta or United's revenue-guarantee code-share agreements be terminated, we cannot assure you that we would be able to enter into substitute code-share arrangements, that any such arrangements would be as favorable to us as the current code-share agreements or that we could successfully fly under our own flight designator code.

As a result of the US Airways' emergence from bankruptcy and their non-assumption of our revenue-guarantee code-share agreement, we began working with US Airways to provide for the orderly transition of the aircraft flown under our US Airways code-share agreement. If we are unable to timely transition the jets flown under this agreement to other code-share arrangements, we may incur unexpected costs which could have a material adverse effect on our business, financial condition and results of operations.

If our code-share partners or other regional carriers experience events that negatively impact their financial strength or operations, our operations also may be negatively impacted.

We are directly affected by the financial and operating strength of our code-share partners. Any events that negatively impact the financial strength of our code-share partners or have a long-term effect on the use of our code-share partners by airline travelers would likely have a material adverse effect on our business, financial condition and results of operations. In the event of a decrease in the financial or operational strength

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of any of our code-share partners, such partner may seek to reduce, or be unable to make, the payments due to us under their code-share agreement. In addition, they may reduce utilization of our aircraft. Although there are certain monthly guaranteed payment amounts, there are no minimum levels of utilization specified in the code-share agreements. UAL Corp., the parent company of our code-share partner United Airlines, has not emerged from reorganization under Chapter 11 of the U.S. Bankruptcy Code. Additionally, US Airways, which accounted for 31% of our consolidated passenger revenue for the fiscal year ended September 30, 2005, filed for bankruptcy protection. On September 16, 2005, the Bankruptcy court entered an order confirming the debtors (US Airways) plan of reorganization, which included the merger between US Airways Group and America West Holding Corporation, the parent company of America West Airlines. US Airways Group will operate under the single brand name of US Airways through two principal operating subsidiaries, US Airways, Inc. and America West Airlines, Inc. As a result of US Airways' emergence from bankruptcy and their non-assumption of our revenue-guarantee code-share agreement, we expanded our regional jet revenue-guarantee code-share agreement with United and entered into a new revenue-guarantee code-share agreement with Delta and are currently working to transition the jets flown under the US Airways code-share agreement to the United and Delta arrangements. In addition, on September 14, 2005, Delta Air Lines filed for reorganization under Chapter 11 of the US Bankruptcy Code. Delta has not yet assumed our code-share agreement in its bankruptcy proceeding and could choose to terminate this agreement or seek to renegotiate the agreement on terms less f