

MESA AIR GROUP INC
Form 10-Q
August 09, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period-ended **June 30, 2006**

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

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 100,
Phoenix, Arizona**

(Address of principal executive offices)

85008

(Zip code)

Registrant's telephone number, including area code:

(602) 685-4000

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 last 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

On August 2, 2006, the registrant had outstanding 36,267,542 shares of Common Stock.

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PART 1. FINANCIAL INFORMATION**Item 1. Financial Statements**

MESA AIR GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended		Nine Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2006	2005	2006	2005
	(Unaudited)			
	(In thousands, except per share amounts)			
Operating revenues:				
Passenger	\$ 331,967	\$ 289,782	\$ 953,034	\$ 801,699
Freight and other	7,070	8,796	21,685	25,498
Total operating revenues	339,037	298,578	974,719	827,197
Operating expenses:				
Flight operations	92,927	78,295	273,625	236,633
Fuel	121,990	81,426	329,996	213,734
Maintenance	60,849	52,302	163,993	147,836
Aircraft and traffic servicing	20,883	17,221	55,403	51,589
Promotion and sales	1,335	961	2,989	3,121
General and administrative	14,335	20,022	47,240	51,211
Depreciation and amortization	8,998	11,588	27,005	30,873
Bankruptcy settlement	(9,742)		(9,742)	
Impairment and restructuring charges (credits)				(1,257)
Total operating expenses	311,575	261,815	890,509	733,740
Operating income	27,462	36,763	84,210	93,457
Other income (expense):				
Interest expense	(9,415)	(11,555)	(27,710)	(30,490)
Interest income	3,609	784	9,206	1,842
Other income (expense)	(3,668)	1,778	(17,995)	3,032
Total other income (expense)	(9,474)	(8,993)	(36,499)	(25,616)
Income before income taxes	17,988	27,770	47,711	67,841
Income taxes	7,059	10,635	18,502	25,983
Net income	\$ 10,929	\$ 17,135	\$ 29,209	\$ 41,858
Income per common share:				
Basic	\$ 0.30	\$ 0.59	\$ 0.89	\$ 1.43
Diluted	\$ 0.25	\$ 0.40	\$ 0.73	\$ 1.00

See accompanying notes to condensed consolidated financial statements.

MESA AIR GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2006	September 30, 2005
	(Unaudited)	
	(In thousands, except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 80,801	\$ 143,428
Marketable securities	177,161	128,162
Restricted cash	11,726	8,848
Receivables, net	51,023	28,956
Income tax receivable	3,003	704
Expendable parts and supplies, net	32,229	36,288
Prepaid expenses and other current assets	127,261	98,267
Deferred income taxes	4,245	8,256
Total current assets	487,449	452,909
Property and equipment, net	617,305	642,914
Lease and equipment deposits	26,854	25,428
Other assets	75,621	46,420
Total assets	\$ 1,207,229	\$ 1,167,671
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 29,397	\$ 27,787
Short-term debt	82,110	54,594
Accounts payable	52,954	52,608
Air traffic liability	5,192	2,169
Accrued compensation	6,421	3,829
Deposit on pending sale of rotatable spare parts		22,750
Rotatable spare parts financing liability		19,685
Income taxes payable	603	2,863
Other accrued expenses	39,020	30,512
Total current liabilities	215,697	216,797
Long-term debt, excluding current portion	549,965	636,582
Deferred credits	102,960	97,497
Deferred income tax liability	41,174	25,684
Other noncurrent liabilities	21,190	14,441
Total liabilities	930,986	991,001
Stockholders' equity:		

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Preferred stock of no par value, 2,000,000 shares authorized; no shares issued and outstanding		
Common stock of no par value and additional paid-in capital, 75,000,000 shares authorized; 36,200,769 and 28,868,167 shares issued and outstanding, respectively	166,492	96,128
Retained earnings	109,751	80,542
Total stockholders' equity	276,243	176,670
Total liabilities and stockholders' equity	\$ 1,207,229	\$ 1,167,671

See accompanying notes to condensed consolidated financial statements.

MESA AIR GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended	
	June 30,	June 30,
	2006	2005
	(Unaudited)	
	(In thousands)	
Cash Flows from Operating Activities:		
Net income	\$ 29,209	\$ 41,858
Adjustments to reconcile net income to net cash flows provided by (used in) operating activities:		
Depreciation and amortization	27,005	30,873
Impairment and restructuring charges (credits)		(1,257)
Deferred income taxes	19,501	25,816
Unrealized (gain) loss on marketable securities	4,615	(744)
Amortization of deferred credits	(8,728)	(4,789)
Amortization of contract incentive payments	2,500	
Amortization of restricted stock awards	883	883
Stock option expense	1,852	
Tax benefit-stock compensation		68
Debt origination costs written off	1,800	
(Gain) loss on sale of assets	611	900
Provision for obsolete expendable parts and supplies	195	900
Provision for doubtful accounts	(4,849)	5,890
Bankruptcy settlement	(9,742)	
Changes in assets and liabilities:		
Net (purchases) sales of investment securities	(53,614)	(67,034)
Receivables	(2,479)	2,870
Income tax receivables	(2,299)	(320)
Expendable parts and supplies	1,601	1,139
Prepaid expenses and other current assets	(28,407)	(18,634)
Other assets	453	
Contract incentive payments	(20,539)	(10,000)
Accounts payable	347	777
Income taxes payable	(632)	(70)
Other accrued liabilities	18,326	(1,934)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	(22,391)	6,292
Cash Flows from Investing Activities:		
Capital expenditures	(26,531)	(32,451)
Proceeds from sale of assets	18,736	
Change in restricted cash	(2,878)	(612)
Change in other assets	(682)	(227)
Net returns (payments) of lease and equipment deposits	(426)	(146)
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(11,781)	(33,436)

Cash Flows from Financing Activities:

Principal payments on long-term debt	(22,729)	(20,399)
Proceeds from short-term debt		2,708
Repayment of financing of rotatable spare parts	(15,882)	
Proceeds from exercise of stock options and issuance of warrants	6,011	371
Common stock purchased and retired	(660)	(10,285)
Proceeds from receipt of deferred credits	4,805	3,339
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(28,455)	(24,266)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(62,627)	(51,410)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	143,428	173,110
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 80,801	\$ 121,700
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid for interest, net of amounts capitalized	\$ 27,675	\$ 29,680
Cash paid for income taxes, net	2,069	16
SUPPLEMENTAL NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Aircraft delivered under interim financing	\$ 27,516	\$ 296,288
Conversion of convertible debentures to common stock	62,278	

	Nine Months Ended	
	June	June 30,
	30,	2005
	2006	
	(Unaudited)	
	(In thousands)	
Note receivable received from sale of rotatable spare parts	18,835	
Inventory and other credits received in conjunction with aircraft financing	7,212	
Rotable spare parts financed with long-term payable	2,373	
Note payable to aircraft manufacturer for deposits on interim aircraft		14,591
See accompanying notes to condensed consolidated financial statements.		

MESA AIR GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Business and Basis of Presentation

The accompanying unaudited, condensed consolidated financial statements of Mesa Air Group, Inc. (Mesa or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for a complete set of financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the results for the periods presented have been made. Operating results for the three and nine-month periods ended June 30, 2006, are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2006. These condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and notes thereto included in the Company s annual report on Form 10-K/A for the fiscal year ended September 30, 2005.

The accompanying condensed consolidated financial statements include the accounts of Mesa Air Group, Inc. and its wholly-owned operating subsidiaries: Mesa Airlines, Inc. (Mesa Airlines), a Nevada corporation and certificated air carrier; Freedom Airlines, Inc. (Freedom), a Nevada corporation and certificated air carrier; Air Midwest, Inc. (Air Midwest), a Kansas corporation and certificated air carrier; MPD, Inc. (MPD), a Nevada corporation, doing business as Mesa Pilot Development; Regional Aircraft Services, Inc. (RAS) a Pennsylvania corporation; Mesa Leasing, Inc., a Nevada corporation; Mesa Air Group Airline Inventory Management, LLC (MAG-AIM), an Arizona Limited Liability Company; Ritz Hotel Management Corp., a Nevada Corporation; and MAGI Insurance, Ltd. (MAGI), a Barbados, West Indies based captive insurance company. MPD, Inc. provides pilot training in coordination with a community college in Farmington, New Mexico and with Arizona State University in Tempe, Arizona. RAS performs aircraft component repair and overhaul services and ground handling services. MAG-AIM is an inventory procurement and sales company. MAGI is a captive insurance company established for the purpose of obtaining more favorable aircraft liability insurance rates. All significant intercompany accounts and transactions have been eliminated in consolidation. In addition, the Company has launched its inter-island service in Hawaii under the brand name *go!* This operation is referred to herein as *go!*

2. Segment Reporting

Statement of Financial Accounting Standard (SFAS) No. 131, Disclosures about Segments of an Enterprise and Related Information, requires disclosures related to components of a company for which separate financial information is available that is evaluated regularly by a company s chief operating decision maker in deciding the allocation of resources and assessing performance. The Company has three airline operating subsidiaries, Mesa Airlines, Freedom Airlines and Air Midwest, as well as various other subsidiaries organized to provide support for the Company s airline operations. In addition, Mesa Airlines began providing inter-island service in Hawaii as *go!* in the third quarter of fiscal 2006. The Company has aggregated these subsidiaries into three reportable segments: Mesa Airlines / Freedom, Air Midwest / *go!* and Other. Mesa Airlines and Freedom Airlines operate regional jets and Dash-8 aircraft pursuant to revenue guarantee contracts. Air Midwest operates the Company s Beech 1900 turboprop aircraft and *go!* operates regional jets. Air Midwest and *go!* assume all revenue risk for their flying. The Other reportable segment includes Mesa Air Group (the holding company), RAS, MPD, MAG-AIM, MAGI, Mesa Leasing, Inc. and Ritz Hotel Management Corp., all of which support Mesa s operating subsidiaries. In October 2004, the Company transitioned certain of its regional jets from Freedom into Mesa and transferred a B1900D aircraft from Air Midwest into Freedom. As a result, Freedom was grouped with Air Midwest in fiscal 2005 for segment purposes. In fiscal 2006, Freedom began operating under a revenue-guarantee code-share agreement with Delta utilizing ERJ-145 aircraft that were transitioned from Mesa Airlines. As such, the Company has aggregated Freedom with Mesa Airlines beginning in the first quarter of fiscal 2006. Operating revenues in the Other segment are primarily sales of rotatable and expendable parts to the Company s operating subsidiaries and ground handling services performed by employees of RAS for Mesa Airlines.

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Mesa Airlines and Freedom Airlines provide passenger service with regional jets under revenue-guarantee contracts with United Airlines, Inc. (United), Delta Air Lines, Inc. (Delta) and US Airways, Inc. (US Airways). Mesa Airlines also provides passenger service with Dash-8 aircraft under revenue-guarantee contracts with US Airways and United. As of June 30, 2006, Mesa Airlines and Freedom Airlines operated a fleet of 160 aircraft 108 CRJs, 36 ERJs and 16 Dash-8s. Prior to operating ERJ 145 aircraft, Freedom most recently operated Beechcraft 1900D under a pro-rate agreement with US Airways.

Air Midwest provides passenger service with Beechcraft 1900D aircraft under pro-rate contracts with US Airways and Midwest Airlines, Inc. (Midwest Airlines) as well as independent operations as Mesa Airlines. As of June 30, 2006, Air Midwest operated a fleet of 20 Beechcraft 1900D turboprop aircraft. Mesa Airlines, operating as *go!*, provides independent inter-island Hawaiian passenger service with CRJ-200 aircraft. *go!* operated a fleet of five CRJ-200 as of June 30, 2006. Air Midwest and Mesa, operating as *go!*, do not receive contractually-guaranteed revenue for their operations.

Activity in the Other category consists primarily of sales of rotatable and expendable parts and ground handling services to the Company's operating subsidiaries, but also includes all administrative functions not directly attributable to any specific operating company. These administrative costs are allocated to the operating companies based upon specific criteria including headcount, available seat miles (ASM s) and other operating statistics.

Three Months Ended June 30, 2006 (000 s)	Mesa/ Freedom	Air Midwest/ go!	Other	Eliminations	Total
Total operating revenues	\$ 325,262	\$ 14,247	\$ 68,116	\$ (68,588)	\$ 339,037
Depreciation and amortization	7,710	116	1,172		8,998
Operating income (loss)	29,147	(2,751)	10,618	(9,552)	27,462
Interest expense	(7,230)	(21)	(2,312)	146	(9,415)
Interest income	3,220	11	524	(146)	3,609
Income (loss) before income tax	21,778	(2,745)	8,508	(9,553)	17,988
Income tax (benefit)	8,581	(1,073)	3,294	(3,743)	7,059
Total assets	1,386,844	13,877	481,316	(674,808)	1,207,229
Capital expenditures (including non-cash)	6,199	2,558	10,984		19,471

Three Months Ended June 30, 2005 (000 s)	Mesa	Air Midwest/ Freedom	Other	Eliminations	Total
Total operating revenues	\$ 282,012	\$ 14,052	\$ 75,547	\$ (73,033)	\$ 298,578
Depreciation and amortization	10,590	58	1,325	(385)	11,588
Operating income (loss)	39,244	(1,692)	10,064	(10,853)	36,763
Interest expense	(8,653)		(3,045)	143	(11,555)
Interest income	779	4	144	(143)	784
Income (loss) before income tax	33,201	(2,036)	7,458	(10,853)	27,770
Income tax (benefit)	12,716	(779)	2,855	(4,157)	10,635
Total assets	1,587,883	13,265	257,032	(405,380)	1,452,800
Capital expenditures (including non-cash)	124,602		15,027		139,629

Nine Months Ended June 30, 2006 (000 s)	Mesa/ Freedom	Air Midwest/ go!	Other	Eliminations	Total
Total operating revenues	\$ 930,605	\$ 39,855	\$ 172,752	\$ (168,493)	\$ 974,719
Depreciation and amortization	23,084	173	3,748		27,005
Operating income (loss)	85,925	(5,255)	26,742	(23,202)	84,210
Interest expense	(19,909)	(21)	(8,216)	436	(27,710)
Interest income	8,533	19	1,090	(436)	9,206
Income (loss) before income tax	70,302	(5,850)	6,462	(23,203)	47,711
Income tax (benefit)	27,263	(2,269)	2,506	(8,998)	18,502

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Total assets	1,386,844	13,877	481,316	(674,808)	1,207,229
Capital expenditures (including non-cash)	37,662	2,573	16,186		56,421

Nine Months Ended June 30, 2005 (000 s)	Air				Total
	Mesa	Midwest/ Freedom	Other	Eliminations	
Total operating revenues	\$ 770,488	\$49,663	\$223,171	\$(216,125)	\$ 827,197
Depreciation and amortization	27,656	184	3,418	(385)	30,873
Operating income (loss)	100,630	(6,855)	32,559	(32,877)	93,457
Interest expense	(22,119)		(8,800)	429	(30,490)
Interest income	1,823	9	439	(429)	1,842
Income (loss) before income tax	84,007	(7,214)	23,925	(32,877)	67,841
Income tax (benefit)	32,174	(2,763)	9,163	(12,591)	25,983
Total assets	1,587,883	13,265	257,032	(405,380)	1,452,800
Capital expenditures (including non-cash)	276,305		52,434		328,739

3. Marketable Securities

The Company has a cash management program which provides for the investment of excess cash balances primarily in short-term money market instruments, US treasury securities and intermediate-term debt instruments.

SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, requires that all applicable investments be classified as trading securities, available for sale securities or held-to-maturity securities. The Company currently has \$177.2 million in marketable securities that include US Treasury notes, government bonds, corporate bonds, short positions on common equity securities and auction rate securities (ARS). These investments are classified as trading securities during the periods presented and accordingly, are carried at market value with changes in value reflected in the current period operations. Unrealized losses relating to trading securities held at June 30, 2006 and September 30, 2005, were \$4.6 million and \$0.5 million, respectively.

ARS generally have long-term maturities; however, these investments have characteristics similar to short-term investments because at predetermined intervals, generally every 28 days, there is a new auction process. As such, the Company classifies ARS as short-term investments. The balance of marketable securities at June 30, 2006 and September 30, 2005 includes investments in ARS of \$48.3 million and \$46.7 million, respectively.

In the third quarter of fiscal 2006, the Company entered into a short position on certain equity securities in order to hedge its exposure to shares expected to be received in connection with a settlement. The Company marks short positions to market at each reporting period with the associated gain or loss in value reflected in other income (expense) in the condensed consolidated statement of income. Included in marketable securities are liabilities related to short positions on common equity securities of \$2.6 million at June 30, 2006. The short position was closed subsequent to June 30, 2006.

4. Restricted Cash

At June 30, 2006, the Company had \$11.7 million in restricted cash on deposit with two financial institutions. In September 2004, the Company entered into an agreement with a financial institution for a \$9.0 million letter of credit facility and to issue letters of credit for landing fees, workers compensation insurance and other business needs. Pursuant to the agreement, \$6.7 million of outstanding letters of credit at June 30, 2006 are collateralized by amounts on deposit. The Company also maintains \$5.0 million on deposit with another financial institution to collateralize its direct deposit payroll obligations.

5. Bankruptcy Settlement

In the quarter ended June 30, 2006, the Company determined, based upon publicly available bankruptcy court documents, that its minimum distribution from its US Airways bankruptcy claim would be 301,937 shares of US Airways common stock. The Company valued the minimum amount to be received based upon the closing market price of the stock on June 30, 2006 of \$50.54 per share; applied the expected proceeds to existing receivables and recorded the remaining amount of \$9.7 million as a bankruptcy settlement in the condensed consolidated statement of income. On July 11, 2006, the Company received 351,456 shares of US Airways common stock. The difference between the number of shares actually received and the amount recorded at June 30, 2006, will be valued at the market price of the shares on the date of receipt and recorded as a bankruptcy settlement in the fourth quarter.

6. Concentrations

The Company has code-share agreements with US Airways, United, Delta and Midwest Airlines. Approximately 99% of the Company's consolidated passenger revenue for the three months ended June 30, 2006 was derived from these agreements. Accounts receivable from the Company's code-share partners were 40% and 35% of total gross accounts receivable at June 30, 2006 and September 30, 2005, respectively.

Prior to the merger of America West and US Airways, US Airways filed for Chapter 11 bankruptcy protection on September 12, 2004. As a result of US Airways' emergence from bankruptcy in September 2005 and their non-assumption of the Company's revenue-guarantee code-share agreement, the Company expanded its regional jet revenue-guarantee code-share agreement with United and entered into a new revenue-guarantee code-share agreement with Delta. The Company completed the transition of aircraft from US Airways to United and Delta during the third quarter of fiscal year 2006. 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 the code-share agreement with the Company in its bankruptcy proceeding and could choose to terminate our regional jet agreement or seek to renegotiate the agreement on less favorable terms. At June 30, 2006, we operated twenty-six regional jet aircraft under the Delta agreement. Non-assumption of the Delta agreement in the bankruptcy proceeding could have a material adverse effect on our business, financial condition and results of operations.

7. Contract Incentives

In May 2005, the Company amended its code-sharing arrangement with United to allow the Company to put up to an additional 30 50-seat regional jet aircraft into the United Express system. The agreement with respect to the additional 30 50-seat regional jet aircraft expires in April 2010. Additionally, the expiration dates under the existing code-share agreement with respect to certain

aircraft were extended. The code-share agreement for (i) the ten Dash-8 aircraft terminates in July 2013, and United Airlines' right to terminate earlier will not begin until April 2010, (ii) the 15 50-seat CRJ-200s currently terminates in April 2010, (iii) the 15 70-seat regional jets (to be delivered upon the withdrawal of the 50-seat regional jets) terminates on the earlier of ten years from delivery date or October 2018 and (iv) the remaining 15 70-seat regional jets terminates in three tranches between December 2011 and December 2013. In connection with the amendment, the Company made three \$10 million payments to United as follows: i) \$10 million in June 2005, ii) \$10 million in October 2005, and iii) \$10 million in November 2005. Amounts paid are recorded as a deferred charge and included in other assets on the condensed consolidated balance sheet. The deferred charge is being amortized over the term of the code-share agreement as a reduction of passenger revenue. Amortization of \$1.0 million and \$2.5 million was recorded for the three and nine-month periods ended June 30, 2006, respectively.

8. Sale Leaseback of Rotable Spare Parts