

MESA AIR GROUP INC
Form 10-Q
February 09, 2007

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**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 December 31, 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 February 1, 2007, the registrant had outstanding 33,142,268 shares of Common Stock.

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Table of Contents**PART 1. FINANCIAL INFORMATION****Item 1. Financial Statements****MESA AIR GROUP, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

	Three Months Ended	
	December 31,	December 31,
	2006	2005
	(Unaudited)	
	(In thousands, except per share amounts)	
Operating revenues:		
Passenger	\$ 338,974	\$ 315,415
Freight and other	8,639	8,202
Total operating revenues	347,613	323,617
Operating expenses:		
Flight operations	96,722	89,864
Fuel	117,798	104,849
Maintenance	63,404	55,539
Aircraft and traffic servicing	21,375	16,210
Promotion and sales	1,573	772
General and administrative	17,462	18,391
Depreciation and amortization	10,710	9,182
Bankruptcy settlement	(620)	
Total operating expenses	328,424	294,807
Operating income	19,189	28,810
Other income (expense):		
Interest expense	(10,670)	(9,585)
Interest income	4,545	2,997
Loss from equity method investment	(70)	
Other income (expense)	205	(1,098)
Total other expense	(5,990)	(7,686)
Income before income taxes	13,199	21,124
Income taxes	5,187	8,133

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Net income	\$	8,012	\$	12,991
Income per common share:				
Basic	\$	0.24	\$	0.45
Diluted	\$	0.20	\$	0.31

See accompanying notes to condensed consolidated financial statements.

Table of Contents**MESA AIR GROUP, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

	December 31, 2006	September 30, 2006
	(In thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 72,077	\$ 35,559
Marketable securities	172,184	186,764
Restricted cash	12,001	12,001
Receivables, net	49,587	47,382
Income tax receivable	539	615
Expendable parts and supplies, net	35,576	32,771
Prepaid expenses and other current assets	129,119	139,563
Deferred income taxes	4,505	4,115
 Total current assets	 475,588	 458,770
Property and equipment, net	688,774	669,912
Lease and equipment deposits	27,394	27,389
Equity method investment	12,440	12,510
Other assets	63,784	69,632
 Total assets	 \$ 1,267,980	 \$ 1,238,213

LIABILITIES AND STOCKHOLDERS EQUITY

Current liabilities:		
Current portion of long-term debt	\$ 30,021	\$ 29,659
Short-term debt	143,354	123,076
Accounts payable	57,234	56,097
Air traffic liability	4,725	6,677
Accrued compensation	8,468	4,545
Income taxes payable	461	1,008
Other accrued expenses	43,791	42,001
 Total current liabilities	 288,054	 263,063
Long-term debt, excluding current portion	535,371	542,569
Deferred credits	102,556	101,723
Deferred income taxes	50,025	44,531
Other noncurrent liabilities	23,217	22,117
 Total liabilities	 999,223	 974,003

Commitments and contingencies (notes 8, 9, 11 and 17)

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Stockholders' equity:

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; 33,389,278 and 33,904,053 shares issued and outstanding, respectively

Retained earnings	146,236	149,701
	122,521	114,509
Total stockholders' equity	268,757	264,210
Total liabilities and stockholders' equity	\$ 1,267,980	\$ 1,238,213

See accompanying notes to condensed consolidated financial statements.

Table of Contents**MESA AIR GROUP, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Three Months Ended	
	December 31,	December 31,
	2006	2005
	(Unaudited)	
	(In thousands)	
Cash Flows from Operating Activities:		
Net income	\$ 8,012	\$ 12,991
Adjustments to reconcile net income to net cash flows provided by (used in) operating activities:		
Depreciation and amortization	10,710	9,182
Deferred income taxes	5,104	7,297
Unrealized (gain) loss on investment securities	(45)	303
Equity in net loss of unconsolidated subsidiary	70	
Amortization of deferred credits	(3,200)	(1,933)
Amortization of restricted stock awards	349	294
Amortization of contract incentives	994	
Stock based compensation expense	354	803
Provision for obsolete expendable parts and supplies	378	169
Provision for doubtful accounts	591	530
Changes in assets and liabilities:		
Net (purchases) sales of investment securities	14,625	(15,275)
Receivables	(1,796)	3,575
Income tax receivables	76	(435)
Expendable parts and supplies	(3,158)	1,825
Prepaid expenses	10,444	21,158
Other assets	564	
Contract incentive payments		(20,000)
Accounts payable	1,137	(9,036)
Income taxes payable	(547)	(2,863)
Other accrued liabilities	4,861	8,214
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	49,523	16,799
Cash Flows from Investing Activities:		
Capital expenditures	(6,871)	(3,076)
Proceeds from sale of flight equipment and expendable inventory	43	15,965
Change in restricted cash		(2,824)
Change in other assets	4,165	592
Net returns (payments) of lease and equipment deposits	(5)	617
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(2,668)	11,274
Cash Flows from Financing Activities:		

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Principal payments on short and long-term debt	(10,202)	(6,555)
Proceeds from exercise of stock options and issuance of warrants	91	720
Proceeds (payments) on financing rotatable inventory		(17,768)
Tax benefit-stock compensation		302
Common stock purchased and retired	(4,259)	(193)
Proceeds from receipt of deferred credits	4,033	
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(10,337)	(23,494)
NET CHANGE IN CASH AND CASH EQUIVALENTS	36,518	4,579
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	35,559	143,428
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 72,077	\$ 148,007
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid for interest, net of amounts capitalized	\$ 10,247	\$ 10,220
Cash paid for income taxes, net	554	3,985
SUPPLEMENTAL NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Aircraft delivered under interim financing provided by the manufacturer	\$ 23,644	\$ 27,516
Receivable for credits related to aircraft financing	1,000	
Inventory and other credits received in conjunction with aircraft financing		1,791
Conversion of convertible debentures to common stock		4,800
Note receivable received from sale of rotatable spare parts		18,835

See accompanying notes to condensed consolidated financial statements.

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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-month period ended December 31, 2006, are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2007. 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 for the fiscal year ended September 30, 2006.

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; Air Midwest, LLC, a Nevada limited liability company, MPD, Inc., a Nevada corporation, doing business as Mesa Pilot Development; Regional Aircraft Services, Inc. (RAS) a California company; Mesa Air Group Airline Inventory Management, LLC (MAG-AIM), an Arizona Limited Liability Company; Ritz Hotel Management Corp., a Nevada Corporation; Nilchii, Inc. (Nilchii), a Nevada corporation, Ping Shan, SRL (Ping Shan), a Barbados, West Indies based investment company, Shan Yue (Shan Yue), SRL a Barbados, West Indies based investment company, and MAGI Insurance, Ltd. (MAGI), a Barbados, West Indies based captive insurance company. Air Midwest LLC was formed for the purpose of a contemplated conversion of Air Midwest from a corporation to a limited liability company (which has not yet occurred). 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. MAG-AIM purchases, distributes and manages the Company s inventory of rotatable and expendable spare parts. Ritz Hotel Management is a Phoenix area hotel property that is used for crew-in-training accommodations. MAGI is a captive insurance company established for the purpose of obtaining more favorable aircraft liability insurance rates. Ping Shan and Shan Yue were established to invest in a Joint Venture in the People s Republic of China. Nilchii was established to invest in certain airline related businesses. All significant intercompany accounts and transactions have been eliminated in consolidation.

New Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) ratified Emerging Issues Task Force Issue No. 06-3 (EITF 06-3), How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation). EITF 06-3 applies to any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer. EITF 06-3 allows companies to present taxes either gross within revenue and expense or net. If taxes subject to this issue are significant, a company is required to disclose its accounting policy for presenting taxes and the amount of such taxes that are recognized on a gross basis. The Company currently presents such taxes net. EITF 06-3 is required to be adopted during the second quarter of fiscal 2007. These taxes are currently not material to the Company s

consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements. This standard defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America, and expands disclosure about fair value measurements. This pronouncement applies to other accounting standards that require or permit fair value

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MESA AIR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

measurements. Accordingly, this statement does not require any new fair value measurement. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company will be required to adopt SFAS No. 157 in the first quarter of fiscal year 2009. Management has not yet determined the impact of adopting this statement.

In September, 2006, the FASB issued FASB Staff Position (FSP) No. AUG AIR-1 Accounting for Planned Major Maintenance Activities. This position amends the existing major maintenance accounting guidance contained within the AICPA Industry Audit Guide Audits of Airlines and prohibits the use of the accrue in advance method of accounting for planned major maintenance activities for owned aircraft. The provisions of the announcement are applicable for fiscal years beginning after December 15, 2006. Mesa currently uses the direct expense method of accounting for planned major maintenance; therefore, the adoption of FSP No. AUG AIR-1 will not have an impact on the Company's consolidated financial statements.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108 (SAB 108). Due to diversity in practice among registrants, SAB 108 expresses SEC staff views regarding the process by which misstatements in financial statements are evaluated for purposes of determining whether financial statement restatement is necessary. SAB 108 is effective for fiscal years ending after November 15, 2006. The Company will adopt SAB 108 in fiscal 2007. Management does not believe the adoption of SAB 108 will have a material impact on the Company's consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in financial statements. FIN 48 requires the impact of a tax position to be recognized in the financial statements if that position is more likely than not of being sustained by the taxing authority. Mesa will be required to adopt FIN 48 in the first quarter of fiscal year 2008. Management has not yet determined the impact on the Company's consolidated financial statements.

2. Segment Reporting

Statement of Financial Accounting Standards 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. The Company has aggregated these subsidiaries into three reportable segments: Mesa Airlines/Freedom, Air Midwest/*go!* and Other. 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.

Mesa Airlines and Freedom Airlines provide passenger service under revenue-guarantee contracts with United Airlines, Inc. (United), Delta Air Lines, Inc. (Delta) and US Airways, Inc. (US Airways). As of December 31, 2006, Mesa Airlines and Freedom Airlines operated a fleet of 175 aircraft 110 CRJs, 36 ERJs and 28 Dash-8s.

Air Midwest and Mesa Airlines, operating as *go!*, provide passenger service where revenue is derived from ticket sales either independently or through pro-rate agreements. Air Midwest provides passenger service under pro-rate contracts with US Airways, Pre-Merger US Airways and Midwest Airlines, as well as independently under the brand name Mesa Airlines. As of December 31, 2006, Air Midwest operated a fleet of 20 Beechcraft 1900D turboprop aircraft. Mesa Airlines, operating as *go!*, provides independent inter-island Hawaiian passenger service. As of December 31, 2006, Mesa's *go!* operation operated a fleet of five CRJ-200 aircraft. Air Midwest and Mesa, operating as *go!*, do not receive contractually-guaranteed revenue for their operations. Air Midwest LLC will be included in Air Midwest/*go!* if it begins operations.

Table of Contents**MESA AIR GROUP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Other reportable segment includes Mesa Air Group (the holding company), RAS, MPD, MAG-AIM, MAGI, Shan Yue, Ping Shan, Nilchii and Ritz Hotel Management Corp. 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 December 31, 2006 (000 \$)	Mesa/ Freedom	Air Midwest /go!	Other	Eliminations	Total
Total operating revenues	\$ 328,187	\$ 20,795	\$ 56,447	\$ (57,816)	\$ 347,613
Depreciation and amortization	9,049	539	1,122		10,710
Operating income (loss)	22,691	(3,396)	7,466	(7,572)	19,189
Interest expense	(8,424)		(2,394)	148	(10,670)
Interest income	3,050	66	1,577	(148)	4,545
Income (loss) before income tax	17,829	(3,330)	6,272	(7,572)	13,199
Income tax (benefit)	7,008	(1,309)	2,464	(2,976)	5,187
Total assets	1,455,801	17,725	518,898	(724,444)	1,267,980
Capital expenditures (including non-cash)	26,764	241	3,510		30,515

Three Months Ended December 31, 2005 (000 \$)	Mesa/ Freedom	Air Midwest	Other	Eliminations	Total
Total operating revenues	\$ 308,525	\$ 13,023	\$ 41,931	\$ (39,862)	\$ 323,617
Depreciation and amortization	8,005	26	1,151		9,182
Operating income (loss)	31,032	(1,188)	4,406	(5,440)	28,810
Interest expense	(6,799)		(2,932)	146	(9,585)
Interest income	3,056	5	82	(146)	2,997
Income (loss) before income tax	26,766	(1,182)	980	(5,440)	21,124
Income tax (benefit)	10,326	(477)	378	(2,094)	8,133
Total assets	1,348,288	11,731	316,131	(510,154)	1,165,996
Capital expenditures (including non-cash)	29,054	8	1,530		30,592

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, intermediate-term debt instruments, and common

equity securities of companies operating in the airline industry.

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 \$172.2 million in marketable securities that include US Treasury notes, government bonds and corporate bonds. 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 gains (losses) relating to trading securities held at December 31, 2006 and September 30, 2006, were \$0.1 million and (\$0.3) million, respectively.

The Company has determined that investments in auction rate securities (ARS) should be classified as short-term investments. 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.

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MESA AIR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As such, the Company classifies ARS as short-term investments. The balance of marketable securities at September 30, 2006 includes investments in ARS of \$17.4 million.

4. Restricted Cash

At December 31, 2006, the Company had \$12.0 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, \$7.0 million of outstanding letters of credit at December 31, 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. Concentrations

The Company has code-share agreements with Delta Air Lines, US Airways and United Airlines. Approximately 98% of the Company's consolidated passenger revenue for the three month period ended December 31, 2006 was derived from these agreements. Accounts receivable from the Company's code-share partners were 40% and 45% of total gross accounts receivable at December 31, 2006 and September 30, 2006, respectively.

US Airways accounted for approximately 45% of the Company's total passenger revenue in the three month period ended December 31, 2006. A termination of the US Airways revenue-guarantee code-share agreements would have a material adverse effect on the Company's business prospects, financial condition, results of operations and cash flows.

United Airlines accounted for approximately 37% of the Company's total passenger revenue in the three month period ended December 31, 2006. A termination of the United agreement would have a material adverse effect on the Company's business prospects, financial condition, results of operations and cash flows.

Delta Air Lines accounted for approximately 17% of the Company's total passenger revenue in the three month period ended December 31, 2006. A termination of the Delta agreement or the failure of Delta to successfully emerge from bankruptcy would have a material adverse effect on the Company's business prospects, financial condition, results of operations and cash flows. Delta has not yet assumed our regional jet code-share agreement in its bankruptcy proceedings and could choose to terminate the agreement at any time prior to its emergence from bankruptcy. In addition, according to news reports, US Airways, one of the Company's code-share partners, has dropped its previous proposal to merge with Delta, another of our code-share partners. If such a proposal were to be made again and be accepted, the Company is unable to predict what effect such a merger would have on its relationship with the parties or on its financial condition and operations.

6. 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. 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 balance sheet. The deferred charge is being amortized over the term of the code-share agreement as a reduction of passenger revenue.

7. Deferred Credits

Deferred credits consist of aircraft purchase incentives provided by the aircraft manufacturers and deferred gains on the sale and leaseback of interim financed aircraft. These incentives include credits that may be used to

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purchase spare parts, pay for training expenses or reduce other aircraft operating costs. These deferred credits and gains are amortized on a straight-line basis as a reduction of lease expense over the term of the respective leases.

8. Short-Term Debt

At December 31, 2006 and September 30, 2006, the Company had \$143.4 million and \$123.1 million, respectively, in notes payable to an aircraft manufacturer for aircraft on interim financing. Under interim financing arrangements, the Company takes delivery and title to the aircraft prior to securing permanent financing and the acquisition of the aircraft is accounted for as a purchase with debt financing. Accordingly, the Company reflects the aircraft and debt under interim financing on its balance sheet during the interim financing period. After taking delivery of the aircraft, it is the Company's intention to permanently finance the aircraft as an operating lease through a sale and leaseback transaction with an independent third-party lessor. Upon permanent financing, the proceeds are used to retire the notes payable to the manufacturer. Any gain recognized on the sale and leaseback transaction is deferred and amortized over the life of the lease. The Company had six aircraft on interim financing with the manufacturer at December 31, 2006. These interim financings agreements are typically six months in length and provide for monthly interest only payments at LIBOR plus three percent (8.35% at December 31, 2006). 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. Subsequent to December 31, 2006, the Company permanently financed these six aircraft with \$135 million in long-term debt.

9. Notes Payable and Long-Term Debt

Long-term debt consisted of the following:

	December 31, 2006	September 30, 2006
	(In thousands)	
Notes payable to bank, collateralized by the underlying aircraft, due 2019	\$ 324,593	\$ 329,478
Senior convertible notes due June 2023	37,834	37,834
Senior convertible notes due February 2024	100,000	100,000
Notes payable to manufacturer, principal and interest due monthly through 2011, interest at LIBOR plus 1.8% (7.8% at December 31, 2006), collateralized by the underlying aircraft	77,700	79,290
Note payable to financial institution due 2013, principal and interest due monthly at 7% per annum through 2008 converting to 12.5% thereafter, collateralized by the underlying aircraft	22,479	22,831
Note payable to manufacturer, principal due semi-annually, interest at 7% due quarterly through 2007	1,792	1,792
Mortgage note payable to bank, principal and interest at 7 1/2% due monthly through 2009	871	882
Other	123	121

Total debt	565,392	572,228
Less current portion	(30,021)	(29,659)
Long-term debt	\$ 535,371	\$ 542,569

10. Earnings Per Share

The Company accounts for earnings per share in accordance with SFAS No. 128, Earnings per Share. Basic net income per share is computed by dividing net income by the weighted average number of common shares

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outstanding during the periods presented. Diluted net income per share reflects the potential dilution that could occur if outstanding stock options and warrants were exercised. In addition, dilutive convertible securities are included in the denominator while interest on convertible debt, net of tax, is added back to the numerator. A reconciliation of the numerator and denominator used in computing net income per share is as follows:

	Three Months Ended December 30, 2006 2005 (In thousands)	
Share calculation:		
Weighted average shares basic	33,632	28,677
Effect of dilutive outstanding stock options and warrants	506	1,764
Effect of restricted stock	88	286
Effect of dilutive outstanding convertible debt	10,704	16,455
Weighted average shares diluted	44,930	47,182
Adjustments to net income:		
Net income	\$ 8,012	\$ 12,991
Interest expense on convertible debt, net of tax	909	1,516
Adjusted net income	\$ 8,921	\$ 14,507

Options to purchase 717,639 and 460,224 shares of common stock were outstanding during the quarters ended December 31, 2006 and 2005, respectively, but were excluded from the calculation of dilutive earnings per share because the options' exercise prices were greater than the average market price of the common shares and, therefore, the effect would have been antidilutive.

11. Stock Repurchase Program

The Company's Board of Directors has authorized the Company to purchase up to 19.4 million shares of the Company's outstanding common stock. As of December 31, 2006, the Company has acquired and retired approximately 11.0 million shares of its outstanding common stock at an aggregate cost of approximately \$71.0 million, leaving approximately 8.4 million shares available for purchase under the current Board authorizations. Purchases are made at management's discretion based on market conditions and the Company's financial resources.

The Company repurchased the following shares for \$4.3 million during the three months ended December 31, 2006:

**Maximum
Number of**

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Shares That May yet be Purchased Under the Plan
October 2006	24,773	\$ 7.68	10,455,313	8,966,948
December 2006	505,452	\$ 8.05	10,960,765	8,461,496

12. Beechcraft 1900D Cost Reductions

In February 2002, the Company entered into an agreement with Raytheon Aircraft Company (the Raytheon Agreement) to, among other things, reduce the operating costs of the Company s Beechcraft 1900D fleet. In connection with the Raytheon Agreement and subject to the terms and conditions contained therein, Raytheon agreed to provide up to \$5.5 million in annual operating subsidy payments to the Company contingent upon the

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MESA AIR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Company remaining current on its payment obligations to Raytheon. The amount was subsequently reduced to \$5.3 million as a result of a reduction in the Company's fleet of B1900D aircraft. Approximately \$1.3 million was recorded as a reduction to expense during the three months ended December 31, 2006 and 2005. In return, the Company granted Raytheon a warrant to purchase up to 233,068 shares of the Company's common stock at a per share exercise price of \$10. The Company recorded the issuance of the warrant at a value of \$0.4 million within stockholders' equity as a debit and credit to common stock. The contra equity value of the warrant was being amortized to expense over the vesting period of three years. Raytheon must pay a purchase price of \$1.50 per common share underlying the warrant. The warrant was exercisable at any time over a three-year period following its date of purchase. Raytheon is completely vested in the 233,068 shares of common stock underlying the warrant.

13. Interest Expense

Included in interest expense on the statements of income was interest expense related to aircraft financing of \$9.3 million and \$7.1 million for the three months ended December 31, 2006 and 2005, respectively.

14. Bankruptcy Settlement

In the first quarter of fiscal 2007, the Company received approximately 13,000 shares of US Airways common stock from its bankruptcy claim against US Airways, Inc. prior to its merger with America West (Pre-Merger US Airways). The Company sold the stock and realized proceeds of \$0.6 million.

15. Equity Method Investment

In fiscal 2006, the Company participated with a private equity fund in making an investment in the common stock and notes of a closely held airline related business (the Investee). The Company, through its subsidiary Nilchii, invested \$15 million, which represents approximately 20% and 11.8% of the Investee's common stock and notes, respectively.

The Company accounts for its investment using the equity method of accounting. Under the equity method, the Company adjusts the carrying amount of its investment for its share of the earnings or losses of the Investee subsequent to the date of investment and reports the recognized earnings or losses in income. The Company's share of the Investee's losses subsequent to the date of investment have exceeded the carrying value of the common stock investment, which has been reduced to zero. In accordance with EITF Issue No. 99-10, Percentage Used to Determine the Amount of Equity Method Losses, the Company recognized equity method losses based on the ownership level of the Investee common stock held by the Company until the carrying value of its investment in the common stock was reduced to zero, then by the ownership level of the Investee notes held by the Company. During the first quarter of fiscal 2007, the Company recorded equity method losses from this investment of \$0.1 million.

The Investee notes held by the Company bear interest at 17%. At December 31, 2006, the Company has a receivable for and has recorded interest income related to these notes in the amount of \$1.2 million.

16. Stock-Based Compensation

Stock based compensation expense is calculated by estimating the fair value of stock options at the time of grant and amortized over the stock options' vesting period.

Table of Contents**MESA AIR GROUP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following amounts were recognized for stock-based compensation (in thousands):

	Three Months Ended	
	December 31, 2006	December 31, 2005
	(In thousands)	(In thousands)
General and administrative expenses:		
Stock options expense	\$ 354	\$ 803
Restricted stock expense	349	294
Total	\$ 703	\$ 1,097

17. Commitments and Contingencies

As of December 31, 2006, the Company had firm orders with Bombardier Aerospace, Inc. for two CRJ-700 aircraft and two CRJ-900 which can be converted to CRJ-700s. In conjunction with this purchase agreement, Mesa had \$16.0 million on deposit with Bombardier Regional Aircraft Division that was included in lease and equipment deposits at September 30, 2006. The remaining deposits are expected to be returned upon completion of permanent financing on each of the last five aircraft.

The Company accrues for potential income tax contingencies when it is probable that a liability has been incurred and the amount of the contingency can be reasonably estimated. The Company's accrual for income tax contingencies is adjusted for changes in circumstances and additional uncertainties, such as amendments to existing tax law, both legislated and concluded through the various jurisdictions' tax court systems. At December 31, 2006, the Company had an accrual for income tax contingencies of approximately \$2.9 million. If the amounts ultimately settled are greater than the accrued contingencies, the Company would record additional income tax expense in the period in which the assessment is determined. To the extent amounts are ultimately settled for less than the accrued contingencies, or the Company determines that a liability is no longer probable, the liability is reversed as a reduction of income tax expense in the period the determination is made.

The Company also has long-term contracts for the performance of engine maintenance and rotatable spare parts. A description of each of these contracts is as follows:

In January 1997, the Company entered into a 10-year engine maintenance contract with General Electric Aircraft Engines (GE) for its CRJ-200 aircraft. The agreement was subsequently amended in the first quarter of fiscal 2003. The amended contract requires a monthly payment based upon the prior month's flight hours incurred by the covered engines. The hourly rate increases over time based upon the engine overhaul costs that are expected to be incurred in that year and is subject to escalation based on changes in certain price indices. Maintenance expense is recognized based upon the product of flight hours flown and the rate in effect for the period. The contract also provides for a fixed

number of engine overhauls per year. To the extent that the number of actual overhauls is less than the fixed number, GE is required to issue to Mesa a credit for the number of events less than the fixed number multiplied by an agreed upon price. To the extent that the number of actual overhauls is greater than the fixed number, Mesa is required to pay GE for the number of events greater than the fixed number multiplied by the same agreed upon price. Any adjustment payments or credits are recognized in the period they occur.

In April 1997, the Company entered into a 10-year engine maintenance contract with Pratt & Whitney Canada Corp. (PWC) for its Dash-8 aircraft. The contract requires Mesa to pay PWC for the engine overhaul upon completion of the maintenance based upon a fixed dollar amount per flight hour. The rate under the contract is subject to escalation based on changes in certain price indices.

In April 2000, the Company entered into a 10-year engine maintenance contract with Rolls-Royce Allison (Rolls-Royce) for its ERJ aircraft. The contract requires Mesa to pay Rolls-Royce for the engine overhaul upon completion of the maintenance based upon a fixed dollar amount per flight hour. The rate per flight hour is based

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MESA AIR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

upon certain operational assumptions and may vary if the engines are operated differently than these assumptions. The rate is also subject to escalation based on changes in certain price indices. The agreement with Rolls-Royce also contains a termination clause and look back provision to provide for any shortfall between the cost of maintenance incurred by the provider and the amount paid up to the termination date by the Company and includes a 15% penalty on such amount. The Company does not anticipate an early termination under the contract.

In May 2002, the Company entered into a six-year fleet management program with PWC to provide maintenance for the Company's Beechcraft 1900D turboprop engines. The contract requires a monthly payment based upon flight hours incurred by the covered aircraft. The hourly rate is subject to annual adjustment based on changes in certain price indices and is guaranteed to increase by no less than 1.5% per year. Pursuant to the agreement, the Company sold certain assets of its Desert Turbine Services unit, as well as all spare PT6 engines to PWC for \$6.8 million, which approximated the net book value of the assets. Pursuant to the agreement, the Company provided a working capital loan to PWC for the same amount, which is to be repaid through a reduced hourly rate being charged for maintenance. The agreement covers all of the Company's Beechcraft 1900D turboprop aircraft and engines. The agreement also contains a termination clause and look back provision to provide for any shortfall between the cost of maintenance incurred by the provider and the amount paid up to the termination date by the Company and provides for return of a pro-rated share of the prepaid amount upon early termination. The Company does not anticipate an early termination under the contract.

In August 2005, the Company entered into a ten-year agreement with AAR Corp. (the "AAR Agreement") for the management and repair of certain of the Company's CRJ-200, -700, -900 and ERJ-145 aircraft rotatable spare parts inventory. Under the agreement, the Company sold certain existing spare parts inventory to AAR for \$39.6 million in cash and \$21.5 million in notes receivable (discounted to \$18.8 million) to be paid over four years. The AAR agreement was contingent upon the Company terminating an agreement for the Company's CRJ-200 aircraft rotatable spare parts inventory with GE Commercial Aviation Services ("GECAS") and including these rotatables in the arrangement. The Company terminated the GECAS agreement and finalized the AAR agreement in November 2005. Upon entering into the agreement, the Company received \$22.8 million (\$23.8 million less \$1 million deposit that was retained by AAR), which was recorded as a deposit at September 30, 2005, pending the termination of the GECAS agreement. An additional \$15.8 million was received in the quarter ended December 31, 2005. Under the agreement, the Company is required to pay AAR a monthly fee based upon flight hours for access to and maintenance and servicing of the inventory. The agreement also contains certain minimum monthly payments that Mesa must make to AAR. Based on this arrangement, the Company accounts for the transaction as a service agreement and an operating lease of rotatable spare parts with AAR. The sale of the rotatable spare parts resulted in a gain of \$2.1 million, which has been deferred and is being recognized over the term of the agreement. At termination, the Company may elect to purchase the covered inventory at fair value, but is not contractually obligated to do so.

In June 2006, the Company entered into a separate two-year agreement with AAR for the management and repair of the Company's CRJ-200 aircraft rotatable spare parts inventory associated with its *go!* operations. Under this agreement, the Company transferred certain existing spare parts inventory to AAR for \$1.2 million in cash. AAR was required to purchase an additional \$2.9 million in rotatable spare parts to support the agreement. Under the agreement, the Company is required to pay AAR a monthly fee based upon flight hours for access to and maintenance of the inventory. At termination, the Company has guaranteed the fair value of the underlying rotatables. Based on this arrangement, the Company accounts for the transaction as a financing arrangement, thus recording both the rotatable spare parts inventory as an asset and the related payable to AAR as a liability.

In February 2006, Hawaiian Airlines, Inc. (Hawaiian) filed a complaint against the Company in the United States Bankruptcy Court for the District of Hawaii (the Bankruptcy Court) alleging that the Company breached the terms of a Confidentiality Agreement entered into in April 2004 with the Trustee in Hawaiian s bankruptcy proceedings. Hawaiian s complaint alleges, among other things, that the Company breached the Confidentiality Agreement by (a) using the evaluation material to obtain a competitive advantage over Hawaiian,

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MESA AIR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

through the development and implementation of a business plan to compete with Hawaiian in the inter-island market, and (b) failing to return or destroy any evaluation materials after being notified by Hawaiian on or about May 12, 2004 that the Company had not been selected as a potential investor for a transaction with Hawaiian. Hawaiian, in its complaint, seeks unspecified damages, requests that the Company turn over to Hawaiian any evaluation material in the Company's possession, custody or control (the Turnover Claim), and an injunction preventing the Company from providing inter-island transportation services in the State of Hawaii for a period of two years from the date of such injunctive relief.

The Company vigorously denies Hawaiian's allegations and requests for relief contained in its complaint. The Company filed both an answer and an antitrust counterclaim against Hawaiian in response to its complaint. In May 2006, the Company filed a motion to dismiss the Turnover Claim contained in Hawaiian's complaint, but the Bankruptcy Court denied that motion. On December 8, 2006 the Bankruptcy Court, based on constitutional access to the courts, also granted Hawaiian's motion for summary judgment against the Company on its antitrust counterclaim. The Company does not believe that either of these decisions has a material impact on the Company's position in the lawsuit. Finally, in October 2006, the Bankruptcy Court denied Hawaiian's effort to enjoin the Company's *go!* operation from selling tickets claiming that *go!*'s entry into the inter-island air transport business was based on trade secrets furnished to Mesa during the Hawaiian bankruptcy. The Court found no such misuse of confidential information and rejected Hawaiian's motion for a preliminary injunction.

In June 2006, Hawaiian requested a preliminary injunction to prevent the Company from issuing new airline tickets for the Hawaiian inter-island market for a period of one year. In this request, Hawaiian alleges that initial discovery conducted reveals that the Company breached the Confidentiality Agreement. The Court has recently denied Hawaiian's request for a preliminary injunction. The case will be tried sometime in 2007.

On October 13, 2006, Aloha Airlines filed suit against Mesa Air Group and two of its Hawaii based employees, Charles Lauritsen, *go!*'s Chief Operating Officer and Joe Bock, *go!*'s Chief Marketing Officer. The complaint was filed in State Court in Hawaii and contains 11 counts and seeks damages and injunctive relief. The Company believes the purpose of the complaint is to blunt Mesa's entry into the Hawaii inter-island market segment. Aloha alleges that Mesa's inter-island air fares are below cost and that Mesa is, therefore, violating specific provisions of Hawaii antitrust and unfair competition law. Aloha also alleges breach of contract and fraud by Mesa in connection with two confidentiality agreements, one in 2005 and the other in 2006.

In 1992, The Supreme Court of the United States decided *Morales v. TWA*, in which it construed the Airline Deregulation Act as prohibiting any state court, under any state law legal theory, from adjudicating issues which implicated an air carrier's pricing (or other service) practices. Accordingly, an airline's pricing decisions can be attacked only under federal laws. In response to the complaint, Mesa filed a motion on December 8, 2006 seeking dismissal of all claims based upon Hawaii Statutory Law that rest on Mesa's alleged below-cost pricing. Following the filing of Mesa's Motion to Dismiss, Aloha, on January 10, 2007, voluntarily chose to dismiss the action filed in State Court, and simultaneously filed a new complaint in the United States District Court for the District of Hawaii (filed on January 9, 2007). Aloha's federal complaint abandoned claims regarding below-cost pricing under Hawaii's Statutory Law and instead asserted claims under federal contract and antitrust law.

Mesa denies any improper use of the data furnished by Aloha while Mesa was considering a bid for Aloha during its bankruptcy. The case is in its incipient stages and no trial date has yet been set.

The Company is also involved in various legal proceedings and FAA civil action proceedings that the Company does not believe will have a material adverse effect upon its business, financial condition or results of operations, although no assurance can be given to the ultimate outcome of any such proceedings.

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

The following discussion and analysis provides information which management believes is relevant to an assessment and understanding of the Company's results of operations and financial condition. The discussion should be read in conjunction with the Consolidated Financial Statements and the related notes thereto, and the Selected Financial Data and Operating Data contained elsewhere herein.

Forward-Looking Statements

This Quarterly Report on Form 10-Q 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 Delta Air Lines, US Airways or United Airlines to pay their obligations under the code-share agreements; the inability of Delta Air Lines to successfully restructure and emerge from bankruptcy; the ability of Delta Air Lines to reject our regional jet code-share agreement in bankruptcy; 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; our ability to operate our new Hawaiian airline service profitably; unfavorable resolution of legal proceedings involving Hawaiian Airlines and Aloha Airlines regarding our Hawaiian operation; 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-Q.

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

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GENERAL

The following discussion and analysis provides information which management believes is relevant to an assessment and understanding of the Company's results of operations and financial condition. The discussion should be read in conjunction with the Condensed Consolidated Financial Statements and the related notes thereto, contained elsewhere in this Form 10-Q.

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Executive Overview

The first quarter of fiscal year 2007 marked a number of milestones for us. We completed the transition of the last of the jets into Delta operations as well as placing the remaining Dash-8 aircraft into Delta's operational hub at New York's JFK airport.

We also signed a Joint Venture agreement with Shenzhen Airlines to create a new Chinese regional airline. The new airline is expected to commence scheduled services within 12 months, initially operating 50-seat regional jets on domestic routes within the People's Republic of China. Cities for the new services we intend to focus on will include Shenzhen, Beijing, Chongqing, Xiamen, Nanjing, Kunming, Dalian, Shenyang, Xian, Zhengzhou and Nanning.

Mesa's independent operation in Hawaii, *go!*, continues to perform in accordance with our expectations.

We also added five essential Air Service markets and one guaranteed minimum revenue market.

Code-Share Agreements

Delta has not yet assumed our jet code-share agreement in its bankruptcy proceedings and could choose to terminate our agreement at any time prior to its emergence from bankruptcy. The Delta Dash-8 agreement was entered into post-petition and does not need to be assumed in the bankruptcy proceedings.

Fleet

During the first quarter of fiscal 2007, we added three CRJ-700s to our United fleet and added six Dash-8 aircraft into our Delta fleet.

Aircraft in Operation at December 31, 2006

Type of Aircraft

CRJ-200/100 Regional Jet	60
CRJ-700 Regional Jet	18