

SKYWEST INC
Form 10-Q
November 03, 2014
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from _____ to _____

Commission file number 0-14719

SKYWEST, INC.

Incorporated under the laws of Utah

87-0292166
(I.R.S. Employer ID No.)

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444 South River Road

St. George, Utah 84790

(435) 634-3000

Indicate by a check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

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

Class	Outstanding at October 29, 2014
Common stock, no par value	51,179,324

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SKYWEST, INC.

QUARTERLY REPORT ON FORM 10-Q

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(Dollars in Thousands)

ASSETS

	September 30, 2014 (unaudited)	December 31, 2013
CURRENT ASSETS:		
Cash and cash equivalents	\$ 151,393	\$ 170,636
Marketable securities	392,690	487,239
Restricted cash	11,582	12,219
Income tax receivable		840
Receivables, net	92,662	111,186
Inventories, net	150,133	138,094
Prepaid aircraft rents	381,046	360,781
Deferred tax assets	132,789	156,050
Other current assets	24,798	27,392
Total current assets	1,337,093	1,464,437
PROPERTY AND EQUIPMENT:		
Aircraft and rotatable spares	4,504,659	4,080,886
Deposits on aircraft	40,000	40,000
Buildings and ground equipment	283,350	279,965
	4,828,009	4,400,851
Less-accumulated depreciation and amortization	(1,869,304)	(1,749,058)
Total property and equipment, net	2,958,705	2,651,793
OTHER ASSETS		
Intangible assets, net	13,311	14,998
Other assets	88,523	101,991
Total other assets	101,834	116,989
Total assets	\$ 4,397,632	\$ 4,233,219

See accompanying notes to condensed consolidated financial statements.

Table of Contents**SKYWEST, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(Dollars in Thousands)

LIABILITIES AND STOCKHOLDERS' EQUITY

	September 30, 2014 (unaudited)	December 31, 2013
CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 202,067	\$ 177,389
Accounts payable	252,180	245,518
Accrued salaries, wages and benefits	133,744	133,002
Accrued aircraft rents	2,688	7,492
Taxes other than income taxes	23,477	19,626
Other current liabilities	45,755	37,437
Total current liabilities	659,911	620,464
OTHER LONG-TERM LIABILITIES	47,730	76,305
LONG-TERM DEBT, net of current maturities	1,467,506	1,293,179
DEFERRED INCOME TAXES PAYABLE	718,719	727,358
DEFERRED AIRCRAFT CREDITS	74,696	80,974
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, 5,000,000 shares authorized; none issued		
Common stock, no par value, 120,000,000 shares authorized; 78,089,208 and 77,322,304 shares issued, respectively	624,810	618,511
Retained earnings	1,195,351	1,197,819
Treasury stock, at cost, 26,765,386 and 26,095,636 shares, respectively	(391,364)	(382,950)
Accumulated other comprehensive income	273	1,559
Total stockholders' equity	1,429,070	1,434,939
Total liabilities and stockholders' equity	\$ 4,397,632	\$ 4,233,219

See accompanying notes to condensed consolidated financial statements.

Table of Contents**SKYWEST, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Dollars and Shares in Thousands, Except per Share Amounts)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
OPERATING REVENUES:				
Passenger	\$ 815,867	\$ 836,890	\$ 2,372,054	\$ 2,448,883
Ground handling and other	18,766	13,850	51,538	44,474
Total operating revenues	834,633	850,740	2,423,592	2,493,357
OPERATING EXPENSES:				
Salaries, wages and benefits	315,766	306,887	944,253	904,625
Aircraft maintenance, materials and repairs	159,920	176,822	509,905	515,506
Aircraft rentals	72,899	80,928	232,682	245,330
Depreciation and amortization	65,822	61,135	192,389	183,309
Aircraft fuel	49,177	49,656	154,420	146,139
Ground handling services	31,114	30,541	100,446	98,235
Station rentals and landing fees	12,290	29,473	36,729	100,559
Special charges (see Note J)			4,713	
Other operating expenses	68,565	59,124	203,507	177,363
Total operating expenses	775,553	794,566	2,379,044	2,371,066
OPERATING INCOME	59,080	56,174	44,548	122,291
OTHER INCOME (EXPENSE):				
Interest income	2,549	567	3,608	3,164
Interest expense	(16,883)	(16,999)	(48,697)	(52,490)
Other, net	23,598	4,625	20,709	10,477
Total other income (expense), net	9,264	(11,807)	(24,380)	(38,849)
INCOME BEFORE INCOME TAXES	68,344	44,367	20,168	83,442
PROVISION FOR INCOME TAXES	27,006	17,973	16,455	33,094
NET INCOME	\$ 41,338	\$ 26,394	\$ 3,713	\$ 50,348
BASIC EARNINGS PER SHARE				
DILUTED EARNINGS PER SHARE	\$ 0.81	\$ 0.51	\$ 0.07	\$ 0.97
DILUTED EARNINGS PER SHARE	\$ 0.79	\$ 0.50	\$ 0.07	\$ 0.96
Weighted average common shares:				
Basic	51,322	51,881	51,324	51,841
Diluted	52,036	52,610	51,562	52,551
Dividends declared per share	\$ 0.04	\$ 0.04	\$ 0.12	\$ 0.12
COMPREHENSIVE INCOME:				
Net income	\$ 41,338	\$ 26,394	\$ 3,713	\$ 50,348
Proportionate share of other companies foreign currency translation adjustment, net of taxes	(1,130)	67	(1,130)	67
Net unrealized appreciation (depreciation) on marketable securities, net of taxes	(222)	363	(157)	(137)
TOTAL COMPREHENSIVE INCOME	\$ 39,986	\$ 26,824	\$ 2,426	\$ 50,278

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See accompanying notes to condensed consolidated financial statements

Table of Contents**SKYWEST, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)**

(In Thousands)

	Nine Months Ended September 30	
	2014	2013
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 186,369	\$ 251,406
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of marketable securities	(198,690)	(328,442)
Sales of marketable securities	293,056	443,950
Proceeds from the sale of equipment	3,468	270
Proceeds received from sale of Trip Linhas Aereas stock	17,237	16,658
Acquisition of property and equipment:		
Aircraft and rotatable spare parts	(479,451)	(70,246)
Deposits on aircraft		(35,629)
Buildings and ground equipment	(16,017)	(8,847)
Increase in other assets	(12,218)	(3,710)
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(392,615)	14,004
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of long-term debt	323,665	
Principal payments on long-term debt	(124,660)	(117,850)
Tax benefit (deficiency) from exercise of common stock options	(1,245)	(150)
Net proceeds from issuance of common stock	3,831	4,510
Purchase of treasury stock	(8,414)	(11,739)
Payment of cash dividends	(6,174)	(6,207)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	187,003	(131,436)
Increase (decrease) in cash and cash equivalents	(19,243)	133,974
Cash and cash equivalents at beginning of period	170,636	133,772
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 151,393	\$ 267,746
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest, net of capitalized amounts	\$ 46,757	\$ 50,479
Income taxes	\$ 485	\$ 2,509

See accompanying notes to condensed consolidated financial statements.

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SKYWEST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note A Condensed Consolidated Financial Statements

Basis of Presentation

The condensed consolidated financial statements of SkyWest, Inc. (SkyWest or the Company) and its operating subsidiaries, SkyWest Airlines, Inc. (SkyWest Airlines) and ExpressJet Airlines Inc. (ExpressJet) included herein have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the following disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements reflect all adjustments that, in the opinion of management, are necessary to present fairly the results of operations for the interim periods presented. All adjustments are of a normal recurring nature, unless otherwise disclosed. The Company suggests that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. The results of operations for the three and nine-months ended September 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results will likely differ, and may differ materially, from those estimates and assumptions.

Effective December 31, 2011, the Company's subsidiary, ExpressJet Airlines, Inc., a Delaware corporation, was merged into the Company's subsidiary, Atlantic Southeast Airlines, Inc., a Utah corporation, with the surviving corporation named ExpressJet Airlines, Inc. (the ExpressJet Combination). In these condensed consolidated financial statements, Atlantic Southeast refers to Atlantic Southeast Airlines, Inc. for periods prior to the ExpressJet Combination, ExpressJet Delaware refers to ExpressJet Airlines, Inc., a Delaware corporation, for periods prior to the ExpressJet Combination, and ExpressJet refers to ExpressJet Airlines, Inc., the Utah corporation resulting from the combination of Atlantic Southeast and ExpressJet Delaware, for periods subsequent to the consummation of the ExpressJet Combination.

Recent Accounting Pronouncements

In June 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (ASU 2014-12). The FASB issued ASU 2014-12 to provide explicit guidance for share-based awards which allow for an employee to vest in an award

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upon achievement of a performance condition met after completion of a requisite service period regardless of whether the employee is rendering service on the date the performance target is achieved. ASU 2014-12 provides that the performance target should not be reflected in estimating the grant-date fair value of the award but rather compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and recognized prospectively over the remaining requisite service period. This guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2015. The Company does not believe ASU 2014-12 will have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. Under the new standard, revenue is recognized at the time a good or service is transferred to a customer for the amount of consideration received for that specific good or service. The standard is effective for annual reporting periods beginning after December 15, 2016, including interim reporting periods, and early adoption is not permitted. Entities may use a full retrospective approach or report the cumulative effect as of the date of adoption. Our management is currently evaluating the anticipated impact, if any, the adoption of this standard will have on our Consolidated Financial Statements.

In April 2014, the FASB issued Accounting Standards Update (ASU) 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. The standard changes the requirements for reporting discontinued operations in Subtopic 205-20. The standard is effective in the first quarter of 2015, and the impact to the consolidated financial statements is not expected to be material.

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The Company recognizes passenger and ground handling revenues when the service is provided. Under the Company's contract and pro-rate flying agreements with Delta Airlines, Inc. (Delta), United Air Lines, Inc. (United), US Airways Group, Inc. (US Airways), American Airlines, Inc. (American) and Alaska Airlines (Alaska), revenue is considered earned when the flight is completed. Revenue is recognized under the Company's pro-rate flying agreements based upon the portion of the pro-rate passenger fare the Company anticipates that it will receive. Other ancillary revenues commonly associated with airlines such as baggage fee revenue, ticket change fee revenue and the marketing component of the sale of mileage credits are retained by the Company's major airline partners on flights that the Company operates under its code-share agreements.

In the event that the contractual rates under the Company's flying agreements have not been finalized at quarterly or annual financial statement dates, the Company records revenues based on the lower of prior period's approved rates, as adjusted to reflect any contract negotiations and the Company's estimate of rates that will be implemented in accordance with revenue recognition guidelines.

In the event the Company has a reimbursement dispute with a major partner, the Company evaluates the dispute under its established revenue recognition criteria and, provided the revenue recognition criteria have been met, the Company recognizes revenue based on management's estimate of the resolution of the dispute.

In several of the Company's contractual agreements with its major partners, the Company is eligible for incentive compensation upon the achievement of certain performance criteria. The incentives are defined in those agreements and are measured and determined on a monthly, quarterly or semi-annual basis. At the end of each period covered by those agreements, the Company calculates the incentives achieved during that period and recognizes revenue accordingly.

The following table summarizes the significant provisions of each flying agreement the Company has executed with its major partners:

Delta Connection Agreements

Agreement	Number of aircraft under contract	Term / Termination Dates	Pass through costs or costs paid directly by major partner	Performance Incentive Structure	Payment Structure
SkyWest Airlines Delta Connection Agreement	• CRJ 200 - 36	• The contract expires on an individual aircraft basis beginning in 2014	• Fuel	• No financial performance based incentives	• Rate per block hour, per departure and per aircraft under contract
	• CRJ 700 - 19				
	• CRJ 900 - 32		• Engine Maintenance		

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				<ul style="list-style-type: none"> The final aircraft expires in 2022 The weighted average remaining term of the aircraft under contract is 5.3 years Upon expiration, aircraft may be renewed or extended 	<ul style="list-style-type: none"> Landing fees, Station Rents, De-ice Insurance 		
ExpressJet Delta Connection Agreement	<ul style="list-style-type: none"> CRJ 200 57 CRJ 700 - 41 CRJ 900 28 		<ul style="list-style-type: none"> The contract expires on an individual aircraft basis beginning in 2014 	<ul style="list-style-type: none"> Fuel Engine Maintenance 	<ul style="list-style-type: none"> Performance based financial incentives 	<ul style="list-style-type: none"> Rate per block hour, per departure and per aircraft under contract 	

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		<ul style="list-style-type: none"> • Landing fees, Station Rents, De-ice 				
		<ul style="list-style-type: none"> • The final aircraft expires in 2022 				
		<ul style="list-style-type: none"> • Insurance 				
		<ul style="list-style-type: none"> • The weighted average remaining term of the aircraft under contract is 4.1 years 				
		<ul style="list-style-type: none"> • Upon expiration, aircraft may be renewed or extended 				
SkyWest Airlines Prorate Agreement	• EMB 120	7	• Terminable upon 120 days notice	• None	• None	• Pro-rata sharing of the passenger fare revenue
	• CRJ 200	10				

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SkyWest Airlines and ExpressJet are each parties to a Delta Connection Agreement with Delta, pursuant to which SkyWest Airlines and ExpressJet provide contract flight services for Delta. The SkyWest Airlines and ExpressJet Delta Connection Agreements contain multi-year rate reset provisions that became operative in 2010 and resets each fifth year thereafter. The Delta Connection Agreements also provide that, beginning with the fifth anniversary of the execution of the agreements (September 8, 2010), Delta has the right to require that certain contractual rates under those agreements shall not exceed the second lowest of all carriers within the Delta Connection program. SkyWest Airlines and ExpressJet have agreed with Delta on contractual rates that are effective through December 31, 2015.

United Express Agreements

Agreement	Number of aircraft under contract	Term / Termination Dates	Pass through costs or costs paid directly by major partner	Performance Incentive Structure	Payment Structure
SkyWest Airlines United Express Agreement	• CRJ 200 - 61	<ul style="list-style-type: none"> The contract expires on an individual aircraft basis beginning in 2015 The final aircraft expires in 2026 The weighted average remaining term of the aircraft under contract is 3.2 years Upon expiration, aircraft may be renewed or extended 	• Fuel	• Performance based incentives	• Rate per block hour, per departure and per aircraft under contract
	• CRJ 700 - 70		• Landing fees, Station Rents, De-ice		
	• EMB 120 9				
	• E175 14		• Insurance		
Atlantic Southeast United Express Agreement	• CRJ 200 - 14	<ul style="list-style-type: none"> Terminates 2015 Upon expiration, aircraft may be renewed or extended 	<ul style="list-style-type: none"> Fuel Landing fees, Station Rents, De-ice 	• Performance based incentives	• Rate per block hour, per departure and per aircraft under contract

- Insurance

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Agreement	Number of aircraft under contract	Term / Termination Dates	Pass through costs or costs paid directly by major partner	Performance Incentive Structure	Payment Structure
ExpressJet Delaware United Express Agreement	<ul style="list-style-type: none"> ERJ 135 - 9 ERJ 145 - 234 	<ul style="list-style-type: none"> The contract expires on an individual aircraft basis beginning in 2014 The final aircraft expires in 2020 The weighted average remaining term of the aircraft under contract is 3.2 years Upon expiration, aircraft may be renewed or extended 	<ul style="list-style-type: none"> Fuel Engine Maintenance Landing fees, Station Rents, De-ice Insurance 	<ul style="list-style-type: none"> Performance based incentives or penalties 	<ul style="list-style-type: none"> Rate per block hour, per departure and per aircraft under contract
SkyWest Airlines United Express Prorate Agreement	<ul style="list-style-type: none"> CRJ200 - 21 EMB 120 - 20 	<ul style="list-style-type: none"> Terminable upon 120 days notice 	<ul style="list-style-type: none"> None 	<ul style="list-style-type: none"> None 	<ul style="list-style-type: none"> Pro-rata sharing of the passenger fare revenue

Alaska Capacity Purchase Agreement

Agreement	Number of aircraft under contract	Term / Termination Dates	Pass through costs or costs paid directly by major partner	Performance Incentive Structure	Payment Structure
SkyWest Airlines Capacity Purchase Agreement	<ul style="list-style-type: none"> CRJ 700 - 9 	<ul style="list-style-type: none"> Terminates 2018 Upon expiration, aircraft may be renewed or 	<ul style="list-style-type: none"> Fuel Landing fees, Station Rents, De-ice 	<ul style="list-style-type: none"> Performance based incentives 	<ul style="list-style-type: none"> Rate per block hour, per departure and per aircraft under contract

extended • Insurance

US Airways Express Agreement

Agreement		Number of aircraft under contract	Term / Termination Dates	Pass through costs or costs paid directly by major partner	Incentive Structure	Payment Structure
SkyWest Airlines US Airways Express Agreement	•	CRJ 200 - 10	• Terminates 2015	• Fuel	• Performance based incentives	• Rate per block hour, per departure and per aircraft under contract
	•	CRJ 900 - 4	• Upon expiration, aircraft may be renewed or extended	• Landing fees, Station Rents, De-ice • Insurance		
SkyWest Airlines US Airways Express Prorate Agreement	•	CRJ 200 - 1	• Terminable upon 120 days notice	• None	• None	• Pro-rata sharing of the passenger fare revenue

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American Agreement

Agreement		Number of aircraft under contract	Term / Termination Dates	Pass through costs or costs paid directly by major partner	Incentive Structure	Payment Structure
SkyWest Airlines American Capacity Purchase Agreement	•	CRJ 200 - 12	<ul style="list-style-type: none"> Terminates 2016 Upon expiration, aircraft may be renewed or extended 	<ul style="list-style-type: none"> Fuel Landing fees, Station Rents, De-ice Insurance 	<ul style="list-style-type: none"> Performance based incentives 	<ul style="list-style-type: none"> Rate per block hour, per departure and per aircraft under contract
SkyWest Airlines American Prorate Agreement	•	CRJ 200 - 4	<ul style="list-style-type: none"> Terminable upon 120 days notice 	<ul style="list-style-type: none"> None 	<ul style="list-style-type: none"> None 	<ul style="list-style-type: none"> Pro-rata sharing of the passenger fare revenue
ExpressJet American Capacity Purchase Agreement	•	CRJ 200 - 11	<ul style="list-style-type: none"> Terminates 2017 Upon expiration, aircraft may be renewed or extended 	<ul style="list-style-type: none"> Fuel Landing fees, Station Rents, De-ice Insurance 	<ul style="list-style-type: none"> Performance based incentives 	<ul style="list-style-type: none"> Rate per block hour, per departure and per aircraft under contract

Other Revenue Items

The Company's passenger and ground handling revenues could be impacted by a number of factors, including changes to the Company's flying agreements with its major partners, contract modifications resulting from contract re-negotiations, the Company's ability to earn incentive payments contemplated under the Company's flying agreements and settlement of reimbursement disputes with the Company's major partners.

Note C Share-Based Compensation

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The fair value of stock options granted by the Company has been estimated as of the grant date using the Black-Scholes option pricing model. During the nine months ended September 30, 2014, the Company granted options to purchase 250,175 shares of common stock under the SkyWest, Inc. 2010 Long-Term Incentive Plan (the "2010 Incentive Plan"). The following table shows the assumptions used and weighted average fair value for stock option grants during the nine months ended September 30, 2014.

Expected annual dividend rate	1.33%
Risk-free interest rate	1.50%
Average expected life (years)	5.8
Expected volatility of common stock	0.427
Forfeiture rate	0.0%
Weighted average fair value of option grants	\$ 4.41

During the nine months ended September 30, 2014, the Company granted 306,704 restricted stock units to the Company's employees under the 2010 Incentive Plan. The restricted stock units have a three-year vesting period, during which the recipient must remain employed with the Company or one of the Company's subsidiaries. Upon vesting, a restricted stock unit will be replaced with a share of common stock. Additionally, during the nine months ended September 30, 2014, the Company granted 44,631 fully-vested shares of common stock to the Company's directors. The weighted average fair value of the shares of restricted stock on the date of grant was \$12.10 per share.

The Company records share-based compensation expense only for those options and restricted stock units that are expected to vest. The estimated fair value of the stock options and restricted stock units is amortized over the applicable vesting periods. During the three months ended September 30, 2014 and 2013, the Company recorded pre-tax share-based compensation expense of \$0.9 million and \$1.1 million, respectively. During the nine months ended September 30, 2014 and 2013, the Company recorded pre-tax share-based compensation expense of \$3.7 million and \$3.6 million, respectively.

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Basic net income per common share (Basic EPS) excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share (Diluted EPS) reflects the potential dilution that could occur if stock options or other contracts to issue common stock were exercised or converted into common stock. The computation of Diluted EPS does not assume exercise or conversion of securities that would have an anti-dilutive effect on net income per common share. During the three and nine months ended September 30, 2014, options to acquire 2,942,000 and 3,055,000 shares, respectively, were excluded from the computation of Diluted EPS as their impact was anti-dilutive. During the three and nine months ended September 30, 2013, options to acquire 3,164,000 and 3,300,000 shares, respectively, were excluded from the computation of Diluted EPS as their impact was anti-dilutive.

The calculation of the weighted average number of common shares outstanding for Basic EPS and Diluted EPS for the periods indicated (in thousands, except per share data) is as follows:

	Three Months Ended September 30, 2014		September 30, 2013		Nine Months Ended September 30, 2014		September 30, 2013	
	(Unaudited)				(Unaudited)			
Numerator								
Net Income	\$	41,338	\$	26,394	\$	3,713	\$	50,348
Denominator								
Weighted average number of common shares outstanding		51,322		51,881		51,324		51,841
Effect of outstanding share-based awards		714		729		238		710
Weighted average number of shares for diluted net income per common share		52,036		52,610		51,562		52,551
Basic earnings per share	\$	0.81	\$	0.51	\$	0.07	\$	0.97
Diluted earnings per share	\$	0.79	\$	0.50	\$	0.07	\$	0.96

Note E Segment Reporting

Generally accepted accounting principles require disclosures related to components of a company for which separate financial information is available to and regularly evaluated by the Company's chief operating decision maker (CODM) when deciding how to allocate resources and in assessing performance.

The Company's two operating segments consist of the operations of its two operating subsidiaries, SkyWest Airlines and ExpressJet. The following represents the Company's segment data for the three months ended September 30, 2014 and 2013 (in thousands).

	Three months ended September 30, 2014			
SkyWest Airlines	ExpressJet	Other		Consolidated

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Operating revenues	\$	493,606	\$	340,553	\$	474	\$	834,633
Operating expense		430,024		345,606		(77)		775,553
Depreciation and amortization expense		43,853		21,969				65,822
Interest expense		11,492		4,692		699		16,883
Segment profit (loss)(1)		52,090		(9,745)		(148)		42,197
Identifiable intangible assets, other than goodwill(2)				13,311				13,311
Total assets (2)		2,825,243		1,572,389				4,397,632
Capital expenditures (including non-cash)		186,678		6,152				192,830

Three months ended September 30, 2013

	SkyWest Airlines		ExpressJet		Other		Consolidated	
Operating revenues	\$	468,517	\$	381,749	\$	474	\$	850,740
Operating expense		409,320		382,583		2,663		794,566
Depreciation and amortization expense		38,845		22,290				61,135
Interest expense		10,812		5,274		913		16,999
Segment profit (loss)(1)		48,385		(6,108)		(3,102)		39,175
Identifiable intangible assets, other than goodwill(3)				15,560				15,560
Total assets(3)		2,711,009		1,554,385				4,265,394
Capital expenditures (including non-cash)		21,977		8,891				30,868

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- (1) Segment profit (loss) is equal to operating income less interest expense
- (2) As of September 30, 2014
- (3) As of September 30, 2013

The following represents the Company's segment data for the nine-month periods ended September 30, 2014 and 2013 (in thousands).

	Nine months ended September 30, 2014			
	SkyWest Airlines	ExpressJet	Other	Consolidated
Operating revenues	\$ 1,416,149	\$ 1,006,021	\$ 1,422	\$ 2,423,592
Operating expense	1,289,218	1,089,923	(97)	2,379,044
Depreciation and amortization expense	125,811	66,578		192,389
Interest expense	32,180	14,309	2,208	48,697
Segment profit (loss)(1)	94,751	(98,211)	(689)	(4,149)
Identifiable intangible assets, excluding goodwill(2)		13,311		13,311
Total assets(2)	2,825,243	1,572,389		4,397,632
Capital expenditures (including non-cash)	487,711	18,653		506,364

	Nine months ended September 30, 2013			
	SkyWest Airlines	ExpressJet	Other	Consolidated
Operating revenues	\$ 1,380,930	\$ 1,109,085	\$ 3,342	\$ 2,493,357
Operating expense	1,236,003	1,128,757	6,306	2,371,066
Depreciation and amortization expense	116,309	67,000		183,309
Interest expense	33,535	16,099	2,856	52,490
Segment profit (loss)(1)	111,392	(35,771)	(5,820)	69,801
Identifiable intangible assets, other than goodwill(3)		15,560		15,560
Total assets(3)	2,711,009	1,554,385		4,265,394
Capital expenditures (including non-cash)	66,339	28,242		94,581

- (1) Segment profit (loss) is equal to operating income less interest expense
- (2) As of September 30, 2014
- (3) As of September 30, 2013

Note F Commitments and Contingencies

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As of September 30, 2014, the Company leased 544 aircraft, as well as airport facilities, office space and various other property and equipment under non-cancelable operating leases which are generally on a long-term net rent basis where the Company pays taxes, maintenance, insurance and certain other operating expenses applicable to the leased property. The Company expects that, in the normal course of business, such operating leases that expire may be renewed or replaced by other leases. The following table summarizes future minimum rental payments required under operating leases that had initial or remaining non-cancelable lease terms in excess of one year as of September 30, 2014 (in thousands):

September through December 2014	\$	96,439
2015		341,184
2016		267,626
2017		197,709
2018		153,301
Thereafter		571,781
	\$	1,628,040

During the nine months ended September 30, 2014, the Company took delivery of fourteen Embraer E175 dual-class jet aircraft (E175s) and initially financed the aircraft through the issuance of \$323.7 million of long-term debt. The debt associated with the E175 aircraft has a fifteen year term with a variable interest rate and is secured by the E175 aircraft.

Table of Contents**Note G Fair Value Measurements**

The Company holds certain assets that are required to be measured at fair value in accordance with GAAP. The Company determined fair value of these assets based on the following three levels of inputs:

<i>Level 1</i>	Quoted prices in active markets for identical assets or liabilities.
<i>Level 2</i>	Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company's marketable securities primarily utilize broker quotes in a non-active market for valuation of these securities and are classified as Level 2 investments.
<i>Level 3</i>	Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities, therefore requiring an entity to develop its own assumptions.

As of September 30, 2014 and December 31, 2013, the Company held certain assets that are required to be measured at fair value on a recurring basis. Assets measured at fair value on a recurring basis are summarized below (in thousands):

Fair Value Measurements as of September 30, 2014					
	Total	Level 1	Level 2	Level 3	
Marketable Securities					
Bonds and bond funds	\$ 392,565	\$	\$ 392,565	\$	
Asset backed securities	125		125		
	392,690		392,690		
Cash, Cash Equivalents and Restricted					
Cash	162,975	162,975			
Other Assets	2,272(a)			2,272	
Total Assets Measured at Fair Value	\$ 557,937	\$ 162,975	\$ 392,690	\$ 2,272	
Fair Value Measurements as of December 31, 2013					
	Total	Level 1	Level 2	Level 3	
Marketable Securities					
Bonds and bond funds	\$ 487,049	\$	\$ 487,049	\$	
Asset backed securities	190		190		
	487,239		487,239		
Cash, Cash Equivalents and Restricted					
Cash	182,855	182,855			
Other Assets	2,245(a)			2,245	
Total Assets Measured at Fair Value	\$ 672,339	\$ 182,855	\$ 487,239	\$ 2,245	

(a) Comprised of auction rate securities which are reflected in Other assets in the Company's unaudited condensed consolidated balance sheets

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Based on market conditions, the Company uses a discounted cash flow valuation methodology for auction rate securities. Accordingly, for purposes of the foregoing condensed consolidated financial statements, these securities were categorized as Level 3 securities. The Company's Marketable Securities classified as Level 2 primarily utilize broker quotes in a non-active market for valuation of these securities.

The Company did not make any significant transfers of securities between Level 1, Level 2 and Level 3 during the nine months ended September 30, 2014. The Company's policy regarding the recording of transfers between levels is to record any such transfers at the end of the reporting period.

The following table presents the Company's assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at September 30, 2014 (in thousands):

Table of Contents**Fair Value Measurements Using Significant Unobservable Inputs****(Level 3)**

	Auction Rate Securities
Balance at January 1, 2014	\$ 2,245
Total realized and unrealized gains or (losses)	
Included in earnings	
Included in other comprehensive income	27
Transferred out	
Settlements	
Balance at September 30, 2014	\$ 2,272

The fair value of the Company's long-term debt classified as Level 2 was estimated using discounted cash flow analyses, based on the Company's current estimated incremental borrowing rates for similar types of borrowing arrangements. The fair value of the Company's long-term debt is estimated based on current rates offered to the Company for similar debt and was estimated to be \$1,706.3 million as of September 30, 2014, as compared to the carrying amount of \$1,669.6 million as of September 30, 2014. The fair value of the Company's long-term debt is estimated based on current rates offered to the Company for similar debt and approximated \$1,509.2 million as of December 31, 2014, as compared to the carrying amount of \$1,470.6 million as of December 31, 2013.

Note H Income Taxes

The income tax provision for the nine months ended September 30, 2014 included a valuation allowance of \$5.5 million for previously generated state net operating loss benefits specific to ExpressJet that are scheduled to expire before the benefits are anticipated to be utilized. The Company did not record a valuation allowance for the three months ended September 30, 2014. The effective tax rate for the nine months ended September 30, 2014 is higher than the expected federal and state statutory rate due to the valuation allowance recorded during the nine months ended September 30, 2014 and a disproportionate increase in expense with limited tax deductibility relative to the Company's pre-tax income for the nine months ended September 30, 2014.

Note I Legal Matters

The Company is subject to certain legal actions which it considers routine to its business activities. As of September 30, 2014, management believed, after consultation with legal counsel, that the ultimate outcome of such legal matters was not likely to have a material adverse effect on the Company's financial position, liquidity or results of operations. During the three months ended September 30, 2014, SkyWest Airlines and ExpressJet executed a confidential settlement agreement with Delta resolving all disputed issues of a complaint filed in the Georgia State Court of Fulton County. The complaint related to the allocation of liability for certain irregular operation expenses paid by SkyWest Airlines and ExpressJet to their passengers and vendors under certain situations (IROPs). The financial impact of the settlement approximated the amount accrued by the Company prior to the settlement agreement. The parties also reached an agreement on the allocation of IROP liabilities for the remaining term of the Delta Connection Agreements, which the Company's management does not believe will have a negative impact to the Company's financial results.

Note J Special charges

In connection with the acquisition of ExpressJet Delaware, the Company acquired an aircraft paint facility in Saltillo, Mexico, and recorded a foreign value added tax (VAT) asset attributable to the paint facility. The realizability of the VAT asset is dependent upon the Company's future utilization of the facility. During the nine months ended September 30, 2014, the Company wrote-off the VAT asset value of \$2.5 million as the Company was no longer using the paint facility. Additionally, during the nine months ended September 30, 2014, the Company wrote down the value of the paint facility by \$2.2 million. The Company did not record any special charges during the three months ended September 30, 2014. On October 1, 2014, the Company sold the paint facility to a third party for an amount that approximated the net book value of the paint facility.

Note K Investment in Trip Linhas Aereas S.A.

On July 12, 2012, the Company sold its 20% interest in Trip Linhas Aereas S.A., a Brazilian regional airline ("TRIP"), for a price of \$42 million. The purchase price was scheduled to be paid in three installments payments with the final payment due in July 2014. As part of the transaction, the Company also received an option to acquire 15.38% of the ownership in Trip Investimentos Ltda. ("Trip Investimentos"), the purchaser of the Company's TRIP shares. The Company recorded the fair value of the option as additional consideration received in the transaction. The option has an initial exercise price per share equal to the price paid by Trip Investimentos to acquire the TRIP shares from the Company. The exercise price escalates annually at a specified rate and the

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Company can exercise the option, at its discretion, between the second and fourth anniversaries of the Company's receipt of the final required installment payment from Trip Investimentos. The option has been written down to a nominal amount based on the Company's assessment of its current fair value. Under the terms of the agreement, Trip Investimentos could not transfer the TRIP shares until the final installment payment has been made, which prevented the Company from recognizing the gain on the transaction until the final payment was received and the Trip Investimentos' restriction to transfer the shares was removed.

During the three months ended September 30, 2014, the Company received the final installment payment attributable to the sale of its TRIP shares, which removed Trip Investimentos' restriction to transfer the TRIP shares. Accordingly, during the three months ended September 30, 2014 the Company recorded a gain of \$24.9 million in other income as a result of the completed transaction. Additionally, under the terms of the purchase agreement, the Company received \$2.1 million of interest payments from Trip Investimentos, which the Company recorded as interest income during the three months ended September 30, 2014.

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis presents factors that had a material effect on the results of operations of SkyWest, Inc. (SkyWest we or us) during the three and nine month periods ended September 30, 2014 and 2013. Also discussed is our financial position as of September 30, 2014 and December 31, 2013. You should read this discussion in conjunction with our condensed consolidated financial statements for the three and nine-month periods ended September 30, 2014, including the notes thereto, appearing elsewhere in this Report. This discussion and analysis contains forward-looking statements. Please refer to the following section of this Report entitled Cautionary Statement Concerning Forward-Looking Statements for discussion of the uncertainties, risks and assumptions associated with these statements.

Cautionary Statement Concerning Forward-Looking Statements

Certain of the statements contained in this Report should be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may be identified by words such as may, will, expect, intend, anticipate, believe, estimate, plan, project, could, should, hope, likely and continue and similar terms used in connection with statements regarding our outlook, the revenue environment, our contract relationships and our expected financial performance. These statements include, but are not limited to, statements about our future growth and development plans, including our future financial and operating results, our plans for SkyWest Airlines and ExpressJet, our objectives, expectations and intentions, and other statements that are not historical facts. You should also keep in mind that all forward-looking statements are based on our existing beliefs about present and future events outside of our control and on assumptions that may prove to be incorrect. If one or more risks identified in this Report materializes, or any other underlying assumption proves incorrect, our actual results will likely vary, and may vary materially, from those anticipated, estimated, projected or intended.

There may be other factors not identified above of which we are not currently aware that may affect matters discussed in the forward-looking statements, and may also cause actual results to differ materially from those discussed. We assume no obligation to publicly update any forward-looking statement to reflect actual results, changes in assumptions or changes in other factors affecting these statements other than as required by law.

Overview

Through SkyWest Airlines and ExpressJet, we operate the largest regional airline in the United States. As of September 30, 2014, SkyWest Airlines and ExpressJet offered scheduled passenger service with approximately 3,700 total daily departures to destinations in the United States, Canada, Mexico and the Caribbean. As of September 30, 2014, we operated a combined fleet of 751 aircraft consisting of the following:

	CRJ200	ERJ145	ERJ135	CRJ700	CRJ900	E175	EMB120	Total
United	96	234	9	70		14	29	452
Delta	110			60	60		7	237
American	27							27
US Airways	11				4			15
Alaska				9				9
Subleased to an un-affiliated entity	2							2
Unassigned (a)	2						7	9
Total	248	234	9	139	64	14	43	751

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(a) As of September 30, 2014, these aircraft were in transition between flying contracts with major partners.

For the nine months ended September 30, 2014, approximately 61.2% of our aggregate capacity was operated for United, approximately 31.9% was operated for Delta, approximately 3.1% was operated for American, approximately 2.1% was operated for Alaska and approximately 1.7% was operated for US Airways.

Under a fixed-fee flying arrangement, the major airline generally pays the regional airline a fixed fee for each departure, with additional incentives based on completion of flights, on-time performance and baggage handling performance. In addition, under the fixed-fee arrangement, the major airline bears the financial risk of changes in the price of fuel and other agreed-upon costs that are directly reimbursed by the major partner or paid directly by the major partner. Regional airlines benefit from a fixed-fee arrangement because they are sheltered from many of the elements that could cause volatility in airline financial performance, including variations in ticket prices, passenger loads and fuel prices. However, regional airlines in fixed-fee arrangements do not benefit from positive trends in ticket prices, ancillary revenue, passenger loads or fuel prices.

Under our fixed-fee arrangements, three compensation components have a significant impact on comparability of revenue and operating expense for the periods presented in this Report. One compensation component is the reimbursement of fuel expense, which is a directly-reimbursed expense under all of our fixed-fee arrangements. If we purchase fuel directly from vendors, our major partners reimburse us for fuel expense incurred under each respective fixed-fee contract, and we record such reimbursement as passenger revenue. Thus, the price volatility of fuel and the volume of fuel expensed under our fixed-fee arrangements during a particular period will impact the comparability of our fuel expense and our passenger revenue during the period equally, with no impact on our operating income.

The second compensation component is the reimbursement of landing fees and station rents, which is a directly-reimbursed expense under all of our fixed-fee arrangements. Our major partners reimburse us for landing fees and station rent expense incurred under each of our existing fixed-fee contracts, and we record such reimbursements as passenger revenue. Over the past few years, some of our major airline partners have paid an increased volume of landing fees and station rents directly to airport authorities on flights we operated under our fixed-fee contracts, which impacts the comparability of revenue and operating expense for the periods presented in this Report.

The third compensation component is the compensation we receive for engine maintenance under our fixed-fee arrangements. Under our United, American, US Airways and Alaska fixed-fee contracts, a portion of our compensation is based upon fixed hourly rates the aircraft is in operation, which is intended to compensate us for engine maintenance costs (Fixed-Rate Engine Contracts). Under the compensation structure for our Delta Connection and ExpressJet United CPA flying contracts, our major partner reimburses us for engine maintenance expense when the expense is incurred (Directly-Reimbursed Engine Contracts). We use the direct-expense method of accounting for our Bombardier CRJ200 Regional Jet (CRJ200) engine overhaul costs and, accordingly, we recognize engine maintenance expense on our CRJ200 engines on an as-incurred basis. Under the direct-expense method, the maintenance liability is recorded when the maintenance services are performed (CRJ200 Engine Overhaul Expense).

Because we use the direct-expense method of accounting for our CRJ200 engine expense, and because we recognize revenue using the applicable fixed hourly rates under our Fixed-Rate Engine Contracts, the number of engine maintenance events and related expense we incur each reporting period under the Fixed-Rate Engine Contracts has a direct impact on the comparability of our operating income for the presented reporting periods.

Because we recognize revenue at the same amount and in the same period when we incur engine maintenance expense on engines operating under our Directly- Reimbursed Engine Contracts, the number of engine events and related expense we incur each reporting period does not have a direct impact on the comparability of our operating income for the presented reporting periods.

We have an agreement with a third-party vendor to provide long-term engine maintenance covering scheduled and unscheduled repairs for engines on our Bombardier CRJ700 Regional Jets (CRJ700s) operating under our Fixed-Rate Engine Contracts (the Power by the Hour Agreement). Under the terms of the Power by the Hour Agreement, we are obligated to pay a set dollar amount per engine hour flown on a monthly basis and the vendor assumes the obligation to repair the engines at no additional cost to us, subject to certain specified exclusions. Thus, under the Power by the Hour Agreement, we expense the engine maintenance costs as flight hours are incurred on the engines and using the contractual rate set forth in the agreement. Because we record engine maintenance expense based on the fixed hourly rate pursuant to the Power by the Hour Agreement on our CRJ700s operating under our Fixed-Rate Engine Contracts, and because we recognize revenue using the applicable fixed hourly rates under our Fixed-Rate Engine Contracts, the number of engine events and related expense we incur each reporting period does not have a direct impact on the comparability of our operating income for the presented reporting periods. The table below summarizes how we are compensated by our major partners under our flying contracts for engine expense and the method we use to recognize the corresponding expense.

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Flying Contract	Compensation of Engine Expense	Expense Recognition
SkyWest Delta Connection	Directly-Reimbursed Engine Contracts	Direct Expense Method
ExpressJet Delta Connection	Directly-Reimbursed Engine Contracts	Direct Expense Method
SkyWest United Express (CRJ200)	Fixed-Rate Engine Contracts	Direct Expense Method
SkyWest United Express (CRJ700)	Fixed-Rate Engine Contracts	Power by the Hour Agreement
SkyWest United Express (E175)	Fixed-Rate Engine Contracts	Power by the Hour Agreement
SkyWest United Express (EMB120)	Fixed-Rate Engine Contracts	Deferral Method
ExpressJet United Express (CRJ200)	Fixed-Rate Engine Contracts	Direct Expense Method
ExpressJet United CPA (ERJ145)	Directly-Reimbursed Engine Contracts	Power by the Hour Agreement
Alaska Agreement	Fixed-Rate Engine Contracts	Power by the Hour Agreement
American Eagle Agreement (CRJ200)	Fixed-Rate Engine Contracts	Direct Expense Method
US Airways Express (CRJ200 / CRJ900)	Fixed-Rate Engine Contracts	Direct Expense Method

Historically, multiple contractual relationships with major airlines have enabled us to reduce our reliance on any single major airline code and to enhance and stabilize operating results through a mix of contract flying and our controlled or pro-rate flying. For the nine months ended September 30, 2014, contract flying revenue and pro-rate revenue represented approximately 88.1% and 11.9%, respectively, of our total passenger revenues. On contract routes, the major airline partner controls scheduling, ticketing, pricing and seat inventories and we are compensated by the major airline partner at contracted rates based on completed block hours, flight departures and other operating measures.

Third Quarter Summary

We had total operating revenues of \$834.6 million for the three months ended September 30, 2014, a 1.9% decrease, compared to total operating revenues of \$850.7 million for the three months ended September 30, 2013. We generated net income of \$41.3 million, or \$0.79 per diluted share, for the three months ended September 30, 2014, compared to net income of \$26.4 million or \$0.50 per diluted share, for the three months ended September 30, 2013.

The significant items affecting our financial performance during the three months ended September 30, 2014 are summarized below:

Revenue

Under certain of our flying contracts, certain expenses are subject to direct reimbursement from our major partners and we record such reimbursements as passenger revenue. These reimbursed expenses include fuel, landing fees, station rents and certain engine maintenance expenses. Excluding the impact of the expenses incurred for fuel, landing fees, station rents and engine maintenance expense and associated reimbursements from our major partners, our passenger revenues increased from \$755.4 million for the three months ended September 30, 2013 to \$763.0 million for the three months ended September 30, 2014, or by \$7.6 million or 1.0%. This increase was primarily due to certain contact renewals and modifications and operation of the additional E175 aircraft during the three months ended September 30, 2014 compared to the corresponding period in 2013. Although we had a reduction in block hour production during the three months ended September 30, 2014 compared to the corresponding period in 2013, the decrease in block hour production was significantly concentrated in the ExpressJet ERJ145 flying contract with United, which has a lower revenue per block hour than our other flying contracts as both fuel and aircraft lease payments are paid directly by United under the ExpressJet ERJ145 contract and we do not record revenue for expenses paid directly to vendors by our major partners.

Operating and Other Expense Related Items

Salaries, wages and employee benefits increased \$8.9 million, or 2.9%, during the three months ended September 30, 2014, compared to the three months ended September 30, 2013. The increase in salaries, wages and employee benefits expenses was primarily due to increased pilot costs associated with the implementation of the Airline Safety and Pilot Training Improvement Act of 2009 (the Improvement Act), which had a negative effect on pilot scheduling and work hours. We anticipate that the negative impact of compliance with the Improvement Act will continue in future periods. The increase in salaries, wages and employee benefits was also due to additional hiring and training associated with the deliveries of our E175 aircraft.

Other operating expenses, which primarily consist of property taxes, hull and liability insurance, crew simulator training and crew hotel costs, increased \$9.4 million, or 16.0%, during the three months ended September 30, 2014, compared to the three months ended September 30, 2013. The increase in other expenses during the three months ended September 30, 2014 was primarily due to an increase in crew lodging expenses resulting from our compliance with the Improvement Act. During the three months ended September 30, 2014, we received the final installment payment from Trip Investimentos related to our sale of TRIP shares. Because Trip Investimentos was restricted from transferring the shares until we received the final payment, we did not record the gain on the

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transaction until the final payment was received. During the three months ended September 30, 2014 we recorded a gain of \$24.9 million in other income as a result of the completed transaction. Additionally, under the terms of the purchase agreement, we received \$2.1 million of interest payments from Trip Investimentos, which was recorded as interest income during the three months ended September 30, 2014.

Other Items

On May 16, 2013, SkyWest Airlines and United entered into a United Express Agreement to operate 40 new E175 aircraft. Under the agreement, we acquired the first fourteen of these aircraft during the nine months ended September 30, 2014, with deliveries scheduled to continue to mid-2015. The United Express Agreement has a 12-year term for each of the aircraft subject to the agreement, and other terms which are generally consistent with the SkyWest Airlines United Express Agreement. During the three months ended September 30, 2014, SkyWest Airlines began passenger service with six additional E175s to be operated under the United Express Agreement. Twelve of the fourteen aircraft acquired have been placed into service as of September 30, 2014.

Under the ExpressJet Delaware United Express Agreement, 16 ERJ145s were removed from contract due to scheduled contract expirations during the nine months ended September 30, 2014 and the aircraft are being returned to United. Additionally, there are ten ERJ145s and eight ERJ145s with scheduled contract expirations for the month of December 2014 and January 2015, respectively. Nine ERJ135s are scheduled for removal in early 2015. We do not currently anticipate that we will reach an agreement with United to extend the flying contract term with these aircraft and ExpressJet will return these aircraft to United. We do not anticipate the termination of these aircraft will have a material negative effect on our financial results.

Critical Accounting Policies

Our significant accounting policies are summarized in Note 1 to our consolidated financial statements for the year ended December 31, 2013, which are presented in our Annual Report on Form 10-K for the year ended December 31, 2013. Critical accounting policies are those policies that are most important to the preparation of our consolidated financial statements and require management's subjective and complex judgments due to the need to make estimates about the effect of matters that are inherently uncertain. Our critical accounting policies relate to revenue recognition, maintenance, aircraft leases, impairment of long-lived assets and intangibles, stock-based compensation expense and fair value. The application of these accounting policies involves the exercise of judgment and the use of assumptions as to future uncertainties and, as a result, actual results will likely differ, and could differ materially, from such estimates.

Recent Accounting Pronouncements

In June 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (ASU 2014-12). The FASB issued ASU 2014-12 to provide explicit guidance for share-based awards which allow for an employee to vest in an award upon achievement of a performance condition met after completion of a requisite service period regardless of whether the employee is rendering service on the date the performance target is achieved. ASU 2014-12 provides that the performance target should not be reflected in estimating the grant-date fair value of the award, but rather compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and recognized prospectively over the remaining requisite service period. The standard is effective for fiscal

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years and interim periods within those years beginning after December 15, 2015. We do not believe the implementation of ASU 2014-12 will have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. Under the new standard, revenue is recognized at the time a good or service is transferred to a customer for the amount of consideration received for that specific good or service. The standard is effective for annual reporting periods beginning after December 15, 2016, including interim reporting periods, and early adoption is not permitted. Entities may use a full retrospective approach or report the cumulative effect as of the date of adoption. Our management is currently evaluating the impact, if any, the adoption of this standard will have on our Consolidated Financial Statements.

In April 2014, the FASB issued Accounting Standards Update 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. The standard changes the requirements for reporting discontinued operations in Subtopic 205-20. The standard is effective in the first quarter of 2015. We do not believe the implementation of the standard will have a material impact to the consolidated financial statements.

Table of Contents**Results of Operations****Our Business Segments**

For the three months ended September 30, 2014 and 2013, we had two reportable segments which are the basis of our internal financial reporting: SkyWest Airlines and ExpressJet.

For the three months ended September 30, (dollar amounts in thousands)				
	2014 Amount	2013 Amount	\$ Change Amount	% Change Percent
Operating Revenues:				
SkyWest Airlines Operating Revenues	\$ 493,606	\$ 468,517	\$ 25,089	5.4%
ExpressJet Operating Revenues	340,553	381,749	(41,196)	(10.8)%
Other Operating Revenues	474	474		0.0%
Total Operating Revenues	\$ 834,633	\$ 850,740	\$ (16,107)	(1.9)%
Airline Expenses:				
SkyWest Airlines Expense	\$ 441,516	\$ 420,132	\$ 21,384	5.1%
ExpressJet Expense	350,298	387,857	(37,559)	(9.7)%
Other Airline Expense	622	3,576	(2,954)	(82.6)%
Total Airline Expense(1)	\$ 792,436	\$ 811,565	\$ (19,129)	(2.4)%
Segment profit (loss):				
SkyWest Airlines segment profit	\$ 52,090	\$ 48,385	\$ 3,705	7.7%
ExpressJet segment loss	(9,745)	(6,108)	(3,637)	59.5%
Other profit (loss)	(148)	(3,102)	2,954	(95.2)%
Total Segment profit	\$ 42,197	\$ 39,175	\$ 3,022	7.7%
Interest Income	2,549	567	1,982	349.6%
Other	23,598	4,625	18,973	410.2%
Consolidated Income before taxes	\$ 68,344	\$ 44,367	\$ 23,977	54.0%

(1) Total Airline Expense includes operating expense and interest expense

SkyWest Airlines Segment Profit. SkyWest Airlines segment profit increased \$3.7 million, or 7.7%, during the three months ended September 30, 2014, compared to the three months ended September 30, 2013. The increase in the SkyWest Airlines segment profit was due primarily to the following factors:

- Excluding the directly reimbursed expenses associated with our contract flying, which is reflected in operating revenues, SkyWest Airlines operating revenue increased by \$31.9 million or 7.9 % during the three months ended September 30, 2014, compared to the three months ended September 30, 2013. The increase was primarily due to increased government subsidies applicable to certain routes we operated, improvements in the provisions of certain of our flying contracts and due to the operation of twelve new E175s placed into service by September 30, 2014.

- SkyWest Airlines salaries, wages and employee benefits increased \$9.7 million or 6.8% during the three months ended September 30, 2014, compared to the three months ended September 30, 2013, primarily due to direct labor costs associated with the E175 operations and increased expenses associated with the implementation of the Improvement Act, which had a negative effect on pilot scheduling and work hours. Additionally, pilot training costs increased due to preparation for upcoming E175 deliveries during the three months ended September 30, 2014 compared to the comparable period of 2013.

- Excluding the directly reimbursed expenses associated with our contract flying and salaries wages and employee benefits, SkyWest Airlines remaining airline expense increased by \$18.5 million, or 8.8%, during the three months ended September 30, 2014, compared to the three months ended September 30, 2013. The increase was primarily attributable to an increase in direct operating costs associated with the additional E175 operations and additional crew hotel expenses due to crew scheduling resulting from the Improvement Act.

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ExpressJet Segment Loss. ExpressJet segment loss increased \$3.6 million, or 59.5%, during the three months ended September 30, 2014, compared to the three months ended September 30, 2013. The increase in ExpressJet segment loss was due primarily to the following factors:

- Excluding the directly reimbursed expenses associated with our contract flying, which is reflected in operating revenues, ExpressJet Airlines operating revenue decreased by \$18.9 million, or 6.8%, during the three months ended September 30, 2014, compared to the three months ended September 30, 2013. The decrease in operating revenue was primarily due to a reduction in the ExpressJet fleet size and related decrease in block hour production of approximately 27,000 block hours, or 7.7%, from the three months ended September 30, 2013 to the three months ended September 30, 2014. Block hour production is a significant driver of revenue in our flying contracts with our major partners.
- Excluding the directly reimbursed expenses associated with our contract flying, ExpressJet's other airline expenses decreased \$15.3 million, or 5.4%, during the three months ended September 30, 2014, compared to the three months ended September 30, 2013. The decrease was primarily related to the reduction in ExpressJet fleet size, related block hour production and direct operating expenses. The ExpressJet airline expenses for the three months ended September 30, 2014 were negatively influenced by inefficiencies associated with the implementation of the Improvement Act, which negatively impacted crew wages and crew lodging expenses.

Three Months Ended September 30, 2014 and 2013

Operational Statistics. The following table sets forth our major operational statistics and the associated percentages-of-change for the periods identified below.

	For the three months ended September 30,		
	2014	2013	% Change
Revenue passenger miles (000)	8,342,394	8,384,129	(0.5)%
Available seat miles (ASMs) (000)	10,037,729	10,256,027	(2.1)%
Block hours	590,534	613,821	(3.8)%
Departures	355,273	378,063	(6.0)%
Passengers carried	15,630,168	15,929,930	(1.9)%
Passenger load factor	83.1%	81.7%	1.4Pts
Revenue per available seat mile	8.3¢	8.3¢	0.0%
Cost per available seat mile	7.9¢	7.9¢	0.0%
Cost per available seat mile excluding fuel	7.4¢	7.4¢	0.0%
Fuel cost per available seat mile	0.5¢	0.5¢	0.0%
Average passenger trip length (miles)	534	526	1.5%

Revenues. Total operating revenues decreased \$16.1 million, or 1.9%, during the three months ended September 30, 2014, compared to the three months ended September 30, 2013. Under certain of our flying contracts, certain expenses are subject to direct reimbursement from our major partners and we record such reimbursements as passenger revenue. The most significant reimbursed expenses include fuel, landing fees, station rents and certain engine maintenance expenses. Our fuel expense, landing fees, station rents and directly-reimbursed engine expense decreased by \$28.6 million, during the three months ended September 30, 2014, from the three months ended September 30, 2013, due primarily to our major partners paying an increased volume of landing fees and station rents directly to airport authorities on flights we operated under our code-share agreements. The following table summarizes the amount of fuel, landing fees, station rents and engine overhaul reimbursements included in our passenger revenues for the periods indicated (dollar amounts in thousands).

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	For the three months ended September 30,				
	2014	2013	\$ Change	% Change	
Passenger revenues	\$ 815,867	\$ 836,890	\$ (21,023)	(2.5)%	
Less: Fuel reimbursement from major partners	16,666	22,527	(5,861)	(26.0)%	
Less: Landing fee and station rent reimbursements from major partners	4,699	25,021	(20,322)	(81.2)%	
Less: Engine overhaul reimbursement from major partners	31,470	33,922	(2,452)	(7.2)%	
Passenger revenue excluding fuel, landing fee, station rent and engine overhaul reimbursements	\$ 763,032	\$ 755,420	\$ 7,612	1.0%	

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Passenger revenues. Passenger revenues decreased \$21.0 million, or 2.5%, during three months ended September 30, 2014, compared to the three months ended September 30, 2013. Our passenger revenues, excluding fuel, landing fee, station rent and engine overhaul reimbursements from major partners, increased \$7.6 million, or 1.0%, during the three months ended September 30, 2014, compared to the three months ended September 30, 2013. Passenger revenues excluding fuel, landing fee, station rent and engine overhaul reimbursements increased primarily due to an increase in E175 operations and certain contract renewals and modifications at SkyWest Airlines, partially offset by a reduction in the ERJ145 fleet and related revenue at ExpressJet.

Ground handling and other. Total ground handling and other revenues increased \$4.9 million, or 35.5%, during the three months ended September 30, 2014, compared to the three months ended September 30, 2013. Revenue attributed to ground handling services for our aircraft is reflected in our consolidated statements of comprehensive income under the heading Operating Revenues Passenger and revenue attributed to ground handling services we provide for third-party aircraft and government subsidies we receive related to our pro-rate operations is reflected in our consolidated statements of comprehensive income under the heading Operating Revenues Ground handling and other. The increase in ground handling and other revenues we generated during the three months ended September 30, 2014, compared to the three months ended September 30, 2013, was primarily related to an increase in government subsidies we received for providing service to certain locations under our pro-rate operations.

Individual expense components attributable to our operations are expressed in the following table on the basis of cents per ASM. (dollar amounts in thousands).

	For the three months ended September 30,				2014 Cents Per ASM	2013 Cents Per ASM
	2014 Amount	2013 Amount	\$ Change Amount	% Change Percent		
Aircraft fuel	\$ 49,177	\$ 49,656	\$ (479)	(1.0)%	0.5	0.5
Salaries, wages and benefits	315,766	306,887	8,879	2.9%	3.1	3.0
Aircraft maintenance, materials and repairs	159,920	176,822	(16,902)			