

MESA AIR GROUP INC
Form 10-K
December 14, 2004

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended September 30, 2004

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)*

**410 North 44th Street, Suite 700,
Phoenix, Arizona**

(Address of Principal Executive Offices)

85-0302351

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

85008

(Zip Code)

Registrant's telephone number, including area code:

(602) 685-4000

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, No Par Value

(Title of Class)

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

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

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

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The aggregate market value of the voting stock held by non-affiliates of the Registrant as of December 1, 2004: Common Stock, no par value: \$226.0 million.

On December 1, 2004, the Registrant had outstanding 30,794,571 shares of Common Stock.

Documents Incorporated by Reference

Portions of the registrant's proxy statement for the 2004 annual meeting of stockholders

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PART I

Forward-Looking Statements

This Form 10-K Report contains certain statements including, but not limited to, information regarding the replacement, deployment, and acquisition of certain numbers and types of aircraft, and projected expenses associated therewith; costs of compliance with Federal Aviation Administration regulations and other rules and acts of Congress; the passing of taxes, fuel costs, inflation, and various expenses to the consumer; the relocation of certain operations of Mesa; the resolution of litigation in a favorable manner and certain projected financial obligations. These statements, in addition to statements made in conjunction with the words expect, anticipate, intend, plan, believe, seek, estimate, and similar expressions, are forward-looking statements within the meaning of the Harbor provision of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements relate to future events or the future financial performance of Mesa and only reflect management's expectations and estimates. The following is a list of factors, among others, that could cause actual results to differ materially from the forward-looking statements: changing business conditions in certain market segments and industries; changes in Mesa's code-sharing relationships; the inability of America West, US Airways or United Airlines to pay their obligations under the code-share agreements; the inability of United Airlines and/or US Airways to successfully restructure and emerge from bankruptcy; the ability of US Airways to reject our code-share agreements 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; unfavorable resolution of negotiations with municipalities for the leasing of facilities; and risks associated with litigation outcomes. One or more of these or other factors may cause Mesa's actual results to differ materially from any forward-looking statement. Mesa is not undertaking any obligation to update any forward-looking statements contained in this Form 10-K.

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

Item 1. Business
General

Mesa Air Group, Inc. (Mesa or the Company) is a holding company whose principle subsidiaries operate as regional air carriers providing scheduled passenger and airfreight service. The Company serves 181 cities in 43 states, the District of Columbia, Canada, Mexico and the Bahamas. At September 30, 2004, the Company operated a fleet of 180 aircraft and had approximately 1,000 daily departures.

Approximately 99% of our consolidated passenger revenues for the fiscal year ended September 30, 2004 were derived from operations associated with code-share agreements. Our subsidiaries have code-share agreements with America West Airlines, Inc. (America West), Midwest Airlines, Inc. (Midwest Airlines), United Airlines, Inc. (United Airlines or United) and US Airways, Inc. (US Airways). These code-share agreements allow use of the code-share partners' flight designator code to identify flights and fares in computer reservation systems, permit use of logos, service marks, aircraft paint schemes and uniforms similar to the code-share partner and provide coordinated schedules and joint advertising. The remaining passenger revenues are derived from our independent operations.

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

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Our airline operations are conducted by the following airline subsidiaries:

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

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

Freedom Airlines, Inc. (Freedom), a Nevada corporation, operated CRJ-900 regional jets during the past fiscal year pursuant to the Company's code-share agreement with America West. As of November 2004, all of the CRJ aircraft previously operated by Freedom have been transitioned to Mesa Airlines. Freedom is currently pursuing certification to operate Beechcraft 1900D aircraft.

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

Corporate Structure

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

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

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

Regional Aircraft Services, Inc., a California corporation, performs aircraft component repair and overhaul services with locations in Reading, Pennsylvania and Phoenix, Arizona. In October 2004, RAS announced plans to expand operations to include certain other aviation related services offered to Mesa subsidiaries as well as other airlines and related aviation entities.

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

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

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

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The following table sets forth our aircraft fleet (owned and leased) in operation by aircraft type as of September 30, 2004:

| | Canadair Regional Jet-200 (CRJ-200) | Canadair Regional Jet-700 (CRJ-700) | Canadair Regional Jet-900 (CRJ-900) | Embraer Regional Jet-145 (ERJ-145) | Beechcraft 1900D | DeHavilland Dash 8-200 | Total |
|----------------------|--|--|--|---|-----------------------------|-----------------------------------|--------------|
| US Airways Express | 21 | | | 36 | 22 | | 79 |
| America West Express | 18 | | 24 | | 4 | 6 | 52 |
| United Express | 15 | 15 | | | | 10 | 40 |
| Mesa Airlines | | | | | 9 | | 9 |
| Total | 54 | 15 | 24 | 36 | 35 | 16 | 180 |

Code-Share Agreements

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

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

The following table summarizes our available seat miles (ASMs) flown and revenue recognized under our code-share agreements for the years ended September 30, 2004 and 2003:

| | Fiscal 2004 | | | | Fiscal 2003 | | | |
|----------------------------------|---------------------|-----|------------------------------|-----|--------------------|-----|------------------------------|-----|
| | ASMs | | Passenger Revenue | | ASMs | | Passenger Revenue | |
| | In thousands | | | | | | | |
| America West (Revenue-Guarantee) | 2,983,969 | 42% | \$323,889 | 37% | 2,012,185 | 45% | \$252,181 | 44% |
| US Airways (Revenue-Guarantee) | 2,471,476 | 35% | 304,290 | 35% | 1,778,365 | 40% | 218,457 | 38% |
| Frontier (Revenue-Guarantee) | 55,949 | 1% | 7,440 | 1% | 154,544 | 3% | 19,199 | 3% |
| United (Revenue-Guarantee) | 1,269,454 | 18% | 171,493 | 20% | 20,487 | 1% | 6,101 | 1% |
| America West (Pro-rate) | 21,372 | | 4,558 | 1% | 5,790 | | 1,017 | |
| US Airways (Pro-rate) | 211,195 | 3% | 47,177 | 5% | 295,726 | 7% | 63,205 | 11% |
| Frontier (Pro-rate) | | | | | 91,746 | 2% | 8,129 | 1% |
| Mesa Airlines | 94,269 | 1% | 9,568 | 1% | 94,864 | 2% | 9,293 | 2% |
| Total | 7,107,684 | | \$868,415 | | 4,453,707 | | \$577,582 | |

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America West Code-Sharing Agreement

Revenue-Guarantee

As of September 30, 2004, we operated 24 CRJ-900, 18 CRJ-200, and six Dash-8 aircraft for America West under a revenue-guarantee code-share agreement. The code-share agreement provides for the Company to increase its aircraft fleet up to 38 CRJ-900s. In addition, America West has an option to increase its CRJ-900 fleet size to 58 aircraft. In exchange for providing flights and all other services under the agreement, we receive a fixed monthly minimum amount plus certain additional amounts based upon the number of flights flown and block hours performed during the month. America West also reimburses us for certain costs on an actual basis, including fuel costs, aircraft ownership and financing costs, landing fees, passenger liability and hull insurance, and aircraft property taxes, all as defined in the agreement. In addition, America West also provides, at no cost to Mesa, certain ground handling and customer service functions, as well as airport-related facilities and gates at America West hubs and cities where both carriers operate. We also receive a monthly payment from America West based on a percentage of revenue from flights that we operate under the code-share agreement. Under the amended code-share agreement, America West has the right to reduce the combined CRJ fleets utilized under the code-share agreement by one aircraft in any six-month period commencing in January 2007. In addition, beginning in February 2007, America West may eliminate the Dash-8 aircraft upon 180 days prior written notice. The code-share agreement terminates on June 30, 2012 unless America West elects to extend the contract for two years or exercises options to increase fleet size. The code-share agreement is subject to termination prior to that date in various circumstances including:

If our flight completion factor falls below a specified percentage for a specified period of time, subject to notice and cure rights;

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

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

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

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

Pro-Rate

Pursuant to a turboprop code-share agreement with America West, we operated four Beechcraft 1900D turboprop aircraft in the Phoenix hub under a pro-rate revenue-sharing arrangement as of September 30, 2004. We control scheduling, inventory and pricing. We are allocated a portion of each passenger's fare based on a standard industry formula and are required to pay all costs of transporting the passenger. The pro-rate agreement terminates on March 31, 2012 unless America West elects to extend the contract for successive one-year periods. The pro-rate agreement could also be terminated prior to the termination under similar circumstances as the revenue-guarantee agreement.

US Airways Code-Sharing Agreements

Revenue-Guarantee

As of September 30, 2004, we operated 57 50-seat regional jets for US Airways under a code-sharing agreement. Under the jet code-share agreement, we provide US Airways Express service between US Airways hubs and cities designated by US Airways. In exchange for performing the flight services under the agreement, we receive from US Airways a fixed monthly minimum amount, plus certain additional amounts based upon the number of flights flown and block hours performed during the month. Additionally, certain costs incurred by Mesa in performing the flight services are pass-through costs, whereby US Airways agrees to reimburse

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us for the actual amounts incurred for these items: insurance, property tax per aircraft, fuel and oil cost, catering cost and landing fees. We also receive a fixed profit margin based upon certain costs reimbursements under the agreement. In addition, US Airways also provides, at no cost to Mesa, certain ground handling and customer service functions, as well as, airport-related facilities and gates at US Airways hubs and cities. Twenty-seven of the fifty-seven jets must be in compliance with the jets-for-jobs provisions in the US Airways pilot contract. Jets-for-jobs is an agreement between Mesa, US Airways and their respective pilot unions in which furloughed US Airways pilots receive an agreed upon number of captain and first officer positions on certain aircraft added to the agreement. The code-share agreement for (i) the initial 32 ERJ-145s terminates on December 31, 2008, unless US Airways elects to exercise its option to extend the term for three years upon 12 months notice; and (ii) the additional 24 jets terminates in January 2013, unless US Airways elects to exercise its option to extend the term for two years upon 12 months notice. On November 19, 2003, the Company signed a Seventh Amendment to the US Airways code-share agreement in which the number of additional aircraft was increased from 24 jets to 27 jets. One of these aircraft was placed in service in the second quarter of fiscal 2004 and the remaining two were placed into revenue service in November 2004. Further, in January 2004, the Company signed an Eighth Amendment to the US Airways code-share agreement in which the additional aircraft was increased from 27 to 35 (for a total of 67). None of these additional aircraft have yet been placed in service at US Airways and the timing of such is subject to discussions between the Company and US Airways. However, US Airways has not yet assumed our code-share agreement in its bankruptcy proceeding and could choose to terminate this agreement at any time prior to its emergence from bankruptcy.

Notwithstanding the foregoing, US Airways may terminate the code-share agreement at any time for cause upon 90 days notice and subject to our right to cure under any of the following conditions:

If we fail to retain or utilize the aircraft in the manner required under the jet code-share agreement.

If we admit liability or are found liable for serious safety infractions by the Federal Aviation Administration (FAA), a finding which leads to the suspension or revocation of Mesa s operating certificate.

Pro-Rate

Pursuant to a turboprop code-sharing agreement with US Airways, we operated 22 Beechcraft 1900D turboprop aircraft under a pro-rate revenue-sharing arrangement as of September 30, 2004. We control scheduling, inventory and pricing subject to US Airways concurrence that such service does not adversely affect its other operations in the region. We are allocated a portion of each passenger s fare based on a standard industry formula and are required to pay all the costs of transporting the passenger. Additionally, we are required to pay certain franchise, marketing and reservation fees to US Airways.

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

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

If we fail to achieve specified levels of operating performance in completion factors and on-time arrival performance.

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

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

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

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

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United Code-Sharing Agreement

As of September 30, 2004, we operated 15 CRJ-200, 15 CRJ-700 and 10 Dash-8 aircraft for United under a code-sharing arrangement. The code-share agreement provides for the Company to increase its fleet to 30 70-seat regional aircraft (15 of which would be replacements for 15 CRJ-200s). In exchange for performing the flight services under the agreement, we receive from United a fixed monthly minimum amount, plus certain additional amounts based upon the number of flights flown and block hours performed during the month. Additionally, certain costs incurred by Mesa in performing the flight services are pass-through costs, whereby United agrees to reimburse us for the actual amounts incurred for these items: insurance, property tax per aircraft, fuel cost, oil cost, catering cost and landing fees. We also receive a profit margin based upon certain reimbursable costs under the agreement as well as our operational performance. The code-share agreement for (i) the ten Dash-8 aircraft terminates in July 2013 unless terminated by United Airlines by giving notice six months prior to the fifth anniversary, (ii) the 15 50-seat CRJ-200s terminates in July 2008, which can be accelerated up to two years at Mesa's discretion, (iii) the 15 70-seat regional jets (to be delivered upon the withdrawal of the 50-seat regional jets) terminates ten years from delivery date, and (iv) the remaining 15 70-seat regional jets terminates in three tranches between December 31, 2011 and December 31, 2013. The code-share agreement is subject to termination prior to these dates in various circumstances including:

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

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

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

Fleet Plans and Aircraft Manufacturer Relationships

Interim Financing of Aircraft

Upon delivery of an aircraft from the manufacturer it is our customary business practice to enter into an interim financing arrangement with the manufacturer until such time as permanent financing as an operating lease or debt can be arranged. The interim financing period can be for up to six months after delivery of the aircraft. This practice allows us to take delivery of aircraft quicker while arranging permanent financing or structuring a sale of the aircraft through a sale-leaseback transaction with an independent third party.

At September 30, 2004, we had \$231.0 million in notes payable to an aircraft manufacturer for aircraft on interim financing. We had nine aircraft on interim financing with the manufacturer at September 30, 2004. These interim financing agreements are six months in length and provide for monthly interest only payments at LIBOR plus three percent. The current interim financing agreement with the manufacturer provides for the Company to have a maximum of 15 aircraft on interim financing at a given time. Subsequent to year end, we placed five of these aircraft on permanent financing as debt with a bank.

ERJ Program

In June 1999, we entered into an agreement with Empresa Brasileira de Aeronautica SA (Embraer) to acquire 36 Embraer ERJ-145 50-passenger regional jets. Mesa introduced the ERJ-145 aircraft into revenue service in the third quarter of fiscal 2000 as US Airways Express. As of September 30, 2004, we have taken delivery of all 36 ERJ-145s, which have been financed as operating leases with initial terms of 16.5 to 18 years. We also have options for 45 additional aircraft. In November 2004, our contract with Embraer was amended to extend the option exercise date to May 2005 for deliveries beginning in November 2006.

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In August 1996, we entered into an agreement (the 1996 BRAD Agreement) with Bombardier Regional Aircraft Division (BRAD) to acquire 32 CRJ-200 50-passenger regional jet aircraft. The 32 aircraft have been delivered and are currently under permanent financing as operating leases with initial terms of 16.5 to 18.5 years.

In May 2001, we entered into a second agreement with BRAD (the 2001 BRAD Agreement) under which we committed to purchase a total of 15 CRJ-700s and 25 CRJ-900s. In January 2004, the Company exercised options to purchase 20 CRJ-900 aircraft (seven of which can be converted to CRJ-700 aircraft) reserved under the option provision of the 2001 BRAD Agreement. The transaction includes standard product support provisions, including training, preferred pricing on initial inventory provisioning, maintenance and technical publications. We have accepted delivery of 15 CRJ-700s under the 2001 BRAD Agreement. We are the launch customer of the CRJ-900 and as of September 30, 2004, have taken delivery of 24 CRJ-900 aircraft. In addition to the firm orders, we have an option to acquire an additional 60 CRJ-700 or CRJ-900 regional jets. In conjunction with the 2001 BRAD Agreement, we had \$15.0 million on deposit with BRAD, which was included with lease and equipment deposits at September 30, 2004.

In 2004, we leased nine used CRJ-200 and CRJ-100 aircraft in order to meet required deliveries under our code-share agreements. The aircraft are financed as operating leases.

The following table summarizes our jet fleet status and fleet expansion plans currently under contract with aircraft manufacturers for the periods indicated:

| | <u>CRJ-200/100</u> | <u>CRJ-700 Firm Orders</u> | <u>CRJ-900 Firm Orders</u> | <u>CRJ-700 Options</u> | <u>CRJ-900 Options</u> | <u>ERJ-145 Firm Orders</u> | <u>ERJ-145 Options</u> | <u>Cumulative Total</u> |
|------------------------|--------------------|----------------------------|----------------------------|------------------------|------------------------|----------------------------|------------------------|-------------------------|
| Delivered: | | | | | | | | |
| At 9/30/2004 | 54 | 15 | 24 | | | 36 | | 129 |
| Scheduled deliveries: | | | | | | | | |
| Fiscal 2005 | | | 14 | | 7 | | | 150 |
| Fiscal 2006 | | | 7* | 5 | | | 2 | 164 |
| Fiscal 2007 | | | | 8 | | | 12 | 184 |
| Fiscal 2008 | | | | | | | 12 | 196 |
| Fiscal 2009 | | | | | | | 12 | 208 |
| Fiscal 2010 and Beyond | | | | 20 | 20 | | 7 | 255 |
| Total | 54 | 15 | 45 | 33 | 27 | 36 | 45 | |

* These aircraft can be converted to CRJ-700s at our option upon sufficient notice to Bombardier.

Beechcraft 1900D

As of September 30, 2004, we owned 35 Beechcraft 1900D aircraft. Subsequent to September 30, 2004, we executed an agreement to lease four of these aircraft to Gulfstream International Airlines, Inc. for a five-year term.

Dash-8

As of September 30, 2004, we operated 16 leased Dash-8 aircraft.

Marketing

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

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Under the America West, US Airways and United revenue-guarantee code-share agreements, market selection, pricing and yield management functions are performed by our respective partners. Our role is simply to operate our fleet in the safest and most reliable manner in exchange for fees paid under a generally fixed payment schedule. We intend to expand our operations performed pursuant to these revenue-guarantee agreements.

The Company's market selection process for its B1900 turboprop operations, outside the Essential Air Service program flights, follows an in-depth analysis on a route-by-route basis and is followed by a review and approval process in a joint effort with US Airways or America West, as the case may be, regarding the level of service and fares. We believe that this selection process enhances the likelihood of profitability in a given market.

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

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

Competition

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

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

We believe our code-share agreements provide a significant competitive advantage in hub airports where our major partner has a predominant share of the market. The ability to control connecting passenger traffic by offering superior service creates difficulty for other regional airlines wishing to compete at such hubs. In addition to enhanced competitiveness offered by the code-share agreements, we compete with other airlines by offering frequent flights, flexible schedules and numerous fare levels.

Fuel

Historically, we have not experienced problems with the availability of fuel, and believe that we will be able to obtain fuel in quantities sufficient to meet our existing and anticipated future requirements at competitive prices. Standard industry contracts generally do not provide protection against fuel price increases, nor do they ensure availability of supply. However, our revenue-guarantee code-share agreements with

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America West, United and US Airways (regional jet) allow fuel used in the performance of the agreements to be billed to the code-share partner, thereby reducing our exposure to fuel price fluctuations. In fiscal 2004, approximately 92% of the Company's fuel purchases was associated with its America West, United and US Airways (regional jet) code-share agreements. A substantial increase in the price of jet fuel, to the extent our fuel costs are not reimbursed, or the lack of adequate fuel supplies in the future, may have a material adverse effect on the Company's business, financial condition, results of operations and liquidity.

Maintenance of Aircraft and Training

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

Insurance

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

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

Employees

As of September 30, 2004, we employed approximately 5,000 employees. Approximately 2,700 of our employees are represented by various labor organizations. Our continued success is partly dependent on our ability to continue to attract and retain qualified personnel. Historically, we have had no difficulty attracting qualified personnel to meet our requirements.

Mesa Airline's flight attendants are represented by the Association of Flight Attendants (AFA). Mesa Airline's contract with the AFA becomes amendable in June 2006. Our pilots are represented by the Air Line Pilot Association (ALPA). Our contract with ALPA becomes amendable in September 2007.

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

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

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Essential Air Service Program

The Essential Air Service (EAS) program administered by the United States Department of Transportation (DOT) guarantees a minimum level of air service in certain communities, predicated on predetermined guidelines set forth by Congress. Based on these guidelines, the DOT subsidizes air service to communities that might not otherwise have air service. At September 30, 2004, we provided service to 30 such cities for an annualized subsidy of approximately \$21.3 million. EAS rates are normally set for two-year contract periods for each city. There is no guarantee that we will continue to receive subsidies for the cities we serve. The DOT may request competitive proposals from other airlines at the end of the contract period for EAS service to a particular city. Proposals, when requested, are evaluated on, among other things, level of service provided, subsidy requested, fitness of the applicant and comments from the communities served. If the funding under this program is terminated for any of the cities served by the Company, in all likelihood we would not continue to fly in these markets, and as a result, we would be forced to find alternative uses for the Beechcraft 1900D 19-seat turboprop aircraft affected.

Regulation

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

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

Effective March 1997, the FAA required that regional airlines with aircraft of ten or more passenger seats operating under FAR Part 135 rules to begin operating those aircraft under FAR Part 121 regulations. The Company, which at one time was one of the largest regional airlines operating under FAR Part 135 regulations, completed the transition to Part 121 within the FAA's deadline. These requirements have resulted in a significant increase in Air Midwest's costs, adversely affecting our ability to profitably serve certain markets. Such increased costs are primarily related to additional training, dispatch and maintenance procedures. We continue to work to minimize the cost of these new operating procedures while fully complying with FAR Part 121 operating requirements.

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

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

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

Available Information

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

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Risk Factors

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

Risks Related to Our Business

The negative impact of the September 11, 2001 terrorist attacks and the resulting government responses could be material to our financial condition, results of operations and prospects.

The terrorist attacks of September 11, 2001 were highly publicized. The impacts that these events will continue to have on the airline industry in general, and on us in particular, is not known at this time, but is expected to include a substantial impact on our operations due to:

a reduction in the demand for travel in the near and mid-term until public confidence in the air transportation system is restored;

an increase in costs due to enhanced security measures and government directives in response to the terrorist attacks;

an increase in the cost of aviation insurance in general, and the cost and availability of coverage for acts of war, terrorism, hijacking, sabotage and similar acts of peril in particular; and

an increase in airport rents and landing fees.

In addition, we expect that the general increase in hostilities relating to reprisals against terrorist organizations and the continued threat of further terrorist attacks will continue to negatively impact our revenues and costs in the near and mid-term. The extent of the impact that the terrorist attacks and their aftermath will have on our operations, and the sufficiency of our financial resources to absorb this impact, will depend on a number of factors, including:

the adverse impact that terrorist attacks, and the resulting government responses, will have on the travel industry and the economy in general;

the potential increase in fuel costs and decrease in availability of fuel if oil-producing countries are affected by the aftermath of the terrorist attacks, including the government's responses, and our ability to manage this risk in connection with that part of our operations where our fuel costs are not reimbursed by our code-share partners under the terms of our code-share agreements;

our ability to reduce our operating costs and conserve financial resources, taking into account the cost increases (including significant increases in the cost of aviation insurance) expected to result from the aftermath of the terrorist attacks and the government's responses;

any resulting decline in the value of the aircraft in our fleet;

our ability to raise additional financing, if necessary, taking into account our current leverage and the limitations imposed by the terms of our existing indebtedness;

the number of crew members who may be called for duty in the reserve forces of the armed services and the resulting impact on our ability to operate as planned; and

the scope and nature of any future terrorist attacks.

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

We depend on relationships created by our code-share agreements. We derive a significant portion of our consolidated passenger revenues from our revenue guarantee code-share agreements with America West, United Airlines, and US Airways. Our code-share partners have certain rights to cancel the applicable code-share agreement upon the occurrence of certain events or the giving of appropriate notice, subject to certain conditions. Although no notice has been given to date that any party intends to cancel these contracts, there can be no assurance that they will not serve notice at a later date of their intention to cancel, forcing us to stop

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selling those routes with the applicable partner's code and potentially reducing our traffic and revenue. In addition, our code-share agreement with America West allows America West, subject to certain restrictions, to reduce the combined CRJ fleets utilized under the code-share agreement by one aircraft in any six-month period commencing in January 2007. In addition, beginning in February 2007, America West may eliminate the Dash-8 aircraft upon 180 days prior written notice. America West has used this provision to reduce the number of aircraft covered by the code-share agreement and there can be no assurance that, commencing in January 2007, they will not continue to further reduce the number of covered aircraft.

In addition, because a majority of our operating revenues are currently generated under revenue-guarantee code-share agreements, if any one of them is terminated, our operating revenues and net income could be materially adversely affected unless we are able to enter into satisfactory substitute arrangements or, alternatively, fly under our own flight designator code, including obtaining the airport facilities and gates necessary to do so. For the year ended September 30, 2004, our America West code-share agreement accounted for 38% of our consolidated passenger revenues, our US Airways code-share agreement accounted for 40% of our consolidated passenger revenues and our United code-share agreement accounted for 20% of our consolidated passenger revenues. Any material modification to, or termination of, our code-share agreements with any of these partners could have a material adverse effect on our financial condition, the results of our operations and the price of our common stock. Should any of our revenue-guarantee code-share agreements be terminated, we cannot assure you that we would be able to enter into substitute code-share arrangements, that any such arrangements would be as favorable to us as the current code-share agreements or that we could successfully fly under our own flight designator code.

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

We are directly affected by the financial and operating strength of our code-share partners. Any events that negatively impact the financial strength of our code-share partners or have a long-term effect on the use of our code-share partners by airline travelers would likely have a material adverse effect on our business, financial condition and results of operations. In the event of a decrease in the financial or operational strength of any of our code-share partners, such partner may seek to reduce, or be unable to make, the payments due to us under their code-share agreement. In addition, they may reduce utilization of our aircraft. Although there are certain monthly guaranteed payment amounts, there are no minimum levels of utilization specified in the code-share agreements. UAL Corp., the parent of our code-share partner United Airlines, has not emerged from reorganization under Chapter 11 of the U.S. Bankruptcy Code. Additionally, US Airways, which accounted for 40% of our consolidated passenger revenue for the fiscal year ended September 30, 2004, has filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. The financial performance of US Airways and United could directly affect their ability to perform under our code-share agreements with them. Additionally, US Airways has not yet assumed our code-share agreement in its bankruptcy proceeding and could choose to terminate this agreement. If any of our other current or future code-share partners become bankrupt, our code-share agreement with such partner may not be assumed in bankruptcy and would be terminated. This and other such events could have an adverse effect on our business, financial condition and results of operations. In addition, any negative events that occur to other regional carriers and that affect public perception of such carriers generally could also have a material adverse effect on our business, financial condition and results of operations.

Our code-share partners may expand their direct operation of regional jets thus limiting the expansion of our relationships with them.

We depend on major airlines like America West, United Airlines and US Airways electing to contract with us instead of purchasing and operating their own regional jets. However, these major airlines possess the resources to acquire and operate their own regional jets instead of entering into contracts with us or other regional carriers. We have no guarantee that in the future our code-share partners will choose to enter into contracts with us instead of purchasing their own regional jets or entering into relationships with competing regional airlines. A decision by America West, United Airlines, or US Airways to phase out our

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contract-based code-share relationships or to enter into similar agreements with competitors could have a material adverse effect on our business, financial condition or results of operations. In addition to Mesa Airlines, US Airways and United Airlines have similar code-share agreements with other competing regional airlines. Mesa Airlines is currently America West's only code-share partner.

If we experience a lack of labor availability or strikes, it could result in a decrease of revenues due to the cancellation of flights.

The operation of our business is significantly dependent on the availability of qualified employees, including, specifically, flight crews, mechanics and avionics specialists. Historically, regional airlines have experienced high pilot turnover from time to time as a result of air carriers operating larger aircraft hiring their commercial pilots. Further, the addition of aircraft, especially new aircraft types, can result in pilots upgrading between aircraft types and becoming unavailable for duty during the required extensive training periods. There can be no assurance that we will be able to maintain an adequate supply of qualified personnel or that labor expenses will not increase.

At September 30, 2004, we had approximately 5,000 employees, a significant number of whom are members of labor unions, including ALPA and the AFA. Our collective bargaining agreement with ALPA becomes amendable in September 2007 and our collective bargaining agreement with the AFA becomes amendable in June 2006. The inability to negotiate acceptable contracts with existing unions as agreements expire or with new unions could result in work stoppages by the affected workers, lost revenues resulting from the cancellation of flights and increased operating costs as a result of higher wages or benefits paid to union members. We cannot predict which, if any, other employee groups may seek union representation or the outcome or the terms of any future collective bargaining agreement and therefore the effect, if any, on our financial condition and results of operations. If negotiations with unions over collective bargaining agreements prove to be unsuccessful, following specified cooling off periods, the unions may initiate a work action, including a strike, which could have a material adverse effect on our business, financial condition and results of operations.

Increases in our labor costs, which constitute a substantial portion of our total operating costs, will cause our earnings to decrease.

Labor costs constitute a significant percentage of our total operating costs, and we have experienced pressure to increase wages and benefits for our employees. Under our code-share agreements, our reimbursement rates contemplate labor costs that increase on a set schedule generally tied to an increase in the consumer price index or the actual increase in the contract. We are responsible for our labor costs, and we may not be entitled to receive increased payments under our code-share agreements if our labor costs increase above the assumed costs included in the reimbursement rates. As a result, a significant increase in our labor costs above the levels assumed in our reimbursement rates could result in a material reduction in our earnings.

If new airline regulations are passed or are imposed upon our operations, we may incur increased operating costs and experience a decrease in earnings.

Laws and regulations, such as those described below, have been proposed from time to time that could significantly increase the cost of our operations by imposing additional requirements or restrictions on our operations. We cannot predict what laws and regulations will be adopted or what changes to air transportation agreements will be effected, if any, or how they will affect us, and there can be no assurance that laws or regulations currently proposed or enacted in the future will not increase our operating expenses and therefore adversely affect our financial condition and results of operations.

As an interstate air carrier, we are subject to the economic jurisdiction, regulation and continuing air carrier fitness requirements of the Department of Transportation, which include required levels of financial, managerial and regulatory fitness. The Department of Transportation is authorized to establish consumer protection regulations to prevent unfair methods of competition and deceptive practices, to prohibit certain pricing practices, to inspect a carrier's books, properties and records, to mandate conditions of carriage and to

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suspend an air carrier's fitness to operate. The DOT also has the power to bring proceedings for the enforcement of air carrier economic regulations, including the assessment of civil penalties, and to seek criminal sanctions.

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

We incur substantial costs in maintaining our current certifications and otherwise complying with the laws, rules and regulations to which we are subject. We cannot predict whether we will be able to comply with all present and future laws, rules, regulations and certification requirements or that the cost of continued compliance will not significantly increase our costs of doing business.

The FAA has the authority to issue mandatory orders relating to, among other things, the grounding of aircraft, inspection of aircraft, installation of new safety-related items and removal and replacement of aircraft parts that have failed or may fail in the future. A decision by the FAA to ground, or require time-consuming inspections of, or maintenance on, all or any of our turboprops or regional jets, for any reason, could negatively impact our results of operations.

In addition to state and federal regulation, airports and municipalities enact rules and regulations that affect our operations. From time to time, various airports throughout the country have considered limiting the use of smaller aircraft, such as Embraer or Canadair regional jets, at such airports. The imposition of any limits on the use of our regional jets at any airport at which we operate could interfere with our obligations under our code-share agreements and severely interrupt our business operations.

Fluctuations in fuel costs could adversely affect our operating expenses and results.

The price and supply of jet fuel is unpredictable and fluctuates based on events outside our control, including geopolitical developments, regional production patterns and environmental concerns. Although approximately 92% of our fuel costs for the fiscal year ended September 30, 2004 was reimbursed by our code-share partners, price escalations or reductions in the supply of jet fuel will increase our operating expenses and, to the extent such fuel costs are not reimbursed by our code-share partners, could cause our operating results and net income to decline.

If additional security and safety measures regulations are adopted, we may incur increased operating costs and experience a decrease in earnings.

Congress recently adopted increased safety and security measures designed to increase airline passenger security and protect against terrorist acts. Such measures have resulted in additional operating costs to the airline industry. The Aviation Safety Commission's report recommends the adoption of further measures aimed at improving the safety and security of air travel. We cannot forecast what additional security and safety requirements may be imposed on our operations in the future or the costs or revenue impact that would be associated with complying with such requirements, although such costs and revenue impact could be significant. To the extent that the costs of complying with any additional safety and security measures are not reimbursed by our code-share partners, our operating results and net income could be adversely affected.

If our operating costs increase as our aircraft fleet ages and we are unable to pass along such costs, our earnings will decrease.

As our fleet of aircraft age, the cost of maintaining such aircraft, if not replaced, will likely increase. There can be no assurance that costs of maintenance, including costs to comply with aging aircraft requirements, will not materially increase in the future. Any material increase in such costs could have a material adverse effect on our business, financial condition and results of operations. Because many aircraft components are required to be replaced after specified numbers of flight hours or take-off and landing cycles,

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and because new aviation technology may be required to be retrofitted, the cost to maintain aging aircraft will generally exceed the cost to maintain newer aircraft. We believe that the cost to maintain our aircraft in the long-term will be consistent with industry experience for these aircraft types and ages used by comparable airlines.

We believe that our aircraft are mechanically reliable based on the percentage of scheduled flights completed and as of September 30, 2004 the average age of our regional jet fleet is 4.0 years. However, there can be no assurance that such aircraft will continue to be sufficiently reliable over longer periods of time. Furthermore, any public perception that our aircraft are less than completely reliable could have a material adverse effect on our business, financial condition and results of operations.

Our fleet expansion program will require a significant increase in our leverage and the financing we require may not be available on favorable terms or at all.

The airline business is very capital intensive and, as a result, many airline companies are highly leveraged. For the year ended September 30, 2004, our debt service payments totaled \$41.0 million and our lease payments totaled \$179.4 million. We have significant lease obligations with respect to our aircraft and ground facilities, which aggregated approximately \$2.0 billion at September 30, 2004. As of September 30, 2004, our growth strategy involves the acquisition of 14 more Bombardier regional jets during fiscal 2005. As of September 30, 2004, we had permanently financed 30 of the 39 CRJ-700 and CRJ-900 aircraft delivered under the 2001 BRAD agreement; the remaining aircraft are subject to interim financing. We may utilize interim financing provided by the manufacturer and have the ability to fund up to 15 aircraft at any one time under this facility. Our ability to obtain additional interim financing is contingent upon obtaining permanent financing for the aircraft already delivered. There are no assurances that we will be able to obtain permanent financing for future aircraft deliveries.

There can be no assurance that our operations will generate sufficient cash flow to make such payments or that we will be able to obtain financing to acquire the additional aircraft necessary for our expansion. If we default under our loan or lease agreements, the lender/lessor has available extensive remedies, including, without limitation, repossession of the respective aircraft and, in the case of large creditors, the effective ability to exert control over how we allocate a significant portion of our revenues. Even if we are able to timely service our debt, the size of our long-term debt and lease obligations could negatively affect our financial condition, results of operations and the price of our common stock in many ways, including:

increasing the cost, or limiting the availability of, additional financing for working capital, acquisitions or other purposes;

limiting the ways in which we can use our cash flow, much of which may have to be used to satisfy debt and lease obligations; and

adversely affecting our ability to respond to changing business or economic conditions or continue our growth strategy.

If we need funds and cannot raise them on acceptable terms, we may be unable to realize our current plans or take advantage of unanticipated opportunities and could be required to slow our growth.

We depend on Bombardier to supply us with the aircraft we require to expand.

As of September 30, 2004, we are obligated under our code-share agreements to place an additional 14 CRJ 900 regional jets over the next 12 months. As of September 30, 2004, we have firm orders with Bombardier for an additional 21 regional jets. We also have options to acquire an additional 20 regional jets that are exercisable through 2007 and 40 regional jets that are exercisable in 2010 and beyond.

We are dependent on Bombardier as manufacturer of these jets and certain factors may limit or preclude our ability to obtain these regional jets, including:

Bombardier could refuse, or may not be financially able, to perform its obligations under the applicable purchase agreement for the delivery of the regional jets; and

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a fire, strike or other event could occur that affects Bombardier's ability to completely or timely fulfill its contractual obligations.

Any disruption or change in the delivery schedule of these regional jets would affect our overall operations and our ability to fulfill our obligations under our code-share agreements.

Our operations could be materially adversely affected by the failure or inability of Bombardier or any key component manufacturers to provide sufficient parts or related support services on a timely basis or by an interruption of fleet service as a result of unscheduled or unanticipated maintenance requirements for our aircraft.

Reduced utilization levels of our aircraft under the revenue-guarantee agreements would adversely impact our revenues and earnings.

Even though our revenue-guarantee agreements require a fixed amount per month to compensate us for our fixed costs, if our aircraft are underutilized (including taking into account the stage length and frequency of our scheduled flights) we will lose the opportunity to receive a margin on the variable costs of flights that would have been flown if our aircraft were more fully utilized.

If we incur problems with any of our third-party service providers, our operations could be adversely affected by a resulting decline in revenue or negative public perception about our services.

Our reliance upon others to provide essential services on behalf of our operations may result in the relative inability to control the efficiency and timeliness of contract services. We have entered into agreements with contractors to provide various facilities and services required for our operations, including aircraft maintenance, ground facilities, baggage handling and personnel training. It is likely that similar agreements will be entered into in any new markets we decide to serve. All of these agreements are subject to termination after notice. Any material problems with the efficiency and timeliness of contract services could have a material adverse effect on our business, financial condition and results of operations.

We are at risk of losses and adverse publicity stemming from any accident involving any of our aircraft.

If one of our aircraft were to crash or be involved in an accident, we could be exposed to significant tort liability.

On January 8, 2003, US Airways Express Flight 5481, operated by Air Midwest, crashed shortly after takeoff from Charlotte Douglas International Airport en route to Greenville/ Spartanburg, S.C. The estates of the passengers from Flight 5481, or the passengers, or their estates, of any other future aircraft accident may seek to recover damages for death or injury. Although we believe our present insurance coverage is sufficient to cover any claims arising from the crash of Flight 5481, there can be no assurance that the insurance we carry to cover damages arising from these or any future accidents will be adequate. Accidents could also result in unforeseen mechanical and maintenance costs. In addition, any accident involving an aircraft that we operate could create a public perception that our aircraft are not safe, which could result in air travelers being reluctant to fly on our aircraft. To the extent a decrease is associated with our operations not covered by our code-share agreements, such a decrease could have a material adverse affect on our business, financial condition or results of operations.

If we become involved in any material litigation or any existing litigation is concluded in a manner adverse to us, our earnings may decline.

We are, from time to time, subject to various legal proceedings and claims, either asserted or unasserted. Any such claims, whether with or without merit, could be time-consuming and expensive to defend and could divert management's attention and resources. There can be no assurance regarding the outcome of current or future litigation.

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Our business would be harmed if we lose the services of our key personnel.

Our success depends to a large extent on the continued service of our executive management team. We have employment agreements with certain executive officers, but it is possible that members of executive management may leave us. Departures by our executive officers could have a negative impact on our business, as we may not be able to find suitable management personnel to replace departing executives on a timely basis. We do not maintain key-man life insurance on any of our executive officers.

We may experience difficulty finding, training and retaining employees.

Our business is labor-intensive, we require large numbers of pilots, flight attendants, maintenance technicians and other personnel and we anticipate that our expansion plans will require us to recruit, train and retain a significant number of new employees over the next several years.

The airline industry has from time to time experienced a shortage of qualified personnel, specifically pilots and maintenance technicians. In addition, as is common with most of our competitors, we have faced considerable turnover of our employees. Although our employee turnover has decreased significantly since September 11, 2001, our pilots, flight attendants and maintenance technicians often leave to work for larger airlines, which generally offer higher salaries and better benefit programs than regional airlines are financially able to offer. Should the turnover of employees, particularly pilots and maintenance technicians, sharply increase, the result will be significantly higher training costs than otherwise would be necessary. We cannot assure you that we will be able to recruit, train and retain the qualified employees that we need to carry out our expansion plans or replace departing employees. If we are unable to hire and retain qualified employees at a reasonable cost, we may be unable to complete our expansion plans, which could have a material adverse affect our financial condition, results of operations and the price of our common stock.

Risks Related to Our Industry

If competition in the airline industry increases, we may experience a decline in revenue.

Increased competition in the airline industry as well as competitive pressure on our code-share partners or in our markets could have a material adverse effect on our business, financial condition and results of operation. The airline industry is highly competitive. The earnings of many of the airlines have historically been volatile. The airline industry is susceptible to price discounting, which involves the offering of discount or promotional fares to passengers. Any such fares offered by one airline are normally matched by competing airlines, which may result in lower revenue per passenger, i.e., lower yields, without a corresponding increase in traffic levels. Also, in recent years several new carriers have entered the industry, typically with low cost structures. In some cases, new entrants have initiated or triggered price discounting. The entry of additional new major or regional carriers in any of our markets, as well as increased competition from or the introduction of new services by established carriers, could negatively impact our financial condition and results of operations.

Our reliance on our code-share agreements with our major airline partners for the majority of our revenue means that we must rely on the ability of our code-share partners to adequately promote their respective services and to maintain their respective market share. Competitive pressures by low-fare carriers and price discounting among major airlines could have a material adverse effect on our code-share partners and therefore adversely affect our business, financial condition and results of operations.

The results of operations in the air travel business historically fluctuate in response to general economic conditions. The airline industry is sensitive to changes in economic conditions that affect business and leisure travel and is highly susceptible to unforeseen events, such as political instability, regional hostilities, economic recession, fuel price increases, inflation, adverse weather conditions or other adverse occurrences that result in a decline in air travel. Any event that results in decreased travel or increased competition among airlines could have a material adverse effect on our business, financial condition and results of operations.

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In addition to traditional competition among airlines, the industry faces competition from ground and sea transportation alternatives. Video teleconferencing and other methods of electronic communication may add a new dimension of competition to the industry as business travelers seek lower-cost substitutes for air travel.

The airline industry is heavily regulated.

Airlines are subject to extensive regulatory and legal compliance requirements, both domestically and internationally, that involve significant costs. In the last several years, the FAA has issued a number of directives and other regulations relating to the maintenance and operation of aircraft that have required us to make significant expenditures. FAA requirements cover, among other things, retirement of older aircraft, security measures, collision avoidance systems, airborne wind shear avoidance systems, noise abatement, commuter aircraft safety and increased inspection and maintenance procedures to be conducted on older aircraft.

We incur substantial costs in maintaining our current certifications and otherwise complying with the laws, rules and regulations to which we are subject. We cannot predict whether we will be able to comply with all present and future laws, rules, regulations and certification requirements or that the cost of continued compliance will not significantly increase our costs of doing business, to the extent such costs are not reimbursed by our code-share partners.

The FAA has the authority to issue mandatory orders relating to, among other things, the grounding of aircraft, inspection of aircraft, installation of new safety-related items and removal and replacement of aircraft parts that have failed or may fail in the future. A decision by the FAA to ground, or require time consuming inspections of or maintenance on, all or any of our aircraft, for any reason, could negatively impact our results of operations.

In addition to state and federal regulation, airports and municipalities enact rules and regulations that affect our operations. From time to time, various airports throughout the country have considered limiting the use of smaller aircraft at such airports. The imposition of any limits on the use of our aircraft at any airport at which we operate could interfere with our obligations under our code-share agreements and severely interrupt our business operations.

Additional laws, regulations, taxes and airport rates and charges have been proposed from time to time that could significantly increase the cost of airline operations or reduce revenues. For instance, passenger bill of rights legislation was introduced in Congress in 2001 which would have, among other things, required the payment of compensation to passengers as a result of certain delays and limited the ability of carriers to prohibit or restrict usage of certain tickets. If adopted, these measures could have had the effect of raising ticket prices, reducing revenue and increasing costs. Restrictions on the ownership and transfer of airline routes and takeoff and landing slots have also been proposed. In addition, as a result of the terrorist attacks in New York and Washington, D.C. in September 2001, the FAA has imposed more stringent security procedures on airlines. We cannot predict what other new regulations may be imposed on airlines and we cannot assure you that laws or regulations enacted in the future will not materially adversely affect our financial condition, results of operations and the price of our common stock.

The airline industry has been subject to a number of strikes which could affect our business.

The airline industry has been negatively impacted by a number of labor strikes. Any new collective bargaining agreement entered into by other regional carriers may result in higher industry wages and add increased pressure on us to increase the wages and benefits of our employees. Furthermore, since each of our code-share partners is a significant source of revenue, any labor disruption or labor strike by the employees of any one of our code-share partners could have a material adverse effect on our financial condition, results of operations and the price of our common stock.

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Our articles of incorporation and bylaws contain provisions that, among other things:

authorize our board of directors to issue preferred stock ranking senior to our common stock without any action on the part of the shareholders;

establish advance notice procedures for shareholder proposals, including nominations of directors, to be considered at shareholders meetings;

authorize a majority of our board of directors, in certain circumstances, to fill vacancies on the board resulting from an increase in the authorized number of directors or from vacancies;

restrict the ability of shareholders to modify the number of authorized directors; and

restrict the ability of stockholders to call special meetings of shareholders.

In addition, Section 78.438 of the Nevada general corporation law prohibits us from entering into some business combinations with interested stockholders without the approval of our board of directors. These provisions could make it more difficult for a third party to acquire us, even if doing so would benefit our stockholders.

Our stock price may continue to be volatile and could decline substantially.

The stock market has, from time to time, experienced extreme price and volume fluctuations. Many factors may cause the market price for our common stock to decline following this Form 10-K, including:

our operating results failing to meet the expectations of securities analysts or investors in any quarter;

downward revisions in securities analysts' estimates;

material announcements by us or our competitors;

public sales of a substantial number of shares of our common stock following this Form 10-K;

governmental regulatory action; or

adverse changes in general market conditions or economic trends.

Item 2. *Properties*

Our primary property consists of the aircraft used in the operation of our flights. The following table lists the aircraft owned and leased by the Company as of September 30, 2004.

| Type of Aircraft | Number of Aircraft | | | | Operating on Sept. 30, 2004 | Passenger Capacity |
|--------------------------|--------------------|----------------------|--------|-------|--------------------------------|-----------------------|
| | Owned | Interim Financing | Leased | Total | | |
| CRJ-200/100 Regional Jet | 2 | | 52 | 54 | 54 | 50 |
| CRJ-700 Regional Jet | 5 | | 10 | 15 | 15 | 64 |
| CRJ-900 Regional Jet | 6 | 9 | 9 | 24 | 24 | 86 |

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| | | | | | | |
|--------------------------|-------------|-------------|-------------|-------------|-------------|----|
| Embraer 145 Regional Jet | | | 36 | 36 | 36 | 50 |
| Beechcraft 1900D | 35 | | | 35 | 35 | 19 |
| Dash 8-200 | | | 16 | 16 | 16 | 37 |
| Embraer EMB-120 | | | 6 | 6 | | 30 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> | |
| Total | 48 | 9 | 129 | 186 | 180 | |
| | | | | | | |

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See Business Airline Operations and MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS Liquidity and Capital Resources for a discussion regarding the Company's aircraft fleet commitments.

In addition to aircraft, we have office and maintenance facilities to support our operations. Our facilities are summarized in the following table:

| Type | Location | Ownership | Approximate Square Feet |
|---|--------------------|-----------|-------------------------|
| Headquarters | Phoenix, AZ | Leased | 27,000 |
| Training/ Administration | Phoenix, AZ | Leased | 27,000 |
| Hangar/ Office | Phoenix, AZ | Leased | 22,000 |
| Engine Shop & Commissary | Phoenix, AZ | Leased | 25,000 |
| RAS Office/ Component Overhaul Facility | Phoenix, AZ | Leased | 19,000 |
| Customer Service Training/ Storage | Phoenix, AZ | Leased | 10,000 |
| Office (East Coast) | Charlotte, NC | Leased | 5,500 |
| Hangar | Charlotte, NC | Leased | 30,000 |
| Hangar | Columbia, SC | (1) | 20,000 |
| Hangar | Grand Junction, CO | (1) | 25,000 |
| Hangar/ Office | Wichita, KS | (1) | 20,000 |
| Training/ Administration | Farmington, NM | (1) | 10,000 |
| Hangar | Farmington, NM | (1) | 24,000 |
| Hangar/ Office | Dubois, PA | (1) | 23,000 |
| Hangar | Little Rock, AR | Leased | 10,000 |
| Hangar | Philadelphia, PA | Leased | 10,000 |
| Hangar | Reading, PA | (1) | 30,000 |
| Hangar (RAS) | Reading, PA | (1) | 32,000 |

(1) Building is owned, underlying land is leased.

We lease ticket counters, check-in and boarding and other facilities in the passenger terminal areas in the majority of the airports we serve and staff those facilities with our personnel. America West, US Airways and United also provide facilities, ticket handling and ground support services for the Company at certain airports.

Our corporate headquarters and Training/ Administrative facilities in Phoenix, Arizona are subject to long-term leases expiring on August 31, 2012 and November 1, 2012, respectively.

We believe our facilities are suitable and adequate for our current and anticipated needs.

Item 3. Legal Proceedings

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

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

None.

Table of Contents**Executive Officers of the Registrant**

The following table sets forth the names and ages of the executive officers of the Company and certain additional information:

| Name | Age | Position |
|----------------------|-----|--|
| Jonathan G. Ornstein | 47 | Chief Executive Officer |
| Michael J. Lotz | 44 | President and Chief Operating Officer |
| George Murnane III | 46 | Executive Vice President and Chief Financial Officer |
| Michael Ferwerda | 60 | Senior Vice President West Coast Operations |
| Brian S. Gillman | 35 | Vice President, General Counsel and Secretary |
| F. Carter Leake | 42 | Senior Vice President East Coast Operations |
| Edward J. Wegel | 46 | Senior Vice President Corporate Planning |

Jonathan G. Ornstein was appointed President and Chief Executive Officer of Mesa Air Group, Inc. effective May 1, 1998. Mr. Ornstein relinquished his position as President of the Company in June 2000. From April 1996 to his joining the Company as Chief Executive Officer, Mr. Ornstein served as President and Chief Executive Officer and Chairman of Virgin Express S.A./N.V., a European airline. From 1995 to April 1996, Mr. Ornstein served as Chief Executive Officer of Virgin Express Holdings, Inc. Mr. Ornstein joined Continental Express Airlines, Inc., as President and Chief Executive Officer in July 1994 and, in November 1994, was named Senior Vice President, Airport Services at Continental Airlines, Inc. Mr. Ornstein was previously employed by the Company from 1988 to 1994, as Executive Vice President and as President of the Company's WestAir Holding, Inc. subsidiary.

Michael J. Lotz, President and Chief Operating Officer, joined the Company in July 1998. In January 1999, Mr. Lotz became Chief Operating Officer. In August 1999, Mr. Lotz became the Company's Chief Financial Officer and in January 2000 returned to the position of Chief Operating Officer. On June 22, 2000, Mr. Lotz was appointed President of the Company. Prior to joining the Company, Mr. Lotz served as Chief Operating Officer of Virgin Express, S.A./N.V., a position he held from October 1996 to June 1998. Previously, Mr. Lotz was employed by Continental Airlines, Inc., most recently as Vice President of Airport Operations, Properties and Facilities at Continental Express.

George Murnane III, Executive Vice President and Chief Financial Officer, was appointed Executive Vice President of the Company effective December 2001 and Chief Financial Officer in January 2003. Mr. Murnane served as a director of the Company from June 1999 until October 2003. Mr. Murnane has served as the President of Barlow Management, Inc. from 1998 until October 2003. From 1996 to December 2001, Mr. Murnane was a Director and Executive Vice President of International Airline Support Group, Inc., a redistributor of aftermarket commercial aircraft spare parts and lessor and trader of commercial aircraft and engines, most recently as its Chief Operating Officer. From 1995 to 1996, Mr. Murnane served as Executive Vice President and Chief Operating Officer of Atlas Air, Inc., an air cargo company. From 1986 to 1996, he was an investment banker with the New York investment banking firm of Merrill Lynch & Co., most recently as a Director in the firm's Transportation Group.

Michael Ferwerda, Senior Vice President West Coast Operations joined the Company in 1990. He was appointed President of Freedom Airlines in May 2002 and Senior Vice President West Coast Operations in February 2003. Prior to the appointments, Mr. Ferwerda served as the Senior Vice President of Operations for Mesa Airlines, Inc. Mr. Ferwerda has served the Company in various capacities including pilot, Flight Instructor/ Check Airman, Assistant Chief Pilot, FAA Designated Examiner, FAA Director of Operations and Divisional Vice President. Mr. Ferwerda was a pilot with Eastern Airlines from 1973 to 1989. Prior to joining Eastern Airlines, Mr. Ferwerda served as an Aviator in the United States Navy. Mr. Ferwerda is a graduate of Indiana University.

Brian S. Gillman, Vice President, General Counsel and Secretary, joined the Company in February 2001. From July 1996 to February 2001, he served as Vice President, General Counsel and Secretary of Vanguard

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Airlines, Inc. in Kansas City, Missouri. From September 1994 to July 1996, Mr. Gillman was a corporate associate in the law firm of Stinson, Mag & Fizzell, P.C., Kansas City, Missouri. Mr. Gillman received his Juris Doctorate and B.B.A. in Accounting from the University of Iowa in 1994 and 1991, respectively.

F. Carter Leake, Senior Vice President – East Coast Operations, joined the Company in 2001. Mr. Leake served as Executive Vice-President of CCAir, Inc., a former wholly-owned subsidiary of the Company in January 2001 and was promoted to President of CCAir in October 2001. In February 2003, Mr. Leake was appointed to Senior Vice President – East Coast Operations. Prior to joining the Company, Mr. Leake served as a Director of Sales for Bombardier Regional Aircraft from November 1996 to January 2001. Previously, Mr. Leake was an analyst with SH&E, an aviation consulting firm in New York, and a US Air Force military pilot.

Edward J. Wegel, Senior Vice President, Corporate Planning, joined the Company in February 2004. From 1999 to February 2004, he was a consultant to the airline industry. From 1997 to 1999, he served as the President and Chief Executive Officer of Chautauqua Airlines, a US Airways Express carrier. From 1994 to 1996, he served as President and Chief Operating Officer of BWIA, the national airline of Trinidad. Mr. Wegel participated as a co-founder in the start-up of Atlantic Coast Airlines, served on the Atlantic Coast Board of Directors from 1991 to 1996 and also as Senior Vice President – Corporate Finance from 1991 to 1995. From 1987 to 1991, Mr. Wegel worked at Shearson Lehman Brothers where he specialized in aircraft finance. Prior to joining Shearson Lehman, he worked on the finance, operations and marketing staff of Eastern Airlines. Mr. Wegel graduated from the US Military Academy at West Point with a Bachelor of Science in Engineering and from the University of Northern Colorado with an MBA in Finance.

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity and Related Stockholder Matters**
Market Price of Common Stock

The following table sets forth, for the periods indicated, the high and low price per share of Mesa common stock for the two most recent fiscal years, as reported by NASDAQ. Mesa's common stock is traded on the NASDAQ National Market System under the symbol MESA.

| Quarter | Fiscal 2004 | | Fiscal 2003 | |
|---------|-------------|----------|-------------|---------|
| | High | Low | High | Low |
| First | \$ 13.85 | \$ 10.17 | \$ 7.09 | \$ 2.71 |
| Second | 12.45 | 7.48 | 4.97 | 3.00 |
| Third | 9.01 | 6.56 | 7.96 | 4.50 |
| Fourth | 8.12 | 5.10 | 13.20 | 8.42 |

On December 1, 2004, we had approximately 1,137 shareholders of record. We have never paid cash dividends on our common stock. The payment of future dividends is within the discretion of our board of directors and will depend upon our future earnings, if any, our capital requirements, bank financing, financial condition and other relevant factors.

Recent Sales of Unregistered Securities

On February 7, 2002, in connection with an agreement entered into with Raytheon Aircraft Company (Raytheon), we granted Raytheon a warrant to purchase up to 233,068 shares of our common stock at a per share exercise price of \$10. Raytheon must pay a purchase price of \$1.50 per share underlying the warrant. The warrant is exercisable at any time over a three-year period following its date of issuance. Absent a default by us under the agreement with Raytheon in which case vesting is accelerated, the shares underlying the warrant vest (and are therefore purchasable by Raytheon) according to the following schedule: 13,401 shares in fiscal year 2001; 116,534 shares in fiscal year 2002; 58,267 shares in fiscal year 2003 and 44,866 shares in fiscal year 2004. As of December 1, 2004, Raytheon has exercised its option to purchase the 2001, 2002 and 2003 components of the warrant, but has not yet exercised its option to purchase the 2004 component of the warrant. In addition, Raytheon has not exercised any component of the warrant. The sale of the warrant and the shares underlying the warrant were made pursuant to an exemption from registration pursuant to Section 4(2) under the Securities Act of 1933, as amended.

In June 2003, the Company completed the private placement of senior convertible notes due 2023, raising approximately \$97.1 million net proceeds. At maturity, the principal amount of each note will be \$1,000 and the aggregate amount due will be \$252 million. These notes are convertible into shares of the Company's common stock at a conversion rate of 39.727 shares per \$1,000 in principal amount at maturity of the notes, which equals an initial conversion price of approximately \$10.00 per share. This conversion rate is subject to adjustment in certain circumstances. Holders of these notes may convert their notes only if: (i) the sale price of our common stock exceeds 110% of the accreted conversion price for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding quarter; (ii) prior to June 16, 2018, the trading price for these notes falls below certain thresholds; (iii) these notes have been called for redemption; or (iv) specified corporate transactions occur. The Company may redeem these notes, in whole or in part, beginning on June 16, 2008, at a redemption price equal to the issue price, plus accrued original issue discount, plus any accrued and unpaid cash interest. The holders of these notes may require the Company to repurchase the notes on June 16, 2008 at a price of \$397.27 per note plus accrued and unpaid cash interest, if any, on June 16, 2013 at a price of \$540.41 per note plus accrued and unpaid cash interest, if any, and on June 16, 2018 at a price of \$735.13 per note plus accrued and unpaid cash interest, if any.

In February 2004, the Company completed the private placement of senior convertible notes due 2024, raising approximately \$97.0 million net proceeds. At maturity, the principal amount of each note will be \$1,000 and the aggregate amount due will be \$171.4 million. These notes are convertible into shares of the

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Company's common stock at a conversion rate of 40.3737 shares per \$1,000 in principal amount at maturity of the notes, which equals an initial conversion price of approximately \$14.45 per share. This conversion rate is subject to adjustment in certain circumstances. Holders of these notes may convert their notes only if: (i) the sale price of our common stock exceeds 110% of the accreted conversion price for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding quarter; (ii) prior to February 10, 2019, the trading price for these notes falls below certain thresholds; (iii) these notes have been called for redemption; or (iv) specified corporate transactions occur. The Company may redeem these notes, in whole or in part, beginning on February 10, 2009, at a redemption price equal to the issue price, plus accrued original issue discount, plus any accrued and unpaid cash interest. The holders of the notes may require the Company to repurchase the notes on February 10, 2009 at a price of \$583.4 per note plus accrued and unpaid cash interest, if any, on February 10, 2014 at a price of \$698.20 per note plus accrued and unpaid cash interest, if any, and on February 10, 2019 at a price of \$835.58 per note plus accrued and unpaid cash interest, if any.

The following table sets forth information required regarding repurchases of common stock that we made during the three months ended September 30, 2004:

Issuer Purchases of Equity Securities

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plan (1) | Maximum Number of Shares that May Yet Be Purchased Under the Plan |
|----------------|----------------------------------|------------------------------|---|---|
| July 2004 | 372,880 | \$ 6.65 | 5,156,546 | 1,243,454 |
| August 2004 | 583,214 | \$ 6.35 | 5,739,760 | 660,240 |
| September 2004 | 553,684 | \$ 5.56 | 6,293,444 | 106,556 |
| Total | 1,509,778 | | | |

- (1) Under resolutions adopted and publicly announced in December, 1999, January 2001 and October 2002, our Board of Directors has authorized the repurchase, at management's discretion, of up to an aggregate of 6.4 million shares of our common stock.

Item 6. Selected Financial Data
Selected Financial Data and Operating Statistics

The selected financial data as of and for each of the five years ended September 30, 2004, are derived from the Consolidated Financial Statements of the Company and its subsidiaries and should be read in conjunction with the Consolidated Financial Statements included elsewhere in this Form 10-K and the related notes thereto and MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

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In thousands of dollars except per share data and average fare amounts and as otherwise indicated.

| | 2004(1) | 2003(2) | 2002(3) | 2001(4) | 2000(5) |
|---|--------------|-------------|-------------|-------------|------------|
| Consolidated Statement of Operations Data: | | | | | |
| Operating revenues | \$ 896,812 | \$ 599,990 | \$ 496,783 | \$ 523,378 | \$ 471,612 |
| Operating expenses | \$ 829,454 | \$ 544,711 | \$ 503,343 | \$ 593,291 | \$ 429,888 |
| Operating income (loss) | \$ 67,358 | \$ 55,279 | \$ (6,560) | \$ (69,913) | \$ 41,724 |
| Interest expense | \$ 25,063 | \$ 12,664 | \$ 7,983 | \$ 14,419 | \$ 15,721 |
| Income (loss) before income taxes | \$ 45,181 | \$ 41,020 | \$ (16,405) | \$ (71,596) | \$ 27,683 |
| Net income (loss) | \$ 26,282 | \$ 25,305 | \$ (11,268) | \$ (48,225) | \$ 58,636 |
| Net income (loss) per share: | | | | | |
| Basic | \$ 0.83 | \$ 0.80 | \$ (0.34) | \$ (1.50) | \$ 1.77 |
| Diluted | \$ 0.70 | \$ 0.76 | \$ (0.34) | \$ (1.50) | \$ 1.77 |
| Consolidated Balance Sheet Data: | | | | | |
| Working capital (deficit) | \$ 13,563 | \$ (57,380) | \$ 27,483 | \$ 6,399 | \$ 63,953 |
| Total assets | \$ 1,121,537 | \$ 716,936 | \$ 399,161 | \$ 496,616 | \$ 386,707 |
| Long-term debt, excluding current Portion | \$ 550,613 | \$ 199,023 | \$ 110,210 | \$ 118,492 | \$ 136,127 |
| Stockholders equity | \$ 128,904 | \$ 111,973 | \$ 86,758 | \$ 102,742 | \$ 144,339 |
| Consolidated Operating Statistics: | | | | | |
| Passengers carried | 10,239,915 | 6,444,459 | 5,118,839 | 4,789,180 | 4,457,989 |
| Revenue passenger miles (000) | 5,035,165 | 2,814,480 | 1,986,164 | 1,796,058 | 1,561,197 |
| Available seat miles (ASM) (000) | 7,107,684 | 4,453,707 | 3,459,427 | 3,289,216 | 2,951,116 |
| Block hours | 513,881 | 393,335 | 352,323 | 383,310 | 395,446 |
| Average passenger journey in miles | 492 | 436 | 388 | 375 | 350 |
| Average stage length in miles | 390 | 337 | 298 | 268 | 250 |
| Load factor | 70.8% | 63.2% | 57.4% | 54.6% | 52.9% |
| Break-even passenger load factor | 53.6% | 46.3% | 60.1% | 63.8% | 48.5% |
| Revenue per ASM in cents | 12.6 | 13.4 | 14.4 | 15.9 | 16.0 |
| Operating cost per ASM in cents | 11.7 | 12.3 | 14.6 | 18.0 | 14.6 |
| Average yield per revenue passenger mile in cents | 17.8 | 21.3 | 25.0 | 28.8 | 30.2 |
| Average fare | \$ 84.81 | \$ 89.44 | \$ 93.93 | \$ 106.18 | \$ 103.45 |
| Aircraft in service | 180 | 150 | 124 | 118 | 133 |
| Cities served | 181 | 163 | 147 | 153 | 120 |
| Number of employees | 5,000 | 3,600 | 3,100 | 2,820 | 3,480 |

- (1) Net income in fiscal 2004 includes the net effect of impairment and restructuring charges of \$11.9 million (pretax).
- (2) Net income in fiscal 2003 includes the effect of impairment and restructuring charges of \$1.1 million (pretax) and the reversal of CCAir impairment and restructuring charges of \$12.0 million (pretax).
- (3) Net loss in fiscal 2002 includes the effect of impairment and restructuring charges of \$26.7 million (pretax).

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- (4) Net loss in fiscal 2001 includes the effect of impairment and restructuring charges of \$80.9 million (pretax).
- (5) Net earnings in fiscal 2000 include the cumulative effect of the accounting change from the accrual method to the direct expense method for maintenance costs of \$18.1 million (pretax) and the benefit of reversing a valuation allowance for deferred tax assets of \$21.9 million.

Item 7. 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 Statistics contained elsewhere herein.

Executive Overview*General*

Mesa Air Group, Inc. and its subsidiaries (collectively referred to herein as *Mesa* or the *Company*) is an independent regional airline serving 181 cities in 43 states, the District of Columbia, the Bahamas and Mexico. At September 30, 2004, Mesa operated a fleet of 180 aircraft and had approximately 1,000 daily departures.

Mesa's airline operations during fiscal year 2004 were primarily conducted by three regional airline subsidiaries primarily utilizing hub-and-spoke systems. Mesa Airlines, a wholly owned subsidiary of Mesa, operates as America West Express under a code-share and revenue-sharing agreement with America West Airlines, Inc., as US Airways Express under a code-sharing agreement with US Airways, Inc. and as United Express under a code-sharing agreement with United. Air Midwest, a wholly owned subsidiary of Mesa, operates under a code-sharing agreement with US Airways and flies as US Airways Express and also operates an independent division, doing business as Mesa Airlines, from Albuquerque, New Mexico and Dallas, Texas. Air Midwest flights flown as Mesa Airlines in Phoenix operate under a code-sharing agreement with America West. Air Midwest also has a code-sharing agreement with Midwest Airlines in Kansas City on flights operated as US Airways Express. In addition, Freedom Airlines, a wholly owned subsidiary of Mesa Air Group began operating as America West Express pursuant to the code-share and revenue-sharing agreement with America West in October 2002. As of November 2004, all of the CRJ aircraft previously operated by Freedom have been transitioned to Mesa Airlines. Freedom is currently pursuing certification to operate Beechcraft 1900D aircraft.

Fleet

In fiscal 2004, the Company continued its regional jet fleet growth by growing from 96 regional jets at September 30, 2003 to 129 regional jets at September 30, 2004. The Company also continues to reduce its fleet of B1900 aircraft from 42 at September 30, 2003 to 35 at September 30, 2004.

Aircraft in Operation at September 30,

| Type of Aircraft | 2004 | 2003 | 2002 |
|--------------------------|-------|-------|-------|
| CRJ-200/100 Regional Jet | 54 | 43 | 34 |
| CRJ-700 Regional Jet | 15 | 15 | 2 |
| CRJ-900 Regional Jet | 24 | 6 | |
| Embraer 145 Regional Jet | 36 | 32 | 32 |
| Beechcraft 1900D | 35 | 42 | 46 |
| Dash 8-200 | 16 | 12 | 18 |
| | <hr/> | <hr/> | <hr/> |
| Total | 180 | 150 | 124 |
| | <hr/> | <hr/> | <hr/> |

Table of Contents*Code-Share Agreements*

On September 12, 2004, US Airways, which represented approximately 40% of the Company's fiscal 2004 passenger revenue, filed a petition for Chapter 11 bankruptcy protection. Unpaid amounts related to pre-petition obligations, net of any amounts owed by the Company to US Airways, were less than \$3 million and the Company believes it is adequately reserved. The Company has been paid for all amounts due post petition in accordance with contractual terms and continues to operate its normal flight schedule. In addition, the Company has developed a number of contingency plans to address potential outcomes of US Airways' bankruptcy.

Summary of Financial Results

Mesa Air Group recorded consolidated net income of \$26.3 million in fiscal 2004, representing diluted earnings per share of \$0.70. This compares to consolidated net income of \$25.3 million or \$0.76 per share in fiscal 2003 and a consolidated net loss of \$11.3 million in fiscal 2002.

The fiscal 2004 results included \$12.4 million in costs to terminate the leases of seven Beechcraft 1900D aircraft, one-time compensation payments of \$3.4 million, merger costs of \$3.4 million related to our failed attempt to merge with Atlantic Coast Airlines, the reversal of certain restructuring liabilities of \$0.5 million and investment income of \$0.6 million.

The fiscal 2003 results included the reversal of \$12.0 million in restructuring liabilities related to the closure of CCAir, \$1.1 million in costs of returning Beechcraft 1900D aircraft to the manufacturer, a \$4.1 million settlement with the DOT related to payments made to the Company under the Air Transportation Safety and System Stabilization Act, \$1.0 million in TSA funds collected on the Company's behalf by other airlines, a gain on the involuntary conversion of an aircraft of \$1.3 million related to the crash of Flight 5481 and an investment loss of \$0.7 million.

The fiscal 2002 results included an impairment and restructuring charge of \$26.7 million primarily comprised of costs related to the shut down of CCAir.

Results of Operations

The following tables set forth selected operating and financial data of the Company for the years indicated below.

| | Operating Data | | |
|--|----------------------------------|-------------|-------------|
| | Years Ended September 30, | | |
| | 2004 | 2003 | 2002 |
| Passengers | 10,239,915 | 6,444,459 | 5,118,839 |
| Available seat miles (ASM)(000s) | 7,107,684 | 4,453,707 | 3,459,427 |
| Revenue passenger miles (000s) | 5,035,165 | 2,814,480 | 1,986,164 |
| Load factor | 70.8% | 63.2% | 57.4% |
| Yield per revenue passenger mile (cents) | 17.8 | 21.3 | 25.0 |
| Revenue per ASM (cents) | 12.6 | 13.4 | 14.4 |
| Operating cost per ASM (cents) | 11.7 | 12.3 | 14.6 |
| Average stage length (miles) | 390 | 337 | 298 |
| Number of operating aircraft in fleet | 180 | 150 | 124 |
| Gallons of fuel consumed | 170,867,222 | 115,640,808 | 90,969,241 |
| Block hours flown | 513,881 | 393,335 | 352,323 |
| Departures | 353,083 | 296,921 | 285,680 |

Table of Contents**Operating Expense Data****Years Ended****September 30, 2004, 2003 and 2002**

| | 2004 | | | 2003 | | | 2002 | | |
|--|------------------|---------------------------------|-------------------------------|------------------|---------------------------------|-------------------------------|------------------|---------------------------------|-------------------------------|
| | Amount (000s) | Percent of Total Revenues | Cost Per ASM (cents) | Amount (000s) | Percent of Total Revenues | Cost Per ASM (cents) | Amount (000s) | Percent of Total Revenues | Cost Per ASM (cents) |
| Flight operations | \$297,521 | 33.2% | 4.2 | \$212,080 | 35.3% | 4.8 | \$178,158 | 35.9% | 5.1 |
| Fuel | 194,510 | 21.7% | 2.7 | 113,370 | 18.9% | 2.5 | 78,200 | 15.7% | 2.3 |
| Maintenance | 163,463 | 18.2% | 2.3 | 118,517 | 19.8% | 2.6 | 103,300 | 20.8% | 3.0 |
| Aircraft & traffic servicing | 66,223 | 7.4% | 0.9 | 50,053 | 8.3% | 1.1 | 46,057 | 9.3% | 1.3 |
| Promotion & sales | 5,806 | 0.6% | 0.1 | 7,966 | 1.3% | 0.2 | 12,663 | 2.5% | 0.4 |
| General & Administrative | 62,035 | 6.9% | 0.9 | 37,982 | 6.3% | 0.9 | 44,140 | 8.9% | 1.3 |
| Depreciation & amortization | 28,001 | 3.2% | 0.4 | 15,700 | 2.6% | 0.4 | 14,150 | 2.8% | 0.4 |
| Impairment and restructuring charge | 11,895 | 1.3% | 0.2 | (10,957) | (1.7)% | (0.3) | 26,675 | 5.4% | 0.8 |
| Total operating expenses | 829,454 | 92.5% | 11.7 | 544,711 | 90.8% | 12.2 | 503,343 | 101.3% | 14.5 |
| Interest expense | 25,063 | 2.8% | 0.4 | 12,664 | 2.1% | 0.3 | 7,983 | 1.6% | 0.2 |
| Other income (expense) | 1,723 | 0.0% | 0.0 | (2,758) | (0.5)% | (0.1) | (3,404) | (0.7)% | (0.1) |

Note: Numbers in the table above may not be recalculated due to rounding

| Year Ended September 30, 2004 (000 s) | Mesa/ Freedom | Air Midwest | Other | Elimination | Total |
|--|------------------|----------------|-----------|-------------|-----------|
| Total operating revenues | \$807,736 | \$81,714 | \$365,858 | \$(358,496) | \$896,812 |
| Total operating expenses | 725,975 | 91,349 | 313,243 | (301,113) | 829,454 |
| Operating income (loss) | 81,761 | (9,635) | 52,615 | (57,383) | 67,358 |

| Year Ended September 30, 2003 (000 s) | Mesa/ Freedom | Air Midwest | CCAir | Other | Elimination | Total |
|--|------------------|----------------|----------|-----------|-------------|-----------|
| Total operating revenues | \$507,555 | \$86,142 | \$1,254 | \$175,956 | \$(170,917) | \$599,990 |
| Total operating expenses | 462,018 | 95,533 | (10,556) | 131,922 | (134,206) | 544,711 |
| Operating income (loss) | 45,537 | (9,391) | 11,810 | 44,034 | (36,711) | 55,279 |

Year Ended Mesa/ Air

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| September 30, 2002 (000 \$) | Freedom | Midwest | CCAir | Other | Elimination | Total |
|-----------------------------|------------|-----------|-----------|----------|-------------|------------|
| Total operating revenues | \$ 372,370 | \$ 94,333 | \$ 24,335 | \$ 5,745 | \$ | \$ 496,783 |
| Total operating expenses | 347,749 | 92,208 | 58,418 | 4,968 | — | 503,343 |
| Operating income (loss) | 24,621 | 2,125 | (34,083) | 777 | — | (6,560) |

All of the Company's Beechcraft 1900D aircraft are owned by Mesa Airlines. As such, the associated aircraft and debt are recorded on the separate company financial statements of Mesa Airlines. These aircraft are operated by Air Midwest, and as a result, Mesa charges Air Midwest rent to offset its depreciation and

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interest cost. Any impairment charges related to these aircraft are recorded on the separate company financial statements of Mesa Airlines.

Fiscal 2004 Versus Fiscal 2003***Operating Revenues***

In fiscal 2004, operating revenue increased by \$296.8 million, or 49.5%, from \$600.0 million to \$896.8 million. The increase in revenue is primarily attributable to a \$300.2 million increase in revenue associated with the operation of 39 additional regional jets flown by Mesa and Freedom compared to 2003. Offsetting this increase was a decrease in passenger revenue of approximately \$7.8 million at Air Midwest. The decrease in passenger revenue at Air Midwest was primarily due to a decline in passengers carried as a result of parking seven leased aircraft in the second quarter (the leases on these aircraft were subsequently early terminated, with five aircraft returned to the lessor and two purchased and resold). However, EAS subsidies received by Air Midwest increased by \$3.6 million as a result of additional markets served and higher subsidy rates on existing markets.

Operating Expenses***Flight Operations***

In fiscal 2004, flight operations expense increased \$85.4 million or 40.3%, to \$297.5 million from \$212.1 million for fiscal 2003. On an ASM basis, flight operations expense decreased 12.5% to 4.2 cents per ASM in fiscal 2004 from 4.8 cents per ASM in fiscal 2003. The increase in expense is consistent with the increased capacity from the regional jets added to Mesa and Freedom's fleet during this period. The decrease on an ASM basis is due to the addition of larger regional jets at Mesa and Freedom and the reduction in turboprop aircraft at Air Midwest.

Fuel

In fiscal 2004, fuel expense increased \$81.1 million or 71.6%, to \$194.5 million from \$113.4 million for fiscal 2003. On an ASM basis, fuel expense increased 8.0% to 2.7 cents per ASM in fiscal 2004 from 2.5 cents per ASM in fiscal 2003. Into-plane fuel cost increased 16% per gallon, resulting in a \$26.2 million unfavorable price variance and consumption increased 48% resulting in a \$54.1 million unfavorable volume variance (excluding fuel used in other operations). The increase in volume was due to the additional regional jets added to the fleet. In fiscal 2004 approximately 92% of our fuel costs were reimbursed by our code-share partners.

Maintenance Expense

In fiscal 2004, maintenance expense increased \$44.9 million or 37.9%, to \$163.5 million from \$118.5 million for fiscal 2003. On an ASM basis, maintenance expense decreased 11.5% to 2.3 cents per ASM in fiscal 2004 from 2.6 cents per ASM in fiscal 2003. Mesa and Freedom's maintenance expense increased \$40.3 million primarily as a result of increases in the number of aircraft in their fleet, repair costs on certain rotatable parts, headcount and engine overhaul expenses. Maintenance expenses in the Other segment increased \$6.8 million due to increases in rotatable repair expenses and certain purchasing related administrative expenses at our procurement company. These increases were offset by a \$1.3 million decrease in maintenance expenses at CCAIR, due to its dissolution, and a \$0.9 million decrease at Air Midwest as a result of reductions in its fleet. The decrease on an ASM basis is due to the lower maintenance costs associated with adding new jets into the Company's fleet.

Aircraft and Traffic Servicing

In fiscal 2004, aircraft and traffic servicing expense increased by \$16.2 million or 32.3%, to \$66.2 million from \$50.1 million for fiscal 2003. On an ASM basis, aircraft and traffic servicing expense decreased 18.2% to 0.9 cents per ASM in fiscal 2004 from 1.1 cents per ASM in fiscal 2003. The increase in expense is primarily related to a 19% increase in regional jet departures. The decrease on an ASM basis is due to the efficiencies

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attained by adding additional regional jets at Mesa and Freedom and the reduction in turboprop aircraft at Air Midwest.

Promotion and Sales

In fiscal 2004, promotion and sales expense decreased \$2.2 million or 27.1%, to \$5.8 million from \$8.0 million for fiscal 2003. On an ASM basis, promotion and sales expense decreased 50.0% to 0.1 cents per ASM in fiscal 2004 from 0.2 cents per ASM in fiscal 2003. The decrease in expense is due to a decline in booking and franchise fees paid by Air Midwest under the Company's pro-rate agreements with its code-share partners, caused by a decline in passengers carried under these agreements. The Company does not pay these fees under its regional jet revenue-guarantee contracts.

General and Administrative

In fiscal 2004, general and administrative expense increased \$24.1 million or 63.3%, to \$62.0 million from \$38.0 million for fiscal 2003. On an ASM basis, general and administrative expense remained the same at 0.9 cents per ASM in fiscal 2004 and 2003. The increase in expense includes \$3.4 million in costs associated with the failed merger with Atlantic Coast Airlines, Inc., \$3.4 million in executive compensation as a result of the restructuring of employment contracts of top executives, a \$6.1 million increase in bad debt expense as the Company increased its allowance for doubtful accounts by \$4.3 million in fiscal 2004 (the Company reduced its allowance by \$1.8 million in fiscal 2003), a \$3.6 million increase in passenger liability insurance associated with increases in the Company's fleet, a \$1.2 million increase in property taxes associated with increases in the Company's fleet, a \$3.6 million increase in administrative wages and benefits and a \$2.2 million increase in health insurance costs as a result of increased headcount.

Depreciation and Amortization

In fiscal 2004, depreciation and amortization expense increased \$12.3 million or 78.4%, to \$28.0 million from \$15.7 million for fiscal 2003. On an ASM basis, depreciation and amortization expense remained the same at 0.4 cents per ASM in fiscal 2004 and 2003. The increase in expense is primarily due to the purchase of 11 regional jets in 2004, the acquisition of two CRJ200 aircraft acquired as part of the purchase of Midway assets, depreciation of aircraft on interim financing and an increase in rotatable aircraft inventory at Mesa and Freedom.

Impairment and Restructuring Charges

In fiscal 2004, the Company recognized an impairment charge of \$12.4 million related to the early termination of leases on seven B1900D aircraft. The Company negotiated the terms of the early return with the majority of the aircraft lessors and took a charge that included \$2.4 million for the present value of future lease payments, \$2.4 million for the negotiated settlement of return conditions, \$1.2 million for the cancellation of maintenance agreements, \$0.8 million to reduce maintenance deposits to net realizable value, \$4.5 million to reduce the value of rotatable and expendable inventory to fair value less costs to sell. The Company was forced to purchase two of the aircraft from the lessors, which were subsequently scrapped. As a result, the Company also took a \$1.1 million impairment charge for the difference between the buy out of the lease and the subsequent sale of the aircraft. These charges were offset by the reversal of \$0.4 million of prior year restructuring charges.

In fiscal 2003, the Company recognized an additional impairment charge of \$1.1 million related to the costs of returning Beechcraft 1900D aircraft to the manufacturer. The Company also reversed \$7.4 million in restructuring charges for future aircraft leases related to CCAir aircraft that were returned to the lessor and \$4.6 million in aircraft related return costs for these same aircraft.

Interest Expense

In fiscal 2004, interest expense increased \$12.4 million or 97.9%, to \$25.1 million from \$12.7 million for fiscal 2003. The increase in interest expense is primarily comprised of \$8.6 million in interest on the senior

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convertible notes and an increase of \$4.5 million in interest on interim and permanently financed aircraft debt. These increases were offset by a decrease of \$1.3 million in interest expense on the Company's B1900 debt due to aircraft returns and principal payments.

Other Income (Expense)

In fiscal 2004, other income (expense) increased \$4.5 million or 162%, to income of \$1.7 million from expense of \$2.8 million for fiscal 2003. In fiscal 2004, other income is primarily comprised of investment income of \$0.6 million related to the Company's portfolio of aviation related securities.

In fiscal 2003, other expense is primarily comprised of the settlement with the DOT of \$4.1 million related to payments made to the Company under the Air Transportation Safety and System Stabilization Act and \$0.7 million in net investment related losses on the Company's portfolio of aviation related securities. These expenses were offset by the gain on an involuntary conversion of an aircraft of \$1.3 million related to the crash of Flight 5481 as well as \$1.0 million for TSA funds collected on the Company's behalf by US Airways and Frontier.

Minority Interest

Amounts included in minority interest in fiscal 2003 reflect the after-tax portion of earnings of UFLY, LLC that are applicable to the minority interest partners. UFLY was dissolved in fiscal 2003.

Fiscal 2003 Versus Fiscal 2002

Operating Revenues

In fiscal 2003, operating revenues increased by \$103.2 million (20.8%) to \$600.0 million, from \$496.8 million in fiscal 2002. Mesa and Freedom revenue increased \$135.2 million. The primary reason for the increase was the additional revenue derived from placing 30 regional jets into service in 2003. Offsetting this increase, pro-rate revenue at Air Midwest decreased \$8.2 million and pro-rate revenue at CCAir decreased \$23.1 million. The decrease in pro-rate revenue was primarily due to a 31% decrease in passengers carried by Air Midwest and CCAir, the reduction of four turboprop aircraft in service (as a result of the cessation of CCAir's operations), as well as a nine percent decrease in the average fare as a result of industry economic conditions. Under revenue-guarantee contracts, we are substantially insulated from industry passenger trends.

Operating Expenses

Flight Operations

In fiscal 2003, flight operations expense increased 19.0% to \$212.1 million (4.8 cents per ASM) from \$178.2 million (5.1 cents per ASM) in fiscal 2002. Flight operations expense for Mesa and Freedom increased \$54.3 million due to the additional costs associated with operating 30 additional regional jets placed in service in 2003, net of any purchase incentives received in conjunction with the additional jets. This increase was offset by a decrease of \$14.2 million in flight operations expense at CCAir, due to the cessation of its operations in November of 2002. The decrease on a cost per ASM basis for the year ended September 30, 2003, is a result of the increase in both the proportion of regional jets to turboprops, as well as the addition of larger regional jets which, on a relative basis, produce more ASMs per mile. Regional jets generally have lower operating costs per ASM than turboprop aircraft.

Fuel

In fiscal 2003, fuel expense increased 45.0% to \$113.4 million (2.5 cents per ASM) from \$78.2 million (2.3 cents per ASM) in fiscal 2002. Fuel expense at Mesa and Freedom increased \$35.1 million due to the addition of regional jets and fuel expense at Air Midwest increased \$2.6 million due to the additional flying assumed by Air Midwest after the cessation of operations at CCAir. The increase is also due to a 14% increase in the average price of fuel, or 12 cents per gallon, due to the rising costs of fuel in the past year. These

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increases were offset by a decrease in fuel expense at CCAir of \$2.3 million due to the cessation of its operations. The increase on an ASM basis is due to the 14% increase in the average price of a gallon of fuel.

Maintenance Expense

In fiscal 2003, maintenance expense increased 14.7% to \$118.5 million (2.6 cents per ASM) from \$103.3 million (3.0 cents per ASM) in fiscal 2002. Mesa and Freedom maintenance expenses increased \$20.8 million primarily as a result of an increased number of aircraft in the fleet, increased repair costs on certain rotatable parts and increased engine overhaul expenses at Mesa Airlines. Air Midwest's maintenance expense increased \$2.1 million primarily as a result of transitioning to the power-by-the-hour program for engines and an increase in heavy maintenance checks. Maintenance expenses in the Other segment increased \$2.8 million due to our procurement company incurring rotatable repair expenses as well as certain purchasing related administrative expenses. These increases in maintenance expense were offset by a decrease at CCAir of \$10.0 million due to the cessation of its operations. The decrease on an ASM basis is due to the lower operating costs of flying regional jets versus turboprop aircraft.

Aircraft and Traffic Servicing Expense

In fiscal 2003, aircraft and traffic servicing expense increased 8.7% to \$50.1 million (1.1 cents per ASM) from \$46.1 million (1.3 cents per ASM) in fiscal 2002. Mesa and Freedom aircraft and traffic serving expenses increased \$9.5 million due to the additional costs associated with operating the 30 additional regional jets that were placed into service in 2003. Offsetting this increase was a \$5.2 million decrease at CCAir due to the cessation of its operations. The decrease on a cost per ASM basis for the year ended September 30, 2003, is a result of an increase in the proportion of regional jet ASMs in our fleet. Regional jets generally have lower operating costs per ASM than turboprop aircraft.

Promotion and Sales

In fiscal 2003, promotion and sales expense decreased 37.1% to \$8.0 million (0.2 cents per ASM) from \$12.7 million (0.4 cents per ASM) in fiscal 2002. The decrease is due to a decline in the booking and franchise fees paid by Air Midwest and CCAir under pro-rate agreements with their code-share partners caused by a decline in passenger carried under these agreements. The Company does not pay these fees under its regional jet-revenue contracts.

General and Administrative Expense

In fiscal 2003, general and administrative expense decreased 14.0% to \$38.0 million (0.9 cents per ASM) from \$44.1 million (1.3 cents per ASM) in fiscal 2002. The decrease is primarily due to a reduction in bad debt expense of \$7.4 million as a result of collections on certain receivables that were reserved in prior years. Legal and professional expense decreased \$1.9 million in 2003 as a result of the large charge associated with the Beus Gilbert lawsuit that was recognized in 2002. These decreases were offset by an increase in property taxes of \$1.9 million, primarily due to the addition of jet aircraft in 2003 and an increase in accrued compensation and benefits of \$0.9 million due to headcount increases.

Depreciation and Amortization

In fiscal 2003, depreciation and amortization expense increased 11.0% to \$15.7 million (0.4 cents per ASM) from \$14.2 million (0.4 cents per ASM) in fiscal 2002. The increase in depreciation expense is due to depreciation on interim financed aircraft at Mesa and Freedom.

Impairment and Restructuring Charges (Credits)

In 2003, the Company recognized an additional impairment charge of \$1.1 million related to the costs of returning Beechcraft 1900D aircraft to the manufacturer.

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The Company also reversed \$7.4 million in restructuring charges for future aircraft leases related to CCAir aircraft that were returned to the lessor and \$4.6 million in aircraft related return costs for these same aircraft. The reversal of these charges was precipitated by the dissolution of CCAir and the Company's subsequent determination, after consultation with counsel, that the Company should not be held legally responsible for the aircraft lease obligations and aircraft related return costs incurred solely by CCAir and not guaranteed by the Company.

Interest Expense

Interest expense increased \$4.7 million from \$8.0 million in 2002 to \$12.7 million in 2003. The majority of the increase is due to interest on interim financed aircraft at Mesa and Freedom. Also included in the increase is \$1.9 million in interest expense related to the senior convertible notes that were issued in June of 2003. These increases were offset by reduced interest on the Company's B1900D debt as three B1900D aircraft were returned under our agreement with Raytheon and the outstanding debt on another was settled as a result of the crash of flight 5481.

Other Expense

In fiscal 2003, other expense decreased \$0.6 million from \$3.4 million in 2002 to \$2.8 million in 2003. In fiscal year 2003, other expense is primarily comprised of the settlement with the DOT of \$4.1 million related to payments made to the Company under the Air Transportation Safety and System Stabilization Act passed after the terrorist acts of September 11, 2001. Also included in other expense is \$0.7 million in net investment related losses on the Company's portfolio of aviation related securities. These expenses were offset by the gain on an involuntary conversion of an aircraft of \$1.3 million related to the crash of Flight 5481 as well as other income received of \$1.0 million for TSA funds collected on the Company's behalf under the Emergency Wartime Supplemental Appropriations Act of 2003 by US Airways and Frontier.

Included in other expense in fiscal 2002 is \$3.2 million in net investment related losses from the Company's portfolio of aviation related securities, including \$1.9 million incurred by our subsidiary UFLY. The minority interest in these losses is deducted out of our net income or loss after income taxes.

Liquidity and Capital Resources

Sources and Uses of Cash

At September 30, 2004, we had cash, cash equivalents, and marketable securities (including restricted cash and held-to-maturity securities) of \$241.1 million, compared to \$166.1 million at September 30, 2003. We improved our cash position by issuing convertible notes in February 2004, raising \$97.0 million in capital (after expenses), and financing \$15 million of our existing inventory. Our cash and cash equivalents and marketable securities are intended to be used for working capital, capital expenditures, acquisitions, and to fund our obligations with respect to regional jet deliveries.

Uses of cash included capital expenditures of \$50.3 million attributable to the expansion of our regional jet fleet and related provisioning of rotatable inventory to support the additional jets, the purchase of certain assets of bankrupt Midway Airlines Corporation (Midway) for \$9.2 million in December 2003 and the purchase of \$10.9 million of the Company's outstanding common stock.

As of September 30, 2004, we had receivables of approximately \$30.7 million (net of an allowance for doubtful accounts of \$7.1 million), compared to receivables of approximately \$25.5 million (net of an allowance for doubtful accounts of \$4.7 million) as of September 30, 2003. The amounts due consist primarily of receivables due from our code-share partners and passenger ticket receivables due through the Airline Clearing House. The increase is primarily a result of the growth in our revenue guarantee business with each of our code-share partners. Accounts receivable from our code-share partners was 59% of total gross accounts receivable at September 30, 2004.

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We have significant long-term lease obligations primarily relating to our aircraft fleet, including six leased aircraft acquired in a transaction involving the purchase of certain assets of Midway. The leases are classified as operating leases and are therefore excluded from our consolidated balance sheets. At September 30, 2004, we leased 129 aircraft with remaining lease terms ranging from 1 to 17 years. Future minimum lease payments due under all long-term operating leases were approximately \$2.0 billion at September 30, 2004.

3.625% Senior Convertible Notes due 2024

In February 2004, we completed the private placement of senior convertible notes due 2024, which resulted in gross proceeds of \$100.0 million (\$97.0 million net). Cash interest is payable on the notes at the rate of 2.115% per year on the principal amount at maturity, payable semiannually in arrears on February 10 and August 10 of each year, beginning August 10, 2004, until February 10, 2009. After that date, we will not pay cash interest on the notes prior to maturity, and the notes will begin accruing original issue discount at a rate of 3.625% until maturity. On February 10, 2024, the maturity date of the notes, the principal amount of each note will be \$1,000. The aggregate amount due at maturity, including interest accrued from February 10, 2009, will be \$171.4 million. Each of our wholly owned domestic subsidiaries guarantees the notes on an unsecured senior basis. The notes and the note guarantees are senior unsecured obligations and rank equally with our existing and future senior unsecured indebtedness. The notes and the note guarantees are junior to the secured obligations of our wholly owned subsidiaries to the extent of the collateral pledged.

The notes are convertible into shares of our common stock at a conversion rate of 40.3737 shares per \$1,000 in principal amount at maturity of the notes. This conversion rate is subject to adjustment in certain circumstances. Holders of the notes may convert their notes only if: (i) after March 31, 2004, the sale price of our common stock exceeds 110% of the accreted conversion price for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding quarter; (ii) on or prior to February 10, 2019, the trading price for the notes falls below certain thresholds; (iii) the notes have been called for redemption; or (iv) specified corporate transactions occur. We may redeem the notes, in whole or in part, beginning on February 10, 2009, at a redemption price equal to the issue price, plus accrued original issue discount, plus any accrued and unpaid cash interest. The holders of the notes may require us to repurchase the notes on February 10, 2009 at a price of \$583.40 per note plus accrued and unpaid cash interest, if any, on February 10, 2014 at a price of \$698.20 per note plus accrued and unpaid cash interest, if any, and on February 10, 2019 at a price of \$835.58 per note plus accrued and unpaid cash interest, if any. It is our intent to settle the notes in cash if the holders require repurchase in 2009, 2014 or 2019.

6.25% Senior Convertible Notes Due 2023

In June 2003, we completed the private placement of senior convertible notes due 2023, which resulted in gross proceeds of \$100.1 million (\$96.9 million net). Cash interest is payable on the notes at the rate of 2.4829% per year on the principal amount at maturity, payable semiannually in arrears on June 16 and December 16 of each year, beginning December 16, 2003, until June 16, 2008. After that date, we will not pay cash interest on the notes prior to maturity, and the notes will begin accruing original issue discount at a rate of 6.25% until maturity. On June 16, 2023, the maturity date of the notes, the principal amount of each note will be \$1,000. The aggregate amount due at maturity, including interest accrued from June 16, 2008, will be \$252 million. Each of our wholly owned domestic subsidiaries guarantees the notes on an unsecured senior basis. The notes and the note guarantees are senior unsecured obligations and rank equally with our existing and future senior unsecured indebtedness. The notes and the note guarantees are junior to the secured obligations of our wholly owned subsidiaries to the extent of the collateral pledged.

The notes are convertible into shares of our common stock at a conversion rate of 39.727 shares per \$1,000 in principal amount at maturity of the notes. This conversion rate is subject to adjustment in certain circumstances. Holders of the notes may convert their notes only if: (i) the sale price of our common stock exceeds 110% of the accreted conversion price for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding quarter; (ii) prior to June 16, 2018, the trading price for the

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notes falls below certain thresholds; (iii) the notes have been called for redemption; or (iv) specified corporate transactions occur. The Company may redeem the notes, in whole or in part, beginning on June 16, 2008, at a redemption price equal to the issue price, plus accrued original issue discount, plus any accrued and unpaid cash interest. The holders of the notes may require the Company to repurchase the notes on June 16, 2008 at a price of \$397.27 per note plus accrued and unpaid cash interest, if any, on June 16, 2013 at a price of \$540.41 per note plus accrued and unpaid cash interest, if any, and on June 16, 2018 at a price of \$735.13 per note plus accrued and unpaid cash interest, if any. It is our intent to settle the notes in cash if the holders require repurchase in 2008, 2013 or 2018. As the sale price of our common stock exceeded 110% of the accreted conversion price for at least 20 trading days in the 30 consecutive trading day period ending September 30, 2003, the notes became convertible September 30, 2003.

Interim and Permanent Aircraft Financing Arrangements

At September 30, 2004, we had an aggregate of \$231.0 million in notes payable to an aircraft manufacturer for delivered aircraft on interim financing (relating to nine CRJ-900 aircraft). Under interim financing arrangements, the Company takes delivery and title of the aircraft prior to securing permanent financing and the acquisition of the aircraft is accounted for as a purchase with debt financing. Accordingly, we reflect the aircraft and debt under interim financing on our balance sheet during the interim financing period. After taking delivery of the aircraft, it is the Company's intention to subsequently enter into a sale-leaseback transaction with an independent third-party lessor. Upon permanent financing, the proceeds from the sale and leaseback transaction are used to retire the notes payable to the manufacturer. Any gain recognized on the sale-leaseback transaction is deferred and amortized over the life of the lease. At September 30, 2004, we had nine aircraft on interim financing with the manufacturer. These interim financings agreements are six months in length and provide for monthly interest only payments at LIBOR plus three percent. The current interim financing agreement with the manufacturer provides for the Company to have a maximum of 15 aircraft on interim financing at any one time. Subsequent to year end, we permanently financed five of the nine aircraft with debt. Our ability to obtain additional interim financing is contingent upon obtaining permanent financing for the aircraft already delivered. There are no assurances that we will be able to obtain permanent financing for future aircraft deliveries.

Other Indebtedness and Obligations

As of September 30, 2004, we had \$9.5 million in restricted cash on deposit collateralizing various letters of credit outstanding and the ACH funding of our payroll. We have entered into a \$9.5 million letter of credit facility with a financial institution, of which \$4.2 million is required to be secured.

In December 2003, we assumed \$24.1 million of debt in connection with our purchase of two CRJ-200 aircraft in the Midway Chapter 7 bankruptcy proceedings. The debt, due in 2013, bears interest at the rate of 7% per annum through 2008, converting to 12.5% thereafter, with principal and interest due monthly.

As previously disclosed, in 1999 our Board of Directors authorized us to repurchase up to 8.4 million shares of our outstanding common stock (including 2.0 million shares authorized on October 22, 2004). As of September 30, 2004, we acquired and retired approximately 6.3 million shares (approximately 20.8%) of our outstanding common stock at an aggregate cost of approximately \$36.5 million, leaving approximately 2.1 million shares available for repurchase under the existing Board authorizations. The timing of repurchases and the actual number of shares repurchased will depend on market conditions, alternative uses of capital and other considerations.

In June 2004, the Company entered into a ten-year agreement with LogisTechs, Inc., a wholly-owned subsidiary of GE Capital Aviation Services, for the management and repair of certain of the Company's CRJ-200 aircraft rotatable spare parts inventory. Under the agreement, LogisTechs financed approximately \$21 million in existing spare parts inventory for \$15 million in cash and a \$6 million promissory note. Under the agreement, LogisTechs is required to perform maintenance on the covered spare parts in exchange for a monthly fee that is based upon a rate per flight hour. The promissory note is to be repaid over three years through a reduction in the monthly maintenance fees. The value of the covered rotatable spare parts inventory

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will be amortized on a straight-line basis to its estimated fair value over the life of the agreement. The liability for amounts financed of \$21 million will be reduced through monthly principal reduction payments that are included in the monthly fees. At termination, the Company may elect to purchase the covered inventory at fair value, but is not contractually obligated to do so. The agreement includes stipulations that require LogisTechs to ensure minimum levels of availability for covered parts. Mesa is required to repay amounts financed if it terminates the agreement early for convenience. LogisTechs is also committed to finance approximately \$4 million of additional spare parts to support our CRJ-200 fleet. We are currently negotiating similar agreements for up to \$43 million of spare parts for our current and to be delivered fleet of Bombardier CRJ-700s and 900s and current fleet of Embraer 145 aircraft, representing \$31 million of our existing inventory and forgone purchases of \$12 million where LogisTechs will purchase spare parts on our behalf.

Contractual Obligations

As of September 30, 2004, we had \$572.5 million of long-term debt (including current maturities). This amount consisted of \$367.8 million in notes payable related to owned aircraft, \$200.1 in aggregate principal amount of our senior convertible notes due 2023 and 2024 and \$4.6 million in other miscellaneous debt.

The following table sets forth our cash obligations as of September 30, 2004.

| Obligations | Payment Due by Period | | | | | | Total |
|---|-----------------------|---------------|---------------|---------------|---------------|----------------|----------------|
| | 2005 | 2006 | 2007 | 2008 | 2009 | Thereafter | |
| In thousands: | | | | | | | |
| Long-term debt: | | | | | | | |
| Note payable related to CRJ700s and 900s(2) | \$ 24,474 | \$ 24,386 | \$ 24,295 | \$ 24,204 | \$ 24,101 | \$ 221,592 | \$ 343,052 |
| Senior convertible debt notes 2.4829% (assuming no conversions) | 6,257 | 6,257 | 6,257 | 6,257 | | 100,112 | 125,140 |
| Senior convertible debt notes 2.115% (assuming no conversions) | 3,625 | 3,625 | 3,625 | 3,625 | 1,813 | 100,000 | 116,313 |
| Notes payable related to B1900Ds | 9,628 | 9,628 | 9,628 | 9,628 | 9,628 | 61,355 | 109,495 |
| Note payable related to CRJ200s(2) | 3,325 | 3,000 | 3,000 | 3,000 | 3,000 | 20,952 | 36,277 |
| Note payable to manufacturer | 997 | 941 | 1,823 | | | | 3,761 |
| Mortgage note payable | 109 | 109 | 109 | 109 | 109 | 1,036 | 1,581 |
| Other | 68 | 61 | 25 | 25 | 25 | 75 | 279 |
| Total long-term debt | 48,483 | 48,007 | 48,762 | 46,848 | 38,676 | 505,122 | 735,898 |
| Short-term debt: | | | | | | | |
| Notes payable to manufacturer interim financing(1)(2) | 19,396 | 22,184 | 22,103 | 22,044 | 21,910 | 218,780 | 326,417 |
| Payments under operating leases: | | | | | | | |
| Cash aircraft rental payments(2) | 188,970 | 188,846 | 182,522 | 168,898 | 166,583 | 1,133,452 | 2,029,271 |

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|--|-----------|-----------|-----------|-----------|-----------|-------------|-------------|
| Lease payments on equipment and operating facilities | 891 | 844 | 679 | 703 | 705 | 2,450 | 6,272 |
| Total lease payments | 189,861 | 189,690 | 183,201 | 169,601 | 167,288 | 1,135,902 | 2,035,543 |
| Future aircraft acquisition costs(3) | 350,000 | 175,000 | | | | | 525,000 |
| Total | \$607,740 | \$434,881 | \$254,066 | \$238,493 | \$227,874 | \$1,859,804 | \$3,622,858 |

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- (1) Represents the principal and interest on notes payable to the manufacturer for interim financed aircraft. These notes payable have a six-month maturity. For purposes of this schedule, the Company has assumed that aircraft on interim financing are converted to permanent financing as debt upon the expiration of the notes with future maturities included on this line.
- (2) Aircraft ownership costs, including depreciation and interest expense on owned aircraft and rental payments on operating leased aircraft, of aircraft flown pursuant to our guaranteed-revenue agreements are reimbursed by the applicable code-share partner.
- (3) Represents the estimated cost of commitments to acquire CRJ-700 and CRJ-900 aircraft in the future.

Maintenance Commitments

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.

In April 1997, the Company entered into a 10-year engine maintenance contract with Pratt & Whitney Canada Corp. (PWC) for its Dash 8-200 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. Maintenance expense is recognized in the period the maintenance is performed.

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 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. Maintenance expense is recognized in the period the maintenance is performed. 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 new 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. Maintenance expense is recognized based upon the product of flight hours flown and the rate in effect for the period. 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.

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Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. In connection with the preparation of these financial statements, we are required to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, and expenses, and related disclosure of contingent liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, the allowance for doubtful accounts, medical claims reserve, valuation of assets held for sale and costs to return aircraft and a valuation allowance for certain deferred tax assets. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Such historical experience and assumptions form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We have identified the accounting policies below as critical to our business operations and the understanding of our results of operations. The impact of these policies on our business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results. The discussion below is not intended to be a comprehensive list of our accounting policies. For a detailed discussion on the application of these and other accounting policies, see Note 1 in the Notes to the Consolidated Financial Statements, which contains accounting policies and other disclosures required by accounting principles generally accepted in the United States of America.

Revenue Recognition

The America West, United and the US Airways regional jet code-share agreements are revenue-guarantee flying agreements. Under a revenue-guarantee arrangement, the major airline generally pays a fixed monthly minimum amount, plus certain additional amounts based upon the number of flights flown and block hours performed. The contracts also include reimbursement of certain costs incurred by Mesa in performing flight services. These costs, known as pass-through costs, may include aircraft ownership cost, passenger and hull insurance, aircraft property taxes as well as, fuel, landing fees and catering. The contracts also include a profit component that may be determined based on a percentage of profits on the Mesa flown flights, a profit margin on certain reimbursable costs as well as a profit margin based on certain operational benchmarks. The Company primarily recognizes revenue under its revenue-guarantee agreements when the transportation is provided. The majority of the revenue under these contracts is known at the end of the accounting period and is booked as actual. The Company performs an estimate of the profit component based upon the information available at the end of the accounting period. All revenue recognized under these contracts is presented at the gross amount billed.

The America West, US Airways and Midwest Airlines B1900D turboprop code-share agreements are pro-rate agreements. Under a prorate agreement, the Company receives a percentage of the passenger's fare based on a standard industry formula that allocates revenue based on the percentage of transportation provided. Revenue from our pro-rate agreements and our independent operation is recognized when transportation is provided. Tickets sold but not yet used are included in air traffic liability on the consolidated balance sheets.

The Company also receives subsidies for providing scheduled air service to certain small or rural communities. Such revenue is recognized in the period in which the air service is provided. The amount of the subsidy payments is determined by the United States Department of Transportation on the basis of its evaluation of the amount of revenue needed to meet operating expenses and to provide a reasonable return on investment with respect to eligible routes. EAS rates are normally set for two-year contract periods for each city.

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Allowance for Doubtful Accounts

Amounts billed by the Company under revenue guarantee arrangements are subject to our interpretation of the applicable code-share agreement and are subject to audit by our code-share partners. Periodically our code-share partners dispute amounts billed and pay amounts less than the amount billed. Ultimate collection of the remaining amounts not only depends upon Mesa prevailing under audit, but also upon the financial well-being of the code-share partner. As such, the Company periodically reviews amounts past due and records a reserve for amounts estimated to be uncollectible. The allowance for doubtful accounts was \$7.1 million and \$4.7 million at September 30, 2004 and 2003, respectively. If the Company's actual ability to collect these receivables and the actual financial viability of its partners is materially different than estimated, the Company's estimate of the allowance could be materially understated or overstated.

Accrued Health Care Costs

The Company is currently self-insured for health care costs and as such, a reserve for the cost of claims that have not been paid as of the balance sheet date is estimated. The Company's estimate of this reserve is based upon historical claim experience and upon the recommendations of its health care provider. At September 30, 2004 and 2003, the Company accrued \$2.2 million and \$1.8 million, respectively, for the cost of future health care claims. If the ultimate development of these claims is significantly different than those that have been estimated, the reserves for future health care claims could be materially overstated or understated.

Long-lived Assets, Aircraft and Parts Held for Sale

Property and equipment are stated at cost and depreciated over their estimated useful lives to their estimated salvage values using the straight-line method. Long-lived assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the related carrying amount may be impaired. Under the provisions of Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the Company records an impairment loss if the undiscounted future cash flows are found to be less than the carrying amount of the asset. If an impairment loss has occurred, a charge is recorded to reduce the carrying amount of the asset to fair value. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less cost to sell.

Valuation of Deferred Tax Assets

The Company records deferred tax assets for the value of benefits expected to be realized from the utilization of alternative minimum tax credit carryforwards and state and federal net operating loss carryforwards. The Company periodically reviews these assets for realizability based upon expected taxable income in the applicable taxing jurisdictions. To the extent the Company believes some portion of the benefit may not be realizable, an estimate of the unrealized portion is made and an allowance is recorded. At September 30, 2004, the Company had no valuation allowance for deferred tax assets as it believes it will generate sufficient taxable income in the future to realize its recorded deferred tax assets. This belief is based upon the Company having had pretax income in fiscal 2004, 2003 and 2002 (excluding impairment charges) and as the Company has taken steps to minimize the financial impact of its unprofitable subsidiaries. Realization of these deferred tax assets is dependent upon generating sufficient taxable income prior to expiration of any net operating loss carryforwards. Although realization is not assured, management believes it is more likely than not that the recorded deferred tax assets will be realized. If the ultimate realization of these deferred tax assets is significantly different from the Company's expectations, the value of its deferred tax assets could be materially overstated.

Recent Accounting Pronouncements

In September 2004, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 04-08, The Effect of Contingently Convertible Debt on Diluted Earnings per Share. EITF Issue No. 04-08 requires shares of common stock issuable upon conversion of contingently convertible debt instruments to be included in the calculation of diluted earnings per share whether or not the contingent

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conditions for conversion have been met, unless the inclusion of these shares is anti-dilutive. Previously, shares of common stock issuable upon conversion of contingently convertible debt securities were excluded from the calculation of diluted earnings per share. EITF Issue No. 04-08 is effective for reporting periods ending after December 15, 2004. If applicable, EITF Issue No. 04-08 will require the restatement of prior period diluted earnings per share amounts. Our 3.625% senior convertible notes due 2024 are contingently convertible debt securities. These debt securities are contingently convertible into 6.9 million shares of our common stock, subject to adjustment in certain circumstances. When we adopt EITF Issue No. 04-08 as of December 31, 2004, we will restate our previously reported diluted earnings per share for the second, third and fourth quarters of fiscal 2004 to include the dilutive impact of the 6.9 million shares.

Item 7A *Quantitative and Qualitative Disclosures About Market Risk*

We have exposure to market risk associated with changes in interest rates related primarily to our debt obligations and short-term marketable investment portfolio. Certain of the Company's debt obligations are variable in rate and therefore have exposure to changes in interest rates. A 10% change in interest rates would result in an approximately \$1.3 million impact on interest expense. The Company also has investments in debt securities. If short-term interest rates were to average 10% more than they did in fiscal year 2004 interest income would be impacted by approximately \$0.3 million. The Company's investments in equity securities are subject to market risk related to fluctuations in share prices for those shares held. A 10% change in the price of trading securities held at the level of investment at September 30, 2004 would impact the results of the Company by approximately \$0.7 million.

We have exposure to certain market risks associated with our aircraft fuel. Aviation fuel expense is a significant expense for any air carrier and even marginal changes in the cost of fuel greatly impact a carrier's profitability. Standard industry contracts do not generally provide protection against fuel price increases, nor do they insure availability of supply. However, the America West, United and US Airways revenue-guarantee code-share agreements allow fuel costs to be reimbursed by the code-share partner, thereby reducing our overall exposure to fuel price fluctuations. In fiscal 2004, 92% of our fuel requirements were associated with these contracts. Each one cent change in the price of jet fuel amounts to a \$0.1 million change in annual fuel costs for that portion of fuel expense that is not reimbursed by our code-share partners.

**Item 8. *Financial Statements and Supplementary Data*
Consolidated Financial Statements**

| | |
|---------|---|
| Page 42 | Report of Independent Registered Public Accounting Firm. |
| Page 43 | Consolidated Statements of Operations Years ended September 30, 2004, 2003 and 2002. |
| Page 44 | Consolidated Balance Sheets September 30, 2004 and 2003. |
| Page 45 | Consolidated Statements of Cash Flows Years ended September 30, 2004, 2003 and 2002. |
| Page 47 | Consolidated Statements of Stockholders Equity Years ended September 30, 2004, 2003 and 2002. |
| Page 48 | Notes to Consolidated Financial Statements. |

All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission have been omitted because they are not applicable, not required or the information has been furnished elsewhere.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Mesa Air Group, Inc.
Phoenix, Arizona

We have audited the accompanying consolidated balance sheets of Mesa Air Group, Inc. and subsidiaries (the Company) as of September 30, 2004 and 2003, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended September 30, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Mesa Air Group, Inc. and subsidiaries as of September 30, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2004 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2, substantially all of the Company's passenger revenue is derived from code-share agreements with America West Airlines, Inc., United Airlines, Inc. and US Airways, Inc.

DELOITTE & TOUCHE LLP

Phoenix, Arizona

December 13, 2004

Table of Contents**PART 1. FINANCIAL INFORMATION****MESA AIR GROUP, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

| | Years Ended September 30, | | |
|--|--|-------------------|-------------------|
| | 2004 | 2003 | 2002 |
| | (In thousands, except per share amounts) | | |
| Operating revenues: | | | |
| Passenger | \$ 868,415 | \$ 577,582 | \$ 480,826 |
| Freight and other | 28,397 | 22,408 | 15,957 |
| | <u> </u> | <u> </u> | <u> </u> |
| Total operating revenues | 896,812 | 599,990 | 496,783 |
| | <u> </u> | <u> </u> | <u> </u> |
| Operating expenses: | | | |
| Flight operations | 297,521 | 212,080 | 178,158 |
| Fuel | 194,510 | 113,370 | 78,200 |
| Maintenance | 163,463 | 118,517 | 103,300 |
| Aircraft and traffic servicing | 66,223 | 50,053 | 46,057 |
| Promotion and sales | 5,806 | 7,966 | 12,663 |
| General and administrative | 62,035 | 37,982 | 44,140 |
| Depreciation and amortization | 28,001 | 15,700 | 14,150 |
| Impairment and restructuring charges (credits) | 11,895 | (10,957) | 26,675 |
| | <u> </u> | <u> </u> | <u> </u> |
| Total operating expenses | 829,454 | 544,711 | 503,343 |
| | <u> </u> | <u> </u> | <u> </u> |
| Operating income (loss) | 67,358 | 55,279 | (6,560) |
| | <u> </u> | <u> </u> | <u> </u> |
| Other income (expense): | | | |
| Interest expense | (25,063) | (12,664) | (7,983) |
| Interest income | 1,163 | 1,163 | 1,542 |
| Other income (expense) | 1,723 | (2,758) | (3,404) |
| | <u> </u> | <u> </u> | <u> </u> |
| Total other expense | (22,177) | (14,259) | (9,845) |
| | <u> </u> | <u> </u> | <u> </u> |
| Income (loss) before income taxes | 45,181 | 41,020 | (16,405) |
| Income taxes (benefit) | 18,899 | 15,710 | (4,554) |
| | <u> </u> | <u> </u> | <u> </u> |
| Income (loss) before minority interest | 26,282 | 25,310 | (11,851) |
| Minority interest in consolidated subsidiary | | (5) | 583 |
| | <u> </u> | <u> </u> | <u> </u> |
| Net income (loss) | \$ 26,282 | \$ 25,305 | \$ (11,268) |
| | <u> </u> | <u> </u> | <u> </u> |
| Net income (loss) per common share basic | \$ 0.83 | \$ 0.80 | \$ (0.34) |
| | <u> </u> | <u> </u> | <u> </u> |
| Net income (loss) per common share diluted | \$ 0.70 | \$ 0.76 | \$ (0.34) |
| | <u> </u> | <u> </u> | <u> </u> |

See accompanying notes to consolidated financial statements.

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

| | September 30, | |
|--|-----------------------------------|------------|
| | 2004 | 2003 |
| | (In thousands, except share data) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 220,885 | \$ 152,547 |
| Marketable securities | 8,264 | 13,558 |
| Restricted cash | 9,484 | |
| Receivables, primarily traffic, net | 30,744 | 25,493 |
| Income tax receivable | 1,466 | |
| Expendable parts and supplies, net | 34,790 | 25,044 |
| Prepaid expenses and other current assets | 43,907 | 28,202 |
| Deferred income taxes | 8,855 | 28,436 |
| | <hr/> | <hr/> |
| Total current assets | 358,395 | 273,280 |
| Property and equipment, net | 697,425 | 398,192 |
| Lease and equipment deposits | 31,342 | 27,352 |
| Deferred income taxes | 5,342 | 4,484 |
| Other assets | 26,550 | 13,628 |
| Investments in corporate bonds and US Treasury notes | 2,483 | |
| | <hr/> | <hr/> |
| Total assets | \$ 1,121,537 | \$ 716,936 |
| | <hr/> | <hr/> |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$ 21,850 | \$ 8,519 |
| Short-term debt | 230,969 | 241,623 |
| Accounts payable | 46,821 | 39,315 |
| Air traffic liability | 2,585 | 3,490 |
| Accrued compensation | 7,284 | 6,581 |
| Income taxes payable | 456 | 896 |
| Other accrued expenses | 34,867 | 30,236 |
| | <hr/> | <hr/> |
| Total current liabilities | 344,832 | 330,660 |
| Long-term debt, excluding current portion | 550,613 | 199,023 |
| Deferred credits | 71,451 | 70,456 |
| Other noncurrent liabilities | 25,737 | 4,824 |
| | <hr/> | <hr/> |
| Total liabilities | 992,633 | 604,963 |
| | <hr/> | <hr/> |
| Commitments and contingencies (notes 2, 6, 9, 14 and 15) | | |
| 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; 30,066,777 and 31,704,625 shares issued and outstanding, respectively | 108,173 | 114,580 |
| Retained earnings (accumulated deficit) | 23,675 | (2,607) |

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| | | |
|--|-------------------|-------------------|
| Unearned compensation on restricted stock | (2,944) | |
| | <u> </u> | <u> </u> |
| Total stockholders' equity | 128,904 | 111,973 |
| | <u> </u> | <u> </u> |
| Total liabilities and stockholders' equity | \$1,121,537 | \$716,936 |
| | <u> </u> | <u> </u> |

See accompanying notes to consolidated financial statements.

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

| | Years Ended September 30, | | |
|--|---------------------------|-----------------|-----------------|
| | 2004 | 2003 | 2002 |
| (In thousands) | | | |
| Cash Flows from Operating Activities: | | | |
| Net income (loss) | \$ 26,282 | \$ 25,305 | \$(11,268) |
| Adjustments to reconcile net income (loss) to net cash flows provided by (used in) operating activities: | | | |
| Depreciation and amortization | 28,001 | 15,519 | 13,898 |
| Tax benefit on stock compensation | 137 | 449 | 188 |
| Impairment and restructuring charges (credits) | 11,895 | (10,957) | 26,675 |
| Deferred income taxes | 18,723 | 13,702 | (5,573) |
| Gain on involuntary conversion of aircraft | | (1,283) | |
| Unrealized (gain) loss on investment securities | 620 | (255) | 5,175 |
| Amortization of deferred credits | (6,243) | (5,830) | (3,982) |
| Amortization of restricted stock awards | 589 | | |
| Provision for (recovery of) doubtful accounts | 4,315 | (1,771) | 5,605 |
| Provision for obsolete expendable parts and supplies | 1,269 | 1,639 | |
| Department of Transportation settlement | | 4,154 | |
| Minority interest | | 5 | (583) |
| Changes in assets and liabilities: | | | |
| Restricted cash | (9,484) | | |
| Net purchases (sales) of investment securities | 4,674 | (4,786) | (10,035) |
| Receivables | (9,566) | 3,001 | (5,228) |
| Income tax receivables | (1,466) | | |
| Expendable parts and supplies | (11,415) | (5,445) | 10,953 |
| Prepaid expenses and other current assets | (14,708) | (2,472) | (7,526) |
| Accounts payable | 4,921 | 14,881 | (19,692) |
| Income taxes payable | (440) | 386 | 510 |
| Cost to return aircraft held for sale | (2,392) | (2,097) | (6,648) |
| Other accrued liabilities | 1,619 | 6,144 | (4,098) |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | 47,331 | 50,289 | (11,629) |
| Cash Flows from Investing Activities: | | | |
| Capital expenditures | (50,283) | (27,370) | (9,737) |
| Acquisition of Midway | (9,160) | | |
| Proceeds from sale of rotatable and expendable inventory | 2,383 | 2,637 | 8,198 |
| Proceeds from aircraft insurance | | 3,218 | |
| Change in other assets | (1,181) | 935 | (6,301) |
| Lease and equipment deposits | (5,491) | (12,013) | 4,860 |
| Purchase of held-to-maturity securities | (2,483) | | |
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES | (66,215) | (32,593) | (2,980) |

(Continued)

Table of Contents**MESA AIR GROUP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**

| | Years Ended September 30, | | |
|---|---------------------------|-------------------|------------------|
| | 2004 | 2003 | 2002 |
| (In thousands) | | | |
| Cash Flows from Financing Activities: | | | |
| Principal payments on long-term debt | (16,859) | (15,733) | (9,424) |
| Proceeds from senior convertible notes | 100,000 | 100,112 | |
| Net payments on line of credit | | | (20,000) |
| Debt issuance costs | (3,009) | (3,262) | |
| Proceeds from financing rotatable inventory | 15,000 | | |
| Proceeds from exercise of stock options and issuance of warrants | 843 | 1,775 | 742 |
| Common stock purchased and retired | (10,921) | (2,314) | (5,956) |
| Proceeds from receipt of deferred credits | 2,168 | 9,375 | 13,927 |
| Contribution from minority interest | | | 5,000 |
| Distribution to minority interest shareholders | | (972) | (3,000) |
| | <u>87,222</u> | <u>88,981</u> | <u>(18,711)</u> |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | | | |
| | <u>87,222</u> | <u>88,981</u> | <u>(18,711)</u> |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 68,338 | 106,677 | (33,320) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | <u>152,547</u> | <u>45,870</u> | <u>79,190</u> |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | <u>\$ 220,885</u> | <u>\$ 152,547</u> | <u>\$ 45,870</u> |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | | |
| Cash paid for interest | \$ 24,105 | \$ 11,665 | \$ 9,731 |
| Cash paid for income taxes | 1,906 | 1,130 | 556 |
| SUPPLEMENTAL NON-CASH INVESTING AND FINANCING ACTIVITIES: | | | |
| Aircraft and engine delivered under interim financing | \$ 463,936 | \$ 402,639 | \$ 46,018 |
| Aircraft and engine debt permanently financed as operating lease | (203,362) | (207,034) | (72,687) |
| Long-term debt assumed in Midway asset purchase | 24,109 | | |
| Inventory and other credits received in conjunction with aircraft financing | 5,073 | 4,978 | 3,729 |
| Note receivable received in conjunction with financing of rotatable inventory | 6,000 | | |
| Return of aircraft for reduction of long-term debt and accrued interest | | 8,164 | 32,749 |

(Concluded)

See accompanying notes to consolidated financial statements.

Table of Contents**MESA AIR GROUP, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

| Years Ended September 30, 2004, 2003, and 2002 | Number of Shares | Common Stock | Retained Earnings (Accumulated Deficit) | Unearned Compensation on Restricted Stock | Total |
|---|-----------------------------|-------------------------|--|--|--------------|
| (In thousands, except number of shares) | | | | | |
| Balance at October 1, 2001 | 33,049,183 | \$ 119,387 | \$(16,644) | \$ | \$ 102,743 |
| Exercise of stock options | 154,123 | 930 | | | 930 |
| Common stock purchased and retired | (1,213,420) | (5,956) | | | (5,956) |
| Tax benefit stock compensation | | 188 | | | 188 |
| Amortization of warrants | | 121 | | | 121 |
| Net loss | | | (11,268) | | (11,268) |
| Balance at September 30, 2002 | 31,989,886 | 114,670 | (27,912) | | 86,758 |
| Exercise of stock options | 270,088 | 1,465 | | | 1,465 |
| Common stock purchased and retired | (555,349) | (2,314) | | | (2,314) |
| Tax benefit stock compensation | | 449 | | | 449 |
| Amortization of warrants | | 134 | | | 134 |
| Issuance of warrants | | 176 | | | 176 |
| Net income | | | 25,305 | | 25,305 |
| Balance at September 30, 2003 | 31,704,625 | 114,580 | (2,607) | | 111,973 |
| Exercise of stock options | 110,208 | 622 | | | 622 |
| Common stock purchased and retired | (1,748,056) | (10,921) | | | (10,921) |
| Restricted stock | | 3,533 | | (3,533) | |
| Amortization of restricted stock grant | | | | 589 | 589 |
| Tax benefit stock compensation | | 137 | | | 137 |
| Amortization of warrants | | 135 | | | 135 |
| Issuance of warrants | | 87 | | | 87 |
| Net income | | | 26,282 | | 26,282 |
| Balance at September 30, 2004 | 30,066,777 | \$ 108,173 | \$ 23,675 | \$(2,944) | \$ 128,904 |

See accompanying notes to consolidated financial statements.

Table of Contents**MESA AIR GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Years ended September 30, 2004, 2003 and 2002****1. Summary of Significant Accounting Policies*****Principles of Consolidation and Organization***

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and include the accounts of Mesa Air Group, Inc. and its wholly-owned operating subsidiaries (collectively Mesa or the Company): 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; CCAir, Inc. (CCAir), a Delaware corporation and certificated air carrier; MPD, Inc., a Nevada corporation, doing business as Mesa Pilot Development; Regional Aircraft Services, Inc. (RAS) a Pennsylvania company; Mesa Leasing, Inc., a Nevada corporation; Mesa Air Group Aircraft Inventory Management, LLC (MAG-AIM), an Arizona Limited Liability Company; Ritz Hotel Management Corp., a Nevada Corporation; UFLY, LLC. (UFLY), a Delaware Limited Liability Company; and MAGI Insurance, Ltd. (MAGI), a Barbados, West Indies based captive insurance company. MPD, Inc. provides pilot training in coordination with a community college in Farmington, New Mexico and with Arizona State University in Tempe, Arizona. RAS performs aircraft component repair and overhaul services. UFLY was established in fiscal 2002 to make strategic investments in US Airways common stock. MAGI is a captive insurance company established for the purpose of obtaining more favorable aircraft liability insurance rates. CCAir ceased operations and was dissolved in fiscal 2003. UFLY distributed its assets and was subsequently dissolved in fiscal 2003. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company is an independent regional airline serving 181 cities in 43 states, the District of Columbia, Canada Mexico and the Bahamas. At September 30, 2004, the Company operated a fleet of 180 aircraft and had over 1,000 daily departures. The Company's airline operations are conducted by three regional airline subsidiaries primarily utilizing hub-and-spoke systems. Mesa Airlines operates as America West Express under a code-share agreement with America West Airlines, Inc. (America West), as United Express under a code-share relationship with United Airlines (United) and as US Airways Express under a code-share agreement with US Airways, Inc. (US Airways). Freedom operates as America West Express pursuant to the Company's code-share agreement with America West. Air Midwest operates under code-share agreements with America West, US Airways and Midwest Airlines. Air Midwest also operates an independent division, doing business as Mesa Airlines, from Albuquerque, New Mexico and select Essential Air Service markets. Prior to ceasing operations, CCAir operated under a code-share agreement with US Airways as US Airways Express. Approximately 99% of the Company's consolidated passenger revenues for 2004 were derived from operations associated with code-share agreements.

The financial arrangement between Mesa and its code-share partners involve either a revenue-guarantee or pro-rate arrangement. Under a revenue-guarantee arrangement, the major airline generally pays a monthly guaranteed amount. The America West jet and Dash-8 code-share agreement, the United code-share agreement and the US Airways regional jet agreement are revenue-guarantee flying agreements. Under the terms of these flying agreements, the major carrier controls marketing, scheduling, ticketing, pricing and seat inventories. The Company receives a guaranteed payment based upon a fixed minimum monthly amount plus amounts related to departures and block hours flown plus direct reimbursement for expenses such as fuel, landing fees and insurance. Among other advantages, revenue-guarantee arrangements reduce the Company's exposure to fluctuations in passenger traffic and fare levels, as well as fuel prices. The America West B1900 agreement, Midwest Airlines agreement and US Airways turboprop agreement are pro-rate agreements, for which the Company receives an allocated portion of the passengers' fare and pays all of the costs of transporting the passenger.

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MESA AIR GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In addition to carrying passengers, the Company carries freight and express packages on its passenger flights and has interline small cargo freight agreements with many other carriers. Mesa also has contracts with the U.S. Postal Service for carriage of mail to the cities it serves and occasionally operates charter flights when its aircraft are not otherwise used for scheduled service.

Renewal of one code-share agreement with a code-share partner does not guarantee the renewal of any other code-share agreement with the same code-share partner. The agreements with America West expire in 2012; the revenue-guarantee agreements with US Airways expire in 2014 (with various aircraft expiring on dates between 2008 and 2014); the pro-rate agreement with US Airways expires in October 2006; the agreement with United expires between 2011 and 2013; and the agreement with Midwest Airlines expires in 2006. Although the provisions of the code-share agreements vary from contract to contract, generally each agreement is subject to cancellation should the Company's subsidiaries fail to meet certain operating performance standards, and breach other contractual terms and conditions.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

Restricted Cash

At September 30, 2004, the Company has \$9.5 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, \$4.2 million of outstanding letters of credit are required to be collateralized by amounts on deposit. The Company also must maintain \$5.3 million on deposit with another financial bank to collateralize its direct deposit payroll.

Investments

Marketable securities consist of shares of common stock and exchange traded options stated at market value as determined by the most recently traded price of each security at the balance sheet date. Holdings and the related gains or losses are based upon trade date, regardless of whether settlement has occurred. All marketable securities are defined as trading securities under the provisions of Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities.

Investments in long-term debt securities are accounted for in accordance with SFAS 115, and based upon the Company's intentions, it has classified these investments as held to maturity. As such, these investments are recorded at amortized cost.

Receivables and Concentration of Risk

The majority of the Company's receivables relate to amounts due from its revenue-guarantee code share partners. Under these agreements, the Company receives a guaranteed payment based upon a fixed minimum monthly amount, plus amounts related to departures and block hours flown and direct reimbursement for certain expenses such as fuel, landing fees and insurance.

Expendable Parts and Supplies

Expendable parts and supplies are stated at the lower of cost using the first-in, first-out method or market, and are charged to expense as they are used. The Company provides for an allowance for obsolescence over the useful life of its aircraft after considering the useful life of each aircraft fleet, the estimated cost of

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MESA AIR GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

expendable parts expected to be on hand at the end of the useful life and the estimated salvage value of the parts. The Company reviews the adequacy of this allowance on a quarterly basis.

Property and Equipment

Property and equipment are stated at cost and depreciated over their estimated useful lives to their estimated salvage values using the straight line method.

Estimated useful lives of the various classifications of property and equipment are as follows:

| | |
|------------------------|--|
| Buildings | 30 years |
| Flight equipment | 7-20 years |
| Equipment | 5-12 years |
| Furniture and fixtures | 3-5 years |
| Vehicles | 5 years |
| Rotable inventory | Life of the aircraft or term of the lease, whichever is less |
| Leasehold improvements | Life of asset or term of lease, whichever is less |

Long-lived assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the related carrying amount may be impaired. Under the provisions of Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the Company records an impairment loss if the undiscounted future cash flows are found to be less than the carrying amount of the asset. If an impairment loss has occurred, a charge is recorded to reduce the carrying amount of the asset to fair value. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less cost to sell.

Interest related to deposits on aircraft purchase contracts is capitalized as part of the aircraft. The Company capitalized approximately \$1.0 million, \$0.8 million and \$1.2 million of interest in fiscal 2004, 2003 and 2002, respectively.

Other Assets

Other assets primarily consist of the capitalized costs associated with establishing financing for aircraft, prepaid maintenance, a note receivable received pursuant to the rotable spare parts financing and debt issuance costs associated with the senior convertible notes. The financing costs are amortized over the lives of the associated aircraft leases which are primarily 16-17 years. Prepaid maintenance is amortized over the six-year term of the related maintenance contract based upon the hours flown by the related aircraft. The debt issuance costs are amortized over the 20 year life of the senior convertible notes.

Air Traffic Liability

Air traffic liability represents the cost of tickets sold but not yet used. The Company records the revenue associated with these tickets in the period the passenger flies.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in future years in which those temporary differences are expected to be recovered or settled.

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MESA AIR GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company and its subsidiaries file a consolidated federal income tax return.

Notes Payable for Aircraft on Interim Financing

Aircraft under interim financing are recorded as a purchase with debt financing. As such, the Company reflects the aircraft in property and equipment and the debt financing in current portion of long-term debt on its balance sheet during the interim financing period. Upon permanent financing, the proceeds from the sale and lease back transaction are used to retire the notes payable to the manufacturer. Any gain recognized on the sale-leaseback transaction is deferred and amortized over the life of the lease.

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

Revenue Recognition

The America West, United and the US Airways regional jet code-share agreements are revenue-guarantee flying agreements. Under a revenue-guarantee arrangement, the major airline generally pays a fixed monthly minimum amount, plus certain additional amounts based upon the number of flights flown and block hours performed. The contracts also include reimbursement of certain costs incurred by Mesa in performing flight services. These costs, known as pass-through costs, may include aircraft ownership cost, passenger and hull insurance, aircraft property taxes as well as, fuel, landing fees and catering. In addition, the Company's code-share partners also provide, at no cost to Mesa, certain ground handling and customer service functions, as well as airport-related facilities and gates at their hubs and other cities. The contracts also include a profit component that may be determined based on a percentage of profits on the Mesa flown flights, a profit margin on certain reimbursable costs as well as a profit margin based on certain operational benchmarks. The Company primarily recognizes revenue under its revenue-guarantee agreements when the transportation is provided. The majority of the revenue under these contracts is known at the end of the accounting period and is booked as actual. The Company performs an estimate of the profit component based upon the information available at the end of the accounting period. All revenue recognized under these contracts is presented at the gross amount billed.

Under the Company's revenue-guarantee agreements with America West, US Airway and United, the Company is reimbursed under a fixed rate per block-hour plus an amount per aircraft designed to reimburse the Company for certain aircraft ownership costs. In accordance with Emerging Issues Task Force Issue No. 01-08, *Determining Whether an Arrangement Contains a Lease*, the Company has concluded that a component of its revenue under the agreement discussed above is rental income, inasmuch as the agreement identifies the right of use of a specific type and number of aircraft over a stated period of time. The amount deemed to be rental income during fiscal 2004 was \$189.0 million and has been included in passenger revenue on the Company's statements of income.

The America West, US Airways, and Midwest Airlines turboprop code-share agreements are pro-rate agreements. Under a pro-rate agreement, the Company receives a percentage of the passenger's fare based on a standard industry formula that allocates revenue based on the percentage of transportation provided. Revenue from the Company's pro-rate agreements and the Company's independent operation is recognized

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MESA AIR GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

when transportation is provided. Tickets sold but not yet used are included in air traffic liability on the consolidated balance sheets.

The Company also receives subsidies for providing scheduled air service to certain small or rural communities. Such revenue is recognized in the period in which the air service is provided. The amount of the subsidy payments is determined by the United States Department of Transportation on the basis of its evaluation of the amount of revenue needed to meet operating expenses and to provide a reasonable return on investment with respect to eligible routes. Essential Air Service (EAS) rates are normally set for two-year contract periods for each city.

Maintenance Expense

The Company generally charges the cost of engine and aircraft maintenance to expense as incurred. The Company also has long-term contracts for the performance of engine maintenance on some of its aircraft. 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 adjustments 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 8-200 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. Maintenance expense is recognized in the period the maintenance is performed.

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 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. Maintenance expense is recognized in the period the maintenance is performed. 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 new 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. Maintenance expense is recognized based upon the product of flight hours flown and the rate in effect for the period. Pursuant to the agreement, the Company sold certain assets of its Desert

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

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.

Minority Interest

In 2001, the Company entered into an agreement to form UFLY for the purpose of making strategic investments in US Airways, Inc. In 2002, UFLY was capitalized with \$5.0 million from the Company and \$5.0 million from other members, which included Jonathan Ornstein, the Company's Chairman and Chief Executive Officer. UFLY distributed its assets and was subsequently dissolved in fiscal 2003. The Company owned greater than 50% of UFLY in 2003 and 2002 and therefore the financial results of UFLY are included in the consolidated financial results of the Company. Amounts included in the consolidated statements of operations as minority interest reflect the after-tax portion of earnings of UFLY that are applicable to the minority interest partners.

Earnings (Loss) Per Share

The Company accounts for earnings (loss) per share in accordance with SFAS No. 128, Earnings per Share. Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the periods presented. Diluted net income (loss) 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 income (loss) per share is as follows:

| | Years Ended September 30, | | |
|---|---------------------------|-----------------|-------------------|
| | 2004 | 2003 | 2002 |
| | (In thousands) | | |
| Share calculation: | | | |
| Weighted average shares outstanding basic | 31,490 | 31,556 | 32,803 |
| Effect of dilutive outstanding stock options and warrants | 1,139 | 507 | |
| Effect of restricted stock | 214 | | |
| Effect of dilutive outstanding convertible debt due 2023 | 10,011 | 2,935 | |
| | <u>42,854</u> | <u>34,998</u> | <u>32,803</u> |
| Adjustments to net income (loss): | | | |
| Net income (loss) | \$26,282 | \$25,305 | \$(11,268) |
| Interest expense on convertible debt, net of tax | 3,680 | 1,144 | |
| | <u>\$29,962</u> | <u>\$26,449</u> | <u>\$(11,268)</u> |

The effect of options to purchase 599,000 shares of common stock in fiscal 2002 would have been antidilutive to the per share calculation. Accordingly, those options were excluded from the calculation.

At September 30, 2004, the conversion features of the Company's senior convertible notes due 2024 had not been met; therefore, the dilutive effect of the notes was not included in the determination of earnings per common share. Diluted income per share would have been \$0.63 for fiscal 2004, if the dilutive effect of the notes was included in the computation of income per common share.

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

The Company accounts for its stock-based compensation arrangements in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. The Company has adopted only the disclosure requirements of SFAS No. 123, Accounting for Stock-Based Compensation, as amended, which permits pro-forma net earnings and pro-forma earnings per share disclosures for employee stock option grants made in fiscal 1996 and future years as if the fair value based measurement method defined in SFAS No. 123 had been applied. Warrants issued to non-employees are also accounted for under SFAS No. 123, at fair value on the measurement date.

Had the compensation cost for the Company's stock-based compensation plans been determined consistent with the measurement provisions of SFAS No. 123, the Company's net income (loss) and net income (loss) per share would have been as indicated by the pro forma amounts below:

| | 2004 | 2003 | 2002 |
|--|---|----------|------------|
| | (In thousands, except per share amounts) | | |
| Net income (loss) as reported | \$26,282 | \$25,305 | \$(11,268) |
| Stock option compensation expense determined under fair value based method, net of related tax effects | (1,324) | (2,082) | (2,221) |
| Pro forma | \$24,958 | \$23,223 | \$(13,489) |
| Income (loss) per share basic: | | | |
| As reported | \$ 0.83 | \$ 0.80 | \$ (0.34) |
| Pro forma | \$ 0.79 | \$ 0.74 | \$ (0.41) |
| Net income (loss) per share diluted: | | | |
| As reported | \$ 0.70 | \$ 0.76 | \$ (0.34) |
| Pro forma | \$ 0.67 | \$ 0.70 | \$ (0.41) |

The per share weighted-average fair value of stock options granted during 2004, 2003 and 2002 was \$6.77, \$3.29 and \$4.12, respectively, on the grant date as determined by using the Black-Scholes option pricing model with the following weighted average assumptions: an expected dividend yield 0.0%, an expected life of 6 years, a risk-free interest rate of 4.1%, 4.3% and 3.0%, and volatility of 79.8%, 80.5% and 75.5% in 2004, 2003 and 2002, respectively.

Use of Estimates in the Preparation of Financial Statements

The preparation of the Company's consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Segment Reporting

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, requires disclosures related to components of a company for which separate financial information is available that is evaluated regularly by a company's chief operating decision maker in deciding the allocation of resources and assessing performance. The Company has three airline operating subsidiaries, Mesa Airlines, Freedom Airlines and Air Midwest and various other subsidiaries organized to provide support for the Company's airline operations. The Company has aggregated these operating segments into three reportable segments; Mesa/ Freedom, Air Midwest and Other. Mesa Airlines and Freedom primarily operate the Company's regional jets pursuant to revenue guarantee agreements. Air Midwest operates the Company's Beech 1900D

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MESA AIR GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

turboprop aircraft. The Other reportable segment includes Mesa Air Group, RAS, MPD, MAG-AIM and MAGI, all of which support Mesa's operating subsidiaries.

Recent Accounting Pronouncements

In September 2004, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 04-08, The Effect of Contingently Convertible Debt on Diluted Earnings per Share. EITF Issue No. 04-08 requires shares of common stock issuable upon conversion of contingently convertible debt instruments to be included in the calculation of diluted earnings per share whether or not the contingent conditions for conversion have been met, unless the inclusion of these shares is anti-dilutive. Previously, shares of common stock issuable upon conversion of contingently convertible debt securities were excluded from the calculation of diluted earnings per share. EITF Issue No. 04-08 is effective for reporting periods ending after December 15, 2004. If applicable, EITF Issue No. 04-08 will require the restatement of prior period diluted earnings per share amounts. Our 3.625% senior convertible notes due 2024 are contingently convertible debt securities. These debt securities are contingently convertible into 6.9 million shares of our common stock, subject to adjustment in certain circumstances. When we adopt EITF Issue No. 04-08 as of December 31, 2004, we will restate our previously reported diluted earnings per share for the second, third and fourth quarters of fiscal 2004 to include the dilutive impact of the 6.9 million shares.

Reclassifications

Certain reclassifications were made to the 2003 and 2002 financial statements to conform to the 2004 presentation.

2. Concentrations

The Company has code share agreements with America West, US Airways, United Airlines and Midwest Airlines. Approximately 99%, 98% and 98% of the Company's consolidated passenger revenue for the years ended September 30, 2004, 2003 and 2002, respectively, were derived from these agreements. Accounts receivable from the Company's code-share partners were 59% and 57% of total gross accounts receivable at September 30, 2004 and 2003, respectively.

Passenger revenue received from America West amounted to 38%, 44% and 40% of the Company's total passenger revenue in fiscal 2004, 2003 and 2002, respectively. A termination of the America West revenue-guarantee code-share agreements would have a material adverse effect on the Company's business prospects, financial position, results of operations and cash flows.

US Airways, which accounted for approximately 40%, 38% and 35% of the Company's passenger revenue in fiscal 2004, 2003 and 2002, respectively, filed for Chapter 11 bankruptcy protection on September 12, 2004. In connection with this filing, US Airways has not yet assumed our code-share agreement in bankruptcy and could choose to terminate our agreement. A termination or rejection of our revenue-guarantee agreement or the failure of US Airways to successfully emerge from bankruptcy would have a material adverse effect on the Company.

United Airlines, a subsidiary of UAL Corp., which accounted for approximately 20% and 1% of the Company's passenger revenue in fiscal 2004 and 2003, respectively. A termination of the United agreement or the failure of United to successfully emerge from bankruptcy would have a material adverse effect on the Company.

Table of Contents**MESA AIR GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****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, 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 \$8.3 million in marketable securities that include common equity securities of companies operating in the airline industry. 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. The Company also has \$2.5 million in investments in US treasury notes and corporate bonds that are classified as held-to-maturity securities that are included in noncurrent investments at September 30, 2004 and carried at amortized cost.

In the past, the Company has entered into short positions on common equity securities when management believed that the Company could capitalize on downward moves in particular securities and as a hedge against its investment in common stocks of other airlines. Furthermore, by taking a short position in other airline's common stock, the Company effectively hedged against downturns in the airline industry. Unlike traditional investing where the investor's risk is limited to the amount of their investment, when stocks are sold short, there is no limit to the potential price appreciation of the stock thus there is no limit to the investor's loss. The Company marks short positions to market at each reporting period with the associated gain or loss in value reflected in other income (expense) in the statement of operations. Included in marketable securities at September 30, 2003 are liabilities related to short positions on common equity securities of \$13.2 million. As of September 30, 2004, the Company had no liabilities related to short positions. Unrealized losses relating to trading securities held (including short positions) at September 30, 2004 and 2003, were \$1.7 million and \$2.5 million, respectively.

Investments in held-to-maturity securities were as follows at September 30, 2004 (in thousands):

| | Cost | Gross Unrealized Gains (Losses) | Estimated Fair Value |
|--|-------------------|---------------------------------------|-------------------------|
| | <u> </u> | <u> </u> | <u> </u> |
| Held-to-maturity securities (carried at amortized cost): | | | |
| US treasury note | \$2,008 | \$ 50 | \$2,058 |
| Corporate bond | 475 | 7 | 482 |
| | <u> </u> | <u> </u> | <u> </u> |
| Total | \$2,483 | \$ 57 | \$2,540 |
| | <u> </u> | <u> </u> | <u> </u> |

4. Property and Equipment

Property and equipment consists of the following:

| | September 30, | |
|---|-------------------|-------------------|
| | 2004 | 2003 |
| | <u> </u> | <u> </u> |
| | (In thousands) | |
| Flight equipment, substantially pledged | \$ 731,859 | \$ 416,304 |
| Other equipment | 24,775 | 26,476 |
| Leasehold improvements | 2,620 | 4,006 |

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| | | |
|--|-------------------|-------------------|
| Furniture and fixtures | 1,087 | 2,018 |
| Buildings | 3,968 | 4,418 |
| Vehicles | 1,045 | 1,092 |
| | <u>765,354</u> | <u>454,314</u> |
| Less accumulated depreciation and amortization | (67,929) | (56,122) |
| Net property and equipment | <u>\$ 697,425</u> | <u>\$ 398,192</u> |

Table of Contents**MESA AIR GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. Short-Term Debt**

At September 30, 2004 and 2003, the Company had \$231.0 million and \$241.6 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 subsequently enter into a sale-leaseback transaction with an independent third-party lessor. Upon permanent financing, the proceeds from the sale-leaseback transaction are used to retire the notes payable to the manufacturer. Any gain recognized on the sale-leaseback transaction is deferred and amortized over the life of the lease. The Company had nine aircraft on interim financing with the manufacturer at September 30, 2004. These interim financings agreements are six months in length and provide for monthly interest only payments at LIBOR plus three percent. The current interim financing agreement with the manufacturer provides for the Company to have a maximum of 15 aircraft on interim financing at a given time. Subsequent to year end, the Company placed five of these aircraft on permanent financing as debt with a bank, thus transferring \$118.0 million from short-term debt to long-term debt.

6. Other Accrued Expenses

Other accrued expenses consist of the following:

| | September 30, | |
|-------------------------------------|----------------|----------|
| | 2004 | 2003 |
| | (In thousands) | |
| Accrued fuel | \$ 6,085 | \$ 693 |
| Accrued property taxes | 5,236 | 3,183 |
| Accrued compensation and benefits | 4,810 | 4,398 |
| Accrued interest | 4,103 | 2,189 |
| Accrued aircraft return costs | 2,812 | |
| Accrued landing fees | 2,300 | 1,322 |
| Accrued medical insurance | 2,218 | 1,282 |
| Accrued legal and professional fees | 1,078 | 7,980 |
| Accrued lease expense | 756 | 4,864 |
| Accrued simulator time | 73 | 89 |
| Other | 5,396 | 4,236 |
| | \$34,867 | \$30,236 |

7. Deferred Credits

The Company accounts for aircraft purchase incentives provided by the aircraft manufacturers as deferred credits. These credits are amortized over the life of the related lease as a reduction of lease expense, which is included in flight operations in the statements of operations. Deferred credits include the value of aircraft purchase incentives, such as credits that may be used to purchase spare parts, pay for training expenses or reduce other aircraft operating costs. Deferred credits also include deferred gains on the sale and leaseback of interim financed aircraft. These deferred gains are also amortized over the life of the related leases as a reduction of lease expense, which is included in flight operations in the statements of operations.

Table of Contents**MESA AIR GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****8. Financing Arrangement**

In June 2004, the Company entered into a ten-year agreement with LogisTechs, Inc., a wholly-owned subsidiary of GE Capital Aviation Services, for the management and repair of certain of the Company's CRJ-200 aircraft rotatable spare parts inventory. Under the agreement, LogisTechs financed approximately \$21 million in existing spare parts inventory for \$15 million in cash and a \$6 million promissory note. Under the agreement, LogisTechs is required to perform maintenance on the covered spare parts in exchange for a monthly fee that is based upon a rate per flight hour. The promissory note is to be repaid over three years through a reduction in the monthly maintenance fees. The value of the covered rotatable spare parts inventory will be amortized on a straight-line basis to its estimated fair value over the life of the agreement. The liability for amounts financed of \$21 million will be reduced through monthly principal reduction payments that are included in the monthly fees. At termination, the Company may elect to purchase the covered inventory at fair value. If the Company elects to do so, the fair value of the covered inventory will be offset by the unamortized portion of the liability. The Company is not required to repurchase the covered inventory at termination. The agreement includes stipulations that require LogisTechs to ensure minimum levels of availability for covered parts. Mesa is required to repay amounts financed if it terminates the agreement early for convenience. LogisTechs also committed to finance approximately \$4 million of additional spare parts to support Mesa's CRJ-200 fleet. The Company is currently negotiating similar agreements for up to \$43 million of spare parts for its current and to be delivered fleet of Bombardier CRJ-700s and 900s and current fleet of Embraer 145 aircraft, representing \$31 million of our existing inventory and forgone purchases of \$12 million where LogisTechs will purchase spare parts on our behalf. The unamortized balance of the liability is included in other accrued expenses and other noncurrent liabilities on the balance sheet.

9. Long-Term Debt

In December 2003, we assumed \$24.1 million of debt in connection with our purchase of two CRJ-200 aircraft in the Midway Chapter 7 bankruptcy proceedings. The debt, due in 2013, bears interest at the rate of 7% per annum through 2008, converting to 12.5% thereafter, with principal and interest due monthly.

In January 2004, the Company permanently financed five CRJ-700 and four CRJ-900 aircraft with \$207.5 million in debt. In March, two additional CRJ-900 aircraft were also financed with \$47.2 million in debt. The debt bears interest at the monthly LIBOR plus three percent and requires monthly principal and interest payments. The manufacturer has entered into an arrangement on the Company's behalf to limit the Company's variable interest rate exposure with respect to these aircraft. These aircraft were on interim financing.

In February 2004, the Company completed the private placement of senior convertible notes (the February 2004 Notes) due 2024, which resulted in gross proceeds of \$100.0 million (\$97.0 million net). Cash interest is payable on these notes at the rate of 2.115% per year on the principal amount at maturity, payable semiannually in arrears on February 10 and August 10 of each year, beginning August 10, 2004, until February 10, 2009. After that date, the Company will not pay cash interest on these notes prior to maturity, and they will begin accruing original issue discount at a rate of 3.625% until maturity. On February 10, 2024, the maturity date of these notes, the principal amount of each note will be \$1,000. The aggregate amount due at maturity, including interest accrued from February 10, 2009, will be \$171.4 million. Each of the Company's wholly-owned domestic subsidiaries guarantees these notes on an unsecured senior basis. The February 2004 Notes and the note guarantees are senior unsecured obligations and rank equally with the Company's existing and future senior unsecured and unsubordinated indebtedness. These notes and the note guarantees are junior to any secured obligations of the Company and any of its wholly owned subsidiaries to the extent of the collateral pledged.

The February 2004 Notes are convertible into shares of the Company's common stock at a conversion rate of 40.3737 shares per \$1,000 in principal amount at maturity of the notes. This conversion rate is subject

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

to adjustment in certain circumstances. Holders of these notes may convert their notes only if: (i) the sale price of the Company's common stock exceeds 110% of the accreted conversion price for at least 20 trading days in the 30 consecutive days ending on the last trading day of the preceding quarter; (ii) on or prior to February 10, 2019, the trading price for these notes falls below certain thresholds; (iii) these notes have been called for redemption; or (iv) specified corporate transactions occur. The Company may redeem these notes, in whole or in part, beginning on February 10, 2009, at a redemption price equal to the sum of the issue price, plus accrued original issue discount, plus any accrued and unpaid cash interest. The holders of these notes may require the Company to repurchase the notes on February 10, 2009 at a price of \$583.40 per note plus accrued and unpaid cash interest, if any, on February 10, 2014 at a price of \$698.20 per note plus accrued and unpaid cash interest, if any, and on February 10, 2019 at a price of \$835.58 per note plus accrued and unpaid cash interest, if any. It is the Company's intent to settle these notes in cash if the holders require repurchase in 2009, 2014 and 2019. The Company has filed a shelf registration statement with the U.S. Securities and Exchange Commission covering the resale of the February 2004 Notes and the shares of common stock issuable upon conversion thereof. The Company plans to use the net proceeds from the sale of these notes for working capital and to fund its obligations with respect to regional jet deliveries.

In June 2003, the Company completed the private placement of senior convertible notes (the June 2003 Notes) due 2023, which resulted in gross proceeds of \$100.1 million to the Company. Cash interest is payable on these notes at a rate of 2.4829% per year on the principal amount at maturity, payable semiannually in arrears on June 16 and December 16 of each year, beginning December 16, 2003, until June 16, 2008. After that date, the Company will not pay cash interest on these notes prior to maturity, and the notes will begin accruing compounded interest at a rate of 6.25% until maturity. On June 16, 2023, the maturity date of these notes, the principal amount of each note will be \$1,000. The aggregate amount due at maturity, including interest accrued from June 16, 2008, will be \$252 million. The June 2004 Notes and the note guarantees are senior unsecured obligations and rank equally with the Company's existing and future senior unsecured indebtedness. These notes and the note guarantees are junior to any secured obligations of the Company and any of its wholly owned subsidiaries to the extent of the collateral pledged.

The June 2003 Notes are convertible into shares of the Company's common stock at a conversion rate of 39.727 shares per \$1,000 in principal amount at maturity of the notes. This conversion rate is subject to adjustment in certain circumstances. Holders of these notes may convert their notes only if: (i) the sale price of the Company's common stock exceeds 110% of the accreted conversion price for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding quarter; (ii) prior to June 16, 2018, the trading price for these notes falls below certain thresholds; (iii) these notes have been called for redemption; or (iv) specified corporate transactions occur. The Company may redeem these notes, in whole or in part, beginning on June 16, 2008, at a redemption price equal to the issue price, plus accrued original issue discount, plus any accrued and unpaid cash interest. The holders of these notes may require the Company to repurchase the notes on June 16, 2008 at a price of \$397.27 per note plus accrued and unpaid cash interest, if any, on June 16, 2013 at a price of \$540.41 per note plus accrued and unpaid cash interest, if any, and on June 16, 2018 at a price of \$735.13 per note plus accrued and unpaid cash interest, if any. As the sale price of our common stock exceeded 110% of the accreted conversion price for at least 20 trading days in the 30 consecutive trading day period ending September 30, 2003, these notes became convertible September 30, 2003.

Repayment of the February 2004 and June 2003 Notes (collectively, the Notes) is jointly and severally guaranteed on an unconditional basis by the Company's wholly owned domestic subsidiaries. Except as otherwise specified in the indentures pursuant to which the Notes were issued, there are no restrictions on the ability of such subsidiaries to transfer funds to the Company in the form of cash dividends, loans or advances. General provisions of applicable state law, however, may limit the ability of any subsidiary to pay dividends or make distributions to the Company in certain circumstances.

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

Separate financial statements of the Company's subsidiaries are not included herein because the aggregate assets, liabilities, earnings, and equity of the subsidiaries are substantially equivalent to the assets, liabilities, earnings, and equity of the Company on a consolidated basis; the subsidiaries are jointly and severally liable for the repayment of the Notes; and the separate financial statements and other disclosures concerning the subsidiaries are not deemed by the Company to be material to investors.

Long-term debt consists of the following:

| | September 30, | |
|---|-----------------------|-------------|
| | 2004 | 2003 |
| | (In thousands) | |
| Notes payable to bank, collateralized by the underlying aircraft, due 2019 | \$ 248,135 | \$ |
| Senior convertible notes due June 2023 | 100,112 | 100,112 |
| Senior convertible notes due February 2024 | 100,000 | |
| Notes payable to manufacturer, principal and interest due monthly through 2011 at variable rates of interest ranging from 2.91% to 7.15% at September 30, 2004, collateralized by the underlying aircraft | 93,900 | 100,601 |
| 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 | 25,758 | |
| Note payable to manufacturer, principal due semi-annually, interest at 7% due quarterly through 2007 | 3,363 | 4,149 |
| Mortgage note payable to bank, principal and interest at 7 1/2% due monthly through 2009 | 961 | 996 |
| Other | 234 | 1,684 |
| | <hr/> | <hr/> |
| Total debt | 572,463 | 207,542 |
| Less current portion | (21,850) | (8,519) |
| | <hr/> | <hr/> |
| Long-term debt | \$ 550,613 | \$ 199,023 |
| | <hr/> | <hr/> |

Principal maturities of long-term debt for each of the next five years and thereafter are as follows:

| | Years Ending September 30, |
|------------|---------------------------------------|
| | (In thousands) |
| 2005 | \$ 21,850 |
| 2006 | 22,388 |
| 2007 | 24,258 |
| 2008 | 23,388 |
| 2009 | 24,449 |
| Thereafter | 456,130 |

Subsequent to year end, the Company permanently financed five CRJ-900 aircraft with \$118.0 million in debt. The debt bears interest at the monthly LIBOR plus three percent and requires monthly principal and interest payments. These aircraft were on interim financing at

September 30, 2004.

10. Common Stock Purchase and Retirement

In December 1999, the Company's Board of Directors authorized the Company to purchase up to approximately 3.4 million shares of the outstanding common stock of the Company. In January 2001, the Board approved the purchase by the Company of up to an additional one million shares of its common stock.

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

In October 2002, the Company's Board authorized the purchase of an additional two million shares. As of September 30, 2004, the Company has acquired and retired approximately 6.3 million shares of its outstanding common stock at an aggregate cost of approximately \$36.5 million leaving approximately 0.1 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. Subsequent to year end, the Board of Directors authorized the Company to purchase up to 2.0 million additional shares of the outstanding common stock of the Company.

11. Income Taxes

Income tax expense (benefit) consists of the following:

| | Years Ended September 30, | | |
|-----------|---------------------------|------------------|-------------------|
| | 2004 | 2003 | 2002 |
| | (In thousands) | | |
| Current: | | | |
| Federal | \$ | \$ 777 | \$ (470) |
| State | 176 | 1,231 | 1,489 |
| | <u>176</u> | <u>2,008</u> | <u>1,019</u> |
| Deferred: | | | |
| Federal | 16,765 | 13,278 | (4,731) |
| State | 1,958 | 424 | (842) |
| | <u>18,723</u> | <u>13,702</u> | <u>(5,573)</u> |
| | <u>\$ 18,899</u> | <u>\$ 15,710</u> | <u>\$ (4,554)</u> |

The difference between the actual income tax expense (benefit) and the statutory tax expense (benefit) (computed by applying the U.S. federal statutory income tax rate of 35 percent to income or loss before income taxes) is as follows:

| | Years Ended September 30, | | |
|--|---------------------------|------------------|-------------------|
| | 2004 | 2003 | 2002 |
| | (In thousands) | | |
| Computed expected tax expense (benefit) | \$ 15,813 | \$ 14,357 | \$ (5,742) |
| Increase (reduction) in income taxes resulting from: | | | |
| State taxes, net of federal taxes (benefit) | 2,134 | 966 | 598 |
| Nondeductible compensation | 987 | | |
| Other | 45 | 387 | (106) |
| Increase (decrease) in valuation allowance | (80) | | 696 |
| | <u>\$ 18,899</u> | <u>\$ 15,710</u> | <u>\$ (4,554)</u> |

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

Elements of deferred income tax assets (liabilities) are as follows:

| | September 30, | |
|---------------------------------------|-------------------|-------------------|
| | 2004 | 2003 |
| (In thousands) | | |
| Deferred tax assets: | | |
| Net operating loss carryforwards | \$ 47,707 | \$ 19,329 |
| Deferred credits | 15,271 | 18,138 |
| Other accrued expenses | 5,115 | 7,752 |
| Deferred gains | 3,133 | |
| Allowance for doubtful receivables | 2,710 | 1,793 |
| Alternative minimum tax | 1,918 | 1,918 |
| Unrealized trading (gains) losses | 664 | 945 |
| Inventory | 567 | 730 |
| Intangibles | 474 | 574 |
| Other | 237 | 255 |
| Valuation allowance | | (80) |
| Total deferred tax assets | \$ 77,796 | \$ 51,354 |
| Deferred tax liabilities: | | |
| Property and equipment | \$(62,923) | \$(15,070) |
| Other | (676) | (3,364) |
| Total deferred tax liabilities | \$(63,599) | \$(18,434) |

Deferred tax assets include benefits expected to be realized from the utilization of alternative minimum tax credit carryforwards of approximately \$1.9 million that do not expire and federal net operating loss carryforwards of approximately \$125.3 million that expire in years 2017 through 2024. The Company also has state net operating loss carryforwards of approximately \$108.1 million that expire in years 2005 through 2019. During 2002, the Company established a valuation allowance of \$0.7 million for certain state net operating loss carryforwards that expired in 2003 or are expected to expire unutilized in the future. In fiscal 2004, the Company reversed the remaining valuation allowance of \$0.1 million. Realization of these deferred tax assets is dependent upon generating sufficient taxable income prior to expiration of any net operating loss carryforwards. Although realization is not assured, management believes it is more likely than not that the recorded deferred tax asset, net of the valuation allowance provided, will be realized.

12. Stockholders Equity

In March 2004, the Company issued restricted stock grants of 428,297 shares to the Company's Chief Executive Officer and the Company's President and Chief Operating Officer. The restricted stock shares vest in one-third increments over a three-year period beginning on March 31, 2005. The Company recorded \$3.5 million in stockholders' equity for deferred compensation. The deferred compensation is amortized on a straight-line basis over the vesting period of the grants.

In February 2004, the Company completed the private placement of senior convertible notes due February 2024. At maturity, the principal amount of each note will be \$1,000 and the aggregate amount due will be \$171.4 million. These notes are convertible into shares of the Company's common stock at a conversion rate of 40.3737 shares per \$1,000 in principal amount at maturity of the notes, which equals an initial conversion price of approximately \$10.00 per share. This conversion rate is subject to adjustment in certain

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

circumstances. Holders of these notes may convert their notes only if: (i) the sale price of the Company's common stock exceeds 110% of the accreted conversion price for at least 20 trading days in the 30 consecutive days ending on the last trading day of the preceding quarter; (ii) on or prior to February 10, 2019, the trading price for these notes falls below certain thresholds; (iii) these notes have been called for redemption; or (iv) specified corporate transactions occur. The Company may redeem these notes, in whole or in part, beginning on February 10, 2009, at a redemption price equal to the sum of the issue price, plus accrued original issue discount, plus any accrued and unpaid cash interest. The holders of these notes may require the Company to repurchase the notes on February 10, 2009 at a price of \$583.40 per note plus accrued and unpaid cash interest, if any, on February 10, 2014 at a price of \$698.20 per note plus accrued and unpaid cash interest, if any, and on February 10, 2019 at a price of \$835.58 per note plus accrued and unpaid cash interest, if any.

In June 2003, the Company completed the private placement of senior convertible notes due June 2023. At maturity, the principal amount of each note will be \$1,000 and the aggregate amount due will be \$252 million. These notes are convertible into shares of the Company's common stock at a conversion rate of 39.727 shares per \$1,000 in principal amount at maturity of the notes which equals an initial conversion price of approximately \$10.00 per share. This conversion rate is subject to adjustment in certain circumstances. Holders of these notes may convert their notes only if: (i) the sale price of our common stock exceeds 110% of the accreted conversion price for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding quarter; (ii) prior to June 16, 2018, the trading price for these notes falls below certain thresholds; (iii) these notes have been called for redemption; or (iv) specified corporate transactions occur. The Company may redeem these notes, in whole or in part, beginning on June 16, 2008, at a redemption price equal to the issue price, plus accrued original issue discount, plus any accrued and unpaid cash interest. The holders of these notes may require the Company to repurchase the notes on June 16, 2008 at a price of \$397.27 per note plus accrued and unpaid cash interest, if any, on June 16, 2013 at a price of \$540.41 per note plus accrued and unpaid cash interest, if any, and on June 16, 2018 at a price of \$735.13 per note plus accrued and unpaid cash interest, if any.

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 Company remaining current on its payment obligations to Raytheon. Approximately \$5.3 million, \$5.3 million and \$6.0 million (which included \$0.7 million relating to 2001) was recorded as a reduction to flight operations during 2004, 2003 and 2002, respectively. In return, the Company granted Raytheon a warrant to purchase up to 233,068 shares of our 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 and therefore the amounts net to zero. The contra equity value of the warrant is 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 is exercisable at any time over a three-year period following its date of purchase. Absent an event of default by the Company in which case vesting is accelerated, the option to purchase the warrant vests concurrently with Raytheon's payment of the related annual operating subsidy for the following periods or January 15 of each year, whichever comes first. Shares of common stock underlying the warrant vest according to the following schedule: 13,401 shares for a portion of fiscal year 2001; 116,534 shares in fiscal year 2002; 58,267 shares in fiscal year 2003 and 44,866 shares in fiscal year 2004. As of December 1, 2004, Raytheon has exercised its option to purchase the 2001, 2002 and 2003 components of the warrant, but has not yet exercised its option to purchase the 2004 component of the warrant. In addition, Raytheon has not exercised any component of the warrant.

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

At September 30, 2004, the Company sponsored the following stock-based compensation plans:

In March 1993, and December 1994, the Company adopted stock option plans for outside directors. These plans originally provided for the grant of options to purchase up to 450,000 shares of the Company's common stock at fair value on the date of grant. At September 30, 2004, there were 52,000 options outstanding under this plan. There are 69,000 options available for grant under this plan.

In July 1998, the Company adopted a new stock option plan for outside directors. This plan, as amended, provides for the grant of options to purchase up to 275,000 shares of the Company's common stock at fair value on the date of the grant. On February 11, 2003 an additional 200,000 options were approved by the stockholders to be granted under this plan. At September 30, 2004, there were 194,515 options outstanding and 142,773 options available for future grants under this plan.

In April 1996, the Company adopted an employee stock option plan under the new management incentive program (the 1996 Stock Option Plan) that provides for the granting of options to purchase up to 2,800,000 shares of the Company's common stock at the fair value on the date of grant. On July 24, 1998, an additional 1,500,000 options were approved by the stockholders to be granted under this plan. At September 30, 2004, there were 2,406,923 options outstanding and 231,992 options available for future grants under this plan.

In June 1998, the Company adopted a Key Officer Stock Option Plan for compensating the Company's Chief Executive Officer and Chief Operating Officer, which provided for the grant of options to purchase up to 1,600,000 shares of the Company's common stock at the fair value on the date of grant. At September 30, 2004 there were 1,112,533 options outstanding and no options available for future grants under this plan.

In June 1999, the Company adopted the 1999 Non-Qualified Stock Option Plan in connection with the CCAir merger. At September 30, 2004, there were 37,284 options outstanding and there are no options available for future grants under this plan.

In October 2001, the Company adopted a Key Officer Stock Option Plan for compensating the Company's Chief Executive Officer and Chief Operating Officer, which provided for the grant of options to purchase up to 2,000,000 shares of the Company's common stock at the fair value on the date of grant. At September 30, 2004 there were 750,000 options outstanding and 1,250,000 options available for future grants under this plan.

Generally, options granted to employees vest over a three-year period and options granted to directors vest immediately upon grant or six months following the grant.

Transactions involving stock options under these plans are summarized as follows:

| | 2004 | | 2003 | | 2002 | |
|----------------------------------|-----------------|--|-----------------|--|-----------------|--|
| | Shares (000) | Weighted Average Exercise Price | Shares (000) | Weighted Average Exercise Price | Shares (000) | Weighted Average Exercise Price |
| Outstanding at beginning of year | 4,357 | \$6.73 | 3,824 | \$7.10 | 2,820 | \$7.56 |
| Granted | 430 | 9.89 | 1,019 | 4.96 | 1,486 | 6.31 |
| Exercised | (110) | 5.58 | (270) | 5.42 | (154) | 6.09 |
| Canceled/ Forfeited | (124) | 6.95 | (216) | 6.51 | (328) | 8.11 |
| Outstanding at end of year | 4,553 | \$7.20 | 4,357 | \$6.73 | 3,824 | \$7.10 |
| Exercisable at end of year | 3,161 | \$7.13 | 2,485 | \$7.47 | 2,014 | \$7.59 |

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

At September 30, 2004, the range of exercise prices for the aforementioned options was \$2.36 to \$12.24.

The following table summarizes information concerning options outstanding at September 30, 2004:

| Range of Exercise Prices | Stock Options Outstanding | | | Stock Options Exercisable | |
|-------------------------------|---------------------------|---------------------------------|---------------------------------|---------------------------|---------------------------------|
| | Number Outstanding | Weighted Average Remaining Life | Weighted Average Exercise Price | Number Exercisable | Weighted Average Exercise Price |
| \$ 2.31 - \$ 3.45 | 31,789 | 3.5 Years | \$ 2.52 | 26,056 | \$ 2.36 |
| \$ 3.46 - \$ 5.17 | 1,350,576 | 6.6 Years | 4.57 | 635,751 | 4.49 |
| \$ 5.18 - \$ 6.90 | 927,318 | 6.1 Years | 5.99 | 799,219 | 5.98 |
| \$ 6.91 - \$ 8.62 | 1,615,568 | 4.2 Years | 8.23 | 1,380,382 | 8.25 |
| \$ 8.63 - \$10.35 | 113,056 | 7.0 Years | 9.64 | 74,657 | 9.56 |
| \$10.36 - \$12.07 | 389,980 | 5.8 Years | 11.20 | 230,947 | 11.16 |
| \$12.08 - \$13.80 | 124,968 | 5.0 Years | 12.50 | 14,168 | 12.24 |
| Options at September 30, 2004 | 4,553,255 | 5.5 Years | 7.06 | 3,161,180 | 7.13 |

13. Benefit Plans

The Company has a 401(k) plan covering the employees of Mesa Airlines, Air Midwest and the airline support operations (the Mesa Plan). Under the Mesa Plan, employees may contribute up to 15 percent of their annual compensation, as defined. Employer contributions are made at the discretion of the Board of Directors. During fiscal 2004, the Company made matching contributions of 25 percent of employee contributions up to 10 percent of annual employee compensation. Upon completing one year of service, the employee is 20 percent vested in employer contributions and the remainder of the employer contributions vest 20 percent per year thereafter. Employees become fully vested in employer contributions after completing five years of employment. The Company has the right to terminate the 401(k) plan at any time. Contributions by the Company to the Mesa Plan for the years ended September 30, 2004, 2003 and 2002 were approximately \$0.8 million, \$0.7 million and \$0.3 million, respectively.

CCAir also had a 401(k) plan covering the employees of CCAir. The plan was terminated and the assets were distributed to the participants on September 12, 2003. All employees became 100% vested when CCAir ceased operations in November 2002. Contributions by CCAir to this plan were approximately \$0.1 million in fiscal 2002. There were no contributions by CCAir in 2003.

14. Lease Commitments

At September 30, 2004, the Company leased 129 aircraft under non-cancelable operating leases with remaining terms of up to 17 years. The aircraft leases require the Company to pay all taxes, maintenance, insurance and other operating expenses. The Company has the option to terminate certain of the leases at various times throughout the lease. Aggregate rental expense totaled approximately \$162.0 million, \$130.4 million and \$107.6 million for the years ended September 30, 2004, 2003 and 2002, respectively.

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

Future minimum lease payments under non-cancelable operating leases are as follows:

| | Years Ending September 30, |
|------------|---------------------------------------|
| | (In thousands) |
| 2005 | \$ 189,861 |
| 2006 | 189,690 |
| 2007 | 183,201 |
| 2008 | 169,601 |
| 2009 | 167,288 |
| Thereafter | 1,135,902 |

15. Commitments and Contingencies

In May 2001, the Company entered into an agreement with Bombardier Regional Aircraft Division (BRAD) under which the Company is committed to purchase a total of 15 CRJ-700s and 25 CRJ-900s. The transaction includes standard product support provisions, including training, preferred pricing on initial inventory provisioning, maintenance and technical publications. As of September 30, 2004, the Company has taken delivery of all 15 CRJ-700 aircraft and 24 CRJ-900 aircraft. The Company took delivery of the remaining CRJ-900 aircraft on November 5, 2004. In January 2004, the Company exercised its option to convert options on 20 CRJ-900 aircraft to firm orders (seven of which can be converted to CRJ-700s). In addition to the firm orders, Mesa has an option to acquire an additional 60 CRJ-700 and CRJ-900 regional jets. In conjunction with this purchase agreement, Mesa had \$15.0 million on deposit with BRAD that was included in lease and equipment deposits at September 30, 2004. The remaining deposits are expected to be returned on upon completion of permanent financing on each of the last five aircraft (\$3.0 million per aircraft).

On January 8, 2003, US Airways Express Flight 5481, operated by Air Midwest, crashed shortly after takeoff from Charlotte Douglas International Airport en route to Greenville/ Spartanburg, S.C. There were no survivors among the 21 passengers and crew members aboard the Beechcraft 1900D aircraft. The Company is cooperating fully with all federal, state and local regulatory and investigatory agencies to ascertain the cause of the crash. The Company is unable to predict the amount of claims, if any, relating to the crash which may ultimately be made against it and how those claims might be resolved. The Company maintains substantial insurance coverage and, at this time, management has no reason to believe that such insurance coverage will not be sufficient to cover any claims arising from the crash. Therefore, the Company believes that the resolution of any claims will not have a material adverse effect on its financial position, results of operations or cash flows.

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 the Company's business, financial condition or results of operations, although no assurance can be given to the ultimate outcome of any such proceedings.

16. Financial Instruments

The carrying amount of cash and cash equivalents, receivables, accounts payable, accrued compensation and other liabilities approximates fair value due to the short maturity periods of these instruments. The fair value of the Company's marketable securities is based on quoted market prices. The fair value of the Company's held-to-maturity securities approximates fair value (see note 3) based upon quoted market prices for these securities. The Company's variable rate long-term debt had a carrying value of approximately \$342.0 million at September 30, 2004, which approximates fair value because these borrowings have variable

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

interest rate terms that approximate market interest rates for similar debt instruments. The Company's fixed rate long-term debt, having a carrying value of approximately \$230.5 million at September 30, 2004, had a fair value of approximately \$196.4 million. The Company uses a financial model to calculate the fair value of its senior convertible debt.

17. Valuation and Qualifying Accounts

| | Balance at Beginning of Year | Additions/ Subtractions Charged to Costs and Expenses | Deductions | Balance at End of Year |
|---|---|--|-------------------|-----------------------------------|
| (In thousands) | | | | |
| Allowance for Obsolescence Deducted from Expendable Parts and Supplies | | | | |
| September 30, 2004 | \$ 1,906 | \$ 1,269 | \$(1,694) | \$ 1,481 |
| September 30, 2003 | 267 | 1,639 | | 1,906 |
| September 30, 2002 | 2,496 | | (2,229) | 267 |
| Allowance for Doubtful Accounts Deducted from Accounts Receivable | | | | |
| September 30, 2004 | \$ 4,681 | \$ 4,315 | \$(1,919) | \$ 7,077 |
| September 30, 2003 | 12,799 | (1,771) | (6,347) | 4,681 |
| September 30, 2002 | 14,695 | 5,605 | (7,501) | 12,799 |

18. Selected Quarterly Financial Data (Unaudited)

The following table presents selected unaudited quarterly financial data (in thousands):

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|-------------------------------------|--------------------------|---------------------------|--------------------------|---------------------------|
| 2004(1)(3) | | | | |
| Operating revenues | \$ 187,553 | \$ 209,664 | \$ 239,586 | \$ 260,009 |
| Operating Income (loss) | 11,597 | 6,708 | 22,785 | 26,268 |
| Net income (loss) | 4,134 | 1,769 | 9,658 | 10,721 |
| Net income (loss) per share basic | \$ 0.13 | \$ 0.06 | \$ 0.31 | \$ 0.35 |
| Net income (loss) per share diluted | \$ 0.12 | \$ 0.05 | \$ 0.25 | \$ 0.28 |
| 2003(2)(3) | | | | |
| Operating revenues | \$ 133,093 | \$ 137,312 | \$ 154,075 | \$ 175,510 |
| Operating Income (loss) | 486 | 19,969 | 14,612 | 20,212 |
| Net income (loss) | (955) | 11,040 | 5,367 | 9,853 |
| Net income (loss) per share basic | \$ (0.03) | \$ 0.35 | \$ 0.17 | \$ 0.31 |
| Net income (loss) per share diluted | \$ (0.03) | \$ 0.35 | \$ 0.17 | \$ 0.25 |

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- (1) Second quarter amounts include restructuring charges of \$11.3 million (pretax), third quarter amounts include restructuring charges of \$1.1 million, and fourth quarter amounts include the reversal of certain CCAir restructuring charges of \$0.4 million (pretax).

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MESA AIR GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- (2) Second quarter amounts include impairment and restructuring charges of \$1.1 million (pretax) and the reversal of CCAir impairment and restructuring charges of \$12.0 million (pretax).
- (3) The sum of quarterly earnings per share may not equal annual earnings per share due to rounding.

19. Impairment and Restructuring Charges (Credits)

Beechcraft 1900D Impairment and Restructuring Charges

In fiscal 2001, the Company entered into an agreement to return 15 B1900D aircraft to Raytheon. As a result of the agreement, the Company took an impairment charge to write the net book value of 15 B1900D aircraft down to the contractual selling price, less the cost of preparing the aircraft for return. The Company also took an impairment charge to reduce the carry value of its remaining fleet of B1900D aircraft.

In fiscal 2002, the Company returned 12 of the 15 B1900D aircraft permitted under its agreement with Raytheon, and as a result of unanticipated increases in the cost of meeting return conditions, the Company recorded an additional restructuring charge of \$3.3 million. In fiscal 2003, the Company returned the three remaining B1900D aircraft permitted under its agreement with Raytheon, and as a result of additional costs required of meeting the return conditions of these and previous aircraft, the Company recorded an additional impairment charge of \$1.1 million.

In the fiscal 2004, the Company recognized an impairment and restructuring charge of \$12.4 million related to the planned early return of seven leased B1900D aircraft with lease expirations between December 2004 and September 2005. The Company negotiated the terms of the early return with the aircraft lessors and took a charge that included \$2.4 million for the present value of future lease payments, \$2.4 million for the negotiated settlement of return conditions, \$1.2 million for the cancellation of maintenance agreements, \$1.1 million for the difference between the buyout option of two aircraft and the proceeds from the subsequent sale of the aircraft, \$0.8 million to reduce maintenance deposits to net realizable value and \$4.5 million to reduce the value of rotatable and expendable inventory to fair value less costs to sell.

CCAir Impairment and Restructuring

In fiscal 2002, as a result of the inability of CCAir to reduce its operating costs and its continued history of operating losses, as well as receiving a notification by US Airways of their intent to cancel CCAir's pro-rate contract effective November 3, 2002, management at CCAir elected to cease operations on the effective date of US Airways' cancellation. As a result, the Company took an impairment and restructuring charge of \$19.8 million in fiscal 2002, including \$7.8 million for future aircraft lease payments, \$4.6 million in aircraft related return costs, \$4.1 million to reduce the value of rotatable and expendable inventory to fair value less costs to sell, \$1.7 million to reduce maintenance deposits held by a lessor to net realizable value, \$0.9 million to write off the value of equipment and leasehold improvements and \$0.7 million of severance and other employee related liabilities. Once operations ceased, CCAir stopped making lease payments on its fleet of Dash 8-100 aircraft. CCAir subsequently returned the aircraft to the lessors. At the time of the shutdown, it was the Company's intention to maintain the legal entity of CCAir as well as its operating certificate with the possibility of either restructuring the airline and operating it under amended labor agreements in the future or affecting a sale of CCAir.

In fiscal 2003, CCAir surrendered its operating certificate to the FAA and filed articles of dissolution with the State of Delaware. As a result of these events and CCAir's lack of liquidity, it became clear that CCAir would be unable to pay any of its obligations. In fiscal 2003, in light of CCAir's inability to pay its obligations and the resulting dissolution, the Company reversed the restructuring charges recorded in fiscal 2002 by approximately \$12 million. The reversal of these charges was precipitated by the dissolution of CCAir and the Company's subsequent determination, after consultation with counsel, that the Company should not be held legally responsible for the obligations incurred solely by CCAir and not guaranteed by the Company.

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

Including these charges and reversals, CCAir had after tax net income of \$8.3 million and an after tax net loss of (\$21.2) million for the years ended September 30, 2003 and 2002, respectively.

In fiscal 2004, the Company reversed certain restructuring charges recorded in fiscal 2002 by approximately \$0.4 million as the recorded liabilities were no longer needed.

Shorts 360 Impairment

Also in fiscal 2002, the Company's sublease of two Shorts 360 aircraft the Company had been subleasing to an operator in Europe expired and the Company did not anticipate the lease to be renewed. As a result, the Company took a charge for \$3.6 million to accrue for the remaining lease payments and the future costs of returning these aircraft to the lessor. The remaining restructuring reserves are primarily related to the remaining lease payments and the future costs of returning these two aircraft.

The changes in the impairment and restructuring charges for the three fiscal years ended September 30, 2004 are as follows:

| Description of Charge | Reserve Oct. 30, 2001 | Provision | Cash Utilized | Non- Cash Utilized | Reserve Sept. 30, 2002 | Provision | Reversal of Charges | Cash Utilized | Non- Cash Utilized | Reserve Sept. 30, 2003 |
|--|-----------------------------|-------------|------------------|--------------------------|------------------------------|------------|---------------------------|------------------|--------------------------|------------------------------|
| Restructuring: | | | | | | | | | | |
| Severance and other | \$ | \$ (658) | \$ | \$ | \$ (658) | \$ | \$ | \$ 110 | \$ | \$ (548) |
| Costs to return aircraft | (4,715) | (10,040) | 6,648 | | (8,107) | (1,050) | 4,593 | 2,097 | 250 | (2,217) |
| Aircraft lease payments | (3,610) | (9,238) | 3,610 | | (9,238) | | 7,414 | 120 | 516 | (1,188) |
| Cancellation of maintenance agreement | (1,200) | | 1,200 | | | | | | | |
| Impairment: | | | | | | | | | | |
| Impairment of surplus inventory | | (4,143) | | 4,143 | | | | | | |
| Impairment of maintenance deposits | | (1,682) | | 1,682 | | | | | | |
| Impairment of aircraft and other property | | (914) | | 914 | | | | | | |
| Total | \$ (9,525) | \$ (26,675) | \$ 11,458 | \$ 6,739 | \$ (18,003) | \$ (1,050) | \$ 12,007 | \$ 2,327 | \$ 766 | \$ (3,953) |

[Continued from above, first column repeated]

| Description of Charge | Reserve Sept. 30, 2003 | (Provision) Reversal | Cash Utilized | Non- Cash Utilized | Reserve Sept. 30, 2004 |
|---------------------------------------|------------------------------|-------------------------|------------------|--------------------------|------------------------------|
| Restructuring: | | | | | |
| Severance and other | \$ (548) | \$ 482 | \$ 66 | \$ | \$ |
| Costs to return aircraft | (2,217) | (2,400) | 2,400 | | (2,217) |
| Aircraft lease payments | (1,188) | (2,398) | 2,542 | 594 | (450) |
| Cancellation of maintenance agreement | | (1,179) | 1,179 | | |
| Impairment: | | | | | |
| Impairment of surplus inventory | | (4,517) | | 4,517 | |
| Impairment of maintenance deposits | | (823) | | 823 | |
| Impairment of aircraft | | (1,060) | | 1,060 | |

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| | | | | | |
|-------|------------------|-------------------|----------------|----------------|------------------|
| Total | <u>\$(3,953)</u> | <u>\$(11,895)</u> | <u>\$6,187</u> | <u>\$6,994</u> | <u>\$(2,667)</u> |
|-------|------------------|-------------------|----------------|----------------|------------------|

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MESA AIR GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The reserve balance of \$2.7 million above is included in other accrued expenses on the accompanying consolidated balance sheets.

20. Related Party Transactions

In February 1999, the Company entered into an agreement with Barlow Capital, LLC (Barlow), whereby Barlow would provide financial advisory services related to aircraft leases, mergers and acquisitions, and certain other financing arrangements. The Company paid fees totaling \$2.5 million, \$1.3 million and \$0.9 million to Barlow in fiscal 2004, 2003 and 2002, respectively, for arranging for leasing companies to participate in the Company's various aircraft financings under this agreement. At September 30, 2004, Jonathan Ornstein, the Company's Chairman of the Board and Chief Executive Officer, and George Murnane III, the Company's Executive Vice President and Chief Financial Officer were each members of Barlow holding a 25% membership interest therein. Messrs. Ornstein and Murnane intend to dispose of their membership interest at the end of the first quarter of fiscal 2005. Distributions to the members of Barlow are determined by the members on a year-to-year basis. Substantially all of Barlow's revenues are derived from its agreement with the Company.

On September 9, 1998, the Company entered into an agreement with International Airline Support Group (IASG) whereby the Company would consign certain surplus airplane parts to IASG to sell on the open market. IASG in turn would submit proceeds from such sales to the Company less a market-based fee. At September 30, 2003, the Company had \$2.5 million in inventory on consignment with IASG. The Company had accounts receivable from IASG for the proceeds from inventory sales of \$0.2 million as of September 30, 2003. During fiscal 2003 and 2002, the Company paid IASG approximately \$0.4 million and \$0.3 million, respectively, in commissions on sales of surplus aircraft parts. During 2003, IASG provided consultation on determining the fair value of the Company's surplus inventory. Mr. Ronald Fogleman, a member of the Company's Board of Directors, and Mr. Murnane were members of the board of directors of IASG during fiscal 2003 and Mr. Murnane was an executive officer of IASG before joining the Company. Messrs. Fogleman and Murnane resigned from the Board of Directors of IASG in mid 2003. In September 2003, IASG ceased operations and any inventory remaining at IASG was moved to another consignment firm.

The Company provides reservation services to Europe-By-Air, Inc. The Company billed Europe-By-Air approximately \$57,000, \$61,000 and \$70,000 for these services during fiscal 2004, 2003 and 2002, respectively. At September 30, 2004 and 2003, the Company had receivables from Europe-By-Air of \$24,000 and \$35,000, respectively. Mr. Ornstein is a major shareholder of Europe-By-Air.

The Company uses the services of the law firm of Piper Rudnick for labor related legal services. The Company paid Piper Rudnick \$0.2 million, \$0.3 million and \$0.6 million for legal-related services in 2004, 2003 and 2002, respectively. Mr. Joseph Manson, a member of the Company's Board of Directors, is a partner with Piper Rudnick.

During fiscal 2001, the Company established Regional Airline Partners (RAP), a political interest group formed to pursue the interests of regional airlines, communities served by regional airlines and manufactures of regional airline equipment. Mr. Maurice Parker, a member of the Company's Board of Directors, is the Executive Director of RAP. During 2004, 2003 and 2002, the Company paid RAP's operating costs totaling approximately \$241,000, \$200,000 and \$165,000, respectively. Included in these amounts are the wages and expense of Mr. Parker, which amounted to \$93,000, \$114,000 and \$99,000 in fiscal 2004, 2003 and 2002, respectively. Since inception, the Company has financed 100% of RAP's operations.

In September 2001, the Company entered into an agreement to form UFLY, LLC (UFLY), for the purpose of making strategic investments in US Airways, Inc. In fiscal 2002, the Company contributed \$5.0 million in investments and the other members contributed \$5.0 million in cash to form UFLY. Also during 2002, UFLY made capital distributions of \$2.5 million back to the Company and \$3.0 million to the

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MESA AIR GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

other members. UFLY had investment gains of \$28,000 and investment losses of \$1.9 million during fiscal 2003 and 2002, respectively. Mr. Ornstein is a shareholder/owner and managing member of UFLY. Mr. Ornstein received no additional compensation from the Company or UFLY for his role as managing member of UFLY. UFLY's assets were distributed and UFLY was dissolved in fiscal 2003.

In fiscal 2003, Durango Pro-Focus used the services of the Company for pilot training. The Company billed Durango Pro-Focus \$25,000 and \$45,000 in fiscal year 2004 and 2003, respectively, for pilot training services. In 2004, Durango Pro-Focus was dissolved. Amounts due from Durango Pro-Focus of \$70,000 were written off in fiscal 2004. Mr. Fogleman was the President and Chief Executive Officer of Durango Pro-Focus.

The Company will enter into future business arrangements with related parties only where such arrangements are approved by a majority of disinterested directors and are on terms at least as favorable as available from unaffiliated third parties.

21. Segment Reporting

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, requires disclosures related to components of a company for which separate financial information is available that is evaluated regularly by a company's chief operating decision maker in deciding the allocation of resources and assessing performance. The Company has three airline operating subsidiaries, Mesa Airlines, Freedom Airlines and Air Midwest and various other subsidiaries organized to provide support for the Company's airline operations. CCAir ceased operations and was dissolved in fiscal 2003. The Company has aggregated these operating segments into three reportable segments in fiscal 2004. Mesa Airlines and Freedom primarily operate the Company's regional jets. Air Midwest operates the Company's Beech 1900 turboprop aircraft. CCAir, prior to ceasing operations, operated a mixed fleet of turboprop aircraft. The Other reportable segment includes Mesa Air Group, RAS, MPD, MAG-AIM, MAGI and UFLY, all of which support Mesa's operating subsidiaries. MAG-AIM was established to purchase, distribute and manage the operating companies' inventory. Operating revenues in the Other segment are primarily sales of rotatable and expendable parts to the Company's operating subsidiaries.

Mesa Airlines and Freedom provide passenger service with regional jets under revenue-guarantee contracts with America West, United, US Airways and Frontier Airlines. Mesa Airlines also provides passenger service with Dash-8 aircraft under a revenue-guarantee contract with America West and under a pro-rate contract with US Airways. As of September 30, 2004, Mesa Airlines and Freedom operated a fleet of 145 aircraft - 93 CRJs, 36 ERJs and 16 Dash-8's.

Air Midwest provides passenger service with Beechcraft 1900D aircraft under the revenue-guarantee contract with America West and under pro-rate contracts with US Airways and Midwest Airlines. As of September 30, 2004, Air Midwest operated a fleet of 35 Beechcraft 1900D turboprop aircraft.

CCAir provided passenger service with Dash-8 and Jetstream 31 turboprop aircraft under pro-rate revenue contracts with US Airways. As of September 30, 2002, CCAir operated a fleet of 14 aircraft - 9 Jetstreams and 5 Dash-8s. CCAir ceased operations on November 3, 2002.

The Other category consists of Mesa Air Group (holding company), MPD, RAS, MAGI, UFLY and MAG-AIM. Mesa Air Group performs 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, ASM's and other operating statistics. MPD operates pilot training programs in conjunction with San Juan College in Farmington, New Mexico and Arizona State University in Tempe, Arizona. Graduates of these training programs are eligible to be hired by the Company's operating subsidiaries. RAS primarily provides repair services to the Company's operating subsidiaries. MAGI is a captive insurance company located in Barbados. MAG-AIM is the Company's inventory procurement

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

company. UFLY was established for the purpose of making strategic investments in other airline s common stock.

| Year Ended September 30, 2004 (000 s) | Mesa/ Freedom | Air Midwest | Other | Eliminations | Total |
|---|--------------------------|------------------------|--------------|---------------------|--------------|
| Total operating revenues | \$ 807,736 | \$81,714 | \$365,858 | \$(358,496) | \$ 896,812 |
| Depreciation and amortization | 24,749 | 432 | 2,820 | | 28,001 |
| Operating income (loss) | 81,761 | (9,635) | 52,615 | (57,383) | 67,358 |
| Interest expense | (16,564) | (139) | (8,645) | 285 | (25,063) |
| Interest income | 851 | 6 | 591 | (285) | 1,163 |
| Income (loss) before income tax and minority interest | 67,311 | (9,830) | 45,082 | (57,382) | 45,181 |
| Income tax (benefit) | 28,156 | (4,112) | (5,145) | | 18,899 |
| Total assets | 1,054,028 | 17,196 | 403,238 | (352,923) | 1,121,537 |
| Capital expenditures (including non-cash) | 474,449 | 243 | 39,527 | | 514,219 |

| Year Ended September 30, 2003 (000 s) | Mesa/ Freedom | Air Midwest | CCAair | Other | Eliminations | Total |
|---|--------------------------|------------------------|---------------|--------------|---------------------|--------------|
| Total operating revenues | \$507,555 | \$86,142 | \$ 1,254 | \$175,956 | \$(170,917) | \$599,990 |
| Depreciation and amortization | 12,453 | 709 | | 2,538 | | 15,700 |
| Operating income (loss) | 45,537 | (9,391) | 11,810 | 44,034 | (36,711) | 55,279 |
| Interest expense | (10,997) | | (173) | (1,720) | 226 | (12,664) |
| Interest income | 837 | 4 | 4 | 593 | (275) | 1,163 |
| Income (loss) before income tax and minority interest | 28,855 | (6,817) | 13,486 | 42,253 | (36,757) | 41,020 |
| Income tax (benefit) | 10,794 | (2,353) | 5,165 | 16,182 | (14,078) | 15,710 |
| Total assets | 610,228 | 19,073 | 441 | 310,095 | (222,901) | 716,936 |
| Capital expenditures (including non-cash) | 408,467 | 121 | | 21,421 | | 430,009 |

| Year Ended September 30, 2002 (000 s) | Mesa/ Freedom | Air Midwest | CCAair | Other | Eliminations | Total |
|---|--------------------------|------------------------|---------------|--------------|---------------------|--------------|
| Total operating revenues | \$372,370 | \$94,333 | \$ 24,335 | \$ 5,745 | \$ | \$496,783 |
| Depreciation and amortization | 8,534 | 3,492 | 485 | 1,639 | | 14,150 |
| Operating income (loss) | 24,621 | 2,125 | (34,083) | 777 | | (6,560) |
| Interest expense | (1,385) | (5,364) | (1,375) | 141 | | (7,983) |
| Interest income | 125 | 2 | 35 | 1,380 | | 1,542 |
| Income (loss) before income tax and minority interest | 23,105 | (3,475) | (35,431) | (604) | | (16,405) |
| Income tax (benefit) | 6,053 | (933) | (9,515) | (159) | | (4,554) |
| Total assets | 271,865 | 22,488 | 6,710 | 359,557 | (261,459) | 399,161 |
| Capital expenditures (including non-cash) | 49,867 | 2,001 | 987 | 2,900 | | 55,755 |

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Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure*

There were no disagreements with accountants on accounting and financial disclosure.

Item 9A. *Controls and Procedures*

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures. Disclosure controls and procedures are designed to ensure that information required to be disclosed in the periodic reports filed or submitted under the Securities and Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the annual period covered by this report but also noted certain weaknesses in the control environment. These result from recent turnover/advancement of accounting, inventory/purchasing and internal audit personnel and the domination of management by a small group. We are dedicating resources to correct these issues and are in the process of implementing the necessary corrections. Certain weaknesses were noted in our previous filing related to expendable and rotatable parts and the accounting for interim financing arrangements which have been corrected. The Company has also implemented a contract review process to ensure that provisions of our contractual obligations are appropriately reflected in our consolidated financial statements. Other than the above issues, there were no changes in the Company's internal control over financial reporting known to the Chief Executive Officer or the Chief Financial Officer that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

Item 9B. *Other Information*

None.

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PART III

All items in Part III are incorporated herein by reference as indicated below to our definitive proxy statement for our 2005 annual meeting of stockholders anticipated to be held February 8, 2005, which will be filed with the SEC, except for information relating to executive officers under the heading Executive Officers of the Registrant, which can be found in Part I following Item 4.

Item 10. Directors and Executive Officers of the Registrant

The information required by Item 10 is incorporated herein by reference to the information contained under the headings Election of Directors and Executive Officers as set forth in our definitive proxy statement for our 2005 annual meeting of stockholders.

Item 11. Executive Compensation

The information required by Item 11 relating to our directors is incorporated herein by reference to the information under the heading Compensation of Directors and the information relating to our executive officers is incorporated herein by reference to the information under the heading Executive Compensation as set forth in our definitive proxy statement for our 2005 annual meeting of stockholders.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by Item 12 is incorporated herein by reference to the information under the headings Election of Directors and Security Ownership of Certain Beneficial Owners and Management as set forth in our definitive proxy statement for our 2005 annual meeting of stockholders.

Item 13. Certain Relationships and Related Transactions

The information required by Item 13 is incorporated herein by reference to the information under the heading Certain Relationships and Related Transactions as set forth in our definitive proxy statement for our 2005 annual meeting of stockholders.

Item 14. Principal Accountants Fees and Services

Information regarding principal accounting fees and services is incorporated herein by reference to the information under the heading Disclosure Of Audit And Non-Audit Fees contained in the Proxy Statement for our 2005 annual meeting of stockholders.

PART IV

Item 15. Exhibits and Financial Statement, Schedules

(A) Documents filed as part of this report:

1. Reference is made to Item 8 hereof.
2. Exhibits

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The following exhibits are either filed as part of this report or are incorporated herein by reference from documents previously filed with the Securities and Exchange Commission:

| Exhibit Number | Description | Reference |
|-------------------|---|--|
| 3.1 | Articles of Incorporation of Registrant dated May 28, 1996 | Filed as Exhibit 3.1 to Registrant's Form 10-K for the fiscal year ended September 30, 1996, incorporated herein by Reference |
| 3.2 | Bylaws of Registrant as amended | Filed as Exhibit 3.2 to Registrant's Form 10-K for the fiscal year ended September 30, 1996, incorporated herein by Reference |
| 4.1 | Form of Common Stock certificate | Filed as Exhibit 4.5 to Amendment No. 1 to Registrant's Form S-18, Registration No. 33-11765 filed March 6, 1987, incorporated herein by reference |
| 4.2 | Form of Common Stock certificate (issued after November 12, 1990) | Filed as Exhibit 4.8 to Form S-1, Registration No. 33-35556 effective December 6, 1990, incorporated herein by Reference |
| 4.3 | Indenture dated as of June 16, 2003 between the Registrant, the guarantors executing a signature page thereto and U.S. Bank National Association, as Trustee, relating to Senior Convertibles Notes due 2023 | Filed as Exhibit 4.1 to Form 10-Q for the quarterly period ended June 30, 2003, incorporated herein by reference |
| 4.4 | Registration Rights Agreement dated as of June 16, 2003 between the Registrant, the subsidiaries of the Registrant listed on The signature pages thereto, and Merrill Lynch & Co., a representatives of the Initial Purchasers of Senior Convertibles Notes due 2023 | Filed as Exhibit 4.2 to Form 10-Q for the quarterly period ended June 30, 2003, incorporated herein by reference |
| 4.5 | Form of Guarantee (Exhibit A-2 to Indenture filed as Exhibit 4.3 above) | Filed as Exhibit 4.3 to Form 10-Q for the quarterly period ended June 30, 2003, incorporated herein by reference |
| 4.6 | Form of Senior Convertible Note due 2023 (Exhibit A-1 to Indenture filed as Exhibit 4.3 above) | Filed as Exhibit 4.4 to Form 10-Q for the quarterly period ended June 30, 2003, incorporated herein by reference |
| 4.7 | Indenture, dated as of February 10, 2004 between Mesa Air Group, Inc., the guarantors named therein and U.S. Bank National Association, as Trustee, relating to Senior Convertible Notes due 2024 | Filed as Exhibit 4.1 to Form S-3 filed on May 7, 2004, incorporated herein by reference |
| 4.8 | Registration Rights Agreement dated as of February 10, 2004 between Mesa Air Group, Inc., the subsidiaries of Mesa Air Group, Inc. Listed on the signature pages thereto, and Merrill Lynch, Pierce, Fenner & Smith Incorporated, As Initial Purchaser of the Senior Convertible Notes due 2024 | Filed as Exhibit 4.2 to Form S-3 filed on May 7, 2004, incorporated herein by reference |

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| Exhibit Number | Description | Reference |
|-----------------------|---|---|
| 4.9 | Form of Guarantee (included in Exhibit 4.7). | Filed as Exhibit 4.1 to Form S-3 filed on May 7, 2004, incorporated herein by reference |
| 4.10 | Form of Senior Convertible Notes due 2024 (included in Exhibit 4.7). | Filed as Exhibit 4.1 to Form S-3 filed on May 7, 2004, incorporated herein by reference |
| 5.1 | 1998 Key Officer Stock Option Plan | Filed as Appendix A to Registrant's Definitive Proxy Statement, dated June 19, 1998 |
| 5.2 | 2001 Key Officer Stock Option Plan, as amended | Filed as Exhibit 5.2 to Form 10-Q for fiscal year ended September 30, 2003 |
| 5.3 | Outside Directors' Stock Option Plan, as amended | Filed as Exhibit 5.3 to Form 10-K for fiscal year ended September 30, 2003 and incorporated herein by reference |
| 5.4 | Employee Stock Option Plan, as amended | Filed as Exhibit 5.4 to Form 10-K for fiscal year ended September 30, 2003 and incorporated herein by reference |
| 5.5 | Deferred Compensation Plan | Filed as Exhibit 5.4 to Form 10-K for fiscal year ended September 30, 2003 and incorporated herein by reference |
| 10.1 | Form of Directors' and Officers' Indemnification Agreement | Filed as Exhibit 10.1 to Form 10-K for fiscal year ended September 30, 2002 and incorporated herein by reference |
| 10.2 | Code-share and Revenue Sharing Agreement, dated as of February 1, 2001, by and between Mesa Airlines, Inc. and America West, Inc. (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.1 to Form 10-Q for the period ended March 31, 2001, incorporated herein by reference |
| 10.3 | First Amendment to Code-share and Revenue Sharing Agreement dated as of April 27, 2001, by and between Mesa Airlines, Inc. and America West, Inc. | Filed as Exhibit 10.10 to Form 10-K for Fiscal year ended September 30, 2002 and incorporated herein by reference |
| 10.4 | Second Amendment to Code-share and Revenue Sharing Agreement dated as of October 24, 2002, by and between Mesa Airlines, Inc. and America West, Inc. (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.4(1) to Form 10-K for fiscal year ended September 30, 2003 and incorporated herein by reference |
| 10.5 | Third Amendment to Code-share and Revenue Sharing Agreement dated as of December 2, 2002, by and between Mesa Airlines, Inc., Freedom Airlines, Inc. and America West, Inc. (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.5(1) to Form 10-K for fiscal year ended September 30, 2003 and incorporated herein by reference |
| 10.6 | Fourth Amendment to Code-share and Revenue Sharing Agreement dated as of September 5, 2003, by and between Mesa Airlines, Inc., Freedom Airlines, Inc., Air Midwest, Inc. and America West, Inc. (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.6(1) to Form 10-K for fiscal year ended September 30, 2003 and incorporated herein by reference |

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| Exhibit Number | Description | Reference |
|-----------------------|--|--|
| 10.7 | Service Agreement dated as of November 11, 1997 between Mesa Airlines, Inc. and US Airways, Inc. | Filed as Exhibit 10.86 to Form 10-Q for the quarter ended December 31, 1997 |
| 10.8 | First Amendment to Service Agreement dated as of November 24, 1999, by and between Mesa Airlines, Inc. and US Airways, Inc. (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.15 to Form 10-K for fiscal year ended September 30, 2002 and incorporated herein by reference |
| 10.9 | Second Amendment to Service Agreement dated as of October 6, 2000, by and between Mesa Airlines, Inc. and US Airways, Inc. (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.16 to Form 10-K for fiscal year ended September 30, 2002 and incorporated herein by reference |
| 10.10 | Third Amendment to Service Agreement dated as of October 17, 2002, by and between Mesa Airlines, Inc. and US Airways (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.17 to Form 10-K for fiscal year ended September 30, 2002 and incorporated herein by reference |
| 10.11 | Fourth Amendment to Service Agreement dated as of October 17, 2002, by and between Mesa Airlines, Inc. and US Airways (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.18 to Form 10-K for fiscal year ended September 30, 2002 and incorporated herein by reference |
| 10.12 | Fifth Amendment to Service Agreement dated as of October 17, 2002, by and between Mesa Airlines, Inc., and US Airways (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.19 to Form 10-K for fiscal year ended September 30, 2002 and incorporated herein by reference |
| 10.13 | Sixth Amendment to Service Agreement dated as of August 14, 2003, by and between Mesa Airlines, Inc., and US Airways (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.13(1) to the Form 10-K for fiscal year ended September 30, 2002 and incorporated herein by reference |
| 10.14 | Seventh Amendment to Service Agreement dated as of November 24, 2003, by and between Mesa Airlines, Inc., and US Airways (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.3(1) to the Form 10-Q for the quarter ended March 31, 2004 |
| 10.15 | Eighth Amendment to Service Agreement dated as of January 30, 2004, by and between Mesa Airlines, Inc. and US Airways (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.4(1) to the Form 10-Q for the quarter ended March 31, 2004 |
| 10.16 | Service Agreement between US Airways, Inc. and Air Midwest, Inc. dated as of May 14, 2003 (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.16(1) to the Form 10-K for Fiscal year ended September 30, 2004 and incorporated herein by reference |
| 10.17(1)(2) | Amended and Restated United Express Agreement between United Airlines, Inc. and Mesa Air Group, Inc. | Previously filed as Exhibit 10.1 to the Form 10-Q for the quarter ended June 30, 2004 and refiled herewith |

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| Exhibit Number | Description | Reference |
|-------------------|--|---|
| 10.18 | Master Purchase Agreement between Bombardier, Inc. and the Registrant Dated May 18, 2001 (Certain portions deleted Pursuant to confidential treatment) | Filed as exhibit 10.1 to the Form 10-Q for the quarter ended June 30, 2001 |
| 10.19 | Agreement between the Registrant and Barlow Capital, LLC, as amended | Filed as Exhibit 10.23 to Registrant s Form 10-K for the year ended September 30, 2001 |
| 10.20 | Employment Agreement dated as of March 31, 2004, between the Registrant and Jonathan G. Ornstein | Filed as Exhibit 10.1 to the Form 10-Q for the quarter ended March 31, 2004 |
| 10.21 | Employee Agreement, dated as of March 31, 2004, between the Registrant and Michael J. Lotz | Filed as Exhibit 10.2 to Form 10-Q for the quarter ended March 31, 2004 |
| 10.22 | Employment Agreement, dated as of December 6, 2001 between the Registrant and George Murnane III, as amended | Filed as Exhibit 10.27 to Form 10-K for fiscal year ended September 30, 2002 and incorporated herein by reference |
| 10.23 | Form of Employment Agreement entered into by and between the Registrant and Carter Leake and Brian Gillman | Filed as Exhibit 10.26 to Registrant s Form 10-K for the year ended September 30, 2001 |
| 10.24 | Three Gateway Office Lease between Registrant and DMB Property Ventures Limited Partnership, dated October 16, 1998, as amended | Filed as Exhibit 10.22 to Registrant s Form 10-K for the year ended September 30, 2002 |
| 18.1 | Letter regarding change in accounting principle | Filed as exhibit 18.1 to Registrant s form 10-K for the year ended September 30, 2001 |
| 21.1 | Subsidiaries of the Registrant | Filed herewith |
| 23.1 | Consent of Independent Registered Public Accounting Firm | Filed herewith |
| 31.1 | Certification Pursuant to Rule 13a-14(a)/ 15d-14(a) of the Securities Exchange Act of 1934, as amended | Filed herewith |
| 31.2 | Certification Pursuant to Rule 13a-14(a)/ 15d-14(a) of the Securities Exchange Act of 1934, as amended | Filed herewith |
| 32.1 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | Filed herewith |
| 32.2 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | Filed herewith |

(1)The Company has sought confidential treatment of portions of the referenced exhibits.

(2)The Company is refiling this Exhibit to include previously redacted language regarding the termination date of the agreement.

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/s/ JULIE SILCOCK

Director

December 13, 2004

Julie Silcock

/s/ JOSEPH L. MANSON

Director

December 13, 2004

Joseph L. Manson

Table of Contents**EXHIBIT INDEX**

| Exhibit Number | Description | Reference |
|-----------------------|--|--|
| 3.1 | Articles of Incorporation of Registrant dated May 28, 1996 | Filed as Exhibit 3.1 to Registrant's Form 10-K for the fiscal year ended September 30, 1996, incorporated herein by Reference |
| 3.2 | Bylaws of Registrant as amended | Filed as Exhibit 3.2 to Registrant's Form 10-K for the fiscal year ended September 30, 1996, incorporated herein by Reference |
| 4.1 | Form of Common Stock certificate | Filed as Exhibit 4.5 to Amendment No. 1 to Registrant's Form S-18, Registration No. 33-11765 filed March 6, 1987, incorporated herein by reference |
| 4.2 | Form of Common Stock certificate (issued after November 12, 1990) | Filed as Exhibit 4.8 to Form S-1, Registration No. 33-35556 effective December 6, 1990, incorporated herein by Reference |
| 4.3 | Indenture dated as of June 16, 2003 between the Registrant, the guarantors executing a signature page thereto and U.S. Bank National Association, as Trustee, relating to Senior Convertibles Notes due 2023 | Filed as Exhibit 4.1 to Form 10-Q for the quarterly period ended June 30, 2003, incorporated herein by reference |
| 4.4 | Registration Rights Agreement dated as of June 16, 2003 between the Registrant, the subsidiaries of the Registrant listed on The signature pages thereto, and Merrill Lynch & Co., a representative of the Initial Purchasers of Senior Convertibles Notes due 2023 | Filed as Exhibit 4.2 to Form 10-Q for the quarterly period ended June 30, 2003, incorporated herein by reference |
| 4.5 | Form of Guarantee (Exhibit A-2 to Indenture filed as Exhibit 4.3 above) | Filed as Exhibit 4.3 to Form 10-Q for the quarterly period ended June 30, 2003, incorporated herein by reference |
| 4.6 | Form of Senior Convertible Note due 2023 (Exhibit A-1 to Indenture filed as Exhibit 4.3 above) | Filed as Exhibit 4.4 to Form 10-Q for the quarterly period ended June 30, 2003, incorporated herein by reference |
| 4.7 | Indenture, dated as of February 10, 2004 between Mesa Air Group, Inc., the guarantors named therein and U.S. Bank National Association, as Trustee, relating to Senior Convertible Notes due 2024. | Filed as Exhibit 4.1 to Form S-3 filed on May 7, 2004, incorporated herein by reference |
| 4.8 | Registration Rights Agreement dated as of February 10, 2004 between Mesa Air Group, Inc., the subsidiaries of Mesa Air Group, Inc. listed on the signature pages thereto, and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Initial Purchaser of the Senior Convertible Notes due 2024. | Filed as Exhibit 4.2 to Form S-3 filed on May 7, 2004, incorporated herein by reference |
| 4.9 | Form of Guarantee (included in Exhibit 4.7). | Filed as Exhibit 4.1 to Form S-3 filed on May 7, 2004, incorporated herein by reference |
| 4.10 | Form of Senior Convertible Notes due 2024 (included in Exhibit 4.7). | Filed as Exhibit 4.1 to Form S-3 filed on May 7, 2004, incorporated herein by reference |

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| Exhibit Number | Description | Reference |
|-------------------|---|---|
| 5.1 | 1998 Key Officer Stock Option Plan | Filed as Appendix A to Registrant's Definitive Proxy Statement, dated June 19, 1998 |
| 5.2 | 2001 Key Officer Stock Option Plan, as amended | Filed as Exhibit 5.2 to Form 10-Q for fiscal year ended September 30, 2003 |
| 5.3 | Outside Directors' Stock Option Plan, as amended | Filed as Exhibit 5.3 to Form 10-K for fiscal year ended September 30, 2003 and incorporated herein by reference |
| 5.4 | Employee Stock Option Plan, as amended | Filed as Exhibit 5.4 to Form 10-K for fiscal year ended September 30, 2003 and incorporated herein by reference |
| 5.5 | Deferred Compensation Plan | Filed as Exhibit 5.4 to Form 10-K for fiscal year ended September 30, 2003 and incorporated herein by reference |
| 10.1 | Form of Directors' and Officers' Indemnification Agreement | Filed as Exhibit 10.1 to Form 10-K for fiscal year ended September 30, 2002 and incorporated herein by reference |
| 10.2 | Code-share and Revenue Sharing Agreement, dated as of February 1, 2001, by and between Mesa Airlines, Inc. and America West, Inc. (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.1 to Form 10-Q for the period ended March 31, 2001, incorporated herein by reference |
| 10.3 | First Amendment to Code-share and Revenue Sharing Agreement dated as of April 27, 2001, by and between Mesa Airlines, Inc. and America West, Inc. | Filed as Exhibit 10.10 to Form 10-K for Fiscal year ended September 30, 2002 and incorporated herein by reference |
| 10.4 | Second Amendment to Code-share and Revenue Sharing Agreement dated as of October 24, 2002, by and between Mesa Airlines, Inc. and America West, Inc. (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.4(1) to Form 10-K for fiscal year ended September 30, 2003 and incorporated herein by reference |
| 10.5 | Third Amendment to Code-share and Revenue Sharing Agreement dated as of December 2, 2002, by and between Mesa Airlines, Inc., Freedom Airlines, Inc. and America West, Inc. (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.5(1) to Form 10-K for fiscal year ended September 30, 2003 and incorporated herein by reference |
| 10.6 | Fourth Amendment to Code-share and Revenue Sharing Agreement dated as of September 5, 2003, by and between Mesa Airlines, Inc., Freedom Airlines, Inc., Air Midwest, Inc. and America West, Inc. (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.6(1) to Form 10-K for fiscal year ended September 30, 2003 and incorporated herein by reference |
| 10.7 | Service Agreement dated as of November 11, 1997 between Mesa Airlines, Inc. and US Airways, Inc. | Filed as Exhibit 10.86 to Form 10-Q for the quarter ended December 31, 1997 |
| 10.8 | First Amendment to Service Agreement dated as of November 24, 1999, by and between Mesa Airlines, Inc. and US Airways, Inc. (Certain portions deleted pursuant to confidential treatment.) | Filed as Exhibit 10.15 to Form 10-K for fiscal year ended September 30, 2002 and incorporated herein by reference |

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