

MESA AIR GROUP INC
Form 10-Q
February 13, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2018

Or

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

FOR THE TRANSITION PERIOD FROM TO .

Commission File Number 001-38626

MESA AIR GROUP, INC.

(Exact name of registrant as specified in its charter)

Nevada	85-0302351
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

410 North 44th Street, Suite 700

Phoenix, Arizona 85008	85008
(Address of principal executive offices)	(Zip Code)

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

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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 whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of January 31, 2019 the registrant had 24,306,411 shares of common stock, no par value per share, issued and outstanding.

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Where You Can Find More Information

Investors and others should note that we may announce material business and financial information to our investors using our investor relations website (<http://investor.mesa-air.com/>), SEC filings, webcasts, press releases, and conference calls. We use these mediums, including our website, to communicate with our members and public about our company, our products, and other issues. It is possible that the information that we make available may be deemed to be material information. We therefore encourage investors and others interested in our company to review the information that we make available on our website.

Cautionary Note Regarding Forward Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical fact contained in this Quarterly Report on Form 10-Q, including statements regarding our future results of operations and financial position, business strategy and plans, and objectives of management for future operations, are forward-looking statements. These statements involve known and unknown risks, uncertainties, and other important factors that may cause our actual results, performance or achievements to be materially different from any future results, performance, or achievements expressed or implied by the forward-looking statements.

In some cases, you can identify forward-looking statements by terms such as "may," "should," "expects," "might," "plans," "anticipates," "could," "intends," "target," "projects," "contemplates," "believes," "estimates," "predicts," "potential," "seek," "would" or "continue," or the negative of these terms or other similar expressions. The forward-looking statements in this Quarterly Report on Form 10-Q are only predictions. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, financial condition and results of operations. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that the future results, levels of activity, performance or events and circumstances reflected in the forward-looking statements will be achieved or occur. These forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q and are subject to a number of risks, uncertainties and assumptions described in the "Risk Factors" section and elsewhere in this Quarterly Report on Form 10-Q. Because forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified, you should not rely on these forward-looking statements as predictions of future events. The events and circumstances reflected in our forward-looking statements may not be achieved or occur and actual results could differ materially from those projected in the forward-looking statements. Some of the key factors that could cause actual results to differ from our expectations include:

- the supply and retention of qualified airline pilots;
- the volatility of pilot attrition;
- dependence on, and changes to, or non-renewal of, our capacity purchase agreements;
- increases in our labor costs;
- reduced utilization (the percentage derived from dividing (i) the number of block hours actually flown during a given month under a particular capacity purchase agreement by (ii) the maximum number of block hours that could be flown during such month under the particular capacity purchase agreement) under our capacity purchase agreements;
- direct operation of regional jets by our major airline partners;
- the financial strength of our major airline partners;
- limitations on our ability to expand regional flying within the flight systems of our major airline partners' and those of other major airlines;
- our significant amount of debt and other contractual obligations;
- our compliance with ongoing financial covenants under our credit facilities; and
- our ability to keep costs low and execute our growth strategies.

While we may elect to update these forward-looking statements at some point in the future, whether as a result of any new information, future events, or otherwise, we have no current intention of doing so except to the extent required by applicable law.

Part I – Financial Information

Item 1. Financial Statements

MESA AIR GROUP, INC.

Condensed Consolidated Balance Sheets

(In thousands) (Unaudited)

	December 31, 2018	September 30, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$88,600	\$103,311
Marketable securities	14,974	19,921
Restricted cash	3,644	3,823
Receivables, net	6,015	14,290
Expendable parts and supplies, net	17,402	15,658
Prepaid expenses and other current assets	43,018	40,914
Total current assets	173,653	197,917
Property and equipment, net	1,247,784	1,250,829
Intangibles, net	10,889	11,341
Lease and equipment deposits	1,838	2,598
Other assets	9,798	9,703
Total assets	\$1,443,962	\$1,472,388
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt and capital leases	\$149,842	\$155,170
Accounts payable (\$2,046 and \$1,330 to related party)	40,439	54,307
Accrued compensation	9,920	12,208
Other accrued expenses	31,017	29,696
Total current liabilities	231,218	251,381
Noncurrent liabilities:		
Long-term debt and capital leases, excluding current portion	727,839	760,177
Deferred credits (\$7,366 and \$7,702 to related party)	14,412	15,393
Deferred income taxes	45,750	39,797
Other noncurrent liabilities	29,584	31,173
Total noncurrent liabilities	817,585	846,540
Total liabilities	1,048,803	1,097,921
Commitments and contingencies (Note 13 and Note 14)		
Stockholders' equity:		
Preferred stock of no par value, 5,000,000 shares authorized;		
no shares issued and outstanding	—	—
Common stock of no par value and additional paid-in capital,	236,294	234,683

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125,000,000 shares authorized; 23,902,903 shares issued

and outstanding, 10,614,990 warrants issued and outstanding

Retained earnings	158,865	139,784
Total stockholders' equity	395,159	374,467
Total liabilities and stockholders' equity	\$1,443,962	\$1,472,388

See accompanying notes to these condensed consolidated financial statements.

MESA AIR GROUP, INC.

Condensed Consolidated Statements of Operations

(In thousands, except per share amounts) (Unaudited)

	Three Months Ended December 31,	
	2018	2017
Operating revenues:		
Contract revenue (\$93,631 and \$85,994 from related party)	\$ 170,449	\$ 154,389
Pass-through and other (\$1,659 and \$1,687 from related party)	7,707	10,295
Total operating revenues	178,156	164,684
Operating expenses:		
Flight operations	53,245	49,160
Fuel	121	68
Maintenance	39,802	54,347
Aircraft rent	14,119	18,263
Aircraft and traffic servicing	934	961
General and administrative	12,214	10,930
Depreciation and amortization	18,491	15,932
Total operating expenses	138,926	149,661
Operating income	39,230	15,023
Other (expenses) income, net:		
Interest expense	(14,842)	(14,131)
Interest income	156	9
Other (expense) income, net	486	(66)
Total other (expense), net	(14,200)	(14,188)
Income before taxes	25,030	835
Income tax expense (benefit)	5,949	(21,789)
Net income	\$ 19,081	\$ 22,624
Net income per share attributable to common shareholders		
Basic	\$ 0.80	\$ 2.00
Diluted	\$ 0.55	\$ 0.96
Weighted-average common shares outstanding		
Basic	23,903	11,294
Diluted	34,821	23,559

See accompanying notes to these condensed consolidated financial statements.

MESA AIR GROUP, INC.

Condensed Consolidated Statement of Stockholders' Equity

(In thousands, except share amounts) (Unaudited)

	Three Months Ended December 31, 2017				
	Number of Shares	Number of Warrants	Common Stock and Additional Paid-In Capital	Retained Earnings	Total
Balance at September 30, 2017	11,294,083	12,230,625	\$ 114,456	\$ 107,768	\$ 222,224
Stock compensation expense	—	—	428	—	428
Cumulative effect of change in accounting principle (See note 3)	—	—	—	665	665
Net income	—	—	—	22,624	22,624
Balance at December 31, 2017	11,294,083	12,230,625	\$ 114,884	\$ 131,057	\$ 245,941

	Three Months Ended December 31, 2018				
	Number of Shares	Number of Warrants	Common Stock and Additional Paid-In Capital	Retained Earnings	Total
Balance at September 30, 2018	23,902,903	10,614,990	\$ 234,683	\$ 139,784	\$ 374,467
Stock compensation expense	—	—	1,454	—	1,454
Stock issuance costs	—	—	157	—	157
Net income	—	—	—	19,081	19,081
Balance at December 31, 2018	23,902,903	10,614,990	\$ 236,294	\$ 158,865	\$ 395,159

See accompanying notes to these condensed consolidated financial statements.

MESA AIR GROUP, INC.

Condensed Consolidated Statements of Cash Flows

(In thousands) (Unaudited)

	Three Months Ended December 31,	
	2018	2017
Cash flows from operating activities:		
Net income	\$ 19,081	\$ 22,624
Adjustments to reconcile net income to net cash flows provided by operating activities:		
Depreciation and amortization	18,491	15,932
Stock compensation expense	1,454	428
Deferred income taxes	5,953	(19,253)
Amortization of unfavorable lease liabilities and deferred credits	(2,736)	(2,695)
Amortization of debt financing costs and accretion of interest on non-interest-bearing subordinated notes	1,042	1,769
(Gain) loss on disposal of assets	(1)	82
Provision for obsolete expendable parts and supplies	122	62
Changes in assets and liabilities:		
Receivables	8,275	(1,442)
Expendable parts and supplies	(1,866)	(286)
Prepaid expenses and other current assets	(2,042)	6,890
Accounts payable	(2,829)	2,705
Accrued liabilities	(799)	1,296
Net cash provided by operating activities	44,145	28,112
Cash flows from investing activities:		
Capital expenditures	(26,036)	(10,312)
Sales of investment securities	4,947	—
Net returns of lease and equipment deposits	760	85
Net cash used in investing activities	(20,329)	(10,227)
Cash flows from financing activities:		
Proceeds from long-term debt	—	76,903
Principal payments on long-term debt and capital leases	(38,605)	(69,840)
Debt financing costs	(258)	(2,476)
Stock issuance costs	157	—
Net cash (used in) provided by financing activities	(38,706)	4,587
Net change in cash, cash equivalents and restricted cash	(14,890)	22,472
Cash, cash equivalents and restricted cash at beginning of period	107,134	60,347
Cash, cash equivalents and restricted cash at end of period	\$ 92,244	\$ 82,819
Supplemental cash flow information		
Cash paid for interest	\$ 12,266	\$ 8,760

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Cash paid for income taxes, net	\$ —	\$ 21
Supplemental non-cash investing and financing activities		
Accrued capital expenditures	\$ 5,635	\$ —

See accompanying notes to these condensed consolidated financial statements.

MESA AIR GROUP, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Organization and Operations
About Mesa Air Group, Inc.

Headquartered in Phoenix, Arizona, Mesa Air Group, Inc. ("Mesa" or the "Company") is a holding company whose principal subsidiary, Mesa Airlines, Inc. ("Mesa Airlines"), operates as a regional air carrier providing scheduled passenger service to 121 cities in 40 states, the District of Columbia, Canada, Mexico, Cuba, and the Bahamas. As of December 31, 2018, Mesa operated a fleet of 145 aircraft with approximately 628 daily departures and 3,400 employees. Mesa operates all of its flights as either American Eagle or United Express flights pursuant to the terms of the capacity purchase agreements entered into with American Airlines, Inc. and United Airlines, Inc.

The financial arrangements between the Company and its major airline partners involve a revenue-guarantee arrangement (i.e. a "capacity purchase agreement") whereby the major airline pays a monthly guaranteed amount for each aircraft under contract, a fixed fee for each block hour and flight flown and reimbursement of certain direct operating expenses in exchange for providing regional flying. The major airline partners also pay certain expenses directly to suppliers, such as fuel, ground operations and landing fees. Under the terms of these capacity purchase agreements, the major airline controls route selection, pricing and seat inventories, thereby reducing the Company's exposure to fluctuations in passenger traffic, fare levels, and fuel prices.

On August 8, 2018, the Company filed its Second Amended and Restated Articles of Incorporation, which, among other things: (i) effected a 2.5-for-1 stock split of its common stock; and (ii) increased the authorized number of shares of its common and preferred stock to 125,000,000 and 5,000,000, respectively. All references to share and per share amounts in the Company's condensed consolidated financial statements have been retrospectively revised to reflect the stock split and increase in authorized shares.

On August 14, 2018, the Company completed an initial public offering ("IPO") of its common stock, in which it issued and sold 9,630,000 shares (the "Firm Shares") of common stock at a public offering price of \$12.00 per share, resulting in gross proceeds to the Company of approximately \$115.6 million. Additionally, in connection with the IPO, the Company granted the underwriters an option to purchase up to an additional 1,444,500 shares of common stock at the same price. On September 11, 2018, the Company closed the sale of 1,344,500 shares ("Option Shares") of its common stock, in connection with the partial exercise of the overallotment option granted to the underwriters in its IPO. Of the 1,344,500 Option Shares sold, 723,985 were purchased directly from the Company and the remaining 620,515 shares were purchased directly from the selling shareholders. The Firm Shares and Option Shares were sold to the public for a price of \$12.00 per share.

The sale of the Firm Shares and Option Shares raised gross proceeds of approximately \$124.2 million. The Company did not receive any proceeds from the sale of the Option Shares by the selling shareholders. The Company received \$111.7 million in net proceeds after deducting \$8.7 million of underwriting discounts and commissions and \$3.8 million in offering costs.

As part of the IPO, stock appreciation rights ("SARs") previously issued under the Mesa Air Group, Inc. Amended and Restated Stock Appreciation Rights Plan (the "SAR Plan"), which settled only in cash, were cancelled and exchanged for an aggregate of 1,266,034 shares of restricted common stock under the Company's 2018 Equity Incentive Plan (the "2018 Plan"), of which 966,022 were fully vested upon issuance and are included in the number of shares of common stock outstanding after the IPO. Of the 966,022 fully vested shares, 314,198 shares were retained by the Company to satisfy tax withholding obligations, resulting in a net issuance of 651,824 shares. Additionally,

983,113 shares of restricted common stock were issued to certain of its employees and directors under its 2018 Plan in exchange for the cancellation of 491,915 shares of existing unvested restricted phantom stock units and 491,198 shares of restricted stock under the 2011 and 2017 Plans, respectively.

American Capacity Purchase Agreement

As of December 31, 2018, the Company operated 64 CRJ-900 aircraft for American under a capacity purchase agreement (the "American Capacity Purchase Agreement"). Unless otherwise extended or amended, the capacity purchase agreement for the aircraft expires between 2021 and 2025. In exchange for providing flights and all other services under the agreement, the Company receives a fixed monthly minimum amount per aircraft, plus certain additional amounts based upon the number of flights and block hours (the number of hours during which the aircraft is in revenue service, measured from the time of gate departure before take-off until the time of gate arrival at the destination) flown during the month. In addition, the Company may also receive incentives or pay penalties based upon the Company's operational performance, including controllable on-time departure and controllable completion percentages. American also reimburses the Company for the actual amount incurred for certain items such as passenger liability and hull insurance, and aircraft property taxes. In addition, American also provides, at no cost to the Company, certain ground

handling and customer service functions, as well as airport-related facilities and fuel. The Company also receives a monthly profit margin payment from American based on the number of aircraft operating. The capacity purchase agreement is subject to early termination for cause under specified circumstances and subject to the Company's right to cure under certain conditions. American had a 7.2% ownership interest in the Company, calculated on a fully-diluted basis as of December 31, 2018, and September 30, 2018. The related party amounts presented on the condensed consolidated balance sheets and statements of operations pertain to American.

United Capacity Purchase Agreement

As of December 31, 2018, the Company operated 20 CRJ-700 and 60 E-175 aircraft for United under a capacity purchase agreement (the "United Capacity Purchase Agreement"). Subject to certain early termination rights, the capacity purchase agreement for each of the 20 CRJ-700 aircraft expires between August and December 2019. Subject to early termination rights, the capacity purchase agreement for 30 of the E-175 aircraft (owned by United) expires between June 2019 and August 2020, subject to United's right to extend for four additional two-year terms (maximum of eight years). Subject to early termination rights, the capacity purchase agreement for 18 of the E-175 aircraft (owned by Mesa) expires between January 2028 and November 2028. During fiscal 2017, the Company and United expanded the capacity purchase agreement to include, subject to early termination rights, an additional 12 E-175 aircraft (purchased by United) with the aircraft entering service through January 2018 for five-year terms, subject to United's right to extend for four additional two-year terms (maximum of eight years). In exchange for performing the flight services under such agreement, the Company receives from United a fixed monthly minimum amount per aircraft, plus certain additional amounts based upon the number of flights and block hours flown during the month. Additionally, certain costs incurred by the Company in performing the flight services are "pass-through" costs, whereby United agrees to reimburse the Company for the actual amounts incurred for the following items: property tax per aircraft, passenger liability insurance, and additionally for the E-175 aircraft owned by United, heavy airframe and engine maintenance, landing gear, auxiliary power units ("APU") and component maintenance. The Company also receives a profit margin based upon certain reimbursable costs under the agreement, as well as its operational performance in addition to a fixed profit margin. The capacity purchase agreement is also subject to early termination for cause under specified circumstances and subject to the Company's right to cure under certain circumstances. United is also permitted, subject to certain conditions, to terminate the agreement early in its discretion by giving us notice of 90 days or more.

In February 2018, the Company mutually agreed with United to temporarily remove two aircraft from service under its United capacity purchase agreement until the Company was able to fully staff flight operations. During the temporary removal, the Company agreed to pay the lease costs associated with the two E-175 aircraft, which totaled \$1.9 million. In June 2018, the Company was able to fully staff flight operations and these two E-175 aircraft were placed back into service under the United capacity purchase agreement.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and include the accounts of the Company and its wholly owned operating subsidiaries. Any reference in these notes to applicable guidance is meant to refer to the authoritative United States generally accepted accounting principles as found in the Accounting Standards Codification ("ASC") and Accounting Standards Update ("ASU") of the Financial Accounting Standards Board ("FASB"). All intercompany accounts and transactions have been eliminated in consolidation.

These condensed consolidated financial statements should be read in conjunction with, the Company's audited consolidated financial statements and notes thereto as of and for the year ended September 30, 2018 included in the Company's Annual Report on Form 10-K for the year ended September 30, 2018 on file with the U.S. Securities and Exchange Commission (the "SEC"). Information and footnote disclosures normally included in financial statements

have been condensed or omitted in these condensed consolidated financial statements pursuant to the rules and regulations of the SEC and GAAP. These condensed consolidated financial statements reflect all adjustments that, in the opinion of management, are necessary to present fairly the results of operations for the interim periods presented.

The Company is an "emerging growth company," as defined in the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act,") and may remain an emerging growth company until the last day of its fiscal year following the fifth anniversary of the IPO, subject to specified conditions. The JOBS Act provides that an emerging growth company can take advantage of the extended transition period afforded by the JOBS Act for the implementation of new or revised accounting standards. The Company has elected to "opt out" of such extended transition period, which means that when a standard is issued or revised and it has different application dates for public or private companies, the Company will be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies.

Adoption of New Revenue Standard

On October 1, 2018, the Company adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09" or "Topic 606") using the modified retrospective method. See Note 3: "Recent Accounting Pronouncements" for more information. To conform to Topic 606, the Company modified its revenue recognition policy as described below.

Revenue Recognition

The Company recognizes revenue when the service is provided under its capacity purchase agreements. Under these agreements, the major airline partners generally pay a fixed monthly minimum amount per aircraft, plus certain additional amounts based upon the number of flights and block hours flown. The contracts also include reimbursement of certain costs incurred by the Company in performing flight services. These costs, known as "pass-through costs," may include passenger and hull insurance as well as aircraft property taxes. Additionally, for the E-175 aircraft owned by United, the capacity purchase agreement provides that United will reimburse the Company for heavy airframe and engine maintenance, landing gear, APUs and component maintenance. The Company also receives compensation under its capacity purchase agreements for heavy maintenance expenses at a fixed hourly rate or per aircraft rate for all aircraft in scheduled service other than the E-175 aircraft owned by United. The contracts also include a profit margin on certain reimbursable costs, as well as a profit margin, incentives and penalties based on certain operational benchmarks. The Company is eligible to receive incentive compensation upon the achievement of certain performance criteria defined in the capacity purchase agreements. At the end of each period during the term of an agreement, the Company calculates the incentives achieved during that period and recognizes revenue attributable to the agreement during the period accordingly, subject to the variable constraint guidance under Topic 606. All revenue recognized under these contracts is presented as the gross amount billed to the major airline partners.

Under the capacity purchase agreements, the Company has committed to perform various activities that can be generally classified into in-flight services and maintenance services. When evaluating these services, the Company determined that the nature of its promise is to provide a single integrated service, flight services, because its contracts require integration and assumption of risk associated with both services to effectively deliver and provide the flights as scheduled over the contract term. Therefore, the in-flight services and maintenance services are inputs to that combined integrated flight service. Both the services occur over the term of the agreement and the performance of maintenance services significantly effects the utility of the in-flight services. The Company's individual flights flown under the capacity purchase agreements are deemed to be distinct and the flight service promised in the capacity purchase agreements represents a series of services that should be accounted for as a single performance obligation. This single performance obligation is satisfied over time as the flights are completed. Therefore, revenue is recognized when each flight is completed.

In allocating the transaction price, variable payments (i.e. billings based on flights and block hours flown, pass-through costs, etc.) that relate specifically to the Company's efforts in performing flight services are recognized in the period in which the individual flight is completed. The Company has concluded that allocating the variability directly to the individual flights results in an overall allocation meeting the objectives in ASC 606. This results in a pattern of revenue recognition that follows the variable amounts billed from the Company to their customers.

A portion of the Company's compensation under its capacity purchase agreements with American and United is designed to reimburse the Company for certain aircraft ownership costs. The Company has concluded that a component of its revenue under these agreements is deemed to be lease revenue, as such agreements identify the "right of use" of a specific type and number of aircraft over a stated period-of-time. The lease revenue associated with the Company's capacity purchase agreements is accounted for as an operating lease and is reflected as contract revenue on the Company's condensed consolidated statements of operations. The Company recognized \$54.9 million and \$54.6 million of lease revenue for the three months December 31, 2018 and 2017, respectively. The Company has not separately stated aircraft rental income and aircraft rental expense in the condensed consolidated statements of operations because the use of the aircraft is not a separate activity of the total service provided.

The Company's capacity purchase agreements are renewable periodically and contain provisions pursuant to which the parties could terminate their respective agreements, subject to certain conditions as described in Note 1. The capacity purchase agreements also contain terms with respect to covered aircraft, services provided and compensation as described in Note 1. The capacity purchase agreements are amended from time to time to change, add or delete terms of the agreements.

The Company's revenues could be impacted by a number of factors, including amendment or termination of its capacity purchase agreements, contract modifications resulting from contract renegotiations, its ability to earn incentive payments contemplated under applicable agreements, and settlement of reimbursement disputes with the Company's major airline partners. In the event contracted rates are not finalized at a quarterly or annual financial statement date, the Company evaluates the enforceability of its contractual terms and when it has an enforceable right, it estimates the amount the Company expects to be entitled to that is subject to the ASC 606 constraint.

The Company's capacity purchase agreements contain an option that allows its major airline partners to assume the contractual responsibility for procuring and providing the fuel necessary to operate the flights that it operates for them. Both of the Company's major airline partners have exercised this option. Accordingly, the Company does not record an expense or revenue for fuel and related fueling costs for flying under its capacity purchase agreements. In addition, the Company's major airline partners also provide, at no cost to the Company, certain ground handling and customer service functions, as well as airport-related facilities and gates at their hubs and other cities. Services and facilities provided by the Company's major airline partners at no cost are presented net in its condensed consolidated financial statements; hence, no amounts are recorded for revenue or expense for these items.

Contract Liabilities

Contract liabilities consist of deferred credits for cost reimbursements from major airline partners related to aircraft modifications associated with capacity purchase agreements and pilot training. The deferred credits are recognized over time depicting the pattern of transfer of control of services resulting in ratable recognition of revenue over the remaining term of the capacity purchase agreements.

Current and non-current deferred credits are recorded to other accrued expenses and non-current deferred credits in the condensed consolidated balance sheets. The Company's total current and non-current deferred credit balances at December 31, 2018 and September 30, 2018 are \$14.4 million and \$15.4 million, respectively. The Company recognized \$1.2 million and \$1.0 million of the deferred credits to revenue in the condensed consolidated statement of operations during the three months ended December 31, 2018 and 2017, respectively.

Contract Assets

The Company recognizes assets from the costs incurred to fulfill a contract including aircraft painting and reconfiguration and flight service personnel training costs. These costs are amortized based on the pattern of transfer of the services in relation to flight hours over the term of the contract. Contract assets are recorded as other assets in the condensed consolidated balance sheets. The Company's contract assets balances at December 31, 2018 and

September 30, 2018 are \$4.1 million and \$4.6 million, respectively. Contract cost amortization was \$0.5 million for the three months ended December 31, 2018 and 2017.

Use of Estimates

The preparation of the Company's condensed consolidated financial statements in conformity with GAAP 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 condensed consolidated financial statements. Actual results could differ from those estimates.

Maintenance Expense

The Company operates under a Federal Aviation Administration ("FAA") approved continuous inspection and maintenance program. The Company uses the direct expense method of accounting for its maintenance of regional jet engine overhauls, airframe, landing gear, and normal recurring maintenance wherein the Company recognizes the expense when the maintenance work is completed, or over the repair period, if materially different. For leased aircraft, the Company is subject to lease return provisions that require a minimum portion of the "life" of an overhaul be remaining on the engine at the lease return date. The Company estimates the cost of maintenance lease return obligations and accrues such costs over the remaining lease term when the expense is probable and can be reasonably estimated.

Under the Company's aircraft operating lease agreements and FAA operating regulations, it is obligated to perform all required maintenance activities on its fleet, including component repairs, scheduled air frame checks and major engine restoration events. The Company estimates the timing of the next major maintenance event based on assumptions including estimated usage, FAA-mandated maintenance intervals and average removal times as recommended by the manufacturer. The timing and the cost of maintenance are based on estimates, which can be impacted by changes in utilization of its aircraft, changes in government regulations and suggested manufacturer maintenance intervals. Major maintenance events consist of overhauls to major components.

Engine overhaul expense totaled \$4.1 million, and \$19.5 million for the three months ended December 31, 2018, and 2017, respectively, of which \$1.5 million and \$2.3 million, respectively, was pass-through expense. Airframe C-check expense totaled \$1.5 million and \$5.6 million for the three months ended December 31, 2018, and 2017, respectively, of which \$0 million, and \$3.0 million, respectively, was pass-through expense.

3. Recent Accounting Pronouncements

In May 2014, the FASB issued ASU ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("Topic 606"). Topic 606 establishes a new recognition model that requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be entitled in exchange for those goods or services. On October 1, 2018, the Company adopted this ASU using the modified retrospective method. Under the new standard, the Company concluded that, in addition to the aircraft lease, the individual flights are distinct services and the flight services promised in the capacity purchase agreements represent a series of services that should be accounted for as a single performance obligation. Revenue is recognized over time as the flights are completed. The adoption of this ASU did not have an impact on recorded amounts when applied to the opening balance sheet as of October 1, 2018. The adoption did not impact the condensed consolidated financial statements presented other than the disclosures noted in Note 2.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments—Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"), which provides guidance related to the classification and measurement of financial instruments. The guidance primarily impacts the accounting for equity investments other than those accounted for using the equity method of accounting, financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. The accounting for other financial instruments, such as loans, investments in debt securities and financial liabilities is largely unchanged. The

guidance is effective for fiscal years beginning after December 15, 2017 with early adoption permitted. The Company has adopted ASU 2016-01 effective October 1, 2018; the adoption of this standard did not have a material impact on the financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which was subsequently amended and clarified and provides guidance requiring lessees to recognize a right-of-use asset and a lease liability on the balance sheet for substantially all leases, with the exception of short-term leases. Leases will be classified as either financing or operating, with classification affecting the pattern of expense recognition in the statement of income. The guidance is effective for annual periods beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the potential impact of adopting this new guidance on its condensed consolidated financial statements.

In March of 2016, the FASB issued Accounting Standards Update No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). With this standard, all excess tax benefits and tax deficiencies are required to be recognized as income tax benefit or expense in the income statement. The tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur. An entity also should recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company adopted ASU 2016-09 in the first quarter of the year ended September 30, 2018. This change in accounting principle has been applied on a modified retrospective transition method by means of a cumulative effect adjustment to equity as of the beginning of fiscal year 2018 as a cumulative-effect adjustment increasing deferred tax assets by \$0.4 million, increasing income tax expense by \$0.3 million, and increasing retained earnings by \$0.7 million. Adoption of ASU 2016-09 did not have any other material effect on the Company's results of operations, financial position or cash flows.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the FASB Emerging Issues Task Force), which clarifies how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The new standard is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. The Company adopted the standard effective October 1, 2018; the adoption of this standard did not have a material impact on the financial statements.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force), that requires restricted cash and cash equivalents to be included with cash and cash equivalents on the statement of cash flows. The new standard is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. The Company adopted the standard effective October 1, 2018 and modified the presentation to include changes in restricted cash in the Company's Condensed Consolidated Statement of Cash Flows.

4. Concentrations

At December 31, 2018, the Company had capacity purchase agreements with American and United. All of the Company's condensed consolidated revenue for the three months ended December 31, 2018 and 2017 and accounts receivable at the end of each of these periods was derived from these agreements. The terms of both the American and United capacity purchase agreements are not aligned with the lease obligations on the aircraft performing services under such agreements.

Amounts billed by the Company under capacity purchase agreements are subject to the Company's interpretation of the applicable capacity purchase agreement and are subject to audit by the Company's major airline partners. Periodically, the Company's major airline partners dispute amounts billed and pay amounts less than the amount billed. Ultimate collection of the remaining amounts not only depends upon the Company prevailing under the applicable audit, but also upon the financial well-being of the major airline 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 \$1.3 million at December 31, 2018 and September 30, 2018. If the Company's ability to collect these receivables and the financial viability of its partners is materially different than estimated, the Company's estimate of the allowance could be materially impacted.

American accounted for approximately 53% of the Company's total revenue for the three months ended December 31, 2018 and 2017. United accounted for approximately 47% of the Company's revenue for the three months ended December 31, 2018 and 2017. A termination of either the American or the United capacity purchase agreement would have a material adverse effect on the Company's business prospects, financial condition, results of operations, and cash flows.

5. Intangible Assets

Information about the intangible assets of the Company at December 31, 2018 and September 30, 2018, were as follows (in thousands):

	December 31, 2018	September 30, 2018
Customer relationship	\$ 43,800	\$ 43,800
Accumulated amortization	(32,911)	(32,459)
	\$ 10,889	\$ 11,341

Total amortization expense recognized was approximately \$0.5 million and \$0.1 million for the three months ended December 31, 2018 and 2017, respectively. The Company expects to record amortization expense of \$1.4 million for the remainder of 2019, and \$1.5 million, \$1.2 million, \$1.0 million, \$0.9 million for fiscal years 2020, 2021, 2022, and 2023 respectively.

6. Balance Sheet Information

Certain significant amounts included in the Company's condensed consolidated balance sheet as of December 31, 2018 and September 30, 2018, consisted of the following (in thousands):

	December 31, 2018	September 30, 2018
Expendable parts and supplies, net		
Expendable parts and supplies	\$ 20,830	\$ 18,907
Less obsolescence and other	(3,428)	(3,249)
	\$ 17,402	\$ 15,658
Prepaid expenses and other current assets		
Prepaid aircraft rent	\$ 33,849	\$ 30,267
Unutilized manufacturer credits	4,500	4,500
Deferred offering and reimbursed costs	1,925	1,945
Other	2,744	4,202
	\$ 43,018	\$ 40,914
Property and equipment—net		
Aircraft and other flight equipment substantially		
pledged	\$ 1,516,680	\$ 1,502,940
Other equipment	3,707	3,721
Leasehold improvements	2,836	2,754
Vehicles	842	692
Building	699	699
Furniture and fixtures	287	287
Total property and equipment	1,525,051	1,511,093
Less accumulated depreciation	(277,267)	(260,264)
	\$ 1,247,784	\$ 1,250,829

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Other accrued expenses		
Accrued property taxes	\$ 7,272	\$ 6,981
Accrued interest	7,742	6,118
Accrued vacation	5,557	5,470
Accrued wheels, brakes and tires	1,459	1,452
Other	8,987	9,675
	\$ 31,017	\$ 29,696

Depreciation expense totaled approximately \$18.0 million and \$15.8 million for the three months ended December 31, 2018 and 2017, respectively.

The Company recorded amortization of the unfavorable lease liability for approximately \$1.5 million and \$1.7 million for the three months ended December 31, 2018 and 2017, respectively, as a reduction to lease expense.

7. Fair Value Measurements

The carrying values reported in the condensed consolidated balance sheets for cash and cash equivalents, accounts receivable, and accounts payable approximate fair value because of the immediate or short-term maturity of these financial instruments. Marketable securities are reported at fair value based on market quoted prices in the condensed consolidated balance sheets.

The Company's debt agreements are not traded on an active market. The Company has determined the estimated fair value of its debt to be Level 3, as certain inputs used to determine the fair value of these agreements are unobservable and, therefore, could be sensitive to changes in inputs. The Company utilizes the discounted cash flow method to estimate the fair value of Level 3 debt.

The carrying value and estimated fair value of the Company's long-term debt, including current maturities, were as follows (in millions):

	December 31, 2018		September 30, 2018	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt, including current maturities ⁽¹⁾	\$ 891.7	\$ 889.2	\$ 930.2	\$ 926.2

⁽¹⁾ Current and prior period long-term debts' carrying and fair values exclude net debt issuance costs.

8. Long-Term Debt and Other Borrowings

Long-term debt as of December 31, 2018 and September 30, 2018, consisted of the following (in thousands):

	December 31, 2018	September 30, 2018
Notes payable to financial institution, collateralized by the underlying aircraft, due 2019 ⁽¹⁾⁽²⁾	\$ 1,780	\$ 4,428
Notes payable to financial institution, collateralized by the underlying aircraft, due 2022 ⁽³⁾⁽⁴⁾	63,784	69,340
Notes payable to financial institution, collateralized by the underlying aircraft, due 2024 ⁽⁵⁾	69,231	72,438
Senior and subordinated notes payable to secured parties, collateralized by the underlying aircraft, due 2027 ⁽⁶⁾	119,701	122,591
Notes payable to secured parties, collateralized by the underlying aircraft, due 2028 ⁽⁷⁾	209,240	209,240
Senior and subordinated notes payable to secured parties, collateralized by the underlying aircraft, due 2028 ⁽⁸⁾	163,734	167,269
Senior and subordinated notes payable to secured parties, collateralized by the underlying aircraft, due 2022 ⁽¹⁷⁾	89,440	95,060
Notes payable to financial institution, collateralized by the underlying equipment, due 2022 ⁽⁹⁾	84,872	88,162
Senior and subordinated notes payable to secured parties, collateralized by the underlying aircraft, due 2022 ⁽¹⁰⁾	59,467	63,403
Notes payable to financial institution, collateralized by the underlying equipment, due 2020 ⁽¹¹⁾	2,903	3,318
Notes payable to financial institution due 2020 ⁽¹²⁾	3,852	4,360
Notes payable to financial institution, collateralized by the underlying equipment, due 2020 ⁽¹³⁾	12,159	14,971
Notes payable to financial institution due 2019 ⁽¹⁴⁾	2,088	5,896
Working capital draw loan, collateralized by certain flight equipment and spare parts ⁽¹⁵⁾	—	—
Other obligations due to financial institution, collateralized by the underlying equipment, due 2023 ⁽¹⁶⁾	9,441	9,731
Total long-term debt	891,692	930,207
Less current portion	(149,842)	(155,170)
Less unamortized debt issuance costs	(14,011)	(14,860)
Long-term debt—excluding current portion	\$ 727,839	\$ 760,177

(1) In fiscal 2005, the Company financed five CRJ-900 aircraft with \$118 million in debt. The debt bears interest at the monthly London Inter-bank Offered Rate ("LIBOR"), plus 3% (5.503% at December 31, 2018) and requires monthly principal and interest payments.

(2) In fiscal 2004, the Company financed five CRJ-700 and nine CRJ 900 aircraft with \$254.7 million in debt. The debt bears interest at the monthly LIBOR plus 3% (5.503% at December 31, 2018) and requires monthly principal and interest payments.

(3) In fiscal 2007, the Company financed three CRJ-900 and three CRJ-700 aircraft for \$120.3 million. The debt bears interest at the monthly LIBOR plus 2.25% (4.753% at December 31, 2018) and requires monthly principal and interest payments.

(4)

In fiscal 2014, the Company financed 10 CRJ-900 aircraft for \$88.4 million. The debt bears interest at the monthly LIBOR plus a spread ranging from 1.95% to 7.25% (4.453% to 9.753% at December 31, 2018) and requires monthly principal and interest payments.

- (5) In fiscal 2014, the Company financed eight CRJ-900 aircraft with \$114.5 million in debt. The debt bears interest at 5% and requires monthly principal and interest payments.

- (6) In fiscal 2015, the Company financed seven CRJ-900 aircraft with \$170.2 million in debt. The senior notes payable of \$151 million bear interest at monthly LIBOR plus 2.71% (5.213% at December 31, 2018) and require monthly principal and interest payments. The subordinated notes payable are noninterest-bearing and become payable in full on the last day of the term of the notes. The Company has imputed an interest rate of 6.25% on the subordinated notes payable and recorded a related discount of \$8.1 million, which is being accreted to interest expense over the term of the notes.
- (7) In fiscal 2016, the Company financed 10 E-175 aircraft with \$246 million in debt under an EETC financing arrangement (see discussion below). The debt bears interest ranging from 4.75% to 6.25% and requires semi-annual principal and interest payments.
- (8) In fiscal 2016, the Company financed eight E-175 aircraft with \$195.3 million in debt. The senior notes payable of \$172 million bear interest at the three-month LIBOR plus a spread ranging from 2.20% to 2.32% (5.008% to 5.128% at December 31, 2018) and require quarterly principal and interest payments. The subordinated notes payable bear interest at 4.50% and require quarterly principal and interest payments.
- (9) In fiscal 2017, the Company financed certain flight equipment with \$99.1 million in debt. The debt bears interest at the monthly LIBOR (rounded to the nearest 16th) plus 7.25% (9.753% at December 31, 2018) and requires monthly principal and interest payments.
- (10) In December 2017, the Company refinanced nine CRJ-900 aircraft with \$74.9 million in debt. The senior notes payable of \$46.9 million bear interest at the three-month LIBOR plus 3.50% (6.308% at December 31, 2018) and require quarterly principal and interest payments. The subordinated notes payable bear interest at the three-month LIBOR plus 4.50% (7.308% at December 31, 2018) and require quarterly principal and interest payments.
- (11) In fiscal 2015, the Company financed certain flight equipment with \$8.3 million in debt. The debt bears interest at 5.163% and requires monthly principal and interest payments.
- (12) In fiscal 2015 and 2016, the Company financed certain flight equipment maintenance costs with \$10.2 million in debt. The debt bears interest at the monthly LIBOR plus 3.07% (5.878% at December 31, 2018) and requires quarterly principal and interest payments.
- (13) In fiscal 2016 and 2017, the Company financed certain flight equipment maintenance costs with \$11.9 million in debt. The debt bears interest at the three-month LIBOR plus a spread ranging from 2.93% to 2.96% (5.738% to 5.768% at December 31, 2018) and requires quarterly principal and interest payments. The debt is subject to a fixed charge ratio covenant. As of December 31, 2018, the Company was in compliance with this covenant.
- (14) In fiscal 2017, the Company financed certain flight equipment maintenance costs with \$25 million in debt. The debt bears interest at the three-month LIBOR plus 3.30% (6.108% at December 31, 2018) and requires quarterly principal and interest payments. The debt is subject to a fixed charge ratio covenant. As of December 31, 2018, the Company was in compliance with this covenant.
- (15) In fiscal 2016, the Company obtained a \$35 million working capital draw loan, which terminates in August 2019. Interest is assessed on drawn amounts at one-month LIBOR plus 4.25% (6.753% at December 31, 2018). As of December 31, 2018, there were no borrowings outstanding under this facility. The working capital draw loan is subject to an interest and rental coverage ratio covenant. As of December 31, 2018, the Company was in compliance with this covenant.
- (16) In February 2018, the Company leased two spare engines. The leases were determined to be capital as the leases contain a bargain purchase option at the end of the term. Imputed interest is 9.128% and the leases requires monthly payments.
- (17) In June 2018, the Company refinanced six CRJ-900 aircraft with \$27.5 million in debt and financed nine CRJ-900 aircraft, which were previously leased, with \$69.6 million in debt. The senior notes payable of \$67.3 million bear interest at the three-month LIBOR plus 3.50% (6.308% at December 31, 2018) and require quarterly principal and interest payments. The subordinated notes payable bear interest at three month LIBOR plus 7.50% (10.308% at December 31, 2018) and require quarterly principal and interest payments.

Principal maturities of long-term debt as of December 31, 2018, and for each of the next five years are as follows (in thousands):

Periods Ending September 30,	Total Principal Amount
Remainder of 2019	\$ 117,339
2020	150,467
2021	144,919
2022	141,917
2023	69,232
Thereafter	267,818
	\$ 891,692

The net book value of collateralized aircraft and equipment as of December 31, 2018 was \$1,140.7 million.

In December 2015, an Enhanced Equipment Trust Certificate ("EETC") pass-through trust was created to issue pass-through certificates to obtain financing for new E-175 aircraft. At December 31, 2018 Mesa has \$209.2 million of equipment notes outstanding issued under the EETC financing included in long-term debt on the condensed consolidated balance sheets. The structure of the EETC financing consists of a pass-through trust created by Mesa to issue pass-through certificates, which represent fractional undivided interests in the pass-through trust and are not obligations of Mesa.

The proceeds of the issuance of the pass-through certificates were used to purchase equipment notes which were issued by Mesa and secured by its aircraft. The payment obligations under the equipment notes are those of Mesa. Proceeds received from the sale of pass-through certificates were initially held by a depository in escrow for the benefit of the certificate holders until Mesa issued equipment notes to the trust, which purchased such notes with a portion of the escrowed funds.

Mesa evaluated whether the pass-through trust formed for its EETC financing is a Variable Interest Entity ("VIE") and required to be consolidated. The pass-through trust was determined to be a VIE, however, the Company has determined that it does not have a variable interest in the pass-through trust, and therefore, has not consolidated the pass-through trust with its financial statements.

On June 27, 2018, the Company refinanced \$16.0 million of debt on six CRJ-900 aircraft (due in 2019), with \$27.5 million of debt, resulting in net cash proceeds to the Company of \$10.4 million after transaction related fees. The notes payable require quarterly payments of principal and interest through fiscal 2022 bearing interest at LIBOR plus 3.50%.

On June 28, 2018, the Company purchased nine CRJ-900 aircraft, which were previously leased under its aircraft lease facility with Wells Fargo Bank Northwest, National Association, as owner trustee and lessor (the "GECAS Lease Facility"), for \$76.5 million. The Company financed the aircraft purchase with \$69.6 million in new debt and proceeds from the June 2018 refinancing of six CRJ-900 aircraft. The notes payable of \$69.6 million require quarterly payments of principal and interest through fiscal 2022 bearing interest at LIBOR plus a spread ranging from 3.50% for the senior promissory notes to 7.50% for the subordinated promissory notes. The Company recorded non-cash lease termination expense of \$15.1 million in connection with the lease buyout. Also, as part of the transaction, the Company (i) received \$4.5 million of future goods and services credits and \$5.6 million of loan forgiveness for loans with a maturity date in 2027 from the aircraft manufacturer, and (ii) mutually agreed with GE Capital Aviation Services LLC to terminate the GE Warrant to purchase 250,000 shares of common stock.

On August 14, 2018 the Company paid down the outstanding balance on the CIT Revolving Credit Facility of \$25.7 million.

9. Earnings Per Share and Equity

Calculations of net income per common share attributable to Mesa Air Group were as follows (in thousands, except per share data):

Three Months Ended December 31,
2018