

SKYWEST INC
Form 10-Q
August 05, 2015
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2015

OR

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

For the transition period from _____ to _____

Commission file number 0-14719

SKYWEST, INC.

Incorporated under the laws of Utah

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

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444 South River Road

St. George, Utah 84790

(435) 634-3000

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

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

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

Class	Outstanding at July 31, 2015
Common stock, no par value	50,602,727

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SKYWEST, INC.

QUARTERLY REPORT ON FORM 10-Q

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(Dollars in Thousands)

ASSETS

	June 30, 2015 (unaudited)	December 31, 2014
CURRENT ASSETS:		
Cash and cash equivalents	\$ 171,165	\$ 132,275
Marketable securities	322,050	415,273
Restricted cash	11,584	11,582
Income tax receivable	1,378	2,779
Receivables, net	71,827	83,099
Inventories, net	139,671	137,452
Prepaid aircraft rents	437,193	397,850
Deferred tax assets	151,377	94,385
Other current assets	24,840	16,308
Total current assets	1,331,085	1,291,003
PROPERTY AND EQUIPMENT:		
Aircraft and rotatable spares	5,060,487	4,608,663
Deposits on aircraft	37,700	40,000
Buildings and ground equipment	282,606	274,900
	5,380,793	4,923,563
Less-accumulated depreciation and amortization	(1,975,389)	(1,902,375)
Total property and equipment, net	3,405,404	3,021,188
OTHER ASSETS		
Intangible assets, net	11,623	12,748
Other assets	90,442	84,989
Total other assets	102,065	97,737
Total assets	\$ 4,838,554	\$ 4,409,928

See accompanying notes to condensed consolidated financial statements.

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

(Dollars in Thousands)

LIABILITIES AND STOCKHOLDERS EQUITY

	June 30, 2015 (unaudited)	December 31, 2014
CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 263,725	\$ 211,821
Accounts payable	278,019	270,097
Accrued salaries, wages and benefits	138,302	138,902
Accrued aircraft rents	3,530	3,303
Taxes other than income taxes	20,598	17,457
Other current liabilities	40,544	42,775
Total current liabilities	744,718	684,355
OTHER LONG-TERM LIABILITIES	48,603	49,625
LONG-TERM DEBT, net of current maturities	1,800,452	1,533,990
DEFERRED INCOME TAXES PAYABLE	754,195	669,385
DEFERRED AIRCRAFT CREDITS	67,373	72,227
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY:		
Preferred stock, 5,000,000 shares authorized; none issued		
Common stock, no par value, 120,000,000 shares authorized; 78,496,807 and 77,951,411 shares issued, respectively	631,078	626,521
Retained earnings	1,202,437	1,165,478
Treasury stock, at cost, 28,015,386 and 26,765,386 shares, respectively	(410,090)	(391,364)
Accumulated other comprehensive (loss)	(212)	(289)
Total stockholders equity	1,423,213	1,400,346
Total liabilities and stockholders equity	\$ 4,838,554	\$ 4,409,928

See accompanying notes to condensed consolidated financial statements.

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SKYWEST, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

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

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
OPERATING REVENUES:				
Passenger	\$ 773,107	\$ 800,548	\$ 1,515,605	\$ 1,556,187
Ground handling and other	15,310	16,026	33,210	32,773
Total operating revenues	788,417	816,574	1,548,815	1,588,960
OPERATING EXPENSES:				
Salaries, wages and benefits	298,573	310,844	601,418	628,486
Aircraft maintenance, materials and repairs	156,319	171,722	314,576	349,984
Aircraft rentals	68,442	79,449	138,854	159,783
Depreciation and amortization	64,659	64,252	130,350	126,567
Aircraft fuel	31,192	58,018	58,492	105,243
Ground handling services	20,117	32,314	44,089	69,332
Special charges		4,713		4,713
Other operating expenses	79,183	82,018	157,028	159,382
Total operating expenses	718,485	803,330	1,444,807	1,603,490
OPERATING INCOME (LOSS)	69,932	13,244	104,008	(14,530)
OTHER INCOME (EXPENSE):				
Interest income	697	511	1,336	1,060
Interest expense	(18,081)	(16,138)	(36,546)	(31,814)
Other, net		(2,618)		(2,891)
Total other expense, net	(17,384)	(18,245)	(35,210)	(33,645)
INCOME (LOSS) BEFORE INCOME TAXES	52,548	(5,001)	68,798	(48,175)
PROVISION (BENEFIT) FOR INCOME TAXES	21,073	9,736	27,703	(10,551)
NET INCOME (LOSS)	\$ 31,475	\$ (14,737)	\$ 41,095	\$ (37,624)
BASIC EARNINGS (LOSS) PER SHARE				
BASIC EARNINGS (LOSS) PER SHARE	\$ 0.61	\$ (0.29)	\$ 0.80	\$ (0.73)
DILUTED EARNINGS (LOSS) PER SHARE				
DILUTED EARNINGS (LOSS) PER SHARE	\$ 0.61	\$ (0.29)	\$ 0.79	\$ (0.73)
Weighted average common shares:				
Basic	51,357	51,183	51,407	51,310
Diluted	51,971	51,183	52,182	51,310
Dividends declared per share	\$ 0.04	\$ 0.04	\$ 0.08	\$ 0.08
COMPREHENSIVE INCOME (LOSS):				
Net income (Loss)	\$ 31,475	\$ (14,737)	\$ 41,095	\$ (37,624)
Net unrealized appreciation (depreciation) on marketable securities, net of taxes	(223)	42	78	65
TOTAL COMPREHENSIVE INCOME (LOSS)	\$ 31,252	\$ (14,695)	\$ 41,173	\$ (37,559)

See accompanying notes to condensed consolidated financial statements

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SKYWEST, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(In Thousands)

	Six Months Ended June 30	
	2015	2014
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 168,807	\$ 32,489
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of marketable securities	(337,375)	(112,664)
Sales of marketable securities	430,688	215,005
Proceeds from the sale of equipment	5,719	3
Acquisition of property and equipment:		
Aircraft and rotatable spare parts	(503,317)	(297,758)
Buildings and ground equipment	(16,842)	(11,644)
Return of deposits on aircraft	2,300	
Increase in other assets	(8,325)	(13,563)
NET CASH USED IN INVESTING ACTIVITIES	(427,152)	(220,621)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of long-term debt	432,568	187,389
Principal payments on long-term debt	(114,202)	(88,236)
Tax deficiency from exercise of common stock options	(2,012)	(1,266)
Net proceeds from issuance of common stock	3,721	1,933
Purchase of treasury stock	(18,726)	(8,414)
Payment of cash dividends	(4,114)	(4,119)
NET CASH PROVIDED BY FINANCING ACTIVITIES	297,235	87,287
Increase (decrease) in cash and cash equivalents	38,890	(100,845)
Cash and cash equivalents at beginning of period	132,275	170,636
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 171,165	\$ 69,791
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest, net of capitalized amounts	\$ 37,530	\$ 33,103
Income taxes	\$ 613	\$ 382

See accompanying notes to condensed consolidated financial statements.

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SKYWEST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note A Condensed Consolidated Financial Statements

Basis of Presentation

The condensed consolidated financial statements of SkyWest, Inc. (SkyWest or the Company) and its operating subsidiaries, SkyWest Airlines, Inc. (SkyWest Airlines) and ExpressJet Airlines Inc. (ExpressJet) included herein have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the following disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements reflect all adjustments that, in the opinion of management, are necessary to present fairly the results of operations for the interim periods presented. All adjustments are of a normal recurring nature, unless otherwise disclosed. The Company suggests that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014. The results of operations for the three and six-month periods ended June 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015.

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

Note B Passenger and Ground Handling Revenue

The Company recognizes passenger and ground handling revenues when the service is provided under its code-share agreements. Ground handling revenue primarily consists of customer service functions such as gate and ramp agent services at applicable airports where the Company provides such services to other airlines. Under the Company's fixed-fee arrangements (referred to as fixed-fee arrangements, contract flying or capacity purchase agreements) with Delta Airlines Inc. (Delta), United Airlines Inc. (United), US Airways Group, Inc. (US Airways), American Airlines, Inc. (American) and Alaska Airlines, Inc. (Alaska), the major airline generally pays the Company a fixed-fee for each departure, flight or block time incurred, and an amount per aircraft in service each month with additional incentives based on flight completion and on-time performance. The major airline partner also directly reimburses the Company for certain direct expenses incurred under the fixed-fee arrangement, such as fuel expense and landing fee expenses. Under the fixed-fee arrangements, revenue is earned when each flight is completed.

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Under the Company's revenue-sharing arrangements (referred to as revenue-sharing or pro-rate arrangements), the major airline and the Company negotiate a passenger fare proration formula when a passenger has a connecting flight operated by both the Company and the major airline partner, pursuant to which the Company receives a percentage of the ticket revenues for those passengers traveling for the portion of their trip operated by the Company, and the major airline retains the ticket revenues for the other portion of their trip on the major airline. Revenue is recognized under the Company's pro-rate flying agreements when each flight is completed based upon the portion of the pro-rate passenger fare the Company anticipates that it will receive for each completed flight.

Other ancillary revenues commonly associated with airlines such as baggage fee revenue, ticket change fee revenue and the marketing component of the sale of mileage credits are retained by the Company's major airline partners on flights that the Company operates under its code-share agreements.

In the event that the contractual rates under the Company's flying agreements have not been finalized at quarterly or annual financial statement dates, the Company records revenues based on the lower of the prior period's approved rates, as adjusted to reflect any contract negotiations, and the Company's estimate of rates that will be implemented in accordance with revenue recognition guidelines. In the event the Company has a reimbursement dispute with a major partner, the Company evaluates the dispute under its established revenue recognition criteria and, provided the revenue recognition criteria have been met, the Company recognizes revenue based on management's estimate of the resolution of the dispute.

In several of the Company's agreements, the Company is eligible to receive incentive compensation upon the achievement of certain performance criteria. The incentives are defined in the agreements and are measured and determined on a monthly, quarterly or

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semi-annual basis. 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 that agreement accordingly.

The following table summarizes the significant provisions of each code share agreement the Company has with each major partner:

Delta Connection Agreements

Agreement	Number of aircraft under contract	Term / Termination Dates
SkyWest Airlines Delta Connection Agreement (fixed-fee arrangement)	<ul style="list-style-type: none"> • CRJ 200 48 • CRJ 700 19 • CRJ 900 32 	<ul style="list-style-type: none"> • The contract expires on an individual aircraft basis with expirations commencing in 2015 • The final aircraft expires in 2022 • The average remaining term of the aircraft under contract is 4.3 years • Upon expiration, aircraft may be renewed or extended
ExpressJet Delta Connection Agreement (fixed-fee arrangement)	<ul style="list-style-type: none"> • CRJ 200 59 • CRJ 700 41 • CRJ 900 28 	<ul style="list-style-type: none"> • The contract expires on an individual aircraft basis with expirations commencing in 2015 • The final aircraft expires in 2022 • The average remaining term of the aircraft under contract is 3.7 years • Upon expiration, aircraft may be renewed or extended
SkyWest Airlines Pro-rate Agreement (revenue-sharing arrangement)	<ul style="list-style-type: none"> • CRJ 200 13 	<ul style="list-style-type: none"> • Terminates with 30-day notice

United Express Agreements

Agreement	Number of aircraft under contract	Term / Termination Dates
SkyWest Airlines United Express Agreements	<ul style="list-style-type: none"> • CRJ 200 49 	

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(fixed-fee arrangement)	<ul style="list-style-type: none">• CRJ 700 70• E175 35	<ul style="list-style-type: none">• The contract expires on an individual aircraft basis with expirations commencing in 2015• The final aircraft expires in 2026• The average remaining term of the aircraft under contract is 3.8 years• Upon expiration, aircraft may be renewed or extended
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ExpressJet United ERJ Agreement (fixed-fee arrangement)	<ul style="list-style-type: none">• ERJ 135 5• ERJ 145 180	<ul style="list-style-type: none">• The contract expires on an individual aircraft basis with expirations commencing in 2015• The final aircraft expires in 2017• The average remaining term of the aircraft under contract is 1.5 years• Upon expiration, aircraft may be renewed or extended
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SkyWest Airlines United Express Pro-rate Agreement (revenue-sharing arrangement)	<ul style="list-style-type: none">• CRJ 200 23	<ul style="list-style-type: none">• Terminates with 120-day notice
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Table of Contents*Alaska Capacity Purchase Agreement*

Agreement	Number of aircraft under contract	Term / Termination Dates
SkyWest Airlines Alaska Agreement (fixed-fee arrangement)	<ul style="list-style-type: none"> • CRJ 700 9 • E175 3 	<ul style="list-style-type: none"> • CRJ 700 Terminates 2018 E175 Terminates 2027 • Upon expiration, aircraft may be renewed or extended

US Airways Agreements

Agreement	Number of aircraft under contract	Term / Termination Dates
SkyWest Airlines US Airways Agreement (fixed-fee arrangement)	<ul style="list-style-type: none"> • CRJ 200 10 • CRJ 900 4 	<ul style="list-style-type: none"> • Terminates by the end of 2015 • Upon expiration, aircraft may be renewed or extended
SkyWest Airlines US Airways Pro-rate Agreement (revenue-sharing arrangement)	<ul style="list-style-type: none"> • CRJ 200 1 	<ul style="list-style-type: none"> • Terminates with 120- day notice

American Agreements

Agreement	Number of aircraft under contract	Term / Termination Dates
SkyWest Airlines American Agreement (fixed-fee arrangement)	<ul style="list-style-type: none"> • CRJ 200 12 	<ul style="list-style-type: none"> • Terminates 2016 • Upon expiration, aircraft may be renewed or extended
SkyWest Airlines American Pro-rate Agreement (revenue-sharing arrangement)	<ul style="list-style-type: none"> • CRJ 200 5 	<ul style="list-style-type: none"> • Terminates with 120- day notice
ExpressJet American Agreement (fixed-fee arrangement)	<ul style="list-style-type: none"> • CRJ 200 11 • ERJ 145 16 	<ul style="list-style-type: none"> • Terminates 2017 • Upon expiration, aircraft may be renewed or extended

ExpressJet American Pro-rate
Agreement (revenue-sharing arrangement)

- CRJ 200 3
- Terminates with 120- day notice

In June 2015, SkyWest Airlines reached an agreement with Alaska to place eight additional E175 aircraft into service pursuant to the SkyWest Airlines Alaska Agreement, which would result in a total of 15 E175 aircraft under contract with Alaska.

Other Revenue Items

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

Note C Share-Based Compensation and Stock Repurchases

The fair value of stock options granted by the Company has been estimated as of the grant date using the Black-Scholes option pricing model. The Company uses historical data to estimate option exercises and employee termination in the option pricing model. The expected term of options granted is derived from the output of the option pricing model and represents the period of time that options granted are expected to be outstanding. The expected volatilities are based on the historical volatility of the Company's

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traded stock and other factors. During the six months ended June 30, 2015, the Company granted options to purchase 261,473 shares of common stock under the SkyWest, Inc. 2010 Long-Term Incentive Plan (the 2010 Incentive Plan). The following table shows the assumptions used and weighted average fair value for stock option grants during the six months ended June 30, 2015.

Expected annual dividend rate		1.18%
Risk-free interest rate		1.62%
Average expected life (years)		5.7
Expected volatility of common stock		0.401
Forfeiture rate		0.0%
Weighted average fair value of option grants	\$	4.75

During the six months ended June 30, 2015, the Company granted 403,917 restricted stock units and 218,493 performance restricted stock units to employees of the Company and its subsidiaries under the 2010 Incentive Plan. Both the restricted stock and performance restricted stock units have a three-year vesting period, during which the recipient must remain employed with the Company or one of the Company's subsidiaries. In addition to the three-year vesting period, certain profit metrics of the Company must be met before the recipient will receive any shares of stock attributable to the performance restricted stock units. Upon vesting, a restricted stock unit and a performance restricted stock unit will be replaced with a share of common stock. Additionally, during the six months ended June 30, 2015, the Company granted 36,950 fully-vested shares of common stock to the Company's directors. The fair value of the shares of restricted stock on the date of grant was \$13.51 per share.

The Company records share-based compensation expense only for those options and restricted and performance restricted stock units that are expected to vest. The estimated fair value of the stock options and restricted stock units is amortized over the applicable vesting periods. During the three months ended June 30, 2015 and 2014, the Company recorded pre-tax share-based compensation expense of \$1.3 million and \$1.1 million, respectively. During the six months ended June 30, 2015 and 2014, the Company recorded pre-tax share-based compensation expense of \$2.8 million and \$2.8 million, respectively.

The Company repurchased 1.25 million shares of its common stock for \$18.7 million during the six months ended June 30, 2015. The Company repurchased 670,000 shares of its common stock for \$8.4 million during the six months ended June 30, 2014.

Note D Net Income (Loss) Per Common Share

Basic net income per common share (Basic EPS) excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share (Diluted EPS) reflects the potential dilution that could occur if stock options or other contracts to issue common stock were exercised or converted into common stock. The computation of Diluted EPS does not assume exercise or conversion of securities that would have an anti-dilutive effect on net income per common share. During the three and six months ended June 30, 2015, options to acquire 459,000 and 2,019,000 shares, respectively, were excluded from the computation of Diluted EPS as their impact was anti-dilutive. During the three and six months ended June 30, 2014, options to acquire 3,279,000 and 3,112,000 shares, respectively, were excluded from the computation of Diluted EPS as their impact was anti-dilutive.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(Unaudited)		(Unaudited)	
Numerator				
Net Income (loss)	\$ 31,475	\$ (14,737)	\$ 41,095	\$ (37,624)
Denominator				
Weighted average number of common shares outstanding	51,357	51,183	51,407	51,310
Effect of outstanding share-based awards	614		775	
Weighted average number of shares for diluted net income per common share	51,971	51,183	52,182	51,310