

MESA AIR GROUP INC
Form 10-K
January 13, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended September 30, 2008
Commission file number 000-15495

Mesa Air Group, Inc.

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction of incorporation or organization)

85-0302351

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

410 North 44th Street, Suite 100
Phoenix, Arizona 85008

(Address of principal executive offices including zip code)

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

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

Title of each class

Name of each exchange on which registered

Common Stock, No Par Value

The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:
None

Edgar Filing: MESA AIR GROUP INC - Form 10-K

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

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 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 (§229.405 of this chapter) 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 a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The aggregate market value of common stock held by non-affiliates of the Registrant (26,842,081 shares) as of March 31, 2008 was approximately \$63.1 million based on the closing sales price per share as reported on Nasdaq on such date.

On January 9, 2009, the Registrant had outstanding 29,618,159 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

Certain sections of the Company's Proxy Statement to be filed in connection with the Company's 2008 Annual Meeting of Shareholders to be held in the first calendar quarter of 2009 are incorporated by herein at Part III, Items 10-14.

PDF provided as courtesy

MESA AIR GROUP, INC.

2008 FORM 10-K REPORT
TABLE OF CONTENTS

	Page No.
PART I	
<u>Item 1.</u> Business	3
<u>Item 1A.</u> Risk Factors	14
<u>Item 1B.</u> Unresolved Staff Comments	28
<u>Item 2.</u> Properties	28
<u>Item 3.</u> Legal Proceedings	29
<u>Item 4.</u> Submission of Matters to a Vote of Security Holders	31
PART II	
<u>Item 5.</u> Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	32
<u>Item 6.</u> Selected Financial Data	34
<u>Item 7.</u> Management's Discussion and Analysis of Financial Condition and Results of Operations	36
<u>Item 7A.</u> Quantitative and Qualitative Disclosure about Market Risk	56
<u>Item 8.</u> Financial Statements and Supplementary Data	56
<u>Item 9.</u> Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	94
<u>Item 9A.</u> Controls and Procedures	94
<u>Item 9B.</u> Other Information	97
PART III	
<u>Item 10.</u> Directors, Executive Officers and Corporate Governance	97
<u>Item 11.</u> Executive Compensation	98
<u>Item 12.</u> Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	98
<u>Item 13.</u> Certain Relationships and Related Transactions, and Director Independence	98

<u>Item 14.</u>	Principal Accountant Fees and Services	98
	PART IV	
<u>Item 15.</u>	Exhibits, Financial Statement Schedules	99

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 our customers; the relocation of certain operations of Mesa; the resolution of litigation in a favorable manner and certain projected financial obligations. These statements, in addition to statements made in conjunction with the words "expect," "anticipate," "intend," "plan," "believe," "seek," "estimate," and similar expressions, are forward-looking statements within the meaning of the Safe Harbor provision of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements relate to future events or the future financial performance of Mesa and only reflect management's expectations and estimates. The following is a list of factors, among others, that could cause actual results to differ materially from the forward-looking statements: changing business conditions in certain market segments and industries; changes in Mesa's code-sharing relationships; an increase in competition along the routes Mesa operates or plans to operate; availability and cost of funds for financing new aircraft; changes in general and/or regional economic conditions; changes in fuel prices; Mesa's relationship with its employees and the terms of future collective bargaining agreements; the impact of current and future laws; additional terrorist attacks; Congressional investigations, and governmental regulations affecting the airline industry and Mesa's operations; bureaucratic delays; amendments to existing legislation; consumers unwilling to incur greater costs for flights; our ability to operate our Hawaiian airline service profitably; Mokulele Airlines regarding our Hawaiian operation, and Delta Air Lines regarding our code share agreement; unfavorable resolution of negotiations with municipalities for the leasing of facilities; failure of our joint venture in China or changes in Chinese laws or regulations that have an adverse effect on Kunpeng's operations. 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," the "Company" 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 principal subsidiaries operate as regional air carriers providing scheduled passenger and airfreight service. As of September 30, 2008, the Company served 124 cities in 38 states, the District of Columbia, Canada, and Mexico and operated a fleet of 159 aircraft with approximately 800 daily departures.

Approximately 96% of our consolidated passenger revenues from continuing operations for the fiscal year ended September 30, 2008 were derived from operations associated with code-share agreements. Our subsidiaries have code-share agreements with Delta Air Lines, Inc. ("Delta"), United Airlines, Inc. ("United Airlines" or "United") and America West Airlines, Inc. ("America West") which currently operates as US Airways and is referred to herein as "US Airways." The current US Airways is the result of a merger between America West and US Airways, Inc. 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. Our remaining passenger revenues from continuing operations are derived from our independent *go!* operations in Hawaii.

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.

Our airline operations are conducted by the following airline subsidiaries:

- Mesa Airlines, Inc. ("Mesa Airlines"), a Nevada corporation, flies regional jet and turboprop aircraft and operates as US Airways Express under code-share agreements with US Airways, as United Express under a code-share agreement with United Airlines and independently in Hawaii as *go!* The *go!* flights are "Independent Operations" and are not subject to a code-sharing agreement with a major carrier.
- Freedom Airlines, Inc. ("Freedom"), a Nevada corporation, flies ERJ-145 50-seat regional jet aircraft and operates as Delta Connection under code-share agreements with Delta.

Discontinued Operation

In the fourth quarter of fiscal 2007, the Company committed to a plan to sell Air Midwest or certain of its assets. Air Midwest consisted of Beechcraft 1900D turboprop operations, which included our independent Mesa operations and Midwest Airlines and US Airways code-share operations. As a result, the Company began soliciting bids for the sale of the twenty Beechcraft 1900D aircraft in operation and exited all of its Essential Air Service ("EAS") markets on or before June 30, 2008. All assets and liabilities, results of operations, and other financial and operational data associated with these assets have been presented in the accompanying consolidated financial statements as discontinued operations separate from continuing operations, unless otherwise noted.

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. ("RAS"), a California corporation, performs aircraft component repair, certain overhaul services, and ground handling services, primarily to Mesa subsidiaries.
- 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 -Airline 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.
- Nilchii, Inc., a Nevada corporation ("Nilchii"), was established to invest in certain airline related businesses.
- Mesa In-Flight, Inc., a Colorado corporation, was established to hold liquor licenses services for airline operations.
- Regional Aviation Advisors, Inc., a Nevada corporation, was established to provide aircraft financing advisory services.

Edgar Filing: MESA AIR GROUP INC - Form 10-K

- Patar, Inc., a Nevada corporation ("Patar"), was established to invest in certain foreign businesses.
- Mesa Air New York, Inc., a New York corporation, was established to hold and own aircraft parts and equipment to support the Company's New York flight operations.
- Ping Shan, SRL, a Barbados society with restricted liability, was established for the purpose of being a holding company of our interest in Kunpeng Airlines, a regional airline based in the People's Republic of China.

Aircraft

The following table sets forth our aircraft fleet (owned and leased) by aircraft type and code-share service as of September 30, 2008:

	Canadair Regional Jet-200 (CRJ-200) (A)	Canadair Regional Jet-700 (CRJ-700)	Canadair Regional Jet-900 (CRJ-900) (B)	Embraer Regional Jet-145 (ERJ-145) (C)	Beechcraft 1900D (D)	DeHavilland Dash 8	Total
US Airways Express	11	-	38	-	-	6	55
United Express	26	20	-	-	-	10	56
Delta Connection	-	-	7	30	-	-	37
Mesa Airlines (dba <i>go!</i>)	5	-	-	-	-	-	5
Mesa Air Group-Operating	2	-	-	4	-	-	6
Subtotal	44	20	45	34	-	16	159
Kunpeng Airlines (sublease)	5	-	-	-	-	-	5
Trans States Airlines (sublease)	-	-	-	2	-	-	2
Subtotal	49	20	45	36	-	16	166
Discontinued Operations	-	-	-	-	20	-	20
Non-Operating Aircraft (E)	3	-	-	-	-	-	3
Total	52	20	45	36	20	16	189

(A) Five CRJ-200's are currently in China in a sublease agreement with Kunpeng Airlines.

(B) Subsequent to fiscal year-end 2008, the company removed the 7 CRJ 900 aircraft from the Delta Connection program.

(C) Two ERJ-145's are currently subleased to an unaffiliated airline, Trans States Airlines.

(D) As previously discussed, in the fourth quarter of fiscal 2007, we committed to a plan to sell certain assets used by Air Midwest and to discontinue our Air Midwest turboprop operations. The net book value of these aircraft are included within "Assets of discontinued operations" on the Consolidated Balance Sheets.

(E) Three CRJ-200's which are parked and held for lease return in first quarter of 2009.

Code-Share Agreements

Our airline subsidiaries have agreements with Delta, US Airways and United Airlines to use those carriers' designation codes (commonly referred to as "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 us.

The financial arrangement with our code-share partners involves a revenue-guarantee arrangement. The US Airways (regional jet and Dash-8), Delta (regional jet) and United (regional jet and Dash-8) code-share agreements are revenue-guarantee code-share agreements. Under the terms of these code-share agreements, the major carrier controls marketing, scheduling, ticketing, pricing and seat inventories. We receive 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 our exposure to fluctuations in passenger traffic and fare levels, as well as fuel prices.

Edgar Filing: MESA AIR GROUP INC - Form 10-K

The following table summarizes our available seat miles ("ASMs") flown and passenger revenue recognized under our code-share agreements and independent operations for the years ended September 30, 2008 and 2007:

	Fiscal 2008				Fiscal 2007			
	<u>ASM's</u> (000's)		<u>Passenger Revenue</u> (000's)		<u>ASM's</u> (000's)		<u>Passenger Revenue</u> (000's)	
US Airways (Revenue-Guarantee)	4,105,517	51%	\$ 635,439	48%	4,331,579	48%	\$ 576,257	44%
United (Revenue-Guarantee)	2,573,519	32%	382,392	29%	3,074,054	34%	461,732	35%
Delta (Revenue-Guarantee)	1,182,271	15%	252,530	19%	1,438,698	16%	249,774	19%
<i>go!</i>	166,659	2%	43,075	4%	152,629	2%	25,457	2%
Total - Continuing Operations	8,027,966		\$ 1,313,436		8,996,960		\$ 1,313,220	
Discontinued Operations	75,089		\$ 12,588		185,557		\$ 30,188	

US Airways Code-Sharing Agreements

As of September 30, 2008, we operated 38 CRJ-900, 11 CRJ-200, and 6 Dash-8 aircraft for US Airways under a revenue-guarantee code-share agreement. In exchange for providing flights and all other services under such 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. US Airways also reimburses us for certain costs on an actual basis, including fuel costs, aircraft ownership and financing costs, landing fees, passenger liability, hull insurance and aircraft property taxes, all as defined in 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 where both carriers operate. We also receive a monthly payment from US Airways based on a percentage of revenue from flights that we operate under the code-share agreement. Under our code-share agreement, US Airways has the right to reduce the combined CRJ fleets utilized under the code-share agreement by one aircraft in any six-month period. The Company has received notice of US Airways' intent to reduce one CRJ-200 in January 2009, one in July 2009 and one CRJ-200 in January 2010. We anticipate US Airways will continue to further reduce the number of covered aircraft in accordance with the agreement. In addition, US Airways may eliminate the Dash-8 aircraft upon 180 days prior written notice. The code-share agreement terminates on June 30, 2012 unless US Airways 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 or arrival performance in our Phoenix hub falls below certain levels for a specified period of time, subject to notice and cure rights;
- If either US Airways 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 US Airways to perform the covenants, conditions or provisions of the code-share agreement, subject to 15 days notice and cure rights;
- If we or US Airways fail to make a payment when due, subject to ten business days notice and cure rights;
- If we are required by the FAA or the U.S. Department of Transportation ("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, US Airways may terminate the agreement;

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

United Code-Sharing Agreement

As of September 30, 2008, we operated 26 CRJ-200, 20 CRJ-700 and 10 Dash-8 aircraft for United under a code-sharing arrangement. Additionally, the code-share agreement allows us to swap up to 10 CRJ-200s for 10 CRJ-700s upon providing at least 180 days notice prior to October 31, 2009. 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 us in performing the flight services are "pass-through" costs, whereby United agrees to reimburse us for the actual amounts incurred for these items: aircraft ownership costs, property tax per aircraft, fuel costs, 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 10 Dash-8 aircraft terminates in July 2013 unless terminated by United by giving notice six months prior to April 30, 2010, (ii) 10 50-seat CRJ-200's terminates no later than April 30, 2010, which can be accelerated up to two years at our discretion and can be swapped for CRJ-700's for a term of up to 10 years but not beyond October 2018, (iii) 20 50-seat regional jets terminate in April 2010, (iv) the 5 CRJ-700's delivered in fiscal 2007 (the 12 to be delivered upon the withdrawal of the 50-seat regional jets) terminates ten years from delivery date, but no later than October 31, 2018, and (v) the remaining 15 CRJ-700's terminates in three tranches of five aircraft between December 31, 2011, December 31, 2012 and December 31, 2013.

The code-share agreement is subject to termination prior to these dates under 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; or
- In the event that we merge with, or if control of us is acquired by another air carrier or a corporation directly or indirectly owning or controlling another air carrier.

Delta Code-Sharing Agreement

As of September 30, 2008, we operated 7 CRJ-900 and 30 ERJ-145 aircraft for Delta pursuant to a code-sharing agreement. Flight operations for Delta are performed by our wholly-owned subsidiary, Freedom Airlines. During the second quarter 2007, as part of Delta's bankruptcy, we reached an agreement with Delta for an amendment to and assumption of our existing code-sharing agreement ("Amended DCA"), as well as for a new code-sharing agreement ("Expansion DCA"). The Amended DCA provided for the addition of six ERJ aircraft for an initial term of two years. These aircraft are scheduled to be removed from service in March 2009. The parties currently have a disagreement regarding the effectiveness of a notice issued by Mesa to extend the term for these aircraft for an additional one year term at reduced compensation in accordance with the terms of the Amended DCA. Also, pursuant to the Amended DCA, commencing in August 2008, the parties agreed to remove eight ERJ aircraft at a rate of three aircraft per month. Six of the eight aircraft had been removed as of September 30, 2008. Under the Amended DCA, in exchange for performing the flight services and our other obligations under the agreement, we receive from Delta monthly compensation made up of a fixed monthly amount, plus certain additional amounts based upon number of block hours flown and departures during the month. Additionally, certain costs incurred by Freedom are pass-through costs, whereby Delta agrees to reimburse us for the actual amounts incurred for these items: landing fees, hull insurance, passenger liability costs, fuel costs, catering costs and property taxes. Aircraft rent/ownership expenses are also considered a pass-through cost, but are limited to a specified amount for each type of aircraft. We are eligible to receive additional compensation based upon our completion rate and on-time arrival rate each month. Further, for each semi-annual period during the term of the agreement, we are eligible to receive additional compensation from Delta based upon performance. The fixed rates payable to us by Delta under the Amended DCA have been determined through the term of such agreement and are subject to annual revision.

The compensation structure for the Expansion DCA is similar to the structure in the Amended DCA, except that the CRJ-900 aircraft will be owned by Delta and leased to us for a nominal amount and no mark-up or incentive compensation will be paid on fuel costs above a certain level or on fuel provided by Delta. Additionally, certain major maintenance expense items (engine and airframe) will be reimbursed based on actual expenses incurred. As a result, our revenue and expenses attributable to flying the CRJ-900's will be substantially less than if we provided the aircraft.

At the end of the term of the Amended DCA, Delta has the right to extend the agreement for additional one year successive terms on the same terms and conditions. Delta may terminate the Amended DCA at any time, with or without cause, upon twelve months prior written notice, provided such notice shall not be given prior to the earlier of (i) the sixth anniversary of the in-service date of the 30th aircraft added to the Delta Connection fleet by the Company, or (ii) November 2012. The Expansion DCA terminates on the tenth anniversary of the in-service date of the first aircraft. At the end of the term, the Expansion DCA will automatically renew for successive one-year terms on the same terms and conditions unless Delta provides us 180 days prior written notice of its intention to not renew such agreement.

The agreements may be subject to early termination under various circumstances including:

- If either Delta or we file for bankruptcy, reorganization or similar action or if either Delta or we make an assignment for the benefit of creditors;
- If either Delta or we commit a material breach of the code-share agreement, subject to 30 days notice and cure rights; or
- Upon the occurrence of an event of force majeure that continues for a period of 30 or more consecutive days.

In addition, Delta may immediately terminate the agreements upon the occurrence of one or more of the following events:

- If there is a change of control of Freedom or Mesa;
- If there is a merger involving Freedom or Mesa;
- If we fail to maintain a specified completion rate with respect to the flights we operate for Delta during a specified period; or
- If our level of safety is not reasonably satisfactory to Delta.

On March 28, 2008, Delta notified the Company of its intent to terminate the Delta Connection Agreement among Delta, the Company and the Company's wholly owned subsidiary, Freedom Airlines, Inc. alleging failure to maintain a specified completion rate with respect to its ERJ-145 Delta Connection flights during three months of the six-month period ended February, 2008. Following Delta's termination notification, the Company filed a Complaint on April 7, 2008 in the United States District Court for the Northern District of Georgia ("the Court") seeking declaratory and injunctive relief. An evidentiary hearing was conducted on May 27 through May 29, 2008. Following the hearing, the Court ruled in the Company's favor and issued a preliminary injunction against Delta.

The effect of this ruling is to prohibit Delta from terminating the Delta Connection Agreement covering the ERJ-145 aircraft operated by Freedom, based on Freedom's completion rate prior to April 2008, pending a final trial at a date to be determined by the Court. Following the Court's decision, the Company and Delta reached an interim financial understanding (subject to the mutual reservation of rights) in which Delta will reimburse the Company for certain costs (such as lease payments, insurance, maintenance, pilots/flight attendants wage minimums and a normal profit) and the majority of the ERJ-145 aircraft will remain out of service until October 2008. On June 27, 2008, Delta filed a Notice of Appeal and on July 15, 2008, Delta filed a motion requesting that the appeal be heard on an expedited basis. The Company has responded to Delta's motion in accordance with the applicable rules and the Court of Appeals, after reviewing the filings, denied Delta's request. Delta and the Company have fully briefed the issue on appeal and oral argument in the 11th Circuit Court of Appeals have been scheduled for January 30, 2009.

On August 1, 2008, Delta notified the Company of the termination of the CRJ-900 Delta Connection Agreement citing an alleged failure to meet certain contractual benchmarks in the CRJ-900 Delta Connection Agreement. Specifically, the notice states that Delta is terminating the CRJ-900 Connection Agreement as a result of Freedom's alleged failure to maintain a specified on-time arrival rate with respect to its CRJ-900 Delta Connection Flights during each of the four months of March, April, May, and June 2008, as well as Freedom's alleged failure, during the months of March, April and June 2008 to maintain a specified completion rate. On October 1, 2008, Mesa removed three CRJ-900 aircraft from Delta Connection service. The remaining four CRJ-900 aircraft were removed from Delta Connection service on November 1, 2008. Upon their removal from Delta Connection service, those aircraft were returned to Delta. Mesa has placed Delta on notice that it disputes the basis for Delta's actions and that it intends to seek all remedies available at law to challenge Delta's decision.

Joint Venture Agreement in China

On December 22, 2006, our wholly-owned subsidiary, Ping Shan, SRL "(Ping Shan)" entered into a joint venture agreement (the "Joint Venture Agreement") with Shan Yue SRL ("Shan Yue") and Shenzhen Airlines, pursuant to which the parties agreed to form Kungpeng Airlines ("Kungpeng"), an equity joint venture company organized under the laws of China. Ping Shan holds a 25% share of the registered capital of Kungpeng. Additionally, Shan Yue, a Barbados Society with restricted liability, holds 24% of the registered capital of Kungpeng. Shan Yue holds 5% of the 24% interest in Kungpeng for the exclusive benefit of an unaffiliated third party. Wilmington Trust Company holds 100% of the outstanding equity of Shan Yue as trustee of Shan Yue Trust, a Delaware statutory trust. We are the sole beneficiary of Shan Yue Trust. Through Ping Shan and our beneficial interest in Shan Yue Trust, we effectively own 49% of Kungpeng. After taking into consideration the 5% interest in Kungpeng held for the exclusive benefit of an unaffiliated third party, our net ownership interest in Kungpeng is reduced to 44%. Kungpeng commenced common carrier passenger service on September 28, 2007. As of September 30, 2008, Kungpeng operated five 50-seat CRJ 200 aircraft on regional routes

between the Chinese cities Xian, Yulin, Yantai, Changchun, Zhengzhou, Nanning, Wuzhou, Changsha, Hefei, Baise, Shijiazhuang, Beihai, and Guangzhou.

Under the terms of the Joint Venture Agreement, Ping Shan and Shan Yue agreed to assist Kunpeng in securing aircraft and spare part supplies from foreign suppliers and to provide high level executives for the management of Kunpeng and technical support, including pilot, maintenance and operations support and training for employees of Kunpeng. Kunpeng's fiscal year ends on December 31st. Pursuant to the Joint Venture Agreement, Ping Shan and Shan Yue will receive 25% and 24%, respectively, of the after-tax net profit of Kunpeng, if any, at the end of each fiscal year unless Kunpeng's board of directors determines that such profits should be reinvested. In general, the Company records 44% of the income or loss of Kunpeng, except that the parties to the Joint Venture Agreement have agreed to share losses according to their respective percentage ownership, with Mesa's exposure capped at a percentage of the gross revenues of Kunpeng that is materially below its percentage ownership interest. Additionally, the amount of profit available for distribution is reduced by an amount equal to allocations to a reserve fund and expansion fund of Kunpeng and a bonus and welfare fund for Kunpeng's employees, as determined by Kunpeng's board of directors. No profit is distributed unless any cumulative deficit carried forward for previous years is recovered. Kunpeng's board consists of seven members, four of whom are appointed by Shenzhen Airlines, two of whom are appointed by Ping Shan and one of whom is appointed by Shan Yue.

As of September 30, 2008, we had contributed \$6.5 million in capital contributions to the joint venture in accordance with the terms of the Joint Venture Agreement. Under the terms of the Joint Venture Agreement, Shenzhen Airlines and the Company are obligated to contribute an additional RMB 204,000,000 and RMB 196,000,000, respectively (approximately \$29.8million and \$28.6 million, respectively), at September 30, 2008 to Kunpeng in accordance with Kunpeng's operational requirements as determined by Kunpeng's board of directors, but in any event, prior to May 16, 2009.

In June 2008, the Company entered into a Letter of Intent ("LOI") to sell its interest in Kunpeng to Shenzhen for \$4.8 million. Negotiations aimed at consummating the sale of the interest have been ongoing since such time, and Shenzhen and we have exchanged numerous drafts of a proposed agreement. However, no assurance can be given that the LOI will result in a sale of our equity interest in Kunpeng to Shenzhen, or that, if such a sale were to occur, that it will be on terms acceptable to the Company.

As a result of the negotiated valuation of the interest by the parties set forth in the LOI, the Company has recorded a loss on its investment in Kunpeng of \$1.3 million at September 30, 2008. This loss reflects the expected proceeds from the sale of \$4.8 million less the Company's investment at September 30, 2008 of \$5.8 million and estimated transaction costs of \$300,000. The loss has been recorded in the gain (loss) from equity method investment in the consolidated statements of operations.

The Company also subleases five regional jets to Kunpeng. These leases are not affected by the LOI. Total sublease revenue for the year ended September 30, 2008 was \$4.4 million. At September 30, 2008, the Company had gross receivables from Kunpeng of approximately \$2.9 million.

Fleet Plans

CRJ Program

As of September 30, 2008, we operated 109 Canadair Regional Jets (44 CRJ- 200/100, 20 CRJ-700 and 45 CRJ-900's).

In January 2004, we exercised options to purchase twenty CRJ-900 aircraft (seven of which can be converted to CRJ-700 aircraft). As of September 30, 2007, we have taken delivery of thirteen CRJ-900 aircraft and five CRJ-700 aircraft. The obligation to purchase the remaining two CRJ-900's (which can be converted to CRJ-700's) was

terminated in June 2007 in connection with our agreement to purchase 10 new CRJ-700 NextGen aircraft. In conjunction with this purchase agreement, Mesa has \$500,000 on deposit with Bombardier that was included in lease and equipment deposits on September 30, 2008. The deposit amount is expected to be returned upon completion of permanent financing on each of the ten aircraft. On September 26, 2008, the Company and Bombardier amended the purchase agreement to return \$6.0 million of the \$6.5 million previously held on deposit, delayed deliveries of the 10 CRJ-700 aircraft and advanced rebates related to Bombardier's heavy maintenance service agreement.

On August 1, 2008, Delta notified the Company of its election to immediately terminate the Delta Connection Agreement among Delta, the Company and Freedom, dated March 13, 2007 (as thereafter amended, the "CRJ-900 Connection Agreement"). The notice states that Delta is terminating the CRJ-900 Connection Agreement as a result of Freedom's alleged failure to maintain a specified on-time arrival rate with respect to its CRJ-900 Delta Connection Flights during each of the four months of March, April, May and June 2008, as well as Freedom's alleged failure, during the months of March, April, and June 2008 to maintain a specified completion rate. As of September 30, 2008 the Company operated 7 CRJ-900 aircraft for Delta. The Company ceased operating these aircraft as of

November 2, 2008. The CRJ-900 Connection Agreement contributed 3.1% and 0% to the Company's revenue for the year ended September 30, 2008 and 2007, respectively.

ERJ Program

As of September 30, 2008, we operated 34 ERJ-145 aircraft and subleased 2 ERJ-145 to a third party. We acquired 36 ERJ-145s through a June 1999 agreement with Empresa Brasileira de Aeronautica S.A. ("Embraer").

Beechcraft 1900D

As of September 30, 2008, we owned 20 Beechcraft 1900D aircraft. The net book value of these aircraft are included within "Assets of Discontinued Operations" on the Consolidated Balance Sheets.

On May 16, 2008, the Company sold all 14 of its previously leased Beechcraft 1900D aircraft. All 14 were sold to Raytheon Aircraft Company and Raytheon Aircraft Credit Corporation (collectively "Raytheon") pursuant to an agreement reached between the parties regarding such planes. The Company sold the aircraft "as is," made a payment of \$500,000, and in return Raytheon eliminated approximately \$28 million of long-term debt due to Raytheon associated with such aircraft. This transaction resulted in a net gain of \$5.8 million, which amount is recorded in extinguishment of debt in the accompanying consolidated statement of operations.

Dash-8

As of September 30, 2008, we had 16 Dash-8 aircraft in operation: 6 with US Airways Express and 10 with United Express. The Company leases all 16 Dash-8 aircraft with four of the leases ending in 2009 and the remaining 12 ending in 2013.

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.

Under the Delta, United and US Airways revenue-guarantee code-share agreements, market selection, pricing and yield management functions are performed by our respective partners. For our *go!* operations in Hawaii, we make all decisions on market selection, pricing and yield management functions.

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 independent flights are promoted through, and our revenues are generally believed to benefit from, newspaper and radio promotions and advertisements, promotions on our website www.iflygo.com, 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 passengers booked by travel agents using such systems.

Pursuant to the Joint Venture Agreement, Kunpeng's general manager and chief deputy general manager, who are the highest officers of Kunpeng, perform all management functions, including route selection and pricing. Our Chinese

partner to the Joint Venture Agreement, Shenzhen Airlines, handles all public relations, branding and marketing on behalf of Kunpeng.

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.

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 Delta, United and US Airways (regional jet and Dash-8) allow fuel used in the performance of the agreements to be reimbursed by our code-share partner, thereby reducing our exposure to fuel price fluctuations. In fiscal 2008, approximately 95.5% of our fuel purchases were associated with our Delta, United and US Airways (regional jet and Dash-8) revenue-guarantee 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, could have a material adverse effect on our 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, we maintain our 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 (terrorism) 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 revenue-guarantee code-share agreements.

Employees

As of September 30, 2008, we employed approximately 4,113 employees. Approximately 2,485 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.

Relations between air carriers and labor unions in the United States are governed by the Railway Labor Act or RLA. Under the RLA, collective bargaining agreements generally contain "amendable dates" rather than expiration dates, and the RLA requires that a carrier maintain the existing terms and conditions of employment following the amendable date through a multi-stage and usually lengthy series of bargaining processes often overseen by the National Mediation Board. Mesa Airline's and Freedom Airline's flight attendants are represented by the Association of Flight Attendants ("AFA"). Both contracts covering flight attendants became amendable in June 2006 and we are in the mediated negotiations with our flight attendants. The pilots of Mesa Airlines, Freedom Airlines and Air Midwest are collectively represented under a single contract by the Air Line Pilot Association ("ALPA"). Our contract with ALPA became amendable in September 2007. We recently reached a tentative agreement with our pilots, which is subject to a ratification vote by our pilots.

As of September 30, 2008, Kunpeng employed approximately 160 employees. The laws of China presently require a trade union to be established if requested by any 25 or more employees, but because no such request has been received, no such trade union has been established for Kunpeng. Each of Kunpeng's employees independently entered into an employment contract with Kunpeng in accordance with Chinese Law. Kunpeng has hired pilots from outside China as well as from flight training schools in China. However, hiring and retaining qualified pilots is one of the risks that could hinder the growth of Kunpeng.

Pilot turnover at times is a significant issue among regional carriers, particularly when major carriers are hiring experienced commercial pilots away from regional carriers. During the first and second quarters of fiscal 2008, the Company experienced higher than average turnover as a result of hirings by major carriers. In addition, changes to the aircraft fleet, especially the addition of new aircraft types, or transitions from one operating entity to another, can result in pilots upgrading between aircraft types and as a result, becoming unavailable for duty during the extensive training periods required. No assurances can be made that pilot turnover will not become a significant problem in the future, particularly if major carriers expand their operations. Similarly, there can be no assurance that a sufficient number of new pilots will be available to support any future growth of the Company.

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

Investment Activities

On December 22, 2006, our wholly-owned subsidiary, Ping Shan, entered into the Joint Venture Agreement with Shan Yue and Shenzhen Airlines ("Shenzhen"), pursuant to which the parties formed Kunpeng, an equity joint venture company organized under the laws of the Peoples Republic of China. As of September 30, 2008, we had contributed \$6.5 million in capital contributions to the joint venture in accordance with the terms of the Joint Venture Agreement. Under the terms of such Agreement, the Company is required to contribute an additional RMB 196,000,000 (approximately \$28.6 million at September 30, 2008) prior to May 16, 2009.

During the third quarter the Company entered into a Letter of Intent ("LOI") to sell its interest in Kunpeng to Shenzhen. Negotiations aimed at consummating the sale of the interest have been ongoing since June 2008, and Shenzhen and we have exchanged numerous drafts of a proposed agreement, However, no assurance can be given that the LOI will result in a sale of our equity interest in Kunpeng to Shenzhen, or that, if such a sale were to occur, that it will be on terms acceptable to the Company.

As a result of the negotiated valuation of the interest by the parties set forth in the LOI, the Company has recorded a loss on its investment in Kunpeng of \$1.3 million at September 30, 2008. This loss reflects the expected proceeds from the sale of \$4.8 million less the Company's investment at September 30, 2008 of \$5.8 million and estimated transaction costs of \$300,000. The loss has been recorded in the gain (loss) from equity method investments in the accompanying consolidated statement of operations.

The Company also subleases five CRJ-200 regional jets to Kunpeng. These leases are not affected by the LOI. Total sublease revenue for the year ended September 30, 2008 was \$4.4 million. At September 30, 2008, the Company had gross receivables from Kunpeng of approximately \$2.9 million.

In fiscal 2007, we participated with a private equity fund in making an investment, through a limited liability limited partnership, in the preferred shares of a closely held emerging markets payment processing related business (the "2007 Investee"). Through our subsidiary Patar, Inc., we invested \$1.3 million, which represents approximately 19.6% of the 2007 Investee's preferred stock. In fiscal 2008, due to the improbability of recovering our investment, we wrote-off the remaining \$0.8 million of the investment.

In fiscal 2006, the Company participated with a private equity fund in making an investment in the common stock and notes of a closely held airline related business (the "2006 Investee"). The Company, through its subsidiary Nilchii, invested \$15.0 million, which represents approximately 20% and 11.8% of the 2006 Investee's common stock and notes, respectively. On December 17, 2008, the

Company received a letter from the 2006 Investee requesting that, pursuant to the terms of the governing limited liability company agreement, the Company purchase from the 2006 Investee \$3.0 million in aggregate principal amount of notes by December 31, 2008. As of January 12, 2009, the Company has not determined whether or not it will meet these obligations. In the event Company does not do so, it will suffer dilution of its equity interest in the 2006 Investee.

Each of these investments are being accounted for under the equity method of accounting.

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 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. The FAA also has the power to bring proceedings for the enforcement of Federal Aviation Regulations including the assessment of civil penalties and to seek criminal sanctions.

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 our radio facilities and the United States Postal Service with respect to carriage of United States mail. We believe we are in compliance with any such governmental laws and regulations.

Local governments in certain markets have adopted regulations governing various aspects of aircraft operations, including noise abatement and curfews. We believe we are in compliance with any such governmental laws and regulations.

Kunpeng is subject to the laws and regulations of China applicable to domestic commercial regional air carriers, including the regulations of the Civil Aviation Administration of China (the "CAAC"). In order to operate as a commercial carrier, Kunpeng is required to apply for various approvals and permits and is subject to the examination and inspection of the CAAC. The CAAC has the authority to establish consumer protection regulations to prevent unfair methods of competition and deceptive practices, to prohibit certain pricing practices, to inspect Kunpeng's books, properties and records, and to mandate conditions of carriage. The CAAC 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.

Kunpeng is also subject to the jurisdiction of the Administration of Industry and Commerce (the "AIC") with respect to corporate document filing and general business activities. The AIC has the authority to inspect the business activities and the business records of Kunpeng and has the power to initiate proceedings for sanctions on Kunpeng's corporate activities for any violation of laws and/or regulations.

In addition, Kunpeng is subject to various national and local laws and regulations of China, including those regarding safety, security, environmental protection and noise.

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. You may also read and copy any materials we file with the Securities and Exchange Commission ("SEC") at the SEC's Public Reference Room by calling the SEC at 1-800-SEC-0330. A copy of this Annual Report on Form 10-K, as well as other Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to

those reports are accessible free of charge at www.mesa-air.com and at the SEC's website at www.sec.g