

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

FRONTIER AIRLINES INC /CO/
Form 10-Q
August 05, 2004

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2004
- TRANSITION REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 1-12805

FRONTIER AIRLINES, INC.

(Exact name of registrant as specified in its charter)

Colorado (State or other jurisdiction of incorporated or organization) 84-1256945 (I.R.S. Employer Identification Number)

7001 Tower Road, Denver, CO (Address of principal executive offices) 80249 (Zip Code)

Issuer's telephone number including area code: (720) 374-4200

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in rule 12b-2 of the Exchange Act). Yes X No ___

The number of shares of the Company's Common Stock outstanding as of July 28, 2004 was 35,609,942

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

	<u>Page</u>
Item 1. Financial Information	
Financial Statements	1

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	7
Item 3: Quantitative and Qualitative Disclosures About Market Risk	26
Item 4. Controls and Procedures	26

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K	27
--	----

PART I. FINANCIAL INFORMATION

FRONTIER AIRLINES, INC.

Balance Sheets

(Unaudited)

	June 30, 2004	March 2004
Assets		
Current assets:		
Cash and cash equivalents	\$ 193,557,848	\$ 188,600,000
Short-term investments	-	2,000,000
Restricted investments	27,404,296	24,730,000
Receivables, net of allowance for doubtful accounts of \$139,000 and \$225,000 at June 30, 2004 and March 31, 2004, respectively	26,267,559	26,570,000
Security and other deposits	946,250	210,000
Prepaid expenses and other assets	16,962,222	13,090,000
Inventories, net of allowance of \$3,317,000 and \$2,991,000 at June 30, 2004 and March 31, 2004, respectively	6,875,306	6,120,000
Deferred tax assets	<u>6,016,121</u>	<u>8,380,000</u>
Total current assets	278,029,602	269,730,000
Property and equipment, net	472,694,867	440,470,000
Security and other deposits	18,469,245	16,260,000
Aircraft pre-delivery payments	9,702,070	28,320,000
Restricted investments	9,534,473	9,970,000
Deferred loan expenses and other assets	<u>4,675,644</u>	<u>4,940,000</u>
	\$ 793,105,901	\$ 769,700,000
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 33,201,985	\$ 31,160,000
Air traffic liability	98,130,203	83,330,000
Other accrued expenses	46,328,155	44,660,000
Current portion of long-term debt	17,502,986	17,380,000
Deferred revenue and other current liabilities	<u>7,076,926</u>	<u>5,100,000</u>
Total current liabilities	202,240,255	181,650,000
Long-term debt	296,258,009	280,000,000
Deferred tax liability	26,345,460	32,220,000
Deferred revenue and other liabilities	<u>15,787,197</u>	<u>17,870,000</u>
Total liabilities	540,630,921	511,760,000
Stockholders' equity:		
Preferred stock, no par value, authorized 1,000,000 shares; none issued	-	-

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

Common stock, no par value, stated value of \$.001 per share, authorized 100,000,000; 35,609,942 and 35,597,442 issued and outstanding at June 30, 2004 and March 31, 2004, respectively

	35,610	3
Additional paid-in capital	185,159,948	185,07
Unearned ESOP shares	(1,455,089)	(2,18
Other comprehensive income (loss)	160,167	(13
Retained earnings	68,574,344	75,14
Total stockholders' equity	<u>252,474,980</u>	<u>257,94</u>
	\$ 793,105,901	\$ 769,70
	=====	=====

See accompanying notes to financial statements.

FRONTIER AIRLINES, INC.
Statements of Operations
For the Three Months Ended June 30, 2004 and 2003
(Unaudited)

	June 30, 2004	June 20
Revenues:		
Passenger	\$ 169,437,481	\$ 139,00
Passenger- regional partner	19,126,445	-
Cargo	1,427,495	1,68
Other	<u>2,431,649</u>	<u>1,66</u>
Total revenues	<u>192,423,070</u>	<u>142,36</u>
Operating expenses:		
Flight operations	31,789,164	24,97
Aircraft fuel expense	40,003,182	22,60
Aircraft lease expense	18,890,826	17,19
Aircraft and traffic servicing	31,692,204	23,99
Maintenance	19,282,232	17,87
Promotion and sales	19,838,676	14,71
General and administrative	10,294,244	8,93
Operating expenses - regional partner	21,293,435	-
Loss on sale-leaseback of aircraft	488,889	-
Aircraft lease and facility exit costs	-	68
Depreciation and amortization	<u>6,618,439</u>	<u>5,18</u>
Total operating expenses	<u>200,191,291</u>	<u>136,17</u>
Operating income (loss)	<u>(7,768,221)</u>	<u>6,19</u>
Nonoperating income (expense):		
Interest income	570,570	41
Interest expense	(2,908,016)	(3,83
Emergency Wartime Supplemental Appropriations Act compensation	-	15,02
Other, net	<u>(106,302)</u>	<u>(17</u>
Total nonoperating income (expense), net	<u>(2,443,748)</u>	<u>11,42</u>
Income (loss) before income tax (benefit) expense	(10,211,969)	17,62
Income tax (benefit) expense	<u>(3,638,251)</u>	<u>6,68</u>

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

Net income (loss)	\$	(6,573,718)	\$	10,93
Earnings (loss) per share:				
Basic	\$	(0.18)	\$	
Diluted	\$	(0.18)	\$	
Weighted average shares of common stock outstanding				
Basic		35,603,426		29,82
Diluted		35,603,426		30,17

See accompanying notes to financial statements.

FRONTIER AIRLINES, INC.

Statements of Stockholders' Equity and Other Comprehensive Income (Loss)

For the Year Ended March 31, 2004 and the Three Months Ended June 30, 2004

	Common Stock Shares (000s)	Stock Stated value	Additional paid-in capital	Unearned ESOP shares	Accumulated other comprehensive income (loss)	Retained earnings
Balances, March 31, 2003	29,674	29,674	96,424,525	-	-	62,512,927
Net income	-	-	-	-	-	12,635,135
Other comprehensive loss - unrealized loss on derivative instruments, net of tax	-	-	-	-	(137,785)	-
Total comprehensive income						
Sale of common stock, net of offering costs of \$257,000	5,050	5,050	81,072,096	-	-	-
Exercise of common stock options	227	227	1,000,487	-	-	-
Tax benefit from exercises of common stock options	-	-	1,261,937	-	-	-
Equity adjustment for the repricing of warrants issued in conjunction with a debt agreement	-	-	116,701	-	-	-
Contribution of common stock to employees stock ownership plan (note 13)	646	646	5,202,640	(5,203,286)	-	-
Amortization of employee stock compensation (note 13)	-	-	-	3,020,652	-	-
Balances, March 31, 2004	35,597	\$35,597	\$185,078,386	\$(2,182,634)	\$(137,785)	\$75,148,062
Net loss	-	-	-	-	-	(6,573,718)
Other comprehensive income-						

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

unrealized gain on derivative instruments, net of tax	-	-	-	-	297,952	-
Total comprehensive loss						
Exercise of common stock options	13	13	63,350	-	-	-
Tax benefit from exercises of common stock options	-	-	18,212	-	-	-
Amortization of employee stock compensation	-	-	-	727,545	-	-
Balances, June 30, 2004	35,610	\$35,610	\$185,159,948	\$(1,455,089)	\$ 160,167	\$68,574,344

See accompanying notes to financial statements.

FRONTIER AIRLINES, INC.
Statements of Cash Flows
For the Three Months Ended June 30, 2004 and 2003
(Unaudited)

	Three Months Ended June 30, 2004	June 2003
Cash flows from operating activities:		
Net income (loss)	\$ (6,573,718)	\$ 10,930
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Employee stock option plan compensation expense	727,545	62,000
Depreciation and amortization	6,618,439	6,190,000
Depreciation and amortization - regional partner	75,413	
Impairment recorded on inventories	387,635	
Deferred tax (benefit) expense	(3,675,807)	6,670,000
Unrealized derivative (gain) loss	476,928	(75,000)
Loss on disposal of equipment	525,722	1,000
Changes in operating assets and liabilities:		
Restricted investments	(3,531,333)	(5,050,000)
Receivables	302,884	95,000
Security and other deposits	(207,239)	(1,620,000)
Prepaid expenses and other assets	(3,868,723)	(81,000)
Inventories	(1,136,368)	(3,000)
Deferred loan expenses and other assets	346,900	
Accounts payable	2,034,817	(7,060,000)
Air traffic liability	14,790,643	14,030,000
Other accrued expenses	1,848,304	10,960,000
Deferred revenue and other liabilities	(119,813)	70,000
Net cash provided by operating activities	<u>9,022,229</u>	<u>35,750,000</u>
Cash flows from investing activities:		
Decrease in short-term investments	2,000,000	
Decrease (increase) in aircraft lease and purchase deposits, net	15,895,734	(7,590,000)
Decrease in restricted investments	1,295,800	20,000
Proceeds from the sale of aircraft and equipment	63,625,010	
Capital expenditures	(103,068,885)	(2,120,000)
Net cash used in investing activities	<u>(20,252,341)</u>	<u>(9,520,000)</u>

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

Cash flows from financing activities:

Net proceeds from issuance of common stock	63,363	
Proceeds from long-term borrowings	22,000,000	
Principal payments on long-term borrowings	(5,626,295)	(2,84
Payment of financing fees	(257,837)	
Net cash provided by (used in) financing activities	16,179,231	(2,84
Net increase in cash and cash equivalents	4,949,119	23,38
Cash and cash equivalents, beginning of period	188,608,729	102,88
Cash and cash equivalents, end of period	\$ 193,557,848	\$ 126,26

See accompanying notes to financial statements.

FRONTIER AIRLINES, INC.
Notes to Financial Statements
June 30, 2004

(1) Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the Company's Annual Report on Form 10-K/A for the year ended March 31, 2004. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the three months ended June 30, 2004 are not necessarily indicative of the results that will be realized for the full year.

(2) Summary of Significant Accounting Policies

Stock-Based Compensation

The Company follows Accounting Principles Board Opinion No. 25, "Accounting for Stock Options to Employees" ("APB 25") and related Interpretations in accounting for its employee stock options and follows the disclosure provisions of Statement of Financial Accounting Standards No. 123 (SFAS 123). The Company applies APB 25 and related Interpretations in accounting for stock-based compensation plans. Accordingly, no compensation cost is recognized for options granted at a price equal to the fair market value of the Common Stock on the date of grant. Pro forma information regarding net income and earnings per share is required by SFAS 123, which also requires that the information be determined as if the Company has accounted for its employee stock options under the fair value method of that Statement. If compensation cost for the Company's stock-based compensation had been determined using the fair value of the options at the grant date, the Company's pro forma net income (loss) and earnings (loss) per share would be as follows:

	2004	2003
Net Income (loss) as reported	\$ (6,573,718)	\$10,933,690
Less: total compensation expense determined under fair value method, net of tax	406,518	453,596
Pro Forma net income (loss) as reported	\$ (6,980,236)	\$10,480,094

Earnings (loss) per share, basic:

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

As Reported	\$	(0.18)	\$	0.37
Pro Forma	\$	(0.20)	\$	0.35
Earnings (loss) per share, diluted:				
As Reported	\$	(0.18)	\$	0.36
Pro Forma	\$	(0.20)	\$	0.35

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

(3) Long-term Debt

During the quarter ended June 30, 2004, the Company borrowed an additional \$22,000,000 for the purchase of one Airbus A318 aircraft. The aircraft loan has a term of 12 years and is payable in monthly installments of \$144,000 as of June 30, 2004, including interest, payable in arrears with a floating interest rate adjusted quarterly based on LIBOR plus a margin of 1.95% resulting in an overall rate of 3.09% at June 30, 2004. At the end of the term, there is a balloon payment of \$2,640,000. A security interest in the aircraft secures the loan.

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

This report contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 that describe the business and prospects of Frontier Airlines, Inc. and the expectations of our company and management. All statements, other than statements of historical fact, included in this report that address activities, events or developments that we expect, believe, or anticipate will or may occur in the future, are forward-looking statements. When used in this document, the words "estimate," "anticipate," "project" and similar expressions are intended to identify forward-looking statements. Forward-looking statements are inherently subject to risks and uncertainties, many of which cannot be predicted with accuracy and some of which might not be anticipated. These risks and uncertainties include, but are not limited to: the timing of, and the success of, our expansion associated with, expansion and modification of our operations in accordance with our business strategy or in response to competitive pressures or other factors; failure of our new markets to develop as anticipated; the inability to obtain sufficient gates at Denver International Airport to accommodate the expansion of our operations; general economic factors and behavior of the fare-paying public that could have a potential impact on our liquidity; terrorist attacks or other incidents that could cause the public to question the safety and/or efficiency of air travel; operational disruptions, including weather, industry consolidation; the impact of labor disputes; enhanced security requirements; changes in the government's policy regarding relief or assistance to the airline industry; the economic environment of the airline industry generally; increased federal scrutiny of low-fare carriers generally that could increase our operating costs or otherwise adversely affect us; actions of competing airlines, such as increasing capacity and pricing actions of United Airlines ("United") and other competitors and actions taken by United either in or out of bankruptcy protection; the availability of suitable aircraft which may inhibit our ability to achieve operating economies and implement our business strategy; the unavailability of, or inability to secure upon acceptable terms, financing necessary to purchase aircraft which we have ordered; issues relating to our transition to an Airbus aircraft fleet; uncertainties regarding aviation fuel prices; and uncertainties as to when and how fully consumer confidence in the airline industry will be restored, if ever. Because our business, like that of the airline industry generally, is characterized by high fixed costs relative to revenues, small fluctuations in our yield per available seat mile ("RASM") or cost per available seat mile ("CASM") can significantly affect our results.

General

Now in our eleventh year of operations, we are a low cost, affordable fare airline operating primarily in a hub and spoke fashion connecting cities coast to coast primarily through our Denver International Airport ("DIA"). We are the second largest jet service carrier at DIA b

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

departures. As of July 28, 2004, we, in conjunction with Frontier JetExpress operated by Horizon Industries, Inc. ("Horizon"), operate routes linking our Denver hub to 43 U.S. cities spanning the nation from coast to coast and to five cities in Mexico. In April 2004, we began our first expansion of point-to-point routes outside of our DIA hub with three routes from our focus city Los Angeles, California, and added an additional route in May 2004. In July 2004, we began our first point-to-point route to Mexico with one weekly round-trip frequency to Cancun, Mexico from Kansas City and from Salt Lake City.

We were organized in February 1994 and began flight operations in July 1994 with two Boeing 737-200 aircraft. We have since expanded our fleet in service to 46 aircraft as of July 28, 2004 (32 of which we lease and 14 of which we own), consisting of eight Boeing 737-300s, 32 Airbus A320s and six Airbus A318s. In May 2001, we began a fleet replacement plan to replace our Boeing 737-200s with new purchased and leased Airbus jet aircraft, a transition we expect to complete by September 2004. As of November 1, 2003, we no longer operate Boeing 737-200 aircraft. During the quarters ended June 30, 2004 and 2003, we increased year-over-year capacity by 32.0% and 22.3%, respectively. During the quarter ended June 30, 2004, we increased passenger traffic by 39.0% over the prior comparable period, or 35.0% when we take into account our increase in capacity during the period.

In September 2003, we signed a 12-year agreement with Horizon, under which Horizon will operate up to nine 70-seat CRJ 700 aircraft under our Frontier JetExpress brand. The service began on January 1, 2004 with three aircraft in service and one spare aircraft. This service replaced our previous code share arrangement with Mesa Airlines which terminated on December 31, 2003. We have increased the number of CRJ aircraft to a total of eight aircraft in service and one spare aircraft. We control the schedule of this service. We reimburse Horizon for its expenses related to the operation plus a margin. The agreement also provides for financial incentives, penalties and changes to the margin based on performance of Horizon and our financial performance. As of July 28, 2004, Frontier JetExpress provides service to Denver, Colorado; Arizona; Ontario, California; Boise, Idaho; Billings, Montana; Oklahoma City, Oklahoma; El Paso, Texas and Spokane, Washington, and supplements our mainline service to, San Jose, California; Minneapolis/St. Paul, Minnesota; Omaha, Nebraska; Albuquerque, New Mexico; Portland, Oregon and Dallas, Texas.

We currently operate on 16 gates on Concourse A at DIA on a preferential basis. Together with our regional jet codeshare partner, Frontier JetExpress, we use these 16 gates and share use of our common use regional jet parking positions to operate approximately 228 daily system mainline flight departures and arrivals and 50 Frontier JetExpress daily system flight departures and arrivals.

During the quarter ended June 30, 2004 and as of June 30, 2004, we added departures from the following cities with commencement dates as follows:

<u>Destination</u>	<u>Commencement Date</u>
Washington, D.C. (Dulles International)	April 11, 2004
Anchorage, Alaska (1)	May 9, 2004
Billings, Montana (2)	May 23, 2004
Spokane, Washington (2)	May 23, 2004
Philadelphia, Pennsylvania	May 23, 2004
Nashville, Tennessee	June 20, 2004

- (1) Service to this destination is seasonal.
- (2) Operated exclusively by Frontier JetExpress.

On April 11, 2004, we began our first significant point-to-point routes from our focus city Los Angeles, California. We began service from Los Angeles International Airport to the following cities with commencement dates as follows:

<u>Destination</u>	<u>Commencement Date</u>
Kansas City, Missouri	April 11, 2004
Minneapolis/St. Paul, Minnesota	April 11, 2004
St. Louis, Missouri	April 11, 2004
Philadelphia, Pennsylvania	May 23, 2004

In August 2004, we intend to cease non-stop service between Los Angeles International Airport and Minneapolis/St. Paul and intend to reduce non-stop service to St. Louis and Kansas City for seasonal demand and poor operating results.

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

On July 3, 2004, we began our first point-to-point routes to Mexico with one weekly round-trip frequency to Cancun, Mexico from Kansas City International Airport and from Salt Lake City International Airport. We intend to increase service to Cancun from Kansas City International to three weekly round-trip frequencies and to begin three weekly round-trip frequencies from Nashville International Airport to Bergstrom International Airport in November 2004. We have also filed an application with the U.S. Department of Transportation ("DOT") for authorization to serve Cancun from Lambert-St. Louis International Airport.

We intend to begin Frontier JetExpress service to Little Rock, Arkansas from our DIA hub with one daily round-trip frequency and terminate our service to Ontario, California on October 10, 2004.

Our filings with the Securities and Exchange Commission are available at our website, www.frontierairlines.com, in the Investor Relations folder contained in the section titled "Investor Relations". These reports include our annual report on Form 10-K, our quarterly reports on Form 10-Q, reports on Form 8-K, Section 16 reports on Forms 3, 4 and 5, and any related amendments or other reports and are typically available within two days after we file the materials with the SEC.

Our corporate headquarters are located at 7001 Tower Road, Denver, Colorado 80249. Our office telephone number is 720-374-4200 and our reservations telephone number is 800-432-1359.

Overview

We intend to continue our focused growth strategy, which includes a fleet transition from Boeing to an all Airbus fleet. We intend to operate an all Airbus fleet by September 2005. One element of this strategy is to produce cost savings because crew training is standardized for all elements of a common type, maintenance issues are simplified, spare parts inventory is reduced, the Airbus aircraft are more fuel efficient, and scheduling is more efficient. As of July 28, 2004, we have remaining purchase commitments for 13 Airbus aircraft and intend to lease as many as 13 additional A318 or A319 aircraft from third party lessors over the next three years. We intend to use these additional aircraft to replace Boeing aircraft being retired, provide service to new markets and/or to add frequencies to existing markets that we believe are underserved.

The airline industry continues to be intensely competitive. We expect competition will remain intense. Business and leisure travelers continue to reevaluate their travel budgets and remain highly price sensitive. Increased competition has prompted aggressive strategies from competitors through discounted fares and frequent flyer promotions. Additionally, the intense competition has created financial hardships for some of our competitors that have been forced to reduce capacity or have been forced into bankruptcy protection.

We believe we have a proven management team and a strong company culture and will continue to focus on differentiating the product and service we provide to our passengers. We intend for our product and service to be affordable, flexible, and accommodating. This begins with our employees who strive to provide friendly customer service and keep operations running efficiently, which we believe leads to lower operating costs.

Quarter in Review

During the quarter ended June 30, 2004, we had a net loss of \$6,574,000. This was driven primarily by increased fuel costs and a decline in our average fare as we continue to operate in a highly competitive environment. We have seen a sharp rise in fuel costs since January 2004, and it may continue to increase. Our fuel cost per gallon was \$1.25 during the quarter ended June 30, 2004 compared to 93(cents) during the quarter ended June 30, 2003, an increase of 34.4%.

Highlights from the Quarter

- o Took delivery of nine new aircraft including seven Airbus A319 aircraft and two Airbus A320 aircraft and retired one Boeing B737 aircraft.
- o Began mainline service to Washington, D.C. (Dulles International); Anchorage, Alaska; Philadelphia, Pennsylvania; Nashville, Tennessee and Frontier JetExpress service to Billings, Montana and Spokane, Washington.
- o Expanded service to Washington, D.C. (Reagan National) from one daily round-trip to three daily round-trips.

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

round-trips.

- o Began our first non-stop, point-to-point flights outside of the Denver hub depart from our new "focus" city in Los Angeles with two daily non-stop flights from Los Angeles to Minneapolis/St. Paul, St. Louis, and Kansas City and one daily non-stop flight to Philadelphia.

Results of Operations

We had a net loss of \$6,574,000 or 18(cents) per diluted share for the quarter ended June 30, 2004 compared to net income of \$10,934,000 or 36(cents) per diluted share for the quarter ended June 30, 2003. Included in our net loss for the quarter ended June 30, 2004 were the following special items with a net effect of income taxes: a loss of \$489,000 on the sale of two Airbus A319 aircraft in sale-leaseback transactions, a write down of \$388,000 of the carrying value of expendable Boeing 737 inventory, and an unrealized loss on fuel hedges of \$477,000. These items, net of income taxes, increased net income by 2(cents) per share. Our net income for the quarter ended June 30, 2003 included \$15,024,000 under the Appropriations Act and an unrealized gain on fuel hedges of \$752,000, offset by aircraft exit costs of \$686,000. The net effect of these items, net of income taxes and related profit contributions, increased net income by 29(cents) per diluted share.

Our mainline passenger yield per RPM was 10.79(cents) and 12.30(cents) for the quarters ended June 30, 2004 and 2003, respectively, or a decrease of 12.3%. Our mainline average fare was \$100.50 for the quarter ended June 30, 2004 as compared to \$104.70 for the quarter ended June 30, 2003, a decrease of 4.0%. The length of haul was 988 and 917 miles for the quarters ended June 30, 2004 and 2003, respectively, an increase of 7.7%. The decrease in the average fare is offset by an increase in our mainline load factor of 70.7% for the quarter ended June 30, 2004 as compared to 67.2% for the quarter ended June 30, 2003, an increase of 3.5 points. Our mainline passenger revenue per available seat mile ("RASM") for the quarters ended June 30, 2004 and 2003 was 7.63(cents) and 8.26(cents), respectively, a decrease of 7.6%. That our average fare during the quarter ended June 30, 2004 was negatively impacted as a result of entering six new markets during the quarter ended June 30, 2004 and offering introductory fares and aggressive pricing actions by our competitors in these new markets. We did not add any new markets during the quarter ended June 30, 2003.

Our mainline cost per ASM for the quarters ended June 30, 2004 and 2003 was 8.09(cents) and 8.55(cents), respectively, a decrease of .46(cents). Mainline CASM excluding fuel for the quarters ended June 30, 2004 was 6.28(cents) and 6.78(cents), respectively, a decrease of .50(cents). Our mainline CASM decreased 7.4% for the quarter ended June 30, 2004 as a result of an increase in the average number of owned aircraft from 12.5 to 13.9, which generated a corresponding decrease of .18(cents) in aircraft lease expense, a decrease in maintenance cost per ASM of .20(cents) as a result of the reduction in our Boeing fleet that were replaced by new Airbus A319 aircraft, a decrease of .07(cents) per ASM in employee performance bonuses, and an increase in aircraft utilization and economies of scale associated with lower increases in indirect costs compared to the 32.0% increase in mainline ASMs over the prior comparable period. This decrease was significantly offset by an increase in the average price of fuel per gallon from 93(cents) to \$1.00, an increase of .07(cents) per ASM, and an increase of .46(cents) per ASM.

An airline's mainline break-even load factor is the passenger load factor that will result in operating revenues being equal to operating expenses, assuming constant revenue per passenger and operating expenses. For the quarter ended June 30, 2004, our mainline break-even load factor adjusted for special items was 73.5% compared to our achieved passenger load factor of 70.7%. Our mainline break-even load factor adjusted for special items for the quarter ended June 30, 2003, was 65.4% compared to our achieved passenger load factor of 67.2%. Our mainline break-even load factor increased from the prior period as a result of a decrease in our RASM to 7.63(cents) during the period ended June 30, 2004, from 8.26(cents) during the period ended June 30, 2003, partially offset by a decrease in our mainline operating expenses.

During the quarter ended June 30, 2004, our mainline average daily block hour utilization increased to 11.7 from 10.2 for the quarter ended June 30, 2003. The calculation of our block hour utilization includes all aircraft that are on our operating certificate, which includes scheduled aircraft, as well as aircraft out of service for maintenance and operational spare aircraft, and excludes aircraft removed from revenue service or new aircraft not yet placed in revenue service. It also excludes JetExpress aircraft operated by Horizon.

Small fluctuations in our RASM or CASM can significantly affect operating results because

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

other airlines, have high fixed costs in relation to revenues. Airline operations are highly to various factors, including the actions of competing airlines and general economic factors, adversely affect our liquidity, cash flows and results of operations.

The following table provides certain of our financial and operating data for the year ended 2004 and the quarters ended June 30, 2004 and 2003.

	Year Ended		
	March 31, 2004	Quarters Ended June 2004	
Selected Operating Data:			
Passenger revenue (000s) (1)			
Mainline	\$ 615,390	\$ 169,438	\$ 139,126
Regional Partner (2)	11,191	19,126	19,126
System Combined	626,581	188,564	139,126
Revenue passengers carried (000s)			
Mainline	5,569	1,584	1,584
Regional Partner (2)	115	203	203
System Combined	5,684	1,787	1,787
Revenue passenger miles (RPMs) (000s) (3)			
Mainline	5,120,587	1,564,587	1,125,587
Regional Partner (2)	75,974	131,554	131,554
System Combined	5,196,561	1,696,141	1,125,587
Available seat miles (ASMs) (000s) (4)			
Mainline	7,153,740	2,211,652	1,675,652
Regional Partner (2)	111,144	177,578	177,578
System Combined	7,264,884	2,389,230	1,675,652
Passenger load factor (5)			
Mainline	71.6%	70.7%	68.8%
Regional Partner (2)	68.4%	74.1%	74.1%
System Combined	71.5%	71.0%	71.0%
Mainline break-even load factor (6)	68.8%	73.5%	73.5%
Mainline block hours (7)	142,466	43,974	33,974
Mainline departures	61,812	17,650	14,650
Mainline average seats per departure	132	131	131
Mainline average stage length	877	957	957
Mainline average length of haul	919	988	988
Mainline average daily block hour utilization (8)	10.4	11.7	11.7
Yield per RPM (cents) (9) (10)			
Mainline	11.96	10.79	10.79
Regional Partner (2)	14.73	14.54	14.54
System Combined	12.01	11.08	11.08
Total yield per RPM (cents) (11)			
Mainline	12.35	11.08	11.08
Regional Partner (2)	14.73	14.54	14.54
System Combined	12.39	11.34	11.34
Yield per ASM (cents) (10) (12)			
Mainline	8.56	7.63	7.63
Regional Partner (2)	10.07	10.77	10.77
System Combined	8.59	7.86	7.86
Total yield per ASM (cents) (13)			
Mainline	8.84	7.84	7.84
Regional Partner (2)	10.07	10.77	10.77
System Combined	8.86	8.05	8.05

Selected Operating Data (continued):

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

Cost per ASM (cents)			
Mainline	8.40	8.09	
Regional Partner (2)	13.17	11.99	
System Combined	8.47	8.38	
Mainline fuel expense per ASM (cents)	1.52	1.81	
Mainline cost per ASM excluding fuel (cents) (14)	6.88	6.28	
Mainline average fare (15)	\$ 103.50	\$ 100.50	\$ 100.00
Mainline average aircraft in service	37.3	41.4	
Mainline aircraft in service at end of period	38	46	
Mainline average age of aircraft at end of period	3.9	3.1	

- (1) "Passenger revenue" includes revenues for non-revenue passengers, charter revenues, administrative and revenue recognized for unused tickets that are greater than one year from issuance, incremental revenue from passengers connecting from regional flights to mainline flights in our mainline passenger revenue.
- (2) In September 2003, we signed a 12-year agreement with Horizon, under which Horizon operates 70-seat CRJ 700 aircraft under our Frontier JetExpress brand. The service began on January 1, 2003 and replaced our codeshare with Mesa Airlines which terminated on December 31, 2003. In accordance with Emerging Issues Task Force No. 01-08, "Determining Whether an Arrangement Contains a Lease" we have concluded that the Horizon agreement contains leases as the agreement conveys the right to use a specific number and specific type of aircraft over a stated period of time. Therefore, we book revenues and expenses related to the Horizon agreement gross. Under the Mesa agreement, we book JetExpress revenues reduced by related expenses net in other revenues. JetExpress operations from January 1, 2003 to December 31, 2003 are not included in regional partner statistics as the Mesa arrangement was effective prior to May 28, 2003, the effective date of EITF 01-08.

Amounts included in other revenues for Mesa for the year ended March 31, 2004, and for the three months ended June 30, 2004 and 2003 were as follows:

	Year Ended March 31, 2004	Quarters Ended June 30, 2004	2003
Mesa revenues (000s)	\$ 25,155	\$ -	\$ 7,840
Mesa expenses (000s)	(23,438)	-	(7,770)
Net amount included in other revenues	\$ 1,717	\$ -	\$ 60

Mesa's revenue passenger miles (RPMs) and available seat miles (ASMs) for the year ended March 31, 2004 and for the three months ended June 30, 2004 and 2003 were as follows:

	Year Ended March 31, 2004	Quarters Ended June 30, 2004	2003
Mesa RPMs (000s)	148,163	-	47,700
Mesa ASMs (000s)	174,435	-	68,600

- (3) "Revenue passenger miles," or RPMs, are determined by multiplying the number of fare-paying passengers carried by the distance flown.
- (4) "Available seat miles," or ASMs, are determined by multiplying the number of seats available for revenue by the number of miles flown.
- (5) "Passenger load factor" is determined by dividing revenue passenger miles by available seat miles.
- (6) "Break-even load factor" is the passenger load factor that will result in operating revenues equal to operating expenses, net of certain adjustments, assuming constant yield per RPM and no change in operating expenses. Break-even load factor as presented above may be deemed a non-GAAP financial measure under rules issued by the Securities and Exchange Commission. We believe that presentation of break-even load factor calculated after certain adjustments is useful to investors because the elimination of special items allows a meaningful period-to-period comparison. Furthermore, in preparing operating forecasts we rely on an analysis of break-even load factor exclusive of these special and non-recurring items. Our presentation of non-GAAP results should not be viewed as a substitute for our financial results based on GAAP, and other airlines may not necessarily compute break-even load factor that is consistent with our computation.

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

A reconciliation of the components of the calculation of the mainline break-even load factor follows:

	Year Ended		
	March 31,	Quarters Ended June	
	2004	2004	2003
			(In thousands)
Net (income) loss	\$ (12,635)	\$ 6,574	\$ (10,93)
Income tax (expense) benefit	(7,822)	3,638	(6,68)
Passenger revenue	615,390	169,437	139,01
Revenue - regional partner	11,191	19,126	-
Charter revenue	(2,724)	(656)	(61)
Operating expenses - regional partner	(14,634)	(21,293)	-
Passenger revenue - mainline (excluding charter and regional partner revenue) required to break even (based on GAAP amounts)	\$ 588,766	\$ 176,826	\$ 120,77
Non-GAAP adjustments:			
Emergency Wartime Supplemental Appropriations Act compensation, net of bonuses	13,842	-	13,84
Aircraft and facility lease exit costs, net of bonuses	(4,949)	-	(63)
Early retirement of debt costs, net of bonuses	(9,677)	-	-
Loss on sale-leaseback of aircraft, net of bonuses	(1,219)	(489)	-
Loss on sale of aircraft engine, net of bonuses	(445)	-	-
Impairment of Boeing engine and rotatable parts, net of bonuses	(2,807)	-	-
Provision for Boeing spare parts inventory, net of bonuses	(569)	(388)	-
Horizon start-up costs, net of bonuses	(1,061)	-	-
Unrealized derivative gain (loss), net of bonuses	-	(477)	69
Passenger revenue- mainline (excluding charter and regional partner revenue) required to break-even (based on adjusted amounts)	\$ 581,881	\$ 175,472	\$ 134,67

The calculation of the break-even load factor follows:

	Year Ended		
	March 31,	Quarters Ended June	
	2004	2004	2003
Calculation of mainline break-even load factor using GAAP amounts:			
Passenger revenue- mainline (excluding charter and regional partner revenue) required to break even (based on GAAP amounts) (\$000s)	\$ 588,766	\$ 176,826	\$ 120,77
Mainline yield per RPM (cents)	11.96	10.79	12.3
Mainline revenue passenger miles (000s) to break even assuming constant yield per RPM	4,922,793	1,638,795	981,89
Mainline available seat miles (000s)	7,153,740	2,211,652	1,675,05
Mainline break-even load factor using GAAP amounts	68.8%	74.1%	58.6
Calculation of mainline break-even load factor using Non-GAAP amounts:			
Passenger revenue (excluding charter and regional partner revenue) required to break even (based on adjusted amounts) (\$000s)	\$ 581,881	\$ 175,472	\$ 134,67
Mainline yield per RPM (cents)	11.96	10.79	12.3
Mainline revenue passenger miles (000s) to break			

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

even assuming constant yield per RPM	4,865,226	1,626,247	1,094,92
Mainline available seat miles (000's)	7,153,740	2,211,652	1,675,05
=====			
Mainline break-even load factor using non-GAAP amounts	68.0%	73.5%	65.4
=====			

- (7) "Mainline block hours" represent the time between aircraft gate departure and aircraft gate arrival.
- (8) "Mainline average daily block hour utilization" represents the total block hours divided by the number of aircraft days in service, divided by the weighted average of aircraft in our fleet during the period. The number of aircraft includes all aircraft on our operating certificate, which includes aircraft in service, aircraft out of service for maintenance and operational spare aircraft, aircraft removed permanently from revenue service or new aircraft not yet placed in revenue service.
- (9) "Yield per RPM" is determined by dividing passenger revenues (excluding charter revenue) by passenger miles.
- (10) For purposes of these yield calculations, charter revenue is excluded from passenger revenue figures. Non-GAAP financial measures under regulations issued by the Securities and Exchange Commission. We believe that presentation of yield excluding charter revenue is useful to investors because charter flights are not included in RPMs or ASMs. Furthermore, in preparing operating plans we rely on an analysis of yield exclusive of charter revenue. Our presentation of non-GAAP financial measures should not be viewed as a substitute for our financial or statistical results based on the calculation of passenger revenue excluding charter revenue is as follows:

	Year Ended March 31,		Quarters Ended June 30,	
	2004	2004	2004	2003
Passenger revenues - mainline, as reported	\$ 615,390	\$ 169,437	\$ 169,437	\$ 139,800
Less: charter revenue	2,724	656	656	1,000
Passenger revenues - mainline excluding charter	612,666	168,781	168,781	138,800
Add: Passenger revenues - regional partner	11,191	19,126	19,126	10,000
Passenger revenues, system combined	\$ 623,857	\$ 187,907	\$ 187,907	\$ 148,800
=====				

- (11) "Total yield per RPM" is determined by dividing total revenues by revenue passenger miles.
- (12) "Yield per ASM" is determined by dividing passenger revenues (excluding charter revenue) by available seat miles.
- (13) "Total yield per ASM" is determined by dividing total revenues by available seat miles.
- (14) This may be deemed a non-GAAP financial measure under regulations issued by the Securities and Exchange Commission. We believe the presentation of financial information excluding fuel expense is useful to investors because we believe that fuel expense tends to fluctuate more than other operating expenses and facilitates comparison of results of operations between current and past periods and enables better forecast future trends in our operations. Furthermore, in preparing operating plans we rely, in part, on trends in our historical results of operations excluding fuel expense. Our presentation of non-GAAP financial measures should not be viewed as a substitute for our financial results determined in accordance with GAAP.
- (15) "Mainline average fare" excludes revenue included in passenger revenue for charter and non-mainline passengers, administrative fees, and revenue recognized for unused tickets that are greater than the fare from issuance date.

The following table provides our operating revenues and expenses for our mainline operations as cents per total mainline ASMs and as a percentage of total mainline operating revenues, as reported for the year ended March 31, 2004 and the quarters ended June 30, 2004 and 2003. Regional partner revenue and ASMs were excluded from this table to provide comparable amounts to the prior period presented.

	Year Ended March 31,		Quarters Ended June 30,	
	2004	2004	2004	2003
	Per total ASM	% of Revenue	Per total ASM	% of Revenue

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

Revenues:					
Passenger - mainline	8.60	97.3%	7.66	97.8%	8.30
Cargo	0.11	1.3%	0.07	0.8%	0.10
Other	0.13	1.4%	0.11	1.4%	0.10
Total revenues	8.84	100.0%	7.84	100.0%	8.50

Operating expenses:					
Flight operations	1.47	16.6%	1.44	18.3%	1.49
Aircraft fuel expense	1.52	17.2%	1.81	23.1%	1.35
Aircraft lease expense	0.98	11.1%	0.85	10.9%	1.03
Aircraft and traffic servicing	1.54	17.5%	1.43	18.3%	1.43
Maintenance	1.04	11.7%	0.87	11.1%	1.07
Promotion and sales	0.91	10.3%	0.90	11.5%	0.88
General and administrative	0.52	5.8%	0.47	5.9%	0.53
Aircraft lease and facility exit costs	0.07	0.8%	-	-	0.04
Loss on sale-leaseback of aircraft	0.02	0.2%	0.02	0.3%	-
Depreciation and amortization	0.33	3.8%	0.30	3.8%	0.31
Total operating expenses	8.40	95.0%	8.09	103.2%	8.13

Revenues

Industry fare pricing behavior has a significant impact on our revenues. Because of the passenger demand, we believe that increases in fares may at certain levels result in a decrease demand in many markets. We cannot predict future fare levels, which depend to a substantial degree of competitors and the economy. When sale prices or other price changes are initiated by competitors in our markets, we believe that we must, in most cases, match those competitive fares in order to maintain our market share. Passenger revenues are seasonal in leisure travel markets depending on the markets' location.

Passenger Revenues. Mainline passenger revenues totaled \$169,437,000 for the quarter ended June 30, 2004 compared to \$139,010,000 for the quarter ended June 30, 2003, an increase of 21.9%. Mainline revenue includes revenues for reduced rate standby passengers, administrative fees, revenue from unused tickets that are not used within one year from their issue dates, and revenue recognized from our credit card arrangement. We carried 1,584,000 mainline revenue passengers during the quarter ended June 30, 2004 compared to 1,227,000 in the quarter ended June 30, 2003, an increase of 29.1%. We had an average of 35.6 aircraft in service during the quarter ended June 30, 2004 compared to an average of 35.6 aircraft in the quarter ended June 30, 2003, an increase of 16.3%. Mainline ASMs increased to 2,211,652,000 for the quarter ended June 30, 2004 from 1,675,050,000 for the quarter ended June 30, 2003, an increase of 32.0%. Mainline RASM for the quarter ended June 30, 2004 were 1,564,587,000 compared to 1,125,233,000 for the quarter ended June 30, 2003, an increase of 39.0%, outpacing the increase in mainline ASMs. Our mainline RASM decreased to 7.63(cent), a decrease of 7.6%. Our mainline average fare was \$100.50 for the quarter ended June 30, 2004 compared to \$104.70 for the quarter ended June 30, 2003, a decrease of 4.0%. Our length of haul was 1,100 miles for the quarters ended June 30, 2004 and 2003, respectively, or an increase of 7.7%, causing pressure on our yield. We offered introductory fares in the six new markets we entered during the quarter ended June 30, 2004, which we believe negatively impacted our average fare. The decrease in average fare was partially offset by an increase in our mainline load factor to 70.7% for the quarter ended June 30, 2004 as compared to 67.2% for the quarter ended June 30, 2003, an increase of 3.5 points. In May 2003, we launched a unique branding campaign, 'A Whole Different Animal,' and we believe customer response to this campaign, in addition to our lower fare structure is a positive contributor to our results for the quarters ended June 30, 2004 and 2003.

Passenger Revenues - Regional Partner. Regional partner revenues, consisting of revenues from JetExpress operated by Horizon, totaled \$19,126,000 for the quarter ended June 30, 2004 and none for the quarter ended June 30, 2003. The incremental revenue from passengers connecting from regional flight to our mainline flights is included in our mainline passenger revenue. Horizon began service January 1, 2004 and replaced Frontier JetExpress service formerly provided by Mesa. For the three months ended June 30, 2003, we recognized \$7,847,000 from regional jet operations, at the time provided by Mesa Airlines, were netted against our mainline passenger revenue.

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

expenses and included in "Other revenues". See footnote (2) in "Selected Financial Data", which different accounting methods for our Frontier JetExpress operations.

Cargo Revenues. Cargo revenues, consisting of revenues from freight and mail services, totaled \$1,427,000 and \$1,689,000 for the quarters ended June 30, 2004 and 2003, representing .8% and 1.2% of total operating revenues excluding regional partner revenues, respectively, or a decrease of 15.5%. The passenger business is highly competitive and depends heavily on aircraft scheduling, alternate means of same day delivery service and schedule reliability. During the quarter ended June 30, 2004, we determined that carrying mail for the United States Postal Service was not profitable and we terminated the contract effective July 1, 2004.

Other Revenues. Other revenues, comprised principally of interline handling fees, liquor sales and excess baggage fees, totaled \$2,432,000 and \$1,667,000 or 1.4% and 1.2% of total operating revenues excluding regional partner revenue for the quarters ended June 30, 2004 and 2003, respectively, or a decrease of 45.9%. Other revenue increased over the prior comparable period as a result of an increase in liquor sales.

Operating Expenses

Operating expenses include those related to flight operations, aircraft and traffic control, maintenance, promotion and sales, Frontier JetExpress operations, general and administrative and depreciation and amortization. Total operating expenses were \$200,191,000 and \$136,171,000 for the quarters ended June 30, 2004 and 2003 and represented 104.0% and 95.6% of total revenue, respectively. Operating expenses increased 34.4% as a percentage of revenue during the quarter ended June 30, 2004 largely a result of a 34.4% increase in fuel cost per gallon for the quarter ended June 30, 2004 as compared to the quarter ended June 30, 2003.

Salaries, Wages and Benefits. We record salaries, wages and benefits within the specific category identified in our statements of operations to which they pertain. Salaries, wages and benefits totaled \$47,581,000 and \$37,002,000 and were 27.5% and 26.0% of total mainline revenues for the quarters ended June 30, 2004 and 2003, respectively, an increase of 28.6%. Salaries, wages and benefits increased over prior comparable periods largely as a result of overall wage increases and an increase in the number of employees to support our continued ASM growth as well as the ASM growth that we expect for the first three quarters of fiscal year 2005. Our mainline ASMs increased 32.0% for the quarter ended June 30, 2004 as compared to the quarter ended June 30, 2003. Our employees increased from approximately 3,400 in June 2003 to 4,400 in June 2004, or 29.4%. During the quarter ended June 30, 2004, we increased the number of aircraft in service by nine and took one Boeing aircraft out of service. During the quarter ended June 30, 2004, we added one Airbus aircraft and retired one Boeing aircraft. We pay pilot and flight attendant salaries during training, consisting of approximately six and three weeks, respectively, prior to scheduled increase in service, which can cause the compensation expense during such periods to appear high in relation to the average number of aircraft in service.

Flight Operations. Flight operations expenses of \$31,789,000 and \$24,973,000 were 18.3% and 18.3% of total mainline revenue for the quarters ended June 30, 2004 and 2003, respectively, an increase of 27.2%. Flight operations expenses include all expenses related directly to the operation of the aircraft excluding depreciation of owned aircraft and lease expenses and including insurance expenses, pilot and flight attendant salaries, in-flight catering, crew overnight expenses, flight dispatch and flight operations administrative expenses.

Aircraft insurance expenses totaled \$2,646,000 (1.5% of total mainline revenue) and \$2,146,000 (1.9% of total mainline revenue) for the quarters ended June 30, 2004 and 2003, respectively. Aircraft insurance expenses were .12(cent) and .16(cent) per mainline ASM for the quarters ended June 30, 2004 and 2003, respectively. Aircraft insurance decreased per mainline ASM as a result of a 30% decrease in basic hull and liability insurance rates effective June 7, 2003 through June 6, 2004 as compared to our previous policy and an additional 25% decrease in our basic hull and liability insurance rates effective June 7, 2004. The FAA currently provides war risk coverage at a less expensive rate as compared to the coverage that was previously provided by commercial underwriters. The current FAA war risk policy expires on December 31, 2004. We do not know whether the government will extend the coverage until December 2004, and if it does, how long the extension will last. We expect that if the government provides excess war risk coverage to the airline industry, the premiums charged by the government for this coverage will be substantially higher than the premiums currently charged by the government. If the coverage will not be available from reputable underwriters.

Pilot and flight attendant salaries before payroll taxes and benefits totaled \$16,880,000 for the quarter ended June 30, 2004.

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

\$12,485,000 or 10.0% and 9.0% of passenger mainline revenue, for the quarters ended June 30, 2004 respectively, or an increase of 35.3%. Pilot and flight attendant compensation increased as a result of a 16.3% increase in the average number of aircraft in service, an increase of 32.7% in block hours, a wage increase in pilot and flight attendant salaries, and additional crews required to replace crews on transitional training on the Airbus equipment.

Aircraft fuel expense. Aircraft fuel expenses include both the direct cost of fuel included as well as the cost of delivering fuel into the aircraft. Aircraft fuel costs of \$40,003,000 for 24,412,000 gallons used and \$22,601,000 for 24,412,000 gallons used resulted in an average fuel cost of 1.293(cents) per gallon for the quarters ended June 30, 2004 and 2003, respectively. Aircraft fuel expense represented 23.1% and 15.9% of total mainline revenue for the quarters ended June 30, 2004 and 2003, respectively. The average fuel cost per gallon increased 34.4% over the prior comparable period. Fuel prices are subject to change weekly, as we purchase a very small portion in advance for our operations. The results of operations for the quarter ended June 30, 2004 include an unrealized derivative loss of \$477,000 and a realized net gain of approximately \$543,000 in cash settlements received from a counterparty recorded as a decrease in fuel expense. The results of operations for the quarter ended June 30, 2003 include an unrealized derivative gain of \$752,000 and a realized loss of approximately \$213,000 in cash payments made to a counterparty recorded as an increase in fuel expense. Fuel consumption per block hour for the quarters ended June 30, 2004 and 2003 averaged 730 and 737 gallons per block hour, respectively, or a decrease of .9%. Fuel consumption per block hour decreased during the quarter ended June 30, 2004 from the prior comparable period because of the more fuel-efficient Airbus aircraft added to our fleet coupled with the reduction in our Boeing fleet, which has slightly higher fuel burn rates.

Aircraft Lease Expenses. Aircraft lease expenses totaled \$18,891,000 (10.9% of total mainline revenue) and \$17,192,000 (12.1% of total mainline revenue) for the quarters ended June 30, 2004 and 2003, respectively, or an increase of 9.9%. The average number of leased aircraft increased to 27.5 from 26.6, an increase of 4.1%. Aircraft lease expense increased slightly as a result of newer and larger aircraft leased during the quarter ended June 30, 2004 compared to the aircraft leased during the quarter ended June 30, 2003.

Aircraft and Traffic Servicing. Aircraft and traffic servicing expenses were \$31,600,000 and \$23,998,000 (an increase of 32.1%) for the quarters ended June 30, 2004 and 2003, respectively, or an increase of 18.3% and 16.9% of total mainline revenue. Aircraft and traffic servicing expenses include expenses incurred at airports including landing fees, facilities rental, station labor, ground handling expenses, and interrupted trip expenses associated with delayed or cancelled flights. Interrupted trip expenses are paid to other airlines to protect passengers as well as hotel, meal and other incidental expenses. Aircraft and traffic servicing expenses will increase with the addition of new cities to our route system. As of June 30, 2004, we served 49 cities compared to 38 cities as of June 30, 2003, or an increase of 28.9%. For the quarter ended June 30, 2004, our departures increased to 17,650 from 14,610, or an increase of 20.8% and traffic servicing expenses were \$1,796 per departure for the quarter ended June 30, 2004 as compared to \$1,643 per departure for the quarter ended June 30, 2003, or an increase of 9.3%. Aircraft and traffic servicing expenses increased per departure as a result of overall wage increases, increase in air traffic at existing cities and costs associated with the start-up of six new cities in the quarter and the increase in flying from our Los Angeles focus city.

Maintenance. Maintenance expenses of \$19,282,000 and \$17,878,000 were 11.1% and 12.5% of total mainline revenue for the quarters ended June 30, 2004 and 2003, respectively. These expenses include all labor, parts and materials expenses related to the maintenance of the aircraft. Maintenance is charged to maintenance expense. Maintenance cost per block hour was \$438 and \$540 for the quarters ended June 30, 2004 and 2003, respectively, or a decrease of 18.9%. Maintenance cost per block hour decreased as a result of a decrease in our Boeing fleet coupled with the additional new Airbus aircraft that are less costly to maintain than our older Boeing aircraft. Our mainline average age of aircraft was 3.1 years as of June 30, 2004 as compared to 6.7 years as of June 30, 2003. The owned Airbus fleet comprising about 37.8% of our total Airbus fleet is new and we are realizing lower maintenance costs as compared to the older aircraft that are in our fleet. Maintenance reserves are required to be paid on a monthly basis to lessors of our leased Boeing and Airbus fleet and are expensed as incurred. As the Airbus aircraft age, they will require more maintenance and maintenance expense per block hour will increase.

Promotion and Sales. Promotion and sales expenses totaled \$19,839,000 and \$14,720,000 or 16.3% and 10.3% of total revenue excluding revenues from our regional partner operations for the quarters ended June 30, 2004 and 2003, respectively. These expenses include advertising expenses, telecommunications and benefits for reservation agents and related supervision as well as marketing management and sales support credit card fees, travel agency commissions and computer reservations costs. During the quarter

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

2004, promotion and sales expenses per mainline passenger increased to \$12.52 from \$12.00 for the June 30, 2003. Promotion and sales expenses per mainline passenger increased as a result of our awareness campaign, which began May 2003 and includes television, print and radio components. Add have increased our involvement in professional and collegiate sports team sponsorships resulting promotion expense during the quarter ended June 30, 2004 as compared to the quarter ended June Advertising expenses also increased as a result of increased advertising in the Los Angeles, Cali to promote brand awareness in our new focus city.

General and Administrative. General and administrative expenses for the quarters ended and 2003 totaled \$10,294,000 and \$8,936,000, respectively, and were 5.9% and 6.3% of total mainline respectively. During the quarter ended June 30, 2003, we accrued for employee performance bonuses \$1,125,000 or .8% of total revenue. Bonuses are based on profitability. As a result of our pre- the quarter ended June 30, 2004, we did not accrue bonuses. General and administrative expenses wages and benefits for several of our executive officers and various other administrative personnel legal, accounting, information technology, aircraft procurement, corporate communications, training resources and other expenses associated with these departments. Employee health benefits, accrued and bonus expenses, general insurance expenses including worker's compensation, and write-offs as credit card and check fraud are also included in general and administrative expenses. Our employ from approximately 3,400 in June 2003 to approximately 4,400 in June 2004, an increase of 29.4%. we experienced increases in our human resources, training, information technology, and health insurance expenses.

Regional Partner Expense. Regional partner expense for the quarter ended June 30, 2003 totaled \$21,293,000 and was 111.3% of total regional partner revenues. Regional partner expenses costs associated with Frontier JetExpress operated by Horizon. Horizon began service June 2003 replaced the JetExpress service formerly provided by Mesa. During the quarter ended June 30, 2003 Mesa expenses were netted against related revenues and included in other revenues. See footnote "Financial Data", which explains the different accounting methods for our Frontier JetExpress operations.

Aircraft Lease and Facility Exit Costs. In May 2003, we ceased using one of our Boeing 737 leased aircraft that had a lease termination date in October 2005 and recorded a charge of \$686,000 amount includes the estimated fair value of the remaining lease payments and the write off of the leasehold improvements on the aircraft.

Loss on Sale-leaseback of Aircraft. During the quarter ended June 30, 2004, we incurred a loss totaling \$489,000 on the sale-leaseback of two Airbus A319 aircraft.

Depreciation and Amortization. Depreciation and amortization expenses of \$6,618,000 and \$5,980,000, an increase of 27.6%, were approximately 3.8% and 3.6% of total mainline revenue for the quarters ended June 30, 2004 and 2003, respectively. These expenses include depreciation of aircraft and aircraft office equipment, ground station equipment, and other fixed assets. Depreciation expense increased prior year largely as a result of an increase in the average number of Airbus A319 and A318 aircraft from nine during the quarter ended June 30, 2003 to 13.9 during the quarter ended June 30, 2004.

Nonoperating Income (Expense). Net nonoperating expense totaled \$2,444,000 for the quarter ended June 30, 2004 compared to net nonoperating income of \$11,427,000 for the quarter ended June 30, 2003. During the quarter ended June 30, 2003, we recognized \$15,024,000 of compensation as a result of the Appropriations Act for expenses and revenue foregone related to aviation security. We received \$15,573,000 in May 2003, of which we paid \$549,000 to Mesa for the revenue passengers Mesa carried on JetExpress.

Interest income increased to \$571,000 from \$413,000 during the quarter ended June 30, 2004 from the prior comparable period as a result of an increase in invested cash. Interest expense decreased for the quarter ended June 30, 2004 from \$3,834,000 for the quarter ended June 30, 2003. Interest expense for the quarter ended June 30, 2003 included the interest expense associated with a \$70,000,000 government loan we obtained in February 2002 and subsequently repaid in December 2003. The decrease in interest expense from the government guaranteed loan for the quarter ended June 30, 2004 from the prior comparable period was partially offset by the interest expense associated with the financing of five additional Airbus A319 aircraft purchased since June 30, 2003.

Income Tax Expense (Benefit). We recorded an income tax benefit of \$3,638,000 during the quarter ended June 30, 2004 at a 36.0% rate, compared to an income tax expense of \$6,689,000 for the quarter ended June 30, 2003.

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

June 30, 2003, at a 38.0% rate.

Liquidity and Capital Resources

Our liquidity depends to a large extent on the number of passengers who fly with fares we charge, our operating and capital expenditures, and our financing activities. on lease or mortgage-style financing to acquire all of our aircraft, including 26 additional aircraft that as of July 28, 2004 are scheduled for delivery through March 2008.

We had cash, cash equivalents and short-term investments of \$193,558,000 and \$190,6 June 30, 2004 and March 31, 2004, respectively. At June 30, 2004, total current assets were \$ as compared to \$202,240,000 of total current liabilities, resulting in working capital of \$75,7 March 31, 2004, total current assets were \$269,733,000 as compared to \$181,659,000 of total curre resulting in working capital of \$88,074,000. The decrease in our working capital from March largely a result of capital expenditures and debt principal payments.

Cash provided by operating activities for the quarter ended June 30, 2004 was \$9 This is attributable to our net loss adjusted for non-cash charges and credits and changes in wor accounts. Our restricted investments increased largely a result of increased collateral r for our bankcard processor associated with the increase in our business. Prepaid expens principally as a result of an increase in fuel deposits as a result of the increase in the pr and an increase in fuel consumption associated with the increase in block hours flown. Our a liability increased as a result of the growth of our business associated with the increase in of aircraft in our fleet coupled with the increase in the number of passengers we carried in e increased capacity. Our accrued expenses increased as a result of increases in employee benefits with the increase in the number of employees and increases in health care expenses, and increa passenger related taxes associated with our increase in revenue and passengers carried. Cas by operating activities for the quarter ended June 30, 2003 was \$35,753,000. This is attributa net income adjusted for non-cash charges and credits and changes in working capital accounts. investments increased as a result of increased collateral requirements for our bankcard p associated with the increase in our business and an increase in collateral for our w compensation insurance.

Cash used in investing activities for the quarter ended June 30, 2004 was \$20,252,0 aircraft lease and purchase deposits decreased by \$15,896,000 during the period. Capital exp were \$103,069,000 for the quarter ended June 30, 2004 and included the purchase of one Airbus A31 and two Airbus A319 aircraft we took delivery of and subsequently completed sale-leaseback tr on both A319 aircraft. Additionally, capital expenditures included the purchase of LiveTV rotatable aircraft components, aircraft improvements and ground equipment. We applied the pr payments totaling \$6,412,000 for the purchase of an Airbus A318 aircraft to the purchase of tha and the pre-delivery deposits totaling \$14,716,000 for the two Airbus A319 aircraft were retu We received \$63,625,000 from the sale of the two A319 aircraft and other equipment. Cash used in activities for the quarter ended June 30, 2003 was \$9,520,000. Net aircraft lease and purchase d increased by \$7,599,000 during this period, principally for pre-delivery payments. We used \$2, purchase rotatable aircraft components and other general equipment purchases.

Cash provided by financing activities for the quarter ended June 30, 2004 was \$16,179,0 the quarter ended June 30, 2004, we borrowed \$22,000,000 for the purchase of one Airbus A31 and paid \$5,626,000 of debt principal payments. Cash used in financing activities for the qua June 30, 2003 was \$2,846,000 for debt principal payments.

We have been working closely with DIA, our primary hub for operations, and the offices o of the City and County of Denver, in which DIA is located, to develop plans for expanding Con where our aircraft gates are located in order to accommodate our anticipated growth over the years. In the interim, we have gained temporary rights to two gates, and permanent rights previously used by United on the East end of Concourse A. We are currently obligated to return temporary gates to United in October 2005. DIA has also completed construction of two tempora the West end of Concourse A. We are currently using all five of these temporary gates until a expansion can be completed. Initial negotiations with the City and County of Denver and its contractor have stalled, and we are working with the City and County of Denver to establish a pro a second round of competitive bids for design and construction of the expansion project. If final

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

is reached, upon completion of the permanent expansion to Concourse A we would be obligated to build additional gates, thereby increasing our overall rates and charges paid to the airport. Because our rates and charges will be based on the final project costs as well as the number of passengers and aircraft weight landed at the airport, it is impossible at this time to determine what our future rates and charges at DIA will be.

As part of the lease restructure between the City and County of Denver and United, that United has been provided certain concessions and reductions in the rents, rates and charges from their lease of facilities at DIA. The City and County of Denver has indicated that it will prevent the reduced rates and charges being paid by United from increasing the rates and charges paid by other airlines. However, the City and County of Denver has also made it clear that in certain circumstances it will have no choice but to increase rates and charges being paid by other airlines in order to comply with their own cash flow, reserve account and bond financing requirements. As one of the second largest airline operating out of DIA, we may incur a larger impact of any increase in rates and charges imposed by DIA. At this time, we cannot quantify what the increase in our rates and charges would be, if any, due to the concessions being provided to United.

In April 2004, we entered into a services agreement with Sabre, Inc. for its SabreSonic solution to power our reservations and check-in capabilities along with a broad scope of technology streamlining our operations and improving revenues. With SabreSonic, we will have access to passenger data including the customer's history with Frontier and any *EarlyReturns* frequent flyer program current travel plans and any changes made to an existing reservation. The data can be accessed by our customer service agents via an open-source, Windows-based interface at all customer touch points including the website, reservations, the ticket counter and the gate, providing a seamless customer service from the time the customer books the ticket until they arrive at their final destination. We are in the complete implementation of SabreSonic in the first half of calendar 2005. We are estimating transition costs for the implementation which includes training of our customer service and reservation agents to be approximately \$2,800,000 and will largely fall in the last half of our fiscal year ending March 31, 2005.

On July 22, 2004, the National Mediation Board (NMB) reported that our twenty Materials Management employees elected not to join the International Brotherhood of Teamsters (IBT) Union. On July 30, 2004, there was an allegation of election interference with the NMB, requesting a new election. We believe these allegations are without merit and we will file our response with the NMB in the near future. Our Materials Management Specialists are part of the Materials Management group, which is under the finance department. Materials Management Specialists are involved in the receiving, shipping, transporting, issuing, handling, and relocating of materials and equipment to the appropriate internal customers.

In July 2004 we entered into an agreement with a vendor and are in final negotiations with the vendor to market and sell all of our Boeing 737-200 and certain Boeing 737-300 spare parts inventories. We are in the process of putting the initial inventory package together which will include all of our Boeing 737-200 expendables and rotables and certain spares that support the Boeing 737-300 fleet. We intend to begin to actively sell these parts in August 2004. During the quarter ended September 30, 2004, we expect to record the value of the rotables as "Assets held for sale" on our balance sheet, at which time we will record a charge of the estimated costs of selling these assets. At this time we have not determined the total value of the assets to be sold, however, as of June 30, 2004, the total net book value of our Boeing rotables including two spare engines approximated \$15,285,000. The total value of our expendable inventory at June 30, 2004 was \$2,735,000.

We have been assessing our liquidity position in light of our aircraft purchase commitments, other capital requirements, the economy, our competition, and other uncertainties surrounding the airline industry. Prior to applying for a government guaranteed loan under the Stabilization Act, we filed a registration with the Securities and Exchange Commission in April 2002 that allows us to sell equity securities from time to time as market conditions permit. In September 2003, we completed a public offering of 5,050,000 shares of our common stock. Although the stock offering and our results of operations have improved our liquidity, we may need to continue to explore avenues to enhance our liquidity in light of our current economic and operating environment changes. We intend to continue to examine domestic and foreign bank aircraft financing, bank lines of credit and aircraft sale-leasebacks, the sale of equity or debt securities, and other transactions as necessary to support our capital and operating needs. For further information on our financing plans and activities and commitments, see "Contractual Obligations" and "Commercial Commitments" below.

Contractual Obligations

The following table summarizes our contractual obligations as of June 30, 2004:

	Less than 1 year	1-3 years	4-5 years	After 5 years
Long-term debt (1)	\$ 17,503,000	\$ 38,008,000	\$ 42,439,000	\$ 215,811,000
Operating leases (2)	124,644,000	239,128,000	235,239,000	704,651,000
Unconditional purchase obligations (3) (4)	<u>60,359,000</u>	<u>316,420,000</u>	<u>127,583,000</u>	-
Total contractual cash obligations	<u>\$202,506,000</u>	<u>\$ 593,556,000</u>	<u>\$405,261,000</u>	<u>\$ 920,462,000</u>

(1) At June 30, 2004, we had 14 loan agreements for nine Airbus A319 aircraft and five Airbus A320 aircraft. Two of the loans have a term of 10 years and are payable in equal monthly installments including interest, payable in arrears. These loans require monthly principal and interest of \$215,000 and \$218,000, bear interest with rates of 6.71% and 6.54%, with maturities in August 2011, at which time a balloon payment totaling \$10,200,000 is due with respect to the remaining 12 loans have interest rates based on LIBOR plus margins that adjust quarterly semi-annually. At June 30, 2004, interest rates for these loans ranged from 2.44% to 3.72%. Of these loans have a term of 12 years, and each loan has balloon payments ranging from \$2,000,000 to \$7,770,000 at the end of the term. All of the loans are secured by the aircraft.

(2) As of June 30, 2004, we lease 22 Airbus A319 type aircraft, one Airbus A318 aircraft, and one Boeing 737 type aircraft under operating leases with expiration dates ranging from 2004 to 2014. Of the Boeing 737 type aircraft are no longer in service, one is being stored until the lease expiration date of October 2005 and the other two aircraft will be returned to their lessors in the August and September 2004. Under all of our leases, we have made cash security deposits or arranged for letters of credit representing approximately two months of lease payments per aircraft. At June 30, 2004, we had made cash security deposits of \$13,986,000 and had arranged for letters of credit of \$10,000,000 collateralized by restricted cash balances. Additionally, we are required to make supplemental rent payments to cover the cost of major scheduled maintenance overhauls of these aircraft. Supplemental rent payments are based on the number of flight hours flown and/or flight departures. Payments for these items are not included as an obligation in the table above.

As a complement to our Airbus purchase agreement, in April 2000 we signed an agreement, subsequently amended, to lease 15 new Airbus A320 aircraft for a term of 12 years. As of June 30, 2004, we had taken delivery of 13 of these aircraft and have letters of credit on the remaining two aircraft to be delivered totaling \$411,800 to secure these leases, collateralized by restricted cash balances.

During the year ended March 31, 2004, we entered into additional aircraft lease agreements for 15 Airbus A318 aircraft and 18 Airbus A319 aircraft. Three of the aircraft leases were accounted for as sale-leaseback transactions of three new Airbus A318 aircraft. As of June 30, 2004, we have taken delivery of eight of these aircraft. The remaining 12 aircraft are scheduled for delivery beginning in July 2004 through February 2007. As of June 30, 2004, we have made \$2,362,000 in cash security deposit payments for future leased aircraft deliveries.

We also lease office and hangar space, spare engines and office equipment for our headquarters and airport facilities, and certain other equipment with expiration dates ranging from 2004 to 2014. In addition, we lease certain airport gate facilities on a month-to-month basis. Payments for these leases that are on a month-to-month basis are not included as an obligation in the table above.

(3) As of June 30, 2004, we have remaining firm purchase commitments for 13 additional Airbus A320 aircraft, three spare engines, which have scheduled delivery dates beginning in September 2004 and ending in 2008. Included in the purchase commitments are the remaining amounts due Airbus for spare aircraft components to support the additional purchase and leased aircraft. These commitments are not under any contractual obligations with respect to spare parts. Under the terms of the

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

agreement, we are required to make scheduled pre-delivery payments for these aircraft. payments are non-refundable with certain exceptions. As of June 30, 2004, we had made payments on future deliveries totaling \$9,702,000 to secure these aircraft.

We signed two letters of intent for the debt financing for two of our 13 A319 aircraft scheduled for delivery from Airbus in fiscal year 2006. The terms of these agreements permit borrow up to \$24,500,000 per aircraft at 80% of the appraised base value of the aircraft, is less, over a period of 12 years at floating interest rates with a balloon payment equal of the original loan amount due at maturity.

We have signed a letter of intent for the sale-leaseback of one owned and three spare engines scheduled for delivery between September 2004 and February 2006. The terms of this agreement allow us to sell each spare engine to the buyer at the time of delivery, and then lease the engine back for a period of ten years commencing on the delivery date. The agreement will provide for an additional two spare engines which we expect we will order at some point in the future.

- (4) In October 2002, we entered into a purchase and 12-year services agreement with LiveTV DIRECTV AIRBORNE(TM) satellite programming to every seatback in our Airbus fleet. We have completed the purchase of 46 units. As of June 30, 2004, we have purchased 35 units and have made payments toward the purchase of six additional units. The table above includes the remaining purchase amounts for the six units on which we have made partial payments and all amounts not yet paid on the remaining five units.

Commercial Commitments

As we enter new markets, increase the amount of space we lease, or add leased aircraft, we are often required to provide the airport authorities and lessors with a letter of credit, bond, or security deposits. These generally approximate up to three months of rent and fees. We also have standby letters of credit for our workers' compensation insurance. As of June 30, 2004, we had outstanding standby letters of credit, bonds, and cash security deposits totaling \$12,908,000, \$1,467,000, and \$1,500,000, respectively. In order to meet these requirements, we have a credit agreement with a financial institution for up to \$1,500,000, which expires August 31, 2004, and another credit agreement with a second institution for up to \$20,000,000, which expires December 1, 2004. These credit lines can be used for the issuance of standby letters of credit. Any amounts drawn under the credit agreements are collateralized by certificates of deposit, which are carried as restricted investments on our balance sheet. As of June 30, 2004, we have utilized \$12,908,000 under these credit agreements for standby letters of credit that collateralize certain leases. In the event that these credit agreements are renewed beyond their present expiration dates, the certificates of deposit would be redeemed and paid to various lessors as cash security deposits in lieu of standby letters of credit. As a result, there would be no impact on our liquidity if these agreements were not renewed. In the event that the surety company determined that issuing bonds on our behalf were a risk they were no longer willing to underwrite, we would be required to collateralize certain of these lease obligations with either cash security deposits or standby letters of credit, which would decrease our liquidity.

We have a contract with a bankcard processor that requires us to pledge a certificate of deposit equal to a certain percentage of our air traffic liability associated with bankcard customer transactions. As of June 30, 2004, that amount totaled \$23,388,000. The amount is adjusted quarterly in arrears based on our air traffic liability associated with bankcard transactions. As of September 1, 2004, we are required to increase the amount by approximately \$4,705,000.

We use the Airline Reporting Corporation ("ARC") to provide reporting and settlement services for our travel agency sales and other related transactions. In order to maintain the minimum bond (or letter of credit) coverage of \$100,000, ARC requires participating carriers to meet, on a quarterly basis, certain financial tests such as, but not limited to, working capital ratio, and percent of debt plus equity. As of June 30, 2004, we met these financial tests and presently are only required to provide the minimum amount of \$100,000 in coverage to ARC. If we were to fail the minimum testing, we would be required to increase our bonding coverage to four times the weekly agency net sales (sales net of refunds and agency commissions). Based on net cash sales remitted to us for the week ending July 28, 2004, the coverage would be increased to \$7,991,000 if we failed the tests. If we are unable to increase the bond amount as a result of our then financial condition, we could be required to issue a letter of credit that would restrict cash in an amount equal to the letter of credit.

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

In November 2002, we initiated a fuel hedging program comprised of swap and collar. Under a swap agreement, we receive the difference between a fixed swap price and a price an agreed upon published spot price for jet fuel. If the index price is higher than the fixed price, we receive the difference between the fixed price and the spot price. If the index price is lower than the fixed price, we pay the difference. A collar agreement has a cap price, a primary floor price, and, in the case of a three-way collar, a secondary floor price. When the U.S. Gulf Coast Pipeline Jet index price is above the cap, we receive the difference between the index and the cap. When the hedged product's index price is below the primary floor but above the secondary floor, we pay the difference between the index and the primary floor. However, when the price is below the secondary floor, we are only required to pay the difference between the primary and secondary floor prices. When the price is between the secondary floor and the primary floor, no payments are required.

In September 2003, we entered into a swap agreement with a notional volume of 630,000 gallons per month for the period from January 1, 2004 to June 30, 2004. The fixed price of the swap was \$4.00 per gallon and the agreement is estimated to represent 7% of our fuel purchases for that period. On May 21, 2004, we entered into a two way collar agreement that hedges approximately 25% of our fuel requirements in the quarters ended December 31, 2004 and March 31, 2005. The collar uses West Texas Intermediate crude oil as its basis. The cap price is set at \$39.00 per barrel, and the floor is set at \$34.85 per barrel.

In March 2003, we entered into an interest rate swap agreement with a notional amount of \$27,000,000 to hedge a portion of our LIBOR based borrowings. Under the interest rate swap agreement, we are paying a fixed rate of 2.45% and receive a variable rate based on the three month LIBOR.

Effective January 1, 2003, we entered into an engine maintenance agreement with GE Aviation Services, Inc. ("GE") covering the scheduled and unscheduled repair of our aircraft engines on most of our Airbus aircraft. The agreement is for a 12-year period from the effective date of the agreement on owned aircraft or December 31, 2014, whichever comes first, and for each leased aircraft, the term of the agreement with the initial lease term of 12 years. This agreement precludes us from using another third party for such services during the term. This agreement requires monthly payments at a specified rate based on the number of flight hours the engines were operated during that month. The amounts due based on flight hours are not included in table above. As of June 30, 2004, the agreement covers 14 purchased aircraft and 23 leased Airbus aircraft. The costs under this agreement for our purchased aircraft for the quarters ended June 30, 2004 and 2003 were approximately \$663,000 and \$395,000, respectively. For leased aircraft, the lessors pay GE directly for the repair of aircraft engines in conjunction with the agreement from reserve accounts established under the applicable lease documents.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the end of the reporting period. The most significant estimates of the financial statements and the reported amounts of revenues and expenses during the reporting period are discussed below. Actual results could differ from those estimates.

Critical accounting policies are defined as those that are both important to the portrayal of the company's financial condition and results, and require management to exercise significant judgments. The most significant critical accounting policies are described briefly below.

Revenue Recognition

Passenger, cargo, and other revenues are recognized when the transportation is provided to the customer after the tickets expire, one year after date of issuance, and are net of excise taxes, passenger facility charges and security fees. Revenues that have been deferred are included in the accounts receivable balance sheets as air traffic liability. In limited circumstances, we grant credit for tickets that have expired. We do not recognize as revenue the amount of credits estimated to be granted at the date a ticket expires.

Inventories

Inventories consist of expendable aircraft spare parts, supplies and aircraft fuel and are valued at the lower of cost or market. Inventories are accounted for on a first-in, first out basis.

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

charged to expense as they are used. During the fiscal years ended March 31, 2004 and 2003, we a provision for excess Boeing expendable parts inventory totaling \$618,000 and \$2,478,000, The provision in 2004 was principally the result of declining resale values of excess Boeing expe We monitor resale values for Boeing parts quarterly using estimates obtained from our vendors. W the decline in resale values of parts for the less fuel efficient Boeing 737-200 and Boeing 737- was due in part to increasing fuel prices during the quarter. The provision in 2003 was princi result of returning five Boeing aircraft to the lessors in 2003, and our decision during the quar March 31, 2003, to discontinue the use of our three remaining Boeing 737-200 aircraft in advance of the term of their respective leases. This decision was in response to the significant decline demand as a result of the war in Iraq and the continuing economic recession. The provision was estimates of the resale value of the excess expendable parts, which were obtained from our ven evaluated our estimated usage of these parts and the current resale value at June 30, 2004 and re additional provision of \$388,000.

Impairment of Long-Lived Assets

We record impairment losses on long-lived assets used in operations when indicators of i are present and the undiscounted future cash flows estimated to be generated by those ass less than the carrying amount of the assets. If an impairment occurs, the loss is measured by c the fair value of the asset to its carrying amount. During the year ended March 31, 2004, we an impairment charge for engines and rotatable parts that support the Boeing 737-300 aircraft of The impairment charge for rotatables totaling \$901,000 was principally the result of declining resa for Boeing rotatables. We monitor resale values for Boeing rotatables quarterly using estimates obta our vendors. The impairment for the two Boeing 737-300 spare engines totaling \$2,146,000 was t of our decision in the fourth quarter to sell these remaining spare engines. The impairment was three separate quotes from third parties. No further indicators of impairment exist at June 3 based on current resale values.

Aircraft Maintenance

We operate under an FAA-approved continuous inspection and maintenance program. We ac for maintenance activities on the direct expense method. Under this method, major overhaul main costs are recognized as expense as maintenance services are performed, as flight hours ar for nonrefundable maintenance payments required by lease agreements, and as the obligation is for payments made under service agreements. Routine maintenance and repairs are charged to op as incurred. Prior to fiscal year 2003, we accrued for major overhaul costs on a per-flight-ho in advance of performing the maintenance services.

Effective January 1, 2003, we and GE executed a 12-year engine services agreement cove scheduled and unscheduled repair of Airbus engines. Under the terms of the services agreement, w to pay GE a fixed rate per-engine-hour, payable monthly, and GE assumed the responsibility t our engines on Airbus aircraft as required during the term of the services agreement, subject t exclusions. We believe the fixed rate per-engine hour approximates the periodic cost we wo incurred to service those engines. Accordingly, these payments are expensed as the obligation i

Derivative Instruments

We account for derivative financial instruments in accordance with the provisions of St of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Ac ("SFAS 133"). SFAS 133 requires us to measure all derivatives at fair value and to recognize the balance sheet as an asset or liability. For derivatives designated as cash flow hedges, ch fair value of the derivative are generally reported in other comprehensive income ("OCI") and are reclassified into earnings when the hedged item affects earnings. Changes in fair value of instruments not designated as hedging instruments and ineffective portions of hedges are recogniz in the current period.

We enter into derivative transactions to hedge the interest payments associated wit of our LIBOR-based borrowings and fuel purchases. We designate certain interest rate swaps as cash flow hedges. We also enter into derivative transactions to reduce exposure to the ef fluctuations in fuel prices. These transactions are accounted for as trading instruments unde As a result, we record these instruments at fair market value and recognizes realized and u gains and losses in aircraft fuel expense.

Customer Loyalty Program

In February 2001, we established *EarlyReturns*, a frequent flyer program to encourage our airline and customer loyalty. We account for the *EarlyReturns* program under the incremental method whereby travel awards are valued at the incremental cost of carrying one passenger based on redemptions. Those incremental costs are based on expectations of expenses to be incurred on a per passenger basis and include food and beverages, fuel, liability insurance, and ticketing costs. The costs do not include a contribution to overhead, aircraft cost or profit. We do not record a liability for mileage earned by participants who have not reached the level to become eligible for a travel award. We believe this is appropriate because the large majority of these participants are expected to earn a free flight award. We do not record a liability for the expected redemption of non-travel awards since the cost of these awards to us is negligible.

Co-branded Credit Card Arrangement

We entered into a co-branded credit card arrangement with a Mastercard issuing bank in 2003. The terms of this affinity agreement provide that we will receive a fixed fee for each new account which varies based on the type of account, and a percentage of the annual renewal fees that the bank receives. We receive an increased fee for new accounts solicited by us. We also receive fees for the purchase of flier miles awarded to the credit card customers.

During the year ended March 31, 2003, we received a \$10,000,000 advance from the issuer for fees expected to be earned under the program. This advance was recorded as deferred revenue when it was received. Fees earned as credit cards are issued or renewed, and as points are awarded to credit card customers are applied against this advance.

We account for all fees received under the co-branded credit card program by allocating the fees between the portion that represents the estimated value of the subsequent travel award to be earned and the portion which represents a marketing fee to cover marketing and other related costs to administer the program. This latter portion (referred to as the marketing component) represents the residual after determination of the value of the travel component. The marketing component is determined by reference to an equivalent restricted fare, which is used as a proxy for the cost of travel of a frequent flyer mileage award. The travel component is deferred and recognized over the estimated usage period of the frequent flyer mileage awards of 20 months. We record the marketing component of the revenue earned under this agreement as a reduction of sales and promotion expense on a per month received.

Because of our limited history with our frequent flier program, we have estimated the period over which the frequent flier mileage awards will be used based on industry averages adjusted to take into account that most domestic airlines require 25,000 frequent flyer miles for a domestic round-trip ticket, whereas we require only 15,000 frequent flyer miles for a domestic round-trip ticket.

Item 3: Quantitative and Qualitative Disclosures About Market Risk

Aircraft Fuel

Our earnings are affected by changes in the price and availability of aircraft fuel. Market risk is estimated as a hypothetical 10 percent change in the average cost per gallon of fuel for the year ended March 31, 2004. Based on fiscal year 2004 actual fuel usage, such a change would have had the effect of increasing or decreasing our aircraft fuel expense by approximately \$10,880,000 in fiscal year 2004. Comparatively, based on projected fiscal year 2005 fuel usage, including the fuel required for our regional partner, such a change would have the effect of increasing or decreasing our aircraft fuel expense by approximately \$15,205,000 in fiscal year 2005, excluding the effect of our fuel hedging arrangements. The increase in exposure to fuel price fluctuations in fiscal year 2005 is due to the increase of our average aircraft fleet size projected for the year ending March 31, 2005 and related gallons expected to be purchased.

In September 2003, we entered into a swap agreement with a notional volume of 630,000 gallons.

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

per month for the period from January 1, 2004 to June 30, 2004. The fixed price of the swap was 30 cents per gallon and the agreement was estimated to represent 7% of our fuel purchases for that period. The results of operations for the quarter ended June 30, 2004 include an unrealized derivative loss of \$302,000 that is included in fuel expense and a realized net gain of approximately \$543,000 from settlements received from a counter-party recorded as a decrease in fuel expense. On May 21, 2004, we entered into an additional derivative transaction that is designed to economically hedge approximately 25% of our projected fuel requirements in the quarters ending December 31, 2004 and March 31, 2005. This additional derivative transaction is a collar agreement that uses West Texas Intermediate oil futures as its basis. The cap price is set at \$39.00 per barrel, and the floor is set at \$34.85 per barrel. The results of operations for the quarter ended June 30, 2004 include an unrealized derivative loss of \$175,000 that is included in fuel expense for a total unrealized loss of \$477,000.

Interest

We are susceptible to market risk associated with changes in variable interest rates on our long-term debt obligations we incurred and will incur to finance the purchases of our Airbus aircraft. Interest expense on 86.8% of our owned Airbus A319 and A318 aircraft is subject to interest rate adjustments every three to six months based upon changes in the applicable LIBOR rate. A change in the base LIBOR rate of 100 basis points (1.0 percent) would have the effect of increasing or decreasing our annual interest expense by \$2,722,000, assuming the loans outstanding that are subject to interest rate adjustments at June 30, 2004 totaling \$272,197,000 are outstanding for the entire period.

In March 2003, we entered into an interest rate swap agreement with a notional amount of \$27,000,000 to hedge a portion of our LIBOR based borrowings. Under the interest rate swap agreement we are paying a fixed rate of 2.45% and receive a variable rate based on the three month LIBOR rate. The term of the swap that expires in March 2007. As of June 30, 2004, we had hedged approximately \$127,000 of our variable interest rate loans. As of June 30, 2004, the fair value of the swap agreement is a liability of \$127,000.

Item 4. Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our "disclosure controls and procedures" (as defined in Exchange Act Rules 13a-15 or 15d-15) as of June 30, 2004, and concluded that as of June 30, 2004, our disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted to the Exchange Act is recorded, processed, summarized and completely and accurately reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There were no changes in our internal control over financial reporting in connection with the evaluation required by paragraph (d) of the Exchange Act Rules 13a-15 or 15d-15, that occurred during the quarter ended June 30, 2004, that has materially affected, or is reasonable likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 6: Exhibits and Reports on Form 8-K

- | | |
|------|--|
| 31.1 | Section 302 certification of President and Chief Executive Officer, Jeffrey S. Potter. (1) |
| 31.2 | Section 302 certification of Chief Financial Officer, Paul H. Tate. (1) |
| 32 | Section 906 certification of President and Chief Executive Officer, Jeffrey S. Potter, and Chief Financial Officer, Paul H. Tate (1) |
| (1) | Filed herewith. |

Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-Q

(b) Reports on Form 8-K

During the quarter ended June 30, 2004, the Company filed the following reports on Form

<u>Date of Reports</u>	<u>Item Numbers</u>	<u>Financial Required</u>
May 27, 2004	7 and 12	

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the r
duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FRONTIER AIRLINES, INC.

Date: August 4, 2004

By: /s/ Paul H. Tate
Paul H. Tate, Senior Vice President and
Chief Financial Officer

Date: August 4, 2004

By: /s/ Elissa A. Potucek
Elissa A. Potucek, Vice President, Controller
Treasurer and Principal Accounting Officer