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FRONTIER AIRLINES INC /CO/  
Form 10-Q  
November 12, 2003

**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 September 30, 2003.

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

Commission file number: 0-24126

**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 by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 November 1, 2003 was 35,190,768.

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## PART I. FINANCIAL INFORMATION

### Item 1. Financial Information

#### FRONTIER AIRLINES, INC.

#### Balance Sheets

|                                                                                                                                       | <u>September 30, 2003</u> | <u>March 31, 2003</u> |
|---------------------------------------------------------------------------------------------------------------------------------------|---------------------------|-----------------------|
| <b><u>Assets</u></b>                                                                                                                  |                           |                       |
| Current assets                                                                                                                        |                           |                       |
| Cash and cash equivalents                                                                                                             | \$ 201,332,308            | \$ 102,880,404        |
| Short-term investments                                                                                                                | 2,000,000                 | 2,000,000             |
| Restricted investments                                                                                                                | 22,603,189                | 14,765,000            |
| Receivables, net of allowance for doubtful accounts of \$241,000 and \$237,000 at September 30, 2003 and March 31, 2003, respectively | 22,186,140                | 25,856,692            |
| Income taxes receivable                                                                                                               | 329,823                   | 24,625,616            |
| Security and other deposits                                                                                                           | 912,399                   | 912,399               |
| Prepaid expenses and other assets                                                                                                     | 9,404,212                 | 9,050,671             |
| Inventories, net of allowance of \$2,478,000 at September 30, 2003 and March 31, 2003, respectively                                   | 5,780,345                 | 5,958,836             |
| Deferred tax asset                                                                                                                    | <u>7,410,930</u>          | <u>4,788,831</u>      |
| Total current assets                                                                                                                  | 271,959,346               | 190,838,449           |
| Property and equipment, net                                                                                                           | 415,633,962               | 334,492,983           |
| Security and other deposits                                                                                                           | 11,998,393                | 6,588,023             |
| Aircraft pre-delivery payments                                                                                                        | 25,884,661                | 30,531,894            |
| Restricted investments                                                                                                                | 9,709,781                 | 9,324,066             |
| Deferred loan fees and other assets, net                                                                                              | <u>6,428,472</u>          | <u>16,068,361</u>     |
|                                                                                                                                       | \$ 741,614,615            | \$ 587,843,776        |
|                                                                                                                                       | =====                     | =====                 |
| <b><u>Liabilities and Stockholders' Equity</u></b>                                                                                    |                           |                       |
| Current liabilities:                                                                                                                  |                           |                       |
| Accounts payable                                                                                                                      | \$ 19,308,980             | \$ 26,388,621         |
| Air traffic liability                                                                                                                 | 77,050,721                | 58,875,623            |
| Other accrued expenses                                                                                                                | 40,763,309                | 22,913,659            |

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|                                                                                                                                                                                               |                    |                    |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|--------------------|
| Current portion of long-term debt                                                                                                                                                             | 15,316,629         | 20,473,446         |
| Deferred revenue and other liabilities                                                                                                                                                        | <u>1,330,000</u>   | <u>1,396,143</u>   |
| Total current liabilities                                                                                                                                                                     | 153,769,639        | 130,047,492        |
| Long-term debt                                                                                                                                                                                | 279,378,528        | 261,738,503        |
| Deferred tax liability                                                                                                                                                                        | 32,916,660         | 20,017,787         |
| Deferred revenue and other liabilities                                                                                                                                                        | <u>20,096,590</u>  | <u>17,072,868</u>  |
| Total liabilities                                                                                                                                                                             | <u>486,161,417</u> | <u>428,876,650</u> |
| Stockholders' equity:                                                                                                                                                                         |                    |                    |
| Preferred stock, no par value, authorized 1,000,000 shares; none issued                                                                                                                       | -                  | -                  |
| Common stock, no par value, stated value of \$.001 per share, authorized 100,000,000; 35,147,768 and 29,674,050 issued and outstanding at September 30, 2003 and March 31, 2003, respectively | 35,148             | 29,674             |
| Additional paid-in capital                                                                                                                                                                    | 180,663,677        | 96,424,525         |
| Unearned ESOP shares                                                                                                                                                                          | (573,277)          | -                  |
| Other comprehensive loss                                                                                                                                                                      | (116,690)          | -                  |
| Retained earnings                                                                                                                                                                             | <u>75,444,340</u>  | <u>62,512,927</u>  |
|                                                                                                                                                                                               | <u>255,453,198</u> | <u>158,967,126</u> |
|                                                                                                                                                                                               | \$ 741,614,615     | \$ 587,843,776     |
|                                                                                                                                                                                               | =====              | =====              |

See accompanying notes to financial statements.

## **FRONTIER AIRLINES, INC.** **Statements of Operations** **(Unaudited)**

|                                                                | Three Months Ended    |                       | Six Months Ended      |                       |
|----------------------------------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                                                | September 30,<br>2003 | September 30,<br>2002 | September 30,<br>2003 | September 30,<br>2002 |
| Revenues:                                                      |                       |                       |                       |                       |
| Passenger                                                      | \$ 159,964,675        | \$ 116,709,640        | \$ 298,855,237        | \$ 226,000,000        |
| Cargo                                                          | 2,369,222             | 1,366,251             | 4,058,247             | 2,900,000             |
| Other                                                          | <u>3,487,275</u>      | <u>1,278,633</u>      | <u>5,273,638</u>      | <u>2,200,000</u>      |
| Total revenues                                                 | 165,821,172           | 119,354,524           | 308,187,122           | 231,100,000           |
| Operating expenses:                                            |                       |                       |                       |                       |
| Flight operations                                              | 42,267,994            | 38,236,779            | 84,433,315            | 75,300,000            |
| Aircraft fuel expense                                          | 25,900,551            | 21,332,131            | 48,501,320            | 38,700,000            |
| Aircraft and traffic servicing                                 | 26,077,456            | 21,274,015            | 50,074,966            | 40,600,000            |
| Maintenance                                                    | 17,120,004            | 17,500,920            | 34,997,976            | 33,900,000            |
| Promotion and sales                                            | 16,470,511            | 13,505,113            | 31,190,508            | 28,200,000            |
| General and administrative                                     | 9,784,376             | 6,574,920             | 18,720,012            | 12,600,000            |
| Depreciation and amortization                                  | <u>5,870,300</u>      | <u>4,133,227</u>      | <u>11,057,498</u>     | <u>7,900,000</u>      |
| Total operating expenses                                       | <u>143,491,192</u>    | <u>122,557,105</u>    | <u>278,975,595</u>    | <u>237,400,000</u>    |
| Operating income (loss)                                        | <u>22,329,980</u>     | <u>(3,202,581)</u>    | <u>29,211,527</u>     | <u>(6,300,000)</u>    |
| Nonoperating income (expense):                                 |                       |                       |                       |                       |
| Interest income                                                | 524,468               | 487,798               | 937,831               | 1,100,000             |
| Interest expense                                               | (4,034,387)           | (1,895,668)           | (7,868,780)           | (3,100,000)           |
| Emergency Wartime Supplemental Appropriations Act compensation | -                     | -                     | 15,024,188            | -                     |
| Early extinguishment of debt                                   | (8,742,489)           | -                     | (8,742,489)           | -                     |
| Aircraft lease and facility exit costs                         | (4,659,058)           | -                     | (5,345,353)           | -                     |
| Loss on sale-leaseback of aircraft                             | (1,237,718)           | -                     | (1,237,718)           | -                     |
| Other, net                                                     | <u>(676,218)</u>      | <u>(286,772)</u>      | <u>(852,311)</u>      | <u>(400,000)</u>      |
| Total nonoperating expense, net                                | <u>(18,825,402)</u>   | <u>(1,694,642)</u>    | <u>(8,084,632)</u>    | <u>(2,300,000)</u>    |

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|                                                                                                                           |                     |                       |                      |                |
|---------------------------------------------------------------------------------------------------------------------------|---------------------|-----------------------|----------------------|----------------|
| Income (loss) before income tax expense (benefit) and cumulative effect of change in method of accounting for maintenance | 3,504,578           | (4,897,223)           | 21,126,895           | (8,6           |
| Income tax expense (benefit)                                                                                              | <u>1,506,855</u>    | <u>(1,842,729)</u>    | <u>8,195,482</u>     | <u>(3,1</u>    |
| Income (loss) before cumulative effect of change in method of accounting for maintenance                                  | 1,997,723           | (3,054,494)           | 12,931,413           | (5,5           |
| Cumulative effect of change in method of accounting for maintenance, net of tax                                           | <u>-</u>            | <u>-</u>              | <u>-</u>             | <u>2,0</u>     |
| Net income (loss)                                                                                                         | <u>\$ 1,997,723</u> | <u>\$ (3,054,494)</u> | <u>\$ 12,931,413</u> | <u>\$ (3,5</u> |

## FRONTIER AIRLINES, INC. Statements of Operations (Unaudited)

|                                                                            | September 30,<br>2003 | September 30,<br>2002 | September 30,<br>2003 | Septemb<br>200 |
|----------------------------------------------------------------------------|-----------------------|-----------------------|-----------------------|----------------|
| Earnings (loss) per share:                                                 |                       |                       |                       |                |
| Basic:                                                                     |                       |                       |                       |                |
| Income (loss) before cumulative effect of a change in accounting principle | \$0.07                | (\$0.10)              | \$0.43                |                |
| Cumulative effect of change in method of accounting for maintenance checks | <u>-</u>              | <u>-</u>              | <u>-</u>              |                |
| Net income (loss)                                                          | <u>\$0.07</u>         | <u>(\$0.10)</u>       | <u>\$0.43</u>         |                |
| Diluted:                                                                   |                       |                       |                       |                |
| Income (loss) before cumulative effect of a change in accounting principle | \$0.06                | (\$0.10)              | \$0.40                |                |
| Cumulative effect of change in method of accounting for maintenance checks | <u>-</u>              | <u>-</u>              | <u>-</u>              |                |
| Net income (loss)                                                          | <u>\$0.06</u>         | <u>(\$0.10)</u>       | <u>\$0.40</u>         |                |
| Weighted average shares of common stock outstanding:                       |                       |                       |                       |                |
| Basic                                                                      | <u>30,440,589</u>     | <u>29,632,898</u>     | <u>30,133,571</u>     | <u>29,5</u>    |
| Diluted                                                                    | <u>33,620,352</u>     | <u>29,632,898</u>     | <u>32,514,599</u>     | <u>29,5</u>    |

See accompanying notes to financial statements.

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**FRONTIER AIRLINES, INC.**

**Statements of Stockholders' Equity and Other Comprehensive Loss**

**For the Year Ended March 31, 2003 and the Six Months Ended September 30, 2003**

|                                                                            | Common<br>Stock  | Additional<br>paid-in<br>capital | Unearned<br>ESOP<br>shares | Accumulated<br>Other<br>Comprehensive<br>Loss | Retained<br>earnings | st         |
|----------------------------------------------------------------------------|------------------|----------------------------------|----------------------------|-----------------------------------------------|----------------------|------------|
| <b>Balances, March 31, 2002</b>                                            | <u>\$ 29,422</u> | <u>\$85,867,486</u>              | <u>\$ (2,119,670)</u>      | <u>\$ -</u>                                   | <u>\$85,356,055</u>  | <u>\$1</u> |
| Net loss                                                                   | -                | -                                | -                          | -                                             | (22,843,128)         | (          |
| Exercise of common stock options                                           | 252              | 616,695                          | -                          | -                                             | -                    |            |
| Warrants issued in conjunction<br>with debt agreement                      | -                | 9,282,538                        | -                          | -                                             | -                    |            |
| Tax benefit from exercises of<br>common stock options and<br>warrants      | -                | 657,806                          | -                          | -                                             | -                    |            |
| Contribution of common stock to<br>employees stock ownership plan          | -                | -                                | -                          | -                                             | -                    |            |
| Amortization of employee stock<br>compensation                             | -                | -                                | 2,119,670                  | -                                             | -                    |            |
| <b>Balances, March 31, 2003</b>                                            | <u>29,674</u>    | <u>96,424,525</u>                | <u>-</u>                   | <u>-</u>                                      | <u>62,512,927</u>    | <u>1</u>   |
| Net income                                                                 | -                | -                                | -                          | -                                             | 12,931,413           |            |
| Other comprehensive loss -<br>Unrealized loss on<br>derivative instruments | -                | -                                | -                          | (116,690)                                     | -                    |            |
| Total comprehensive income                                                 |                  |                                  |                            |                                               |                      |            |
| Sale of common stock, net of<br>offering costs of \$257,000                | 5,050            | 81,080,419                       | -                          | -                                             | -                    |            |
| Exercise of common stock<br>options                                        | 76               | 348,974                          | -                          | -                                             | -                    |            |
| Tax benefit from exercises of<br>common stock options and<br>warrants      | -                | 516,999                          | -                          | -                                             | -                    |            |
| Contribution of common stock to<br>employees stock ownership plan          | 348              | 2,292,760                        | (2,293,108)                | -                                             | -                    |            |
| Amortization of employee stock<br>compensation                             | -                | -                                | 1,719,831                  | -                                             | -                    |            |
| <b>Balances, September 30, 2003</b>                                        | <u>\$35,148</u>  | <u>\$180,663,677</u>             | <u>\$ (573,277)</u>        | <u>\$ (116,690)</u>                           | <u>\$75,444,340</u>  | <u>\$2</u> |

See accompanying notes to financial statements.

**FRONTIER AIRLINES, INC.**

**Statements of Cash Flows**

**For the Six Months Ended September 30, 2003 and 2002**

**(Unaudited)**

|                                                                                                    | 2003          | 2002           |
|----------------------------------------------------------------------------------------------------|---------------|----------------|
| Cash flows from operating activities:                                                              |               |                |
| Net income (loss)                                                                                  | \$ 12,931,413 | \$ (3,516,243) |
| Adjustments to reconcile net income (loss) to net cash<br>provided (used) by operating activities: |               |                |

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|                                                                  |                     |                      |
|------------------------------------------------------------------|---------------------|----------------------|
| Employee stock plan compensation expense                         | 1,197,879           | 1,413,113            |
| Depreciation and amortization                                    | 11,057,498          | 7,931,639            |
| Loss on disposal of equipment                                    | 2,246,836           | -                    |
| Unrealized derivative gain                                       | (358,743)           | -                    |
| Deferred tax expense                                             | 10,276,774          | 5,282,898            |
| Changes in operating assets and liabilities:                     |                     |                      |
| Restricted investments                                           | (8,841,604)         | (8,434,423)          |
| Receivables                                                      | 3,670,552           | 3,756,330            |
| Income taxes receivable                                          | 24,295,793          | (311,321)            |
| Security, maintenance and other deposits                         | (2,719,470)         | (450,300)            |
| Prepaid expenses and other assets                                | (353,541)           | 1,680,945            |
| Inventories                                                      | 178,491             | (689,900)            |
| Deferred loan and other expenses                                 | 10,870,936          | (559,797)            |
| Accounts payable                                                 | (7,079,641)         | (1,510,843)          |
| Air traffic liability                                            | 18,175,098          | (3,100,527)          |
| Other accrued expenses                                           | 18,421,955          | (3,104,387)          |
| Deferred stabilization act compensation                          | -                   | (4,000,000)          |
| Accrued maintenance expense                                      | -                   | (3,196,617)          |
| Deferred revenue and other liabilities                           | <u>2,957,579</u>    | <u>2,159,384</u>     |
| Net cash provided (used) by operating activities                 | <u>96,927,805</u>   | <u>(6,650,049)</u>   |
| Cash flows from investing activities:                            |                     |                      |
| Decrease (increase) in aircraft lease and purchase deposits, net | 1,956,333           | (10,235,887)         |
| Decrease in restricted investments                               | 617,700             | 411,800              |
| Capital expenditures                                             | <u>(94,445,313)</u> | <u>(98,755,494)</u>  |
| Net cash used by investing activities                            | <u>(91,871,280)</u> | <u>(108,579,581)</u> |
| Cash flows from financing activities:                            |                     |                      |
| Net proceeds from issuance of common stock                       | 81,951,518          | 570,976              |
| Proceeds from long-term borrowings                               | 76,500,000          | 73,200,000           |
| Payment of financing fees                                        | (1,039,347)         | (988,351)            |
| Principal payments on long-term borrowing                        | <u>(64,016,792)</u> | <u>(2,542,438)</u>   |
| Net cash provided by financing activities                        | <u>93,395,379</u>   | <u>70,240,187</u>    |
| Net increase (decrease) in cash and cash equivalents             | 98,451,904          | (44,989,443)         |
| Cash and cash equivalents, beginning of period                   | <u>102,880,404</u>  | <u>87,555,189</u>    |
| Cash and cash equivalents, end of period                         | \$ 201,332,308      | \$ 42,565,746        |
|                                                                  | =====               | =====                |

See accompanying notes to financial statements.

## FRONTIER AIRLINES, INC. Notes to Financial Statements September 30, 2003

### (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 for the year ended March 31, 2003. In the opinion of management, all adjustments (consisting only of

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normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the three and six months ended September 30, 2003 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 Issued 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 its 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. Had compensation cost for the Company's stock-based compensation plan 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:

|                                     | Three Months Ended    |                       | Three Months Ended    |                       |
|-------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                     | September 30,<br>2003 | September 30,<br>2002 | September 30,<br>2003 | September 30,<br>2002 |
| Net income (loss):                  |                       |                       |                       |                       |
| As Reported                         | \$ 1,997,723          | \$ (3,054,494)        | \$ 12,931,413         | \$ (3,511,413)        |
| Pro Forma                           | \$ 1,378,809          | \$ (3,592,239)        | \$ 11,864,756         | \$ (6,111,413)        |
| Earnings (loss) per share, basic:   |                       |                       |                       |                       |
| As Reported                         | \$ 0.07               | \$ (0.10)             | \$ 0.43               | \$ (0.10)             |
| Pro Forma                           | \$ 0.05               | \$ (0.12)             | \$ 0.39               | \$ (0.12)             |
| Earnings (loss) per share, diluted: |                       |                       |                       |                       |
| As Reported                         | \$ 0.06               | \$ (0.10)             | \$ 0.40               | \$ (0.10)             |
| Pro Forma                           | \$ 0.04               | \$ (0.12)             | \$ 0.36               | \$ (0.12)             |

#### **FRONTIER AIRLINES, INC. Notes to Financial Statements September 30, 2003**

#### *Interest Rate Hedging Program*

During the six months ending September 30, 2003, the Company designated certain interest rate swaps as qualifying cash flow hedges. Under these hedging arrangements, the Company is hedging the interest payments associated with a portion of its LIBOR-based borrowings. Under the swap agreements, the Company pays a fixed rate of interest on the notional amount of the contracts of \$27 million, and it receives a variable rate of interest based on the three month LIBOR rate, which is reset quarterly. Interest expense for the three and six months ended September 30, 2003 includes \$93,000 and \$172,000 of settlement amounts payable to the counter party for the period. Changes in the fair value of interest rate swaps designated as hedging instruments are reported in accumulated other comprehensive income. These amounts are subsequently reclassified into interest expense as a yield adjustment in the same period in which the related

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interest payments on the LIBOR-based borrowings affects earnings. Approximately \$117,000 of unrealized losses are included in accumulated other comprehensive loss at September 30, 2003 and are expected to be reclassified into interest expense as a yield adjustment of the hedged interest payments over the next 12 months.

### (3) Government Assistance

The Emergency Wartime Supplemental Appropriations Act (the "Appropriations Act"), enacted in April 2003, made available approximately \$2.3 billion to U.S. flag air carriers for expenses and revenue foregone related to aviation security. The payment received by each carrier was for the reimbursement of the TSA security fees, the September 11th Security Fee and/or the Aviation Security Infrastructure Fee paid by the carrier as of the date of enactment of the Appropriations Act. According to the Appropriations Act, an air carrier may use the amount received as the air carrier determines. Pursuant to the Appropriations Act, the Company received \$15,573,000 in May 2003, of which \$549,000 was paid to Mesa Air Group for the revenue passengers Mesa carried as Frontier JetExpress.

The Appropriations Act provides for additional reimbursements to be made to U.S. flag air carriers for costs incurred related to the FAA requirements for enhanced flight deck door security measures that were mandated as a result of the September 11 terrorist attacks. Pursuant to the Appropriations Act, the Company received \$889,000 in September 2003 for expenses related to the installation of enhanced flight deck doors on its aircraft, \$275,000 of which was recorded as a reduction to property and equipment, net, and \$614,000 was recorded as a reduction to maintenance expense.

### (4) Stockholders' Equity

#### *Common Stock*

The Company completed a secondary public offering of 5,050,000 shares of common stock in September 2003. The Company received \$81,085,000, net of offering expenses, from the sale of these shares. See note 5 for a discussion of the required prepayment of the Company's government guaranteed loan as a result of this sale of stock. Additionally, the government guaranteed loan includes certain anti-dilution adjustments in the event of any sale of the Company's common stock. As a result, the exercise price of the warrants issued in connection with the loan was adjusted from \$6.00 per share to \$5.92 per share. The total warrants outstanding at September 2003 in connection with the loan was 3,833,945.

## FRONTIER AIRLINES, INC. Notes to Financial Statements September 30, 2003

### (5) Long-Term Debt

#### *Government Guaranteed Loan*

In July 2003, the Company received a federal income tax refund totaling \$26,574,000 from the Internal Revenue Service. The Company prepaid \$10,000,000 on its government guaranteed loan upon receipt of this refund as required by the terms of the loan agreement.

The government guaranteed loan also required a prepayment equal to 60% of the net proceeds from any sales of common stock. As a result of the sale of common stock (see note 4) in September 2003, the Company prepaid approximately \$48,418,000 on

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the loan. As a result of the prepayments made during the six months ended September 30, 2003, the remaining loan balance is approximately \$11,582,000 at September 30, 2003. The remaining principal payments under the loan will consist of \$571,000 payable in September 2004, four quarterly installments of approximately \$2,643,000 beginning in December 2004, and one final payment of \$439,000 in December 2005.

### *Other Long-Term Debt*

During the six months ended September 30, 2003, the Company borrowed an additional \$76,500,000 for the purchase of three Airbus A318 aircraft. Each aircraft loan has a term of 12 years and is payable in monthly installments, including interest, payable in arrears, with a floating interest rate adjusted quarterly based on LIBOR plus a margin of 2.25%. At the end of the term, there is a balloon payment of \$3,060,000 for each aircraft loan. The loans are secured by the aircraft.

## **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 facts, included in this report that address activities, events or developments that we expect, believe, intend 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 even be anticipated. These risks and uncertainties include, but are not limited to: the timing of, and expense associated with, expansion and modification of our operations in accordance with our business strategy or in response to competitive pressures or other factors; 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 and its 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 may increase our operating costs or otherwise adversely affect us; actions of competing airlines, such as increasing capacity and pricing actions of United Airlines and other competitors and other actions taken by United Airlines 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 or lease aircraft we anticipate adding to our fleet through lease financing; 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*

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*mile ("CASM") can significantly affect operating results. See "Risk Factors" in our Form 10-K for the year ended March 31, 2003 and our Form 8-K filed September 19, 2003, which updates our risk factors.*

### General

We are a scheduled passenger airline based in Denver, Colorado. We are the second largest jet service carrier at Denver International Airport ("DIA"). As of November 1, 2003, we, in conjunction with Frontier JetExpress operated by Mesa Air Group ("Mesa"), operate routes linking our Denver hub to 37 cities in 22 states spanning the nation from coast to coast and to three cities in Mexico. We are a low cost, affordable fare airline operating in a hub and spoke fashion connecting points coast to coast. We were organized in February 1994 and we began flight operations in July 1994 with two leased Boeing 737-200 jets. We have since expanded our fleet in service to 39 jets (26 of which we lease and 13 of which we own), consisting of 14 Boeing 737-300s, 21 Airbus A319s, and four Airbus A318s. In May 2001, we began a fleet replacement plan to replace our Boeing aircraft with new purchased and leased Airbus jet aircraft, a transition we expect to complete by approximately of the end of calendar year 2005. As of November 1, 2003, we no longer operate Boeing 737-200 aircraft. During the three and six months ended September 30, 2003, we increased capacity by 10.4% and 16.0% over the prior comparable periods, respectively. In the three and six months ended September 30, 2003, we increased passenger traffic by 42.8% and 37.1% over the prior comparable periods, respectively, outpacing our increase in capacity during the periods.

We currently lease 10 gates at DIA. Together with our regional jet codeshare partner, Frontier Jet Express, we use up to 14 gates at DIA and three regional jet parking positions, where we operate approximately 180 daily system flight departures and arrivals and 22 Frontier JetExpress daily system flight departures and arrivals at DIA. We have signed a letter of intent to lease an additional gate at DIA and are waiting final lease documentation to add that gate to our lease agreement. In the meantime, we are using this additional gate with preference over all other domestic flights. DIA has also commenced construction of two additional gates at the west end of Concourse A where we now operate. Upon completion of the construction, we intend to lease the two additional gates on a preferential basis. At this time it is anticipated these two additional gates will be available in late Spring 2004. On November 9, 2003, the City and County of Denver and United Airlines announced that they reached agreement with respect to the restructuring of United's lease of gates and other facilities at DIA. The agreement will permit United to proceed with the assumption of the restructured lease as part of its bankruptcy reorganization process. As part of that settlement, we are advised that United has agreed to relinquish one gate on Concourse A that DIA would then lease to Frontier on a permanent basis. In addition, United would make available two additional gates for use by Frontier until the earlier of the construction of additional gates for Frontier on the West end of Concourse A or October 31, 2005. We are currently in discussions with DIA to develop detailed plans relating to an expansion of Concourse A to add additional gates for Frontier's future use.

We began service to Orange County, California and Milwaukee, Wisconsin on August 31, 2003 with two and three daily round-trips, respectively, and we added a third round-trip to Orange County, California on October 1, 2003. Additionally, On November 1, 2003 we began service to St. Louis, Missouri with two daily round-trip flights, resumed our seasonal service to Mazatlan, Mexico with one weekly round-trip frequency, increasing to three weekly round-trip frequencies on November 22, 2003; and began service to Cabo San Lucas with one weekly round-trip frequency, increasing to three weekly round-trip frequencies beginning on November 22, 2003. We intend to begin service to Puerto Vallarta, Mexico on November 22, 2003 with three weekly round-trip frequencies and to Ixtapa/Zihuatanejo, Mexico, on January 31, 2004 with two weekly round-trip frequencies. We have applied for authority to add a third frequency at New York's LaGuardia airport. There can be no assurances that we will receive the authority to do so.

In June 2003, we entered into an agreement with Kinetics, Inc., a provider of

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enterprise and self-service technology to the U.S. airline industry, to deploy their new automated check-in system. The launch of "FlexCheck," our suite of airport and web-based automated check-in services, utilizes Kinetics' TouchPort self-service terminals and associated Kinetics software solutions for airport and Internet check-in. FlexCheck became available via the Internet in early August 2003 with deployment of self-service kiosks at our hub at DIA in September 2003. The system will allow our customers to check in for their flights using a standard credit card for identification purposes only, their EarlyReturns frequent flyer number, E-ticket number or confirmation number.

On September 18, 2003, we signed a 12 year agreement with Horizon Air Industries, Inc. ("Horizon") under which Horizon will operate up to nine 70-seat CRJ 700 aircraft under our Frontier JetExpress brand. The service will begin on January 1, 2004 with four aircraft, and the remaining aircraft will be added to service periodically through May 2004. We will control the scheduling of this service. We will reimburse Horizon for its expenses related to the operation plus a margin. The agreement provides for financial incentives, penalties and changes to the margin based on performance of Horizon and our financial performance. This service will replace our current codeshare arrangement with Mesa Airlines, which terminates on December 31, 2003.

In March 2003, we entered into an agreement with Juniper Bank ([WWW.JUNIPERBANK.COM](http://WWW.JUNIPERBANK.COM)), a full-service credit card issuer, to offer exclusively Frontier MasterCard products to consumers, customers and Frontier's EarlyReturns frequent flyer members. We launched the co-branded credit card in May 2003. As of November 1, 2003, Juniper Bank has issued approximately 23,170 of these credit cards. We believe that the Frontier/Juniper Bank co-branded MasterCard will offer one of the most aggressive affinity card programs because free travel can be earned for as little as 15,000 miles.

In October 2002, we signed a purchase and long-term services agreement with LiveTV to bring DIRECTV AIRBORNE(TM) satellite programming to every seatback in our Airbus fleet. In February 2003, we completed the installation of the LiveTV system on all Airbus A319 aircraft. The installed systems became operational upon receipt of regulatory approval in December 2002. We are moving forward with the installation of the LiveTV systems in our Airbus A318 aircraft and anticipate these systems will become operational by January 2004. We have implemented a \$5 per segment usage charge for access to the system to offset the costs for the system equipment, programming and services. We believe the DIRECTV(TM) product represents a significant value to our customers and offers a competitive advantage for our company.

In September 2001, we entered into a codeshare agreement with Mesa. Under the terms of the agreement, we market and sell flights operated by Mesa as Frontier JetExpress using five 50-passenger Bombardier CRJ-200 regional jets. Effective May 4, 2003, Frontier Jet Express replaced our mainline service to Tucson, Arizona, Oklahoma City, Oklahoma and Boise, Idaho and terminated service to Oakland, California. Frontier JetExpress also provides service to Ontario, California and Wichita, Kansas, and supplements our mainline service to San Jose, California, Albuquerque, New Mexico and Austin, Texas. Mesa terminated service to Wichita, Kansas on October 31, 2003 and this service was replaced by Great Lakes Aviation, Ltd. ("Great Lakes"), another codeshare partner, on November 1, 2003. In February 2003, we amended our codeshare agreement with Mesa from a prorated-based compensation method to a "cost plus" compensation method effective March 1, 2003 through August 31, 2003. In June 2003, Mesa and us agreed to extend the term through December 31, 2003. Horizon replaces Mesa as the Frontier JetExpress operation on January 1, 2004 as previously discussed.

Effective July 9, 2001, we began a codeshare agreement with Great Lakes. We recently added two additional markets under the codeshare agreement: Rapid City, South Dakota on July 30, 2003 and to Grand Junction, Colorado on August 1, 2003. Including these two new cities, Great Lakes provides service to 36 regional markets located in Arizona, Colorado, Kansas, New Mexico, Nebraska, North Dakota, South Dakota, Texas, Utah, and Wyoming under this codeshare agreement.

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Our filings with the Securities and Exchange Commission are available at no cost on our website, [WWW.FRONTIERAIRLINES.COM](http://WWW.FRONTIERAIRLINES.COM), in the Investor Relations folder contained in the section titled "About Frontier". These reports include our annual report on Form 10-K, our quarterly reports on Form 10-Q, current reports on Form 8-K, Section 16 reports on Forms 3, 4 and 5, and any related amendments or other documents, 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 administrative office telephone number is 720-374-4200 and our reservations telephone number is 800-432-1359.

### Results of Operations

We had net income of \$1,998,000 or 6¢ per diluted share for the three months ended September 30, 2003 as compared to a net loss of \$3,055,000, or 10¢ per share for the three months ended September 30, 2002. Included in our net income for the three months ended September 30, 2003 were the following special items on a pre-tax and profit sharing basis; write-off of deferred loan costs of \$8,742,000 associated with the prepayment of all but \$11,582,000 remaining principal of the government guaranteed loan; a charge for Boeing aircraft and facility lease exit costs of \$4,659,000; loss of \$1,721,000 on the sale of one Airbus aircraft in a sale-leaseback transaction and from the sale of a spare engine; and an unrealized derivative loss of \$276,000. These items, net of income taxes and profit sharing, totaled \$0.27 per diluted share.

We had net income of \$12,931,000 or 40¢ per diluted share for the six months ended September 30, 2003 as compared to a net loss of \$3,516,000, before cumulative effect of change in accounting for maintenance checks, or 19¢ per share for the six months ended September 30, 2002. Included in our net income for the six months ended September 30, 2003 were the following special items on a pre-tax and profit sharing basis; \$15,024,000 of compensation received under the Appropriations Act; write-off of deferred loan costs of \$8,742,000 associated with the prepayment of all but \$11,582,000 remaining principal of the government guaranteed loan; a charge for Boeing aircraft and facility lease exit costs of \$5,345,000; loss of \$1,721,000 on the sale of one Airbus aircraft in a sale-leaseback transaction and from the sale of a spare engine; and an unrealized derivative gain of \$475,000. These items, net of income taxes and profit sharing, totaled \$0.03 per diluted share.

The following table provides certain of our financial and operating data for the three month and six month periods ended September 30, 2003 and 2002.

|                                                | Three Months Ended Sept. 30, |            | Six Months Ended Sept. |            |
|------------------------------------------------|------------------------------|------------|------------------------|------------|
|                                                | 2003                         | 2002       | 2003                   | 2002       |
| Selected Operating Data:                       |                              |            |                        |            |
| Passenger revenue (000s) (1)                   | \$ 159,965                   | \$ 116,710 | \$ 298,855             | \$ 226,855 |
| Revenue passengers carried (000s)              | 1,457                        | 987        | 2,684                  | 1,782      |
| Revenue passenger miles (RPMs) (000s) (2)      | 1,318,020                    | 922,817    | 2,443,253              | 1,782,817  |
| Available seat miles (ASMs) (000s) (3)         | 1,721,397                    | 1,559,879  | 3,396,447              | 2,929,879  |
| Passenger load factor (4)                      | 76.6%                        | 59.2%      | 71.9%                  | 61.7%      |
| Break-even load factor (1) (5)                 | 74.9%                        | 61.7%      | 65.0%                  | 61.7%      |
| Block hours (6)                                | 33,908                       | 30,875     | 67,035                 | 58,875     |
| Departures                                     | 15,078                       | 13,583     | 29,688                 | 25,466     |
| Average aircraft stage length (miles)          | 858                          | 870        | 860                    | 870        |
| Average passenger length of haul (miles)       | 905                          | 935        | 910                    | 935        |
| Average daily fleet block hour utilization (7) | 10.0                         | 9.9        | 10.1                   | 9.9        |

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|                                          |        |        |        |    |
|------------------------------------------|--------|--------|--------|----|
| Passenger yield per RPM (cents) (8) (9)  | 12.09  | 12.57  | 12.18  |    |
| Passenger yield per ASM (cents) (9) (10) | 9.26   | 7.44   | 8.76   |    |
| Total yield per ASM (cents) (10)         | 9.63   | 7.65   | 9.07   |    |
| Cost per ASM (cents)                     | 8.34   | 7.86   | 8.21   |    |
| Fuel cost per ASM (cents) (12)           | 1.51   | 1.37   | 1.43   |    |
| Cost per ASM excluding fuel (cents)      | 6.83   | 6.49   | 6.78   |    |
| Average fare (13)                        | \$ 103 | \$ 109 | \$ 104 | \$ |
| Average aircraft in service              | 37.0   | 33.8   | 36.3   |    |
| Aircraft in fleet at end of period       | 38.0   | 35.0   | 38.0   |    |
| Average age of aircraft at end of period | 4.6    | 9.3    | 4.6    |    |

- (1) "Passenger revenue" includes revenues for non-revenue passengers, administrative fees, and revenue recognized for unused tickets that are greater than one year from issuance date.
- (2) "Revenue passenger miles," or RPMs, are determined by multiplying the number of fare-paying passengers carried by the distance flown.
- (3) "Available seat miles," or ASMs, are determined by multiplying the number of seats available for passengers by the number of miles flown.
- (4) "Passenger load factor" is determined by dividing revenue passenger miles by available seat miles.
- (5) "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 mile and expenses. The break-even load factor for the three months ended September 30, 2003 includes special items net of profit-sharing; write-off of deferred loan costs of \$8,624,000 associated with the prepayment of the guaranteed loan; a charge for Boeing aircraft and facility lease exit costs of \$4,292,000; loss of \$1,586,000 on the sale of one Airbus aircraft in a sale-leaseback transaction and from the sale of a spare engine; and an unrealized derivative loss of \$254,000. The break-even load factor for the six months ended September 30, 2003 includes special items net of profit-sharing; compensation received under the Appropriations Act of \$13,842,000; write-off of deferred loan costs of \$8,624,000 associated with the prepayment of the guaranteed loan; a charge for Boeing aircraft and facility lease exit costs of \$4,924,000; loss of \$1,586,000 on the sale of one Airbus aircraft in a sale-leaseback transaction and from the sale of a spare engine; and an unrealized derivative gain of \$438,000.
- (6) "Block hours" represent the time between aircraft gate departure and aircraft gate arrival.
- (7) "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 that period. The number of aircraft includes all aircraft on our operating certificate, which includes scheduled aircraft, as well as aircraft out of service for maintenance and operation spare aircraft, and excludes aircraft removed permanently from revenue service or new aircraft not yet placed in revenue service.
- (8) "Yield per RPM" is determined by dividing passenger revenues (excluding charter revenue) by revenue passenger miles.
- (9) For purposes of these yield calculations, charter revenue is excluded from passenger revenue. These figures may be deemed 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 and forecasts, 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 GAAP. The calculation of passenger revenue excluding charter revenue is as follows:

|                                 | Three Months Ended Sept. 30,<br>2003 | 2002      | Six Months Ended<br>2003 |
|---------------------------------|--------------------------------------|-----------|--------------------------|
| Passenger revenues, as reported | \$159,965                            | \$116,710 | \$298,855                |

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|                                               |           |           |           |
|-----------------------------------------------|-----------|-----------|-----------|
| Charter revenue                               | 580       | 721       | 1,194     |
| Passenger revenues, excluding charter revenue | \$159,385 | \$115,989 | \$297,661 |
| =====                                         |           |           |           |

- (10) "Yield per ASM" is determined by dividing passenger revenues (excluding charter revenue) by available seat miles.
- (11) "Total yield per ASM" is determined by dividing passenger revenues by available seat miles.
- (12) 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, it facilitates comparison of results of operations between current and past periods and enables investors to better forecast future trends in our operations. Furthermore, in preparing operating plans and forecasts, we rely, in part, on trends in our historical results of operations excluding fuel expense. However, our presentation of non-GAAP financial measures should not be viewed as a substitute for our financial results determined in accordance with GAAP.
- (13) "Average fare" excludes revenue included in passenger revenue for non-revenue passengers, administrative fees, and revenue recognized for unused tickets that are greater than one year from issuance date.

The following table provides our operating revenues and expenses expressed as cents per total ASMs and as a percentage of total operating revenues, as rounded, for the three and six month periods ended September 30, 2003 and 2002.

|                                | Three Months Ended September 30, |              | Six Months Ended |              |
|--------------------------------|----------------------------------|--------------|------------------|--------------|
|                                | 2003                             | 2002         | 2003             |              |
|                                | Per total ASM                    | % of Revenue | Per total ASM    | % of Revenue |
| Revenues:                      |                                  |              |                  |              |
| Passenger                      | 9.29                             | 96.5%        | 7.48             | 97.8%        |
| Cargo                          | 0.14                             | 1.4%         | 0.09             | 1.1%         |
| Other                          | 0.20                             | 2.1%         | 0.08             | 1.1%         |
| Total revenues                 | 9.63                             | 100.0%       | 7.65             | 100.0%       |
| =====                          |                                  |              |                  |              |
| Operating expenses:            |                                  |              |                  |              |
| Flight operations              | 2.46                             | 25.5%        | 2.71             | 32.0%        |
| Aircraft fuel expense          | 1.51                             | 15.6%        | 1.12             | 17.9%        |
| Aircraft and traffic servicing | 1.51                             | 15.7%        | 1.36             | 17.8%        |
| Maintenance                    | 0.99                             | 10.3%        | 1.12             | 14.7%        |
| Promotion and sales            | 0.96                             | 10.0%        | 0.87             | 11.3%        |
| General and administrative     | 0.57                             | 5.9%         | 0.42             | 5.5%         |
| Depreciation and amortization  | 0.34                             | 3.5%         | 0.26             | 3.5%         |
| Total operating expenses       | 8.34                             | 86.5%        | 7.86             | 102.7%       |
| =====                          |                                  |              |                  |              |

Our passenger yield per RPM was 12.09¢ and 12.57¢ for the three months ended September 30, 2003 and 2002, respectively, or a decrease of 3.8%. Our length of haul was 905 and 935 for the three months ended September 30, 2003 and 2002, respectively, or a decrease of 3.2%. Our average fare was \$103 for the three months ended September 30, 2003 as compared to \$109 for the three months ended September 30, 2002, a decrease of 5.5%. Our passenger yield per RPM was 12.18¢ and 12.64¢ for the six months ended September 30, 2003 and 2002, respectively, or a decrease of 3.6%. Our length of haul was 910 and 930 for the six months ended September 30, 2003 and 2002, respectively, or a decrease of 2.2%. Our average fare was \$104 for the six months ended September 30, 2003 as compared to \$108 for the six months ended September 30, 2002, a decrease of 3.7%. As part of our new fare structure, which we implemented in February 2003,

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our highest-level business fares were reduced by 25 to 45 percent, and our lowest available walk-up fares were reduced by 38 to 77 percent. The new fare structure, which is comprised of six fare categories, caps all fares to and from Denver at \$399 or \$499 one-way, excluding passenger facility, security or segment fees, depending on length of haul. Unlike some other airlines, these fares can be booked each way, allowing customers to get the best price on both the inbound and outbound portion of their itinerary with no round-trip purchase required. Our new fare structure removes the advance purchase requirements of past pricing structures, and there are no Saturday night stayovers required. Although this has created downward pressure on our passenger yield per RPM and average fare, we believe the effect on our revenues was offset by an increase in passenger traffic. Our RASM for the three months ended September 30, 2003 and 2002 was 9.26¢ and 7.44¢, an increase of 24.5%. Our RASM for the six months ended September 30, 2003 and 2002 was 8.76¢ and 7.69¢, an increase of 13.9%. Additionally, we believe that our average fare during the three and six months ended September 30, 2003 was a result of intense competition from United Airlines, a carrier operating under Chapter 11 bankruptcy protection, which is our principal competitor at DIA.

Our CASM for the three months ended September 30, 2003 and 2002 was 8.34¢ and 7.86¢, respectively, an increase of .48¢ or 6.1%. CASM excluding fuel for the three months ended September 30, 2003 and 2002 was 6.83¢ and 6.49¢, respectively, an increase of .34¢ or 5.2%. Our CASM increased during the three months ended September 30, 2003 as a result of an increase in the average price of fuel from .92¢ to \$1.01 or .39¢ per ASM; an increase in aircraft and traffic servicing expenses combined with sales and promotions expenses of .24¢ as a result of the increase in the number of passengers we serve and general increases in DIA airport costs as well as related increases in sales and promotion expenses for booking fees associated with the increase in passengers, the ongoing costs of LiveTV service of .05¢; and, an increase in general and administrative expenses of .15¢ as a result of the bonus accrual associated with our return to profitability and an increase in health insurance costs associated with general increase in health insurance costs. These increases were partially offset by a decrease of .13¢ in maintenance expense primarily as a result of the reduction in the number of aircraft in our Boeing fleet that were replaced with new Airbus A319 aircraft. Our CASM also increased as a result of a reduction in planned block hours flown due to the timing of Boeing 737-200 aircraft returns while the number of crew personnel and related salaries remained relatively static while we prepared for the deliveries of new Airbus aircraft. Our CASM for the six months ended September 30, 2003 and 2002 was 8.21¢ and 8.11¢, respectively, an increase of .10¢ or 1.2%. CASM excluding fuel for the six months ended September 30, 2003 and 2002 was 6.78¢ for each of the periods.

An airline's 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 mile. For the three months ended September 30, 2003, our break-even load factor was 74.9% compared to our achieved passenger load factor of 76.6%. The break-even load factor for the three months ended September 30, 2003 includes the following special items net of profit-sharing; write-off of deferred loan costs of \$8,624,000 associated with the prepayment of the guaranteed loan; a charge for Boeing aircraft and facility lease exit costs of \$4,292,000; loss of \$1,586,000 on the sale of one Airbus aircraft in a sale-leaseback transaction and from the sale of a spare engine; and an unrealized derivative loss of \$254,000. These items, net of profit sharing, accounted for 6.2 load factor points of the breakeven load factor amount. For the six months ended September 30, 2003, our break-even load factor was 65.0% compared to our achieved passenger load factor of 71.9%. The break-even load factor for the six months ended September 30, 2003 includes the following special items net of profit-sharing; compensation received under the Appropriations Act of \$13,842,000; write-off of deferred loan costs of \$8,624,000 associated with the prepayment of the guaranteed loan; a charge for Boeing aircraft and facility lease exit costs of \$4,924,000; loss of \$1,586,000 on the sale of one Airbus aircraft in a sale-leaseback transaction and from the sale of a spare engine; and an unrealized derivative gain of \$438,000. These items, net of profit sharing, had no impact on the

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break-even load factor.

Small fluctuations in our RASM or in our CASM can significantly affect operating results because we, like other airlines, have high fixed costs in relation to revenues. Airline operations are highly sensitive to various factors, including the actions of competing airlines and general economic factors, which can adversely affect our liquidity, cash flows and results of operations.

Our operations during the three and six months ended September 30, 2003, are not necessarily indicative of future operating results or comparable to the prior periods ended September 30, 2002.

### Revenues

Our revenues are highly sensitive to changes in fare levels. Competitive fare pricing policies have a significant impact on our revenues. Because of the elasticity of passenger demand, we believe that increases in fares may at certain levels result in a decrease in passenger demand in many markets. We cannot predict future fare levels, which depend to a substantial degree on actions 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 depending on the markets' locations.

We believe that our new fare structure that was implemented in February 2003 may have had a downward effect on the average fare offset by an increase in passenger traffic. Our load factors of 75.6%, 80.1%, 79.7%, and 69.5% for the months of June through September 2003, respectively, represent record load factors for us as compared to prior comparable months. Our July 2003 load factor was the highest in our history. We cannot predict whether or for how long these higher load factors will continue.

*Passenger Revenues.* Passenger revenues totaled \$159,965,000 for the three months ended September 30, 2003 compared to \$116,710,000 for the three months ended September 30, 2002, or an increase of 37.1%, on increased ASMs of 161,518,000 or 10.4%. Passenger revenues totaled \$298,855,000 for the six months ended September 30, 2003 compared to \$226,002,000 for the six months ended September 30, 2002, or an increase of 32.2%, on increased ASMs of 467,169,000 or 16.0%. Passenger revenues include revenues for reduced rate standby passengers, administrative fees, and revenue recognized for tickets that are not used within one year from their issue dates. We carried 1,457,000 revenue passengers during the three months ended September 30, 2003 compared to 987,000 during the three months ended September 30, 2002, an increase of 47.6%. We had an average of 37.0 aircraft in our fleet during the three months ended September 30, 2003 compared to an average of 33.8 aircraft during the three months ended September 30, 2002, an increase of 9.5%. RPMs for the three months ended September 30, 2003 were 1,318,020,000 compared to 922,817,000 for the three months ended September 30, 2002, an increase of 42.8%. Our load factor increased to 76.6% for the three months ended September 30, 2003 from 59.2% for the prior comparable period, or an increase of 17.4 points, or 29.4%. We carried 2,684,000 revenue passengers during the six months ended September 30, 2003 compared to 1,916,000 during the six months ended September 30, 2002, an increase of 40.1%. We had an average of 36.3 aircraft in our fleet during the six months ended September 30, 2003 compared to an average of 32.2 aircraft during the six months ended September 30, 2002, an increase of 12.7%. RPMs for the six months ended September 30, 2003 were 2,443,253,000 compared to 1,782,421,000 for the six months ended September 30, 2002, an increase of 37.1%. Our load factor increased to 71.9% for the six months ended September 30, 2003 from 60.8% for the prior comparable period, or an increase of 11.1 points, or 18.3%.

Cargo revenues, consisting of revenues from freight and mail service, totaled \$2,369,000 and \$1,366,000 for the three months ended September 30, 2003 and 2002,

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respectively, representing 1.4% and 1.1%, respectively, of total revenues, an increase of 73.4%. Cargo revenues totaled \$4,058,000 and \$2,946,000 for the six months ended September 30, 2003 and 2002, respectively, representing 1.3% of total revenues for each of the periods, an increase of 37.7%. Cargo revenues increased over the prior comparable periods as a result of our new contract to carry mail under the United States Postal Service Commercial Air 2003 Air System Contract. This adjunct to the passenger business is highly competitive and depends heavily on aircraft scheduling, alternate competitive means of same day delivery service and schedule reliability.

Other revenues, comprised principally of interline handling fees, liquor sales, LiveTV sales, co-branded credit card revenue, and excess baggage fees totaled \$3,487,000 and \$1,279,000, or 2.1% and 1.1% of total revenues for the three months ended September 30, 2003 and 2002, respectively, an increase of 172.6%. Other revenues totaled \$5,274,000 and \$2,219,000, or 1.7% and 1.0% of total operating revenues for the six months ended September 30, 2003 and 2002, respectively, an increase of 137.7%. Other revenues increased over the prior comparable period primarily due to the Mesa codeshare agreement, LiveTV sales, and revenue generated from our co-branded credit card program. For the three and six months ended September 30, 2003, we recognized \$182,000 and \$301,000, respectively.

### Operating Expenses

Operating expenses include those related to flight operations, aircraft and traffic servicing, maintenance, promotion and sales, general and administrative and depreciation and amortization. Total operating expenses for the three months ended September 30, 2003 and 2002 were \$143,491,000 and \$122,557,000 and represented 86.5% and 102.7% of revenue, respectively. Total operating expenses were \$278,976,000 and \$237,467,000 for the six months ended September 30, 2003 and 2002 and represented 90.5% and 102.7% of revenue, respectively. Operating expenses decreased as a percentage of revenue during the three and six months ended September 30, 2003 as a result of an increase in total revenues as compared to the six months ended September 30, 2002.

*Salaries, Wages and Benefits.* We record salaries, wages and benefits within the specific expense category identified in our statement of operations for which they are relevant. Salaries, wages and benefits totaled \$39,429,000 and \$31,199,000 and were 23.8% and 26.1% of total revenues for the three months ended September 30, 2003 and 2002, respectively, an increase of 26.4%. Salaries, wages and benefits totaled \$76,431,000 and \$60,775,000 and were 24.8% and 26.3% of total revenues for the six months ended September 30, 2003 and 2002, respectively, an increase of 25.8%. Salaries, wages and benefits increased over the prior comparable periods largely as a result of our bonus accrual due to our return to profitability, overall wage increases, and an increase in the number of employees to support our ASM growth of 16.0% during the six months ended September 30, 2003. Our employees increased from approximately 2,950 in September 2002 to approximately 3,570 in September 2003, an increase of 21.0%.

*Flight Operations.* Flight operations expenses of \$42,268,000 and \$38,237,000 were 25.5% and 32.0% of total revenue for the three months ended September 30, 2003 and 2002, respectively, an increase of 10.5%. Flight operations expenses of \$84,433,000 and \$75,320,000 were 27.4% and 32.6% of total revenue for the six months ended September 30, 2003 and 2002, respectively, an increase of 12.1%. Flight operations expenses include all expenses related directly to the operation of the aircraft including lease and insurance expenses, pilot and flight attendant compensation, in-flight catering, crew overnight expenses, flight dispatch and flight operations administrative expenses.

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Aircraft lease expenses totaled \$17,921,000 (10.8% of total revenue) and \$17,671,000 (14.8% of total revenue) for the three months ended September 30, 2003 and 2002, respectively, an increase of 1.4%. Aircraft lease expenses totaled \$35,113,000 (11.4% of total revenue) and \$34,601,000 (15.0% of total revenue) for the six months ended September 30, 2003 and 2002, respectively, an increase of 1.5%. The average number of leased aircraft decreased 6.8% from 28.2 to 26.4 during the three months ended September 30, 2003. The average number of leased aircraft decreased 4.5% from 27.7 to 26.5 during the six months ended September 30, 2003. The marginal increase is due to the replacement of older and smaller leased Boeing 737-200 aircraft that have unfavorable lease rates with newer and larger Airbus A319 leased aircraft with more favorable lease rates.

Aircraft insurance expenses totaled \$2,258,000 (1.4% of total revenue) for the three months ended September 30, 2003. Aircraft insurance expenses for the three months ended September 30, 2002 were \$2,548,000 (2.1% of total revenue). Aircraft insurance expenses were .17¢ and .28¢ per RPM for the three months ended September 30, 2003 and 2002, respectively. Aircraft insurance expenses totaled \$5,004,000 (1.6% of total revenue) for the six months ended September 30, 2003. Aircraft insurance expenses for the six months ended September 30, 2002 were \$5,166,000 (2.2% of total revenue). Aircraft insurance expenses were .20¢ and .29¢ per RPM for the six months ended September 30, 2003 and 2002, respectively. Aircraft insurance decreased per RPM as a result of less expensive war risk coverage that is presently provided by the FAA than during the periods ended September 30, 2002 that was previously provided by commercial underwriters combined with a 30% decrease in our basic hull and liability insurance rates effective June 7, 2003. The current FAA war risk policy is in effect until December 10, 2003. We do not know whether the government will extend the coverage, and if it does, how long the extension will last. We expect that if the government stops providing excess war risk coverage to the airline industry, the premiums charged by aviation insurers for this coverage will be substantially higher than the premiums currently charged by the government or the coverage will not be available from reputable underwriters.

Pilot and flight attendant salaries before payroll taxes and benefits totaled \$12,510,000 and \$10,575,000 or 7.8% and 9.1% of passenger revenue for the three months ended September 30, 2003 and 2002, an increase of 18.3%. Pilot and flight attendant salaries before payroll taxes and benefits totaled \$24,995,000 and \$20,434,000 or 8.4% and 9.0% of passenger revenue for the six months ended September 30, 2003 and 2002, an increase of 22.3%. Pilot and flight attendant compensation for the three and six months ended September 30, 2003 also increased as a result of a 9.5% and 12.7% increase in the average number of aircraft in service, respectively, an increase of 9.8% and 14.5% in block hours, respectively, a general wage increase in flight attendant and pilot salaries and additional crew required to replace those who were attending training on the Airbus equipment. We pay pilot and flight attendant salaries for training, consisting of approximately six and three weeks, respectively, prior to scheduled increases in service, which can cause the compensation expense during such periods to appear high in relationship to the average number of aircraft in service. We expect these costs to continue to increase as we place additional aircraft into service and continue to retire Boeing equipment.

*Aircraft Fuel Expenses.* Aircraft fuel expenses include both the direct cost of fuel, including taxes, as well as the cost of delivering fuel into the aircraft. Aircraft fuel expenses of \$25,901,000 for 25,543,000 gallons used and \$21,332,000 for 23,170,000 gallons used resulted in an average fuel expense \$1.01 and 92.1¢ per gallon for the three months ended September 30, 2003 and 2002, respectively. Aircraft fuel expenses represented 15.6% and 17.9% of total revenue for the three months ended September 30, 2003 and 2002, respectively. Aircraft fuel expenses of \$48,501,000 for 49,955,000 gallons used and \$38,728,000 for 44,028,000 gallons used resulted in an average fuel cost of 97.1¢ and 88.0¢ per gallon, for the six months ended September 30, 2003 and 2002, respectively. Aircraft fuel expenses represented 15.7% and 16.7% of total revenue for the six months ended September 30, 2003 and 2002, respectively. Fuel prices are subject to change weekly, as we purchase a very small portion in

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advance for inventory. We initiated a fuel hedging program in late November 2002, which increased fuel expense by \$36,000 for the three months ended September 30, 2003 and decreased fuel expense \$503,000 for the six months ended September 30, 2003. Fuel consumption for the three months ended September 30, 2003 and 2002 averaged 753 and 750 gallons per block hour, respectively, or an increase of .4%. Fuel consumption per block hour increased during the three months ended September 30, 2003 from the prior comparable period because of the 17.4 point increase in our load factor, partially offset by the increase in Airbus aircraft. Fuel consumption for the six months ended September 30, 2003 and 2002 averaged 745 and 752 gallons per block hour, respectively, or a decrease of .9%. Fuel consumption per block hour decreased during the six months ended September 30, 2003 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 had higher fuel burn rates.

*Aircraft and Traffic Servicing.* Aircraft and traffic servicing expenses were \$26,077,000 and \$21,274,000 (an increase of 22.6%) for the three months ended September 30, 2003 and 2002, respectively, and represented 15.7% and 17.8% of total revenue. Aircraft and traffic servicing expenses were \$50,075,000 and \$40,623,000 (an increase of 23.3%) for the six months ended September 30, 2003 and 2002, respectively, and represented 16.2% and 17.6% of total revenue. Aircraft and traffic servicing expenses include all 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 amounts paid to other airlines to reaccommodate 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. During the three months ended September 30, 2003, our departures increased to 15,078 from 13,583 for the six months ended September 30, 2002, or 11.0%. Aircraft and traffic servicing expenses were \$1,729 per departure for the three months ended September 30, 2003 as compared to \$1,566 per departure for the three months ended September 30, 2002, or an increase of \$163 per departure. During the six months ended September 30, 2003, we served approximately 36 cities compared to 31 during the six months ended September 30, 2002, or an increase of 16.1%. During the six months ended September 30, 2003, our departures increased to 29,688 from 25,767 for the six months ended September 30, 2002, or 15.2%. Aircraft and traffic servicing expenses were \$1,687 per departure for the six months ended September 30, 2003 as compared to \$1,577 per departure for the six months ended September 30, 2002, or an increase of \$110 per departure. Aircraft and traffic servicing expenses increased per departure as a result of general increases in airport rents and landing fees and a 47.6% and a 40.1% increase in passengers for the three and six months ended September 30, 2003, respectively, as compared to the prior periods. Additionally, cargo (including mail) revenue increased 73.4% and 37.7% for the three and six months ended September 30, 2003, respectively, as compared to prior periods. Aircraft and traffic servicing expenses increase with increases in passengers and cargo handling. We also experienced higher landing fees associated with the Airbus aircraft which have higher landing weights than the Boeing aircraft.

*Maintenance.* Maintenance expenses of \$17,120,000 and \$17,501,000 were 10.3% and 14.7% of total revenue for the three months ended September 30, 2003 and 2002, respectively, a decrease of 2.2%. Maintenance expenses of \$34,998,000 and \$33,943,000 were 11.4% and 14.7% of total revenue for the six months ended September 30, 2003 and 2002, respectively, an increase of 3.1%. These expenses include all labor, parts and supplies expenses related to the maintenance of the aircraft. Routine maintenance is charged to maintenance expense as incurred while major engine overhauls and heavy maintenance check expense are accrued monthly with variances from accruals recognized at the time of the check. Maintenance cost per block hour for the three months ended September 30, 2003 and 2002 were \$505 and \$567, respectively. Maintenance cost per block hour for the six months ended September 30, 2003 and 2002 were \$522 and \$580, respectively. 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. During the three months ended September 30, 2003, we recorded a credit to maintenance expenses totaling \$614,000 as a result of the cockpit door reimbursement under the Appropriations Act, or \$18 per block

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hour.

*Promotion and Sales.* Promotion and sales expenses totaled \$16,471,000 and \$13,505,000 and were 10.0% and 11.3% of total revenue for the three months ended September 30, 2003 and 2002, respectively, an increase of 22.0%. Promotion and sales expenses totaled \$31,191,000 and \$28,224,000 and were 10.1% and 12.2% of total revenue for the six months ended September 30, 2003 and 2002, respectively, an increase of 10.5%. These include advertising expenses, telecommunications expenses, wages and benefits for reservationists and as well as marketing management and sales personnel, credit card fees, travel agency commissions and computer reservations costs. During the three months ended September 30, 2003, promotion and sales expenses per passenger decreased to \$11.30 compared to \$13.68 for the three months ended September 30, 2002. During the six months ended September 30, 2003, promotion and sales expenses per passenger decreased to \$11.62 compared to \$14.73 for the six months ended September 30, 2002. Promotion and sales expenses per passenger decreased as a result of variable expenses that are based on lower average fares, the elimination of substantially all travel agency commissions effective on tickets sold after May 31, 2002, and economies of scale associated with our growth.

*General and Administrative.* General and administrative expenses for the three months ended September 30, 2003 and 2002 totaled \$9,784,000 and \$6,575,000 (an increase of 48.8%) and were 5.9% and 5.5% of total revenue, respectively. General and administrative expenses for the six months ended September 30, 2003 and 2002 totaled \$18,720,000 and \$12,697,000 (an increase of 47.4%) and were 6.1% and 5.5% of total revenue for each of the six months ended September 30, 2003 and 2002, respectively. During the three months ended September 30, 2003, we accrued \$1,298,000 for employee performance bonuses, or .8% of total revenue. During the six months ended September 30, 2003, we accrued for employee performance bonuses totaling \$2,423,000, or .8% of total revenue. Bonuses are based on profitability. As a result of our pre-tax loss for the three and six months ended September 30, 2002, we did not accrue bonuses. General and administrative expenses include the wages and benefits for several of our executive officers and various other administrative personnel including legal, accounting, information technology, aircraft procurement, corporate communications, training and human resources and other expenses associated with these departments. Employee health benefits, accrued vacation and bonus expenses, general insurance expenses including worker's compensation and write-offs associated with credit card and check fraud are also included in general and administrative expenses. Our employees increased from approximately 2,950 in September 2002 to approximately 3,570 in September 2003, or 21.0%. Accordingly, we experienced increases in our human resources, training, information technology, and health insurance benefit expenses. General and administrative expenses increased with a general increase in the cost of providing health insurance..

*Depreciation and Amortization.* Depreciation and amortization expenses of \$5,870,000 and \$4,133,000 were approximately 3.5% of total revenue for each of the periods ended the three months ended September 30, 2003 and 2002, respectively, an increase of 42.0%. Depreciation and amortization expenses of \$11,057,000 and \$7,932,000 were approximately 3.6% and 3.4% of total revenue for the six months ended September 30, 2003 and 2002, respectively, an increase of 39.4%. These expenses include depreciation of aircraft and aircraft components, office equipment, ground station equipment and other fixed assets. Depreciation expense increased over the prior year largely as a result of an increase in the average number of Airbus A319 and A318 aircraft owned from an average of 4.7 during the September 2002 quarter to an average of 9.8 during the September 2003 quarter, an increase of 108.5%.

*Nonoperating Income (Expense).* Net nonoperating expense totaled \$8,085,000 for the six months ended September 30, 2003 compared to net nonoperating expense totaling \$2,398,000 for the six months ended September 30, 2002.

Interest income decreased to \$938,000 from \$1,195,000 during the six months ended September 30, 2003 from the prior period due a decrease in interest rates. Interest expense increased to \$7,869,000 for the six months ended September 30, 2003

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from \$3,155,000 as a result of interest expense associated with the financing of additional aircraft purchased since September 30, 2002 and the government guaranteed loan we obtained in February 2003.

During the six months ended September 30, 2003, we ceased using three of our Boeing 737-200 leased aircraft, two of which had lease terminations in October 2003 and one with a lease termination date in October 2005. In August 2003, we closed our maintenance facility in El Paso Texas, which had a lease termination date in August 2007. As a result of these transactions we recorded a pre-tax charge of \$5,345,000. This amount recognizes the remaining fair value of the lease payments and the unamortized leasehold improvements on the aircraft and facility.

We completed a public offering of 5,050,000 shares of common stock in September 2003. Under the terms for our government guaranteed loan by the ATSB, as a result of this offering, we were required to make a prepayment of the loan equal to 60% of the net proceeds from the offering. As a result, we prepaid approximately \$48,418,000 on the loan and wrote off approximately \$8,742,000 of deferred loan costs associated with the prepayment amount. Of the \$8,742,000, approximately \$7,239,000 represented the value assigned to the warrants issued to the ATSB and to two other guarantors in connection with the loan transaction. The warrants had an estimated fair value of \$9,282,000 when issued. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model.

Other, net nonoperating expense includes a loss totaling \$1,238,000 on the sales leaseback of an Airbus A319 aircraft and a loss totaling \$483,000 on the sale of an aircraft engine during the six months ended September 30, 2003.

Offsetting these nonoperating expenses during the six months ended September 30, 2003, is pre-tax compensation of \$15,024,000 as a result of payments under the Appropriations Act for expenses and revenue foregone related to aviation security. We received a total of \$15,573,000 in May 2003, of which we paid \$549,000 to Mesa for the revenue passengers Mesa carried as Frontier JetExpress.

Income Tax Expense. Income tax expense totaled \$8,195,000 during the six months ended September 30, 2003 at a 38.8% rate, compared to an income tax benefit of \$3,172,000 for the six months ended September 30, 2002, at a 36.5% rate.

### **Liquidity and Capital Resources**

Our liquidity depends to a large extent on the number of passengers who fly with us, the fares we charge, our operating and capital expenditures, and our financing activities. We depend on lease or mortgage financing to acquire all of our aircraft, including 40 firm additional owned and leased Airbus aircraft as of September 30, 2003 scheduled for delivery through 2008. In August 2003, we amended our purchase agreement with Airbus to provide for 15 additional firm Airbus A319 aircraft purchases with deliveries scheduled beginning in calendar year 2004 and continuing through 2008.

We had cash and cash equivalents and short-term investments of \$203,332,000 at September 30, 2003 and \$104,880,000 at March 31, 2003, respectively. At September 30, 2003, total current assets were \$271,959,000 as compared to \$153,770,000 of total current liabilities, resulting in working capital of \$118,189,000. At March 31, 2003, total current assets were \$190,838,000 as compared to \$130,047,000 of total current liabilities, resulting in working capital of \$60,791,000. The increase in our cash and working capital from March 31, 2003 is largely a result of cash provided by a stock offering in September 2003 which netted \$81,085,000 after offering expenses offset by a required prepayment of principal and interest totaling \$48,633,000 on our government guaranteed loan and by operating activities. Also favorably impacting our liquidity during the six months ended September 30, 2003, was the receipt of \$15,913,000 under the Appropriations Act. In September 2003 we completed an aircraft sale leaseback with net proceeds to us totaling \$4,374,000. In July 2003, we received our income tax refund from the Internal Revenue Service totaling \$26,574,000 and

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prepaid \$10,000,000 on our government guaranteed loan upon receipt of this refund as required by the loan agreement.

Cash provided by operating activities for the six months ended September 30, 2003 was \$96,928,000. This is attributable to our net income for the period, the income tax refund we received, an increase in air traffic liability and accrued expenses, offset by a decrease in restricted investments and accounts payable. Cash used by operating activities for the six months ended September 30, 2002 was \$6,650,000. This is attributable to the net loss for the period, increases in restricted investments, receivables, security, maintenance and other deposits, decreases in accounts payable, air traffic liability, other accrued expenses, and deferred Stabilization Act compensation, offset by a decrease in prepaid expenses and increases in accrued maintenance expense and deferred lease and other expenses. Included in cash used by operating activities in the 2002 period is a \$4,000,000 repayment of the excess amounts received under the Stabilization Act.

Cash used in investing activities for the six months ended September 30, 2003 was \$91,871,000. Net aircraft lease and purchase deposits decreased by \$1,956,000 during this period. We used \$94,445,000 for the purchase of three additional Airbus aircraft, aircraft leasehold improvements, ground equipment to support increased below-wing operations, and computer equipment which included scanning equipment for the new mail transportation requirements. During the six months ended September 30, 2003, we took delivery of three purchased Airbus A318 aircraft and applied their respective pre-delivery payments to the purchase of those aircraft. Additionally, we completed a sale-leaseback transaction on one of our purchased aircraft that we took delivery of in September 2003, generating cash proceeds of approximately \$4,374,000 from the sale and the return of the pre-delivery payments relating to the purchase commitment. We agreed to lease the aircraft over a 12 year term. Cash used by investing activities for the six months ended September 30, 2002 was \$108,580,000. We used \$98,755,000 for the purchase of three additional Airbus aircraft and to purchase rotatable aircraft components, leasehold improvements and other general equipment purchases. Net aircraft lease and purchase deposits increased by \$10,236,000 this period. During the six months ended September 30, 2002, we took delivery of three purchased Airbus aircraft and applied their respective pre-delivery payments to the purchase of those aircraft.

Cash provided by financing activities for the six months ended September 30, 2003 and 2002 was \$93,395,000 and 70,240,000, respectively. During the six months ended September 30, 2003, we completed a stock offering of 5,050,000 shares of our common stock. We received \$81,085,000, net of offering expenses, from the sale of these shares. We used \$48,418,000 of the proceeds to prepay the government guaranteed loan. During the six months ended September 30, 2003 and 2002, we received \$349,000 and \$571,000, respectively, from the exercise of common stock options. During the six months ended September 30, 2003 and 2002, we borrowed \$76,500,000 and \$73,200,000, respectively, to finance the purchase of Airbus aircraft, of which \$5,599,000 and \$2,542,000 was repaid as principal payments during the respective periods. During the six months ended September 30, 2003 we prepaid an additional \$10,000,000 on the government guaranteed loan as required by the loan agreement.

We have been working closely with DIA, our primary hub or operations, and the offices of the Mayor of the City and County of Denver, in which DIA is located, to develop strategies and plans for expanding Concourse A where our aircraft gates are located and also improving efficient use of existing gates, in order to accommodate our anticipated growth over the next several years. At this time, DIA has committed to adding two additional gates to Concourse A for our preferential use. It is expected that these gates will become available in late spring of 2004. We are examining other expansion options that could add up to an additional eight gates and five regional jet parking positions to the west side of Concourse A. As new gates are constructed, we would enter into long-term lease arrangements to use those gates on a preferential basis. On November 9, 2003, the City and County of Denver and United Airlines announced that they had reached agreement with respect to the restructuring of United's lease of gates and other facilities at DIA. The agreement will permit United

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to proceed with the assumption of the restructured lease as part of its bankruptcy reorganization process. As a part of the negotiations, we are advised that United has agreed to relinquish one gate on Concourse A for immediate lease to Frontier on a permanent basis. In addition, United would make available two additional gates for use by Frontier until the earlier of the construction of additional gates for Frontier on the West end of Concourse A or October 31, 2005. Plans for our expansion of Concourse A are still in development and the final scope of the project, if any, and a firm estimate of the project costs, is yet to be determined. We also have not been advised of the amount of increased rents that will result from Frontier's lease of the gates being made available by United. It is impossible at this time to estimate the increased rates and charges that we would incur as the result of the construction and leasing of newly constructed gates on Concourse A or the lease by Frontier of the gates being made available by United.

As part of the lease restructure between the City and County of Denver and United Airlines, we believe that United has been provided certain concessions and reductions in the rents, rates and charges arising from their lease of facilities at DIA. We have been advised by the City and County of Denver that they will seek to prevent the reduced rates and charges being paid by United from increasing the rates and charges being 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. Because we are the second largest airline operating out of Denver, we may incur a larger impact of any increase in rates and charges imposed by DIA. At this time, it is impossible to quantify what the increase in our rates and charges would be, if any, due to the concession being provided to United.

We have been assessing our liquidity position in light of; our aircraft purchase commitments and other capital needs, the economy, our competition, the events of September 11, and other uncertainties surrounding the airline industry. Prior to applying for a government guaranteed loan under the Stabilization Act, we filed a shelf registration with the Securities and Exchange Commission in April 2002 that allowed us to sell equity or debt securities from time to time as market conditions permit. In September 2003, we completed a stock offering of 5,050,000 shares of our common stock. Although the stock offering has improved our liquidity, we may need to continue to explore avenues to enhance our liquidity if our current economic and operating environment changes. We intend to continue to examine domestic or 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, see "Contractual Obligations" below.

### Contractual Obligations

The following table summarizes our contractual obligations as of September 30, 2003:

|                                        | Less than<br>1 year | 1-3<br>years  | 4-5<br>years  | After<br>5 years |       |
|----------------------------------------|---------------------|---------------|---------------|------------------|-------|
| Long-term debt (1)                     | \$ 15,317,000       | \$ 42,938,000 | \$ 35,490,000 | \$200,950,000    | \$2   |
| Operating leases (2) (4)               | 83,570,000          | 161,762,000   | 159,555,000   | 521,681,000      | 9     |
| Unconditional purchase obligations (3) | 125,210,000         | 207,082,000   | 249,879,469   | -                | 5     |
| Total contractual cash obligations     | \$224,097,000       | \$411,782,000 | \$444,924,469 | \$722,631,000    | \$1,8 |

- (1) In February 2003, we obtained a \$70,000,000 guaranteed loan of which \$69,300,000 was guaranteed by the Air Transportation Stabilization Board ("ATSB") and two other parties. The loan has three tranches, Tranche A, Tranche B and Tranche C, in amounts that initially totaled \$63,000,000, \$6,300,000 and \$700,000, respectively. At September 30, 2003, the interest rates were 1.80%, 2.15%, and 3.6%, respectively. The interest rates on each tranche of the loan adjust

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quarterly based on LIBOR rates. The loan required quarterly installments of approximately \$2,642,000 beginning in December 2003 with a final balloon payment of \$33,000,000 due in June 2007. Upon receipt of our income tax refund, which was pledged under this loan agreement, we were required to make a prepayment of \$10,000,000, which was to be applied against the next successive installments due. In July 2003, we received our income tax refund and made the required pre-payment. Additionally, the loan required a prepayment of 60% of the net proceeds from any sale of equity. As a result of the stock offering we completed in September 2003, we prepaid an additional \$48,418,000 in principal on the loan. As a result of these prepayments, the loan balance was \$11,542,000 at September 30, 2003. The prepayment of \$48,418,000, as required by the loan agreement, was applied to the installments including the balloon payment that were due at the end of the loan. As a result, the final principal payment due on the loan is now December 2005. Interest is payable quarterly, in arrears. Guarantee fees of 4.5% annually are payable quarterly in advance to the guarantors of the Tranche A and Tranche B loans. The loan facility is secured by certain assets of ours as described in the loan agreement, consisting primarily of Boeing rotatable fixed assets, all expendable inventory and 50% of other property and equipment. In connection with this transaction, we issued warrants to purchase of 3,833,946 shares of our common stock at \$6.00 per share to the ATSB and to two other guarantors. The warrants had an estimated fair value of \$9,282,538 when issued and expire seven years after issuance. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model. This amount is being amortized to interest expense over the life of the loan. The effective interest rate on the notes is approximately 11.39% including the non-cash value of the warrants and other costs associated with obtaining the loan, assuming that the variable interest rates payable on the notes at September 30, 2003. The notes contain certain covenants that require us to maintain certain ratios with respect to indebtedness to earnings before income taxes, depreciation and amortization, and rents ("EBITDAR") and EBITDAR to fixed charges beginning January 1, 2004. We are not required to meet certain liquidity tests until the quarter ending March 31, 2004. Unrestricted cash balances cannot be less than \$25,000,000 at any time through September 30, 2004 or \$75,000,000 thereafter. We are in compliance with these requirements at September 30, 2003.

During the year ended March 31, 2002, we entered into two loan agreements for two Airbus A319 aircraft. Each aircraft loan has a term of 10 years and is payable in equal monthly installments, including interest, payable in arrears. The aircraft secure the loans. Each of the loans require monthly principal and interest payments of \$215,000 and \$218,110, bears interest with rates of 6.71% and 6.54%, with maturities in May and August 2011, at which time a balloon payment totaling \$10,200,000 is due with respect to each loan.

During the year ended March 31, 2003, we entered into additional loans to finance seven additional Airbus aircraft with interest rates based on LIBOR plus margins that adjust quarterly or semi-annually. At September 30, 2003 interest rates for these loans ranged from 2.375% to 2.888%. Each loan has a term of 12 years, and each loan has balloon payments ranging from \$4,800,000 to \$7,770,000 at the end of the term. The loans are secured by the aircraft.

During the six months ended September 30, 2003, we borrowed an additional \$75,600,000 for the purchase of three Airbus A318 aircraft. Each aircraft loan has a term of 12 years and is payable in monthly installments, including interest, payable in arrears, with a floating interest rate adjusted quarterly based on LIBOR plus a margin of 2.25%. At the end of the term, there is a balloon payment of \$3,060,000 for each aircraft loan. At September 30, 2003, interest rates for these loans ranged from 3.36% to 3.39%. The loans are secured by the aircraft.

In October 2003, we took delivery of an Airbus A318 aircraft and we borrowed \$22,000,000 for the purchase of that aircraft. The loan has a term of 12 years and is payable in monthly installments, including interest, payable in arrears, with a floating interest rate adjusted quarterly based on LIBOR plus a margin of

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1.95%. At the end of the term, there is a balloon payment of \$2,640,000. At September 30, 2003, the interest rate for this loan was 3.12%. The loan is secured by the aircraft. We entered into this loan agreement in October 2003 and the payment obligations are not included in the table.

- (2) As of September 30, 2003, we lease 11 Airbus 319 type aircraft and 19 Boeing 737 type aircraft under operating leases with expiration dates ranging from 2003 to 2014. Five of the Boeing 737 type aircraft are no longer in service and are in the process of being brought into return conditions and returned to the aircraft lessors. 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 September 30, 2003, we had made cash security deposits of \$7,786,000 and had arranged for letters of credit of \$6,106,000 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. These supplemental rent payments are based on the number of flight hours flown and/or flight departures and 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, as subsequently amended, to lease 15 new Airbus aircraft for a term of 12 years. As of September 30, 2003, we had arranged for issuance of letters of credit on the remaining six aircraft we agreed to lease totaling \$1,235,000, to secure these leases, collateralized by restricted cash balances.

During the six months ended September 30, 2003, we entered into three additional aircraft lease agreements; one for two additional Airbus A318 aircraft, scheduled for delivery in May 2004 and March 2005, and one additional Airbus A319 aircraft, scheduled for delivery in February 2005; another for eight A319s with deliveries in January, March, May, and June of 2005, March, April and May of 2006, and one in February 2007; and two additional A319 aircraft, one of which we took delivery of in September 2003 as a result of the sale leaseback transaction, and another that is scheduled for delivery in March 2004. As of September 30, 2003, we have made \$726,000 in security deposits for these aircraft. The lease commitment amounts are included in these amounts.

In July 2003, we entered into a letter of intent to lease another five Airbus A319 aircraft and executed a lease for one of these in October 2003. The scheduled delivery dates are in April, May, June, and December 2004; and the last one is scheduled for delivery in February 2006. As of September 30, 2003, we have made \$500,000 in security deposits for these aircraft.

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 2003 to 2014. In addition, we lease certain airport gate facilities on a month-to-month basis. Amounts for leases that are on a month-to-month basis are not included as an obligation in the table above.

- (3) We have adopted a fleet replacement plan to phase out our Boeing 737 aircraft and replace them with a combination of Airbus A319 and A318 aircraft. In March 2000, we entered into an agreement, as subsequently amended, to purchase up to 17 new Airbus aircraft. Included in the purchase commitment are amounts for spare aircraft components to support the aircraft. We are not under any contractual obligations with respect to spare parts. As of September 30, 2003, we had taken delivery of 15 of these aircraft, one of which we sold in December 2002. Prior to the delivery of the aircraft we assigned two of the purchase commitments to two lessors in February 2003 and September 2003. We agreed to lease two of these aircraft over a five year term and the third for a 12 year term. As of September 30, 2003, we have remaining firm purchase commitments for two additional aircraft which, one of which we took delivery of in October 2003 and one of which is scheduled to be delivered in April 2004. Under the terms of the purchase agreement, we are required to make scheduled pre-delivery payments for these

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aircraft. These payments are non-refundable with certain exceptions. As of September 30, 2003, we had made pre-delivery payments on future deliveries totaling \$10,474,000 to secure the remaining aircraft.

In August 2003, we amended the purchase agreement with Airbus to purchase 15 additional firm Airbus A319 aircraft purchases. Our purchase agreement with Airbus also includes purchase rights for up to 23 additional aircraft, and allows us to purchase Airbus A318 or A320 aircraft in lieu of the A319 aircraft at our option. The firm Airbus A319 aircraft have scheduled delivery dates beginning in calendar year 2004 and continuing through 2008. Under the terms of the amendment, we have rights to modify some or all of these additional aircraft into A320 aircraft by providing Airbus notice prior to December 31, 2004. The amendment also requires us to lease at least three new Airbus A319 or A320 aircraft from operating lessors for delivery in calendar year 2004. Including these three aircraft, we intend to lease as many as 14 additional A318 or A319 aircraft from third party lessors over the next five years. As of September 30, 2003, we had made pre-delivery payments on future deliveries totaling \$15,411,000 to secure these aircraft. In August 2003, we entered into a letter of intent to a sale leaseback of two of these aircraft. As the agreement has not been fully negotiated and executed, the purchase amounts of these two aircraft are included in the purchase commitment amounts.

In October 2002 we entered into a purchase and 12 year services agreement with LiveTV to bring DIRECTV AIRBORNE(TM) satellite programming to every seatback in our Airbus fleet. We have agreed to the purchase of 46 units of the hardware; however, we have the option to cancel up to a total of 6 units by providing written notice of cancellation at least 12 months in advance of installation. As of September 30, 2003, we have purchased 22 units and have made deposits toward the purchase of 7 units. The table above includes the remaining purchase commitment amounts not yet paid for on the remaining firm 18 units.

### Commercial Commitments

As we enter new markets, increase the amount of space leased, or add leased aircraft, we are often required to provide the airport authorities and lessors with a letter of credit, bond or cash security deposits. These generally approximate up to three months of rent and fees. As of September 30, 2003, we had outstanding letters of credit, bonds, and cash security deposits totaling \$12,416,000, \$4,267,000, and \$12,911,000, 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 financial institution for up to \$20,000,000, which expires November 30, 2003. These credit lines can be used solely for the issuance of standby letters of credit. Any amounts drawn under the credit agreements are fully collateralized by certificates of deposit, which are carried as restricted investments on our balance sheet. As of September 30, 2003, we have drawn \$12,416,000 under these credit agreements for standby letters of credit that collateralize certain leases. In the event that these credit agreements are not renewed beyond their present expiration dates, the certificates of deposit would be redeemed and paid to the 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 companies 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 use the Airline Reporting Corporation ("ARC") to provide reporting and settlement services for travel agency sales and other related transactions. In order to maintain the minimum bond (or irrevocable 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, net profit margin percentage, working capital ratio, and percent of debt to debt plus equity. As of September 30, 2003, we met these financial tests and presently are only obligated to provide the minimum amount

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of \$100,000 in coverage to ARC. If we were to fail the minimum testing requirements, we would be required to increase our bonding coverage to four times the weekly agency net cash sales (sales net of refunds and agency commissions). Based on net cash sales remitted to us for the week ended October 31, 2003, the coverage would be increased to 5,505,000 if we failed the tests. If we were 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.

In November 2002, we initiated a fuel hedging program comprised of swap and collar agreements. Under a swap agreement, we receive the difference between a fixed swap price and a price based on 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, we pay the difference. A collar agreement has a cap price, a primary floor price, and 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 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 obligated to pay the difference between the primary and secondary floor prices. When the price is between the cap price and the primary floor the hedge has no cash effect.

We entered into a three-way collar in November 2002 with a notional volume of 385,000 gallons per month for the period December 1, 2002 to November 30, 2003. The cap prices for this agreement is 82¢ per gallon, and the primary and secondary floor prices are at 72 and 64.5¢ per gallon, respectively. This agreement is estimated to represent 5% of our fuel purchases for that period. In April 2003, we entered into a swap agreement with a notional volume of 1,260,000 gallons per month for the period from July 1, 2003 to December 31, 2003. The fixed price of the swap is 71.53¢ per gallon and the agreement is estimated to represent 15% of our fuel purchases for that period. 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 is 74.50¢ per gallon and the agreement is estimated to represent 7% of our fuel purchases for that period. Our results of operations for the three months ended September 30, 2003 include an unrealized derivative loss of \$276,000 which is included in fuel expense and a realized gain of approximately \$240,000 in cash settlements recovered from the counter-party recorded as a decrease in fuel expense. We were not a party to any derivative contracts during the three or six months ended September 30, 2002.

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. At September 30, 2003, our interest rate swap agreement had an estimated unrealized loss of \$249,000, \$117,000 of which was recorded as accumulated other comprehensive loss and is included in the balance sheet. We did not have any interest rate swap agreements outstanding during the six months ended September 30, 2002.

Effective January 1, 2003, we entered into an engine maintenance agreement with GE Engine Services, Inc. ("GE") covering the scheduled and unscheduled repair of our aircraft engines used on most of our Airbus aircraft. The agreement is for a 12 year period from the effective date for our owned aircraft or December 31, 2014, whichever comes first, and for each leased aircraft, the term coincides 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 multiplied by the number of flight hours flown on the aircraft during that month. The amounts due based on flight hours are not included in table above.

### Critical Accounting Policies

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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 date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Critical accounting policies are defined as those that are both important to the portrayal of our financial condition and results, and require management to exercise significant judgments. Our most critical accounting policies are described briefly below. For additional information about these and our other significant accounting policies, see Note 1 of the Notes to the Financial Statements.

### **Revenue Recognition**

Passenger, cargo, and other revenues are recognized when the transportation is provided or 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 accompanying balance sheet as air traffic liability.

### **Impairment of Long-Lived Assets**

We record impairment losses on long-lived assets used in operations when indicators of impairment are present and the undiscounted future cash flows estimated to be generated by those assets are less than the carrying amount of the assets. If an impairment occurs, the loss is measured by comparing the fair value of the asset to its carrying amount.

### **Aircraft Maintenance**

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

Effective January 1, 2003, GE and we executed a 12-year engine services agreement (the "Services Agreement") covering the scheduled and unscheduled repair of most of our Airbus engines. Under the terms of the Services Agreement, we agreed to pay GE a fixed rate per-engine-hour, payable monthly, and GE assumed the responsibility to overhaul our engines on Airbus aircraft as required during the term of the Services Agreement, subject to certain exclusions. We believe the fixed rate per-engine hour approximates the periodic cost we would have incurred to service those engines. Accordingly, these payments are expensed as the obligation is incurred.

### **Fuel Derivative Instruments**

We have entered into derivative instruments which are intended to reduce our exposure to changes in fuel prices. We account for the derivative instruments entered into as trading instruments under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" and record the fair value of the derivatives as an asset or liability as of each balance sheet date. We record any settlements received or paid as an adjustment to the cost of fuel or interest expense.

### **Interest Rate Hedging Program**

During the six months ending September 30, 2003, we designated certain interest rate swaps as qualifying cash flow hedges. Under these hedging arrangements, we are hedging the interest payments associated with a portion of our LIBOR-based

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borrowings. Under the swap agreements, we pay a fixed rate of interest on the notional amount of the contracts of \$27 million, and we receive a variable rate of interest based on the three month LIBOR rate, which is reset quarterly. Changes in the fair value of interest rate swaps designated as hedging instruments are reported in accumulated other comprehensive income. These amounts are subsequently reclassified into interest expense as a yield adjustment in the same period in which the related interest payments on the LIBOR-based borrowings affects earnings.

### **Customer Loyalty Programs**

In February 2001, we established EarlyReturns, a frequent flyer program to encourage travel on our airline and customer loyalty. We account for the EarlyReturns program under the incremental cost method whereby travel awards are valued at the incremental cost of carrying one passenger based on expected 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 incremental 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 free travel award. We believe this is appropriate because the large majority of these participants are not expected to earn a free flight award. We do not record a liability for the expected redemption of miles for non-travel awards since the cost of these awards to us is negligible.

As of September 30, 2003 and 2002, we estimated that approximately 24,815 and 8,827 round-trip flight awards, respectively, were eligible for redemption by EarlyReturns members who have mileage credits exceeding the 15,000-mile free round-trip domestic ticket award threshold. Of these earned awards, we expect that approximately 84% would be redeemed. The difference between the round-trip awards outstanding and the awards expected to be redeemed is the estimate of awards which will (1) never be redeemed, or (2) be redeemed for something other than a free trip.

We account for point sales to third parties by allocating the funds received for each mile (or point) between a component representing the value of the subsequent travel award to be provided and the remainder being recognized in revenue at collection to cover marketing and other related costs to administer the program. The marketing component is not determined directly, but instead represents the residual after determination of the value of the travel component deferral. The component representing travel is determined based on an equivalent restricted fare, which is used as the value of travel on a frequent flyer mileage award. The travel component is recognized as revenue on a straight-line basis over the historical usage period of the frequent flyer mileage awards which we estimate to be 20 months.

### **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, 2003. Based on fiscal year 2003 actual fuel usage, such a change would have the effect of increasing or decreasing our aircraft fuel expense by approximately \$8,590,000 in fiscal year 2003. Comparatively, based on projected fiscal year 2004 fuel usage, such a change would have the effect of increasing or decreasing our aircraft fuel expense by approximately \$9,890,000 in fiscal year 2004, excluding the effects of our fuel hedging arrangements. The increase in exposure to fuel price fluctuations in fiscal year 2004 is due to the increase of our average aircraft fleet size during the year ended March 31, 2004, projected increases to our fleet during the year ended March 31, 2004 and related gallons purchased.

As of September 30, 2003, we had hedged approximately 12.8% of our remaining

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projected fiscal 2004 fuel requirements. In November 2002, we initiated a fuel hedging program comprised of swap and collar agreements. Under a swap agreement, we receive the difference between a fixed swap price and a price based on 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, we pay the difference. A collar agreement has a cap price, a primary floor price, and 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 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 obligated to pay the difference between the primary and secondary floor prices. When the price is between the cap price and the primary floor the hedge has no cash effect.

We entered into a three-way collar in November 2002, with a notional volume of 385,000 gallons per month for the period December 1, 2002 to November 30, 2003. The cap prices for this agreement is 82¢ per gallon, and the primary and secondary floor prices are 72 and 64.5¢ per gallon, respectively. The volume of fuel covered by this contract is estimated to represent 5% of our fuel purchases for that period. In April 2003, we entered into a third swap agreement with a notional volume of 1,260,000 gallons per month for the period from July 1, 2003 to December 31, 2003. The fixed price of the swap is 71.53¢ per gallon and the agreement is estimated to represent 15% of our fuel purchases for that period. 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, 2003 to June 30,, 2004. The fixed price of the swap is 74.50¢ per gallon and the agreement is estimated to represent 7% of our fuel purchases for that period. The results of operations for the quarter ended September 30, 2003 include an unrealized derivative gain of \$475,000 which is included in fuel expense and a realized gain of approximately \$28,000 in cash settlements received from a counter-party recorded as a decrease in fuel expense. We were not a party to any derivative contracts during the six months ended September 30, 2002.

### **Interest**

We are susceptible to market risk associated with changes in variable interest rates on long-term debt obligations we incurred to finance the purchases of our Airbus aircraft and our government guaranteed loan. Interest expense on seven of our owned Airbus A319 aircraft is subject to interest rate adjustments every three to six months based upon changes in the applicable LIBOR rate. The interest rate on borrowings under our government guaranteed loan is also subject to adjustment based on changes in the applicable LIBOR rates. 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 \$2,513,000 assuming the loans outstanding that are subject to interest rate adjustments at September 30, 2003 totaling \$251,376,000 are outstanding for the entire period. As of September 30, 2003, we had hedged approximately 10.7% of our variable interest rate loans.

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 over the term of the swap which expires in March 2007. As of September 30, 2003, the fair value of the swap agreement is a loss of \$249,000.

### **Item 4. Controls and Procedures**

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15. Based upon that evaluation, our Chief Executive Officer

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and Chief Financial Officer concluded that our disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under 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 have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out this evaluation.

### PART II. OTHER INFORMATION

#### Item 4: Submission of Matters to a Vote of Security Holders

Our annual meeting of shareholders was held on September 4, 2003, at which a quorum for the transaction of business was present. One matter was voted upon, as described below.

Members of the Board of Directors elected at the meeting were Samuel D. Addoms, Hank Brown, D. Dale Browning, Paul S. Dempsey, William B. McNamara, B. Larae Orullian, Jeff S. Potter, and James B. Upchurch. The votes cast with respect to each nominee were as follows:

|                                |                      |
|--------------------------------|----------------------|
| 18,193,479 "For" Mr. Addoms;   | 8,349,763 "Withheld" |
| 23,867,207 "For" Mr. Brown;    | 2,676,034 "Withheld" |
| 23,856,871 "For" Mr. Browning; | 2,686,371 "Withheld" |
| 23,860,264 "For" Mr. Dempsey;  | 2,682,978 "Withheld" |
| 23,840,753 "For" Mr. McNamara; | 2,702,489 "Withheld" |
| 23,841,241 "For" Ms. Orullian; | 2,702,001 "Withheld" |
| 23,861,524 "For" Mr. Potter    | 2,681,718 "Withheld" |
| 23,849,141 "For" Mr. Upchurch; | 2,694,101 "Withheld" |

#### Shareholder Proposals

Shareholders are entitled to submit proposals on matters appropriate for shareholder action consistent with regulations of the Securities and Exchange Commission and our bylaws. If a shareholder wishes to have a proposal appear in our proxy statement for next year's annual meeting, under the regulations of the Securities and Exchange Commission it must be received by our Corporate Secretary at 7001 Tower Road, Denver, Colorado 80249-7312 on or before March 19, 2004.

#### Item 6: Exhibits and Reports on Form 8-K

##### (a) Exhibits

##### Exhibit Numbers

Exhibit 10 - Material Contracts

10.21 Credit Agreement dated as of July 30, 2003 between Frontier Airlines, Inc. and a Lender in respect to an Airbus 318 aircraft. Frontier has financed the purchase of 3 additional Airbus 318 aircraft with this

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Lender under Credit Agreements that are substantially identical in all material respects to this Exhibit. Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (1)

10.22 Aircraft Mortgage and Security Agreement dated as of July 30, 2003 between Frontier Airlines, Inc. and a Lender in respect to an Airbus 318 aircraft. Frontier has financed the purchase of 3 additional Airbus 318 aircraft with this Lender under Aircraft Mortgage and Security Agreements that are substantially identical in all material respects to this Exhibit. Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (1)

10.23 Codeshare Agreement dated as of September 18, 2003 between Horizon Air Industries, Inc. and Frontier Airlines, Inc. Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (1)

### Exhibit 31 - Rule 13a-14(a)/15d-14(a) Certifications

31.1 Section 302 certification of President and Chief Executive Officer, Jeffery S. Potter. (1)

31.2 Section 302 certification of Chief Financial Officer, Paul H. Tate. (1)

### Exhibit 32 - Section 1350 Certifications

32 Section 906 certification of President and Chief Executive Officer, Jeffery S. Potter, and Chief Financial Officer, Paul H. Tate (1)

(1) Filed herewith.

### (b) Reports on Form 8-K

During the quarter ended September 30, 2003, the Company filed the following reports on Form 8-K.

| Date of Report     | Item Numbers | Financial Statements Required to be Filed |
|--------------------|--------------|-------------------------------------------|
| July 31, 2003      | 7 and 12     | None                                      |
| September 4, 2003  | 5            | None                                      |
| September 18, 2003 | 7 and 9      | None                                      |
| September 19, 2003 | 5 and 7      | None                                      |

## SIGNATURES

Pursuant to the requirements of the Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

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FRONTIER AIRLINES, INC.

Date: November 7, 2003

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

Date: November 7, 2003

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