

SKYWEST INC  
Form 10-Q  
August 09, 2006

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

### Form 10-Q

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

For the quarterly period ended June 30, 2006

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-14719

**SKYWEST, INC.**

Incorporated under the laws of Utah

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

Edgar Filing: SKYWEST INC - Form 10-Q

444 South River Road  
St. George, Utah 84790  
(435) 634-3000

Indicate by a check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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

Class	Outstanding at August 7, 2006
Common stock, no par value	63,873,846

SKYWEST, INC.

QUARTERLY REPORT ON FORM 10-Q

TABLE OF CONTENTS

<u>PART I</u>	<u>Financial Information:</u>	
<u>Item 1.</u>	<u>Consolidated Balance Sheets as of June 30, 2006 (unaudited) and December 31, 2005</u>	3
	<u>Condensed Consolidated Statements of Income (unaudited) for the three and six months ended June 30, 2006 and 2005</u>	5
	<u>Condensed Consolidated Statements of Cash Flows (unaudited) for the six months ended June 30, 2006 and 2005</u>	6
	<u>Notes to Condensed Consolidated Financial Statements</u>	7
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	14
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	25
<u>Item 4.</u>	<u>Controls and Procedures</u>	26
<u>PART II</u>	<u>Other Information:</u>	26
<u>Item 1.</u>	<u>Legal Proceedings</u>	26
<u>Item 1A.</u>	<u>Risk Factors</u>	26
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>	34
<u>Item 6.</u>	<u>Exhibits</u>	35
	<u>Signature</u>	36
Exhibit 31.1	Certification of Chief Executive Officer	
Exhibit 31.2	Certification of Chief Financial Officer	
Exhibit 32.1	Certification of Chief Executive Officer	
Exhibit 32.2	Certification of Chief Financial Officer	

**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****SKYWEST, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands)

## ASSETS

	<b>June 30, 2006 (unaudited)</b>	<b>December 31, 2005</b>
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 239,715	\$ 140,614
Marketable securities	167,939	159,054
Restricted cash	22,100	24,823
Income tax receivable	3,835	12,534
Receivables, net	53,766	28,267
Inventories	74,195	68,611
Prepaid aircraft rents	208,898	178,762
Deferred tax assets	39,978	41,012
Other current assets	56,395	39,955
Total current assets	866,821	693,632
<b>PROPERTY AND EQUIPMENT:</b>		
Aircraft and rotatable spares	2,777,657	2,727,595
Deposits on aircraft	36,569	90,235
Buildings and ground equipment	157,187	150,426
	2,971,413	2,968,256
Less-accumulated depreciation and amortization	(474,929)	(415,734)
Total property and equipment, net	2,496,484	2,552,522
<b>OTHER ASSETS</b>		
Intangible assets, net	31,874	33,043
Other assets	55,390	41,449
Total other assets	87,264	74,492
Total assets	\$ 3,450,569	\$ 3,320,646

See accompanying notes to condensed consolidated financial statements.

## LIABILITIES AND STOCKHOLDERS EQUITY

	June 30, 2006 (unaudited)	December 31, 2005
<b>CURRENT LIABILITIES:</b>		
Current maturities of long-term debt	\$ 243,985	\$ 331,145
Accounts payable	112,494	95,283
Lines of credit		60,000
Accrued salaries, wages and benefits	56,909	53,105
Accrued aircraft rents	26,656	26,279
Taxes other than income taxes	24,948	18,224
Other current liabilities	50,486	31,881
Total current liabilities	515,478	615,917
<b>OTHER LONG-TERM LIABILITIES</b>	36,704	33,829
<b>LONG-TERM LINE OF CREDIT</b>		30,000
<b>LONG-TERM DEBT, net of current maturities</b>	1,470,741	1,422,758
<b>DEFERRED INCOME TAXES PAYABLE</b>	243,608	225,068
<b>DEFERRED AIRCRAFT CREDITS</b>	85,009	79,876
<b>STOCKHOLDERS EQUITY:</b>		
Preferred stock, 5,000,000 shares authorized; none issued		
Common stock, no par value, 120,000,000 shares authorized; 70,483,245 and 65,509,631 shares issued, respectively	480,683	364,535
Retained earnings	652,740	582,620
Treasury stock, at cost, 6,794,056 shares	(32,551)	(32,551)
Accumulated other comprehensive loss	(1,843)	(1,406)
Total stockholders equity	1,099,029	913,198
Total liabilities and stockholders equity	\$ 3,450,569	\$ 3,320,646

See accompanying notes to condensed consolidated financial statements.

**SKYWEST, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(Dollars and Shares in Thousands, Except per Share Amounts)  
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
<b>Operating revenues:</b>				
Passenger	\$ 784,332	\$ 378,243	\$ 1,518,758	\$ 713,799
Ground handling and other	6,072	5,800	14,501	10,536
	790,404	384,043	1,533,259	724,335
<b>Operating expenses:</b>				
Flying operations	442,731	208,356	841,197	386,372
Customer service	99,390	55,984	199,066	111,761
Maintenance	73,779	34,349	152,090	66,381
Depreciation and amortization	47,262	21,611	92,751	42,642
General and administrative	37,621	19,147	75,671	38,136
	700,783	339,447	1,360,775	645,292
Operating income	89,621	44,596	172,484	79,043
<b>Other income (expense):</b>				
Interest income	4,225	3,381	7,132	6,343
Interest expense	(28,519 )	(7,392 )	(57,062 )	(14,037 )
Other	13		(1,084 )	
	(24,281 )	(4,011 )	(51,014 )	(7,694 )
Income before income taxes	65,340	40,585	121,470	71,349
Provision for income taxes	26,054	15,828	47,596	27,826
Net income	\$ 39,286	\$ 24,757	\$ 73,874	\$ 43,523
<b>Basic earnings per share</b>				
Basic earnings per share	\$ 0.62	\$ 0.43	\$ 1.21	\$ 0.75
<b>Diluted earnings per share</b>				
Diluted earnings per share	\$ 0.62	\$ 0.42	\$ 1.19	\$ 0.75
<b>Weighted average common shares:</b>				
Basic	62,970	57,671	61,044	57,670
Diluted	63,759	58,323	62,088	58,260
<b>Dividends declared per share</b>				
Dividends declared per share	\$ 0.03	\$ 0.03	\$ 0.06	\$ 0.06

See accompanying notes to condensed consolidated financial statements.

**SKYWEST, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**  
(In thousands)

	<b>Six Months Ended June,</b>	
	<b>2006</b>	<b>2005</b>
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	\$ 175,304	\$ 71,958
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of marketable securities	(13,476 )	(265,696 )
Sales of marketable securities	4,154	275,709
Acquisition / Disposition of property and equipment:		
Aircraft and rotatable spare parts	(40,673 )	(166,265 )
Deposits on aircraft	(416 )	(56,998 )
Buildings and ground equipment	(6,761 )	(6,267 )
Proceeds from sales of aircraft	7,322	11,734
Increase in other assets	(12,571 )	(2,487 )
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	(62,421 )	(210,270 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Payment on lines of credit	(90,000 )	
Tax benefit from exercise of common stock options	1,328	
Proceeds from issuance of long-term debt	7,093	140,980
Return of deposits on aircraft and rotatable spare parts	7,573	23,941
Principal payments on long-term debt	(46,270 )	(18,018 )
Net proceeds from issuance of common stock	110,097	2,714
Payment of cash dividends	(3,603 )	(3,513 )
<b>NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES</b>	(13,782 )	146,104
Increase in cash and cash equivalents	99,101	7,792
Cash and cash equivalents at beginning of period	140,614	113,020
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	\$ 239,715	\$ 120,812
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the year for:		
Interest, net of capitalized amounts	\$ 56,312	\$ 14,419
Income taxes	\$ 1,284	\$ 1,663
<b>NON-CASH INVESTING AND FINANCING ACTIVITIES</b>		
Deposits applied to delivered aircraft	\$	\$ 22,043
Debt transferred to operating lease	\$	\$ 55,375

See accompanying notes to condensed consolidated financial statements.

**SKYWEST, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**Note A Condensed Consolidated Financial Statements**

The condensed consolidated financial statements of SkyWest, Inc. ( SkyWest, we or us ) and its wholly-owned subsidiaries, SkyWest Airlines, Inc. ( SkyWest Airlines ) and Atlantic Southeast Airlines, Inc. ( ASA ) included herein have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although we believe that the following disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements reflect all adjustments that, in the opinion of management, are necessary to present fairly the results of operations for the interim periods presented. All adjustments are of a normal recurring nature, unless otherwise disclosed. We suggest that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005 and our Current Report on Form 8-K dated September 7, 2005. The results of operations for the three and six month periods ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

**Note B Acquisition of ASA**

On September 7, 2005, we completed our acquisition of all of the issued and outstanding capital stock of ASA. ASA is a regional airline with primary hub operations in Atlanta, Salt Lake City and Cincinnati.

Pursuant to the terms of the Stock Purchase Agreement entered into between us, Delta Air Lines, Inc. ( Delta ), and ASA Holdings, Inc. ( ASA Holdings ) we paid \$421.3 million in cash for ASA, plus \$5.3 million of transaction fees. Additionally, as part of the purchase, we assumed approximately \$1,251.3 million in long-term debt which combined with the amounts paid at closing, resulted in an aggregate purchase price of approximately \$1,677.9 million. The purchase price of ASA has been adjusted to reflect certain post-closing adjustments related to ASA's working capital as of September 7, 2005.

In connection with the acquisition of ASA, SkyWest Airlines and Delta entered into an Amended and Restated Delta Connection Agreement with Delta for SkyWest Airlines and entered into a Second Amended and Restated Delta Connection Agreement (collectively, the Delta Connection Agreements ) with Delta for ASA, whereby SkyWest Airlines, ASA, Delta agreed to provide regional airline service in the Delta flight system through SkyWest Airlines and ASA. Among other provisions, the Delta Connection Agreements provide for the transfer of certain ownership and lease rights among SkyWest Airlines, ASA, Delta and Comair Inc., a wholly-owned subsidiary of Delta ( Comair ). As part of the Delta Connection Agreements, SkyWest Airlines, ASA, Delta and/or Comair, as applicable, have terminated two master sublease agreements with respect to ten Canadair CRJ200 Regional Jets ( CRJ200s ) and transferred to Delta ten CRJ200s financed in part by an affiliate of Bombardier, and ASA and Delta entered into a sublease agreement whereby ASA will sublease the ten CRJ200s from Delta.

Under the terms of the Stock Purchase Agreement, Delta and ASA Holdings have agreed to indemnify us, and we have agreed to indemnify Delta and ASA Holdings from damages suffered due to breaches of representations, warranties or covenants made in the Stock Purchase Agreement. Recoveries under the indemnification provisions of the Purchase Agreement are subject to certain minimum losses per event, and an aggregate minimum for all losses. Recoveries are also subject to an aggregate cap on all losses.

The acquisition value of ASA was accounted for using the purchase method of accounting. Accordingly, the aggregate purchase price was assigned to the assets acquired and liabilities assumed based on fair market values at the respective purchase date. We recorded an intangible of approximately \$33 million relating to the acquisition of ASA. The intangible is being amortized over fifteen years under the straight-line method.

**Note C Stock Compensation**

Effective January 1, 2001, we adopted two stock option plans: the Executive Stock Incentive Plan (the Executive Plan ) and the 2001 Allshare Stock Option Plan (the Allshare Plan ). These plans replaced our Combined Incentive and Non-Statutory Stock Option Plans (the Prior Plans ); however, as of June 30, 2006, options to purchase approximately 940,000 shares of our common stock remained outstanding under the Prior Plans. The Executive Plan originally provided for the issuance of options to purchase up to





## Edgar Filing: SKYWEST INC - Form 10-Q

4,000,000 shares of common stock to officers, directors and other management employees of which 3,696,477 options had been issued as of June 30, 2006. The Allshare Plan originally provided for the issuance of options to purchase up to 4,000,000 shares of common stock to our employees, of which 2,508,961 options had been issued as of June 30, 2006. Our Board of Directors has adopted amendments that reduce the total number of shares issuable under the Executive Plan and the Allshare Plan to 3,700,000 and 2,510,000 shares, respectively. As of June 30, 2006, 3,523 shares and 1,039 shares remained available for issuance under the Executive Plan and the Allshare Plan, respectively.

At our annual meeting of shareholders held on May 2, 2006, our shareholders approved the adoption of the SkyWest, Inc. Long-Term Incentive Plan, which provides for the issuance of up to 6,000,000 shares of common stock to our directors, employees, consultants and advisors (the 2006 Incentive Plan ). The 2006 Incentive Plan provides for awards in the form of options to acquire shares of common stock, stock appreciation rights, restricted stock grants and performance awards. The Long-Term Plan is administered by the Compensation Committee of our Board of Directors (the Compensation Committee ) who is authorized to designate option grants as either incentive or non-statutory. Incentive stock options are granted at not less than 100% of the market value of the underlying common stock on the date of grant. Non-statutory stock options are granted at a price as determined by the Compensation Committee.

Prior to January 1, 2006, we applied Accounting Principles Board Opinion No. 25 and related interpretations in accounting for its stock-based compensation plans. Statement of Financial Accounting Standards ( SFAS ) No. 123, *Accounting for Stock-Based Compensation*, requires pro forma information regarding net income and net income per share as if we had accounted for its stock options under the fair value method. We did not record any stock-based compensation expense related to stock options for the year ended December 31, 2005.

The following table contains the pro forma disclosures and the related impact on net income and net income per share (in thousands, except per share information) relating to stock-based compensation:

	For the three months ended June 30, 2005	For the six months ended June 30, 2005
<b>Net income:</b>		
As reported	\$ 24,757	\$ 43,523
Stock based compensation under fair value method	1,564	3,164
Pro forma	\$ 23,193	\$ 40,359
<b>Net income per common share:</b>		
Basic as reported	\$ 0.43	\$ 0.75
Basic pro forma	\$ 0.40	\$ 0.70
Diluted as reported	\$ 0.42	\$ 0.75
Diluted pro forma	\$ 0.40	\$ 0.69

Effective January 1, 2006, we adopted the fair value recognition provisions of SFASB No. 123(R), *Share-Based Payment* ( SFAS No. 123(R) ), using the modified-prospective-transition method. Under the modified-prospective-transition method, compensation cost recognized during the three and six months ended June 30, 2006 includes compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123(R). Results for prior periods have not been restated.

The fair value of stock options has been estimated as of the grant date using the Black-Scholes option pricing model. During the three months ended June 30, 2006 we granted 377,303 stock options to employees. The following table shows the assumptions used and weighted average fair value for grants in the three months ended June 30, 2006 and for the years ended December 31, 2005 and 2004.

	2006	2005	2004
Expected annual dividend rate	0.70	% 0.70	% 0.63
Risk-free interest rate	4.31	% 3.87	% 2.75
Average expected life (years)	4.1	6.0	4.0
Expected volatility of common stock	.294	.391	.422

Edgar Filing: SKYWEST INC - Form 10-Q

Forfeiture rate	6.0	%	6.7	%	6.6	%
Weighted average fair value of options grants	\$	6.80	\$	7.04	\$	6.66

8

---

## Edgar Filing: SKYWEST INC - Form 10-Q

As required by SFAS 123(R), we recorded share-based compensation expense only for those options that are expected to vest. The estimated fair value of the stock options is amortized over the vesting period of the respective stock option grants.

During the three months ended June 30, 2006, we granted 317,901 shares of restricted stock to our employees under the 2006 Long Term Incentive Plan. The restricted stock has a three year vesting period, during which the recipient must remain employed with SkyWest or our subsidiaries. Additionally, we granted 12,600 fully-vested shares of restricted stock to our directors. The fair value of the stock on the date of grants made during three months ended June 30, 2006 was \$23.80 per share.

During the three and six months ended June 30, 2006, we recorded pre-tax equity based compensation expense of \$3.1 million and \$4.7 million, respectively, related to the adoption of SFAS No. 123(R) and due to the issuance of restricted stock under the SkyWest, Inc. 2006 Incentive Plan. As a result of adopting SFAS No. 123(R) on January 1, 2006, our net income for the three and six months ended June 30, 2006 was \$1.6 million and \$2.9 million lower, respectively, than if we had continued to account for share-based compensation under Opinion 25. Basic and diluted earnings per share for the three months ended June 30, 2006 were \$0.03 and \$0.02 lower, respectively, than if we had continued to account for share-based compensation under Opinion 25. Basic and diluted earnings per share for the six months ended June 30, 2006 were \$0.05 and \$0.04 lower, respectively, than if we had continued to account for share-based compensation under Opinion 25.

Prior to the adoption of SFAS No.123(R), we presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the Statement of Cash Flows. SFAS No.123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. The \$1.3 million excess tax benefit for the six months ended June 30, 2006 classified as a financing cash inflow would have been classified as an operating cash inflow if we had not adopted SFAS No.123(R).

We had \$17.1 million of total unrecognized compensation cost related to non-vested stock options and non-vested restricted stock grants. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures. We expect to recognize this cost over a weighted average period of 1.5 years.

We received approximately \$14.7 million in cash from option exercises during for the six months ended June 30, 2006.

### Note D Marketable Securities

Our investments in marketable debt securities are deemed by management to be available for sale and are reported at fair market value with the net unrealized appreciation or depreciation reported as a component of accumulated other comprehensive loss in stockholders' equity. At the time of sale, any realized appreciation or depreciation, calculated by the specific identification method, is recognized in other income in our operating results. Our position in marketable debt securities as of June 30, 2006 and December 31, 2005 was as follows (in thousands):

Investment Types	June 30, 2006	Market Value	December 31, 2005	Market Value
	Cost (Unaudited)		Cost	
Bonds and bond funds	\$ 166,666	\$ 163,700	\$ 155,192	\$ 152,929
Asset backed securities	4,332	4,239	6,167	6,125
	170,998	167,939	161,359	159,054
Unrealized depreciation	(3,059 )		(2,305 )	
Total	\$ 167,939	\$ 167,939	\$ 159,054	\$ 159,054

## Edgar Filing: SKYWEST INC - Form 10-Q

Marketable securities had the following maturities as of June 30, 2006 (in thousands):

<b>Maturities</b>		
July	Dec 2006	\$ 82,868
Year 2007 through 2010		6,143
Years 2011 through 2015		2,771
Thereafter		76,157

We classified all marketable securities as short-term since we have the intent to maintain a liquid portfolio and the right to redeem the securities within the next year.

### Note E Passenger and Ground Handling Revenue

We recognize passenger and ground handling revenues when the service is provided. Under our contract and pro-rate flying agreements with Delta and United revenue is considered earned when the flight is completed. In the event that our contractual rates have not been finalized at quarterly or annual financial statement dates, we record revenues based on a prior period's approved rates, adjusted to reflect management's current estimate of the results of the then-current contract negotiations.

On September 7, 2005, we completed our acquisition of all of the issued and outstanding capital stock of ASA from ASA Holdings, Inc. a subsidiary of Delta. ASA is a regional airline with primary hub operations in Atlanta, Salt Lake City and Cincinnati. In connection with the acquisition of ASA, SkyWest Airlines and ASA entered into Delta Connection Agreements with Delta which became effective September 8, 2005. On September 14, 2005, Delta filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. With the approval of the U.S. Bankruptcy Court charged with administration of Delta's reorganization proceedings, Delta assumed the Delta Connection Agreements on October 6, 2005.

Each of the Delta Connection Agreements provides for a fifteen-year term, subject to early termination by Delta or SkyWest Airlines or ASA, as applicable, upon the occurrence of certain events. Delta's termination rights include (i) cross-termination rights between the two Delta Connection Agreements, (ii) the right to terminate each of the Delta Connection Agreements upon the occurrence of certain force major events, including certain labor-related events, that prevent SkyWest Airlines or ASA from performance for certain periods, and (iii) the right to terminate each of the ASA Delta Connection Agreements if SkyWest Airlines or ASA fails to maintain competitive base rate costs, subject to certain adjustment rights. In addition to the termination rights, Delta has the right to extend the term of the Delta Connection Agreements upon the occurrence of certain events or at the expiration of the initial term. SkyWest Airlines and ASA have the right to terminate their respective Delta Connection Agreements upon the occurrence of certain breaches by Delta, including the failure to cure payment defaults. SkyWest Airlines and ASA also have cross-termination rights between the two Delta Connection Agreements.

Under the terms of the SkyWest Airlines Delta Connection Agreement, Delta has agreed to compensate us for our direct costs associated with operating the Delta Connection flights, plus a payment based on block hours flown. However, among other changes, the SkyWest Airlines Delta Connection Agreement established a multi-year rate reset provision. Under the terms of the ASA Delta Connection Agreement, Delta agrees to compensate ASA for its direct costs associated with operating the Delta Connection flights, plus, if ASA completes a certain minimum percentage of its Delta Connection flights, an additional percentage of such costs. Additionally, ASA's Delta Connection Agreement provides for the payment of incentive compensation upon satisfaction of certain performance goals. Under the ASA Delta Connection Agreement, excess margins over certain percentages must be returned or shared with Delta, depending on various conditions. The parties to the Delta Connection Agreements make customary representations, warranties and covenants, and the agreements contain other provisions typical of agreements of this kind, including with respect to various operational, marketing and administrative matters.

The SkyWest Airlines and ASA Delta Connection Agreements also provide a weekly payment for an amount per aircraft designed to reimburse us for certain aircraft ownership costs. In accordance with Emerging Issues Task Force No. 01-08, Determining Whether an Arrangement Contains a Lease, we have concluded that a component of its revenue under the Delta Connection Agreements is rental income, inasmuch as the Delta Connection Agreements identify the right of use of a specific type and number of aircraft over a stated period of time. The amounts deemed to be rental income under the Delta Connection Agreement for the three months ended June 30, 2006 and 2005 were \$71.1 million and \$18.9 million, respectively. The amounts deemed to be rental income under the Delta Connection Agreement for the six months ended June 30, 2006 and 2005 were \$138.7 million and \$37.7 million, respectively. These amounts were recorded in passenger revenue on our consolidated statements of income.



## Edgar Filing: SKYWEST INC - Form 10-Q

Effective July 31, 2003, SkyWest Airlines entered into the United Express Agreement, which sets forth the principal terms and conditions governing our United Express operations. Under the terms of the United Express Agreement, SkyWest Airlines is compensated primarily on a fee-per-completed-block hour and departure basis and is reimbursed for fuel and other costs. Additionally, SkyWest Airlines is eligible for incentive compensation upon the achievement of certain performance criteria.

The United Express Agreement also provides a monthly reimbursement for an amount per aircraft designed to reimburse us for certain aircraft ownership costs. In accordance with EITF 01-08, we have concluded that a component of our revenue under the United Express Agreement is rental income, inasmuch as the United Express Agreement identifies the right of use of a specific type and number of aircraft over a stated period of time. The amounts deemed to be rental income under the United Express Agreement for the three months ended June 30, 2006 and 2005 were \$48.8 million and \$41.7 million, respectively. The amounts deemed to be rental income under the United Express Agreement for the six months ended June 30, 2006 and 2005 were \$98.5 million and \$79.2 million, respectively. These amounts were recorded in passenger revenue on our consolidated statements of income. The United Express Agreement contains certain provisions pursuant to which the parties could terminate the agreement, subject to certain rights of the other party, if certain performance criteria are not maintained.

Our revenues could be impacted by a number of factors, including changes to our code-share agreements with Delta and United, contract modifications resulting from contract re-negotiations and our ability to earn incentive payments contemplated under our code-share agreements.

The preparation of financial statements in conformity with accounting principals 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.

### Note F Net Income Per Common Share

Basic net income per common share ( Basic EPS ) excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share ( Diluted EPS ) reflects the potential dilution that could occur if stock options or other contracts to issue common stock were exercised or converted into common stock. The computation of Diluted EPS does not assume exercise or conversion of securities that would have an anti-dilutive effect on net income per common share. During the three months ended June 30, 2006 and 2005, options to acquire 1,265,000 and 3,770,000 shares, respectively, were excluded from the computation of Diluted EPS as their impact was anti-dilutive. During the six months ended June 30, 2006 and 2005, options to acquire 633,000 and 3,775,000 shares, respectively, were excluded from the computation of Diluted EPS as their impact was anti-dilutive.

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

	Three months ended June 30, (unaudited)		Six months ended June 30, (unaudited)	
	2006	2005	2006	2005
<b>Numerator</b>				
Net Income	\$ 39,286	\$ 24,757	\$ 73,874	\$ 43,523
<b>Denominator</b>				
Weighted average number of common shares outstanding	62,970	57,671	61,044	57,670
Effect of outstanding stock compensation	789	652	1,044	590
Weighted average number of shares for Diluted net income per common share	63,759	58,323	62,088	58,260
Basic earnings per share	\$ 0.62	\$ 0.43	\$ 1.21	\$ 0.75
Diluted earnings per share	\$ 0.62	\$ 0.42	\$ 1.19	\$ 0.75





Edgar Filing: SKYWEST INC - Form 10-Q

Note G Comprehensive Income

We report comprehensive income in accordance with SFAS No. 130, *Reporting Comprehensive Income*, which establishes standards for reporting and displaying comprehensive income and its components in financial statements. Comprehensive income includes charges and credits to stockholders' equity that are not the result of transactions with shareholders. Also, our comprehensive income consisted of net income plus changes in unrealized depreciation on marketable securities, net of tax, for the periods indicated (in thousands):

	Three months ended June 30, (unaudited)		Six months ended June 30, (unaudited)	
	2006	2005	2006	2005
<b>Net Income</b>	\$ 39,286	\$ 24,757	\$ 73,874	\$ 43,523
Unrealized appreciation (depreciation) on marketable securities, net of tax	(206 )	600	(437 )	(211 )
<b>Comprehensive income</b>	\$ 39,080	\$ 25,357	\$ 73,437	\$ 43,312

Note H Long-term Debt and Lines of Credit

Long-term debt consisted of the following for the periods indicated (in thousands):

	June 30, 2006 (Unaudited)	December 31, 2005
Notes payable to banks, due in semi-annual installments, variable interest based on LIBOR, or with interest rates ranging from 4.16% to 6.23% through 2012 to 2020, secured by aircraft	\$ 645,151	\$ 666,758
Notes payable to a financing company, due in semi-annual installments, variable interest based on LIBOR, or with interest rates ranging from 3.51% to 7.01% through 2006 to 2021, secured by aircraft	640,584	643,831
Notes payable to banks, due in semi-annual installments plus interest at 6.06% to 7.18% through 2021, secured by aircraft	289,883	297,624
Notes payable to a financing company, due in semi-annual installments plus interest at 5.78% to 6.23% through 2019, secured by aircraft	89,149	93,327
Notes payable to banks, due in monthly installments plus interest of 6.05% to 7.38% through 2020, secured by aircraft	30,436	31,406
Notes payable to banks, due in semi-annual installments, plus interest at 3.72% to 3.86%, net of the benefits of interest rate subsidies through the Brazilian Export financing program, through 2011, secured by aircraft	12,337	13,546
Notes payable to a bank, due in monthly installments interest based on LIBOR through 2012, interest rate at 7.9% secured by building	7,186	7,411
Long-term debt	\$ 1,714,726	\$ 1,753,903
Less current maturities	(243,985 )	(331,145 )
Long-term debt, net of current maturities	\$ 1,470,741	\$ 1,422,758

At June 30, 2006, the three-month and six-month LIBOR rates were 5.48% and 5.59%, respectively. At December 31, 2005, the three-month and six-month LIBOR rates were 4.54% and 4.70%, respectively.



## Edgar Filing: SKYWEST INC - Form 10-Q

The aggregate amounts of principal maturities of long-term debt as of June 30, 2006 were as follows (in thousands):

<b>For the twelve month period ended June 30,</b>	
2007	\$ 243,985
2008	102,041
2009	106,421
2010	111,009
2011	114,741
Thereafter	1,036,529
	<b>\$ 1,714,726</b>

As of December 31, 2005, we had \$30 million outstanding under a \$40 million line-of-credit facility with a bank. As of June 30, 2006, we repaid the borrowings under the facility. The facility expires on January 31, 2007 and bears interest at a rate equal to prime less 0.25%. Additionally, as of December 31, 2005, we had \$60 million outstanding under another borrowing facility with a financing company. As of June 30, 2006, we repaid the borrowings under the second facility and the facility was terminated.

During the six months ended June 30, 2006, ASA refinanced six Canadair CRJ700 Regional Jets from short-term financing arrangements facilities into long-term financing facilities with the same financing company.

As of June 30, 2006, we had \$36.4 million in letters of credit and surety bonds outstanding with various banks and surety institutions.

Certain of our long-term debt arrangements contain limitations on, among other things, the sale or lease of assets and ratio of long-term debt to tangible net worth. As of June 30, 2006, we were in compliance with all debt covenants contained in our long-term debt agreements.

### Note I Commitments and Contingencies

We lease 258 aircraft, as well as airport facilities, office space, and various other property and equipment under non-cancelable operating leases which are generally on a long-term net rent basis where we pay taxes, maintenance, insurance and certain other operating expenses applicable to the leased property. We expect that, in the normal course of business, leases that expire will be renewed or replaced by other leases. The following table summarizes future minimum rental payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of June 30, 2006 (in thousands):

July through December 2006	\$ 151,926
2007	302,277
2008	278,434
2009	293,723
2010	287,274
2011	284,170
Thereafter	1,924,928
	<b>\$ 3,522,732</b>

On June 30, 2006, we had commitments of approximately \$463 million to purchase 17 Canadair CRJ900 Regional Jets ( CRJ900s ), four CRJ200s and related flight equipment. We currently anticipate that we will take delivery of these aircraft from July 2006 through April 2007. We have also obtained options to acquire another 70 CRJ aircraft that can be delivered in either 70 or 90-seat configurations. We presently anticipate that delivery dates for these aircraft could start in May 2007 and continue through April 2010; however, actual delivery dates remain subject to final determination as agreed upon by us and our code-share partners.

In January 2003, the FASB issued Interpretation No. 46, or (FIN 46), *Consolidation of Variable Interest Entities*, which requires the consolidation of variable interest entities. The majority of our leased aircraft are owned and leased through trusts whose sole purpose is to purchase, finance and lease these aircraft to us; therefore, they meet the criteria of a variable interest entity. However, since these are single owner trusts in which we do not participate, we believe that we are not at risk for losses and are not considered the primary beneficiary. As a result, we are not required to consolidate any of these trusts or any other entities in applying FIN 46. We believe that our maximum exposure under these leases is the aggregated amount of the remaining lease

payments.

13

---

We have leveraged lease agreements that typically require us to indemnify the equity/owner participant against liabilities that may arise due to changes in benefits from tax ownership of the respective leased aircraft. The terms of these contracts range up to 18 years. We have not accrued any liability relating to these indemnification obligations to the equity/owner participants because we believe the probability of material claims arising under the indemnification provisions is remote.

#### Note J Capital Transactions

On April 17, 2006, we completed a public offering of 4,000,000 shares of common stock at a price of \$26.05 per share. We received approximately \$99.3 million in net proceeds which were used to pay off two revolving lines of credit, to provide working capital and for general corporate purposes.

#### Note K Legal Matters

We are subject to certain legal actions which we consider routine to our business activities. As of June 30, 2006, our management believed, after consultation with legal counsel, that the ultimate outcome of such legal matters is not likely to have a material adverse effect on our financial position, liquidity or results of operations.

## ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Overview

*The following discussion and analysis presents factors that had a material effect on the results of operations of SkyWest, Inc. ( SkyWest we or us ) during the three and six month periods ended June 30, 2006 and 2005. Also discussed is our financial position as of June 30, 2006 and 2005. You should read this discussion in conjunction with our consolidated financial statements, including the notes thereto, appearing elsewhere in this report or incorporated herein by reference. This discussion and analysis contains forward-looking statements. Please refer to the sections of this Report entitled Cautionary Statement Concerning Forward-Looking Statements and Risk Factors for discussion of the uncertainties, risks and assumptions associated with these statements.*

### Overview

Through our wholly-owned subsidiaries, SkyWest Airlines, Inc. ( SkyWest Airlines ) and Atlantic Southeast Airlines, Inc. ( ASA ), we operate the largest regional airline in the United States. As of June 30, 2006, SkyWest Airlines and ASA offered scheduled passenger and air freight service with approximately 2,464 total daily departures to 285 destinations in the United States, Canada, Mexico and the Caribbean. Additionally, we provide ground handling services for approximately ten other airlines throughout our system. As of June 30, 2006, our consolidated fleet consisted of 231 Bombardier CRJ200 Regional Jets ( CRJ200s ) (66 assigned to United Air Lines, Inc. ( United ) and 165 assigned to Delta Air Lines, Inc. ( Delta ), 92 Bombardier CRJ700 Regional Jets ( CRJ700s ) (52 assigned to United and 40 assigned to Delta), 62 Embraer EMB-120 Brasilia turboprops ( Brasilia turboprops ) (50 assigned to United and 12 assigned to Delta), and 12 Avions de Transport 72-210 turboprops ( ATR-72 turboprops ) (all assigned to Delta). We believe our success in attracting multiple contractual relationships with major airline partners is attributable to our delivery of high-quality customer service with an all cabin-class fleet at a competitive cost structure. For the month of June 30, 2006, approximately 57.7% of our aggregate capacity was operated under the Delta code and approximately 42.3% was operated under the United code.

SkyWest Airlines has been a partner with Delta in Salt Lake City and United in Los Angeles since 1987 and 1997, respectively. In 1998, SkyWest Airlines expanded its relationship with United to provide service in Portland, Seattle/Tacoma, San Francisco and additional Los Angeles markets. In 2001, SkyWest Airlines expanded its operations to serve as the Delta Connection in Dallas/Fort Worth. Effective January 31, 2005, however, SkyWest Airlines re-deployed all its Delta Connection flights to Salt Lake City as a result of Delta's decision to de-hub its Dallas/Fort Worth operations. In 2004, SkyWest Airlines expanded its United Express operations to provide service in Chicago. As of June 30, 2006, SkyWest Airlines operated as a Delta Connection carrier in Salt Lake City, and as United Express carrier in Los Angeles, San Francisco, Denver, Chicago and the Pacific Northwest, operating approximately 1,630 total daily flights.

## Edgar Filing: SKYWEST INC - Form 10-Q

On September 7, 2005, we completed the acquisition of ASA from Delta for \$421.3 million in cash. Additionally, as part of the purchase, we paid \$5.3 million of transaction fees and ASA assumed approximately \$1.25 billion in long-term debt. In addition, we returned to Delta \$50 million in deposits that Delta had previously paid on future ASA aircraft deliveries. We believe the combination of SkyWest Airlines and ASA presents us with new opportunities for growth through our two geographically-focused regional airline platforms SkyWest Airlines in the Western United States and ASA in the Eastern United States. We now provide the vast majority of regional airline service for Delta in Atlanta, its most important eastern hub, and Salt Lake City, its most important western hub. In connection with our acquisition of ASA in September 2005, we have established new, separate, but substantially similar, long-term fixed-fee Delta Connection Agreements with Delta for both SkyWest Airlines and ASA. We also obtained control of 26 gates in the Hartsfield-Jackson International Airport located in Atlanta, from which we currently provide service to Delta. Delta has committed to provide to us opportunities to utilize 28 additional regional jets in our fleet by the end of 2007. Delta has also agreed that, starting in 2008, ASA is guaranteed to maintain its percentage of total Delta Connection flights that it has in 2007, so long as its bid for additional regional flying is competitive with other regional carriers.

ASA has been a code-share partner with Delta in Atlanta since 1984. ASA expanded its operations as a Delta Connection carrier to also include Cincinnati/Northern Kentucky and Salt Lake City in September 2002 and April 2003, respectively. ASA operates approximately 830 daily flights, all in the Delta Connection system.

Historically, multiple contractual relationships have enabled us to reduce reliance on any single major airline code and to enhance and stabilize operating results through a mix of our controlled or pro-rate flying and contract flying. On contract routes, the major airline partner controls scheduling, ticketing, pricing and seat inventories and we are compensated by the major airline partner at contracted rates based on the completed block hours, flight departures and other operating measures. On pro-rate flights, we control scheduling, ticketing, pricing and seat inventories and receive a pro-rated portion of passenger fares. Since August 1, 2003, substantially all of our ASM production was generated by contract flights. As of June 30, 2006, essentially all of our Brasilia turboprops flown for Delta were flown under pro-rate arrangements while approximately 64% of our Brasilia turboprops flown in the United States were flown under contractual arrangements, with the remaining 36% flown under pro-rate arrangements.

In September 2005, Delta filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. Prior to the date of Delta's bankruptcy filing, each of SkyWest Airlines and ASA entered into an amended Delta Connection Agreement which provides for a 15-year term, subject to certain termination and extension rights. Delta received all necessary approvals from the U.S. Bankruptcy Court and the Delta Connection Agreements were assumed by Delta on October 6, 2005. Under the terms of its Delta Connection Agreement, SkyWest Airlines is compensated primarily on a fee-per-completed-block hour and departure basis, is reimbursed for fuel and other direct costs, and is paid a margin based on completed block hours. Under its Delta Connection Agreement, ASA is compensated primarily on a fee-per-completed-block-hour basis, is directly reimbursed for fuel and other costs, and is paid a margin based on performance incentives. Notwithstanding the assumption by Delta of the Delta Connection Agreements, Delta's bankruptcy filing could still lead to many other unforeseen expenses, risks and uncertainties for SkyWest Airlines, ASA or both.

Although Delta has reported that it intends to reorganize and emerge from its ongoing Chapter 11 bankruptcy proceeding, it could convert its reorganization proceeding to a liquidation proceeding under the U.S. Bankruptcy Code or liquidate some or all of its assets through one or more transactions with third parties. Such events could jeopardize our Delta Connection operations, leave us unable to efficiently utilize the additional aircraft which we are currently obligated to purchase, or result in other outcomes which could have a material adverse effect on our operating results or financial condition.

Although a plan of reorganization has been confirmed in United's bankruptcy proceedings, which became effective on February 1, 2006, there is no assurance that United's plan will ultimately succeed. Among other uncertainties, United's order of confirmation is subject to a pending appeal. There is no assurance that United will be able to operate successfully under the terms of its plan. In the event United is not able to perform successfully under the terms of its plan, our United Express operations could be jeopardized, which could have a material adverse effect on our operating results or financial condition.

On February 4, 2005, we announced that SkyWest Airlines had been selected by United to operate 20 new CRJ700s in its United Express operations, and that SkyWest Airlines had placed a firm order for these CRJ700s with Bombardier. Deliveries of these aircraft began in the third quarter of 2005 and these deliveries were completed in March 2006. Our total firm aircraft orders and commitments, as of June 30, 2006, consisted of orders for 17 Bombardier CRJ900 Regional Jets ( CRJ900s ) and commitments to lease four CRJ200s from Delta. Total expenditures for these aircraft and related flight equipment, including amounts for contractual price escalations are estimated to be approximately \$463 million through April 2007. Additionally, our agreement with Bombardier includes options for another 70 aircraft that can be delivered in either 70 or 90-seat configurations. We presently anticipate that



delivery dates for these aircraft could start in January 2007 and continue through April 2010; however, actual delivery dates remain subject to final determination as agreed upon by us and our code-share partners.

#### Cautionary Statement Concerning Forward-Looking Statements

Certain of the statements contained in this Quarterly Report on Form 10-Q should be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may be identified by words such as may, will, expect, intend, anticipate, believe, estimate, plan, project, could, should, hope, likely, and continue and similar with statements regarding our outlook, the revenue environment, our contract relationships, and our expected financial performance. These statements include, but are not limited to, statements about the benefits of our acquisition of ASA, including our future financial and operating results, our plans for SkyWest Airlines and ASA, our objectives, expectations and intentions and other statements that are not historical facts. You should also keep in mind that all forward-looking statements are based on our existing beliefs about present and future events outside of our control and on assumptions that may prove to be incorrect. If one or more risks identified in this report, or any applicable filings materializes, or any other underlying assumptions prove incorrect, our actual results may vary materially from those anticipated, estimated, projected, or intended. These risks and uncertainties include, but are not limited to, those described below in Item 1A., Risk Factors, and the following:

- our ability to achieve anticipated potential benefits with respect to our acquisition of ASA;
- our ability to obtain and maintain financing necessary for operations and other purposes;
- our ability to maintain adequate liquidity;
- the impact of high fuel prices on the airline industry;
- the impact of global instability, including the continued impact of the United States military presence in foreign countries, the September 11, 2001 terrorist attacks and the potential impact of future hostilities, terrorist attacks or other global events;
- our ability to attract and retain code-share partners;
- changes in our code-share relationships;
- the cyclical nature of the airline industry;
- Competitive practices in the airline industry, including significant fare-restructuring activities, capacity reductions and bankruptcy and other airline restructurings by major and regional carriers, including Delta and United;
- global and national economic conditions;
- labor costs;
- security-related and insurance costs;
- weather conditions;
- government legislation and regulation;
- unfavorable resolution of negotiations with municipalities for the leasing of facilities;
- relations with ASA's unionized employees and the impact and outcome of labor negotiations;



- unionization efforts among SkyWest Airlines employees; and
- other risks and uncertainties listed from time to time in our reports filed with the SEC.

There may be other factors not identified above of which we are not currently aware that may affect matters discussed in the forward-looking statements, and may also cause actual results to differ materially from those discussed. We assume no obligation to publicly update any forward-looking statement to reflect actual results, changes in assumptions or changes in other factors affecting these statements other than as required by law.

#### **Critical Accounting Policies**

Our significant accounting policies are summarized in Note 1 to our consolidated financial statements for the year ended December 31, 2005, which are presented in our Annual Report on Form 10-K filed with the SEC on March 14, 2006. Critical accounting policies are those policies that are most important to the preparation of our consolidated financial statements and require management's subjective and complex judgments due to the need to make estimates about the effect of matters that are inherently uncertain. Our critical accounting policies relate to revenue recognition, aircraft maintenance, aircraft leases and impairment of long-lived assets and intangibles as discussed below. The application of these accounting policies involves the exercise of judgment and the use of assumptions as to future uncertainties and, as a result, actual results will differ, and could differ materially from such estimates.

**Adoption of SFAS No. 123(R)**

Prior to January 1, 2006, we applied Accounting Principles Board Opinion No. 25 and related interpretations in accounting for its stock-based compensation plans. Statement of Financial Accounting Standards ( SFAS ) No. 123, *Accounting for Stock-Based Compensation*, requires pro forma information regarding net income and net income per share as if we had accounted for our stock options under the fair value method. We did not record any stock-based compensation expense related to stock options for the year ended December 31, 2005.

Effective January 1, 2006 we adopted the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment*, using the modified-prospective-transition method. Under that modified-prospective-transition method, compensation cost recognized during the three months ended June 30, 2006 includes compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123(R). Results for prior periods have not been restated.

The fair value of stock options has been estimated as of the grant date using the Black-Scholes option pricing model. During the three months ended June 30, 2006 we granted 377,303 stock options to employees. The following table shows the assumptions used for grants in the three months ended June 30, 2006 and for the years ended December 31, 2005 and 2004.

	2006	2005	2004
Expected annual dividend rate	0.70 %	0.70 %	0.63 %
Risk-free interest rate	4.31 %	3.87 %	2.75 %
Average expected life (years)	4.1	6.0	4.0
Expected volatility of common stock	.294	.391	.422
Forfeiture rate	6.0 %	6.7 %	6.6 %

As required by SFAS 123(R), we recorded share-based compensation expense only for those options that are expected to vest. The estimated fair value of the stock options is amortized over the vesting period of the respective stock option grants.

During the three months ended June 30, 2006, we granted 317,901 shares of restricted stock to our employees under the SkyWest, Inc. 2006 Long Term Incentive Plan. The restricted stock has a three year vesting period, during which the recipient must remain employed with SkyWest or our subsidiaries. Additionally, we granted 12,600 fully-vested shares of restricted stock to our directors. The fair value of the stock on the date of grants made during three months ended June 30, 2006 was \$23.80 per share.

We had \$17.1 million of total unrecognized compensation cost related to non-vested stock options. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures. We expect to recognize this cost over a weighted average period of 1.5 years.

**Revenue Recognition**

Passenger and ground handling revenues are recognized when service is provided. Under our contract and pro-rate flying agreements with our code-share partners, revenue is considered earned when the flight is completed. In the event that our contractual rates have not been finalized at quarterly or annual financial statement dates, we record revenues based on a prior period's approved rates, adjusted to reflect management's current estimate of the results of the then-current contract negotiations. Our agreements with our code-share partners contain certain provisions pursuant to which the parties could terminate the respective agreements, subject to certain rights of the other party, if certain performance criteria are not maintained. Our revenues could be impacted by a number of factors, including changes to the code-share agreements, contract modifications resulting from contract renegotiations and our ability to earn incentive payments contemplated under applicable agreements.

**Maintenance**

We use the direct-expense method of accounting for our regional jet aircraft engine overhaul costs. Under this method, the maintenance liability is not recorded until the maintenance services are performed, thus substantially reducing significant estimates and judgments inherent under the accrual method. We use the deferral method of accounting for our Brasilia turboprop engine overhauls, which provides for engine overhaul costs to be capitalized and depreciated over the estimated useful life of the engine. For leased aircraft, we are subject to lease return provisions that require a minimum portion of the life of an overhaul be remaining on the engine at the



lease return date. With respect to engine overhauls related to leased Brasilia turboprops to be returned, we adjust the estimated useful lives of the final engine overhauls based on the respective lease return dates. With respect to SkyWest Airlines, a third-party vendor provides our long-term engine services covering the scheduled and unscheduled repairs for engines on our CRJ700s. Under the terms of the agreement, we pay a set dollar amount per engine hour flown on a monthly basis and the third-party vendor assumes the obligation to repair the engines at no additional cost to us, subject to certain specified exclusions.

### Aircraft Leases

The majority of SkyWest Airlines' aircraft are leased from third parties, while ASA's aircraft are primarily debt-financed on a long-term basis. In order to determine the proper classification of our leased aircraft as either operating leases or capital leases, we must make certain estimates at the inception of the lease relating to the economic useful life and the fair value of an asset as well as select an appropriate discount rate to be used in discounting future lease payments. These estimates are utilized by management in making computations as required by existing accounting standards that determine whether the lease is classified as an operating lease or a capital lease. All of our aircraft leases have been classified as operating leases, which results in rental payments being charged to expense over the terms of the related leases. Additionally, operating leases are not reflected in our condensed consolidated balance sheet and accordingly, neither a lease asset nor an obligation for future lease payments is reflected in our condensed consolidated balance sheet.

### Impairment of Long-Lived and Intangible Assets

As of June 30, 2006, we had approximately \$2.5 billion of property and equipment and related assets. Additionally, as of June 30, 2006, we had approximately \$31.9 million in net intangible assets. In accounting for these long-lived and intangible assets, we make estimates about the expected useful lives of the assets, the expected residual values of certain of these assets, and the potential for impairment based on the fair value of the assets and the cash flows they generate. We recorded an intangible of approximately \$33.8 million relating to the acquisition of ASA. The intangible is being amortized over fifteen years under the straight-line method. As of June 30, 2006, we had recorded \$1.9 million in accumulated amortization expense associated with the ASA intangible. Factors indicating potential impairment include, but are not limited to, significant decreases in the market value of the long-lived assets, a significant change in the condition of the long-lived assets and operating cash flow losses associated with the use of the long-lived assets. On a periodic basis, we evaluate whether the book value of our aircraft is impaired in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Based on the results of the evaluations, our management concluded no impairment was necessary as of June 30, 2006. However, there is inherent risk in estimating the future cash flows used in the impairment test. If cash flows do not materialize as estimated, there is a risk the impairment charges recognized to date may be inaccurate, or further impairment charges may be necessary in the future.

### Results of Operations

#### Three Months Ended June 30, 2006 and 2005

*Operating Statistics.* The following table sets forth our major operational statistics and the percentage-of-change for the quarters identified below.

	For the three months ended June 30,		
	2006	2005	% Change
Passengers carried	8,144,992	4,149,351	96.3 %
Revenue passenger miles (000)	4,054,908	1,910,017	112.3 %
Available seat miles (000)	5,070,300	2,536,065	99.9 %
Passenger load factor	80.0 %	75.3 %	4.7 pts
Passenger breakeven load factor	73.8 %	68.0 %	5.8 pts
Yield per revenue passenger mile	19.3 ¢	19.8 ¢	(2.5)%
Revenue per available seat mile	15.6 ¢	15.1 ¢	3.3 %
Cost per available seat mile	14.4 ¢	13.7 ¢	5.1 %
Fuel cost per available seat mile	5.2 ¢	4.2 ¢	23.8 %
Average passenger trip length (miles)	498	460	8.3 %



Our total available seat miles, or ASMs generated during the quarter ended June 30, 2006 increased 99.9% from the quarter ended June 30, 2005. The increase in ASMs was primarily a result of increasing the size of our aircraft fleet, including our acquisition of ASA, from 223 aircraft as of June 30, 2005, to 397 aircraft as of June 30, 2006. On the date we acquired ASA, ASA's fleet consisted of 149 aircraft (35 CRJ700s, 102 CRJ200s and 12 ATRs). In addition to the aircraft acquired in connection with the acquisition of ASA, we took delivery of 2 CRJ 200s during the three months ended June 30, 2006. Both aircraft delivered during the three months ended June 30, 2006 were financed under operating leases.

*Net Income.* Net income increased to \$39.3 million, or \$0.62 per diluted share, for the quarter ended June 30, 2006, compared to \$24.8 million, or \$0.42 per diluted share, for the quarter ended June 30, 2005. Factors relating to the change in net income are discussed below.

*Operating Revenues.* Operating revenues increased 105.8% for the quarter ended June 30, 2006, compared to the quarter ended June 30, 2005. The increase in total operating revenues was primarily due to the acquisition of ASA. Airline operating and interest expenses, excluding fuel charges, per ASM decreased 3.2% to 9.2¢ for the quarter ended June 30, 2006, from 9.5¢ for the quarter ended June 30, 2005. The primary reason for the decrease in cost per ASM, excluding fuel charges, was due to increased operating efficiencies obtained from increased stage lengths flown by the regional jets.

*Passenger Revenues.* Passenger revenues, which represented 99.2% of consolidated operating revenues for the quarter ended June 30, 2006, increased 107.4% to \$784.3 million for the quarter ended June 30, 2006, from \$378.2 million, or 98.5% of consolidated operating revenues, for the quarter ended June 30, 2005. Our passenger revenues, excluding fuel reimbursements from major partners, increased 90.1% for the quarter ended June 30, 2006 compared to the quarter ended June 30, 2005. The increase in passenger revenues excluding fuel was primarily due to a 99.9% increase in ASMs, principally as a result of our increase in operating aircraft to 397 aircraft as of June 30, 2006, from 223 aircraft as of June 30, 2005. Revenue per ASM increased 3.3% to 15.6¢, from 15.1¢ for the quarter ended June 30, 2006, primarily due to an increase in fuel reimbursements from our major partners. Passenger revenues include an amount designed to reimburse us for aircraft ownership costs. The amount deemed to be rental income for the three months ended June 30, 2006 was \$119.9 million.

*Passenger Load Factor.* Passenger load factor increased to 80.0% for the quarter ended June 30, 2006, from 75.3% for the quarter ended June 30, 2005. The increase in load factor was due primarily to the further development of our relationships with United and Delta, whereby we supplement mainline service in previously established and developed markets. Additionally, we believe passenger acceptance of our regional aircraft has increased from the comparable period of 2005.

*Ground Handling and Other Revenue.* Total ground handling revenue for the quarter ended June 30, 2006 increased approximately 4.7% from the same period of 2005. The increase was primarily related to additional service provided under ground handling contracts with United and Delta, whereby we perform the ground handling for several other regional airlines.

*Total Airline Expenses Excluding Fuel.* Total airline expenses for the quarter ended June 30, 2006, excluding fuel charges (which are substantially reimbursable by our major partners), increased approximately 93.0% from the same period of 2005. The increase was primarily a result of a 99.9% increase in ASMs (which resulted principally from the acquisition of ASA). Total operating expenses for the quarter ended June 30, 2006 increased at a lower rate than ASM growth, primarily due to the increased operating efficiencies obtained from increased stage lengths flown by the regional jets.

*Operating and Interest Expenses.* Operating and interest expenses increased 110.3% to \$729.3 million for the quarter ended June 30, 2006, compared to \$346.8 million for the quarter ended June 30, 2006. The increase in total operating and interest expenses was due principally to our acquisition of ASA. As a percentage of consolidated operating

revenues, total operating and interest expenses increased to 92.3% for the quarter ended June 30, 2006, from 90.3% for the quarter ended June 30, 2005. The increase in operating and interest expenses as a percentage of consolidated operating revenues was primarily due to significant increases in fuel costs quarter-over-quarter.

19

---

## Edgar Filing: SKYWEST INC - Form 10-Q

The following table sets forth information regarding our operating expense components for the quarters ended June 30, 2006 and 2005. Operating expenses are expressed as a percentage of operating revenues. Individual expense components are also expressed as cents per ASM.

<b>Three months ended June 30,</b>								
	<b>2006</b>			<b>2005</b>				
	<b>Amount</b> <b>(in thousands)</b>	<b>Percentage</b> <b>of</b> <b>Revenue</b>	<b>Cents</b> <b>per</b> <b>ASM</b>	<b>Amount</b> <b>(in thousands)</b>	<b>Percentage</b> <b>of</b> <b>Revenue</b>	<b>Cents</b> <b>Per</b> <b>ASM</b>		
Salaries, wages and employee benefits	\$ 165,850	21.0	%	3.3	\$ 85,749	22.3	%	3.4
Aircraft costs	117,587	14.9	%	2.3	68,974	18.0	%	2.7
Maintenance	51,576	6.5	%	1.0	23,977	6.2	%	0.9
Fuel	263,868	33.4	%	5.2	105,639	27.5	%	4.2
Other airline expenses	101,903	12.8	%	2.0	55,108	14.3	%	2.2
Interest	28,518	3.6	%	0.6	7,392	1.9	%	0.3
<b>Total airline expenses</b>	<b>\$ 729,302</b>			<b>14.4</b>	<b>\$ 346,839</b>			<b>13.7</b>

The cost per ASM for salaries, wages and employee benefits decreased to 3.3¢ for the quarter ended June 30, 2006, compared to 3.4¢ for the quarter ended June 30, 2005. The average number of full-time equivalent employees increased 79.7% to 13,335 for the quarter ended June 30, 2006 from 7,421 for the quarter ended June 30, 2005. The increase in number of employees was due, in large part, to our acquisition of ASA and addition of personnel required for the new regional jet flying and ground handling operations within our United Express operations. Additionally, during the three months ended June 30, 2006, we recorded \$3.1 million pre-tax (\$2.2 million after tax) of equity based compensation expense related to the adoption of SFAS No. 123(R) and due to the issuance of restricted stock grants under the SkyWest, Inc. 2006 Long Term Incentive Plan.

The cost per ASM for aircraft costs, including aircraft rent and depreciation, decreased to 2.3¢ for the quarter ended June 30, 2006, from 2.7¢ for the quarter ended June 30, 2005. The decrease in cost per ASM was primarily due to the addition of ASA's regional jet fleet and the addition of 25 CRJ700s, which have a lower operating cost per ASM than our existing CRJ200 and turboprop fleets.

The cost per ASM for maintenance expense increased to 1.0¢ for the quarter ended June 30, 2006, compared to 0.9¢ for the quarter ended June 30, 2005. The increase was primarily related to the timing of certain maintenance events during the quarter ended June 30, 2006. Under our United Express Agreement, specific amounts are included in the rates and charges for mature maintenance on regional jet engines that we record as revenue. However, consistent with the change to a direct expense maintenance policy, we record maintenance expense on our CRJ200 engines as it is incurred. As a result, during the quarter ended June 30, 2006, we collected and recorded as revenue \$6.9 million (pretax) under the United Express Agreement to compensate us for future engine maintenance overhauls, with no corresponding expense relative to CRJ200 engine maintenance overhauls. Because the Maintenance line in the table above does not include salaries, wages and employee benefits associated with our maintenance operations (those costs are stated separately in the table), the maintenance expense line in the above table differs from the maintenance line in our Condensed Consolidated Statements of Income.

The cost per ASM for fuel increased 23.8% to 5.2¢ for the quarter ended June 30, 2006, from 4.2¢ for the quarter ended June 30, 2005. This increase was primarily due to the average price of fuel increasing to \$2.26 per gallon during the quarter ended June 30, 2006, from \$1.87 per gallon for the quarter ended June 30, 2005.

The cost per ASM for other expenses, primarily consisting of landing fees, station rentals, computer reservation system fees and hull and liability insurance, decreased 9.1% to 2.0¢ for the quarter ended June 30, 2006, from 2.2¢ for the quarter ended June 30, 2005. The decrease was primarily related to the increase in stage lengths flown by our regional jets.

Interest expense increased to approximately \$28.5 million during the quarter ended June 30, 2006, from approximately \$7.4 million during the quarter ended June 30, 2005. The increase in interest expense was primarily due to the addition of ASA's aircraft which are primarily financed with long-term debt.



## Edgar Filing: SKYWEST INC - Form 10-Q

### Six Months Ended June 30, 2006 and 2005

*Operating Statistics.* The following table sets forth our major operational statistics and the percentage-of-change for the periods identified below.

	For the six months ended June 30,				
	2006			2005	% Change
Passengers carried	15,553,706	7,869,727		97.6	%
Revenue passenger miles (000)	7,701,308	3,542,444		117.4	%
Available seat miles (000)	9,772,278	4,766,166		105.0	%
Passenger load factor	78.8	%	74.3	%	4.5 pts
Passenger breakeven load factor	72.9	%	67.6	%	5.3 pts
Yield per revenue passenger mile	19.7	¢	20.1	¢	(2.0)%
Revenue per available seat mile	15.7	¢	15.2	¢	3.3
Cost per available seat mile	14.5	¢	13.8	¢	5.1
Fuel cost per available seat mile	5.0	¢	3.9	¢	28.2
Average passenger trip length (miles)	495		450		10.0

Our total ASMs generated during the six months ended June 30, 2006 increased 105.0% from the six months ended June 30, 2005. The increase in ASMs was primarily a result of increasing the size of our aircraft fleet, including our acquisition of ASA, from 223 aircraft as of June 30 2005, to 397 aircraft as of June 30, 2006. On the date we acquired ASA, ASA's fleet consisted of 149 aircraft (35 CRJ700s, 102 CRJ200s and 12 ATRs). In addition to the aircraft acquired in connection with the acquisition of ASA, we took delivery of 15 CRJ 700s and 2 CRJ 200s during the six months ended June 30, 2006. All aircraft delivered during the six months ended June 30, 2006 were financed under operating leases.

*Net Income.* Net income increased to \$73.9 million, or \$1.21 per diluted share, for the six months ended June 30, 2006, compared to \$43.5 million, or \$0.75 per diluted share, for the six months ended June 30, 2005. Factors relating to the change in net income are discussed below.

*Operating Revenues.* Operating revenues increased 111.7% for the six months ended June 30, 2006, compared to the six months ended June 30, 2005. The increase in total operating revenues was primarily due to our acquisition of ASA. Airline operating and interest expenses, excluding fuel charges, per ASM decreased 4.0% to 9.5¢ for the six months ended June 30, 2006, from 9.9¢ for the six months ended June 30, 2005. The primary reason for the decrease in cost per ASM, excluding fuel charges, was the effect of increased operating efficiencies obtained from increased stage lengths flown by the regional jets.

*Passenger Revenues.* Passenger revenues, which represented 99.1% of consolidated operating revenues for the six months ended June 30, 2006, increased 112.8% to \$1.52 billion for the six months ended June 30, 2006, from \$713.8 million, or 98.5% of consolidated operating revenues, for the six months ended June 30, 2005. Our passenger revenues, excluding fuel reimbursements from our major partners, increased 94.0% for the six months ended June 30, 2006 compared to the six months ended June 30, 2005. The increase in passenger revenues excluding fuel was primarily due to a 105.0% increase in ASMs, principally as a result of our increase in operating aircraft to 397 aircraft as of June 30, 2006, from 223 aircraft as of June 30, 2005. Revenue per ASM increased 3.3% to 15.7¢, from 15.2¢ for the six months ended June 30, 2006, primarily due to an increase in fuel reimbursements from our major partners. Passenger revenues include an amount designed to reimburse us for aircraft ownership costs. The amount deemed to be rental income for the six months ended June 30, 2006 was \$237.2 million.

*Passenger Load Factor.* Passenger load factor increased to 78.8% for the six months ended June 30, 2006, from 74.3% for the six months ended June 30, 2005. The increase in load factor was due primarily to the further development of

our relationships with United and Delta, whereby we supplement mainline service in previously established and developed markets. Additionally, we believe passenger acceptance of our regional aircraft has increased from the comparable period of 2005.

21

---

## Edgar Filing: SKYWEST INC - Form 10-Q

*Ground Handling and Other Revenue.* Total ground handling revenue and other revenue for the six months ended June 30, 2006 increased approximately 37.6% from the same period of 2005. The increase was primarily related to contracts with United and Delta, whereby we perform the ground handling for several other regional airlines.

*Total Airline Expenses Excluding Fuel.* Total airline expenses for the six months ended June 30, 2006, excluding fuel charges (which are substantially reimbursable by our major partners), increased approximately 96.8% from the same period of 2005. The increase was primarily a result of a 105.0% increase in ASMs (which resulted principally from the acquisition of ASA). Total operating expenses for the six months ended June 30, 2006 increased at a lower rate than ASM growth, primarily due to the increased operating efficiencies obtained from increased stage lengths flown by the regional jets.

*Operating and Interest Expenses.* Operating and interest expenses increased 115.0% to \$1.42 billion for the six months ended June 30, 2006, compared to \$659.3 million for the six months ended June 30, 2005. The increase in total operating and interest expenses was due principally to our acquisition of ASA. As a percentage of consolidated operating revenues, total operating and interest expenses increased to 92.5% for the six months ended June 30, 2006, from 91.0% for the six months ended June 30, 2005. The increase in operating and interest expenses as a percentage of consolidated operating revenues for the six-months ended June 30, 2006 was primarily due to significant increases in fuel costs compared to the six-months ended June 30, 2005.

The following table sets forth information regarding our operating expense components for the quarters ended June 30, 2006 and 2005. Operating expenses are expressed as a percentage of operating revenues. Individual expense components are also expressed as cents per ASM.

	Six months ended June 30,					
	2006			2005		
	Amount (in thousands)	Percentage of Revenue	Cents per ASM	Amount (in thousands)	Percentage of Revenue	Cents Per ASM
Salaries, wages and employee benefits	\$ 331,175	21.6 %	3.3	\$ 169,162	23.4 %	3.5
Aircraft costs	231,424	15.1 %	2.4	133,553	18.4 %	2.8
Maintenance	106,754	7.0 %	1.1	45,719	6.3 %	1.0
Fuel	488,531	31.9 %	5.0	187,057	25.8 %	3.9
Other airline expenses	202,892	13.2 %	2.1	109,800	15.2 %	2.3
Interest	57,061	3.7 %	0.6	14,038	1.9 %	0.3
Total airline expenses	\$ 1,417,837		14.5	\$ 659,329		13.8

The cost per ASM for salaries, wages and employee benefits decreased to 3.3¢ for the six months ended June 30, 2006, compared to 3.5¢ for the six months ended June 30, 2005. The average number of full-time equivalent employees increased 81.1% to 13,207 for the six months ended June 30, 2006 from 7,291 for the six months ended June 30, 2005. The increase in number of employees was due, in large part, to the acquisition of ASA and addition of personnel required for the new regional jet flying and ground handling operations within our United Express operations. Additionally, during the six months ended June 30, 2006, we recorded \$4.7 million pre-tax (\$3.5 million after tax) of equity based compensation expense related to the adoption of SFAS No. 123(R) and due to the issuance of restricted stock grants under the SkyWest Inc. 2006 Long Term Incentive Plan.

The cost per ASM for aircraft costs, including aircraft rent and depreciation, decreased to 2.4¢ for the six months ended June 30, 2006, from 2.8¢ for the six months ended June 30, 2005. The decrease in cost per ASM was primarily due to the addition of ASA's regional jet fleet and the addition of 25 CRJ700s, which have a lower operating cost per ASM than our existing CRJ200 and turboprop fleets.

The cost per ASM for maintenance expense increased to 1.1¢ for the six months ended June 30, 2006, compared to 1.0¢ for the six months ended June 30, 2005. The increase was primarily due to the timing of certain maintenance events during the six months ended June 30, 2006.

## Edgar Filing: SKYWEST INC - Form 10-Q

Under our United Express Agreement, specific amounts are included in the rates and charges for mature maintenance on regional jet engines that we record as revenue. However, consistent with the change to a direct expense maintenance policy, we

22

---

record maintenance expense on our CRJ200 engines as it is incurred. As a result, during the six months ended June 30, 2006, we collected and recorded as revenue \$13.4 million (pretax) under the United Express Agreement to compensate us for future engine maintenance overhauls, with no corresponding expense relative to CRJ200 engine maintenance overhauls. Because the Maintenance line in the table set forth above does not include salaries, wages and employee benefits associated with our maintenance operations (those costs are stated separately in the table), the maintenance expense line in the above table differs from the maintenance line in our Condensed Consolidated Statements of Income.

The cost per ASM for fuel increased 28.2% to 5.0¢ for the six months ended June 30, 2006, from 3.9¢ for the six months ended June 30, 2005. This increase was primarily due to the average price of fuel increasing to \$2.21 per gallon during the six months ended June 30, 2006, from \$1.75 per gallon for the six months ended June 30, 2005.

The cost per ASM for other expenses, primarily consisting of landing fees, station rentals, computer reservation system fees and hull and liability insurance, decreased 8.7% to 2.1¢ for the six months ended June 30, 2006, from 2.3¢ for the six months ended June 30, 2005. The decrease was primarily related to the increase in stage lengths flown by our regional jets.

Interest expense increased to approximately \$57.1 million during the six months ended June 30, 2006, from approximately \$14.0 million during the six months ended June 30, 2005. The increase in interest expense was primarily due to the addition of ASA's aircraft which are primarily financed with long-term debt.

### Liquidity and Capital Resources

We had working capital of \$351.3 million and a current ratio of 1.7:1 at June 30, 2006, compared to working capital of \$77.7 million and a current ratio of 1.1:1 at December 31, 2005. The increase was principally caused by the cash generated from operations and cash generated from the stock offering used to extinguish amounts outstanding under two lines of credit. The principal sources of cash during the six months ended June 30, 2006 were \$175.3 million provided by operating activities, \$4.1 million of proceeds from the sale of marketable securities, \$110.1 million from the sale of 4.0 million shares and the sale of common stock in connection with the exercise of stock options under our stock option and employee stock purchase plans, \$7.6 million from returns on aircraft deposits, \$7.1 million in proceeds from issuance of long-term debt, and \$7.3 million of proceeds from the sale of owned aircraft and \$1.3 million in tax benefit from exercise options to purchase shares of common stock. We invested \$13.4 million in marketable securities, \$40.7 million in flight equipment, \$12.6 million in other assets, \$6.7 million in buildings and ground equipment and \$0.4 million in deposits for aircraft. We reduced the amounts outstanding under our lines of credit by \$90.0 million, made principal payments on long-term debt of \$46.3 million, and paid \$3.6 million in cash dividends. These factors resulted in a \$99.1 million increase in cash and cash equivalents during the six months ended June 30, 2006.

We believe that in the absence of unusual circumstances, the working capital currently available to us will be sufficient to meet our present financial requirements, including expansion, planned capital expenditures, and scheduled lease payments and debt service obligations for at least the next 12 months.

Our position in marketable securities, consisting primarily of bonds, bond funds and commercial paper, increased to \$167.9 million at June 30, 2006, compared to \$159.0 million at December 31, 2005. The increase in marketable securities was due primarily to the \$175.3 million in cash provided for through operating activities for the six months ended June 30, 2006.

At June 30, 2006, our total capital mix was 42.8% equity and 57.2% long-term debt, compared to 39.1% equity and 60.9% long-term debt at December 31, 2005.

During 2005, SkyWest Airlines increased an existing \$10.0 million line-of-credit facility with a bank, to \$40.0 million. As of June 30, 2006, SkyWest Airlines had no borrowings outstanding under the facility. The facility expires on January 31, 2007 and bears interest at a rate equal to prime less 0.25%. Additionally during 2005, SkyWest Airlines entered into another borrowing facility with a financing company and borrowed \$60.0 million. As of June 30, 2006, SkyWest Airlines repaid the borrowings under the second facility and the facility was terminated.

As of June 30, 2006, we had \$36.4 million in letters of credit and surety bonds outstanding with various banks and surety institutions.

On June 30, 2006, we classified \$22.1 million as restricted cash, related to our workers compensation policies and our purchase of ASA. On December 31, 2005, we classified \$24.8 million as restricted cash as required by our workers compensation policy.



## Edgar Filing: SKYWEST INC - Form 10-Q

On April 17, 2006, we completed a public offering of 4,000,000 shares of common stock at a price of \$26.05 per share. We received approximately \$99.3 million in proceeds which were used to pay off two revolving lines of credit, to provide working capital and for general corporate purposes.

### Significant Commitments and Obligations

#### General

The following table summarizes our commitments and obligations stated in calendar years except as noted for each of the next five years and thereafter (in thousands):

	Total	July-Dec						
		2006	2007	2008	2009	2010	2011	Thereafter
<b>Firm aircraft</b>								
<b>Commitments</b>	\$ 463,000	\$ 243,000	\$ 220,000	\$	\$	\$	\$	\$
Operating lease payments for aircraft and Facility Obligations	3,522,732	151,926	302,277	278,434	293,723	287,274	284,170	1,924,928
<b>Principal maturities on long-term debt</b>	1,714,726	194,498	99,985	104,182	108,687	113,395	115,766	978,213
<b>Total commitments and obligations</b>	\$ 5,700,458	\$ 589,424	\$ 622,262	\$ 382,616	\$ 402,410	\$ 400,669	\$ 399,936	\$ 2,903,141

#### Purchase Commitments and Options

On February 4, 2005, we announced that SkyWest Airlines had been selected by United to operate 20 new CRJ700s in its United Express operations, and that SkyWest Airlines had placed a firm order for these CRJ700s with Bombardier. Deliveries of these aircraft began in the third quarter of 2005 and these deliveries were completed in March 2006. Our total firm aircraft orders and commitments as of June 30, 2006 consisted of orders for 17 CRJ900s and commitments to lease four CRJ200s from Delta. Total expenditures for these aircraft and related flight equipment, including amounts for contractual price escalations are estimated to be approximately \$463 million. Additionally, our agreement with Bombardier includes options for another 70 aircraft that can be delivered in either 70 or 90-seat configurations. We presently anticipate that delivery dates for these aircraft could start in May 2007 and continue through April 2010; however, actual delivery dates remain subject to final determination as agreed upon by us and our code-share partners.

SkyWest Airlines has not historically funded a substantial portion of its aircraft acquisitions with working capital. Rather, it has generally funded its aircraft acquisitions through a combination of operating leases and debt financing. At the time of each aircraft acquisition, we evaluate the financing alternatives available, and select one or more of these methods to fund the acquisition. In the event that alternative financing can not be arranged at the time of delivery, Bombardier has financed aircraft acquisitions until more permanent arrangements can be made. Subsequent to this initial acquisition of an aircraft, we may also refinance the aircraft or convert one form of financing to another (e.g., replacing debt financing with leveraged lease financing).

At present, we intend to satisfy our 2006 firm aircraft purchase commitment, as well as our acquisition of any additional aircraft, through a combination of operating leases and debt financing, consistent with our historical practices. Based on current market conditions and discussions with prospective leasing organizations and financial institutions, we currently believe that we will be able to obtain financing for the committed acquisitions, as well as additional aircraft, without materially reducing the amount of working capital available for our operating activities.

#### Aircraft Lease and Facility Obligations

We also have significant long-term lease obligations primarily relating to our aircraft fleet. At June 30, 2006, we had 258 aircraft





under lease with remaining terms ranging from one to 18 years. Future minimum lease payments due under all long-term operating leases were approximately \$3.5 billion at June 30, 2006. Assuming a 7.39% discount rate, which is the rate used to approximate the implicit rates within the applicable aircraft leases, the present value of these lease obligations would have been equal to approximately \$2.1 billion at June 30, 2006.

As part of our leveraged lease agreements, we typically agree to indemnify the equity/owner participant against liabilities that may arise due to changes in benefits from tax ownership of the respective leased aircraft.

#### *Long-term Debt Obligations*

Our total long-term debt at June 30, 2006 was \$1,714.7 million, of which \$1,707.5 million related to the acquisition of Brasilia turboprop, CRJ200 and CRJ700 aircraft and \$7.2 million related to our corporate office building. The average effective rate on the debt related to the Brasilia turboprop and CRJ200 aircraft was approximately 6.46% at June 30, 2006. We currently anticipate that approximately \$148 million of our current portion of long-term debt will be refinanced into permanent long-term financing within the next year.

#### **Seasonality**

As is common in the airline industry, our pro-rate operations are favorably affected by increased travel, historically occurring in the summer months, and are unfavorably affected by decreased business travel during the months from November through January and by inclement weather which occasionally results in cancelled flights, principally during the winter months.

During the first quarter of 2005, we experienced significant weather-related cancellations, primarily in January, of 1,325 flights which is approximately 3.1% of total scheduled departures. Based on historical averages for weather-related cancellations of one-half of one percent, it is estimated that we experienced approximately 1,100 more cancellations than normal during January 2005. The cancellations contributed to an increase in certain cost components, while we were unable to record the revenue for the cancelled flights.

#### **ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

##### **Aircraft Fuel**

In the past, we have not experienced difficulties with fuel availability and we currently expect to be able to obtain fuel at prevailing prices in quantities sufficient to meet our future needs. Pursuant to our contract flying arrangements, United has agreed to bear the economic risk of fuel price fluctuations on our United Express flights. On our Delta Connection regional jet flights, Delta has agreed to bear the economic risk of fuel price fluctuations. On the majority of our Delta Connection routes flown using Brasilia turboprops, we will bear the economic risk of fuel fluctuations. At present, we believe that our results from operations will not be materially and adversely affected by fuel price volatility.

##### **Interest Rates**

Our earnings are affected by changes in interest rates due to the amounts of variable rate long-term debt and the amount of cash and securities held. The interest rates applicable to variable rate notes may rise and increase the amount of interest expense. We would also receive higher amounts of interest income on cash and securities held at the time; however, the market value of our available-for-sale securities would likely decline. At June 30, 2006, we had variable rate notes representing 68.0% of our total long-term debt compared to 74.7% of our long-term debt at December 31, 2005. For illustrative purposes only, we have estimated the impact of market risk using a hypothetical increase in interest rates of one percentage point for both variable rate long-term debt and cash and securities. Based on this hypothetical assumption, we would have incurred an additional \$2,720,000 in interest expense and received \$975,000 additional interest income for the three months ended June 30, 2006. Additionally, we would have incurred an additional \$5,920,000 in interest expense and received \$1,825,000 additional interest income for the six months ended June 30, 2006.

We currently intend to finance the acquisition of aircraft through the manufacturer, third-party leases or long-term borrowings. Changes in interest rates may impact the actual cost to us to acquire these aircraft. To the extent we place these aircraft in service under our code-share agreements with Delta and United, our code-share agreements currently provide that reimbursement rates will be adjusted higher or lower to reflect any changes in our aircraft rental rates.

We have an interest rate swap agreement to manage our exposure on the debt instrument related to our headquarters. Our policies do not permit management to enter into derivative instruments for any purpose other than cash flow hedging purposes. Accordingly, we do not speculate using derivative instruments. We assess interest rate cash flow risk by identifying and monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities. The fair values of our derivative instruments are recognized as other current liabilities in the accompanying balance sheet. In accordance with provisions of SFAS No. 133, we recorded a \$86,000 and \$641,000 liability at June 30, 2006 and 2005 respectively, in the accompanying consolidated balance sheets representing the fair value of the outstanding interest rate swap agreement. We decreased interest expense by \$257,000 and \$50,000 during the six months ended June 30, 2006 and 2005, respectively, relating to adjustments to the fair value of the derivatives.

#### ITEM 4. CONTROLS AND PROCEDURES

##### Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of its disclosure controls and procedures, as such term is defined under Rule 13a-14(c) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of June 30, 2006. During the three months ended June 30, 2006, we changed ASA's accounting software system to the SkyWest accounting software system. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective in alerting them on a timely basis to material information relating to our company required to be included in our reports filed or submitted under the Exchange Act. There have been no significant changes (including corrective actions with regard to material weaknesses) in our internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation referenced above.

#### PART II. OTHER INFORMATION

##### ITEM 1. LEGAL PROCEEDINGS

We are subject to certain legal actions which we consider routine to our business activities. As of June 30, 2006, our management believed, after consultation with legal counsel, that the ultimate outcome of such legal matters is not likely to have a material adverse effect on our financial position, liquidity or results of operations. The most significant of these matters is summarized below:

##### *Securities and Exchange Commission*

Effective January 1, 2002, we changed our method of accounting for CRJ200 engine overhaul expenses. In connection with the change in accounting method, we restated our financial statements for the year ended December 31, 2001 and the first and second quarters of the year ended December 31, 2002. The restated financial information, together with a discussion of the change in accounting method, was presented in Amendment No. 1 on our Form 10-K/A for the year ended December 31, 2001 and Amendments No. 1 on Forms 10-Q/A for the quarters ended June 30, 2002 and June 30, 2002. The staff of the SEC undertook an investigation of the facts pertaining to the change in our accounting method and other changes presented in the restatement of our financial statements. During the quarter ended June 30, 2006, the staff of the SEC notified us that the investigation had been terminated and that no enforcement action will be recommended to the SEC with respect to the matter.

##### ITEM 1A. RISK FACTORS

*In addition to factors discussed elsewhere in this Report, the following are important risks which could adversely affect our future results. We have updated the risk factors previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2005 (our Annual Report), filed with the Securities and Exchange Commission on March 14, 2006, as set forth below. We do not believe any of the changes constitute material changes to the risk factors identified in our Annual Report. Additional risks and uncertainties not presently known to us or that we currently do not deem material may also impair our business operations. If any of the risks we describe below occur, or if any unforeseen risk develops, our operating results may suffer, our financial condition may deteriorate, the trading price of our common stock may decline and investors could lose all or part of their investment in us.*

### **Risks Related to Our Operations**

#### **We are highly dependent on Delta and United.**

The current terms of the SkyWest Airlines and ASA Delta Connection Agreements are subject to certain early termination provisions. Delta's termination rights include cross-termination rights (meaning that a breach by SkyWest Airlines or ASA of its Delta Connection Agreement could, under certain circumstances, permit Delta to terminate both Delta Connection Agreements), the right to terminate each of the agreements upon the occurrence of certain force majeure events (including certain labor-related events) that prevent SkyWest Airlines or ASA from performance for certain periods and the right to terminate each of the agreements if SkyWest Airlines or ASA, as applicable, fails to maintain competitive base rate costs, subject to certain rights of SkyWest Airlines to take corrective action to reimburse Delta for lost revenues. The current term of our United Express Agreement is subject to certain early termination provisions and subsequent renewals. United may terminate the United Express Agreement due to an uncured breach by SkyWest Airlines of certain operational and performance provisions, including measures and standards related to flight completions, baggage handling and on-time arrivals.

If any of our code-share agreements are terminated pursuant to the terms of those agreements, due to the bankruptcy and restructuring proceedings of Delta and United, or otherwise, we would be significantly impacted and likely would not have an immediate source of revenue or earnings to offset such loss. A termination of any of these agreements would have a material adverse effect on our financial condition, operating revenues and net income unless we are able to enter into satisfactory substitute arrangements for the utilization of the affected aircraft by other code-share partners, or, alternatively, obtain the airport facilities and gates and make the other arrangements necessary to fly as an independent airline. We may not be able to enter into substitute code-share arrangements, and any such arrangements we might secure may not be as favorable to us as our current agreements. Operating our airline independent from major partners would be a significant departure from our business plan, would likely be very difficult and may require significant time and resources, which may not be available to us at that point.

We currently use Delta's and United's systems, facilities and services to support a significant portion of our operations, including airport and terminal facilities and operations, information technology support, ticketing and reservations, scheduling, dispatching, fuel purchasing and ground handling services. If Delta or United were to cease any of these operations or no longer provide these services to us, due to termination of one of our code-share agreements, a strike by Delta or United personnel or for any other reason, we may not be able to replace these services on terms and conditions as favorable as those we currently receive, or at all. Since our revenues and operating profits are dependent on our level of flight operations, we could then be forced to significantly reduce our operations. Furthermore, upon certain terminations of our code-share agreements, Delta and United could require us to sell or assign to them facilities and inventories, including maintenance facilities, we use in connection with the code-share services we provide. As a result, in order to offer airline service after termination of any of our code-share agreements, we may have to replace these airport facilities, assets and services. We may be unable to arrange such replacements on satisfactory terms, or at all.

#### **We may be negatively impacted by the troubled financial condition, bankruptcy proceedings and restructurings of Delta and United.**

Substantially all of our revenues are attributable to our code-share agreements with Delta, which is currently reorganizing under Chapter 11 of the U.S. Bankruptcy Code, and United, which recently emerged from bankruptcy proceedings. The U.S. Bankruptcy Courts charged with administration of the Delta and United bankruptcy cases have entered final orders approving the assumption of our code-share agreements. Notwithstanding those approvals, these bankruptcies and restructurings present considerable continuing risks and uncertainties for our code-share agreements and, consequently, for our operations.

Although a plan of reorganization has been confirmed in the United bankruptcy proceedings, which became effective on February 1, 2006 (subject to a pending appeal), and Delta reports that it intends to reorganize and emerge from its bankruptcy proceedings, there is no assurance that either of United or Delta will ultimately succeed in its reorganization efforts or that either Delta or United will remain a going concern over the long term. Likewise, even though both Delta and United have assumed our code-share agreements with bankruptcy court approval, there is no assurance that these agreements will survive the Chapter 11 cases. For example, the Delta reorganization could be converted to liquidation, or Delta could liquidate some or all of its assets through one or more transactions with one or more third parties with bankruptcy court approval. In addition, Delta may not be able to confirm and consummate a successful plan of reorganization that provides for continued performance of its obligations under its code-share agreements with us.

In the event United is not able to perform successfully under the terms of its plan of reorganization, assumption of our United Express Agreement could be subjected to similar risks.

Other aspects of the Delta and United bankruptcies and reorganizations pose additional risks to our code-share agreements. Delta may not be able to obtain bankruptcy court approval of various motions necessary for it to administer its bankruptcy case. As a consequence, Delta may not be able to maintain normal commercial terms with vendors and service providers, including other code-share partners that are critical to its operations. Delta also may be unable to reach satisfactory resolutions of disputes arising out of collective bargaining agreements or to obtain sufficient financing to fund its business while it reorganizes. These and other factors not identified here could delay the resolution of the Delta bankruptcy and reorganization significantly and could threaten Delta's operations. As to United, even though a plan of reorganization has been confirmed in the United bankruptcy proceedings, the order of confirmation is subject to a pending appeal, and there is no assurance that United will be able to operate successfully under the terms of its confirmed plan.

In light of the importance of our code-share agreements with Delta and United to our business, the termination of these agreements or the failure of Delta to ultimately emerge from its bankruptcy proceeding could jeopardize our operations. Such events could leave us unable to operate much of our current aircraft fleet and the additional aircraft we are obligated to purchase. As a result, they could have a material adverse effect on our operations and financial condition.

Even though United has emerged from bankruptcy proceedings and if Delta is ultimately able to emerge from its bankruptcy proceedings, their respective financial positions will continue to pose risks for our operations. Serial bankruptcies are not unprecedented in the commercial airline industry, and Delta and/or United could file for bankruptcy again after emergence from Chapter 11, in which case our code-share agreements could be subject to termination under the U.S. Bankruptcy Code. Regardless of whether subsequent bankruptcy filings prove to be necessary, Delta and United have required, and will likely continue to require, our participation in efforts to reduce costs and improve their respective financial positions. These efforts could result in lower utilization rates of our aircraft, lower departure rates on the contract flying portion of our business, and more volatile operating margins. We believe that any of these developments could have a negative effect on many aspects of our operations and financial performance.

**We may not achieve the potential benefits of the ASA acquisition.**

Our achievement of the potential benefits of the ASA acquisition will depend, in substantial part, on our ability to successfully implement our business strategy, including improving the utilization of equipment and facilities, increasing employee productivity and allocating overhead and administrative expenses over a larger platform. We will be unable to achieve the potential benefits of the ASA acquisition unless we are able to efficiently integrate the SkyWest Airlines and ASA operating platforms in a timely manner. The integration of SkyWest Airlines and ASA may be costly, complex and time-consuming, and the managements of SkyWest Airlines and ASA will have to devote substantial effort to such integration. If we are not able to successfully achieve these objectives, the potential benefits of the ASA acquisition may not be realized fully or at all, or it may take longer to realize than expected. In addition, assumptions underlying estimates of expected cost savings and expected revenues may be inaccurate, or general industry and business conditions may deteriorate. Our combined operations with ASA may experience increased competition that limits our ability to expand our business. We cannot assure you that the ASA acquisition will result in combined results of operations and financial condition consistent with our expectations or superior to what we and ASA could have achieved independently. Nor do we represent to you that any estimates or projections we have developed or presented in connection with the ASA acquisition can or will be achieved.

**The amounts we receive under our code-share agreements may be less than the actual amounts of the corresponding costs we incur.**

Under our code-share agreements with Delta and United, we are compensated for certain costs we incur in providing services. With respect to costs that are defined as pass-through costs, our code-share partner is obligated to pay to us the actual amount of the cost (and, with respect to the ASA Delta Connection Agreement, a pre-determined rate of return based upon the actual cost we incur). With respect to other costs, our code-share partner is obligated to pay to us amounts based, in part, on pre-determined rates for certain costs. During the six months ended June 30, 2006, approximately 55.6% of our costs were pass-through costs and 44.4% of our costs were reimbursable at pre-determined rates. These pre-determined rates may not be based on the actual expenses we incur in delivering the associated services. If we incur expenses that are greater than the pre-determined reimbursement amounts payable by our code-share partners, our financial results will be negatively affected.

**We have a significant amount of contractual obligations.**

As of June 30, 2006, we had a total of approximately \$1.7 billion in total long-term debt obligations. Substantially all of this long-term debt was incurred in connection with the acquisition of aircraft, engines and related spare parts including debt assumed in the ASA acquisition. We also have significant long-term lease obligations primarily relating to our aircraft fleet. These leases are classified as operating leases and therefore are not reflected as liabilities in our condensed consolidated balance sheets. At June 30, 2006, we had 258 aircraft under lease, with remaining terms ranging from one to 18 years. Future minimum lease payments due under all long-term operating leases were approximately \$3.5 billion at June 30, 2006. At a 7.39% discount factor, the present value of these lease obligations was equal to approximately \$2.1 billion at June 30, 2006. As of June 30, 2006, we had commitments of approximately \$463 million to purchase 17 CRJ900s and to lease four CRJ200 s, together with related flight equipment. We expect to complete these deliveries by April 2007. Our high level of fixed obligations could impact our ability to obtain additional financing to support additional expansion plans or divert cash flows from operations and expansion plans to service the fixed obligations.

**There are risks associated with our regional jet strategy, including potential oversupply and possible passenger dissatisfaction.**

Our selection of Bombardier Regional Jets as the primary aircraft for our existing operations and projected growth involves risks, including the possibility that there may be an oversupply of regional jets available for sale in the foreseeable future, due, in part, to the financial difficulties of regional and major airlines, including Delta, United, Northwest, Comair, Mesaba, and FLYi which is in the process of liquidating its regional jet fleet. A large supply of regional jets may allow other carriers, or even new carriers, to acquire aircraft for unusually low acquisition costs, allowing them to compete more effectively in the industry, which may ultimately harm our operations and financial performance.

Our regional jet strategy also presents the risk that passengers may find the Bombardier Regional Jets to be less attractive than other aircraft, including other regional jets. Recently, several other models of regional jets have been introduced by manufacturers other than Bombardier. If passengers develop a preference for other regional jet models, our results of operation and financial condition could be negatively impacted.

**We may be limited from expanding our flying within the Delta and United flight systems, and there are constraints on our ability to provide airline services to airlines other than Delta and United.**

Additional growth opportunities within the Delta and United flight systems are limited by various factors. Except as currently contemplated by our existing code-share agreements, we cannot assure that Delta or United will contract with us to fly any additional aircraft. We may not receive additional growth opportunities, or may agree to modifications to our code-share agreements that reduce certain benefits to us in order to obtain additional aircraft, or for other reasons. Furthermore, the troubled financial condition, bankruptcies and restructurings of Delta and United may reduce the growth of regional flying within their flight systems. Given the troubled nature of the airline industry, we believe that some of our competitors may be more inclined to accept reduced margins and less favorable contract terms in order to secure new or additional code-share operations. Even if we are offered growth opportunities by our major partners, those opportunities may involve economic terms or financing commitments that are unacceptable to us. Any one or more of these factors may reduce or eliminate our ability to expand our flight operations with our existing code-share partners. Additionally, even if Delta and/or United choose to expand our fleet on terms acceptable to us, they may be allowed at any time to subsequently reduce the number of aircraft covered by our code-share agreements. We also cannot assure you that we will be able to obtain the additional ground and maintenance facilities, including gates, and support equipment, to expand our operations. The failure to obtain these facilities and equipment would likely impede our efforts to implement our business strategy and could materially adversely affect our operating results and our financial condition.

Delta and/or United may be restricted in increasing their business with us, due to scope clauses in the current collective bargaining agreements with their pilots that restrict the number and size of regional jets that may be operated in their flight systems not flown by their pilots. Delta s scope limitations restrict its partners from operating aircraft with over 70 seats even if those aircraft are operated for an airline other than Delta. We cannot assure that these scope clauses will not become more restrictive in the future. Any additional limit on the number of regional jets we can fly for our code-share partners could have a material adverse effect on our expansion plans and the price of our common stock.

Our business model depends on major airlines, including Delta and United, electing to contract with us instead of operating their own regional jets. Some major airlines, including Delta, American, US Airways and JetBlue, own their own regional airlines or operate their own regional jets instead of entering into contracts with regional carriers. We have no guarantee that in the future our code-share partners will choose to enter into contracts with us instead of operating their own regional jets. Our partners are not prohibited from doing so under our code-share agreements. A decision by Delta or United to phase out code-share relationships and



instead acquire and operate their own regional jets could have a material adverse effect on our financial condition, results of operations or the price of our common stock.

Additionally, our code-share agreements limit our ability to provide airline services to other airlines in certain major airport hubs of each of Delta and United. Under the SkyWest Airlines Delta Connection Agreement, our growth is contractually restricted in Atlanta, Cincinnati, Orlando and Salt Lake City. Under the ASA Delta Connection Agreement, our growth is restricted in Atlanta, Cincinnati, New York (John F. Kennedy International Airport), Orlando and Salt Lake City. Under SkyWest Airlines United Express Agreement, growth is restricted in Chicago (O'Hare International Airport), Denver, Los Angeles, San Francisco, Seattle/Tacoma and Washington D.C. (Dulles International Airport).

**Increased labor costs, strikes, labor disputes and increased unionization of our workforces may adversely affect our ability to conduct our business.**

Our business is labor intensive, requiring large numbers of pilots, flight attendants, mechanics and other personnel. Labor costs constitute a significant percentage of our total operating costs. For example, during the six months ended June 30, 2006, our labor costs constituted approximately 23.2% of our total operating costs. Increases in our unionized labor costs could result in a material reduction in our earnings and affect our revenue under our code-share agreements. Any new collective bargaining agreements entered into by other regional carriers may also result in higher industry wages and increased pressure on us to increase the wages and benefits of our employees. Future agreements with unionized and non-unionized employees may be on terms that are not as attractive as our current agreements or comparable to agreements entered into by our competitors.

ASA's pilots, flight attendants and flight controllers are represented by unions, including: The Air Line Pilots Association, International, the Association of Flight Attendants - CNA and the Professional Airline Flight Control Association. ASA's pilots and flight attendants are currently working under open labor contracts, and ASA has been in negotiations with respect to such contracts since 2002 and 2003 respectively. Negotiations with unions representing SkyWest Airlines' employees could divert management attention and disrupt operations, which may result in increased operating expenses and lower net income. Moreover, we cannot predict the outcome of any future negotiations relating to union representation or collective bargaining agreements.

SkyWest Airlines' employees are not currently represented by any union; however, collective bargaining group organization efforts among those employees occur from time to time. We recognize that such efforts will likely continue in the future and may ultimately result in some or all of SkyWest Airlines' employees being represented by one or more unions. Moreover, one or more unions representing ASA employees may seek a single carrier determination by the National Mediation Board, which could require SkyWest Airlines to recognize such union or unions as the certified bargaining representative of SkyWest Airlines' employees. One or more unions representing ASA employees may also assert that SkyWest Airlines' employees should be subject to ASA collective bargaining agreements. If SkyWest Airlines' employees were to unionize or be deemed to be represented by one or more unions, negotiations with unions representing SkyWest Airlines' employees could divert management attention and disrupt operations, which may result in increased operating expenses and lower net income. Moreover, we cannot predict the outcome of any future negotiations relating to union representation or collective bargaining agreements. Agreements reached in collective bargaining may increase operating expenses and lower operating results and net income. If unionizing efforts among SkyWest Airlines' employees are successful, we may be subjected to risks of work interruption or stoppage and/or incur additional administrative expenses associated with union representation.

If we are unable to reach labor agreements with any current or future unionized work groups, we may be subject to work interruptions or stoppages, which may adversely affect our ability to conduct our operations and may even allow Delta or United to terminate their respective code-share agreements.

**We may be unable to obtain all of the aircraft, engines, parts or related maintenance and support services we require, which could have a material adverse impact on our business.**

We rely on a limited number of aircraft types, and are dependent on Bombardier as the sole manufacturer of our regional jets. For the six months ended June 30, 2006, 57.9% of our available seat miles (which represents the number of seats available for passengers, multiplied by the number of miles those seats are flown (ASMs)) were flown using CRJ200s, 35.7% of our ASMs were flown using CRJ700s, 4.8% of our ASMs were flown using Brasilia turboprops and 1.5% of our ASMs miles were flown using ATR-72 turboprops. As of June 30, 2006, we had commitments of approximately \$463 million to purchase 17 CRJ900s and to lease four CRJ200s, together with related flight equipment. Additionally, we had obtained options to acquire another 70 regional jets that can





be delivered in either 70 or 90-seat configurations. Delivery dates for these aircraft remain subject to final determination as agreed upon by us and our major partners.

Any significant disruption or delay in the expected delivery schedule of our fleet would adversely affect our business strategy and overall operations and could have a material adverse impact on our operating results or our financial condition. Certain of Bombardier's aerospace workers are represented by unions and have participated in at least one strike in recent history. Any future prolonged strike at Bombardier or delay in Bombardier's production schedule as a result of labor matters could disrupt the delivery of regional jets to us, which could adversely affect our planned fleet growth. We are also dependent on General Electric as the manufacturer of our aircraft engines. General Electric also provides parts, repair and overhaul services, and other types of support services on our engines. Our operations could be materially and adversely affected by the failure or inability of Bombardier or General Electric to provide sufficient parts or related maintenance and support services to us on a timely or economical basis, or the interruption of our flight operations as a result of unscheduled or unanticipated maintenance requirements for our aircraft or engines. In addition, the issuance of FAA directives restricting or prohibiting the use of Bombardier aircraft types we operate would have a material adverse effect on our business and operations.

**Maintenance costs will likely increase as the age of our regional jet fleet increases.**

Because the average age of our CRJ700s and CRJ200s is approximately 1.7 and 4.6 years, respectively, our regional jet fleet requires less maintenance now than it will in the future. We have incurred relatively low maintenance expenses on our regional jet fleet because most of the parts on our regional jet aircraft are under multi-year warranties and a limited number of heavy airframe checks and engine overhauls have occurred. Our maintenance costs will increase significantly, both on an absolute basis and as a percentage of our operating expenses, as our fleet ages and these warranties expire. Under our United Express Agreement, specific amounts are included in the rates for future maintenance on CRJ200 engines used in our United Express operations. The actual cost of maintenance on CRJ200 engines may vary from the estimated rates.

**If we incur problems with any of our third-party service providers, our operations could be adversely affected.**

Our reliance upon others to provide essential services on behalf of our operations may limit our ability to control the efficiency and timeliness of contract services. We have entered into agreements with contractors to provide various facilities and services required for our operations, including fuel supply and delivery, aircraft maintenance, services and ground facilities, and expect to enter into additional similar agreements in the future. These agreements are subject to termination after notice. Any material problems with the efficiency and timeliness of our automated or contract services could have a material adverse effect on our business, financial condition and results of operations.

**Interruptions or disruptions in service at one of our hub airports, due to adverse weather or for any other reason, could have a material adverse impact on our operations.**

We currently operate primarily through hubs in Atlanta, Los Angeles, San Francisco, Salt Lake City, Chicago, Denver, Cincinnati/Northern Kentucky and the Pacific Northwest. Nearly all of our flights will either originate or fly into one of these hubs. Our revenues depend primarily on our completion of flights and secondarily on service factors such as timeliness of departure and arrival. Any interruptions or disruptions could, therefore, severely and adversely affect us. Extreme weather can cause flight disruptions, and during periods of storms or adverse weather, fog, low temperatures, etc., our flights may be canceled or significantly delayed. Hurricanes Katrina and Rita, in particular, caused severe disruption to air travel in the affected areas and adversely affected airlines operating in the region, including ASA. We operate a significant number of flights to and from airports with particular weather difficulties, including Atlanta, Salt Lake City, Chicago and Denver. A significant interruption or disruption in service at one of our hubs, due to adverse weather or otherwise, could result in the cancellation or delay of a significant portion of our flights and, as a result, could have a severe impact on our business, operations and financial performance.

**Fluctuations in interest rates could adversely affect our liquidity, operating expenses and results.**

A substantial portion of our indebtedness bears interest at fluctuating interest rates. These are primarily based on the London interbank offered rate for deposits of U.S. dollars, or LIBOR. LIBOR tends to fluctuate based on general economic conditions, general interest rates, federal reserve rates and the supply of and demand for credit in the London interbank market. We have not hedged our interest rate exposure and, accordingly, our interest expense for any particular period may fluctuate based on LIBOR and other variable interest rates. To the extent these interest rates increase, our interest expense will increase, in which event, we may

have difficulty making interest payments and funding our other fixed costs and our available cash flow for general corporate requirements may be adversely affected.

**Our business could be harmed if we lose the services of our key personnel.**

Our business depends upon the efforts of our chief executive officer, Jerry C. Atkin, and our other key management and operating personnel. We may have difficulty replacing management or other key personnel who leave and, therefore, the loss of the services of any of these individuals could harm our business. We do not maintain key-man insurance on any of our executives.

**Risks Related to the Airline Industry**

**We may be materially affected by the uncertainty of the airline industry.**

The airline industry has experienced tremendous challenges in recent years and will likely remain volatile for the foreseeable future. Among other factors, the financial challenges faced by major carriers, including Delta, United and Northwest, the slowing U.S. economy and increased hostilities in Iraq, the Middle East and other regions have significantly affected, and are likely to continue to affect, the U.S. airline industry. These events have resulted in declines and shifts in passenger demand, increased insurance costs, increased government regulations and tightened credit markets, all of which have affected, and will continue to affect, the operations and financial condition of participants in the industry, including us, major carriers (including our major partners), competitors and aircraft manufacturers. These industry developments raise substantial risks and uncertainties which will affect us, major carriers (including our major partners), competitors and aircraft manufacturers in ways that we are unable to currently predict.

**The airline industry is highly competitive and has undergone a period of consolidation and transition leaving fewer potential code-share partners.**

The airline industry is highly competitive. We not only compete with other regional airlines, some of which are owned by or operated as code-share partners of major airlines, but we also face competition from low-cost carriers and major airlines on many of our routes. Low-cost carriers such as Southwest, JetBlue, US Airways, and AirTran, among others, operate at many of our hubs, resulting in significant price competition. Additionally, a large number of other carriers operate at our hubs, creating intense competition. Certain of our competitors are larger and have significantly greater financial and other resources than we do. Moreover, federal deregulation of the industry allows competitors to rapidly enter our markets and to quickly discount and restructure fares. The airline industry is particularly susceptible to price discounting because airlines incur only nominal costs to provide service to passengers occupying otherwise unsold seats. Increased fare competition could adversely affect our operations and the price of our common stock. The airline industry has undergone substantial consolidation, and it may in the future undergo additional consolidation. Recent examples include the merger between America West Airlines and US Airways in September 2005, and American Airlines' acquisition of the majority of Trans World Airlines' assets in 2001. Other developments include domestic and international code-share alliances between major carriers, such as the SkyTeam Alliance, that includes Delta, Continental and Northwest, among others. Any additional consolidation or significant alliance activity within the airline industry could limit the number of potential partners with whom we could enter into code-share relationships and materially adversely affect our relationship with our code-share partners.

**Terrorist activities or warnings have dramatically impacted the airline industry, and will likely continue to do so.**

The terrorist attacks of September 11, 2001 and their aftermath have negatively impacted the airline industry in general, including our operations. The primary effects experienced by the airline industry include a substantial loss of passenger traffic and revenue. Although, to some degree, airline passenger traffic and revenue have recovered since the September 11th attacks, additional terrorist attacks could have a similar or even more pronounced effect. Even if additional terrorist attacks are not launched against the airline industry, there will be lasting consequences of the attacks, including increased security and insurance costs, increased concerns about future terrorist attacks, increased government regulation and airport delays due to heightened security. Additional terrorist attacks and the fear of such attacks could negatively impact the airline industry, and result in further decreased passenger traffic and yields, increased flight delays or cancellations associated with new government mandates, as well as increased security, fuel and other costs. We cannot provide any assurance that these events will not harm the airline industry generally or our operations or financial condition in particular.



**Rapidly increasing fuel costs have adversely affected, and will likely continue to adversely affect, the operations and financial performance of the airline industry.**

The price of aircraft fuel is unpredictable and has increased significantly in recent periods. Higher fuel prices may lead to higher airfares, which would tend to decrease the passenger load of our code-share partners. In the long run, such decrease will have an adverse effect on the number of flights such partner will ask us to provide and the revenues associated with such flights. Additionally, fuel shortages have been threatened. The future cost and availability of fuel to us cannot be predicted, and substantial fuel cost increases or the unavailability of adequate supplies of fuel may have a material adverse effect on our results of operations. During periods of increasing fuel costs, our operating margins have been, and will likely continue to be, adversely affected.

**We are subject to significant governmental regulation.**

All interstate air carriers, including SkyWest Airlines and ASA, are subject to regulation by the DOT, the FAA and other governmental agencies. Regulations promulgated by the DOT primarily relate to economic aspects of air service. The FAA requires operating, air worthiness and other certificates; approval of personnel who may engage in flight, maintenance or operation activities; record keeping procedures in accordance with FAA requirements; and FAA approval of flight training and retraining programs. We cannot predict whether we will be able to comply with all present and future laws, rules, regulations and certification requirements or that the cost of continued compliance will not have a material adverse effect on our operations. We incur substantial costs in maintaining our current certifications and otherwise complying with the laws, rules and regulations to which we are subject. A decision by the FAA to ground, or require time-consuming inspections of or maintenance on, all or any of our aircraft for any reason may have a material adverse effect on our operations. In addition to state and federal regulation, airports and municipalities enact rules and regulations that affect our operations. From time to time, various airports throughout the country have considered limiting the use of smaller aircraft, such as our aircraft, at such airports. The imposition of any limits on the use of our aircraft at any airport at which we operate could have a material adverse effect on our operations.

**The occurrence of an aviation accident would negatively impact our operations and financial condition.**

An accident or incident involving one of our aircraft could result in significant potential claims of injured passengers and others, as well as repair or replacement of a damaged aircraft and its consequential temporary or permanent loss from service. In the event of an accident, our liability insurance may not be adequate to offset our exposure to potential claims and we may be forced to bear substantial losses from the accident. Substantial claims resulting from an accident in excess of our related insurance coverage would harm our operational and financial results. Moreover, any aircraft accident or incident, even if fully insured, could cause a public perception that our operations are less safe or reliable than other airlines.

**Risks Related to Our Common Stock**

**We can issue additional shares without shareholder approval.**

Our Restated Articles of Incorporation, as amended (the "Restated Articles"), authorize the issuance of up to 120,000,000 shares of common stock, all of which may be issued without any action or approval by our shareholders. As of June 30, 2006, we had 63,689,189 shares of common stock outstanding, net of treasury stock. In addition, we have a stock option plan under which 4,796,445 shares are reserved for issuance, and an employee stock purchase plan under which 2,500,000 shares are reserved for issuance, both of which may dilute the ownership interests of our shareholders. The issuance of any additional shares of common stock would further dilute the percentage ownership of existing shareholders. Our Restated Articles also authorize the issuance of up to 5,000,000 shares of preferred stock. Our board of directors has the authority to issue preferred stock with the rights and preferences, and at the price, which it determines. Any shares of preferred stock issued would likely be senior to shares of our common stock in various regards, including dividends, payments upon liquidation and voting. The value of our common stock could be negatively affected by the issuance of any shares of preferred stock.

**We issued more shares of common stock than were authorized by our employee stock purchase plan, which could result in administrative sanctions or other adverse consequences.**

During the quarter ended December 31, 2005, we discovered that in January and July 2005 we issued shares of common stock to our employees under the SkyWest, Inc. 1995 Employee Stock Purchase Plan (the "Employee Stock Purchase Plan") that exceeded the number of shares authorized for issuance under the Employee Stock Purchase Plan. In an effort to address the over issuance, we amended the SkyWest, Inc. Executive Stock Incentive Plan (the "Executive Plan") and the SkyWest, Inc. 2001 Allshare Stock Option Plan (the "Allshare Plan") to reduce the number of shares issuable pursuant to those plans by a number that exceeded the number of



shares issued in excess of the number of shares authorized pursuant to the Employee Stock Purchase Plan. On February 8, 2006, after reviewing the issues associated with the over issuance, the staff of The Nasdaq Stock Market notified us that the over issuance violated the shareholder approval rule set forth in Nasdaq Marketplace Rule 4350(i)(1)(A). The Nasdaq staff letter also notified us that the reduction in the number of shares issuable pursuant to the Executive Plan and the Allshare Plan, both of which had been previously approved by our shareholders, had the effect of restoring our compliance with Marketplace Rule 4350(i)(1)(A). The Nasdaq staff letter indicates that, as of the date of the letter, the matter is closed.

**Distribution of dividends may decrease or cease.**

Historically, we have paid dividends in varying amounts on our common stock. The future payment and amount of cash dividends will depend upon our financial condition and results of operations, loan covenants and other factors deemed relevant by our board of directors. There can be no assurance that we will continue our practice of paying dividends on our common stock or that we will have the financial resources to pay such dividends.

**Provisions of our charter documents and code-share agreements may affect the ability or desire of others to gain control of our company.**

Our ability to issue preferred and common shares without shareholder approval may have the effect of delaying or preventing a change in control and may adversely affect the voting and other rights of the holders of our common stock, even in circumstances where such a change in control would be viewed as desirable by most investors. The provisions of the Utah Control Shares Acquisition Act may also discourage the acquisition of a significant interest in or control of our company. Additionally, our code-share agreements contain termination and extension trigger provisions related to change in control type transactions that may have the effect of deterring a change in control of our company.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

On May 2, 2006, we held our 2006 Annual Meeting of Shareholders at which our shareholders considered and voted as follows on the items described below:

1. The shareholders considered whether to elect the following persons as directors, each to serve until the next annual meeting of shareholders and until his respective successor shall have been duly elected and shall qualify:

Name of Nominee	Votes For	Votes Withheld
W. Steve Albrecht	52,822,168	1,467,396
Jerry C. Atkin	52,124,763	2,200,585
J. Ralph Atkin	44,571,216	9,461,291
Mervyn K. Cox	52,997,355	1,338,612
Ian M. Cumming	47,025,430	7,264,239
Henry J. Eying	53,106,469	1,218,784
Steven F. Udvar-Hazy	46,120,947	8,223,823
Robert G. Sarver	53,121,239	1,214,528

2. The shareholders also considered a proposal to ratify the appointment by our Board of Directors of Ernst & Young, LLP as our independent public accountants for the fiscal year ending December 31, 2006. There were 53,610,093 votes cast in favor of the proposal, 102,640 votes cast against the proposal and 204,694 votes withheld.

3. The shareholders also considered a proposal to approve the adoption of the SkyWest, Inc. 2006 Employee Stock Purchase Plan. There were 47,544,532 votes cast in favor of the proposal, 1,093,314 votes cast against the proposal and 273,157 votes withheld.

4. Finally, the shareholders also considered a proposal to approve the adoption of the SkyWest, Inc. 2006 Long-Term Incentive Plan. There were 32,829,402 votes cast in favor of the proposal, 14,161,228 votes cast against

the proposal and 287,347 votes withheld.

34

---

**ITEM 6: EXHIBITS**

- 31.1 Certification of Chief Executive Officer
- 31.2 Certification of Chief Financial Officer
- 32.1 Certification of Chief Executive Officer
- 32.2 Certification of Chief Financial Officer

35

---



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Quarterly Report on Form 10-Q for the quarter ended June 30, 2006, to be signed on its behalf by the undersigned, thereunto duly authorized, on August 9, 2006.

SKYWEST, INC.

By

/s/ Bradford R. Rich  
Bradford R. Rich  
Executive Vice President,  
Chief Financial Officer and  
Treasurer