

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

FRONTIER AIRLINES INC /CO/  
Form 10-K  
June 15, 2004

**FORM 10-K**

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended March 31, 2004

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

Commission file number: 1-12805

**FRONTIER AIRLINES, INC.**

(Exact name of registrant as specified in its charter)

Colorado

84-1256945

(State or other jurisdiction of incorporated or organization) (I.R.S. Employer Identification No)

7001 Tower Road, Denver, CO

80249

(Address of principal executive offices)

(Zip Code)

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

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

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

Common Stock, No Par Value

Title of Class

Indicate by check mark whether the Registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes  No

The aggregate market value of common stock held by non-affiliates of the Company computed by reference to the last quoted price at which such stock sold on such date as reported by the Nasdaq National Market as of September 30, 2003 was \$571,006,527.

The number of shares of the Company's common stock outstanding as of June 1, 2004 is 35,603,442.

Documents incorporated by reference - Certain information required by Parts II and III is incorporated by reference to the Company's 2004 Proxy Statement.

**TABLE OF CONTENTS**

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

Page

PART I

Item 1:	Business.....	3
Item 2:	Properties .....	21
Item 3:	Legal Proceedings.....	22
Item 4:	Submission of Matters to a Vote of Security Holders.....	22

PART II

Item 5:	Market for Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.....	23
Item 6:	Selected Financial Data.....	24
Item 7:	Management's Discussion and Analysis of Financial Condition and Results of Operations.....	28
Item 7A:	Quantitative and Qualitative Disclosures About Market Risk.....	48
Item 8:	Financial Statements and Supplemental Data.....	48
Item 9:	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.....	48
Item 9A:	Controls and Procedures.....	49

PART III

Item 10:	Directors and Executive Officers of the Registrant.....	49
Item 11:	Executive Compensation.....	49
Item 12:	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.....	49
Item 13:	Certain Relationships and Related Transactions.....	50
Item 14:	Principal Accountant Fees and Services.....	50

PART IV

Item 15(a):	Exhibits, Financial Statement Schedules and Reports on Form 8-K.....	50
-------------	--	----

**PART I**

*This report contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 that describe the business and prospects of Frontier Airlines, Inc. and the expectations of our company and management. All statements, other than statements of historical facts, included in this report that address activities, events or developments that we expect, believe, intend or anticipate will or may occur in the future, are forward-looking statements. When used in this document, the words "estimate," "anticipate," "project" and similar expressions are intended to identify forward-looking statements. Forward-looking statements are inherently subject to risks and uncertainties, many of which cannot be predicted with accuracy and some of which might not even be anticipated. These risks and uncertainties include, but are not limited to: the timing of, and expense associated with, expansion and modification of our operations in accordance with our business strategy or in response to competitive pressures or other factors; the inability to obtain sufficient gates at Denver International Airport to accommodate the expansion of our operations; general economic factors and behavior of the fare-paying public and its potential impact on our liquidity; terrorist attacks or other incidents that could cause the public to question the safety and/or efficiency of air travel; operational disruptions, including weather; industry consolidation; the impact of labor disputes; enhanced security requirements; changes in the government's*

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

*policy regarding relief or assistance to the airline industry; the economic environment of the airline industry generally; increased federal scrutiny of low-fare carriers generally that may increase our operating costs or otherwise adversely affect us; actions of competing airlines, such as increasing capacity and pricing actions of United Airlines ("United") and other competitors and other actions taken by United either in or out of bankruptcy protection; the availability of suitable aircraft, which may inhibit our ability to achieve operating economies and implement our business strategy; the unavailability of, or inability to secure upon acceptable terms, financing necessary to purchase aircraft that we have ordered or lease aircraft we anticipate adding to our fleet through lease financing; issues relating to our transition to an Airbus aircraft fleet; uncertainties regarding aviation fuel prices; and uncertainties as to when and how fully consumer confidence in the airline industry will be restored, if ever. Because our business, like that of the airline industry generally, is characterized by high fixed costs relative to revenues, small fluctuations in our yield per available seat mile ("RASM") or cost per available seat mile ("CASM") can significantly affect operating results.*

### **Item 1: Business**

#### **General**

Now in our tenth year of operations, we are a low cost, affordable fare airline operating primarily in a hub and spoke fashion connecting cities coast to coast primarily through our hub at Denver International Airport ("DIA"). We are the second largest jet service carrier at DIA based on departures. As of June 1, 2004, we, in conjunction with Frontier JetExpress operated by Horizon Air Industries, Inc. ("Horizon"), operate routes linking our Denver hub to 43 U.S. cities spanning the nation from coast to coast and to five cities in Mexico. In April 2004, we began our first expansion of point-to-point routes outside of our DIA hub with three routes from our focus city Los Angeles, California ("LAX") and added an additional route in May 2004.

We were organized in February 1994 and we began flight operations in July 1994 with two leased Boeing 737-200 jets. We have since expanded our fleet in service to 41 jets as of June 1, 2004 (27 of which we lease and 14 of which we own), consisting of nine Boeing 737-300s, 2 Airbus A319s, and six Airbus A318s. In May 2001, we began a fleet replacement plan to replace our Boeing aircraft with new purchased and leased Airbus jet aircraft, a transition we expect to complete by September 2005. As of November 1, 2003, we no longer operate Boeing 737-200 aircraft. During the years ended March 31, 2003 and 2004, we increased year-over-year capacity by 30.9% and 19.0%, respectively. During the year ended March 31, 2004, we increased passenger traffic by 42.3% over the prior year, outpacing our increase in capacity during the period. We intend to continue our growth strategy and will add frequency to new markets and existing markets that we believe are underserved.

We currently operate on 16 gates on Concourse A at DIA on a preferential basis. Together with our regional jet codeshare partner, Frontier JetExpress, we use these 16 gates and share use of up to four common use regional jet parking positions to operate approximately 204 daily system flight departures and arrivals and 50 Frontier JetExpress daily system flight departures and arrivals.

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

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

In March 2003, we entered into an agreement with Juniper Bank ([www.juniperbank.com](http://www.juniperbank.com)), a full-service credit card issuer, to offer exclusively Frontier MasterCard products to consumers, customers and Frontier's EarlyReturns frequent flyer members. We launched the co-branded credit card in May 2003. We believe that the Frontier/Juniper Bank co-branded MasterCard offers one of the most aggressive affinity card programs because free travel can be earned for as little as 15,000 miles.

In October 2002, we signed a purchase and long-term services agreement with LiveTV to bring DIRECTV AIRBORNE(TM) satellite programming to every seatback in our Airbus fleet. We have completed the installation of the LiveTV system on all of our Airbus A318 and A319 aircraft. We have implemented a \$5 per segment usage charge for access to the system to offset the costs for the system equipment, programming and services. We are also in discussions with film distributors to offer current-run pay-per-view movies on four additional channels to be added to our basic LiveTV service. We cannot predict whether or when we will provide this service. We believe the DIRECTV(TM) product represents a significant value to our customers and offers competitive advantage for our company.

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

Our filings with the Securities and Exchange Commission are available at no cost on our website, [www.frontierairlines.com](http://www.frontierairlines.com), in the Investor Relations folder contained in the section titled "About Frontier". These reports include our annual report on Form 10-K, our quarterly reports on Form 10-Q, current reports on Form 8-K, Section 16 reports on Forms 3, 4 and 5, and any related amendments or other documents, and are made available as soon as reasonably practicable after we file the materials with the SEC.

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

### **Business Strategy and Markets**

Our business strategy is to provide air service at affordable fares to high volume markets from our DIA hub and limited point-to-point routes outside of our DIA hub principally from our Los Angeles focus city. Our strategy is based on the following factors:

- o Stimulate demand by offering a combination of low fares, quality service and frequent flyer credits in our frequent flyer program, EarlyReturns.
- o Expand our Denver hub operation and increase connecting traffic by adding additional high volume markets to our current route system and by code sharing agreements.
- o Continue filling gaps in flight frequencies to current markets from our DIA hub and evaluate other opportunities for additional non-hub point-to-point routes.

### **Route System Strategy**

Our route system strategy encompasses connecting our Denver hub to top business and leisure destinations. We currently serve 21 of the top 25 destinations from Denver, as defined by the U.S. Department of Transportation's Origin and Destination Market Survey. During the year ended March 31, 2004 and as of June 1, 2004, we added departures from DIA to the following cities with commencement dates as follows:

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

<u>Destination</u>	<u>Commencement Date</u>
Milwaukee, Wisconsin	August 31, 2003
Santa Ana, California	August 31, 2003
St. Louis, Missouri	November 1, 2003
Cabo San Lucas, Mexico	November 22, 2003
Puerto Vallarta, Mexico	November 22, 2003
Ixtapa/Zihuatanejo, Mexico	January 31, 2004
Washington, D.C. (Dulles International)	April 11, 2004
Anchorage, Alaska (1)	May 9, 2004
Billings, Montana (2)	May 23, 2004
Spokane, Washington (2)	May 23, 2004
Philadelphia, Pennsylvania	May 23, 2004

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

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

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

We will continue to maintain a disciplined growth strategy by focusing on the growth of our DIA hub, increasing frequency on our existing routes, and entering new markets.

We intend to begin service to Nashville, Tennessee from our DIA hub with two daily round-trip frequencies on June 20, 2004. We have also been granted four additional slots, representing two more round trips, at Ronald Reagan Washington National Airport ("National") and intend to increase our flights to this destination from one daily round-trip frequency to three daily round-trip frequencies from our Denver hub with the second round-trip frequency beginning July 1, 2004 and the third round-trip frequency beginning July 18, 2004.

In April 2004, we filed an application with the U.S. Department of Transportation ("DOT") for authorization to serve Cancun, Mexico from Kansas City International Airport, Lambert-St. Louis International Airport and Salt Lake City International Airport. We have been granted authority and intend to serve Cancun, Mexico from Kansas City International Airport and Salt Lake City International Airport beginning July 3, 2004 with one weekly round-trip frequency. If we are granted authority from the DOT, we intend to begin one weekly round-trip frequency from St. Louis to Cancun on November 7, 2004.

### **Marketing and Sales**

Our sales efforts are targeted to price-sensitive passengers in both the leisure and corporate travel markets. In the leisure market, we offer discounted fares marketed through the Internet, newspaper, radio and television advertising along with special promotions. In May 2003, we launched a new brand strategy and advertising campaign designed to identify Frontier as "A Whole Different Animal" and set us apart from our competition. The campaign includes television, print and radio components that began running in the Denver market and have since expanded to additional markets along our routes. We have gathered extensive customer and employee feedback that has allowed us to identify elements of service that are important to our customers who have the potential to fly with us more often.

In conjunction with the branding campaign, we have signed sponsorship agreements to be the exclusive airline of The Pepsi Center in Denver, Denver's National Hockey League team, the Colorado Avalanche, and Denver's National Basketball Association team, the Nuggets. We have also signed sponsorship agreements with Colorado's Major League Baseball team the Rockies, Colorado's National Lacrosse League team, the Colorado Mammoth, and Colorado's Arena Football

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

League team, the Colorado Crush. We have also entered into sponsorship agreements to be the exclusive airline partner for the college athletic programs of the Air Force Academy, Colorado State University, the University of Denver, the University of Northern Colorado, and University of Colorado. The agreements allow for prominent signage in applicable stadiums and arenas; participation in-game promotions; receipt of prominent logo and advertising placement in publications; and access to joint promotion opportunities. These agreements vary in terms of length.

In order to increase connecting traffic, we began two code share agreements, one with Great Lakes, Aviation Ltd. in July 2001 and the other with Mesa Air Group operating as Frontier JetExpress in February 2002. Mesa was subsequently replaced with Horizon in January 2004. We have also negotiated interline agreements with approximately 110 domestic and international airlines serving cities on our route system. Generally, these agreements include joint ticketing and baggage services and other conveniences designed to expedite the connecting process.

To balance the seasonal demand changes that occur in the leisure market, we have introduced programs over the past several years that are designed to capture a larger share of the corporate market, which tends to be less seasonal than the leisure market. These programs include negotiated fares for large companies that sign contracts committing to a specified volume of travel, future travel credits for small and medium size businesses contracting with us, and special discounts for members of various trade and nonprofit associations.

We also pursue sales opportunities with meeting and convention arrangers and government travel offices. The primary tools we use to attract this business include personal sales calls, direct mail and telemarketing. In addition, we offer air/ground vacation packages to many destinations on our route system under contracts with various tour operators.

Our relationship with travel agencies is important to us and other airlines. In March 2002, several of the major airlines eliminated travel agency "base" commissions but continued to pay individually negotiated incentive commissions to select agents. Effective June 1, 2002, we also eliminated travel agency base commissions with the exception of certain strategic relationships. We communicate with travel agents through personal visits by our executives and sales managers, sales literature mailings, trade shows, telemarketing and advertising in various travel agent trade publications.

We participate in the four major computer reservation systems used by travel agents to make airline reservations: Amadeus, Galileo, Worldspan and Sabre. We maintain reservation centers in Denver, Colorado and Las Cruces, New Mexico, operated by our employees.

### **Customer Loyalty Programs**

Effective February 1, 2001, we commenced *EarlyReturns*, our own frequent flyer program. Our frequent flyer program won awards at this year's Freddie Awards for frequent flyer programs and was one of the youngest frequent flyer programs to be recognized. *EarlyReturns* was awarded second place for best customer service, best award redemption, best bonus promotion, and best award for the 15,000 miles ticket redemption. In addition, *EarlyReturns* was awarded third place for program of the year. We believe that our frequent flyer program offers some of the most generous benefits in the industry, including a free round trip after accumulating only 15,000 miles (25,000 miles to our destinations in Mexico). There are no blackout dates for award travel. Additionally, members who earn 25,000 or more annual credited *EarlyReturns* flight miles attain Summit Level status, which includes a 25% mileage bonus on each paid Frontier flight, priority check-in and boarding, complimentary on-board alcoholic beverages, extra allowance on checked baggage and priority baggage handling, guaranteed reservations on any Frontier flight when purchasing an unrestricted coach class ticket at least 72 hours prior to departure, standby at no charge on return flights the day before, the day of, and the day after, and access to an exclusive Summit customer service toll-free phone number. Members earn one mile for every mile flown on Frontier plus additional mileage with program partners, which presently include Midwest Airlines, Virgin Atlantic Airways, Alamo, Hertz, National and Dollar Car Rentals, Kimpton Boutique Hotels, Inverness Hotel & Golf Resort, Peaks at Vail Resorts, The Flower Club and Citicorp Diners Club, Inc. Effective September 2002, our reciprocal frequent flyer agreement with Continental Airlines ended. To apply for the *EarlyReturns* program,

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

customers may visit our Web site at [www.frontierairlines.com](http://www.frontierairlines.com), obtain an *EarlyReturns* enrollment form at any of our airport counters or call our *EarlyReturns* Service Center toll-free hotline at 866-26-EARLY, or our reservations at 800-4321-FLY.

### Product Pricing

In January 2004, we capped all fares to and from Denver at \$314 one-way, excluding passenger facility, security or segment fees, with the exception of flights to Mexico and Anchorage, Alaska. The \$314 fare is a base fare of \$299 plus a \$15 fuel surcharge, which is temporarily in place. The new fare cap is a 25 to 50 percent reduction from the February 2003 caps of \$399 and \$499. Unlike some other airlines, these fares can be booked each way, allowing customers to get the best price on both the inbound and outbound portion of their itinerary with no round-trip purchase required. Our new fare structure reinstated some of the advance purchase requirements of past pricing structures.

### Competition

The Airline Deregulation Act of 1978 produced a highly competitive airline industry, freed of certain government regulations that for 40 years prior to the Deregulation Act had dictated where domestic airlines could fly and how much they could charge for their services. Since then, we and other smaller carriers have entered markets long dominated by larger airlines with substantially greater resources, such as United Airlines, American Airlines, Northwest Airlines and Delta Air Lines.

In February 2003, United launched a new low-fare airline, Ted, which we believe was developed in an attempt to operate with lower costs than United's mainline operations. We cannot predict if other major carriers will also begin to offer low-cost business models in response to competition from low-fare airlines or whether these attempts will prove to be successful.

We compete principally with United, the dominant carrier at DIA. During the month of March 2004, United, Ted, and its commuter affiliates had a total market share at DIA of approximately 60.0%, down from 62.6% during the month of March 2003. United has a competitive advantage due to its larger number of flights from DIA. Our market share, including our codeshare affiliates, at DIA for the month of March 2004 approximated 17.9%, up from 13.1% during the month of March 2003. We compete with United primarily on the basis of fares, fare flexibility, the number of markets we operate in and the number of frequencies within a market, our frequent flyer programs and the quality of our customer service.

At the present time, three domestic airports, including New York's LaGuardia and John F. Kennedy International Airports and Washington Ronald Reagan National Airport, are regulated by means of "slot" allocations, which represent government authorization to take off or land at a particular airport within a specified time period. Federal Aviation Administration ("FAA") regulations require the use of each slot at least 80% of the time and provide for forfeiture of slots in certain circumstances. We were awarded six high-density exemption slots at LaGuardia, and at the present time, we utilize these slots to operate three daily round-trip flights between Denver and LaGuardia. In addition to slot restrictions, National is limited by a perimeter rule, which limits flights to and from National to 1,250 miles. In April 2000, the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century, or AIR 21, was enacted. AIR 21 authorizes the Department of Transportation ("DOT") to grant up to 12 slot exemptions beyond the 1,250-mile National perimeter, provided certain specifications are met. Under AIR 21, we were awarded two slots for one daily round trip flight. In 2004 the Vision 100 - Century of Flight Aviation Authorization Act was enacted, which authorized the DOT to grant an additional 12 slot exemptions into Reagan National. In April 2004, we were granted four additional slots at National.

Other airports around the country, such as John Wayne International Airport in Santa Ana, California (SNA) are also slot controlled at the local level as mandated by a federal court order. We were originally awarded six arrival and departure slots at SNA, or three daily round trips. We began service with two daily flights to SNA in August 2003 and began a third daily flight in March 2004.

## Maintenance and Repairs

All of our aircraft maintenance and repairs are accomplished in accordance with our maintenance program approved by the FAA. We maintain spare or replacement parts primarily in Denver, Colorado. Spare parts vendors supply us with certain of these parts, and we purchase or lease others from other airline or vendor sources.

Since mid-1996, we have trained, staffed and supervised our own maintenance work force at Denver, Colorado. We sublease a portion of Continental Airlines hangar at DIA where we currently perform most of our own maintenance through the "D" check level. Other major maintenance, such as major engine repairs, is performed by outside FAA approved contractors. We also maintain line maintenance facilities at Phoenix, Arizona and Kansas City, Missouri. The new maintenance facility at Kansas City International airport commenced operations on April 1, 2004. Effective August 30, 2003, we closed the El Paso, Texas line maintenance facility and transferred the functions to the facilities in Denver and Phoenix.

Under our aircraft lease agreements, we pay all expenses relating to the maintenance and operation of our aircraft, and we are required to pay supplemental monthly rent payments to the lessors based on usage. Supplemental rents are applied against the cost of scheduled major maintenance. To the extent not used for major maintenance during the lease terms, excess supplemental rents are forfeited to the aircraft lessors after termination of the lease.

Our monthly completion factors for the years ended March 31, 2004, 2003, and 2002 ranged from 98.9% to 99.9%, 98.2% to 99.7%, from 97.3% to 99.8%, respectively. The completion factor is the percentage of our scheduled flights that were operated by us (i.e., not canceled). Canceled flights were principally as a result of mechanical problems, and, to a lesser extent, weather. We believe that the year over year improvement in our monthly completion factors is attributable to better maintenance and the increase in aircraft reliability as a result of the new Airbus aircraft added to our fleet.

In December 2002, we entered into an engine maintenance agreement with GE Engine Service Inc. (GE) for the servicing, repair, maintenance and functional testing of our aircraft engines used on our Airbus aircraft effective January 1, 2003. The agreement is for a 12-year period from the effective date for our owned aircraft or December 31, 2014, whichever comes first, and for each leased aircraft the term coincides with the initial lease term of 12 years. This agreement precludes us from using another third party for such services during the term on the covered engines. This agreement requires monthly payments at a specified rate times the number of flight hours the engine operated during that month. In most instances, we have been able to negotiate with our lessors to coordinate the monthly payments due under our agreement with GE and the supplemental rent applicable to the engines under the lease.

In calendar years 1999 through 2004, our maintenance and engineering department received the FAA's highest award, the Diamond Certificate of Excellence, in recognition of 100 percent of our maintenance and engineering employees completing advanced aircraft maintenance training programs. The Diamond Award recognizes advanced training for aircraft maintenance professionals throughout the airline industry. We were the first Part 121 domestic air carrier to achieve 100 percent participation in this training program by our maintenance employees.

## Fuel

During the years ended March 31, 2004, 2003, and 2002, jet fuel accounted for 17.7%, 17.2%, and 14.3%, respectively, of our operating expenses. We have arrangements with major fuel suppliers for substantial portions of our fuel requirements, and we believe that these arrangements assure an adequate supply of fuel for current and anticipated future operations. Jet fuel costs are subject to wide fluctuations as a result of sudden disruptions in supply beyond our control. Therefore, we cannot predict the future availability and cost of jet fuel with any degree of certainty. Fuel prices increased significantly in fiscal 2004. Our average fuel price per gallon including taxes and into-plane fees was \$1.04 for the year ended March 31, 2004, with the monthly average price per gallon during the same period ranging from a low of 89(cents) to a high of \$1.20. Our average fuel price per gallon including taxes and into-plane fees was 96(cents) for the year ended March 31, 2003, with the monthly average price per

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

gallon during the same period ranging from a low of 82(cents) to a high of \$1.26. As of June 1, 2004, the price per gallon was approximately 1.34(cents) excluding the impact of fuel hedges. We implemented a fuel hedging program in 2003, under which we enter into Gulf Coast jet fuel option contracts to partially protect us against significant increases in fuel prices. Our fuel hedging program is limited in fuel volume and duration. As of March 31, 2004, we had hedged approximately 6.0% of our projected fuel requirements for the quarter ending June 30, 2004. On May 21, 2004, we entered into an additional derivative transaction that hedges approximately 25% of our projected fuel requirements in the quarters ending December 31, 2004 and March 31, 2005.

Increases in fuel prices or a shortage of supply could have a material adverse effect on our operations and financial results. Our ability to pass on increased fuel costs to passengers through price increases or fuel surcharges may be limited, particularly because of our affordable fare strategy.

### **Insurance**

We carry insurance limits of \$800 million per aircraft per occurrence in property damage and passenger and third-party liability insurance, and insurance for aircraft loss or damage with deductible amounts as required by our aircraft lease agreements, and customary coverage for other business insurance. While we believe such insurance is adequate, there can be no assurance that such coverage will adequately protect us against all losses that we might sustain. Our aircraft hull and liability coverage renewed on June 7, 2004 for one year.

In December 2002, through authority granted under the Homeland Security Act of 2002, the U.S. government expanded its insurance program to enable airlines to elect either the government's excess third-party war risk coverage or for the government to become the primary insurer for all war risks coverage. We elected to take primary government coverage in February 2003 and dropped the commercially available war risk coverage. The Appropriations Act of 2002 authorized the government to offer both policies through August 31, 2004. We cannot assure you that any extension will occur, or if it does, how long the extension will last. We expect that if the government stops providing war risk coverage to the airline industry, the premiums charged by aviation insurers for this coverage will be substantially higher than the premiums currently charged by the government.

### **Employees**

As of June 1, 2004, we had 4,392 employees, including 3,473 full-time and 919 part-time personnel. Our employees included 545 pilots, 790 flight attendants, 1,063 customer service agents, 536 ramp service agents, 308 reservations agents, 109 aircraft appearance agents, 79 catering agents, 342 mechanics and related personnel, and 620 general management and administrative personnel. We consider our relations with our employees to be good.

We have established a compensation philosophy that we will pay competitive wages compared to other airlines of similar size and other employers with which we compete for our labor supply. Employees have the opportunity to earn above market rates through the payment of profit sharing bonuses.

Three of our employee groups have voted for union representation: our pilots voted in November 1998 to be represented by an independent union, the Frontier Airline Pilots Association, our dispatchers voted in September 1999 to be represented by the Transport Workers Union, and our mechanics voted in July 2001 to be represented by the International Brotherhood of Teamsters. The first bargaining agreement for the pilots, which has a five-year term, was ratified and became effective in May 2000. Negotiations for a new agreement will begin in early 2005. The first bargaining agreement for the dispatchers, which had a three-year term, was ratified and became effective in September 2000. A new three-year agreement with the dispatchers became effective on September 14, 2003. The first bargaining agreement for the mechanics, which has a three-year term, was ratified and became effective in July 2002. Negotiations for a new agreement will begin in mid-2005. In July 2003, the International Brotherhood of Teamsters filed an application with the National Mediation Board "NMB" for an accretion of the Company's aircraft appearance agents and maintenance cleaners into the mechanics union. On October 9, 2003, the NMB issued a decision that the aircraft appearance

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

agents and maintenance cleaners should be accreted into the mechanics union. We appealed this decision, and in February 2004 the NMB denied the appeal. Negotiations with these two employee groups began in May 2004. Since 1997, we have had other union organizing attempts that were defeated by our flight attendants, ramp service agents, and material services specialists. We have received official notification from the NMB of a representation application for our material services specialists by the International Brotherhood of Teamsters. An election has been authorized which will be held from June 30, 2004 through July 21, 2004 and the results will be announced on July 21, 2004.

Effective May 2000, we enhanced our 401(k) Retirement Savings Plan by announcing an increased matching contribution by the Company. Participants may receive a 50% Company match for contributions up to 10% of salary. This match is discretionary and is approved on an annual basis by our Board of Directors. The Board of Directors has approved the continuation of the match through the plan year ending December 31, 2004. We also have an Employee Stock Ownership Plan, to which the Board of Directors may authorize contributions of company stock for further allocation to employees. For the plan year ended December 31, 2003 and for the plan year ending December 31, 2004, the Board of Directors contributed 347,968 and 298,174 shares of stock to the plan, respectively. These shares are allocated to eligible employees at the end of the plan year. Employees become vested in shares allocated to their account 20% per year, and may obtain a distribution of vested shares upon leaving the company. We believe that the 401(k) match and the Company ESOP and the related vesting schedules of 20% per year may reduce our employee turnover rates.

All new employees are subject to pre-employment drug testing. Those employees who perform safety sensitive functions are also subject to random drug and alcohol testing, and testing in the event of an accident.

Training, both initial and recurring, is required for many employees. We train our pilots, flight attendants, ground service personnel, reservations personnel and mechanics. FAA regulations require pilots to be licensed as commercial pilots, with specific ratings for aircraft to be flown, to be medically certified or physically fit, and have recent flying experience. Mechanics, quality control inspectors and flight dispatchers must be licensed and qualified for specific aircraft. Flight attendants must have initial and periodic competency, fitness training and certification. The FAA approves and monitors our training programs. Management personnel directly involved in the supervision of flight operations, training, maintenance and aircraft inspection must meet experience standards prescribed by FAA regulations.

### **Government Regulation**

*General.* All interstate air carriers are subject to regulation by the DOT, the FAA and other state and federal government agencies. In general, the amount of regulation over domestic air carriers in terms of market entry and exit, pricing and inter-carrier agreements has been greatly reduced since the enactment of the Deregulation Act.

*U.S. Department of Transportation.* The DOT's jurisdiction extends primarily to the economic aspects of air transportation, such as certification and fitness, insurance, advertising, computer reservation systems, deceptive and unfair competitive practices, and consumer protection matters such as on-time performance, denied boarding and baggage liability. The DOT also is authorized to require reports from air carriers and to investigate and institute proceedings to enforce its economic regulations and may, in certain circumstances, assess civil penalties, revoke operating authority and seek criminal sanctions. We hold a Certificate of Public Convenience and Necessity issued by the DOT that allows us to engage in air transportation.

*Transportation Security Administration.* On November 19, 2001, in response to the terrorist acts of September 11, 2001, the President of the United States signed into law the Aviation and Transportation Security Act ("ATSA"). The ATSA created the Transportation Security Administration, an agency within the DOT, to oversee, among other things, aviation and airport security. The ATSA provided for the federalization of airport passenger, baggage, cargo, mail and employee and vendor screening processes. The ATSA also enhanced background checks, provided federal air marshals aboard flights, improved flight deck security, and

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

enhanced security for airport perimeter access. The ATSA also required that all checked baggage be screened by explosive detection systems by December 31, 2002.

*U.S. Federal Aviation Administration.* The FAA's regulatory authority relates primarily to flight operations and air safety, including aircraft certification and operations, crew licensing and training, maintenance standards, and aircraft standards. The FAA also oversees aircraft noise regulation, ground facilities, dispatch, communications, weather observation, and flight and duty time. It also controls access to certain airports through slot allocations, which represent government authorization for airlines to take off and land at controlled airports during specified time periods. The FAA has the authority to suspend temporarily or revoke permanently the authority of an airline or its licensed personnel for failure to comply with FAA regulations and to assess civil and criminal penalties for such failures. We hold an operating certificate issued by the FAA pursuant to Part 121 of the Federal Aviation Regulations. We must have and we maintain FAA certificates of airworthiness for all of our aircraft. Our flight personnel, flight and emergency procedures, aircraft and maintenance facilities and station operations are subject to periodic inspections and tests by the FAA.

*Environmental Matters.* The Aviation Safety and Noise Abatement Act of 1979, the Airport Noise and Capacity Act of 1990 and Clean Air Act of 1963 oversee and regulate airlines with respect to aircraft engine noise and exhaust emissions. We are required to comply with all applicable FAA noise control regulations and with current exhaust emissions standards. Our fleet is in compliance with the FAA's Stage 3 noise level requirements. In addition, various elements of our operation and maintenance of our aircraft are subject to monitoring and control by federal and state agencies overseeing the use and disposal of hazardous materials and storm water discharge. We believe we are currently in substantial compliance with all material requirements of such agencies.

*Railway Labor Act/National Mediation Board.* Three of our employee groups have voted for union representation: our pilots are represented by an independent union, the Frontier Airline Pilots Association, our dispatchers are represented by the Transport Workers Union, and our mechanics, tool room attendants, aircraft appearance agents and maintenance cleaners are represented by the International Brotherhood of Teamsters. Our labor relations with respect to these unions are covered under Title II of the Railway Labor Act and are subject to the jurisdiction of the National Mediation Board.

*Foreign Operations.* The availability of international routes to U.S. carriers is regulated by treaties and related agreements between the United States and foreign governments. The United States typically follows the practice of encouraging foreign governments to enter into "open skies" agreements that allow multiple carrier designation on foreign routes. In some cases, countries have sought to limit the number of carriers allowed to fly these routes. Certain foreign governments impose limitations on the ability of air carriers to serve a particular city and/or airport within their country from the U.S. For a U.S. carrier to fly to any such international destination, it must first obtain approval from both the U.S. and the "foreign country authority". For those international routes where there is a limit to the number of carriers or frequency of flights, studies have shown these routes have more value than those without restrictions. In the past, U.S. government route authorities have been sold between carriers.

*Foreign Ownership.* Pursuant to law and DOT regulation, each United States air carrier must qualify as a United States citizen, which requires that its President and at least two-thirds of its Board of Directors and other managing officers be comprised of United States citizens, that not more than 25% of its voting stock may be owned by foreign nationals, and that the carrier not be otherwise subject to foreign control.

*Miscellaneous.* We are also subject to regulation or oversight by other federal and state agencies. Antitrust laws are enforced by the U.S. Department of Justice and the Federal Trade Commission. All air carriers are subject to certain provisions of the Communications Act of 1934 because of their extensive use of radio and other communication facilities, and are required to obtain an aeronautical radio license from the Federal Communications Commission. The Immigration and Naturalization Service, the U.S. Customs Service and the Animal and Plant Health Inspection Service of the U.S. Department of Agriculture each have jurisdiction over

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

certain aspects of our aircraft, passengers, cargo and operations.

### **Risk Factors**

In addition to the other information contained in this Form 10-K, the following risk factors should be considered carefully in evaluating our business and us. Our business, financial condition or results of operations could be materially adversely affected by any of these risks. In addition, please read "Special Note About Forward-Looking Statements" in this Form 10-K, where we describe additional uncertainties associated with our business and the forward-looking statements included or incorporated by reference in this Form 10-K. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by us described below and elsewhere included or incorporated by reference in this Form 10-K. Please note that additional risks not presently known to us or that we currently deem immaterial may also impair our business and operations.

### **Risks Related to Frontier**

#### ***We may not be able to obtain or secure financing for our new aircraft.***

As of March 31, 2004, we have commitments to purchase 13 additional new Airbus A319 aircraft and one additional Airbus A318 aircraft, excluding the June and July 2004 sale-leaseback aircraft. We have secured financing commitments for one additional Airbus A318 aircraft and have executed a sale-leaseback agreement for two A319 Aircraft. To complete the purchase of the remaining aircraft, we must secure aircraft financing, which we may not be able to obtain on terms acceptable to us, if at all. The amount of financing required will depend on the required down payment on mortgage financed aircraft and the extent to which we lease as opposed to purchase the aircraft. We are exploring various financing alternatives, including, but not limited to, domestic and foreign bank financing, leveraged lease arrangements or sale/leaseback transactions. There can be no guarantee that additional financing will be available when required or on acceptable terms. The inability to secure the financing could have a material adverse effect on our cash balances or result in delays in or our inability to take delivery of Airbus aircraft that we have agreed to purchase, which would impair our strategy for long-term growth and could result in the loss of pre-delivery payments and deposits previously paid to the manufacturer, and/or the imposition of other penalties or the payment of damages for failure to take delivery of the aircraft in accordance with the terms of the purchase agreement with the manufacturer.

#### ***We have a significant amount of fixed obligations and we will incur significantly more fixed obligations, which could increase the risk of failing to meet payment obligations.***

As of March 31, 2004, our total debt was \$297 million. Maturities of our long-term debt are \$17 million in fiscal year 2005, \$17 million in fiscal year 2006, \$18 million in fiscal year 2007, \$19 million in 2008, \$20 million in 2009, and an aggregate of \$206 million for the years thereafter. After accounting for the effect of our interest rate derivative hedge, approximately 85.8% of our total long-term debt bears floating interest rates, and the remaining 14.2% bears fixed rates. In addition to long-term debt, we have a significant amount of other fixed obligations under operating leases related to our aircraft, airport terminal space, other airport facilities and office space. As of March 31, 2004, future minimum lease payments under noncancelable operating leases were approximately \$121 million in fiscal year 2005, \$118 million in fiscal year 2006, \$118 million in fiscal year 2007, \$119 million in fiscal year 2008, \$116 million in fiscal year 2009 and an aggregate of \$726 million for the years thereafter. Approximately 88% of our minimum lease payments are fixed in nature, and the remaining 12% are adjusted periodically based on floating interest rates. As of March 31, 2004, we will have commitments of approximately \$531 million to purchase 14 additional aircraft, including the June and July 2004 sale-leaseback aircraft over approximately the next four years, including estimated amounts for contractual price escalations, spare parts to support these aircraft and to equip the aircraft with LiveTV. We have also signed lease agreements representing an obligation to lease 22 aircraft over the next three years, which, subject to the satisfaction of certain contingencies, represent lease payments of about \$1,318 million in the aggregate. We will incur additional debt or long-term lease obligations as we take delivery of new aircraft and other equipment and continue to expand into new markets.

***Many of our financial obligations contain cross-default provisions.***

Financial arrangements that contain cross-default provisions could be declared in default and all amounts outstanding could be declared immediately due and payable. If we did not have sufficient available cash to pay all amounts that become due and payable, we would have to seek additional debt or equity financing, which may not be available on acceptable terms, or at all. If such financing were not available, we would have to sell assets in order to obtain the funds required to make the accelerated payments.

***Our failure to successfully implement our growth strategy could harm our business.***

Our growth strategy involves transitioning to an all Airbus fleet, including the addition of up to 32 Airbus aircraft, increasing the frequency of flights to markets we currently serve, expanding the number of markets served and increasing flight connection opportunities. It is critical that we achieve our growth strategy in order for our business to attain economies of scale and to sustain or improve our results of operations. Increasing the number of markets we serve depends on our ability to access suitable airports located in our targeted geographic markets in a manner that is consistent with our cost strategy. We will also need to obtain additional gates and other operational facilities at DIA. Any condition that would deny, limit or delay our access to airports we seek to serve in the future will constrain our ability to grow. Opening new markets requires us to commit a substantial amount of resources, even before the new services commence. Expansion will also require additional skilled personnel, equipment and facilities. An inability to hire and retain skilled personnel or to secure the required equipment and facilities efficiently and cost-effectively may affect our ability to achieve our growth strategy. We cannot assure you that we will be able to successfully expand our existing markets or establish new markets, and our failure to do so could harm our business.

Transition and growth of our fleet and expansion of our markets and services may also strain our existing management resources and systems to the point that they may no longer be adequate to support our operations, requiring us to make significant expenditures in these areas. We expect that we may need to further develop our information technology systems and other corporate infrastructure to accommodate future growth. We cannot assure you that we will be able to sufficiently develop our systems and infrastructure on a timely basis, and the failure to do so could harm our business.

***We depend heavily on the Denver market to be successful.***

Our business strategy has historically focused on adding flights to and from our Denver base of operations. A reduction in our share of the Denver market, increased competition, or reduced passenger traffic to or from Denver could have a material adverse effect on our financial condition and results of operations. In addition, our dependence on a hub system operating out of DIA makes us more susceptible to adverse weather conditions and other traffic delays in the Rocky Mountain region than some of our competitors that may be better able to spread these traffic risks over large route networks.

***We face intense competition and market dominance by United and uncertainty with respect to its ability to emerge from Chapter 11 successfully; we also face competition from other airlines at DIA.***

The airline industry is highly competitive, primarily due to the effects of the Airline Deregulation Act of 1978, which substantially eliminated government authority to regulate domestic routes and fares and increased the ability of airlines to compete with respect to flight frequencies and fares. We compete with United in our hub in Denver, and we anticipate that we will compete principally with United in our future market entries. United, Ted, and United's regional airline affiliates are the dominant carriers out of DIA, accounting for approximately 60.0% of all revenue passengers for the year ended March 31, 2004. Fare wars, "capacity dumping" in which a competitor places additional aircraft on selected routes, and other activities could adversely affect us. The future activities of United and other carriers may have a material adverse effect on our revenues and results of operations. United has applied for and received authorization to fly from Denver to Iztapa/Zihuantanejo and Cabo San Lucas, Mexico which we began service to during the 2003-2004 winter season. United has also

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

applied for service from Denver to Cancun and Puerto Vallarta, Mexico. As of June 1, 2004, they have not received authorization for that service. Most of our current and potential competitors have significantly greater financial resources, larger route networks, and superior market identification. In addition, United is currently operating under the protection of Chapter 11 of the Bankruptcy Code. As it seeks to develop a plan of reorganization, United has created a low-cost operation in order to compete more effectively with us and other low-cost carriers. Denver is a hub for its new low-cost operation, which began in February 2004. United's low-cost venture may place downward pressure on air fares charged in the Denver market and adversely affect our market share at DIA and our ability to maintain yields required for profitable operations. The uncertainty regarding United's business plan, its ability to restructure under Chapter 11, and its potential for placing downward pressure on air fares charged in the Denver market are risks on our ability to maintain yields required for profitable operations. In addition, in the last two years Alaska Airlines, Spirit Airlines, JetBlue Airways, AirTran Airways and ATA Airlines, Inc. have commenced service at DIA. These airlines have offered low introductory fares and compete on several of our routes. Competition from these airlines could adversely affect us.

***We may not have access to adequate gates or airport slots, which could decrease our competitiveness.***

The number of gates available to us at DIA may be limited due to restricted capacity or disruptions caused by airport renovation projects. Available gates may not provide for the best overall service to our customers, and may prevent us from scheduling our flights during peak or opportune times. As a temporary solution to meet our need for additional gates at DIA, we have gained the temporary use of two gates, and the permanent use of one gate, previously used by United Airlines on the East end of Concourse A. We are also using two temporary gates that DIA constructed on the West end of Concourse A. We are currently negotiating with the City and County of Denver for the construction of a permanent expansion to Concourse A that would provide us with up to four additional mainline gates and four or five regional jet positions. However, final terms for this construction project and our lease of the expansion gates have not been determined, and there is some risk that final agreement will not be reached, or may not be reached in time to provide the additional gates by the time we need to return gates to United. If we are unable to obtain additional gates at DIA, we may be forced to move a portion of our operations to another airport, potentially resulting in increased operating costs, or to schedule our flights at DIA in a manner that would provide our passengers with less efficient service. Any failure to obtain gate access at DIA or the other airports that we serve could adversely affect us. In addition, the number of gates available to us at other airports may be limited due to restricted capacity or disruptions caused by major renovation projects.

We could encounter barriers to airport slots that would deny or limit our access to the airports that we currently use or intend to use in the future. A slot is an authorization to schedule a takeoff or landing at the designated airport within a specific time window. The FAA must be advised of all slot transfers and can disallow any such transfer. In the United States, the FAA currently regulates slot allocations at O'Hare International Airport in Chicago, JFK and LaGuardia Airports in New York City, and Ronald Reagan National Airport in Washington D.C. We use LaGuardia Airport and Ronald Reagan National Airport in our current operations. The FAA's slot regulations require the use of each slot at least 80% of the time, measured on a monthly basis. Failure to comply with these regulations may result in a recall of the slot by the FAA. In addition, the slot regulations permit the FAA to withdraw the slots at any time without compensation to meet the operational needs of the U.S. Department of Transportation, or DOT. We also have commenced service to John Wayne Airport in Orange County, California, which limits arrivals and departures as a result of slot allocations for noise control purposes. Our ability to increase slots at these regulated airports is limited by the number of slots available for takeoffs and landings.

***We experience high costs at DIA, which may impact our results of operations.***

We operate our hub of flight operations from DIA where we experience high costs. Financed through revenue bonds, DIA depends on landing fees, gate rentals, income from airlines, the traveling public, and other fees to generate income to service its debt and to support its operations. Our cost of operations at DIA will vary as traffic increases or

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

diminishes at that airport. We believe that our operating costs at DIA substantially exceed those that other airlines incur at most hub airports in other cities, which decreases our ability to compete with other airlines with lower costs at their hub airports. In addition, United, currently operating under the protection of Chapter 11 of the Bankruptcy Code, represents a significant tenant at DIA. At this time, United and DIA have completed negotiations relating to the restructuring of its lease agreement in a fashion that reduced the amounts United is required to pay under its lease. Normally, the decrease in payments by United would result in the increase in amounts paid by all other airlines. At this time, however, the City and County of Denver has agreed to offset the decrease negotiated by United. The City's obligation to make these offset payments is subject to rescission in certain circumstances. If these payments are rescinded, if the renegotiated lease is not approved under United's final plan of reorganization, or if United otherwise significantly reduces operations at DIA, our overall costs at DIA may significantly increase.

### ***Our transition to an Airbus fleet creates risks.***

As of June 1, 2004, we operate 9 Boeing aircraft and 32 Airbus aircraft. We plan to transition our fleet so that we are operating only Airbus aircraft by September 2005. One of the key elements of this strategy is to produce cost savings because crew training is standardized for aircraft of a common type, maintenance issues are simplified, spare parts inventory is reduced, and scheduling is more efficient. However, during our transition period we will be incurring additional costs associated with retraining our Boeing crews in the Airbus aircraft. We also may retire the Boeing aircraft in advance of the end of the lease agreements, which causes us to recognize remaining lease obligations as expense in the current period and to incur costs associated with returning the aircraft.

Once we operate only Airbus aircraft, we will be dependent on a single manufacturer for future aircraft acquisitions or deliveries, spare parts or warranty service. If Airbus is unable to perform its obligations under existing purchase agreements, or is unable to provide future aircraft or services, whether by fire, strike or other events that affect its ability to fulfill contractual obligations or manufacture aircraft or spare parts, we would have to find another supplier for our aircraft. Currently, Boeing is the only other manufacturer from which we could purchase or lease alternate aircraft. If we were forced to acquire Boeing aircraft, we would need to address fleet transition issues, including substantial costs associated with retraining our employees, acquiring new spare parts, and replacing our manuals. In addition, the fleet efficiency benefits described above may no longer be available.

In addition, once we operate only Airbus aircraft we will be particularly vulnerable to any problems that might be associated with these aircraft. Our business would be significantly disrupted if an FAA airworthiness directive or service bulletin were issued, resulting in the grounding of all Airbus aircraft of the type we operate while the defect is being corrected. Our business could also be harmed if the public avoids flying Airbus aircraft due to an adverse perception about the aircraft's safety or dependability, whether real or perceived, in the event of an accident or other incident involving an Airbus aircraft of the type we fly.

### ***We are reliant on one vendor to provide our LiveTV service.***

One of the unique features of our Airbus fleet is that every seat in each of our Airbus aircraft will be equipped with LiveTV. LiveTV is provided by LiveTV, LLC, a subsidiary of JetBlue Airways, a competitor of ours. We do not know of any other company that could provide us with LiveTV equipment and if LiveTV were to stop supplying us with the equipment or service for any reason, we could lose one of the unique services that differentiate us from our competitors.

### ***Our maintenance expenses may be higher than we anticipate.***

We bear the cost of all routine and major maintenance on our owned and leased aircraft. Maintenance expenses comprise a significant portion of our operating expenses. In addition, we are required periodically to take aircraft out of service for heavy maintenance checks, which can adversely increase costs and reduce revenue. We also may be required to comply with regulations and airworthiness directives the FAA issues, the cost of which our

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

aircraft lessors may only partially assume depending upon the magnitude of the expense. Although we believe that our purchased and leased aircraft are currently in compliance with all FAA issued airworthiness directives, additional airworthiness directives likely will be required in the future, necessitating additional expense.

### ***Our landing fees may increase because of local noise abatement procedures.***

Compliance with local noise abatement procedures may lead to increased landing fees. As a result of litigation and pressure from airport area residents, airport operators have taken actions over the years to reduce aircraft noise. These actions have included regulations requiring aircraft to meet prescribed decibel limits by designated dates, curfews during night time hours, restrictions on frequency of aircraft operations, and various operational procedures for noise abatement. The Airport Noise and Capacity Act of 1990 recognized the right of airport operators with special noise problems to implement local noise abatement procedures as long as the procedures do not interfere unreasonably with the interstate and foreign commerce of the national air transportation system.

An agreement between the City and County of Denver and another county adjacent to Denver specifies maximum aircraft noise levels at designated monitoring points in the vicinity of DIA with significant payments payable by Denver to the other county for each substantiated noise violation under the agreement. DIA has incurred these payment obligations and likely will incur such obligations in the future, which it will pass on to us and other air carriers serving DIA by increasing landing fees. Additionally, noise regulations could be enacted in the future that would increase our expenses and could have a material adverse effect on our operations.

### ***We have a limited number of aircraft, and any unexpected loss of any aircraft could disrupt and harm our operations.***

Because we have a limited number of aircraft, if more than one of our aircraft unexpectedly are taken out of service, our operations may be disrupted. We can schedule all of our aircraft for regular passenger service and only maintain limited spare aircraft capability should one or more aircraft be removed from scheduled service for unplanned maintenance repairs or for other reasons. The unplanned loss of use of more than one of our aircraft for a significant period of time could have a material adverse effect on our operations and operating results. A replacement aircraft may not be available or we may not be able to lease or purchase additional aircraft on satisfactory terms or when needed. The market for leased or purchased aircraft fluctuates based on worldwide economic factors that we cannot control.

### ***Unionization affects our costs and may affect our operations.***

Three of our employee groups have voted for union representation: our pilots, dispatchers, and mechanics. In addition, since 1997 we have had union organizing attempts that were defeated by our flight attendants, ramp service agents, and stock clerks. We have received official notification from the NMB of a representation application for our material services specialists by the International Brotherhood of Teamsters. An election has been authorized which will be held from June 30, 2004 through July 21, 2004 and the results will be announced on July 21, 2004.

The collective bargaining agreements we have entered into with our pilots, dispatchers and mechanics have increased our labor and benefit costs, and additional unionization of our employees could increase our overall costs. If any group of our currently non-unionized employees were to unionize and we were unable to reach agreement on the terms of their and other currently unionized employee groups collective bargaining agreements or we were to experience widespread employee dissatisfaction, we could be subject to work slowdowns or stoppages. In addition, we may be subject to disruptions by organized labor groups protesting certain groups for their non-union status. Any of these events would be disruptive to our operations and could harm our business.

### ***Our limited marketing alliances could harm our business.***

Many airlines have marketing alliances with other airlines, under which they market

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

and advertise their status as marketing alliance partners. Among other things, they share the use of two-letter flight designator codes to identify their flights and fares in the computerized reservation systems and permit reciprocity in their frequent flyer programs. Our program partners presently include Midwest Airlines and Virgin Atlantic Airways, but we do not have the significant network of marketing partners that many other airlines do. Our limited marketing alliances put us at a competitive disadvantage to global network carriers, whose ability to attract passengers through more widespread alliances, particularly on international routes, may adversely affect our passenger traffic, and therefore our results of operations.

***Our lack of an established line of credit or borrowing facility makes us highly dependent upon our operating cash flows.***

Airlines require substantial liquidity to operate under most conditions. We have no material lines of credit, and rely primarily on operating cash flows to provide working capital. Unless we secure a line of credit, borrowing facility or other financing, we will be dependent upon our existing cash and operating cash flows to fund our operations and to make scheduled payments on our debt and other fixed obligations. If we deplete our existing cash, fail to generate sufficient funds from operations to meet these cash requirements and are unable to secure a line of credit, borrowing facility or other financing, we could default on our debt and other fixed obligations. Our inability to meet our obligations as they become due would seriously harm our business and financial results, particularly, as discussed earlier, in light of the cross-default clauses contained in many of our financing arrangements.

***If we are unable to attract and retain qualified personnel at reasonable costs, our business will be harmed.***

Our business is labor intensive, with labor costs representing 31.6% of our operating expenses excluding fuel for the year ended March 31, 2004 and 30.3% of our operating expenses excluding fuel for the year ended March 31, 2003. We expect salaries, wages and benefits to increase on a gross basis and these costs could increase as a percentage of our overall costs, which could harm our business. Our growth plans will require us to hire, train and retain a significant number of new employees in the future. From time to time, the airline industry has experienced a shortage of personnel licensed by the FAA, especially pilots and mechanics. We compete against the major U.S. airlines for labor in these highly skilled positions. Many of the major U.S. airlines offer wage and benefit packages that exceed our wage and benefit packages. As a result, in the future, we may have to significantly increase wages and benefits in order to attract and retain qualified personnel or risk considerable employee turnover. If we are unable to hire, train and retain qualified employees at a reasonable cost, we may be unable to complete our growth plans and our business could be harmed.

### **Risks Associated with the Airline Industry**

***We may be subject to terrorist attacks or other acts of war and increased costs or reductions in demand for air travel due to hostilities in the Middle East or other parts of the world.***

On September 11, 2001, four commercial aircraft were hijacked by terrorists and crashed into The World Trade Center in New York City, the Pentagon in Northern Virginia and a field in Pennsylvania. These terrorist attacks resulted in an overwhelming loss of life and extensive property damage. Immediately after the attacks, the FAA closed U.S. airspace, prohibiting all flights to, from and within the United States of America. Airports reopened on September 13, 2001, except for Washington D.C. Ronald Reagan International Airport, which partially reopened on October 4, 2001.

The September 11 terrorist attacks and the war in Iraq created fear among consumers and resulted in significant negative economic impacts on the airline industry. Primary effects were substantial loss of revenue and flight disruption costs, increased security and insurance costs, increased concerns about the potential for future terrorist attacks, airport shutdowns and flight cancellations and delays due to additional screening of passengers and baggage, security breaches and perceived safety threats, and significantly reduced passenger traffic and yields due to the subsequent drop in demand for air travel.

Given the magnitude and unprecedented nature of the September 11 attacks, the

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

uncertainty and fear of consumers resulting from the war in Iraq, or the potential for other hostilities in other parts of the world, it is uncertain what long-term impact these events will or could have on the airline industry in general and on us in particular. These factors could affect our operating results and financial condition by creating weakness in demand for air travel, increased costs due to new security measures and the potential for new or additional government mandates for security related measures, increased insurance premiums, increased fuel costs, and uncertainty about the continued availability of war risk coverage or other insurances. In addition, several plaintiffs filed lawsuits in the United States District Court, Southern District of New York based on the events of September 11, 2001. The complaints name as defendants various security system manufacturers and suppliers and several airlines that were operating at Boston Logan International Airport and Portland (Maine) International Jetport on September 11, 2001, including us. The complaints generally allege that the defendants failed to provide adequate security systems or supervision of security procedures at Logan Airport and Portland Jetport. At this time, we have been dismissed from all existing lawsuits, but it is possible for plaintiffs to file new complaints against us until the statute of limitations period expires.

In addition, although the entire industry is substantially enhancing security equipment and procedures, it is impossible to guarantee that additional terrorist attacks or other acts of war will not occur. Given the weakened state of the airline industry, if additional terrorist attacks or acts of war occur, particularly in the near future, it can be expected that the impact of those attacks on the industry may be similar in nature to but substantially greater than those resulting from the September 11 terrorist attacks.

### ***Increases in fuel costs affect our operating costs and competitiveness.***

Fuel is a major component of our operating expenses, accounting for 17.7% of our total operating expenses for the year ended March 31, 2004. Both the cost and availability of fuel are influenced by many economic and political factors and events occurring in oil producing countries throughout the world, and fuel costs fluctuate widely. Recently the price per barrel of oil is as at an all-time high and has significantly impacted our results of operations. We cannot predict our future cost and availability of fuel, which affects our ability to compete. The unavailability of adequate fuel supplies could have a material adverse effect on our operations and profitability. In addition, larger airlines may have a competitive advantage because they pay lower prices for fuel. We generally follow industry trends by imposing a fuel surcharge in response to significant fuel price increases. However, our ability to pass on increased fuel costs may be limited by economic and competitive conditions. Although we implemented a fuel hedging program in 2003, under which we enter into Gulf Coast jet fuel and West Texas Intermediate crude derivative contracts to partially protect against significant increases in fuel prices, this program is limited in fuel volume and duration. As of March 31, 2004, we had hedged approximately 6.0% of our projected fuel requirements for the quarter ending June 30, 2004. On May 21, 2004, we entered into an additional derivative transaction that hedge approximately 25% of our projected fuel requirements in the quarters ending December 31, 2004 and March 31, 2005.

### ***The airline industry is seasonal and cyclical, resulting in unpredictable liquidity and earnings.***

Because the airline industry is seasonal and cyclical, our liquidity and earnings will fluctuate and be unpredictable. Our operations primarily depend on passenger travel demand and seasonal variations. Our weakest travel periods are generally during the quarters ending in March and December. The airline industry is also a highly cyclical business with substantial volatility. Airlines frequently experience short-term cash requirements. These requirements are caused by seasonal fluctuations in traffic, which often reduce cash during off-peak periods, and various other factors, including price competition from other airlines, national and international events, fuel prices, and general economic conditions including inflation. Our operating and financial results are likely to be negatively impacted by the continued stagnation in national or regional economic conditions in the United States, and particularly in Colorado.

We, like many in the industry, have seen a negative impact to passenger traffic caused by the war with Iraq as well as threats of further terrorist activities. The impact has been

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

more prevalent with our business traffic, which is higher yield traffic that books closer to the date of departure, than with our leisure customers. Even though the war with Iraq has impacted us, we believe that the larger, more established carriers are being impacted to a greater extent as more price sensitive business travelers who typically fly these carriers are looking for affordable alternatives similar to the service we provide. The larger carriers have reduced their "close-in" fare structure to more aggressively compete for this traffic. Aggressive pricing tactics by our major competitors have had and could continue to have an impact on our business.

### ***Security screening delays may negatively impact passenger traffic.***

The federal government is now responsible for conducting security screening activities at all airports in the United States. The ability to complete this screening quickly and efficiently depends upon the adequacy of the security screening facilities and staffing levels. At times the screening system has resulted in significant delays at larger airports. It is believed that these delays have resulted in a loss of passengers for shorter haul trips. While we have not seen a drastic reduction in passenger traffic in our shorter routes, at times congestion and delays at DIA from security screening are significant. Airlines may be able to augment security services in not vital areas by hiring support staff, which will further increase the security costs being paid by the airlines. Notwithstanding such support, significant delays caused by a lack of federal resources may further reduce passenger traffic and our revenues.

### ***The airline industry tends to experience adverse financial results during general economic downturns, and recent airline financial results may lead to significant changes in our industry.***

Since a substantial portion of both business and leisure airline travel is discretionary, the industry tends to experience adverse financial results during general economic downturns. The airline industry has been experiencing a decline in traffic, particularly business traffic, due to slower general economic conditions beginning in 2000 and more recently, from the lingering impact of the terrorist attacks of September 11, 2001, the war in Iraq and the outbreak of severe acute respiratory syndrome. The industry experienced record losses for the year ended 2001 and the major U.S. airlines reported net losses of more than \$3.6 billion in calendar year ended December 31, 2003.

In response to these adverse financial results, some airlines have been reexamining their traditional business models and have taken actions in an effort to increase profitability, such as reducing capacity and rationalizing fleet types, furloughing or terminating employees, limiting service offerings, attempting to renegotiate labor contracts and reconfiguring flight schedules, as well as other efficiency and cost-cutting measures. Despite these business model adjustments, financial losses have continued and US Airways and United filed for Chapter 11 bankruptcy protection in 2002. Additional airline bankruptcies and restructurings may occur, potentially resulting in substantial change in our industry, which could adversely affect our business.

### ***Our insurance costs have increased substantially as a result of the September 11th terrorist attacks, and further increases in insurance costs would harm our business.***

Following the September 11 terrorist attacks, aviation insurers dramatically increased airline insurance premiums and significantly reduced the maximum amount of insurance coverage available to airlines for liability to persons other than passengers for claims resulting from acts of terrorism, war or similar events to \$50 million per event and in the aggregate. In light of this development, under the Air Transportation Safety and System Stabilization Act, the U.S. government has provided domestic airlines with excess war risk coverage above \$50 million up to an estimated \$1.6 billion per event for us.

In December 2002, under the Homeland Security Act of 2002, the U.S. government expanded its insurance program to permit airlines to elect either the government's excess third-party coverage or for the government to become the primary insurer for all war risks coverage. We elected the latter in February 2003 and discontinued the commercially available war risk coverage. The Appropriations Act authorized the government to offer both policies through August 31, 2004. We cannot assure you that this coverage will continue. We expect that

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

if the government stops providing war risk coverage to the airline industry, the premiums charged by aviation insurers for this coverage will be substantially higher than the premiums currently charged by the government. Significant increases in insurance premiums would harm our financial condition and results of operations.

***Our financial results and reputation could be harmed in the event of an accident or incident involving our aircraft.***

An accident or incident involving one of our aircraft could involve repair or replacement of a damaged aircraft and its consequential temporary or permanent loss from service, and significant potential claims of injured passengers and others. We are required by the DOT and our lenders and lessors to carry hull, liability and war risk insurance. Although we believe we currently maintain liability insurance in amounts and of the type generally consistent with industry practice, the amount of such coverage may not be adequate and we may be forced to bear substantial losses from an accident. Substantial claims resulting from an accident in excess of our related insurance coverage would harm our business and financial results. Moreover, any aircraft accident or incident, even if fully insured, could cause a public perception that we are less safe or reliable than other airlines, which would harm our business.

***We are in a high fixed cost business, and any unexpected decrease in revenues would harm us.***

The airline industry is characterized by low profit margins and high fixed costs primarily for personnel, fuel, aircraft ownership and lease costs and other rents. The expenses of an aircraft flight do not vary significantly with the number of passengers carried and, as a result, a relatively small change in the number of passengers or in pricing would have a disproportionate effect on the airline's operating and financial results. Accordingly, a shortfall from expected revenue levels can have a material adverse effect on our profitability and liquidity. Airlines are often affected by factors beyond their control, including weather conditions, traffic congestion at airports and increased security measures, any of which could harm our operating results and financial condition.

Like other airlines, we are subject to delays caused by factors beyond our control, including adverse weather conditions, air traffic congestion at airports and increased security measures. Delays frustrate passengers, reduce aircraft utilization and increase costs, all of which negatively affect profitability. During periods of snow, rain, fog, storms or other adverse weather conditions, flights may be cancelled or significantly delayed. Cancellations or delays due to weather conditions, traffic control problems and breaches in security could harm our operating results and financial condition.

***We are subject to strict federal regulations, and compliance with federal regulations increases our costs and decreases our revenues.***

Airlines are subject to extensive regulatory and legal requirements that involve significant compliance costs. In the last several years, Congress has passed laws and the DOT and FAA have issued regulations relating to the operation of airlines that have required significant expenditures. For example, the President signed into law the Stabilization Act in November 2001. This law federalized substantially all aspects of civil aviation security and requires, among other things, the implementation of certain security measures by airlines and airports, including a requirement that all passenger baggage be screened. Funding for airline and airport security under the law is primarily provided by a new \$2.50 per enplanement ticket tax effective February 1, 2002, with authority granted to the TSA to impose additional fees on air carriers if necessary. Under the Appropriations Act enacted on April 16, 2003, the \$2.50 enplanement tax was temporarily suspended on ticket sales from June 1, 2003 through September 30, 2003. This enplanement tax resumed on October 1, 2003. In addition, the acquisition, installation and operation of the required baggage screening systems by airports will result in capital expenses and costs by those airports that will likely be passed on to the airlines through increased use and landing fees. On February 17, 2002, the Stabilization Act imposed a base security infrastructure fee on commercial air carriers in an amount equal to the calendar year ended 2000 airport security expenses. The infrastructure fee for us is \$1,625,000 annually subject to final audit. The Administration is proposing a legislative change to the Aviation and Transportation Security Act that would more than double the amount of the infrastructure

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

fees paid by airlines under the Aviation Security Infrastructure Fee. It is impossible to determine at this time exactly what the full cost impact will be of the increased security measures imposed by the Stabilization Act.

Although we have obtained the necessary authority from the DOT and the FAA to conduct flight operations and are currently obtaining such authority from the FAA with respect to our Airbus aircraft, we must maintain this authority by our continued compliance with applicable statutes, rules, and regulations pertaining to the airline industry, including any new rules and regulations that may be adopted in the future. We believe that the FAA strictly scrutinizes smaller airlines like ours, which makes us susceptible to regulatory demands that can negatively impact our operations. We may not be able to continue to comply with all present and future rules and regulations. In addition, we cannot predict the costs of compliance with these regulations and the effect of compliance on our profitability, although these costs may be material. We also expect substantial FAA scrutiny as we transition from our Boeing fleet to an all Airbus fleet. An accident or major incident involving one of our aircraft would likely have a material adverse effect on our business and results of operations.

### ***Substantial consolidation in the airline industry could harm our business.***

Since its deregulation in 1978, the airline industry has undergone substantial consolidation through mergers and strategic alliances, and it may undergo additional consolidation in the future. Recent economic conditions and airline financial losses may contribute to further consolidation within our industry. Any consolidation or significant alliance activity within the airline industry could increase the size and resources of our competitors, which, in turn, could adversely affect our ability to compete.

## **Item 2: Properties**

### Aircraft

As of June 1, 2004, excluding JetExpress, we operate 9 Boeing 737 aircraft, 26 Airbus A319 aircraft, and 6 Airbus A318 aircraft in all-coach seating configurations. The age of these aircraft, their passenger capacities and expiration years for the leased aircraft are shown in the following table:

<u>Aircraft Model</u>	<u>No.of Aircraft</u>	<u>Year of Manufacture</u>	<u>Approximate Number of Passenger Seats</u>	<u>Lease Expiration</u>
B-737-300	9	1986-1998	136	2004-2006
A319	9	2001-2003	132	owned
A319	17	2001-2004	132	2007-2016
A318	5	2002-2003	114	owned
A318	1	2004	114	2016

We have adopted a fleet replacement plan to phase out our Boeing aircraft and replace them with a combination of Airbus A319 and A318 aircraft. In March 2000, we entered into an agreement, as subsequently amended in 2003, to purchase 32 Airbus aircraft. As of March 31, 2004, we had taken delivery of 16 of these aircraft, one of which we sold in December 2002 and leased back. Prior to the delivery of the aircraft we assigned two of the purchase commitments to two lessors in February 2003 and September 2003. We agreed to lease two of these aircraft over a five-year term and the third for a 12-year term. In January 2004, we executed an agreement for the sale-leaseback of two A319 aircraft scheduled for delivery in June and July 2004. There are no other purchased aircraft scheduled for delivery until June 2005. Our purchase agreement with Airbus also includes purchase rights for up to 23 additional aircraft, and allows us to purchase Airbus A318 or A320 aircraft in lieu of the A319 aircraft at our

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

option. The agreement also requires us to lease at least three new Airbus A319 or A320 aircraft from operating lessors for delivery in calendar year 2004, one of which we took delivery of in February 2004 and the remaining two are to be leased under operating leases beginning with their delivery in April 2004 and May 2004. As of March 31, 2004, we intend to lease as many as 22 additional A318 or A319 aircraft from third party lessors over the next three years. We have remaining firm purchase commitments for 14 Airbus aircraft, excluding the June and July 2004 sale-leaseback aircraft. We plan to completely phase out our older Boeing aircraft by September 30, 2005, and anticipate the following fleet composition as of the end of each fiscal year through 2008:

Fiscal Year Ending	A319	A318	B737-300	End of Year Cumulative Total Fleet
March 31, 2005	37	7	4	48
March 31, 2006	43	7	0	50
March 31, 2007	50	7	0	57
March 31, 2008	55	7	0	62

This table does not include any of the 23 Airbus aircraft for which we have purchase rights, which would allow us to take delivery of additional A319 or A320 aircraft beginning in fiscal year 2006.

During the year ended March 31, 2004, we ceased using the remaining three Boeing 737-200 leased aircraft, two of which had lease terminations in October 2003 and one with a lease termination date in October 2005. We also took six Boeing 737-300 aircraft out of service due to lease expirations.

### **Facilities**

In January 2001, we moved our general and administrative offices to a new headquarters facility near DIA, where we lease approximately 70,000 square feet of space for a lease term of 12 years at an average annual rental of approximately \$964,000 plus operating and maintenance expenses. In May 2004 we leased an additional 14,000 square feet of space in a building adjacent to our main headquarters beginning July 2004 for a lease term of 4 years at an average annual rental of approximately \$266,000 plus operating and maintenance expenses.

The Denver reservations facility relocated in July 2001 to a 16,000 square foot facility also in Denver, which we have leased for a 10-year lease term at an average annual rental of approximately \$141,000 plus operating and maintenance expenses. In August 2000, we established a second reservations center facility in Las Cruces, New Mexico. This facility is approximately 12,000 square feet and is leased for a term of 122 months at an average annual rental of approximately \$129,000 plus operating and maintenance expenses.

We have entered into an airport lease and facilities agreement expiring in 2010 with the City and County of Denver at DIA for ticket counter space, gates and associated operations space at a current annual rental rate of approximately \$10,368,000 for these facilities. We anticipate leasing an additional two gates beginning July 2004 and are negotiating the final details of the lease amendment.

We sublease a portion of Continental Airlines hangar at DIA until February 2007 for a current annual rental of approximately \$2,904,000. Upon 18 months written notice, either party can terminate the agreement.

Each of our airport locations requires leased space associated with gate operations, ticketing and baggage operations. We either lease the ticket counters, gates and airport office facilities at each of the airports we serve from the appropriate airport authority or sublease

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

them from other airlines. Total annual rent expense for these facilities, excluding DIA, is approximately \$12,681,000 based on rents paid for the month of March 2004. Additionally, we lease maintenance facilities in Kansas City, Missouri and Phoenix, Arizona at a current annual rental of approximately \$172,000 for these facilities. In August 2003, we closed our maintenance facility in El Paso, Texas but we are still obligated for the monthly rent through August 2007. The current annual rental for our El Paso, Texas maintenance facility is approximately \$88,000

### Item 3: Legal Proceedings

From time to time, we are engaged in routine litigation incidental to our business. We believe there are no legal proceedings pending in which we are a party or of which any of our property is the subject that are not adequately covered by insurance maintained by us or which have sufficient merit to result in a material adverse affect upon our business, financial condition, results of operations, or liquidity.

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

During the fourth quarter of the fiscal year covered by this report, we did not submit any matters to a vote of our security holders through the solicitation of proxies or otherwise.

## PART II

### Item 5: Market for Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

#### Price Range of Common Stock

The following table shows the range of high and low sales prices per share for our common stock for the periods indicated and as reported by Nasdaq through June 1, 2004. As of June 1, 2004, there were 1,401 holders of record of our common stock.

<u>Quarter Ended</u>		<u>High</u>	<u>Price Range of Common Stock</u>	<u>Low</u>
June 30, 2002	\$	20.00		7.75
September 30, 2002		8.98		4.43
December 31, 2002		8.00		4.00
March 31, 2003		7.12		3.51
June 30, 2003		10.00		4.95
September 30, 2003		18.26		9.06
December 31, 2003		19.40		11.94
March 31, 2004		15.17		8.90
June 30, 2004 (through June 1, 2004)		11.63		8.49

#### Dividend Policy

We have not declared or paid cash dividends on our common stock. We currently intend to retain any future earnings to fund operations and the continued development of our business,

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

and, thus, do not expect to pay any cash dividends on our common stock in the foreseeable future. Future cash dividends, if any, will be determined by our Board of Directors and will be based upon our earnings, capital requirements, financial condition and other factors deemed relevant by the Board of Directors.

### Securities Authorized for Issuance Under Equity Compensation Plans

The information required by this Item is incorporated herein by reference to the data under the heading "Securities Authorized for Issuance Under Equity Compensation Plans" in the Proxy Statement to be used in connection with the solicitation of proxies for our annual meeting of shareholders to be held on September 9, 2004. We intend to file the definitive Proxy Statement with the SEC on or before July 30, 2004.

### Item 6: Selected Financial Data

The following selected financial and operating data as of and for each of the years ended March 31, 2004, 2003, 2002, 2001, and 2000 are derived from our audited financial statements. This data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the financial statements and the related notes thereto included elsewhere in this report.

	2004	2003	2002	2001	2000
	<u>(Amounts in thousands except per share amounts)</u>				
<b>Statement of Operations Data:</b>					
Total operating revenues	\$ 643,679	\$ 469,936	\$ 445,075	\$ 472,876	\$ 329,822
Total operating expenses	615,682	500,727	428,689	392,155	290,511
Operating income (loss)	27,997	(30,791)	16,386	80,721	39,309
Income (loss) before income tax expense (benefit) and cumulative effect of change in accounting principle	20,457	(39,509)	24,832	88,332	43,411
Income tax expense (benefit)	7,822	(14,655)	8,282	33,465	16,955
Income (loss) before cumulative effect of change in accounting principle	12,635	(24,854)	16,550	54,868	26,456
Cumulative effect of change in accounting principle	-	2,011	-	-	54
Net income (loss)	12,635	(22,843)	16,550	54,868	27,010
Income (loss) per share before cumulative effect of a change in accounting principle:					
Basic	0.39	(0.84)	0.58	2.02	1.00
Diluted	0.36	(0.84)	0.56	1.90	0.90
Net income (loss) per share:					
Basic	0.39	(0.77)	0.58	2.02	1.00
Diluted	0.36	(0.77)	0.56	1.90	0.90
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 188,609	\$ 102,880	\$ 87,555	\$ 109,251	\$ 67,852
Current Assets	269,733	191,291	193,393	199,794	140,362
Total assets	769,706	588,315	413,685	295,317	187,544
Current liabilities	181,659	130,519	152,064	136,159	98,472
Long-term debt	280,001	261,739	66,832	204	32

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

Total liabilities	511,764	429,348	244,552	150,538	106,500
Stockholders equity	257,942	158,967	169,133	144,779	81,040
Working capital	88,074	60,772	41,329	63,635	41,880

	Year Ended March 31,				
	2004	2003	2002	2001	2000
<b>Selected Operating Data:</b>					
Passenger revenue (000s) (1)					
Mainline	\$ 615,390	\$ 460,188	\$ 435,946	\$ 462,609	\$ 320,850
Regional partner (2)	11,191	-	-	-	-
System combined	626,581	460,188	435,946	462,609	320,850
Revenue passengers carried (000s)					
Mainline	5,569	3,926	3,069	3,017	2,280
Regional partner (2)	115	-	-	-	-
System combined	5,684	3,926	3,069	3,017	2,280
Revenue passenger miles (RPMs) (000s) (3)					
Mainline	5,120,587	3,599,553	2,756,965	2,773,833	2,104,460
Regional partner (2)	75,974	-	-	-	-
System combined	5,196,561	3,599,553	2,756,965	2,773,833	2,104,460
Available seat miles (ASMs) (000s) (4)					
Mainline	7,153,740	6,013,261	4,592,298	4,260,461	3,559,590
Regional partner (2)	111,144	-	-	-	-
System combined	7,264,884	6,013,261	4,592,298	4,260,461	3,559,590
Passenger load factor (5)					
Mainline	71.6%	59.9%	60.0%	65.1%	59.1%
Regional partner (2)	68.4%	-	-	-	-
System combined	71.5%	59.9%	60.0%	65.1%	59.1%
Mainline break-even load factor (6)	68.8%	65.0%	56.6%	52.7%	51.1%
Mainline block hours (7)	142,466	120,297	92,418	83,742	71,270
Mainline departures	61,812	53,081	41,736	38,556	33,280
Mainline average seats per departure	132	132	132	132	122
Mainline average stage length	877	858	834	837	820
Mainline average length of haul	919	917	898	919	920
Mainline average daily block hour utilization (8)	10.4	9.8	9.1	9.4	9.0
Yield per RPM (cents) (9) (10)					
Mainline	11.96	12.74	15.78	16.66	15.20
Regional partner (2)	14.73	-	-	-	-
System combined	12.01	12.74	15.78	16.66	15.20
Total yield per RPM (cents) (11)					
Mainline	12.35	13.06	16.14	17.05	15.60
Regional partner (2)	14.73	-	-	-	-
System combined	12.39	13.06	16.14	17.05	15.60
Yield per ASM (cents) (10) (12)					
Mainline	8.56	7.63	9.47	10.85	9.00
Regional partner (2)	10.07	-	-	-	-
System combined	8.59	7.63	9.47	10.85	9.00
Total yield per ASM (cents) (13)					
Mainline	8.84	7.81	9.69	11.10	9.20
Regional partner (2)	10.07	-	-	-	-
System combined	8.86	7.81	9.69	11.10	9.20

Year Ended March 31,

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

	2004	2003	2002	2001	2000
<b>Selected Operating Data (continued):</b>					
Cost per ASM (cents)					
Mainline	8.40	8.33	9.33	9.20	8.1
Regional Partner (2)	13.17	-	-	-	-
System Combined	8.47	8.33	9.33	9.20	8.1
Fuel expense per ASM (cents)	1.52	1.43	1.33	1.66	1.2
Mainline cost per ASM					
excluding fuel (cents) (14)	6.88	6.90	8.00	7.54	6.9
Mainline average fare (15)	\$104	\$109	\$132	\$146	\$13
Mainline average aircraft in service	37.3	33.8	27.8	24.5	19.
Mainline aircraft in service at end of year	38.0	36.0	30.0	25.0	23.
Mainline average age of aircraft at end of year	3.9	7.4	10.6	11.4	10.

- (1) "Passenger revenue" includes revenues for non-revenue passengers, charter revenues, administrative fees, and revenue recognized for unused tickets that are greater than one year from issuance.
- (2) In September 2003, we signed a 12-year agreement with Horizon, under which Horizon operates to nine 70-seat CRJ 700 aircraft under our Frontier JetExpress brand. The service began on January 1, 2004 and replaced our codeshare with Mesa Airlines which terminated on December 31, 2003. In accordance with Emerging Issues Task Force No. 01-08, "Determining Whether an Arrangement Contains a Lease" ("EITF 01-08"), we have concluded that the Horizon agreement contains leases as the agreement conveys the right to use a specific number and specific type of aircraft over a stated period of time. Therefore, we began recording revenues and expenses related to the Horizon agreement gross. Under the Mesa agreement, we recorded JetExpress revenues reduced by related expenses net in other revenues. JetExpress operations under the Mesa agreement from April 1, 2003 to December 31, 2003 and from February 1, 2003 to March 31, 2003 are not included in regional partner statistics in 2004 and 2003 as the Mesa arrangement was effective prior to May 28, 2003, the effective date of EITF 01-08.

Amounts included in other revenues for Mesa for the years ended March 31, 2004, 2003, 2002, 2001 and 2000 were as follows:

	Year Ended March 31,				
	2004	2003	2002	2001	2000
Mesa revenues (000s)	\$ 25,155	\$ 1,608	\$ -	\$ -	\$ -
Mesa expenses (000s)	(23,438)	(2,314)	-	-	-
Net amount in other revenues	\$ 1,717	\$ (706)	\$ -	\$ -	\$ -

Mesa's revenue passenger miles (RPMs) and available seat miles (ASMs) for the years ended March 31, 2004, 2003, 2002, 2001 and 2000 were as follows:

	Year Ended March 31,				
	2004	2003	2002	2001	2000
Mesa RPMs (000s)	148,163	11,004	-	-	-
Mesa ASMs (000s)	174,435	17,759	-	-	-

- (3) "Revenue passenger miles," or RPMs, are determined by multiplying the number of fare-paying passengers carried by the distance flown.
- (4) "Available seat miles," or ASMs, are determined by multiplying the number of seats available for passengers by the number of miles flown.
- (5) "Passenger load factor" is determined by dividing revenue passenger miles by available seat miles.

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

- (6) "Mainline break-even load factor" is the passenger load factor that will result in operating revenues being equal to operating expenses, assuming constant revenue per passenger mile and expenses. The break-even load factor for the year ended March 31, 2004 includes the following special items net of the effect of profit-sharing: \$13,842,000 of compensation received under the Appropriations Act, the write-off of deferred loan costs of \$9,677,000 associated with the prepayment of all of the government guaranteed loan; a charge for Boeing aircraft and facility lease exit costs of \$4,949,000; a loss of \$1,664,000 on the sale of one Airbus aircraft in a sale-leaseback transaction and from the sale of a spare engine; a write down of \$3,376,000 of the carrying value of spare engines and rotatable parts that support the Boeing 737-300 aircraft; and \$1,061,000 of flight crew training expenses related to the start-up of our new Frontier JetExpress regional jet relationship with Horizon. The break-even load factor for the year ended March 31, 2003 includes special items net of the effect of profit-sharing of the cost associated with the early extinguishment of debt totaling \$1,774,000 and a write-down of the carrying values of the Boeing aircraft parts totaling \$2,478,000.
- (7) "Mainline block hours" represent the time between aircraft gate departure and aircraft gate arrival.
- (8) "Mainline average daily block hour utilization" represents the total block hours divided by the number of aircraft days in service, divided by the weighted average of aircraft in our fleet during that period. The number of aircraft includes all aircraft on our operating certificate, which includes scheduled aircraft, as well as aircraft out of service for maintenance and operational spare aircraft, and excludes aircraft removed permanently from revenue service or new aircraft not yet placed in revenue service.
- (9) "Yield per RPM" is determined by dividing passenger revenues (excluding charter revenue) by revenue passenger miles.
- (10) For purposes of these yield calculations, charter revenue is excluded from passenger revenue. These figures may be deemed non-GAAP financial measures under regulations issued by the Securities and Exchange Commission. We believe that presentation of yield excluding charter revenue is useful to investors because charter flights are not included in RPMs or ASMs. Furthermore, in preparing operating plans and forecasts, we rely on an analysis of yield exclusive of charter revenue. Our presentation of non-GAAP financial measures should not be viewed as a substitute for our financial or statistical results based on GAAP. The calculation of passenger revenue excluding charter revenue is as follows:

	Year Ended March 31,				
	2004	2003	2002	2001	2000
Passenger revenues - mainline, as reported	\$ 615,390	\$ 460,188	\$ 435,946	\$ 462,609	\$ 320,000
Less: charter revenue	2,724	1,515	1,101	472	-
Passenger revenues - mainline excluding charter	612,666	458,673	434,845	462,137	320,000
Add: Passenger revenues - regional partner	11,191	-	-	-	-
Passenger revenues, system combined	\$ 623,857	\$ 458,673	\$ 434,845	\$ 462,137	\$ 320,000

- (11) "Total yield per RPM" is determined by dividing total revenues by revenue passenger miles.
- (12) "Yield per ASM" is determined by dividing passenger revenues (excluding charter revenue) by available seat miles.
- (13) "Total yield per ASM" is determined by dividing total revenues by available seat miles.
- (14) This may be deemed a non-GAAP financial measure under regulations issued by the Securities and Exchange Commission. We believe the presentation of financial information excluding fuel expense is useful to investors because we believe that fuel expense tends to fluctuate more than other operating expenses, it facilitates comparison of results of operations between current and past periods and enables investors to better forecast future trends in our operations. Furthermore, in preparing operating plans and forecasts, we rely, in part, on trends in our historical results of operations excluding fuel expense. However, our presentation of non-GAAP financial measures should not be viewed as a substitute for our financial results.

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

determined in accordance with GAAP.

- (15) "Mainline average fare" excludes revenue included in passenger revenue for charter and non-revenue passengers, administrative fees, and revenue recognized for unused tickets that are greater than one year from issuance date.

### Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations

#### Selected Operating Statistics

The following table provides our operating revenues and expenses for our mainline operations expressed as mainline costs per available seat mile ("CASM") and as a percentage of total mainline operating revenues, for the years ended March 31, 2004, 2003, and 2002. Regional partner revenues, expenses and ASMs were excluded from this table to provide comparable amounts to the prior years presented.

	2004		2003		2002	
	Per total <u>ASM</u>	% of <u>Revenue</u>	Per Total <u>ASM</u>	% of <u>Revenue</u>	Per total <u>ASM</u>	% of <u>Revenue</u>
<b>Revenues:</b>						
Passenger	8.60	97.3%	7.65	97.9%	9.49	97.9%
Cargo	0.11	1.3%	0.09	1.2%	0.15	1.5%
Other	<u>0.13</u>	<u>1.4%</u>	<u>0.07</u>	<u>0.9%</u>	<u>0.05</u>	<u>0.6%</u>
Total revenues	8.84	100.0%	7.81	100.0%	9.69	100.0%
<b>Operating expenses:</b>						
Flight operations	1.47	16.6%	1.42	18.2%	1.41	14.6%
Aircraft fuel expense	1.52	17.2%	1.43	18.3%	1.33	13.7%
Aircraft lease expense	0.98	11.1%	1.18	15.0%	1.42	14.6%
Aircraft and traffic servicing	1.54	17.5%	1.44	18.4%	1.53	15.8%
Maintenance	1.04	11.7%	1.26	16.1%	1.53	15.8%
Promotion and sales	0.91	10.3%	0.88	11.3%	1.29	13.4%
General and administrative	0.52	5.8%	0.43	5.6%	0.57	5.9%
Aircraft lease and facility exit costs	0.07	0.8%	-	-	-	-
Loss on sale-leaseback of aircraft	0.02	0.2%	-	-	-	-
Depreciation and amortization	<u>0.33</u>	<u>3.8%</u>	<u>0.29</u>	<u>3.7%</u>	<u>0.25</u>	<u>2.6%</u>
Total operating expenses	8.40	95.0%	8.33	106.6%	9.33	96.4%

#### Results of Operations - Year Ended March 31, 2004 Compared to Year Ended March 31, 2003

##### Overview

We intend to continue our focused growth strategy, which includes a fleet transition from a Boeing fleet to an all Airbus fleet. We intend to operate an all Airbus fleet by September 2005. One of the key elements of this strategy is to produce cost savings because crew training is standardized for aircraft of a common type, maintenance issues are simplified, spare parts inventory is reduced, and scheduling is more efficient. As of March 31, 2004, we

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

have remaining firm purchase commitments for 14 Airbus aircraft, excluding two sale-leaseback aircraft expected to be delivered in June and July 2004, and intend to lease as many as 22 additional A318 or A319 aircraft from third party lessors over the next three years. We intend to use these additional aircraft to provide service to new markets and or to add frequencies to existing markets that we believe are underserved.

The airline industry continues to operate in an intensely competitive market. We expect competition will remain intense, as adverse economic conditions continue to exist. Business and leisure travelers continue to reevaluate their travel budgets and remain highly price sensitive. Increased competition has prompted aggressive strategies from competitors through discounted fares and sales promotions. Additionally, the intense competition has created financial hardship for some of our competitors that have been forced to reduce capacity or have been forced into bankruptcy protection.

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

### **Year in Review**

While the industry suffered significant losses during the year ended March 31, 2004, we returned to profitability during one of the most challenging periods in the airline industry. During the fiscal year ended March 31, 2004, we had net income of \$12,635,000. This was driven by an increase in revenue passenger miles that has outpaced our increase in capacity, coupled with an increase in aircraft utilization, and a decrease in our mainline CASM.

### Highlights from the 2004 Fiscal Year

- o Took delivery of 11 new aircraft including seven Airbus A319 aircraft and four Airbus A318 aircraft, and retired the final three Boeing 737-200s in the Company's fleet.
- o Began service to Milwaukee, Wisconsin; Orange County, California; Cabo San Lucas, Mexico; Ixtapa/Zihuatanejo, Mexico; St. Louis, Missouri and Puerto Vallarta, Mexico.
- o Generated net proceeds of \$81,077,000 from a secondary offering of 5,050,000 shares of common stock in September 2003.
- o Became the first airline to pay back the government-guaranteed ATSB loan.
- o Announced plans for a new "focus" city in Los Angeles, with our first non-stop, point-to-point flights outside of the Denver hub. Service began on April 11, 2004 with two daily non-stop flights from Los Angeles to Minneapolis/St. Paul, St. Louis, and Kansas City.
- o Launched an aggressive branding campaign in support of "A Whole Different Airline" tagline, which has increased visibility in the Denver market.
- o Introduced a co-branded Frequent Flyer MasterCard with Juniper Bank, which contributed to a 70.2% increase in EarlyReturns membership during the fiscal year ended March 31, 2004.
- o Partnered with a new regional jet provider, Horizon, which began operations as Frontier JetExpress on January 1, 2004, upon the expiration of the agreement with Mesa Air.
- o Expanded our codeshare agreement with Great Lakes Airlines to serve Rapid City, South Dakota and Grand Junction Colorado.
- o Enhanced the ease of customer check-in with the launch of "FlexCheck," a Frontier branded online and web-based check-in service, including FlexCheck kiosks at our Denver ticket counter.

## Results of Operations

We had net income of \$12,635,000 or 36(cent)per diluted share for the year ended March 31, 2004 as compared to a net loss of \$22,843,000 or 77(cent)per diluted share for the year ended March 31, 2003. Included in our net income for the year ended March 31, 2004 were the following special items before the effect of profit sharing and income taxes: \$15,024,000 of compensation received under the Appropriations Act offset by the write-off of deferred loan costs of \$9,816,000 associated with the prepayment of all of the government guaranteed loan; a charge for Boeing aircraft and facility lease exit costs of \$5,372,000; a loss of \$1,806,000 on the sale of one Airbus aircraft in a sale-leaseback transaction and from the sale of a spare engine; a write down of \$3,665,000 of the carrying value of spare engines and rotatable parts that support the Boeing 737-300 aircraft; and \$1,152,000 of flight crew training expenses related to the start-up of our new Frontier JetExpress regional jet relationship with Horizon. These items, net of income taxes and profit sharing, reduced net income by 12(cent)per diluted share. Our net loss for the year ended March 31, 2003 included a \$2,011,000 million after-tax credit for the cumulative effect of a change in accounting for major aircraft overhauls from the accrual method to the expense as incurred method. The net loss before the cumulative effect of the change in accounting was \$24,854,000, or \$0.84 per common share. Our net loss for the year ended March 31, 2003 included the following special items on a pre-tax and profit sharing basis: the cost associated with the early extinguishment of debt totaling \$1,774,000 and a write-down of the carrying values of the Boeing spare aircraft parts totaling \$2,478,000. These items, net of income taxes and profit sharing, increased our net loss by 9(cent)per diluted share.

Our mainline passenger yield per RPM was 11.96(cent)and 12.74(cent)for the years ended March 31, 2004 and March 31, 2003, respectively, or a decrease of 6.1%. Our length of haul was 919 and 917 miles for the years ended March 31, 2004 and March 31, 2003, respectively, or an increase of .2%. Our mainline average fare was \$104 for the year ended March 31, 2004 as compared to \$109 for the year ended March 31, 2003, a decrease of 4.6%. The decrease in the average fare is offset by an increase in our mainline load factor to 71.6% for the year ended March 31, 2004 as compared to 59.9% for the year ended March 31, 2003, an increase of 11.7 points. As part of our new fare structure, which we implemented in February 2003, our highest-level business fares were initially reduced by 25 to 45 percent, and our lowest available walk-up fares were reduced by 38 to 77 percent. The new fare structure was comprised of six fare categories and capped all fares to and from Denver at \$399 or \$499 one-way, excluding passenger facility, security or segment fees, depending on length of haul. In February 2004, we capped all fares to and from Denver at \$314 one-way, excluding passenger facility, security or segment fees, with the exception of flights to Mexico and Anchorage, Alaska. The \$309 fare is a base fare of \$299 plus a \$15 fuel surcharge, which is temporarily in place. The new fare cap is a 25 to 50 percent reduction from the February 2003 caps of \$399 and \$499. Unlike some other airlines, these fares can be booked each way, allowing customers to get the best price on both the inbound and outbound portion of their itinerary with no round-trip purchase required. Our new fare structure reinstated some of the advance purchase requirements of past pricing structures. Although this has created downward pressure on our mainline passenger yield per RPM and average fare, we believe the effect on our revenues was offset by an increase in passenger traffic. Our mainline passenger revenue per available seat mile ("RASM") for the years ended March 31, 2004 and March 31, 2003 was 8.56(cent) and 7.63(cent), respectively, an increase of 12.2%. Additionally, we believe that our average fare during the year ended March 31, 2004 was negatively impacted as a result of intense competition from United, a carrier operating under Chapter 11 bankruptcy protection, which is our principal competitor at DIA. We also believe that passenger traffic during the year ended March 31, 2003 was impacted by the threat of war with Iraq, which began in March 2003. During March 2003, the Denver area also experienced an unusual blizzard, which caused DIA to be closed for approximately two days.

Our mainline cost per ASM for the year ended March 31, 2004 and 2003 was 8.40(cent) and 8.47(cent), respectively, an increase of .07(cent) or .8%. Mainline CASM, excluding fuel for the year ended March 31, 2004 and 2003 were 6.88(cent) and 6.90(cent), respectively, a decrease of .02(cent) or .3%. Our mainline CASM increased during the year ended March 31, 2004 as a result of an increase in the average price of fuel per gallon from 96(cent) to \$1.04 or an increase of .09(cent)per ASM. An increase in aircraft and traffic servicing expenses combined with sales and promotions expense

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

of .13(cent) as a result of the increase in the number of passengers we serve and general increases in DIA facility charges as well as related increases in sales and promotion expenses for booking associated with the increase in passengers, the ongoing costs of LiveTV service of .04(cent); an increase in general and administrative expenses of .09(cent) as a result of the bonus accrual associated with our return to profitability and an increase in health insurance costs. Mainline CASM also increased over the prior comparable period .07(cent) for costs associated with aircraft lease and facility exit costs and .02(cent) for a loss on the sale-leaseback of an aircraft. The increases were partially offset by a decrease of .20(cent) in aircraft lease expense as a result of replacing four leased aircraft with four additional purchased aircraft, offset by an increase in related depreciation expense of .04(cent) and a decrease of .22(cent) in maintenance expense principally as a result of the reduction in the number of aircraft in our Boeing fleet that were replaced with new Airbus A319 and A318 aircraft.

During the year ended March 31, 2004, our average daily block hour utilization increased to 10.4 from 9.8 for the year ended March 31, 2003. The calculation of our block hour utilization includes all aircraft that are on our operating certificate, which includes scheduled aircraft, as well as aircraft out of service for maintenance and operational spare aircraft, and excludes aircraft removed permanently from revenue service or new aircraft not yet placed in revenue service. It also excludes Frontier JetExpress aircraft operated by Horizon

An airline's break-even load factor is the passenger load factor that will result in operating revenues being equal to operating expenses, assuming constant revenue per passenger mile and expenses. For the years ended March 31, 2004 and 2003, our mainline break-even load factors were 68.8% and 65.0%, respectively, compared to our achieved passenger load factors of 71.6% and 59.9%. Our mainline break-even load factor increased from the prior comparable period largely as a result of a decrease in our average fare to \$104 during the year ended March 31, 2004 from \$109 during the year ended March 31, 2003.

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

### Revenues

Our revenues are highly sensitive to changes in fare levels. Competitive fare pricing policies have a significant impact on our revenues. Because of the elasticity of passenger demand, we believe that increases in fares may at certain levels result in a decrease in passenger demand in many markets. We cannot predict future fare levels, which depend to a substantial degree on competitive factors and the economy. When sale prices or other price changes are initiated by competitors in our markets, we believe that we must, in most cases, match those competitors.

*Passenger Revenues - Mainline.* Passenger revenues from our mainline operations totaled \$615,390,000 for the year ended March 31, 2004 compared to \$460,188,000 for the year ended March 31, 2003, or an increase of 33.7%, on increased ASMs of 1,140,479,000, or 19.0%. Passenger revenues include revenues for reduced rate standby passengers, administrative fees, and revenue recognized for tickets that are not used within one year from their issue dates. We carried 5,569,000 revenue passengers during the year ended March 31, 2004 compared to 3,926,000 revenue passengers during the year ended March 31, 2003, an increase of 41.8%. We had an average of 37.3 aircraft in our mainline fleet during the year ended March 31, 2004 compared to an average of 33.8 aircraft during the year ended March 31, 2003, an increase of 10.4%. RPMs for the year ended March 31, 2004 were 5,120,587,000 compared to 3,599,553,000 for the year ended March 31, 2003, an increase of 42.3%. Our load factor increased to 71.6% for the year ended March 31, 2004 from 59.9% for the prior comparable period, an increase of 11.7 points, or 19.5%.

*Passenger Revenues - Regional Partner.* Regional partner revenues, consisting of revenues from Frontier JetExpress operated by Horizon, totaled \$11,191,000 for the year ended March 31, 2004 and none for the year ended March 31, 2003. Horizon began service January 1, 2004 and replaced the Frontier JetExpress service formerly provided by Mesa. Revenues from the Frontier

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

JetExpress service, formerly provided by Mesa, were netted against related expenses and included in "Other revenues" for the nine months ended December 31, 2003. See footnote (2) in Item 6. "Selected Financial Data", which explains the different accounting methods for our Frontier JetExpress operations.

*Cargo Revenues.* Cargo revenues, consisting of revenues from freight and mail service, totaled \$8,077,000 and \$5,557,000 for the years ended March 31, 2004 and 2003, respectively, representing 1.3% and 1.2%, respectively, of total revenues, an increase of 45.3%. Cargo revenues increased over the prior comparable periods as a result of our new contract to carry mail under the United States Postal Service Commercial Air 2003 Air System (CAIR-03) program. In April 2003, we were selected as one of only 18 airlines in the United States and the Caribbean to be offered a 3-year contract to carry products for the United States Postal Service ("USPS") under the CAIR-03 program. The new program began on June 28, 2003. This adjunct to the passenger business is highly competitive and depends heavily on aircraft scheduling, alternate competitive means of same day delivery service and schedule reliability. In April 2004, given extensive scanning requirements imposed by the USPS, we determined that carrying mail was not cost effective for us. We are working with the USPS to phase out of this business.

*Other Revenues.* Other revenues, comprised principally of LiveTV sales, net revenue from the Mesa codeshare agreement, liquor sales, ground handling fees, and excess baggage fees, totaled \$9,021,000 and \$4,191,000 or 1.4% and .9% of total operating revenues for the years ended March 31, 2004 and 2003, respectively. Other revenue increased over the prior comparable period predominately as a result of LiveTV sales and the Mesa codeshare agreement. LiveTV sales commenced during the fourth fiscal quarter for the year ended March 31, 2003.

### **Operating Expenses**

Operating expenses include those related to flight operations, aircraft and traffic servicing, maintenance, promotion and sales, Frontier JetExpress operations, general and administrative and depreciation and amortization. Total operating expenses were \$615,682,000 and \$500,727,000, respectively, for the years ended March 31, 2004 and 2003, and represented 95.7% and 106.6% of total revenue, respectively. Operating expenses excluding expenses from our regional partner operations totaled \$601,048,000 for the year ended March 31, 2004, or 95.0% of total revenue, excluding regional partner revenues. Operating expenses decreased as a percentage of revenue during the year ended March 31, 2004 as a result of an increase in total revenue as compared to the year ended March 31, 2003.

*Salaries, Wages and Benefits.* We record salaries, wages and benefits within the specific expense category identified in our statements of operations to which they pertain. Salaries, wages and benefits totaled \$160,260,000 and \$125,847,000 and were 25.3% and 26.8% of total revenue excluding regional partner revenues for the years ended March 31, 2004 and 2003, respectively, an increase of 27.3%. Salaries, wages and benefits increased over the prior comparable period largely as a result of our bonus accrual due to our return to profitability, overall wage increases and an increase in the number of employees to support our ASM growth of 19.0% during the year ended March 31, 2004 as well as the ASM growth that we expect for fiscal year 2005. Our employees increased from approximately 3,160 in March 2003 to approximately 4,100 in March 2004, or 29.7%.

*Flight Operations.* Flight operations expenses of \$105,255,000 and \$85,675,000 were 16.6% and 18.2% of total revenue excluding revenues from our regional partner operations for the years ended March 31, 2004 and 2003, respectively, an increase of 22.9%. Flight operations expenses include all expenses related directly to the operation of the aircraft excluding depreciation of owned aircraft and lease expenses and including insurance expenses, pilot and flight attendant compensation, in-flight catering, crew overnight expenses, flight dispatch and flight operations administrative expenses.

Aircraft insurance expenses totaled \$9,950,000 (1.6% of total revenues excluding revenues from our regional partner operations) for the year ended March 31, 2004. Aircraft insurance expenses for the year ended March 31, 2003 were \$11,095,000 (2.4% of total revenues excluding revenues from our regional partner operations). Aircraft insurance expenses decreased per RPM as a result of less expensive war risk coverage that is presently provided by the FAA compared to the coverage that was previously provided by commercial underwriters.

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

combined with a 30% decrease in our basic hull and liability insurance rates effective June 7, 2003. The current FAA war risk policy is in effect until August 31, 2004. We do not know whether the government will extend the coverage beyond August 2004, and if it does, how long the extension will last. We expect that if the government stops providing excess war risk coverage to the airline industry, the premiums charged by aviation insurers for this coverage will be substantially higher than the premiums currently charged by the government or the coverage will not be available from reputable underwriters.

Pilot and flight attendant salaries before payroll taxes and benefits totaled \$53,358,000 and \$42,982,000 or 8.7% and 9.3% of passenger revenue, excluding revenues from our regional partner operations, for each of the years ended March 31, 2004 and 2003, or an increase of 24.1%. Pilot and flight attendant compensation for the year ended March 31, 2004 increased as a result of a 10.4% increase in the average number of mainline aircraft in service and an increase of 18.4% in mainline block hours, respectively, a general wage increase in flight attendant and pilot salaries and additional crew required to replace those who were attending training on the Airbus equipment. We pay pilot and flight attendant salaries for training, consisting of approximately six and three weeks, respectively, prior to scheduled increases in service, which can cause the compensation expense during such periods to appear high relative to the average number of aircraft in service. During the year ended March 31, 2004, we added two additional aircraft to our fleet and replaced nine Boeing aircraft with Airbus aircraft. We expect these additional costs to continue as we place additional aircraft into service and continue to retire Boeing equipment.

*Aircraft Fuel Expense.* Aircraft fuel expenses include both the direct cost of fuel including taxes as well as the cost of delivering fuel into the aircraft. Aircraft fuel costs of \$108,863,000 for 104,799,000 gallons used and \$86,064,000 for 89,236,000 gallons used resulted in an average fuel cost of \$1.04 and 96(cen)t per gallon for the years ended March 31, 2004 and 2003, respectively. Aircraft fuel expenses represented 17.2% and 18.3% of total revenue, excluding revenue from our regional partner operations, for the years ended March 31, 2004 and 2003, respectively. Fuel prices are subject to change weekly, as we purchase a very small portion in advance for inventory. We initiated a fuel hedging program in late November 2002, which decreased fuel expense by \$1,387,000 for the year ended March 31, 2004 and decreased fuel expense \$558,000 for the year ended March 31, 2003. Fuel consumption for the years ended March 31, 2004 and 2003 averaged 736 and 742 gallons per block hour, respectively, or a decrease of .8%. Fuel consumption per block hour decreased during the year ended March 31, 2004 from the prior year because of the more fuel-efficient Airbus aircraft added to our fleet coupled with the reduction in our Boeing fleet, which had higher fuel burn rates, partially offset by the increase in our load factors.

*Aircraft Lease Expenses.* Aircraft lease expenses, totaled \$70,061,000 (11.1% of total revenues excluding revenues from our regional partner operations) and \$70,239,000 (14.9% of total revenues excluding revenues from our regional partner operations) for the years ended March 31, 2004 and 2003, respectively, or a decrease of .3%. The decrease is a result of a decrease in the average number of leased aircraft to 26.0 from 27.9, or 6.8%, during the year ended March 31, 2004 compared to the same period in 2003.

*Aircraft and Traffic Servicing.* Aircraft and traffic servicing expenses were \$110,378,000 and \$86,448,000 (an increase of 27.7%) for the years ended March 31, 2004 and 2003, respectively, and represented 17.5% and 18.4% of total revenues, excluding revenues from our regional partner operations. Aircraft and traffic servicing expenses include all expenses incurred at airports, including landing fees, facilities rental, station labor, ground handling expenses (passenger and cargo) and interrupted trip expenses associated with delayed or cancelled flights. Interrupted trip expenses are amounts paid to other airlines to reaccommodate passengers as well as hotel, meal and other incidental expenses. Aircraft and traffic servicing expenses increase with the addition of new cities and departures to our route system. As of March 31, 2004, we served 43 cities compared to 38 as of March 31, 2003, or an increase of 13.2%. During the year ended March 31, 2004, our mainline departures increased to 61,812 from 53,081 during the year ended March 31, 2003, or 16.4%. Aircraft and traffic servicing expenses were \$1,786 per departure for the year ended March 31, 2004 as compared to \$1,629 per departure for the year ended March 31, 2003, or an increase of \$157 per departure. Aircraft and traffic servicing expenses increased per departure as a result of general increases in airport rents and landing fees and a 41.9% increase in mainline passengers for the year ended

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

March 31, 2004 as compared to the prior year. Certain airport facility rent charges are calculated using the numbers of originating and departing passengers, as well as additional personnel required to handle the increased number of passengers. Additionally, cargo (including mail) revenue increased 45.3% for the year ended March 31, 2004 as compared to the prior year. Aircraft and traffic servicing expenses increase with increases in passengers and cargo handling. We also experienced higher landing fees associated with the Airbus aircraft, which have higher landing weights than the Boeing aircraft.

*Maintenance.* Maintenance expenses for the years ended March 31, 2004 and 2003 of \$74,004,000 and \$75,559,000, respectively, were 11.7% and 16.1% of total revenues, excluding revenues from our regional partner operations, a decrease of 2.1%. These include all labor, parts and supplies expenses related to the maintenance of the aircraft. Maintenance costs per block hour for the years ended March 31, 2004 and 2003 were \$519 and \$628 per block hour, respectively, a decrease of 17.4%. Maintenance cost per block hour decreased as a result of the addition of new Airbus aircraft that are less costly to maintain than our older Boeing aircraft. The owned Airbus fleet is new and we are experiencing a "maintenance holiday". As the Airbus aircraft age, they will require more maintenance and maintenance expenses will increase.

*Promotion and Sales.* Promotion and sales expenses totaled \$65,322,000 and \$53,032,000 and were 10.3% and 11.3% of total revenues, excluding revenues from our regional partner operations, for the years ended March 31, 2004 and 2003, respectively. These include advertising expenses, telecommunications expenses, wages and benefits for reservation agents and reservations supervision, marketing management and sales personnel, credit card fees, travel agency commissions and computer reservations costs. During the year ended March 31, 2003, we reduced advertising expenditures in order to apply those funds toward our new branding campaign that was scheduled to begin in March 2003. Due to the commencement of the hostilities in Iraq, we postponed the roll out of our branding campaign until May 2003. Additionally, during the year ended March 31, 2004, we became heavily involved in sports team sponsorships as part of our branding awareness initiative. During the year ended March 31, 2004, promotion and sales expenses per mainline passenger decreased to \$11.73 compared to \$13.51 for the year ended March 31, 2003, a decrease of 13.2%. Promotion and sales expenses per passenger decreased as a result of variable expenses that are based on lower average fares, the elimination of substantially all travel agency commissions effective on tickets sold after May 31, 2002, and economies of scale associated with our growth.

*General and Administrative.* General and administrative expenses for the years ended March 31, 2004 and 2003 totaled \$36,750,000 and \$26,061,000, and were 5.8% and 5.6% of total revenues, excluding revenues from our regional partner operations, respectively, or an increase of 41.0%. During the year ended March 31, 2004, we accrued \$2,436,000 for employee performance bonuses, or .4% of total revenues. Bonuses are based on profitability. As a result of our pre-tax loss for the year ended March 31, 2003, we did not accrue bonuses. General and administrative expenses include the wages and benefits for several of our executive officers and various other administrative personnel including legal, accounting, information technology, aircraft procurement, corporate communications, training and human resources and other expenses associated with these departments. Employee health benefits, accrued vacation and bonus expenses, general insurance expenses including worker's compensation and write-offs associated with credit card and check fraud are also included in general and administrative expenses. Our employees increased from approximately 3,160 in March 2003 to approximately 4,100 in March 2004, or 29.7%. Accordingly, we experienced increases in our human resources, training, information technology, and health insurance benefit expenses. General and administrative expenses also increased with a general increase in the cost of providing health insurance.

*Regional Partner Expense.* Regional partner expenses for the year ended March 31, 2004 totaled \$14,634,000, and was 130.8% of total regional partner revenues. Regional partner expenses include all direct costs associated with Frontier JetExpress operated by Horizon. Horizon began service January 1, 2004 and replaced the JetExpress service formerly provided by Mesa. During the year ended March 31, 2003 and through December 31, 2003, expenses were netted against related revenues associated with Mesa and included in other revenues. The net amount included in other revenues was \$1,717,000 and (\$706,000) during the years ended March 31, 2004 and 2003, respectively. During the three months ended March 31, 2004, we incurred \$1,152,000 for flight crew training costs and other related costs associated with the start-up of our regional

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

partnership with Horizon. We do not expect to incur these costs going forward unless we were to add additional aircraft under the Horizon agreement, which we do not contemplate at this time. For additional information about Frontier JetExpress, see Note 1 of the Notes to the Financial Statements.

*Aircraft Lease and Facility Exit Costs.* During the year ended March 31, 2004, we ceased using three of our Boeing 737-200 leased aircraft, two of which had lease terminations in October 2003 and one with a lease termination in October 2005. In August 2003, we closed our maintenance facility in El Paso, Texas, which had a lease termination date of August 2007. As a result of these transactions we recorded a pre-tax charge of \$5,372,000. This amount includes the estimated fair value of the remaining lease payments and the write off of the unamortized leasehold improvements on the aircraft and the facility.

*Loss on Sale-leaseback of Aircraft.* During the year ended March 31, 2004, we incurred a loss totaling \$1,323,000 on the sale-leaseback of an Airbus A319 aircraft.

*Depreciation and Amortization.* Depreciation and amortization expenses of \$23,720,000 and \$17,650,000, an increase of 34.4%, were approximately 3.8% and 3.7% of total revenues excluding revenues from our regional partner operations, for the years ended March 31, 2004 and 2003, respectively. These expenses include depreciation of aircraft and aircraft components, office equipment, ground station equipment and other fixed assets. Depreciation expense increased over the prior year largely as a result of an increase in the average number of Airbus A318 and A319 aircraft owned from an average of 6.3 during the year ended March 31, 2003 to an average of 11.4 for the year ended March 31, 2004, an increase of 81.0%.

*Nonoperating Income (Expense).* Net nonoperating expenses totaled \$7,539,000 for the year ended March 31, 2004 compared to net nonoperating expense of \$8,718,000 for the year ended March 31, 2003.

Interest income increased to \$2,074,000 during the year ended March 31, 2004 from \$1,883,000 for the prior period due to an increase in invested cash. Interest expense increased to \$13,961,000 for the year ended March 31, 2004 from \$8,041,000 for the prior period as a result of interest expense associated with the financing of additional aircraft purchased since March 31, 2003 and the government guaranteed loan we obtained in February 2003 which we subsequently repaid in December 2003.

We completed a public offering of 5,050,000 shares of common stock in September 2003. Under the terms of our government guaranteed loan, we were required to make a prepayment of the loan equal to 60% of the net proceeds from the offering. As a result, we prepaid approximately \$48,418,000 on the loan. In December 2003, we repaid the remaining loan balance due of \$11,582,000. As a result of paying off the government guaranteed loan, we wrote off approximately \$9,816,000 of deferred loan costs associated with the prepayment amount. Of this amount, approximately \$8,053,000 represented the unamortized portion of the value assigned to the warrants issued to the ATSB and to two other guarantors in connection with the loan transaction.

Offsetting these nonoperating expenses during the year ended March 31, 2004 is pre-tax compensation of \$15,024,000 as a result of payments under the Appropriations Act for expenses and foregone revenue related to aviation security. We received a total of \$15,573,000 in May 2003, of which we paid \$549,000 to Mesa Airlines for the revenue passengers Mesa carried as Frontier JetExpress.

During the year ended March 31, 2003, we completed a sale-leaseback transaction of one of our purchased aircraft and paid off the loan that was collateralized by this aircraft. As a result, we incurred \$1,774,000 in costs associated with the early extinguishment of this debt.

*Income Tax Expense.* We recorded income tax expense of \$7,822,000 during the year ended March 31, 2004 at a 38.2% effective tax rate, compared to an income tax benefit of \$14,655,000 for the year ended March 31, 2003, at a 37.1% effective tax rate. During the year ended March 31, 2004, the Company's tax expense was at a federal rate of 35% plus the blended state rate of 3% (net of federal benefit) and was increased by the tax effect of permanent differences of 3%. During the year ended March 31, 2004 the Company recorded a \$558,000 reduction to income

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

tax expense as a result of an adjustment to deferred income taxes provided for in prior years, which approximated 3%. The expected benefit for the year ended March 31, 2003 was at a federal rate of 35% plus the blended state rate of 3.7% (net of federal tax benefit) and was reduced by the tax effect of permanent differences of 1%.

### Results of Operations - Year Ended March 31, 2003 Compared to Year Ended March 31, 2002

We had a net loss of \$22,843,000 or 77(cents) per share for the year ended March 31, 2003 as compared to net income of \$16,550,000 or 56(cents) per diluted share for the year ended March 31, 2002. Our net loss for the year ended March 31, 2003 included a \$2.0 million after-tax credit for the cumulative effect of a change in accounting for major aircraft overhauls from the accrual method to the expense as incurred method. The net loss before the cumulative effect of the change in accounting was \$24,854,000, or \$0.84 per common share. During the year ended March 31, 2003, as compared to the prior comparable period, we experienced lower average fares as a result of the slowing economy, United's competitive pricing on discount fares available inside 14 days of travel, principally in our Denver market, and low introductory fares by new carriers serving the Denver market. Our average fare was \$109 for the year ended March 31, 2003, compared to \$132 for the year ended March 31, 2002. We also believe that passenger traffic during the year ended March 31, 2003 was impacted by the threat of war with Iraq, which began in March 2003. During March 2003, the Denver area also experienced an unusual blizzard, which caused DIA to be closed for approximately two days. During the year ended March 31, 2003, we completed a sale-leaseback transaction of one of our purchased aircraft and paid off the loan that was collateralized by this aircraft. As a result we incurred \$1,774,000 in costs associated with the early extinguishment of this debt. Additionally, we wrote down the value of our Boeing spare parts inventory by \$2,478,000.

Our mainline CASM for the year ended March 31, 2003 and 2002 was 8.33(cents) and 9.33(cents) respectively, a decrease of 1.00(cent) or 10.7%. Mainline CASM excluding fuel for the year ended March 31, 2003 and 2002 was 6.90(cents) and 8.00(cents), respectively, a decrease of 1.10(cents) or 13.8%. Our mainline CASM decreased during the year ended March 31, 2003 as a result of an increase in the average number of owned aircraft from 2.0 to 6.3, a decrease in the cost per block hour on our Boeing fleet for rotatable repairs and engine overhauls, a decrease in our distribution expenses in relation to the reduction in the average fare and a reduction in travel agency commissions as a result of the elimination of substantially all travel agency commissions effective June 1, 2002, the lack of an employee bonus accrual as a result of the net loss for the period, an increase in aircraft utilization, and economies of scale associated with lower increases in indirect costs compared to the 30.9% increase in ASMs over the prior comparable period. These reductions were partially offset by an increase of .07(cents) per ASM as a result of an increase in war risk and hull and liability insurance premiums after the events of September 11. Due to the flight cancellations as a result of the September 11 terrorist attacks during the year ended March 31, 2002, our ASMs were less than we had planned, which caused our fixed costs to be spread over fewer ASMs and, we believe, distorted our mainline CASM for the year ended March 31, 2002.

During the year ended March 31, 2003, our mainline average daily block hour utilization increased to 9.8 from 9.1 for the year ended March 31, 2002. The calculation of our block hour utilization includes all aircraft that are on our operating certificate, which includes scheduled aircraft, as well as aircraft out of service for maintenance and operational spare aircraft, and excludes aircraft removed permanently from revenue service or new aircraft not yet placed in revenue service. In September 2001, we temporarily grounded four aircraft as a result of the September 11, 2001 terrorist attacks, resulting in reduced aircraft utilization during the 2002 period.

For the year ended March 31, 2003 and 2002, our mainline break-even load factors were 65.0% and 56.6%, respectively, compared to our achieved passenger load factors of 59.9% and 60.0%. Our mainline break-even load factor increased from the prior comparable period largely as a result of a decrease in our average fare to \$109 during the year ended March 31, 2003 from \$132 during the year ended March 31, 2002, partially offset by a decrease in our mainline CASM to 8.33(cents) for the year ended March 31, 2003 from 9.33(cents) for the year ended March 31, 2002.

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

### Revenues

Our mainline average fare for the year ended March 31, 2003 and 2002 was \$109 and \$132, respectively, a decrease of 17.4%. We believe that the decrease in the mainline average fare during the year ended March 31, 2003 from the prior comparable period was principally a result of the slowing economy, the threat of a war with Iraq which began in March 2003, United States competitive pricing on discount fares available inside 14 days of travel, principally in our Denver market, and low introductory fares by new carriers serving the Denver market.

Effective February 17, 2002, the DOT began to provide security services through the TSA and assumed many of the contracts and oversight of security vendors that we and other carriers use to provide airport security services. Additionally, the DOT reimbursed us and all other air carriers for certain security services provided by our own personnel. In order to be able to provide and fund these security services, the DOT has imposed a \$2.50 security service fee per passenger segment flown, not to exceed \$5.00 for one-way travel or \$10.00 for a round trip, on tickets purchased on and after February 1, 2002. We believe that these fees have had downward pressure on our average fare and in some cases we have been unable to pass these costs along.

*Passenger Revenues.* Passenger revenues totaled \$460,188,000 for the year ended March 31, 2003 compared to \$435,946,000 for the year ended March 31, 2002, or an increase of 5.6%, on increased capacity of 1,420,963,000 ASMs or 30.9%. The number of revenue passengers carried was 3,926,000 for the year ended March 31, 2003 compared to 3,069,000 for the year ended March 31, 2002 or an increase of 27.9%. We had an average of 33.8 aircraft in our mainline fleet during the year ended March 31, 2003 compared to an average of 27.8 aircraft during the year ended March 31, 2002, an increase of 21.6%. RPMs for the year ended March 31, 2003 were 3,599,553,000 compared to 2,756,965,000 for the year ended March 31, 2002, an increase of 30.6%. Our load factor decreased slightly to 59.9% for the year ended March 31, 2003, from 60.0% for the prior year.

Cargo revenues, consisting of revenues from freight and mail service, totaled \$5,557,000 and \$6,624,000 for the years ended March 31, 2003 and 2002, respectively, representing 1.2% and 1.5% of total operating revenues, respectively, a decrease of 16.1%. We believe that our cargo revenues were impacted by the slowing economy as well as the agreement the United States Postal Service entered into with Federal Express, Inc., which began in August 2001 that increased Federal Express's volume of mail transportation.

Other revenues, comprised principally of interline handling fees, liquor sales and excess baggage fees, totaled \$4,191,000 and \$2,505,000 or .9% and .6% of total operating revenues for the years ended March 31, 2003 and 2002, respectively. Other revenue increased over the prior comparable period as a result of an increase in interline handling fees primarily due to the Mesa codeshare agreement and an increase in ground handling for Mesa and other airlines.

### Operating Expenses

Total operating expenses were \$500,727,000 and \$428,689,000, respectively, for the years ended March 31, 2003 and 2002, and represented 106.6% and 96.4% of total revenue, respectively. Operating expenses increased as a percentage of revenue during the year ended March 31, 2003 as a result of the 17.4% decrease in the average fare.

*Flight Operations.* Flight operations expenses of \$85,675,000 and \$64,825,000 were 18.2% and 14.6% of total revenue for the years ended March 31, 2003 and 2002, respectively. Included in flight operations expenses during the year ended March 31, 2003 and 2002 were approximately \$3,330,000 and \$3,086,000, respectively, for Airbus training and related travel expenses.

Aircraft insurance expenses totaled \$11,095,000 (2.4% of total revenue) for the year ended March 31, 2003. Aircraft insurance expenses for the year ended March 31, 2002 were \$5,324,000 (1.2% of total revenue). Aircraft insurance expenses were .31(cents) and .19(cents) per RPM for the years ended March 31, 2003 and 2002, respectively. Aircraft insurance expenses during the year ended March 31, 2002 were not fully impacted by the result of the terrorist attacks on September 11, 2001. Immediately following the events of September 11, our aviation war risk underwriters limited war risk passenger liability coverage on third party bodily injury and

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

property damage to \$50 million per occurrence. A special surcharge of \$1.25 per passenger carried was established as the premium for this coverage by our commercial underwriters. At the same time, the FAA provided us supplemental third party war risk coverage from the \$50 million limit to \$1.6 billion. Effective December 16, 2002, the FAA amended this coverage to include war risk hull as well as passenger, crew and property liability insurance. In February 2003, we cancelled our commercial hull and liability war risk coverage after binding the FAA coverages. The premium for the revised FAA war risk coverage is derived from a formula that takes into account total enplanements, total revenue passenger miles, and total revenue ton-miles flown, and is significantly less than the original commercial coverage premium. The Appropriations Act authorized the government to offer both policies through August 31, 2004. We do not know whether the government will extend the coverage, and if it does, how long the extension will last. We expect that if the government stops providing excess war risk coverage to the airline industry, the premiums charged by aviation insurers for this coverage will be substantially higher than the premiums currently charged by the government or the coverage will not be available from reputable underwriters.

Pilot and flight attendant salaries before payroll taxes and benefits totaled \$42,982,000 and \$32,042,000 or 9.3% and 7.4% of passenger revenue for each of the years ended March 31, 2003 and 2002, or an increase of 34.1%. Pilot and flight attendant compensation increased as a result of an increase of 30.2% in block hours, a general wage increase in pilot and flight attendant salaries, and additional crews required to replace those attending training on the Airbus equipment. In order to maintain competitive pay for pilots, a revised pilot pay schedule was negotiated with the Frontier Airline Pilots Association (FAPA) for an approximate 2.5% increase in salaries. The FAPA members accepted this proposal, which was effective August 1, 2002. During the year ended March 31, 2002, FAPA agreed to an 11% decrease in salaries for all pilots in lieu of furloughs as a result of the September 11, 2001 terrorist attacks. The pilot salary levels were reinstated effective January 1, 2002.

*Aircraft Fuel Expense.* Aircraft fuel costs of \$86,064,000 for 89,236,000 gallons used and \$61,226,000 for 70,530,000 gallons used resulted in an average fuel cost of 96(cents) and 87(cents) per gallon for the years ended March 31, 2003 and 2002, respectively.

We initiated a fuel hedging program in late November 2002, which allowed us to reduce fuel expenses during the year ended March 31, 2003 by approximately \$558,000. Fuel consumption for the years ended March 31, 2003 and 2002 averaged 742 and 763 gallons per block hour, respectively. Fuel consumption per block hour decreased 2.8% during the year ended March 31, 2003 from the prior comparable period because of the more fuel-efficient Airbus aircraft added to our fleet, and a fuel conservation program implemented in August 2001.

*Aircraft Lease Expenses.* Aircraft lease expenses totaled \$70,239,000 (14.9% of total revenue) and \$64,990,000 (14.6% of total revenue) for the years ended March 31, 2003 and 2002, respectively, or an increase of 8.1%. The increase is largely due to an increase in the average number of leased aircraft to 27.9 from 25.8, or 8.1%, during the year ended March 31, 2003 compared to the same period in 2002.

*Aircraft and Traffic Servicing.* Aircraft and traffic servicing expenses were \$86,448,000 and \$70,202,000 (an increase of 23.1%) for the years ended March 31, 2003 and 2002, respectively, and represented 18.4% and 15.8% of total revenue. Aircraft and traffic servicing expenses increase with the addition of new cities and departures to our route system. As of March 31, 2003, we served 38 cities compared to 30 as of March 31, 2002, or an increase of 26.7%. During the year ended March 31, 2003, our departures increased to 53,081 from 41,736 or 27.2%. Aircraft and traffic servicing expenses were \$1,629 per departure for the year ended March 31, 2003 as compared to \$1,682 per departure for the year ended March 31, 2002, or a decrease of \$53 per departure. Aircraft and traffic servicing expenses increased as a result of a general wage rate increase and an increase in interrupted trip expenses as a result of the number of flight cancellations related to the aircraft out of service for repair of hail damage. The September 11 terrorist attacks caused us to reduce our flight schedule and related capacity from October 2001 through February 2002, which caused our fixed costs to be spread over fewer departures and increased our expenses per departure for the year ended March 31, 2002.

*Maintenance.* Maintenance expenses for the years ended March 31, 2003 and 2002 of \$75,559,000 and \$68,560,000 (pro forma amount adjusting for the effect of the accounting

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

change), respectively, were 16.1% and 15.4% of total revenue, an increase of 10.2%. Maintenance is charged to maintenance expense as incurred. During the year ended March 31, 2002, we had previously accrued monthly for major engine overhauls and heavy maintenance checks. Maintenance costs per block hour for the years ended March 31, 2003 and 2002 were \$628 and \$742 per block hour, respectively, a decrease of 15.4%. Maintenance cost per block hour decreased as a result of the addition of new Airbus aircraft that are less costly to maintain than our older Boeing aircraft. During the year ended March 31, 2003, we incurred approximately \$21,600, or less than \$1 per block hour for Airbus maintenance training, compared to \$881,000 or \$10 per block hour for the year ended March 31, 2002. Due to the flight cancellations as a result of the September 11 terrorist attacks, our block hours were less than we had planned, which caused our fixed costs to be spread over fewer block hours and, we believe, distorted our cost per block hour for year ended March 31, 2002.

In July 2001, our mechanics voted to be represented by International Brotherhood of Teamsters. The first bargaining agreement for the mechanics, which has a 3-year term, was ratified and made effective in July 2002. The effect of this agreement was to increase mechanics salaries by approximately 12% over the term of the agreement.

*Promotion and Sales.* Promotion and sales expenses totaled \$53,032,000 and \$59,459,000 and were 11.3% and 13.4% of total revenue for the years ended March 31, 2003 and 2002, respectively. During the year ended March 31, 2003, promotion and sales expenses per passenger decreased to \$13.51 from \$19.37 for the year ended March 31, 2002. Promotion and sales expenses per passenger decreased as a result of variable expenses which are based on lower average fares, the overall elimination of substantially all travel agency commissions effective on tickets sold after May 31, 2002 and a decrease in advertising expenses. We reduced advertising expenses from the prior comparable period as efforts were put into identifying who our customers are and developing our brand in preparation for a new advertising campaign. The campaign, which was scheduled to begin in our fourth fiscal quarter, was postponed until fiscal year 2004 as a result of the war in Iraq. During the year ended March 31, 2002, we incurred costs associated with the start-up and promotion of our frequent flyer program as well as the redesign of our web site.

*General and Administrative.* General and administrative expenses for the years ended March 31, 2003 and 2002 totaled \$26,061,000 and \$26,174,000, and were 5.5% and 5.9% of total revenue, respectively. During the year ended March 31, 2002 we accrued for employee performance bonuses totaling \$2,521,000, which was .6% of total revenue. Bonuses are based on profitability. As a result of our pre-tax loss for the year ended March 31, 2003, we did not accrue bonuses. We experienced increases in our human resources, training and information technology expenses as a result of an increase in employees from approximately 2,700 in March 2002 to approximately 3,160 in March 2003, an increase of 17.0%. Because of the increase in personnel, our health insurance benefit expenses, workers compensation, and accrued vacation expense increased accordingly. During the year ended March 31, 2003, we brought revenue accounting in-house. We previously had outsourced this function. We have realized a reduction in expenses totaling approximately \$1,000,000 associated with processing revenue accounting transactions.

*Depreciation and Amortization.* Depreciation and amortization expenses of \$17,650,000 and \$11,587,000, an increase of 52.3%, were approximately 3.8% and 2.6% of total revenue for the years ended March 31, 2003 and 2002, respectively. These expenses include depreciation of aircraft and aircraft components, office equipment, ground station equipment and other fixed assets. Depreciation expense increased over the prior year due to an increase in the number of Airbus A319 aircraft owned from three at March 31, 2002 to nine at March 31, 2003.

*Nonoperating Income (Expense).* Net nonoperating expense totaled \$8,718,000 for the year ended March 31, 2003 compared to net nonoperating income of \$8,447,000 for the year ended March 31, 2002. During the year ended March 31, 2002, we recognized \$12,703,000 of compensation as a result of payments under the Stabilization Act to offset direct and incremental losses we experienced as a result of the terrorist attacks on September 11, 2001. We received a total of \$17,538,000 as of December 31, 2001. The remaining \$4,835,000 represents amounts received in excess of estimated allowable direct and incremental losses incurred from September 11, 2001 to December 31, 2001, which we repaid during the year ended March 31, 2003.

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

Interest income decreased to \$1,883,000 during the year ended March 31, 2003 from \$4,388,000 for the prior period due to a decrease in cash balances as a result of cash used for pre-delivery payments for future purchases of aircraft, our net loss for the period and a decrease in interest rates. Interest expense increased to \$8,041,000 for the year ended March 31, 2003 from \$3,383,000 for the prior period as a result of interest expense associated with the financing of additional purchased Airbus aircraft and a \$70,000,000 loan facility obtained to increase our liquidity.

During the year ended March 31, 2003, we completed a sale-leaseback transaction of one of our purchased aircraft and paid off the loan that was collateralized by this aircraft. As a result we incurred \$1,774,000 in costs associated with the early extinguishment of this debt.

During the year ended March 31, 2002, we negotiated early lease terminations on two of our Boeing 737-200 aircraft resulting in a pre-tax charge of \$4,914,000 representing a negotiated settlement of future rent amounts due.

*Income Tax Expense.* We accrued an income tax benefit of \$14,655,000 during the year ended March 31, 2003 at a 37.1% effective tax rate, compared to an income tax expense accrual of \$8,282,000 for the year ended March 31, 2002, at a 38.7% effective tax rate. The expected benefit for the year ended March 31, 2003 at a federal rate of 35% plus the blended state rate of 3.7% (net of federal tax benefit) is reduced by the tax effect of permanent differences of 1%. During the year ended March 31, 2002, we recorded a credit to income tax expense totaling \$1,327,000 for this excess accrual. During the year ended March 31, 2002, we also recorded a \$441,000 reduction to income tax expense as a result of a review and revision of state tax apportionment factors used in filing amended state tax returns for 2000.

### **Liquidity and Capital Resources**

Our liquidity depends to a large extent on the number of passengers who fly with us, the fares we charge, our operating and capital expenditures, and our financing activities. We depend on lease or mortgage-style financing to acquire all of our aircraft, including 32 additional Airbus aircraft that as of June 1, 2004 are scheduled for delivery through March 2008.

We had cash and cash equivalents and short-term investments of \$190,609,000 and \$104,880,000 at March 31, 2004 and 2003, respectively. At March 31, 2004, total current assets were \$269,733,000 as compared to \$181,659,000 of total current liabilities, resulting in working capital of \$88,074,000. At March 31, 2003, total current assets were \$191,291,000 as compared to \$130,519,000 of total current liabilities, resulting in working capital of \$60,772,000. The increase in our cash and working capital from March 31, 2003 is largely a result of cash provided by our net income for the year ended March 31, 2004 adjusted for non-cash charges and credits and changes in working capital accounts, the common stock offering in September 2003, which netted \$81,077,000 after offering expenses, an income tax refund from the Internal Revenue Service totaling \$26,574,000, and the net proceeds from a sale-leaseback of one of our aircraft. These were offset by required principal prepayments on our government guaranteed loan totaling \$58,418,000 from the income tax refund and from a portion of the proceeds from the stock offering, our decision to repay the remaining balance due of \$11,582,000 on the government guaranteed loan after the required prepayments, and an increase in restricted investments totaling \$13,058,000 which was largely a result of the increase in our collateral requirements to our bankcard processor associated with the increase in our air traffic liability.

Cash provided by operating activities for the year ended March 31, 2004 was \$128,018,000. This is attributable to our net income adjusted for non-cash charges and credits and changes in working capital accounts. Our air traffic liability increased as a result in the growth of our business associated with the increase in the number of aircraft in our fleet coupled with the increase in the number of passengers we carried in excess of our increased capacity. Our accrued expenses increased as a result of increases in employee benefits associated with the increase in the number of employees and increases in health care expenses, the bonus accrual for our employees as a result of our profitability and increases in passenger related taxes associated with our increase in revenue and passengers carried. Cash provided by operating activities for the year ended March 31, 2003 was \$874,000. This is attributable to a

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

a net loss of \$22,843,000, a decrease in receivables and prepaid expenses, an increase in accounts payable and deferred liabilities, an increase in deferred expenses and inventories, decreases in air traffic liability, and the repayment of excess Stabilization Act compensation received. Included in cash provided by operating activities for the year ended March 31, 2003 was a \$10,000,000 advance payment on the new affinity card program we launched in May 2003.

Cash used in investing activities for the year ended March 31, 2004 was \$138,311,000. Net aircraft lease and purchase deposits increased by \$6,446,000 during this period, offset by a decrease in restricted investments of \$2,444,000 associated with collateral on returned aircraft and new aircraft deliveries where we substituted cash security deposits in lieu of the letters of credit that were previously in place. We used \$134,651,000 for the purchase of four additional Airbus aircraft, aircraft leasehold improvements including LiveTV, ground equipment to support increased below-wing operations, and computer equipment, including scanning equipment for our new mail transportation requirements. During the year ended March 31, 2004, we took delivery of four purchased Airbus A318 aircraft and applied their respective pre-delivery payments to the purchase of those aircraft. Additionally, we completed a sale-leaseback transaction on one of our purchased aircraft that was delivered to us in September 2003, generating cash proceeds of approximately \$4,374,000 from the sale and the return of the pre-delivery payments relating to the purchase commitment. We agreed to lease the aircraft over a 12-year term. Cash used in investing activities for the year ended March 31, 2003 was \$195,335,000. We used \$238,668,000 for the purchase of six additional Airbus aircraft, rotatable aircraft components, LiveTV for the Airbus aircraft, leasehold improvements and other general equipment purchases. Net aircraft lease and purchase deposits and restricted investments decreased by \$12,405,000 and \$1,177,000, respectively, during this period. During the year ended March 31, 2003, we took delivery of six purchased Airbus aircraft and applied their respective pre-delivery payments to the purchase of those aircraft. Additionally, we completed a sale-leaseback transaction on one of our purchased aircraft and assigned a purchase commitment on another Airbus A319 to a lessor, generating cash proceeds of approximately \$12,306,000 from the sale of one aircraft and the return of the pre-delivery payments relating to the purchase commitment assigned. We agreed to lease both of these aircraft over a five-year term.

Cash provided by financing activities for the year ended March 31, 2004 was \$96,022,000. During the year ended March 31, 2004, we completed a public offering of 5,050,000 shares of our common stock. We received \$81,077,000, net of offering expenses, from the sale of these shares. During the year ended March 31, 2004, we borrowed \$98,500,000 to finance the purchase of four Airbus aircraft and made principal repayments on this debt of \$83,325,000. In July 2003, we received an income tax refund from the Internal Revenue Service totaling \$26,574,000 and prepaid \$10,000,000 on our government guaranteed loan upon receipt of this refund. In September 2003, we used \$48,418,000 of the proceeds from the stock offering to prepay a portion of the government guaranteed loan. Both prepayments were required by the loan agreement. In December 2003, we repaid the remaining loan balance due of \$11,582,000. During the year ended March 31, 2004, we received \$1,001,000 from the exercise of common stock options. Cash provided by financing activities for the year ended March 31, 2003 was \$209,787,000. In February 2003, we received \$70,000,000 from the government guaranteed loan. During the year ended March 31, 2003, we borrowed \$171,100,000 to finance the purchases of Airbus aircraft, of which \$28,946,000 was repaid during the year. In December 2002, we entered into a sale-leaseback transaction for one of our purchased aircraft. We received net proceeds of approximately \$5,300,000 from the sale of this aircraft, net of repayment of debt that collateralized this aircraft totaling \$22,772,000 and payment of fees associated with the early extinguishments of the debt. During the year ended March 31, 2003, we received \$1,275,000 from the exercise of common stock options.

We have been working closely with DIA, our primary hub for operations, and the offices of the Mayor of the City and County of Denver, in which DIA is located, to develop plans for expanding Concourse A where our aircraft gates are located in order to accommodate our anticipated growth over the next several years. In the interim, we have gained temporary rights to two gates, and permanent rights to one gate, previously used by United Airlines on the East end of Concourse A. We are currently obligated to return the two temporary gates to United in October 2005. DIA has also completed construction of two temporary gates on the West end of Concourse A. We are currently using all five of these temporary gates until a permanent expansion can be completed. We are currently negotiating with the City and County of Denver and its primary contractor to reach final terms for the lease of at least four mainline

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

gates and the shared use of four or five common use regional jet pads to be constructed on the West end of Concourse A. Final terms for the project and the lease of these facilities have not yet been reached. Once final terms are reached, upon completion of the permanent expansion to Concourse A we would be obligated to lease the additional gates, thereby increasing our overall rates and charges paid to the airport. Because our overall rates and charges are also based upon the number of passengers and gross weight landed at the airport, it is impossible at this time to determine what our future rates and charges at DIA will be with any certainty.

As part of the lease restructure between the City and County of Denver and United, we believe that United has been provided certain concessions and reductions in the rents, rates and charges arising from their lease of facilities at DIA. The City and County of Denver has indicated that it will seek to prevent the reduced rates and charges being paid by United from increasing the rates and charges being paid by other airlines. However, the City and County of Denver has also made it clear that in certain circumstances it will have no choice but to increase rates and charges being paid by other airlines in order to comply with their own cash flow, reserve account and bond financing requirements. Because we are the second largest airline operating out of DIA, we may incur a larger impact of any increase in rates and charges imposed by DIA. At this time, it is impossible to quantify what the increase in our rates and charges would be, if any, due to the concessions being provided to United.

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

### **Emergency Wartime Supplemental Appropriations Act**

The Emergency Wartime Supplemental Wartime Supplemental Appropriations Act (the "Appropriations Act"), enacted on April 16, 2003, made available approximately \$2.3 billion to U.S. flag air carriers for expenses and revenue foregone related to aviation security. In order to have been eligible to receive a portion of this fund, air carriers must have paid one or both of the TSA security fees, the September 11th Security Fee and/or the Aviation Security Infrastructure Fee as of the date of enactment of the Appropriations Act. According to the Appropriations Act, an air carrier may use the amount received as the air carrier determines.

The Appropriations Act provides for additional reimbursements to be made to U.S. flag air carriers for costs incurred related to the FAA requirements for enhanced flight deck door security measures that were mandated as a result of the September 11 terrorist attacks. Pursuant to the Appropriations Act, we received \$889,000 in September 2003 for expenses related to the installation of enhanced flight deck doors on our aircraft. Upon receipt of the \$889,000 reimbursement, we credited maintenance expense and charged fixed assets for the labor component of the flight deck door installation, and correspondingly we credited property, plant, and equipment to reflect the reimbursement.

### **Contractual Obligations**

The following table summarizes our contractual obligations as of March 31, 2004:

Less than	1-3	4-5	After
-----------	-----	-----	-------

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

	1 year	years	years	5 years
Long-term debt (1)	\$ 17,387,000	\$ 35,082,000	\$ 39,084,000	\$205,834,000
Operating leases (2)	121,221,000	236,055,000	234,534,000	725,940,000
Unconditional purchase obligations(3) (4)	60,869,000	250,385,000	219,947,000	-
Total contractual cash obligations	\$199,477,000	\$521,522,000	\$493,565,000	\$931,774,000

(1) At March 31, 2004 we had 13 loan agreements for nine Airbus A319 aircraft and 4 Airbus A318 aircraft. Two of the loans have a term of 10 years and are payable in equal monthly installments, including interest, payable in arrears. The loans require monthly principal and interest payments of \$215,000 and \$218,110, bears interest with rates of 6.71% and 6.54%, with maturities in May and August 2011, at which time a balloon payment totaling \$10,200,000 is due with respect to each loan. The remaining 11 loans have interest rates based on LIBOR plus margins that adjust quarterly or semi-annually. At March 31, 2004, interest rates for these loans ranged from 2.38% to 3.37%. Each of the loans have a term of 12 years, and each loan has balloon payments ranging from \$2,640,000 to \$7,770,000 at the end of the term. All of the loans are secured by the aircraft.

(2) As of March 31, 2004, we lease 15 Airbus A319 type aircraft and 12 Boeing 737 type aircraft under operating leases with expiration dates ranging from 2004 to 2015. Two of the Boeing 737 type aircraft are no longer in service, one is being stored until the lease return date of October 2005 and the other aircraft was returned to the lessor in April 2004. Under all of our leases, we have made cash security deposits or arranged for letters of credit representing approximately two months of lease payments per aircraft. At March 31, 2004, we had made cash security deposits of \$8,511,000 and had arranged for letters of credit of \$4,692,000 collateralized by restricted cash balances. Additionally, we are required to make supplemental rent payments to cover the cost of major scheduled maintenance overhaul of these aircraft. These supplemental rent payments are based on the number of flight hours flown and/or flight departures and are not included as an obligation in the table above.

As a complement to our Airbus purchase agreement, in April 2000 we signed an agreement, as subsequently amended, to lease 15 new Airbus aircraft for a term of 12 years. As of March 31, 2004, we had taken delivery of 11 of these aircraft and have letters of credit on the remaining four aircraft to be delivered totaling \$824,000 to secure these leases, collateralized by restricted cash balances.

During the year ended March 31, 2004, we entered into additional aircraft lease agreements for two Airbus A318 aircraft and 18 Airbus A319 aircraft, two of which we took delivery of in September 2003 and February 2004 with the remaining scheduled for delivery beginning in April 2004 through February 2007. Three of the aircraft leases were a result of sale-leaseback transactions of three new Airbus aircraft. As of March 31, 2004, we have made \$3,896,000 in security deposit payments for future leased aircraft deliveries.

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

(3) As of March 31, 2004, we have remaining firm purchase commitments for 14 additional aircraft, excluding the June and July 2004 sale-leaseback aircraft, which have scheduled delivery dates beginning in calendar year 2004 and continuing through 2008. Including these aircraft, we intend to lease as many as 22 additional A318 or A319 aircraft from third party lessors over the next five years. Included in the purchase commitments are the remaining amounts due Airbus and amounts for spare aircraft components to support the additional purchase and leased aircraft. We are not under any contractual obligations with respect to spare parts. Under the terms of the purchase agreement, we are required to make scheduled pre-delivery payments for these aircraft. These payments are non-refundable with certain exceptions. As of March 31, 2004, we had made pre-delivery payments on future deliveries totaling \$28,329,000 to secure these aircraft.

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

- (4) In October 2002, we entered into a purchase and 12-year services agreement with LiveTV to bring DIRECTV AIRBORNE(TM) satellite programming to every seatback in our Airbus fleet. We have agreed to the purchase of 46 units. As of March 31, 2004, we have purchased 25 units and have made deposits toward the purchase of 12 additional units. The table above includes the remaining purchase commitment amounts for the 12 units we have made partial payments on and all amounts not yet paid on the remaining firm seven units.

### Commercial Commitments

As we enter new markets, increase the amount of space we lease, or add leased aircraft, we are often required to provide the airport authorities and lessors with a letter of credit, bonds or cash security deposits. These generally approximate up to three months of rent and fees. As of March 31, 2004, we had outstanding letters of credit, bonds, and cash security deposits totaling \$13,789,000, \$1,462,000, and \$16,477,000, respectively. In order to meet these requirements, we have a credit agreement with a financial institution for up to \$1,500,000, which expires August 31, 2004, and another credit agreement with a second financial institution for up to \$20,000,000, which expires December 1, 2004. These credit lines can be used solely for the issuance of standby letters of credit. Any amounts drawn under the credit agreements are fully collateralized by certificates of deposit, which are carried as restricted investments on our balance sheet. As of March 31, 2004, we have utilized \$13,789,000 under these credit agreements for standby letters of credit that collateralize certain leases. In the event that these credit agreements are not renewed beyond their present expiration dates, the certificates of deposit would be redeemed and paid to the various lessors as cash security deposits in lieu of standby letters of credit. As a result, there would be no impact on our liquidity if these agreements were not renewed. In the event that the surety companies determined that issuing bonds on our behalf were a risk they were no longer willing to underwrite, we would be required to collateralize certain of these lease obligations with either cash security deposits or standby letters of credit, which would decrease our liquidity.

We have a contract with a bankcard processor that requires us to pledge a certificate of deposit equal to a certain percentage of our air traffic liability associated with bankcard customers. As of March 31, 2004, that amount totaled \$20,488,000. The amount is adjusted quarterly in arrears based on our air traffic liability associated with bankcard transactions. As of June 1, 2004, we are required to increase the amount by approximately \$2,900,000.

We use the Airline Reporting Corporation ("ARC") to provide reporting and settlement services for travel agency sales and other related transactions. In order to maintain the minimum bond (or irrevocable letter of credit) coverage of \$100,000, ARC requires participating carriers to meet, on a quarterly basis, certain financial tests such as, but not limited to, net profit margin percentage, working capital ratio, and percent of debt to debt plus equity. As of March 31, 2004, we met these financial tests and presently are only obligated to provide the minimum amount of \$100,000 in coverage to ARC. If we were to fail the minimum testing requirements, we would be required to increase our bonding coverage to four times the weekly agency net cash sales (sales net of refunds and agency commissions). Based on net cash sales remitted to us as of June 2, 2004, the coverage would be increased to \$9,167,000 if we failed the tests. If we were unable to increase the bond amount as a result of our financial condition at the time, we could be required to issue a letter of credit that would restrict cash in an amount equal to the letter of credit.

Immediately following the events of September 11, our aviation war risk underwriters limited war risk passenger liability coverage on third party bodily injury and property damage to \$50 million per occurrence. A special surcharge of \$1.25 per passenger carried was established as the premium for this coverage by our commercial underwriters. At the same time, the FAA provided us supplemental third party war risk coverage from the \$50 million limit to \$1.6 billion. Effective December 16, 2002, the FAA amended this coverage to include war risk hull as well as passenger, crew and property liability insurance. In February 2003, we cancelled our commercial hull and liability war risk coverage after binding the FAA coverage. The premium for the revised FAA war risk coverage is derived from a formula that takes into account total enplanements, total revenue passenger miles, and total revenue ton miles flown, and is significantly less than the original commercial coverage premium. The Appropriations Act authorized the government to offer both policies through August 31, 2004. We do not know

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

whether the government will extend the coverage, and if it does, how long the extension will last. We expect that if the government stops providing excess war risk coverage to the airline industry, the premiums charged by aviation insurers for this coverage will be substantially higher than the premiums currently charged by the government or the coverage will simply not be available from reputable underwriters.

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

In September 2003, we entered into a swap agreement with a notional volume of 630,000 gallons per month for the period from January 1, 2004 to June 30, 2004. The fixed price of the swap is 74.50 cents per gallon and the agreement is estimated to represent 7% of our fuel purchases for that period. On May 21, 2004 we entered into a collar agreement that hedges approximately 25% of our expected fuel requirements in the quarters ended December 31, 2004 and March 31, 2005. The collar uses West Texas Intermediate crude oil as its basis. The cap price is set at \$39.00 per barrel, and the floor is set at \$34.85 per barrel.

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

Effective January 1, 2003, we entered into an engine maintenance agreement with GE Engine Services, Inc. ("GE") covering the scheduled and unscheduled repair of our aircraft engines used on most of our Airbus aircraft. The agreement is for a 12-year period from the effective date for our owned aircraft or December 31, 2014, whichever comes first, and for each leased aircraft, the term coincides with the initial lease term of 12 years. This agreement precludes us from using another third party for such services during the term. This agreement requires monthly payments at a specified rate multiplied by the number of flight hours the engines were operated during that month. The amounts due based on flight hours are not included in table above. As of March 31, 2004, the agreement covers 13 purchased Airbus aircraft and 15 leased Airbus aircraft. The cost associated with this agreement for our purchased aircraft for the years ended March 31, 2004 and 2003 were approximately \$1,833,000 and \$270,000, respectively. For our leased aircraft, the lessors pay GE directly for the repair of aircraft engines in conjunction with this agreement from reserve accounts established under the applicable lease documents.

### **Critical Accounting Policies**

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

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

### **Revenue Recognition**

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

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

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

### **Aircraft Maintenance**

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

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

### **Derivative Instruments**

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

The Company enters into derivative transactions to hedge the interest payments associated with a portion of its LIBOR-based borrowings and fuel purchases. The Company designates certain interest rate swaps as qualifying cash flow hedges. The Company also enters into derivative transactions to reduce exposure to the effect of fluctuations in fuel prices. These transactions are accounted for as trading instruments under SFAS 133. As a result, the Company records these instruments at fair market value and recognizes realized and unrealized gains and losses in aircraft fuel expense.

### **Customer Loyalty Program**

In February 2001, we established *EarlyReturns*, a frequent flyer program to encourage travel on our airline and customer loyalty. We account for the *EarlyReturns* program under the incremental cost method whereby travel awards are valued at the incremental cost of carrying

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

one passenger based on expected redemptions. Those incremental costs are based on expectations of expenses to be incurred on a per passenger basis and include food and beverages, fuel, liability insurance, and ticketing costs. The incremental costs do not include a contribution to overhead, aircraft cost or profit. We do not record a liability for mileage earned by participants who have not reached the level to become eligible for a free travel award. We believe this is appropriate because the large majority of these participants are not expected to earn a free flight award. We do not record a liability for the expected redemption of miles for non-travel awards since the cost of these awards to us is negligible.

As of March 31, 2004 and 2003, we estimated that approximately 47,600 and 14,600 round-trip flight awards, respectively, were eligible for redemption by *EarlyReturns* members who have mileage credits exceeding the 15,000-mile free round-trip domestic ticket award threshold. As of March 31, 2004 and 2003, we had recorded a liability of approximately \$584,000 and \$283,000, respectively, for these rewards

### ***Co-branded Credit Card Arrangement***

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

During the year ended March 31, 2003, we received a \$10,000,000 advance from the issuing bank for fees expected to be earned under the program. This advance was recorded as deferred revenue when it was received. For the year ended March 31, 2003, we had not yet earned or recognized any revenue from this arrangement. Fees earned as credit cards are issued or renewed, and as points are awarded to the credit card customers are applied against this advance.

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

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

For the year ended March 31, 2004, we earned total fees of \$4,245,000, all of which were applied to the original \$10,000,000 advance. Of that amount, \$3,286,000 was deferred as the travel award component, and the remaining marketing component of \$959,000 was recognized as a reduction to sales and promotions expense. Amortization of deferred revenue recognized in earnings in this period was \$786,000 and is included in passenger revenues.

### ***New Accounting Standards***

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

Standards (SFAS) No. 132 (revised 2003), "Employers Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88, and 106" (SFAS 132R) in December 2003. SFAS 132R revises employers disclosures about pension plans and other postretirement benefit plans by requiring additional disclosures about assets, obligations, cash flows and net periodic benefit costs. SFAS 132R is effective for financial statements issued after December 15, 2003 and for interim periods thereafter.

We adopted SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS 143) on January 1, 2003. The adoption of SFAS 143 had no impact on our financial statements.

The FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" (SFAS 149) in April 2003. This statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133). SFAS 149 is effective for contracts entered into or modified after June 30, 2003, except in certain circumstances. The adoption of SFAS 149 had no impact on our financial statements.

The FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" (SFAS 150) in May 2003. This statement establishes standards for classifying and measuring certain financial instruments with characteristics of both liabilities and equity. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003; otherwise, this statement, as it applies to our financial statements, is effective July 1, 2003. The adoption of SFAS 150 had no impact on our financial statements.

The FASB issued FASB Staff Position SFAS No. 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (FSP 106-1) in January 2004. The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Medicare Act) introduced a prescription drug benefit under Medicare and a federal subsidy to sponsors of health care benefit plans in certain circumstances. FSP 106-1 permits a sponsor of a postretirement health care plan that provides a prescription drug benefit to make a one-time election to defer accounting for the Medicare Act. It also requires certain disclosures regarding the Medicare Act and is effective for financial statements issued after December 7, 2003. Our financial statements were not impacted by the Medicare Act.

The FASB issued FASB Interpretation No. (FIN) 46, "Consolidation of Variable Interest Entities" (FIN 46) in February 2003. FIN 46 addresses how to identify variable interest entities (VIEs) and the criteria that require a company to consolidate such entities in its financial statements. FIN 46, as revised by FIN 46R, was effective on February 1, 2003 for new transactions and is effective for reporting periods ending after March 15, 2004 for transactions entered into prior to February 1, 2003. We have evaluated our transactions that may be impacted by FIN 46, including (1) contract carrier arrangements; (2) aircraft operating leases; and (3) fuel consortiums. While we determined that some of these arrangements are VIEs, we neither hold a significant variable interest in, nor are the primary beneficiary of, any of these arrangements. The adoption of FIN 46 will not have a material impact on our financial statements.

The Emerging Issues Task Force (EITF) reached a consensus on EITF Issue 01-08, "Determining Whether an Arrangement Contains a Lease" (EITF 01-08) in May 2003. This EITF provides guidance on how to determine whether an arrangement contains a lease that is within the scope of SFAS No. 13, "Accounting for Leases" (SFAS 13). The guidance should be applied to arrangements agreed to or modified after June 30, 2003. We have determined that our arrangement with Horizon is subject to this EITF issue and have applied this in accounting for this arrangement effective January 1, 2004.

**Item 7A: Quantitative and Qualitative Disclosures About Market Risk**

***Aircraft Fuel***

Our earnings are affected by changes in the price and availability of aircraft fuel. Market risk is estimated as a hypothetical 10 percent change in the average cost per gallon of fuel for the year ended March 31, 2004. Based on fiscal year 2004 actual fuel usage, such a change would have had the effect of increasing or decreasing our aircraft fuel expense by approximately \$10,886,000 in fiscal year 2004. Comparatively, based on projected fiscal year 2005 fuel usage, including fuel required for our regional partner, such a change would have the effect of increasing or decreasing our aircraft fuel expense by approximately \$15,436,000 in fiscal year 2005, excluding the effects of our fuel hedging arrangements. The increase in exposure to fuel price fluctuations in fiscal year 2004 is due to the increase of our average aircraft fleet size during the year ended March 31, 2004 and related gallons purchased.

In September 2003, we entered into a swap agreement with a notional volume of 630,000 gallons per month for the period from January 1, 2003 to June 30, 2004. The fixed price of the swap is 74.50 cents per gallon and the agreement is estimated to represent 7% of our fuel purchases for that period. The results of operations for the year ended March 31, 2004 include an unrealized derivative gain of \$469,000 that is included in fuel expense and a realized net gain of approximately \$918,000 in cash settlements received from a counter-party recorded as a decrease in fuel expense. On May 21, 2004, we entered into an additional derivative transaction that is designed to economically hedge approximately 25% of our projected fuel requirements in the quarters ending December 31, 2004 and March 31, 2005.

The additional derivative transaction is a collar agreement that uses West Texas Intermediate crude oil as its basis. The cap price is set at \$39.00 per barrel, and the floor is set at \$34.8 per barrel.

***Interest***

We are susceptible to market risk associated with changes in variable interest rates on long-term debt obligations we incurred and will incur to finance the purchases of our Airbus aircraft. Interest expense on 85.8% of our owned Airbus A319 aircraft is subject to interest rate adjustments every three to six months based upon changes in the applicable LIBOR rate. A change in the base LIBOR rate of 100 basis points (1.0 percent) would have the effect of increasing or decreasing our annual interest expense by \$2,552,000 assuming the loans outstanding that are subject to interest rate adjustments at March 31, 2004 totaling \$255,234,000 are outstanding for the entire period.

In March 2003, we entered into an interest rate swap agreement with a notional amount of \$27,000,000 to hedge a portion of our LIBOR based borrowings. Under the interest rate swap agreement, we are paying a fixed rate of 2.45% and receive a variable rate based on the three month LIBOR over the term of the swap that expires in March 2007. As of March 31, 2004, we had hedged approximately 10.6% of our variable interest rate loans. As of March 31, 2004, the fair value of the swap agreement is a liability of \$356,000.

**Item 8: Financial Statements and Supplementary Data**

Our financial statements are filed as a part of this report immediately following the signature page.

**Item 9: Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

**Item 9A: Controls and Procedures**

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and completely and accurately reported within the time periods specified in the Securities and Exchange Commission rules and forms.

There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out this evaluation.

### PART III

#### **Item 10: Directors and Executive Officers of the Registrant.**

##### **Code of Ethics**

The information required by this Item is incorporated herein by reference to the data under the heading "Election of Directors" in the Proxy Statement to be used in connection with the solicitation of proxies for our annual meeting of shareholders to be held on September 9, 2004. We will file the definitive Proxy Statement with the Commission on or before July 30, 2004.

##### **Audit Committee Financial Expert**

The information required by this Item is incorporated herein by reference to the data under the heading "Election of Directors" in the Proxy Statement to be used in connection with the solicitation of proxies for our annual meeting of shareholders to be held on September 9, 2004. We will file the definitive Proxy Statement with the Commission on or before July 30, 2004.

#### **Item 11. Executive Compensation.**

The information required by this Item is incorporated herein by reference to the data under the heading "Executive Compensation" in the Proxy Statement to be used in connection with the solicitation of proxies for our annual meeting of shareholders to be held on September 9, 2004. We will file the definitive Proxy Statement with the Commission on or before July 30, 2004.

#### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information required by this Item is incorporated herein by reference to the data under the heading "Voting Securities and Principal Holders Thereof" in the Proxy Statement to be used in connection with the solicitation of proxies for our annual meeting of shareholders to be held on September 9, 2004. We will file the definitive Proxy Statement with the Commission on or before July 30, 2004.

#### **Item 13. Certain Relationships and Related Transactions.**

The information required by this Item is incorporated herein by reference to the data under the heading "Related Transactions" in the Proxy Statement to be used in connection with the solicitation of proxies for our annual meeting of shareholders to be held on September 9, 2004. We will file the definitive Proxy Statement with the Commission on or before July 30, 2004.

**Item 14. Principal Accountant Fees and Services**

The information required by this Item is incorporated herein by reference to the data under the heading "Principal Accountant Fees and Services" in the Proxy Statement to be used in connection with the solicitation of proxies for our annual meeting of shareholders to be held on September 9, 2004. We will file the definitive Proxy Statement with the Commission on or before July 30, 2004.

**PART IV**

**Item 15(a): Exhibits, Financial Statement Schedules, and Reports on Form 8-K.**

Exhibit  
Numbers

Description of Exhibits

Exhibit 3 - Articles of Incorporation and Bylaws:

- 3.1 Restated Articles of Incorporation of the Company. (Exhibit 3.1 to the Company Quarterly Report on Form 10-Q for the quarter ended September 30, 1999)
- 3.2 Amended and Restated Bylaws of the Company. (Exhibit 3.2 to the Company s Quarterly Report on Form 10-Q for the quarter ended September 30, 1999)

Exhibit 4 - Instruments defining the rights of security holders:

- 4.1 Specimen common stock certificate of the Company. (Exhibit 4.1 to the Company s Registration Statement on Form SB-2, declared effective May 20, 1994)
- 4.2 Rights Agreement, dated as of February 20, 1997, between Frontier Airlines, Inc. and American Securities Transfer & Trust, Inc, including the form of Rights Certificate and the Summary of Rights attached thereto as Exhibits A and B, respectively (Exhibit 3.1 to the Company s Registration Statement on Form 8-A filed March 12, 1997)
- 4.2(a) Amendment to Rights Agreement dated June 30, 1997. (Exhibit 4.4(a) to the Company s Annual Report on Form 10-KSB for the year ended March 31, 1997; Commission File No. 0-24126)
- 4.2(b) Amendment to Rights Agreement dated December 5, 1997. (Exhibit 4.4(b) to the Company s Annual Report on Form 10-K for the year ended March 31, 1999)
- 4.2(c) Third Amendment to Rights Agreement dated September 9, 1999. (Exhibit 4.4 to the Company s Registration Statement on Form 8-A/A filed October 14, 1999)
- 4.2(d) Fourth Amendment to Rights Agreement dated May 30, 2001. (Exhibit 4.4(d) to the Company s Annual Report on Form 10-K for the year ended March 31, 2001)
- 4.3 Frontier Airlines Inc. Warrant to Purchase Common Stock, No. 1 - Air Stabilization Board. Two Warrants, dated as of February 14, 2003, substantially identical in all material respect to this Exhibit, have been entered into with each of the Supplemental Guarantors granting each Supplemental Guarantor a warrant to purchase 191,697 shares under the same terms and conditions described in this Exhibit. Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (Exhibit 4.5 to the Company s Current Report on Form 8-K dated March 25, 2003)

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

- 4.4 Registration Rights Agreement dated as of February 14, 2003 by and Frontier Airlines, Inc. as the Issuer, and the Holders to Herein of Warrants to Purchase Common Stock, No Par Value. Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (Exhibit 4.6 to the Company's Current Report on Form 8-K dated March 25, 2003)

### Exhibit 10 - Material Contracts:

- 10.1 1994 Stock Option Plan. (Exhibit 10.3 to the Company's Registration Statement on Form SB-2, declared effective May 20, 1994)
- 10.1(a) Amendment No. 1 to 1994 Stock Option Plan. (Exhibit 10.4 to the Company's Annual Report on Form 10-KSB for the year ended March 31, 1995; Commission File No. 0-4877)
- 10.1(b) Amendment No. 2 to 1994 Stock Option Plan. (Exhibit 10.2 to the Company's Annual Report on Form 10-KSB for the year ended March 31, 1997; Commission File No. 0-24126)
- 10.2 Airport Use and Facilities Agreement, Denver International Airport (Exhibit 10.7 to the Company's Annual Report on Form 10-KSB for the year ended March 31, 1995; Commission File No. 0-4877)
- 10.3 Space and Use Agreement between Continental Airlines, Inc. and the Company. (Exhibit 10.43 to the Company's Annual Report on Form 10-K for the year ended March 31, 1999)
- 10.3(a) Second Amendment to Space and Use Agreement between Continental Airlines, Inc. and the Company. Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (filed herewith)
- 10.4 Airbus A318/A319 Purchase Agreement dated as of March 10, 2000 between AVSA, S.A.R.L., Seller, and Frontier Airlines, Inc., Buyer. Portions of this exhibit have been excluded from the publicly available document and an order granting confidential treatment of the excluded material has been received. (Exhibit 10.51 to the Company's Annual Report on Form 10-K for the year ended March 31, 2000)
- 10.5 Aircraft Lease Common Terms Agreement dated as of April 20, 2000 between General Electric Capital Corporation and Frontier Airlines, Inc. Portions of this exhibit have been excluded from the publicly available document and an order granting confidential treatment of the excluded material has been received. (Exhibit 10.52 to the Company's Annual Report on Form 10-K for the year ended March 31, 2000)
- 10.6 Aircraft Lease Agreement dated as of April 20, 2000 between Aviation Financial Services, Inc., Lessor, and Frontier Airlines, Inc., Lessee, in respect of 15 Airbus A319 Aircraft. After 3 aircraft were leased under this Exhibit with Aviation Financial Services, Inc. as Lessor, related entities of Aviation Financial Services, Inc. replaced it as the Lessor, but each lease with these related entities is substantially identical in all material respects to this Exhibit. Portions of this exhibit have been excluded from the publicly available document and an order granting confidential treatment of the excluded material has been received. (Exhibit 10.53 to the Company's Annual Report on Form 10-K for the year ended March 31, 2000)
- 10.7 Lease dated as of May 5, 2000 for Frontier Center One, LLC, as landlord, and Frontier Airlines, Inc., as tenant. Portions of this exhibit have been

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

- excluded from the publicly available document and an order granting confidential treatment of the excluded material has been received. (Exhibit 10.55 to the Company's Annual Report on Form 10-K for the year ended March 31, 2000)
- 10.8 Operating Agreement of Frontier Center One, LLC, dated as of May 10, 2000 between Shea Frontier Center, LLC, and 7001 Tower, LLC, and Frontier Airlines, Inc. Portions of this exhibit have been excluded from the publicly available document and an order granting confidential treatment of the excluded material has been received. (Exhibit 10.56 to the Company's Annual Report on Form 10-K for the year ended March 31, 2000)
- 10.9 Standard Industrial Lease dated April 27, 2000, between Mesilla Valley Business Park, LLC, landlord, and Frontier Airlines, Inc., tenant. Portions of this exhibit have been excluded from the publicly available document and an order granting confidential treatment of the excluded material has been received. (Exhibit 10.57 to the Company's Annual Report on Form 10-K for the year ended March 31, 2000)
- 10.10 General Terms Agreement No. 6-13616 between CFM International and Frontier Airlines, Inc. Portions of this exhibit have been excluded from the publicly available document and an order granting confidential treatment of the excluded material has been received. (Exhibit 10.60 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000)
- 10.11 Lease Agreement dated as of December 15, 2000 between Gateway Office Four, LLC, Lessor, and Frontier Airlines, Inc., Lessee. (Exhibit 10.61 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2000)
- 10.12 Code Share Agreement dated as of May 3, 2001 between Frontier Airlines, Inc. and Great Lakes Aviation, Ltd. Portions of this exhibit have been excluded from the publicly available document and an order granting confidential treatment of the excluded material has been received. (Exhibit 10.62 to the Company's Annual Report on Form 10-K for the year ended March 31, 2001)
- 10.12(a) Amendment No. 1 to the Codeshare Agreement dated as of May 3, 2001 between Frontier Airlines, Inc. and Great Lakes Aviation, Ltd. Portions of the exhibit have been excluded from the publicly available document and an order granting confidential treatment of the excluded material has been received. (Exhibit 10.62(a) to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2001)
- 10.13 Codeshare Agreement between Mesa Airlines, Inc. and Frontier Airlines, Inc. (Exhibit 10.61 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001)
- 10.14(a) Amendment No. 1 to the Codeshare Agreement dated as of September 4, 2001 between Mesa Airlines, Inc. and Frontier Airlines, Inc. Portions of this exhibit have been excluded from the publicly available document and an order granting confidential treatment of the excluded material has been received. (Exhibit 10.65(a) to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2001)
- 10.14(b) Amendment No. 2 to Codeshare Agreement dated as of August 1, 2002 between Mesa Airlines, Inc. and Frontier Airlines, Inc. Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (filed herewith)
- 10.14(c) Letter Agreement No. 1 to the Codeshare Agreement dated February 1, 2003 between Mesa Airlines, Inc. and Frontier Airlines, Inc. Portions of this

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (filed herewith)

- 10.15 Employee Stock Ownership Plan of Frontier Airlines, Inc. as amended and restated, effective January 1, 1997 and executed February 5, 2002. (Exhibit 10.66 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2001)
- 10.15(a) Amendment of the Employee Stock Ownership Plan of Frontier Airlines, Inc. as amended and restated, effective January 1, 1997 and executed February 5, 2002 for EGTRRA. (Exhibit 10.66(a) to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2001)
- 10.16 Director Compensation Agreement between Frontier Airlines, Inc. and Samuel D. Addoms dated effective April 1, 2002. This agreement was modified on April 1, 2003, to expressly describe the second installment exercise period as on or after December 31, 2003, and the third installment exercise period as on or after April 1, 2004. (Exhibit 10.67 to the Company's Annual Report on Form 10-K for the year ended March 31, 2002)
- 10.17 Secured Credit Agreement dated as of October 10, 2002 between Frontier Airlines, Inc. and Credit Agricole Indosuez in respect to 3 Airbus 319 aircraft. Portions of this exhibit have been excluded from the publicly available document and an order granting confidential treatment of the excluded material has been received. (Exhibit 10.75 to the Company's Quarterly Report on Form 10-Q/A for the quarter ended September 30, 2002)
- 10.18 Aircraft Mortgage and Security Agreement dated as of October 10, 2002 between Frontier Airlines, Inc. and Credit Agricole Indosuez in respect to 3 Airbus 319 aircraft. Portions of this exhibit have been excluded from the publicly available document and an order granting confidential treatment of the excluded material has been received. (Exhibit 10.76 to the Company's Quarterly Report on Form 10-Q/A for the quarter ended September 30, 2002)
- 10.19 \$70,000,000 Loan Agreement dated as of February 14, 2003 among Frontier Airlines, Inc. as Borrower, West LB AG, as Tranche A Lender and Tranche C Lender, Wells Fargo Bank, N.A., as Tranche B-1 Lender, Tranche B-2 Lender, and a Tranche C Lender, Bearingpoint, Inc. as Loan Administrator, Wells Fargo Bank Northwest, N.A. as Collateral Agent, LB AG, as Agent, and Air Transportation Stabilization Board. Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (Exhibit 10.77 to the Company's Current Report on Form 8-K dated March 25, 2003)
- 10.20 Mortgage and Security Agreement dated as of February 14, 2003 made by Frontier Airlines, Inc. in favor of Wells Fargo Bank Northwest, N.A. the Collateral Agent. Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (Exhibit 10.78 to the Company's Current Report on Form 8-K dated March 25, 2003)
- 10.21 Credit Agreement dated as of July 30, 2003 between Frontier Airlines, Inc. and a Lender in respect to an Airbus 318 aircraft. Frontier has financed the purchase of 3 additional Airbus 318 aircraft with this Lender under Credit Agreements that are substantially identical in all material respects to this Exhibit. Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (Exhibit 10.21 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003)

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

- 10.22 Aircraft Mortgage and Security Agreement dated as of July 30, 2003 between Frontier Airlines, Inc. and a Lender in respect to an Airbus aircraft. Frontier has financed the purchase of 3 additional Airbus 318 aircraft with this Lender under Aircraft Mortgage and Security Agreements that are substantially identical in all material respects to this Exhibit. Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (Exhibit 10.22 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003)
- 10.23 Codeshare Agreement dated as of September 18, 2003 between Horizon Air Industries, Inc. and Frontier Airlines, Inc. Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (Exhibit 10.23 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003)
- 10.24 Aircraft Lease Agreement dated as of December 5, 2003 between International Lease Finance Corporation, Inc., and Frontier Airlines, Inc., Lessee, in respect of 1 Airbus A319 Aircraft. Frontier has signed leases for 4 additional Airbus 319 aircraft with this Lessor under Aircraft Lease Agreements that are substantially identical in all material respects to this Exhibit. Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission in a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. (Exhibit 10.24 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2003)

### Exhibit 23 - Consents of Experts:

- 23.1 Consent of KPMG LLP (filed herewith)

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

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

### Exhibit 32 - Section 1350 Certifications

- 32 Section 906 certifications of President and Chief Executive Officer, Jeffery S. Potter, and Chief Financial Officer, Paul H. Tate (Filed herewith)

### Item 16(b): Reports on Form 8-K.

During the quarter ended March 31, 2004, the Company furnished the following reports on Form 8-K.

<u>Date of Reports</u>	<u>Item Numbers</u>	<u>Financial Statements Required to be Filed</u>
January 30, 2004	7 and 12	None
March 9, 2004	7 and 12	None

# Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

## SIGNATURES

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

FRONTIER AIRLINES, INC.

Date: June 11, 2004

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

Date: June 11, 2004

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: June 11, 2004

By: /s/ Jeffery S. Potter  
Jeffery S. Potter, Director

Date: June 11, 2004

By: /s/ Samuel D. Addoms  
Samuel D. Addoms, Director

Date: June 11, 2004

By:  
William B. McNamara, Director

Date: June 11, 2004

By: /s/ Paul Stephen Dempsey  
Paul Stephen Dempsey, Director

Date: June 11, 2004

By: /s/ LaRae Orullian  
B. LaRae Orullian, Director

Date: June 11, 2004

By: /s/ D. Dale Browning  
D. Dale Browning, Director

Date: June 11, 2004

By: /s/ Jim Upchurch  
James B. Upchurch, Director

Date: June 11, 2004

By: /s/ Hank Brown  
Hank Brown, Director

Date: June 11, 2004

By: /s/ Patricia A. Engels  
Patricia A. Engels, Director

**Report of Independent Registered Public Accounting Firm**

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

**The Board of Directors and Stockholders  
Frontier Airlines, Inc.:**

We have audited the accompanying balance sheets of Frontier Airlines, Inc. as of March 31, 2004 and 2003, and the related statements of operations, stockholders equity and other comprehensive loss, and cash flows for each of the years in the three-year period ended March 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Frontier Airlines, Inc. as of March 31, 2004 and 2003, and the results of its operations and its cash flows for each of the years in the three-year period ended March 31, 2004, in conformity with U.S. generally accepted accounting principles.

As discussed in note 1 to the financial statements, the Company changed its method of accounting for aircraft maintenance checks from the accrual method of accounting to the direct expense method in 2003.

**KPMG LLP**

Denver, Colorado  
May 27, 2004

**FRONTIER AIRLINES, INC.  
Balance Sheets  
March 31, 2004 and 2003**

	<u>2004</u>	<u>2003</u>
<b><u>Assets</u></b>		
Current assets:		
Cash and cash equivalents	\$ 188,608,729	\$ 102,880,404
Short-term investments	2,000,000	2,000,000
Restricted investments	24,732,024	14,765,000
Receivables, net of allowance for doubtful accounts of \$225,000 and \$237,000 at March 31, 2004 and 2003, respectively	26,308,352	25,856,692
Income taxes receivable (note 9)	262,091	24,625,616
Security and other deposits (note 7)	215,000	912,399
Prepaid expenses and other assets	13,093,499	9,503,389
Inventories, net of allowance of \$2,991,000 and \$2,478,000 at March 31, 2004 and 2003, respectively	6,126,573	5,958,836

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

Deferred tax asset (note 9)	<u>8,386,390</u>	<u>4,788,831</u>
Total current assets	269,732,658	191,291,167
Property and equipment, net (note 4)	440,470,566	334,492,983
Security and other deposits (note 7)	16,261,690	6,588,023
Aircraft pre-delivery payments	28,329,370	30,531,894
Restricted investments	9,971,212	9,324,066
Deferred loan fees and other assets	<u>4,940,102</u>	<u>16,086,948</u>
	\$ 769,705,598	\$ 588,315,081
	=====	=====

**Liabilities and Stockholders Equity**

Current liabilities:		
Accounts payable	\$ 31,167,168	\$ 26,859,926
Air traffic liability	83,339,560	58,875,623
Other accrued expenses (note 6)	44,660,868	22,913,659
Current portion of long-term debt (note 8)	17,386,538	20,473,446
Deferred revenue and other liabilities (note 5)	<u>5,105,136</u>	<u>1,396,143</u>
Total current liabilities	181,659,270	130,518,797
Long-term debt (note 8)	280,000,752	261,738,503
Deferred tax liability (note 9)	32,225,150	20,017,787
Deferred revenue and other liabilities (note 5)	<u>17,878,800</u>	<u>17,072,868</u>
Total liabilities	<u>511,763,972</u>	<u>429,347,955</u>

Stockholders equity:

Preferred stock, no par value, authorized 1,000,000 shares; none issued	-	-
Common stock, no par value, stated value of \$.001 per share, authorized 100,000,000 shares; 35,597,442 and 29,674,050 shares issued and outstanding at March 31, 2004 and March 31, 2003, respectively	35,597	29,674
Additional paid-in capital	185,078,386	96,424,525
Unearned ESOP shares (note 13)	(2,182,634)	-
Accumulated other comprehensive loss, net of tax	(137,785)	-
Retained earnings	<u>75,148,062</u>	<u>62,512,927</u>
Total stockholders equity	<u>257,941,626</u>	<u>158,967,126</u>

Commitments and contingencies (notes 3, 7, 13 and 16)	\$ 769,705,598	\$ 588,315,081
	=====	=====

See accompanying notes to financial statements.

**FRONTIER AIRLINES, INC.**

**Statements of Operations**

**Years Ended March 31, 2004, 2003 and 2002**

	2004	2003	2002
Revenues:			
Passenger	\$ 615,389,565	\$ 460,187,753	\$ 435,945,581
Passenger- regional partner	11,191,338	-	-
Cargo	8,077,106	5,557,153	6,623,665
Other	<u>9,021,133</u>	<u>4,191,009</u>	<u>2,505,479</u>
Total revenues	<u>643,679,142</u>	<u>469,935,915</u>	<u>445,074,725</u>
Operating expenses:			
Flight operations	105,255,438	85,674,568	64,824,609

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

Aircraft fuel expense	108,862,582	86,063,581	61,226,385
Aircraft lease expense	70,061,270	70,239,038	64,989,820
Aircraft and traffic servicing	110,377,894	86,447,925	70,201,825
Maintenance	74,003,778	75,559,243	70,227,020
Promotion and sales	65,322,259	53,031,888	59,458,779
General and administrative	36,750,152	26,060,812	26,173,864
Operating expenses - regional partner	14,634,258	-	-
Loss on sale-leaseback of aircraft	1,323,094	-	-
Aircraft lease and facility exit costs	5,371,799	-	-
Depreciation and amortization	<u>23,719,743</u>	<u>17,649,815</u>	<u>11,586,703</u>
Total operating expenses	<u>615,682,267</u>	<u>500,726,870</u>	<u>428,689,005</u>
Operating income (loss)	<u>27,996,875</u>	<u>(30,790,955)</u>	<u>16,385,720</u>
Nonoperating income (expense):			
Interest income	2,074,050	1,882,691	4,388,249
Interest expense	(13,961,074)	(8,041,412)	(3,382,695)
Emergency Wartime Supplemental Appropriations Act and Stabilization Act compensation	15,024,052	-	12,703,007
Loss on early extinguishment of debt	(9,815,517)	(1,774,311)	-
Aircraft lease and facility exit costs	-	-	(4,913,650)
Unrealized derivative loss	-	(132,282)	-
Other, net	(860,890)	(652,897)	(348,329)
Total nonoperating income (expense), net	(7,539,379)	(8,718,211)	8,446,582
Income (loss) before income tax expense (benefit) and cumulative effect of change in method of accounting for maintenance	20,457,496	(39,509,166)	24,832,302
Income tax expense (benefit)	7,822,361	(14,655,366)	8,282,312
Income (loss) before cumulative effect of change in method of accounting for maintenance	12,635,135	(24,853,800)	16,549,990
Cumulative effect of change in method of accounting for maintenance, net of tax (note 1)	-	2,010,672	-
Net income (loss)	<u>\$ 12,635,135</u>	<u>\$ (22,843,128)</u>	<u>\$ 16,549,990</u>

(continued)

See accompanying notes to financial statements.

**FRONTIER AIRLINES, INC.**

**Statement of Operations, continued**

**Years Ended March 31, 2004, 2003 and 2002**

	2004	2003	2002
Earnings (loss) per share:			
Basic:			
Income (loss) before cumulative effect of change in accounting principle	\$0.39	(\$0.84)	\$0.58
Cumulative effect of change in method of			

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

accounting for maintenance checks	-	0.07	-
Net income (loss)	\$0.39	(\$0.77)	\$0.58
Diluted:			
Income (loss) before cumulative effect of change in accounting principle	\$0.36	(\$0.84)	\$0.56
Cumulative effect of change in method of accounting for maintenance checks	-	0.07	-
Net income (loss)	\$0.36	(\$0.77)	\$0.56
Pro forma amounts assuming the new method of accounting for maintenance checks is applied retroactively:			
Net income	-	-	\$ 17,661,307
Earnings per share:			
Basic	-	-	\$0.62
Diluted	-	-	\$0.60
Weighted average shares of common stock outstanding			
Basic	32,732,567	29,619,742	28,603,861
Diluted	35,276,416	29,619,742	29,515,150

See accompanying notes to financial statements.

**FRONTIER AIRLINES, INC.**

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

**Years Ended March 31, 2004, 2003 and 2002**

	Common Stock Shares (000s)	Stated value	Additional paid-in capital	Unearned ESOP shares	Accumulated other comprehensive loss	
<b>Balances, March 31, 2001</b>	\$28,195	\$28,195	\$77,606,918	\$(1,662,087)	\$ -	\$6
Net income	-	-	-	-	-	1
Exercise of common stock warrants (note 11)	525	525	1,311,975	-	-	
Exercise of common stock options	529	529	1,870,516	-	-	
Tax benefit from exercises of common stock options and warrants	-	-	2,252,023	-	-	
Contribution of common stock to employees stock ownership plan (note 13)	173	173	2,826,054	(2,826,227)	-	
Amortization of employee stock compensation (note 13)	-	-	-	2,368,644	-	
<b>Balances, March 31, 2002</b>	29,422	29,422	85,867,486	(2,119,670)	-	8

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

Net loss	-	-	-	-	-	(2)
Exercise of common stock options	252	252	616,695	-	-	
Warrants issued in conjunction with debt agreement (note 11)	-	-	9,282,538	-	-	
Tax benefit from exercises of common stock options	-	-	657,806	-	-	
Amortization of employee stock compensation (note 13)	-	-	-	2,119,670	-	
<b>Balances, March 31, 2003</b>	<b>29,674</b>	<b>29,674</b>	<b>96,424,525</b>	<b>-</b>	<b>-</b>	<b>6</b>
Net income	-	-	-	-	-	1
Other comprehensive loss - unrealized loss on derivative instruments, net of tax	-	-	-	-	(137,785)	
Total comprehensive income						
Sale of common stock, net of offering costs of \$257,000	5,050	5,050	81,072,096	-	-	
Exercise of common stock options	227	227	1,000,487	-	-	
Tax benefit from exercises of common stock options	-	-	1,261,937	-	-	
Equity adjustment for the repricing of warrants issued in conjunction with a debt agreement (note 11)	-	-	116,701	-	-	
Contribution of common stock to employees stock ownership plan (note 13)	646	646	5,202,640	(5,203,286)	-	
Amortization of employee stock compensation (note 13)	-	-	-	3,020,652	-	
<b>Balances, March 31, 2004</b>	<b>\$35,597</b>	<b>\$35,597</b>	<b>\$185,078,386</b>	<b>\$(2,182,634)</b>	<b>\$(137,785)</b>	<b>\$7</b>

See accompanying notes to financial statements.

**FRONTIER AIRLINES, INC.**

**Statements of Cash Flows**

**Years ended March 31, 2004, 2003, and 2002**

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Cash flows from operating activities:			
Net income (loss)	\$ 12,635,135	\$ (22,843,128)	\$ 16,54

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

Adjustments to reconcile net income (loss) to net cash and cash equivalents provided by operating activities:

Employee stock ownership plan compensation expense	2,498,700	2,641,624	2,36
Depreciation and amortization	23,719,743	18,297,444	11,67
Depreciation and amortization - regional partner	63,091	-	
Impairments recorded on property and equipment	3,047,482	-	1,51
Provisions recorded on inventories	617,749	2,478,196	-
Write off of deferred loan costs	9,815,517	-	-
Loss on disposal of equipment	1,501,465	573,075	32
Unrealized derivative (gains) losses, net	(469,394)	299,328	-
Deferred tax expense	9,957,271	10,300,219	4,43
Changes in operating assets and liabilities:			
Restricted investments	(13,057,670)	(1,031,556)	(4,58
Receivables	(451,660)	2,679,621	(75
Income taxes receivable	24,363,525	(17,770,072)	-
Security and other deposits	(328,127)	144,788	(7,88
Prepaid expenses and other assets	(3,590,110)	1,510,213	(16
Inventories	(785,486)	(1,832,654)	(2,53
Deferred loan fees and other assets	2,981,579	(3,339,467)	-
Accounts payable	4,512,197	3,674,660	(1,47
Air traffic liability	24,463,937	(2,215,082)	1,45
Other accrued expenses	22,007,937	32,295	3,82
Refundable stabilization act compensation	-	(4,835,381)	4,83
Accrued maintenance expense	-	(2,269,046)	7,63
Deferred revenue and other liabilities	4,514,925	14,378,900	3,07
Net cash provided by operating activities	<u>128,017,806</u>	<u>873,977</u>	<u>40,29</u>

Cash flows from investing activities:

(Increase) decrease in aircraft lease and purchase deposits, net	(6,445,617)	12,405,471	(17,48
(Increase) decrease in restricted investments	2,443,500	1,176,700	1,13
Proceeds from the sale of property and equipment	341,435	29,750,000	-
Capital expenditures	<u>(134,650,799)</u>	<u>(238,667,511)</u>	<u>(118,18</u>
Net cash used in investing activities	<u>(138,311,481)</u>	<u>(195,335,340)</u>	<u>(134,52</u>

Cash flows from financing activities:

Net proceeds from issuance of common stock and warrants	82,077,860	1,274,753	3,18
Proceeds from long-term borrowings	98,500,000	241,100,000	72,00
Payment of financing fees	(1,231,201)	(3,504,435)	(57
Principal payments on long-term borrowings	(83,324,659)	(28,945,720)	(1,94
Principal payments on obligations under capital leases	-	(138,020)	(12
Net cash provided by financing activities	<u>96,022,000</u>	<u>209,786,578</u>	<u>72,53</u>

Net increase (decrease) in cash and cash equivalents	85,728,325	15,325,215	(21,69
--	------------	------------	--------

Cash and cash equivalents, beginning of year	<u>102,880,404</u>	<u>87,555,189</u>	<u>109,25</u>
--	--------------------	-------------------	---------------

Cash and cash equivalents, end of year	\$188,608,729	\$102,880,404	\$87,55
--	---------------	---------------	---------

See accompanying notes to financial statements.

**FRONTIER AIRLINES, INC.**

**Notes to Financial Statements**

**March 31, 2004**

**(1) Nature of Business and Summary of Significant Accounting Policies**

***Nature of Business***

Frontier Airlines, Inc. (Frontier or the Company) provides air transportation for passengers and freight. Frontier was incorporated in the State of Colorado on February 8, 1994 and commenced operations on July 5, 1994. Denver-based Frontier in conjunction with its regional jet partner, Frontier JetExpress, currently serves 37 cities coast to coast and five cities in Mexico with a fleet of 10 Boeing 737 aircraft, 24 Airbus A319 aircraft, four Airbus A318 aircraft, and seven CRJ 700 aircraft (operated by Horizon Air Industries, Inc.) from its base in Denver, and employs approximately 4,200 aviation professionals as of March 31, 2004.

Airline operations have high fixed costs relative to revenues and are highly sensitive to various factors, including the actions of competing airlines and general economic factors. Small fluctuations in yield per revenue passenger mile or expense per available seat mile can significantly affect operating results.

**Preparation of Financial Statements and Use of Estimates**

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

***Cash and Cash Equivalents***

For financial statement purposes, the Company considers cash and short-term investments with an original maturity of three months or less to be cash equivalents. These investments are stated at cost, which approximates fair value.

***Short-term Investments***

Short-term investments consist of certificates of deposit with maturities between three months and one year. These investments are classified as held-to-maturity and are carried at amortized cost which approximates fair value. Held-to-maturity securities are those securities in which the Company has the ability and intent to hold the security until maturity. Interest income is recognized when earned.

**FRONTIER AIRLINES, INC.**

**Notes to Financial Statements, continued**

***Supplemental Disclosure of Cash Flow Information***

*Cash Paid During the Year for:*

	2004	2003	2002
Interest	\$ 9,836,737	\$ 6,490,758	\$ 3,081,370
Taxes	\$ 312,484	\$ -	\$ 8,838,909

*Supplemental disclosure of non-cash activities:*

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

In connection with the commercial loan facility the Company obtained during the year ended March 31, 2003, the Company issued warrants to the ATSB and to two other guarantors for the purchase of 3,833,946 of our common stock at \$6.00 per share. The warrants had an estimated fair value of \$9,282,538 which was recorded as deferred loan fees with a corresponding adjustment to additional paid-in capital. See Note 8.

### **Restricted Investments**

Restricted investments include certificates of deposit which secure certain letters of credit issued primarily to companies which process credit card sale transactions, certain airport authorities and aircraft lessors. Restricted investments are carried at cost, which management believes approximates fair value. Maturities are for one year or less and the Company intends to hold restricted investments until maturity.

### **Valuation and Qualifying Accounts**

The following table summarizes our valuation and qualifying accounts as of March 31, 2004, 2003, and 2002, and the associated activity for the years then ended.

	Allowance for Doubtful Accounts	Allowance for Inventory
Balance at March 31, 2001	\$ 368,000	\$ -
Additional expenses	450,000	-
Deductions	(663,000)	-
Balance at March 31, 2002	155,000	-
Additional expenses	477,000	2,478,000
Deductions	(395,000)	-
Balance at March 31, 2003	237,000	2,478,000
Additional expenses	593,000	618,000
Deductions	(605,000)	(105,000)
Balance at March 31, 2004	\$ 225,000	\$ 2,991,000

### **Inventories**

Inventories consist of expendable aircraft spare parts, supplies and aircraft fuel and are stated at the lower of cost or market. Inventories are accounted for on a first-in, first-out basis and are charged to expense as they are used. During the fiscal years ended March 31, 2004 and 2003, the Company recorded a provision for excess Boeing expendable parts inventory totaling \$618,000 and \$2,478,000, respectively. The provision in 2004 was principally the result of declining resale values of excess Boeing expendable parts. The Company monitors resale values for Boeing parts quarterly using estimates obtained from its vendors. The Company believes the decline in resale values of parts for the less fuel efficient Boeing 737-200 and Boeing 737-300 aircraft was due in part to increasing fuel prices during the quarter. The provision in 2003 was principally the result of returning five Boeing aircraft to the lessors in 2003, and the Company's decision during the quarter ended March 31, 2003, to discontinue the use of the Company's three remaining Boeing 737-200 aircraft in advance of the end of the term of their respective leases. This decision was in response to the significant decline in passenger demand as a result of the war in Iraq and the continuing economic recession. The provision was based on estimates of the resale value of the excess expendable parts, which were obtained from the Company's vendors.

### **Property and Equipment**

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

Property and equipment are carried at cost. Major additions, betterments and renewals are capitalized. Depreciation and amortization is provided for on a straight-line basis to estimated residual values over estimated depreciable lives as follows:

Aircraft, spare aircraft parts, and flight equipment	7-25 years
Improvements to leased aircraft	Life of improvements or term of lease whichever is less
Capitalized software	3 years
Ground property, equipment, and leasehold improvements	3-5 years or term of lease

Residual values for aircraft are at 25% of the aircraft cost, residual values for engines range in amounts up to 48% of the engine's cost and residual values for major rotatable parts are generally 10%.

### ***Deferred Loan Fees***

Deferred loan fees, including the estimated fair value of warrants issued to the lenders, are deferred and amortized over the term of the related debt obligation using the effective interest method. During the year ended March 31, 2004, the Company wrote off \$9,816,000 in deferred loan costs associated with the prepayment of the government guaranteed loan.

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

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

### ***Manufacturers Credits***

The Company receives credits in connection with its purchase of aircraft, engines, auxiliary power units and other rotatable parts. These credits are deferred until the aircraft, engines, auxiliary power units and other rotatable parts are delivered and then applied as a reduction of the cost of the related equipment.

### ***Aircraft Maintenance***

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

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

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

Effective April 1, 2002, the Company changed its method of accounting for certain aircraft maintenance costs from the accrual method of accounting to the direct expense method. Under the new accounting method, maintenance costs are recognized as expense as maintenance services are performed and as flight hours are flown for nonrefundable maintenance payments required by lease agreements. The Company believes the direct-expense method is preferable in the circumstances because the maintenance liability is not recorded until there is an obligating event (when the maintenance event is actually being performed or flight hours are actually flown), the direct expense method eliminates significant estimates and judgments inherent under the accrual method, and it is the predominant method used in the airline industry. Accordingly, effective April 1, 2002, the Company reversed its major overhaul accrual against the corresponding maintenance deposits and recorded a cumulative effect of a change in accounting principle of \$3,196,617 (\$2,010,672, net of income taxes).

### **Advertising Costs**

The Company expenses the costs of advertising as promotion and sales in the year incurred. Advertising expense was \$7,897,365, \$5,717,438, and \$9,086,752 for the years ended March 31, 2004, 2003, and 2002, respectively.

### **Revenue Recognition**

Passenger, cargo, and other revenues are recognized when the transportation is provided or after the tickets expire, and are net of excise taxes. Unearned revenues have been deferred and included in the accompanying balance sheets as air traffic liability.

### **Passenger Traffic Commissions and Related Expenses**

Passenger traffic commissions and related expenses are expensed when the transportation is provided and the related revenue is recognized. Passenger traffic commissions and related expenses not yet recognized are included as a prepaid expense.

### **Frontier JetExpress**

In September 2003, the Company signed a 12-year agreement with Horizon Air Industries, Inc. ( Horizon ), under which Horizon will operate up to nine 70-seat CRJ 700 aircraft under our Frontier JetExpress brand. The service began on January 1, 2004 and replaced our codeshare with Mesa Airlines which terminated in December 2003. In accordance with Emerging Issues Task Force No. 01-08, Determining Whether an Arrangement Contains a Lease ( EITF 01-08 ), we have concluded that the Horizon agreement contains leases as the agreement conveys the right to use a specific number and specific type of aircraft over a stated period of time. Frontier establishes the scheduling, routes and pricing of the flights operated as Frontier JetExpress under the agreement. EITF 01-08 was effective for new arrangements or arrangements modified after the beginning of an entity's next reporting period after May 28, 2003. The assessment of whether an arrangement contains a lease is made at the inception of or upon modification of an arrangement. Therefore, we began recording revenues and expenses related to the Horizon Agreement gross, as opposed to net, upon inception of service. Prior to the implementation of EITF 01-08, JetExpress revenues were reduced by related expenses and reported net as other revenues. Revenues are pro-rated to the segment operated by the regional partner based on miles flown and are included in passenger revenues regional partner. Expenses directly related to the flights flown by the regional partner are included in operating expenses regional partner. The Company allocates indirect expenses between mainline and JetExpress operations by using regional partner departures, available seat miles, or passengers as a percentage of system combined departures, available seat miles or passengers.

Amounts included in other revenues for the years ended March 31, 2004, 2003, and 2002 were as follows:

Year Ended March 31

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

	2004	2003	2002
Mesa revenues	\$25,155,000	\$1,608,000	\$ -
Mesa expenses	(23,438,000)	(2,314,000)	-
Net amount in other revenues	1,717,000	(706,000)	-

**Customer Loyalty Program**

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

As of March 31, 2004 and 2003, the Company estimated that approximately 47,600 and 14,600 round-trip flight awards, respectively, were eligible for redemption by EarlyReturns members who have mileage credits exceeding the 15,000-mile free round-trip domestic ticket award threshold. As of March 31, 2004 and 2003, the Company had recorded a liability of approximately \$584,000 and \$283,000, respectively, for these rewards.

**Co-branded Credit Card Arrangement**

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

During the year ended March 31, 2003, the Company received a \$10,000,000 advance from the issuing bank for fees expected to be earned under the program. This advance was recorded as deferred revenue when it was received. For the year ended March 31, 2003, we had not yet earned or recognized any revenue from this arrangement. Fees earned as credit cards are issued or renewed, and as points are awarded to the credit card customers are applied against this advance.

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

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

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

require only 15,000 frequent flyer miles for a domestic round-trip ticket.

For the year ended March 31, 2004, the Company earned total fees of \$4,245,000, all of which were applied to the original \$10,000,000 advance. Of that amount, \$3,286,000 was deferred as the travel award component, and the remaining marketing component of \$959,000 was recognized as a reduction to sales and promotions expense. Amortization of deferred revenue recognized in earnings in 2004 was \$786,000.

### ***Earnings (Loss) Per Common Share***

Basic earnings per common share excludes the effect of potentially dilutive securities and is computed by dividing income by the weighted-average number of common shares outstanding for the period. Diluted earnings per common share reflects the potential dilution of all securities that could share in earnings.

### ***Income Taxes***

The Company accounts for income taxes using the asset and liability method. Under that method, deferred income taxes are recognized for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and tax bases of existing assets and liabilities. A valuation allowance for net deferred tax assets is provided unless realizability is judged by management to be more likely than not. The effect on deferred taxes from a change in tax rates is recognized in income in the period that includes the enactment date.

### ***Fair Value of Financial Instruments***

The Company estimates the fair value of its monetary assets and liabilities based upon existing interest rates related to such assets and liabilities compared to current rates of interest for instruments with a similar nature and degree of risk. The Company estimates that the carrying value of all of its monetary assets and liabilities approximates fair value as of March 31, 2004 and 2003 with exception of its fixed rate loans at March 31, 2004. The Company estimates the fair value of its fixed rate loans to be approximately \$46,663,221 as compared to the carrying amount of \$42,153,401 at March 31, 2004.

### ***Derivative Instruments***

The Company accounts for derivative financial instruments in accordance with the provisions of Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). SFAS 133 requires the Company to measure all derivatives at fair value and to recognize them in the balance sheet as an asset or liability. For derivatives designated as cash flow hedges, changes in fair value of the derivative are generally reported in other comprehensive income (OCI) and are subsequently reclassified into earnings when the hedged item affects earnings. Changes in fair value of derivative instruments not designated as hedging instruments and ineffective portions of hedges are recognized in earnings in the current period.

The Company enters into derivative transactions to hedge the interest payments associated with a portion of its LIBOR-based borrowings and fuel purchases. The Company designates certain interest rate swaps as qualifying cash flow hedges. The Company also enters into derivative transactions to reduce exposure to the effect of fluctuations in fuel prices. These transactions are accounted for as trading instruments under SFAS 133. As a result, the Company records these instruments at fair market value and recognizes realized and unrealized gains and losses in aircraft fuel expense.

### ***Stock Based Compensation***

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

At March 31, 2004, we had a stock-based employee compensation plan, as described in Note 12, Stock Option Plan. The Company accounts for these plans under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. No stock-based employee compensation cost for stock options is reflected in our financial statements, as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

If compensation cost for the stock-based employee compensation plan had been determined using the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, we would have reported our net loss and loss per share as the pro forma amounts indicated below:

	2004	2003	2002
Net income (loss) as reported	\$ 12,635,135	\$ (22,843,128)	\$ 16,549,990
Less: total compensation expense determined under fair value method, method, net of tax	<u>1,862,553</u>	<u>3,447,779</u>	<u>2,125,568</u>
Pro forma net income (loss)	\$ 10,772,582	\$ (26,290,907)	\$ 14,424,422
=====			
Earnings (loss) per share, basic:			
As Reported	\$ 0.39	\$ (0.77)	\$ 0.58
Pro Forma	\$ 0.33	\$ (0.89)	\$ 0.50
Earnings (loss) per share, diluted:			
As Reported	\$ 0.36	\$ (0.77)	\$ 0.56
Pro Forma	\$ 0.31	\$ (0.89)	\$ 0.49

### **Reclassifications**

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

#### **(2) Government Assistance**

##### ***Air Transportation Safety and System Stabilization Act***

As a result of the September 11, 2001 terrorist attacks on the United States, on September 22, 2001 President Bush signed into law the Air Transportation Safety and System Stabilization Act (the Act). The Act which provided, among other things, for compensation to U.S. passenger and cargo airlines for direct and incremental losses incurred from September 11, 2001 to December 31, 2001 as a result of the September 11 terrorist attacks. The Company was eligible to receive up to approximately \$20,200,000 from the \$5 billion in cash compensation provided for in the Act, of which \$17,538,388 was received as of March 2002. The Company recognized \$12,703,007 of the grant during the year ended March 31, 2002 which is included in non-operating income and expense. The remaining \$4,835,381 represents amounts received in excess of estimated allowable direct and incremental losses incurred from September 11, 2001 through December 31, 2001 and was repaid during the year ended March 31, 2003.

##### ***Emergency Wartime Supplemental Wartime Supplement Appropriations Act***

The Emergency Wartime Supplemental Appropriations Act (the Appropriations Act) enacted on April 16, 2003, which made available approximately \$2.3 billion to U.S. flag air carriers for expenses and revenue foregone related to aviation security. In order to have been eligible to receive a portion of this fund, air carriers must have paid one or both of the TSA security fees, the September 11th Security Fee and/or the Aviation Security Infrastructure Fee as of the date of enactment of the Appropriations Act.

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

According to the Appropriations Act, an air carrier may use the amount received as the air carrier determines. The Appropriations Act requires air carriers who accept these funds to limit the compensation paid during the 12 month period beginning April 1, 2003 to each executive officer to an amount equal to no more than the annual salary paid to that officer with respect to the air carrier's fiscal year 2002. Pursuant to the Appropriations Act, the Company received \$15,573,000 in May 2003, of which \$549,000 was paid to Mesa Air Group for the revenue passengers Mesa carried as Frontier JetExpress.

The Appropriations Act provides for additional reimbursements to be made to U.S. flag air carriers for costs incurred related to the FAA requirements for enhanced flight deck door security measures that were mandated as a result of the September 11 terrorist attacks. Pursuant to the Appropriations Act, the Company received \$889,000 in September 2003 for expenses related to the installation of enhanced flight deck doors on its aircraft. Upon receipt of the \$889,000 reimbursement, the Company credited maintenance expense and charged fixed assets for the labor component of the flight deck door installation, and correspondingly credited property, plant, and equipment to reflect the reimbursement.

### (3) **Derivative Instruments**

#### ***Fuel Hedging***

In November 2002, the Company initiated a fuel hedging program comprised of swap and collar agreements. Under a swap agreement, the Company receives the difference between a fixed swap price and a price based on an agreed upon published spot price for jet fuel. If the index price is higher than the fixed price, the Company receives the difference between the fixed price and the spot price. If the index price is lower, the Company pays the difference. A collar agreement has a cap price, a primary floor price, and a secondary floor price. When the U.S. Gulf Coast Pipeline Jet index price is above the cap, the Company receives the difference between the index and the cap. When the index price is below the primary floor but above the secondary floor, the Company pays the difference between the index and the primary floor. However, when the price is below the secondary floor, the Company is only obligated to pay the difference between the primary and secondary floor prices. When the price is between the cap price and the primary floor, no payments are required.

In November 2002, the Company entered into a swap agreement with a notional volume of 770,000 gallons per month of jet fuel for the period from December 1, 2002 to May 31, 2003. The fixed price under this agreement was 72.25 cents per gallon. The volumes were estimated to represent 10% of fuel purchases for that period. The Company entered into a second contract in November 2002, a three-way collar, with a notional volume of 385,000 gallons per month for the period December 1, 2002 to November 30, 2003. The cap prices for this agreement is 82 cents per gallon, and the primary and secondary floor prices are at 72 and 64.5 cents per gallon respectively. The volume of fuel covered by this contract was estimated to represent 5% of fuel purchases for that period. In March 2003, the Company entered into a second swap agreement with a notional volume of 1,260,000 gallons per month for the period from April 1, 2003 to June 30, 2003. The fixed price of the swap is 79.25 cents per gallon and the agreement was estimated to represent 15% of fuel purchases for that period. In April 2003, we entered into a third swap agreement with a notional volume of 1,260,000 gallons per month for the period from July 1, 2003 to December 31, 2003. The fixed price of the swap is 71.53 cents per gallon and the agreement is estimated to represent 15% of fuel purchases for that period. In September 2003, we entered into a swap agreement with a notional volume of 630,000 gallons per month for the period from January 1, 2004 to June 30, 2004. The fixed price of the swap was 74.50 cents per gallon and the agreement is estimated to represent 7% of our fuel purchases for that period. The results of operations for the year ended March 31, 2004 and 2003 include an unrealized derivative gain of \$469,000 and an unrealized derivative loss of \$167,000, respectively, which is included in fuel expense. Additionally, a realized net gain of approximately \$918,000 and \$726,000 in cash settlements from a counter-party is recorded as a reduction of fuel expense for the years ended March 31, 2004 and 2003, respectively. The Company was not a party to any derivative contracts during the year

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

ended March 31, 2002.

### **Interest Rate Hedging Program**

In March 2003, the Company entered into an interest rate swap agreement with a notional amount of \$27,000,000 to hedge the interest payments associated with a portion of its LIBOR-based borrowings. Under the interest rate swap agreement, the Company is paying a fixed rate of 2.45% and receiving a variable rate based on the three month LIBOR which is reset quarterly. Interest expense for the year ended March 31, 2004 includes \$351,000 of settlement amounts paid or payable to the counter party for the period. At March 31, 2004 and 2003, our interest rate swap agreement had an estimated unrealized loss of \$356,000 and \$132,000, respectively. Changes in the fair value of interest rate swaps designated as hedging instruments are reported in accumulated other comprehensive loss. Approximately \$223,000 of unrealized losses are included in accumulated other comprehensive loss, net of income taxes of \$85,000 for the year ended March 31, 2004. The unrealized losses are expected to be reclassified into interest expense as a yield adjustment in the same period in which the related interest payments on the LIBOR-based borrowings effects earnings. The Company did not have any interest rate swap agreements outstanding during the year ended March 31, 2002.

### **(4) Property and Equipment, Net**

As of March 31, 2004 and 2003 property and equipment consisted of the following:

	2004	2003
Aircraft, flight equipment, and improvements to leased aircraft	\$ 458,627,110	\$ 345,804,415
Ground property, equipment and leasehold improvements	33,219,581	24,460,880
Construction in progress	<u>3,940,114</u>	<u>1,293,135</u>
	495,786,805	371,558,430
Less accumulated depreciation and amortization	<u>(55,316,239)</u>	<u>(37,065,447)</u>
Property and equipment, net	\$ 440,470,566	\$ 334,492,983

Property and equipment includes certain office equipment and software under capital leases. At March 31, 2003, office equipment and software recorded under capital leases were \$602,000 and accumulated amortization was \$494,000. There are no capital leases as of March 31, 2004. Airbus flight equipment received but not yet placed in service totaled approximately \$3,612,000 and \$1,219,000, at March 31, 2004 and 2003, respectively.

During the quarter ended March 31, 2004, the Company recorded an impairment charge for engines and rotatable parts that support the Boeing 737-300 aircraft of \$3,047,000. The impairment charge for rotatables totaling \$901,000 was principally the result of declining resale values for Boeing rotatables. The Company monitors resale values for Boeing rotatables quarterly using estimates obtained from its vendors. The impairment for the two Boeing 737-300 spare engines totaling \$2,146,000 was the result of the Company's decision in the fourth quarter to sell these remaining spare engines. The impairment was based on three separate quotes for sale leaseback transaction on these engines.

During the year ended March 31, 2004, we completed a sale-leaseback transaction of an Airbus A319 aircraft resulting in a loss of \$1,323,000. The charge is included in operating expenses. We agreed to lease this aircraft over a 12-year term. During the year ended March 31, 2003, we completed a sale-leaseback transaction on one of our purchased aircraft and assigned a purchase commitment on another Airbus A319. We agreed to lease both of these aircraft over a five-year term. The Company recognized a gain of approximately \$1,169,000 on the 2003 sale-leaseback which has been deferred and is being amortized as a reduction of lease expense over the five-year term of the leases.

**(5) Deferred Revenue and Other Liabilities**

At March 31, 2004 and 2003, deferred revenue and other liabilities is comprised of the following:

	2004	2003
Advance received for co-branded credit card	\$ 8,254,281	\$ 10,000,000
Deferred rent	13,154,287	8,122,500
Remaining lease payments for aircraft and facilities abandoned before lease termination date	1,128,582	-
Other	446,786	346,511
	<hr/>	<hr/>
Total deferred revenue and other liabilities	22,983,936	18,469,011
Less current portion	(5,105,136)	(1,396,143)
	<hr/>	<hr/>
	\$ 17,878,800	\$ 17,072,868
	=====	=====

**(6) Other Accrued Expenses**

The March 31, 2004 and 2003 other accrued expenses is comprised of the following:

	2004	2003
Accrued salaries and benefits	\$ 27,120,734	\$ 14,103,101
Federal excise and other passenger taxes payable	10,441,301	6,648,502
Property tax payable	1,850,202	745,434
Remaining lease payments for aircraft and facilities abandoned before lease termination date	1,695,927	-
Other	3,552,704	1,416,622
	<hr/>	<hr/>
	\$ 44,660,868	\$ 22,913,659
	=====	=====

**(7) Lease Commitments**

***Aircraft Leases***

At March 31, 2004 and 2003, the Company operated 25 and 27 leased aircraft, respectively, which are accounted for under operating lease agreements with initial terms ranging from 5 years to 12 years. Certain leases allow for renewal options. Security deposits related to leased aircraft and future leased aircraft deliveries at March 31, 2004 and 2003 totaled \$12,406,932 and \$6,320,933, respectively, and are included in security and other deposits. Letters of credit issued to certain aircraft lessors in lieu of cash deposits and related restricted investments to secure these letters of credit at March 31, 2004 and 2003 totaled \$5,515,600 and \$7,959,100, respectively.

During the year ended March 31, 2004, the Company ceased using three of its Boeing 737-200 leased aircraft, two of which had lease terminations in October 2003 and one with a lease termination date in October 2005. This resulted in a charge of \$5,054,000, representing the estimated fair value of the remaining lease payments and the write-off of the unamortized leasehold improvements on the aircraft. These charges are included in operating expenses. The current portion of the remaining lease payments totaling

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

\$1,619,887 is included in other accrued expenses and the long-term portion totaling \$929,514 is included in deferred revenue and other liabilities.

During the year ended March 31, 2002, the Company negotiated early lease terminations on two of its Boeing 737-200 aircraft resulting in a charge of \$4,913,650, representing the payment amounts due to terminate the lease early. The charges are included in nonoperating expense.

In addition to scheduled future minimum lease payments, the Company is required to make supplemental rent payments to cover the cost of major scheduled maintenance overhauls of these aircraft. These supplemental rentals are based on the number of flight hours flown and/or flight departures. The lease agreements require the Company to pay taxes, maintenance, insurance, and other operating expenses applicable to the leased property. Effective April 1, 2002, we changed our method of accounting for maintenance costs. This change in accounting method resulted in a decrease in maintenance deposits of \$52,858,641, including deposits due for March, 2002 which were made in April, 2002 of \$1,803,451, and a decrease in maintenance accruals totaling \$56,055,258.

### **Other Leases**

The Company leases office and hangar space, spare engines and office equipment for its headquarters, reservation facilities, airport facilities, and certain other equipment. The Company also leases certain airport gate facilities on a month-to-month basis.

During the year ended March 31, 2004, the Company closed its El Paso, Texas maintenance facility which had a lease termination date of August 2007 resulting in a charge of \$318,000, representing the estimated fair value of the remaining lease payments. The charge is included in operating expenses. The current portion of the remaining lease payments totaling \$76,040 is included in other accrued expenses and the long-term portion totaling \$199,068 is included in deferred revenue and other liabilities.

For leases that contain escalations, the company records the total rent payable during the lease term on a straight-line basis over the term of the lease and records the difference between the rent paid and the straight-line rent as a deferred rent liability.

At March 31, 2004, commitments under non-cancelable operating leases (excluding aircraft supplemental rent requirements) with terms in excess of one year were as follows:

	Operating Leases
Year ended March 31:	
2005	\$ 121,220,894
2006	118,452,537
2007	117,602,387
2008	119,049,328
2009	115,484,490
Thereafter	<u>725,939,852</u>
Total minimum lease payments	\$ 1,317,749,488 =====

Rental expense under operating leases, including month-to-month leases, for the years ended March 31, 2004, 2003 and 2002 was \$98,472,585, \$92,337,439 and \$86,603,234, respectively.

### **(8) Long-term Debt**

Long-term debt at March 31, 2004 and 2003 consisted of the following:

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

	2004	2003
Commercial loan facility (1)	\$ -	\$ 70,000,000
Aircraft notes payable, 6.62% weighted average fixed interest rate (2)	42,153,401	44,434,300
Aircraft notes payable, variable interest rates based on LIBOR plus margins ranging from 1.25% to 1.70%, 2.6% weighted average interest rate at March 31, 2004 (3)	159,585,104	167,777,640
Aircraft notes payable, variable interest rates based on LIBOR plus margins ranging from 1.95% to 2.25%, 3.30% weighted average interest rate at March 31, 2004 (4)	<u>95,648,785</u>	<u>-</u>
Total Debt	297,387,290	282,211,940
Less current maturities	<u>(17,386,538)</u>	<u>(20,473,440)</u>
	\$ 280,000,752	\$ 261,738,500

- (1) In February 2003, the Company obtained a \$70,000,000 commercial loan facility of which \$69,300,000 was guaranteed by the ATSB and two other parties. The loan had three tranches; Tranche A, Tranche B and Tranche C, in amounts totaling \$63,000,000, \$6,300,000 and \$700,000, respectively. At March 31, 2003 the interest rates were 2.09%, 2.44%, and 3.89%, respectively. The interest rates on each tranche of the loan adjusted quarterly based on LIBOR rates. The loan required quarterly installments of approximately \$2,642,000 beginning in December 2003 with a final balloon payment of \$33,000,000 due in June 2007. In connection with this transaction, the Company issued warrants to purchase of 3,833,946 shares of our common stock at \$6.00 per share to the ATSB and to two other guarantors. The warrants had an estimated fair value of \$9,282,538 when issued and expire seven years after issuance. These warrants have subsequently been repriced from \$6.00 to \$5.92 per share as a result of the Company's secondary public offering in September 2003 as discussed in note 11. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model. Prior to the prepayment the amount was being amortized to interest expense over the life of the loan. The effective interest rate on the note was approximately 10.26% including the value of the warrants and other costs associated with obtaining the loan, assuming the variable interest rates payable on the notes as of March 31, 2003. In July 2003, the Company received a federal income tax refund totaling \$26,574,000 from the Internal Revenue Service. The Company prepaid \$10,000,000 on the government guaranteed loan upon receipt of this refund, as required by the terms of the loan agreement. The government guaranteed loan also required a prepayment equal to 60% of the net proceeds from any sales of common stock. As a result of the sale of common stock in September 2003 (see note 11), the Company prepaid approximately \$48,418,000 on the loan. In December 2003, the Company repaid the remaining loan balance of \$11,582,000. The Company wrote off approximately \$9,816,000 of unamortized deferred loan costs associated with the loan which is classified as a loss on early extinguishment of debt in the 2004 statement of operations. Of this amount, approximately \$8,053,000 represented the unamortized portion of the value assigned to the warrants issued to the ATSB and two other guarantors.
- (2) During the year ended March 31, 2002, the Company entered into a credit agreement to borrow up to \$72,000,000 for the purchase of three Airbus aircraft with a maximum borrowing of \$24,000,000 per aircraft. During the year ended March 31, 2003, the Company entered into a sale-leaseback transaction for one of these purchased aircraft and repaid the loan with the proceeds of the sale. The two remaining aircraft loans have a term of 10 years and are payable in equal monthly installments, including interest, payable in arrears. The aircraft are secured by the aircraft financed. The remaining loans require monthly principal and interest payments of \$215,000 and \$218,110, respectively, bear interest with rates of 6.71%

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

and 6.54%, with maturities in May and August 2011, at which time a balloon payment totaling \$10,200,000 is due with respect to each loan.

- (3) During the year ended March 31, 2003, the Company borrowed \$171,100,000 for the purchase of seven Airbus A319 aircraft. Each aircraft loan has a term of 12 years and is payable in quarterly or semi-annually installments, including interest, payable in arrears, with a floating interest rate adjusted quarterly or semi-annually based on LIBOR plus margins of 1.25% to 1.70%. At March 31, 2004, interest rates for these loans ranged from 2.38% to 2.83%. At the end of the term, there are balloon payments that range from \$4,800,000 to \$7,770,000 at the end of the term. The loans are secured by the aircraft financed.
- (4) During the year ended March 31, 2004, the Company borrowed \$98,500,000 for the purchase of four Airbus A318 aircraft. Each aircraft loan has a term of 12 years and is payable in monthly installments, including interest, payable in arrears, with a floating interest rate adjusted quarterly based on LIBOR plus a margin of 2.25% for three of the loans, and LIBOR plus a margin of 1.95% for the fourth. At March 31, 2004 interest rates for these loans ranged from 3.07% to 3.37%. At the end of the term, there is a balloon payment of \$3,060,000 each for three of the aircraft loans and \$2,640,000 for the fourth. The loans are secured by the aircraft financed.

Maturities of long-term debt are as follows:

2005	\$17,386,538
2006	17,072,472
2007	18,010,077
2008	19,007,859
2009	20,076,485
Thereafter	<u>205,833,859</u>
	\$ 297,387,290
	=====

### (9) Income Taxes

Income tax expense (benefit) for the years ended March 31, 2004, 2003, and 2002, including amounts recorded as the cumulative effect of a change in accounting principle, is presented below. Income tax expense (benefit) for the year ended March 31, 2003, is reflected in income tax benefit totaling (\$14,655,366) on the 2003 statement of operations, net of \$1,185,945 in income tax expense reflected in cumulative effect of change in method of accounting for maintenance.

	Current	Deferred	Total
Year ended March 31, 2004:			
U.S. Federal	\$ (1,891,662)	\$10,851,098	\$ 8,959,436
State and local	<u>(243,248)</u>	<u>(893,827)</u>	<u>(1,137,075)</u>
	\$ (2,134,910)	\$ 9,957,271	\$ 7,822,361
=====			
Year ended March 31, 2003:			
U.S. Federal	\$ (24,433,153)	\$12,431,462	\$ (12,001,691)
State and local	<u>-</u>	<u>(1,467,730)</u>	<u>(1,467,730)</u>
	\$ (24,433,153)	\$10,963,732	\$ (13,469,421)
=====			
Year ended March 31, 2002:			
U.S. Federal	\$ 4,714,262	\$ 3,971,593	\$ 8,685,855
State and local	<u>(867,353)</u>	<u>463,809</u>	<u>(403,544)</u>
	\$ 3,846,909	\$ 4,435,402	\$ 8,282,311

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

The differences between the Company's effective rate for income taxes and the federal statutory rate are shown in the following table:

	2004	2003	2002
Income tax expense (benefit)			
at the statutory rate	\$ 7,160,123	\$ (13,828,208)	\$ 8,691,000
State and local income tax, net of federal income tax benefit	646,449	(1,222,250)	(657,000)
Nondeductible expenses	573,643	395,092	248,000
Adjustment to deferred taxes previously provided	(557,854)	-	
	<u>\$ 7,822,361</u>	<u>\$ (14,655,366)</u>	<u>\$ 8,282,000</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets (liabilities) at March 31, 2004 and 2003 are presented below:

	2004	2003
Deferred tax assets:		
Accrued vacation and health insurance liability not deductible for tax purposes	\$ 3,124,883	\$ 2,383,676
Accrued workers compensation liability not deductible for tax purposes	1,667,388	939,777
Deferred rent not deductible for tax purposes	4,946,012	3,025,846
Impairment recorded on inventory and fixed assets not deductible for tax purposes	2,582,461	1,420,127
Deferred affinity revenue	-	3,760,000
Interest capitalized for tax purposes and expensed for books	2,115,163	-
Net operating loss carryforwards	16,940,482	1,815,034
Alternative minimum tax credit carryforward	1,757,517	1,113,004
Other	1,457,409	201,573
Total gross deferred tax assets	<u>34,591,315</u>	<u>14,659,037</u>
Deferred tax liabilities:		
Equipment depreciation and amortization	(57,704,400)	(29,107,695)
Accrued maintenance expense deductible for tax purposes	(543,495)	(724,659)
Prepaid commissions	(182,180)	(55,639)
Total gross deferred tax liabilities	<u>(58,430,075)</u>	<u>(29,887,993)</u>
Net deferred tax liabilities	\$ (23,838,760)	\$ (15,228,956)

The net deferred tax assets (liabilities) are reflected in the accompanying balance sheet as follows:

	2004	2003
Current deferred tax assets	\$ 8,386,390	\$ 4,788,831

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

Non-current deferred tax liabilities	(32,225,150)	(20,017,787)
Net deferred tax assets	\$ (23,838,760)	\$ (15,228,956)

During the year ended March 31, 2004, the Company recorded income tax expense at a rate of 38.2%. During the year ended March 31, 2004, the Company recorded a \$558,000 reduction to income tax expense as a result of an adjustment to deferred taxes previously provided based on subsequently filed returns. During the year ended March 31, 2002, the Company recorded a \$441,000 reduction to income tax expense as a result of a review and revision of state tax apportionment factors used in filing the amended state tax returns for 2000. During the year ended March 31, 2001, the Company accrued income tax expense at a rate of 38.7% which was greater than the actual effective tax rate of 37.6% determined upon completion and filing of the income tax returns in December 2001. As a result, during the year ended March 31, 2002, the Company recorded a credit to income tax expense totaling \$1,327,000 for this excess accrual.

The Company has Federal net operating loss carryforwards totaling \$40,091,000, \$5,050,000 of which expires in 2023 and \$35,041,000 of which expires in 2024.

### (10) Common Stock

The Company completed a secondary public offering of 5,050,000 shares of common stock in September 2003. The Company received \$81,077,000, net of offering expenses, from the sale of these shares.

### (11) Warrants and Stock Purchase Rights

In April 1998, in connection with a private placement of shares of its Common Stock, the Company issued a warrant to an institutional investor to purchase 1,075,393 shares of its Common Stock at a purchase price of \$2.50 per share. During the years ended March 31, 2002 and 2001, the institutional investor exercised 524,999 and 550,394 warrants, respectively, with net proceeds to the Company totaling \$1,312,000 and \$1,375,984, respectively.

In February 2003, the Company issued warrants to purchase 3,833,946 shares of common stock at \$6.00 per share to the ATSB and to two other guarantors. The warrants had an estimated fair value of \$9,282,538 when issued and expire seven years after issuance. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model. These warrants have subsequently been repriced from \$6.00 to \$5.92 per share as a result of the Company's secondary public offering in September. The Company recorded \$117,000 as additional debt issuance costs in conjunction with this repricing.

In February 1997, the Board of Directors declared a dividend of one Common Stock purchase right for each share of the Company's Common Stock outstanding on March 15, 1997. Each right entitles a shareholder to purchase one share of the Company's Common Stock at a purchase price of \$65.00 per full common share, subject to adjustment. There are currently 0.67 rights associated with each outstanding share of Common Stock. The rights are not currently exercisable, but would become exercisable if certain events occurred relating to a person or group acquiring or attempting to acquire 20 percent or more of the outstanding shares of the Company's common stock. The rights expire on February 20, 2007, unless redeemed by the Company earlier. Once the rights become exercisable, each holder of a right will have the right to receive, upon exercise, common stock (or, in certain circumstances, cash, property or other securities of the Company) having a value equal to two times the exercise price of the right.

### (12) Stock Option Plan

The Company adopted a stock option plan in 1994 whereby the Board of Directors or its Compensation Committee may grant options to purchase shares of the Company's common stock to employees, officers, and directors of the Company.

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

Under the plan, the Company reserved an aggregate of 6,375,000 shares of common stock for issuance pursuant to the exercise of options. With certain exceptions, options issued through March 31, 2004 generally vest over a five-year period from the date of grant and expire from December 14, 2004 to March 8, 2014. The plan terminated on March 10, 2004.

SFAS No. 123 establishes a fair value based method of accounting for stock options. As discussed in Note 1, Nature of Business and Summary of Significant Accounting Policies Stock Based Compensation, the Company has elected to continue using the intrinsic value method of accounting prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, as permitted by SFAS No. 123.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option valuation model with the following assumptions:

	2004	2003	2002
Assumptions:			
Risk-free interest rate	2.97%	4.14%	4.47%
Dividend yield	0%	0%	0%
Volatility	77.48%	82.06%	83.75%
Expected life (years)	5	5	5

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including expected stock price volatility. Because our stock options have characteristics significantly different from those of traded options and because changes in the input assumptions can materially affect the fair value estimate, in our opinion, the existing models do not necessarily provide a reliable single measure of the fair value of our stock options.

A summary of the stock option activity and related information for the years ended March 31, 2004, 2003 and 2002 is as follows:

	2004		2003		2002
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price	Options
Outstanding-beginning of year	2,430,815	\$10.28	2,070,033	\$ 8.78	2,203,444
Granted	22,500	\$11.41	667,500	\$12.07	579,300
Exercised	(227,250)	\$ 4.40	(252,719)	\$ 2.44	(528,711)
Surrendered	(147,500)	\$ 9.67	(53,999)	\$12.72	(184,000)
Outstanding-end of year	2,578,565	\$11.06	2,430,815	\$10.28	2,070,033
Exercisable at end of year	1,407,899	\$10.43	1,168,815	\$10.01	831,834

The grant date fair value of the options granted during the years ended March 31, 2004, 2003 and 2002 were \$11.41, \$12.07, and \$14.95, respectively.

Exercise prices for options outstanding under the plan as of March 31, 2004 ranged from \$2.08 to \$24.17 per share. The weighted-average remaining contractual life of those options is 7.43 years. A summary of the outstanding and exercisable options at March 31, 2004, segregated by exercise price ranges, is as follows:

Weighted-

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

Exercise Price Range	Options Outstanding	Weighted Average Exercise Price	Average Remaining Contractual Exercisable Life(in years)	Exercisab Options
\$ 2.08 - \$ 4.98	173,765	\$ 3.27	5.8	129,765
\$ 5.15 - \$ 9.63	952,500	\$ 6.56	6.6	612,000
\$10.00 - \$ 14.85	678,000	\$11.79	7.7	262,500
\$15.14 - \$19.46	658,000	\$16.96	8.1	305,334
\$21.20 - \$24.17	116,300	\$21.95	7.7	98,300
	2,578,565	\$11.06	7.3	1,407,899

(13) **Retirement Plans**

**Employee Stock Ownership Plan**

The Company has established an Employee Stock Ownership Plan (ESOP) which inures to the benefit of each employee of the Company, except those employees covered by a collective bargaining agreement that does not provide for participation in the ESOP. Company contributions to the ESOP are discretionary and may vary from year to year. In order for an employee to receive an allocation of Company common stock from the ESOP, the employee must be employed on the last day of the ESOP's plan year, with certain exceptions. The Company's annual contribution to the ESOP, if any, is allocated among the eligible employees of the Company as of the end of each plan year in proportion to the relative compensation (as defined in the ESOP) earned that plan year by each of the eligible employees. The ESOP does not provide for contributions by participating employees. Employees vest in contributions made to the ESOP based upon their years of service with the Company. A year of service is an ESOP plan year during which an employee has at least 1,000 hours of service. Vesting generally occurs at the rate of 20% per year, beginning after the first year of service, so that a participating employee will be fully vested after five years of service. Distributions from the ESOP will not be made to employees during employment. However, upon termination of employment with the Company, each employee will be entitled to receive the vested portion of his or her account balance.

During the year ended March 31, 2004 and 2002, the Company contributed 646,142 and 173,018 shares, respectively to the plan. The Company did not contribute shares to the plan during the year ended March 31, 2003. Total Company contributions to the ESOP from inception through March 31, 2004 totaled 1,840,973 shares. In May 2003, the Company contributed 347,968 shares to the plan for the plan year ending December 31, 2003. In January 2004, the Company contributed 298,174 shares to the plan for the plan year ending December 31, 2004. The Company recognized compensation expense during the years ended March 31, 2004, 2003, and 2002 of \$2,498,700, \$2,642,545 and \$2,368,644, respectively, related to its contributions to the ESOP.

**Retirement Savings Plan**

The Company has established a Retirement Savings Plan (401(k)). Participants may contribute from 1% to 60% of their pre-tax annual compensation. Annual individual pre-tax participant contributions are limited to \$13,000 if under the age of 50, and \$16,000 if over the age of 50 for calendar year 2004, \$12,000 if under the age of 50, and \$14,000 if over the age of 50 for calendar year 2003, and \$11,000 for calendar year 2002, under the Internal Revenue Code. Participants are immediately vested in their voluntary contributions.

The Company's Board of Directors have elected to match 50% of participant contributions up to 10% of salaries from May 2000 through December 2004. During the years ended March 31, 2004, 2003, and 2002, the Company recognized compensation expense associated with the matching contributions totaling \$2,598,581, \$2,536,363 and \$2,087,984, respectively. Future matching contributions, if any, will be determined annually by the

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

Board of Directors. In order to receive the matching contribution, participants must be employed on the last day of the plan year. Participants vest in contributions made to the 401(k) based upon their years of service with the Company. A year of service is a 401(k) plan year during which a participant has at least 1,000 hours of service. Vesting generally occurs at the rate of 20% per year, beginning after the first year of service, so that a participant will be fully vested after five years of service. Upon termination of employment with the Company, each participant will be entitled to receive the vested portion of his or her account balance.

### **Retirement Health Plan**

In conjunction with the Company's collective bargaining agreement with its pilots, retired pilots and their dependents may retain medical benefits under the terms and conditions of the Health and Welfare Plan for Employees of Frontier Airlines, Inc. (the Plan) until age 65. The cost of retiree medical benefits are continued under the same contribution schedule as active employees.

We regularly evaluate ways to better manage employee benefits and control costs. Any changes to the plan or assumptions used to estimate future benefits could have a significant effect on the amount of the reported obligation and future annual expense.

The following table provides a reconciliation of the changes in the benefit obligations under the Plan for the years ended March 31, 2004 and 2003.

Reconciliation of benefit obligation:

	2004	2003
Obligation at beginning of period	\$ 2,286,750	\$ 758,162
Service cost	640,082	423,009
Interest cost	146,494	55,445
Benefits paid	(22,000)	(22,450)
Net actuarial loss (gain)	<u>629,185</u>	<u>1,072,584</u>
Obligation at end of period	<u>\$ 3,680,511</u>	<u>\$ 2,286,750</u>

The following is a statement of the funded status as of March 31:

	2004	2003
Funded status	\$ (3,680,511)	\$ (2,286,750)
Unrecognized net actuarial (gain) loss	<u>1,623,648</u>	<u>1,055,873</u>
Accrued benefit liability	<u>\$ (2,056,863)</u>	<u>\$ (1,230,877)</u>

Net periodic benefit cost for the years ended March 31, 2004, 2003, and 2002 include the following components.

	2004	2003	2002
Service cost	\$ 640,082	\$ 423,009	\$ 402,866
Interest cost	146,494	55,445	25,288
Recognized net actuarial loss	<u>61,410</u>	<u>-</u>	<u>-</u>
Net periodic benefit cost	<u>\$ 847,986</u>	<u>\$ 478,454</u>	<u>\$ 428,154</u>

Assumed healthcare cost trend rates have a significant effect on the amounts reported for the other postretirement benefit plans. A 1% change in the healthcare cost trend rate used in measuring the accumulated postretirement benefit obligation (APBO) at March 31, 2004, would have the following effects:

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

		1% increase	1% decrease
Increase (decrease) in total service and interest cost	\$	91,598	\$ (79,761)
Increase (decrease) in the APBO	\$	423,104	\$ (367,122)

The Company used the following actuarial assumptions to account for this postretirement benefit plan:

	2004	2003	2002
Weighted average discount rate	6.00%	6.50%	7.50%
Assumed healthcare cost trend (1)	10.00%	9.75%	6.50%

(1) Trend rates were assumed to reduce until 2014 when an ultimate rate of 5.00% is reached.

**(14) Earnings Per Share**

The following table sets forth the computation of basic and diluted earnings per share:

	2004	2003	2002
Income before cumulative effect of change in method of accounting for maintenance	\$ 12,635,135	\$ (24,853,800)	\$ 16,549,999
Cumulative effect of change in method of accounting for maintenance	-	2,010,672	-
Net income	\$ 12,635,135	\$ (22,843,128)	\$ 16,549,999
Denominator:			
Weighted average shares outstanding, basic	32,732,567	29,619,742	28,603,866
Dilutive effect of employee stock options	582,150	-	911,280
Dilutive effect of warrants	1,961,699	-	-
Adjusted weighted-average shares outstanding, diluted	35,276,416	29,619,742	29,515,146
Basic earnings per share:			
Income before cumulative effect of change in method of accounting for maintenance	\$0.39	\$ (0.84)	\$0.58
Cumulative effect of change in method of accounting for maintenance	-	\$ 0.07	-
Basic earnings per share	\$0.39	\$ (0.77)	\$0.58
Diluted earnings per share:			
Income before cumulative effect of change in method of accounting for maintenance	\$0.36	\$ (0.84)	\$0.58
Cumulative effect of change in method of accounting for maintenance	-	\$ 0.07	-

## Edgar Filing: FRONTIER AIRLINES INC /CO/ - Form 10-K

Diluted earnings per share	\$0.36	\$ (0.77)	\$0.5
	=====		

For the years ending March 31, 2004 and 2002, the Company has excluded from its calculations of diluted earnings per share, 1,022,300 and 326,800 options and warrants, with exercise prices ranging from \$12.68 to \$24.17, and \$15.14 to \$24.17, respectively, because the exercise price of the options and warrants was greater than the average market price of the common shares for the respective year. All outstanding options and warrants were excluded from the calculation of earnings per share for the year ended March 31, 2003 since the effect was anti-dilutive.

**(15) Concentration of Credit Risk**

The Company does not believe it is subject to any significant concentration of credit risk relating to receivables. At March 31, 2004 and 2003, 42.2% and 69.2% of the Company's receivables relate to tickets sold to individual passengers through the use of major credit cards, travel agencies approved by the Airlines Reporting Corporation, tickets sold by other airlines and used by passengers on Company flights, the United States Postal Service, and the Internal Revenue Service. Receivables related to tickets sold are short-term, generally being settled shortly after sale or in the month following ticket usage.

**(16) Commitments and Contingencies**

From time to time, we are engaged in routine litigation incidental to our business. The Company believes there are no legal proceedings pending in which the Company is a party or of which any of our property may be subject to that are not adequately covered by insurance maintained by us, or which, if adversely decided, would have a material adverse affect upon our business or financial condition.

As of March 31, 2004, we have remaining firm purchase commitments for 14 additional aircraft, excluding the June and July 2004 sale-leaseback aircraft, which have scheduled delivery dates beginning in calendar year 2004 and continuing through 2008. Including these aircraft, we intend to lease as many as 22 additional A318 or A319 aircraft from third party lessors over the next three years. Included in the purchase commitments are the remaining amounts due Airbus and amounts for spare aircraft components to support the additional purchase and leased aircraft. We are not under any contractual obligations with respect to spare parts. Under the terms of the purchase agreement, we are required to make scheduled pre-delivery payments for these aircraft. These payments are non-refundable with certain exceptions. As of March 31, 2004, we had made pre-delivery payments on future deliveries totaling \$28,329,000 to secure these aircraft.

In October 2002 we entered into a purchase and long-term services agreement with LiveTV to bring DIRECTV AIRBORNE satellite programming to every seatback in our Airbus fleet. We have agreed to the purchase of 46 units of the hardware. As of March 31, 2004, we have purchased 25 units and have made deposits toward the purchase of 12 additional units.

The aggregate additional amounts due under these purchase commitments and estimated amounts for buyer-furnished equipment, spare parts for both the purchased and leased aircraft and to equip the aircraft with LiveTV was approximately \$531,200,000 at March 31, 2004.

**(17) Selected Quarterly Financial Data (Unaudited)**

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
--	------------------	-------------------	------------------	-------------------

2004

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

Revenues (1)	\$142,365,950	\$165,620,612	\$163,560,475	\$172,132,105
Operating Expenses (1)	\$136,170,698	\$149,187,408	\$151,071,827	\$179,252,334
Net income	\$ 10,933,690	\$ 1,997,723	\$ 5,455,864	\$ (5,752,142)
Earnings per share:				
Basic	\$ 0.37	\$ 0.07	\$ 0.15	\$ (0.16)
Diluted	\$ 0.36	\$ 0.06	\$ 0.14	\$ (0.16)
2003				
Revenues	\$111,812,407	\$119,354,524	\$120,253,288	\$118,515,696
Operating Expenses	\$114,910,166	\$122,557,105	\$126,608,444	\$136,484,109
Loss before cumulative effect of change in accounting principle	\$ (2,472,421)	\$ (3,054,494)	\$ (6,367,833)	\$ (12,959,052)
Cumulative effect of change in method of accounting for maintenance	\$ 2,010,672	-	-	-
Net loss	\$ (461,749)	\$ (3,054,494)	\$ (6,367,833)	\$ (12,959,052)
Basic loss per share:				
Loss before cumulative effect of change in accounting principle	(0.08)	(0.10)	(0.21)	(0.44)
Cumulative effect of change in method of accounting for maintenance	0.07	-	-	-
Basic loss per share	(0.01)	(0.10)	(0.21)	(0.44)
Diluted loss per share:				
Loss before cumulative effect of change in accounting principle	(0.08)	(0.10)	(0.21)	(0.44)
Cumulative effect of change in method of accounting for maintenance	0.07	-	-	-
Diluted loss per share	(0.01)	(0.10)	(0.21)	(0.44)

(1)

Operating expenses in the first quarter for the year ended March 31, 2004 differ from the amount previously reported on Form 10-Q by (\$751,666) as the Company reclassified the unrealized derivative gain previously recorded in nonoperating expense to fuel expense. Operating revenues differ from the amount previously reported on Form 10-Q in the second quarter of the year ended March 31, 2004 as a result of the reclassification of the marketing component of the co-branded credit card revenue of \$200,560 to an offset of marketing expense. Operating expenses in the first quarter for the year ended March 31, 2004 differ from the amount previously reported on Form 10-Q by \$686,295, \$5,896,776, and \$111,822 as the Company reclassified its aircraft lease and facility exit costs and the loss on the sale-leaseback of an aircraft from nonoperating expense to operating expenses.

