Spirit Airlines, Inc.
Form 10-Q
October 25, 2016

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

Form 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-35186

SPIRIT AIRLINES, INC.
(Exact name of registrant as specified in its charter)

Delaware	38-1747023
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2800 Executive Way Miramar, Florida	33025
(Address of principal executive offices)	(Zip Code)

(954) 447-7920
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

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

Large accelerated filer	ý	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes o No ý

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the close of business on October 18, 2016:

Class	Number of Shares
Common Stock, $0.0001 par value	69,322,496

Table of Contents
INDEX

PART I. Financial Information
ITEM 1. UNAUDITED CONDENSED FINANCIAL STATEMENTS
Spirit Airlines, Inc.
Condensed Statements of Operations
(unaudited, in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Operating revenues:				
Passenger	$331,004	$319,812	$900,031	$901,851
Non-ticket	290,325	255,029	843,574	719,766
Total operating revenues	621,329	574,841	1,743,605	1,621,617
Operating expenses:				
Aircraft fuel	121,844	115,899	321,018	356,232
Salaries, wages and benefits	120,190	95,081	349,530	281,175
Aircraft rent	49,367	53,525	151,433	159,440
Landing fees and other rents	39,345	34,577	114,096	98,487
Distribution	25,565	23,074	73,190	65,920
Maintenance, materials and repairs	30,443	21,473	72,010	61,904
Depreciation and amortization	25,304	19,628	73,370	51,630
Other operating	66,277	54,151	197,833	156,071
Loss on disposal of assets	423	290	1,166	1,300
Special charges (credits)	7,355	(76)	31,609	673
Total operating expenses	486,113	417,622	1,385,255	1,232,832
Operating income	135,216	157,219	358,350	388,785
Other (income) expense:				
Interest expense	11,362	5,951	29,588	13,182
Capitalized interest	(3,067)	(3,030)	(9,163)	(8,392)
Interest income	(1,222)	(233)	(4,235)	(544)
Other expense	180	166	407	282
Total other (income) expense	7,253	2,854	16,597	4,528
Income before income taxes	127,963	154,365	341,753	384,257
Provision for income taxes	46,581	57,251	125,367	141,437
Net income	$81,382	$97,114	$216,386	$242,820
Basic earnings per share	$1.17	$1.35	$3.06	$3.35
Diluted earnings per share	$1.17	$1.35	$3.05	$3.34

The accompanying Notes are an integral part of these Condensed Financial Statements.

Spirit Airlines, Inc.
Condensed Statements of Comprehensive Income
(unaudited, in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$81,382	$97,114	$216,386	$242,820
Unrealized gain (loss) on interest rate derivative instruments, net of deferred taxes of $0, ($320), $0 and ($511)	—	(553)	—	(909)
Unrealized gain (loss) on investment securities, net of deferred taxes of $3, $0, $3 and $0	4	—	4	—
Interest rate swap losses reclassified into earnings, net of taxes of $32, $15, $97 and $15	56	25	170	25
Other comprehensive income (loss)	$60	$(528)	$174	$(884)
Comprehensive income	$81,442	$96,586	$216,560	$241,936

The accompanying Notes are an integral part of these Condensed Financial Statements.

Spirit Airlines, Inc.
Condensed Balance Sheets
(unaudited, in thousands)

	September 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 825,904	$ 803,632
Investment securities	100,083	—
Accounts receivable, net	35,892	28,266
Aircraft maintenance deposits	87,105	73,415
Prepaid income taxes	6,060	72,278
Prepaid expenses and other current assets	48,455	48,749
Total current assets	1,103,499	1,026,340
Property and equipment:		
Flight equipment	1,386,310	834,927
Ground property and equipment	109,451	74,814
Less accumulated depreciation	(105,653)	(65,524)
	1,390,108	844,217
Deposits on flight equipment purchase contracts	272,690	286,837
Long-term aircraft maintenance deposits	198,426	206,485
Deferred heavy maintenance, net	79,878	89,127
Other long-term assets	85,024	77,539
Total assets	$ 3,129,625	$ 2,530,545
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	$ 29,906	$ 17,043
Air traffic liability	238,793	216,831
Current maturities of long-term debt	84,443	49,637
Other current liabilities	217,779	182,729
Total current liabilities	570,921	466,240
Long-term debt, less current maturities	894,809	596,693
Long-term deferred income taxes	299,231	221,481
Deferred gains and other long-term liabilities	20,108	20,821
Shareholders' equity:		
Common stock	7	7
Additional paid-in-capital	549,375	544,277
Treasury stock, at cost	(218,572)	(116,182)
Retained earnings	1,015,140	798,754
Accumulated other comprehensive loss	(1,394)	(1,546)
Total shareholders' equity	1,344,556	1,225,310
Total liabilities and shareholders' equity	$ 3,129,625	$ 2,530,545

The accompanying Notes are an integral part of these Condensed Financial Statements.

Spirit Airlines, Inc.
Condensed Statements of Cash Flows
(unaudited, in thousands)

	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Operating activities:		
Net income	$216,386	$242,820
Adjustments to reconcile net income to net cash provided by operations:		
Unrealized losses on open derivative contracts, net	—	2,239
Losses reclassified from other comprehensive income	267	—
Equity-based compensation	5,503	6,999
Allowance for doubtful accounts	213	7
Amortization of deferred gains and losses	3,837	730
Depreciation and amortization	73,370	51,630
Deferred income tax expense	77,627	63,960
Loss on disposal of assets	1,166	1,300
Lease termination cost	31,609	—
Changes in operating assets and liabilities:		
Accounts receivable	(7,840)	(10,374)
Aircraft maintenance deposits	(38,299)	(17,488)
Prepaid income taxes	66,218	—
Long-term deposits and other assets	(43,252)	(44,294)
Accounts payable	(7,044)	2,340
Air traffic liability	21,684	56,960
Other liabilities	38,596	12,161
Net cash provided by operating activities	440,041	368,990
Investing activities:		
Proceeds from sale of property and equipment	50	—
Capitalized interest	(7,032)	(2,707)
Pre-delivery deposits for flight equipment, net of refunds	(109,260)	(87,658)
Purchase of investment securities	(100,076)	—
Purchase of property and equipment	(447,455)	(451,799)
Net cash used in investing activities	(663,773)	(542,164)
Financing activities:		
Proceeds from issuance of long-term debt	378,569	416,000
Proceeds from stock options exercised	92	32
Payments on debt and capital lease obligations	(29,663)	(16,609)
Proceeds from sale and leaseback transactions	—	7,300
Excess tax benefit (deficiency) from equity-based compensation	(497)	8,818
Repurchase of common stock	(102,390)	(112,162)
Debt issuance costs	(107)	(14,092)
Net cash provided by financing activities	246,004	289,287
Net increase in cash and cash equivalents	22,272	116,113
Cash and cash equivalents at beginning of period	803,632	632,784
Cash and cash equivalents at end of period	$825,904	$748,897
Supplemental disclosures		
Cash payments for:		
Interest, net of capitalized interest	$26,025	$3,851

Income taxes paid, net of refunds	$(18,169)	$95,135

The accompanying Notes are an integral part of these Condensed Financial Statements.

Notes to Condensed Financial Statements
(unaudited)
1. Basis of Presentation
The accompanying unaudited condensed financial statements include the accounts of Spirit Airlines, Inc. (the Company). These unaudited condensed financial statements reflect all normal recurring adjustments that management believes are necessary to fairly present the financial position, results of operations and cash flows of the Company for the respective periods presented. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission for Form 10-Q. These unaudited interim condensed financial statements should be read in conjunction with the audited financial statements of the Company and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission on February 17, 2016.
The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect both 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 may differ from these estimates.
The interim results reflected in the unaudited condensed financial statements are not necessarily indicative of the results that may be expected for other interim periods or for the full year.
Certain prior period amounts have been reclassified to conform to the current year's presentation.
2. Recent Accounting Developments

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) No. 2014-09, (ASU 2014-09), "Revenue from Contracts with Customers." The objective of ASU 2014-09 is to establish a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. ASU 2014-09 will supersede most of the existing revenue recognition guidance, including industry-specific guidance. The core principle of ASU 2014-09 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 applies to all contracts with customers except those that are within the scope of other topics in the FASB Accounting Standards Codification. The new guidance is effective for the Company in the first quarter of 2018. Early adoption is permitted, but not before the first quarter of 2017. Entities have the option to use either a full retrospective or modified approach to adopt ASU 2014-09. The Company is currently evaluating the new guidance and has neither determined the full impact this standard may have on its financial statements nor decided upon the planned method of adoption. While the Company is still evaluating the impact, it expects the accounting for its frequent flier program to be impacted as ASU 2014-09 will no longer allow use of the incremental cost method when recording revenue related to the Company's loyalty programs. The Company also expects the classification and timing of recognition of certain ancillary fees to be impacted by adoption of ASU 2014-09.

Financial Instruments

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10).” ASU 2016-01 makes several modifications to Subtopic 825-10 including the elimination of the available-for-sale classification of equity investments, and requires equity investments with readily determinable fair values to be measured at fair value with changes in fair value recognized in net income. ASU 2016-01 is effective for interim and annual periods beginning after December 15, 2017 and is not expected to have a material impact on the Company’s financial statements.

Leases

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." This standard will require all leases with durations greater than twelve months to be recognized on the balance sheet and is effective for the Company in the first quarter of 2019, with early adoption permitted. The Company is currently evaluating the new guidance and believes adoption of this standard will have a significant impact on its balance sheets although adoption is not expected to significantly change the

5

recognition, measurement or presentation of lease expenses within the statements of operations and cash flows. See Note 8, Commitments and Contingencies for information regarding the Company's undiscounted future lease payments and the timing of those payments.

Share-Based Compensation

In March 2016, the FASB issued ASU No. 2016-09, "Improvements to Employee Share-Based Payment Accounting," which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification on the statement of cash flows. The new guidance is effective for the Company in the first quarter of 2017, with early adoption permitted. The Company is in the process of evaluating the impact of adoption of this guidance on its financial statements.

3. Special Charges

During the three months ended September 30, 2016, the Company purchased three A319 aircraft which were formerly financed under operating lease agreements. The purchase price for the 3 aircraft was $58.8 million, comprised of a cash payment of $58.1 million and the application of security deposits held by the previous lessor of $0.7 million. The Company estimated the fair value of the aircraft to be $38.2 million and has recorded the 3 purchased aircraft within flight equipment on the condensed balance sheets. The Company determined the valuation of the aircraft based on a third-party appraisal considering the condition of each aircraft (a Level 3 measurement). The Company recognized $7.4 million as a cost of terminating the leases within special charges on the condensed statement of operations, made up of the excess of the purchase price paid over the fair value of the aircraft, less previously expensed supplemental rent and other non-cash items of $13.2 million.

During the nine months ended September 30, 2016, the Company purchased six A319 aircraft which were formerly financed under operating lease agreements. The purchase price for the 6 aircraft was $124.7 million, comprised of cash payments of $91.9 million and the application of maintenance and security deposits held by the previous lessors of $32.8 million. The Company estimated the fair value of the aircraft to be $79.4 million and has recorded the 6 purchased aircraft within flight equipment on the condensed balance sheets. The Company determined the valuation of the aircraft based on a third-party appraisal considering the condition of each aircraft (a Level 3 measurement). The Company recognized $31.6 million as a cost of terminating the leases within special charges on the condensed statement of operations, made up of the excess of the purchase price paid over the fair value of the aircraft, less previously expensed supplemental rent and other non-cash items of $13.7 million.

Notes to Condensed Financial Statements—(Continued)

4. Earnings per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands, except per share amounts)			
Numerator				
Net income	$81,382	$97,114	$216,386	$242,820
Denominator				
Weighted-average shares outstanding, basic	69,727	71,738	70,689	72,432
Effect of dilutive stock awards	81	146	143	248
Adjusted weighted-average shares outstanding, diluted	69,808	71,884	70,832	72,680
Net income per share				
Basic earnings per common share	$1.17	$1.35	$3.06	$3.35
Diluted earnings per common share	$1.17	$1.35	$3.05	$3.34
Anti-dilutive weighted-average shares	122	57	87	47

5. Investment Securities

The Company's investment securities consist of available-for-sale asset-backed securities with contractual maturities of twelve months or less. These securities are stated at fair value within current assets on the Company's balance sheet. Realized gains and losses on sales of investments, if any, are reflected in nonoperating income (expense) in the statements of operations. Unrealized gains and losses on investment securities are reflected as a component of accumulated other comprehensive income, (AOCI).

During the third quarter of 2016, the Company invested $100 million in available-for-sale investment securities, earning interest income at a weighted-average fixed rate of approximately 1.2%. For the three and nine months ended September 30, 2016, an unrealized gain of $4 thousand, net of deferred taxes of $3 thousand, was recorded within AOCI related to these investment securities. The Company has not recognized any realized gains or losses related to these securities as the Company has not transacted any sales of these securities.

6. Accrued Liabilities

Other current liabilities as of September 30, 2016 and December 31, 2015 consist of the following:

	September 30, 2016	December 31, 2015
	(in thousands)	
Salaries and wages	$45,696	$ 34,123
Federal excise and other passenger taxes and fees payable	41,452	38,254
Aircraft maintenance	39,393	21,688
Airport obligations	36,788	30,849
Interest payable	14,796	12,355
Fuel	11,225	7,084
Aircraft and facility lease obligations	11,117	24,014
Other	17,312	14,362
Other current liabilities	$217,779	$ 182,729

Notes to Condensed Financial Statements—(Continued)

7. Financial Instruments and Risk Management

As part of the Company’s risk management program, the Company from time to time may use a variety of financial instruments to reduce its exposure to fluctuations in the price of jet fuel and interest rates. The Company does not hold or issue derivative financial instruments for trading purposes.

The Company is exposed to credit losses in the event of nonperformance by counterparties to these financial instruments. The Company periodically reviews and seeks to mitigate exposure to the financial deterioration and nonperformance of any counterparty by monitoring absolute exposure levels, credit ratings, and historical performance of counterparties relating to derivative transactions. The credit exposure related to these financial instruments is limited to the fair value of contracts in a net receivable position at the reporting date. The Company also maintains security agreements that require the Company to post collateral if the value of selected instruments falls below specified mark-to-market thresholds. The Company records financial derivative instruments at fair value, which includes an evaluation of each counterparty's credit risk.

Fuel Derivative Instruments

The Company's fuel derivative contracts generally consist of United States Gulf Coast jet fuel swaps (jet fuel swaps) and United States Gulf Coast jet fuel options (jet fuel options). Both jet fuel swaps and jet fuel options are used at times to protect the refining price risk between the price of crude oil and the price of refined jet fuel and to manage the risk of increasing fuel prices. Fair value of the instruments is determined using standard option valuation models.

The Company accounts for its fuel derivative contracts at fair value and recognizes them in the balance sheet in prepaid expenses and other current assets or other current liabilities. The Company did not enter into any fuel derivative instruments during the three and nine months ended September 30, 2016. The Company did not elect hedge accounting on any fuel derivative instruments entered into during the three and nine months ended September 30, 2015 and, as a result, changes in the fair value of these fuel derivative contracts are recorded in aircraft fuel expense. During the three and nine months ended September 30, 2016, the Company did not pay any premiums to acquire jet fuel options. During the three and nine months ended September 30, 2015, the Company paid $0.3 million and $2.5 million in premiums to acquire jet fuel options, respectively.

The following table summarizes the components of aircraft fuel expense for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Into-plane fuel cost	$121,844	$114,081	$321,018	$349,549
Realized losses (gains) related to fuel derivative contracts, net	—	1,736	—	8,575
Unrealized losses (gains) related to fuel derivative contracts, net	—	82	—	(1,892)
Aircraft fuel	$121,844	$115,899	$321,018	$356,232

Any premiums and settlements received or paid on fuel derivative contracts are reflected in the accompanying statements of cash flows in net cash provided by operating activities.

As of September 30, 2016 and December 31, 2015, the Company did not have any outstanding fuel derivatives and had no fuel hedging activity for the three and nine months ended September 30, 2016.

Interest Rate Swaps

During 2015, the Company settled six forward interest rate swaps that were designed to fix the benchmark interest rate component of interest payments on the debt related to three Airbus A321 aircraft, which the Company took delivery of during the third quarter of 2015. These instruments limited the Company's exposure to changes in the benchmark interest rate in the period from the trade date through the date of maturity. The interest rate swaps were designated as cash flow hedges. The Company accounts for interest rate swaps at fair value and recognizes them in the balance sheet in prepaid expenses and other current assets or other current liabilities with changes in fair value recorded within accumulated other comprehensive income (AOCI). As of September 30, 2016 and December 31, 2015, the Company did not have any outstanding interest rate swaps.

Notes to Condensed Financial Statements—(Continued)

Realized gains and losses from cash flow hedges are recorded in the statement of cash flows as a component of cash flows from operating activities. Subsequent to the issuance of each debt instrument, amounts remaining in AOCI are amortized over the life of the fixed-rate debt instrument. For the three and nine months ended September 30, 2016, there were no unrealized gains or losses recorded within AOCI related to these instruments as they settled in 2015. For the three and nine months ended September 30, 2015, an unrealized loss of $0.6 million and $0.9 million, net of deferred taxes of $0.3 million and $0.5 million, respectively, was recorded within AOCI related to these instruments. For the three and nine months ended September 30, 2016, the Company reclassified interest rate swap losses of $56 thousand and $170 thousand, net of tax of $32 thousand and $97 thousand, into earnings, respectively. For the three and nine months ended September 30, 2015, the Company reclassified interest rate swap losses of $25 thousand, net of tax of $15 thousand, into earnings. As of September 30, 2016 and December 31, 2015, $1.4 million and $1.5 million, net of tax, remained in AOCI related to these instruments.

Commitments and Contingencies

Aircraft-Related Commitments and Financing Arrangements

The Company’s contractual purchase commitments consist primarily of aircraft and engine acquisitions through manufacturers and aircraft leasing companies. As of September 30, 2016, the Company's aircraft orders consisted of the following:

	Airbus			Third-Party Lessor	
	A320ceo	A320neo	A321ceo	A320neo	Total
remainder of 2016	—	—	1	5	6
2017	4	—	11	—	15
2018	5	4	5	—	14
2019	1	12	—	—	13
2020	—	16	—	—	16
2021	—	18	—	—	18
	10	50	17	5	82

On April 27, 2016, the Company entered into an amendment to the Airbus A320 Family Purchase Agreement, by and between the Company and Airbus S.A.S., dated May 5, 2004 (Airbus Amendment) which included the conversion of ten Airbus A321neo orders to Airbus A320neo orders. The Company also has four spare engine orders for V2500 SelectOne engines with International Aero Engines (IAE) and nine spare engine orders for PurePower PW1100G-JM engines with Pratt & Whitney. Spare engines are scheduled for delivery from 2016 through 2023. Purchase commitments for these aircraft and spare engines, including estimated amounts for contractual price escalations and pre-delivery payments, are estimated to be approximately $104 million for the remainder of 2016, $659 million in 2017, $650 million in 2018, $679 million in 2019, $823 million in 2020, and $803 million in 2021 and beyond. The Company has secured debt financing commitments of $38.7 million for 1 aircraft scheduled for delivery in the remainder of 2016 and $38.5 million for 1 aircraft scheduled for delivery in 2017. See Note 10, Long-Term Debt - 2015-1 EETCs. In addition, the Company has secured financing for five aircraft to be leased directly from a third party, scheduled for delivery in 2016. The Company does not have financing commitments in place for the remaining 75 Airbus aircraft currently on firm order, which are scheduled for delivery in 2017 through 2021.

Interest commitments related to the secured debt financing of 13 delivered aircraft as of September 30, 2016 are approximately $16.1 million for the remainder of 2016, $40.6 million in 2017, $36.8 million in 2018, $33.3 million in 2019, $29.7 million in 2020, and $118.3 million in 2021 and beyond. For principal commitments related to these financed aircraft, refer to Note 10, Long-Term Debt. Principal and interest commitments related to the Company's future secured debt financing of 2 undelivered aircraft as of September 30, 2016 are approximately $1.6 million for the remainder of 2016, $11.6 million in 2017, $8.1 million in 2018, $7.4 million in 2019, $7.1 million in 2020, and $65.7 million in 2021 and beyond.

As of September 30, 2016, the Company had a fleet consisting of 89 A320 family aircraft. During the nine months ended September 30, 2016, the Company took delivery of ten aircraft financed under secured debt arrangements and purchased six previously leased aircraft. For further discussion on the six previously leased aircraft, refer to Note 3, Special Charges. These aircraft are capitalized within flight equipment and generally have depreciable lives of 25 years and estimated residual values of 10%. As of September 30, 2016, the Company had 55 aircraft and 11 spare engines financed under operating leases with

Notes to Condensed Financial Statements—(Continued)

lease term expiration dates ranging from 2017 to 2029. The Company entered into sale and leaseback transactions with third-party aircraft lessors for the majority of these aircraft and engine leases. Deferred losses resulting from these sale and leaseback transactions are included in other long-term assets on the accompanying balance sheet. Deferred losses are recognized as an increase to rent expense on a straight-line basis over the term of the respective operating leases. Deferred gains are included in deferred credits and other long-term liabilities on the accompanying balance sheet. Deferred gains are recognized as a decrease to rent expense on a straight-line basis over the term of the respective operating leases.

Under the terms of the lease agreements, the Company will continue to operate and maintain the aircraft. Payments under the majority of the lease agreements are fixed for the term of the lease. The lease agreements contain standard termination events, including termination upon a breach of the Company's obligations to make rental payments and upon any other material breach of the Company's obligations under the leases, and standard maintenance and return condition provisions. These return provisions are evaluated at inception of the lease and throughout the lease terms and are accounted for as supplemental rent expense when it is probable that such amounts will be incurred. Upon a termination of the lease due to a breach by the Company, the Company would be liable for standard contractual damages, possibly including damages suffered by the lessor in connection with remarketing the aircraft or while the aircraft is not leased to another party.

Future minimum lease payments under noncancellable operating leases with initial or remaining terms in excess of one year at September 30, 2016 were as follows:

	Operating Leases		
	Aircraft and Spare Engine Leases	Property Facility Leases	Total Operating Lease Obligations
	(in thousands)		
remainder of 2016	$50,986	$10,824	$61,810
2017	194,607	34,988	229,595
2018	177,717	34,714	212,431
2019	158,818	30,312	189,130
2020	150,842	19,111	169,953
2021 and thereafter	520,857	60,513	581,370
Total minimum lease payments	$1,253,827	$190,462	$1,444,289

Aircraft rent expense consists of all minimum lease payments under the terms of the Company's aircraft and spare engine lease agreements recognized on a straight-line basis. Aircraft rent expense also includes supplemental rent. Supplemental rent is made up of maintenance reserves paid or expected to be paid to aircraft lessors in advance of the performance of major maintenance activities that are not probable of being reimbursed and probable return condition obligations. The Company expects supplemental rent to increase as individual aircraft lease agreements approach their respective termination dates and the Company begins to accrue the estimated cost of return conditions for the corresponding aircraft.

Some of the Company’s master lease agreements provide that the Company pay maintenance reserves to aircraft lessors to be held as collateral in advance of the Company’s required performance of major maintenance activities. Substantially all of these maintenance reserve payments are calculated based on a utilization measure, such as flight hours or cycles, while some maintenance reserve payments are fixed contractual amounts. Fixed maintenance reserve payments for these aircraft and related flight equipment, including estimated amounts for contractual price escalations, are expected to be $1.8 million for the remainder of 2016, $6.6 million in 2017, $5.6 million in 2018, $4.2 million in 2019, $3.9 million in 2020, and $10.2 million in 2021 and beyond. These lease agreements provide that maintenance reserves are reimbursable to the Company upon completion of the maintenance event in an amount equal to either (1) the amount of the maintenance reserves held by the lessor associated with the specific maintenance event or (2) the qualifying costs related to the specific maintenance event. Some of the master lease agreements do not require that the

Company pay maintenance reserves so long as the Company's cash balance does not fall below a certain level. As of September 30, 2016, the Company was in full compliance with those requirements and does not anticipate having to pay reserves related to these master leases in the future.

In July 2015, the Company executed an upgrade service agreement with Airbus Americas Customer Services Inc. (Airbus) to reconfigure the seating and increase capacity in 40 of the Company's existing A320 aircraft from 178 to 182 seats (reconfiguration). The reconfiguration of the aircraft commenced in the first quarter of 2016 and is expected to be completed during the fourth quarter of 2017. The cost of the reconfiguration is expected to be approximately \$0.6 million per aircraft and purchase commitments for the reconfiguration kits are estimated to be approximately \$5.0 million for the remainder of 2016, \$8.7 million in 2017 and none thereafter.

Notes to Condensed Financial Statements—(Continued)

In September 2015, the Company executed a lease agreement with Wayne County Airport Authority (the Authority), which owns and operates Detroit Metropolitan Wayne County Airport (DTW). Under the lease agreement, the Company leases a 10-acre site, adjacent to the airfield at DTW, in order to construct, operate and maintain an approximately 126,000-square-foot hangar facility (the project). The project allows for the development of a maintenance hangar in order to fulfill the requirements of the Company's growing fleet and to reduce dependence on third-party facilities and contract line maintenance. The lease agreement has a 30-year term with 2 10-year extension options. Upon termination of the lease, ownership will automatically pass to the Authority. The Company estimates it will complete the project during the fourth quarter of 2016 at a cost of approximately $32 million. The Company will depreciate all capitalized costs related to the project over the lesser of the useful life of the asset or the lease term.
The Company is contractually obligated to pay the following minimum guaranteed payments for its reservation system, data center and advertising media as of September 30, 2016: $1.4 million for the remainder of 2016, $5.2 million in 2017, $3.8 million in 2018, $0.2 million in 2019, $0.2 million in 2020, and $0.0 million in 2021 and beyond. The Company's current agreement with its reservation system provider expires in 2018.

Litigation

The Company is subject to commercial litigation claims and to administrative and regulatory proceedings and reviews that may be asserted or maintained from time to time. The Company believes the ultimate outcome of such lawsuits, proceedings and reviews will not, individually or in the aggregate, have a material adverse effect on its financial position, liquidity or results of operations.

Credit Card Processing Arrangements

The Company has agreements with organizations that process credit card transactions arising from the purchase of air travel, baggage charges, and other ancillary services by customers. As is standard in the airline industry, the Company's contractual arrangements with credit card processors permit them, under certain circumstances, to retain a holdback or other collateral, which the Company records as restricted cash, when future air travel and other future services are purchased via credit card transactions. The required holdback is the percentage of the Company's overall credit card sales its credit card processors hold to cover refunds to customers if the Company fails to fulfill its flight obligations.
The Company's credit card processors do not require the Company to maintain cash collateral if the Company satisfies certain liquidity and other financial covenants. Failure to meet these covenants would provide the processors the right to place a holdback, resulting in a commensurate reduction of unrestricted cash. As of September 30, 2016 and December 31, 2015, the Company was in compliance with such liquidity and other financial covenants in its credit card processing agreements, and the processors were holding back no remittances.
The maximum potential exposure to cash holdbacks by the Company's credit card processors, based upon advance ticket sales and $9 Fare Club memberships as of September 30, 2016 and December 31, 2015, was $281.4 million and $250.2 million, respectively.

Employees

The Company has 4 union-represented employee groups that together represented approximately 72% of all employees at September 30, 2016. The table below sets forth the Company's employee groups and status of the collective bargaining agreements as of September 30, 2016.

Employee Groups	Representative	Amendable Date	Percentage of Workforce
Pilots	Air Line Pilots Association, International (ALPA)	August 2015	26%
Flight Attendants	Association of Flight Attendants (AFA-CWA)	May 2021	42%
Dispatchers	Transport Workers Union (TWU)	August 2018	1%
Ramp Service Agents	International Association of Machinists and Aerospace Workers (IAMAW)	June 2020	3%

In March 2016, under the supervision of the National Mediation Board (NMB), the Company and AFA-CWA reached a tentative agreement for a five-year contract with the Company's flight attendants. In May 2016, the flight attendants voted to approve the new five-year contract with the Company. In connection with this agreement, the Company paid a $9.6 million ratification incentive payment to the flight attendants recorded within salaries, wages and benefits in the statement of operations.

Notes to Condensed Financial Statements—(Continued)

In August 2015, the Company's collective bargaining agreement with its pilots, represented by ALPA, became amendable. In June 2016, ALPA requested the services of the National Mediation Board (NMB) to facilitate negotiations for an amended agreement and the Company joined ALPA in the request. The NMB has assigned a mediator and the parties continue to meet and work toward a new agreement with the guidance of the mediator. Under the RLA, the parties' current agreement remains in effect until an amended agreement is reached.

In July 2014, certain ramp service agents directly employed by the Company voted to be represented by the IAMAW. In May 2015, the Company entered into a five-year interim collective bargaining agreement with the IAMAW, covering material economic terms. In June 2016, the Company and the IAMAW reached an agreement on the remaining terms of the collective bargaining agreement, which is amendable in June 2020. As of September 30, 2016, ramp service agents represented by the IAMAW service 1 of the 56 airports where the Company operates.

The Company is self-insured for health care claims, up to a stop loss amount for eligible participating employees and qualified dependent medical claims, subject to deductibles and limitations. The Company’s liabilities for claims incurred but not reported are determined based on an estimate of the ultimate aggregate liability for claims incurred. The estimate is calculated from actual claim rates and adjusted periodically as necessary. The Company has accrued $4.6 million and $3.7 million in health care claims as of September 30, 2016 and December 31, 2015, respectively.

9. Fair Value Measurements

Under ASC 820, Fair Value Measurements and Disclosures, disclosures relating to how fair value is determined for assets and liabilities are required, and a hierarchy for which these assets and liabilities must be grouped is established, based on significant levels of inputs, as follows:

Level 1—Quoted prices in active markets for identical assets or liabilities.

Level 2—Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company utilizes several valuation techniques in order to assess the fair value of the Company’s financial assets and liabilities.

Fuel Derivative Instruments

From time to time, the Company may enter into fuel derivative contracts in order to mitigate the risk of future volatility in fuel prices. The Company’s fuel derivative contracts generally consist of jet fuel swaps and jet fuel options. These instruments are valued using energy and commodity market data, which is derived by combining raw inputs with quantitative models and processes to generate forward curves and volatilities.

The Company utilizes the market approach to measure fair value for its fuel derivative instruments, if any. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

The Company does not elect hedge accounting on its fuel derivative instruments. As a result, the Company records the fair value adjustment of its fuel derivatives in the accompanying statement of operations within aircraft fuel and on the balance sheet within prepaid expenses and other current assets or other current liabilities, depending on whether the net fair value of the derivatives is in an asset or liability position as of the respective date. Fair values of the fuel derivative instruments are determined using standard option valuation models. The Company also considers counterparty risk and its own credit risk in its determination of all estimated fair values. The Company offsets fair value amounts recognized for derivative instruments executed with the same counterparty under a master netting arrangement. The Company determines fair value of jet fuel options utilizing an option pricing model based on inputs that are either readily available in public markets or can be derived from information available in publicly quoted markets. The Company has consistently applied these valuation techniques in all periods presented and believes it has obtained the most accurate information available for the types of derivative contracts it holds.

12

Notes to Condensed Financial Statements—(Continued)

The fair value of the Company's jet fuel swaps is determined based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets; therefore, the Company categorizes these instruments as Level 2. Due to the fact that certain inputs utilized to determine the fair value of jet fuel options are unobservable (principally implied volatility), the Company categorizes these derivatives as Level 3. Implied volatility of a jet fuel option is the volatility of the price of the underlying commodity that is implied by the market price of the option based on an option pricing model. Thus, it is the volatility that when used in a particular pricing model yields a theoretical value for the option equal to the current market price of that option. Implied volatility, a forward-looking measure, differs from historical volatility because the latter is calculated from known past returns. At each balance sheet date, the Company substantiates and adjusts unobservable inputs. The Company routinely assesses the valuation model's sensitivity to changes in implied volatility. Based on the Company's assessment of the valuation model's sensitivity to changes in implied volatility, it concluded that holding other inputs constant, a significant increase (decrease) in implied volatility would result in a significantly higher (lower) fair value measurement for the Company's aircraft fuel derivatives. As of September 30, 2016 and December 31, 2015, the Company had no outstanding fuel derivatives.

Long-Term Debt

The estimated fair value of the Company's non-publicly held debt agreements has been determined to be Level 3, as certain inputs used to determine the fair value of these agreements are unobservable. The Company utilizes a discounted cash flow method to estimate the fair value of the Level 3 long-term debt. The estimated fair value of the Company's publicly held debt agreements has been determined to be Level 2, as the Company utilizes quoted market prices to estimate the fair value of its public long-term debt.

The carrying amounts and estimated fair values of the Company's long-term debt at September 30, 2016 and December 31, 2015 were as follows:

	September 30, 2016		December 31, 2015		
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value	Fair value level hierarchy
	(in millions)				
Senior long-term debt	$460.1	$477.4	$484.2	$ 477.8	Level 3
Junior long-term debt	48.9	50.5	54.3	54.6	Level 3
Class A enhanced equipment trust certificates	394.8	402.7	95.8	94.8	Level 2
Class B enhanced equipment trust certificates	104.5	106.1	25.0	25.2	Level 2
Total long-term debt	$1,008.3	$1,036.7	$659.3	$ 652.4	

Cash and Cash Equivalents

Cash and cash equivalents at September 30, 2016 and December 31, 2015 are comprised of liquid money market funds and cash, and are categorized as Level 1 instruments. The Company maintains cash with various high-quality financial institutions.

Investment Securities

Investment securities at September 30, 2016 are comprised of short-term available-for-sale securities and are categorized as Level 1 instruments, as the Company uses quoted market prices in active markets when determining the fair value of these securities. As of December 31, 2015, the Company had no outstanding investment securities.

Assets and liabilities measured at gross fair value on a recurring basis are summarized below:

Notes to Condensed Financial Statements—(Continued)

	Fair Value Measurements as of September 30, 2016			
	Total	Level 1	Level 2	Level 3
	(in millions)			
Cash and cash equivalents	$ 825.9	$ 825.9	$ —	$ —
Investment securities	$ 100.1	$ 100.1	$ —	$ —
Total assets	$ 926.0	$ 926.0	$ —	$ —
Total liabilities	$ —	$ —	$ —	$ —

	Fair Value Measurements as of December 31, 2015			
	Total	Level 1	Level 2	Level 3
	(in millions)			
Cash and cash equivalents	$ 803.6	$ 803.6	$ —	$ —
Total assets	$ 803.6	$ 803.6	$ —	$ —
Total liabilities	$ —	$ —	$ —	$ —

The Company had no transfers of assets or liabilities between any of the above levels during the periods ended September 30, 2016 and December 31, 2015.

The Company's Valuation Group, which reports to the Chief Financial Officer, is made up of individuals from the Company's Treasury and Corporate Accounting departments. The Valuation Group is responsible for the execution of the Company's valuation policies and procedures. The Valuation Group compares the results of the Company's internally developed valuation methods with counterparty reports at each balance sheet date, assesses the Company's valuation methods for accurateness and identifies any needs for modification.

10. Long-Term Debt

As of September 30, 2016, the Company has issued non-public and public debt instruments. The Company's indebtedness includes the 2014 Framework Agreement, the 2015 Facility Agreements and the 2015-1 EETCs, as defined in the Company's Form 10-K for the year ended December 31, 2015.

2015-1 EETCs

In August 2015, the Company created two separate pass-through trusts, which issued approximately $576.6 million aggregate face amount of Series 2015-1 Class A and Class B enhanced equipment trust certificates (EETCs) in connection with the financing of 15 aircraft. Each class of certificates represents a fractional undivided interest in the respective pass-through trusts and is not an obligation of the Company. The proceeds from the issuance of these certificates are initially held in escrow by a depositary and, upon satisfaction of certain terms and conditions, are released and used to purchase equipment notes which are issued by the Company and secured by the Company's aircraft. As of September 30, 2016, $499.3 million of the proceeds from the sale of the 2015-1 EETCs had been used to purchase equipment notes in connection with the financing of 3 Airbus A320 aircraft and 10 Airbus A321 aircraft. The remaining two aircraft are scheduled for delivery between November 2016 and January 2017.

The Company evaluated whether the pass-through trusts formed are variable interest entities (VIEs) required to be consolidated by the Company under applicable accounting guidance. The Company determined that the pass-through trusts are VIEs and that it does not have a variable interest in the pass-through trusts. Based on this analysis, the Company determined that it is not required to consolidate these pass-through trusts.

Long-term debt is comprised of the following:

Notes to Condensed Financial Statements—(Continued)

	As of		Three Months Ended September 30,		Nine Months Ended September 30,	
	September 30, 2016	December 31, 2015	2016	2015	2016	2015
	(in millions)		(weighted-average interest rates)			
Fixed-rate senior term loans due through 2027	$460.1	$ 484.2	4.10%	4.10%	4.10%	4.10%
Fixed-rate junior term loans due through 2022	48.9	54.3	6.90%	6.90%	6.90%	6.90%
Fixed-rate class A enhanced equipment trust certificates due through 2028	394.8	95.8	4.03%	N/A	4.03%	N/A
Fixed-rate class B enhanced equipment trust certificates due through 2024	104.5	25.0	4.38%	N/A	4.38%	N/A
Long-term debt	$1,008.3	$ 659.3				
Less current maturities	84.4	49.6				
Less unamortized discounts, net	29.1	13.0				
Total	$894.8	$ 596.7				

During the three and nine months ended September 30, 2016, the Company made scheduled principal payments of $10.0 million and $29.6 million on its outstanding debt obligations, respectively. During the three and nine months ended September 30, 2015, the Company made scheduled principal payments of $7.6 million and $15.8 million on its outstanding debt obligations, respectively.

At September 30, 2016, long-term debt principal payments for the next five years and thereafter were as follows:

	September 30, 2016
	(in millions)
remainder of 2016	$ 34.7
2017	84.6
2018	80.4
2019	79.1
2020	77.3
2021 and thereafter	652.2
Total debt principal payments	$ 1,008.3

Interest Expense

Interest expense related to long-term debt consisted of the following:

	Three Months Ended September 30		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Senior term loans	$4,917	$4,639	$14,929	$10,260
Junior term loans	879	926	2,721	2,023
Class A enhanced equipment trust certificates	3,538	—	7,419	—
Class B enhanced equipment trust certificates	1,015	—	2,124	—
Commitment fees	32	—	97	—

Amortization of debt discounts	979	340	2,289	729
Total	$11,360	$5,905	$29,579	$13,012

11. Subsequent Events

In October 2016, the Company took delivery of two A320neos, the first US based carrier to take delivery and service such aircraft. These aircraft are financed under operating lease agreements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL COND