Virgin America Inc.
Form 10-Q
August 05, 2016

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016

¨ 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 001-36718

VIRGIN AMERICA INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	20-1585173 (I.R.S. Employer Identification Number)

555 Airport Boulevard
Burlingame, CA 94010
(Address of Principal Executive Offices) (Zip Code)

(650) 762-7000
(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 x No ¨

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

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 “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x
As of July 26, 2016, the registrant had 44,677,032 shares of common stock outstanding.

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PART 1. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
Virgin America Inc.
Condensed Consolidated Balance Sheets
(In thousands)

	June 30, 2016 (Unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$601,090	$496,349
Receivables, net	35,200	19,556
Prepaid expenses and other assets	19,849	10,675
Total current assets	656,139	526,580
Property and equipment:		
Flight equipment	630,649	373,199
Ground and other equipment	95,057	85,471
Less accumulated depreciation and amortization	(107,932)	(92,173)
	617,774	366,497
Pre-delivery payments for flight equipment	25,959	72,402
Total property and equipment, net	643,733	438,899
Aircraft maintenance deposits	231,143	216,207
Aircraft lease deposits	58,047	58,330
Restricted cash	22,193	19,800
Deferred income taxes	123,802	171,443
Other non-current assets	161,395	137,272
	596,580	603,052
Total assets	$1,896,452	$1,568,531

See accompanying notes to the condensed consolidated financial statements.

Virgin America Inc.
Condensed Consolidated Balance Sheets
(In thousands)

	June 30, 2016 (Unaudited)	December 31, 2015
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$63,989	$76,603
Air traffic liability	272,327	174,853
Other current liabilities	123,076	117,135
Long-term debt-current portion	29,878	48,843
Total current liabilities	489,270	417,434
Long-term debt	396,408	216,477
Long-term debt-related parties	44,470	42,421
Other long-term liabilities	81,114	84,052
Total liabilities	1,011,262	760,384
Contingencies and commitments (Note 5)		
Stockholders' equity		
Preferred stock	—	—
Common stock	444	442
Treasury stock	(6,856)	(5,038)
Additional paid-in capital	1,256,691	1,251,524
Accumulated deficit	(356,921)	(412,479)
Accumulated other comprehensive loss	(8,168)	(26,302)
Total stockholders' equity	885,190	808,147
Total liabilities and stockholders' equity	$1,896,452	$1,568,531

See accompanying notes to the condensed consolidated financial statements.

Virgin America Inc.
Consolidated Statements of Operations
(In thousands, except per share data) (Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Operating revenues:				
Passenger	$377,505	$359,709	$700,136	$649,073
Other	48,221	41,177	89,599	78,165
Total operating revenues	425,726	400,886	789,735	727,238
Operating expenses:				
Salaries, wages and benefits	83,145	74,758	162,013	139,490
Aircraft fuel	74,394	93,743	141,671	182,301
Aircraft rent	47,787	45,708	95,107	90,690
Landing fees and other rents	40,765	34,071	79,897	68,054
Sales and marketing	35,431	30,704	67,818	57,083
Aircraft maintenance	16,898	12,656	33,732	26,489
Depreciation and amortization	9,472	4,225	17,278	8,328
Other operating expenses	48,663	37,363	91,120	71,762
Total operating expenses	356,555	333,228	688,636	644,197
Operating income:	69,171	67,658	101,099	83,041
Other expense:				
Interest expense	(4,322)	(1,616)	(7,788)	(2,831)
Interest expense-related-party	(1,024)	(822)	(2,049)	(1,628)
Capitalized interest	155	1,242	635	2,309
Other income (expense), net	73	(1,109)	290	(2,428)
Total other expense	(5,118)	(2,305)	(8,912)	(4,578)
Income before income tax	64,053	65,353	92,187	78,463
Income tax expense	25,949	364	36,629	688
Net income	$38,104	$64,989	$55,558	$77,775
Net income per share:				
Basic	$0.86	$1.50	$1.25	$1.80
Diluted	$0.85	$1.47	$1.24	$1.75
Shares used for computation:				
Basic	44,321	43,298	44,275	43,239
Diluted	44,927	44,083	44,773	44,538

See accompanying notes to the condensed consolidated financial statements

Virgin America Inc.
Consolidated Statements of Comprehensive Income
(In thousands) (Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Net income	$38,104	$64,989	$55,558	$77,775
Fuel derivative financial instruments:				
Change in unrealized gains on fuel derivatives, net of tax expense of $4,889 and $0 for the three months ended June 30, 2016 and 2015, and $5,364 and $0 for the six months ended June 30, 2016 and 2015	8,053	4,527	8,831	1,509
Net fuel derivative losses reclassified into earnings, net of tax expense of $1,276 and $0 for the three months ended June 30, 2016 and 2015, and $6,196 and $0 for the six months ended June 30, 2016 and 2015	2,102	9,080	10,204	24,315
Interest rate swap derivative financial instruments:				
Change in unrealized losses on interest rate swaps, net of tax benefit of $28 for the three months ended June 30, 2016 and of $572 for the six months ended June 30, 2016	(81)	42	(973)	42
Interest rate swap losses reclassified into earnings, net of tax expense of $12 for the three months ended June 30, 2016 and of $24 for the six months ended June 30, 2016	52	—	72	—
Other comprehensive income	10,126	13,649	18,134	25,866
Total comprehensive income	$48,230	$78,638	$73,692	$103,641

See accompanying notes to the condensed consolidated financial statements

Virgin America Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands) (Unaudited)

	Six months ended June 30,	
	2016	2015
Cash flows from operating activities	$175,165	$130,920
Cash flows from investing activities:		
Acquisition of property and equipment	(231,215)	(16,273)
Pre-delivery payments for flight equipment	—	(5,805)
Net cash used in investing activities	(231,215)	(22,078)
Cash flows from financing activities:		
Net proceeds of equity issuance	1,081	1,526
Proceeds of debt issuance	207,000	—
Debt issuance costs	(2,274)	(818)
Payment of long-term debt	(43,198)	—
Shares repurchased for tax withholdings	(1,818)	(3,736)
Net cash provided by (used in) financing activities	160,791	(3,028)
Net increase in cash and cash equivalents	104,741	105,814
Cash and cash equivalents, beginning of period	496,349	394,643
Cash and cash equivalents, end of period	$601,090	$500,457
Non-cash transactions:		
Fixed assets in accounts payable	$9,090	$149
Non-cash loan borrowings on pre-delivery payments for flight equipment	—	17,416

See accompanying notes to the condensed consolidated financial statements

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Virgin America Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

(1) Basis of Presentation

The condensed consolidated financial statements of Virgin America Inc. (the “Company”) for the three and six months ended June 30, 2016 include the accounts of the Company and its variable interest entities, for which it was the primary beneficiary. These unaudited condensed consolidated financial statements and related notes should be read in conjunction with the Company's 2015 audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 (“2015 Form 10-K”).

These unaudited condensed consolidated financial statements have been prepared as required by the U.S. Securities Exchange Commission (the “SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) have been condensed or omitted as permitted by the SEC. The financial statements include all adjustments, including normal recurring adjustments and other adjustments, which are considered necessary for a fair presentation of the Company’s financial position and results of operations. Operating results for the periods presented herein are not necessarily indicative of the results that may be expected for the entire year. Certain prior year amounts have been reclassified to conform to current year presentation. These amounts were not material to any of the periods presented.

On April 1, 2016, the Company entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Alaska Air Group, Inc. (“Alaska Air Group” or “Parent”) and Alpine Acquisition Corp. ("Merger Sub"), its wholly-owned subsidiary. The Merger Agreement provides that Merger Sub will merge with and into the Company, with the Company surviving as a subsidiary of Parent (the “Merger.”)

At the closing of the acquisition, the Company’s stockholders will receive the right to receive $57.00 in cash, without interest and less any applicable withholding taxes, for each share of Virgin America’s stock that they own. Immediately prior to the closing of the acquisition, each unexpired and unexercised option to purchase shares of the Company's common stock will vest and be canceled in exchange for the right to receive $57.00 in cash per share less the option exercise price for such option, each outstanding restricted stock unit will vest and be canceled in exchange for the right to receive $57.00 in cash, and each outstanding award of shares that is subject to restrictions based on performance or continuing service will vest and be converted into the right to receive $57.00 in cash per share. All consideration is payable without interest and subject to deduction for any required withholding tax.

The closing of the acquisition is subject to the approval by the Company's stockholders, performance by the parties of all their obligations under the Merger Agreement, regulatory approvals and the satisfaction of other customary closing conditions, as set forth in further detail in the Merger Agreement. On June 15, 2016, Alaska Air Group and the Company entered into a timing agreement with the U.S. Department of Justice outlining the phasing of certain steps to be taken in connection with the U.S. Department of Justice’s review of the Merger. Under the timing agreement, Alaska Air Group and the Company agreed to provide the U.S. Department of Justice with materials on a planned schedule and also agreed not to consummate the Merger prior to September 30, 2016, unless the U.S. Department of Justice has closed its investigation sooner. The Company obtained stockholder approval on July 26, 2016 and anticipates that it will complete the transaction in the fourth quarter of 2016, however, the Company cannot predict with certainty whether and when any of the remaining required closing conditions will be satisfied or if the Merger will close.

For the three months and six months ended June 30, 2016, the Company incurred $4.4 million and $6.0 million of costs related to the Merger Agreement.

New and Recently Adopted Accounting Standards

In March 2016, the Financial Accounting Standards Board (the “FASB”) issued an accounting standards update to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in this update are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods with early adoption permitted. The Company is in the process of evaluating the new guidance on its consolidated financial statements.

In February 2016, the FASB issued a comprehensive new leases standard that amends various aspects of existing accounting guidance for leases. It will require recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The main difference between previous U.S. GAAP and the amended standard is the recognition of lease assets and lease liabilities by lessees on the balance sheet for those leases classified as operating leases under previous U.S. GAAP. The accounting applied by a lessor is largely unchanged from that applied under previous U. S. GAAP. As a result, the Company will have to recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company will evaluate the new guidance and plans to provide additional information about its expected financial effect at a future date.

In August 2014, the FASB issued an accounting standards update to require evaluation of whether there are conditions and events that raise substantial doubt about an entity's ability to continue as a going concern within one year after its financial statements are issued (or available to be issued when applicable) and, if so, disclosure of that fact. The standard requires the Company to make this evaluation for both annual and interim reporting periods, if applicable, and disclose whether its plans alleviate that doubt. The standard is effective for annual periods ending after December 15, 2016 and interim periods within annual periods beginning after December 15, 2016. The Company does not expect this accounting standards update to have an impact on its consolidated financial statements.

In May 2014, the FASB and the International Accounting Standards Board ("IASB") jointly issued a comprehensive new revenue recognition standard that will replace most existing revenue recognition standards under U.S. GAAP and International Financial Reporting Standards ("IFRS"). The new standard will require the Company to recognize revenue when goods or services are transferred to customers in an amount that reflects the consideration to which it expects to be entitled in exchange for those goods or services. As a result, the Company will need to use more judgments and estimates to determine when and how revenue is recognized than U.S. GAAP currently requires. In August 2015, the FASB issued an accounting standards update that provides a one-year deferral of the effective date for the new revenue standard for public and non-public entities, resulting in an effective date for the Company of January 1, 2018. In March 2016, the FASB issued an accounting standards update to improve the operability and understandability of the implementation guidance on principal versus agent considerations in the new revenue recognition standard. In April 2016, the FASB issued an accounting standards update to improve the guidance and reduce the cost and complexity of applying the guidance on identifying performance obligations in a contract and to improve the operability and understandability of the licensing implementation guidance in the new revenue recognition standard. In May 2016, the FASB issued an accounting standards update to make several narrow scope improvements and to provide a practical expedient for contract modifications at transition. The Company believes the most significant effect of the accounting standards update will be the elimination of the incremental cost method for frequent flyer accounting, which would require the Company to re-value its liability earned by customers associated with flights points with a relative fair value approach. The Company is continuing to evaluate the new guidance and plans to provide additional information about its expected financial effect at a future date.

(2) Fair Value

The accounting guidance establishes a fair value hierarchy as follows:

Level 1	Observable inputs such as quoted prices in active markets for identical assets or liabilities.
Level 2	Observable inputs other than Level 1 prices such as quoted prices in active markets for similar assets and 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 for the assets or liabilities.
Level 3	Unobservable inputs in which there is little or no market data and that are significant to the fair value of the assets or liabilities.

Virgin America Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

The following is a listing of the Company's assets and liabilities required to be measured at fair value on a recurring basis and where they are classified within the fair value hierarchy as of June 30, 2016 and December 31, 2015 respectively (in thousands):

	June 30, 2016			
	Level 1	Level 2	Level 3	Total
Assets (Liability)				
Cash equivalents	$510,754	$—	$ —	$510,754
Restricted cash	22,193	—	—	22,193
Heating oil swaps - fuel derivative instruments	—	150	—	150
Jet fuel swaps - fuel derivative instruments	—	4,613	—	4,613
	$532,947	$4,763	$ —	$537,710

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
Assets (Liability)				
Cash equivalents	$419,176	$—	$ —	$419,176
Restricted cash	19,800	—	—	19,800
Heating oil swaps - fuel derivative instruments	—	(17,895)	—	(17,895)
Jet fuel swaps - fuel derivative instruments	—	(9,655)	—	(9,655)
Interest rate swaps	—	155	—	155
	$438,976	$(27,395)	$ —	$411,581

The following are estimated fair values of the Company's debt at June 30, 2016 (in thousands):

	Carrying value	Estimated fair value
Third-party debt:		
Aircraft-related term loans	$392,252	$391,868
Term loan credit facility	40,000	40,000
Related-party debt:		
Virgin Group	44,470	51,713

The estimated fair values of the Company's related-party debt and aircraft-related term loans were based on rates currently offered for debt with similar maturities and terms. The carrying value of the airport slots term loan credit facility approximated fair value because it has a variable interest rate that approximates rates that would currently be available to the Company on borrowings for similar assets. The Company uses significant unobservable inputs in determining discounted cash flows to estimate the fair value, and therefore, such amounts are categorized as Level 3 in the fair value hierarchy.

(3) Financial Derivative Instruments and Risk Management

(a) Fuel Derivatives

To manage economic risks associated with the fluctuations of aircraft fuel prices, since 2012, the Company has hedged a targeted percentage of its forecasted fuel requirements over the following 12 months with a rolling strategy of entering into call options for crude oil and collar contracts for heating oil in the longer term, three to 12 months before the expected fuel purchase date; then prior to maturity of these contracts, within three months of the fuel purchase, the Company exited these contracts by entering into offsetting trades and locking in the price of a percentage of its fuel requirements through the purchase of fixed forward pricing ("FFP") contracts in jet fuel. In 2015, the Company changed its fuel hedging program strategy by discontinuing the purchase of call options and collars, and began utilizing forward swaps on jet fuel, heating oil and crude oil to lock in future fuel purchase prices.

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The Company’s remaining heating oil collars matured by the end of the second quarter 2015 and the remaining Brent call options matured by the end of the third quarter 2015.

The Company utilizes FFP contracts with its fuel service provider as part of its risk management strategy, wherein fixed prices are negotiated for set volumes of future purchases of fuel. The Company takes physical delivery of the future purchases. The Company has applied the normal purchase and normal sales exception for these commitments. The Company did not have any commitments related to FFP contracts outstanding at June 30, 2016.

The Company designates the majority of its fuel hedge derivatives contracts as cash flow hedges under the applicable accounting standard, if they qualify for hedge accounting. Under hedge accounting, all periodic changes in the fair value of the derivatives designated as effective hedges are recorded in accumulated other comprehensive income (loss) (AOCI) until the underlying fuel is purchased, at which point the deferred gain or loss will be recorded as fuel expense. In the event that the Company’s fuel hedge derivatives do not qualify as effective hedges, the periodic changes in fair value of the derivatives are included in fuel expense in the period they occur. If the Company terminates a fuel hedge derivative contract prior to its settlement date, the cumulative gain or loss recognized in AOCI at the termination date will remain in AOCI until the terminated intended transaction occurs. In the event it becomes improbable that such event will occur, the cumulative gain or loss is immediately reclassified into earnings. All cash flows associated with purchasing and settling of fuel hedge derivatives are classified as operating cash flows in the accompanying condensed consolidated statements of cash flows.

(b) Interest Rate Swaps

The Company enters into interest rate swaps to protect against adverse fluctuations in interest rates associated with variable rate debt financing by reducing its exposure to variability in cash flows related to the future interest payments on the financing for committed aircraft. The interest rate swaps are designated cash flow hedges. The Company has no active swaps as of June 30, 2016. The AOCI loss balance of $2.1 million at June 30, 2016 relates to interest rate swaps that matured in 2015 and 2016, which is being amortized to interest expense over the term of the debt in the accompanying consolidated statements of operations.

(c) Summary of Derivative Instruments

All of the Company's derivatives were designated as cash flow hedges at June 30, 2016 and December 31, 2015. The following tables present the fair value of derivative assets and liabilities that are designated as hedging instruments, as well as the location of the asset and liability balances within the condensed consolidated balance sheets as of June 30, 2016 and December 31, 2015 (in thousands):

Derivatives designated as cash flow hedges	Consolidated balance sheet location	Fair value of derivatives as of June 30, 2016	December 31, 2015
Fuel derivative instruments—Heating oil swaps	Current liabilities	$ (496)	$ (17,895)
Fuel derivative instruments—Jet fuel swaps	Current liabilities	—	(9,655)
Total current liabilities		$ (496)	$ (27,550)
Fuel derivative instruments—Heating oil swaps	Current assets	$ 646	$ —
Fuel derivative instruments—Jet fuel swaps	Current assets	4,613	—
Interest rate swaps	Current assets	—	155
Total current assets		$ 5,259	$ 155

As of June 30, 2016, the Company has no collateral deposited to comply with margin call requirements. As of December 31, 2015, the Company had deposited $9.7 million as collateral with two of its counterparties to comply with margin call requirements related to derivative losses that exceeded the portfolio’s credit limit. The Company recorded margin call deposits in other current liabilities in the accompanying condensed consolidated balance sheet as an offset to fuel hedge liability. Total fuel hedge net current assets was $4.8 million at June 30, 2016, and at December 31, 2015, the total current liability was $17.9 million.

Virgin America Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

The following table summarizes the effect of derivative instruments in the condensed consolidated statements of operations for the three and six months ended June 30, 2016 and 2015 (in thousands):

Derivatives accounted for as hedging instruments under ASC 815	Consolidated financial statement location	Gains (losses) on derivative contracts for the three months ended		Gains (losses) on derivative contracts for the six months ended	
		June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Fuel derivative instruments	Aircraft fuel expense	$(3,652)	$(9,219)	$(17,746)	$(24,434)
Interest rate swaps	Interest expense	64	—	96	—
Total impact to the consolidated statements of operations		$(3,588)	$(9,219)	$(17,650)	$(24,434)

Derivatives not accounted for as hedging instruments under ASC 815	Consolidated financial statement location	Gains (losses) on derivative contracts for the three months ended		Gains (losses) on derivative contracts for the six months ended	
		June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Fuel derivative instruments	Aircraft fuel expense	$ —	$ 800	$ —	$ 353
Total impact to the consolidated statements of operations		$ —	$ 800	$ —	$ 353

At June 30, 2016, the Company estimates that approximately $4.9 million of net fuel derivative gains related to its cash flow fuel hedges included in accumulated other comprehensive income will be reclassified into earnings within the next 12 months.

At June 30, 2016, the Company estimates that approximately $0.2 million of net derivative losses related to its interest rate swaps included in accumulated other comprehensive income will be reclassified into earnings within the next 12 months.

The effect of derivative instruments designated as cash flow hedges and the underlying hedged items on the condensed consolidated statements of operations for three and six months ended June 30, 2016 and 2015, respectively, is summarized as follows (in thousands):

Derivatives designated as cash flow hedges	Amount of gain (loss) recognized in AOCI on derivatives (Effective portion)		Gain (loss) reclassified from AOCI into income (Fuel expense or interest expense) (Effective portion)		Amount of gain (loss) recognized into income (Ineffective portion)	
	Three months ended		Three months ended		Three months ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Fuel derivative instruments	$ 12,942	$ 4,527	$ (3,378)	$ (9,080)	$(274)	$(139)

Interest rate swaps	(109)	42	(64)	—	—	—

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Virgin America Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Derivatives designated as cash flow hedges	Amount of gain (loss) recognized in AOCI on derivatives (Effective portion)		Gain (loss) reclassified from AOCI into income (Fuel expense or interest expense) (Effective portion)		Amount of gain (loss) recognized into income (Ineffective portion)	
	Six months ended		Six months ended		Six months ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Fuel derivative instruments	$ 14,195	$ 1,509	$ (16,400)	$ (24,315)	$ (1,346)	$ 20
Interest rate swaps	(1,545)	42	(96)	—	—	—

The notional amounts of the Company’s outstanding derivatives are summarized as follows (gallons in millions):

	June 30, 2016	December 31, 2015
Derivatives designated as hedging instruments:		
Fuel derivative instruments—Heating oil swaps (gallons)	11	38
Fuel derivative instruments—Jet fuel swaps (gallons)	22	25
Interest rate swaps (dollars)	$ —	$ 34

As of June 30, 2016, the Company had entered into fuel derivative contracts for approximately 32% of its forecasted aircraft fuel requirements for 2016 at a weighted-average cost per gallon of $1.31, excluding related fuel taxes.
The Company presents its derivative instruments at net fair value in the accompanying condensed consolidated balance sheets. The Company’s master netting arrangements with counterparties allow for net settlement under certain conditions. As of June 30, 2016, information related to these offsetting arrangements was as follows (in thousands):

	June 30, 2016					
	Derivatives offset in consolidated balance sheet			Derivatives eligible for offsetting		
	Gross derivative amounts	Gross derivative amounts offset in consolidated balance sheet	Net amount	Gross derivative amounts	Gross derivative amounts eligible for offsetting	Net amount
Fair value of assets	$5,899	$ (640)	$ 5,259	$ 5,899	$ (640)	$ 5,259
Fair value of liabilities	(1,136)	640	(496)	(1,136)	640	(496)
Margin call deposits			—			—
Total			$ 4,763			$ 4,763

As of December 31, 2015, no fuel derivative or interest rate swap amounts were available for offset.

(4) Long-Term Debt
During the first half of 2016, the Company took delivery of five aircraft as scheduled. Simultaneously, the Company executed financing agreements totaling $168.2 million with senior debt facilities subject to 12-year repayment terms with an average interest rate of 3.9% and $31.1 million with subordinated debt facilities subject to seven-year repayment terms with an average interest rate of 6.5%. Principal and interest are payable quarterly in arrears. Loans related to two aircraft are pre-payable any time. Loans related to the other three aircraft are not pre-payable prior to the third anniversary of the delivery date (for two aircraft) or issuance date (for one aircraft) and are pre-payable at par

thereafter, subject to payment of early termination charges, if applicable. The debt agreements have no financial covenants.

Virgin America Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

In March 2016, the Company financed $7.8 million of the purchase price of a spare engine acquired in 2015 with a debt facility subject to 7-year repayment terms and at a 90 day floating rate based on LIBOR. Principal and interest are payable quarterly in arrears. The loan related to the engine is not pre-payable prior to the third anniversary of the delivery date and is pre-payable at par thereafter. The debt agreement has no financial covenants.

Long-term debt including accrued paid-in-kind interest consisted of the following as of June 30, 2016 and December 31, 2015 (in thousands):

	June 30, 2016	December 31, 2015
Third-party debt:		
Aircraft-related term loans	$392,252	$193,618
Pre–delivery payment loans	—	34,823
Term loan credit facility	40,000	40,000
Total third-party debt	432,252	268,441
Related-party debt:		
Virgin Group	54,114	52,808
Total debt	486,366	321,249
Less: current maturities	(29,878)	(48,843)
Less: unamortized debt issuance costs	(5,966)	(3,121)
Less: discount on Virgin Group debt	(9,644)	(10,387)
Long–term debt	$440,878	$258,898

In connection with three of the 2015 aircraft-related term loans and three of the 2016 aircraft-related term loans, special purpose entities were formed to authorize and issue senior and junior secured notes and to acquire, finance, own and lease to the Company certain aircraft. Under variable interest entity accounting guidelines, the Company consolidated these entities because the Company is the primary beneficiary. As of June 30, 2016, the entities' assets consisted of six aircraft leased to the Company and its only liabilities consisted of notes payable in relation to the financing of such aircraft.

(5) Contingencies and Commitments

(a) Contingencies

The Company is subject to legal proceedings, claims and investigations arising in the ordinary course of business. While the outcome of these matters is currently not determinable, the Company does not expect that the ultimate costs to resolve these matters will have a material adverse effect on its condensed consolidated financial position, results of operations or cash flows.

The Company is party to routine contracts under which it indemnifies third parties for various risks. The Company has not accrued any liability for these indemnities, as the amounts are not determinable nor estimable.

In its aircraft-related agreements, as is typical of commercial arrangements made in order to purchase, finance and operate commercial aircraft, the Company indemnifies the manufacturer, the financing parties and other related parties against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the aircraft for tort liability, whether or not these liabilities arise out of or relate to the negligence of these indemnified parties, except for their gross negligence or willful misconduct. The Company believes that it will be covered by insurance subject to deductibles for most tort liabilities and related indemnities as described above with respect to the aircraft the Company will operate. Additionally, if there is a change in the law that results in the imposition of any reserve, capital adequacy, special deposit or similar requirement the result of which is to increase the cost to the lender, the Company will pay the lender the additional amount necessary to compensate the lender for the actual cost increase. The Company cannot estimate the potential amount of future payments under the foregoing indemnities.

(b) Commitments

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In December 2010, the Company entered into a purchase agreement with Airbus for 60 A320 aircraft, including 30 A320neo aircraft, the first commercial order for the new eco-efficient engine option. Under the terms of the Company's aircraft purchase agreement, the Company is committed to making pre-delivery payments at varying dates prior to delivery.

In December 2012, the Company amended its 2010 aircraft purchase agreement with Airbus reducing its order of 60 A320 aircraft to 40 aircraft and deferring delivery dates to begin in 2015. Under the amended agreement, the Company also obtained cancellation rights for the last 30 of the 40 aircraft, which cancellation rights are exercisable in groups of five aircraft three years prior to the stated delivery periods in 2020 to 2022, subject to loss of deposits and credits as a cancellation fee. All of the deposits have been reapplied according to the new delivery schedule except for $11.0 million which was converted into a credit earned upon delivery of the last 10 of the 40 aircraft.

The Company evaluated the recoverability of the deposits, credits and related capitalized interest in connection with the anticipated purchase of aircraft in future periods and determined them to be recoverable. If the Company ultimately exercises its cancellation rights for up to 30 aircraft, it would incur a loss of deposits and credits of up to $26.0 million as a cancellation fee. Because the Company concluded that the deposits and credits are recoverable and that it is not likely to incur cancellation fees, the Company did not record such fees and maintained such deposits as pre-delivery payments in its accompanying condensed consolidated balance sheet as of June 30, 2016.

The Company had five spare engines on hand as of June 30, 2016, four of which were leased under operating lease contracts and one of which was purchased in 2015. In March 2016, the Company financed $7.8 million of the purchase price of the engine purchased in 2015 with a debt facility subject to 7-year repayment term and a 90 day floating interest rate based on three month LIBOR.

(6) Related-Party Transactions

The Company licenses the use of its brand name from certain entities affiliated with Virgin Enterprises Limited, a company incorporated in England and Wales ("VEL"). VEL is an affiliate of one of the Company's largest stockholders, the Virgin Group, which has an employee who sits on the Company's board of directors. In connection with the recapitalization agreement the Company entered into in November 2014, the annual license fee to the Virgin Group increased from 0.5% to 0.7% of total revenue starting January 1, 2016. The annual license fee increase will resume at 0.5% once the Company's total revenue for four consecutive quarters exceeds $4.5 billion. The Company paid license fees of $3.0 million and $2.0 million for the three months ended June 30, 2016 and 2015 and $4.9 million and $3.7 million for the six months ended June 30, 2016 and 2015. The Company has accrued unpaid royalty fees of $3.0 million and $2.0 million at June 30, 2016 and December 31, 2015.

As of June 30, 2016, the Virgin Group, through its affiliates including VX Holdings L.P., owned approximately 18.2% of the Company's issued and outstanding voting stock and all of the outstanding related-party debt. In order to comply with requirements under U.S. law governing the ownership and control of U.S. airlines, at least 75% of the voting stock of the Company must be held by U.S. citizens and at least two-thirds of the Company's board of directors must be U.S. citizens. U.S. citizen investors own over 75% of the voting stock of the Company, of which Cyrus Aviation Holdings, LLC, the largest single U.S. investor, owned approximately 27.8% as of June 30, 2016.

As of June 30, 2016, 9.4% of the Company's $470.8 million debt is held by related-party investors. The Company incurred $1.0 million and $0.8 million of related-party interest expense for the three months ended June 30, 2016 and 2015 and $2.0 million and $1.6 million for the six months ended June 30, 2016 and 2015. Commencing in November 2014, the Company began to incur an annual commitment fee on the $100.0 million Letter of Credit Facility issued by the Virgin Group. The fee was equal to 5.0% per annum of the daily maximum amount available to be drawn, accruing on a daily basis from the date of issuance and was payable quarterly. In June 2015, the Company canceled the Letter of Credit Facility in conjunction with the elimination of the credit card holdback requirement and stopped incurring related commitment fees. For the three and six months ended June 30, 2015, the Company recorded $1.1 million and $2.5 million in commitment fees related to this Letter of Credit Facility in other income (expense) in the accompanying condensed consolidated statement of operations.

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Virgin America Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

(7) Income Taxes

The provision for income taxes for the three and six months ended June 30, 2016 was $25.9 million and $36.6 million as compared to $0.4 million and $0.7 million for the three and six months ended June 30, 2015. The Company’s effective tax rate was approximately 40.5% and 39.7% for the three and six months ended June 30, 2016 compared to 0.6% and 0.9% for the three and six months ended June 30, 2015. The differences were primarily related to the effects of the valuation allowance the Company had on its deferred tax assets through the first three quarters of 2015 that was fully released as of December 31, 2015. The effective tax rates for the three and six months ended June 30, 2016, differ from the statutory rate of 35% primarily as a result of state taxes, nondeductible meals and entertainment expenses, and nondeductible merger-related costs.

(8) Net Income Per Share

Employee equity share options and unvested stock and stock units granted by the Company are treated as potential common shares outstanding in computing diluted earnings per share. Diluted shares outstanding include the dilutive effect of in-the-money options, unvested restricted stock and stock units, and shares to be issued under the Company's ESPP. The dilutive effect of such equity awards is calculated based on the average share price for each fiscal period using the treasury stock method. Under the treasury stock method, the amount the employee must pay for exercising stock options, the amount of compensation cost for future service that the Company has not yet recognized, and the amount of tax benefits that would be recorded in additional paid-in capital when the award becomes deductible are collectively assumed to be used to repurchase shares.

The following table sets forth the computation of the Company’s basic and diluted net income for the periods presented (in thousands, except per share data):

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
BASIC:				
Net income	$38,104	$64,989	$55,558	$77,775
Weighted-average common shares outstanding	44,321	43,298	44,275	43,239
Basic net income per share	$0.86	$1.50	$1.25	$1.80
DILUTED:				
Net income	$38,104	$64,989	$55,558	$77,775
Weighted-average common shares outstanding-basic	44,321	43,298	44,275	43,239
Effect of dilutive potential common shares	606	785	498	1,299
Weighted-average common shares outstanding-diluted	44,927	44,083	44,773	44,538
Diluted net income per share	$0.85	$1.47	$1.24	$1.75

The following director and employee stock awards were excluded from the calculation of diluted net income per share because their effect would have been anti-dilutive for the periods presented (share data, in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Stock option awards	—	10	—	13
Restricted stock units	—	12	—	5
ESPP	—	—	17	—

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

Forward-Looking Statements

This report contains various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. When used in this report, the words "expect," "estimate," "plan," "anticipate," "indicate," "believe," "forecast," "guidance," "outlook," "may," "will," "wou "target" and similar expressions are intended to identify forward-looking statements. Forward-looking statements represent our expectations and beliefs concerning future events, based on information available to us on the date of the filing of this report, and are subject to various risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements. Forward-looking statements should not be read as a guarantee of future performance or results and will not necessarily be accurate indications of the times at which or by which such performance or results will be achieved. Factors that could cause actual results to differ materially from those referenced in the forward-looking statements include those listed in Part II, Item 1A of this report. We disclaim any intent or obligation to update or revise any of the forward-looking statements, whether in response to new information, unforeseen events, changed circumstances or otherwise, except as required by applicable law.

Reconciliation of Reported Amounts to Non-GAAP Financial Measures

We evaluate our financial performance using various financial measures, some of which are measures calculated under GAAP, and some of which use alternative methods of calculation (non-GAAP). These measures include operating income/loss, operating margin, net income/loss, net earnings/loss per share and CASM, among others. Pursuant to SEC Regulation G, we have included the following reconciliations of reported non-GAAP financial measures to comparable financial measures reported on a GAAP basis. CASM is a common metric used in the airline industry to measure an airline's cost structure and efficiency. We believe that adjusting CASM for certain special items is useful to investors because the items are not expected to be incurred on a regular basis in future periods. We also believe that excluding fuel costs from CASM is useful to investors because it provides an additional measure of management's performance excluding the effects of a significant cost item over which management has limited influence. We also believe that reporting economic fuel cost per gallon excluding gains or losses on hedges that related to future periods is useful to investors because such gain or loss is not indicative of the actual future value of the underlying hedge contract, and we believe that excluding such gain or loss helps investors to understand the core operating performance in the current period. In addition, we believe that excluding profit sharing costs from CASM better allows investors to understand the core operating cost performance for the period and provides for a more meaningful comparison of the costs of our operations to those of the rest of the industry.

Special items, or Special Items, consist of costs related to the Merger Agreement with Alaska Air Group, Inc. and out-of-period fuel related adjustments for the three and six months ended June 30, 2016 and of out-of-period fuel related adjustments for the three and six months ended June 30, 2015. Three and six months ended June 30, 2016 include the statutory tax effect of Special Items. For the three and six months ended June 30, 2015 tax effect on Special Items was marginal and excluded.

The following table provides the reconciliation of statements of operations and excluding fuel and profit sharing for the three and six months ended June 30, 2016 and 2015 (dollar amounts in thousands, except per share data):

	Three months ended June 30,		%	Six months ended June 30,		%
	2016	2015	Change	2016	2015	Change
Operating income, as reported	$69,171	$67,658	2.2	$101,099	$83,041	21.7
Add: merger-related costs	4,402	—		6,049	—	
Add (deduct): out-of-period fuel costs	(636)	(552)		(1,047)	$(2,815)	
Operating income, non-GAAP	$72,937	$67,106	8.7	$106,101	$80,226	32.3
Operating margin, as reported	16.2 %	16.9 %	(0.7) pts	12.8 %	11.4 %	1.4 pts
Add: merger-related costs	1.0	—		0.7	—	
Add (deduct): out-of-period fuel costs	(0.1)	(0.2)		(0.1)	(0.4)	
Operating margin, non-GAAP	17.1 %	16.7 %	0.4 pts	13.4 %	11.0 %	2.4 pts
Income before taxes, as reported	$64,053	$65,353	(2.0)	$92,187	$78,463	17.5
Add: merger-related costs	4,402	—		6,049	—	
Add (deduct): out-of-period fuel costs	(636)	(552)		(1,047)	(2,815)	
Income before taxes, non-GAAP	$67,819	$64,801	4.7	$97,189	$75,648	28.5
Net income, as reported	$38,104	$64,989	(41.4)	$55,558	$77,775	(28.6)
Add: merger-related costs	4,402	—		6,049	—	
Add (deduct): out-of-period fuel costs	(636)	(552)		(1,047)	(2,815)	
Add (deduct): income tax effect of special items	(33)	—		(365)	—	
Net income, non-GAAP	$41,837	$64,437	(35.1)	$60,195	$74,960	(19.7)
Fully diluted earnings per share, as reported	$0.85	$1.47	(42.2)	$1.24	$1.75	(29.1)
Add: merger-related costs	0.09	—		0.13	—	
Add (deduct): out-of-period fuel costs	(0.01)	(0.01)		(0.02)	(0.06)	
Add (deduct): income tax effect of special items	—	—		(0.01)	—	
Fully diluted earnings per share, non-GAAP	$0.93	$1.46	(36.3)	$1.34	$1.69	(20.7)

The following table provides the reconciliation of CASM excluding Special Items, fuel and profit sharing and CASM excluding fuel and fuel and profit sharing for the three and six months ended June 30, 2016 and 2015 (in cents):

	Three months ended June 30,		%	Six months ended June 30,		%
	2016	2015	Change	2016	2015	Change
CASM, as reported	9.67	10.41	(7.1)	9.90	10.70	(7.5)
Deduct: merger-related costs	(0.12)	—		(0.09)	—	
Add: out-of-period fuel costs	0.01	0.02		0.02	0.05	
CASM, non-GAAP, excluding special items	9.56	10.43	(8.3)	9.83	10.75	(8.6)
Deduct: aircraft fuel, net of out-of-period fuel costs	(2.03)	(2.95)		(2.05)	(3.08)	
Deduct: profit sharing	(0.18)	(0.21)		(0.15)	(0.14)	
CASM, non-GAAP, excluding special items, aircraft fuel and profit sharing	7.35	7.27	1.1	7.63	7.53	1.3
CASM, as reported	9.67	10.41	(7.1)	9.90	10.70	(7.5)
Deduct: aircraft fuel	2.02	2.93		2.03	3.03	
CASM, non-GAAP, excluding aircraft fuel	7.65	7.48		7.87	7.67	
Deduct: profit sharing	0.18	0.21		0.15	0.14	
CASM, non-GAAP, excluding aircraft fuel and profit sharing	7.47	7.27	2.8	7.72	7.53	2.5

The following table provides the reconciliation of fuel cost per gallon excluding Special Items, for the three and six months ended June 30, 2016 and 2015:

	Three months ended June 30,		%	Six months ended June 30,		%
	2016	2015	Change	2016	2015	Change
GAAP fuel cost per gallon	$1.51	$2.18	(30.7)	$1.54	$2.28	(32.5)
Add: out-of-period fuel adjustments	0.02	0.02		0.01	0.04	
Non-GAAP fuel cost per gallon excluding special item	$1.53	$2.20	(30.5)	$1.55	$2.32	(33.2)

Overview

Virgin America is a premium-branded, low-cost airline based in California that provides scheduled air travel in the United States and Mexico. We operate primarily from our focus cities of Los Angeles and San Francisco, with a smaller presence at Dallas Love Field, to other major business and leisure destinations in North America. We provide a distinctive offering for our passengers, whom we call guests, that is centered around our brand and our premium travel experience, while at the same time maintaining a low-cost structure through our point-to-point network and high utilization of our efficient, single fleet type. As of June 30, 2016, we provided service to 24 airports in the United States and Mexico with a fleet of 62 narrow-body aircraft. We also took delivery of one aircraft in June 2016 that was not yet placed in service as of June 30, 2016.

Second Quarter 2016 Highlights

Our pre-tax income for the second quarter of 2016 was $64.1 million. We recorded $4.4 million of legal and professional costs associated with the proposed acquisition of Virgin America by Alaska Air Group (as more fully described below), and we recorded a $0.6 million gain to fuel expense related to out-of-period adjustments on jet fuel hedge instruments where we did not apply hedge accounting, for a net total of $3.8 million of operating costs that we consider Special Items for the period. Excluding these Special Items, our pre-tax income was $67.8 million for the second quarter of 2016 (a non-GAAP financial measure). This represents an improvement of 4.7% as compared to pre-tax income excluding Special Items (a non-GAAP financial measure) for the second quarter of 2015. Highlights of our financial results, both with and without Special Items are as follows:

Capacity: Available Seat Miles (ASMs) for the second quarter of 2016 increased by 15.3% compared with the second quarter of 2015. We took delivery of three new Airbus A320 aircraft in the second quarter of 2016, ending the quarter with 63 total Airbus A-320 family aircraft, of which 62 aircraft were in operating service.

Operating Revenue: Total operating revenue was $425.7 million, an increase of 6.2% over the second quarter of 2015.

Revenue per Available Seat Mile (RASM): Passenger revenue per available seat mile (PRASM) decreased 9.0% compared to the second quarter of 2015, to 10.23 cents. We recorded an adjustment related to accounting for loyalty points in 2015 which increased second quarter 2015 PRASM by approximately 1 percentage point. Excluding the impact of this item, PRASM declined approximately 8.0% year-over-year. Our decline in PRASM has been caused by significantly reduced yields in our core markets. Despite this, our revenue share growth in our markets (as measured by Airlines Reporting Corporation) slightly outpaced our capacity share growth, indicating that our performance in our markets relative to competitors remains stable. Total RASM decreased 7.9% year-over-year.

Cost per Available Seat Mile (CASM): Total CASM for the second quarter of 2016 decreased 7.1%, to 9.67 cents. Total CASM excluding Special Items decreased 8.3%, to 9.56 cents. A decrease in fuel costs was the primary factor in the decline in total CASM. Our recorded salaries, wages and benefits in the second quarter of 2016 includes a $6.6 million accrual for teammate profit sharing and related payroll taxes. CASM excluding Special Items, fuel costs and profit sharing increased 1.1% year-over-year, to 7.35 cents. CASM excluding Special Items, fuel costs and profit sharing was negatively impacted by increased maintenance costs, and by an increase in passenger re-accommodation costs due to higher than expected summer delays and cancellations.

Fuel Expense: Our fuel cost per gallon was $1.51 for the second quarter of 2016. Excluding Special Items, our fuel cost per gallon for the second quarter of 2016 was $1.53, a decrease of 30.5% from the second quarter of 2015.

Operating Income: Second quarter operating income and operating margin were $69.2 million and 16.2%, respectively. Excluding Special Items, second quarter operating income (a non-GAAP financial measure)was $72.9 million, an increase of 8.7% compared to the second quarter of 2015. Our operating margin excluding Special Items (a non-GAAP financial measure) was 17.1%, an increase of 0.4 points from the second quarter of 2015.

Total Other Expense: Total other expense was $5.1 million, an increase of $2.8 million as compared to the second quarter of 2015. The increase is due to higher interest expense associated with the financing of ten new A320 aircraft that we have acquired since the second quarter of 2015.

Net Income: Net income for the second quarter of 2016 was $38.1 million and for the second quarter of 2015 was $65.0 million. Excluding Special Items, net income for the second quarter of 2016 (a non-GAAP financial measure) was $41.8 million, a decrease of 35.1% compared to the second quarter of 2015. We recorded a provision for income taxes excluding special items of $26.0 million in the second quarter of 2016. We did not record a material provision for income taxes in the second quarter of 2015 due to a valuation allowance recorded against our deferred income tax assets. We released substantially all of this valuation allowance in the fourth quarter of 2015.

Fully Diluted Earnings per Share (EPS): Our fully diluted earnings per share for the second quarter of 2016 was $0.85. Excluding Special Items, fully diluted earnings per share (a non-GAAP financial measure) was $0.93 for the second quarter of 2016.

Proposed Acquisition by Alaska Air Group

On April 1, 2016, we entered into that certain Agreement and Plan of Merger, or the Merger Agreement, with Alaska Air Group, Inc., or Alaska Air Group, and Alpine Acquisition Corp., or Merger Sub. The Merger Agreement provides that Merger Sub will merge with and into Virgin America, with Virgin America surviving as a subsidiary of Alaska Air Group.

At the closing of the acquisition, our stockholders will receive the right to receive $57.00 in cash for each share of Virgin America's stock that they own. Immediately prior to the closing of the acquisition, each unexpired and unexercised option to purchase shares of our common stock will vest and be canceled in exchange for the right to receive $57.00 in cash per share less the option exercise price per share for such option, each outstanding

restricted stock unit will vest and be canceled in exchange for the right to receive $57.00 in cash per share, and each outstanding award of shares that is subject to restrictions based on performance or continuing service will vest and be converted into the right to receive $57.00 in cash per share. All consideration is payable without interest and subject to deduction for any required withholding tax.

The merger was approved by our stockholders on July 26, 2016, but is subject to performance by the parties of all their obligations under the Merger Agreement, regulatory approvals and the satisfaction of other customary closing conditions. On June 15, 2016, we and Alaska Air Group entered into a timing agreement with the U.S. Department of Justice outlining the phasing of certain steps to be taken in connection with the U.S. Department of Justice's review of the Merger. Under the timing agreement, we and Alaska Air Group have agreed to provide the U.S. Department of Justice with materials on a planned schedule and have also agreed not to consummate the Merger prior to September 30, 2016, unless the U.S. Department of Justice has closed its investigation sooner. We anticipate that we will complete the transaction in the fourth quarter of 2016, however, we cannot predict with certainty whether and when any of the remaining required closing conditions will be satisfied or if the merger will close.

Results of Operations

Three Months Ended June 30, 2016 Compared to Three Months Ended June 30, 2015

For the three months ended June 30, 2016, we had net income of $38.1 million compared to net income of $65.0 million for the same period in 2015. Our operating income of $69.2 million for the three months ended June 30, 2016 increased by $1.5 million, or 2.2%, from the three months ended June 30, 2015. Our operating margin decreased by 0.7 points to 16.2% in the three months ended June 30, 2016 as compared to 16.9% in the three months ended June 30, 2015.

Our operating capacity, as measured by available seat miles, or ASMs, increased by 15.3% for the three months ended June 30, 2016 from the same period in 2015. Our number of passengers increased by 15.6% in the three months ended June 30, 2016 year-over-year, and our yield decreased by 9.7%.

Our CASM decreased by 7.1% to 9.67 cents for the three months ended June 30, 2016 as compared to 10.41 cents for the same period in 2015. This was primarily a result of lower fuel costs, partially offset by increased salaries, wages and benefits, landing fees and other rents, and depreciation, as well as $4.4 million of professional fees associated with the negotiation of the proposed acquisition of Virgin America by Alaska Air Group.

In addition, net other expense for the three months ended June 30, 2016 increased by $2.8 million from the prior year period as a result of a financing we entered into for nine aircraft that we acquired and placed into service from July 2015 through June 2016, partially offset by a decrease in fees associated with a letter of credit facility that we terminated in the second quarter of 2015.

Operating Revenues

	Three months ended June 30,		Change	
	2016	2015	Amount	%
Operating revenues (in thousands):				
Passenger	$377,505	$359,709	$17,796	4.9
Other	48,221	41,177	7,044	17.1
Total operating revenues	$425,726	$400,886	$24,840	6.2
Operating statistics:				
Available seat miles (millions)	3,689	3,200	489	15.3
Revenue passenger miles (millions)	3,164	2,722	442	16.2
Average stage length (statute miles)	1,450	1,421	29	2.0
Load factor	85.8 %	85.1 %	0.7	pts
Total passenger revenue per available seat mile—PRASM (cents)	10.23	11.24	(1.01)	(9.0)
Total revenue per available seat mile—RASM (cents)	11.54	12.53	(0.99)	(7.9)
Yield (cents)	11.93	13.21	(1.28)	(9.7)
Average fare	$180.92	$199.30	$(18.38)	(9.2)
Passengers (thousands)	2,087	1,805	282	15.6

Passenger revenue for the three months ended June 30, 2016 increased 4.9% from the three months ended June 30, 2015 on a 15.3% increase in capacity as measured by our ASMs. Second quarter 2016 PRASM decreased 9.0% year-over-year due to a 9.7% decrease in passenger yield. Total RASM for the three months ended June 30, 2016 decreased 7.9% from the three months ended June 30, 2015, primarily from the decrease in PRASM, slightly offset by an 17.1% increase in other revenue.

Other revenue for the three months ended June 30, 2016 increased 17.1% from the three months ended June 30, 2015 primarily due to higher ancillary fee revenue from new ancillary products introduced in February 2016, reserved seat assignments and priority boarding in our main cabin and higher bag revenue primarily driven by higher capacity.

Operating Expenses

	Three months ended June 30,		Change		Cost per ASM		Change
	2016	2015	Amount	%	2016	2015	%
					(In cents)		
Operating expenses (in thousands):							
Salaries, wages and benefits	$83,145	$74,758	$8,387	11.2	2.25	2.34	(3.8)
Aircraft fuel	74,394	93,743	(19,349)	(20.6)	2.02	2.93	(31.1)
Aircraft rent	47,787	45,708	2,079	4.5	1.30	1.43	(9.1)
Landing fees and other rents	40,765	34,071	6,694	19.6	1.11	1.06	4.7
Sales and marketing	35,431	30,704	4,727	15.4	0.96	0.96	—
Aircraft maintenance	16,898	12,656	4,242	33.5	0.46	0.40	15.0
Depreciation and amortization	9,472	4,225	5,247	124.2	0.26	0.13	100.0
Other operating expenses	48,663	37,363	11,300	30.2	1.31	1.16	12.9
Total operating expenses	$356,555	$333,228	$23,327	7.0	9.67	10.41	(7.1)
Operating statistics:							
Available seat miles (millions)	3,689	3,200	489	15.3			
Average stage length (statute miles)	1,450	1,421	29	2.0			
Departures	17,666	15,722	1,944	12.4			
CASM (excluding fuel)	7.65	7.48	0.17	2.3			
CASM (excluding fuel and profit sharing)	7.47	7.27	0.20	2.8			
Fuel cost per gallon	$1.51	$2.18	$(0.67)	(30.7)			
Fuel gallons consumed (thousands)	49,133	42,915	6,218	14.5			
Teammates (FTE)	2,810	2,565	245	9.6			

Salaries, wages and benefits

Salaries, wages and benefits expense for the three months ended June 30, 2016 increased by $8.4 million, or 11.2%, from the three months ended June 30, 2015, primarily driven by a 9.6% increase in teammate FTE headcount as we continued hiring new teammates in connection with our 2015 and 2016 aircraft deliveries. Salaries and wages for flight crews also increased as a result of pay initiatives we implemented during 2015 due to the competitive marketplace for talent and increasing seniority of our pilots and inflight teammates. Profit sharing expense for the three months ended June 30, 2016 remained relatively constant. Under our annual profit sharing program, we accrued a pro rata portion of our estimated annual total profit sharing, which is based on current internal projections of pre-tax income for the year. Our profit sharing plan provides for profit sharing on pre-tax income above a threshold which is based on $1.5 million times the weighted average number of aircraft in our fleet. For the full year 2016, we estimate the threshold to be approximately $92.7 million.

Our overall benefit plan costs for the three months ended June 30, 2016 increased from the prior year period due to an increase in the amount of the 401(k) match benefits paid to our teammates primarily driven by higher headcount.

Aircraft fuel

Aircraft fuel expense for the three months ended June 30, 2016, which includes the effect of our fuel hedges, decreased by $19.3 million, or 20.6%, from the three months ended June 30, 2015. The decrease was primarily due to a decrease of $0.67, or 30.7%, in the average fuel cost per gallon offset in part by a 14.5% increase in fuel consumption, and $3.7 million net fuel hedge losses. The increased fuel consumption was substantially consistent with the increase in available seat miles.

We maintain a fixed forward pricing, or FFP, and derivative hedging program, primarily jet fuel and heating oil swaps, to reduce the impact of sudden, sharp increases in fuel prices. We use FFPs and jet fuel swaps to lock in the price of jet fuel for specified quantities and at specified locations in future periods. At June 30, 2016, we had entered into derivative hedging instruments and FFPs for approximately 32% of our then expected nine-month fuel requirements, with all of our then existing hedge contracts expected to settle by the end of the fourth quarter of 2016. Due in part to the impact of declining fuel prices, we recorded $3.7 million in fuel hedge net losses in the three months ended June 30, 2016, which include the effect of $0.4 million offsetting unrealized gains associated with fuel hedges that will mature after June 30, 2016.

Aircraft rent

Aircraft rent expense remained relatively constant for the three months ended June 30, 2016 compared with the three months ended June 30, 2015.

Landing fees and other rents

Landing fees and other rents expense for the three months ended June 30, 2016 increased by $6.7 million, or 19.6%, compared with the three months ended June 30, 2015, primarily as a result of our increase in departures of 12.4% from the addition of frequencies throughout our network and the opening of two Hawaii stations at the end of 2015 and our Denver station in March 2016.

Sales and marketing

Sales and marketing expense for the three months ended June 30, 2016 increased by $4.7 million, or 15.4%, from the three months ended June 30, 2015, primarily due to increases in distribution costs and commissions and increased efforts in ad purchasing to support new markets launched in Hawaii and Denver.

Aircraft maintenance

Aircraft maintenance expense for the three months ended June 30, 2016 increased by $4.2 million, or 33.5% from the three months ended June 30, 2015 primarily due to overall increases in fleet size and flight hours. There were also five scheduled heavy aircraft maintenance events that occurred during the second quarter of 2016, whereas there were none during the same period in 2015.

Depreciation and amortization

Depreciation and amortization expense increased by $5.2 million, or 124.2%, for the three months ended June 30, 2016 as compared to the three months ended June 30, 2015, primarily due to depreciation associated with the nine aircraft that were delivered and placed in service beginning July 2015 and additional aircraft and building leasehold improvements.

Other operating expenses

Other operating expense increased by $11.3 million, or 30.2%, for the three months ended June 30, 2016 as compared to the three months ended June 30, 2015, primarily related to catering and crew travel costs commensurate with capacity growth as well as consulting fees and legal costs, including $4.4 million of professional fees associated with the negotiation of our proposed acquisition by Alaska Air Group.

Other Income (Expense)

Other income (expense) for the three months ended June 30, 2016 increased by $2.8 million, or 122.0%, from the three months ended June 30, 2015, as a result of interest expense associated with financings we entered into in relation to the nine aircraft we acquired and placed into service from July 2015 through June 2016, partially offset by a decrease in fees associated with a letter of credit facility that we terminated in the second quarter of 2015.

Income Taxes

Our effective tax rate was approximately 40.5% in the three months ended June 30, 2016, compared with 0.6% in the three months ended June 30, 2015. The difference was primarily related to the effect of the valuation allowance we had on our deferred tax assets through the first three quarters of 2015 that was fully released as of December 31, 2015.

The effective tax rate for the three months ended June 30, 2016 differed from the federal statutory rate of 35.0% primarily as a result of state taxes, nondeductible meals and entertainment expenses, and nondeductible merger-related costs.

Six Months Ended June 30, 2016 Compared to Six Months Ended June 30, 2015

For the six months ended June 30, 2016, we had net income of $55.6 million compared to net income of $77.8 million for the same period in 2015. Our operating income of $101.1 million for the six months ended June 30, 2016 increased by $18.1 million, or 21.7%, from the six months ended June 30, 2015. Our operating margin increased by 1.4 points to 12.8% in the six months ended June 30, 2016 as compared to 11.4% in the six months ended June 30, 2015.

Our operating capacity, as measured by available seat miles, or ASMs, increased by 15.5% for the six months ended June 30, 2016 from the same period in 2015. Our number of passengers increased by 15.7% in the six months ended June 30, 2016 year-over-year, while our yield decreased by 7.1%.

Our CASM decreased by 7.5% to 9.90 cents for the six months ended June 30, 2016 as compared to 10.70 cents for the same period in 2015. This was primarily a result of lower fuel costs, partially offset by increased salaries, wages and benefits, sales and marketing costs and lending fees and other rents tied to our expansion, as well $6.0 million of professional fees associated with the negotiation of our proposed acquisition by Alaska Air Group.

In addition, net other expense for the six months ended June 30, 2016 increased by $4.3 million from the prior year period as a result of financings we entered into for nine aircraft that we acquired and placed into service from July 2015 through June 2016, partially offset by a decrease in fees associated with a letter of credit facility that we terminated in the second quarter of 2015.

Operating Revenues

	Six months ended June 30,		Change	
	2016	2015	Amount	%
Operating revenues (in thousands):				
Passenger	$700,136	$649,073	$51,063	7.9
Other	89,599	78,165	11,434	14.6
Total operating revenues	$789,735	$727,238	$62,497	8.6
Operating statistics:				
Available seat miles (millions)	6,953	6,019	934	15.5
Revenue passenger miles (millions)	5,779	4,979	800	16.1
Average stage length (statute miles)	1,437	1,423	14	1.0
Load factor	83.1 %	82.7 %	0.4	pts
Total passenger revenue per available seat mile—PRASM (cents)	10.07	10.78	(0.71)	(6.6)
Total revenue per available seat mile—RASM (cents)	11.36	12.08	(0.72)	(6.0)
Yield (cents)	12.11	13.04	(0.93)	(7.1)
Average fare	$181.74	$195.06	$(13.32)	(6.8)
Passengers (thousands)	3,852	3,328	524	15.7

Passenger revenue for the six months ended June 30, 2016 increased 7.9% from the six months ended June 30, 2015 on a 15.5% increase in capacity as measured by our ASMs. 2016 six months year-to-date PRASM decreased 6.6% year-over-year due to a 7.1% decrease in passenger yield. Total RASM for the six months ended June 30, 2016 decreased 6.0% from the six months ended June 30, 2015, primarily from the decrease in PRASM, slightly offset by an 14.6% increase in other revenue.

Other revenue for the six months ended June 30, 2016 increased 14.6% from the six months ended June 30, 2015 primarily due to higher ancillary fee revenue from new ancillary products introduced in February 2016, reserved seat assignments and priority boarding in our main cabin and higher bag revenue primarily driven by higher capacity.

Operating Expenses

	Six months ended June 30,		Change		Cost per ASM		Change
	2016	2015	Amount	%	2016	2015	%
					(In cents)		
Operating expenses (in thousands):							
Salaries, wages and benefits	$162,013	$139,490	22,523	16.1	2.33	2.32	0.4
Aircraft fuel	141,671	182,301	(40,630)	(22.3)	2.03	3.03	(33.0)
Aircraft rent	95,107	90,690	4,417	4.9	1.37	1.51	(9.3)
Landing fees and other rents	79,897	68,054	11,843	17.4	1.15	1.13	1.8
Sales and marketing	67,818	57,083	10,735	18.8	0.98	0.95	3.2
Aircraft maintenance	33,732	26,489	7,243	27.3	0.49	0.44	11.4
Depreciation and amortization	17,278	8,328	8,950	107.5	0.25	0.14	78.6
Other operating expenses	91,120	71,762	19,358	27.0	1.30	1.18	10.2
Total operating expenses	$688,636	$644,197	$44,439	6.9	9.90	10.70	