

CONTINENTAL AIRLINES INC /DE/
Form 10-Q
July 23, 2010

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

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2010

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission File Number: 1-10323

CONTINENTAL AIRLINES, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation or organization)

74-2099724
(I.R.S. Employer
Identification No.)

1600 Smith Street, Dept. HQSEO
Houston, Texas 77002
(Address of principal executive offices)
(Zip Code)

713-324-2950

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant 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 (Section

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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 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	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

(Do not check if smaller reporting company)

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

As of July 21, 2010, 140,333,618 shares of Class B common stock of the registrant were outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

CONTINENTAL AIRLINES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except per share data) (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Operating Revenue:				
Passenger:				
Mainline	\$2,713	\$2,300	\$5,034	\$4,498
Regional	598	467	1,080	886
Total Passenger Revenue	3,311	2,767	6,114	5,384
Cargo	111	82	213	167
Other	286	277	550	536
Total Operating Revenue	3,708	3,126	6,877	6,087
Operating Expenses:				
Aircraft fuel and related taxes	968	891	1,822	1,626
Wages, salaries and related costs	822	799	1,618	1,564
Aircraft rentals	230	235	459	472
Landing fees and other rentals	215	216	428	425
Regional capacity purchase	211	217	413	431
Distribution costs	190	150	361	307
Maintenance, materials and repairs	136	161	283	314
Depreciation and amortization	122	118	256	229
Passenger services	100	96	193	183
Special charges	6	44	16	48
Merger-related costs	18	-	18	-
Other	362	353	732	696
Total Operating Expenses	3,380	3,280	6,599	6,295
Operating Income (Loss)	328	(154)	278	(208)
Nonoperating Income (Expense):				
Interest expense	(92)	(90)	(187)	(183)
Interest capitalized	6	8	13	17
Interest income	2	4	4	8
Other, net	(11)	19	(20)	17
Total Nonoperating Income (Expense)	(95)	(59)	(190)	(141)
Income (Loss) before Income Taxes	233	(213)	88	(349)
Income Taxes	-	-	(1)	-
Net Income (Loss)	\$233	\$(213)	\$87	\$(349)
Earnings (Loss) per Share:				
Basic	\$1.67	\$(1.72)	\$0.62	\$(2.82)

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Diluted	\$1.46	\$(1.72) \$0.60	\$(2.82)
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Shares Used for Computation:

Basic	140	124	139	124
Diluted	167	124	153	124

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

CONTINENTAL AIRLINES, INC.
CONSOLIDATED BALANCE SHEETS
(In millions, except for share data)

ASSETS	June 30, 2010 (Unaudited)	December 31, 2009	June 30, 2009 (Unaudited)
Current Assets:			
Cash and cash equivalents	\$ 3,047	\$2,546	\$ 2,521
Short-term investments	457	310	247
Total unrestricted cash, cash equivalents and short-term investments	3,504	2,856	2,768
Restricted cash and cash equivalents	167	164	167
Accounts receivable, net	610	494	488
Spare parts and supplies, net	275	254	242
Deferred income taxes	221	203	172
Prepayments and other	437	402	494
Total current assets	5,214	4,373	4,331
Property and Equipment:			
Owned property and equipment:			
Flight equipment	8,796	8,769	8,614
Other	1,827	1,787	1,740
Flight equipment and other	10,623	10,556	10,354
Less: Accumulated depreciation	3,708	3,509	3,388
Owned property and equipment, net	6,915	7,047	6,966
Purchase deposits for flight equipment	335	242	257
Capital leases	195	194	194
Less: Accumulated amortization	68	63	58
Capital leases, net	127	131	136
Total property and equipment, net	7,377	7,420	7,359
Routes and airport operating rights, net	780	778	797
Other assets	228	210	175
Total Assets	\$ 13,599	\$12,781	\$ 12,662

(continued on next page)

CONTINENTAL AIRLINES, INC.
CONSOLIDATED BALANCE SHEETS
(In millions, except for share data)

LIABILITIES AND STOCKHOLDERS' EQUITY	June 30, 2010 (Unaudited)	December 31, 2009	June 30, 2009 (Unaudited)
Current Liabilities:			
Current maturities of long-term debt and capital leases	\$ 1,142	\$975	\$ 980
Accounts payable	988	924	1,062
Air traffic and frequent flyer liability	2,607	1,855	2,128
Accrued payroll	391	367	379
Accrued other liabilities	304	268	307
Total current liabilities	5,432	4,389	4,856
Long-Term Debt and Capital Leases	4,912	5,291	4,963
Deferred Income Taxes	221	203	172
Accrued Pension Liability	1,232	1,248	1,375
Accrued Retiree Medical Benefits	223	216	239
Other Non-Current Liabilities	855	844	821
Stockholders' Equity:			
Class B common stock - \$.01 par, 400,000,000 shares authorized; 140,126,934, 138,537,127 and 123,657,537 issued and outstanding	1	1	1
Additional paid-in capital	2,240	2,216	2,047
Accumulated deficit	(355)	(442)	(509)
Accumulated other comprehensive loss	(1,162)	(1,185)	(1,303)
Total stockholders' equity	724	590	236
Total Liabilities and Stockholders' Equity	\$ 13,599	\$12,781	\$ 12,662

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

CONTINENTAL AIRLINES, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (In millions) (Unaudited)

	Six Months Ended June 30,	
	2010	2009
Cash Flows from Operating Activities:		
Net income (loss)	\$87	\$(349)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	256	229
Special charges	16	48
Stock-based compensation related to equity awards	4	3
Other, net	15	27
Changes in operating assets and liabilities	623	401
Net cash provided by operating activities	1,001	359
Cash Flows from Investing Activities:		
Capital expenditures	(148)	(147)
Aircraft purchase deposits (paid) refunded, net	(84)	17
Proceeds from sales (purchases) of short-term investments, net	(124)	233
Proceeds from sales of property and equipment	25	7
Decrease (increase) in restricted cash and cash equivalents	(3)	23
Other	-	(2)
Net cash (used in) provided by investing activities	(334)	131
Cash Flows from Financing Activities:		
Payments on long-term debt and capital lease obligations	(411)	(169)
Proceeds from issuance of long-term debt, net	225	30
Proceeds from issuance of common stock pursuant to stock plans	20	5
Net cash used in financing activities	(166)	(134)
Net Increase in Cash and Cash Equivalents	501	356
Cash and Cash Equivalents - Beginning of Period	2,546	2,165
Cash and Cash Equivalents - End of Period	\$3,047	\$2,521
Investing and Financing Activities Not Affecting Cash:		
Property and equipment acquired through the issuance of debt	-	197

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

CONTINENTAL AIRLINES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

In our opinion, the unaudited consolidated financial statements included herein contain all adjustments necessary to present fairly our financial position, results of operations and cash flows for the periods indicated. Such adjustments, other than nonrecurring adjustments that have been separately disclosed, are of a normal, recurring nature. We recorded \$11 million of depreciation expense during the quarter ended March 31, 2010 that relates to prior periods, the impact of which is not material to any individual prior period or our expected annual results for 2010.

The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2009 (the "2009 Form 10-K"). Due to seasonal fluctuations common to the airline industry, our results of operations for the periods presented are not necessarily indicative of the results of operations to be expected for the entire year. As used in these Notes to Consolidated Financial Statements, the terms "Continental," "we," "us," "our" and similar terms refer to Continental Airlines, Inc. and, unless the context indicates otherwise, its consolidated subsidiaries.

NOTE 1 – MERGER WITH UNITED

On May 2, 2010, Continental, UAL Corporation ("UAL"), and JT Merger Sub Inc., a wholly-owned subsidiary of UAL ("Merger Sub"), entered into an Agreement and Plan of Merger (the "Merger Agreement"), providing for a business combination of Continental and UAL. The Merger Agreement provides that, upon the terms and subject to the conditions set forth in the Merger Agreement, Merger Sub will be merged with and into Continental, with Continental continuing as the surviving corporation and as a wholly-owned subsidiary of UAL (the "Merger"). Upon completion of the Merger, UAL will be the parent company of both Continental and United Air Lines, Inc. ("United") and UAL's name will be changed to United Continental Holdings, Inc.

Under the terms of the Merger Agreement, our stockholders will receive 1.05 shares of UAL common stock for each share of Continental common stock they hold at the effective time of the Merger. The exchange ratio is fixed and will not be adjusted for changes in the market value of the common stock of Continental or UAL. The Merger will be accounted for using the acquisition method of accounting with UAL being considered the acquirer of Continental for accounting purposes. UAL will allocate the purchase price to the fair value of our tangible and intangible assets and liabilities at the acquisition date, with the excess purchase price being recorded as goodwill. Under the acquisition method of accounting, goodwill is not amortized but is tested for impairment at least annually. The new basis for our assets and liabilities will also be reflected in our separate-entity financial statements.

The Merger Agreement contains certain termination rights for both UAL and Continental, including if the Merger is not consummated on or before December 31, 2010 (which is subject to extension under certain circumstances but generally not beyond September 30, 2011) and if the approval of the stockholders of either UAL or Continental is not obtained. The Merger Agreement further provides that, upon termination of the Merger Agreement by UAL or Continental as a result of an adverse change in the recommendation of the other party's board of directors, UAL may be required to pay to Continental, or Continental may be required to pay to UAL, a termination fee of \$175 million.

The consummation of the Merger is subject to receipt of various regulatory clearances, approval by the stockholders of Continental and UAL and the satisfaction or waiver of other conditions as described in the Merger Agreement, and it is possible that factors outside the control of UAL and Continental could result in the Merger being completed at an earlier time, a later time or not at all. As part of its review of the Merger under the Hart-Scott-Rodino Antitrust Improvement Act of 1976, as amended, and the rules and regulations promulgated thereunder (the "HSR review

process"), the Department of Justice ("DOJ") issued Second Requests to Continental and UAL on June 7, 2010. This is a standard part of the HSR review process and was part of our planning from the outset. Continental and UAL are working to comply with the Second Requests and have agreed to provide the DOJ with additional time to complete the HSR review process. As stated previously, Continental and UAL expect the closing of the Merger to occur in the fourth quarter of 2010.

NOTE 2 – ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Variable Interest Entities. In June 2009, the Financial Accounting Standards Board ("FASB") issued guidance to change financial reporting by enterprises involved with variable interest entities ("VIEs"). The standard replaces the quantitative-based risks and rewards calculation for determining which enterprise has a controlling financial interest in a VIE with an approach focused on identifying which enterprise has the power to direct the activities of a VIE and the obligation to absorb losses of the entity or the right to receive the entity's residual returns. This accounting standard became effective for us on January 1, 2010. The adoption of this pronouncement did not have any effect on our consolidated financial statements.

Revenue Arrangements with Multiple Deliverables. In October 2009, the FASB issued guidance that changes the accounting for revenue arrangements with multiple deliverables. The guidance requires an entity to allocate consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices and eliminates the use of the residual method of allocation. The guidance establishes a hierarchy for determining the selling price of a deliverable, based on vendor-specific objective evidence, third-party evidence or estimated selling price. In addition, this guidance expands required disclosures related to a vendor's multiple-deliverable revenue arrangements. This accounting standard is effective for us on January 1, 2011 and may change our accounting for the sale of frequent flyer mileage credits. We may elect to adopt this guidance through either prospective application for revenue arrangements entered into, or materially modified, after the effective date or retrospective application to all applicable revenue arrangements for all periods presented. We are currently evaluating the requirements of this pronouncement and have not determined the impact, if any, that adoption of this standard will have on our consolidated financial statements.

NOTE 3 – EARNINGS (LOSS) PER SHARE

The following table sets forth the components of basic and diluted earnings (loss) per share (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Numerator:				
Numerator for basic earnings (loss) per share - net income (loss)	\$233	\$(213)	\$87	\$(349)
Effect of dilutive securities - interest expense on:				
5% convertible notes	4	-	-	-
6% convertible junior subordinated debentures held by subsidiary trust	3	-	-	-
4.5% convertible notes	3	-	5	-
Numerator for diluted earnings (loss) per share - net income (loss) after assumed conversions	\$243	\$(213)	\$92	\$(349)
Denominator:				
Denominator for basic earnings (loss) per share - weighted average shares	140	124	139	124

Effect of dilutive securities:

5% convertible notes	9	-	-	-
6% convertible junior subordinated debentures held by subsidiary trust	4	-	-	-
4.5% convertible notes	12	-	12	-
Employee stock options	2	-	2	-
Dilutive potential shares	27	-	14	-
Denominator for diluted earnings (loss) per share - weighted average shares after assumed conversions	167	124	153	124

The adjustments to net income (loss) to determine the numerator for diluted earnings (loss) per share are net of the related effect of applicable income taxes and profit sharing.

Approximately 13 million potential shares of our common stock related to convertible debt securities were excluded from the computation of diluted earnings (loss) per share in the three months ended June 30, 2009 and the six months ended June 30, 2010 and 2009 because they were antidilutive. In addition, approximately one million weighted average options to purchase shares of our common stock for the three and six months ended June 30, 2010 and approximately eight million weighted average options for the three and six months ended June 30, 2009 were excluded from the computation of diluted earnings per share because the effect of including the options would have been antidilutive.

NOTE 4 – FLEET INFORMATION

As of June 30, 2010, our operating fleet consisted of 337 mainline jets and 251 regional aircraft. The 337 mainline jets are operated exclusively by us, while the 251 regional aircraft are operated on our behalf by other operators under capacity purchase agreements.

We own or lease 274 regional jets. Of these, 206 are leased or subleased to ExpressJet Airlines, Inc. ("ExpressJet") and operated on our behalf under a capacity purchase agreement with ExpressJet, 43 are subleased to ExpressJet and other operators but are not operated on our behalf and 25 are temporarily grounded. Additionally, our regional operating fleet includes 45 regional jet and turboprop aircraft owned or leased by third parties that are operated on our behalf by other operators under capacity purchase agreements.

The following table summarizes our operating fleet (aircraft operated by us and by others on our behalf) as of June 30, 2010:

Aircraft Type	Total	Owned	Leased	Third-Party Aircraft
Mainline (a):				
777-200ER	20	8	12	-
767-400ER	16	14	2	-
767-200ER	10	9	1	-
757-300	21	9	12	-
757-200	41	15	26	-
737-900ER	30	30	-	-
737-900	12	8	4	-
737-800	117	44	73	-
737-700	36	12	24	-
737-500	34	-	34	-

Total mainline	337	149	188	-
Regional (b):				
ERJ-145XR	89	-	89	-
ERJ-145	132	18	99	15 (c)
Q400	14	-	-	14 (d)
Q200	16	-	-	16 (e)
Total regional	251	18	188	45
Total	588	167	376	45

- (a) Excludes five grounded Boeing 737-500 aircraft (two owned and three leased) and five grounded owned Boeing 737-300 aircraft.
- (b) Excludes 25 ERJ-135 aircraft that are temporarily grounded and 15 ERJ-145XR aircraft, 23 ERJ-145 aircraft and five ERJ-135 aircraft that are subleased to other operators, but are not operated on our behalf.
- (c) Operated by Chautauqua Airlines, Inc. ("Chautauqua") under a capacity purchase agreement.
- (d) Operated by Colgan Air, Inc. ("Colgan") under a capacity purchase agreement.
- (e) Operated by Champlain Enterprises, Inc. ("CommutAir") under a capacity purchase agreement.

Substantially all of the aircraft and engines we own are subject to mortgages.

Mainline Fleet Activity. During the first six months of 2010, we placed into service three leased Boeing 757-300 aircraft and removed three Boeing 737-300 aircraft from service.

Regional Fleet Activity. In December 2009, we agreed with ExpressJet to amend our capacity purchase agreement to permit ExpressJet to fly eight ERJ-145 aircraft for United under a capacity purchase agreement. These eight aircraft had been removed from service on our behalf as of June 30, 2010.

Firm Order and Option Aircraft. As of June 30, 2010, we had firm commitments to purchase 86 new aircraft (58 Boeing 737 aircraft, three Boeing 777 aircraft and 25 Boeing 787 aircraft) scheduled for delivery from 2010 through 2016, with an estimated aggregate cost of \$5.1 billion including related spare engines. In addition to our firm order aircraft, we had options to purchase a total of 98 additional Boeing aircraft as of June 30, 2010.

We are currently scheduled to take delivery of two Boeing 777 aircraft and 12 Boeing 737 aircraft through the end of 2010. Due to issues arising out of the governmental certification process used by the manufacturer of the coach seats on the Boeing 777 aircraft and the coach and first class seats on the Boeing 737 aircraft scheduled for delivery this year, we have incurred delays for most of the aircraft scheduled for delivery in 2010. We expect to take delivery of the two Boeing 777 aircraft and nine Boeing 737 aircraft by the end of August 2010. While this seat manufacturer also provided the seats installed on most of the Boeing aircraft currently in our fleet, we do not believe these issues will have a material impact on our ability to continue to operate any of the aircraft in our fleet based on information currently available to us.

NOTE 5 – LONG-TERM DEBT

Maturities. Maturities of long-term debt due before December 31, 2010 and for the next four years are as follows (in millions):

July 1, 2010 through December 31, 2010	\$401
Year ending December 31,	
2011	1,151
2012	595
2013	821
2014	345

Convertible Debt Securities. Our 5% Convertible Notes with a principal amount of \$175 million are convertible into 50 shares of common stock per \$1,000 principal amount at a conversion price of \$20 per share. If a holder of the notes exercises the conversion right, in lieu of delivering shares of our common stock, we may elect to pay cash or a combination of cash and shares of our common stock for the notes surrendered. All or a portion of the notes are also redeemable at any time for cash at our option at par plus accrued and unpaid interest, if any. Holders of the notes may require us to repurchase all or a portion of their notes at par plus any accrued and unpaid interest on June 15 of 2013 or 2018. We may at our option choose to pay the repurchase price on those dates in cash, shares of our common stock or any combination thereof. However, if we are required to repurchase all or a portion of the notes, our policy is to settle the notes in cash. The holders of the notes also had the right to require us to repurchase their notes on June 15, 2010; however, none did so. Accordingly, we have classified these notes as long-term debt and capital leases at June 30, 2010. The maturity table above reflects the principal amount of the notes as due in 2013.

Holders of the notes may also require us to repurchase all or a portion of their notes for cash at par plus any accrued and unpaid interest if certain changes in control of Continental occur. The Merger will not result in the holders of the notes having any additional rights to require us to repurchase their notes, nor will it trigger any repayment obligation on any of our other outstanding debt.

NOTE 6 - FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Accounting rules for fair value clarify that fair value is an exit price, representing the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants based on the highest and best use of the asset or liability. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. FASB Accounting Standards Codification ("ASC") Topic 820 requires us to use valuation techniques to measure fair value that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs are prioritized as follows:

- Level 1: Observable inputs such as quoted prices for identical assets or liabilities in active markets
- Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar assets or liabilities or market-corroborated inputs
- Level 3: Unobservable inputs for which there is little or no market data and which require us to develop our own assumptions about how market participants would price the assets or liabilities

The valuation techniques that may be used to measure fair value are as follows:

- (A) Market approach - Uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities
- (B) Income approach - Uses valuation techniques to convert future amounts to a single present amount based on current market expectations about those future amounts, including present value techniques, option-pricing models and the excess earnings method
- (C) Cost approach - Based on the amount that currently would be required to replace the service capacity of an asset (replacement cost)

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Assets (liabilities measured at fair value on a recurring basis include (in millions):

	Carrying Amount	Level 1	Level 2	Level 3	Valuation Technique
June 30, 2010					
Cash and cash equivalents	\$3,047	\$3,047	\$-	\$-	(A)
Short-term investments:					
Auction rate securities	117	-	-	117	(B)
CDARS	21	21	-	-	(A)
Asset-backed securities	121	121	-	-	(A)
Fixed income mutual fund	107	-	107	-	(A)
Corporate debt	42	42	-	-	(A)
U.S. government and agency notes	33	33	-	-	(A)
Notes guaranteed by foreign governments	16	16	-	-	(A)
Restricted cash and cash equivalents	167	167	-	-	(A)
Fuel derivatives:					
Swaps	(6)	-	-	(6)	(A)
Call options	6	-	-	6	(A)
Collars	(3)	-	-	(3)	(A)
December 31, 2009					
Cash and cash equivalents	\$2,546	\$2,546	\$-	\$-	(A)
Short-term investments:					
Auction rate securities	201	-	-	201	(B)
CDARS	102	102	-	-	(A)
Asset-backed securities	7	7	-	-	(A)
Restricted cash and cash equivalents	164	164	-	-	(A)
Auction rate securities put right	20	-	-	20	(B)
Fuel derivatives:					
Swaps	6	-	-	6	(A)
Call options	8	-	-	8	(A)
Foreign currency forward contracts	5	-	5	-	(A)
June 30, 2009					
Cash and cash equivalents	\$2,521	2,521	\$-	\$-	(A)
Short-term investments:					
Auction rate securities	230	-	-	230	(B)
CDARS	14	14	-	-	(A)
Asset-backed securities	3	3	-	-	(A)
Restricted cash and cash equivalents	167	167	-	-	(A)
Auction rate securities put right	27	-	-	27	(B)
Fuel derivatives:					
Swaps	16	-	-	16	(A)
Collars	(33)	-	-	(33)	(A)
Foreign currency forward contracts	1	-	1	-	(A)

The determination of fair value of each of these items is discussed below:

Cash and Cash Equivalents and Restricted Cash. Cash and cash equivalents and restricted cash consist primarily of U.S. Government and Agency money market funds and other AAA-rated money market funds with original maturities of three months or less. The original cost of these assets approximates fair value due to their short-term maturity.

Short-Term Investments Other than Auction Rate Securities. The fair values of short-term investments other than auction rate securities are based on observable market data. "CDARS" are certificates of deposit placed through an account registry service. Asset-backed securities mature through 2012. The fixed income mutual fund invests primarily in money market instruments and investment grade fixed income securities and is valued at the net asset value of shares held by us. The underlying investments have a weighted average contractual maturity of less than 90 days. Corporate debt securities, government and agency notes and notes guaranteed by foreign governments have a weighted average maturity of less than two years.

Student Loan-Related Auction Rate Securities. At June 30, 2010, we held student loan-related auction rate securities with a fair value of \$117 million, a par value of \$145 million and amortized cost of \$117 million. These securities, which we classify as available-for-sale, are variable-rate debt instruments with contractual maturities generally greater than ten years who interest rates are reset every seven, 28 or 35 days, depending on the terms of the particular instrument. These securities are secured by pools of student loans guaranteed by state-designated guaranty agencies and reinsured by the U.S. government. All of the auction rate securities we hold are senior obligations under the applicable indentures authorizing the issuance of the securities. We estimated the fair value of these securities taking into consideration the limited sales and offers to purchase such securities and using internally-developed models of the expected future cash flows related to the securities. Our models incorporated our probability-weighted assumptions about the cash flows of the underlying student loans and discounts to reflect a lack of liquidity in the market for these securities.

During the first six months of 2010, we sold, at par, auction rate securities having a par value of \$106 million. Certain of these auction rate securities were subject to a put right granted to us by an institution permitting us to sell to the institution at their full par value certain auction rate securities by June 30, 2010. We recognized gains on the sales using the specific identification method. The gains were substantially offset by the cancellation of any related put rights. The net gains are included in other non-operating income (expense) in our consolidated statement of operations and were not material.

We continue to monitor the market for auction rate securities and consider its impact, if any, on the fair value of our investments. If currently market conditions deteriorate further, we may be required to record additional losses on these securities.

Fuel Derivatives. We determine the fair value of our fuel derivatives by obtaining inputs from a broker's pricing model that is based on inputs that are either readily available in public markets or can be derived from information available in publicly quoted markets. We verify the reasonableness of these inputs by comparing the resulting fair values to similar quotes from our counterparties as of each date for which financial statements are prepared. For derivatives not covered by collateral, we also make an adjustment to incorporate credit risk into the valuation. Due to the fact that certain of the inputs utilized to determine the fair value of the fuel derivatives are unobservable (principally volatility of crude oil prices and the credit risk adjustments), we have categorized these option contracts as Level 3.

Foreign Currency-Forward Contracts. We determine the fair value of our foreign currency derivatives by comparing our contract rate to a published forward price of the underlying currency, which is based on market rates for comparable transactions.

Unobservable Inputs. The reconciliation of our assets (liabilities) measured at fair value on a recurring basis using unobservable inputs (Level 3) is as follows (in millions):

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	Auction Rate Securities	Put Right	Swap	Fuel Derivatives Call Options	Collars
Three Months Ended June 30, 2010					
Balance at beginning of period	\$164	\$16	\$24	\$14	\$-
Purchases, sales, issuances and settlements (net)	(64)	-	5	5	2
Gains and losses:					
Reported in earnings:					
Realized	17	(16)	-	-	-
Unrealized	-	-	-	(1)	(1)
Reported in other comprehensive income (loss)					
	-	-	(35)	(13)	(3)
Balance as of June 30, 2010	\$117	\$-	\$(6)	\$5	\$(2)

Three Months Ended June 30, 2009					
Balance at beginning of period	\$229	\$26	\$2	\$-	\$(254)
Purchases, sales, issuances and settlements (net)	(1)	-	-	-	177
Gains and losses:					
Reported in earnings:					
Unrealized	-	1	8	-	-
Reported in other comprehensive income (loss)					
	2	-	6	-	44
Balance as of June 30, 2009	\$230	\$27	\$16	\$-	\$(33)

	Auction Rate Securities	Put Right	Swap	Fuel Derivatives Call Options	Collars
Six Months Ended June 30, 2010					
Balance at beginning of period	\$201	\$20	\$6	\$8	\$-
Purchases, sales, issuances and settlements (net)	(106)	-	1	17	2
Gains and losses:					
Reported in earnings:					
Realized	23	(21)	-	-	-
Unrealized	-	1	-	(1)	(1)
Reported in other comprehensive income (loss)					
	(1)	-	(13)	(19)	(3)
Balance as of June 30, 2010	\$117	\$-	\$(6)	\$5	\$(2)

Six Months Ended June 30, 2009					
Balance at beginning of period	\$229	\$26	\$2	\$1	\$(418)
Purchases, sales, issuances and settlements (net)	(1)	-	5	(1)	366
Gains and losses:					
Reported in earnings:					
Unrealized	-	1	8	-	(2)
	2	-	1	-	21

Reported in other comprehensive
income (loss)

Balance as of June 30, 2009	\$230	\$27	\$16	\$-	\$(33)
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Other Financial Instruments. Other financial instruments that are not subject to the disclosure requirements of ASC Topic 820 are as follows:

- Debt. The fair value of our debt was approximately as follows (in billions):

	Carrying Amount	Fair Value
June 30, 2010	\$5.9	\$5.8
December 31, 2009	6.1	5.8
June 30, 2009	5.7	4.8

These estimates were based on either market prices or the discounted amount of future cash flows using our current incremental rate of borrowing for similar liabilities.

- Accounts Receivable and Accounts Payable. The fair values of accounts receivable and accounts payable approximated carrying value due to their short-term maturity.

NOTE 7 - HEDGING ACTIVITIES

As part of our risk management program, we use a variety of derivative financial instruments to help manage our risks associated with changes in fuel prices and foreign currency exchange rates. We do not hold or issue derivative financial instruments for trading purposes.

We are exposed to credit losses in the event of non-performance by issuers of derivative financial instruments. To manage credit risks, we select issuers based on credit ratings, limit our exposure to any one issuer under our defined guidelines and monitor the market position with each counterparty.

Fuel Price Risk Management. We routinely hedge a portion of our future fuel requirements, provided the hedges are expected to be cost effective. We have historically entered into swap agreements, purchased call options or structured costless collar arrangements to protect us against sudden and significant increases in jet fuel prices. We typically conduct our fuel hedging activities using a combination of crude oil, jet fuel and heating oil contracts. We strive to maintain fuel hedging levels and exposure generally comparable to that of our major competitors, so that our fuel cost is not disproportionate to theirs.

As of June 30, 2010, our projected consolidated fuel requirements for the remainder of 2010 and the first quarter of 2011 were hedged as follows:

	Maximum Price % of Expected Consumption (per gallon)	Weighted Average price Consumption (per gallon)	Minimum Price % of Expected Consumption (per gallon)	Weighted Average price Consumption (per gallon)
--	---	--	---	--

Remainder of 2010
WTI crude oil swaps

19 % \$