

CONTINENTAL AIRLINES INC /DE/
Form 10-Q
April 19, 2007

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 MARCH 31, 2007

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

74-2099724

(State or other jurisdiction

(I.R.S. Employer

of incorporation or organization)

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

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

As of April 16, 2007, 97,127,746 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)

<u>Three Months Ended March 31,</u>	
<u>2007</u>	<u>2006</u>
(Unaudited)	

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Operating Revenue:

Passenger (excluding fees and taxes of \$347 and \$315)	\$2,895	\$2,683
Cargo	107	107
Other	<u>177</u>	<u>157</u>
	<u>3,179</u>	<u>2,947</u>

Operating Expenses:

Wages, salaries and related costs	726	672
Aircraft fuel and related taxes	684	661
Regional capacity purchase, net	430	415
Aircraft rentals	248	245
Landing fees and other rentals	193	185
Distribution costs	161	160
Maintenance, materials and repairs	144	127
Depreciation and amortization	99	96
Passenger services	90	82
Special charges (credits)	11	(6)
Other	<u>329</u>	<u>299</u>
	<u>3,115</u>	<u>2,936</u>

Operating Income	<u>64</u>	<u>11</u>
------------------	-----------	-----------

Nonoperating Income (Expense):

Interest expense	(96)	(101)
Interest capitalized	5	3
Interest income	36	25
Income from other companies	5	17
Gain on disposition of ExpressJet Holdings, Inc. shares	7	-
Other, net	<u>1</u>	<u>5</u>
	<u>(42)</u>	<u>(51)</u>

))
Income (Loss) before Income Taxes and Cumulative Effect of Change in Accounting Principle	22	(40)
Income Taxes	<u>—</u>	<u>—</u>
Income (Loss) before Cumulative Effect of Change in Accounting Principle	22	(40)
Cumulative Effect of Change in Accounting Principle	<u>—</u>	<u>(26)</u>
))
Net Income (Loss)	\$ <u>22</u>	\$ <u>(66)</u>
		(continued on next page)

CONTINENTAL AIRLINES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except per share data)

	<u>Three Months Ended March 31,</u>	
	<u>2007</u>	<u>2006</u>
	(Unaudited)	
Earnings (Loss) per Share:		
Basic:		
Income (Loss) before Cumulative Effect of Change in Accounting Principle	\$ 0.23	\$ (0.46)
Cumulative Effect of Change in Accounting Principle	<u>—</u>	<u>(0.30)</u>
))
Net Income (Loss)	\$ <u>0.23</u>	\$ <u>(0.76)</u>
Diluted:		
Income (Loss) before Cumulative Effect of Change in Accounting	\$ 0.21	\$ (0.46)

Principle		
Cumulative Effect of Change in Accounting Principle	<u>—</u> -	<u>(0.30)</u>
)
Net Income (Loss)	\$ <u>0.21</u>	\$ <u>(0.76)</u>
Shares Used for Computation:		
Basic	<u>95</u>	<u>87</u>
Diluted	<u>109</u>	<u>87</u>

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	March 31, <u>2007</u>	December 31, <u>2006</u>	March 31, <u>2006</u>
	(Unaudited)		(Unaudited)
Current Assets:			
Cash and cash equivalents	\$ 2,285	\$ 2,123	\$ 1,807
Short-term investments	<u>357</u>	<u>361</u>	<u>205</u>
Total unrestricted cash, cash equivalents and short-term investments	2,642	2,484	2,012
Restricted cash	200	265	245
Accounts receivable, net	753	582	649
Spare parts and supplies, net	223	217	217
Deferred income taxes	170	165	159
Prepayments and other	<u>515</u>	<u>416</u>	<u>451</u>
Total current assets	<u>4,503</u>	<u>4,129</u>	<u>3,733</u>

Property and Equipment:

Owned property and equipment:

Flight equipment	7,102	6,973	6,709
Other	<u>1,460</u>	<u>1,430</u>	<u>1,397</u>
	8,562	8,403	8,106
Less: Accumulated depreciation	<u>2,618</u>	<u>2,539</u>	<u>2,383</u>
	<u>5,944</u>	<u>5,864</u>	<u>5,723</u>
Purchase deposits for flight equipment	<u>214</u>	<u>183</u>	<u>216</u>
Capital leases	296	303	340
Less: Accumulated amortization	<u>84</u>	<u>87</u>	<u>111</u>
	<u>212</u>	<u>216</u>	<u>229</u>
Total property and equipment, net	<u>6,370</u>	<u>6,263</u>	<u>6,168</u>
Routes	484	484	484
Airport operating rights, net	116	120	130
Investment in other companies	58	81	123
Intangible pension asset	-	-	0
Other assets, net	<u>227</u>	<u>231</u>	<u>227</u>
Total Assets	<u>\$11,758</u>	<u>\$11,308</u>	<u>\$10,925</u>

(continued on next page)

CONTINENTAL AIRLINES, INC.

CONSOLIDATED BALANCE SHEETS
(In millions, except for share data)

LIABILITIES AND STOCKHOLDERS' EQUITY	March 31, <u>2007</u>	December 31, <u>2006</u>	March 31, <u>2006</u>
	(Unaudited)		(Unaudited)
Current Liabilities:			
Current maturities of long-term debt and capital leases	\$ 386	\$ 574	\$ 769
Accounts payable	997	1,076	898
Air traffic and frequent flyer liability	2,274	1,712	1,949
Accrued payroll	235	233	232
Accrued other liabilities	<u>355</u>	<u>360</u>	<u>314</u>
 Total current liabilities	 <u>4,247</u>	 <u>3,955</u>	 <u>4,162</u>
 Long-Term Debt and Capital Leases	 <u>4,823</u>	 <u>4,859</u>	 <u>4,671</u>
 Deferred Income Taxes	 <u>170</u>	 <u>165</u>	 <u>159</u>
 Accrued Pension Liability	 <u>1,096</u>	 <u>1,149</u>	 <u>1,100</u>
 Accrued Retiree Medical Benefits	 <u>217</u>	 <u>203</u>	 <u>34</u>
 Other	 <u>622</u>	 <u>630</u>	 <u>579</u>
 Commitments and Contingencies			

Stockholders' Equity:

Preferred Stock - \$.01 par, 10,000,000 shares authorized; one share of Series B issued and outstanding, stated at par value	-	-	-
Class B common stock - \$.01 par, 400,000,000, 400,000,000 and 200,000,000 shares authorized;	1	1	1
96,528,423, 91,816,121 and 112,704,030 issued			
Additional paid-in capital	1,557	1,370	1,660
Retained earnings (accumulated deficit)	11	(11)	340
Accumulated other comprehensive loss	(986)	(1,013)	(640)
Treasury stock - 0, 0 and 25,489,413 shares, at cost	<u>-</u>	<u>-</u>	<u>(1,141)</u>
Total stockholders' equity	<u>583</u>	<u>347</u>	<u>220</u>
Total Liabilities and Stockholders' Equity	<u>\$11,758</u>	<u>\$ 11,308</u>	<u>\$ 10,925</u>

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)

	<u>Three Months Ended March 31,</u>	
	<u>2007</u>	<u>2006</u>
	(Unaudited)	
Net Cash Provided by Operations	\$ <u>299</u>	\$ <u>387</u>
Cash Flows from Investing Activities:		
Capital expenditures	(78)	(68)
Purchase deposits paid in connection with future aircraft deliveries, net	(31)	(113)
Decrease (increase) in restricted cash, net	65	(4)
Proceeds from sale of ExpressJet Holdings shares, net	35	-
Sale of short-term investments, net	4	29
Proceeds from dispositions of property and equipment	<u>1</u>	<u>2</u>

Net cash used in investing activities	<u>(4</u>	<u>(154</u>
))
Cash Flows from Financing Activities:		
Payments on long-term debt and capital lease obligations	(166)	(178)
Proceeds from issuance of long-term debt	25	15
Proceeds from issuance of common stock pursuant to stock plans	<u>8</u>	<u>14</u>
Net cash used in financing activities	<u>(133</u>	<u>(149</u>
))
Net Increase in Cash and Cash Equivalents	162	84
Cash and Cash Equivalents - Beginning of Period	<u>2,123</u>	<u>1,723</u>
Cash and Cash Equivalents - End of Period	<u>\$2,285</u>	<u>\$1,807</u>
Investing and Financing Activities Not Affecting Cash:		
Common stock issued upon conversion of 4.5% Convertible Notes	\$ 170	\$ -
Property and equipment acquired through the issuance of debt	\$ 95	\$ -

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.

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, 2006 (the "2006 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 - RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENT

We adopted the Financial Accounting Standards Board's Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" ("FIN 48"), effective January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements and requires the impact of a tax position to be recognized in the financial statements if that position is more likely than not of being sustained by the taxing authority. The adoption of FIN 48 did not have a material effect on our consolidated financial position or results of operations.

NOTE 2 - EARNINGS (LOSS) PER SHARE

The following table sets forth the components of basic and diluted earnings (loss) per share for the three months ended March 31 (in millions):

	<u>2007</u>	<u>2006</u>
Numerator:		
Numerator for basic and diluted earnings (loss) per share - net income (loss)	\$ 22	\$(66)
Effect of dilutive securities - interest expense on 5.0% Convertible Notes	<u>1</u>	<u>-</u>
Numerator for diluted earnings (loss) per share - net income (loss) after assumed conversions	\$ <u>23</u>	\$ <u>(66)</u>
Denominator:		
Denominator for basic and diluted earnings (loss) per share - weighted average shares	95	87
Effect of dilutive securities:		
5.0% Convertible Notes	9	-

Employee stock options	<u>5</u>	<u>-</u>
Dilutive potential common shares	<u>14</u>	<u>-</u>
Denominator for diluted earnings (loss) per share - weighted-average shares after assumed conversions	<u>109</u>	<u>87</u>

The adjustments to net income to determine the numerator for diluted earnings per share for the three months ended March 31, 2007 are net of the related effect of profit sharing.

Approximately 6 million and 18 million potential common shares related to convertible debt securities were excluded from the computation of diluted earnings per share in the three months ended March 31, 2007 and 2006, respectively, because they were antidilutive. In addition, approximately 13 million weighted average options to purchase shares of our common stock were excluded from the computation of diluted loss per share for the three months ended March 31, 2006 because the options' exercise price was greater than the average market price of the common shares or the effect of including the options would have been antidilutive.

NOTE 3 - FLEET INFORMATION

As of March 31, 2007, we owned or leased 367 mainline jets and 274 regional jets. All mainline jets are operated exclusively by us. Of the 274 regional jets that we own or lease, 238 are leased or subleased to ExpressJet Airlines, Inc. ("ExpressJet") and operated on our behalf under a capacity purchase agreement with ExpressJet (the "ExpressJet CPA"). The remaining 36 regional aircraft are subleased to ExpressJet, but are not operated on our behalf and, accordingly, are not included in the operating fleet table below. Additionally, our regional operating fleet includes 26 regional aircraft owned or leased by third parties that are operated on our behalf by other operators under capacity purchase agreements. See Note 9 for a discussion of our regional capacity purchase agreements.

The following table summarizes our operating fleet (aircraft operated by us and by others on our behalf) as of March 31, 2007:

<u>Aircraft Type</u>	<u>Total</u>	<u>Owned</u>	<u>Leased</u>	Third-Party <u>Aircraft</u>
Mainline:				
777-200ER	19	7	12	
767-400ER	16	14	2	
767-200ER	10	9	1	
757-300	17	9	8	

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757-200	41	13	28	
737-900	12	8	4	
737-800	105	32	73	
737-700	36	12	24	
737-500	63	15	48	
737-300	<u>48</u>	<u>22</u>	<u>26</u>	
Total mainline	<u>367</u>	<u>141</u>	<u>226</u>	
Regional:				
ERJ-145XR	82	-	82	-
ERJ-145	130	18	108	4
ERJ-135	30	-	30	-
CRJ200LR	11	-	-	11
Q200	1	-	-	1
Beech1900	<u>10</u>	<u>-</u>	<u>-</u>	<u>10</u>
Total regional	<u>264</u>	<u>18</u>	<u>220</u>	<u>26</u>
Total	<u>631</u>	<u>159</u>	<u>446</u>	<u>26</u>

Fleet Activity. During the first quarter of 2007, we took delivery of, and placed into service, one new 777-200ER aircraft. Although we did not take delivery of any new regional aircraft, we began regional service with a third party who is operating 15 of their aircraft on our behalf. We also removed 34 regional aircraft from the ExpressJet CPA and we are now subleasing such aircraft to ExpressJet outside the scope of the ExpressJet CPA.

Firm Order and Option Aircraft. As of March 31, 2007, we had firm commitments for 86 new aircraft from Boeing (60 737 aircraft, one 777 aircraft and 25 787 aircraft), with an estimated aggregate cost of \$5.0 billion including related spare engines. Our final 777-200ER aircraft on order was delivered on April 16, 2007. We are scheduled to take delivery of the 85 firm order Boeing aircraft between 2008 and 2013. In addition to our firm order aircraft, we have options to purchase a total of 82 additional Boeing aircraft.

On April 10, 2007, we obtained financing for 30 of the next 39 Boeing 737 aircraft scheduled to be delivered in 2008 and the first quarter of 2009. The aircraft financed will be 12 737-800s and 18 737-900ERs. Pass-through trusts raised \$1.1 billion through the issuance of three classes of pass-through certificates. Class A certificates, with an aggregate principal amount of \$757 million, bear interest at 5.983%, Class B certificates, with an aggregate principal amount of \$222 million, bear interest at 6.903% and Class C certificates, with an aggregate principal amount of \$168 million, bear interest at 7.339%. The proceeds from the sale of the certificates will be held in escrow by the trusts and not reported as debt on our consolidated balance sheet. As we take delivery of each aircraft, we will issue equipment notes to the trusts, which will purchase such notes with a portion of the escrowed funds. We will use the proceeds to finance

the purchase of the aircraft and will record the principal amount of the equipment notes that we issue as debt on our consolidated balance sheet. Principal payments on the equipment notes and the corresponding distribution of these payments to certificate holders will begin in April 2010 and will end in April 2022 for Class A and B certificates and April 2014 for Class C certificates. Additionally, the Class A and B certificates have the benefit of a liquidity facility under which a third party agrees to make three semiannual interest payments on the certificates if a payment default occurs.

Our final 777-200ER aircraft on order was delivered on April 16, 2007 and was financed under existing finance agreements, discussed in Note 4 below. We have manufacturer backstop financing for up to 24 (depending on the model selected) of the 30 737 aircraft scheduled to be delivered in 2009. However, we do not have backstop financing or any other financing currently in place for the remaining six 737 aircraft on order, nor do we have backstop financing or any other financing for the 25 787 aircraft on order. Further financing will be needed to satisfy our capital commitments for our firm aircraft and other related capital expenditures. We can provide no assurance that sufficient financing will be available for our capital requirements other than the financing commitments we currently have in effect.

NOTE 4 - LONG-TERM DEBT

In January 2007, \$170 million in principal amount of our 4.5% Convertible Notes due on February 1, 2007 was converted by the holders into 4.3 million shares of our Class B common stock at a conversion price of \$40 per share. The remaining \$30 million in principal amount was paid on February 1, 2007.

During the first quarter of 2007, we incurred \$95 million of floating rate indebtedness pursuant to existing finance agreements secured by one 777-200ER aircraft that was delivered in March 2007. This indebtedness consists of \$78 million of senior notes due in 2019 and \$17 million of junior notes due in 2014. The loans bear interest at the London Interbank Offered Rate ("LIBOR") plus a blended margin of approximately 1.9% per year. On April 16, 2007, we incurred pursuant to the same finance agreements an additional \$95 million of floating rate indebtedness secured by our final 777-200ER aircraft on order, which was delivered on that day. This indebtedness has terms identical to that discussed above. The commitments under the finance agreements are now fully funded.

NOTE 5 - STOCK PLANS AND AWARDS

Profit Based RSU Awards

. During the first quarter of 2007, we issued 0.6 million profit based restricted stock unit ("RSU") awards pursuant to our Long-Term Incentive and RSU Program, which can result in cash payments to our officers upon the achievement of specified profit based performance targets. The performance targets require that we reach target levels of cumulative employee profit sharing under our enhanced employee profit sharing program during the period from January 1, 2007 through December 31, 2009, and that we have net income calculated in accordance with U.S. generally accepted accounting principles for the applicable fiscal year. To serve as a retention feature, payments related to the achievement of a performance target will generally be made in one-third annual increments to participants who remain continuously employed by us through each payment date. Payments also are conditioned on our having a minimum unrestricted cash, cash equivalents and short-term investments balance of \$2.0 billion at the end of the fiscal year preceding the date any payment is made. If we do not achieve the cash target applicable to a payment date, the payment will be deferred until the next payment date (March 31 of the next year), subject to a limit on the number of years payments may be carried for