

DELTA AIR LINES INC /DE/

Form 10-Q

October 13, 2016

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

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

**For the quarterly period ended September 30, 2016**

**Or**

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

**Commission File Number 001-5424**

**DELTA AIR LINES, INC.**

(Exact name of registrant as specified in its charter)

**State of Incorporation: Delaware**

**I.R.S. Employer Identification No.: 58-0218548**

**Post Office Box 20706, Atlanta, Georgia 30320-6001**

**Telephone: (404) 715-2600**

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  No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  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. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a 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

Number of shares outstanding by each class of common stock, as of September 30, 2016:

Common Stock, \$0.0001 par value - 736,384,650 shares outstanding

This document is also available through our website at <http://ir.delta.com/>.

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Unless otherwise indicated, the terms “Delta,” “we,” “us” and “our” refer to Delta Air Lines, Inc. and its subsidiaries.

## **FORWARD-LOOKING STATEMENTS**

Statements in this Form 10-Q (or otherwise made by us or on our behalf) that are not historical facts, including statements about our estimates, expectations, beliefs, intentions, projections or strategies for the future, may be “forward-looking statements” as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from historical experience or our present expectations. Known material risk factors applicable to Delta are described in “Item 1A. Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 (“Form 10-K”) and in “Part II, Item 1A. Risk Factors” of our Form 10-Q for the quarterly period ended June 30, 2016, other than risks that could apply to any issuer or offering. All forward-looking statements speak only as of the date made, and we undertake no obligation to publicly update or revise any forward-looking statements to reflect events or circumstances that may arise after the date of this report.

**REVIEW REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of  
Delta Air Lines, Inc.

We have reviewed the consolidated balance sheet of Delta Air Lines, Inc. (the Company) as of September 30, 2016, and the related condensed consolidated statements of operations and comprehensive income for the three-month and nine-month periods ended September 30, 2016 and 2015 and condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2016 and 2015. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Delta Air Lines, Inc. as of December 31, 2015 and the related consolidated statements of operations, comprehensive income, cash flows and stockholders' equity for the year then ended (not presented herein) and we expressed an unqualified audit opinion on those consolidated financial statements in our report dated February 5, 2016.

/s/ Ernst & Young LLP

Atlanta, Georgia  
October 13, 2016



**DELTA AIR LINES, INC.**  
**Consolidated Balance Sheets**  
**(Unaudited)**

| (in millions, except share data)   | September 30,<br>2016 | December 31,<br>2015 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>  |                       |                      |
| <b>Current Assets:</b>   |                       |                      |
| Cash and cash equivalents  | \$ 1,638              | \$ 1,972             |
| Short-term investments   | 1,514                 | 1,465                |
| Accounts receivable, net of an allowance for uncollectible accounts of \$13 and \$9 at September 30, 2016 and December 31, 2015, respectively                            | 1,996                 | 2,020                |
| Fuel inventory   | 424                   | 379                  |
| Expendable parts and supplies inventories, net of an allowance for obsolescence of \$108 and \$114 at September 30, 2016 and December 31, 2015, respectively             | 351                   | 318                  |
| Hedge derivatives asset  | 496                   | 1,987                |
| Prepaid expenses and other   | 910                   | 915                  |
| Total current assets   | 7,329                 | 9,056                |
| <b>Property and Equipment, Net:</b>  |                       |                      |
| Property and equipment, net of accumulated depreciation and amortization of \$12,106 and \$10,871 at September 30, 2016 and December 31, 2015, respectively              | 24,105                | 23,039               |
| <b>Other Assets:</b>   |                       |                      |
| Goodwill   | 9,794                 | 9,794                |
| Identifiable intangibles, net of accumulated amortization of \$824 and \$811 at September 30, 2016 and December 31, 2015, respectively                                   | 4,848                 | 4,861                |
| Deferred income taxes, net   | 3,150                 | 4,956                |
| Other noncurrent assets  | 1,722                 | 1,428                |
| Total other assets   | 19,514                | 21,039               |
| Total assets   | \$ 50,948             | \$ 53,134            |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                       |                      |
| <b>Current Liabilities:</b>  |                       |                      |
| Current maturities of long-term debt and capital leases  | \$ 1,092              | \$ 1,563             |
| Air traffic liability  | 5,142                 | 4,503                |
| Accounts payable   | 2,567                 | 2,743                |
| Accrued salaries and related benefits  | 2,628                 | 3,195                |
| Hedge derivatives liability  | 724                   | 2,581                |
| Frequent flyer deferred revenue  | 1,628                 | 1,635                |
| Other accrued liabilities  | 1,366                 | 1,306                |
| Total current liabilities  | 15,147                | 17,526               |
| <b>Noncurrent Liabilities:</b>   |                       |                      |
| Long-term debt and capital leases  | 6,473                 | 6,766                |
| Pension, postretirement and related benefits   | 12,587                | 13,855               |
| Frequent flyer deferred revenue  | 2,275                 | 2,246                |
| Other noncurrent liabilities   | 1,956                 | 1,891                |
| Total noncurrent liabilities   | 23,291                | 24,758               |
| <b>Commitments and Contingencies</b>   |                       |                      |
| <b>Stockholders' Equity:</b>   |                       |                      |
| Common stock at \$0.0001 par value; 1,500,000,000 shares authorized, 750,515,601 and 799,850,675 shares issued at September 30, 2016 and December 31, 2015, respectively | —                     | —                    |
| Additional paid-in capital   | 8,887                 | 10,875               |
| Retained earnings  | 11,109                | 7,623                |
| Accumulated other comprehensive loss   | (7,212)               | (7,275)              |
| Treasury stock, at cost, 14,130,951 and 21,066,684 shares at September 30, 2016 and December 31, 2015, respectively  | (274)                 | (373)                |

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|  |           |           |
|--|-----------|-----------|
| Total stockholders' equity                 | 12,510    | 10,850    |
| Total liabilities and stockholders' equity | \$ 50,948 | \$ 53,134 |

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

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**DELTA AIR LINES, INC.**  
**Condensed Consolidated Statements of Operations and Comprehensive Income**  
**(Unaudited)**

| (in millions, except per share data)               | Three Months Ended September 30, |          | Nine Months Ended September 30, |           |
|--|----------------------------------|----------|---------------------------------|-----------|
|  | 2016                             | 2015     | 2016                            | 2015      |
| <b>Operating Revenue:</b>                          |                                  |          |                                 |           |
| Passenger:   |                                  |          |                                 |           |
| Mainline   | \$ 7,615                         | \$ 8,059 | \$ 21,530                       | \$ 22,195 |
| Regional carriers                                  | 1,456                            | 1,536    | 4,273                           | 4,462     |
| Total passenger revenue                            | 9,071                            | 9,595    | 25,803                          | 26,657    |
| Cargo  | 167                              | 196      | 494                             | 620       |
| Other  | 1,245                            | 1,316    | 3,884                           | 3,925     |
| Total operating revenue                            | 10,483                           | 11,107   | 30,181                          | 31,202    |
| <b>Operating Expense:</b>                          |                                  |          |                                 |           |
| Salaries and related costs                         | 2,463                            | 2,276    | 7,165                           | 6,563     |
| Aircraft fuel and related taxes                    | 1,422                            | 1,819    | 3,877                           | 5,111     |
| Regional carriers expense                          | 1,119                            | 1,073    | 3,221                           | 3,223     |
| Contracted services                                | 520                              | 477      | 1,480                           | 1,375     |
| Depreciation and amortization                      | 474                              | 466      | 1,430                           | 1,384     |
| Aircraft maintenance materials and outside repairs | 462                              | 479      | 1,357                           | 1,430     |
| Passenger commissions and other selling expenses   | 466                              | 463      | 1,291                           | 1,270     |
| Landing fees and other rents                       | 399                              | 403      | 1,123                           | 1,164     |
| Profit sharing                                     | 326                              | 563      | 922                             | 1,110     |
| Passenger service                                  | 264                              | 247      | 674                             | 664       |
| Aircraft rent                                      | 72                               | 63       | 204                             | 183       |
| Other  | 527                              | 565      | 1,505                           | 1,640     |
| Total operating expense                            | 8,514                            | 8,894    | 24,249                          | 25,117    |
| <b>Operating Income</b>                            | 1,969                            | 2,213    | 5,932                           | 6,085     |
| <b>Non-Operating Expense:</b>                      |                                  |          |                                 |           |
| Interest expense, net                              | (95 )                            | (121 )   | (295 )                          | (379 )    |
| Miscellaneous, net                                 | 26                               | (20 )    | 47                              | (82 )     |
| Total non-operating expense, net                   | (69 )                            | (141 )   | (248 )                          | (461 )    |
| <b>Income Before Income Taxes</b>                  | 1,900                            | 2,072    | 5,684                           | 5,624     |
| <b>Income Tax Provision</b>                        | (641 )                           | (757 )   | (1,933 )                        | (2,078 )  |
| <b>Net Income</b>                                  | \$ 1,259                         | \$ 1,315 | \$ 3,751                        | \$ 3,546  |
| <b>Basic Earnings Per Share</b>                    | \$ 1.70                          | \$ 1.67  | \$ 4.95                         | \$ 4.42   |
| <b>Diluted Earnings Per Share</b>                  | \$ 1.69                          | \$ 1.65  | \$ 4.92                         | \$ 4.37   |
| <b>Cash Dividends Declared Per Share</b>           | \$ 0.2025                        | \$ 0.135 | \$ 0.4725                       | \$ 0.315  |
| <b>Comprehensive Income</b>                        | \$ 1,326                         | \$ 1,287 | \$ 3,814                        | \$ 3,541  |

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

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**DELTA AIR LINES, INC.**  
**Condensed Consolidated Statements of Cash Flows**  
**(Unaudited)**

| (in millions)   | <b>Nine Months<br/>Ended<br/>September 30,</b> |             |
|---|--|-------------|
|   | <b>2016</b>                                    | <b>2015</b> |
| <b>Net Cash Provided by Operating Activities</b>                          | \$6,080  | \$6,448     |
| <b>Cash Flows from Investing Activities:</b>                              |  |             |
| Property and equipment additions:   |  |             |
| Flight equipment, including advance payments                              | (2,149 )                                       | (1,583 )    |
| Ground property and equipment, including technology                       | (448 )   | (484 )      |
| Purchase of equity investments  | —  | (500 )      |
| Purchase of short-term investments  | (1,480 )                                       | (740 )      |
| Redemption of short-term investments                                      | 1,436  | 510         |
| Other, net  | 41   | 21          |
| Net cash used in investing activities                                     | (2,600 )                                       | (2,776 )    |
| <b>Cash Flows from Financing Activities:</b>                              |  |             |
| Payments on long-term debt and capital lease obligations                  | (1,403 )                                       | (2,151 )    |
| Repurchase of common stock  | (2,301 )                                       | (1,775 )    |
| Cash dividends  | (360 )   | (254 )      |
| Fuel card obligation  | (14 )  | (343 )      |
| Payments on hedge derivative contracts                                    | (401 )   | (17 )       |
| Proceeds from hedge derivative contracts                                  | 166  | 145         |
| Proceeds from short-term obligations                                      | 68   | —           |
| Proceeds from long-term obligations                                       | 450  | 1,038       |
| Other, net  | (19 )  | (34 )       |
| Net cash used in financing activities                                     | (3,814 )                                       | (3,391 )    |
| <b>Net (Decrease) Increase in Cash and Cash Equivalents</b>               | <b>(334 )</b>                                  | <b>281</b>  |
| Cash and cash equivalents at beginning of period                          | 1,972  | 2,088       |
| Cash and cash equivalents at end of period                                | \$1,638  | \$2,369     |
| <b>Non-Cash Transactions:</b>   |  |             |
| Treasury stock contributed to our qualified defined benefit pension plans | \$350  | \$—         |
| Flight equipment acquired under capital leases                            | 55   | 104         |

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

**DELTA AIR LINES, INC.**

**Notes to the Condensed Consolidated Financial Statements**

**(Unaudited)**

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Basis of Presentation***

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of Delta Air Lines, Inc. and our wholly owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information. Consistent with these requirements, this Form 10-Q does not include all the information required by GAAP for complete financial statements. As a result, this Form 10-Q should be read in conjunction with the Consolidated Financial Statements and accompanying Notes in our Form 10-K for the year ended December 31, 2015.

Management believes the accompanying unaudited Condensed Consolidated Financial Statements reflect all adjustments, including normal recurring items, considered necessary for a fair statement of results for the interim periods presented.

Due to seasonal variations in the demand for air travel, the volatility of aircraft fuel prices and other factors, operating results for the three and nine months ended September 30, 2016 are not necessarily indicative of operating results for the entire year.

We reclassified certain prior period amounts to conform to the current period presentation. Unless otherwise noted, all amounts disclosed are stated before consideration of income taxes.

***Recent Accounting Standards***

***Revenue from Contracts with Customers***

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." Under this ASU and subsequently issued amendments, revenue is recognized at the time a good or service is transferred to a customer for the amount of consideration received. Entities may use a full retrospective approach or report the cumulative effect as of the date of adoption. The standard is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption of the standard is permitted, but not before December 15, 2016. We are currently evaluating how the adoption of the revenue recognition standard will impact our Consolidated Financial Statements.

***Leases***

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." This standard will require all leases with durations greater than twelve months to be recognized on the balance sheet and is effective for interim and annual reporting periods beginning after December 15, 2018, although early adoption is permitted.

Although we have not completed our assessment, we believe adoption of this standard will have a significant impact on our Consolidated Balance Sheets. However, we do not expect the adoption to change the recognition, measurement or presentation of lease expenses within the Consolidated Statements of Operations or the Consolidated Statements of Cash Flows. Information about our undiscounted future lease payments and the timing of those payments is in Note 7, "Lease Obligations," in our Form 10-K.

*Equity Method Investments*

In March 2016, the FASB issued ASU No. 2016-07, "Investments—Equity Method and Joint Ventures (Topic 323)." This standard eliminates the requirement that when an existing cost method investment qualifies for use of the equity method, an investor must restate its historical financial statements, as if the equity method had been used since the investment was acquired. Under the new guidance, at the point an investment qualifies for the equity method, any unrealized gain or loss in accumulated other comprehensive income/(loss) ("AOCI") will be recognized through earnings.

We early adopted this standard during the March 2016 quarter. Although none of our available-for-sale or cost investments qualified for use of the equity method during 2016, we expect the tender offer for additional capital stock of Grupo Aeroméxico to be completed in the next six months, at which point our investment will qualify for the equity method of accounting. As of September 30, 2016, the unrealized gain recorded in AOCI related to our investment in Grupo Aeroméxico was \$4 million.

### *Share-Based Compensation*

In March 2016, the FASB issued ASU No. 2016-09, "Compensation—Stock Compensation (Topic 718)." This standard makes several modifications to Topic 718 related to the accounting for forfeitures, employer tax withholding on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. ASU 2016-09 also clarifies the statement of cash flows presentation for certain components of share-based awards.

We early adopted this standard during the June 2016 quarter. The adoption of this standard resulted in the recognition of \$95 million of previously unrecognized excess tax benefits in deferred income taxes, net and an increase to retained earnings on our Consolidated Balance Sheet as of the beginning of the current year and the recognition of \$31 million of excess tax benefits to our income tax provision for the nine months ended September 30, 2016.

## **NOTE 2. FAIR VALUE MEASUREMENTS**

### *Assets (Liabilities) Measured at Fair Value on a Recurring Basis*

| (in millions)                               | September 30,<br>2016 | Level 1 | Level<br>2 |
|---|-----------------------|---------|------------|
| Cash equivalents                            | \$ 1,080              | \$1,080 | \$ —       |
| Short-term investments                      |                       |         |            |
| U.S. government and agency securities       | 250                   | 170     | 80         |
| Asset- and mortgage-backed securities       | 265                   | —       | 265        |
| Corporate obligations                       | 880                   | —       | 880        |
| Other fixed income securities               | 119                   | —       | 119        |
| Restricted cash equivalents and investments | 69                    | 69      | —          |
| Long-term investments                       | 161                   | 135     | 26         |
| Hedge derivatives, net                      |                       |         |            |
| Fuel hedge contracts                        | (271                  | ) (4    | )(267      |
| Interest rate contract                      | 8                     | —       | 8          |
| Foreign currency exchange contracts         | (64                   | ) —     | (64)       |
| (in millions)                               | December 31,<br>2015  | Level 1 | Level<br>2 |
| Cash equivalents                            | \$ 1,543              | \$1,543 | \$ —       |
| Short-term investments                      |                       |         |            |
| U.S. government and agency securities       | 151                   | 74      | 77         |
| Asset- and mortgage-backed securities       | 380                   | —       | 380        |
| Corporate obligations                       | 896                   | —       | 896        |
| Other fixed income securities               | 38                    | —       | 38         |
| Restricted cash equivalents and investments | 49                    | 49      | —          |
| Long-term investments                       | 155                   | 130     | 25         |
| Hedge derivatives, net                      |                       |         |            |
| Fuel hedge contracts                        | (672                  | ) 65    | (737       |
| Interest rate contract                      | (3                    | ) —     | (3 )       |
| Foreign currency exchange contracts         | 94                    | —       | 94         |





*Cash Equivalents and Restricted Cash Equivalents and Investments.* Cash equivalents generally consist of money market funds. Restricted cash equivalents and investments generally consist of money market funds and time deposits, which relate to certain self-insurance obligations and facility lease commitments. The fair value of these investments is based on a market approach using prices and other relevant information generated by market transactions involving identical or comparable assets.

*Short-Term Investments.* The fair values of short-term investments are based on a market approach using industry standard valuation techniques that incorporate observable inputs such as quoted market prices, interest rates, benchmark curves, credit ratings of the security and other observable information.

*Long-Term Investments.* Our long-term investments that are measured at fair value primarily consist of equity investments in Grupo Aeroméxico, the parent company of Aeroméxico, and GOL Linhas Aéreas Inteligentes, the parent company of VRG Linhas Aéreas (operating as GOL). Shares of the parent companies of Aeroméxico and GOL are traded on public exchanges and have been valued based on quoted market prices. The investments are classified in other noncurrent assets.

*Hedge Derivatives.* A portion of our derivative contracts are negotiated over-the-counter with counterparties without going through a public exchange. Accordingly, our fair value assessments give consideration to the risk of counterparty default (as well as our own credit risk). Such contracts are classified as Level 2 within the fair value hierarchy. The remainder of our hedge contracts are comprised of futures contracts, which are traded on a public exchange. These contracts are classified within Level 1 of the fair value hierarchy.

*Fuel Contracts.* Our fuel hedge portfolio consists of options, swaps and futures. The hedge contracts include crude oil, diesel fuel and jet fuel, as these commodities are highly correlated with the price of jet fuel that we consume. Option contracts are valued under an income approach using option pricing models based on data either readily observable in public markets, derived from public markets or provided by counterparties who regularly trade in public markets. Volatilities used in these valuations ranged from 21% to 46% depending on the maturity dates, underlying commodities and strike prices of the option contracts. Swap contracts are valued under an income approach using a discounted cash flow model based on data either readily observable or provided by counterparties who regularly trade in public markets. Discount rates used in these valuations vary with the maturity dates of the respective contracts and are based on the London interbank offered rate ("LIBOR"). Futures contracts and options on futures contracts are traded on a public exchange and valued based on quoted market prices.

*Interest Rate Contract.* Our interest rate derivative is a swap contract, which is valued based on data readily observable in public markets.

*Foreign Currency Exchange Contracts.* Our foreign currency derivatives consist of Japanese yen and Canadian dollar forward contracts and are valued based on data readily observable in public markets.

### **NOTE 3. INVESTMENTS**

#### ***Short-Term Investments***

The estimated fair values of short-term investments, which approximate cost at September 30, 2016, are shown below by contractual maturity. Actual maturities may differ from contractual maturities because issuers of the securities may have the right to retire our investments without prepayment penalties. Investments with maturities beyond one year when purchased may be classified as short-term investments if they are expected to be available to support our short-term liquidity needs.

(in Available-For-Sale millions)

Due  
in  
one  
\$ 341  
year  
or  
less  
Due  
after  
one  
~~940~~  
through  
three  
years  
Due  
after  
three  
~~160~~  
through  
five  
years  
Due  
after  
~~64~~  
five  
years  
Total \$ 514

### ***Long-Term Investments***

We have developed strategic relationships with certain international airlines through equity investments or other forms of cooperation and support. Strategic relationships improve our coordination with these airlines and enable our customers to seamlessly connect to more places while enjoying a consistent, high-quality travel experience.

*Aeroméxico.* We own 4.2% of the outstanding shares of Grupo Aeroméxico, and we have derivative contracts that may be settled for shares of Grupo Aeroméxico, including one obtained in the September 2016 quarter. Our total derivative contract holdings represent 12.9% of Grupo Aeroméxico's shares. During 2015, we announced our intention to acquire additional shares of the capital stock of Grupo Aeroméxico through a cash tender offer, subject to regulatory approvals. If approved, the tender offer is expected to be completed in the next six months. As a result of this tender offer, when combined with our current holdings, we would own up to 49% of the outstanding capital stock of Grupo Aeroméxico. Based on current exchange rates, the total amount to be paid for the additional shares and the shares underlying the derivatives would be approximately \$710 million.

*GOL.* During 2015, we acquired preferred shares of GOL's parent company, increasing our ownership to 9.5% of GOL's outstanding capital stock. Additionally, GOL entered into a \$300 million five-year term loan facility with third parties, which we have guaranteed. Our entire guaranty is secured by GOL's ownership interest in Smiles, GOL's publicly traded loyalty program. Because GOL remains in compliance with the terms of its loan facility, we have not recorded a liability on our Consolidated Balance Sheet as of September 30, 2016.

Challenges in the Brazilian economy and GOL's recent financial performance have caused the fair value of our equity investment in GOL's parent company to decline to \$64 million with a \$42 million loss recorded in AOCI at September 30, 2016. The loss recorded in AOCI as of December 31, 2015 was \$84 million. As GOL's shares have traded below our cost basis for longer than a year, we evaluated whether the investment was other-than-temporarily impaired. We determined the investment was not impaired as GOL's management is executing measures to maximize operational and network efficiency and control costs, which we anticipate will improve GOL's financial performance and the fair value of our investment. The market price of GOL's shares has more than doubled since December 31, 2015. In addition, we currently have the intent and ability to maintain our investment in GOL to allow for the recovery of its market value as GOL is a strategic investment for us and operates as an extension of our global network.

*China Eastern.* During 2015, we acquired shares of China Eastern, which provide us with a 3.2% stake in the airline. In conjunction with this transaction, we and China Eastern entered into a new commercial agreement to expand our relationship and better connect the networks of the two airlines. As the investment agreement restricts our sale or transfer of these shares for a period of three years after acquisition, we are accounting for the investment at cost during this period. Although China Eastern shares are actively traded on a public exchange, it is not practicable to estimate the fair value of the investment due to the restriction on our ability to sell or transfer the shares.

We have, however, evaluated whether the decline in the value of China Eastern's shares would impair our investment. We considered the recent conditions and outlook for both China Eastern and the broader Chinese economy, as well as the nature of our investment in China Eastern. We determined that the investment was not impaired as the share price decline primarily results from declines in the broader Chinese equity markets and is not specific to China Eastern's financial performance. In addition, we have the intent and ability to maintain our investment in China Eastern to allow for the recovery of its market value as China Eastern is a strategic investment for us and operates as an extension of our global network.

### **NOTE 4. DERIVATIVES**

Changes in aircraft fuel prices, interest rates and foreign currency exchange rates impact our results of operations. In an effort to manage our exposure to these risks, we enter into derivative contracts and adjust our derivative portfolio as market conditions change.

***Aircraft Fuel Price Risk***

Changes in aircraft fuel prices materially impact our results of operations. We have historically managed our fuel price risk through a hedging program intended to reduce the financial impact from changes in the price of jet fuel as jet fuel prices are subject to potential volatility.

In response to this volatility, during the March 2015 quarter, we entered into transactions that effectively deferred settlement of a portion of our hedge portfolio. These deferral transactions, excluding market movements from the date of inception, provided approximately \$300 million in cash receipts during the second half of 2015 and require approximately \$300 million in cash payments in 2016. We early terminated certain of the March 2015 quarter deferral transactions in the second half of 2015.

During the March 2016 quarter, we entered into transactions to further defer settlement of a portion of our hedge portfolio until 2017. These deferral transactions, excluding market movements from the date of inception, would provide approximately \$300 million in cash receipts during the second half of 2016 and require approximately \$300 million in cash payments in 2017.

Subsequently, to better participate in the low fuel price environment, we entered into derivatives designed to offset and effectively neutralize our existing airline segment hedge positions, which include the deferral transactions discussed above. As a result, we locked in the amount of the net hedge settlements for the remainder of 2016 and 2017. During the June 2016 quarter, we early settled \$455 million of our airline segment's 2016 positions.

During the three and nine months ended September 30, 2016, we recorded fuel hedge losses of \$11 million and \$326 million, respectively. During the three and nine months ended September 30, 2015, we recorded fuel hedge losses of \$250 million and \$563 million, respectively.

Cash flows associated with the deferral transactions are reported as cash flows from financing activities within our Condensed Consolidated Statements of Cash Flows.

### *Hedge Position as of September 30, 2016*

| (in millions)                             | Volume                                       | Final Maturity Date | Hedge Derivatives Asset | Other Noncurrent Assets | Hedge Derivatives Liability | Other Noncurrent Liabilities | Hedge Derivatives net |
|---|--|---------------------|-------------------------|-------------------------|-----------------------------|------------------------------|-----------------------|
| <i>Designated as hedges</i>               |  |                     |                         |                         |                             |                              |                       |
| Interest rate contract (fair value hedge) | 349 U.S. dollars                             | August 2022         | \$ 3                    | \$ 5                    | \$ —                        | \$ —                         | \$ 8                  |
| Foreign currency exchange contracts       | 60,509 Japanese yen<br>396 Canadian dollars  | February 2019       | 10                      | 2                       | (44)                        | (32)                         | (64)                  |
| <i>Not designated as hedges</i>           |  |                     |                         |                         |                             |                              |                       |
| Fuel hedge contracts <sup>(1)</sup>       | 179 gallons - crude oil, diesel and jet fuel | December 2017       | 483                     | 39                      | (680)                       | (113)                        | (271)                 |
| Total derivative contracts                |  |                     | \$ 496                  | \$ 46                   | \$ (724)                    | \$ (145)                     | \$ (327)              |

As discussed above, we have early settled \$455 million of our airline segment's 2016 hedge positions and entered into hedges designed to offset and effectively terminate our 2017 airline segment hedge positions. The dollar amounts shown above primarily represent the offsetting derivatives that were used to neutralize the 2016 and 2017 airline segment hedge portfolio.

### *Hedge Position as of December 31, 2015*

| (in millions)                             | Volume                                       | Final Maturity Date | Hedge Derivatives Asset | Other Noncurrent Assets | Hedge Derivatives Liability | Other Noncurrent Liabilities | Hedge Derivatives net |
|---|--|---------------------|-------------------------|-------------------------|-----------------------------|------------------------------|-----------------------|
| <i>Designated as hedges</i>               |  |                     |                         |                         |                             |                              |                       |
| Interest rate contract (fair value hedge) | 384 U.S. dollars                             | August 2022         | \$ 4                    | \$ —                    | \$ —                        | \$ (7)                       | \$ (3)                |
| Foreign currency exchange contracts       | 46,920 Japanese yen<br>395 Canadian dollars  | July 2018           | 76                      | 20                      | (1)                         | (1)                          | 94                    |
| <i>Not designated as hedges</i>           |  |                     |                         |                         |                             |                              |                       |
| Fuel hedge contracts                      | 887 gallons - crude oil, diesel and jet fuel | November 2017       | 1,907                   | 4                       | (2,580)                     | (3)                          | (672)                 |
| Total derivative contracts                |  |                     | \$ 1,987                | \$ 24                   | \$ (2,581)                  | \$ (11)                      | \$ (581)              |



**Offsetting Assets and Liabilities**

We have master netting arrangements with our counterparties giving us the right to offset hedge assets and liabilities. However, we have elected not to offset the fair value positions recorded on our Consolidated Balance Sheets. The following table shows the net fair value positions by counterparty had we elected to offset.

| (in millions)             | Hedge<br>Derivatives<br>Asset | Other<br>Noncurrent<br>Assets | Hedge<br>Derivatives<br>Liability | Other<br>Noncurrent<br>Liabilities | Hedge<br>Derivatives,<br>net |
|---------------------------|-------------------------------|-------------------------------|-----------------------------------|------------------------------------|------------------------------|
| <b>September 30, 2016</b> |                               |                               |                                   |                                    |                              |
| Net derivative contracts  | \$ 10                         | \$ 7                          | \$ (238 )                         | \$ (106 )                          | \$ (327 )                    |
| <b>December 31, 2015</b>  |                               |                               |                                   |                                    |                              |
| Net derivative contracts  | \$ 143                        | \$ 21                         | \$ (737 )                         | \$ (8 )                            | \$ (581 )                    |

**Designated Hedge Gains (Losses)**

Gains (losses) related to our designated hedge contracts are as follows:

| (in millions)                           | Effective<br>Portion<br>Reclassified<br>from AOCI<br>to Earnings<br>2016 | Effective<br>Portion<br>Recognized in<br>Other<br>Comprehensive<br>Income<br>2015 | Effective<br>Portion<br>Recognized in<br>Other<br>Comprehensive<br>Income<br>2016 | Effective<br>Portion<br>Recognized in<br>Other<br>Comprehensive<br>Income<br>2015 |
|---|--|---|---|---|
| <b>Three Months Ended September 30,</b> |  |   |   |   |
| Foreign currency exchange contracts     | \$(2 )   | \$69  | \$(2 )  | \$(53 )   |
| <b>Nine Months Ended September 30,</b>  |  |   |   |   |
| Foreign currency exchange contracts     | \$34   | \$161   | \$(147)   | \$(105)   |

As of September 30, 2016, we have recorded \$24 million of losses on cash flow hedge contracts in AOCI, which are scheduled to settle and be reclassified into earnings within the next 12 months.

**Credit Risk**

To manage credit risk associated with our aircraft fuel price, interest rate and foreign currency hedging programs, we evaluate counterparties based on several criteria including their credit ratings and limit our exposure to any one counterparty.

Our hedge contracts contain margin funding requirements. The margin funding requirements may cause us to post margin to counterparties or may cause counterparties to post margin to us as market prices in the underlying hedged items change. Due to the fair value position of our hedge contracts, we posted margin of \$20 million and \$119 million as of September 30, 2016 and December 31, 2015, respectively.

**NOTE 5. LONG-TERM DEBT****Fair Value of Debt**

Market risk associated with our fixed- and variable-rate long-term debt relates to the potential reduction in fair value and negative impact to future earnings, respectively, from an increase in interest rates. The fair value of debt, shown below, is principally based on reported market values, recently completed market transactions and estimates based on interest rates, maturities, credit risk and underlying collateral. Long-term debt is primarily classified as Level 2 within the fair value hierarchy.



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| (in millions)                                 | September 30, December 31, |          |
|---|----------------------------|----------|
|   | 2016                       | 2015     |
| Total debt at par value                       | \$ 7,402                   | \$ 8,098 |
| Unamortized discount and debt issue cost, net | (110 )                     | (152 )   |
| Net carrying amount                           | \$ 7,292                   | \$ 7,946 |
| Fair value                                    | \$ 7,700                   | \$ 8,400 |

***Aircraft Financings***

During the March 2016 quarter, we entered into financing arrangements to borrow \$450 million, which are secured by 26 aircraft. These loans bear interest at a variable rate equal to LIBOR plus a specified margin and mature between 2019 and 2021.

***Covenants***

We were in compliance with the covenants in our financing agreements at September 30, 2016.

**NOTE 6. EMPLOYEE BENEFIT PLANS**

The following table shows the components of net periodic cost:

| (in millions)                           | Pension Benefits and |       | Other Postretirement Postemployment Benefits |       |
|---|----------------------|-------|--|-------|
|   | 2016                 | 2015  | 2016   | 2015  |
| <b>Three Months Ended September 30,</b> |                      |       |  |       |
| Service cost                            | \$—                  | \$—   | \$ 17  | \$ 16 |
| Interest cost                           | 229                  | 221   | 37   | 35    |
| Expected return on plan assets          | (226)                | (220) | (18)   | (20)  |
| Amortization of prior service credit    | —                    | —     | (7)  | (7)   |
| Recognized net actuarial loss           | 59                   | 61    | 6  | 6     |
| Net periodic cost                       | \$62                 | \$62  | \$ 35  | \$ 30 |
| <b>Nine Months Ended September 30,</b>  |                      |       |  |       |
| Service cost                            | \$—                  | \$—   | \$ 51  | \$ 48 |
| Interest cost                           | 687                  | 663   | 111  | 105   |
| Expected return on plan assets          | (678)                | (660) | (54)   | (60)  |
| Amortization of prior service credit    | —                    | —     | (21)   | (21)  |
| Recognized net actuarial loss           | 177                  | 177   | 18   | 18    |
| Net periodic cost                       | \$186                | \$180 | \$ 105                                       | \$ 90 |

**NOTE 7. COMMITMENTS AND CONTINGENCIES*****Aircraft Purchase and Lease Commitments***

Our future aircraft purchase commitments totaled approximately \$15.4 billion at September 30, 2016:

| (in millions)                         | Total    |
|---------------------------------------|----------|
| Three months ending December 31, 2016 | \$450    |
| 2017                                  | 2,690    |
| 2018                                  | 2,880    |
| 2019                                  | 3,380    |
| 2020                                  | 2,540    |
| Thereafter                            | 3,480    |
| Total                                 | \$15,420 |



Our future aircraft purchase commitments included the following aircraft at September 30, 2016:

| Aircraft Type | Purchase Commitments |
|---------------|----------------------|
| B-737-900ER   | 55                   |
| B-787-8       | 18                   |
| A321-200      | 71                   |
| A330-300      | 2                    |
| A330-900neo   | 25                   |
| A350-900      | 25                   |
| CS100         | 75                   |
| E190-100      | 8                    |
| Total         | 279                  |

We have obtained, but are under no obligation to use, long-term financing commitments for a substantial portion of the purchase price of a significant number of these aircraft. Our purchase commitment for the 18 B-787-8 aircraft provides for certain aircraft substitution rights, including for our current orders of B-737-900ER aircraft.

During the June 2016 quarter, we reached an agreement with Bombardier to acquire 75 CS100 aircraft with deliveries beginning in 2018 and continuing through 2022. We have flexibility under the purchase agreement with respect to deferral, acceleration, conversion and a limited number of cancellation rights. The agreement also includes options to purchase 50 additional aircraft. Following the CS100 purchase agreement, we entered into an agreement to sell the E190-100 fleet following their delivery to us.

Also during the June 2016 quarter, we entered into firm commitments with Airbus for the delivery of 37 additional A321-200 aircraft. Deliveries will begin in November 2017 and continue through 2019.

### ***Legal Contingencies***

We are involved in various legal proceedings related to employment practices, environmental issues, antitrust matters and other matters concerning our business. We record liabilities for losses from legal proceedings when we determine that it is probable that the outcome in a legal proceeding will be unfavorable and the amount of loss can be reasonably estimated. Although the outcome of the legal proceedings in which we are involved cannot be predicted with certainty, management believes that the resolution of these matters will not have a material effect on our Condensed Consolidated Financial Statements.

### ***Shuttle America***

Shuttle America and its parent, Republic Airways Holdings (collectively, Republic Airways), filed for bankruptcy in February 2016. In connection with agreements to settle litigation currently pending between Republic Airways and Delta, wind-down 50-seat aircraft operations, return to full capacity of contracted operations for Embraer 170/175 aircraft and lease certain takeoff and landing slots at New York-LaGuardia, we entered into a debtor-in-possession credit agreement to provide up to \$75 million in liquidity to Republic Airways. The debtor-in-possession credit agreement remained undrawn as of September 30, 2016. We do not believe that Republic Airways' bankruptcy filing will have a material effect on our operations or financial statements.

### ***Other Contingencies***

#### ***General Indemnifications***

We are the lessee under many commercial real estate leases. It is common in these transactions for us, as the lessee, to agree to indemnify the lessor and the lessor's related parties for tort, environmental and other liabilities that arise out of or relate to our use or occupancy of the leased premises. This type of indemnity would typically make us responsible to indemnified parties for liabilities arising out of the conduct of, among others, contractors, licensees and invitees at, or in connection with, the use or occupancy of the leased premises. This indemnity often extends to related liabilities arising from the negligence of the indemnified parties, but usually excludes any liabilities caused by either their sole or gross negligence or their willful misconduct.

Our aircraft and other equipment lease and financing agreements typically contain provisions requiring us, as the lessee or obligor, to indemnify the other parties to those agreements, including certain of those parties' related persons, against virtually any liabilities that might arise from the use or operation of the aircraft or other equipment.

We believe that our insurance would cover most of our exposure to liabilities and related indemnities associated with the commercial real estate leases and aircraft and other equipment lease and financing agreements described above. While our insurance does not typically cover environmental liabilities, we have certain insurance policies in place as required by applicable environmental laws.

Certain of our aircraft and other financing transactions include provisions that require us to make payments to preserve an expected economic return to the lenders if that economic return is diminished due to certain changes in laws or regulations. In certain of these financing transactions, we also bear the risk of certain changes in tax laws that would subject payments to non-U.S. lenders to withholding taxes.

We cannot reasonably estimate our potential future payments under the indemnities and related provisions described above because we cannot predict (1) when and under what circumstances these provisions may be triggered and (2) the amount that would be payable if the provisions were triggered because the amounts would be based on facts and circumstances existing at such time.

#### *Employees Under Collective Bargaining Agreements*

At September 30, 2016, we had approximately 84,000 full-time equivalent employees. Approximately 18% of these employees were represented by unions.

On September 30, 2016, we reached a comprehensive agreement in principle with the Air Line Pilots Association ("ALPA") for a new Pilot Working Agreement. From this agreement in principle, a tentative agreement will be finalized and presented to ALPA's Master Executive Council ("MEC"). If the MEC approves the tentative agreement, the agreement will be presented to our pilots for ratification. This process could take several months. If this new agreement is ratified, the pilots will receive an 18% pay increase retroactive to January 1, 2016.

#### *Other*

We have certain contracts for goods and services that require us to pay a penalty, acquire inventory specific to us or purchase contract-specific equipment, as defined by each respective contract, if we terminate the contract without cause prior to its expiration date. Because these obligations are contingent on our termination of the contract without cause prior to its expiration date, no obligation would exist unless such a termination occurs.

**NOTE 8. ACCUMULATED OTHER COMPREHENSIVE LOSS**

The following tables show the components of accumulated other comprehensive loss:

| (in millions)  | Pension and<br>Other<br>Benefits<br>Liabilities <sup>(2)</sup> | Derivative<br>Contracts | Investments | Total      |
|--|--|-------------------------|-------------|------------|
| Balance at January 1, 2016 (net of tax effect of \$1,222)                  | \$(7,354 )   | \$ 140                  | \$ (61 )    | \$(7,275 ) |
| Changes in value (net of tax effect of \$43)                               | —  | (72 )                   | 46          | (26 )      |
| Reclassifications into earnings (net of tax effect of \$51) <sup>(1)</sup> | 111  | (22 )                   | —           | 89         |
| Balance at September 30, 2016 (net of tax effect of \$1,214)               | \$(7,243 )   | \$ 46                   | \$ (15 )    | \$(7,212 ) |

| (in millions)   | Pension and<br>Other<br>Benefits<br>Liabilities <sup>(2)</sup> | Derivative<br>Contracts | Investments | Total      |
|---|--|-------------------------|-------------|------------|
| Balance at January 1, 2015 (net of tax effect of \$1,279)                 | \$(7,517 )   | \$ 222                  | \$ (16 )    | \$(7,311 ) |
| Changes in value (net of tax effect of \$21)                              | —  | 35                      | (52 )       | (17 )      |
| Reclassifications into earnings (net of tax effect of \$7) <sup>(1)</sup> | 114  | (102 )                  | —           | 12         |
| Balance at September 30, 2015 (net of tax effect of \$1,251)              | \$(7,403 )   | \$ 155                  | \$ (68 )    | \$(7,316 ) |

Amounts reclassified from AOCI for pension and other benefits liabilities are recorded in salaries and related costs in the Condensed Consolidated Statements of Operations and Comprehensive Income. Amounts reclassified from AOCI for derivative contracts designated as foreign currency cash flow hedges are recorded in passenger revenue in the Condensed Consolidated Statements of Operations and Comprehensive Income.

<sup>(2)</sup> Includes \$1.9 billion of deferred income tax expense primarily related to pension obligations that will not be recognized in net income until the pension obligations are fully extinguished.

**NOTE 9. SEGMENTS*****Refinery Operations***

Our refinery segment operates for the benefit of the airline segment by providing jet fuel to the airline segment from its own production and through jet fuel obtained through agreements with third parties. The refinery's production consists of jet fuel, as well as gasoline, diesel and other refined products ("non-jet fuel products"). We use several counterparties to exchange the non-jet fuel products produced by the refinery for jet fuel consumed in our airline operations. The gross fair value of the products exchanged under these agreements during the three and nine months ended September 30, 2016 was \$734 million and \$2.0 billion, respectively, compared to \$761 million and \$2.4 billion during the three and nine months ended September 30, 2015, respectively.

***Segment Reporting***

Segment results are prepared based on our internal accounting methods described below, with reconciliations to consolidated amounts in accordance with GAAP. Our segments are not designed to measure operating income or loss directly related to the products and services included in each segment on a stand-alone basis.

| (in millions)                                | Airline   | Refinery | Intersegment<br>Sales/Other | Consolidated |
|--|-----------|----------|-----------------------------|--------------|
| <b>Three Months Ended September 30, 2016</b> |           |          |                             |              |
| Operating revenue:                           | \$ 10,473 | \$ 971   |                             | \$ 10,483    |
| Sales to airline segment                     |           |          | \$ (173 ) <sup>(1)</sup>    |              |
| Exchanged products                           |           |          | (734 ) <sup>(2)</sup>       |              |
| Sales of refined products to third parties   |           |          | (54 ) <sup>(3)</sup>        |              |
| Operating income (loss) <sup>(4)</sup>       | 2,014     | (45 )    | —                           | 1,969        |
| Interest expense, net                        | 94        | 1        | —                           | 95           |
| Depreciation and amortization                | 464       | 10       | —                           | 474          |
| Total assets, end of period                  | 49,748    | 1,200    | —                           | 50,948       |
| Capital expenditures                         | 652       | 28       | —                           | 680          |
| <b>Three Months Ended September 30, 2015</b> |           |          |                             |              |
| Operating revenue:                           | \$ 10,994 | \$ 1,258 |                             | \$ 11,107    |
| Sales to airline segment                     |           |          | \$ (267 ) <sup>(1)</sup>    |              |
| Exchanged products                           |           |          | (761 ) <sup>(2)</sup>       |              |
| Sales of refined products to third parties   |           |          | (117 ) <sup>(3)</sup>       |              |
| Operating income <sup>(4)</sup>              | 2,107     | 106      | —                           | 2,213        |
| Interest expense, net                        | 121       | —        | —                           | 121          |
| Depreciation and amortization                | 458       | 8        | —                           | 466          |
| Total assets, end of period                  | 52,287    | 1,258    | —                           | 53,545       |
| Capital expenditures                         | 536       | 26       | —                           | 562          |

<sup>(1)</sup> Represents transfers, valued on a market price basis, from the refinery to the airline segment for use in airline operations. We determine market price by reference to the market index for the primary delivery location, which is New York Harbor, for jet fuel from the refinery.

<sup>(2)</sup> Represents value of products delivered under our exchange agreements, as discussed above, determined on a market price basis.

<sup>(3)</sup> Represents sales of refined products to third parties. These sales were at or near cost; accordingly, the margin on these sales is de minimis.

<sup>(4)</sup> Includes the impact of pricing arrangements between the airline and refinery segments with respect to the refinery's inventory price risk.



| (in millions)                               | Airline  | Refinery | Intersegment<br>Sales/Other | Consolidated |
|---|----------|----------|-----------------------------|--------------|
| <b>Nine Months Ended September 30, 2016</b> |          |          |                             |              |
| Operating revenue:                          | \$30,043 | \$2,763  |                             | \$30,181     |
| Sales to airline segment                    |          |          | \$ (495 ) <sup>(1)</sup>    |              |
| Exchanged products                          |          |          | (2,005 ) <sup>(2)</sup>     |              |
| Sales of refined products to third parties  |          |          | (125 ) <sup>(3)</sup>       |              |
| Operating income (loss) <sup>(4)</sup>      | 6,015    | (83 )    | —                           | 5,932        |
| Interest expense, net                       | 293      | 2        | —                           | 295          |
| Depreciation and amortization               | 1,402    | 28       | —                           | 1,430        |
| Capital expenditures                        | 2,536    | 61       | —                           | 2,597        |

**Nine Months Ended September 30, 2015**

|  |          |         |                          |          |
|--|----------|---------|--------------------------|----------|
| Operating revenue:                         | \$30,900 | \$3,755 |                          | \$31,202 |
| Sales to airline segment                   |          |         | \$ (792 ) <sup>(1)</sup> |          |
| Exchanged products                         |          |         | (2,401 ) <sup>(2)</sup>  |          |
| Sales of refined products to third parties |          |         | (260 ) <sup>(3)</sup>    |          |
| Operating income <sup>(4)</sup>            | 5,803    | 282     | —                        | 6,085    |
| Interest expense, net                      | 379      | —       | —                        | 379      |
| Depreciation and amortization              | 1,361    | 23      | —                        | 1,384    |
| Capital expenditures                       | 2,021    | 46      | —                        | 2,067    |

(1) Represents transfers, valued on a market price basis, from the refinery to the airline segment for use in airline operations. We determine market price by reference to the market index for the primary delivery location, which is New York Harbor, for jet fuel from the refinery.

(2) Represents value of products delivered under our exchange agreements, as discussed above, determined on a market price basis.

(3) Represents sales of refined products to third parties. These sales were at or near cost; accordingly, the margin on these sales is de minimis.

(4) Includes the impact of pricing arrangements between the airline and refinery segments with respect to the refinery's inventory price risk.

**NOTE 10. RESTRUCTURING**

The following table shows the balances and activity for restructuring charges:

| (in millions)                      | Severance<br>and<br>Related<br>Costs | Lease<br>Restructuring |
|------------------------------------|--------------------------------------|------------------------|
| Liability as of January 1, 2016    | \$ 52                                | \$ 415                 |
| Additional costs and expenses      | 15                                   | —                      |
| Payments                           | (48 )                                | (63 )                  |
| Liability as of September 30, 2016 | \$ 19                                | \$ 352                 |

Lease restructuring charges include remaining lease payments for permanently grounded aircraft related to domestic and Pacific fleet restructurings. Our domestic fleet restructuring initiative is replacing 50-seat regional aircraft and older B-757-200 aircraft with more efficient and customer preferred CRJ-900, B-717-200 and B-737-900ER aircraft. We are also restructuring our Pacific fleet by removing less efficient B-747-400 aircraft and replacing them with smaller-gauge, widebody aircraft to better match capacity with demand.

**NOTE 11. EARNINGS PER SHARE**

We calculate basic earnings per share by dividing net income by the weighted average number of common shares outstanding, excluding restricted shares. We calculate diluted earnings per share by dividing net income by the weighted average number of common shares outstanding plus the dilutive effect of outstanding share-based awards, including stock options and restricted stock awards. Antidilutive common stock equivalents excluded from the diluted earnings per share calculation are not material. The following table shows the computation of basic and diluted earnings per share:

|   | Three Months<br>Ended<br>September 30, |         | Nine Months<br>Ended<br>September 30, |         |
|---|--|---------|---------------------------------------|---------|
|   | 2016                                   | 2015    | 2016                                  | 2015    |
| (in millions, except per share data)        |  |         |                                       |         |
| Net income                                  | \$1,259                                | \$1,315 | \$3,751                               | \$3,546 |
| Basic weighted average shares outstanding   | 740                                    | 788     | 758                                   | 803     |
| Dilutive effect of share-based awards       | 4                                      | 7       | 4                                     | 8       |
| Diluted weighted average shares outstanding | 744                                    | 795     | 762                                   | 811     |
| Basic earnings per share                    | \$1.70                                 | \$1.67  | \$4.95                                | \$4.42  |
| Diluted earnings per share                  | \$1.69                                 | \$1.65  | \$4.92                                | \$4.37  |

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

### September 2016 Quarter Financial Highlights

Our pre-tax income for the September 2016 quarter was \$1.9 billion, representing a \$172 million decrease compared to the corresponding prior year period as lower passenger revenue, higher salaries and related costs and costs associated with a technology outage offset the benefit provided by lower fuel prices.

On the morning of August 8, 2016, our corporate data center suffered a loss of power leading to a widespread technology outage. The outage resulted from certain data center components failing to connect to backup power. As a result of the outage, we canceled approximately 2,300 flights over three days. The outage and subsequent recovery efforts reduced pre-tax income by an estimated \$150 million.

*Revenue.* Our operating revenue decreased \$624 million, or 5.6%, and passenger revenue per available seat mile ("PRASM") decreased 6.8% on 1.5% higher capacity compared to the September 2015 quarter, resulting primarily from the impact of U.S. dollar strength on sales in international markets, imbalances between supply and demand principally in the Atlantic region and China, weakness in the domestic close-in yield environment and the technology outage.

*Operating Expense.* Total operating expense decreased \$380 million, and our consolidated operating cost per available seat mile ("CASM") decreased 5.7% to 12.33 cents compared to the September 2015 quarter, primarily due to lower fuel prices, which were partially offset by higher salaries and related costs as well as costs associated with the technology outage. During the September 2016 quarter, Brent crude oil averaged \$46 per barrel compared to the average of \$50 per barrel during the September 2015 quarter. Salaries and related costs were higher as a result of pay rate increases implemented during the December 2015 quarter.

Despite pay rate increases, non-fuel unit costs ("CASM-Ex, including profit sharing," a non-GAAP financial measure) only increased 0.1% to 9.58 cents compared to the September 2015 quarter due to the impact of cost savings resulting from our domestic upgauging and other initiatives.

In addition to the previously-implemented pay rate increases, on September 30, 2016, we reached a comprehensive agreement in principle with ALPA for a new Pilot Working Agreement. From this agreement in principle, a tentative agreement will be finalized and presented to ALPA's MEC. If the MEC approves the tentative agreement, the agreement will be presented to our pilots for ratification. This process could take several months. If this new agreement is ratified, the pilots will receive an 18% pay increase retroactive to January 1, 2016.

The non-GAAP financial measure for CASM-Ex, including profit sharing is defined and reconciled in "Supplemental Information" below.

**Results of Operations - Three Months Ended September 30, 2016 and 2015****Operating Revenue**

| (in millions)           | Three Months Ended    |           | Increase<br>(Decrease) | % Increase<br>(Decrease) |
|-------------------------|-----------------------|-----------|------------------------|--------------------------|
|                         | September 30,<br>2016 | 2015      |                        |                          |
| Passenger:              |                       |           |                        |                          |
| Mainline                | \$7,615               | \$8,059   | \$ (444 )              | (5.5 )%                  |
| Regional carriers       | 1,456                 | 1,536     | (80 )                  | (5.2 )%                  |
| Total passenger revenue | 9,071                 | 9,595     | (524 )                 | (5.5 )%                  |
| Cargo                   | 167                   | 196       | (29 )                  | (14.8 )%                 |
| Other                   | 1,245                 | 1,316     | (71 )                  | (5.4 )%                  |
| Total operating revenue | \$ 10,483             | \$ 11,107 | \$ (624 )              | (5.6 )%                  |

**Passenger Revenue**

| (in millions)     | Three Months<br>Ended<br>September 30,<br>2016 | Increase (Decrease)<br>vs. Three Months Ended September 30, 2015 |                                  |                                   |                            |         |                |
|-------------------|--|--|----------------------------------|-----------------------------------|----------------------------|---------|----------------|
|                   |  | Passenger<br>Revenue   | RPMs <sup>(1)</sup><br>(Traffic) | ASMs <sup>(2)</sup><br>(Capacity) | Passenger<br>Mile<br>Yield | PRASM   | Load<br>Factor |
| Mainline          | \$ 4,615                                       | (3.3 )%  | 2.0 %                            | 4.4 %                             | (5.3 )%                    | (7.4 )% | (2.0) pts      |
| Regional carriers | 1,456  | (5.2 )%  | (1.0 )%                          | 0.5 %                             | (4.2 )%                    | (5.7 )% | (1.3) pts      |
| Domestic          | 6,071  | (3.8 )%  | 1.5 %                            | 3.7 %                             | (5.2 )%                    | (7.2 )% | (1.8) pts      |
| Atlantic          | 1,671  | (8.0 )%  | (1.5 )%                          | 1.9 %                             | (6.6 )%                    | (9.7 )% | (2.9) pts      |
| Pacific           | 758  | (14.5 )%   | (5.7 )%                          | (7.7 )%                           | (9.3 )%                    | (7.4 )% | 1.9 pts        |
| Latin America     | 571  | (1.9 )%  | (1.0 )%                          | (3.2 )%                           | (0.9 )%                    | 1.4 %   | 2.0 pts        |
| Total             | \$ 9,071                                       | (5.5 )%  | (0.2 )%                          | 1.5 %                             | (5.3 )%                    | (6.8 )% | (1.4) pts      |

<sup>(1)</sup> Revenue passenger miles ("RPMs")

<sup>(2)</sup> Available seat miles ("ASMs")

Passenger revenue decreased \$524 million, or 5.5%, compared to the September 2015 quarter. PRASM decreased 6.8% and passenger mile yield decreased 5.3% on 1.5% higher capacity. Approximately one percentage point of the PRASM decrease related to the August technology outage. Load factor was 1.4 points lower than the prior year quarter at 85.4%.

Unit revenues of the mainline domestic region and regional carriers decreased 7.4% and 5.7%, respectively, resulting from weakness in the close-in yield environment, primarily in the first half of the September 2016 quarter.

Revenues related to our international regions decreased 8.7% year-over-year primarily due to yield declines resulting from imbalances between supply and demand principally in the Atlantic region and China, the impact of foreign currency fluctuations and economic challenges in certain regions.

In the Atlantic, the unit revenue decline predominantly resulted from lower yields driven by industry capacity growth outpacing passenger demand. To address this imbalance between supply and demand, we will continue to reduce capacity between the U.S. and the United Kingdom ("U.K.") during the December 2016 quarter.

Unit revenue declines in the Pacific compared to the September 2015 quarter primarily resulted from lower yen hedge gains and yield declines resulting from industry capacity growth between the U.S. and China. During the September 2016 quarter, the U.S. Department of Transportation announced that we have been awarded two daytime slot pairs at Tokyo's Haneda Airport (from Los Angeles and Minneapolis). We plan to commence these routes and cancel other routes in the Pacific region during the December 2016 quarter as part of our ongoing optimization of the Pacific

region.

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Unit revenues increased in Latin America principally as a result of a 30% unit revenue improvement in Brazil compared to the September 2015 quarter, related to improved traffic and the strengthening of the Brazilian real against the U.S. dollar. Business markets in Mexico also contributed to the Latin America unit revenue improvement. Open Skies between the U.S. and Mexico was ratified and took effect in August 2016 and our application for antitrust immunity with Aeroméxico may be approved in the next six months, which should continue to strengthen our performance in the important Mexican business markets.

*Cargo Revenue.* Cargo revenue decreased \$29 million, or 14.8%, primarily due to weaker international demand compared to the September 2015 quarter.

*Other Revenue.* Other revenue decreased \$71 million, or 5.4%, primarily due to lower refinery sales, which were partially offset by higher loyalty program revenues, compared to the September 2015 quarter.

### Operating Expense

| (in millions)                                      | Three Months Ended |                    | Increase (Decrease) | % Increase (Decrease) |   |
|--|--------------------|--------------------|---------------------|-----------------------|---|
|  | September 30, 2016 | September 30, 2015 |                     |                       |   |
| Salaries and related costs                         | \$2,463            | \$2,276            | \$ 187              | 8.2                   | % |
| Aircraft fuel and related taxes                    | 1,422              | 1,819              | (397)               | (21.8)                | % |
| Regional carriers expense                          | 1,119              | 1,073              | 46                  | 4.3                   | % |
| Contracted services                                | 520                | 477                | 43                  | 9.0                   | % |
| Depreciation and amortization                      | 474                | 466                | 8                   | 1.7                   | % |
| Aircraft maintenance materials and outside repairs | 462                | 479                | (17)                | (3.5)                 | % |
| Passenger commissions and other selling expenses   | 466                | 463                | 3                   | 0.6                   | % |
| Landing fees and other rents                       | 399                | 403                | (4)                 | (1.0)                 | % |
| Profit sharing                                     | 326                | 563                | (237)               | (42.1)                | % |
| Passenger service                                  | 264                | 247                | 17                  | 6.9                   | % |
| Aircraft rent                                      | 72                 | 63                 | 9                   | 14.3                  | % |
| Other  | 527                | 565                | (38)                | (6.7)                 | % |
| Total operating expense                            | \$8,514            | \$8,894            | \$(380)             | (4.3)                 | % |

*Salaries and Related Costs.* The increase in salaries and related costs is primarily due to pay rate increases implemented in 2015. In the December 2015 quarter, base pay rates increased 14.5% for eligible merit, ground and flight attendant employees in conjunction with changes in the profit sharing program.

*Aircraft Fuel and Related Taxes.* Including our regional carriers, fuel expense decreased \$424 million compared to the prior year quarter due to a 10% decrease in the market price per gallon of fuel and lower fuel hedge losses, partially offset by a loss from our refinery segment in the current period compared to a profit in the prior year period. The table below presents fuel expense including our regional carriers:

| (in millions)   | Three Months Ended |                    | Increase (Decrease) | % Increase (Decrease) |
|---|--------------------|--------------------|---------------------|-----------------------|
|   | September 30, 2016 | September 30, 2015 |                     |                       |
| Aircraft fuel and related taxes <sup>(1)</sup>                            | \$1,422            | \$1,819            | \$(397)             |                       |
| Aircraft fuel and related taxes included within regional carriers expense | 230                | 257                | (27)                |                       |
| Total fuel expense  | \$1,652            | \$2,076            | \$(424)             | (20.4)%               |

<sup>(1)</sup> Includes the impact of fuel hedging and refinery results described further in the table below.



The table below shows the impact of hedging and the refinery on fuel expense and average price per gallon, adjusted (non-GAAP financial measures):

| (in millions, except per gallon data)            | Three Months Ended |         | Change  | Average Price Per Gallon |        | Change   |
|--|--------------------|---------|---------|--------------------------|--------|----------|
|  | September 30,      |         |         | Three Months Ended       |        |          |
|  | 2016               | 2015    |         | September 30,            | 2015   |          |
| Fuel purchase cost <sup>(1)</sup>                | \$1,585            | \$1,833 | \$(248) | \$1.44                   | \$1.67 | \$(0.23) |
| Airline segment fuel hedge losses <sup>(2)</sup> | 22                 | 349     | (327)   | 0.02                     | 0.32   | (0.30)   |
| Refinery segment impact <sup>(2)</sup>           | 45                 | (106)   | 151     | 0.04                     | (0.10) | 0.14     |
| Total fuel expense                               | \$1,652            | \$2,076 | \$(424) | \$1.50                   | \$1.89 | \$(0.39) |
| MTM adjustments and settlements <sup>(3)</sup>   | (23)               | (99)    | 76      | (0.02)                   | (0.09) | 0.07     |
| Total fuel expense, adjusted                     | \$1,629            | \$1,977 | \$(348) | \$1.48                   | \$1.80 | \$(0.32) |

<sup>(1)</sup> Market price for jet fuel at airport locations, including related taxes and transportation costs.

<sup>(2)</sup> Includes the impact of pricing arrangements between the airline and refinery segments with respect to the refinery's inventory price risk. For additional information regarding the refinery segment impact, see "Refinery Segment" below.

<sup>(3)</sup> MTM adjustments and settlements include the effects of the derivative transactions discussed in Note 4 of the Notes to the Condensed Consolidated Financial Statements. For additional information and the reason for adjusting fuel expense, see "Supplemental Information" below.

**Regional Carriers Expense.** The increase in regional carrier expense is primarily due to aircraft maintenance and scheduled contract carrier rate escalations, partially offset by lower fuel cost from the decrease in the market price of fuel.

**Contracted Services.** The increase in contracted services expense predominantly related to costs associated with the 1.5% increase in capacity.

**Profit Sharing.** The decrease in profit sharing is primarily due to an adjustment to the profit sharing calculation. Our broad-based employee profit sharing program provides that for each year in which we have an annual pre-tax profit, as defined by the terms of the program, we will pay a specified portion of that profit to employees. In determining the amount of profit sharing, the program defines profit as pre-tax profit adjusted for profit sharing and certain other items. In 2015, our profit sharing program paid 10% to employees for the first \$2.5 billion of annual profit and 20% of annual profit above \$2.5 billion. Beginning with 2016 pre-tax profit (for the profit sharing payment in 2017), the profit sharing formula has been adjusted to pay 10% of annual pre-tax profit (as defined by the terms of the program) and, if we exceed our prior year results, the program will pay 20% of the year-over-year increase in pre-tax profit to eligible employees. The profit sharing program for pilots remains unchanged from the prior year.

**Other.** The decrease in other expense primarily relates to lower costs associated with sales of non-jet fuel products to third parties by our oil refinery, partially offset by costs associated with the technology outage that occurred in August 2016.



**Results of Operations - Nine Months Ended September 30, 2016 and 2015****Operating Revenue**

| (in millions)           | Nine Months Ended<br>September 30, |          | Increase<br>(Decrease) | % Increase<br>(Decrease) |
|-------------------------|------------------------------------|----------|------------------------|--------------------------|
|                         | 2016                               | 2015     |                        |                          |
| Passenger:              |                                    |          |                        |                          |
| Mainline                | \$21,530                           | \$22,195 | \$(665)                | (3.0)%                   |
| Regional carriers       | 4,273                              | 4,462    | (189)                  | (4.2)%                   |
| Total passenger revenue | 25,803                             | 26,657   | (854)                  | (3.2)%                   |
| Cargo                   | 494                                | 620      | (126)                  | (20.3)%                  |
| Other                   | 3,884                              | 3,925    | (41)                   | (1.0)%                   |
| Total operating revenue | \$30,181                           | \$31,202 | \$(1,021)              | (3.3)%                   |

**Passenger Revenue**

| (in millions)     | Nine Months<br>Ended<br>September 30,<br>2016 | Increase (Decrease)<br>vs. Nine Months Ended September 30, 2015 |                |                 |                            |                         |
|-------------------|---|---|----------------|-----------------|----------------------------|-------------------------|
|                   |   | Passenger<br>Revenue  | RPMs (Traffic) | ASMs (Capacity) | Passenger<br>Mile<br>Yield | PRASM<br>Load<br>Factor |
| Mainline          | \$ 13,547                                     | (0.2)%  | 4.5%           | 5.9%            | (4.4)%                     | (5.7)% (1.1) pts        |
| Regional carriers | 4,273   | (4.2)%  | 0.5%           | 1.3%            | (4.7)%                     | (5.4)% (0.6) pts        |
| Domestic          | 17,820  | (1.2)%  | 3.8%           | 5.1%            | (4.8)%                     | (5.9)% (1.0) pts        |
| Atlantic          | 4,101   | (6.5)%  | (1.0)%         | 0.6%            | (5.6)%                     | (7.0)% (1.3) pts        |
| Pacific           | 2,057   | (12.4)%   | (4.1)%         | (6.7)%          | (8.7)%                     | (6.1)% 2.4 pts          |
| Latin America     | 1,825   | (3.6)%  | 3.4%           | 1.1%            | (6.8)%                     | (4.6)% 1.9 pts          |
| Total             | \$ 25,803                                     | (3.2)%  | 1.9%           | 2.4%            | (5.0)%                     | (5.5)% (0.5) pts        |

Passenger revenue decreased \$854 million, or 3.2%, compared to the nine months ended September 30, 2015. PRASM decreased 5.5% and passenger mile yield decreased 5.0% on 2.4% higher capacity. Load factor was 0.5 points lower than the prior year period at 84.4%.

Unit revenues of the mainline domestic region and regional carriers decreased 5.7% and 5.4%, respectively, resulting from weakness in the close-in yield environment despite strong volume.

Revenues related to our international regions decreased 7.5% year-over-year primarily due to yield declines resulting from imbalances between supply and demand principally in the Atlantic region and China, the impact of foreign currency fluctuations, continued reductions in international fuel surcharges and economic challenges in certain regions.

In the Atlantic, the unit revenue decline predominantly resulted from lower yields driven by industry capacity growth outpacing passenger demand and the strength of the U.S. dollar. To address the imbalance between supply and demand, we will continue to reduce capacity between the U.S. and the U.K. during the December 2016 quarter. In core European markets, U.S. point-of-sale demand was strong and recovered quickly following the events in Brussels in March. However, Europe point-of-sale demand has been soft largely due to the impact of weaker Euro exchange rates.

Unit revenue declines in the Pacific compared to the first nine months of 2015 primarily resulted from lower yen hedge gains, lower international fuel surcharges and yield declines resulting from industry capacity growth between the U.S. and China. During the September 2016 quarter, the U.S. Department of Transportation announced that we have been awarded two daytime slot pairs at Tokyo's Haneda Airport (from Los Angeles and Minneapolis). We plan

to commence these routes and cancel other routes in the Pacific region during the December 2016 quarter as part of our ongoing optimization of the Pacific region.

Unit revenues declined in Latin America compared to the prior year, despite improvement during the September 2016 quarter. We continued to address unit revenue declines by investing in higher performing Mexican business markets. Open Skies between the U.S. and Mexico was ratified and took effect in August 2016 and our application for antitrust immunity with Aeroméxico may be approved in the next six months, which should continue to strengthen our performance in the important Mexican business markets.

*Cargo Revenue.* Cargo revenue decreased \$126 million, or 20.3%, primarily due to weaker international demand compared to the nine months ended September 30, 2015.

### **Operating Expense**

| (in millions)                                      | Nine Months Ended     |          | Increase<br>(Decrease) | % Increase<br>(Decrease) |
|--|-----------------------|----------|------------------------|--------------------------|
|  | September 30,<br>2016 | 2015     |                        |                          |
| Salaries and related costs                         | \$7,165               | \$6,563  | \$ 602                 | 9.2 %                    |
| Aircraft fuel and related taxes                    | 3,877                 | 5,111    | (1,234)                | (24.1)%                  |
| Regional carriers expense                          | 3,221                 | 3,223    | (2)                    | (0.1)%                   |
| Contracted services                                | 1,480                 | 1,375    | 105                    | 7.6 %                    |
| Depreciation and amortization                      | 1,430                 | 1,384    | 46                     | 3.3 %                    |
| Aircraft maintenance materials and outside repairs | 1,357                 | 1,430    | (73)                   | (5.1)%                   |
| Passenger commissions and other selling expenses   | 1,291                 | 1,270    | 21                     | 1.7 %                    |
| Landing fees and other rents                       | 1,123                 | 1,164    | (41)                   | (3.5)%                   |
| Profit sharing                                     | 922                   | 1,110    | (188)                  | (16.9)%                  |
| Passenger service                                  | 674                   | 664      | 10                     | 1.5 %                    |
| Aircraft rent                                      | 204                   | 183      | 21                     | 11.5 %                   |
| Other  | 1,505                 | 1,640    | (135)                  | (8.2)%                   |
| Total operating expense                            | \$24,249              | \$25,117 | \$ (868)               | (3.5)%                   |

*Salaries and Related Costs.* The increase in salaries and related costs is primarily due to pay rate increases implemented in 2015. In the December 2015 quarter, base pay rates increased 14.5% for eligible merit, ground and flight attendant employees in conjunction with changes in the profit sharing program.

*Aircraft Fuel and Related Taxes.* Including our regional carriers, fuel expense decreased \$1.4 billion compared to the prior year due to a 26% decrease in the market price per gallon of fuel and lower fuel hedge losses, partially offset by a loss from our refinery segment in the current year period compared to a profit in the prior year period and a 1.1% increase in consumption. The table below presents fuel expense including our regional carriers:

| (in millions)   | Nine Months Ended     |         | Increase<br>(Decrease) | % Increase<br>(Decrease) |
|---|-----------------------|---------|------------------------|--------------------------|
|   | September 30,<br>2016 | 2015    |                        |                          |
| Aircraft fuel and related taxes <sup>(1)</sup>                            | \$3,877               | \$5,111 | \$(1,234)              |                          |
| Aircraft fuel and related taxes included within regional carriers expense | 616                   | 816     | (200)                  |                          |
| Total fuel expense  | \$4,493               | \$5,927 | \$(1,434)              | (24.2)%                  |

<sup>(1)</sup> Includes the impact of fuel hedging and refinery results described further in the table below.

The table below shows the impact of hedging and the refinery on fuel expense and average price per gallon, adjusted (non-GAAP financial measures):

| (in millions, except per gallon data)            | Nine Months Ended |         | Change    | Average Price Per Gallon |               |          |
|--|-------------------|---------|-----------|--------------------------|---------------|----------|
|  | September 30,     |         |           | Nine Months              |               | Change   |
|  | 2016              | 2015    |           | Ended                    | September 30, |          |
|  | 2016              | 2015    | 2016      | 2015                     |               |          |
| Fuel purchase cost <sup>(1)</sup>                | \$4,118           | \$5,519 | \$(1,401) | \$1.34                   | \$1.81        | \$(0.47) |
| Airline segment fuel hedge losses <sup>(2)</sup> | 292               | 690     | (398)     | 0.09                     | 0.23          | (0.14)   |
| Refinery segment impact <sup>(2)</sup>           | 83                | (282)   | 365       | 0.03                     | (0.09)        | 0.12     |
| Total fuel expense                               | \$4,493           | \$5,927 | \$(1,434) | \$1.46                   | \$1.95        | \$(0.49) |
| MTM adjustments and settlements <sup>(3)</sup>   | 439               | 1,210   | (771)     | 0.14                     | 0.40          | (0.26)   |
| Total fuel expense, adjusted                     | \$4,932           | \$7,137 | \$(2,205) | \$1.60                   | \$2.35        | \$(0.75) |

(1) Market price for jet fuel at airport locations, including related taxes and transportation costs.

(2) Includes the impact of pricing arrangements between the airline and refinery segments with respect to the refinery's inventory price risk. For additional information regarding the refinery segment impact, see "Refinery Segment" below.

(3) MTM adjustments and settlements include the effects of the derivative transactions discussed in Note 4 of the Notes to the Condensed Consolidated Financial Statements. For additional information and the reason for adjusting fuel expense, see "Supplemental Information" below.

**Regional Carriers Expense.** The decrease in regional carrier expense is primarily due to lower fuel cost from the decrease in the market price of fuel, partially offset by increases in aircraft maintenance and scheduled contract carrier rate escalations.

**Contracted Services.** The increase in contracted services expense predominantly related to costs associated with the 2.4% increase in capacity.

**Aircraft Maintenance Materials and Outside Repairs.** Aircraft maintenance materials and outside repairs consist of costs associated with the maintenance of aircraft used in our operations and costs associated with maintenance sales to third parties by our MRO business. The decrease in aircraft maintenance materials and outside repairs expense primarily relates to the timing of maintenance events on our fleet and lower volume of sales from our MRO business.

**Profit Sharing.** The decrease in profit sharing is primarily due to an adjustment to the profit sharing calculation. Our broad-based employee profit sharing program provides that for each year in which we have an annual pre-tax profit, as defined by the terms of the program, we will pay a specified portion of that profit to employees. In determining the amount of profit sharing, the program defines profit as pre-tax profit adjusted for profit sharing and certain other items. In 2015, our profit sharing program paid 10% to employees for the first \$2.5 billion of annual profit and 20% of annual profit above \$2.5 billion. Beginning with 2016 pre-tax profit (for the profit sharing payment in 2017), the profit sharing formula has been adjusted to pay 10% of annual pre-tax profit (as defined by the terms of the program) and, if we exceed our prior year results, the program will pay 20% of the year-over-year increase in pre-tax profit to eligible employees. The profit sharing program for pilots remains unchanged from the prior year.

**Other.** The decrease in other expense primarily relates to lower costs associated with sales of non-jet fuel products to third parties by our oil refinery, partially offset by costs associated with the technology outage that occurred in August 2016.

| Non-Operating Results            | Three Months Ended |         |           | Nine Months Ended |         |           |
|----------------------------------|--------------------|---------|-----------|-------------------|---------|-----------|
|                                  | September 30,      |         |           | September 30,     |         |           |
| (in millions)                    | 2016               | 2015    | Favorable | 2016              | 2015    | Favorable |
| Interest expense, net            | \$(95)             | \$(121) | \$ 26     | \$(295)           | \$(379) | \$ 84     |
| Miscellaneous, net               | 26                 | (20)    | 46        | 47                | (82)    | 129       |
| Total non-operating expense, net | \$(69)             | \$(141) | \$ 72     | \$(248)           | \$(461) | \$ 213    |

The decline in interest expense, net results from reduced levels of debt and from the refinancing of debt obligations at lower interest rates. The principal amount of debt and capital leases has declined from \$8.9 billion at September 30, 2015 to \$7.7 billion at September 30, 2016.

In the three and nine months ended September 30, 2016, miscellaneous, net is favorable primarily due to our proportionate share of earnings from our equity investment in Virgin Atlantic and lower foreign exchange losses compared to the three and nine months ended September 30, 2015.

### ***Income Taxes***

We project that our annual effective tax rate for 2016 will be approximately 34%. The expected reduction in our rate from prior years is primarily related to differences in our global tax rates and the recognition of \$31 million of excess tax benefits as a result of the adoption of ASU No. 2016-09 in the June 2016 quarter. See Note 1 of the Notes to the Consolidated Financial Statements for a discussion of this accounting pronouncement. In certain interim periods, we may have adjustments to our net deferred tax assets as a result of changes in prior year estimates and tax laws enacted during the period, which will impact the effective tax rate for that interim period.

### **Refinery Segment**

The refinery primarily produces gasoline, diesel and jet fuel. Monroe exchanges substantially all the non-jet fuel products it produces with third parties for jet fuel consumed in our airline operations. The jet fuel produced and procured through exchanging gasoline and diesel fuel produced by the refinery provides approximately 180,000 barrels per day for use in airline operations. We believe that the jet fuel supply resulting from the refinery's operation has contributed to the reduction in the market price of jet fuel, and thus lowered our cost of jet fuel compared to what it otherwise would have been.

A refinery is subject to annual U.S. Environmental Protection Agency ("EPA") requirements to blend renewable fuels into the gasoline and on-road diesel fuel it produces. Alternatively, a refinery may purchase renewable energy credits, called RINs, from third parties in the secondary market. Because the refinery operated by Monroe does not blend renewable fuels, it must purchase its entire RINs requirement in the secondary market. We recognized \$48 million and \$17 million of expense related to the RINs requirement in the September 2016 and 2015 quarters, respectively, and \$130 million and \$67 million for the nine months ended September 30, 2016 and 2015, respectively.

The refinery recorded losses of \$45 million and \$83 million in the three and nine months ended September 30, 2016, respectively, compared to profits of \$106 million and \$282 million in the three and nine months ended September 30, 2015, respectively. The refinery's losses in the current periods compared to profits in the prior year were primarily attributable to lower product crack spreads. For more information regarding the refinery's results, see Note 9 of the Notes to the Condensed Consolidated Financial Statements.

### **Operating Statistics**

|   | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |              |
|---|-------------------------------------|--------|------------------------------------|--------------|
|   | 2016                                | 2015   | 2016                               | 2015         |
| Consolidated <sup>(1)</sup>                               |                                     |        |                                    |              |
| Revenue passenger miles (in millions)                     | 58,973                              | 59,076 | 163,113                            | 160,052      |
| Available seat miles (in millions)                        | 69,028                              | 68,031 | 193,152                            | 188,565      |
| Passenger mile yield                                      | 15.38¢                              | 16.24¢ | 15.82¢                             | 16.66¢       |
| PRASM   | 13.14¢                              | 14.10¢ | 13.36¢                             | 14.14¢       |
| CASM  | 12.33¢                              | 13.07¢ | 12.55¢                             | 13.32¢       |
| CASM-Ex, including profit sharing <sup>(2)</sup>          | 9.58 ¢                              | 9.57 ¢ | 9.79 ¢                             | 9.66 ¢       |
| Passenger load factor                                     | 85.4                                | %86.8  | %                                  | 84.4 %84.9 % |
| Fuel gallons consumed (in millions)                       | 1,099                               | 1,096  | 3,075                              | 3,043        |
| Average price per fuel gallon <sup>(3)</sup>              | \$1.50                              | \$1.89 | \$1.46                             | \$1.95       |
| Average price per fuel gallon, adjusted <sup>(3)(4)</sup> | \$1.48                              | \$1.80 | \$1.60                             | \$2.35       |
| Full-time equivalent employees, end of period             | 84,084                              | 83,033 |                                    |              |

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- (1) Includes the operations of our regional carriers under capacity purchase agreements. Full-time equivalent employees exclude employees of non-owned regional carriers.
- (2) Non-GAAP financial measure defined and reconciled to CASM in "Supplemental Information" below.
- (3) Includes the impact of fuel hedge activity and refinery segment results.
- (4) Non-GAAP financial measure defined and reconciled to average fuel price per gallon in "Results of Operations" for the three and nine months ended September 30, 2016 and 2015.

## Fleet Information

Our operating aircraft fleet and commitments at September 30, 2016 are summarized in the following table:

| Aircraft Type           | Current Fleet <sup>(1)</sup> |               |                 | Commitments |             |          |               |
|-------------------------|------------------------------|---------------|-----------------|-------------|-------------|----------|---------------|
|                         | Owned                        | Capital Lease | Operating Lease | Total       | Average Age | Purchase | Lease Options |
| B-717-200               | 3                            | 13            | 75              | 91          | 15.1        | —        | —             |
| B-737-700               | 10                           | —             | —               | 10          | 7.7         | —        | —             |
| B-737-800               | 73                           | —             | —               | 73          | 15.7        | —        | 4             |
| B-737-900ER             | 41                           | —             | 24              | 65          | 1.7         | 55       | —             |
| B-747-400               | 4                            | 5             | —               | 9           | 24.5        | —        | —             |
| B-757-200               | 79                           | 16            | 6               | 101         | 19.3        | —        | —             |
| B-757-300               | 16                           | —             | —               | 16          | 13.6        | —        | —             |
| B-767-300               | 10                           | —             | —               | 10          | 24.7        | —        | —             |
| B-767-300ER             | 54                           | 4             | —               | 58          | 20.5        | —        | —             |
| B-767-400ER             | 21                           | —             | —               | 21          | 15.6        | —        | —             |
| B-777-200ER             | 8                            | —             | —               | 8           | 16.7        | —        | —             |
| B-777-200LR             | 10                           | —             | —               | 10          | 7.5         | —        | —             |
| B-787-8 <sup>(2)</sup>  | —                            | —             | —               | —           | —           | 18       | —             |
| A319-100                | 55                           | —             | 2               | 57          | 14.7        | —        | —             |
| A320-200                | 58                           | —             | 11              | 69          | 21.6        | —        | —             |
| A321-200                | 7                            | —             | 4               | 11          | 0.2         | 71       | —             |
| A330-200                | 11                           | —             | —               | 11          | 11.5        | —        | —             |
| A330-300                | 26                           | —             | 3               | 29          | 8.3         | 2        | —             |
| A330-900neo             | —                            | —             | —               | —           | —           | 25       | —             |
| A350-900                | —                            | —             | —               | —           | —           | 25       | —             |
| CS100 <sup>(3)</sup>    | —                            | —             | —               | —           | —           | 75       | 50            |
| E190-100 <sup>(4)</sup> | —                            | —             | —               | —           | —           | 8        | —             |
| MD-88                   | 93                           | 23            | —               | 116         | 26.2        | —        | —             |
| MD-90                   | 65                           | —             | —               | 65          | 19.6        | —        | —             |
| Total                   | 644                          | 61            | 125             | 830         | 16.9        | 279      | 4 50          |

<sup>(1)</sup> Excludes certain aircraft we own or lease, which are operated by regional carriers on our behalf and are shown in the table below.

<sup>(2)</sup> Our purchase commitment for the 18 B-787-8 aircraft provides for certain substitution rights, including for our current orders of B-737-900ER aircraft.

During the June 2016 quarter, we reached an agreement with Bombardier to acquire 75 CS100 aircraft with deliveries beginning in 2018 and continuing through 2022. We have flexibility under the purchase agreement with respect to deferral, acceleration, conversion and a limited number of cancellation rights.

The agreement also includes options to purchase 50 additional aircraft.

<sup>(4)</sup> Following the CS100 purchase agreement, we entered into an agreement to sell the E190-100 fleet following their delivery to us.

The following table summarizes the aircraft fleet operated by our regional carriers on our behalf at September 30, 2016:

| Carrier                           | Fleet Type |         |         |             |             |             | Total |
|-----------------------------------|------------|---------|---------|-------------|-------------|-------------|-------|
|                                   | CRJ-200    | CRJ-700 | CRJ-900 | Embraer 145 | Embraer 170 | Embraer 175 |       |
| Endeavor Air, Inc. <sup>(1)</sup> | 49         | —       | 81      | —           | —           | —           | 130   |
| ExpressJet Airlines, Inc.         | 40         | 36      | 28      | —           | —           | —           | 104   |
| SkyWest Airlines, Inc.            | 59         | 25      | 36      | —           | —           | 3           | 123   |
| Compass Airlines, Inc.            | —          | —       | —       | —           | 6           | 36          | 42    |
| Shuttle America                   | —          | —       | —       | 6           | 14          | 16          | 36    |
| GoJet Airlines, LLC               | —          | 22      | 7       | —           | —           | —           | 29    |
| Total                             | 148        | 83      | 152     | 6           | 20          | 55          | 464   |

<sup>(1)</sup> Endeavor Air, Inc. is a wholly owned subsidiary of Delta.





## **Financial Condition and Liquidity**

We expect to meet our cash needs for the next 12 months with cash flows from operations, cash and cash equivalents, short-term investments and financing arrangements. As of September 30, 2016, we had \$5.6 billion in unrestricted liquidity, consisting of \$3.2 billion in cash and cash equivalents and short-term investments and \$2.4 billion in undrawn revolving credit facilities. During the nine months ended September 30, 2016, we generated \$6.1 billion in cash from operating activities, which we used, along with existing cash, to fund capital expenditures of \$2.6 billion and return \$2.7 billion to shareholders, while maintaining a sufficient liquidity position.

### ***Sources of Liquidity***

#### ***Operating Activities***

Cash flows from operating activities provide our primary source of liquidity. We generated positive cash flows from operations of \$6.1 billion and \$6.4 billion in the nine months ended September 30, 2016 and 2015, respectively. We also expect to generate positive cash flows from operations for the remainder of 2016.

Our operating cash flows can be impacted by the following factors:

*Seasonality of Advance Ticket Sales.* We sell tickets for air travel in advance of the customer's travel date. When we receive a cash payment at the time of sale, we record the cash received on advance sales as deferred revenue in air traffic liability. The air traffic liability increases during the winter and spring as advanced ticket sales grow prior to the summer peak travel season and decreases during the summer and fall months.

*Fuel.* Including our regional carriers, fuel expense represented approximately 19% of our total operating expenses for the nine months ended September 30, 2016. The market price for jet fuel is highly volatile, which can impact the comparability of our cash flows from operations from period to period.

We have historically managed our fuel price risk through a hedging program intended to reduce the financial impact from changes in the price of jet fuel as jet fuel prices are subject to potential volatility. During the March 2016 quarter, in order to better participate in the low fuel price environment, we reduced our hedging activity and entered into derivatives designed to offset and effectively terminate our existing airline segment hedge positions. As a result, we locked in the amount of the net hedge settlements for the remainder of 2016 and 2017. During the June 2016 quarter, we early settled \$455 million of our airline segment's 2016 positions.

*Pension Contributions.* We sponsor defined benefit pension plans for eligible employees and retirees. These plans are closed to new entrants and are frozen for future benefit accruals. Our funding obligations for these plans are governed by the Employee Retirement Income Security Act, as modified by the Pension Protection Act of 2006. We contributed \$1.3 billion, including \$950 million in cash and shares of our common stock from treasury with a value of \$350 million, to our qualified defined benefit pension plans during the first half of 2016. As a result of these contributions, we satisfied, on an accelerated basis, our 2016 required contributions for our defined benefit plans, including more than \$750 million above the minimum funding requirements. During the first half of 2015, we contributed \$1.2 billion in cash to our qualified defined benefit pension plans.

*Profit Sharing.* Our broad-based employee profit sharing program provides that for each year in which we have an annual pre-tax profit, as defined by the terms of the program, we will pay a specified portion of that profit to employees. In determining the amount of profit sharing, the program defines profit as pre-tax profit adjusted for profit sharing and certain other items. In 2015, our profit sharing program paid 10% to employees for the first \$2.5 billion of annual profit and 20% of annual profit above \$2.5 billion. Beginning with 2016 pre-tax profit (for the profit sharing payment in 2017), the profit sharing formula has been adjusted to pay 10% of annual pre-tax profit (as defined by the terms of the program) and, if we exceed our prior year results, the program will pay 20% of the year-over-year

increase in pre-tax profit to eligible employees. The profit sharing program for pilots remains unchanged from the prior year. During the nine months ended September 30, 2016, we accrued \$922 million in profit sharing expense based on current expectations for 2016 pre-tax profit.

We paid \$1.5 billion in profit sharing in February 2016 related to our 2015 pre-tax profit in recognition of our employees' contributions toward meeting our financial goals. We paid \$756 million in profit sharing in February 2015, after making an advanced profit sharing payment of more than \$300 million in October 2014, related to our 2014 pre-tax profit.

*Pilot Working Agreement.* On September 30, 2016, we reached a comprehensive agreement in principle with ALPA for a new Pilot Working Agreement. From this agreement in principle, a tentative agreement will be finalized and presented to ALPA's MEC. If the MEC approves the tentative agreement, the agreement will be presented to our pilots for ratification. This process could take several months. If this new agreement is ratified, the pilots will receive an 18% pay increase retroactive to January 1, 2016.

#### *Investing Activities*

*Capital Expenditures.* Our capital expenditures were \$2.6 billion and \$2.1 billion for the nine months ended September 30, 2016 and 2015, respectively. Our capital expenditures during the nine months ended September 30, 2016 were primarily related to the purchase of B-737-900ER aircraft to replace a portion of our older B-757-200 aircraft, purchases of A321-200, E190-100 and A330-300 aircraft, advanced deposit payments on future aircraft order commitments, and seat density projects for our domestic fleet.

We have committed to future aircraft purchases that will require significant capital investment and have obtained, but are under no obligation to use, long-term financing commitments for a substantial portion of the purchase price of a significant number of these aircraft. Our total 2016 investment of over \$3 billion will be primarily for (1) aircraft, including deliveries of B-737-900ERs, A321-200s and A330-300s, along with advance deposit payments for these and our A330-900neo, A350-900 and CS100 orders, as well as for (2) aircraft modifications, the majority of which relate to increasing the seat density and enhancing the cabins on our domestic fleet.

*Equity Investments.* During 2015, we announced our intention to acquire additional shares of the capital stock of Grupo Aeroméxico through a cash tender offer, subject to regulatory approvals. If approved, the tender offer is expected to be completed in the next six months. As a result of this tender offer, when combined with our current holdings, we would own up to 49% of the outstanding capital stock of Grupo Aeroméxico. Based on current exchange rates, the total amount to be paid for the additional shares and the shares underlying the derivatives would be approximately \$710 million.

*LAX Redevelopment.* During the September 2016 quarter, we executed a new lease agreement with Los Angeles World Airports ("LAWA"), which owns and operates Los Angeles International Airport ("LAX"), and announced plans to modernize, upgrade and connect Terminals 2 and 3 at LAX over the next seven years. Based on the lease agreement, we will design and manage the construction of the initial investment of \$350 million to renovate gate areas, support space and other amenities for passengers; upgrade the baggage handling systems in the terminals; and facilitate the relocation of those airlines currently located in Terminals 2 and 3 to Terminals 5, 6, and Tom Bradley International Terminal ("TBIT"). Subject to required approvals, we have an option to expand the project, which is expected to cost an additional \$1.5 billion and would include (1) redevelopment of Terminal 3 and enhancement of Terminal 2; (2) rebuild of the ticketing, arrival hall and security checkpoint; (3) construction of infrastructure for the planned airport people mover; (4) ramp improvements; and (5) construction of a secure connector to the north side of TBIT.

We expect a substantial majority of the project costs will be funded by loans to be issued to a quasi-governmental entity, and the outstanding loans will be repaid with the proceeds from LAWA's purchase of completed project assets.

#### *Financing Activities*

*Debt and Capital Leases.* The principal amount of debt and capital leases was \$7.7 billion at September 30, 2016. Since December 31, 2009, we have reduced our principal amount of debt and capital leases by \$10.6 billion. We have focused on reducing our total debt in recent years as part of our strategy to strengthen our balance sheet. As a result, in the past year we have received upgrades to our credit ratings by all three major rating agencies, including investment grade ratings from Moody's and Fitch. Continued improvement in our credit ratings could result in lower costs of borrowing, among other benefits. At September 30, 2016, our ratings were:

| Rating Agency     | Current Rating | Outlook  |
|-------------------|----------------|----------|
| Moody's           | Baa3           | Stable   |
| Fitch             | BBB-           | Stable   |
| Standard & Poor's | BB+            | Positive |

*Capital Return to Shareholders.* During the nine months ended September 30, 2016, we repurchased and retired 54 million shares of our common stock at a cost of \$2.3 billion, including \$350 million of shares repurchased in conjunction with treasury stock we contributed to our qualified defined benefit pension plans.

| (in millions, except average repurchase price) | Share Repurchase Authorization | Average Repurchase Price | Completion Date   | Authorization Remaining |
|--|--------------------------------|--------------------------|-------------------|-------------------------|
| May 2013 Program                               | \$ 500                         | \$ 28.43                 | June 30, 2016     | Completed<br>June 2014  |
| May 2014 Program                               | \$ 2,000                       | \$ 42.86                 | December 31, 2016 | Completed<br>June 2015  |
| May 2015 Program                               | \$ 5,000                       | \$ 43.62                 | December 31, 2017 | \$ 1,650                |

In the June 2016 quarter, the Board of Directors approved a program to increase the quarterly dividend by 50% to \$.025 per share beginning in the September 2016 quarter.

*Fuel Hedge Restructuring.* During the June 2016 quarter, we early terminated certain of our outstanding deferral transactions and made cash payments of \$170 million, including normal settlements. As a result, during the nine months ended September 30, 2016, we reported \$166 million in cash receipts and \$401 million in cash payments associated with these transactions. For additional information regarding these deferral transactions, see Note 4 to the Notes to the Condensed Consolidated Financial Statements.

#### *Undrawn Lines of Credit*

We have \$2.4 billion available in undrawn revolving lines of credit. Our credit facilities have covenants, including minimum collateral coverage ratios. If we are not in compliance with these covenants, we may be required to repay amounts borrowed under the credit facilities or we may not be able to draw on them. We currently have a substantial amount of unencumbered assets available to pledge as collateral.

#### *Covenants*

We were in compliance with the covenants in our financing agreements at September 30, 2016.

## **Critical Accounting Policies and Estimates**

For information regarding our Critical Accounting Policies and Estimates, see the “Critical Accounting Policies and Estimates” section of “Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations” in our Form 10-K.

### ***Recent Accounting Standards***

#### *Revenue from Contracts with Customers*

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." Under this ASU and subsequently issued amendments, revenue is recognized at the time a good or service is transferred to a customer for the amount of consideration received. Entities may use a full retrospective approach or report the cumulative effect as of the date of adoption. The standard is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption of the standard is permitted, but not before December 15, 2016. We are currently evaluating how the adoption of the revenue recognition standard will impact our Consolidated Financial Statements.

#### *Leases*

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." This standard will require all leases with durations greater than twelve months to be recognized on the balance sheet and is effective for interim and annual reporting periods beginning after December 15, 2018, although early adoption is permitted.

Although we have not completed our assessment, we believe adoption of this standard will have a significant impact on our Consolidated Balance Sheets. However, we do not expect the adoption to change the recognition, measurement or presentation of lease expenses within the Consolidated Statements of Operations or the Consolidated Statements of Cash Flows. Information about our undiscounted future lease payments and the timing of those payments is in Note 7, "Lease Obligations," in our Form 10-K.

#### *Equity Method Investments*

In March 2016, the FASB issued ASU No. 2016-07, "Investments—Equity Method and Joint Ventures (Topic 323)." This standard eliminates the requirement that when an existing cost method investment qualifies for use of the equity method, an investor must restate its historical financial statements, as if the equity method had been used since the investment was acquired. Under the new guidance, at the point an investment qualifies for the equity method, any unrealized gain or loss in AOCI will be recognized through earnings.

We early adopted this standard in the March 2016 quarter. Although none of our available-for-sale or cost investments qualified for use of the equity method during 2016, we expect the tender offer for additional capital stock of Grupo Aeroméxico to be completed in the next six months, at which point our investment will qualify for the equity method of accounting. As of September 30, 2016, the unrealized gain recorded in AOCI related to our investment in Grupo Aeroméxico was \$4 million.

#### *Share-Based Compensation*

In March 2016, the FASB issued ASU No. 2016-09, "Compensation—Stock Compensation (Topic 718)." This standard makes several modifications to Topic 718 related to the accounting for forfeitures, employer tax withholding on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. ASU 2016-09 also clarifies the statement of cash flows presentation for certain components of share-based awards.

We early adopted this standard during the June 2016 quarter. The adoption of this standard resulted in the recognition of \$95 million of previously unrecognized excess tax benefits in deferred income taxes, net and an increase to retained earnings on our Consolidated Balance Sheet as of the beginning of the current year and the recognition of \$31 million of excess tax benefits to our income tax provision for the nine months ended September 30, 2016.



## Supplemental Information

We sometimes use information (“non-GAAP financial measures”) that is derived from the Condensed Consolidated Financial Statements, but that is not presented in accordance with GAAP. Under the U.S. Securities and Exchange Commission rules, non-GAAP financial measures may be considered in addition to results prepared in accordance with GAAP, but should not be considered a substitute for or superior to GAAP results.

The following table shows a reconciliation of CASM (a GAAP measure) to CASM-Ex, including profit sharing (a non-GAAP financial measure). We adjust CASM for the following items to determine CASM-Ex, including profit sharing, for the reasons described below:

*Aircraft fuel and related taxes.* The volatility in fuel prices impacts the comparability of year-over-year financial performance. The adjustment for aircraft fuel and related taxes (including our regional carriers) allows investors to better understand and analyze our non-fuel costs and year-over-year financial performance.

*Restructuring and other.* Because of the variability in restructuring and other, the adjustment for this item is helpful to investors to analyze our recurring core performance in the period shown.

*Other expenses.* Other expenses include aircraft maintenance and staffing services we provide to third parties, our vacation wholesale operations and refinery cost of sales to third parties. Because these businesses are not related to the generation of a seat mile, we adjust for the costs related to these sales to provide a more meaningful comparison of the costs of our airline operations to the rest of the airline industry.

|                                   | Three Months<br>Ended<br>September 30,<br>2016 |         | Nine Months<br>Ended<br>September 30,<br>2015 |         |
|-----------------------------------|--|---------|---|---------|
| CASM                              | 12.33 ¢  | 13.07 ¢ | 12.55 ¢                                       | 13.32 ¢ |
| Adjusted for:                     |  |         |   |         |
| Aircraft fuel and related taxes   | (2.39 )  | (3.05 ) | (2.33 )                                       | (3.14 ) |
| Restructuring and other           | —  | —       | —   | (0.02 ) |
| Other expenses                    | (0.36 )  | (0.45 ) | (0.43 )                                       | (0.50 ) |
| CASM-Ex, including profit sharing | 9.58 ¢   | 9.57 ¢  | 9.79 ¢  | 9.66 ¢  |

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes in market risk from the information provided in “Item 7A. Quantitative and Qualitative Disclosures About Market Risk” in our Form 10-K, other than those discussed below.

The following sensitivity analysis does not consider the effects of a change in demand for air travel, the economy as a whole or actions we may take to seek to mitigate our exposure to a particular risk. For these and other reasons, the actual results of changes in these prices or rates may differ materially from the following hypothetical results.

#### ***Aircraft Fuel Price Risk***

Changes in aircraft fuel prices materially impact our results of operations. We have historically managed our fuel price risk through a hedging program intended to reduce the financial impact from changes in the price of jet fuel as jet fuel prices are subject to potential volatility. During the March 2016 quarter, to better participate in the low fuel price environment, we entered into derivatives designed to offset and effectively neutralize our existing airline segment hedge positions. As a result, we locked in the amount of the net hedge settlements for the remainder of 2016 and 2017. During the June 2016 quarter, we early settled \$455 million of our airline segment's 2016 positions. During the September 2016 quarter, we recorded fuel hedge losses of \$11 million.

For the nine months ended September 30, 2016, aircraft fuel and related taxes, including our regional carriers, accounted for \$4.5 billion, or 19%, of our total operating expense, based on annual consumption of approximately four billion gallons of jet fuel. Assuming we do not enter into new derivative contracts, we are exposed to changes in the market price of jet fuel. A one cent increase in the cost of jet fuel would result in approximately \$40 million of additional annual fuel expense.

### **ITEM 4. CONTROLS AND PROCEDURES**

Our management, including our Chief Executive Officer and Chief Financial Officer, performed an evaluation of our disclosure controls and procedures, which have been designed to permit us to effectively identify and timely disclose important information. Our management, including our Chief Executive Officer and Chief Financial Officer, concluded that the controls and procedures were effective as of September 30, 2016 to ensure that material information was accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

During the three months ended September 30, 2016, we did not make any changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

“Item 3. Legal Proceedings” of our Form 10-K includes a discussion of our legal proceedings. The legal proceeding described below has been described previously, including in our Form 10-K. The matter is described in this Form 10-Q to include developments in the case since we filed our Form 10-K. Except as presented below, there have been no material changes from the legal proceedings described in our Form 10-K.

#### ***First Bag Fee Antitrust Litigation***

In May-July 2009, a number of purported class action antitrust lawsuits were filed against Delta and AirTran Airways (“AirTran”), alleging that Delta and AirTran engaged in collusive behavior in violation of Section 1 of the Sherman Act in November 2008 based upon certain public statements made in October 2008 by AirTran’s CEO at an analyst conference concerning fees for the first checked bag, Delta’s imposition of a fee for the first checked bag on November 4, 2008 and AirTran’s imposition of a similar fee on November 12, 2008. The plaintiffs sought to assert claims on behalf of an alleged class consisting of passengers who paid the first bag fee after December 5, 2008 and seek injunctive relief and unspecified treble damages. All of these cases have been consolidated for pre-trial proceedings in the Northern District of Georgia. On July 12, 2016, the Court issued an order granting the plaintiffs’ motion for class certification. On October 7, 2016, the U.S. Court of Appeals for the Eleventh Circuit granted the defendants’ petition for immediate review of this order, and that review remains pending. The defendants have filed motions for summary judgment, which also remain pending. Delta believes the claims in these cases are without merit and is vigorously defending these lawsuits.

### **ITEM 1A. RISK FACTORS**

“Item 1A. Risk Factors” of our Form 10-K and in our Form 10-Q for the quarterly period ended June 30, 2016 includes a discussion of our risk factors. There have been no material changes from the risk factors described in our Form 10-K and the referenced Form 10-Q.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table presents information with respect to purchases of common stock we made during the September 2016 quarter. The total number of shares purchased includes shares repurchased pursuant to our \$5 billion share repurchase program, which was publicly announced on May 13, 2015 (the "2015 Repurchase Program"). The 2015 Repurchase Program will terminate no later than December 31, 2017. Some purchases made in the September 2016 quarter were made pursuant to a trading plan meeting the requirements of Rule 10b5-1 under the Securities Exchange Act of 1934.

In addition, the table includes shares withheld from employees to satisfy certain tax obligations due in connection with grants of stock under the Delta Air Lines, Inc. Performance Compensation Plan (the "Plan"). The Plan provides for the withholding of shares to satisfy tax obligations. It does not specify a maximum number of shares that can be withheld for this purpose. The shares of common stock withheld to satisfy tax withholding obligations may be deemed to be "issuer purchases" of shares that are required to be disclosed pursuant to this Item.

| Period         | Total Number<br>of Shares<br>Purchased | Average<br>Price<br>Paid Per<br>Share | Approximate<br>Dollar Value<br>(in millions)  |  |
|----------------|--|---------------------------------------|---|--|
|                |  |                                       | Total Number<br>of Shares<br>Purchased as<br>Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | Total Number<br>of Shares<br>That May<br>Yet be<br>Purchased<br>Under the<br>Plan or<br>Programs |
| July 2016      | 2,447,165                              | \$39.61                               | 2,447,165   | \$ 2,055   |
| August 2016    | 7,923,113                              | \$37.17                               | 7,923,113   | \$ 1,760   |
| September 2016 | 2,935,771                              | \$37.73                               | 2,935,771   | \$ 1,650   |
| Total          | 13,306,049                             |                                       | 13,306,049  |  |

**ITEM 6. EXHIBITS**

(a) Exhibits

- 15 Letter from Ernst & Young LLP regarding unaudited interim financial information
- 31.1 Certification by Delta's Chief Executive Officer with respect to Delta's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2016
- 31.2 Certification by Delta's Executive Vice President and Chief Financial Officer with respect to Delta's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2016
- 32 Certification pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code by Delta's Chief Executive Officer and Executive Vice President and Chief Financial Officer with respect to Delta's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2016
- 101.INS XBRL Instance Document - The instance document does not appear in the interactive data file because its XBRL tags are embedded within the inline XBRL document.
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Labels Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Delta Air Lines, Inc.  
(Registrant)

/s/ Craig M. Meynard  
Craig M. Meynard  
Vice President and Chief Accounting Officer  
(Principal Accounting Officer)

October 13, 2016