BARCLAYS PLC
Form 6-K
March 01, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13A-16 OR 15D-16
UNDER THE SECURITIES EXCHANGE ACT OF 1934

March 01, 2016

Barclays PLC and
Barclays Bank PLC
(Names of Registrants)

1 Churchill Place
London E14 5HP
England

(Address of Principal Executive Offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F x Form 40-F

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes No x

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b):

This Report is a joint Report on Form 6-K filed by Barclays PLC and Barclays Bank PLC. All of the issued ordinary share capital of Barclays Bank PLC is owned by Barclays PLC.

This Report comprises:

Information given to The London Stock Exchange and furnished pursuant to General Instruction B to the General Instructions to Form 6-K.

EXHIBIT INDEX

Annual Financial Report dated 01 March 2016

SIGNATURES

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

BARCLAYS PLC
(Registrant)

Date: March 01, 2016

By: /s/ Patrick Gonsalves

Patrick Gonsalves
Deputy Secretary

BARCLAYS BANK PLC
(Registrant)

Date: March 01, 2016

By: /s/ Patrick Gonsalves

Patrick Gonsalves
Joint Secretary

1 March 2016

Barclays PLC

Annual Report and Accounts 2015

UK Listing Authority submissions

In compliance with Disclosure & Transparency Rule (DTR) 4.1, Barclays PLC announces that the following documents will today be submitted to the National Storage Mechanism and will shortly be available for inspection at: www.Hemscott.com/nsm.do

· Barclays PLC Annual Report 2015;
· Barclays PLC Strategic Report 2015; and
· Pillar 3 Report for 2015

These documents may also be accessed via Barclays PLC's website at home.barclays/investorrelations

The Barclays PLC Strategic Report 2015 (or the full Annual Report 2015 for those shareholders who have requested it) will be posted to shareholders on Friday, 18 March 2016.

Additional information

The following information is extracted from the Barclays PLC Annual Report 2015 (page references are to pages in the Annual Report) and should be read in conjunction with Barclays PLC's Final Results announcement issued on 1 March 2016. Both documents can be found at home.barclays/investorrelations and together constitute the material required by DTR 6.3.5 to be communicated to the media in unedited full text through a Regulatory Information Service. This material is not a substitute for reading the Barclays PLC Annual Report 2015 in full.

Risk Review
Material existing and emerging risks

Material existing and emerging risks to the Group's future performance

This section describes the material risks to which senior management pays particular attention, which they believe could cause the future results of the Group's operations, financial condition and prospects to differ materially from current expectations. These expectations include the ability to pay dividends, maintain appropriate levels of capital and meet capital and leverage ratio targets, and achieve stated commitments as outlined in the Strategic Report. In addition, risks relating to the Group that are not currently known, or that are currently deemed immaterial, may individually or cumulatively have the potential to materially affect the future results of the Group's operations, financial condition and prospects.

Material risks and their impact are described below in two sections: i) risks which senior management believes are likely to impact a single Principal Risk; and ii) risks which senior management believes are likely to affect more than one Principal Risk. Certain risks below have been classified as an 'emerging risk', which is a risk that has the potential to have a significant detrimental effect on the Group's performance, but currently the outcome and the time horizon for the crystallisation of its possible impact is more uncertain and more difficult to predict than for other risk factors that are not identified as emerging risks.

More information on the management of risks may be found in Barclays' Approach to Managing Risk in the Barclays PLC 2015 Pillar 3 Report.

Material existing and emerging risks by Principal Risk

Credit risk

The financial condition of the Group's customers, clients and counterparties, including governments and other financial institutions, could adversely affect the Group.

The Group may suffer financial loss if any of its customers, clients or market counterparties fails to fulfil their contractual obligations to the Group. The Group may also suffer loss when the value of its investment in the financial instruments of an entity falls as a result of that entity's credit rating being downgraded. In addition, the Group may incur significant unrealised gains or losses due to changes in the Group's credit spreads or those of third parties, as these changes affect the fair value of the Group's derivative instruments, debt securities that the Group holds or issues, and loans held at fair value.

i) Deterioration in political and economic environment
The Group's performance is at risk from deterioration in the economic and political environment which may result from a number of uncertainties, including the following:

a) Specific regions
Political instability, economic uncertainty or deflation in regions in which the Group operates could weaken growth prospects and have an adverse impact on customers' ability to service debt and so result in higher impairment charges for the Group. These include:

China (emerging risk)
Economic uncertainty in China continues to affect a number of emerging economies, particularly those with high fiscal deficits and those reliant on short-term external financing and/or material reliance on commodity exports. Their vulnerability has been further impacted by the fall, and sustained volatility in oil prices, the strong US dollar and the winding down of quantitative easing policies by some central banks. The impact on the Group may vary depending on the vulnerabilities present in each country, but the impact may result in increased impairment charges through sovereign defaults, or the inability or unwillingness of clients and counterparties in that country to meet their debt obligations.

South Africa

The negative economic outlook in South Africa continues, with a challenging domestic and external environment. Recent political events including changes to leaders in the Finance Ministry have added to the domestic challenges. Real GDP growth remains low as a result of declining global demand, in particular China, prices for key mineral exports, a downturn in tourism, persistent power shortages and slowing house price growth. In the retail sector, concerns remain over the level of consumer indebtedness and affordability as the slowdown in China impacts the mining sector with job losses increasing. Emerging market turmoil has added further pressure on the Rand, which has continued to depreciate against major currencies. The decline in the economic outlook may impact a range of industry sectors in the corporate portfolio, with clients with higher leverage being impacted most.

b) Interest rate rises, including as a result of slowing of monetary stimulus, could impact consumer debt affordability and corporate profitability

To the extent that central banks increase interest rates in certain developed markets, particularly in our main markets, the UK and the US, they are expected to be small and gradual in scale during 2016, albeit following differing timetables. The first of these occurred in the US with a quarter point rise in December 2015. While an increase may support Group income, any sharper than expected changes could cause stress in the loan portfolio and underwriting activity of the Group, particularly in relation to non-investment grade lending, leading to the possibility of the Group incurring higher impairment. Higher credit losses and a requirement to increase the Group's level of impairment allowance would most notably occur in the Group's retail unsecured and secured portfolios as a result of a reduction in recoverability and value of the Group's assets, coupled with a decline in collateral values.

Interest rate increases in developed markets may also negatively impact emerging economies, as capital flows to mature markets to take advantage of the higher returns and strengthening economic fundamentals.

ii) Specific sectors

The Group is subject to risks arising from changes in credit quality and recovery rate of loans and advances due from borrowers and counterparties in a specific portfolio. Any deterioration in credit quality could lead to lower recoverability and higher impairment in a specific sector. The following provides examples of areas of uncertainties to the Group's portfolio which could have a material impact on performance.

a) UK property

With UK property representing the most significant portion of the overall PCB credit exposure, the Group is at risk from a fall in property prices in both the residential and commercial sectors in the UK. Strong house price growth in London and the South East of the UK, fuelled by foreign investment, strong buy to let (BTL) demand and subdued housing supply, has resulted in affordability levels reaching record levels; average house prices as at the end of 2015 were more than seven times average earnings. A fall in house prices, particularly in London and the South East of the UK, would lead to higher impairment and negative capital impact as loss given default (LGD) rates increase. Potential losses would likely be most pronounced in the higher loan to value (LTV) segments.

The proposal on BTL properties announced by the UK Chancellor of the Exchequer in 2015, changing both the level of tax relief on rental income and increasing levels of stamp duty from April 2016, may cause some dislocation in the BTL market. Possible impacts include a reduced appetite in the BTL market and an influx of properties for sale causing downward pricing pressure, as well as reduced affordability as increased tax liabilities reduce net retail yields. As a consequence this may lead to an increase in BTL defaults at a time when market values may be suppressed, with the potential that, while the Group carefully manages such exposures, it may experience increased credit losses and impairment from loans with high LTV ratios.

b) Natural Resources (emerging risk)

The risk of losses and increased impairment is more pronounced where leverage is higher, or in sectors currently subject to strain, notably oil and gas, mining and metals and commodities. Sustained oil price depression continues and is driven by ongoing global excess supply. While the positioning of these portfolios is relatively defensive and focuses on investment grade customers or collateralised positions, very severe stress in this market does have the potential to significantly increase credit losses and impairment.

c) Large single name losses
The Group has large individual exposures to single name counterparties. The default of such counterparties could have a significant impact on the carrying value of these assets. In addition, where such counterparty risk has been mitigated by taking collateral, credit risk may remain high if the collateral held cannot be realised, or has to be liquidated at prices which are insufficient to recover the full amount of the loan or derivative exposure. Any such defaults could have a material adverse effect on the Group's results due to, for example, increased credit losses and higher impairment charges.

d) Leverage Finance underwriting
The Group takes on significant sub-investment grade underwriting exposure, including single name risk, particularly focused in the US and Europe and to a lesser extent in South Africa and other regions. The Group is exposed to credit events and market volatility during the underwriting period. Any adverse events during this period may potentially result in loss for the Group or an increased capital requirement should there be a need to hold the exposure for an extended period.

Market risk

The Group's financial position may be adversely affected by changes in both the level and volatility of prices leading to lower revenues, or reduced capital:

i) Concerns of major unexpected changes in monetary policy and quantitative easing programmes, foreign exchange movements or slowdown in emerging market economies spilling over to global markets (emerging risk)
The trading business model is focused on client facilitation in wholesale markets, involving market making activities, risk management solutions and execution.

The Group's trading business is exposed to a rapid unwinding of quantitative easing programmes and deterioration in the macro environment driven by concerns in global growth. An extremely high level of volatility in asset prices could affect market liquidity and cause excess market volatility, impacting the Group's ability to execute client trades and may also result in lower income or portfolio losses.

A sudden and adverse volatility in interest or foreign currency exchange rates also has the potential to detrimentally impact the Group's income from non-trading activity.

This is because the Group has exposure to non-traded interest rate risk, arising from the provision of retail and wholesale non-traded banking products and services, including, products which do not have a defined maturity date and have an interest rate that does not change in line with base rate movements, e.g. current accounts. The level and volatility of interest rates can impact the Group's net interest margin, which is the interest rate spread earned between lending and borrowing costs. The potential for future volatility and margin changes remains in key areas such as in the UK benchmark interest rate to the extent such volatility and margin changes are not fully addressed by hedging programmes.

The Group is also at risk from movements in foreign currency exchange rates as these impact the sterling equivalent value of foreign currency denominated assets in the banking book, exposing it to currency translation risk.

ii) Adverse movements in the pension fund

Adverse movements between pension assets and liabilities for defined benefit pension schemes could contribute to a pension deficit. The liabilities discount rate is a key driver and, in accordance with International Financial Reporting Standards (IAS 19), is derived from the yields of high quality corporate bonds (deemed to be those with AA ratings) and consequently includes exposure to both risk-free yields and credit spreads. Therefore, the Group's defined benefits scheme valuation would be adversely affected by a prolonged fall in the discount rate or a persistent low rate and/or credit spread environment. Inflation is another significant risk driver to the pension fund, as the liabilities are adversely impacted by an increase in long term inflation expectation. However in the long term, inflation and rates risk tend to be negatively correlated and therefore partially offset each other.

Funding risk

The ability of the Group to achieve its business plans may be adversely impacted if it does not effectively manage its capital (including leverage), liquidity and other regulatory requirements.

The Group may not be able to achieve its business plans due to: i) being unable to maintain appropriate capital ratios; ii) being unable to meet its obligations as they fall due; iii) rating agency methodology changes resulting in ratings downgrades; and iv) adverse changes in foreign exchange rates on capital ratios.

i) Inability to maintain appropriate prudential ratios

Should the Group be unable to maintain or achieve appropriate capital ratios this could lead to: an inability to support business activity; a failure to meet regulatory capital requirements including the requirements of regulator set stress tests; increased cost of funding due to deterioration in credit ratings; restrictions on distributions including the ability to meet dividend targets; and/or the need to take additional measures to strengthen the Group's capital or leverage position. While the requirements in CRD IV are now in force in the UK, further changes to capital requirements could occur, whether as a result of (i) further changes to EU legislation by EU legislators (for example, implementation of Bank of International Settlements (BIS) regulatory update recommendations), (ii) relevant binding regulatory technical standards updates by the European Banking Authority (EBA), (iii) changes to UK legislation by the UK government, (iv) changes to PRA rules by the PRA, or (v) additional capital requirements through Financial Policy Committee (FPC) recommendations. Such changes, either individually and/or in aggregate, may lead to further unexpected additional requirements in relation to the Group's regulatory capital.

Additional prudential requirements may also arise from other regulatory reforms, including UK, EU and the US proposals on bank structural reform and current proposals for 'Minimum Requirement for own funds and Eligible Liabilities (MREL) under the EU Bank Recovery and Resolution Directive (BRRD). Included within these reforms are the BoE proposals on MREL requirements for UK banks which were published in December 2015. The BoE stated its intentions to communicate MREL requirements to UK banks during 2016. Many of the proposals are still subject to finalisation and implementation and may have a different impact when in final form. The impact of these proposals is still being assessed. Overall, it is likely that these changes in law and regulation will have an impact on the Group as they are likely, when implemented, to require changes to the legal entity structure of the Group and how businesses are capitalised and funded. Any such increased prudential requirements may also constrain the Group's planned activities, lead to forced asset sales and balance sheet reductions and could increase the Group's costs, impact on the Group's earnings and restrict the Group's ability to pay dividends. Moreover, during periods of market dislocation, as currently seen, or when there is significant competition for the type of funding that the Group needs, increasing the Group's capital resources in order to meet targets may prove more difficult and/or costly.

ii) Inability to manage liquidity and funding risk effectively
Failure to manage its liquidity and funding risk effectively may result in the Group either not having sufficient financial resources to meet its payment obligations as they fall due or, although solvent, only being able to meet these obligations at excessive cost. This could cause the Group to fail to meet regulatory liquidity standards, be unable to support day-to-day banking activities, or no longer be a going concern.

iii) Credit rating changes and the impact on funding costs
A credit rating assesses the creditworthiness of the Group, its subsidiaries and branches and is based on reviews of a broad range of business and financial attributes including risk management processes and procedures, capital strength, earnings, funding, liquidity, accounting and governance. Any adverse event to one or more of these attributes may lead to a downgrade, which in turn could result in contractual outflows to meet contractual requirements on existing contracts.

Furthermore, outflows related to a multiple notch credit rating downgrade are included in the LRA stress scenarios and a portion of the liquidity pool held against this risk. There is a risk that any potential downgrades could impact the Group's performance should borrowing costs and liquidity change significantly versus expectations.

For further information, please refer to Credit Ratings in the Liquidity Risk Performance section on page 199.

iv) Adverse changes in foreign exchange rates on capital ratios
The Group has capital resources and risk weighted assets denominated in foreign currencies. Therefore changes in foreign currency exchange rates may adversely impact the sterling equivalent value of foreign currency denominated capital resources and risk weighted assets. As a result, the Group's regulatory capital ratios are sensitive to foreign currency movements, and a failure to appropriately manage the Group's balance sheet to take account of foreign currency movements could result in an adverse impact on regulatory capital ratios. The impact is difficult to predict with any accuracy, but it may have a material adverse effect on the Group if capital and leverage ratios fall below required levels.

Operational risk

The operational risk profile of the Group may change as a result of human factors, inadequate or failed internal processes and systems, or external events.

The Group is exposed to many types of operational risk. This includes: fraudulent and other internal and external criminal activities; breakdowns in processes, controls or procedures (or their inadequacy relative to the size and scope of the Group's business); systems failures or an attempt, by an external party, to make a service or supporting infrastructure unavailable to its intended users, and the risk of geopolitical cyber threat activity which destabilises or destroys the Group's information technology, or critical infrastructure the Group depends upon but does not control. The Group is also subject to the risk of business disruption arising from events wholly or partially beyond its control, for example, natural disasters, acts of terrorism, epidemics and transport or utility failures, which may give rise to losses or reductions in service to customers and/or economic loss to the Group. All of these risks are also applicable where the Group relies on outside suppliers or vendors to provide services to it and its customers. The operational risks that the Group is exposed to could change rapidly and there is no guarantee that the Group's processes, controls, procedures and systems are sufficient to address, or could adapt promptly to, such changing risks to avoid the risk of loss.

i) Cyber attacks (emerging risk)
The risk posed by cyber attacks continues to grow. The proliferation of online marketplaces trading criminal services and stolen data has reduced barriers of entry for criminals to perpetrate cyber attacks, while at the same time increasing motivation.

Attacker capabilities continue to evolve as demonstrated by a marked increase in denial of service attacks, and increased sophistication of targeted fraud attacks by organised criminal networks. We face a growing threat to our information (whether it is held by us or in our supply chain), to the integrity of our financial transactions, and to the availability of our services. All of these necessitate a broad intelligence and response capability.

Given the level of increasing global sophistication and scope of potential cyber attacks, future attacks may lead to significant breaches of security which jeopardise the sensitive information and financial transactions of the Group, its clients, counterparties, or customers, or cause disruption to systems performing critical functions. Failure to adequately manage cyber threats and to continually review and update processes in response to new threats could result in increased fraud losses, inability to perform critical economic functions, customer detriment, regulatory censure and penalty, legal liability and reputational damage.

ii) Infrastructure and technology resilience
As the dependency on digital channels and other technologies grows, the impact of technology issues can become more material and immediate. This is also the case in many other industries and organisations but particularly impactful in the banking sector.

The Group's technology, real-estate and supplier infrastructure is critical to the operation of its businesses and to the delivery of products and services to customers and clients and to meet our market integrity obligations. Sustained disruption to services provided by Barclays, either directly or through third parties, could have a significant impact to customers and to the Group's reputation and may also lead to potentially large costs to rectify the issue and reimburse losses incurred by customers, as well as possible regulatory censure and penalties.

iii) Ability to hire and retain appropriately qualified employees
The Group requires a diverse mix of highly skilled and qualified colleagues to deliver its strategy and so is dependent on attracting and retaining appropriately qualified individuals. Barclays ability to attract and retain such talent is impacted by a range of external and internal factors.

External regulatory changes such as the introduction of the Individual Accountability Regime and the required deferral and claw back provisions of our compensation arrangements may make Barclays a less attractive proposition relative to both our international competitors and other industries. Similarly, meeting the requirements of structural reform may increase the competitiveness in the market for talent. Internally, restructuring of our businesses and functions, and an increased focus on costs may all have an impact on employee engagement and retention.

Failure to attract or prevent the departure of appropriately qualified employees who are dedicated to overseeing and managing current and future regulatory standards and expectations, or who have the necessary skills required to deliver the Group strategy, could negatively impact our financial performance, control environment and level of employee engagement.

iv) Losses due to additional tax charges
The Group is subject to the tax laws in all countries in which it operates, including tax laws adopted at the EU level, and is impacted by a number of double taxation agreements between countries. There is risk that the Group could suffer losses due to additional tax charges, other financial costs or reputational damage due to a range of possible factors. This includes a failure to comply with, or correctly assess the application of, relevant tax law, a failure to deal with tax authorities in a timely and effective manner or an incorrect calculation of tax estimates for reported and

forecast tax numbers. Such charges, or the conduct of any dispute with a relevant tax authority, could lead to adverse publicity, reputational damage and potentially to costs materially exceeding current provisions, which could have an adverse effect on the Group's operations, financial conditions and prospects.

v) Critical accounting estimates and judgements

The preparation of financial statements in accordance with IFRS requires the use of estimates. It also requires management to exercise judgement in applying relevant accounting policies. The key areas involving a higher degree of judgement or complexity, or areas where assumptions are significant to the consolidated and individual financial statements include provisions for conduct and legal, competition and regulatory matters, fair value of financial instruments, credit impairment charges for amortised cost assets, impairment and valuation of available for sale investments, calculation of current and deferred tax and accounting for pensions and post-retirements benefits. There is a risk that if the judgement exercised, or the estimates or assumptions used, subsequently turn out to be incorrect, this could result in significant loss to the Group, beyond what was anticipated or provided for.

As part of the assets in the Non-Core business, the Group holds a UK portfolio of generally longer term loans to counterparties in ESHLA sectors, which are measured on a fair value basis. The valuation of this portfolio is subject to substantial uncertainty due to the long dated nature of the portfolios, the lack of a secondary market in the relevant loans and unobservable loan spreads. As a result of these factors, the Group may be required to revise the fair values of these portfolios to reflect, among other things, changes in valuation methodologies due to changes in industry valuation practices and as further market evidence is obtained in connection with the Non-Core asset rundown and exit process. For further information refer to Note 18 Fair value of assets and liabilities of the Group's consolidated financial statements.

The further development of standards and interpretations under IFRS could also significantly impact the financial results, condition and prospects of the Group. The introduction of the impairment requirements of IFRS 9 Financial Instruments will result in impairment being recognised earlier than is the case under IAS 39 because it requires expected losses to be recognised before the loss event arises. Measurement will involve increased complexity and judgement including estimation of probabilities of defaults, losses given default, a range of unbiased future economic scenarios, estimation of expected lives, estimation of exposures at default and assessing increases in credit risk. It is expected to have a material financial impact, but it will not be practical to disclose reliable financial impact estimates until the implementation programme is further advanced.

For more information please refer to Note 1 Significant accounting policies on pages 260 to 262.

vi) Legal, competition and regulatory matters

Legal disputes, regulatory investigations, fines and other sanctions relating to conduct of business and financial crime may negatively affect the Group's results, reputation and ability to conduct its business.

The Group conducts diverse activities in a highly regulated global market and is therefore exposed to the risk of fines and other sanctions relating to the conduct of its business. In recent years authorities have increasingly investigated past practices, vigorously pursued alleged breaches and imposed heavy penalties on financial services firms. This trend is expected to continue. In relation to financial crime, a breach of applicable legislation and/or regulations could result in the Group or its staff being subject to criminal prosecution, regulatory censure and other sanctions in the jurisdictions in which it operates, particularly in the UK and the US. Where clients, customers or other third parties are harmed by the Group's conduct this may also give rise to legal proceedings, including class actions. Other legal disputes may also arise between the Group and third parties relating to matters such as breaches, enforcement of legal rights or obligations arising under contracts, statutes or common law. Adverse findings in any such matters may result in the Group being liable to third parties seeking damages, or may result in the Group's rights not being enforced as intended.

Details of material legal, competition and regulatory matters to which the Group is currently exposed are set out in Note 29 Legal, competition and regulatory matters. In addition to those material ongoing matters, the Group is engaged in various other legal proceedings in the UK and a number of overseas jurisdictions which arise in the ordinary course of business. The Group is also subject to requests for information, investigations and other reviews by regulators, governmental and other public bodies in connection with business activities in which the Group is or has been engaged. In light of the uncertainties involved in legal, competition and regulatory matters, there can be no assurance that the outcome of a particular matter or matters will not be material to the Group's results, operations or cash flow for a particular period, depending on, among other things, the amount of the loss resulting from the matter(s) and the amount of income otherwise reported for the period.

The outcome of material, legal, competition and regulatory matters, both those to which the Group is currently exposed and any others which may arise in the future, is difficult to predict. However, it is likely that in connection with any such matters the Group will incur significant expense, regardless of the ultimate outcome, and any such matters could expose the Group to any of the following: substantial monetary damages and/or fines; remediation of affected customers and clients; other penalties and injunctive relief; additional litigation; criminal prosecution in certain circumstances; the loss of any existing agreed protection from prosecution; regulatory restrictions on the Group's business operations including the withdrawal of authorisations; increased regulatory compliance requirements; suspension of operations; public reprimands; loss of significant assets or business; a negative effect on the Group's reputation; loss of investor confidence and/or dismissal or resignation of key individuals.

There is also a risk that the outcome of any legal, competition or regulatory matters in which the Group is involved may give rise to changes in law or regulation as part of a wider response by relevant law makers and regulators. An adverse decision in any one matter, either against the Group or another financial institution facing similar claims, could lead to further claims against the Group.

vii) Risks arising from regulation of the financial services industry

The financial services industry continues to be the focus of significant regulatory change and scrutiny which may adversely affect the Group's business, financial performance, capital and risk management strategies. For further information on regulations affecting the Group, including significant regulatory developments, see the section on Supervision and Regulation.

a) Regulatory change

The Group, in common with much of the financial services industry, remains subject to significant levels of regulatory change and increasing scrutiny in many of the countries in which it operates (including, in particular, the UK and the US). This has led to a more intensive approach to supervision and oversight, increased expectations and enhanced requirements. As a result, regulatory risk will remain a focus for senior management and consume significant levels of business resources. Furthermore, this more intensive approach and the enhanced requirements, uncertainty and extent of international regulatory coordination as enhanced supervisory standards are developed and implemented may adversely affect the Group's business, capital and risk management strategies and/or may result in the Group deciding to modify its legal entity structure, capital and funding structures and business mix, or to exit certain business activities altogether or not to expand in areas despite otherwise attractive potential.

b) Changes in prudential requirements, including changes to CRD IV

The Group's results and ability to conduct its business may be negatively affected by changes to, or additional supervisory expectations.

In July 2015, the Financial Policy Committee (FPC) of the BoE published a policy statement directing the PRA to require all major UK banks and building societies to hold enough Tier 1 capital to satisfy a minimum leverage ratio of 3% and a countercyclical leverage ratio buffer of 35% of the institution-specific countercyclical capital buffer rate. The FPC also directed that UK G-SIBs and domestically systemically important banks should meet a supplementary leverage buffer ratio of 35% of corresponding risk-weighted capital buffer rates. The PRA published a policy statement, finalised rules and a supervisory statement implementing the FPC's directions in December 2015 and the new leverage ratio framework came into force on 1 January 2016.

In January 2016, the BCBS endorsed a new market risk framework, including rules made as a result of its fundamental review of the trading book, which will take effect in 2019. Barclays continues to monitor the potential effects on its capital position arising from these rules and from (i) revisions to the BCBS's standardised rules for credit risk, counterparty credit risk, CVA volatility risk and operational risk; and (ii) the BCBS considering the position regarding the limitation of the use of internal models in certain areas (for example, removing the Advanced Measurement Approach for operational risk) and applying RWA floors based on the standardised approaches.

Changes to, or additional supervisory expectations, in relation to capital and/or leverage ratio requirements either individually or in aggregate, may lead to unexpected enhanced requirements in relation to the Group's capital, leverage, liquidity and funding ratios or alter the way such ratios are calculated. This may result in a need for further management actions to meet the changed requirements, such as: increasing capital or liquidity resources, reducing leverage and risk weighted assets; modifying legal entity structure (including with regard to issuance and deployment of capital and funding for the Group); changing the Group's business mix or exiting other businesses; and/or undertaking other actions to strengthen the Group's position.

c) Market infrastructure reforms

The derivatives markets are subject to extensive and increasing regulation in many of the Group's markets, including, in particular, Europe pursuant to the European Market Infrastructure Regulation (EMIR) and in the US under the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 (DFA). Certain of these increased regulatory requirements have already come into force, with further provisions expected to become effective in stages, including through a new recast version of the Markets in Financial Instruments Directive and a new regulation (the Markets in Financial Instruments Regulation) in Europe.

It is possible that additional regulations, and the related expenses and requirements, will increase the cost of and restrict participation in the derivatives markets, thereby increasing the costs of engaging in hedging or other transactions and reducing liquidity and the use of the derivatives markets.

Changes in regulation of the derivatives markets could adversely affect the business of the Group and its affiliates in these markets and could make it more difficult and expensive to conduct hedging and trading activities, which could in turn reduce the demand for swap dealer and similar services of the Group and its subsidiaries. In addition, as a result of these increased costs, the new regulation of the derivatives markets may also result in the Group deciding to reduce its activity in these markets.

d) Recovery and resolution planning

There continues to be a strong regulatory focus on 'resolvability' from regulators, particularly in the UK, the US and South Africa. The Group made its first formal Recovery and Resolution Plan (RRP) submissions to the UK and US regulators in mid-2012 and made its first Recovery Plan submission to the South African regulators in 2013. Barclays continues to work with the relevant authorities to identify and address potential impediments to the Group's 'resolvability'.

In the UK, RRP work is considered part of continuing supervision. Removal of potential impediments to an orderly resolution of the Group or one or more of its subsidiaries is considered as part of the BoE and PRA's supervisory strategy for each firm, and the PRA can require firms to make significant changes in order to enhance resolvability. Barclays provides the PRA with a Recovery Plan annually and with a Resolution Pack every other year.

In the US, Barclays is one of several systemically important banks required to file resolution plans with the Board of Governors of the Federal Reserve System (Federal Reserve) and the Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) under provisions of the DFA. Pursuant to the resolution plan regulation in the US, a joint determination by the Agencies that a resolution plan is not credible or would not facilitate an orderly resolution under the US Bankruptcy Code may result in a bank being made subject to more stringent capital, leverage, or liquidity requirements, or restrictions on growth, activities or operations in the US.

Additionally, there are further resolution-related proposals in the US, such as the Federal Reserve's proposed regulation requiring internal total loss absorbing capital (TLAC) for Barclays' US Intermediate Holding Company (IHC) that will be established during 2016, and increased record keeping and reporting requirements for obligations under qualified financial contracts (QFC proposal) that may, depending on final rules, materially increase the operational and financing costs of Barclays' US operations.

In South Africa, the South African Treasury and the South Africa Reserve Bank are considering material new legislation and regulation to adopt a resolution and depositor guarantee scheme in alignment with FSB principles. Barclays Africa Group Limited (BAGL) and its primary subsidiary Absa Bank Limited, will be subject to these schemes when they are adopted. It is not clear what shape these schemes will take, or when the schemes will be adopted, but current proposals for a funded deposit insurance scheme and for operational continuity may result in material increases in operational and financing costs for the BAGL group.

While the Group believes that it is making good progress in reducing potential impediments to resolution, should the relevant authorities ultimately determine that the Group or any significant subsidiary could not be resolved in an orderly manner, the impact of potential structural changes that may be required to address such a determination (whether in connection with RRP or other structural reform initiatives) may impact capital, liquidity and leverage ratios, as well as the overall profitability of the Group, for example, due to duplicated infrastructure costs, lost cross-rate revenues and/or additional funding costs.

viii) Regulatory action in the event of a bank failure

The EU Bank Recovery and Resolution Directive (BRRD) contains provisions similar to the Banking Act on a European level, many of which augment and increase the powers which national regulators are required to have in the event of a bank failure.

The UK Banking Act 2009, as amended (the Banking Act) provides for a regime to allow the BoE (or, in certain circumstances, HM Treasury) to resolve failing banks in the UK. Under the Banking Act, these authorities are given powers to make share transfer orders and property transfer orders. Amendments introduced by the Banking Reform Act gave the BoE statutory bail-in power from 1 January 2015. This power enables the BoE to recapitalise a failed institution by allocating losses to its shareholders and unsecured creditors. It also allows the BoE to cancel liabilities or modify the terms of contracts for the purposes of reducing or deferring the liabilities of the bank under resolution, and gives it the power to convert liabilities into another form (e.g. equity). In addition to the bail-in power, relevant UK resolution authorities are granted additional powers under the Banking Act including powers to direct the sale or transfer of a relevant financial institution or all or part of its business in certain circumstances. Further, parallel developments such as the implementation in the UK of the FSB's TLAC requirements may result in increased risks that a bank would become subject to resolution authority requirements by regulators seeking to comply with international standards in this area. Please see Funding risk, inability to maintain appropriate prudential ratios on page 121.

If any of these powers were to be exercised, or there is an increased risk of exercise, in respect of the Group or any entity within the Group, this might result in a material adverse effect on the rights or interests of shareholders and creditors including holders of debt securities and/or could have a material adverse effect on the market price of shares and other securities issued by the Group. Such effects could include losses of shareholdings/associated rights including, the dilution of percentage ownership of the Group's share capital, and may result in creditors, including debt holders, losing all or a part of their investment in the Group's securities.

Conduct risk

Barclays is committed to Group-wide changes to business practices, governance and mindset and behaviours so that good customer outcomes and protecting market integrity are integral to the way Barclays operates. Improving our reputation will demonstrate to customers that in Barclays they have a partner they can trust. Conduct risk is the risk that detriment is caused to the Group's customers, clients, counterparties or the Group itself because of inappropriate judgement in the execution of our business activities.

During 2015 potential customer impact and reputation risk inherent in varied emerging risks has been managed across the Group and escalated to senior management for discussion. These risks will remain prevalent in 2016 and beyond and the most significant of these include:

i) Organisational change
The Group is at risk of not being able to meet customer and regulatory expectations due to a failure to appropriately manage the: i) complexity in business practice, processes and systems; ii) challenges faced in product suitability, automation and portfolio-level risk monitoring; iii) resilience of its technology; and, iv) execution strategy, including the failure to fulfil the high level of operational precision required for effective execution in order to deliver positive customer outcomes.

ii) Legacy issues
Barclays remains at risk from the potential outcomes of a number of investigations relating to our past conduct. While we are continuing to embed cultural change and improved governance, many stakeholders will remain sceptical and so until there is clear and sustained evidence of consistent cultural and behavioural change, the risk to Barclays' reputation will remain. Barclays continues to work to rebuild customer trust and market confidence impacted by legacy issues.

For further information in respect of such investigations and related litigation and discussion of the associated uncertainties, please see the Legal, competition and regulatory matters note on page 303.

iii) Market integrity
There are potential risks arising from conflicts of interest, including those related to the benchmark submission process. While primarily relevant to the Investment Bank, these potential risks may also impact the corporate and retail customer base. The Group may be adversely affected if it fails to mitigate the risk of individuals making such inappropriate judgement by the enhancing of operating models, and effective identification and management of conflicts of interest, controls and supervisory oversight.

iv) Financial crime
The Group, as a global financial services firm, is exposed to the risks associated with money laundering, terrorist financing, bribery and corruption and sanctions. As a result, the Group may be adversely affected if it fails to effectively mitigate the risk that its employees or third parties facilitate, or that its products and services are used to facilitate financial crime.

Any one, or combination, of the above risks could have significant impact on the Group's reputation and may also lead to potentially large costs to both rectify this issue and reimburse losses incurred by customers and regulatory censure and penalties.

Material existing and emerging risks potentially impacting more than one Principal Risk

i) Structural reform (emerging risk)
The UK Financial Services (Banking Reform) Act 2013 (the UK Banking Reform Act) and associated secondary legislation and regulatory rules, require the separation of the Group's UK and EEA retail and SME deposit taking

activities into a legally, operationally and economically separate and independent entity and restrict the types of activity such an entity may conduct (so-called 'ring fencing').

The PRA issued a policy statement (PS10/15) in May 2015 setting up legal structures and governance requirements that the UK regulator considers as 'near-final'. A PRA Consultation was issued in October 2015 relating to post ring fencing prudential requirements and intra-group arrangements among other matters. PRA final rules are expected in 2016. UK ring fencing rules will become binding from January 2019 and Barclays has an internal structural reform programme to implement the changes required by these new regulations (alongside other group structural requirements applicable to or in the course of development for the Group both in the UK and other jurisdictions in which the Group has operations - such as the proposed move towards a single point of entry (Holding Company) resolution model under the BoE's preferred resolution strategy and the requirement under section 165 of the DFA to create a US intermediate holding company (IHC) to hold the Group's US banking and non-banking subsidiaries) and to evaluate the Group's strategic options in light of all current and proposed global structural reform initiatives. Changes resulting from this work will have a material impact in the way the Group operates in the future through increased cost and complexity associated with changes required by ring fencing laws and regulations. Specifically, in order to comply with the UK Banking Reform Act and the DFA, it is proposed that:

- Barclays will create a new UK banking entity which will serve as the ring fenced bank (RFB). It is expected to serve retail and small business customers as well as UK Wealth and credit card customers

- Barclays Bank PLC (BBPLC) is expected to serve corporate, institutional and investment banking clients and will also serve international Wealth and credit card customers; it is also expected to house both the Corporate Banking payments and Barclaycard merchant acquiring businesses

- many of the Group’s US businesses (including Barclays Bank Delaware and Barclays Capital Inc., the Group’s US broker-dealer subsidiary) will be organised under an IHC

- the Group will establish a number of service companies in order to support its revised operating entity structure.

Implementation of these changes involves a number of risks related to both the revised Group entity structure and also the process of transition to that revised Group structure. Those risks include the following:

- the establishment and ongoing management of the RFB and BBPLC as separate entities will require the Group to evaluate and restructure its intra-group and external capital, funding and liquidity arrangements to ensure they continue to meet regulatory requirements and support business needs. The changes required by ring fencing will in particular impact the sources of funding available to the different entities, including restricting BBPLC’s access to certain categories of deposit funding

- while the Group will seek to manage the changes to business mix and capital, funding and liquidity resources so as to maintain robust credit ratings for each of its key operating entities, the restructuring required by ring fencing is complex and untested, and there is a risk that the changes may negatively impact the assessment made by credit rating agencies, creditors and other stakeholders of the credit strength of the different entities on a standalone basis. Adverse changes to the credit assessment, including the potential for ratings downgrades, could in turn make it more difficult and costly for the Group’s entities to obtain certain sources of funding

- the Financial Services and Markets Act 2000 (Banking Reform) (Pensions) Regulations 2015 provide that, after 1 January 2026, ring fence banks cannot be or become liable for pension schemes outside of the ring fence. To comply with the regulations, the Group will need to decide which Group entities will participate in the Barclays Bank UK Retirement Fund (UKRF) from 2026, and reach a mutually satisfactory position with the UKRF Trustee regarding past service liabilities. The Group is currently discussing a variety of options with the UKRF Trustee, and engaging with the PRA and the UK Pensions Regulator

- execution risk associated with moving a material number of customer accounts and contracts from one legal entity to another and in particular the risk of legal challenge to the ring-fenced transfer scheme that will be used in order to transfer certain assets and liabilities from BBPLC to the RFB

- customer impacts derived from operational changes related to, for example, the reorganisation of sort codes. In addition, uncertain and potentially varying customer preference in terms of being served by the RFB or BBPLC may increase the execution risk associated with ring fencing; customers may also be impacted by reduced flexibility to provide products through a single entity interface

- at the European level, the draft Bank Structural Reform Regulation contains powers restricting proprietary trading and, if certain conditions are met, for the mandated separation of core retail banking activity from certain trading activities save where a bank is already subject to a national regime which provides for the separation of such activities in a manner compatible with the regulation. The regulation is currently in draft form and no single version (including the scope of any national derogation) has yet been agreed by the Council of Ministers, the European Commission and the European Parliament. The implementation date for these proposals will depend on the date on which any final legislation is agreed. Accordingly, the potential impact on the Group remains unclear.

These, and other regulatory changes and the resulting actions taken to address such regulatory changes, may have an adverse impact on the Group's profitability, operating flexibility, flexibility of deployment of capital and funding, return on equity, ability to pay dividends, credit ratings, and/or financial condition.

ii) Business conditions, general economy and geopolitical issues
The Group's performance could be adversely affected in relation to more than one Principal Risk by a weak or deteriorating global economy or political instability. These factors may also occur in one or more of the Group's main countries of operation.

The Group offers a broad range of services to retail, institutional and government customers, in a large number of countries. The breadth of these operations means that deterioration in the economic environment, or an increase in political instability in countries where it is active, or any other systemically important economy, could adversely affect the Group's performance.

Global growth is expected to remain modest, with low single digit growth in advanced economies alongside a slowdown in emerging markets. This moderate economic performance, lower commodity prices and increased geopolitical tensions mean that the distribution of risks to global economic activity continues to be biased to the downside.

As the US Federal Reserve embarks on monetary policy tightening, the increasing divergence of policies between major advanced economies risks triggering further financial market volatility. The sharp change in value of the US dollar during 2015 reflected this and, has played a major role in driving asset price volatility and capital reallocation as markets adjusted. Changes to interest rate expectations risk igniting further volatility and US dollar appreciation, particularly if the US Federal Reserve were to increase rates faster than markets currently expect.

Emerging markets have already seen growth slow following increased capital outflows, but a deeper slowdown in growth could emerge if tighter US interest rate policy drives further reallocation of capital. Moreover, sentiment towards emerging markets as a whole continues to be driven in large part by developments in China, where there is significant concern around the ability of authorities to manage the growth transition towards services. A stronger than expected slowdown could result if authorities fail to appropriately manage the end of the investment and credit-led boom, while the consequences from a faster slowdown would flow through both financial and trade channels into other economies, and affect commodity markets.

Commodity prices, particularly oil prices, have already fallen significantly, but could fall further if demand growth remains weak or supply takes longer than expected to adjust. At the same time, countries with high reliance on commodity related earnings have already experienced a tightening of financial conditions. A sustained period of low prices risks triggering further financial distress, default and contagion.

In several countries, reversals of capital inflows, as well as fiscal austerity, have already caused deterioration in political stability. This could be exacerbated by a renewed rise in asset price volatility or sustained pressure on government finances. In addition, geopolitical tensions in some areas of the world, including the Middle East and Eastern Europe are already acute, and are at risk of further deterioration.

While in Europe, risks of stagnation, entrenched deflation and a Eurozone break up have diminished, they remain a risk.

In the UK, the referendum on EU membership gives rise to some political uncertainty and raises the possibility of a disruptive and uncertain exit from the EU, with attendant consequences for investment and confidence. Following the referendum in June 2016, in the event that there is a vote in favour of leaving the EU, a period of negotiation is likely, widely anticipated to be around two years, with unpredictable implications on market conditions.

A drop in business or consumer confidence related to the aforementioned risks may have a material impact on GDP growth in one or more significant markets and therefore Group performance. At the same time, even if output in most advanced economies does grow, it would also be likely to advance at a slower pace than seen in the pre-crisis period. Growth potential could be further eroded by the low levels of fixed asset investment and productivity growth.

For the Group, a deterioration of conditions in its key markets could affect performance in a number of ways including, for example: (i) deteriorating business, consumer or investor confidence leading to reduced levels of client activity; (ii) higher levels of default rates and impairment; and (iii) mark to market losses in trading portfolios resulting from changes in credit ratings, share prices and solvency of counterparties.

iii) Business change/execution (emerging risk)

As Barclays moves towards a single point of entry (Holding Company) resolution model and implementation of the structural reform programme execution, the expected level of structural and strategic change to be implemented over the medium term will be disruptive and is likely to increase funding and operational risks for the Group and could impact its revenues and businesses. These changes will include: the creation and rundown of Non-Core; the delivery against an extensive agenda of operational and technology control and infrastructure improvements; and, planned cost reductions. Execution may be adversely impacted by external factors (such as a significant global macroeconomic downturn or further significant and unexpected regulatory change in countries in which the Group operates) and/or internal factors (such as availability of appropriately skilled resources or resolution of legacy issues). Moreover, progress in regard to Barclays' strategic plans is unlikely to be uniform or linear and progress on certain targets may be achieved more slowly than others.

If any of the risks outlined above were to occur, singly or in aggregate, they could have a material adverse effect on the Group's business, results of operations and financial condition.

Related party transactions and Directors' remuneration

Related party transactions
Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions, or one other party controls both. The definition includes subsidiaries, associates, joint ventures and the Group's pension schemes.

Subsidiaries
Transactions between Barclays PLC and its subsidiaries also meet the definition of related party transactions. Where these are eliminated on consolidation, they are not disclosed in the Group Financial Statements. Transactions between Barclays PLC and its subsidiary, Barclays Bank PLC are fully disclosed in Barclays PLC's balance sheet and income statement. A list of the Group's principal subsidiaries is shown in Note 36.

Associates, joint ventures and other entities
The Group provides banking services to its associates, joint ventures, the Group pension funds (principally the UK Retirement Fund) and to entities under common directorships, providing loans, overdrafts, interest and non-interest bearing deposits and current accounts to these entities as well as other services. Group companies also provide investment management and custodian services to the Group pension schemes. The Group also provides banking services for unit trusts and investment funds managed by Group companies, which are not individually material. All of these transactions are conducted on the same terms as third party transactions. Summarised financial information for the Group's investments in associates and joint ventures is set out in Note 38.

Amounts included in the Group's financial statements, in aggregate, by category of related party entity are as follows:

	Associates £m	Joint ventures £m	Pension funds, unit trusts and investment funds £m
For the year ended and as at 31 December 2015			
Income	(19)	40	4
Impairment	(4)	(2)	-
Total assets	36	1,578	-
Total liabilities	158	133	184
For the year ended and as at 31 December 2014			
Income	(5)	9	4
Impairment	-	(1)	-
Total assets	130	1,558	-
Total liabilities	264	188	149
For the year ended and as at 31 December 2013			
Income	(10)	24	3
Impairment	(3)	(4)	-
Total assets	116	1,521	5
Total liabilities	278	185	207

Guarantees, pledges or commitments given in respect of these transactions in the year were £881m (2014: £911m) predominantly relating to joint ventures. No guarantees, pledges or commitments were received in the year. Derivatives transacted on behalf of the pension funds unit trusts and investment funds were £13m (2014: £587m).

Key Management Personnel

The Group's Key Management Personnel, and persons connected with them, are also considered to be related parties for disclosure purposes. Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of Barclays PLC (directly or indirectly) and comprise the Directors of Barclays PLC and the Officers of the Group, certain direct reports of the Group Chief Executive and the heads of major business units and functions.

There were no material related party transactions with entities under common directorship where a Director or other member of Key Management Personnel (or any connected person) is also a Director or other member of Key Management Personnel (or any connected person) of Barclays.

The Group provides banking services to Directors and other Key Management Personnel and persons connected to them. Transactions during the year and the balances outstanding were as follows:

Loans outstanding

	2015	2014
	£m	£m
As at 1 January	11.4	13.4
Loans issued during the year	1.1	1.3
Loan repayments during the year	(2.7)	(3.3)
As at 31 December	9.8	11.4

No allowances for impairment were recognised in respect of loans to Directors or other members of Key Management Personnel (or any connected person).

Deposits outstanding

	2015	2014
	£m	£m
As at 1 January	103.0	100.2
Deposits received during the year	44.8	25.7
Deposits repaid during the year	(31.3)	(22.9)
As at 31 December	116.5	103.0

Total commitments outstanding

Total commitments outstanding refers to the total of any undrawn amounts on credit cards and/or overdraft facilities provided to Key Management Personnel. Total commitments outstanding as at 31 December 2015 were £0.5m (2014: £1.3m).

All loans to Directors and other Key Management Personnel (and persons connected to them), (a) were made in the ordinary course of business, (b) were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other persons and (c) did not involve more than a normal risk of collectability or present other unfavourable features.

Remuneration of Directors and other Key Management Personnel

Total remuneration awarded to Directors and other Key Management Personnel below represents the awards made to individuals that have been approved by the Board Remuneration Committee as part of the latest remuneration decisions, and is consistent with the approach adopted for disclosures set out on pages 83 to 116. Costs recognised in the income statement reflect the accounting charge for the year and are included within operating expenses. The difference between the values awarded and the recognised income statement charge principally relates to the recognition of deferred costs for prior year awards. Figures are provided for the period that individuals met the definition of Directors and other Key Management Personnel.

	2015	2014
	£m	£m
Salaries and other short-term benefits	31.3	28.3
Pension costs	0.3	0.3
Other long-term benefits	4.7	8.1
Share-based payments	11.0	15.0
Employer social security charges on emoluments	5.2	5.8
Costs recognised for accounting purposes	52.5	57.5
Employer social security charges on emoluments	(5.2)	(5.8)
Other long-term benefits - difference between awards granted and costs recognised	2.5	(4.3)
Share-based payments - difference between awards granted and costs recognised	(2.3)	(8.4)
Total remuneration awarded	47.5	39.0

Disclosure required by the Companies Act 2006

The following information regarding Directors is presented in accordance with the Companies Act 2006:

	2015	2014
	£m	£m
Aggregate emolumentsa	7.0	7.8
Amounts paid under LTIPsb	2.2	-
	9.2	7.8

There were no pension contributions paid to defined contribution schemes on behalf of Directors (2014: nil). There were no notional pension contributions to defined contribution schemes.

As at 31 December 2015, there were no Directors accruing benefits under a defined benefit scheme (2014: nil).

Directors' and Officers' shareholdings and options

The beneficial ownership of ordinary share capital of Barclays PLC by all Directors and Officers of Barclays PLC (involving 26 persons) at 31 December 2015 amounted to 10,586,812 (2014: 9,078,157) ordinary shares of 25p each (0.06% of the ordinary share capital outstanding).

At 31 December 2015, executive Directors and officers of Barclays PLC (involving 32 persons) held options to purchase a total of 17,206 (2014: 30,398) Barclays PLC ordinary shares of 25p each at prices ranging from 133.01p to 178p under Sharesave.

Advances and credit to Directors and guarantees on behalf of Directors
In accordance with Section 413 of the Companies Act 2006, the total amount of advances and credits made available in 2015 to persons who served as Directors during the year was £0.3m (2014: £0.4m). The total value of guarantees entered into on behalf of Directors during 2015 was nil (2014: nil).

Notes

a The aggregate emoluments include amounts paid for the 2015 year. In addition, deferred share awards for 2015 will be made to Antony Jenkins and Tushar Morzaria which will only vest subject to meeting certain conditions. The total of the deferred share awards is £0.7m (£1.2m for 2014).

b The figure shown for 2015 in 'Amounts paid under long-term incentive schemes' is the amount that was released in 2015 in respect of the 2012-2014 Barclays Long Term Incentive Plan ('LTIP') cycle. The LTIP amount in the single total figure table for executive Directors' 2015 remuneration in the Directors' Remuneration report relates to the award that is scheduled to be released in 2016 in respect of the 2013-2015 LTIP cycle.

Directors' responsibility statement
The Directors have responsibility for ensuring that the Company and the Group keep accounting records which disclose with reasonable accuracy the financial position of the Company and the Group which enable them to ensure the accounts comply with the Companies Act 2006.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors, whose names and functions are set out on pages 36 and 37, confirm to the best of their knowledge that:

(a) the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole, and

(b) the management report, which is incorporated into the Directors' Report on pages 35 to 78, includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

Lawrence Dickinson
Company Secretary
29 February 2016

Barclays PLC
Registered in England, Company No. 48839

- Ends -

For further information, please contact:

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About Barclays

Barclays is a major global financial services provider engaged in retail banking, credit cards, corporate and investment banking and wealth and investment management, with an extensive presence in Europe, the Americas, Africa and Asia.

With over 300 years of history and expertise in banking, Barclays operates in over 50 countries and employs over 132,000 people. Barclays moves, lends, invests and protects money for 48 million customers and clients worldwide.

For further information about Barclays, please visit our website home.barclays

INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This document contains certain forward-looking statements within the meaning of Section 21E of the US Securities Exchange Act of 1934, as amended, and Section 27A of the US Securities Act of 1933, as amended, with respect to the Group. Barclays cautions readers that no forward-looking statement is a guarantee of future performance and that actual results or other financial condition or performance measures could differ materially from those contained in the forward-looking statements. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. Forward-looking statements sometimes use words such as 'may', 'will', 'seek', 'continue', 'aim', 'anticipate', 'target', 'projected', 'expect', 'estimate', 'intend', 'plan', 'goal', 'believe', 'achieve' or other words of similar meaning. Examples of forward-looking statements include, among others, statements regarding the Group's future financial position, income growth, assets, impairment charges and provisions, business strategy, capital, leverage and other regulatory ratios, payment of dividends (including dividend pay-out ratios), projected levels of growth in the banking and financial markets, projected costs or savings, original and revised commitments and targets in connection with the strategic cost programme and the Group Strategy Update, rundown of assets and businesses within Barclays Non-Core, estimates of capital expenditures and plans and objectives for future operations, projected employee numbers and other statements that are not historical fact. By their nature, forward-looking statements involve risk and uncertainty because they relate to future events and circumstances. These may be affected by changes in legislation, the development of standards and interpretations under International Financial Reporting Standards, evolving practices with regard to the interpretation and application of accounting and regulatory standards, the outcome of current and future legal proceedings and regulatory investigations, future levels of conduct provisions, the policies and actions of governmental and regulatory authorities, geopolitical risks and the impact of competition. In addition, factors including (but not limited to) the following may have an effect: capital, leverage and other regulatory rules (including with regard to the future structure of the Group) applicable to past, current and future periods; United Kingdom (UK), United States (US), Africa, Eurozone and global macroeconomic and business conditions; the effects of continued volatility in credit markets; market related risks such as changes in interest rates and foreign exchange rates; effects of changes in valuation of credit market exposures; changes in valuation of issued securities; volatility in capital markets; changes in credit ratings of any entities within the Group or any securities issued by such entities; the potential for one or more countries exiting the Eurozone; the implementation of the strategic cost programme; and the success of future acquisitions, disposals and other strategic transactions. A number of these influences and factors are beyond the Group's control. As a result, the Group's actual future results, dividend payments, and capital and leverage ratios may differ materially from the plans, goals, and expectations set forth in the

Group's forward-looking statements. Additional risks and factors which may impact the Group's future financial condition and performance are identified in our filings with the SEC (including, without limitation, our Annual Report on Form 20-F for the fiscal year ended 31 December 2015), which are available on the SEC's website at www.sec.gov.

Subject to our obligations under the applicable laws and regulations of the United Kingdom and the United States in relation to disclosure and ongoing information, we undertake no obligation to update publicly or revise any forward looking statements, whether as a result of new information, future events or otherwise.

a Date of Grant (the first day of the Option Period) are eligible to participate in the Purchase Plan; provided, however, that an eligible employee may not participate if such employee would own (directly or indirectly) 5% or more of the total combined voting power or value of all classes of stock of the company or a subsidiary, taking into account options to purchase stock and stock that may be purchased under the Purchase Plan. At the present time, no employee of the company would be prevented from participating by reason of this limitation. Approximately 42,000 employees are eligible to participate in the Purchase Plan.

Participation. An eligible employee may elect to participate in the Purchase Plan for any calendar quarter (beginning April 1, 2004) by designating a percentage of such employee's Eligible Compensation to be deducted from compensation for each pay period and paid into the Purchase Plan for such employee's account. The designated percentage may not be less than 1% nor more than 10% (or such greater percentage as the board or Human Resources Committee may establish from time to time before a Date of Grant). An eligible employee may participate in the Purchase Plan only by means of payroll deduction. No employee will be granted an option under the Purchase Plan that permits such employee's rights to purchase common stock to accrue at a rate that exceeds $25,000 of fair market value of such stock (determined at the time such option is granted) for the calendar year in which such option is outstanding. Unless an employee's payroll deductions are withdrawn (as described below), the aggregate payroll deductions credited to the employee's account will be used to purchase shares of common stock at the end of the Option Period. The per share purchase price of the common stock will be 85% of the lesser of the fair market value of the common stock on the Date of Grant or on the Date of Exercise (the last day of the Option Period); provided, however, in any event the minimum Option Price that may be paid by a participant may not be less than $10 per share (subject to

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adjustment). The board and Human Resources Committee each have the power to increase the purchase price percentage from 85% of the fair market value to a greater percentage as determined in the discretion of the board or Human Resources Committee and to make other changes to comply with future accounting rules. For all purposes under the Purchase Plan, the fair market value of a share of common stock on a particular date shall be equal to the closing market price of such stock on the NYSE on that date (or, if no shares of common stock have been traded on that date, on the prior regular business date on which shares of the common stock are so traded). If the Option Price for any Option Period is less than the minimum Option Price, then the participant's option relating to such Option Period will automatically terminate and the company will refund to each participant the amount of his unused payroll deductions. Payroll deductions will be included in the general funds of the company, free of any trust or other arrangement and may be used for any corporate purpose. No interest will be paid or credited to any participant.

Changes in and Withdrawal of Payroll Deductions. A participant may elect to decrease, suspend or resume payroll deductions during a relevant Option Period by delivering to the company a new payroll deduction authorization in the manner specified by the company. A participant may withdraw in whole from the Purchase Plan, but not in part, at any time prior to the Date of Exercise relating to a particular Option Period by timely delivering to the company a notice of withdrawal in the manner specified by the company. The company promptly will refund to the participant the amount of the participant's payroll deductions under the Purchase Plan that have not been otherwise returned or used upon exercise of options, and thereafter the participant's payroll deduction authorization and interest in unexercised options under the Purchase Plan will terminate.

Delivery of Shares; Restrictions on Transfer. As soon as practicable after each Date of Exercise, the company will deliver to a custodian (currently Mellon Investor Services) one or more certificates representing (or shall otherwise cause to be credited to the account of such custodian) the total number of whole shares of common stock respecting options exercised on such Date of Exercise in the aggregate (for both whole and fractional shares) of all of the participating eligible employees under the Purchase Plan. Any remaining amount representing a fractional share will not be certificated (or otherwise so credited) and will be carried forward to the next Date of Exercise for certification (or credit) as part of a whole share. Such custodian will keep accurate records of the beneficial interests of each participant in such shares by means of participant accounts under the Purchase Plan, and will provide each eligible employee with quarterly or such other periodic statements with respect thereto as the Human Resources Committee (or its designee) may specify. A participant may not generally transfer or otherwise dispose of the shares for a period of six months from the Date of Exercise. During this six-month period, the company (or the custodian) will retain custody of the shares. This period may be changed at the discretion of the board or Human Resources Committee.

Termination of Employment; Leaves of Absence. Except as described below, if the employment of a participant terminates for any reason, then the participant's participation in the Purchase Plan ceases and the company will refund the amount of such participant's payroll deductions under the Purchase Plan that have not yet been otherwise returned or used upon exercise of options. If the employment of a participant terminates due to retirement, death or disability, the participant, or the participant's designated beneficiary, as applicable, may elect either to (i) withdraw all of the accumulated unused payroll deductions and common stock credited to the participant's account or (ii) exercise the participant's option for the purchase of common stock at the end of the Option Period. Any excess cash in such account will be returned to the participant or such designated beneficiary. If no such election is timely received by the company, the participant or designated beneficiary will automatically be deemed to have elected the second alternative.

During a paid leave of absence approved by the company and meeting the requirements of Internal Revenue Service regulations, a participant's elected payroll deductions will continue. A

participant may not contribute to the Purchase Plan during an unpaid leave of absence. If a participant takes an unpaid leave of absence that is approved by the company and meets the requirements of Internal Revenue Service regulations, then such participant's payroll deductions for such Option Period that were made prior to such leave may remain in the Purchase Plan and be used to purchase common stock on the Date of Exercise relating to such Option Period. If a participant takes a leave of absence not described in the first or third sentence of this paragraph, then the participant will be considered to have withdrawn from the Purchase Plan. Further, notwithstanding the foregoing, if a participant takes a leave of absence that is described in the first or third sentence of this paragraph and such leave of absence exceeds the Maximum Period (generally, the 90-day period beginning on the first day of the participant's leave of absence or such longer period during which the participant's reemployment rights are guaranteed either by statute or contract), then the participant will be considered to have withdrawn from the Purchase Plan and terminated his or her employment for purposes of the Purchase Plan on the day immediately following the last day of the Maximum Period.

Restriction Upon Assignment of Option. An option granted under the Purchase Plan may not be transferred other than by will or the laws of descent and distribution. Subject to certain limited exceptions, each option is exercisable, during the employee's lifetime, only by the employee to whom granted.

Administration, Amendments and Termination. The Purchase Plan is to be administered by the Human Resources Committee of the board. In connection with its administration of the Purchase Plan, the Committee is authorized to interpret the Purchase Plan. Any of the payroll deduction authorizations, enrollment documents and any other forms and designations referenced in the Purchase Plan and their submission may be electronic or telephonic, as directed by the Human Resources Committee.

The Purchase Plan may be amended from time to time by the board or the Human Resources Committee, including but not limited to any amendment to conform the Purchase Plan to the requirements of SFAS 123 to prevent adverse accounting treatment of the Purchase Plan or the options granted thereunder or otherwise; provided, however, that no change in any option theretofore granted may be made that would impair the rights of a participant without the consent of such participant. The board in its discretion may terminate the Purchase Plan at any time with respect to any stock for which options have not theretofore been granted. Unless sooner terminated by the board, the Purchase Plan will terminate and no further options will be granted after December 31, 2014.

United States Federal Income Tax Consequences

The following is a brief summary of certain of the U.S. federal income tax consequences of certain transactions under the Purchase Plan based on federal income tax laws in effect on January 1, 2004. This summary applies to the Purchase Plan as normally operated and is not *intended to provide or supplement tax advice to eligible employees. The summary contains general statements based on current U.S. federal income tax statutes, regulations and currently available interpretations thereof. This summary is not intended to be exhaustive and does not describe state, local or foreign tax consequences or the effect, if any, of gift, estate and inheritance taxes. The Purchase Plan is not qualified under Section 401(a) of the Code.*

Tax Consequences to Participants. A participant's payroll deductions to purchase common stock are made on an after-tax basis. There is no tax liability to the participant when shares of common stock are purchased pursuant to the Purchase Plan. However, the participant may incur tax liability upon disposition (including by way of gift) of the shares acquired under the Purchase Plan. The participant's U.S. federal income tax liability will depend on whether the disposition is a qualifying disposition or a disqualifying disposition as described below.

If a qualifying disposition of the shares is made by the participant (i.e., a disposition that occurs more than two years after the first day of the Option Period in which the shares were purchased), or in the event of death (whenever occurring) while owning the shares, the participant will recognize in the year of disposition (or, if earlier, the year of the participant's death) ordinary income in an amount equal to the lesser of (i) the excess of the fair market value of the shares at the time of disposition (or death) over the Option Price or (ii) 15% of the fair market value of the shares at the Date of Grant (the beginning of the Option Period). Upon the sale of the shares, any amount realized in excess of the ordinary income recognized by the participant will be taxed to the participant as a long-term capital gain. If the shares are sold at less than the Option Price, then there will be no ordinary income. Instead, the participant will have a capital loss equal to the difference between the sales price and the Option Price.

If a disqualifying disposition of the shares is made (i.e., a disposition (other than by reason of death) within two years after the first day of the Option Period in which the shares were purchased) the participant generally will recognize ordinary income in the year of disposition in an amount equal to any excess of the fair market value of the shares at the Date of Exercise over the Option Price for the shares (even if no gain is realized on the sale or if a gratuitous transfer is made). Any further gain (or loss) realized by the participant generally will be taxed as short-term or long-term capital gain (or loss) depending on the holding period.

Tax Consequences to the Company or Participating Company. The company, or the Participating Company for which a participant performs services, will be entitled to a deduction only if the participant makes a disqualifying disposition of any shares purchased under the Purchase Plan. In such case, the company or such Participating Company can deduct as a compensation expense the amount that is ordinary income to the participant provided that, among other things, (i) the amount meets the test of reasonableness, is an ordinary and necessary business expense and is not an "excess parachute payment" within the meaning of Section 280G of the Code, (ii) any applicable reporting obligations are satisfied and (iii) the one million dollar limitation of Section 162(m) of the Code is not exceeded.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" APPROVAL OF THE 2004 EMPLOYEE STOCK PURCHASE PLAN, AS DESCRIBED ABOVE AND AS SET FORTH IN APPENDIX B, WHICH IS DESIGNATED AS PROPOSAL NO. 2 ON THE ENCLOSED PROXY.

Proposal 3:
RATIFICATION OF APPOINTMENT OF INDEPENDENT AUDITORS

The firm of Ernst & Young LLP has been our independent auditors since 1993, and the board of directors desires to continue to engage the services of this firm for the fiscal year ending December 31, 2004. Accordingly, the board of directors, upon the recommendation of the Audit Committee, has reappointed Ernst & Young LLP to audit the financial statements of Continental and its subsidiaries for fiscal 2004 and report on those financial statements. Stockholders are being asked to vote upon the ratification of the appointment. If stockholders do not ratify the appointment of Ernst & Young LLP, the Audit Committee will reconsider their appointment. Fees paid to Ernst & Young LLP during the last two fiscal years were as follows:

Audit Fees. Fees for professional services provided during the years ended December 31, 2003 and 2002, were $2.5 million and $3.4 million, respectively. Audit fees consist primarily of the audit and quarterly reviews of the consolidated financial statements, statutory audits of subsidiaries required by governmental or regulatory bodies, attestation services required by statute or regulation, comfort letters, consents, assistance with and review of documents filed with the SEC, work performed by tax professionals in connection with the audit and quarterly reviews, and accounting and financial reporting consultations and research work necessary to comply with generally accepted auditing standards.

Audit-Related Fees. Fees for professional services provided during the years ended December 31, 2003 and 2002, were $0.3 million and $0.2 million, respectively. Audit-related fees consist primarily of audits of subsidiaries.

Tax Fees. Fees for professional services provided during the years ended December 31, 2003 and 2002, were $1.6 million and $1.9 million, respectively. Tax fees include professional services provided for preparation of federal and state tax returns, review of tax returns prepared by the company, assistance in assembling data to respond to governmental reviews of past tax filings, and tax advice, exclusive of tax services rendered in connection with the audit.

All Other Fees. Fees for professional services provided during the years ended December 31, 2003 and 2002, were $0.4 million and $0.5 million, respectively. Other fees consist primarily of attestation services associated with third-party contract compliance.

The charter of the Audit Committee provides that the committee is responsible for the pre-approval of all auditing services and permitted non-audit services to be performed for the company by the independent auditors, subject to the requirements of applicable law. In accordance with such law, the committee has delegated the authority to grant such pre-approvals to the committee chair, which approvals are then reviewed by the full committee at its next regular meeting. Typically, however, the committee itself reviews the matters to be approved. The procedures for pre-approving all audit and non-audit services provided by the independent auditors include the committee reviewing a budget for audit services, audit-related services, tax services and other services. The budget includes a description of, and a budgeted amount for, particular categories of non-audit services that are anticipated at the time the budget is submitted. Committee approval would be required to exceed the budgeted amount for a particular category of services or to engage the independent auditors for any services not included in the budget. The committee periodically monitors the services rendered by and actual fees paid to the independent auditors to ensure that such services are within the parameters approved by the committee.

Representatives of Ernst & Young LLP will be present at the stockholders meeting and will be available to respond to appropriate questions and make a statement should they so desire.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" THE RATIFICATION OF THE APPOINTMENT OF THE INDEPENDENT AUDITORS, WHICH IS DESIGNATED AS PROPOSAL NO. 3 ON THE ENCLOSED PROXY.

Proposal 4:
RETENTION OF RIGHTS PLAN

At the company's annual meeting of stockholders on May 14, 2003, the stockholders approved a proposal, entitled "Shareholder Vote on Poison Pills", that requested the company to submit annually to a stockholder vote any rights plan that was adopted since the previous annual meeting or that was currently in place.

The company currently has in effect an amended and restated stockholders rights agreement (which agreements are sometimes referred to as "poison pills" and is referred to herein as our "rights plan") that was in effect approved by the company's stockholders and adopted in January 2001. Notwithstanding this vote, as explained in last year's proxy, the company will not be able to redeem the rights issued under our rights plan, or amend or alter our rights plan to effect such a redemption or a termination of the plan, in response to any vote on this proposal without the consent of Northwest and Northwest has advised us that it will not approve the elimination of our rights plan. The board has elected to give effect to the adoption of last year's stockholder proposal by proposing that the company's stockholders vote on a recommendation to retain the rights plan currently in effect. The following is a summary of the material terms of the rights plan. The full text of the rights plan is filed

as Exhibit 99.11 to the company's Current Report on Form 8-K dated November 16, 2000 and we will furnish a copy to interested stockholders without charge, upon written request submitted to our Secretary at Continental Airlines, Inc., P. O. Box 4607, Houston, Texas 77210-4607.

Under the terms of the rights plan, until the earlier of (i) the tenth day following a public announcement or public disclosure of facts indicating that a person or group of affiliated or associated persons (an "Acquiring Person") has acquired beneficial ownership of shares of Class B Common Stock, par value $.01 per share (the "Common Shares") representing 15% or more of the total number of votes entitled to be cast by the holders of the Common Shares then outstanding, taking into account the operation of Article Six of the Amended and Restated Certificate of Incorporation and related provisions of the company's bylaws (the "Voting Power"), or (ii) the tenth business day (or such later date as may be determined by action of the board prior to such time as any Person becomes an Acquiring Person) following the commencement of, or announcement of an intention to make, a tender offer or exchange offer the consummation of which would result in any Person becoming an Acquiring Person (the earlier of such dates being called the "Distribution Date"), the rights will be evidenced, with respect to any of the Common Share certificates outstanding as of the Record Date, by such Common Share certificates registered in the names of the holders thereof and, with respect to any Common Share certificates issued after the Record Date, by such certificate containing the appropriate legend as contemplated by the rights plan.

Certain "exempt persons" are excluded from the definition of Acquiring Person including: (i) the company, (ii) any Subsidiary of the company, (iii) any employee benefit plan of the company or any Subsidiary of the company, and (iv) any entity holding Common Shares for or pursuant to the terms of any such employee benefit plan. The company intends to amend the rights plan to eliminate the status of David Bonderman, James Coulter or William S. Price, III and certain of their affiliates as exempt persons whose acquisition of stock would not trigger the provisions of the rights plan.

The rights plan provides that, until the Distribution Date, the preferred share purchase rights (the "Rights") will be transferred with and only with the Common Shares. Until the Distribution Date (or earlier redemption or expiration of the Rights), new Common Share certificates issued after the Effective Time, will contain a notation incorporating the rights plan by reference. Until the Distribution Date (or earlier redemption or expiration of the Rights), the surrender for transfer of any certificates for Common Shares outstanding as of the Record Date, even without such notation or a copy of the Summary of Rights being attached thereto, will also constitute the transfer of the Rights associated with the Common Shares represented by such certificate. As soon as practicable following the Distribution Date, separate certificates evidencing the Rights ("Right Certificates") will be mailed to holders of record of the Common Shares as of the close of business on the Distribution Date and such separate Right Certificates alone will evidence the Rights.

The Rights are not exercisable until the Distribution Date. The Rights will expire on November 20, 2008 (the "Final Expiration Date"), unless the Final Expiration Date is extended or unless the Rights are earlier redeemed or exchanged by the company, in each case, as described below.

Subject to the various terms, conditions and adjustments set forth in the rights plan, each Right represents the right to purchase, at the current exercise price (the "Exercise Price), one one-thousandth of the Company's Series A Junior Participating Preferred Stock, par value $.01 per share ("Preferred Share"), or such different amount or kind of securities as provided under the rights plan.

The Exercise Price payable, and the number of Preferred Shares or other securities or property issuable, upon exercise of the Rights are subject to adjustment from time to time to prevent dilution (i) in the event of a stock dividend on, or a subdivision, combination or reclassification of, the Preferred Shares; (ii) upon the grant to holders of the Preferred Shares of certain rights, options or warrants to subscribe for or purchase Preferred Shares (or shares having the same rights, powers and preferences as the Preferred Shares) at a price, or securities convertible into Preferred Shares (or

shares having the same rights, powers and preferences as the Preferred Shares) with a conversion price, less than the then current market price of the Preferred Shares or (iii) upon the distribution to holders of the Preferred Shares of evidences of indebtedness or assets (excluding regular periodic cash dividends or dividends payable in Preferred Shares) or of subscription rights or warrants (other than those referred to above).

The number of outstanding Rights and the number of one one-thousandths of a Preferred Share issuable upon exercise of each Right are also subject to adjustment in the event of a stock dividend on the Common Shares payable in Common Shares or subdivisions, consolidations or combinations of the Common Shares occurring, in any such case, after the date of the rights plan and prior to the Distribution Date.

Preferred Shares purchasable upon exercise of the Rights will not be redeemable. Subject to the rights of holders of any series Preferred Shares superior to the Series A Preferred Shares with respect to dividends, the holders of Preferred Shares shall be entitled to receive when, as and if declared by the board out of funds legally available for the purpose, a quarterly dividend payment in an amount per share, subject to adjustment, equal to 1000 times the aggregate per share amount of all cash dividends, and 1000 times the aggregate per share amount (payable in kind) of all non-cash dividends or other distributions, other than a dividend payable in Common Shares, declared on the Common Shares. Such dividends are cumulative. In the event of liquidation, the holders of the Preferred Shares will be entitled to receive an aggregate amount per share, subject to adjustment, equal to 1000 times the aggregate payment made per Common Share. Each Preferred Share will have 1000 votes, voting together with the Common Shares. In the event of any merger, consolidation or other transaction in which Common Shares are exchanged, each Preferred Share will be entitled to receive 1000 times the amount received per Common Share. These rights are protected by customary antidilution provisions.

From and after the occurrence of an event described in Section 11(a)(ii) of the rights plan, if Rights are or were at any time on or after the earlier of (x) the date of such event and (y) the Distribution Date acquired or beneficially owned by an Acquiring Person or an Associate or

Affiliate (as such terms are defined in the rights plan) of an Acquiring Person, such Rights shall become void, and any holder of such Rights shall thereafter have no right to exercise such Rights.

In the event that any Person becomes an Acquiring Person, proper provision shall be made so that each holder of a Right, other than Rights beneficially owned by the Acquiring Person and its Affiliates and Associates (which Rights will thereafter be void), will thereafter have the right to receive, upon exercise thereof, that number of Common Shares having a market value of two times the Exercise Price of the Right. If the company does not have sufficient Common Shares to satisfy such obligation to issue Common Shares, or if the board so elects, the company shall make adequate provision to substitute for such Class B Common Shares, upon payment of the applicable Exercise Price, an amount of cash, a reduction in the Exercise Price, Preferred Shares or other equity or debt securities of the company, or other assets equivalent in value to the excess of Common Shares issuable upon exercise of a Right over the Exercise Price; provided that, if the company shall not have made adequate provision to deliver value within 30 days following the date a person becomes an Acquiring Person, the company must deliver, upon exercise of a Right, but without requiring payment of the Exercise Price then in effect, Common Shares (to the extent available) and cash equal in value to the difference between the value of the Common Shares otherwise issuable upon the exercise of a Right and the Exercise Price then in effect. The board may extend the 30-day period for up to an additional 60 days to permit the taking of action that may be necessary to authorize sufficient additional Common Shares to permit the issuance of Common Shares upon the exercise in full of the Rights.

In the event that, at any time after a Person becomes an Acquiring Person, (i) the company consolidates with or merges into any other Person, (ii) any Person consolidates with or merges into the company, the company is the continuing or surviving corporation and all or part of the outstanding

Common Shares do not remain outstanding after such consolidation or merger, or (iii) the company sells 50% or more of its consolidated assets or earning power, proper provision will be made so that each holder of a Right will thereafter have the right to receive, upon the exercise thereof at the then current Exercise Price, in lieu of Preferred Shares for which a Right is then exercisable, that number of shares of common stock of the acquiring corporation (including the company as successor thereto or as the surviving corporation) which at the time of such transaction will have a market value of two times the Exercise Price of the Right. The acquiring corporation will thereafter be liable for the duties and obligations of the company under the rights plan.

At any time after any Person becomes an Acquiring Person, and prior to the acquisition by any person or group of a majority of the Voting Power, the board may exchange the Rights (other than Rights owned by such Acquiring Person which have become void), in whole or in part, at an exchange ratio of one Common Share per Right (subject to adjustment). The company may, at its option, substitute Preferred Shares or common stock equivalents for Common Shares, at the rate of one one-thousandth of a Preferred Share for each Common Share (subject to adjustment). No fractional Common Shares will be issued and in lieu thereof, an adjustment in cash will be made based on the market price of the Common Shares on the last trading day prior to the date of exchange.

With certain exceptions, no adjustment in the Exercise Price will be required until cumulative adjustments require an adjustment of at least 1% in such Exercise Price. No fractional Preferred Shares will be issued (other than fractions which are integral multiples of one one-thousandth of a Preferred Share which may, at the election of the company, be evidenced by depositary receipts) upon exercise of the Rights and in lieu thereof, an adjustment in cash will be made based on the market price of the Preferred Shares on the last trading day prior to the date of exercise.

At any time prior to any person becoming an Acquiring Person, the board, by the affirmative vote of two-thirds of the members of the board voting on the action (the "Required Board Vote"), may redeem the Rights in whole, but not in part, at a price of $.001 per Right (the "Redemption Price"). The redemption of the Rights may be made effective at such time, on such basis and subject to such conditions as the board in its sole discretion may establish. The company may, at its option, pay the Redemption Price in cash, Common Shares or some other form of consideration deemed appropriate by the board. Immediately upon any redemption of the Rights (or upon such later date as the board shall specify in the resolution approving such redemption), the right to exercise the Rights will terminate and the only right of the holders of Rights will be to receive the Redemption Price. The redemption of the Rights may be subject to certain restrictions and limitations contained in the Amended and Restated Certificate of Incorporation.

The terms of the Rights may be amended by the board, by the Required Board Vote, without the consent of the holders of the Rights, except that from and after such time as any Person becomes an Acquiring Person no such amendment may adversely affect the interests of the holders of the Rights (other than the Acquiring Person and its Affiliates and Associates). The right of the board to amend the rights plan may be subject to certain restrictions and limitations contained in the Amended and Restated Certificate of Incorporation.

Until a Right is exercised, the holder thereof, as such, will have no rights as a stockholder of the company, including, without limitation, the right to vote or to receive dividends.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE "FOR" THE PROPOSAL TO RECOMMEND THAT THE COMPANY RETAIN THE RIGHTS PLAN CURRENTLY IN EFFECT.

The principal reason that the board recommends a vote for this proposal is that our stockholders have already approved our rights plan.

We adopted our amended and restated stockholders rights plan in January 2001 as required by our November 15, 2000 Omnibus Agreement with Northwest Airlines Corporation and its affiliates (collectively, "Northwest"). The Omnibus Agreement covered a number of transactions, including (i) our repurchase from Northwest of our common stock (which constituted a controlling interest at the time), (ii) a recapitalization of the remaining high-vote shares of our equity into Class B common stock, (iii) the extension of our existing commercial alliance with Northwest through the end of 2025, and (iv) our issuance to Northwest of one share of our Series B Preferred Stock ("Special Stock") that gives Northwest a right to a separate class vote in certain events.

In connection with these transactions, our stockholders approved several amendments to our certificate of incorporation (or charter) to effect the recapitalization. One of the amendments requires the approval of Northwest to amend our rights plan or to redeem the rights issued thereunder, except in specified circumstances. The charter, as amended, goes on to provide that:

> "Except as otherwise expressly provided above and unless the Special Stock becomes redeemable in accordance with its terms or is repurchased by the Corporation, the Corporation shall take all necessary action to have in effect a rights agreement with terms and conditions identical in all material respects to the terms and conditions of the Rights Agreement (subject to amendments that may be made without the approval of the holder of the Special Stock as described above) and to issue the rights created thereunder in accordance with such rights agreement."

Each of the foregoing provisions, as well as the relevant terms of our rights plan, was described in the proxy statement relating to the special meeting of stockholders at which the charter amendments were presented. The charter amendments were overwhelmingly approved by our stockholders by a vote of 134,958,329 to 69,103 (with 26,428 votes abstaining). Thus, our stockholders have, in effect, approved the adoption and maintenance of our current rights plan and the provisions in our charter that prevent us from eliminating the agreement without Northwest's approval.

The board also recommends a vote for this proposal because the company cannot unilaterally amend or terminate its rights plan in response to this proposal.

As described above, the company's certificate of incorporation provides that we will take all necessary action to maintain in effect our rights plan, and will not amend or terminate the plan (except in certain circumstances) without the consent of Northwest. Northwest has advised us that it will not approve the elimination of our rights plan. Thus, even if the stockholders reject this proposal, the company will not be able to redeem the rights issued under our rights plan, or amend or alter our rights plan to effect such a redemption or a termination of the plan, in response to any vote on this proposal without the consent of Northwest.

In addition, the board recommends a vote for this proposal because the current stockholders rights plan is in the best interest of the company.

The purpose of a stockholders rights plan is to strengthen the board's ability, in the exercise of its fiduciary duties, to protect and maximize the value of our stockholders' investment in us in the event of an attempt to acquire control of the company. The plan is not intended to, and does not, preclude unsolicited, non-abusive offers to acquire us at a fair price. Furthermore, it is not intended to be a deterrent to a stockholder's initiation of a proxy contest. The plan is designed, instead, to encourage any potential acquirer to negotiate directly with the board. We believe that the board is in the best position to evaluate the adequacy and fairness of proposed offers, to negotiate on behalf of stockholders and to protect stockholders against abusive tactics during a takeover process. The rights do not affect any takeover proposal that the board believes is in the best interests of our stockholders (and to which, if required by our charter, Northwest agrees). The overriding objective of the board in adopting and extending the stockholders rights plan was, and continues to be, the preservation and maximization of value for our stockholders.

Finally, the board recommends a vote for this proposal because a vote against the proposal is an attempt to inappropriately limit the authority of the board of directors to manage the affairs of the company.

Our board has been elected by the stockholders to oversee our business, serves at the discretion of the stockholders, and does so subject to legally imposed fiduciary duties to our stockholders. Our board is also responsible for adhering to prudent governance principles in fulfilling its responsibilities. Our board believes that it is ill advised for our stockholders to recommend that we redeem or otherwise terminate our rights plan as an abstract concept, rather than examine how our rights plan functions in a particular set of facts and circumstances. Such a recommendation could obligate us to pursue a course of action in the future, without allowing our board to engage in a thoughtful analysis of the relevant facts and circumstances at that time.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" THE PROPOSAL, WHICH IS DESIGNATED AS PROPOSAL NO. 4 ON THE ENCLOSED PROXY.

Proposal 5:
PROPOSAL OF STOCKHOLDER

We have been advised that John Chevedden, 2215 Nelson Ave., No. 205, Redondo Beach, California, who owns 100 shares of the company's common stock, intends to submit the following proposal at the meeting:

"5 Shareholder Input on a Poison Pill

Shareholders request that our Directors increase shareholder voting rights and submit any adoption, maintenance or extension of a poison pill to a shareholder vote as a separate ballot item on the earliest possible shareholder ballot. Also once this proposal is adopted, any material change or discontinuing of this proposal is requested to be submitted to a shareholder vote as a separate ballot item on the earliest possible shareholder ballot.

We as shareholders voted in support of this topic:

Year	Rate of Approval
2003	72% (passed)

This percentage is based on yes and no votes cast. I believe this level of shareholder support is more impressive because the 72% approval followed our Board's objection to the proposal. I do not see how our Board could object to this proposal because it gives our Board the flexibly [*sic*] to override our shareholder vote if our Board seriously believes it has a good reason.

This topic also won an overall 60% yes-vote rate at 79 companies in 2003.

Shareholders' Central Role

Putting poison pills to a vote is a way of affirming the central role that shareholders should play in the life of a corporation. There are often reasons that a hostile tender offer should fail. But an anti-democratic scheme to flood the market with diluted stock is not one of them.

Source: *The Motley Fool*

The key negative of poison pills is that pills can preserve management deadwood instead of protecting investors.

Source: *Moringstar.com* [*sic*]

Akin to a Dictator

Poison pills are akin to the argument of a dictator who says, "Give up more of your freedom and I'll take care of you.

"Performance is the greatest defense against getting taken over. Ultimately if you perform well you remain independent, because your stock price stays up."

Source: T.J. Dermot Dunphy, CEO of Sealed Air (NYSE) for more than 25 years.

I believe our board may be tempted to partially implement this proposal to gain points in corporate governance scoring systems. I do not believe that a partial implementation, which could still allow our board to give us a poison pill on short notice, would be a substitute for complete implementation.

The Potential of a Tender Offer Can Motivate Our Management

Hectoring board members to act more independently is a poor substitute for the bracing possibility that shareholders could turn on a dime and sell the company out from under its present management.

Wall Street Journal, Feb. 24, 2003

Council of Institutional Investors Recommendation

The Council of Institutional Investors *www.cii.org*, an organization of 130 pension funds investing $2 trillion, called for shareholder approval of poison pills. Based on our 72% yes-vote many shareholders believe our company should allow shareholders a vote.

Shareholder Input on a Poison Pill
Yes on 5"

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE "AGAINST" THIS PROPOSAL

The principal reason that the board recommends a vote against this proposal is that our stockholders have already adopted a substantially similar proposal and the board is giving effect to that proposal at this year's annual meeting in Proposal 4.

At the company's annual meeting of stockholders on May 14, 2003, the stockholders approved a proposal, entitled "Shareholder Vote on Poison Pills," that requested the company to submit annually to a stockholder vote any rights plan that was adopted since the previous annual meeting or that was currently in place. The company currently has in effect an amended and restated stockholders rights agreement (which agreements are sometimes referred to as "poison pills" and is referred to herein as our "rights plan") that was in effect approved by the company's stockholders and adopted in January 2001. The board of directors has elected to give effect to the adoption of last year's stockholder proposal by proposing that the company's stockholders vote on a recommendation to retain the rights plan currently in effect. This proposal, together with the board's detailed recommendation that the stockholders vote in favor of retaining the rights plan, is discussed above in "Proposal 4: Retention of Rights Plan."

The board believes that stockholder adoption of the current proposal would be duplicative and redundant because the board is giving effect to last year's proposal, the provisions of which are substantially similar to this proposal. The two proposals are distinguishable only in the language that they employ their objectives and the effects of their adoption by the stockholders are largely indistinguishable. Both proposals seek to submit the company's stockholders rights plan to a vote of the

stockholders and the board is giving effect to this aim by recommending that the stockholders vote on the rights plan. Thus, the board believes that this proposal is duplicative and unnecessary.

The board also recommends a vote against this proposal because, like last year's proposal, it is ambiguous as to what it purports to require, and its effect would be unclear in light of the adoption of last year's proposal.

The company's stockholders adopted a resolution in last year's annual meeting which requested that the board submit our rights plans to a vote of the stockholders. The current proposal, which is being submitted by the same stockholder who submitted last year's proposal, also seeks to submit our rights plan to a vote of the stockholders, but the wording of the statement is not precisely the same. It is not clear what effect, if any, stockholder adoption of this proposal would have on the company in light of the adoption of last year's proposal.

The board believes that adoption of this proposal, in light of the adoption of last year's proposal, compounds the ambiguity of the proposals themselves. A second and separate proposal or policy concerning our rights plan is unwise because it's potentially confusing to have two policies concerning the same issue. Although the board believes that these proposals are substantially similar, both in their objectives and in the effects of their implementation, it is conceivable that at some point in the future they may, depending upon particular facts and circumstances, dictate that the board pursue two separate and conflicting courses of action.

Like last year's proposal, the current proposal could be read to mean that the adoption of a rights agreement by the board or an existing rights agreement should be put to a stockholder vote. Our existing rights agreement, in effect, has already been approved by our stockholders, and our charter requires us to maintain in effect our rights agreement (or one just like it), except in limited circumstances, unless we obtain the approval of Northwest. Northwest has advised us that it would not approve the elimination of our rights agreement. Alternatively, the current proposal could also be interpreted to mean that our rights agreement should be submitted annually to a stockholder vote. If this is what the proposal means, then, for the reasons explained above, any such vote would be meaningless because we cannot eliminate our rights agreement without Northwest's consent, which Northwest has indicated it will not give. As a result, any such vote would be a wasteful expenditure of our limited resources.

The board also recommends a vote against this proposal because it is an attempt to inappropriately limit the authority of the board of directors to manage the affairs of the company.

Our board has been elected by the stockholders to oversee our business, serves at the discretion of the stockholders, and does so subject to legally imposed fiduciary standards of accountability. Our board is also responsible for adhering to prudent governance principles in fulfilling its responsibilities. Our board concurs with others that have considered this same issue and believes that it is ill advised and dangerous for corporate governance matters to be decided by an abstract public referendum when the results of that referendum could obligate us to pursue a course of action in the future, without allowing our board to engage in a thoughtful analysis of the proposal at that time.

Finally, the board recommends a vote against this proposal because, for various reasons set forth in the supporting statement to Proposal 4, the rights plan currently in effect is in the best interests of the stockholders.

The board recommends a vote against this proposal because our stockholders have already approved the company's rights plan, because the company cannot unilaterally amend or terminate its rights plan, because the current rights plan is in the best interests of the stockholders, and because this proposal is an attempt to inappropriately limit the authority of the board to manage the company's affairs. For further discussion of these issues, please see the board's supporting statement to Proposal 4 above.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE "AGAINST" THE STOCKHOLDER PROPOSAL, WHICH IS DESIGNATED AS PROPOSAL NO. 5 ON THE ENCLOSED PROXY.

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OTHER MATTERS

We have not received notice as required under our bylaws of any other matters to be proposed at the meeting. Consequently, the only matters to be acted on at the meeting are those described in this proxy statement, along with any necessary procedural matters related to the meeting. As to procedural matters, or any other matters that were determined to be properly brought before the meeting calling for a vote of the stockholders, it is the intention of the persons named in the accompanying proxy, unless otherwise directed in that proxy, to vote on those matters in accordance with their best judgment.

Section 16(a) Beneficial Ownership Reporting Compliance

Each director, executive officer (and, for a specified period, certain former directors and executive officers) and each holder of more than ten percent of a class of our equity securities is required to report to the SEC his or her pertinent position or relationship, as well as transactions in such securities, by certain specified dates. During 2003, there were no late filings of Section 16 beneficial ownership reporting relating to the company's securities.

2005 Annual Meeting

Any stockholder who wants to present a proposal at the 2005 annual meeting of stockholders and to have that proposal set forth in the proxy statement and form of proxy mailed in conjunction with that annual meeting must submit that proposal in writing to the Secretary of the company no later than October 16, 2004. Our bylaws require that for nominations of persons for election to the board of directors or the proposal of business not included in our notice of the meeting to be considered by the stockholders at an annual meeting, a stockholder must give timely written notice thereof. To be timely for the 2005 annual meeting of stockholders, that notice must be delivered to the Secretary of the company at our principal executive offices not less than 70 days and not more than 90 days prior to March 12, 2005. However, if the 2005 annual meeting of stockholders is advanced by more than 20 days, or delayed by more than 70 days, from March 12, 2005, then the notice must be delivered not earlier than the ninetieth day prior to the 2005 annual meeting and not later than the close of business on the later of (a) the seventieth day prior to the 2005 annual meeting or (b) the tenth day following the day on which public announcement of the date of the 2005 annual meeting is first made. The stockholder's notice must contain and be accompanied by certain information as specified in the bylaws. We recommend that any stockholder desiring to make a nomination or submit a proposal for consideration obtain a copy of our bylaws, which may be obtained under Corporate Governance at *www.continental.com/company/investor* or without charge from the Secretary of the company upon written request addressed to the Secretary at our principal executive offices.

EVEN IF YOU PLAN TO ATTEND THE MEETING, PLEASE VOTE BY INTERNET OR TELEPHONE AS DESCRIBED ABOVE IN THE PROXY STATEMENT, OR SIGN, DATE AND MAIL PROMPTLY THE ENCLOSED PROXY.

Continental's annual report on Form 10-K for the year ended December 31, 2003, including exhibits, is available on the company's website under Annual and Periodic Reports at *www.continental.com/company/investor*. We will furnish a copy of the 10-K to interested security holders without charge, upon written request. We will also furnish any exhibit to the 10-K, if requested in writing and accompanied by payment of reasonable fees relating to our furnishing the exhibit. Requests for copies should be addressed to our Secretary at Continental Airlines, Inc., P.O. Box 4607, Houston, Texas 77210-4607. The financial statements filed with the 10-K, together with certain other financial data and analysis, are included in this proxy statement as Appendix A.

APPENDIX A

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SELECTED FINANCIAL DATA

Year Ended December 31,

	Year Ended December 31,				
	2003	2002	2001	2000	1999
Statement of Operations Data (in millions except per share data)(1)(2):					
Operating revenue	$ 8,870	$ 8,402	$ 8,969	$ 9,899	$ 8,639
Operating expenses	8,667	8,714	8,825	9,170	8,024
Operating income (loss)	203	(312)	144	729	615
Income (loss) before cumulative effect of accounting changes	38	(451)	(95)	342	488
Net income (loss)	38	(451)	(95)	342	455
Basic earnings (loss) per share:					
Income (loss) before cumulative effect of accounting changes	0.58	(7.02)	(1.72)	5.62	7.02
Net income (loss)	0.58	(7.02)	(1.72)	5.62	6.54
Diluted earnings (loss) per share:					
Income (loss) before cumulative effect of accounting changes	0.58	(7.02)	(1.72)	5.45	6.64
Net income (loss)	0.58	(7.02)	(1.72)	5.45	6.20

	As of December 31,				
	2003	2002	2001	2000	1999
Balance Sheet Data (in millions)(1):					
Cash and cash equivalents, including restricted cash, and short-term investments	1,600	1,342	1,132	1,395	1,590
Total assets	10,649	10,641	9,798	9,208	8,223
Long-term debt and capital lease obligations	5,558	5,471	4,448	3,624	3,055
Redeemable common stock				450	
Redeemable preferred stock of subsidiary		5			
Stockholders' equity	792	767	1,161	1,160	1,593

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	Year Ended December 31,				
	2003	2002	2001	2000	1999
Mainline Statistics:					
Revenue passengers (thousands)	39,861	41,016	44,238	46,896	45,540
Revenue passenger miles (millions)(3)	59,165	59,349	61,140	64,161	60,022
Available seat miles (millions)(4)	78,385	80,122	84,485	86,100	81,946
Cargo ton miles (millions)	917	908	917	1,096	1,000
Passenger load factor(5)	75.5%	74.1%	72.4%	74.5%	73.2%
Passenger revenue per available seat mile (cents)	8.73	8.61	8.98	9.84	9.12
Total revenue per available seat mile (cents)	9.64	9.27	9.58	10.52	9.75
Operating cost per available seat mile (cents)(6)	9.36	9.53	9.22	9.68	9.07
Average yield per revenue passenger mile (cents)(7)	11.57	11.63	12.42	13.20	12.45
Average price per gallon of fuel, excluding fuel taxes (cents)	87.18	69.97	78.24	84.21	46.56
Average price per gallon of fuel, including fuel taxes (cents)	91.40	74.01	82.48	88.54	50.78
Fuel gallons consumed (millions)	1,257	1,296	1,426	1,533	1,536
Average fare per revenue passenger	$ 171.72	$ 168.25	$ 171.59	$ 180.66	$ 164.11
Average length of aircraft flight (miles)	1,270	1,225	1,185	1,159	1,114
Average daily utilization of each aircraft (hours)(8)	9:19	9:31	10:19	10:36	10:29
Actual aircraft in fleet at end of period(9)	355	366	352	371	363
Regional Statistics:					
Revenue passenger miles (millions)(3)	5,769	3,952	3,388	2,947	2,149
Available seat miles (millions)(4)	8,425	6,219	5,437	4,735	3,431

	Year Ended December 31,				
Passenger load factor(5)	68.5%	63.5%	62.3%	62.2%	62.6%
Consolidated Statistics (Mainline and Regional):					
Consolidated passenger load factor	74.8%	73.3%	71.8%	73.9%	72.8%
Consolidated breakeven passenger load factor(10)	73.7%	82.5%	73.5%	67.9%	64.0%

(1)

Consolidated amounts include ExpressJet for the years ended December 31, 1999 through December 31, 2002. In 2003, ExpressJet is consolidated through November 12, 2003 and reported using the equity method of accounting thereafter.

(2)

Includes the following special expense (income) items (in millions) for year ended December 31,

	2003	2002	2001	2000	1999
Operating revenue (income):					
Change in expected redemption of frequent flyer mileage credits sold	$ (24)	$	$	$	$
Operating expense (income):					
Fleet impairment and restructuring charges	100	242	61		81
Air Transportation Safety and System Stabilization Act grant		12	(417)		
Security fee reimbursement	(176)				
Severance and other special charges			63		
Nonoperating expense (income):					
Gain on sale of investments (after related compensation expense and including adjustment to fair value of remaining investment in Orbitz)	(305)			(9)	(326)
Impairment of investments			22		
Cumulative effect of change in accounting, net of taxes					33

(3)

The number of scheduled miles flown by revenue passengers.

(4)

The number of seats available for passengers multiplied by the number of scheduled miles those seats are flown.

(5)

Revenue passenger miles divided by available seat miles.

(6)

Includes operating expense special items noted in (2). These special items represented (0.09), 0.31, (0.36), 0.00 and 0.09 cents of operating cost per available seat mile in each of the five years, respectively.

(7)

The average revenue received for each mile a revenue passenger is carried.

(8)

The average number of hours per day that an aircraft flown in revenue service is operated (from gate departure to gate arrival).

(9)

Excludes aircraft that were removed from service.

(10)

The percentage of seats that must be occupied by revenue passengers for us to break even on a net income basis. The special items noted in (2) included in the consolidated breakeven passenger load factor account for (4.5), 3.3, (3.0), (0.1) and (2.3) percentage points in each of the five years, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion contains forward-looking statements that are not limited to historical facts, but reflect our current beliefs, expectations or intentions regarding future events. All forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those in the forward- looking statements. For examples of such risks and uncertainties, please see the cautionary statements contained in Item 1 of our annual report on Form 10-K for the year ended December 31, 2003, "Business Risk Factor Relating to Terrorist Attacks and International Hostilities", "Business Risk Factors Relating to the Company" and "Business Risk Factors Relating to the Airline Industry". 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. Hereinafter, the terms "Continental", "we", "us", "our" and similar terms refer to Continental Airlines, Inc. and its subsidiaries, unless the context indicates otherwise.

Overview

We recorded consolidated net income of $38 million for the year ended December 31, 2003, as compared to consolidated net losses of $451 million and $95 million for the years ended December 31, 2002 and 2001. Our results for each of the last three years have been affected by a number of special items which are not necessarily indicative of our core operations or our future prospects, and impact comparability between years. These special items are discussed in "Results of Operations" below. Without the special items in 2003, we would have incurred another significant loss.

Despite recent improvements, the current U.S. domestic airline environment continues to be one of the worst in our history and could deteriorate further. Prior to September 2001, we were profitable, although many U.S. air carriers were losing money and our profitability was declining. The terrorist attacks of September 11, 2001 dramatically worsened the difficult financial environment and presented new and greater challenges for the airline industry. Since the terrorist attacks, several of our competitors, including United Air Lines and US Airways, have filed for bankruptcy. During 2003, our bookings and passenger traffic were significantly reduced as a result of the hostilities and post-war unrest in Iraq and the spread of Severe Acute Respiratory Syndrome, or "SARS", in China, Hong Kong, Canada and elsewhere. Both of these events disproportionately affected our international passenger traffic. We responded to the actual and anticipated reduction in demand by reducing capacity on certain trans-Atlantic and trans-Pacific routes (including the suspension of our flights between Hong Kong and Liberty International from April 2003 until August 2003) and by reducing our summer schedule.

Although we have been able to raise capital, downsize our operations and reduce our expenses significantly, current trends in the airline industry, particularly if historically high fuel prices continue, make achieving our goal of reaching breakeven in 2004 unlikely. It is also possible that our financial resources might not be sufficient to absorb the impact of any further terrorist attacks or an increase in post-war unrest in Iraq or other hostilities involving the United States. The revenue environment continues to be weak in light of changing pricing models driven by the continued growth of low-cost carriers, excess capacity in the market, reduced corporate travel spending and other issues. In addition, fuel prices have significantly escalated and, at current levels, are expected to offset a substantial portion of the significant cost-saving measures that we have implemented.

Absent adverse factors outside our control, we believe that our liquidity and access to cash will be sufficient to fund our current operations through 2004 and beyond if we are successful in implementing our previously announced revenue generation and cost cutting measures. However, in light of the changing competitive environment in the airline industry, we believe that the economic environment, including unusually high fuel prices, must improve for us to continue to operate at our current size and

expense level over the long term. We may find it necessary to further downsize our operations, including the further elimination of service to small and medium-sized communities and additional job eliminations.

Among the many factors that threaten us and the airline industry generally are the following:

Low-Cost Competitors. The continued growth of low-cost carriers is dramatically changing the airline industry. Other carriers have implemented or announced plans to implement separate low-cost products, such as a low-cost "airline within an airline". In addition, carriers emerging from bankruptcy have or will have significantly reduced cost structures and operational flexibility that will allow them to compete more effectively, and other carriers have used the threat of bankruptcy to achieve substantial cost savings. We have initiated two sets of revenue-generating and cost-savings initiatives in the past two years that were designed to improve our annual pre-tax results by over $900 million. While we are on track to meet or exceed these goals, our cost structure remains higher than that of the low-cost carriers.

Fuel Costs. Fuel costs rose significantly during 2003 and are, and could remain, at historically high levels. Post-war unrest in Iraq, other conflicts in the Middle East and political or other significant events in other oil-producing nations could cause fuel prices to increase further (or be sustained at current high levels) and may impact the availability of fuel. Based on gallons consumed in 2003, for every one dollar increase in the price of crude oil, our annual fuel expense would increase by approximately $35 million. This increase changes to approximately $38 million when considering our expected volume increases in 2004. We currently anticipate that high fuel prices in 2004 will offset the impact of a substantial portion of the cost-saving measures we have implemented. As of December 31, 2003, we did not have any fuel price hedges in place.

Reduced Demand. Demand for air travel has not recovered to the levels experienced prior to September 11, 2001. Although the global and domestic economy has improved in recent months, business traffic, our most profitable source of revenue, and yields are down. We believe that the reduced demand reflects the weak economy, competition from low-cost carriers, some customers' concerns about further terrorist attacks and reprisals and the hostilities and post-war unrest in Iraq. We also believe that demand is weakened by customer dissatisfaction with the delays of heightened airport security and screening procedures, and by some business travelers switching to lower priced ticket categories and to low-cost carriers.

Labor Costs. We are engaged in labor negotiations with unions representing our pilots, our dispatchers and our mechanics and our agreement with our flight attendants becomes amendable in October 2004. We cannot predict the outcome of these negotiations or the financial impact on us of any new labor contracts. Recent significant concession agreements with labor groups at US Airways, United and American Airlines have had the effect of lowering industry standard wages and benefits, and our negotiations may be influenced by these and other labor cost developments.

Security Costs. The terrorist attacks of 2001 have caused security costs to increase significantly. Security costs are likely to continue rising for the foreseeable future as additional security measures are implemented. In the current environment of lower consumer demand and discounted pricing, these costs cannot effectively be passed on to customers. Insurance costs have also risen sharply, in part due to greater perceived risks and in part due to the reduced availability of insurance coverage. We must absorb these additional expenses in the current pricing environment.

Pension Liability. We have significant commitments to our defined benefit pension plan. Pension expense for the year 2003 was $328 million. Pension expense for 2004 is expected to be

approximately $280 million. We contributed $272 million in cash and approximately 7.4 million shares of Holdings common stock valued at approximately $100 million to our primary defined benefit pension plan in 2003. As a result, our 2004 minimum funding requirements are not expected to be significant. However, we currently intend to maintain the plan's funding at 90% of its current liability, which would result in our making contributions of approximately $300 million to our pension plan in 2004. As a result of declines in interest rates, we were required to increase the minimum pension liability and reduce stockholders' equity at December 31, 2003 by $20 million. This adjustment did not impact current earnings, the actual funding requirements of the plans or our compliance with debt covenants.

Results of Operations

Special Items. The comparability of our financial results between years is affected by a number of special items. In addition, the deconsolidation of Holdings from our financial statements effective November 12, 2003, more fully described in Note 4 to our consolidated financial statements also impacts the comparability of our 2003 results to those of prior years. Our results for each of the last three years included the following special items (in millions):

	Income (Expense)	
	Pre Tax	After Tax
Year Ended December 31, 2003		
Gain on dispositions of ExpressJet stock(1)	$ 173	$ 100
Gain on Hotwire and Orbitz investments (after related compensation expense and including an adjustment to fair value of remaining investment in Orbitz)(2)	132	83
MD-80 fleet impairment loss(3)	(65)	(41)
Security fee reimbursement(4)	176	111
Revenue adjustment for change in expected redemption of frequent flyer mileage credits sold(5)	24	15
Lease exit costs for permanently grounded MD-80 aircraft(3)	(21)	(13)
Boeing 737 aircraft delivery deferral(3)	(14)	(8)
	$ 405	$ 247
Year Ended December 31, 2002		
Lease exit costs for DC 10-30, MD-80 and turboprop aircraft(3)	$ (149)	$ (94)
Impairment of MD-80 and turboprop aircraft(3)	(93)	(59)
Write-down of Stabilization Act receivable(6)	(12)	(8)
	$ (254)	$ (161)
Year Ended December 31, 2001		
Stabilization Act grant(6)	$ 417	$ 263
Severance and other special charges following the September 11, 2001 terrorist attacks(3)	(63)	(40)
Impairment of DC 10-30, 747, 727 and turboprop aircraft(3)	(61)	(39)
Impairment of investments in affiliates and write-off of related notes receivable(3)	(22)	(13)
	$ 271	$ 171

(1) See Note 4 to our consolidated financial statements.

(2) See Note 7 to our consolidated financial statements.

(3) See Note 13 to our consolidated financial statements and "Critical Accounting Policies and Estimates".

(4) See Note 14 to our consolidated financial statements.

(5) See Note 1(j) to our consolidated financial statements and "Critical Accounting Policies and Estimates".

(6) See Note 15 to our consolidated financial statements.

Comparison of 2003 to 2002. Passenger revenue increased 3.5%, $273 million, during 2003 as compared to 2002, which was principally due to increased regional traffic in conjunction with ExpressJet's capacity increases, offset in part by reduced mainline traffic. The mainline traffic and capacity declines were largely due to a reduction in certain international flights in response to decreased demand during the war in Iraq and related to SARS. Mainline yields were essentially unchanged year over year.

The deconsolidation of Holdings effective November 12, 2003 did not impact our passenger revenue because, under our capacity purchase agreement with Holdings and ExpressJet, we purchase all of ExpressJet's capacity and are responsible for selling all of the seat inventory. As a result, after deconsolidation, we continue to record the related passenger revenue and related expenses, with payments under the capacity purchase agreement reflected as a separate operating expense.

Comparisons of passenger revenue, revenue per available seat mile (RASM) and available seat miles (ASMs) by geographic region for our mainline and regional operations are shown below:

Increase (Decrease) for Year Ended December 31, 2003 vs. December 31, 2002

	Passenger Revenue	RASM	ASMs
Domestic	(0.6)%	2.4 %	(3.0)%
Latin America	(0.1)%	1.3 %	(1.3)%
Trans-Atlantic	2.2 %	0.6 %	1.5 %
Pacific	(9.3)%	(4.5)%	(5.0)%
Total Mainline	(0.8)%	1.4 %	(2.2)%
Regional	34.3 %	(0.9)%	35.5 %

Cargo, mail and other revenue increased 36.1%, $195 million, in 2003 compared to 2002, primarily due to military charter flights associated with the war in Iraq, higher volumes, and revenue-generating initiatives. 2003 also included $24 million of additional revenue resulting from a change in the expected redemption of frequent flyer mileage credits sold.

Wages, salaries and related costs increased 3.3%, $97 million, during 2003 as compared to 2002, as a result of increased pension costs and higher wage rates principally caused by increases in seniority, partially offset by a 3.8% reduction in the average number of mainline employees. Wages, salaries and related costs would have been $50 million higher in 2003 had we not deconsolidated Holdings effective November 12, 2003.

Aircraft fuel expense increased 22.7%, $232 million, in 2003 as compared to 2002. The average mainline fuel price per gallon increased 24.6% from 69.97 cents in 2002 to 87.18 cents in 2003. Mainline fuel consumption was down 3.0% as a result of reduced flights and more fuel-efficient aircraft. Regional jet fuel expense increased $43 million, even with the deconsolidation of Holdings, due to increased flights and higher jet fuel prices.

Aircraft rentals decreased slightly year over year due to aircraft rent on grounded aircraft not requiring expense in the current year as such amounts were previously recognized as part of the fleet impairment charge, exiting aircraft, and lower lease rates partially offset by increases from aircraft deliveries in 2003 and 2002. The deconsolidation of Holdings did not have an impact on aircraft rental expense because we are the primary obligor under the leases of the aircraft flown by ExpressJet. Rental income received by us from ExpressJet is reported in regional capacity purchase, net.

Landing fees and other rentals decreased 2.1%, $13 million, in 2003 as compared to 2002 primarily due to lower variable rent at selected airports, partially offset by higher facilities rent, primarily attributable to the completion of substantial portions of the Global Gateway project at Liberty International Airport. Landing fees and other rentals would have been $9 million higher in 2003 had we not deconsolidated Holdings effective November 12, 2003.

Maintenance, materials and repairs expense increased 6.9%, $33 million, during 2003 as compared to 2002 resulting from increases in our contractual engine maintenance cost per hour rates, higher wide-body maintenance activity and the higher number of regional jets in service. Maintenance, materials and repairs expense would have been $19 million higher in 2003 had we not deconsolidated Holdings effective November 12, 2003.

Fleet impairment and other special charges in 2003 consisted of a $65 million impairment charge in the first quarter for our MD-80 fleet and spare parts associated with the grounded aircraft, a $14 million charge in the second quarter for expenses associated with the deferral of Boeing 737 aircraft deliveries and a $21 million charge in the fourth quarter for lease exit costs for MD-80 aircraft. In 2002, we recorded $149 million of lease exit costs for leased DC 10-30, MD-80 and turboprop aircraft and a $93 million charge for impairment of owned MD-80 and turboprop aircraft.

Commissions expense decreased 30.2%, $64 million, in 2003 as compared to 2002 primarily due to the elimination of domestic base commissions during 2002 and certain international commission reductions.

Payments made to ExpressJet under our capacity purchase agreement, previously eliminated in consolidation, are reported as regional capacity purchase, net, beginning November 12, 2003, the date we deconsolidated Holdings. In addition to the payments for the purchased capacity, regional capacity purchase, net, also includes ExpressJet's fuel expense in excess of the cap (66.0 cents per gallon in 2003) provided in the capacity purchase agreement and a related fuel purchase agreement and is net of our rental income on aircraft we lease to ExpressJet.

Other operating expense decreased 13.0%, $147 million, as a result of lower insurance costs and cost-saving measures. These expenses would have been $21 million higher in 2003 had we not deconsolidated Holdings effective November 12, 2003.

Interest expense increased 5.6%, $21 million, in 2003 compared to 2002 due to an increase in long-term debt resulting from the purchase of new aircraft.

Equity in the income (loss) of affiliates included our equity in the earnings (loss) of Copa Airlines, Orbitz (until its initial public offering in December 2003) and, effective November 12, 2003, Holdings.

Other nonoperating income (expense) in 2003 included $132 million of gains related to the sale of investments in Hotwire and Orbitz and an adjustment to fair value of our remaining investment in Orbitz, after associated compensation expense.

Our effective tax rates differ from the federal statutory rate of 35% primarily due to expenses that are not deductible for federal income tax purposes, state income taxes and the accrual of income tax expense on our share of Holdings' net income. We are required to accrue income tax expense on our share of Holdings' net income after its initial public offering in all periods where we consolidate Holdings' operations. The accrual of this income tax expense increased our tax expense by approximately $16 million during 2003 and reduced our tax benefit by $12 million in 2002. During 2003, we contributed 7.4 million shares of Holdings common stock valued at approximately $100 million to our defined benefit pension plan. For tax purposes, our deduction was limited to the market value of the shares contributed. Since our tax basis in the shares was higher than the market value at the time of the contribution, the nondeductible portion increased our tax expense by $9 million.

Minority interest of $49 million in 2003 represents the portion of Holdings' net income attributable to the equity of Holdings that we did not own prior to November 12, 2003, the date we deconsolidated Holdings. This amount is based on Holdings' results of operations under the capacity purchase agreement. Under this agreement, we pay ExpressJet for scheduled block hours based on an agreed upon formula. Transactions between us and Holdings or ExpressJet under the capacity purchase agreement prior to deconsolidation were otherwise eliminated in the consolidated financial statements.

Comparison of 2002 to 2001. Passenger revenue decreased 7.0%, $595 million, during 2002 as compared to 2001, which was principally due to a decrease in both traffic and yields subsequent to the September 11, 2001 attacks, as well as the continuing weak economy. Yield was 6.4% lower in 2002 compared to 2001.

Comparisons of passenger revenue, RASM and ASMs by geographic region for our mainline and regional operations are shown below:

Increase (Decrease) for Year Ended December 31, 2002 vs. December 31, 2001

	Passenger Revenue	RASM	ASMs
Domestic	(12.3)%	(5.8)%	(6.8)%
Latin America	(5.4)%	(4.4)%	(1.1)%
Trans-Atlantic	2.6 %	4.5 %	(1.9)%
Pacific	(8.6)%	(3.6)%	(5.2)%

	Passenger Revenue	RASM	ASMs
Total Mainline	(9.1)%	(4.1)%	(5.2)%
Regional	10.9 %	(3.0)%	14.4 %

Cargo, mail and other revenue increased 5.5%, $28 million, in 2002 compared to 2001 primarily due to increased charter revenue and passenger related fees, partially offset by new security restrictions that reduced mail volumes.

Wages, salaries and related costs decreased 2.1%, $62 million, during 2002 as compared to 2001, primarily due to a reduction in the average number of employees and lower employee incentives, partially offset by higher wage rates.

Aircraft fuel expense decreased 16.8%, $206 million, in 2002 as compared to 2001. The average price per gallon decreased 10.6% from 78.24 cents in 2001 to 69.97 cents in 2002. Jet fuel consumption decreased 9.1% principally reflecting decreased flight operations due to the current industry environment and the fuel efficiency of our younger fleet.

Aircraft rentals decreased 0.1%, $1 million, in 2002 compared to 2001, due to aircraft rent on grounded aircraft not requiring expense as such amounts were previously recognized as part of the fleet impairment charge, offset by increased rental expense related to the delivery of new aircraft.

Landing fees and other rentals increased 9.0%, $52 million, in 2002 as compared to 2001 primarily due to higher landing fees resulting from rate increases and higher facilities rent, partially attributable to the completion of substantial portions of the Global Gateway project at Liberty International Airport.

Maintenance, materials and repairs expense decreased 16.2%, $92 million, during 2002 as compared to 2001 primarily due to the replacement of older aircraft with new aircraft that generally require less maintenance.

Depreciation and amortization expense decreased 4.9%, $23 million, in 2002 as compared to 2001 due to lower depreciation expense on grounded aircraft which have been written down to fair market value and $22 million related to the discontinuation of amortization of routes following the adoption of SFAS 142, partially offset by the addition of new owned aircraft and related spare parts.

Booking fees, credit card discounts and sales expense decreased 14.6%, $65 million, in 2002 as compared to 2001 principally due to lower credit card fees as a result of lower revenue.

Commissions expense decreased 41.8%, $152 million, in 2002 compared to 2001 due to elimination of domestic base commissions and lower revenue.

Passenger servicing expense decreased 14.7%, $51 million, in 2002 as compared to 2001 primarily due to improved baggage performance and a decrease in food costs caused by a decrease in passengers.

Interest expense increased 19.6%, $61 million, in 2002 compared to 2001 due to an increase in long-term debt primarily resulting from the purchase of new aircraft.

Interest income decreased 46.7%, $21 million, in 2002 compared to 2001 due to lower interest rates.

Equity in the income (loss) of affiliates included our equity in the earnings (loss) of Copa, Orbitz and, in 2001, Gulfstream.

Other nonoperating income (expense) in 2001 included $22 million of special charges related to the impairment of investments in two of our affiliates and the uncollectibility of related notes receivable as a consequence of the events of September 11, 2001.

Liquidity and Capital Resources

As of December 31, 2003, we had $1.6 billion in consolidated cash, cash equivalents and short-term investments, which is $258 million higher than at December 31, 2002. The December 31, 2002 cash balance included $121 million cash held by Holdings. Holdings' cash is not included in the consolidated balance at December 31, 2003 since Holdings is no longer consolidated with Continental. At December 31, 2003, we had $170 million of restricted cash, which is primarily collateral for estimated future workers' compensation claims, letters of credit, performance bonds and interest rate swap agreements. Restricted cash at December 31, 2002 totaled $62 million. We will be required to maintain additional restricted cash of approximately $30 million beginning in the first quarter of 2004 as a result of our new credit card processing agreement. We expect our cash, cash equivalents and short-term investments balance (including restricted cash) at the end of the first quarter of 2004 to be approximately $1.5 billion.

For a discussion of a number of factors that may impact our liquidity and the sufficiency of our capital resources, see "Overview" above.

Operating Activities. Cash flows provided by operations for the year ended December 31, 2003 were $342 million, compared to cash flows used in operations of $46 million for the year ended December 31, 2002 and cash flows provided by operations of $567 million for the year ended December 31, 2001. Significant cash flows in 2003 included the May 2003 receipt of $176 million from the United States government pursuant to the Supplemental Appropriations Act and our payment of $272 million in cash to our primary defined benefit pension plan. Excluding these special items, the change in cash flows from 2002 to 2003 reflects improved revenues and our cost-saving initiatives. The 2002 period was impacted by our January 2002 payment of $168 million in transportation taxes, the payment of which had been deferred pursuant to the Stabilization Act, and our contribution of $150 million to our pension plan. Cash flows from operations in 2001 included $417 million received under the Stabilization Act.

Absent adverse factors outside our control such as additional terrorist attacks, hostilities involving the United States or further significant increases in fuel prices, we believe that our liquidity and access to cash will be sufficient to fund our current operations through 2004 and beyond if we are successful in implementing our previously announced revenue-generating and cost-cutting measures. These measures were originally designed to permit us to operate profitably in a prolonged low-fare environment. Although we expect to meet or exceed our cost-savings targets, current trends in the

airline industry, particularly if historically high fuel prices continue, make achieving our goal of reaching breakeven in 2004 unlikely. Our revenue-generating and cost-saving measures are as follows:

- In August 2002, we announced plans to implement a number of revenue-generating and cost-saving measures intended to achieve a pre-tax contribution in excess of $350 million. Included in the more than 100 planned changes were the assessment of fees for paper tickets, the elimination of discounts on certain fares, the enforcement of all fare rules with a policy prohibiting exceptions, the optimization of our flight schedule to best match demand and capacity and the modification of certain employee programs. We estimate that these measures resulted in savings of approximately $400 million in 2003.

- In March 2003, we announced plans to implement measures designed to improve our then current 2004 pre-tax outlook by $500 million. We estimate that these measures resulted in savings of approximately $200 million in 2003 and believe that we will achieve our goal of $500 million in pre-tax benefits in 2004. The cost-saving measures include a significant reduction in distribution expenses through increased utilization of our website, continental.com, the reduction of airport facility costs and landing fees, the elimination of paper tickets worldwide by December 31, 2004 (subject to market and technological conditions), the closing of select city ticket offices and the renegotiation of contracts with key suppliers.

Investing Activities. Cash flows used by investing activities were $8 million for the year ended December 31, 2003, compared to $36 million for the year ended December 31, 2002. These amounts reflect fewer aircraft deliveries in 2003. We received $134 million from Holdings in 2003 related to Holding's purchase of approximately 9.8 million shares of our Holdings common stock. Also in 2003, we received $76 million related to dispositions of our investment in Hotwire, Inc. and a portion of our investment in Orbitz. In 2002, we received $447 million related to the initial public offering of Holdings.

We have substantial commitments for capital expenditures, including for the acquisition of new aircraft. Our capital expenditures during 2003 totaled $205 million, or $153 million when reduced by net purchase deposits refunded. Capital expenditures for 2004 are expected to be $270 million, or $155 million when reduced by net purchase deposits to be refunded. Projected capital expenditures consist of $90 million of fleet expenditures, $125 million of non-fleet expenditures and $55 million for rotable parts and capitalized interest.

As of December 31, 2003, we had firm commitments for 63 aircraft from Boeing, with an estimated cost of approximately $2.4 billion and options to purchase an additional 84 Boeing aircraft. We expect to take delivery of a total of 16 Boeing aircraft in 2004, seven Boeing aircraft in 2005 and none in 2006 and 2007, with delivery of the remaining 40 aircraft occurring in 2008 and 2009.

We currently have agreements for the financing of six of the eleven 737-800 aircraft scheduled for delivery in 2004 and all five of the 757-300 aircraft scheduled for delivery in 2004, subject to customary conditions. We do not have backstop financing or any other financing currently in place for the remainder of the aircraft. Further financing will be needed to satisfy our capital commitments for our firm aircraft. We can provide no assurance that sufficient financing will be available for the aircraft on order or other related capital expenditures.

As of December 31, 2003, ExpressJet had firm commitments for 50 regional jets from Empresa Brasileira de Aeronautica S.A. ("Embraer"), with an estimated cost of approximately $1.0 billion. ExpressJet currently anticipates taking delivery of 21 regional jets in 2004, with the remainder being delivered through 2006. ExpressJet does not have an obligation to take any of these firm Embraer aircraft that are not financed by a third party and leased to either ExpressJet or us. Under the capacity purchase agreement between us and ExpressJet, we have agreed to lease as lessee and sublease to ExpressJet the regional jets that are subject to ExpressJet's firm purchase commitments. In addition, under the capacity purchase agreement with ExpressJet, we generally are obligated to purchase all of

the capacity provided by these new aircraft as they deliver to ExpressJet. We cannot predict whether passenger traffic levels will enable us to utilize fully regional jets delivering to ExpressJet in the future.

We also have significant operating lease and facility rental obligations. For the year ended December 31, 2003, annual aircraft and facility rental expense under operating leases approximated $1.3 billion.

Financing Activities. Cash flows used in financing activities were $93 million for the year ended December 31, 2003, compared to cash flows provided by financing activities of $204 million in the year ended December 31, 2002. Debt and capital lease payments essentially equaled proceeds from new issuances of debt during 2003; in 2002, we borrowed $213 million more than we paid on debt and capital lease obligations.

At December 31, 2003, we had approximately $6.0 billion (including current maturities) of long-term debt and capital lease obligations. We do not currently have any undrawn lines of credit and substantially all of our otherwise readily financeable assets are encumbered.

In May 2003, we issued $100 million of Floating Rate Secured Subordinated Notes due December 2007 (the "Junior Notes"). The Junior Notes are secured by a portion of our spare parts inventory and bear interest at the three-month LIBOR plus 7.5%. In connection with the Junior Notes and $200 million of Floating Rate Secured Notes due December 2007 secured by the same pool of spare parts (the "Senior Notes"), we have entered into a collateral maintenance agreement requiring us, among other things, to maintain a loan-to-collateral value ratio of not greater than 45% with respect to the Senior Notes and a loan-to-collateral value ratio of not greater than 67.5% with respect to both the Senior Notes and the Junior Notes combined. We must also maintain a certain level of rotable components within the spare parts collateral pool. The ratios are calculated on a semi-annual basis based on an independent appraisal of the spare parts collateral pool. If any of the collateral ratio covenants are not met, we must take action to meet all covenants by adding additional eligible spare parts to the collateral pool, purchasing or redeeming some of the outstanding notes, providing other collateral acceptable to the bond insurance policy provider for the Senior Notes, or any combination of the above. At December 31, 2003, $195 million of the Senior Notes and $97 million of the Junior Notes were outstanding.

During 2003, we incurred $130 million of floating rate indebtedness under a term loan agreement that matures in May 2011. This indebtedness is secured by a portion of our spare engines and initially bears interest at the three-month LIBOR plus 3.5%.

In June 2003, we issued $175 million of 5% Convertible Notes due 2023. The notes are convertible into our Class B common stock at an initial conversion price of $20 per share, subject to certain conditions on conversion. The notes are redeemable for cash at our option on or after June 18, 2010 at par plus accrued and unpaid interest, if any. Holders may require us to repurchase the notes on June 15 of 2010, 2013 or 2018, or in the event of certain changes in control, at par plus accrued and unpaid interest, if any. The indenture provides that we may at our option choose to pay this repurchase price in cash, in shares of common stock or any combination thereof, except in certain circumstances involving a change in control, in which case we will be required to pay cash. Should we be required to repurchase the notes at any of the redemption dates, it is our policy that we would satisfy the requirement in cash.

During the fourth quarter of 2003, we incurred $120 million of floating rate indebtedness due at various intervals through 2015. This indebtedness is secured by four 737-800 aircraft that were delivered in the fourth quarter of 2003 and bears interest at LIBOR plus 2.5%, with an initial average rate of 3.71%.

On several occasions subsequent to September 11, 2001, Moody's Investors Service and Standard and Poor's both downgraded the credit ratings of a number of major airlines, including us. Additional downgrades to our credit ratings were made in March and April 2003 and further downgrades are possible. As of December 31, 2003, our senior unsecured debt was rated Caa2 by Moody's and CCC+ by Standard and Poor's. Reductions in our credit ratings have increased the interest we pay on new issuances of debt and may increase the cost and reduce the availability of financing to us in the future. We do not have any debt obligations that would be accelerated as a result of a credit rating downgrade. However, we would have to post additional collateral under our credit card processing agreement if our debt rating falls below Caa3 as rated by Moody's or CCC- as rated by Standard and Poor's.

We have utilized proceeds from the issuance of pass-through certificates to finance the acquisition of 257 leased and owned mainline jet aircraft. Typically, these pass-through certificates, as well as a separate financing secured by aircraft spare parts, contain liquidity facilities whereby a third party agrees to make payments sufficient to pay at least 18 months of interest on the applicable certificates if a payment default occurs. The liquidity providers for these certificates include the following: Landesbank Hessen-Thuringen Girozentrale, Morgan Stanley Capital Services, Westdentsche Landesbank Girozentrale, AIG Matched Funding Corp., ABN AMRO Bank N.V., Credit Suisse First Boston, Caisse des Depots et Consignations, Bayerische Landesbank Girozentrale, ING Bank N.V. and De Nationale Investeringsbank N.V.

We currently utilize policy providers to provide credit support on three separate financings with an outstanding principal balance of $570 million at December 31, 2003. The policy providers have unconditionally guaranteed the payment of interest on the notes when due and the payment of principal on the notes no later than 24 months after the final scheduled payment date. Policy providers on these notes are MBIA Insurance Corporation (a subsidiary of MBIA, Inc.), Ambac Assurance Corporation (a subsidiary of Ambac Financial Group, Inc.) and Financial Security Assurance, Inc. (a subsidiary of Financial Security Assurance Holdings Ltd.). Financial information for the parent companies of these policy providers is available over the internet at the SEC's website at
http//www.sec.gov or at the SEC's public reference room in Washington, D.C.

Contractual Obligations. The following table summarizes the effect that minimum debt, lease and other material noncancelable commitments listed below are expected to have on our cash flow in the future periods set forth below (in millions):

	Payments Due						
Contractual Obligations	**Total**	**2004**	**2005**	**2006**	**2007**	**2008**	**Later Years**
Debt and leases:							
Long-term debt(1)	$ 7,993	$ 728	$ 964	$ 781	$ 1,097	$ 771	$ 3,652
Capital lease obligations(1)	687	44	46	39	40	45	473
Aircraft operating leases(2)	11,368	897	975	864	833	811	6,988
Nonaircraft operating leases(3)	7,483	360	362	365	367	354	5,675
Future operating leases(4)	1,069	15	42	64	67	67	814
Other:							
Capacity Purchase Agreement(5)	3,586	1,236	985	924	441		
Aircraft purchase commitments(6)	2,438	638	252			891	657
Other purchase obligations(7)	325	94	83	74	56	18	
Projected pension contributions(8)	1,190	300	338	220	185	147	
Total(9)	$ 36,139	$ 4,312	$ 4,047	$ 3,331	$ 3,086	$ 3,104	$ 18,259

(1) Amounts represent contractual amounts due, including interest. Interest on floating rate debt was estimated using projected forward rates as of the fourth quarter of 2003.

(2) Amounts represent contractual amounts due and exclude $3.7 billion of projected sublease income to be received from ExpressJet.

(3)
Amounts represent minimum contractual amounts. We have assumed no escalations in rent or changes in variable expenses.

(4)
Amounts represent payments for firm regional jets to be financed by third parties and leased by us. We will sublease the regional jets to ExpressJet. Neither we nor ExpressJet has an obligation to take any firm aircraft that are not financed by a third party. Amounts are net of previously paid purchase deposits and exclude sublease income we will receive from ExpressJet. See Note 16 to our consolidated financial statements for a discussion of these purchase commitments.

(5)
Amounts represent our estimates of future minimum noncancelable commitments under our agreement with ExpressJet and do not include the portion of the underlying obligations for aircraft and facility rent that are disclosed as part of aircraft and nonaircraft operating leases. See Note 4 to our consolidated financial statements for the assumptions used to estimate the payments.

(6)
Amounts represent contractual commitments for firm-order aircraft only and are net of previously paid purchase deposits. See Note 16 to our consolidated financial statements for a discussion of these purchase commitments.

(7)
Amounts represent noncancelable commitments to purchase goods and services, including spare engines and information technology support.

(8)
Amounts represent our estimate of the contributions necessary to maintain our defined benefit pension plan's funding at 90% of its current liability. Amounts are subject to change based on the performance of the assets in the plan as well as the discount rate used to determine the obligation. These amounts are greater than the minimum funding requirements as determined by government regulations. See "Critical Accounting Policies and Estimates" for a discussion of our assumptions regarding our pension plan. We are unable to estimate the projected contributions beyond 2008.

(9)
Total contractual obligations do not include long-term contracts where the commitment is variable in nature, such as credit card processing agreements, or where short-term cancellation provisions exist, such as power-by-the-hour engine maintenance agreements.

We expect to fund our future capital and purchase commitments through internally generated funds together with general company financings and aircraft financing transactions. However, there can be no assurance that sufficient financing will be available for all aircraft and other capital expenditures or that, if necessary, we will be able to defer or otherwise renegotiate our capital commitments.

Operating Leases. At December 31, 2003, we had 469 aircraft under operating leases, 38 of which have been removed from service. These leases have remaining lease terms ranging up to 21$^{1}/_{2}$ years. In addition, we have non-aircraft operating leases, principally related to airport and terminal facilities and related equipment. The obligations for these operating leases are not included in our consolidated balance sheet. Our total rental expense for aircraft and non-aircraft operating leases was $896 million and $395 million, respectively, in 2003.

Capacity Purchase Agreement. Our capacity purchase agreement with ExpressJet provides that we purchase, in advance, all of its available seat miles for a negotiated price, and we are at risk for reselling the available seat miles at market prices. Under the agreement, ExpressJet has the right through December 31, 2006 to be our sole provider of regional jet service from our hubs. See Note 4 to our consolidated financial statements for details of our capacity purchase agreement with ExpressJet.

Guarantees and Indemnifications. We have entered into agreements with the cities of Houston, Texas and Cleveland, Ohio, the New Jersey Economic Development Authority, the Port Authority of New York and New Jersey, The New York City Industrial Development Agency, the Hawaii Department of Transportation, the Regional Airports Improvement Corporation (in Los Angeles) and the Harris County (Houston) Industrial Development Corporation to provide funds for constructing, improving and modifying facilities that have been or will be leased to us and for acquiring related equipment. In connection with those agreements, we have unconditionally guaranteed the principal and interest on tax-exempt bonds issued by these entities with a current outstanding balance of approximately $1.6 billion (excluding the City of Houston bonds and including the US Airways contingent liability, both discussed below) and entered into long-term leases with the respective authorities under which rental payments will be sufficient to service the related bonds. The leases generally have terms ranging from 20 to 30 years. These leasing arrangements are accounted for as operating leases in the accompanying consolidated financial statements.

In August 2001, the City of Houston completed the offering of $324 million aggregate principal amount of tax-exempt special facilities revenue bonds to finance the construction of Terminal E and a new international ticketing hall facility at Bush Intercontinental Airport. In connection therewith, we entered into a long-term lease with the City of Houston requiring that upon completion of construction, with limited exceptions, we will make rental payments sufficient to service the related tax-exempt bonds through their maturity in 2029. Approximately $222 million of the bond proceeds had been expended as of December 31, 2003. During the construction period, we retain certain risks related to our own actions or inactions while managing portions of the construction. Potential obligations associated with these risks are generally limited based upon certain percentages of construction costs incurred to date.

We have also entered into a binding corporate guaranty with the bond trustee for the repayment of the principal and interest on the bonds that becomes partially effective (based on a pro rata share of bond proceeds) upon the completion of construction of the terminal or of the international ticketing hall facility. The corporate guaranty would also become effective if we fail to comply with the lease agreement (which is within our control), or if we terminate the lease agreement. Further, we have not assumed any condemnation risk, any casualty event risk (unless caused by us), or risk related to certain overruns (and in the case of cost overruns, our liability for the project would be limited to 89.9% of the capitalized costs) during the construction period of each respective phase. Accordingly, we are not considered the owner of the project for financial reporting purposes and, therefore, have not capitalized the construction costs or recorded the debt obligation in our consolidated financial statements. However, our potential obligation under the guarantee is for payment of the principal of $324 million and related interest charges, at an annual rate of 6.78%. We expect the guaranty to become effective for a portion of the bonds relating to the terminal, in the amount of $271 million, during the first quarter of 2004. Our lease payments, which are sufficient to service the bonds, are included in the table under "Contractual Obligations" in "Liquidity and Capital Resources".

We remain contingently liable for US Airways' obligations under a lease agreement between US Airways and the Port Authority of New York and New Jersey related to the East End Terminal at LaGuardia airport. These obligations include the payment of ground rentals to the Port Authority and the payment of principal and interest on special facilities revenue bonds issued by the Port Authority with an outstanding balance of $174 million at December 31, 2003 and having a final scheduled maturity in 2015. If US Airways defaults on these obligations, we will be required to cure the default, and we would have the right to occupy the terminal after US Airways' interest in the lease had been terminated.

We are the lessee under many real estate leases. It is common in such commercial lease transactions for us as the lessee to agree to indemnify the lessor and other related third parties for tort liabilities that arise out of or relate to our use or occupancy of the leased premises. In some cases, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but usually excludes any liabilities caused by their gross negligence or willful misconduct. Additionally, we typically indemnify such parties for any environmental liability that arises out of or relates to our use of the leased premises.

In our aircraft financing agreements, we typically indemnify the financing parties, trustees acting on their behalf and other related parties against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the aircraft and for tort liability, whether or

not these liabilities arise out of or relate to the negligence of these indemnified parties, except for their gross negligence or willful misconduct.

We expect that we would be covered by insurance (subject to deductibles) for most tort liabilities and related indemnities described above with respect to real estate we lease and aircraft we operate.

In our financing transactions that include loans from banks in which the interest rate is based on LIBOR, we typically agree to reimburse the lenders for certain increased costs that they incur in carrying these loans as a result of any change in law and for any reduced returns with respect to these loans due to any change in capital requirements. We had $1.4 billion of floating rate debt at December 31, 2003. In several financing transactions, with an aggregate carrying value of $975 million, involving loans from non-U.S. banks, export-import banks and certain other lenders secured by aircraft, we bear the risk of any change in tax laws that would subject loan payments thereunder to non-U.S. lenders to withholding taxes. In addition, in cross-border aircraft lease agreements for two 757 aircraft, we bear the risk of any change in U.S. tax laws that would subject lease payments made by us to a resident of Japan to U.S. taxes. Our lease obligations for these two aircraft totaled $68 million at December 31, 2003.

We cannot estimate the potential amount of future payments under the foregoing indemnities and agreements.

Deferred Tax Assets. We have not paid federal income taxes in the last three years. As of December 31, 2003, we had a net non-current deferred tax liability of $446 million including gross deferred tax assets aggregating $1,537 million, $1,077 million related to net operating losses ("NOLs") and a valuation allowance of $219 million.

At December 31, 2003, we had estimated tax NOLs of $3.0 billion for federal income tax purposes that will expire through 2023. Due to our ownership change on April 27, 1993, the ultimate utilization of our NOLs may be limited. Reflecting this limitation, we had a valuation allowance of $219 million at December 31, 2003 and 2002.

Section 382 of the Internal Revenue Code ("Section 382") imposes limitations on a corporation's ability to utilize NOLs if it experiences an "ownership change." In general terms, an ownership change may result from transactions increasing the ownership of certain stockholders in the stock of a corporation by more than 50 percentage points over a three-year period. In the event of an ownership change, utilization of our NOLs would be subject to an annual limitation under Section 382 determined by multiplying the value of our stock at the time of the ownership change by the applicable long-term tax exempt rate (which was 4.74% for December 2003). Any unused annual limitation may be carried over to later years. The amount of the limitation may under certain circumstances be increased by certain built-in gains that we held at the time of the change that are recognized in the five-year period after the change. Under current conditions, if an ownership change were to occur, our annual NOL utilization would be limited to approximately $51 million per year, before consideration of any built-in gains.

The Internal Revenue Service ("IRS") is in the process of examining our income tax returns for years through 1999 and has indicated that it may disallow certain deductions we claimed. In addition, the IRS has begun an examination of our income tax returns for the years 2000 and 2001. We believe the ultimate resolution of these audits will not have a material adverse effect on our financial condition, liquidity or results of operations.

Environmental Matters. We could potentially be responsible for environmental remediation costs primarily related to jet fuel and solvent contamination surrounding our aircraft maintenance hangar in Los Angeles. In 2001, the California Regional Water Quality Control Board mandated a field study of the site and it was completed in September 2001. We have established a reserve for estimated costs of environmental remediation at Los Angeles and elsewhere in our system, based primarily on third party environmental studies and estimates as to the extent of the contamination and nature of the required

remedial actions. We have evaluated and recorded this accrual for environmental remediation costs separately from any related insurance recovery. We have not recognized any receivables related to insurance recoveries at December 31, 2003.

We expect our total losses from environmental matters to be $52 million, for which we were fully accrued at December 31, 2003. During 2003, we received insurance settlements totaling $16 million for future environmental claims. Although we believe, based on currently available information, that our reserves for potential environmental remediation costs are adequate, reserves could be adjusted as further information develops or circumstances change. However, we do not expect these items to materially impact our financial condition, results of operations or liquidity.

Off-Balance Sheet Arrangements

An off-balance sheet arrangement is any transaction, agreement or other contractual arrangement involving an unconsolidated entity under which a company has (1) made guarantees, (2) a retained or a contingent interest in transferred assets, (3) an obligation under derivative instruments classified as equity or (4) any obligation arising out of a material variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the company, or that engages in leasing, hedging or research and development arrangements with the company.

We have no arrangements of the types described in the first three categories that we believe may have a material current or future effect on our financial condition, liquidity or results of operations. Certain guarantees that we do not expect to have a material current or future effect on our financial condition, liquidity or resulted operations are disclosed in Note 16 to our consolidated financial statements.

We do have obligations arising out of variable interests in unconsolidated entities. Effective July 1, 2003, we adopted Financial Accounting Standards Board Interpretation No. 46, "Consolidation of Variable Interest Entities", which addresses the accounting for these variable interests. See Note 2 to our consolidated financial statements for a discussion of our off-balance sheet aircraft leases, airport leases (which includes the US Airways contingent liability), subsidiary trust and our capacity purchase agreement between us and Holdings and ExpressJet.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. We believe that our critical accounting policies are limited to those described below. For a detailed discussion on the application of these and other accounting policies, see Note 1 to our consolidated financial statements.

Pension Plan. We account for our defined benefit pension plan using Statement of Financial Accounting Standards No. 87, "Employer's Accounting for Pensions" ("SFAS 87"). Under SFAS 87, pension expense is recognized on an accrual basis over employees' approximate service periods. Pension expense calculated under SFAS 87 is generally independent of funding decisions or requirements. We recognized expense for our defined benefit pension plan of $328 million, $185 million and $127 million in 2003, 2002 and 2001, respectively. We expect our pension expense to be approximately $280 million in 2004.

The fair value of our plan assets increased from $866 million at December 31, 2002 to $1.3 billion at December 31, 2003. We contributed $272 million in cash and 7.4 million shares of Holdings common stock valued at approximately $100 million to our primary defined benefit pension plan in 2003. As of December 31, 2003, the plan held 4.5 million shares of Holdings common stock, which had a fair value of $67 million. As a result of these contributions and higher investment returns, our plan's under-funded status decreased from $1.2 billion at December 31, 2002 to $1.1 billion at December 31, 2003. Funding requirements for defined benefit pension plans are determined by government regulations, not SFAS 87. Our 2004 minimum funding requirements are not expected to be significant. However, we currently intend to maintain the plan's funding at 90% of its current liability, which would result in our making contributions of approximately $300 million to our pension plan in 2004. Although a number of bills have been proposed in Congress that could significantly affect pension funding rules, none of the current proposals would increase our minimum required contribution or our expected contributions in 2004.

The calculation of pension expense and our pension liability requires the use of a number of assumptions. Changes in these assumptions can result in different expense and liability amounts, and future actual experience can differ from the assumptions. We believe that the two most critical assumptions are the expected long-term rate of return on plan assets and the assumed discount rate.

When calculating pension expense for 2003, we assumed that our plan's assets would generate a long-term rate of return of 9.0%. This rate is lower than the assumed rate of 9.5% used to calculate the 2002 and 2001 expense. We develop our expected long-term rate of return assumption based on historical experience and by evaluating input from the trustee managing the plan's assets, including the trustee's review of asset class return expectations by several consultants and economists as well as long-term inflation assumptions. Our expected long-term rate of return on plan assets is based on a target allocation of assets, which is based on our goal of earning the highest rate of return while maintaining risk at acceptable levels. The plan strives to have assets sufficiently diversified so that adverse or unexpected results from one security class will not have an unduly detrimental impact on the entire portfolio. Our allocation of assets (excluding the Holdings shares held by the plan) was as follows at December 31, 2003:

	Percent of Total	Expected Long-Term Rate of Return
Equities	46%	10.0
Fixed income	27	6.5
International equities	17	10.0
Other	10	13.0
Total	100%	

We believe that our long-term asset allocation on average will approximate the targeted allocation. We regularly review our actual asset allocation and periodically rebalance the pension plan's investments to our targeted allocation when considered appropriate.

Pension expense increases as the expected rate of return on plan assets decreases. Lowering the expected long-term rate of return on our plan assets by 0.5% (from 9.0% to 8.5%) would increase our estimated 2004 pension expense by approximately $6 million.

We discounted our future pension obligations using a rate of 6.25% at December 31, 2003, compared to 6.75% at December 31, 2002 and 7.5% at December 31, 2001. We determine the appropriate discount rate based on the current rates earned on long-term bonds that receive one of the two highest ratings given by a recognized rating agency. The pension liability and future pension expense both increase as the discount rate is reduced. Lowering the discount rate by 0.5% (from 6.25% to 5.75%) would increase our pension liability at December 31, 2003 by approximately $206 million and increase our estimated 2004 pension expense by approximately $31 million.

At December 31, 2003, we have unrecognized actuarial losses of $1.0 billion. These losses will be recognized as a component of pension expense in future years. Our estimated 2004 pension expense of $280 million includes the recognition of approximately $75 million of these losses.

Future changes in plan asset returns, assumed discount rates and various other factors related to the participants in our pension plans will impact our future pension expense and liabilities. We cannot predict with certainty what these factors will be in the future.

Revenue Recognition. We recognize passenger revenue and related commissions, if any, when transportation is provided or when the ticket expires unused rather than when a ticket is sold. Prior to October 1, 2002, unused nonrefundable tickets expired one year from the date the ticket was sold, or for partially used tickets, the date of first flight. Effective October 1, 2002, unused nonrefundable tickets expire on the date of intended flight unless the date is extended by payment of a change fee. Effective August 20, 2003, we modified our policy to give customers with nonrefundable tickets who cancel their reservations prior to scheduled departure time a full year from the date their original ticket was sold to reschedule and pay the change fee, without losing the value of their tickets.

The amount of passenger ticket sales and commissions not yet recognized as revenue is reflected as air traffic liability and prepaid commissions, respectively, in our consolidated balance sheet. We perform periodic evaluations of this estimated liability and any adjustments, which can be significant, are included in results of operations for the periods in which the evaluations are completed. These adjustments relate primarily to differences between our statistical estimation of certain revenue transactions and the related sales price, as well as refunds, exchanges, interline transactions and other items for which final settlement occurs in periods subsequent to the sale of the related tickets at amounts other than the original sales price.

Impairments of Long-Lived Assets. We record impairment losses on long-lived assets used in operations, primarily property and equipment and airport operating rights, when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. Our estimates of fair value represent our best estimate based on industry trends and reference to market rates and transactions.

We recognized fleet impairment losses in 2003, 2002 and 2001, each of which was partially the result of the September 11, 2001 terrorist attacks and the related aftermath. These events resulted in a reevaluation of our operating and fleet plans, resulting in the grounding of certain older aircraft types or acceleration of the dates on which the related aircraft were to be removed from service. The grounding or acceleration of aircraft retirement dates resulted in reduced estimates of future cash flows.

In 2003, we recorded an impairment charge of $44 million to reflect decreases in the fair value of our owned MD-80s, along with other impairments totaling $21 million. In 2002, we recognized an impairment charge of $93 million related to owned MD-80 and ATR-42 aircraft. In 2001, we determined that the carrying amounts of our owned DC 10-30, ATR-42, EMB-120 and Boeing 747 and 727 aircraft and related inventories were no longer recoverable and recognized an impairment charge of approximately $61 million. We estimated the fair value of these aircraft and related inventory based on industry trends and, where available, reference to market rates and transactions. All other long-lived assets, principally our other fleet types and airport operating rights, were determined to be recoverable based on our estimates of future cash flows. For purposes of this computation, our assumptions about future cash flows reflect a return to more historical levels of industry profitability on a longer-term basis.

We also perform annual impairment tests on our routes, which are indefinite life intangible assets. These tests are based on estimates of discounted future cash flows, using assumptions consistent with those used for aircraft and airport operating rights impairment tests. We determined that we did not have any impairment of our routes at December 31, 2003.

We provide an allowance for spare parts inventory obsolescence over the remaining useful life of the related aircraft, plus allowances for spare parts currently identified as excess. These allowances are based on our estimates and industry trends, which are subject to change and, where available, reference to market rates and transactions. The estimates are more sensitive when we near the end of a fleet life or when we remove entire fleets from service sooner than originally planned.

We regularly review the estimated useful lives and salvage values for our aircraft and spare parts.

Frequent Flyer Accounting. We utilize a number of estimates in accounting for our OnePass frequent flyer program which are consistent with industry practices.

For those OnePass accounts that have sufficient mileage credits to claim the lowest level of free travel, we record a liability for the estimated incremental cost of providing travel awards that are expected to be redeemed. Incremental cost includes the cost of fuel, meals, insurance and miscellaneous supplies and does not include any costs for aircraft ownership, maintenance, labor or overhead allocation. A change to these cost estimates, the actual redemption activity or the minimum award level could have a significant impact on our liability in the period of change as well as future years.

We also sell mileage credits in our frequent flyer program to participating partners, such as credit card companies, phone companies, other airlines, alliance members, hotels and car rental agencies. Revenue from the sale of mileage credits is deferred and recognized as passenger revenue when transportation is likely to be provided, based on estimates of the fair value of tickets to be redeemed. In the fourth quarter of 2003, we adjusted our estimates of the mileage credits we expect to be redeemed for travel, resulting in a one-time increase in other revenue of $24 million. Amounts received in excess of the tickets' fair value are recognized in income currently and classified as a reimbursement of advertising expenses. A change to the time period over which the mileage credits are used (currently six to 32 months), the actual redemption activity or our estimate of the number or fair value of tickets could have a significant impact on our revenue in the year of change as well as future years.

We have entered into marketing alliances with several airlines, including Northwest Airlines, Delta Airlines, Alaska Airlines and KLM Royal Dutch Airlines. These marketing alliances generally include, among other things, reciprocal frequent flyer benefits that allow members of both airlines' frequent flyer programs to both earn and redeem frequent flyer credits on both airlines. For certain of these arrangements, we do not record a liability for the gross payments we expect to make to the other airlines for OnePass members' redemptions for travel on the other airlines until we meet certain contractual thresholds and other provisions that are required prior to cash payments being made. Cash

payments on these agreements have not been significant in the past and are not expected to be significant in the future. For other of these arrangements, we record a liability for the gross payments we expect to make to the other airline for OnePass members' redemptions for travel on the other airline, without regard to the payments we expect to receive from the other airline for their frequent flyer members' redemptions for travel on us.

Related Party Transactions

See Note 17 to our consolidated financial statements for a discussion of related party transactions.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk Sensitive Instruments and Positions

We are subject to certain market risks, including commodity price risk (i.e., aircraft fuel prices), interest rate risk, foreign currency risk and price changes related to certain investments in debt and equity securities. The adverse effects of potential changes in these market risks are discussed below. The sensitivity analyses presented do not consider the effects that such adverse changes may have on overall economic activity nor do they consider additional actions we may take to mitigate our exposure to such changes. Actual results may differ. See the notes to the consolidated financial statements for a description of our accounting policies and other information related to these financial instruments. We do not hold or issue derivative financial instruments for trading purposes.

Aircraft Fuel. Our results of operations are significantly impacted by changes in the price of aircraft fuel. During 2003 and 2002, aircraft fuel accounted for 14.5% and 11.7%, respectively, of our operating expenses. Based on our expected fuel consumption in 2004, a one dollar increase in the price of crude oil will increase our annual fuel expense by approximately $38 million. From time to time we enter into petroleum swap contracts, petroleum call option contracts and/or jet fuel purchase commitments to provide some short-term protection (generally three to six months) against a sharp increase in jet fuel prices. Depending on the hedging method employed, our strategy may limit our ability to benefit from declines in fuel prices. As of December 31, 2003, we did not have any fuel hedges in place, as compared to the hedge of 23% of our projected 2003 fuel requirements at December 31, 2002.

Foreign Currency. We are exposed to the effect of exchange rate fluctuations on the U.S. dollar value of foreign currency denominated operating revenue and expenses. We attempt to mitigate the effect of certain potential foreign currency losses by entering into forward and option contracts that effectively enable us to sell Japanese yen, British pounds and euros expected to be received from the respective denominated net cash flows over the next six to 12 months at specified exchange rates. As of December 31, 2003, we had entered into option and forward contracts to hedge approximately 61% of our projected yen-denominated net cash flows for 2004, forward contracts to hedge approximately 63% of our projected British pound-denominated net cash flows for 2004 and forward contracts to hedge approximately 50% of our projected euro-denominated net cash flows for the first six months of 2004. At December 31, 2002, we had option contracts in place to hedge approximately 90% of our projected yen-denominated net cash flows for the first six months of 2003 and no material hedge contracts in place for our British pound- and euro-denominated net cash flows. We estimate that at December 31, 2003, a 10% strengthening in the value of the U.S. dollar relative to the yen, pound and euro would have increased the fair value of the existing option and/or forward contracts by $6 million, $12 million and $2 million, respectively, offset by a corresponding loss on the underlying 2004 exposure of $13 million, $9 million and $3 million, respectively, resulting in a net $(7) million, $3 million and $(1) million gain (loss). At December 31, 2002, such a change would have resulted in a $4 million increase in the fair value of existing yen-denominated option contracts offset by a corresponding loss on the underlying exposure of $15 million, resulting in a net $11 million loss.

Interest Rates. Our results of operations are affected by fluctuations in interest rates (e.g., interest expense on variable-rate debt and interest income earned on short-term investments).

We had approximately $1.4 billion of variable-rate debt as of December 31, 2003 and 2002. We have mitigated our exposure on certain variable-rate debt by entering into interest rate cap and swap agreements. Our interest rate cap, which limited the amount of potential increase in the LIBOR rate component of our floating rate debt to a maximum of 9% over the term of the contract, expired July 31, 2002. The interest rate swap outstanding at December 31, 2003 and 2002 had a notional amount of $153 million and $162 million, respectively. The interest rate swap effectively locks us into paying a fixed rate of interest on a portion of our floating rate debt securities through 2005. If average interest rates increased by 100 basis points during 2004 as compared to 2003, our projected 2004 interest expense would increase by approximately $12 million, net of interest rate swap. At December 31, 2002, an interest rate increase of 100 basis points during 2003 as compared to 2002 was projected to increase 2003 interest expense by approximately $11 million, net of interest rate cap and swap.

As of December 31, 2003 and 2002, we estimated the fair value of $3.4 billion and $3.6 billion (carrying value) of our fixed-rate debt to be $3.2 billion and $2.6 billion, respectively, based upon discounted future cash flows using our current incremental borrowing rates for similar types of instruments or market prices. Market risk, estimated as the potential increase in fair value resulting from a hypothetical 100 basis points decrease in interest rates, was approximately $113 million and $107 million as of December 31, 2003 and 2002, respectively. The fair value of the remaining fixed-rate debt at December 31, 2003 and 2002, (with a carrying value of $826 million and $684 million, respectively), was not practicable to estimate.

If 2004 average short-term interest rates decreased by 100 basis points over 2003 average rates, our projected interest income from cash, cash equivalents and short-term investments would decrease by approximately $13 million during 2004, compared to an estimated $11 million decrease during 2003 measured at December 31, 2002.

Investment in Orbitz. We are exposed to the effect of price changes related to our investment in Orbitz, as traded on Nasdaq under the symbol "ORBZ". As of December 31, 2003, we held 3.6 million shares of Orbitz common stock, which we reported at its fair value of $83 million. We estimate that a 10% decrease in the fair value of Orbitz common stock would result in an $8 million decrease in the fair value of our investment at December 31, 2003. Any changes in the fair value of our Orbitz shares would be partially offset by a change in our related compensation liability, as discussed in Note 7 to our consolidated financial statements included in Item 8 of this report.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Continental Airlines, Inc.

We have audited the accompanying consolidated balance sheets of Continental Airlines, Inc. (the "Company") as of December 31, 2003 and 2002, and the related consolidated statements of operations, common stockholders' equity and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2003 and 2002, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 1 to the consolidated financial statements, the Company adopted, effective January 1, 2002, Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets". As discussed in Note 2 to the consolidated financial statements, the Company adopted, effective January 1, 2003, Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Disposal or Exit Activities" and, effective July 1, 2003, Financial Accounting Standards Board Interpretation No. 46, "Consolidation of Variable Interest Entities".

Houston, Texas
January 20, 2004

CONTINENTAL AIRLINES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except per share data)

	Year Ended December 31,		
	2003	**2002**	**2001**
Operating Revenue:			
Passenger	$ 8,135	$ 7,862	$ 8,457
Cargo, mail and other	735	540	512
	8,870	8,402	8,969
Operating Expenses:			
Wages, salaries and related costs	3,056	2,959	3,021
Aircraft fuel	1,255	1,023	1,229

	Year Ended December 31,		
Aircraft rentals	896	902	903
Landing fees and other rentals	620	633	581
Maintenance, materials and repairs	509	476	568
Depreciation and amortization	444	444	467
Booking fees, credit card discounts and sales	377	380	445
Passenger servicing	297	296	347
Regional capacity purchase, net	153		
Commissions	148	212	364
Other	988	1,135	1,193
Security fee reimbursement	(176)		
Stabilization Act grant		12	(417)
Fleet impairment losses and other special charges	100	242	124
	8,667	8,714	8,825
Operating Income (Loss)	203	(312)	144
Nonoperating Income (Expense):			
Interest expense	(393)	(372)	(311)
Interest capitalized	24	36	57
Interest income	19	24	45
Gain on dispositions of ExpressJet Holdings shares	173		
Equity in the income (loss) of affiliates	23	8	(20)
Other, net	152	(15)	(45)
	(2)	(319)	(274)
Income (Loss) before Income Taxes and Minority Interest	201	(631)	(130)
Income Tax Benefit (Expense)	(114)	208	35
Minority Interest	(49)	(28)	
Net Income (Loss)	$ 38	$ (451)	$ (95)
Basic and Diluted Earnings (Loss) per Share	$ 0.58	$ (7.02)	$ (1.72)
Shares Used for Computation:			
Basic	65.4	64.2	55.5
Diluted	65.6	64.2	55.5

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

CONTINENTAL AIRLINES, INC.

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

	December 31, 2003	December 31, 2002
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 999	$ 983
Restricted cash and cash equivalents	170	62
Short-term investments	431	297
Total cash, cash equivalents and short-term investments	1,600	1,342
Accounts receivable, net of allowance for doubtful receivables of $19 and $30	403	378
Spare parts and supplies, net of allowance for obsolescence of $98 and $98	191	248
Deferred income taxes	157	165
Note receivable from ExpressJet Holdings, Inc.	67	
Prepayments and other	168	145
Total current assets	2,586	2,278
Property and Equipment:		
Owned property and equipment:		
Flight equipment	6,574	6,762
Other	1,195	1,275
	7,769	8,037
Less: Accumulated depreciation	1,784	1,599
	5,985	6,438
Purchase deposits for flight equipment	225	269
Capital leases:		
Flight equipment	107	117
Other	297	262
	404	379
Less: Accumulated amortization	126	118
	278	261
Total property and equipment	6,488	6,968
Routes	615	615
Airport operating rights, net of accumulated amortization of $293 and $268	259	287
Intangible pension asset	124	144
Investment in affiliates	173	89
Note receivable from ExpressJet Holdings, Inc.	126	
Other assets, net	278	260

	December 31,	
Total Assets	$ 10,649	$ 10,641

(continued on next page)

CONTINENTAL AIRLINES, INC.

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

	December 31,	
	2003	**2002**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Current maturities of long-term debt and capital leases	$ 422	$ 493
Accounts payable	840	930
Air traffic liability	957	882
Accrued payroll	281	285
Accrued other liabilities	366	336
Total current liabilities	2,866	2,926
Long-Term Debt and Capital Leases	5,558	5,471
Deferred Income Taxes	446	413
Accrued Pension Liability	678	723
Other	309	329
Commitments and Contingencies		
Minority Interest		7
Redeemable Preferred Stock of Subsidiary		5
Stockholders' Equity:		
Preferred stock $.01 par, 10,000,000 shares authorized; one share of Series B issued and outstanding, stated at par value		
Class B common stock $.01 par, 200,000,000 shares authorized; 91,507,192 and 91,203,321 shares issued	1	1
Additional paid-in capital	1,401	1,391
Retained earnings	948	910
Accumulated other comprehensive loss	(417)	(395)
Treasury stock -25,471,881 and 25,442,529 shares, at cost	(1,141)	(1,140)

	December 31,	
Total stockholders' equity	792	767
Total Liabilities and Stockholders' Equity	$ 10,649	$ 10,641

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

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CONTINENTAL AIRLINES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)

	Year Ended December 31,		
	2003	**2002**	**2001**
Cash Flows from Operating Activities:			
Net income (loss)	$ 38	$ (451)	$ (95)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Deferred income taxes	101	(179)	(40)
Depreciation and amortization	444	444	467
Fleet disposition/impairment losses	100	242	61
Gains on sales of investments	(305)		
Equity in the (income) loss of affiliates	(23)	(8)	20
Other, net	(36)	12	31
Changes in operating assets and liabilities:			
(Increase) decrease in accounts receivable	(25)	(23)	73
(Increase) decrease in spare parts and supplies	4	4	(20)
Increase (decrease) in accounts payable	(19)	(79)	(8)
Increase (decrease) in air traffic liability	75	(132)	(111)
Increase (decrease) in other	(12)	124	189
Net cash provided by (used in) operating activities	342	(46)	567
Cash Flows from Investing Activities:			
Capital expenditures	(205)	(539)	(568)
Purchase deposits paid in connection with future aircraft deliveries	(29)	(73)	(432)
Purchase deposits refunded in connection with aircraft delivered	81	219	337
Purchase of short-term investments	(134)	(56)	(96)
Proceeds from sales of ExpressJet Holdings, net	134	447	
Proceeds from sales of Internet-related investments	76		
Proceeds from disposition of property and equipment	16	9	11
Other	53	(43)	(26)
Net cash used in investing activities	(8)	(36)	(774)

	Year Ended December 31,		
Cash Flows from Financing Activities:			
Proceeds from issuance of long-term debt, net	559	596	436
Payments on long-term debt and capital lease obligations	(549)	(383)	(367)
Purchase of common stock			(451)
Proceeds from issuance of common stock	5	23	241
Increase in restricted cash to collateralize letters of credit	(108)	(32)	(22)
Other			(11)
Net cash (used in) provided by financing activities	(93)	204	(174)
Impact on cash of ExpressJet deconsolidation	(225)		
Net Increase (Decrease) in Cash and Cash Equivalents	16	122	(381)
Cash and Cash Equivalents Beginning of Period	983	861	1,242
Cash and Cash Equivalents End of Period	$ 999	$ 983	$ 861
Supplemental Cash Flows Information:			
Interest paid	$ 374	$ 345	$ 314
Income taxes paid (refunded)	$ 13	$ (31)	$ (4)
Investing and Financing Activities Not Affecting Cash:			
Property and equipment acquired through the issuance of debt	$ 120	$ 908	$ 707
Capital lease obligations incurred	$ 22	$ 36	$ 95
Contribution of ExpressJet stock to pension plan	$ 100	$	$

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

CONTINENTAL AIRLINES, INC.

CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDERS' EQUITY
(In millions, except for share data)

	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Treasury Stock, At Cost
December 31, 2000	$ 379	$ 1,456	$ 13	$ 356	$ (689)
Net Loss		(95)		(95)	
Increase in Additional Minimum Pension Liability, net of income taxes of $77			(138)	(138)	
Purchase of Common Stock					(451)
Issuance of Common Stock pursuant to Stock Plans	79				
Issuance of Common Stock pursuant to Stock Offering	173				
Reclass for Redeemable Common Stock	450				
Other	(12)		(5)	(5)	

	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Treasury Stock, At Cost
December 31, 2001	1,069	1,361	(130)	(238)	(1,140)
Net Loss		(451)		(451)	
Increase in Additional Minimum Pension Liability, net of income taxes of $146			(250)	(250)	
Issuance of Common Stock pursuant to Stock Plans	36				
Sale of ExpressJet Holdings Stock, net of applicable income taxes of $175	291				
Other	(5)		(15)	(15)	
December 31, 2002	1,391	910	(395)	(716)	(1,140)
Net Income		38		38	
Increase in Additional Minimum Pension Liability, net of income taxes of $11			(20)	(20)	
Issuance of Common Stock pursuant to Stock Plans	5				
Other	5		(2)	(2)	(1)
December 31, 2003	$ 1,401	$ 948	$ (417)	$ 16	$ (1,141)

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

CONTINENTAL AIRLINES, INC.

CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDERS' EQUITY
(In millions, except for share data)

	Class A Common Stock	Class B Common Stock	Treasury Stock
		(in thousands)	
Shares outstanding at December 31, 2000	10,964	47,487	16,587
Repurchase of Northwest Stock	(6,686)		8,824
Purchase of Common Stock		(23)	23
Issuance of Common Stock pursuant to Stock Offering		7,751	
Issuance of Common Stock pursuant to Stock Plans		2,313	
Issuance of Common Stock pursuant to Conversion of Class A to Class B Common Stock	(4,278)	5,646	
Other			9
Shares outstanding at December 31, 2001		63,174	25,443
Issuance of Common Stock pursuant to Stock Plans		2,587	
Shares outstanding at December 31, 2002		65,761	25,443

	Class A Common Stock	Class B Common Stock	Treasury Stock
Issuance of Common Stock pursuant to Stock Plans		303	
Other		(29)	29
Shares outstanding at December 31, 2003		66,035	25,472

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

CONTINENTAL AIRLINES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Continental Airlines, Inc., a Delaware corporation, is a major United States air carrier engaged in the business of transporting passengers, cargo and mail. We are the fifth largest United States airline (as measured by the number of scheduled miles flown by revenue passengers, known as revenue passenger miles, in 2003) and, together with ExpressJet Airlines, Inc. ("ExpressJet"), a wholly-owned subsidiary of ExpressJet Holdings, Inc. ("Holdings") and from which we purchase seat capacity, and our wholly-owned subsidiary, Continental Micronesia, Inc. ("CMI"), each a Delaware corporation, we served 228 airports worldwide at December 31, 2003. As of December 31, 2003, we flew to 127 domestic and 101 international destinations and offered additional connecting service through alliances with domestic and foreign carriers. We directly served 16 European cities, seven South American cities, Tel Aviv, Hong Kong and Tokyo as of December 31, 2003. In addition, we provide service to more destinations in Mexico and Central America than any other U.S. airline, serving 31 cities. Through our Guam hub, CMI provides extensive service in the western Pacific, including service to more Japanese cities than any other United States carrier.

As used in these Notes to Consolidated Financial Statements, the terms "Continental", "we", "us", "our" and similar terms refer to Continental Airlines, Inc. and, unless the context indicates otherwise, its consolidated subsidiaries.

Note 1 Summary of Significant Accounting Policies

(a) *Principles of Consolidation*

Our consolidated financial statements include the accounts of Continental and all wholly-owned domestic and foreign subsidiaries. Through November 12, 2003, we also consolidated Holdings. See Note 4 for a discussion of the changes in our ownership of Holdings in 2002 and 2003 and their impact on our consolidated financial statements. All intercompany accounts, transactions and profits arising from consolidated entities have been eliminated in consolidation.

(b) *Investments in Affiliates*

Investments in unconsolidated affiliates that are not variable interest entities are accounted for by the equity method when we hold more than 20% but less than 50% interest, or below 20% interest but have significant influence over the operations of the companies.

As of December 31, 2003, we had a 49% interest in Compania Panamena de Aviacion, S.A. ("Copa") with a carrying value of $84 million. The investment is accounted for under the equity method of accounting. The excess of the amount at which the investment is carried and the amount of underlying equity in the net assets was $40 million at December 31, 2002. This difference was treated as goodwill and was amortized over 40 years prior to 2002. Effective January 1, 2002, we discontinued amortization of this goodwill in accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142").

(c) *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

(d) *Cash and Cash Equivalents*

Cash and cash equivalents consist of cash and short-term, highly liquid investments, which are readily convertible into cash and have a maturity of three months or less when purchased. Restricted cash is primarily collateral for estimated future workers' compensation claims, letters of credit, performance bonds and interest rate swap agreements.

(e) *Short-Term Investments*

We invest in commercial paper, asset-backed securities and U.S. government agency securities with original maturities in excess of 90 days but less than one year. These investments are classified as short-term investments in the accompanying consolidated balance sheet. Short-term investments are stated at cost, which approximates market value, and are classified as held-to-maturity securities.

(f) *Spare Parts and Supplies*

Inventories, expendable parts and supplies relating to flight equipment are carried at average acquisition cost and are expensed when consumed in operations. An allowance for obsolescence is provided over the remaining estimated useful life of the related aircraft, plus allowances for spare parts currently identified as excess to reduce the carrying costs to the lower of amortized cost or net realizable value. These allowances are based on management estimates, which are subject to change.

(g) *Property and Equipment*

Property and equipment are recorded at cost and are depreciated to estimated residual values over their estimated useful lives using the straight-line method. Jet aircraft are assumed to have an estimated residual value of 15% of original cost; other categories of property and equipment are assumed to have no residual value. The estimated useful lives for our property and equipment are as follows:

	Estimated Useful Life
Jet aircraft and simulators	25 to 30 years
Buildings and improvements	10 to 30 years
Food service equipment	6 to 10 years
Maintenance and engineering equipment	8 years
Surface transportation and ground equipment	6 years
Communication and meteorological equipment	5 years
Computer software	3 to 10 years
Capital lease flight and ground equipment	Lease Term

(h) *Routes and Airport Operating Rights*

Routes represent the right to fly between cities in different countries. Airport operating rights represent gate space and slots (the right to schedule an arrival or departure within designated hours at a particular airport). Effective January 1, 2002, we adopted SFAS 142 and discontinued amortization of our goodwill on investments in unconsolidated subsidiaries and routes, which are indefinite-lived intangible assets. We performed an impairment test upon the adoption of SFAS No. 142 and an annual test in the fourth quarter of each year thereafter. Our tests indicated

that we did not have any impairment of our routes. Airport operating rights are amortized over the stated term of the related lease or 20 years.

Pro forma results for the year ended December 31, 2001, assuming the discontinuation of amortization of routes and goodwill amortization on investments in unconsolidated subsidiaries had occurred at the beginning of 2001, are presented below (in millions, except per share data).

Reported net loss	$	(95)
Route and goodwill amortization, net of taxes		15
Adjusted net loss	$	(80)
Basic and diluted loss per share:		
As reported	$	(1.72)
Route and goodwill amortization, net of taxes		0.27
Pro forma	$	(1.45)

(i) *Measurement of Impairment of Long-Lived Assets*

We record impairment losses on long-lived assets used in operations, consisting principally of property and equipment and airport operating rights, when events or changes in circumstances indicate, in management's judgement, that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those assets. The net carrying value of assets not recoverable is reduced to fair value if lower than carrying value. In determining the fair market value of the assets, we consider market trends and recent transactions involving sales of similar assets.

(j) *Revenue/Air Traffic Liability*

Passenger revenue is recognized either when transportation is provided or when the ticket expires unused rather than when a ticket is sold. Prior to October 1, 2002, nonrefundable tickets expired one year from the date the ticket was sold, or for partially used tickets, the date of first flight. Effective October 1, 2002, unused nonrefundable tickets expire on the date of intended flight, unless the date is extended by payment of a change fee. Effective August 20, 2003, we modified our policy to give customers with nonrefundable tickets who cancel their reservations prior to scheduled departure time a full year from the date their original ticket was sold to reschedule and pay the change fee, without losing the value of their tickets.

We also sell mileage credits in our frequent flyer program to participating partners, such as credit card companies, phone companies, other airlines, alliance members, hotels and car rental agencies. Revenue from the sale of mileage credits is deferred and recognized as passenger revenue when transportation is likely to be provided, based on estimates of the fair value of tickets to be redeemed. Amounts received in excess of the tickets' fair value are recognized in income currently and classified as a reimbursement of advertising expenses. In the fourth quarter of 2003, we adjusted our estimates of the mileage credits we expect to be redeemed for travel, resulting in a one-time increase in other revenue of $24 million ($0.23 per share, after income taxes).

Revenue from the shipment of cargo and mail is recognized when transportation is provided. Other revenue includes charter services, ticket change fees and other incidental services.

The amount of passenger ticket sales and sales of mileage credits to partners not yet recognized as revenue is included in the accompanying consolidated balance sheets as air traffic liability. We perform periodic evaluations of this estimated liability and any adjustments resulting therefrom, which can be significant, are included in results of operations for the periods in which the evaluations are completed. These adjustments relate primarily to differences between our statistical estimation of certain revenue transactions and the related sales price, as well as refunds, exchanges, interline transactions and other items for which final settlement occurs in periods subsequent to the sale of the related tickets at amounts other than the original sales price.

The deconsolidation of Holdings effective November 12, 2003 had no impact on our passenger revenue because, under our capacity purchase agreement with Holdings and ExpressJet, we purchase all of ExpressJet's capacity and are responsible for selling all of the seat inventory. As a result, after deconsolidation, we continue to record the related passenger revenue and related expenses, with payments under the capacity purchase agreement reflected as a separate operating expense.

(k) *Frequent Flyer Program*

For those OnePass accounts that have sufficient mileage credits to claim the lowest level of free travel, we record a liability for the estimated incremental cost associated with providing travel awards that are expected to be redeemed. Incremental cost includes the cost of incremental fuel, meals, insurance and miscellaneous supplies and does not include any costs for aircraft ownership, maintenance, labor or overhead allocation. We also record, for certain reciprocal frequent flyer agreements, a liability for payments we expect to make to other airlines for OnePass members' redemptions for travel on the other airline. The liability is adjusted periodically based on awards earned, awards redeemed, changes in the incremental costs and changes in the OnePass program, and is included in the accompanying consolidated balance sheets as air traffic liability.

(l) *Deferred Income Taxes*

Deferred income taxes are provided under the liability method and reflect the net tax effects of temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements.

(m) *Maintenance and Repair Costs*

Maintenance and repair costs for owned and leased flight equipment, including the overhaul of aircraft components, are charged to operating expense as incurred, including engine overhaul costs covered by power-by-the-hour agreements, which are expensed on the basis of hours flown.

(n) *Advertising Costs*

We expense the costs of advertising as incurred. Gross advertising expense was $87 million, $89 million and $98 million for the years ended December 31, 2003, 2002 and 2001, respectively. These amounts are reported in the consolidated statement of operations net of the reimbursement of some of our advertising expenses by third-party purchasers of our OnePass miles.

(o) *Stock Plans and Awards*

We account for our stock-based compensation plans under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). No stock-based employee compensation cost is reflected in net income (loss) for our stock option plans, as all options granted under our plans have an exercise price equal to the market value of the underlying common stock on the date of grant.

The following table illustrates the pro forma effect on net income (loss) and earnings (loss) per share if we had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-based Compensation" ("SFAS 123"), for the years ended December 31, 2003, 2002 and 2001. See Note 9 for the assumptions we used to compute the pro forma amounts.

	2003	**2002**	**2001**
Net income (loss), as reported	$ 38	$ (451)	$ (95)
Deduct/Add Back: total stock-based employee compensation income (expense) determined under SFAS 123, net of tax	(6)	(20)	6
Net income (loss), pro forma	$ 32	$ (471)	$ (89)
Basic and diluted earnings (loss) per share:			
As reported	$ 0.58	$ (7.02)	$ (1.72)
Pro forma	$ 0.49	$ (7.33)	$ (1.61)

(p) *Regional Capacity Purchase, Net*

Payments made to ExpressJet under our capacity purchase agreement, previously eliminated in consolidation, are reported as regional capacity purchase, net, beginning November 12, 2003, the date we deconsolidated Holdings. In addition to the payments for the purchased capacity, regional capacity purchase, net, also includes ExpressJet's fuel expense in excess of the cap (66.0 cents per gallon in 2003) provided in the capacity purchase agreement and a related fuel purchase agreement and is net of our sublease income on aircraft we lease to ExpressJet.

(q) *Reclassifications*

Certain reclassifications have been made in the prior years' consolidated financial statement amounts and related note disclosures to conform with the current year's presentation. As discussed in Note 2, additional reclassifications have been made upon the adoption of Financial Accounting Standards Board ("FASB") Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46").

Note 2 New Accounting Pronouncements

Effective January 1, 2003, we adopted SFAS No. 146, "Accounting for Costs Associated with Disposal or Exit Activities" ("SFAS 146"), which requires liabilities for costs associated with exit or disposal activities to be recognized when the liabilities are incurred, rather than when an entity commits to an exit plan. The new rule changes the timing of liability and expense recognition related to exit or disposal activities, but not the ultimate amount of such expenses. In July 2003, we announced plans to remove all our remaining MD-80 aircraft from service by January 2005. Prior to the adoption of SFAS 146, we would have recognized a charge associated with future obligations for rent and return conditions, net of estimated sublease income, on these aircraft at the time we were committed to

permanently removing the aircraft from service. However, subsequent to the adoption of SFAS 146, we will record these charges as the aircraft are permanently grounded. In December 2003, we determined five previously grounded leased MD-80 aircraft to be permanently grounded and recorded a charge of $21 million ($13 million after income taxes) associated with future obligations for rent and return conditions, net of estimated sublease income, on those aircraft. We will record similar charges as the remaining 17 leased MD-80 aircraft exit revenue service and are permanently grounded.

We also adopted FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 requires a guarantor to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. This interpretation applies to guarantees issued or modified after December 31, 2002 and has had no impact on our consolidated results of operations or consolidated balance sheet.

Effective July 1, 2003, we adopted FIN 46 that requires the consolidation of certain types of entities in which a company absorbs a majority of another entity's expected losses, receives a majority of the other entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the other entity. These entities are called "variable interest entities". The principal characteristics of variable interest entities are (1) an insufficient amount of equity to absorb the entity's expected losses, (2) equity owners as a group are not able to make decisions about the entity's activities, or (3) equity that does not absorb the entity's losses or receive the entity's residual returns. "Variable interests" are contractual, ownership or other monetary interests in an entity that change with fluctuations in the entity's net asset value. As a result, variable interest entities can arise from items such as lease agreements, loan arrangements, guarantees or service contracts.

If an entity is determined to be a "variable interest entity", the entity must be consolidated by the "primary beneficiary". The primary beneficiary is the holder of the variable interests that absorb a majority of the variable interest entity's expected losses or receive a majority of the entity's residual returns in the event no holder has a majority of the expected losses. There is no primary beneficiary in cases where no single holder absorbs the majority of the expected losses or receives a majority of the residual returns. The determination of the primary beneficiary is based on projected cash flows at the inception of the variable interests.

We have variable interests in the following types of variable interest entities:

Aircraft Leases. We are the lessee in a series of operating leases covering the majority of our leased aircraft. The lessors are trusts established specifically to purchase, finance and lease aircraft to us. These leasing entities meet the criteria for variable interest entities. We are generally not the primary beneficiary of the leasing entities if the lease terms are consistent with market terms at the inception of the lease and do not include a residual value guarantee, fixed-price purchase option or similar feature that obligates us to absorb decreases in value or entitles us to participate in increases in the value of the aircraft. This is the case for most of our operating leases; however, leases of approximately 75 aircraft contain a fixed-price purchase option that allow us to purchase the aircraft at predetermined prices on specified dates during the lease term. We have not consolidated the related trusts upon application of FIN 46 because, even taking into consideration these purchase options, we are still not the primary beneficiary based on our cash flow analysis. Our maximum exposure under these leases is the remaining lease payments, which are reflected in future lease commitments in Note 6.

Airport Leases. We are the lessee of real property under long-term operating leases at a number of airports where we are also the guarantor of approximately $1.6 billion of underlying debt and interest thereon. The leases are typically with municipalities or other governmental entities. FIN 46 is not applicable to arrangements with governmental entities. To the extent our lease and related guarantee are with a separate legal entity other than a governmental entity, we are not the primary beneficiary because the lease terms are consistent with market terms at the inception of the lease and the lease does not include a residual value guarantee, fixed price purchase option or similar feature as discussed above.

Subsidiary Trust. We have a subsidiary trust that has Mandatorily Redeemable Preferred Securities outstanding with a liquidation value of $248 million ($241 million net of issuance costs). These securities were issued in November 2000 and were previously reported on our balance sheet as Mandatorily Redeemable Preferred Securities of Subsidiary Trust. The trust is a variable interest entity under FIN 46 because we have a limited ability to make decisions about its activities. However, we are not the primary beneficiary of the trust. Therefore, the trust and the Mandatorily Redeemable Preferred Securities issued by the trust are no longer reported on our balance sheet. Instead, we report our Convertible Junior Subordinated Debentures held by the trust as long-term debt. These notes have previously been eliminated in our consolidated financial statements. Distributions on the Mandatorily Redeemable Preferred Securities are no longer reported on our statements of operations, but interest on the notes is recorded as interest expense. These reclassifications are reflected for all periods presented in the accompanying financial statements.

Capacity Purchase Agreement. Holdings and ExpressJet each meet the criteria for a variable interest entity because the voting rights and economic interests we hold in these entities are disproportional to our obligations to absorb expected losses or receive expected residual returns. The variable interests in Holdings and ExpressJet include our capacity purchase agreement, a tax sharing agreement with us, a note payable to us, convertible debentures held by third parties and common stock. Our assessment of expected losses and expected residual returns indicated that we were the primary beneficiary of Holdings and ExpressJet until the combined common stock holdings of us and our pension plan fell below 41%. This occurred on November 12, 2003. Therefore, we have deconsolidated Holdings as of that date. See Note 4 for further discussion of our ownership of Holdings and our capacity purchase agreement with Holdings and ExpressJet.

Note 3 Earnings Per Share

Basic earnings (loss) per common share ("EPS") excludes dilution and is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other obligations to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in our earnings (losses). In 2003, our Convertible Junior Subordinated Debentures Held by Subsidiary Trust and 4.5% Convertible Notes were antidilutive and therefore were not included in the calculation of diluted earnings per share. Because we reported net

losses in 2002 and 2001, all potentially dilutive securities were antidilutive and basic and diluted EPS were the same in those years.

	2003	2002	2001
Numerator for basic and dilutive:			
Net income (loss)	$ 38	$ (451)	$ (95)

	2003	2002	2001
Denominator:			
Denominator for basic earnings (loss) per share weighted- average shares	65.4	64.2	55.5
Effect of dilutive securities:			
Employee stock options	0.2		
Denominator for diluted earnings (loss) per share adjusted weighted average and assumed conversions	65.6	64.2	55.5

Approximately 5.3 million in 2003, 4.0 million in 2002 and 6.0 million in 2001 of weighted average options to purchase shares of our Class B common stock were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares and, therefore, the effect would have been antidilutive.

Holders of our 5% Convertible Notes issued in June 2003 may require us to repurchase the notes on June 15 of 2010, 2013 or 2018 at par plus accrued and unpaid interest, if any. The indenture provides that we may at our option choose to pay this repurchase price in cash, in shares of common stock or any combination thereof. Should we be required to repurchase the notes at any of the redemption dates, it is our policy that we would satisfy the requirement in cash. Therefore, the 5% Convertible Notes are not considered to be potentially dilutive securities in the EPS calculation.

Note 4 Investment In ExpressJet and Regional Capacity Purchase Agreement

Investment in ExpressJet

In April 2002, Holdings, our then wholly owned subsidiary and the sole stockholder of ExpressJet, which operates as "Continental Express", sold 10 million shares of its common stock in an initial public offering and used the net proceeds to repay $147 million of ExpressJet's indebtedness to us. In addition, we sold 20 million of our shares of Holdings common stock in the offering for net proceeds of $300 million. In connection with the offering, our ownership of Holdings fell to 53.1%. The sale of Holdings' shares and our shares in the offering was accounted for as a capital transaction resulting in a $291 million increase in additional paid-in capital and a $175 million increase in tax liabilities. We contributed $150 million of our proceeds to our defined benefit pension plan and used the remainder of our proceeds for general corporate purposes.

During the third quarter of 2003, we sold approximately 9.8 million shares of our Holdings common stock to Holdings, reducing our ownership of Holdings from 53.1% to 44.6%. We contributed the proceeds to our primary defined benefit pension plan. We also contributed approximately 7.4 million shares of Holdings common stock to that plan, further reducing our ownership of Holdings to 30.9%. We recognized gains totaling $173 million ($100 million after taxes) as a result of these transactions. The independent trustee for our defined benefit pension plan has subsequently sold a

portion of the shares of Holdings that we contributed to the plan. As a result of these sales by the defined benefit pension plan, on November 12, 2003, the combined amount of Holdings common stock owned by us and our primary defined benefit pension plan fell below 41%, the point at which we no longer consolidated Holdings, pursuant to FIN 46. Accordingly, we deconsolidated Holdings as of that date.

Effective November 12, 2003, we account for our interest in Holdings using the equity method of accounting set forth in APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock", rather than consolidating Holdings. Under our capacity purchase agreement with Holdings and ExpressJet, we purchase all of ExpressJet's capacity and are responsible for selling all of the seat inventory. As a result, after deconsolidation, we continue to record the related passenger revenue and related expenses, with payments under the capacity purchase agreement reflected as a separate operating expense. The primary effects of deconsolidation of Holdings from our financial statements are a decrease in current assets, primarily due to the elimination of Holdings' cash, an increase in assets resulting from the inclusion of our note receivable from Holdings (previously eliminated in consolidation), a decrease in long-term debt and a decrease in operating income as a result of the exclusion of Holdings' operating income from our statement of operations. This decrease in operating income is offset by increases in nonoperating income from our equity in Holdings' earnings, provided our ownership interest remains constant. Additionally, after deconsolidation, we no longer record minority interest on either our balance sheet or statement of operations.

We continue to own 16.7 million shares of Holdings common stock with a market value of $251 million as of December 31, 2003. We do not currently intend to remain a stockholder of Holdings over the long term. Subject to market conditions, we intend to sell or otherwise dispose of some or all of our shares of Holdings common stock in the future.

Capacity Purchase Agreement with ExpressJet

General. Under our capacity purchase agreement, ExpressJet currently flies all of its aircraft (which consist entirely of regional jet aircraft) on our behalf, and we handle scheduling, ticket prices and seat inventories for these flights. In exchange for ExpressJet's operation of the flights and performance of other obligations under the agreement, we pay them for each scheduled block hour based on an agreed formula. Under the agreement, we recognize all passenger, cargo and other revenue associated with each flight, and are responsible for all revenue-related expenses, including commissions, reservations, catering and passenger ticket processing expenses. Following the deconsolidation of Holdings on November 12, 2003, the payments made to ExpressJet under the agreement are reported as regional capacity purchases net in our consolidated statement of operations. Prior to deconsolidation, the payments were eliminated in our consolidated financial statements and the minority interest in Holdings' earnings was reported as a deduction on our consolidated statement of operations, based on Holdings' stand-alone earnings under the capacity purchase agreement.

Compensation and Operational Responsibilities. Under the agreement, we pay ExpressJet a base fee for each scheduled block hour based on a formula that will remain in place through December 31, 2004. The formula is designed to provide ExpressJet with an operating margin of approximately 10% before taking into account variations in some costs and expenses that are generally controllable by them, the most significant of which is wages, salaries and benefits.

Our payments to ExpressJet under the capacity purchase agreement totaled $1.3 billion, $1.1 billion and $980 million in 2003, 2002 and 2001, respectively. Our future payments under the

capacity purchase agreement are dependent on numerous variables, and therefore difficult to predict. The most important of those variables is the number of scheduled block hours, which takes into account the number of ExpressJet aircraft and our utilization rates of such aircraft. However, if we changed our utilization of ExpressJet's aircraft, we would also change the number of available seat miles on ExpressJet's flights and the revenue that we generate by selling those seats. Any decision by us to change the utilization of ExpressJet's aircraft (or to remove aircraft from the capacity purchase agreement) would be made by determining the net effect of such change on our income and cash flow, taking into account not only our cash commitment to ExpressJet but also our expected revenue from ExpressJet's flights.

Set forth below are estimates of our future minimum noncancelable commitments under the capacity purchase agreement. These estimates of our future minimum noncancelable commitments under the capacity purchase agreement do not include the portion of the underlying obligations for aircraft and facility rent that are disclosed as part of our consolidated operating lease commitments. For purposes of calculating these estimates, we have assumed (i) that ExpressJet's aircraft deliveries continue as scheduled through January 2005, (ii) contracted rates through 2004 (rates are re-negotiated annually beginning in 2005), (iii) a constant fuel rate of 66.0 cents per gallon, the rate of the current contractual fuel cap, (iv) that we exercise our rights to initiate termination of the capacity purchase agreement at the earliest possible date permitted under the contract (January 1, 2007), (v) that prior to termination we exercise our rights to remove as many aircraft as quickly as contractually permitted (beginning February 2005) from the capacity purchase agreement, (vi) an average daily utilization rate of 8.9 hours for 2004 through 2007 and (vii) cancellations are at historical levels resulting in no incentive compensation payable to ExpressJet. Based on these assumptions, our future minimum noncancelable commitments under the capacity purchase agreement at December 31, 2003 are estimated as follows (in millions):

2004	$	1,236
2005		985
2006		924
2007		441
2008 and thereafter		
Total	$	3,586

It is important to note that in making the assumptions used to develop these estimates, we are attempting to estimate our minimum noncancelable commitments and not the amounts that we currently expect to pay to ExpressJet (which amounts are expected to be higher as we do not currently expect to reduce capacity under the agreement to the extent assumed above or terminate the agreement at the earliest possible date). In addition, our actual minimum noncancelable commitments to ExpressJet could differ materially from the estimates discussed above, because actual events could differ materially from the assumptions described above. For example, a 10% increase or decrease in scheduled block hours (whether a result of change in delivery dates of aircraft or average daily utilization) in 2004 would result in a corresponding increase or decrease in cash obligations under the capacity purchase agreement of approximately 8% or $94 million.

ExpressJet's base fee includes compensation for scheduled block hours associated with some cancelled flights, based on historical cancellation rates constituting rolling five-year monthly averages. To the extent that ExpressJet's rate of controllable or uncontrollable cancellations is less than its

historical cancellation rate, ExpressJet will be entitled to additional payments. ExpressJet is also entitled to receive a small per-passenger fee and incentive payments for first flights of a day departing on time and baggage handling performance. As a result of a better-than-expected completion rate and other incentives in 2003, we paid ExpressJet an additional $16 million.

Under the agreement and a related fuel purchase agreement, ExpressJet's fuel costs were capped at 66.0 cents per gallon in 2003 and will remain capped at this level in 2004. Accordingly, we absorbed a portion of ExpressJet's fuel costs in 2003 and may continue to do so in the future.

If a change of control (as defined in the agreement) of ExpressJet occurs without our consent, the block hour rates that we will pay under the agreement will be reduced by an amount approximately equal to the operating margin built into the rates.

In accordance with the agreement, ExpressJet has agreed to meet with us each year beginning in 2004 to review and set the block hour rates to be paid in the following year, in each case based on the formula used to set the original block hour rates (including a 10% targeted operating margin). If we and ExpressJet cannot come to an agreement on the annual adjustments, we have agreed to submit our disagreement to arbitration. In addition, the agreement gives each party the right to "meet and confer" with the other regarding any material change in the underlying assumptions regarding the cost of providing services under the agreement and whether the compensation provisions of the agreement should be changed as a result, but does not require any party to agree to any change in the compensation provisions.

Capacity and Fleet Matters. The agreement covers all of ExpressJet's existing fleet, as well as the 50 Embraer regional jets subject to firm orders. Under the capacity purchase agreement, we have the right to give no less than twelve months' notice to ExpressJet reducing the number of its aircraft covered by the contract. As of December 31, 2003, we had not given any such notice. Under the agreement, we are entitled to remove capacity under an agreed upon methodology. If we remove aircraft from the terms of the agreement, ExpressJet will have the option to (i) fly the released aircraft for another airline (subject to its ability to obtain facilities, such as gates and slots, and subject to its exclusive arrangement with us that prohibits ExpressJet during the term of the agreement from flying under its or another carrier's code in or out of our hub airports), (ii) fly the aircraft under ExpressJet's own flight designator code subject to its ability to obtain facilities, such as gates and slots, and subject to ExpressJet's exclusive arrangement with us respecting our hubs or (iii) decline to fly the aircraft and cancel the related subleases with us. If ExpressJet does not cancel the aircraft subleases, the interest rate used to calculate the scheduled lease payments will automatically increase by 200 basis points to compensate us for our continued participation in ExpressJet's lease financing arrangements.

Term of Agreement. The agreement currently expires on December 31, 2010 but allows us to terminate the agreement at any time after December 31, 2006 upon 12 months' notice, or at any time without notice for cause (as defined in the agreement). We may also terminate the agreement at any time upon a material breach by ExpressJet that does not constitute cause and continues for 90 days after notice of such breach, or without notice or opportunity to cure if we determine that there is a material safety concern with ExpressJet's flight operations. We have the option to extend the term of the agreement with 24 months' notice for up to four additional five-year terms through December 31, 2030.

Service Agreements. We provide various services to ExpressJet and charge them at rates in accordance with the capacity purchase agreement. The services provided to ExpressJet by us include fuel service, certain customer services such as ground handling and infrastructure services, including but not limited to insurance, technology, transaction processing, treasury, human resources and risk management. For providing these services, we charged ExpressJet approximately $270 million in 2003 and $205 million in each of 2002 and 2001.

Note Receivable from ExpressJet. At December 31, 2003 we had a $193 million note receivable from ExpressJet. In accordance with our amended and restated promissory note agreement dated November 5, 2002 with ExpressJet, principal and accrued interest on the note are payable quarterly by ExpressJet. We anticipate that the final payment will be made on March 31, 2006. The interest rate is fixed for each quarter at a rate equal to the three-month London interbank offered rate ("LIBOR") on the second business day prior to such quarter plus 1.25% per annum, subject to an aggregate cap of 5.35% in 2003 and 6.72% in 2004.

Leases. As of December 31, 2003, ExpressJet subleased all 224 of its aircraft under long-term operating leases from us. ExpressJet's sublease agreements with us have substantially the same terms as the lease agreements between us and the lessors and expire between 2013 and 2020. ExpressJet leases or subleases, under various operating leases, ground equipment and substantially all of its ground facilities, including facilities at public airports, from us or the municipalities or agencies owning and controlling such airports. If ExpressJet defaults on any of its payment obligations with us, we are entitled to reduce any payments required to be made by us to ExpressJet under the capacity purchase agreement by the amount of the defaulted payment. ExpressJet's total rental expense related to all leases with us was approximately $279 million, $231 million and $196 million in 2003, 2002 and 2001, respectively. After deconsolidation of Holdings on November 12, 2003, our related aircraft rental income is reported as a reduction to regional capacity purchase, net.

Income Taxes. In conjunction with Holdings' offering, our tax basis in the stock of Holdings and the tax basis of ExpressJet's tangible and intangible assets were increased to fair value. The increased tax basis should result in additional tax deductions available to ExpressJet over a period of 15 years. To the extent ExpressJet generates taxable income sufficient to realize the additional tax deductions, our tax sharing agreement with ExpressJet provides that it will be required to pay us a percentage of the amount of tax savings actually realized, excluding the effect of any loss carrybacks. ExpressJet will be required to pay us 100% of the first third of the anticipated tax benefit, 90% of the second third and 80% of the last third. However, if the anticipated benefits are not realized by the end of 2018, ExpressJet will be obligated to pay us 100% of any benefits realized after that date. We do not recognize the benefit of the tax savings associated with ExpressJet's asset step-up for financial reporting purposes until paid to us by ExpressJet due to the uncertainty of realization. ExpressJet paid us $17 million in 2003 related to the agreement, which is included in other nonoperating income in the accompanying statement of operations.

Other. So long as we are ExpressJet's largest customer, if it enters into an agreement with another major airline (as defined in the agreement) to provide regional airline services on a capacity purchase or other similar economic basis for 10 or more aircraft on terms and conditions that are in the aggregate less favorable to ExpressJet than the terms and conditions of the capacity purchase agreement, we will be entitled to amend our capacity purchase agreement to conform the terms and conditions of the capacity purchase agreement to the terms and conditions of the agreement with the other major airline.

Note 5 Long-Term Debt

Long-term debt as of December 31 is summarized as follows (in millions):

	2003	2002
Secured		
Notes payable, interest rates of 5.0% to 8.5%, (weighted average rate of 7.01% as of December 31, 2003) payable through 2019	$ 3,268	$ 3,446
Floating rate notes, interest rates of LIBOR (1.15% on December 31, 2003) plus 0.45% to 1.3%; Eurodollar (1.25% on December 31, 2003) plus 1.375%, payable through 2014	923	997
Floating rate notes, interest rate of LIBOR plus 2.5%, payable through 2015	120	
Revolving credit facility, floating interest rate of LIBOR plus 3.5%, payable through 2004		190
Floating rate notes, interest rate of LIBOR plus 4.53%, payable through 2007	139	146
Floating rate notes, interest rate of LIBOR plus 3.5% to 4.0% payable through 2011	155	60
Notes payable, interest rates of 9.9%, payable through 2003		30
Floating rate notes, interest rate of LIBOR plus 7.5%, payable through 2007	97	
Other	17	18
Unsecured		
Convertible notes, interest rate of 4.5%, payable in 2007	200	200
Senior notes payable, interest rate of 8.0%, payable in 2005	195	195

	2003	2002
Note payable, interest rate of 8.1%, payable in 2008	112	111
Convertible junior subordinated debentures, interest rate of 6.0%, payable in 2030	248	250
Convertible notes, interest rate of 5.0%, payable in 2023	175	
Other	8	13
	5,657	5,656
Less: current maturities	397	468
Total	$ 5,260	$ 5,188

Maturities of long-term debt due over the next five years are as follows (in millions):

Year ending December 31,	
2004	$ 397
2005	646
2006	494
2007	845
2008	569

Substantially all of our property and equipment and spare parts inventory is subject to agreements securing our indebtedness.

We also have letters of credit and performance bonds at December 31, 2003 in the amount of $47 million with expiration dates through June 2008.

We do not have any debt obligations that would be accelerated as a result of a credit rating downgrade. However, we would have to post additional collateral under our credit card processing agreement if our debt rating falls below Caa3 as rated by Moody's or CCC- as rated by Standard and Poor's.

In May 2003, we issued $100 million of Floating Rate Secured Subordinated Notes due December 2007 (the "Junior Notes"). The Junior Notes are secured by a portion of our spare parts inventory and bear interest at the three-month LIBOR plus 7.5%. In connection with the Junior Notes and with $200 million of Floating Rate Secured Notes due December 2007 secured by the same pool of spare parts (the "Senior Notes"), we have entered into a collateral maintenance agreement requiring us, among other things, to maintain a loan-to-collateral value ratio of not greater than 45% with respect to the Senior Notes and a loan-to-collateral value ratio of not greater than 67.5% with respect to both the Senior Notes and the Junior Notes combined. We must also maintain a certain level of rotable components within the spare parts collateral pool. The ratios are calculated on a semi-annual basis based on an independent appraisal of the spare parts collateral pool. If any of the collateral ratio requirements are not met, we must take action to meet all ratio requirements by adding additional eligible spare parts to the collateral pool, purchasing or redeeming some of the outstanding notes, providing other collateral acceptable to the bond insurance policy provider for the Senior Notes, or any combination of the above. At December 31, 2003, $195 million of the Senior Notes and $97 million of the Junior Notes were outstanding.

During 2003, we incurred $130 million of floating rate indebtedness under a term loan agreement that matures in May 2011. This indebtedness is secured by certain of our spare engines and initially bears interest at the three-month LIBOR plus 3.5%.

In June 2003, we issued $175 million of 5% Convertible Notes due 2023. The notes are convertible into our Class B common stock at an initial conversion price of $20 per share, subject to certain conditions on conversion. The notes are redeemable for cash at our option on or after June 18, 2010 at par plus accrued and unpaid interest, if any. Holders of the notes may require us to repurchase the notes on June 15 of 2010, 2013 or 2018 or in the event of certain changes in control at par plus accrued and unpaid interest, if any.

During the fourth quarter of 2003, we incurred $120 million of floating rate indebtedness due at various intervals through 2015. The indebtedness is secured by four 737-800 aircraft that were delivered in the fourth quarter of 2003 and bears interest at LIBOR plus 2.5%, with an initial average rate of 3.71%.

In the first quarter of 2002, we issued $200 million of 4.5% convertible notes due February 1, 2007. The notes are convertible into our common stock at an initial conversion price of $40 per share. The notes are redeemable at our option on or after February 5, 2005, at specified redemption prices. In December 2002, we closed an offering of $200 million of floating rate secured notes due December 2007 at a then-current annual interest rate of less than 3.5 percent, including all costs and fees. The notes are secured by certain of our spare parts inventory.

Preferred Securities of Trust

In November 2000, Continental Airlines Finance Trust II, a Delaware statutory business trust (the "Trust") of which we own all the common trust securities, completed a private placement of five million 6% Convertible Preferred Securities, Term Income Deferrable Equity Securities or "TIDES". The

TIDES have a liquidation value of $50 per preferred security and are convertible at any time at the option of the holder into shares of Class B common stock at a conversion rate of $60 per share of Class B common stock (equivalent to approximately 0.8333 share of Class B common stock for each preferred security). Distributions on the preferred securities are payable by the Trust at an annual rate of 6% of the liquidation value of $50 per preferred security.

The sole assets of the trust are 6% Convertible Junior Subordinated Debentures ("Convertible Subordinated Debentures") with an aggregate principal amount of $248 million as of December 31, 2003 issued by us and which mature on November 15, 2030. The Convertible Subordinated Debentures are redeemable by us, in whole or in part, on or after November 20, 2003 at designated redemption prices. If we redeem the Convertible Subordinated Debentures, the Trust must redeem the TIDES on a pro rata basis having an aggregate liquidation value equal to the aggregate principal amount of the Convertible Subordinated Debentures redeemed. Otherwise, the TIDES will be redeemed upon maturity of the Convertible Subordinated Debentures, unless previously converted.

Taking into consideration our obligations under (i) the Preferred Securities Guarantee relating to the TIDES, (ii) the Indenture relating to the Convertible Subordinated Debentures to pay all debt and obligations and all costs and expenses of the Trust (other than U.S. withholding taxes) and (iii) the Indenture, the Declaration relating to the TIDES and the Convertible Subordinated Debentures, we have fully and unconditionally guaranteed payment of (i) the distributions on the TIDES, (ii) the amount payable upon redemption of the TIDES and (iii) the liquidation amount of the TIDES.

As discussed in Note 2, upon our adoption of FIN 46 in 2003, the Convertible Subordinated Debentures are included in long-term debt for all periods presented.

Note 6 Leases

We lease certain aircraft and other assets under long-term lease arrangements. Other leased assets include real property, airport and terminal facilities, sales offices, maintenance facilities, training centers and general offices. Most aircraft leases include both renewal options and purchase options. The purchase options are generally effective at the end of the lease term at the then-current fair market value. Our leases do not include residual value guarantees.

At December 31, 2003, the scheduled future minimum lease payments under capital leases and the scheduled future minimum lease rental payments required under operating leases, that have initial or remaining noncancelable lease terms in excess of one year, are as follows (in millions):

		Operating Leases	
Year ending December 31,	**Capital Leases**	**Aircraft**	**Non-aircraft**
2004	$ 44	$ 897	$ 360
2005	46	975	362
2006	39	864	365
2007	40	833	367

		Operating Leases	
2008	45	811	354
Later years	473	6,988	5,675
Total minimum lease payments	687	$ 11,368	$ 7,483
Less: amount representing interest	364		
Present value of capital leases	323		
Less: current maturities of capital leases	25		
Long-term capital leases	$ 298		

At December 31, 2003, Continental had 469 aircraft under operating leases and seven aircraft under capital leases, including aircraft subleased to ExpressJet. These operating leases have remaining lease terms ranging up to 21 1/2 years. Projected sublease income to be received from ExpressJet, not included in the above table, is approximately $3.7 billion.

Note 7 Financial Instruments and Risk Management

As part of our risk management program, we use or have used a variety of financial instruments, including petroleum call options, petroleum swap contracts, jet fuel purchase commitments, foreign currency average rate options, foreign currency forward contracts and interest rate cap and swap agreements. We do not hold or issue derivative financial instruments for trading purposes.

Notional Amounts and Credit Exposure of Derivatives

The notional amounts of derivative financial instruments summarized below do not represent amounts exchanged between parties and, therefore, are not a measure of our exposure resulting from our use of derivatives. The amounts exchanged are calculated based upon the notional amounts as well as other terms of the instruments, which relate to interest rates, exchange rates or other indices.

Fuel Price Risk Management

We use a combination of petroleum call options, petroleum swap contracts and jet fuel purchase commitments to provide some short-term protection (generally three to six months) against a sharp increase in jet fuel prices.

We account for the call options and swap contracts as cash flow hedges. They are recorded at fair value with the offset to accumulated other comprehensive income (loss), net of applicable income taxes and hedge ineffectiveness, and recognized as a component of fuel expense when the underlying fuel being hedged is used. The ineffective portion of these call options and swap agreements is determined

based on the correlation between West Texas Intermediate Crude Oil prices and jet fuel prices. Hedge ineffectiveness is included in other nonoperating income (expense) in the accompanying consolidated statement of operations and was not material for the years ended December 31, 2003, 2002 and 2001. Our gains (losses), net of premium expense, related to these hedging instruments were not material in the years ended December 31, 2003, 2002 and 2001.

There were no fuel hedges outstanding at December 31, 2003. We had petroleum call options outstanding with an aggregate notional amount of approximately $270 million and a fair value of $6 million at December 31, 2002.

Foreign Currency Exchange Risk Management

We use a combination of foreign currency average rate options and forward contracts to hedge against the currency risk associated with our forecasted Japanese yen, British pound and euro-denominated net cash flows. The average rate options and forward contracts have only nominal intrinsic value at the date contracted.

We account for these instruments as cash flow hedges. They are recorded at fair value with the offset to accumulated other comprehensive income (loss), net of applicable income taxes and hedge ineffectiveness, and recognized as passenger revenue when the underlying service is provided. We measure hedge effectiveness of average rate options and forward contracts based on the forward price of the underlying currency. Hedge ineffectiveness is included in other nonoperating income (expense) in the accompanying consolidated statement of operations and was not material for the years ended December 31, 2003, 2002 and 2001. Our net gains on our foreign currency forward and option contracts were not material in the years ended December 31, 2003, 2002 and 2001. These gains are included in passenger revenue in the accompanying consolidated statement of operations. As of December 31, 2003, we had outstanding option and forward contracts to hedge approximately 61% of our projected yen-denominated net cash flows for 2004, forward contracts to hedge approximately 63% of our projected British pound-denominated net cash flows 2004 and forward contracts to hedge approximately 50% of our projected euro-denominated net cash flows for the first six months of 2004. The fair value of these outstanding contracts was not material. At December 31, 2002, we did not have any yen forward contracts outstanding and the fair value of our yen option contracts was not material.

Interest Rate Risk Management

We have entered into interest rate cap and interest rate swap agreements to reduce the impact of potential interest rate increases on floating rate debt. The interest rate swap outstanding at December 31, 2003 and 2002 had notional amounts of $153 million and $162 million, respectively, and is effective through 2005. There were no interest rate cap agreements outstanding at December 31, 2003 or 2002. We account for the interest rate cap and swap as cash flow hedges whereby the fair value of the interest rate cap and swap is reflected in other assets in the accompanying consolidated balance sheet with the offset, net of income taxes and any hedge ineffectiveness (which is not material), recorded as accumulated other comprehensive income (loss). The fair value of the interest rate swap liability was $11 million at December 31, 2003 and the fair value of the interest rate swap liability was $17 million at December 31, 2002. Amounts recorded in accumulated other comprehensive income (loss) are amortized as an adjustment to interest expense over the term of the related hedge. Such amounts were not material during 2003, 2002 or 2001.

Other Financial Instruments

Judgment is necessarily required in interpreting market data and the use of different market assumptions or estimation methodologies may affect the estimated fair value amounts.

(a)

Cash Equivalents

Cash equivalents are carried at cost and consist primarily of commercial paper with original maturities of three months or less and approximate fair value due to their short maturity.

(b)

Short-term Investments

Short-term investments consist primarily of commercial paper, asset-backed securities and U.S. government agency securities with original maturities in excess of 90 days but less than one year and approximate fair value due to their short maturity. We classify these investments as held-to-maturity securities.

(c)

Internet Travel Distribution Investments

In November 2003, we sold all of our investment in Hotwire, Inc. for $42 million in cash, resulting in a gain of $40 million ($25 million after taxes).

On December 19, 2003, we sold approximately 28% of our investment in Orbitz in connection with their initial public offering ("IPO"), reducing our interest in Orbitz from approximately 13% to 9%. The total amount that we originally invested in Orbitz was approximately $29 million and, based on the IPO valuation, that investment had appreciated in value by approximately $100 million since March 2000. We sold 1.3 million of our 4.9 million shares of Orbitz common stock and all of our shares of Orbitz preferred stock for proceeds of $34 million, net of underwriting discount. Our gain on the sale was $32 million ($20 million after income taxes).

Prior to the IPO, we accounted for our investment in Orbitz using the equity method of accounting based on our voting rights and board representation. As part of the IPO, we gave up one of our two seats on Orbitz's board of directors and changed certain provisions of the corporate governance of Orbitz. As a result, we now account for our investment in Orbitz in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities". We have designated the remaining investment as a "trading security", based on our intention to dispose of the securities of Orbitz that we own. Therefore, our remaining investment is carried at its fair value, with changes to fair value reported in our statement of operations. The fair value adjustment on the Orbitz shares held at December 31, 2003 of $76 million is included in other nonoperating income in the accompanying consolidated statement of operations, as are the gains on the disposition of Hotwire and Orbitz.

During 2000, we established an officer retention and incentive award plan (the "Incentive Award Program") that allows officers to share in approximately 25% of the appreciation of certain of our internet-related investments. Under the Incentive Award Program, participants receive phantom appreciation rights ("PARs") when we make investments in internet-related businesses. We made one PARs award and one follow-up award in 2003, and five PARs awards and one follow-up award in 2002. Each PARs is a right, which generally vests quarterly over a four-year period, to receive the difference, if any, between the market value of the applicable equity investment over the established base value (generally the cost of the investment). As the value of the PARs changes with changes in the value of the underlying investment, this plan represents a derivative instrument that is accounted for in accordance with SFAS No. 133, "Accounting for

Derivative Instruments and Hedging Activities" ("SFAS 133"). We measure the value of these awards at grant date and record both deferred compensation and a PARs liability equal to this valuation. The deferred compensation is then amortized over the vesting period and the PARs liability is measured at fair value in accordance with SFAS 133. Our related PARs expense was $21 million in 2003 and $9 million in 2002.

(d) *Debt*

The fair value of our debt with a carrying value of $4.9 billion and $4.9 billion at December 31, 2003 and 2002, respectively, estimated based on the discounted amount of future cash flows using our current incremental rate of borrowing for a similar liability or market prices, approximated $4.6 billion and $4.0 billion, respectively. The fair value of the remaining debt was not practicable to estimate.

(e) *Investment in Company Owned Life Insurance (COLI) Products*

In connection with some of our executive compensation plans, we have company owned life insurance policies on certain of our officers. As of December 31, 2003 and 2002, the carrying value of the underlying investments was approximately $36 million and $30 million, respectively, which approximates the market value.

(f) *Note Receivable from Holdings*

The fair value of our note receivable from Holdings with a carrying value of $193 million at December 31, 2003, approximated carrying value. The fair value was estimated based on anticipated future cash flows discounted at our current incremental rate of borrowing for similar liabilities.

Credit Exposure of Financial Instruments

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

Note 8 Preferred and Common Stock

Preferred Stock

We have 10 million shares of authorized preferred stock.

On November 15, 2000, we entered into a number of agreements with Northwest Airlines Corporation and some of its affiliates under which we would, among other things, repurchase approximately 6.7 million shares of our Class A common stock, owned by Northwest Airlines Corporation, reclassify all issued shares of Class A common stock into Class B common stock, make other adjustments to our corporate and alliance relationship with Northwest Airlines, Inc., and issue to Northwest Airlines, Inc. one share of preferred stock, designated as Series B preferred stock with blocking rights relating to certain change of control transactions involving us and certain matters relating to our stockholder rights plan (the "Rights Plan"). The transactions closed on January 22, 2001. As of December 31, 2003, 2002 and 2001, respectively, this one share of Series B preferred stock was outstanding. Some of the material provisions of the Series B preferred stock are listed below.

Ranking. The Series B preferred stock ranks junior to all classes of capital stock other than our common stock upon liquidation, dissolution or winding up of the company.

Dividends. No dividends are payable on the Series B preferred stock.

Voting Rights. The holder of the Series B preferred stock has the right to block certain actions we may seek to take, including:

- Certain business combinations and similar changes of control transactions involving us and a third party major air carrier;
- Certain amendments to our rights plan (or redemption of those rights);
- Any dividend or distribution of all or substantially all of our assets; and
- Certain reorganizations and restructuring transactions involving us.

Redemption. The Series B preferred stock is redeemable by us at a nominal price under the following circumstances:

- Northwest Airlines, Inc. transfers or encumbers the Series B preferred stock;
- There is a change of control of Northwest Airlines Corporation involving a third party major air carrier;
- Our alliance with Northwest Airlines Corporation terminates or expires (other than as a result of a breach by us); or
- Northwest Airlines Corporation materially breaches its standstill obligations to us or triggers our rights agreement.

Common Stock

We currently have one class of common stock issued and outstanding, Class B common stock. Each share of Class B common stock is entitled to one vote per share.

We began a stock repurchase program in 1998 under which we repurchased a total of 28.2 million shares of Class B common stock for a total of approximately $1.2 billion through December 31, 2001. We repurchased no shares of Class B common stock in 2003 or 2002.

Stockholder Rights Plan

Effective November 20, 1998, we adopted the Rights Plan in connection with the disposition by Air Partners, L.P. of its interest in Continental to Northwest Airlines Corporation. Effective January 22, 2001, we amended the Rights Plan to take into account, among other things, the effects of the recapitalization and to eliminate the status of the Northwest parties as exempt persons that would not trigger the provisions of the Rights Plan.

The rights become exercisable upon the earlier of (i) the tenth day following a public announcement or public disclosure of facts indicating that a person or group of affiliated or associated persons has acquired beneficial ownership of 15% (25%, or more in some cases, in the case of an Institutional Investor) or more of the total number of votes entitled to be cast generally by holders of

our common stock then outstanding, voting together as a single class (such person or group being an "Acquiring Person"), or (ii) the tenth business day (or such later date as may be determined by action of our board of directors prior to such time as any person becomes an Acquiring Person) following the commencement of, or announcement of an intention to make, a tender offer or exchange offer the consummation of which would result in any person becoming an Acquiring Person. Certain persons and entities related to us or Air Partners are exempt from the definition of "Acquiring Person."

The rights will expire on November 20, 2008, unless extended or unless the rights are earlier redeemed or exchanged by us.

Subject to certain adjustments, if any person becomes an Acquiring Person, each holder of a right, other than rights beneficially owned by the Acquiring Person and its affiliates and associates (which rights will thereafter be void), will thereafter have the right to receive, upon exercise thereof, that number of shares of Class B common stock having a market value of two times the exercise price ($200, subject to adjustment) of the right.

If at any time after a person becomes an Acquiring Person, (i) we merge into any other person, (ii) any person merges into us and all of our outstanding common stock does not remain outstanding after such merger, or (iii) we sell 50% or more of our consolidated assets or earning power, each holder of a right (other than the Acquiring Person and its affiliates and associates) will have the right to receive, upon the exercise thereof, that number of shares of common stock of the acquiring corporation (including us as successor thereto or as the surviving corporation) which at the time of such transaction will have a market value of two times the exercise price of the right.

At any time after any person becomes an Acquiring Person, and prior to the acquisition by any person or group of a majority of our voting power, our board of directors may exchange the rights (other than rights owned by such Acquiring Person, which will have become void), in whole or in part, at an exchange ratio of one share of Class B common stock per right (subject to adjustment).

At any time prior to any person becoming an Acquiring Person, our board of directors may redeem the rights at a price of $.001 per right. The Rights Plan may be amended by our board of directors without the consent of the holders of the rights, except that from and after the time that any person becomes an Acquiring Person no such amendment may adversely affect the interests of the holders of the rights (other than the Acquiring Person and its affiliates and associates). Until a right is exercised, its holder, as such, will have no rights as one of our stockholders, including the right to vote or to receive dividends.

Note 9 Stock Plans and Awards

Stock Options

Our stockholders have approved the following incentive plans, which, subject to adjustment as provided in the respective plans, permit the issuance of the number of shares of Class B common stock set forth below:

Incentive Plan 2000	3,000,000 shares
1998 Stock Incentive Plan	5,500,000 shares
1997 Stock Incentive Plan	2,000,000 shares
1994 Incentive Equity Plan	9,000,000 shares

The Incentive Plan 2000 provides for awards in the form of stock options, restricted stock, performance awards and incentive awards. Each of the other plans permits awards of either stock options or restricted stock. Each plan permits awards to be made to the non-employee directors of the company or the employees of the company or its subsidiaries. Stock issued under the plans may be originally issued shares, treasury shares or a combination thereof. The total shares remaining for award under the plans as of December 31, 2003 was approximately 890,000, although no new awards can be made under the 1994 Incentive Equity Plan.

Stock options are awarded under the plans with exercise prices equal to the fair market value of the stock on the date of grant and typically vest over a three to four-year period. Employee stock options generally have a five-year term, while outside director stock options have ten-year terms.

Under the terms of the Plans, a change in control would result in all outstanding options under these plans becoming exercisable in full and restrictions on restricted shares being terminated.

The table below summarizes stock option transactions pursuant to our Plans (share data in thousands).

	2003		2002		2001	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at Beginning of Year	6,871	$ 18.28	980	$ 36.34	7,468	$ 37.30
Granted	296	$ 15.00	6,079	$ 15.82	1,651	$ 49.47
Exercised	(306)	$ 15.62	(65)	$ 28.04	(1,612)	$ 31.48
Cancelled	(392)	$ 24.82	(123)	$ 35.45	(6,527)	$ 41.96
Outstanding at End of Year	6,469	$ 17.86	6,871	$ 18.28	980	$ 36.34
Options exercisable at end of year	5,018	$ 18.27	3,856	$ 19.61	711	$ 35.66

The following tables summarize the range of exercise prices and the weighted average remaining contractual life of the options outstanding and the range of exercise prices for the options exercisable at December 31, 2003 (share data in thousands):

	Options Outstanding		
Range of Exercise Prices	Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
$3.65-$15.77	263	5.04	$ 10.54
$15.78	5,493	3.08	$ 15.78
$16.84-$56.81	713	3.95	$ 36.57
$3.65-$56.81	6,469	3.26	$ 17.86

	Options Exercisable	
Range of Exercise Prices	Exercisable	Weighted Average Exercise Price
$3.65-$15.77	111	$ 9.74
$15.78	4,352	$ 15.78
$16.84-$56.81	555	$ 39.52
$3.65-$56.81	5,018	$ 18.27

In April 2002, we awarded 444,750 shares of restricted stock. The restricted stock was awarded pursuant to our equity incentive plans and had a fair value on the grant date of $12.5 million ($28.10 per share). The restricted stock is scheduled to vest in 25% increments on the first four anniversaries of the grant. In July 2000, we issued 150,000 shares of restricted stock under the Incentive Plan 2000, with a weighted average grant date fair value of $8 million and vesting over a three-year period. Compensation expense related to these awards is charged to earnings over the restriction periods and totaled approximately $6 million, $6 million and $4 million in 2003, 2002 and 2001, respectively.

Employee Stock Purchase Plan

All of our employees (including participating subsidiary employees) were eligible to participate in our employee stock purchase program under which they may purchase shares of Class B common stock at 85% of the lower of the fair market value on the first day of the option period or the last day of the option period. During 2002 and 2001, 2,076,745 and 710,394 shares, respectively, of Class B common stock were issued at prices ranging from $4.58 to $34.60 in 2002 and $13.40 to $38.30 in 2001. The employee stock purchase program has been suspended due to lack of shares and there were no issuances of stock during 2003.

SFAS 123 Assumptions

We account for our stock-based compensation plans under the recognition and measurement principles of APB 25. Pro forma information regarding net income and earnings per share disclosed in Note 1(o) has been determined as if we had accounted for our employee stock options and purchase rights under the fair value method of SFAS 123. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions indicated below for the year ended December 31:

	2003	2002	2001
Risk-free interest rates	2.5%	2.9%	4.8%
Dividend yields	0%	0%	0%
Expected market price volatility of our Class B common stock	77%	64%	46%
Weighted-average expected life of options (years)	3.2	2.0	4.9
Weighted-average fair value of options granted	$ 7.77	$ 5.73	$ 22.63

The fair value of the purchase rights under the stock purchase plans was also estimated using the Black-Scholes model with the following weighted-average assumptions indicated below for the year ended December 31:

	2003	2002	2001
Risk-free interest rates	N/A	1.7%	3.3%
Dividend yields	N/A	0%	0%
Expected market price volatility of our Class B common stock	N/A	63%	46%
Weighted-average expected life of the purchase rights (years)	N/A	0.25	0.25
Weighted-average fair value of purchase rights granted	N/A	$ 2.86	$ 5.12

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option

valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because our employee stock options and purchase rights have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in our opinion, the existing models do not necessarily provide a reliable single measure of the fair value of our employee stock options and purchase rights.

Note 10 Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive income (loss) (which are all net of applicable income taxes) are as follows (in millions):

	Minimum Pension Liability	Unrealized Gain/(Loss) on Derivative Instruments	Total

Balance at December 31, 2000	$	$ 13	$ 13
Current year net change in accumulated other comprehensive loss	(138)	(5)	(143)
Balance at December 31, 2001	(138)	8	(130)
Current year net change in accumulated other comprehensive loss	(250)	(15)	(265)
Balance at December 31, 2002	(388)	(7)	(395)
Current year net change in accumulated other comprehensive loss	(20)	(2)	(22)
Balance at December 31, 2003	$ (408)	$ (9)	$ (417)

The minimum pension liability recorded in other comprehensive income (loss) before applicable income taxes was $642 million and $611 million at December 31, 2003 and 2002, respectively.

Note 11 Employee Benefit Plans

We have noncontributory defined benefit pension and defined contribution (including 401(k) savings) plans. Substantially all of our domestic employees are covered by one or more of these plans. The benefits under the active defined benefit pension plan are based on years of service and an employee's final average compensation. Our pension obligations are measured as of December 31 of each year.

The following table sets forth the defined benefit pension plan's change in projected benefit obligation (in millions) at December 31,

	2003	2002
Accumulated benefit obligation	$ 1,957	$ 1,587
Projected benefit obligation at beginning of year	$ 2,059	$ 1,543
Service cost	156	114
Interest cost	134	114
Plan amendments	5	14
Actuarial losses	193	399
Benefits paid	(188)	(125)
Projected benefit obligation at end of year	$ 2,359	$ 2,059

The following table sets forth the defined benefit pension plan's change in the fair value of plan assets (in millions) at December 31,

	2003	2002
Fair value of plan assets at beginning of year	$ 866	$ 956
Actual gain (loss) on plan assets	218	(115)
Employer contributions	384	150
Benefits paid	(188)	(125)
Fair value of plan assets at end of year	$ 1,280	$ 866

Pension cost recognized in the accompanying consolidated balance sheets at December 31 is computed as follows (in millions):

	2003	2002
Funded status of the plan net underfunded	$ (1,079)	$ (1,193)

	2003	2002
Unrecognized net actuarial loss	1,041	1,079
Unrecognized prior service cost	126	146
Net amount recognized	$ 88	$ 32
Accrued benefit liability	$ (678)	$ (723)
Intangible asset	124	144
Accumulated other comprehensive loss	642	611
Net amount recognized	$ 88	$ 32

The following actuarial assumptions were used to determine the actuarial present value of our projected benefit obligation at December 31:

	2003	2002
Weighted average assumed discount rate	6.25%	6.75%
Weighted average rate of compensation increase	2.87%	3.34%

Net periodic defined benefit pension expense for the year ended December 31 included the following components (in millions):

	2003	2002	2001
Service cost	$ 156	$ 114	$ 94
Interest cost	134	114	117
Expected return on plan assets	(72)	(95)	(118)
Amortization of prior service cost	20	19	22
Amortization of unrecognized net actuarial loss	90	33	12
Net periodic benefit expense	$ 328	$ 185	$ 127

Unrecognized prior service cost is expensed using a straight-line amortization of the cost over the average future service of employees expected to receive benefits under the plan.

The following actuarial assumptions were used to determine our net periodic benefit expense for the year ended December 31:

	2003	2002	2001
Weighted average assumed discount rate	6.75%	7.50%	8.00%
Expected long-term rate of return on plan assets	9.00%	9.50%	9.50%
Weighted average rate of compensation increase	3.34%	3.34%	3.34%

Plan assets consist primarily of equity and fixed-income securities. As of December 31, 2003, the plan held 4.5 million shares of Holdings common stock, which had a fair value of $67 million. As of December 31, the asset allocations by category were as follows:

	2003	2002
Equities	46%	45%
Fixed income	27	28
International equities	17	17
Other	10	10

	2003	2002
Total	100%	100%

We develop our expected long-term rate of return assumption based on historical experience and by evaluating input from the trustee managing the plan's assets, including the trustee's review of asset class return expectations by several consultants and economists as well as long-term inflation assumptions. Our expected long-term rate of return on plan assets is based on a target allocation of assets, which is based on our goal of earning the highest rate of return while maintaining risk at acceptable levels. The plan strives to have assets sufficiently diversified so that adverse or unexpected results from one security class will not have an unduly detrimental impact on the entire portfolio. Our target allocation of assets (excluding the Holdings shares held by the plan) is as follows:

	Percent of Total	Expected Long-Term Rate of Return
Equities	50%	10.0
Fixed income	35	6.5
International equities	10	10.0
Other	5	13.0
Total	100%	

We believe that our long-term asset allocation on average will approximate the targeted allocation. We regularly review our actual asset allocation and periodically rebalance the pension plans' investments to our targeted allocation when considered appropriate.

Our 2004 minimum funding requirements are not expected to be significant. However, we currently intend to maintain the plan's funding at 90% of its current liability, which would result in our making contributions of approximately $300 million to our pension plan in 2004. Our policy is to fund the noncontributory defined benefit pension plans in accordance with Internal Revenue Service ("IRS") requirements.

Our defined contribution 401(k) employee savings plan covers substantially all domestic employees. Company matching contributions are made in cash. For the years ended December 31, 2003, 2002 and 2001, total expense for the defined contribution plan was $35 million, $36 million and $34 million, respectively.

We also have a profit sharing program under which an award pool consisting of 15% of our annual pre-tax earnings, subject to certain adjustments, is distributed each year to substantially all Continental employees (other than employees whose collective bargaining agreement provides otherwise or who participate in our management or officer bonus programs). We paid no profit sharing to Continental employees in 2003, 2002 or 2001.

Note 12 Income Taxes

Income tax benefit (expense) for the years ended December 31 consists of the following (in millions):

	2003	2002	2001
Federal:			
Current	$ (7)	$ 40	$
Deferred	(94)	158	34
State:			
Current	(5)	(10)	(5)
Deferred	(7)	21	7
Foreign:			
Current	(1)	(1)	(1)

	2003	2002	2001
Total income tax benefit (expense)	$ (114)	$ 208	$ 35

The reconciliations of income tax computed at the United States federal statutory tax rates to income tax benefit (expense) for the years ended December 31 are as follows (in millions):

	Amount			Percentage		
	2003	2002	2001	2003	2002	2001
Income tax (expense) benefit at United States statutory rates	$ (70)	$ 222	$ 46	35.0%	35.0%	35.0%
State income tax benefit (expense) (net of federal benefit)	(8)	8	2	3.8	1.3	1.8
Tax on equity in the income of subsidiary	(16)	(12)		8.1	(1.9)	
Non-deductible loss on contribution of Holdings stock to defined benefit pension plan	(9)			4.4		
Meals and entertainment disallowance	(8)	(9)	(11)	3.9	(1.4)	(8.5)
Other	(3)	(1)	(2)	1.6	(0.1)	(1.7)
Income tax benefit (expense), net	$ (114)	$ 208	$ 35	56.8%	32.9%	26.6%

Holdings' initial public offering caused it to separate from our consolidated tax group. As a result, we are required to accrue income tax expense on our share of Holdings' net income after its initial public offering in all periods where we consolidate Holdings' operations. The impact of this is reflected above in tax on equity in the income of subsidiary.

During 2003, we contributed 7.4 million shares of Holdings common stock valued at approximately $100 million to our defined benefit pension plan. For tax purposes, our deduction was limited to the market value of the shares contributed. Since our tax basis in the shares was higher than the market value at the time of the contribution, the nondeductible portion increased our tax expense by $9 million.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the related amounts used for income tax purposes. Significant components of our deferred tax liabilities and assets as of December 31 are as follows (in millions):

	2003	2002
Spare parts and supplies, fixed assets and intangibles	$ 1,196	$ 994
Deferred gain	63	69
Capital and safe harbor lease activity	123	115
Other, net	225	164
Gross deferred tax liabilities	1,607	1,342
Accrued liabilities	(351)	(386)
Net operating loss carryforwards	(1,077)	(729)
Intangible assets (1)		(353)
Basis in subsidiary stock	(105)	(225)
Minimum tax credit carryforward	(4)	(4)
Gross deferred tax assets	(1,537)	(1,697)

	2003	2002
Valuation allowance	219	219
Valuation allowance net tax agreement obligation (1)		384
Net deferred tax liability	289	248
Less: current deferred tax asset	(157)	(165)
Non-current deferred tax liability	$ 446	$ 413

(1) There is no balance at December 31, 2003 due to the deconsolidation of Holdings.

In conjunction with Holdings' initial public offering, our tax basis in the stock of Holdings and the tax basis in ExpressJet's tangible and intangible assets were increased to fair value. The increased tax basis should result in additional tax deductions available to ExpressJet over a period of 15 years. To the extent ExpressJet generates taxable income sufficient to realize the additional tax deductions, our tax sharing agreement with ExpressJet provides that it will be required to pay us a percentage of the amount of tax savings actually realized, excluding the effect of any loss carrybacks. ExpressJet will be required to pay us 100% of the first third of the anticipated tax benefit, 90% of the second third and 80% of the last third. However, if the anticipated benefits are not realized by the end of 2018,

ExpressJet will be obligated to pay us 100% of any benefits realized after that date. We do not recognize for accounting purposes the benefit of the savings associated with ExpressJet's asset step-up until paid to us by ExpressJet due to the uncertainty of realization. ExpressJet paid us $17 million in 2003 related to the agreement, which is included in other nonoperating income.

At December 31, 2003, we had estimated tax NOLs of $3.0 billion for federal income tax purposes that will expire through 2023. Due to our ownership change on April 27, 1993, the ultimate utilization of our NOLs may be limited. Reflecting this limitation, we had a valuation allowance of $219 million at December 31, 2003 and 2002.

Section 382 of the Internal Revenue Code ("Section 382") imposes limitations on a corporation's ability to utilize NOLs if it experiences an "ownership change." In general terms, an ownership change may result from transactions increasing the ownership of certain stockholders in the stock of a corporation by more than 50 percentage points over a three-year period. In the event of an ownership change, utilization of our NOLs would be subject to an annual limitation under Section 382 determined by multiplying the value of our stock at the time of the ownership change by the applicable long-term tax-exempt rate (which is 4.74% for December 2003). Any unused annual limitation may be carried over to later years. The amount of the limitation may under certain circumstances be increased by certain built-in gains held by us at the time of the change that are recognized in the five-year period after the change. If we were to have an ownership change under current conditions, our annual NOL utilization could be limited to approximately $51 million per year, before consideration of any built-in gains.

The IRS is in the process of examining our income tax returns for years through 1999 and has indicated that it may disallow certain deductions we claimed. In addition, the IRS has begun an examination of our income tax returns for the years 2000 and 2001. We believe the ultimate resolution of these audits will not have a material adverse effect on our financial condition, liquidity or results of operations.

Note 13 Fleet Impairment Losses, Severance and Other Special Charges

We recognized fleet impairment losses in 2003, 2002 and 2001, each of which was partially the result of the September 11, 2001 terrorist attacks and the related aftermath. As a result of the U.S. domestic airline industry environment and our continuing losses, we determined that indicators of impairment were present for certain fleet types in each year. We estimated undiscounted cash flows to be generated by each fleet type. Our cash flow estimates were based on historical results adjusted to reflect our best estimate of future market and operating conditions. The net carrying values of impaired aircraft and related items not recoverable were reduced to fair value. Our estimates of fair value represent our best estimate based on industry trends and reference to market rates.

In 2003, we recorded fleet impairment losses and other special charges of $100 million ($62 million after taxes). In the first quarter of 2003, we recorded fleet impairment losses and the special charges of $65 million ($41 million after taxes). This charge includes a $44 million additional impairment of our fleet of owned MD-80s, which was initially determined to be impaired and written down to then current fair value in 2002. The remainder of the charge consisted primarily of the write-down to market value of spare parts inventory for permanently grounded fleets. The first quarter 2003 charge reflects the impact of the war in Iraq and the resulting deterioration of the already weak revenue environment for the U.S. airline industry. These write-downs were necessary because the fair market values of the

MD-80 and spare parts inventory had declined as a result of the difficult financial environment and further reductions in capacity by U.S. airlines, combined with the relatively short remaining life of that fleet.

In the second quarter of 2003, we recorded a special charge of $14 million ($8 million after taxes) relating to the deferral of aircraft deliveries. In December 2003, we determined five previously grounded leased MD-80 aircraft to be permanently grounded and recorded a charge of $21 million ($13 million after income taxes) associated with future obligations for rent and return conditions, net of estimated sublease income, on those aircraft. We will record similar charges as the remaining 17 leased MD-80 aircraft exit revenue service and are permanently grounded.

During 2002, we recorded special charges totaling $242 million ($153 million after taxes) primarily related to the impairment of owned aircraft and the accrual of future obligations for leased aircraft which have been permanently grounded or were to be permanently grounded within 12 months following the charge. The charge included $93 million for the impairment of owned MD-80s and ATR-42s and $149 million for the accrual of future lease payments, return conditions and storage costs for DC 10-30s, MD-80s, ATR-42s and EMB-120s.

In 2001, we recorded a $124 million charge ($79 million after taxes) for fleet impairment losses, severance and other special charges including a fleet impairment loss of approximately $61 million associated primarily with the impairment of various owned aircraft and spare engines. The fleet impairment loss relates to DC 10-30, ATR-42, EMB-120 and Boeing 747 and 727 aircraft that we determined were impaired. This impairment of these fleet types was directly related to grounding of a majority, or in some cases all, of our aircraft within each of these fleet types. The charge related to assets to be disposed of by sale. The remaining special charge in 2001 included $29 million related to costs associated with company-offered leaves of absence and severance for furloughed employees as a result of reduced operations following the September 11, 2001 terrorist attacks, $17 million of additional costs for remediation of environment contamination at various airport locations, $9 million for future contractual obligations for leased property that was either being abandoned or was unutilized, $7 million for bad debt expense related to potential uncollectible receivables from other companies affected by the attacks of September 11, 2001 and $1 million for legal and accounting costs related to the terrorists attacks.

Activity related to the accruals for severance/leave of absence costs, environmental reserves, allowance for future lease payments, return condition and storage costs and closure/under-utilization of facilities for the years ended December 31 are as follows (in millions):

	Beginning Balance	Accrual	Payments	Other	Ending Balance
2003					
Allowance for future lease payments, return conditions and storage costs	$ 107	$ 21	$ (45)	$	$ 83
Closure/under-utilization of facilities	22		(5)		17
Environmental reserves	37		(1)	16	52
2002					
Allowance for future lease payments, return conditions and storage costs	$ 20	$ 142	$ (45)	$ (10)	$ 107
Closure/under-utilization of facilities	26		(4)		22
Severance/leave of absence costs	11		(11)		
Environmental reserves	36	2	(1)		37

	Beginning Balance	Accrual	Payments	Other	Ending Balance
2001					
Allowance for future lease payments, return conditions and storage costs	$ 31	$ 5	$ (16)	$	$ 20
Closure/under-utilization of facilities	23	9	(6)		26
Severance/leave of absence costs		29	(18)		11
Environmental reserves	11	17		8	36

We expect these accruals to be substantially paid by 2006.

Also in 2001, and as a consequence of the September 11, 2001 terrorist attacks, we recorded a special non-operating charge of $22 million ($13 million after taxes) related to the impairment of investments in two of our affiliates and the uncollectibility of related notes receivable. The affiliates were an internet travel agency that went out of business in late September 2001 and a small airline that was affected by the shutdown of all travel for several days following September 11, 2001. This charge is included in other nonoperating income in the accompanying consolidated statements of operations.

As of December 31, 2003, we had the following mainline aircraft out of service:

Aircraft Type	Total Aircraft	Owned	Leased
DC 10-30	5	2	3
MD-80	14	9	5
737-300	2		2
Total	21	11	10

The 11 owned out-of-service mainline aircraft are being carried at an aggregate fair market value of $22 million. As of December 31, 2003, we subleased two of the out-of-mainline service aircraft to third parties and we are currently exploring sublease or sale opportunities for the remaining out-of-service aircraft that do not have near-term lease expirations. The timing of any disposition of

these aircraft is dependent upon the stabilization of the economic environment in the airline industry as well as our ability to find purchasers or sublessees for the aircraft, which is limited in part because of a large surplus of similar aircraft available in the market. We cannot predict when such stabilization will occur or if purchasers or sublessees can be found, and it is possible that our assets could suffer additional impairment. We will record charges for future obligations for rent and return conditions, net of estimated sublease income, as the remaining MD-80 aircraft exit revenue service and are permanently grounded.

Additionally, we have 18 Embraer 120 turboprop aircraft and 22 ATR 42 turboprop aircraft out of service. We lease 32 and own eight of these aircraft. The eight owned aircraft are being carried at an aggregate fair value of $11 million. We currently sublease five of the leased out-of-service turboprop aircraft to third parties and are exploring sublease or sale opportunities for the remaining out-of-service aircraft that do not have near-term lease expirations, subject to the same uncertainties as the out-of-service mainline aircraft discussed above.

Note 14 Security Fee Reimbursement

In May 2003, we received and recognized in earnings $176 million in cash from the United States government pursuant to the Emergency Wartime Supplemental Appropriations Act enacted in April 2003. This amount is reimbursement for our proportional share of passenger security and air carrier security fees paid or collected by U.S. air carriers as of the date of enactment of the legislation, together with other items. Highlights of the legislation are as follows:

$2.3 billion was paid to carriers for reimbursement of airline security fees both the passenger and the air carrier security fees that had been paid or collected by the carriers as of the date of enactment. Additionally, the passenger security fees were not imposed from June 1, 2003 to September 30, 2003.

$100 million was paid to carriers for reimbursement for the direct costs associated with installing strengthened flight deck doors and locks, of which we received $7 million.

Aviation war risk insurance provided by the government was extended for one year to August 2004.

Our two most highly compensated executives' total compensation is limited, during the 12-month period beginning April 1, 2003, to the annual salary paid to those officers with respect to fiscal year 2002 (and any violation of this limitation will require us to repay the government most of the $176 million reimbursement described above). We have entered into agreements with our two most highly compensated executives permitting us to reduce their total compensation to comply with the restrictions of the supplemental appropriations bill. However, there are limited situations, such as a change in control of the company, the termination of such executives' employment or the retirement or voluntary resignation of the executive during the restricted period, that could result in our being unable to comply with those restrictions and thus being required to repay to the government substantially all of the amount of our reimbursement. We believe that the likelihood of these situations occurring is remote.

Note 15 Stabilization Act Grant

On September 21, 2001, Congress passed, and the President subsequently signed into law, the Air Transportation Safety and System Stabilization Act (the "Stabilization Act"), which provides, among other matters, for $5 billion in payments to compensate U.S. air carriers for losses incurred by the air carriers as a result of the September 11, 2001 terrorist attacks. The grant was for the direct losses incurred beginning on September 11, 2001, resulting from the FAA grounding and for incremental losses incurred through December 31, 2001 as a direct result of the attacks. We recognized a $417 million grant under the Stabilization Act for the year ended December 31, 2001. In 2002, we recorded a charge of $12 million to write down our receivable from the U.S. government based on our final application. Our total cash receipts under the grant were $405 million.

Note 16 Commitments And Contingencies

Purchase Commitments. We have substantial commitments for capital expenditures, including for the acquisition of new aircraft. As of December 31, 2003, we had firm commitments for 63 aircraft from Boeing, with an estimated cost of approximately $2.4 billion and options to purchase an additional 84 Boeing aircraft. During the second quarter of 2003, we agreed with Boeing to defer firm deliveries of 36 Boeing 737 aircraft that were originally scheduled for delivery in 2005, 2006 and 2007. These aircraft will now be delivered in 2008 and beyond. In connection with the deferrals, we recorded a second quarter special charge of $14 million. During the fourth quarter of 2003, we agreed with Boeing to substitute six 737-800 aircraft, to be delivered in the second half of 2005, for the final six 757-300 aircraft, originally scheduled for delivery in late 2004 and the first half of 2005. Additionally, we eliminated all remaining 757-300 and 767-200ER options, reduced our 777-200ER option count from three to one, and increased our 737 option positions by 12. As a result of these agreements with Boeing, we expect to take delivery of a total of 16 Boeing aircraft in 2004 (including five 757-300s), seven Boeing aircraft in 2005 and none in 2006 and 2007, with delivery of the remaining 40 aircraft occurring in 2008 and 2009.

We currently have agreements for the financing of six of the eleven 737-800 aircraft scheduled for delivery in 2004 and all five of the 757-300 aircraft scheduled for delivery in 2004, subject to customary conditions. We do not have backstop financing or any other financing currently in place for the remainder of the aircraft. Further financing will be needed to satisfy our capital commitments for our firm aircraft. We can provide no assurance that sufficient financing will be available for the aircraft on order or other related capital expenditures.

As of December 31, 2003, ExpressJet had firm commitments for 50 regional jets from Empresa Brasileira de Aeronautica S.A. ("Embraer"), with an estimated cost of approximately $1.0 billion. ExpressJet currently anticipates taking delivery of 21 regional jets in 2004. ExpressJet does not have an obligation to take any of these firm Embraer aircraft that are not financed by a third party and leased to either ExpressJet or us. Under the capacity purchase agreement between us and ExpressJet, we have agreed to lease as lessee and sublease to ExpressJet the regional jets that are subject to ExpressJet's firm purchase commitments. In addition, under the capacity purchase agreement with ExpressJet, we generally are obligated to purchase all of the capacity provided by these new aircraft as they deliver to ExpressJet. We cannot predict whether passenger traffic levels will enable us to utilize fully regional jets scheduled for future delivery to ExpressJet.

Financings and Guarantees. We are the guarantor of approximately $1.6 billion aggregate principal amount of tax-exempt special facilities revenue bonds and interest thereon (excluding the City

of Houston bonds and including the US Airways contingent liability, both discussed below). These bonds, issued by various airport municipalities, are payable solely from our rentals paid under long-term agreements with the respective governing bodies. These leasing arrangements are accounted for as operating leases in the consolidated financial statements.

In August 2001, the City of Houston completed the offering of $324 million aggregate principal amount of tax-exempt special facilities revenue bonds to finance the construction of Terminal E and a new international ticketing hall facility at Bush Intercontinental Airport. Upon completion of the entire project, Terminal E will contain 23 gates capable of both domestic and international operations. We began using seven gates for domestic operations in June 2003 and placed the remaining gates into service in early January 2004. In connection therewith, we entered into a long-term lease with the City of Houston requiring that upon completion of construction, with limited exceptions, we will make rental payments sufficient to service the related tax-exempt bonds through their maturity in 2029. Approximately $222 million of the bond proceeds had been expended as of December 31, 2003. During the construction period, we retain certain risks related to our own actions or inactions while managing portions of the construction. Potential obligations associated with these risks are generally limited based upon certain percentages of construction costs incurred to date.

We have also entered into a binding corporate guaranty with the bond trustee for the repayment of the principal and interest on the bonds that becomes partially effective (based on a pro rata share of bond proceeds) upon the completion of construction of the terminal or of the international ticketing hall facility. The corporate guarantee would also become effective if we fail to comply with the lease agreement (which is within our control), or if we terminate the lease agreement. Further, we have not assumed any condemnation risk, any casualty event risk (unless caused by us), or risk related to certain overruns (and in the case of cost overruns, our liability for the project would be limited to 89.9% of the capitalized costs) during the construction period of each respective phase. Accordingly, we are not considered the owner of the project for financial reporting purposes and, therefore, have not capitalized the construction costs or recorded the debt obligation in our consolidated financial statements. However, our potential obligation under the guarantee is for payment of the principal of $324 million and related interest charges, at an average rate of 6.78%. We expect the guaranty to become effective for a portion of the bonds relating to the terminal, in the amount of $271 million, during the first quarter of 2004.

We remain contingently liable, for US Airways' obligations under a lease agreement between US Airways and the Port Authority of New York and New Jersey related to the East End Terminal at LaGuardia airport. These obligations include the payment of ground rentals to the Port Authority and the payment of principal and interest on special facilities revenue bonds issued by the Port Authority with an outstanding balance of $174 million at December 31, 2003 and having a final scheduled maturity in 2015. If US Airways defaults on these obligations, we will be required to cure the default, and we would have the right to occupy the terminal after US Airways' interest in the lease had been terminated.

General Guarantees and Indemnifications. We are the lessee under many real estate leases. It is common in such commercial lease transactions for us as the lessee to agree to indemnify the lessor and other related third parties for tort liabilities that arise out of or relate to our use or occupancy of the leased premises. In some cases, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but usually excludes any liabilities caused by their gross negligence or willful

misconduct. Additionally, we typically indemnify such parties for any environmental liability that arises out of or relates to our use of the leased premises.

In our aircraft financing agreements, we typically indemnify the financing parties, trustees acting on their behalf and other related parties against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the aircraft and for tort liability, whether or not these liabilities arise out of or relate to the negligence of these indemnified parties, except for their gross negligence or willful misconduct.

We expect that we would be covered by insurance (subject to deductibles) for most tort liabilities and related indemnities described above with respect to real estate we lease and aircraft we operate.

In our financing transactions that include loans from banks in which the interest rate is based on LIBOR, we typically agree to reimburse the lenders for certain increased costs that they incur in carrying these loans as a result of any change in law and for any reduced returns with respect to these loans due to any change in capital requirements. We had $1.4 billion of floating rate debt at December 31, 2003. In several financing transactions, with an aggregate carrying value of $975 million, involving loans from non-U.S. banks, export-import banks and certain other lenders secured by aircraft, we bear the risk of any change in tax laws that would subject loan payments thereunder to non-U.S. lenders to withholding taxes. In addition, in cross-border aircraft lease agreements for two 757 aircraft, we bear the risk of any change in U.S. tax laws that would subject lease payments made by us to a resident of Japan to U.S. taxes. Our lease obligations for these two aircraft totaled $68 million at December 31, 2003.

We cannot estimate the potential amount of future payments under the foregoing indemnities and agreements.

Employees. As of December 31, 2003, we had approximately 37,680 full-time equivalent employees, consisting of approximately 16,710 customer service agents, reservations agents, ramp and other airport personnel, 7,270 flight attendants, 5,850 management and clerical employees, 3,960 pilots, 3,790 mechanics and 100 dispatchers. While there can be no assurance that our generally good labor relations and high labor productivity will continue, we have established as a significant component of our business strategy the preservation of good relations with our employees, approximately 42% of whom are represented by unions.

Of those employees covered by collective bargaining agreements, approximately 94% presently have contracts under negotiation or becoming amendable in 2004. Our mechanics, represented by the Teamsters, ratified a new four-year collective bargaining agreement in December 2002 that made an adjustment to current pay and recognized current industry conditions. The agreement became amendable with respect to wages, pension and health insurance provisions on December 31, 2003. Negotiations commenced with the Teamsters regarding these subjects in December 2003 and are continuing. Work rules and other contractual items are established through 2006. The collective bargaining agreement between us and our dispatchers (who are represented by the TWU) became amendable in October 2003. Negotiations commenced with the TWU in September 2003 and are continuing. The collective bargaining agreement between us and our pilots (who are represented by the Air Line Pilots Association) became amendable in October 2002. After being deferred due to the economic uncertainty following the September 11, 2001 terrorist attacks, negotiations recommenced in September 2002 and are continuing. The collective bargaining agreement between us and our flight

attendants (who are represented by the IAM) becomes amendable in October 2004. We continue to believe that mutually acceptable agreements can be reached with such employees, although the ultimate outcome of the negotiations is unknown at this time. Any labor disruptions which result in a prolonged significant reduction in flights could have a material adverse impact on our results of operations and financial condition.

ExpressJet is also currently engaged in labor negotiations with its pilots and mechanics. ExpressJet and its unions have requested the assistance of federal mediators in the negotiations. A labor disruption by either group resulting in a prolonged significant reduction in their flights could have a material adverse impact on our results of operations and financial condition.

Environmental Matters. We could potentially be responsible for environmental remediation costs primarily related to jet fuel and solvent contamination surrounding our aircraft maintenance hangar in Los Angeles. In 2001, the California Regional Water Quality Control Board mandated a field study of the site and it was completed in September 2001. We have established a reserve for estimated costs of environmental remediation at Los Angeles and elsewhere in our system, based primarily on third party environmental studies and estimates as to the extent of the contamination and nature of the required remedial actions. We have evaluated and recorded this accrual for environmental remediation costs separately from any related insurance recovery. We have not recognized any receivables related to insurance recoveries at December 31, 2003.

We expect our total losses from environment matters to be $52 million, for which we were fully accrued at December 31, 2003. During 2003, we received insurance settlements totaling $16 million for future environmental claims. Although we believe, based on currently available information, that our reserves for potential environmental remediation costs are adequate, reserves could be adjusted as further information develops or circumstances change. However, we do not expect these items to materially impact our financial condition, liquidity or our results of operations.

Legal Proceedings. During the period between 1997 and 2001, we reduced or capped the base commissions that we paid to travel agents, and in 2002 we eliminated such base commissions. This was similar to actions also taken by other air carriers. We are now a defendant, along with several other air carriers, in a number of lawsuits brought by travel agencies relating to these base commission reductions and eliminations.

Sarah Futch Hall d/b/a/ Travel Specialists v. United Air Lines, et al. (U.S.D.C. Eastern District of North Carolina). This class action was filed in federal court on June 21, 2000 by a travel agent, on behalf of herself and other similarly situated U.S. travel agents, challenging the reduction and subsequent elimination of travel agent base commissions. The amended complaint alleged an unlawful agreement among the airline defendants to reduce, cap or eliminate commissions in violation of federal antitrust laws during the years 1997 to 2002. The plaintiffs sought compensatory and treble damages, injunctive relief and their attorneys' fees. The class was certified on September 18, 2002. On October 30, 2003, a summary judgment and order was granted in favor of all of the defendants. Plaintiffs filed their appeal to this judgment and order on November 5, 2003.

Several travel agents who opted out of the Hall class action filed similar suits against Continental and other major carriers alleging violations of antitrust laws in eliminating the base commission: *Tam Travel, Inc. v. Delta Airlines, Inc., et al.* (U.S.D.C., Northern District of California), filed on April 9, 2003; *Paula Fausky, et al. v. American Airlines, et al.* (U.S.D.C., Northern District of Ohio), filed on

May 8, 2003; and *Swope Travel Agency, et al. v. Orbitz LLC et al.* (U.S.D.C., Eastern District of Texas), filed on June 5, 2003. By order dated November 12, 2003, these actions were transferred and consolidated for pretrial purposes by the Judicial Panel on Multidistrict Litigation to the Northern District of Ohio.

On December 6, 2002, the named plaintiffs in *Always Travel, et. al. v. Air Canada, et al.*, pending in the Federal Court of Canada, Trial Division, Montreal, filed an amended statement of claim alleging that between 1995 and the present, Continental, the other defendant airlines, and the International Air Transport Association conspired to reduce commissions paid to Canada-based travel agents in violation of the Competition Act of Canada. The plaintiffs seek to certify a nationwide class of travel agents.

In each of the foregoing cases, we believe the plaintiffs' claims are without merit and are vigorously defending the lawsuits. Nevertheless, a final adverse court decision awarding substantial money damages could have a material adverse impact on our financial condition, liquidity and results of operations.

We and/or certain of our subsidiaries are defendants in various other lawsuits, including suits relating to certain environmental claims, and proceedings arising in the normal course of business. While the outcome of these lawsuits and proceedings cannot be predicted with certainty and could have a material adverse effect on our financial position, results of operations and cash flows, it is our opinion, after consulting with outside counsel, that the ultimate disposition of such suits will not have a material adverse effect on our financial position, results of operations or cash flows.

Note 17 Related Party Transactions

The following is a summary of significant related party transactions that occurred during 2003, 2002 and 2001, other than those discussed elsewhere in the Notes to Consolidated Financial Statements.

Northwest Airlines, Inc. holds the one share of our Series B preferred stock issued and outstanding. In November 1998, we began implementing a long-term global alliance with Northwest involving extensive codesharing, frequent flyer reciprocity and other cooperative activities. The services provided are considered normal to the daily operations of both airlines. As a result of these activities, we paid Northwest $43 million, $34 million and $36 million in 2003, 2002 and 2001, respectively, and Northwest paid us $24 million, $30 million and $22 million in 2003, 2002 and 2001, respectively.

Two of our directors, Mr. Bonderman and William Price, may be deemed to indirectly control approximately 54% of the voting power of America West Holdings Corporation. In 1994, we entered into a series of agreements with America West Airlines, Inc., a subsidiary of America West Holdings Corporation, related to codesharing and ground handling activities such as passenger check-in and ticketing and baggage handling and delivery. The services provided are considered normal to the daily operations of both airlines. As a result of these agreements, we paid America West Airlines $5 million, $18 million and $25 million in 2003, 2002 and 2001, respectively, and they paid us $16 million, $24 million and $30 million in 2003, 2002 and 2001, respectively. The majority of these agreements were terminated in 2002, although agreements for services at certain airports are continuing.

As of December 31, 2003, we had an approximate 9% equity interest in Orbitz, a comprehensive travel planning website, as more fully discussed in Note 7. We paid Orbitz approximately $5 million, $3 million and $2 million for services during 2003, 2002 and 2001, respectively. Consumers booked approximately $229 million, $171 million and $55 million of air travel on us via Orbitz in 2003, 2002 and 2001, respectively. Other airlines also own equity interests in Orbitz and distribute air travel tickets through Orbitz. The distribution services provided by Orbitz are considered normal to the daily operations of both Orbitz and us.

In 2002, we extended through January 7, 2006 our marketing agreement with Hotwire, Inc., a web-based travel services company, pursuant to which we make available to Hotwire tickets for air travel. Other airlines also sell air travel tickets to Hotwire. We sold Hotwire approximately $38 million, $33 million and $19 million of tickets during 2003, 2002 and 2001, respectively, and, in January 2002, we purchased $2 million of redeemable preferred stock of Hotwire in a transaction in which other airlines made similar investments. Prior to the sale of their indirect interests in Hotwire during 2003, Messrs. Bonderman and Price controlled approximately 27% of Hotwire's general voting power. We sold our interest in Hotwire for $42 million in cash in 2003, as more fully discussed in Note 7. The distribution services provided to us by Hotwire are considered normal to both their and our daily operations.

During each of 2003 and 2002, we paid approximately $43 million to Gate Gourmet International AG for catering services considered normal to the daily operations of both Gate Gourmet and us. Messrs. Bonderman and Price may be deemed to indirectly control substantially all of the voting securities of Gate Gourmet.

Note 18 Segment Reporting

We have two reportable segments: mainline and regional. Both reportable segments are engaged in the business of transporting passengers and cargo, but have different operating and economic characteristics which are separately reviewed by our management. The mainline segment involves flights to cities with larger capacity aircraft. The regional segment involves flights with smaller capacity aircraft from smaller cities to the mainline jet hubs to feed traffic into the mainline network. We evaluate segment performance based on several factors, of which the primary financial measure is operating income (loss). Since certain assets can be readily moved between the two segments and are often shared, we do not report information about total assets or capital expenditures between the segments.

Financial information for the year ended December 31 by business segment is set forth below (in millions):

	2003	2002	2001
Operating Revenue:			
Mainline	$ 7,559	$ 7,432	$ 8,094
Regional	1,311	970	875
Total Consolidated	$ 8,870	$ 8,402	$ 8,969
Depreciation and amortization expense:			
Mainline	$ (416)	$ (403)	$ (426)
Regional	(28)	(41)	(41)
Total Consolidated	$ (444)	$ (444)	$ (467)
Special Charges (Note 13):			
Mainline	$ (91)	$ (184)	$ (91)
Regional	(9)	(58)	(33)
Total Consolidated	$ (100)	$ (242)	$ (124)
Stabilization Act grant (Note 15):			
Mainline	$	$ (13)	$ 392

	2003	2002	2001
Regional		1	25
Total Consolidated	$	$ (12)	$ 417
Operating Income (Loss):			
Mainline	$ 234	$ (154)	$ 303
Regional	(31)	(158)	(159)
Total Consolidated	$ 203	$ (312)	$ 144
Interest Expense:			
Mainline	$ (372)	$ (350)	$ (286)
Regional	(27)	(37)	(52)
Intercompany Eliminations	6	15	27
Total Consolidated	$ (393)	$ (372)	$ (311)

Interest Income:			
Mainline	$ 16	$ 22	$ 41
Regional	9	17	31
Intercompany Eliminations	(6)	(15)	(27)
Total Consolidated	$ 19	$ 24	$ 45
Income Tax Benefit (Expense):			
Mainline	$ (110)	$ 160	$ (27)
Regional	(4)	48	62
Total Consolidated	$ (114)	$ 208	$ 35
Net Income (Loss):			
Mainline	$ 131	$ (300)	$ 17
Regional	(93)	(151)	(112)
Total Consolidated	$ 38	$ (451)	$ (95)

The amounts presented above for the regional segment are not the same as the amounts reported in stand-alone financial statements of Holdings. The amounts presented above are presented on the basis of how our management reviews segment results. Under this basis, the regional segment's revenue include a pro-rated share of our ticket revenue for segments flown by Holdings and expenses include all activity related to the regional operations, regardless of whether the costs were paid by us or by Holdings. Net income (loss) for the regional segment for 2003 and 2002 include a $49 million and $28 million, respectively, after tax reduction in earnings attributable to the minority interest that is reflected in our consolidated statement of operations.

Holdings' stand-alone financial statements and the calculation of our equity in Holdings' earnings (post deconsolidation) and minority interest (pre-deconsolidation) in our consolidated financial statements are based on Holdings' results of operations under the capacity purchase agreement which became effective January 1, 2001. Under this agreement, we pay Holdings for each scheduled block hour based on an agreed formula as discussed in Note 4. On this basis, selected Holdings' results of operations were as follows for the year ended December 31 (in millions):

	2003	2002	2001
Revenue	$ 1,311	$ 1,089	$ 980
Operating Income (Loss) Before Taxes and Dividends	175	139	80
Net Income	108	84	48
Capital Expenditures	49	55	53
Total Assets	510	434	430

Information concerning operating revenue for the year ended December 31 by principal geographic areas is as follows (in millions):

	2003	2002	2001
Domestic (U.S.)	$ 6,050	$ 5,570	$ 6,108
Atlantic	1,203	1,205	1,179
Latin America	1,050	1,016	1,024
Pacific	567	611	658
	$ 8,870	$ 8,402	$ 8,969

We attribute revenue among the geographical areas based upon the origin and destination of each flight segment. Our tangible assets and capital expenditures consist primarily of flight equipment, which is mobile across geographic markets and, therefore, has not been allocated.

Note 19 Quarterly Financial Data (Unaudited)

Unaudited summarized financial data by quarter for 2003 and 2002 is as follows (in millions, except per share data):

	Three Months Ended			
	March 31	June 30	September 30	December 31
2003				
Operating revenue	$ 2,042	$ 2,216	$ 2,365	$ 2,248
Operating income (loss)	(224)	238	174	16
Nonoperating income (expense), net	(90)	(79)	87	80
Net income (loss)	(221)	79	133	47
Earnings (loss) per share(a):				
Basic	$ (3.38)	$ 1.20	$ 2.04	$ 0.72
Diluted	$ (3.38)	$ 1.10	$ 1.83	$ 0.67
2002				
Operating revenue	$ 1,993	$ 2,192	$ 2,178	$ 2,038
Operating income (loss)	(187)	(115)	46	(56)
Nonoperating expense, net	(71)	(83)	(77)	(88)
Net loss	(166)	(139)	(37)	(109)
Basic and diluted loss per share(a)	$ (2.61)	$ (2.18)	$ (0.58)	$ (1.67)

(a) The sum of the four quarterly earnings per share amounts does not agree with the earnings per share as calculated for the full year due to the fact that the full year calculation uses a weighted average number of shares based on the sum of the four quarterly weighted average shares divided by four quarters.

The quarterly results are impacted by the following significant items:

During the first quarter of 2003, we recorded $65 million of special charges related to additional impairment of our fleet of owned MD-80s and the write-down to market value of spare parts inventory for permanently grounded fleet.

In the second quarter of 2003, we recorded $176 million income related to the security fee reimbursement received from the U.S. government and a special charge for $14 million related to the deferral of aircraft deliveries.

In the third quarter of 2003, we recognized gains of $173 million related to dispositions of Holdings stock.

In the fourth quarter of 2003, we recorded gains of $132 million related to our Hotwire and Orbitz investments, after related compensation expense and including an adjustment to fair value of the remaining investment in Orbitz, and a special charge of $21 million related to five permanently grounded MD-80 aircraft. Also in the fourth quarter of 2003, we adjusted our estimates of the frequent flyer mileage credits we expect to be redeemed for travel, resulting in a one-time increase in other revenue of $24 million.

During the first quarter of 2002, we recorded $90 million of special charges related to the permanent grounding of our DC 10-30 fleet.

During the second quarter of 2002, we recorded fleet disposition and impairment losses of $152 million, primarily related to the impairment and accrual of lease exit costs of our MD-80 and turboprop fleet, and a charge of $12 million to write down our receivable under the Stabilization Act.

APPENDIX B

CONTINENTAL AIRLINES, INC.

2004 EMPLOYEE STOCK PURCHASE PLAN

1. **Purpose.** The Continental Airlines, Inc. 2004 Employee Stock Purchase Plan (the "Plan") is intended to provide an incentive for employees of Continental Airlines, Inc. (the "Company") and any Participating Company (as defined in paragraph 3) to acquire or increase a proprietary interest in the Company through the purchase of shares of the Company's Class B common stock, par value $.01 per share (the "Stock"). The Plan is intended to qualify as an "Employee Stock Purchase Plan" under Section 423 of the Internal Revenue Code of 1986, as amended (the "Code"). The provisions of the Plan shall be construed in a manner consistent with the requirements of that section of the Code.

2. **Administration of the Plan.** The Plan shall be administered by the Human Resources Committee (the "Committee") of the Board of Directors of the Company (the "Board"). Subject to the provisions of the Plan, the Committee shall interpret the Plan and all options granted under the Plan, make such rules as it deems necessary for the proper administration of the Plan and make all other determinations necessary or advisable for the administration of the Plan. In addition, the Committee shall correct any defect, supply any omission or reconcile any inconsistency in the Plan, or in any option granted under the Plan, in the manner and to the extent that the Committee deems desirable to carry the Plan or any option into effect. The Committee shall, in its sole discretion, make such decisions or determinations and take such actions, and all such decisions, determinations and actions taken or made by the Committee pursuant to this and the other paragraphs of the Plan shall be conclusive on all parties. The Committee shall not be liable for any decision, determination or action taken in good faith in connection with the administration of the Plan. The Committee shall have the authority to delegate routine day-to-day administration of the Plan to such officers and employees of the Company as the Committee deems appropriate, and such persons shall not be liable for any decision, determination or action taken in good faith in connection with such delegated administration.

3. **Participating Companies.** The Committee may designate any present or future parent or subsidiary corporation of the Company that is eligible by law to participate in the Plan as a "Participating Company" by written instrument delivered to the designated Participating Company. Such written instrument shall specify the effective date of such designation and shall become, as to such designated Participating Company and persons in its employment, a part of the Plan. The terms of the Plan may be modified as applied to the Participating Company only to the extent permitted under Section 423 of the Code. Transfer of employment among the Company and Participating Companies (and among any other parent or subsidiary corporation of the Company) shall not be considered a termination of employment hereunder. Any Participating Company may, by appropriate action of its Board of Directors, terminate its participation in the Plan. Moreover, the Committee may, in its discretion, terminate a Participating Company's Plan participation at any time.

4. **Eligibility.** Subject to the provisions hereof, all employees of the Company and the Participating Companies who are employed by the Company or any Participating Company as of a Date of Grant (as defined in subparagraph 6(a)) shall be eligible to participate in the Plan; provided, however, that no option shall be granted to an employee if such employee, immediately after the option is granted, owns stock possessing five percent or more of the total combined voting power or value of all classes of stock of the Company or of its parent or subsidiary corporations (within the meaning of Sections 423(b)(3) and 424(d) of the Code).

5. **Stock Subject to the Plan.** Subject to the provisions of paragraph 12, the aggregate number of shares that may be sold pursuant to options granted under the Plan shall not exceed 3,000,000

shares of the authorized Stock, which shares may be unissued or reacquired shares, including shares bought on the market or otherwise for purposes of the Plan. Should any option granted under the Plan expire or terminate prior to its exercise in full, the shares theretofore subject to such option may again be subject to an option granted under the Plan. Any shares that are not subject to outstanding options upon the termination of the Plan shall cease to be subject to the Plan.

6. **Grant of Options.**

(a) **General Statement; "Date of Grant"; "Option Period"; "Date of Exercise".** Following the effective date of the Plan and continuing while the Plan remains in force, the Company shall offer options under the Plan to purchase shares of Stock to all eligible employees who elect to participate in the Plan. Except as otherwise determined by the Committee, these options shall be granted on April 1, 2004, and, thereafter, on the first day of each successive July, October, January and April (each of which dates is herein referred to as a "Date of Grant"). Except as provided in paragraph 12, the term of each option granted shall be for three months (each of such three-month periods is herein referred to as an "Option Period"), which shall begin on a Date of Grant and end on the last day of each Option Period (herein referred to as a "Date of Exercise"). The Board and the Committee shall each have the power to change the duration and/or the frequency of Option Periods with respect to future offerings without stockholder approval if such change is announced to participants (which may take the form of an announcement on the Company's intranet website) at least five (5) business days prior to the scheduled beginning of the first Option Period to be affected. Subject to subparagraph 6(e), the number of shares subject to an option for a participant shall be equal to the quotient of (i) the aggregate payroll deductions withheld on behalf of such participant during the Option Period in accordance with subparagraph 6(b), divided by (ii) the Option Price (as defined in subparagraph 7(b)) of the Stock applicable to the Option Period, including fractions; provided, however, that the maximum number of shares that may be subject to any option for a participant may not exceed 2,500 (subject to adjustment as provided in paragraph 12).

(b) **Election to Participate; Payroll Deduction Authorization.** An eligible employee may participate in the Plan only by means of payroll deduction. Except as provided in subparagraph 6(g), each eligible employee who elects to participate in the Plan shall deliver to the Company or any third party administrator designated by the Company, within the time period prescribed by the Committee, a payroll deduction authorization in a form prepared by the Company (which may be in electronic or telephonic form) whereby he gives notice of his election to participate in the Plan as of the next following Date of Grant, and whereby he designates an integral percentage of his Eligible Compensation (as defined in subparagraph 6(d)) to be deducted from his compensation for each pay period and paid into the Plan for his account. The designated percentage may not be less than 1% nor exceed 10% (or such greater percentage as the Board or the Committee may establish from time to time before a Date of Grant) of such participant's Eligible Compensation on each payday during the Option Period.

(c) **Changes in Payroll Authorization.** A participant may withdraw from the Plan as provided in paragraph 8. In addition, on one occasion only during an Option Period, a participant may decrease the percentage rate of his payroll deduction authorization referred to in subparagraph 6(b) or may suspend or resume payroll deductions during the relevant Option Period by delivering to the Company a new payroll deduction authorization in a form prepared by the Company (which may be in electronic or telephonic form). Such decrease, suspension or resumption will be effective as soon as administratively feasible after receipt of the participant's new payroll deduction authorization form.

(d) **"Eligible Compensation" Defined.** The term "Eligible Compensation" means regular straight-time earnings or base salary, except that such term shall not include payments for overtime, incentive compensation, bonuses or other special payments.

(e) **$25,000 Limitation.** No employee shall be granted an option under the Plan which permits his rights to purchase Stock under the Plan and under all other employee stock purchase plans of the Company and its parent and subsidiary corporations to accrue at a rate which exceeds $25,000 of fair market value of such Stock (determined at the time such option is granted) for each calendar year in which such option is outstanding at any time (within the meaning of Section 423(b)(8) of the Code). Any payroll deductions in excess of the amount specified in the foregoing sentence shall be returned to the participant as soon as administratively feasible after the next following Date of Exercise.

(f) **Leaves of Absence**. During a paid leave of absence approved by the Company and meeting the requirements of Treasury Regulation §1.421-7(h)(2), a participant's elected payroll deductions shall continue. A participant may not contribute to the Plan during an unpaid leave of absence. If a participant takes an unpaid leave of absence that is approved by the Company and meets the requirements of Treasury Regulation §1.421-7(h)(2), then such participant's payroll deductions for such Option Period that were made prior to such leave may remain in the Plan and be used to purchase Stock under the Plan on the Date of Exercise relating to such Option Period. If a participant takes a leave of absence that is not described in the first or third sentence of this subparagraph 6(f), then he shall be considered to have terminated his employment and withdrawn from the Plan pursuant to the provisions of paragraph 8 hereof. Further, notwithstanding the preceding provisions of this subparagraph 6(f), if a participant takes a leave of absence that is described in the first or third sentence of this subparagraph 6(f) and such leave of absence exceeds the Maximum Period, then he shall be considered to have withdrawn from the Plan pursuant to the provisions of paragraph 8 hereof and terminated his employment for purposes of the Plan on the day immediately following the last day of the Maximum Period. For purposes of the preceding sentence, the term "Maximum Period" shall mean, with respect to a participant, the 90-day period beginning on the first day of the participant's leave of absence; provided, however, that if the participant's right to reemployment by the Company (or a parent or subsidiary corporation of the Company) is guaranteed either by statute or contract, then such 90-day period shall be extended until the last day upon which such reemployment rights are so guaranteed.

(g) **Continuing Election.** Subject to the limitation set forth in subparagraph 6(e), a participant (i) who has elected to participate in the Plan pursuant to subparagraph 6(b) as of a Date of Grant and (ii) who takes no action to change or revoke such election as of the next following Date of Grant and/or as of any subsequent Date of Grant prior to any such respective Date of Grant shall be deemed to have made the same election, including the same attendant payroll deduction authorization, for such next following and/or subsequent Date(s) of Grant as was in effect immediately prior to such respective Date of Grant; provided, however, that each participant shall be required to renew his enrollment election for the Option Period that begins January 1, 2005 (and/or such other Option Periods as may be specified by the Board or the Committee). Payroll deductions that are limited by subparagraph 6(e) shall re-commence at the rate provided in such participant's payroll deduction authorization at the beginning of the first Option Period that is scheduled to end in the following calendar year, unless the participant changes the amount of his payroll deduction authorization pursuant to paragraph 6, withdraws from the Plan as provided in paragraph 8 or is terminated from the Plan as provided in paragraph 9.

7. **Exercise of Options.**

(a) **General Statement.** Subject to the limitation set forth in subparagraph 6(e), each participant in the Plan automatically and without any act on his part shall be deemed to have exercised his option on each Date of Exercise to the extent of his unused payroll deductions under the Plan and to the extent the issuance of Stock to such participant upon such exercise is lawful.

(b) **"Option Price" Defined.** The term "Option Price" shall mean the per share price of Stock to be paid by each participant on each exercise of his option, which price shall be equal to 85% (subject to adjustment as described below) of the fair market value of the Stock on the Date of Exercise or on the Date of Grant, whichever amount is lesser; provided, however, in any event the minimum Option Price that may be paid by a participant may not be less than $10 per share (subject to adjustment as provided in paragraph 12. The Board and the Committee shall each have the power to increase the purchase price percentage from 85% of the fair market value to a greater percentage as determined in the discretion of the Board or Committee; provided that such increase is announced to participants (which may take the form of an announcement on the Company's intranet web site) at least five (5) business days prior to the scheduled beginning of the first Option Period to be affected. For all purposes under the Plan, the fair market value of a share of Stock on a particular date shall be equal to the closing market price of the Stock on the New York Stock Exchange, Inc. on that date (or, if no shares of Stock have been traded on that date, on the prior regular business date on which shares of the Stock are so traded). If the Option Price for any Option Period is less than the minimum Option Price, then the participant's option relating to such Option Period shall automatically terminate and shall not be exercised. The Company shall promptly refund to each participant the amount of his payroll deductions under the Plan which have not yet been otherwise returned to him or used upon exercise of options, and he shall have no further interest in the unexercised option relating to such Option Period.

(c) **Delivery of Shares; Restrictions on Transfer.** As soon as practicable after each Date of Exercise, the Company shall deliver to a custodian selected by the Committee one or more certificates representing (or shall otherwise cause to be credited to the account of such custodian) the total number of whole shares of Stock respecting options exercised on such Date of Exercise in the aggregate (for both whole and fractional shares) of all of the participating eligible employees hereunder. Any remaining amount representing a fractional share shall not be certificated (or otherwise so credited) and shall be carried forward to the next Date of Exercise for certification (or credit) as part of a whole share. Such custodian shall keep accurate records of the beneficial interests of each participating employee in such shares by means of participant accounts under the Plan, and shall provide each eligible employee with quarterly or such other periodic statements (which statements may be in electronic or telephonic form) with respect thereto as may be directed by the Committee. If the Company is required to obtain from any U.S. commission or agency authority to issue any such shares, the Company shall seek to obtain such authority. Inability of the Company to obtain from any commission or agency (whether U.S. or foreign) authority which the Company's General Counsel or his designee deems necessary for the lawful issuance of any such shares shall relieve the Company from liability to any participant in the Plan except to return to him the amount of his payroll deductions under the Plan which would have otherwise been used upon exercise of the relevant option. Except as hereinafter provided, for a period of six months (or such other period as the Committee may from time to time specify with respect to a particular grant of options) after the Date of Exercise of an option (the "Restriction Period"), the shares of Stock issued in connection with such exercise may not be sold, assigned, pledged, exchanged, hypothecated or otherwise transferred, encumbered or disposed of by the optionee who has purchased such shares; provided, however, that such restriction shall not apply to the transfer, exchange or conversion of such shares of Stock pursuant to a merger, consolidation or other plan of reorganization of the Company, but the stock, securities or other property (other than cash)

received upon any such transfer, exchange or conversion shall also become subject to the same transfer restrictions applicable to the original shares of Stock, and shall be held by the custodian, pursuant to the provisions hereof. Upon the expiration of such Restriction Period, the transfer restrictions set forth in this subparagraph 7(c) shall cease to apply and the optionee may, pursuant to procedures established by the Committee and the custodian, direct the sale or distribution of some or all of the whole shares of Stock in his Company stock account that are not then subject to transfer restrictions and, in the event of a sale, request payment of the net proceeds from such sale. Further, upon the termination of the optionee's employment with the Company and its parent or subsidiary corporations by reason of death, permanent and total disability (within the meaning of Section 22(e)(3) of the Code) or retirement, the transfer restrictions set forth in this subparagraph 7(c) shall cease to apply and the custodian shall, upon the request of such optionee (or as applicable, such optionee's personal representative), deliver to such optionee a certificate issued in his name representing (or otherwise credit to an account of such optionee) the aggregate whole number of shares of Stock in his Company stock account under the Plan. At the time of distribution of such shares, any fractional share in such Company stock account shall be converted to cash based on the fair market value of the Stock on the date of distribution and such cash shall be paid to the optionee. The Committee may cause the Stock issued in connection with the exercise of options under the Plan to bear such legends or other appropriate restrictions, and the Committee may take such other actions, as it deems appropriate in order to reflect the transfer restrictions set forth in this subparagraph 7(c) and to assure compliance with applicable laws.

8. **Withdrawal from the Plan.**

(a) **General Statement.** Any participant may withdraw in whole from the Plan at any time prior to the Date of Exercise relating to a particular Option Period. Partial withdrawals shall not be permitted. A participant who wishes to withdraw from the Plan must timely deliver to the Company a notice of withdrawal in a form prepared by the Company (which may be in electronic or telephonic form). The Company, promptly following the time when the notice of withdrawal is delivered, shall refund to the participant the amount of his payroll deductions under the Plan which have not yet been otherwise returned to him or used upon exercise of options; and thereupon, automatically and without any further act on his part, his payroll deduction authorization and his interest in unexercised options under the Plan shall terminate.

(b) **Eligibility Following Withdrawal.** A participant who withdraws from the Plan shall be eligible to participate again in the Plan upon expiration of the Option Period during which he withdrew (provided that he is otherwise eligible to participate in the Plan at such time).

9. **Termination of Employment.**

(a) **General Statement.** Except as provided in subparagraph 9(b), if the employment of a participant terminates for any reason whatsoever, then his participation in the Plan automatically and without any act on his part shall terminate as of the date of the termination of his employment. The Company shall promptly refund to him the amount of his payroll deductions under the Plan which have not yet been otherwise returned to him or used upon exercise of options, and thereupon his interest in unexercised options under the Plan shall terminate.

(b) **Termination by Retirement, Death or Disability.** If the employment of a participant terminates due to (i) retirement, (ii) death or (iii) permanent and total disability (within the meaning of Section 22(e)(3) of the Code), the participant, or (in the event of the participant's death) the participant's designated beneficiary, as applicable, will have the right to elect, no later

than 10 days prior to the last day of the Option Period during which such retirement, death or disability occurred, either to:

(1) withdraw all of the accumulated unused payroll deductions and shares of Stock credited to the participant's account under the Plan (whether or not the Restriction Period with respect to such shares has expired); or

(2) exercise the participant's option for the purchase of Stock on the last day of the Option Period during which termination of employment occurs for the purchase of the number of full shares of Stock which the accumulated payroll deductions at the date of the participant's termination of employment will purchase at the applicable Option Price (subject to subparagraph 6(e)), with any excess cash in such account to be returned to the participant or such designated beneficiary.

The participant or, if applicable, such designated beneficiary, must make such election by giving notice to the Committee in such manner as the Committee prescribes. In the event that no such notice of election is timely received by the Committee, the participant or designated beneficiary will automatically be deemed to have elected as set forth in clause (2) above, and promptly after the exercise so described in clause (2) above, all shares of Stock in such participant's account under the Plan will be distributed to the participant or such designated beneficiary.

(c) **Beneficiary Designation.** Each participant shall have the right to designate a beneficiary to exercise the rights specified in subparagraph 9(b) in the event of such participant's death. Any designation (or change in designation) of a beneficiary must be filed with the Committee in a time and manner designated by the Committee in order to be effective. Any such designation of a beneficiary may be revoked by the participant by filing a later valid designation or an instrument of revocation with the Committee in a time and manner designated by the Committee. If no beneficiary is designated, the designated beneficiary will be deemed to be the participant's personal representative.

10. **Restriction Upon Assignment of Option.** An option granted under the Plan shall not be transferable otherwise than by will or the laws of descent and distribution. Subject to subparagraph 9(b), each option shall be exercisable, during his lifetime, only by the employee to whom granted. The Company shall not recognize and shall be under no duty to recognize any assignment or purported assignment by an employee of his option or of any rights under his option or under the Plan.

11. **No Rights of Stockholder Until Exercise of Option.** With respect to shares of Stock subject to an option, an optionee shall not be deemed to be a stockholder, and he shall not have any of the rights or privileges of a stockholder, until such option has been exercised. With respect to an individual's Stock held by the custodian pursuant to subparagraph 7(c), the custodian shall, as soon as practicable, pay the individual any cash dividends attributable thereto and shall, in accordance with procedures adopted by the custodian, facilitate the individual's voting rights attributable thereto.

12. **Changes in Stock; Adjustments.** Whenever any change is made in the Stock, by reason of a stock dividend or by reason of subdivision, stock split, reverse stock split, recapitalization, reorganization, combination, reclassification of shares or other similar change, appropriate action will be taken by the Committee to adjust accordingly the number of shares subject to the Plan, the maximum number of shares that may be subject to any option, the number and Option Price of shares subject to options outstanding under the Plan, and the minimum Option

Price, if any, established pursuant to subparagraph 7(b) with respect to both future and outstanding options.

If the Company shall not be the surviving corporation in any merger or consolidation (or survives only as a subsidiary of another entity), or if the Company is to be dissolved or liquidated, then, unless a surviving corporation assumes or substitutes new options (within the meaning of Section 424(a) of the Code) for all options then outstanding, (i) the Date of Exercise for all options then outstanding shall

be accelerated to a date fixed by the Committee prior to the effective date of such merger or consolidation or such dissolution or liquidation and (ii) upon such effective date any unexercised options shall expire and the Company promptly shall refund to each participant the amount of such participant's payroll deductions under the Plan which have not yet been otherwise returned to him or used upon exercise of options.

13. **Use of Funds; No Interest Paid.** All funds received or held by the Company under the Plan shall be included in the general funds of the Company free of any trust or other restriction, and may be used for any corporate purpose. No interest shall be paid or credited to any participant.

14. **Term of the Plan.** The Plan shall be effective upon the date of its adoption by the Board, provided the Plan is approved by the stockholders of the Company at its 2004 annual meeting of stockholders. Notwithstanding any provision in the Plan, no option granted under the Plan shall be exercisable prior to such stockholder approval, and, if the stockholders of the Company do not approve the Plan at such meeting, then the Plan shall automatically terminate, no options may be granted or exercised under the Plan, and, automatically without any further act on the part of any participant, each payroll deduction authorization by a participant with respect to the Plan shall terminate. Except with respect to options then outstanding, if not sooner terminated under the provisions of paragraph 15, the Plan shall terminate upon and no further payroll deductions shall be made and no further options shall be granted after December 31, 2014.

15. **Termination or Amendment of the Plan.** The Board in its discretion may terminate the Plan at any time with respect to any Stock for which options have not theretofore been granted. The Board and the Committee shall each have the right to alter or amend the Plan or any part thereof from time to time, including but not limited to any alterations or amendments deemed appropriate by the Board and/or the Committee to conform the Plan to the requirements of SFAS 123 to prevent adverse accounting treatment of the Plan or the options granted thereunder or otherwise; provided, however, that no change in any option theretofore granted may be made that would impair the rights of the optionee without the consent of such optionee. Any alterations or amendments to the Plan shall be announced to participants (which may take the form of an announcement on the Company's intranet website) at least five (5) business days prior to the scheduled beginning of the first Option Period to be affected.

16. **Securities Laws.** The Company shall not be obligated to issue any Stock pursuant to any option granted under the Plan at any time when the offer, issuance or sale of shares covered by such option has not been registered under the Securities Act of 1933, as amended, or does not comply with such other state, federal or foreign laws, rules or regulations, or the requirements of any stock exchange upon which the Stock may then be listed, as the Company or the Committee deems applicable and, in the opinion of legal counsel for the Company, there is no exemption from the requirements of such laws, rules, regulations or requirements available for the offer, issuance and sale of such shares. Further, all Stock acquired pursuant to the Plan shall be subject to the Company's policies concerning compliance with securities laws and regulations, as such policies may be amended from time to time. The terms and conditions of options granted hereunder to, and the purchase of shares by, persons subject to Section 16 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), shall comply with any applicable provisions of Rule 16b-3. As to such persons, this Plan shall be deemed to contain, and such options shall contain, and the shares issued upon exercise thereof shall be subject to, such additional conditions and restrictions as may be required from time to time by Rule 16b-3 to qualify for the maximum exemption from Section 16 of the Exchange Act with respect to Plan transactions.

17. **No Restriction on Corporate Action.** Nothing contained in the Plan shall be construed to prevent the Company or any subsidiary from taking any corporate action that is deemed by the Company or such subsidiary to be appropriate or in its best interest, whether or not such action would

have an adverse effect on the Plan or any option granted under the Plan. No employee, beneficiary or other person shall have any claim against the Company or any subsidiary as a result of any such action.

18. **Miscellaneous Provisions.**

(a) **Parent and Subsidiary Corporations.** For all purposes of the Plan, a corporation shall be considered to be a parent or subsidiary corporation of the Company only if such corporation is a parent or subsidiary corporation of the Company within the meaning of Sections 424(e) or (f) of the Code.

(b) **Retirement.** For all purposes of the Plan, "retirement" shall mean separation of service with the Company or any Participating Company on or after the earlier of (i) the attainment of age 65 (or mandatory retirement age, if applicable), (ii) the attainment of age 55 with 10 years of service, or (iii) the attainment of age 50 with 20 years of service. For purposes of this definition "years of service" shall be based on the Company's adjusted service date, a measure of active service.

(c) **Number and Gender.** Wherever appropriate herein, words used in the singular shall be considered to include the plural and words used in the plural shall be considered to include the singular. The masculine gender, where appearing in the Plan, shall be deemed to include the feminine gender.

(d) **Headings.** The headings and subheadings in the Plan are included solely for convenience, and if there is any conflict between such headings or subheadings and the text of the Plan, the text shall control.

(e) **Not a Contract of Employment; No Acquired Rights.** The adoption and maintenance of the Plan shall not be deemed to be a contract between the Company or any Participating Company and any person or to be consideration for the employment of any person. Participation in the Plan at any given time shall not be deemed to create the right to participate in the Plan, or any other arrangement permitting an employee of the Company or any Participating Company to purchase Stock at a discount, in the future. The rights and obligations under any participant's terms of employment with the Company or any Participating Company shall not be affected by participation in the Plan. Nothing herein contained shall be deemed to give any person the right to be retained in the employ of the Company or any Participating Company or to restrict the right of the Company or any Participating Company to discharge any person at any time, nor shall the Plan be deemed to give the Company or any Participating Company the right to require any person to remain in the employ of the Company or such Participating Company or to restrict any person's right to terminate his employment at any time. The Plan shall not afford any participant any additional right to compensation as a result of the termination of such participant's employment for any reason whatsoever.

(f) **Compliance with Applicable Laws.** The Company's obligation to offer, issue, sell or deliver Stock under the Plan is at all times subject to all approvals of and compliance with any governmental authorities (whether domestic or foreign) required in connection with the authorization, offer, issuance, sale or delivery of Stock as well as all federal, state, local and foreign laws. Without limiting the scope of the preceding sentence, and notwithstanding any other provision in the Plan, the Company shall not be obligated to grant options or to offer, issue, sell or deliver Stock under the Plan to any employee who is a citizen or resident of a jurisdiction the laws of which, for reasons of its public policy, prohibit the Company from taking any such action with respect to such employee.

(g) **Severability.** If any provision of the Plan shall be held illegal or invalid for any reason, said illegality or invalidity shall not affect the remaining provisions hereof; instead, each provision

shall be fully severable and the Plan shall be construed and enforced as if said illegal or invalid provision had never been included herein.

(h) **Electronic and/or Telephonic Documentation and Submission.** Any of the payroll deduction authorizations, enrollment documents and any other forms and designations referenced in the Plan and their submission may be electronic and/or telephonic, as directed by the Committee.

(i) **Governing Law.** All provisions of the Plan shall be construed in accordance with the laws of Texas except to the extent preempted by federal law.

CONTINENTAL AIRLINES, INC.

PROXY FOR ANNUAL MEETING OF STOCKHOLDERS

March 12, 2004
This Proxy is Solicited on Behalf of the Board of Directors

The undersigned hereby authorizes Gordon M. Bethune, Jennifer L. Vogel, and Kristin H. Becnel and each of them, with full power of substitution, to represent and vote the stock of the undersigned in Continental Airlines, Inc. as directed and, in their sole discretion, on all other matters that may properly come before the Annual Meeting of Stockholders to be held on March 12, 2004, and at any postponement or adjournment thereof, as if the undersigned were present and voting thereat. The undersigned acknowledges receipt of the notice of annual meeting and proxy statement with respect to such annual meeting and certifies that, to the knowledge of the undersigned, all equity securities of Continental Airlines, Inc. owned of record or beneficially by the undersigned are owned and controlled only by U.S. citizens (as defined in the proxy statement), except as indicated on the reverse side hereof.

Whether or not you expect to attend the annual meeting, please vote your shares. As explained on the other side of this proxy, you may vote by internet or by telephone, or you may execute and return this proxy, which may be revoked at any time prior to its use.

This proxy, when properly executed, will be voted in the manner directed by the undersigned stockholder(s). **IF NO DIRECTION IS MADE, THIS PROXY WILL BE VOTED "*FOR*" THE ELECTION OF DIRECTORS NAMED ON THE OTHER SIDE OF THIS PROXY (PROPOSAL 1), "*FOR*" ADOPTION OF THE 2004 EMPLOYEE STOCK PURCHASE PLAN (PROPOSAL 2), "*FOR*" RATIFICATION OF AUDITORS (PROPOSAL 3), "*FOR*" THE RECOMMENDATION TO RETAIN THE STOCKHOLDERS' RIGHTS AGREEMENT (PROPOSAL 4) AND "*AGAINST*" THE STOCKHOLDER PROPOSAL (PROPOSAL 5).**

(Continued and to be signed on other side)

Address Change/Comments (Mark the corresponding box on the reverse side)

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You can now access your Continental Airlines account online.

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Mellon Investor Services LLC, agent for Continental Airlines, now makes it easy and convenient to get current information on your shareholder account. After a simple and secure process of establishing a Personal Identification Number (PIN), you are ready to log in and access your account to:

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IF NO DIRECTION IS MADE, THIS PROXY WILL BE VOTED "FOR" THE ELECTION OF DIRECTORS NAMED, "FOR" PROPOSAL 2, "FOR" PROPOSAL 3, "FOR" PROPOSAL 4 AND "AGAINST" PROPOSAL 5.

Please Mark Here for Address **o**

Change or
Comments
SEE REVERSE SIDE

1. Election of Directors: 01 Thomas J. Barrack, Jr., 02 Gordon M. Bethune, 03 Kirbyjon H. Caldwell, 04 Lawrence W. Kellner, 05 Douglas H. McCorkindale, 06 Henry L. Meyer III, 07 George G. C. Parker, 08 Karen Hastie Williams, 09 Ronald B. Woodard, 10 Charles A. Yamarone	**FOR** all nominees listed to the left (except as marked to the contrary)	**WITHHOLD AUTHORITY** to vote for all nominees listed to the left
	O	O

(Instruction: To withhold authority to vote for any nominee, write that nominee's name on the line below.)

	FOR	AGAINST	ABSTAIN
2. Proposal to Adopt 2004 Employee Stock Purchase Plan	O	O	O
3. Ratification of Independent Auditors	O	O	O
4. Proposal to Recommend Retention of Stockholders' Rights Agreement	O	O	O
5. Proposal of Stockholder	O	O	O

Please mark this box ONLY if stock owned of record or beneficially by you is owned or controlled by persons who are not U.S. citizens (as defined in the proxy statement). O

Consenting to receive all future annual meeting materials and shareholder communications electronically is simple and fast! Enroll today at www.melloninvestor.com/ISD for secure online access to your proxy materials, statements, tax documents and other important shareholder correspondence.

Signature of Stockholder(s) ____________ **Title (if applicable)** ____________ **Date** ____________

Note: Please sign exactly as name appears hereon. Joint owners should each sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such.

/*\ FOLD AND DETACH HERE /*

Vote by Internet or Telephone or Mail
24 Hours a Day, 7 Days a Week

Internet and telephone voting is available through 11:59 PM Eastern Time the day prior to annual meeting day.

Your telephone or internet vote authorizes the named proxies to vote your shares in the same manner as if you marked, signed and returned your proxy card.

Internet **http://www.eproxy.com/cal**		**Telephone** **1-800-435-6710**		**Mail**
Use the internet to vote your proxy. Have your proxy card in hand when you access the web site. You will be prompted to enter your control number, located in the box below, to create and submit an electronic ballot.	**OR**	Use any touch-tone telephone to vote your proxy. Have your proxy card in hand when you call. You will be prompted to enter your control number, located in the box below, and then follow the directions given.	**OR**	Mark, sign and date your proxy card and return it in the enclosed postage-paid envelope.

If you vote your proxy by internet or by telephone, you do NOT need to mail back your proxy card.

You can view the Annual Report and Proxy Statement
on the internet at http://www.continental.com/company/proxy