

SOUTHWEST AIRLINES CO

Form 10-Q

April 30, 2019

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2019

or

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

For the transition period from _____ to _____

Commission File No. 1-7259

Southwest Airlines Co.

(Exact name of registrant as specified in its charter)

TEXAS 74-1563240
(State or other jurisdiction of (IRS Employer
incorporation or organization) Identification No.)

P.O. Box 36611
Dallas, Texas 75235-1611

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(214) 792-4000**

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

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Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Number of shares of Common Stock outstanding as of the close of business on April 26, 2019: 543,064,878

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SOUTHWEST AIRLINES CO.
FORM 10-Q
PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Southwest Airlines Co.

Condensed Consolidated Balance Sheet

(in millions)

(unaudited)

	March 31,	December 31,
	2019	2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,344	\$ 1,854
Short-term investments	1,517	1,835
Accounts and other receivables	784	568
Inventories of parts and supplies, at cost	484	461
Prepaid expenses and other current assets	354	310
Total current assets	5,483	5,028
Property and equipment, at cost:		
Flight equipment	21,666	21,753
Ground property and equipment	5,082	4,960
Deposits on flight equipment purchase contracts	780	775
Assets constructed for others	120	1,768
	27,648	29,256
Less allowance for depreciation and amortization	9,875	9,731
	17,773	19,525
Goodwill	970	970
Operating lease right-of-use assets	1,508	—
Other assets	725	720
	\$ 26,459	\$ 26,243

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:

Accounts payable	\$ 1,412	\$ 1,416
Accrued liabilities	1,350	1,749
Current operating lease liabilities	361	—
Air traffic liability	5,029	4,134
Current maturities of long-term debt	571	606
Total current liabilities	8,723	7,905

Long-term debt less current maturities	2,602	2,771
Air traffic liability - noncurrent	985	936
Deferred income taxes	2,480	2,427
Construction obligation	120	1,701
Noncurrent operating lease liabilities	1,150	—
Other noncurrent liabilities	608	650
Stockholders' equity:		
Common stock	808	808

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Capital in excess of par value	1,513	1,510
Retained earnings	16,320	15,967
Accumulated other comprehensive income	96	20
Treasury stock, at cost	(8,946)	(8,452)
Total stockholders' equity	9,791	9,853
	\$ 26,459	\$ 26,243

See accompanying notes.

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Southwest Airlines Co.
Condensed Consolidated Statement of Comprehensive Income
(in millions, except per share amounts)
(unaudited)

	Three months ended March 31,	
	2019	2018
OPERATING REVENUES:		
Passenger	\$4,745	\$4,585
Freight	42	42
Other	362	317
Total operating revenues	5,149	4,944
OPERATING EXPENSES:		
Salaries, wages, and benefits	1,976	1,821
Fuel and oil	1,015	1,018
Maintenance materials and repairs	293	257
Landing fees and airport rentals	333	330
Depreciation and amortization	297	277
Other operating expenses	730	625
Total operating expenses	4,644	4,328
OPERATING INCOME	505	616
OTHER EXPENSES (INCOME):		
Interest expense	31	32
Capitalized interest	(9)	(10)
Interest income	(23)	(12)
Other (gains) losses, net	2	4
Total other expenses (income)	1	14
INCOME BEFORE INCOME TAXES	504	602
PROVISION FOR INCOME TAXES	117	139
NET INCOME	\$387	\$463
NET INCOME PER SHARE, BASIC	\$0.70	\$0.79
NET INCOME PER SHARE, DILUTED	\$0.70	\$0.79
COMPREHENSIVE INCOME	\$463	\$547
WEIGHTED AVERAGE SHARES OUTSTANDING		
Basic	551	587
Diluted	552	588
See accompanying notes.		

Southwest Airlines Co.
Condensed Consolidated Statement of Stockholders' Equity

(in millions, except per share amounts)
(unaudited)

	Quarter ended March 31, 2018					Total
	Common Stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	
Balance at December 31, 2017	\$ 808	\$ 1,451	\$ 13,832	\$ 12	\$(6,462)	\$ 9,641
Cumulative effect of adopting Accounting Standards Update No. 2017-12, Targeted Improvements to Accounting for Hedging Activities	—	—	18	(18)	—	—
Repurchase of common stock	—	—	—	—	(500)	(500)
Issuance of common and treasury stock pursuant to Employee stock plans	—	(9)	—	—	5	(4)
Share-based compensation	—	10	—	—	—	10
Cash dividends, \$.125 per share	—	—	(75)	—	—	(75)
Comprehensive income	—	—	463	84	—	547
Balance at March 31, 2018	\$ 808	\$ 1,452	\$ 14,238	\$ 78	\$(6,957)	\$ 9,619

	Quarter ended March 31, 2019					Total
	Common Stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	
Balance at December 31, 2018	\$ 808	\$ 1,510	\$ 15,967	\$ 20	\$(8,452)	\$ 9,853
Cumulative effect of adopting Accounting Standards Update No. 2016-02, Leases, codified in Accounting Standards Codification 842 (See Note 2)	—	—	55	—	—	55
Repurchase of common stock	—	—	—	—	(500)	(500)
Issuance of common and treasury stock pursuant to Employee stock plans	—	(10)	—	—	6	(4)
Share-based compensation	—	13	—	—	—	13
Cash dividends, \$.160 per share	—	—	(89)	—	—	(89)
Comprehensive income	—	—	387	76	—	463
Balance at March 31, 2019	\$ 808	\$ 1,513	\$ 16,320	\$ 96	\$(8,946)	\$ 9,791

See accompanying notes.

Southwest Airlines Co.
Condensed Consolidated Statement of Cash Flows
(in millions)
(unaudited)

	Three months ended March 31,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 387	\$ 463
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Depreciation and amortization	297	277
Unrealized/realized gains on fuel derivative instruments	—	(7)
Deferred income taxes	13	72
Changes in certain assets and liabilities:		
Accounts and other receivables	(222)	(15)
Other assets	29	(178)
Accounts payable and accrued liabilities	(257)	(501)
Air traffic liability	944	866
Other liabilities	(69)	—
Cash collateral received from derivative counterparties	15	65
Other, net	(32)	(40)
Net cash provided by operating activities	1,105	1,002
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(160)	(409)
Assets constructed for others	—	(24)
Purchases of short-term investments	(251)	(200)
Proceeds from sales of short-term and other investments	575	560
Net cash provided by (used in) investing activities	164	(73)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from Employee stock plans	10	9
Reimbursement for assets constructed for others	—	139
Payments of long-term debt and finance lease obligations	(99)	(82)
Payments of cash dividends	(178)	(148)
Repayment of construction obligation	—	(7)
Repurchase of common stock	(500)	(500)
Other, net	(12)	(13)
Net cash used in financing activities	(779)	(602)
NET CHANGE IN CASH AND CASH EQUIVALENTS	490	327
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,854	1,495
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 2,344	\$ 1,822
CASH PAYMENTS FOR:		
Interest, net of amount capitalized	\$ 15	\$ 18
Income taxes	\$ 4	\$ 4

SUPPLEMENTAL DISCLOSURE OF NONCASH TRANSACTIONS

Flight equipment under finance leases	\$1	\$14
Assets constructed for others	\$21	\$40
See accompanying notes.		

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Southwest Airlines Co.
Notes to Condensed Consolidated Financial Statements
(unaudited)

1. BASIS OF PRESENTATION

Southwest Airlines Co. (the "Company" or "Southwest") operates Southwest Airlines, a major passenger airline that provides scheduled air transportation in the United States and near-international markets. The unaudited Condensed Consolidated Financial Statements include accounts of the Company and its wholly owned subsidiaries.

The accompanying unaudited Condensed Consolidated Financial Statements of the Company and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles in the United States ("GAAP") for complete financial statements. The unaudited Condensed Consolidated Financial Statements for the interim periods ended March 31, 2019 and 2018 include all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods. This includes all normal and recurring adjustments and elimination of significant intercompany transactions. Financial results for the Company and airlines in general can be seasonal in nature. In many years, the Company's revenues, as well as its Operating income and Net income, have been better in its second and third fiscal quarters than in its first and fourth fiscal quarters. Air travel is also significantly impacted by general economic conditions, the amount of disposable income available to consumers, unemployment levels, corporate travel budgets, extreme or severe weather and natural disasters, fears of terrorism or war, and other factors beyond the Company's control. These and other factors, such as the price of jet fuel in some periods, the nature of the Company's fuel hedging program, and the periodic volatility of commodities used by the Company for hedging jet fuel, have created, and may continue to create, significant volatility in the Company's financial results. See Note 3 for further information on fuel and the Company's hedging program. Operating results for the three months ended March 31, 2019, are not necessarily indicative of the results that may be expected for future quarters or for the year ended December 31, 2019. For further information, refer to the Consolidated Financial Statements and footnotes thereto included in the Southwest Airlines Co. Annual Report on Form 10-K for the year ended December 31, 2018.

Effective as of January 1, 2019, the Company adopted Accounting Standards Update ("ASU") No. 2016-02, Leases, codified in Accounting Standards Codification ("ASC") 842 (the "New Lease Standard"). All amounts and disclosures set forth in this Form 10-Q for first quarter 2019 reflect the adoption of this ASU, while all periods prior to 2019 remain in accordance with prior accounting requirements. See Note 2 for further information.

2. NEW ACCOUNTING PRONOUNCEMENTS

On August 29, 2018, the Financial Accounting Standards Board (the "FASB") issued ASU No. 2018-15, Intangibles—Goodwill and Other—Internal-Use Software. This new standard requires a customer in a cloud computing arrangement that is a service contract to follow the internal-use software guidance in ASC 350-40, Accounting for Internal-Use Software, to determine which implementation costs to (i) capitalize as assets and amortize over the term of the hosting arrangement or (ii) expense as incurred. This new standard is effective for public business entities in fiscal years beginning after December 15, 2019. Early adoption is permitted, including during an interim period. Entities have the option to apply this standard prospectively to all implementation costs incurred after the date of adoption or retrospectively. The Company is evaluating this new standard, but does not expect it to have a significant impact on its financial statement presentation or results.

On August 28, 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement. This standard is effective for public business entities in fiscal years beginning after December 15, 2019, and for interim periods within those years. Early adoption is permitted, including during an interim period. This new standard requires changes to the disclosure requirements for fair value measurements for certain Level 3 items, and specifies that some of the changes must be applied prospectively, while others should be applied retrospectively. The Company is evaluating this new standard, but does not expect it to have a significant impact on its financial statement disclosures. See Note 8 for further information

Southwest Airlines Co.
Notes to Condensed Consolidated Financial Statements
(unaudited)

on the Company's fair value measurements.

On February 25, 2016, the FASB issued the New Lease Standard. The New Lease Standard requires lessees to recognize a right-of-use asset and a lease liability on the balance sheet for all leases (with the exception of short-term leases, as defined in the New Lease Standard) at the lease commencement date and recognize expenses on the income statement in a similar manner to the legacy guidance in ASC 840, Leases ("ASC 840"). The lease liability is measured as the present value of the unpaid lease payments and the right-of-use asset will be derived from the calculation of the lease liability. Lease payments include fixed and in-substance fixed payments, variable payments based on an index or rate, reasonably certain purchase options, termination penalties, fees paid by the lessee to the owners of a special-purpose entity for restructuring the transaction, and probable amounts the lessee will owe under a residual value guarantee. Lease payments do not include (i) variable lease payments other than those that depend on an index or rate, (ii) any guarantee by the lessee of the lessor's debt, or (iii) any amount allocated to non-lease components, if such election is made upon adoption, per the provisions of the New Lease Standard.

The Company adopted the provisions of the New Lease Standard effective January 1, 2019, using the modified retrospective adoption method, utilizing the simplified transition option available in the New Lease Standard, which allows entities to continue to apply the legacy guidance in ASC 840, including its disclosure requirements, in the comparative periods presented in the year of adoption. The Company elected the package of practical expedients available under the transition provisions of the New Lease Standard, including (i) not reassessing whether expired or existing contracts contain leases, (ii) not reassessing lease classification, and (iii) not revaluing initial direct costs for existing leases.

In addition, the New Lease Standard eliminated the previous build-to-suit lease accounting guidance and resulted in derecognition of build-to-suit assets and liabilities that remained on the balance sheet after the end of the construction period, including the related deferred taxes. However, given the Company's guarantee associated with the bonds issued to fund the Dallas Love Field Modernization Program (the "LFMP"), the remaining debt service amount as of the adoption date was considered a minimum rental payment under the New Lease Standard, and therefore was recorded as a lease liability on the unaudited Condensed Consolidated Balance Sheet that will be reduced through future debt service payments made in 2019 and beyond. See Note 7 for disclosures related to the New Lease Standard, and Note 10 for further information on the Company's build-to-suit projects.

Southwest Airlines Co.
Notes to Condensed Consolidated Financial Statements
(unaudited)

The following table provides the unaudited Condensed Consolidated Balance Sheet impact of applying the New Lease Standard effective as of January 1, 2019. The impact to the Company's results of operations and cash flows was not significant:

<u>(in millions)</u>	Balance as of January 1, 2019		
	Balances removed under prior accounting	Balances added under New Lease Standard	Net impact of New Lease Standard
Prepaid expenses and other current assets	\$ 1	\$ —	\$ (1)
Flight equipment	—	(110)	(110)
Assets constructed for others	1,669	—	(1,669)
Less allowance for depreciation and amortization	(166)	(2)	164
Operating lease right-of-use assets	—	1,466	1,466
Other assets	121	—	(121)
Total assets	\$ 1,625	\$ 1,354	\$ (271)
Accounts payable	\$ 8	\$ —	\$ (8)
Accrued liabilities	37	—	(37)
Current operating lease liabilities	—	355	355
Current maturities of long-term debt	—	(14)	(14)
Long-term debt less current maturities	—	(96)	(96)
Deferred income taxes	(17)	—	17
Construction obligation	1,602	—	(1,602)
Noncurrent operating lease liabilities	—	1,119	1,119
Other noncurrent liabilities	60	—	(60)
Retained earnings	(65)	(10)	55
Total liabilities and stockholders' equity	\$ 1,625	\$ 1,354	\$ (271)

3. FINANCIAL DERIVATIVE INSTRUMENTS

Fuel contracts

Airline operators are inherently dependent upon energy to operate and, therefore, are impacted by changes in jet fuel prices. Furthermore, jet fuel and oil typically represents one of the largest operating expenses for airlines. The Company endeavors to acquire jet fuel at the lowest possible cost and to reduce volatility in operating expenses through its fuel hedging program. Although the Company may periodically enter into jet fuel derivatives for short-term timeframes, because jet fuel is not widely traded on an organized futures exchange, there are limited opportunities to hedge directly in jet fuel for time horizons longer than approximately 24 months into the future. However, the Company has found that financial derivative instruments in other commodities, such as West Texas Intermediate ("WTI") crude oil, Brent crude oil, and refined products, such as heating oil and unleaded gasoline, can be useful in decreasing its exposure to jet fuel price volatility. The Company does not purchase or hold any financial derivative instruments for trading or speculative purposes.

The Company has used financial derivative instruments for both short-term and long-term timeframes, and primarily uses a mixture of purchased call options, collar structures (which include both a purchased call option and a sold put option), call spreads (which include a purchased call option and a sold call option), put spreads (which include a purchased put option and a sold put option), and fixed price swap agreements in its portfolio. Although the use of collar structures and swap agreements can reduce the overall cost of hedging, these instruments carry more risk than purchased call options in that the Company could end up in a liability position when the collar structure or swap agreement settles.

Southwest Airlines Co.
Notes to Condensed Consolidated Financial Statements
(unaudited)

With the use of purchased call options and call spreads, the Company cannot be in a liability position at settlement, but does not have coverage once market prices fall below the strike price of the purchased call option.

For the purpose of evaluating its net cash spend for jet fuel and for forecasting its future estimated jet fuel expense, the Company evaluates its hedge volumes strictly from an "economic" standpoint and thus does not consider whether the hedges have qualified or will qualify for hedge accounting. The Company defines its "economic" hedge as the net volume of fuel derivative contracts held, including the impact of positions that have been offset through sold positions, regardless of whether those contracts qualify for hedge accounting. The level at which the Company is economically hedged for a particular period is also dependent on current market prices for that period, as well as the types of derivative instruments held and the strike prices of those instruments. For example, the Company may enter into "out-of-the-money" option contracts (including "catastrophic" protection), which may not generate intrinsic gains at settlement if market prices do not rise above the option strike price. Therefore, even though the Company may have an economic hedge in place for a particular period, that hedge may not produce any hedging gains at settlement and may even produce hedging losses depending on market prices, the types of instruments held, and the strike prices of those instruments.

For the three months ended March 31, 2019, the Company had fuel derivative instruments in place for up to 84 percent of its fuel consumption. As of March 31, 2019, the Company also had fuel derivative instruments in place to provide coverage at varying price levels, but up to a maximum of approximately 67 percent of its remaining 2019 estimated fuel consumption, depending on where market prices settle. The following table provides information about the Company's volume of fuel hedging on an economic basis considering current market prices:

Period (by year)	Maximum fuel hedged as of March 31, 2019 (gallons in millions)	Derivative underlying commodity type as of March 31, 2019
Remainder of 2019	1,103	WTI crude and Brent crude oil
2020	1,301	WTI crude oil, Brent crude oil, and Heating oil
2021	698	WTI crude and Brent crude oil
2022	88	WTI crude oil

(a) Due to the types of derivatives utilized by the Company and different price levels of those contracts, these volumes represent the maximum economic hedge in place and may vary significantly as market prices fluctuate.

Upon proper qualification, the Company accounts for its fuel derivative instruments as cash flow hedges. All periodic changes in fair value of the derivatives designated as hedges are recorded in Accumulated other comprehensive income (loss) ("AOCI") until the underlying jet fuel is consumed. See Note 4.

The Company's results are subject to the possibility that the derivatives will no longer qualify for hedge accounting, in which case any change in the fair value of derivative instruments since the last reporting period would be recorded in Other (gains) losses, net, in the unaudited Condensed Consolidated Statement of Comprehensive Income in the period

of the change; however, any amounts previously recorded to AOCI would remain there until such time as the original forecasted transaction occurs, at which time these amounts would be reclassified to Fuel and oil expense. Factors that have and may continue to lead to the loss of hedge accounting include: significant fluctuation in energy prices, significant weather events affecting refinery capacity and the production of refined products, and the volatility of the different types of products the Company uses in hedging. Increased volatility in these commodity markets for an extended period of time, especially if such volatility were to worsen, could cause the Company to lose hedge accounting altogether for the commodities used in its fuel hedging program, which would create further volatility in the Company's GAAP financial results. However, even though derivatives may not qualify for hedge accounting, the Company continues to hold the instruments as management believes derivative instruments continue to afford the Company the opportunity to stabilize jet fuel costs. When the Company has sold derivative positions in order to effectively "close" or offset a derivative already held as part of its fuel derivative instrument portfolio, any subsequent

Southwest Airlines Co.
Notes to Condensed Consolidated Financial Statements
(unaudited)

changes in fair value of those positions are marked to market through earnings. Likewise, any changes in fair value of those positions that were offset by entering into the sold positions and were de-designated as hedges are concurrently marked to market through earnings. However, any changes in value related to hedges that were deferred as part of AOCI while designated as a hedge would remain until the originally forecasted transaction occurs. In a situation where it becomes probable that a fuel hedged forecasted transaction will not occur, any gains and/or losses that have been recorded to AOCI would be required to be immediately reclassified into earnings. The Company did not have any such situations occur during 2018, or during the three months ended March 31, 2019.

All cash flows associated with purchasing and selling fuel derivatives are classified as Other operating cash flows in the unaudited Condensed Consolidated Statement of Cash Flows. The following table presents the location of all assets and liabilities associated with the Company's derivative instruments within the unaudited Condensed Consolidated Balance Sheet:

	Balance Sheet location	Asset derivatives		Liability derivatives	
		Fair value at 3/31/2019	Fair value at 3/31/2018	Fair value at 3/31/2019	Fair value at 3/31/2018
(in millions)					
Derivatives designated as hedges (a)					
Fuel derivative contracts (gross)	Prepaid expenses and other current assets	\$ 104	\$ 43	\$ —	\$ —
Fuel derivative contracts (gross)	Other assets	150	95	—	—
Interest rate derivative contracts	Accrued liabilities	—	—	15	2
Interest rate derivative contracts	Other noncurrent liabilities	—	—	8	12
Total derivatives designated as hedges		\$ 254	\$ 138	\$ 23	\$ 14

(a) Represents the position of each trade before consideration of offsetting positions with each counterparty and does not include the impact of cash collateral deposits provided to or received from counterparties. See discussion of credit risk and collateral following in this Note.

The following table presents the amounts recorded on the unaudited Condensed Consolidated Balance Sheet related to fair value hedges:

<u>Balance Sheet location of hedged item</u>	Carrying amount of the hedged liabilities	Cumulative amount of fair value hedging adjustment included in the carrying amount of the hedged liabilities (a)	
		March 31, 2019	March 31, 2018
(in millions)			
Current maturities of long-term debt	\$ 300	\$ —	\$ 2
Long-term debt less current maturities	495	784	13

\$795 \$784 \$ 15 \$ 5

(a) At March 31, 2019 and 2018, these amounts include the cumulative amount of fair value hedging adjustments remaining for which hedge accounting has been discontinued of \$20 million and \$21 million, respectively.

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In addition, the Company also had the following amounts associated with fuel derivative instruments and hedging activities in its unaudited Condensed Consolidated Balance Sheet:

<u>(in millions)</u>	Balance Sheet location	March December	
		31, 2019	31, 2018
Cash collateral deposits held from counterparties for fuel contracts - current	Offset against Prepaid expenses and other current assets	\$ 15	\$ —
Due to third parties for fuel contracts	Accounts payable	7	—
Receivable from third parties for fuel contracts	Accounts and other receivables	6	2

All of the Company's fuel derivative instruments and interest rate swaps are subject to agreements that follow the netting guidance in the applicable accounting standards for derivatives and hedging. The types of derivative instruments the Company has determined are subject to netting requirements in the accompanying unaudited Condensed Consolidated Balance Sheet are those in which the Company pays or receives cash for transactions with the same counterparty and in the same currency via one net payment or receipt. For cash collateral held by the Company or provided to counterparties, the Company nets such amounts against the fair value of the Company's derivative portfolio by each counterparty. The Company has elected to utilize netting for both its fuel derivative instruments and interest rate swap agreements and also classifies such amounts as either current or noncurrent, based on the net fair value position with each of the Company's counterparties in the unaudited Condensed Consolidated Balance Sheet.

The Company's application of its netting policy associated with cash collateral differs depending on whether its derivative instruments are in a net asset position or a net liability position. If its fuel derivative instruments are in a net asset position with a counterparty, cash collateral amounts held are first netted against current outstanding derivative asset amounts associated with that counterparty until that balance is zero, and then any remainder is applied against the fair value of noncurrent outstanding derivative instruments. If the Company's fuel derivative instruments are in a net liability position with the counterparty, cash collateral amounts provided are first netted against noncurrent outstanding derivative amounts associated with that counterparty until that balance is zero, and then any remainder is applied against the fair value of current outstanding derivative instruments.

The Company has the following recognized financial assets and financial liabilities resulting from those transactions that meet the scope of the disclosure requirements as necessitated by applicable accounting guidance for balance sheet offsetting:

Offsetting of derivative assets
(in millions)

Description	Balance Sheet location	(i)	(ii)	(iii) = (i) + (ii)	(i)	(ii)	(iii) = (i) + (ii)
		March 31, 2019			December 31, 2018		
		Gross amounts of recognized assets	Gross amounts offset in Balance Sheet	Net amounts presented in the Balance	Gross amounts of recognized assets	Gross amounts offset in Balance Sheet	Net amounts presented in the Balance

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				Sheet				Sheet
Fuel derivative contracts	Prepaid expenses and other current assets	\$ 104	\$ (15)	\$ 89	\$ 43	\$	—	\$ 43
Fuel derivative contracts	Other assets	\$ 150	\$ —	\$ 150	(a)\$ 95	\$	—	\$ 95 (a)

(a) The net amounts of derivative assets and liabilities are reconciled to the individual line item amounts presented in the unaudited Condensed Consolidated Balance Sheet in Note 9.

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Offsetting of derivative liabilities
(in millions)

Description	Balance Sheet location	March 31, 2019			December 31, 2018		
		(i) Gross amounts of the recognized liabilities of the Balance Sheet	(ii) Gross amounts offset in the Balance Sheet	(iii) = (i) + (ii) Net amounts of liabilities presented in the Balance Sheet	(i) Gross amounts of the recognized liabilities of the Balance Sheet	(ii) Gross amounts offset in the Balance Sheet	(iii) = (i) + (ii) Net amounts of liabilities presented in the Balance Sheet
Interest rate derivative contracts	Accrued liabilities	\$ 15	\$ —	\$ 15	\$ 2	\$ —	\$ 2
Interest rate derivative contracts	Other noncurrent liabilities	\$ 8	\$ —	\$ 8	\$ 12	\$ —	\$ 12

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