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EDITED TRANSCRIPT

Alaska Air Group Inc Investor Day

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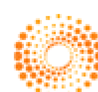

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PRESENTATION

Matt Grady ***Alaska Air Group, Inc. - Director of IR***

Good morning, everyone. Hope you enjoyed the video. We're pleased to be able to give you a sense for our history and where we've come from. Over the last 80 years, there's obviously been a lot that's taken place. And today, we're probably just going to talk about the last couple of years and where we're going over the next couple.

But I wanted to officially welcome everyone to Alaska Air Group's 2018 Investor Day. Thank you all for taking the time out of your busy schedules to be here with us and to hear an update from our leadership team on what we've been up to of late and where we're headed as an organization over the next 2 to 3 years.

Hosting this event in New York, we recognize that we likely traveled further than many of you did today. We took a 6-hour flight, and some of you probably walked here. One investor emailed me a few days ago saying he was excited about the event location because it was located directly across the street from his office. So I certainly hope that gentleman is here today because he has very little excuse not to be. But no, it is great, it's wonderful, that's why we host the event here. The whole reason we do it is so that we ensure as many folks as possible that would like to attend are able to do so in person.

I'm sure there are many people here as well who traveled quite a great distance to be here. Thank you very much for making the trip. And I'm also sure that many of us still have some fond memories of turkey and other Thanksgiving favorites still in our minds, and if we don't, that's because we probably already moved ahead to whatever the next holiday is that we're going to be celebrating within the next few weeks. It's a busy time of the year and we appreciate you making the time.

The same goes to our folks that are watching and listening in online over the webcast. For those not here in person, you will have almost as good a time as the folks present with us today. You will definitely be able to listen to all of our comments and the Q&A conversation later, and you have access to all of our presentation materials. As the slides move in the room, they will move for you as well on the webcast. I should note, however, there will be a couple of short videos played in the room today that unfortunately you will not be able to view. And at the end of the event, you will also miss out on the raffle and the other giveaways we have planned. So the folks present will have just a little bit more fun than the folks listening from far, but we expect you will enjoy the event regardless of your location today.

Before Brad comes up to make some opening remarks, I did want to quickly walk through today's agenda and I'm going to queue next slide. There it is. Presentations will last for the next 2 hours until about 1:30. We have 6 brief but closely related presentations prepared for you today, all of which will tie back to our main theme of how we plan to improve our margin performance in the years ahead.

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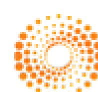

You'll be hearing from our CEO, Brad Tilden; our President and COO, Ben Minicucci; our VP of People, Andy Schneider; our EVP of Strategy and Planning, Shane Tackett; our Chief Commercial Officer, Andrew Harrison; and our Chief Financial Officer, Brandon Pedersen. And as you probably noted by now, many other leaders from Alaska are also in the room today to help answer your questions once the formal presentations have concluded. We hope you take advantage of the large group that we have here from Seattle today.

Immediately following the fourth presentation, or Shane's presentation, we'll take a 10-minute break before reconvening for the final 2 presentations. From there, we'll hold 45 minutes of Q&A, concluding around 2:15 when we'll get to those giveaways that I mentioned before. I realize this is largely an East Coast audience today, but we will be raffling off a basketball signed by Kevin Durant. If you -- I'm sure there are some folks that would like to win that and if you would like to make sure your name's in the drawing, you can place a business card at the registration desk, and we will be choosing from the business cards that we have and there will be a winner named later. Finally, at 2:30, right around 2:30, Brad will come back up for some concluding remarks and to close us out.

Okay. And finally, as is my duty, I'd like you to note the safe harbor statement that is now up on the screen. As a reminder, our comments today will include forward-looking statements regarding our future performance, which may differ materially from our actual results. Though, of course, we hope they don't, unless we exceed them! Information on risk factors that could affect our business can be found in our SEC filings. We will also refer to certain non-GAAP financial measures such as adjusted earnings and unit costs excluding fuel. As usual, a reconciliation between the most directly comparable GAAP and non-GAAP measures can be found in our quarterly earnings releases and also in our regular SEC filings.

Okay. And with that item out of the way, it's my pleasure to turn today's presentation over to our CEO, Brad Tilden.

Bradley D. Tilden ***Alaska Air Group, Inc. - Chairman, CEO & President***

Thanks very much, Matt. Good morning, everybody. Matt, thanks for that -- for kicking this off, and I just want to take a minute to thank you right now for all of the work you've done to get us ready for this Investor Day. We are super glad to be with you all again for another Investor Day. I think, it was about 18 months ago when we were last with you. That would have been just a few months after the closing of our transaction with Virgin America. So we are about 2 years into it now, and we're really, really happy to be here and give you an update on the company on how that's going. As the video shows -- by the way, that's the video that we've produced for our employees to give them a sense of the great heritage that the company has. But as the video shows, we're really proud of Alaska. We are proud of what we build, and we're really excited to be here with you, to talk to you a little bit about our sense of the industry that we're competing in, the plans that we put together to help this business prosper in the environment that we have today.

We're also excited to have some back-and-forth and have your input from you all. We've said this before, but this company gets better because of you all and because of your questions, your interest and your -- the consistent challenging of the leadership team so that we can be at our best.

The big themes, I think, for this year's Investor Day are as follows; one is that we're getting through the merger. We're moving from things like computer systems and figuring out the brands, converting customers, getting a single operating certificate with the FAA, negotiating joint collective bargaining agreements, working with our unions to get joint seniority lists. We're moving from those things to things that are fully within our control to harvest the benefits of this substantial investment. That's -- we believe that we passed through an inflection point in the last few months, and we're now moving to harvest time and to realizing the benefits of this merger.

I just mentioned labor. I think we've got more work to do on the culture side of the business. Ben and Andy will talk about that, but we're very happy that if the mechanics ratify their agreement, we will have joint collective bargaining agreements and joint seniority lists in place for all of our labor groups.

We have always loved the geographies where this company operates and that gets even better with the Virgin America acquisition. Andrew and others will talk to you about our strength up and down the West Coast, about the presence we have in our hubs and then our key cities.

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And before I go further, I've got 6 or 8 slides that I'm going to take you through that cover our various stakeholders. They take you through our team. We'll talk to you about our advantage, our network, some of our -- a bit on financial performance. But before we get further into that, I do want to take a minute and thank in addition to Matt, Susan Ewbank and Paula Marchitto. They may be outside the room right now, but they've had a lot to do with this, and I also want to welcome to this group some of our flight attendants and pilots: Cassie Dole, Jennifer Kelsey, Rob Alan, Jake Jones, Brian Burks, Jared Haddock. I probably missed 1 or 2, but these folks are all here. We're happy you're here. For the analysts and investors in the business, these are folks that, if you have a question about how the merger is going, I encourage you to -- they're truth tellers. They'll keep us honest, and I encourage you to ask questions to any of us, including them.

Okay. So moving into the slides. Every business talks about this, but these are our various stakeholders. One of the things that I believe about airlines is we are probably far more visible than most other businesses. So if you're running your business in a way where everybody gets better as you move forward or not, it's probably more visible in our industry than in others. But our simple idea is that we try to make this a fantastic place for our people to spend their careers. We want them to be compensated well. We want them to have great benefits. We do need to be very, very productive. We want them to feel empowered. We want them to feel like they can sort of realize their life dreams while working here. Our belief is that if we do that well, our people will do a great job of taking care of our guests and that has panned out year after year after year as the video shows. If we can do these things, we can do a good job taking care of you, our owners, and we also take -- we try to do the right thing with our communities along the way. It's -- I do think Alaska has been unique. Airlines have been challenged by this, but I think Alaska, if you look at us over the decade, it's always -- it is hard to keep these groups one by one sort of happy in the short run, but what we strive to do is over time, over 5, 10, 15 years when you look back as an owner of the business, as a community, as an employee, we want this to have been a great investment or a great place for you to have spent your career. That's the basic idea. That's what we're trying to do.

I want to talk a minute about our team. I think if this will advance. Here, you'll see the executive committee. I'm not going to talk about each of these folks individually. I think what I will do is talk -- we did a leadership change in the last few months. I think we announced it in August and I might talk about that for a minute. Ben Minicucci is our President and Chief Operating Officer, extremely very, very talented leader. Ben is known for being great with process and really sort of -- really robust procedures, tracking many, many metrics. Ben, I will tell you, is also a great people leader. He is a very empowering leader. He's done great with the teams that he's had, and we're really excited for Ben to get more involved with the commercial side of the business, with revenue management, with schedule planning, with marketing, those sorts of areas. That's an important change.

Shane Tackett is -- Shane, you're right here. Shane's been in the company for a long time. He is now Executive Vice President of Planning and Strategy. The simple idea here is that airlines have an extraordinary amount of algebra and it's going to be Shane's challenge to make sure that we're moving forward in a coordinated way. So what airplanes we fly, where we fly them, not the details of revenue management, but what revenue products we have, how we think about ancillary offers, our resources, our fleets, the cost side of the business, the productivity side of the business, after utilization, these are all areas that we're going to bring together underneath Shane. He's definitely earned this with a terrific job. He's earned this responsibility with the terrific job he's done with the company. Shane will also be responsible for labor relations, an extraordinarily important function in an airline, and Shane, I know you'll do great there.

I might just talk about 2 other folks that are affected by this. Andrew Harrison will continue as Chief Commercial Officer. Many of you know Andrew from our conference calls and other settings. Extraordinarily passionate and talented leader. A lot of this company's success and benefit, a lot of the network growth and the commercial growth is directly a function of Andrew's skill and passion and dedication. Andrew, we're so glad that you're part of the team. And, of course, Brandon is a world-class CFO, and where is Brandon sitting? And Brandon will continue in that role.

Next we have some other folks here as well, other leaders, I think, I hope, but these folks run our airports. They run flight operations, marketing, sales, other functions. We're here to answer any questions that you have.

For those many of you, our old friends, some of you I've known for 20 or 25 years, but for those new to the story, this slide basically is the Alaska story. This is our competitive advantage. We think it's a durable, competitive advantage and simply going through these panels slide by slide, low cost and low fares. Andrew will tell you our fares are $35, $40, $45 on a -- lower than the big 3 airlines on a one-way

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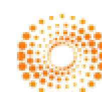

basis, and we can do that because we operate with lower overhead, and we operate in a highly productive fashion. We have excellent operations. Ben has done a -- I would say that something that's really become a real strength of Alaska in the last 10 or 12 years is Ben has taken leadership of that area. Award-winning service. We sometimes call it genuine and caring service. This, I would say, is a 30-, 40-, 50-year strength of the company, and we're really proud of things like the 11 years of J.D. Power, the Condé Nast awards, and so forth, but great customer service. We have an incredible loyalty program. We pride ourselves, and the program being extremely generous, and folks will talk about that more. And then finally, this notion of 1 team, of a culture where we're all working together. That is a challenge in airlines. I think everyone here knows that can be a challenge in airlines and is something that we work hard on. Our company is getting larger. We're 22,000 or 23,000 people today. So it's something that we're actually spending as much energy and time on today as we have in recent years. As we move forward, I think -- we got to push this thing a little bit harder.

You saw some of this in the video, but we're really, really proud of the route network. Here we are at the time of 9/11, mainly a north-south network, and then with the growth at 9/11, where we went east. In 2007, 2008, we went to Hawaii. That's now 30 flights a day, then we grew into the Mid-Con. In the 2012-13, we really filled out Seattle and then recently, we've done more Central America, and so forth. But as the route network that we're extraordinarily proud of, we are 5x larger than we were 20 years ago, so this -- Andrew will talk more about that, but we pride ourselves in responsible growth, and we pride ourselves in providing something that does bring value to all of our stakeholders, so that we can continue growing.

Okay. So second to last slide from me. We have a long record of fantastic financial performance. On the left column, you can see airlines generally over the 8- or 9-year period from 2010 to 2018, the middle column is high-quality industrials and on the right, this is Alaska Airlines, how we performed. I might talk for a brief moment about our leadership team. I think the senior leaders of Alaska are people-people. We spend a lot of time with our frontline employees. We spend a lot of time running the airline and doing the things that make Alaska a great airline, but we also have a lot of folks who do have good finance backgrounds, and we know that the only way that we can be a good airline over time is by being a good airline for customers, for employees and for the owners of the business, and I think that helped us with this fantastic financial performance over time.

Last slide from me is our roadmap for margin improvement. As we've talked about, we are coming up on in the next couple of weeks the 2-year anniversary of closing the merger with Virgin America. We've had hundreds of systems that we combined. We've done a lot of the messiest work of the integration, and it's now time to really bring together 1 culture and to really focus on market and financial performance. Our mentality of what we should be doing is we should be earning margins of 13% to 15% on a pretax basis. That's our belief of what we should do. In terms of the way we do the math, that's 400 or 500 basis points higher than our cost of capital and that's sort of an appropriate return, we believe, for a good quality, high-quality industrial company. So that's what we're attempting to do.

The team is going to take you through these, but what you are going to see are detailed plans for merger synergies, revenue synergies, operational efficiencies and support functions. There's targets that we will set to you over the next couple of years. And then at the end, Brandon is going to share with you targets that we are setting for ourselves in 2019. So we're very excited for you all to be here. We're excited to take you through our plan for the future, and then we're excited to have some good conversation with you about -- and address whatever questions that you might have.

With that, I'm going to turn it over to our President, Ben Minicucci. Ben?

Benito Minicucci ***Alaska Air Group, Inc. - President & COO of Alaska Airlines Inc and CEO of Virgin America Inc***

Thanks, Brad, and hello, everyone. It's great to see everybody. As all of you know, it's been an incredibly busy 2 years at Alaska. One question we get asked a lot and we get asked this question from employees and customers and some of you in the room, is knowing what we know today, would we do this merger again? And one of the reasons we get asked that question is because Alaska was doing extremely well prior to the merger. Let me run through just some stats on what that looked like. So we had a great market share at the Pacific Northwest. We were leading the industry in on-time performance. We won our ninth J.D. Power in 2016. We had strong loyalty growth. We had a strong track record of CASM reduction for 6 straight years, and of course, we had a stellar balance sheet. And that resulted in strong annual EPS growth and a lot of capital returned to shareholders. So the question was why did we want to do a merger and screw that up because mergers are complicated. Mergers drive risk, and it's true, they are risky. And we've seen our share of some challenges through it, but what I can tell you is this company has grown stronger because of what we've undergone in the last 2 years.

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And we've had a lot of successes and one that I actually do want to point out, which is one I think I'm most proud of is, in the 2 years during this merger, we have continued to win customer service awards. And when you think about the challenge of bringing 2 companies together and everything we're trying to implement in terms of systems, we won our 11th J.D. Power last May. And just last month, we won for the first time as the new Alaska, we won Condé Nast as the best U.S. airline and this was an award that Virgin America had won 10 times previously. So to do this, I'm incredibly proud in these employees sitting in the tables, and it's because of them, our culture and our balance that made this happen and the incredible leadership team that goes along with it, so just a big shout out to them.

So given that, would we do this merger again? And the answer is, yes. And let me run you through a little bit of the reasons why. Let me remind you why we did this merger. In 2006, the big 4 of today had 57% domestic market share. By 2016, through massive consolidation, they had 84% of the domestic market share. That's not to say, we hadn't grown as well. We had grown a lot. We were one of the fastest-growing airlines over that period, and we grew over a 100 markets, and you could see that our relevance was really high in the Pacific Northwest, 65%, which means if you're a customer in the Pacific Northwest, we can take you to 65% of the places you want to fly on a nonstop basis. But we knew that -- and from our relative perspective that our market position was declining with all of this massive consolidation, so what were we going to do? We wanted to look for opportunities to grow and the question was where would you want to grow. And if you look at we already had a presence in California. It wasn't big, but we had relevance of 19%. We knew California. We were operating there for a long time and we knew some of the hubs that we wanted to go into. The question became California is -- and the LAs and San Franciscos were overcapacity. It's tough to grow organically in an LA and San Francisco and put airplanes in there when you're limited on gates and airspace and real estate. So the only real option for us was the acquisition route. So if we wanted to grow in California, we wanted to do an acquisition. The only airline that made sense for us was Virgin America. And let me show you what Virgin America brought to us.

Today, we have an extremely powerful West Coast network from Anchorage to Seattle to Portland to San Francisco in the Bay, Los Angeles, San Diego. If you look at our relevance, we are one of -- we have one of the highest relevance across the West Coast. And just look at some of the departures, we've increased in L.A. and in San Francisco, those are just big increases in the departure since 2016. Now one fact that you may not know is that we have 30 departures in the New York metro area. They're equally split from Newark and JFK, but that's a lot of departures in New York. So I hope if you're traveling on the West Coast, you consider Alaska for your travels because I think we can take you to pretty much where you want to go. And you can see that New York now is almost as big as our Hawaii franchise, which is fairly big.

So again, when you look at this, you say does it make sense? I think it makes a lot of sense. But let's look at California in a little more detail. California is a big state. When you compare the population of Washington, Oregon and Alaska with California, it's 3.5x. And yet even our market share after the acquisition is only 12% compared to what we have in the Pacific Northwest. And if you look at our loyalty penetration, it's still small compared to what we have in the Northwest. So we just have a strong belief that there is runway for us to grow California in a way that make sense for us. One of the things about loyalty, Virgin America was an extremely strong brand, but we define loyalty a bit different. For us, loyalty was about customers having preference for our brand and having the credit card in their wallet -- our credit card in their wallet. So we just see a lot of opportunity here for us going forward. So again, when you look at all these factors, would we do this merger again? Absolutely, no question about it.

Now let me get to the merger. Brad gave a good synopsis of the merger. We're extremely proud of how we've executed this merger over the last 2 years. If you look at all the checkmarks, we pretty much executed every milestone we had on budget, on time. And a lot of back-office systems, which were important, the big things, single operating certificate, I was just going to reemphasize, PSS passenger service system, and we executed that. We're a lot -- this could be one where you can actually trip and fall, but we executed that without a glitch. And a couple of things that Brad alluded to, but I do want to talk about is, getting integrated seniority lists with labor and getting all these labor agreements done. And accomplishing that in 2 years, I'll talk about that in a second. And then the one that doesn't have a checkmark is culture, and that's deliberate. We don't think you can ever put a checkmark against culture because culture is something that you're going to have to work all the time. It's not something where there is a destination, it's a journey and things are always happening. So you always have to continue talking about culture and I'll get into a little bit more detail here in a second.

So this is an overview of our labor agreements. We're almost 90% unionized at Alaska. 5 big unions, and you could see the time frame with the IAM with airports, ALPA with pilots, flight attendants with AFA, dispatch with TWU and now we -- the last one we're working on,

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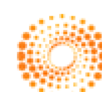

the tentative agreement is getting voted here in the next couple of weeks and we hope to have that ratified and that would give us joint collective bargaining agreements with all our unions and integrated seniority lists in about 2 years, which is -- if you look at the speed and rapid pace, this was a big, big milestone for us to have done. And just to give you a sense of what it means, so starting in February of 2019, our flight attendants now only fly Airbus and Boeing. By February '19, we'll have 1 flight attendant team that will fly both airplanes, which is pretty powerful. So when you think about consistency of service and culture and people working together, it's just a big, big milestone. And I can't emphasize enough how big this is for us to really start harvesting the merger.

But I want to talk about culture. It's funny, last night, you'll go unnamed. One of our bean counters would say, "You know these guys don't want to hear about culture." They want to hear about financial stuff, and -- but I think you do have to hear about culture because culture is one of the things that has always kept Alaska different, has always allowed us to outperform the industry and it's why we are who we are. And the integration has put a tremendous amount of strain on our culture. It has. And yet, we're proud that we continue to win customer service awards, but it's something that we believe that if you lose, you become a different company. So we're doubling down. You'll hear more from Andy, but we started a workshop called Flight Path. It's a 5-hour workshop. We bring all 23,000 employees in person, and it's a big venue. It's way bigger than this. 600 people at a time. So we've gone through 11 of these workshops with over 6,000 people through it. And we talk about certain things. We talk about being together, being truly 1 team, working together to win in this competitive industry. We talk about our history, where we come from, where our values have been built. We talk about where we are. We snap a chocolate and we say, here's the good, bad and ugly of where the company is. And then we talk about the vision, the plan of this great company in the next 3 to 5 years. And then again, we finish it with a lot about culture and working together as 1 team. We've got a -- we have a great social afterwards and it's a -- and there's a lot of Q&A in there and it does get exciting some of the Q&A questions where I will say, but it's good. People are -- what we get out of the Q&A is people are hopeful, and they're proud, but there is some frustration through the integration that we're working through. So it's been excellent and you'll hear more from Andy on that.

So you probably wonder when the ops guy is going to start talking about ops. I'm talking about all the soft and fluffy stuff. Okay, well, ops is something I love to my core. A lot of you who know us know that one of the reasons we've been so consistently at the top of industry for the last 10 years is that we are very process focused. We've got a playbook that lays out what everybody does, when they do it, how they do it. We measure it. We scorecard it. We get feedback and we hold a high bar. We hold people accountable. That's how our playbook works. So usually, every year, I come, I bring you some element of what we're doing with our operation. Like L1 door, we showed you how fast we opened up the L1 door. That's an example. But I want to -- because there's a lot of focus on cost at Alaska, I want to just describe philosophically how we take cost out of our operation. So you could be a departure-focused airline, you could be an arrivals-focused airline. We are the departure-focused airline because when you're a departure-focused airline, what you could do is, take cost out of your operation. So if you look at the stats, we lead the industry in departures on 0. You include weather, ATC, snowstorms, anything you want in there, we lead in departure performance. We're the best (inaudible) airline. That means, when we say we leave at 8 a.m., it's not 8:00 a.m. and 20 seconds, it's not 8:01 a.m. In fact we leave at 8:00 a.m. or a little bit earlier, that's what we want to do. Because if you do that then your block time from gate to gate, you could really optimize that because that's where the money is. You have excessive block times, you throw money away in utilization and pay. So our philosophy is be a highly departure-focused airline, use a lot of algorithms to program your block, keep that as tight as possible because that's where you can throw money away.

So just to give you a sense, so when we brought our playbook, so that's -- when we brought it to Virgin America, I wouldn't say it was welcome with open arms at first because it was very radical to what they were doing because the playbook is very prescriptive. But what I will say is we brought in the other part about Alaska, our culture. As we have a playbook, but all 23,000 employees are empowered, can make exceptions whether it's a stop deal operation for safety or to make exceptions day to day. So when we brought this to Virgin America, you could see that this was controllable departures on 0, so this one, we strip out weather in ATC, that their performance improved by 6 points while we're still winning customer service awards and while we're taking cost out of the operation. That's what we do.

An opportunity as well on the Airbus side is aircraft utilization. This is quarter-to-quarter from first quarter '16 to quarter '18. You can see we popped the utilization 2 hours, but there's still room to grow. The Boeing is much higher than that. And as we get through '19 with all the aircraft modifications and configurations, we will see another step change in Airbus utilization.

May be a little talk about productivity. So we're very focused on productivity. The merger did push our productivity down a little bit. And

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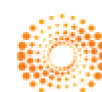

one of the things that we're very honest with our employees is that we want to pay them well. We want to have great benefits. We want us sharing PBP, but we're going to be a highly productive workforce. And so we measure pilot hard time. Flights and the hard times, those are 2 examples. One point of pilot hard time is $12 million. A point of flight attendant hard time is $7 million. So just for example now, flight attendants when they come together in February of '19, we won't have Airbus reserves and Boeing reserves. We only have 1 pool reserves. So this is going to take a lot of soft time out of the reserve bucket and put it back into hard time. So you'll see that flight attendant productivity will start closing the gap.

On the pilot side, it's a little more difficult. 2 fleets, we can't have cross-trained pilots. So I was mentioning outside with a few folks as we started cross fleeting airplanes, with putting the right airplane on the right markets to optimize revenue, one of the things that we're finding is that sometimes you get the synergies in productivity with crews. So what we're doing right now is, we're putting scheduling. This is what's great with me and Andrew being together with our teams. We're putting scheduling and flight operations together because as we build to optimize revenue, we're also looking at optimizing the best cost profile for crews at the same time, with this Boeing-Airbus mix. So that's something that's in work. I don't think we'll close it with a dual fleet to the levels we were with pilots with a single fleet, but our goal is to close that gap as we get through '19 and into '20.

So maybe just to finish off what Brad had and maybe just to reinforce it, this leadership team is absolutely laser focused on getting back to a 13% to 15% pretax margin on a consistent and sustainable basis. I think our track record shows that we know how to operate well. We know how to manage costs. And we simply have just a great culture to go do that. What you're going to hear in the next few presentations is Andy is going to come and talk about culture, just to get little more detail because we do think it's foundational to our success. Shane is going to talk about all the elements of the margin drivers forward that we're going to use to expand our current margin. Then we'll have a break, and Andrew is going to come up and talk to us about all the exciting commercial opportunities we have. And then Brandon's going to wrap us up with all the financial components with a financial framework for 2019 and into the future.

So with that, I look forward to your questions. I'm going to hand it over to Andy Schneider, our Vice President of People.

Andrea L. Schneider ***Alaska Airlines, Inc. - VP of People***

Good afternoon. Can you guys hear me? As Ben said, I'm Andy Schneider, and I am the Vice President of People. And we did have a good discussion about how much interest you really have in this notion of talking about culture. And I'm just here to tell you that we think culture is extremely important and something that we never want to take for granted. Over my nearly 30 years with the Air Group, I have seen where time and time again, it's the strength of our employees, who've come together as a huge source of competitive advantage.

We believe that investing in culture and in our values is foundational to all the rest that we're going to talk to you about, and you are going to hear a lot today about our goals to improve margin performance and to talk about brand awareness, but great plans only matter if we can execute on them extremely well. And we only execute really well if we bring our people along with us.

And we know that together we can do such a thing.

When we started the merger, one of the first things we did is, we brought cross-functional groups of employees from both Alaska and Virgin together to talk about our values and to talk about our vision. One of the things that both carriers have been known for is a really strong service culture and really strong values-based approach to the way they handle things. And the values you see on the screen behind me are values that we came up with jointly with our folks that joined us from Virgin. The first one that you'll see on there is this notion of own safety. You saw it in the video. Brad talked about it. Ben talked about it, but every employee at Air Group knows that they can stop the operation in the name of safety at any point in time. And it's foundational to what we do, and I think every one owns and takes that job very, very seriously.

The next item is, "deliver performance." And not only do we deliver award-winning customer service performance, we're known for great performance with on-time, with safety and financial performance as well. And we have a leadership principle called high-performance culture, and we work to ensure that our leaders are inspired to create and maintain and have cultures and network areas where delivering high performance is just a natural outcome.

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The next item is, "do the right thing," and as everybody will say, integrity really matters and we really work hard to hold ourselves to high standards that way and to make sure our decisions reflect the highest integrity as we move forward.

And then there's, "be remarkable." This is actually something that had come from Virgin. And for our guests and our communities and each other, we work hard to be memorable. If you're in the operation, our employees are trained to go beyond to create memorable experiences and in the back offices we work to help support and deliver on our brand and help and support the operation as it works to deliver good service for our guests.

And then lastly, we have, "be kindhearted." We work hard to hire folks that are that way, and we work to reward employees who have a deep sense of caring. We look for people at Alaska who kind of see the world outside themselves, and in one of the flight attendant interviews, he's told me that the kind of people we try to hire are the kind of people that always put the shopping cart back in the rack because nobody's watching them do it. They just know it's the right thing to do and that's who we are about.

And these values are more than just something that we have on our web page or something that's in a book. They really are something that we live and they serve as a guidepost for who we hire and how we promote and how we measure performance. And then, additionally, they serve as a framework, what we call the beyond service framework for all of our frontline employees to use when they have to make decisions, so they start with safety. Is the situation safe and they work their way down through this and know that they are empowered and they're encouraged and they're supported when they make decisions for our guests, using this framework as a backdrop for decision-making. We think that it really matters.

And great cultures matter because when your employees are engaged, they turn -- in turn deliver the service rewards we get and that thing engages employees and customers to come back. If you -- you've heard a little bit about these awards, but the ones that are listed here are the ones that we think matter because these are the ones that you can't buy. These are the ones that come because other people outside you take the time to tell you that you've earned them. The airline quality rating is an objective measure. It's come together from folks (inaudible) and Wichita State where they take a look at DOT data and they help determine, which airline is the best-performing airline out there. We're really proud of that. 3 years in a row, we have been the recipients of that award. And Brad mentioned it and Ben, I don't need to dwell on it too long, but Condé Nast mattered because that was won by Virgin America for 10 years in a row when they were separate. And this last year, we won it as a combined entity, so that makes us extremely proud. And then there again there is our 11th J.D. Power, which we are extremely proud of. And all that should matter for you because this is the thing that get loyal customers to buy tickets and improve our demand and ensure that we are more profitable airline as we go forward.

You've seen -- you see here that we have had a lot of growth. And that growth is really, really helpful and challenging as we move forward because one of the things that we know matters is being close to our employees. We work really hard to make sure that there is a very tight close relationship and that's part of the reason why we have frontline employees with us here today. And so as we continue to move forward, we will not lose this notion of creating small company feel for our guests. In fact, in this year, we launched an effort where each executive was to establish a partnership with a frontline workgroup and they were there to help facilitate to a conversation and help solve problems.

And in 2019, we're going to launch a project where every director level employee and above will spend a week in the operation with our frontline employees. This will help them understand the challenges that our frontline face and it will help make sure that we've got deeper relationships with the employees that we are here to support. And then lastly, we're going to be launching more training for our supervisors and managers, so that they have the tools to communicate effectively and lead effectively as our company continues to grow. Time with our employees to build a strong culture of engagement, which results in great service for our guests.

And then further to align our organization, we have a unique gain sharing program. There's 2 components to this program and the first is called "performance-based pay." And you can see on the slide before me, it has a number of components both operational, financial, safety and satisfaction as being part of how this metric pays out.

Every employee from Brad to the frontline is rewarded based on how we do against these same metrics. If you're a frontline employee, the target payout is set at 5% of your annual salary with an opportunity to earn up to 10%. And over the last 10 years, the payout for this

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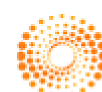

has been at 8% for frontline employees.

In 2018, while we were doing well, we don't believe that we'll continue that strong and that high of a payout. But assuming that we get back on track in 2019, you can expect to see that our rewards payments will be higher for variable pay because we expect to meet all of our goals.

And as you can also see in 2018, which are the measures that are reflecting here behind me, 60% of the targets have to do with financial measures when you combine CASM and profit and that's important because we want to make sure our employees are aligned with our investors and that our metrics are set up to ensure that we are focused on the right business and directives. Each year, these objectives are reviewed and approved by our Board of Directors.

And then, in addition to PBP, we have a program called Operational Performance Rewards or OPR and that is set up to payout on 2 metrics. It's measured monthly. One is on-time performance based on departures within 0, as Ben talked about that's really important to us. And then the other one is on guest satisfaction. Each one of those have a potential of paying $50 per metric, per month and it's paid out quarterly.

And lastly, Ben talked about Flight Path. Flight Path has been an effort that we launched just a little bit ago in October and it will be running through the month of April. We actually rented a warehouse down the street from our corporate office and are bringing employees in mixed groups, 600 at a time and plan to put all 23,000 employees at Alaska and Horizon through this. And it's -- as you can see, there's been facilitating there. It's facilitated by the highest levels in our organization. Also I don't know if you can see it from where you are at, but on the screen you can see the virtuous cycle. We spent some time talking to our employees about how important it is as an organization to make sure we balance the interest of all of our constituents. And the conversations are spicy. We have people coming in with various perspectives, but at the end of the day when everybody leaves, they have a renewed sense of where we've come from, where we're headed and why 1 team and working together really matters. And we think that this is going to help us significantly as we work to bring our 2 groups together and how we work to support the margin improvements in the coming years.

We're going to play a short video and then I'd like to -- we're going to invite Shane Tackett, our Newest EVP up to the stage.

(presentation)

Shane Tackett ***Alaska Airlines, Inc. - EVP of Planning and Strategy***

All right. Good afternoon, everybody. Thanks, Andy. Brad, the volume is good on the video? Brad has always worried about the volume of the videos. One thing over 20 years is our AV has gotten much better, our videos are better than they've ever been. So yes, Brad and Ben sort of laid out through a systematically high level sort of where we've been, where we're going. I'm going to sort of pivot now into more of the detail. So we're going to bring back the road map, the sort of margin expansion tree that you saw a few minutes ago, both with Brad and with Ben. And the goal here is to give you more detail on specifics on the commercial side of the business where there is a lot of opportunity to drive margin expansion and then also to begin a discussion on the cost side of the business, which we are -- finally after 2 years of working really in a focused way on integrating these 2 companies, we're back to pivoting that focus into being a very, very good, disciplined cost management leadership team.

So we want to talk a little bit more about that. Before we dive into that, I'll just go backwards one more time, and Ben talked about the case for the Virgin America acquisition, it was absolutely, I think, the right thing to do. It built a great platform for us to go forward. We've got a great future ahead of us. The reality has been over the nearly 2 years that have intervened is there has been a lot of change to our business. And one of the big, most important pieces is our financial results have deteriorated. And we just wanted to be open and transparent about it. And if you wanted to sort of high level understand that, I think, all of you know this, you follow us and have over the course of the last couple of years, but it was worth spending a couple of minutes talking about the biggest piece has been fuel. And in fact, 2 of the largest drivers on the screen are things that the entire industry has dealt with. Every airline has dealt with fuel. The other thing that every airline has dealt with is really a market change in the rates of pay for people working in the industry, which I think and we think at Alaska is entirely appropriate. The industry went from making no money forever to finally being healthy, being well -- earning well above its cost of capital, and it is the right thing for folks working in this industry to ultimately do better as well.

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We were a little bit behind that curve just because we had secured long-term contracts since sort of the early 2000s that were still in force, while others were in the midst of negotiating contracts in sort of '15, '16, '17. And so our labor cost, we had, I guess, what you can call, is a period of arbitrage, sort of advantage just from a labor rate perspective. But it's not our strategy to sort of win on labor rate, so we want to do and Ben talked about that, and I'm going to talk more about it is ultimately pay very competitively and then be the industry leader in productivity to ultimately have a better labor CASM just through how productive we're able to be with our assets and with our people.

The other 2 are sort of self-induced. The 2 in the middle there were things that we did. We decided to grow quite a bit. Especially after the acquisition, we decided to start a number of new markets, 44 new markets depends on the date that you begin counting, 44 new markets in the course of a couple of years or 18 months. And just mathematically that's going to have an impact on margin typically as you go into new markets and it became 10% of our capacity for a couple of years, just the average revenue production is going to be less than what your sort of normal system is. And we thought that it was smartest to get that all through the system, get a good platform that we could then optimize right as we came out of the integration, and so that's what we did. And then we saw a lot of competitive intensity on the West Coast, and we could debate whether we brought it on ourselves or this was more of a natural move of competition sort of from the east to west. Because in the West Coast there were relatively better margins, better pricing for a while, but certainly we, I think, have had the most sort of competitive intensity in the markets that we are strong and over the last couple of years, and they've been a contributor to sort of the margin profile that we've had. I think the big question that we've had and a question that's been on many of your minds is everybody has dealt with the fuel increase. Others have had a chance to recover or shown more recovery of that fuel. And I think that's true. We -- I think there are a couple of reasons for that, not only the growth that we've had and the competitive intensity, but the last thing that I would mention is we've gone slower with updating the revenue model and that was very deliberate. The nice position we are in now is we have a very, very strong commercial opportunity and revenue road map. We know exactly what we want to go and do over the next year or so. We know exactly what the value of those initiatives are. And basically, we are in execution mode and all of that. Now I know we've asked for patience sort of the last several quarters on earnings calls, we talked about the inflection coming out of Q3, and we will talk more about the revenue opportunities ahead of us. They are going to be the largest sort of levered piece of getting margin expansion into the business. And quite simply, in the midst of an integration, as we were trying to move into a single passenger service system, it's just not the right time to bring sort of new products to market like basic economy or other things that folks were ahead of us in doing. And so those opportunities are all available to us now. They sort of are within our own control, and we're excited to get going not only the synergy capture, but all of the other revenue initiatives that we've talked to you about, and we're going to recap again today.

So the question though is, okay, we've got synergy capture, we've -- and if you look at the next few years, I think, we would tell you today in our P&L, there is about $65 million of synergy benefits. We told you the value of synergy as $300 million ultimately. And I think on the last call, we talked about this as well, we view an incremental $130 million coming to synergy next year, which we'll get into and I'll talk -- I'll remind you of some of those categories and why I think we should have a high level of confidence that those revenues are real. They're not phantom synergies. They're measurable. They're identifiable. But the reality is and the point of this side is the right hand of this slide that synergy alone isn't enough to get us back to 13% to 15%, and our goal is ultimately to regain our leadership margin position versus the industry and that's why we need more initiatives. That's why we want to talk a little bit about revenue initiatives. But again, begin to really look at where we can go with costs over the next couple of years in the business. And so we are going to have to get as much out of non-synergy initiatives as we're getting from synergies to get to the 13% to 15% margin goal that we have set for ourselves over the next couple of years.

And so let's -- this is the road map that Brad had brought up before. We could go into a lot of detail. We didn't want to create an eye chart. We've put a few bullets up here. I'll tell you on the revenue side of the business, there is something like 26 initiatives. We track initiatives that's sort of $5 million and then we have initiatives that are worth $100 million or more. Every single one of them is owned. They're all measured. They're reported on, we mean, twice a month basically biweekly, and we're just -- we're in execution mode. And I think we're just excited to sort of get into 2019. Andrew is going to spend a little bit more time on the commercial side of the house. But again, it's more refined and we've a high level of confidence that we'll be able to achieve the commercial opportunities ahead of us.

One thing we did want to share is sort of the total value. Don't update your models for 2019 with these numbers. The numbers that

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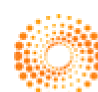

should be in 2019, I think, we've talked about on the earnings call, we'll talk about again today. But if you're wondering the total value out of the incremental synergies we have ahead of us and the total value of the revenue initiatives that we've already talked with you all about from Saver Fares to some of the bag fee and ancillary changes we've already made over the past 2 quarters as well as some additional revenue management, revenue performance synergies and corporate sales -- sorry, initiative and corporate sales opportunities, I think they begin to get close to $500 million. And if you look at just breaking down this 5 or 6 or 7 points of margin expansion, $500 million, it's going to be about 80% of that coming through the commercial side of the business. The other big point on this slide that we want to drive home is this is not really reliant on the industry environment to go and get. A lot of this is ultimately us sort of more or less lining up with the model that the industry has already decided to use when it comes to segmentation on Saver Fares. The synergy categories are really mathematically sound. When you talk about (inaudible) all that is, is putting the right equipment in the right market. It's something every single airline that has multiple seat counts in their fleet deal with. We do this. We did it with Boeing. Now we have an opportunity to do it with the integrated network and schedule really starting in earnest in Q1 of next year. When we talk about densifying the Airbus aircraft, we're going to add 4 seats. That's real economics. It's calculable. We've densified our fleets in the past. We know how to model the stuff. There is real growth in feeding our partners out of the hubs up and down the West Coast, Andrew is going to talk more about. And we know that loyalty -- folks in our loyalty program, especially when they own the credit card, simply produce more economics for the business than those that don't and there is just a lot of upward trajectory in the new geographies that we're operating and then there is more ground to cover there.

So all of these are just things that we need to go execute on. They're really not dependent on the external environment. The external environment, it could change, who knows. We could have tailwinds from sort of the competitive environment. From the economy, we could have headwinds, but independent of all of that, I think the commercial opportunities are sound and we can go and deliver on this over the next couple of years. And just sort of quick through each of those, Andrew is going to talk to you more about this, but the big reminder here is one of the drivers of margin degradation over the couple -- last couple of years has not -- it's not the lack of commercial synergies from the merger, that's all still to come. 80% of that value is in front of us. And then the last point that I'll make before turning to cost and it's just important for us to always sort of remind ourselves and then remind all of you about this as well because we are not going to lose the value proposition we have with guests. There are a couple of reasons people choose us and want to fly with us. The single largest is the service that's delivered by all of our front line employees. The second is we're generous, and we have, in general, the same parity or better sort of policies, fees, fares, loyalty program on almost any metric and measurement that you look at across the majority of the industry. And we look at this stuff internally. We look at several pages, I think 20 or 30 different benchmark data points. We've chosen a few here, but all of this is to say even though we've remodeled the revenue model a bit, it's not drastically changed for customers. We are not going to impair the value proposition that we're delivering to people and we're going to continue to be mindful about giving people reasons to continue to choose us, especially through our loyalty program, which Brad mentioned and Andrew will talk more about is the best in the industry.

All right. So enough on revenues and commercial issues. We will spend a few minutes here on the cost side of the business. The interesting thing about airlines is the cost inputs for all of us are pretty much the same. And over time, they don't change a lot. So you won't be shocked that we're going to go after productivity and utilization and Ben already talked a little bit about how we think about saving costs in the operation. You won't be surprised that we're also going to refocus on overhead drag as the company is becoming truly a low overhead company and then also working sort of the cost of distribution of sales and tickets. I don't think we shared numbers in terms of value like this before, but I want to tell you, again, these are multiyear values. They're not 2019 values. We are going to share some guidance for next year on the CASM side in a moment. And I think that these are probably values that could be higher and that's why we put the plus sign on that. It's purposeful. We don't put numbers in front of you we don't think we can deliver on. But the reality is, as we had the last year to work on the revenue model, we're really just using the 2019 planning process as we have come through the heavy lifting of the integration to refocus all of the energy of the folks who were working on integration back onto the day-to-day cost management of the company. We know where to go look. We know how to go manage this stuff. It's just a matter of defining initiatives and going out and executing.

And the only thing I'd mention and you may say, why didn't you do this over the last 2 years? It is -- there has been a step change in complexity. If you take 2 fleets, 2 maintenance programs, 2 crews, 2 different operating methodologies, 2 different charts of accounts, 2 different types of reporting, 2 different sort of cultures in terms of how you focus on managing costs, you've got to get your arms around all of that. You have to sort of normalize it, get it all together make it a single system before you can really begin to optimize. And that's

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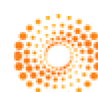

really where we are today. We've got it all under sort of one system. We've got sort of the right historical approach we've used to cost management, we're starting to adopt that across the broader network and really from here to just optimize being what we already know how to do well.

So I'll talk a little bit more about each one of these in a second, but one question that comes up is just as we face a lower growth scenario next year than we've had in the past, what sort of hypothetically happens to us, what do we look at every year when we sit down to build a budget and this is really a theoretical example, but it's true and it's real. Before we get into the budget process, we just expect 4% to 5% of core inflation in the business. We have labor contracts that go up every single year. We've got vendors who expect their revenues to go up every single year. There is just natural cost pressure in the business. It tends to be 4% to 5%. I think we talked a little bit about this on the earnings call recently. And with no growth, you might expect sort of a baseline increase of something like 4% to 5% that we'd have to sit down and overcome through either growth or through cost initiatives. And that's just sort of what we deal with every single year when we get into the budget cycle.

The philosophy, and I won't spend too much time on the philosophy, but it's sort of represented up here. It is an important thing. When I look at managing costs at the airline for us, it's not -- you can't sort of take a scalpel and just take large slough of cost. You really have to shave cost off dollar-by-dollar, minute-by-minute, 1,300 times a day in the operation. And the way you do that is you set very aggressive targets, you deliver those out to leaders, they put in plans that manage to those targets every single day, you report on them daily, weekly, monthly, and then as you reach a level of success, you just keep ratcheting that up. It's the -- the trade-offs are too severe if you just think you're going to go into a group and say, hey, take $15 million out, you end up under-resourcing the company, you end up taking product away from customers, you stop advertising the company. It's just -- it's too hard. This really is 1,300 flights a day, $10 at a time. And Ben mentioned it, but if you think about it what we really try to do is operate excellent, on-time, all the time. When we can do that, we drive variability out of the system. We now can predictably and reliably operate. As soon as we do that, we start taking those block times, the gate-to-gate time down. And as soon as we start taking those down, we shed cost and the productivity goes up. It naturally happens, but there is nothing more we have to do, then we produce more minutes for Andrew's team to go schedule more flights in and that's got a great uplift to revenue and CASM and that's sort of the cycle that we're going to get in. We do this to target budgeting. We sort of say forget what you spent last year, it's not important to us, we're going to tell you what we want you to spend this year. The real deliverable in the budget planning cycle is a plan to deliver the target that we've given you. We sort of zero-base everything.

And then on the back office side, what we really like to do is force trade-offs, and so we have what are similar arbitrary, but I think they are informed caps on the number of people that we allowed to be in the management team, and we've changed that over the last little bit here, which I'll talk about and then we just -- we have constraints and caps on other sources of spend just to force good decision-making within the company to just make sure we have low drag on the overhead side of the business.

From a productivity standpoint, Ben mentioned a lot of this. Most of the operation will get more productive next year. Flight attendants will get more productive. The airport personnel will get more productive. The pilots, they won't -- they'll actually be a little bit less productive and this really does have to do with the fact that we have a training level that we have to get through to allow pilots to move between Boeing and Airbus and Airbus and Boeing, so part of getting to a single seniority list is they get the ability to choose which aircraft they want to fly on. We've got Airbus pilots that live in Seattle and might want to fly on Boeing aircraft and vice versa. It's sort of a onetime thing. Once you get through the initial couple of bids. We get that through the system and we will begin to work productivity back up after that. To Ben's points, with 2 fleets, it's just not as possible to get to sort of our benchmark level of peak performance and productivity as we had in the past, but we can certainly work up materially from where we are today.

And then the last thing I would just mention is we've seen a massive adoption of, as you would expect, customers using our technology from an app, from a website to check in and to change flights. It really leaves our airport agents and res agents to the most difficult sort of customer situations, the most complicated situations, and we will be doubling down on sort of guest self-service just through our mobile offerings over the next year or 2, which will be a driver for our productivity as well.

On the overhead side of the business, I think we didn't present it up here, but I think we've been historically closer or under 10% of our nonfuel cost structure would be overhead. It did step up a little bit. A lot of this has been IT investment. We do put IT in this bucket. The good news is as we took a step down in terms of the overhead drag on the business in 2018, we're going to take another nice step down

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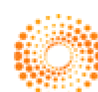

in 2019. This comes with hard decisions. We did reduce the total number of management folks or positions that we allow ourselves to have by 200 or about give or take 10% this past year. A lot of that was unfilled positions, but there were 60 or 70 folks who were in position who were impacted this past month, and they gave a lot to this company, it's hard to do, but it was ultimately about getting focused, getting the lines of communication open and just making sure that we're very lean from a management leadership team perspective. And I think after 2019, there is probably more leverage on this line as well as we continue to grow.

Another large opportunity for us is just supply chain discipline. $20 million is probably low. There is $1 billion or $1.5 billion of addressable spend we can go after. This is really working with large suppliers of ours to make sure that we have a great deal with them and we strive to be a great partner. I think we are a great partner to our suppliers. I think most of them believe that, but the interesting thing when you merge 2 companies is you get to see what their deals were and you get to see what our deals were and they weren't the same and you just learn from that, just a reality. And so we have a chance to reengage with some of our suppliers and look for sort of more leveraged deals that work for them as well. And so we'll be taking a conservative step forward in this in 2019 and 2020.

And then, the last thing just on the cost side is selling expenses. A lot of this was done when we moved $2 billion of Virgin America revenue over to the Alaska distribution sort of contracts and systems. We had a much lower cost base to distribute revenue or tickets than they did, that was nice. But the real leverage here is we have phenomenal economics. If we sell tickets to people who use our Affinity Card with Bank of America, we do a fair amount of that in Pacific Northwest. We're seeing a really nice tick up in selling our revenue in the State of California over the credit card as well. And when we sort of model that going forward, we think there is a lot of continued opportunity on the distribution side of the business, primarily from just getting penetration of the credit card.

[I think altogether you get to the $75 million of operational efficiencies, $85 million sort of back office and distribution of value.] (corrected by company after the call)

So if you put all of this together, I only have a couple more slides and this is one that you probably are interested in. This is sort of where we're guiding and Brandon will talk more about it in a moment. We are guiding to be up 2% to 2.5% next year on 2% growth. But I was hoping that before you update your spreadsheets, at least let me take you through the waterfall chart here. And I do -- I think it's sort of contextually important, there is an algebra reality that is a headwind to us, which I'll get to in a second. But basically, if you start at $0.085, which is, I think, where our guidance midpoint is for full year 2018, we sort of started with cost inflation of 2.78% or -- 2.7% to 3% and then we have a little bit of growth that helps us mitigate a piece of that. And then we've really gone in and identified 1 to 1.5 percentage points of reduction through cost initiatives through all those things I just mentioned. And we get close to flat when we do that as the business, and we've talked about a flattish goal on low growth for a while. That was originally talked about when we're going to grow 4%, so it was ambitious to be thinking about that at 0%. There are some onetime things that are happening in 2019 that I'm going to talk about in one slide forward. There are always onetime things admittedly and they should sort of replace each other over time, but we do have a little bit of drag with the low growth this year on some onetime investments. And then we have a strange regional versus mainline mix. So we have traditionally been something like 90% mainline ASMs, 10% regional ASMs. We have, as you know, taken a lot of E175's in the last couple of years. We've really built out a much larger regional sort of network. A lot of the growth has been on regional aircraft. And this is not going to be with us in the future, but essentially a lot of our growth next year is on the regional side of the business and not the mainline side of the business. And all we're doing is exchanging regional level costs for mainline level costs and they're basically double on a CASM basis. So the regional operation is basically double the mainline operation and you just get this math consequence within the CASM calculation. That's worth about a point next year. Like I said, it's not going to be with us. We've got the regional fleet where we want it now. I think we took 16 aircraft in the last quarter of this year or something and there is not a lot more to take going forward.

So on the investment side, and I'm sure you'll have questions on the cost side of the business, it'd be fun to talk about. Andy mentioned one, as we expand margins, we do expect for our variable incentive pay to move up a little bit, Flight Path is a cost, but it's absolutely the right thing to do to bring 23,000 people together to share this vision to get us all working on it together. And then we've got some other product stuff and Andrew can speak more to this as we roll out satellite Wi-Fi and it tends to come in at a material enough cost to call it out. And so that's the 0.8% change in CASM we showed you on the waterfall for investments.

And I think -- and this is the last slide. We have been a cost-focused airline, at least, internally ever since I got to the company in 2000.

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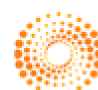

So for 18, 20 years, we talk about it all the time, we talk about it with you all the time, we talk about it with employees all the time. Sometimes, they tell us we talk about it too much. But we firmly believe that our success is rooted in a low-cost foundation. We haven't changed that, the last 2 years hasn't changed that. That's what we're going to go work on in 2019 and beyond. This is about a 20% cost advantage that we have today over legacy airlines that really hasn't changed over the last several years. We haven't lost any of that cost advantage over the last several years. We've maintained it. We intend to maintain it and honestly we are as close as we've ever been to the airline on the left side of that chart. When I started 18 years ago, I think they had 20% cost advantage over us. We're going to be in the mid- sort of single-digit area at the end of this year and as we move into next year. And so costs are definitely part of our DNA. I think we've been known for it in the past, and it's something that we're excited to get refocused on and ultimately deliver on for you all over the next couple of years.

And I think with that, I'm done, and we get a 10-minute break and then back to Andrew afterwards. Thanks, everybody.

Matt Grady ***Alaska Air Group, Inc. - Director of IR***

Thank you, Shane. Yes, we'll take a 10-minute break now, so feel free to get up, move around and make phone calls, but we will be back here in 10 minutes sharp for Andrew's presentation.

(Break)

Matt Grady ***Alaska Air Group, Inc. - Director of IR***

Okay, we're going to resume the meeting in 1 minute. So Andrew will be coming up to the stage in 60 seconds.

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

Well, this is the most well-behaved group I have ever been in front of, Matt. They immediately stopped talking. They've taken their seats. I'm worried, expectations are high for this section.

Well, thank you, everyone, for being here, and I'm going to take you now through really building our brand and really taking more detail on what Shane's been talking about, which, of course, is our revenue growth. One of the really important things that I want to make sure folks understand today is that in order to grow revenue, you have to have the foundation in place and it has to be ready to go. And I'm going to talk you through those 3 pillars you can see there that are in place and ready to go that hopefully give you full confidence that we're going to be able to do this and has been repeated many times, everything I'm going to talk about are things that are in our control.

But before we can get too far into this, you've got to talk about the network. 40% of the reason anyone buys a ticket is because you fly where they need to go at the time they need to go. When we embarked on Virgin America, we spent $4 billion to acquire a very significant network in California. And people have different views on this, but my personal view was that acquisitions are hard and that we wanted to get this done. And as you've seen, we wanted to get it done quickly. So we undertook significant organic growth in the last 2 years. It had its consequences for sure, but much as Sangita has taught me in a marketing org is when you get valuable assets you need to activate them, whether it's Russell Wilson or Kevin Durant, you need to spend money against them to activate them. So versus just bolt-on Virgin's network, we really filled it out. And I think what I'm going to show you now is a testament that not only has it got us to where we needed to be, but I think it's going to set us up very strong for the revenue growth. So what you see here 4 key aspects of our network part of the merger and nonstop markets, daily flights, this is all on the West Coast and you look at the same statistics today, and you can see a very significant increase in the last couple of years, 27% on the nonstop markets and daily flights. But most importantly, we have the #1 ranking across every one of these off the West Coast. So we have built exactly what we wanted to build. We're very, very happy with it. And it's a very, very significant foundation. And it's not just the Pacific Northwest. Obviously, it's California, and you can see here the significant growth we've had in building out our network, 133 markets in California, over 330 departures a day, our seat share is only 12%, but our utility or our relevance is at 40%. We serve all the significant markets. So as you know, we're slowing down our growth. We built the platform, and now we're going to expect it and create revenue from that platform.

But one really important thing you often ask about is, what about Seattle? I remember being in this room over a number of years and the future was uncertain. There was a massive incursion in the Seattle hub and we all wondered where was this going to go, where was the story going to take us. I think even after the last 2 years, we feel very, very excited about how this has actually played out in Seattle. Not

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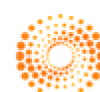

only that you can see that we've maintained our seat share, haven't lost anything, but you also see the significant increase in departures well over up to 300 now and in the peak more than that and that has brought many more good things, which I'll show you later on around loyalty and utility and everything else. So it's been a real success story in Seattle. It's a very constrained airport now, and we feel very, very good about that economic engine.

But there are also some other things that have been going on, which we just announced recently. We're going to be starting service from Paine Field. Why is that relevant? It's 20 miles north of Seattle. It's in a very large catchment area of Seattle and in Washington, in general. You see the markets there, 18 flights a day to very large O&Ds. This is the equivalent of increasing our departures out of Sea-Tac by 6% without any other congestion and huge convenience for our guests. And even in talking of Sea-Tac, about 40% of our departures are regional aircraft, so we still have opportunity over the coming years to continue to grow gauge. We feel very good about the revenue-generating proposition of our Pacific Northwest network.

You heard Shane mention about the mix in regional aircraft, and back when we started this acquisition, we only had 15 Embraer 175s. By the end of this year, we will have 58. And by mid-next year, we'll have a regional network of 95, bringing huge flexibility into short or thin markets, including still highly fuel-efficient Q400s. And, of course, our mainline network, which is large and significant as we talked about a lot today, you're going to hear us talk more and more about international. You can see here on the West Coast, we connect to our global partners and then when you look at beyond their hubs, we've really created the platform to be the West Coast's favorite airline. You need to have regional, you need to have mainline and you need to have global reach. And we have built that. What you're looking at today is what we've actually built.

I wanted to reintroduce you to our 15 global partners, I will say since the merger with Virgin America, we have seen a huge increase in interest amongst our global partners about working more with us because they've seen the impact of what we've been able to do for those businesses in California and, of course, in Seattle. So let's take a look at that for a minute. We talked a little bit about Seattle and where we are domestically, but if you look at this chart here, Alaska global partners represent 39% of all long-haul seats listed out of Seattle, the highest, higher than Sky team and with more destinations. Also you can see same thing on the West Coast, we have a very significant footprint internationally with our partners, we're going to start selling next year, international partners, on our website, direct from our website. One thing just recently the testament to this is that in the last 6 months, we have announced or started 4 new partners coming to Seattle, Aer Lingus, Cathay Pacific, Japan Airlines and Singapore Airlines, why did they come? I believe they've come because they've seen what happened in California, when they've turned us on with our new network. And they've come to Seattle because they've also seen the strength of our network and how we can feed them. But for us, why is this important and why is that important that we measure how are Mileage Plan members are accruing on our international partners. The reason is very simple.

We are in a very competitive West Coast environment, especially in Seattle now with international and the West Coast. When people fly internationally, we don't fly. So if they fly on somebody else that we're not partners with, they might earn miles or they might want to redeem miles, so when they come back to the domestic marketplace they might go with another program. So they get domestic and international. What we are doing here is ensuring that we can give international utility to keep people on our network, in our loyalty programs, so when they fly domestically in the United States, they're in our program and it drives value.

So I think, I just went backwards, and that's not what we want to do here. You can't do all of this and create this future road map without the infrastructure. Again, 2.5 years ago, we were in a dilemma. We were, sort of, not sure where we're going to go in Seattle. We had challenges in Portland, certainly in San Francisco, Los Angeles and New York City, all I can get is 1 flight in there -- I had no space there. There is $48 billion being spent by the key airports in the West Coast for infrastructure over the coming years. And we positioned ourselves to very much participate in that and be beneficiaries of that. I'm just going to touch on a couple of those.

Firstly in Seattle. We're building this state-of-the-art North Satellite terminal that will be 20 gates right there altogether, opens in 2021. The first phase opens next year. We're going to have a 15,000 square foot lounge that opens next year. And as I mentioned, just on the regional to mainline potential to upgauge over time. So we have runway in Seattle for our continued guest experience improvement and growth.

In Portland, very constrained, especially in peak hours. They're doing rebalancing in Portland and moving 1 airline to the north, so Alaska

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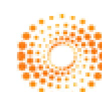

will have much more room on the south and more importantly, we're getting a new concourse for our regional fleet, both our Embraer 175 and Q400 more efficient, again more room to grow and to have a secure future.

California is a huge success story, thanks to Virgin America. We used to talk about where are our gates? How to hang on to our gates? Today, we talk about our terminals. Los Angeles, we're going to enter a new agreement with LAWA in the first quarter for a long-term agreement that continues to secure our gates. Gives us access to more gates, expand security, lounge, has a lot of good things for us. San Francisco I believe is a crown jewel in the Virgin America achievement. Beautiful terminal too. We have 10 gates there with terminal 1 expanding and being opened up. American Airlines will be moving their operations out from terminal 2, which again, gives us ability over the years to come to continue if the conditions are right to continue our growth.

But the really important thing here is value proposition. And Sangita Woerner is our Vice President of Marketing. She's here. She came to us nearly 4 years ago. It was close to my birthday, right, Sangita? And that was a birthday present because she has brought a thinking and a mindset that bean counters do not possess much to our chagrin. And she has really revised and helped us focus. And I've enjoyed the journey on building our brand. 30% of the reason people fly us is because of low fares. And so there it's critically important, but we bring high value, too. This is our value proposition.

If you look at this, we believe we have a very unique place in the industry. Got the ULCCs far left and you've got the legacy carriers on the right. We're right in the middle with both good fares, low fares, but the value for money with good product offerings, and I'm going to prove each one of these out, over the next few slides.

So let's start with low fares. 12 months ended first quarter 2018, O&D fares domestically in North America, these are what they are. Significantly below the legacy carriers. And again, not so far off the low cost carriers. So we will be increasing revenue through initiatives and all the rest of it, but this is a really good place to be. But more importantly, is our model working? We talk about West Coast vibe and how we look at how we feel and how we sound through the guest lens. This is really exciting for us. We just won it before Thanksgiving on J.D. Power mid-year results. You can see us there at 816. This is guest satisfaction in North America. We have never broken the 800 barrier. In fact, 816 was only 3 points away from Southwest. We grew 41 points. We've increased our lead. Why does this matter? It's because our value proposition of low fares and our generous product and our brand is working. This is only through September. This does not include all the 60 aircraft cabin reconfigurations, the 150 satellite units that are going to go on our fleet next year, doesn't include our new service flow of food and beverage programs and all the good things we're delivering. So what we're seeing right now is guest satisfaction is really leaning into what we are offering.

We've talked a lot about the Mileage Plan and generosity, this is one of the things and cornerstones of our business that we will continue to focus on miles for miles. We're going to do a better job at telling people what that actually means.

We were talking recently to employees and I showed them average fares to Los Angeles from JFK. Ours were actually lower than our competitors. But when you look at the miles because we did it for flying when you competed it, it's what you paid. We were on an average giving 1,300 more miles to a guest who flew our Mileage Plan -- this is a competitor at the basic level. Low redemption prices. You get to a lead faster without the barbed wire and you going to spend this and that. We have a very clean, simple to understand program. We've talked about global partners, which we're going to activate in a much bigger we going forward and complimentary upgrades, that is a core part of our generosity. We are not looking to sell 70% of our first class seats on our aircraft. 50% is more the number we want to aim for.

The other half is upgrade and generating loyalty. And of course, our credit card, the lowest annual fee, the famous companion fare, you could have flown back on Thanksgiving Sunday for $99, if you had this program, the miles and everything else. But none of this matters, none of these matter unless they generate revenue and help build our business and that loyalty. And I think what we're going to share with you today is that it absolutely is: Firstly, revenues since acquisition, up $280 million from the loyalty program. And you can see the growth there 38% growth in the Mileage Plan across our system, 17% in the credit card. Pacific Northwest - very mature, but look at those growth numbers again. It's sort of like this positive halo across our whole system, everything from this merger is working together to create more value. And then specifically in California, very, very strong and significant results. I'm asked often, I've heard on our earnings calls about the Virgin America brand and loyalty. Ben touched on it, but I'm going to give you a few data points and hopefully, the

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question has been asked and really my goal is to answer it today. And that is if you take a look at the loyalty program in California that we acquired, active elevate members at the time we converted them to Mileage Plan members. Since our acquisition, we have increased our net new Mileage Plan members to the value of the total number of members that we acquired from Virgin America. Remember Virgin America was around for 10 years before we acquired them. And so in the last 2 years, we've actually grown equal to what we brought over. More importantly, in the last 12 months, they have spent -- or they have earned 3x the miles. The original elevate members have earned 3x the miles on us this year than they did the year earlier. So they're more active and they're more engaged.

And lastly, the credit card. When we acquired Virgin America, it only took us 7 months, 7 months its all it took for us to get net new California credit cards to equate to the entire 10-year portfolio from Virgin America. So our brand and our product offering is working and it's growing.

And then if you want to talk about awareness and brand awareness. There has been huge strides here. You can see here that we have grown from 32% to 46%. Virgin America was at 40% when we acquired them. We've already exceeded them at that light level at 46%. Some of you might be looking at this and saying this is nice, Andrew. But I don't really know what this means. I think we all agree that the 82% awareness in the Pacific Northwest has driven huge value to our business. Awareness does drive consideration and consideration drives preference. And we are on the road to doing that in California as we continue to grow this. And then we talk about our premium products and what we're offering our guests, both how we look, how we feel, this West Coast vibe that we talk more and more about with our employees. But instead of showing you a bunch of slides and pictures, I thought what might be best is to show a video, where you can see and you can feel what is being rolled out in 2019.

(presentation)

All right. So one thing to really mention that's important is that when you heard from Shane, everything you saw there and everything that is launching next year has been done thoughtfully with very strong cost control and value put to that. And again, as I shared earlier, all of this is actually starting to roll out now and into 2019. So the value that's coming to our guests is going to continue to grow.

Every 10 years over the past 3 decades, we have doubled revenues at this airline. And we are going to continue to follow that theme and grow and grow our revenues on this new platform that we have.

So let's just look at some of the specifics. Shane shared this with you. These are the 4 main areas, $235 million in revenues to capture on the synergy side, $130 million next year. We're not showing you the detailed breakdown. I will tell you though that the order of these panels, so cross-fleeting is the highest value, then loyalty and working the way down Global Partners is very much also connected with loyalty growth. But we have specific plans on how to do this.

I wanted to give you a real-life example of cross fleeting, because we throw that term around. But given the size of the Airbus aircraft, it is actually significant for us. You can see there, that when you put an ER on JFK to Los Angeles we get 32 more seats. You can see the revenue there generated by Boeing spill models and their own natural demand that we are aware of and we see and we model. Then you're going to put the shorter gauged aircraft on the West Coast and there is going to be a bit of spill and a little bit of loss there, but overall, net revenue positive for this 6.5 margin points. We're doing all of New York. You heard 28-plus flights a day there, but we have more to come in other parts of the network in 2020 and beyond. So there is a real upside here.

The other one, we don't talk about so much is sort of the retrofit. When you hear retrofit, you should be hearing significant revenue generation adjustments. The Airbuses were not configured to be revenue generating machines in our current network. So not only are we adding 4 seats under the 319 and 20 on the 320s, but we are also increasing first class cabin by 50% and our ancillary revenues Premium Class and exit rows. So currently today, the 319, we have 10 of them. We're only selling 2 rows. The bulkhead and the exit row, 1 exit row. After reconfiguration, we're going to be selling 6 rows, 4 Premium Class rows and 2 exit rows. The same with the 320, it's going to go to 6 and there's 53 of those. And again, this is just a margin point on an example, Los Angeles to Seattle, I think it's very conservative. But these are tangible real ways that as we move forward, we're going to unlock revenues. You heard me talk on the last call about revenue initiatives and Shane's been huge part of that and he's now moving into a new role so I'm going to take full credit for all the goodness that comes from these initiatives going forward. That was meant to be a joke by the way. But you can see here Saver Fare, Bags, and

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ancillary, one thing we're going to start talking to more about is corporate revenues, corporate sales, and I'm going to touch on that in a second.

But what we're really excited about is we are now on parity with the industry. We have segmentation. It's been clear that this is a model that works and we can see here that's not meant to be a wide-body in case anyone gets excited, that is a narrowbody with some extra width on there. But you can see here we now have the 4 different types of cabins/products. We launched Saver Fare Wednesday last week system-wide and we are still getting information. So we don't have a whole lot to report to you today, but I'll tell you really 2 important things. Firstly, from a technology and a purchase distribution perspective, flawless. It went beautifully. And the average fare that went out, we did it simply across-the-board at $30 sell up and of course, working towards that going forward depending on the market. The second thing, I will tell you is, it's very early days yet, but the uptake was a little higher than we actually expected. So as we go out of the gate, things are really looking good. And then our rule of thumb here on average is that when folks going into the Saver Fare, we expect 3 of 10 times someone to buy up into our main cabin product. $100 million of revenue opportunity here, it's going to be something very exciting.

And then of course ancillary revenues, that's another area that we're growing and will continue to grow. And you can see here, $2 uplift and you're going to see this continue to be done in a thoughtful way as we go forward.

And then really quickly on corporate sales, David Oppenheim is here, he's the Vice President who came to us from BCG and also United Airlines. He has already started significantly growing our corporate contracts in our easybiz and from large contracts, but more importantly, given the competitive nature of Seattle and the West Coast, we're growing the TMC relationships. Of the big 3 TMCs, we had 2 and recently bought on the third. And we're going to expect good things, higher-yielding volume coming through our aircraft.

So to close all of this up, we built the foundation. We've activated it. And as part of really the trajectory, I want to update our revenue guidance for you this morning. And then if you look at the fourth quarter guidance, we're updating that to 3% to 5% unit revenue growth in the fourth quarter. Not only do we see continued strength, but we also see some of these ancillaries that we already turned on starting to come through in a very meaningful way.

So in closing, you've seen $130 million from synergies. You have seen $200 million from the ancillaries. The one thing I haven't put in here because of the nature of the industry, is our RM, our management of RM, we have lower growth, we have stability in the market, we have our hands around the California network. We've got our hands around ancillaries. There is a lot of revenue management goodness to come our way.

And with that, I'm going to ask Brandon Pedersen to come up and bring this all together for you.

Brandon S. Pedersen ***Alaska Air Group, Inc. - CFO & Executive VP of Finance***

Thank you, Andrew, and good afternoon, everybody. I'm getting a few texts saying, can you move a little quicker to bring this home because I recognize that I am between you and Q&A. So I'm going to do just that. But I thought I might start with just a couple of conversations that I've had today and basically the questions that folks have asked me was along the lines of how are you feeling about things? How are things going, are you optimistic about getting into 2019? And the answer to that unequivocally is, yes. 2018 was a year that we were in construction, we had a lot of transition. Our margins eroded, that's no surprise to anybody in this room, but I'm really looking forward to turning the page to 2019 and getting into a year where we have lots of things working for us including a plan to get us to higher margins. And I want to just recap that really quick.

Okay, we're going to show this slide one last time and basically, what I want to you to know is that this is just a recap of all the opportunity that we think we have in each of these buckets that are going to drive margin improvement in both 2019 and we believe 2020 and beyond. That's the point of the pie charts on the right-hand side, which is really just to say, on merger synergies, we're only 50% done roughly. Revenue initiatives much of that will come into play in 2019, but we will have some of that left over in 2020. And then on the cost side, I will talk more about that in just a second. We think we have more cost opportunities, both in terms of the support function efficiencies that we still think we can get and some of the operational efficiency that we think we can get as we move out of this training bubble in particular, with respect to the pilots.

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Okay, then I wanted to step back and just share some broader guidance with you and some of you may use this in your modeling. Here is where we think we're going over the next couple of years. First, on capacity growth. 2019, we've already told you that we think we're going to be at 2% ASM growth.

For 2020, right now we believe it would be between 3% and 4% ASM growth. On the margin side, that really is suggesting improved margins in 2019 and 2020. We think we have opportunity to do more on the RASM side and the CASM side to increase that spread as we go through 2019 and 2020. On the fuel side, we really think we'll be in a stable position with respect to the fuel efficiency of our fleet. We think we've got a fantastic fleet, super fuel-efficient, the mix will change a little bit as you've heard us as we go to 2019 but going forward, I think, we're going to be pretty stable, pretty competitive with respect to the fleet.

Nothing new here, but we're reaffirming our CapEx guidance of $750 million a year for 2019 and for 2020. And then if you're doing your math, what that would suggest to you is that we would have a whole lot of free cash flow and that would in fact, we put $500 million in the box, but if you're doing your models, it should be actually more than that, so it's $500 million plus.

Speaking or just looking at specifics in 2019, Andrew and Shane touched on this, so I'll just move really quickly to recap. $130 million of merger-related synergies, $200 million of revenue initiatives and then aside from that, we have a whole lot of new markets that we added in 2016 and 2017, we'll be through all of that annualization. So I would call it market maturity, I would call it maybe just improvement in those markets or perhaps just not the drag of those lower RASM markets. That will be a tailwind for us as we look forward into 2019.

On the cost side, Shane walked you through this and I've been doing this job for about -- well since I was the controller, for about 15 years now, so I've spent a lot of time looking at costs. And so what I want you to know is that for us to be at basically flat to up a half on 2% growth is an absolutely remarkable accomplishment. And I really want to congratulate the FP&A team and the divisional leaders, who really demonstrated a willingness to look at things differently, to embrace productivity, to embrace some of the other things that we had to do to get to this result. It really is beyond impressive. And then you heard us about the other things that we will layer on so that will give us CASM guidance for the year of about 2 to 2.5 and that excluding new labor deals. What I want you to take from this slide is that we have an absolute commitment to low cost. We have a long track record of reducing costs. We recognize that it was super important to our success. It's going to be super important to our success going forward and it is what allows us to offer those low fares that Andrew talked about.

Okay, I want to talk a little bit about the fleet. From a fleet perspective, we're in great shape. You can see pretty modest fleet growth over the next couple of years, that's pretty consistent with the lower CapEx. We'll go from 328 total airplanes at the end of 2018 to 335 and then 341 at the end of 2020. The thing that you don't see on the slide is the number of unencumbered airplanes that we have in the fleet currently. As of today, we have 22 unencumbered E175s. These are basically brand-new airplanes, and we have 70 unencumbered mainline aircraft. Absolutely fantastic and provides liquidity, should we need it. I wouldn't expect to need it, but it's a source of insurance that investors would appreciate.

On the CapEx history, nothing new there. You can see the guidance for 2019 and 2020 that I already talked about.

Okay. In terms of capital allocation, I wanted to walk you through the funnel on the left and then give you some specifics on the right. First of all, with respect operating cash flow, what you've heard today is a plan to significantly improve the profitability of the company and with that, will come in an improvement in operating cash flow. What you should know though for your modeling purposes is that operating cash flow will not rise as fast as pretax and that's because taxes will take a larger bite. In 2018, we'll pay cash tax rate of roughly 1% to 2%, so pretty darn low. In 2019, our cash tax rate will be about 20%, so that will impact operating cash flow. So it will not grow as meaningfully as profit next year, but it will absolutely grow on a year-to-year basis.

On organic growth, you'll know that we have lower CapEx coming down to that $750 million I talked about from about $1 billion this year. We also have a dividend and I think everybody in the room knows that we started the dividend back in 2013. It's currently yielding about 1.9%. We have a track record of raising the dividend. We've done so 5 times, since we initiated the dividend, and I would expect that we

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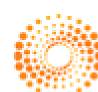

would do so again next year, at least modestly. And then finally -- excuse me. I missed the debt repayment, that will be about $350 million next year. And so what that leaves us is cash available for either further debt reduction, deleveraging as I would call it, or returns to shareholders.

On the right-hand side is a really specific example for 2019. So if you take consensus earnings and you say what does that translate to in operating cash flow, that would be roughly $1.4 billion. $750 million CapEx gets you $650 million of free cash flow. Maturities next year will be $350 million. On the dividend side, I just put $170 million here, that would be a very modest increase over the $162 million or $163 million that we have this year, which would leave roughly $130 million for, as I said, further deleveraging or further returns to shareholders.

Looking at the debt. On the debt to cap side, we'll end this year at 49%. Depending on what we do with that $130 million, we could get to the end of 2019 and we could be at 41% to 43%, essentially achieving the goal that we set out when we announced the merger and being at that level by 2020. So this is essentially a year ahead of when we originally targeted. And on the balance sheet side, on balance sheet debt, we will end this year with about $2.2 billion on balance sheet, that's going to have roughly $800 million of the acquisition debt paid off. With the current maturities and the additional debt payments next year that we could do, we could get on balance sheet debt of $1.7 billion to $1.8 billion or so. Some of you might say, where are you on pension obligations? On pension obligations, we're about 90% funded. Our pension liability is about $2.2 billion right now. Our pension assets are about $2 billion right now, so there's a $200 million unfunded amount, we feel fine about that. We wouldn't have any required contribution until 2021 or 2022 based on our projections currently.

Longer-term, here is what we're trying to achieve. We're trying to be an airline that grows about 4% to 6%. Some of you have asked, you've said do you think that 2% that you have this year is indicative of what you're going to do in the future? Do you think the 4% that you talked about for next year is indicative of the future? No, I don't think so. I think that we can grow at 4% to 6%, of course, profits permitting. As you've heard today, we want to be an airline that generates 13% to 15% pretax margins. Why do we think we can do that? We think we can do that because we have real and sustainable competitive advantage. We have low costs. We have low fares. We have great employees that can deliver award-winning service. We run a great operation, which is by definition low cost. We've got really loyal guests, a fabulous loyalty program that generates a lot of cash for us, and we operate in a geography that's particularly attractive in terms of growth and economic well-being.

With that, we think we will be a company that will want to keep an investment grade balance sheet. This notion of conservatism has been really, really good for Air Group over the years. Because, all the way back to that video that we showed you earlier today, where Air Group is the only remaining pre deregulation carrier that's never filed for bankruptcy. This is because of the conservative bias that we've had. We want to retain this investment grade balance sheet, and ultimately, that gets to growing profit, which comes full circle to where we started. We believe that profitable growth is really what underpins this whole thing, that's what we're all here for. That's what you guys want, that's what our people want, that's what our guests want, and that's what our communities want.

So with that, I think we'll move to Q&A.

Matt, maybe you can kick off the Q&A.

Matt Grady ***Alaska Air Group, Inc. - Director of IR***

Okay. So now we will begin Q&A and several of you already have your hands in the air. So just before we dive right in, just to kind of set some ground rules here. We do have 2 runners in the room with microphones. So if you raise your hand they will come to you with a microphone., And also if I missing you they will wave the wands so that I don't miss you. This is a 45 minute session. I would request that you ask one question and one follow-up question until everybody who would like to ask question had a chance to ask a question. If there's still time left after everybody has asked a question then we will get you back in and you can ask your third, fourth, fifth question after that, okay? All right, very good. So we're going to kick it off. Dan McKenzie, please.

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Daniel J. McKenzie ***The Buckingham Research Group Incorporated - Research Analyst***

Daniel McKenzie, Buckingham Research. 2 Questions, one would be the revenue beat for the fourth quarter, I think a lot of the sell-side will want to extrapolate that in the first half of 2019, so if you can please clarify what's really driving that? Is it just better than expected holiday demand, is it better-than-expected Saver Fares? Second question, how are the Saver Fares, can you help us connect the dots, you have maintained your $100 million revenue good guy from that initiative, yet the upsell is $30. And I think if I'm not mistaken you have said $12.50 for the upsell. The upsell looks like it's coming in to $2 and change relative to, so there is a lot that has changed with respect to the original guide on Saver Fare. So if you just kind of help us think what that could really be like please.

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

Sure. Maybe I'll start and then I'll maybe have Shane, who's been closest to talk about Saver Fare. But on the fourth quarter, as we went into the fourth quarter, we've seen good solid strength, but new also just unleash a lot of new revenue initiatives that are going to start to come through like same-day confirmed, tickets going up the fare wave and then also we have been getting our loyalty redemption program back to what it needed to be. And so we've seen a lot of the things play out to the positive. So we saw real strength in the pricing, strength in demand and the ancillary revenue. So that's really the reason for the beat. We were trying to be conservative and things are played out toward the high end.

Shane Tackett ***Alaska Airlines, Inc. - EVP of Planning and Strategy***

On the math, I'll just make sure sort of everybody is grounded in the original math. We set this about a year ago, maybe either 9 months ago, we sort of based it on what we saw other people quoted in terms of the basic economy into having fares. And then what really matters is how many fares you attach to. We have 12 different fares in the main cabin, the question is do you have a Saver Fare for all 12 of those, to 8 of them, to 6 of them, the 5 of them, to 4 of them. The original amount assumed that every time we assigned the lowest 4 buckets or classes on an aircraft would have a Saver Fare and that everybody who saw that about 35% of the people who saw that would buy out of it. And that the average buy up is going to be $25. If you do all of that math, that got us to about $100 million. I think what we have seen in market in terms of where others have gone with this, the numbers that they quote are higher in terms of the buy up rate. I think that sellout might have trended up a little bit. And I think they maybe attached on it to 1 or 2 additional fare classes. So we just got this into market last week. We will sort of watch how this goes for the next couple of months. The one thing that we will update probably on our earnings call is if we think it's going to be materially more than $100 million. The last thing I'll just note is, we are more leisure-oriented that the Legacies. The Legacies expect higher buy up out of Save Fare because they don't expect corporate customers by and large to purchase basic economy fares. But we mix more leisure less business. So we should have a lower average buy up rate relative to legacies. So I wouldn't assume that we get the same buy up that the Legacies do.

Matt Grady ***Alaska Air Group, Inc. - Director of IR***

Jamie Baker. Jamie, go ahead. I think Jamie's hand was up first. We'll come to you next.

Jamie Nathaniel Baker ***JP Morgan Chase & Co, Research Division - U.S. Airline and Aircraft Leasing Equity Analyst***

First question for Brad, so against the backdrop of 13% to 15% pretax margin guide. You cited stable fuel prices in '19 and '20, I understand the definition of stability, but is that based on the current fuel price? Or is that stable as of October fuel prices because it's a very, very large difference?

Bradley D. Tilden ***Alaska Air Group, Inc. - Chairman, CEO & President***

I think, Jamie, what we're really trying to say today is we do -- it is harvest time, we are through the bulk of the merger. There's a lot of things like Saver Fares, Bag Fees, productivity improvements, further debt reductions, a lot of things that are in our control that are going to get better in the future. I think that 13% to 15% is really based on our mindset that we have competitive advantage. We don't know that fuel prices are going to be $80 a barrel or $40 a barrel 2 or 3 years from now. We don't control that. What we do know is that we need to outperform the average airline and we think given our cost of capital, 7.5%, 8% something like that, we think 13% to 15% is a level that a good strong performing airline should do in this industry. And I know that's probably not that satisfactory of an answer, but I think maybe, second answer we can give is we actually think we should be able to outperform the industry like that with any - when fuels prices move around, it does take a little bit for the industry to respond, but I personally believe the industry can be profitable at higher fuel prices and lower fuel prices. So I think give us a little bit of an adjustment period as a company and the industry and we should be able to achieve that in any fuel environment.

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Jamie Nathaniel Baker ***JP Morgan Chase & Co, Research Division - U.S. Airline and Aircraft Leasing Equity Analyst***

Okay, fair enough. Second question for Shane, I'm still trying to understand why a move to a revenue-based loyalty program wouldn't be the profit maximizing decision. Your competitors who made the move had been very enthusiastic about the margin benefits and almost reluctant to extrapolate my own travel idiosyncrasies to building models and picking stocks, the fact of the matter is that the model works extremely well for me, I like to fly a lot more on Transcon, but the mileage that I have to give up on the companies that I'm already locked into now that they moved into a revenue model is simply too great for me personally to bare. So you said simplicity, maybe it has to do with the large portfolio of international partners, just a little more color there.

Shane Tackett ***Alaska Airlines, Inc. - EVP of Planning and Strategy***

Thanks, Jamie. Andrew, you might want to jump in on this. I think number one and Andrew might share, there's probably always room for somebody to be different so that the entire industry has gone one direction, there's probably value we think there's value in being differentiated on this point. I think the other thing for us, loyalty is really about breadth... of course we're not... a lot of folks in this room travel a lot, you guys buy tickets last minute, you pay a lot of money for those tickets. If that's the profile from just a purely economic, personal economic point of view, revenue-based programs can do very well, for the neighbor across the street, who flies 2 or 3 times a year. I think, there is tremendous value in those folks deciding always to come to the website never really look around, just go to what they trust and what they have come to know, have their credit card, get their kids to fly at $99 and change in this is honestly what we hear from neighbors across the street all the time. They don't go to an OTA, they don't go anywhere else and I think having that relationship with our customer has given us more natural demand to work with. And ultimately, that helps us shape revenue better over time.

Bradley D. Tilden ***Alaska Air Group, Inc. - Chairman, CEO & President***

On Alaska, flying Seattle to Newark you get 2,300 miles. If you're buying a relatively -- just a typical low-fare on a competitor, how many miles...

Shane Tackett ***Alaska Airlines, Inc. - EVP of Planning and Strategy***

1,300 to 1,600

Bradley D. Tilden ***Alaska Air Group, Inc. - Chairman, CEO & President***

That's actually what we hear a lot of. But not to say that the hi wi customer is not getting expense different experience.

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

And might be just real quick, honestly Southwest could also immediately make a lot more money if they charged bag fees, but in the short term may be, but I think, every airline needs to play its own game and its own business model. The minute you start mimicking or being a Me Too, you lose who you are. The generous loyalty program, at the heart of our DNA is rewarding a lot of people that we need to help fill out airplanes in the leisure. We can always update the mileage later on, but I think the economics and what we're saying today is that our miles-to-miles program is working and working incrementally solid.

Brandon Robert Oglenski ***Barclays Bank PLC, Research Division - VP & Senior Equity Analyst***

Brandon Oglenski from Barclays. So Brad, coming back to Brandon's last slide here talking about what Alaska wants to be down the road. Should we be thinking that 4% to 6% capacity expansion, is that inclusive or exclusive of the margin percentage so you're not going to exceed those levels of growth until you hit the margin? And along those lines, have you aligned the executive compensation with these goals here?

Brandon S. Pedersen ***Alaska Air Group, Inc. - CFO & Executive VP of Finance***

That's for me?

Bradley D. Tilden ***Alaska Air Group, Inc. - Chairman, CEO & President***

So Brandon, it's 4% to 6% is our mindset and that's exactly comp aligned with that.

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Brandon Robert Oglenski ***Barclays Bank PLC, Research Division - VP & Senior Equity Analyst***

No. Are you going to grow the numbers before you hit your margin targets.

Bradley D. Tilden ***Alaska Air Group, Inc. - Chairman, CEO & President***

So I think, we need a little bit more time. We're quite confident about the next couple of years. We -- the plan we shared today with you, we think we've got great ability, great odds of hitting. But in terms of raising the growth numbers, I think, we actually want to see. We want to get into 2019, some evidence that the environment we see is there. So I hope that's a response to your question. That's what we are thinking about things as Brandon said next year's 2%, current thinking about 2020, 4% and we just need to get few good quarters under our belt and we will see what late 2020, 2021 looks like. Is executive comp aligned? I think in general it's highly aligned. The basic setup we have is the short-term plan we call performance-based pay. It's got a very strong return on invested capital orientation. It's going to get even more so in 2019 and beyond. It also has CASM, safety, customer service, right now it's got a loyalty focus. It's all things that we do to drive long-term value. And then in terms of the equity program, there is heavy orientation towards performance. So I do think there is quite good alignment there.

Brandon Robert Oglenski ***Barclays Bank PLC, Research Division - VP & Senior Equity Analyst***

Maybe one quick follow-up for Brandon. On the CapEx outlook, its 750 that you're spending this year, next year right to maintain the network and the answer should we be thinking little bit higher in the future?

Brandon S. Pedersen ***Alaska Air Group, Inc. - CFO & Executive VP of Finance***

For maintenance CapEx? It's probably a realistic number for maintenance CapEx, maybe a bit lower than that. We're in sort of a bubble with respect to non-aircraft capex with the construction of the building many of you saw when you were visiting Seattle and then out of the retrofit activity. So that would come down and maybe aircraft CapEx would go up. As we get into a higher growth level, we would need a higher CapEx amount to support that. But for the next couple of years, I think, $750 million is the right level to be at.

Helane R. Becker ***Cowen and Company, LLC, Research Division - MD & Senior Research Analyst***

Helane Becker with Cowen. So let's see, the balance sheet numbers for next year that you gave us assuming random level, does that include capitalizing the off balance sheet debt that you have to do beginning January 1?

Brandon S. Pedersen ***Alaska Air Group, Inc. - CFO & Executive VP of Finance***

Yes, we have a long history of doing that in a pro forma, presenting those numbers on a pro forma way with leases on the balance sheet. So yes, it wouldn't change at all with the adoption of the lease accounting rules.

Helane R. Becker ***Cowen and Company, LLC, Research Division - MD & Senior Research Analyst***

Okay, great. And then one follow-up, when you think about where your headquarters are and maybe this is for you Andy. And therefore, when you think, your headquarters are in Seattle, you have a lot of competition from a lot of very high-paying companies that maybe you can't compete with or you find you have to pay up for talent. So could you just talk about the cost differential that causes? And what do you do to attract really high-quality people and then retain them, so you don't lose them to other high-paying companies in your basin?

Andrea L. Schneider ***Alaska Airlines, Inc. - VP of People***

It's an excellent question. It has been a bit of a struggle for us. And I think a lot of the people who are going to high-tech in Seattle and even area market, it's a different company and they go there for different reasons. And I think it's part of why we think culture, good culture is very important. People come to Alaska Airline because they love the culture there, they're lured by the desire to travel and they are really focused on service. We do have to constantly look at our compensation rates and incentive plans and even our benefits. And it's a struggle for us. Especially at the entry level, I think, Ben said, 90% of our employee workforce is unionized and we were behind some of those contracts. So what the rest of the industry was that and it's been challenging on the, a lot of the market in the West Coast and lot of cities in local ordinances putting their own minimum fee compensation. So it's a constant struggle, but we keep looking at it. And we are relentless on ensuring that we are not downgrading our standards in order to fill the empty positions, because it effects long-term what we can provide for guests.

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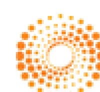

Brandon S. Pedersen ***Alaska Air Group, Inc. - CFO & Executive VP of Finance***

I just want to make sure, I give you a complete answer. We do have some of the airport real estate that's on the balance sheet. I don't think it will move the needle, but Chris, can you confirm that? Okay. Over to the side.

Unidentified Analyst

David with Bernstein. Question for you on the background why shifting flying focused for next year in to more regional flight if you talk a little bit about the rationale for that and whether that flying will come in with a revenue premium to match the headwind you're expecting to see next year?

Unidentified Company Representative

What's really going on is number one, we have like 5 airbuses in mod-line. So we have a lot of fleet with mods. Paine Field is E175. So we need 8 aircraft to operate Paine Field. And then we are just in the process of filling out some of those in our markets. At the end of the day, if you look at our capacity for next year, we're still about 89% mainline ASM 11% regional. And you are going to see us next year settle a bit so it should stay there. So really what you're seeing now is just new fleets coming in to generate a lot of these new markets that we have in California.

Unidentified Company Representative

And on the unit revenue side, will there be a RASM premium as well.

Unidentified Company Representative

One thing that's again one of the really exciting things is that we've been learning how to manage these 175s, First Class, Premium Class, main cabin. You can sell out the main cabin like that if you're not paying attention. So we're seeing the revenue mix improve on these aircraft as we deploy them and the other thing I'll mention is, we talk about cross-fleeting mainline. There are certain markets where 175 has a sweet spot. We haven't got them all in those markets yet, that's what you're going to see. So overall you're seeing a rising tide and a premium on that regional fleet.

Unidentified Company Representative

Can you come down in front here to Duane Pfennigwerth please?

Unidentified Analyst

So with the training initiatives you're doing, economics of 2 fleet types are clearly improving. Could you give us a high-level sense for how much higher your margins might be if you went back to 1 fleet type and along those lines, when you are through this training bubble, would there be any other additional training to get done to get back to 1 type?

Benito Minicucci ***Alaska Air Group, Inc. - President & COO of Alaska Airlines Inc and CEO of Virgin America Inc***

It's a great question. We talk about internally when we actually did the acquisition, we put the of cost of the dual fleet types at about $25 million, that was the number we kind of pegged it at -- we probably think now as we are going into it, it's probably a little higher than that. It would be maybe in the $40 million range is what we think. And so what we have to decide is single fleet and we will make that decision next year. We would have to figure out what the best way is to get to a single fleet in terms of managing training costs because those are the ones that can really spike up bubbles and it really harms growth. So we're working internally with that and our plan that, that gives you a sense of how we're thinking about it.

Unidentified Analyst

And just as a follow-up, I think, you said reserve costs were about $19 million per point. How many points do you free up from eliminating the reserves on one side of the fleet?

Benito Minicucci ***Alaska Air Group, Inc. - President & COO of Alaska Airlines Inc and CEO of Virgin America Inc***

I don't remember the $19 million. So there's 1 point of productivity for pilots is about $12 million.

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Unidentified Company Representative

And the FA's is $7 million.

Benito Minicucci ***Alaska Air Group, Inc. - President & COO of Alaska Airlines Inc and CEO of Virgin America Inc***

Sorry, you added both.

Unidentified Company Representative

That's what we do.

Benito Minicucci ***Alaska Air Group, Inc. - President & COO of Alaska Airlines Inc and CEO of Virgin America Inc***

I see that. You confused the ops guy really quick there. How the heck do you get to $19 million? No, just on the pilot side, I mean, it's just a hard time productivity we would say so when you convert the soft time to hard time, whether it's reserves we have got certain level of reserves and you will put into hard time. At one point, we would look at it, so we have a 1.5 point gap trying to get back to it, if you went back to single fleet. So that will be worth $18 million in that sense and the flight attendant one, we should hit that in the next 12 to 18 months.

Unidentified Company Representative

Okay. Come over here. Catie (2:16)

Catherine Maureen O'Brien ***Goldman Sachs Group Inc., Research Division - Equity Analyst***

Catie from Goldman Sachs. So first one, as you're thinking about hitting these new corporate revenue targets. I was really impressed with the connectivity you have with your global partners, but as you speak to corporates, do they ever ask if you would be interested in doing an antitrust-immunized joint venture, do you think be benefits on the corporate side from doing such an agreement?

Unidentified Company Representative

We just started looking at, We got to be careful with all of that. A lot of our big carriers are a part of joint business arrangements and JVs. So we don't mess or want to do anything with that. And of course, as you said, we have to be invited in. I think where we are right now is we are in this real value generation stage, with our global partners. There is a real mind shift from us especially from me personally where we used to view our partners as an outlet for redemptions and that was really important. We have moved our mindset now to generating huge value for our partners internationally and what we see from that because these are large carriers they are more engaged with us and looking for ways to further enhance that. So this will play out over time, but nothing immediate.

Catherine Maureen O'Brien ***Goldman Sachs Group Inc., Research Division - Equity Analyst***

Just a quick follow-up on Paine Field. Should we think about that more as a way for you guys to avoid the congestion at Seattle or should we think of that as a margin builder at some point?

Unidentified Company Representative

I think as it stands today it's a two-gate facility. There is a hard stand as well, it really compliments Sea-Tac but of course, the region over the next decade has real challenges. And so who knows, but as we look forward, we'll have to be looking at a whole lot of things to make sure we can get the lift we need for our guests as we grow into the future.

Unidentified Company Representative

And Paine Field will be a huge help with congestion next year. It is -- you heard me talk about block times that we want to squeeze block times, just the taxi out times at Sea-Tac over 3 years has gone from 15 minutes out at peak times to 25 minutes.

Unidentified Company Representative

Our captain that brought us out yesterday is here, what was our taxi time, Brian?

Unidentified Company Representative

About 25 minutes.

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Unidentified Company Representative

And that was at 8 o'clock in the morning, so of course at peak of day that is the impact. Having Paine Field will

Unidentified Company Representative

If you don't go to Seattle often, it is very, very congested. The airspace is congested, the concrete is congested, the gates. In most cities, Seattle is the number 9 or 10 airport now. In most cities of Seattle's size do have a San Jose or an Orange County or Burbank or something like that. So I think we will see how Paine Field starts. We are very, very bullish on Paine Field over time just given the growth of our region.

Unidentified Company Representative

Over here.

Michael John Linenberg ***Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst***

I'm gonna actually stand up, Michael Linenberg with Deutsche Bank and just to follow up 2 things, One to follow-up on Catie's point about Paine Field. I think recently there was a transfer of may be rights at that airport from Southwest to you. I guess was there any sort of consideration that you had to offer in return for that? Was there any sort of regulatory approval that you needed for DoJ basis? And then I have a follow-up.

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

Yes, I think, Mike. I can't speak to the specifics because of privilege of contract, but what I'll say is that it's a three-way arrangement between the airport, ourselves and Southwest and very reasonable, all interests were met by this trade. So we picked up 5 additional slots or gate slots and that's what got us to 18 flights a day. So we will be there with United starting in March and they will have 6 flights, we will have 18 flights a day.

Michael John Linenberg ***Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst***

Is the limit 24 or 25

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

The environmental review that's out, that's pending starting in February is for a 25 departure facility, yes.

Michael John Linenberg ***Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst***

Okay, great. And then the second follow-up to that, you earlier mentioned Seattle basically being constrained once this -- the airport project is done. Do you have a sense at what point either Seattle, San Fran, LAX. over the next couple of years become level 3 IATA slot constrained airports, are we just a few years away from that or is it much longer? Any thoughts on that?

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

Right now it's not really being talked about. These are one of those things be careful what you ask for, you know what I'm saying, they cut both ways just to be frank. I think what you're seeing also in Seattle is massive construction both on the north side of the airport, south side of the airport and when that's all done by 2022 you're going to get some gates freed up. San Francisco is already working with Oakland and San Jose, long long-term about the future of lift in the region and where it belongs. So I think it will play out over time, but I think, over the next little bit here, I don't see any changes.

Unidentified Company Representative

We'll go to the back, Joe DeNardi.

Joseph William DeNardi ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst***

Joe DeNardi, Stifel. Andrew or Shane, I think, you outlined about 3 to 4 points of RASM initiatives for next year, really growing capacity 2%, but the regional mix tailwind, and you've got some pretty easy comps. Can you talk about why RASM next year shouldn't be up in the high single digits?

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Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

That's interesting, but yes, what I think, a couple of things. I think you've nailed it on the 4 points, I mean, $80 million is a point give or take, so $320 million, $330 million that we talked about that, so that's four as long as we get positive on the growth. I think like in anything in this business, there are always puts and takes. We don't know what's going on with the competitive environment. We don't know how the fare environment will sustain, we're already seeing interest rates rise. We are seeing housing sales slow down especially in the Pacific Northwest. So I think if everything went the right way and all were headed north, you could maybe see a higher mid digit or higher. But that's -- we don't give guidance, but that's sort of not our mindset right now.

Joseph William DeNardi ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst***

Andrew, mid-single digits implies that 2% capacity growth produces like 1% PRASM growth. why is that a good way to think about it, it should be much higher than that for airline that operates in the strongest economy in the country.

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

Yes, I'm not providing guidance, but I think, we fully expect on 2% growth, which is basically the annualization and maturing of our network to have a good solid unit revenue return, but we are not going to provide guidance on how much that will be.

Unidentified Analyst

It's David from Jay Goldman. I want to go back to the F word that Jamie attempted to get some color on. Obviously there is a lot of variability to jet fuel prices. How do you want investors to think about your capacity planning and your revenue planning as well as potential capital return? If I hear you correctly, you are setting your model based on your revenue assumptions and your CASMx, which implies any gains from fuel declines, you might consider to be excess returns. Does that mean you are going to have alternative plans for the capital? And additionally, if you can round back to how you think about capacity planning relative to jet fuel?

Unidentified Company Representative

Yes, hey, David, I will take that one. So here is what I would say, I would say that the box on the slide really meant stable fuel in terms of fuel efficiency. But you're getting to a bigger question is how do we think about fuel? And the way I'll talk about it is I would say, it was a mere 70 days ago, that we were complaining about our inability to pass on the ridiculously high fuel prices and our inability to generate significant or sufficient returns for fuel prices where they were. We had a gigantic decline in fuel prices. The reality is I don't necessarily know what to think of that. Could it be 70 days and back up to $70 a barrel? It would be wrong for us to make our 2019 capacity plan based on a 30% pullback of oil prices here over the last 2.5 months or something like that. If it does stay at that level, fuel would be at about 2 or 2.10 a gallon and that would be a significant improvement over where we were in 2018. That will generate cash flow, you're right, to the extent that we have that cash flow and we need to decide whether or not to deploy it out to shareholders, to reinvest it in the business, to hold it on the balance sheet, to pay down debt, we haven't crossed that bridge yet.

Unidentified Company Representative

Adam Hackel from Imperial Capital. So couple of questions on Hawaii. You haven't really talked about that much, but we talked about the headwind for the fourth quarter on your last call. I'm assuming that's still the case, even though we have a new guide. But mostly I'd like to hearhow you're thinking about not just the price structure of that market, but also the frequent flyer dynamic and an airline coming in that obviously is going to be pretty promotional probably and trying to get frequent fliers to that?

Unidentified Company Representative

Yes, so as I've shared Hawaii is very sensitive to supply and demand. But again way we feel very good and especially sitting here today because everything we talked about as well as these initiatives Saver Fares, Premium Class, all of these things are going to directly benefit Hawaii. So all of these initiatives and synergies, all at the end of the day will continue to help Hawaii. We feel very good not only about our product that goes to Hawaii, but as we are across 8 different gateways to four islands in most of those cases and a strong loyalty base, we feel like overall, no matter what happens next year, we are going to be prepared to handle what comes our way. We do have some negative unit revenues baked in on that network, and we will see how it plays out.

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Unidentified Company Representative

Just a second question from me quickly. Just curious how you guys think about the potential for this company from a tech perspective? Given your acumen before the merger, obviously Virgin being in Silicon Valley and sort of can this company at some point be longer term sort of a tech company with wings, if that makes any sense?

Unidentified Company Representative

Maybe I'll take that. I have e-commerce under my group. I think that's hitting me sort of cold, I think, we do consider ourselves an airline. I know there are other carriers whether they are domestic looking at themselves as travel companies or -- I know there's a big European company that's focused on sort of the technology side of the business. And one thing we've been proud about is we really have sort of been the first-to-market with a number of things over our history from a technology perspective. We live in a high-tech part of the country or part of the world, Seattle really has become a satellite for Silicon Valley, basically every Silicon Valley firm is set up in Seattle today. We get to enjoy some of the benefit in terms of some folks don't want to live in the city and downtown and take 3 hours to go 4 blocks in South Lake Union and get south of the city and sort of more hospitable conditions. I think what we know what we need to do is get to refocus on innovation and on technology, it's just not something we have been able to do for last couple of years. I'm going to take a pass on whether we're going to become a technology company with wings, but

I think, certainly, we can sort of regain leadership in our innovation within the industry.

Brandon S. Pedersen ***Alaska Air Group, Inc. - CFO & Executive VP of Finance***

I would say we are a technology company with wings because tech companies get a way higher multiple.

Matt Grady ***Alaska Air Group, Inc. - Director of IR***

Okay. Hunter?

Hunter Kent Keay ***Wolfe Research, LLC - MD and Senior Analyst of Airlines, Aerospace & Defense***

I thought you were a Prius with wings. Haven't heard that one in a while. Okay. So a question about this David Oppenheim person, who's here I think.

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

He's right back there.

Hunter Kent Keay ***Wolfe Research, LLC - MD and Senior Analyst of Airlines, Aerospace & Defense***

Hey, man. He's like Jim Halpert. What was he hired to do? I'm curious of that, and you can talk -- answer this yourself, if you want. But is it a new role? And was he hired to kind of roll up your existing corporate business and make it more managed and create structure around your existing corporate business? Or was he brought in to really kind of exploit some of the high-value assets you have and the utility you have by driving new corporate gains?

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

I'm going to let David answer this because this is a test.

David Oppenheim ***Alaska Airlines, Inc. - VP of Sales***

Well, thanks for the question, Hunter. I'm David Oppenheim. I'm our VP of Sales. I joined the company at the beginning of this year. There is a few things we're doing. I mean, one is, as was mentioned a couple times today, we're a heavier leisure mix airline than the legacy carriers. But when you look at our route network, there is no great reason for that. Yes, we are a little heavier in Hawaii. Maybe that makes sense. But we're across the whole West Coast. These are big business centers. And so my big objective is to increase our corporate share. It's a big piece of our business today. It's obviously a really a high-yield portion of our business today, so we need to grow that. And I'll tell you the 2 big things we are going to do that: Number one is going deeper with our corporate contracts. We actually already had relationships with most companies, though as you saw, we've grown it quite a bit just during this year. But we need to get more performance out of those. And being lower fare helps, but the other carriers can do things globally, and so what we're doing global partners and other things, we need to become more relevant to them. That's a big focus with our corporates. And the second half is the

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TMC piece. And so our travel agencies, we've had limited partnerships with them and not with all of them. We are expanding that, but doing so really carefully. It is not just to enter an arms race and spend away. We're actually spending more conservatively than we used to, but getting better returns for it. And there are places that you can drive business, and there are places where it doesn't make sense to drive business. And so we're looking really carefully at what those different places are.

Hunter Kent Keay ***Wolfe Research, LLC - MD and Senior Analyst of Airlines, Aerospace & Defense***

Appreciate that. And then, Brandon, I want to lock you down on that one slide with the capital returns where, I think, you showed the consensus operating cash flow was, what, like $1.4 billion or something.

Brandon S. Pedersen ***Alaska Air Group, Inc. - CFO & Executive VP of Finance***

Yes.

Hunter Kent Keay ***Wolfe Research, LLC - MD and Senior Analyst of Airlines, Aerospace & Defense***

And that waterfall chart had, what, $130 million left over at the end.

Brandon S. Pedersen ***Alaska Air Group, Inc. - CFO & Executive VP of Finance***

Right, after debt repayment and assumed dividend.

Hunter Kent Keay ***Wolfe Research, LLC - MD and Senior Analyst of Airlines, Aerospace & Defense***

So that's where buybacks would go, somewhere in there. Is that...

Brandon S. Pedersen ***Alaska Air Group, Inc. - CFO & Executive VP of Finance***

I mean, there is always more context that's required. It's hard to do it all on a chart. But theoretically, you could use it for buybacks. Theoretically, you could use it for debt paydown. Theoretically, we could make more of a glide slope down to that level and go borrow more -- borrow some next year and increase the returns that way as well.

Hunter Kent Keay ***Wolfe Research, LLC - MD and Senior Analyst of Airlines, Aerospace & Defense***

And does the macro environment factor into how you're thinking about that balance of using that $130 million or whatever it turns out to be, for either repos or buybacks? Is that stock performance? or what are the things that factor into that decision?

Brandon S. Pedersen ***Alaska Air Group, Inc. - CFO & Executive VP of Finance***

Yes, I -- certainly you have to consider the macro environment when you make that decision. What I would say is that our desire to re-delever the balance sheet will factor big into that decision. Obviously, it's a conversation that we need to have with our board. We love being investment grade. We think it's super important to the way we operate. We think our investors really appreciate that. We think the history of us being conservative with our balance sheet has been successful. There is a great track record associated with that. But in terms of whether or not we pay down $130 million, $50 million, $80 million, $200 million, we haven't really locked that down yet. And so yes, it very much depend on the macro environment.

Matt Grady ***Alaska Air Group, Inc. - Director of IR***

Okay, Susan.

Susan Marie Donofrio ***Macquarie Research - Senior Analyst***

Susan Donofrio, Macquarie. Couple of questions. One is with respect to your global partnerships and how you think about corporate revenues going after that. Are you looking to grow your partnerships? I'm just trying to understand that a little more. Is that important? Or is it more you've got this great network now. Can we expect more of the connecting of the dots? And are you getting requests to become more relevant in certain areas to kind of grow that? Just trying to flesh that out a little more.

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

So a couple of things. Firstly, just again, I'm deliberately being a little vague on the corporate side because I don't think it benefits any of us to get deep into that, except to say you can imagine those independent carriers, where we have very strong brand strength in the United States, that we could be in a place where we can work together and do something special there. So there's always that.

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But I think, really -- and we've done not a great job of this. But you'd be stunned at how many people still don't know if they flew Qantas to London, that they will get Alaska miles. And so -- and also, our distribution. So really, the benefit to Alaska Airlines on these global partners is when people start to think of Alaska as starting to think global and starting to bring their plans around flying on our global partners. We're looking at ways to get more seamless. Lounge agreements, we've instituted a number across the world right now. Elite recognition, honestly, there is a oneworld connect membership that we're looking at. Its new. Fiji Airways just went with it, but if you're sponsored by partners, you get full reciprocity on a linked benefit. So there are a number of things that we're looking at.

But the whole goal here is to ensure that when people in the cities that we serve travel internationally, they're on our partners, so they stay in our program. And that these partners continue to offer us good, healthy redemption seats to help complete global reach. So that's really the big idea, and I think that competitively in California, we have something that one of our major competitors does not have. And I think, especially on the East Coast, it's a huge asset for us, especially out of New York and even Boston.

Susan Marie Donofrio ***Macquarie Research - Senior Analyst***

Great. And then just an unrelated follow-up, Andy, just on the culture. I think, Brad, you've said you're kind of like the Brady Bunch with respect to a happy family, but not fully together. Obviously, your customer service is impressive with what you've achieved. Do you feel that there is more that you need to be doing now? Because sometimes, when you keep highlighting that you need to fix culture, it means that there is an issue, like there's a balance there. .

Andrea L. Schneider ***Alaska Airlines, Inc. - VP of People***

I'd say there is still a little bit more that we need to do. I think that we've been so focused on systems and labor contracts and cross-training on the technical aspects of the work. It is time to bring our groups together and have healthy, honest conversations about what's on people's minds, what their concerns are. And I think it's not until we force some of the groups to work together that some of the issues will come out. There are a couple of folks here today that are helping with our Flight Path sessions. [Cassie] right here in the front and where is [Mike], right here behind you. They are actually MCs. And Cassie is one of -- a flight attendant that came to us from Virgin America, and she could probably speak as well to sort of what we're hearing.

But there are concerns people have, and we want to make sure that we are allowing those questions and their concerns to be aired and then have conversations about them. And then you talk about our service, we have very different service models onboard our airplanes, Virgin versus Alaska. So we've invested, too, in making sure that we're training all of the -- refreshing training for all Alaska flight attendants, but all the flight attendants coming from Virgin have got new training on our service flow and are learning our new products, and we're rolling out some new features. In fact, we just did some of that just this last month. So yes, there is a little bit more work to do, but I think, we're making great headway.

Bradley D. Tilden ***Alaska Air Group, Inc. - Chairman, CEO & President***

Susan, would you -- do you want to hear from 1 or 2 of our front-line folks to see their thoughts on this?

Susan Marie Donofrio ***Macquarie Research - Senior Analyst***

Sure.

Bradley D. Tilden ***Alaska Air Group, Inc. - Chairman, CEO & President***

[Cassie], you or -- we sort of want to put people on the spot, but not too much. Anybody feel like...

Susan Marie Donofrio ***Macquarie Research - Senior Analyst***

If you're comfortable.

Unidentified Participant

Yes. My name is [Cassie], and I started with Virgin America pre-launch for Virgin and came over with the merger to Alaska. And it has been a big cultural shift definitely from Virgin, but the amount of effort, it's been slow going at first, like Andy mentioned. There were a lot of systems slowly that changed little by little. But now there's the light at the end of the tunnel with at least our Airbus folks being

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able to fly with the Boeing flight attendants come March. And I think that, that outlook and having everyone on the same team really brings the final bit together.

Unidentified Participant

Yes, I think we're moving the needle on that. Every session has gotten better and better. It's always being evaluated. And at the end of the day, I always get a sense that a lot of the people are enjoying it, and we're becoming one team, which is very important.

Bradley D. Tilden ***Alaska Air Group, Inc. - Chairman, CEO & President***

Thank you, [Michael].

Matt Grady ***Alaska Air Group, Inc. - Director of IR***

Great. Right down here.

Darryl J. John Genovesi ***Vertical Research Partners, LLC - Principal***

Darryl Genovesi from Vertical Research Partners. Shane, this was in your numbers, so I guess I'll ask you. But if Brandon or Brad, you want to chime in, that would be nice, too. So you said that the underlying inflationary pressures in the business -- and I believe this was an ex fuel number, were 4% to 5% per year. And I think that those are the sorts of numbers that we've kind of become accustomed to, including in our models, over the course of the last economic cycle. But we've also seen sort of big upward pay increases for labor that, I think, a lot of us are viewing as kind of a onetime catch-up. And you've also just done this power-by-the-hour agreement, which I thought was also sort of a onetime step-up in nature. And so I don't know, can you just try to bucket this 4% to 5% number by what are the major cost pressures? And if you can try to contrast that somehow to the 1% to 2% kind of CPI, PPI inflationary more macro numbers that we're used to seeing? And where you think the big pressure points are? That would be helpful.

Shane Tackett ***Alaska Airlines, Inc. - EVP of Planning and Strategy***

Yes. Again, thanks, Darryl. And Brandon, you should jump in. I think the first thing is 30%, 35% of the cost structure is labor. And if you just go into the contracts, basically, everybody, who isn't at the top of the scale, which is a considerable number of our folks, just because we've grown so much. We've had a lot of people come into the contracts over the last several years. I think the average raise step to step is something like 5%, 5% to 6%. So you've got just a lot of natural embedded labor rate inflation regardless of whether or not we're in a new contract cycle or not.

The top of the scale tends to move a little bit slower. I think our contracts have tended to be more like 1.5% or 2%. That's not necessarily the case across the board. Today, we have some of the contracts that are going by a bit -- a little bit more. But that's really the single largest driver. Then, yes, most of our contracts do have -- like our GDS contract. That has embedded rate increases that could be offset with volume. But if we're not growing a lot, its not going to be offset with volumes. So you've got enough of those that start to just sort of drive sort of the natural core inflation of the $5.5 billion of nonfuel spend that we have. And then there is -- we are growing 2%. There are more departures. There is a cost of operating those departures obviously. We're going to try to do it pretty much neutral with productivity. But absent productivity, we would have more crews, more outside services, more vendors, more suppliers, providing the services to turn aircraft, to tap the ramp, all those sorts of things. So that's just the natural volume driver as well. I guess my slide was without the growth. I'm just talking about the 2% growth now. So there is that natural sort of lift for us next year with the 2% volumes.

Brandon S. Pedersen ***Alaska Air Group, Inc. - CFO & Executive VP of Finance***

Yes. No, the only thing I would add to that is airport costs always seem to be a cost increase as well. As Andrew highlighted, we're having significant construction at many of our airports. Airports will pass that along, and so that's probably something that's going to inflate at something more than 1% to 2%.

Coming back to the power-by-the-hour agreement that we signed last year on the Dash 7 engines, what I would say is that, that was a smoothing of cost. But ultimately, things like that are really good for the company. That's going to be $100 million savings for us over a period of 8 or 9 years. So you get some timing step in there. But ultimately, we don't do that kind of stuff unless it's got real economics that improve the business.

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Darryl J. John Genovesi ***Vertical Research Partners, LLC - Principal***

Okay. And then, I guess this one's for Andrew. From that same CASM waterfall chart, there was, I think, 120 basis points of CASM pressure from the regional mix. Should there be a similar 120 or so basis point RASM boost?

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

I mean, as you look at our 10-K and Q filings, you can see that the overall regional business is underperforming. There's no question. So we have very clear line of sight to how we're going to get that back to not only breakeven, but profitability over the next 2 to 3 years. And I see -- I mean, when Horizon's getting 4 175s a month, what that does to productivity, delivery costs, soft time, all of these things are going to be ironed out by the middle of next year when we're sort of done. And I see much better unit revenue performance and profitability from our regional fleet to get it back to where it used to be.

Matt Grady ***Alaska Air Group, Inc. - Director of IR***

Next.

Joseph William DeNardi ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst***

Joe DeNardi, again. Andrew, just want to poke at the RASM question again. Back here in the corner. Yes. Sorry. You spoke how confident you are that the revenue initiatives you outlined will be achieved. Wouldn't it suggest there is a problem with the core business if you can't generate materially positive RASM with only growing 2%? If we get to the end of next year and RASM's only up 4% or 5%, wouldn't that suggest that there's something wrong with the kind of core network?

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

What we've focused on today was 2 things, things that are in our control. So that $330 million is incremental. I mean, to your point and as I shared at the end of my slides, which we're not quantifying or providing guidance on, the management of our network, the strengthening of fares, the slowing of growth, the maturation of markets, the ability to sell first class, premium class, main cabin, all of that are going to work together to do positive momentum. I think what I'm trying to say right now is that we're not quantifying that for you.

Joseph William DeNardi ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst***

Okay. That's fair. And then, if there is one airline other than Hawaiian, that could justify serving the neighbor island network, it's probably you guys. Can you just talk about why that hasn't interested you historically? And whether Island Air leaving makes that more attractive?

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

I think big picture, a couple of things. We serve all 4 islands from the majority of our West Coast launch points. So the last thing we want to do is start diluting and prorating revenues with inter-island. That's the first thing.

The second thing is, the history has shown that 1 airline does well; 2, someone ends up in bankruptcy or out of business. At the end of the day, as I shared earlier, we are focused on our core business. The one thing I did fail to mention, that Brad reminded me on Hawaii is we've had the lowest fares to Hawaii off the West Coast for the last 7 straight years. In fact, fares are around $130 today. So anyone, who is going to -- no one is going to really disrupt those fares in a major way longer term, you got to have the low cost. But I think, overall, our Hawaii franchise is all about a West Coast focus, going over to the islands.

Matt Grady ***Alaska Air Group, Inc. - Director of IR***

Okay. I think we have time for one more question. Back over here.

Unidentified Participant

So I believe it was you, Andrew, who mentioned that you are going to be selling your partner fares next year. Is that going to be a model like we've seen on easyJet and Ryanair, where you sell a ticket with no connection to Alaska? Or is that going to be a more classical code share-type fare?

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Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

Yes, we're -- and of course, you've got to appreciate the complexity, because every carrier is different. Qantas, I will just to say, is in the forefront of who we're working with right now, but essentially just using code. We've always only had only one way codes. So we've had our foreign-flagged friends put their code on us, but we've never put our code on them. So once we do that, we can actually sell and distribute their tickets through our direct channels. And I think, the opportunity here is that our brand strength will bring significant distribution strength to those carriers on our point-of-sales strength in the U.S. Yes, so we would start off by selling local to London, but also from some of our major feeder hubs. So we would start off slow to make sure that it's a good experience for our guests. But local would be the first place we would start.

Unidentified Participant

Understood. And the upside from that, is that in your revenue initiatives for next year?

Andrew R. Harrison ***Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP***

No.

Matt Grady ***Alaska Air Group, Inc. - Director of IR***

Go ahead.

Bradley D. Tilden ***Alaska Air Group, Inc. - Chairman, CEO & President***

We -- I just wanted to sort of wrap a little bit. I wanted to thank you all very, very much for coming. Thank you for your fantastic questions. It's been great. Like in my mind, the big message that we have for you today is that we are making great progress with the merger. We're into a mode now of controlling what we can control, and there's really 2 things there that are chief among others: One, and it's -- we talked a lot about it, and it is tough to model. But the small-company feel, the sense of investment, the sense of accountability, we believe that's what provides a differentiated experience. We think it's what's driven the success of our company over the decades. So we are spending a lot of energy on that. And you can model it, sorry - you cannot model it. But we -- I personally think if you look at the U.S. airline industry, companies that can execute as one team over time and produce fantastic results over time. So that's one big thing that we're focusing on.

The second is it's time to improve our financial performance. So what we've talked to you today about are specific revenue initiatives and cost initiatives. And we're looking forward to moving forward throughout 2019 to do just that.

So thank you all very, very much. We appreciate your interest and support. We will hang around, have any conversation you want to have. And Matt -- our next time we talk is probably the fourth quarter conference call, huh.

Matt Grady ***Alaska Air Group, Inc. - Director of IR***

That's correct. That's correct. Thank you, Brad.

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