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ALK - Q4 2008 Alaska Airlines Earnings Conference Call

Event Date/Time: Jan. 29. 2009 / 11:30AM ET

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PRESENTATION

Operator

Good morning. I will be your conference Operator today. At this time, I would like to welcome everyone to the Alaska Air Group 2008 fourth quarter earnings call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session. (Operator Instructions)

At this time it is my pleasure to turn the conference over to the Managing Director of Investor Relations, Shannon Alberts. Please go ahead.

Shannon Alberts - *Alaska Air Group - Managing Director, IR*

Thanks. Hello everyone and thank you for joining us for Alaska Air Group's fourth quarter 2008 conference call. Alaska Air Group Chairman and CEO Bill Ayer; CFO Glenn Johnson; Alaska President Brad Tilden; and Horizon Air President and CEO Jeff Pinneo will provide an overview of the quarter after which we will be happy to address questions from analysts and then from journalists. Other members of the senior management team are also present to help answer your questions.

Today's call will include forward-looking statements that may differ materially from actual results. Additional information on risk factors that could affect our business can be found in our periodic SEC filings available on our website. Our presentation includes some non-GAAP financial measures and we provided a reconciliation between the most directly comparable GAAP and non-GAAP measures in our earnings release.

This morning, Alaska Air Group reported a GAAP loss of $75.2 million for the fourth quarter, excluding the impact of mark-to-market adjustments for fuel and charges associated with the write-off of premiums for hedges that we replaced, our transition out of CRJ Aircraft, and severance, Air Group reported an adjusted net profit of $16.4 million or $0.45 per share. This compares to a First Call mean loss of $0.04 per share and to an adjusted net loss of $17.9 million or $0.46 per share last year. Again, excluding special items, Air Group was slightly better than breakeven for the year posting a small profit of $4.4 million or $0.12 per share compared to a profit of $91.6 million or $2.26 per share in 2007. Additional information about expected capacity changes, unit costs, fuel hedge positions, capital expenditures and fleet count can be found in our investor update which is included in our Form 8-K available on our investor website at Alaskaair.com. Now I'll turn the call over to Bill Ayer.

Bill Ayer - *Alaska Air Group - Chairman, CEO*

Thanks Shannon and good morning everybody. Before I give you my perspective on the quarter and full year, I want to mention our recent reorganization. Brad Tilden who previously served as our CFO was promoted to President of Alaska Airlines. We have a new CFO, Glenn Johnson who is a 26 year Alaska and Horizon veteran. And Ben Minicucci was promoted to Chief Operating Officer of Alaska and he's reporting to Brad. With Glenn's help, my focus will be on Air Group performance and I'll be working with Brad at Alaska and Jeff at Horizon as we strive to achieve the required return on invested capital over the long term. I couldn't be more pleased to have proven leaders of their caliber in these new roles.

Today I'll begin our discussion with an overview of the quarter and the year. Glenn will then discuss Air Group's hedging strategy and balance sheet followed by Brad and Jeff who will provide perspective on Alaska's and Horizon's performance.

The industry experienced unprecedented volatility during 2008 with extraordinary summer fuel prices giving way to depressed passenger demand in the wake of today's economic meltdown. In the face of these realities we eked out a small adjusted full year profit and are pleased to be one of two major airlines to do so. In fact this is our fifth consecutive year of profitability on an adjusted basis. While we had planned for a better result, considering where fuel prices were, things would have been much worse had we not made so much progress over the years on reducing non-fuel costs, strengthening the network and improving our operation. The most important factor of all has been our people taking really good care of customers. We're proud of the fact that we paid $12.5 million in operational performance bonuses to our people -- an increase of $3.6 million over last year -- tied to improved performance.

2008 marks several milestones for Alaska Air Group. One, we achieved our goal of a single 737 fleet type at Alaska, and at Horizon we're down to two aircraft and on our way to a single Q400 fleet. Two, we responded to last summer's stratospheric oil prices by reducing and reallocating capacity, a move that will serve us well as we navigate the current economic storm. Three, we significantly improved our operation in Seattle through some new processes and better accountability, and we are extending these processes to the rest of our system. And fourth, we reached a long term agreement with the new Delta that will be great for our customers and will support our future growth. Delta is now the largest airline in the world and we're pleased that they chose us to be their preferred West Coast partner. Of course this is in addition to several other of our important alliance partners including American Airlines which together give our customers access to a global network and outstanding Frequent Flier benefits.

The year ended in a dramatic way with a series of storms in December that crippled much of our core Pacific Northwest operation during the peak holiday travel period. The storms disrupted travel for many of our customers and we apologize for any inconvenience that resulted. I also want to recognize the extraordinary effort of so many Alaska and Horizon employees who brave the elements to get into work, or cancelled their own vacations to help out. The difficult circumstances of the storm reminded me again of what a privilege it is to lead a group of people who have such a strong commitment to our customers, and I want to publicly thank all of our employees for their efforts.

During 2008, we moved our business forward through better planning and execution of goals. We will apply the lessons we've learned to achieve our key initiative for 2009, which is to optimize revenue in this difficult economy. It's also imperative that we sustain the operational improvements that we achieved in 2008. More generally in 2009 we'll continue to pursue the basic tenets of our 2010 vision, which include a high value product for customers, good careers for employees, and a reasonable return for investors.

The most significant risk to airline profitability in 2009 and beyond continues to be the uncertainty of customer demand and the volatility of fuel prices. Our conservative financial management, which includes maintaining a strong balance sheet and a consistent fuel hedging program, provides a buffer against that uncertainty and gives us the flexibility to take advantage of opportunities to improve our bottom line. If I had to sum up the principles that we've been adhering to and that will guide our future decisions, they would sound a lot like something your parents or grandparents probably taught you. Don't buy things you can't afford, don't borrow money you can't pay back, don't agree to things you don't understand, and finally, if it doesn't seem right, it probably isn't. And with that I'll turn the call over to Glenn.

Glenn Johnson - *Alaska Air Group - CFO*

Thanks, Bill and good morning, everybody. I'm thrilled to be speaking with you this morning and I'm really looking forward to my new role. As Shannon said, Air Group reported an adjusted net profit of $16.4 million for the quarter compared to a loss of $17.9 million last year, a swing of more than $34 million after-tax and $56 million on a pre-tax basis. As is our usual practice, our adjusted figures state fuel on an economic basis and exclude fleet transition, severance, and hedge restructuring charges. It's gratifying to see that kind of quarter-over-quarter improvement, particularly given the events of the past year; however, for the 12 months just ended, Air Group generated a return of just 3.5% on its $3.5 billion base of capital deployed, well short of our 10% ROIC goal.

Consolidated revenues for the fourth quarter were boosted by more than $8 million in late December as a result of the favorable settlement of a lost revenue claim and additional proceeds from our Affinity card partner, but the quarter's results are really a cost story -- both fuel and non-fuel. During the quarter, we saw a decline of $58 million or more than 9% in consolidated non-fuel operating costs. Our people at both companies did an excellent job managing capacity related costs and Horizon's maintenance costs continue to show dramatic year-over-year improvement because of the timing of events and process improvements that they've made.

Our economic fuel costs declined by $32 million in the quarter despite a net hedge cost of $6.7 million in 2008, versus a net hedge benefit of $28.9 million in 2007. That $6.7 million hedge cost represents the original premium expense paid for hedges that settled during the period.

Hedging has continued to receive a lot of attention in the past couple months as fuel prices have tumbled. Last quarter, our Treasurer, Jay Schaefer said it best when he described our hedge program as an insurance policy that helps us manage the volatility of rising fuel prices while allowing us to enjoy most of the benefit of falling fuel prices. Most of our portfolio consists of call options or Caps, where our only out of pocket cost is the premium that we pay up front. Caps make up about 93% of our current portfolio although we do have a small number of call instruments where we are exposed to a future cash outlay if the price drops below a pre-defined floor. At December 31, when oil was at about $45 per barrel, we were exposed to future cash outlays of approximately $24 million, but we had no collateral held by counterparties. All of our call instruments expire in 2009.

As you might have seen in our recent investor updates, we've been aggressively restructuring our hedge portfolio to take advantage of lower fuel prices. We've been able to reduce our 2009 average strike price from $103 per barrel at the end of the third quarter to $76 today for 50% of our planned consumption. And just to clarify, we're not locked in at that price. That's the most we'll pay. We have also improved our 2010 protection.

Terminating old hedges did not come without a cost, however. We sold existing hedges for which we originally paid $56 million and received proceeds of $6 million, resulting in a net economic impact of about $50 million. We then spent $38 million on the replacement hedges. Notwithstanding the cost, we believe that restructuring our hedge portfolio was a wise use of Air Group resources and consistent with our stated objective of managing volatility.

Turning to the Air Group balance sheet, we closed the quarter with cash and short-term investments of $1.08 billion, about flat with the end of third quarter and up by more than $250 million compared to the $823 million at the end of 2007. That puts our cash at 29% of revenues, which we believe is the strongest position in the industry. On the other hand, the substantial increase in debt, the pension charge to equity of $198 million, and the GAAP loss puts our debt to total capitalization ratio at just over 81%, significantly higher than last year's 70%. We generated $164 million of operating cash flow during the year, down from $482 million last year. The decline was due to lower profitability, higher hedge premiums, and slower advanced bookings. In addition to the $164 million of operating cash flow, we had proceeds from new financings of $884 million and a return of $80 million in pre-delivery payments from Boeing to reflect the change in timing of deliveries, for total cash inflows of $964 million. These were offset by capital expenditures of $482 million, debt repayment of $343 million, and share repurchases very early in the year of $49 million.

We expect our 2009 capital spending to be at $455 million, of which $405 million relates to aircraft and $50 million to non-aircraft spending. These figures are before any cash proceeds that would be realized from the potential sale of up to four Boeing 737-700 aircraft, which we are planning to sell in an effort to better match fleet size with our lower capacity. We have debt financing commitments in place for all of our firm Q400 deliveries, and we're working right now on a number of options to finance our 737-800 deliveries. At this point we expect to finance at least three and possibly up to six airplanes using sale lease back financing in the first half of 2009. This will drive up Alaska's non-fuel unit costs slightly since all of the ownership costs are reflected in the rent line when an airplane is leased, as opposed to being split between depreciation and interest costs when an airplane is financed with debt.

Finally, turning to pensions. Our pension assets were affected by the dramatic drop in the stock market, declining nearly 30% during 2008 to $650 million and increasing our unfunded amount by approximately $300 million to $445 million. At the end of 2008, our funded status had fallen to 59% on a PBO basis, which is the most conservative measure. The decline in the portfolio value and increase in the unfunded amount will result in a very significant increase in our pension expense in 2009, more than doubling from $48 million in 2008 to $99 million in 2009. On a unit basis, this will increase Alaska's CASM by more than two-tenths of a cent.

During the year we contributed $52 million to our defined benefit plans, bringing our post-9/11 funding to $420 million. We have no required funding in 2009, but our historical practice has been to fund the service cost, and our current plan is to continue with this funding formula throughout 2009. Of course, we'll be mindful of our liquidity as we evaluate each month's contribution; however, assuming we make this estimated $45 million contribution, the plans would still be under funded by $400 million, which underscores how vulnerable these plans are to external forces. Now over to Brad.

Brad Tilden - *Alaska Airlines - President*

Thanks, Glenn, and good morning, everyone. For the quarter, Alaska Airlines reported an adjusted pre-tax profit of $23.8 million compared to a loss of $18.8 million in 2007. For the full year, Alaska's profit was $25.2 million versus a profit of $171.7 million in 2007. The 2008 profit represents a pre-tax margin of slightly less than 1% compared to a margin of 5.5% in 2007. While we're pleased to report profits for both the quarter and the year, particularly given the environment, we acknowledge that our results are far from satisfactory.

Alaska's passenger revenue for the fourth quarter was down 1.7% to $603 million. Our revenue was the result of a 7.1% reduction in capacity and a 5.9% increase in passenger unit revenues. Sequentially, passenger RASM improved by 6.6% in October, was flat in November, and increased by 10.9% in December. Fourth quarter results included the one-time proceeds of $4 million from our affinity card partner that Glenn referred to earlier. Without this benefit, our RASM increase would have been 5.2% for the quarter.

Our capacity reduction of 7.1% was significantly less than the industry's reduction of 11.9%, but our RASM performance exceeded the industries by 1.5 points. We believe we've made the right cuts and the right markets, and we also believe our growth into markets such as Hawaii and the Twin Cities has brought important new revenue into our network as demand in our core markets declined.

Regionally, we saw strength in Alaska, Hawaii and the Transcons, where we both grew and saw RASM improvement. We also saw RASM improvement in Mexico and Canada as a result of capacity reductions both by us and our competitors. And finally, we were able to hold our unit revenues about flat in California, Arizona, and Nevada, where our schedule reductions were most pronounced. Revenue flown under our capacity purchase agreements declined by 7% for the quarter on an 18% reduction in capacity, resulting in strong RASM increase of 13.7%.

We continue to be encouraged by the success of our ancillary revenue initiatives such as the fee for checking a second bag and the increases in our reservations and change fees. Together, these grew by more than $6 million or 35% during the quarter. Looking forward, we don't anticipate the unit revenue trend that we saw in December. We expect our January load factor to be up about 2 points and yield to be down, resulting in PRASM that's about even with last year. Alaska's advance booked load factor for February is down 1 point and for March is down 3 points, with the late Easter this year. Our visibility is not good beyond March but as you would expect, there are obvious signs of weakness in demand.

Turning now to costs, our CASM ex-fuel for the quarter was $0.078 at the low end of our most recent guidance and well below the initial fourth quarter guidance we issued in October. This means we had CASM ex-fuel of $0.0749 for the year, below our planned range of $0.075 to $0.076, despite a significant reduction in planned capacity. I really want to thank our people who did a great job of meeting their plan and managing down their costs as we reduced the schedule.

As we look to 2009, we're forecasting non-fuel unit costs of $0.081 per ASM on an 8% decline in capacity and a 12% decline in departures. This forecast is very disappointing given the progress we've made over the last seven years, and is worth taking a couple of minutes to walk you through the reasons for the increase. When we decided to cut Alaska's capacity by 8%, we set a goal of reducing our cost by two-thirds of the capacity decrease, or about 5.5%. Given our size, that amounts to about $100 million of reductions and, combined with the capacity cut, that would have given us a unit cost increase of about 2.5%. Almost all of our divisions met that goal and some exceeded it. However, there are four things that are offsetting the decreases our divisions produced.

First, as Glenn indicated earlier, our pension costs will go up dramatically, from $48 million in 2008 to $99 million this year. Second, instead of an $8 million decline in maintenance cost, we expect an increase of $10 million due to the timing of planned maintenance events and the start of engine power by the hour agreements on our 737-700 and 900 aircraft. Third, because of the way we're choosing to finance aircraft, rent expense will contain $10 million in 2009 that would have been reported as interest expense had we used debt financing. And finally, we're budgeting $15 million more for incentive pay-outs in 2009 than we had in 2008. These items total $95 million, essentially offsetting the reductions we achieved. This means that absolute costs in 2009 will be relatively unchanged from 2008 and our unit costs will increase by about 8% to $0.081. Again, this is our guidance, and we will of course try to improve upon this number as we move forward in 2009. I might also note that our capacity number could change as we get more clarity on the economic picture and a better sense for demand in our markets.

On the operations front, Alaska's on-time performance improved by 6 points for the year, from 72.4% in 2007 to 78.3% in 2008. This was accomplished despite the storm that hampered our operations for a number of days in December. One side benefit to these very good results was a $5.9 million or 42% reduction in passenger remuneration costs. We ended the year with 110 aircraft, down 5 from the end of 2007. Our plan, however was to end the year with 115 aircraft, flat with 2007, but the Boeing machinist strike pushed 5 aircraft into 2009. We've previously announced we're attempting sell four 737-700s. If we're successful, we'll end the year with 112 aircraft, up two from 2008 and down three from 2007. At this point I'll turn the call over to Jeff.

Jeff Pinneo - *Horizon Air - President, CEO*

Thank you, Brad, and good day, everybody. I'm pleased to report that Horizon posted an adjusted pre-tax profit of $3.2 million for the quarter. While modest in scale, it represents a $14.4 million improvement over Q4 '07 and was achieved in a period of steep economic decline and Arctic-like weather in December that crippled operations at several of our airports. Our full year adjusted loss of $10.4 million was a significant improvement over last year's $19.6 million loss, yet it remains far short of our goal and is a disappointment for all our people who worked so hard to produce a positive outcome this year.

The big driver in this picture was a precipitous drop in demand, leading to a 21.1% reduction in capacity. Our fourth quarter revenues were down 10% on a 22.4% decline in traffic, which matched the 21.1% reduction in capacity. Our system yield was up 15.5%, which helped drive a system RASM improvement of 14%. Ancillary revenue played a larger role this year, increasing $1.5 million for the quarter. As in previous quarters, line of business mix was a modest factor in the year-over-year comparison as we are no longer flying low RASM, low CASM missions for Frontier.

On the expense side, our CASM ex-fuel increased by only 2.9% on the 21% decline in capacity. As at Alaska, our people did a great job bringing down non-fuel costs by $27.3 million or 18%. This was on top of the $6.5 million decline in economic fuel costs.

Shifting the focus to operations, record December snowstorms in the Pacific Northwest made for an extremely challenging holiday season. In the face of this, our team posted a 75.5% DOT on time rating for the quarter, a slight decline over last years 76.2%. For the full year, our performance improved 2.4 points to 83.1%.

As previously announced, we ended scheduled service of our 37-seat Q200 fleet on October 25. We currently have six Q200s remaining in the fleet and we anticipate their successful remarketing during the first quarter. All our attention will then be focused on finding new homes for our CRJ700 fleet, two of which we subleased during the quarter, leaving 18 that we continue to operate during the transition. While we are engaging interested parties, the economic downturn and its impacts on aircraft financing and customer demand have undoubtedly slowed the remarketing process. In the event we fall short of our remarketing goals, we'll be working with Bombardier to retime our remaining Q400 deliveries, to ensure that our capacity remains aligned with market conditions.

The capacity reduction and fleet simplification efforts outlined are two of several initiatives focused on producing returns sufficient to justify the capital investments we've made in Horizon's assets. We recognize that current returns are not adequate and as economic conditions evolve we will continue to work these and all other levers as needed to generate the returns our employees and shareholders expect and deserve.

As we reduce capacity once again this coming year in anticipation of demand softness, we must continue the good work of 2008 in further reducing costs proportionately throughout the rest of our business. Our success in managing non-fuel costs last year produced a full year CASM ex-fuel that was actually down slightly from the prior years despite a 9% capacity decline. Productivity continues to be a central theme in our story. Our 2008 rate of 166 passengers per FTE represents an 8.3% gain over the prior year and is the product of continual improvements in 25 of the last 28 quarters. This is tribute to the skill, hard work and sacrifice of Horizon people in every quarter.

As we move into 2009 we expect that the combination of increased scheduled maintenance and further reduced capacity will modestly increase our unit costs, yet I'm confident that the resilience and adaptability evident in many aspects of our recent performance will continue to serve us well as we face the challenges and opportunities of the coming year. For the full year 2009, we're forecasting CASM ex-fuel of $0.154 to $0.155, 6 to 7% higher than in 2008 on about a 9% reduction in capacity. This stems from an increase in planned maintenance activity, mitigated by forecast reductions in wages and benefits, aircraft rent and fleet transition expenses. At this point I'll turn the call back to Bill.

Bill Ayer - *Alaska Air Group - Chairman, CEO*

So there you have the details of what is a solid fourth quarter, considering the environment. On the positive side, our revenue performance outpaced the industry, and so far we've done a good job of adjusting our schedule to match demand. Our cost performance was very good for both the quarter and full year as we ended up beating our full year guidance even with capacity well below planned levels. Our fuel hedges benefited us significantly during the first three quarters and in the fourth quarter when fuel prices collapsed, the nature of our hedge instruments allowed us to enjoy the lower market prices.

On the other side of the coin, the economy is in bad shape and it's pretty clear that airlines, like virtually all other businesses, are going to be under significant revenue pressure for the foreseeable future. We held on to our sound cash position, but this was largely through taking on a lot of debt during the year, more than $500 million. This debt along with the reduction in equity due to both our GAAP losses and a large pension funding charge has pushed our adjusted debt-to-capitalization above 80% for the first time in many years. Additionally, the decline in the funding levels of our pension plans creates cost and liquidity headwinds for this year and beyond.

While the outlook for the economy is extremely uncertain, our competitive position remains strong. We're optimistic that we're going to weather this storm and be ready for new opportunities when conditions improve. And now we're ready for your questions. Shannon?

Shannon Alberts - *Alaska Air Group - Managing Director, IR*

Thanks, Bill. At this time we would like to invite questions from analysts. Would you please assemble the roster?

QUESTIONS AND ANSWERS

Operator

Absolutely. (Operator Instructions) We'll take our first question today from Mike Linenberg with Merrill Lynch.

Mike Linenberg - *Merrill Lynch - Analyst*

Yes, two questions. First, Bill, you had talked about the Delta relationship and you also highlighted the fact that in the past Alaska has multiple partners. Going forward, should we anticipate that the extent of the various agreements that you have with other carriers, will then remain in place or will there be potential restrictions? Could we see dual code shares in some markets, Delta and another carrier and then just as part of this question, maybe a stab on incremental revenue that you could potentially get from this now that you have the preferred carrier partner status with Delta?

Bill Ayer - *Alaska Air Group - Chairman, CEO*

Okay, Mike. Good morning. Maybe I'll start on the first part of that and really, it's just I think the recognition on our part and our partners part that these things have been good for all of us, and from our standpoint, these alliances have given us just a broader network, kind of a virtual network globally, and that's been a really important competitive tool for us, as we've continued to grow our network at Alaska and Horizon, so as long as they work for both parties, that's the thing that keeps them going into the future and that's our hope right now.

Mike Linenberg - *Merrill Lynch - Analyst*

And on the revenue side?

Brad Tilden - *Alaska Airlines - President*

Mike, it's Brad. We haven't disclosed revenue to these things but I guess I would say the nature of our network, that connecting traffic is important. The thing that's important is that we had an alliance relationship with both Delta and Northwest before so what we have now is an expanded relationship with the new Delta and we're very excited about that. But as Bill said we're also excited about our other Alliance relationships and we're optimistic that this is going to be good for us and help us grow and bring more passengers into our network in the future.

Bill Ayer - *Alaska Air Group - Chairman, CEO*

The other focus we have Mike is on customers and I think the world is full of code shares and some work well for customers and some of them don't. Some of them are just window dressing with a code on a reservation screen, and with our partners we work really hard on making sure these things really deliver value for customers so we work closely to build schedules that connect, we look at hub airports to make sure there's enough connect time for customers that baggage, if I was the customer and makes the connection, that the miles get credited correctly and so forth so there's a real operational focus and working groups at both companies here to make sure these things work for the customer because at the end of the day, it's the customers that get to decide whether these things are adding value or not and whether they're successful.

Mike Linenberg - *Merrill Lynch - Analyst*

Okay, good and then just my second question on baggage fees. I know I believe you charge for the second not the first, obviously there's sort of a value proposition argument there on one hand but then a lot of your competitors or carriers that you have decent overlap with like Southwest and Virgin America do not charge. Is that the primary reason why you want to be competitive with your primary competitors or do you see an opportunity there?

Brad Tilden - *Alaska Airlines - President*

Mike, it's a great question. I mean I guess the way we think about this at a very high level is that at the end of the day, our customers are going to decide how they want to be charged for the services we provide, and we feel like we're in a pretty good spot right now and as you said we do charge for the second bag but not the first. We do have some change fees and some fees for calling in the res and so forth. We feel like we're in a pretty good position. The thing we're trying to do right now is make some noise about the fact that we don't charge for the first bag, and I guess the economic case is that we're hoping that we get more loyalty and more business because of our position on this issue, but this is something we'll watch carefully as we move down the road and try to make the right adjustments.

Mike Linenberg - *Merrill Lynch - Analyst*

Okay, very good. Thanks. Nice quarter.

Operator

Our next question comes from William Greene with Morgan Stanley.

William Greene - *Morgan Stanley - Analyst*

Yes, hi. I'm wondering if you can talk a little bit about, you made some comments about capacity and how you could flex it up or down as it relates to your profitability. So I guess the question is can we bookend a little bit how much flexibility you have on the upside or the downside and in what time frame? And then also what kind of metrics do you watch to determine whether to make a change to the outlook?

Brad Tilden - *Alaska Airlines - President*

Bill, it is Brad again. I don't know that we have absolute numbers to give you to respond to your question but I think we might be able to talk with you a little bit in terms of how we think about this. When we saw the high fuel prices last Summer and then the economic weakness, we made an initial kind of estimate of what kind of capacity reductions we needed to make and what we were saying today we think is we feel really good about those adjustments that were made. We feel like the RASM performance and the financial performance is showing that we got it about right. We use kind of the terminology around here, plan due check act a lot in terms offer just continuous iterations, keep looking and keep making adjustments. We don't like to shrink the network but we do want to get, we do want to have the right size network for the demand that we have in our markets, so I don't know. If in terms of... to me three or four months out is that's about the latest that you want to be making significant changes. If they're really material changes you have to be farther out than that.

On the other hand, like the state of Alaska business this Summer, we will be watching very carefully for the next few months to see how it books up, and we will have 21 flights a day this Summer so we could make a late adjustment. By late I mean the last month or two to a flight or two. Not a great answer to your question but I think the biggest point is we want to be flexible. We want to watch demand carefully and we do want to continually make the adjustments to size our network to the demand that we see out there.

Bill Ayer - *Alaska Air Group - Chairman, CEO*

And Bill, I think we all agree that this is the time to be cautious with capacity. The economy I think everybody thinks the economy is still going South. It hasn't turned the corner yet, and so we're -- and we have been impressed with the effect that we've seen from these capacity reductions. If you look at our numbers, you see that our load factor has been maybe even up a little bit or constant. RASM has certainly responded to these things, so I mean our bias is to continue down this path and just kind of see where demand is and be cautious about adding capacity too quickly until we have some really strong signals so I think and we do, you do lock in. You can't just turn on a dime here. If you try to move too quickly it runs your cost up so we're going to look out into the future and be cautious and try to make prudent decisions.

William Greene - *Morgan Stanley - Analyst*

And yet your margins are actually, at least the outlook for them is improving quite nicely given the drop in fuel, so I guess I'm just trying to get a sense for the profitability level whereby you say okay you know what? It's okay to put a little bit more out there in terms of capacity.

Brad Tilden - *Alaska Airlines - President*

Yes, it's a good point. You can't just look at RASM, with fuel costs having moved as much as they have, if you look at our I think a couple quarters ago we were talking about our fuel cost per passenger on a Transcon flight and it was way North of $100 and now it's about $50, so we can live with a little lower RASM in this environment and still have good financial performance.

William Greene - *Morgan Stanley - Analyst*

All right let me turn a question to cash flow. You I think will have better cash flows in 2009 than you did in 2008 and yet you've also got some cash flow headwinds as you mentioned on the pension side and whatnot, but you were willing to do a buyback earlier last year so can you talk a little bit about how you rank sort of priorities for use of cash?

Brad Tilden - *Alaska Airlines - President*

Sure, Bill. I think in this environment, the number one thing is to basically keep this franchise sound and keep us here to kind of fight another day and kind of manage our way through this financial crisis and economic crisis that we're all dealing with. After that, you would begin to think about things like capital spending and debt repayment and maybe way down the list at this stage share repurchases but I think right now the big focus is really on just maintaining what we have and securing what we have. We aren't, in terms of capital spending, we aren't particularly bullish at the moment. You don't see us whatever, talking to Boeing about additional firm commitments and that sort of thing. It's kind of the mind set is maybe just hold on here and get a little time under our belt and see if we can't navigate our way through this thing, get the performance up and then look at growth.

William Greene - *Morgan Stanley - Analyst*

Thanks for the time. Appreciate it.

Bill Ayer - *Alaska Air Group - Chairman, CEO*

Yes.

Operator

Our next question today comes from Ray Neidl with Calyon Securities.

Ray Neidl - *Calyon Securities - Analyst*

Well, congratulations on the fourth quarter. It's very good. Usually, the first quarter, fourth quarter, usually the fourth quarter and the first quarter are the worst quarters for Alaska for obvious reasons. You're more seasonal than other airlines. Looks like you made great improvements at Horizon and looks like you got a lot of your costs down in the fourth quarter. I mean for the first quarter do you think you can do the same thing? Do you think you can produce that kind of profit?

Glenn Johnson - *Alaska Air Group - CFO*

Well, as you know, Ray, this is Glenn. We don't provide profit forecasts and I think we've talked here on the call about our concerns about the revenue picture going forward and while we have had positive movement on the cost side on the absolute cost side, the reduction in capacity is going to put pressure on the CASM piece of it. Probably the most positive element going forward into the first quarter is the lower fuel costs that we're seeing.

Ray Neidl - *Calyon Securities - Analyst*

Okay, and secondly, I thought I'd try anyway. Second thing though, a little bit more specific is you did talk quite a bit about your pension, your defined benefit pensions and the potential liabilities out there. It looks like, there's not too many airlines left or even that many companies in America left with defined benefit programs and even though 401Ks can be just as expensive you do have an additional potential liability by being responsible for the funding. Going forward, can a small Company like Alaska, smaller airline like Alaska afford to keep that program up or is there something you do voluntarily with employees to convert over to a 401K profit-sharing type of program?

Glenn Johnson - *Alaska Air Group - CFO*

Yes, that's a great question, Ray and it's Glenn again. It's obviously a question that we are very focused on. We've been focused on for a number of years actually and we've actually moved most of our employees, new hires into very generous 401K programs, as you've mentioned. It's probably not sustainable for companies to have these defined benefit plans out into the future. We have a notable exception with the pilot group and we're working on that in terms of what to do with that plan on a go forward basis. Having said that we have an obligation to the people that have been in these plans up to this point. We intend to fulfill those obligations and we have an ongoing obligation until we move the remaining folks over into enhanced 401Ks.

Ray Neidl - *Calyon Securities - Analyst*

When did that program convert to 401K for new employees?

Glenn Johnson - *Alaska Air Group - CFO*

It's been at different points in time, with the management group I believe went first and then some of the other labor groups throughout their various labor negotiations over the last five years or so.

Ray Neidl - *Calyon Securities - Analyst*

Okay, good. Thank you.

Glenn Johnson - *Alaska Air Group - CFO*

You're welcome.

Operator

Our next question comes from Peter Jacobs with Ragen MacKenzie.

Peter Jacobs - *Ragen MacKenzie - Analyst*

Good morning everybody.

Bill Ayer - *Alaska Air Group - Chairman, CEO*

Good morning Peter.

Peter Jacobs - *Ragen MacKenzie - Analyst*

A couple questions. First on the purchase capacity, I noticed in the fourth quarter that you matched your purchased capacity revenues with expenses and that has not happened over the last couple years except in the third quarter, so is there anything different about either the revenue model there that you're employing or just in terms of the expense of purchasing that capacity in that we should think about it a little bit different going forward or was there some kind of anomaly happening in the fourth quarter?

Brad Tilden - *Alaska Airlines - President*

Yes, Peter, the goal is for that line of business to make money, and so that is the high level objective. I think what you saw happen in the fourth quarter is more aggressive capacity reductions. We trimmed flights that were not working. I think we disclosed it, capacity was down 18% but revenue was only down 7% so the unit revenues were up 14% so you combine those schedule adjustments with lower fuel costs and we got the result that you saw and we're hopeful that we're going to see more of that in the future.

Peter Jacobs - *Ragen MacKenzie - Analyst*

I mean would it be considered a positive if you could just keep that at a breakeven standpoint as opposed to losing money there or do you actually really want to make money off of that purchased capacity program?

Glenn Johnson - *Alaska Air Group - CFO*

This is Glenn again. Our objective is for all three of the entities to be profitable and contribute to the ROIC goals that we've set.

Peter Jacobs - *Ragen MacKenzie - Analyst*

Okay, second question. What price are you paying for raw fuel now at Sea-Tac? Can you give us that number?

Jay Schaefer - *Alaska Air Group - VP of Finance, Controller*

Yes, Peter, this is Jay. Raw, unhedged about $1.61.

Peter Jacobs - *Ragen MacKenzie - Analyst*

Okay, great, thanks. And lastly, maybe to get into a little bit more of a sensitive subject, could you give us an update on the negotiations with both the Alaska Airlines Pilot Union and the Horizon Air Pilot Union?

Brad Tilden - *Alaska Airlines - President*

Yes, Peter, it's Brad. Maybe I'll start with Alaska and we'll get Jeff to talk about Horizon. When Bill put me into this new role one of the first things he and I agreed on is number one priority is to try to get an agreement with our Pilot Group so that's what we're going to be trying to do. It's a hard deal. There have been big adjustments through the arbitration that our folks have suffered and at the same time the industry has changed by just a huge amount over the last six or eight years, but we are in mediation. There's a mediator involved. I know our Union group is working really hard on trying to get to an agreement. We're doing the same and I guess we plug away and I'm personally very optimistic that we are going to get something done. It is important we get a deal that works for everyone over the long run so that's what we're trying to accomplish here.

Peter Jacobs - *Ragen MacKenzie - Analyst*

Are there any areas where you're on the same page as the Pilot Union that you can share with us and also are there any areas that are sticky points or you're pretty far apart you could share with us so we can get a sense of what the issues are out there?

Brad Tilden - *Alaska Airlines - President*

We all have a very vested interest in this place being around for a long time so I think we're all on the same page in that regard. In terms of the detail of the different parts of the negotiation I think it's best to leave that conversation for the negotiating table.

Peter Jacobs - *Ragen MacKenzie - Analyst*

Okay, fair enough and then Jeff, can you add some little color around the Horizon Air, please?

Jeff Pinneo - *Horizon Air - President, CEO*

Yes, I sure can, Peter. As you know, the contract that we had in place for five years was amendable about a year ago September and we've been in negotiations for about two years right now. It was a tall order to face given the contract we had in place at that time was signed just five days before 9/11. It was built on the status of the industry at that point and left us through the post-9/11 period with the highest pilot cost in our sector. To the groups credit, they came together in acknowledgement of that, really focused on what we needed to be aligned on to the principles that Brad mentioned and about a year ago decided to engage in a different approach to negotiations. They've all participated in a process of learning interest based tools and applying them to the process and I am really pleased with the progress that they've made through the application of those tools this last year. They continue to meet. They've made excellent progress, in spite of the big challenges that they face, and I'm confident it's going to produce a good outcome here soon.

Peter Jacobs - *Ragen MacKenzie - Analyst*

Okay, I appreciate the update. That's all I have.

Brad Tilden - *Alaska Airlines - President*

Thanks, Peter.

Operator

Our next question comes from Helane Becker with Jesup and Lamont.

Helane Becker - *Jesup and Lamont - Analyst*

Thank you very much, Operator. Hi, everybody.

Bill Ayer - *Alaska Air Group - Chairman, CEO*

Hi, Helane.

Helane Becker - *Jesup and Lamont - Analyst*

Just two things. One of the big issues for Seattle for a long time was that the airport costs were higher than some of the other airports that your peer group operate from and then over the years as you grew there, the costs sort of came into line. Can you just talk about how that is, those costs are now given all of the capacity adjustments that you're making on a cost per passenger basis?

Glenn Johnson - *Alaska Air Group - CFO*

Sure Helane, this is Glenn. Let me start on that and Brad can jump in on this as well, Brad and Jeff. I guess I would just say first of all that we're working really hard with Sea-Tac primarily but across our system with all of our airports to bring the cost down. It is clearly a big line item for us and while we are sensitive to the fact that they have to make long term decisions, we still need them to partner with us on how to bring immediate costs down. We've had, I would characterize it as good luck with those discussions with Sea-Tac. We've had very collaborative productive discussions on how to get their capital programs lined up with what we want to have happen and bring the costs down as a result, but there's more work to do to get particularly Sea-Tac's costs down to where we think they need to be and then similarly with our other large airports up and down the West Coast in particular, we have got a focus on bringing down the cost and then we've also got an equal focus on our efficient use of space, so we're reducing gates at Sea-Tac, at Portland and other areas so that our utilization of space is more efficient. Brad? Anything to add?

Brad Tilden - *Alaska Airlines - President*

No.

Bill Ayer - *Alaska Air Group - Chairman, CEO*

I might just add one thing, and that's the efficiency of the airport from an air traffic standpoint. We've got a third runway out here now, although it was very expensive runway but now we have it and so we're working with the FAA to make sure we can take full advantage of our airborne technology for fewer delays, foreclosure spacing of airplanes and we get a lot of rain and low clouds up here as you know so a lot of times, before we had the third runway we had some just arrival delays because of the weather and we're trying to make sure we can mitigate that as much as possible and in particular take advantage of our position with all of the technology we have, the satellite technology and the airplanes of both companies really, of Horizon and Alaska.

Helane Becker - *Jesup and Lamont - Analyst*

Right because aren't your planes among the most advanced in being able to land in fog and so on?

Bill Ayer - *Alaska Air Group - Chairman, CEO*

That's right. Exactly right.

Helane Becker - *Jesup and Lamont - Analyst*

Yes, okay. And then the other question I had, I think Hawaii service started some time in the last year. Has that shaped up to be the way you thought it would be?

Brad Tilden - *Alaska Airlines - President*

Helane, Hawaii has been a really fun success story for this Company. We did start I think October 12, Seattle to Honolulu and we've slowly added since then. Now we fly four Hawaiian destinations from Seattle and two from Anchorage and I think by all accounts those markets are doing terrific for first year markets.

Helane Becker - *Jesup and Lamont - Analyst*

Great. Okay, thank you guys.

Bill Ayer - *Alaska Air Group - Chairman, CEO*

Thank you.

Operator

(Operator Instructions) At this time we have no further questions from analysts.

Shannon Alberts - *Alaska Air Group - Managing Director, IR*

Okay, then I think we'll turn the call over to Alaska's Managing Director of Corporate Communications Caroline Boren to conduct the media portion of the call.

Caroline Boren - *Alaska Airlines - Managing Director, Corporate Communications*

Thanks, Shannon. At this time we welcome questions from journalists participating in today's call. Would you please remind our callers of the procedure for asking questions?

Operator

(Operator Instructions) We'll take our first question from [Megan Kuhn] with Flight International.

Megan Kuhn - *Flight International - Media*

Hi, good morning. I was wondering if you could talk a bit about the status of the Row 44 trial, if that's happening in the first quarter?

Glenn Johnson - *Alaska Air Group - CFO*

Sure, Megan. This is Glenn again. There is a trial going on. We flew the system on one of our airplanes before the Christmas holidays and then needed to put the aircraft back in service to sustain our schedule during Christmas. We're planning to outfit a second airplane here shortly and Southwest, which is also a customer of Row 44, is currently in the testing process as well so we're very excited about the technology. As you probably know it's satellite based technology so it's superior to the ground based technology that some other folks are using that would give us coverage to Alaska, to Hawaii and to Mexico as well as across the contiguous U.S. So we're looking forward to getting that out there. It's another one of these things that Bill talks about in terms of providing what customers want and demand these days and we think it's going to be a big hit.

Megan Kuhn - *Flight International - Media*

During the initial trial before the holidays, was that with customers on board?

Glenn Johnson - *Alaska Air Group - CFO*

No, that was simply test aircraft on trials.

Megan Kuhn - *Flight International - Media*

Do you know how soon on the second aircraft will be outfitted with the technology?

Glenn Johnson - *Alaska Air Group - CFO*

I believe we're planning that in the first portion of February. Depending on aircraft availability to get that outfitted and tested, again in test configuration and then with passengers testing.

Megan Kuhn - *Flight International - Media*

And so the test configuration will happen first and then passenger testing would begin after that?

Glenn Johnson - *Alaska Air Group - CFO*

Correct.

Megan Kuhn - *Flight International - Media*

Okay. That's all that I wanted to ask.

Glenn Johnson - *Alaska Air Group - CFO*

Okay.

Operator

(Operator Instructions) At this time, there are no further questions.

Bill Ayer - *Alaska Air Group - Chairman, CEO*

Okay. Thanks, everybody for joining us today. We look forward to speaking with you next quarter. Take care.

Operator

Thank you very much, ladies and gentlemen, for joining today's Alaska Air conference call. This concludes your conference. You may now disconnect.
