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PRESENTATION

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

All right, folks. Well, let's get started just so we can remain on schedule. I think people are still going to be filtering in. Again, I apologize for the clunkiness of the location this year and the lethargic elevator service and all of that. But I don't want to penalize Alaska Air Group for that. We're fortunate to have Brandon Pedersen, the CFO, presenting here today, certainly not the first time that you've been attending our event. So it's good to have you back. Matt Grady, in IR, joining us up on stage. I think you have a couple of slide decks, and then I got a ton of questions, but you did, to my surprise, having issued an 8-K just about 1.5 weeks ago, after the Seattle storms I was, I will admit, taken somewhat by surprise that there were some additional disclosures today. So please, for people that have been here at the conference and may not have been tied to their Bloomberg screens, a quick update there. Then we get into the Q&A. Thanks for being here.

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

Yes, no problem. This is great. Actually, I love this conference. It's great. Thank you for hosting it. The venue is an interesting change out, we're already getting back to the building. And I do have a few slides that I want to start with and then, you're right, we did issue an investor update this morning, be glad to talk about that. But I wanted to start maybe with the slides, and then we can get to that either Q&A, or I can share some commentary with that going forward.

First is the perfunctory safe harbor statement. My presentation will contain forward-looking information. Things may be different. I encourage you to read our 10-K to understand the risk factors in our business.

I wanted to start with this one. Now this is a slide that we're actually seeing a lot of at Air Group these days. Many of you who have listened to our webcast or attended our Investor Day back in November or read the transcripts know that we have a program going on internally that we're calling Flight Path. And what Flight Path is, is a workshop that we're putting all 23,000 of our employees through and really to teach them about the business. It's an interactive workshop. There is some candid dialogue that goes back and forth, people get to ask questions to the leadership, and it's really all about creating one team post-merger with Virgin America.

And what we talk about a lot with our folks is the challenge that any business, including ours, has with making sure that we're balancing the needs of all of our stakeholders. Employees want to be paid well. In fact, we want to pay our employees well. We want them to have long-term successful careers. Our guests want low fares, they want great onboard product. Our communities want more service or they want tickets to charity auctions and things like that. But at the same time, none of this works unless you have the right mix that includes something for the owners as well, and whether it's share price appreciation or dividends or share buyback, whatever it may be. Everybody kind of needs to benefit to make this thing work, and that's what we're trying to do.

In the short-term, any one of the constituents can benefit, but really on the long-term, it happens at the detriment of the other group. So at the end of the day, if you do this well, which we're trying to do, you get profitable growth. There's a couple of slides that I'm going to move past really, really quickly. One is just showing how that growth has happened for us. If you look at 2001 to 2019, you can see the big change in the network. A lot of that from the organic growth that Alaska premerger had from 2001 through 2016, when we averaged about 7% growth per year. Then we merged with Virgin America, a big step up in the network. And then since that time, we've continued to grow, albeit a little more slowly in 2019 and as we look forward into 2020. But the point being is that we see ourselves as a growth carrier, we think we bring lots of important things to the industry. And as we fix our business or we refine our business, I maybe should say, what we want to do is get back on the track of growing successfully.

You can't do that unless you have good service, you run a great operation. Pictured on the slides is just some of the logos of the awards and accolades that we received. I don't need to spend much time there either. I do want to spend the time to maybe just park a little bit and talk about this one, some investors even today have asked, where do you guys fit in the industry? You've got the big 3 on one side, you've got the ULCCs on the other. So what is the Alaska market position? And I think the Alaska market position is really one where you get great service and great value. And I thought I might illustrate that just with a story. So about 2 or 3 weeks ago, we had a customer who lives in New York City and he flies every 2 weeks to San Francisco and he was a big Virgin America loyalist. And he was flying on Alaska, had a bad experience. I don't need to bore you with that. Anyway, he wrote an e-mail to a number of folks on the leadership team, including Brad Tilden, our CEO, and said here's what happened. And Brad said, "Hey, really sorry that, that happened. Could I get you to come talk to our leadership team?" And so this person flew from New York on his way to San Francisco, he stopped at Seattle and he met with 100-or-so top leaders of the company and he described his experience. But what was better is that, he didn't dwell on the experience at all. He came and he said, "Hey, I just want to tell you that I was a loyal Virgin American flyer, I really like this and that attribute, and I was actually somewhat reluctant or hesitant about the merger and what it would be like going to Alaska." And he says, "I got to tell you, it's actually exceeded my expectations. It's been delightful." He said that he's become a huge fan of Alaska. And again, he is a flyer that lives in New York and travels to San Francisco. So an East Coast presence.

What he said in closing was, he said Alaska -- and I wrote it down just to make sure I got the quote right. He said, "Alaska is the best kept secret in the business and you need to get your story out." And that's one of the ways to tell the story is just to say, here we have a product that we really think is a great product. We have low fares, we've got great service and we can be appealing to not only people who live in Seattle or Portland or the State of Alaska, but all up and down the West Coast. And in fact, more broadly than that, people that live even in -- live in the East Coast I should say.

Okay. Moving on, again, I don't want to spend a lot of time with these just to make sure we have enough time for Q&A, but one of the things that I wanted to make sure folks in this room knew is what we got out of the merger just in terms of our network presence. You can see some of the increases in departures on the right-hand side, but what's notable particularly for this group is making sure that folks in this room know that we have 27 flights a day out of New York City airports, that's New York and JFK. That's about the same sizes of our -- as our Hawaii franchise. And so as we grow the business, we're growing places that are maybe nontraditional for Alaska. Here is the -- what I would call the money slide. And it really is kind of the strategy for us as we look backwards and then as we look forwards.

In the center column, we're in 2019 and 2020, and really I want to talk about that for a second. We have had tremendous growth, as I said, for a number of years now, including the massive growth that occurred with the acquisition of Virgin America and the addition of 44 new markets following that merger to act -- what we call to activate the merger. We're slowing things down. In 2019, our growth is going to be 2% on an ASM basis. As we look forward to 2020, we think our growth rate will be more in the 3% to 4% range. What we're not saying though is just that we're not a growth carrier anymore. What we're simply doing is giving our network and our business time to mature, time to digest all of the growth that we have had. We have made a tremendous number of investments into the business and we're going to give those investments time to mature and we're really moving from a highly growth and investment phase of the evolution of the company to a harvest or a margin improvement part of the company, because we recognize that our financial performance in 2018 was not what we wanted it to be. Actually, we think we're underperforming giving (sic) [given] the platform that we have, so the objective is to focus on margin-accretive initiatives in 2019 and in 2021 -- excuse me, 2019 and 2020. So that as we get into thinking about 2021 and 2022, we're setup well with an integrated business that's got a great revenue model, great people, great service, great operation, safe and we're positioned for significant growth going forward.

So with that -- unless, Matt, you want to add anything. With that maybe we'll just go to Q&A.

QUESTIONS AND ANSWERS

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

And the guidance from this morning?

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

Yes. The guidance from this morning. So we did issue an investor update this morning. And as you can imagine, it's -- we've had a number of conversations about that during the day. And what we did was, we said that our unit revenue projection for Q1 was now between growth of -- unit revenue growth of plus 1% to plus 2%, so 1.5% at the midpoint. Compared to our guidance of plus 2.5% to plus 4.5% when we did our Q4 call back in January. So dropped to 200 basis points. There is a couple of drivers behind that and we talked about it a little bit in the investor update, but perhaps some context.

The first is related to storms, and I would be the first to admit that every airline all the time blames storms for underperformance. But what I will say for those who are listening back in Seattle or the Pacific Northwest, this truly was unprecedented. We had 3 big storms within the period of about 10 days that really just shut the Pacific Northwest down with more snow in that 10-day period than we have gotten all winter over like the last 50 years or something. We did an investor update about 2 weeks ago that said, we canceled 1,100 flights over that period. And just to give you a context, we do about 1,300 flights a day. So over that 10-day period, we canceled about 1,100 flights and we did lose a substantial amount of revenue because of those cancellations. On an absolute dollar perspective, we say we lost $15 million of revenue. It cost us $7 million. Net of fuel savings, $5 million. So an impact of $20 million. We also said that it was revenue dilutive, because a lot of the flying that was canceled was higher RASM regional flying. What we didn't see at the time was the slower recovery in bookings, because often times what happens is somebody cancels their business trip on Monday, they say, hey, we'll reschedule and go next Monday or what? Yes, see you next week and that didn't happen because of the duration of the storm, maybe people were just distracted with all the other things. You still can't go anywhere without really talking about you still have snow in your yard.

So that was thing one is just saying, hey, the broader knock-on effect, if you will, of the storms was more significant than they would have -- what we would have anticipated. Just in terms of the time that it took people to kind of come back and that was factor one. The second factor is that we're continuing to see weakness in the transcon markets, particularly in trans -- California transcon. And it's just -- and we've talked about that a lot today. I think there is just too much capacity in that market right now, and we're seeing some fares that are extraordinary low. Alaska, of course, wants to be known for low fares, but we also want to be known for smart fares and profitable growth.

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

But presumably that's more of a leisure observation since you have not completely unwound, but distanced yourself from the onetime premium approach that Virgin had in the transcon markets?

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

Yes. I don't know if it's fair to say that it was -- it just isolated the leisure. I think the Alaska model is not necessarily to attract the super, super high premium transcon traveler that wants the lie-flat product with the -- it's a transcon PS service, whatever you call it. I think we play in a little different space where we're still appealing to business travelers who want to travel across the country, but perhaps, at a lower price point and perhaps with a different model not necessarily that lie-flat product, but rather the Alaska model, which is more oriented around having plenty of first-class seats, premium-class seats and rewarding people for their royalty with upgrades. That's the model that works for us.

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

Okay. Fair enough. As an analyst and I'm sure investors in the room and listening in would agree to this, we're all for financial targets. When they are legitimate and achievable, and you can illuminate a path towards those targets. How do I -- how should I be thinking, how should your owners be thinking about the 13% to 15% pretax? Is it a mindset? Is it a articulated target? I mean, you've made significant progress in terms of tightening cost controls, optimizing the network. My concern is that, it becomes almost like a scarlet letter the way that 357 sort of did for American.

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

Yes.

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

Help us think about this 13% to 15%?

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

Yes. And just maybe set the table a little bit for folks that aren't as familiar at our Investor Day in November, we did give a target to say, we're working on our business in a way that we believe will get us to a 13% to 15% pretax margin. If you go back longer term, prior to the merger of Virgin America, we were at 22%, 24% pretax margins. We don't aspire to get back to that point. We think that's the wrong place for us to be. In fact, it's probably not a -- it's probably not possible for us to get to 24% pretax margin again, just given how our network has evolved. But we were very clear that we're structuring our business in a way that we think we can achieve a 13% to 15% pretax margin. The rationale for that, as we say, our weighted average cost to capital is 8%, we want to grow -- we want to deliver returns that are 400 to 500 basis points in average of our weighted average cost to capital. And for us in our business, with our capital structure, pretax margin and ROIC go about hand-in-hand, probably within a point. So that's the genesis of that. If you look at what we did in 2018, we were at 8.9% pretax margin. So we have our ways to go. But what I would say is, is that it's not a mindset. It is a target. We will be structuring our business. We will be taking steps to change our business, so that we, hopefully, strive to get there. It does remind me a little bit of the days that I used to talk -- and I've been doing this a while, but we used to talk about a 10% return on invested capital. And investors used to say, man, that would be super cool if you did it, how are you going to do it? And we said, well, I'm not actually sure how we're going to do it, but we're going to take steps to manage our business in a way that we can achieve that result. And I think we're doing that now. If you look at our guidance for 2019 and the revenue initiatives that we have in place and the cost control that we've demonstrated thus far in 2019 just in terms of our guidance, I think we're making a nice down payment on that. We have synergy realization to occur, we've got Saver Fares, we can talk about that if you like. We have other revenue initiatives to say we got great cost momentum going forward. So that's -- we're on the path.

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

Can you back up to Slide 6 for a minute. I mean, just to play devil's advocate on that. I liked Slide 6. This is...

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

Go back. Oh, Slide 8.

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

Yes.

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

All right, I have my glasses.

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

Because I think this...

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

Slide 6, here we go.

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

I think this is a good chart and speaks to kind of how I see the industry having evolved over the last 10 or 15 years. But I also think it highlights why the 13% to 15% might be more challenging to achieve, because again -- and we've been describing in a very similar way, you have a boxing ring, you have the legacy airlines over here doing what they do. Ultra-low cost carriers, occasionally Scott Kirby comes out and beats up these guys. But for the most part, competitively they have retreated to their opposing sides in the rings, but it's the tweeners.

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

Yes, I think that's...

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

That I think is a challenge for -- and I think that JetBlue is going to be here...

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

Maybe that's an org chart.

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

But I mean, isn't that part of your problem, the fact that you're not at one extreme or the other, because you're getting both boxers to kind of come out on -- you're getting it from both sides.

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

Yes. No, it's a very fair observation. Although what we would say is, is that there's a whole lot of white space in the marketplace between the carriers that are on the left-hand side of the chart and the legacy carriers on the right-hand side of the chart. And that big white space is people who want low fares, but not the lowest fares. They want better pitch, they want better service, they want good food onboard, the ability to have an assigned seat, a network that gets them where they want to go and a generous loyalty program. And I think where we sit is, as I said, there is a lot of white space there. The challenge for us is to make sure that we're true to that space. If we try to do everything that the big 3 are doing at a lower price point, that won't be a sustainable place to be. If we try to have a cost structure of the ULCCs, that won't be a sustainable place to be. So we got be really disciplined in the middle to say, what do customers value, what are we going to invest in, how do we make sure that we're going to be in a position where we can have low cost and actually have lower fares, yet deliver good service and that comes from having great people, which we do.

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

Okay. You used the G word a moment ago, generosity.

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

Yes.

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

As it relates to the loyalty program and how should we think about the potential for evolution there, because, one, as a passenger, as a consumer of your product, I too find it generous. I mean, I also find it generous, not overly generous. But the point is, Delta today did speak and has been speaking very enthusiastically about its relationship with American Express and how they've really been able to monetize that. They are now to the point that they are truly agnostic as to whether a passenger pays with a mile or with a dollar. United on the other hand, very dissatisfied with the construct of its loyalty program right now. Isn't this an upside driver for shareholders? Or is passenger generosity core to the value proposition that keeps you in the middle of the ring?

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

Yes. It -- I mean, it's a great question and one we think about a lot because loyalty and generosity have been super important to our business model. And I think there is actually 2 things inside your question. One is, are we satisfied with the arrangement we have with our co-branded credit card, which I would say, yes, we are. Bank of America has been a fantastic partner over the years. We've been able to grow the program substantially, both prior to the merger and even after the merger as people in the Bay Area, in particular California generally and still up in the Pacific Northwest, frankly, look at that and the value proposition and say, man, you get a lot and it's at a lower price point for the card. So we're very pleased with that, we're very pleased with how its developing. We think we've got a lot of opportunity to go on that. It generates more than $1 billion of cash flow for us a year. The second part of it is just the concept of loyalty and generosity. We still have a miles-based program. So you earn miles, when you buy tickets you can use those miles to redeem not only on us, but on our global partners. Upgrades are a big part of what we do. So if you're an elite on Alaska, you're going to get upgraded, you don't necessarily have to pay more for that into either premium cabin or at the first-class cabin. And our guests, they get to know the deal, right, and they sort of expect that and then it's one of the compelling things about flying on Alaska as is the opportunity to get upgraded. That's why we do our cabin configuration as we do, which is to make sure that we have first-class seats and premium-class seats that afford our customers the opportunity to get upgraded. Matt, did you want to add anything to that?

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

Yes. Just maybe one thought that, when we're generous with the loyalty program, it -- to some extent means we're -- there is some profit that we could have had today that we're not taking, but that basically enables us to attract more customers and also retain customers, because they're getting real value from being loyal to us, and we've proven that over a long time in the Northwest. And the focus of what we're doing in California over the next couple of years is continuing to grow that. The loyalty has been growing quite rapidly. We talked about it at yesterday. And the idea is to continue to grow that and to grow the engagement within the new loyalty members.

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

But I mean, maybe I didn't understand the catalysts behind the merger as much, but I always view generosity as making up for sort of the paucity of network breadth premerger that you had. Post-merger with the connectivity that you have, linking the networks together, I was just kind of the mindset that maybe the generosity need not be as generous going forward. And in fairness, you have tightened up some of the rules and regulations a little bit with the program.

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

Yes. We have, but certainly, it's one way we differentiate ourselves.

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

True.

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

And it needs to continue to be a way to differentiate ourselves because, again, going back to the Slide 6, if you look at the carriers on the right-hand side, they have, to your point, breadth of network. If you look at the carriers on the far left-hand side, they offer something entirely different, and so for us it's great value, great service and generosity.

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

Fair enough. You touched before on Saver Fares. How is the rollout there going? Is this a defensive measure? Was this just kind of going with the industry flow? Or was there something strategic about the network that made the implementation of that fare category more critical for you?

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

Yes. It's -- I mean, to answer your question directly, it's going great. Our estimate was that Saver Fares were going to produce $100 million of revenue for us annually. And I think, we'll probably -- we'll certainly hit that if not do a little better than that. The rollout has gone fine. Certainly, there has been some feedback from our employees and some feedback around our guests of things that we could have done differently and better and you take that into consideration as you think about future initiatives. But for all intents and purposes, it has gone great and we're super pleased with how that has rolled out. In terms of did we do it from a strategic perspective or a defensive perspective? What I would say is, is that as we thought about our targets for profitability, this is something where we recognized that we were at a revenue disadvantage compared to others. So you would get a customer, they would enter the booking funnel. We needed to be competitive on that initial price point into the funnel, but if you were the other guys, you had the opportunity to upsell that customer who was already in the funnel into a better seat, however, you want to describe it, a nonbasic economy seat. And when that customer entered the Alaska funnel, we didn't have that opportunity necessarily. So for us, it was a way for us to close some of that revenue disadvantage. We're actually doing it in a way that's a little bit different from the rest of the industry. I think we're a little bit more generous in terms of seat assignments and things like that. But what I will say is, is that, we needed to get there to -- in order to close the revenue gap that we had with others. Alaska, generally speaking, is a little more egalitarian in terms of how we think about things, and so this is not something that you would have ever see us be an industry leader on. But I think the whole notion of basic economy and having the lowest fare, having a portion of the cabin set aside for people who truly want the lowest fare, I think that's a part of the business that has evolved and here we are where we are.

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

Earlier today, Southwest spoke about the importance of the California market and how the Hawaii expansion is a natural evolution in terms of satisfying that market demand. Specific to Southwest, I'm curious, does their lack of embrace of segmentation thus far, does that make your life vis-à-vis Saver Fares and what you're doing, does that make it easier or more difficult for you to compete in California? So I could see it breaking either way.

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

Yes. And I don't know if there is a right answer to that. What I would say is, is that Southwest is a great airline, they have a great thing going, they do it very well, they know who they are. We have a ton of respect for Southwest. We're just going about it a different way, and we've decided that Saver is right for us and it's the way we're going to compete. And I don't know if that's an advantage to Alaska or an advantage to Southwest, I think the products are very different. But like I said, they are a great airline and we've got a ton of respect for them.

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

So you received a lot of credit in the market from your owners, from those of us that follow the company in response to the diminished growth rate this year. And you touched on the longer term 4% to 6% number. But following the enthusiastic response to a slower growth rate, why is 4% to 6% still the right longer term number? Is it driven by the demographics of your network and where the economy is strongest? Is it there is some critical share that you are hoping to achieve or natural share, not a term that investors really chose to embrace, but how do we think about that figure, that 4% to %6?

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

Yes, I mean, so what that is, is that's a mindset around where we think our growth can be in a more normalized area. We used to talk about 4% to 8% growth profits permitting and as our base gets larger, we'll be closer to $9 billion company this year. It's really tough to put 8% on top of $9 billion every single year, and we said, okay, well 8% was -- even though it was the historic growth rate over the last 4 or 5 years prior to the merger, that's probably not where we're going to be going forward. But 4% to 6% does seem right and our thinking is, is that, Alaska has real competitive advantage that should allow us to grow faster than industry average. And if industry average revenues grow at, you'd know better than me, maybe 3% to 4% in a...

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

5% would be better.

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

5% would be better.

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

Yes, 3% to 4% is okay.

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

No doubt about it. So if industry revenues can grow at 3% to 4%, we believe that we've got the product structure, the loyalty, the customer service, the cost structure, the balance sheet to be able to do a little bit better than that, hence 4% to 6%. And of course, the same appendix or the same asterisks applies to that as well, which is profits permitting. We're not into growth for the sake of growth, just to manage cost or something like that. We want to make sure that we're doing it in a way that justifies the investment that we're making. Matt, did you want to add to that at all?

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

Not on that particular point, no.

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

Okay. Any of the other points I have made?

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

No, I'll jump in.

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

Okay, good.

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

So when I think about the next 10 years of the industry, I would think that most consolidation has run its course. I still think that there is a very aggressive, embracive technology and more dynamic pricing that can come, but when I really think about what's going to sort of separate the men from the boys, for lack for better term in the industry going forward, I keep coming back to real estate, particularly given the fact that at the major airports, there's not really any room left at the end. Did you get enough real estate through your recent embrace of M&A?

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

Yes. What I would say is...

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

And do you agree that real estate is kind of...

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

Yes, I absolutely agree that real estate is a scarce commodity and will be sought after in the industry over the next decade or so, as you say. Here is what I would say, I would say that we got a lot in our merger with Virgin America. We've got a fantastic terminal at San Francisco with T2. We have more gates at LAX. We got slots at JFK. We got some other things as well. And for us, what we're trying to do now is we're saying, let's take all of that great stuff that we got and let's optimize it. And we're going to work hard this year, next year, the year after. We're going to optimize what we have before we thinking about -- think about going and getting more.

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

Okay. Fair enough. Any questions from the audience? I've got a few more, but I don't want to cut anybody off. I see -- I actually only see hands. I can't even see the bodies, there's one.

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

We got David out there.

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

Sorry, I didn't recognize. You almost...

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

You got to get away -- out from behind the pole.

Unidentified Analyst

I was going to hide right here, none of you can see me. I do have a question about the guide this morning relative to what we've heard some -- from some other airlines on trends. There seems to be an isolation of weakness on a few routes. How often have we seen that where significant weakness on just a few routes can stay that way? Or I guess the question is, are we going to have a reversion, reversion back to those routes get better and everything is fine? Or do you see this as some type of signal that if transcon is this week or some other lanes or this is the -- have this kind of weakness, that it's a sign that there is a potentially broader issue that has to be faced?

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

Yes. I mean, certainly, Jamie, chime in. You're way more knowledgable about the industry than I am. But here is what I would say is, I don't know at the end of the day. I know that we are seeing pricing weakness in one particular part of our network. Last year, we might have seen pricing weakness in a different part of the network as you think about all the battles over the years, there was the battle in Seattle, there is prior weakness in Hawaii and there is the battle in Boston, the battle in Dallas. I mean, there is lots of battles that go on and the -- what the airline industry does is, it always has a battle, but things always seem to find their equilibrium. And so I'm confident in the trans -- that we'll ultimately find equilibrium in the transcon markets and we'll -- water will find its level, as they say. The other is, is that I don't know and I'm not sure that it matters at the end of the day. Alaska is going to do what Alaska needs to do to manage its profitability. We're actually super optimistic about 2019. We've got revenue initiatives that are going great, as I said. We've got revenue synergies from the merger that will be taking effect in a big way this year as well. And so, yes, we have weakness in a handful of markets. But I think broad -- more broadly across the network and the business, we're very pleased with what we're seeing for all intents and purposes thus far.

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

And let me jump in here. Is it potentially driven by your exposure to any particular sector of the economy? And the reason I ask, David's question reminds me back in 1999 having discussions with Delta as to why is your RASM holding up so well against United's, and the answer was San Francisco. It was because United was uniquely exposed to the implosion of the tech bubble, and then, of course, the investment banking model that it'd been chasing, it subsequently collapsed. So could it be driven by a certain sector or sectors of the economy or is it just too much capacity?

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

Yes. I -- go ahead.

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

Yes. I -- we have seen the pricing impact in the first quarter that's been a little more acute in transcon than in other places, which is why we've called it out. But I would say, in general, it does feel like there is just a lot of seats. I mean, it's actually part of the reason that we slowed our growth about a year ago and we said, we think there is too many seats on the West Coast, and we don't want to be trying to grow as aggressively into that environment as maybe we would have in a different environment. But I think our perspective on the year is that, while you go through the seasonal trough period, you're going to see that impact more pronounced. But as you move into the peak, the amount of capacity we have should tighten relative to demand and that we should get a better pricing environment later in the year, but we'll have to see when we...

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

Are there better parts of your network that some of your transcon capacity could be deployed, particularly given the increased fleet complexity that you now have or fleet optionality that you now enjoy?

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

Yes. I mean, there's always the option of moving airplanes around the network, and I think we've done a good job demonstrating over the years that we'll do that. I think though, right now at a 2% growth level, we're pretty happy with where the airplanes are and the amount of capacity we have in the market. But we'll, of course, evaluate that as the year goes on. And just to fully close off your answer, I don't see any weakness in a -- in any particular industry that might be driving it. I think, Matt's right, I think there is just probably excess capacity in the marketplace right now.

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

Any other bodiless hands to go up in the audience, torso-less hands? So one thing that I was wondering about and I guess, we touched on this somewhat, but I had a very easy -- I've -- with a benefit of hindsight, I think premerger Alaska was more easily defined. I think that you played nice with others and you had a significant double-digit revenue contribution from alliances and robust domestic cochairing. You showed excellent labor cost control over the long run. You attended to your balance sheet in a way that was -- that airline investors were unaccustomed to seeing that level of capital stewardship and you produced better-than-average returns and you traded at a multiple premium to the sector. Going forward...

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

Those were great days.

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

Don't admit that, you're supposed to say the better days are ahead.

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

No, better days ahead.

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

But I mean, that's the challenge that I'm having. How do you think you will be defined by your owners or by this analyst going forward? You seem to back away earlier from the ability or the likelihood of generating returns that were superior to the industry, they are still going to be very, very strong in absolute. But tying that back to your earnings multiple, doesn't that also suggest that, yes, you just kind of trade like everybody else?

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

No, I don't think so. And I don't want to correct the record officially if I suggested in anyway that I don't think we can generate returns that are better than the industry. I think we can generate returns that are better than the industry, and that all goes back to, do we have competitive advantage that would allow us to do that. And I think the answer to that is, yes. In terms of what we're trying to be when we grow up, if you will, I think we're trying to be basically the same Alaska that we were before, yet, with a bigger platform. We went from being primarily focused to flying in the Pacific Northwest to a larger airline that really has a much more robust West Coast presence as we showed on the slide with the departures in the various cities. But the fundamentals of who we are and how we think about the world really haven't changed. We think we've got a great onboard product. We think we bring low fares to the marketplace. We do want to be known for being a really good steward of capital and having a very strong balance sheet. And so while a lot of those fundamental things, really those attributes that people would say, that's what I liked about Alaska part of the merger. We're going through a period of change, but at the end of the day, that's what we're trying to do.

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

Okay. Understood. Any final questions? Some -- oh, yes, we've got one there.

Unidentified Analyst

You talked about on one of your slide right there, investment-grade balance sheet, does that mean that you want to be investment grade or you just want a balance sheet that's reflective of investment-grade metrics? And I guess, if it's the former, what's key to being investment grade for your business model?

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

Well, right now, we are split rating. We do have investment grade with Fitch and what I'd like to do is get back to having a consistent investment grade across 2 or 3 rating agencies. I think, honestly, we just need to prove that the model is going to generate the kind of cash flow that we think that we can generate, and I think we'll get there. I don't want to just be investment grade without the investment-grade rating. I think that's suboptimal. But I do think that it's an important place for us to be just as a validation of how we're treating the balance sheet and the kinds of returns that we think we can generate.

Unidentified Analyst

I guess, the next part of the question is, does that imply that you're going to be using the investment-grade rating to fund yourselves in the future?

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

Yes. I mean, that -- for us having an investment-grade balance sheet is really, really important. I think if you go back to 2015, having a fortress balance sheet with a dual investment-grade rating gave us the optionality to do the merger with Virgin America. We could have chose a more organic growth approach and we would have used it for that as well. So I think it's -- the answer is, is that, we would use it, but we would use it in a way that benefited our business and our owners and our other constituents as well.

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

We're about out of time.

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

I think we're out of time. Thank you very much, everybody.

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

Thank you very much everybody. Thank you. We appreciate it.